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# The State of Arab Economies: Global Engagement, Reforms, and Regional Trade Agreements

Later chapters will explore the potential impact that a US–Middle East free trade agreement (MEFTA) might have on increasing trade, investment, economic reform, and regional integration. Before doing this, however, it is useful to briefly consider the current state of play of these factors in the region. This chapter starts by presenting evidence on the degree to which Arab countries trade with each other and the rest of the world. It then reviews the evidence on governance institutions and describes regional trade agreements.

It is common to read characterizations of Arab economies asserting that, aside from oil, economic performance has been poor and that they have generally failed to participate in globalization. While the data actually indicate that a far more nuanced judgment is in order, there is considerable evidence that many of the countries trade less with the world than would be expected on the basis of international norms. This suggests that there is considerable scope for policies that remove barriers to trade and investment. This chapter provides evidence that, throughout the region, institutions are particularly weak with respect to regulatory policies. This implies there is also considerable scope for policies that stimulate reforms of these policies. The chapter also will demonstrate that existing regional trade arrangements remain limited. Again, this suggests considerable scope for deepening these arrangements and making them more effective.

The central problem in the region is employment creation. Table 2.1 shows that over the past decade, economic growth in the Arab economies has actually been fairly robust. With the exception of Kuwait and the

**Table 2.1 Growth in GDP and GDP per capita, 1995–2005, and unemployment (percent)**

Country	GDP,		GDP per capita		Unemployment <sup>a</sup>
	1995–2005	1980–85	1985–95	1995–2005	
Qatar	9.2	–9.8	–2.7	4.6	2.7 (2001)
Iran	4.7	3.3	–1.3	3.9	11.2 (2004)
Tunisia	4.9	1.7	1.2	3.8	14.2 (2005)
Egypt	4.8	3.9	1.0	2.7	10 (2005)
Algeria	3.9	1.6	–1.9	2.5	22.5 (2005)
Morocco	2.9	0.8	0.7	2.4	10.5 (2005)
Oman	3.8	9.3	–1.0	2.2	15 (2004)
Bahrain	5.0	0.0	0.8	1.8	15 (2005)
Libya	3.2	–6.2	–3.6	1.4	30 (2004)
Jordan	4.6	–0.1	–1.1	1.3	12.5–30 (2004) <sup>b</sup>
Syria	3.9	–0.5	1.0	0.9	12.5 (2004)
Lebanon	3.2	7.0	–4.0	0.8	18 (1997)
Saudi Arabia	3.0	–7.1	–1.0	0.7	13 (2004) <sup>c</sup>
Yemen	5.2	n.a.	n.a.	0.6	35 (2003)
United Arab Emirates	6.5	–6.7	–2.2	–0.5	2.4 (2001)
West Bank and Gaza					19.9/31 (2005)
Kuwait	2.6	–8.9	1.3	–0.7	12.2 (2004)
Iraq					25–30 (2005e)
Average	4.5	–0.8	–0.9	1.8	15.4

e = estimate

n.a. = not available

a. Latest data available.

b. 12.5 percent is official figure for 2004; 30 percent is the unofficial figure.

c. Some estimates place male unemployment at 25 percent.

Sources: International Monetary Fund, *World Economic Outlook* database, September 2005; and CIA World Factbook.

United Arab Emirates (two high-income countries with large foreign-worker populations that cloud the data), all the countries shown in the table managed to record positive average annual growth in GDP per capita between 1995 and 2005. On average, the increase in GDP per capita was a respectable 1.8 percent. This was a marked contrast to the dismal record of the prior 15 years (1980–95), when average living standards actually declined by about 1 percent annually. At the same time, with the exceptions of the United Arab Emirates and Qatar, the more recent growth still remained too weak to provide adequate employment opportunities for those seeking work. Unemployment throughout the region remains very high, with the average at about 15 percent.

But the region has not participated in globalization to the degree found elsewhere. By a wide variety of measures, global integration has proceeded rapidly in recent years. According to The Economist Intelligence

Unit, for example, between 1980 and 2004, global trade in goods and services as a percentage of global GDP increased by 32 percent, and since 1985 by 46 percent. By contrast, as reported in table 2.2, the share of imports in Arab countries in 2004 was considerably lower than in 1981 and about the same as it was in 1984. While oil revenues play an important role in these fluctuations, even in non-oil producing countries such as Morocco and Tunisia, the ratio of imports of goods and services to GDP was virtually the same in 2004 as it was in 1980. Excluding oil, for the Middle East region as a whole, trade (exports plus imports) declined from 53 percent of GDP in the early 1980s to 43 percent in 2000 (Yousef 2004, 106).

Regional performance with respect to foreign investment is somewhat mixed. It has been relatively strong in North Africa and much weaker in the Gulf. Again the global indicators indicate rapid growth. According to the United Nations *World Investment Report*, between 1990 and 2004 the ratio of the stock of foreign direct investment (FDI) to GDP in the world as a whole soared from 8.4 to 21.7 percent (table 2.3). Similar growth is evident for the developing world, up from 9.8 to 26.4 percent. Significant and particularly large and rapid increases relative to GDP occurred in Morocco, Jordan, and Syria. In Tunisia, the FDI stock grew only as rapidly as GDP, but at 62 percent in 2004 it was by far the highest in the region. While the rise in North Africa as a whole was not quite as rapid (from 13.3 to 24.4 percent), as in other developing countries it was nonetheless rapid. With the exception of Bahrain, however, where FDI growth has boomed (from 13 percent of GDP in 1990 to 70.5 percent in 2004), FDI stock in most oil-producing states is extraordinarily low, and in West Asia as a whole there was only modest growth relative to GDP.

While there are clearly exceptions, and the picture should not be overdrawn, there is considerable evidence that these Middle Eastern countries have significantly less trade than countries with similar incomes and geographic proximity to trading partners in other parts of the world. As is discussed in the paragraphs that follow, this is true both of intraregional trade and trade with other parts of the world, and it is the conclusion of numerous studies using a variety of methodologies and specifications.

## Arab Trade

In work done for the World Bank, Nugent (2002) uses a gravity model specification and finds the Middle East under-trading relative to its potential in the mid-1990s. He obtained shortfalls in trade with respect to Europe and the North American Free Trade Agreement (NAFTA). Nugent ascribes this to a variety of causes, including low oil prices, high tariff barriers, poor telecommunications, capital and exchange controls, and, interestingly, trade diversion effects (i.e., the fact that other countries are part of NAFTA and the European Union).

