Assessing Arab Economic Integration: Towards the Arab Customs Union

By Mohamed Chemingui and Mehmet Eris
Regional Integration Section/EDID
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Why is this report timely and relevant?

- Integration is increasingly regional
  - Motivated by difficulties to reach agreements at the WTO
  - Global financial crisis underlined the contagion risk

- New priorities for Arab governments after 2011 upheavals
  - economic growth to absorb young population into labor force
  - human development
1. Provide a novel quantitative assessment of efforts and successes in economic integration across the Arab region and with the rest of the world

2. Generate practical and implementable policy recommendations
Outline

- **Chapter 1** – Arab Economic Integration in the Context of an Evolving and Dynamic World
- **Chapter 2** – Regional Economic Integration – Monitoring System of Indexes
- **Chapter 3** – Productive Capacities and Integration
- **Chapter 4** - Facilitating Factors for Integration
- **Chapter 5** – From PAFTA to the Customs Union: a bumpy pathway for Arab economic prosperity
- **Chapter 6**– Recommendations
1. A system of monitoring and evaluation
2. Ex-post assessment
3. The thematic chapter
Chapter 1

Arab Economic Integration in the Context of an Evolving and Dynamic World
Benefits of regional integration

Economic benefits include:
• more efficient allocation of resources due to specialization
• larger product and factor markets lead to efficiency gains
• greater product variety
• large and regional investment projects feasible
• insurance against shocks

Political benefits include:
• increased visibility and power in multilateral negotiations
• greater levels of trust, interdependence, and opportunity cost of conflict
• a commitment mechanism to domestic policies and reforms
Regional integration versus multilateral liberalization

In a regional setting:

- complex and numerous trade barriers better dealt
- interests of developing countries better preserved
- market imperfections and distortions better addressed
- multinational corporations tend to operate

And

- proliferation of regional integration agreements leads to new blocs or expansion of existing ones
- regional integration helps counter the hub-and-spoke bilateral agreements between developing and developed countries
full implementation of trade agreements Arab countries parties to entail

• addressing restrictive rules-of-origin practices
• mitigating unduly restrictive effects of non-tariff measures
• ensuring transparency through monitoring commitments
• extending FTAs to services trade

But also

• more comprehensive approach to investment, competition policy and the movement of capital and labor
Chapter 2

Assessment of Arab economic integration through a comprehensive system of indexes
An attempt at understanding the changing (global, regional and bilateral) contexts, weaknesses, strengths, challenges and opportunities.

So helps us answer:

• How to improve Arab countries connectivity to GVCs?
• Arab Regional economic integration as a building block to multilateralism?
• What are Arab countries’ specific strengths and weaknesses in regional and global integration?
• What would be the impact of greater integration on economic growth, job creation, and human development?
Why now?

- The political context may bring new momentum to Arab Economic Regional integration

- International environment is changing and need to rethink Arab insertion in regional markets
Monitoring which regional integration

A process

- Agreements
- Instrument, Policies
- Results
- Final Goal

3 Types

**Functional:** Integration in key regional markets such as
- Energy
- Agriculture
- Gas and oil
- Etc..

**Economic integration**
- Trade
- Finance
- Labor
- Etc.

**Policy harmonization**
Scalable: should allow evaluating the challenges, risks and opportunities at global, regional and bilateral levels

Maximum possible coverage

Versatile: Possibility to track progresses towards specific goal as needed

Simple and transparent

Allow an effective action-information-action loop
But contrary to existing CI
Few indicators for clarity of integration channels and mechanisms and effective policymaking

COMPOSITE INDEXES+ SCOREBOARDS

Indicators: criteria for choice
• Clear and strong causality between economic integration, policies and outcomes
• Significant impact

EXPORTS, FDI, Workers’ Remittances

Methodology
Simplicity for non-technical audience
Feasibility

SIMPLE AVERAGE
Globalization Index

- Are Arab countries falling behind the top best performers?
- What are the main channels of countries integration?
- Is there regional patterns?

