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UNITED NATIONS

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ESCWA

Assessing Arab Economic Integration

Towards the Arab Customs Union

Economic and Social Commission for Western Asia (ESCWA)

Assessing Arab Economic Integration

Towards the Arab Customs Union

United Nations
Beirut

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Abbreviations and explanatory notes

AAAID	Arab Authority for Agricultural Investment and Development
AACO	Arab Air Carriers' Organization
ACU	Arab Customs Union
AEISI	Arab Economic Integration System of Indices
AFESD	Arab Fund for Economic and Social Development
AFTA	ASEAN Free Trade Area
Agadir	Agadir free trade agreement between Egypt, Jordan, Morocco and Tunisia
AMU	Arab Maghreb Union
AMWC	Arab Ministerial Water Council
ASEAN	Association of Southeast Asian Nations
AVE	Ad valorem equivalent
BoP	Balance of payments
CAP	Common agricultural policy
CGE	Computable general equilibrium
CEPII	Institute for Research on International Economy (Centre d'Etudes Prospectives et d'Informations Internationales)
CET	Common external tariff
COMESA	Common Market for Eastern and Southern Africa
EC	Economic Commission
ECO	Economic Cooperation Organization
ECOWAS	Economic Community of West African States
ENTSOE	European Network of Transmission System Operators for Electricity
ESCWA	Economic and Social Commission for Western Asia
EU	European Union
EUROMED	Euro-Mediterranean Partnership
FAO	Food and Agriculture Organization
FDI	Foreign direct investment
FTA	Free trade agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GCC	Gulf Cooperation Council
GCCIA	Gulf Cooperation Council Interconnection Authority

GDP	Gross domestic product
GNI	Gross national income
GTAP	Global Trade Analysis Project
GW	Gigawatt
HS	Harmonized System
ICT	Information and communications technology
IEA	International Energy Agency
IIT	Intra-industry trade
ILO	Industrial Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
IT	Information technology
ITC	International Trade Centre
ITSAM	Integrated Transport System in the Arab Mashreq
kW	Kilowatt
kWh	Kilowatt hour
LDC	Least developed country
LPI	Logistics Performance Index
MENA	Middle East and North Africa
MEPV	Major episodes of political violence
MERCOSUR	Southern Common Market
MFN	Most favoured nation
NAFTA	North American Free Trade Agreement
NELTI	New Eurasian Land Transport Initiative
NOPC	Non-oil-producing country
OAPEC	Organization of Arab Petroleum Exporting Countries
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
OPC	Oil-producing country
PAFTA	Pan-Arab Free Trade Area
PTA	Preferential trade agreement
RIA	Regional integration agreement
RoW	Rest of the world
SME	Small and medium-sized enterprise
STR	Single transformation rule
STRI	Service Trade Restrictiveness Index
TEU	Twenty-foot equivalent unit
TPL	Tariff preference level

TWh	Terawatt-hour
UAE	United Arab Emirates
UMA	Arab Maghreb Union
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	Economic Commission for Africa
UNESCO	United Nations Educational, Scientific, and Cultural Organization
UNITAR	United Nations Institute for Training and Research
UNOSAT	Operational Satellite Applications Programme
UNWTO	United Nations World Tourism Organization
USA	United States of America
VAT	Value added tax
WTO	World Trade Organization

Foreword

Arab leaders and stakeholders are, more than ever, keen to accelerate progress towards Arab economic integration as a vehicle for economic growth, job creation and poverty reduction. The aim is to develop regional value chains and integrate in global value chains. Integration efforts have already resulted in the establishment of the Pan-Arab Free Trade Area (PAFTA), bringing together 18 Arab countries, with a combined population of over 375 million and a total gross domestic product of $2.8 trillion. This initiative has encouraged Arab policymakers to develop a much broader integration scheme in the form of an Arab Customs Union (ACU), announced at the first Arab Economic and Social Development Summit of the League of Arab States, held in Kuwait in 2009, with the aim of achieving a functional customs union by 2015. To date, however, no tangible results have been reached and no decisions on the launch date have been taken. Furthermore, the requirements of establishing the union have yet to be fulfilled by member States. At the 26th Arab Summit, held in Sharm el Sheikh in March 2015, member States were requested to form national teams composed of relevant ministries and institutions to follow up on the ACU requirements at the national level to ensure full endorsement and a gradual implementation starting in 2018. Yet experiences have shown that moving from a free trade area to a customs union is not an easy task. A move towards an ACU should be first consolidated in all member States by

ensuring the full operation of free trade agreements (FTAs) and strengthening economic integration beyond trade. Outstanding issues regarding the implementation of PAFTA must therefore be resolved before the region can move towards a customs union.

The establishment of an ACU, with better cooperation on the movement of people, capital and services, will help bring Arab countries closer in a more coherent large market with a common trade policy. It will also help resolve the challenges of multiple and overlapping free trade area memberships.

This first edition of the Assessing Arab Economic Integration Report comes at a time of renewed enthusiasm to rapidly attain the vision of a more economically integrated Arab region that is more connected to global value chains. The present report, which builds on the 2014 Economic and Social Commission for Western Asia (ESCWA) report entitled *Arab Integration: A 21st Century Development Imperative*, provides a timely analysis of progress in the Arab region towards economic integration. It introduces a new quantitative system of indices to accurately measure economic integration across a variety of indicators, over time and compared with other countries and regions. Through these indices, this report provides a flexible tool for policymakers to assess, monitor and evaluate their progress towards economic integration. It uses these findings to analyse

integration across a number of specific sectors, drawing out clear conclusions and recommendations to move the region towards greater cohesion and unity. Lastly, it provides a road map for launching an ACU with a quantitative assessment of the economic impacts of a set of plausible implementation scenarios.

ESCWA hopes that this report will play a role in facilitating the economic coordination of the Arab region, so as to unlock countless new opportunities for trade, growth, investment and job creation for current and future generations.

Introduction

Located on the trading routes of three continents, the Arab region is home to some 350 million people with a combined gross domestic product (GDP) of $2.84 billion and a per-capita GDP close to $8,100. Arab countries share a common language, borders and similar social norms, which should facilitate regional integration. At a time when the global economic landscape is changing rapidly, with shifting wealth and increased interconnectedness through trade, investment and capital movement, the Arab region faces the imperatives of economic reform and adaptation. Fostering regional economic integration is a strategic response to these forces, and a foundation on which Arab countries can build their reform and development plans.

The road to Arab regional economic integration has proven long and tortuous. Initiatives in the region have ranged from free trade agreements (FTAs) to custom unions. Some progress has been achieved through initiatives taken under the League of Arab States and at the subregional level, including the Pan-Arab Free Trade Area (PAFTA) and the Gulf Cooperation Council (GCC) Customs Union. Although the region is currently marred by conflict and instability, regional economic integration efforts must not take a back seat until conflicts are resolved and stability is attained. Rather, a push for deeper integration is warranted more than ever under such circumstances, given that strong regional cooperation is instrumental in restoring and maintaining peace, security, stability, economic development and growth. The Economic and Social Commission for Western Asia (ESCWA) is promoting greater regional cooperation and integration as a strategy to help Arab countries enhance their productivity and competitiveness, and integrate more fully into global markets for goods, services and ideas. Through the process of regional economic integration, Arab States can pool their capacities, endowments and assets to spur productivity and economic growth, transformation and job creation, while improving the lives of millions across the region. Economic integration can also increase investment by reducing distortions, enlarging markets and instilling confidence in economic and political reforms. Eventually, the current roadmap of establishing FTAs and customs unions is expected to contribute significantly to the establishment of an Arab economic union, with coordinated economic, monetary, fiscal, social and sectoral policies. With a larger joint market, the Arab region can strengthen its role in the global economy and have more connectivity to global value chains.

Currently, economic integration in the Arab region is advocated, decided and supported by many actors. The integration process can be successful only if stakeholders work in unison. Among these actors, Arab Governments, national stakeholders and regional economic organizations, such as the League of Arab

States and the GCC secretariat, emerge as key players. The latter are the bodies in charge of conceiving, executing and monitoring the implementation and reporting of the most comprehensive policies and programmes related to regional integration. As such, they are the nerve centres of the integration process.

Nevertheless, economic integration in the Arab region continues to face many challenges. There has been limited progress in mainstreaming regional agreements into national development plans and strategies. Despite a wide understanding of the benefits of regional integration, the current environment for economic cooperation and integration is not sufficiently conducive for Arab countries to streamline their development plans and visions. Political tensions and conflicts in the region are hindering efforts to integrate by disrupting progress in intraregional trade and by preventing effective dialogue between countries that could be regional partners. A lack of political will has also prevented the adoption of integration initiatives and policies that support cooperation with neighbouring countries. ESCWA hopes that economic integration can serve as a catalyst to bring policymakers across the region together to reach agreements that will boost growth and recovery and, moreover, lead to constructive dialogue towards conflict resolution. Furthermore, the great heterogeneity across the region in terms of population size, GDP, development levels, macroeconomic balances and trade structures, among other things, requires that countries consider an integration framework that works with and takes advantage of this diversity, given that a uniform union or FTA may encounter problems owing to varied country specificities.

Integration agreements to date have lacked commensurate implementation, cooperation on domestic policies and practices, and a general adherence to integration measures established by Arab countries. The analyses and findings of this report illustrate that there has been limited progress in Arab economic integration, which is evident across a variety of sectors and indicators, especially compared with other regional blocs, such as the European Union (EU) and the Association of Southeast Asian Nations (ASEAN). For example, intra-Arab trade stood at 9 per cent of total trade by 2013, whereas intraregional trade reached 50 per cent for the EU and 23 per cent for ASEAN. Although productivity and industrial exports are growing across the region, once the contribution of natural resource-based industries are removed from this analysis, the figures are less promising, with trade in value-added products playing a small role in the region's economies. Value added services in the Arab region are lower than relative figures for the EU and world averages (just over 40 per cent of GDP versus over 70 per cent in 2013), and services trade restrictiveness is comparatively higher than in the EU and many ASEAN countries. Moreover, import and export procedures are restrictive and trade logistics performance varies across the Arab region.

Given the state of regional integration in the Arab world and the plethora of issues hindering its progress, the goal of this publication is to provide a quantitative assessment of regional economic integration efforts and generate practical and implementable policy advice for Arab countries. This report begins by setting out the goals of and justifications for economic integration, and the status of integration in

some key areas, so as to take stock of efforts and challenges faced thus far. A new and comprehensive quantitative system of indices is developed to analyse the economic integration experience of the Arab region, capturing the involvement of all actors at the national, subregional and regional levels, culminating in an aggregate measure of Arab economic integration. This system of indexes will help to track progress in Arab regional economic integration in the future, providing a relatively reliable diagnostic tool. An assessment of the progress in specific agreements governing FTAs in the Arab region provides an additional practical element to the discussion on integration, supplemented with an analysis of the potential economic benefits of accession to an ACU. All of these analyses will culminate in clear policy implications and messages for policymakers and other stakeholders.

The report is organized as follows: Chapter I provides an analytical introduction and background to the process of integration in the Arab region, including a theoretical discussion on the urgent need for economic integration, the established objectives and goals, the institutions and capacities involved, and the broad spectrum of constraints and challenges facing the process. This chapter addresses the case for Arab economic integration in the context of an evolving and dynamic world, and provides a clear concept and understanding of why economic integration is vital for the Arab region, including a review of the Arab development problematics and the importance of integration as a transformation strategy.

Chapter II introduces the Arab Economic Integration System of Indices (AEISI), which has

been constructed for this report. This system addresses the Arab region's level of global economic integration and the level of economic integration between Arab countries. Integration measurement is structured around the following three key flows: exports, foreign direct investment (FDI) and workers' remittances. AEISI then assesses a number of integration indicators, chosen based on thorough research and a literature review, and provides insight into progress and gaps in economic integration in the region. Depending on the performance of this maiden AEISI, the data collection and evaluation exercise will be scaled up in future editions.

Chapters III and IV detail the specificities of Arab economic integration, highlighting the status of integration across a variety of sectors that are vital for growth, diversification and job creation, as well as the policies and framework in place to promote greater cross-country linkages. This progress is compared with past and current integration experiences in the EU and ASEAN. While much research on regional economic integration has focused on trade and FDI as key aspects of economic integration, in these chapters the various structural characteristics of Arab countries are addressed to provide a more comprehensive picture of economic integration in the region. In this regard, chapter III focuses on productive capacities for integration, which include global and intraregional trade, industrialization and agricultural development, which are drivers of growth and whose success will inherently result in greater integration, a pooling of production and markets, and expansion of value chains across the region. It also highlights key inflows which are vital to well-integrated countries, namely, migration,

remittances and tourism. Chapter IV details the facilitating factors for economic integration, which are the assets and vital inputs across a region that can help to forge stronger ties between countries, including energy, water, transport, services trade facilitation and finance. These two chapters make intensive use of the system of indices and information developed in the AEISI.

Chapter V tackles the potential benefits of an ACU. It reviews the justifications for creating an ACU and its implementation challenges. An assessment of the economic effects of establishing an ACU under a number of different scenarios is also provided. These scenarios cover options for selecting a common external tariff (CET), taking into account various lists of products, flexibilities and the future of existing FTAs between some Arab countries and their extraregional partners. These scenarios show differential effects on intra-Arab and total trade, output and employment.

Chapter VI discusses the policy implications of Arab economic integration, based on the analysis presented in the previous chapters of this report, with special focus on ACU policy recommendations and a set of proposals on how to proceed with the Arab economic integration agenda.

I. Arab economic integration in the context of an evolving and dynamic world

A. Introduction

The push for global and regional economic integration is an old concept that has seen renewed emphasis in recent years, particularly regarding regional and subregional integration, with regional integration agreements (RIAs) becoming a ubiquitous feature of global economic frameworks. RIAs often take the form of FTAs that grant each member preferential access to the markets of other participants. These agreements are also recognized as a vehicle for achieving deeper forms of economic integration, requiring a higher level of policy coordination that is more feasible regionally than globally (Lawrence, 1996). While ultimately very beneficial, the process of economic integration is likely to be long and rife with difficulties, as the prominent example of the European integration experience illustrates. Strong political will is of vital importance to overcome initial challenges in the economic integration process and future hurdles that are likely to determine the viability of integration efforts.

Following numerous regional initiatives, Arab regional economic integration has become imperative. Despite a move towards a more liberal regional trade regime, non-tariff measures and restrictive rules of origin still exert a pervasive influence on intraregional trade; the depth and breadth of economic integration in the region has remained very limited, despite a number of regional integration initiatives (ESCWA, 2014a). Compared with more successful regional economic integration attempts, there is a substantial gap in the Arab region in terms of policies and outcomes.

This chapter aims to provide a brief discussion of the benefits of regional economic integration, the status of Arab regional economic integration and its challenges. Section B presents the main channels, including economic and political factors, through which regional economic integration can benefit member countries, and justifies why regional trade liberalization could be preferable to multilateral trade liberalization. Section C delineates the current status and challenges of Arab economic integration.

B. Economic integration: an imperative for economic development and stability

Regional economic integration efforts have traditionally focused on dismantling trade barriers.[1] This approach to regional economic integration is considered as "shallow integration". In contrast, "deep integration" refers to political and economic integration, covering the development or reform of common

policies, institutions and a framework aimed at actively promoting multidimensional integration. RIAs increasingly feature behind-the-border policies that have direct effects on domestic transactions, given that international negotiation and enforcement provide a convenient tool to anchor domestic policies and align regulatory frameworks with good practices. RIAs also provide a natural platform to address regional coordination and capacity-building with a view to achieving regional policy goals (Schiff and Winters, 2003).

As most national economies progressively move away from import substitution policies to more open regimes, RIAs have become increasingly prominent. They not only ensure market access and a level playing field, but also strengthen regional cooperation and coordination, and lock in domestic reforms. Various theoretical and practical arguments are put forward in the literature in favour of RIAs.

1. Economic arguments

The economic effects of RIAs have been explored in detail. In a study that surveys the theoretical and applied literature on the subject, Baldwin and Venables (1995) put these effects into the following three broad categories: static allocation of resources; accumulation of productive factors; and spatial allocation of resources.

RIAs influence the static allocation of resources through a number of channels. The traditional channel is greater trade volumes facilitated by regional economic integration. To the extent that goods and services within an RIA are close substitutes and the RIA diverts trade flows from countries outside the region to those within, regional production will be boosted, increasing real incomes and welfare. This gain is due to a more efficient allocation of the factors of production by exploiting comparative advantage, and refers to a mainstream regional economic integration theory developed by Viner (1950). The concepts of trade creation (the increase in the sum of imports from RIA members and the rest of the world) and diversion (reduced imports from outside the RIA) are often used to express trade volume effects. Trade diversion takes place when there is geographical discrimination against trading partners, which leads private agents to import from less efficient suppliers, raising the cost of consuming such products, thereby causing a reduction in national welfare. While an RIA could result in either a net loss or a net gain of overall welfare, welfare loss is a more probable outcome of RIAs between countries that maintain significant tariffs vis-à-vis the rest of the world. Lipsey (1957) argues that RIAs are more likely to be beneficial if participating economies account for a large share of each other's imports, as there would be limited trade diversion among countries that already are lowest-cost suppliers. It is also necessary to consider the loss of tariff revenues that might follow the diversion of trade from non-member countries in assessing national welfare (Salvatore, 2004).

The development of an RIA could improve the terms of trade between a region and the rest of the world, particularly if participating economies are large and changes in their trade could induce changes in world prices. This effect may be further strengthened if countries outside the

region lower their prices to maintain exports to the region.

Market enlargement effects of RIAs could lead to efficiency gains through increased competition and by allowing firms to exploit economies of scale and scope. In smaller markets there would likely be trade-offs between economies of scale and competition. In large markets, big firms can take full advantage of increased returns in sectors where this is applicable. At the same time, greater competition would force firms to cut prices and costs, and allow them to expand production. Competition would also lead to the rationalization of production whereby inefficient producers are replaced by their more efficient competitors. In this regard, more developed economies in an RIA are more likely to dominate the market. Maintaining low tariffs vis-à-vis the rest of the world would reinforce the competition effect by allowing for import competition from outside the region.

RIAs can boost economic activity through favourable impacts on investment, including FDI from within and outside a region. Given that large capital-intensive investment projects become economically viable beyond a certain high threshold, market enlargement spurs investment. Production rationalization can also drive investment activity, and RIAs may allow countries to undertake regional infrastructure and cross-border issues in a harmonized and integrated manner. A regional approach to infrastructure could be particularly attractive for smaller economies, which often find it difficult to fund large fixed costs associated with major infrastructure projects.

RIAs may also foster a spatial clustering of economic activity. Reducing trade barriers facilitates serving a larger customer base from a few locations. While spatial concentration of a regional industrial structure is associated with aggregate benefits as a result of efficiency gains, there is a possibility that manufacturing as a whole could cluster in some locations, leading to deindustrialization of some member countries, as agglomeration benefits accentuate comparative advantages and drive divergence in economic activity and incomes. This outcome is less likely to materialize if consumer demand from outside the centres of production, trade barriers and transportation costs remain high. Concentration of producers is also deterred by competition for immobile factors of production, such as land and labour in the centres of activity.

RIAs can provide insurance to member countries against a number of shocks, including trade wars, resurgence of protection by third countries and asymmetric terms-of-trade shocks. This could become an important consideration in the Arab region, where a disparate degree of resource abundance is a salient feature of Arab economies.

According to the hypothesis of "natural trading partners", an important determinant of potential trade creation effects of an RIA is the distance and, implicitly, the level of transport costs between partners (Krugman, 1991). The smaller the distance and transportation costs between partners, the higher the potential trade creation effects of a trade agreement. Baier and Bergstrand (2004) find that, beyond geographical factors, the size of the economies involved is an important determinant of whether

a trade agreement is trade-creating. Larger economies, economies of similar size and diverse factor endowments are more likely to benefit from the trade creation effects of trade agreements, given that the scope for exploiting economies of scale and comparative advantage is greater among such countries. This in essence suggests that South-South agreements offer limited benefits to developing countries, which tend to be small in economic size, similar in factor endowments and often face high transportation costs, and developing countries may be better served by North-South partnerships. However, there are certain factors that developing countries may benefit from more when forming trade blocs among themselves. For instance, geographical proximity cuts down on a number of costs, and South-South cooperation and reforms at the regional level will have large initial impacts owing to the generally higher level of policy-induced trade barriers among regional developing countries.

2. Factor mobility

RIAs can change both the barriers to and incentives for the mobility of factors of production, namely, capital and labour. Improved factor mobility would not only reinforce the economic effects of RIAs but also lead to the agglomeration of activity and divergence of income levels across countries under a regional integration agreement. The static effects of capital and labour mobility can be analysed within a partial equilibrium framework wherein differentials in returns lead to the relocation of factors of production to equalize returns under perfectly competitive markets. Generally, the movement of mobile

factors of production, which makes the allocation of resources more efficient and equalizes payments to these factors across countries and regions, would lead to welfare gains. For instance, if wage levels diverge between regions, to the extent that workers are able and willing to move to regions with higher wages, migration would close the regional wage gap.

In an imperfect competition setting, factor mobility could bring about and reinforce divergences in factor prices and income levels between regions. For example, as workers move from smaller to larger markets to seek higher wages in the latter, they augment the larger market with additional demand, thereby further widening the wage gap and encouraging even more migration (Krugman, 1991). Similarly, labour mobility, apart from creating a positive demand linkage between industrial location and the location of final expenditure, might give rise to a cost linkage by allowing firms to benefit from a localized pool of skilled labour. Given that analogous arguments could be made for capital, factor mobility can lead to an outcome in which mobile factors of production are concentrated in a few locations.

Location effects of a common market are also relevant. The new economic geography models of Krugman (1991) and Krugman and Venables (1995) combine both trade and partial mobility of factors of production to highlight the interaction of agglomeration and dispersion forces in the process of reducing trade costs. Agglomeration effects lead to the concentration of production at the location of demand, while dispersion effects work against them, owing to increasing costs of production on account of

congestion and market crowding-out. Low trade costs imply agglomeration, whereas high trade costs imply dispersion. Thus, depending on the model's assumption, trade integration can, at different stages, lead either to a core-periphery situation with more gains for the core than for the periphery, or to a reindustrialization of the periphery where the latter countries gain more. To examine this through the integration lens, poor integration within the proxy of high trade costs implies dispersion. However, as economic integration improves through lower trade barriers, the agglomeration forces do become stronger, with factors consolidating in the prevailing centres of production. Lastly, at further integration levels with low trade costs, dispersion forces become stronger again and lead to a redispersion of industrial production to the benefit of new and different countries and subregions of an RIA.

Dynamic movement of capital and labour also has balance-of-payments effects, public finance implications and technological and skills spillovers, and can lead to a possible brain drain. These effects are predominantly positive and, in cumulative terms, result in a net gain for society. However, market forces alone do not necessarily lead to equitable distribution of the costs and benefits of economic integration, so it is important to develop mechanisms to help equalize the gains and compensate parties that suffer under this process.

3. Empirical evidence

Quantifying the effects of RIAs and disentangling them from other changes taking place in an economy is a difficult task. Quantitative assessments in this context are traditionally carried out by estimating econometric models or using computable general equilibrium (CGE) models. Econometric evaluations are used predominantly for ex-post analyses of RIAs and generally involve estimating simple models, and focus on few endogenous variables. Gravity models are commonly used to assess econometrically the impact of FTAs on trade flows by estimating the extent to which trade in RIA member counties exceeds the level that could be explained by standard bilateral trade determinants, notably income and geographical distance. CGE frameworks are the most commonly used methods for ex-ante evaluation of RIAs. CGE models are often large-scale and based rigorously on theory, which allow researchers to capture the complicated interplay of policy changes associated with an RIA. However, they also tend to be complex and opaque, and require researchers to make arbitrary decisions on parameter values, functional forms and data. These evaluation methods are used to study the impact of RIAs empirically on a wide range of variables, including intraregional trade, growth, trade diversion and creation, firm size, price-cost margins, the stock market and economic growth.

Empirical studies based on gravity models find that entering into an FTA has comparatively large effects on trade flows. For instance, Baier and Bergstand (2007) estimate that FTAs increase bilateral trade flows by around 100 per cent on average after 10 years, using a large panel of countries and covering the period 1960-2000. The positive effects of joining a preferential trade agreement (PTA) are confirmed by a number of other studies using a similar approach, albeit to a lesser but still

significant extent (Ghosh and Yamarik, 2004; Magee, 2008; Acharya and others, 2011; Soloaga and Winters, 2001). Overall, this strand of empirical studies tends to find rather large trade creation effects of PTAs, dominating the limited trade diversion effects estimated.

Behar and Crivillé (2011) examined the extent to which FTAs have differential effects on the bilateral trade flows of developing and developed partners. That is, they examined whether trade agreements involving developing and developed countries have systematically different effects on bilateral trade when distinguished by trading partner, North-North, North-South and South-South trade agreements. In fact, they find that the empirical impact of an FTA crucially depends on the partners. Based on gravity model estimations, they estimate that a four-country, North-South FTA would boost bilateral trade flows by 53 per cent, while a South-South FTA would boost this by 107 per cent.

In the context of the North American Free Trade Agreement (NAFTA), there is strong evidence that Mexico has benefited significantly from entering, whereas the gains for the United States and Canada have been limited. Econometric studies confirm that NAFTA has boosted Mexican exports, productivity and output (De Hoyos and Iacovone, 2013). Romalis (2007), by contrast, finds that NAFTA is overall trade diverting. Ex-post evaluations of the effects of NAFTA are largely in line with the ex-ante assessments. The evaluations of NAFTA using the CGE framework predicted sizable gains in terms of GDP, particularly for Mexico and Canada (Bachrach and Mizrahi, 1992; Brown, Deardorff and Stern, 1992)[2]. The United

States, however, was not expected to reap significant benefits from NAFTA given the initially low level of trade barriers and the smaller share of the economy affected by this policy change.

CGE evaluations of the Single Market Programme in Europe, EC-92, however point to rather modest gains.[3, 4] The limited prospective gains can be partly attributed to the fact that tariff barriers were already largely eliminated on internal trade and remaining distortions mostly included external tariffs and imperfect competition.

The ASEAN Free Trade Area (AFTA) has also been found to have a positive effect on intra-ASEAN trade (Kien, 2009; Okabe and Urata, 2013). Elliot and Ikemeto (2004), based on gravity model estimations, find that AFTA has not only boosted actual intraregional imports and exports, but also trade between members and non-members.

ESCWA (2014a) presents simulation results in a CGE framework under different scenarios. Potential gains from the completion of PAFTA and the creation of a customs union are rather limited. These results suggest that non-tariff and other distortions remain significant, and deeper regional economic integration is necessary to ensure that the region's full potential is reached. In this regard, extending PAFTA to trade services and facilitating the intraregional mobility of capital and labour could potentially yield significant benefits in the region and should become areas of focus in the regional economic integration process.

In an effort to analyse the impact of FTAs on actual trade flows, Robles, Martínez-Zarzoso and Burguet (2012) estimate an econometric model comparing North-South and South-South agreements and differentiating between industrial and agricultural products, drawing on the Middle East and North Africa (MENA) classification.[5] They find that the Euro-Mediterranean Partnership (EUROMED) FTA had a significant positive impact on EU exports over the period 1990-2010, particularly of industrial products, to MENA partner countries. Moreover, the FTA between other MENA countries and Turkey had a significant positive impact on Turkish exports to MENA partners, but not a significant effect on MENA exports to Turkey. The United States-Morocco and United States-Jordan FTAs have boosted industrial MENA exports, mainly driven by textile and apparel exports of Jordan. PAFTA and the Agadir Agreement, which was signed by Egypt, Jordan, Morocco and Tunisia in 2004, are not estimated to have had a meaningful impact on the trade flows of the countries involved. The EU-Turkey customs union, however, is estimated to have significantly boosted trade and investment integration between the two partners, with trade having quadrupled since 1996. These results are also confirmed by Gylfason and others (2012). The customs union has helped Turkish firms integrate into European production and supply chain networks. Coupled with macroeconomic stability, regulatory cooperation, increased imports of machinery and capital goods, and greater foreign investment into Turkey's services and manufacturing sectors, the agreement has boosted Turkey's competitiveness and facilitated Turkish exports not only to Europe but also to other markets,

notably in the MENA region (World Bank, 2014a).

4. Political arguments

The political context plays a crucial role in explaining why some countries participate in RIAs. The role of RIAs in political integration, domestic politics, wielding power and influencing forms of governments and institutions are key motives for decision makers to enter into regional integration initiatives.

An important consideration is that RIAs can help countries to develop common positions and bargain as a group, with increased visibility, credibility and power in multilateral negotiations, eventually helping them to obtain better negotiation outcomes. This may be particularly relevant for smaller economies with limited impact on a country-by-country basis, allowing them to tap into the collective bargaining power of the region as a whole. RIAs also prepare countries for multilateral agreements as they determine their policy stances and make trade-offs between different policy areas in the negotiation processes. Moreover, RIAs could play a crucial role in minimizing harmful rents in parts of the economy. If these rent holders form a significant barrier to multilateral talks, then RIAs could greatly facilitate multilateral negotiations. Liberalization, whether regional or multilateral, is likely to lead to even more liberalization (Baldwin, 1994).

By intensifying trade and investment links and interactions, RIAs raise the levels of trust, interdependency and opportunity cost of conflict in a region. RIAs are likely to promote a

culture and institutions of cooperation, and create mechanisms to address contentious issues. For instance, the success of EU integration is argued to be underpinned to a great extent by an overriding political objective of avoiding conflict.

RIAs can also serve as a commitment mechanism to domestic economic policies and reforms. RIAs force Governments to maintain policies and practices that may be time-inconsistent albeit welfare-improving. In this regard, entering into an RIA can signal a country's policy orientation and approach, especially if it lacks credibility. There are two necessary conditions for an RIA to become a strong commitment mechanism. Firstly, the benefits of continued membership in the RIA must outweigh the benefits of exiting. Secondly, the punishment stipulated in the RIA must be credible and serve as a deterrent. Moreover, RIAs can be formulated as an instrument for joint commitment for the region to a reform agenda. In fact, empirical evidence suggests that developing country leaders enter into deep, legally binding trade agreements with advanced economies, notably the United States and the EU, to enact and implement politically controversial domestic reforms (Baccini and Urpelainen, 2014).

5. Regionalism versus multilateral liberalization

What is the difference between the impact of globalization and regional economic integration, given that both give rise to expanded markets and increased competition? Regionalism is viewed as a viable strategy to limit the impact of major global economic shocks on the domestic economy. Regionalism also allows Governments to support their weak sectors at a regional level without entirely undermining the long-term growth benefits of international trade. Moreover, deeper agreements covering behind-the-border measures are relatively easier to reach at the regional level rather than globally, given the wide range of different policy needs and preferences among countries. Krugman (1993) argues that the relative convenience of dealing with complex and numerous trade barriers in a regional setting as opposed to at the multilateral level explains the popularity of RIAs. Another major advantage is that it is possible to deliver supranational public goods, such as regional infrastructure and redistribution mechanisms, at the regional level.

There are also concerns that better organized developed countries are more likely to exert a stronger influence on common policies (Brou and Ruta, 2006). In this regard, the interests of developing countries could be better preserved and pursued in a regional setting.

Another justification for pursuing RIAs is provided by the theory of the second best, as formalized by Lipsey and Lancaster (1956). This implies that, when market imperfections or distortions are present, it is theoretically possible to design a trade policy that can improve national welfare. This could become a rationale for different types of protectionist policies in an economy and for participating in regional economic integration initiatives that entail discriminatory trade policies.

The tendency of multinational corporations to operate on a regional rather than a global level has been documented, among others, by

Rugman and Verbeke (2004) and Rugman (2005). Antràs and Foley (2011) provide theoretical and empirical evidence in the context of AFTA, supporting the thesis that the formation of a regional FTA spurs multinational firm activity in the region. This is likely to benefit the region as a whole given that multinational firms tend to exhibit high levels of productivity, pay higher wages and create positive spillovers for local firms.

Pressures from globalization are also drivers of regional economic integration. Changes in global trade patterns provide an impetus to countries to form new PTAs or to join existing ones. In explaining the enlargement of the EU, Baldwin (1995) develops the domino theory of regionalism, implying that the potential loss of market share creates an incentive for non-members to join existing PTAs or create new ones. There appears to be broad empirical support for this theory (Egger and Larch, 2008; and Baldwin and Jaimovich, 2010; Chen and Joshi, 2010). Dür (2010) argues that PTAs signed by the EU and the United States are largely explained by competition for market access in emerging countries.

Furthermore, RIAs could counter hub-and-spoke bilateral agreements between developed and developing countries. It is argued that hub-and-spoke agreements undermine economic linkages between countries in the periphery of such arrangements, as firms tend to concentrate in hub countries. For instance, negative effects and impacts of bilateral trade agreements between most Arab countries and the EU or the United States were factors in the launching of PAFTA (Ferabolli, 2015).

Yet, regional economic integration should not discourage individual countries from engaging in multilateral liberalization. As the ASEAN experience shows, for example, the open regionalism approach, in which multilateral and regional liberalization are undertaken concurrently, strengthens the beneficial effects of regional economic integration. Regional economic integration, through logistics, free trade, and connectivity improvements, increases the virtual size of an economy and leads to substantial benefits from scale, network and agglomeration economies. This leads to a rise of unit values in exports and, thus, to increased production of high quality products, which are highly networked and produced with many additional features, requiring complex global value chains. With the lowering of trade costs due to regional integration agreements, global value chains have increasingly evolved geographically. For regions and countries that produce lower quality goods, structural change entails moving into product components (and services) that are incorporated into higher quality products in sectors with high vertical product differentiation. Consequently, structural change also means the integration of global value chains in the region and the linkage of the regional portion(s) of global value chains to the global portion(s) of global value chains (Asian Development Bank, 2013). Regional economic integration initiatives will lead to greater opportunities of economic diversification and specialization through a better connectivity to global value chains.

C. The status and challenges of Arab economic integration

1. The status of Arab economic integration

PAFTA has made important progress by removing tariff and non-tariff barriers, which include policy barriers to trade, such as quotas. Nevertheless, more progress is needed in certain areas, and addressing the issues of unduly restrictive rules of origin and non-tariff barriers remain key concerns. PAFTA needs to be further deepened in order to boost meaningfully intra-Arab trade volumes, particularly given the limited impact of PAFTA to date on intra-Arab trade integration. Extending PAFTA to services trade should be a high priority and could provide a basis for greater integration in the Arab region, as is discussed below. Intensifying efforts to foster regional cooperation in the areas of investment, labour mobility, standards and procedures, and policy coordination should also feature prominently in the Arab regional economic integration agenda.

(a) Trade integration

Despite the progress in the implementation of PAFTA, the magnitude of intra-Arab trade in goods remains relatively small, registering between 6 and 12 per cent of the region's total trade during the period 2000 to 2013. These shares are well below those of the EU and ASEAN, where, as of 2013, intraregional trade stood at 50 per cent and 23 per cent of total trade, respectively.[6] The Arab region exhibits comparable regional trade integration levels with the Economic Community of West African States (ECOWAS) and the Common Market for Eastern and Southern Africa (COMESA), where regional trade integration appears to have intensified since the mid-2000s. Reflecting the lack of diversification in their export bases and proximity to major non-Arab export markets, intra-Arab trade is also very limited at the subregional level, with the GCC and Arab Maghreb Union (UMA) share of imports within each subregion in their total imports hovering around 10 per cent and 4 per cent, respectively.

(b) Labour integration

Migration has historically provided an important link between countries in the Arab region, helping host countries overcome labour shortages and supporting labour-abundant countries to better deal with employment and associated social challenges. The extent of intraregional movement of labour in the Arab region sets it apart from other regions. The Arab region had roughly 22 million immigrants in 2013.[7] GCC countries are the most important destination for Arab emigrants, owing to the growth of GCC economies spurred by past oil price increases. GCC countries, however, increasingly rely on Asian workers, who currently dominate the inflow of migrant workers (chapter III for more depth on this issue).

In addition to other factors, economic instability and weak and non-inclusive growth performance that fails to absorb new entrants into the labour market and to reduce poverty rates have been important drivers of migration from Arab countries, dubbed as push factors. Conflict is also a key push factor. For instance, Iraq and Libya, which were historically important destinations for Arab migrant

workers, have been hit hard by conflict and have lost their prominence in hosting Arab migrant workers (ESCWA, 2014a). Employment opportunities and higher wages in GCC countries and Europe also attracted Arab workers and are considered pull factors.

Migrant remittances are a significant source of external finance and help reduce balance of payment deficits in a number of countries in the Arab region (chapter III for further details). In 2010, migrant remittances of around $24 billion were sent from the Arab region to other Arab countries, up significantly from previous years.[8] Remittances trends also reflect the decreasing importance of Arab workers in the GCC countries. For example, remittances from the GCC to Egypt in 2010 were around one-seventh of remittances sent to India and half of those sent to the Philippines (ESCWA, 2014a).

(c) FDI flows and capital market integration

While most of the Arab region is classified as capital-poor, some notable exceptions, including the GCC countries, Algeria and Libya, are capital-rich. This suggests that the scope for gains from integrating capital markets in the region could be substantial.[9] On the one hand, capital-poor countries in the region can take advantage of capital flows to boost growth and ultimately accommodate their growing labour forces. Capital-rich countries, on the other hand, benefit from investing in those countries, particularly as their cultural and linguistic affinity with the host countries provides them with an advantage over investors from outside the region as they are better positioned to deal with information asymmetries.

FDI flows are considered a key source of funding in the Arab region. Arab countries made great strides in increasing the region's share in global FDI flows in the 2000s, with the global share of the region's FDI inflows surging from 1 per cent in 2001 to 6.6 per cent in 2008 (ESCWA, 2014a). As a share of GDP, in the 2000s, FDI inflows to the Arab region overtook such regions as NAFTA and the Southern Common Market (MERCOSUR), and reached levels comparable to the EU and ASEAN, which are traditionally attractive destinations for FDI (figure 1.1). In fact, the Arab region now receives a share of global FDI greater than its share in global GDP, after a reversal of trends since 2002 (Sekkat, 2014). This is in large part a result of active efforts to attract foreign investment, which included the reduction of red tape and business licensing, reduction of barriers to international trade, greater infrastructure investment, and legal frameworks to protect the rights of investors. FDI outflows from the region, while still below levels implied by the Arab region's share in global GDP, have increased substantially since 2004.

Intra-Arab FDI flows have also increased markedly, from around $1.4 billion in 1995 to $35 billion in 2008, just before the global financial crisis; although as a percentage of total FDI inflows, this actually decreased over this period from around 50 per cent to approximately 37 per cent. Over the period 1995-2011, cumulative intra-Arab FDI inflows totalled $178.5 billion, or roughly 31 per cent of total FDI inflows to the region (ESCWA, 2014a). The dramatic increase in intraregional FDI flows after 2004 has nevertheless been accompanied by sizable fluctuations, reflecting the lumpy nature of much FDI driven by large projects.

Sekkat (2014) argues that Arab countries receive a disproportionately high level of FDI flows from within the Arab region, given their share of global GDP. Intraregional FDI has predominantly gone into the service sector, notably real estate and financial securities. After the service sector, industry accounts for around one-quarter of intraregional FDI, more specifically the oil and gas sector. In terms of the geographical distributions of FDI flows, Saudi Arabia has been the main beneficiary of intra-Arab FDI, followed by Egypt and the Sudan (ESCWA, 2014a).

A distinguishing feature of intra-Arab FDI flows is that standard determinants of FDI inflows do not appear to exert significant influence on their patterns. While the quality of institutions, infrastructure and human capital are important factors determining the attractiveness of FDI recipients outside the Arab region, intra-Arab FDI flows are in large part governed by regional strategic considerations. Sekkat (2014) suggests that a large share of FDI in the region is provided by Governments and/or Government-related entities, and the distribution of FDI across the region might be a result of a bargain between Governments, in addition to such economic determinants as risk-adjusted returns on investment and high rates of growth in many Arab countries.

(d) Development cooperation and policy coordination

Arab development funds constitute an important vehicle to promote Arab socioeconomic development and regional economic integration.[10] Support from Arab development funds to national and regional projects to foster regional economic integration has been channelled primarily to energy, electricity (both generation and interconnection of networks), telecommunications (modernization and interlinking networks), transport (linking road networks) and water services. Regional economic integration projects tend to be funded mainly by grants, with loans playing a smaller role (ESCWA, 2014a). Arab development funds tend to offer assistance that is more in line with the priorities of beneficiary countries without the conditionality attached by global and other regional development funds. Although Arab donor countries are more generous than the members of the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD), given the size of their economies, the share of grants from Arab funds in total funding has decreased significantly, from around 65 per cent in the early 2000s to around 40 per cent in 2011 (ESCWA, 2014a). A larger share of assistance now takes the form of loans, and preferential and concessionary credit facilities.

Little has been done in Arab countries to harmonize and coordinate sectoral and macroeconomic policies in Arab countries since the 1957 Economic Unity Agreement. Coordination of sectoral and macroeconomic policies plays a crucial role in creating an environment for increased investment and trade by stabilizing exchange rates, reducing uncertainties, improving competition and reducing inefficiencies. While GCC countries have been in the process of macroeconomic policy harmonization and even monetary integration, other Arab countries by and large have not.

Figure 1.1 Trends in FDI inflows across various regions as a share of GDP (percentage change)
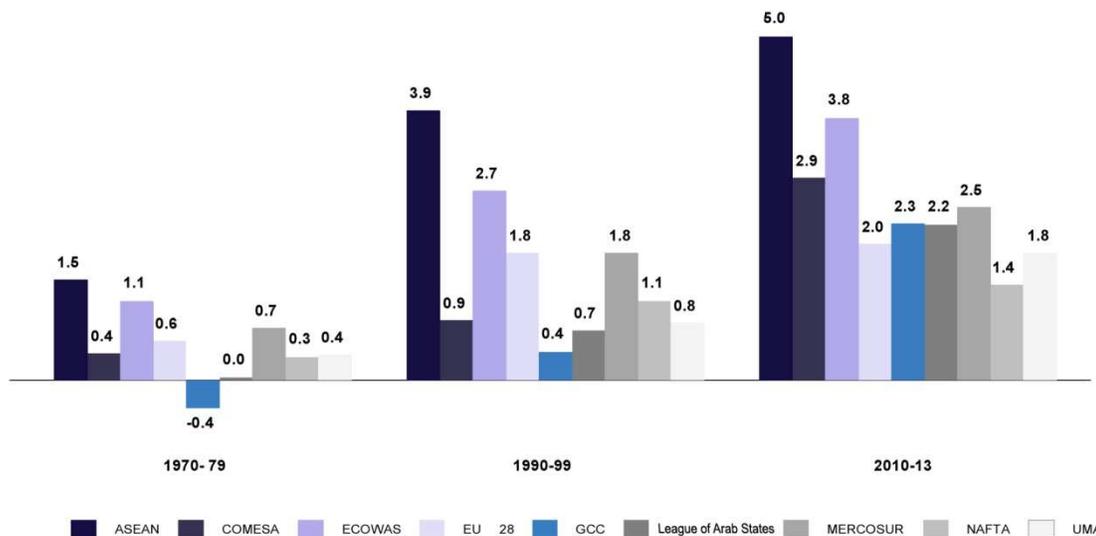
Source: UNCTAD (2014b).

2. Challenges to the integration process in the Arab context

While merchandise trade was an important driver of economic integration efforts in some notable cases, such as the EU, there is limited scope for this to form the basis of Arab economic integration. Initial conditions in the EU were favourable to use merchandise trade liberalization as the main vehicle for integration. In the mid-1950s, each of the six founding members conducted more than 25 per cent of their total external merchandise trade with other members and Germany, the largest member, exported almost 30 per cent of its merchandise exports to the rest of the EU (Hoekman and Messerlin, 2003). Against this background, the members of the EU had a significant economic stake in further fostering intraregional trade; and initially, trade in the EU predominantly involved goods, while trade in factors of production and services was rather limited.

Various factors weigh on intraregional trade in the Arab region. For example, the region's relatively small population and GDP are fragmented into many smaller countries, and vary greatly across these countries. A major implication of this is that differences in national laws and regulations drive trade and investment costs higher. That is, compliance with national laws and regulations that are not harmonized across countries in the region raises the costs of cross-border investors and traders. This is further exacerbated by the limited size of the markets and potential trade volumes involved.

While Arab countries are heterogeneous in terms of their production structures and the diversity of their exports, the relatively large number of countries that rely on oil exports

limits the scope for taking advantage of differences in endowments in the region. Not surprisingly, oil-exporting Arab countries exhibit low levels of trade complementarity with the Arab region as a group. By contrast, given their limited reliance on resource-based commodities, Jordan, Lebanon, Morocco and Tunisia exhibit higher diversity in their exports.

Transport and trade costs are another significant constraint in the Arab region. There is evidence that bilateral transport costs in particular are comparatively high in the region. Shepherd (2011) finds that bilateral trade costs between Arab countries are around twice as high as bilateral trade costs between the EU and Arab countries. Maghreb countries in particular have substantially higher bilateral trade costs among themselves and with the rest of the Arab region than with France, Italy and Spain. Trade costs are substantially higher for agricultural than industrial products, reflecting their higher transportation costs per unit value and time sensitivity of perishables, as well as higher incidence of non-tariff measures and border controls. Based on bilateral trade costs from observed trade and production data, Jelassi (2015) estimates bilateral merchandise trade costs between Arab countries and their major trading partners over the period 2000-2011 at a disaggregated industrial sector level. While bilateral trade costs vary greatly across different industrial sectors and partners, they tend to be rather high in the region, exceeding, in ad-valorem equivalents, 150 per cent in food and beverages, 330 per cent in tobacco products, and 230 per cent in motor vehicles, trailers and semi-trailers on average over the period 2000-2011. The results also suggest that on average bilateral trade costs between Arab countries

tend to be lower than those between Arab and external partners for most industrial sectors and PAFTA has had a favourable impact on intra-Arab bilateral trade costs, with bilateral trade costs in the region having been on a downward trend for a number of industrial sectors. Nevertheless, UMA countries appear to trade at a lower cost with Europe than their Arab counterparts for most industrial sectors, notably textiles, wearing apparel and fur products, wood products, chemicals and chemical products, and motor vehicles.

The evidence on high estimated trade costs is also corroborated by the poor logistics performance of most countries in the region, as measured by various indicators.[11] Trucking services are often performed by small-scale, informal operators, serving short distances. The fragmented nature of logistics services is also prevalent in intermediary services, such as brokerage services. Moreover, nationality requirements leave markets uncontested to a small number of domestic operators (Chauffour and Hoekman, 2013). Zarrouk (2003) identifies that nationality restrictions on drivers, discriminatory surcharges and taxes, and document requirements raise land transport costs substantially in the Arab region.

3. Linking Arab services markets: imperative for competitiveness

Regionally, services accounted for around 45 per cent of GDP in 2013, but Arab countries show significant heterogeneity in terms of this share, with the share reaching 75 per cent in Lebanon (see chapter III for further details). From the sheer size of the service sector it is evident that any significant improvement in

overall income levels must come from that sector. Exposure to ideas and competition from international markets enhances productivity in any sector. Services are no different. An inefficient service sector acts like a prohibitive tax on a national economy. For this reason, the economic cost of an inefficient service sector is arguably of greater overall significance than that stemming from inefficiencies in the goods sector. Services, such as retail trade, communications, transport, finance and insurance services, are important drivers of domestic production and determinants of trade costs. Furthermore, high quality, reliable and efficient services, some of which are not tradable, are an important determinant of a firm's competitiveness. Having access to such services would enhance the ability of firms to compete in world markets by reducing their input and trade costs, as services are not only directly used as inputs in production but also indirectly impact input and trade costs through the logistics-related costs channel. Yet services-related costs appear to be high in many Arab countries. If firms, especially small and medium-sized enterprises (SMEs), are overburdened by costs that are beyond their control, their competitiveness is undermined, thereby limiting opportunities to serve export and domestic markets.

One area related to the service sector in which regionally concerted action and cooperation could be particularly useful is the establishment of regional regulatory agencies to oversee network industries, which notably include telecommunications, energy and transport (maritime, rail, air and road). The existence of network externalities and economies of scale are the defining features of network industries,

suggesting that they tend to give rise to natural monopolies (Economides, 2005). Investing in and managing network industries in a regional setting could yield substantial gains. In particular, further integration efforts in the region can be achieved by issuing region-wide licences to create a market that is sufficiently large to attract global players, and by coordinating regional efforts to ensure competition in such industries by creating a common competition authority.

The experience of Europe illustrates that extending regional economic integration efforts to services and investment is not easy. As mentioned above, economic integration in Europe, as in the Arab region, initially focused on goods markets, despite the fact that services constituted a much larger share of GDP. European countries only gradually moved to include services in their regional economic integration agreement in the 1990s. This was in large part driven by the concern that many service providers in the EU were either public monopolies or firms with concessions. EU member countries started major privatization and regulatory reforms of services only in the late 1980s. Intraregional services liberalization in the EU gives priority to those services that directly affect production costs with a view to further promoting trade in goods. The initial focus was on telecommunications, transport (land, air and maritime) and financial services. Electricity, natural gas, e-commerce, railways and postal services became subject to intra-EU liberalization in the late 1990s, with varying degrees of success (Hoekman and Sekkat, 2010).

Given the dominant role of the State in many Arab economies, the liberalization of

intraregional services trade is likely to be challenging due to political economy reasons and red tape, as illustrated in the European experience. While it is necessary to include provisions on State-owned enterprises and State subsidies in PAFTA, it will be necessary to go further and gradually undertake key service-sector reforms to deepen regional economic integration. Potential candidates for priority sectors to be liberalized are to be determined largely by the common interests of Arab countries, as well as the balance of national benefits and adjustment costs (Hoekman and Messerlin, 2003).

4. Arab regional initiatives in place and binding constraints facing integration

There have been several integration attempts in the Arab region, most of which ultimately have fallen short of initial objectives and have not delivered significant benefits. Subregional integration agreements also have not contributed meaningfully to the integration of the countries in the region (ESCWA, 2014a; and Fawzy, 2003). While the GCC subregion has been comparatively more successful, even there progress has been slow (Hoekman and Sekkat, 2010).

Economic integration efforts in the Arab region are currently in the form of an FTA, and this is now being further deepened into a customs union. PAFTA has been a significant step and is considered the most extensive initiative to date. Survey evidence suggests that most firms in the region already benefit from PAFTA. These benefits relate mainly to the elimination of tariffs on intra-PAFTA trade, and firms in the region have also reported a marked

improvement in customs clearance procedures, and they view the need to make irregular payments as less of an issue (Hoekman and Zarrouk, 2009). PAFTA has led to progress in reducing barriers to trade in goods. However, it has so far not provided as large a boost to trade integration in the region as intended. While this outcome is largely in line with what has been observed in some selected major RIAs, where differences in trade integration levels to a great extent reflect historical trading patterns, a critical review of some aspects of PAFTA and the Arab integration process compared to the experiences and practices in some major RIAs could provide valuable insight on how to amend current integration agreements and move forward (table 1.1).

As tariffs and non-tariff barriers have been officially removed, non-tariff measures have become the most binding constraint to intraregional merchandise trade, as espoused in surveys of private sector operators (Zarrouk, 2003; and Hoekman and Zarrouk, 2009). These non-tariff measures go beyond the reach of policy-barriers alone that are inherent in non-tariff barriers; and in the Arab region, they often take the form of excessively lengthy clearance and inspection processes, high and variable number of documentary requirements, and standards-related issues. Non-tariff measures appear to be at least as prevalent in the Arab region as other regions with similar income levels, and standards and technical barriers have increasingly replaced licences, outright prohibitions and quotas (Gourdon, 2011). The most recent estimates of the cost of non-tariff measures on goods in ad-valorem terms confirm these observations. The estimates range from 22 per cent in Egypt to 33 per cent in

Lebanon, 40 per cent in Morocco and 45 per cent in Tunisia (ESCWA, 2015b).

There is no systematic process in PAFTA of monitoring that trade commitments are implemented, and it is often comparatively difficult to identify the extent of implementation in member countries. It is also important to involve the private sector in the implementation of PAFTA not only as a source of information but also as a partner to better address key issues (Hoekman and Zarrouk, 2009). Periodic assessments based, for instance, on surveys of trade patterns and firms involved in intraregional trade could greatly improve the implementation of PAFTA and inform the discussion on how to deal with emerging issues.

Lejárraga and Shepherd (2013) provide empirical evidence on the trade effects of negotiating transparency provisions in RIAs. They find that, based on a dataset on transparency provisions in more than 100 RIAs, transparency commitments have a significant and sizable impact on intraregional trade.[12] Transparency measures would also greatly facilitate compliance and monitoring of the commitments made in an RIA. Although the collection and dissemination of information is less costly and more feasible, owing to technological innovations, some countries may refrain from transparency measures, as they may perceive these as a relinquishment of national sovereignty. Some countries may practise a disguised form of protectionism by not allowing outsiders to scrutinize trade-related measures. This leads to discretionary rent-seeking and, consequently, resistance to greater transparency by incumbents.

The lack of effective dispute settlement mechanisms in PAFTA is another important issue. The Economic and Social Council of the League of Arab States is the main body responsible for implementing PAFTA. Although there is a framework that includes the necessary elements of dispute settlement in PAFTA, the decisions of the Council are not binding and it has no executive power. Given that PAFTA does not allow sanctions, the settlement of disputes and more generally the effective implementation of PAFTA is not assured (Hoekman and Sekkat, 2010). This departs radically from the EU approach whereby supranational institutions take precedence over the authority of member countries in integration-related matters. The Arab region, rather, ensures that the sovereignty of member countries is preserved and not transferred to supranational bodies (Fawzy, 2003). Kheir el Din and Ghoneim (2005) argue that the lack of effective regional institutional mechanisms and bodies, mainly due to the lack of political support, is the principal factor that limits the full implementation of RIAs and the extent of regional economic integration.

Some Arab countries participate in overlapping RIAs, reducing the transparency of these agreements and making it difficult for firms engaging in intraregional trade to take full advantage of agreements in place. In fact, PAFTA is built on principles to ensure that a minimum level of trade cooperation among members is achieved and member countries have the right to enter into bilateral or multilateral agreements with other Arab States. The Agadir Agreement, for instance, is justified under this provision. It covers customs procedures, product standards, Government

procurement rules, intellectual property protection measures, rules of origin, and conflict-resolution mechanisms (Hoekman and Sekkat, 2010).

There is evidence that PAFTA rules of origin are used not only to counter trade deflection, but also to protect local industries, which constrains intraregional trade opportunities. Hoekman and Zarrouk (2009) find that importers still have to pay tariffs on some products owing to differing interpretations of PAFTA rules in a way that the minimum local content value requirement is not met, even though exporters provide the necessary documents to show that PAFTA rules of origin are met. Survey evidence suggests that the products on which importers still pay tariffs are concentrated in the prepared foodstuffs group but also notably include unfinished wooden furniture, facial tissues, textile and garments, articles of base metal, and ceramics.

As opposed to PAFTA, other recent RIAs focus increasingly on services, investment and domestic regulatory reform. Many RIAs that initially covered only goods have subsequently been amended to extend coverage to services. Specific service sectors are often included in RIAs, notably financial services and ICT. A smaller number of RIAs have dedicated disciplines to deepen commitments and promote cooperation in professional services, transport (including air and maritime),

audiovisual and cultural services, education, tourism and energy services. This is also evident in some major RIAs, including the EU, MERCOSUR and NAFTA, which cover services as well as goods (table 1.2). The PAFTA agreement also mentions trade in services. Arab countries have held several rounds of negotiations on liberalizing regional services markets in the context of the 2003 Regional Agreement on Liberalizing Trade in Services, with the most recent held in Beirut in 2013. No concrete results have yet been reached (Ghoneim, 2012).

Reaching true free trade within the region requires deeper integration, covering domestic regulatory regimes and economic policies. Harmonized policies on taxes, wages, prices and employment would help to equalize costs and prevent member countries from using domestic policies to raise protectionist barriers. The EU has made significant efforts to ensure deeper integration by limiting the market segmenting effects of national regulations, in particular related to health and safety. Progress in this area has been slow but essential to the functioning and completion of the single market in the EU. While the Arab region has yet to reach this stage of integration, given that this is likely to be a lengthy and challenging process, Arab authorities should muster political will, start preparing the ground and pave the way for eventual deep integration.

Table 1.1 Deep integration measures in selected RIAs

Goods markets	EU	NAFTA	ASEAN	MERCOSUR	PAFTA
Beyond-the-border measures					
National treatment	✓	✓	✗	✓	✗
Prohibition of trade-distorting production subsidies	*	✗	✗	✗	✗
Across-borders measures					
Harmonisation/convergence of product standards	✓	✗	*	✗	✗
Mutual recognition of product standards	✓	✗	*	✗	✗
Services markets					
Beyond-the-border measures					
National treatment	✓	✓	*	✓	✗
Across-borders measures					
Mutual recognition of labour standards	✓	✓	✗	✗	✗
Capital markets					
Beyond-the-border measures					
National treatment	✓	✓	✓	✓	✗
Prohibition of performance requirements	✓	✓	✗		✗
Prohibition of incentives to foreign investors	✓	✓	✗		✗
Investor protection	✓	✓	✓	✓	✗
Across-borders measures					
Harmonization of business laws	✓	✗	✗	✗	✗
Taxes: double tax treaty/bilateral investment treaty	✓	✓	✓	✓	✗
Taxes: harmonization of taxes on business	*	✗	✗	✗	✗
Labour markets					
Across-borders measures					
Mutual recognition of labour standards	✓	✓	✗	✓	✗
Single market measures					
Regional competition law: convergence of competition laws	✓	*	✗	*	✗
Bilateral cooperation agreements	✓	*	✗	*	✗
Intellectual property rights	✓	✓	✓	✓	✗
Monetary union	✓	✗	✗	✗	✗
Fiscal union	*	✗	✗	✗	✗

Source: Lloyd (2008).

Notes: The symbols ✓, * and ✗ stand for all, some and none, respectively.

Table 1.2 Selected regional integration agreements

	PAFTA	COMESA	NAFTA	EC15	MERCOSUR	AFTA
Type of agreement	Free trade area	Free trade area	Free trade area	Customs union and economic integration agreement	Customs union and economic integration agreement	Free trade area
Date of entry into force	1998	1994	1994	1994	1991 (goods), 2005 (services)	1993
Date of full implementation	2005		2008	2005	2006	
Member States	Algeria, Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Sudan, Syrian Arab Republic, Tunisia, United Arab Emirates and Yemen (Palestine and Sudan are granted preferential treatment)	Angola, Burundi, Comoros, D.R. Congo, Djibouti, Egypt, Eretria, Ethiopia, Kenya, Libya, Madagasca, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe	Canada, Mexico and the United States	Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Swede and United Kingdom	Argentina, Brazil, Paraguay, Uruguay, Bolivia and Venezuela (Chile, Peru, Colombia and Ecuador are associate members)	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Viet Nam
Coverage	Goods	Goods	Goods and services	Goods and services	Goods and services	Goods
Trade liberalization measures	Elimination of quotas and other quantitative restrictions	Elimination of quotas and other quantitative restrictions	Elimination of tariffs on all traded goods	Elimination of tariffs on all traded goods	Elimination of tariffs on all traded goods, except sugar and automotives	Reduction of tariff levels to 0-5 % for traded products that are covered in the Inclusion Lists.
	Reduction of tariff rates by 10 % annually on traded goods	Reduction of tariff rates on traded goods				

Source: Mehr (2008).

5. Political economy of Arab regional economic integration

Political economy factors play a central role in the regional economic integration process. Malik and Awadallah (2013) argue that, without paying due attention to these factors, it is not possible to fully understand and address the issues undermining Arab regional economic integration. These factors are essentially deep determinants of the institutional setting in which PAFTA and other regional integration agreements in the Arab world operate. While political economy factors are not specific to the regional economic integration process, they can be informative as to why the performance of integration agreements has been poor and what challenges and pitfalls lie ahead.

While economic integration is likely to yield substantial dividends by expanding product and factor markets and fostering more efficient allocation of resources across the region, as has been noted above, gains from regional economic integration may be unevenly distributed, with varying benefits from trade, finance and infrastructure accruing in different locations. Venables (2001) finds that the comparative advantages of member countries, relative to each other and to the rest of the world, provide a basis for predicting who gains or loses from an RIA. Although not specific to the Arab region, the issue of putting in place mechanisms to compensate the losers could ensure sustained political support for integration efforts. Carrère, Gourdon and Olarreaga (2012) estimate that gains from regional economic integration are unevenly distributed among resource-rich and -poor countries in the MENA region. They find that

resource-poor countries are likely to benefit from trade creation effects, but resource-rich countries stand to lose due to trade diversion effects. Although this potentially suggests that regional economic integration offers a way to share the unevenly distributed resource wealth, it also could negate the benefits and incentives of resource-rich countries in the Arab region, which need to play a leading role in regional economic integration initiatives in order to have a reasonable chance of success. In fact, Fawzy (2003) argues that the absence of such mechanisms is an important reason why regional economic integration initiatives in the Arab region have failed.

