REGIONAL ECONOMIC CO-OPERATION IN THE MIDDLE EAST

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INTRODUCTION

The second half of the twentieth century represents an age of integration. For the last fifty years, countries in almost all parts of the globe have been attempting to combine their separate national economies into larger economic regions and to engage in economic activities under various forms of integration. All nations in Latin and North America, the Caribbean, Africa, Pacific, South East Asia and almost all European countries are members of an integrated organisation. Although countries such as Japan, China and India have for a long time seemed unaffected by the mood of integration, the recent attempts of APEC have included Japan and China in a new regional economic cooperation organisation since 1989.

Among the many arrangements for economic integration that have come into existence during the last four decades, the most important ones are the European Union (EU) (which started out as the European Economic Community (EEC), and evolved into the European Community (EC), before it finally became the EU in 1993), and the European Free Trade Area (EFTA), which was established in 1960 as a trade grouping. EFTA never committed itself to any objectives beyond those of free trade in industrial products. EFTA completed its mission and almost every member county joined the EU as of 1996. Preferential trade relations similar to EFTA are the North American Free Trade Association (NAFTA) and Australia and New Zealand Closer Economic Relations Agreement (ANZCERTA).

Economic co-operation attempts are most successful between advanced nations. On the contrary, most of the relatively less advanced examples display the look of negative integration. The success of efforts involving nations of various levels of development depends on the type of arrangement selected and the speed of economic adjustment the relatively less advanced countries attain during the partnership. The rationale of integration between developing countries, on the other hand, rests mainly on the creation of regional markets or their fundamental problems rather than concrete and specific outcomes like trade creation. Therefore, it follows that the lower the level of development, the greater will be the importance of the benefits from prospective rationalisation.

Numerous examples of economic integration are found in Africa, Latin America and the Caribbean. While numerous regional blocks exist almost all over the world, the geographic areas of western Asia, North Africa and the Middle East have been slow and unsuccessful in joint efforts for economic co-operation among themselves. Limited arrangements for sectoral industrial integration have been attempted in the past by a number of countries from the region. However, they mostly failed to accomplish concrete results.

In this study, I will first determine the factors that prevent the countries of the Middle East from making successful, long lasting regional economic arrangements among themselves. Then, secondly, give a brief history of co-operation efforts in the region. Thirdly, considering the developments that took place after the 1970s, I will try to form possible economic pairings and groupings of countries in the region and identify areas of potential co-operation. I would also like to discuss optimal forms of economic co-operation for countries in question.

I. FACTORS THAT PREVENT SUCCESSFUL REGIONAL ECONOMIC CO-OPERATION IN THE MIDDLE EAST

Although there is no consensus over the boundaries of the Middle East, the area covered by the Ottoman Empire until after World War I is often referred to as such. However, another definition covers all the countries west of India and stretching all the way to Morocco1. In this study, the term 'the Middle East' refers to the area covering Turkey, Israel, Lebanon, Syria, Jordan, Egypt, the Gulf Countries, North Africa, and Saudi Arabia.

This area covers the fertile and resource rich regions of the northern Mediterranean and the barren, resource poor land of the Arabian peninsula. Turkey, Israel, Egypt, and Syria have the greatest level of economic development in comparison with the mostly oil-rich countries of the region. Although the geographical proximity of the countries in the region is conducive to the formation of economic co-operation agreements, the following factors have prevented these countries from making long lasting mutually beneficial arrangements.

A. Historical factors

After the peace settlement following World War I, the Arab provinces of the Ottoman Empire found themselves under either British or French occupation. Therefore, they were ruled by the occupying countries and did not develop any conscious national policies until after World War II.

Historical animosities among the countries of the Middle East prevented them from developing sound economic co-operation arrangements among themselves. Furthermore, the establishment of the state of Israel presented another set of political problems for the Arab states of the region, and not pooling their efforts, they failed to form any rational economic arrangements.

B. The economic factors

As I mentioned earlier, most of the countries of the region suffered from the negative economic integration syndrome of being less advanced. With the exception of Turkey, Egypt and Israel, they failed to follow import substitution policies to establish their domestic industries. Therefore, economic activities in most of the Middle East are not satisfactorily diversified. Furthermore, their growth policies have long been led by mineral exports2, and their economies have been import-dependent.