**Table 2.2 Trade in goods and services as a percent of GDP, selected years**

<b>Country</b>	<b>1981</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>2000</b>	<b>2004</b>
United Arab Emirates						
Exports	69.1	58.2	66.3	74.4	74.0	89.8
Imports	33.7	31.6	40.9	67.3	56.1	75.1
Bahrain						
Exports	131.5	101.8	90.9	82.0	89.4	88.3
Imports	120.2	89.8	88.3	70.5	64.4	72.7
Qatar						
Exports	68.0	51.4	53.5	44.3	67.3	69.1
Imports	28.7	29.5	32.1	43.3	22.3	27.0
Kuwait						
Exports	69.0	53.7	44.8	52.4	57.8	60.2
Imports	37.0	42.7	57.8	42.0	30.8	33.2
Oman						
Exports	65.2	48.0	47.2	44.0	59.1	59.0
Imports	38.7	35.8	27.6	35.6	31.0	38.4
Saudi Arabia						
Exports	67.6	36.0	46.2	37.6	43.7	52.7
Imports	35.8	43.9	36.1	27.9	24.9	24.9
Jordan						
Exports	43.6	39.7	59.8	51.7	41.9	52.2
Imports	98.5	76.3	89.6	72.9	68.6	71.9
Tunisia						
Exports	41.4	32.1	43.6	44.9	44.5	46.9
Imports	49.8	38.1	50.6	48.8	48.2	49.8
Algeria						
Exports	34.6	23.5	23.4	26.6	42.3	46.0
Imports	30.9	20.4	25.1	30.7	20.9	28.4
Libya						
Exports	46.9	44.6	39.7	29.2	35.2	43.6
Imports	54.5	30.2	31.1	22.4	15.3	30.2
Syria						
Exports	15.6	12.0	28.3	31.0	36.1	34.7
Imports	33.0	25.4	28.0	37.9	29.2	35.5
Yemen						
Exports	n.a.	n.a.	14.8	22.4	41.9	30.1
Imports	n.a.	n.a.	20.8	42.1	34.3	31.1
Egypt						
Exports	30.9	17.6	20.1	22.5	16.2	28.6
Imports	42.9	28.4	32.8	28.6	22.8	28.9

*(table continues next page)*

**Table 2.2** (continued)

Country	1981	1985	1990	1995	2000	2004
Morocco						
Exports	17.7	19.9	24.6	22.8	25.0	26.9
Imports	32.9	32.3	29.9	29.5	31.3	32.9
Lebanon						
Exports	n.a.	n.a.	18.0	11.8	13.6	20.5
Imports	n.a.	n.a.	99.9	65.4	37.1	40.6
Iran						
Exports	13.8	9.0	15.1	24.4	14.5	11.3
Imports	27.9	13.8	24.3	14.1	9.3	9.2
Iraq						
Exports	32.2	24.4	18.5	n.a.	n.a.	n.a.
Imports	63.4	28.9	17.8	n.a.	n.a.	n.a.
All Arab countries						
Exports	52.1	33.3	35.0	36.3	40.6	49.0
Imports	40.4	33.8	32.5	35.4	28.9	33.9
World	20.3	18.4	19.6	21.1	24.8	26.8

n.a. = not available

Source:

## With the European Union

Also with a gravity specification, Péridy (2005a) finds that almost all Arab countries are far below their estimated export potential with respect to the European Union.<sup>1</sup> He examines the exports of 15 countries to Europe and concludes that on average they are 33.5 percent lower than they would be if they were integrated into Europe to the same extent as other European countries.

## With the United States

The same conclusion appears to be the case in trade with the United States. Soderling (2005) estimates a gravity model following a theoretically well-grounded specification for 90 countries. He then uses this global benchmark to examine the bilateral trade of six Middle East and North African

1. Péridy finds the following shortfalls in Arab trade with the European Union: Algeria, 24.4 percent; Bahrain, 26.9 percent; Egypt, 27.6 percent; Iran, 25.2 percent; Iraq, 56.3 percent; Jordan, 54.1 percent; Kuwait, 30.7 percent; Lebanon, 48.9 percent; Libya, 5 percent; Morocco, 17.3 percent; Oman, 65.1 percent; Qatar, 61.5 percent; Syria, 28.3 percent; Tunisia, 17.6 percent; and United Arab Emirates, 14.4 percent.

**Table 2.3 Exports and foreign direct investment (FDI)**

Country/region	GDP, 2004 (billions of dollars)	FDI stock/ GDP	FDI, 2003 (millions of dollars)	Exports, 2004 (millions of dollars)	% Man	FDI/GDP (percent)	Exports/ GDP (percent)	Manufacturing exports/GDP (percent)
Morocco	50.1	36.1	2,279	9,661	69	4.55	19.30	13.32
Jordan	11.2	31.9	376	3,970	69	3.36	35.46	24.47
Tunisia	28.2	61.7	541	9,685	81	1.92	34.36	27.83
Lebanon	21.8	11.6	358	1,749	68	1.64	8.03	5.46
Algeria	84.6	9.1	634	31,713	2	0.75	37.46	0.75
Syria	23.1		150	6,435	11	0.65	27.82	3.06
Oman	21.7	14	138	14,236	14	0.64	65.61	9.19
Egypt	75.1	27.1	237	7,682	31	0.32	10.22	3.17
Iran	162.7		120	42,450	8	0.28	26.09	2.09
Kuwait	41.7	0.7	-67	27,390	7	-0.16	65.61	4.59
Yemen	12.8	7.7	-89	4,555	n.a.	-0.69	35.49	n.a.
World	40,887.8		572,774	9,122,837	77	1.40	22.31	17.18
Middle East and North Africa	600.3		4,756	170,996	20	0.79	28.49	5.70
Lower-middle income countries	3,941.6		90,627	1,223,079	68	2.30	31.03	21.10
Middle-income countries	6,930.7		138,493	2,244,720	64	2.00	32.39	20.73
Sub-Saharan Africa Latin America and the Caribbean	544.0		10,099	149,265	n.a.	1.86	27.44	n.a.
Upper-middle income countries	2,988.4		47,867	1,021,641	61	1.60	34.19	20.85
South Asia	878.8		1,143	101,332	79	1.27	11.53	9.11

% Man = percent of exports that are manufactured goods  
n.a. = not available

Source: United Nations, *World Investment Report 2005*.

(MENA) countries (Algeria, Tunisia, Morocco, Egypt, Jordan, and Syria) with the United States. Soderling concludes that they have seriously underexploited their trade potential with the United States, and that while the preferential arrangements these countries have had with Europe have had positive impacts that are statistically significant, these are also moderate in size. His central conclusion, too, is that substantial trade potential remains to be exploited. Soderling finds, in particular that the United States is a major untapped market for Jordan, Morocco, Syria, and Tunisia, while Algeria and Egypt “overexport” to the United States. Not surprisingly, he also finds that for Jordan and Egypt, Israel is a major untapped market. An important issue relates to the role of oil, which often explains the “over-trading,” particularly of Syria and Algeria. Péridy (2005b) reaches a similar conclusion. His results indicate that even as compared with the other Organization for Economic Cooperation and Development (OECD) countries, the United States suffers from a substantial trade integration deficit with MENA countries. He estimates that the ratio of actual-to-potential US exports to these countries is only 0.76.

### **Intra-Arab Trade**

Bolbol and Ayen (2005) find that the Arab countries do not export enough among themselves—in fact close to four times less than would be expected.<sup>2</sup> However, according to Blavy (2001), what are known as the Mashreq Arab countries appear to trade with each other more than expected by the gravity model because of trade between Syria and Lebanon.<sup>3</sup>

### **Intraindustry Trade**

Havrylyshyn and Kunzel (1997) use the Grubel-Lloyd intraindustry trade index (IIT) as an indicator of a degree of industrial specialization to study Arab countries’ ability to compete. They conclude that although Arab countries have made significant progress in increasing their IIT levels, IIT remains low both in absolute terms and in cross-country comparisons, even when normalized for development.

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2. They confirm that Arab countries also trade less with the European Union than would be expected and find no evidence that Tunisia’s trade deficiencies with the European Union have declined over time.

