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ECONOMIC INTEGRATION IN MENA:

THE GCC, THE MAGHREB, AND THE MASHREQ

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Introduction: Though the Middle East and North Africa (MENA) region has weathered the recent global financial and economic crisis relatively well, it still faces daunting medium-term challenges. These include high unemployment (especially among young people), vulnerability to oil and food price shocks and water scarcity and inefficiencies of public sectors. Integration of the region into the global economy has been slow. Of particular concern is the stagnation in the region's share of global non-oil exports, an indication of missed opportunities for diversification and growth. Integration within the region, while rising, is also on the low side when compared with other middle- and high-income regional blocs.

The region has been able to make some inroads, albeit at different degrees in each of the geographical groupings, to support the integration of the Arab world into the global economy. To start off the removal of intra-regional tariffs under the Pan-Arab Free Trade Area (PAFTA) and the adoption of low common tariffs by the Gulf Cooperation Council (GCC) which coupled with improvements in infrastructure, especially roads and telecommunications is generating benefits. But much remains to be done, especially in reducing nontariff barriers to trade, harmonizing policies and procedures, and facilitating cross-border trade through development of infrastructure links and trade facilitation. Fortunately, trade in services has recently emerged on the agenda of national and regional authorities—this is an area of substantial potential welfare gain for the region.

Regional Integration and the World Bank: Recognizing the problems, there has been an increasing momentum on the part of the region and the World Bank Group over the last year or so to focus on a set of initiatives to promote more cooperation within the region. These initiatives include the development and implementation of regional activities—investment projects, institution-building, harmonization of policies and procedures—that are likely to enhance economic growth and address common challenges across the region. They also include a host of analytical pieces to examine the current state of regional collaborative arrangements with emphasis on assessing and exploring ways of fostering greater trade integration, labor mobility and migration prospects, prospects for energy integration and resource sharing and infrastructure development to reduce nontariff barriers.

As part of this endeavor, the Office of the Chief Economist, MENA Region, has prepared a series of reports to assess the achievements of

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the region with respect to integration. The first report, "*2008 Economic Developments and Prospects,*" looks at the role of integration in global competitiveness for the region as a whole and special reports have been prepared to take stock of the regional cooperative frameworks, their issues and prospects. These reports examine economic integration among three sub-regions: the *Gulf countries* (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates), the *Maghreb* (Algeria, Libya, Mauritania, Morocco, and Tunisia), and the *Mashreq* (Iraq, Jordan, Lebanon, Syria, and West Bank and Gaza). Egypt is sometimes classified in the literature as a Mashreq country though with ties with North Africa given its location.

The GCC: The Gulf Cooperation Council (GCC) is the most advanced model of sub-regional integration in the broader Middle East and North Africa (MENA) region, and its objectives are among the most ambitious in the developing world. It has evolved well beyond a focus on free trade in goods to embrace high levels of national labor and capital mobility, and the progressive opening of many sectors within each economy to all member states.

Intraregional GCC trade flows remain relatively small despite strong growth in recent years. The average nominal value of intraregional trade increased by approximately 30 percent per annum during 2004–2008, as compared to 6 percent during 2000–2003. However, the share of intraregional trade in non-oil trade remained relatively unchanged at less than 10 percent, with the UAE taking the lead as a source of regional trade. This figure compares unfavorably with other trading blocs such as ASEAN (23 percent), NAFTA (41 percent), and EU-15 (57 percent), reflecting weak complementarities among GCC member states and the relatively liberal trade regimes that had historically characterized the GCC economies.

The GCC is much more integrated with the rest of the world than with MENA because of the role of oil and gas in trade patterns. But integration via labor markets is significant in MENA, especially for Mashreq countries and Egypt. Foreign direct investment (FDI) linkages from the GCC to the rest of MENA are also increasingly important. Nevertheless, because GCC integration occurs against the backdrop of fairly similar circumstances in the member countries, the mechanisms and drivers of integration are somewhat different than in other regional blocs that have larger variation within their membership.

