# Intra-middle eastern trade: why is it so low?

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## 1. Introduction

Dollar and Kraay (2000) examined a sample of 80 countries over 4 decades and concluded that trade liberalization is good for growth, that growth benefits the poor, and has a positive impact on the whole economy in the same way as do fiscal discipline and institutional quality; and trade openness proved to be an important determinant of per capita income.[1] Trade liberalization caused positive spillovers in the countries studied and helped improve infrastructure, transportation and the performance of the export sector; it has discouraged corruption and encouraged institutional reforms; and has generally encouraged competition for capital, goods, services and new ideas. They thus advocate trade openness to be a major part of any reform in developing countries. Other economists, such as Lundberg and Squire (1999, p. 28), have warned that the growth slowdown of the last two decades has coincided with increased globalization and showed that "greater openness to trade is negatively correlated with income growth amongst the poorest 40 percent of the population which is 2 billion people". Does trade cause growth is a debated question.[2] Is growth good for the poor and are the World Bank and IMF policies good for growth are separate issues.[3] Most, if not all

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[1] Dollar (1992).

[2] Frankel and Romer (1999).

[3] Weisbrot *et al*. (2001).

economists acknowledge the positive impact of trade on growth but disagree on the means to maximize the benefits and on the distribution of the benefits among the population.

If free trade is assumed to be generally beneficial, what has been the trade performance of the countries of the Middle East (ME)? Has the level of their trade been commensurate with that of other regions of the world? In particular, what has been the performance of intra-ME trade? What factors have played a significant role in overall and intra-ME trade? We attempt to answer these questions in Sections 3, 4 and 5. In Section 2, we take a brief look at the factors that generally determine trade.

## 2. Determinants of trade

The determinants of trade can be broadly classified as: *i*) those totally outside of a country's purview, *ii*) those that are somewhat outside of its control and *iii*) those that it affects directly.

Geographical factors affect trade and encompass a number of dimensions that are totally outside of country's purview. The physical attributes of a country are the most obvious. A country with direct access to the sea and a longer coastline is more open to trade than a landlocked country. A country that is itself physically harsh – divided by high mountains, desert and the like – is more likely to be oriented toward international, as opposed to domestic commerce. The physical size of a country may both encourage and discourage trade. A large country may produce a larger variety of goods and be less dependent on trade; yet because of economies of scale it may be more efficient in the production of certain goods and more open to trade. Geographic proximity to countries with large demand for imports, especially of those goods produced by the country in question, encourages trade. The endowment of natural resources in high demand, for example oil and natural gas, enhances trade.

Factors affecting trade that are to some degree under a country's control include demographics. On the one hand, a highly populated country may be more self-sufficient than a sparsely populated country that cannot produce a wide range of goods. On the other hand, because of a large domestic market, a country with a large population can more readily take advantage of economies of scale and thus produce goods more efficiently for exports. Political stability promotes investment and enhances trade. A politically stable country is a much more reliable trading partner than an unstable one. Similarly, good political relations with the rest of the world, absence of economic sanctions, and regional peace and harmony all promote trade. The history of a country's trade in turn affects its trading pattern, as countries with a long tradition of trade are more likely to be the traders of today.

Countries' policies play a key role in shaping their trade relations. Macroeconomic and supply side policies affect economic growth; GDP and GDP per capita are important determinants of trade. Economic performance, political stability, the rule of law and policies governing capital flows are the most important factors affecting foreign direct investment (FDI). FDI in turn affects growth and increases the presence of multinational firms (MNCs). MNCs, with operations in a number of countries, promote trade through trade between their subsidiaries located in different countries. More directly, trade policies, tariffs and non-tariff barriers (NTBs) affect the volume of trade and are a key determinant of openness. A country's membership in a customs union affects its trade relations. Customs unions may promote regional trade but may at the same time deter trade with non-custom union members.

All in all, in trade as with most other things in life, where a country finds itself today is a result of its natural endowments (geographical characteristics, etc.), its history (what it did and where it has been) and what it is doing now (policies). The ME is not different.

If everything else were the same, we would expect more trade with a neighboring country because of lower transportation costs. The demographic factors could also encourage commerce because neighboring countries are often expected to have cultural or religious similarities and preferences and a common or similar language. Neighboring countries, having common boundaries, are often more exposed to conflicts, wars, old rivalries, accumulated hatred, and xenophobic feelings. Good neighborly relations are often a myth and in this case the adverse effects on trade are obvious. Nationalism can induce xenophobia, political isolation and the search for economic autarky between neighboring countries who have had a history of wars and conflicting interests. In the case of the ME,[4] if we disregard the obvious case of the nearly non-existent relations between Israel and its neighbors, and if we exclude Greek Cyprus, we find most of the other countries sharing a common language, a common history, many cultural similarities, a common Arab League and a common Muslim faith. On the face of it, intra-ME trade should be significant if these factors are indeed significant determinants of trade.

## 3. The broad trade picture of the ME

In this paper we have divided the world into seven regions in order to have a basis for comparing the ME to other regions with regard to intra-regional trade and total trade with the rest of the world. These seven regions are: North America, Latin America, Western Europe, Central and Eastern Europe (including the Baltic States and the Commonwealth of Independent States – CIS), Africa, the ME and Asia.[5] The value of trade differs from region to region depending on the number of countries, their size, their Gross Domestic Product (GDP) and their openness to foreign trade (see Table 1).

There are a number of ways to measure the trade openness of a country or a region. The traditional measure is the ratio of total trade to GDP. In Table 1 we calculate this ratio for each region. From Table 1, we see somewhat surprisingly that the ME has the highest export ratio of all regions. This could be explained by the fact that this region is the major exporter of oil in the world, and at the same time has a relatively low GDP. It is important to note that even though this ratio is high in the ME, it does not mean that the ME economies are open economies. In other words, when we remove oil from total exports (see second row for the ME), the ratio drops significantly. Europe, both Eastern and Western, have high ratios. In the case of

[4] Middle East Definition: The Middle East region for the purpose of this study includes the following fifteen countries: Bahrain, Cyprus, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates and Yemen. This definition was adopted because the data from the IMF Direction of Trade Statistics (2001) were based on such a definition.

[5] Based on the WTO definition of regions (2001).

TABLE 1

TOTAL EXPORT BY REGION IN BILLIONS OF USD AND AS A PERCENTAGE OF GDP

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| North America | 522 | 777 | 897 | 941 | 1058 |
| | 8.25% | 9.82% | 9.61% | 9.53% | 10.05% |
| Latin America | 147 | 229 | 280 | 299 | 359 |
| | 13.35% | 13.67% | 14.07% | 16.91% | 18.44% |
| Western Europe | 1637 | 2215 | 2364 | 2370 | 2441 |
| | 22.16% | 23.85% | 25.66% | 25.79% | 28.72% |
| Central and Eastern Europe/Baltic States/CIS | 105 | 159 | 216 | 215 | 271 |
| | 10.19% | 20.74% | 28.36% | 33.35% | 38.38% |
| Africa | 104 | 107 | 104 | 114 | 145 |
| | 23.76% | 22.95% | 20.70% | 22.70% | 27.97% |
| ME | 134 | 146 | 140 | 180 | 263 |
| | 28.31% | 29.04% | 24.49% | 33.35% | 43.36% |
| ME (excluding oil exports) | n.a. | n.a. | n.a. | 10.97 | 11.71 |
| Asia | 739 | 1301 | 1295 | 1392 | 1649 |
| | 15.59% | 16.26% | 19.41% | 18.59% | 20.62% |

*Sources*: World Bank (2002) and WTO (2001).

