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Is MENA a Region?
The Scope for Regional Integration

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Abstract

The paper analyzes the scope and implications of greater economic integration in the Middle East and North Africa (MENA). After reviewing whether MENA satisfies the defining characteristics of a region, it documents the low level of regional economic interaction. It argues that gains from greater regional interactions will depend primarily on implementing domestic reform and external policies that, in any case, are needed for the region to benefit from the broader process of globalization of the world economy. It also discusses measures aimed directly at facilitating regional interaction.

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Summary

Increasing attention is being devoted to the prospects and implications of regional integration in the Middle East and North Africa (MENA) region. This attention comes at a time of greater global interest in regional economic arrangements, including as a means of realizing economic welfare gains and increasing regions' collective political bargaining power.

Despite favorable geographical and cultural elements, the MENA region remains remarkably unintegrated economically. Intraregional trade is small, tourist and labor flows are skewed, and private capital transactions remain limited. Moreover, there has been very little effective regional economic policy coordination.

Given this low level of interaction, the paper finds that there are gains to be achieved from increased regional interaction in MENA, including the stimulation of growth and employment, which is the major challenge facing the region. The scope for such gains is limited, however, by some of the economic characteristics of the economies (particularly, the similarity of their resource endowments) and political factors (including the legacy of the prolonged Arab-Israeli conflict).

Realizing gains from increased regional interaction requires policy changes, most of which are also needed if these countries are to benefit from the broader process of globalization of the international economic system. Indeed, the policy implications of the analysis in this paper is that, rather than set as their first economic policy priority the goal of regional integration, MENA countries should focus on domestic policy reforms and the associated process of greater integration into the world economy. Successful liberalization will promote regional interaction.

While domestic reforms and multilateral liberalization will be the main engines of greater MENA economic interaction, the paper notes that direct measures could also play a role. These include reducing divergences in regulatory frameworks, improving transportation facilities, and undertaking regional infrastructural projects. There is also a need to strengthen the institutional framework to improve regional policy discussions and coordination, and to provide regional financing instruments.

I. Introduction

Despite many attempts over the years since World War II to promote economic and political cooperation among states in the Middle East and North Africa (MENA), economic interactions within the region have remained limited.¹ Recent progress in the Arab-Israeli peace process and steps by several countries toward external economic liberalization have focused increasing attention on the economic potential of MENA *as a region*. This attention comes at a time of renewed global interest in regional arrangements, be they among industrial countries (such as the European Union), industrial and developing countries (NAFTA and APEC), or developing countries (Mercosur).²

There is a need in any region for a framework in which intra-regional issues--political, security, or economic--can be addressed on a regular basis, and most regions have many, overlapping, regional organizations. A recent OECD survey identifies three reasons countries seek greater regional integration: (i) *economic welfare gains*; (ii) *increasing the region's collective political bargaining power in extra-regional issues*; and (iii) *achieving other non-economic national goals, such as meeting security concerns and preventing future conflict* (OECD, 1993).

A region is defined by several characteristics, the most basic being geography and culture. However these two aspects say little about the extent of, or potential for, welfare-enhancing regional economic interaction. These are also determined by economic and political factors. The more similar the economic and political systems, and the more similar the political goals among countries, the easier it has been to promote effective regional economic integration. The returns to economic integration will also reflect the relative resource endowments, including human capital, of

^{1/} There is no unique way to define the MENA region. The most comprehensive definition covers 24 economies: the 21 members of the Arab League (Algeria, Bahrain, Djibouti, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, Sudan, Syria, Tunisia, the United Arab Emirates and Yemen), Iran, Israel and Turkey. More limited definitions have been used, the most restrictive being that encompassing Egypt, Israel, Jordan, Lebanon, Syria and the West Bank and Gaza. For the purposes of this paper, MENA is defined to cover four Maghreb countries (Algeria, Libya, Morocco, and Tunisia), the six economies situated at the geographical center of the region (Egypt, Israel, Jordan, Lebanon, Syria, and West Bank and Gaza) and the six member countries of the Council of the Arab States of the Gulf (or GCC--Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates).

^{2/} For reviews of recent regional trade arrangements, see Brown (1994), De la Torre and Kelly (1992) and De Melo and Panagariya (1993).

the participating countries, albeit not in a unique and unambiguous manner.³ It is these factors--the degree of actual and potential economic and political coherence among countries, and the potential returns to integration -- that provide the basis for our exploration of the extent to which MENA is a region, and the extent to which it can gain from becoming more economically integrated.

In Section II we discuss the defining characteristics of a region in more detail. Section III assesses the extent to which MENA meets these criteria, both in absolute terms and relative to other regions in the world economy. In Section IV we discuss the scope and requirements for enhanced regional integration in MENA. We present concluding remarks in Section V.

II. What is a Region?

At the most basic level, regions are defined in terms of geography: they are usually contiguous land masses or share a common littoral. Geography is a significant determinant of agents' proximity to markets within the region--an aspect that assumes greater importance the higher the costs of transportation and communications, as demonstrated, for example, by the work on gravity models.⁴ It also plays an important role in facilitating contacts among residents of the region, be they government officials, business people, or journalists. Of course, geographical proximity is also almost a necessary condition for active enmity among non-superpower states; even so, it may contribute to creating a general sense of belonging, if only to the extent that problems are shared or need to be dealt with jointly if they are to be solved.