Furthermore, the costs of regional economic integration are likely to be concentrated and borne by certain sectors, with potential benefits likely to be widely distributed across the economy. The inefficient operation and management of some major firms and utilities, where the State has a dominant stake, is a salient feature of economies in the Arab region. Ensuring the contestability of markets by dismantling entry barriers for both domestic and foreign investors, forming independent regulatory agencies, and through privatization all remain priorities. While unilateral reforms in these areas can theoretically be implemented without resorting to regional initiatives, there are likely to be political economy constraints that impede unilateral action. Regional economic integration-based efforts could help overcome national political constraints to liberalizing domestic services and could provide a mechanism to lock in a reform agenda.

The EU's success in integration was also dependent on the balance of economic power

among its founding members. The three large countries, France, Germany and Italy, had comparable populations and income levels and the other, smaller founding members had managed to contribute to the balance. The Arab region, however, is composed of countries of very different sizes and economic power, suggesting that it could be more difficult to reach a consensus on contentious issues in the integration process.

A major reason behind why countries in the Arab region show weak trade performance compared to other developing countries is a lack of competitiveness. Economies in the region feature two general traits – a heavy dependence on hydrocarbons, and a large and often dominant public sector – leaving the private sector weak, with a few exceptions, and unable to compete in global markets. The Arab region is characterized by fragmented economies, with limited economic links between them. Small markets impede the capacity of the private sector to thrive and compete outside of domestic markets. State patronage appears to be a determining factor in the success of the private sector, rather than entrepreneurship and performance. Malik and Awadallah (2013) argue that traditional recipes to develop a vibrant private sector, such as improving the investment climate, greater access to credit, and reducing the costs of doing business, are not sufficient in the Arab region due to political economy distortions. A strong private sector, which can generate income independent of the support of the regime, could easily challenge the existing status quo.

These considerations are further reinforced by the fragmentation of the labour market in terms of nationals and non-nationals in most Arab States, regardless of resource endowments. A sizable share of the workforce is foreign and tends to be employed in the private sector, where wages are lower than the public sector, whereas nationals tend to have well-paid public sector jobs. Similarly, remittances and foreign aid play an important role in labour-abundant countries in the region. Oil-rich countries rely on their natural resources as an external revenue source and Governments do not need to rely on domestic taxes to raise revenue. This leads to the outcome that neither citizens nor States have a stake in the emergence of a strong private sector in the region. Overall, most Arab countries lack incentives to support the development of a vibrant private sector as their incentives are not aligned with opening and fostering regional markets.

D. Conclusions

While economic integration in the Arab region is under way, it has so far failed to significantly boost intraregional trade, services, investment and other linkages, the reasons for which have been outlined here and will be elaborated throughout this report. The gap in intraregional trade shares in the Arab region vis-à-vis more successful regional integration arrangements, notably including the EU and ASEAN, not only points to the scale and scope of the progress that needs to be made but also the size of potential gains from achieving regional economic integration. Although not only limited to the service sector, facilitating investment in a regional setting is an important and promising avenue, with sizable potential gains in productivity and economic growth.

The scope of PAFTA is currently limited, and stronger dedication to this and other arrangements could lead to greater benefits over time. Intraregional service-sector liberalization and an improvement in the quality and efficiency of services is a very promising step. An area of reform pertinent to the service sector where comprehensive regional action and cooperation is promising is the establishment of regional regulatory agencies to oversee network industries, including telecommunications, energy and railroad networks.

At a juncture where negotiations on the ACU have been intensifying, Arab countries could greatly benefit from taking stock of the shortcomings, limitations of and constraints on PAFTA, with a view to improving it and its implementation. As argued in this chapter, addressing unduly restrictive rules of origin and various non-tariff measures, and the lack of transparency provisions and dispute settlement mechanisms should be priorities. In doing so, the region is more likely to reap full benefits from the ACU, as delineated and discussed in chapter V.

Political economy factors have considerable impact on the Arab economic integration process and are likely to become even more important and challenging as the regional economic integration process advances. Regional economic integration can be an important driving force in the emergence of a competitive, vibrant private sector, which in return could push for deeper integration and stronger economic linkages.

II. The Arab economic integration system of indices: a monitoring and evaluation toolkit

A. Introduction

Economic integration entails extraordinary political and social challenges and rapid change to the regional economic landscape. On one side, the globalization process seems to have gained a life of its own fuelled by technological progress, especially in the fields of communication and transportation. On the other, it reflects Government policies and the need to meet population claims for a higher standard of living. As highlighted in chapter I, the linkages between international and regional economic integration, on the one hand, and economic diversification and trade creation, economic growth and human development, on the other, have been explored in great depth. The Arab region must reap the gains of such an integration process if it is to meet the needs of its citizens, ease the democratic transition process and bring back social peace.

The globalization context has changed with the emergence of powerful engines of integration and growth in the South and new integration patterns through the creation of corporate networks and production process fragmentation worldwide. This new context presents renewed opportunities for the Arab region that missed out on previous waves of globalization and has neither widened nor intensified intraregional

ties. A new start is possible with huge leverage effects.

Fostering regional economic integration necessitates developing a toolkit for closely monitoring and evaluating the ongoing international and regional economic integration process, with a view to initiating an effective action-information-action loop. Monitoring can help as follows: first, to identify economic integration patterns and best practices across the world, the opportunities offered by the actual context in which economic integration is taking place as background material on which Arab countries can develop their economic integration strategy (opportunities); second, to state and redefine goals, objectives and targets (ends or desired outcomes); and third, in spotting the most effective levers for each Arab country to be able to effectively tailor policies and programmes (means or policies). The monitoring system is then used to track country achievements towards meeting the stated intermediary or final goals (recorded outcomes) and to provide an evaluation of these. The closure of the loop happens by eventually shifting policy levers, or consolidating and fine-tuning policy instruments and improving the operationalization of the ends, including by using scenario and benchmark analysis. The whole process further requires updating and upgrading the monitoring system itself to

improve constantly understanding among policymakers and other stakeholders of the economic integration process and its specificities in the Arab region. Due to its above-mentioned properties, such a monitoring exercise addresses the needs of Arab Governments to establish credibility and accountability for their engagement to improve their people's economic prospects.

The AEISI developed for this report is a monitoring and evaluation system that builds on the most up-to-date methodological and conceptual findings in the realm of composite indicators and scoreboards as tools aimed at grasping effectively the complexity of a given phenomenon while displaying the information about its characteristics, channels, dynamic and evolution in a simple, concise and transparent manner. Composite indicators and scoreboards are popular tools for impact and policymaking analysis in various domains from business environment (World Bank Ease of Doing Business Index), to competitiveness (the World Economic Forum Global Competitiveness Index) and economic integration (the Global Enabling Trade Index from the same organization), among others.

The AEISI contains a globalization index and ranking. Globalization indices usually possess various dimensions and are computed using tens of underlying indicators. Despite their comprehensiveness, most globalization indices lack an analytical background highlighting the final goal of the process to justify a country's economy opening up. The report thus pursues this goal by developing an intensity of flows index that draws on the impacts of economic integration on a country's economic activity and

exposure to shocks that originate in foreign countries. This second index is used to articulate international, regional and bilateral economic integration strategies and outcomes. Country profiles and cross-country comparisons are based on indicators gathered in three scoreboards covering national potential, governing policies and outcomes of economic integration. Constructing such a system is not free of discretionary decisions and the elements of political economy are clarified with a view to foster the debate. For the purpose of this report, it was decided to keep the system as "neutral" as possible, so it does not preclude any best path towards economic integration. Nor does it set ad hoc goals and targets, which remain the prerogatives of individual member countries.

Following this introduction, the second section of this chapter presents the conceptual and methodological frameworks of the AEISI which is based on three levels of analysis. After highlighting the limits of globalization indices, the section reviews the motives for the development of an alternative, focusing on the economic impacts of a country's opening up strategy, and describes the structure of the AEISI. In this report, the explanations have been kept as non-technical as possible, and privilege economic intuition.[13]

The third section focuses on the global level of integration, namely, the globalization ranking and its breakdown by component to highlight the dynamic channels and patterns of globalization; and allows an evaluation of the gaps between the 146 countries of our sample and the top five best and worst performers. The section then addresses the question of conduciveness of the international context to a

widening and intensification of Arab countries' interconnections and catching up with the best global performers.

Section four tackles Arab regional issues in general with a particular focus on intra-Arab economic integration. Within that context, the investigation turns to the impact of economic integration on a country's economic activity and exposure to external shocks, which are two faces of the same coin and affect a country's incentives dramatically. The section illustrates how the AEISI permits a close monitoring and evaluation of the intraregional complementarities and interconnections and how it can further be used to identify the countries from within and outside the region that contribute most to Arab economic activity and integration. Finally, the section sheds light on the linkages between multilateralism and regionalism in the Arab region.

Section five presents performance assessments at the country level through the use of three scoreboards. The first covers national "potentialities", namely, the structural integration push and pull factors and other features that are beyond a country's reach, such as conflicts, or those which cannot be changed in the short run, such as infrastructure or labour force quality. The second "policy" scoreboard captures the policies aimed at fostering the free movement of goods and services, capital and labour across the region and worldwide, which is recorded on the "outcomes" scoreboard. The AEISI permits the evaluation of performances on a country basis or through cross-country comparisons. While the treatment of the 22 member countries of the League of Arab States is beyond the scope of this report, section five

offers three initial and representative country cases, namely, Egypt, Tunisia and Saudi Arabia.

B. Conceptual and methodological frameworks

Composite indices have been recently developed by various international organizations and other regional commissions of the United Nations. The oldest index tackling globalization issues is the KOF Index of Globalization, which distinguishes the economic, political, personal and technological channels of the process.[14] The DHL Global Connectedness Index, which is one of the most recently developed globalization indexes, refers to the same four dimensions but also measures the depth, breadth and distribution of flows.[15] Some globalization indices go beyond the question of countries' abilities to widen and strengthen their interconnections worldwide by looking into the impact of the process on human development, such as the Trade and Development Index of the United Nations Conference on Trade and Development (UNCTAD).

Composite indices sometimes aggregate the informational content of up to 80 underlying indicators. While they are hence very comprehensive, the integration channels and mechanisms are obscured by the use of very large datasets and complex methodologies entailing strong assumptions regarding the nature of the process itself, making the use of such tools for policymaking delicate. As a consequence, the AEISI makes use of composite indices computed using only a handful of the most relevant individual indicators for the Arab

region, leaving the three scoreboards focusing respectively on country enablers, policies and outcomes. The AEISI permits three levels of analysis, namely global, regional and bilateral, at which national performances are assessed with a view to evaluating the influence of their opening-up strategy on domestic economic activity. The first part of this section presents the conceptual framework and the type of questions the AEISI is meant to tackle. The structure of the AEISI and computation methodological issues are the subject of the second part.

1. Conceptual framework

While the integration process covers a variety of connections between countries, including the movement of goods, people, services and finance, the AEISI focuses on the economic facet of integration in order to assist countries in their quest to create jobs and wealth to help improve the lives of their citizens. This focus takes root in Dreher (2005), among others, who evaluates the impact of four subdimensions (economic, political, technological and interpersonal) that most globalization indices comprise, and finds that economic issues are most related to a country's economic growth.

These considerations led to the selection of three channels of integration which are relevant to Arab countries, namely, trade, FDI and workers' remittances. These underlying indicators obey quite distinctly though equally important economic rationale, with trade and FDI being driven by profit and strategic economic relationship building, while workers' remittances supplement household- and community-level development spending,

savings and consumption. A globalization index based only on the first two would be more consistent and very strongly and directly linked to economic activity, which is the final goal of Arab economic integration. However, it would not genuinely reflect reality, especially for developing countries in general and most Arab countries in particular for which workers' remittances may be vital.

There are numerous definitions of globalization or regionalization. The AEISI sees economic integration as a process that requires the translation of agreements' provisions into national plans and development strategies, then into regulatory frameworks, in order to allow specific policies to be developed which will then impact the degree of intercountry connectivity. As such, it departs from the indices developed against a "readiness" framework that uses the five steps distinguished by Balassa (1961), namely, FTA, customs union, common market, economic union and, total economic integration, and captures the macroeconomic, institutional and, to a lesser extent, political conditions in member countries.

A country's overall economic integration performance relies on the opportunities offered by and features of the international, regional and national contexts. The AEISI was thus designed to cover these three layers. The analysis can be carried out independently at each level or can adopt a more comprehensive stand depending on the question raised and the matter the user is willing to investigate. At the global and regional levels, the agreed principle was to assess performances by comparing country achievements with benchmarks and through a measurement of the privileged

direction and intensification of countries' interconnections. At the national or country level, the AEISI surveys the three components of an opening-up strategy: the structural-historical-cultural features, the policies developed and their outcome.

Two final elements that the AEISI is meant to monitor and which had an impact on its structure and composition were first the will to track the relationship between multilateralism and regionalism; and, second, to integrate country performances with the opportunities and risks such a policy entails, thereby tracking their incentives more adequately.

Globalization rankings implicitly consider that the top performers are in an enviable situation that other countries should be eager to attain, given that intense interconnections with foreign countries are conducive to further economic growth and the creation of a shared prosperity, unlocking a catching-up process in poorer countries. However, most globalization indices do not actually monitor "sound" globalization. Hence, the top performers are not necessarily those that record healthy sustained economic growth rates.

Meeting this second requirement would have been possible, for example, through the production of an index aggregating some financial soundness or reserves adequacy indicators that are commonly used in surveillance systems to help prevent crisis occurrence and contagion. This option was discarded as it was considered preferable, at this stage, to refrain from expanding beyond the most relevant economic integration channels for the Arab region covered by the globalization

index that would have introduced great complexity. Thus, for this analysis, it was preferred to use the underlying indicators of the globalization index and to treat separately the flows that appear at the credit and the debit of the balance of payments. Indeed, among the six indicators used to compute the globalization index, three relate to money that leaves the country income stream, namely, imports, FDI and worker's remittances outflows, and can be called leakages. Conversely, exports, FDI and workers' remittances inflows are injections of money in the economy that join the income loop and foster economic activity. The advantage of such an index using the former "injection" indicators is to give a good idea of the risks when compared to the globalization index while being effective in analysing the linkages between economic integration and recipient country economic activity.

As with any model, the AEISI simplifies the reality it is meant to capture. Much effort has been made to tailor it in such a way that it grabs enough of the studied phenomenon to permit an informative assessment, and effective experience-based policymaking. The analyses carried out in the second and third parts of this chapter illustrate this point and suggest avenues for further improvements.

2. The structure of the AEISI and methodological issues

For the sake of clarity, the AEISI includes a narrow set of channels and underlying indicators. Countries' various paths to economic integration as well as their performance determinants are taken into consideration in the analysis and included in the scoreboards.

Figure 2.1 illustrates the nested structure of the AEISI at the bilateral level and annex I at the regional level.

The breakdown of the globalization index along its components allows an understanding of the specific globalization channels at the country level. Regional complementarities and patterns are further identified. The AEISI evaluates country performances and relationships with each other in "relative" rather than "absolute" terms as trade, FDI and workers' remittances flows are measured relative to GDP. However, it is important to highlight that the globalization ranking suffers from a size effect given that small countries that rely more heavily on foreign countries for their economic development tend to top the ranking, particularly when they are also resource-rich as they may receive a relatively larger share of total world foreign investment, concomitantly to recording massive capital imports and/or exports given their comparatively small size. Despite these limits, the globalization index provides valuable insights into a country's capacity to grab a share of the massive global demand, and capture and absorb technological progress that can affect their competitiveness and productivity which, in the case of developing countries, is mostly produced outside their home region. A country's ability to integrate internationally is key to its economic development and welfare.

The second level of the AEISI comprises the regional level based on flow intensity indices (annex I). Contrary to the globalization index, the flow intensity indices are computed using financial receipts, as share of GDP, linked to economic operations with the rest of the world

in the form of exports and inflows of FDI and workers' remittances.

Flow intensity indices are computed for each Arab country in reference to ASEAN and the EU. In order to improve the accuracy of the analysis, it was necessary to expand this set beyond the stated benchmark regions to include several key partners. Doing so makes it possible to cover more than 90 per cent of Arab countries' trade, FDI and workers' remittances flows with the world and a fair geographic distribution of these flows which is required to understand a country's vulnerability to specific shocks. These partners included China, Japan, Republic of Korea (the +3 countries of the ASEAN+3), India, Turkey, the United States and the rest of the world. In the same vein, due to substantial differences in development levels that affect intercountry economic relationships, potential creation and the impact that geographical closeness may have, the Arab region was divided into three mutually exclusive subregions, namely, GCC, UMA and other Arab countries. Intensity of flow indices and rankings reveal the closeness of a given country's ties with the selected countries or regions and thus its exposure to shocks originating in a certain part of the world. The changes in the distribution of the partners across the world over time highlight the main engine of economic integration and help to evaluate the deepening of Arab intra- and extraregional relations.

Z-scores are used as a measure of the intensity of countries' economic relationships above the average.[16] Comparisons over time permit an evaluation of the progresses towards higher economic integration between pairs of countries

through cross-border activities. Combined with the bilateral flows intensity indices, this provides information on the impact regional economic integration has on a given country's economic activity and, conversely, on its dependence on foreign countries and vulnerability to fluctuations of their economy.

Three scoreboards have been used for the country-level analysis, namely, potentialities, policies and outcomes. The scoreboards are organized so as to facilitate a transversal analysis along the lines of the main domain for policymakers' action.

The developed AEISI covers the period 2000-2013. The sample includes 146 countries for which data are available.

For the globalization and regional indices, trade time series are from the UNCTADstat database. FDI values were collected from the UNCTAD website, and workers' remittances from the World Bank. Missing values were filled by interpolation. The sources of the underlying indicators used in the scoreboards are provided in annex II, and additional information regarding the conceptual and methodological issues can be found in the methodological note.[17]

Figure 2.1 Illustration of the AEISI at the bilateral level
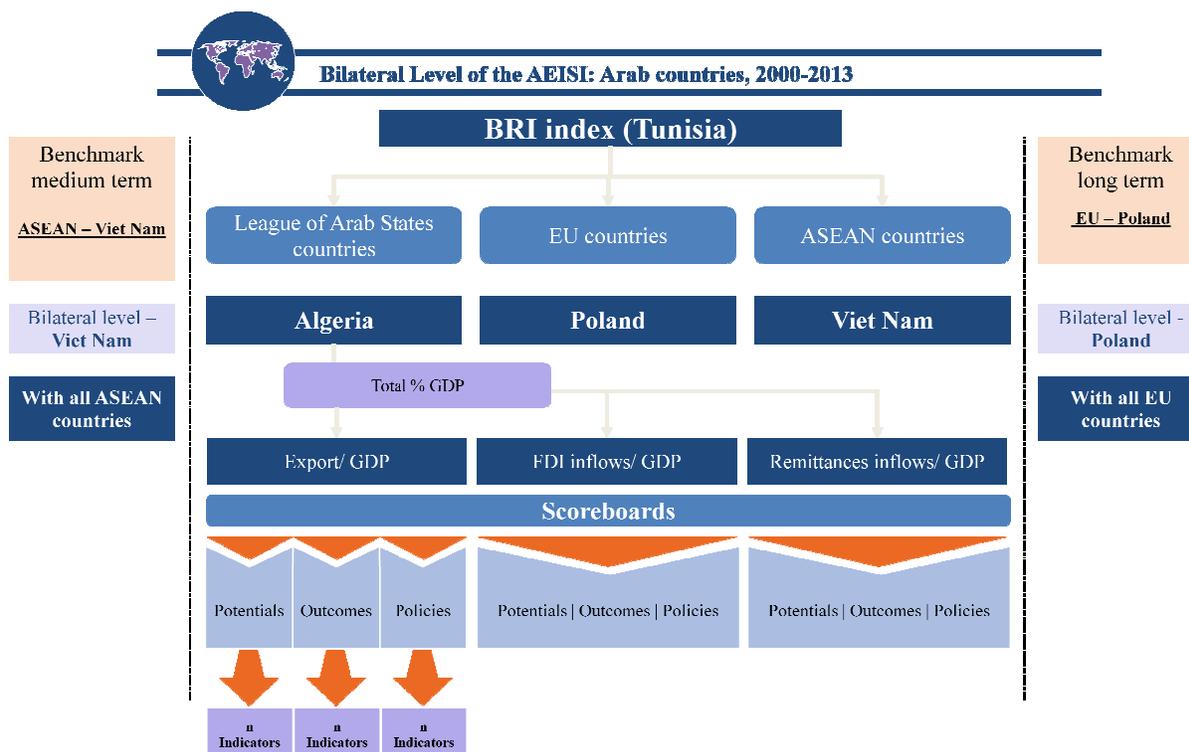
Source: Prepared by authors.

Comparative analysis focuses on benchmark regional economic communities of the EU and ASEAN. The EU provides a comparative best-case scenario to examine in terms of sectoral integration, with measurable outcomes and results, which should be seen as a long-term and deeper form of integration. ASEAN presents a relatively close comparison for the region in terms of both level of development as well as the infancy of formal regional integration agreements. The pragmatic process that the region has undertaken reflects a more realistic medium-term strategy that does not entail building supranational bodies and transferring part of the national sovereignties of member countries. Within these regional groupings, several individual countries have been used to illustrate national-level comparisons with Arab States. Poland and Viet Nam in particular are used for country-level comparisons owing to their economic achievements, particularly regarding economic growth and exports since joining the EU and ASEAN, respectively, and their significant progress in catching up to high performers from those regions. These benchmarks are useful not only for the AEISI but also the report in general.

As an introduction to the system, the following sections focus on the international and regional layers and offer a comprehensive analysis of the overall performances of Arab countries as a group and individually. Insights are provided with regard to the use of the scoreboards in order to understand the drivers, strengths and weaknesses at the country level.

C. Globalization and economic performances of the Arab region

1. First layer of the AEISI: a global view

Country rankings have been calculated for the entire period 2000-2013, and results for 2013 are displayed in table 2.1, along with the ranking change between 2000 and 2013.

The findings largely follow those of other institutions. The top 60 "globalizers" are largely dominated by developing countries among which are 16 Arab countries, including all members of the GCC, as well as 5 ASEAN and 12 EU countries. The ranking highlights that, in addition to the policy environment, comparative advantages and structural features of countries,[18] their performances are determined by other factors that are partly beyond their direct control. These include a size effect, a natural resource endowment effect and a catching-up effect. Although the size effect is accounted for,[19] relatively smaller countries that, economically speaking, depend more on their foreign partners, tend to be found at the top of the ranking. Larger countries, such as the United States and China, which benefit from a large domestic market, tend to record lower levels of economic globalization. The natural resource endowment effect typically involves such countries as Honduras, Mauritania, Mongolia and Mozambique. Globalization in these countries is driven mainly by FDI inflows in the extraction of natural resources. Finally, the case of the EU reflects the catching-up effect. Indeed, the European countries that are at the top of the ranking joined the EU only in 2003. Structural funds from the EU smoothed the adjustment process and reduced its costs. Their closeness

to the EU, easy access to this huge market as well as the mandatory upgrading of legal and regulatory environments lowered uncertainties and boosted investment and trade, unlocking a catching-up, fuelled by these countries' respective comparative advantages. Many analyses indicate that these countries benefited from a technology-led growth through intra-European FDI inflows (Borota and Kutan, 2005).

Three ASEAN countries are found at the top of the ranking, namely, Singapore, Viet Nam and Malaysia. They are located in a dynamic region and their proximity to Australia, Japan, India and China plays an important role in defining their good globalization performances (Asghar, Nasreen and Rehman, 2011; and Behname, 2012).

Membership in RIAs that comprise or are geographically close to a fast-growing or economically advanced country or group are economic growth boost factors that can be emulated if the geography allows, but this is also contingent on the nature and effects of RIAs. Their importance for the economic integration of Arab countries is further analysed below.

To better understand globalization drivers, countries have been ranked, still relatively to the five best and worst performers, but this time based on their performance for each indicator used to compute the globalization index. Table 2.2 summarizes the results for the three regions of interest to the AEISI, namely league of Arab states, EU and ASEAN.

From a methodological point of view, the sensitivity of the rankings to the underlying indicators and their variation can be illustrated by the large impact of workers' remittances. Some countries appear among the top 60 only because of their very strong performances on this front. Other globalization indices, such as the globalization index by A.T. Kearney, the KOF index or the depth index of globalization, are also prone to sensitivity to a particular characteristic although they include up to 80 underlying indicators of very different nature which stabilizes the ranking given that these variables are country- and region-specific and each variable-specific influence is diluted.

Three main lessons can be drawn from comparing the rankings with the drivers of globalization. First, trade remains a privileged engine of integration as all the best trade performers are also in the top 25 globalized countries. Second, despite the fact that trade and financial flows usually go hand in hand, the dispersion of the best performers in terms of FDI inflows and outflows increased markedly in 2013 compared to 2000, and decoupled from the best performers on the trade front. The 2008 global crisis may explain this outcome. The higher dispersion in 2013 also illustrates investors' shrinking appetite for the risk triggered by the severity of the economic crisis and low interest rates in developed countries, the emergence of new poles of fast economic growth in the South and the redirection of flows, including of hot money, towards emerging countries in the South. Finally, and as expected, countries that perform well with respect to trade and FDI do not necessarily perform well with respect to remittances, as the drivers for these flows differ.

Table 2.1 Globalization rankings in 2013 and change compared to 2000

2013											
Singapore	1	Ireland	27	Tunisia	53	Costa Rica	79	Burkina Faso	105	France	131
Lebanon	2	Cambodia	28	Zambia	54	Mauritius	80	Ecuador	106	Tanzania	132
Republic of Moldova	3	Czech Republic	29	Somalia	55	Germany	81	Norway	107	Nigeria	133
Mozambique	4	El Salvador	30	Côte d'Ivoire	56	Kazakhstan	82	Canada	108	United Kingdom	134
Oman	5	GCC	31	Saudi Arabia	57	Romania	83	Spain	109	Burundi	135
Honduras	6	Libya	32	Botswana	58	Iraq	84	South Africa	110	Australia	136
Mauritania	7	Albania	33	Yemen	59	Afghanistan	85	Zimbabwe	111	New Zealand	137
Viet Nam	8	Brunei	34	Guatemala	60	Ghana	86	Rwanda	112	Venezuela	138
Lithuania	9	Qatar	35	Sri Lanka	61	Iceland	87	Laos	113	Greece	139
Malta	10	Bulgaria	36	Morocco	62	Chile	88	Pakistan	114	Japan	140
Mongolia	11	Senegal	37	Bolivia	63	Dominica	89	Algeria	115	Myanmar	141
Hungary	12	Palestine	38	Gabon	64	Benin	90	India	116	United States	142
Slovakia	13	Fiji	39	Namibia	65	Poland	91	Peru	117	Iran	143
Bahrain	14	ASEAN	40	Austria	66	Russian Federation	92	Cyprus	118	Ethiopia	144
Nicaragua	15	Comoros	41	Paraguay	67	Mexico	93	Finland	119	Argentina	145
Kuwait	16	Thailand	42	Dominican Republic	68	Denmark	94	Syrian Arab Republic	120	Brazil	146
Jordan	17	Belarus	43	Philippines	69	Sweden	95	Guinea	121		
Georgia	18	Belgium	44	Korea	70	Portugal	96	Italy	122		
Congo	19	Macedonia	45	Arab Mashreq	71	EU28	97	Indonesia	123		
Jamaica	20	Slovenia	46	Niger	72	Israel	98	Kenya	124		
Estonia	21	Djibouti	47	AMU	73	Arab LDCs	99	Turkey	125		
United Arab Emirates	22	League of Arab States	48	Malawi	74	Congo	100	Uruguay	126		
Malaysia	23	Switzerland	49	Arab non-GCC	75	Croatia	101	Sudan	127		
Togo	24	Ukraine	50	Agadir	76	Egypt	102	Colombia	128		
Bosnia-Herzegovina	25	Latvia	51	Bangladesh	77	Angola	103	China	129		
Netherlands	26	Mali	52	Guinea-Bissau	78	Uganda	104	Cameroon	130		

Ranking change 2000-2013											
Bahrain	-7	Arab LDCs	-28	Slovenia	13	Botswana	-2	Iceland	3	Rwanda	23
Kuwait	37	League of Arab States	18	Spain	-45	Brazil	-10	India	17	Senegal	35
Oman	19	Agadir	21	Sweden	-61	Burkina Faso	4	Iran	-15	South Africa	8
Qatar	-7	Austria	-5	United Kingdom	-79	Burundi	4	Israel	-35	Sri Lanka	-14
Saudi Arabia	-22	Belgium	-43	EU28	-45	Cameroon	-4	Jamaica	7	Switzerland	-26
United Arab Emirates	67	Bulgaria	13	Brunei	6	Canada	-65	Japan	5	Macedonia	-6
GCC	14	Croatia	-28	Cambodia	-3	Chile	-3	Kazakhstan	-51	Togo	46
Arab non-GCC	5	Cyprus	-42	Indonesia	9	China	-7	Kenya	-10	Turkey	5
Algeria	-9	Czech Republic	1	Laos	-5	Colombia	3	Korea, Republic	16	Uganda	-29
Libya	84	Denmark	-79	Malaysia	-13	Congo	25	Malawi	64	Ukraine	10
Morocco	17	Estonia	-2	Myanmar	-38	Costa Rica	-10	Mali	35	Tanzania	11
Tunisia	12	Finland	-86	Philippines	-48	Côte d'Ivoire	1	Mauritius	-34	United States	-8
Mauritania	74	France	-60	Singapore	1	Congo	11	Mexico	12	Uruguay	14
AMU	22	Germany	-13	Thailand	0	Dominica	-38	Mongolia	26	Venezuela	-25
Egypt	27	Greece	-18	Viet Nam	28	Dominican Republic	-27	Mozambique	87	Zambia	30
Iraq	-71	Hungary	8	ASEAN	-14	Ecuador	-29	Namibia	13	Zimbabwe	1
Jordan	-12	Ireland	-18	Afghanistan	19	El Salvador	2	New Zealand	-35		
Lebanon	1	Italy	1	Albania	-4	Ethiopia	-3	Nicaragua	43		
Syrian Arab Republic	-5	Latvia	45	Angola	-89	Fiji	15	Niger	53		
Palestine	-30	Lithuania	58	Argentina	-3	Gabon	19	Nigeria	-16		
Arab Mashreq	17	Malta	2	Australia	-17	Georgia	32	Norway	-33		
Somalia	89	Netherlands	-15	Bangladesh	43	Ghana	15	Pakistan	23		
Sudan	19	Poland	2	Belarus	-21	Guatemala	34	Paraguay	-5		
Comoros	41	Portugal	-48	Benin	9	Guinea	3	Peru	10		
Djibouti	63	Romania	15	Bolivia	29	Guinea-Bissau	29	Moldova	3		
Yemen	-21	Slovakia	3	Bosnia-Herzegovina	-21	Honduras	12	Russian Federation	8		

ASEAN states   EU 28   Country groups   League of Arab States

Source: ESCWA calculations using the AEISI.

Table 2.2 Ranking of drivers of globalization by country and region, 2013

	2013						
	Globalization ranking	Exports	Imports	FDI outflows	FDI inflows	WR outflows	WR inflows	Flow intensity (percentage)
Algeria	115	61	87	132	123	132	82	33
Libya	32	20	43	77	121	10	136	59
Mauritania	7	31	25	99	3	8	140	69
Morocco	62	95	48	72	49	121	24	31
Tunisia	53	51	34	107	70	127	31	44
AMU	73	54	59	104	90	54	47	38
Bahrain	14	17	45	14	54	5	140	67
Kuwait	16	13	141	5	109	4	137	67
Oman	5	6	50	23	82	2	131	73
Qatar	35	11	138	9	140	6	106	68
Saudi Arabia	57	30	124	56	113	7	134	52
United Arab Emirates	22	2	14	53	65	139	140	97
GCC	31	12	75	28	99	9	130	68
Egypt	102	131	127	90	78	113	22	21
Iraq	84	27	79	75	96	89	119	54
Jordan	17	87	22	106	25	30	9	40
Lebanon	2	125	41	35	19	3	4	37
Syrian Arab Republic	120	144	133	117	94	49	33	12
Palestine	38	137	39	129	101	117	7	26
Mashreq	71	76	93	76	73	48	27	34
Comoros	41	146	58	141	75	107	2	24
Djibouti	47	142	38	141	4	50	52	30
Somalia	55	66	3	141	12	139	140	36
Sudan	127	128	137	27	22	111	86	19
Yemen	59	91	70	83	138	44	14	32
LDCs	45	118	118	46	44	76	36	24
League of Arab States	48	29	74	45	92	15	65	54
Poland	91	44	55	139	143	84	72	40
Viet Nam	8	5	6	41	27	139	26	89
ASEAN	40	26	37	18	28	77	55	60
China	129	82	125	44	108	124	90	26
India	116	117	113	96	98	82	39	21
Japan	140	126	136	15	137	122	132	14
United States	142	138	142	21	115	86	133	11

■ Rank 1-10   ■ Rank 11-25   ■ Rank 26-50   ■ >100 percent GDP   ■ 50-99 percent GDP   ■ <50 percent GDP

Source: ESCWA calculations using the AEISI.

Note: WR stands for "workers' remittances".

2. Globalization experiences of Arab countries

Figure 2.2 below focuses on the specific globalization experiences of Arab countries. As expected, oil-exporting countries are faring comparatively well, with the exception of the middle-ranked Iraq, Saudi Arabia and bottom-ranked Algeria. The ranking is based on data for December 2013 when oil prices were still high at $99.45 per barrel against $38.62 per barrel in December 2000, which pushed the level of globalization up through increased trade. The United Arab Emirates and Kuwait moved up by 67 and 37 ranks, respectively, far above the average of the countries that are closing the gap with the top five global performers (22 ranks).

The performances of UMA countries improved slightly, in particular Libya, for which oil exports surged following the resumption of hydrocarbon production after the 2011 civil war. Mauritania improved its ranking by 74 levels and is now among the top 10 most globalized countries thanks to the discovery of natural resources. On the other side, the rest of the Arab countries (that is, excluding GCC and UMA countries) are struggling to keep pace with the world's top five performers; the noteworthy exception is Egypt, which went up 24 ranks between 2000 and 2013, yet the country's records are still volatile and questions remain regarding the sustainability of these trends.

The rankings of Arab least developed countries (LDCs) improved markedly. Somalia, Djibouti and the Comoros moved up 89, 63 and 41 ranks, respectively, and are now in the middle of the rankings. The improvement originates in the strategic geographical situation of Djibouti as a re-exporting hub attracting massive FDI. The very sizable improvement in infrastructure availability and quality must now be translated into further economic development. A surge in workers' remittances inflows in 2013 explains Somalia's favourable record, and workers' remittances provide a crucial life support to the country due to the social and political situation.

Figure 2.2 Globalization experiences of Arab countries, 2000-2013
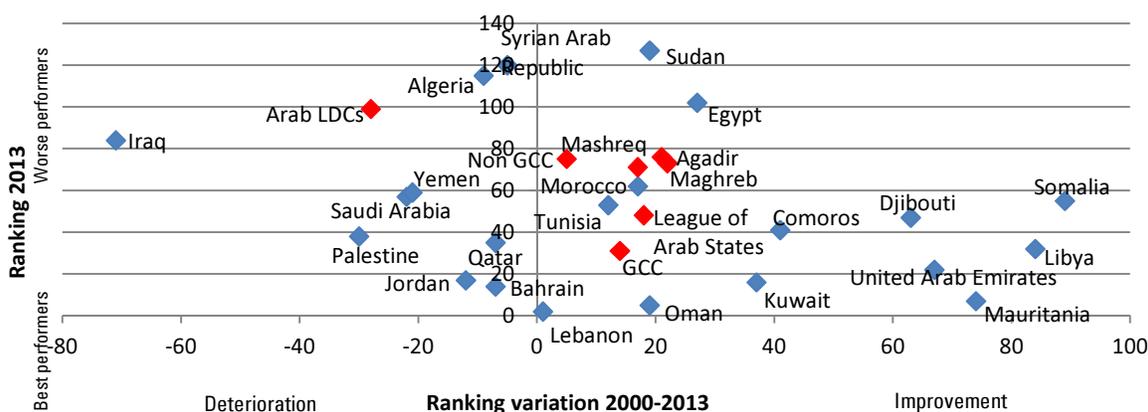
Source: ESCWA calculations using the AEISI.

Note: The closer the countries are to the bottom of the vertical axis, the higher they top in the 2013 globalization index (among which are Lebanon, Oman and Bahrain). The countries that appear on the right side of the vertical axis experienced an improvement in their integration between 2000 and 2013. This is the case of Somalia, Libya and Mauritania. The country at the top of the ranking that improved most between 2000 and 2013 is Mauritania.

Furthermore, the globalization index highlights the complementarity between the globalization patterns of Arab countries. Workers' remittances outflows are a strong engine of the GCC's integration with the world which is coherent with the subregion's oil wealth and need for foreign labour. These countries are top performers on this item. However, workers' remittances inflows are strong determinants of the globalization rankings of other Arab countries, except oil-exporters and some LDCs. This issue thus highlights a channel through which the GCC may impact overall Arab economic development.

Box 2.1 Globalization risks: the domino effect of the 2008 crisis

The AEISI can be used to investigate the trade-offs between the benefits of a greater integration on the world market and the dangers of a higher exposure to shocks originating in foreign countries on which the vast majority of countries have little control. Results from the AEISI reflect events in the global economy and confirm the accuracy of the index.

Between 2000 and 2007, a period analysts consider as the golden age of globalization with the phenomenon reaching its peak in 2007, the gains and losses relative to the best performers were quite equally shared among countries. Around as many countries out of the 146 of this study's sample improved their globalization performances against the five best and worst performers as those that did not.

This is the norm in a comparative ranking. In such a framework, the crucial information is how the total number of steps gained and lost is spread across countries. Shocks of great magnitude and/or contagion effects lead to a sizeable reshuffling of the ranking where some countries are losing and keep on losing a relatively high number of steps, thereby indicating that a domino effect is unfolding.

At the start of the crisis in 2008, only one-third (57) of the 146 countries in the sample lost steps. Countries moved downward by 14 steps on average, 6 steps more than the trend. These figures tell a great deal about the severity of the crisis and the subsequent collapse in the intensity of intercountries economic flows. The year after, in 2009, more than half of the countries studied lost an average of 10.3 levels, most of them further losing ground or being hit by the crisis for the first time. Still, in 2011, one-third of the countries in the sample recorded major setbacks of 12.7 levels on average, which is still far from the trend of 8 steps. As a consequence, the gaps with the best performers widened.

In 2013, a weak stabilization seems to have taken place as 75 countries out of the 146 of the sample saw their performances worsening slightly, which is closer to the trend as well as the number of steps lost that shrunk to 7.3 on average.

Applied to the Arab region, these tools show that the globalization ranking of Arab countries improved between 2000 and 2007 as 15 countries moved 27.5 steps up, on average, while only 5 lost ground (15.8 steps). As some countries are poorly integrated internationally and rank low, one might think it is relatively easy for them to encounter substantial gains which favourably push up the figures for the region's performances. However, the reality is more nuanced.

The globalization index also underlines the importance of FDI inflows in improving LDC rankings. This finding derives partly from the GCC's active investment policy in their Arab neighbours, a drive that begin in the 1980s. The integration of Arab countries in the global market through trade remains extremely weak, especially compared to ASEAN or EU records. One would have expected this channel of integration at the global level to exhibit a stronger influence owing to the numerous regional trade agreements Arab countries have signed with each other but also with the EU, the United States and countries in East Asia.

While globalization brings benefits to countries in terms of higher productivity growth and hence faster development and economic growth, it also exposes them to developments in other economies, including the risk of trade and financial contagion. These aspects are examined in box 2.1.

D. Arab economic intra- and interregional integration

The regional layer of the AEISI can help answer many important questions. Specifically, are oil-rich Arab countries an engine of economic integration in the Arab region the way China is for ASEAN countries? If not or not to the desired degree, what are the alternatives and how will they affect intra-Arab economic integration? How do intra-Arab regional trade agreements contribute to the strengthening of intra-Arab economic relationships and to what extent do they contribute to fostering countries' abilities to strengthen their ties with countries beyond the Arab region, and to reap the largest possible gains in terms of economic growth? What are the remaining bottlenecks to intra-Arab economic integration and how do Arab countries compare to their main competitors when it comes to attracting FDI, workers' remittances, and generating demand for their exports?

The section proceeds in three steps. First, the intensity of Arab countries' ties with various regions and main trading partners is examined in order to identify the contributors to the economic activity of Arab countries. Second, the same analysis is carried out at a bilateral level. Here again, the different economic channels (trade, investment and workers' remittances) are

tackled separately, given that they respond to different incentive structures with differential impacts on economic performance. The third step relates country performances to their "potentialities", as well as to the implemented "policies" and their degree of effectiveness which is determined from their "outcomes", using the three relevant scoreboards.

1. Arab economic integration: the regional layer

Table 2.3 illustrates the relative importance different partners exerted on the economic activity of Arab countries in 2013.[20] The rest of the world never tops the ranking for Arab partner countries (except the United Arab Emirates), indicating that the main trading partners of Arab countries have indeed been included and that the AEISI accurately captures the relative influence of different partners (figure 2.3).

The intensity of interregional flows shows that the EU is the partner with the most relative influence on the economic activities of Arab countries. The EU impacts the economic activity of a large host of Arab States, from oil-rich countries (Algeria, Iraq and Libya) to LDCs (Comoros and Mauritania). The diversified economies from the Maghreb and the rest of Arab countries excluding LDCs, particularly Egypt, Lebanon, Morocco and Tunisia, rank in the top 20s. The ties with Djibouti, Jordan, Somalia, the Sudan, Syrian Arab Republic and Yemen are much weaker as is the case with most of the GCC. Bahrain is ranked 35 followed by Qatar (42) and Saudi Arabia (54). Still, EU member countries absorb 11.7 per cent of total exports of Bahrain, and 9.2 per cent of total exports of Qatar and Saudi Arabia. The GCC as

a whole is still the EU's fifth largest export market and as such the biggest trading partner as a group.

This state of affairs is partly driven by such pull factors as geographic proximity, and strong historic and cultural ties. It is also the result of the EU's efforts to further its trade and investment ties with the Arab region through its neighbourhood policy and the EUROMED partnership;[21] and the 1988 cooperation agreement signed between the EU and the GCC that entails a commitment from both sides to negotiate an FTA, a process that was eventually suspended in 2008.

A comparison between the rankings in 2000, 2009 and 2013 shows that in 2000, the ranking was dominated by the relationships of such oil-rich Arab countries as Iraq, Oman and Qatar, and to a lesser extent Saudi Arabia and Kuwait, with countries in Asia, particularly ASEAN+3 member countries.[22] The role of GCC countries as enhancers of economic growth owes mostly to their position as sources of workers' remittances, as mentioned above. This role is at the same time limited by the small production bases of GCC member countries. Nevertheless, the GCC's economic impact was sizable, particularly for Yemen, Jordan, Egypt, Lebanon, the Sudan, Syrian Arab Republic and Djibouti. The GCC's contribution to intra-Arab economic integration proved its robustness given that GCC countries appear 15 times in the top 150 in 2000 and 2013. However, this economic cooperation still palls in terms of magnitude and scope with that of the EU or the United States.

Table 2.3 Contribution to economic situation by key partner regions and countries, 2013

Libya-EU 28	10.00	Kuwait-Japan	1.84	Oman-RoW	1.02	Qatar-RoW	0.61
Tunisia-EU 28	7.03	Iraq-China	1.84	Syrian Arab Republic-Mashrek	1.02	Djibouti-GCC	0.59
Mauritania-China	5.79	Qatar-India	1.83	Kuwait-ASEAN	1.00	Egypt-Mashrek	0.59
Oman-China	5.69	Palestine-RoW	1.82	Lebanon-GCC	1.00	Iraq-RoW	0.56
Algeria-EU 28	5.05	Yemen-China	1.79	Saudi Arabia-India	0.99	Kuwait-Mashrek	0.55
Bahrain-GCC	4.69	Somalia-LDC	1.76	Yemen-Korea	0.97	Yemen-India	0.52
Qatar-Japan	4.66	Bahrain-EU 28	1.76	Sudan-GCC	0.96	Djibouti-US	0.50
United Arab Emirates-RoW	4.32	Kuwait-US	1.73	Saudi Arabia-ASEAN	0.96	Mauritania-Japan	0.49
Morocco-EU 28	4.29	Jordan-EU 28	1.71	Syrian Arab Republic-EU 28	0.94	Tunisia-US	0.48
Lebanon-EU 28	3.30	Oman-Japan	1.69	Kuwait-EU 28	0.94	Comoros-RoW	0.47
Qatar-Korea	3.26	Sudan-China	1.60	Oman-India	0.93	Syrian Arab Republic-US	0.44

Country pair	Value	Country pair	Value	Country pair	Value	Country pair	Value
United Arab Emirates-Japan	3.20	Somalia-India	1.59	Djibouti-EU 28	0.92	Bahrain-China	0.44
United Arab Emirates-ASEAN	2.93	Oman-Korea	1.51	Comoros-US	0.90	Somalia-GCC	0.44
Comoros-EU 28	2.86	Qatar-EU 28	1.50	United Arab Emirates-EU 28	0.90	Saudi Arabia-GCC	0.44
United Arab Emirates-India	2.79	Saudi Arabia-China	1.48	Bahrain-India	0.88	Mauritania-US	0.43
Oman-GCC	2.59	Saudi Arabia- US	1.47	United Arab Emirates-China	0.86	Jordan-India	0.40
Kuwait-Korea	2.56	Saudi Arabia-Japan	1.41	Algeria-RoW	0.85	Oman-EU 28	0.39
Lebanon-RoW	2.48	Bahrain-ASEAN	1.38	Libya-China	0.82	Egypt-AMU	0.38
Kuwait-India	2.40	Tunisia-AMU	1.38	Bahrain-US	0.82	Iraq-ASEAN	0.38
Egypt-EU 28	2.39	Kuwait-China	1.31	Yemen-EU 28	0.80	Egypt-RoW	0.38
Jordan-Mashrek	2.36	United Arab Emirates-Korea	1.31	Libya-US	0.80	Somalia-RoW	0.38
Iraq-India	2.26	Oman-ASEAN	1.31	Morocco-US	0.79	Djibouti-LDC	0.38
Mauritania-EU 28	2.22	United Arab Emirates-GCC	1.30	Saudi Arabia-RoW	0.79	Yemen-Japan	0.37
Bahrain-RoW	2.16	Yemen-ASEAN	1.22	United Arab Emirates-Mashrek	0.79	Lebanon-Japan	0.35
Jordan-US	2.11	Mauritania-RoW	1.15	Bahrain-Korea	0.79	Iraq-Japan	0.35
Yemen-GCC	2.08	Egypt-GCC	1.14	Libya-RoW	0.78	Yemen-RoW	0.35
Iraq-US	2.06	Saudi Arabia-EU 28	1.10	Syrian Arab Republic-GCC	0.69	Oman-US	0.33
Morocco-RoW	2.06	Iraq-Korea	1.08	Lebanon-Mashrek	0.69	United Arab Emirates-Turkey	0.33
Qatar-ASEAN	1.99	Qatar-China	1.06	Algeria-US	0.67	Algeria-AMU	0.33
Iraq-EU 28	1.96	Saudi Arabia-Korea	1.06	Bahrain-Japan	0.66	Comoros-Japan	0.32
Lebanon-US	1.90	Tunisia-RoW	1.04	Somalia-China	0.64	Jordan-ASEAN	0.31
Jordan-GCC	1.89	Kuwait-RoW	1.03	Jordan-RoW	0.62	Bahrain-Mashrek	0.31

ASEAN + 3   RoW   European countries   India   US   Turkey   Arab states

Source: ESCWA calculations using the AEISI.

Note: The country pairs first list the recipient of certain flows, followed by the origin.

Figure 2.3 Ranking by relative weight in intensity of flows in the Arab region (percentage)
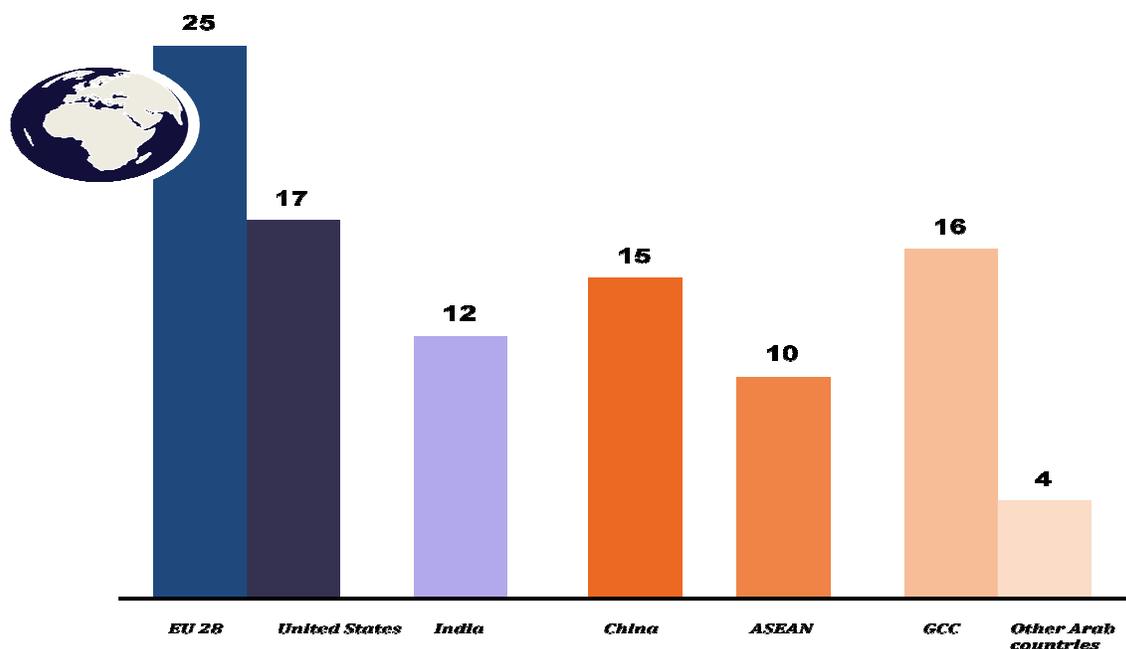
Source: ESCWA calculations using the AEISI.

Note: ASEAN+3 has not been treated as a region per se, comprising the ASEAN plus Japan, Republic of Korea and China. The same applies to the Arab region. As a consequence the weights have been normalized to allow comparison.

Finally, despite the progress made towards deeper economic integration in the GCC, the impact of tighter subregional integration on the national economies of member countries remains limited. Bahrain is the leading beneficiary of deeper economic integration, followed by Oman in 2013, but Qatar, Saudi Arabia and Kuwait still lag behind.

In the future, the roles played by ASEAN+3 countries and India, which is rapidly strengthening its relationships with Arab countries, need to be closely monitored, especially with regards to their ramifications on intra-Arab integration which have yet to be properly assessed and evaluated.

2. Arab economic integration: intraregional trade and FDI channels

The relative intensity of flows between each pair of Arab countries is illustrated in table 2.4. A colour scale from light blue (less intense) to red (more intense) is used to highlight the relative intensity of these flows. The findings confirm the role oil-rich countries, in particular GCC countries, seem to be playing at the regional level to fuel economic integration. These countries distinctly strengthened their interconnections with other Arab countries. It is worth noting that their influence was felt beyond the close circle of their Arab neighbours and reached some Arab LDCs.

The table also shows which countries are leading the process. It appears that the United Arab Emirates contributed the most to the intensification of intraregional economic integration in 2013, as the country deepened its ties with Bahrain, Djibouti, Oman, and the Sudan, and to a lesser extent with Lebanon, Mauritania and Yemen. Saudi Arabia strengthened its relationship with Bahrain, Jordan and Oman. Lebanon, the United Arab Emirates and Yemen also increased their interconnections with Saudi Arabia but to a lesser extent. Qatar intensified its economic relations with Bahrain and the United Arab Emirates; and finally, Iraq another oil-rich country, strengthened its ties with Jordan, the Syrian Arab Republic and the United Arab Emirates.

Arab countries do not trade more intensively with countries from the same subregion. Intraregional trade share indices are low.[23] In 2013, this index was 6.1 for the GCC, 4.8 for non-GCC Arab countries and 9.1 for the League of Arab States against 23 for the ASEAN and 59.6 for EU-28. This means there is a significant untapped potential for economic integration at the subregional level. With the exception of GCC countries, Arab countries are poorly integrated worldwide; their share of world trade is small and even smaller when natural resource exports are removed from the picture.

Seizing on existing opportunities will require improving Arab countries' attractiveness to FDI, which was reversed following the 2011 upheavals after having strongly and consistently improved since the 1990s. The League of Arab States share in total world FDI was 3.3 per cent in 2013, against 6.7 per cent in 2009. While GCC countries still capture the lion's share of FDI inflows to the region (53.8 per cent of the total), some countries have improved dramatically, including Egypt (12.5 per cent), Morocco, (7.4 per cent), Iraq and Lebanon (6.4 per cent) in 2013 (figure 2.4).

These flows are large in terms of share to GDP and gross fixed capital formation for some Arab countries (17.9 per cent in Jordan, 29 per cent in Lebanon, 9 per cent in Morocco, and 17 per cent in Egypt). However, structural problems still prevent FDI inflows from acting as a lever of economic growth. Arab countries suffer from low financial development, underdevelopment of human capital, low quality infrastructure and uneven distribution of finances across different sectors, wherein most of the resources have been poured into the oil and construction industries (el-Wassal, 2012; and Méon and Sekkat, 2013). Moreover, in some countries, FDI is simply prohibited in many sectors.

The countries that seem best positioned to fuel intra-Arab economic integration are the oil-rich Arab States, especially those in the GCC. However, currently low oil prices are expected to have a significant and negative impact on economic growth and remittances outflows in the GCC. The eastward shift for oil-exporting Arab countries is not necessarily bad news for Arab intraregional trade integration. Access by Arab countries to these large markets may help to unlock an economic diversification process that could in turn benefit Arab intraregional integration through the creation of intra-Arab regional value chains. Unlocking this spillover effect will necessitate the removal of some of the obstacles that hinder intra-Arab regional economic integration, which the AEISI monitors through the "policy", "outcomes" and "potentialities" scoreboards.

Table 2.4 Intra-Arab bilateral flow intensity ranking, 2013

Receiving \ Sending	Algeria	Bahrain	Comoros	Djibouti	Egypt	Iraq	Jordan	Kuwait	Lebanon	Libya	Mauritania	Morocco	Oman	Qatar	Saudi Arabia	Somalia	Sudan	Syrian Arab Republic	Tunisia	United Arab Emirates
Algeria	0	0	0	0	0.4	0	0	0	0	0	0	0.6	0	0	0	0	0	0	1.1	0
Bahrain	0.4	0	0	0	0.5	0.1	0.7	1.6	0.1	0.1	0	0.5	1.9	5.5	9.9	0	0.2	0.2	0.1	6.1
Comoros	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.2	0	0	0	0	0.7
Djibouti	0	0	0	0	0.9	0	0	0	0	0	0	0	0.4	0.1	0.3	0	0	0	0	2.4
Egypt	0.2	0.1	0	0	0	0.3	2	1.1	0.3	1.5	0	0.2	0.2	0.4	3.5	0	0.3	0.2	0.1	0.8
Iraq	0	0	0	0	0.3	0	0.1	0	0	0	0	0.8	0	0	0	0	0	0.7	0	0.1
Jordan	0.6	0.2	0	0	0.6	4.9	0	0.5	0.5	0.2	0	0	0.4	0.5	6.8	0	0.3	0.5	0.1	1.6
Kuwait	0	0	0	0	2	0	0.1	0	0.5	0	0	0	0.3	0.1	0.4	0	0.1	0.4	0	0.4
Lebanon	0.3	0.1	0	0	0.4	0.9	0.8	0.3	0	0.1	0	0.1	0.1	0.4	2.5	0	0.1	1.3	0	2
Libya	0.4	0	0	0	0.3	0	0	0	0.1	0	0	0	0	0	0	0	0	0.6	0.7	0.6
Mauritania	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Morocco	0.3	0	0	0	0.2	0	0.1	0	0.1	0.1	0.2	0	0	0	0.4	0	0	0	0.2	0.1
Oman	0.1	0.2	0	0.1	0.3	0.5	0.1	0.5	0	0.2	0	0	0	0.9	2.3	0.3	0	0.1	0	10
Qatar	0	0.2	0	0	0.1	0	0	0	0	0	0	0.1	0.2	0	0.1	0	0	0	0	0.5
Saudi Arabia	0.1	0.7	0	0	0.4	0	0.6	0.3	0.1	0	0	0.4	0.2	0.4	0	0	0.1	0.5	0	0.7
Somalia	0	0	0	0	0.1	0	0	0	0.1	0	0	0	2.3	0	0	0	0	0	0	0
Sudan	0	0	0	0	0.1	0	0.1	0	0	0	0	0	0	0	1	0	0	0	0	4.1
Syrian Arab Republic	0	0	0	0	0.1	3.8	1.3	1.4	0.2	0.5	0	0	0	0.1	1.5	0	0	0	0	0.7
Tunisia	1.3	0	0	0	0.2	0	0.1	0	0	5.4	0.1	0.5	0	0	0.6	0	0	0	0	0.2
United Arab Emirates	0.3	0.2	0	0	0.3	2.7	0.3	0.5	0.2	0.1	0	0.1	3.2	1.3	1.6	0.1	0.3	0.7	0.1	0
Yemen	0	0.1	0	0.1	0.1	0.1	0.3	0.9	0	0	0	0	0.1	0	7.8	0.3	0.4	0	0	2.2
Palestine	0.1	0	0	0	0	0	0.8	0.1	0	0	0	0	0	0.1	0.2	0	0	0	0	0.2

Legend: <0.1 | 0.1-1 | 1-4 | 4-7 | 7-10

Source: ESCWA calculations using the AEISI.

Figure 2.4. FDI share of total world by region, 1990-2013, and Arab share in League of Arab States total, 2013
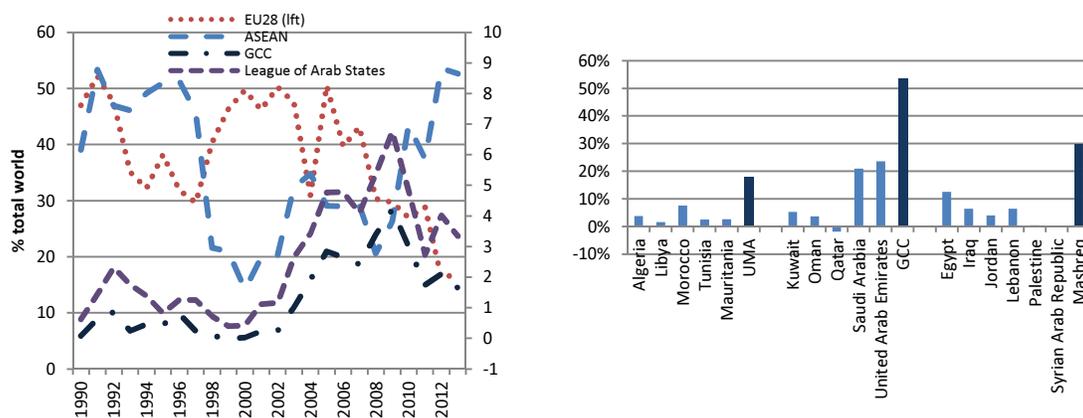
Source: ESCWA calculations using the AEISI.

3. Arab economic integration: the labour channel

In the Arab region, labour flows have been a central component of intraregional economic integration since the 1970s, and intraregional integration via migration is a natural response to countries' complementarities. Labour-rich countries, which include Egypt, Jordan, Lebanon, Morocco, the Sudan, Syrian Arab Republic, Tunisia and Yemen, exist alongside labour-poor countries (GCC countries and Libya, to some extent). The situation in Algeria and Iraq is very specific and relatively more balanced.

Given that workers' remittances do not always conform to basic economic theories, labour flows are more stable than any other foreign financial flow. They are also quite significant, sometimes larger than official development assistance (ODA) or FDI, and as such have become an essential part of many Arab economies. In 2013, workers' remittances

accounted for 20 per cent of Palestine's GDP, compared to 17 per cent in Lebanon. The Comoros, Jordan and Yemen followed, with workers' remittances inflows accounting for around 10 per cent of these countries' GDPs; and Egypt and Morocco benefit from a boost to their economic cycles from remittances of approximately 7 per cent and 6.6 per cent of GDP, respectively. In the case of the Syrian Arab Republic and Tunisia, inflows are slightly lower at about 4.7 per cent of GDP. These figures illustrate the boost Arab countries could receive by properly harnessing their potential for economic growth and poverty reduction.

These flows provide the required foreign currencies to achieve stability for a country's balance of payments and to finance needed imports. Workers' remittances cover 64 per cent of Palestine's imports, for example, while in the Sudan and Egypt, they represent 220 per cent and 108 per cent of foreign reserves, respectively.

