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THE LAW AND ECONOMICS OF REGIONAL AND GLOBAL INTEGRATION

An Empirical Analysis on the Middle East and North Africa (MENA)

HADI ABEDINI





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The Law and Economics of Regional and Global Integration:

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“May we be among those who renew the world.”

Gathas 30:9

Zoroaster

The Law and Economics of Regional and Global Integration

An Empirical Analysis on the Middle East and North Africa (MENA)

By: **Hadi Abedini**

ABSTRACT

Benchmarking with other regions of the world, MENA is considered as one of the least globally and regionally integrated regions of the world. Home to 5.5 percent of the world's population while having 3.9 percent of the world's gross domestic products (GDP), the region's share of non-oil world trade is only 1.8 percent. How can a new social contract along with the processes of institutionalization and deeper integration change the current status for the region towards further and more effective contribution to the global economy? Designed in three distinct yet interrelated Parts, this dissertation is to answer this pivotal question with its main attempt to establish that economic integration—regionally and globally—can make an important contribution to growth, job creation, and poverty reduction within the MENA region provided that some major efforts would be focused on institution-formation within the national and regional contexts in an enabling peaceful environment away from regional conflicts. Hence, as the first step to deeper regional integration, such regional conflicts and civil wars need to be settled within a cooperative environment involving the major powers of the region. Secondly, the theory of institutional change along with social contract theory have been suggested at the core theoretical part of this dissertation aimed at establishing the rule of law, well-defined property rights, good democratic polity while bringing more freedoms along with individual and citizenry rights into the socio-political and economic spheres which together can bring about the necessary voice and accountability to the citizens and the governments respectively. Traditional economic analysis based on institutional economics blended with empirical economic surveys and scientific findings on economic structure of the MENA region as well as comparative analysis of institutions constitute the core part of the methodology for this thesis. Along with this methodology, a correlation-triangle is established among the three important factors namely integration, institutions, and social contract that together bring sustainable development with freedom and stronger role for individuals as well as those of private sectors. It is suggested that the countries of the MENA region can expand such progress through regional cooperation and deeper integration processes. In other words, adequate institutions and proper social contract may serve as two pivotal pillars for a successful regional integration which in turn can reward such national efforts. The thesis stresses that institutions greatly matter for economic integration processes. With better policies, adequate strategies, and inclusive institutions, a desirable growth and sustainable development can be attained in the MENA region. Last but not least; studying legal aspects of economic integration in different regions of the world including the EU, MERCOSUR and NAFTA, ASEAN, and AFRICA as all explained in Part (II) render valuable lessons and experiences along with more lessons that can be learned by success and failure stories of countries within the MENA region (Chapter 9). Such historically evolved models can also help achieve a successful model for the MENA region as expounded through this dissertation. To achieve such economic success, and inclusive growth within a regional context; building infrastructures, fostering diversification away from the curse of natural resources while attracting FDIs are of paramount importance. Moreover, PTAs coupled with behind-the-border trade facilitation as well as logistic services are also crucial along with deeper integration to be aligned with the global value chains. To attain that success, it is important to have the regional integration processes as complementary to the process of global integration and vice versa.

Keywords: *Integration, Institutions, Social Contract, Rule of Law, Economic Success and Development.*

Introduction

The Middle East and North Africa (MENA) region has become more open to the global economy when it is compared with its last two decades, as the participation of this region to the global economy has been relatively increased. But the fact is that apart from oil and gas and the abundance of energy resources, MENA is considered as one of the least globally and regionally integrated regions of the world. Accordingly, the region consists 5.5 percent of the world's population while having 3.9 percent of the world's gross domestic products, nonetheless, the share of non-oil world trade of this region is only 1.8 percent.¹

This thesis' attempt is to show that economic integration –globally and regionally- could make an important contribution to growth, job creation, and poverty reduction in the Middle East and North Africa (MENA) region. In this respect, there has been some little progress as for example tariffs have been reduced under the Pan-Arab Free Trade Area (PAFTA), and the prospect for regional energy trade is also good.

Lagging behind in the process of regional and global integration has imposed a large cost for MENA thus causing limited regional integration that is 1-2% lower GDP growth. In a region with the stock of over 20 million unemployed men and women while having a labor force that grows by 3.4% annually, there is a great opportunity for job creation. And to that effect, regional and global integration can be an effective tool for MENA in increasing productivity and overall economic growth by way of economies of scale with enhancing country specialization by which many jobs can be created for the MENA region.²

The European Union is used, throughout this dissertation, as a comparative model of success to show the progressive status of integration in other regions of the world. As far as MENA is concerned, it is perceived that member states need to invent a model of integration based on the circumstances and conditions peculiar to its region.³

Furthermore, the reasons for success and failure of the countries in MENA would be looked upon while taking in to account the significance of *institutions* and thereby the necessity for the revision of the social contract for the MENA region. Hence, my expectation would be that economic integration in general and

¹ Rouis, Mustapha; and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa." The World Bank, 2013, Overview, p. xix.

² The World Bank. "Trade Integration in the Middle East and North Africa." March 23, 2010: <http://www.worldbank.org/en/news/feature/2010/03/23/trade-integration-in-the-middle-east-and-north-africa>

³ Ibid.

for developing countries such as the ones within MENA in particular, can bring about economic growth, sustainable development, prosperity, more stability and even peace to the region provided that some preconditions would be met including the improvement of infrastructure, technological advancement and harmonization of market along with proper regulatory policies at macro level which would all encompass a ‘New Social Contract’ on the one hand, while commencing the process of ‘institutional change’ on the other. If these components of integration are fully implemented along with political will at a regional level, economic integration can cause more efficiency in a broader term for the region with a path to sustainable development for the member countries in a long run.

This thesis deals with the question as to what policies, strategies and regulatory frameworks can lead to a successful economic integration in MENA while promoting economic growth for member countries? And, can economic integration act as an incentive to improve the above mentioned variables so as to result in a better economic performance and success? Moreover, can economic integration even help as a motive to form the desirable social contract for the MENA region? This thesis is to answer such questions while ultimately taking the case of success stories both in MENA and other regional integrations explaining what factors have caused their success or possibly failure. In that approach the thesis is to conclude that some determining factor such as the role of institutions and positive institutional change ought to be salient in the course of reaching development and success.

A. Organization of the Thesis

As far as the organization of this thesis is concerned, this dissertation comprises of three interrelated parts; part (I) is on the theoretical framework illustrating the role of the rule of law and that of the social contract, as well as the role of institutions in delivering that success in general for both developed and developing countries. Part (II) would be on the subject of economic integration within a global context explaining some major regional integration such as MERCOSUR and NAFTA, ASEAN, and AFRICA.

The aim of the PART (II) of this essay is to furnish examples to the final PART (III) of the dissertation that exclusively delivers the main objective of the thesis on the MENA region after we have examined the overall cases of integration in different parts of the world. Hence, Part (III) is wholly dedicated to the MENA region so as to answer the pivotal question as to why integration can work towards a better economic well-being of MENA in view of achieving the proper institution-formation while establishing a new social contract for the region.

In short, PART (I) establishes the theoretical foundations on the basis of the necessity for institutional change by way of creating a new social contract aiming at reconstructing preconditions for successful integration in MENA.

PART (II) delivers examples of regional integrations in the world with its limits taking into account other factors such as democracy and relational issues... while PART (III) focuses on MENA with the aim of using examples and lessons as explained in the previous parts to formulate a model for the MENA region.

Further examples of success within the MENA region will be given at the end of PART (III) in Chapter 9 to illustrate the root causes of success or failure of economies in that region. Chapter 10, with some concluding remarks, gives an overall assessment of the dissertation searching for both theoretical and practical trends to achieve the ultimate goal of success through establishing a new social contract in view of institutional changes while having integration as a tool to improve the infrastructures at different angles in the MENA region.

In a simple term, in PART (II) of this dissertation, I explain some major regional integration schemes within a global and comparative context particularly in contrast with that of the EU model. They include MERCOSUR and NAFTA, ASEAN, and Integration in AFRICA. In fact, PART (II) renders lessons through such regional examples adaptable for the PART (III) that is the main subject of this thesis on the integration in MENA.

In other words, we look into the reasons why the integration in MENA in contrast with the above regions has been less successful while proposing strategies to change this trend for a better economic performance within the framework of integration adaptable for MENA. For example, Richard Frimpong Oppong in his book “Legal Aspects of Economic Integration in Africa” proposes amendments to community and national laws making the regulatory framework more susceptible to the integration. Although the book addresses the issue for the whole continent of Africa but I found many common trends in the course of its legal framework that can similarly be used for the Middle East and North Africa region.

Many similar conclusions can be drawn in respect to the deficiencies of the legal institutions that hinder a successful integration particularly in developing countries. All this, in other words, is in fact the other way of projecting what *Why Nations Fail*⁴ is to offer. Within PART (III) we shall look into some success stories in MENA including Oman, Bahrain, UAE, and Tunisia. We will look into the policies and strategies which were adopted in these countries that resulted in a more overall successful economy

⁴ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity and Poverty.” Crown Publishing Group, New York, 2012.

making them more compatible towards a practical integration. The thesis then shows that such strategies are not but precisely the first cornerstone and necessary elements to serve for a regional integration as it did happen in the case of the GCC countries for example.

The overall lessons that can be learned through all these empirical examples would be the ultimate goal of this dissertation in achieving economic success and sustainable development in MENA. Similar lessons can be learned from the cases of economic failure examining the reasons behind it. Chapter (9) reflects the two sides of the story to conclude upon the common threads that may lead to success or failure.

Moreover, Chapter (9) delves into the reasons behind the success or failures of economies in the MENA region taking into account such determining factors as the quality of institutions, the governments' policies and strategies in respect to trade and investment, as well as improving the infrastructures within and beyond the borders thus making it more susceptible for regional cooperation. A reasonable degree of liberalization in the successful economies has been witnessed to attain a sustainable development. In contrast, it also shows that countries inflicted with conflict and war, have lost many of such opportunities for growth and development. Chapter (10) ends with some concluding remarks.

B. Motivation for this Dissertation

As summarized above, the Middle East and North Africa (MENA) region despite its volatile economy has been one of the main agenda on daily NEWS at the political front. I perceive that bringing peace and stability especially through economic means to this part of the world would have fruitful economic and political outcomes not only for the countries in MENA, but also for the rest of the world as it can create a cooperative atmosphere solving many problems in particular on the political fronts at a global level. Hence, this dissertation would be an attempt using some scientific and empirical methods while recommending ideas through effective policies and strategies which can lead to that positive outcome in achieving a more harmonious, prosperous and peaceful region in the Middle East and North Africa.

Being educated in the west with specialization in international law while having lived in MENA knowing the peculiarities of the politics and culture, I decided to continue this international trend in education with a particular view on regional integration in MENA as a most important Geo-Strategic region. I took aim on writing this dissertation as an academic attempt in bringing peace and prosperity for MENA and the rest of the world. Be it a work to the attention of researchers, policy-makers, civil societies, NGOs, and officials within the MENA governments as well as scholars and students in particular with interdisciplinary subjects of study and research in law and economics, as well as international relations.

C. Methodology

As mentioned above, because of my approach to the problems of socio-economic patterns particularly in MENA, I intend to use institutional economics through my methodology within which I present a framework suitable for the integration. In other words, the issue of development in MENA is discussed from a specific perspective. This includes, inter alia, the role of institutions with particular emphasis and special focus on global and regional integration as it has been discussed in the literature concerning the new institutional economics. Parallel to this attempt, the emphasis is also put upon the social contract theory as relevant criteria in creating the social and political atmosphere necessary to reach development. In short, traditional economic analysis based on institutional economics blended with empirical economic surveys and scientific findings on economic structure of the MENA region as well as comparative analysis of institutions constitute the core part of this methodology.

The initial source for my institutional approach would be to use the book entitled “Institutions, Institutional Change and Economic Performance” written by Douglass C. North. This thesis thus underpins a theoretical perspective by giving the first three chapters (Part I) on the subject of social contract, institutions and their inter-relations, followed by the theories of economic integration in PART (II) while getting into the models of regional integration in a global context where the thesis is then to show or apply those theories and hypotheses into the practical examples. In other words, from PART (II) onward, the relevance, effectiveness and practicality of these theoretical issues are well illustrated over different examples of regional integration, as well as the regional patterns of development and success.

Through this thesis methodology, the attempt is to have a parallel approach to the philosophy of the social contract on the political front on the one hand, and the institutional economics upon the economic perspective on the other. Then the idea of economic integration would be posed as an effective tool to achieve the economic well-being of MENA on the backbone of the theories of social contract and institutional economics. As such, following the theories of social contract, the primary theory of institutional change is given in the second chapter and then supported with examples of inclusive and extractive institutions as exemplified in the remarkable work of Acemoglu/Robinson’s *Why Nations Fail*.

The main sources used over this dissertation such as *Why Nations Fail* are well-known ground-breaking works with some in-depth research taking into account a great amount of scientific endeavors. They also include some relatively recent qualitative and quantitative data using mathematical model gathered from the World Bank as well as other sources on the issue of integration in MENA along with some effective policies and reforms as suggested.

The Globalization Paradox written by Dani Rodrik is another remarkable source which can help specify the limits and boundaries to global economic integration or simply globalization and that of democracy. Throughout this analysis, my approach would be on a priori (deductive reasoning) as well as a posteriori (inductive reasoning) to reach a conclusive theory derived from my hypotheses. The substantive approach for this dissertation is revealed in parts from theory into practice as we go on from social contract to institutional change and eventually with the aim of reaching a feasible regional integration for MENA.

I start off with institutions and theoretical foundations and then applicably extend it to economic policies and strategies, a blend of theory and empirical approach to achieve a model of success. In short, this doctoral dissertation is designed with particular emphasis on the MENA region taking into account the parameters that can lead to regional development and success. It is an interdisciplinary approach between the disciplines of law, economics, philosophy and international relations, which can take all that is necessary for the betterment of the situation in the Middle East and North Africa while taking an extended view to the rest of the world's experiences along with historical lessons to be learned accordingly.

D. Objectives of this Dissertation

In conjunction with the above-explained methodology, the main idea presented in this dissertation as establishing the backbone of its theoretical framework may be explained through a triangle whose apexes are comprised of three important components of development namely:

- 1- Institutions; 2- Social Contract; and, 3- Integration.

The interrelation and impacts of these three components in respect to one another would be the main subject of this dissertation from a theoretical perspective. As such, the correlation between the above components is stressed particularly in part (I); to express that good institutions in both forms of formal rules (laws) as well as informal constraints (custom) should be the result of a better social contract.

A formidable social contract that is shaped on a solid ground can make institutions evolve so as to shape both of a more effective polity as well as better economic performance in a long run. Furthermore, an incremental change in the process of institutional formation can consolidate the kind of social contract that has been established to the betterment of polity and citizenry rights of individual as well as the establishment of property rights and the rule of law.

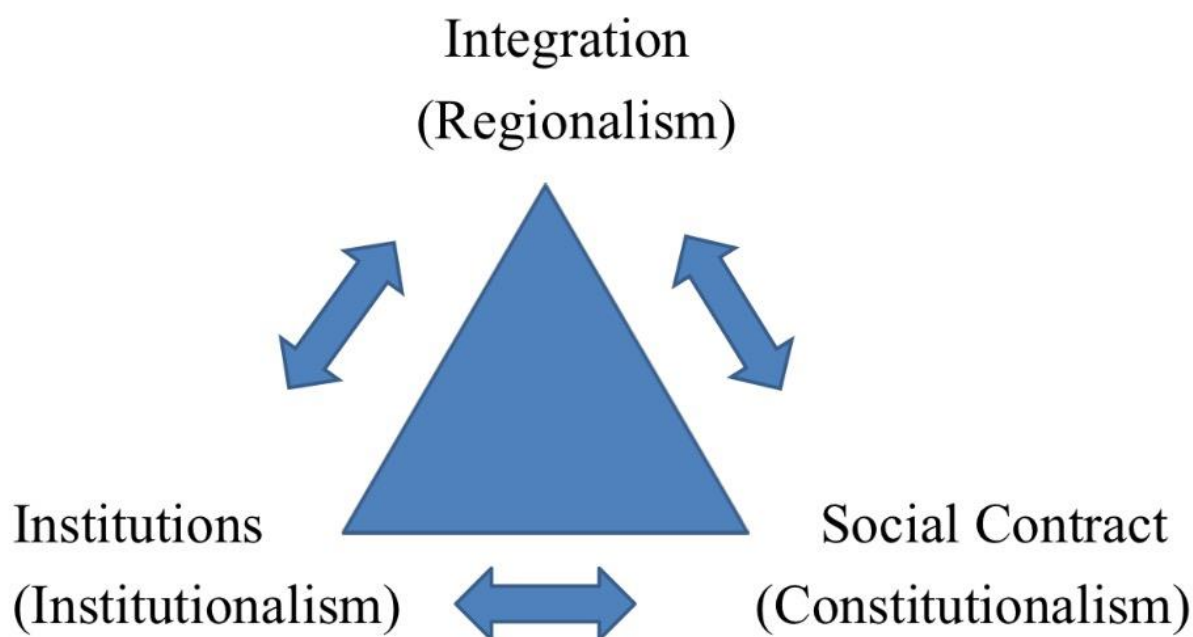
These two elements namely *institutions* and *social contract* would then serve as the two principal pillars expanding such development process beyond the geographical boundaries thus forming a cooperation or

integration in a regional sense. This would occur when a higher degree of development has emerged thus demanding for a behind-the-border facilitation for economy as well as cooperation in the political sphere.

Put it differently, since institutions are difficult to change due to the path dependency and the persistency of informal institutions embedded in society and history, a social contract can act as a catalyst for change mainly because social contract is in fact an important set of institutions including economic and political ones and thereby can help trigger the process of institutional change. Hence, the establishment of a proper social contract (a new one for MENA) can follow the emergence of adequate institutions in society while consolidating the state of constitutionalism and the rule of law. In return, the commencement of the institutional change in society can reciprocally corroborate with the establishment of the social contract.

The improvement of these two correlating pillars of development can help the expansion of such institutions beyond national boundaries forming regionalism. Regionalism in return may have positive impact on and strengthen national institutions on the one hand while also consolidating the establishment of social contract harmonizing such efforts at both national and regional levels. Hence, these three factors together form a correlation triangle so as to achieve a sustainable development in a long run (Figure D-1).

Figure (D-1.): Development Correlation Triangle



More in details, the process of institutionalization may well lead to the establishment of the rule of law while the social contract can bring about a well-devised degree of constitutionalism. Regionalism would also create the necessary process for deeper integration in a regional as well as global sense. Hence, the achievement of the above three important factors together can base socio-economic and political success on the way to achieve sustainable development.

In other words, national and regional institutions can consolidate the improvement of each other. As Sheila Page also explains the above two processes complement each other, for at this level of regionalism; national institutions are in fact strengthened or encouraged through the development of regional institutions. In this process the improvement of national institutions is in fact a requirement for development of the broader regional institutions. The European Union can furnish the best example in levelling up such national institutions with the aim of reaching a supranational entity. Such pattern can be followed in case of MERCOSUR, as it has been important for NAFTA i.e. in respect to intellectual property, the environment, and labour legislation.⁵ And of course this should be also the focal point of attention in case of developing countries including member states of the MENA region.

A proper social contract with a regional integration scheme can be fruitful when it is coupled with the polity of democratic freedom and perhaps secularism in case of the majority of states in the MENA region. Like many historical examples of the kind, only under the banner of freedom and democracy a sustainable development can be born thus consolidating the status of individual and those of fundamental freedoms while defining good and responsible governance to bear out such fruitful results.

Moreover, the objective of this dissertation is to look upon the issues of liberty (freedom) and development which are fairly discussed within the framework of the social contract. And to this effect, the regional integration beyond the scope of sheer economic facts of costs and benefits is presented later on as a solution. From this perspective, the kind of freedom that can be the product of development would encompass a much broader definition. As an example, the growth of GNP or the individual income can be considered as one of the criteria in expanding and enjoying the freedoms for the members within the realm of the society. However, there are other determinants affecting and allowing the freedom to grow within such realm including social and economic arrangements such as facilities for education and healthcare on the one hand and political and civil rights on the other, that include the liberty for participation in public discussion and scrutiny.⁶

⁵ Page, Sheila. "Regionalism among Developing Countries." Overseas Development Institute, London, 2000, p. 288.

⁶ Sen, Amartya Kumar. "Development as freedom." PUBLISHED BY ALFRED A. KNOPF, INC. 1999, p. 3.

From this perspective, Amartya Sen divides freedom into five categories that simultaneously can bring about the development; accordingly (1) political freedoms, (2) economic facilities, (3) social opportunities, (4) transparency guarantees and (5) protective security⁷ form such categories bearing in mind that such freedoms can complement one another leading to the fact that the existence of such link among all of them is the crucial factor in rendering “development as freedom.”

Hence, political freedoms that can take the form of free speech and elections may help promote economic security, while social opportunities i.e. under the form of education and health facilities can be effective in facilitating economic participation. Economic facilities that include opportunities for participation in trade and production can thus help the emergence of social facilities by generating personal abundance and public resources for them. Therefore, such freedoms of different kinds can act to strengthen one another.⁸ Under the banner of a well-defined social contract such freedoms can flourish in societies leading way for further development and success in all different aspects for a societal progress.

The aim of this dissertation is to take into view all such factors of political and economic nature from the perspective of a new social contract as a necessary tool and objective for developing countries in particular the MENA region. It aims at reaching a higher level of cooperation and economic integration to strengthen ties within a regional context in order to reach prosperity, stability, and security.

As we shall explain in the course of this dissertation, economic and political institutions should go hand-in-hand if we are to have some positive and constructive institutional change within the society. However, we should bear in mind that there is a distinction between the power structure among the developed regions (such as the European Union) and those of the developing ones (i.e. the MENA region).

In the former, (the developed nations), the economic factors are mainly established behind the scene so as to direct the political affairs including the major policy-makings and implementing strategies. Whereas in developing countries (i.e. the majority of states in MENA), the political ties and mind-setting are the main established criteria to then decide upon the political scene that is behind all the affairs including the economic policies and behavior.

This distinction becomes therefore important particularly when it comes to institutional change and when establishing a new social contract. It in fact serves as the precise challenging juncture for any change in the societies. It suggests that in case of developing countries including the ones in MENA, the process of institutional change need to starkly begin with the political institutions and be paralleled with economic

⁷ *Ibid*, p. 10.

⁸ *Ibid*, p. 11.

institutional change and reforms. Hence, likewise for the MENA region, the above categories of freedom ought to be taken into consideration with a much broader view beyond the sheer economic reasons of trade-creation and trade-diversion. For, the ultimate goal and objective would be to achieve a sustainable development by way of regional cooperation in tandem with political and economic factors.

In case of the countries in MENA, such objective would take the form of a long-term plan encompassing significant changes and reforms from the status quo or the state of the art towards a new social contract for the region. Inter alia, such attempts should include the establishment of the rule of law and property rights in particular.

Schaefer and Cooter present a similar emphasis from the point of law.⁹ Their institutional prescription for economic growth states that establishment of *Property Law*, *Contract Law* as well as *Business Law* in particular in the given society would bear out the desirable growth when such bundle of laws is coupled with a reasonable degree of *Liberalization* (Figure D-2.).

Figure (D-2.) Institutional Prescription for Growth



According to them, law can serve as a good means to establish the kind of trust a society needs to grow. In such depicting picture, law would have a central role in the forefront of economic growth in which innovation would create sustained growth. Such prescription specifically contains “legal institutions, especially private and business law.” In short, by establishing law (the rule of law in general) away from the situation of mistrust (by way of establishing contract), we can “accelerate growth and alleviate the poverty of nations.”¹⁰ Democracy; public debate and scrutiny coupled with legalized freedom (including economic freedom) can bear out growth and development for society with significant role given to innovation and educated people thus utilizing law to end the poverty of nations.

⁹ Schaefer, Hans-Bernd; and Cooter, Robert D. “Solomon’s Knot: How Law Can End the Poverty of Nations.” Berkeley Law (preliminary manuscript) December 2011; Chapter 13; pp. 21-22.

¹⁰ Ibid, p. 24.

PART (I): Theoretical Foundations;
The Significance of Civil Society and Social Contract

- **Introduction**
- **Chapter One (1): Philosophy of Social Contract**
- **Chapter Two (2): Institutions and Institutional Change**
- **Chapter Three (3): From Status quo towards a New Social Contract**

Introduction

A. Why Social Contract?

The idea of a “New Social Contract” particularly in case of MENA was incorporated to this work mainly because it correlates with the idea of institutions and helps in formulating the institutional change which all together would bring about the necessary foundation for regional cooperation. The place of “formal rules” reflects the status of social contract to be nurtured in parallel with informal rules and norms in societies that would all together form the institutional structures of such societies. Moreover, the idea of forming a new social contract in case of MENA is relevant to this thesis because throughout the chapters the attempt is to cover legal aspects of integration, therefore having the social contract idea as well as the rule of law, at least in the theoretical part, would be of essence. Moreover, I see social contract as an aim by itself particularly in case of MENA, which would ease the way towards regional integration.

Simply put it, as indicated in the works of Acemuglo/Robinson (*Why Nations Fail*) as well as Douglass C. North’s *Institutions*; institutional change is difficult to achieve due to the path dependency and the persistency of the historically rooted institutions that may bounce back on the political scene even after fundamental revolutions. Therefore, to make this process susceptible and possible for emergence, the status of law, the rule of law and formal rules ought to be salient. The relations between the states and the individuals and among the individuals within a society are what are counted for social contract. Hence, forming a social contract or firmly establishing one for such societies could be an essential cornerstone towards the achievement of institutional change. On the other hand, achieving institutional change for better within the national borders of societies can help facilitate the establishment of an efficient regional cooperation, and such regional accord may be reached through the framework of a proper social contract.

Strictly speaking of institutions, unfortunately in many countries including the MENA region, the idea and relevant institutions of civil societies and NGOs and overall the status of individual rights and even the role of the courts are not properly established. The Islamic Republic of Iran would be an example where we do not see civil societies being properly or officially active in their place mainly because civil institutions are not given the chance to grow particularly after the Islamic revolution of 1979. The idea of social contract not only furnishes the ground as a good start, but it looks appealing as a necessary step in institution-building and as a move forward at national levels towards a more regional cooperation. As such, simply put it; finding the historical root-causes of social contract would help in structuring a new social contract and institution-formation for MENA.

Historically speaking, the idea of social contract is derived from the ancient Greeks referring to the implicit agreements that exist among members of a society thus defining their relationship with each other and the state. Such relationship is perceived to be significance i.e. for unravelling the puzzle of the Arab Spring.¹¹

Social contract is in fact rooted in the societal fabrics in each nation or community of people living together and therefore, is directly formed and influenced by their culture. Inter alia institutions are inherent in such societies forming the most important components of each culture including their social contract. In this dissertation it is thus intended to establish the correlation between the social contract and that of the institutional structure through which societies evolve. As such in brief to explain; institutions are the important components of cultural infrastructure and economic behavior in a given society, which can help attain the ultimate goal to be establishing a civil society by acquiring a proper social contract.

Social contract is a more complex issue in case of the Middle East and North Africa region (MENA) due to so many historical, cultural and political factors and therefore to go forward for a more regional cooperation we should take into consideration the idea of a “new social contract” for this region.

Of course one of the most important elements upon which social norms and values are placed would also include economic factors. In short, what this dissertation offers within its theoretical foundation is in fact the importance of institutions as well as the social contract that can together create the economic and political atmosphere necessary for change and development. As such, the social contract is the necessary foundation for political activism, individual’s rights, and economic growth, while the inclusive institutions in both political and economic forms are responsible for the well-being of the economies and political structures away from corruption and eventually towards achieving success and sustainable development.

B. More on the Role of Institutions, Institutional Change, and Success

The importance of institutions in shaping economic performance and bringing success not only for the purpose of integration but at every endeavor within a given society made me allocate the first part of my dissertation to this issue. As indicated by North; “institutions are the rules of the game in a society... and institutional change shapes the way societies evolve through time and hence is the key to understanding

¹¹ Devarajan, Shanta. “What is the social contract and why does the Arab world need a new one?” Voices and Views: Middle East and North Africa, The World Bank: <http://blogs.worldbank.org>

historical change.”¹² Accordingly, in jargon of the economist, institutions –in both forms of formal (Law) and informal (Norms or customs) - define and limit the set of choices of individuals. Moreover, institutions have the role of reducing uncertainty by establishing a stable structure to human interaction and everyday life. In the economic sphere they simply reduce the transaction costs. Hence, with this theoretical approach one would distinguish the significant place of institutionalism in delivering economic success. In Chapter two of this thesis, the nature of institutions are examined which can consequently result in proper economic performance. What will follow includes formal rules (Law) and informal constraints (Custom), and the effectiveness of their enforcement in order to tie together the threads and illustrate the relationship between institutions and transaction and transformation (production) costs.

Furthermore, Chapter two in fact explains the importance of institutional change by examining the relationship between the past, present and future through incremental change. In fact through the path independency, the past influences both the present and future by way of such incremental change. The place of history is also salient as the theory of institutional change can provide a framework for economic history. From the lines of Douglass North we may also deduct the complexity of the changing process; as such, changes would be in fact a consequence of changes in rules, formal constraints while taking into account the effectiveness of enforcement as well. Hence, changes in institutions take place in an incremental fashion rather than a continuous one.

North further explains the reason for this incremental change and the fact that even revolution and conquest may not change such trend mainly because informal constraints are well imbedded in societies. Therefore, even though formal rules can change overnight as the result of deliberative political or judicial decision-making, informal constraints that are embedded in customs and traditions as well as the codes of conduct would act more impervious to deliberate policies and as such persist to change. Such cultural constraints in fact have the role of connecting the past with present and future and thus are considered the key fact in explaining the path to historical change with its dependency character.¹³

This thesis in its theoretical part will explore the role of organizations and the way they interact with institutions to shape institutional change. What comes next is the change to economic performance as the result of that institutional change. Thus, the theoretical implications of institutional analysis for the performance of economies will be explained. Despite the neoclassical and international trade theory, which implies that overtime economies would converge, according to Douglass North the historical facts in the last ten millennia confirm that societies have radically evolved into different religious, cultural,

¹² North, Douglass, C. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990, p. 3.

¹³ *Ibid*, p. 6.

political, ethnic as well as economic societies and as such the gap between rich and poor nations has widened as it has between developed and underdeveloped societies.¹⁴

Parallel to these lines, this thesis' attempt would be to present economic integration as a tool and incentive which can contribute to a positive convergence within a regional context while keeping up the norms and values. And institutional change can pave the way for such a positive outcome while creating more efficiency in a broader term. Moreover, the boundaries and the extent to which economic integration and globalization should progress are well described through Rodrik's work on globalization paradox.

C. Economic Success

One of the essential aims of this thesis along with its methodology would be to introduce the ways to economic success. Achieving economic success and expanding it beyond regional boundaries by way of economic integration is the prime goal of this dissertation. On a research basis, as an example, *Why Nations Fail* by Acemoglu and Robinson, is in fact a complementary work affirming the claims asserted by Douglass North. Institutions in two distinct kinds of "inclusive" and "extractive" forms can cause the success or failure of economic performance. The gap between the rich nations and the poor and the root causes of such huge differences are well illustrated in those books (i.e. Egypt vs. USA, UK, or Germany).

To render an account of such distinction, Acemoglu and Robinson theorize on the existence of "extractive" institutions in which a "small" group of people so called the elites would exploit the rest of the population, whereas "inclusive" institutions according to which "many" people are included within the process of governing. According to Acemoglu and Robinson these two kinds of institutions are the main criteria in bringing success or failure for economies through their different political approach.¹⁵

Such difference is explained in *Why Nations Fail* through the contrast of South and North Korea where in the former, inclusive institutions foster economic activity thus bringing productivity growth leading to economic prosperity. For inclusive institutions secure property rights, the law, public services and the freedom to contract and exchange seem to be central.¹⁶ In contrast, the economic institutions in North Korea or those of colonial Latin America including the *mita*, *encomienda*, or *repartimiento*, do not possess the above properties and due to the extractive nature of their institutions they don't present a

¹⁴ Ibid.

¹⁵ HUFFPOST (m.huffpost.com); Inclusive institutions re: "why Nations Fails."

¹⁶ Acemoglu, Daron; and Robinson, James, A. "Why Nations Fail: The Origins of Power, Prosperity, and Poverty." Crown Publishing, 2012, p. 73-75.

proper form of private properties.¹⁷ Acemoglu and Robinson in their book *Why Nations Fail* argue that any kind of success heavily depends on the above mentioned institutions in such a manner that inclusive institutions enable innovation leading to continuing growth whereas extractive institutions can only bring about growth when the economy is trying to catch up with the technological frontier. In such a circumstance, when innovation is needed to push that frontier, they will fail because innovation is not freely allowed under extractive institutions.¹⁸

From this angle, according to Acemoglu and Robinson like that of Douglass North; institutions play the crucial role in explaining the economic success or failure of nations throughout history. Even though growth may take place under extractive political and economic institutions because the monopolized power can somewhat create the law and order as well as the system of rules and laws which all together can stimulate the economic activity and the achievement of growth; however, the growth generated under inclusive institutions is quite different in nature with that obtained under extractive institutions. In the former, a vitality exists that would lead to a sustainable development and innovative growth whereas in extractive institutions like that of the Soviet Union despite spearheading rapid economic growth, such type of growth ultimately may come to an end and collapse.¹⁹

The proper place of institutions as illustrated in the above works renders good examples supporting the theory of institutional change that can lead to a better economic performance and eventually economic success. *Why Nations Fail* as one of the main sources used for Chapter (2) contributes to this thesis by worldly bringing good instances of economic failure or success. Through such examples and in particular the ones in MENA as presented in Chapter (9) of the thesis, we shall achieve a better understanding of all factors determining the economic success. Chapter (3) gives an overall view through an empirical approach from the current status of economies in MENA (the Status-quo) to illustrate where we are to start and to conclude that it is incumbent to move forward towards a new social contract in MENA.

Generally speaking, MENA with its vast resources and great potential for economic productivity offers great opportunities for regional cooperation which contribute to both its region and the world trade. This, however, requires proper strategies from within and high level of cooperation from outside the MENA region for the above goal to happen. Within the context of this thesis, the EU is presented not as an in full model—as many critic say it has become too much integrated—but as a successful union with significant regional and global achievements. That is a model by which one can show the significance of the

¹⁷ Ibid, p. 76.

¹⁸ Huffpost; second Para.

¹⁹ Acemoglu, Daron; Robinson, James A. "Why Nations Fail: The Origins of Power, Prosperity, and Poverty." Crown Publishing, 2012, p. 124.

institutions in creating such achievement. Hence, it is rightly perceived that there are lessons that can be learned historically and politically from the EU experience as well. It provides some experienced policies as an achievement to override national obstacles in favor of regional cooperation. Likewise lessons can well be drawn from other regional integration processes that have been delivered in PART (II) of this dissertation.

Moreover, some countries in MENA also adopted successful strategies to tackle regional problems and paved the path to development that can serve as examples to further regional cooperation and create deeper integration in MENA without having excessive erosion of economic borders or sacrificing national sovereignty. This thesis is designed to show that achieving the regional peace and development would be certainly beneficial as well to the developed nations including the European Union which has been facing the overwhelming burden for the influx of emigration from the developing world particularly from the MENA region in recent years.

To summarize, adequate institutions in general play a key role in achieving economic success, prosperity, and even in bringing a fruitful integration in a regional sense. Through institutions this thesis is in fact presenting the significant place of law, rules, regulations and eventually social contract on the one hand, while having policies and strategies as effective tools on the other along with determining political factors which all together can bring about the economic success. The direct impact of such institutions is evident in the forms of inclusive vs. extractive institutions which are shown through different historical examples. The ultimate objective of this dissertation is about economic integration and success through the means of proper laws and institutions as effective and determining factors in attaining that objective. Moreover, the thesis tends to address the existing challenges posed by current regulatory frameworks as well as development policies and strategies in particular for the MENA region, thus rendering reform recommendations on the above issues.

D. Role of institutions in establishing a social contract

As we see the global economy has had a gradual pick up, while in contrast economic prospects in the Middle East and North Africa (MENA) remain flat. For instance growth in MENA slowed down in two consecutive years of 2015 and 2016 ranging between 3.1 and 3.3 percent according to the World Bank.²⁰ Indeed political instability and prolonged conflict in Syria, Iraq, Libya and Yemen could be considered as

²⁰ WORLD BANK MIDDLE EAST AND NORTH AFRICA REGION; MENA ECONOMIC MONITOR. "Towards a New Social Contract." World Bank Group, 2015, page 2.

the main reasons for such a sluggish growth coupled with low oil prices (affecting oil exporters) as well as slow pace of reforms that would hinder the investment.²¹

What can be learned from the above examples is that political and economic factors are indispensable to the idea of social contract and to reform the social contract we ought inevitably to take the political and economic institutions together into picture as the key playing factors of growth and development. Indeed, political and economic institutions would act as complementary to each other and should move forward hand in hand.

As an example, labor markets are considered as one of the main issues to be discussed in political reforms within MENA. The existing labor crisis that confronts the MENA region calls for an urgent need in establishing a new social contract—*the basic laws and understandings that define the relationship between the state and labor*—followed by political reform.²² And for such reform this thesis is suggesting here an institutional change particularly in the political arena and through economic reconstruction of the MENA region with a reasonable degree of integration.

I envisage integrating economies particularly in case of MENA can help accelerate the formation of a practical social contract that we look for that region; and establishing adequate institutions in member countries can help attain a more feasible social contract, something in form of a constitution where the relational issues are settled between the relevant players in this region. In return, such constitutional approach can also positively affect the process of institutional change towards development in a long run.

In other words, the significance of institutions is emphasized here in shaping economic performance and bringing success not only for the purpose of integration but at every endeavor within a given society i.e. the social contract reformation in MENA. As mentioned above, institutions are the rules of the game in a society and institutional change has a key role in shaping the way societies evolve through time and as such they are considered the key to understanding historical change including a change towards “a new social contract” in case of MENA.

The MENA region has been the center of gravity of importance mainly for three reasons; first; historically speaking, it is the origin of divine beliefs and thoughts including the three prominent religions of Judaism, Christianity and Islam. Secondly, it is the cradle of ancient civilizations and plurality of rich cultures. And thirdly the significance is attributed to the abundance of its vast natural resources including oil and gas. Even though these elements of truth have bestowed a unique advantage to the MENA region, historical

²¹ Ibid.

²² HEYDEMANN, Steven. “Toward a New Social Contract in the Middle East and North Africa.” Carnegie Endowment for international peace, August, 2008.

facts however, confirm that they have also been the root causes of many conflicts and problems in that region so called the “curse of a rich endowment” as the result of the abundance of the natural resources.

As such, defining a social contract for MENA can adequately furnish the ground with solution to the regional problems while having those advantages served for the purpose of peace, justice and equality. If peace and prosperity is restored to the MENA region; for the significance that was enumerated above, it would directly bear positive and constructive impact on the rest of the world both economically and politically. The present dissertation tends to take into consideration all such facts with an aim to establish the cornerstone of a new social contract for MENA while illustrating the role of institutions and the necessity for institutional change to serve the purpose of re-establishing peace and prosperity to that region so as to witness its positive impact on the rest of the world.

According to the World Bank, MENA is a region— relatively speaking— as one of the least integrated economies to the world. Nonetheless, there have been some attempts in the last two decades to change that trend towards opening the economies in MENA into the global integration. In short, the attempt through this thesis is to show that overall *integration* –globally and regionally- can act as a major factor in creating jobs, boosting the economic growth while reducing poverty in the MENA region.

With reference to the success and failure of economies throughout the world, the MENA region with all its peculiarities would be no exception. As well explained by Acemoglu and Robinson in *Why Nations Fail*; today nations fail mainly because their extractive economic institutions do not allow or do not create the necessary motives among their people “to save, invest, and innovate.”

On the other hand, extractive political institutions also support such economic institutions in favor of a particular group of elites who have possessed the power and benefit from the extraction. Even though such extractive political and economic institutions may differ in forms at different parts of the world, but they share the commonality of causing the failure for such states and thus reflecting the root causes of such failure. In extreme cases of Africa such as Zimbabwe and Sierra Leone, the extractive institutions open the course for the complete failure of their governments that not only can destroy law and order but also the most fundamental economic motives within a society. This would result in an economic stagnation followed by regional conflicts and wars as witnessed in different parts of Africa and the MENA region.²³

²³ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity, and Poverty.” Crown Publishing Group, 2012, p. 372-373.

Ultimately, this thesis tries to show that if proper attempts are invested upon the formation of inclusive institutions particularly the political ones in case of the MENA region, and with proper rule-making, such regional conflicts can be controlled and even be possibly replaced by regional cooperation. In addition, the overall role of good governance particularly in case of developing countries in reaching economic success would be undeniable. And I believe parallel to the social contract theory, regional integration can render a good solution for the emergence of proper national and regional institutions in practice. Simply put it, as the first step to development, each country needs to get the domestic economy succeeded through its institutional structure and then venture up on regional and global integration.

E. Organization of PART (I)

Each PART of this thesis is divided into three Chapters. Before an explanation of economic and political institutions for MENA, in the first Chapter what is presented is a philosophical foundation into the formation of social contract in its classical term searching for its historical roots (Philosophy of Social Contract). Then the second Chapter explains the theoretical foundations on institutions, institutional change, and their impact on economic performance followed by different historical and contemporary examples to support my argument (Political Economy of Social Contract). And finally through an empirical approach we look at the current situation and status quo in the Middle East and North Africa (the state of the art) taking the economic facts and indices into account in order to reach or define a feasible and practical social contract to the region to be susceptible for further regional cooperation or economic integration. This would be in fact the simultaneous fruit resulting from the impact of the institutions or institutional change that can bear out a new social contract for the MENA region.

In other words, to acquire the status of a reformed or a “new” set of social contract for MENA, it would be very effective to simultaneously begin with institutions or venture to attempt for institutional change. Since these two have a complementary relation to each other, designing a new social contract suitable for the MENA region can ease the way for institutional change even though on an incremental basis.

In brief, to establish such correlation, this thesis is to show that *integration* can act as a motive or constructive impetus for *institutional change* and the *institution-building* towards the formation of a *social contract*. But first on the coming chapter, we look into the theories and the philosophy that lie behind the idea of social contract.

Chapter (1): The Philosophy of Social Contract

Economic integration is the main subject of this dissertation. With a view to different regional integration the question arises as to why some regional arrangements are far more successful (such as the EU) and some are relatively facing challenges (such as MERCOSUR and ASEAN), and some lagging behind such as the MENA region. Along with the institutional framework, as far as *formal rules* or laws and regulations are concerned, we can see that in more successful socio-economic patterns such as the EU, the idea of social contract is well established, where as in other regions or particularly in developing countries like those in the MENA region, there is a lack of proper social contract both in application of the theory and in its practice. In the more successful countries (particularly in the west) the idea of *citizenry rights* and the status of *individual* are well defined and established, where as in developing countries in MENA, there is a long tail of political inefficacy and institutional weaknesses when it comes to such rights and in a word the social contract is inadequate. Social contract has its roots in ancient history and therefore, as an approach, studying such literature would help for the establishment of a proper social contract. What are the main components of a social contract that has bestowed such an important status upon some social criteria that would have an impact on institutions within the society? And what is the main subject of the social contract that can form the necessary bondage within a society in which institutions can evolve and then create the formal rules (law and constitutionalism) and informal constraints (norms and custom)?

Jean Jacques Rousseau says that “man is born free, and everywhere he is in chains.” He goes on to say that he doesn’t know this came to be true, but believes he can answer the question of what would render it legitimate. How can the great champion of democratic freedom undertake to legitimize the chains that encumber humanity? This question bases the modern theory of the social contract.

Plato’s Republic, Hobbes’s Leviathan, and Rousseau’s Social Contract are three remarkable works that allow a historical contrast towards the evolution of the social contract. Each of them initially presents a similar definition of “Man” as his natural being and condition. Some interesting point about these works is that in the succession of time they seem to be kind of complementary in regard to one another. In other words, as time progresses, throughout history there is a progressive witness concerning the emergence of social contract which is highly visible in the work of Rousseau.

As such, regardless of their differences in proposing their ideal form of government, they all would ultimately make a fundamental point of view in regard to the “Nature of Man” and “State,” which starts with Plato’s Republic. The difference however, is that in case of Plato’s Republic, the government apparatus is considered a “top-down” hierarchy whereas according to the social contract theories such governing apparatus is organized bottom-up. Such top-down order is well observed in Hobbes’ Leviathan

as well with the difference that Hobbes' struggle is to define and establish the necessary order within the English society under the monarch; that is to form the initial phase of a social contract.

My focus here would be mainly on Rousseau's Social Contract with the subject of Man, liberty and its discontents that Rousseau implies to them as "Chains." Nevertheless, I could not disregard the other two works as I found them making similar and historically important points, which create a consequential journey from the old Republic to the modernized view of the Social Contract.

According to Celeste Friend, social contract theory with a long standing history as old as philosophy itself, portrays the view that within a society moral and political obligations are basically dependent on a contract or agreement.²⁴ For example, when Socrates is trying to convince Crito as to why he must remain in prison while accepting the death penalty is in fact similar to arguing for a framework of social contract. However, the modern day meaning of social contract theory deals with more recent moral and political theory derived from what originally Thomas Hobbes has written in Leviathan. This theory was then followed by John Locke and Jean-Jacques Rousseau as the most influential and dominant theory in the history of the modern west. Later on, John Rawls' Kantian version of such theory (social contract) also gave a philosophical momentum to it in the twentieth century.²⁵

1.1- Plato's Republic

Plato in the Republic, through a Socratic discussion, presents the meaning, a proper form, and the necessity of Justice within an appropriate form of government that to his view is to be the one ruled by the philosophers. By the definition of justice that is everyone/thing to be in his/her appropriate and deserving place, he classifies the society of his ideal state into three groups. As each individual's conscience consists of three major forces of "reason, courage, and appetite desire," and as the just person is the one in whom the force of wisdom (reason) is dominant to those of the other two, Socrates reasons that an ideal state is similarly the one in which the wise group of people dominate the other classes in order to rule the society in a just manner. Then to foster such apt group of guardians under wisdom and virtue, he introduces "education" and explains its important role as an instrument that can bring up justice within the ideal state.²⁶

²⁴ Friend, Celeste. "Social Contract Theory." Internet Encyclopedia of Philosophy, A Peer-Reviewed Academic Resource, Hamilton College: <https://www.iep.utm.edu/soc-cont/>

²⁵ Ibid.

²⁶ Plato. "The Republic." Written in Ancient Greece, 380 BC.

1.2- Hobbes' Leviathan

In Leviathan, Hobbes takes a fundamental approach toward Man as he starts with the basic natural and instinctual condition of mankind rather than introducing a moralistic heavenly creature. Thus he refers to the necessity of having an absolute "Sovereign" that all the will and liberty of his subjects consist in him as the only power that regulates the covenants originated from the laws of Nature. The existence of such absolute power is a necessity for maintaining the order and justice within such state. Otherwise, according to Hobbes, a state is in condition of war; and the life of man "solitary, poor, nasty, brutish, and short." In a more concrete way, Hobbes is in fact founding the preconditions for the state of Monarchy in which the monarch as the absolute power reflects the wills, wisdom and discretion of the subjects. Under Hobbes presenting state, every value such as liberty brings about its meaning in its conjugation with the sovereign, and every power is identified within his power.²⁷

Celeste Friend describes Thomas Hobbes' attempts as a masterpiece which took place during his life time coinciding with the most crucial periods of England's history during which the English Civil War waged from 1642-1648. The war started as a clash between the Monarchists who were supporting the King on the one hand, and the Parliamentarians on the other led by Oliver Cromwell who demanded more power for the quasi-democratic institution of Parliament.²⁸ That was in fact the time to establish the first forms of institutions under the banner of parliament. Accordingly Hobbes is in fact suggesting a compromise between these two factions of the King loyalists and the Parliamentarians.

Hobbes in his Leviathan is somewhat rejecting the full projection of God's will upon the Monarch as the absolute power (under religious obligation), as he also rejects the early democratic views as expressed by the parliamentarians who suggested the power should be shared between the King and the Parliament.

Hobbes' political theory basically consists of two parts; the first one includes the theory of human motivation; Psychological Egoism, and the second part consists of the theory of social contract. Hence, Hobbes deals with the issues of morality and politics while taking into account his theory of human nature as presented in his philosophical masterpiece, Leviathan, which was published in 1651. Interestingly this theory thus extends to human behavior. In different terms, Hobbes is in fact describing same micro-behavior that corresponds to the notion we use as "institutions" or "micro components forming human's macro-behavior."²⁹

²⁷ Hobbes, Thomas. "Leviathan." UK, 1651.

²⁸ Friend, Celeste. "Social Contract Theory." Internet Encyclopedia of Philosophy, A Peer-Reviewed Academic Resource: <https://www.iep.utm.edu/soc-cont/>

²⁹ Ibid.

Hobbes also explains that human-beings are reasonable even though they are self-interested. Accordingly, there is a rational capacity in human-beings to pursue their desires in the most efficient manner. Hence, Hobbes is in fact representing an argument as to why humans should reasonably submit themselves to a political authority be it a king or an apparatus called leviathan. This is done by imagining persons in a situation similar to the state of nature which existed before the establishment of society.³⁰

Thomas Hobbes explains the justification and necessity for political obligation in respect to the fact that men are naturally self-interested while they are also rational and therefore they tend to submit themselves to an authority of a Sovereign in order to live in a civil society which in practice would be to their interest.³¹ Here therefore, the aim would be achieving a civil society for the purpose of man or individuals as the subjects.

Hobbes imagines men in the state of nature which is purely hypothetical in which “men are naturally and exclusively self-interested” and somewhat equal to one another (‘even the strongest man can be killed in his sleep’). Due to the limited resources in such a state there is no power able to force men to cooperate. Under these conditions in the State of Nature, Hobbes concludes that the situation would be unbearably brutal, as momentarily in such a state of nature every person would be in fear of being killed by another. Since they are rational and wish to avoid their own deaths, therefore such state would be the worst situation to imagine. Such situation would be in fact a state of perpetual and unavoidable war but not quite hopeless due to the rationality of men. Through such rationality they look for a way out of that situation by apprehending the laws of nature. Such laws can help them to escape the state of nature and thus begin creating a civil society.³²

In accordance with the “first and most important law of nature”, men are naturally willing to pursue peace when others are willing to do the same and they would continue war when others are looking for war. Out of reasonableness and rationality, men thus try to form “a Social Contract to afford them a life away from that state of nature”. Such social contract is comprised of two distinguishable contracts: First they need to establish social rights collectively and second; they should choose a person or assembly of persons with an authoritative power to enforce such collectively gained contract.³³ In a simple term, there need to be a contract among the individuals or subjects forming the members of the society; as well as a contract between the individuals as subjects and the state as the governing apparatus or the leviathan.

³⁰ Friend, Celeste: <https://www.iep.utm.edu/soc-cont/>

³¹ Ibid.

³² Ibid.

³³ Ibid.

In other words, they agree to accord with common laws through an enforcement mechanism that is constituted under the social contract. A sovereign with invested power and authority for punishment would be able to create a safeguard for that social contract with the least possible cost. That cost would be for any breach of contract by the parties upon which they agree to cooperate out of rationality and in view of being self-interested. In short, their reason would help them accord themselves with the artifice of morality in general, and with justice in particular.³⁴

According to the above view, the society becomes possible away from that state of nature. Even though living under discretion of the Sovereign could be harsh (such absolute authority according to Hobbes would be necessary because men's passion might overwhelm their reason and therefore that absolute figure is to ensure the success of the contract). Relatively, it is at least better than living in the State of Nature. And, no matter how poorly the Sovereign might manage the affairs of the state, the members of such society are never justified to resist his power, as it is the only apparatus that can avoid the return of the state of nature.³⁵

According to Hobbes then, every concept such as morality, politics, society namely "commodious living" would be purely conventional. After the establishment of such a social contract, the society becomes possible and as such the people (subjects of the social contract) are expected to abide by the laws and keep their promises and so on. As such, the social contract turns to the most fundamental source of all that is good and necessary for the people to live well. They either abide by the laws and the terms of the contract or choose to return to the state of nature which according to Hobbes no reasonable person would possibly prefer.³⁶

In conclusion, all the above efforts are to apprehend and introduce the formation of a civil society. Despite Hobbes's severe view of human nature, his prime attempt is to create the civil society and making the advantages of such society possible. While doing this he was also successful in preserving the traditional form of authority that existed in the society of England thus trying to place it as a foundation which could be far more acceptable.³⁷ Such preservation of traditions and upholding accepted norms and morality within a society and culture should perhaps be exemplary in forming the desirable social contract in case of the MENA region. The change towards a renewing contractarian scheme needs to encompass the needs and peculiarities adaptable to the cultures concerned within the region.

³⁴ Friend, Celeste. "Social Contract Theory." Internet Encyclopedia of Philosophy, A Peer-Reviewed Academic Resource: <https://www.iep.utm.edu/soc-cont/>

³⁵ Ibid.

³⁶ Ibid.

³⁷ Ibid.

1.3- John Locke

According to John Locke (1632-1704), the State of Nature is a very different type of place, and therefore he has a bit different approach to the argument concerning the social contract and the nature of men's relationship to authority. Locke is in fact using the same methodological approach as Hobbes in respect to the State of Nature, as all social contract theorists do, yet he uses it to a quite different end. Interestingly Locke's arguments on the social contract and the citizenry rights to revolt against their king turned out to be influential towards the formation of the democratic revolutions that followed, especially on Thomas Jefferson, and the other founders of the United States.³⁸

In his *Two Treatises of Government*, Locke goes beyond civil society through his explanation on "An Essay Concerning the True Original, Extent and End of Civil Government". Locke is presenting a more lenient view in respect to the State of Nature as "the natural condition of man-kind [that] is a state of perfect and complete liberty to conduct one's life as one best sees fit; free from the interference of others."³⁹ Accordingly the State of Nature doesn't necessarily mean the state of war as it was portrayed by Hobbes. Moreover, the state of nature might be pre-political but not necessarily pre-moral. Even though it lacks a civil authority or government that can punish the infringements of rights, it can carry a weight of morality at the same time. However, since the State of Nature lacks civil authority, once war begins it is likely to continue in particular over property disputes. And this also can base the strong argument according to which men would choose to abandon the state of nature by way of contracting together in order to form civil government.⁴⁰

In Locke's argument for civil government, property has a significant place and plays a key role which can be established through the contract. In fact "private property is created when a person mixes his labor with the raw materials of nature." So, for example, when a person puts efforts in changing a land in nature and turns it into a farmland by tilling that land in order to produce food, then that person is entitled to own that land as well as the food produced upon it. According to such analogy, Locke argues that America didn't really belong to the natives simply because they failed to utilize the basic materials of nature, that is; they didn't farm the land and therefore could not legitimately claim for it, and instead others came and

³⁸ Friend, Celeste; On *John Locke*: <https://www.iep.utm.edu/soc-cont/>

³⁹ Ibid, (under section: "John Locke").

⁴⁰ Ibid.

could justifiably appropriate the lands.⁴¹ Nonetheless, this view was essential in creating the new status to the *property rights* as one of the most important components of civil society.

Since Locke's vision of the State of Nature was not as harsh as that of Hobbes', some conditions could be introduced therefore; to assert that the door is open according to his view to reject a particular civil government and return to the state of nature in order to construct a better civil government instead. The concepts of civil liberties can be drawn through such philosophy. In short, the differences of view on human nature and morality itself have caused different views between Hobbes and Locke in respect to the social contract.

1.4- Rousseau's Social Contract

Unlike The Republic and Leviathan that introduce the best form of power within a state as the one to be concentrated on either the best group (Guardians) or a sovereign (Monarch), Rousseau has a different approach to this issue. Along with the Plato's social classification and Hobbes' nature of Man and his inevitable state, Rousseau approaches Man not only as an instinctual creature, but also as the one who has possessed the potential and power of the will to make a "free" but responsible creature for himself, others and ultimately the state.⁴² In fact Rousseau's point of view is a transmission of Man from his natural limits to a free person by transforming the instinctual chains to the boundaries of a civil state. In other words, laws and regulations forming the formal institutions of a society from one hand, and even the informal institutions imbedded in culture would become salient in Rousseau's view of the social contract.

In regard to the form of the power within such civil state he believes that such transmission can be mandated within the society when it is prescribed for each individual pointing out that under such a state the power ought to be dispensed not only within a particular minority as the best representatives of the state, but also the best within each individual that can collectively bring about the civil liberty to the society. In other words, Rousseau accepts the factual bounds on Man that have surrounded him like "Chains", as also defined previously by Plato and Hobbes. But he formulates a new form of government by combining the conception of Hobbes' natural equity with the Plato's idea of fostering the bests within an ideal state.

⁴¹ Celeste, Social Contract Theory, John Locke.

⁴² Rousseau, Jean-Jacques. "On the Social Contract." France, 1762.

Rousseau is in a way proposing the way to release Man from his chains not by the complete elimination, as it is not possible, but rather by taking the yoke of the chain in control, and leading them towards a different form of bounding and freedom, which can base a *civil society*. As he explains: “This passage from the state of nature to the civil state produces quite remarkable change in man, it substitutes justice for instinct in his behavior and gives his actions a moral quality they previously lacked... [As the result] he ought constantly to bless the happy moment that pulled him away from it forever and which transformed him from a stupid, limited animal into an intelligent being and a man.”⁴³ By this passage through the social contract he in fact substitutes “civil liberty” for the natural liberty. “For to be driven by appetite alone is slavery, and obedience to the law one has prescribed for oneself is liberty.”⁴⁴

Freud has a similar concept in his book “Civilization and its discontents”. Accordingly, civilization due to the nature of its state creates consequences that bring about some inevitable discontents which Rousseau refers to them as chains. These chains or discontents are in fact the constraint of obeying the law, and the responsibility of individual in regard to the others and the state itself.⁴⁵

The main theme of Freud’s book—the irremediable antagonism between the demands of instinct and the restrictions of civilization—can also be found in some of his very earliest psychological writings.⁴⁶ Hence, similar to Rousseau, Freud also likes to emphasize the power of *education* and its status to divert the instinctual behavior in Man. For example in 1898 in a paper on ‘Sexuality in the Aetiology of the Neuroses’ he wrote that “we may justly hold our civilization responsible for the spread of neurasthenia,”⁴⁷ on the other hand in his other early writings he doesn’t really regard repression as being completely due to external social influences. He seems to present a struggle between such ‘external social influences’ with internal “dams.” To him not only education but heredity are the power rightfully generating such “dams” vis-a-vis internal instinct which in fact can work as constructive hurdles to the natural world derived from instinct.

Rousseau reasons that man has to pay this price of obeying the law anyway, as in the natural liberty he has to deal with the insecurity and responsibility for defending himself and his members, whereas this duty, in a civil state, is transferred to the state within the context of law which requires a new responsibility for the individual and creates different bounds and conditions for him in order to conserve

⁴³ Ibid; Chapter 8, “On the Civil State.” p. 167.

⁴⁴ Ibid.

⁴⁵ Freud, Sigmund. “Civilization and Its Discontents.” (written in 1929), W.W. NORTON Company Inc. N.Y., 1962.

⁴⁶ Ibid, p. 6.

⁴⁷ Ibid.

its civil context. In this new state, individual's will confronts the "general will" when it is contrary or different from it:

"...his private interest can speak to him in an entirely different manner than the common interest. His absolute and naturally independent existence can cause him to envisage what he owes the common cause as a gratuitous contribution, the loss of which will be less harmful to others than its payment is burdensome to him."⁴⁸

Thus, for the social contract to be away from an empty formula, it tacitly follows and endues the commitment thus creating the sort of condition that "guarantees him against all personal dependence a condition that produces the skill and performance of the political machine, and which alone bestows legitimacy upon civil commitment. Without it such commitment would be absurd, tyrannical and subject to the worst abuses."⁴⁹

The main factor that Rousseau represents in this substitution is *laws*. And as individuals are the ones that, according to the best rationale of the state which reflects their wills, agree upon the law and regulations, in this respect, Rousseau's chains are in fact the laws which bound the individual to a rational freedom and a "civil liberty:" he explains how one can be both free and subject to the laws, as to his view they both "are merely the record of our own wills."

Rousseau further elaborates on such a state that promotes the individual rights while confirming and respecting the civil laws, and calls every state ruled by laws a Republic, regardless of the form its administration may take. Furthermore, Rousseau states that as long as the power of decision-making is in the public hand it cannot be corrupted, because the public wills (the best within each of us) cannot be corrupted. I don't quite agree with this point of view as I believe it can only be immune of corruption when the public minds are educated in such a way to reach the level of understanding and recognizing the rights and values to be the best for all. In other words, they should be trained/educated to establish that "best" within each of them. This quality differs from society to society.

From an economic analytical standpoint, we see a similar conclusion drawn in Amartya Sen's work when introducing freedom within the concept of development.⁵⁰ Freedom under a true and sustainable development can only be attained when necessary constraints (Rousseau's chains) are accepted as norms within the civil society; such as the laws and institutions that dictate the economic behavior of the society.

⁴⁸ Rousseau, Jean-Jacques. "On the Social Contract." France, 1762, p. 26.

⁴⁹ Ibid, Chapter VII, p. 26.

⁵⁰ Sen, Amartya Kumar. "Development as freedom." PUBLISHED BY ALFRED A. KNOPF, INC. 1999.

1.5. A New Social Contract for the MENA Region

For MENA which is the main focus of this paper, the above explained quality needs to be attained by setting the kind of that necessary bound or Rousseau's "chains" as a new mentality of tolerance and indulgence that can be reduced into the social and political institutions that are later to form the new social contract. The process of institutional change should be encouraged simultaneously as the result of the new social contract, as these two processes have positive and constructive impact on each other.

Hence, understanding and necessitating such constraints and discontents for our societies is the main objective to be drawn from all the above discussions. Forming a new social contract in particular for MENA would require a societal as well as political will for the acceptance and development of the rule of law. Furthermore, if an overall hierarchy of morality and justice is well perceived in a regional level, it can further progress the process of cooperation and integration within a regional context in alignment with the global development.

The history of MENA affirms that the social contract precedence in the region has been mainly under the category of Plato's Republic or that of Leviathan. One can simply look at the fact that the long list of hierarchical systems of different kings and monarchs along the history making it a region filled with despotic regimes along with occurrences of continuously unjustified invasions didn't in fact leave much room to the people for a breath of freedom as the most fundamental component to the modern theory of social contract.⁵¹

But how that quality could be attained in MENA? Along with the institutional change and bringing the kind of public education necessary for such change, the first step would be the establishment of the *rule of law* particularly for some countries in the region along with those that are more susceptible for such transformation. That is to introduce social responsibility and the burden of office in private and public spheres respectively. Introducing such responsibility and civil burden-taking would be in fact the key or prerequisite to establish the state of democracy. Justice and the rule of law can flourish the kind of freedom under the banner of democracy which would result in development and success in different aspects of a society.

⁵¹ In major part of the history, this is accompanied with a considerable degree of political inefficacy; as an example, we can refer to the Qajar dynasty whose kings (II) eventually gave up the territorial integrity of Iran (known as *Persia* back then) in the peace negotiations vis-à-vis the Tzar Russia by signing the Treaties of Golestan (1813) and Turkmenchay (1828). These two treaties confirmed the ceding and inclusion of a great part of the Caucasus and other territories now called the CIS, from Iran to the Imperial Russia. After the collapse of the Soviet Union at the expiry date of these treaties, despite the treaties accord, the re-annexation of the above territories into Iran never happened due to the independence of the countries of the CIS. On 12 August 2018, the Islamic Republic of Iran too agreed to reduce its share over the Caspian Sea from 50% to 11-13% vis-a-vis the new emerging states and Russia!

“Strictly speaking, laws are merely the conditions of civil association.”⁵² According to Rousseau, these laws are the chains imposed on man by the civil state and with the will of its people as a whole. Man has to carry on with these chains wherever he goes within this civil society. Since that is the most rational way by which he can create the immunity and protect himself and his rights in a society, it would render the legitimacy to the creation of such civil society and the transformation from the natural liberty to the civil liberty. That is, although such transformation may cause other discontents and keep man “in chains,” that would in fact tame the natural forces in man and divert them into a civil society which would bring immunity to its members and open the course for humanistic growth and improvement. In fact, this chain is the inevitable price that man has to pay in order to take his initial step towards the intelligent being and his humanistic liberty.