There are two important qualifications to the influence of geography. First, proximity per se is normally not sufficient to create contacts within a region that affect the daily life of its residents in a meaningful way. For this, higher degrees of coherence are needed. Second, technological changes (particularly in information and communications) have sharply reduced the effective distance between countries, as have changes in economic strategy away from inward-based policies toward those promoting

3/ Traditional trade theory suggests that the potential payoffs from the opening of trade among countries that formerly did not trade with each other or the rest of the world are higher the more complementary are the structures of their economies. However, the creation of a customs union among countries that could trade before is more likely to be welfare-enhancing for its members the more similar the range of goods they produce, for trade creation is more likely to dominate trade diversion under those circumstances. (See for instance Halevy and Kleiman, 1995). This result may be strengthened by taking into account intra-industry trade based on increasing returns. We return to this issue in Section II below.

4/ See Asilis and Rivera-Batiz (1994), Frankel, Stein and Wei (1993), and Krugman (1991).

cross-border activities. The influence of technological change on regional integration is ambiguous. At the same time that technology has made the globe smaller and encouraged globalism, it has facilitated intra-regional travel and communications, to the point where it is often quicker for a business person or policymaker to visit a neighboring capital than a provincial center, thus encouraging regionalism.

Commonality of *culture* provides a strong bonding element in any region. Dominant history, language, and religion facilitate personal interactions, with a favorable impact on trading relations, tourism, labor and investment flows. They are also likely to enhance perceptions of a mutuality of interests in multilateral deliberations, as well as in bilateral negotiations with other countries or regions.

An illustration of the operation of these factors is provided by a recent analysis of the experience of the European Union (EU). European economic integration has of course been characterized by geographical contiguity and a shared if ambiguous history, which after two world wars pushed in the direction of integration as the alternative to future conflict. Looking at the initial stages of the European integration, Wallace (1994) argues that the effective postwar shrinkage of Western Europe to a core of six largely Catholic countries, which formed the original European Coal and Steel Community, ensured a strong common cultural tradition which, in turn, facilitated their economic and political integration.

There may well be a close relationship between cultural and political factors--in particular, cultural factors may influence the political configuration of a country, as summarized in the form of government and stability of political institutions and traditions.⁵ Two specific political aspects affect the likely coherence of a region: first, the cross-country consistency of political regimes within the region; and second, countries' political commitment to the region.

The more stable and the more similar the political institutions and systems of governance among countries in a region, the easier and more effective the process of integration,⁶ particularly for countries sharing a democratic approach to choosing and changing governments. At the same time, and almost by definition, the greater the commitment to regional goals, the more likely it is that political leaders will be willing and able to override national goals that would otherwise tend to undermine regional integration. Political commitment to regional integration may be driven in part by politicians' views of the likely economic benefits, but it is also powerfully affected by political and security-related considerations. This was certainly the case in Europe, and it is again evident in EU consideration of eastward expansion.

⁵/ Higgins and Savoie (1995).

⁶/ See, for example, OECD (1993).

When regional affiliations begin to take institutional form, they may initially be expressed within a political but not an economic framework; such was the case in the Americas, where the Organization of American States was set up before regional economic arrangements. However, security concerns aside, it is not obvious what states would discuss within a political framework that did not address economic issues. Further, the success of the European enterprise in achieving political goals through economic integration has cast a new light on the potential benefits of intra-regional economic cooperation.

We shall in this paper concentrate on economic aspects of regional cooperation. Such cooperation is not possible without a basic political commitment that closer intra-state relations within the region are desirable; but that political commitment in turn may depend on an evaluation of the economic benefits of regional integration. And successful regional economic integration is in its turn likely to feed back to strengthen political relationships.

Both economic and political economy factors suggest that economic integration is more likely to improve welfare the more similar are countries. Integration among similar countries reduces the scope for trade diversion since the countries are already likely to be producing and importing similar goods. Such integration is likely to enhance intra-industry trade and widen the product variety available to consumers; it can also serve to lessen the monopoly power of local producers, with imports of close substitutes providing increased market discipline.

Similarly, integration is less likely to trigger strong opposition from interest groups if countries are more similar. For example, the more similar the countries, the smaller the differences in wages and work conditions. U.S. labor opposition to Mexican accession to NAFTA, which was far stronger than opposition to free trade with Canada, illustrates this point.

These arguments serve to highlight the potential challenges facing the integration process in the MENA region, with its pronounced differences in political and economic structures.

In considering regional economic integration, the choice is often posed as being between regionalism and multilateralism. If regional liberalization were incompatible with multilateral liberalization, the choice would be clear, particularly in MENA: pursue multilateralism. But the two processes may take place at the same time, and we assume henceforth that closer regional ties in MENA will not come at the expense of multilateral liberalization.