3. Mashreq refers to the Asian part of the Arab world (including Arabia proper). The North African part of the Arabian world (excluding Egypt and the Sudan) is known as the Maghreb. When Syria’s trade with Lebanon is excluded, actual intra-Mashreq trade becomes almost equal to trade predicted by the model.

## Agadir Agreement Countries

On February 25, 2004, the Agadir Agreement was concluded between Jordan, Egypt, Morocco, and Tunisia as a first step toward implementation of a larger pan-Arab trade agreement. Trade flows remain dramatically low between these countries as a result of high trade costs. In particular, the estimated border effects clearly reflect a significant trade integration deficit in this area. However, there is only limited export potential between these countries due to the lack of trade complementarity between them. As a consequence, according to Péridy (2005c), the Agadir Agreement may only have limited trade potential.

In summary, the evidence of shortfalls in trade performance is overwhelming. As emphasized by Zarrouk (2003), trade barriers, particular nontariff barriers, are an obvious part of the explanation for these findings. According to Hoekman (2005), trade policy in MENA countries has become less restrictive—the simple average tariff has fallen by 10 points in countries that have signed Euro-Mediterranean Partnership (Euro-Med) agreements with the European Union, for example, and tariffs have also fallen because of unilateral reforms, World Trade Organization (WTO) commitments, and intra-Arab liberalization. He estimates that across the MENA as a whole, the simple average tariff is 12 percent. Nonetheless, as Hoekman also notes, the region has made little progress on nontariff barriers. According to estimates by the International Monetary Fund and the World Bank, taking these barriers into account suggests that the region is the world's most highly protected.

## Arab Governance and Reforms from a Global Perspective

Why reform? One reason is to improve institutions. As noted by Acemoglu, Johnson, and Robinson (2001), there is strong evidence that institutional quality plays a crucial role in promoting economic growth and development, and there is clearly a very strong positive association between levels of development and institutional quality. As discussed by Galal and Lawrence (2005) in the case of Egypt, an important motivation for deep international trade agreements is to provide an anchor and an opportunity to introduce such reforms. To be sure, international trade and investment policies can only be one component of an overall strategy, but they can be an important one. This section draws on global surveys to highlight and reflect on the widespread institutional deficiencies that characterize the MENA region.

The links between institutional quality and trade agreements run in both directions. On the one hand, there is the possibility, just mentioned, of using such agreements to improve the quality of institutions; on the

other, without appropriate institutions there is a distinct danger that complex agreements will not have much impact. Thus, for example, the trade effects of an agreement could well be disappointing if the major barriers to trade are presented not simply by the level of tariffs but instead by the bureaucratic systems by which trade relationships are regulated, and the efficiency with which products are moved from factory to port. If a regionwide FTA is really to achieve the free regional movement of goods and services, the evidence strongly suggests the need for complementary domestic policy changes that reduce the costs of trading across borders.

Where does the Arab Middle East stand with respect to the quality of its institutions? A large number of surveys of the quality of governance and policy are regularly undertaken. The World Bank, a leader in this work, compiled and reported data every two years on six dimensions of governance for 209 countries between 1996 and 2004 (Kaufmann, Kraay, and Mastruzzi 2005). The indicators are based on several hundred variables drawn from 37 separate data sources constructed by 31 organizations.<sup>4</sup> The results are grouped into six separate categories: two measures of political variables (voice and accountability, and political stability and violence); two measures of government performance (government effectiveness and the regulatory environment); and two measures of behavior (the rule of law and control of corruption).<sup>5</sup>

Table 2.4 reports the 2004 results for 18 Arab countries. On a scale in which the highest rank is 100, the average ranking in all six categories for these countries is the 40th percentile. The countries perform particularly poorly in the indicators reflecting political rights and practices, obtaining average rankings at about the 19th and 37th percentiles, respectively, for the measures of voice and political stability. Kuwait was the highest-ranking country for voice and accountability, and its measure stood at about the 34th percentile. This poses particular challenges for FTAs, especially those which aim to include most countries in the region within a decade. Basically it means that agreements are going to have to be undertaken with

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4. As the World Bank authors note, "The governance indicators presented here reflect the statistical compilation of responses on the quality of governance given by a large number of enterprise, citizen and expert survey respondents in industrial and developing countries, as reported by a number of survey institutes, think tanks, non-governmental organizations, and international organizations" (Kaufmann, Kraay, and Mastruzzi 2005).

5. A further description of those measures: (1) Voice and accountability measures political, civil, and human rights; (2) Political instability and violence measures the likelihood of violent threats to, or changes in, government, including terrorism; (3) Government effectiveness measures the competence of the bureaucracy and the quality of public service delivery; (4) Regulatory burden measures the incidence of market-unfriendly policies; (5) Rule of law measures the quantity of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence; and (6) Control of corruption measures the exercise of public power for private gain, including both petty and grand corruption and state capture (Kaufmann, Kraay, and Mastruzzi 2005, 130).

**Table 2.4 Governance indicators of Arab countries, 2004**

Country	Voice	Political accountability	Government effectiveness	Regulatory quality	Rule of law	Control of corruption	Average	Income rank (Atlas method)
United Arab Emirates	21.8	78.2	86.1	79.3	78.7	86.7	71.8	90
Qatar	26.7	79.1	78.4	45.8	76.8	72.4	63.2	89
Kuwait	34.0	55.3	69.2	55.2	67.6	76.4	59.6	88
Bahrain	27.7	49.5	75.5	72.9	69.1	76.8	61.9	85
Oman	24.3	70.9	79.3	64.0	83.1	77.3	66.5	80
Saudi Arabia	5.8	30.6	55.3	38.9	57.0	61.1	41.5	80
Libya	2.9	47.1	25.0	5.9	30.4	16.3	21.3	75
Lebanon	25.7	23.3	42.3	31.0	43.5	39.9	34.3	71
Tunisia	17.5	51.9	69.7	44.8	58.0	64.5	51.1	55
Jordan	29.1	45.1	62.5	56.2	60.4	68.5	53.6	52
Iran	10.7	19.9	28.8	7.9	23.2	35.0	20.9	51
Algeria	23.8	8.3	36.5	17.7	27.5	41.9	26.0	50
Egypt	20.9	25.2	49.0	27.1	54.1	51.2	37.9	47
Morocco	32.5	39.8	56.3	42.4	51.7	56.7	46.6	42
West Bank and Gaza	12.1	10.2	12.5	16.3	19.3	34.5	17.5	41
Iraq	4.4	0.0	3.4	4.9	0.5	2.5	2.6	40
Syria	3.9	28.2	26.4	10.8	42.0	27.1	23.1	40
Yemen	22.8	7.3	20.7	14.8	12.1	22.7	16.7	26
Average	19.3	37.2	48.7	35.3	47.5	50.6	39.8	61.2

Source: Kaufmann, Kraay, and Mastruzzi (2005).

countries that provide their citizens with considerably fewer political rights than is found not simply in the rest of the world, but also in countries at similar levels of economic development. Countries in the region do considerably better in some other governance attributes, with percentiles of 50.6 for control of corruption, 48.7 for government effectiveness, and 47.5 for the rule of law.