Flow Intensity Index

- What are the country(ies) that are engine of economic integration at the regional level?
- What linkages between regional and global integration?
- What is countries’ level of vulnerability to foreign shocks?
- How integration can help as an engine of economic growth?

Regional Flow Intensity Scoreboards

- Is the framework in which countries are operating conducive? Are the obstacles structural or not?
- What is the relative intensity of governments’ efforts?
- What are the nature, channels, potential for further intra-regional integration?
- What is each country comparative advantage? …
# 3 SCORERBOARD

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<th><strong>Enablers</strong></th>
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| **Structure of the economy**  
Mining value-added (% of GDP)  
Fossil fuel energy consumption (% of total)  
Gross national savings  
Lending rates | **Trade**  
R&D expenditure (% GDP) | **Logistics**  
Container port throughput  
Liner shipping connectivity index  
Air transport, passengers carried |
| **Labor Force quality**  
Life expectancy at birth  
Urban to rural pop  
Literacy rate  
School enrolment rates (primary, secondary and tertiary)  
Mean years of schooling  
Ratio of female to male labor force participation rates  
Apparent productivity of labor | **Investment**  
Taxes on goods and services  
Corporate taxes  
Chinn-Ito Openness index | **Trade**  
Merchandise and services exports and imports (% GDP) |
| **Infrastructure quality**  
Internet bandwidth  
Electricity production | **Labor force**  
Gov exp in education (% total exp)  
Gov exp in education (% GDP)  
Health exp Gov (% total exp)  
Health exp Gov (% GDP) | **Investment**  
FDI stocks & flows, in /outflows  
Portfolio stocks & flows, in/outflows |
| **Conflict** | **Infrastructure**  
General Government final consumption expend (% GDP)  
Rail lines (total route km)  
Air transport freight (million ton)  
Length of total road  
Length of paved road | **People**  
Emigrants and Immigrants, tourists, students |
| | | **Macro convergence**  
Net ODA  
Foreign Reserves  
Inflation  
GDP per capita |
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These rankings driven in part by

- **Scale effect**
  - smaller countries depend more on their external partners and tend to be at the top of the rankings

- **Natural resource abundance effect**
  - This is typically the case for Mauritania, Mozambique or Mongolia. These countries’ globalization is driven by investment inflows, and imports.

- **Catching up effect**
  - The European countries at the top of the ranking joined the European Union in 2003 only
### Globalization ranking

#### Ranking Change 2000-2013

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**Note:** Arab countries in yellow, EU-28 in orange, ASEAN countries in green.

Arrows tracks ranking improvement: red < average bad performers, yellow down between 0 and the average of bad performers, yellow up between 0 and average good performers, green > average good performers

**Sources:** authors’ calculations
Arab intra-regional integration: Overview

Relevance: The analyze covers a large % flows
The GCC and oil exporting foster intra-regional integration
The UAE, Saudi Arabia and Iraq
Through FDI and also
WR which is key to poverty but impact
on economic growth is not straightforward

No impact of the various RTAs, meager for the GCC
Few Arab countries very successful
Global and regional integration, no clear intra-regional preference
Non-Arab partners.
The EU generally speaking, the US and
Eastward shift

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Negative effect: Exposure to exogenous shocks
Positive effect: Partners Diversification
Import high standards
# Globalization ranking breakdown

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Arab intra-regional integration: Channels

FDI

Increased in the 90s
LAS share of total world is 3.3 in 2013 versus 6.7 percent in 2009
Mainly the GCC (53.8 percent), Egypt, Morocco, Iraq, Lebanon increased their share between 2000 and 2013

FDI inflows to LAS, share by country, 2013

For these countries 17.9 percent in Jordan, 29 percent in Lebanon, 9 percent in Morocco, 17 percent in Egypt in percent of GDP

Reforms needed: financial development, human capital and infrastructure quality as well as an inappropriate distribution across sectors