Regional economic arrangements may be characterized as taking the following possible forms:

- preferential trading arrangements, in which regional trading partners enjoy more favorable trading conditions, including lower tariffs, than other countries;
- a free trade area (FTA), in which trade within the area is not subject to taxation but external tariffs on third parties may differ among member countries;
- a customs union, in which a common external tariff is applied, and more generally in which all members of the region treat all conditions of trade with extra-regional economic partners in a similar fashion;
- a common market, in which trade in goods and capital flows within the region is free, where market conditions (including standards) have been made uniform so that producers in one country face no non-market restrictions in selling in other countries in the common market, and where restrictions on labor flows are more limited; and
- an economic union, where members eventually share a single currency, and the concept of national residency is eliminated in all economic relations through two key principles: mutual recognition and minimum harmonization.⁷

These forms are listed in terms of growing intensity of economic integration. They should be thought of as points on a continuum, rather than an exhaustive listing of alternative institutional arrangements. The higher the level of integration among member countries, the greater the loss of discretionary national policy-making capability in areas covered by the regional arrangements. As the integration process strengthens, efficiency dictates that region-wide institutions assume growing power for proposing, regulating and supervising the rules that are needed for the operation of a single market.⁸ While economists might view such changes as superior methods of coordinating and/or precommitting on relevant economic policies, politicians tend to view them as a loss of sovereignty; as such, enhanced integration has often proved controversial among members of the European Union,⁹ with monetary union the most contentious example.

7/ Under the principle of mutual recognition, laws and regulations enforced in one country are recognized by all other members of the Union. The minimum harmonization principle requires members to harmonize regulations at the minimum level among countries in the union; the principle prevents competition between rule books from leading to disruptive deregulation. See the discussion in Padoa-Schioppa (1993).

8/ In the European Union, central institutions may also have the power to approve these rules.

9/ See, for example, Strain (1993).

III. Regional Characteristics of MENA

In this section we consider the extent to which MENA constitutes a region. While geography and culture favor regional integration, the absence of political and economic prerequisites has so far limited the scale of market and institutional integration.¹⁰

The MENA region covers a contiguous geographical land mass extending from the Atlantic Ocean in the west to the Arabian Sea in the east. Its land mass of 15 million square kilometers is almost equal to that of the EU and three quarters that of Latin America. While tending to be characterized by harsh climates and limited ground water and rainfall, the region is rich and diverse in its natural resources--important crude oil and gas reserves, numerous non-fuel mineral and non-mineral resources, and some very productive agricultural pockets.¹¹

In some respects, MENA is unusually culturally homogenous. Arabic is the primary language in all countries of the region except Israel, and is an official language in all countries; Arabic and Hebrew are closely related. Monotheistic religions, with historical relations among them, dominate the region. In each country but Israel, the population is predominantly, in most cases overwhelmingly, Muslim. The Arab countries in the region share a rich historic heritage, part of which is also shared with Israel. But relations have had a checkered history, and in recent years the region has been dominated by the human suffering, hostilities and mistrust associated with armed conflicts -- particularly, but not exclusively, the prolonged Arab-Israeli conflict.

This extent of language and religious coherence compares favorably with other regions. The similarities of language are considerably greater than in the European Union for example. Latin America has similar coherence with respect to language but less diversity with respect to religion.¹² APEC, the emerging regional bloc seeking to establish an FTA by 2020, is considerably less homogenous in terms of language, religion and historical heritage.

Reflecting religious and historical influences, culture in several of the countries in the region endorses commercial activities. Nationals of the region have a well-established trade and entrepreneurial reputation.

^{10/} As the names imply, market integration relates to the economic relationships among goods and factors within the region, while institutional integration refers to the extent of legal and institutional relationships. See Cooper (1974).

^{11/} The share of agricultural land varies from 3 percent in Egypt and the United Arab Emirates to 75 percent in Tunisia.

^{12/} This comparison abstracts from differences among sects within the major religions.

This is illustrated by the success of Lebanese and Palestinian minorities around the world, be it in Latin America, west Africa or North America.

The populations of MENA countries (Chart 1) range from almost 60 million in Egypt to around 0.5 million in the smaller GCC countries (Bahrain and Qatar). Many countries in the region have experienced high population growth rates and rapid labor force growth, and have a large share of young people in their population.¹³ Urban population accounts for around 70 percent of the total, well above the average for developing countries (44 percent), below that of the EU (74 percent), and similar to that of APEC and Latin American countries.¹⁴ Israel has the highest urbanization rate (90 percent) and Egypt the lowest (44 percent).

The rhetoric of international relations within the region has been dominated since World War II by Arab nationalism and the Arab-Israeli conflict. The political peak of Arab nationalism was attained in the 1960s. However, the political unity of the Arab bloc, as exemplified in the activities of the Arab League and Arab regional organizations, was adversely affected by two events in the last 20 years: the Egyptian-Israeli peace in 1979; and the 1990-91 regional crisis triggered by Iraq's invasion of Kuwait.

The erosion in Arab political unity has been accompanied by, first, fluctuating tensions among certain Arab countries, and, second, the emergence of security and economic arrangements among sub-regions, the most notable being the GCC. There has also been a strengthening of the role of religion in everyday and political life.

More recently, progress in reaching a comprehensive, just and durable Arab-Israeli peace has forged new links in the region, the most important being the developing Israeli-Jordanian-Palestinian nexus. Despite this, powerful divisions of opinion both between and within countries on the desirability and pace of moving towards peace cast a shadow over the possibilities for regional integration involving Israel. While the history of regional integration efforts in Europe and now in Asia suggest that enhanced regional integration can help cement peace, forward motion requires the development of constituencies within each country supporting the peace.