Eastern Europe, this ratio has been increasing since 1990, after the fall of the communist regimes and economic liberalization. As for Western Europe, this ratio has been increasing also after the European Union (EU) was formed. North America, a huge economy, made up of the US and Canada, has a relatively low ratio compared to other regions. These numbers do not mean that these two countries have a closed economy; the low figure is in part due to their high GDP (around $ 10,525 billion in 2000[6]). Moreover, the North American economies are very mature and rely heavily on services (as opposed to manufacturing). As for other regions, these numbers vary depending on a number of factors. In order to overcome the weakness embedded in this ratio for measuring economic openness, the IMF developed an alternative measure called the Trade Restrictiveness Index. As defined by the IMF, this index measures restrictiveness on a 10-point scale. This measurement incorporates two elements: first, it considers the tariff on imports. Five ranges are designed for import tariffs with the lowest range being from 0 to 10% and the highest being 25% and above. Second, this composite measure incorporates NTBs. Three categories are specified for NTBs ranging from open to moderate and, finally, restrictive. This classification depends on the number of eco-

[6] World Bank (2002).

nomic sectors that are covered by the NTBs. With these two measurements, a fifteen-cell matrix is set up. Cells are then given a relative ranking ranging from 1-10, depending on their restrictiveness. In Table 2, we give the matrix explaining how each category is classified.

TABLE 2

CLASSIFICATION SCHEME FOR OVERALL TRADE RESTRICTIVENESS

| | Non-tariff barriers | | |
|---|---|---|---|
| | Open | Moderate | Restrictive |
| **Tariffs** | | | |
| Open | 1 | 4 | 7 |
| Relatively open | 2 | 5 | 8 |
| Moderate | 3 | 6 | 9 |
| Relatively restrictive | 4 | 7 | 10 |
| Restrictive | 5 | 8 | 10 |

*Source*: IMF staff estimates; Trade Liberalization in IMF-Supported Programs.

In Table 3,[7] we summarize the restrictiveness for each region.

Europe has the highest percentage of open economies (91.2% in 2000), whereas the ME has the highest percentage of restrictive economies (50% in 2000). As for the rest of the world, their economies lie somewhere in between these two extremes.

While there are major differences across the regions in export to GDP and Restrictiveness Index, it is also possible that intra-regional trade may be very different. Regions that are restrictive toward trade could be very open to intra-regional trade, with high barriers to international trade and no barrier to regional trade. In Table 4 we show intra-regional trade as a percentage of total trade for each region.

Again we notice that Western Europe has the highest percentage of intra-regional trade, whereas the ME has the lowest. There could be a number of reasons for this low ratio, including high oil exports, weak internal political relations, wars, boycotts and similar economic structures. We will examine these factors in more detail in the next section.

[7] The regions under consideration in this table are different than our original regions due to the fact that we have to adopt the IMF definition of regions when considering the restrictiveness index instead of the WTO definition.

TABLE 3

TRADE RESTRICTIVENESS BY GEOGRAPHIC AREA (AT YEAR'S END)

| | 1997 | 1998 | 1999 | 2000 | 1997-2000 |
|---|---|---|---|---|---|
| | Percent of countries in each rating group | | | | Change over period |
| World | | | | | |
| Open | 46.9 | 50.8 | 53.1 | 56.5 | 9.6 |
| Moderate | 30.0 | 29.9 | 29.9 | 29.4 | (0.6) |
| Restrictive | 23.2 | 19.2 | 16.9 | 14.1 | (9.0) |
| Asia | | | | | |
| Open | 43.3 | 50.0 | 53.3 | 56.7 | 13.3 |
| Moderate | 33.3 | 30.0 | 30.0 | 26.7 | (6.7) |
| Restrictive | 23.3 | 20.0 | 16.7 | 16.7 | (6.7) |
| Baltic, Russia and Other | | | | | |
| Open | 53.3 | 53.3 | 60.0 | 60.0 | 6.7 |
| Moderate | 26.7 | 26.7 | 20.0 | 20.0 | (6.7) |
| Restrictive | 20.0 | 20.0 | 20.0 | 20.0 | n.a. |
| Europe | | | | | |
| Open | 79.4 | 82.4 | 85.3 | 91.2 | 11.8 |
| Moderate | 14.7 | 17.6 | 14.7 | 8.8 | (5.9) |
| Restrictive | 5.9 | n.a. | n.a. | n.a. | (5.9) |
| ME and North Africa | | | | | |
| Open | 35.0 | 35.0 | 35.0 | 35.0 | n.a. |
| Moderate | 15.0 | 15.0 | 10.0 | 15.0 | n.a. |
| Restrictive | 50.0 | 50.0 | 55.0 | 50.0 | n.a. |
| Sub-Saharan Africa | | | | | |
| Open | 29.5 | 36.4 | 36.4 | 43.2 | 13.6 |
| Moderate | 31.8 | 31.8 | 40.9 | 43.2 | 11.4 |
| Restrictive | 38.6 | 31.8 | 22.7 | 13.6 | (25.0) |
| Western Hemisphere | | | | | |
| Open | 44.1 | 47.1 | 50.0 | 50.0 | 5.9 |
| Moderate | 50.0 | 50.0 | 47.1 | 47.1 | (2.9) |
| Restrictive | 5.9 | 2.9 | 2.9 | 2.9 | (2.9) |

* Numbers in parentheses are negative.

*Source*: IMF's Trade Policy Information Database.

TABLE 4

SHARE OF INTRA-REGIONAL TRADE AS A PERCENTAGE OF TOTAL EXPORT

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| North America | 34.2 | 35.92 | 37.58 | 39.63 | 39.75 |
| Latin America | 14.0 | 20.46 | 20.36 | 16.80 | 17.27 |
| Western Europe | 71.4 | 69.09 | 68.96 | 69.18 | 67.76 |
| Central and Eastern Europe/Baltic States/CIS | 23.8 | 18.18 | 30.78 | 25.84 | 26.57 |
| Africa | 5.9 | 9.86 | 9.11 | 8.60 | 7.59 |
| ME | 6.3 | 7.76 | 8.49 | 7.10 | 6.46 |
| Asia | 42.1 | 51.26 | 44.56 | 46.48 | 48.94 |

*Source*: WTO (2001).

## 4. The ME trade background

### 4.1. *Trade structure*

Historically, ever since the Phoenicians, Middle Easterners have been known as "Masters of the Sea" because of their active role in trade, both among themselves and with other countries. ME countries are similar yet different. On the one hand, most of them are Muslim countries and many of them have oil. On the other hand, there are significant differences in income levels ranging from a high of around $ 17,000 (UAE, Israel) to a low of around $ 300 (Yemen),[8] and in economic structures. The structure of the GDP of ME countries is shown in Table 5.

In the ME the service sector is the largest contributor to GDP, followed by industry and agriculture. The small contribution of the agricultural sector could be explained by the fact that most of these countries have a desert climate. The industrial sector is large in the oil exporting countries[9] because oil is included in industry. But manufacturing is still quite small in all of these countries except in Israel. The ME economies rely heavily on services, which include government

[8] World Bank (2002).