But poor data quality, flow largely informal, relationships are certainly closer
Arab intra-regional integration: Channels

**Labor**
- Traditionally effective integration channel
- Flow stable, provide hard currency
- Countercyclical

**Main Recipients**: In 2013, in percentage of GDP, remittances =
- 20 percent in Palestine, 19 percent in Lebanon.
- 10 percent, Yemen, Jordan and the Comoros
- 7 percent in Egypt and Morocco
- 4.7 percent in Syria, Tunisia

**Reforms needed**:
- highest cost of sending money in the world
- Linkages with economic growth not straightforward
- promote access to savings, loans and health care tied to remittances
- affected by exchange controls, capital controls or exchange rates and interest rates differentials
- Common labor market

**Main contributors**
- Saudi Arabia for Yemen, Jordan, Egypt, Lebanon
- Libya for Tunisia
- Jordan

**Cost of sending money**

![Graph showing cost of sending money over time]

Source: The World Bank, 2015, Remittances prices worldwide, issue no.13, March

**But poor data quality, no data for GCC countries except SA, flow largely informal**
Arab intra-regional integration: Channels

Trade

Arab countries are falling behind
ASEAN share of world GDP = 3.2% but share in world trade = 13.2% = LAS share of world GDP = 3.6% (2.2% for GCC alone)
RTAs non efficient
No strong intra-regional preference at the difference of the EU and the ASEAN, except for the GCC

Success of the ASEAN due to
Large intra-regional and foreign investment flows
Outsourcing strategy and regional value chains
Cheap labor force
Financial system quality
Vulnerability to foreign crisis

Similar bottlenecks
- Difficulty to reach consensus
- Meager political support
- Attachment to national sovereignty
- Low complementarity originally

GDP growth comparison, 2001-2013
GLOBALIZATION: risks and opportunities

The AEISI highlights the 2008 and European crisis domino effect.

Intensity of flow index ranking
Calculated using exports, FDI and Workers’ remittances inflows
the ‘positive’ side of globalization and the crisis exposure

Lebanon, Palestine, Comoros highly vulnerable
Egypt, Morocco, Jordan, Tunisia insertion rather balanced
Globalization as an engine of growth for: The UAE (re-export),
The GCC, Libya, Iraq fuel the world growth
Lebanon, Libya and Syria and LDCs strengthened

No discernible improvement (trade creation) from the Agadir agreement

Questions:
Does globalization contribute to improve Arab countries economic prospects?
What is the contribution of intra-Arab integration?
What are the risks of such a strategy?
Possible improvements to the system of indexes

- The shift of focus from gross trade to trade in value added using OECD-WTO TiVA database

- Broadening of the indicator set
  - more indicators capturing policy stance
  - new or richer indicators reflecting priority areas
  - more systematic and explicit inclusion of SDGs
Chapter 3

Productive capacities and integration
This chapter addresses the progresses made and the challenges faced in the pursuit of regional economic integration within the following sectors:

- Trade
- Manufacturing
- Agricultural
- Tourism
- Services
Intra-Regional Trade as a Ratio of Total Trade
Intra regional exports (2000, 2013)

- Somalia
- Syria
- Djibouti
- Lebanon
- Jordan
- Bahrain
- Egypt
- UAE
- Palestine
- Oman
- Yemen
- Tunisia
- Algeria
- Kuwait
- Saudi Arabia
- Morocco
- Iraq
- Libya
- Comoros
- Qatar
- Mauritius

2013, 2000
Regional Value Chains: Boost Latent Arab Manufacturing

- industrial sector in the Arab region generally underdeveloped
- dominance of the state in industry is an issue
- exclusive reliance of many Arab states on the energy and natural resources sectors
- Arab states with excess capital stand much to gain from cross-border industrial partnerships with Arab states that enjoy surpluses of cheap labor, and vice-versa
- industrialization and regional integration are not mutually exclusive, but mutually reinforcing
Intra-regional imports of intermediate goods as % of total intermediate imports
• many countries have agricultural support programs that are incompatible with free trade.
• Arab states export most of their total agricultural exports to other Arab states
• agricultural imports into Arab states from other Arab states only make up a very small portion their total agricultural imports
• intra-Arab agricultural trade is of unprocessed or raw commodities
• agricultural investment falls short of required levels
Tourism

- Tourism in the Arab region has been growing rapidly.