The region remains diverse in terms of political systems and governance. Democratization has not proceeded very far in several countries. There has been little political commitment to regional goals. Very few of the numerous regional political initiatives have been translated

^{13/} According to World Bank data, the average annual rate of population growth has been 3 percent. Over half the region's population is below the age of 17. The total labor force has been increasing at an annual rate of 3.5 percent (4.9 percent for female labor participation), well above the developing country average of 2.2 percent.

^{14/} Data derived from World Bank (1995).

into sustained and effective institutional foundations. Time and again, national considerations have undermined regional efforts.¹⁵

On the economic front, MENA is remarkably unintegrated--in terms of both the extent of economic interactions within the region, and the absence of an effective framework or institutions responsible for formulating and implementing rules and policies to influence, regulate, and supervise economic relations.

- The scale of intra-regional *merchandise trade* is limited, amounting to only some 7-8 percent of total exports and imports; this compares to over 60 percent in the EU, over 30 percent in Asia and around 20 percent in the Western Hemisphere (Table 1). For no country in the region does intra-MENA trade amount to more than 25 percent of total trade, and the (unweighted) average share of intra-MENA trade for the fifteen countries in Table 2 is under 10 percent. With the exception of mineral fuels, there is no category of commodities for which intra-MENA trade is very important.¹⁶ As a result of the Arab-Israeli conflict, there has been virtually no trade between Israel and its neighbors; even after 1979, there was very little trade between Egypt and Israel.¹⁷
- *Capital transactions* have also been relatively limited, with the exception of large official flows from the oil-exporting economies to other Arab countries, particularly following the 1973-74 and 1979-80 oil price increases.¹⁸
- *Tourism and other nonfactor service flow patterns* have been quite segmented. Some countries--primarily Egypt, Jordan, Lebanon, Morocco and Tunisia--have received substantial tourist flows from within MENA. For other countries, particularly Israel, regional tourism has been inhibited by political and security considerations.
- *Labor movements* have been more important, taking the form of (i) flows from the non-oil economies to the GCC economies;¹⁹ and (ii) Palestinian labor working in Israel. In the 1990s, these flows have been subjected to major restrictions and there has been

^{15/} See Ghantus (1982).

^{16/} Additional information may be found in Fischer (1993).

^{17/} See Handoussa and Shafik (1993).

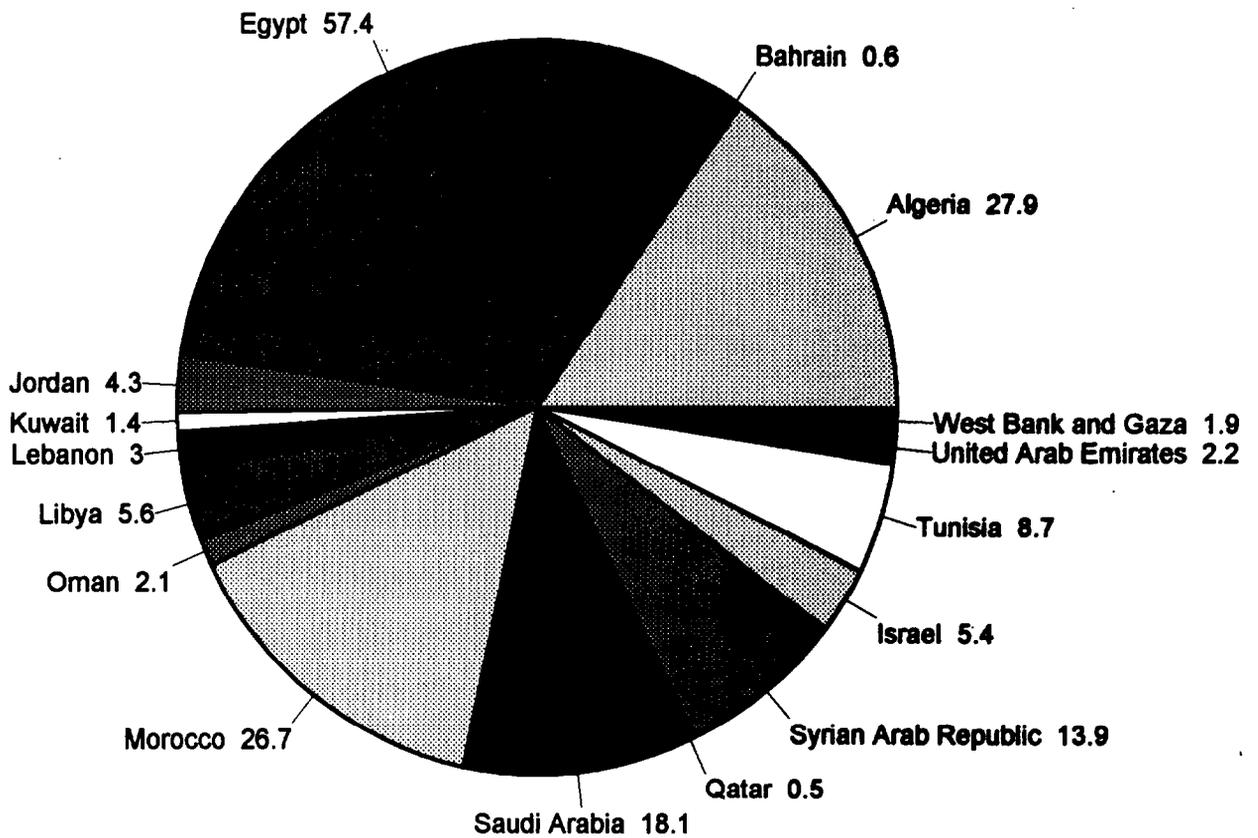
^{18/} This is detailed in van den Boogaerde (1991).