Therefore, bringing justice and the rule of law with an understanding of the needs of cultural aptitudes in MENA would be the key to establish a social contract for the region. In my philosophical approach I mainly offered the version of the social contract whose focus is on “individuals” as associates of society and the “state”, the version which was in fact a pleading justification of political power, because it reconciles the power of the state with the freedom and equality of each associate. In the cross-boundary relations however, according to Rousseau, states can be considered like individuals thus having an incentive to enter into a contractual relationship when there is *no common and constant rule for judging the claims made by one against another*.⁵³ Through this argument, Rousseau is in fact entering into the subject of a contract that he calls it a confederation in which each party chooses to connive any aspiration of conquest “in exchange for a guarantee that they will not be attacked by any of the contracting parties: it is good for [the Powers of Europe] to renounce what they desire in order to secure what they possess.”⁵⁴

In contrast Kant too, considers states like “moral persons” in respect to one another in which same condition of natural freedom exists that can trigger and create a condition of continual war.⁵⁵ This in fact mirrors the similarity that exists here with that of the Hobbes’ view concerning the state of nature; that is, as reason compels individuals to enter into a contract and form a union, states too have a similar incentive to leave their state of nature in order to form a *union of states* which he describes as a ‘*juridical state of affairs, that is, a state of distributive legal justice*’.⁵⁶

⁵² Rousseau, Jean-Jacques. “On the Social Contract.” France, 1762; p. 38.

⁵³ Neidleman, Jason. “The Social Contract Theory in a Global Context.” Application to the International Arena: Rousseau and Kant, (IV); 2012: <https://www.e-ir.info/2012/10/09/the-social-contract-theory-in-a-global-context/>; Section IV.

⁵⁴ Ibid.

⁵⁵ Kant, Immanuel. “The Metaphysics of Morals.” (Hackett, 1999), Originally published in 1785, p. 151.

⁵⁶ Neidleman, Jason with reference to Kant, Immanuel; “Metaphysics of Morals,” p. 115.

The main question for Kant is on the nature of such union of states and engaging into contracts which would take place in two occasions: first as a contract among associates instituting sovereign power and the principles by which it may be legitimately exercised, and second as a contract among states instituting an analogous set of principles and an analogous sovereign authority, this time in the form of a “federation of free states.”⁵⁷ The notion “union of states” or the “confederation” as mentioned in Kant’s theory can well describe the precondition and theoretical grounding for what is going to be presented in this dissertation as the subject of integration.

Nonetheless, Rousseau and Kant both seem to be skeptical in respect to the formation of such confederation. According to Kant, states are usually reluctant to surrender any of their sovereign power to a world Republic. However he sounded optimistic to the fact that, over the course of time, moral reasoning can play a key role to bring about the notion of right effective as he described in *Perpetual Peace*.⁵⁸ Perhaps the evolution of converging economies and policies i.e. in the EU today as the European integration would be a manifestation of such philosophical undertakings.

Similarly for MENA, only when the concept of individualism in human societies as well as citizenry rights are well perceived within the theory of social contract, we can have a more open course of actualization of rights under the rule of law. Such definition can then expand the sphere of influence into the political arena widening the space for individuals in a more democratic environment. Indeed, as Jason Neidleman concludes; it is fair to say that the social contract survives as the most viable instrument for materializing the principles of global justice.⁵⁹

In summary, we may describe ‘institutions’ as the brick-stones forming the cultural structure of a nation, which dictate, inter alia, the economic behavior of the society. If social contract is well understood, widely accepted and well implemented within a society, it would ease the process of institution formation and the institutional change in that society. In addition, through the process of forming a social contract, the place of man or status of individual in society acquires a pivotal role when it is coupled with the process of democratic freedom and that of civil liberty, as they can adjoin fundamental freedoms on the one hand and responsibility of individual and the state on the other. This view is also extended beyond the geo-political borders thus creating a civil responsibility upon the states vis-à-vis one another forming the backbone of the regional cooperation and integration processes. Such criteria have proved to be necessary for achievement of development success both within the domestic economies and as well in the regional context when forming a bloc like that of the European Union.

⁵⁷ Kant, Immanuel. “Perpetual Peace: A Philosophical Sketch.” 1795, p. 115.

⁵⁸ Neidleman; with reference to Kant’s *Perpetual Peace*, p. 133.

⁵⁹ Neidleman, Jason; Last para, last sentence.

In this chapter (1) the significance of civil society and that of social contract have been depicted not only as the main key to attain development and success but also as the bondage necessary to societal and political security and justice. The important place of the rule of law was also emphasized in this Chapter.

In the following Chapter (2) we aim at getting into more details on institutions; their status in leading a society towards success and the way to achieve institutional change for the purpose of economic success. Such philosophical foundation would pave the way with an in-depth vision to reach a consensus on the necessity to establish a new social contract while forging for regional cooperation and deeper integration in MENA.

Chapter (2): Institutions and Institutional Change

2.1- Institutions

As initially defined, “institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction.”⁶⁰ Earlier I conveyed that as the consequence of establishing the rule of law, in fact social responsibility is set and defined for individuals in private sphere and the burden of office for the state in public sphere.

And now, “...the humanly devised constraints that shape interaction”... that is the kind of burden or responsibility necessary to shape human and/or state interactions. Such “constraints” resemble the “chains” of Rousseau in defining social contract. In other words, institutionalizing the interactions would result in a better-formed social contract in the course of time. It is an incremental process that can let institutions and social contract act as complementary to each other. But the pivotal question is how do institutions affect the performance of political and economic systems? If we capture on the two important kinds of institutions (inclusive vs. extractive), we are set on the right path to the social contract.

Douglass North in his book⁶¹ examines how to explain the vastly different performances of economies over long periods of time. Again the pivotal question here is what combination of institutions would act the best to capture the gains out of trade? North offers a broad perspective on how institutions *persist* and *change* and for both cases he is trying to show that history matters. Accordingly history matters not merely because we learn from the past, but it further connects the past to the present and the future through the continuity of institutions in society.⁶² And thus he concludes that integrating institutions into economic theory and economic history is an essential step in improving that theory and history.⁶³

Therefore to evaluate or change the economic behavior of a society, one ought to be aware of the history of that nation or its economic upheavals. Moreover, institutions act to lower uncertainty thus creating a structure to everyday life; they act as a guide to human interactions from simple greeting on the streets, driving, shopping, borrowing and forming business to burying the dead or whatever it takes for us to perform such societal tasks. According to the jargon of the economist, the set of choices of individuals in

⁶⁰ North, Douglass C. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990, p. 3.

⁶¹ Ibid.

⁶² Ibid, Preface, p. vii.

⁶³ Ibid.

society are limited and defined by institutions. They include “any form of constraint” that human beings devise to shape their interaction and thus they can be either formal (i.e. the US Constitution) or informal (customary interactions). Therefore, working on both directions (formal and informal) if we deliver the major role of institutions in a society to reduce uncertainty or transaction cost by establishing a stable (even though not necessarily efficient) structure to human interaction, we shall be on a right path to even establish a proper social contract with the aim of attaining regional cooperation or integration. This shows the salient role of institutions towards forming a social contract within a society and reaching a successful integration in a broader term within regional context.

In other words, to form such a social contract, institutional change would have a direct impact and an apparent role to play upon the formation of the social contract. Institutional change is a complicated process indeed because the changes at the margin can be a consequence of changes: a) in rules, b) in informal constraints, and c) in kinds and effectiveness of enforcement. In other words, formal rules, informal constraints and the enforcement mechanism are the key factors in delivering the kind of change we seek in institutions.

Moreover, institutional change typically occurs in an incremental fashion rather than a continuous one. This means even discontinuous changes such as revolution and conquest are not quite effective mainly because of informal constraints in societies that are embedded deeply along the course of history. North well explains that even though formal rules can change overnight due to political and judicial decision-makings, yet informal constraints that are embedded in traditions, customs or codes of conducts would remain impervious vis-à-vis the policies or changes in deliberated policies.⁶⁴

The Arab rising delivers a good example in particular the case of Egypt. The recent history few years after the revolution in Tahrir Square revealed that long-lasting embedded political institutions in Egypt were strong enough to resist the cause of a radical change as the result of an overnight revolution. Out of the views gathered from the Egyptian citizens at Tahrir square, one may realize that factors such as corruption, depletions of ethic and cultural values in the ruler’s traits and mismanagement through the wrongly adopted policies and strategies have been the main causes of poverty in Egypt. “We are suffering from corruption, oppression and bad education. We are living amid a corrupt system which has to change” says Noha Hamed a 24 years old worker at an advertising agency in Cairo.⁶⁵ According to Acemoglu and Robinson, Egypt as an example is a poor country mainly because it has been ruled by a narrow group of elites who have organized the government and society in such a way to benefit

⁶⁴ North, Douglass C. p. 6.

⁶⁵ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity and Poverty.” Crown Business, N.Y. 2012, preface, p. 2.

themselves or their chosen groups at the cost of the rest of the Egyptian people.⁶⁶ In contrast, for example, Britain is richer than Egypt because they experienced a revolution in 1688 that transformed the politics and consequently the economics of the nation.⁶⁷ In Britain alongside their revolution the institutions were set up so as to result in such transformation bringing about economic growth and development.

According to Acemoglu and Robinson, such political transformation is fundamental for a poor society like Egypt to become rich. Reda Metwaly, another protestor in Tahrir Square, believes the revolution basically made Muslims and Christians united, as it did the old and the young all having similar quest.⁶⁸ In accordance with the authors' analogy if we get to realize "when and why such transitions occur", we may be better in a position to evaluate that such movement might fail like many instances in the past, or "succeed and improve the lives of millions."⁶⁹

In case of Egypt therefore, what is missing seems to be the strength of the institutional framework of their politics and society as the main root cause of the poverty that eventually triggered the revolution. Such institutional framework in fact persisted in different forms having it eventually bounced back on the political stage. Why? Mainly because of the path dependency and their persistence to stay on the scene in the course of a history.

Therefore, the time of writing the book was perhaps a bit premature to hope for drastic changes as expressed by Acemoglu and Robinson. From this angle, what should be appreciated about Douglass North's work is the significance of history and the fact that he is aiming at "human cooperation" by referring to the evolution of institutions as a way to create a *hospitable solutions* thus leading to economic growth. This idea of cooperation looks to serve as a complementary factor to what Acemoglu and Robinson perceive as simply finding the right time to do the change or as they call it "the critical junctures." Of course there are sections in time that would deliver the changes easier and more susceptible for societies, as it has been the case in many revolutions, however, generally speaking the effective changes should be viewed with a fundamental approach towards incremental changes of institutions for better. And for that, the human cooperation is highly demanded to deliver such change.

A mere replication of revolutions like what 'happened in England, France, and the United States' does not necessarily bring about the same fruit for Egypt or the MENA region in general but rather contemplating and studying the root causes of the poverty in that region and taking into account the gradual increment of institutional change in the course of time might bear out the solution towards an economic growth and

⁶⁶ Ibid, p. 3.

⁶⁷ Ibid, p. 4.

⁶⁸ Ibid, p. 5.

⁶⁹ Ibid.

sustainable development which indeed may also result in an institutionally constructed social contract. When one refers to “economic history,” it should be the history of the country or the region concerned rather than exemplifying the replication of revolutionary models regardless of strong institutional bondage that resists on the way to the progress of societies concerned.

North also expresses the imposition of “constraints” that exist in societies from the most primitive to the most advanced... parallel to the same idea of imposed “chains” as expressed by Rousseau or “discontents” as expressed by Freud. Put it differently; in our daily interactions with each other be it within a family unit or societal relations or business activities, there is a governing structure managing such relational issues which are overwhelmingly defined by norms of behavior, codes of conduct and conventions.⁷⁰ Here is where the common cause or values seem quite relevant and terms such as language and culture as important criteria appeal when it comes to social cooperation or unification, because they form a major part of the heritage that we call culture thus applying transmitted information in a social sphere.⁷¹

The process of information in the mind depends on the brain’s ability to learn through structured natural languages that can code for perceptual, attitudinal and moral (behavioral) as well as factual information (Johansson, 1988, p. 176).⁷² Hence, culture is in fact a transmission from one generation to the next by way of teaching and imitation, which includes values, knowledge, and other factors important to social behavior (Boyd and Richerson, 1985, p. 2).⁷³ Moreover, North provides that culture is a conceptual framework with language-centric basis that has the ability to encode and interpret the kinds of information necessary to be presented to the brain.⁷⁴ Therefore, we may conclude that in case of MENA, with a view to commonality of language and culture in many countries of the region, the processes as well as the prospect for regional cooperation and economic integration based on a similar institutional framework can be promising and hopeful.

Besides, North seems to highly and positively consider the value of thoughts, beliefs and ideologies in forming human behavior; as such that human valuable actions including free blood donation, or dedication to a particular ideology such as communism, commitments to religious beliefs and sacrificing for abstract reasons could not easily be dismissed as many neo-classical economists try to dismiss them. Such values are not isolated events and as such they should be counted for in our understanding of human

⁷⁰ North, Chap. 5, p. 36.

⁷¹ Ibid, p. 37.

⁷² Johansson, S. Ryan. “The Computer Paradigm and the Rule of Cultural Information in Social Systems.” *Historical Methods*, 1988, 21: pp. 172-188.

⁷³ Boyd, R. and P. J. Richerson. “Culture and the Evolutionary Process.” University of Chicago Press, 1985.

⁷⁴ Ibid.

behavior especially within a social sphere.⁷⁵ Such common cause of thoughts and ideologies are also well rooted within the societies of the MENA region, which can positively base a common principle to progress both socially (to be reflected on the social contract) as well as politically/economically forming more formidable inclusive institutions towards creating a new social contract and further cooperation.

North also proposes his transaction theory of exchange by which the place of institutions becomes salient when it is coupled with the theory of the costs of transacting. By combining them we get to realize why institutions exist and what important role they play in the functioning of our societies.⁷⁶ If we add a theory of production (productivity and efficiency) we can then analyze the role of institutions in the performance of economies. Accordingly, the costliness of information is realized as the key to the costs of transacting, and beyond that, the costs of protecting rights and policing and enforcing agreements could also be added. Such measurement and enforcement costs form institutions on all social, political and economic levels.⁷⁷ In other words, formal and informal rules and constraint along with an enforcement mechanism are illustrated in measuring such costs.

Moreover, protection of rights connotes to the *property rights* whose status is well identified in North's writing. Property rights are considered to be the rights that individuals possess as the result of their own labor and goods and/or services they hold. Such possession or appropriation has a legal nature which encompasses legal rules and enforcement as well as organizational forms and the norms of behavior, or in a word; the institutional framework.⁷⁸ Adequate institutions can insure property rights therefore.

To illustrate the vital importance of the property rights, he mentions a good example comparing property rights in Beirut in 1980s with those of a modern small-town U.S. community to cover the spectrum. In Beirut for example, most valuable rights are defined within in the *public domain* which is in the hands of those with the more violent potential to be successful. Whereas in the US town, a large share of rights are defined by legal rules and such rights in the public domain are mainly allocated through traditional norms of behavior. In fact the differences between these two examples are to be seen in the functions of their institutional structure. In short, viewing the philosophical roots; when law and order exist, and the rule of law governs, public and private spheres are much more in their right places, otherwise anarchy of power prevails. As North explains; the productivity of a modern high income society may not accord with political anarchy.⁷⁹ As such, it can be concluded from these lines that to sketch a proper model of

⁷⁵ North, Douglass. "Institutions, Institutional Change and Economic Performance." Cambridge University Press, 1990; p. 26.

⁷⁶ Ibid. p. 27.

⁷⁷ Ibid.

⁷⁸ Ibid, p. 33.

⁷⁹ Ibid, p. 35.

institutions we need to take into account all characteristics of informal constraints in societies along with formal rules and enforcement as well as the way they have evolved within such societies. Then we would be in a better position to put them all together forming the institutional structure that sets up the political as well as economic orders.

To further exemplify the existing correlation between property rights and that of institutional framework which sets the order in society, we may look at the striking deadlines in interest rates in the Dutch capital market in the 17th Century as well as the English Capital market in the 18th Century both confirming the high level of security in property rights which are indeed the fruit of the effective interaction of both formal and informal institutional constraints. The merchant codes of behavior along with its enforcement of contracts are also of significance as they evolved in the course of customary practices into the formal law.⁸⁰ In other words, establishing proper institutional framework and practicing accordingly could make the formal and informal institutions emerge in the course of time thus shedding light on and insuring the important components of individual rights including the property rights.

Acemoglu and Robinson in their book *Why Nations Fail* divide institutions into two forms of “inclusive institutions” and “extractive institutions.” By such terms, they firstly connote to the political institutions which consequently would bring about the same kind of economic institutions. North in his book⁸¹ also has a similar notion to the significance of the political institutions as he explains the persistence of inefficient property rights that existed mainly because enacting efficient rules could jeopardize the rulers’ interest or simply because less efficient property rights could deliver more tax revenues than efficient property rights.⁸² Obviously the former could bring more benefits to the extracting group of the elite.

North then refers to the efficiency of the political market as the key to the above issue. In other words, with low political transaction costs and accurate models to guide them, the result would be the efficient property rights. In contrast the high transaction costs of political markets would result in the kind of property rights that doesn’t produce economic growth and from it no more effective economic rules can be generated.⁸³ What matters here is in fact not only the incremental character of institutional change but an attempt to devise the kind of institutions that can provide commitment along with more efficient bargains. And efficient bargain will result when the bargaining power would be in the hands of those who

⁸⁰ See Douglass C. North. “Institutions, Transaction Costs, and the Rise of Merchant Empires.” in J. Tracy, editor, *The political Economy of Merchant Empires*, Cambridge University Press, 1991.

⁸¹ North, Douglass. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990.

⁸² *Ibid*, p. 52.

⁸³ *Ibid*.

a) wish to act towards a positive change, and b) would be trained and educated to that cause and c) be immune of corruption; all reflecting same conclusion which was the fruit of Rousseau's social contract.

Moreover to the importance of property rights, North is of the belief that effective rules arise from politics to property rights or to individual contracts. Contracts reflect the kind of property rights structure including the enforcement characteristics, and the structure of property rights would dictate the opportunity set of the players as well as the forms of organization they devise in specific contracts.⁸⁴ And for this, the language that economics presents along with its theory is "simple, complete, and straightforward." Or simply put it, economics can adequately be the common language of development.

In short, the important moral lesson drawn from the above discussion can consolidate the major role that institutions play in the performance of an economy.⁸⁵ Moreover, Douglass North is in fact trying as well to show the important role of the markets within such institutional framework as, according to him, the market too would be a mixed bag of institutions that either increase efficiency or decrease it.⁸⁶

Comparing the institutional framework in case of the advanced economies such as the United States, England, France, Germany, and Japan with those of the Third World confirms, as exemplified, that how importantly institutional framework plays a key role in delivering relative success to the economies both from a cross-sectional point of view and in the course of time. Such institutional constraints and the way they evolve through time would be the key characteristics of economies in delivering success or failure as, many examples from the above two categories of the advance and developing nations can prove this claim by showing how institutional change can lead to incredible result towards economic success. However, there are perplexities on the way of such institutional changes which are well explained in many works including North's and Acemoglu/Robinson's. They can guide us to the relevancy and important position of the formation of social contract in the context of legalizing the rights and freedoms that may have positive and direct impact on the process of institutional change in society.

Moreover, with reference to the significance of *freedom* as explained by Amartya Sen in all aspects of society including the economy, such institutional change should be nurtured within an environment that is well exposed to economic freedom which then may result in economic success and development. There is some good literature making the link between economic freedom and that of growth and measures of well-being. They include some studies by Scully (1988⁸⁷, 1992⁸⁸); Barro (1991)⁸⁹; Barro and Sala-i-

⁸⁴ Ibid, p. 52 (Section IV).

⁸⁵ North, Douglass. "Institutions, Institutional Change and Economic Performance." p. 69.

⁸⁶ Ibid.

⁸⁷ Scully, Gerald W. "The Institutional Framework and Economic Development." *Journal of Political Economy*, 1988, vol. 96, issue 3, 652-62.

Martin (1995)⁹⁰; Knack and Keefer (1995)⁹¹; Knack (1996)⁹²; and Keefer and Knack (1997)⁹³ all showing that overall the rule of law when coupled with measures of well-defined property rights along with public policies that do not attenuate such rights, are among the factors that generate economic growth.⁹⁴ Oman is a success example within the developing world where economic reforms programs coupled with economic freedom resulted in its high rates of growth and the flows of FDIs into the country. Chapter (9) delves in detail into some examples of economic success in the MENA region including Oman.

2.2- From Institutional Change to Economic Behavior

In the first Part of this Chapter, I tried to show that institutions due to their social and cultural strength and influence play the key role in guiding the societies towards forming a new social contract for MENA. And such social contract can then shape the economic behavior leading to a successful economic performance. Reciprocally, achieving a proper social contract would yield the field for institutional change in society. In other words, institutions are the forming components of a feasible social contract. The way I interpret; in fact, institutions are presently the actual effects of history in every society.

Douglass C. North in his book on institutions argues that investing on and shaping the institutions could lower transaction costs in a society. The act of individuals is based on incomplete information as well as subjective models that can turn out to be erroneous, and that incomplete information is not enough to correct such models.⁹⁵ Therefore, he concludes that the significant role of institutions in shaping the economic behavior is inevitable. In the societal sphere, institutions are not created to be necessarily efficient; they are in fact the reflection of the interests of those with bargaining power who are to devise

⁸⁸ Scully, Gerald W. "Constitutional Environments and Economic Growth." The Princeton Legacy Library, 1992.

⁸⁹ Barro, Robert J. "Economic Growth in a Cross Section of Countries." The Quarterly Journal of Economics, Volume 106, Issue 2, May 1991, Pages 407–443. Retrieved from: <https://doi.org/10.2307/2937943>

⁹⁰ Barro, Robert J. and Sala-i-Martin, Xavier. "Economic Growth." (McGraw-Hill, 1995), 539 pp, Journal of Economic Dynamics and Control, Elsevier, vol. 21(4-5), pages 895-898.

⁹¹ Knack, Stephen; and Keefer, Philip. "INSTITUTIONS AND ECONOMIC PERFORMANCE: CROSS-COUNTRY TESTS USING ALTERNATIVE INSTITUTIONAL MEASURES." Economics and Politics, Wiley, 1995, pp. 207-227. Retrieved from: <https://doi.org/10.1111/j.1468-0343.1995.tb00111.x>

⁹² Knack, Steve. "Institutions and the Convergence Hypothesis: The Cross-National Evidence." Public Choice, Springer, June 1996. vol. 87(3-4), pages 207-228.

⁹³ Knack, Stephen; and Keefer, Philip. "Why Don't Poor Countries Catch-Up? A Cross National Test of Institutional Expectations." Economic Inquiry, 1997, 35 (3): 590-602.

⁹⁴ Looney, Robert E. "The Omani and Bahraini Paths to Development: Rare and Contrasting Oil-based Economic Success Stories." Achieving Development Success: Strategies and Lessons from the Developing World; 2013, p. 15.

⁹⁵ North, Douglass, C. "Institutions, Institutional Change and Economic Performance." Cambridge University Press, 1990; p. 16.

new rules accordingly. Therefore, institutions would act in this case as a power instrument in the hands of the particular group(s) to result in the economic behavior.

However, when transaction cost in such a society is considered zero, the efficiency of outcomes is not usually affected by the bargaining power strength, but when the cost is positive it does affect it as part of the characteristics of the institutions which is greatly counted to shape the direction of long-run economic change.⁹⁶ Therefore it is *utmost important for economies to realize the gains out of trade by creating relatively efficient institutions*. From this angle, as previously mentioned; Acemoglu and Robinson in their book “Why Nations Fail” interestingly divides the political institutions into two groups; one *inclusive institutions* which obviously includes all different societal and political groups considering a trend of pluralism i.e. political systems in democratic societies. And second the *extractive political institutions* in which the power is narrowly distributed in the hands of some particular groups(s) or *the elites* that would then shape the economic institutions likewise. Properly defined institutions or social contract as the result of trade could therefore help deliver the kind of inclusiveness societies need.

History has shown that the majority of the political structures in MENA are classified under extractive institutions. Social contract is indeed the product of the society and as such it would affect all economic institutions that are also created by society.⁹⁷ Therefore taking into consideration the kind of institutions that shape the power politics would also be inevitable in our social contract for MENA. Furthermore, Acemoglu and Robinson reason that for example in North Korea the citizens were forced with extractive institutions by the communist party who took the country in 1940s. Accordingly North Koreans share a commonality with the people in colonial Latin America where Spanish conquistadors imposed the same kinds of extractive institutions upon them. Hence, in North Korea, people have to experience poverty away from entrepreneurial initiative or creativity, and without adequate education (spoiled with propaganda) to be able to prepare them for any skilled work.⁹⁸

In contrast, the people in South Korea have the choice to pursue good education with incentives that can promote them in their chosen vocation and excel their skills.⁹⁹ Inclusive economic institutions hand in hand with inclusive political institutions supported economic activity with enough freedom and defined property rights in South Korea like that of the United States which could create an environment for entrepreneurship and creativity that lead to economic success and prosperity under an unbiased system of

⁹⁶ Ibid.

⁹⁷ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity, and Poverty.” Crown Business Group, New York, 2012, p. 79.

⁹⁸ Ibid, p. 74.

⁹⁹ Ibid.

laws. Such inclusive environment would in fact invite the majority of people into economic activities thus making the best use of their talents and skills.

What can be drawn from the contrast between South and North Korea, or the United States and Latin America guides us to a general principle so as to say that inclusive economic institutions have the fostering capability for inclusive economic activity, productivity growth, and economic prosperity.¹⁰⁰ The significant places of “property rights, the law, public services, and the freedom to contract” were salient in the countries with inclusive institutions in which the state had the role of proper enforcement of laws and preventing theft and fraud, or combating corruption. In other words, a proper social contract has been established in such countries.

In a simple term, the politics along with its inclusive institutions were in the hand of different people in South Korea with differently defined interests and objectives compared with that of North Korea. Unlike such politics that generates and encourages inclusive institutions, the Communist Party in North Korea or the sugar planters under the colonial Barbados in Latin America would find themselves better off to set up extractive institutions through which they can pursue their own interests.¹⁰¹ The key factor here is the inclusiveness of the kind of political institutions in place to run the economy and politics.

What mostly count here are in fact the distribution of political power that determines the win-game and the kinds of institutional framework that encompasses society and politics. Therefore, shaping such political institutions matters a lot when shaping the social contract. If the distribution of power is narrowed and unconstrained, then the political institutions are absolutist, as exemplified by the absolutist monarchies reigning throughout the world during much of history with so many examples inside the MENA region in particular. In other word, the strong link between political and economic institutions is also what counts in delivering the failure or success of economies.

With a mixed bundle of institutions that is having growth under extractive political institutions but economic institutions having inclusive aspects, as they did in South Korea, in the course of time there would be the risk of turning the economic institutions more extractive and thus stopping economic growth.¹⁰² Here is again where the significance of social contract can be illustrated in which democratic freedom and a proper system of check and balance can be present. An effective social contract with inclusive institutions can then maintain the viability of growth and sustainability of development.

¹⁰⁰ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity, and Poverty.” Crown Business Group, New York, 2012, p. 75.

¹⁰¹ *Ibid.* p. 79.

¹⁰² *Ibid.*, p. 95.

Similar to Douglass North, Acemoglu and Robinson are also acknowledging the significance of history. Accordingly the weight of history in particular during critical junctures can shape the events in the same way that the political and economic institutions shape the balance of power while delivering what is politically feasible.¹⁰³ Hence, the social contract in case of MENA should endorse a political feasibility that acknowledges the weight of history as such taking into account the embedded informal institutions. Only in this manner, a new social contract can be drawn peculiar to the MENA region.

Moreover, according to Acemoglu and Robinson, at times that political feasibility and the outcome would not be historically predetermined but rather contingent; the precise path of institutional development is determined on the fact that which opposing forces would succeed, which political group would form effective coalition and which leaders would turn out to be the political winners to structure events in accordance with their advantage.¹⁰⁴

Interestingly the authors in both works (Douglass North and, Acemoglu and Robinson) give an account of path dependency through contrasting stories of the societies in England and Spain that according to North such a societal intertwined web of formal rules and informal constraints together forms the institutional matrix by which the economies are led down different path.¹⁰⁵ By this and similar contrasts, Acemoglu and Robinson also reveal the story of how inclusive economic and political institutions emerged in England to have the Industrial Revolution happen thus proving as to why some countries benefited from such revolution while others didn't or chose to refute the process of such industrialization.¹⁰⁶ What can be drawn from the these lines is that such *institutional dynamics* caused a divergence between the countries that seem to be rich today as they embarked on the process of industrialization and technological change at the break of the nineteen century, in contrast with those that did not and stayed poor as the result.¹⁰⁷

By the above attribution, Acemoglu and Robinson are referring to the fact that how history and critical junctures play their important part in shaping the path to the kinds of political and economic institutions as the responsible criteria and the origins of differences in poverty and prosperity.¹⁰⁸ Moreover, the failure of nations today have roots in their institutional histories whose lessons trigger the hope as to how nations

¹⁰³ Acemoglu, Daron; and Robinson, James A. "Why Nations Fail: The Origins of Power, Prosperity, and Poverty." Crown Business Group, New York, 2012, p. 110.

¹⁰⁴ Ibid.

¹⁰⁵ North, Douglass. "Institutions, Institutional Change and Economic Performance." Cambridge University Press, 1990. p. 115.

¹⁰⁶ Acemoglu, Daron; and Robinson, James A. "Why Nations Fail: The Origins of Power, Prosperity, and Poverty." Crown Business Group, New York, 2012, pp. 298-299.

¹⁰⁷ Ibid, p. 301.

¹⁰⁸ Ibid, p. 101.

can effectively seize critical junctures and embark on the path to reform their institutions by breaking their historical mold and lead their countries to greater prosperity.¹⁰⁹

Property rights, implicitly or explicitly, are the core part of a social contract. Property rights are also well established within the institutional framework which would encompass appropriation as a function of legal rules and enforcement as well as organizational forms and norms of behavior.¹¹⁰ Hence, incorporating property rights into the social contract ought to be central in our consideration. As to the given example above, from a different angle, Douglass North is in fact comparing the status of property rights in Beirut in the 1980s with those of a modern small-town U.S. community to cover the spectrum... and he shows that what counts in delivering the different outcomes is in fact a function of institutional structures in each that differ. In Beirut, the public domain is ¹¹¹seized by those with the violence potential which reminds me of Acemoglu and Robinson's notion of "extractive political institutions."

That is perhaps the reason why Douglass North is proposing a "third-party enforcement" mechanism. He acknowledges the role of ideology or norms while professing that immense resources have been put to promulgate codes of conduct. In addition, the issue of opportunism, cheating, and shirking that exist in complex societies all led to the necessity of a coercive third party.¹¹² Moreover, here too political stability is of significance to North, as productivity of a modern high income society cannot be the fruit of a political anarchy.¹¹³ Indeed, effective third party enforcement is best realized by creating a set of rules that then make a variety of informal constraints effective and thus what can be proposed here is in fact an "institutional evolution" through incremental change which can be learned as the best possible solution particularly for the societies in MENA.

According to Acemoglu and Robinson, extractive institutions are the main cause for economic failure of nations. Such institutions in fact keep the poor countries poor and prevent them to reform by embarking on a different path to economic growth.¹¹⁴ Best examples in Africa, such as Zimbabwe and Sierra Leone, or in Latin America taking into view Colombia and Argentina, or in Asia some countries like North Korea and Uzbekistan and finally in the Middle East an example like that of Egypt can prove the above claim. Despite their differences in geography and culture what they share is the commonality of extractive institutions mostly designed by the elite to serve their own interests. This stands as the best reason why such institutions insist as long as the elite are in power. This creates a vicious circle thus having these

¹⁰⁹ *Ibid*, p. 183.

¹¹⁰ North, Douglass, C. "Institutions, Institutional Change and Economic Performance." p. 33.

¹¹¹ *Ibid*, p. 34.

¹¹² *Ibid*. p. 35.

¹¹³ *Ibid*.

¹¹⁴ Acemoglu and Robinson. "Why Nations Fail: The Origins of Power, Prosperity, and Poverty." p. 398.

extractive institutions persist and such institutions would have similar implications in different countries to impoverish their citizens even though their intensity differs in various places.¹¹⁵

What can be done? As North suggests efficient institutions could be the result of an adequate Polity where we have incentives to create and enforce effective property rights.¹¹⁶ But it is hard to model such a Polity with “wealth-maximizing actors” (the “elites” in Acemoglu and Robinson’s term) who act like ‘Mafia’ or a ‘leviathan.’ The complexity and difficulty of modelling such a polity relate to the informal constraints embedded in cultures that matter a great deal. Therefore, we need to know more into details about the cultures and the norms of behavior derived from them that interact with formal rules. This can also guide us to the formation of a new social contract while taking into considerations such parameters as cultures and informal constraints particularly in case of the MENA region.

As Douglass North captures on his concluding remark, institutions are not something that we can see or touch or even measure, they are simply the construct of human mind.¹¹⁷ But even according to many neoclassical economists institutions exist as they consider institutional parameters in their models. As North concludes; *institutions matter as do tariffs, rules and regulations.*

The place of government is also of significance as for example we see the difference between the economic well-being of the United States with that of Mexico as soon as we cross to the southern border. These are the questions upon which we are to illustrate the significance of institutions in bringing a successful economic performance. Interestingly, North proposes something more fundamental to the roles of institutions as the main determinant for the performance of economies. And that is to say; a dynamic theory of change should mainly and primarily be based upon a model of institutional change than anything else.¹¹⁸ According to Douglass North; institutions have created the kind of structure for human beings to establish order and reduce uncertainty in exchange throughout the history. When technology is employed along with institutions; then transaction and transformation costs and as the result the profitability and feasibility are taken into picture of economic activity. Moreover, performance of economies is understood like a sequential story in which institutional evolution connects the past to the present and future thus making the history as largely an incremental story.¹¹⁹

¹¹⁵ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity, and Poverty.” Crown Business Group, New York, 2012, p. 399.

¹¹⁶ North, Douglass. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990, p. 140.

¹¹⁷ *Ibid*, p. 107.

¹¹⁸ *Ibid*.

¹¹⁹ *Ibid*, p. 118.

To express differently, institutions encompass all aspects of a living society including their political and economic behaviors. These institutions are rooted in the cultural components of societies. Hence, the better and more efficient they are defined, the better off we will be in our socio-economic outcome. And to reach that end, as prescribed, a feasible social contract can play the key role like a beginning jolt in preparing the ground for institutional change. In return, institutions can shape the desired social contract and make it more formidable upon the social, economic and political spheres.

Reiterating the fact that efficient institutions are the result of an adequate Polity which can provide incentive and enforce effective property rights, we need to venture to know and understand more about what North calls “culturally derived norms of behavior” and get to know how they interact with formal rules so as to render the answer to our questions. As he concludes; the promise is there even though the answers may not be definitive but that provides the best motive for us to certainly do better.¹²⁰

To get there, of course would not be easy particularly for developing countries (such as the MENA region) as many of the above explained extractive institutions have had a prolongation of existence in their history both imposed by the colonial powers and then through their governmental proxies in the course of time. Egypt is a good example illustrating the patterns of these institutions. During the presidency of Nasser some aspects of inclusive institutions were apparent in particular for educational system. As such, he created some opportunity that did not exist during the king Farouh. However, that created a situation where a combination of extractive political institutions with somewhat inclusive institutions took place as followed by worsening situation during Mobarak.

Acemoglu and Robinson believe, this triggered the Arab Spring ending the reign of Mobarak. Tunisians during Bin Ali and his family experienced a similar situation and outcome during which the country was plundered economically. According to *Why Nations Fail*, poverty in these countries is in fact the main roots of such discontent. Moreover, the lack of political rights (lack of proper social contract) has been also the main cause of economic problems in Egypt and Tunisia.¹²¹

In short, economically nations fail as the result of their established extractive institutions. Such institutions basically keep the poor countries poor. And the reason why such institutions persist to remain in the course of time is somehow related to the vicious circle as explained by Acemoglu and Robinson.¹²² Such institutions in fact transfer the power and wealth to the governing class or the “elites.” The more such institutions are controlled through democratic means, the better economic outcome would be. For

¹²⁰ Ibid.

¹²¹ Acemoglu and Robinson. “Why Nations Fail.” 2012, pp. 1 and 2.

¹²² Ibid. Chapter 13.

instance, Argentina due to its relative democratic institutions claims to have controlled violence in comparison with that of Colombia. As the result, we see a GDP in Argentina twice that of Colombia. Likewise, the political institutions in both of these countries are relatively better than those in Zimbabwe and Sierra Leone for which these two latter countries are poorer than the former.

As indicated, historical junctures or revolutions may have temporary change but basically they do not necessarily bring about any fundamental institutional change. Sierra Leone is also an example of the kind or the Soviet Union in which the way of governance continued on the same path as the Tzar regime (path dependency).

In brief, the way out of such vicious circle of failure would be through an incremental change of the extractive institutions by transforming them towards the inclusive institutions. The vicious circle implies that such transformation would not be an easy task but it is not impossible and “the iron law of oligarchy is not inevitable.”¹²³ To example the possibility of such change for success, Oliver Cromwell was to replace the despotic power of James (II) but after the civil war in England, parliament proved to be more powerful. As the result with more pluralist views, new institutions emerged causing a new path to economic success.

In addition, developing a proper social contract in particular for the MENA region can pave the way for such institutional change while creating the necessary societal bondage along with a democratic political atmosphere which would all together lead to economic prosperity and success. Along the course of such success further regional cooperation and integration would be suggested which is all explained in the coming chapters.

To summarize; the theory of institutional change is considered a key factor for economic performance and its successful behavior. Such changing process can be initiated by creating an enabling environment that allows freedoms into the society including economic freedom as well as political freedom. Such interrelated freedoms coupled with democratic Polity, or in a word an adequate social contract can then transform the extractive institutions into inclusive institutions in their both political and economic forms which hand in hand can lead to economic success and sustainable development. Moreover, law can play a key role in this process with a reasonable degree of liberalization. In fact, such transformation can be consolidated through the rule of law and well-defined property rights. In tandem with these theories, Chapter (3) takes a rather empirical economic approach to specify what institutional factors can applicably establish a new social contract for the MENA region.

¹²³ Ibid, p. 402.

Chapter (3): From Status-quo towards a New Social Contract

3.1- Recent Economic Developments and Prospects

When it comes to economics, *Trade* is perhaps the most actual acquisition of a social contract. And in case of MENA, oil has been the focal point of trade which has a vast impact on global economy. In practice, low oil prices are good for the global recovery but it has different impacts on oil importers and exporters. It obviously increased oil importers GDP (growth) while improving trade balances and easing fiscal pressures. When calculating such gains it is important to consider the share of oil imports in GDP. For the oil exporters such as Russia their growth rates could drop, their fiscal balances would deteriorate thus facing significant regional consequences (Mottaghi, 2015).¹²⁴

There are more diverse and challenging economic situations in case of the developing nations or emerging economies. In such countries the growth prospects in the medium term are reduced due to falling exports, massive capital outflows with depreciating currencies along with rising private and public debts.¹²⁵ According to Fardoust the slow-down of economies such as China would have an impact on commodity prices including oil prices and such a decline would severely affect the performance of many countries in the MENA region.¹²⁶ He acknowledges the dramatic change that occurred in the region compared with forty years ago. Today the region is facing serious chaos that could result in changing borders and collapsing states with spillovers into neighboring countries. Accordingly, intra-regional political rivalries have a direct hand in this chaos thus engaging larger regional players and resulting in “an army of unemployed and disgruntled youth.” This situation has had no precedent in the last century since the fall of the Ottoman Empire.

According to the OECD also, MENA economies are facing daunting challenges. Despite geographically privileged location and the young population, as well as the comparative advantage in some sectors including the renewable energies, economic growth in the MENA region is lagging behind compared to other developing countries. This is despite the fact that there have been dynamic economic growth and investment rates in the region particularly during the first decade of the century. These include significant reforms undertaken by many governments towards economic openness, private sector development,

¹²⁴ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. “MENA Economic Monitor: Towards a New Social Contract.” The World Bank Middle East and North Africa Region, April 2015, p. 1.

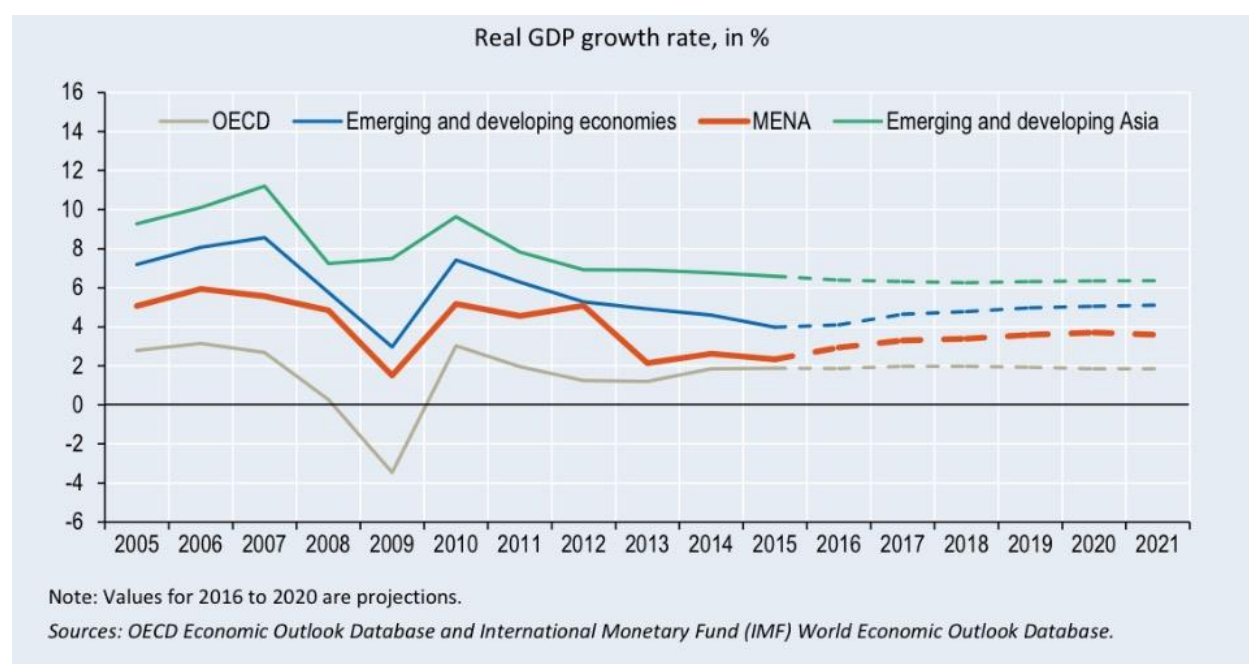
¹²⁵ Fardoust, Shahrokh. “Economic Integration in the Middle East: Prospects for Development and Stability.” MEI (Middle East Institute) Policy Paper; 2016, The Global Context and the Current Economic Situation in the Region, p. 5.

¹²⁶ Ibid.

diversification and institutional reforms.¹²⁷ Nonetheless, the MENA region today is still struggling to regain its pre-crisis growth level (see Figure 3.1.A. and Table 3.1.B.).

Furthermore, according to the OECD a list of reform priorities have been suggested for the MENA region which includes: fostering private sector development, improvement of public administrations, enhancing tax design and collection, expanding international trade and investment, improving and upgrading the region's infrastructure, and proper management of water and energy resources along with upgrading the educational systems as well as fostering adequate inclusion of women and youth.¹²⁸ In other words, the above list confirms the necessity of a new social contract for the MENA region which should importantly include upgrading the infrastructures at different angles such as education, and developing private sector while developing the laws and regulations governing the relationship between private and public sectors.

Figure 3.1.A. Economic Growth in the MENA Region lagging behind other Emerging and Developing Economies



Moreover, according to the OECD; despite all the wealth diversity in the region, GDP Per Capita is still below the OECD average in most of the countries in MENA as for example annual growth between 2009 and 2015 has been 2 percentage points below the pre-crisis rate and as such the long-term growth rate of

¹²⁷ OECD. "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policy Series, October 2016, p. 1.

¹²⁸ Ibid, Foreword.

the region has also been declined.¹²⁹ Moreover, inequality on development and job opportunities still remain high particularly among the youth and women. For example, youth unemployment rate in the MENA region increased from 24% to 29% between the years 2009-2015 thus reversing the declining trend of the previous decade.¹³⁰

Hence, the OECD report is suggesting two pillars as a more sustainable development model; the first is *diversification* and the second *inclusiveness*. In fact in a different way, the role of institutions in delivering prosperity and the significance of institutional change have been suggested in the above report. All this greatly involves the status of individuals and their relationship with that of the public sectors thus demanding for a serious move towards a new social contract.

In view of security tensions in the region and volatility of oil prices as well as the broad-based weaknesses that exist in competitiveness...all such factors hurdle the development for both the oil-importers and exporters. Hence, engaging the private sector would be of the utmost importance to boost diversification and competitiveness. Besides, the ongoing conflicts in the region would have no fruit but great damage on the human and physical capital, disruption of trade routes and production methods, as well as creating uncertainty. Hence, reforms aiming at strengthening the rule of law and promoting more inclusive and open approaches in respect to designing policies and services on the one hand, and fighting corruption and modernizing the governments apparatus on the other would be of essence and thus necessary to be adopted. All this will be taken into account in more details in Part (III) of this dissertation.

According to Fardoust, in the course of 21st Century and in particular by 2030 there are emerging forces in the global economy affected by the current conditions in MENA and the future of its citizens. As such he believes that the center of gravity of the global economy has already started moving towards Asia.¹³¹

According to the World Bank, the global economy overall has had a gradual pick up while the economic prospects in the Middle East and North Africa region confirm to have remained flat. Growth in the MENA region for example, slowed down in 2015 and 2016 ranging between 3.1 and 3.3 percent according to the World Bank (See Table 3.1.B. for complete data). However, the recent data on the MENA region confirms that overall economic growth in the region has increased to an average 2.0 percent in 2018 from 1.4 percent in the previous year (2017). This well reflects the positive role of reforms and stabilization policies in the region. Moreover, such data also confirms an increase in the

¹²⁹ Ibid, p. 2.

¹³⁰ Ibid.

¹³¹ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects for Development and Stability", MEI (Middle East Institute) Policy Paper; *The Global Context and the Current Economic Situation in the Region*, 2016, pp, 6-7.

Table (3.1.B.) Middle East and North Africa Forecast Summary

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(Real GDP growth at market prices in percent, unless indicated otherwise)

Percentage point differences from June 2017 projections

	2015	2016	2017e	2018f	2019f	2020f	2017e	2018f	2019f
Algeria	3.7	3.3	2.2	3.6	2.5	1.6	0.4	2.6	1.0
Bahrain	2.9	3.2	2.4	2.0	1.6	1.7	0.5	0.1	-0.7
Djibouti	6.5	6.5	7.1	7.0	7.0	7.0	0.1	0.0	-0.2
Egypt, Arab Rep.	4.4	4.3	4.4	4.9	5.6	5.8	0.1	-0.1	0.3
<i>Fiscal year basis</i> ²	4.4	4.3	4.2	4.5	5.3	5.8	0.3	-0.1	0.0
Iran, Islamic Rep.	-1.3	13.4	3.6	4.0	4.3	4.3	-0.4	-0.1	0.1
Iraq	4.8	11.0	-0.8	4.7	1.7	1.9	2.3	2.1	0.6
Jordan	2.4	2.0	2.1	2.2	2.4	2.5	-0.2	-0.4	-0.6
Kuwait	0.6	3.6	-1.0	1.9	3.5	3.5	-1.2	-0.8	0.6
Lebanon	0.8	2.0	2.0	2.2	2.0	2.0	-0.5	-0.4	-0.6
Morocco	4.5	1.2	4.1	3.1	3.2	3.2	0.3	-0.6	-0.4
Oman	4.7	5.4	0.7	2.3	2.5	2.5	-0.2	-0.1	-0.4
Qatar	3.6	2.2	1.7	2.6	3.0	3.0	-1.5	0.0	0.5
Saudi Arabia	4.1	1.7	0.3	1.2	2.1	2.2	-0.3	-0.8	0.0
Tunisia	1.1	1.0	2.0	2.7	3.3	4.0	-0.3	-0.3	-0.2
United Arab Emirates	3.8	3.0	1.4	3.1	3.3	3.3	-0.6	0.6	0.1
West Bank and Gaza	3.4	4.1	3.0	3.0	2.9	2.9	-0.5	-0.4	-0.5

Source: World Bank.

Notes: e = estimate; f = forecast. World Bank forecasts are frequently updated based on new information. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not differ at any given moment in time.

1. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars. Excludes Libya, the Syrian Arab Republic, and the Republic of Yemen due to data limitations.

2. The fiscal year runs from July 1 to June 30 in Egypt; the column labeled 2017 reflects the fiscal year ended June 30, 2017.

For additional information, please see www.worldbank.org/gep.

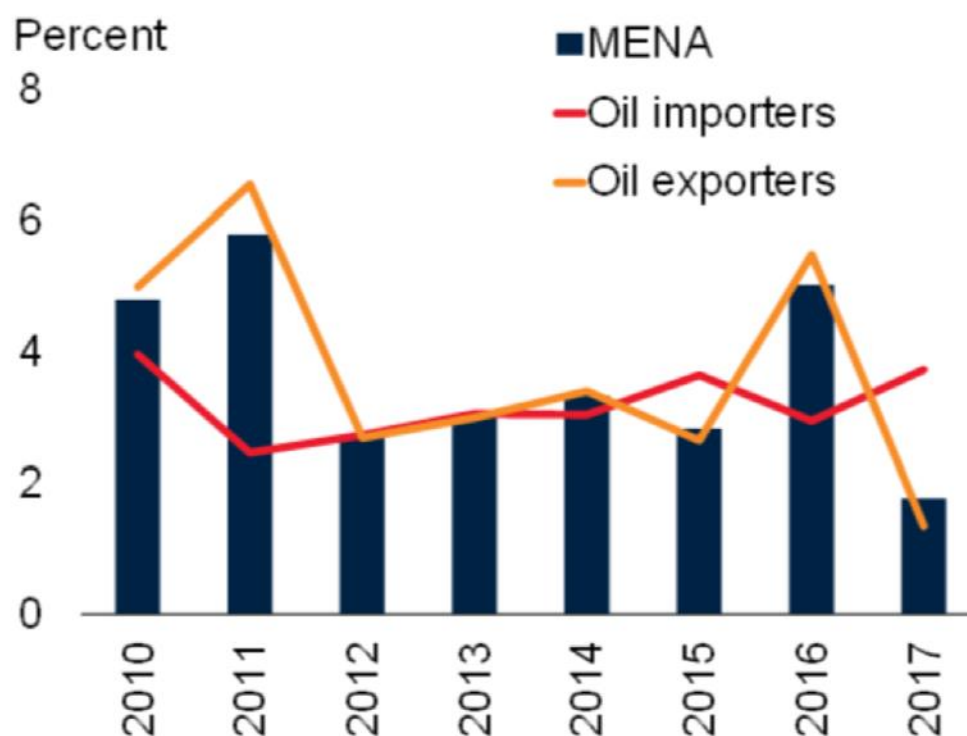
economic growth of the region for the years 2019-2020 reaching an average 2.6 percent. (Also see the above Table 3.1.B.). Overall three reasons could be attributed for such a sluggish growth in the MENA region:

1- Continued conflict and political instability in Syria, Iraq, Libya and Yemen; 2- The low oil prices that have been dragging down growth in particular among the oil exporting countries ; and 3- The significant slow pace of reforms that has been hurdling resumption of investment for the region.¹³² In fact, the slow pace of reforms in the region makes the economic recovery somewhat sluggish with high unemployment rates which are to be addressed properly otherwise it may deter economic recovery of the region while hampering long-term prospects for the MENA region as well.¹³³

¹³² The World Bank. "MENA Economic Monitor: Towards a New Social Contract." 2015, p. 2.

¹³³ The World Bank. *Global Economic Prospects*, January 2018, p. 118.

Figure (3.1.C.): Growth



Source¹³⁴: World Bank; Global Economic Prospects—January 2018

The slow pace of reforms coupled with the continued conflicts have created a situation shadowing like nightmare on the region for years bringing halt and stagnation to the majority of the countries involved. To find a solution out of this vicious circle of conflict and instability, such conflicts need to be settled involving the major regional powers and then a new social contract scheme would be introduced encompassing the elements described above to change the economic prospects of the region. This could furthermore trigger the process of institutional change within the countries of the region supporting a dynamic and sustainable economic development in the long run.

Recent reports by the World Bank confirm the above claim laying the foundations for the new economy in the MENA region based on a new social contract in a broader term. This region has already exhausted the old social contract as the economies of the region fail to employ the most talented and educated

¹³⁴ The World Bank. *Global Economic Prospects*, January 2018, p. 118.

workers and therefore a gradualist approach should come to change the situation.¹³⁵ That is to say that the region requires attempting towards establishing a new social contract as a criterion to unite the people for their common goals thus transforming the ways in which governments, institutions, civil societies and companies conduct business.¹³⁶

As an example, the growth for the group of oil exporters in 2015 was around 2.8 percent while the growth for the high-income Gulf Cooperation Council (GCC) oil exporters was something between 3.2 to 3.8 percent for the same year as predicted by the consensus forecasts and the World Bank respectively. This report confirms the fact that economic growth is plummeting in all MENA oil exporting countries. Taking the growth in Saudi Arabia for example, it surpassed 8 percent in 2011 while it was set to decline to 4.6 percent in 2015.¹³⁷ (See the above Figure 3.1.C.).

More into details on the above examples, the World Bank estimated that Gulf countries could lose about \$215 billion in oil revenues which is equivalent to 14 percent of their combined GDP, for the year 2015. Saudi Arabia, UAE, Kuwait and Qatar were overall in a better position thus withstanding the worst effects of the low oil prices mainly due to their large reserves while Bahrain and Oman has also less of a cushion.¹³⁸

Nonetheless, the pressure on fiscal balances is felt even for those countries with large buffers. For instance, Saudi Arabia's large fiscal surplus is disappearing, as it left a double-digit fiscal deficit for the country in 2015. Saudi Arabia and Kuwait usually manage their expansionary fiscal policies partially by their large foreign assets. Abu Dhabi's sovereign wealth fund being worth of \$800 billion could cushion the impacts of low oil prices on its economy. But such remedies are only temporary solution and cannot last forever since fiscal deficits are rising. Similarly, the aid flows from GCC that could help the rest of MENA could also decline because of the low oil prices.

Among developing oil exporters, Iran's economic prospects have been heavily affected by the sanctions mainly imposed by the US as well as the fluctuations in oil prices. As the result, the government had to adopt "a contractionary fiscal policy" on its budgets. As such, capital spending has been prioritized and the rich would be excluded from so called cash transfer system. Moreover, an increase of 5 percent in gas prices has kept the budget deficit at around 3.4 percent for two years of 2015 and 2016. This situation

¹³⁵ <https://www.worldbank.org/en/region/mena/publication/mena-economic-monitor-october-2018-a-new-economy-for-mena>

¹³⁶ Ibid.

¹³⁷ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. "MENA Economic Monitor: Towards a New Social Contract." The World Bank Middle East and North Africa Region, April 2015, p. 3.

¹³⁸ Ibid.

however, is currently in a suspending mode or even worsening as the United States simply rejected the Iran deal (under President Trump) and has opted out of it.

With a view to the recent Consensus forecast for MENA in August 2018,¹³⁹ even though growth dynamics are improving in the region, the top political agenda yet has been the rift between Iran and the USA. Following Washington's withdrawal from the nuclear deal on 8 May, there have been more effective sanctions imposed on Iran by the United States. Accordingly, after 4th of November 2018, more sanctions have been imposed on Iran's energy and financial sectors. In return, Iran has warned that if its oil exports are to be blocked, Iran would simply close the Strait of Hormuz, the crucial maritime route in the Persian Gulf that is the checkpoint of like 30% of global seaborne oil trade. Such war of words has, however, pushed up the price of oil in recent months. However, if Iran's threats to close the Strait of Hormuz would be materialized, it could get the US drawn to a military intervention, as it can disrupt global oil supply.¹⁴⁰

3.1.1. MENA Countries Outlook

Algeria's growth rate dropped in 2015, standing at 2.6 percent causing a doubled fiscal deficit for the country. This has also weakened the economic activity causing the unemployment rate to increase from 9.8 percent in 2013 to 10.6 in 2015 and 11 percent in 2016.¹⁴¹ Yet, for 2018 due to relative high oil prices, growth increased a bit in Algeria aided by fiscal support. According to Focus-Economics panelists Algeria's GDP grew at 2.7% in 2018, and is expected to be at 2.5% in 2019.¹⁴²

Since the World Bank report in 2015, for the countries already in conflict such as Iraq – Libya, Yemen, and Syria – economic prospects have been grim. For example, the Iraqi economy has been hit hard due to the ISIS insurgency thus piling up large military expenditures.¹⁴³ The occupation of areas within Iraq by the ISIS negatively affected the growth of the country. As such the percentage of the GDP reached 10.6 percent as the result of the high military expenses while keeping fuel subsidies intact and of course the low oil prices. Over 50 percent of the employments are geared within the public domain causing difficulty for investment spending. Yet, according to Focus-Economics, for 2018 Iraq should have benefited from

¹³⁹ Ricard Torné Codina; "Economic Snapshot for MENA" (August 2018): <http://www.focus-economics.com/regions/middle-east-and-north-africa#>

¹⁴⁰ Ibid, p. 2.

¹⁴¹ The World Bank. "MENA Economic Monitor: Towards a New Social Contract." 2015, p. 4.

¹⁴² Ricard Torné Codina; "Economic Snapshot for MENA" (August 2018): <http://www.focus-economics.com/regions/middle-east-and-north-africa#>

¹⁴³ The World Bank. "MENA Economic Monitor: Towards a New Social Contract." 2015, p. 4.

the relatively higher oil prices. The panelists expected a growth of 2.4% for 2018, as well as 3.9% for the year 2019.

Libya with a recession has had an interruption of oil exports due to the violent conflict. As the result, the economy faced a contraction of 24% following a 14% contraction which occurred in 2013. Even though the political conflict is easing, the rapid recovery has been unlikely despite opening two oil ports, and growth actually remained low in 2015. Libya's large foreign reserves have dramatically declined thus affecting its economy as the country is somewhat depending on it. The Central Bank of Libya estimated a 40% decline on foreign reserves between July 2013 and December 2014 having it at \$85.5 billion.

And in Yemen, the conflict among different political factions and religious sects has heavily affected the economy so as to plummet the growth to zero percent in 2014 from that of 4.8 percent in 2013. The sabotage of oil fields has been an additional reason for fuel shortages and power cuts in the country weak infrastructure. The economy has been approximately contracted by 2.8 percent in 2015 due to the political and security instability. Oil exports dropped to an average of 140 thousand barrels per day counting for 10 percent drop in 2015 on the top of a previous 11 percent drop in 2014.

Furthermore, for Yemen there was a significant rise of the budget deficit with 8.7 percent of GDP in 2014 with a continuous trend in 2015 without much saving. Recent updates show a shrinking growth in Yemen for 2018 as the result of ongoing conflict.¹⁴⁴ Accordingly, Focus-Economics panelists estimated a contraction of 0.7% in 2018 while seeing the possibility of the economy to expand up to 7.9% in 2019.

In Syria as well, due to the civil war there has been a sharp drop on government revenues in view of military spending which has increased the fiscal deficit significantly. Nonetheless, there was a positive growth of 2 percent as estimated by the Economist Intelligence Unit (EIU) mainly through moving the businesses into the coastal areas of an expanded industrial zone. Furthermore, political instability has almost halted investment in the country since 2011.¹⁴⁵

Policy reforms coupled with lower oil prices in Egypt and Morocco have helped their economies (oil importers) recover although slowly. In fact, this group of countries has helped the rest of MENA to maintain an overall growth of 3 percent.¹⁴⁶ In Egypt, low oil prices were the reason to contain domestic inflationary pressures which was triggered by the subsidy reforms as introduced in July 2014. The continuation of such oil low prices could reduce the fiscal deficit by 2 percent of the GDP for 2016. The Gulf countries pledged a package worth of \$12.5 billion for Egypt during the Economic Development

¹⁴⁴ Ricard Torné; Focus-Economics: <http://www.focus-economics.com/regions/middle-east-and-north-africa#>

¹⁴⁵ The World Bank. "MENA Economic Monitor: Towards a New Social Contract." 2015, p. 5.

¹⁴⁶ Ibid.

Conference in mid-March 2015. Overall Egypt raised about \$36.5 billion all of which could help boost the economy. As such, manufacturing as well as tourism confirmed a double-digit growth in 2014 while the Suez Canal construction also showed strong performance in 2014 and 2015. Accordingly, growth was estimated to more than 4 percent in 2016 thus reaching the same rate as the pre-revolutionary period.¹⁴⁷

More recent updates show that the Egyptian economy is expected to grow at a solid pace for the full-year 2019 as the result of improved regulatory reforms as well as higher investment.¹⁴⁸ In order to alleviate the pressure away from the poorest Egyptians for the higher prices, the FY 2019 budget contains provisions that deal with the expanding use of cash transfer and food subsidy programs.

Weak external demand out of the Euro area's anemic economic stance and showing domestic demand have caused a slow economic recovery for Tunisia in 2015 and 2016. The World Bank estimated a growth of 2.6% in 2015 gradually reaching 3.4% in 2016. This could happen through the back-up of tourism and manufacturing sectors (although the attack on the Bardo Museum has affected tourist arrivals).¹⁴⁹ The fiscal deficit has been reduced from 6.8 percent in 2013 to 4.2 percent in 2016 which has been the consequence of low oil prices coupled with the fiscal consolidation so as to help contain inflation to about 4 percent. For 2018 also, because of the Tourism influx and reforms in place, growth has improved so far in Tunisia. As such, Focus-Economics panelists estimated a GDP growth of 2.4% in 2018, and 2.6% in 2019.

Jordan and Lebanon are also on the path to slow recovery despite the civil war in the neighboring countries and the flood of refugees out of the war-afflicted countries. The growth for Jordanian economy grew over 3 percent in 2015 which was slightly higher than the overall observed since 2010. This could be the result of an increase in public investment through the grants from the GCC and a narrower trade deficit.

In Lebanon, due to the internal ISIS conflicts, growth was about 2.5 percent in 2015 and 2016. For 2018, a weak start was shown in Jordan yet there have been benefits as the result of increase in exports in 2018 plus an increase in remittance inflows as well as tourism activity. According to the Focus-Economics panelists; for Jordan a GDP growth of 2.4% in 2018, and 2.7% in 2019 have been estimated. This is while for Lebanon the economy was expected to benefit from tourism industry during the year 2018 having a growth of 1.9% in that year as well as a 2.5% in 2019.

¹⁴⁷ Ibid.

¹⁴⁸ Focus-Economics.

¹⁴⁹ The Tunisian tourism ministry reported that around 3000 bookings have been cancelled since the attack on the Bardo Museum on March 18, 2015. The tourism industry accounts for more than 12 percent of GDP in Egypt.

The Palestinian Territories, West Bank and Gaza, due to the precarious and instability of political and security situation, the brunt of the 2014 Gaza is still felt. Even though the Palestinian economy experienced 7 years of continuous growth, the economy however contracted by 0.8 percent in 2014 as the result of a 15 percent contraction in the Gazan economy which was the consequence of the Gaza war of July-August 2014 that left a physical damage of about \$2.5 billion.

Nonetheless, the West Bank economy experienced 4.4 percent growth mainly as the result of the large investment in construction.¹⁵⁰ Palestinian economy had the growth of 1 percent in 2015. The reconstruction in GAZA has been quite slow due to Israeli restrictions on the import of construction materials while 70,000 households being internally displaced creating fragile environment that can lead to more conflict.

Overall, unemployment increased to 27 percent during 2014 having it 43 percent in Gaza and 17 percent in the West Bank. In particular the youth unemployment in Gaza is alarming which soared by about 60 percent in 2014. Likewise poverty rate has been high in Gaza as it increased from 28% in 2013 to 39% in 2014.