- A total of $4 trillion committed to travel and tourism projects across the region.

- Conflict and instability has taken a toll on traditionally strong tourist performers, most notably Egypt and Syria.

- Income from tourism counts for only 3% of GDP region-wide, but many Arab states significantly depend on the tourism sector.
Intra-Regional Tourism, select regions, 2012

Share of Intra-Arab Tourism: 36.2%
Share of intra-EU Tourism: 59.1%
Share of inbound Tourism from Abroad: 63.8%
Share of EU Tourism from abroad: 40.9%
• The service sector is a major determinant of the economic and trade performance

• The liberalization of trade in services is necessary for enhancing intra-Arab trade and diversification

• Egypt, the UAE, and Jordan are among the top 20 locations that are most accessible to offshore service providers

• Efforts to liberalize trade in services in Arab states are underway but further progress is needed
Overall Services Trade Restrictiveness (score)

- Yemen
- Tunisia
- Morocco
- Lebanon
- Jordan
- Egypt
- Algeria
- Saudi Arabia
- Qatar
- Oman
- Kuwait
- Bahrain
- EU-20

Scores:
- EU-20: 39
Chapter 4

Facilitating factors and structural elements for integration
Chapter 4 – Facilitating Factors For Integration

• An assessment of the factors that facilitate integration, with an analysis of progress made on a number of fronts, the challenges faced, and potential for future integration

• These factors are:
  ▪ Transportation
  ▪ Energy cooperation
  ▪ Water resources
  ▪ Regional migration for employment and livelihoods
  ▪ The growing role of regional remittances
  ▪ Arab financial integration
• Transportation facilitate the movement of production factors, products
• Road transport is the prevalent mode of regional transport in the Arab region
• The Arab region has one of the lowest rail network densities in the world
• Arab maritime transport fares better, with container port throughput having grown by more than 75% between 2008 and 2013
• Arab air transport is also vibrant: grew at an annual average of 7.2% between 2003 and 2013
Linear Shipping Connectivity Index, score (2004 and 2014) and global ranking (2014)
• Arab countries have aimed to connect major oil fields to consumer markers in Europe through pipelines, but sub-regions are still greatly disconnected.

• The interconnection of Arab electric grids is in progress

• Regional energy governance is still weak
Interconnection of electricity networks in the Arab region
• Most Arab countries are classified as ‘water poor’

• There has been some progress on Arab regional water cooperation

• The establishment of shared water resources yet to be implemented
• As of 2010, there were nearly 9 immigrants for every 100 people in the Arab world, which is three times the global average.

• As of 2013, there was an estimated 11 million Arab migrants in other Arab states, which represents about 37% of total immigrants in the Arab world.

• Easing restrictions between Arab states would help home and host countries, foster regional integration.
Intra-Arab migrant stock (millions), and % of total migrants within the region
The Growing Role of Regional Remittances

• Remittances in the Arab region: In 2012, over $520 billion in remittances were sent worldwide, $49 billion of which were sent into the Arab region. Workers in the Arab region sent $82 billion back to their countries of origin in 2012, the majority of which ($69 billion) were sent from the GCC.

• Intra-Arab remittances: Remittances sent from Arab states to other Arab states have been growing rapidly, from $5 billion in 2000 to $17 billion in 2010 and $24 billion in 2012. However, of the total value of remittances that are sent from the Arab region, only 29% are sent to other Arab states.

• There is a great deal to be gained from channeling remittances sent from the Arab world to other Arab states rather than to countries outside of the region.
Intra-regional migration comparisons (in millions and as % of total migrants), by region.
Arab Financial Integration

- Financial markets in the Arab region: The Arab banking sector is the most important sector in the Arab financial system. The region’s total bank assets are concentrated in the UAE, Saudi Arabia, Qatar, and Egypt.