FTAs of the American type are unlikely to have major direct effects on the domestic political system. Moreover, the links between the political variables and economic performance remain a matter of controversy. For purposes here, the measure of regulatory quality is probably the most relevant. Strikingly, the countries perform poorly in this regard, placing on average at about the 35th percentile. To be sure, in this category, the rankings are mixed, with the United Arab Emirates leading at 79.3, followed by Bahrain (72.9), and Oman (64), but thereafter the countries' performances are weak. Even wealthier Gulf states such as Kuwait (55), Qatar (46), and Saudi Arabia (39) do particularly poorly, as do Lebanon (31), Egypt (27.1), Algeria (17.7), and Yemen (14.8). Even worse are Syria (10.8), Iran (7.9), and Libya (5.9). Clearly, policies in this dimension are exceptionally poor. There is also a high variance in the scores that is noteworthy. Regulatory quality rankings range from 79.3 for the United Arab Emirates to 4.9 for Iraq. Likewise, average governance quality ranges from 2.6 for Iraq to 79 for the United Arab Emirates. Given this great range in rankings, it is implausible that a single meaningful regional agreement could actually be operational without very extensive reforms.

To be sure, some of these are poor countries and thus both rankings and variance could simply result from the dispersion in income. An approach to deal with this issue is to adjust these rankings with the country rankings in per capita income. If a country obtains a score of 40 in regulatory quality, but at the same time ranks in the 40th percentile in its income, it could be said to be doing about as well as is to be expected. The ratio of each ranking to the income ranking is reported in table 2.5. Overall, there is still a shortfall. On average, income levels in Arab countries fall in the 61st percentile, considerably higher than the 40th percentile ranking for these governance indicators. The countries are thus at 64 percent of the ranking one would anticipate given their income levels.

For a few countries, however, taking income levels into account in this way is helpful. Morocco (ratio equal to 1.11), Jordan (1.03), and Tunisia (.93) all have average governance indicators that are relatively close to their average income levels. Indeed, Morocco emerges from this analysis as a fairly strong performer. It outranks its income levels on four of the six criteria and comes close in the other two. Jordan also outperforms its income rankings in four areas and is weak only in political accountability. But their behavior is not representative of most countries in the region. The worst performers here are Iraq (.07) (understandably, given its circumstances in 2004), Libya (.28), and Iran (.42). Taking account of income

**Table 2.5 Income-adjusted governance indicators of Arab countries, 2004**

Country/region	Political accountability	Political stability	Government effectiveness	Regulatory quality	Rule of law	Control of corruption	Average
Algeria	0.48	0.17	0.73	0.35	0.55	0.84	0.52
Bahrain	0.33	0.58	0.89	0.86	0.81	0.90	0.73
Egypt	0.44	0.54	1.04	0.58	1.15	1.09	0.81
Iran	0.21	0.39	0.56	0.15	0.45	0.69	0.41
Iraq	0.11	0.03	0.09	0.12	0.01	0.06	0.07
Jordan	0.56	0.87	1.20	1.08	1.16	1.32	1.03
Kuwait	0.39	0.63	0.79	0.63	0.77	0.87	0.68
Lebanon	0.36	0.33	0.60	0.44	0.61	0.56	0.48
Libya	0.04	0.63	0.33	0.08	0.41	0.22	0.28
Morocco	0.77	0.95	1.34	1.01	1.23	1.35	1.11
Oman	0.30	0.89	0.99	0.80	1.04	0.97	0.83
Qatar	0.30	0.89	0.88	0.51	0.86	0.81	0.71
Saudi Arabia	0.07	0.38	0.69	0.49	0.71	0.76	0.52
Syria	0.10	0.71	0.66	0.27	1.05	0.68	0.58
Tunisia	0.32	0.94	1.27	0.81	1.05	1.17	0.93
United Arab Emirates	0.24	0.87	0.96	0.88	0.87	0.96	0.80
West Bank and Gaza	0.30	0.25	0.30	0.40	0.47	0.84	0.43
Yemen	0.88	0.28	0.80	0.57	0.47	0.87	0.64
Average	0.34	0.57	0.78	0.56	0.76	0.83	0.64

Source: Kaufmann, Kraay, and Mastruzzi (2005).

levels, the weakest governance dimensions are political accountability (an average of .34), regulatory quality (.56), and political stability (.57). The strongest performances are with respect to control of corruption (.83), government effectiveness (.78), and the rule of law (.76).

Again, given the concerns of this study, the issue of regulatory quality deserves particular scrutiny. Once income rankings are taken into account, the strongest performers are Jordan (1.08), Morocco (1.01), United Arab Emirates (.88), Bahrain (.86), Tunisia (.81), and Oman (.80). It is striking that the first five countries with which the United States agreed to negotiate bilateral FTAs—Jordan, Morocco, Bahrain, United Arab Emirates, and Oman—rank among the top eight countries ranked in terms of regulatory quality and in the top six on an adjusted basis. The implication here is that US agreements are being signed with the countries in the region that already have the highest regulatory quality.

If the United States is using regulatory quality as a guide, other potential FTA candidates are Kuwait (5th), Qatar (6th), and Tunisia (7th). If adjusted effort is a guide, the next candidates would be Tunisia, Kuwait, and Egypt (8th).

Income levels in several of these countries heavily reflect oil exports. To explore the influence of oil on these rankings, countries have been put into two groups depending on their exports of mineral fuels (table 2.6).<sup>6</sup> Iraq is excluded from these data. It is striking that the shortfalls in governance rankings relative to income rankings is almost exactly the same in non-oil dependent economies as in those dependent on exports of mineral fuels. There is a common view, for example, that oil-rich countries can get away with having weak governance institutions, and indeed the rankings of oil-dependent economies in governance average 72 percent of their income rankings. But the same ratio obtains in the non-oil countries. With respect to regulatory quality, there is a fairly high variance in both oil and nonoil countries. As already noted, the nonoil group has some of the highest income-adjusted scores in this category (Morocco and Jordan) and some very low scores as well (Syria and Iran), although the poorest performer, taking income into account, is Libya.

There is a fairly high correlation across these governance indicators and with incomes, with the exception of the political accountability index. Indeed, it has a remarkably low correlation with income rankings (0.24). The other variables are fairly highly correlated with each other and with incomes.

The countries have on average failed to improve their positions in these rankings over the period studied (1996–2004). Particularly significant is

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6. Using data for 2003, these exports constituted at least 30 percent of income in nine of these economies: Bahrain (52 percent), Libya (51 percent), Kuwait (43 percent), Yemen (41 percent), Oman and Algeria (37 percent), Qatar and Saudi Arabia (34 percent), and United Arab Emirates (33 percent).