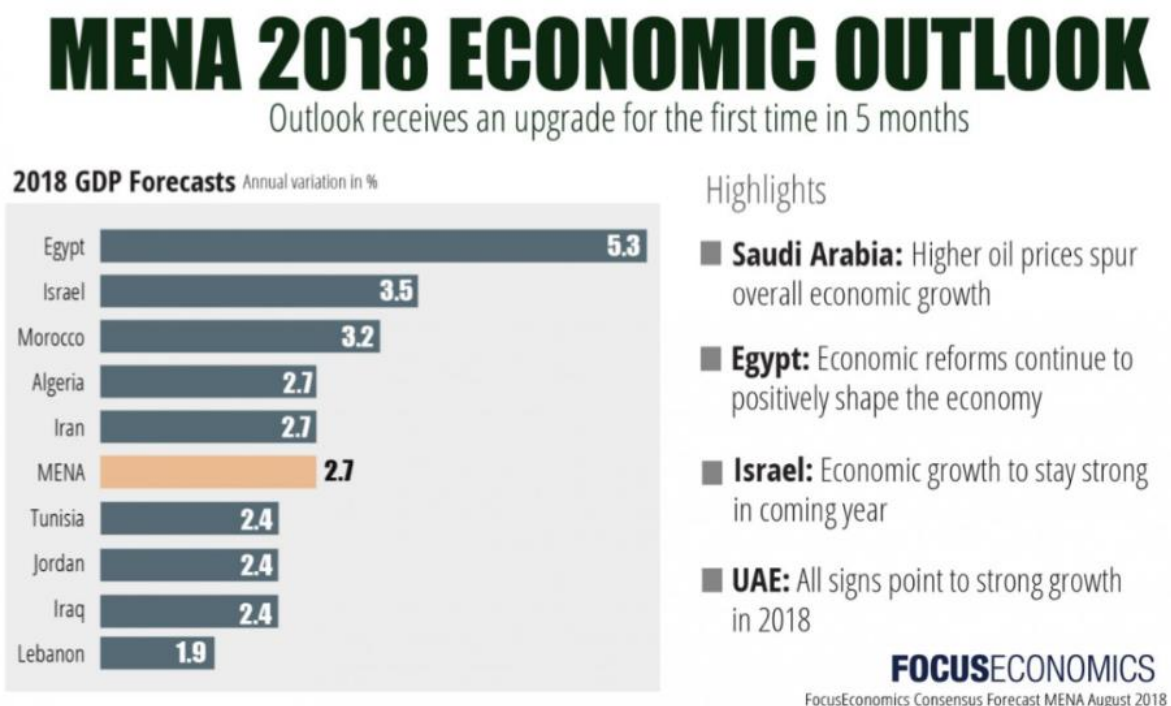
This is while the outlook for Israel remains positive for 2018 and 2019, as the Focus-Economics panelists estimated an economic growth of 3.5% for the year 2018 for that country. Same source sees the economy would expand 3.2% for the year 2019. Overall, according to Focus-Economics economic growth in MENA region strengthened in the April–June period in 2018 thus having a rise of an aggregated 2.8% year-on-year in Q2. (Figure 3.1.2.).

The following figure highlights some countries of the MENA region as samples giving a relatively recent update on their economic outlook. The GDP is given for those sample countries while estimating the 2.7 as the overall GDP of the MENA region. Besides, according to the World Bank; economic growth in the Middle East and North Africa (MENA) region has increased an average of 2.0 percent in 2018 from an average 1.4 percent in 2017.¹⁵¹ While reforms and stabilizing policies have been effective in positive growth for 2018, the rise of oil prices could also have the oil-exporters benefit from the market. Due to the relatively good economic performance of the region for the year 2018, the economic outlook for that year is presented in the following section to highlight the significance of an overall improvement in view of important factors including the role of economic reforms (i.e. in Egypt) as well as stabilizing policies.

¹⁵⁰ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. "MENA Economic Monitor: Towards a New Social Contract." The World Bank Middle East and North Africa Region, April 2015, p. 6.

¹⁵¹ <https://www.worldbank.org/en/region/mena/publication/mena-economic-monitor-october-2018-a-new-economy-for-mena>

Figure 3.1.2. MENA 2018 ECONOMIC OUTLOOK (2018 GDP Forecasts)



3.1.2- MENA ECONOMIC OUTLOOK (2018)

Beyond the overall role of institutions as the main factor, we may name two other factors that are affecting growth in MENA. On the one hand, higher oil prices would boost MENA economies, and on the other hand geopolitical risks may cloud the outlook. In other words, the geopolitical factors are determinants in the growth prospect of MENA region. As indicated above, the MENA regional economy indicates that overall GDP was expected to expand 2.7% in 2018 while the panel projects growth of 2.9% in 2019. Egypt economy has been the best performer for the year 2018, with a 5.3% expansion. Israel and Morocco are the next in the podium with growth rates above 3.0%. Accordingly, Saudi Arabia has had the weakest expansion due to the lion's share of the OPEC oil production cut in the first half of the year. Yemen's economy contracted for the fifth consecutive year in 2018 due to the continuation of the bloody civil war. Nonetheless, it is expected that higher oil prices would spur economic growth for Saudi Arabia despite its military spending and the war on Yemen.

Moreover, according to an aggregate produced by Focus-Economics, inflation in the MENA region has also increased from 3.9% in May to 4.9% in June 2018. Same source indicates that regional inflation was

something like 4.9% in 2018 while it has been expected to slow to 4.7% in 2019.¹⁵²

More on Egypt, the continuation of Abdel Fattah el-Sisi's structural reforms during the month of April-June has been a significant factor in delivering higher growth and economic good performance of the country. According to the same source, the current account deficit of the country narrowed year-on-year by about 60% for the significant tourist revenues as well as remittance inflows and Suez Canal income. Also the price of gas has gone up by 75% coming to effect in August and should improve the fiscal balance. The above estimate confirms that the Egyptian economy could also grow at a solid pace in 2019.

And finally, on Iran's economic growth, the outlook reflects the looming sanctions. Moreover, there has been some growing sporadic social unrest in 2017 plus a wide-spread deadly protest in 2019 with mounting inflationary pressure that could exacerbate the economic quagmire. Focus-Economics Consensus Forecast panelists see growth at 2.7% in SH 2018 while having a slow one to 0.9% in 2019.

Iran with its geographical size and location in the region and its vast resources including the oil and gas, can and should play a positive role in promoting peace and stability in the region and worldwide. This is while due to claiming the "theological" system of the government, it has so far added fire to the fuel of sectarian wars and conflicts getting accused of political meddling and interference in the affairs of neighboring countries in the region. The country need to use its potential firstly to improve its own infrastructure and build its economy and then to foster peace and stability in the region through engaging in regional cooperation and integration. This was so far the trend and attempt of the country back in early 1970s under the Shah of Iran whose development plans were halted by the emergence of the Islamic Revolution. We will cover more into this and the rest of the MENA region in Part (III) of this dissertation.

In short, what the above numbers and figures elucidate is that institutional reforms within the MENA countries while attempting for regional stability away from conflicts play the priority roles towards the reconstructions of economies in the region. That is why, beyond the institutional change for better in MENA, a great part of the opening chapters of this dissertation attempts to deliver the significance of a new social contract as the key element to solve both domestic and regional issues for the MENA region. Regional growth in 2019 is expected to rise to 1.9% in which domestic policy reforms bolsters regional growth. Iran has been, however, forecast to have 3.6 percent contraction due to the sanctions.¹⁵³

¹⁵² Torné, Ricard; Focus-Economics: p. 5; Retrieved from: (<http://www.focus-economics.com/regions/middle-east-and-north-africa#>).

¹⁵³ The World Bank. Regional Outlooks: Middle East and North Africa, *Global Economic Prospects*, January 2019.

TABLE (3-1): MACRO-ECONOMIC OUTLOOK in MENA

	Real GDP Growth						Fiscal Balance						Current Account Balance					
	%						% of GDP						% of GDP					
	2011	2012	2013	2014e	2015p	2016p	2011	2012	2013	2014e	2015p	2016p	2011	2012	2013	2014e	2015p	2016p
MENA	4.8	5.8	2.9	3.2	3.1	5.2	3.9	5.9	2.7	0.3	-8.0	-6.5	13.0	12.3	9.1	5.8	-5.3	-2.9
Developing MENA	1.1	5.0	0.2	1.6	2.0	6.7	-3.6	-2.9	-6.2	-7.4	-9.1	-6.7	4.5	2.1	0.0	-3.1	-6.8	-4.0
Oil Exporters	5.2	6.3	2.8	3.3	2.8	5.3	6.4	8.9	5.5	2.5	-7.8	-6.0	16.8	16.2	12.4	8.0	-5.1	-2.3
High income MENA (GCC)	7.8	6.3	4.9	4.3	3.8	3.8	12.4	14.7	11.3	7.4	-7.0	-6.2	22.6	22.4	17.8	14.0	-3.8	-1.9
Bahrain	1.9	3.6	5.3	4.0	3.0	3.5	-0.1	-2.6	-3.8	-4.9	-11.9	-11.0	19.2	14.3	14.2	12.9	8.5	7.7
Kuwait	10.4	7.5	2.2	1.6	2.1	2.4	34.4	36.0	31.4	21.1	9.0	15.6	40.9	46.4	41.7	35.6	16.9	22.7
Oman	-1.1	7.1	3.9	4.1	3.7	3.6	7.5	2.5	4.2	-1.0	-16.7	-14.4	16.0	12.6	8.6	2.2	-10.0	-9.5
Qatar	13.0	6.2	6.1	5.9	3.0	3.7	15.4	16.8	14.2	9.7	6.5	0.4	38.9	33.2	25.8	21.2	2.3	5.5
Saudi Arabia	8.5	6.8	5.1	4.3	4.6	4.1	8.3	13.2	8.7	5.7	-16.2	-15.1	19.9	19.9	16.2	12.4	-11.8	-9.8
United Arab Emirates	4.9	4.8	5.2	4.7	3.1	4.0	9.3	9.9	7.2	5.7	-6.2	-4.4	12.2	12.4	7.4	5.7	-5.1	-4.0
Developing Oil Exporters	0.4	6.3	-1.3	1.1	0.9	8.1	-1.5	0.2	-3.7	-5.9	-9.3	-5.6	9.2	7.0	3.7	-2.0	-7.4	-3.0
Libya	-62.1	104.5	-13.6	-24.0	2.0	52.0	-15.4	27.8	-4.0	-43.5	-42.8	2.6	9.2	29.1	13.6	-32.8	-47.3	-1.0
Yemen	-12.7	2.4	4.8	0.0	-2.8	2.8	-5.7	-12.4	-7.8	-8.7	-6.5	-6.4	-2.8	-1.6	-2.9	-1.3	-0.8	-0.4
Algeria	2.8	3.3	2.8	4.1	2.6	3.9	-1.5	-5.0	-1.4	-6.8	-14.9	-11.6	9.9	6.0	0.4	-4.2	-18.6	-15.4
Iran	3.0	-6.6	-1.9	3.0	0.6	1.3	-1.4	-1.9	-2.2	-1.4	-3.4	-3.4	11.0	6.3	7.2	3.6	1.6	1.9
Iraq	10.2	10.3	4.2	-0.5	-1.0	5.5	4.7	4.1	-5.9	-4.9	-10.6	-6.0	12.0	6.7	2.1	-2.8	-8.3	-1.8
Syria	-3.4	-19.5	-20.6	0.5	1.9	...	-12.1	-17.0	-12.9	-10.7	-9.2	...	-14.7	-15.3	-12.6	-12.4	-12.4	...
Oil Importers	2.4	2.7	2.7	2.3	3.9	4.1	-8.5	-9.4	-11.0	-10.1	-8.7	-8.3	-6.1	-7.9	-7.0	-5.0	-6.0	-5.4
Egypt	1.8	2.2	2.1	2.2	4.3	4.3	-9.8	-10.6	-13.7	-12.8	-11.3	-10.5	-2.6	-3.1	-2.1	-0.8	-3.3	-3.1
Tunisia	-1.9	3.7	2.3	2.2	2.6	3.4	-3.3	-5.5	-6.8	-4.8	-4.5	-4.2	-7.4	-8.2	-8.4	-8.9	-8.5	-7.1
Djibouti	4.5	4.8	5.0	6.0	6.5	7.0	-0.7	-2.7	-5.9	-12.0	-14.1	-12.5	-14.1	-20.3	-23.3	-27.4	-27.7	-21.8
Jordan	2.6	2.7	3.0	3.1	3.5	3.9	-12.7	-10.5	-14.1	-13.5	-5.4	-5.1	-10.2	-15.2	-10.3	-7.1	-6.6	-5.2
Lebanon	2.0	2.2	0.9	2.0	2.5	2.5	-6.4	-8.7	-9.5	-7.0	-7.2	-10.1	-10.9	-22.7	-26.6	-22.2	-16.7	-16.1
Morocco	5.0	2.7	4.4	2.6	4.6	4.8	-6.7	-7.4	-5.4	-5.0	-4.5	-3.7	-8.0	-9.7	-7.6	-5.8	-5.0	-4.3
West Bank & Gaza	12.4	6.3	2.2	-0.8	0.9	4.3	-16.9	-15.1	-12.5	-12.1	-14.9	-13.8	-32.0	-23.1	-23.0	-27.7	-26.0	-27.8

Source: World Bank and Economist Intelligence Unit.

3.2- Economic Prospects with a New Social Contract in MENA

Due to the explained regional conflicts, a snapshot of the Middle East and North Africa (MENA) doesn't look very hopeful at a glance but rather reveals a diverse and discouraging picture as to the fact that countries like Syria, Iraq, Libya and Yemen are mired in violent conflicts devastating people's lives while ruining national economies and infrastructure with serious spillovers into neighboring countries including Lebanon, Jordan and Tunisia. The cost of the war in Syria and the emergence of the ISIS have been estimated at \$35 billion in terms of lost output between mid-2011 and mid-2014 (Ianchovichina and Ivanic, 2014).¹⁵⁴ Economic reforms have been on the way in the transition countries of Morocco, Tunisia, Egypt and Jordan slowly albeit in a context of anemic growth, high fiscal deficits and rising youth unemployment.¹⁵⁵

The resource rich countries such as Iran, Iraq and Algeria have been experiencing chronic problems of unemployment with lack of diversification. Obviously a decline in oil prices easily puts pressure on their budgets while adding to the fact that those high-income GCC countries are no better in this regard.

However, a long-term outlook of the region with more regional cooperation gives a different outlook. In other words, a longer-term perspective that is a movie rather than a snapshot shows a homogeneous region having a hopeful future.¹⁵⁶ Most of the countries in the MENA region have been following the same economic pattern of development since their independence in which the state has provided free health and education for all while having food and fuels subsidized amounting to about 10 percent of the GDP. As such the public sector has been the main formal-sector employer and all this has limited citizen's voice in such countries. Besides, this also has made almost all the MENA countries below the regression line in connecting voice and accountability with per capita income. Such development model has been described as an "authoritarian bargain" (Yousef, 2004)¹⁵⁷ or a social contract.¹⁵⁸

It is worth mentioning however, that such pattern of the "common social contract" has delivered positive results in its socioeconomic front. For example during the 2000s, economic growth in the region was

¹⁵⁴ Ianchovichina, Elena; Ivanic, Maros. "Economic impact of the Syrian War and the Spread of ISIS." Policy Research working paper No. 7135; Washington, DC: World Bank Group, 2014.

¹⁵⁵ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. "MENA Economic Monitor: Towards a New Social Contract." The World Bank Middle East and North Africa Region, April 2015, p. 11.

¹⁵⁶ Ibid, p. 12.

¹⁵⁷ Yousef, Tarik M. "Development, Growth and Policy Reform in the Middle East and North Africa since 1950." Journal of Economic Perspectives, Vol. 18, No. 3, Summer 2004, pp. 91-115.

¹⁵⁸ Ibid.

estimated about 4-5 percent a year while poverty rates were also low and declining. It was easy for almost everyone to complete primary school while enrolment rates in secondary and tertiary levels of education i.e. among women were also rising.¹⁵⁹ Moreover, infant mortality declined in MENA and contrary to expectations inequality as measured by conventional indicators such as the Gini coefficient seemed to be lower than other comparable countries elsewhere as it was constant or declining.¹⁶⁰

However, by the late 2000s the above pattern started to change downward. Both high subsidies as well as the public sector wage bills were too much for the government to bear in view of the growing fiscal deficits.¹⁶¹ Unemployment started to rise particularly among the educated class of people with a decline of women labor force participation rate. To avoid their growing even higher, public sector employment slowed down, and the public sector's share in total employment started to decline.

In fact, a clear sign of failure for the social contract in MENA was perhaps the “Arab Spring” revolutions in North African countries such as Egypt, Tunisia as well as Yemen which also triggered political protests in Bahrain, Morocco and Jordan. People called on the streets to demand jobs, dignity and better public services. Concerns about unemployment and quality of education were seen even in countries that had not seen popular protests, such as Algeria, Kuwait and Saudi Arabia. The aftermath of the Arab Spring, however, caused with its turbulence, and in some cases also violence, that investment and hence growth rates to slow. In most cases, unemployment rates have risen in particular for youth and females.¹⁶² And in a broader term as explained in previous chapters the institutional problems also persist to stay on the social and political scene.

All the above indicate that the original social contract in MENA has reached its limits. Within such time frame in between the Arab Spring the private sector didn't grow enough to bear the inefficiencies of the huge public sector. Thus the question arose as to why public services that did a good job in delivering the services during the first generation have failed in bringing about the quality and equity to their societies?¹⁶³

The answer lies in the defective extractive institutions within the majority of political frameworks in MENA countries. And even the private firms under the circumstances cannot bring about the solution to the problem. In a simple term, the problem in this case in MENA is that firstly, not enough young firms

¹⁵⁹ Ibid, p. 13.

¹⁶⁰ To be sure, per-capita income growth was slower, and productivity growth quite weak (Schiffbauer et al., 2015).

¹⁶¹ The World Bank. “MENA Economic Monitor: Towards a New Social Contract.” April 2015, p. 14.

¹⁶² Ibid, p. 16.

¹⁶³ Ibid.

are created, and secondly, most small enterprises stay small or simply die. What remains would be a chain of politically connected firms. Such politically connected firms along with monopolistic industries and a great number of small firms stagnating, together create an equilibrium in which there is no intrinsic impetus for the system to change. In such a circumstance, politicians and their business allies would obviously continue with that system to earn further monopoly profits, while those small firms stay small and the private sector is not capable of creating enough jobs either.¹⁶⁴

In other words, Douglass C. North's "persistent institutional framework" is in place in this scenario to hinder the progress. It is obvious that the chain of the old social contract where government was the main employer has been broken wondering whether the government along with the private sector can replace it with a new one where government would be in position of facilitating a dynamic private sector that can create jobs. To do so, governments ought to do major changes in their policies and practices among which promoting competition within the domestic industries are of significance in order for the young firms to grow and create productive jobs. In other words, establishing a new social contract seems necessary which can follow the process of institutional change as described in Chapter (2). As to the reasons why young firms are not growing, the following factors are given as the root-causes of the problem:

1- *Macroeconomic and regulatory uncertainty*; 2- *Corruption*; and, 3- *Political instability*.¹⁶⁵

As for the first two (regulatory uncertainty and corruption); there are channels by which they would impede firms and therefore affect job growth. The politically connected firms under Ben Ali in Tunisia and Mubarak in Egypt are the best examples where they received preferential treatment including protection from domestic and foreign competition (Rijkers et al, 2014).¹⁶⁶

This is in fact the hidden hands of the extractive political institutions along with the vicious circle of Acemoglu and Robinson as described in *Why Nations Fail*. This has made a corruptive hierarchy of power and trade emerged as the result of the same extractive political institutions that are active. Hence, majority of governments in MENA ought to work on their institutional weaknesses to create a system based on efficient incentives. Otherwise the problem would be seen again chronically as it has been seen particularly in cases of countries such as Iran, Iraq and Syria or Lebanon.

¹⁶⁴ Ibid, p. 19.

¹⁶⁵ Ibid, p. 18.

¹⁶⁶ Ibid, p. 19; referring to: Rijkers, Bob; Freund, Caroline; Nucifora, Antonio. 2014. "All in the Family: State Capture in Tunisia." World Bank Policy Research Paper No. 6810. Washington, DC: World Bank.

Democratic voices in such countries ought to be heard and it should institutionally base civil societies and human rights NGOs with formidable presence to prevent the repetition of the old institutional weaknesses that may easily bounce back on the political and economic scenes. And, to give way to such democratic voices, citizen participation ought to be encouraged and respected so that the state is bound to build up effective institutions. In other words, a new social contract would be designed to play its part for citizenry rights while bringing more freedom and of course responsibility in both private and public spheres. As the result, the outcome would be a more democratic society along with a good system of governance where economic activities could be more transparent based on a proper system of check and balance.

3.3. Conclusion

Obviously the old social contract can no longer deliver the needs of new generations in MENA even though it delivered results in the past. Like before, the public sector can/should no longer be the main employer. Politically connected private sector cannot render any adequate solution to fundamentally create jobs either. And public service delivery has been organized in such a way that citizens in particular the poor ones don't have the possibility to keep providers accountable.¹⁶⁷

Moreover, because of the vicious circle or "low level equilibria", incremental reforms just in one particular area would not be able to dislodge the system. For example, if we improve the quality of education while the job creation is intact, we may not find a way out. What is needed therefore is a series of changes at all institutional levels without having to resort to revolution or nor even "shock therapy."

Put it differently, a new set of changes need to be introduced to define the relationships between citizens and the state; in short a new social contract.¹⁶⁸ And to reach that social contract the best way to start up would be working simultaneously on institutions by commencing the process of institutional change that can affect the economies and social status of the citizens in an incremental fashion. In return, forming the social contract would also have a positive impact on the formation of these institutions thus helping achieve institutional change more swiftly and adequately.

At the first glance, what should such a new social contract look like? Instead of having the public sector

¹⁶⁷ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. "MENA Economic Monitor: Towards a New Social Contract." The World Bank Middle East and North Africa Region, April 2015, p. 21.

¹⁶⁸ Ibid.

as the sole provider of the jobs in society, the spirit of competition in an atmosphere away from corruption ought to be mandated to the private sector while promoting the “equality of opportunities for all entrepreneurs”. This would in fact dictate a new role for both the government and the private sector.

Secondly, it would be better to provide subsidies with targeted cash transfers for everybody instead of free or subsidized low quality public services. Thus, poor people would also be able to have access to the private services that are being exclusively consumed by the non-poor. As well, public expenditures would be used for the purpose of financing public goods including infrastructure and cash transfers.¹⁶⁹

Thirdly, an attempt should be made towards the liberalization and openness of economies in a regional context thus making the region susceptible for a more regional cooperation and integration. Obviously such changes would not happen overnight. Nor should they necessarily look like the same in all countries. For example, countries in conflict will firstly need to resolve the conflict. In other words, the regional conflicts through political or diplomatic means ought to be settled.

Moreover, a strategy like security at all costs would not properly work as it would put the country towards a low-level equilibrium with lower growth. Iran would be a good example to show this case as well as those countries directly involved in conflicts. In fact, changes and reforms should take place in such countries away from any situation destabilizing the country or the region. While *security and stability* might be the short-run priorities for such nations, the need for job creation, poverty reduction as well as better public services would be of paramount importance.

Oil-rich countries in view of their reserves can construct long term plans for incremental change within a longer time horizon. Getting there would not be easy because of persistent institutions, the path independency, and interests in the status quo that would all resist the change. As such, a coalition may be built by reform champions for change mainly because the people in the region are demanding for change, for jobs and better service delivery. After all the philosophy behind the Arab Spring was that the peoples’ voices would be heard.

Accordingly, in case of the MENA region, the purpose of the old social contract has been served.¹⁷⁰ Solving the long standing political and economic problems in the Middle East and North Africa region (MENA) would seem quite difficult without embarking on a new social contract. In view of the fact that

¹⁶⁹ The World Bank. By Devarajan, Shatayanan; and Mottaghi, Lili. “MENA Economic Monitor: Towards a New Social Contract.” The World Bank Middle East and North Africa Region, April 2015, p. 21.

¹⁷⁰ Ibid, p. 22.

many countries in MENA have been able to deliver substantial progress to their citizens within the framework of the old social contract, they prove to be able to do the same with the new social contract as well.

Only after taking the above serious and progressive steps, we may feel an odor of amity and cooperation in the region with the hope of creating better ties towards economic prosperity under the banner of regional cooperation and deeper integration. This latter would be the main subject of this dissertation throughout the coming chapters as we delve into it with more details.

The Part (I) of this dissertation illustrated the significance of Civil Society and the necessity to reach a new set of social contract susceptible to the needs and aptitudes of the regional societies in MENA. Then the importance of “institutions” and the necessity of “institutional change” to reach that destiny were stressed so as to achieve an adequate social contract. What offered here is in fact a logical step-by-step incremental change of institutions as the key component of success and development through which the goal of attaining a proper social contract can be achieved along with emerging regional cooperation and integration that are to be elaborated more in the chapters to come.

In fact, once the above steps have been taken, in a tranquil atmosphere away from today’s regional conflicts and civil wars; regionalism would be the flickering light of hope at the end of the tunnel for a stronger cooperation and deeper integration to be the voice resounding security and hope in reaching out to a harmonious region filled with peace and prosperity. These are mainly the subjects of the upcoming Chapters. But in the next step, the best would be firstly to learn from other regional experiences, and to that effect, an overall global outlook is presented on integration as a solution by rendering some major examples that include legal aspects of economic integration within MERCOSUR, NAFTA, ASEAN, and AFRICA that all comprise the second part of this dissertation.

PART (II): INTEGRATION

The Regional and Global Outlook

Introduction

- **Chapter Four (4): MERCOSUR and NAFTA**
- **Chapter Five (5): ASEAN**
- **Chapter Six (6): AFRICA**

Introduction

The underpinning of a successful integration would take some parameters which have been presented in the previous chapters (PART I). That is, achieving a proper and formidable social contract in case of the countries in MENA while working on institutions and institutional change coupled with political will. In fact, as mentioned before, these two processes complement each other paving the ground for economic integration under the banner of political cooperation within a regional context.

According to Balassa (1961)¹⁷¹ economic integration takes place when discrimination within an area is abolished.¹⁷² And Kahnert et al (1969)¹⁷³ deem economic integration as *the process of removing progressively those discriminations which occur at national borders*. Accordingly, measures that can merely diminish discrimination between and among the countries would be considered some forms of cooperation and not necessarily integration.

Moreover, Lipsey (1960, p. 496)¹⁷⁴ has defined economic integration or the theory of customs union as *that branch of tariff theory which deals with the effects of geographically discriminatory changes in trade barriers [among countries]*.¹⁷⁵

This is while according to Machlup (1977)¹⁷⁶ integration is simply defined as the process in which separate economies are combined into one larger economic region. Moreover, Machlup (1977) and Staley (1977, p. 243)¹⁷⁷ argue that *integration is concerned with the utilization of all potential opportunities of efficient division of labor*.¹⁷⁸

The work of Balassa (1961) can be indeed considered as the cornerstone of any work that has been done in the area of integration. Economic integration can take several forms. Balassa (1962)¹⁷⁹ introduces four

¹⁷¹ Balassa, Bela. "TOWARDS A THEORY OF ECONOMIC INTEGRATION," *Kyklos*, Vol. 14, Issue 1, 1961, pages 1-17.

¹⁷² Hosny, Amr Sadek. "Theories of Economic Integration: A Survey of the Economic and Political Literature." *International Journal of Economy, Management and Social Sciences*. May 2013. P. 133.

¹⁷³ Kahnert, F. "Economic Integration Among developing countries." Development Center of the Organization for Economic Co-operation and Development, 1969.

¹⁷⁴ Lipsey, R.G. "The Theory of Customs Unions: A General Survey." *Economic Journal*, 70 (1960), 496-513. Retrieved from: <http://dx.doi.org/10.2307/2228805>

¹⁷⁵ Hosny, p. 133.

¹⁷⁶ Machlup, Fritz. "A History of Thought on Economic Integration." Palgrave Macmillan, London, 1977.

¹⁷⁷ Staley, Charles E. "Review of A History of Thought on Economic Integration." by Fritz Machlup; *Annals of the American Academy of Political and Social Science*, 1977, pp. 242-243.

¹⁷⁸ Hosny, p. 133.

¹⁷⁹ Balassa, B. "The Theory of Economic Integration." Allen Unwin, London, 1962.

different stages of economic integration. They are defined according to the level of their depth in integration that is firstly *Free Trade Area (FTA)*, then a *Customs Union (CU)*, then a *Common Market (CM)*, and finally an *Economic Union*. For the first form of economic integration (FTA) the terms *Preferential Trade Agreement*, *Preferential Trade Area*, or *Preferential Trade Arrangement* have been used as well.¹⁸⁰

In Preferential Trade Arrangements (PTAs) lower trade barriers are taken into consideration among participating members in contrast with those of non-members. According to Panagariya (1998¹⁸¹, p.2; and 2000¹⁸², p.288) PTA is in fact an arrangement between two or more member countries where goods produced within the union of such members would face lower trade barriers than the good produced outside of such union. An example of such PTA would be the eight Muslim countries of the Developing 8 Organization for economic cooperation.¹⁸³

A Free Trade Agreement (FTA) is a PTA where no trade barriers are imposed on goods (zero tariffs) by member states within the union. However, each member country would keep its own tariff barriers to trade vis-a-vis non-members. This is usually referred to as “trade integration”. The North American Free Trade Agreement (NAFTA) would be a good example of trade integration which has been formed by the United States of America, Canada, and Mexico in 1993. More specifically, paragraph (8) of article (XXIV) of the GATT defines a free trade area as follows:

"For the purposes of this Agreement:

(b) A free-trade area shall be understood to mean a group of two or more customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories."

quoted from Par.8, art. XXIV, GATT

“A *Customs Union (CU)* is an FTA in which member countries apply a common external tariff on a good imported from outside countries. This common external tariff can, of course, differ across goods but not across union partners.”¹⁸⁴ One of the most famous examples for Customs Union would be the European Community (EC), formed in 1957 by West Germany, France, Italy, Belgium, the Netherlands, and

¹⁸⁰ Hosny, p. 134.

¹⁸¹ Panagariya, Arvind. “The Regionalism Debate: An Overview.” University of Maryland, 1998.

¹⁸² Panagariya, Arvind. “Preferential Trade Liberalization: The Traditional Theory and New Developments.” *Journal of Economic Literature*, Vol. 38, No. 2, June 2000 (pp. 287-331).

¹⁸³ Hosny, p. 134.

¹⁸⁴ *Ibid.*

Luxembourg. More specifically paragraph (8) of article (XXIV) of the GATT defines a Customs Union as follows:

"For the purposes of this Agreement:

(a) A customs union shall be understood to mean the substitution of a single customs territory for two or more customs territories, so that (i) duties and other restrictive regulations of commerce are eliminated with respect to substantially all the trade between the constituent territories of the union or at least with respect to substantially all the trade in products originating in such territories, and,

(ii) subject to the provisions of paragraph 9, substantially the same duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union"

quoted from Par.8, art. XXIV, GATT

A *Common Market* (CM) is in fact a CU in which more free movement of labor and capital are allowed among member nations that is referred to as the "factor integration". For example, The European Union achieved the status of a CM at the beginning of 1993.

And finally, the most advanced form of economic integration is called the *Economic Union* in which there is a harmonization or unified feature of the monetary and fiscal that is referred to as "policy integration". A Monetary Union (MU) would be considered as the extreme case of an Economic Union. And again a good example for the policy integration would be the countries of the European Union who use the EURO as their single currency.

To survey the gains from economic integration, Amr Sadek Hosny introduces two kinds of approaches as: 1) *Static Effects of Economic Integration*, and 2) *Dynamic Effects of Economic Integration*.¹⁸⁵ Viner's study was the first one to establish robust criteria in order to show the difference between the advantages and disadvantages resulting from economic integration.¹⁸⁶

In Static effects according to Viner (1950)¹⁸⁷ what matters is the emergence of trade creation and trade diversion. In short trade creation occurs when trade flows are redirected as the result of forming the free trade area or customs union. Trade diversion is the case in which trade is rather diverted from a more efficient exporter to a less efficient one as the result of a free trade area or customs union.

When discussing regional integration, what needs to be considered and discussed is that whether there is a

¹⁸⁵ Hosny, Amr Sadek. "Theories of Economic Integration: A Survey of the Economic and Political Literature." *International Journal of Economy, Management and Social Sciences*, May 2013, P. 135.

¹⁸⁶ Viner's book titled "The Customs Union Issue." As follows:

¹⁸⁷ Viner, Jacob. "The Customs Union Issue." Carnegie Endowment for International Peace, New York, 1950.

value added from the regional integration for the member states i.e. whether there is enough scope for trade creation. We know from regional trade theory that there is little scope for the trade creation, but large scope for trade diversion if the economic structure of the member states are very different (e.g. one industrial country, one agricultural country). In this case, regional integration economically would make no sense. And we know from empirical research that there is strong case for trade creation when the economic structures of the countries concerned are similar. For example, Germany and France are both car producers and export cars to other countries by specializing on specific varieties of the product “car”.

However, there might be a problem if the economic structures are too similar. If, for example, two countries are specialized on mineral oil as a homogeneous product, it is then difficult to imagine how these two countries could benefit from trade creation. Nonetheless, when we discuss the overall benefits from an economic integration, the argument on trade creation and trade diversion should not encompass everything. There are other political factors that ought to be salient in a long run and within its regional context. Hence, according to Amr Sadek Hosny a second approach is also introduced that is the dynamic analysis. Within Balassa’s dynamic theory of economic integration, the static analysis proved not to be enough to explain or fully capture welfare gains as the fruit of economic integration.¹⁸⁸

In other words, the static effects (Viner’s) is referred to as “old regionalism,” where as “new regionalism” (introduced by Paul Krugman who won the Nobel Prize for this new research) is more represented by dynamic effects in which we have new parameters including investment flows, increased competition, technology transfer, economies of scale, as well as improved productivity.¹⁸⁹ According to Goldstein (2002, p. 11);¹⁹⁰ integration agreements encompass much more than what is called as reducing tariffs and quotas. In short, the current driving integration may be enumerated as follows:

- 1- Economies of Scale, 2- Investment Creation and Investment Diversion, 3- Increasing importance of Private Sector Participation or involvement, 4- Increased importance of Services, and; 5- Increased importance of Foreign Direct Investment.¹⁹¹

Thus, according to the above new criteria or so called “new regionalism” or “second wave of regionalism” it may be argued that economic integration theories are considered irrelevant (especially

¹⁸⁸ Hosny, Amr Sadek. “Theories of Economic Integration: A Survey of the Economic and Political Literature.” *International Journal of Economy, Management and Social Sciences*. May 2013. Pp. 138-139.

¹⁸⁹ Ibid.

¹⁹⁰ Goldstein, Andrea. “The New Regionalism in Sub-Saharan Africa: More than meets the eye?” OECD Development Center Policy Brief no. 20, France: Organization for Economic Cooperation and Development, 2002.

¹⁹¹ Hosny, pp. 139-140.

those of the Viner period) when it comes to the case concerning developing countries.¹⁹² It is perhaps because Balassa theoretical literature mainly deals with customs union among developed nations where economic development is not the main issue unlike the case of developing countries. Studies undertaken by Meier (1960)¹⁹³, Abdel Jaber (1971, p. 256)¹⁹⁴, and Andic and Dosser (1971, p. 25)¹⁹⁵ confirm that the Viner analysis of economic integration is not considered quite relevant to the case of developing countries.¹⁹⁶

Moreover, Meade (1955)¹⁹⁷ admired but also criticized Viner's notion of trade diversion in which misallocation of the world's resources may occur as the result of a customs union. Accordingly, he argues that such assertions could be true under an inelastic demand and completely elastic supply. As such if the demand becomes more elastic, Meade concludes despite trade diversion, a customs union may actually increase the volume of trade. Meade named this "trade expansion" and believes this should be also added to the traditional Viner analysis of trade creation and diversion, as he believes under this new situation, the trade diversion after all "may not be that harmful."¹⁹⁸

Furthermore, some studies also show that trade diversion may actually be beneficial particularly in case of developing countries (Bhambri¹⁹⁹ 1962, p.245; Demas²⁰⁰ 1965, p.87-88; Chou²⁰¹ 1967, p.354; and Sakamoto²⁰² 1969, p.297). Accordingly, it can be beneficial because firstly, it may act to enlarge the size of the market thus helping reduce costs as the result of economy of scale. And secondly, a higher proportion of foreign exchange may be spent on imports of capital goods within the integrated area thus contributing to the level of growth and investment (Linder²⁰³ 1966, p. 39, Sakamoto 1969, p.283, and

¹⁹² Ibid, p. 140.

¹⁹³ Meier, Gerald M. "Effect of a Customs Union on Economic Development." *Social and Economic Studies*, March 1960, pp. 29-36.

¹⁹⁴ Abdel-Jaber, Tayseer. "The Relevance of Traditional Integration Theory to Less Developed Countries." *Journal of Common Market Studies*, Vol. 9, Issue 3, Sep. 1970, pp. 254-267.

¹⁹⁵ Andic (F.), Andic (S.) & Dosser (D.). "A Theory of Economic Integration for Developing Countries." *University of York, Studies in Economics*: London: Allen and Unwin, 1971.

¹⁹⁶ Hosny, p. 140.

¹⁹⁷ Meade, J.E. "The Theory of Customs Unions." Amsterdam, North Holland, 1955.

¹⁹⁸ Hosny, p. 136.

¹⁹⁹ Bhambri, R.S. "Customs Unions and Underdeveloped Countries." *Economia Internazionale*, May 1962.

²⁰⁰ Demas, William G. "The Economics of Development in Small Countries with Special Reference to the Caribbean." Montreal: McGill University Press, 1965.

²⁰¹ Chou, Yu-Min. "Economic Integration in Less Developed Countries: The Case of Small Countries." *Journal of Development Studies*, 1967, 3 (4): 352-373.

²⁰² Sakamoto, Jorge. "Industrial Development and Integration of Underdeveloped Countries." *Journal of Common Market Studies*, 1969, 7 (4): pp. 283-304.

²⁰³ Linder, S.B. "Customs Union and Economic Development in Latin American Economic Integration." Edited by Miguel S. Wionczek. New York: Praeger, 1966.

Axline²⁰⁴ 1977, p.85). Another argument asserts that trade diversion “will allow consumers to purchase imports at lower prices after the removal of tariffs, thus increasing consumer surplus.” This claim may have special importance and relevancy to developing countries where mostly are dependent upon tariff revenues as one of the main sources of their government revenue.²⁰⁵

What is presented here, therefore, would be an attempt in embossing the need for a development perspective in particular for the case of developing nations such as the ones in our study, the MENA region. According to this new perspective, a number of studies argue that economic integration in case of the developing countries should be considered as an approach in which development is placed in the core part of the project and not as merely a tariff issue. (Andic, Andic and Dosser 1971, p. 25; Abdel Jaber 1971, p.256; Balassa and Stoutjesdijk²⁰⁶ 1975 p.45; Axline 1977, p.83; and Khazeh and Clark²⁰⁷ 1990, p.317).

Moreover, according to Robertson (1970, p.771)²⁰⁸ when reviewing Kahnert et al (1969)²⁰⁹ he has well argued that integration theory is mainly about the benefits gained as the result of better resource allocation, whereas development as the core part of our perspective mainly deals with the benefits acquired out of *faster growth in the long run and the employment of idle or under-utilized resources*.²¹⁰ And in the case of our study, the MENA region that mainly consists of developing countries, the issue of development should be the prime objective, and reaching a sustainable development should be considered as the priority in the political agenda for which regional integration can act as an effective impetus.

Alan Matthews in his article also argues that when it comes to developing countries; regionalism will bring about benefits through net trade creation as long as it is associated with a significant degree of *trade liberalization* where the main objective is tuned towards *reducing cost-creating trade barriers* away from

²⁰⁴ Axline, Andrew W. “Underdevelopment, dependence, and integration: the politics of regionalism in the Third World.” Cambridge University Press, 1977, Vol. 31, Issue 1.

²⁰⁵ Hosny, Amr Sadek. pp. 141-142.

²⁰⁶ Blassa, Bela; and Toutjesdijk, Ardys. “Economic Integration among Developing Countries.” Journal of Common Market Studies, 1975.

²⁰⁷ Khaze, Khashayar; and Clark, Don P. “A Case Study of Effects of Developing Country Integration on Trade Flows: The Andean Pact.” Journal of Latin American Studies, 1990; 22 (2): pp. 61-85.

²⁰⁸ Robertson, David. “Review of Economic Integration among Developing Countries.” By F. Kahnert et al. International Affairs, 1970, 46 (4): pp. 771-772.

²⁰⁹ Kahnert, F. P. Richards, E. Stoutjesdijk, and P. Thomopolous. “Economic Integration among Developing Countries.” Paris, Development Center of the Organization for Economic Co-operation and Development (OECD), 1969.

²¹⁰ Hosny, Amr Sadek, p. 141.

simply wasting resources.²¹¹

In case of the MENA region, similar to other regional examples of success, the political determinants of economic integration ought to be salient along with economic development. In other words, political and economic institutions should develop hand in hand to deliver the objective of success as also discussed in previous chapters in accordance with *Why Nations Fail*. In other words, other non-economic factors should also be considered in the integration processes for the MENA region.

Such political determinants in fact would act as incentives of economic integration. The kind of political will that would create the atmosphere susceptible for regional cooperation is in fact the indispensable part of the process. Moreover, different political regimes and institutions would obviously face more difficulty in forming PTAs. According to Mansfield and Milner (1999, p. 607)²¹² a “substantial institutional heterogeneity” is needed for the PTA to succeed.²¹³ Again, as discussed earlier, this is where the role of a new social contract in case of MENA would be apparent that can create the kind of heterogeneity needed for regional integration.

Furthermore, Haas and Schmitter (1964, p.713-720)²¹⁴ also linked the political and economic factors of integration together. Their studies also confirm that the political factor should favorably exist alongside of the economic factor in order for an economic integration scheme to survive and succeed.²¹⁵

Legal and institutional systems should also act towards a successful integration processes. Sometimes a shallow integration may not work where after the agreement the countries simply change the tariff as “borders barriers.” In this case, a deep integration would be required through which further change in other barriers may take place like *reconciling different national practices with common rules and supra-national implementation mechanism*.²¹⁶ In accordance with Lawrence (1997, p.24)²¹⁷, De Rosa (1998,

²¹¹ Matthews, Alan. “Regional Integration and Food Security in Developing Countries.” FAO 2003, Rome, Executive Summary(Vii).

²¹² Mansfield, Edward D. and Milner, Helen V. “The New Wave of Regionalism.” International Organization, Cambridge University Press, 1999, 53 (3): pp. 589-627.

²¹³ Hosny, p. 152.

²¹⁴ Haas, E., & Schmitter, P. “Economics and Differential Patterns of Political Integration: Projections about Unity in Latin America.” International Organization, Cambridge University Press, 1964, 18 (4): pp. 705-737.

²¹⁵ Hosny, p. 153.

²¹⁶ Ibid, p. 147.

²¹⁷ Lawrence, Robert Z. “Preferential Trading Arrangements: The Traditional and The New.” Chapter 2 in *Regional Partners in Global Markets: Limits and Possibilities of the Euro-Med Agreements*. Edited by Ahmed Galal and Bernard Hoekman; Center for Economic Policy Research (CEPR) and the Egyptian Center for Economic Studies (ECES), 1997.

p.47),²¹⁸ Ethier (1998, p.1152),²¹⁹ Panagaria (1998, p.43), and Pomfret (2005, p.8-10)²²⁰ these national practices may include competition and tax policies, investment policy, administrative procedures, product standard and labor or environmental standards.²²¹ Interestingly, De Melo and Panagaria (1993, p.17)²²² also state that this second wave of regionalism or “new regionalism” has an additional focus upon the *coordination of the whole legal and institutional setup in member countries of a union*.

Overall, what is certain to say is the significant growth of regional integration during the past decades with the increasing number of Regional Trade Agreements (RTAs) within the global spectrum. As we witness this growing numbers of regional integration arrangements toward global development in the world economy, regional integration is considered the key indicator on the trend of global change.

According to the WTO assessment, and as shown in Figure (II-A); from 1948 up to January 2018; the number of regional trade agreements (RTAs) was 669 of which 455 have been in force and effective. More in details, such an effective number of RTAs includes 251 free trade agreements, 151 associated with economic integration agreements, 30 related to Customs Union, and 23 to some other agreements. In addition, according to other sources such as the World Trade Statistical Review 2017; interestingly 58% of the world trade has been made only by the EU, NAFTA, and ASEAN.²²³

The above growing numbers reaffirm the asserted claim that it is incumbent upon the MENA countries to more actively participate in the process of regionalization through regional arrangements such as PTAs or bilateral agreements, while establishing a new framework as described for their social contract. This can be coupled with the commencement of the process of institutional change within their national and regional policies and practices. As prescribed the two pillars of development namely *institutions* and *social contract* can be reinforced by adequate policy of regionalism through deepening integration processes to be aligned with the global trend of development.

²¹⁸ De Rosa, Dean A. “Regional Integration Arrangements: Static Economic Theory, Quantitative Findings, and Policy Guidelines.” Background Paper for a World Bank Policy Research Report entitled Regionalism and development, 1998.

²¹⁹ Ethier, Wilfred J. “The New Regionalism.” *The Economic Journal*, 1998, 108 (449): pp. 1149-1161.

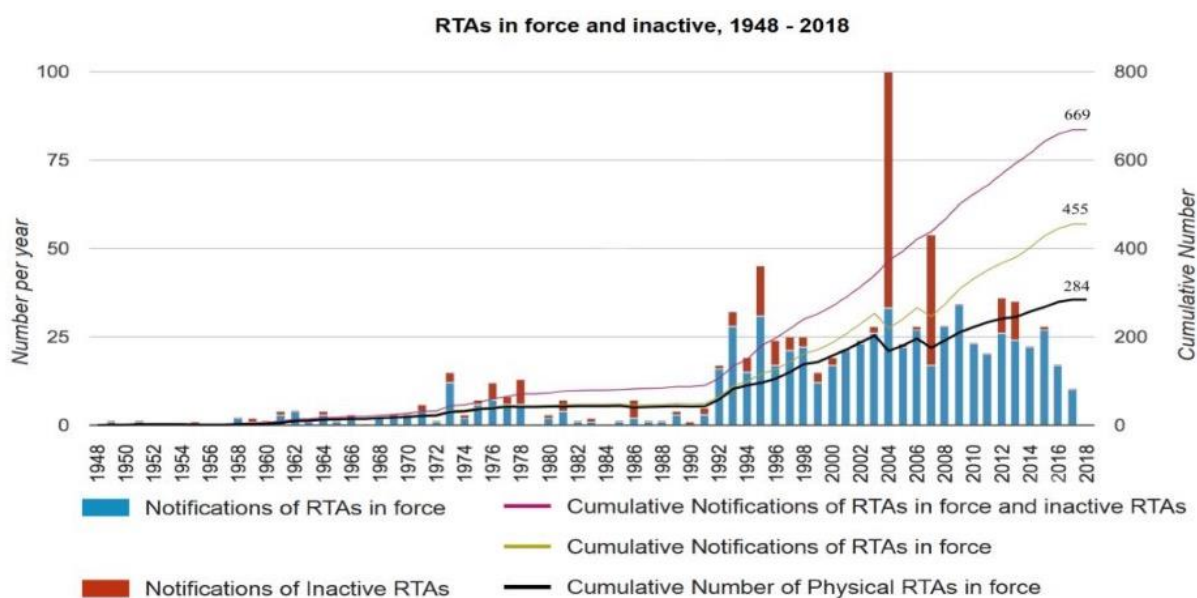
²²⁰ Pomfret, Richard. “Regional Trade Agreements.” Working Paper 2005-15. School of Economics, University of Adelaide, Australia, 2005.

²²¹ Hosny, P. 147.

²²² De Melo, Jaime; Panagariya, Arvind; Rodrik, Dani. “The New Regionalism : A Country Perspective.” Chapter 6 in *New Dimensions in Regional Integration*, edited by Jaime De Melo and Arvind Panagariya, Policy, Cambridge University Press, 1993.

²²³ Luzina T.V. & Dudareva E.A. & Akhmetshin E.M. & Yankovskaya, V.V. “The International and Legal Framework for Transregionalization of Trade and Economic Cooperation of the BRICS Countries.” *European Research Studies Journal*, 2018, pages 167-168.

Figure (II-A): Growth of Regional Trade Agreements in the World, 1948-2018



Source: Regional trade agreements (<http://rtais.wto.org/UI/charts.aspx>.)

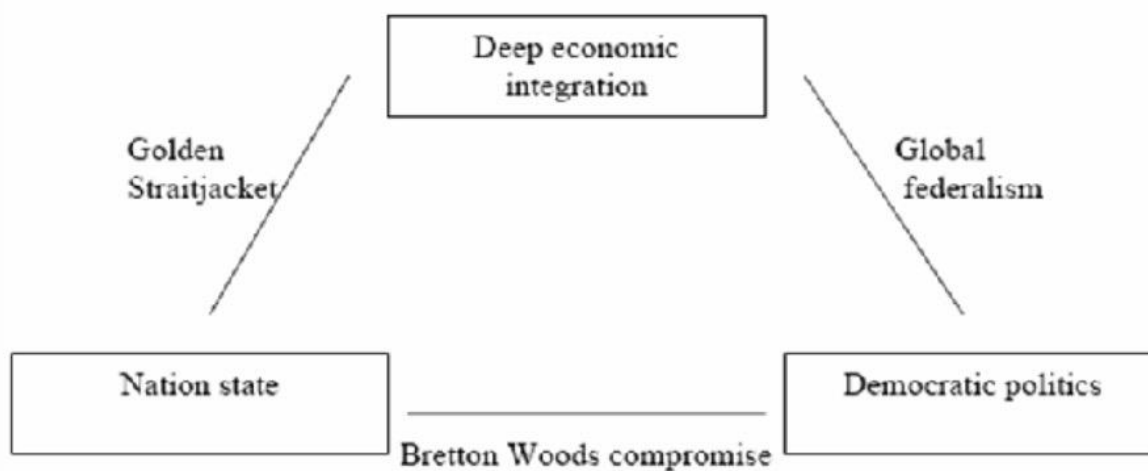
On the other hand, the limits and boundaries to the global integration is well illustrated in Dani Rodrik's analysis. In his work titled *The Globalization Paradox: Democracy and the Future of the World Economy*, Rodrik presents the linkage between the political and economic factors in a simple and straightforward manner. Through his triangle trilemma, he well depicts how the degree of *integration* (economic globalization), *democracy*, and the status of *nation-state* need to be balanced. As such, the three apexes of his triangle in fact show as to how economic and political factors should be managed and progressed.

Dani Rodrik is in fact trying to establish how the tension between national democracy and global markets can be managed. The political trilemma of the world economy as shown in the following Figure (II-B) states that we have basically three options. "We can restrict democracy in the interest of minimizing international transaction costs, disregarding the economic and social whiplash that the global economy occasionally produces. We can limit globalization [lowering the deep economic integration], in the hope of building democratic legitimacy at home. Or, we can globalize democracy, at the cost of national sovereignty."²²⁴ Rodrik is therefore suggesting a "smart globalization" by which regional integration in conformity with that of global integration can be managed so as to enhance national democracies while improving national institutions and protecting their social arrangements and well-crafted regulations.²²⁵

²²⁴ Rodrik, Dani. "The Globalization Paradox: Democracy and the Future of the World Economy." Oxford University Press, 2011; Chapter 9 (The Trilemma): pp. 200-201.

²²⁵ Ibid, pp. 205-6.

Figure (II-B): The Political Trilemma of the World Economy



The above simple analysis gives a guiding menu as how to manage the options for reconstruction of the world economy. According to this menu, our desires to further deepening integration, or expanding democracy, or establishing more formidable nation-state paradigm at home need to be managed and controlled. In other words, we cannot achieve hyper-globalization, democracy, and national self-determination all at once. At most we can have two out of three. If we choose any two to acquire the maximum result, at best it would be at the cost of the third element. For example, if we choose deeper integration (hyper-globalization) and democracy, then we need to give up on the nation state. And in case we want to keep the nation state with hyper-globalization, then democracy would be sacrificed.

In case of a regional integration (i.e. in MENA), all these three categories of the trilemma would be of paramount importance and therefore to reach the balance, the policies and strategies at macro level should be attuned to manage such conflict within the context of a regional cooperation. This cooperative atmosphere can create the ground for the MENA countries to focus on their priorities based on their national and regional preferences. Since the issues to be discussed are mainly common concerns among the countries of the region, a consensus in accordance with the peculiarities of MENA would not be difficult to reach provided that political will for cooperation would be actively apparent aiming to solve or deter the regional conflicts and tensions that seem to be the incumbent priority for such intended regional cooperation or integration scheme in MENA.

Before getting into more analysis on the MENA region that is the main focus of this dissertation, in this Part (II) of my thesis, a general outlook is presented on integration from a global perspective by studying

different regional attempts mainly in three continents of the world being Americas (MERCOSUR and NAFTA), Asia (ASEAN) and, AFRICA. They include some major legal aspects of integration as adopted or intended for each case, by which some experienced lessons can be learned to pave the ground in creating an adaptable model for the MENA region in the course of this empirical analysis.

Chapter (4): MERCOSUR and NAFTA

4.1. MERCOSUR

MERCOSUR is composed of Argentina, Brazil, Paraguay, and Uruguay. It was entered into force on March 26 1991, when these countries signed the treaty of Asuncion. Since then, Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela have been added as associate members. MERCOSUR and the Association of Southeast Asian Nations (ASEAN) are currently the two largest PTAs in the developing world.

The Law of MERCOSUR is the title of a book by four editors that relatively has a thorough look at the issue of regional integration for the Latin America's bloc, MERCOSUR (also known as MERCOSUL; Mercado Comun del Sur, the Common Market of the south) that is one of the most important regional economic integration processes in the world. A glance at its four founding member states (Argentina, Brazil, Paraguay, and Uruguay) reveals that these member-countries comprise some of the most important economies in the western hemisphere i.e. Brazil being the eighth largest economy in the world and Venezuela (as associate member) is the leading oil and gas producer.

Political and legal facts show that MERCOSUR has been created in 1991 on a model like that of the European Union which is argued by now to be much closer to the achievement of a common market than many believe. They initially had an ambitious view in taking such model to achieve deep regional integration. However, the lack of established institutions in delivering the kind of supranational character needed for deeper integration like that of the European Union, has created a challenge for the southern bloc to progress likewise.

More specifically, among the reasons that have hindered the successful progress of MERCOSUR like that of the EU, as a model that was considered as an "ambitious undertaking" for Latin America, we may refer to three factors first being the difficulties that existed on the way of different economic policies as adopted by each country; secondly, the nationalistic feelings that existed in respect to such policies; and finally the overall picture of *institutional instability* that existed in the region.²²⁶

Nonetheless, there have been some political, social as well as economic factors that lead to the creation of MERCOSUR while realizing some shared values among the countries in the bloc along with

²²⁶ De Klor, Adriana Dreyzin. "The Legal-Institutional Structure of MERCOSUR." The Law of MERCOSUR, HART Publishing, 2010, p. 31.

“democratization” that existed among the South American nations which also played an important part. Regional integration has been used as an effective tool in promoting trade along with evolving commercial links within RTAs particularly in the last two decades. In case of the developing countries, national trade policies have been determined through such trade agreements which have been able to amplify the impact of trade upon development.²²⁷ Such aim has also been in the core of an attempt when shaping MERCOSUR. For that objective the MERCOSUR Fund was established for structural convergence.

The MERCOSUR Fund which was inspired by the model of the EU tries to reduce asymmetries among the member states as well as within each individual member by taking each region into account in a distinct manner.²²⁸ An ideal that has not even been fully accomplished in case of the European Union itself! In fact, it has been a *large step towards creating a less member State-centric MERCOSUR* thus paving the ground for a deep integration by creating more supranational identity; an ideal that may look distant from the realities of the countries in Latin America. Despite a long history of Latin American integration, what we see in practice is rather a poor record.²²⁹ The main reason can perhaps be explained through the institutional analogy given by Acemoglu and Robinson²³⁰ comparing institutions derived from the Spanish colonial powers taking the region with those of English conquerors in North America.

As explained earlier, institutions are considered as the most important elements that connect the past to the present thus forming the structure of history that greatly matters in Douglass North assumption. Initially two main colonial powers ruled the Latin America region on the Iberian Peninsula. The Spanish crown then dominated the territory dividing it into two parts, then into four and successively into dozen regions thus leading to the establishment of the nineteen independent, Spanish speaking states that exist today as Latin American countries.²³¹

The leaders of the war of independence tried to nurture a natural unity for Latin America, a myth that had many upheavals towards the ultimate goal of restoring it. Simon Bolivar, one of these leaders despite calling for two Pan-American congresses in 1819 and 1826 failed to bring about that unity to the region. Almost two centuries later similar attempts were failed as such having the Pan-American movement waned resulting in more realistic project of the regional integration. The first serious attempt to promote

²²⁷ DiCaprio, Alisa; Santos-Paulino, Amelia U.; Sokolova, Maria V. “Regional trade agreements, integration and development.” UNCTAD Research Paper No. 1, July 2017, p. 5.

²²⁸ Filho, and Lixinski, and Giupponi. “The Law of MERCOSUR.” Introduction, p. 5.

²²⁹ Malamuc, Andres. “The Law of MERCOSUR.” p. 23.

²³⁰ Acemoglu and Robinson. “Why Nations Fail: The Origins of Power, Prosperity and Poverty.” 2012.

²³¹ Malamuc, Andres. “The Law of MERCOSUR.” The Origins of Mercosur, p. 23.

such regional integration took place in 1960 with the emergence of the Latin American Free Trade Association (ALALC, Asociacion Latinoamericana de Libre Comercio). Some years later it was replaced by the Latin American Integration Association (ALADI, Asociacion Latinoamericana de Integracion)²³² even though better but with unremarkable results.

And finally with the treaty of Asuncion in 1991 MERCOSUR was created bringing together Argentina, Brazil, Paraguay and Uruguay. In their initial phase the Treaty mainly focused on economic and commercial matters instead of referring to political institutions or social actors.²³³ As we stated earlier economic and political institutions need to progress parallel with each other to deliver fruitful results.

The institutional skeleton and juridical backbone of MERCOSUR have been formed mainly by the Treaty of Asuncion and the Protocol of Ouro Preto along with their constituting protocols.²³⁴ Their content primarily deals with economic integration while their form includes organizational structure. Unlike the European Union, they don't deal with highly progressed aspects of integration such as democratic decision-making, regional citizenship, or social cohesion.²³⁵

MERCOSUR was in fact a resistant force vis-à-vis neo-liberalism with its "US-prompted hemisphere free trade area." Therefore practically speaking, it has been considered as a tool for promoting social objectives rather than economic goals. Hence, the aim is to have a strong "political MERCOSUR" that can stand on the way of neo-liberal approach. Pushing towards the above political objective is the argument suggesting that social and representative objectives of integration should be taken to the fore ahead of its trade and investment aims.²³⁶ Such attempts have been made including further participation of the civil society along with the establishment of a regional parliament.

In addition to the four founding members of MERCOSUR and Venezuela, there are five countries with Associate-Member status. These countries are Bolivia, Chile, Colombia, Ecuador, and Peru. Moreover, there have been some attempts for placing MERCOSUR on track towards deeper integration. For instance, the introduction of IIRSA (Initiative for the Integration of South American Regional Infrastructure) in 2000, the creation of a Committee of Permanent Representatives in 2003, the foundation

²³² ALALC and ALADI comprised the 10 Latin American countries of South America plus Mexico and Cuba.

²³³ Malamuc, Andres; p. 25.

²³⁴ They are the Protocols of Brasilia (establishing a system for dispute settlements as signed in 1991), The Protocol of Ushuaia (establishing a democratic clause and signed in 1998), and the Protocol of Olivos (establishing a permanent court for appeals as signed in 2002).

²³⁵ Malamuc, p. 25.

²³⁶ Ibid, pp. 25-26.

of a permanent Court of Appeals in 2004, the establishment of FOCEM (Fund for MERCOSUR Structure Convergence) in 2005, and the creation of a regional parliament in 2006 seem to be steps in that direction.

At the same time a more strident project would be that of the Union of South American Nations (UNASUR). It is worth mentioning that in view of all its upheaval history, MERCOSUR has reached a turning point: it either consolidates its institutional and normative framework while recovering its *raison d'être*, or it keeps its high-profile yet irrelevant political banner to merely survive. As expressed by Monnet, its operation looks like *grands mots, petits effets* (speak grandiloquent words yet to achieve small effects).²³⁷

4.1.1- The Legal-Institutional Structure of MERCOSUR

Adriana Dreyzin De Klor,²³⁸ a former legal consultant to the MERCOSUR Secretariat, in her article on structure of MERCOSUR stresses on the necessity for a change as a political movement within the bloc. Accordingly, it is important to realize the political circumstances that lead to the creation of regional integration processes. In this context, it is worth mentioning that democratization for example, among the South American nations played an important part in firstly shaping a reflection of the ordinary citizens' wishes to live freely and; secondly in having institutional support for both the internal as well as external democratic mechanisms.²³⁹

After all, the aim of the Treaty of Asuncion (TA) was to create efficiency and productivity along with comparative advantages of the region while creating the awareness within the regional governments to achieve a common culture to reach the agreed just outcomes. Therefore, it is important to realize that the main goal of the TA (Treaty of Asuncion) has been to present the quality of a framework agreement that is designed like a *platform* for launching the bloc.²⁴⁰

According to De Klor, several factors of political, social and economic nature simultaneously existed for the creation of MERCOSUR leading us to believe that *democracy* is indeed the key element in the creation and development of the regional integration of the bloc. Hence, it is noteworthy that democracy should be considered a necessary condition for the development of regional integration. Of course, other

²³⁷ Malamuc, Andres; pp. 26-27.

²³⁸ De Klor, Adriana Dreyzin. "The Legal-Institutional Structure of MERCOSUR." In *The Law of MERCOSUR*, p. 29.

²³⁹ *Ibid.*

²⁴⁰ *Ibid.*, pp. 33-34.

factors also played a role including difficult scenarios such as inflation and unemployment that pushed the countries to converge towards a regional integration.

However, in case of MERCOSUR, the processes of integration give a picture showing that they mainly focused on the economic aspects and as such the treaty of Asuncion played a key role in the establishment of the bloc, but as mentioned other elements should also exist in parallel for it to succeed. The TA had of course such a quality of a framework agreement to act as a platform to launch the bloc, nonetheless, the political will and perseverance of the members helped eventually create the bloc. In fact it was not merely a solution to the regional problems but an inevitable cause for it. Nonetheless, the will and common philosophy was there as well. Ouro Preto Protocol was the legal instrument that bestowed the legal personality upon MERCOSUR, yet the “intergovernmental system” as dominated the bloc hindered the progress of the integration processes.

Moreover, the TA has had the role of giving a legal personality to MERCOSUR so that the organization’s existence would be recognized *apart from its Member States*. This independent association has been created by the member states presenting *a legal person in public law, authorized to own property and to impose obligations on its Member States*.²⁴¹ This definition in fact, paves the way towards a supranational identity for the bloc, which can take place in the course of time depending on the other political, economic and social factors.

Furthermore, the designated organic structure of MERCOSUR is set out in the TA which was then retained and amplified by the POP (Ouro Preto Protocol). Accordingly, the first article of Chapter 1 of the POP (‘Structure of MERCOSUR’) lists the following institutions:

- (1) **The Council of Common Market (CCM)** (Consejo Mercado Comun); which is the superior governing body of the bloc doing the functions of political conduct and decision making.
- (2) **The Common Market Group (CMG)** (Grupo Mercado Comun); CMG is the executive governing body of MERCOSUR and the most authoritative organ of the bloc.²⁴² Playing a central role in sub-regional integration, its key functions are: **a)** to monitor the completion of signed treaties, **b)** to take necessary measures to ensure the incorporation of Decisions adopted by the CCM, **c)** to propose concrete means to achieve the implementation of the commercial

²⁴¹ De Klor, Adriana Dreyzin. “The Law of MERCOSUR.” p. 38.