In order to identify Arab countries that are more integrated than the regional average, bilateral z-scores were calculated which required estimating bilateral workers' remittances flows. The matrix of migrant stocks by country and nationality was provided by the United Nations, and the bilateral workers' remittances flows were estimated for a reference year by the World Bank.[24] The time series obtained for 2000-2013 suffers from the pitfalls derived from the deficit of accurate and high quality information. While this weakness is acknowledged, given that workers' remittances are grossly informal and their actual level might be twice the levels recorded, the conclusions of the analysis presented below probably underestimate the reality of the situation (Ratha, Mohapatra and Silwal, 2010; International Monetary Fund, 2009).

The ease of sending remittances is affected by exchange controls, capital controls or exchange rates and interest rates differentials (el-Sakka and McNabb, 1999), and obviously by the cost of sending money, which in the Arab region was found to be one of the highest in the world (World Bank, 2015). Thus, there is high potential for remittances increase, formal remittances in particular, through the implementation of proper competition policies for example. Further substantive background on the role of remittances in the Arab region, and namely intra-Arab remittance flows, is provided in chapter III.

E. Arab economic integration: country analysis

This section provides a deeper country-level analysis of the determinants of the level of and path towards deeper economic integration in the Arab region compared with Viet Nam (ASEAN) and Poland (EU). It looks at the global, regional and country levels with a particular emphasis on the findings drawn from the information gathered under the three previously identified scoreboards as part of the third level of AEISI.[25]

The subsequent chapters of this report provide the reader with cross-country analyses, while this chapter illustrates the way AEISI can be used to develop country profiles, as exemplified below for a small sample of three countries, namely: Egypt, Saudi Arabia and Tunisia. The selection of these countries has been based on two main criteria. First, they represent the three subregions within the League of Arab States (AMU, GCC and the rest of the Arab countries); and second, they have more readily available data for detailed indicators under the three scoreboards. The analyses have been intentionally simplified in order to meet the requirements of the present report and can be expanded upon request by member countries. Finally, this system of indices for Arab economic integration monitoring will be continuously improved and more updated estimates will be made available in the next volume of Assessing Arab Economic Integration.

1. Egypt

(a) Trends in global and regional integration

At the global level, Egypt recorded the highest improvement in globalizing its economy among all Arab countries between 2000 and 2005 (figure 2.5). The achievements in 2000-2005 were, however, reversed following the international economic crisis of 2008 and the Arab regional political crises. The main channels of the country's globalization are FDI and workers' remittances inflows. The impact of the former on

Egypt's domestic investment remains to be assessed while the latter is undoubtedly crucial in reducing poverty. Both of these inflows from within the region, without subsequent outflows, indicate that Egypt benefits more than it contributes to intraregional flows. At the regional level, Egypt is found to be very closely integrated with the EU followed by the GCC and the other Arab countries, which points towards unmet potential for further integration within the region (table 2.5). Moreover, Egypt has strengthened its relationships with the EU, GCC, Turkey and Arab LDCs since the 2008 global crisis but not with its other partners, whether Arab or not. In terms of economic integration at the bilateral level, Egypt developed closer ties than the average with Saudi Arabia, Jordan, Libya, Kuwait and the United Arab Emirates as measured by a bilateral ranking using exports, FDI and workers' remittances inflows (table 2.4). These countries thus appear as important engines of economic growth for Egypt.

Figure 2.5. Trends in Egypt: scores and underlying individual indicators, 2000-2013

A. Globalization indices: comparison with Poland and Viet Nam

Note: A lower score reflects an improvement in the country's globalization performances.
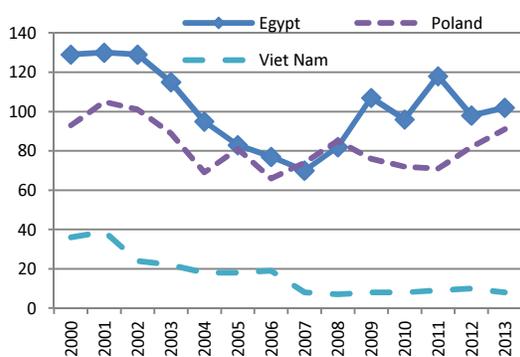
B. Globalization indices: comparison with Tunisia and Saudi Arabia
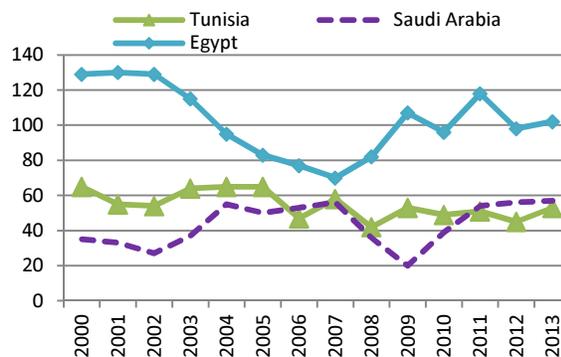
C. Injections in the economy (Ratio to GDP)
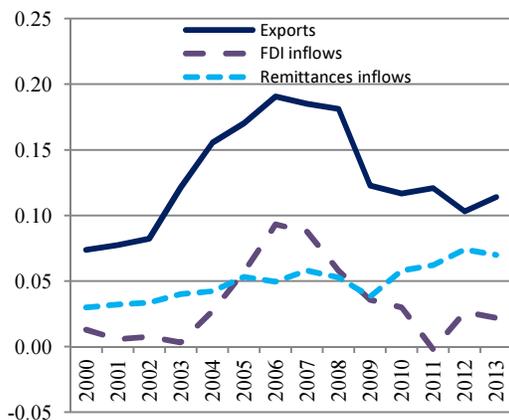
D. Leakages outside the economy (Ratio to GDP)
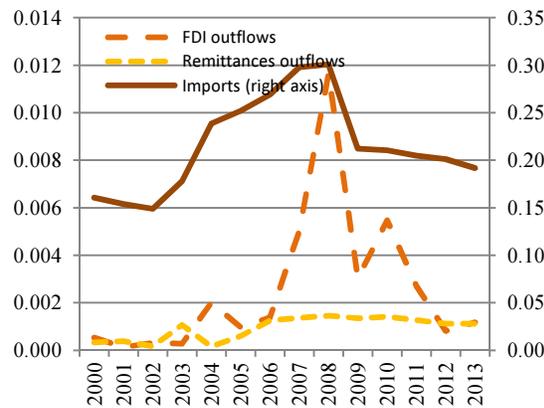
Source: ESCWA calculations using the AEISI.

Table 2.5 Egypt: rankings based on intensity indices, selected regions and large emerging countries

2000		2009		2013	
GCC	87	EU 28	31	EU 28	20
Mashreq	114	GCC	79	GCC	58
ASEAN	115	Mashreq	95	Mashreq	99
EU 28	116	RoW	116	UMA	114
United States	117	UMA	117	RoW	116
RoW	149	United States	121	United States	135
UMA	151	India	134	India	151
India	182	China	162	Turkey	165
Japan	183	Turkey	175	China	173
Turkey	189	LDC	199	LDC	182
Republic of Korea	193	Republic of Korea	206	Republic of Korea	198
LDC	200	Japan	207	Japan	200
China	201	ASEAN	208	ASEAN	225

Source: ESCWA calculations using the AEISI.

(b) Labour force

Regarding the structural features of the economy, the Egyptian literacy rate has been slowly improving, owing essentially to an increase in female literacy. Between 2005 and 2012, the Egyptian male literacy rate fell from 83 per cent to 81.7 per cent, whereas the female literacy rate grew from 59.4 to 65.8 per cent, with an increase in the total adult literacy rate from 71.4 to 73.9 per cent. Between 2000 and 2012, the ratio of girls to boys in primary and secondary school education grew from 92.4 to 96.9 per cent. However, much remains to be done in order to improve the quality of the labour force that was extensively evidenced as a key determinant of a country's competitiveness and capacity to attract FDI.

The "policies" scoreboard tracks Egypt's public expenditures in education and health, which are two factors among the key determinants of the quality and accumulation of human capital. The former decreased from 13.3 per cent of public spending in 2003 to 9.9 per cent in 2008. However, public health expenditures have been stagnating throughout 2003-2008, as evidenced in the scoreboards. If the country is to reap the gains of its successful insertion in the global economy, it will need to compete with such countries as Viet Nam which spent 21.4 per cent of its revenues in 2012 on education. These factors contribute to an increase in Egypt's apparent productivity of labour ($4,500 in 2000 against $9,500 in 2012), albeit at a slower pace than in Jordan ($6,100 in 2000 against $16,700 in 2012) and Lebanon ($16,100 in 2000 against

$25,000 in 2012) or Malaysia ($9,900 in 2000 against $23,700 in 2012).

(c) Investment and business environment

The "policy" scoreboard reports tax rates on goods and services that are relatively small, at 6.9 per cent on average, compared to Jordan (12.17 per cent) or Morocco (15.07 per cent), but corporate taxes remain a deterrent to investment. A new investment law has been passed and recently enacted.[26] The law entails a corporate profits tax reduction from 25 per cent to 22.5 per cent, against a rise from 20 per cent to 25 per cent in 2012, assorted to high income tax cuts (the planned five points increase in the tax rate has been cancelled), better investor protection measures and the establishment of a one-window system to reduce obstacles to setting up new businesses. In 2015, Egypt will benefit from $12.5 billion in financial support from GCC countries in ODA and FDI, and the country reported having signed investment contracts for a total amount of $38 billion (Moody's Investors Services, 2015). This move will also strengthen the credibility of the Government's commitment to reform the economy, along with the bold and long-awaited reform on energy subsidies and could boost intraregional and international FDI flows despite high political risks as evidenced by the "conflict" indicators from the "potentialities" scoreboard.

A rapidly decreasing Chinn-Ito financial openness index between 2008 and 2013, from 1 to 0.16, shows the tendency of Egypt's policy towards greater restriction to international financial flows free circulation.[27] The index is normalized to take a value between 0 and 1,

with 0 being least open and 1 being the most open. Most developed countries have a Chinn-Ito index value of 1, but many do not. The depreciation of the Egyptian pound is putting strong pressure on enterprises operating in the country by increasing input costs and reducing competitiveness.

Domestically, the country would benefit from improving financial liberalization and bank credit access as lending rates remained stubbornly high at 12-13 per cent throughout the entire period covered by the scoreboard, which documents the weakness of the market-based mechanism. This is a situation that could discourage foreign and domestic investors and hinder an effective allocation of financial resources. While this rate is only slightly higher than Jordan (11.8 per cent) and comparable to Morocco (13.31 per cent), it is far above those found in fast growing ASEAN (Malaysia, 7.67 per cent; Singapore, 5.83 per cent; and Thailand, 7.87 per cent). The country ranks also poorly (54 out of 57 countries in 2012) on the domestic financial sector liberalization index computed by the World Economic Forum (2015).

The doing business index, which ranks Egypt below other emerging countries as of 2014, proves the difficulty the country will face in reaping the potential gains from further economic integration in a highly competitive international context. Cutting red tape and fighting corruption, eliminating non-transparent and arbitrary interventions, and strengthening institutional accountability would go a long way towards improving the business climate and enhancing investor confidence.

(d) Logistics and infrastructure

In the field of logistics, Egypt has come a long way since 2000. The policy scoreboard shows the efforts exerted by the country to extend road networks. However, the availability and quality of infrastructure represent only one component of a country's logistics performance, which depends on a host of elements that go beyond mere availability, and range from competence in the field to information technology (IT) tracking quality. These elements are difficult to measure directly and surveys of professionals' perceptions are useful in this regard, which reflect the impact of policies rather than the policies themselves, and are thus included in the outcome scoreboard.

Egypt had a logistics performance index (LPI) score of 2.37 in 2007 and 2.97 in 2014, improving in each of the areas covered by the index, namely, customs, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness between 2007 and 2012. Between 2012 and 2014, Egypt's score fell for quality of infrastructure, international shipments and timeliness. There was also significant improvement in liner shipping connectedness, with the index increasing from 47.6 to 57.5 between 2010 and 2013. It is worth noting that Egypt is one of the top 10 most improved countries, moving in rank from 97 to 57 for infrastructure quality and efficiency of its international shipments.

The liner shipping connectivity index confirms the above findings but highlights the fact that this effective integration strategy relies on the major transhipment function that Egypt's ports, whose impact on the country's economic growth, labour allocation effectiveness and value creation is not straightforward. It remains that this connectivity performance boosts the country's competitiveness, and Egypt could build on this to develop and diversify its exports sector. The role of Egypt as a transhipment hub also explains its greater integration with countries outside of the Arab region.

Air transport figures seem to further demonstrate the country's willingness to insert itself in the global and regional economy by upgrading its infrastructure; and the number of air passengers more than doubled between 2000 and 2013 from 4.5 to 9.9 million, despite the political situation.

(e) Trade

The weighted mean of Egyptian tariff rates on all products has been steadily declining since 2000. The latest available data is from 2009, when the MFN simple average tariff rate was at 8 per cent, compared to 13 per cent in 2005 and 24 per cent in 2002. This is reflected in the values of Egyptian imports. Between 2000 and 2012, imports of goods into Egypt more than tripled, from a total value of $15 billion in 2000 (16 per cent of 2000 GDP) to $52 billion in 2012 (20 per cent of 2012 GDP). Egypt has a long history of trade liberalization on a multilateral and bilateral basis. The country has been a member of the General Agreement on Tariffs and Trade (GATT) since 1970 and of the World Trade Organization (WTO) since its creation in 1995. Egypt has also signed regional trade agreements covering essentially all goods with all its main trading partners, with the exception of the United States. Within that context, while qualifying industrial zones have been established, Egypt remains poorly

integrated and merchandise trade exports represent a meagre 7.4 per cent of GDP against 16 per cent for imports, which is far below the 20 per cent plus recorded by the Arab region's more diversified economies, such as Jordan, Morocco, Syrian Arab Republic and Tunisia.

Figure 2.6 Egypt: changes in complementarity index with selected partners (percentage)
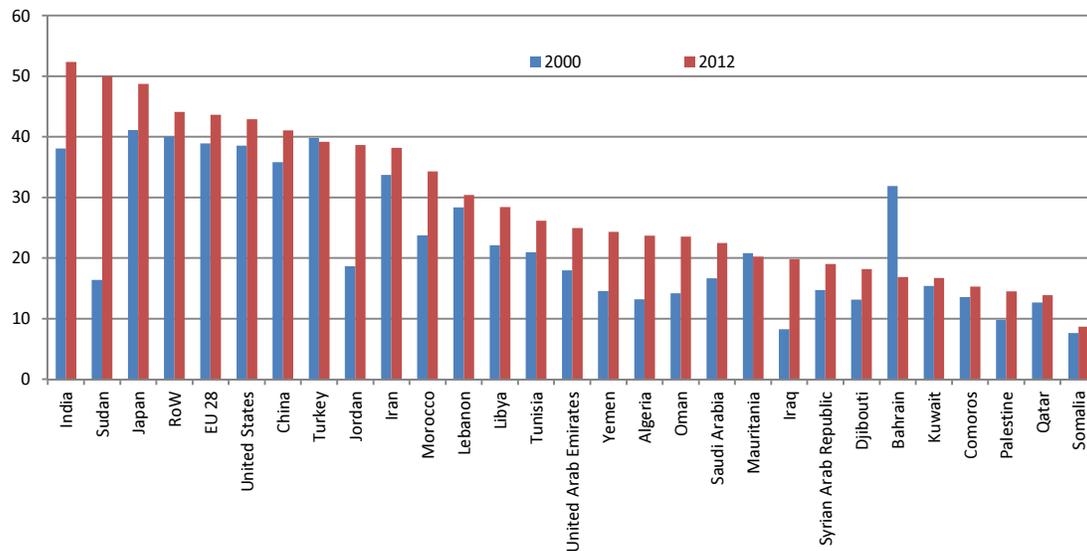
Source: ESCWA calculations using the AEISI.

Figure 2.7 Egypt: changes in exports distribution with selected partners (percentage)
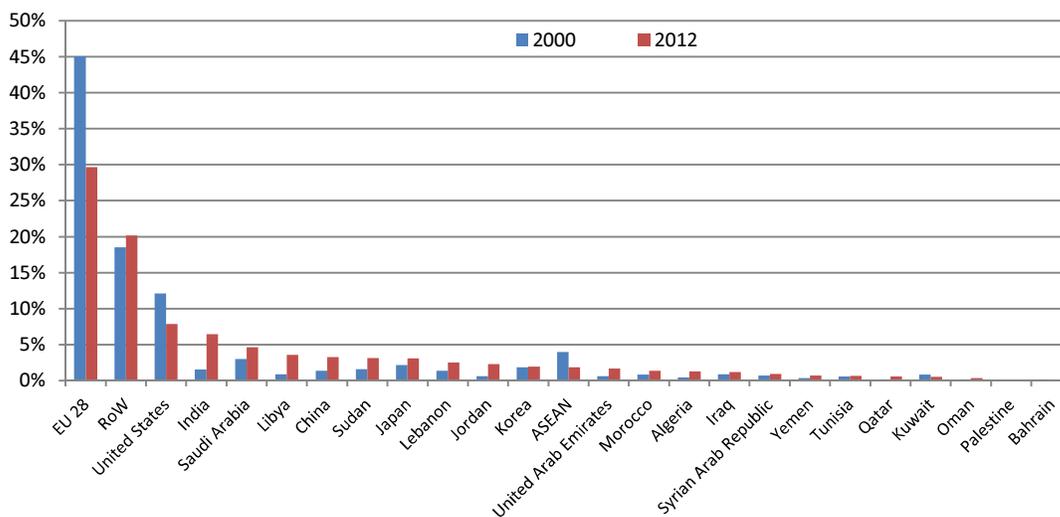
Source: ESCWA calculations using the AEISI.

Egypt's poor integration with its Arab neighbours is in part due to low complementarity rates that exist with most of them despite some observed improvements over the period 2000-2012 (figure 2.6). The EU is by far the country's main trading partner, absorbing 29.7 per cent of Egypt's exports in 2012, which is still 15 percentage points below the levels reached prior to the 2008 global crisis. Egypt is strengthening its relationships with China, India, Japan, and the Republic of Korea. In 2000, the four countries from ASEAN+3 were accounting for 6.9 per cent of Egypt's exports, and by 2012 their share had reached 14.8 per cent; whereas, Egypt's five main Arab trading partners – Saudi Arabia, Libya, the Sudan, Lebanon and Jordan – absorbed 7.5 per cent of Egypt's exports in 2000, against 16.2 per cent in 2012 (figure 2.7). The weight of the ASEAN and Arab regions roughly doubled over the reviewed period of time.

A comparison of the change in trade share and complementarity indices shows that Egypt's eastward relationships are fuelled by strong complementarities, while in the case of its Arab partners, geography matters most. In 2013, 56.2 per cent of Egypt's trade was in the intensive margin, with 43.8 per cent in the extensive margin. Of the latter, 10 per cent consisted of trade in new products in new markets, while 33.8 per cent consisted of trade in old products in new markets. While the majority of Egypt's exports were in the intensive margin, Egypt's trade relationships with some countries and regions (such as Iran, Japan, Turkey and UMA) were dominated by trade in the extensive margin. Exports to Iran, Turkey and UMA mostly consisted of exports of old products into new markets, while Japan was the only country with

which Egypt's trade relationship was dominated by the export of new products into a new market. Egypt's trade relationships with the GCC, EU, United States, China and India were dominated by the export of old products into old markets. A total of 62.3 per cent of Egypt's exports to the GCC, 65.9 per cent of exports to the EU, and 89.5 per cent of exports to the United States were in the intensive margin. It is worth noting that Egypt's second strongest trade tie in terms of the export of new products into new markets (after Japan) was with China, and 20 per cent of exports to China were new products to a new market, while only 9.3 per cent consisted of old products into a new market.

2. Tunisia

(a) Trends in global and regional integration

AEISI indicates that Tunisia has recorded little progress on indicators of globalization (figures 2.5B and 2.8). While it moved from a median ranking of 61 between 2000 and 2008 to 51 between 2009 and 2013, this improvement owes primarily to other countries losing ground rather than a real improvement of the situation. The main channels include trade that improved steadily before the huge setback following the global and European economic crisis starting in 2008; and FDI inflows that more than quadrupled to reach $2.56 million on average in 2006-2008, compared to some $0.7 million in 2000-2003, before falling back after the 2008 global crisis to a level of $1.1-1.5 million in 2013. However, it is worth noting that the intensity of total inward financial flows increased from 35 to 44 per cent of GDP between 2000 and 2013, while in comparison, Viet Nam benefitted from a financial flows injection from its globalization

process as high as 89 per cent of its GDP in 2013. These figures evidence the existence of a large untapped potential for globalization to boost Tunisia's economic development.

At the regional level, Tunisia is tightly integrated with the EU (table 2.6). This is a relationship that did not weaken during the global economic and sovereign debt crises. The intensity of financial inflows into Tunisia's economy is also contingent on the situation in UMA, which in turn strongly depends on the EU's economic performance. Indeed, the EU is the most important economic partner of Algeria, Libya and Morocco. Tunisia is therefore highly vulnerable to foreign shocks over which it has little control. Finally, geography matters at the intraregional integration level as the country has established close relationships with its immediate Arab neighbours (table 2.7). A weakening of ties with Egypt, Libya, Morocco, Oman, Qatar and United Arab Emirates was witnessed after 2008. Two reasons can explain these trends: the European debt crisis and the political situation in the region, which led to the blockage of maritime and land trade routes, such as the Nasib border crossing between Jordan and the Syrian Arab Republic.

Figure 2.8 Trends in Tunisia: scores and underlying individual indicators, 2000-2013

A. Globalization index

Note: A lower score reflects an improvement in the country's globalization performances.

B. Injections in the economy (Ratio to GDP)

C. Leakages outside of the economy (Ratio to GDP)
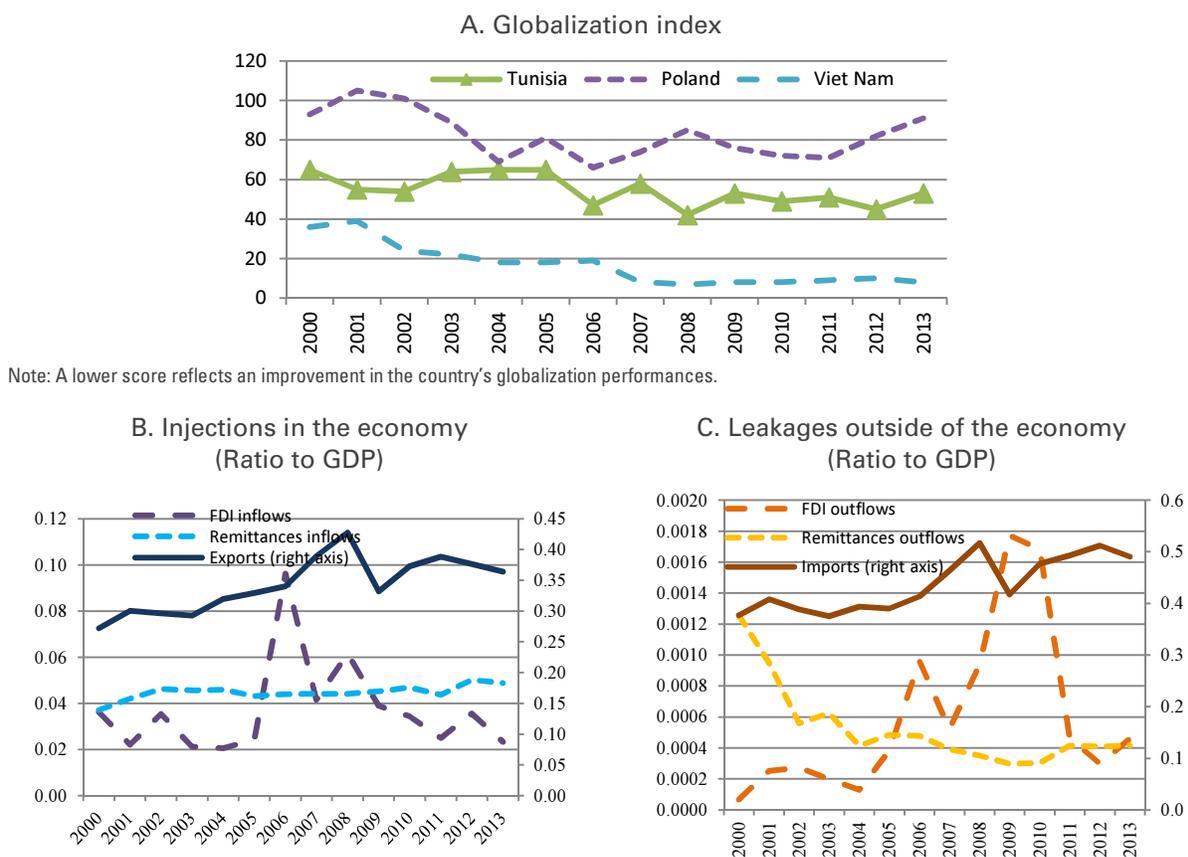
Source: ESCWA calculations using the AEISI.

Table 2.6 Tunisia: regional intensity of flow rankings, 2000, 2009 and 2013

2000		2009		2013	
UMA	63	UMA	43	UMA	51
ASEAN	105	ASEAN	237	ASEAN	233
China	250	China	205	China	234
EU 28	106	EU 28	2	EU 28	2
GCC	135	GCC	146	GCC	155
India	141	India	154	India	219
Japan	172	Japan	181	Japan	196
Republic of Korea	220	Republic of Korea	255	Republic of Korea	258
LDC	226	LDC	251	LDC	254
Mashreq	134	Mashreq	156	Mashreq	177
RoW	83	RoW	84	RoW	63
Turkey	162	Turkey	164	Turkey	174
United States	107	United States	106	United States	105

Source: ESCWA calculations using the AEISI.

Table 2.7 Tunisia: intensity of financial flows injection, bilateral basis, 2013

Receiving \ Sending	Algeria	Bahrain	Comoros	Djibouti	Egypt	Iraq	Jordan	Kuwait	Lebanon	Libya	Mauritania	Morocco	Oman	Qatar	Saudi Arabia	Somalia	Sudan	Syrian Arab Republic	Tunisia	United Arab Emirates
Algeria	0	0	0	0	0.4	0	0	0	0	0	0	0.6	0	0	0	0	0	0	1.1	0
Bahrain	0.4	0	0	0	0.5	0.1	0.7	1.6	0.1	0.1	0	0.5	1.9	5.5	9.9	0	0.2	0.2	0.1	6.1
Comoros	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0.2	0	0	0	0	0.7
Djibouti	0	0	0	0	0.9	0	0	0	0	0	0	0	0.4	0.1	0.3	0	0	0	0	2.4
Egypt	0.2	0.1	0	0	0	0.3	2	1.1	0.3	1.5	0	0.2	0.2	0.4	3.5	0	0.3	0.2	0.1	0.8
Iraq	0	0	0	0	0.3	0	0.1	0	0	0	0	0.8	0	0	0	0	0	0.7	0	0.1
Jordan	0.6	0.2	0	0	0.6	4.9	0	0.5	0.5	0.2	0	0	0.4	0.5	6.8	0	0.3	0.5	0.1	1.6
Kuwait	0	0	0	0	2	0	0.1	0	0.5	0	0	0	0.3	0.1	0.4	0	0.1	0.4	0	0.4
Lebanon	0.3	0.1	0	0	0.4	0.9	0.8	0.3	0	0.1	0	0.1	0.1	0.4	2.5	0	0.1	1.3	0	2

Country																				
Libya	0.4	0	0	0	0.3	0	0	0	0.1	0	0	0	0	0	0	0	0	0.6	0.7	0.6
Mauritania	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	1
Morocco	0.3	0	0	0	0.2	0	0.1	0	0.1	0.1	0.2	0	0	0	0.4	0	0	0	0.2	0.1
Oman	0.1	0.2	0	0.1	0.3	0.5	0.1	0.5	0	0.2	0	0	0	0.9	2.3	0.3	0	0.1	0	10
Qatar	0	0.2	0	0	0.1	0	0	0	0	0	0	0.1	0.2	0	0.1	0	0	0	0	0.5
Saudi Arabia	0.1	0.7	0	0	0.4	0	0.6	0.3	0.1	0	0	0.4	0.2	0.4	0	0	0.1	0.5	0	0.7
Somalia	0	0	0	0	0.1	0	0	0	0.1	0	0	0	2.3	0	0	0	0	0	0	0
Sudan	0	0	0	0	0.1	0	0.1	0	0	0	0	0	0	0	1	0	0	0	0	4.1
Syrian Arab Republic	0	0	0	0	0.1	3.8	1.3	1.4	0.2	0.5	0	0	0	0.1	1.5	0	0	0	0	0.7
Tunisia	1.3	0	0	0	0.2	0	0.1	0	0	5.4	0.1	0.5	0	0	0.6	0	0	0	0	0.2
United Arab Emirates	0.3	0.2	0	0	0.3	2.7	0.3	0.5	0.2	0.1	0	0.1	3.2	1.3	1.6	0.1	0.3	0.7	0.1	0
Yemen	0	0.1	0	0.1	0.1	0.1	0.3	0.9	0	0	0	0	0.1	0	7.8	0.3	0.4	0	0	2.2
Palestine	0.1	0	0	0	0	0	0.8	0.1	0	0	0	0	0	0.1	0.2	0	0	0	0	0.2
2009																				
Tunisia	0.2	0	0	0.2	3.2	0.2	0.4	0.2	0.1	0	0.1	2	1	1.2	0.1	0	0.5	0	0	0.5

Legend: <0.1 | 0.1-1 | 1-4 | 4-7 | 7-10

Source: ESCWA calculations using the AEISI.

(b) Labour force quality and productivity

A gross enrolment rate above 100 per cent (110.3 per cent in 2013)[28] at the primary level, as found in these scoreboards, demonstrates Tunisia's efforts to address the problem of low literacy rates that stand at 79 per cent. This record, although comparable to Egypt (73.9 per cent) or Iraq (79 per cent) and the Sudan (73.4 per cent), is low relative to such countries as Libya (90 per cent) and far below the 99.8 per cent and 93.5 per cent, respectively, recorded in Poland and Viet Nam. The country further suffers from a low and stagnating female to male participation ratio (35 per cent for 2000-2013). As shown on the "policies" scoreboard, Government expenditures in education stagnated at around 6 per cent of GDP throughout the whole period of time under review, and expenditure in health increased only modestly from 3 per cent of GDP in 2000 to 4 per cent in 2013, as compared with higher expenditures by countries referenced above.

This situation partly explains why Tunisia's apparent labour productivity level less than doubled between 2000 and 2012 (increasing by a factor of 1.8). From this perspective, the country is falling behind Jordan (detailed above), which compares to the performance of

Poland ($8,800 in 2000 against $23,700 in 2012, amounting to a multiplication by 2.7) but is far below that of Viet Nam (from $750 to $2,900 over the same period, amounting to a multiplication by 4).

(c) Investment and business environment

Lending rates have been estimated at 7.3 per cent in December 2012 (IndexMundi, n.d.), which represents roughly half of Viet Nam's rate and one-third of Poland's. If the cost of money is comparatively low in Tunisia, the "policies" scoreboard shows a limited decrease in taxes on goods and services, from 12.6 per cent of the value added of industry and services to 10.9 per cent between 2000 and 2013. A first draft of a new investment law was prepared in November 2013 but has not been adopted yet by the National Assembly. The goal is to bring back private investments, mainly foreign, which dropped significantly after the political events of January 2011. In fact, FDI inflows have fallen, between 2000 and 2012, from 11.2 per cent to 9 per cent of the capital stock and portfolio equity inward flows to become negative starting 2009.

Regarding the quality of the doing business index indicator on quality of business environment, Tunisia tops the non-GCC Arab region ranking 60 in 2015, albeit dropping four ranks compared to 2014. The country's performances regarding "starting a business" and "getting credit" are especially poor, coming in at 100 in 2015 (against 89 in 2014) and 116 (against 111 in 2014) on these items, respectively. It is worth noting that, as the gap with the best performers did not significantly widen, the change in the ranking reflects other countries' ability to improve relatively faster.

The country is not faring well either on the front of setting up a business which is still complex, costly and slow. In 2015, total corporate taxes in percentage of profits stood at 62.5 per cent against 40.2 per cent in Viet Nam and, more importantly, 38.7 per cent in Poland (World Bank, 2014b), which is a direct competitor as the EU remains by far the main trading partner and source of FDI in Tunisia. Tunisia's tax policy is one of the most detrimental aspects of the business environment, especially in light of the recent implementation of emergency taxes aimed at containing the budget deficit. Finally, the Chinn-Ito index of financial openness is low and stagnating at 0.16 since 2000, signalling barriers to international financial flows circulation.

(d) Infrastructure and logistics

In an attempt to reduce the inequalities between the coastal area and the rest of the country, Tunisia has engaged in an infrastructure development policy since the mid-1990s. Telecom infrastructure improved markedly between 2000 and 2013. International internet bandwidth is still far from the capacity of Poland but is twice that of Viet Nam, while subscriptions per 100 people equal those in Viet Nam. Pillar 2 of the global competitiveness index confirms the weakness of Tunisia's performances as the country ranks 89 out of 144 countries in 2014.[29] While Viet Nam and Poland do not fare much better given their respective ranks of 86 and 78, the high number of subscriptions in these two countries is considered an asset to their economic development. Viet Nam and Poland rank 42 and 23, respectively, on this front while Tunisia ranks 63. These findings evidence a large

potential for improvement and a catching up would be possible due to the expected cost reduction allowed by increasing competition in the sector. However, political will is needed to unlock it.

The "policies" scoreboard evidences the effectiveness of air connection. Despite a fall of 9.7 per cent in air freight transport between 2000 and 2013, the number of air passengers grew from 1.9 to 4.2 million. According to the last data available, and although the road network expanded modestly by 2.2 per cent between 2000 and 2011, the number of paved roads increased by 14.6 per cent, thereby indicating Government efforts to improve the quality of the service delivered to the public. A costal highway links the country with Algeria and Libya, but its impact on trade exchanges is constrained by the blockades along the border between Morocco and Algeria, while on the Libyan side the civil war is another hindrance to regional economic integration. The case of Tunisia illustrates the consequences of the different types of conflicts in the Arab region which are monitored in the "enablers" scoreboard due to their structural and long-lasting nature.

When it comes to maritime transportation, the container port throughput index, which measures the flow of containers from land to sea transport and vice-versa, grew by a meagre 35 per cent compared to Poland (110 per cent) between 2008 and 2013. Due to its relatively smaller size and greater dependency on foreign countries, Tunisia's records should have been much higher (figure 2.10). Viet Nam managed to boost its

activities by 85 per cent over the same period despite an already high intensity of flows. These unsatisfying outcomes may partly reflect the crises in Europe and within the country as well as the political and economic situation in the Arab region, but they are also the result of a need for upgrading infrastructure and trade facilitation in general. A new deep-water port should be built in the coming years at Enfidha in the north-east of the country that may considerably enhance connections to global shipping networks that remain far below the benchmark as illustrated by the liner shipping connectivity index that decreased from 8.8 to 5.6 (figure 2.9).[30]

The need to upgrade trade facilitation is evidenced by Tunisia's ranking in the enabling trade index. The country is falling behind on the pillars "availability and quality of transport services" and "availability and use of ICTs", where Tunisia is respectively ranked 80 against 50 for Viet Nam and 38 for Poland, and 76 against 64 for Viet Nam and 41 for Poland. Poland presents additionally high performances regarding the "efficiency and transparency of border administration", where it is ranked 31, while Viet Nam is 86, and Tunisia is 79; and on the "operating environment" pillar, on which Poland is 50, Viet Nam is 81, and Tunisia is 76. The logistics performances index further points to the poor efficiency of customs clearance (Tunisia was 33 and moved down to 146 between 2012 and 2014), lack of competency and quality of logistics services (40 to 120 between 2012 and 2014), unsatisfying ability to track and trace consignments (40 to 120 between 2012 and 2014) and timeliness (35 to 80 over the same period).

Figure 2.9 Liner shipping connectivity index*



Figure 2.10 Container port throughput
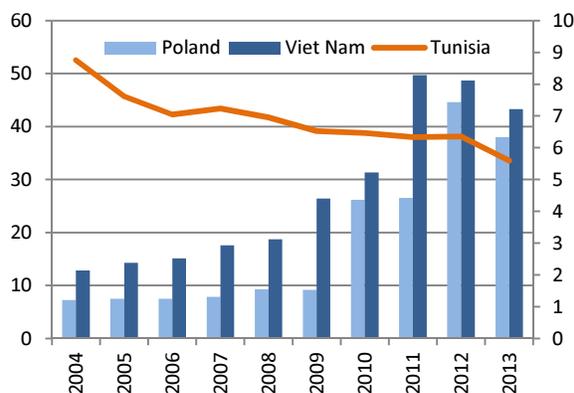
Source: UNCTAD (2014b); and World Bank (2014a).

Note: Figure 2.9: Tunisia: right scale; other countries: left scale.

* The liner shipping connectivity index is computed based on five components of the maritime transport sector: number of ships, their container-carrying capacity, maximum vessel size, number of services, and number of companies that deploy container ships in a country's ports.

(e) Trade

Tunisia is not a very open country. Its exports stood at 47 per cent of GDP in 2013, which represents a very modest improvement compared to 2000 when they amounted to 40 per cent of GDP. Imports show a similar path, growing from 43.4 per cent to 56 per cent of GDP over the same period. As expected, trade growth was comparatively steady between 2000 and 2008, becoming erratic and unstable subsequently. Tunisia ranks 48 on the intensity of flows index compared to Viet Nam which is on fourth place. Tunisia's exports are absorbed by the EU (71 per cent), the rest of the world (12 per cent) and Libya (4 per cent). Furthermore, one-third of Tunisia's imports originate from Europe.

Tunisia's complementarity with partners' import demand improved with Algeria, Iraq, Jordan, Morocco and the Sudan between 2000-2012, which did not translate into a shift in the country's exports that would have allowed a diversification of its trading partners and would

have mitigated against exogenous shocks (figure 2.11). The highest complementarity levels are still observed for non-Arab countries, namely, the EU, Japan, Turkey, India, China, and the United States.

The data shows that an untapped potential for integration with Iraq and Jordan as Tunisia's trade complementarity with these countries is high and increasing while the share of exports in the total remains is negligible. These findings are not a result of the ongoing conflicts that may have blocked trade routes, given that exports to Jordan have plummeted since 2008 and to Iraq since 2002. Exports to Iraq started picking up in 2008. Furthermore, despite geographic closeness and a level of complementarity higher with Morocco than with Algeria, Tunisia's exports to Morocco are sizably lower than to Algeria, and have been decreasing since 2010. One may consider the indirect impact of the financial and debt crises in Europe that negatively affected the Moroccan economy, but this cannot by itself explain the entire phenomenon.

Figure 2.11 Correlation between complementarity and level of Tunisian exports
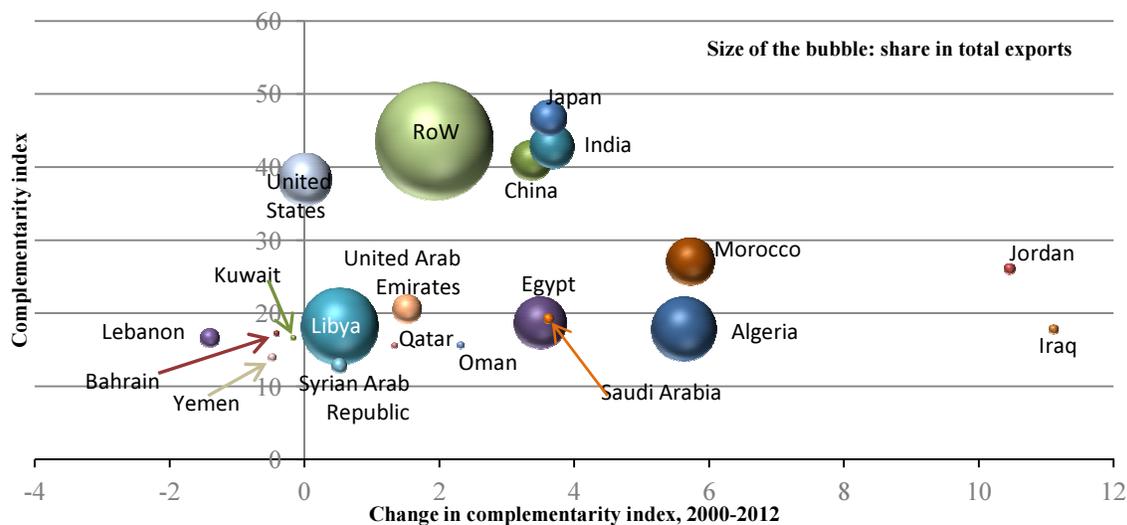

Source: ESCWA calculations using data from the BACI world database of international trade that adjusts the data from the transportation costs.

Thanks to high and rapidly improving complementarity, Tunisia steadily increased its exports to Japan, China and, in a more erratic way, India. The most noticeable change is the sevenfold increase of exports to China from a negligible level in 2000 to 1.1 per cent of Tunisia's total exports in 2012. The same observation applies to Tunisian exports to the United States, the share of which in total doubled between 2000 and 2008 to reach 3.1 per cent but then dropped to 1.9 per cent in 2012 due to, the economic slowdown in the United States, among other causes.

Tunisia records similar levels of complementarity with Algeria, Bahrain, Egypt,

Libya, Oman, Qatar, Saudi Arabia and United Arab Emirates (figure 2.12 and annex IV). The country has further been able to improve its complementarity sizably with Egypt and Saudi Arabia, modestly with the United Arab Emirates, Qatar, and Oman, and even less so with Libya and Bahrain. Despite very close characteristics, Tunisia's exports to Egypt, Libya and the United Arab Emirates in 2013 were 1.8 per cent, 4 per cent and 0.6 per cent, respectively, and negligible for the others. Geography matters as well as the role of the United Arab Emirates as a re-export hub in the region. However, Tunisia could improve its relationships with Saudi Arabia, which is also a large market.

Figure 2.12 Tunisia complementarity index (percentage)
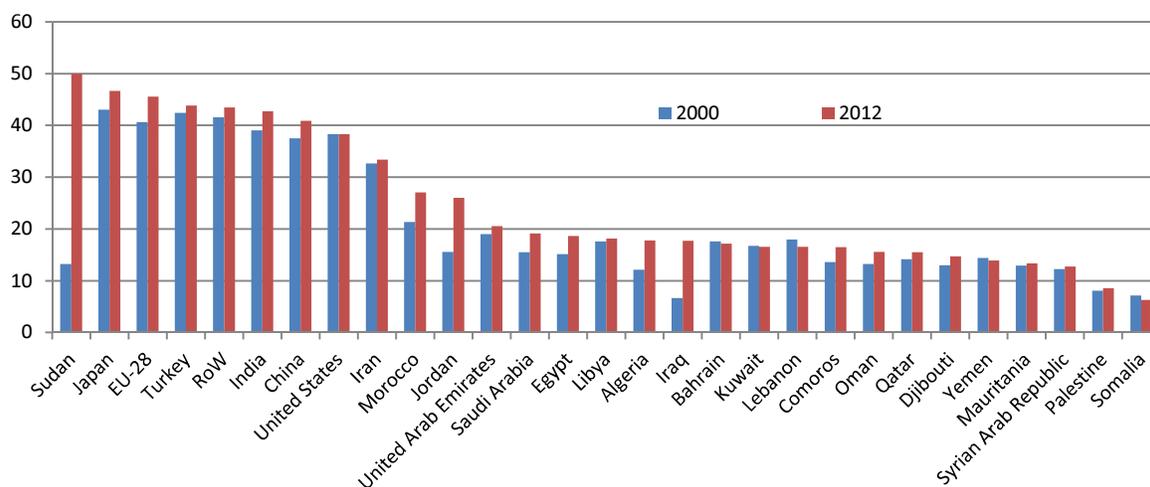
Source: ESCWA calculations using the AEISI.

In 2013, 75.8 per cent of Tunisia's trade was in the intensive margin, that is, Tunisia continued to export 75.8 per cent of its products that it had traditionally manufactured to its traditional export destinations for these products. 2.6 per cent of all Tunisian exports were new products to new destinations, while the remaining 21.6 per cent of exports involved already manufactured products and new destinations. Tunisia's exports to each of the UMA countries, the EU, United States, Turkey, India and Japan were dominated by trade in the intensive margin. Meanwhile, Tunisia's exports to GCC, China, Iran, Poland and Viet Nam were dominated by trade in the extensive margin, specifically exports of old products to these markets, where this export channel was previously non-existent. Even in those countries to which the majority of Tunisia's exports were in the intensive margin, a significant portion of trade was nonetheless in the extensive margin. For example, 32.1 per cent of Tunisia's exports

to the United States consisted of new trade channels whereby the products in question had not been previously exported to the United States. Almost 11 per cent of Tunisian exports to the EU were in the extensive margin and consisted of newly built trade channels.

3. Saudi Arabia

(a) Trends in global and regional integration

The AEISI globalization index indicates that Saudi Arabia followed a tumultuous road towards economic globalization, as evidenced in figure 2.13. Saudi Arabia went from a rank of 35 in 2000 to a rank of 57 in 2013, but its progression along the way was not linear. Interestingly, Saudi Arabia achieved its best rank in 2009, in the midst of the global financial crisis. As expected, the results show that the country's best performing globalization channel is its exports sector (particularly oil-based),

followed by imports and remittance outflows. Income from exports alone was more than twice the value, on average, of all payments leaving the country between 2000 and 2013 (in the form of remittance outflows, FDI outflows and payments on imports). Concerning Saudi Arabia's performance in attracting FDI, inflows remained relatively stable between 2000 and 2004 and rose sharply between 2004 and 2008, before quickly plummeting to below 2006 levels between 2008 and 2013. In 2013, Saudi Arabia had one of the lowest FDI inflow-GDP ratios in the region, namely, 1.3 per cent of GDP in 2013 against 1.5 per cent for the GCC and 2.5 per cent for Arab non-GCC countries. Finally, the regional level of the AEISI shows that Saudi Arabia's economic ties with Arab countries are considerably weak when compared to its ties with other regions, and these have only become weaker (table 2.8). With the exception of Saudi Arabia's ties with non-UMA non-GCC countries,

which improved in relative importance between 2000 and 2009 only to fall again between 2009 and 2013, the relative importance of Saudi Arabia's economic ties to other countries in the Arab region fell between 2000 and 2009 and continued on its downward trend after 2009. Moreover, economic ties to the EU also fell in rank between 2000 and 2009, but became significantly stronger after 2009. Finally, the analysis confirms that the country's economic ties to China and India grew in importance between 2000 and 2009 and continued to grow after 2009. Saudi Arabia's economic relationships with the United States and the Republic of Korea also grew in importance after 2009, but did not witness constant growth before that, unlike in the case of China and India. Saudi Arabia's bilateral relationships with all of its other main partners fell in importance in both periods.

Figure 2.13 Trends in Saudi Arabia: scores and underlying individual indicators, 2000-2013
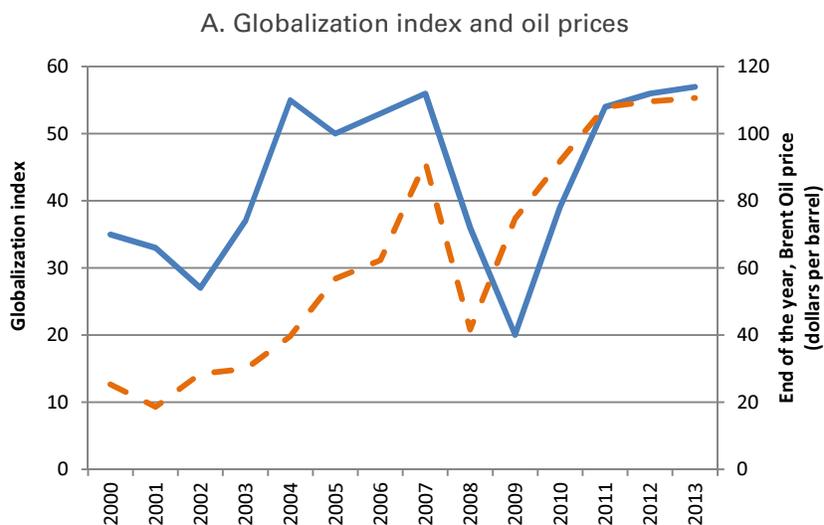
A. Globalization index and oil prices

Note: A lower score reflects an improvement in the country's globalization performances.

B. Injections in the economy
(Ratio to GDP)
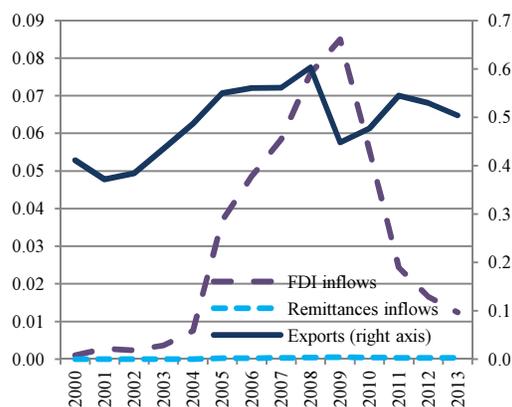
C. Leakages outside of the economy
(Ratio to GDP)
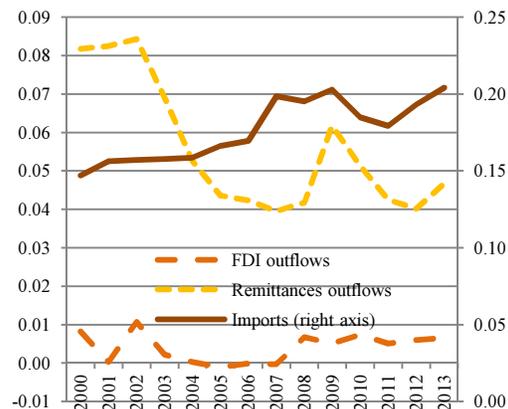
Source: ESCWA calculations using the AEISI.

Table 2.8 Rankings based on the intensity of Saudi Arabia's regional and bilateral economic ties

2000		2009		2013	
China	113	China	51	China	47
United States	30	United States	53	United States	48
Japan	32	Japan	42	Japan	49
EU 28	29	EU 28	77	EU 28	59
Republic of Korea	50	Republic of Korea	65	Republic of Korea	62
India	129	India	82	India	69
ASEAN	28	ASEAN	70	ASEAN	72
RoW	60	RoW	85	RoW	87
GCC	94	GCC	101	GCC	110
Mashreq	131	Mashreq	110	Mashreq	131
UMA	157	UMA	173	UMA	183
Turkey	148	Turkey	174	Turkey	210
LDC	179	LDC	204	LDC	217

Source: ESCWA calculations using the AEISI.

(b) Labour force

While Saudi Arabia has one of the highest female-to-male school enrolment ratios in the Arab world, this does not translate well into the labour market, where the country has one of the lowest ratios of female-to-male labour force participation rates in the Arab region (25.8 per cent in 2013). Saudi Arabia has a high literacy rate (94 per cent in 2013) and a good education system, and such indicators as enrolment rates and mean years of schooling are comparable to those in developed countries. The gap between female and male literacy rates has been quickly closing since 2000 and is now almost non-existent; and Saudi Arabia has the highest secondary and tertiary school enrolment rates in the Arab world reaching 116.17 per cent and 57.5 per cent, respectively, in 2013.

Saudi Arabia's apparent productivity of labour (value added in United States dollars per person employed) steadily rose between 2003 and 2008 from $30,090 to $56,769. It took a hit during the global financial crisis, dropping to $45,828 in 2009 before rebounding to $70,669 in 2012, and fell again in 2013 to a value of $66,633. In 2013, Saudi Arabia had the third-largest apparent labour productivity in the Arab region, following Qatar ($127,266) and Kuwait ($114,412). Saudi Arabia's productivity value is comparable to that of the EU; out of 28 EU member countries, only 12 had higher values than Saudi Arabia for apparent productivity of labour in 2013. However, the dependence of this very high productivity on high oil rents over the years must be noted.

Saudi Arabia has a relatively high rate of Government spending on education as a percentage of GDP, averaging around 6 per cent between 2000 and 2008, the years for which data are available. This is comparable with many countries in Europe and further explains the strength of Saudi Arabia's education system.

(c) Investment and business environment

In 2000, Saudi Arabia had a general Government final consumption expenditure of 26 per cent of GDP, which is greater than that of any other country in the Arab region, the EU and ASEAN. By 2013, this rate had fallen to 22 per cent, while that of many other countries became larger, and Saudi Arabia fell behind.

The country's Chinn-Ito financial openness index has been perfectly stable since 2000, at 0.697, which means that Saudi Arabia has not been taking any concrete steps to liberalize and open its financial markets. Saudi Arabia and Kuwait are the only two GCC countries that do not have a Chinn-Ito score of 1. Poland, in contrast, had a score of 0.16 in 2000, which subsequently rose to 0.45 in 2002 and has been stable at that level ever since. Still, Poland witnessed improvement between 2000 and 2002, so while it still has a score that is less than Saudi Arabia's, it has made progress towards more financial openness while Saudi Arabia's score has not changed at all.

Saudi Arabia scores relatively well on the LPI, scoring 3.0, 3.2 and 3.2 in 2007, 2010 and 2012, respectively, when the average scores for all countries stood at 2.7, 2.9 and 2.9. Between 2007 and 2010, Saudi Arabia's score increased more than the world average, but between 2000 and 2012, when the world average remained

constant, Saudi Arabia's LPI score fell from 3.22 to 3.18. Despite this fact, Saudi Arabia's ranking improved from 45 to 40 between 2007 and 2010, and from 40 to 37 between 2010 and 2012.

With respect to the number of air passengers carried on domestic and international flights of airlines that are registered within the country, Saudi Arabia has come a long way since 2000 when the total number was 12.6 million. In 2013, 28.3 million passengers were carried on airlines that are registered in Saudi Arabia, representing an increase of 125 per cent. An important share of these flows relates to religious tourism, and there is certainly room for improvement as, in 2013, 69.2 million passengers were carried by airlines that are registered in the United Arab Emirates, a country with a population that is roughly 32 per cent the size of Saudi Arabia's (including expatriates).

According to the Agility Emerging Markets Logistics Index 2014, Saudi Arabia was able to climb from a rank of 9 in 2010 to 3 in 2014 through a sustained public spending campaign (Agility, 2014). This index is composed of three different subindices, namely, market size and growth attractiveness, market compatibility and connectedness. Saudi Arabia witnessed declines in both compatibility and connectedness between 2013 and 2014, but still climbed one ranking given the growth it witnessed in the market size and growth attractiveness subindex. It is worth noting that, while Brazil and China both had higher ranks than Saudi Arabia in 2014, Saudi Arabia scored higher than both these countries in market compatibility, and it scored higher than Brazil in connectedness as well. It is also worth noting that the top six ranked countries in the market compatibility

subindex are all Arab States, five of which are in the GCC, namely, Qatar, United Arab Emirates, Oman, Jordan, Saudi Arabia and Kuwait, in that order.

(d) Trade

Saudi Arabia's exports comprised an average of 92.6 per cent of relevant inflows (exports, FDI and remittance inflows) between 2000 and 2013, while exports of oil and gas products comprised 87.2 per cent of Saudi Arabia's exports between 2000 and 2013, on average. Saudi Arabia's reliance on oil and gas exports makes it extremely susceptible to risks associated with drops and volatility in the prices of these products. As can be seen in figure 2.14, the value of Saudi Arabia's exports is very strongly correlated with the price of oil (a correlation of 99.29 per cent). For a country with such a massive value of exports and the highest absolute GDP in the Arab region, Saudi Arabia is falling considerably short of its potential with respect to economic integration and globalization.

While Saudi Arabia's trade complementarity with its Arab neighbours is low, which owes mostly to the fact that its exports are overwhelmingly in petroleum products, Saudi Arabia's complementarity is highest with countries in Asia, followed by the EU, again for the above-mentioned reasons. It should be noted that Saudi Arabia's export complementarity with many Arab countries, including Algeria, Egypt, Iraq, Jordan, Morocco, Oman, Palestine, United Arab Emirates and Yemen, grew between 2000 and 2012 (figure 2.15). It is interesting to note, however, that Saudi Arabia's trade complementarity with

every GCC country with the exception of the United Arab Emirates actually fell between 2000 and 2012.

With respect to export share, 16.9 per cent of Saudi Arabia's total exports in 2000 went to the United States and 16.3 per cent to the EU (figure 2.16). By 2013, the percentage of Saudi Arabia's exports to the United States had decreased, reaching 12.3 per cent, and exports to the EU also fell to 9.3 per cent of total exports. Saudi Arabia's export shares to Arab and ASEAN States stagnated, at around 10 per cent and 7 per cent, respectively. Meanwhile, the share of Saudi Arabia's exports destined for China and India grew from 2.2 and 1.6 per cent in 2000, to 12.4 and 8.3 per cent in 2013, respectively. The rise in Saudi exports to these countries coincided with the rise in export complementarity between them. In the case of the EU, however, export complementarity rose between 2000 and 2012, while export shares plummeted, which partly reflects the impact of the crisis.

In 2013, 74 per cent of Saudi Arabia's trade was in the intensive margin, 25 per cent consisted of exporting old products into new markets, and 1 per cent was exports of new products into new markets. Saudi Arabia's trade with most countries surveyed consisted of trade in the intensive margin, with a few exceptions. Saudi Arabia's exports to India and Viet Nam were dominated by exports in the extensive margin,

as were Saudi Arabia's exports to other GCC countries. Specifically, 29.2 per cent of Saudi Arabia's exports to the GCC were in the intensive margin, while 70.7 per cent were in the extensive margin, 6.3 per cent of which consisted of the export of new products, while 64.4 per cent consisted of exporting already existing products into new markets. This change took place between 2000 and 2013. The only other significant export relationship which saw the most growth in the extensive margin was that of Saudi Arabia with India. As shown in the export shares graph above, Saudi Arabia's exports to India now comprise a much larger portion of Saudi Arabia's total exports than they did in 2000. This is consistent with the data on trade margins. Only 12.1 per cent of Saudi Arabia's exports to India are through the intensive margin; 85.7 per cent of Saudi Arabia's exports to India consist of trade in old products in new markets, while the remaining 2.2 per cent are of trade in new products in new markets. Saudi Arabia's relationships with its main developed trading partners, namely, the United States, EU and Japan, are all very strongly dominated by trade in the intensive margin (98.6 per cent, 92.5 per cent and 99.5 per cent, respectively). This means that the nature of Saudi Arabia's exports to these countries has changed very little between 2000 and 2013, and Saudi Arabia has not made any real progress in diversifying its export mix to these countries and regions at least during the last 15 years.

**Figure 2.14** Saudi Arabia: exports and global oil prices
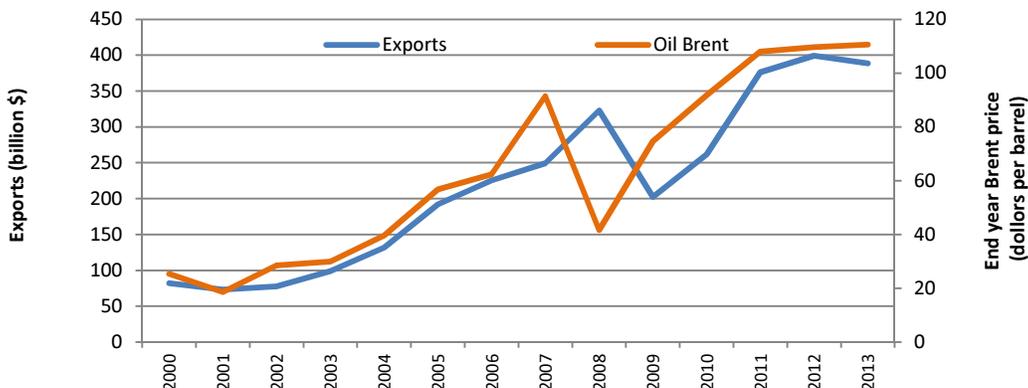
Source: ESCWA calculations using UNCTAD and the World Bank (2014a).

Figure 2.15 Saudi Arabia trade complementarity (percentage)
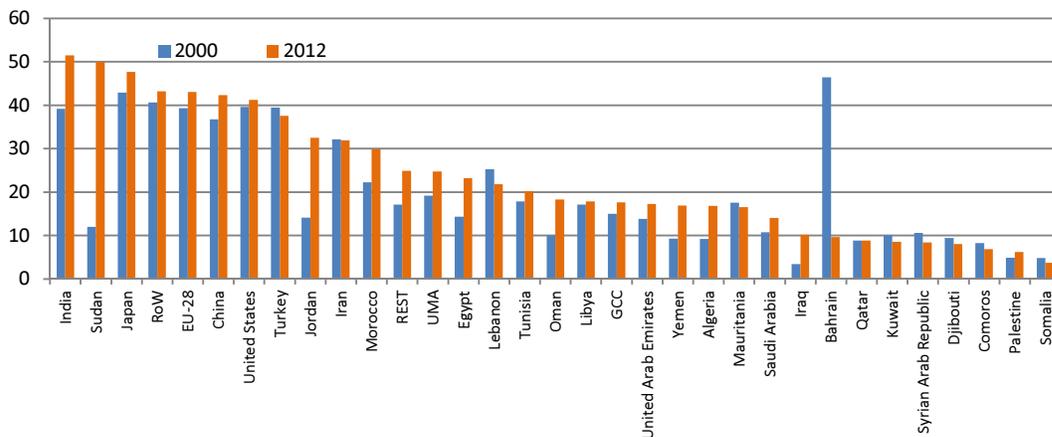
Source: ESCWA calculations using the AEISI.