**Table 2.6 Governance indicators for oil and nonoil producers**

Country	Voice	Political accountability	Government effectiveness	Regulatory quality	Rule of law	Control of corruption	Average	Income rank	Adjusted average
Oil-producing									
United Arab Emirates	21.8	78.2	86.1	79.3	78.7	86.7	71.80	90	0.80
Qatar	26.7	79.1	78.4	45.8	76.8	72.4	63.20	89	0.71
Kuwait	34.0	55.3	69.2	55.2	67.6	76.4	59.62	88	0.68
Bahrain	27.7	49.5	75.5	72.9	69.1	76.8	61.92	85	0.73
Oman	24.3	70.9	79.3	64.0	83.1	77.3	66.48	80	0.83
Saudi Arabia	5.8	30.6	55.3	38.9	57.0	61.1	41.45	80	0.52
Libya	2.9	47.1	25.0	5.9	30.4	16.3	21.27	75	0.28
Algeria	23.8	8.3	36.5	17.7	27.5	41.9	25.95	50	0.52
Yemen	22.8	7.3	20.7	14.8	12.1	22.7	16.73	26	0.64
Average	22.3	42.8	53.4	47.1	45.4	54.7	44.27	58	0.72
Nonoil									
Lebanon	25.7	23.3	42.3	31.0	43.5	39.9	34.28	71	0.48
Tunisia	17.5	51.9	69.7	44.8	58.0	64.5	51.07	55	0.93
Jordan	29.1	45.1	62.5	56.2	60.4	68.5	53.63	52	1.03
Morocco	32.5	39.8	56.3	42.4	51.7	56.7	46.57	42	1.11
Iran	10.7	19.9	28.8	7.9	23.2	35.0	20.92	51	0.41
Egypt	20.9	25.2	49.0	27.1	54.1	51.2	37.92	47	0.81
West Bank and Gaza	12.1	10.2	12.5	16.3	19.3	34.5	17.48	41	0.43
Syria	3.9	28.2	26.4	10.8	42.0	27.1	23.07	40	0.58
Average	19.1	30.5	43.4	29.6	44.0	47.2	35.62	50	0.72

Source: Kaufmann, Kraay, and Mastruzzi (2005).

that the largest declines have come in regulatory quality. In fact, small improvements were evident in countries with very low rankings (Iran, Iraq, Libya, and Jordan, at +3.2 percent). But all other countries fell behind, some by very large percentages: Lebanon by 29.8 percent, Saudi Arabia by 14.7 percent, and Egypt by 13.2 percent. There is thus little evidence that the Euro-Med agreements, or anything else for that matter, have really stimulated any reforms to date.

## Business Environment

Table 2.7 reports the findings of the World Bank survey of general features of national business environments, that is, the ease of conducting business.<sup>7</sup> The survey explores on a comparative basis factors such as the ease of doing business, including starting and closing a business, dealing with licenses, hiring and firing workers, obtaining credit, protecting investors, paying taxes, and enforcing contracts. The average ranking of the 15 Arab countries for which data are available is the 44th percentile—actually quite close to the governance ranking reported above in a slightly different sample. The best performance is with respect to paying taxes (66th percentile)—which reflects the very low tax rates in countries such as Saudi Arabia (taxes equal only 1.4 percent of gross profits) and Kuwait, Oman, and United Arab Emirates (all less than 10 percent)—and in registering property (55th percentile). The worst ranking is in obtaining credit (31st percentile) and starting a business (32nd percentile). Also ranking low is protecting minority national investors (35th percentile), with Morocco (25th), Jordan (20th), and Tunisia (14th) being among the lowest.<sup>8</sup> Generally, the best overall environments for business are Tunisia (71st), Kuwait (70th), and Saudi Arabia (66th). The worst West Bank and Gaza (10th), Iraq (15th), Egypt (20th), and Syria (36th).

Taking account of income rankings, again by dividing each ranking measure by the income ranking, suggests once again that the group as a whole does better than it does with respect to governance. Table 2.8 shows that the average income-adjusted measure here is 0.82, versus 0.72 unadjusted.

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7. The World Bank's Doing Business database provides objective measures of business regulations and their enforcement. Comparable across 175 economies, the indicators are developed by the World Bank's Finance and Private Sector Vice Presidency, [www.doingbusiness.org](http://www.doingbusiness.org) (accessed September 15, 2006).

8. Protecting minority national investors measures the strength of minority shareholder protections against directors' misuse of corporate assets for personal gain. The indicators distinguish three dimensions of investor protection: transparency of transactions (extent of disclosure index), liability for self-dealing (extent of director liability index), and shareholders' ability to sue officers and directors for misconduct (ease of shareholder suits index). The data come from a survey of corporate lawyers and are based on company laws, codes of civil procedure, and securities regulations ([www.doingbusiness.org](http://www.doingbusiness.org) [accessed September 15, 2006]).

**Table 2.7 Overall ease of doing business, 2004 (percentile ranks)**

Country	Ease of doing business	Starting a business	Dealing with licenses	Hiring and firing	Registering property	Getting credit	Protecting investors	Paying taxes	Trading across borders	Enforcing contracts	Closing a business	Average
Algeria	17	30	35	38	11	11	37	4	46	15	70	44
Egypt	9	26	6	10	17	8	26	44	55	24	32	20
Iran	30	65	6	28	37	59	11	85	15	65	39	35
Iraq	26	25	55	34	72	14	45	98	0	52	5	15
Jordan	52	23	62	56	33	58	20	90	61	63	55	54
Kuwait	70	44	39	83	49	66	54	95	55	37	71	70
Lebanon	39	36	42	68	45	57	34	72	39	8	37	38
Morocco	34	68	19	20	63	6	25	19	37	81	67	51
Oman	67	61	26	79	88	5	68	97	49	44	51	59
Saudi Arabia	75	5	78	82	98	64	52	97	44	39	57	66
Syria	22	13	50	39	51	20	32	73	6	4	58	36
Tunisia	63	74	43	35	57	34	14	59	66	96	80	71
United Arab Emirates	55	14	57	53	94	33	38	96	88	14	16	36
West Bank and Gaza	19	2	51	52	45	17	41	38	52	43	0	10
Yemen	42	3	79	66	74	12	30	28	56	63	56	49
Average	41	32	43	50	55	31	35	66	45	43	46	44

Source: World Bank.

**Table 2.8 Ease of doing business (income-adjusted rankings), 2004**

Country	Ease of doing business				Trading across borders				Closing a business	Average	
	Starting a business	Dealing with licenses	Hiring and firing	Registering property	Getting credit	Protecting investors	Paying taxes	Enforcing contracts			
Algeria	0.35	0.71	0.76	0.22	0.22	0.75	0.08	0.92	0.31	1.41	0.57
Egypt	0.19	0.12	0.21	0.36	0.18	0.56	0.93	1.17	0.51	0.67	0.50
Iran	0.59	0.13	0.54	0.72	1.15		1.67	0.29	1.27	0.77	0.84
Iraq	0.66	1.37	0.85	1.79	0.35	1.13	2.45	0.00	1.31	0.11	0.97
Jordan	1.00	1.19	1.08	0.63	1.12	0.38	1.74	1.17	1.20	1.05	1.00
Kuwait	0.79	0.44	0.95	0.56	0.76	0.62	1.08	0.63	0.42	0.81	0.69
Lebanon	0.55	0.59	0.96	0.64	0.81	0.48	1.02	0.55	0.12	0.52	0.61
Morocco	0.81	0.46	0.48	1.49	0.14	0.58	0.45	0.88	1.94	1.60	0.95
Oman	0.84	0.33	0.98	1.10	0.06	0.85	1.22	0.61	0.55	0.64	0.72
Saudi Arabia	0.94	0.98	1.02	1.23	0.80	0.65	1.21	0.55	0.48	0.71	0.79
Syria	0.55	1.24	0.98	1.27	0.50	0.81	1.82	0.15	0.10	1.45	0.84
Tunisia	1.14	0.79	0.63	1.03	0.62	0.26	1.07	1.20	1.75	1.45	1.03
United Arab Emirates	0.62	0.63	0.59	1.04	0.37	0.42	1.07	0.97	0.16	0.18	0.56
West Bank and Gaza	0.47	1.24	1.26	1.09	0.41	1.00	0.93	1.26	1.05	0.00	0.80
Yemen	1.61	3.05	2.53	2.83	0.45	1.17	1.07	2.16	2.43	2.16	1.78
Average	0.74	0.88	0.92	1.07	0.53	0.69	1.19	0.83	0.91	0.90	0.82

Source: World Bank.