²⁴² It is composed of four members and four alternate members from each country, to be appointed by the respective governments.

liberalization program, the coordination of macro-economic policies and the negotiation of agreements, **d)** to formulate work programs in order to promote the advancement of the common market.²⁴³

- (3) **The MERCOSUR Trade Commission (MTC)** (Comision de Comercio del MERCOSUR) which is treated as a governing body of intergovernmental character that was created with the main objective of *assisting the executive body of MERCOSUR (CMG)*. Its core function is to monitor the implementation of the instruments adopted for the common commercial policies.
- (4) **The Joint-Parliamentary Commission (CPC, Comissao Parlamentar Conjunta)**; the parliamentary governing body appears in the founding agreement under the sub-heading 'General Dispositions' with the objective to facilitate the advancement of the common market.
- (5) **The Socio-Economic Consultative Forum (FCES, Forum Consultivo Economico y Social)**; the governing body representing social and economic sectors of the MERCOSUR Member States. It has consulting functions and acts through recommendations to the CMG. And;
- (6) **The administrative Secretariat of MERCOSUR** (Secretaria Administrativa del MERCOSUR); which was intended to be the second most important executive governing body of MERCOSUR (after the CCM).²⁴⁴

One interesting fact to mention is that in the creation of the organizational structure for MERCOSUR or in African integration as we will see in Chapter 6, the body of such structures looks quite modern on which a model like that of the European Union has been adopted. Nonetheless, in practice due to the lack of proper inclusive institutions that should exist in both political and economic spheres, such associations do not render the kind of achievement as expected. Hence, proper institution-formation ought to be nurtured while working on the actual structure-formation of such organizations even though the latter by itself has been of course an important process in creating a disciplinary corner-stone when shaping the bloc.

In case of MERCOSUR, with all such governing organs it seems Member States have not been able to fully delegate to supranational governing bodies like that of the EU model. Nevertheless, the creation of a

²⁴³ Ouro Preto Protocol: Arts 13 and 14.

²⁴⁴ De Klor (The Law of Mercosur); p. 39.

Permanent Review Court in introducing supranational elements to the bloc can be marked as a strongly-based structure to review MERCOSUR's governing bodies by the legislative and judicial authorities that by itself as a legally progressive step can promise a hopeful future. However, according to De Klor, the degree of such supra-nationality in practice is under question as it needs further analysis.²⁴⁵ The attempts to reach any integration in its regional context shows a well-suited institutional environment should be created within the member states to integrate.

Regional integration is overall considered a tool that is capable of bringing about the *consolidation and democratic politics*.²⁴⁶ In case of MERCOSUR, it seems TA has proved to be a good start but still the bloc is highly dependent on the Member States, which makes it difficult to choose representatives for the bloc, or to establish an independent judiciary like that of the European Union. Under the present scheme, failing to create adequate supranational bodies with effective decision-making powers, the current institutional structure has in fact created more confusion while limiting the power of the Secretariat.²⁴⁷

Accordingly, the *institutionalization of the bloc* is the main issue that needs particular attention on the side of the founding members of the bloc. Furthermore, having political will is another necessary element to overcome the current "unsatisfactory state of affairs" while looking at integration from a positive glance to generate benefits. Moreover, away from rhetoric, serious actions need to be taken in consistent with the spirit of the Treaty of Asuncion and all that is necessary for the creation of a common market. As such, the TA can remain as the building-block of MERCOSUR, that is to be considered the main criteria for the advancement of the bloc.

Parallel with these lines explained above, Giupponi²⁴⁸ sees the Southern Cone (MERCOSUR) as a "New Legal Order" and the Treaty of Asuncion (TA) as a "New Legislative Order". Yet, accordingly, the lack of supremacy of the MERCOSUR laws due to its intergovernmental structure seems problematic. The sources of law in MERCOSUR are defined within two categories of *primary sources of law* and *secondary sources of law*.²⁴⁹

Article 41 POP (Protocol of Ouro Preto) identifies the sources of MERCOSUR law that include the Treaty of Asuncion (TA), its protocols as well as the additional or supplementary instruments all together defined as the primary sources of MERCOSUR community law. More specifically they include the TA

²⁴⁵ Ibid, p. 53.

²⁴⁶ Ibid.

²⁴⁷ De Klor, Adriana Dreyzin. "The Law of MERCOSUR: The Legal-Institutional Structure of MERCOSUR." p. 55.

²⁴⁸ Giupponi, Maria Belen Olmos. "Sources of Law in MERCOSUR." In *The Law of MERCOSUR*, 2010, p. 57.

²⁴⁹ Ibid, pp. 57-58.

(1991), POP (1994), Brasilia Protocol (1991), the Olivos Protocol (2002), and the protocol establishing the MERCOSUR parliament (2005).²⁵⁰

In addition, MERCOSUR secondary sources of law include the following:

- 1) **Decisions** adopted by the CCM which are to pursue the aim of harmonizing national laws within a certain area or introducing legislative change.²⁵¹
- 2) **Resolutions** that are adopted by the CMG and are binding on all Member States.²⁵²
- 3) **Directives** which are different from those of Decisions and Resolutions in that they regulate specific technical issues that may not to be incorporated i.e. having a self-executing nature. In accordance with Article 20 POP; *Directives are binding on all Member States.*²⁵³

As previously mentioned despite existence of such legal-institutional structure in MERCOSUR, the heavy burden of inter-governmentalism has shadowed the low level of MERCOSUR's institutionalization and regional integration. According to Susani,²⁵⁴ the role of tradition and ideologies has been apparent in the course of creating the integration processes. The leaders of the four founding MERCOSUR well realized that in the early nineties a real economic integration could follow the process of the institutionalization. In fact, unlike the functionalist theory to their view *institutionalization is considered as a lever of economic integration.*²⁵⁵

Having all this said, I believe the establishment of MERCOSUR parliament is an important step even though as expressed by Maria Giupponi the nature of the legislative powers of the parliament is still uncertain. Yet, the improvement of MERCOSUR community law towards a greater level of supra-nationality in order to achieve a "common legal order" for a deeper integration is suggested.

Through the Olivos Protocol, the Permanent Review Court was established which was an important step

²⁵⁰ *Ibid*, p. 59.

²⁵¹ *Ibid*, p. 62.

²⁵² www.sice.oas.org/trade/mrcsrs/resolutions/indice.asp

²⁵³ Giupponi, Maria Belen Olmos. "Sources of Law in MERCOSUR." In *The Law of MERCOSUR*, 2010, p. 63.

²⁵⁴ Susani, Nadine. "Dispute Settlement"; *The Law of MERCOSUR*, p. 74.

²⁵⁵ Susani, Nadine, "Dispute Settlement." *The Law of MERCOSUR*, p. 74 (For Ernst Haas who has adapted Mitrany's theory, integration can only be a process in which 'States cease to be wholly sovereign ... merge and mix their neighbors so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflicts between themselves. EB Haas, 'The study of Regional Integration: Reflections on the Joy and Anguish of Pretheorizing' (1970).

with two main functions; firstly being in charge of making decisions as the last resort on legal issues, and secondly being in charge of rendering consultative opinions. This is in fact a procedure that opens a path to ensure “the effective and uniform application of community legislation” while preventing divergent interpretations within MERCOSUR.²⁵⁶

Through Olivos Protocol that replaced the Brasilia, Member States decided to initiate a deeper degree of integration by going further towards “the unification of MERCOSUR jurisprudence.”²⁵⁷ For example article 10 of the Olivos Protocol enjoins the ad hoc arbitration court which is of significance. In fact, the authors of the Protocol tried to improve the previous protocol (Brasilia) by giving it a more judicial character. Nevertheless, in comparison with that of the European Union, its efficiency is much lower as the European Court of Justice has the capacity to order a penalty upon a member state for non-compliance with the court’s judgements.²⁵⁸ In other words, the MERCOSUR system has created more difficulties for enforcement. The current mechanism under article 27 and 30 of the protocol don’t entail an effective enforcement but eventually exert some political pressure on the responsible state to comply.

Nonetheless, it is worth mentioning that the consultative opinion proceedings play a positive role in giving a uniform interpretation of MERCOSUR law (Art. 2 and 3 of the Olivos Protocol). Although the consultative opinions lack compulsory force (that has negative effects), yet at least they may promote the law observance while raising legal questions. Even though this type of proceedings may be assessed “far from perfect,” it would be considered a progressive step in establishing a dispute settlement mechanism adapted to the integration process.²⁵⁹ Such mechanism may be adapted in the future as they progress.

4.1.2 Economic Freedoms; MERCOSUR, WTO, and International Law

Within the realm of economic integration, the freedom of movement of goods is considered an essential element forming the economic constitution of a competitive market economy-oriented.²⁶⁰ To attain such freedoms, it takes more than just eliminating customs, as in fact any other direct or indirect trade restrictions need to be eliminated so called the removal of non-tariff barriers.

²⁵⁶ Ibid, p. 75.

²⁵⁷ Ibid.

²⁵⁸ Susani, Nadine; p.80; referring to Article 228(2) EC.

²⁵⁹ Ibid, p. 85.

²⁶⁰ Fuders, Felix. “Economic Freedoms in MERCOSUR.” *The Law of MERCOSUR*, p. 88; referring to “PC Mueller-Graff, ‘Vorbemerkungen Art 28-31 EG.’”

Article 1 of the TA sets out the fundamental concept of a common market in the southern cone and compared to the EU treaty, it has a general connotation concerning the free movement of goods, persons, capitals and services (production factors). According to the art.1 and 2 of the TA, such economic freedom is established through: 1-The elimination of Customs duties, 2- Non-tariff trade barriers, and 3- by provisions of equal impact.²⁶¹ Moreover, Article 1, paragraph 2 of the Treaty of Asuncion plays a key role as a component that is in support of macro-economic policy.²⁶²

Even though freedom of movement of workers is not explicitly mentioned in the TA, Article 1 of the Treaty however, is addressing all the production factors of the required free movement including both capital and labor. The freedom of movement for workers is not very developed in case of MERCOSUR which is not a surprise, because even in the case of the European Union there has been only some recent achievement over true freedom of cross-border movement of workers.²⁶³

Article 5 of the TA sets out in more details “the Trade Liberalization Program” managing the tariff cuts and harmonization of macro-economic policies among the states parties. Article 5 of the TA is in fact an attempt “to establish a common market by the means stated in article 1 of the Trade Liberalization Programme” that encompasses “the abolition of customs, non-tariff trade barriers and measures having an equivalent effect” while adding a fourth obligations that is: “the abolition of all other restrictions amongst Member States.”²⁶⁴

Some policy suggestions caught my attention for such economic freedom including “the alignment of education systems” as a common education policy among the members that can contribute to the realization of the freedom of labor mobility within MERCOSUR. Even though the economic freedom is emphasized through the treaty of Asuncion (TA), maintaining the “Public Order” is among the exemption priorities which are stressed in Art. 50 of the Treaty of Montevideo (as also recognized in Art. 14 GATS).

Samantha Moura Ribeiro in her article²⁶⁵ points out that despite the Doha Development Round and the Uruguay Round (establishing the WTO) the subject of development as stated in the Preamble of its Constitutive agreement, which should be in the core of attention, has been rather forgotten concerning the developing countries in the day-to-day practice of the world trade system. Furthermore, such provision is

²⁶¹ Fuders, Felix, p. 88.

²⁶² Ibid, p. 101.

²⁶³ Fuders, Felix. “Economic Freedoms in MERCOSUR.” *The Law of MERCOSUR*, p. 106.

²⁶⁴ Ibid, pp. 88-89.

²⁶⁵ Ribiero, Samantha S. Moura. “MERCOSUR and the WTO: A Review of the Relations in the International Trading System.” *The Law of MERCOSUR*, 2010. p. 131

not practically sufficient for promoting fundamental rights and/or enhancing development.²⁶⁶

Generally speaking she is referring to the conflicts that exist between multilateral and the regional agreements and in particular between the WTO and MERCOSUR. On the one hand, since there is no hierarchy in international law, such agreements should all have the same weight and as such, regional arrangements exercise some degree of autonomy, yet on the other hand, the fact that such regional agreements have to be approved by GATT/WTO, gives the impression of subordination relation with respect to WTO which is supreme (two approaches which reminding the dualist and monist approach in International Law and Relations). Nonetheless, the Protocol of Olivos (PO) has a choice clause in article 1(2) which allows a member state “to resort to the MERCOSUR system for the settlement of disputes or to a different mechanism to which it is a party²⁶⁷ ...”

However, when it comes to dispute settlement mechanism, in practice WTO has in fact *compulsory and exclusive jurisdiction to rule on complaints that evoke WTO law*, and this gives a more definite nature to the Dispute Settlement Body (DSB) of the WTO. By explaining two case studies among MERCOSUR member states, Ribeiro is trying to show this conflict between the WTO’s DSB and that of MERCOSUR’s as there is a weaker enforcement mechanism in the latter compared with the former. Accordingly, in these two instances, WTO Dispute Settlement Body adopted a position of supremacy with no deference or respect towards MERCOSUR ruling and this can be problematic for MERCOSUR development (Case 1: The Poultry Disputes, and Case 2: The Retreaded Tyres Disputes).

Hence, she is well encouraging the ‘Solange method’ as was created by the German Federal Constitutional Court (BVerfG) and used in the EU at times to maintain this balance and respect. This model, as she believes, contributed to the protection of Human Rights within the EU and might play a positive role in contributing the citizenry rights in accordance with the rule of law while rendering a constitutional protection of participatory, deliberative and cosmopolitan democracy. This as an example also reveals as to how law can serve the purpose of establishing a social contract. As such, the Solange method by which -German Constitutional Court was in fact acting within judicious bounds- is arguably part of the international rule of law.

All this is to re-emphasize that beside WTO Preamble and article XXIV GATT, the values and principles of the rule of law and human rights ought to be taken into consideration as well as the application of the

²⁶⁶ *Ibid*, p. 132.

²⁶⁷ *Ibid*, p. 135.

Vienna Convention on the law of Treaties (i.e. its Preamble), along with the UN Charter (i.e. article 1). Such kind of balancing of trading preferences and exceptions should also be foreseen for the MENA region even though it looks difficult at the first glance yet certainly feasible in a long run.

Unlike Ribeiro who was looking at the nuts and bolts of the disparity between WTO and MERCOSUR, Franca Filho is of the belief that “regionalization and globalization are two convergent and complementary phenomena.”²⁶⁸ To support his argument he refers to the rising number of regional trade agreements notified to the WTO in recent years. Although I agree that regionalism can be a “stepping stone” for further global partnership, I don’t see these two phenomena necessarily symmetrical as for example the founders of MERCOSUR were seeking for a united front against the liberalization and globalization era of 80’s and 90’s as their initial objective. Such stepping stone in their view has been in contradiction with that of globalization pattern as we go along. Yet, I acknowledge that the mutual interaction between regionalism and globalization is necessary and constructive for both to progress effectively.

From the point of Public International Law, MERCOSUR was endowed with the legal personality in accordance with article 34 of the Ouro Preto Protocol while detailing its rights and duties under international law according to art. 35 and 36 (Chapter II of the Protocol) enabling the bloc to enter into external relations with a legal capacity.²⁶⁹ As the result, Filho refers to such relations extended to other economic blocs including the EU. Nonetheless, he also points out that the political trends in the EU-MERCOSUR negotiations have been bearing the opposite perspectives and thus hindering the expansion of relationship. Such slow progress with the EU, lead to the diversification of trade relations with other partners around the world including the Cooperation Council for the Arab States of the Gulf (GCC), ASEAN, as well as the ALADI²⁷⁰ Member States, along with the deepening of South-South diplomacy establishing better ties with and within developing countries. We will cover more on the EU-MERCOSUR agreement in the following sections (4.1.4).

Moreover, two main reasons are detected which hampers the progress of new partnerships in the international sphere for MERCOSUR. One can be stressed as MERCOSUR’s lack of institutional development and second the excessive intergovernmental structure of MERCOSUR that politically

²⁶⁸ Filho, Marcilio Toscano Franca. “External Relations.” In *The Law of MERCOSUR*, p. 147.

²⁶⁹ *Ibid*, p. 148.

²⁷⁰ The Latin-American Integration Association (ALADI) is an intergovernmental organization that continues the process started by the Latin-American Free Trade Association (ALALC) in 1960 and promotes the integration expansion in the region, in order to guarantee its economic and social development. Its final goal is the establishment of a Latin-American common market.

prevents the separation of the will of MERCOSUR from that of the individual member states. In other words, unlike the EU, such a structure hinders reaching a supranational institution within MERCOSUR. And this would weaken the position of the bloc as a relevant actor or global player on the international scene beyond any sheer factor of economic nature.²⁷¹

And, on development as the main goal that multilateral and regional organizations aim to promote, I would like to argue that this idea of MERCOSUR Fund for Structural Convergence (FOCEM),²⁷² which has proved to be a successful and helpful scheme, can furnish a good example for the MENA region. As suggested by Shahrokh Fardoust, a mini-marshall plan is needed to give a jolt for the development as an effective movement towards deeper economic integration in the MENA region.

In case of MERCOSUR, FOCEM is designed to foster the development and structural convergence of less favored regions within the bloc. Such idea was successful in the EU too, because they pursued a higher and exquisite aim to establish a common market that is to achieve *a harmonious development of economic activities* within their region; whereas in MERCOSUR, reaching the common market was the main goal expecting it to bring development and social justice; a sheer idealistic approach.

In FOCEM, larger countries are responsible for a bigger share of the budget (i.e. Argentina and Brazil 27 and 70 percent respectively); an idea that can be considered for the asymmetries in MENA. Yet, as mentioned, a successful model for such movement would be the European Regional Development Fund (ERDF) which had a prominent role in the EU project of integration and can provide lessons for the experience in MERCOSUR as well as MENA. Having such fund of support would be important because in such a scheme the correction of the regional imbalances would be considered to help the continuation of the regional integration and achieve its success. Therefore, establishing such Fund would be necessary or effective for completing the integration project.

4.1.3 MERCOSUR; Comparative Regionalism

In this section, I would like to present a fundamental study approach through comparative regionalism. What follows is mainly an analysis incorporating my contemplation by reference to the books Why

²⁷¹ Filho, Marcilio Toscano Franca. "External Relations." *The Law of MERCOSUR*, p. 163.

²⁷² A MERCOSUR Structural Convergence Fund (FOCEM, its Spanish acronym) was recently created (2005) to spur cooperation and integration among the four full members (Argentina, Brazil, Paraguay and Uruguay) and to increase support for the lesser developed economies.

Nations Fail²⁷³ as well as Douglass North's on institutions.²⁷⁴

It seems there is not much of rich literature on comparative works in respect to MERCOSUR. In Chapter 9 of the book *The Law of MERCOSUR*,²⁷⁵ the authors try to take such comparative analysis between MERCOSUR and other economic blocs. They conceive two preconditions for integration efforts; one "the presence of traditional rivalries" (cases of France and Germany in Europe, or Brazil and Argentina in Latin America), and secondly "the presence of a market failure (post-war Europe market reconstruction, and debt crisis for Brazil and Argentina).

In the case of Latin America, Malamud distinguishes the role of presidents in creating and shaping the integration efforts and cooperation.²⁷⁶ Whereas in ASEAN for example "security reasons" played the key role in establishing the bloc, while the objective of a Free Trade Area in case of NAFTA was the main factor in which multinational firms had a strong footstep in its formation. NAFTA and MERCOSUR represent a hierarchical model of integration with an asymmetrical power relations having two major powers like the US and Brazil, whereas in ASEAN and APEC no dominant power exist and they are not all democratic.²⁷⁷

Hardt gives a comparative analysis between Europe and South America in which the European political structures are full of "shared values and norms" unlike MERCOSUR that is filled with political disunity, and differences in values and norms they seek to promote. I wonder if this asymmetry can be historically rooted in the defected process of institutionalization by the colonial powers in Latin America as explained in "Why Nations Fail" and North's book on Institutions?! The question is if the origins of such institutions are the same and if we attribute the current economic "failure" to the historically ill-planned institutions in Latin America, then why the domestic institutions have grown and remained heterogeneous between MERCOSUR member states so as to hinder the process of a successful integration?!

The solution I see however, retains in pursuing cooperation towards making homogeneous institutions in

²⁷³ Acemoglu, Daron; and Robinson, James A. "Why Nations Fail: The Origins of Power, Prosperity and Poverty." Crown Publishing, N.Y. 2012.

²⁷⁴ North, Douglass, C. "Institutions, Institutional Change and Economic Performance." Cambridge University Press, 1990.

²⁷⁵ De Lombaerde, Philippe; Matteis, Frank,; and Van Fraechem, Charlotte. "MERCOSUR Compared." *The Law of MERCOSUR*, Chapter 9, p. 165.

²⁷⁶ Ibid, referring to: "A. Malamud, 'Presidentialism in MERCOSUR: a Hidden Cause for a Successful Experience' in F Laursen (ed), *Comparative Regional Integration: Theoretical Perspectives* (Aldershot, Ashgate, 2003) 61, 66; A Malamud, 'Presidential Diplomacy and the Institutional Underpinnings of Mercosur: an Empirical Examination' (2005) 40 *Latin American Research Review* 140."

²⁷⁷ *The Law of MERCOSUR*, pp. 170-171.

a regional sense even though there could exist the cultural heterogeneity between member states (the case of the EU) unlike in MERCOSUR where we have more of cultural homogeneity and common language.

De Lombaerde and Pineda regrouped the data for the most important regional integration processes in the world.²⁷⁸ In general, they concluded that the Andean Community, the G-3 and MERCOSUR have the highest level of cultural homogeneity. Within NAFTA and the European Union there are significant cultural distances between the Member States. The European Union is the regional integration process with the highest level of bilateral cultural distances. In other words, European Union has the highest level of heterogeneity.²⁷⁹ This, in a way confirms the point addressed in *Why Nations Fail* that “Culture” cannot necessarily serve as a criterion for economic success.

On the social construction of regional integration, Duina²⁸⁰ believes that market building stands as a process of social construction. And in that process the difference among legal systems within a region is important. Accordingly this process can be brought into alignment through standardization, and law would be considered as the primary tool for such standardization at the regional level. I would like to add that it is not just the law but rather successful implementation and enforcement of the law that matters the most in practice. In this process of market building the problem of “cognitive dissonance” which is inherent in the differences among the legal systems widens the difference in standardization, and Duina has a constructivist explanation for this difference. As such, rich national legal systems might create serious barriers to trade, which can be removed by harmonization of legal systems in view of achieving a rather rich regional legal system, the choice which was supported by many regional groups in the EU and MERCOSUR. This would be in fact considered as an alternative method to remove non-tariff barriers to trade as was the case for the European Union. In other words, mutual recognition of legal norms can be taken into consideration bearing in mind that both of such methods would have specific effects on coping with Rodrik’s trilemma of globalization. There is a limit to such liberalization.

Furthermore, in case of MERCOSUR which has relatively a low level of institutionalized integration, regionalization policies can stimulate real economic integration. In different terms the role of institutions are existent here too. According to Mattli, two conditions play the key role in the success and

²⁷⁸ De Lombaerde, Philippe; Matteis, Frank,; and Van Fraechem, Charlotte. “MERCOSUR Compared.” *The Law of MERCOSUR*, p. 173; referring to “De Lombaerde and Pineda, ‘Diferencias culturales e integracion economica regional’ (n 45) 143.”

²⁷⁹ *Ibid*, 145-146.

²⁸⁰ *MERCOSUR Compared (The Law of MERCOSUR)*, p. 177; referring to “FG Duina, *The Social Construction of Free Trade* (Princeton, NJ, Princeton University Press, 2006), (n 80), 4.”

sustainability of regional integration;²⁸¹ one is the role of political leaders in their willingness for such success²⁸² and second having an undisputed strong leader presence among the group of countries (i.e. the case of Germany for the EU, even though it swings between a “problem solver” and a “too strong partner” as argued by some in the EU).

Brazil could do a similar job for MERCOSUR, yet Shams identifies “insufficiently implemented and coordinated economic policies and reforms as the main impediments to dynamic integration.”²⁸³ Then we may conclude that corresponding and coherent macro-economic policies need to be implemented in the southern regional integration processes. For instance the absence of supra-nationalism, and coordinated monetary policies impede regional monetary integration like that of the EU in other parts of the world.²⁸⁴

The fact is that political issues that encompass a great institutional impetus in the southern cone were not addressed in the Treaty of Asuncion since the participants worried that these issues could generate friction and derail the agreement. This would of course render a lesson in case of MENA which we will discuss in the next part of this dissertation. As aforementioned, the institutional weakness is a problem. Various observers have argued that MERCOSUR needs to do a better job of *coordinating and regulating the macroeconomic policies* of Member States if the organization is to meet its objectives.

4.1.4. The EU-MERCOSUR Agreement

Beyond intra-regional integration processes, international agreements between regional blocs can directly serve global integration. The EU-MERCOSUR agreement that was reached in 2019 is one of such accords. This free trade agreement between the European Union and MERCOSUR is in fact part of a wider association agreement which is currently under negotiation. After twenty years of negotiations the current deal was announced at the 2019 G20 Osaka Summit bearing in mind that the final texts are yet to be finalized, signed or ratified meaning that it is not entered into force yet. According to the agreement, the EU and Mercosur four states—Argentina, Brazil, Paraguay, and Uruguay—could in principle reach a

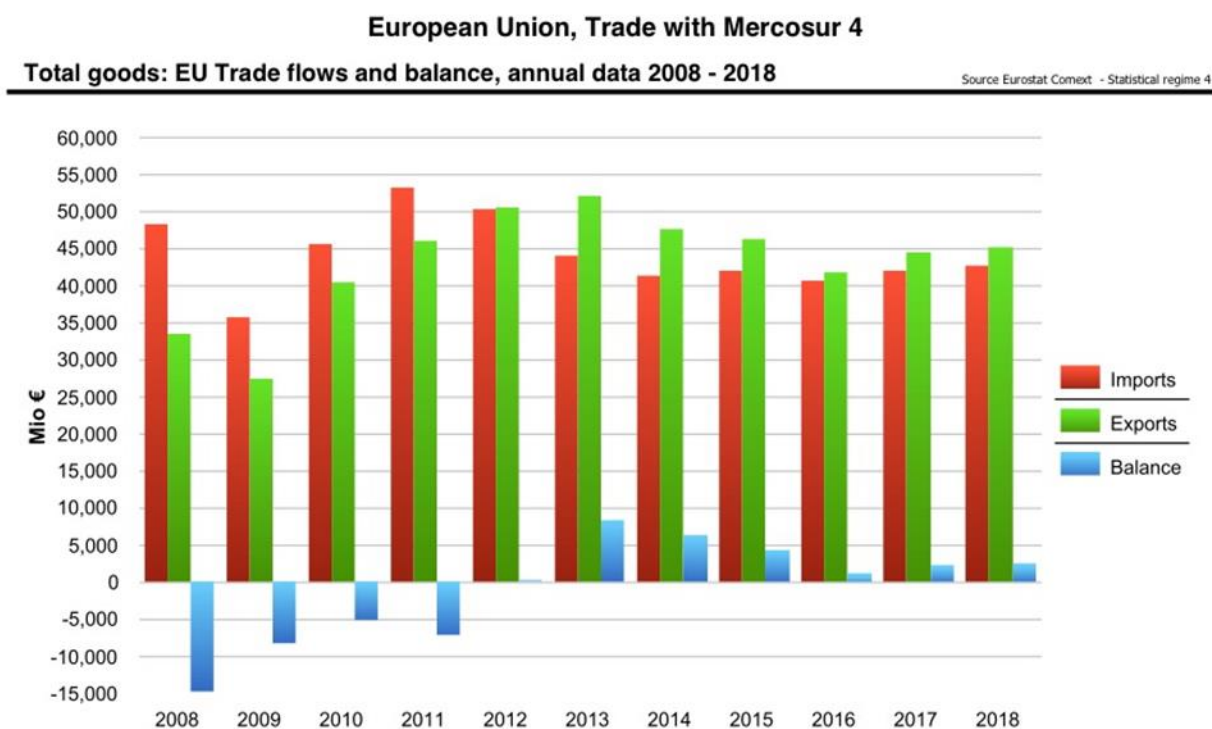
²⁸¹ De Lombaerde, Philippe; Matteis, Frank; and Van Fraechem, Charlotte. “MERCOSUR Compared.” *The Law of MERCOSUR*, p. 185; referring to “Mattli, *The Logic of Regional Integration* (n 5).”

²⁸² Political leaders when having power are unlikely to deepen integration; economic difficulties can be a motive.

²⁸³ De Lombaerde, Philippe; Matteis, Frank; and Van Fraechem, Charlotte. “MERCOSUR Compared.” *The Law of MERCOSUR*, p. 186; referring to “R Shams, “Regional Integration in Developing Countries: Some Lessons Based on Case Studies,” *HWWA Discussion Papers* 251 (2003).”

²⁸⁴ *Ibid* (MERCOSUR Compared), p. 186; referring to “PB Kenen and EE Meade, *Regional Monetary Integration* (Cambridge, Cambridge University Press, 2008”).

Figure 4.1.4. European Union Trade with MERCOSUR Four Member Countries



political agreement for a balanced, ambitious and comprehensive trade agreement.²⁸⁵ Currently trade relations between the two blocs are based on an Inter-regional Framework Cooperation Agreement that was entered into force in 1999.²⁸⁶ Accordingly, the EU is considered as the number one trade and investment partner for MERCOSUR and it is also the second biggest trade in goods partner representing for example 20.1% of MERCOSUR's total trade in 2018. Moreover, the total exports of the EU to the four MERCOSUR countries amounted to 45 billion Euros while MERCOSUR's total exports to the EU were 42.6 billion Euros in 2018²⁸⁷ (Figure 4.1.4.).

As shown in the above Figure (4.1.4),²⁸⁸ the EU trade flows and its balance of trade in respect to MERCOSUR have modestly increased for the periods 2008-2018. It reflects a positive balance of trade for the EU from year 2012 on. The above mentioned agreement between the EU-MERCOSUR can consolidate such trend towards further enhancement of trade for the both blocs.

Despite all the advantages of the EU-MERCOSUR agreement, there are still some concerns within strong

²⁸⁵ <http://ec.europa.eu/trade/policy/in-focus/eu-mercosur-association-agreement/>

²⁸⁶ <https://ec.europa.eu/trade/policy/countries-and-regions/regions/mercosur/>

²⁸⁷ Ibid.

²⁸⁸ http://webgate.ec.europa.eu/isdb_results/factsheets/region/details_mercosur-4_en.pdf

agricultural sectors including France and Ireland thus leaving the deal at risk of being rejected or not ratified by the European Parliament. The above two countries in particular are worried of the surge that can come from South America over beef imports. Nonetheless, most leaders rather defend the deal because according to the European Commission, the deal has the potential to increase access to European firms that are making industrial products and cars which are currently subject to 35% tariffs. Accordingly, such firms would be able to compete for public contracts within the MERCOSUR countries. Likewise, in case of the four MERCOSUR member countries, the deal could be beneficial as it can increase their exports of beef, poultry, sugar, as well as other farm products.²⁸⁹

Moreover, the EU-MERCOSUR agreement can create a market for nearly 800 million people for goods and services amounting for almost one quarter of the world's gross domestic products. It would also reduce tariffs, as duties on EU exports to MERCOSUR would be cut by 4 billion Euros a year. It is considered as the biggest and "first sweeping trade agreement" signed by MERCOSUR since its inception in 1991.²⁹⁰ The deal can eliminate tariffs on 93 percent of exports to the EU while granting "preferential treatment" for the remaining 7 percent. Plus, the increase access for the South American bloc to the European market is the big advantage. Slashing of duties on cars or car parts, chemicals, machinery and textile are considered as the most important wins for Europe in addition to improved market access for the European wine and cheese.²⁹¹

Overall, as depicted, in view of the high potential on trade between the two blocs, what can be concluded is that if the EU-MERCOSUR agreement is ratified, it would represent the largest trade agreement struck by both the European Union and MERCOSUR in terms of citizens involved. And this would be considered as a big fruitful benefit that can be reaped as the result of the two large integration blocs agreement thus setting a successful record for both European Union as well as the MERCOSUR member states. As indicated, such accords can not only expand the dimensions of the regional integration, but also they would directly contribute to the processes of global integration at large.

²⁸⁹ <https://www.cnbc.com/amp/2019/07/25/eu-mercosur-trade-deal-at-risk-of-being-rejected.html>

²⁹⁰ <http://www.google.com/amp/s/amp.ft.com/content/a564ca96-99e7-11e9-8cfb-30c211dcd229>

²⁹¹ *Ibid.*

4.2. NAFTA

The North American Free Trade Association (NAFTA) and MERCOSUR are indeed two of the largest PTAs (FTAs) formed during the second wave of post-war regionalism. NAFTA that is composed of Canada, Mexico and the United States which was entered into force on January 1, 1994 forming the world's largest FTA that encompasses one third of the world's gross domestic product (GDP) and about 365 million people with 19% of world's export, 25% of its imports, 24% of the world's inward FDI and 25% of its outward FDI.²⁹²

In fact, the history of regional integration in North America is dominated by US-Canadian relations and from this aspect the arrangement was significant for Mexico's initial efforts to promote extensive integration with its North American neighbors. Mexico acceded to the General Agreement on Tariffs and Trade (GATT) in 1986 which was an important step in development and towards integration. Yet, there was a fear of liberalization in Mexico particularly agriculture industry saw itself at harm and as such the country had been reluctant to accept FDI.

One of the main goals to design NAFTA was to promote overseas investment in Mexico rather than promoting trade.²⁹³ NAFTA in fact acted as an instrument to promise a "greater and more secure access to North American market" particularly for Mexico and it did help Salinas to continue on the path of his economic and political reforms that he had championed. It was an institutional device for the Mexican reforms towards liberalization. NAFTA was a basis of solution that called for the liberalization of Mexican agriculture over fifteen-year period in order to create time to adjust the traditional farming sector with that of foreign competition.

The arrangement, however, was geared so much in the Mexican economy to the extent that it would be difficult for the future Mexican governments to dismantle economic reforms without having to violate the agreement.²⁹⁴ Salinas simply did his best in buying time through short and long term economic plans at which the most sensitive and politically important sectors were geared thus hoping that some new groups within Mexican society benefitting from economic liberalization would have emerged. Such groups would do their best to fight any subsequent efforts in derailing liberalization. This can be seen as a good strategy to consolidate the more liberal and inclusive institutions in society. Besides, NAFTA can be

²⁹² Mansfield, Edward D. "Regionalism in the Americas at the Twenty-First Century: NAFTA and MERCOSUR." 2013, p. 3.

²⁹³ *Ibid*, p. 4.

²⁹⁴ *Ibid*, p. 5.

taken as an economic integration model by which liberalization policies have been successfully pursued.

As Tornell and Esquivel (1995: 22)²⁹⁵ argue:

“NAFTA is the commitment device that will ensure that... [delays in implementing reforms] will not occur and reforms will continue. This will happen in two ways. First, there are huge political and economic costs associated with breaching an international agreement such as NAFTA. Second, NAFTA will consolidate the power of the new export groups that will have in their interest to defend the new set of property rights.”²⁹⁶

For various reasons, Salinas initial overtures for establishing a North American integration agreement were warmly received by President George H. W. Bush. First, by 1990, due to a halt in the Uruguay round of the GATT, and the view that the USA should in fact try forming regional and bilateral trade agreements, the idea thus gained popularity within the Bush administration.

Second, for Bush administration, NAFTA was an aperture to improve US-Mexican relations towards promoting peace and stability within Mexico. And third, the Bush administration simply considered NAFTA to be in the economic interest of the USA. Mexico was considered a lucrative market for US exporters, a market whose growth could increase the demand for US goods.

Access to relatively cheaper labor in Mexico as well as the preferential access to the entire North American market was additional reasons for the USA to generate economies of scale in production and thus enhancing their competitiveness. Among the three founding members, Canada proved to be the least enthusiastic participant in NAFTA. Canada was already content under the PTA with the USA and didn't see Mexico as an important trade partner; therefore it was not willing to create an institutional firewall vis-à-vis any rise of Mexican protectionism for the future.

Nonetheless, Canada was seeking few additional benefits from NAFTA. Canadian concerns to NAFTA were similar to those raised in the USA. They feared that Canadian firms would relocate to Mexico and thus cheap imports from Mexico would be a threat to Canadian jobs in particular for sensitive sectors including textiles. Mexico's lax labor and its environmental standards were additional reasons for Canada to be concerned. Nevertheless, when in 1990, it became certain that the USA and Mexico were committed to form a regional accord; Canada agreed that the arrangement should cover all of North America.

²⁹⁵ Tornell, A. and Esquivel, G. “The Political Economy of Mexico's Entry to NAFTA.” Cambridge, MA: National Bureau of Economic Research Working Paper, 1995.

²⁹⁶ Mansfield, p. 5.

4.2.1 NAFTA's Institutional Design

The text of NAFTA is designed with nearly 300 articles in 22 chapters. In accordance with the agreement, tariffs on almost half of all import categories were eliminated having mainly the rest also removed in the course of the following five years.²⁹⁷ Eventually, all tariffs were eliminated by January 1, 2008.²⁹⁸ In addition to reducing trade barriers, NAFTA includes *rules of origin* to ensure that only goods produced in Member States would receive tariff preferences. Through NAFTA a set of institutions were also established (let by Free Trade Commission) with the aim of helping address dispute among the members while implementing the agreement.

According to the FTA model formed between the USA-Canada, NAFTA created bi-national panels to deal with issues concerning anti-dumping (AD) and Countervailing duty (CVD) disputes (Goldstein,²⁹⁹ 1996; Abbott³⁰⁰, 2000). The main duty of such panels was to determine as to whether AD or CVD rulings would accord with countries' domestic law and whether they were in lieu of judicial review at the domestic level. The existence of bi-national panels has delivered positive effects as for example Goldstein (1996; 555) argues that these panels have enabled Canada and Mexico to gain considerable relief from US laws regarding unfair trade. Besides, NAFTA also set up a series of working groups to supervise emergency actions on investment and services with a design to facilitate cross-national communication on various technical issues.³⁰¹

Overall, the USA behavior towards NAFTA has been to strongly avert the supra-national character of institutions thus having the authority to regulate its behavior.³⁰² Canada and Mexico were also in accord on this point, that is, neither country wanted its sovereignty to be compromised by a regional organization. The sparse institutional design of NAFTA confirms the fact that it is simply an FTA without an ambition to achieve broader or deeper integration.³⁰³ Therefore, in comparison, the European Union which is considered a Common Market aims to foster political integration as well as much greater economic integration than NAFTA. Furthermore, according to NAFTA each member states is allowed to

²⁹⁷ "Textile quotas for example, were scheduled to be eliminated over ten years and protection over agriculture was slated to be phased out over fifteen years. The automobile sector was also accorded special treatment".

²⁹⁸ Mansfield, Edward D. "Regionalism in the Americas at the Twenty-First Century: NAFTA and MERCOSUR." 2013, p. 7.

²⁹⁹ Goldstein, J. "International Law and Domestic Institutions: Reconciling North American Unfair Trade Laws." International Organization, 1996, 50(4): 541-564.

³⁰⁰ Abbott, F.M. "NAFTA and the Legalization of World Politics: A Case Study." International Organization, 2000, 54(3): 519-547.

³⁰¹ Mansfield, Edward D; pp. 7-8.

³⁰² Ibid, p. 8.

³⁰³ Ibid, referring to: (Abbott, 2000; Fernandez de Castro; 2004, p. 614).

adhere to its own laws and norms which as the result *no NAFTA laws have been established*. Even the labor and environmental side agreement to NAFTA did not reflect a supra-national law; but these agreements simply affirm that each member state would apply its own laws in respect to such areas.³⁰⁴

According to Abbott (2000: 519), the body of NAFTA contains a high degree of precision and obligation thus involving a relatively moderate degree of decision-making authority and delegation. As such NAFTA has no judicial or legislative bodies either. In contrast, in case of the EU, there is a much greater delegation of authority and obligation as transferred to supra-national institutions but relatively less precision in respect to the content of its charter (Abbott, 2000: 521). In contrast with both NAFTA and the EU, the Asia-Pacific Economic Cooperation (APEC) group has low levels of obligation, precision, and delegation.

4.2.2 The Effects of NAFTA

NAFTA is overall considered a qualified success in accordance with most standards.³⁰⁵ Since the inception of the agreement, the intra-regional trade in North America has tripled having Mexico's share of US imports increase by about 50 percent from 1993 to 2008. During that period, Mexico's exports to the USA also increased by somewhat 400 percent. Interestingly, by 2002, *87 percent of Canadian exports, 90 percent of Mexican exports, and 36 percent of US exports were sold within NAFTA*. To many observers these developments could be signs of the fact that NAFTA has been "*trade-creating and therefore welfare enhancing*" (Weintraub 2004: xii).³⁰⁶

Beside the above developments, equally NAFTA has been a success in promoting foreign investment. Accordingly, the United States FDI in Canada and Mexico has been roughly doubled while annual real GDP grew 3.6 percent in Canada, 3.3 in the USA, and 2.7 in Mexico since the inception of NAFTA. Some believe, in fact, that North American integration could have deepened probably even without NAFTA but in a relatively slower pace (Abbott 2000; Hufbauer and Schott³⁰⁷ 2005:2).³⁰⁸

³⁰⁴ Mansfield, Edward D; p. 8.

³⁰⁵ Ibid.

³⁰⁶ Weintraub, S. "Trade, Investment, and Economic Growth." In Weintraub, S. (ed), *NAFTA's Impact on North America: The First Decade*. Washington, DC: Center for Strategies and International Studies Press, 2004.

³⁰⁷ Hufbauer, G.C.; and Schott, J.J. "NAFTA Revised: Achievements and Challenges." Washington, DC: Institute for International Economics, 2005.

³⁰⁸ Mansfield referring to: Hufbauer Gary Clyde & Jeffrey Schott, J. "NAFTA Revisited: Achievements and Challenges." Peterson Institute Press: All Books, Peterson Institute for International Economics, 2005.

Within NAFTA a number of dispute settlement procedures have been established. Nonetheless, as Hufbauer and Schott (2005: 55) argue there has been a mixed record of success in such procedures. For example, they worked well when NAFTA obligations have been defined clearly like the most cases involving Chapter 19 concerning AD and CVD. However, they worked poorly in many cases upon which domestic politics blocked treaty compliance (i.e. in three cases of US-Mexico trucking, Canada-US softwood lumber, and US-Mexico sugar and high-fructose corn syrup).

The above mentioned drastically increasing numbers in the economic performance of the member states explains why Salinas approached the USA to form NAFTA. As a result of NAFTA, Mexico has also experienced a significant increase in productivity in its manufacturing sector suggesting that the arrangement has helped promote efficiency.³⁰⁹ Nonetheless despite such gains that Mexico has made since 1994, problems remain. As for example, the overall rate of investment has not increased despite an increase in the flow of FDI.³¹⁰ Tornell et al. (2004) argue that such troubles would have existed far worse in the absence of NAFTA. Accordingly, NAFTA is not the main source of the problem but rather the lack of structural and judicial reform coupled with a credit crunch existing within the organization, that all seem problematic. Another fact which might create a problem is that the USA and Canada are wealthy states with stringent labor and environmental regulations while Mexico to enter such lucrative markets needs to abide by their standards.

According to Zepeta et al (2009),³¹¹ the overall economic performance of Mexico has slumped along with its exports since the turn of the century. Moreover, it has failed to create jobs so far in Mexico or to reduce income equality or to forestall Mexico's current economic crisis. These problems were exacerbated by the slowdown of the US economy after 2000: as indicated above Mexico and Canada somewhat have been affected by the fluctuations in the US market. As mentioned above, the root-causes of these problems are identified in the lack of structural and judicial reform as well as the existing credit crunch within the organization. Nonetheless, it is certain to say that overall; NAFTA as an institutional fruit of integration has done its positive role in boosting productivity, but reforms within its structure and judicial system need to be mandated.

Another problem would be the immigration issue from Mexico to the USA. Beside its economic and social implications, after 9/11 the USA has been particularly concerned about the possibility of terrorists

³⁰⁹ Mansfield, p. 9.

³¹⁰ Ibid, p. 10.

³¹¹ Zepeda, E., Wise, T.A., and Gallagher, K.P. "Rethinking Trade Policy for Development: Lessons from Mexico under NAFTA." Washington, DC: Carnegie Endowment for International Peace, 2009.

entering the country through the Mexican borders (Bailey, 2004).³¹² Nonetheless, NAFTA doesn't seem to have much impact on immigration even though it has increased migration to the USA as soon as the agreement went into effect. According to Bean and Lowell (2004)³¹³ such migration rose swiftly during 1990s mainly as the result of the affordability of travel to the USA from Mexico.³¹⁴

“Strategic integration has long guided the formation of PTAs”³¹⁵ (Mansfield and Milner, 1999); the formation of PTAs in fact, stimulates third parties with fear of the erosion of their competitiveness in international markets or weakening their bargaining power and therefore, leading them to respond by forming a PTA of their own. NAFTA was in fact a strategic integration of this type stimulating the establishment of other PTAs throughout the Western hemisphere particularly in the Asia-Pacific region (Baldwin, 1995).³¹⁶ One of the best examples and most important agreements of this sort was MERCOSUR which was explained earlier in this Chapter. More examples are explained in the next Chapter on ASEAN.

In early October 2018, there have been signs to reach a new agreement between USA, Mexico, and Canada to replace NAFTA. This new and relatively more comprehensive agreement is called USMCA.

4.2.3. Recent Updates on NAFTA

This new deal in fact, updates the 1994 NAFTA while promising to lead “to freer, fairer markets, and to robust economic growth” within the free trade area of the three countries.³¹⁷ According to this new deal, the US would have a greater access to Canada's dairy market; a result which has been vital for US dairy manufactures.³¹⁸ Accordingly, the deal would bring benefits to the middle class and create better jobs

³¹² Bailey, J. “Security Imperatives of North American Integration: Back to a Future of Hub and Spokes.” In Weintraub, S. (ed.), *NAFTA's Impact on North America: The First Decade*, Washington, DC: Center for Strategic and International Studies Press, 2004.

³¹³ Bean, F.D. and Lowell, B.L. “NAFTA and Mexican Migration to the United States.” In Weintraub, S. (ed.), *NAFTA's Impact on North America: The First Decade*, Washington, DC: Center for Strategic and International Studies Press, 2004.

³¹⁴ Mansfield. p. 11.

³¹⁵ Ibid.

³¹⁶ Baldwin, R.E. “A Domino Theory of Regionalism.” In Baldwin R., Haaparanta, P. and Kiander, J. (eds.), *Expanding Membership of the European Union*. New York: Cambridge University Press, 1995.

³¹⁷ Gies, Heather; “NAFTA out, USMCA in: What's in the Canada, Mexico, US trade deal?”, Aljazeera, 2 Oct. 2018: <https://www.aljazeera.com/amp/news/2018/10/nafta-usmca-canada-mexico-trade-deal-181001195545440.html>

³¹⁸ Collins, Michael. “Canada agrees to join U.S. and Mexico in new trade deal to replace NAFTA, say US and Canadian officials.” USA Today, 1st Oct. 2018.

opportunities for the people of North America by further deepening economic ties between the three countries. The text of the new deal was submitted to Congress and signed by all three parties at the end of November 2018.

In accordance with this new deal (USMCA), Canada may be exempted from the auto tariffs provided that it would agree to limit its auto exports into the U.S. There have been also some changes to the auto rules of origin according to which a certain percentage of an automobile needs to be built from parts that originated out of the member countries within the NAFTA region. Under the new rules, at least 75 percent of the cars need to be built in North America (used to be 62.5% under NAFTA) while having the share of 40-45 percent of the workers earning at least \$16 per hour.

The new rules would also include further protection for Intellectual Property Rights (IPR) and trade secrets, and it places “tougher labor requirement” for Mexico as well as some environmental obligations. Renamed the US-Mexico-Canada agreement (USMCA), the prime minister of Canada Justin Trudeau believes that the new deal will “enhance competitiveness & prosperity, while creating new jobs.” This is while according to Mexico too, it would create a “win-win-win” agreement for the three participating countries. The United States calls it a modernized agreement that would strengthen the middle class while creating well-paying jobs. “The agreement will run for 16 years but will be reviewed after six years and could then be extended for another 16.”³¹⁹

The USMCA creates more jobs while making Canada’s dairy sector more competitive,³²⁰ even though the sector would be left with no specific strategy. Furthermore, The Investor-State Dispute Settlement (ISDS) mechanism according to which companies can sue governments for infringing on potential future profits were scrapped between Canada and the US. This was a good news for Canada which had the highest number of sued-cases under NAFTA (41) having Mexico the second (23) and the 21 for the US.

In summary, the USMCA is just an updated version of the nearly 25-year-old North American Free Trade Agreement (NAFTA) that includes major changes on cars as well as on policies concerning labor and environmental standards, protection of intellectual property rights, and some provisions dealing with digital trade. In brief; what is in this new deal may be enumerated as: **1- Country of origin rules** by which zero tariffs is considered for automobiles whose components (75%) are manufactured in the three member states; **2- Labor provisions** having 40-45% of automobile parts being made by workers earning at least

³¹⁹ USA Today, 1st Oct, 2018.

³²⁰ Professor Charlebois to Al Jazeera.

\$16 an hour by 2023 thus positively affecting Mexico's labor laws and standards; **3- US farmers get more access to the Canadian dairy market;** **4- Intellectual property and digital trade** in which the new deal would extend the terms of copyright up to 70 years from 50; and **5- Sunset clause** meaning that the terms of the agreement would be expired or "sunset" after 16 years during which it can be reviewed after 6 years. USMCA has been ratified so far by Mexico and the US (Trump signed it to become law on Jan. 29, 2020) expecting to be finalized by Canada's parliament ratification that is likely to endorse it.³²¹

4.3. Conclusion

After the first few years of MERCOSUR's existence, the arrangement proved to be widely a success despite existence of some strains on the grouping and tensions among its member states. As the result, generally speaking, many of the core objectives and aims of the bloc have not been materialized particularly on its economic front. Nonetheless, some benefits have been generated under MERCOSUR from a political standpoint. According to Manzetti (1993/94: 110),³²² this arrangement has created a forum for the members to discuss sensitive policy issues including those concerning transport and communications, nuclear proliferation, military operation, environmental protection, illegal immigration, and the drug trafficking.

Furthermore, it has stepped up the advancement of key political objectives. For instance, MERCOSUR added an important clause in 1996 to commit each member state to maintain a democratic government thus calling upon all members to sanction any government that would deviate from such democratic rule. Also, the following year, the Rio Declaration was signed by Argentina and Brazil creating a Permanent Commission for Coordination. Such developments created an atmosphere of cooperation and coordination upon important issues including *political-military affairs, joint military consultations, and an agreement to ban nuclear weapons.*

In 1995 for example, MERCOSUR intervened in a war that was going on between Peru and Ecuador and assisted in enforcing a cease fire while together with the USA and Chile could place pressure on the combatants to create a peace treaty. Therefore, such evidences confirm that in general PTAs have the

³²¹ Jerby, Jen. "USMCA, Trump's new NAFTA deal, explained in 600 words." Feb. 2020: (www.vox.com).

³²² Mansfield, Edward, D. "Regionalism in Americas at the Turn of the Twenty-First Century: NAFTA and MERCOSUR." p. 14, with reference to: Manzetti, Luigi. "The Political Economy of MERCOSUR"; Journal of Interamerican Studies and World Affairs, 35 No. 4, Winter 1993-94, p. 110.

ability to inhabit political-military conflict between Member States³²³ (Mansfield, Pevehouse, and Bearce,³²⁴ 1999; Mansfield and Pevehouse,³²⁵ 2000).

MERCOSUR has proved to be exemplary in this regard making as such important contributions to peace and stability in the region particularly during the 1990s. MERCOSUR was a key factor for enhancing the bargaining power of Member States in their negotiations with the EU and the USA, *a key objective for integration*. Such examples can be taken as constructive lessons for other regional integration schemes and possibly for the MENA region.

Through NAFTA, the three countries of Canada, Mexico, and the USA have overall formed a fruitful regional integration (FTA), yet the association faces some ongoing problems in respect to illegal immigration as well as illegal drug trafficking. Security and border control are other concerns particularly on issues related to terrorism. Environmental challenges also exist for these countries including water allocation issues between US and Mexico as well as some problems associated with deforestation, soil erosion, and the water supply in Mexico. There are also logging and energy issues in the USA and Canada and above all from an economic standpoint, agriculture is considered as the looming problem facing NAFTA.

Within NAFTA all remaining barriers on farm products have been eliminated on January 1, 2008. As the result, Mexican farmers seriously are concerned about the effect of such development affecting the price of bean and corn, the two staples of Mexican diet. The overall removal of trade barriers on agricultural products would be a threat which can place a greater pressure on Mexican farmers. The dispute over sugar is a plus and such issues could be a source of considerable stress on the arrangement. Barack Obama had promised to renegotiate with Canada and Mexico on the key features of NAFTA during 2008 presidential campaign but soon after he backed away from that position. Nevertheless, Trump administration renewed the agreement in 2018 calling it USMCA adding some new features into it concerning the above issues.

USMCA has somewhat brought a new spirit of hope to NAFTA with an updated version by introducing new rules and regulations including the country of origin rules affecting automobile industries (75% manufacturing condition), labor provisions (\$16 minimum wage per hour), further US access to the Canadian fair market, as well as some updates on Intellectual Property Rights (IP) and digital trade, plus

³²³ Mansfield, P. 14.

³²⁴ Mansfield, Edward D.; Jon C. Pevehouse; and David H. Bearce. "Preferential Trading Arrangements and Military Disputes." *Security Studies*, 1999-2000, 9 (1-2): pp. 92-118.

³²⁵ Mansfield, Edward D., and Jon C. Pevehouse. "Trade Blocs, Trade Flows, and International Conflict." *International Organization*, Vol. 54, No. 4 (Autumn, 2000), pp. 775-808.

a sunset clause which deals with the terms of the agreement and possibility of reviewing and updating it within 6 years.

Moreover on the southern cone, MERCOSUR has been trying to expand. This includes Bolivia and Venezuela that have applied for full membership. However, the undemocratic and nationalistic systems of these two states particularly Venezuela has been the source of concern creating the fear that their policy positions would diverge from the original PTA so as to damage the arrangement. On the other hand, if the attempt towards such expansion fails, it will undermine MERCOSUR's position in the global economy. Overall, institutional structure is a concern in MERCOSUR, and under the current arrangement it would be difficult to envisage an effective customs union. In other words, for such a thin and weak set of institutions, the arrangement is considered something much less than a common market.

Finally, as mentioned earlier in this chapter, the dynamics of international relations in the past decades has been affected by globalization and interdependence and in this process regional integration has played a key role while demanding for deeper integration in different parts of the world. Such demand goes beyond merely trade issues encompassing social cohesion and development strategies.³²⁶ Therefore, there are some major challenges facing MERCOSUR for deepening integration which can be shortly numerated as follows:

- 1- The role and functioning of the MERCOSUR Parliament;
- 2- The enlargement process beginning with the accession of Venezuela; and
- 3- The creation of the Union of South American States (UNASUR).

The first challenge concerns the reorientation of MERCOSUR by the Parliament (PARLASUR) where direct election is anticipated at regional level for such Parliament. This aims at bridging the “democratic deficit” in MERCOSUR by reconciling the bloc and its policy or law-making with that of the national policies. The challenge would be on representation as currently the Parliament is composed of 81 MPs, 18 from each member states of the bloc plus 9 from applying member, Venezuela. Associate members – Bolivia, Chile, Colombia, Ecuador and Peru – may also hold seats on the Parliament, but with no voting powers. Currently Mexico and New Zealand are also two observing states of MERCOSUR.

The second challenge concerns the Venezuela's accession as an important step for the expansion of the

³²⁶ Lixinski, Lucas; and DE Andrade Correa, Fabiano. “The Legal Future of MERCOSUR.” in: *The Law of MERCOSUR*, HART Publishing, 2010, pp. 413-414.

bloc from geo-political point of view as well as strategic benefit to the development of MERCOSUR due to the vast wealth of energy resources in that country. This challenge, however, seems to involve a great degree of political conflict that might affect the decision-making agenda of the bloc. A recent update confirms that MERCOSUR has in fact suspended Venezuela from the group for “rupture of the democratic order.” Accordingly the members of MERCOSUR met on the 5th of August 2017 in Sao Paulo to make the decision in accordance with the Ushuaia Protocol which had been signed in 1998 that included a democratic clause leading to the political suspension.³²⁷

And finally, the third challenge is about the creation of UNASUR. The way it can be perceived; the idea is looking for a pattern similar to that of the African Union (AU) trying to create some regional communities alongside. However, the UNASUR is not meant to replace MERCOSUR but rather bringing more dimensions into the southern integration including political integration which would of course create some new challenges for the future of the bloc. Even achieving such integration ideal in a wider spectrum requires the progress of the current MERCOSUR which seems to dictate the preconditions for any further regional development beyond economic prosperity by taking political factors into account. Such progressive strategy in the integration processes of MERCOSUR seems necessary which can consolidate its role as an important international player.³²⁸

³²⁷ *Mercosur suspends Venezuela for “rupture of the democratic order.”* Available at: <http://www.brazil.gov.br/about-brazil/news/2017/08/mercosur-suspends-venezuela-for-rupture-of-the-democratic-order>

³²⁸ Lixinski, Lucas; and DE Andrade Correa, Fabiano. “The Legal Future of MERCOSUR.” in: *The Law of MERCOSUR*, HART Publishing, 2010, p. 423.

Chapter (5): ASEAN

5.1. The Organization of ASEAN

Like the European Union, in fact some degree of political compromise has been undertaken to form the Association of Southeast Asian Nations (ASEAN) the way it is organized today. A historical overview can help sketch the path of such progress for ASEAN with particular emphasis on the role of the rule of law accompanied with the formation of an economic constitution in shaping the ASEAN integration.

5.1.1. An Overview

The Association of Southeast Asian Nations, or ASEAN, was established on 8 August 1967 in Bangkok, Thailand, with the signing of the ASEAN Declaration (Bangkok Declaration) by the Founding Fathers of ASEAN, namely Indonesia, Malaysia, Philippines, Singapore and Thailand. Later on five more members joined the Declaration being Brunei Darussalam, Cambodia, Lao PDR (Laos), Myanmar, and Viet Nam.

In their relations with one another, the ASEAN Member States have adopted the following fundamental principles, as contained in the Treaty of Amity and Cooperation in Southeast Asia (TAC) of 1976:

- 1- “Mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations;
- 2- The right of every State to lead its national existence free from external interference, subversion or coercion;
- 3- Non-interference in the internal affairs of one another;
- 4- Settlement of differences or disputes by peaceful manner;
- 5- Renunciation of the threat or use of force; and
- 6- Effective cooperation among themselves.”³²⁹

As the above principles reveal, the nature of the association is more of a political one. Since its establishment under the Bangkok Declaration in 1967, ASEAN has in fact relied primarily upon diplomacy rather than law. As such, relational issues in the political sphere have been mainly managed by

³²⁹ Ewing-Chow, Michael, and Hsien-Li Tan. “The Role of the Rule of Law in ASEAN Integration.” RSCAS 2013-2016, Robert Schuman Center for Advanced Studies, Global Governance Program-41, EUI Working Paper, pp. 4-5, referring to “Treaty of Amity and Cooperation in Southeast Asia (TAC), 24 February 1976; Article 2.”

way of *consultation and consensus and declaratory statements*. In this respect, treaties bearing out binding legal obligations in particular the ones involving effective dispute settlement mechanisms have been quite few.³³⁰

However, the ASEAN Charter was created upon its 40th anniversary in 2007 which was signed by its member states stipulating that: “We, the peoples of the member states of the Association of South East Asian Nations... [h]ereby decide to establish, through this Charter, the legal and institutional framework for ASEAN.”³³¹

Hence with the establishment of ASEAN Charter, the Legal and Institutional structure were created and for the first time in its history were brought to the forefront of ASEAN discourse. Moreover, Blueprints for each of the three pillars of ASEAN Communities—the *Political-Security Community*, *Economic Community*, and *Socio-Cultural Community*—were also formulated along with a numerous treaties and protocols that often contained the detailed obligations and dispute settlement procedures.

This Chapter intends to explore the aspirations, realities and limitations that the regional organization have tried to develop towards becoming an integrated ASEAN Community while paying particular attention to the new role of law in ASEAN relations. What lies ahead is the need for greater clarity in intra-ASEAN and its international relations if it is to be taken seriously by global actors. Hence, there is an emphasis on the *rule of law* as we go forward for a better and somewhat deeper ASEAN integration. Therefore, we should pay attention to the details while unpacking the core infrastructure needed within ASEAN to reach the goal of regional integration. Such core infrastructure specifically includes *institutions, legislation, and mechanisms for resolving disputes*.

In 1997, clear vision was proclaimed in order to reach a closer regional integration and community-building for ASEAN by its ten member states:

“ASEAN shall have, by the year 2020, established a peaceful and stable Southeast Asia where each Nation is at peace with itself and where the causes for conflict have been eliminated, through abiding respect for *justice and the rule of law* and through the strengthening of national and regional resilience... We will create a stable, prosperous and highly competitive ASEAN Economic Region in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and

³³⁰ Ewing-Chow, Michael, and Hsien-Li Tan. “The Role of the Rule of Law in ASEAN Integration.” RSCAS 2013-2016, Robert Schuman Center for Advanced Studies, Global Governance Program-41, EUI Working Paper, p. 1.

³³¹ *Ibid.*

reduced poverty and socio-economic disparities... We see vibrant and open ASEAN societies with their respective national identities, where all people enjoy equitable access to opportunities for total human development regardless of gender, race, religion, language, or social and cultural background.”³³²

In adopting such vision, some three-fold aspirations were considered being a) *peaceful dispute resolution*, b) to forge *economic integration*, and c) to *be bound by a common regional identity* by 2020. And these three pillars were the foundation to form the 2003 Declaration of ASEAN Concord II (Bali Concord II) that envisions:

“ASEAN Community shall be established comprising three pillars, namely political and security cooperation, economic cooperation, and socio-cultural cooperation that are closely intertwined and mutually reinforcing for the purpose of ensuring peace, stability and shared prosperity in the region.”³³³

As indicated, the ASEAN Charter was signed in November 2007 and came into force on 15 December 2008 as it was ratified by all ten ASEAN members even though there was a hesitation over Myanmar problem. Along with this adoption in 2007, the three pillars seminal documents were created mapping out the necessary steps towards the ASEAN integration through a tri-pillar Community. These are namely the ASEAN Political-Security Community Blueprint, ASEAN Economic Community Blueprint, and ASEAN Socio-Cultural Community Blueprint which were compiled and renamed as “the Roadmap” 2009-2015.

5.1.2. ASEAN Free Trade Area (AFTA)

The ASEAN countries established a trade bloc agreement with the aim of supporting local trade and manufacturing in all such countries while facilitating economic integration with regional as well as international allies. It is called AFTA (ASEAN Free Trade Area) and is considered as one of the largest and most important FTAs in the world.

The AFTA agreement was signed on 28 January 1992 in Singapore with six members at the time upon which Vietnam joined in 1995, Laos and Myanmar in 1997, and Cambodia in 1999. Simply put it, AFTA was established for two prime goals being:

- 1- Increase ASEAN's competitive edge as a production base in the world market through the elimination, within ASEAN, of tariffs and non-tariff barriers; and,
- 2- Attract more foreign direct investment to ASEAN.

³³² Ibid, p.2; with reference to: “ASEAN Vision 2020.”

³³³ Ibid, with reference to: “Declaration of ASEAN Concord II (Bali Concord II) 2003, Para 1.”

To achieve the above objectives, the Common Effective Preferential Tariff (CEPT) scheme was established. According to this scheme, Each ASEAN member may impose tariffs on goods entering from outside ASEAN based on its national schedules. However, for goods originating within ASEAN, ASEAN members are to apply a tariff rate of 0-5 % (the more recent members of Cambodia, Laos, Myanmar and Vietnam, also known as CMLV countries, were given additional time to implement the reduced tariff rates).

Moreover, ASEAN members can exclude products from CEPT in three different cases: 1- Temporary exclusions (products to be temporarily protected by a delay in tariff reduction); 2- Sensitive agricultural products (i.e. rice), and; 3- General exceptions (which involves national security and public good...).