Despite the fact that most of the countries of the Middle East depend upon foreign trade, their mutual trade relationships have not yet developed sufficiently to necessitate a movement toward regional integration. One of the most important factors that retarded trade relations is the lack of infrastructure facilities that eases market accession. No matter how much geographical proximity the neighbouring countries may have, insufficiencies of land, air and marine transportation routes have adverse effects on trade. There is no directly connecting, secure land or sea transportation route between Istanbul and Tripoli, for instance. Furthermore, there is a lack of marketing institutions and incentive systems among the countries of the region.

By the same token, again with the exception of Turkey, Egypt and Israel, due to high production costs, their industrialisation policies failed to create internationally competitive industries and products for trade. In most cases, the policies that have been followed failed to accomplish the reallocation of resources from rural to non-rural sectors, and that created unemployed crowds in urban areas ready to migrate anywhere for permanent or marginal work. This factor makes countries of the region enforce strict immigration controls against each other to protect their labour markets. Furthermore, growing unemployment arouses a strong sentiment for nationalisation of the labour force in countries where the unemployed of neighbouring states had recently had work opportunities. Saudi Arabia and the Gulf countries can be counted as examples of those that currently pursue such strict policies to control penetration of foreign workers into their markets. Visa requirements are still effective for most countries for that purpose.

Because of the undiversified character of their productive activities, they kept their export ties limited to extra-regional arrangements with Europe and the USA rather than diversifying their export markets and improving trade among themselves.

Although most of the countries in the region are not heavily populated, their population growth rates are, on the average, too high to follow policies to increase the number of skilled and professionally qualified people in their labour forces in order to support advanced industrial set-ups.

C. The political factors

Most countries in the Middle East have non-democratic, personalised political regimes. Therefore, the possibility of political instability within these individual countries and the territorial or minority rights crises they often experience in their mutual relations, adversely effect decisions about the type and coverage of regional economic structures. It is not always possible to find appropriate county pairings or groupings which could form flourishing, politically stable economic co-operation agreements. The endless political tensions among the states of the region create country pairings over disputes, but prevent them from forming into mutually beneficial economic arrangements. The Arab-Israeli war, the war in and the separation of the two Yemens, the Iran-Iraq war, the Gulf War, the civil war in Lebanon, the Palestinian problem, and the permanent water and border disputes between Syria and Turkey, can be counted among the political problems that deter any long-lasting economic arrangement in the region.

II. REGIONAL CO-OPERATION ATTEMPTS IN THE MIDDLE EAST

A. Experiences of co-operation prior to the 1970s

The economic and political state of the region prior to the 1970s was far from conducive to any form of economic co-operation, though attempts were made. Among the most notable was the formation of the Arab League in 1945. This was a loose federation between Egypt, Syria, Lebanon, Iraq, Transjordan, Saudi Arabia and Yemen3. The League helped to create a new common consciousness among the participants and economic and financial co-operation were its objectives. Furthermore, it aimed to co-ordinate the economic policies of its member states and attain co-operation in communication and health projects, as well as on cultural and social affairs. Later, Sudan, Libya, Tunisia, Algeria, Morocco, Kuwait, Yemen, Bahrain, Mauritania, Oman, Qatar, Djibouti, Somalia, the United Arab Emirates and Palestine joined the organisation. However, regardless of the efforts of the Middle East Supply Centre that had planned joint regional economic affairs among the participants, the activities of the Arab League remained at a modest level.

One of the major reasons for the failure of the Arab League is that the participants attempted political unification in the form of the United Arab Republic (UAR), before they had clearly defined their economic targets and made specific and co-ordinated plans for economic harmonisation. Furthermore, as the number of participants increased beyond a manageable size, it was inevitable not to have negative externalities in operations without having the communication facilities of today. Following the withdrawal of Syria from the UAR in 1961, another attempt at political union was made, this time including only Syria, Egypt, and Iraq. It failed with no practical economic results.

Aside from the Arab League, there was the Regional Co-operation for Development organisation, the members of which were Iran, Turkey, and Pakistan. It attempted limited economic co-operation but it failed to produce concrete results and it ceased activities.

B. Experiences of post-1970s

The oil-producing states' quadrupling of oil prices in the early 1970s redistributed the wealth of the world and gave great political leverage to the oil-producing Middle East. The recycling of petrodollars set the agenda of policy makers in the West, while the disparity between the oil-producing countries of the region grew enormously. Ideas about using part of this revenue for the development of the region's deprived countries were given organisational expressions from the late 1970s on. The Arab Monetary Fund, the Islamic

Development Bank, and the Islamic Conference are all institutional regional arrangements for economic co-operation to promote trade and investment. Although, the efforts at co-operation at that time did not go beyond unconditional aid, donations, joint industrial projects, investments in infrastructure and financial institutions, a loose arrangement for a currency union in the form of an accounting unit was also attempted. The Arab dinar was used as an accounting unit to denominate transactions between the lenders and the borrowers. However, those involved did not designate the types of regional integration necessary to support or regenerate the activities of the supra-national organisations they had established.