^{19/} Klinov (1991) estimates that about two-thirds of the 8 million migrant workers in the GCC in 1985 were Arabs. See also Shafik (1992) who argues that trade in labor services has been the most successful element of regional integration, because the obstacles to trade in goods have been greater than those to labor movements.

Chart 1

MENA Region: Population in 1994 (In millions)

Total = 179.7 million



4/10/2020

10/10/2020

10

10/10/2020

10/10/2020

10

10/10/2020

10/10/2020

10

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10

recent substitution of Asian labor for Arab labor in both cases. MENA does not enjoy the type of labor mobility, found for example in the EU, where citizens of one country have the right to work in other countries.

- There has been little in the way of regional *economic policy coordination*, with the exception of the GCC, and through the mechanism of OPEC.

Nonetheless there is potential for far greater intra-MENA economic interactions. For example:

- The region has a diverse natural, human and financial endowment base that is spread among countries in the region.
- Its high initial trade barriers suggest a scope for trade-creating gains from regional integration.
- With an average per capita income well above that of developing countries as a whole, and with almost 5 percent of the world's population, it offers a large market with considerable purchasing power.
- It has well established trade links and relatively accessible intra-regional trading routes.
- Commonality of language and cultural affinity should facilitate labor and tourist flows within a substantial part of the region.

Despite these potential advantages, it is often--and correctly--argued that the similarity of resource endowments among many countries in the region, and the greater proximity of the Maghreb countries to Europe than to the Mashreq, will keep intra-regional trade limited.²⁰ Nonetheless, while countries of the region will continue to trade mostly with non-regional partners, the current levels of trade within the region are below the levels that would be attained if economic relations among the countries of the region were freer.²¹ In addition, most types of economic interaction within MENA--with the important exception of labor flows--remain remarkably limited and inconsequential.

^{20/} See for instance the argument developed in Halevy and Kleiman (1995); Fischer (1993) expresses a similar view.

^{21/} See, for example, Ekholm, Torstensson and Torstensson (1995).

IV. Scope for Regional Integration

MENA's overall economic performance in recent years has fallen short of potential.²² Per capita income has stagnated, investment and domestic saving rates are low (Chart 2) and productivity of investment has been disappointing. An insufficiently diversified economic base makes the region extremely vulnerable to unfavorable external shocks.²³ The resulting economic and financial challenges are compounded by high unemployment, a growing number of entrants into the labor force, and poor social indicators.

In this section we explore the rationale and means for attaining the potential gains from greater regional interaction. The region requires economic policy changes, most of which are also needed to benefit from the globalization and integration of the international economic system. Indeed, MENA will attain a higher level of regional economic interaction simply by implementing policies needed to benefit from the changes in the world economy.²⁴ We also argue that pursuit of MENA integration within the overall context of multilateral externally-oriented policies would further growth in the region. Political factors are likely to constrain the pace of integration over the next few years, but as the European experience suggests, even the most ambitious plans need time to develop.

1. The case for regional integration

As already noted, most countries in MENA will continue to trade mostly outside the region, primarily with Europe, the United States, and Asia. However, the volume and the share of regional trade can rise significantly. This is the main reason for believing that there will be substantial economic gains from greater regional integration.²⁵

There is a wide diversity of factor endowments within the MENA--most strikingly in labor and natural resources--as well as differences in the

