

OVER THE HORIZON: A NEW LEVANT

Key Messages

The untapped potentials in the Levant region are significant, and at the World Bank we support deepening and widening integration, that would benefit all countries in terms of diversifying trade, strengthening foreign direct investment and technology transfers, and improving competitiveness.

With large population, high combined nominal GDP, and proximity to major markets, the Levant sub-region presents opportunities and potential for a successful regional integration. Indeed, economic complementarities in the region are significant, pointing at substantial potential welfare gains from increased trade and investments and from growing as a sub-region. Trade complementarities are comparable to index levels among countries that historically formed successful regional trade agreements. Also, among the countries in the region, similarities in stages of economic development, resources endowment, or factor costs generate high potential to benefit from competitiveness and comparative advantages.

The World Bank is highly supportive of public-private partnership that has the power to address common challenges in this region such as (i) limited diversification of production and exports, (ii) high trade and logistics costs, and (iii) large youth unemployment. Collaboration through economic integration could help address common economic and social development issues which is the right direction towards stability.

Jointly with private sector counterparts, the Bank aims at operationalizing a "Levant Private Sector Network" that institutionalizes a network among the private sector in the region for the purposes of regional integration. This will create a platform to bring together private sector firms in the region for the common purpose of advancement of economic integration of the Levant. The private sector is already very proactive in the Levant and is increasingly taking a leadership role in region's welfare improvement. This network can help identify problems that impede intra-regional economic activities especially related to trade flows, labor and capital mobility, and offer solutions through debate and discussion as well as consultation with authorities in their own countries. This could be facilitated through existing bodies, such as the Levant Business Union, and by an interactive

communication network. The World Bank is supportive of private sector's leadership role.

The vision for the future of the region should go beyond politics. One powerful message to governments in the region is that there is a significant opportunity cost of not benefiting from untapped potentials. Through "The New Levant" initiative, the World Bank quantified the economic implications of a deeper regional integration, and showed that this is a positive sum game for all countries involved. Under the scenarios of reducing the restrictiveness of non-tariff measures; lowering transport costs and liberalizing services trade, all countries significantly benefit from welfare gains. For example, cumulative welfare gains are expected to be as high as US\$12 billion for Egypt, and US\$10 billion for Turkey. Jordan will have 6.5 percent increase in per capita income. Therefore, there is a high cost to the welfare of the people in the region if we do not benefit from large economic potentials.

With regards to economic potentials, for example, Egypt and Turkey are poised to form substantial growth poles for a more open economic space in the sub-region. During the last decade, Egypt has experienced a promising rise of trade in goods with Turkey and other regional partners. However, despite growth in goods trade, Egypt and Turkey are still under-trading in the region relative to their potential. The gravity trade model suggests a significant untapped potential for Egypt and Turkey to deepen their trade integration. Regional bilateral exports to these two countries are also less than what is expected given their economic structures. In fact, Jordan, Lebanon, and Tunisia are under-exporting to both countries. Furthermore, Egypt does not over-trade with any regional partner.

In addition to goods trade, there is high potential in the region to integrate further through services trade. During the last decade, services exports showed the fastest growth in Jordan and Lebanon. Lebanese and Jordanian financial institutions have the potential to grow further. Historically, services trade in the region has been dominated by travel and transport, but exports of communication, financial and insurance services witnessed rapid change over the last decade. Prospects of competitiveness are also favorable. Egypt, Iraq, Jordan, Lebanon, Turkey, and Palestine have a comparative advantage in the export of travel services. In addition, transport services stand out as a sector where Egypt, Jordan, and Turkey possess a revealed comparative advantage in exporting. Besides travel services, Lebanon has comparative advantages in financial sector, construction and ICT services exports.

Although trade in goods and services has been expanding and investment flows have been growing, notwithstanding the progress, the potential for deeper and wider integration has not been fully realized. One major reason is the behind the border barriers.

MENA region suffers from high trade costs mostly due to supply chain inefficiencies, and weak trade facilitation framework including transport services and customs procedures. The cost of trade between neighbors is typically twice as high among MENA countries as compared with those in Western Europe. Trade costs are consistently higher for agricultural products. Turkey's trade costs with Arab countries, even adjusting for distance, are typically around 80 percent higher than those with EU and Israel.

Furthermore, despite the larger geographical separation, Turkey's trade costs with Maghreb are not larger than with Mashreq. Mashreq countries have been lagging in key areas such as customs reforms as compared with Maghreb or Gulf Countries.

Trade facilitation and logistics issues constitute important barriers to economic integration. These factors affect the competitiveness. The major issues are poor logistics performance and facilitation bottlenecks. In addition, the transit traffic has been especially affected by absence of active cross-border cooperation, resulting in very heavy and delay prone control systems at borders between Arab states.

Non-tariff measures impact most product lines in trade, especially impact of technical barriers to trade are high.

Weak regulations are also important barriers to integration. Global Innovation Report shows that most countries score weakly in regulatory performance indicators. The governments should turn their attention to providing the regulatory frameworks, institutions and the types of human capital able to sustain intra-regional trade growth.

The reform process should start with improving the existing agreements with parallel behind the border policy measures. Improvement of the behind-the-border policies is particularly important for MENA countries to be able to raise their competitiveness. However, this may not be sufficient to expand trade, diversify production, and accelerate growth. A wide-range of policy weaknesses and supply-side constraints in the region inhibit competitiveness. Substantial improvement in harmonization of the business and investment climate will be necessary to take full advantage of better market access.

This is an area where public and private sector can work together to harmonize trade policies and to lower costs.

The World Bank will continue to support efforts from private sector counterparts. Jointly with the Levant Business Union, the Bank will deliver a major conference in June 2014 under the framework of “the New Levant” work, and invite government and private sector representatives in the region as well as think-tanks and academicians to discuss and agree on practical actions on the way forward.

An economic zone is an ultimate outcome for the long term. When the political conditions permit, the countries in the region have the potential to move forward, as a sub-group, for a deeper regional integration. A variable geometry approach is preferred in strengthening regional integration, which allows sub-groups to move faster than the whole group.

But even in the short term—given the current political situation—tangible results can be reached through sub-regional cooperation in specific areas. For example, this report discusses significant opportunities in energy sector, transport, tourism, ICT and financial services.

The countries in the region should take unilateral measures to remove the barriers to trade. Deepening and widening of integration will require improvement in the trade regime and trade facilitation in each country.

The reforms associated with the formation of an economic zone could promote domestic reform. The countries in the region should review a wide-range of policy weaknesses. For example, countries will need to improve national and cross-country infrastructure, implementation capacity in partner countries, as well as harmonize business and investment climate rules and regulations.

Formulating clear rules and putting an effective implementation mechanism in place will be essential for the success of an economic integration.