[9] Oil exporting countries are: Bahrain, Egypt, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates.

and financial services. Looking at exports and imports, the top 4 expor-

TABLE 5

PERCENTAGE GDP STRUCTURE OF ME COUNTRIES

| | Agriculture | Industry (including oil) | Manufacturing | Services |
|---|---|---|---|---|
| Bahrain | 1.0 | 35.0 | n.a. | 64.0 |
| Cyprus | 6.5 | 20.3 | n.a. | 73.3 |
| Egypt, Arab Republic | 17.0 | 33.0 | 27.0 | 50.0 |
| Iran, Islamic Republic | 19.0 | 26.0 | n.a. | 54.0 |
| Iraq | 6.0 | 13.0 | n.a. | 81.0 |
| Israel | 4.0 | 37.0 | n.a. | 59.0 |
| Jordan | 2.0 | 27.0 | 15.0 | 71.0 |
| Kuwait | 0.3 | 60.0 | n.a. | 39.7 |
| Lebanon | 12.0 | 27.0 | 17.0 | 61.0 |
| Oman | 3.0 | 40.0 | n.a. | 57.0 |
| Qatar | 1.0 | 49.0 | n.a. | 50.0 |
| Saudi Arabia | 7.0 | 48.0 | 10.0 | 45.0 |
| Syria, Arab Republic of | 24.0 | 30.0 | n.a. | 46.0 |
| United Arab Emirates | 3.0 | 46.0 | n.a. | 51.0 |
| Yemen, Republic of | 17.0 | 49.0 | 11.0 | 34.0 |
| Average for ME | 8.4 | 34.2 | n.a. | 57.5 |

*Sources*: World Bank (2000) and CIA (2002). Bahrain, Cyprus estimates are from 2001 (CIA 2002); Kuwait and UAE estimates are from 2000 (CIA 2002); Israel and Oman estimates are from 1999 (CIA 2002); Qatar estimate is from 1996 (CIA 2002); Iraq estimate is from 1993 (CIA 2002). Iran and Syria estimates are from 2001 (World Bank 2000); Egypt, Jordan, Lebanon, Saudi Arabia and Yemen estimates are from 1999 (World Bank 2000).

ters in 2000 were: Saudi Arabia, the United Arab Emirates, Israel and Iran, with Saudi Arabia leading the group by far. As for the top 4 importers in 2000 we have: Israel, the United Arab Emirates, Saudi Arabia and Iran. Imports and exports vary from country to country, however oil remains the main exported commodity in the ME representing around 70% of total exports. Other major exports are metals, precious stones, food products and chemicals. As for imports, the ME imports mainly food, machinery and transportation equipment, clothes, high-tech products and military supplies. The United States is by far the major trading partner of the ME followed by Germany, the United Kingdom, France, Italy and Japan in no particular order. The United States has significant interests in the ME due to two main factors: Israel and oil. Israel trades heavily with the

US. As for oil, the US is the largest importer. As for other trading partners, the vicinity of these countries to the ME and their political and economical relations play an important role. In Table 6 ME import/export of goods and services as a percentage of GDP are given.

TABLE 6

EXPORTS AND IMPORTS OF GOODS AND SERVICES AS A PERCENTAGE OF GDP

| | | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|---|
| Bahrain | Export | 116 | 82 | 65 | 74 | 82 |
| | Import | 95 | 70 | 64 | 62 | 63 |
| Cyprus | Export | 52 | 47 | 44 | 45 | n.a. |
| | Import | 57 | 50 | 51 | 48 | n.a. |
| Egypt, Arab Republic | Export | 20 | 22 | 16 | 15 | 16 |
| | Import | 33 | 28 | 26 | 24 | 23 |
| Iran, Islamic Republic | Export | 22 | 21 | 15 | 23 | 32 |
| | Import | 24 | 18 | 17 | 18 | 19 |
| Iraq | Export | n.a. | n.a. | n.a. | n.a. | n.a. |
| | Import | n.a. | n.a. | n.a. | n.a. | n.a. |
| Israel | Export | 35 | 31 | 32 | 36 | 40 |
| | Import | 45 | 46 | 40 | 45 | 47 |
| Jordan | Export | 62 | 51 | 45 | 43 | 42 |
| | Import | 93 | 72 | 64 | 61 | 68 |
| Kuwait | Export | 45 | 54 | 45 | 46 | 57 |
| | Import | 58 | 43 | 52 | 40 | 31 |
| Lebanon | Export | 18 | 12 | 12 | 12 | 13 |
| | Import | 100 | 65 | 43 | 38 | 38 |
| Oman | Export | 53 | n.a. | n.a. | n.a. | n.a. |
| | Import | 31 | n.a. | n.a. | n.a. | n.a. |
| Qatar | Export | n.a. | 44 | n.a. | n.a. | n.a. |
| | Import | n.a. | 43 | n.a. | n.a. | n.a. |
| Saudi Arabia | Export | 46 | 44 | 35 | 41 | 50 |
| | Import | 36 | 31 | 31 | 27 | 26 |
| Syria, Arab Republic of | Export | 28 | 31 | 30 | 32 | 37 |
| | Import | 28 | 38 | 31 | 32 | 34 |
| United Arab Emirates | Export | 65 | n.a. | n.a. | n.a. | n.a. |
| | Import | 40 | n.a. | n.a. | n.a. | n.a. |
| Yemen, Republic of | Export | 14 | 23 | 26 | 35 | 46 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | Import | 20 | 42 | 47 | 38 | 35 |

*Source*: World Bank (2002).

## 4.2. *Economic openness*

As for economic restrictiveness, the trade restrictiveness index for each country is shown in Table 7.

TABLE 7

ME TRADE RESTRICTIVENESS

| Country | 1998 | 1999 | 2000 |
|---|---|---|---|
| Bahrain | 1 | 1 | 1 |
| Cyprus | 1 | 1 | 1 |
| Egypt | 8 | 8 | 8 |
| Iran, Islamic Republic of | 10 | 10 | 10 |
| Iraq | n.a. | n.a. | n.a. |
| Israel | 1 | 1 | 1 |
| Jordan | 7 | 7 | 6 |
| Kuwait | 4 | 4 | 4 |
| Lebanon | 6 | 7 | 7 |
| Oman | 4 | 4 | 4 |
| Qatar | 1 | 1 | 1 |
| Saudi Arabia[a] | 5 | 5 | 5 |
| Syria, Arab Republic of | 10 | 10 | 10 |
| United Arab Emirates | 1 | 1 | 1 |
| Yemen,[b] Republic of | 5 | 5 | 5 |

[a] In 2001 Saudi Arabia became considered as an open economy with a score of two for trade restrictiveness.
[b] In 2001 Yemen became considered as an open economy with a score of two for trade restrictiveness.
*Source*: IMF Staff Calculation.

Out of the 15 countries, we have 4 countries with restrictive economies (between 7 and 10): Egypt, Iran, Lebanon and Syria; 3 countries with moderate economies (between 5 and 6): Jordan, Saudi Arabia and Yemen; and 7 countries with open trade economies (between 1 and 4): Bahrain, Cyprus, Israel, Kuwait, Oman, Qatar and UAE. Not surprisingly, the countries that are considered less trade restrictive are the same countries that have a well-developed economy.

## 4.3. *WTO membership*

As for membership in the World Trade Organization (WTO), somewhere over half of the countries have joined (see Table 8). Here again, the countries that were considered to have high trade restrictiveness are either an observer or not a member of the WTO (Iran, Iraq, Lebanon, Saudi Arabia). However, the general trend in the ME is toward more open trade regimes.

TABLE 8

WTO MEMBERSHIP

| Country | Status |
|---|---|
| Bahrain | Joined on 1/1/95 |
| Cyprus | Joined on 30/7/95 |
| Egypt | Joined on 30/6/95 |
| Iran, Islamic Republic of | Not a member |
| Iraq | Not a member |
| Israel | Joined on 21/4/95 |
| Jordan | Not a member |
| Kuwait | Joined on 1/1/95 |
| Lebanon | Observer* |
| Oman | Joined on 9/11/00 |
| Qatar | Joined on 13/1/96 |
| Saudi Arabia | Observer |
| Syria, Arab Republic of | Not a member |
| United Arab Emirates | Joined on 10/4/96 |
| Yemen, Republic of | Observer |

* Observer governments are countries that are in the process of accession to the WTO.
*Source*: World Trade Organization website.