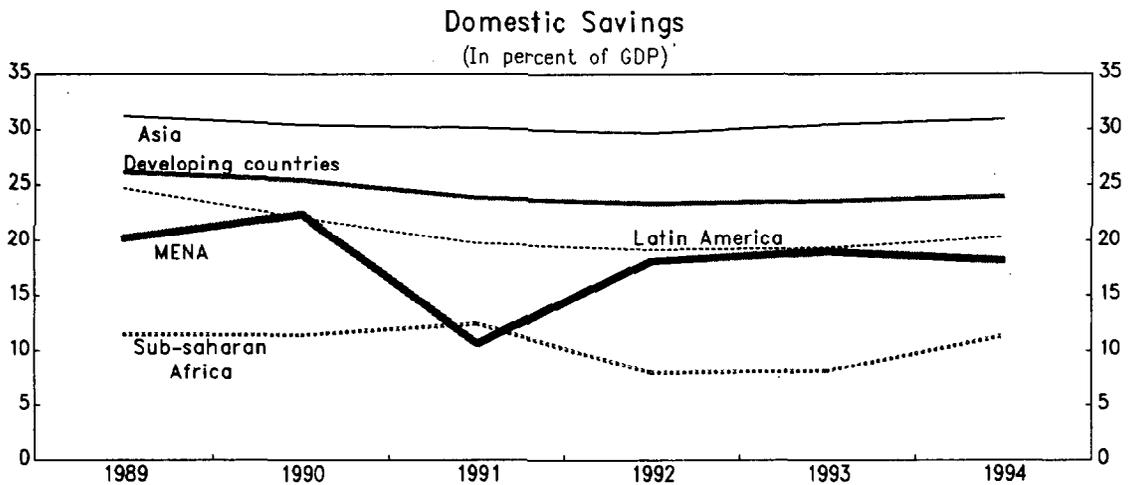
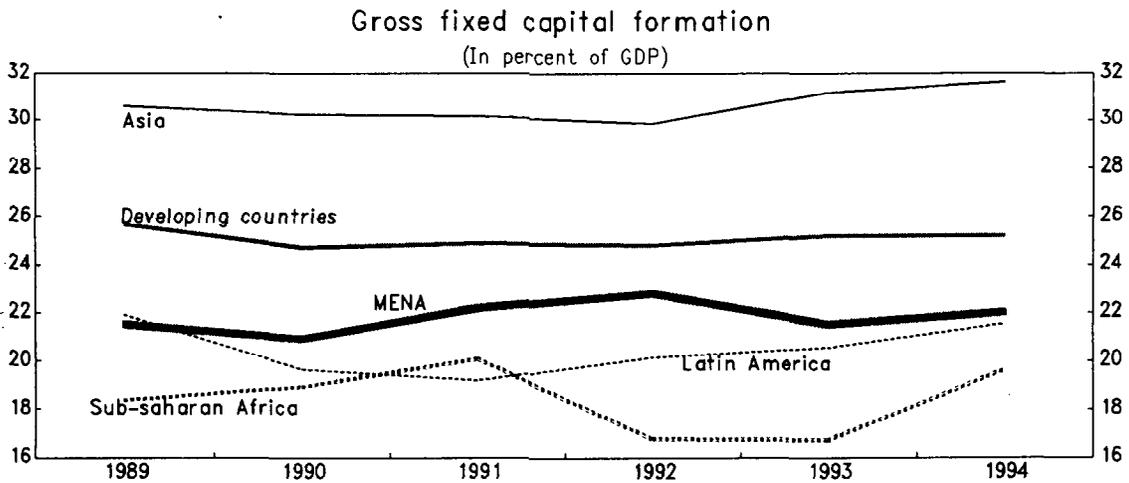
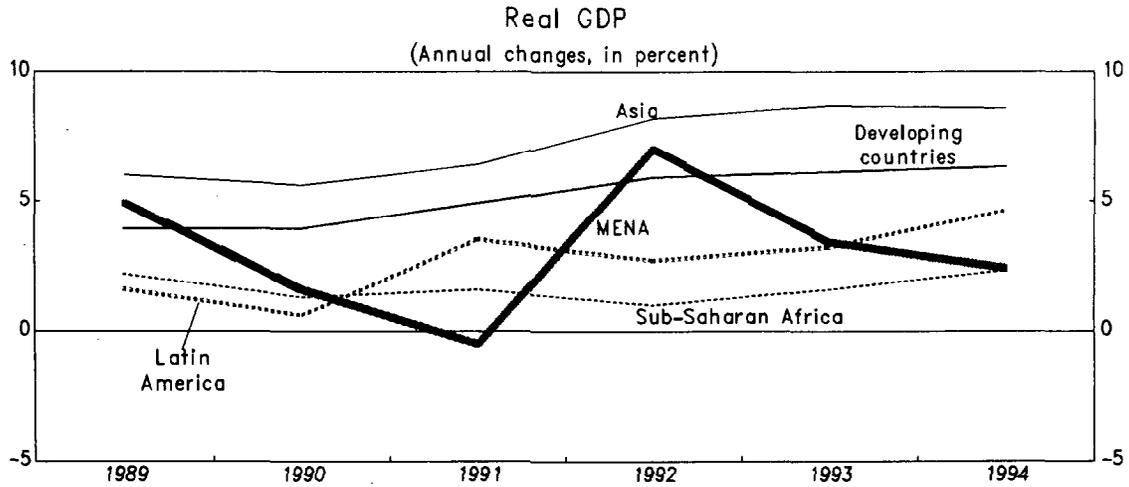
^{22/} For details see El-Erian, Eken, Fennell and Chauffour (1995) and Shafik et. al. (1995).

^{23/} For example, the variance in terms of trade for the MENA countries in 1989-94 was 15 times higher than that for developing countries as a whole and over 30 times that of industrial countries. Fluctuation in oil prices was not the only factor. Thus, the non-oil MENA countries recorded variances that were 3 1/2 and 7 times higher than those for developing and industrial countries, respectively.

^{24/} The example of the dynamic Asian-Pacific economies is particularly relevant: outward-oriented development strategies have been associated with intensified regional economic interactions without official trade discrimination or significant formal institutional support. See Garnaut and Drysdale (1994).

^{25/} The region contains some of the most open (e.g., GCC) and most closed (e.g., Egypt) economies in terms of traditional indicators of international trade activity.