Figure 2.16 Share of Saudi Arabian exports by partner (percentage)
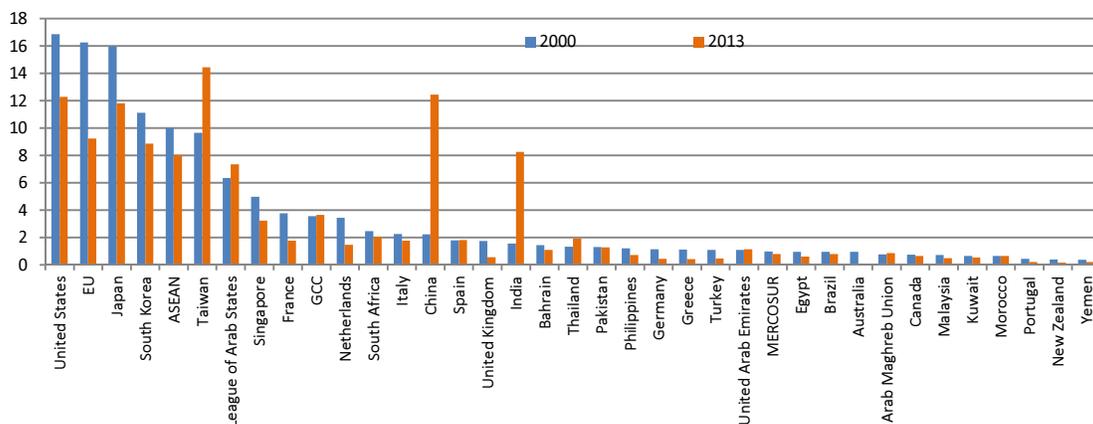
Source: ESCWA calculations using the AEISI.

F. Summary of the findings and venues to improve the AEISI

The analyses carried out using AEISI reveal that the GCC is contributing to the economic situation of some Arab countries through large remittance flows and, in the 1990s, started to increase investments in the region. However, it is far from providing a powerful engine of regional economic integration for Arab countries. The question is whether another group of countries could play this role. The analysis presented here revealed that, while the EU is highly integrated with many Arab countries, it is not clear whether the EU contributed to strengthening intra-Arab regional ties. Moreover, the eastward shift essentially benefits oil-rich countries, while more diversified economies saw the depth of their connection with India or China progress only slightly. Nevertheless, this last aspect of actual Arab economic integration should be closely monitored as it could bring interesting developments.

ASEAN countries are keeping pace with the best performers at the global level. At the same time, thanks to the momentum provided by Japan and China externally, and by Singapore, Thailand and Malaysia internally, the region shows strong performances in terms of intraregional economic integration. The two processes seem to be fuelling each other and, although there is a large intensity of flows that foster economic growth, the countries are highly exposed to external shocks. In the future, including specific indicators in the scoreboards to analyse the problem of crisis contagions would be a bonus.

These ASEAN successes were achieved despite initial obstacles similar to those facing the Arab region, which include the small share of intraregional initial level of trade, huge differences in economic size, development levels and production base, and thus divergent perceptions of the costs and benefits of integration. ASEAN and Arab countries have in common a reluctance to transfer sovereignty to supranational bodies. The ASEAN approach to economic integration has been pragmatic, gradual and targeted. It departs markedly from the European model as economic integration is neither preceded nor accompanied by any strong and systematic institutionalization or institution-building process. Members have not imposed a pace for reforms and agreement implementation, although their progresses are being monitored. As a consequence, compliance indicators should be included in the AEISI in order to identify and track the specificities of each integration process.

Currently, trade in goods represents a very small part of economic activity, including for developing countries where an increasing share of trade, employment and income is generated by the tradable service sector. However, it remains difficult for national statistical systems, particularly in developing countries, to provide reliable and timely data on the growing importance of this sector in the economy.

Developments regarding growing trade fragmentation, firms' networks and trade in tasks calls for new indicators and statistics if monitoring systems are to effectively inform regional integration stakeholders and help them assess and formulate appropriate policies. Existing indicators were largely constructed in

an era when most trade occurred domestically. Although they are still partly accurate for the Arab region, the region is meant to develop and integrate regional as well as global value chains, and progress must be made rapidly on the front of producing relevant information.

However, a large part of international flows of goods, services, capital and labour is now intrafirm and, as such, difficult to value. It is essential to know where the value added is generated, as illustrated by the threat of currency wars triggered by the crisis and persistent trade balance surplus in certain countries, which happened to be much smaller than stated by statistics and not based on value added. The available statistics and indicators produced by Arab countries have to reflect adequately the reality and nature of trade, labour and capital flows so as to identify the compatibilities and differences in Arab country paths towards regional integration, and to assess the role and opportunities embedded in the region's heterogeneity and the policies needed for a successful regional integration.

It will be interesting to note which indicators and performances highlighted in this first edition of the AEISI differ when measured again in the coming years. Following the results of this exercise, new indicators will also be added in order to constantly improve the scope of this exercise.

Following this chapter's analysis, chapters III and IV examine in greater detail the background, trends and implications of integration across a number of sectors in the Arab region. This will help to identify in greater depth the policy implications of the forms of economic integration advocated in this report, and the means by which Arab countries may harness their potential for economic integration.

III. Productive capacities and integration

Sectoral integration in the Arab region, in the areas of building regional value chains, the movement of people and goods, and spurring of industry, is particularly vital in the face of development imperatives and recent global events. Indeed, the sharp decline in oil prices, internal conflicts and other factors have affected the ability of Arab countries to compete globally, drawing attention to the need to integrate in order to raise productivity and competitiveness.

Analysis in existing literature of the factors contributing to stronger regional integration and of the outcomes of this integration has typically addressed a small core selection of trade and financial indicators. Yet these do not capture the variety of sectors that need to be strengthened and linked to spur regional economic integration. AEISI introduced a tool for monitoring and evaluating country-level progress towards integration across a number of domains and facets. Chapters III and IV of this report aim to address the status of and potential for further integration in a variety of important sectors across the Arab region which should be analysed in a cross-country manner.

The undiversified growth of Arab countries, personified most acutely in those countries that continue to depend on oil and natural gas rents despite efforts at economic diversification, has left many countries of the region vulnerable to external shocks and unable to generate enough jobs to absorb the growing workforce. Global

Brent oil prices, while reaching historic highs in recent years, remained relatively stable and began to decline in mid-2014 to below $50 per barrel due to increasing oil production and new sources of supply coming online across the globe, including emerging alternative energy sources. Any subsequent rebound in prices has also been accompanied by continuing instability. This underscores the harm in continued dependence on commodities and the need to diversify into higher-value manufacturing, modern agriculture and efficient services.

This chapter examines the connection between the drivers of productivity and job creation in the Arab region, efforts at economic integration in the light of these trends, and the need to pursue a job-creating economic agenda. Specifically, the chapter addresses the progress made, challenges faced and potential for future integration across a number of sectors that will be increasingly vital for economic activity within the region and for strengthening regional value chains while helping the region boost its positioning in global value chains, with greater income- and job-creating benefits. As established in chapter I, a clear regional transformation agenda will enable Arab countries to shift from natural resource dependence towards an economic model based on industry, a revolutionized agricultural sector and competitive or efficient services. This will lead to stable and productive employment and a more equitable distribution of income, while

providing new opportunities particularly to include those populations that are currently marginalized from formal employment across the region. In addition to analysing these trends within the Arab region, chapters III and IV continue to draw comparisons with progress in the EU (with the case of Poland) and ASEAN (with the case of Viet Nam). This chapter also addresses in greater detail the inflows of people and finance that are inherent in a successful economic integration scheme, examining migration, remittances and tourism, in particular, more closely. The chapter is organized to address the following sectors: trade, industry, agriculture, migration, remittances, and tourism.

A. Trade integration: varying country-level performance, but no significant increase in intra-Arab trade

1. Trends in intraregional trade

Trends in regional Arab trade since 2000 indicate that, despite a slight increase in the role of regional trade flows, Arab countries still trade far less between themselves than do countries in the EU and ASEAN. There is great variation within the Arab region, with such countries as Oman, Palestine and Somalia, trading significantly within the Arab region, whereas others, such as Algeria and Comoros, have almost no trade relations with other Arab countries, trading instead with other regions.

It is notable that, from 2005 to 2008, directly following the formal implementation of PAFTA, intra-Arab trade volumes increased by 76 per cent, and in fact intra-Arab trade as a

percentage of total trade reached a high of 11 per cent in 2005 (figure 3.1). Nevertheless, the rate began to fall following this jump, reaching a low of 8 per cent of imports and 5 per cent of exports in 2009.

Meanwhile, the ratio of intra-EU trade peaked in 2005 at 55.9 per cent, but fell by seven percentage points until 2012, decreasing through the global financial and Eurozone sovereign debt crises (figure 3.2).

Taking a closer look at another set of comparable countries, ASEAN intraregional trade has been remarkably stable, remaining between 21 and 23 per cent of total trade in 2000-2013. It should be noted that at its peak, intra-Arab trade reached 11.5 per cent of the region's total trade, far lower than the EU average of over 50 per cent and the ASEAN average of over 20 per cent (figure 3.3). Compared with these regions, intra-Arab trade is in its infancy.

2. Subregional trade

Turning to the subregions within the Arab world, the GCC is the largest contributor to intra-Arab trade, accounting for 63.5 per cent of intra-Arab exports and 47.4 per cent of total trade during the period 2000-2013. Conversely, UMA has the lowest share in intra-Arab trade in terms of imports and exports, owing to its closer trade ties with the EU. Regarding intra-subregional trade, subregional imports are highest in the GCC, followed by other Arab countries and lastly UMA (figure 3.4). By contrast, exports in the rest of the Arab region were higher than both the GCC and UMA (figure 3.5). In both cases, the GCC exhibits high volatility.

Figure 3.1 Intra-Arab trade (percentage of total trade)
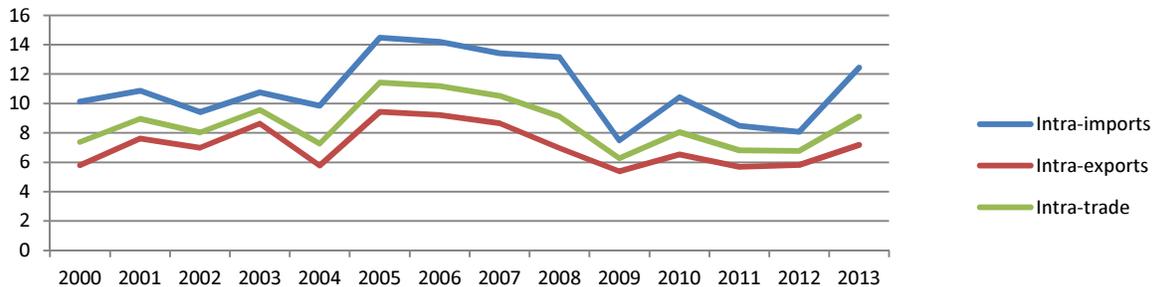
Source: ESCWA calculations using AEISI.

Figure 3.2 Intra-EU trade (percentage of total trade)
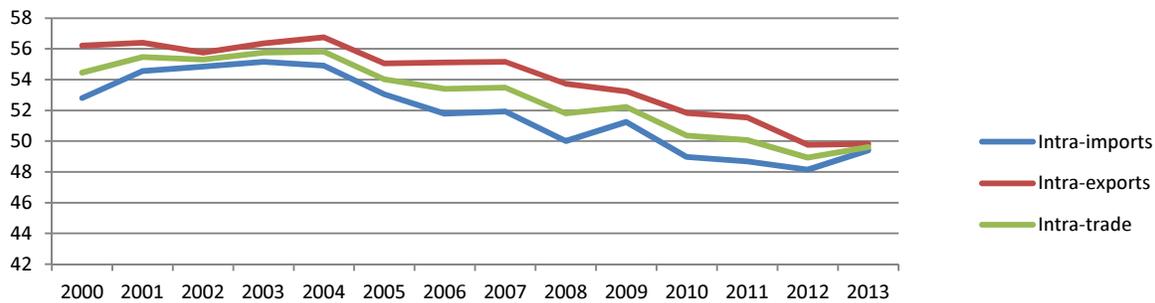
Source: ESCWA calculations using AEISI.

Figure 3.3 Intraregional trade by region
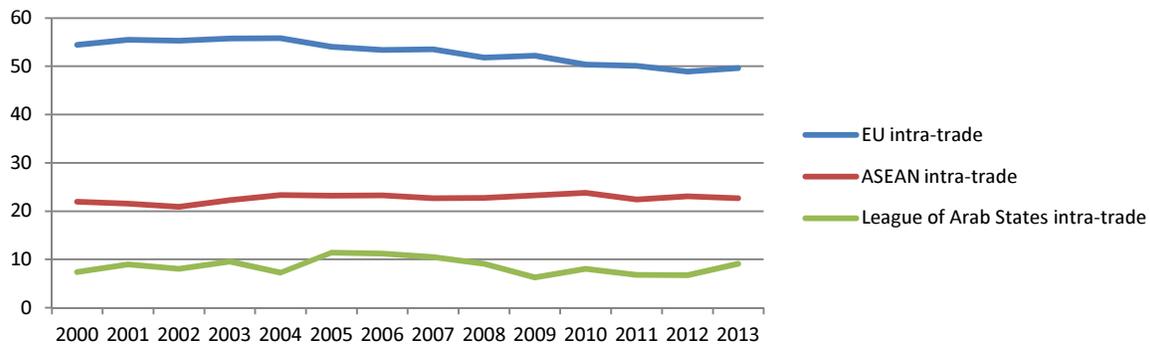
Source: ESCWA calculations using AEISI.

Figure 3.4 Intra-subregional imports (percentage of total imports)
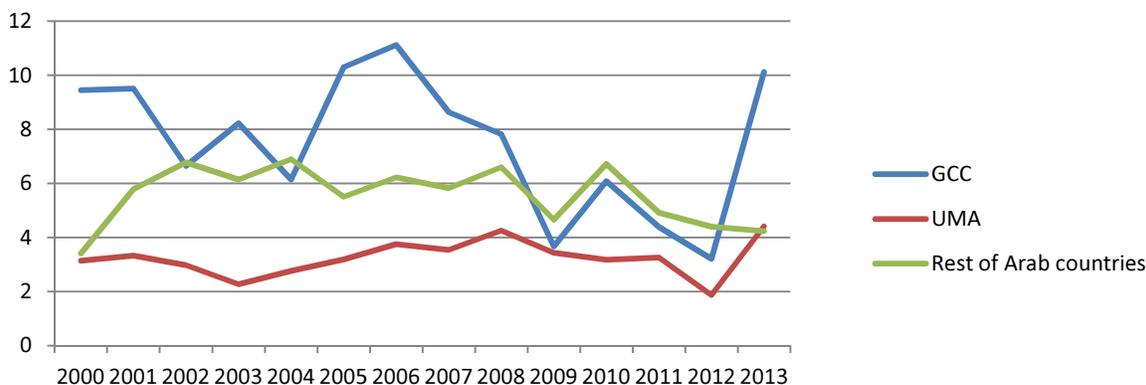
Figure 3.5 Intra-subregional exports (percentage of total exports)
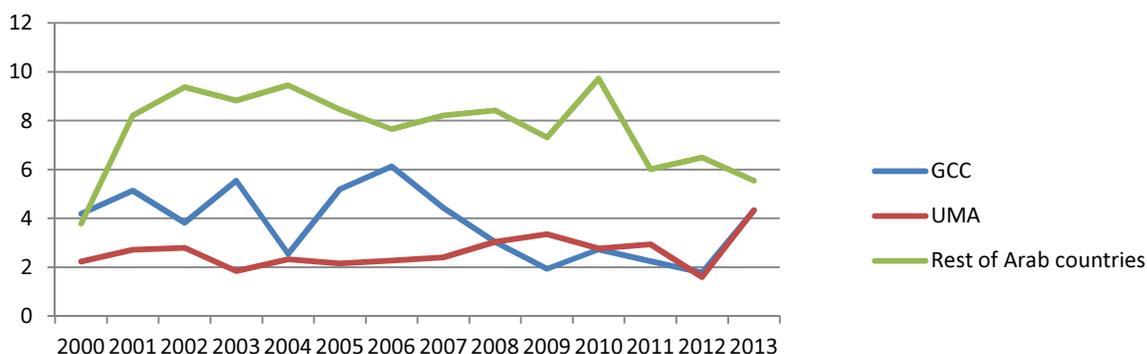
Examining country-level performance throughout the region, it is clear that some countries are very well integrated within the region in terms of trade, whereas others have almost no involvement even with their neighbouring countries. For example, as of 2013, Oman sourced the highest proportion of its imports from within the region (40 per cent), with Comoros sourcing the least at 1 per cent (figure 3.6A). Regarding exports, while over 85 per cent of Somalia's exports are destined to the Arab region, Mauritania only exports 2 per cent to the region (figure 3.6B). The majority of countries have witnessed a moderate increase in the relative importance of regional imports and exports since 2000; however, in some cases, regional trade has noticeably fallen in importance. This was the case of imports into Bahrain and Palestine, and exports from Qatar and Palestine.

Figure 3.6 Intraregional imports and exports by country, 2000 and 2013

A. Intraregional imports

B. Intraregional exports

■ 2013 ■ 2000
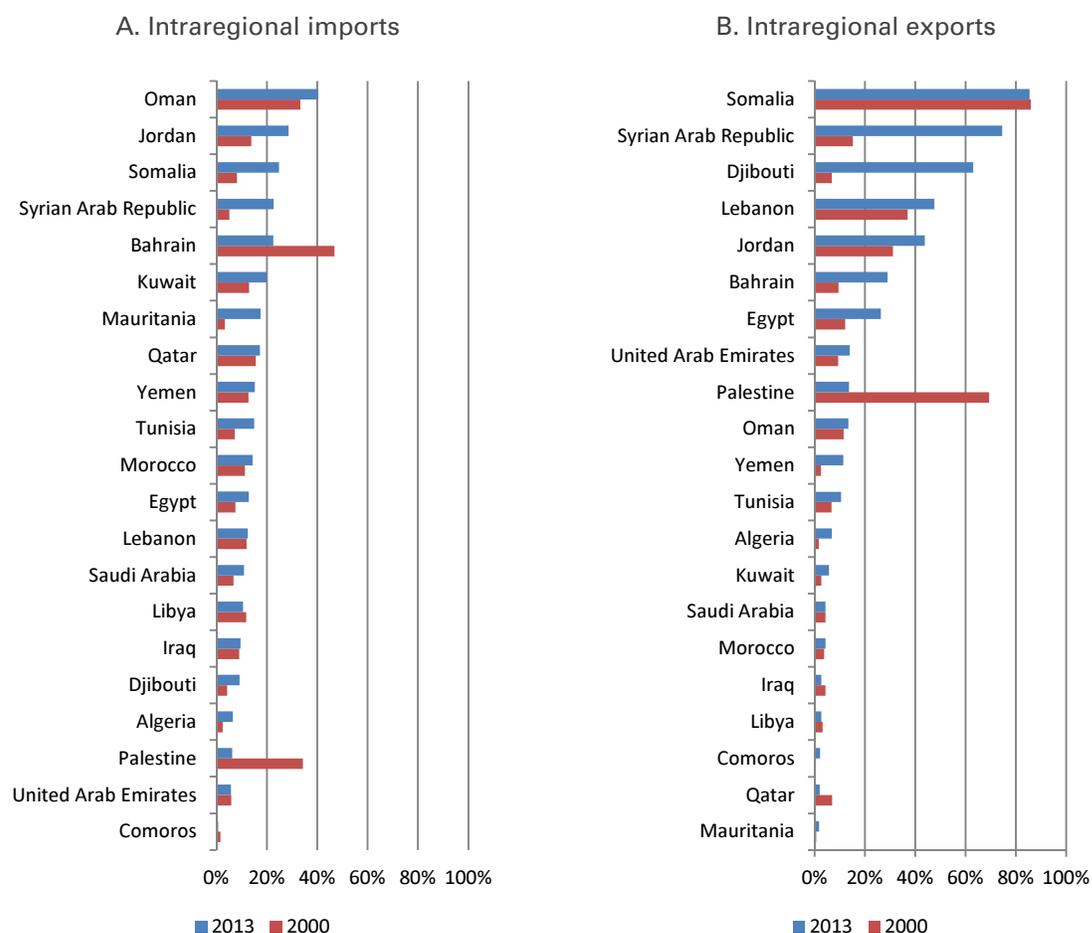
Source: ESCWA calculations using the AEISI.

3. Composition of intraregional trade

A closer examination of the changes in the structure of goods and markets that compose intraregional trade reveals interesting results regarding the types of products traded and their destination markets. Looking into the composition of products traded between GCC countries, there is a considerable amount of new products and new markets in 2013 trade trends vis-à-vis trade in 2000, although results vary by country (figure 3.7). Oman stands out

with remarkable increases in its exports of new products to new markets (around 40 per cent of Oman's total GCC exports), versus 14.5 per cent of new products exported by Kuwait to new markets within the region. Most products traded are "old" commodities that were exported regionally in 2000 as well, and have predominantly been targeted at old (pre-existing) markets in the case of the United Arab Emirates and Bahrain, whereas Saudi Arabia and Qatar are trading old products (64 and 67 per cent, respectively).

Similarly, Oman is the only GCC country that has significantly exported new products to new UMA markets, at 66.7 per cent of total GCC exports to UMA (figure 3.8A). Kuwait and Saudi Arabia, followed by the United Arab Emirates, have been exploring new markets in other Arab countries using their old products. By contrast, Bahrain and Qatar seem to be more set on maintaining old markets, with a bigger portion of their exports involving old products destined for other Arab countries (figure 3.8B). Oman has also been the only GCC country to significantly introduce new products to new other Arab markets (17 per cent of total Omani goods).

Even though intra-UMA trade is still the lowest among all Arab intra-subregional trade, there has been a noticeable increase between 2012 and 2013, with a leap from 1.7 to 4.3 per cent. This could be attributed to countries exploring new markets within the UMA region, reaching a high of 64 per cent out of Morocco's subregional exports, and 50 and 57 per cent for each of Algeria and Libya's respective intra-subregional exports (figure 3.9). The introduction of new products into these markets has been relatively low apart from Mauritania (30 per cent). Morocco has been most active in the region to gain a foothold in new markets while Tunisia has focused primarily on old products and old markets (68 per cent).

Significant changes in terms of product exports from UMA to GCC countries reflect efforts to enter regional markets in general and the GCC in particular (figures 3.10A and B). In 2013, UMA countries entered new GCC markets mainly with old products. Algeria, however, developed new products exported to GCC in 2013, making up 39 per cent of its exports to this subregion. Similar to UMA exports to GCC, Algeria engages in old markets and has opened up new markets for older traded goods in the rest of the Arab countries (figure 3.10B).

Figure 3.7 Composition of intra-GCC export structure in 2013 compared to 2000 by country
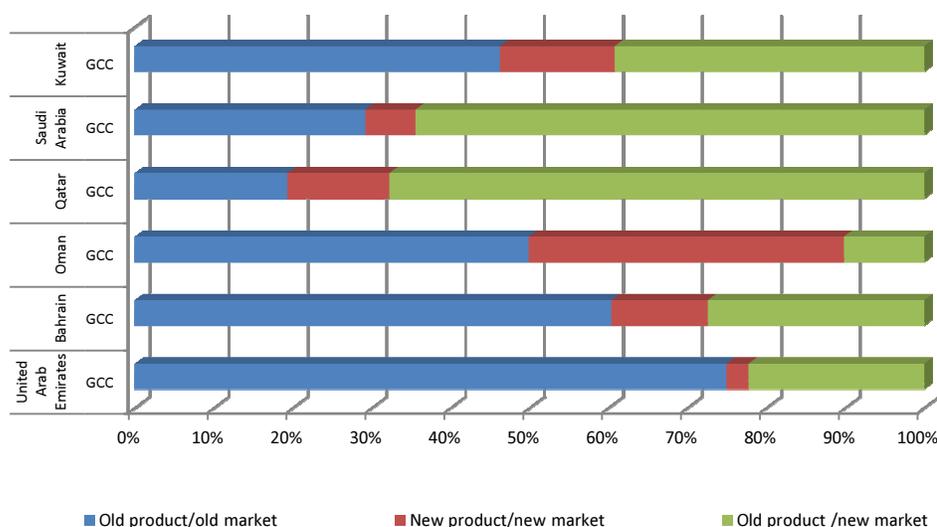
Source: ESCWA calculations using the AEISI.

Figure 3.8 GCC exports, 2013

A. GCC to UMA

B. GCC to rest of Arab countries
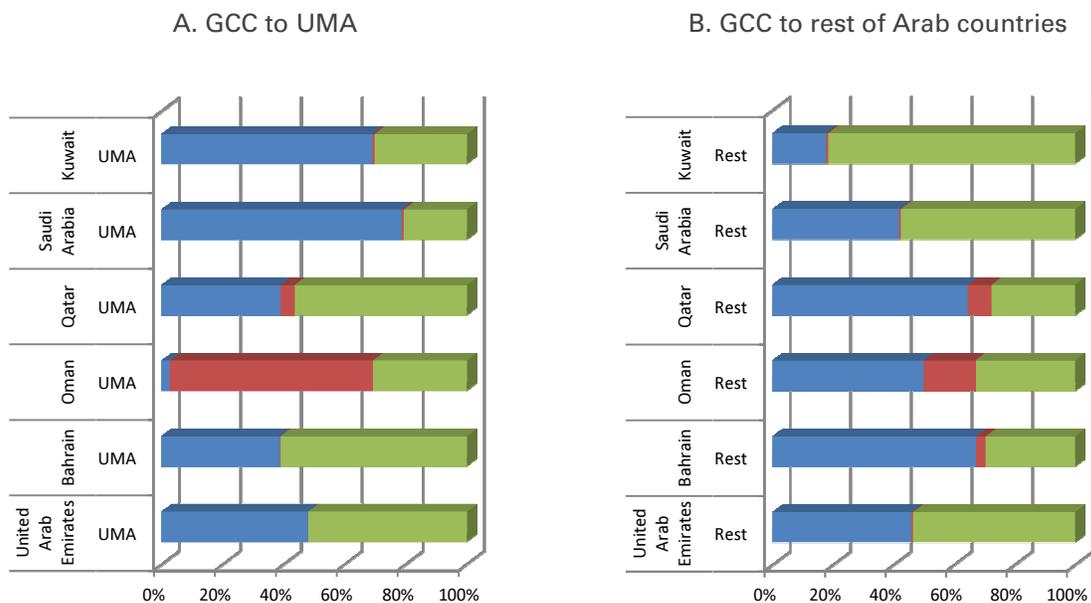
Source: ESCWA calculations using the AEISI.

Figure 3.9 Composition of intra-UMA exports, 2013

■ Old products/old markets

■ New products/new markets

■ Old products/new markets
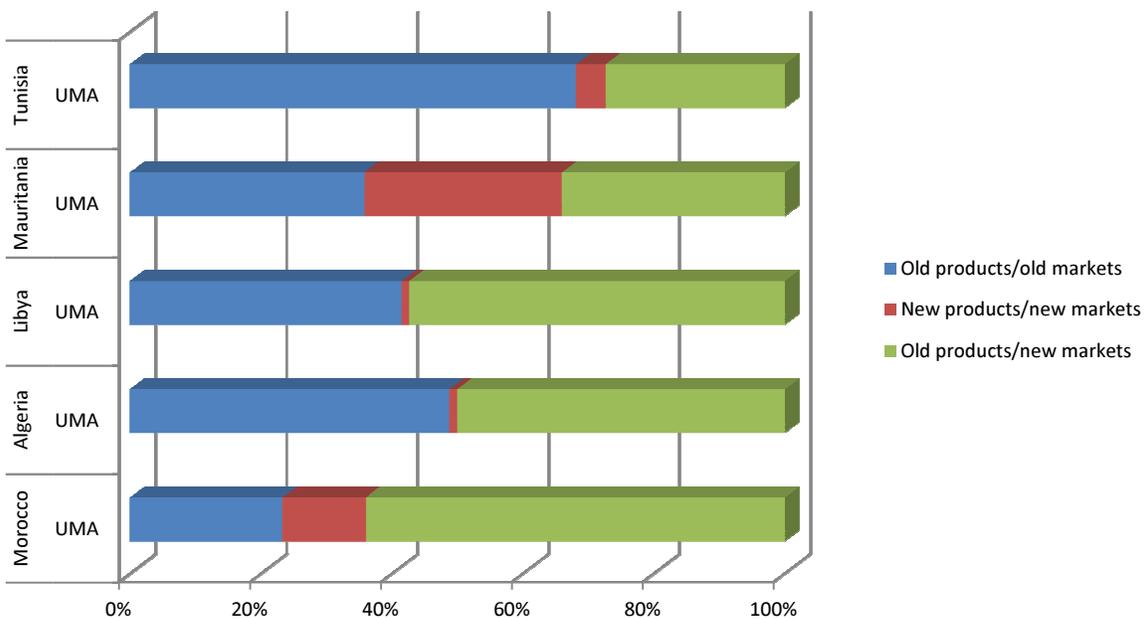
Source: ESCWA calculations using the AEISI.

Figure 3.10 UMA exports, 2013

A. UMA to GCC

B. UMA to rest of Arab countries
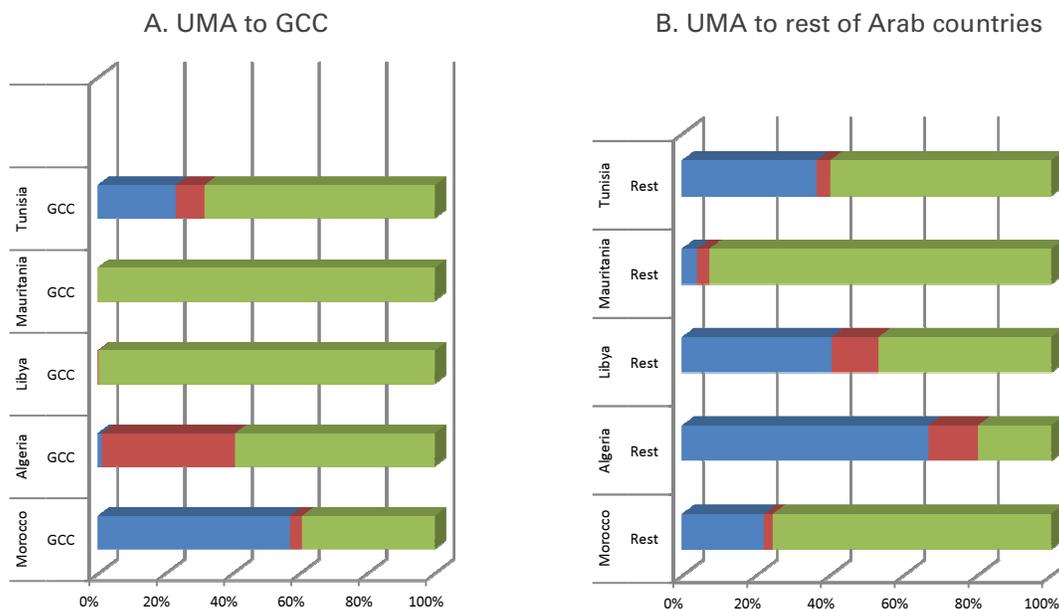
Source: ESCWA calculations using the AEISI.

4. Countries in crisis and trade with non-Arab partners

A closer examination of intraregional trade over time of countries in and affected by crisis, conflict and reconstruction reveals a high level of volatility, and some other interesting results. For example, regarding exports, Palestine has witnessed significant fluctuations in the importance of regional trade (ranging from 10 to 70 per cent), while regional exports of the Syrian Arab Republic as a proportion of total exports have increased dramatically during the recent conflict (figure 3.11). Iraq, however, has very low levels of intraregional exports, and its oil exports are rather oriented towards countries outside the region.

An in-depth evaluation of the Arab region's performance on trade between 2000 and 2013 requires examining the overall performance of trade with the rest of the world. An accurate appraisal of the change in performance level cannot be limited to intraregional trade alone, as it would wrongly assume that good and bad performances over the years can be solely attributed to regional influences. Based on figure 3.12, it is important to draw attention to the percentage of new products and new markets Palestine is exporting to in 2013, as 70 per cent of its exports are new products dispatched to new markets, and an additional 27 per cent of its old commodities are exported to new markets in the rest of the world. Both Lebanon and Yemen are also reaching out to new markets with more than 50 per cent of their total world exports in 2013. Iraq is mainly

sustaining old products and markets (73.9 per cent) in its exports.

In addition to the above-mentioned export achievements of Palestine, also notable is the heavy reliance of the Syrian Arab Republic on exports of old products, especially to the United States and GCC, with a large proportion of new products exported to new markets within the rest of the Arab countries. Around three quarters (74.5 per cent) of Syrian Arab Republic's 2013 exports were to Arab countries – a boost from 42 per cent in 2010 – indicating the importance of these products and markets. Lebanon has had slightly fewer "new" goods exported in 2013 than the Syrian Arab Republic, but a greater market penetration of old exports to new markets.

Iraq has started exporting old products to GCC countries while almost 60 per cent of Yemen's exports to the GCC and 51 per cent to the rest of the Arab countries are new products to new markets. Furthermore, while there is slight to no change in the Iraq-EU and Iraq-United States export structure in terms of products and markets, Yemen has initiated exports to new markets in the United States.

Overall, this data sheds light on the interesting trajectory of the countries and subregions that are expanding their regional and global trade, and the type of products that are playing a role in this.

Figure 3.11 Intraregional exports by selected countries in conflict, crisis or reconstruction (percentage of total exports)
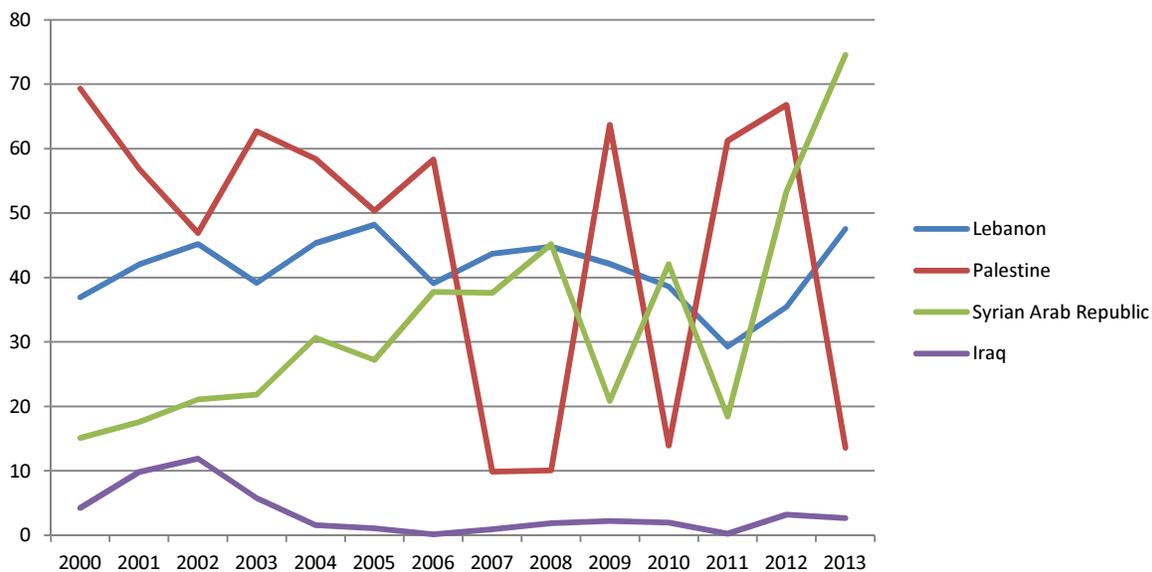
Source: ESCWA calculations using the AEISI.

Figure 3.12 Exports of selected countries in crisis by product (old versus new) and market (old versus new), 2013

A. Lebanon

B. Palestine

C. Syrian Arab Republic

D. Iraq

E. Yemen
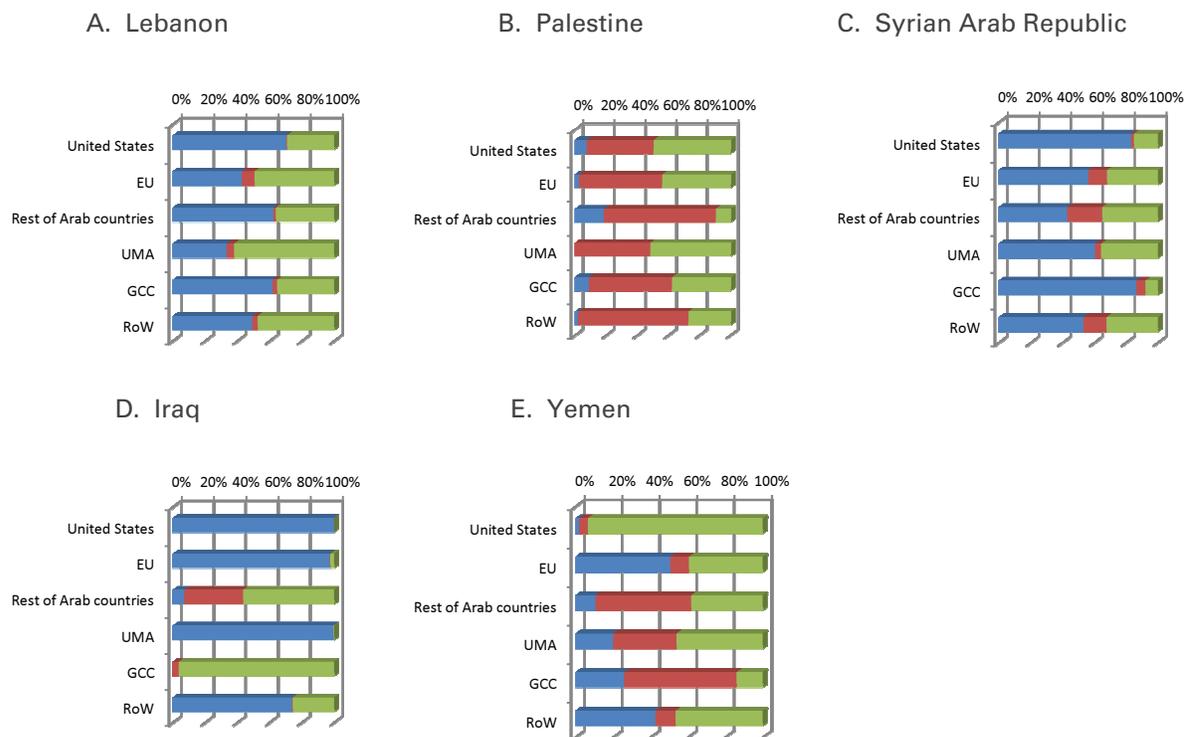
Source: ESCWA calculations using the AEISI.

B. Regional value chains to boost latent Arab manufacturing

1. Regional integration is vital for industrialization

Progress towards Arab regional economic integration is inherently intertwined with the success of the industrial sector, given that industrialization is vital for job creation and sustainable economic growth. Experiences from other regions indicate that cross-border cooperation, the pooling of resources and building of regional value chains are key for neighbouring countries to collectively add value, industrialize and increase their share of global industrial activity though better connectivity to global value chains.

Trade integration has been found to be both an enabler of industrialization, through the movement of equipment, industrial inputs and final industrial goods, and an outcome of industrialization, as those countries diversifying their industrial portfolios will be able to engage in more diversified regional trade. Ecochard and others (2006) notes the importance of cross-border supply chains, revealing that regarding different stages of production, parts and components are the most intensive in intra-

industry-trade (Ecochard and others, 2006, p. 4). In the Arab region, a sectoral analysis of intraregional trade indicates that trade integration is greater in non-oil and non-mining sectors, drawing attention to the need for commodity-based economies to open up to diversified production and trade (ESCWA, 2014a, p. 50). Industrialization through regional integration is not an option for the Arab region; rather, it is imperative due to competition from other regional blocs and the challenges that continue to face the region's growth and development.

Regional economic integration is linked to industrialization through a number of mechanisms. Improved economies of scale arise from increased production to meet greater regional demand from pooled markets, and due to varying trade preferences in the Arab regional market, increasing the scope for product differentiation. Indeed, fostering intraregional trade is vital given that this trade features greater industrial and value-added goods than trade with non-regional partners. Integration will allow the building of regional value chains to capitalize on respective comparative and competitive advantages, as well as technology transfer and other learning opportunities which will boost efficiency and productivity of local industries. Free movement of labour and capital will also help countries within a regional community to alleviate respective deficits and surpluses.

2. The state of industry in the Arab region

Industry is not a new issue in the Arab region, which has a rich history of groundbreaking advancements in mathematics, astronomy,

medicine, architecture and other related fields. More recently, industrialization was pursued through State economic planning along the ideals of the mainstream economic growth theories of the 1940s, 1950s and 1960s based on import substitution strategies. State involvement was also justified based on the tenets of the social contract and in order to harness the collective power of the State to guide redistribution and fuel growth (Nabli and others, 2007). This resulted in strategic nationalization and joint decision making by industrial leaders and Government planners. While initial State-led industrialization resulted in economic growth and the expansion of industry in some instances, successes were limited to those countries that developed competitive industries, such as Jordan, Morocco and Tunisia. Nationalization and political capture had limited the space for domestic and international private firms, which should be key contributors to sustained economic growth and innovation. Costly import-substitution-industrialization, coupled with generous public spending and social transfers, has increased debt levels and, after decades of these policies, productivity growth turned negative with exports remaining undiversified (Nabli and others, 2007). These problems, which have been witnessed in countries across the globe, led to the adoption of structural adjustment programmes in many other regions under the auspices of the World Bank and International Monetary Fund (IMF). Some countries have witnessed a rolling back of direct State involvement, notably including Jordan, Morocco and Tunisia. However, the State still maintains an industrial planning role in several Arab countries (Nabli and others, 2007).

Among the higher-income Arab countries that are dependent on the energy and natural resources sectors, industrial agendas have taken a back seat to the development of these sectors. High global oil prices, despite fluctuations, have allowed countries, including GCC countries, Algeria, Libya, the Sudan and Yemen, among others, to be financially independent of "citizen-taxpayers", thereby making the State less accountable (Moore, 2007), while being detrimental to the development of the State's capacity for economic development (Bräutigam, 2008).

These developments have left industry in many Arab countries in a latent state of development. Indeed, despite a variety of country-level successes, extractive industries account for over 35 per cent of Arab countries' GDP, with non-oil manufacturing accounting for only 9.3 per cent, and agriculture 6.1 per cent (ESCWA, 2014a, p. 88). As of 2011, Arab intraregional direct investments were channelled primarily to services; and while industry received 26 per cent of these intraregional flows, these were mainly in the oil and gas sector (ESCWA, 2014a, p. 46). Apparent productivity, as measured by GDP per employee,[31] has grown moderately for most Arab countries, but has stayed below $20,000 per employee per year for most countries, and has for the most part been lower than the comparative countries of Malaysia and Poland, as detailed in chapter II and illustrated here in figure 3.13. However, the level of apparent productivity in Arab countries is highly biased by two major factors, namely, the inclusion of oil rents and the high contribution of the public sector with high wages, particularly in the GCC.

Manufacturing productivity, while lower than general productivity due to the exclusion of high-value commodity activities, has also grown modestly, as in the case of Egypt, which increased from $8,975 in 2009 to $9,931 in 2013.[32]

Arab countries vary regarding the share of manufacturing in their economies. While the industrial value added indicator captures value added in all industrial activities, ranging from oil and mining to manufacturing, the manufacturing value added indicator is a more specific measure of the subset of manufacturing activities. As illustrated in figure 3.14, many countries feature manufacturing value added as a high percentage of industrial value added (for example, Jordan, Morocco and Tunisia), whereas for others, particularly those with large oil industries, manufacturing value added is a much smaller determinant of industrial value added (for example, Iraq, Saudi Arabia and the United Arab Emirates). Yet over time, most Arab countries have in fact witnessed this percentage decline, thereby indicating the diminishing importance of manufacturing among all industrial activities as a direct result of increasing revenues from exporting crude oil and other mining products, such as phosphates. When compared with other regions, Arab countries have featured a high and more stable manufacturing value added growth rate over the past 20 years, indicating certain progress, including a less dramatic fall in the wake of the global financial crisis, as compared with the EU. As a group, they exhibit a trend more fitting of ASEAN (figure 3.15).

Figure 3.13 Apparent productivity by country (GDP per employee in thousands of $)
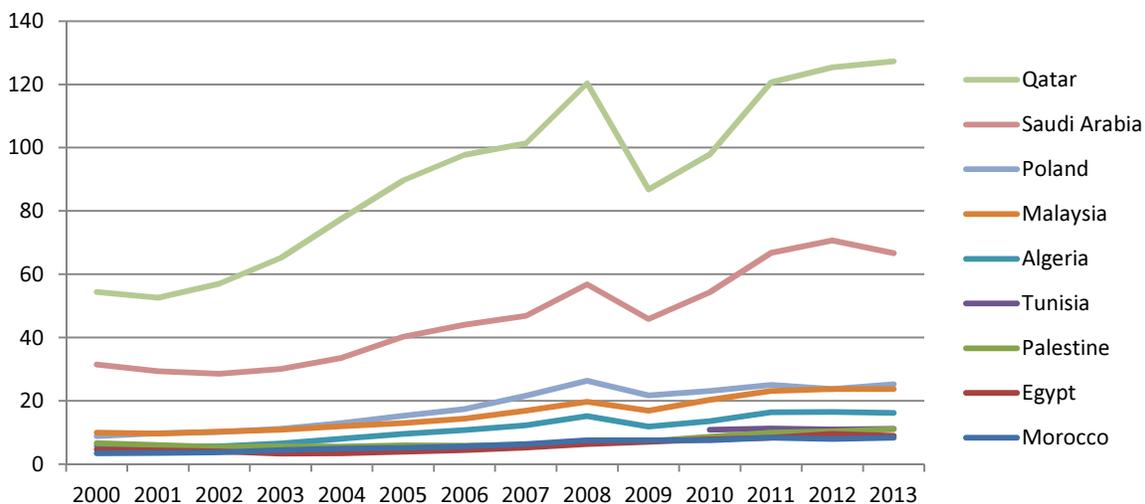
Source: ESCWA calculations using the AEISI.

Figure 3.14 Manufacturing value added in selected countries, 2004 and 2012 (percentage of industrial value added)
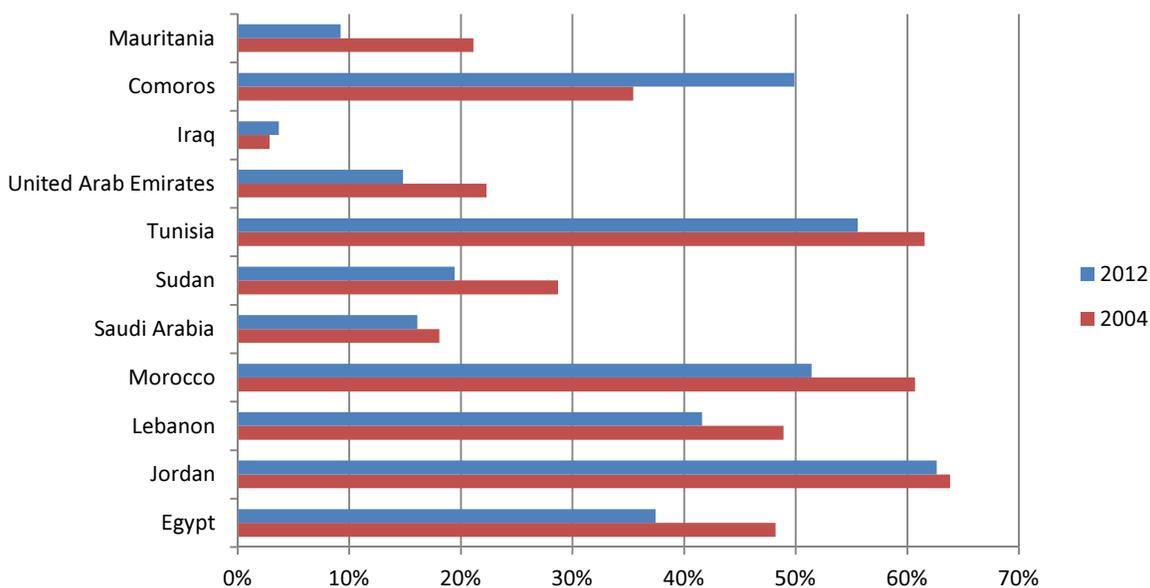
Source: ESCWA calculations using the AEISI.

Figure 3.15 Manufacturing value added in selected regions (annual percentage growth)
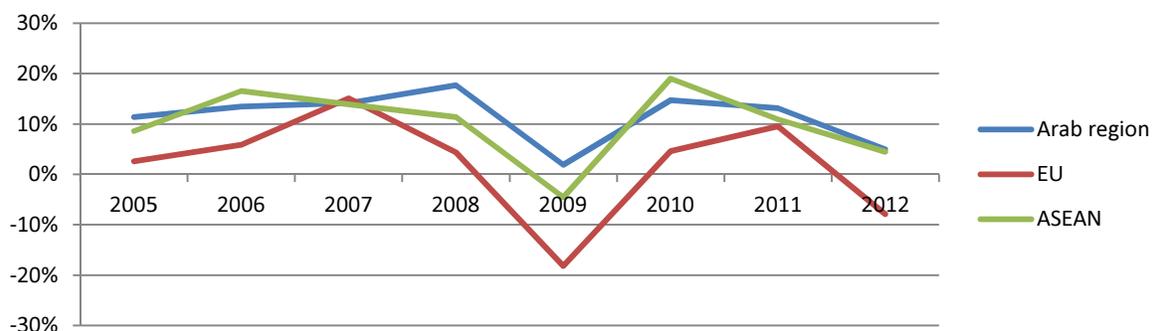
Source: ESCWA calculations using the AEISI.

Figure 3.16 Intraregional imports of intermediate goods (percentage of total intermediate imports)
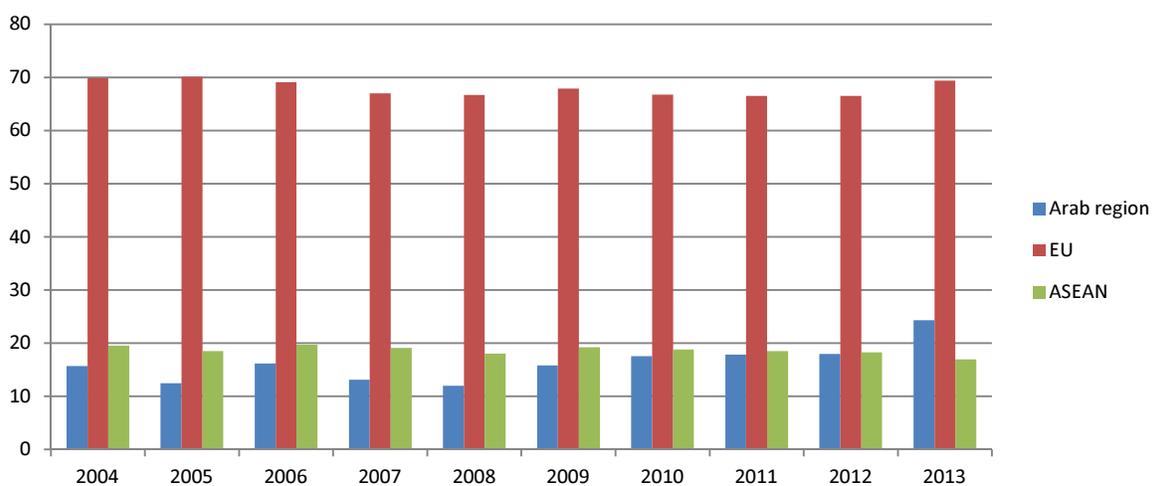
Source: ESCWA calculations using the AEISI.

Regarding the processing and manufacturing activities occurring within the region, Arab countries source a much smaller, albeit growing proportion of their intermediate inputs from within the region than does the EU, on a level comparable with ASEAN (figure 3.16).[33] Country examples illustrate the heterogenous nature of the Arab region: while Oman sourced 54 per cent of its intermediate imports from within the region in 2013, Tunisia sourced only 6 per cent from within the region (World Integrated Trade Solution, 2015). Two implications can be drawn. First, countries that are more diversified and integrated in global value chains are also more diversified in terms of sources of their imports, as is the case of Tunisia. Secondly, the

dominance of non-regionally sourced intermediary products further espouses the limited diversification of many Arab economies.

3. Challenges facing regionally integrated industrialization

While regional efforts have been made to spur industrialization across Arab countries, these have lacked mechanisms by which national industrial sectors may be integrated for growth and deepening. For example, GCC countries adopted a regional industrial policy in 1985 and revised it in 2000. Its aim includes promoting industry, cross-sectoral integration and establishing industry-related research, among other goals (Ghaleb, 2006). Yet, there are still many problems regarding regional transportation, the sharing of trade information and other aspects of industrialization (Hvidt, 2013). Compliance, transparency and implementation have been the main obstacles towards further regional industrial integration, and conflicts also impact industry significantly.

Many of the challenges facing regional industrial integration stem from the domestic nature of industrial and sectoral policies, and the association by some countries of integration with a loss of economic planning autonomy (Nabli and others, 2007). Madani (2001) finds that, based on Malaysia, the Philippines and Singapore, greater market size and production potential of regional integration may not benefit all industries. Rather, output growth may be due to growing intraregional trade, irrespective of regional agreements through ASEAN, indicating that benefits of industrial integration may come through a variety of channels of transmission. In addition to this issue of political will, a variety of

other barriers to industrial integration exists across the Arab region, including high costs of trading and doing business, a lack of sectoral policy harmonization and various non-tariff barriers. Yet, Ecochard and others (2006) note that despite "concerns that integration processes would prompt harsh adjustments … European integration was accompanied by an increase in intra-industry trade (IIT) between member countries".

4. The potential of regional value chains

Regional value chains present a clear opportunity for the Arab region to establish cross-border industrial development and boost local industries. The internationalization of innovation, production and consumption has been particularly driven by the ability to outsource segments of the production chain, given that global transportation and communication costs fall and labour and capital costs increase in many countries. The benefits of global and regional chains have been mapped out in the flying geese model, with greater income- and employment-generating segments of production passed from high- to middle- to low-income countries, the benefits of which will enable developing countries to climb the manufacturing ladder.

Integration is also vital for spurring trade in value added, encompassing the share of value added produced locally within the production value chain, with employment- and income-generating effects, as noted by Maurer (2011) and Meng, Fang and Yamano (2012), among others. Indeed, trade in value-added products through value chains has been increasing, specifically through regional value chains,

indicating the importance of intraregional trade in intermediate goods for developing such chains.

Box 3.1 Saudi Arabia and global value chains

Goods and services traded globally are composed of inputs from various countries and regions. However, the flows of goods and services within these global production chains are not always reflected in conventional measures of international trade. The Trade in Value-Added (TiVA) initiative, which is jointly carried out by the Organisation for Economic Co-operation and Development (OECD) and the World Trade Organization (WTO), addresses this issue by considering the value added by each country in the production of goods and services that are consumed worldwide. It is based on a database with indicators on the share of value added in a group of OECD and non-OECD countries. Saudi Arabia was included in the first database, while the new database posted online at the end of June 2015 also covers Tunisia.

This data reveals that Saudi Arabia in fact performs well regarding the share of domestic value addition as a component of gross exports, having the 14th highest domestic value addition among the 58 countries in the database, outperforming many ASEAN and EU countries. Similarly, Saudi Arabia ranks top among non-OECD countries regarding the share of total domestic value added in gross exports. However, when excluding value addition in mining and quarrying activities for all countries – which includes oil – Saudi Arabia drops to 41st in total value addition, thereby indicating that value addition in non-commodity-based industry is latent. Dynamically, between 2000 and 2009, this figure did grow by 132 per cent for Saudi Arabia, which was the 21st highest rate of growth among the countries listed, placing it behind many EU and ASEAN competitors (in absolute terms, its value addition growth placed it only at 41). The increase is largely the result of the high oil prices between 2000 and 2009 rather than any structural transformation in the economy.

Backer and Miroudot (2013) find that Saudi Arabia participates largely in forward linkages, such as supplying intermediate goods and services for use in other countries, with only a small level of backward linkages as a user of foreign inputs. Saudi Arabia has increased its "upstreamness" as measured by an increased distance within the production process to final demand for its products, which stands high compared with many OECD and non-OECD countries; this indicates increasing specialization in intermediate input goods at the base of global value chains (Backer and Miroudot, 2013). Oil-based exports from Saudi Arabia, serving as inputs for its trading partners, are driving these trends, and Saudi Arabia must focus on a manufacturing diversification agenda to spur local value addition in other sectors that are less vulnerable to global commodity prices and help create more employment opportunities.

There are examples from the Arab world of countries making progress in carving out higher places in regional and global value chains. The case of Saudi Arabia illustrates a strong trade in value added, yet much of this is reliant on oil processing and refining (box 3.1). The Economic Commission for Africa (ECA) (2013) indicates that in the textile industry of Egypt, which accounted for 5 per cent of GDP and 10 per cent of exports in 2008, Egyptian firms hold high-value-added positions within the global market, and their clients include high-end producers. However, firms catering to regional markets have fewer incentives to upgrade production, as they do not face the same quality standards and high returns as exports to the EU and United States. While firms do integrate and rely on each other for upstream and downstream production linkages, the quality of local suppliers is a key hindrance in the domestic and regional value chain for their inputs.

The strategies that Arab countries pursue in order to industrialize and to integrate are not

mutually exclusive – rather, they are mutually reinforcing. The key challenge will be to develop new and innovative industrial policies that help Arab countries to build competitive advantages in new and emerging industries. In this context, global value chains are a critical enabling structural change in the current landscape, and they offer important opportunities to suppliers in the Arab region. Moreover, trade facilitation is also a critical element in achieving such a strategy followed by the regulatory cooperation in sanitary and phytosanitary measures and technical barriers to trade.

C. Agriculture: the need for greater value addition and investment flows within the region

Global trends have led to international specialization of production across borders, and the agricultural sector is no exception. However, agricultural integration presents particular complications given that many countries have domestic agricultural support programmes that are at present incompatible with free trade. Nevertheless, it is possible to foster integration in agriculture by reforming the domestic support programmes. Of particular interest is the integration of regional agricultural value chains. Strengthening supply chains while adding value creates opportunities with many wins for farmers, investors and communities. For example, expanding the EU to an additional seven members from Central and Eastern Europe has in some instances resulted in gains associated with replacing subsidized domestic farm output with imports from new members (Robinson and Thierfelder, 2002).

A brief analysis of the level of integration of agricultural value chains in the Arab region is provided in this section from two perspectives: the trade in agricultural produce among countries of the region, and the source and structure of investment in the agriculture sector.

1. Trade in food and agriculture

Regional trade of food-based agriculture between Arab countries is comparatively limited. As indicated in figure 3.17, intraregional agricultural imports have not exceeded 15 per cent of total agricultural imports, suggesting the need for a more extensive product base which may reflect on the poorly developed value chains in agriculture production.[34] By subregion, UMA countries are those with the lowest imports from the region, followed by the rest of the Arab region and GCC countries.

Regarding cereals in particular, imports have increased over the years, leading to a net deficit for the Arab region of around 70 million tons per year (ESCWA, 2013c). In addition, a number of countries from the region, notably Egypt and Saudi Arabia, are among the highest net cereal importers in the world. The deficit stands at about 16 million tons per year in Egypt and at about 12 million tons per year in Saudi Arabia. Countries of the Arab region have maintained an emphasis on cereals as a staple for food security concerns.

Figure 3.17 Intra-subregional agricultural imports (percentage of total imports)

Figure 3.18 Intra-subregional agricultural exports (percentage of total exports)
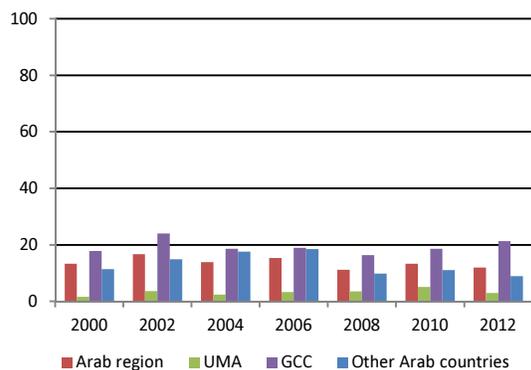
Source: ESCWA calculations using the AEISI.