But at less than unity, this measure nonetheless indicates underperformance. Once their incomes are taken into account, Yemen (1.78), Tunisia (1.03), Jordan (1.0), and Morocco (.95) are more or less where they would be expected to be, whereas Egypt (.50), United Arab Emirates (.56), and Lebanon (.61) still do poorly. It should be noted, however, that in the case of Egypt these numbers are outdated, since the government has undertaken major reform measures since 2004. Income adjusted, the weakest areas again relate to starting a business (.59) and obtaining credit (.53), and the strongest are with respect to paying taxes (1.19). The measures of protecting investors (0.69) and trading across borders (.83) also indicate underperformance, even when income levels are taken into account.

## Trade Environment

In addition to the border barriers, the trade regimes in the region are highly bureaucratized and the movement of goods is extremely time-consuming. The World Bank measures the time it takes and the number of signatures required to conduct trade.<sup>9</sup> For exporting, the measure is of the time from packing the goods at the factory to their departure from the port of exit. For imports, procedures range from the vessel's arrival at the port of entry to delivery of the cargo at the factory warehouse. The results, reported in table 2.9, indicate that the region ranks ahead only of sub-Saharan Africa in terms of the number of signatures required for exports (14.5 versus 3.2 signatures in high-income countries), and imports (21.3 versus 3.3 signatures in high-income countries). In addition, the time taken for exports (33.6 days) and imports (41.9 days) is ahead of only South Asia and sub-Saharan Africa. Even in Gulf countries that do not have very high tariffs, importing entails considerable delays. It takes 39 days in Kuwait to import, and in Saudi Arabia imports require 44 days and 18 signatures.

The measures for each of these six variables were compared with those of the other 155 countries in the sample to obtain a ranking. As reported in table 2.10, the Arab countries overall ranked in the 47th percentile—

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9. All documents required to export and import the goods are recorded. It is assumed that the contract and letter of credit have already been agreed upon and signed by both parties. Documents include port filing documents, customs declaration and clearance documents, and official documents exchanged between the concerned parties. Documents filed simultaneously or in packages are considered different documents but with the same time frame for completion. Time is recorded in calendar days. The time calculation for a procedure starts from the moment it is initiated and runs until it is completed. If a procedure can be accelerated for an additional cost, the fastest legal procedure is chosen. It is assumed that neither the importer nor the exporter wastes time and that each commits to completing each remaining procedure without delay. Procedures that can be completed in parallel are treated as simultaneous for the purpose of measuring time. The waiting time between procedures (for example, during unloading of the cargo) is included in the measure ([www.doingbusiness.org](http://www.doingbusiness.org) [accessed September 15, 2006]).

**Table 2.9 Regional data for trading across borders, 2005**

Region/country	Documents for export (number)	Signatures for export (number)	Time for export (days)	Documents for import (number)	Signatures for import (number)	Time for import (days)
East Asia and Pacific	7.1	7.2	25.8	10.3	9.0	28.6
Europe and Central Asia	7.7	10.9	31.6	11.7	15.0	43.0
Latin America and Caribbean	7.5	8.0	30.3	10.6	11.0	37.0
Middle East and North Africa	7.3	14.5	33.6	10.6	21.3	41.9
OECD	5.3	3.2	12.6	6.9	3.3	14.0
South Asia	8.1	12.1	33.7	12.8	24.0	46.5
Sub-Saharan Africa	8.5	18.9	48.6	12.8	29.9	60.5
Algeria	8	8	29	8	12	51
Kuwait	5	10	30	11	12	39
Lebanon	6	15	22	12	35	34
Morocco	7	13	31	11	17	33
Oman	9	7	23	13	9	27
Saudi Arabia	5	12	36	9	18	44
Syria	12	19	49	18	47	63
Tunisia	5	8	25	8	12	33
United Arab Emirates	6	3	18	6	3	18
West Bank and Gaza	6	10	27	9	18	42
Yemen	6	8	33	9	20	31

OECD = Organization for Economic Cooperation and Development

Source: World Bank, [www.doingbusiness.org](http://www.doingbusiness.org) (accessed September 15, 2006).

**Table 2.10 Rankings for trading across borders, 2004–05**

Country	Documents for export (number)	Signatures for export (number)	Time for export (days)	Documents for imports (number)	Signatures for imports (number)	Time for imports (days)	Average
Algeria	45	52	54	71	47	26	35
Egypt	41	35	57	66	63	60	51
Iran	12	13	21	43	9	25	18
Iraq	15	6	6	1	1	1	8
Jordan	52	66	55	39	74	62	57
Kuwait	89	46	52	48	45	42	65
Lebanon	74	26	66	41	12	51	62
Morocco	49	28	48	46	32	53	51
Oman	25	58	64	32	59	63	44
Saudi Arabia	85	34	34	63	29	31	58
Syria	8	18	19	6	7	13	11
Tunisia	83	56	60	72	48	54	68
United Arab Emirates	65	86	80	89	90	80	73
West Bank and Gaza	63	45	57	67	30	35	49
Yemen	63	55	45	65	25	57	60
Average	54	53	49	68	36	41	47

Source: World Bank.

again a result that is close to the governance and ease of doing business rankings, and well behind the rankings for income (57th percentile). The performance is particularly weak on the number of signatures required for importing (36th percentile), suggesting unusually large amounts of bureaucratic intervention. Overall, the worst average trading environments are in Iraq (8th), Syria (11th), and Iran (18th). As reported in table 2.11, when their income levels are taken into account, Gulf countries such as Oman (.55) and Kuwait (.74) also do relatively poorly. By contrast, income levels do seem to help explain the conditions in Egypt (1.08), Tunisia (1.24), Jordan (1.09), and Morocco (1.21).

What explains the patterns seen in these data? One answer is that they reflect the political economy of reform in the Arab region. There is a conflict between those who obtain rents from the existing regime and those who might gain from reforms and policy, and the patterns reflect the relative power of these two forces. In the current regimes, the beneficiaries are those who enjoy benefits from oil and the rents from quota regimes, strategic aid, and large public sectors. In particular, oil and aid revenues can be used to buy social peace. Under reformed regimes, by contrast, the beneficiaries would be in the private sector, particularly those in sectors with export potential. Nabli (2005, 11–21) reports that “in the Arab region the lobbying power of the manufacturing sector was lower than that of any other region of the world except sub-Saharan Africa,” due in part to the fact that the manufacturing sector in the Arab region has a share in the economy that is “almost half the typical levels of other lower- and middle-income countries.”

## Conclusions on Governance

Five major conclusions emerge from this analysis and have important implications for this study. First, the weakest dimension of governance in the Arab region is accountability. These are autocratic systems with few of the political freedoms that are typical even in countries at similar income levels. If the United States is to conclude the MEFTA within a decade, either there have to be dramatic changes, or the United States is not going to be able to make the provision of these political freedoms a precondition for joining.

Second, the region has particularly weak regulatory policies. To some degree these can be explained by income levels, but even taking income levels into account these policies are weak. This creates environments that make doing business difficult and, in particular, raise the costs of trading across borders. Even in Gulf states where tariffs are relatively low, trade is seriously impeded by bureaucratic intervention. To the degree that FTAs can help change these practices, they have the potential for making a significant contribution.