5.2. ASEAN in Comparison with the EU

From the political and economic perspectives, there are major differences – even fundamental ones – between the EU and ASEAN. Politically speaking, the EU vision is well conveyed through the words of the preamble in the 1957 Treaty Establishing the European Economic Community, EEC Treaty (Treaty of Rome) in which the signatories expressly “determined to lay the foundations of an ever closer union among the peoples of Europe”³³⁴ ... indeed a farsighted goal that was subscribed by all member states. Accordingly; “Temporary derogations and transitional periods are granted but the goal is there for all to strive toward.”³³⁵

In accordance with practical economic considerations, the above European undertaking goes far beyond what ASEAN could plausibly agree to. Such claim would be starkly demonstrated when we simply compare the member state economies that is, within the European Union the ratio between the highest GDP per capita (PPP) Luxemburg and that of the lowest, Bulgaria is approximately 17:1 whereas in ASEAN such ratio between the highest GDP per capita, Singapore, and the lowest GDP per capita, Myanmar, stands at 63:1.³³⁶

Moreover, when forming the European Integration, France and Germany as two propelling and most

³³⁴ Ewing-Chow, Michael, and Hsien-Li Tan. “The Role of the Rule of Law in ASEAN Integration.” p. 3; with reference to: The Treaty of Rome (1957). The Treaty can be retrieved from: http://ec.europa.eu/economy_finance/emu_history/documents/treaties/rometreaty2.pdf”

³³⁵ Ibid, p. 3.

³³⁶ Ibid; “Based on IMF 2011 data on GDP per capita in USD (estimated).”

powerful members formed an alliance to progress the project. This is while ASEAN lacks such a driving force. For example, Indonesia having a population of about 240 million and a territory of 1.9 million square kilometers is considered the largest ASEAN member. Indeed, such population is almost equal to all of other ASEAN countries put together. However, although Indonesia is in fact dwarfing its ASEAN neighbors both in terms of its area (geographically) and in terms of population, it has a much lower GDP per capita than many other ASEAN members. In fact many among the Indonesians are skeptical about the virtues of ASEAN Integration, particularly economic integration.

Interestingly, also, Brunei and Singapore the two ASEAN members with the highest GDP per capita are considered the smallest states that are unable to construct the backbone of any integration project in the same way that the Franco-German alliance has done in the past decades. This re-emphasizes how the institutional backbone can be important in shaping the corner-stone and attaining the goals of integration.

Furthermore, unlike the integration experience in Europe in which states with “democracies” were included and had a major role in the European integration efforts, the political systems of ASEAN members presents a much more diverse picture. They include a broad spectrum ranging from active democracies in Indonesia and the Philippines, or that of one party-dominated democracy in Malaysia or Singapore, a military dominated presidential republic in Myanmar, socialist states in cases of Vietnam or Laos, a constitutional monarchy in Cambodia and Thailand, and a traditional monarchy in the case of Brunei. Moreover, despite such differences, there is yet, even greater diversity when it comes to the role of law and the rule of law in each of the ASEAN member states. This disparity of political approach establishes a major difference with that of the European Union.

Puchala once had a good explanation of the integration process with his famous examples of the story of the blind men trying to describe the elephant.³³⁷ The beast was so big and in their darkness each experienced and perceived it differently so as to disbelieve each other in their saying and this basically maintained a lively debate about the nature of the beast.³³⁸ This can indeed be taken as the case for ASEAN which goes on by the constantly evolving nature of its organization. But the question arises as to why such organization was established in the first place and what factors have been responsible for its development and in driving it towards a regional integration scheme as we witness today.

³³⁷ Ibid, p. 4; referring to: “Donald J Puchala; Of Blind Men, Elephants and International Integration (1971) 10 JCMS 267.”

³³⁸ Ibid.

5.3. Why ASEAN was established

In order to fully understand the ongoing process of ASEAN integration, we need to capture the main reasons for founding such organization while taking into consideration the manner in which it developed, and realizing its modus operandi in international and regional relations.³³⁹

As mentioned above, ASEAN was established by the five founding members (Indonesia, Malaysia, Philippines, Singapore, and Thailand) in Bangkok Thailand on the 8th of August 1967 thus signing the Bangkok Declaration (“the Declaration”). Following that Brunei Darussalam joined the organization on 8 January 1984, Viet Nam on 28 July 1995, Lao PDR and Myanmar on 23 July 1997, and Cambodia on 30 April 1999, all together making the ten member states of ASEAN as we have today.

In most cases of regional integration, prior to the formation of such associations, some effects of regional conflicts and wars are apparent. In case of ASEAN, from 1962 to 1966, the main regional conflict was Konfrontasi; an undeclared military conflict between Indonesia and Malaysia (which included Singapore for part of that time). Even though it was mainly a dispute over the island of Borneo, it was also an exercise of hegemony by the Sukarno government of Indonesia. The Konfrontasi followed some small skirmishes which eventually caused diplomatic break off between Malaysia and Indonesia and also strained diplomatic ties between the parties and other Southeast Asian nations.

At the same time, the Vietnam War was escalating and there was a fear in the region that the idea of communism would spread as predicted by the domino theory. Hence, after ousting President Sukarno by General Suharto in 1966, the five founding members of ASEAN tried to restore diplomatic ties and thus created an organization to mainly encourage peaceful relations with each other. As such they limited external interference as the initial *raison d’être* which found its clearest expression in the 1976 Treaty of Amity and Cooperation,³⁴⁰ thus providing the six main principles for ASEAN members to abide by, as enumerated and aforementioned.³⁴¹

In fact the above outcome (TAC) has been mainly gained as the result of a righteous policy-making which took place by the aftermath of the conflict and war resembling other cases such as Europe that confirm a change in political system under the circumstance, which may serve as a progressive and dynamic factor

³³⁹ Ibid, (Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.”) p. 4.

³⁴⁰ Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.” pp. 4-5, referring to: “Treaty of Amity and Cooperation in Southeast Asia (TAC), 24 February 1976. Retrieved from: <http://www.asean.org>”

³⁴¹ Ibid, with reference to the Article 2 of the Treaty of Amity and Cooperation in TAC.

towards integration. As such, the above six principles have led ASEAN to develop what is known as the *ASEAN WAY* which has been shaped under the banner of the *rule of law* in a regional context to the extent that according to many commentators such strict adherence to non-interference and consensus might undermine the rule of law and that of ASEAN's seriousness to integrate.³⁴²

Yet, to ASEAN; culturally speaking the ASEAN Way has proved to be the more effective method for resolving disputes in South East Asia as introduced by the lyrics proclaiming that "we dare to dream, we care to share, for it's the way of ASEAN."³⁴³ The Bicycle Theory of integration (which developed within the EU), indicates that, like bicycle, integration projects must keep having some minimum forward momentum otherwise they will fall. And the new legal framework under the rule of law in ASEAN can act as such momentum. Accordingly, with more of focus on integration within ASEAN, more legally binding frameworks would emerge to govern economic relations between and among member states.³⁴⁴

Indeed, economics can serve as a common language to start resolving regional conflicts while further expanding cooperation in a regional context. Economic cooperation has been, indeed, the main driving force for community-building within ASEAN along with its integration efforts. And from this angle, with a view to its achievements, ASEAN can perhaps render lessons for the integration scheme in MENA, as a more suitable model than that of MERCOSUR. After all, MENA has gone through similar historical experiences like those of Asian conflicts and wars with much more vast consequences.

The footsteps of the rule of law can be traced in the first generation of the economic agreements adopted by ASEAN. This includes specifically the 1977 Agreement on ASEAN Preferential Trading Arrangements, and the 1979 Agreement on ASEAN Food Security Reserve, as well as the 1980 Basic Agreement on ASEAN Industrial Projects.³⁴⁵

Also more seminally perhaps, the ASEAN Charter was signed on 20 November 2007 in Singapore (13th ASEAN Summit) setting out the purpose of ASEAN. Article 1 of the Charter clearly expresses that ASEAN was to "create a single market and production base." Such a goal has been also iterated in the

³⁴² Ewing-Chow and Hsien-Li. "The Role of the Rule of Law in ASEAN Integration." p. 5.

³⁴³ Ibid, referring to: "ASEAN Anthem Competition."

³⁴⁴ Ewing-Chow and Hsien-Li. "The Role of the Rule of Law in ASEAN Integration." p. 5, referring to: "Paul J Davidson, "The ASEAN Way and the Role of Law in ASEAN Economic Cooperation" (2004) 8 S.Y.B.I.L. 165 at p. 168-169"

³⁴⁵ Ibid, p. 6, referring to: "Basic Agreement On ASEAN Industrial Projects, Kuala Lumpur, 6 March 1980, at: <http://www.aseansec.org>"

AEC Blueprint³⁴⁶ during the 13th Summit in which it indicates:

“The AEC Blueprint will transform ASEAN into a single market and production base, a highly competitive economic region, a region of equitable economic development, and a region fully integrated into the global economy.”³⁴⁷

The above lines as reflected in the AEC Blueprint as well as the Article 1 of the Charter confirm the fact that a major part of ASEAN’s *raison d’être* has been either based on realism that is the self-interest of each state, or based on functionalism representing the common interests of each state.³⁴⁸ In other words, such reflection proves that ASEAN was not the consequence of the Second World War but rather arising out of the *realpolitik* of the Cold War.

Nevertheless, what lacks here is a clear vision like that of the European Union with principle of liberalism and democratic peace as presented in the Schuman Declaration of 9th May 1950 describing that the European Coal and Steel Community (ECSC) was created to establish the solidarity in production so that *“any war... becomes not merely unthinkable, but materially impossible.”*³⁴⁹ *The intention was to pool, through the transfer of sovereignty, the key strategic sectors – coal and steel – making it impossible for any member state to use these resources for rearmament, though it did indirectly lead to a more integrated production base in Europe.*³⁵⁰

The absence of such vision is perhaps why the ASEAN project has been imaged like that story of blind men and the elephant. In comparison with the EU, unlike the single market experience in Europe in which clear benefits were generated for the union, in case of ASEAN unfortunately the benefits have been “more complex and less obvious”. If we take into consideration the combined population of ASEAN being approximately 600 million and compare it favorably with that of EU’s 500 million, the combined

³⁴⁶ Ibid, with reference to: “AEC Blueprint, *Supra* note 11.”

³⁴⁷ Ibid, with reference to: “Declaration on the AEC Blueprint, *Supra* note 37, paragraph 1.”

³⁴⁸ Ibid, with reference to: Michael Ewing-Chow. “Culture Club or Chameleon: Should ASEAN Adopt Legalization for Economic Integration? (2008) 12 SYBIL 225 at 228.”

³⁴⁹ Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.” p. 7; referring to “Schuman Declaration, 9 May 1950.” Retrieved from: http://europa.eu/about-eu/basic-information/symbols/europe-day/schumandeclaration/index_en.htm

³⁵⁰ Ibid; “See Heribert Dieter. “Transnational Production Networks in the Automobile Industry.” (Notre Europe, 2007) Study No.58.” at: http://www.notre-europe.eu/uploads/tx_publication/Etud58_01.pdf.

GDP of ASEAN is only US\$1.8 trillion whereas the overall GDP in the EU is US\$16.3 trillion.³⁵¹

One main reason for such a contrast would be the fact that purchasing-power within ASEAN in comparison with the EU is relatively less. Michael Ewing-Chow and Tan Hsien-Li in their article believe that the main driver of ASEAN integration is the Integrated Production Network (IPN). An IPN is comprised of a network of enterprises that are selected to base their production upon cost effectiveness to the extent that it would not be viable to stand outside of such a network.³⁵²

The IPN can take the forms of being either horizontal or vertical. When an IPN becomes transnational, it creates some challenges among which is ensuring that the rules applicable to each actor of the network would be certain and predictable beyond the cost of transport and logistics planning.³⁵³ As such, when for example the IPN operates in countries with weaker status of the rule of law, it cannot certainly be guaranteed that arbitrary intervention and/or discrimination would not take place on the way of effective functioning of the IPN. The Automobile industry would be an example of IPN in Europe. Production of cars directly amounts for 2.2 million jobs while 9.8 million other jobs come in closely related sectors. In such cases, interestingly countries such as Denmark with 7000 jobs or Finland with 6000 jobs can reap job benefits out of the IPN without having any kind of automotive industry.³⁵⁴

In addition to the above analogy, Richard Baldwin's book "The Great Convergence: Information Technology and the New Globalization" also expresses such transition from the great divergence era to the great convergence and a new age of globalization. Baldwin reasons that as the result of early globalization the share of world income has gone to today's wealthy nations thus soaring from twenty percent to nearly seventy percent between 1820 and 1990. But after the lowering costs of moving goods and ideas across borders particularly into the developing world a new wave of convergence emerged. Since globalization is filled with fast-paced technological change and fragmentation of production, its impact has become *more selective, more unpredictable* and *more uncontrollable*. And therefore, the Great Convergence shows that in fact the new globalization is presenting rich and developing nations alike all facing unprecedented policy challenges in their efforts to keep social cohesion and reliable growth.³⁵⁵

³⁵¹ Ibid, Referring to: "Report for Selected Countries and Subjects, International Monetary Fund, available at <http://www.imf.org>"

³⁵² Ewing-Chow and Hsien-Li. "The Role of the Rule of Law in ASEAN Integration." p. 7.

³⁵³ Ibid.

³⁵⁴ Ibid, p. 8.

³⁵⁵ Baldwin, Richard. "The Great Convergence: Information Technology and the New Globalization." Harvard University Press, 2016.

All this shows that economic integration particularly in case of ASEAN is not merely about the development a single market but rather more importantly about the development of an IPN. Although the European Single Market was an impetus to indirectly create new networks of businesses and production, in Asia however, these networks already exist despite some trade barriers. Instead of changing the general environment for the allowance of such networks, Asian businesses chose the already available transparent discretion as provided to policy makers in their countries to reach specific solutions for the trade barriers they faced.³⁵⁶

According to Baldwin, there is a mess in East Asian regionalism in that while having a high level of regional division of labor in the production process, there is yet limited legislation of the process.³⁵⁷ As such he believes that plan with “Factory Asia” was not truly problematic but the management of the plan was in fact the problem highlighting that the unilateral tariff-cutting was the main cause for the creation of “Factory Asia,” which is not basically subject to WTO discipline (bindings) or any alternative legal disciplines.³⁵⁸

Along the same lines Ewing-Chow and Hsien-Li confirm **(p. 8)** that indeed, production integration in Asia takes a form of bottom-up process rather than a top-down one. According to Abo Tetsuo this process is called “spontaneous integration”³⁵⁹ also described as the de facto regionalization identified by Higgott³⁶⁰ according to which the business environment in Asia is less certain and less transparent than that of the European Union even though it is no less productive.

According to Dieter³⁶¹ the development of the automotive market in Europe confirms the fact that the integration processes could not be possible without the creation of a single regulatory sphere. Moreover, there is an integration of the production of automobiles and electronics in East Asia facing a wave of

³⁵⁶ Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.” p. 8.

³⁵⁷ Ibid, referring to Richard Baldwin. “Managing the Noodle Bowl: The Fragility of East Asian Regionalism”, Centre for Economic Policy Research Working Paper No. 5561, March 2006.

³⁵⁸ Ibid (Ewing-Chow and Hsien-Li).

³⁵⁹ Ibid, p. 8; referring to: “Abo Tetsuo, “Spontaneous Integration in Japan and East Asia: Development, Crisis, and Beyond”, in G.L. Clark, M.P. Feldman, and M.S. Gartler (eds) *The Oxford Handbook of Economic Geography* (Oxford: Oxford University Press, 2000), Chapter 31.

³⁶⁰ Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.” p. 9, referring to “Richard Higgott, “De facto or De Jure Regionalism: The Double Discourse of Regionalization in the Asia Pacific.” 11 *Global Society* (1997) p. 166.

³⁶¹ Ewing-Chow and Hsien-Li, p. 8: referring to “Dieter, Heribert; *Transnational Production Networks in the Automobile Industry*; (Notre Europe, 2007) Study No. 58, at: http://www.notre-europe.eu/uploads/tx_publication/Etud58_01.pdf.

protectionism along with inconsistent governmental policies.³⁶² He also describes that the response and solution to the problem would be through replacing the Brand-to-Brand Complementation (BBC) scheme adopted by ASEAN countries in 1988 with that of the ASEAN Industrial Co-operation (AICO) scheme in 1995. As for example, AICO has notably tried to broaden the scope of ASEAN cooperation beyond sheer automobile parts and has also finally included Indonesia in the regime.³⁶³

Now the question is, if “Factory Asia” already exists, what gains can be brought to the region through the ASEAN integration? In short the answer is that ASEAN integration may provide two core benefits for ASEAN member states. Firstly, the legalization and codification of existing policies for facilitating the IPN would create security and comfort for many of the MNCs who wish to invest in the region. The fact is that without such flow of investment an IPN cannot develop. The ASEAN member states are aware of this and their desire to protect investments (including intra-ASEAN investments) is clearly stated in Articles 1 and 2 of the 2009 ASEAN Comprehensive Investment Agreement (ACIA). Accordingly, ASEAN has proclaimed that it intends to “create a liberal, facilitative, transparent and competitive investment environment in ASEAN” and besides, “to improve transparency and predictability of investment rules, regulations and procedures conducive to increased investment among member states.”³⁶⁴

Second, despite some ASEAN successful prediction on particular industries in the past, it is difficult however to continue such forecasting because of the rapidly evolving global marketplace. Many ASEAN countries have also gone through the democratization process thus making autocratic choices for economic development more difficult which may eventually diminish over time.

Many changes in ASEAN governments affirm the above democratization process including the fall of Marcos in the Philippines, Thaksin in Thailand, or Suharto in Indonesia as well as the reduced parliamentary majorities of the People’s Action Party (PAP) in Singapore, also the Barisan Nasional (BN) and United Malays National Organization (UMNO) in Malaysia; or the decision for allowing election for the military junta in Myanmar may be considered as examples suggesting that centralized choices to favor industries may no longer work for the future of the ASEAN governments.³⁶⁵

Therefore, if a new environment is created to be conducive to an IPN, then it would be easier for the ASEAN member states to focus on macro-economic policies involving more private enterprise over their

³⁶² *Ibid*, p. 9.

³⁶³ *Ibid*.

³⁶⁴ *Ibid*, p. 10; with reference: to “ASEAN Comprehensive Investment Agreement (ACIA), 26 February 2009, at: <http://www.asean.org>”

³⁶⁵ Ewing-Chow and Hsien-Li. “The Role of the Rule of Law in ASEAN Integration.” p. 10.

industrial development. This, according to Porter, would be an easier step while bringing more success in developing industrial policy and it would also free ASEAN governments from obligation of making successful choices (as Porter suggests they do the job less well than it is done through private business) in supporting their perception of legitimacy through their electorate.³⁶⁶ This is in fact an adequate welcome of the private sector into the game.

It should be pointed out here that the ASEAN IPN is in fact a phenomenon beyond a purely intra-ASEAN encompassing a global sphere. Indeed, if we focus on relations among the ASEAN Plus Three (China, Korea, and Japan) it will underscore the point that ASEAN integration is in fact part of an Asian movement and cannot be understood as separate from Asian economic integration. Even though it is about Production Integration but it is by no means limited only to ASEAN.

Generally speaking, the three countries of China, Korea and Japan so called the ASEAN Plus are more looking for a regional free trade agreement with their ASEAN counterparts rather than having such individual agreements with each ASEAN state. In other words, they prefer to deal under the banner of ASEAN as an integrated scheme.

Accordingly, for example, the ASEAN-China agreement entered into force in 2007 and the ASEAN-Korea and ASEAN-Japan agreements entered into force in 2009. Two major exceptions occurred to the above generalization as being firstly the individual free trade agreements that the ASEAN Plus Three countries entered into with Singapore. And secondly, Japan as an exceptional example also pursued individual free trade agreements with many of the ASEAN states before entering into the Japan-ASEAN agreement.³⁶⁷

Under the circumstances, there are some challenges facing ASEAN notably causing a sense of uncertainty and fear within the ASEAN member states in respect to the future of the organization. Such challenges and the sense of uncertainty may also be rooted in the history of ASEAN since its inception in 1967. To mention some major examples, we can refer to the Vietnam War and the Khmer Rouge in Cambodia in the 1970s, while having the consolidation of nation states that continued in the post-war, post-independence period and was challenged by deep-seated inter-ethnic tensions, struggles that existed between political factions, separatist movements, and transitions from monarchy to constitutionalism.³⁶⁸

³⁶⁶ Ibid; with reference to: Michael Porter. "Competitive Advantage of Nations." (USA: Simon and Schuster, 1998).

³⁶⁷ Ibid (EUI Paper-Michael Ewing-Chow and Tan Hsien-Li), p. 13.

³⁶⁸ Ibid. p. 15.

Besides, there was the Asian Financial Crisis that resulted in severe social and political upheavals in Indonesia, Malaysia, and Thailand in the late 1990s. Just as it was recovering from that Asian Financial Crisis, the rise of China and India also imposed a challenge acting as major competitors for FDI. In all these situations, ASEAN has always had to react, adopt, and readjust.

The existence of the *rule of law* has brought a spirit of hope and certainty to ASEAN as it has consolidated a greater role for the rule of law in governing the relationship between its members. As such, clear and binding obligations as well as rules for dispute settlement; and sanctions for breaches of such rules particularly in economic matters have been recognized within the 2007 ASEAN Charter. Nonetheless, in practice ASEAN seems to have a long way to go for consolidating the status of the rule of law. As much that parallel to the IPN development and macroeconomic convergence, there has been a need for legalization and a stronger role given to the rule of law is deemed to be initiating the progress.

For such progress however, as far as internal institutions in ASEAN are concerned, its domestic courts in many members are still considered weak facing underdeveloped human capital, while no ASEAN supranational adjudication body has yet been proposed, and furthermore, the ASEAN Secretariat remains severely underfunded.³⁶⁹ Under such circumstances, the question remains as to what can and should propel ASEAN Integration? In this respect, it is thus imperative for ASEAN to create a more sound infrastructure in order to reach its ultimate goal of regional integration—namely *institutions, legalization, and dispute settlement mechanisms*.³⁷⁰

5.4. ASEAN Institutional Design

To reach a deeper and more successful regional integration, it is paramount important to have enhanced coordination among ASEAN institutions so that the interpretation and enforcement of ASEAN decisions would be facilitated. And to reach that objective the main question is what would be the modes of institutions to consider for ASEAN? According to Huntington's theory on institutions they are described as simply being "absorbers of conflicts."³⁷¹

³⁶⁹ Ibid, p. 16. With reference to: Michael Ewing-Chow. "Translating the Design into a Bloc: The Domestic Implementation of the ASEAN Charter." in S. Tiwari, ed., *ASEAN: Life after the Charter* (ISEAS Publishing, 2010), at 79.

³⁷⁰ Ibid, p. 16.

³⁷¹ Ewing-Chow, Michael, and Hsien-Li Tan. "The Role of the Rule of Law in ASEAN Integration." referring to: Samuel P. Huntington. "Political Order in Changing Societies." Yale University Press, 1968.

Unfortunately, the role of institutions in forging ASEAN has been very limited and to counter this fact, the ASEAN Charter has created some regional organs aiming at developing the ASEAN Community. These include the ASEAN Summit formed in accordance with Article 7; ASEAN Coordinating Council according to the Article 8; ASEAN Community Councils that consist of the Political-Security Council, the Economic Community Council and the Socio-Cultural Community Council which were formed in accordance with Article 9; and ASEAN Intergovernmental Commission on Human Rights as formed in accordance with the Article 14.³⁷²

Beside the above organs, a Committee of Permanent Representatives (CPR) was also established that is comprised of delegates from each ASEAN member states each holding the rank of Ambassadors and based in Jakarta. Nonetheless, the ASEAN summit is the main forum of decision-making through consultation and consensus.

Moreover, according to the Charter, the substantive role of the Secretary-General and that of the ASEAN Secretariat are expanded in order to facilitate and monitor any progress on the implementation of ASEAN agreements and decisions for the realization of an ASEAN Community. As such, Article 11(2) of the Charter enjoins that “one of the functions of the Secretary-General is to improve ASEAN’s compliance to ASEAN agreement, and in light of this function, the Charter accorded the Secretary-General ministerial status.”

Even though such a great responsibility to monitor and compliance of the agreement is given to the Secretary-General and the Secretariat, the budget however, for ASEAN secretariat remains very tight. This distribution of budget is important because practically speaking such a limited budget would in fact limit its effectiveness as a separate legal personality it has obtained.³⁷³

The main purpose for all such organs has been to ensure the adherence of member states to agreements and commitments under the above institutional framework. However, not much more details have been given in the Charter concerning the roles of these organs and that how they relate with one another. For example in case of the ASEAN Summit, Article 7 establishes the ASEAN Summit as “the supreme policy-making body of ASEAN” which is comprised of the Heads of State or Government of the member state. That is in fact, the highest level of decision-making in ASEAN within an intergovernmental structure. One of the tasks of the organ is to decide upon matters that are referred to it under Chapter VII,

³⁷² Ewing-Chow, Michael, and Hsien-Li Tan. “The Role of the Rule of Law in ASEAN Integration.” p. 16.

³⁷³ *Ibid*, p. 17.

which concerns the decision-making within ASEAN.

According to Chapter VII, the basic principle for decision-making within ASEAN would be by way of “consultation and consensus.” As such, only when such a consensus could not be reached the ASEAN Summit comes into play.³⁷⁴ Under such circumstances, the ASEAN Summit may decide as to how a specific decision should be made.³⁷⁵ All this confirms that even more than the institutional framework in MERCOSUR, ASEAN has also more of an intergovernmental framework away from a supranational one. Hence, there is no clear line in elaborating the roles of such organs in the Charter mainly because it was meant to be a general all-encompassing document that is not to deal in details with technical issues of the provisions.

As an example, Article 49 of the Charter facilitates the ASEAN Coordinating Council by empowering this organ “to issue the terms of reference and rules of procedure for ASEAN.” By this, it would be much easier to review and amend such terms of reference and rules of procedures without having to amend the ASEAN Charter. These terms of reference and rules of procedure are in fact aiming at establishing (p. 17) “clear, transparent, and efficient working relationships between the ASEAN organs”. Nonetheless, it is not quite clear as to what degree such rules are being adhered to.

Therefore, we may conclude that ASEAN institutions either are not properly in place or they are not strong enough. As such, the question arises as to whether the domestic institutions such as municipal courts could be restored to in such circumstances? This is an important question that can be similarly applied to the case of MENA, as we shall see, when considering further steps towards integration.

In case of the EU, such institutions are active along with properly evolved legal system where the domestic courts work towards greater legalism thus acting as an integral part to the development of the European Court of Justice (ECJ). In fact there has been a particular development within the ECJ with its own legitimacy and peculiar vision in respect to the European Integration (Despite the will of member states).³⁷⁶ However, such European model would be difficult to replicate in ASEAN. First of all, it is because ASEAN lacks a strong form of supranational court having the ability to push domestic courts to enforce ASEAN laws. And secondly, recent history and studies have proven that in most of the countries in Asia including ASEAN, domestic courts are not strong enough in terms of human capital and/or

³⁷⁴ Ibid, with reference to: “ASEAN Charter, supra note 35, Article 20(1).”

³⁷⁵ Ibid, with reference to: “Article 20(2).”

³⁷⁶ “The ECJ managed to push its vision of European legalization using the preliminary ruling mechanism in Article 177 of the Treaty of Rome, which greatly prompted member states’ compliance with European law by making them subject to binding decisions from their own domestic courts.”

political capital to basically avert conflict,³⁷⁷ let alone the corruption and extreme bureaucracy that heavily exist in such societies.

Having all this said, the question is whether the institutionalization of the new ASEAN would be an impetus to change it culturally towards a more legalized basis particularly for its intra-ASEAN international relationships which would lead to a more effective strategy for decision-making and greater integration within the region. Here too, the roles of institutions are salient, as we may not fully recognize the dichotomy between Intergovernmental and Supranational decision-making institutions. Put it in a simple term, the case is mainly about having good institutions in place instead of the bad or non-existent ones so that the decisions can be effectively made for the purpose of promoting regional integration.³⁷⁸

In addition to ASEAN Institution-formation as described above, the process of *legalization* is also another important cornerstone for ASEAN Integration. Some have suggested that what ASEAN should be looking for is not necessarily adopting the practices of the EU but rather trying to establish some of the rules-based principles.³⁷⁹ Echoing such literature on legalization, this can bestow a stronger role upon the Rule of Law for ASEAN that is definitely considered a positive step forward in making it a better regional integration.

5.5. ASEAN Dispute Settlement Mechanisms³⁸⁰

The above institutionalization and legalization processes in ASEAN followed by fora where disputes could be resolved. Since ASEAN establishment, there have been three main mechanisms for dispute settlement. The first one established in less than ten years after the Bangkok Declaration by which the 1976 Treaty of Amity and Cooperation (TAC) was adopted. The second one took shape by member states adopting the 1996 Protocol on Dispute Settlement Mechanism over economic agreements in about twenty years later, which was later updated by the 2004 ASEAN Protocol for Enhanced Dispute Settlement Mechanism (EDSM). And finally, Chapter VIII of the ASEAN Charter contains provisions on dispute

³⁷⁷ Ewing-Chow, Michael, and Hsien-Li Tan. "The Role of the Rule of Law in ASEAN Integration." p.18.

³⁷⁸ Ibid, p. 19.

³⁷⁹ Ibid, p. 20; referring to: Ong Keng Yong, "Forty Years of ASEAN: Can the European Union be a Model for Asia?" speech delivered to the Konrad Adenauer Foundation, Berlin, 16 July 2007, at <http://www.aseansec.org>

³⁸⁰ Ibid, p. 23, referred as to: Michael Ewing-Chow and Leonardo Bernard "The ASEAN Charter: the Legalization of ASEAN?" in the GAL Casebook (2012) Chapter I.B.7 for more details about this. This section is an abridged version of that chapter.

settlement that could serve as an overarching framework for such matters in ASEAN.³⁸¹ Such Dispute Settlement Mechanisms as provided under the TAC, the EDSM, and the ASEAN Charter, have never been utilized by all the member states.

However, the EDSM presents a mandatory process for dispute settlement. As such, a panel has been established by the senior Economic Officials Meeting (SEOM) whose duty is to assess disputes which could not be settled by way of good offices, mediation, or conciliation.³⁸²

In Chapter VIII of the ASEAN Charter two major roles have been defined for the ASEAN Summit. The first is for the ASEAN Summit to act “as a de facto final arbiter,” That is, when a dispute is left unresolved after using the dispute settlement mechanism within ASEAN framework, the parties can thus bring their dispute to the ASEAN Summit for its decision. Second is the role of an enforcement mechanism. When a decision has been finalized through one of ASEAN’s Dispute Settlement Mechanisms, the member state then can refer the case to the ASEAN Summit for a decision.

However, since the ASEAN Charter is silent in regard to decision-making at the ASEAN Summit level, then, the resolution might be attained by the “ASEAN Way” that is through “dialogue, consultation, and negotiation.” Such roles, however, seem quite weak for ASEAN Summit because firstly, Article 7 of the Charter doesn’t clearly specify a prescribed mechanism for the ASEAN Summit to act within this capacity. Does such silence denote that the Summit can make decision on the consensus approach? And what happens if there is no consensus?

And secondly, according to Article 7 of the Charter, member states are not obliged to comply with the decisions of the ASEAN Summit. Such uncertainties need to be clarified in order to facilitate the enhanced coordination between the members and that of the enforcement of decisions by the ASEAN Summit. But beyond the above-described rule of law and enforcement, the question is what other laws and rule-making or in a word *institutions* would be useful for ASEAN to inquire about the promotion of the integration it desires. Parallel to the idea of the rule of law, the applicability of decision-making process through institutions coupled with an effective dispute settlement mechanism (enforcement mechanism) should be present for an economic integration scheme to flourish. Then an economic constitution can further consolidate such scheme by establishing social contract and the rule of law.

³⁸¹ Ibid, with reference to: “ASEAN Charter, supra note 35, Chapter VIII, Articles 22–28.”

³⁸² Ibid, with reference to: “2004 EDSM, supra note 96, Article 8(2).”

5.6. The Role of an Economic Constitution

Philomena Murray, and Gabriele Orcalli in their article³⁸³ take one step further and pose the idea of an economic constitution in case of both the EU and ASEAN. Their article proposes the creation of an internal market within the European Union and Southeast Asia from a constitutional economics perspective.

According to their assessment, the quality of economic constitution as formed by participating countries has a significant role in the success or failure of a regional integration process. Connoting to our *social contract* theory at the beginning chapters, their article also concludes that the commitment to the implementation of a social contract is what determines the successful establishment of a single market. This quality is saliently needed as well in case of ASEAN, as it was well explained for the MENA region.

Scholarly research work done by Alesina et al, (2001),³⁸⁴ European Central bank [ECB] 2002,³⁸⁵ suggests that the effective relationship between *economic integration* and *institutional integration* may well lead to the success of integration processes. Accordingly, scholars have argued that as the integration advances from Customs Union more towards the creation of a Common Market and an Economic and Monetary Union, in other words the deeper the integration gets, it will, in turn, corroborate and sustain the process of *institutional integration* (ECB 2002).

Murray and Orcalli are, in fact, trying to show that beyond the quality of formal institutions, the nature of economic constitution would be of significance from the view of comparative regional integration. This view can also be applicable in cases of integration in MERCOSUR and AFRICA in that an RIA's (Regional Integration Agreement) success or failure depends on the economic constitution chosen by the participating states, as for instance, the choice of an appropriate economic constitution has been fundamental to the EU's success in bringing about a single market.

Hence, it is argued that the failure, to date, to bring about a single market in ASEAN (as implemented in the EU) has been mainly because of the difficulty it has for constructing an economic constitution as a form of an adequate social contract beyond a simple contract relating to the market. According to

³⁸³ Murray, Philomena; and Orcalli, Gabriele: "Deepening Regionalism in Europe and ASEAN—the Role of an Economic Constitution." *Journal of the Asia Pacific Economy*, Vol. 17, No. 3, August 2012, 426-445.

³⁸⁴ Alesina, A., Angeloni, I., and Etro, F. "Institutional Rules for Federations." Working Paper No. 8646. National Bureau of Economic Research, 2001.

³⁸⁵ European Central Bank (ECB). "European Integration: What Lessons for Other Regions? The Case of Latin America." Working Paper No. 185, 1992. Available from: <http://www.ecb.int/pub/pdf/scpwps/ecbwp185.pdf>

Vanberg a social contract is defined as follows:

“From a constitutional perspective, the – explicit or implicit—social contract ... that underlies any organization can be viewed as an exchange... namely an exchange of commitments among the contracting parties to accept constraints on their future choice options... The social contract establishes relations among the participants that are different in kind from market exchange relations³⁸⁶...” (Vanberg 1994, p. 140).³⁸⁷

Such constitutional approach is in fact giving objectively a binding nature to the market through societal exchanges which would in turn deliver two main outcomes being: 1- enforcement mechanism; and 2- distribution in a just manner. These two objectives are in fact the result of the implementation of a social contract that determines or results in the successful establishment of a single market. As such, institutionalizing regulatory procedures would be the key challenge for establishing an RIA. Such institutionalization would in fact establish a correlation between the complexity of individual trade relations depending on the level of specialization, and that of the complexity in those institutions that allow for trade to take place:

“the greater the specialization and the number and availability of valuable attributes (of commodities, services and the performance of agents) the more weight must be put on reliable institutions that allow individuals to engage in complex contracting with a minimum of uncertainty about whether the terms of the contract can be realized” (North 1990, p. 34).³⁸⁸

Hence, the role of the economic constitution of an RIA would become salient that is the sets of rules along with their enforceability that permit individual trade relations, which are regarded as a ‘reliable institution’ in North’s sense. As such, the effectiveness of such an economic constitution depends on its *ability to channel the choices made by private and public agents*, and such ability also depends on the *quality of the rules of the jurisdiction*. The importance of this channel between private and public becomes more important when establishing an “efficient economic institution” and to choose the kinds of rules of the game (institutions) by which the citizens of a polity would like to live.³⁸⁹ (Vanberg 2001, p.

³⁸⁶ Murray, Phlomena; and Orcalli, Gabriele: “Deepening Regionalism in Europe and ASEAN—the Role of an Economic Constitution.” *Journal of the Asia Pacific Economy*, Vol. 17, No. 3, August 2012, p. 427.

³⁸⁷ Vanberg, V. “Rules and Choices in Economics.” London: Routledge, 1994.

³⁸⁸ Murray and Orcalli, p. 428.

³⁸⁹ *Ibid*, p. 429.

34).³⁹⁰

Such institutional quality by no means is by accident, the EU for example has been the product of considerable political negotiations along with the conflict between national and EU interests. For instance, the Common Agricultural Policy (CAP) has been the consequence of costly intense bargaining which has been very central over time to the regional integration bargain of the EU.³⁹¹ Finding solutions in such conflicts are always costly for all. And a great compromise was the cost in building a single market and reaching the fruit of the CAP.

In contrast, ASEAN since its inception has been firmly in an intergovernmental format, with a policy of non-interference in the affairs of partner nations. As such, there are no supranational institutions like those of the EU even though ASEAN Charter (2007b) conferred a legal personality upon ASEAN for the first time. Therefore, comparatively, the concept of the rule of law in case of the ASEAN is rendered difficult and weaker than that of the EU due to *the lack of deep and embedded institutionalized integration* in ASEAN plus the differences that exist in practices and social cultures between the two.³⁹²

Considering such facts in building a single market, despite the wishes of the participating countries that look for “what is best for all,” what remains is a major challenge for ASEAN. To date there is no binding structure for market regulation and no commitment to binding rules while few pay-offs has thus maintained ASEAN as a loose regional organization. No common economic freedoms have yet been developed nor did any competition policies. Hence; problems of identity along with considerable heterogeneity and in a word weak economic constitution still exist on the way of achieving its internal market while having “inter-governmentalism” among the main characteristics of its negotiations. All such factors urge us to acknowledge the considerable interval between ASEAN and the more complex model of integration like that of the European Union whose main characteristic is based on the well-founded principle of supra-nationalism. Hence, ASEAN integration has a long way to strive as an effectively successful regional accord and as such; a more serious attempt to develop an economic constitution for ASEAN is to be seen for the future.³⁹³

³⁹⁰ Vanberg, V. “Constitutional Order and Economic Evolution: Competitive and Protectionist Interests in Democratic Society.” In: R. Mudambi, P. Navarra, and G. Sobbrío, eds. *Rules and Reason. Perspectives on Constitutional Political Economy*. Cambridge: Cambridge University Press, 2001: pp. 33-55.

³⁹¹ Murray and Orcalli, p. 433.

³⁹² *Ibid*, p. 437.

³⁹³ *Ibid*, p. 442.

5.7. Emerging Asian Regionalism: SCO, EAEU, BRICS, and APEC

As previously mentioned; stimulated by the global competition and strategic alliance, many countries in Asia have attempted to form their own PTAs or regional/transregional accords in the past few decades. Such efforts, in particular are observed to have taken place considerably in the eastern hemisphere in order to counterbalance the predominance of the west concerning regionalism.

To elaborate some examples of this kind, we can refer to Shanghai Cooperation Organization (SCO); Eurasian Economic Union (EAEU); as well as BRICS. The latter is considered an example of transregional agreement whose member countries include Brazil, Russia, India, China, and South Africa. This is while Asia-Pacific Economic Cooperation (APEC) was also established in 1989 as a regional economic forum to leverage the growing interdependence of the Asia-Pacific. Through the APEC forum, its 21 member countries³⁹⁴ aim to create greater economic prosperity by promoting inclusive, innovative, secure, balanced and sustainable growth in the region while accelerating regional economic integration.³⁹⁵

As being seen, the above regional, interregional, or transregional arrangements comprise some of the most important and powerful global economies. Nonetheless, how far such arrangements can be successful in achieving their objectives greatly depends on their institutional design and practice, their legal framework, and the existence of political will among their member countries to implement their laws and policies while abiding by international law and conforming with the processes of global integration.

The Shanghai Cooperation Organization (SCO) also known as Shanghai Pact is a Eurasian economic, political, and security alliance, which was created on 15 June 2001 in Shanghai, China. The organization includes China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan. Formally, the organization was established through the SCO Charter which was entered into force on 19 September 2003. In 2017, Pakistan and India also joined the SCO as full members at a Summit in Astana, Kazakhstan. The SCO is considered the “alliance of the East” known as the primary pillar of the region.

The SCO is not a classic model of economic integration like that of the European Union in which a

³⁹⁴ APEC members include the majority of the countries on the two sides of the Pacific rims; APEC's 21 Member Economies are Australia; Brunei Darussalam; Canada; Chile; China; Hong Kong, China; Indonesia; Japan; Malaysia; Mexico; New Zealand; Papua New Guinea; Peru; The Philippines; Russia; Singapore; Republic of Korea; Chinese Taipei; Thailand; the United States; and Viet Nam.

³⁹⁵ APEC Website. “What is Asia-Pacific Economic Cooperation.” <http://www.apec.org/About-Us/About-APEC>

significant part of sovereign prerogatives and authorities is transferred to some regional supranational institutions. Nonetheless, in its interstate and partnership model of integration, the SCO's consensus model of decision-making confirms the equality of all participants regardless of their potentiality or opportunity.³⁹⁶ Such model of interstate interaction has practically provided an institutional platform for the progress of Eurasian development in its integration processes including the implementation of China's One Belt, One Road initiative forming an overarching partnership between Eurasia and Asia-Pacific.³⁹⁷

Historically speaking, the ancient Silk Road as “coronary arteries” of the civilization of human being has been able to connect the East and the West through different cultures, religions and empires thus serving as the accelerator for the development of trade, economy and human civilization. Silk Road in fact connects China, Central Asia, the Middle East, Europe and North Africa. It encompasses about 30 countries from China to Europe and from India to Central Asia. The combined GDP of these countries accounts for 55% of the world's total while covering a region about 37% of the earth surface area with population and proven reserves accounting for 70% and 75% respectively.³⁹⁸ Perhaps this is why China's initiative plan so called *The Silk Road Economic Belt* looks appealing.

The SCO is considered a classic intergovernmental organization based on the principles of mutual respect and sovereign equality, territorial integrity of states, and non-interference into their internal affairs while rendering peaceful dispute settlement by way of consultation and negotiations. Article 15 of the SCO Charter (7 June 2002) enjoins that the SCO is explicitly endowed with the international legal personality by which it can interact and maintain dialogue with other states and international organizations.³⁹⁹ The SCO has considered the candidacies of Iran, India, and Pakistan in recent years among which the latter two have already become members. Iran is still seeking to become a consolidated member as of now.

The SCO legal framework contains 122 documents mainly related to the economy, which have the role of facilitating trade and investment, as well as banking and financial activities, manufacturing, agriculture, transport, communications, customs and development of tourism. These documents, however, consists only of 7% of the overall SCO contractual and legal framework. The organization needs to take further

³⁹⁶ Alimov, Rashid. “The Shanghai Cooperation Organisation: Its role and place in the development of Eurasia.” *Journal of Eurasian Studies*, 2018, p. 115.

³⁹⁷ *Ibid*, p. 114.

³⁹⁸ *Silk Road Economic Belt Construction: Vision and Path*; Report Released at “The Silk Road Economic Belt Construction and Future: 12 Countries Think Tank Forum.” In: *The Eurasian Era: Blue Book of Silk Road Economic Study 2014-2015*. Renmin University of China, 2014: pp. 2, 3, 4.

³⁹⁹ Kembayev, Zhenis. “The Silk Road Economic Belt and the Shanghai Cooperation Organization.” KIMEP University's School of Law. In: *The Eurasian Era: Blue Book of Silk Road Economic Study 2014-2015*. Renmin University of China, 2014: pp. 61-62.

measures to implement the Program of Multilateral Trade and Economic Cooperation within the member states (adopted in 2003), while materializing the development of projects contained in the SCO 2017-2021 will.⁴⁰⁰

The Eurasian Economic Union (EAEU) is an economic union of states located in central and northern Asia as well as Eastern Europe. The Treaty establishing the EAEU was signed in 29 May 2014 by the leaders of Belarus, Kazakhstan, and Russia and came into force in January 2015. The union has now five members including Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Russia. The above Treaty provides a legal and regulatory basis for the functioning of the EAEU. This Treaty includes articles concerning free movement of goods, services, capital, and labour within the union basing its fundamental principle of four “freedoms.”⁴⁰¹ Moreover, a Declaration was signed in 2018 on Further Development of Integration Processes within the Framework of the EAEU during which the member states agreed to level up the Ease of Doing Business by expanding cooperative ties among member states enterprises while improving the business environment in the common economic space, and promoting investment.⁴⁰²

The above efforts confirm the fact that Asia’s strengthening position as a driver of global economy has been progressive towards deepening regional integration aimed at increasing the competitiveness of the industries in the region while reducing the costs of their product for the market. In this process, further crystallization of integration efforts while involving more countries into the process of such integration shall strengthen the SCO’s and EAEU’s attempts in establishing the policy of multilateralism vs. unilateralism. It is anticipated that necessary institutional basis for such improvement will gradually mature with a more developed form of cooperating framework within both the SCO and EAEU thus leading to further deepening of interaction with the countries of Southeast Asia.⁴⁰³

As indicated, BRICS consists of the five major emerging national economies of Brazil, Russia, India, China, and South Africa. The association was formed in 2009 by the first four members with the inclusion of South Africa in 2010. Many argue that the emergence of such associations as the SCO, EAEU, and BRICS is in fact an integral part of the globalization processes in shaping a multipolar world. This trend has created a new institution in modern international relations through strategic partnership at the

⁴⁰⁰ Alimov, Rashid. “The Shanghai Cooperation Organisation: Its role and place in the development of Eurasia.” *Journal of Eurasian Studies*, 2018, p. 116.

⁴⁰¹ “What is the Eurasian Economic Union (EAEU),” EEC. Moscow, Astana, August 2017, Retrieved from: <http://greater-europe.org/archives/3895>

⁴⁰² Eurasian Economic Integration 2019. “Eurasian Economic Bank, Center for Integration Studies, Moscow, 2019: page 17, and page 123.

⁴⁰³ Alimov, Rashid. “The Shanghai Cooperation Organization: Its role and place in the development of Eurasia.” *Journal of Eurasian Studies*, 2018, p. 124.

regional, interregional, and transregional levels.⁴⁰⁴ The BRICS five nations combined would be the largest entity on the globe in many respects according to Goldman Sachs, as they are considered among the biggest and fastest growing markets encompassing emerging and developing markets of the world.⁴⁰⁵

The legal and international nature of the above associations is a crucial factor for their development. Beyond the international law framework in formulating the relational issues, the BRICS countries tend to use a more delicate tools and diplomatic means with less financial and other costs. The interstate and partnership of the BRICS is based on the Economic Partnership Strategy (7th BRICS Summit: Ufa, Russia, 2015) which provides the basis for cooperation. Moreover, the *BRICS Trade, Economic and Investment Cooperation Road Map up to 2020* has been recently signed comprising of major projects in the fields of infrastructure, industry, and agriculture. Also, the Xiamen Declaration (China, April 9, 2017) was signed to improve the trade and investment cooperation while increasing the complementarity and diversification of the economies.

In Shanghai (September 2017), a plan was also signed for cooperation on promoting investment, trade facilitation including trade in services, e-commerce, and intellectual property. The BRICS Strategic Customs Cooperation Program was also signed including mutual recognition of the results of customs control and mutual assistance in law enforcement. This program serves to simplify the customs procedure in mutual trade while harmonizing the customs rules and procedures using advanced information technologies.⁴⁰⁶

Taking into account the fact that the BRICS countries occupy about a quarter of the world's land, 42% of the world's population while having 30% of the world GDP, and 20% of the world trade,⁴⁰⁷ strengthening of the above legal and institutional framework in conformity with international law could effectively contribute to the development of the global economy thus increasing the economic and political influence of the developing world in particular upon the issues of integrative development.

Asia-Pacific Economic Cooperation or APEC is considered an intergovernmental association and the premium forum for facilitating trade and investment, cooperation, and economic growth within the Asia-

⁴⁰⁴ -Luzina T.V. & Dudareva E.A. & Akhmetshin E.M. & Yankovskaya, V.V. "The International and Legal Framework for Transregionalization of Trade and Economic Cooperation of the BRICS Countries." *European Research Studies Journal*, 2018, p. 166.

⁴⁰⁵ Koba, Mark. "BRICS: CNBC Explains." Updated 2015; Retrieved from: <http://www.cnbc.com/id/44006382>

⁴⁰⁶ Luzina T.V. & Dudareva E.A. & Akhmetshin E.M. & Yankovskaya, V.V. "The International and Legal Framework for Transregionalization of Trade and Economic Cooperation of the BRICS Countries"; *European Research Studies Journal*, 2018, p. 172.

⁴⁰⁷ *Ibid*, with reference to: BRICS Joint Statistical Publication 2017, p. 272.

Pacific region. APEC operates based on equal respect and open dialogues and non-binding commitments. Therefore, it has no treaty obligations for its member countries, and decisions within the APEC are reached by consensus while commitments are on a voluntary basis. APEC 21 member economies account for approximately 55% of the world's GDP, 44% of the world trade and 40% of the world's population.⁴⁰⁸

APEC was established in 1989 to bear out some goals and purposes including the enhancement of economic growth and prosperity while strengthening the Asia-Pacific community. Since then, the organization has attempted to reduce tariffs and other barriers to trade across the Asia-Pacific region in view of increasing economic efficiency and exports among the member countries. In 1994 in Bogor, Indonesia, the leaders of the APEC member economies adopted a vision called the "Bogor Goals" that included free and open trade and investment in the region by 2010 for the industrialized members and by 2020 for developing economies. Such vision is to create jobs by providing opportunities in international trade and investment. It also helps lower the costs of production while reducing the prices of goods and services. Moreover, APEC is also a forum to create a safe and efficient movement of goods, services and people across the region through economic and technical cooperation as well as policy alignment.⁴⁰⁹

5.8. Conclusion

The Charter and as the result the *rule of law* have brought a new spirit of legalization to ASEAN through which governmental, intergovernmental, non-state actors and human rights issues have been taken to the political scene within ASEAN integration for further cooperation. Thus, the Charter of ASEAN has been an instrumental achievement in bringing the legal and institutional issues to the forefront of ASEAN's objectives, while guiding towards ASEAN's future. Along these lines an *institutional integrity* and a greater observance of *the rule of law* within ASEAN seem necessary for a deeper integration.

ASEAN should develop a more comprehensive Dispute Settlement Mechanism while it should be noted that the EDSM has already been a good step forward. Overall, the hope is that the long-term advantage of ASEAN integration shall prevail upon the rhetoric about the preference of national sovereignty and principle of non-interference. Such vision can also be learned and applied in shaping the future of MENA.

Finally, taking the European Union as a progressive model, it should be again emphasized that the EU

⁴⁰⁸ Asia Pacific Economic Cooperation (APEC); World Organizations. Retrieved from: [https://www.onlinegk.com/worlds-organizations/asia-pacific-economic-cooperation-\(apec\)](https://www.onlinegk.com/worlds-organizations/asia-pacific-economic-cooperation-(apec))

⁴⁰⁹ Ibid.

didn't emerge as an experience that is full grown out of the minds of its Fathers despite the fact that legalization had a significant role to play in its progress. However, much compromise and evolution took place on the way of forming the cognitive regionalism that we witness today.⁴¹⁰ It is, nonetheless, certain to say that the current weak legalization is not suitable for a regional integration like that of ASEAN. However, to fully reject it as a regional integration of a sort would be like asserting that Impressionism is not art on the ground that it does not conform to the ideals of Renaissance art.⁴¹¹

ASEAN has well passed the early difficulties of a regional accord and has achieved some regional cooperation and confidence building. Even though like the story of the Elephant it is hard to define integration, it can yet be defined so as to what is not; it is not at hoc, is something progressive and systematic, it is open-ended and future-oriented and not time limited, and beyond the term of self-interest it may be defined by a sense of common interests and commonality in general. After all, they will judge ASEAN based on the fact that how far it has delivered such common interests and goals.⁴¹²

In short, what has been presented here for ASEAN stresses over the formation of adequate and formidable institutions for the purpose of a deeper integration on the one hand while suggesting the important role of an economic constitution on the other under the banner of a proper social contract. Hence, legalizing the rules and institutionalizing the trends of regional integration in ASEAN would be an objective that can serve a suitable social contract for ASEAN as similarly discussed in case of the MENA region.

In addition; as expressed in the work of Schaefer and Cooter titled *Solomon's Knot: How Law Can End the Poverty of Nations*; legal reforms as explained in this chapter are significantly hailed in the case of ASEAN. The above authors stress that in fact attempts in central Europe, South Asia and East Asia leading to legal reforms were considered a fundamental basis in generating significant economic results. Accordingly, pro-growth reforms as in case of ASEAN can gain momentum by way of "comprehensive political bargain" as well as creating an environment to further competition among entrepreneurs.⁴¹³

Within a cooperative atmosphere resulted out of political will (inclusive political institutions in Acemoglu and Robinson's term) as well as fair competition, trust can be born where laws and social norms can then braid into institutions (formal and informal institutions in North's term) thus strengthening each other like

⁴¹⁰ Ewing-Chow, Michael; and Hsien-Li, Tan. "The Role of the Rule of Law in ASEAN Integration." EUI Working Paper RSCAS 2013/16, p. 35; as referred to: JHH Weiler, "The Transformation of Europe" (1991) 100 Yale LJ 2403.

⁴¹¹ Ibid (p. 35).

⁴¹² Ibid.

⁴¹³ Schaefer, Hans-Bernd; and Cooter, Robert D. "Solomon's Knot: How Law Can End the Poverty of Nations." Berkeley Law, December 2011, Chapter 14 (preliminary Manuscript), pp. 16-17.

strands in a rope. Such laws and adequate institutions which can be attained by pro-growth reforms would then provide the framework for innovation that accordingly can end the poverty of nations. This is how law, politics, and economics can together create trust the society needs for progress leading as such towards inclusive growth, innovation, and economic success.

Last but not least, parallel to the ASEAN formation, in recent decades, there has been a growing attempt in the eastern hemisphere to shape the new emerging Asian regionalism. Since a unipolar world especially under the experienced American hegemony proved to be far from perfect, a new mentality gained momentum particularly in Asia according to which the emerging Asian regionalism could lead to the establishment of a rather multipolar world.

To pursue such trend of multilateralism, the emerging powers including China, India, and Russia attempted to form their own regional and transregional paradigm in order to establish the new global order. In every aspect, it is certain to say that the policy of regional integration looks apparent in achieving such economic, geo-strategic and political objectives. Shanghai Cooperation Organization (SCO), Eurasian Economic Union (EAEU), and BRICS are in fact major results of such policy in shaping regional and transregional associations. This is while APEC represents an example of somewhat softer forum for simple cooperation among the Asia-Pacific member economies. As indicated earlier, the Asia-Pacific Economic Cooperation (APEC) group represents low levels of obligation, precision, and delegation. In conclusion, institutional design and practice, and proper legal framework within the above associations are of paramount importance in achieving those global ambitions by way of serving the complementarity with that of the global integration.

Chapter (6): Integration in Africa

6.1. Introduction

In Africa for decades independence and national sovereignty have been the core part of political exercise. Right after the post-independence era we witness a zealous inclination for sovereignty by African states with attempts to strengthen more stable national institutions. Yet, in recent times with African renaissance- calls have been made for transfer of sovereignty from that of the state to regional and continental institutions. As such, national separatism is gradually being replaced by attempts towards regional and continental integration.⁴¹⁴ What they are trying to achieve in Africa is the creation of an African Economic Community (AEC) as the ultimate goal. To that effect, eight regional economic communities have been recognized by the African Union (AU) so far. They include the following:

AMU (Arab Maghreb Union); EAC (East African Community); CEN-SAD (Community of Sahel-Saharan States); COMESA (Common Market for Eastern and Southern Africa); ECCAS (Economic Community of Central African States); ECOWAS (Economic Community of West African States); IGAD (Inter-Governmental Authority on Development); and SADC (Southern African Development Community). This Chapter mainly focuses on the four major communities of ECOWAS, COMESA, EAC as well as SADC.

African integration with its upheavals throughout its history may also furnish good lessons for the MENA region so as to make both economic and political integration progress in parallel with each other. This is in fact the same application of Acemoglu/Robinson and Douglass North views in respect to both political and economic institutions. Like that of MERCOSUR, as we will see the organization is well established within the African integration, yet having the proper institutions work effectively is what counts when it comes to practice like the case of the European Union. In Africa, however, unlike the MENA region, the need has been felt for African states to integrate their economies in order to enhance their growth and development.

Richard Frimpong Oppong in his book⁴¹⁵ emphasizes on legal institutions and thus believes a stronger role should be given to such institutions. Moreover, he examines how relational issues of law in economic

⁴¹⁴ Oppong, Richard Frimpong. "Legal Aspects of Economic Integration in Africa." Cambridge University Press, 2011, P. 1.

⁴¹⁵ Ibid.

integration are being approached in Africa. What we have here is in fact Douglass North's views on institutional change that is being projected over a legal framework with adequate institutions to achieve a successful integration. In short, Oppong through his theory suggests that an effective economic integration is defined within a proper legal framework as a product of well-structured and managed relational issues that exist at different vertical, horizontal and vertico-horizontal levels among states, legal systems, laws, and institutions.⁴¹⁶

In other words, the priority within the organization of African integration is placed upon legal institutions. The above four regional communities form the kind of integration within the continent in which goods, services, labor and capital are able to and will circulate freely. Within the context of relational issues among the states, individuals also play a central role in economic integration. Similar to institutions or as part of them, they serve like media to create relations between legal systems. Their actions by way of litigation would be considered important in particular when enforcing the community law even though such actions to ensure the effectiveness of the community law might be hampered at times by the existing national legal infrastructure.⁴¹⁷

From this perspective, the significance of individualism and the place of individual are revealed in the course of integration processes and development. As such, relational issues become important to institutional understanding. In other words, understanding the complex web of relations reveals the institutional deficiencies that exist in Africa's integration processes.

6.2. Overview of African Integration, Legal Framework and Relational Issues

Relational issues of law or simply relational issues are endemic in economic integration processes⁴¹⁸ and they become more important and more visible as we progress through the different processes of integration. In case of Africa, it seems, such processes have gained a sheer political structure with little attention to the significance of solid legal frameworks.⁴¹⁹ Indeed, according to a report by the UNECA (United Nations Economic Commission for Africa) the current legal framework for Africa's integration is considered imprecise and ambiguous.⁴²⁰ The disjunction between national and community legal systems

⁴¹⁶ *Ibid*, p. 3.

⁴¹⁷ *Ibid*, p. 4.

⁴¹⁸ *Ibid*, p. 12.

⁴¹⁹ *Ibid*; p. 13; with reference to: "Kufuor (1994); Joerges (2002–2003); and Joerges (1996)."

⁴²⁰ *Ibid*, p. 21; with reference to: "25 United Nations Economic Commission for Africa (2006)."

is in such a way that would manifest the inattention of Africa's economic integration to relational issues. The lack of some national legislation which would be necessary to implement decisions taken by Africa's RECs (Regional Economic Community), is an example of such deficiency.

In addition, like the case of MERCOSUR, legally speaking, there are contradictions between Africa's integration processes and global and other international economic arrangements such as WTO. Indeed such integration processes need to comply with WTO law that is comprised of the very foundations for regional economic integration processes especially Article XXIV of the General Agreement on Tariffs and Trade, or the Decision on Differential and More Favorable Treatment Reciprocity and Fuller Participation of Developing Countries. Such contradiction and conflict ought to be reconciled and as such, the rules that deal with resolving conflicts between community law and national law and that of the WTO should be considered to settle such issues. In fact, such relational issues are important for the development of the Africa's integration processes particularly in a situation where the legal aspects of Africa's economic integration processes like that of the situation in the MENA region, seem quite scant.

6.2.1. African Economic Community (AEC)

The Treaty establishing the African Economic Community came into force in May 1994 to envisage an integrated economic area that covers all of Africa.⁴²¹ It was followed by the establishment of the AU in 2002, and as such, the AEC became an integral part of its constitutional structure.⁴²² In fact the AEC Treaty is a basis to gradually establish the African Economic Community through six stages and over a period of thirty-four years.⁴²³ That is, the process is supposed to be completed in 2028.

The first stage involves the 'strengthening of existing regional economic communities.'⁴²⁴ The second stage comprises of "the stabilization of tariff and non-tariff barriers, custom duties and internal taxes at the level of the RECs and the strengthening of sectoral integration at the regional and continental levels."

⁴²¹ Oppong, Richard Frimpong, p. 17, referred to: "As of September 2010, fifty-two African countries had signed the treaty and forty-nine had ratified it. However, unlike the EAC Treaty, I am unaware of any countries (especially common law countries) that have domestically implemented the AEC Treaty through legislation. See generally Ajomo and Adewale (1993)."

⁴²² Ibid; with reference to: "AEC Treaty, art. 98. Constitutive Act, art. 33. In this book, unless a contrary provision exists in the Constitutive Act, references are made to the institutional structures established under the AEC Treaty for consistency and clarity. On some of the difficulties of making the AEC an integral part of the AU, see Jackson (2003a), p. 140."

⁴²³ Ibid, p. 18 with reference to: AEC Treaty, Article 6(1).

⁴²⁴ Ibid, with reference to: AEC Treaty, Article 6(2).

The third stage would be about “the establishment of a free-trade area and a customs union at each regional level”. The fourth is regarding the “coordination and harmonization of tariff and non-tariff systems among the RECs” for the purpose of establishing an African Customs Union throughout the continent. The fifth would be an attempt to establish African Common Market “through the adoption of common policies, harmonization of monetary, financial and fiscal policies, and the application of the principles of the free movement of persons and the right of residence and establishment”. Finally, the sixth stage mainly is to focus on:

“the strengthening of the African common market; the application of the free movement of people, goods, capital and services; the integration of the social, economic, political and cultural sectors; the establishment of a single domestic market; a Pan-African Economic and Monetary Union; a Pan-African Parliament,⁴²⁵ and a single African currency.”⁴²⁶

It is worth mentioning that the above stages are in fact in accordance with the Balassian model of economic integration which was briefly discussed in earlier Chapters. There are currently fourteen RECs at different stages of development in Africa. Each has separate institutions, members, objectives and legal personalities. As such, we may find some states that are member to more than one of such communities at the same time which arguably might create significant legal challenges to the success of the AEC.⁴²⁷

As far as the structure of AEC is concerned, the principal institutions of the AEC are as follows:

Assembly of Heads of State and Government; Council of Ministers; Pan-African Parliament; Economic and Social Commission; Court of Justice; General Secretariat; and Specialized Technical Committees.⁴²⁸

The Assembly is the supreme organ of the Community being responsible for implementing the community’s objectives.⁴²⁹ “The AEC today forms the economic wings of the African Union...⁴³⁰ the functions of the AEC institutions have been taken over by the coordinate organs of the AU.”⁴³¹ As such in case of any conflict of laws, the provisions of the Constitutive Act of the African Union shall prevail.

⁴²⁵ Ibid, p. 19; stating “Protocol to the Treaty Establishing the African Economic Community Relating to the Pan-African Parliament, 2 March 2001, (2005) 13 Afr. J. Int’l & Comp. L. 86 (hereafter, Protocol on the Pan-African Parliament). The parliament was inaugurated in 2003.”

⁴²⁶ AEC Treaty, Article 6.

⁴²⁷ Oppong, p. 19, referred to: “Kiplagat (1995–1996); and Jackson (2003a), pp. 151–4.”

⁴²⁸ Ibid, with reference to: “AEC Treaty Art. 7.”

⁴²⁹ Ibid, Art. 8.

⁴³⁰ Oppong, p. 22; referring to: “Kouassi (2007), p. 6.”

⁴³¹ Ibid: “The organs of the AU are the: Assembly of the Union; Executive Council; Pan-African Parliament; Court of Justice; Commission; Permanent Representatives Committee; Specialized Technical Committees; Economic, Social and Cultural Council; and Financial Institutions.”

6.2.2. Economic Community of West African States (ECOWAS)

The ECOWAS is currently being operated in accordance with the Revised Treaty Establishing the Economic Community of West African States (ECOWAS Treaty). Moreover, it has fifteen members: Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo. The community was initially created under the Treaty establishing the Economic Community of West African States as entered into force in June 1975.⁴³²

According to article 3 of the ECOWAS Treaty, the aims and objectives of the community would be “to promote cooperation and integration, leading to the establishment of an economic union in West Africa to raise the living standards of the peoples, and to maintain and enhance economic stability, foster relations among member states and contribute to the progress and development of the African Continent.”

