Over the Horizon: A New Levant

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Introduction: According to a new World Bank report, economic complementarities between Egypt, Turkey, Jordan, Lebanon, Iraq, Syria, and the Palestinian Territories are significant, with substantial welfare gains expected from increased trade and investments and, ultimately, economic integration. With a population of 224 million, a land area of 2.4 million km², a nominal GDP of 1.4 trillion dollars, and close to major markets and transportation corridors, these “New Levant” countries have significant economic weight and promise. There are opportunities from deeper regional integration to derive significant benefits from economic complementarities and greater competitiveness.

Economic and Social Challenges in the Sub-Region: Most of the countries in the sub-region have common challenges, including: (i) limited diversification of production and exports, (ii) weak regional and global links, and (iii) large youth unemployment. The region also suffers significantly from high trade costs. The major issues are poor logistics performance and facilitation bottlenecks.

For example, Egypt ranks 57 in logistics performance index out of 155 countries. Lebanon ranks 97. Jordan and Iraq rank even lower. In addition, transit traffic has been especially affected by absence of cross-border cooperation, resulting in very heavy delays at borders between Arab states. Non-tariff measures impact most product lines in trade, especially impact of technical barriers to trade are high. For example, Egypt’s technical barriers to trade affect more than 50% of the product lines, ranging from 54.7% of the product line in the food industry to 99.1% in the base metal category.

Weak regulations are also important barriers to integration. The Global Innovation Report shows that most countries score weakly in regulatory performance. The region also suffers from perceptions of corruption. According to Transparency International, Iraq ranks 169 (out of 174 countries), Lebanon ranks 128, and Egypt ranks 118. All these factors affect competitiveness. In 2013, Egypt ranked 107 (out of 144 countries) in global competitiveness index. Lebanon ranked 91 and Jordan ranked 64.

Good and Services Trade in the Region: Egypt and Turkey are potential growth poles for the sub-region with possible spillover effects. In the last decade,
Egypt experienced a promising rise of trade in goods with Turkey and other regional partners. Despite this growth, Egypt and Turkey remain under-traders given their potential. Regional bilateral exports to both are also less than expected. Jordan, Lebanon, and Tunisia are under-exporting to both countries. Also, Egypt does not over-trade with any regional partner yet Egypt provides a key connection to Arab markets, especially while conflict continues in Syria. Turkey provides a large potential market for Arab exports. Egypt and Iraq are well placed to attract capital investments from Turkey due to competitive labor costs. Gains from investments can be particularly high if domestic and international firms cooperate in joint ventures.

As Turkey, Lebanon, and Jordan increase their dynamic comparative advantage, labor-intensive industries can move to lower wage countries such as Syria and Egypt. This had started in the textile and garments sector before the 2011 upheavals. Conversely, higher wage countries can benefit from technology spillovers from Turkish investors. Turkey’s FTA agreements are operational, and the elimination of visa requirement is still on. The EU has a Customs Union with Turkey, and is therefore an important partner affecting the overall picture. Arab countries have a trade agreement among themselves and deeper integration with Turkey and Europe means better integration into global and regional value chains.

Besides prospects for Egypt and Turkey, there are significant economic complementarities and trade and investment opportunities for other Levant countries. Intra-group trade in the Levant increased seven-fold from US$4.2 billion in early 2000s to US$29.7 billion in 2010. This partly reflects better policies but there remains significant untapped potential. For example, exports of Mashreq countries to other Arab countries, including the Gulf, are much more significant than exports destined for Turkey.

**Manufacturing and its Potential:** Currently, traditional sectors such as food, textiles, garments, footwear, and mineral goods are dominant in the sub-region. There is a direct competition for regional and world markets shares in traditional export sectors among Lebanon, Turkey, Jordan, and Egypt. Egypt is experiencing export growth in predominantly low technology industries. Jordan has solid export performance in several chemical sectors. Pharmaceutical firms in Jordan are attempting to move up the value chain where they have a revealed comparative advantage.

Recent export performances reveal diversification towards new, higher value added sectors in all Levant countries. Country-specific diversification potentials complement each other. Turkey is the most diversified country in manufacturing industries. Egypt and Syria have the potential to benefit strongly from more trade and investment integration with Turkey in similar industries. In particular, there are large potential gains from knowledge and technology spillovers through linking with integrated production chains in Turkey. However, diversification into high-productivity products is a slow process. Mashreq exporters are slower to diversify towards higher productivity products than leading global exporters. The figure compares the performance of selected MENA countries with East Asia and Turkey (See Figure 1).

**Figure 1**

**EXPY For Selected MENA (Left) and East Asian Countries (Right) in US$, PPP**

![Figure 1](image-url)

**Source:** UN COMTRADE Database.

**The Services Sector:** Services trade policies are highly restrictive in the Levant. The sub-region ranks among the world’s most restricted in services trade across all sectors and modes of supply. Egypt stands out for the high level of restrictiveness of regulatory regimes. Lebanon has the highest level of
restrictiveness in cross-border supply. All Levant countries have highly restrictive regulatory regimes governing the mobility of service providers, and this affects movement of skilled professionals.