Third, there is considerable diversity in performance across the region, some part of which can be explained by overall income levels. This suggests

**Table 2.11 Income-adjusted rankings for trading across borders**

<b>Country</b>	<b>Documents for export (number)</b>	<b>Signatures for export (number)</b>	<b>Time for export (days)</b>	<b>Documents for imports (number)</b>	<b>Signatures for imports (number)</b>	<b>Time for imports (days)</b>	<b>Average</b>
Algeria	0.89	1.03	1.08	1.42	0.94	0.52	0.70
Egypt	0.88	0.74	1.21	1.41	1.35	1.28	1.08
Iran	0.23	0.25	0.42	0.83	0.18	0.48	0.35
Iraq	0.37	0.15	0.16	0.03	0.03	0.03	0.20
Jordan	0.99	1.28	1.07	0.76	1.41	1.19	1.09
Kuwait	1.01	0.52	0.59	0.54	0.51	0.48	0.74
Lebanon	1.04	0.37	0.94	0.57	0.17	0.72	0.88
Morocco	1.17	0.66	1.15	1.11	0.77	1.26	1.21
Oman	0.31	0.73	0.80	0.40	0.73	0.79	0.55
Saudi Arabia	1.06	0.42	0.42	0.79	0.36	0.39	0.73
Syria	0.21	0.45	0.48	0.16	0.18	0.32	0.27
Tunisia	1.51	1.02	1.09	1.30	0.87	0.97	1.24
United Arab Emirates	0.72	0.96	0.89	0.99	1.00	0.89	0.81
West Bank and Gaza	1.54	1.10	1.40	1.64	0.72	0.85	1.20
Yemen	2.41	2.11	1.71	2.48	0.97	2.18	2.30

Source: World Bank.

that not all nations are likely to be able to adhere to and benefit from a very demanding agreement. The United States has signed agreements with the best regulatory performers.

Fourth, there is little evidence over the past eight years of dramatic reforms and improvements. Even countries with low and simple tariff regimes score quite poorly with respect to the quality of their regulatory environments.

And finally, countries typically do better with respect to government effectiveness, the rule of law, and the control of corruption than they do with respect to regulatory quality. Clearly, the redistributionist part of the traditional Arab state performs better than the interventionist part.

## Regional Trade Agreements

Arab economic integration has long been a goal of Arab governments. They have pursued these goals through agreements signed by almost all governments as well as through subregional and bilateral agreements. Currently, the most important pan-Arab agreement is the Greater Arab Free Trade Agreement (GAFTA), implemented under the aegis of the Arab League, an organization with 22 members. The GAFTA, however, is only the latest of a number of efforts to integrate the region.<sup>10</sup> Adopted in 1997, the GAFTA represented commitments by the Arab governments to create a free trade area within a decade.<sup>11</sup> The agreement required Arab goods to be accorded national treatment.<sup>12</sup> It also required the eventual elimination, over 10 years, of all tariffs, to be achieved through equal annual percentage reductions in customs duties. All nontariff barriers among members were also supposed to be removed.<sup>13</sup> During the transition to free trade, some exceptions were permitted. Members were allowed to postpone the liberalization of an agreed-upon number of industrial products and to suspend liberalization of a limited number of agricultural products during peak harvest seasons. The agreement did not establish its own rules for

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10. In 1953 the Arab League concluded a treaty to organize the transit of goods. In 1964 Egypt, Iraq, Jordan, and Syria agreed to establish an Arab Common Market, and in 1981, 18 members of the Arab League concluded the Agreement for Facilitation and Promotion of Trade among the members.

11. The agreement can be viewed online at the Arab League Web site, [www.arableague.org](http://www.arableague.org).

12. "Arab goods included in trade in accordance with this program shall be treated as national goods with respect to rules of origin, specifications and measurements, health and security safeguard clauses as well as local charges and taxes" (Article 1.4 of the GAFTA).

13. "Arab goods traded within the framework of this Executive Program shall not be subject to any non-tariff restrictions by whatever name" (Article 3 of the GAFTA).

subsidies, countervailing duties, safeguards, and antidumping. Instead it called for the application of “international rules and provisions”<sup>14</sup>—in other words, WTO rules. Yet despite this commitment to WTO rules, originally only seven (and now 11 countries) were WTO members that actually had the institutional frameworks to implement these rules. The GAFTA provided for a committee to determine rules of origin, and until the committee completed its work, the agreement required the use of rules of origin that had been agreed to earlier. These latter rules contained a 40 percent value-added requirement.<sup>15</sup> Dispute settlement and enforcement was to be carried out by a committee of the members, aided by expert panels. A two-thirds majority of member states was required to adopt a decision in a dispute. There were, however, no provisions for retaliation or suspension of concessions.<sup>16</sup>

The GAFTA beat its original deadline for eliminating tariffs by removing all tariffs on intra-Arab trade on January 1, 2005.<sup>17</sup> This has been credited by some for stimulating intra-Arab trade. According to the *Annual Report of Developments in Globalization and Regional Integration* issued in 2003 by the United Nations Economic and Social Commission for Western Asia, since the GAFTA went into effect, intra-Arab exports have increased by an average rate of 13.6 percent annually, reaching \$21.3 billion in 2002.

However, the GAFTA has been much less successful in other respects. Nontariff barriers remain problematic. In some member countries quotas have been reduced, but primarily because of unilateral liberalization efforts. In many other countries, however, import quotas, licensing for safety and health reasons, and customs and administrative procedures present significant obstacles to trade. Little has been achieved in harmonizing such measures or allowing for mutual recognition. The transit of goods remains problematic due to difficulties in obtaining visas and delays and closings of border facilities. Agreements on new rules of origin have not been reached, and as a result some countries have been unwill-

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14. Executive Program to Establish a Pan Arab Free Trade Area (Article 1, No 5).

15. “The value added in a party state shall not be less than 40 [sic] value when finished. This percentage shall be reduced to a minimum of 20 percent for Arab assembly industries,” Executive Program to Establish a Pan Arab Free Trade Area (Article 9).

16. Article 9 (1) of GAFTA states: “The Enforcement and Monitoring Committee shall comprise representatives of the Arab States.” Article 9 (4): “The Committee shall assume the task of settling disputes arising from the implementation of the Program. It may hire Arab experts in world trade or form ad hoc arbitration panels composed of no more than five experts, judges or arbitrators to review cases; in which case an arbitration panel shall submit its recommendation to the Committee for decision-making.” Article 9 (5): “The Committee shall adopt its decisions by a two-thirds majority of Member-States.”

17. In February 2002, the Arab Economic and Social Council decided to accelerate the establishment of the GAFTA and set a new implementation deadline of 2005 instead of 2007.

ing to fully implement the agreement.<sup>18</sup> In addition, there have been concerns about the fraudulent use of rules-of-origin certificates.<sup>19</sup>

In sum, some progress has been made toward regional integration, but much more could be done both with respect to the rules in the agreement and its implementation on the ground. In particular, the agreement has not been extended to include services and investment, and adequate rules of origin have not been negotiated. There remains considerable scope for dealing with nontariff barriers both at the border and those due to the application of discriminatory regulations. In addition, the operation of customs and national administration of trade policies needs to be improved.