The nature of intra-Arab agricultural trade is captured in figures 3.17 and 3.18. Total intra-Arab exports represented one-third of all agricultural exports over the past 12 years. Higher regional exports could be due to a lack of integration with other global markets and stringent standards in external destination countries. For example, under the Common Agricultural Policy (CAP), European countries impose very strict rules and most producers in Arab countries seldom have the financial and technical expertise needed to meet these standards. These barriers are largely affecting the agricultural exports of Arab countries in the Mediterranean, namely Egypt, Morocco, Syrian Arab Republic and Tunisia, which are associated with the EU through the EUROMED partnership. GCC countries and the rest of the Arab region feature high levels of exports to Arab countries, although UMA is less connected and its agricultural exports to the Arab region remain low.

2. Agricultural value chains

Regional agricultural production chains can help to address food security whereby the various actors in producing, storing, distributing, processing, retailing, preparing and consuming goods are well-connected and operate efficiently and sustainably (Committee on Food Security, 2012). The need for more productive and effective food value chains in the Arab region is strongly felt, particularly in the context of food price volatility and growing population and urbanization, thereby resulting in changes in production and consumption patterns. Regional cooperation is made more imperative by the impending impact of climate change on agricultural productivity and water availability.

Nevertheless, agricultural value chains in the Arab region are weak (ESCWA, 2014a), as most agricultural and foods exports from the region are unprocessed, with the region missing out on opportunities to capitalize on the potential of adding value locally. Efforts to date have still

not reached a tipping point that would allow countries to optimize and strengthen their overall agricultural and food value chain capacities (Khoury and Byringiro, 2014). A major issue facing the development of the Arab agricultural sector within global value chains are the disproportionate power and revenues held by developed, world-oriented agricultural value chains. Proposals are being made across the developing world, including Arab countries, for greater cooperation within new groups as viable alternatives to these currently one-sided GVCs. Yet to this end, the region faces many obstacles, including limited movement of factors of production (Sadik, Nimah and Alaoui, 2011), and insufficient incentives for agricultural projects. Furthermore, concerns over food security have led to a duplication of efforts towards comparable agricultural products in some countries, and cooperation along value chains would lead to more efficient regional segmented production of a variety of goods.

This results in the region missing out on numerous opportunities, hindering national efforts to raise incomes, create wealth and build capacities for growth and innovation. Indeed, it is estimated that revenues from intra-Arab exports could double with enhanced value added and better working agricultural value chains (Khoury and Byringiro, 2014). Other spillover effects include ensuring greater food availability, improving food access, food stability and utilization, as well as enhanced quality and safety. Agricultural value chains could play a significant role for certain commodities in particular, such as cotton, sugar, olive oil, dates, livestock and a variety of fruits and vegetables and such staples as wheat.

In order to analyse the state of agricultural value chains in the Arab region, figures 3.19 and 3.20 focus on raw commodity data (including, among others, fresh meat, fish, dairy, plants, vegetables, cereals and fats). There is a clear trend in which intraregional trade of raw agricultural commodities is much higher (exceeding 60 per cent) than that for total agriculture, including manufactured goods. Non-UMA, non-GCC Arab countries are responsible for the highest share of raw products exported to countries of the region, and UMA countries account for the lowest share. Regarding imports, the highest proportion of regional raw imports is held by the GCC and the lowest by UMA.

Figures 3.17 and 3.19 indicate that very few agricultural imports are sourced from within the region, and the majority of imports that do come from the region are unprocessed. While total regional agricultural exports are higher, these are even more predominantly only in raw form. This may have alternative implications. Specifically, it may point to low agricultural value addition in the Arab region or, alternatively, as agricultural goods may be consumed in their raw form unlike other products, it can also indicate regional sourcing of raw goods for consumption.

In comparison with the Arab region, intraregional agriculture inputs in ASEAN countries are marginally higher, while intraregional exports are lower (figure 3.21). Contrary to the Arab region, regional imports are more important than regional exports, with a far greater proportion of agricultural exports flowing abroad than in the Arab region. Nevertheless, the share of raw agricultural

commodities traded at the regional level is lower than that of the Arab region (figure 3.22). This observation suggests that ASEAN agricultural value chains are better integrated and involve more regional trade in value-added products than those in the Arab region. However, it is important to highlight that intra-Arab trade in agriculture and food products is highly subject to a complicated system of sanitary and phytosanitary measures regulations and proliferating national standards across the Arab region (see non-tariff measures in chapter V). For this reason, there is an emerging need to enhance dialogue, cooperation and transparency in the development of these standards that should involve private-public partnerships as well.

Figure 3.19 Share of raw commodities in regional agricultural imports (percentage)
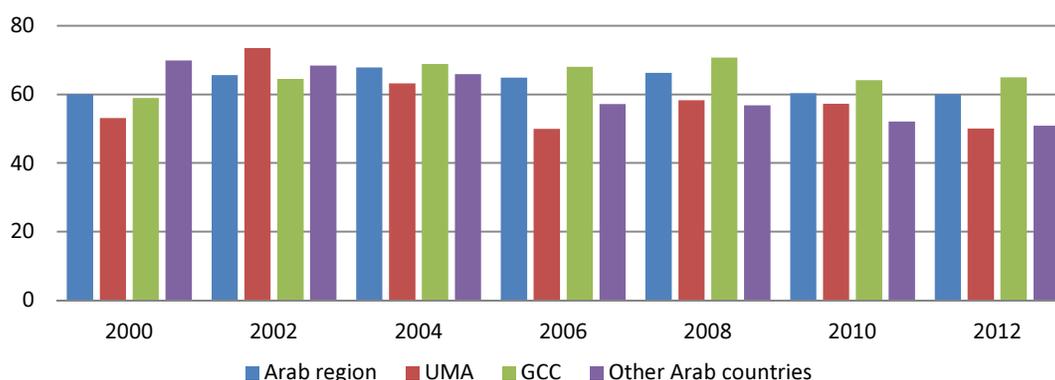
Source: ESCWA calculations using the AEISI.

Figure 3.20 Share of raw commodities in regional agricultural exports (percentage)
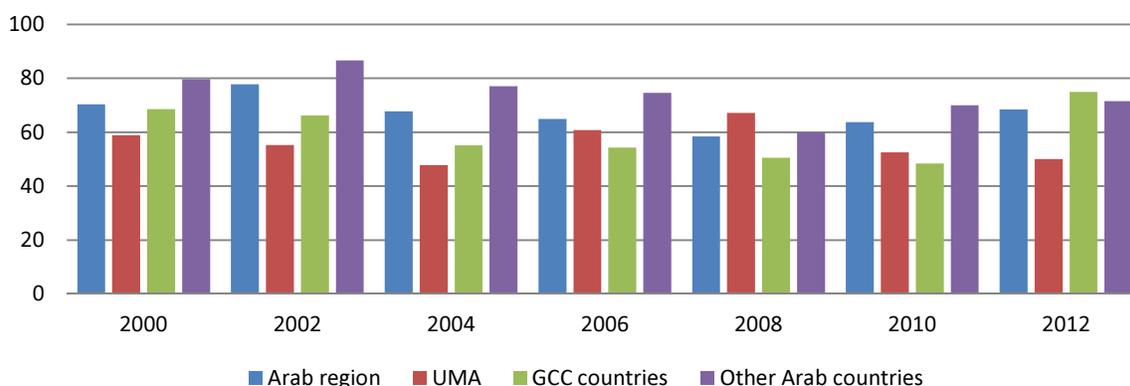
Source: ESCWA calculations using the AEISI.

Figure 3.21 Intraregional trade of agricultural products: ASEAN countries (percentage of total agricultural trade)
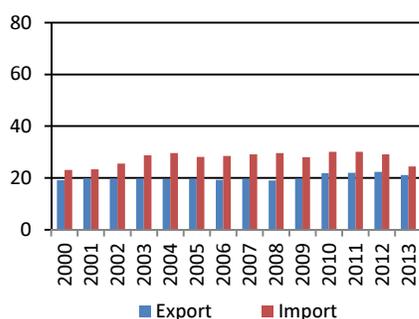
Source: ESCWA calculations using the AEISI.

Figure 3.22 Share of raw products in intraregional trade in agriculture commodities: ASEAN countries (percentage)
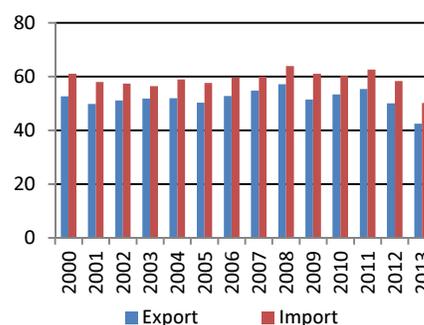
Source: ESCWA calculations using the AEISI.

3. Agricultural investments

The food crisis of 2007-2008 triggered a surge in the flow of FDI towards agriculture production activities in Arab countries as a measure aimed at addressing growing food security concerns. Intra-Arab FDI directed towards regional agriculture production activities is on the rise, especially given that investments from developed countries are declining in the wake of the global financial crisis (IMF, 2009). Indeed, intraregional investment represents more than one-third of total FDI in the agriculture sector in the Arab region (Tanyeri-Abur and Elamin, 2011).

Historically, FDI in the Arab agriculture sector has not yielded the desired impacts in terms of increased food security, improved employment generation and associated economic growth. For example, the agriculture sector in the Sudan, which was once hoped to be the breadbasket of the Arab region, has continued to deteriorate over the years mainly as a result of drought, mismanagement, high taxes and the overall business climate (Sudan Tribune, 2014). Investments have also been criticized for the element of "land grab" and disenfranchising local farmers, while agricultural investments in the Sudan and other countries have not overcome the key barrier of poor physical infrastructure which prevents the transport of goods from remote locations to the coasts.

Nevertheless, recent intraregional FDI in agriculture has involved a greater role for the private sector (al-Sayegh, 2013). In Saudi Arabia, for example, the Government is encouraging the private sector to take the lead in implementing the King Abdullah Initiative aimed at supporting the production of staple foods, namely, wheat, rice, corn, soya beans and alfalfa, by investing in projects conducted beyond the country's boundaries. This is in line with a strategic decision by the Government to phase out completely the domestic production of wheat by 2016 as an important measure to safeguard already scarce water resources and to reduce subsidies. Nevertheless, the Government

maintains a role in overseeing investments by the private sector in projects related to agricultural and food security through the establishment of a regulatory body for the development of bilateral agreements (which covers the delicate issue of quantities to be exported back to the investing country). In addition, the State's Public Investment Fund has financed a Saudi company, to the tune of $800 million, for agricultural investment and animal production responsible to invest in joint ventures across numerous countries and assist in infrastructure development. This illustrates the growing trend to favour investments led by the private sector in agriculture across the region and in initiatives abroad. For example, officials from the Arab Authority for Agricultural Investment and Development (AAAID) have agreed to double the capital of the multilateral lender company with the aim of promoting investment in agriculture. The direction of the organization is to support the establishment of companies in the private sector to produce sugar, oils and other goods. It should be noted that intra-Arab agricultural FDI is not limited to one or two selective countries and sectors; rather, it is broad reaching regarding the numerous agricultural opportunities and high returns in many areas.

Innovative arrangements have been created to coordinate regional investments, such as joint private companies,[35] and sovereign funds are directly investing in intraregional agriculture. Additionally, a number of organizations and agencies have been put in place to promote investment. AAAID was established as a reaction to the 1973 crisis after reaching a consensus on the importance of achieving region-wide food security. Although labelled

pan-Arab, it was mainly a venue to spend Gulf oil revenues in agricultural projects in the Sudan, which had a vast untapped natural resource base. This is reflected by the structure of funds whereby 65 per cent of the paid capital was from GCC countries and 71 per cent of the financed projects took place in the Sudan (Woertz, 2013). Yet, most of the projects did not yield the intended results and remained at the pilot phase, and AAAID's investments remain dominated by the public sector, with a low average annual investment of about $80 million per year, of which the private sector contributed only $25 million (Sadik, Nimah and Alaoui, 2011). Given that it invests as a shareholder rather than as a financier or loan facility, resources are tied for a longer period of time while facing higher risks.

4. National supporting strategies and the way forward for agriculture

Several approaches have been initiated to spur region-wide action to find solutions to food security needs. The Strategy for Sustainable Arab Agricultural Development for the Upcoming Two Decades (2005-2025), which stresses the need for a better balance between production and marketing, and for increasing the effectiveness of institutions and farmers – especially small-scale farmers – could provide a good basis for merging the benefits from trade and sectoral integration. However, in most Arab countries, agricultural development strategies have been based on specific national priorities, such as ensuring food self-sufficiency or the creation of a strong national agroprocessing sector, with little or no attempt to build regional scale economies either in production or consumption based on respective comparative

advantages. Moreover, despite large public subsidies and import-substitution policies pursued by many Arab countries since the 1960s, food self-sufficiency strategies have not succeeded in increasing domestic production at the targeted levels in most countries. Following the adoption of structural adjustment programmes in the 1980s in many non-GCC countries (including Algeria, Egypt, Morocco and Tunisia) and the conclusion of the Uruguay Round in 1994, Arab countries turned to food security objectives rather than food self-sufficiency. A more regional approach regarding agricultural investments and markets for export will open up opportunities for greater returns and increased efficiency in the region's agricultural sector. In fact, an integrated Arab agricultural and food market can provide the bedrock and stimulus for Arab economic integration much in the same way as the European Coal and Steel Agreement served to build trust among nations.

D. Regional migration

1. Migration trends in the Arab region

High levels of migration have characterized the Arab region since the 1950s, with significant intraregional movements of people and growing migration from outside of the region. As of 2010, for every 100 people within the Arab region, there were nearly nine migrants, amounting to three times the global average.[36] ILO and UNDP (2012) argue that migration policies are the most important issue across the Arab region. Labour migration is also seen as one of the major avenues for relieving unemployment pressures in Arab countries.

The Arab region comprises countries with labour surpluses as well as with labour shortages in certain sectors, and both migrant-sending and migrant-receiving countries, with most UMA countries and the rest of Arab countries mainly characterized as sending countries, and the GCC countries and Libya as receiving countries. However, some, such as Jordan and Lebanon, are both, simultaneously exporting high- and semi-skilled workers and receiving unskilled labour.

Statistics gathered for 2013 estimated that nearly 22 million Arabs live and work outside their countries of origin. Out of these, 57 per cent are men and 43 per cent women. The drivers behind Arab emigration can be encapsulated in three main causes: temporary emigration in search of better job opportunities and higher income, particularly to the GCC; seasonal emigration, of usually unskilled labourers, which often occurs between neighbouring countries; and long-term emigration to Europe or North America for permanent residency.

The Arab region as a whole hosts some 30 million migrants in total, which has grown with increasing numbers of refugees in recent years. While the first migration flow from the Arab region, which started after the Second World War, involved workers migrating to other regions, a second migratory flow was oriented towards the GCC countries as well as Iraq and Libya starting with the oil booms of 1973-1974 and 1979, mainly originating from Egypt, Jordan, Lebanon and Yemen.

The primary "push factors" of emigration have included high population growth, economic

instability, high rates of unemployment and poverty, while labour needs and wage differentials have been key "pull factors". Political events have also induced various waves of migration, in addition to the immigration laws and policies in receiving countries. Egypt has been the largest labour exporting country in the region, with 2.9 million citizens living abroad as of 2013.

2. Intra-Arab migration

In 2013, there were more than 11 million Arab migrants in other Arab States, which represents about 37 per cent of total migrants in the Arab region. As indicated in figure 3.23, while the number of intra-Arab migrants has increased significantly over the past 25 years, their share of total migrant workers in the region grew only slightly from 37 per cent in 1990 to 38 per cent in 2013, indicating increasing numbers of migrants from other regions as well.

There is great variation in the importance of intra-Arab migrants for recipient countries. For example, Arabs account for 98 per cent of

migrants in Jordan, 30 per cent in Saudi Arabia and only 4 per cent in the Sudan, as of 2013. The most significant countries of origin of intra-Arab migrants are displayed in figure 3.24.

The Arab region is a significant destination for Arabs seeking employment, with just over half of all Arab migrants remaining within the Arab region in 2013. To take specific country examples, 88 per cent of Yemenis abroad are found in other Arab countries, and half are found in Saudi Arabia (figure 3.25). However, there are variations both among countries of the region and over time. For countries such as Bahrain and Iraq, the proportion of migrants staying within the Arab region has grown dramatically between 1990 and 2013, while this proportion has fallen for Oman, Saudi Arabia and the Sudan, among others. Many countries, such as Algeria and Tunisia, have more established migration linkages with Europe; and others, including the Comoros and Somalia, feature emigration to the rest of Africa. For these countries, greater integration within the Arab region will unlock pathways to more employment opportunities abroad.

Figure 3.23 Intra-Arab migrant stock and total migrants in the region (million and percentage)
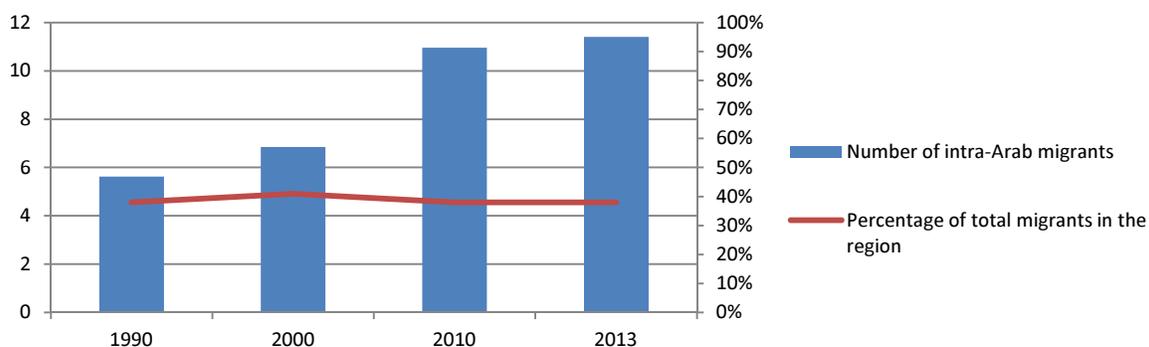
Source: ESCWA calculations using the AEISI.

Figure 3.24 Composition of intra-Arab migration by country of origin, 2013
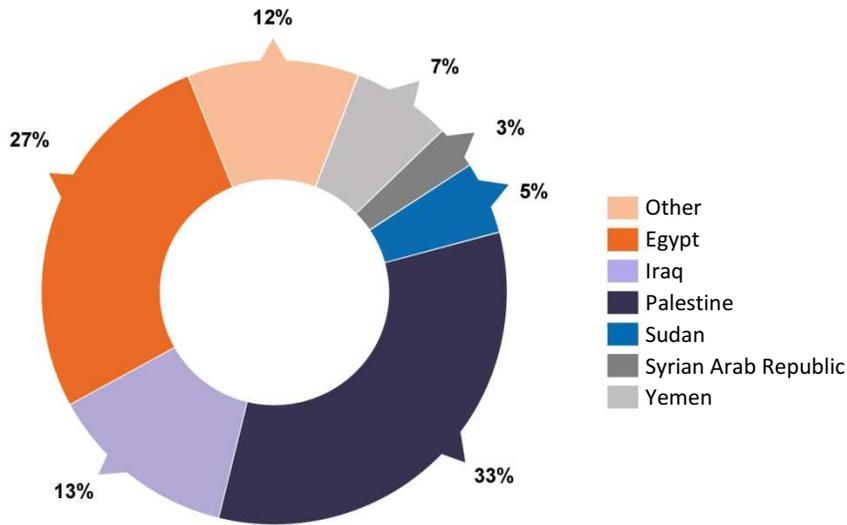
Figure 3.25 Proportion of Arab emigrants staying in the region, 1990 and 2013 (percentage)

A. 1990

B. 2013
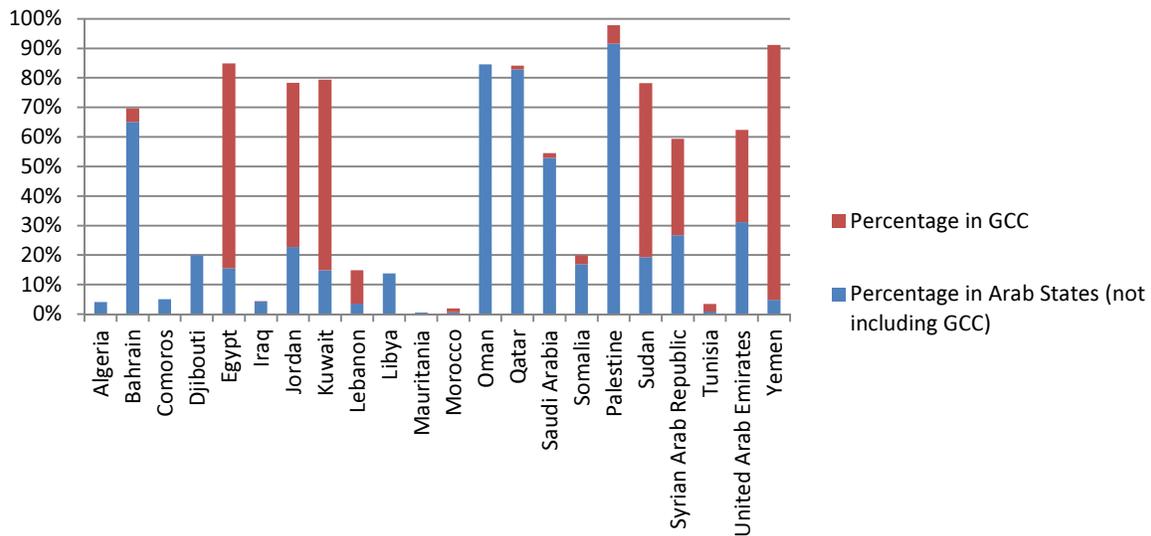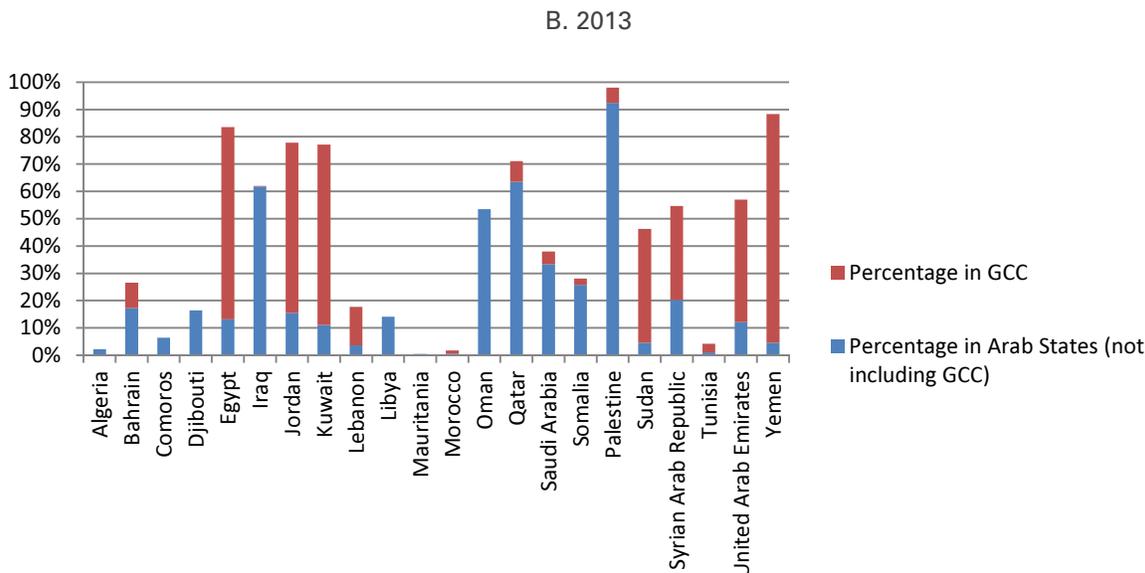
Source: ESCWA calculations using the AEISI.

Figure 3.26 Source of migrants in GCC countries, 2013 (percentage of total)
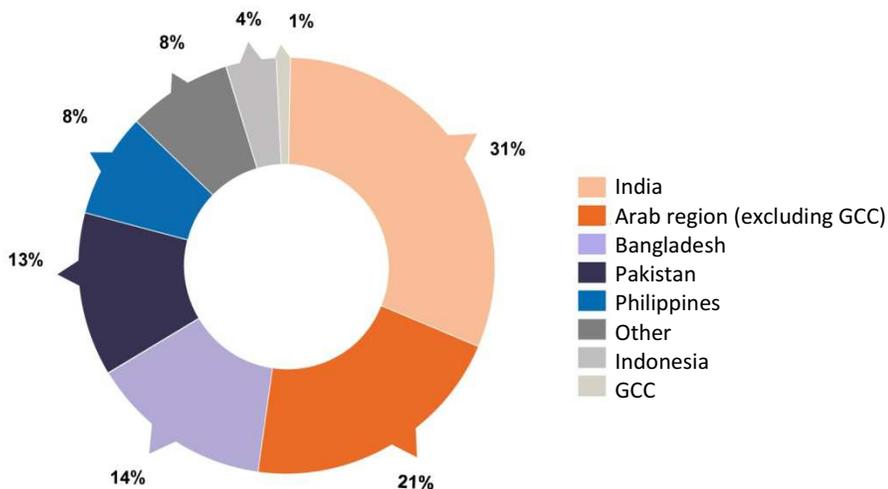
Source: ESCWA calculations using the AEISI.

The GCC plays an important role for intra-Arab migration, and as of 2013, its six member countries together were the destination for 23 per cent of all Arab migrants. Yet, trends indicate that migrants from non-Arab countries play a larger role in these economies than those from within the region. Much of the recent migrant stock increase in the GCC can be

attributed to the significant influx of Asian rather than Arab labour, which, as of 2013, plays a dominant role as a source of migrant labour for the GCC (figure 3.26). India alone accounts for 31 per cent of migrants in the GCC, more than the entire Arab region. Intra-GCC migration, at 1.3 per cent of all migrants in the GCC, is insignificant compared with movement from other countries and regions.

Arab migrants tend to take up skilled and semi-skilled work in the GCC, whereas Asian migrants are employed in unskilled, semi-skilled and domestic work. Yet, despite these differences in labour activities, Arab migrants still face serious competition from their Asian counterparts. An initial wave of hiring Asian migrant workers and repatriating Arab workers followed the fall in oil prices from the mid-1980s to mid-1990s, leading to austerity and cost-cutting (Kapiszewski, 2004). This trend intensified with the Gulf wars and, by 2002, the share of Arab migrants in the total foreign population of GCC States fell to 25-29

per cent compared to 72 per cent in 1975 (ESCWA, 2007b). As noted in figure 3.26 above, total Arab migrants currently account for only 22 per cent of migrants in GCC countries. Migrant labourers are particularly prevalent in the GCC private sector, where the proportion of migrants ranges from 99 per cent in Qatar and 97 per cent in Kuwait to about 80 per cent in the other countries (Baldwin-Edwards, 2011).

3. The case of the EU and ASEAN

Comparing the levels and proportion of regional migration with those in the EU and ASEAN, figure 3.27 indicates that in fact intraregional migrants represent a comparable proportion of total migrants in the Arab region and the EU. Intraregional migration in ASEAN composes a much higher proportion, owing to, among other issues, the lower numbers of migrants from abroad as compared with the Arab region and EU.

Figure 3.27 Intraregional migration comparisons by region (million and percentage of total migrants)
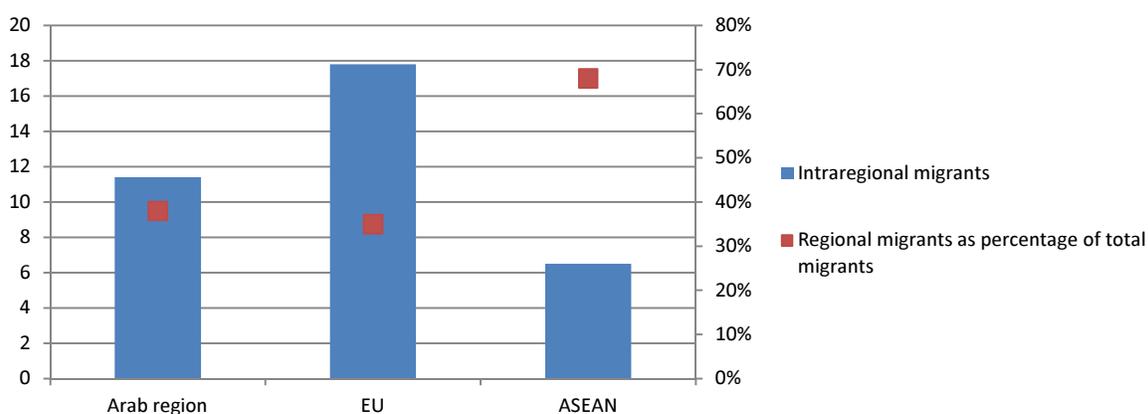
Source: ESCWA calculations using the AEISI.

4. Development impact of intra-Arab migration

Labour flows comprise a main form of integration in the Arab region, owing to both the significant movement of people through the region and the remittances that are subsequently sent. The movement of workers between Arab countries has greatly contributed to economic growth and the reduction of poverty and unemployment. Based on the trends that Arab migrants are predominantly young and male, the aim of this migration is for labour, due to both high and sustained unemployment at home and higher wages attainable abroad (ESCWA, 2013b).

However, labour nationalization programmes, particularly in GCC countries, are aimed at reducing dependence on foreign workers and replacing them with indigenous labour through employment quotas for national workers, the closing of particular sectors to immigrant workers, the deportation of irregular workers, and policies attempting to increase the employability and employment of the indigenous population. Recent conflicts in the region have also resulted in substantial "reflux migration", with adverse effects on sending countries as a result of the sudden and unexpected increases in unemployment. For example, due to the violence in Libya, at least 100,000 Egyptians returned home, adding further pressure on the labour market (Abdelfattah, 2011). Syrian refugees have swelled not only internally, but in other countries as well, including Lebanon.

With increasing demographic pressures and slow job creation in many Arab countries, demand for emigration will certainly increase.

Comprising between 70 and 80 per cent of all the unemployed in the region, the youth (aged 15-24) tend to have the highest propensity towards migration, and bleak employment prospects have led to migration as a main solution (Martin, 2009).

Overall, it is envisioned that greater integration across the region will also facilitate migration. This will require, among other elements, a more comprehensive pan-Arab migration policy to supplement the various bilateral and subregional agreements between some Arab countries and between individual Arab countries and external partners.

E. The growing role of regional remittances

1. Remittances in the Arab region

Remittance transfers are considered to be a major source of financing and foreign exchange for labour-exporting countries. In 2012, more than $520 billion in remittances was sent worldwide; out of this, $49 billion went to the Arab region, up from $41 billion in 2010.[37] Indeed, remittances sent home by Arabs working abroad have for some time been increasing in significance among sources of financing. Workers in Arab countries remitted more than $82 billion in earnings to other countries in 2012, the bulk of which ($69 billion) went out from the GCC. Workers in Saudi Arabia alone sent some $27 billion in remittances. In spite of the economic and financial crisis of 2008 and prevalent political turmoil in the region since 2011, workers' remittances to and from the Arab region have continued to grow,

contrary to the falling trends of other financial sources to the region during the same period, such as FDI which fell from a peak of $98 billion in 2008 to $49 billion in 2012 (UNCTAD, 2014b). The flow of remittances to and from the region has significant implications for consumption, investment, development financing and balance of payments of the countries of the region. Consequently, the integration of the flow of people and capital has many channels of impact on these issues.

The flow of workers' remittances to Arab countries has been steadily increasing at the same pace in both the Arab and ASEAN regions (figure 3.28).[38] However, remittances as a percentage of GDP have stayed roughly constant at between 1 and 3 per cent in each region, with both the absolute level and percentage for ASEAN marginally higher. At a country-level, remittances vary in their contribution to national economies, and

represent as much as 9 per cent of GDP in Yemen in 2013, 11 per cent in Jordan and 17 per cent in Lebanon.

The steady trends of remittances also reflect their importance as a financing tool when juxtaposed against FDI receipts for the two regions (figure 3.29). While remittance receipts are comparable and constant, in the Arab region they are far more steady than FDI receipts. In fact, following the dramatic post-crisis fall, they stood at equal percentages of GDP, whereas ASEAN FDI receipts are more than twice the level of remittances, as a percentage of GDP; and despite volatility, FDI inflows have remained at higher proportions of GDP than remittances. This comparison sheds light on the relative importance of policies regarding the ease of sending and receiving remittances and of movement of labour for development financing in the Arab region.

Figure 3.28 Remittance inflows to the Arab region and ASEAN as a share of GDP, 2000-2013 (billion United States dollars and percentage)
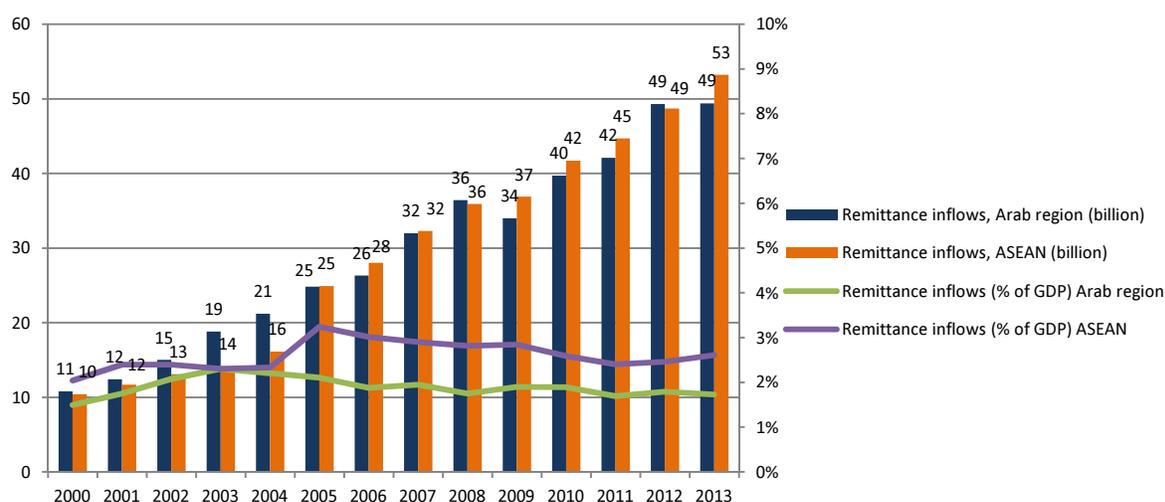
Source: ESCWA calculations using the AEISI.

Figure 3.29 Remittance and FDI inflows in the Arab region and ASEAN, 2000-2012 (percentage of GDP)

A. Arab region

B. ASEAN
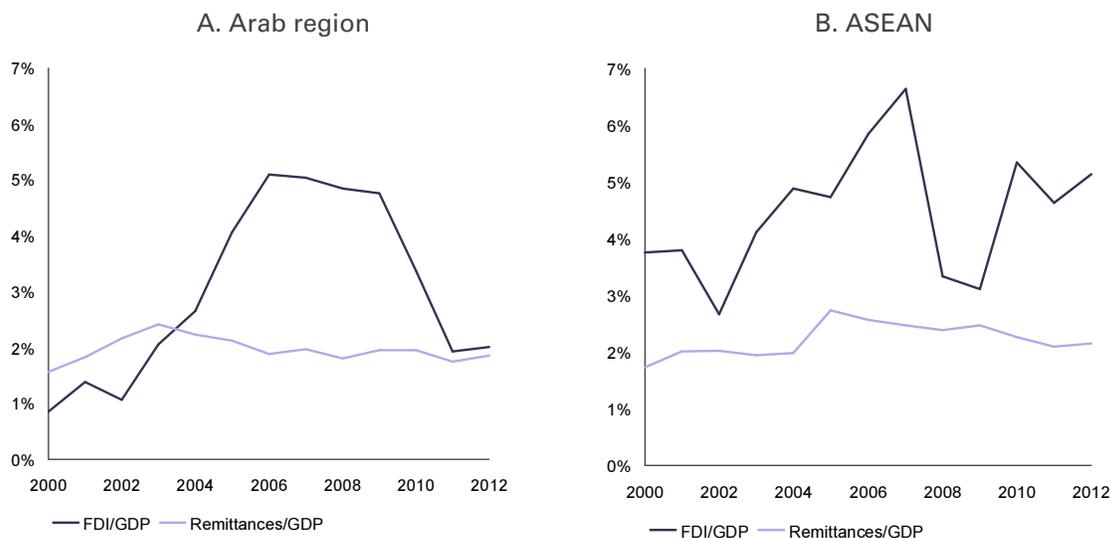
Source: ESCWA calculations using the AEISI.

2. Intra-Arab remittances

Intra-Arab remittances have been increasing as well, up from $5 billion in 2000 to $17 billion in 2010 and $24 billion in 2012. However, out of remittances sent by Arab countries, only 29 per cent are destined to stay within the region. In comparison, of the remittances sent by workers in the EU and ASEAN, larger proportions of these are intraregional (figure 3.30). In fact, in 2012, Egypt was the only Arab country in the top-five recipients of remittances sent from Arab countries (figure 3.31).

As indicated in figure 3.32, intra-Arab remittances account for a larger portion of remittances received than sent, with Arab countries featuring more prominently as sources of Arab remittances, particularly Saudi Arabia. This proportion in the EU stood at similar levels, while intraregional remittances

received in ASEAN are of far smaller significance in total remittances.

Facilitating the intraregional movement of financial and labour flows is even more imperative for the Arab region than comparable regional blocs, due to both the relatively larger role that remittances play in development financing and the fact that nearly half of all remittances to the region originate from Arab countries. The role of remittances is growing, given huge financing gaps in the Arab region, particularly regarding falling savings and investment among countries experiencing conflict and political change. As noted in chapter II, remittances that workers send back home play several developmental roles and are important for boosting consumption, education and health care, as well as savings (UNCTAD, 2013). Portions of remittances are also used for investment, for example in SMEs, as indicated

by several surveys conducted by the World Bank and the International Organization for Migration (IOM) on individual countries. To take an example from the Arab region, based on a survey of the Egyptian diaspora in 2010, over 80 per cent of remittance-receiving households draw upon remittances to address daily needs, health care and education, whereas 20 per cent channel inflows towards investment (IOM, 2010).

Figure 3.30 Intraregional remittances sent and received, 2012 (percentage of total remittances)
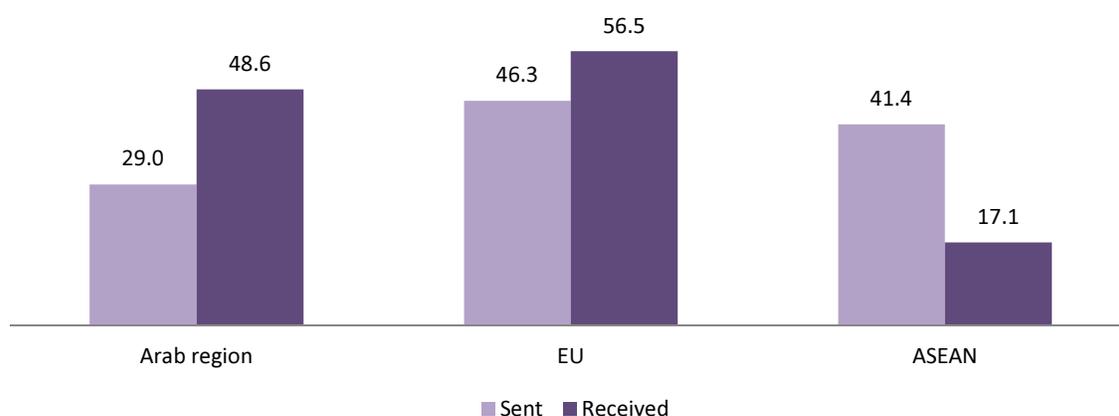
Source: ESCWA calculations using the AEISI.

Figure 3.31 Destination of Arab remittances sent, 2012 (billion United States dollars)
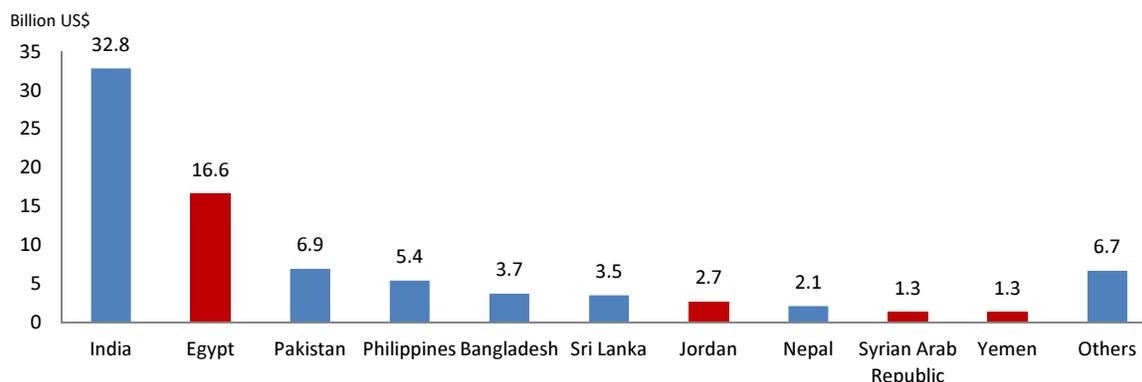
Source: ESCWA calculations using the AEISI.

Figure 3.32 Origin of Arab remittances received, 2012 (billion United States dollars)

Billion US$
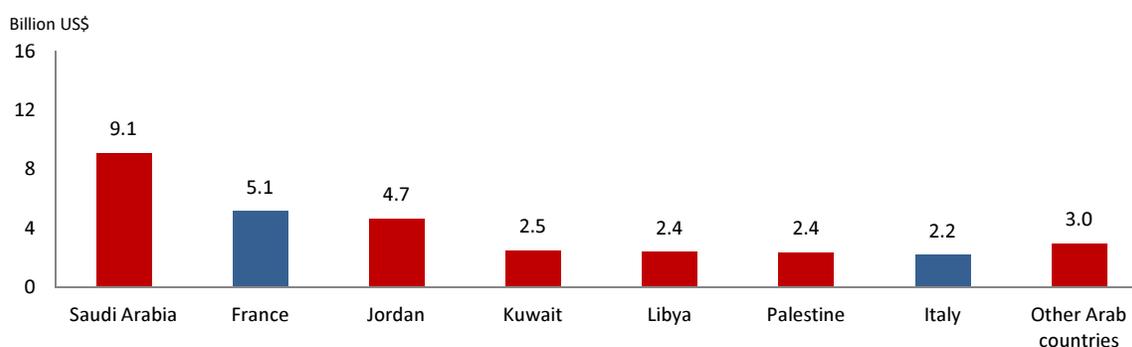
Source: ESCWA calculations using the AEISI.

However, there are some challenges posed by a reliance on remittances. This may increase exposure to global shocks, for example in countries like Yemen with high dependence on migrants' remittances and a majority of migrants based in one country (Saudi Arabia), which is "structurally problematic" (Baldwin-Edwards, 2005). Intra-Arab remittances were hit particularly hard by conflicts within the region, impacting foreign workers employed in Iraq, Libya and elsewhere. The impact of the global financial crisis, particularly in destination countries for Arab migrants, also initially exerted negative pressure on remittance flows. The impact that labour nationalization programmes will have on intra-Arab migration, particularly in the GCC, should be more thoroughly examined as well.

F. Tourism: more visitors from abroad without commensurate intraregional tourism

Tourism is a significant service subsector for employment and foreign exchange generation and is directly linked with integration initiatives, and thus warrants a closer examination in this report. The Arab region has been experiencing increases in outbound and inbound tourism for several years. Historical sites of recognized value, together with vibrant cities and leisure activities, have contributed to making the Arab region one of the top global destinations. Arab tourists travelling within the region have become an important and reliable source of tourism; and with a total of $4 trillion committed to travel and tourism projects across the region and tourist arrivals expected to reach 136 million by 2020, the Arab region is becoming a significant global tourism player (Medawar, 2011). Yet, civil and political changes in recent years have limited to some extent interregional and intraregional movements, and this impact needs to be properly analysed to assess the current status of intra-Arab tourism.

There is an extended and varied literature that addresses the significance of intraregional tourism and its role as an instrument for regional economic development (Chang, 1998; Kauppila and Karjalainen, 2012). Moreover, intraregional

tourism provides a chance to strengthen regional ties and to lay the foundation for regional economic and political cooperation.

Regional tourism also creates new sources of development and increased profits that are vital for national economies, while limiting their exposure to international tourism fluxes, such as conflict and natural disasters. For example, it is evident that the strong growth of intraregional tourism among the economies in Southeast Asia mitigated the effects of international crises on the tourism industry in this region (Mazumder, Sultana and al-Mamun, 2013).

1. Tourism in the Arab region

Tourism in the Arab region has grown at a dramatic pace compared with many regions, as illustrated in figure 3.33. The absolute number of tourists visiting the Arab region has risen significantly over time, with the fall in the wake of the recent political changes less pronounced compared to the unprecedented growth for over two decades (figure 3.34). Factors contributing to this outcome include increasing geographical interest in the region and policies and strategies implemented by Governments to promote their countries.

Figure 3.33 Average annual growth of international tourist arrivals, 2005-2013 (percentage)

ASEAN 8.5

Arab region 4.5

World 3.8

EU 2.2
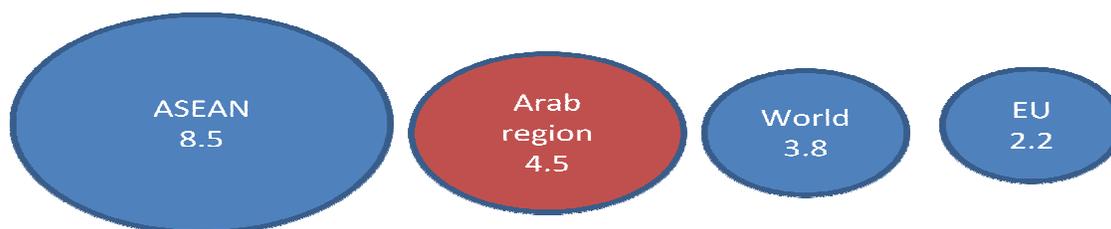
Source: ESCWA calculations using the AEISI.

Figure 3.34 Number of international tourist arrivals, 1990-2013 (million)

- Arab region (not including North Africa)
- North Africa

Source: ESCWA calculations using the AEISI.

The recent political situation across the region has, however, had a negative impact on some traditionally strong tourist performers (box 3.2). Yet, many countries are performing well, with strong growth in 2013 in Morocco (18 per cent), Tunisia (11.2 per cent)[39] and United Arab Emirates (10 per cent),[40] among others (WTO, 2014b).

Expenditures on inbound tourism in the Arab region have also been increasing (figure 3.35). While these expenditures did decrease as expected during the initial periods of unrest in several Arab countries, they rebounded immediately and the increasing trend resumed from 2011 to 2012. As with tourist arrivals,

however, the rebound may be linked to other regional security concerns.

International tourism receipts in 2012 represented 5.3 per cent of total exports of countries in the Arab region, just below world (5.8 per cent), EU (6.1 per cent) and ASEAN (6.6 per cent) levels, indicating the importance of tourism for many countries in attracting foreign currency and for balance-of-payment purposes (World Bank, 2014a). While tourism accounts for less than 3 per cent of GDP region-wide, this level rises to over 14 per cent for Lebanon and Jordan, and 8 per cent for Morocco (World Bank, 2014a). Regarding revenues from Arab tourists in particular, in the years leading up to the global financial crisis and political instability in the region, Arab tourists accounted for as much as 86 per cent of total tourist expenditures in Saudi Arabia, and as little as 1 per cent in Morocco, in 2007 (ESCWA, 2008). This indicates that there is potential for greater revenues from Arab tourists.

Tourism provides employment opportunities for the region's growing population. As calculated based on data for 2012 from WTO (2014a) and ILOStat, direct employment in tourism provided some 485,000 jobs in Morocco (4.6 per cent of the work force) and 709,300 jobs in Saudi Arabia (6.9 per cent of the work force, including expatriate workers). This does not even include jobs indirectly created by tourism. However, while tourism-related job creation is a positive short-term development, these jobs are often vulnerable, low-skill and particularly impacted by global developments. Further analysis is needed on how to improve the quality and not only the quantity of jobs in tourism.

Arab tourism has acquired a growing role in national development priorities as demonstrated by increasing private and public investment in tourism-related infrastructure, including

transport, accommodation, resorts and promotional campaigns. The importance of entrenching tourism in national economic visions is evident in the case of ASEAN (box 3.3).

Figure 3.35 Total expenditures: inbound tourism in the Arab region (billion United States dollars)
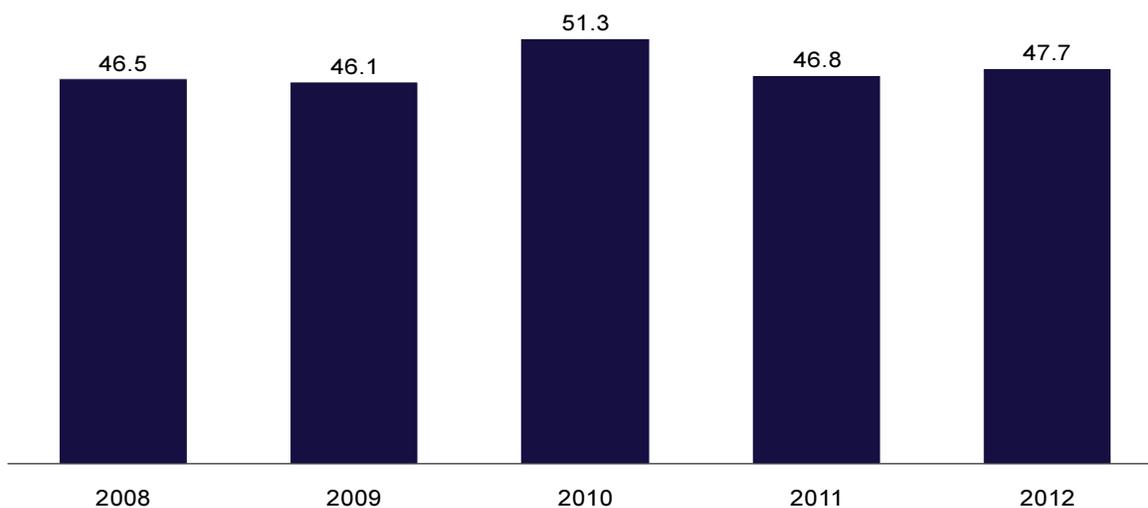
Source: ESCWA calculations using the AEISI.
Note: Data availability for 11 Arab countries.

Box 3.3 Tourism policy in ASEAN

Tourism is important for both regional integration and growth in the ASEAN region. Tourism is entrenched in the organization's charter, and the ASEAN Tourism Agreement was signed with the objective of allowing visa-free travel within the area for nationals from member countries, enhancing cooperation in the tourism industry, reducing restrictions to trade in tourism and travel services among members, and establishing a network of tourism and travel services to maximize the complementary nature of the region's tourist attractions. Since the 1990s, "growth triangles and quadrangles" have been developed to promote and plan common tourist activities. Chang (1998) confirms that in the Singaporean experience, the success of the tourism industry is correlated with regional integration.

2. Intra-Arab tourism

The development of Arab intraregional tourism can benefit from the following elements: same language; free entry among some subregions, such as the GCC, and between Algeria, Libya, and Tunisia; diversity of destinations; growing purchasing power of many citizens; and the emergence of some low-cost airlines. Indeed, visa-free border crossing, among other initiatives, has helped facilitate regional tourism within the EU (box 3.4). Furthermore, family connections and intermarriage among Arabs have created "intraregional extended families", which frequently spend their holidays visiting family members. Other tourism trends,

including medical tourism and educational tourism, contribute extensively to the growth of intraregional tourism (ESCWA, 2008). While conflicts have increased the number of cross-border refugees in the region, this is typically captured only in statistics on arrivals at national borders and not in other tourism indicators, such as number of hotel guests and tourism expenditures, although many fleeing recent conflicts who have the means to do so will stay in hotels and thus will be counted under this tourism data.

Box 3.4 The European Union: a fully integrated tourist market

In the European Union (EU), tourists are free to circulate within the Union's borders, and even external tourists are able to travel among countries that are members of the Schengen Area. The region further benefits from excellent rail, road and low-cost airline systems. A total of 60 per cent of the overall inbound tourists coming to the EU were from within the region over the period 2008-2012, representing over 20 percentage points more than the figure for the Arab region. The European Travel Commission oversees the regional dimension of tourism in Europe, and promotes the region as a tourist destination. While its members are the national tourism organizations of 33 members and other cross-border organizations, it is not an official body of the EU Commission or EU Council. It needs to be examined whether similar facilitating factors could help to expand intraregional tourism in the Arab region.

Inbound tourism within the Arab region accounted for more than one-third of the overall tourist arrivals, standing at over 36 per cent in 2012.[41] In comparison, intra-EU tourism stands at a much higher level of nearly 60 per cent. Figure 3.36 sheds light on the subregional picture, with high intra-subregional tourism in North Africa and the GCC in particular, which may owe to, among other aspects, business ties, convenient transport connections, shared common language, similar traditions and culture. All of these figures have stood at nearly identical levels from 2008 until 2012.

The Gulf subregion has emerged as a key tourist destination in the region. According to a report by the World Economic Forum (2013), Arab countries performed relatively poorly based on a variety of indicators relating to the competitiveness of travel and tourism in each respective country. Only GCC countries were rated high globally, with the United Arab Emirates ranked top in the Arab region (28 globally), followed by Qatar (41), Bahrain (55), Oman (57) and Saudi Arabia (62). Lebanon is the highest ranked non-GCC country (69). GCC countries benefit from well-developed tourism industries, infrastructure and numerous international fairs and exhibitions. In 2009, intra-GCC tourism experienced an unprecedented peak of 71 per cent of the total inbound tourist arrivals. Global and regional crises have contributed to this increasing subregional tourism.

Figure 3.36 Intraregional tourism in selected regions, 2012

A. Arab region

Pie chart: 36.2 / 63.8	■ Share of intra-Arab tourism ■ Share of Arab tourism from abroad

B. EU

Pie chart: 59.1 / 40.9	■ Share of intra-EU tourism ■ Share of EU tourism from abroad

C. North Africa

Pie chart: 40.6 / 59.4	■ Share of intra-North Africa tourism ■ Share of North Africa tourism from abroad

D. GCC

Pie chart: 53.3 / 46.7	■ Share of intra-GCC tourism ■ Share of GCC tourism from abroad
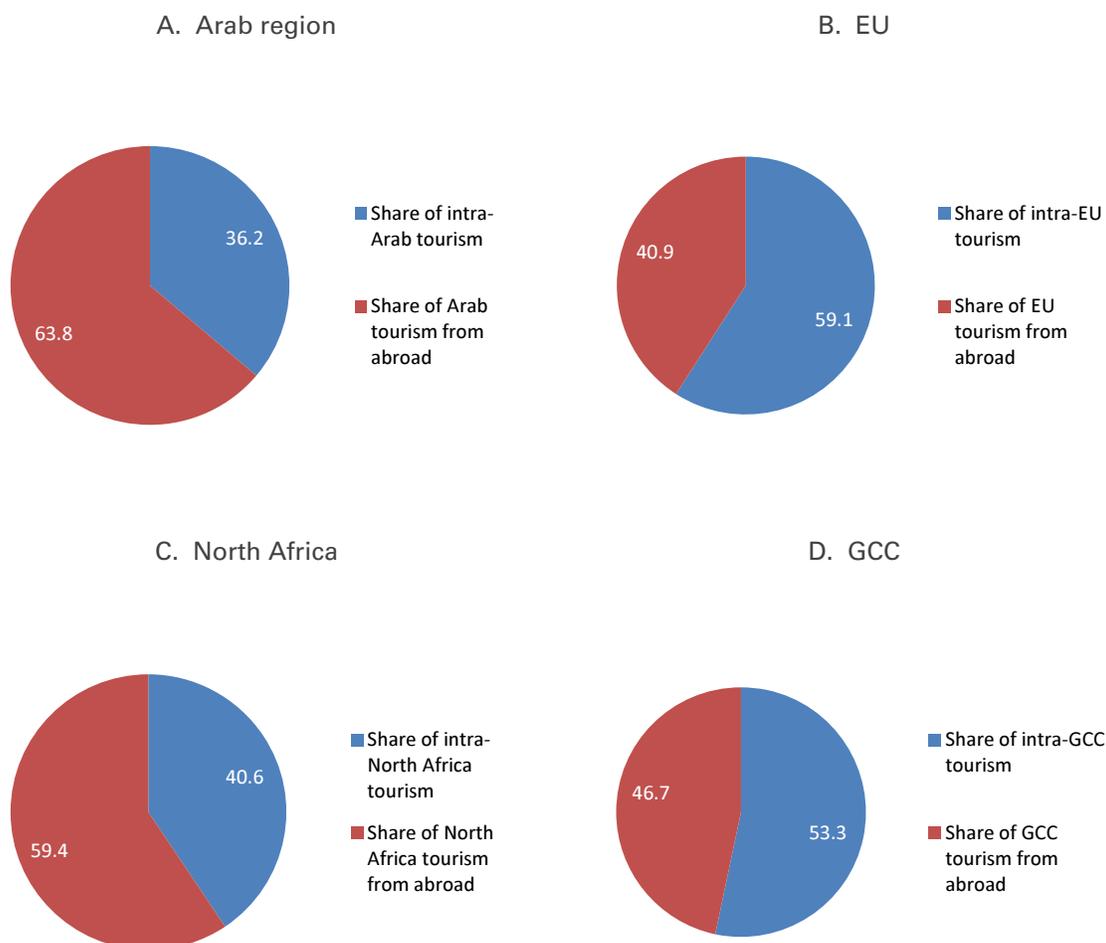
Source: ESCWA calculations using the AEISI.

3. Regional tourism agreements

In the past few years, many Arab Governments, including Oman and Qatar, have planned and implemented tourism-friendly policies.[42] The development of bilateral and regional agreements to promote travel corridors between complementary tourist locations or to ease travel procedures across borders, including through visa policies and transport infrastructure, can be considered as an important element of any regional integration policy.

The League of Arab States has been promoting intraregional tourism and lobbied Governments for increased investments in the region. This led to the creation of the Arab Tourism Ministerial Council, which implements League of Arab States

recommendations and promotes the Arab tourism industry. Moreover, the League of Arab States established the Arab Tourism Organization, based in Jeddah, as one of its independent bodies, with a mandate to support the development of the tourism sector in the Arab region. One of its main objectives is to strengthen its financial operations and create an Arab tourism bank to capitalize $2 billion by serving Arab countries to structure and manage several investment funds focusing on the tourism sector.

Border crossings for Arab travellers have been facilitated by a new set of policies, in addition to those stated above within the GCC and some UMA countries. Other Arab countries (Egypt, Jordan, Lebanon and Syrian Arab Republic) eliminated visa requirements for tourists from the Gulf to encourage Arab tourism. The authorities in Saudi Arabia have proposed the creation of an "Umrah" visa to promote off-season religious tourism.

Intra-Arab tourism still faces challenges, including weak cooperation in tourism, limited low-cost travel solutions and the inadequate provision of tourism products (ESCWA, 2008). Some Arab countries have strong tourism-based economies (for example, Morocco), while others are temporarily suffering owing to political situations (for example, Lebanon and

Tunisia) or are likely to see tourism struggling in the near future (for example, Egypt, Iraq, Palestine, Syrian Arab Republic and Yemen). Subregions still face many connectivity impediments, and security issues are curbing any evolution on economic integration.

Overall, intra-Arab tourism has significant potential and will return to a positive trajectory, with prosperity for Arab States, if these challenges can be overcome.

G. Summary

This chapter elaborated on several key variables from the preceding AEISI, addressed the background policy environment and delved into greater depth regarding the trends of specific sectors. Overall, there is a need for greater economic integration across the Arab region in order to boost productive capacities for growth and job creation. There are indeed many sectors of high potential in which the Arab region already competes globally, and where greater intraregional trade and integration are possible. Further sectors that will unlock greater integration across the region and that deal with more functional aspects of integration are addressed in chapter IV.

IV. Facilitating factors and structural elements for integration

The Arab region holds a number of assets that could play an important role in its efforts to integrate. These include existing and growing physical infrastructure, particularly strong natural resource endowments and pipeline networks that cut across the region; roads and ports; and improving measures to facilitate trade, particularly in services and regional tools for financing. Yet, in each of these fields, binding constraints are preventing the region from pooling its resources and creating closer-knit joint markets to spur integration. Indeed, the state of other infrastructure and other central factors for greater integration remain latent or non-existent, such as rail and cross-border electricity exchange, existing barriers to trade and the expansion of pan-Arab financial institutions. This chapter examines in detail the status of these structural elements across Arab countries and provides an assessment of these and other facilitating factors for integration. As in chapter III, this incorporates an analysis of progress made on a number of fronts, the challenges faced and potential for future integration in light of current and planned policies. This is accompanied by further comparisons with the EU and ASEAN for both best practice scenarios and lessons to draw on. The chapter addresses the facilitating factors of energy, water, transportation, trade and financing.