### 4.4. *Regional arrangements, conflicts and sanctions*

Other major factors shaping the ME trade picture are the free trade area known as the Gulf Cooperation Council (GCC), the Organization of Petroleum Exporting Countries (OPEC) and a number of sanctions imposed on countries in the ME. The members of the GCC are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The GCC is essentially a free trade area where the flow of goods and services from one country to another are not subject to trade restrictions. Relations among ME countries have been highly volatile, with a number of regional conflicts. All Arab countries (and Iran) with the exception of Jordan and Egypt boycott trade with Israel, while Lebanon and Syria are considered to be in a state of war with Israel. Other past conflicts that have shaped relations among ME countries are: the Iraqi-Iranian conflict, the invasion of Kuwait by Iraq and the Gulf War. As for sanctions, the UN has imposed sanctions on Iraq, severely restricting its external trade. There are comprehensive US sanctions on Iran. The implications of these regional factors, namely, the GCC, conflicts, boycotts and sanctions on intra-ME trade are examined below.

## 5. Intra-ME trade

Intra-ME trade (see Table 9) as a percent of total trade was 9.58 (1990), 8.69 (1995), 9.92 (1998), 8.11 (1999) and 6.62 (2000).[10] In 1990, the average was 9.58%, which surprisingly is almost the highest one over the decade. In 1990, Iraq had not yet invaded Kuwait, and was actually an important player in intra-ME trade. Furthermore, in 1990 Oman was trading heavily with ME countries (more than 50% of its trade activity was within the region) and more specifically with the UAE. In addition, Jordan still had not signed a peace agreement with Israel, and official trade between the two countries did not exist. In 1995 this picture changed. The average decreased to 8.69%. The main reason was the Gulf War and the removal of Iraq as a major trader in the region due to UN sanctions. Furthermore, Oman decreased its intra-regional trade significantly and its exports to the UAE fell by almost 50%. In 1998, the regional trade figures increased to 9.92% reaching their highest average over the decade. During this period, namely, from 1995 to 1998, the UN allowed Iraq to sell oil for food and Jordan signed a peace agreement, which was followed by bilateral trade with Israel. In 2000 regional trade plummeted, reaching an all time low of 6.62%. This drop was due to a number of factors. The most significant was that total exports (largely oil) of these countries increased by approximately 85% while intra-regional trade increased by only 25%.

[10] In the calculation of these figures, we divided the total intra-Middle East trade of all countries by the total trade of all Middle Eastern countries for every year and using data from the IMF Direction of Trade Statistics.

TABLE 9

INTRA-ME TRADE[a]
(in percentage)

| Country | 1990 | Diff. | 1995 | Diff. | 1998 | Diff. | 1999 | Diff. | 2000 | Diff. |
|---|---|---|---|---|---|---|---|---|---|---|
| Bahrain | 15.36 | 5.78 | 12.57 | 3.88 | 14.80 | 4.88 | 11.47 | 3.36 | 9.40 | 2.78 |
| Cyprus | 23.31 | 13.73 | 17.90 | 9.21 | 24.13 | 14.21 | 23.87 | 15.76 | 26.62 | 20.00 |
| Egypt | 14.65 | 5.08 | 14.78 | 6.09 | 18.15 | 8.23 | 15.29 | 7.18 | 9.96 | 3.33 |
| Iran, Islamic Republic of | 1.37 | –8.21 | 5.64 | –3.05 | 8.90 | –1.01 | 9.67 | 1.56 | 7.53 | 0.90 |
| Iran, Islamic Republic of | 0.45 | –9.13 | 0.82 | –7.87 | 2.16 | –7.76 | 1.64 | –6.47 | 1.03 | –5.59 |
| Iraq | 4.32 | –5.26 | 82.86 | 74.17 | 4.35 | –5.57 | 3.17 | –4.94 | 3.22 | –3.40 |
| Israel | 0.33 | –9.25 | 0.46 | –8.23 | 0.77 | –9.15 | 1.31 | –6.80 | 0.84 | –5.78 |
| Jordan | 35.06 | 25.48 | 34.99 | 26.30 | 35.46 | 25.54 | 31.11 | 23.00 | 31.31 | 24.69 |
| Kuwait | 6.99 | –2.59 | 2.18 | –6.51 | 2.96 | –6.95 | 1.44 | –6.67 | 0.75 | –5.88 |
| Lebanon | 50.77 | 41.19 | 43.87 | 35.18 | 51.51 | 41.59 | 42.98 | 34.87 | 45.80 | 39.17 |
| Oman | 54.18 | 44.61 | 16.92 | 8.23 | 22.69 | 12.78 | 16.17 | 8.06 | 12.12 | 5.50 |
| Qatar | 5.64 | –3.94 | 6.96 | –1.73 | 5.03 | –4.89 | 3.55 | –4.56 | 7.72 | 1.10 |
| Saudi Arabia | 9.22 | –0.36 | 8.76 | 0.07 | 11.16 | 1.25 | 8.79 | 0.69 | 6.13 | –0.50 |
| Syria, Arab Republic of | 17.51 | 7.93 | 23.15 | 14.46 | 23.88 | 13.96 | 20.21 | 12.10 | 22.05 | 15.42 |
| United Arab Emirates | 9.29 | –0.29 | 10.23 | 1.54 | 12.30 | 2.38 | 10.54 | 2.43 | 9.73 | 3.10 |
| Yemen, Republic of | 4.37 | –5.21 | 11.11 | 2.41 | 9.76 | –0.16 | 2.83 | –5.28 | 4.10 | –2.53 |
| Overall | 9.58 | -- | 8.69 | -- | 9.92 | -- | 8.11 | -- | 6.62 | -- |

[a] In Table 9, for individual countries, the difference represents the country's intra-trade minus the overall intra-regional trade figure for the Middle East.
[b] For the Islamic Republic of Iran, the first row is total trade including bilateral trade with the UAE and the second row is excluding that bilateral trade.

## 6. Why is intra-ME trade so low?

Why has intra-ME trade been so low (around 7%) during these last decades when groups over the world are trying to unite economically and even politically?

### 6.1. *Geographical factors*

The dearth of infrastructure to support trade between neighboring countries in the ME has certainly reduced the incentive for intra-regional trade. The geographical context with desert landscape, rough areas and difficult climates is already an impediment for intra-regional trade. Railroads are almost non-existent between ME countries. The inadequacy of the land routes and the shortages of important air and marine connections between regions with such a geographical proximity are amazing. Until now the expected "Pan Arab highway" is still not completed, although a number of countries have the financial means to complete it. Saudi oil money has built an astonishing network of roads and highways within the deserts of Saudi Arabia, but the road linking Egypt to Saudi Arabia (with a causeway of about 9 miles along Tiran Island between the Saudi coast and the Sinai peninsula) that would connect the Eastern and Western parts of the ME is only a project for the twenty-first century. "The Arab League has put together plans for economic development, economic cooperation and the building of specific projects like the Pan-Arab Highway. They're still sitting on the shelf. The whole thing is a model of non-action",[11] says Sharabi.

### 6.2. *Human and labor factor*

Intra-regional trade would also be promoted through unimpeded travel. Visas are still required for most countries for nearly all citizens of the region, the exception being travel within the GCC by citizens of the GCC. Because of undiversified economies, unemployment and labor difficulties are critical in the region and induce strong national sentiments and restrictive immigration policies toward labor from neighboring countries. Travel is thus restricted among the countries except for pilgrimage, inducing less cultural interaction, less knowledge of the markets of neighboring countries, less familiarity with their local products and therefore less incentive for intra-regional trade.

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[11] Bernard and Abdel-Hadi (2001).

### 6.3. *Historical factors*

After the peace settlement of World War I, the universally despised occupation of most of these countries by the Ottoman Empire was changed to that of a protectorate under British or French rule. As a result, ME countries did not witness a surge of national consciousness until maybe after their independence following World War II. The long and old animosities between ME countries and the creation of the State of Israel in 1948 did not help the area to pool the political efforts conducive to rational economic integration and intra-regional trade.

### 6.4. *Economic structure*

Most of the countries in the region have failed to diversify their economic base and to compete successfully in international markets. Growth policies of the richest countries have been mostly dependant on the oil sector with little diversification. The most important commodity produced in the region, namely oil, could not be traded among oil-producing countries, as 'oil is oil', and other industries were not important enough to generate intra-regional trade. Thus the dearth of economic diversity has made the ME more reliant on US, Japanese or European goods.