Some subregional agreements have achieved somewhat better success in some of these respects. An interesting example is the Agadir Agreement negotiated between Jordan, Egypt, Morocco, and Tunisia.<sup>20</sup> The agreement was signed in 2004 in Rabat and became effective on January 1, 2006.<sup>21</sup> Agadir builds upon the Euro-Med agreements signed by the parties individually.<sup>22</sup> Some of the temporary exceptions to the liberalization are taken directly from liberalization scheduled under the Euro-Med agreements. The agreement breaks no new ground with respect to agriculture liberalization, which follows GAFTA, or services liberalization, which relies upon the countries' WTO commitments. A crucial aspect of Agadir is adoption of the pan-European rules of origin, thereby allowing countries to count value added in any of them (diagonal cumulation) toward meeting these rules.<sup>23</sup> The agreement also provides for safeguards with respect to trade among the parties, but with a standard requiring "immense injury" that is clearly greater than the "substantial" standard

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18. In May 2005, the Egyptian newspaper *Al Ahrām* reported that the head of the Egyptian House of Food Industries complained that while Egypt along with a number of other Arab countries have complied with the GAFTA schedule fully eliminating tariffs, some Arab countries continue to apply tariffs on Arabic goods.

19. For example, in March 2005, *Al Ahrām* reported that the Union of Egyptian Industries convened a meeting in response to the seizure of more than 24,000 television sets produced in China that carried a certificate of origin of one of the Arab countries. Such certificates were said to be widely available for purchase.

20. A copy of the agreement can be found at [www.bilaterals.org](http://www.bilaterals.org) (accessed September 15, 2006).

21. "The Member States shall form between them a free trade zone, in a gradual fashion, during the transitional period lasting no longer than 1/1/2006" (Agadir Agreement, Article 2:1).

22. The Chapeau of the Agadir Agreement states, "And starting from cooperation agreements with the European Union that bind all of them, and in realization of the goals of the Barcelona Declaration of creating a Euro-Mediterranean free trade zone. . ." ([www.bilaterals.org](http://www.bilaterals.org) [accessed September 15, 2006]).

23. "The rules within the country of origin of the materials and merchandise produced should be in accordance with the Pan European Protocol and any future alterations to it" (Agadir Agreement Article 6.1).

under the WTO.<sup>24</sup> The member states are expected to cooperate for the sake of harmonizing their technical legislation, standards, and specifications in accordance with international custom. The agreement also notes that, “If one of the Member States resorts to procedures that create, or will lead to the creation of technical trade obstacles, the member states shall hold immediate deliberations with the goal of finding appropriate solutions” (Agadir, Article 27). The agreement provides for the settlement of disputes by a Decisionary Committee whose decisions “shall be binding on the member states, and the member states will take all necessary steps to implement the decisions of the committee” (Agadir, Article 27). The agreement has clearly been crafted to allow other Arab countries that also have association agreements with the European Union to join.<sup>25</sup>

The Agadir Agreement is particularly interesting because it demonstrates how a subregional arrangement among the parties can be crafted on the basis of the bilateral agreements that they have concluded with the European Union. It shows how bilateral agreements with a major partner can become a building block for an integrated regional arrangement. At the signing agreement, Christopher Patton, the EU Commissioner for External Relations, observed, “The European Union is particularly pleased that you have decided to open up the agreement to all Mediterranean partners that have concluded Association Agreements. We strongly encourage other partners to join the agreement”<sup>26</sup>

A second important subregional arrangement is the Gulf Cooperation Council (GCC).<sup>27</sup> The GCC implemented an economic agreement in 1983, two years after its formation. It began with an intra-GCC free trade area that eliminated all internal duties and charges. Two decades later, a new broad-ranging economic agreement was concluded covering trade, investment, and monetary issues.

In addition to a customs union, the GCC has also agreed to a common market in which citizens of any GCC state are accorded the same treatment as that given to nationals with respect to movement and residence, work in private and government jobs, pensions and social security, real es-

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24. “. . . would cause or threat of immense damage to local industry or agriculture which produces similar goods to those being imported from other members” (Agadir Agreement, Article 8).

25. “All Arabic nation members of the Arab League and the Greater Arab Free-Trade Zone and with Association Agreements or free trade agreements with Europe, may ask to be Annexed into this agreement, and such annexation will occur with the approval of all of the Member States in the Exterior Minister’s Commission, and the countries being annexed will be required to implement all of the applicable requirements upon its annexation under the regulations of this agreement” (Agadir Agreement, Article 29).

26. See <http://europa-eu-un.org> (accessed September 15, 2006).

27. Members are Bahrain, Kuwait, Oman, Saudi Arabia, United Arab Emirates, and Qatar.

tate ownership, capital movement, tax treatment, education, and health and social services.<sup>28</sup> There are commitments to achieve a high level of harmonization between member states in fiscal and monetary policies and banking legislation, with a view to eventual economic and monetary union. In addition, members are committed to unify all of their investment-related laws and regulations, and accord national treatment to all investments owned by GCC natural and legal citizens.<sup>29</sup>

The customs union came into force in January 2003. The key feature is a common external tariff set at 5 percent on imports from outside the area.<sup>30</sup> There are exemptions for a list of 417 commodities,<sup>31</sup> as well as for industry inputs used in domestic production. In addition, higher duties are levied on tobacco products (100 percent), and until 2005, temporary tariffs above 5 percent were allowed on products similar to those produced domestically. There is also a common customs law and uniform customs, financial, and administrative procedures and regulations related to imports, exports, and reexport. Goods are allowed to move freely between GCC states without any tariffs subject to national veterinary, sanitary, and phytosanitary regulations and domestic restrictions or bans in some states on particular goods (e.g., alcohol). Customs duties are allocated to the state that is the final destination where the commodity is consumed. The principle of mutual recognition of national standards until common standards are adopted is to be applied to expedite the clearance of goods.<sup>32</sup>

One advantage that members expected to obtain from the agreement was the ability to negotiate collectively with outsiders. But with respect to the United States, several countries have actually proceeded to negotiate independently. Obviously, these agreements with the United States represent a breach in the common external tariff and, in recognition of this reality, the GCC has agreed to allow members to grant an exception to the United States. It will turn out, therefore, that US goods will not be able to

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28. See chapter II of the "Economic Agreement Between the Gulf Cooperation Council States."

29. The economic agreement also contains provisions to settle disputes on claims brought by any GCC citizen or official entity. If claims cannot be amicably settled by the Secretariat General, they shall be referred to the GCC Commercial Arbitration Center. If the parties do not agree, a specialized judicial commission shall be formed.

30. This description follows that given by the GCC Secretariat General; see [www.gcc-sg.org](http://www.gcc-sg.org).

31. Live animals, meat, and fish; vegetables and cereals; medicines, books, ships, and commercial aircraft.

32. The GCC Secretariat estimates that there has been a rapid increase in the number of common standards from 50 in 1985, to 133 in 1990, 1,065 in 2000, and 1,754 in 2003; see [www.gcc-sg.org](http://www.gcc-sg.org) (accessed September 15, 2006).

circulate freely within the entire GCC until all have FTAs with the United States.

In sum, the Arab countries have built formal structures for FTAs both regionally and subregionally. Generally—the GCC is an exception—these are not deep agreements, although they do remove tariffs on most goods. At the same time, there are many additional steps that Arab countries still need to take if these regional agreements are going to achieve the degree of international integration typical of the agreements negotiated by the United States. If countries extend the agreements they sign with the United States to each other, regional integration could be significantly enhanced.