A. Energy cooperation: from oil exports to electricity exchange

The energy sector has played a vital role in the socioeconomic development of Arab countries, given that many are endowed with large hydrocarbon resources and have huge potential for renewable energy, such as solar and wind. Yet, despite these assets, there are still nearly 36 million people in the region with no access to modern energy services (Arab Union of Electricity, 2013). Regional energy cooperation is minimal, with a situation unsustainable at several levels, and aggravated by systemic inefficiencies in patterns of energy consumption and production. Fostering energy exchange and integration across Arab countries can improve stability in production and consumption of energy products and encourage efficient use of regional energy resources.

1. The Arab energy sector

In 2012, the Arab region provided approximately 13.6 per cent of total world energy production.[43] Arab natural gas production alone reached 16 per cent of world production in 2013, with Qatar being the largest and most significant producer in the region (British Petroleum, 2014). Yet, there are great imbalances between Arab countries in terms of energy endowments and consumption patterns. While intraregional trade of energy

products has been increasing in absolute terms, it has in fact decreased as a share of total energy trade from an already low 6.7 per cent to 5 per cent between 1995 and 2012.[44]

Oil and gas consumption as a percentage of production in Arab countries has steadily risen over several decades, increasing from 5 per cent in the 1970s to 25 per cent in the 1990s, and to about 35 per cent in the past decade through to 2012 (IEA, 2014). Arab countries are going through a remarkable energy transition; the region is changing its role from a source of supply to a growing demand centre with, for example, average annual demand growth of over 10 per cent in Libya, Qatar, United Arab Emirates and Yemen during the 2000s (Fattouh, 2014). Yet, increasing consumption is also facilitated by significant energy subsidies to consumers in many countries.

The differentials in sources of energy generation across Arab countries can be noted in figure 4.1. Many countries still rely heavily on oil, indicating potential for improved regional trade in natural gas. The use of hydro and renewable sources, while growing, is still quite limited. When compared with the EU and ASEAN, the Arab region's fuel sources are far less diversified, and also reflect oil, gas, and hydroelectric endowments (figure 4.2).

Arab countries also have great heterogeneity in energy consumption patterns. GCC countries reported between 3.5 and 9.4 times the world average level of per capita energy use, whereas most countries in UMA and the rest of the Arab region used less energy per capita than the world average (World Bank, 2014a; IEA, 2015).

Arab countries are using more energy to produce the same level of GDP compared to the EU and ASEAN. As measured by "energy intensity", the Arab region used 119 kg of oil equivalent to produce $1,000 GDP in 2011, up from 113 kg in 2000. This figure has fallen from 114 to 95 in the EU, and from 132 to 114 in ASEAN over this period.[45] The ratio is particularly high for several Arab countries, such as Bahrain, Libya and Oman.

Figure 4.1 Electricity production in Arab countries by fuel source, 2012
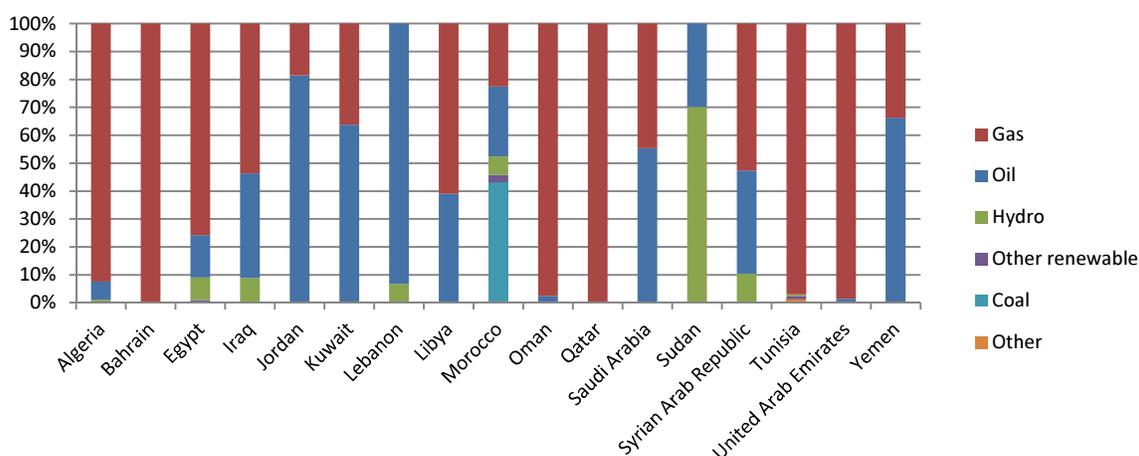
Source: ESCWA calculations using the AEISI.

Figure 4.2 Regional electricity production by fuel source, 2012
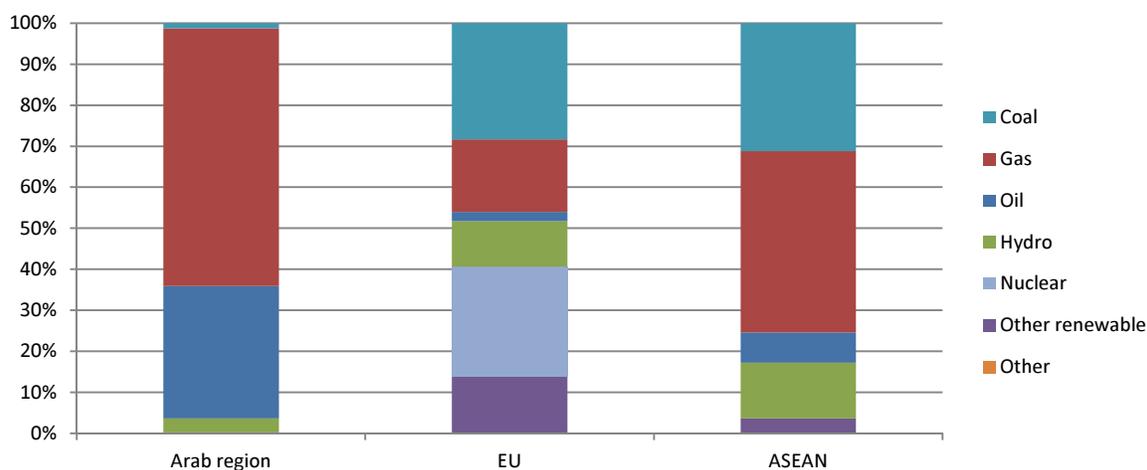
Source: ESCWA calculations using the AEISI.

2. Progress on regional energy cooperation

Energy cooperation in the Arab region falls into two broad categories: cooperation to build and harmonize regional oil and natural gas pipelines, and cooperation to build regional electricity grids.

(a) Cross-border pipelines

Arab countries have aimed to connect major oil fields to consumer markets in Europe by constructing cross-border oil pipelines from the Gulf to the Mediterranean. However, subregions are greatly disconnected from one another; for example, only 1.1 per cent of oil exported from North Africa is destined for the rest of the Arab region, none of Algeria's sizeable natural gas exports go to the region, and while Qatar does export 19.9 billion cubic metres (m^3) of natural gas to the region by pipeline, none of this flows to North Africa, and only 3.3 billion out of its total 105.6 billion m^3 of liquefied natural gas

exports are to the region (British Petroleum, 2014).

The region has constructed several cross-border oil pipelines. The Suez-Mediterranean pipeline, which was established by Egypt, Kuwait, Qatar, Saudi Arabia and United Arab Emirates in 1977, transports crude oil from Ain Sukna on the Red Sea to Sidi Kerir on the Mediterranean through two parallel pipelines 320 km in length (Arab Petroleum Pipelines Company 2015).

Bahrain and Saudi Arabia have recently agreed to lay a new 350,000 barrel-per-day oil pipeline by 2018 between the two countries (Reuters, 2015). Cross-border pipelines also feed greater supplies into the region's growing refining industries, with greater focus on higher value-added oil products (Christie and Dipaola, 2014). According to data from the United States Energy Information Administration, the Arab region has over 56 refineries, with many more planned, having a current refining capacity of

around 88 million barrels per day, or 9 per cent of total global capacity. The importance of regional oil pipelines has substantially decreased due to the emergence of supertankers that can travel to major external markets with larger quantities of crude oil. However, security concerns in the region, particularly around the Strait of Hormuz, underline the continued importance of pipeline connections.

The Arab Gas Pipeline aims to connect Egypt (the producer) to Jordan, Syrian Arab Republic, Lebanon and Turkey. The first phase connecting Egypt and Jordan was completed in 2003, and it is currently being connected to Lebanon and the Syrian Arab Republic, while the connection onward to Turkey has been delayed (the World Bank, 2010). There have also been discussions on establishing a GCC gas pipeline covering the Gulf subregion, but parties have not reached an agreement. Instead, the Dolphin pipeline was built between Qatar and the United Arab Emirates, and started to operate in 2007. This pipeline is further connected to the existing Eastern Gas Distribution System between the United Arab Emirates and Oman, so that Qatari gas is first transported to the United Arab Emirates and then to Oman (Dargin, 2008). Weaknesses in connectivity between Arab countries have led to gas shortages despite the abundance of natural gas; and to date, the Dolphin and Arab Gas Pipelines remain the only two regional Arab natural gas pipelines.

(b) Interconnection of electric grids

Interconnectivity of electric grids among Arab countries has been increasing; and while there is still a need for greater regional cooperation, there have been important achievements. As illustrated in figure 4.3, three significant electric grid interconnections are notable, namely: the Eight Country Interconnection Project (EIJLLPST, incorporating Egypt, Iraq, Jordan, Lebanon, Libya, Palestine, Syrian Arab Republic and Turkey); the Maghreb Countries Interconnection Project (Algeria, Libya, Morocco and Tunisia); and the GCC Power Grid Interconnection Project. Together, these subregional connections create a so-called "Arab power grid" that connects most Arab countries to each other, and also to Europe, Turkey and elsewhere. This regional interconnection of electric grids represents one means of coping with energy shortages and the lack of generation capacity to serve increasing demand, which is recorded even in the GCC (Economist Intelligence Unit, 2010).

Electric grid connectivity has been growing, and total energy exchanged within the region increased from 15.9 terawatt-hours (TWh) in 2007 to 26.3 TWh in 2012 (Arab Union of Electricity, 2013). However, as a percentage of total electricity production, this only increased from a negligible 2.5 to 2.7 per cent over this period. In comparison, energy exchanged across borders in the EU accounts for 15 per cent of energy production; and of Arab countries' cross-border energy exchange, most imports originated outside the region (ENTSOE, 2015). This highlights the overwhelming concentration of imported electricity among the cross-border electricity trade, and the need to facilitate greater intra-Arab electricity trade.

Figure 4.3 Interconnectivity of electricity networks in the Arab region
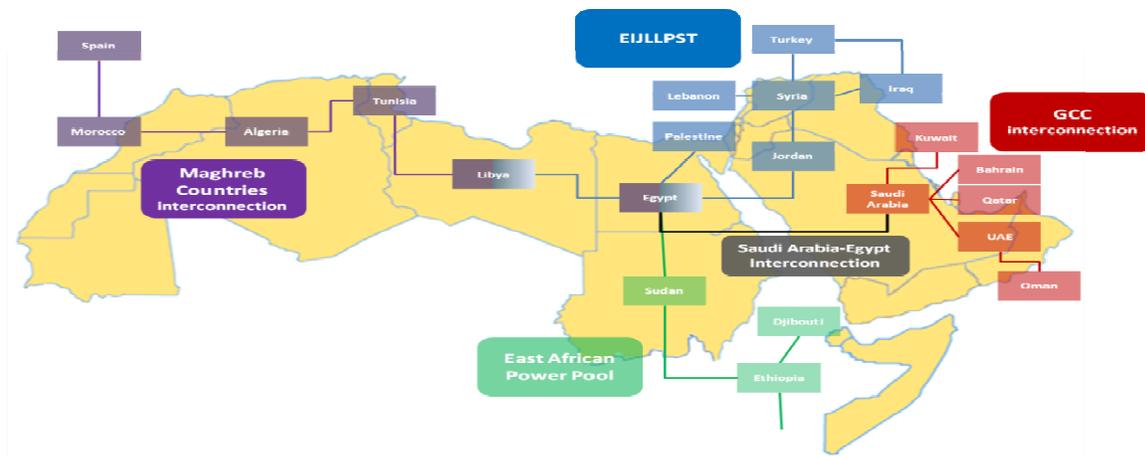
3. Renewable energy

Renewable energy resources could play a major role in enhancing energy exchange in the Arab region. Renewable energy represents a small share of the Arab region's electrical production; the region's 9.7 gigawatts (GW) of installed hydroelectric capacity is found only in Egypt, Iraq, Morocco, Syrian Arab Republic and the Sudan.[46] Regional cooperation in the area of renewable energy is not yet fully entrenched, but the adoption of the Pan-Arab Strategy for the Development of Renewable Energy Applications: 2010-2030 by the third Arab Economic and Social Development Summit of 2013 represents an important milestone, with Arab Governments coming to a consensus on long-term targets, such as reaching more than 107 GW of installed power generation capacity in Arab countries by 2032, with a greater variety of renewable energy sources beyond hydroelectricity.[47] Arab countries are embarking on other ambitious renewable energy projects, such as the Ouarzazate solar energy facility in

Morocco, and increasing focus on solar energy alternatives in the GCC.

4. Regional energy governance

Arab countries have established a number of regional organizations to support and foster energy integration. The main activities of the Organization of Arab Petroleum Exporting Countries (OAPEC) are targeted for its ten member countries,[48] including the Arab Energy Conference, which is also sponsored by the League of Arab States and the Arab Industrial Development and Mining Organization and aims to formulate a pan-Arab perspective on energy issues and to encourage coordination of Arab institutions on energy-related issues. OAPEC has also established five joint ventures with member countries as shareholders in order to promote cooperation and economic integration in the Arab hydrocarbon and petrochemical industry. The Arab Ministerial Council for Electricity, consisting of Arab ministers responsible for the energy sector, was established in 1994 and was

responsible for coordinating and approving the Pan-Arab Strategy for the Development of Renewable Energy 2010-2030. It has played an important role in bringing Arab countries together to discuss regional energy policies and strategies, specifically regarding electricity and renewable energy.

Yet, despite these entities, there is no supranational institution that brings all Arab Governments together to discuss and decide upon regional energy policies governing oil, gas, electricity and renewable resources. As a result, regional cooperation has been somewhat limited, and energy importing countries have not actively engaged in regional cooperation in the sector.

B. Water resources: cooperation to address scarcity and vulnerability

The Arab region has long suffered from scarce water resources. Most Arab countries are reported as water poor, measured by total renewable water resources per capita, and a rapidly increasing population places further strain on available resources. Overall, 66 per cent of freshwater resources in the Arab region cross one or more international borders, thereby complicating the ability to manage and allocate water resources for national development purposes (UNESCO, 2013). Climate change is also expected to amplify water challenges as climate models generally predict an increase in temperature and evapotranspiration rates as well as more extreme weather-related events, such as droughts and floods, in most parts of the region (ESCWA, 2011). The solutions to these regional

challenges lie in close cooperation and common strategies among Arab countries.

1. Water sector overview

(a) Water resources

Located in arid and semi-arid areas, the water scarcity of Arab countries is well-known. As of 2011, long-term annual average precipitation in all 22 Arab countries was less than 1,000 mm, while Algeria, Bahrain, Egypt, Libya, Mauritania, Qatar, Saudi Arabia and United Arab Emirates reported even less than 100 mm (FAO, 2015). Meanwhile, the regional population has jumped from 94 million in 1960 to 370 million in 2013, and is estimated to reach 604 million in 2050 (ESCWA, 2013a; the World Bank, 2014a). In 2011, 18 out of 22 Arab countries had less than 1,000 m^3 (or 1 million litres) of total renewable water resources per person, which is generally considered as a water poverty line. In the case of Bahrain, Kuwait, Qatar, Saudi Arabia, United Arab Emirates and Yemen, total renewable water resources available per person were even less than 100 m^3. As the regional population continues to grow, water pressures are likely to be more severe in the future.

(b) Dependency ratio

The water dependency ratio, measured by the percentage of freshwater resources originating outside of a country's territory, is quite high in the Arab region (figure 4.4). This is not surprising given that major rivers in the region, including the Nile, Euphrates and Tigris, are shared among countries inside and outside of the Arab region, while many Arab countries are located downstream in receiving water resources.

Figure 4.4 Water dependency ratio of selected countries, 2014
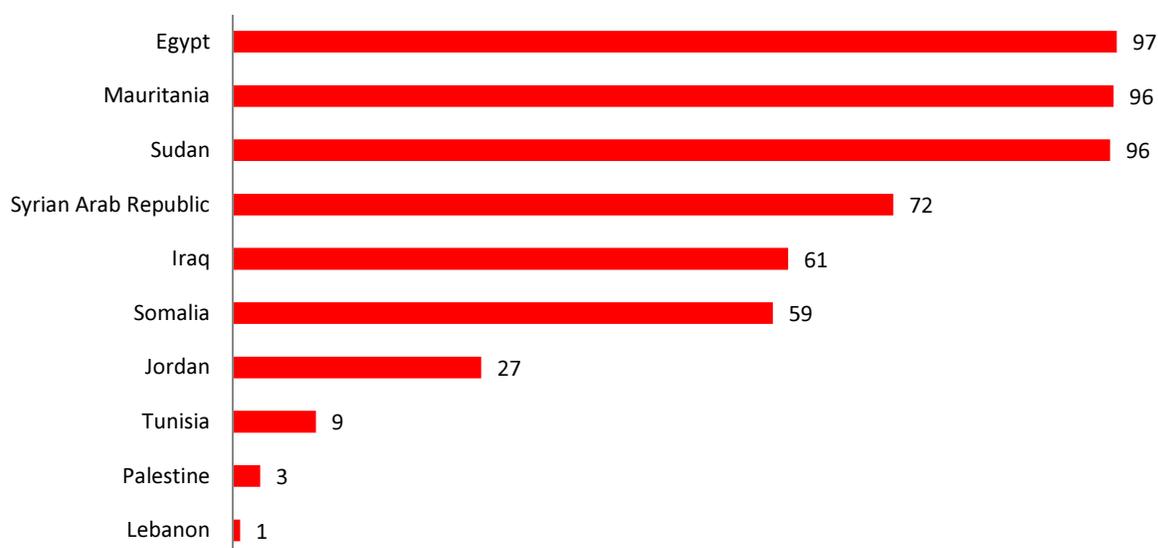
Source: ESCWA calculations using the AEISI.

Sharing these water resources has been a source of political instability in the region. Dam construction in upstream countries has often been challenged by downstream countries, as in the case of Iraqi and Syrian opposition to Turkish dams on the Euphrates and the Tigris. The ownership and use of freshwater resources from the Occupied Golan Heights and the Jordan River have been central to the conflicts on occupied territories in the region (Abu Ju'ub, 2003). Upstream countries on the Nile have also questioned the water allocation agreement recognized by Egypt and the Sudan, and further issues have developed regarding dam construction in Ethiopia. Cooperative management of shared water resources among countries sharing common basins will be a crucial element of Arab regional integration.

(c) Water withdrawal

The majority of water in the Arab region has been withdrawn for agricultural purposes, in line with global trends, but with some cases of particularly and unsustainably high use for agriculture (figure 4.5). Some countries, including Somalia, the Sudan and Yemen, withdrew more than 90 per cent of their water resources for agriculture in 2013, while the majority of Arab countries allocate more than two-thirds of water withdrawal for agriculture. The heavy usage of scarce regional water resources in the water-intensive agricultural sector, often due to food self-sufficiency and political reasons, is not sustainable and calls into question the priorities of water usage across the region.

Figure 4.5 Sectoral water withdrawal by country and region, 2013
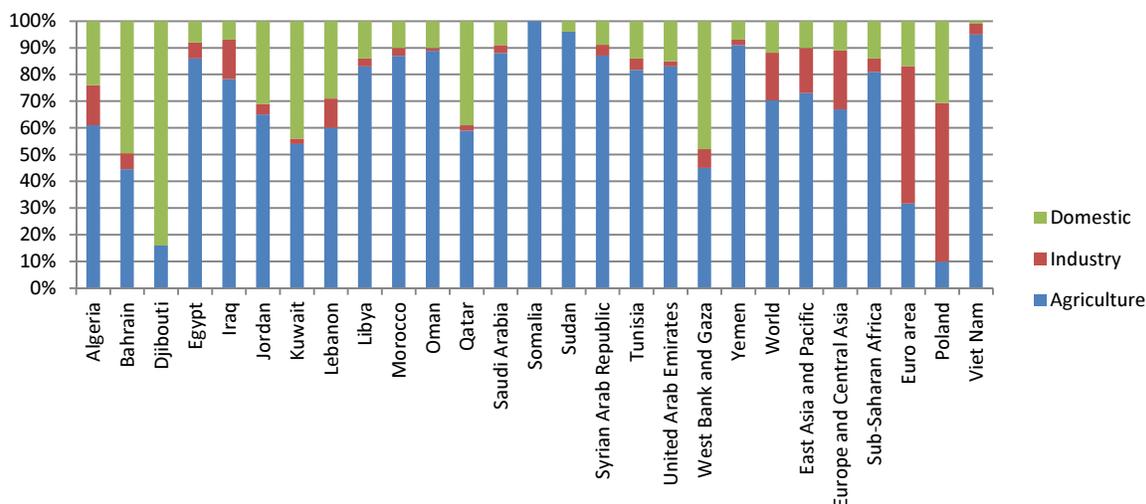
Water intensity, as measured by water withdrawal per $1,000 GDP, is particularly high for the agricultural sector, as a direct result of the arid nature of most Arab countries and low efficiency regarding irrigation techniques used and other aspects of agriculture in the region. For example, the Arab region consumed about 1,323 m^3 of water for agricultural products worth $1,000 in 2013, while the industrial sector consumed only 11 m^3 of water resources per $1,000.[49] In contrast, the EU actually consumed more water per $1,000 in industry (29 m^3), but far less per $1,000 in agriculture (217 m^3). Focusing on agriculture in a water-scarce environment is a main challenge in this situation. While the Arab region must cooperate in harnessing its water resources to improve access and the meeting of basic water and sanitation needs, regional agreements should also weigh the potential efficiency gains from a redistributed water allocation among sectors, and the impact this would have on rural livelihoods. However, it is not only agriculture,

but rather also growing urban demand due to growth in population, tourism and manufacturing that is additionally straining on the region's water resources, warranting a closer examination of opportunities for regional cooperation to address water scarcity.

(d) Desalination

While insufficient water resources in the Arab region have been exacerbated by excessive water withdrawal from depleting aquifers, some countries have actively invested in the production of non-conventional water resources. Six Arab countries are listed among the top 10 desalinating countries in the world, including Saudi Arabia (ranked top), the United Arab Emirates (2), Kuwait (4), Algeria (5), Qatar (7) and Libya (10) (Water World, 2013). However, the production of freshwater through desalination requires large amounts of energy, capital and infrastructure. As a result, desalination plants have been constructed only

in Arab countries that are already rich in energy and financial resources. Nevertheless, the cost of desalination has been decreasing with continuous research and development investment, and regional cooperation and coordination can help to spread more affordable technologies and new methods for desalination. Tunisia is already planning to pursue water desalination.

(e) Virtual water

Virtual water measures the amount of water required to produce a unit of a certain product. For example, 15,400 litres of water is required to produce 1 kg of beef, while 1,600 litres of water is needed to produce 1 kg of wheat bread, with industrial products requiring less (Water Footprint Network, 2015). An analysis of virtual water in trade suggests that the region can fill water shortages to a significant extent by importing water-intensive products and exporting less water-intensive products. According to Mekonnen and Hoekstra (2011), Arab countries have shown different performances in virtual water trade. Specifically, Algeria, Saudi Arabia and Yemen effectively imported virtual water from trade in crop, animal and industrial products between 1996 and 2005. However, several countries recorded losses of virtual water, including Djibouti, Somalia, Syrian Arab Republic and Tunisia. Addressing water stress in the Arab region, for example through these trade patterns, should be a tenet of regional integration efforts to reach win-win scenarios among Arab countries in the collective use of water resources and to capitalize on virtual water potential.

2. Progress on Arab regional water cooperation

The development of regional institutions to foster communication, coordination and cooperation between Arab countries is a crucial element for sustainable management of shared water resources. The following areas of progress and agreement have been reached regarding water cooperation.

(a) Arab Ministerial Water Council (AMWC)

In 2008, the Arab Summit called for the formation of the AMWC as a body of the League of Arab States, in order to create a standalone ministerial council aimed at establishing regional institutional mechanisms for coordinating strategies, plans and policies to examine and collectively address growing water challenges facing the region; and at exchanging experiences and best practices among Arab countries.

(b) Water monitoring services

The first session of AMWC in Algiers in 2009 led to the establishment of a regional mechanism for improved monitoring and reporting on access to water supply and sanitation services in the Arab region.

AMWC prepared the Arab Strategy for Water Security in the Arab Region to Meet the Challenges and Future Needs for Sustainable Development 2010-2030, which was adopted in 2011. A draft legal framework on shared water is currently being developed, and other bilateral agreements exist between neighbouring countries regarding water use in the region.

3. Comparisons with other regions

Other regions have reached comprehensive agreements regarding shared water resources. ASEAN member countries established a long-term strategic plan for water resources management in 2012, with the vision to attain "sustainability of water resources to ensure sufficient water quantity of acceptable quality to meet the needs of the people of Southeast Asia in terms of health, food security, economy and environment" (ASEAN, 2005). The plan identifies a large project portfolio, and it has resulted in several completed projects.[50] The Mekong River Commission is an example of a subregional body overseeing the governance of the shared water resources of countries along the Mekong River.

There has been a history of water agreements in the EU, including the 1992 Convention on the Protection and Use of Transboundary Watercourses and International Lakes (which has been opened to adoption by countries outside the region as well), and the 2000 Water Framework Directive aimed at addressing concerns regarding water degradation in the region, which covers general water policy, river basin management and coordination between members (EU, 2015). This has also been followed by a common implementation strategy. The Directive involves coordination at the basin level rather than along country lines, and promotes cooperation between countries and the use of best practices. The Danube River Protection Convention is an example of spreading the tenets of the directive to cooperation with non-EU countries as well. Several Arab countries are also signatory to the United Nations Convention on the Law of the Non-navigational Uses of International Watercourses.[51]

C. Transportation: investments needed in maritime, rail and improved customs procedures

Transport plays a crucial role in economic growth and development. It facilitates the movement of products and production factors, thereby fostering trade, investment and tourism, and enabling countries to integrate regionally and globally. Efficiency of transport is a major determinant of competitiveness and depends on both the existence of a modern infrastructure network for transport and the availability of competitive transport services.

In the Arab region, transport has seen significant progress over the past half century due largely to the discovery of oil in most parts of the region, which led to sustained investments in the infrastructure for transport.

The role of developed cross-border transport infrastructure is crucial for regional development and regional integration. It allows for smooth and increased intraregional trade and investment, and thus regional development. Yet, despite progress, regional connectivity and ease of transport requires significant attention in order to foster greater integration and connectivity.

1. Road transport: the main means of intra-Arab connectivity

Road transport is the dominant mode of transport in the Arab region owing mainly to

close proximity, existence of a good road network between all countries, subsidized fuel prices in many Arab countries, cheap labour costs, lack of regional railways and of regular direct maritime shipping lines between Arab ports.

However, despite this, shipping across countries in the region is characterized by a high degree of inefficiency that can be attributed to the following: complicated customs procedures applied to shipments when crossing borders; lack of harmonization of regulations in Arab countries concerning standards of trucks; poor quality of some national fleets that prevents them from entering the territories of other countries; difficulties in obtaining visas for truck drivers; and non-application of international transport agreements.

Long delays at borders increase the overall cost of transport. A survey of costs, time and distance on some international corridors in the Arab region between 2012 and 2013 indicates that trucks spend on average 48 per cent of their journey times waiting at borders.[52] Table 4.1 illustrates that the average speed of trucks on those corridors is around 12 km/h, a low speed compared to 15 km/h for the region of the

Economic Cooperation Organization (ECO).[53] Equally notable are the longer waiting times at borders in the Arab region, but also the far lower level of unofficial payment as compared with the faster ECO. Furthermore, average costs on Arab road transport corridors stand at an average of $0.24/km, with costs in some corridors in particular reaching $0.49/km.

Efforts are being made to improve the conditions of road transport in the Arab region. In 1999, ESCWA member countries reached a consensus on the need to develop a comprehensive agreement for trade and transport facilitation and integration, which culminated in the creation of the Agreement on International Roads in the Arab Mashreq. The Agreement was developed under the umbrella of the Integrated Transport System in the Arab Mashreq (ITSAM), which links countries of the subregion. It was adopted on 10 May 2001 and entered into force on 19 October 2003.[54]

According to provisions of the Agreement, the length of the international road network is expected to reach 35,900 km. As of 2014, the Agreement had been ratified by 13 Arab member countries and implementation has been estimated at more than 95 per cent.[55]

Table 4.1 Comparison of transport in League of Arab States and ECO countries

	League of Arab States (NELTI 4)	ECO (NELTI 3)
Average speed per journey	11.8 km/h	14.6 km/h
Average distance per day	283 km	351 km
Average waiting time in queues at borders	48% of total journey time	17% of total journey time
Average unofficial payment	$24	$718

Source: Islamic Development Bank, International Road Transport Union and Arab Union of Land Transport (2013).

2. Railway transport: the need for investment and development

The need to focus on railway development is evidenced both by the dominant role of road-based transport outlined above, and the efficiency gains that can be reaped from transport through rail corridors. The Arab region has one of the lowest rail network densities in the world, with most freight and passengers moving by road, air or sea (The Economist, 2014). For many countries, such as Lebanon, railway networks did exist but fell into disrepair. As of 2013, the total length of railway routes in the region was around 33,000 km spread through only 11 Arab countries. Across the region there exist four different gauge sizes as found in Algeria, Iraq and Tunisia (1000mm); Jordan, Lebanon and the Syrian Arab Republic (1050mm); Algeria (1055mm); and the Sudan (1067mm) (Sabouni, 1997).

GCC countries have recognized the need for an integrated transport system and are planning a vast 2,000 km Gulf railway network to run from Kuwait in the north through Saudi Arabia, Bahrain, Qatar and the United Arab Emirates, to the southern port of Salalah in Oman. The target for completion is 2018.

In UMA, Morocco and Tunisia are planning a railway to connect Tangiers, Casablanca and Rabat with Tunis through Algeria. Railway companies in both countries have coordinated plans for a possible high-speed passenger line, pending political will and despite regional tensions. There are also plans for a railway from Tunisia through Libya and to the Egyptian border, which is envisaged to haul freight over a distance of 2,178 km.

Several railway projects are planned for the rest of the Arab region. Jordan has initiated a national railway network in 2009 aiming to cover its national territory and connect to Iraq, Saudi Arabia and the Syrian Arab Republic with a total length of 897 km (RaillyNews, 2012). Within the framework of ITSAM, the 2005 Agreement on International Railways in the Arab Mashreq aims to establish an international railway network in the subregion, with 11 ratifying countries. Based on provisions of the Agreement, the length of the international railway network is expected to reach 20,896 km. Overall, the rate of implementation of agreements in the region is over 70 per cent according to the national reports received by ESCWA in 2014.

3. Maritime transport: high potential

Access to international shipping and efficient port services are very important for a country's competitiveness. The Arab region is strategically located on the highly active global trade route linking growing economies of East and Southeast Asia with Europe.

Regarding the integration of Arab countries into global liner shipping networks, as measured by UNCTAD's Liner Shipping Connectivity Index, figure 4.6 illustrates that, while there are high performing and improving Arab countries, many also lag behind global competitors in their capabilities to support trade through an efficient shipping system.[56]

Figure 4.6 Liner Shipping Connectivity Index: score and global ranking, 2004 and 2014
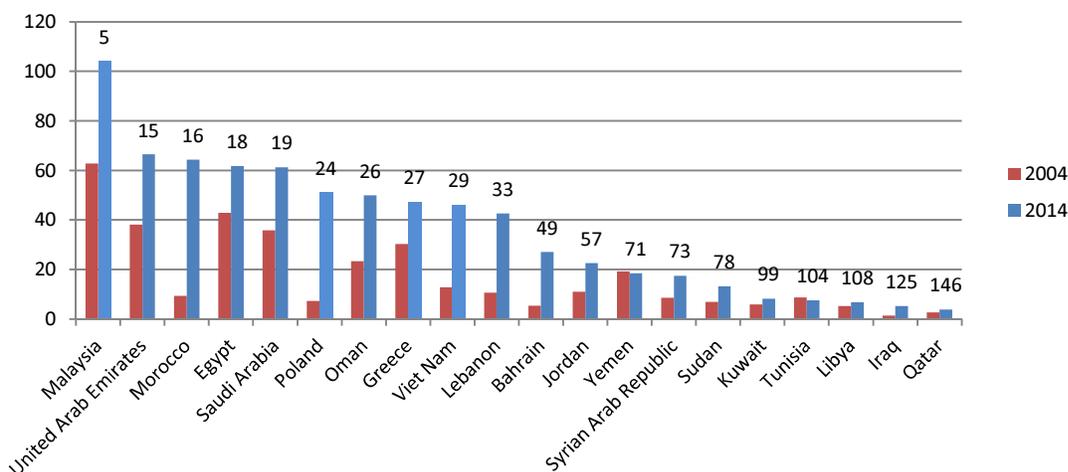
Source: UNCTAD (2014b).

Notes: The maximum score for 2004 is 100; and the global ranking refers to 2014.

The score is expressed by the y-axis, and the ranking by the numbers above the bars.

Container port throughput is also used as a proxy tool to measure port activity and allow for comparison at the regional and global levels. Overall, the Arab region's container throughput grew by more than 75 per cent between 2008 and 2013, and maintained a stable share of around 7 per cent of world container traffic, thereby indicating its status as a hub for trans-shipment to other regions.[57] The United Arab Emirates had the ninth highest throughput globally in 2013, accounting for roughly 3 per cent of global activity, and Egypt was the next highest Arab country with roughly 1 per cent.

According to the Institute of Shipping Economics and Logistics, four Arab countries feature among the world's 35 largest national fleets of ships, namely: Saudi Arabia, the United Arab Emirates, Kuwait and Qatar (UNCTAD, 2012). This follows an observed trend of oil exporters owning their oil tankers, as compared with exporters of containerized cargo.

The Memorandum of Understanding on Maritime Transport Cooperation in the Arab Mashreq was developed in line with ITSAM to coordinate maritime policies and establish cooperation among signatories in order to achieve efficient and effective maritime transport-related activities and services of seaports and harbours. So far, while it has been ratified by 10 Arab countries, there has been no significant progress made on implementation. However, there has been some unilateral progress on maritime shipping, for example Egypt's widening of the Suez Canal to accommodate more shipping.

4. Air transport: the Arab region as a global player

The air transport sector is gaining more importance with the emergence of global value chains which require the collection of inputs to a product from various parts of the world and

within a limited time. In addition, the development of tourism is highly correlated with the geographical coverage of air transport connections and the cost of their services. Such developments have induced massive improvements in the industry both at the infrastructural and the operational levels.

In terms of passenger traffic carried by the 29 airlines of the Arab Air Carriers' Organization (AACO), Arab air transport grew from 105.6 million passengers in 2009 to 176.3 million in 2014, while cargo transported grew from 3 to 5.3 million tons over the same period (AACO, 2015). Most of this growth can be attributed to the substantial investment in air transport infrastructure made by some countries in the region seeking to become regional and global hubs.

Passenger air travel and cargo shipments in GCC countries have developed much faster than the rest of the region, particularly in Qatar and the United Arab Emirates. Ongoing expansion projects of airports and airlines emphasize long-haul networks between the Gulf and global destinations, with much smaller increases in capacities linking the rest of the region (ESCWA, 2007a).

The competitiveness of the air sector in many countries in the region can also be attributed to the comparatively low cost of labour, State support of aviation firms and low fuel costs. Yet this advantage may be lost if global oil prices remain low, weakening the position of some Arab carriers that have been benefiting from relatively cheap fuel as compared with other airlines.

5. Customs clearance procedures

Following more than half a century of negotiations within the context of the GATT that brought tariffs to historically low levels, attention has shifted to the constraints posed by non-tariff barriers and technical barriers to trade. These barriers cover a wide range of issues that can hinder international trade, including the process and procedure of clearing goods through customs facilities. Customs processes and procedures can be major factors in determining the cost of trade. Inefficient customs procedures lead to a longer stay of goods in customs territories, thereby adding costs to the price of goods.

While a few Arab countries have managed to facilitate imports and exports by various measures, including reducing the document requirements which has led to the reduction of the number of days necessary to release a container from the port, many countries still lag behind. This is evident in country performances on the Trading Across Borders indicators, particularly regarding the days required to export (figure 4.7). Few countries have been able to reduce the document requirements to under four (which is the average number of documents required in OECD countries), while the remaining still require many documents and days to clear a shipment from customs. Moreover, within the Logistics Performance Index, the Arab region performs the weakest regarding the customs subindicator (figure 4.8), confirming the long queue time for trucks at borders discussed above.

Figure 4.7 Time required to import and export, 2014 (days)
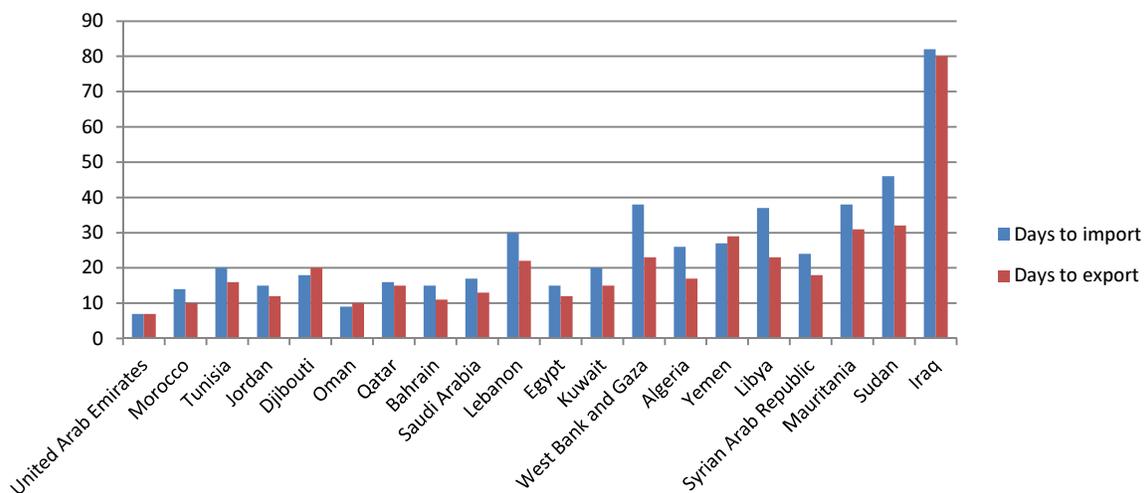
Figure 4.8 Performance of Arab countries in the various subindicators of the Logistics Performance Index, 2014
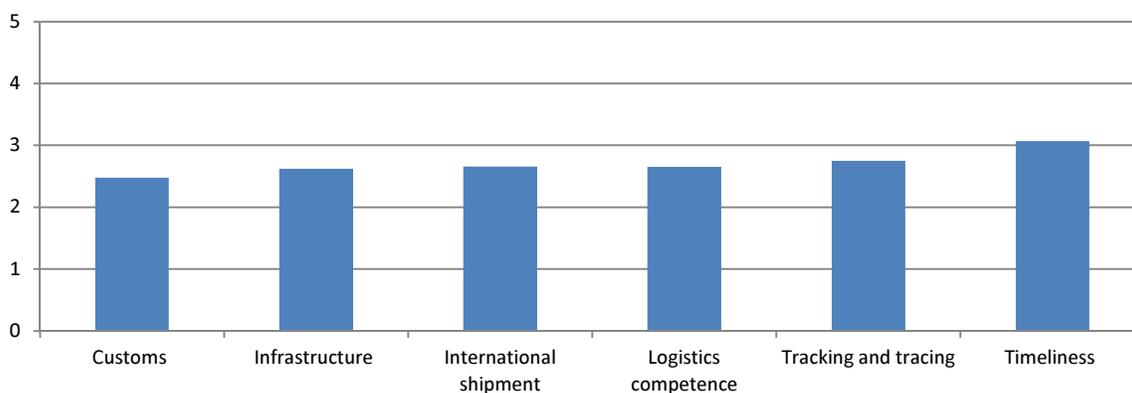
6. Conclusion

Transport in the Arab region has made much progress over the past few decades. Regional road infrastructure seems to be sufficiently developed, particularly to serve the currently low volume of intraregional trade. Yet, the cost of transport resulting from such factors as waiting time at borders is a major hindrance to connectivity in the region. Rail transport is underdeveloped, with one of the lowest coverage rates in the world. While agreements

have been made to expand rail networks for regional transport, enhanced implementation and financing is needed. Maritime transport connectivity in the region is a major issue, and despite progress in the maritime capabilities of some countries, most Arab countries have weak connectivity to international maritime networks. Air transport in the region is faring comparatively better than other modes owing to substantial investments in infrastructure and fleets, consistent with the intention of some countries to become international hubs. However, the current conflicts in many Arab countries highly affected the transport sector in terms of infrastructure, availability and cost of transport services (box 4.1).

Box 4.1 Implications of conflict on transport infrastructure: the cases of Yemen and the Syrian Arab Republic

The war in Yemen has caused massive destruction to the country's infrastructure. The United Nations Development Programme (UNDP) and the Operational Satellite Applications Programme (UNOSAT) of the United Nations Institute for Training and Research (UNITAR) released satellite images illustrating damage and destruction to Sana'a, Aden and Sa'ada. As of May 2015, buildings, roads and bridges along with private homes and businesses, public infrastructure and institutions have been completely or partially destroyed as a result of the fighting. The airports in Sana'a, Aden and Sa'ada as well as Aden's main port have been particularly damaged. Given the intensification of the conflict in mid-July 2015 (when this report was being finalized), the level of destruction is expected to rise tragically (UNDP, 2015).

In the Syrian Arab Republic, the transport sector has also been strongly and negatively affected by conflict. Losses in transport and communications were estimated at $2.8 billion through 2013 alone (ESCWA, 2014b).

D. Trade facilitation and services trade liberalization: untapped potential to drive Arab regional integration

1. Trade in services is positive for national and regional economic growth

Trade in services is an important albeit often overlooked aspect of regional trade and regional value chains. Since 2005, trade in services[58] has accounted for over 10 per cent of global GDP (the World Bank, 2014a), and about two-thirds of GDP in most developing economies (OECD, 2015b). In gross terms, while trade in services account for less than one-quarter of total trade, when accounting for the value added by services in the production of goods, it contributes to more than 50 per cent of total exports in most developed countries (Italy, France, Germany, United Kingdom and United States) and nearly one-third in China (OECD, 2015b).

Liberalization of trade in services aims to enhance efficiency and competitiveness, and research finds a strong correlation between these in a study based on a sample of 139 countries (UNCTAD, 2014a). GDP growth has also been linked to the growth of the service sector in a recent World Bank study that examined 136 countries between 2000 and 2005. A steady growth averaging 10.7 per cent has been registered in the worldwide commercial service sector from 2000-2012, owing mainly to rapid technological expansion and the "servicification" of manufacturing processes (UNCTAD, 2014a). Globally, rising levels of income are related to higher shares of services and value added in GDP.

The service sector is a major determinant of economic and trade performance of a country due to, among other factors, the facilitation and provision of inputs for productive economic activity, such as transport services, banking and communications (OECD, 2005). Compared to the production of tangible goods, services require relatively less natural and more human capital, which adds structural requirements for education systems but reduces economic dependence on natural resources (Soubbotina and Sheram, 2000). Services account for major tasks performed and exchanged in global supply chains. Their share is total value added increased from 24 to 28 per cent from 2000 to 2012, while the share of manufacturing value added decreased from 61 to 52 per cent (UNCTAD, 2014a). This increase allows for more competitive pricing and better access for SMEs to quality services that are tailored to their needs. The service sector is increasingly targeted by foreign enterprises, even more so than the goods market; and investment in the service sector climbed from 49 per cent to over 70 per cent between 1990 and 2012 (UNCTAD, 2014a).

2. Services in the Arab region

Services are important for employment, growth and trade in the Arab region. Many Arab countries are seeking to diversify into modern services, and according to the most recent A.T. Kearny Global Services Location Index, three Arab countries (Egypt, Jordan and the United Arab Emirates) are among the top 20 locations that are most accessible for offshore services (figure 4.9). Egypt is the highest ranking Arab country, despite a drop following the recent political situation, due to favourable costs, good

universities and proximity to Europe. Jordan was able to make it into the top 20 thanks to a relatively stable political situation and a small albeit strong IT and business process outsourcing industry staffed with professionals. Yet, Arab countries face competition from ASEAN, as indicated in the rankings, where less risk coupled with a multilingual workforce, competitive pricing for companies, and more Government support to businesses lend ASEAN countries an edge over their Arab competitors (A.T. Kearney, 2014).

The average share of services in GDP has remained constant in Arab countries, at approximately 44.8 per cent in 2000 and 43 per cent in 2013 (World Bank, 2014a). Countries vary in terms of the share of services in GDP, from relatively low levels in Libya and Oman, to about half of GDP in Egypt, Morocco and the Sudan, and even higher in Jordan, Lebanon, Palestine and Tunisia. Arab countries do have lower shares of services in GDP, compared with EU and global averages, and also feature greater volatility over the period 2000-2013 (figure 4.10). However, changes in the share of services in GDP may be influenced in some cases by oil price fluctuations, particularly for oil exporters. Data on employment in services is particularly difficult to calculate, but the most recent aggregate figure for the region stood at 53 per cent in 2008 (the World Bank, 2014a).

ASEAN is more comparable to the Arab region regarding the relative importance of services. The Arab and ASEAN regions feature countries at the high, medium and low ends of the spectrum of services as a percentage of GDP (figure 4.11); and countries in both regions exhibit either stagnating trends or slow growth

over the period 2000-2013, with a notable slump during the global financial crisis, particularly in the GCC subregion and in UMA countries that rely heavily on European markets.

Figure 4.9 A.T. Kearney Global Services Index rankings, 2014

Rank	Change	Country
1	0	India
2	0	China
3	0	Malaysia
4	+2	Mexico
5	0	Indonesia
6	+1	Thailand
7	+2	Philippines
8	+4	Brazil
9	+8	Bulgaria
10	-6	Egypt
11	+13	Poland
12	-4	Viet Nam
13	-3	Chile
14	+4	United States
15	-1	Lithuania
16	+5	Sri Lanka
17	+9	Germany
18	+7	Romania
19	-4	United Arab Emirates
20	+2	Jordan
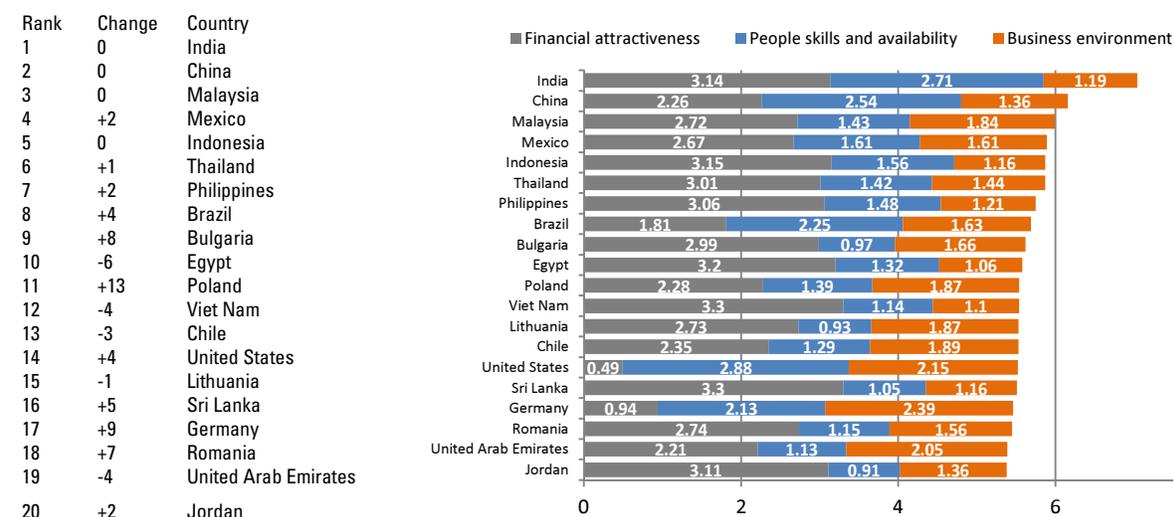
Source: A.T. Kearney (2014).

Figure 4.10 Services value added by region (percentage of GDP)
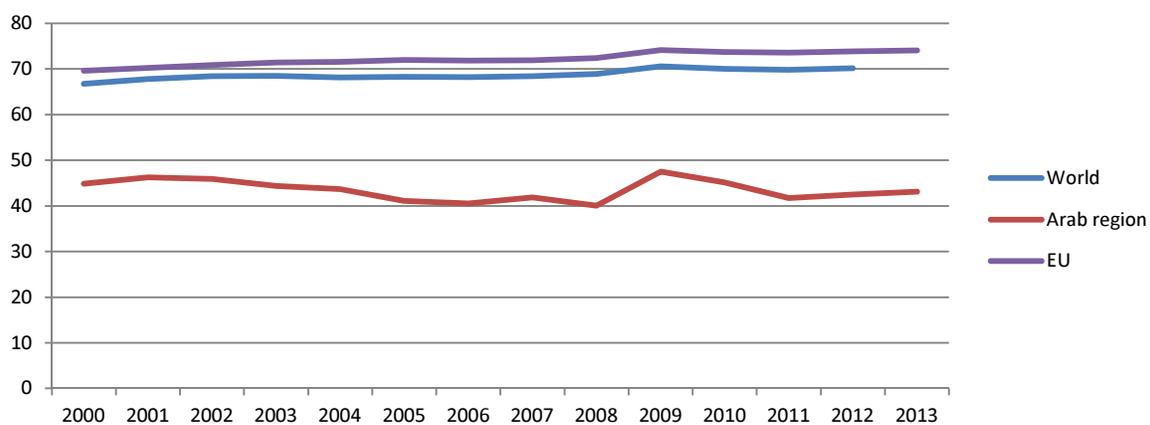
Source: World Bank (2014a).

Figure 4.11 Services value added by country (percentage of GDP)
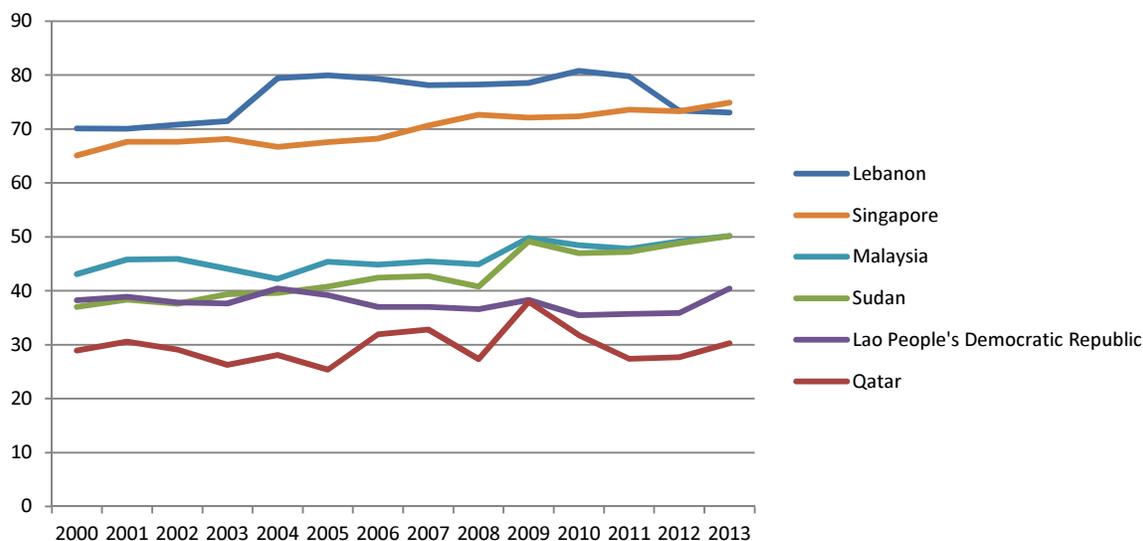
Source: World Bank (2014a).

According to data from the International Trade Centre (ITC, n.d.), Arab countries vary regarding the importance of commercial services in total services traded (figure 4.12). Interestingly, most countries in which value added services account for a large percentage of GDP have a high concentration of commercial services trade (more than 90 per cent), and thus Government services do account for a small proportion of their exported services. Countries with low overall value added services, including Bahrain and Oman, depend entirely on commercial services in their exports, and also lack diversity in terms of developing other service sectors. Travel and transportation services are the major source of trade in services for most Arab countries, and those with services value added as a large percentage of GDP also have a considerable share of other business services contributing to their export growth. This is also reflected globally, with "other business services"[59] ranking after transportation and surpassing travel and financial services exports in the period 2009-2012 (ITC, n.d.). Communication and construction services rank second after travel and transportation in contributing to the total services exported in most countries, with a service value added above 45 per cent, except for Jordan and the United Arab Emirates, where the former sector is not visible at all in exports and diversification is somewhat limited.

Figure 4.12 Commercial services by country, 2014 (percentage of total services traded)
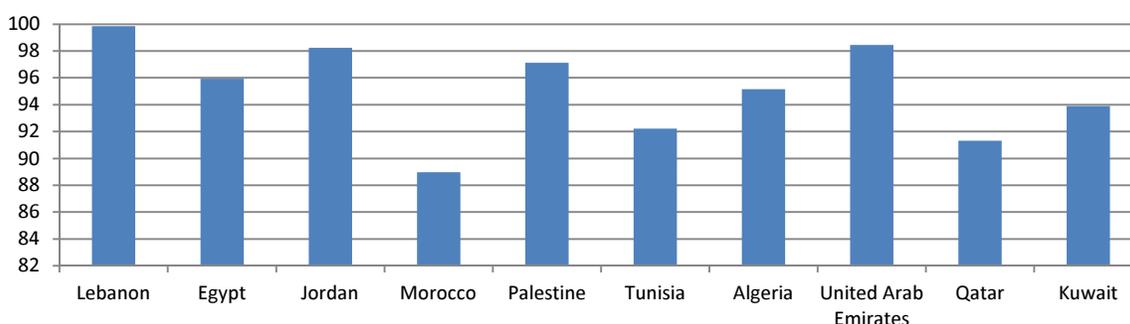
3. Services trade liberalization

Previous research suggests that "global gains in economic welfare of around $250 billion per annum would be generated by a 50 per cent cut in service trade barriers over a five- to ten-year period" (Cali, Ellis and Velde, 2008, p. 2). Regarding the Arab region, if Egypt and Tunisia underwent comprehensive service reforms, this would "yield gains 2-3 times those achieved from tariff removal" (Konan and Kim, 2004).

Liberalization of services trade is important for the goal of enhancing intra-Arab trade and diversification. Trade in services enjoys a relative resilience to crises and an increasing role in global supply chains, and an increasing potential in attracting foreign investments. The EU has focused on intraregional trade in services as a key area in its trade policies. In fact, promoting trade in services is a trade policy priority in the EU given that it wants to use external commitments to promote its own domestic services markets where EU services directives have been implemented in an ad-hoc manner by different member States. The Arab region, nevertheless, is still underachieving on the improved quality, prices and increased variety of services to be gained through actual

regional trade in services agreements that allow for "deep integration" involving behind-the-border reforms in addition to the policy reforms applied at national levels (Galal and Hoekman, 2003). Comparing the Arab and EU cases of services, trade may not be meaningful due to differences in endowments and starting points. In contrast to the gradual progression from goods to services trade in the EU, liberalization of intraregional trade in goods as a starting point is "not likely to be the best way to integrate Arab countries" (Galal and Hoekman, 2003). Owing to differences in market size and structure, level of development, protectionist policies and differences in conditions between Europe in the 1960s and Arab countries today, a reform of the service market in parallel with trade liberalization is expected to be a more successful approach (Galal and Hoekman, 2003).

Arab countries have undertaken various efforts to liberalize the trade of services. Many specific commitments on services trade have been made through the General Agreement on Trade in Services (GATS) of WTO (table 4.2). The commitments cover in principle all types of services,[60] and provisions are defined by "limitations on market access" and "limitations on national treatment".

Despite the number of commitments undertaken by several countries, it has been observed that neither these nor the number of regional and bilateral trade agreements that an Arab country is involved in – regarded as the country's "attitude toward reform" – reflects the actual size of its services trade sector (Dadush and Falcao, 2009). According to the GATS commitments ranking by sector calculated by (Ghoneim, 2012), however, the financial services sector, followed by business services and communication have the most commitments made, despite not being the biggest contributors to trade in services in the Arab region.

In their study on trade barriers in the Arab region, Marouani and Munro (2009) conclude that, while there have been broad reforms across service sectors, there have been "varying degrees of impact on market structure depending on the countries and sectors". Previous studies on service trade restrictiveness indices (STRIs) indicate degrees of liberalization across the region that are relatively low

compared to the EU, with the exception of Morocco (figure 4.13). It is noteworthy that GCC countries have the highest STRIs.

Table 4.2 Status of GATS commitments of Arab members of WTO

Country	Number of commitments
Bahrain	2
Egypt	12
Jordan	39
Kuwait	23
Mauritania	3
Djibouti	6
Morocco	21
Oman	32
Qatar	16
Saudi Arabia	39
Tunisia	5
United Arab Emirates	17
Yemen	28

Source: WTO (2015).

Figure 4.13 Overall service trade restrictiveness, 2012
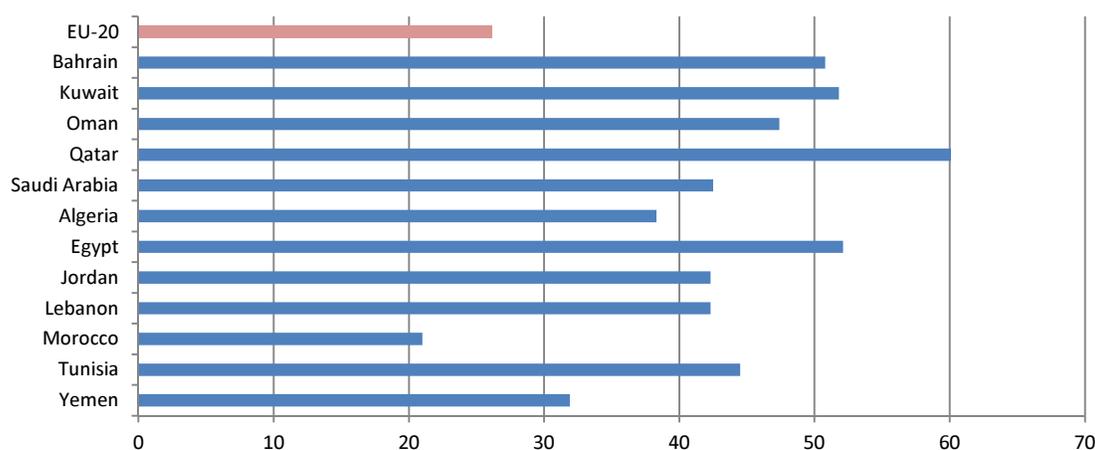
Source: World Bank (2012).

Note: EU-20 was the only data made available through the World Bank STRI database at the time of producing this research.

Figure 4.14 Trade restrictiveness indicator for selected sectors
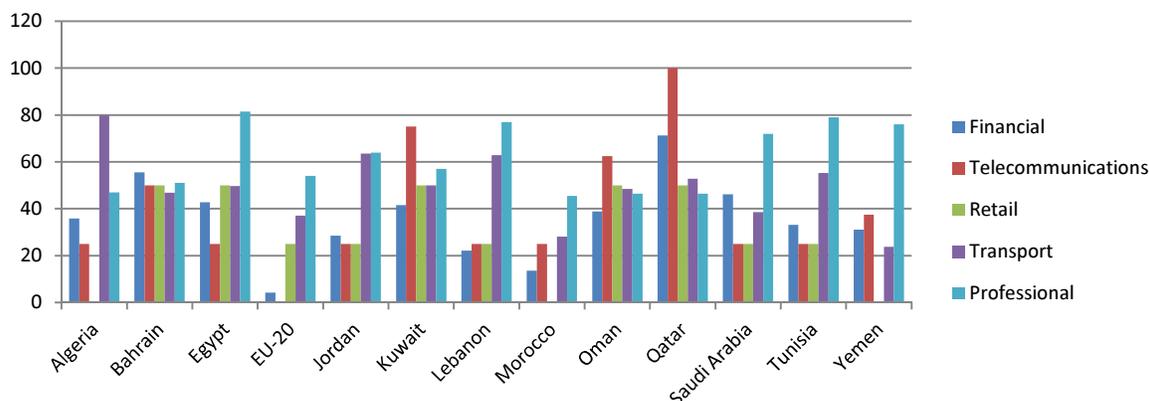
Source: World Bank (2014a).