The divergences in the region in market size, resource availability and per-capita income are significant, so that often the few goods that are produced in the region are not luxurious or fashionable enough for some and out of reach for others. The smaller Gulf countries for example are better served with high-quality goods of the industrialized western or far-eastern countries. The income disparities resulted in significant differences in consumption and buying behaviors. ME countries have ultimately very little to sell to each other. The main exports are often agricultural products or oil, there is an absence of product complementarity within the area, and this of course is detrimental to trade relations. This narrow export base and the similar factor endowments in the region hinder regional trade, which is by definition based on product differentiation.

### 6.5. *Lack of investment incentives*

The low level of cross-border investment is an important hindrance for intra-regional trade. The bureaucracy is difficult to deal with for non-nationals, and the presence of pervasive corruption is common to nearly all countries in the area.[12] Banking and financial regulations are not well defined and there is an absence of legal support for investors.[13] The predominant role of the state and restrictive ownership rules even for citizens of neighboring countries divert potential investments to countries outside the ME.

### 6.6. *Political factors*

The presence of oil makes the ME a strategic area for the western world. Most of the ME has non-democratic regimes, based on heredity (royalty and sheikhdoms) or despotic rulers. Unfortunately, these authoritarian political regimes are very often supported by the West, which finds in them stable partners for a stable oil-producing economic region. Political tensions are therefore difficult to resolve among neighbors and the fear of popular uprisings is always present in the minds of the rulers. The lack of trust and commitment among 'brother' countries is astonishing. It is very often nourished by heavy intervention of foreign agents who fear for their own interests in the region. This is one reason why it is difficult to achieve political agreement to ease tension and create a climate favorable for cultural interactions, economic agreements and therefore intra-regional trade incentives. The region is never at rest with the Arab-Israeli war, the Kurdish problem, the Kuwait-Iraq conflict, the Gulf War, the Iran-Iraq war, the Intifada, the separation of the two Yemens, the Lebanese 'Civil' War and other less-publicized conflicts. The new fear of radical and fundamentalist movements is the most imminent danger for long-settled ME politicians.

The presence of conflicts have also induced ME countries to favor military spending over social and economic development. The military spending for the region as a whole is significantly higher than

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[12] Zarrouk (2002).

[13] *Ibid.*

the average military spending of other developing areas, nourishing conflicts rather than trade between neighboring countries. Although military spending for the region has declined in the past 2 or 3 years in part because of the sanctions on Iraq and Iran, it is still the highest in the world,[14] higher (as a percent of GDP) than the average military spending of any other developing area. The build up of arms has hindered intra-regional trade by nourishing conflicts between neighboring countries.

### 6.7. *Differences in monetary and commercial policies*

The presence and the power of local monopolies (often supported by leaders for personal rather than national economic reasons), differences in exchange rate policies, organization, and market conditions, the existence and tolerance of public intervention in markets, the lack of administrative skills and defined goals, the lack of consensus and information between ME countries and the small size of most ME countries have not allowed entities to incorporate the benefits of economies of scale and have proved to be a hindrance to trade in general and intra-regional trade in particular.

### 6.8. *Tariff barriers, quotas, licenses and custom duties*

One of the most cited tariff barriers by traders[15] in the ME is the unofficial 'bribery' tariff (and agent fees) that can be found in many ME countries. For example, in discharging a container in many Egyptian or Lebanese ports a nomenclature of 'various other costs' accounts for important bribery costs which traders know to take into account when calculating their customs and container discharging costs. This unofficial tariff increases the cost of intra-regional trade. Customs clearance procedures are still very important trade barriers in many ME countries.[16]

The ME region except for the GCC countries can be considered one of the most protectionist areas of the world. Many Arab coun-

[14] Cordesman (2001).
[15] Zarrouk (2002).
[16] *Ibid.*

tries (except for the GCC) have relied on high tariffs to generate revenues to compensate for inefficient tax collection and policies. This of course has constituted a barrier to trade. Tariff rates and structures differ greatly in the ME region. The GCC countries have the lowest tariffs, ranging from 4% to about 12%, whereas other countries like Egypt or Jordan have tariffs of 40% to 100%, and some tariffs in Syria can reach more than 200%. In many industries such as textiles or clothing, tariff escalation is remarkable with tariffs on finished products being multiples of those on raw materials.[17] The use of quotas has been declining in many ME countries, but the import license requirements remain high in many countries, particularly Syria. Furthermore, regulations concerning environmental or product standards are not the same, and there is no agreement within ME countries for certification or testing procedures, whereas in many other areas of the world these regulations have been largely harmonized between neighboring countries. The registration procedures of pharmaceuticals in the different health ministries of the ME have often been reported as the most difficult in the world.[18]

### 6.9. *Economic sanctions*

Sanctions are also an important factor for low intra-regional trade in the ME. The boycott of Israel by most neighboring countries, and the insignificant trade between Israel and countries such as Egypt or Jordan, which resumed political and economic relations with Israel, is due to historical animosities between the Arabs and the Israelis. The sanctions against Iraq have, needless to say, been an extremely important factor for diminishing regional trade relations in the last decade.

### 6.10. *Problems of education and religion*

The high level of illiteracy in many ME countries and the nearly non-existent economic role of nearly half of the population, namely women, can also be viewed as an impediment for intra-regional trade in

[17] Economic Research Forum (2000).
[18] Zarrouk (2002).

particular and international trade in general, because a strong and large base of skilled labor is often a prerequisite for trade. The requirement for a woman to get a travel permit from a male relative has hindered half of the population's ability to travel. Some restrictions encourage smuggling (non-reported trade) at the expense of intra-regional trade. Restrictions (for religious reasons) on alcohol, dolls, books, games, music, movies, etc., in some rich Muslim countries understate formal trade and promote informal trade. In trade-oriented countries such as the UAE (Dubai) or Lebanon, regional trade problems are lower because of a freer society.

### 6.11. *Regional trade agreements*

Some tentative regional trade agreements have been established, but their impact was not enough to increase the poor (7%) intra-regional trade ratio. Eight of the Arab League's twenty-two members did not belong to the WTO in 2002. The main regional agreements were mainly Arab agreements. Some of them have failed, such as the Agreement of Economic Unity in 1957 or the formation of the Arab Common market in 1964. The most promising may be the Greater Arab Free Trade Area (GAFTA) in 1997, whose legal framework was inspired and based on the once forgotten 1981 Facilitation and Promotion of Inter-Arab Trade Agreement. The GAFTA agreement signed by fourteen of the twenty-two members of the Arab League in 1997 is to be fully implemented by roughly 2008 after a 10-year transition period. Learning from past errors, an effort has been made to include an action plan and a predefined implementation schedule. The main objectives of the GAFTA are to reduce tariff barriers among member countries, encourage intra-regional trade and to establish common customs classification and standardized rules of origin; eighteen countries had adhered to GAFTA by 2002.

The goal of the Gulf Cooperation Council (GCC), although initially political, is also to promote trade between its members. At the end of 2001, it agreed in line with WTO requirements to unify regional customs tariffs at 5%[19] in 2003 and to create a single market and currency before 2010. While tariffs between members have been re-

[19] *Middle East Economic Survey* (2002).

moved, significant and differential production subsidies insulate national industries from foreign competition. The main drawbacks of such agreements for intra-regional traders were the lack of information from public agencies of the benefits of such trade accords and the lack of reciprocal respect of many clauses of the arrangement. Many clauses are often left to the interpretation of custom officials who lack knowledge about these agreements.