These developments coincided with Turkey's application of external-oriented trade and financial liberalisation policies in the 1980s. As a non-Arab Muslim country, which has historical relations with the rest of the region, she intensified her relationship with countries such as Libya, Iran, Saudi Arabia and Iraq in the early 1980s. She was better equipped with skilled and professional labour and managerial know-how, yet lacked financial capital to finance her ambitious projects. Therefore, her most welcomed attempt of extending foreign economic relations with the Middle East became mutually beneficial for all parties. Turkey started to play an active role in the Islam Development Conference from the 1980s on. However, she made her commitment to the EC and EFTA, and did not show any overt interest in extending her economic relationship in the Middle East beyond trade and trade-related activities at the time. The eight year-war between Iran and Iraq, the Gulf War of the early 1990s, the civil war that lasted for 16 years in Lebanon, the political climate between Israel, Palestine and the rest of the Arab World, all took their toll on any potential attempt at economic co-operation in the region. Nevertheless, individual countries went on following their traditional economic ties with their European or American partners. Japan extended her interest in oil politics in the region with utmost caution without taking sides in any apparent conflict so as not to risk the steady flow of oil to the Far East.

One of the most recent examples of regional co-operation in the region is the Gulf Co-operation Council (GCC). The GCC was formed in 1981 by six Arab Gulf states to promote co-operation, and integration in economic social and cultural affairs, and on foreign and security policies4. The main motivation for the GCC was to develop a shield against the threat of the Iran-Iraq war; and when that conflict came to an end, the fragile attempt lost its direction and appeal. The free-trade agreement talks between the EU and the GCC could not reach any concrete conclusion either.

In 1989, in Marrakesh the Arab-Maghreb Union treaty was signed between Morocco, Algeria, Mauritania, Tunisia and Libya to co-ordinate economic policies of these respective countries on a road from free exchange to customs union. The current initial aims of the Arab-Maghreb Union are the re-establishment of market mechanisms; the wider opening of the countries to the world; and privatisation.5 The Arab-Maghreb Union option is being promoted by the EU for not only its transition toward market economies, but also for transition towards democracy to eliminate political uncertainties and instabilities.6 The most recent attempts for unstructured economic co-operation are stated in the declarations of the Casablanca, the Middle East and North Africa Economic Summit and Amman Summit of October-November 1995. The latter one hosted 60 countries from the region including Turkey and Israel and carried out a peace mission beyond economic, and technical co-operation on various issues.

III. ALTERNATIVE FORMS OF ECONOMIC CO-OPERATION SUITABLE FOR THE MIDDLE EAST

A. Possibility of a customs union among the countries of the Middle East

The formation of a customs union requires the elimination of tariffs on imports from member countries, the adoption of common external tariffs on imports from the rest of the world, and the distribution of customs revenue according to a predetermined formula.

The first of these essential features necessitates intensive trade relations among the prospective members. When we examine the intra-regional trade relationship between the countries of the Middle East, we discover that it is extremely low. The most important trade partner of each country in the region happens to be countries outside the Middle East. Table 1. shows the first three trade partners of the countries of the Middle East.

Table 1. The Major Trade Partners of the Countries of the Middle East

Coun/Trade Partner	US	EU	Japan South/SEA	Middle East	Other	OECD	Eastern Europe
Egypt	2	1	-	3	-	-	-
Jordan	3	1	-	-	2	-	-
Turkey	-	1	-	-	2	3	-
Israel	2	1	-	-	-	3	-
Syria							
S. Arabia	1	3	2	-	-	-	-
Iraq	-	-	-	-	-	-	-
Iran	2	1	3	-	-	-	-
Tunisia	2	1	-	-	3	-	-
Algeria	2	1	-	-	3	-	-
Morocco	-	1	2	-	3	-	
UAE	3	-	1	2	-	-	-
Qatar	-	-	1	3	2	-	-
Bahrain	-	3	1	-	2	-	-
Kuwait	1	2	3	-	-	-	-
Yemen	2	1	3	-	-	-	-

Source: Compiled by the author from the trade statistics of the related countries.