- Financial integration in the Arab region: Of foreign banks in Arab countries, the greatest proportion come from other Arab countries.

Table 4.1: Number and Share of Foreign Banks in the Arab region, by home region, 2000 and 2009

<table>
<thead>
<tr>
<th>Home Region</th>
<th>Number</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>America</td>
<td>3</td>
<td>6%</td>
</tr>
<tr>
<td>Asia</td>
<td>5</td>
<td>10%</td>
</tr>
<tr>
<td>Europe</td>
<td>20</td>
<td>41%</td>
</tr>
<tr>
<td>Arab</td>
<td>21</td>
<td>43%</td>
</tr>
<tr>
<td>Total</td>
<td>49</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Home Region</th>
<th>Number</th>
<th>Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Americas</td>
<td>2</td>
<td>3%</td>
</tr>
<tr>
<td>Asia</td>
<td>4</td>
<td>5%</td>
</tr>
<tr>
<td>Europe</td>
<td>23</td>
<td>31%</td>
</tr>
<tr>
<td>Arab</td>
<td>46</td>
<td>61%</td>
</tr>
<tr>
<td>Total</td>
<td>75</td>
<td>100%</td>
</tr>
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</table>
Chapter 5

From an FTA to a Customs Union
Why an Arab Customs Union?

• A customs union is an advanced level of economic integration, more so than an FTA.

• A customs union effectively creates a common market, which allows for member states to increase their market size and combine their market power.

• Going from an FTA to a CU requires an agreement on a variety of challenging issues, such as a CET, or the mechanism of tariff revenue distribution.
Major challenges

- Addressing overlapping trade agreements
- Agreeing on a common external tariff
- Harmonization of national customs codes and procedures
- Harmonization of fiscal policies
- Harmonization of competition laws and antitrust policies
Three illustrative trade reform scenarios are analyzed in this chapter: two ‘pure’ tariff reforms scenarios; and one tariff reform that is complemented by a reduction of trade costs on intra-Arab trade.

Each scenario is composed of two major components: one of them is common to all scenarios while the second is more specific.

The common assumption to all the three scenarios is that the CET is selected based on four lists of products.

The first list of products covers those where applied tariffs are below 5% while the second list contains all products where applied tariffs are between 5% and the lowest rates of bound tariffs at HS6 level in all member countries.

Finally, the third list includes all commodities for which applied tariff in the Arab countries are above the lowest bound rates at hs6 level, excluding 5% of tariff lines as negative lists for all member countries.
6.2. Illustrative scenarios for implementing the ACU (Cont.)

- The three scenarios assume the following:
  - Tariffs on commodities in the first list will be fixed at 5 per cent in 2017, the first year of the tariff implementation scheme;
  - 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;
  - Tariffs on commodities in the third list will be reduced to be aligned with the minimum bound rate levels over a period of 5 years: 2021-2025.
  - Finally, 5% of tariff lines for each member countries will be excluded from the new tariff rates. These lists cover the products with the highest tariff rates in each member country.
- Sim1: CET + no changes in FTAs with ROW
- Sim 2: CET + generalisation of FTAs + cut in trade costs on intra-Arab Trade
- Sim3: CET + MFN rates on imports from ROW
Impacts

- No significant changes on GDP
- Important changes in trade patterns and mostly increase of intra-Arab trade
- Fiscal implications will be positive on GCC (except Oman), Libya, and Iraq.
- Negative impacts on the Arab countries without a diversified fiscal instruments.
- Economic gains will not depend only on the CET but on a package of policies to ensure a competitive Arab market.
  - --- more harmonized sectoral policies
  - --- competition policies
  - --- lower trade costs: better transport connectivity, lower transport cost, more efficient custom procedures...
  - --- common trade policy: no more negotiations of FTAs with ROW
Thank you!