The creation of free zones has been significant in the region under the auspices of the WTO. More than twenty-five[20] have been created or are under construction in the Arab countries, the most successful one being in Dubai at Jebel Ali. But on the whole, the results have not been that promising. The main problems faced by investors in ME free zones include excessive bureaucracy, lack of infrastructure, confusion about sudden changes in laws or regulations, overlap of procedures and legal framework policies within the free zone and a lack of autonomy.

## 7. What explanations fit the facts?

While we have suggested a number of possible explanations above for the low level of intra-regional ME trade, we now turn to see which explanation, if any, is supported by facts.

### 7.1. *Economic structure*

Looking at the *World Development Report (2000/2001)* Structure of Output Table, for more than 130 countries for the years 1990 and 1999, we see that the MENA region for the year 1990 has the lowest value added of manufacturing as a percentage of GDP (13%). Although figures for the ME for 1999 are not available in the table, it can be inferred that they could not have changed significantly because the figures for the world as a whole and for similar regions for 1990 and 1999 have been relatively stable for the manufacturing sector:

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[20] Economic Research Forum (2000).

around 21.5% for the world, 18% for low-income countries, 24% for middle-income countries and 21.5% for high-income countries. Furthermore, available data on many individual countries of the ME such as Jordan, Saudi Arabia, Yemen and Egypt allows us to deduce that the 13% figure should not have increased (if it has increased at all) by more than 2 or 3% between 1990 and 1999. This still leaves us with a MENA region lagging significantly behind the world in terms of contribution of manufacturing to total GDP, although the industry figures seem to be higher than the world's or other developing areas' figures (in 1990 for instance, 38% for MENA, 34% for the world, 26% for South Asia and 34% for Sub-Saharan Africa). This can be explained again by the presence of oil (classified as industrial) in the region, which accounts for an important part of GDP in oil-producing countries. The heavy reliance on the oil sector and the failure of ME economies to diversify their economies seem to be the most obvious explanation as to why manufacturing contributes so little to GDP.

The problem for regional trade is that in the first place, 'oil is oil' and therefore cannot be traded within the region with similar factor endowments, and second, the lack of manufactured goods (where product differentiation is widespread) has had a negative impact on regional trade because countries have nothing to sell to each other, at least as far as manufactured goods are concerned. Vertical specialization,[21] which is becoming progressively more important for other developing regions with abundant labor, is delayed in the ME by the rigidity of the economies and the lack of openness to trade. The differences in per-capita income might also explain this poor performance, as rich oil countries are not interested in the low quality manufactured goods of neighboring countries.

### 7.2. *Leave out oil trade totally and leave out oil exporters*

When we leave out the oil sector or the oil exporters we are left with about the same insignificant figures for ME intra-regional trade, because oil is the major commodity exported between any country of the ME that has oil and those who have not. Furthermore, because oil exports are the major component of trade in the ME, and 'oil is oil',

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[21] IMF (2002).

oil-producing countries with similar production structures do not trade with each other. Leaving them out of our calculation is about the same thing as leaving oil out. In fact oil represents more than 70% of the ME export since 1990. Also, the figures show that leaving out oil exporters decreases intra-ME trade significantly. For instance, removing the oil exporters from the ME resulted in a decrease in the overall intra-regional trade of above 4 percentage points (see Table 10).

TABLE 10

EFFECT OF OIL EXPORTERS ON INTRA-ME TRADE
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without oil exporters | 547 | 857 | 789 | 853 | 990 |
| Total ME trade without oil exporters | 40,229 | 28,368 | 30,904 | 66,234 | 43,353 |
| % intra-ME trade without oil exporters | 1.36% | 3.02% | 2.55% | 1.29% | 2.28% |
| Original intra-ME trade values with oil exporters | 9.58% | 8.69% | 9.92% | 8.11% | 6.62% |
| Difference | –8.22% | –5.67% | –7.36% | –6.82% | –4.34% |
| *Percentage difference* | –85.80% | –65.24% | –74.25% | –84.12% | –65.53% |

*Source*: IMF (2002).

The heavy reliance on the oil sector and the dependency on oil revenues show why oil has been intoxicating for the ME. The revenues are so huge that oil exporters did not even feel the need to create a sustainable economy and to diversify their production and their industries – the curse of oil. In the past, major oil exporters could ensure a high standard of living for their citizens and were thus not challenged by their populations to adopt sound economic policies and accelerate necessary reforms for creating new industries, diversifying and privatizing their economies. Social programs are financed by the state and taxes are very low or inexistent, so oil revenues have had an anti-democratic impact and have 'bought' internal peace and stability for ME governments. External protection of ruling classes is assured by the importance of oil for the great powers. Regional projects are usually state-financed, thus reducing the private dynamism needed in an open economy. Even the private sector does not function according to the rules of competition because it is in the hands of people close to the ruling families and under the patronage of the state.[22]

## 7.3. *Leave out GCC and look at intra-GCC trade*

If GCC countries are taken out of the ME, intra-ME trade decreases significantly. The minimum decrease is by about 4.2 percentage points (see Table 11) (or about a 49% decrease from the original intra-ME trade figure) in 2000 and the maximum decrease is about 6.5 percentage points in 1998. GCC are main contributors to the intra-ME trade.

TABLE 11

INTRA-ME TRADE EXCLUDING THE GCC
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without GCC | 1,613 | 2,176 | 1,855 | 1,973 | 2,312 |
| Total ME trade without GCC | 51,334 | 49,114 | 54,102 | 70,489 | 97,359 |
| % intra-ME trade without GCC | 3.14% | 4.43% | 3.43% | 2.80% | 2.37% |
| Original intra-ME trade values with GCC | 9.58% | 8.69% | 9.92% | 8.11% | 6.62% |
| Difference | –6.44% | –4.26% | –6.49% | –5.31% | –4.25% |
| *Percentage difference* | –67.19% | –49.02% | –65.42% | –65.48% | –64.13% |

*Source*: IMF (2001).

GCC intra-regional trade is important. In fact, more than 44% of intra-ME trade is intra-GCC trade (see Table 12). The pattern of GCC trade differs significantly from the rest of the ME. Due to oil, GCC countries are rich with high per capita incomes. For instance, in 1998, the UAE had an average per capita income of $ 15,745, while the average per capita income in neighboring Yemen was only $ 270.[23] The GCC has adopted an open trade policy with low, or sometimes non-existent, tariffs. These countries have the best infrastructure and communications network in the area and they have managed to inte-

[22] Sud (2000)
[23] Mehanna (2001).

grate more soundly within the regional and international trade systems. Additionally, it should be noted that a significant component of GCC trade with other ME countries is re-exports. Oil still remains the main export commodity of the GCC. Further efforts are required to create a viable non-oil sustainable economy for future generations.

TABLE 12

INTRA-GCC TRADE
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Intra-ME trade | 13,092 | 12,956 | 14,199 | 14,842 | 17,707 |
| Intra-GCC trade | 7,230 | 6,832 | 7,358 | 7,192 | 8,453 |
| % of intra-ME trade due to intra-GCC trade | 44.77% | 47.27% | 48.18% | 51.54% | 52.26% |

*Source*: IMF (2001).

### 7.4. *Leave out Israel*

When Israel is taken out of the ME, intra-ME trade (as a percentage of export) rises but not significantly, in fact the maximum increase occurs for 1998, approximately 1.6 percentage points. Israel's trade in the ME is small compared to its trade with the rest of the world. In fact, as of 2000 Israel is only trading with 3 countries (Cyprus, Egypt and Jordan) for a total of $ 264 million; a very small figure compared to its total export of $ 25.7 billion. Because Israel's total exports are high compared to its intra-ME trade, Israel pushes intra-ME trade down, but not significantly.