According to the latest data available, the largest restrictions in GCC countries are in telecommunications followed by professional and financial services (figure 4.14). In contrast, the EU has no restrictions in telecommunications and very low restrictiveness in financial services. Comparing across a number of selected other Arab countries, including those that perform relatively well in services trade in the region, low financial restrictions and high restrictions on professional services can be seen, in a manner similar to the EU. Nevertheless, as indicated above in the ITC dataset, financial services are not yet the highest contributors in these Arab countries.

Overall, a new development paradigm requires a specific policy emphasis on reducing barriers to trade in services, allowing for more freedom in foreign firm entry into domestic markets, thereby facilitating services-based economic growth, employment creation and social benefits.

E. Arab financial integration: concentrated in the Gulf

Integrated finance offers an opportunity for the Arab region to pool resources and harness domestic and external financing for development and economic transformation. An integrated financial market, as defined by Baele and others (2004), is "fully integrated if all potential market participants, with the same relevant characteristics, face a single set of rules when they decide to deal with financial instruments and/or services; have equal access to the set of financial instruments and/or services; and are treated equally when they are active in the market". Full financial integration has three important features, namely: it is independent of the financial structures adopted by different countries; it requires equal access to investment opportunities for investors regardless of the country of origin; and it is not conditioned on the removal of frictions that hamper the optimal allocation of capital, but is rather concerned with asymmetric effects of frictions on different areas.

Financial integration will lead to a significant increase in cross-border holdings of financial assets along with the convergence of prices for assets with identical risks and returns regardless of where the transaction takes place (Baele and others, 2004). A country's financial integration within its region and with the rest of the world can lead to stable and adequately supervised financial markets which facilitate an efficient allocation of resources across national borders, thereby enabling investors to fund profitable investment opportunities. The availability of additional financial instruments and increasing cross-border ownership offers households additional ways of diversifying their portfolios and protecting their revenues against shocks to their income. Furthermore, given that financial integration leads to an increase in the flow of funds for investment opportunities in less developed regions, financial markets in these regions are expected to develop further, thereby enhancing competition among financial institutions and reducing the cost of financial intermediation. Financial integration also improves welfare due to specialization, thereby contributing to economic growth (Baele and others, 2004).

Notwithstanding these benefits, the recent global financial crisis has demonstrated that financial integration can create conditions of high volatility and increase a country's vulnerability to macroeconomic and financial crises due to interconnected banking sectors and financial markets. An improvement in the quality of financial integration by further developing financial markets and enabling them to better play a risk-sharing role could contain external shocks, assuming member countries do not have major structural differences in macroeconomic conditions and policy objectives (Rungcharoenkitkul and Unteroberdoerster, 2011).

1. Characteristics of Arab financial markets

While the Arab banking sector is modest compared to other regions, it is the most important sector in the Arab financial system as expressed by total assets, which amounted to over $2.18 trillion in 2009 and reached $2.3 trillion in 2012. Total deposits reached $1.57 trillion and total loans were around $1.51 trillion as of 2012 (Arab Monetary Fund, 2013). The Arab banking sector benefitted from the increase in oil prices during the early 2000s as total deposits had increased by a significant 77 per cent during 2000-2005 (Arab Monetary Fund, 2006).

However, the importance and size of the banking system differs between countries, with the majority of banking activities being undertaken by a limited number of banks. Figure 4.15 reveals that around 68 per cent of the region's total bank assets are concentrated in the United Arab Emirates, Saudi Arabia, Qatar and Egypt. The Arab banking sector can be compared to ASEAN's banking sector which is also considered small and which has been deemed to have resulted in a low efficiency and reduced international competitiveness for the region (Asian Development Bank, 2013).

The operations of Arab commercial banks have been small when compared with other regions, and have traditionally been domestically oriented. As illustrated in figure 4.16, with the exception of Jordan, Lebanon and Morocco, there has not been much depth in the Arab banking sector as the average domestic credit

provided by the financial sector reached 34.9 per cent of GDP in 2012 as compared to 150.7 per cent of GDP for the EU and 165.5 per cent of GDP for the world average (World Bank, 2014a). It is worth mentioning that, since 2008, domestic credit to the private sector as a percentage of total credit has been growing at a slower pace (7.9 per cent growth in 2012) compared to domestic credit to the public sector (8.9 per cent growth in 2012), as a result of a growing need for funding by Arab Governments to respond to increases in salaries and wages and to maintain certain subsidies (Arab Monetary Fund, 2013).

Figure 4.15 Total bank assets, 2013 (billion United States dollars)
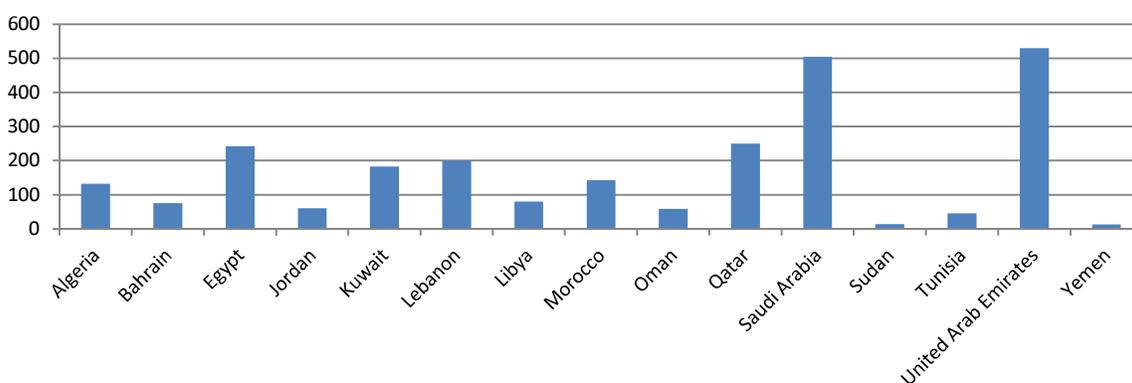
Source: Barakat (2013).

Figure 4.16 Loans and deposits, 2012 (percentage of GDP)
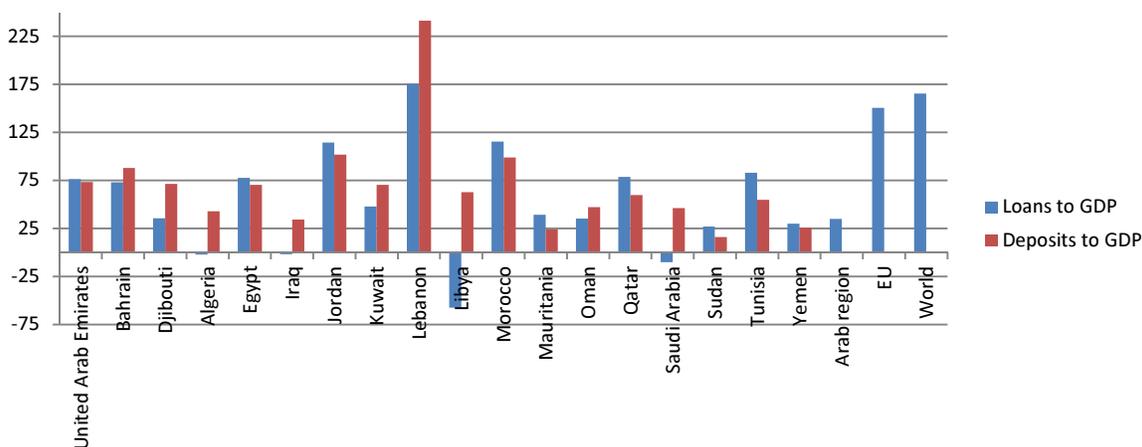
Sources: World Bank (2014a) for loans to GDP; and Arab Monetary Fund (2013) for deposits to GDP.

Table 4.3 Number and share of foreign banks in the Arab region, by home region, 2000 and 2009

2000				2009		
Home region	**Number**	**Share (%)**		**Home region**	**Number**	**Share (%)**
Americas	3	6		Americas	2	3
Asia	5	10		Asia	4	5
Europe	20	41		Europe	23	31
Arab	21	43		Arab	46	61
Total	49	100		Total	75	100

Source: ESCWA, based on Claessens and van Horen (2013).

2. Financial integration in the Arab region

The Arab region has had mixed results regarding financial integration, with both progress and persisting constraints in banking and equity markets.

(a) The banking sector

As of 2000, foreign-owned banks represented only 22 per cent of total banks in the Arab region as compared to 26 per cent in ASEAN and 29 per cent in the EU.[61] However, foreign banks from outside the region have been steadily increasing their share of the local market, reaching 35 per cent in the Arab region in 2009, at a level similar to ASEAN (31 per cent) and the EU (35 per cent).

Banks have been motivated by increased earnings and a diversification of risk in their cross-border expansion decisions, especially after the global financial crisis. Limited growth opportunities in home markets, due to already significant market shares and/or high levels of credit penetration, are further reasons for expansion into new geographical markets. Cultural, geographical and institutional links

between the home and host country have also influenced banks in their decision-making processes. Trade and FDI flows tend to be regional, therefore it is not surprising that most foreign banks demonstrate a strong regional orientation in their geographical expansion strategies. The greatest proportion of foreign banks in the Arab region comes from other Arab countries (table 4.3), as compared to banks from other regions (Claessens and van Horen, 2013). The presence of foreign banks from certain countries or regions can depend on trade ties, tourism flows and other factors.

In comparison, cross-border banking and penetration of ASEAN-based banks within ASEAN have been slow to develop due to stringent regulations regarding the entry of foreign banks into member countries. In 2010, there was not a single ASEAN-based commercial bank that had either a branch or a subsidiary in every ASEAN member country. The three ASEAN banks with the widest regional presence (Maybank of Malaysia, Bangkok Bank of Thailand, and United Overseas Bank of Singapore) have operations in seven ASEAN members. In contrast, global

commercial banks have a large presence in other Asian subregions (Yamanaka, 2014).

Within the GCC, Saudi Arabia has the most closed banking sector – only 3.92 per cent of liabilities originated abroad in 2013 (Saudi Arabian Monetary Authority, 2014) – while Bahrain has the most open banking sector with foreign liabilities reaching 46.5 per cent of total liabilities (Central Bank of Bahrain, 2014). Capital accounts of GCC countries are open with respect to foreign exchange accounts for both residents and non-residents, domestically or abroad. However, there are controls regarding lending to non-residents and foreign borrowing by banks, among others.

(b) Equity markets

In comparison with other regions, Arab stock markets remain small although they have been growing steadily since 2009 thanks to an increase in the number of listed companies and to signs of strong demand for active capital markets in the region. By 2013, total market capitalization for all Arab stock exchanges reached nearly $11 trillion, equivalent to roughly 40 per cent of the Arab region's GDP (Arab Monetary Fund, 2014). Saudi Arabia's "Tadawul" was the most important in the region in terms of market capitalization ($467 billion), number of trades (30 million) and value of shares traded ($365 billion). By market capitalization, it is similar in size to the Bursa Malaysia ($500 billion) but is dwarfed by some of the major stock exchanges in the world. Some of the region's exchanges are compared in figure 4.17 in terms of market capitalization

and value of shares traded, as a share of GDP. This indicates, interestingly, a more significant trading of shares as a proportion of GDP in Arab exchanges than those of the EU and ASEAN.

Arab stock exchanges have been domestically focused due to restrictions on the purchase of shares in local markets by non-residents as well as certain rules and regulations, such as the payment of dividends and repatriation of profits. Indeed, the share of foreign firms listed on Arab stock exchanges is still relatively small, reaching 3.1 per cent of total listed firms in 2012, and total trades conducted by foreign investors in all Arab stock exchanges stood at only 5.9 per cent as of 2012 (Arab Monetary Fund, 2013).[62]

After the financial crisis, Arab countries understood that reforms to their equities markets were needed. Indexes of some Arab stock markets plummeted almost 65 per cent in the three-month period after the beginning of the 2008 crisis, compared to a decrease of around 60 per cent for the world market average. In response to this, major reforms were implemented, including improvements in transparency to boost the credibility of the exchanges after the major losses suffered during the crisis. As such, the Saudi exchange announced in 2014 its decision to open up to foreign investors for the first time in its history with the aim of diversifying its economy away from hydrocarbons. The exchange is deemed to be very attractive to foreign investors owing to its liquidity, diversity of sectors represented and a steady stream of new listings as compared with other Arab exchanges.

Figure 4.17 Stock exchange market capitalization and value of shares traded by country, 2012 (percentage of GDP)
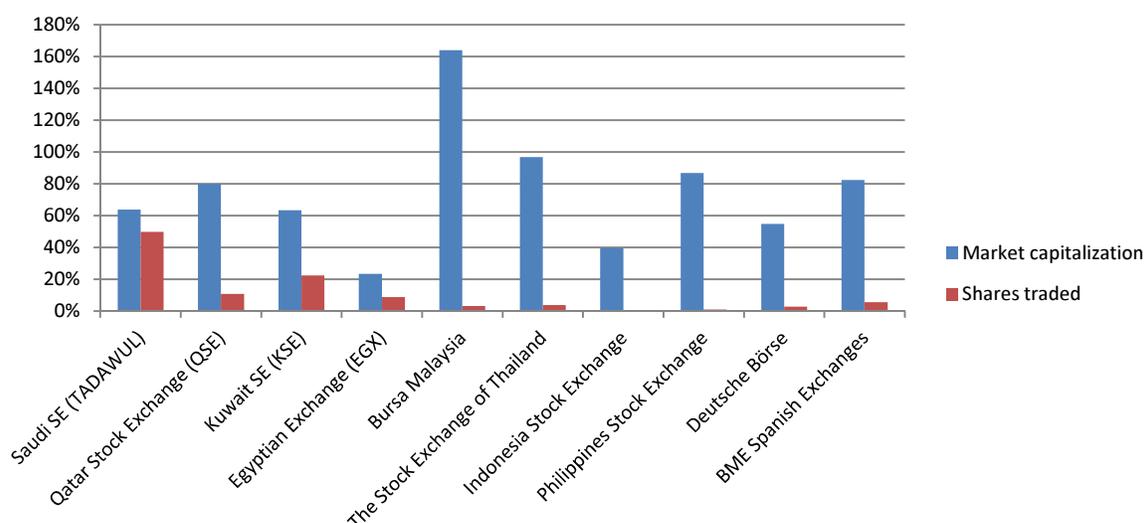
Source: ESCWA calculations based on Arab Federation of Exchanges (2013), Arab Monetary Fund (2014) and the World Bank (2014a).

Moreover, an IMF study conducted using cross-listed stock price data to estimate the size of "arbitrage opportunities" in the GCC showed that while GCC equity markets are more integrated than many markets in emerging economies, there are fairly large arbitrage opportunities due to a lag in information on events in other markets, market illiquidity, the functioning of the market, including transaction costs and Government intervention (Espinoza, Prasad and Williams, 2010).

3. Arab integration and financial cooperation

The EU and ASEAN processes of financial integration, although gradual and slow, have demonstrated that the Arab region could benefit greatly from financial integration. The success of the European integration process owes a lot to the establishment of such long-term goals as economic development and global

competitiveness; the harmonization of regulatory frameworks and cross-border financial activities; a considerable degree of coordination in the face of external shocks; and the creation of supranational institutions with a mandate to implement and monitor integration measures. An Arab integration process will require countries to tackle areas of cooperation through an intergovernmental approach that establishes regional decision-making while assuring countries that they will not have to transfer all economic sovereignty in order to deliver the desired economic returns.

F. Summary

This chapter has built on evaluations from the system of indices in chapter II and the analysis of economic and sectoral integration in chapter III. It has expanded the issue of Arab integration

to address the functional integration of vital sectors across the region, which are also central to unlocking even greater economic integration.

Here, there is great potential for further progress if the region can adhere to integration commitments and expand existing cooperation.

V. From a free trade agreement to a customs union: a bumpy pathway for Arab economic prosperity?

A. Introduction

A customs union is an advanced form of economic integration deeper than that of FTAs. Under a customs union, member countries, following the removal of tariffs among them, apply a common external tariff (CET) to imports from the rest of the world. Despite the various benefits of a customs union, progressing from an FTA to a customs union spawns many challenges, most notably the concurrence on a unified tariff structure; the CET that will be applied against third parties; and the mechanism for distributing the revenues collected as well as dealing with the consequences of fiscal revenue distortion, especially for members that depend heavily on customs duty revenues to finance their budgets.

Enhancing regional integration has been a long-term objective of the Arab region and was always a central issue in all joint Arab work. The entry of PAFTA into force in 1998 and its full implementation in 2005, two years ahead of schedule, marked a turning point in the aspirations for achieving further economic integration. Yet, the impact of PAFTA on intra-Arab trade over approximately 10 years proved to be slight. The weak turnout of PAFTA and limited benefits to member countries is due to

the exclusion of services trade; poor implementation of the agreement in some countries; non-compliance of some countries with the obligations of PAFTA; the significant shortcomings of the agreement in covering measures beyond tariffs; the lack of a dispute settlement and enforcement mechanism; and the lack of clear rules of origin, among other issues. Furthermore, the benefits of PAFTA were also undermined by the persistent structural trade defects, such as the low trade complementarity, high concentration of exports, limited and analogous productive capacities, the growing trade-restrictive role of non-tariff measures and the large disparities among macroeconomic and sectoral policies. It is therefore safe to claim that, while the establishment of the ACU may be the answer to many of these issues directly or indirectly, it is certainly not an answer to all issues. Directly, the ACU can play a role in removing the remaining tariff barriers to trade and reducing the trade-distortive impacts of many non-tariff measures resulting from the application of border controls inside the region and can, therefore, contribute to a smooth flow of trade across countries.

This chapter starts with a discussion of the rationality of establishing a customs union

among member countries of an FTA. The subsequent sections address the measures under PAFTA that are necessary to lead to the ACU; reviews the progress made so far in the discussions on the ACU under the auspices of League of Arab States; and covers the results of an exercise on the simulated impacts of alternative paths of implementing the ACU. It considers the sectoral and macroeconomic impacts that would accrue to the different Arab countries and subregions.

B. Why a customs union matters for economic development

The implementation of a customs union among a group of countries represents a new environment of economic integration and deepened regional economic relationships. A customs union generally requires more coordination and a greater loss of autonomy than an FTA. The process involves substantial harmonization of national legislations and regulations and operational procedures as well as joint administration and common economic policies. The major benefit is substantially improved access to markets, and the free movement and circulation of all economic factors.

In practice, member countries enter first into an FTA and in a second step apply a CET to imports from non-members. There are many economic and political reasons for choosing a customs union over maintaining an FTA. The primary effect of a customs union is to expand trade among members. Expanding intraregional trade can either have trade creation or trade diversion effects, depending on the level of the agreed CET. A customs union acts like a large single market permitting member countries to combine their market size and increase their market power. This can also generate economies of scale, translating into lower business costs, greater benefits for consumers and enhanced competitiveness of member countries. In addition, a customs union will ensure more harmonization of legislation and contribute to lower administration and compliance costs, through which better competitiveness could be achieved jointly with more effective expansion of economic, industrial and agricultural production. In general, trade creation generates both positive producer and consumer effects while trade diversion induces negative effects to both. However, specific effects at the country-level are believed to be heterogeneous and, accordingly, even a trade-diverting customs union can raise welfare.

A customs union is further perceived as a prerequisite for the establishment of a political union or, at least, some even deeper form of economic integration, such as a common market. These are often pursued by countries interested in attaining some political objectives, such as avoiding conflict or democratization. For example, in the case of the EU, Robert Schuman, the former Foreign Minister of France and EU co-founder, stated in May 1950 on the creation of the European Coal and Steel Community that "the solidarity in coal and steel production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible" (European Union, n.d.).

The motives for Argentina and Brazil to form a common market were to reduce tensions between those two countries, resolve security problems and strengthen their fragile democracies. The creation of MERCOSUR in 1991 reinforced this process and brought in smaller neighbours as well (Schiff, 2000). In the case of the Caribbean Community, which consists of both more and less developed countries, member countries were interested in forming a customs union to pool their market power, coordinate their trade policies and combine their efforts to negotiate with the rest of the world. This high degree of coordination enables an environment of trust among member countries and may reduce the likelihood of conflict among them, as has been the case with the EU. Furthermore, if members of a customs union negotiate effectively as a bloc, non-members tend to be more conciliatory and members will be able to affect the outcome of the negotiations in their favour.

Another reason for creating a customs union is to avoid trade deflection, which is the effect of goods being shipped from outside of an FTA to a low-tariff country and then being trans-shipped tariff-free to a high-tariff country. This effectively reduces the tariff of every FTA member to that of the lowest and could cause friction between member countries. The application of a CET in a fully implemented customs union, supplemented by such administrative and economic measures as appropriate common rules of origin and synchronized trade and fiscal policies, will reduce or even eliminate the potential for trade deflection (ESCWA, 2015a). In FTAs, rules of origin have been imposed on intraregional trade to prevent trade deflection and encourage local

content, among other goals. Under a customs union, trade deflection is less of an issue due to the presence of a CET, transforming the need for rules of origin from being imposed on intraregional trade to trade with the rest of the world. A successful customs union should facilitate a significant increase in intra-trade and intra-investment, and introduce adjustments to the economies of its members engendered by new opportunities and competitive advantages.

The establishment of a customs union can also affect the power of lobby groups, although it is not clear whether the effect would be to dilute or to enhance their powers. As noted by Schiff and Winters (2003) and Andriamananjara (2011), lobbying pressure might be diluted as it will be too costly to lobby decision makers in a large number of member countries with at times differing views. The returns to lobbying activities are lower under a customs union as compared to an FTA, given that the lobbied tariff protection rate becomes available to all members. Due to high costs of and low returns to lobbying, there could also be a free-rider problem with all lobbying activities taking place in only one country. This could lead to reduced levels of external protection. A customs union guarantees a large market for consumers in member countries, open to the world and major international supply chains. The controls undertaken by customs systems in the application of a common legislation must ensure a high level of safety and quality of commodities produced by member countries. The customs union is also regarded as a tool supporting the competitiveness of member countries' enterprises and trade operators, minimizing the regulatory costs at border

crossings through programmes of simplification and dematerialization of trade operations.

C. Full implementation of PAFTA is required to ensure a successful launching of the Arab Customs Union

The Arab region's trade pattern is different from that observed in most other regions of the globe. Generally, in other regions, countries trade more with their neighbours. Approximately one-quarter of world trade takes place between neighbouring countries and half of world trade occurs between countries less than 3,000 km apart (UNDP, 2011). However and despite the long history of the League of Arab States trying to foster trade and economic cooperation among its member countries, around 90 per cent on average of the Arab region's external trade is with partners located several thousand miles away. In fact, 10 years after the full implementation of PAFTA, intra-Arab trade is still very modest. These outcomes clearly show that even though Arab countries have been able to remove tariff barriers on intra-Arab trade, many non-tariff barriers and restrictive business practices are still widespread. This section highlights the most restrictive barriers that still harm the expansion of intra-Arab trade which require special actions from Arab countries to ensure full implementation of PAFTA. This is a prerequisite for launching the ACU.

1. Rationalizing and harmonizing non-tariff measures

A key area of PAFTA that must be enforced to ensure a smooth transition to the ACU involves reducing and harmonizing non-tariff measures, which have become more burdensome despite the reduction of tariffs to trade. As noted in Chapter IV, despite some progress in addressing non-tariff barriers in the context of implementing FTAs in the Arab region, many restrictions remain, inhibiting the growth of intraregional trade. A study on non-tariff measures among ESCWA member countries draws upon data from the World Integrated Trade Solution in order to overcome significant data limitations and address non-tariff measures in Egypt, Lebanon, Morocco and Tunisia (ESCWA, 2015b). The study finds that, among these countries, intra-Arab trade is low albeit highly subjected to non-tariff measures, with imports facing several such measures on average, although this number may vary also due to the reporting standards of each country. Non-tariff measures included mostly non-tariff barriers (voluntarily implemented to reduce trade) and technical barriers (not directly designed to act as barriers to trade), depending on the country; and while these did affect most sectors of each country, the severity of the number of barriers varied by sector, particularly impacting agricultural goods for some countries, textiles for others and chemicals, machinery and electrics for the rest. Typically, existing tariffs do equally cover goods facing non-tariff measures and those not facing non-tariff measures, implying that there is not a particular targeting of certain imports by most countries studied, although this trend does not hold for all countries. Finally, intra-PAFTA exports still face many non-tariff measures in destination countries, although this varies by destination. In Tunisia, there is great fluctuation in the amount of imports affected by non-tariff measures, ranging between 16 and 67 per cent,

depending on the country of origin. Roughly two-thirds of non-tariff measures involve technical measures, 20 per cent are non-technical measures, and less than 10 per cent are export-related measures. Moreover, when disaggregating products by Harmonized System (HS) code, each HS code is on average subject to 12 non-tariff measures, which is very burdensome, particularly for domestic value addition as imported input products face significant barriers.

Morocco features results similar to Tunisia, with few imports coming from the PAFTA region and 98 per cent of total imports by value and 97 per cent of products by HS code subject to non-tariff measures. However, unlike Tunisia, over half of non-tariff measures cover non-technical measures, with sub-classification of non-technical measures more diverse than for Tunisia. While there is a seemingly high number of different kinds of non-tariff measures, this may owe more to detailed reporting rather than to a more restrictive trade environment. Processed goods faced more non-tariff measures as compared with Tunisia, with textiles and clothing, chemicals, machinery and electrics facing the most non-tariff barriers in Morocco (agricultural sectors are relatively more accessible).

Egypt trades more with the PAFTA region than do Tunisia and Morocco, yet 60 per cent of imports to the country by value still face non-tariff measures, above all those from PAFTA countries. By product code, PAFTA imports in Egypt in fact rise to over half of all imports, greater than that measured by value, but still remain highly affected by non-tariff measures. There are also fewer numbers of non-tariff

measures by code for Egypt, with technical measures accounting for the vast majority of these, and a number of subclassifications not relevant to the case of Egypt. Textiles and clothing, followed by agriculture, face the most non-tariff measures, thereby also reflecting the importance of domestic processing activities within this industry for Egypt's economy.

In the case of Lebanon, significantly, non-tariff measure coverage among imports is a full 100 per cent, regardless of the country of origin. Non-technical measures account for the lion's share of non-tariff measures and, uniquely, fall nearly completely within the "charges, taxes and other para-tariff measures" subclassification. However, as compared with the other three countries, imports to Lebanon face fewer numbers of non-tariff measures (85 per cent of goods by code are only subject to four non-tariff measures, for example), and these figures are decreasing. By product group, textiles and clothing, chemicals, machinery and electronics are the most protected.

2. Designing less restrictive intra-Arab trade rules of origin

A PAFTA market could potentially provide substantial benefits to its member countries. However, experience has shown that the rules of origin imposed on imports from Arab partners have not only frustrated the benefits of duty-free entry but also contributed to a situation in which non-preferential suppliers have gained market shares at the expense of PAFTA partners. In fact, many domestic sectors are largely dependent on foreign inputs in their production process. Indeed, the current feature

of the Arab rules of origins is among the factors explaining the low intra-Arab trade.

There is a need to adopt more flexible provisions: these include tariff preference levels (TPLs), single transformation rules, cumulation provisions, de minimis foreign content rules, essential character provisions, and short supply provisions. Cumulative provisions allow for the sharing of origin-conferring materials and processes among a wide circle of countries. The short supply provisions list grants unlimited duty-free treatment to products made in some PAFTA countries that are not available in the other countries "in commercial quantities in a timely manner". Beyond this fixed list, PAFTA could also provide the opportunity for firms to petition for the addition of specific inputs to the short-supply list. TPLs grant a quota for items which would otherwise not be granted duty-free entry due to their incorporation of third country inputs. This is potentially the most effective flexibility, but its utility depends on the levels negotiated. Arab negotiators could argue that TPLs should be set high enough to cover existing exports to Arab countries incorporating third country goods (for example, Turkish fabrics), but low enough to ensure that third country input suppliers would not benefit from the growth of exports under preferences. The advantage of TPLs is that separate levels can be negotiated with each party. With regard to de minimis foreign content rules, they can permit up to 10 per cent of the total weight of the "essential character component" to consist of non-originating inputs; the same considerations regarding third-country inputs would apply to the calculation of de minimis. STRs assume that origin is conferred by more simple processes, such as cutting and sewing. The single

transformation rule permits the use of non-originating products used for producing certain articles, provided that these products are additionally transformed in the FTA countries. Finally, essential character provisions generally apply only to the component of a given product that provides to that product its "essential character" and thus determines its tariff classification.[63]

The formulation of a position aimed at obtaining such flexibilities is obviously a very technical endeavour in which the private sector should be engaged so as to be able to advise official negotiators effectively. Obtaining enough flexibility is required to provide meaningful preferential access opportunities in Arab markets.

However, it is important to highlight that Arab countries need to work on two parallel paths in terms of negotiating rules of origins. The first set of Arab rules of origin to be applied under PAFTA should be revised to make them more suitable for Arab economies. These rules will be used over the remaining period before launching the ACU. However, another set of common Arab rules of origin should be negotiated and implemented, commencing with the launching of the ACU, namely, rules on imports from partners with whom FTAs will be implemented.

3. The need for special treatment: the agricultural sector

Some Arab countries have a quasi-liberal trade regime for agricultural products, including Bahrain and the United Arab Emirates, which face generally low tariffs, while other countries apply the highest rates on these products in

addition to non-tariff measures. Tariff rate quotas and special agricultural safeguards are also widely applicable. Many other agricultural products are subject to import licensing and sanitary and phytosanitary measures. Moreover, many Arab Governments intervene in various sectors to safeguard the income and livelihoods of thousands of producers and rural households, thus input and price subsidies are given to farmers. Many Arab Governments are planning to continue addressing food security strategically to ensure the availability, accessibility and affordability of food.

Reflecting these concerns, most countries in the region have included a core group of agricultural products under the Temporary Exclusion List (which includes also the General Exception List) in many FTAs. This same group of products has been excluded from the various FTAs that some Arab countries have negotiated to date while for a number of sensitive products a long phase of tariff dismantling has been established. Achieving a full implementation of PAFTA requires a minimum of coordination of agricultural policies to ensure national concerns, which are diverse, including economic, social and even environmental. The concerns to keep minimum support to the agricultural sector through public support and protection from foreign competition is still justified given the current distortions in the global agricultural markets as a result of supporting policies adopted in rich countries, mainly the EU (CAP) and the United States Farm Bill.

4. Promoting trade in services

Unanimous high expectations from the contribution of the service sector to future economic development are widespread. These expectations hold that growth rates achieved in the service sector will be higher than those in products and that, henceforth, more new jobs will be generated in services compared to manufacturing. Negotiations on trade in services can provide the opportunity to expand domestic capacity and must take account of the role of basic services involved in the formation of human capital. Notably, education, health and other service subsectors can be seen as constituting the underlying basic networks of the economy (for example, financial, telecommunication and transportation services) since their availability, price and quality determine the overall competitiveness of that economy. Furthermore, consultancy and research and development services are responsible for the generation, dissemination and application of knowledge throughout the economy. A variety of other services provide the information required for consumer choice, corporate governance and the protection of rights.

The strengthening of the domestic service sector could also be seen as a prerequisite for liberalizing trade in manufacturing and agriculture. For example, liberalizing markets for agricultural output before the development of markets for services inputs, such as transport, can have a durable effect on agricultural development.

Boosting intra-Arab trade requires profound actions in service liberalization. The existing heterogeneous regulatory frameworks, conditions of competition and the overall policy environment in Arab countries have to be taken into account before embarking on the liberalization of services in the region. A set of

criteria could be developed to assess the contribution that liberalization, both regarding equity limits and the adaptation of regulations, could make to strengthen the domestic service sectors and to improve the overall efficiency and productivity of Arab economies, including that of the manufacturing and agricultural services. However, international experience suggests that sectors should not be opened up until they are "mature" and that new regulations and liberalization measures should be designed to the extent possible so as to contribute to the strengthening of the domestic service sector and to enhance its contribution to the efficiency of the concerned economies. One objective of regulations should be to ensure that the anti-competitive practices of transnational firms are not applied in the region. Regulations could be re-examined in order to identify and remove impediments to the competitiveness of Arab firms, and to ensure against anti-competitive practices of foreign firms. Nevertheless, national treatment obligations, when made, would have to be respected. Comprehensive national competition laws should be in place in advance of substantive liberalization and in preference with maximum harmonization among member countries.

D. The Arab Customs Union: progress made and required accompanying policies

Fuelled by the desire to enhance integration among Arab countries and to revive the long-term national objective of economic unity envisaged since 1957, a proposal for establishing an Arab customs council was made in 1998. Starting from 2000, the Economic and Social Council of the League of Arab States took consecutive decisions to activate the process of studying and examining the possibility and requirements of establishing a customs union. By 2005 and with PAFTA becoming theoretically fully implemented, the Arab summit mandated the Council to prepare an executive programme for the launch of the ACU. In 2009 and following some preparatory work done within the secretariat of the League of Arab States and various committees, the date for launching the ACU was decided to be in 2015 and negotiations on the various aspects began. To date, a common customs law, based solely on the common customs law of the GCC, has been agreed upon and negotiations continue on the other tracks of tariff law and structure, customs formalities, the certificate of origins, qualified customs territories, non-tariff measures, a customs information centre, forms and customs declarations and other related issues.

The major requirements and challenges of establishing the ACU are detailed in the following sections.

1. Addressing overlapping trade agreements

One of the key benefits of the customs union is the free movement and circulation of goods, commodities, and means of transport and allocation of economic resources among its members. As the customs union is an integrated economic entity, policy coordination, particularly on matters related to third parties, must be given a high priority to maintain policy and strategic coherence and consistency. Asymmetries in negotiating agreements with outside partners may seriously affect the functioning of the customs union.

In the case of the Arab region, the proliferation of FTAs with the rest of the world risks generating potential losses for Arab countries not involved in these FTAs, and brings complications for those countries that are members of overlapping FTAs. Well-managed, parallel track negotiations to enhance regional dialogue among Arab countries in the formation of a common commercial and economic policy could help to resolve these problems. In cases such as these, establishing standards of practice within and between Arab countries for drawing up trade and economic agreements constitute the first step to addressing the problems of overlapping and conflicting trade agreements; indeed, with an established institutional framework, such conflicts can be averted outright. However, it is important to highlight the role that FTAs with third parties may play in accelerating institutional and legal reforms that may boost the convergence among member countries in a customs union. The signed FTAs between some Arab countries and the EU in the context of the EUROMED was an early attempt by the EU to share some of its laws with those Arab countries involved in this partnership in the perspective of a deeper and complete integration between the two groups. This agreement has been an opportunity for Arab countries associated in the EUROMED partnership to implement reforms and speed up the process of adopting some EU legislation. These legislations may represent a strong stimulus for customs reforms and modernization in the Arab countries involved.

2. Common external tariff

The choice of an appropriate CET is an important element of any successful customs union and is linked to improved coordination of fiscal policies among participating countries. An optimal CET is one in which the overall welfare benefit to a country or region exceeds customs revenue losses that may be incurred by some member countries. However, the experience of customs unions has demonstrated that negotiations between member countries with different interests and often conflicting positions tend to be complex and long, with disagreements over the level, mechanisms for the collection and distribution of customs revenues and the compensation for revenue losses.

Member countries must make many joint decisions for their CET. For example, will external tariffs be cascading, with higher tariffs applied to final goods rather than production inputs? Such a choice will promote local industries, but is difficult to design and implement. Or should there be a uniform tariff which, while lacking in industrial protection, is easier to design and implement, is more transparent and reduces the incentive to lobby for protection (Lord, 2008)?

The differing economic status of member countries also affects the selection of a CET. When a customs union is established, it is typically the member which is relatively well-endowed with export goods or has relatively inelastic preferences that assumes greatest responsibility for external tariff choice (Melatos and Woodland, 2009).

The selected CET has to take into account agreements by member countries with the rest of the world and WTO commitments. As mentioned above, overlapping membership in

regional organizations results in contradictions in mandates, policy objectives and goals, particularly those regarding a CET. Estimation of implications of the CET in terms of costs to a particular economy must be made at the earliest stage of the design.

The difficulties of agreeing on a CET have sometimes led to an imperfect customs union, which includes country- or sector-specific exemptions. The CET in MERCOSUR does not cover all sectors, and despite divergent positions of member countries regarding CET levels, the final tariff which came into effect on 1 January 1995 essentially reflected the interests of Brazil. In many customs unions that comprise developing countries, the difficulties of agreeing on a CET and on the distribution of revenues have proven to be so great that the resulting tariff schedules tend to include numerous exceptions and sensitive lists.

3. Harmonizing of national customs codes and procedures

An institutional framework for a customs union is instrumental in establishing the customs clearance procedures for imported goods. Procedures are based on the law of the customs union, but are implemented by various national customs systems. This may be pure customs legislations contained in a common customs code covering a variety of related policies including taxes, safety, legislation and measures of trade policy and agricultural policy, environmental rules, and sanitary and technical quality standards for goods from member countries and abroad. These common customs codes have become a larger mandate of customs officials due to the global reduction of

customs duties in the wake of the GATT conclusion and proliferation of various FTAs, the emergence of matters on the design of the new generation of customs unions as well as diminishing the role of customs authorities in revenue collection.

The application of common customs codes will depend on the various national customs systems with different administrative organizations and variable prerogatives and sometimes national sensitivities and controls. Conflicts between regional and national customs laws and their respective administrative structures result from many causes, chiefly from the division of competencies between a regional body responsible for the implementation and monitoring of the customs union and the member countries. In general, the application of the CET, operation and enforcement of regulations, and practical mechanisms are the responsibility of members. Yet, the consistent application of the common customs codes and the efficiency of customs missions justify the search for a more integrated approach of the customs union. The principle of subsidiarity, in fact, calls for pragmatic thinking in terms of the organization of responsibilities between the regional institution and member countries.

4. A harmonized trade facilitation policy

In general, technical barriers to trade are potentially the more significant obstacles to deeper trade integration under a customs union, and should become less relevant where member countries will be aligned to the best practices in the region or even to international standards. The introduction of the mutual

recognition principle into national laws is expected to further decrease the prevalence of technical barriers to trade.

The harmonization of regulations is another important dimension of facilitating intraregional trade. Under a customs union, harmonization should be negotiated and commonly agreed among member countries. However, harmonization of regulations should be considered within a broader scope of policy coherence and consultation for regional integration.

Trade facilitation in the form of simplification and modernization of trade procedures is likely to increase overall trade flows both for exports and imports in the case of countries within a customs union as well as their trading partners, leading to both improved efficiency of customs administration and, consequently, greater revenue collection. Replacing several potentially conflicting practices with one uniform system will have a major role in reducing trade costs among member countries.

5. Better coordination of fiscal policies

In order to ensure the free movement of goods among members of the ACU, parties need to agree on provisions to deal with discriminatory taxation. This is very important in the case of Arab countries where prices of many utilities are significantly heterogeneous as a direct result of high subsidies (for example, energy products) or even due to differing taxation of incomes and profits. It is true that even the EU has not yet enforced a single taxation system, but the situation among Arab countries is very particular. In countries with large oil revenues,

almost no tax has been imposed on income and profits, while many others have a high taxation rate.

Fiscal policy coordination facilitates integration through two main streams. First, it allows the provision of necessary public goods that national action alone is unable to provide. Secondly, it facilitates the internalization of externalities of national fiscal policies. Indeed, fiscal policy in one country can have a significant impact on all countries with which it maintains economic relations through externalities and spillover effects. The existence of strong externalities of fiscal policy appears to be well established in the eurozone or even in less commercially integrated spaces, such as NAFTA (Decreux and Fontagné, 2006). These externalities pass through the impact of fiscal policy on foreign trade, interest rates, tax competition between countries in a "race-to-the-bottom", and impact on the supply of goods and services.

Similarly to the harmonization of custom duties through the adoption of the CET, the harmonization of fiscal policies in the perspective of establishing a customs union may also include the preparation of a common income tax code, a common excise duty code and a similar sales tax code. Agreements on avoidance of double taxation should be negotiated and signed similarly to the customs union protocol and its implementation. Coordination of this magnitude may require a special fiscal affairs committee, which will identify areas of convergence and divergence in tax systems and laws, propose and develop a tax harmonization framework, promote exchange of information on domestic taxation,

and supervise the work of national institutions related to tax matters.

6. A common competition policy

Competition law is a new legal concept in emerging economies, including most Arab countries, and it has been included in the cases of successful customs unions (Mirus and Rylska, 2001). Many economies made use of a number of practices detrimental to competition, such as artificially high commodity prices, targeted and preferential subsidies, and other policies that favour certain businesses and sectors. Competition law is a neutral and non-discriminatory means to ensure fair competition that must accompany economic liberalization. Monopolies and restrictive business practices are as harmful in a regional setting as they are in a national setting, given that they are likely to distort prices and inhibit the efficient allocation of resources. Accordingly, there is a need to ensure that free entry and the pressure of new competitors can function and balance market powers and structures in the regional market. In addition to benefiting consumers, competition law and policy enables SMEs to enter the market and compete with other businesses in the regional economy.

One of the major barriers to fair competition in the ACU is the importance and role of a number of State-owned entities that perform regulatory functions and conduct commercial transactions simultaneously. Large and powerful public authorities face disincentives to make State-owned or supported companies more competitive. Some exceptions to the rules of competition are of course necessary, including, for example, those industries in favour of "public utility enterprises" entrusted with the general economic interest (water, energy and transport, among others) or that require large economies of scale. Nevertheless, the development of trade between customs union partners must not be affected by aid to these enterprises to such an extent as would be contrary to the interests of the union.

7. Investment policy coordination

The establishment of an integrated and comprehensive customs union will also require regional investment policies and instruments that improve the region's attractiveness as an investment destination, in addition to regional improvements regarding macroeconomic stability, ease of doing business and trust in regulators.

A cooperative approach to investment policy coordination would be preferable to a complete harmonization of tax and non-tax incentives. While a regional investment policy needs to be part of the ACU, this does not mean overregulation, but rather more coordination and greater harmonization in the long run. In fact, complete harmonization is not an easy task and may require a relatively long transition period. If a country finds that its incentives are insufficient, instead of acting unilaterally, it would be better to raise the issue with its customs union partners. Furthermore, a wide legal framework for private investments in all member countries could be based on good practices of other regional groupings. It could also incorporate standard guarantees to investors, including the freedom to invest, non-discrimination, national treatment, repatriation and limited expropriation. It would have to

specify whether all firms within the customs union would be treated in exactly the same way and, if not, what differences would be permissible.

Countries within a customs union still face discrepancies in abilities to attract FDI, thus it is important to set up a transparent rules-based system of investment incentives, which would limit the room for discretion and the scope for misuse.

E. Impacts of implementing the Arab Customs Union under alternative scenarios

The complexity arising from the establishment of an ACU and the multitude of legal and technical layers to be assessed, adapted or even completely abolished does add a large margin of inaccuracy to any simulation of possible Arab economic integration scenarios. This chapter provides a second set of scenarios of establishing the ACU in addition to those analysed in the Arab Integration Report (ESCWA, 2014a). The aim is not to compare results and implications with the new set of scenarios designed in this chapter; rather, it is to draw out the transition made in establishing more precise simulations – to the degree that inputs make this possible – that reflect the region's national inclinations captured during the latest discussions with League of Arab States and its member countries, and depicted in the more recent chosen set for ACU simulations.

This new set of simulations has been designed to take into account two main dimensions: flexibility and fiscal challenges. Flexibility is in terms of timeline of implementing the CET (2017-2025) and the corresponding lists of products progressively included. The second dimension is directly linked to the concerns expressed by many member countries regarding the potential loss in their fiscal revenues as a direct implication of the implementation of the CET. The three following subsections discuss the fiscal challenges of the ACU for member countries, present the new set of scenarios, and analyse their economic and fiscal implications.

1. The fiscal challenges of implementing the ACU

The fiscal impact of joining the ACU is largely reliant on each country's degree of dependence on customs revenues for total Government revenues, the other indirect taxes on imports and the weight of intraregional trade.

Arab countries can be split into groups in terms of their high or low reliance on trade taxes as a source of Government revenues. Lebanon and The Sudan, for instance, rely heavily on trade taxes, which accounted for 15.2 per cent and 19.9 per cent of Government revenues in 2013, respectively. By contrast, GCC countries, Egypt, Iraq, Jordan, Libya, Morocco, Syrian Arab Republic and Yemen show very low dependence on trade taxes (table 5.1).

Table 5.1 Total revenues, tax revenues and customs revenues, 2013

Country	Tax revenues (percentage of total government revenues, including grants)	Tax revenues (percentage of GDP)	Customs revenues (percentage of total tax revenues)	Customs revenues (percentage of total government revenues)
Jordan	63.7	15.3	8.9	5.7
United Arab Emirates	8.5	2.4	32.3	2.8
Bahrain	4.5	1.1	87.9	3.9
Tunisia	92.5	29.1	6.0	5.5
Algeria	34.0	11.4	19.9	6.8
Saudi Arabia	6.6	2.7	27.7	1.8
Sudan	70.5	10.9	28.2	19.9
Iraq	2.5	1.3	43.1	1.1
Oman	6.7	3.1	27.6	1.8
Qatar	12.6	5.3	3.8	0.5
Kuwait	1.1	0.7	73.9	0.8
Lebanon	71.2	14.9	21.3	15.2
Libya	4.5	3.0	7.2	0.3
Egypt	71.6	14.3	6.7	4.8
Morocco	85.4	22.1	3.9	3.3
Yemen	29.5	7.9	17.0	5.0

Source: Arab Monetary Fund (2014).

Cross-country differences are in part driven by varying tax systems in place and taxation instruments employed by different countries. GCC countries, for example, rely exclusively on tariffs or customs duties in their tax revenues. By contrast, the high dependence on trade taxes in other Arab countries is even amplified by other indirect taxes on imports (equally imposed on domestic products). This is the case in Egypt, Lebanon, Morocco, The Sudan, and Tunisia. For example, along with customs duties, Lebanon collects a 10 per cent value-added tax (VAT) on imports, and excise duties are collected on cars, tobacco, petrol, and alcoholic and non-alcoholic beverages. Dependence on non-tariff revenues is comparatively high, with excise duties making up 65 per cent of total taxes on international trade (Ministry of Finance, 2013). Similarly, Egypt, Jordan and The Sudan have alternative means of deriving revenue from imports beyond tariffs: Egypt's tax on goods and services is applied to imported goods, forming approximately 12 per cent of total tax revenue collected by the State; Jordan has a general sales tax of 16 per cent on the supply and import of taxable goods and special taxes ranging from 6 to 102 per cent on certain

categories of goods and services; and The Sudan has a VAT of 17 per cent.

Moreover, differing definitions of what constitute international trade taxes can ultimately determine whether a country is highly dependent on imports for their tax revenues. Tunisia provides a case in point. Tariffs account for a small share of Government revenues in Tunisia, which fell from 10.7 per cent in 2000 to 5.5 per cent in 2013. However, Tunisia has a standard VAT rate of 18 per cent, and excise taxes make up around 10 per cent of total tax receipts. When all indirect taxes on imports are included in the definition of international trade taxes, the share of international trade taxes in total Government revenue exceeds 20 per cent.[64]

Countries that rely on taxes on imports other than tariffs are better equipped to compensate for potential losses in revenues resulting from accession to the ACU. Egypt, Jordan, Lebanon, The Sudan and Tunisia have a VAT, excise duties and other taxes on imports. As a result, while the ACU will change the level of tariffs on goods imported from outside the Arab region, these imports will still be subject to the non-tariff taxes in these countries. These countries would fare better than such countries as the Syrian Arab Republic and Yemen that depend exclusively on tariffs to raise revenues from imports. However, the level of fiscal impacts of applying the CET on imports from outside the Arab region will depend largely on the new tariff lines compared with the current national lines.

Accordingly, some countries will generate mechanic surplus while others will incur losses. A country-by-country analysis is required in order to estimate net impacts and design accompanying policies to compensate for any losses.

Table 5.2 presents the simple average bound, simple average MFN applied and trade weighted average rates for the countries of the region. The bound rate represents the highest customs duties rate a country can apply, a rate that is negotiated upon membership in WTO and is difficult to raise once established. Iraq, Lebanon, Libya, and Syrian Arab Republic are not members of WTO and, as a result, do not have bound rates. However, given that most countries are members, any CET agreed upon by the ACU will have to adhere to the agreements the members have with WTO. Saudi Arabia's bound rate of 11.3 per cent represents the highest CET that the proposed ACU could impose while allowing all member countries to honour their commitments to WTO. A CET higher than 11.3 per cent would require Saudi Arabia to renegotiate its agreement with WTO, which is a very costly process that no country is ready for.

These specific features of tariff and fiscal policies in the Arab countries are taken into consideration in defining the "new" set of scenarios which make them complementary to the "old" set of scenarios carried out in ESCWA's Arab Integration Report (ESCWA, 2014a).

Table 5.2 Customs tariffs imposed by Arab countries

Country	Simple average 2012		Trade weighted average 2011
	Bound	**MFN applied**	
Jordan	16.3	10.9	10
United Arab Emirates	14.3	4.7	
Bahrain	34.4	5	6.4
Tunisia	57.9	15.5	14.4 (2010)
Saudi Arabia	11.3	5.1	4.7
Sudan		21.2	-
Syrian Arab Republic		14.2 (2009)	
Iraq			-
Oman	13.7	4.7	5.4
Qatar	15.9	4.7	4.8 (2010)
Kuwait	97.2	4.7	-
Lebanon		6.3 (2010)	
Libya			-
Egypt	36.7	16.8	10
Morocco	41.3	12.9	13.1 (2010)
Yemen	21.1	7.5	6.1
Palestine			

Source: World Trade Organization (2013).

2. The scenarios

Three illustrative trade reform scenarios are analysed in this chapter, namely: two "pure" tariff reform scenarios; and one tariff reform that is complemented by a reduction of intra-Arab trade costs. The main differentiating feature of the scenarios relates to the way in which PTAs Arab countries have with extraregional partners are assumed to evolve once the ACU is implemented. The first scenario, Sim 1, stipulates that no changes take place in PTAs to which Arab countries are

parties. That is, PTAs of the Arab countries are not affected by the implementation of the ACU and, accordingly, controls on intratrade continue to be as active as currently through customs procedures and rules of origin. In the second scenario, Sim 2, it is assumed that PTAs signed by certain Arab countries are extended to other Arab countries to ensure a fully operational customs union. An important implication of this assumption is the free circulation of goods among Arab countries, with favourable effects on intra-Arab trade costs. To reflect the full implementation of an operational

ACU, it is assumed that trade costs are reduced by 50 per cent in 2021. The third scenario, Sim 3, assumes that existing PTAs between some external partners of Arab countries are amended substantially and Arab trade with the rest of the world is governed by MFN rates.

All three scenarios have one common component: the CET is selected based on four lists of products. The first list of products covers those where applied tariffs (MFN rates for WTO members) are below 5 per cent while the second list contains all products where applied tariffs are between 5 and the lowest rates of bound tariffs at the HS6 level in all member countries. Finally, the third list includes all commodities for which applied tariffs in Arab countries are above the lowest bound rates at the HS6 level, excluding 5 per cent of tariff lines as negative lists for all member countries. Notably, the first list covers only 7 per cent of tariff lines at the HS6 level compared with 9.8 per cent and 78.2 per cent, respectively, for lists 2 and 3.

The three scenarios assume the following:

a. Tariffs on commodities in the first list will be fixed at 5 per cent in 2017, the first year of the tariff implementation scheme;
b. Tariffs on commodities in the second list will be increased progressively to be aligned with the minimum bound rate levels over a period of three years: 2018, 2019 and 2020;
c. Tariffs on commodities in the third list will be reduced to be aligned with the minimum bound rate levels over a period of five years: 2021-2025;
d. Finally, 5 per cent of tariff lines for each member country will be excluded from the new tariff rates. These lists cover the products with the highest tariff rates in each member country.

Furthermore, all three scenarios assume that losses in tariff revenues are completely compensated for by changes in domestic indirect taxation. Of course, this applies only to countries where tariff revenues drop.

3. Impacts

Theory alone cannot provide sufficient evidence and support to identify optimal policies. In-depth analyses based on both theory and empirical evidence should guide policymaking. To this end, a dynamic and regional CGE model which is built on a consistent and detailed picture of Arab economies was developed for this study based on the MIRAGE model (box 5.1). The model is not designed to forecast the future; instead, its function is to assess the impact of illustrative scenarios of the ACU on Arab economies by comparing the baseline with the equilibrium that emerges in the long run when full adjustment takes place. Short-term transition costs induced by the reallocation of labour or capital are not considered; however, the magnitude of the reallocation is assessed. The model is based on data for 2011 that is generated from the Global Trade Analysis Project (GTAP) database and country data collected especially for the purpose of this study on the countries individually integrated in the database. The choice of 2011 is dictated by the fact that this is the most recent year for which a consistent and comprehensive set of statistics can be put together for the Arab region, including tariffs, technical barriers to trade by product and origin, imports and exports at

Box 5.1 Why a computable general equilibrium model

Computable general equilibrium (CGE) models have become a standard tool for integrated assessment of trade policies for developing economies. Their main advantage lies in the ability to combine detailed and consistent databases with a theoretically sound framework. They allow feedback effects and market interdependencies to be considered that may either mute or accentuate first-order effects. For instance, a decrease in tariffs would affect demand for imports of both final and intermediate goods. This, in turn, would affect the supply of domestic goods and demand for labour and capital, prices of goods and factor of production, and the disposable income of households, which would, in turn, affect their demand for products and their labour supply decisions, and so forth. In this regard, the CGE framework is well suited to analyse trade reforms, which are often complex and require detailed analyses of both macro and sectoral channels over different time horizons. Furthermore, these models need to be fairly detailed to answer such questions as the impact of reforms and would critically depend on a number of factors, including, among others, initial tariff rates and revenues, the relative and absolute prices of products and production factors. For instance, reforms aimed at eliminating already low and uniform tariffs would not produce the same effects as the case where barriers are not only high on average but also vary across sectors. The initial position of the country vis-à-vis other countries (their levels of protection) is also important, especially in the case of a negotiated agreement.

This report uses the global general equilibrium model, MIRAGE, to assess the set of scenarios of implementing the ACU. The MIRAGE model is built to assess the impact of globalization on individual countries and regions across the world. The model is a relatively standard neoclassical model of economic activity. It is based on the latest release of the GTAP data set, version 9.0. The model is designed for analysing dynamic scenarios. The scenarios are solved as a sequence of static equilibrium, with the periods being linked by dynamic variables: population and labour growth, capital accumulation and productivity. Policy scenarios are compared to a baseline scenario (Bchir and others, 2002).

bilateral levels, other indirect production taxes and subsidies, consumption taxes and subsidies, detailed input/output information on intermediate consumption by firms, and employment of labour and capital by sector of activity. The richness of the database is deemed to outweigh the costs of relying on data that is not up to date.

Based on the CGE model, the dimensions of which can be found in annex V, the rest of this section presents the simulated impacts of the three distinct scenarios, as described above, on total trade, intraregional trade, growth, fiscal revenues and employment. The implications of these results are discussed to draw some policy recommendations and assess what lies ahead in

the process of designing and implementing the ACU.

The impacts of the alternative integration scenarios represent the changes compared to the baseline scenario. The baseline simulation is intended to present a most likely path of development for Arab economies over the simulation period 2012-2025 in the absence of the potential establishment of the ACU scenarios described above. In this exercise, the construction of the baseline is intended to capture the influence of underlying demographic and economic factors. Accordingly, several assumptions have been made to define what seems to be the plausible development of Arab economies up to 2025.

This simulation exercise must not, however, be seen as an exercise in forecasting, for which general equilibrium models are not the best tools. The definition of a benchmark using major exogenous hypotheses is intended merely to define a baseline scenario to which alternative policy scenarios can then be compared in order to isolate the specific impact of the latter. However, the fact that the value of the exogenous variables are set on a priori basis within a realistic confidence interval does not have any major consequences on the results.

The reference scenario is built using data from the World Development Indicators for the period 2012-2014 and World Bank forecast for the period 2015-2025. The World Bank global forecast provides the yearly growth rates of the population, skilled and unskilled labour supplies and economic growth for the countries and regions individually included in the model for the period 2015-2025. In the reference scenario, the global productivity factor is considered as an endogenous variable whereas the economic growth rate is supposed to be exogenous. Once the model runs on itself (calibration), it replicates the trends as initially projected by the World Bank. In addition, the tariffs in the GTAP9, which are extracted from the Mac Map database 2, have been updated using the latest tariff data available for the year 2011.

(a) Impact on trade

(i) Total and intra-Arab exports
The simulation results indicate that operationalizing the ACU would boost the region's exports, particularly driven by an increase in intraregional exports. As compared with the baseline, total exports

would increase by 0.3 percentage points under Sim 2, with non-oil-producing countries (NOPCs) witnessing a more pronounced 1 percentage point boost (figure 5.1). Indeed, individual NOPCs would experience varying levels of increase in their exports, exceeding 1 percentage point in certain cases. Under Sim 1, with an implemented CET and no changes in FTAs with outsiders, total exports would stand at levels roughly equal to those in the baseline. Under Sim 3, where protectionist measures are intensified by repealing PTAs with partners outside the region, exports fall slightly compared with the baseline. Oil-producing countries (OPCs) witness roughly the same trends, albeit to a lesser extent, with their total exports increasing marginally under Sim 2 and falling under Sim 1 and Sim 3. These trends are plausible, given the lower reliance on oil and more diversified export portfolio of goods and services of NOPCs, and the opportunities that would arise, resulting from their goods' unrestricted access to regional markets as well as the markets of all external economies that have bilateral FTAs with Arab countries.

The impact of various scenarios on export performance is more pronounced for intra-Arab exports (figure 5.2). Under Sim 2, intraregional exports increase by 3 percentage points across the region, 4 percentage points across NOPCs and 2.6 percentage points across OPCs. Interestingly, for intraregional exports, Sim 1 and Sim 3 do have a slightly positive impact on intraregional exports while total exports remain unchanged or decrease slightly. This is in large part driven by the CET promoting

intraregional exports under Sim 1 and Sim 3, without the benefits of external agreements being extended to all ACU members, as is done in Sim 2.

Figure 5.1 Total exports
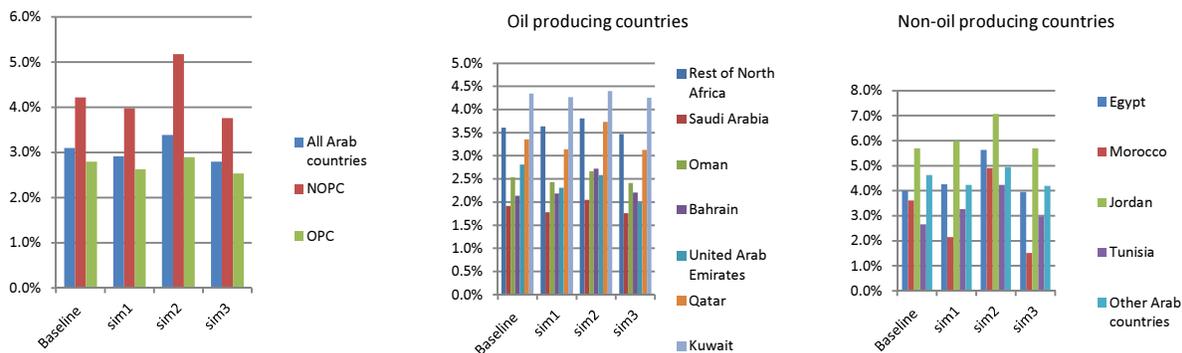
Figure 5.2 Intra-Arab exports
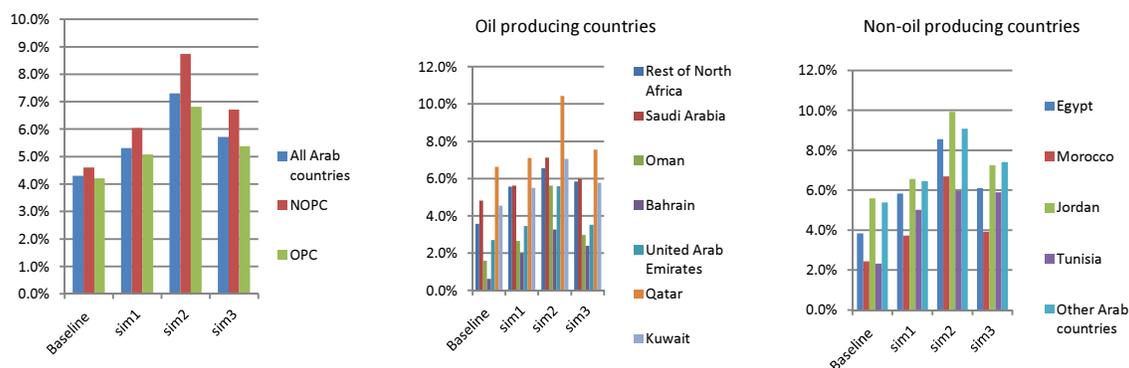
(ii) Total and intra-Arab imports

Total imports follow a similar pattern to total exports across all simulations (figure 5.3). Total imports increase under the favourable conditions of Sim 2, with a more marked increase for NOPCs. Sim 1 and Sim 3, however, yield effects on total imports similar to those under the baseline. Individual country performances are largely in line with their respective baseline simulations. Saudi Arabia stands out as an apparent outlier in that its total imports are simulated to shrink by between 1 and 1.5 per cent across all the scenarios, including the baseline. Coupled with the increase in its total exports in the simulations as noted above, Saudi Arabia is to experience an improvement in its external balance of payments.