Services trade in the Levant is dominated by travel and transport, but exports of communication, financial, and insurance services also increased rapidly over the last decade. Egypt, Jordan, and Turkey have comparative advantages in transport services. Lebanon has comparative advantages in the financial sector and construction and computer services exports. Jordan and Lebanon have large services sectors and Lebanese and Jordanian financial institutions have the potential to grow further—a great opportunity for economies with limited natural resource endowments.

FDI, the Sub-Region and the Critical Role of the GCC: FDI inflows are concentrated in real estate, construction, tourism, and oil sectors. The Gulf Cooperation Council countries were by far the most important investors into Arab countries. Total investments from the GCC between 2003 and 2010 represented 75% of total FDI inflows for Lebanon, 69% for Jordan, 61% for Syria, 59% for Egypt, and 46% for Iraq. GCC will remain as a potential source of capital to the entire Levant region (See Figure 2).

![Figure 2](FDI inflows 2003-2010)

Trade Complementary and the Levant: Indeed, trade complementarities among Levant countries are high and roughly comparable to levels among countries that historically formed successful regional trade agreements. The six founding members of the European Economic Community (EEC) had an average trade complementarity index of 53 at its onset; the Canada and U.S. free trade area was 64. EU’s Eastern enlargement (Bulgaria, Hungary, Poland, Czech Republic, and Slovak Republic) was 61. Turkey, Egypt, Jordan, Lebanon, Syria, and Iraq are not too far off with trade complementarity indices of 40-50 on average.

Concrete Steps in Pushing the Integration Agenda: Despite the current political situation, there are concrete results that can be achieved through sub-regional cooperation in specific areas. Governments have the opportunity to act now. The vision for the future of the region should go beyond day-to-day politics. Countries in the region should review policy weaknesses and put in place an effective implementation mechanism to improve national and cross-country infrastructure, business rules and regulations.

Although current regional trade agreements generated some positive impacts, they were unable to remove obstacles. There is scope for additional regional liberalization of trade policies. The Levant countries should take unilateral measures to remove barriers to trade. This can promote domestic reforms and create positive spill-over effects especially for countries that are working towards WTO accession, for example Iraq and Lebanon.

There is an urgent need to establish and maintain trade routes with faster handling and processing of trade flows. Some projects have been identified to improve transport infrastructure. For example, constructing eastward connections from Iraq on Jordanian side, and hence linking the northern corridor to Basra, Baghdad and Kerkuk. Constructing a main north transport corridor between Aqaba and Mersin and constructing a highway to connect to the Gulf by linking it to UAE. There are also railway and maritime projects, such as connecting Lebanon’s Tripoli port to the rehabilitated Hedjaz railway and to Basra. More projects are in the offing.

ICT, and broadband in particular, is a powerful enabler of trade development. It is estimated that a 10% increase in broadband penetration is associated with an increase in exports by over 4%. Turkey is the leader in the region, with international communications charges about 11 times cheaper
than Tunisia. A reform path similar to the one followed by Turkey in telecommunications is a condition for trade development. To encourage competition, Levant countries need to remove monopolistic structures that control prices.

In the energy sector, there is a clear need to expand the capacity of electricity generation. For example, new electricity projects have been identified for implementation between Egypt and Jordan; other projects link Iraq to Jordan; Jordan to West Bank; Egypt to Gaza; and Iraq to Turkey. The region has the capacity to compete in the international markets for gas. For example, Iraq has the potential to develop as a major supplier of pipeline gas. Also, a positive development is the discovery of offshore gas in the Eastern Mediterranean. There is also a clear need for additional pipeline networks for cross-border flows. For example Kerkuk - Amman and Basra - Kerkuk - Turkey represent potential gas trade networks. In parallel, investments are needed for processing, storage and handling at terminal points. In addition to actions on infrastructure side, countries will need to reduce subsidies and other forms of policies that distort energy prices.

In financial services, it is important to remove limitations for regional banks’ ability to operate in financial markets. Also, it is critical to put in place dispute settlement mechanisms.

Expected Welfare Gains: Levant economic integration is a positive sum game under scenarios of reducing the restrictiveness of non-tariff measures; lowering transport costs; liberalizing services trade; and removing tariffs on agricultural goods and processed food. A computable general equilibrium model shows that effects of potential reforms will be significant. For example, cumulative welfare gains are expected to be as high as US$12 billion for Egypt, and US$10 billion for Turkey as measured in income. Iraq will likely gain the most in relative terms as its welfare rises by almost 17%. Jordan will have a 6.5% increase in per capita income, and Lebanon will have 3.3% increase. This means that all countries significantly benefit from deeper integration.

Services liberalization is estimated to contribute 70% to 95% of overall welfare gains. Nearly all cumulative gains are a result of deeper integration through services trade. It is important to note that households’ real income will increase under all scenarios. Total employment is fixed in the model, but the rising real income indicates potential benefits. Especially, services trade liberalization will lead to greater increase in demand for skilled labor.

Conclusion: There is a great potential to change the economic dynamics in the region through deeper economic integration. There is already a good platform to build on—much of which was created by private sector leaders in the region. This is clearly an area in which governments, the private sector, and CSOs will all play a role. Few Europeans in the depths of the depression or the unimaginable horrors of World War II could have imagined the emergence of the EU. Yet, despite the current crisis, it remains a resounding success. There is no reason why the Levant cannot move forward as well and possibly do so in a quicker fashion.

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