CHART 2
DEVELOPING COUNTRIES AND THE MENA REGION
GROWTH, INVESTMENT AND SAVINGS, 1989-94



Source: IMF, World Economic Outlook.

extent of economic diversification.²⁶ Much of the trade within the region is based on this diversity, with oil the main traded commodity, and labor the main traded factor. Closer regional integration is unlikely to lead to much trade diversion in these commodities, but should promote greater merchandize trade in other commodities. Beyond its effects on merchandize trade, regional integration would boost service flows and intra-regional investments. MENA residents hold a very large share of their portfolios outside the region, with estimates ranging from US\$350 billion to US\$600 billion. Given the right economic policies in recipient countries, even a small reallocation of portfolios in favor of regional activities would make a large difference in the region's investible resource base.

The right policies would be encouraged if regional integration efforts include an attempt to develop an investment code that conforms to the highest international standards and practices. There would also be gains from policy harmonization, particularly in reducing the cost of competitive tax exemptions and concessions--aspects that undermine the tax base and are tending to proliferate in the region.

Recent progress towards Arab-Israeli peace provides both an opportunity for moving towards greater political coherence within the region, and some direct economic benefits.²⁷ Peace will permit reductions over time in military spending, which is the highest in the world as a share of GDP.²⁸ It should also increase the returns to investment by reducing country risk and by opening up regional projects in such areas as power generation, tourism and water management. And of course, peace makes it more likely that countries will be able to agree on measures to promote or facilitate intra-regional private sector economic activities.

We also need to note some qualifications. First, overcoming the legacy of recent history will take time; the length of time will depend on the perceived nature and dividend of the peace arrangements and their institutional support. Second, the Arab-Israeli conflict is only one, albeit the most important, of the political conflicts and uncertainties facing MENA countries. Third, the scope for regional integration may be undermined by real or imagined perceptions of unequal allocations of the gains and losses associated with regional integration. Already there is concern in the

^{26/} In some countries, a single sector accounts for over half of GDP (e.g., oil in the GCC economies and hydro-carbons in Algeria). Others--such as Israel, Morocco and Tunisia--are more diversified, with an important manufacturing component, albeit varying in terms of the preponderance of high-tech industries.

^{27/} For details, see Fischer, Rodrik and Tuma (1993).

^{28/} See Hewitt (1995) and Knight, Loayza and Villanueva (1995). Military spending is unlikely to be reduced significantly in the early stages of the peace process--indeed, redeployments may require increased spending--but military spending should decline as confidence in the durability of the peace increases.

region that Israel will become economically dominant and contribute to the deindustrialization of other countries, or at least retard their industrialization process. More likely, the relative size of Israel in the regional economy can be expected to decline over time as other countries, further from the technology frontier, grow more rapidly.

2. Policy implications

Given the current outlook for the region, the policy implication of this paper's analysis is not that countries in the region should set as their first economic policy priority the goal of embarking on the complex process that leads to the creation of an EU- or NAFTA-type arrangement. Rather, each country should focus first on domestic economic policy reform, and second on the associated process of integrating into the world economy through multilateral trade and payments liberalization. Successful liberalization will promote regional interaction.

It is critical to continue structural reforms aimed at deregulating and liberalizing MENA economies. As noted earlier, some MENA economies are among the most protected in the world. In addition to denying consumers access to world-quality goods, high tariff and non-tariff barriers have reduced the efficiency and responsiveness of the production sectors of several MENA economies. To be sustainable and effective, the liberalization of the external trade and payments regimes will need to be accompanied by appropriately tight macroeconomic policies and by concurrent progress on domestic structural reforms, particularly those affecting investment and the labor and financial markets.

Progress at the country level holds the key to increased integration within the MENA region. The experience of other regions, particularly Asia-Pacific, illustrates the advantages of open regionalism. One possibility may be for regional integration in MENA to evolve from an initial subset of core countries, starting perhaps from the Israeli, Jordanian and Palestinian economies and broadening to include the other countries in the heartland of MENA, first Egypt, then as the peace process unfolds, Syria and Lebanon, and perhaps too and eventually Iraq. Similar processes can be envisaged within the GCC and within the Maghreb. Over time, and as more countries in the MENA region progress in deregulating and liberalizing their economies, cross-linkages among these groupings would strengthen MENA-wide economic ties.

The process of integration among these economies will be strengthened by their development of strong trading ties with major partners outside the region (e.g. through free trade arrangements with the United States and the European Union). The EU's Mediterranean Basin Initiative contains incentives not only for closer economic ties between EU countries and those in the southern and eastern Mediterranean, but also for closer ties among the latter group of countries. Israel, Morocco and Tunisia have already reached association agreements with the EU, and Algeria, Egypt, Jordan and Lebanon are in the midst of negotiations. While the liberalization schedule under

these agreements is spread over 12 years, and while full liberalization does not apply to agriculture, their encouragement of regional integration may be very important.²⁹

Even though domestic reforms and multilateral liberalization will be the main engines of greater MENA economic integration, there is also a clear need for measures aimed directly at regional interaction. These include reducing divergences in regulatory frameworks (including customs nomenclatures), improving road and rail transportation and the ability to move goods between countries, enhancing other communications, and developing facilities for regional export financing. To the extent possible, these measures should be harmonized with best international standards and practices. In addition, several studies point to significant opportunities for regional projects with high payoffs. These include electricity generation (particularly, better linkages of power grids within the region), water management, and tourism.