Intraregional imports vary more across simulations than total imports, suggesting that, as is the case with exports, the impact of various preferential agreements to which Arab countries are signatories has a stronger influence on intraregional imports. As illustrated in figure 5.4, intra-Arab imports increase by between 1 and 1.5 percentage points for the region as a whole, OPCs and NOPCs, under Sim 1 and Sim 3, with slight decreases noted in certain country cases. The combination of the fall in trade costs and

extension of the benefits of external FTAs across the Arab region under Sim 2 leads to a boost of 4 percentage points of intraregional imports across the entire region, 2.6 percentage points across NOPCs and 3.5 percentage points across OPCs. As opposed to exports, Sim 2 leads to larger increases in imports in OPCs than NOPCs, reflecting different propensities to import and foreign exchange constraints faced by Arab countries.

Figure 5.3 Total imports
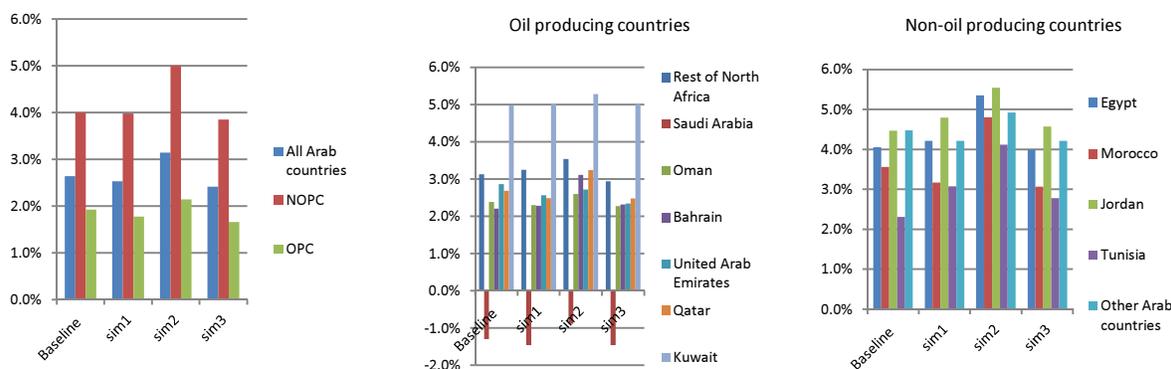
Source: ESCWA simulations using the modified MIRAGE model.

Note: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.

Figure 5.4 Intra-Arab imports
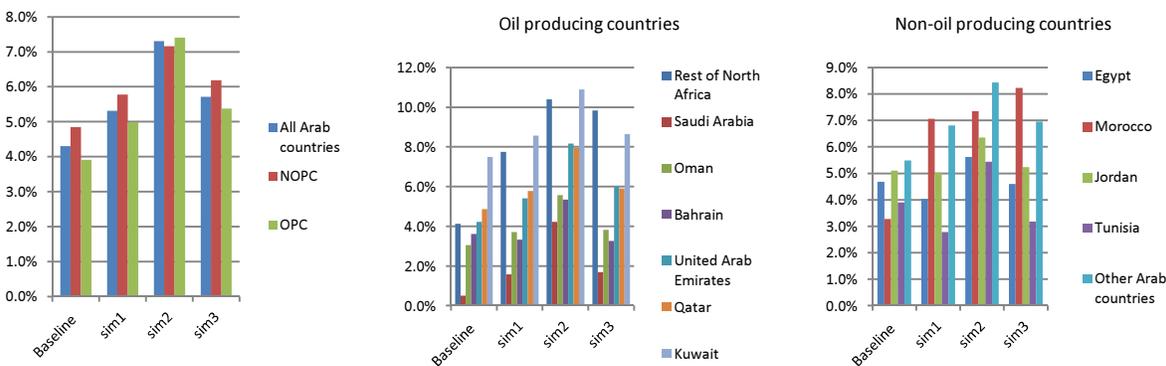
Source: ESCWA simulations using the modified MIRAGE model.

Note: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.

(b) Impact on growth

Simulated effects on GDP across different scenarios are small. As indicated in figure 5.5, growth remains nearly identical across all three scenarios relative to the baseline for the Arab region as a whole, subregions, the subcategories of OPCs and NOPCs, and individual countries. That is, differential simulated changes in trade (and particularly in intraregional trade) across the various scenarios have a negligible impact on economic growth in the region. This is somewhat surprising considering significant simulated changes trade undergoes in the region. An important factor that can help to explain this apparent contradiction is the relatively low level of existing trade, and intraregional trade in particular. Significant changes in trade therefore do not translate into commensurate changes in GDP. Nevertheless, the average annual economic growth figures reported in this chapter do not reflect cumulative effects. In fact, an increase of 0.1 percentage points in GDP vis-à-vis the baseline scenario represents a cumulative increase of 1 percentage point in GDP by 2025.

(c) Impact on fiscal revenues

The simulation results presented above suggest that increases in intraregional trade under Sim 2, especially at the expense of total trade, would exert pressure on tariff revenues, whereas under Sim 1 and Sim 3, tariff revenues would see an increase. These results hold across the region as a whole, OPCs and NOPCs, although the magnitude of gains under Sim 1 and Sim 3 would be greater for OPCs, and losses under Sim 2 would be greater for NOPCs (figure 5.6). This implies that potential revenue losses following the imposition of a CET that is lower than current rates in Sim 1 would be offset by tariff increases to meet the CET and subsequent increases in total trade flows, particularly as existing FTAs would remain unchanged. Under Sim 3, the lack of FTAs with external partners would allow for greater tariff duty collection on imports. However, in the case of Sim 2, with the extension of external FTA provisions to all Arab countries, tariff revenues would be adversely affected, particularly in NOPCs.

(d) Impact on employment: skilled and unskilled labour

On a positive note for workers across the region, unemployment among both skilled and unskilled workers is projected to decrease in the region as a whole and in nearly every country, in the baseline and all three simulations. The largest unemployment drop would occur under Sim 3, with unemployment among the skilled falling by 2 percentage points compared to the baseline across the region for both NOPCs and OPCs (figure 5.7). Under Sim 2, however, limited employment benefits accrue to skilled workers compared with other scenarios. Unemployment among the skilled is projected to fall significantly in some OPCs in particular. However, the "rest of North Africa", composed by Algeria and Libya, would experience an increase in the unemployment of skilled workers, with a particularly pronounced effect under Sim 2.

Employment among unskilled workers shows a pattern that is very similar to that of skilled workers. However, the fall in unemployment among the unskilled is less dramatic across the simulations (figure 5.8).

Figure 5.5 Gross domestic product
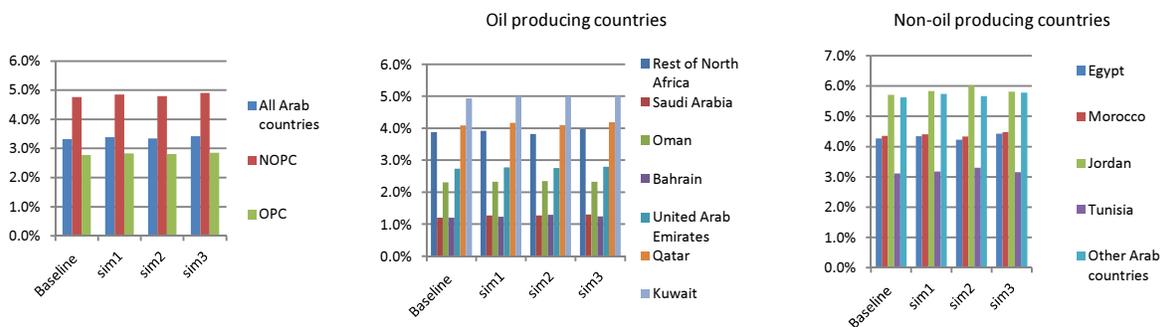
Source: ESCWA simulations using the modified MIRAGE model.
Note: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.

Figure 5.6 Tariff revenues
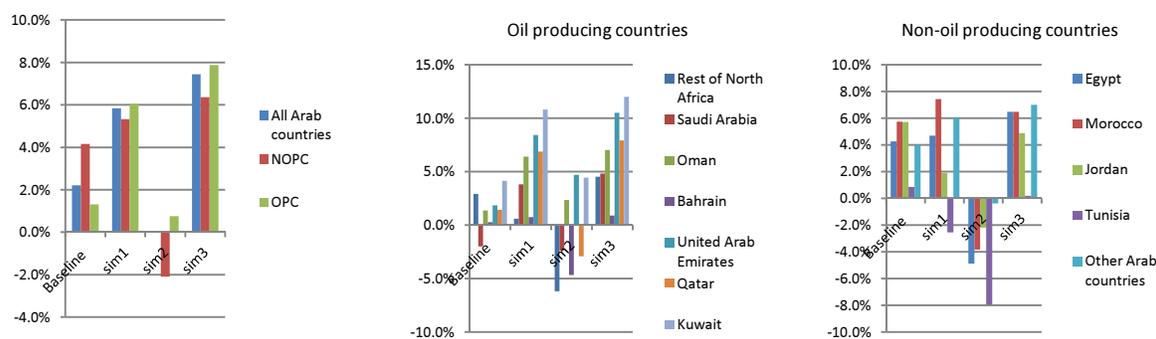
Source: ESCWA simulations using the modified MIRAGE model.
Notes: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.
Large unemployment falls in Kuwait and Qatar are excluded for purposes of scale and readability.

Figure 5.7 Unemployment: skilled workers
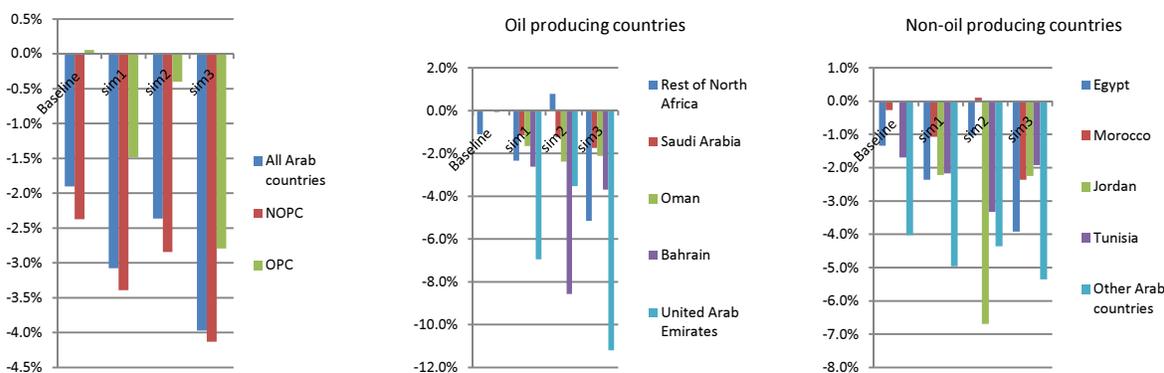
Source: ESCWA simulations using the modified MIRAGE model.
Notes: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.
Large unemployment falls in Kuwait and Qatar are excluded for purposes of scale and readability.

Figure 5.8 Unemployment: unskilled workers
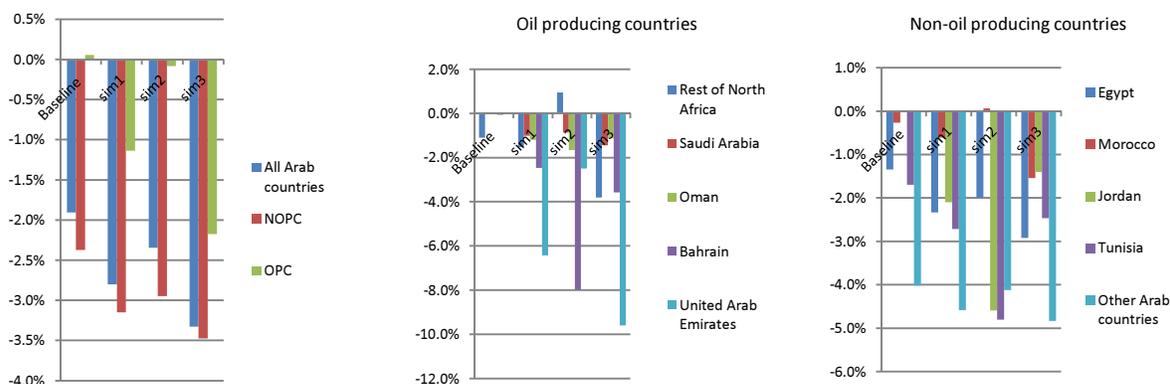
Source: ESCWA simulations using the modified MIRAGE model.
Note: Results are expressed in average percentage changes compared to the baseline scenario over the period 2016-2025.

F. Conclusions

History has seen numerous failed attempts at establishing customs unions, and the only fully-fledged and well-functioning customs union in the world today is the EU. Other customs unions are either incomplete or plagued by political frictions among members over the distribution of costs and benefits of the arrangement: the EU-Turkey customs union, established in the mid-1990s, excludes agricultural products; MERCOSUR, founded by Argentina, Brazil, Paraguay and Uruguay in 1991, has failed to establish a CET (to avoid reversals in trade liberalization) and avert political tensions; and a previous East African Customs Union collapsed in 1978, with the ensuing closure of borders, and contributed to subsequent regional military confrontations (Dreyer and Popescu, 2014).

The chances that an ACU can truly materialize are highly dependent on two factors: one, the level of political will among members; and two, the ability to overcome the critical issues entrenched in a customs union. As has been espoused in this chapter's quantitative analysis, the changes associated with various simulations on the implementation of the ACU will have the added benefit of spurring total trade, and intra-Arab trade in particular, as well as further reducing the medium- and long-term unemployment prospects of the region.

Establishing the ACU, although challenging, is not the end in itself but rather the beginning of a more challenging era where many issues will need to be dealt with, including competition, competitiveness, compliance, harmonization of policies, conflict of interests, overlapping memberships, and trade interests with external parties. The success of a customs union crucially depends on the welfare gains it leads to and existence of incentives for members to undertake necessary reforms to thrive in and sustain the customs union. If policymakers manage to reach agreements and devise a feasible plan to implement the provisions of the ACU, then the Arab region will further its integration efforts and realize significant economic and political benefits, including attaining and maintaining peace and stability.

VI. Recommendations

Based on this analysis of economic integration among Arab countries across various sectors, a number of preliminary recommendations have emerged. These recommendations are presented below under two main rubrics, based on their scope. The first set of recommendations relate to more general guidelines governing economic integration, while the second set includes sector-specific recommendations.

(a) Using integration as a means to address economic and political challenges

Regional economic integration is imperative for unleashing the potential of Arab countries in terms of trade, investment and movement of people. It should foster growth and job creation and ultimately help to build a strong and stable Arab region. A unified Arab region would be better equipped to link into the global economy, with greater benefits accruing locally to Arab countries. This would be primarily driven by improved regional value chains and Arab countries moving up within global value chains, as well as reduced reliance on foreign financing and external demand for raw commodities to support growth in the region. Fostering regional economic integration to the extent to make this possible, however, requires more decisive steps to be taken, while ensuring full implementation of PAFTA and other agreements, as well as gradually adopting more advanced forms of integration, notably the ACU.

Many other regions have, over the past several decades, witnessed increasing economic and political ties, and have presented clear examples of how collective action and planning are far more desirable than unilateral action when it comes to issues with cross-border implications, such as trade, migration and investment. This is made more imperative in the Arab region not only by the limited integration as compared with other regions, but also due to growing competition from large emerging markets and emerging regions, requiring the pooling of resources and efforts among Arab countries in order to compete. The complications in this region added by continuing conflicts and instability warrant even greater efforts at dismantling barriers that exist between States. These efforts should not wait until a period with less instability; rather, continuing integration dialogue is more imperative than ever, and can help lead to a de-escalation of animosities in this turbulent time. Mainstreaming regional integration agreements into national development plans now rather than at later stages will ensure that ongoing negotiations and implementation blueprints regarding PAFTA and the ACU are made actionable at the national level as soon as possible.

The AEISI developed in this report sheds light on the constraints facing Arab countries regarding their integration performances (potentialities scoreboard), the policies they implement (policies scoreboard) and the

achievements they reach (outcomes scoreboard). The ability of Arab countries to draw on existing assets and unlock greater integration has been captured in the "potentialities" aspect of the AEISI, and potential sector-specific policies to assist in this are found in the latter part of this chapter.

Economic integration efforts at the subregional level should also be sustained, as illustrated in the case of the GCC, and accommodate eventual expansion of subregional agreements to other Arab countries. Addressing non-tariff barriers, which greatly hinder trade integration, should remain a priority. In order to sustain political support in the integration process, losers from liberalization measures should be compensated both within and across member countries. Accordingly, such mechanisms for the redistribution of benefits and compensation should be introduced in PAFTA and other regional agreements. Effective dispute settlement mechanisms, monitoring and evaluation systems are still needed in PAFTA to ensure its commensurate implementation. Meanwhile, the Arab private sector, which has long failed to receive adequate attention in economic policymaking, must be an integral part of the integration agenda. Arab countries by and large need to overcome issues of political will to integrate and recognize that the collective power and bargaining abilities, trust and other attributes of a united region will be enhanced by integration.

(b) Trading more within the region

Given the relatively low levels of intra-Arab trade as compared with regional trade in the EU and ASEAN, Arab countries need to pursue

unified measures to reduce barriers to trade, encourage regional partnerships and assist many disconnected markets in linking in with the Arab region. One way to boost intraregional trade is to develop cooperatively regional value chains that would create new dynamic comparative advantages and accelerate the strategic diversification and sophistication of member countries, and eventually facilitate participation in higher added-value segments of global value chains. In this regard, regional value chains would be a practical short-term alternative to participation in global value chains in the longer term, which require significant investments not only in logistics and transportation infrastructure but also in the institutional and legal environment. More generally, PAFTA can be supplemented with transparency provisions to ensure that uncertainties decrease and trade opportunities increase. In other words, countries in the Arab region should go beyond opening markets by improving market awareness so that foreign suppliers are informed about measures affecting trade and rules are implemented and predictable. Adopting more liberal origin criteria and ensuring that rules of origin are implemented by individual countries would help to soften their trade-impeding effects. Following the EU example with the pan-European cumulation system, allowing sourcing from any country that has an FTA with an Arab country, could be a good first step (Hoekman and Sekkat, 2010). The expansions of total and intraregional trade that have taken place have involved new products and new markets for some Arab countries, while others have continued focusing on old products and markets. Countries should examine which product and market portfolios offer them the

greatest options for expansion, particularly within the region.

(c) Industrializing and adding value

The Arab region must address how it can more thoroughly link into global value chains, and how regional value chains can be promoted for domestic and sustainable industrial development. A strong policy environment is needed to ensure that countries are competitive in capturing higher segments of global production, and that opportunities extend to other countries across the region. Given the dominance of oil-exporting countries in overall economic activity and intensity within the Arab region, non-oil-exporting Arab countries must realize their own potential in order to increase their domestic economic growth rates, gain ground in international markets and avoid falling behind relative to those countries which are most globalized. Such interventions as special economic zones, infrastructure investments, incentives for domestic manufacturing, and other strategies must be devised in close collaboration with the domestic private sector and in consideration of inputs from international firms and partners operating in the region, complemented by strong commitment from the State. Countries need to foster domestic linkages through incentives for scaling up the quality of inputs produced domestically, and should offer business service support for local firms to integrate into both existing and newer cutting-edge regional value chains. Taking the example of the textile industry in Egypt, facilitating regional markets for intermediate and final industrial goods will assist in downstream linkage development, while building capacities through skills development, subsidies for research and development and technology transfer, improved access to finance and other initiatives would assist in building upstream linkage development through regionally oriented production and supply chains. These strategies would also address the falling proportion of manufacturing value added within total industrial value added for most countries in the region. Arab countries can potentially specialize along the quality spectrum of a product to respond to the range of incomes and different tastes that exist across the region in order to spur intraregional industrial trade.

(d) Promoting agricultural trade, investment and value addition

Regional agricultural trade should be encouraged so that countries can draw on endowments and comparative advantages, thereby dealing more efficiently with issues of food security, rather than the current state of each country pursuing unsustainably costly and water-intensive production. For example, a scenario that was perceived as the most efficient arrangement included Iraq and Syrian Arab Republic specializing in cereal production, Jordan and Lebanon in fruit and vegetables, The Sudan in cattle, and GCC countries providing mainly the financial resources needed for food security-related infrastructure and agricultural projects (Lawton, 1978). More nuanced divisions of production, accompanied by greater intraregional agricultural trade, will help the region to develop its own local value chains, as alternatives to the inherent skewing of global value chains towards the demands and specifications of high-income developed agricultural producers.

Agricultural integration is made especially difficult by the fact that many partners of Arab countries have domestic agricultural support programmes that distort prices and thus incentives. The role of Arab Governments is crucial here due to the structure of the sector, in particular its fragmentation. Arab Governments have to tailor their agricultural development strategies with a view to build regional scale economies either in production or consumption based on respective comparative advantages, agricultural investment and markets for exports instead of privileging a national length. In the light of the food security and climate change challenges the region is facing, the creation of an Arab agricultural and food market, similar to the development in the EU, would open up opportunities for greater returns and increasing efficiency. Arab Governments also have to address the problem of a complicated system of sanitary and phytosanitary measures regulations and differing national standards across the region that prevent the creation of a large enough market to compete with non-Arab food providers.

Governments should commit to easing restrictions and barriers in agriculture, particularly regarding private sector investment, regional investments and a sharing of agricultural best practices across the region. Successful experiences need to be built on in conducting public private partnerships in large-scale, agriculture-related projects, such as dams, irrigation projects and transport. Another option is to develop sovereign and investment funds to invest in joint ventures across numerous countries and assist in infrastructure development. The actions of these funds would be magnified if dedicated agencies were created or existing agencies were given clear mandates to identify existing agricultural opportunities with high returns. The work of these agencies has to be properly monitored with a view to ensuring a positive impact.

(e) Easing intraregional migration

There is a pressing need for substantial changes in national and regional policies regarding job creation (particularly through the private sector), skills training, facilitation of migration, and encouraging investment by returning migrants. Indeed, the issues of migration and easing the sending and receiving of remittances have been central to the AEISI measurements in this report. Regarding labour strategies and policies, particularly in the GCC, preferable employment policies would address incentives and the skills mismatch that results in underemployment of Arab nationals in the private sector and across the economy as a whole, and utilize intra-Arab labour flows to their advantage, rather than hindering intraregional migration and integration. Relaxing restrictions on migration and employment, as has been done in the EU, would facilitate this progress in the integration of people and labour. As the region's demand for labourers has grown, fuelled by several high-growth countries, particularly in the Gulf subregion, the easing of migration will help to fill labour shortages with surplus labour found in other Arab countries, thereby allowing the region as a whole to address its own labour mismatches through integration.

(f) Using remittances as important financing tool

Given that remittances are a growing and relatively stable source of financing, these flows need to be facilitated both by lowering associated fees with and barriers to sending and receiving remittances, and by increasing the number of formal and informal venues for remittance sending available to the members of the Arab diaspora, especially for those working in the Arab region. In order to further improve the channelling of workers' remittances, namely, personal funds, towards the creation of productive capacities and increasing the quality of the labour force, Governments may consider promoting access to savings, loans and health care tied to remittances, or influence remit behaviours that are affected by exchange controls, capital controls or exchange rates and interest rates differentials (el-Sakka and McNabb, 1999). Facilitating policies for the movement of peoples within the region will help to expand intra-Arab financial flows.

(g) Boosting intra-Arab tourism

Boosting the development of the tourism sector entails mainstreaming a strong integration of tourism development into national development planning visions; promoting more visa-free travel among the subregions and across the Arab world; developing and removing barriers to regional low-cost airlines; prioritizing and integrating firms that develop intraregional tourism within the region, with a central role for multilateral Arab institutions; initiating public private partnerships in developing tourism and direct State support for regional efforts through, for example, financing schemes and business support; branding regional Arab tourism through promotional and marketing campaigns; improving road and rail infrastructures; and ending political uncertainty in order to lead to a tourism rebound for those countries that have seen tourism plummet in the wake of tension and crises. Furthermore, adequate investments in transport-related IT are necessary to ensure that transport infrastructure advances are coupled with the most efficient and cutting-edge means to do business and ship goods.

(h) Strengthening cooperation for energy exchange and cross-border electricity connections

Establishing a regional venue that brings both energy exporters and importers together to address energy-related issues would be a crucial step to facilitate regional energy integration. Continuing to support the connection of electricity grids so that the resources of energy-rich countries can spill over to all Arab countries is also important. This energy cooperation will help to address significant and persisting gaps, providing greater electricity access to those without it across the region while proving more efficient and with greater revenues for energy providers. All countries, and particularly oil-importers, should work together to reduce dependence on oil and continue to diversify into natural gas and renewable energy in order to match diversification levels of the EU and ASEAN.

(i) Finding regional solutions to the consequences of water scarcity

With a view to addressing water shortage and access issues in the region, Arab countries could cooperate at the basin level. A regional

agreement must be reached on dealing with the water-related impact of climate change. Water withdrawal by sector must be re-examined, particularly with regard to agriculture and in light of water intensity differentials in order to reach a more even distribution. Improving the efficiency of the agriculture sector could realize great savings in terms of water use. Moreover, there is great potential in the reuse of treated sewage effluent. The region would further gain by reaching an agreement to share desalination technology. National and regional trade policy schemes should be revised through the water lens to optimize the virtual water potential of Arab countries.

(j)   Facilitating the transport of people and goods

Conditions of road transport and border crossings must be improved, and regulations and standards harmonized in order to facilitate transportation across the region and reach the levels of connectivity achieved in comparable regions. Maritime and, particularly, rail transport need to be vastly improved to match the progress reached in road and air transport, especially in the Gulf subregion. Greater investment, the standardization of gauges and the removal of such barriers as border crossing delays would greatly benefit efforts at transport integration, which, in fact, facilitates other forms of integration across the Arab region. Rail improvements must be paired with strong follow-up and maintenance programmes to ensure that past reversals in rail networks across the region are not repeated. Improving the performance of transport sectors in the region will lead to improved connectivity and efficiency. Reforming customs must be a

priority for countries in order to realize the benefits of current and future transport advantages. Trade facilitation has been widely recognized as the next target of the international trade liberalization process. It is expected that, by implementing the measures of the WTO Trade Facilitation Agreement, which was concluded in December 2013 during the ninth WTO ministerial conference in Bali, Arab countries can greatly improve the customs clearance process, thereby reducing the cost of trade flowing into and out of the region. Other measures, such as the implementation of the Customs Convention on the International Transport of Goods under Cover of TIR Carnets (TIR Convention), can also play a role in improving customs performance in the region.

(k)   Liberalizing services trade

The region needs to reflect and evaluate the importance of the service sector in general and of regional trade in services in particular for revenue generation and employment within Arab economies and cross-border economic activity and integration. Actionable recommendations towards the establishment of the ACU by 2020 and implementation of the measures of the WTO Trade Facilitation Agreement include upgrading logistics services, modernizing customs, automating border operations, creating subregional trade corridors, and increasing trade finance liquidity. Arab countries also have to reform their education systems to equip people with the necessary skills and capabilities for working in the service sector. Trade in services can also be influenced by efficient monetary policy reforms, such as more flexible exchange rates, thereby allowing clients to valuate services based on quality

without a skewing influence of fixed exchange rates that affect competiveness.

(l) Expanding and deepening the Arab financial sector

Countries should capitalize on the growing role of Arab banks for regional banking and help to perpetuate this trend towards intra-Arab financial integration by establishing long-term goals that cover the issues of regulatory framework harmonization and cross-border financial activities, and by creating supranational bodies with a mandate to implement and monitor integration measures. Apex-level political commitment to these issues would help to transform regional finance in a manner similar to that experienced in the EU. Moreover, Arab countries need to adopt and ensure the effective implementation of reforms aimed at improving transparency and information quality and transmission on events in other markets, reducing market transaction costs, and opening up exchange markets to foreign investors while diminishing State involvement. For the equities and bond markets to play a better risk-sharing role and with a view to attaining financial integration, Arab Governments have to harmonize legal, institutional and macroeconomic policy objectives that could contain external shocks.

(m) Cementing the Arab Customs Union as a pillar for integrated policy in the region

The ACU will help the region build on progress achieved to date towards economic integration by taking PAFTA and other trade agreements both within the Arab region and between Arab countries and external partners to the next level. The ACU can be used as a forum to discuss the plethora of sectoral integration issues introduced in this report. Countries need institutions, both at the national and regional levels, that are capable of overseeing and enforcing a common customs code, CET and other harmonized laws. In light of the potential great tariff revenue losses the ACU may imply, Arab countries should adjust their fiscal policies, which requires first to evaluate their specific vulnerabilities in order to be able to find the best ways to collaborate with one another and design new and mutually compatible tax schemes given the characteristics of a customs union. Countries need to further consider which specific but common fiscal policies to introduce in order to ensure harmony across national boundaries. New institutions will also be needed to implement fiscal reforms and collect taxes.

Annex I
Structure of the AEISI at the regional level

Regional level of the AEISI: Arab countries 2000-2013

Regional integration index (Tunisia)

| Arab countries | EU-28 | ASEAN and ASEAN+3 | India, Turkey, RoW, United States |

Total % GDP

| Export/GDP | FDI inflows/GDP | Remittances inflows/GDP |

Scoreboards

| Potentials | Policies | Outcomes | Potentials | Policies | Outcomes | Potentials | Policies | Outcomes |

| n Indicators | n Indicators | n Indicators |
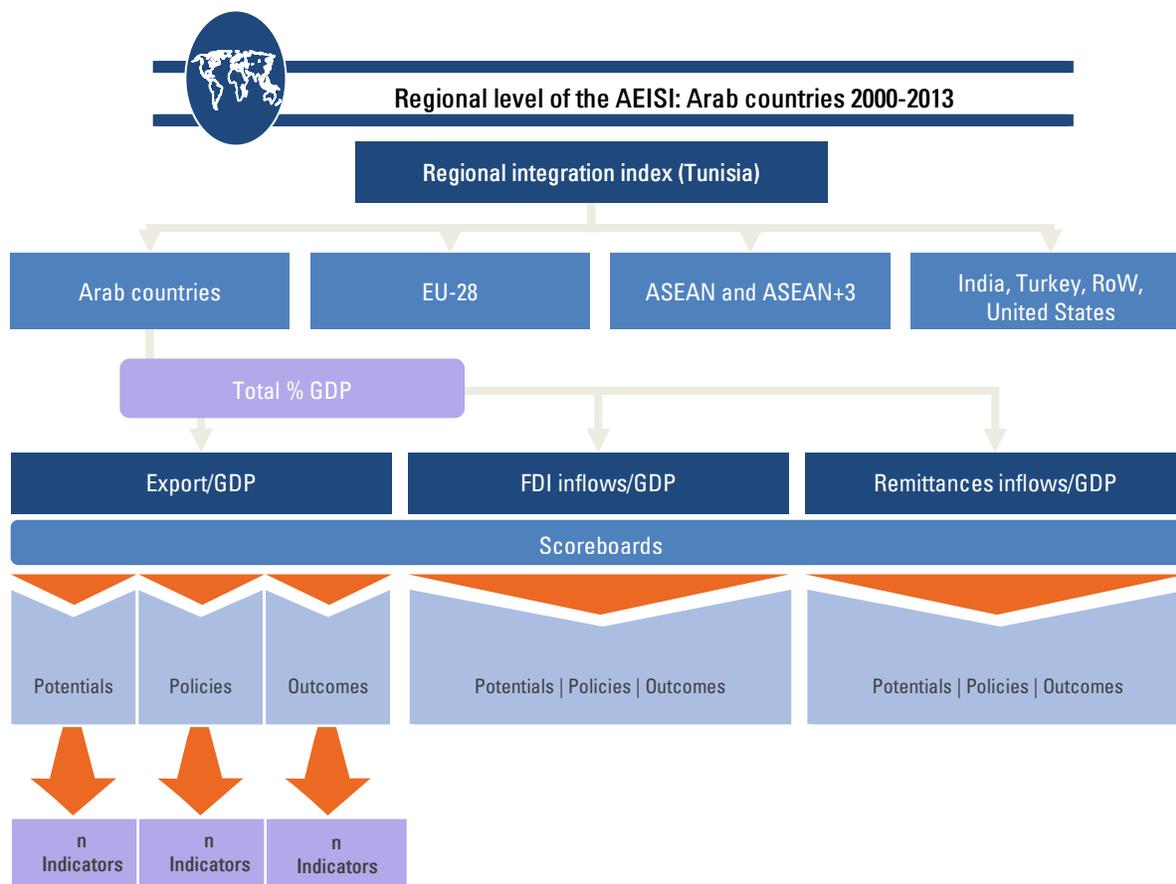
Source: Prepared by authors.

Annex II
List of indicators in the AEISI

Indicator	Source	Scoreboard	Years
Mining value added as a percentage of GDP	United Nations National Accounts Main Aggregates Database	Potentialities	2000-2012
Apparent labour productivity	ESCWA calculation, value added in $/person employed	Potentialities	2000-2012
Ratio of female-to-male labour force participation rate (percentage) (modelled ILO estimate)	World Bank	Potentialities	2000-2012
Urban to rural population ratio	World Bank	Potentialities	2000-2013
Literacy rate, adult total (percentage of people aged 15 and above)	World Bank	Potentialities	2000-2013
School enrolment, primary (percentage, gross)	World Bank	Potentialities	2000-2012
School enrolment, secondary (percentage, gross)	World Bank	Potentialities	2000-2013
School enrolment, tertiary (percentage, gross)	World Bank	Potentialities	2000-2014
Mean years of schooling	World Bank	Potentialities	2000-2013
Life expectancy at birth, total (years)	World Bank	Potentialities	2000-2012
Gross national savings rate	World Bank	Potentialities	2000-2013
International internet bandwidth (bits per second per internet user)	International Telecommunications Union	Potentialities	2000-2013
Fixed (wired) broadband subscriptions (per 100 people)	International Telecommunications Union	Potentialities	2000-2013
Electricity production (kWh)	United Nations Statistics Division - Energy Statistics Database	Potentialities	2000-2012
Fossil fuel energy consumption (percentage of total)	United Nations Statistics Division - Energy Statistics Database	Potentialities	2000-2011
Total summed magnitudes of all societal and interstate MEPV	Center for Systemic Peace - Integrated Network for Societal Conflict Research	Potentialities	2000-2012
Total summed magnitudes of all societal and interstate MEPV of neighbouring States	Center for Systemic Peace - Integrated Network for Societal Conflict Research	Potentialities	2000-2013

Indicator	Source	Scoreboard	Years
Total summed magnitudes of all societal and interstate MEPV of regional States	Center for Systemic Peace - Integrated Network for Societal Conflict Research	Potentialities	2000-2014
Lending interest rate (percentage)	World Bank	Potentialities	2000-2013
Electricity, net installed capacity of electric power plants (kW)	United Nations Statistics Division - Energy Statistics Database	Policies	2000-2011
Research and development expenditure (percentage of GDP)	World Bank	Policies	2000-2011
Rail lines (total route in km)	World Bank	Policies	2000-2011
Air transport, freight (million ton, km)	World Bank	Policies	2000-2013
Taxes on goods and services (percentage value added of industry and services)	World Bank	Policies	2000-2012
Taxes on total value added	World Bank (2014b)	Policies	2012-2014
General Government final consumption expenditure (percentage of GDP)	World Bank	Policies	2000-2013
Government expenditure on education, total (percentage of Government expenditure)	World Bank	Policies	2000-2012
Government expenditure on education, total (percentage of GDP)	World Bank	Policies	2000-2012
Health expenditure, public (percentage of GDP)	World Bank	Policies	2000-2012
Health expenditure, public (percentage of Government expenditure)	World Bank	Policies	2000-2012
Length of total road network (km)	World Bank	Policies	2000-2010
Length of paved road network (km)	World Bank	Policies	2000-2011
Chinn-Ito Financial Openness Index (not open – 0, very open – 1)	Chinn and Ito (2006)	Policies	2000-2013
Ad valorem tariff	MacMap database, ITC	Policies	2012
MFN rates	MacMap databse, ITC	Policies	2012
Applied tariff rates	MacMap database, ITC	Policies	2012
NTMs	World Integrated Trade Solution, World Bank	Policies	2012

Indicator	Source	Scoreboard	Years
AVE of NTMs	ESCWA calculations using World Integrated Trade Solution	Policies	2012
Procedures to start a business (number)	World Bank (2014b)	Outcomes	2014-2015
Time to start a business (days)	World Bank (2014b)	Outcomes	2014-2015
Trade costs (per product and by origin and destination)	ESCWA calculations using TradeMap database, ITC	Outcomes	2000-2012
Cost of starting a business (percentage of income per capita)	World Bank (2014b)	Outcomes	2014-2015
Procedures to get electricity (number)	World Bank (2014b)	Outcomes	2014-2015
Time to get electricity (days)	World Bank (2014b)	Outcomes	2014-2015
Cost of getting electricity (percentage of income per capita)	World Bank (2014b)	Outcomes	2014-2015
Strength of minority investor protection index (0-10)	World Bank (2014b)	Outcomes	2014-2015
Time to enforce contracts (days)	World Bank (2014b)	Outcomes	2014-2015
Cost of enforcing contracts (percentage of claim)	World Bank (2014b)	Outcomes	2014-2015
Enforcing contracts procedures (number)	World Bank (2014b)	Outcomes	2014-2015
Corporate taxes in percentage of profits	World Bank (2014b)	Outcomes	2014-2015
Pillar two: infrastructure quality	World Economic Forum (2015)	Outcomes	2014-2015
Market compatibility subindex	World Economic Forum, Emerging markets logistics index	Outcomes	2014-2015
Market size and growth attractiveness subindex	World Economic Forum, Emerging markets logistics index	Outcomes	2014-2015
Connectedness subindex	World Economic Forum, Emerging markets logistics index	Outcomes	2014-2015
Availability and use of ICTs	World Economic Forum, Enabling trade index	Outcomes	2014-2015
Availability and quality of transport services	World Economic Forum, Enabling trade index	Outcomes	2014-2015
Efficiency and transparency of border administration	World Economic Forum, Enabling trade index	Outcomes	2014-2015
Operating environment	World Economic Forum, Enabling trade index	Outcomes	2014-2015

Indicator	Source	Scoreboard	Years
Container port throughput (TEU)	World Bank	Outcomes	2008-2013
Liner shipping connectivity index (maximum value in 2004 = 100)	UNCTAD	Outcomes	2004-2014
Air transport, passengers carried	World Bank	Outcomes	2000-2013
Logistics performance index	World Bank	Outcomes	2007; 2010; 2012; 2014
Ability to track and trace consignments	World Bank	Outcomes	2007; 2010; 2012; 2014
Ease of arranging competitively priced shipments	World Bank	Outcomes	2007; 2010; 2012; 2014
Efficiency of customs clearance process	World Bank	Outcomes	2007; 2010; 2012; 2014
Timeliness	World Bank	Outcomes	2007; 2010; 2012; 2014
Quality of trade and transport-related infrastructure	World Bank	Outcomes	2007; 2010; 2012; 2014
Competence and quality of logistics services	World Bank	Outcomes	2007; 2010; 2012; 2014
Merchandise trade exports (percentage of GDP)	Trade data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	2000-2013
Merchandise trade imports (percentage of GDP)	Trade data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	2000-2013
Services trade exports (percentage of GDP)	Trade data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	2000-2013
Services trade imports (percentage of GDP)	Trade data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	2000-2013
Extensive margin to trade	ESCWA calculations using BACI database, CEPII	Outcomes	2000-2012
Intensive margin to trade	ESCWA calculations using BACI database, CEPII	Outcomes	2000-2012
Distribution of trade	ESCWA calculations using BACI database, CEPII	Outcomes	2000-2012

Indicator	Source	Scoreboard	Years
Complementarity index	ESCWA calculations using BACI database, CEPII	Outcomes	2000-2013
Globalization index	ESCWA calculations using various databases	Outcomes	2000-2013
Regional flow intensity index	ESCWA calculations using various databases	Outcomes	2000-2013
Bilateral flow intensity index	ESCWA calculations using various databases	Outcomes	2000-2013
Symmetric trade introversion index	ESCWA calculations using various databases	Outcomes	2000-2013
Intraregional trade intensity	ESCWA calculations using BACI database, CEPII	Outcomes	2000-2013
Intraregional trade share	ESCWA calculations	Outcomes	2000-2013
FDI stock outward (percentage of GDP)	FDI data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
FDI stock inward (percentage of GDP)	FDI data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
FDI outflows (percentage of gross fixed capital formation, three-year average)	FDI data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
FDI inflows (percentage of gross fixed capital formation, three-year average)	FDI data from UNCTAD, GDP data from the United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
Portfolio equity stock outward (percentage of GDP)	IMF BoP Statistics	Outcomes	2005-2013
Portfolio equity stock inward (percentage of GDP)	IMF BoP Statistics	Outcomes	2005-2013
Portfolio equity flows outward (percentage of GDP, three-year average)	IMF BoP Statistics	Outcomes	2005-2013
Portfolio equity flows inward (percentage of GDP, three-year average)	IMF BoP Statistics	Outcomes	2005-2013
Printer publications trade exports ($ per capita)	United Nations Comtrade	Outcomes	2000-2013

Indicator	Source	Scoreboard	Years
Printer publications trade imports ($ per capita)	United Nations Comtrade	Outcomes	2000-2013
Emigrants (percentage of population)	United Nations Population Division	Outcomes	2000-2013
Immigrants (percentage of population)	United Nations Population Division	Outcomes	2000-2013
Tourist departures (per capita)	World Bank	Outcomes	2000-2013
Tourist arrivals (per capita)	World Bank	Outcomes	2000-2013
Outbound international students (percentage of tertiary enrolment)	UNESCO	Outcomes	2000-2013
Inbound international students (percentage of tertiary enrolment)	UNESCO	Outcomes	2000-2013
Net ODA (percentage of GDP)	United Nations Statistics Division	Outcomes	2000-2012
Foreign exchange reserves as a ratio of public debt	World Bank	Outcomes	1995-2013
Inflation, consumer prices (annual percentage)	World Bank	Outcomes	1970-2013
GDP (current $)	United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
GDP per capita (current $)	United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
GDP (percentage growth)	United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
GDP per capita (percentage growth)	United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	1970-2013
GNI (current $)	United Nations Statistics Division's National Accounts Estimates of Main Aggregates	Outcomes	2000-2013

Annex III
## Intraregional trade share, intraregional trade intensity and symmetric trade introversion indices

Intraregional trade share index	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AMU	2.6	3.0	2.9	2.0	2.5	2.6	2.8	2.9	3.5	3.4	3.0	3.1	1.7	4.4
GCC	5.8	6.7	4.9	6.6	3.6	6.9	7.9	5.9	4.4	2.5	3.8	3.0	2.3	6.1
Rest of Arab States	3.6	6.8	7.9	7.2	8.0	6.7	6.9	6.8	7.4	5.7	7.9	5.4	5.2	4.8
Arab LDCs	1.3	1.5	0.5	0.1	1.5	1.7	1.3	1.2	1.7	2.5	1.0	1.2	4.5	2.0
Mashreq	3.2	6.5	7.5	6.8	7.3	5.9	6.2	6.1	7.0	4.8	7.4	4.9	4.9	4.5
League of Arab States	7.4	9.0	8.0	9.6	7.3	11.4	11.2	10.5	9.1	6.3	8.0	6.8	6.8	9.1
Agadir	1.0	1.2	1.3	1.4	1.6	1.8	2.0	2.2	2.0	2.5	2.4	2.0	2.2	2.0
EU	63.7	65.0	65.3	65.8	66.0	64.2	63.6	63.9	62.3	62.7	60.4	60.1	58.7	59.6
ASEAN	22.4	22.0	21.3	22.6	23.8	23.8	23.9	23.4	23.5	23.9	24.2	22.9	23.4	23.0
ASEAN +3	31.4	31.4	31.5	32.4	32.6	31.9	31.3	30.7	30.6	31.8	32.5	32.4	32.4	31.1

Intraregional trade intensity index	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AMU	3.8	4.3	4.2	2.8	3.4	3.1	3.4	3.2	3.6	3.6	3.2	4.2	1.9	6.0
GCC	2.5	3.0	2.2	3.2	1.3	2.5	2.8	1.8	1.0	0.8	1.1	1.0	0.7	1.4
Rest of Arab States	6.1	10.3	12.9	11.9	11.9	9.0	8.9	8.3	7.4	6.5	8.2	5.7	5.9	5.4
Arab LDCs	34.7	30.6	10.1	2.2	23.2	18.1	13.7	12.1	14.9	25.9	12.6	17.8	..	64.6
Mashreq	5.8	10.7	13.5	12.5	12.1	9.1	9.1	8.5	7.9	6.3	8.3	5.6	5.5	5.2
League of Arab States	2.1	2.5	2.3	2.8	1.8	2.7	2.5	2.1	1.5	1.2	1.5	1.5	1.4	1.5
Agadir	1.8	2.1	2.3	2.5	2.8	3.0	3.3	3.3	2.6	3.6	3.3	2.9	2.9	2.8
EU	1.7	1.7	1.7	1.6	1.7	1.7	1.7	1.7	1.7	1.8	1.8	1.8	1.8	1.9
ASEAN	3.6	3.7	3.6	3.8	4.0	4.0	4.0	4.2	4.1	3.9	3.7	3.4	3.5	3.4
ASEAN +3	1.8	1.8	1.8	1.7	1.7	1.6	1.6	1.6	1.6	1.5	1.4	1.4	1.3	1.3

Symmetric trade introversion index	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
AMU	0.6	0.6	0.6	0.5	0.6	0.5	0.6	0.5	0.6	0.6	0.5	0.6	0.3	0.7
GCC	0.5	0.5	0.4	0.6	0.2	0.5	0.5	0.3	0.0	-0.1	0.0	0.0	-0.1	0.2
Rest of Arab States	0.7	0.8	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.7	0.7
Arab LDCs	0.9	0.9	0.8	0.4	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	1.0	1.0
Mashreq	0.7	0.8	0.9	0.9	0.9	0.8	0.8	0.8	0.8	0.7	0.8	0.7	0.7	0.7
League of Arab States	0.4	0.5	0.4	0.5	0.3	0.5	0.5	0.4	0.3	0.1	0.2	0.2	0.2	0.3
Agadir	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.5	0.5	0.5
EU	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.8
ASEAN	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
ASEAN +3	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4

Annex IV
Tunisia: correlation between complementarity and level of exports with EU 28
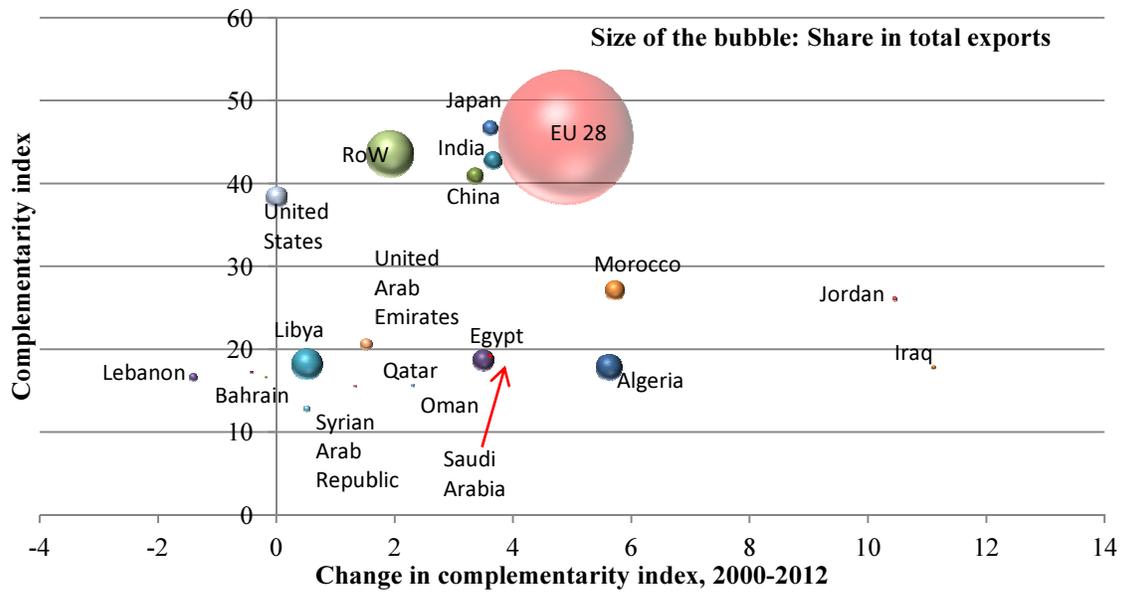
Source: Calculated by ESCWA based on data from the BACI database that adjusts the data from the transportation costs.

Annex V

Dimensions of the CGE model

The model utilized in chapter VI has three dimensions: regions and countries (r), sectors (s) and time (t). For the regional details of model, the selected level of disaggregation takes into account the objectives of this study itself in terms of including all Arab countries and regions individually, the remaining main trade partners of the Arab region, and the main economic players in the world. Table 1 below displays the regional dimension of the model used in this study.

The sectoral dimension of the model focuses on trade in goods given the lack of data to integrate special scenarios of trade liberalization in services. Table 2 presents the sectoral details of the model. The individually selected sectors appear in the second column while the first column presents the aggregate sector to which the specific sectors included in the model belong.

Finally, regarding time dimension, the model is solved annually for the period 2011-2025.

Table A1. Regional dimension of the model

Countries and regions
Morocco
Egypt
Tunisia
Rest of North Africa
Kuwait
Saudi Arabia
United Arab Emirates
Oman
Qatar
Bahrain
Rest of Arab countries in the Middle East
United States
EU 27
Japan
China
India
Turkey
Sub-Saharan Africa
Rest of the world

Table A2. Sectoral dimension of the model

Sectors included individually in the model	
Agriculture	Agriculture
Manufacturing and non-manufacturing industries	Chemical industries
	Construction materials
	Electrical equipment
	Food industries
	Machinery
	Metallic industries
	Textiles
	Transport equipment
	Oil production
	Petroleum and coal production
	Other manufacturing
Services	Transport
	Other services

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Endnotes

1. This is also coined as negative integration by Tinbergen (1954). Balassa (1961) defines economic integration both as a process as well as a state: "Regarded as a process, it encompasses measures designed to abolish discrimination between economic units belonging to different national states; viewed as a state of affairs, it can be represented by the absence of various forms of discrimination between national economies." Another definition by Kahnert and others (1969) describes integration as "the process of removing progressively those discriminations which occur at national borders".

2. Baldwin and Venables (1995) report that the median predicted GDP gains for Mexico and Canada are at 2.3 and 3.3 per cent of GDP, respectively.

3. EC-92 is a set of policy measures aimed at removing non-tariff barriers to trade in Europe.

4. See Baldwin and Venables, 1995, for a more comprehensive review.

5. Robles, Martínez-Zarzoso and Burguet (2012) focused on a selection of MENA countries rather than League of Arab States countries.

6. A more thorough analysis of intraregional trade is provided in chapter III.

7. Calculations by ESCWA are based on data by the Department of Economic and Social Affairs.

8. ESCWA calculations are based on data by the World Bank.

9. Evidence on the potential impact of capital markets integration in the region is relatively scarce. Available evidence, however, suggests that gains from the regional integration of capital markets are likely to be large. Konan (2003), for instance, shows that the liberalization of FDI in services, along with the full implementation of PAFTA, would yield substantial payoffs in Egypt and Tunisia.

10. These include such national funds as the Kuwait Fund for Arab Economic Development, the Abu Dhabi Fund for Development and the Saudi Fund for Development; and multilateral and regional funds, such as the Arab Fund for Economic and Social Development, the Arab Gulf Programme for Development, the Arab Monetary Fund, the Arab Bank for Development in Africa, the Islamic Development Bank, and the Fund for International Development of the Organization of the Petroleum Exporting Countries.

11. These indicators are examined in depth in chapter IV and include the World Bank's Logistics Performance Index (LPI), Doing Business indicators and Trading across Borders indicators; and UNCTAD's Liner Shipping Connectivity Indices.

12. Lejárraga and Shepherd (2013) find that each transparency measure boosts bilateral trade flows by around one per cent. Coupled with the observation that comprehensive regional integration agreements typically contain around one dozen transparency provisions, such measures have the potential to significantly boost intraregional trade.

13. The technical elements can be found in the dedicated methodological note that is available on ESCWA's website.

14. The KOF Index of Globalization is available from http://globalization.kof.ethz.ch/.

15. The DHL Global Connectedness Index is available from http://www.dhl.com/en/about_us/logistics_insights/studies_research/global_connectedness_index/global_connectedness_index.html#.VeQJTvmqpBe.

16. The Z-score measures how many standard deviations a given pair of countries' economic integration performance is from the sample mean. Each pair record is compared against the group mean and the dispersion from the mean is scaled by the group standard deviation. Z-score calculations implicitly take into account common global factors, related to the (un)favourable global and economic environment, which may impact cross-border flow intensity of all countries. If the impact of such common factors is symmetrical across countries, the Z-score will not change for an individual country.

17. The methodological note is available on ESCWA's website in the Working Paper Series.

18. These three elements are the object of the three AEISI scoreboards.

19. For further details, see the methodological section of this chapter and the methodological note relating to the AEISI.

20. Rankings for 2000 and 2009 can be found in annex III.

21. This partnership includes Albania, Algeria, Bosnia and Herzegovina, Egypt, Israel, Jordan, Lebanon, Mauritania, Monaco, Montenegro, Morocco, Palestine, Syrian Arab Republic (suspended), Tunisia and Turkey.

22. In addition to the 10 members of ASEAN (namely, Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, the Philippines, Singapore, Thailand, and Viet Nam) China, Japan and the Republic of Korea are members of ASEAN+3.

23. However, the intraregional trade share index does suffer a measurement bias and tends to increase with the number of members of the regional groupings. For full results, see annex III.

24. The World Bank estimations are based on harmonized bilateral matrices of migration stocks (World Bank, 2013). Bilateral forecasts of bilateral workers' remittances are available for 2010, 2011 and 2012. For 2013, extrapolations were made using workers' remittances flows to developing countries forecasts of the World Bank. Data for worker's remittances inflows by country are available from the World Bank website.

25. The list of indicators by scoreboard can be found in annex II.

26. At that stage, the "policies" scoreboard includes only an indicator of taxes on goods and services. Indicators for corporate taxes will be displayed when data quality will be improved.

27. The index measures the degree of capital account liberalization and covers four types of restrictions: the existence of multiple exchange rates, restrictions on current account transactions, restrictions on capital account transactions and requirements of the surrender of export proceeds (Chinn and Ito, 2006).

28. A ratio of 100 per cent means all children that should be attending school, given their age. A score higher than 100 per cent means that children older than the supposed age are also attending, indicating catching up.

29. Data are from the *Global Competitiveness Report 2014-2015* (WEF, 2015), with the 2014 edition of the World Economic Forum's Executive Opinion Survey being a major component.

30. Including all countries against which the indices are not calculated.

31. For countries with data availability.

32. ESCWA calculations are based on data from World Bank and International Labour Organization (ILO).

33. As categorized by UNCTAD HS 1998/92 classification.
34. Data for this analysis is based on calculations from World Integrated Trade Solution, particularly focusing on food-based agriculture, as this can be easily disaggregated into raw food-based agriculture and total food-based agriculture (including processed agricultural goods).
35. One such example in Saudi Arabia is Jannat Agricultural Investment Company (England, 2009).
36. Data in this section is based on United Nations, Department of Economic and Social Affairs (2012 and 2013).
37. ESCWA calculations based on the World Bank (2013), as in chapter II.
38. There are difficulties in obtaining accurate figures on the true value of remittances, given that many workers still resort to unofficial channels as a result of high transfer costs in some cases, or because of an absence of banks and transfer service providers in their home countries, especially in rural areas. Conversely, the expanding of formal options of sending remittances may influence the increasing trends in recorded remittances. A further interacting variable in the GCC in particular is the lack of access by migrant workers to areas of the domestic economy, such as real estate, resulting in a larger proportion of incomes than usual sent home to countries of origin.
39. In some cases, however, the rebound may be explained by security concerns in neighbouring countries, with, for example, visitors from Libya increasing in Tunisia. Arrivals from other origins and receipts in Tunisia have declined.
40. Dubai only.
41. Where possible, inbound tourism data reflect hotel stays; where such information is unavailable, this is supplemented by data on arrivals at borders.
42. Qatar National Tourism Sector Strategy 2030.
43. ESCWA calculations are based on IEA (2015).
44. ESCWA calculations are based on UNCTAD (2014b).
45. ESCWA calculations are based on the World Bank (2014a).
46. Based on Arab Union of Electricity (2013).
47. Estimated by ESCWA based on the national renewable energy targets of member countries.
48. These are, namely, Algeria, Bahrain, Egypt, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, Syrian Arab Republic and United Arab Emirates.
49. Calculated by ESCWA based on data from the World Bank (2014a).
50. More information on these projects is available from http://environment.asean.org/asean-working-group-on-water-resources-management-awgwrm/.
51. The Arab countries include Iraq, Jordan, Lebanon, Libya, Morocco, Qatar, Palestine, Syrian Arab Republic, Tunisia and Yemen.
52. The corridors covered are those connecting Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syrian Arab Republic and Yemen.
53. The League of Arab States includes all Arab countries. ECO includes Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Republic of Tajikistan, Turkey, Turkmenistan and Uzbekistan.
54. It is worth noting that this agreement is the first United Nations treaty to be negotiated within ESCWA.
55. For the ESCWA report on the implementation of the Roads Agreement, please see http://css.escwa.org.lb/EDGD/3401/ L1400234.pdf.
56. The Liner Shipping Connectivity Index is generated from five components, namely: (a) the number of ships; (b) the total container-carrying capacity of those ships; (c) the maximum vessel size; (d) the number of services; and (e) the number of companies that

deploy container ships on services from and to a country's ports.

57. ESCWA calculations are based on UNCTAD (2014b).

58. International trade in services is defined by four modes of supply in the General Agreement on Trade in Services (GATS), namely: cross border trade, consumption abroad, commercial presence and presence of natural persons.

59. This category does refer to a very broad range of different services that vary between countries.

60. These include business services; communication services; construction and engineering services; distribution services; education services; financial services; health-related and social services; tourism and travel-related services; recreational, cultural and sporting services; and transport services.

61. ESCWA calculations are based on Claessens and van Horen (2013).

62. This was due to the low shares reported by the stock exchanges in Saudi Arabia (3.2 per cent) and Kuwait (9.4 per cent), although Bahrain's stock exchange reported 61.1 per cent of total trades conducted by foreign investors; and Dubai, Abu Dhabi and Qatar reported 46.1, 39.2 and 28.6 per cent, respectively.

63. For example, a garment subject to the yarn-forward rule will be eligible for TPL preferences if the component that determines the tariff classification of the good is made of originating yarns and fabrics, without regard to the source of any collar, cuffs or most other components incorporated into the garment.

64. Calculated from IMF Country Report on Tunisia (IMF, 2014). Indirect taxes on imports are defined as VAT on imports, excise on imports and other taxes on imports.

This first edition of the Assessing Arab Economic Integration Report aims to provide a quantitative assessment of regional economic integration efforts, and generate practical and executable policy advice for member countries. Following a concise review of the potential impact and channels of economic integration, a system of indices has been developed to evaluate and compare performance, monitoring and integration at the global, regional and bilateral levels.

The report shows that the capacity of Arab countries to unlock the potential for further intraregional integration relies partly on their ability to address a number of cross-cutting structural features that act as facilitators and condition their performances. The limited progress in economic integration in the Arab region in part reflects limited progress in mainstreaming regional integration commitments into national development plans and strategies. Moreover, the report shows that an Arab customs union can only truly materialize given both the political will among members and the ability to overcome the critical issues entrenched in such a union. Finally, the report makes a clear argument that economic integration is a means by which Arab countries can ensure their growth and diversification, thereby bringing benefits at both the individual (national) and communal (regional) level.

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