First and foremost, GCC countries are all highly dependent on hydrocarbons, which remain a core prerogative of national—not regional—policy. Second, sovereignty is still shared cautiously so supranational institutions are being built up slowly; key decisions work through opaque intergovernmental processes rather than empowered regional institutions. Third, public sectors in each country are closely linked to the sharing of benefits from hydrocarbon wealth among nationals. This complicates the political economy of economic reform strategies such as privatization and subsidy reduction, which in turn limits the scope for regional integration in areas where the public sector is dominant. Fourth, GCC countries compete with each other in sectors that might otherwise offer scope for regional initiatives, such as finance, transport, and downstream energy.

Besides ongoing integration mechanisms (particularly in infrastructure), addressing common challenges should impart further momentum to the GCC. These include: labor market strategy, where there is scope to revisit the open immigration policy at the regional level; the financial sector, given the regional spillovers from country-level debt distress episodes; fiscal policy, given the countries' objective of diversifying revenue sources; and service sector liberalization, which would expand the size of markets and promote the efficient allocation of resources for the GCC as a whole. However, a more empowered regional secretariat will be necessary to push this agenda forward.

The Maghreb: Trade between the Maghreb countries and the Arab world, as well as the rest of the world, is relatively small, with exports concentrated in a few commodities or products. There are wide country variations, however, with Morocco and Tunisia exhibiting higher trade volume and export diversification.

Despite the establishment of the Arab Maghreb Union over two decades ago, the bulk of the Maghreb trade is with Europe. The level of intra-Maghreb trade is lower than that of many of the world's trading blocs. In 2007, intra-Maghreb trade represented less than 2 percent of the sub-region's combined gross domestic product (GDP) and less than 3 percent of the sub-region's total trade. Some of the reasons for this low performance include high barriers to trade, logistical bottlenecks, lack of production base diversification, and political considerations.

The focus on trade liberalization with the European Union (EU) provides an opportunity for individual Maghreb countries to lock in policies that would eventually help them harmonize policies within their own region. The same argument can be made regarding accession to the World Trade Organization (WTO). The Maghreb countries would reap significant additional benefits if, in parallel to reforms undertaken to improve trade liberalization with Europe, they improved conditions for streamlined trade among themselves.

There is significant potential for trade in services in the financial sector, transportation and logistics, and communications and information, among other sectors. According to some studies, comprehensive services reforms that involve increased competition and regulatory streamlining would yield benefits that are at least twice the magnitude of those achieved through tariff removal alone. Morocco has seen the most substantive growth in recent years, while Tunisia is the most active country of the group.

The Mashreq: The overall trade levels of Mashreq countries are significantly lower as a share of GDP than those in the MENA region more broadly. Once adjusted for oil, however, non-oil trade in the Mashreq is only marginally lower than in MENA. Apart from Iraq, Mashreq countries trade the most within the MENA region. Nevertheless, Mashreq countries trade more with EU countries than they do among themselves and within MENA. In the services sector, the Mashreq accounts for a significant share of regional exports and imports. Also, with the exception of Iraq, a major oil exporter, the Mashreq countries export a relatively large share of manufactured goods—only surpassed by Tunisia and Morocco. Furthermore, Mashreq exports are relatively less concentrated than other MENA countries, with the exception of Tunisia and Morocco.

Regional economic integration would be enhanced by better trade facilitation processes and procedures as well as by better transport infrastructure. Of course, policies related to a good climate for investment and private sector development matter as well.

Conclusion: There is a great heterogeneity among MENA countries in terms of reforms and integration within the region, the subregions and the rest of the world. Overall, the countries which have been more aggressive in trade reforms, managed to attract more FDI and diversify their economies. Accession to WTO and Regional Trade Agreements such as with Europe; do not exclude the need for greater cooperation within MENA and its subregional blocs. The economic welfare gain from this regional cooperation is substantial.

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