More than 60 per cent of Saudi Arabia's exports go to industrial countries, whereas only six per cent goes to Jordan. More than 50 per cent of Jordan's exports go to developing countries and countries other than the USA, and the EU. This share is the same for the UAE. Egypt sends 70 per cent of her exports to the industrialised countries. This ratio is 40 per cent for Syria and the industrial countries.7

By just looking at the direction of trade, one sees that it is not easy to pair any countries for customs union formation. Even those countries for which trade with the Middle East ranks second (as shown in Table 1), may have different trade partners from each other in the region. As an exception, there may be a certain degree of complementarity among the Gulf countries and Saudi Arabia with the involvement of the Gulf countries in re-export activities and their specialisation in banking and finance.8

Under normal circumstances, the larger the economic area for a customs union and the greater the number of participating countries, the greater will be the scope of trade creation as opposed to trade diversion.9 However, when the composition of Middle Eastern countries' trade partners and their domestic production is taken into consideration, the enlargement of the boundaries of a hypothetical customs union for the Middle East may not necessarily result in the same effect. A customs union that may include numerous countries from the region may represent more of a vertical integration than a horizontal one which does not necessarily create country or industrial specialisation in competing products. Vertical integration depends upon the movement of basic inputs such as minerals, and other raw materials from some members to other members that have processing industries. A limited customs union arrangement between competing economies in the region may accomplish horizontal integration, and may induce reallocation of resources among member states by shifting from high-cost products to low-cost ones, resulting in country specialisation. However, the more limited the boundaries of such a union, the greater the possibility of trade diversion effect may be; and this is regarded as detrimental rather than beneficial to welfare.

Due to the economic problems of individual countries in the region concerning the growing threat of unemployment, a customs union arrangement needs to exclude the movement of labour and services. This factor alone works against the possibility of a more efficient allocation of human resources. Most of the time, the accomplishment of an improved allocation of resources through a customs union in the sense of the mere elimination of tariffs, may not be possible anyhow. Other policy obstacles that stem from non-tariff protectionism, structural factors, distribution processes, and monetary and fiscal measures need to be harmonized too. The countries of the Middle East have bureaucratic traditions, administrative complexities, non-transparent procedures, and arbitrary and personalised treatment of transactions as applied to each other and to the rest of the world. All of these factors appear to hamper the expansion of trade, if not impede the functioning of the market as an integrated body.

There are structural differences between the countries of the region: differences of organisation, market conditions, the power of monopolies, and the existence and tolerance of public intervention in markets. Some of the countries in the region are not even considered market economies to begin with. Although countries such as Egypt and Turkey started deregulation of their economies as early as the 1980s, a lack of administrative skills, ill-defined goals and lack of information and consensus have left these efforts incomplete. Monopolistically structured economies where competition can only be enforced within limitations, create impediments for integration. The operation of market forces alone may result in a widening disparity among members rather than closing the gap between them.

Furthermore, they must develop an ability to create a supra-national authority to deal with distributive issues of the customs union such as financial transfers and the distribution of common external tariff revenues. If such an organisational structure can be established, the group's external bargaining power may increase and management of common external tariffs can be accomplished. This is perhaps the only consideration which gives the alternatives to customs union some relevance, and ignores the static criteria of trade diversion and trade creation.

Financial policy integration to facilitate intra-group trade and investment has its own requirements such as exchange rate stability and full currency convertibility among the member countries. Many countries in the region have liberalised trade to a certain degree to resume currency convertibility in due time, but this does not ensure exchange stability with respect to the hard currencies of their main trading partners. The alignment of regional currencies to control exchange rate fluctuations among themselves or with respect to a hard currency in the interest of promoting intra-regional trade and investment, is a remote possibility because of the secondary trade ties they currently have. There is a limited usage of the Arab accounting dinar which functions as an accounting unit to denominate the oil revenues of the oil exporting countries of the region and the grants disbursed to the non-producing, low-income ones. Nevertheless, a full utilisation of such an option is not very likely either, because only a low proportion of external trade is intra-regional trade in the Middle East.

Another difficulty which prohibits the establishment of a customs union between the countries of the Middle East is the lack of sophisticated bureaucratic organization to harmonise policies of all kinds. Furthermore, differences in economic and political systems also prevent common goals from being developed and targeted. Lack of confidence among politicians also adds another layer of difficulty to any attempt at integration as sophisticated as the formation of a customs union.

The difficulties of establishing a customs union in the Middle East excludes the possibility of regional common markets, leaving the establishment of free trade areas as the only sound alternative for those seeking co-operation beyond ordinary trade agreements and protocols.