Such direct regional cooperation efforts would be enhanced by the creation of an appropriate institutional framework. There is a need for a forum in which countries from within the region can meet to discuss regional economic problems, and to do the work needed to develop solutions for them. This organization would be similar to the OECD in emphasizing policy coordination and discussion, but go beyond the OECD in having an action-oriented policy research staff dedicated to finding solutions to the problems and plans that emerge from discussions among policymakers. In addition, there is a need for a regional financing organization, whose primary goals would be to finance regional (involving more than one country) public projects, and to provide financial and informational assistance, for the development of the private sector in all members of the region. These are essentially the functions of the proposed Middle East Bank--for which several regional and nonregional countries have already expressed interest in 75 percent of the proposed shares.

V. Concluding Remarks

Increased regional interaction, particularly in the context of outward oriented development strategies, can enhance economic welfare through specialization and rationalization of consumption and production activities, increase the region's collective political bargaining power in extra-regional fora, and improve security considerations. These considerations go a long way in explaining the renewed worldwide interest in regional arrangements, including in the Americas, Asia and Europe.

Countries in the MENA region face important political, social and economic challenges. Meeting these challenges is easier in the context of

^{29/} See however Hoekman and Djankov (1995) for a more skeptical view of the Mediterranean Basin Initiative.

economic growth than the economic stagnation that continues in some countries in the region. Indeed, sustained high economic growth is required if MENA is to address its unemployment problem, find jobs for the large numbers about to enter the labor market, and improve its social indicators. The main key to economic progress for each country is reform of its own economy, taking advantage of the process of globalization to integrate with the world economy.

There are many indicators--be they geographical, cultural or economic--that point to a scope for considerable gains from greater economic interactions within the MENA region. However, the Arab-Israeli conflict and intra-Arab conflicts, as well as inappropriate economic policies, have kept intra-regional economic interactions at an abnormally low level during recent decades. Merely restoring these interactions to their natural levels will give an important impetus to economic growth within the region.

The developing peace process offers an important opportunity for enhanced economic cooperation within MENA. As the post World War II western European experience demonstrates, such cooperation will strengthen not only the economic well-being of countries in the region, but also peace. What is required is steadfast country commitment to structural reforms, including continued multilateral liberalization, and the removal of impediments to regional economic interaction, as well as the strengthening of the institutional framework.

Table 1. Intra-regional Exports, 1990 - 1994

(In percent of total exports)

	1990	1991	1992	1993	1994	Average 1990 - 94
Industrialized Countries	76.3	74.9	74.0	70.6	70.7	73.3
of which:						
E.U.	66.0	66.8	66.8	61.7	61.6	64.6
Developing Countries	35.8	37.7	39.5	39.9	41.2	38.8
of which:						
Africa	7.2	7.4	7.7	9.0	9.8	8.2
Asia	33.3	36.0	37.8	37.1	38.9	36.6
MENA	8.7	7.7	7.4	7.5	7.4	7.7
Western Hemisphere	18.1	20.0	22.7	21.2	20.2	20.4

Source: International Monetary Fund, Direction of Trade Statistics.

Table 2. MENA countries. Trade Patterns, 1990-94

(In percent of total trade, except as indicated)

	Industrialized Countries	E.U.	U.S.A.	Japan	Asia	Latin America	MENA	Sub- Saharan Africa	Total Trade (In millions of US \$)
Algeria	88.6	67.3	14.4	2.3	1.8	2.7	2.6	0.4	19,338
Bahrain	20.2	8.1	4.9	4.0	8.8	0.4	18.7	1.3	11,401
Egypt	67.9	41.0	15.1	3.7	11.4	2.0	6.2	1.3	14,988
Israel	78.8	41.9	22.1	4.8	7.1	1.8	0.1	1.5	32,568
Jordan	41.5	24.3	8.9	3.5	16.7	1.5	13.5	1.9	4,128
Kuwait	62.0	29.4	15.3	18.0	26.0	1.5	3.7	0.4	11,928
Lebanon	56.0	39.0	6.0	2.6	12.0	1.5	10.0	0.5	4,965
Libya	82.3	76.7	0.2	1.3	2.7	0.7	5.7	1.3	15,292
Morocco	68.8	55.6	4.9	2.6	5.0	2.5	11.0	2.6	12,434
Oman	47.6	14.9	5.5	21.2	27.1	0.4	22.9	1.7	8,622
Qatar	67.7	15.6	4.8	41.5	16.5	3.4	9.5	0.2	5,073
Saudi Arabia	66.8	25.3	19.6	14.9	18.9	2.6	7.6	1.1	73,707
Syria	55.8	43.3	4.0	3.6	3.2	1.1	13.6	0.1	7,046
Tunisia	80.3	69.9	3.4	1.3	3.0	1.5	7.2	1.2	10,209
U.A.E.	55.1	17.0	5.4	26.5	24.0	0.7	9.4	1.0	38,996

Source: International Monetary Fund, Direction of Trade Statistics.

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