And in order to reach such objectives, Article 3(2) enjoins that the “community shall ensure among other things: the harmonization and coordination of national policies and the promotion of integration programmes, projects and activities, particularly in food, agriculture and natural resources, industry, transport and communications, energy, trade, money and finance, taxation, economic reform policies, human resources, education, information, culture, science, technology, services, health, tourism and legal matters; the establishment of a common market and an economic union through the adoption of common policies in the economic, financial, social and cultural sectors, and the creation of a monetary union...”

ECOWAS institutions include: Authority of Heads of State and Government; Council of Ministers; Community Parliament; Economic and Social Council; Community Court of Justice; Executive Secretariat; Fund for Cooperation, Compensation and Development; and Specialized Technical commissions.⁴³³

6.2.3. The Common Market for Eastern and Southern Africa (COMESA)

The COMESA Treaty was entered into force in 1994 establishing the Common Market which currently has nineteen members that are: Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland,

⁴³² Oppong, p. 22.

⁴³³ Oppong, p. 23; with reference to: ECOWAS Treaty, Art. 6 (1).

Uganda, Zambia and Zimbabwe. In short, COMESA is in fact the follow-up organization of the PTA (1982) for Eastern and Southern African States.⁴³⁴

In accordance with Article 3 of the COMESA Treaty, the aims and objectives of COMESA are numerated as: “to attain sustainable growth and development of the member states by promoting a more balanced and harmonious development of its production and marketing structures; to promote joint development in all fields of economic activity and the joint adoption of macro-economic policies and programs to raise the standard of living of the people and to foster closer relations among its member states; to cooperate in the creation of an enabling environment for foreign, cross-border and domestic investment, including the joint promotion of research and adoption of science and technology for development; to cooperate in the promotion of peace, security and stability among the member states to enhance economic development in the region; to cooperate in strengthening the relations between COMESA and the rest of the world, and the adoption of common positions in international forums; and to contribute towards the establishment, progress and realization of the objectives of the African Economic Community.”

In short, the community was established for the promotion of regional and global integration while moving towards deeper integration. Accordingly, members have agreed to establish a customs union through trade liberalization thus abolishing all non-tariff barriers to trade among themselves while establishing a common external tariff to cooperate in customs procedures and activities. Such customs union was launched in 2009 with the hoping view of forming a common market and a monetary union by 2025.⁴³⁵

Accordingly the principal institutions of COMESA include the following: Authority of Heads of State and Government; Council of Ministers; Court of Justice; Committee of Governors of Central Banks; Intergovernmental Committee; Technical Committees; Secretariat; and Consultative Committee.

All such progressive steps along with proper legal articles (such as article 3 of COMESA) generates the promotion of regional and global integration while establishing deeper integration in its regional context which may set examples for other regional cooperation and activities such as a one for the MENA region. However, such progressive economic integration processes should reflect a harmonization of laws and policies between different levels of national, regional and global procedures. As we shall explain, there is a lack of such complementarity and harmonization in case of the majority of communities in Africa.

⁴³⁴ Ibid, referred to: Gondwe (1998).

⁴³⁵ Oppong, p. 24.

6.2.4. East African Community (EAC)

The Treaty of East African Community⁴³⁶ entered into force in 2001 and accordingly established a community that consisted of Kenya, Uganda and Tanzania. However, the community was expanded in 2008 and now includes Burundi and Rwanda as well. Its history is rooted in the colonial times.⁴³⁷ Initially the EAC was established under the 1967 Treaty on East African Cooperation upon which its present form would be a “resurrection” of that initial establishment. As we see, such integration processes can begin in forms of regional cooperation as the first step which is indeed vital in today’s MENA region as well.

According to Article 5 of the EAC Treaty, the aims and objectives of the community have been defined as “to develop policies and programs aimed at widening and deepening cooperation among the member states, for their mutual benefit, in the political, economic, social and cultural fields, research and technology, defense, security and legal and judicial affairs.”⁴³⁸ Along with the above objectives, the states’ attempt has been mainly to establish “a customs union, common market, monetary union and ultimately a political federation.” The EAC Common Market was established in July 2010, which was considered a *major feat for economic integration in Africa*. This happened about five years after the EAC customs union was launched. This shows a step-by-step process towards a deeper integration.

The EAC has proved to have a relatively faster pace of progress in Africa for which a number of factors can be reasoned as follows: a) its size, b) the existence of relatively *stable and democratic political structures* within the founding members, and c) the strong bondage between and among the member states from colonial times and the days of the old East African Community. The principal institutions of the EAC include: the Summit of Heads of State and Government, Council of Ministers, Coordination Committee, Sectoral Committees, East African Court of Justice, East African Legislative Assembly and Secretariat.⁴³⁹

6.2.5. Southern African Development Community (SADC)

The SADC Treaty, which entered into force in 1992, established a community called SADC consisting of Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius,

⁴³⁶ Ibid, referred to: Kaahwa (1999); and Fitzke (1999).

⁴³⁷ Ibid, referred to: “di Delupis (1970), pp. 19–50; Franck (1964); Sebalu (1972); and Bentil (1969).”

⁴³⁸ Oppong, p. 24.

⁴³⁹ Ibid, p. 25.

Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. Initially the community was called “the Southern African Development Coordination Conference” (SADCC). It was an ‘organization’ formed in 1980 aiming at “facilitating economic development in the member states and lessening dependence on South Africa.” Eventually, the SADCC was transformed into the SADC with the signing of the SADC Treaty in August 1992. The step-by-step process towards a deeper integration can be observed here too from a simple cooperation to a more complex web of integration.

Furthermore, all fundamental values that can help for institution-building are asserted in Article 5 of the SADC Treaty. Accordingly, Article 5 of the SADC Treaty enjoins the objectives of SADC that are to:

“Promote sustainable and equitable economic growth and socio-economic development that will ensure poverty alleviation with the ultimate objective of its eradication; enhance the standard and quality of life of the people of Southern Africa and support the socially disadvantaged through regional integration; promote common political values, systems and other shared values that are transmitted through institutions that are democratic, legitimate and effective; consolidate, defend and maintain democracy, peace, security and stability; promote self-sustaining development on the basis of collective self-reliance, and the interdependence of member states; *achieve complementarity between national and regional strategies and programs*; promote and maximize productive employment and utilization of the region’s resources; achieve sustainable utilization of natural resources and effective protection of the environment; and strengthen and consolidate the long-standing historical, social and cultural affinities and links among the people of the region.”

Even though among the above broad and far-reaching objectives, economic integration is not specifically prescribed, what is important is that Article 1 of the treaty clearly defines ‘community’ –the Southern African Community– as ‘the organization for economic integration established by article 2 of this Treaty.’⁴⁴⁰

6.2.6. Laws, Institutions, and Economic Integration in Africa

Relational issues are mostly related to the socio-economic and political factors that provide the *raison d’etre* for Africa’s regional economic integration conditioning at times its progress and effectiveness. Such political and economic factors in case of Africa are greatly influenced by the colonial (British) era

⁴⁴⁰ Ibid, p. 25.

coupled with the geographical tightness and proximity which have formed a natural “bond of interdependency.”⁴⁴¹ In addition, from a legal perspective, the colonial experience may often be considered an important complement to economic integration due to the common legal infrastructure it has created.

Communities in Africa mainly adhere to the Common Law system, and Roman-Dutch law or civil law tradition which all are the result of their colonial associations with Britain, France and, to a lesser extent, Belgium, Portugal, Germany and the Netherlands. Within the above explained colonial legacy lie solutions to the challenges in integration. In other words, they can meaningfully address such challenges through the ‘harmonization of laws’.

On the other hand, such colonial legal legacy can also sometimes constrain economic integration. In this scenario, the difference in legal infrastructure is like the difference in institutional infrastructures and it matters when it comes to regional integration or cooperation agreements. Nonetheless, what matters the most is the key success in economic integration which can be achieved by the principle of good governance composed of democratic governance, the rule of law, and political stability.

Many African countries in fact have been trying to consolidate the rule of law within their colonies while struggling to strongly maintain their sovereignty. This has created clashes by which a number of member states of the communities are reversely suffering from undemocratic regimes, abuse of power and political instability. In some cases such as the EAC, in which Kenya, Tanzania and Uganda were British colonies, the association with such former colonial powers could have been a drain on the processes of economic integration in Africa.⁴⁴² Same analogy can be seen in Acemoglu and Robinson’s *Why Nations Fail*. They show the defects of political institutions in some of African countries that hinder the economic progress even inside their regimes let alone further development within the regional context.

Comparing the slave trade in south east Asia and India with that of Africa, Acemoglu and Robinson illustrate how the machinery of such trade caused many of the local African governments to crumble and as the result the ‘persistent extractive institutions’ got in place even through the public sectors of the African states thus capturing and selling slaves to Europeans. This whole scenario repeated itself in Africa consolidating such extractive institutions and thus bringing about the failed states of today in Africa.

⁴⁴¹ Ibid, p. 26, referred to: “Ndulu (2006).”

⁴⁴² Ibid; referred to: Amuwo (1999).

Some few parts of Africa could escape such a slave trade system such as South Africa is which a different set of institutions had been imposed by Europeans as designed to create a reservoir of rather cheap labor for their farms and mines. This created a dual economy for the South Africa thus preventing 80 percent of their population from participating in commercial farming, skilled occupations and entrepreneurship. All this shows how and why industrialization greatly passed by large parts of the world and how economic development would feed on so as to create underdevelopment in some other parts of the world either domestically or globally.⁴⁴³

It is noteworthy that the above story in its different forms took place in case of many countries within the MENA region as well. In MENA, many of the governments were in fact acting as the proxies of the colonial powers establishing such extractive institutions in their countries and thus expanding it throughout the region. Likewise, the above explained impact of the colonial era expound a great part of the hurdle to development in Africa which even caused serious regional conflicts in that continent from time to time. As we go on through stages of regional cooperation and economic integration, the effects of such era still shadow integration. As such, there are many socio-economic and political factors that challenge or even hinder economic integration processes or undermine its effectiveness. These include the diversity in political ideology and political systems in Africa, the absence of mutual trust among the relevant member states, or lack of homogeneity in the level of economic development, as well as the issue concerning the even-distribution of the benefits gained out of economic integration.⁴⁴⁴

Richard Opong is suggesting a legal framework for managing relational issues. Indeed, regardless of the stage of an REC, it is certain to say that integration through a harmonized legal framework creates some juxtaposition among states, laws, legal systems and institutions to achieve a common vision in respect to economic development.⁴⁴⁵ As a result of these institutions, a complex web of relations would emerge that encompasses the principal actors such as the community, member states, some other international organizations and of course individuals. And the main challenge in an attempt to reach economic integration would be structuring and managing the relations between and among such actors. Accordingly, such legal framework and mechanism to address relational issues have their foundations in *public and private international law*. They are also influenced by domestic constitutional laws. They can act as relational principles of law for economic integration (“relational principles”).⁴⁴⁶ Since many of these principles have roots in public and private international law; therefore, a harmonization of the legal

⁴⁴³ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity and Poverty.” New York, p. 273.

⁴⁴⁴ Opong, Richard Frimpong. “Legal Aspects of Economic Integration in Africa.” pp. 28-29.

⁴⁴⁵ *Ibid*, p. 30.

⁴⁴⁶ *Ibid*, p. 32.

structures with that of international law could be a key factor to an effective regional economic integration. The WTO laws would be an example and the compliance of the community laws with it would be an effective step in forming successful regional integration.

The first step to reach this goal would be to establish an economic community. Interestingly, some significant international organizations that first demonstrated supranational characteristics were in fact economic communities, namely the European Communities (now the EU) and, subsequently, the East African Community.⁴⁴⁷ The difference however, is that the EU adopted some norms through the jurisprudence of the European Court of Justice (ECJ) for which Joseph Weiler uses the concept of “normative supranationalism.” Normative supranationalism deals with the hierarchy and the relationship between the legal measures and community policies on the one hand, and legal measures and competing policies on the other.⁴⁴⁸ Notably he provides three key elements namely *direct effect*, *supremacy* and *pre-emption* as the core attributes of the concept.⁴⁴⁹

Normative supranationalism is in fact the result of well-matured institutions within the community. Therefore, the more economic interactions take place between and among communities, the more we would be able to institutionalize such norms. And in this process, local norms are important. Not every norm may claim a legitimate place in a legal system. Hence, norms that are external to a legal system, such as international law and the laws of other states, would be treated differently from the norms that are considered internal to the legal system. Noteworthy to mention that the four elements of a legal system (order) are: 1- Rules; 2- Subjects; 3- Legitimate sources of law and; 4- Obligation to obey the rules. Within such framework the ‘normative supranationalism’ can emerge in the course of time. That is why it is important to recognize the local institutions; their strengths and weaknesses and then venture to find solutions at a regional level.

In case of MENA too, such quality as to the strengths and weaknesses of the local institutions ought to be recognized as it can base the corner-stone of an economic integration. In forming such structure, political consensus, and compliance with the laws ought to be apparent. Under such a common banner of cooperation, relational principles can be adopted by communities aimed at enhancing their lawmaking and enforcement powers. And as such, the autonomy of community would also be respected. Moreover, the principles of Direct Applicability, Direct Effect, the Supremacy of Community Law, and the principle

⁴⁴⁷ Oppong, p. 35: referring to: “Schermers (1972), p. 21, where he characterizes the East African Community together with the European Communities as the most supranational organizations existing at the time”.

⁴⁴⁸ Ibid, with reference to: “Weiler (1981), p. 271; and Weiler (1991).”

⁴⁴⁹ Ibid, referred to: “Weiler (1981), pp. 273–279.”

of Preliminary Reference Procedure need to be considered. Through the principle of *direct effect* in fact individuals can invoke community law before a national court.⁴⁵⁰

To emboss the role of individual within the community legal system and with democratic freedom, parliamentary participation may also present the active involvement of national parliaments in a community's legislative processes thus providing an indirect means for individuals to influence the activities of the community. It is noteworthy that the principles of direct applicability and direct effect are different.⁴⁵¹ "Direct applicability deals with the processes or means by which community law is implemented nationally. Direct effect deals with the legal enforceability of rights created by the laws that have become part of national law." In other words, direct effect is a more advanced stage of applicability and what it means is that all directly effective laws would be considered as part of national law, however, not all directly applicable laws are directly effective; in other words, not all laws are enforceable.⁴⁵²

Furthermore, a preliminary reference procedure as part of the legal framework regulating community–state relations can help to overcome this challenge of interpretation. In fact, through *preliminary reference procedure* a lower court may seek interpretive guidance from a superior court on the matter of law in the administration of justice so as to make sure the conformity with that of superior court's ruling. Within the context of economic integration, the preliminary reference procedure has the role of uniting community and national courts in an integrated system of judicial decision-making. In other words, it simply creates an institutional link between community and national courts.⁴⁵³ Beyond diffusing the meaning of law for the member states to be applied in their national courts, it also ensures *unity and coherence* within a community's legal system.

To summarize, relational issue can pose one of the main challenges to an effective economic integration. Therefore, the effectiveness of the integration processes heavily depends on relational issues especially when implementing the community law. The above mentioned principles can give a constructive response to such challenges depending on the constitutional accommodation in member states. Besides, various socio-cultural, economic and political factors, rethink of national laws, procedures, legislative and judiciary, while adopting international laws can all play positive role on the effectiveness of the integration processes. National and community courts and their relations constitute the core part of such integration processes.

⁴⁵⁰ Oppong, pp. 45-46; referring to: "Craig (1992); and Dashwood (1977)."

⁴⁵¹ Oppong, p. 46; referring to: "Winter (1972)."

⁴⁵² *Ibid*, p. 46.

⁴⁵³ Oppong, p. 49.

6.3. The Role of African Community Courts in Regional Integration

Community courts should be taken as the main legal guardians of an economic integration process. As such, their functions would go beyond the boundaries of a national court. In this role, both judicial and political functions can be attributed to the community court. In other words, when compared with national courts, their role would resemble more of a constitutional court than other lower courts. Hence, courts are important in economic integration both from the points of organization and jurisdiction.⁴⁵⁴ Therefore, in a complex regime as created by economic integration, the role of a robust court in monitoring different aspects of the regime through dispute settlement would be essential.⁴⁵⁵ It improves and enhances the compliance of states with their treaty obligations while ensuring business confidence.

Nonetheless, as previously said, institutional design is one thing and whether the institution properly functions as it was meant to, is another issue. Therefore, a simple provision of supranational character within a jurisdiction is not a guarantee for effective adjudication.⁴⁵⁶ For example it would be possible to design a supranational court on paper, but under the existing institutional framework of socio-economic, political and cultural conditions, they might simply alter when it comes to practice, or such institutions may simply prevent it from operating as such.

Within the treaties creating COMESA, ECOWAS, EAC and SADC, courts of justice have been established.⁴⁵⁷ Each court is to ensure the adherence to law both in the interpretation and application of the treaty concerned.⁴⁵⁸ Furthermore, in accordance with the treaties, judges⁴⁵⁹ are supposed to be *persons of proven integrity, impartiality and independence*, while fulfilling the conditions of holding high judicial office in their countries and recognized as competent jurists.⁴⁶⁰

Furthermore, the principle of the exhaustion of local remedies before litigating at the international level

⁴⁵⁴ Ibid, pp. 117-118

⁴⁵⁵ Ibid, p. 118; referring to: “Keck and Schropp (2008); Taylor (1996–7); and Nyman-Metcalf and Papageorgiou (2005).”

⁴⁵⁶ Oppong, p. 119.

⁴⁵⁷ Ibid, with reference to: “COMESA Treaty, Art. 7; ECOWAS Treaty, Art. 6(e); and EAC Treaty, Art. 9. The detailed provisions on the ECOWAS and SADC courts are contained in protocols. See Protocol A/P.1/7/91 on the Community Court of Justice of the High Contracting Parties as amended by Supplementary Protocol A/SP/.1/01/05 Amending the Protocol Relating to the Community Court of Justice (hereafter, ECOWAS Court Protocol); and SADC Tribunal Protocol. See generally Ruppel and Bangamwabo (2008).”

⁴⁵⁸ Oppong, p. 120; with reference to: “COMESA Treaty, art. 19; ECOWAS Court Protocol, art. 9(1); EAC Treaty, art. 23; and SADC Treaty, art. 16(1).”

⁴⁵⁹ Oppong, p. 121.

⁴⁶⁰ Oppong, p. 121; with reference to: “COMESA Treaty, art. 20(2); ECOWAS Court Protocol, art. 3(1); EAC Treaty, art. 24(1); and SADC Tribunal Protocol, art. 3(1).”

poses significant problems for individuals. Besides, a judge with international law background can consider international norms in his/her decisions. In this regard, Article 20 of the ECOWAS Court Protocol (unlike the COMESA and EAC treaties⁴⁶¹) takes into effect the Article 38 of the Statute of International Court of Justice (ICJ) in its decision-making. Likewise, Article 21(1) of the SADC Tribunal Protocol enjoins applying ‘general principles and rules of public international law as well as rules and principles of the law of states.’ Indeed, bringing such visions beyond the national courts at regional level would be of significance.

Republic of Kenya v. Coastal Aquaculture,⁴⁶² is a case example showing that in Africa, exhausting local remedies can be problematic for individuals particularly when it involves property rights. According to the facts of the case, the applicant, for over eight years, had not been able to obtain compensation in regard to the compulsory acquisition of his land. While the COMESA court sympathized with his plight, it held that he needed to yet exhaust local remedies as he lacked locus standi. This outcome turned out to be unpleasant to the applicant.

A great portion of cases decided at the level of community courts particularly in ECOWAS and COMESA have been concerning the staff cases or cases involving the violation of human rights. However, there have been some cases involving economic integration in which the jurisprudence of the COMESA, ECOWAS, EAC and SADC courts reflects a myriad of legal problems.⁴⁶³

Another famous example reflecting the inefficiencies of property rights in Africa would be the case of **Mike Campbell v. Republic of Zimbabwe**.⁴⁶⁴ This case has been the best instance of community court being confronted with a major national policy of a state in Africa; in this instance: *Zimbabwe’s controversial land-reform policy*. In this case, the applicant (Mike Campbell) filed an application at the SADC Tribunal to challenge the compulsory acquisition by the respondent (Republic of Zimbabwe) of their agricultural land. Simultaneously, the applicant filed for an interim measure preventing the Respondent from removing or allowing to removal of the applicant from their land. The SADC Tribunal held that the Zimbabwean government violated the SADC’s treaty by denying access to the courts and engaging in racial discrimination against white farmers whose lands had been confiscated under the land reform program in the country. On 20 June 2008, the applicant reported the failure of Respondent to comply with the tribunal decision concerning the interim measure. Thus, the Tribunal reported the finding

⁴⁶¹ The absence of such a provision in the COMESA and EAC treaties has, however, not prevented their respective courts from relying on international law.

⁴⁶² *Republic of Kenya v. Coastal Aquaculture* [2003] 1 East Afr. LR 271.

⁴⁶³ Oppong, p. 133.

⁴⁶⁴ The facts of the case can be found here: [https://en.wikipedia.org/wiki/Mike_Campbell_\(Pvt\)_Ltd_v_Zimbabwe](https://en.wikipedia.org/wiki/Mike_Campbell_(Pvt)_Ltd_v_Zimbabwe)

to the Summit, pursuant to Article 32(5) of the SADC Tribunal Protocol.

Moreover, according to the applicants, the acquisitions were inconsistent with articles 4(c) and 6(2) of the SADC Treaty. These articles enjoin that member states are obliged to act in accordance with the principles of democracy, human rights and the rule of law, while prohibiting them from discriminating against any person on grounds of race.⁴⁶⁵

Also, on the issue of jurisdiction, the Tribunal, citing Article 15(1) of the SADC Tribunal Protocol, found that it does have jurisdiction on dispute concerning *human rights, democracy and the rule of law* which were indeed raised in the application.⁴⁶⁶ The applicant also sought an order for the lands to be preserved pending the final determination of the application. After making sure that it was a case between natural and legal persons with that of the state,⁴⁶⁷ there came a question of interpretation of the treaty⁴⁶⁸ and as such the tribunal had jurisdiction to grant interim relief.⁴⁶⁹

The Tribunal examined as to whether the applicants exhausted local remedies as required by the SADC Tribunal Protocol.⁴⁷⁰ The respondent's counsel asserted that the same matter is pending before the Supreme Court of Zimbabwe. Nonetheless, the Tribunal, with no further reasoning held that the issue concerning the exhaustion of local remedies may not be raised in the present interlocutory application, as the applicants were simply seeking an interim measure for protection. However, the matter was raised in the substantive case.⁴⁷¹

Examining the law in details—including national and international—as well as the facts, it was established that the applicants had been indeed deprived of their lands without having the right of access to the courts and to a fair hearing. Hence, the Tribunal held that it was breaches of article 4(c) of the SADC Treaty. As well, it held that even though Amendment 17 has not explicitly referred to 'white' farmers, its implementation has in fact affected white farmers only and therefore would constitute indirect

⁴⁶⁵ Oppong, Richard Frimpong. "Legal Aspects of Economic Integration in Africa." Cambridge University Press, 2011, pp. 139-140.

⁴⁶⁶ Osiemo, Onsando. "Lost in Translation: The Role of African Regional Courts in Regional Integration in Africa." *Legal Issues of Economic Integration* 41, no 1 (2014):p. 108.

⁴⁶⁷ Oppong, p. 140; referring to "SADC Tribunal Protocol, art. 15(1). The tribunal has no jurisdiction in action between natural and legal persons. *Nixon Chirinda v. Mike Campbell (Pvt) Ltd*, SADC (T) Case No. 09/08 (SADC Tribunal, 2008); and *Albert Fungai Mutize v. Mike Campbell (Pvt) Ltd*, SADC (T) Case No. 8/08 (SADC Tribunal, 2008)."

⁴⁶⁸ *Ibid*, with reference to: "Art. 14".

⁴⁶⁹ *Ibid*, With reference to: "Art. 28."

⁴⁷⁰ *Ibid*, with reference to: "Art. 15(2)."

⁴⁷¹ Oppong, p. 140.

discrimination.⁴⁷²

The Tribunal finally and by unanimity held that: “ the Respondent is directed to take all necessary measures, through its agents, to protect the possession, occupation and ownership of the lands of the Applicants, except for Christopher Mellish Jarret, Tengwe Estates (Pvt) Ltd. and France Farm (Pvt) Ltd. that have already been evicted from their lands, and to take all appropriate measures to ensure that no action is taken, pursuant to Amendment 17 (2005), directly or indirectly, whether by its agents or by others, to evict from, or interfere with, the peaceful residence on, and of those farms by, the Applicants, and...by unanimity, the Respondent is directed to pay fair compensation, on or before 30 June 2009, to the three Applicants, namely, Christopher Mellish Jarret, Tengwe Estates (Pvt) Ltd. and France Farm (Pvt) Ltd.”⁴⁷³

In Zimbabwe, both political and judicial reacted to the decisions unfavorable and even hostile as the executive condemned it (including the President and Attorney General) while the High Court declined to enforce it.⁴⁷⁴ In two separate rulings –the second given after non-compliance with the first – the Tribunal reported the non-compliance matter to the Summit in accordance with article 32(5) of the SADC Treaty for it to take ‘appropriate action’.⁴⁷⁵ No action has been taken to date.⁴⁷⁶

The above case example reaffirms the connotations that Acemoglu and Robinson had vis-à-vis Zimbabwe as a relatively challenging example among the economics in Africa. It shows the lack of proper relation that should have been established between the courts structures in their national and regional contexts. In fact, the persistence of the old institutions has kept its shadow over the legal system hindering as such a dynamic mechanism that could solve the very fundamental property rights within their structure. The jurisprudence of the community courts through the above decisions and judgments shows the steps that ought to be taken and the role that—community as well as national— courts need to play in Africa’s economic integration processes.⁴⁷⁷

⁴⁷² Noteworthy to mention that Mike Campbell, his wife Angela, and their son-in-law Ben Freeth were kidnapped, taken to an indoctrination camp and beaten by thugs on 29 June 2008. Campbell died on 6 April 2011; his family stated he died from complications of the 2008 beating.

⁴⁷³ http://www.worldcourts.com/sadct/eng/decisions/2008.11.28_Campbell_v_Zimbabwe.htm (Last Paragraph).

⁴⁷⁴ Oppong, p. 141; referring to: “Gramara (Pvt) Ltd v. Government of the Republic of Zimbabwe, HC 33/09 (Zimbabwe, High Court, 2010)”.

⁴⁷⁵ Ibid, p. 142, referring to: “William Michael Campbell v. The Republic of Zimbabwe, Case No. SADC (T) 03/2009 (SADC Tribunal, 2009); and Fick v. The Republic of Zimbabwe, Case No. SADC (T) 01/2010 (SADC Tribunal, 2010).”

⁴⁷⁶ Oppong, p. 142.

⁴⁷⁷ Ibid, referring to: “Jackson (2003–4).”

Moreover, Douglass North's emphasis on the essence and significant status of property rights is well shown in this case. There are in fact many similar cases thrown at African Community Court even though there are not alone dealing with such cases. Yet, African courts, happily, have the rich experiences of other courts working on issues of regional and international economic law, such as the ECJ, WTO Panels and Appellate Body, to take the examples from. Nonetheless, they should eventually seek their own unique regional models as all this just furnishes the ground with relevant legal examples and experiences that can be useful for regional integration as they are to set examples too applicable to the MENA region.

Last but not least, despite the fact that there are a great amount of reported treaty infringements in African RTAs (Regional Trade Agreements), in particular Non-Tariff Barriers (NTBs), there are few trade disputes mechanisms, and infringement actions in the African Regional Courts. In brief, we can refer to four possible explanations for this phenomenon: 1- Preference of Diplomacy methods, 2- Low-level of Trade, 3- Unwillingness of the Secretary General of the RTAs in proceeding action, and 4- Weak sanctioning provisions.⁴⁷⁸ In short, from all the above discussions it can be asserted that in fact the legal and institutional structure and performance are weak in majority of states in Africa.

6.4. Legal and Institutional Challenges of Economic Integration in Africa

There is a direct relation between successful institutions and the rule of law. And one of the integral parts of any legal system, and a key to its effectiveness, are the enforcement mechanisms provided to ensure compliance with its laws. Within the context of economic integration, enforcement mechanisms are established as avenues linking community and national legal systems.⁴⁷⁹ In other words, through such mechanism, the relationship between national and regional legal systems is practically defined. Enforcement of community law can take place at both national and community levels. As such, when we have an effective enforcement at both levels along with a high level of coordination between the two, community law will become effective and we step towards a more successful economic integration.

In accordance with the AEC Treaty, the Assembly of Heads of State and Government (Assembly) is considered as the supreme institution of the community⁴⁸⁰ being responsible as such for the

⁴⁷⁸ Osiero, Onsando. "Lost in Translation: The Role of African Regional Courts in Regional Integration in Africa." *Legal Issues of Economic Integration* 41, no 1 (2014): 87-122; PP. 111-114.

⁴⁷⁹ Oppong, p. 165.

⁴⁸⁰ *Ibid*, p. 166; with reference to AEC Treaty, art. 8(1).

implementation of the community's objectives.⁴⁸¹ Oppong is suggesting the predominance of the rule of law at community level in order to reach the objectives of the economic integration, even though he acknowledges a disadvantage to this view when it comes to decision-making at the community level. Since the Assembly is composed of politicians representing member states' interests, it is possible that under such structure, rather political consideration would be taken into account instead of the ultimate goal of the AEC.

In case of the European Union for example, the issue would be quite different because in their context, we have the European Commission that is described as being the most important political force behind integration thus pushing forward the objectives of the Union.⁴⁸² As such, in contrast; the executive, legislative, judicial and administrative functions of the European Commission cannot be matched with any of the AEC's institutions or the rest of communities in Africa⁴⁸³ (inclusive vs. extractive institutions).

Having that said, the African Court of Justice (the Court of Justice of the AEC) is an important institution playing the key role for the enforcement of AEC law.⁴⁸⁴ Having an independent status from all other community institutions, its mandate is to 'ensure the adherence to law in the interpretation and application of [the AEC Treaty] and . . . decide on disputes submitted thereto pursuant to [the AEC Treaty].'⁴⁸⁵

Moreover, Article 20 of the AEC Treaty stipulates that a protocol should be adopted to regulate the work of the court. This is while no such protocol has been adopted yet.⁴⁸⁶ Unfortunately, the African Court of Justice perhaps would be a good example reflecting the convolution as well as the inappropriateness of institutional roles.⁴⁸⁷ This is while in accordance with Article 28 of the Statute of the African Court of Justice, the far-reaching jurisdiction over all cases, as well as all necessary mandates are rested upon the African Court of Justice.

The African Court of Justice, as a court performing for the political organization of the African Union, looks unproblematic in the sense that its structure and jurisdiction are very much like those of the International Court of Justice of the United Nations Organization. However, as a court whose jurisdiction

⁴⁸¹ Ibid, with reference to: art. 8(2) of AEC Treaty.

⁴⁸² Oppong, p. 168; referring to: "Craig and de Bu'rc'a (2003), p. 64."

⁴⁸³ Oppong, p. 168-169.

⁴⁸⁴ Ibid, p. 171; referring to: "Obilade (1993), p. 312."

⁴⁸⁵ Ibid, with reference to: "AEC Treaty, art. 18(2)."

⁴⁸⁶ Oppong, p. 171.

⁴⁸⁷ Ibid, p. 184.

encompasses economic integration issues, its structure and jurisdiction seem very inadequate.⁴⁸⁸ It is so far the only court whose jurisdiction encompasses an economic integration treaty and such jurisdiction is not compulsory. That is to say a party to the AEC Treaty would not be subject to the jurisdiction of the court when it has not ratified the Protocol of the African Court of Justice.⁴⁸⁹ This has a direct impact on the application and enforcement of AEC law.

As shown in different parts of this analysis, the European Community (EC) has been like the pioneer model for regional integration projects around the globe while resting in particular great inspiration for regional integration in Africa. Within the EC structure we see two important existing elements that bring about such success for the organization. The first is the *EC legal framework* backed by the second factor that is an *effective regional enforcement regime* in the European Court of Justice (ECJ). These two have played a significant role in bringing success to the European Economic Community (ECC) since its inception in 1957.⁴⁹⁰

Like Opong, Salami also emphasizes the weakness of the legal institutions within the African continent. Accordingly, the RECs (Regional Economic Communities) that are to provide legal instruments with binding effect have overall failed to clarify the methods by which their implementation within the member states (such as ECOWAS, EAC and AMU) could be materialized. Such implementation in fact has been left to the whim of national parliaments for decision-making.⁴⁹¹ Because of the major institutional differences, despite embracing the EC model of economic integration, such RECs may not achieve the same successes as those of the EC unless some necessary reforms would take place. Iwa Salami is suggesting some proposals as reform policies which follow:

- 1- REC Treaty Clarity on Status of REC Legal Instruments in Member States,
- 2- Strengthening the Regional Enforcement Mechanisms (i.e. the Role of the Courts),
- 3- Effective Domestic Legal and Judicial Systems (i.e. through “a legal and judicial reform”),
- 4- Recognition of African Integration Law within the Legal Education Curriculum,
- 5- Member States according Supreme Status to REC Law, and;
- 6- Recognition of Superior Status of REC Law by All the Organs of the State and at All Levels of Government (in other words, institution-building at all levels).

⁴⁸⁸ Ibid.

⁴⁸⁹ Ibid, referring to: “Statute of the African Court of Justice: art. 29(2).”

⁴⁹⁰ Salami, Iwa. “Legal and Institutional Challenges of Economic Integration in Africa.” *European Law Journal*, Vol. 17, No. 5, Sep. 2011 pp. 667-682.

⁴⁹¹ Salami, P. 673.

6.5. The African Continental Free Trade Area (AfCFTA): A Glean of Hope

Trade facilitation and liberalization can perhaps be the first stepping stones in shaping an FTA, while expanding such process on a wider scale through Continental Free Trade Area (CFTA) would certainly be an effective move forward in further deepening regional integration. The African Continental Free Trade Area (AfCFTA) is an FTA in accordance with the African Continental Free Trade Agreement among 54 of the 55 AU nations. It is considered to be the largest FTA in the world in terms of the participating countries involved since the formation of the WTO.

In case of Africa, the CFTA carries some important objectives that are inter alia creating a single market for goods and services within continental boundaries with free movement of people and investments in view of achieving the Continental/African Customs Union. It can be a tool to expand intra-Africa trade by way of better coordination and harmonization of trade facilitation and liberalization regimes encompassing all RECs and FTAs across Africa. Moreover, such CFTA would be an instrument to resolve the challenges emanated from multiple and overlapping memberships while expediting the regional and continental integration processes. Finally, it would enhance competitiveness on different industries and enterprises by way of creating opportunities for scale production. It would also increase continental market access while adjusting better allocation of resources.⁴⁹² And of course it would also be a major step contributing to global integration.

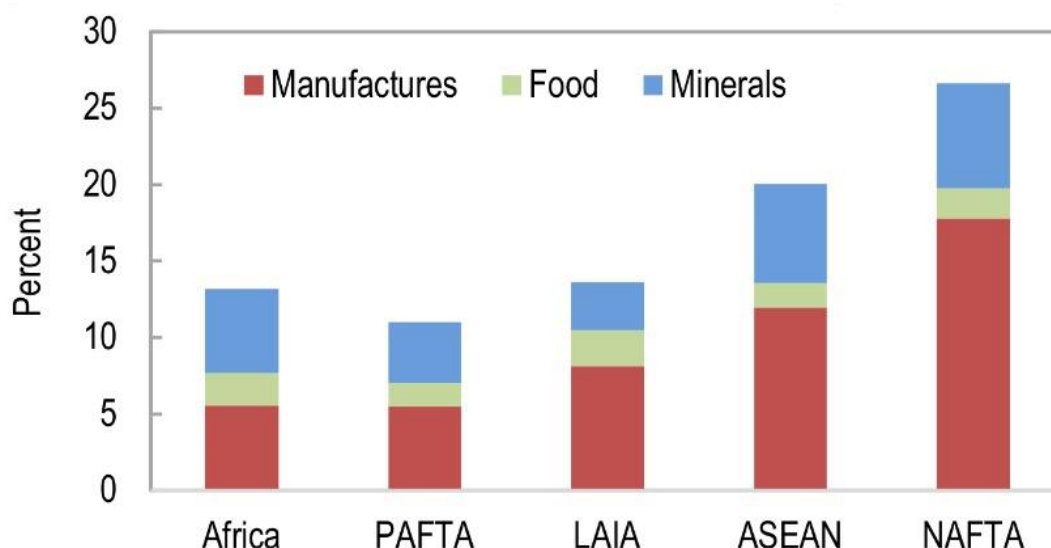
In short, the CFTA can increase economic openness and be a potential tool to further regional trade integration in Africa. As a result of Africa's fast integration with that of global trade system, the intraregional trade flows have rapidly expanded in Africa during the past two decades. For example between the periods 1990-2017 the region's trade openness (exports and imports of goods and services) increased from about 53 percent of GDP to 67 percent. New emerging partners in market economies such as China also helped the above trend progress.⁴⁹³

In contrast, the size of intraregional trade in Africa is compatible with those patterns in developing regions and emerging markets but relatively smaller than the developed regions. For instance, such pattern is similar to or exceeds regional trade in areas like the Pan-Arab Free Trade Area (PAFTA)/Latin American Free Trade Association (LAIA) but much lower compared to ASEAN and NAFTA (Fig. 6.5.).

⁴⁹² <http://au.int/en/ti/cfta/about>

⁴⁹³ IMF: REGIONAL ECONOMIC OUTLOOK: SUB-SAHARAN AFRICA; "Is the African Continental Free Trade Area a Game Changer for the Continent," (Chapter 3), 2019, p. 42. Retrieved from: <http://www.imf.org/~/media/Files/Publications/REO/AFR/2019/April/English/ch3.ashx>

Figure 6.5. Intraregional Trade in Selected Regions, 2007–17
(Average share of total imports originating from the region)



Sources: United Nations COMTRADE database; and IMF staff calculations.

Note: ASEAN = Association of Southeast Asian Nations; LAIA = Latin American Integration Association; NAFTA = North American Free Trade Agreement; PAFTA = Pan-Arab Free Trade Area.

Since most of the African countries are members of the World Trade Organization (WTO), the CFTA must be consistent with WTO rules. That is to say, firstly; such preferential trade arrangements (PTAs) must be in conformity with Art. XXIV of GATT 1994 along with its addendum, updates, and understanding of its implementation. And secondly; the consistency should exist with “Decision on Differential and More Favourable Treatment Reciprocity and fuller participation of developing countries (The Enabling Clause, Decision of 28 November 1979).”⁴⁹⁴

The entry into force of the CFTA shall definitely have impact upon Africa’s RECs, as it can supersede the REC’s on the trade integration role. As such, the RECs should rather re-adopt themselves with the new realities as for example more important roles should be mandated to the RECs within the areas of macro-economic, financial and fiscal policy harmonization at a sub-regional level, along with the implementation of sub-regional integration. It is also imperative for the CFTA to incorporate adequate Dispute Settlement Mechanisms through consultation, mediation, and arbitration while being in conformity with WTO laws and procedures.⁴⁹⁵

⁴⁹⁴ UNCTAD: “AFRICAN CONTINENTAL FREE TRADE AREA: Policy and Negotiation Options for Trade in Goods.” UN, New York and Geneva, 2016, p. 4.

⁴⁹⁵ Ibid; pp. 25-26.

6.6. Conclusion

Institutions matter a great deal if we are to achieve effective economic integration. How far they can facilitate economic integration greatly depends on how they relate to the institutions within member states. How far this has been perceived and appreciated by the framers of the AEC Treaty and other laws is open to debate. With what was presented in this chapter, two main lessons can be drawn as conclusion.

Firstly the creation of an independent institution with enough power in proposing policies along with implementation of the AEC's decisions would be preferred. Secondly, to achieve a successful economic integration in Africa, it is paramount important to reconstruct the court along with other relevant institutions. And to reach that end in case of Africa, the economic integration processes ought to be isolated from that of the political integration agenda.⁴⁹⁶

Of the 14 regional economic communities in Africa, only eight are recognized by the African Union (AU) namely: AMU, *EAC*, CEN-SAD, *COMESA*, ECCAS, *ECOWAS*, IGAD, and *SADC* among which four of them were the focal point of this Chapter. One of the AEC's objectives is to establish an African central bank and single currency in Six Stages that are to be achieved by 2028. Since the RECs are considered the building blocks of the AU/AEC, they play a significant role to this process and accordingly their success greatly depends on the overall success of the AU/AEC agenda.⁴⁹⁷ Hence, it would be of paramount importance for the member states to grant supremacy to REC provisions so as to be recognized at all levels of governments. Without such strategy it would be very difficult for the AU/AEC to achieve the "Pan-African Single Currency."

When analyzing economic integration, relational issues of law are considered endemic.⁴⁹⁸ The relational issues are in fact the focal point of interactions among community, national, regional and international legal systems. The stage that such issues have been effective depends on the level of integration. Such relational issues have proved to play an important role in economic development and effectiveness, and the challenges posed by relational issues also relate to different relational principles and mechanisms as part of the legal framework in addressing relational issues.

The path to move forward should include inter alia an environment where relations are relatively rationalized between different communities while overcoming the canker of multiple memberships of the

⁴⁹⁶ Oppong, p. 186-187.

⁴⁹⁷ Salami, p. 681.

⁴⁹⁸ Oppong, p. 318.

communities, and putting the path towards forming the AEC on solid legal foundations in which the relations between the communities and the AEC would be regulated within a clear legal framework.⁴⁹⁹

After all, as the communities move towards deeper integration in Africa, relational issues become more important and therefore the sooner states, policy-makers, communities, businesses and scholars devote some time to such relational issues, the better it will be for Africa.⁵⁰⁰ The CFTA as a good platform and a gleam of hope can address such important issues. Such relational paradoxes are apparent in case of the Middle East and North Africa (MENA) region as well which is the subject of the coming chapters of this dissertation. Therefore, similar profound strategies to tackle such relational problems and the role of law and policies in playing their part should also be taken seriously into consideration for the MENA region.

Put it differently, what has been presented in this Chapter, is the emphasis on the establishment of formal institutions (laws) at community level along with a coordinating link with those of national laws. Once the institutions in both formal rules and informal constraints are well developed within the national boundaries, it would pave the way for further regional cooperation especially when it is presented within a regional context of similar language and culture.

To summarize, the regional integration as discussed in this PART (II) contained important lessons to be learned from each region. The progressive steps in legalization of the southern bloc, MERCOSUR along with TA/Olivos Protocol and the establishment of a judicial mechanism (Permanent Review Court) similar to that of the EU model is exemplary although far from perfect yet reflecting the important steps taken towards deeper integration. NAFTA with its structure as designed peculiar to the needs of trade for the three countries in North America is another example. The role of the rule of law and more legalization through an *economic constitution* with a social contract in case of ASEAN rendered good lessons along with successful model of its IPNs. And finally, the intertwined web of communities in Africa and the role of private and public international law in structuring relational issues are among the lessons to be learned and possibly applied in particular to the case of developing countries such as the MENA region.

Moreover, in fact, abiding by international laws in forming and practicing community laws would be important for such community involvement and their relational issues. Relational issues can be improved through the establishment of a social contract with a proper polity of democratic freedom in which citizenry rights as well as property rights are well defined while the status of individuals are guaranteed.

⁴⁹⁹ Oppong. p. 319.

⁵⁰⁰ Ibid.

As such, the improvement of institutions along with the establishment of an adequate social contract can greatly serve the formation of an effective economic integration within the framework of regional communities in Africa and likewise in MENA. As reiterated, we focus on this latter with more details in the coming chapters.

**PART (III): Regional Integration in the Middle East and North Africa
(MENA)**

- **Introduction**
- **Chapter (7): Economic Integration in MENA**
- **Chapter (8): Natural Resource Endowment, and Integration in MENA**
- **Chapter (9): Development and Success Examples in MENA**

Introduction

Economic integration in MENA is a phenomenon that globally and regionally can create employment; contribute to growth; and lower poverty in the region. This PART (III) of my dissertation focuses on MENA and summarizes in fact the challenges and constraints to, as well as the opportunities for deepening economic integration within the MENA region and beyond. It mainly deals with some aspects of economic integration including the gains from integration; the development of regional integration through Trade in Goods and Services; and Preferential Trade Agreements (PTAs).

Particularly at this stage of world economy, it is a compelling case for MENA countries to deepen and expand *reforms* in order to enhance economic integration so as to become more competitive. As such, opening up to the global economy would be a vital and constructive policy for MENA. In this process, regional and global integration policies should be designed in such a way to complement one another in order to avoid misallocation of resources or costly trade diversion.⁵⁰¹

An effective economic integration should include policies concerning trade and investment and improvement of institutions including the institutions for border facilitation as well as the domestic economic and political institutions, while seamlessly integrating economic infrastructure throughout the region. If such measures are designed towards an effective integration, it would create competitiveness and productivity throughout the economy which would then bring down costs to consumers while boosting job creation within industries whose markets are steadily expanding.⁵⁰²

Since a considerable part of this discussion on the MENA region relates to the formation of Preferential Trade Agreements (PTAs), the question arises as to whether such agreements are in conformity with the multilateral trading system and the global integration, or they might be at odd with those processes. We may answer this question by referring to the GATT which defines the PTAs or FTAs as well as the Customs Union (CU) as the integration processes. There are three main components that are considered as the cornerstone of the GATT system. They are namely the principles of *reciprocity*, and *non-discrimination*, on the one hand forming the *pillars* of the GATT architecture; and the *enforcement mechanism* as the heart of the GATT system (Dam⁵⁰³ 1970, p.81).⁵⁰⁴

⁵⁰¹ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. xi-xii (Preface).

⁵⁰² Ibid.

⁵⁰³ Dam, K. W. "The GATT: Law and International Economic Organization." University of Chicago Press, 1970.

Non-discrimination is comprised of the Most Favored Nation (MFN) treatment and the National Treatment (NT). The MFN obligation prohibits a country to discriminate *between* other countries while the NT prohibits from discrimination *against* other countries. The significance of eliminating discrimination as such is well highlighted in the preamble of the WTO Agreement as a means to attain the objectives of the WTO.⁵⁰⁵

According to Baldwin, Cohen, Sapir and Venables; in the absence of enforcement difficulties, the principles of reciprocity and non-discrimination are expected to work thus bringing about an efficient outcome.⁵⁰⁶ Moreover, the principle of reciprocity may not have an efficient outcome when an FTA would enter this scenario, but it rather works efficiently in the presence of a Customs Union *only if the union comprises similar countries*. According to their findings there would be only some *limited support* for the hypothesis that in the presence of PTAs, *the principle of reciprocity can deliver an efficient trade agreement*.⁵⁰⁷

If there are enforcement concerns, it can make the picture more complicated because of the consequent changes to the trading environment as the result of the regional agreement. Accordingly, such regional agreements can be a tool to influence the level of tariffs that are to be enforced at the multilateral level.

In short, to answer the question posed above, their findings support the view that when multilateral enforcement mechanisms are sufficiently weak, then the creation of preferential agreements can enhance the efficiency of the multilateral trading system.⁵⁰⁸ In other words, the more enforcement-dispute settlement procedures are successfully strengthened, the weaker the case would become for preferential agreements. This is why there should always be some coordination between regional and global integration and these two need to go forward hand-in-hand.

In case of the MENA region, I envisage if the institutional economics would be properly applied to the facts of economies in this apt region, a further integration at the regional level could be a solution to many current crisis in MENA. If the institution-building and institutional change as explained in PART (I) take

⁵⁰⁴ Baldwin, Richard; Cohen, Daniel; Sapir, Andre; and Venables, Anthony. "Market Integration, Regionalism and the Global Economy." Cambridge University Press, 1999, p. 53.

⁵⁰⁵ Van den Bossche, Peter. "The Law and Policy of the World Trade Organizations: Texts, Cases, and Materials." Chap. 4; Principles of Non-discrimination, Cambridge University Press, 2008 (online 2012), Summary, Introduction: DOI: <http://doi.org/10.1917/CBO9780511818394.006>

⁵⁰⁶ Baldwin, Richard; Cohen, Daniel; Sapir, Andre; and Venables, Anthony. "Market Integration, Regionalism and the Global Economy." Cambridge University Press, 1999, p. 76.

⁵⁰⁷ Ibid. p. 77.

⁵⁰⁸ Ibid.

place in case of the majority of member states in MENA; economic integration, both regionally and globally, can spur the growth along with job creation leading to an increase in the well-being of the population and thus consolidating the ongoing political transitions in the MENA region.⁵⁰⁹

Considering the high potential that the MENA region possesses, limited integration has stifled the region's ability to apply such potential towards economic growth and job creation. The MENA region is considered as one of the least integrated regions in the world economy. MENA is home to 5.5 percent of the world's population (on average for 2008–10) while having 3.9 percent of the world's gross domestic product (GDP), nonetheless, *the region's share of nonoil world trade is only 1.8 percent.*⁵¹⁰ In contrast with MENA, in case of the countries in East Asia due to their liberal trade and investment policy, there has been a significant increase in employment, trade, and per capita income. Of course considering petroleum and gas, the MENA region would be far more integrated in the world economy, as the total exports account for 6.2 percent of total world trade. Exports of oil and gas contain close to three-quarters total exports out of the MENA region.⁵¹¹

The above study conducted by the World Bank shows despite commendable reform efforts in recent years, there are still considerable constraints towards economic competitiveness in general, and trade barriers in particular. This suggests that the MENA region need to work on its institutional framework to improve inter alia trade-related infrastructure while strengthening its trade facilitation activities. As seen through the examples of regional integration in different parts of the world, integration can help as leverage to bring about the above desired outcomes.

Furthermore, beyond pursuing PTAs in the region, MENA must open up its economy to the rest of the world bearing in mind that like in other regional agreement explained earlier, even though regional cooperation and integration can bring benefits, such efforts can be very costly if not carried out in a manner to be compatible with the broader global integration trends like those of WTO and international law.⁵¹² Moreover, as there is a good potential to enhance trade in goods, proportionally, trade in services ought to be pursued and encouraged within the MENA region and between the region and the rest of the world.

According to some analysis, regional integration can enhance economic growth on the one hand while

⁵⁰⁹ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. xi-xii (Preface).

⁵¹⁰ Ibid, p. xix (Overview).

⁵¹¹ Ibid.

⁵¹² The case of MERCOSUR was a good example of such costliness.

lowering within-country in-equality on the other in member countries. Besides, indirect benefits that can be gained as the result of any agreement to which the trading partner is a regional member state, would enhance development.

In other words, regional integration can act as a tool to promote trade by increasing trade flows and evolving commercial links within RTAs (Regional Trade Agreements), as many have been performed in the last two decades. In case of developing countries such as the MENA region, trade agreements play a key role in determining national trade policy and thus they can amplify the impact of trade on development. RTAs would level up the standards in terms of labor, environment, transparency while encompassing other progressive reforms and non-economic policy objectives.⁵¹³

Moreover, RTAs are simply effective tools in promoting growth. They structure trade in such a way that would result in increasing domestic productive capacity, improving institutions, while promoting upward harmonization of standards. They also introduce technical know-how into the domestic market while increasing preferential access to desirable markets. These are the fruits that can benefit developing countries [such as the ones in MENA] and in particular the least developed and low-income countries.⁵¹⁴

As we have seen in the past decades the MENA region has also incurred losses as the result of conflicts and its considerable military expenses and therefore a policy shift is needed to deploy its human, natural and financial resources in a more efficient manner by adopting social and economic policies that would create more inclusive economic growth for the whole MENA region.⁵¹⁵

Fardoust in his policy paper is suggesting that the four major powers in the region including Saudi Arabia, Egypt, Iran and Turkey should get together to solve the root causes of the regional problems. According to him, major projects concerning regional infrastructure in the fields of energy, water, and transport are needed to better integrate such economies in order to expand intra-regional trade as well as the worldwide trade.⁵¹⁶

Chapter (7) of this dissertation takes into account a broad set of MENA countries to provide more in-depth background information and analysis emphasizing the reforms within the areas that can help toward

⁵¹³ DiCaprio, Alisa; Santos-Paulino, Amelia U.; Sokolova, Maria V. "Regional trade agreements, integration and development." UNCTAD Research Paper No. 1, July 2017, p. 5.

⁵¹⁴ Ibid. p. 3.

⁵¹⁵ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects for Development and Stability." Middle East Institute (MEI), Regional Cooperation Series, Policy Paper, June 2016.

⁵¹⁶ Ibid, Summary.

achieving a deeper and broader integration. Such analysis includes Trade in Goods and Services, Preferential Trade Agreements (PTAs); as well as infrastructure, trade facilitation and logistics. Then Chapter (8) takes into account the role of resource abundance in MENA; the curse and the advantages, and Chapter (9) presents an outlook of the success and failure stories of development in the MENA region to illustrate good lessons and experiences that can be learned to achieve sustainable development.

The main question posed here is; why should economies integrate? By looking at the past experiences of integration, we don't see a positive picture particularly in case of the developing countries. The reason goes back to the theory of the Customs Union. Accordingly, RTAs (Regional Trade Agreements) can create trade-creation as well as trade-diversion, plus transfers between the member countries. The design of RTAs in the past within developing countries was somewhat in favor of creating trade diversion (due to the high external tariffs) followed by regressive transfers from poorer nations into the better-off ones.

However, the above trend in recent years has changed towards a design for building trade creation. Accordingly; *Regionalism* would result in trade creation when it is accompanied with a significant degree of trade liberalization where the emphasis is put to reduce cost-creating trade barriers that simply waste resources. In this sense, regional economic integration would be in fact a precondition rather than obstacle in integrating developing countries into the world economy by reducing or minimizing the costs related to market fragmentation.⁵¹⁷

Taking one step further; deep economic integration would help policy makers address the critical challenges and issues concerning development, same issues that were brought to the forefront via the Arab Spring for instance.⁵¹⁸ These challenges include weak governance, inefficient public sectors, global commodity market shocks, and high youth unemployment.

In fact what the Arab Spring did was to protest and give voice which was the result of frustration over *exclusive, ineffective, and inefficient policy choices*. Such movement took the attention of the policy makers to revise their strategies related to development and inclusive growth, good governance and job creation. As such, the region's leaders did their attempts to reform by taking measures to stimulate job growth while having a more inclusive economic growth and fostering popular participation in the

⁵¹⁷ Mathews, Alan. "Regional Integration and Food Security in the Developing countries." Food and Agriculture Organization of the United Nations (FAO), Rome, 2003, (Executive Summary), Retrieved from: <http://www.fao.org/docrep/004/y4793e/y4793e00.htm#Contents>

⁵¹⁸ Rouis and Tabor. "Regional Economic Integration in MENA." The World Bank, 2013, p. xx (overview).

development process.⁵¹⁹

Such challenges can be addressed through economic cooperation and integration by initiating the process to boost growth while stimulating employment and fostering diversification. Besides, economic integration can attract Foreign Direct Investment (FDI) which can create jobs needed. Such absorbing investment generates better jobs while creating better environment for both domestic and foreign investment. In short, integration can serve to foster trade and investment to attain a sustainable development.

As earlier analyzed; regional cooperation and global economic integration are considered as complementary processes. As such, through geographical proximity and creating competitiveness, regional integration would contribute to global integration.

Global integration can also be a leverage to put pressure on countries to improve integration within their region. In many respects, regional cooperation and integration should be in fact considered as a stepping-stone towards a wider global market cooperation, while investing on regional infrastructure plus trade in goods, services, and factors within the region that can all serve to boost competitiveness and encourage to develop the kinds of institutions necessary for integration on a wider scale.

Studies show that the MENA region has, relatively speaking, performed far below its economic potential during the past three decades. Accordingly, despite its large resource endowments, the region's per capita income on average grew by only 0.9 percent per year in the past three decades. Such a level of growth is below all other regions except Sub-Saharan Africa. The fact shows that unemployment has been the main issue in MENA, as the region only created 3.2 million jobs per year during the past decade that is considered less than half of the number of jobs the region in fact needed.⁵²⁰

The MENA region is mainly known for export of primary commodities, largely oil and gas that comprise of 76 percent of its total export in 2008–10. Manufactured goods account for just over 11 percent of exports, and the remaining 13 percent is accounted for other sectors. As such, the regions' export is less diversified even though some countries have been doing relatively better in this regard that include the Arab Republic of Egypt, Jordan, Lebanon, Morocco, and Tunisia. Despite the fact that some attempts have brought some improvements in export diversification in the past 15 years, the level of diversification

⁵¹⁹ *Ibid.*

⁵²⁰ *Ibid.*: Rouis and Tabor (The World Bank, 2013), p. xxi.

in MENA compared with the world average is still low.

Parallel to this trend, integration within the MENA region has also remained low when it is compared with other regions of middle and high level income class. For example, during the period 2008-10 intraregional exports of goods have been less than 8 percent of total exports in MENA on average as compared with that of 25 percent in the Association of Southeast Asian Nations (ASEAN) and 66 percent in the European Union (EU).⁵²¹ Oil importers trade the most in MENA including the Mashreq countries having strong links to the GCC (45 percent of their exports take place within MENA) as well as Egypt (28 percent). Maghreb countries export the least in the region (less than 5%) due to their strong ties with the EU and among themselves.⁵²²

A glance at regional integration shows some progress in reducing barriers to trade in goods inter and intra-region over the last decade through preferential liberalization. For example, the Pan Arab Free Trade Area (PAFTA) and other PTAs have taken such liberalization policy having had reductions in most favored nation (MFN) tariffs. As a consequence, the average uniform tariff equivalent of all tariffs (ad valorem and specific) fell from nearly 15 percent in 2002 to 6 percent in 2009 for the MENA region.

The above numbers confirm that MENA has decreased tariffs the most during the global financial crisis in particular on manufacturing goods that is considered an achievement. Nonetheless, the level of tariff protection in the region is still high by international standards.⁵²³

According to Alan Mathews, institutional weaknesses are the factor that should be viewed in the design of RTAs. Such institutional weaknesses would affect the RTAs to act effectively. The nature of agreements in the majority of the RTAs between developing countries is intergovernmental in which the countries are not willing to cede authority to supranational bodies. MENA is indeed considered a region of the kind.

As explained; institutional change particularly in case of the countries in MENA is considered the stepping-stone for successful development within member states economies and towards a fruitful regional integration. Along with such institution-building, the infrastructures within the countries ought to be improved. This includes inter alia the backbone services such as telecommunications, power and transport, which are crucial to productivity and international competitiveness.⁵²⁴

⁵²¹ *Ibid*, p. xxii.

⁵²² *Ibid*, pp. xxii-xxiii.

⁵²³ *Ibid*, p. xxiii.

⁵²⁴ *Ibid*, p. xxiv.

Bringing such sectors into trade and competition would reduce production costs, promote spillovers, rather increase FDI, and expand markets which all together can enhance competitiveness. As an example of the current deficient institutions and infrastructure in MENA we may look at the fact that the cost of trade between neighboring countries in the region is twice as high for MENA countries as in Western Europe. Such cost is imposed on the countries as the result of the institutional design of the region.

Efficient ports, maritime, and aviation services are also important in creating the competitive export of goods. Reversely, the deficiency of the quality of transport infrastructure is a hurdle for supporting the growing, modern economies. Some progress has been made in improving transport infrastructure. For example the implementation of the Mashreq Corridor Program has basically removed cross-border constraints, and it is expected to increase trade by about US\$ 15 billion per year by 2020, while generating some 250,000 additional permanent jobs. A great number of these jobs are within the export-oriented light manufacturing industries that mainly attract a high share of female employment. Moreover, economic integration is still in the early stage of development when it comes to the power sector.⁵²⁵

Fardoust is also suggesting two major initiatives which would spur growth: First, to undertake institutional reforms in the internal economies to accelerate job creation and growth while enhancing competitiveness and productivity along with the private sectors involvement. And second, implementation of major projects in the fields of energy, water and transport (including ground and air) in order to improve links among the major countries of the region in view of deepening trade integration both regionally and globally. Such integration can also bring FDIs into the countries and thus create jobs and spur growth to the economy.

PTAs are among the stepping-stones that are considered a good start for regional cooperation and integration. However, studies show mixed effects of PTAs in MENA. Nonetheless, they overall confirm the significant reduction of trade and investment barriers while providing an impetus for behind-the-border economic reforms, and moreover help spur rising trade. PTAs have also encouraged for the improvement of the infrastructure while harmonizing border policies and procedures, and improving their supply chains and logistics facilities.⁵²⁶

As explained earlier, in order for the PTAs to be effective thus bearing out a successful regional integration, we should adhere to the fact that such regional integration would move hand-in-hand with

⁵²⁵ Rouis and Tabor (The World Bank), p. xxv.

⁵²⁶ Ibid, p. xxvi.

that of global integration. There are currently tremendous opportunities to get MENA countries into wider and deeper spectrum of global markets, and this can be done through vertical integration in global production chains.⁵²⁷

To welcome trade in goods, the MFN tariffs need to be reduced in the region in particular with the reduction of tariff peaks to the level of the most competitive regions of the world (i.e. East Asia). Efforts should also encompass rolling back non-tariff barriers to trade in the region. Reforms to strengthen trade in services will also be required that would include easing entry and licensing restrictions. In accordance to each country specific circumstances, a broad reform agenda should be considered for each country.⁵²⁸

The MENA region is divided into three parts, The Mashreq countries (Iran, Iraq, Jordan, Lebanon, Syria, and the West Bank and Gaza), the GCC, and Maghreb countries in North Africa. In the GCC countries a substantial progress has been achieved in reducing tariffs and nontariff barriers while improving infrastructure and trade logistics. However some reforms are needed in the services area. In the Mashreq countries, which have strong links to the GCC, good infrastructure and cross-border trade facilitation are still needed. In case of the Maghreb countries, in view of strong links they have to the European Union, reducing tariffs and nontariff measures, plus cross-border trade facilitation should be considered in their agenda. For the MENA region overall, political will and proper leadership shall be required to contribute to growth and employment in the region.⁵²⁹

Fardoust also stresses on domestic reforms, coupled with a few win-win regional projects that can proceed without necessarily having a comprehensive regional political and security agreement.⁵³⁰ But for these initiatives to bear fruit, the major powers in the region should act in unison by way of diplomacy and by supporting the international community to put an end to the regional conflicts with the aim of achieving détente and to substantially reduce tensions in the region.

When such tensions are settled and the level of risks and uncertainty is well lowered in the MENA region, a well-coordinated regional strategy can then emerge aimed at forming regional integration with a view to speed up the pace of growth while bringing down the rate of unemployment through enhanced trade and FDI that can increase productivity and competitiveness of the regional economy. They altogether can serve the political stability in the region.

⁵²⁷ Ibid, p. xxvii.

⁵²⁸ Ibid, p. xxviii.

⁵²⁹ Ibid.

⁵³⁰ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects For Development and Stability." Middle East Institute (MEI), Regional Cooperation Series, Policy Paper, June 2016.

Parallel to these lines, the OECD, in a broader perspective, is also suggesting common economic and institutional trends that would support the need for more concerted action in the region to ensure its fruitful integration into the global economy.⁵³¹ Moreover, the empirical results in the UNCTAD Research Paper confirm that overall participation in RTAs would bring about higher economic growth and lower inequality [within the domestic economies of the participating members]. RTAs are effective tools not only in promoting growth, but also in increasing domestic product capacity, harmonizing standards, improving institutions, and increasing market access while introducing tech. know-how into the market.⁵³²

It is noteworthy that the above impact is revealed to be strongest in case of the developing Asia and also it is evident in case of Latin America.⁵³³ Such cases can be taken as exemplifying successful patterns for the MENA region in view of deepening regional integration as they were fully explained in previous chapters through major regional integration schemes across the globe.

⁵³¹ OECD; "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policies Series, October 2016.

⁵³² DiCaprio, Alisa; Santos-Paulino, Amelia U.; Sokolova, Maria V. "Regional trade agreements, integration and development." UNCTAD Research Paper No. 1, July 2017, p. 1, and p. 3.

⁵³³ Ibid, p. 8.

Chapter (7): Economic Integration in MENA

7.1. Why Economic Integration Matters: Potential Gains and Challenges

In view of challenges facing regional accords, regional cooperation and global integration are to be taken as complementary processes. As such, forming deeper and stronger regional economies shall have the confidence and the capacity to effectively compete on highly competitive and volatile markets. And in this process, the development of overarching links between the region and greater markets outside that region would eventually lead to creating higher standards, more incentives and deeper economic integration. In other words, regional cooperation and integration on the one hand and global integration on the other can have positive feedback to each other.