TABLE 13

INTRA-ME TRADE EXCLUDING ISRAEL
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without Israel | 12,873 | 12,672 | 13,825 | 14,227 | 17,326 |
| Total ME trade without Israel | 124,602 | 130,024 | 120,193 | 157,237 | 235,941 |
| % intra-ME trade without Israel | 10.33% | 9.75% | 11.50% | 9.05% | 7.34% |
| Original intra-ME trade values with Israel | 9.58% | 8.69% | 9.92% | 8.11% | 6.62% |
| Difference | 0.75% | 1.05% | 1.59% | 0.94% | 0.72% |
| *Percentage difference* | 7.87% | 12.13% | 15.99% | 11.58% | 10.84% |

*Source*: IMF (2001).

It would be interesting to see what would happen if trade were to develop between Israel and the Arab countries in the ME. One of the most important benefits for Israel is that it would have easier access to lower priced oil, thus reducing its productions costs and enhancing its comparative advantage. A study estimated the cost of transporting crude oil, from Mexico to Israel at US$ 1.53 per barrel in 1999 and at US$ 0.74 from Saudi Arabia.[24] Israel would also have access to the natural gas of the Arab countries, which would mean changing electricity generation from oil and coal to gas, implying lower costs and an improved environment.

## 7.5. *Leave out Iraq*

Taking out Iraq from the ME leaves us with the following scenario in Table 14.

TABLE 14

INTRA-ME TRADE EXCLUDING IRAQ
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without Iraq | 11,798 | 12,273 | 13,690 | 14,238 | 16,905 |
| Total ME trade without Iraq | 124,302 | 148,574 | 136,236 | 171,031 | 247,979 |
| % intra-ME trade without Iraq | 9.49% | 8.26% | 10.05% | 8.32% | 6.82% |
| Original intra-ME trade values with Iraq | 9.58% | 8.69% | 9.92% | 8.11% | 6.62% |
| Difference | –0.09% | –0.43% | 0.13% | 0.22% | 0.20% |
| *Percentage difference* | –0.91% | –4.96% | 1.33% | 2.66% | 2.98% |

*Source*: IMF (2001).

The change in intra-ME trade is small, ranging from –0.43 to 0.22 percentage points. Iraq is not a major player in the intra-ME trade. Before 1995, before the Gulf War and United Nations (UN) sanctions, Iraq pushed the intra-ME trade up. In fact, the majority of its trade was with the ME since its exports to the rest of the world were limited. Starting in 1996 with the Oil for Food Program, Iraq's trade with the rest of the world increased significantly, reducing the relative importance of ME trade. For instance, in 1995 the share of Iraq's ME trade with respect to Iraq's total export was approximately

[24] Rivlin (2000, pp. 56-66).

83%, after 1995 its share was below 4.5%. When looking at Iraq's trade with its ME neighbors, in the post-1991 era, the figures for intra-regional trade are difficult to find, in part because of smuggling. Arab solidarity with Iraq (which flourished during the Arab summit of Beirut in March 2002) and the free trade agreements between Iraq and neighboring countries (Syria and Egypt) converge toward the efforts of the GAFTA agreements to create a free zone and to cancel trade barriers by 2007.

## 7.6. *Leave out Iran*

The majority of Iran's ME trade is with the UAE (largely Dubai). For instance, in 2000 the total export of Iran to the ME was about $ 2,260 million, and 91% of it was to the UAE. However Iran's contribution to overall intra-ME trade is small. In fact, when Iran is removed from the ME, the change in intra-ME trade is negligible, ranging from –0.7 percentage points in 1999 to 0.18 percentage point in 1990. In 1990 Iran pushed the ME intra-regional trade down. However, after 1990, due to its enhanced relations with other ME countries, Iran's effect on intra-ME trade is slightly positive. If we consider that the major part of Iran's exports to the UAE is in fact re-exported to other countries, then the effect of Iran on ME intra-regional trade becomes even less significant.

TABLE 15

INTRA-ME TRADE EXCLUDING IRAN
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without Iran | 11,688 | 11,231 | 12,077 | 12,103 | 14,365 |
| Total ME trade without Iran | 119,812 | 132,270 | 130,068 | 163,305 | 237,262 |
| % intra-ME trade without Iran | 9.76% | 8.49% | 9.29% | 7.41% | 6.05% |
| Original intra-ME trade values with Iran | 9.58% | 8.69% | 9.92% | 8.11% | 6.62% |
| Difference | 0.18% | –0.20% | –0.63% | –0.70% | –0.57% |
| *Percentage difference* | 1.85% | –2.30% | –6.37% | –8.60% | –8.61% |

*Source*: IMF (2001).

TABLE 16

EFFECT OF IRANIAN-UAE BILATERAL TRADE
ON THE OVERALL ME PICTURE
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without Iran to UAE export | 12,938 | 12,147 | 13,314 | 13,258 | 15,651 |
| Total ME trade without Iran to UAE export | 136,528 | 148,261 | 142,301 | 181,447 | 265,223 |
| % intra-ME trade without Iran to UAE export | 9.48 | 8.19 | 9.36 | 7.31 | 5.90 |
| Original intra-ME trade values with Iran to UAE export | 9.58 | 8.69 | 9.92 | 8.11 | 6.62 |
| Difference | –0.10 | –0.50 | –0.56 | –0.80 | –0.72 |
| *Percentage difference* | –1.06 | –5.73 | –5.65 | –9.89 | –10.86 |
| % intra-ME trade values without Iran | 9.76 | 8.49 | 9.29 | 7.41 | 8.80 |
| Difference (% intra-ME trade without Iran – % intra without Iran to UAE export) | 0.28 | 0.30 | –0.07 | 0.10 | 2.90 |

*Source*: IMF (2001).

When we take out bilateral trade relations between Iran and the UAE, we are left with insignificant figures for the impact of Iran on ME regional trade. The Dubai Chamber of Commerce and Industries showed that in recent years Iran has ranked first among UAE partners in import and re-export of goods. In fact, the total figure is about US$ 3 billion, which represents roughly 25% of Dubai's total foreign trade. Iran's small bilateral trade with the rest of the ME can be explained by three major factors: the political instability and the conflicts that have taken place in Iran since 1980; the issue of three disputed islands in the Persian Gulf that has created regional tensions; and the dominance of oil in Iran's external trade. Iran had nothing important to sell to the ME countries except perhaps carpets, fresh and dried fruits and vegetables.

The Iran-Iraq war devastated Iran in 1980, lasted for eight years, depleted Iran's financial reserves and prevented Iran (and Iraq) from achieving economic prosperity. During the war foreign currency reserves and oil exports were used to pay for the war and afterwards to reconstruct what the war had destroyed. Decades of development were lost and the war ended without any gain for either party, with the main issues remaining unresolved. US sanctions on Iran have retarded the flow of foreign investment to stimulate economic growth.

Governmental policies have not promoted economic diversification and growth. Instead nationalization, price and tariff controls, over-valued exchange rates coupled with tight import regulations and strenuous procedures for obtaining trade permits have encouraged smuggling and discouraged trade in general, and regional trade in particular.

### 7.7. *Leave out Israel, Iran and Iraq*

When Israel, Iran and Iraq are taken out of the ME (leaving the Arab countries and Cyprus), the impact on the intra-ME trade figures is not significant. As seen above, the impact of each of these countries individually on intra-ME trade is unimportant, and together their impact still remains insingnificant. However, it appears that their overall effect is to push ME intra-regional trade down since 1990 but not significantly. For instance, the maximum effect occurs in 1998 and represents a 1.26 percentage points increase in ME intra-regional trade when the three countries are removed.

TABLE 17

INTRA-ME TRADE EXCLUDING ISRAEL, IRAN AND IRAQ
(in millions of USD)

| | 1990 | 1995 | 1998 | 1999 | 2000 |
|---|---|---|---|---|---|
| Total intra-ME trade without Israel, Iraq and Iran | 10,176 | 10,264 | 11,194 | 10,884 | 13,182 |
| Total ME trade without Israel, Iraq and Iran | 95,352 | 112,728 | 100,125 | 125,511 | 186,624 |
| % intra-ME trade without Israel, Iraq and Iran | 10.67 | 9.11 | 11.18 | 8.67 | 7.06 |
| Original values of intra-ME trade with Israel, Iraq and Iran | 9.58 | 8.69 | 9.92 | 8.11 | 6.62 |
| Difference | 1.09 | 0.41 | 1.26 | 0.56 | 0.44 |
| *Percentage difference* | 11.42 | 4.76 | 12.74 | 6.94 | 6.70 |

*Source*: IMF (2001).