B. Possibilities for free trade areas in the Middle East

Two basic features distinguish a free trade area from a customs union: first, while member countries may dismantle trade restrictions among themselves, they retain the right to determine their own external tariffs on imports from the rest of the world. Second, since there would be external tariff differentials among the member states in order to limit trade deflection, the rules of origin are enforced on imports. As in the case of customs unions, free trade areas bring trade creation and trade diversion as static effects in the short-run.

Such an arrangement enlarges markets, creates positive consumption and production effects, eliminates the burden of harmonising domestic policies, and the loss of government revenue. Therefore, it may be a more suitable alternative for the countries of the Middle East, the limits of which may be determined upon the past and potential interactions of the countries under the guidance of their respective economic performance. There are already effective applications of free trade arrangements in the area such as the bilateral free trade agreement between Saudi Arabia and Egypt which came into effect in 1990 and significantly improved competitiveness in respective markets. The Arab-Maghreb Union is also a limited free trade application as of today among the countries of North Africa. It promotes initiatives to develop trade among the Maghreb countries, yet employs effective measures such as anti-dumping watch to protect domestic industries from the competition of respective countries. Currently the Arab-Maghreb Union is engaged in efforts for another free trade agreement, the Euro-Maghreb Union.10 Another notable set of free trade negotiations has already been completed and an agreement has recently been signed between Israel and Turkey. However, the attempts are still limited to mostly bilateral free trade agreements and are far from expanding their coverage to convert them into free trade areas that include more than just two countries. The existing examples are still in the process of extending the list of goods that are exempt from tariffs in trade among the countries concerned.

For a free trade area to be established between two or more countries, the initial and the most essential condition is the existence of significant trade relations that would make the countries trade partners. This is also true for customs union. The theory of Heckscher-Ohlin-Samuelson (HOS) contends that the more widely trade partners differ in their factor endowments, the higher will be trade between these countries. Therefore, a labour abundant country will trade more with a capital abundant country and less with another labour abundant country. The HOS theory, in this respect alone, does not explain the trade relationship between Turkey and the Arab countries, even though it may somewhat explain the low level of intra-Arab trade. Another contribution of the theory is that trade between countries with similar capital-labour ratios but that are not specialised enough to produce diversified products, will be rather low in comparison to trade between them and the industrial countries. This is exactly what the situation is between most of the countries of the region.

As I mentioned at the beginning of my paper, the Middle East countries have different factor endowments which, as a consequence, affect the nature, availability and level of diversification of production, and foreign economic relations. There are countries in the region at the lower and middle stages of economic development, oil exporting ones, and the ones that have somewhat achieved or are in the process of achieving industrialisation. Therefore, the basic indicators of those countries vary widely, indicating possible difficulties in policy approximation should customs union be attempted. Nevertheless, the level of industrialisation, the possibility of exporting manufacturing goods to world markets (rather than just protected regional ones), the magnitude of scale economies in the prospective regional industries, the differences in the cost of producing industrial goods in member countries, the location of markets and transportation costs, are all extremely important for the formation of free trade associations as well as customs unions.

Many of the countries in the region are subject to external and internal constraints which prevent them from enjoying the full benefits of policy implementations. Rapid population growth is a common problem in all the countries of the region. The average population growth rate is 2.5 per cent (Saudi Arabia and Jordan have the highest, and Turkey and Egypt have the lowest). This puts enormous pressure on respective governments to follow appropriate human resource management policies, which they hardly ever do. They are mostly trade dependent. Trade/GDP ratios are 46 per cent for Algeria, 119 per cent for Jordan, 87 per cent for Lebanon, 44 per cent for Turkey, 50 per cent for Morocco and 84 per cent for Tunisia[11]. Also, concerns over the availability of natural resources such as water and uncertain raw material prices on the world markets, retard development efforts at an individual country level. The countries of the region do not have rich factor endowments with the exception of the single resource-rich ones and the diversified economies of Turkey, Egypt, Jordan and Israel. Israel is the only country in the region which has reached the stage of high-tech production.