For MENA, in view of its sizable resource endowments, the region's economic performance has been relatively below its potential having its per capita income grow by only 0.9 percent on average per year over the past three decades. Such growth is only comparable with Sub-Saharan Africa (World Bank 2011a). To use the much greater capacity of the region, Fardoust is suggesting reforms and regional cooperation that can boost growth and create employment. Accordingly, limited integration in the MENA region has stifled its ability to tap its significant potential for job creation and economic growth.⁵³⁴ The region now is home to 6.5 percent of the world's population while having 5.1 percent of the world's GDP; nonetheless, it covers only less than 2 percent of nonoil world trade and a bit more than 7 percent including oil and gas trade.⁵³⁵ In contrast, countries in East Asia for example have established high levels of trade, per capita income, and employment as the result of their *liberal trade and investment regime*.⁵³⁶

Such liberalization policy for the regional economies in MENA would blossom similar positive outcomes, as the countries work towards necessary reforms on their policies and institutions to make them more inclusive. Otherwise, major challenges facing the MENA region would continue that include: weak governance, high youth unemployment, water scarcity, vulnerability to global commodity market shocks, as well as inefficient institutions particularly within the public sectors.⁵³⁷

⁵³⁴ Fardoust, p. 17.

⁵³⁵ Ibid, with reference to: Hoekman, Bernard. "Intra-Regional Trade: Potential Catalyst for Growth in the Middle East." The Middle East Institute (2016), accessed May 19, 2016. Retrieved from: http://www.mei.edu/sites/default/files/publications/Hoekman_PDF%20%282%29.pdf

⁵³⁶ Fardoust, p. 17 and p. 19.

⁵³⁷ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 2.

Only embarking on such liberal policy can radically change the political landscape in MENA. To that effect, we may use the past experiences suggesting a fact for the region that *like-minded political regimes tend to boost economic ties*. As an example; Iran, Iraq, and Syria and some other countries with political factions within Levant states can form an economic bloc. Moreover, such trend of embarking on reforms while strengthening their democratic institutions from within and throughout the region can flourish deeper and broader political and economic integration. And intensifying economic ties while expanding such blocs that are formed based on similar political orientations can also be a response to the growing uncertainties in the region. The Gulf Cooperation Council (GCC)'s recent move in expanding membership to Jordan and Morocco would be an example of such constructive trend.⁵³⁸

To meet the region's employment challenge would demand the development of a comprehensive private sector. For job creation, the region did relatively better during the period 2004-2008. For that period, MENA's employment growth elasticity was 0.65 thus leading to a 1 percent increase in gross domestic product (GDP). Nonetheless, the unemployment rates remained high in MENA particularly for women and youth taking into account the region's demographic realities of rapid population and labor force growth. Hence, the number of jobs created could not properly be a response to such rapid increase in labor force. As the result, some informal sectors emerged having low quality jobs with low-productivity. According to a report (World Bank 2011c); the average MENA country produces one-third of its GDP while employing two-thirds of its labor force informally. These are mainly the jobs without any security of tenure, benefits, or relative financial stability that exist among formal sector jobs.⁵³⁹ All this in a way reiterates the necessity to embark on a new scheme based on a new social contract as explained earlier.

Economic integration can also be a solution to help policy makers address such critical development challenges. As earlier defined, economic integration is the *elimination of tariff and nontariff barriers to the flow of goods, services, and factors of production among a group of cooperating countries*. A deeper integration would encompass the improvement of transport and trade logistic systems while strengthening the infrastructure along with harmonization of institutional arrangements and practices, plus the improvement in behind-the-border **policies and regulations** that can impose burden on business activity. Such policies and regulations can also affect the exchange rate policy as well as investment or competition policies, and policies concerning trade in services. They may also contain the efficient provision of key backbone services such as energy, water, transport, telecommunications, and finance.⁵⁴⁰

⁵³⁸ Rouis and Tabor (The World Bank, 2013), p. 3.

⁵³⁹ Ibid.

⁵⁴⁰ Ibid, p. 4.

Economic integration can also address these challenges by strengthening incentives and creating opportunities for growth, employment, and economic diversification. Integration would be a tool to attract the investment needed to create more and better jobs as it removes barriers to trade and investment thus bringing a more enabling environment for domestic as well as foreign investment. Coupled with institutional reform, economic integration can result in *positive market, efficiency, and long-term welfare effects*.⁵⁴¹ Moreover, it can create joint action economic activities to overcome institutional and policy barriers to the flow of goods, services, capital, and labor. By lowering interregional barriers, partner countries are able to expand exports of internationally competitive products, while lowering the price of the goods in the importing country and thus benefiting both parties.

The opposite of economic integration would be isolation which may clearly cause disadvantages (Freund and Ornelas⁵⁴² 2010; Winters⁵⁴³ 2010). Accordingly, isolated economies have a structure with less diversified production and more vulnerability towards shocks as compared with larger and more economically integrated economies.⁵⁴⁴

As explained earlier, *regional and global integration are complementary processes*. Regional integration would in fact contribute to global integration by using and reaping the benefits of geographical proximity, while promoting learning by doing, and through fostering competitiveness. Through regional integration processes, the need for better domestic infrastructure and cross-border trading would gradually emerge. To ensure such complementary processes in between the two levels of regional and global integration, up to a reasonable degree open regionalism ought to be encouraged by way of negotiating with regional partners over reciprocal preferences while opening up to international markets simultaneously.⁵⁴⁵

Reciprocally, global integration can act as an impetus to bear pressure on countries to improve their regional integration along with positive neighborhood effects which occur when countries within a region are integrated into global trade and investment flows. In such cases global economic integration will bolster competitiveness and lower costs, while it induces countries to adopt the kinds of institutional arrangements and policies that are necessary for conducting business in competitive global markets.⁵⁴⁶

⁵⁴¹ Rouis and Tabor (The World Bank, 2013), p. 4.

⁵⁴² Freund, Caroline; and Emanuel Ornelas. "Regional Trade Agreements." *Annual Review of Economics* 2010, 2 (1): P. 139.

⁵⁴³ Winters, L. Alan. "Regional Integration and Small Countries in South Asia." In *Accelerating Growth and Job Creation in South Asia*, ed. Ejaz Ghani and Sadiq Ahmed, Oxford University Press, 2010: pp. 291-342.

⁵⁴⁴ Rouis and Tabor, p. 4.

⁵⁴⁵ *Ibid*; p. 5, and Fardoust; p. 22.

⁵⁴⁶ Rouis and Tabor (World Bank), p. 5.

The effects of integration both at regional and global levels confirm the positive correlation between integration and institutionalization. Regional economic integration can boost productivity and eventually lead to efficiency gains. By opening up domestic market, competition would be increased in sectors helping towards the formation of the inclusive institutions while helping frame a new social contract. Moreover, regional economic integration efforts would be considered a training ground for policy makers for negotiating highly technical aspects of trade and investment agreements.⁵⁴⁷ While attaining a good level of institutional practice, regional integration can also contribute to establishing good governance while speeding up institutional transformation. In addition, adopting domestic rules and regulations on investment, or common customs procedures along with product quality standards can boost foreign domestic investment inflows in order to enhance the credibility of domestic investment regimes.⁵⁴⁸

Regional integration efforts may also help in implementing constructive policy reforms in a multiparty arrangement making a stronger leverage against the domestic lobby groups who attempt to rather reverse policy reforms with the aim of enhancing their economic rents. In other words, regional integration efforts would be supportive of the institutional changes which are to be implemented for better within domestic spheres.

Furthermore, international experience suggests that “early wins” have direct impact on the progress of economic integration which can build widespread awareness of the potential benefits of economic integration, along with strong political support for the integration (De Melo⁵⁴⁹ 2008; Hill and Menon⁵⁵⁰ 2010; Olarreaga⁵⁵¹ 2008). In most successful economic integration efforts, we see such process is followed by the development of cross-country supplier networks which by itself stands as a significant progress.⁵⁵²

For example, automobile industry in Eastern Europe, and electronics industry, natural resources, as well as petrochemical sectors in case of East Asia have had a direct role in delivering that success to these regions. Indeed ASEAN can furnish a relatively successful model of “open regionalism” for MENA countries. The ASEAN integration has been substantially fruitful (well-payoffs). The total trade-to GDP

⁵⁴⁷ Rouis and Tabor (The World Bank, 2013), p. 6.

⁵⁴⁸ Ibid.

⁵⁴⁹ De Melo, Jaime. “Lessons from COMESA Integration for PAFTA.” Paper prepared for the Seminar on Strengthening the Pan Arab Free Trade Area, Oman, May 2008.

⁵⁵⁰ Hill, Hal; and Jayant Menon. “ASEAN Economic Integration: Features, Fulfillments, Failures and the Future.” ADB Working Paper Series on Regional Economic Integration, Asian Development Bank, Manila, 2010.

⁵⁵¹ Olarreaga, Marcelo. “Regionalism: A View from Mercosur.” Paper prepared for the Seminar on Strengthening the Pan Arab Free Trade Area, Oman, 2008.

⁵⁵² Rouis and Tabor, p. 6.

ratio in case of the ASEAN nations increased from 20 percent in the 1960s to an overall average of 140 percent in the first decade of the 2000s thus even surpassing that of the European Union's (EU) that is the world's most trade-oriented region. Moreover, trade has increased within ASEAN from 4 percent of GDP in the mid-1960s to something like 35 percent of GDP 40 years later.⁵⁵³

Therefore, what I propose here for MENA would be a model of integration similar to a community based in Africa combined with that of the ASEAN regional integration. As such, each geo-political sub-region including Mashreq countries (which include Iran, Iraq, Jordan, Lebanon, Syria, and West Bank and Gaza), as well as Maghreb Countries (North Africa), and the GCC (in the Persian Gulf), as three sub-regions, can consolidate their economic and political ties within regional communities of states and all together may act as PTAs under the greater umbrella of regional integration in MENA.

In my view, integration in Africa can furnish a community based organization as a model like that of Arab Maghreb Union, AMU; or East African Community, EAC, while ASEAN would serve as a relatively successful model of 'open regionalism' with successful markets including the IPNs. Interestingly, each of the above sub-regions i.e. Mashreq countries including Iran, Iraq, Syria, Lebanon and the Levant have so many similarities and commonalities of cultural and political ties which, in a way, can act as an impetus or political incentive for economic competition with other regions in MENA. Same aptness and similarities of institutions can be observed within the GCC countries and among the North African states (the Maghreb) as well. I believe such combination model can work for MENA with an ultimate view of a model to be attained similar to that of the European Union in many aspects.

The similarities of cultural and political aspects among Mashreq countries coupled with geographical proximity can easily pave the way to build up that community based integration within the first pillar of the Greater MENA integration. Likewise would be the case of the GCC countries where the common geo-political and historical bondage can build the second community while having the both sub-regions connected with the countries in North Africa (the Maghreb) which forms the third sub-region possessing good ties with the European Union.

Respecting and helping the above arrangement to intensify towards deeper integration in the MENA region would foster the opportunities for enhancing competition and eventually job creation in each sub-region or community of states. However, the first step for the above model would be to create peaceful atmosphere away from current conflicts in each sub-region and then to work away at getting the major

⁵⁵³ Ibid, pp. 7-8.

players of the three sub-regions together to establish further cooperation and deeper regional integration.

Getting the major players of the region on a common platform to solve regional conflicts and foster cooperation is also suggested by Fardoust.⁵⁵⁴ In his policy book, he highlights the important role that the larger and most powerful countries in the region can play. Accordingly, he is suggesting that Saudi Arabia, Egypt, Iran and Turkey can and should properly address root problems of the region while spearheading stabilization of the political and economic situation within the MENA region.⁵⁵⁵ Hence, the immediate step to take should include calming the region by halting the conflicts and then replacing the significantly high military budget with investment on infrastructure of the regional economies in view of fostering competition while enhancing welfare of the people in the region.

Moreover, Fardoust is proposing what is called “a mini Marshal plan” for the region upon which the United States, Europe, the above regional powers as well as the GCC countries can have a major share of a donor community in order to reconstruct the MENA region. For the above model and such proposed plans, economic integration not only as an objective but also as an effective tool can play a significant role. For, the limited integration of the region into the global economy will make it difficult for MENA to accelerate its economic growth. If such necessary steps are not quickly taken, it would have devastating consequences for the already weak economic performance of the region resulting in deeper economic stagnation followed by eventual chaos and destruction. We have already witnessed adversities in parts of the region along with their unpleasant global consequences.⁵⁵⁶

As also posed by Fardoust; the question is what fundamental factors and policies have been responsible for the social and economic deficits of the region in spite of its financial wealth and immense natural resources? Moreover, what steps should be taken in terms of economic institutional reforms to address regional challenges to achieve better outcomes for the citizens of the region?

In the following sections, I discuss the Middle East and North Africa (MENA) region’s achievements in and constraints to regional trade integration in goods and services. What is proposed here includes some actions that can be taken to further trade within and outside the region. This part of the chapter is drawing and updating by the work of the World Bank, namely, Chauffour (2011),⁵⁵⁷ Rouis (2010),⁵⁵⁸ Rouis and

⁵⁵⁴ Fardoust, Shahrokh. “Economic Integration in the Middle East: Prospects for Development and Stability.” Middle East Institute Policy Paper, June 2016.

⁵⁵⁵ Fardoust, p. 1.

⁵⁵⁶ Ibid, p. 2.

⁵⁵⁷ Chauffour, Jean-Pierre. “Trade Integration as a Way Forward for the Arab World: A Regional Agenda.” World Bank Policy Research Working Paper No. 5581, World Bank, Washington, DC, 2011.

Al-Abdulrazzaq (2010),⁵⁵⁹ and Rouis and Kounetsron (2010).⁵⁶⁰ The work complements the Deauville Partnership Report as requested by G8 for Mediterranean Integration (World Bank 2012) in view of the MENA integration through policies, regulations, competitiveness, diversification, and employment; trade facilitation, trade finance and remittances, inclusiveness, equity and sustainability as the main criteria in the process of institutional change and a fruitful integration into the global economy.

7.1.1. Regional Integration through Trade in Goods

Trade volumes usually increase when competitiveness improves and thus demands for exports to go up. This has been well illustrated for MENA as the total exports in the region has been quadrupled from the late 1990s to the late 2000s thus rising from US\$ 194 billion per year to US\$ 825 billion per year. Accordingly, total imports have also increased from US\$ 165 billion per year to US\$ 607 billion per year. Nearly 80 percent of the growth in exports is associated with petroleum, and the petroleum exporting countries of the region have accounted for two-thirds of the growth in import demand.⁵⁶¹

The above numbers confirm the important role that petroleum plays as the most competitive product, in the region. Nonetheless, if we consider nonoil export of the region, trade integration in the global economy would be quite slow. As mentioned, the share of non-oil world trade was only 1.8 percent despite the fact that MENA inhabits 5.5 percent of the world population (2008-10) plus 3.9 percent of the world's GDP. Therefore, outside of petroleum, most countries represent a narrow trade base being 2-3 percent of the total trade as merchandise trade of the region (Hoekman and Zarrouk 2009).⁵⁶²

Nevertheless, the Gulf Cooperation Council (GCC) nations took a relatively different path during the past decade by a rapid expansion of trade and investment in particular with China and India, two emerging economic powers, as such basing a strong complementarity with these countries (Habibi 2011).⁵⁶³ These

⁵⁵⁸ Rouis, Mustapha. "Economic Integration in the Mashreq." Middle East and North Africa Region. Washington, DC: World Bank, 2010.

⁵⁵⁹ Rouis, Mustapha; and Ali Al-Abdulrazzaq. "Economic Integration in the GCC." Middle East and North Africa Region. Washington, DC: The World Bank, 2010.

⁵⁶⁰ Rouis, Mustapha; and Komlan Kounetsron. "Economic Integration in the Maghreb." MENA Region, Washington, DC: The World Bank. 2010.

⁵⁶¹ Rouis and Tabor (The World Bank, 2013), p. 11-12.

⁵⁶² Ibid, p. 12; With reference to:

Hoekman, Bernard; and Jemal Zarrouk. "Changes in Cross-Border Trade Costs in Pan Arab Free Trade Area." Policy Research Working Paper No. 5031, Washington, DC: The World bank, 2009.

⁵⁶³ Habibi, Nader. "Growth in Economic Relations of China and India with the GCC Countries." Asian Pacific Economic Literature, 2011; 25 (2): pp. 52-67.

two powers are considered the fastest-growing oil consumers of the world, while the GCC countries are considered having the largest deposits of oil and gas. The bilateral trade is being led mainly by Saudi Arabia and the United Arab Emirates. Moreover, fossil fuels are the main exports from the GCC to India and China. In return, the main imports from India into the GCC are food and refined products while manufactured consumer goods and capital goods are those from China to the GCC. This rapid growth in merchandise trade has also triggered growth in other sectors including bilateral investments in the energy, finance sectors and real estate.⁵⁶⁴

The lowest share of intraregional nonoil merchandise trade belongs to the Maghreb countries so far⁵⁶⁵ as being less than 5 percent, which has somewhat increased a bit since 2000. Intraregional trade in the Mashreq and GCC, have been relatively larger. In the Syrian Arab Republic and the Republic of Yemen (both currently engulfed with conflicts), regional markets account for more than half of all nonoil exports. In Oman, Bahrain, the United Arab Emirates, and Lebanon, they account for 35–40 percent while they comprise of more than 25 percent of nonoil exports in case of the Arab Republic of Egypt, Jordan, Kuwait, and Saudi Arabia. For Jordan and Syria, the ratio of intraregional trade to GDP exceeds 15 percent while it is in the low single digits in the other countries of the MENA region. Such ratio is in fact low in resource-rich, labor-importing countries in which the ratio of total exports to GDP is considered high (Hoekman and Zarrouk 2009).⁵⁶⁶

With the rise of India and China a competition has emerged in the new markets for nonoil products making it difficult for MENA countries to retain market share. For example the EU market has been affected by this competition. China's share drastically rose in particular for textiles, apparel, and electronics. Between 1995 and 2006, the EU market has been gradually replaced from Maghreb countries nonoil products to the Chinese ones. The dominant market for Maghreb countries' exports in 1995 was the European Union accounting for half of exports from Egypt, Syria, and Islamic Republic of Iran.⁵⁶⁷ This is while, by 2006 with the exception of the Republic of Yemen, the above share in the EU market fell in all Maghreb countries. Also, on the home front, the rapid increase in imports from China and India affected the consumer prices in the MENA region, and as the result of the competition, domestic producers faced difficulty particularly in the electronics, textiles, leather, and furniture industries (Pigato

⁵⁶⁴ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 12.

⁵⁶⁵ *Ibid*, p. 13.

⁵⁶⁶ *Ibid*.

⁵⁶⁷ *Ibid*, p. 14.

2009).⁵⁶⁸

Even though Barriers to Trade in Goods have been lowered, compared with other regions, the level of tariff protection in MENA is still high by international standards particularly in agriculture that is considered a sector heavily protected by high tariffs within the MENA region. Nontariff measures (NTMs) have also become the most important barriers to trade in case of the MENA region. Accordingly NTMs continue to impede regional integration in spite of tariff liberalization that took place under PAFTA. Beside the border closures, such NTMs cause excessive delays as the result of lengthy clearance and inspection processes as well as the bureaucracy involved in the customs. Taking into account such NTMs when calculating the OTRI (Overall Trade Restrictiveness Index), the MENA region would be considered the most restrictive region in the world in particular because of such high NTMs on agriculture goods (Figure 7.2.). The only exception in Agriculture would be South Asia. Overall, such high NTMs continue to impede regional integration in spite of the tariff liberalization under PAFTA.⁵⁶⁹

Beside the NTMs impediment, the poor regional trade logistics performance is also an issue. The current logistic services imposed some internal costs on the way of shipping goods from the factory gate to the port, and from ports to retail outlets, that all create significant hurdles in the region with the exception of the United Arab Emirates (UAE) that is among the world's better performers in this regard. More into details; for example, the *Doing Business* "cost of trading" data confirms the high costs related to the procedures involved in export or import of a 20-foot container within MENA. Such costs include document and administrative fees for customs clearance as well as technical control, inland transport and terminal handling charges.⁵⁷⁰ As exceptions, in 2012 however, the United Arab Emirates, Qatar, and Saudi Arabia were among the top 40 logistics performers. This whole picture suggests the necessity to implement the institutional reforms as such in order to facilitate trade within the MENA region.

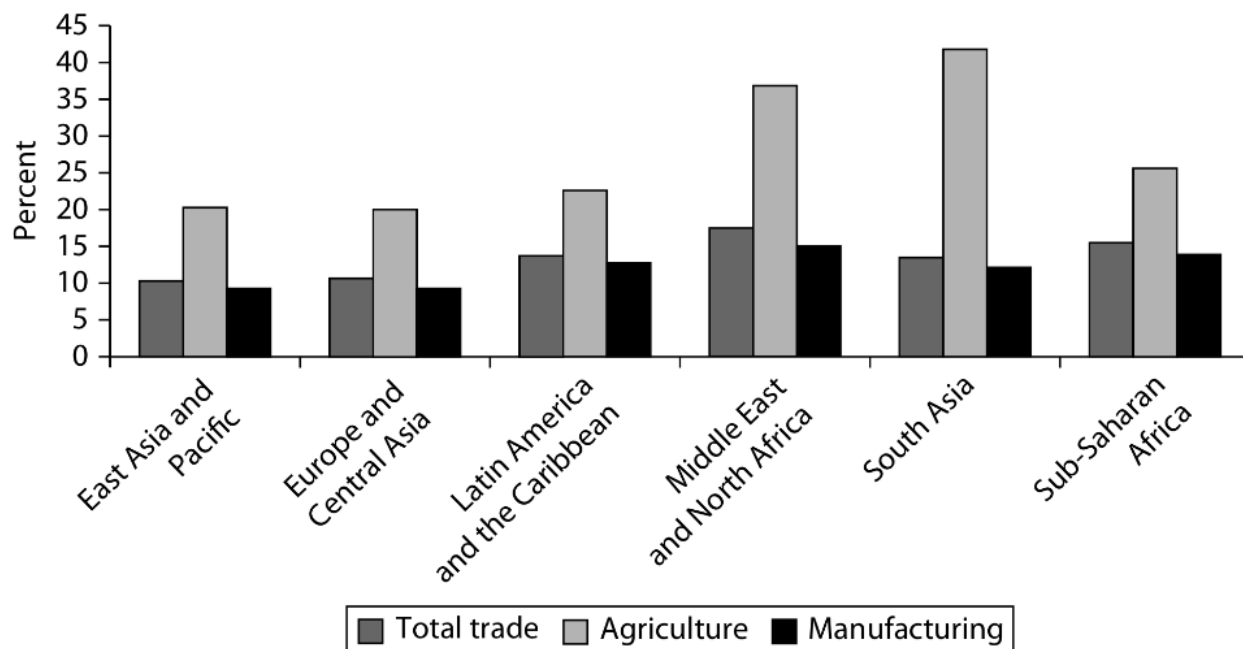
In parallel with such institutional reforms, MENA has significant opportunities to reform trade regimes in the region to achieve deeper economic integration. MENA countries should first unilaterally reduce their MFN tariffs to the level of the most competitive regions such as East Asia. In addition, the existing NTMs ought to be reviewed and streamlined by learning from other countries experiences.

⁵⁶⁸ Ibid, with reference to: Pigato, Miria. "Strengthening China's and India's Trade and Investment Ties to the Middle East and North Africa." *Orientations in Development Series*. Washington, DC: The World Bank, 2009.

⁵⁶⁹ Rouis and Tabor (The World Bank, 2013), p. 19.

⁵⁷⁰ The cost measure does not include tariffs or trade taxes. Only official costs are recorded. Inland transport costs are based on distance to the shipping port. The methodology, surveys, and data are available at: <http://www.doingbusiness.org>.

Figure 7.2. Overall Trade Restrictiveness Index (OTRI) by Region, 2009



Source: Kee, Neagu, and Nicita, forthcoming.

New regulatory impact should be established so as to improve the process through which new NTMs are created.⁵⁷¹ Furthermore, some mechanisms need to be strengthened for the purpose of tracking and enforcing commitments in order to liberalize trade within the MENA region. In case of some Arab nations, an independent PAFTA Secretariat should contain skilled staff like those in the Common Market for Eastern and Southern Africa (COMESA) Secretariat.⁵⁷²

Moreover, the implementation of PAFTA should be monitored that includes inter alia PAFTA members' liberalization commitments, i.e. for dismantling the NTMs, and for the liberalization of services. As such, an instrumental role may be bestowed upon the organization to devise a service negotiation strategy that is comprehensive for the regional bloc and yet designed to be appropriate to the PAFTA members' goals and needs. Such monitoring is important for the policy-makers to receive the feedback and to assess the effects of the agreement. The rules and disciplines should be strengthened applicable to PAFTA as well as other regional institutions by which Arab Customs Union or Common Market (2020) can be created. Prohibition of NTMs would be a necessary step to help PAFTA while establishing effective national

⁵⁷¹ Rouis and Tabor (The World Bank, 2013), p. 21.

⁵⁷² Ibid.

treatment in the services trade, as well as reaching an effective framework that can guarantee the free movement of labor within the MENA region. And above all, this should include a dispute settlement mechanism along with proper enforcement to ensure compliance.⁵⁷³

Overall, in view of a recent assessment concerning MENA's trade agreement, we may conclude that trade within the region is relatively below its potential and that the level of diversification is low. Even the performance of PTAs has not been effectively stimulating trade within the region. Nonetheless, Algadir Agreement, as well as US-Jordan Agreement contained some positive impact on trade similar to the effect of a standard PTA. In order for the regional preferential agreements to have a significant effect upon trade and economic growth, they need to be designed much deeper so as to involve improved governance, regulatory harmonization, services trade as well as labor mobility. Except for the GCC, the majority of MENA economies are facing challenges in their regional schemes due to their inadequate infrastructure, political frictions among the members, as well as policy distortions in domestic economies. According to Fardoust, Economic Cooperation Organization might have the capacity to address the challenges of trade facilitation and act like a bridge between East Asia and the MENA region.⁵⁷⁴

Beyond the formation of the PTAs, deeper integration such as the customs union (CUs) in which countries set up common external tariffs (CETs) in accordance with the GATT's Article XXIV exception to the principle of non-discrimination, could also bring more conformity between regionalism (regional integration) and that of the global integration. In other words, creating the complementarity between the two levels of regional and global integration could properly inhabit the integration processes.⁵⁷⁵

The significance of infrastructure are also revealed in the OECD report which states that apart from the GCC and despite some recent achievements, the quality and quantity of infrastructure in the MENA still lags behind.⁵⁷⁶ In fact, infrastructure investment can facilitate trade while having a positive impact on growth and productivity, and the quality of life. Therefore, it is incumbent upon the governments in MENA to improve their institutional framework so as to better manage the infrastructure investment with a view to increase trade and productivity.

⁵⁷³ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, pp. 21-22.

⁵⁷⁴ Fardoust, p. 20.

⁵⁷⁵ See Baldwin, Richard; Cohen, Daniel; Sapir, Andre; and Venables, Anthony. "Market Integration, Regionalism and the Global Economy." Cambridge University Press, 1999, pp. 53-76.

⁵⁷⁶ OECD: "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policy Series, October 2016, p. 22.

7.1.2. Regional Integration through Trade in Services

Trade in services is considered a major untapped source of trade growth in the MENA region.⁵⁷⁷ The services sector in MENA comprises 46 percent of its gross domestic product (GDP) having wide variations among the countries. Despite the increase in recent decades, its share is relatively low by international comparison. Since services trade involves operations in new markets by skilled individuals, it is important to establish the regulatory framework to be conducive to cross-border flows of skilled labor, capital, and technology.⁵⁷⁸

MENA has had a low services trade performance so far. In fact, MENA is a minor player like those of Latin America and Sub-Saharan Africa regions when it comes to the global trade of information and communications technology, finance, and other business services. During 2000-8 the services trade in MENA grew by 12.4 percent annually as compared to that of 23 percent in South Asia, 16 percent in East Asia, and 14 percent in Europe and Central Asia. Moreover, between 2000 and 2008, MENA's share in the global services trade stagnated at around 2.8 percent (Borchert, Demartino, and Mattoo 2010).⁵⁷⁹

There is a lack of dynamism in services exports in the MENA region which reflects its low value-added orientation. Tourism and travel related services form the biggest share of the exports of services in MENA. In 2008 the tourism industry accounted for 53 percent of total services exports while travel and transport together made up something like 78 percent of total MENA service exports. In contrast with South Asia (mainly driven by India) information and communications technology as well as finance are the leading positions in export services making up to 55 percent of service exports. Transport and travel services together account for only 24 percent of total service exports in the South Asia region (Figure 7.3.).

Relatively speaking, there has been more dynamism for services sectors in East Asia with an average growth of 9.5%; South Asia 8.3%, and Europe and Central Asia 5.4% between the periods 2000-10. Roughly for the same period, MENA's share in total global services trade has stagnated at around 2 to 3 percent.⁵⁸⁰ Moreover, temporary movement of people forms a significant portion of the services trade operation. In fact, free movement of people is significant in creating a regional labor market. In MENA,

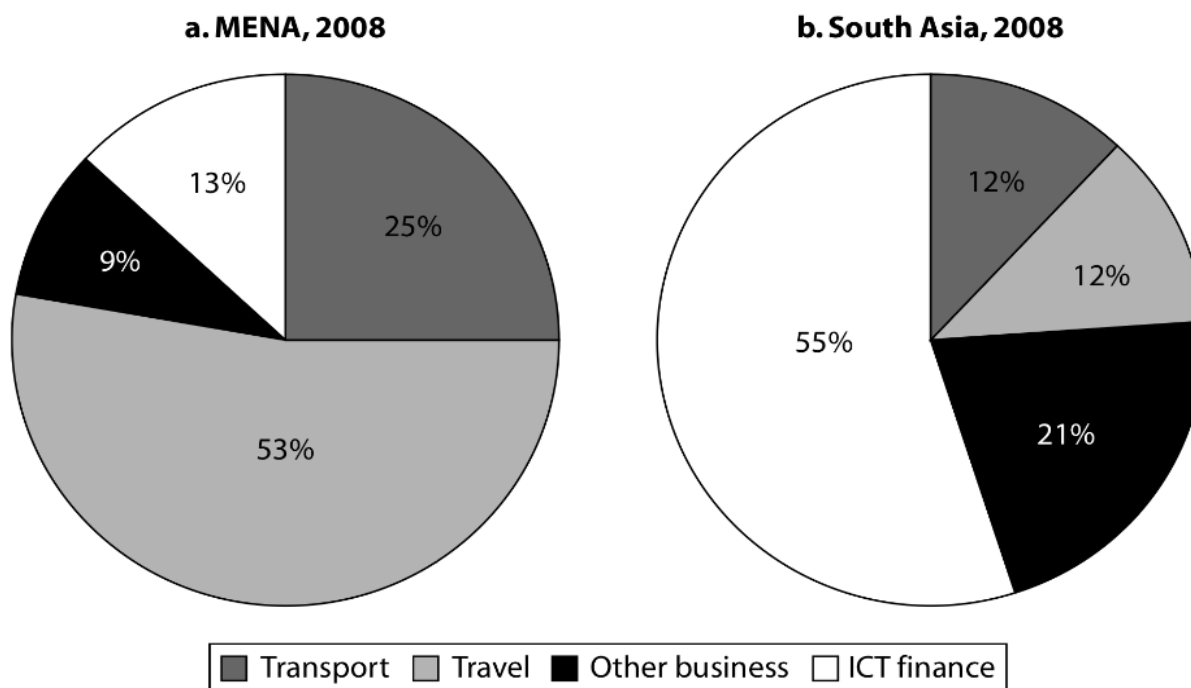
⁵⁷⁷ Ibid.

⁵⁷⁸ Rouis and Tabor (The World Bank, 2013), p. 25.

⁵⁷⁹ Ibid, p. 26; With reference to: Borchert, Ingo; Samantha Demartino; and Aaditya Mattoo. "Services Trade Policies in the Pan-Arab Free Trade Area (PAFTA)." Draft Report, Trade and Integration Team of the Development Research Group (DECTI), World Bank, Washington, DC, 2010.

⁵⁸⁰ Rouis and Tabor (The World Bank, 2013), p. 26.

Figure 7.3. Export Outlook



Source: International Monetary Fund 2012.

the lack of properly established institutions in this regard is apparent.

The fact is that most MENA countries are labor-exporters, nonetheless labor demand from the Gulf Cooperation Council (GCC) in particular from Saudi Arabia is so high that has made the region a net importer of labor vis-à-vis the rest of the world, and this is while the region has high unemployment rates. Two main reasons can explain such apparent paradox; first, in spite of significant bilateral flows between some countries of the region, labor markets are not integrated enough at the regional level. Second, labor importing countries of the region including the GCC tend to import mainly lower-skilled workers from Asia among which a majority are not considered skilled workers.⁵⁸¹

A general outlook of the region confirms that there are some impediments to the services trade. These include labor restrictions, overregulation, and overvaluation of exchange rate. By an econometric analysis, Diop and De Melo show that an overvalued exchange rate in the region causes to depress services sector production, especially within the resource-rich countries. Yet demand for services is very

⁵⁸¹ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 27.

high in the region (owing to oil wealth and Engel's Law⁵⁸²). But a great part of this demand for services are satisfied by imports in the MENA region while domestic production of tradable services has been lowered as the result of overvalued real exchange rates as well as Dutch disease effects. Consequently, contrary to global trends; this would lower the share of services in GDP as well as the income in MENA's resource-rich countries. According to Diop and De Melo's econometric analysis, rents associated with natural resource abundance can partially explain the negative correlation that exists between services production and that of the per-capita income.

According to De Melo and Ugarte, with an exception of Iran and the Republic of Yemen, the real exchange rates of resource-rich countries in MENA have been mostly overvalued between 1980 and 2010 which lead to an underdeveloped manufacturing sector in this region (via Dutch disease phenomenon). In other words, when revenues are increased due to the oil exports the country's currency will become stronger in comparison with that of other nations, thus making the country's other exports more expensive for other countries to buy, and this makes the manufacturing sector less competitive. In such circumstances, the competitive services production will be reduced (via the Dutch disease Effects).⁵⁸³

Secondly, overregulation stifles investment and trade in services. Overall it is observed that regulatory barriers to market entry, business conduct and licensing are highly significant in MENA compared to other regions. In view of the diverse extent of General Agreement on Trade in Services (GATS); liberalization commitments among the region's World Trade Organization (WTO) members, the fact suggests that countries have taken different approaches to the process of international services liberalization. And further to the above facts, in case of MENA we see in particular a more restriction when it comes to financial services compared with other regions.

Thirdly, there are also restrictions on the movement of labor in the MENA region, which can be the result of labor market law in MENA. According to such laws, there is not a clear distinction between temporary and permanent labor mobility. Such restrictions include the burdensome and costliness of the procedures related to obtaining work permits and the limitations on the length of stay, also quantitative limits and sectoral bans on such work permits, workers' educational status, job nationalization, restrictions on foreign investment, as well as restrictions on the mobility of family members.⁵⁸⁴ Because of these restrictions, most of the bilateral, regional and international agreements have aimed at liberalizing trade in

⁵⁸² Engel's Law stipulates that "as income rises, the proportion of income spent on food falls, even if actual expenditures on food rise."

⁵⁸³ Rouis and Tabor (The World Bank, 2013), p. 29 and p. 37.

⁵⁸⁴ Ibid, p. 33.

goods and commodities and not at liberalization of services in general.

However, it is worth mentioning that bilateral agreements have been acting as the main instrument to foster trade in services among neighboring countries. For example, Lebanon has initiated several such bilateral agreements, including one with Iraq with the aim to further cooperation. Accordingly, Article 3 of this agreement enjoins that the parties ought to exchange expertise, trainers as well as specialists. Lebanon and Kuwait have reached a similar agreement according to which the two parties agree to *facilitate the procedure of granting entry visas to businessmen in both countries (Article 6)*. Likewise, there has been agreement between Lebanon and Syria for the promotion of labor mobility between the two countries. These agreements mainly encompass the exchange of expertise while facilitating visa procedures; however, they do not seem to have direct provisions dealing with the temporary movement of workers.

Another successful example of bilateral agreement in the region would be the one signed between Egypt and Jordan, by which labor migration is to be facilitated between the two countries. Accordingly the Egyptian workers would be treated the same as Jordanian workers when it comes to the labor law, insurance, or social benefits.

Key macroeconomic as well as microeconomic reforms are needed to reveal the kind of potential that the services sectors can have in the MENA region. On the macro level, overvaluation of real exchange rates ought to be avoided particularly in resource-rich countries in which rents gained from natural resources can impede the development of the services sector. Throughout the region encompassing all the countries macroeconomic reforms should take place with the aim of removing barriers to entry and business conduct while enhancing domestic and international competition in services.⁵⁸⁵ Besides, existing obstacles need to be removed on the way of regional labor movement by engaging in trade agreements and as well with mutual recognition of educational degrees and diplomas aiming at the improvement of labor resource allocation and maximizing regional growth. All of such efforts can reduce unemployment and create jobs within services sectors in the MENA region.

Much more gains for MENA countries can be obtained through regional services liberalization if it is coupled with comprehensive reforms and strategies aiming at strengthening competition while streamlining regulatory frameworks which would result in reaping benefits two to three times greater than

⁵⁸⁵ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 36.

those achieved by way of tariff removal alone (Konan 2003).⁵⁸⁶ In particular, opening the regional services sectors would also facilitate trade in parts and components⁵⁸⁷ thus helping the emergence of regional production networks like that of the ASEAN.

Moreover, building backbone services in the cross-border infrastructure is critical in boosting productivity and international competitiveness. Hence, good quality in backbone services such as telecommunication, transport, and power are crucial, as opening such services to more competition can encourage trade. Besides, harmonizing regulations related to services sectors may reduce production costs, promote knowledge spill-overs, and increase foreign direct investment (FDI) and thus help to expand markets.⁵⁸⁸

Similarly, Fardoust is suggesting the implementation of some major regional projects on infrastructure for energy, water, and transport both ground and air, aimed at improving links between the major countries for deepening trade integration within the MENA region and the rest of the world.⁵⁸⁹ Accordingly, doing so would increase exports, attract FDIs and speed up reforms in new areas to compete including reductions of tariff and non-tariff barriers, having access to markets in advanced economies, as well as important areas related to trade facilitation and export promotion.

OECD is particularly stressing on openness to trade and investment while following national development plans. Accordingly, sound macroeconomics and structural policies are suggested by which capacity of host economies would be strengthened leading to important benefits resulted from international trade and investment (**p. 19**) *from enhanced economic and inclusive growth to job creation and innovation*.

Trade facilitation and logistics also play important role in the regional and global integration processes. Countries in MENA are lagging behind on logistics efficiency in comparison with countries at similar income levels such as Asia and Latin America. This has, therefore, a negative impact in taking advantage of good shipping connectivity in the Mediterranean as well as the proximity with those of the European markets.⁵⁹⁰

New strategies should emerge in the region to primarily include implementation of remedial policies and

⁵⁸⁶ Konan, Denise E. "Alternative Paths to Prosperity: Trade Liberalization in Egypt and Tunisia." In *Arab Economic Integration: Between Hope and Reality*, ed. Ahmed Galal and Bernard Hoekman. Washington, DC: Brookings Institution Press, 2003.

⁵⁸⁷ Rouis and Tabor (The World Bank, 2013), p. 37.

⁵⁸⁸ Ibid. p. 39.

⁵⁸⁹ Fardoust, p. 4.

⁵⁹⁰ Rouis and Tabor (The World Bank, 2013), p. 76.

investment and the countries afflicted by internal conflicts are in immediate need to end such conflicts including Iraq, Libya, and Syria, or Yemen. On the other hand, there are instances of some middle income countries including Jordan, Morocco, and Tunisia representing more export bases with diversified production in which some trade facilitation and logistics services reforms have been implemented. They render good lessons to be followed by other countries of the region.

Also, in case of the Mediterranean region; its proximity to Europe has shown a convergence towards European regulations and border management processes i.e. the EU Association Agreement process that has been a major driver for reforms. In fact many sub-regional dynamics can complement and support national efforts in harmonizing their regulations with those of European standards. Notably, under the AMU the Maghreb countries would be able to integrate further for border management and services. For Mashreq countries, there is a “corridor-based” initiative through which trade can be facilitated. Sub-regional activities, thus, can deliver benefits towards national capacity building and reform initiatives. And for such national capacity and reform initiatives, having experts in the field from countries including Iraq, Libya, and Syria would be of essence. As such, Libya’s focus on regional Maghreb integration can help its reconstruction further progress. For instance, activities within their customs could be re-launched on the basis of a *convergence of codes, tools, and border management principles* with other Maghreb countries.⁵⁹¹

7.2. Upgrading Infrastructure, Trade Facilitation, and Logistics

As mentioned above, having and building good quality infrastructure can serve the purpose of regional economic integration as it has direct impact on openness of the economies and it is considered as a necessary means to foster trade in goods and services. Transport sector is among the most important whose infrastructures play a key role to regional economic integration.⁵⁹² Despite the high capacity in air, ground and sea transport as well as the sizable rail networks in the MENA region, unfortunately the quality of transport infrastructure is mainly deficient being unable to match for or support growing, modern economies. Hence, improving regional transport policies is the key for upgrading the infrastructure of the sector in the region.

Furthermore, energy sector (gas and electricity) in the region does not have the infrastructure and

⁵⁹¹ Ibid, pp. 76-77.

⁵⁹² Ibid, p. 39.

development necessary to increase trade and cooperation within the MENA region. This by itself creates a hurdle on the way of deeper economic integration in the region. Also, there is not much harmonization among MENA countries when it comes to the issues concerning safety, environment, and energy.⁵⁹³ For example, quite few countries in MENA enjoy *independent and informed regulatory agencies* on the matters of decision-making away from politics. Gas market is not deregulated either which would pose challenges for sustainability, environmental objectives, and to the promotion of competition. In addition, some reforms are needed in MENA's power sector in order to have a more open and fair access to national transmission systems. For example, there is a need for the construction of the proposed Egypt-Saudi Arabia high-voltage direct current (HVDC) interconnection.

As simply explained by OECD; infrastructure and basic services are to facilitate trade and investment by way of connecting producers to markets.⁵⁹⁴ Hence, having proper services for a competitive economy and integration of businesses would be crucial for making the region integrate into the world economy. And according to the World Bank; weak infrastructure governance and lack of proper regulation and policies are major obstacles in making the needed infrastructure services available namely inadequate institutions and procedures, or tools to identify, develop and execute infrastructure investments.⁵⁹⁵ As a solution, OECD is encouraging more involvement of the private sector into upgrading the infrastructure of economies in MENA through enhancing the governance of infrastructure projects. Accordingly, this should be done by de-risking infrastructure projects through widely using Public Private Partnerships (PPPs). Such an attempt can help in attracting global investors into the region as well.

As illustrated by Figure 7.4.; apart from some GCC countries, the quality and quantity of infrastructure and infrastructure services in the MENA region are considered poor. In fact, in the resource-rich countries or oil-exporting ones including the GCC, they use direct provision and public investment *funded by oil revenues* for developing advanced infrastructure, whereas in other countries the capacity to finance or build such infrastructure is not available. Regional integration can reconstruct this uneven growth and development by directing investment both at public and private sectors to work and construct at a regional level. In this process, the need for drawing the private sector investment is quite clear, as the private sector commitment in infrastructure in MENA region is quite low compared with other regions of the world. This inefficiency is attributed mainly to the structural characteristics as well as the challenges that are specific to the MENA region.⁵⁹⁶

⁵⁹³ Rouis and Tabor (The World Bank, 2013), p. 51.

⁵⁹⁴ OECD; "Better policies for inclusive growth and economic integration in the MENA region." p. 22.

⁵⁹⁵ *Ibid.*

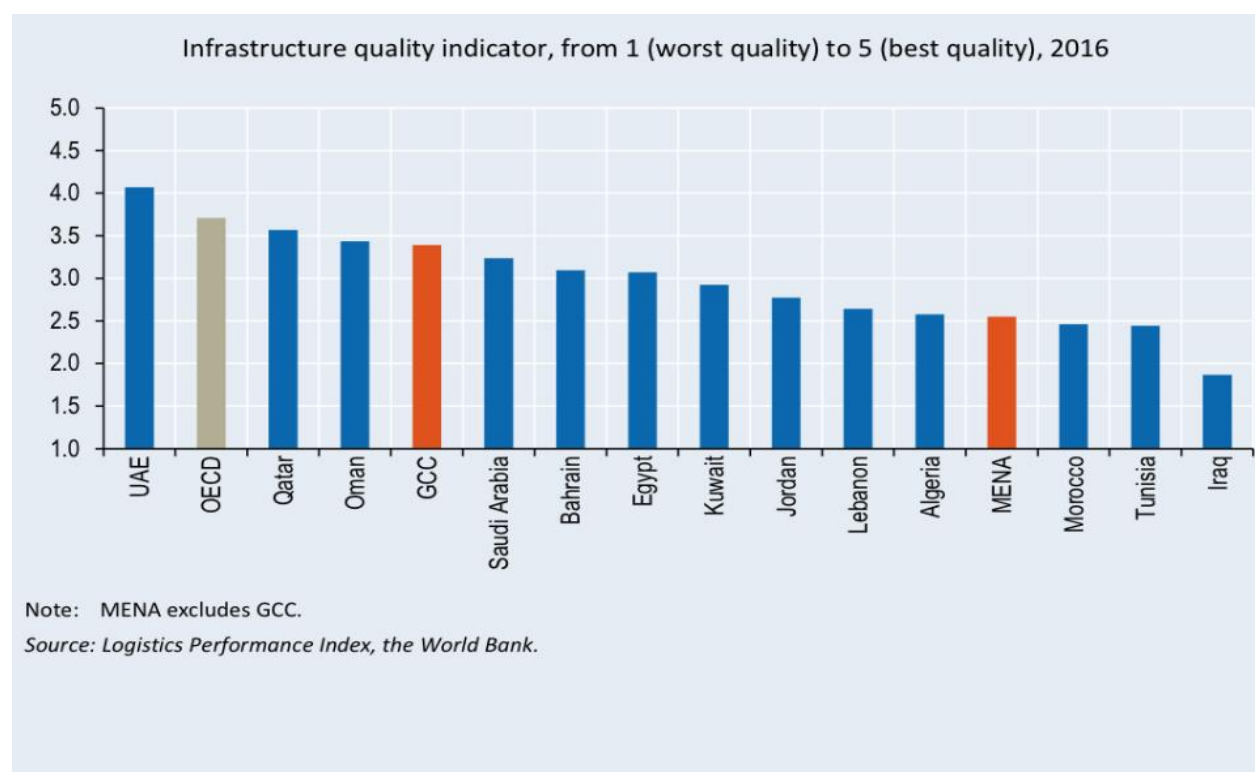
⁵⁹⁶ *Ibid.*, p. 23.

The link between investment in infrastructure and policy actions have a direct impact on trade facilitation and logistics reforms which all together would connect the domestic producers to international buyers. In brief, there are three main pillars of logistics performance for reform consideration which follows:

- (1) The quality and availability of infrastructure related to trade including ports, airports, roads, and railroads;
- (2) Transparency of trade procedures as implemented by customs and other border control agencies;
- (3) The development of logistics services and their quality which may include trucking, warehousing, shipping and customs agent services, as well as freight forwarding and value-added logistics services.⁵⁹⁷

Moreover, nationally and regionally focused policy and institutional measures are mainly important in a country's logistics performance in order to connect to international markets. Such measures include major reforms on the above three categories including the development of trade corridors with good transit regimes and border-crossing; reforms on customs, ports and border management to facilitate trade; and, reforms on regulation and development of logistics with public-private coalitions to implement them.⁵⁹⁸

Figure 7.4. The Quality of Trade and Transport-related Infrastructure is Low in MENA Economies



⁵⁹⁷ Rouis and Tabor (The World Bank, 2013), p. 65.

⁵⁹⁸ Ibid, pp. 65-66.

Overall, as mentioned, the GCC countries have been better off so far regarding performance in trade facilitation, infrastructure development, and logistics. Even though the impetus to logistics and reforms has been mainly focused on trade with Europe and Asia, but recently, more attention has been given in facilitating the cross-border trade inside the region in particular within the GCC, Maghreb, and Mashreq sub-regions. Mashreq and Maghreb Corridor Programs are among such recent attempts.

7.3. Preferential Trade Agreements in MENA

In general, there has been a significant increase in the number and depth of Preferential Trade Agreements in the recent decades having the number doubled in that period as reaching 278 at the end of 2010.⁵⁹⁹ PTAs have become the norms i.e. in the form of bilateral agreements between the countries throughout the world including the MENA region. It is worth mentioning that South-South PTAs represent about two-thirds of all PTAs while North-South PTAs are about one-quarter (Chauffour and Kleimann).⁶⁰⁰

There are different motives to form PTAs beyond which is the goal of simply having access to market. Modern PTAs encompass regulatory and policy issues going well beyond the removal of tariff and quantitative restrictions to issues concerning trade in goods and services.⁶⁰¹ Deep PTAs encompass rules and regulatory disciplines on different border as well as behind-the-border policies including competition as well as investment policies, government procurement, and intellectual property. PTAs often encompass commitments pertaining to trade-in-services that go beyond those accepted at the multilateral level or outside the current mandate of the World Trade Organization (WTO). As such, the main advantage of PTAs is that they have the influence of spurring beyond-the-border regulatory reforms, which by itself is a contribution towards the competitiveness and productivity within the participating nations.⁶⁰²

Although PTAs are taken mainly to expand economic opportunities and market access, political commitment is also a key factor in shaping regional integration. In fact, successful regions tend to have

⁵⁹⁹ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 79.

⁶⁰⁰ Ibid, with reference to:

Chauffour, Jean-Pierre; and David Kleimann. "The Implementation of Preferential Trade Agreements for Development: Lessons from 13 World Bank Country Case Studies." Washington, DC: The World Bank.

⁶⁰¹ Rouis and Tabor (The World Bank, 2013), p. 79.

⁶⁰² Ibid, p. 80.

the will to evolve beyond merely freeing trade.⁶⁰³ Hence, political will is an important ingredient in attaining a successful regional integration starting with different forms of PTAs. Trade may be considered as the secondary tool to those of political and security objectives. As such, we can hardly find a group with only a strict trade agenda.⁶⁰⁴

Moreover, PTAs are the tools presenting significant opportunities and challenges for reform-minded governments.⁶⁰⁵ One of the main challenges would be the emergence of the complex web of overlapping regulatory regimes out of deep PTAs making trade relations less transparent and more unpredictable (Chauffour and Maur 2011).⁶⁰⁶ This is because in each PTA we may find a web of regulatory rules that coexist alongside multilateral rules. By expanding market access, PTAs have also the capacity to boost trade and investment flows while being able to lock in wide-ranging policy and regulatory reforms. In the MENA region, there have been attempts by some countries to engage in different levels of PTAs including a variety of multilateral, regional, and bilateral trade PTAs with the purpose of deepening regional and global economic integration.

There are several motivations for signing a PTA agreement, and this multiplicity of objectives in fact makes the implementation of PTAs more challenging. Such motivations may vary from country to country and from region to region. In practice, MENA countries are members of several different PTAs. They include some existing arrangements within the region such as: (Gulf Cooperation Council or GCC, Pan Arab Free Trade Agreement or PAFTA, Arab Maghreb Union or AMU), with the EU (Euro-Mediterranean Free Trade Area Agreement), and with the United States (Free Trade Agreement or FTA).

As an example of success in this regard, we can name the GCC which has been fairly well implemented, while for the others the progress is mixed. Moreover, the GCC's progress on PTA implementation can be divided into two phases. From 1981 to 2001, the emphasis was on coordination of trade policies. Since 2002, the emphasis has been on full economic integration. Interestingly there has been more progress in implementing PTAs between MENA and other regions of the world than among the countries within the MENA region. Such multitude of PTAs has caused their implementation and management cumbersome due to their complexity.

⁶⁰³ Mathews, Alan. "Regional Integration and Food Security in Developing Countries." FAO, April 2003, p.18.

⁶⁰⁴ Ibid; with reference to: Page, Sheila. "Regionalism among Developing Countries." London: MacMillan for Overseas Development Institute, 2000.

⁶⁰⁵ Rouis and Tabor (The World Bank, 2013), p. 80.

⁶⁰⁶ Chauffour, Jean-Pierre; and Jean-Christopher Maur, eds. "Preferential Trade Agreements Policies for Development: A Handbook." Washington, DC: The World Bank, 2011.

Despite the above mentioned successful performance of the GCC, according to Kshetri and Ajami the institutions and institutional reforms in that sub-region have been slow to change within their economies. Even though the GCC countries have agreed to embark on the path toward more economic freedom and the establishment of the rule of law, their reforms prove to be only “superficial.” (Cook, 2005, 2006).⁶⁰⁷ Accordingly, within the GCC, political and economic liberalizations have not had significant progress mainly because in most cases they are *reluctant*, *crisis-induced*, and *top-down* (Robinson, 1998).⁶⁰⁸ Besides, according to the Journal of Democracy noted in its October 2002 editorial: the Third Wave of democratization has hardly touched the Arab World. There isn’t a single full-fledged democracy in GCC and (Jamal, 2006)⁶⁰⁹ on the contrary some new repressive institutions have also emerged (Cook, 2006).⁶¹⁰

In the ideological arena, Islam’s influence is obvious in businesses and economics. Accordingly, Islamic economics is different from that of western capitalism in many aspects, as the ideology claims to provide an all-encompassing model for economic, social, and political life (Heftier, 2006).⁶¹¹ Many old GCC leaders don’t in fact share an open vision concerning social technological and economic ideas (Harman, 2007).⁶¹² On the other hand, newly western educated leaders in the GCC have been trying hard to bring institutional reform in recent years (Waldman,⁶¹³ 1994; Marr,⁶¹⁴ 2003). Accordingly, western educated GCC technocrats who are well disciplined, energetic and competent are very much open to reforms. Hence, they are seen as potentials to build the future on the basis of democracy and the rule of law. As such they have been considered the agents of important institutional change or institutional entrepreneurs.⁶¹⁵

Moreover, GCC economies’ reform arguably will bring about far-reaching implications beyond their populations encompassing the entire global economy (De Boer and Turner, 2007).⁶¹⁶ The analogy here

⁶⁰⁷ Cook, S.A. “The Right Way to Promote Arab Reform.” *Foreign Aff.* 2005: 83 (3), p. 80. AND; Cook, S.A. “The Promise of Pacts.” *J. Democ.* 2006, 17 (1), pp: 63-74.

⁶⁰⁸ Robinson, G.E. “Elite Cohesion, Regime Succession and Political Instability in Syria.” *Middle East Policy*, 1998, 5 (4): pp. 159-179.

⁶⁰⁹ Jamal, A.A. “Reassessing Support for Islam and Democracy in the Arab World? Evidence from Egypt and Jordan.” *World Affairs*, 2006; 169 (2): pp. 51-63.

⁶¹⁰ Kshetri, Nir and Riad Ajami: “Institutional reforms in the Gulf Cooperation Council economies: A conceptual framework.” *Journal of International Management* (2008) 300-318.

⁶¹¹ Heftier, R.W. “Islamic Economies and Global Capitalism.” *Society*, 2006; 44 (1), pp. 16-22.

⁶¹² Harman, D. “Backstory: The Royal Couple that put Qatar on the Map.” *Christian Science Monitor* 20, 2007.

⁶¹³ Waldman, P. “Turning Back: As Economy of Iran worsens, government reverts to hard line—Racial Clerics who oppose Market Reforms regain control over Rafsanjani—missed chance for the U.S.?” *Wall Street Journal*, 1994 June 28.

⁶¹⁴ Marr, P. “Iraq ‘the day after’: Internal Dynamics in Post-Saddam Iraq.” *Naval War*, 2003; *Coll. Rev.* 56 (1): pp. 12-29.

⁶¹⁵ , Kshetri, Nir; and Riad Ajami, p. 310.

⁶¹⁶ De Boer, K. Turner, J.M. “Beyond Oil: Reappraising the Gulf States.” *McKinsey Q.* 2007; Issue 1: pp. 112-117.

suggests that a free enterprise economy coupled with strong rule of law as well as property rights would benefit not only the society of the GCC but also the entire global economy.⁶¹⁷ In this process, policy makers and managers can also gain significantly through a richer and deeper understanding of GCC regional institutions. In fact, falling oil and gas production as well as the increase in youth unemployment are currently among strong factors that push reforms in the GCC economies. However, achieving a high growth rate has been a top agenda (Dhonte et al.,⁶¹⁸ 2000, UNDP,⁶¹⁹ 2002; World Bank,⁶²⁰ 2003; Elbadawi,⁶²¹ 2005), while the impact of oil revenues on institutional change should be the focal attention.⁶²²

Overall, concepts and theory building are still lacking on the nature of institutions and institutional changes as well as a proper form of social contract in the GCC regions like the majority of other countries in MENA. In case of the GCC however, according to Kshetri and Ajami, since reform has been a stated goal of the GCC regimes, some gradual progressive institutional change can be expected within the region (Carothers, 1998)⁶²³ and as such the results could be produced over time.⁶²⁴

One of the studies on PTAs by the World Bank (2011) suggests that PTAs are in fact living instruments that are subject to continuous adjustments, which can further provide for institutional feedback mechanism.⁶²⁵ Moreover, PTAs can have a positive impact on trade, reform, and investment flows. In short, they would make lower protection, stronger reform, and higher investment for the countries. A series of case studies of PTAs in the MENA region prepared by Chauffour and Maur (2011), finds that implementation of the PTAs has a strong impact on laws governing trade and investment as well as the actual economic performance of the countries.⁶²⁶

In fact, PTAs have been significant in inspiring countries to reform their trade regimes.⁶²⁷ The case studies on the MENA countries have confirmed the above claim to be true. For example, in Egypt the

⁶¹⁷ Kshetri, Nir; and Riad Ajami, p. 301.

⁶¹⁸ Dhonte, P. Bhattacharya, R. Yousef, T. "Demographic Transition in the Middle East: Implications for Growth, Employment, and Housing." International Monetary Fund Working Paper No. WP/00/41. IMF, Washington DC, 2000.

⁶¹⁹ United Nations Development Program. "Arab Human development Report." UNDP, Amman, 2002.

⁶²⁰ World Bank. "World Development Indicators." Washington, DC: The World Bank, 2003.

⁶²¹ Elbadawi, I.A. "Reviewing Growth in the Arab World." *Econ. Dev. Cult. Change* 2005: 53 (2): pp. 293-326.

⁶²² Kshetri, Nir; and Riad Ajami, p. 312.

⁶²³ Carothers, T. "The Rule of Law Revival." *Foreign Affairs*, 1998: 77 (2); pp. 95-106.

⁶²⁴ Kshetri, and Ajami; p. 314.

⁶²⁵ Rouis and Tabor (The World Bank, 2013), p. 84.

⁶²⁶ *Ibid.*

⁶²⁷ *Ibid.*, p. 87.

maximum applied tariff rate declined from over 100 percent in 1986 to 30 percent in 2009, and simple weighted average tariff dropped from 19.3 percent in 2005 to 6.3 percent in 2008.⁶²⁸ In Morocco, the simple average tariff was lowered from 34.5 percent in 2000 (following the Association Agreement with the EU) to 20 percent in 2009. As such, Tariffs were also reduced across all sectors of the economy.⁶²⁹

Moreover, in case of the GCC, their common external tariff was reduced to 5 percent on most imported merchandise and zero percent on essential goods (comprising some 400 items). Also, Tariffs were waived for goods of the GCC origin; defined as those with a minimum of 40 percent local value-added and 51 percent local investment.⁶³⁰ For goods outside the rule-of-origin criteria, tariffs are applied same as the non-GCC markets. As the result, the members agreed on the elimination of the use of tariff escalation for the protection of industry. Instead, in favor of domestic production and export industries, they switched to exemptions for imports of intermediate inputs and equipment.⁶³¹

PTAs are typically used as an instrument for promotion and locking in economic reforms and to help increase confidence in the process of trade liberalization. In case of Egypt, Jordan, and Morocco to implement their agreement commitments, these countries needed to take some regulatory actions thus passing new legislation and updating existing legislation. Under such preferential agreements, reforms were included which covered a wide spectrum ranging from improvement in government procurement, environmental protection, the eradication of child labor, as well as the enhancement of IPR (Intellectual Property Rights). Such agreements had a significant role in inspiring new legislation. In case of Egypt, PTAs have been a major reason for the government to rather shift its focus to domestic issues including trade facilitation away from demand-related problems in foreign markets such as nontariff barriers and high tariff revenue.⁶³²

Studies show that FDIs have been risen sharply in MENA since 2003 (World Bank, 2011) and the major part of this increase has occurred out of the GCC countries. PTAs in contrast have had a more modest impact upon FDI flows with relative small contribution of the EU and United States within the MENA region. Rarely some provisions may be found among the PTAs to deal with the FDI and Capital transfers. The EU Association Agreement; and European Free Trade Association (EFTA) and, to a lesser extent; the

⁶²⁸ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 87.

⁶²⁹ Ibid.

⁶³⁰ Under typical customs unions, the rules of origin are abolished due to the adoption of common external tariffs. In the case of the GCC, this procedure still is followed pending more complete harmonization of external tariffs.

⁶³¹ Rouis and Tabor (The World Bank, 2013), p. 87.

⁶³² Ibid, pp. 87-88.

Turkey FTA would be considered as exceptions to the above rule. And in case of Jordan for example, the only foreign trade agreement was the Qualifying Industrial Zone (QIZ) which was effective in encouraging substantial FDI.⁶³³

An overall look at the findings of before-and-after analysis of some PTAs in MENA such as Euro-med Association Agreement, Free Trade Agreement with the US, and ultimately the Pan-Arab Free Trade Agreement (PAFTA also known as GAFTA; the Greater Arab Free Trade Agreement) confirms the significance of PTAs and suggests that the scope for boosting intraregional trade through PTAs has been rather modest. Accordingly, the findings confirm that Egypt and Morocco benefited from the PTA with the EU while Jordan and Morocco from the PTA with the United States. However, according to these studies, exporters that signed the FTAs with the EU and the United States (i.e. the case of Morocco) are subject to different rules when selling in the United States or the European Union.

Fardoust also touches on the effects of the Preferential Trade Agreements in his book confirming the significant increase in number and depth of the PTAs in the last 15 years having the number doubled during this period.⁶³⁴ He also acknowledges the fact that PTAs have had mixed effects in case of MENA. They have been effective in reducing trade and investment barriers acting as an impetus for behind-the-border economic reforms, while being effective to help spur trade as well. Moreover, they had positive impact to improve countries infrastructures along with their logistics facilities while harmonizing border policies and procedures. Regarding the FDI in the region, Fardoust stipulates that in the MENA region over the last decade, the total FDI rose sharply whose bulk came from within the region, particularly from the GCC reiterating the fact that little FDI has come from the United States or, the European Union. Accordingly, the positive effects of Agadir and PAFTA have been stressed as relatively successful PTAs in the region. Through PAFTA and the Agadir Agreement that established a Free Trade Zone between Jordan, Egypt, Tunisia and Morocco the member countries expanded exports even though from a low intra-regional trade base.⁶³⁵

To mention the main reasons behind the success of the above two PTAs is that firstly, in case of PAFTA; its 18 members account for over 80 percent of total trade in MENA out of which less than 10 percent was traded within the region in 2007 for instance. Secondly, the provisions of PAFTA have been also effective in delivering such success namely the ones concerning the progressive removal of tariffs (by January 1,

⁶³³ Ibid.

⁶³⁴ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects for Development and Stability." MEI Policy Paper, 2016, p.27-28.

⁶³⁵ Ibid, p. 28.

2005) as well as nontariff barriers to trade in goods among the 18 members as was materialized by 2010.⁶³⁶ Interestingly, more recent update confirms such progressive trend through which the signatories of PAFTA attempted to further integrate trade and investment in services while addressing nontariff measures (NTMs) as an impediment restricting trade flows.