### 7.8. *Summary*

The fact that intra-ME trade is low cannot be denied. However, adjusting for a number of individual factors such as regional conflict does not explain this low figure; no single factor, besides economic structure, could explain this low figure. Oil has been a crutch for the countries that have oil. They have not diversified their economic base and have (relative to oil) few non-oil exports. Moreover, a number of these economies are not open economies and do not afford countries in the region an attractive export market even though they are not distant. At the same time, the close vicinity of regional markets is made less attractive because of poor regional transportation and communication infrastructure. The formation of the GCC has contributed somewhat to promoting trade among its members and thus also to intra-ME trade.

Looking at all the factors that might have reduced intra-ME trade during the last century, we can come up with some answers to the question: how can regional trade be increased in the ME and what policies are needed?

Economic policies are useless if there is no fundamental political agreement between countries in the region. The Arab Summit of Beirut in March 2002 and its conclusions, which were for once taken unanimously, can be regarded as a shy attempt to general consensus, at least among Arabs. Most Arabs listen cynically to words that seem hollow to them like "Arab unity, ME integration". Very few still believe in them, as was the case in the 1950s. "The Arab League is a pioneer in international regional relations – verbally",[25] says Sharabi.

As Mr Nasser Ali Khasawneh, Vice-President of the international association "Business Software Alliance" (BSA) for North-Africa and the Middle-East,[26] puts it:

> "After years of meaningless sloganeering about pan-Arabism, I do not blame Arabs for their skepticism about AFTZA [another name for GAFTA]. But the fact remains, this is the most tangible step in the past 50 years towards real economic integration. It is now for the people to protect it. We have to keep talking about AFTZA and monitoring its application. We have to make it clear to our governments that we congratulate them on this step and

[25] Bernard and Abdel-Hadi (2001).
[26] Khasawaneh (2000).

> that we want them to continue down this track. It is for us to ensure that the political will behind AFTZA does not wane".

If and only if the above conditions are fulfilled, the policies needed to encourage intra-regional trade in the ME can be envisaged.

Given regional peace and political cooperation, countries must start by launching internal domestic reforms of their financial and legal systems to ensure economic and political stability before heading toward integration and trade liberalization. Red tape, smuggling, monopolies, bureaucracy and legal abuses of powerful interest groups should be eliminated to encourage potential investors and to promote the private sector. Bilateral or multilateral agreements can prove to be a more successful and realistic first step before launching the process of full integration. The pool of skilled labor must be increased through better education.

The transportation of people and goods should be facilitated by simplifying or even canceling visa issuance and cumbersome cross-border trade regulations for goods and people of neighboring countries. A regional common agreement on maritime road transport and on shipping policies is a must. Information is an important prerequisite for the success of the process.

For the ME, and looking at the success of free zones like Jebel Ali Free Zone Area (JAFZA), the easiest and fastest road toward the simplification of trading procedures seems to be the creation of free zones in all the countries of the ME. The freedom of ownership, the elimination of tariff barriers through the exemption of taxes and custom duties, the diminishing legal constraints on investor and the simplification of bureaucracy by decreasing the need for licenses and permits attract investors and FDI from nearby regions and the world. The concentration of many tax-free activities in one zone with extensive infrastructure based on the latest technologies has also contributed to the success of the leading free zones. Creating a free zone seems to be easier than changing the regulatory environment and the bureaucracy. Such an approval is in harmony with the standards of the WTO in terms of trade openness and equal opportunities and protections for investors. In 1998, JAFZA, with nearly 2000 companies, surpassed on-shore Dubai in terms of the volume of external trade (more than US$ 6 billion), growth rate, investments and employment in manufacturing.[27] In 2001, according to Dr Mohammed Khalfan bin Khirbash, UAE Minister of State for Finance and Industry, on the occasion of UAE National Day 30th anniversary,

> "The share of free zones in the total non-oil exports increased from 22 per cent in 1999 to 57 per cent last year. The net exports of free zones have also risen, reaching 1.4 billion US dollars in 2000. Currently, there are more than 3,000 companies operating in the free zones, with an estimated trade of around 8 billion dollars and investment of 4 billion dollars".[28]

> "In ten years time the UAE has managed to establish itself as the most sought after economic hub in the region. Free zones stand out as one of its major achievements, Jebel Ali Free Zone is one of the most enviable example for this region and I rate this superb facility amongst the first three free zones in the world",

said Juan Torrents, president of the Federation of World Free Zones, the apex body of over 2,000 free zones in the world.[29]

Legal, institutional and regulatory frameworks should exist and be applied to ensure the application of any agreement by all members. Businessmen, custom officials, industrial and agricultural producers should all be aware of the importance of the integration process and of existing agreements. Many people in the area do not seem to have even heard of the GAFTA agreement for instance, or perhaps do not believe in the long life of such an agreement. As Mr Hamdi Tabaa, the Chairman of the Federation of Arab Businessmen, puts it,[30] "We have the responsibility to work towards the success of this experience [GAFTA] and to achieve it as soon as possible in a way that makes it necessary to open up to each other before opening up to the world".

The most obvious benefit of higher intra-regional trade is that economic growth will be enhanced. The ME market accounts for over 250 million people.[31] The large ME markets can attract investments if political stability and the safety of investments are guaranteed. The potential benefits from economies of scale are huge. As in

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[27] HSBC (2001).
[28] "National Day / 30th Anniversary / Economy" (2001).
[29] "Free Zones Fastest-Growing" (2002).
[30] Tabaa (2000).
[31] Gresh and Vidal (1996).

any flourishing trade area, higher intra-regional trade will mean that comparative advantage will replace import substitution. Efficient industries will develop and employment, per capita income and growth will be enhanced.

## 8. Conclusion

The European Economic Community and the Arab Economic Community were projects that both started in 1957. The importance of such communities for the economic development of areas with political and military conflict was appreciated by European statesmen. Looking back after a lapse of time of more than 45 years, it is sad to see the tremendous differences in the evolution of the two projects. The EEC had enormous difficulties at all stages of development but overcame them, whereas the ME project was only fed by sterile speeches and arguments. Darwin's principles of survival of the 'fittest' in the struggle for existence can be replaced today by the survival of the 'most united' to face the global world.

During the last century oil turned out to be more of a curse than a blessing for the ME. Oil exporters have used oil as a crutch to avoid painful, but necessary economic reforms. As a result, ME economies are still heavily dependent on oil and oil constitutes the lion's share of aggregate ME exports. The exports of manufactured goods are insignificant, with the exception of Israel. In short, ME countries export oil and because their economies are not diversified and complementary, there is little regional trade. Where regional trade could be significant, for example with Israel, it is prevented by deep-rooted political differences and hostilities. The basis for enhanced trade is diversified economies and the political commitment to peaceful coexistence. The formation of the GCC and GAFTA are a first step. Bilateral agreements and free zones in the area could serve as catalysts toward regional economic integration. The road is long and difficult, but it is imperative. Increased regional trade relations are the first and easiest step. It seems appropriate to end with words written by one of the most famous Arab poets and philosophers in 1923 (Gibran 1923, p. 40):

"It is in exchanging the gifts of the earth that you shall find abundance and be satisfied. Yet unless the exchange be in love and kindly justice, it will but lead some to greed and others to hunger [...] and before you leave the marketplace, see that no one has gone his way with empty hands. For the master spirit of the earth shall not sleep peacefully upon the wind till the needs of the least of you are satisfied".

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