The inflation rates of the relatively diversified countries of the region were poorer than the other countries throughout the 1980s and in the first half of the 1990s. In 1995, Turkey had the highest rate of inflation (86 per cent), while it was 35 per cent for Algeria, 10 per cent for Egypt and Israel, 2.5 per cent for Saudi Arabia, three per cent for Jordan and seven per cent for Morocco[12]. Iraq suffers from a 250 per cent inflation rate; however, because of her current political problems, this country may not for now be considered for participation in any arrangement. Macro-economic aggregates for the countries in the region as a whole display important differences among individuals. The performance of public enterprises has not only been much less than satisfactory in most cases, but also the rationalisation schemes to correct the public deficit and debt are far from adequate. Most countries in the region are handicapped by high external debt/GDP ratios and are highly dependent on external financing. The external debt/GDP ratios are 57.5 per cent for Algeria, 157.3 per cent for Jordan, 24.0 per cent for Lebanon, 37.7 per cent for Turkey, and 58.1 per cent for Tunisia. Despite the common characteristics of the internal and external constraints for most of the countries, they are not at similar development levels. Therefore, rather than regional co-operation relying on the horizontal integration of sectors, industries or that would induce intra-industry trade, a vertical integration or inter-industry trade is to be expected among the countries of the region in most cases, although some of the countries show remarkably high levels of per capita income. Nevertheless, trade of differentiated products with similar factor endowments can be possible to a certain extent only among Egypt, Turkey, Israel and Jordan on the condition of using economies of scale. Otherwise, so far as other countries are concerned, there may be only inter-industry trade, the trade between different sectors for ones that have different factor ratios.

Unless the process of industrialisation starts, speeds up or is already complete, the road to high trade levels and eventual economic integration can not be realised fully in the Middle East. The establishment of free trade areas may be a futile effort as well. Be this as it may, there may be sub-regional arrangements of complete customs abolition or substantial reductions among the core countries of the region, namely Jordan, Turkey, Israel and Egypt. Other possible free trade areas may be established among the Maghreb and the Gulf countries, assuming that a level of complementarity is achieved between their production structures so that the level of product diversification also takes place at the same pace.

Another avenue for possible regional arrangements may be choosing target sectors or industries for co-operation. The goal may be articulated as increasing competitiveness by joining efforts and reducing costs by developing economies of scale. This may be horizontal or vertical types of sector- or industry-based integration which may only be realised upon an almost perfect information exchange between the interested private parties. Although governmental involvement in such arrangements may not be greatly desired, official assistance from central or local governments or an international agency may be extremely vital. Otherwise, as long as they have private access to information, technology and know-how, multinationals may carry out this duty even on project-by-project basis.

IV. Conclusion

Integrated regional trade blocs are a reaction to the growth of managed trade in the world. From 1992, the European integration organisations further deepened extending toward Central and Eastern European countries and this has been perceived by the Middle East as a new form of managed trade threat. Despite the fact that the countries of the Middle East enjoy preferential tariff arrangements with the EU, they feel the need to strengthen their respective economic stances by unifying their efforts one way or another. The countries of the Middle East, however, do not constitute a homogeneous bloc. There are important differences among them in market size, level of per capita income and resource endowment. The current outlook of their inter-economic relations in most cases displays sectoral and regional disintegration rather than integration. There are historical, political and institutional, as well as economic, causes for this de facto stance. On the other hand, although each and every country in the region has an intensive individual economic relationship with EU countries, they have failed in most cases to capture a greater share of European imports. Furthermore, decreasing petroleum prices has become quite alarming over the last couple of years for countries dependent on oil exports. This factor is also increasing strong divergences in growth patterns in favour of some of the non-oil exporting states of the region at this time. Although, Arab oil still accounts for 50 per cent of the EU oil imports, the market demand for such a price-inelastic input is surprisingly shifting toward new resources in some major markets. Declining terms of trade induces the idea of sharing the, so-called, common regional gains from trade through the sale of more diversified foreign trade schemes instead of petroleum. This creates another initiative for regional integration in the Middle East.

What kind of regional integration and among which countries are the major questions that remain to be answered. There are strong indicators, however, that a customs union, even one involving a very limited number of countries, may not be an appropriate choice. The formation of a customs union requires more than just the elimination of tariff barriers. Institutional inadequacies and the divergence of individual economic policy goals, are major setbacks for such an attempt in the region, in addition to the already existing economic constraints. The establishment of free trade areas, on the other hand, may be a more plausible alternative at a sub-regional level, following a gradual liberalisation of trade and finance in individual countries and after making use of existing bilateral free trade agreements.

Trade is the first and the most natural economic relation and it can expand into joint investments in industry, services and infrastructure projects and may boost vertical (if not horizontal) integration from the outset. The most likely sub-regional integrations seem to be the formation of a Maghreb free trade area, the Gulf, and a loose arrangement between Turkey, Israel, Jordan and Egypt.

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