In case of the Agadir Agreement, its success could be in part related to the fact that the European Union supported the agreement in view of establishing a free trade area and possibly towards the formation of Euro-med. The four original members also kept the agreement open-ended so as to possibly expand to Algeria, Lebanon, Libya, Mauritania, the Syrian Arab Republic, as well as the West Bank and Gaza.⁶³⁷

7.4. Conclusion

More recent experience and assessment of regional integration particularly in case of the developing countries confirm that regionalism can lead to net trade creation when it is accompanied with a significant degree of trade liberalization. In such regionalism however, the emphasis should be put upon reducing cost-creating trade barriers that can greatly waste resources. As such, regional economic integration should be considered a precondition for, rather than an obstacle to, integrating developing countries into the global economy by way of minimizing the costs of market fragmentation.⁶³⁸

In the MENA region like other parts of the world, there have been an increasing number of PTAs formed during the last 20 years with the aim of improving trade and investment, as well as regulatory settings. The scope of influence of such PTAs has gone beyond the border issues covering trade facilitation measures, competition policy, government procurement, and services liberalization as well as Intellectual Property Rights (IPR).⁶³⁹

One of the most important results of such PTAs has been the creation of deeper regulatory and institutional reform helping the business environment while boosting competitiveness. Nonetheless, there are challenges to the implementation of PTAs particularly in volatile political economies such as the ones in the MENA region due to the existing weak institutional capacity. Hence, improving PTA enforcement,

⁶³⁶ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, pp. 109-110.

⁶³⁷ Ibid, p. 110.

⁶³⁸ Mathews, Alan. "Regional Integration and Food Security in Developing Countries." p. 80.

⁶³⁹ Rouis and Tabor (The World Bank, 2013), p. 96.

while deepening the agenda through exploring open regionalism are key steps for maximizing the potential benefits that can be gained through regional integration.⁶⁴⁰

There are obviously challenges and opportunities emanating from regional economic integration in MENA. These challenges include some serious economic management along with a growing political demand for reforms in the region. As a solution economic integration can in fact help address such challenges facing the regional development by strengthening incentives and opportunities for growth, employment as well as economic diversification. As such, if managed properly, economic integration in MENA would attract the investment necessary for creating jobs while improving the business environment for investment at both domestic and foreign levels. If economic integration is pursued with proper institutional reforms and changes, it would have a prosperous result in different aspects of economies both for the region as well as the global economy.

Liberalization of services in MENA would generate significant benefits to the countries in the region. Such backbone services include telecommunications, financial services, transport, and power that have crucial role in leveling up productivity and international competitiveness. In particular, efficient ports and maritime along with aviation services are essential for the competitive export of goods (Um, Straub, and Vellutini 2009).⁶⁴¹ In particular, the transport sector plays a key role for the majority of MENA countries in shaping regional integration. Power sector is another arena which presents enormous potential in the MENA region. Solar energy also has a tremendous potential for the region, provided that cross-border investment would be implemented to realize economies of scale and scope in this area.⁶⁴² For the MENA region, economic integration in the power sector is still considered immature.

Pursuing and implementing PTAs would reflect both positive and negative socioeconomic effects within the MENA region and the rest of the world. For example, they can reduce barriers in trade and investment thus boosting trade and investment flows while spurring behind-the-border economic reforms. However, it is noteworthy that the PTAs signed between MENA countries and those of the EU and the United States, have been promising for the rapid expansion of imports into the region rather than exports out of it. Moreover, across the region, PTAs have created an atmosphere of cooperation while encouraging the participating countries to improve their trade infrastructure along with their supply chains and logistics

⁶⁴⁰ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 96.

⁶⁴¹ Ibid, p. 101; Referring to: Um, Paul Nomba; Stephane Straub; and Charles Vellutini. "Infrastructure and Economic Growth in the Middle East and North Africa." Policy Research Working Paper No. 5105, World Bank, Washington, DC, 2009.

⁶⁴² Rouis and Tabor (The World Bank, 2013), p. 102.

facilities while harmonizing their border policies and procedures. If properly managed, the PTAs in MENA have the potential to serve as a steppingstone to global market integration contributing to more competitive markets with greater economic openness and more reliance on trade in goods and services.⁶⁴³

Under PAFTA's customs union, and the Arab Common Market to be established by 2020, efforts ought to be put towards strengthening the rules and disciplines which are applicable to PAFTA and other regional trade agreements. This should include agreeing on a new set of rules and disciplines for strengthening PAFTA's governance upon strict limits on nontariff measures (NTMs) as well as some meaningful provisions concerning national treatment in the services trade, and an effective framework to guarantee the free movement of labor in the region. Besides, a permanent and independent dispute settlement mechanism needs to be established to oversee enforcement while ensuring compliance.⁶⁴⁴

Moreover, there should be mechanisms for tracking and enforcing commitments within a regional context. As such, a stronger mandate is needed on the side of the General Secretariat of the League of Arab States in order to monitor the implementation of members' liberalization commitments. This includes inter alia, the dismantling of nontariff measures and the liberalization of services. Regular monitoring of implementation commitments is critical in supporting policy makers' ability to assess and report on the effects of regional integration agreements.⁶⁴⁵

Lastly, as proposed; having the MENA region divided into three geo-political sub-regions (Mashreq, Maghreb and the GCC), as already implemented within the GCC and Maghreb Countries (the case of Arab Maghreb Union- AMU); like-minded countries in Mashreq can also form PTAs, as an economic community of states, with a view to boost trade and competitiveness to level up intraregional economic activities under a greater umbrella of economic integration in the MENA region. Within this context, with reforms and services liberalization, they can harmonize regulatory agreements and practices and lower restrictions on the mobility of foreign workers residing in the region (freedom of movement). This requires the Mashreq countries to restore a peaceful atmosphere away from the ongoing conflicts to achieve the objectives of integration in its regional/sub-regional context as well as moving forward to acquire a more progressive region with economic dynamism in the process of global development.

⁶⁴³ Rouis, Mustapha and Tabor, Steven R. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, Washington DC, 2013, p. 104.

⁶⁴⁴ Ibid, p. 105.

⁶⁴⁵ Ibid, pp. 105-106.

Chapter (8): Natural Resources, Diversification and Growth in MENA

As explained in Chapter (3), the old social contract has performed its job for the MENA region and it is time for the region to move forward on the direction of establishing a new social contract that would firstly serve their domestic policies; and secondly work as a harmonized movement towards a regional cooperation particularly in view of the advantages that exist in the MENA region taking into account the geographical proximity with common language and culture.

For such a movement to bear fruits, policy reforms coupled with building the backbone of the infrastructure in the region are considered as effective and determinant factors which can bring positive results for the region both politically and economically under the banner of cooperation away from regional conflicts. Indeed, a successful integration scheme for the MENA region can be the fruit of a new social contract which may sweep across the region through the structure of reforms so as to envisage a constructive institutional change in the long run.

MENA is considered as one of the richest regions of the world with great abundance of natural resources including oil and gas. Such endowment can bear direct effects in forming economies of the member states in MENA towards the direction of regional and global integration. Hence, this chapter tends to focus more on the role of natural resource abundance in MENA, as well as the level of diversification on the one hand, and the rate of growth on the other taking also into account the role of policies and regulations.

8.1. Resource Abundance and Diversification

During 1990s the majority of MENA countries undertook some reform policies to boost growth and create jobs while shifting away from the old state-led import substitution model of development (Nabli et al. 2007).⁶⁴⁶ These shifts were firstly “from a public-sector-dominated economy to a private-sector-led economy”; secondly “from closed economies to globally integrated ones”, and thirdly “from oil-dominated economies to more diversified ones.”⁶⁴⁷ This agenda is still on its way towards further development. Even though the private sector has been relatively more involved in today’s MENA than

⁶⁴⁶ Nabli, M., et al. “Job Creation in a High Growth Environment: The MENA Region.” MENA Working Paper 49, World Bank, Washington, DC, 2007.

⁶⁴⁷ Diop, Ndiame, Daniela Marotta, and Jaime de Melo: “Natural Resource Abundance, Growth, and Diversification in the Middle East and North Africa: The Effects of Natural Resources and the Role of Policies.” The World Bank 2012; P. 1.

before, according to the World Bank Report *From Privileges to Competition*, the shift is yet considered far from being a strong engine for growth (World Bank 2009).⁶⁴⁸

In practice, governments had failed to establish the active institutions for interaction with private sectors due to the lack of rule-based modes for such interaction with the private sector. Some reforms were introduced in a weak institutional atmosphere and within the context of nepotism keeping the market entry barriers with limited domestic competition. This was enough to undermine innovation and growth of small and medium enterprises. As the result, in particular for the case of MENA, we see very slow evolution of economic institutions in accordance with the social order and the balance of power within economic and political interests (North, Wallis, and Weingast 2009).⁶⁴⁹ Hence, the necessity of a new social contract as described in earlier chapters (PART I), can be understood in case of the MENA region. From this angle, the Arab Spring could be a chance to trigger a rather more genuine institutional change if coupled with empowering citizens and other non-state institutions.⁶⁵⁰

In respect to global integration, recent studies confirm that there is an unfinished agenda concerning regulatory reforms at the macro-level in MENA. According to Lopez-Calix, Walkenhorst, and Diop (2010)⁶⁵¹ despite some trade integration reforms in MENA, the pace is still slow compared with fast-growing East Asia, as well as Europe and Central Asia (ECA). Hence, the region has not been able to fully reap the benefits of participating in global production networks, or increasing global trade in services, regional integration as well as the rise of China and India.⁶⁵²

Also at the micro level, according to Freund and Bolaky (2008)⁶⁵³ within the sample of 126 countries that they studied, the 12 MENA countries are among those considered having the most regulated economies.⁶⁵⁴ Most studies strongly suggest that *oil rents, remittances, and foreign aid* are the main reasons for such a slow pace of integration reforms thus acting together to lessen the pressure for further

⁶⁴⁸ Ibid, with reference to: The World Bank. "From Privileges to Competition. Unlocking Private-Led Growth in the Middle East and North Africa." The World Bank, Washington, DC, 2009.

⁶⁴⁹ Ibid, p. 2; referring to: North, D.; J.J. Wallis; and B.R. Weingast. "Violence and Social Orders." Cambridge, U.K.: Cambridge University Press, 2009.

⁶⁵⁰ Diop, Ndiame, Daniela Marotta, and Jaime de Melo. "Natural Resource Abundance, Growth, and Diversification in the Middle East and North Africa: The Effects of Natural Resources and the Role of Policies." The World Bank, 2012. P. 1-2.

⁶⁵¹ Lopez-Calix, J. ;P. Walkenhorst; and N. Diop, eds. "Trade Competitiveness of the Middle East and North Africa." Washington, DC: World Bank, 2010.

⁶⁵² Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 2.

⁶⁵³ Freund, C. and B. Bolaky. "Trade, Regulations, and Income." *Journal of Development Economics* 87, 2 October 2008: pp. 309-321.

⁶⁵⁴ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 2.

or effective reform in the MENA region.⁶⁵⁵ Moreover, studies done on the Doing Business data from a large sample of 133 countries by Amin and Djankov (2009)⁶⁵⁶ suggest that in countries whose exports are mainly concentrated in abundant natural resources, the proclivity to undertake micro-reforms that reduce unjustified regulatory restrictions is much lower.⁶⁵⁷

The main focus in this Chapter would be on diversification away from Oil with a view to the pace of structural transformation in MENA. The question is whether MENA has been able to diversify in the past 30 years or so away from its natural-resource-based sectors towards more of services and manufacturing. Thus, the role that natural resource abundance can play as well as macro-economic policies in delivering diversification patterns are of significance here. As such, the impact of natural resource rents, and real exchange rate would also be of significance on diversification toward manufacturing and tradable services. The opportunities for the resource-poor but more diversified MENA countries vis-à-vis the resource-rich MENA countries through trade would be also the focal point of this chapter.

The fact is that MENA economies have had a low level of diversification so far. Typically, when countries become richer, the share of agriculture would decline while the share of manufacturing and services would rise (Baumol⁶⁵⁸ 1967; Chenery and Syrquin⁶⁵⁹ 1975). This is somewhat parallel to Engel's Law that stipulates in case of an increase in household income, *the percentage of income spent on food decreases while the proportion spent on other goods and services increases.*⁶⁶⁰ Accordingly, what supply and demand forces suggest is that when income rises, the share of agriculture in overall GDP (gross domestic product) would decline while non-agricultural GDP increases. But, has this been really the pattern of productivity and growth in case of MENA?

As mentioned above, MENA's production structures have not reached that desired level of diversification in the past 30 years. Facts show that unlike the global trends, the size of manufacturing, as well as the services sectors have hardly increased in MENA (the latter shrank from 1980 to 2010). Even though

⁶⁵⁵ Ibid, with reference to: Diwan and Squire 1993; Hoekman 1995; Shafik 1995; Nabli 2004; WEF and OECD 2005; and Havrylyshyn 2010 (see bibliography for details).

⁶⁵⁶ Amin, M. and S. Djankov. "Democracy and Reforms." Policy Research Working Paper 4835, World Bank, Washington, DC, 2009.

⁶⁵⁷ Diop, Ndiame, Daniela Marotta, and Jaime de Melo: "Natural Resource Abundance, Growth, and Diversification in the Middle East and North Africa;" *The Effects of Natural Resources and the Role of Policies.* The World Bank 2012. P. 2.

⁶⁵⁸ Baumol, W.J. "Macroeconomics of Unbalanced Growth: The Anatomy of Urban Crisis." *American Economic Review* 62, June 1967: pp. 415-426.

⁶⁵⁹ Chenery, H. and M. Syrquin. "Patterns of Development, 1950-1970." Oxford, U.K.: Oxford University Press for the World Bank, 1975.

⁶⁶⁰ Engel's Law was introduced by Ernest Engel in 1857.

agriculture contracted, unlike the case of other regions, instead no vibrant and innovative manufacturing and services sectors were expanded. Beyond MENA's difficulty in expanding manufacturing, the contraction of services as a share of GDP is also strikingly apparent.⁶⁶¹

The pattern of the share of the services sector in GDP looks differentiated within the MENA region. The share of the services in GDP is relatively modest in case of the resource-poor countries (Jordan, Lebanon, Morocco, and Tunisia), but it shows a decrease in case of resource rich countries namely Algeria, Bahrain, Islamic Republic of Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, and the Republic of Yemen. In other words, the decline of services share in GDP can be mainly attributed to the resource-rich countries. The United Arab Emirates would be considered as a notable exception mainly because it dramatically increased the share of services in its economy (+32 percent) while also having a moderate shift toward manufacturing during the past 30 years.⁶⁶² The wealth funds of the country may also play key part in bringing such growth to the country coupled with the flow of the FDIs into the UAE. Overall, in resource-rich countries a shrinking share of services in GDP is observed within non-mining sectors (mining would include oil and gas too); whereas in resource-poor countries such share of services in non-mining GDP has been either increasing or stagnant.

As mentioned above, the private sector in MENA has not been properly involved by the public sector leaving the same deficient circle of manufacturing and services repeating themselves. Therefore, OECD is suggesting a more dynamic private sector that can have the developing role in MENA's economies. Accordingly, MENA economies need to develop a dynamic private sector aimed at providing jobs, while fostering economic diversification to achieve more resilient, sustainable and inclusive economies.⁶⁶³ Such assertion is in fact another way of endorsing the necessity to establish a new social contract for the MENA region as explained in the opening chapters. According to OECD; the current picture in the MENA region depicting low hydrocarbon prices along with subdued economic activity and conflict spillovers does envisage the need for rather ambitious and articulated reforms in order to increase the role of private sector into the economy while scaling back the role of the state.⁶⁶⁴

The OECD report is in fact recommending a policy reform to streamline the regulatory environment for all businesses. Reaching such effective business regulation can be a tool in combating corruption and in support of economic, social and environmental goals. In the past recent years, some economies in MENA

⁶⁶¹ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 3.

⁶⁶² *Ibid*; p. 4 and p. 6.

⁶⁶³ OECD; "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policies Series, 2016, Chapter 4, p. 14.

⁶⁶⁴ *Ibid*.

have implemented some initiatives to improve their regulatory frameworks i.e. notably Tunisia's "regulatory guillotine" (i.e. paring down regulation that is deemed unnecessary). Egypt has been also following a program for regulatory simplification while Jordan is promoting transparency and reducing bureaucracy by lowering the level of administrative burden and costs.⁶⁶⁵

How can this be done? By promoting the development of starts-up and SMEs (Small and Medium Entrepreneurs), which can be a key in getting the private sectors into play. The SME policy would thus be a key component for the overall economic policy of countries like Morocco, or Jordan implementing a multi-year SME strategy, and the Palestinian Authority that has established a Private Sector Council to improve SME policy co-ordination.⁶⁶⁶ SME's access to finance in banking would also be a big assistance through fostering competition in the banking sector while promoting financial literacy and strengthening the legal and regulatory framework.⁶⁶⁷

Diversification is also stressed in the OECD report as the first pillar of a more sustainable development model along with the second pillar that is *inclusiveness*. In view of the security tensions and the long run volatility of the oil prices, and uncertainty, the growth deceleration of MENA economies clearly expounds the region's exposure to oil price movements along with broad-based weaknesses in competitiveness.⁶⁶⁸ All this has made the scenario of development challenging for the MENA region. The movement of oil prices is a problem for oil-exporters of the region in particular, as they need to avoid currency depreciation mainly by relying on their substantial net foreign assets. They also need to safeguard fiscal sustainability through diversification of public revenue sources.⁶⁶⁹

The weakness in competitiveness would also treat the oil-exporting and oil-importing countries alike for which some countries in MENA have launched serious reform strategies to tackle such structural weaknesses. As explained above, involving and strengthening the role of the private sector into the development plans are needed as the most effective strategy for boosting diversification and competitiveness. For example, in 2014, the private sector accounted for about 40% of the GDP across the region which is below the average of the OECD⁶⁷⁰ (59%).

⁶⁶⁵ OECD; "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policies Series, 2016, Chapter 4, p. 14.

⁶⁶⁶ *Ibid*, p. 15.

⁶⁶⁷ *Ibid*, p. 18.

⁶⁶⁸ *Ibid*, p. 1-2.

⁶⁶⁹ *Ibid*, p. 2.

⁶⁷⁰ *Ibid*.

Moreover; similar to the World Bank report, the OECD also emphasizes the importance of improving infrastructure to facilitate trade and investment while fostering integration into regional and global value chains with better connectivity.⁶⁷¹ In particular, improving energy sectors as well as the water management would also be of essence for the MENA region. While the regional conflicts have devastating impact on economies of the afflicted countries and their neighbors, and the Arab upheavals have put social pressure for more streamlined institutions to fight corruption at all levels, reforms are strongly needed in the MENA region in order to strengthen the rule of law, while promoting a more inclusive and open approach towards designing policies and services as well as modernizing the machinery of the government.⁶⁷² For example, labor market should be more inclusive away from its current clientelistic feature and family networks to more include women and youth. Likewise access to education ought to be available in view of building social stability and achieving better economic outcomes.⁶⁷³ Put it differently, the second pillar of *inclusiveness* as expressed by the OECD is in a way the rendition of Acemoglu and Robinson's "inclusive political and economic institutions" by which we may reach a successful development model thus paving the way for implementing the necessary reforms that are required for the MENA region.

8.2. Natural Resource Rents and Growth Volatility

In view of the limited diversification in MENA, natural resource rents seem to have the major impact on growth volatility in the region. A glance at the over-dominance of the oil and gas sector in MENA for example, shows a large share of such natural resource rents in GDP of the region. An overview of the situation shows that rents from natural resources reached 24 percent of GDP in the MENA region in 2010, in contrast with 14 percent in Sub-Saharan Africa and Eastern Europe and 5–7 percent in East Asia, South Asia, and Latin America as well as the Caribbean⁶⁷⁴ (Figure 8-2).

Such natural resource dependency has also impact on production and growth resulted from large, oil-price-driven fluctuations.⁶⁷⁵ Indeed, growth in the MENA region shows the highest level of volatility in comparison to the other regions of the world. According to the World Bank, for example, the six members of the GCC show a volatility of growth twice as high as the volatility in the other resource-rich countries

⁶⁷¹ OECD, p. 3.

⁶⁷² *Ibid*, pp. 3-4.

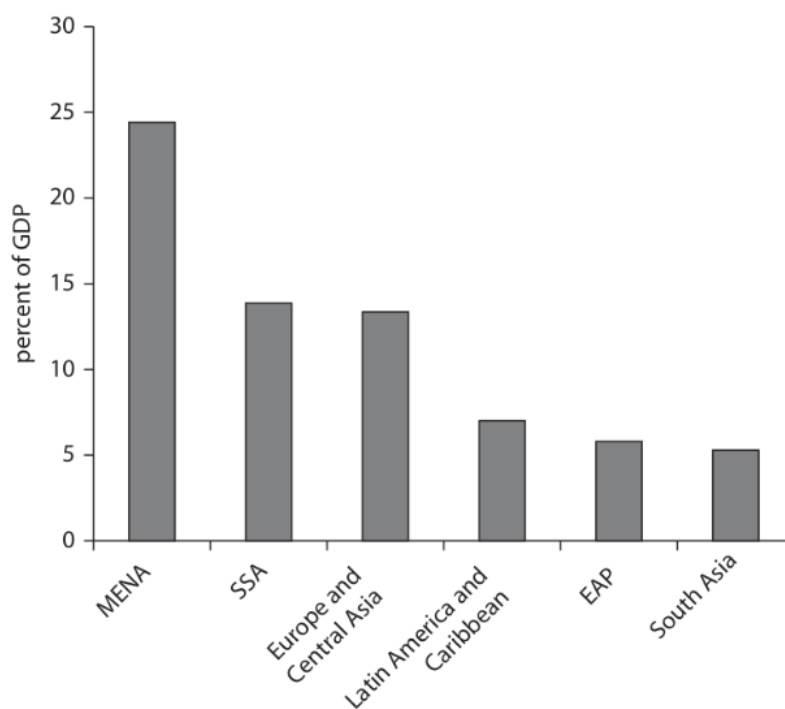
⁶⁷³ *Ibid*, p. 4.

⁶⁷⁴ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 9-10.

⁶⁷⁵ *Ibid*.

in MENA namely Algeria, Islamic Republic of Iran, Iraq, Libya, Syrian Arab Republic, and Republic of Yemen; and as well four times as high as in the resource-poor countries of the MENA region.⁶⁷⁶ In fact the growth volatility in the GCC and other resource-rich countries in MENA show to be higher than other income classification groups as observed by the World Bank for the period 1982-2010 (except the low-income group). Likewise, if we compare the oil exporters in MENA, their growth volatility is higher than other major oil exporters in the world.⁶⁷⁷ Such volatility is deemed to be detrimental to long-term diversification and growth, as well as for investment and capital accumulation. Moreover, it may harm productivity growth as well.

Figure 8-2. Natural Resource Rents in 2010, by Region



Source: World Development Indicators.

In short, such a limited diversification in MENA coupled with natural resources rents would make growth quite volatile for the region. Hence, a greater diversification is desirable in case of MENA mainly because:

⁶⁷⁶ It is worth mentioning that the GCC was formed in May 1981 in order to encourage policy coordination, integration, and unity among its member states.

⁶⁷⁷ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012), p. 11.

- 1) It is effective for job creation, and;
- 2) It is a key to reduce macroeconomic volatility. Empirical study and research by Di Giovanni and Levchenko (2008)⁶⁷⁸ and Loyaza et al. (2008)⁶⁷⁹ show that export concentration is related to the real exchange rate such that its greater volatility would result in greater volatility in GDP growth. Such concentration coupled with the volatility of the real exchange rate would also create a channel for a resource curse (Lederman and Maloney⁶⁸⁰ 2008; Hausmann and Rigobon⁶⁸¹ 2002). *The latter can undermine long-term growth.*⁶⁸² The so called “easy life” accrued out of such rents with few activities can practically lower investment in human capital and thus lead to less learning and innovation (Gylafson, 2001).⁶⁸³ This further creates macroeconomic volatility (Hausmann and Rigobon 2002) and eventually this would lead to institutional weaknesses as groups try to capture rents (Mehlum, Moene, and Torvik 2006).⁶⁸⁴ All this can lead to corruption within a nondemocratic context (Bhattacharya and Hodler 2010)⁶⁸⁵ and possibly even conflicts (Collier and Hoeffler 2004).⁶⁸⁶ The above phenomenon can easily be traced through the curse of natural resource endowment in MENA which hinder tradable manufacturing and services.

According to McMillan and Rodrik (2011),⁶⁸⁷ for growth we need both new activities as well as ongoing structural changes. In case of MENA, the expansion of both—the new activities and structural changes—are very limited. In case of Asia for example; structural shift from agriculture that has a low productivity towards manufacturing and services where productivity is higher, has been both the cause and consequence of Asia’s high growth.⁶⁸⁸ Hence, greater diversification would be the key answer which ought to be directed towards manufacturing and services, where we have further scope for creating jobs and fostering growth.

⁶⁷⁸ Di Giovanni, J. and A.A. Levchenko. “Trade Openness and Volatility.” IMF Working Papers, International Monetary Fund, Washington, DC, June 2008.

⁶⁷⁹ Loyaza N. et al. “Natural Disasters and Growth – Going Beyond the Averages.” Policy Research Working Papers, 2008-2009. Retrieved from World Bank eLibrary Group: <http://doi.org/10.1596/1813-9450-4980>

⁶⁸⁰ Lederman, D. and W. Maloney, eds. “In Search of the Missing Resource Curse.” *Economia (Journal of the Latin American and Caribbean Economic Association)* 9 (1); 2008, pp. 1-51.

⁶⁸¹ Hausmann, R. and R. Rigobon. “An Alternative Interpretation of the Resource Curse.” Working Paper 9424, National Bureau of Economic Research, Cambridge, MA. 2002.

⁶⁸² Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012), p. 12.

⁶⁸³ Ibid, with reference to: Gylafson, T. “Natural Resources, Education and Economic development.” *European Economic Review* 45 (6); 2001: pp. 847-859.

⁶⁸⁴ Mehlum, H. , K. Moene, and R. Torvik. “Institutions and the Resource Curse.” *Economic Journal* 116 (508); 2006: pp. 1-20.

⁶⁸⁵ Bhattacharya, S. and R. Hodler. “Natural Resources, Democracy and Corruption.” *European Economic Review* 54 (4); 2010: pp. 608-621.

⁶⁸⁶ Collier, P., and A. Hoeffler. “Greed and Grievance in Civil War.” *Oxford Economic Papers* 56, 2004: pp. 563-595.

⁶⁸⁷ Mc Millan, M., and D. Rodrik. “Globalization Structural Change and Productivity Growth.” Working paper 17143, National Bureau of Economic Research, Cambridge, MA. 2011.

⁶⁸⁸ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 11.

Concerning the curse of natural resource endowment, there are mainly three channels within which its deleterious effects can be created: First, natural resources are mainly concentrated within sectors representing lower productivity growth and fewer spillovers. Secondly, natural resources are also extracted out of a narrow economic base creating *rents*. As explained above, these rents would create an “easy life” for the elite resulting in lower investment in human capital which would contribute to less learning and innovative capacity (Gylafson 2001). Such aspects are considered important to the *Dutch Disease aspect of the curse*, through which tradable services and manufacturing activities are depressed as the result of an appreciated real exchange rate during resource booms. The situation would be exacerbated during busts, when exchange rate policies are rigid and countercyclical fiscal policies are not operative.⁶⁸⁹ And thirdly; the high level of export concentration can lead to higher price volatility thus resulting in macroeconomic volatility.⁶⁹⁰ Nonetheless, this vulnerability to changes in a country’s terms of trade is more associated with a country’s overall openness to trade rather than its natural resource abundance.⁶⁹¹ Therefore, along with diversification, some degree of trade liberalization is essential for directing the country towards a more stable growth and sustainable development.

A fourth case can be also envisaged in which the natural endowment “engender institutional weaknesses” through which a group of elites try to capture rents (Mehlum, Moene, and Torvik 2006). Such a curse-via-politics is something created out of the political environment and is not likely to be improved as long as the government is in power mainly because the government includes the elite who have vested interest in blocking institutional change.⁶⁹² This reiterates the vicious circle as explained by Acemoglu and Robinson and institutional persistency in North’s term.

Moreover, resource endowment can also be the cause of conflicts. Several studies confirm that there is a positive correlation between an index of corruption and that of natural resources as proxied by resource rents or the share of exports of fuels and minerals (Isham et al.⁶⁹³ 2005; Leite and Weidman⁶⁹⁴ 2002 in

⁶⁸⁹ The Dutch Disease model is examined in Corden and Neary (1982). Gelb (1988) and many others have applied it in the context of oil windfalls.

⁶⁹⁰ A higher volatility of the real exchange rate is typical of natural-resource-abundant countries and can also be a channel for a resource curse (Lederman and Maloney 2008; Hausmann and Rigobon 2003).

⁶⁹¹ World Bank (De Melo and Ugarte) in: Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. 40.

⁶⁹² Ibid, p. 42; explaining that according to Acemoglu, Johnson, and Robinson (2005): “institutions evolve very slowly, largely as a result of a change in the balance of power between parties with opposing wealth.”

⁶⁹³ Isham, J., M. Woolcock, L. Pritchett, and G. Busby. “The Varieties of Resource Experience: Natural Resource Export Structures and the Political Economy of Economic Growth.” The World Bank Economic Review 19 (2): pp. 141-174, February 2005.

cross section). However, according to Bhattacharya and Hodler (2010) this correlation becomes negative when we divide the sample into two groups of democratic and nondemocratic countries. Such classification can simply clarify as to why some resource-rich countries such as Canada, Iceland, and Norway have been able to avoid the curse. Through panel data covering the period 1980–2004, Isham et al. (2005) show that the quality of democratic institutions matters when studying the relationship between natural resources and corruption and that the curse is applicable only in nondemocratic environments.⁶⁹⁵

There is obviously a strong incentive for Preferential Trade Liberalization among the resource-poor countries with their neighboring resource-rich counterparts as it creates an opportunity for them to get access to the rents. However, Venables (2011)⁶⁹⁶ argues that in this process some degree of trade diversion would emerge particularly affecting the resource-rich country with a loss of efficiency.⁶⁹⁷ As the result of this process though, the source of labor-intensive goods can be used in the resource-poor countries helping them to diversify and reach a higher level of economic growth. In the meantime, while regional trade integration is desirable for political, social, cultural, and economic reasons, an MFN liberalization (that is, a liberalization of trade vis-à-vis all countries) is considered the best option for resource-rich countries of the region.

Moreover, in a broader term according to North and Acemoglu/Robinson, institutional formation can have a long term fruitful outcome in which there are other factors i.e. political ones in particular that can draw a bright picture for regional integration. Hence, the solution would be for the Resource-rich countries to lower their restrictions, build strong human capital while improving their institutions aimed at creating an enabling environment towards more diversification over the long run.

Meanwhile such transformation can offer opportunities to resource-poor MENA towards formidable export diversification provided that they would similarly lower their own regulatory restrictions to investments particularly in exporting service industries while improving their backbone services (i.e. telecom) trying to proactively engage resource-rich countries to reduce barriers to labor mobility within the region.⁶⁹⁸ Overall, to achieve regional inclusive growth and development in MENA, political and economic institutions need progress hand-in-hand with better policies designed for regional integration.

⁶⁹⁴ Leite, C., and J. Weidmann. "Does Mother Nature Corrupt? Natural Resources, Corruption, and Economic Growth." In *Governance, Corruption and Economic Performance*, eds. George T. Abed and Sajeev Gupta. Washington, D.C.: International Monetary Fund, 2002.

⁶⁹⁵ The World Bank (De Melo and Ugarte), p. 41.

⁶⁹⁶ Venables, A. "Economic Integration in Remote Resource-Rich Regions." In *Costs and Benefits of Economic Integration in Asia*, ed. R. Barro and J. W. Lee, New York: Oxford University Press, 2011.

⁶⁹⁷ The World Bank, Carrere, Gourdon, and Olarreaga, p. 176.

⁶⁹⁸ Diop, Ndiame, Daniela Marotta, and Jaime de Melo (The World Bank, 2012); p. xviii-xix.

8.3. Resource Abundance and Growth

There has been an overall progress for economic performance in MENA recently. Despite competition from fast-growing economies such as China and India, the MENA region has set some progress featuring *higher growth rates, less growth volatility, and increased market shares for its exports* compared to its past.⁶⁹⁹ Such performance is encouraging in view of the disappointing performance we have seen from the region during the past 50 years particularly on the part of the resource-rich countries.

However, with the exception of Oman, the fact shows that MENA countries have failed overall to progress on the economic path the way they should have and as the result; they have remained in the same level as the lower-middle- or the upper-middle-income group. At the macro level, it has been difficult for MENA to maintain the depreciated (undervalued) real exchange rate, as the facts confirm that during the period between 1970 and 2005 the Real Exchange Rates (RERs) has been overvalued for most of the time and for the majority of the countries in MENA. The above finding seems to be consistent with the natural resource curse or Dutch Disease thesis. Besides, supporting evidence shows that the above is the consequence of inadequate macro and micro-policies within a weak institutional environment.⁷⁰⁰

Cross-country evidence shows that there is a positive correlation between openness and that of per capita income. However, this mainly holds only for the countries in which some degrees of regulatory reforms have taken place. Hence, improved domestic regulatory policies along with improved public sector governance can help MENA in achieving greater integration into the world economy.⁷⁰¹ As an example, in mid 1990s, the GCC countries adopted fewer countercyclical fiscal policies in contrast with some other resource-rich countries in the region resulting in greater volatility of the real effective exchange rate in these countries in MENA due to the lack of development of new activities outside the resource sectors.⁷⁰²

In designing such domestic policies, Fardoust also stresses the fact that regional and global economic integration are complementary processes and should go hand in hand. As such, there are tremendous opportunities for MENA to strengthen this linkage with the global production chain through deeper regional integration. And for this to happen, he is suggesting that the region would step up policy reforms along with political commitment. Accordingly, MENA countries need to reduce their MFN tariffs thus

⁶⁹⁹ Ibid, p. xvii.

⁷⁰⁰ De Melo, Jaime, and Ugarte Cristian. "Resource Abundance and Growth: Benchmarking MENA with the Rest of the World." The World Bank, 2012, p. 28.

⁷⁰¹ Ibid, p. 29.

⁷⁰² Ibid.

lowering tariff peaks to the same level as the most competitive regions of the world.⁷⁰³ Furthermore, trade in services need to be strengthened and the cost of trade ought to be reduced. Fardoust is of the opinion that if public ownership is continued in services sectors, it would become a major hurdle on the way of furthering regional cooperation or integration. Hence, addressing such issues it is important to move on towards further privatization which would help to reduce unemployment in the MENA region.

Similar to our previous assessments, he moreover suggests that to reduce the cost of intra-region trade we need to improve the efficiency of border-crossing points, while harmonizing the customs procedures. Likewise, the improvement of the logistics systems should be vastly followed while abolishing policies that reserve activities for specific categories of domestic firms. In short, improving the infrastructure as explained before would be of essence while enhancing the competitiveness.

Since trade is considered a major factor in growth acceleration episodes, it is therefore important to review MENA's barriers to trade. With a view to the trade policies, and barriers to trade in MENA, we see some limited reforms even though all the indicators show some progress in reducing barriers to trade. Beside the fact that government intervention ought to be reduced to attain the success, empirical research suggests that a comprehensive approach would be necessary to be conducted on the basis of competitiveness in respect to exports and growth.⁷⁰⁴ Beyond this, governments still need to overcome market failures in respect to information externalities as well as coordination challenges and collective. In case of MENA, the evidence shows that in particular, trade and regulatory barriers seem quite widespread while trade costs are also high. These two in fact would impede the pace of regional and global integration.⁷⁰⁵

Moreover, in case of the MENA region, the reduction in protection has not taken place in parallel with openness. Similarly, most Latin American countries were somewhat disappointed with their export performance despite opening up their economies when compared with the rapid growth in export as experienced by the Asian countries during the 1960s. According to Wood (1997)⁷⁰⁶ this was mainly because the wages in Latin America were not sufficiently low in comparison with the low-wages in the Asian countries including China.⁷⁰⁷

⁷⁰³ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects for Development and Stability." Middle East Institute, MEI Policy Paper, Regional Cooperation Series, June 2016, p. 28-29.

⁷⁰⁴ The World Bank (De Melo and Ugarte), p. 42-43.

⁷⁰⁵ Ibid, p. 43.

⁷⁰⁶ Wood, A. "Openness and Wage Inequality in Developing Countries: The Latin American Challenge to East Asian Conventional Wisdom." World Bank Economic Review, 11 (1): pp. 33-57, 1997.

⁷⁰⁷ De Melo and Ugarte, p. 43.

Drawing the above examples as lesson for MENA, the region would not be able to compete in the high-tech sectors due to the lack of skills or similarly because of high wages in the labor intensive sector. Hence, the region should participate in *outward processing* for which an improved hard and soft infrastructure would be required while closely monitoring the evolution of trade cost indicators as compared with those of other competitors.⁷⁰⁸

More into details; according to the study done by Kinda, Plane, and Veganzones-Varoudakis (2011),⁷⁰⁹ at the micro-level, due to technical inefficiency, there is a low level of productivity, and higher labor costs in MENA manufacturing compared with other middle-income countries of other regions.⁷¹⁰

Kinda, Plane, and Veganzones-Varoudakis (2011) also find across the majority of sectors in MENA, that as captured by the Investment Climate Assessment indicators; lower technical efficiency is positively correlated with below-average indicator values for the regulatory and legal environment taking into account such variables as quality of infrastructure, experience and education of labor force, and different dimensions concerning the government-business relationship.⁷¹¹ Accordingly, such findings confirm the poor ranking of the MENA region when it comes to issues pertaining to *trade and regulator*.

Moreover, some studies, reports and findings (Nabli⁷¹² 2007; World Bank⁷¹³ 2004; World Bank⁷¹⁴ 2009) conclude that during the past three decades in the MENA region, investment has been lagging behind while manufacturing exports have not diversified, and instead a large amount of inefficient manufacturing sector has developed.⁷¹⁵

⁷⁰⁸ De Melo, Jaime, and Ugarte Cristian. "Resource Abundance and Growth: Benchmarking MENA with the Rest of the World." The World Bank, 2012, p. 43.

⁷⁰⁹ Kinda, T., P. Plane, and M. A. Veganzones-Varoudakis. "Firm Productivity and Investment Climate in Developing Countries: How Does Middle East and North Africa Manufacturing Perform?" *The Developing Economies* 49 (4): pp. 429-462, 2011.

⁷¹⁰ The World Bank, (De Melo and Ugarte), p.80: In their sample of 22 middle-income countries, 5 were from MENA (Algeria, Egypt, Lebanon, Morocco, and Saudi Arabia), and the firms are taken from 8 different sectors namely textiles, leather, garment, agro-processing, metals and machinery, chemical and pharmaceuticals, wood and furniture, and plastics. The number of firms per industry per country is often small (no more than 1,600 in leather), calling for caution in interpreting the results.

⁷¹¹ The World Bank (De Melo and Ugarte), p. 53.

⁷¹² Nabli, M. K. "Breaking the Barriers to Higher Economic Growth." World Bank, Washington, DC, 2007.

⁷¹³ World Bank. "Trade, Investment, and Development in the Middle East and North Africa: Engaging with the World." World Bank, Washington, DC, 2004.

⁷¹⁴ World Bank. "From Privilege to Competition: Unlocking Private-Sector Led Growth." World Bank, Washington, DC, 2009.

⁷¹⁵ De Melo, Jaime, and Ugarte Cristian. "Resource Abundance and Growth: Benchmarking MENA with the Rest of the World." The World Bank, 2012, p. 53.

8.4. Diversification towards Services and the Role of Microeconomic Regulations

Findings show that as the result of rents accumulated out of natural resource abundance in MENA, there is a negative correlation between services production and per capita income. Thus, the role that policies and regulations play here would be of significance in light of the relative underperformance of MENA over services sectors. Study shows that restrictions on entry and business conduct is a source of creating rents within the services sectors as captured by “protected incumbents,” or they would increase the real cost of producing services. In either case, these restrictions act so as to inflate the price of services (Dee 2005).⁷¹⁶ On the contrary, opening up the services sectors aimed at enhancing competition would reduce the productivity loss equivalent of the restrictions, as well as the behind-the-border tax equivalent thus enhancing the competitiveness of services.⁷¹⁷

Beside the effects of rent, the underdevelopment of the services sectors in resource-rich MENA countries has got some roots in policy-making. Indeed, regulatory barriers to market entry, business conduct and licensing are considered significant in the MENA region. Such restrictedness would create challenges for the resource-rich MENA to maintain their domestic production of services, whereas lowering such restrictions coupled with diversification can create formidable opportunities for the resource-poor countries in MENA over tradability of services.

Indeed, in view of their common language and cultural proximity, there is a great market of tradable services through resource-rich countries upon which the poor countries of MENA can capture its significant share. To take advantage of these opportunities, such resource-poor countries in MENA need to implement some reforms to increase their competitiveness while coordinating with resource-rich countries for reducing barriers to labor mobility within the region.⁷¹⁸ Therefore, on the part of the resource-poor countries there would be the need to reduce the regulatory restrictions on business entry, business conduct, and licensing in their own services sectors in order to foster competition while improving their backbone services (i.e. telecom) so as to yield the ground for deeper integration.

Fardoust is similarly suggesting same policy reforms also taking into account foreign firms with the aim of strengthening trade in services within the region. Accordingly, such reforms may include easing entry

⁷¹⁶ Dee, P., and N. Diop. “The Economy-Wide Effects of Further Trade Reforms in Tunisia’s Services Sectors.” Policy Research Working Paper 5341, World Bank, Washington, DC, 2010.

⁷¹⁷ The World Bank (De Melo and Ugarte), p. 102.

⁷¹⁸ The World Bank (Diop and de Melo); p. 105 as referred: “See Marouani and Zaki (2011) for a comprehensive discussion of barriers to mode 4 trade in MENA.” Citation: Marouani, M. A., and L. Munro. “Assessing Barriers to Trade in Services in the MENA Region.” Trade Policy Working Papers 84, OECD, Paris, 2009.

and licensing restrictions for both domestic and foreign firms in the services sectors in view of promoting competition, while harmonizing and strengthening regulatory practices and arrangements, and lowering restrictions on the mobility of foreign workers who reside in the region.⁷¹⁹

Besides, bilateral agreements are among the key factors in fostering trade in services among neighboring countries in MENA. For instance, we can refer to the agreement signed and concluded between Iraq and Lebanon which aimed at increasing the economic cooperation between the two countries, including *inter alia* “exchange of expertise, specialists, and trainers” (Article 3). A similar agreement was also signed between Kuwait and Lebanon that enjoins for both parties to “facilitate the procedures for granting entry visas to businessmen in both countries” (Article 6). Other agreements have been also concluded between Lebanon and Syria for the promotion of labor mobility between the two nations. It is noteworthy however; that some provisions are mentioned in the above agreements that include “exchanging expertise or facilitating visa procedures”, but there is no direct provision “organizing the temporary movement of people,”⁷²⁰ that is considered an effective factor in deepening integration.

For resource-poor countries of MENA to export services to the resource-rich MENA in particular the GCC countries, they need to sign comprehensive bilateral agreements in which the specific barriers for entry to the markets would be addressed. In short, there is great potential and complementarities for trade in services in the MENA region provided that all countries would implement relevant policies aimed at reaping these potential benefits by reducing regulatory restrictions and increasing competitiveness.⁷²¹

8.5. Growth, Trade and Investment; and the Role of Policies

In view of a decrease in FDI inflows and the sluggish growth in foreign trade, MENA countries need to level up their openness to trade and investment while facilitating efforts to support their national development plans. Taking such steps can help to achieve sound macroeconomic and structural policies and to strengthen capacity of host economies leading to inclusive growth, job creation, and innovation.⁷²² According to the OECD, MENA economies accounted for 9% of world exports and 5% of world imports in 2015.⁷²³ Deepening regional integration in harmony with the global value chains while targeting quality

⁷¹⁹ Fardoust, p. 29.

⁷²⁰ The World Bank (Diop and de Melo), p. 108.

⁷²¹ *Ibid.*

⁷²² OECD; “Better Policies for Inclusive Growth and Economic Integration in the MENA Region.” Oct. 2016, p. 19.

⁷²³ *Ibid.*

investment can empower the countries' potential for trade and investment at both regional and national levels. And as a means to that end, the framework for foreign investment (FDIs) needs to be improved in the MENA region.

In accordance with the OECD, Foreign Direct Investment (FDI) inflows decreased from 5.3% to only 1% from 2006 to 2015. To reverse this trend of decline, some countries in the MENA region embarked on the path of legal and institutional reforms. For example, Egypt, Iraq, Jordan and Kuwait revised their investment laws in the course of two years namely 2014 and 2015. New investment regimes are to be introduced in Morocco and Tunisia as well. Nonetheless, according to the same source (OECD), trade and investment are still limited in the region due to the existence of ground-level obstacles and regulatory restrictions. In MENA, some GCC countries in particular, are limiting foreign investment beyond a threshold requiring "local intermediary" to facilitate investment even though sectoral restrictions are common throughout the region. The OECD FDI Restrictiveness Index as shown in (Figure 8.5.) illustrates that Egypt and Morocco are imposing restrictions close to OECD levels while Jordan and Saudi Arabia are reaching higher levels of restrictions.⁷²⁴

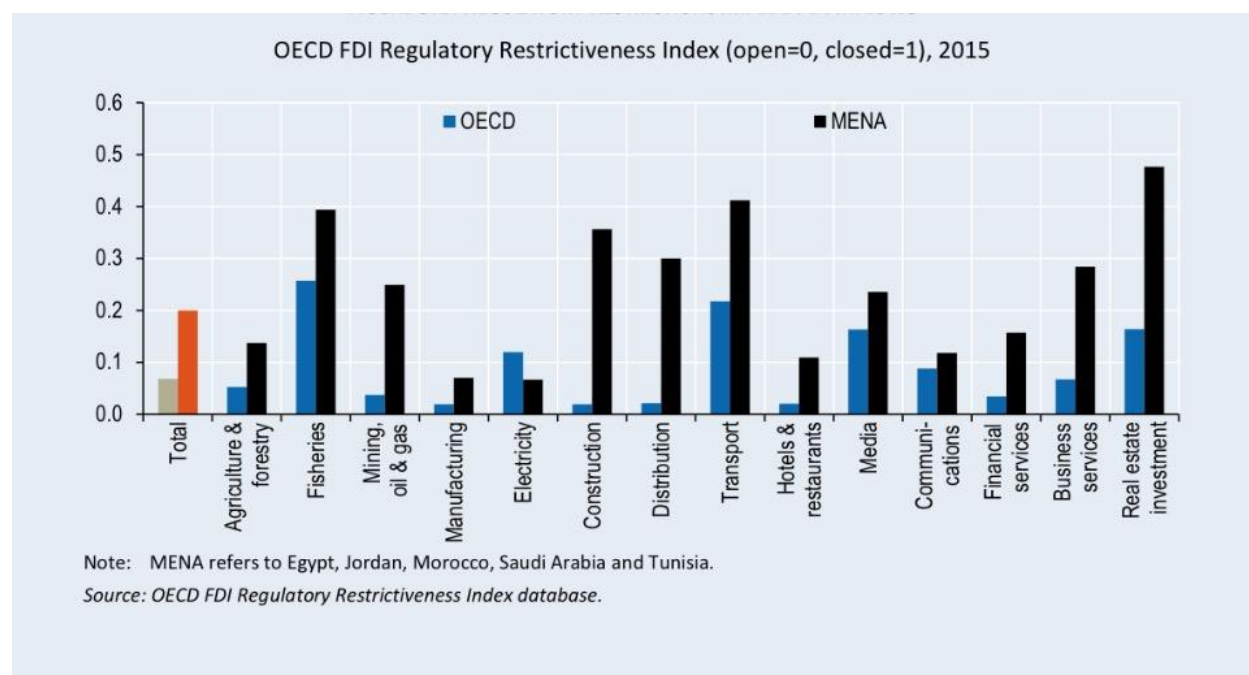
Besides, some countries are adding limitations on visas and permits. Nonetheless, some liberalization reforms have been introduced by MENA countries recently. Saudi Arabia would be an example which opened its retail sector to foreign investors within the framework of its National Transformation Plan as released in June 2016. In May 2016, Jordan also introduced and adopted a new by-law on FDI restrictions while the new investment regime in Iraq contains no closed or restricted sectors as adopted in January 2016 except for the oil-and-gas as well as banking-and-finance sectors.⁷²⁵ In addition, investor protection as well as property rights are of paramount importance while dispute settlement and prevention mechanism in MENA are underdeveloped with an exception of Egypt and the UAE.

The following Figure 8.5. reveals how regulatory restrictions can impede the FDI inflows. Accordingly, the FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in different countries and regions of the world. In other words, in measuring FDI restrictiveness, the FDI Index gauges the level of restrictiveness of the FDI rules within a country taking into account the following main four types of restrictions on FDI:

⁷²⁴ OECD: "Better Policies for Inclusive Growth and Economic Integration in the MENA Region." Better Policy Series, October 2016, pp. 19-20.

⁷²⁵ Ibid, p. 20.

Figure 8.5. Showing “REGULATORY RESTRICTIONS IMPEDE FDI INFLOWS”



- 1- Limitations on Foreign equity;
- 2- Screening or approved mechanisms;
- 3- Restrictions that exist on the way of employment for foreigners as key personnel;
- 4- Operational restrictions; for example restrictions concerning branching, or land ownership or capital repatriation.⁷²⁶

While governments pursue the policy of opening their legal regimes to investment, they need to work on their qualitative impact as well. FDI can trigger the advancement of technology to create innovation, increase productivity and foster export while improving competitiveness on the way to growth and job creation. Therefore, governments in MENA should stimulate FDI within the labor-intensive industries such as tourism and traditional manufacturing while encouraging linkages with domestic SMEs (Small, Medium Entrepreneurs). In addition, more balanced, sustainable and inclusive development may be attained and supported through investment in network industries such as transport, ICT and energy, in particular renewable energy.⁷²⁷

In brief, what governments need to do in the MENA region is to lower trade costs for foreign businesses

⁷²⁶ The OECD: <http://www.oecd.org/investment/fdiindex.htm>

⁷²⁷ OECD; “Better Policies for Inclusive Growth and Economic Integration in the MENA Region.” Oct. 2016, p. 21.

and ease up the linkages with their host economies. Deepening market access through trade and investment agreements while reducing regulatory obstacles for such activities would be of essence. Moreover, alignment ought to be enhanced between international trade and investment agreements and those of domestic legal and regulatory frameworks so as to foster regional and international integration.

8.6. Conclusion

This chapter shed light on the fact that despite good growth performance in MENA particularly in the first decade of the new century, the share of services sector in the GDP has been declining (as well as the share of non-mining GDP) even though income per capita has increased. Such a negative relationship between the share of services in GDP and income per capita is not consistent with observed global patterns. Thus, the analysis suggests that this result could be attributed to the large rents that are generated by natural resources in these MENA countries.⁷²⁸ When such a negative effect of rents is coupled with the negative impact emanated from regulatory restrictions and policies on business entry, business conduct and licensing, it can then hinder the development of services sectors in the MENA region.

Furthermore, rents from natural resources tend to inflate wages and non-tradable prices in resource-rich countries causing to appreciate the real exchange rate and to discourage domestic production of tradable goods and services.⁷²⁹ This well explains as to why the resource-rich countries in MENA have become large importers of tradable services and also why mainly domestic production of non-tradable services has been developed including real estate, retail trade, hotels, and restaurants.⁷³⁰

Overall, there are three reasons why the MENA region should enhance the development of services sectors as a crucial factor in widening the scope of job creation for which regional integration can help along with some degree of liberalization in services sectors. Furthermore, diversification should be enhanced towards such tradable services with less regulatory restrictions and more open policies in this regard. These reasons are applicable especially for the case of the resource-rich countries in MENA.

First, the public sector has reached a saturation point for employment almost in all countries of the region and thus, there is need for development and engagement of the private sector for creating jobs. Second, as

⁷²⁸ The World Bank (Diop and de Melo), p. 108.

⁷²⁹ Ibid, p. xviii.

⁷³⁰ The rapid development of a non-tradable service, namely, the real estate sector, in conjunction with the underdevelopment of tradable services is an illustration of this point.

explained above, rents from natural resources as a big obstacle hinders the development of manufacturing sectors because of currency overvaluation (Rodrik⁷³¹ 2008; Havrylyshyn⁷³² 2010; Lopez-Calix, Walkenhorst, and Diop 2010). And third, the share of agriculture in GDP has declined with income growth (Engel's Law) and technological advances.⁷³³ Hence, we may conclude that under the shadow of economic integration in MENA, one of the most promising sources of job creation would be the services sector within the region.

Besides, Micro and Macro-economic regulations and policies have been an additional source of problem in the MENA region on the way of development, fostering trade and business, and attracting investment. As such, restrictions on business entry, business conduct and licensing, are indeed considered significant in the MENA region causing a negative correlation with the share of services in GDP. Benchmarking the MENA region with the rest of the world, the region represents some heavy and discretionary restrictions within the services sectors particularly on the side of the resource-rich countries of the region. Such restrictions have two impacts; they are either another source of creating rents within the services sector by which *protected incumbents* would then capture the benefits, or they can simply increase the real cost of producing such services. In both such cases they would inflate the price of services and further reduce the competitiveness of tradable services sectors.⁷³⁴

The following figure (Figure 8.6.) shows the Services Trade Restrictiveness Average Index (STRI) as calculated by Borchert, Gootiiz, and Mattoo (2011)⁷³⁵ using the World bank data base as gathered from 102 countries. Accordingly, the GCC in that figure is the most restrictive region compared to the rest of the world. It also illustrates the negative correlation between the magnitude of restrictions to trade in services and the share of services in GDP.⁷³⁶

The underdevelopment of the tradable services in MENA would create challenges for the countries i.e. for the development of manufacturing and fostering competitiveness for similar reasons namely rents and Dutch Disease, plus the fact that oil-related industries are capital-intensive instead of being labor-intensive, and public sectors are simply bloated. This would in fact limit the scope for job creation in particular for the resource-rich countries with abundant labor supply i.e. Algeria, Saudi Arabia, Syria, and

⁷³¹ Rodrik, D. "The Real Exchange Rate and Economic Growth." *Brookings Papers on Economic Activity* 2008 (2).

⁷³² Havrylyshyn, O. "Does the Global Crisis Mean the End of Export-Led Open-Economy Strategies?" Paper prepared for World Bank, Washington, DC, 2010.

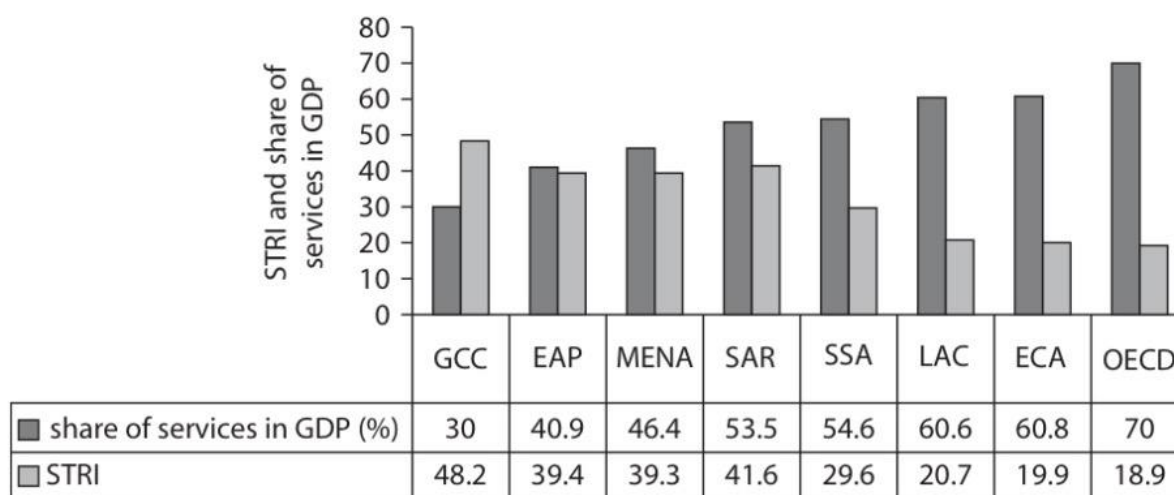
⁷³³ Diop and de Melo (World Bank, 2012), p. 87.

⁷³⁴ *Ibid*, p. 108.

⁷³⁵ Borchert, I., B. Gootiiz, and A. Mattoo. "Policy Barriers to International Trade in Services: New Empirical Evidence." World Bank, Washington, DC., 2011.

⁷³⁶ Diop and de Melo (The World Bank), p. 102.

Figure 8.6. Restrictiveness of Services Trade Policies and Share of Services in GDP, MENA-GCC, GCC, and Other Regions



Source: Borchert, Gootiiz, and Mattoo 2011.

Note: STRI = services trade restrictiveness index.

the Republic of Yemen. Hence, it is paramount important for these countries to lower regulatory restrictions in services sectors and moreover, invest on *education* as a way to compensate for the negative effect that rent may create on competitiveness.⁷³⁷ Moreover, for resource-rich countries the production costs need to be reduced to offset the negative effect of rents in non-resource tradable sectors. And they can do it through lowering regulatory restrictions on entry and competition in such sectors.⁷³⁸ Besides, these countries need to invest on human capital while strengthening institutions within their countries (see Gelb 2011 for a summary).⁷³⁹ Notable successful examples would be Finland, the Republic of Korea, and Norway where they have invested heavily on human capital and further diversified into high-tech manufacturing and services.⁷⁴⁰

Strong evidence similarly suggests that institutions significantly matter to achieve diversification. According to Gelb (2011, 67) a glance at manufacturing sectors reveals that they are heavily dependent on a rule of law, a strong contract enforcement, and a strong business environment in general. Similarly such argument would be true in case of services sectors as well. Hence, institutions that prevent or reduce

⁷³⁷ Diop and de Melo (The World Bank), pp. 108-109.

⁷³⁸ Ibid, p. 109.

⁷³⁹ Gelb, A. 2011. "Economic Diversification in Resource Rich Countries." Center for Global Development, Washington, DC, 2011. Retrieved from: www.imf.org/external/np/seminars/eng/2010/afrfin/pdf/Gelb2.pdf.

⁷⁴⁰ Diop and de Melo, p. 109.

rent-seeking are considered quite important as shown for example in Botswana case (see Acemoglu, Johnson, and Robinson 2005).⁷⁴¹

In brief, resource-rich countries need to lower the regulatory restrictions for trade in goods and services while improving institutions and building strong human capital aimed to create an enabling environment for further diversification in the long run. In view of the cultural proximity and common language, by deepening regional integration, the resource-rich countries can offer formidable opportunities vis-à-vis resource-poor countries in the region for export diversification.

In return, resource-poor countries also need to undertake autonomous reforms in boosting their competitiveness. Working with resource-rich countries of the region, they also need to reduce barriers to labor mobility. More in details, they will need to reduce their own restrictions to both entry and competition in professional services while improving their backbone services such as transport and telecom. They should also proactively engage resource-rich countries to reduce barriers to trade and mobility *through specific bilateral agreements*.⁷⁴²

Alongside the idea of gathering the four major powers in the MENA region—Saudi Arabia, Egypt, Iran, and Turkey—to address the root causes of the regional problems; Fardoust is recommending a “Four-Pronged” strategy to be adopted in order to tackle the regional problems; these four prongs for the major players can be enumerated as follows:

- 1- Regional problems and conflicts need to be settled through diplomacy, otherwise the current situation would only impede investment and economic growth resulting in “lose-lose outcomes.”
- 2- The four countries need to undertake some major reforms within their home countries to enhance growth and development away from constraints. Such reforms in particular should target manufacturing and services, and should include the banking and financial sectors, while engaging the private sector and citizens, and improving the quality of education.
- 3- Effective structural reforms with well-targeted policies should be mandated aimed at reducing the unemployment particularly among youth and females. They should cut military expenditure while

⁷⁴¹ The World Bank (Diop and de Melo), p. 109; with reference to: Acemoglu, D., S. Johnson, and J. Robinson. “Institutions as a Fundamental Cause of Long-Run Growth.” In: *Handbook of Economic Growth*, vol. 2, 2005.

P. Aghion and S. Durlauf, eds., pp. 385–472. Amsterdam: North-Holland.

⁷⁴² Diop and de Melo, (The World Bank), p. xviii.

settling the regional conflicts and instead; shift the savings towards infrastructure investments, clean energy, as well as private investment in order to boost growth.

- 4- Trade should be increased and encouraged through regional and global cooperation and integration particularly with major global growth poles. Countries in the region should expand on the regional projects—involving the private sectors and citizens—in particular within the sectors of tourism, transport (air and ground), regional energy and water, regional health and education, as well as research hubs with a view to increase trade in goods and services both regionally and globally.⁷⁴³

Accordingly, the above country-based reforms along with regional initiatives could enhance the long-term growth of the region having it increase from the 3.0–4.5 percent a year range to the 5–8 percent a year range, thus moving up to the same level as the developing nations in Asia.⁷⁴⁴ Moreover, along with economic reform agenda involving private sector, they should foster openness and competition towards inclusive economy, thus deepening trade integration through boosting exports and attracting FDIs. Trade integration has the capacity to catalyze reforms while creating competition. For deeper integration they need to reduce tariffs and nontariff barriers to trade while increasing trade facilitation and export promotion.⁷⁴⁵

⁷⁴³ Fardoust, Shahrokh. “Economic Integration in the Middle East: Prospects for Development and Stability.” Middle East Institute, Policy Paper, 2016, p. 31.

⁷⁴⁴ Ibid.

⁷⁴⁵ Ibid, p. 34.

Chapter (9): Examples of Success and Failure in MENA Countries

Chapter (9) is set to reflect some success stories in achieving development within some countries of the MENA region. Strategies adopted to attain such success, and lessons to be learned from such experiences are the main focus of this Chapter. Moreover, failed economies are also the focal point of study in the second half of this Chapter projecting the other side of lessons that can be learned as well.

9.1.1. The Oman and Bahrain Paths to Development

In this first section of the Chapter, the social factors and development strategies in case of Oman and Bahrain are examined that had the main role in leading the two countries to economic success. It shows that their development policies, the quality of governance and degree of economic freedom have been significant criteria in delivering their success while their development strategy has been viable for future. In general; perplexing patterns of growth show that resource-based economies have slower rates of growth than resource-poor countries.⁷⁴⁶

Chapter (8) thoroughly explained the reasons why resource abundance inherently can be disadvantageous. In general, developing oil states have a tendency to be rich while being weak and unstable. The fact is that oil wealth comes and goes in such countries and the fluctuation of oil prices creates a volatile market, and the lack of predictability in the market makes the process of economic development much more difficult.⁷⁴⁷ Nonetheless, the additional rents coupled with foreign exchange obtained from commodity exports would allow higher levels of investment as well as greater capacity to import capital goods which together can level up the economic growth (Auty and Mikesell 1999).⁷⁴⁸ To explain this further, the oil states can be divided into two groups.

The first are the ones that have been economically developed even before discovering oil, for example Canada, Norway, and Australia. For these countries oil is considered a *supplementary source of income* which has little impact on their broader economy. In contrast, oil is considered a primary economic

⁷⁴⁶ Looney, Robert E. "The Omani and Bahraini Paths to Development: Rare and Contrasting Oil-Based Economic Success Stories." Fosu, Augustin K. "Achieving Development Success: Strategies and Lessons from the Developing World" Oxford University Press, 2013, p. 1.

⁷⁴⁷ Ibid, pp. 1-2.

⁷⁴⁸ Auty, R. M. and R. F. Mikesell. "Sustainable Development in Mineral Economies." Oxford: Clarendon Press, 1999.

activity for the second group of countries including Nigeria, Angola, and Iran.⁷⁴⁹ In case of this second group, the easy money obtained from the oil income can easily divert into corruption reinforcing the oil industry while the other sectors of the economy remain underdeveloped.⁷⁵⁰ In other words, revenues obtained as the result of their petroleum are not usually invested in development of the infrastructure and manufacturing sectors of such countries.

The above two grouping, however, is in such a way that distinction between them is not absolute. To give examples; Oman and a small country like Bahrain have had effective attempts in developing their economies even though they are considered resource-rich while Russia is slipping from an industrial economy to a resource-based one.⁷⁵¹ The main reason to explain this situation is the fact that in case of countries like Oman and Bahrain there are limited reserves and therefore these countries are under pressure to diversify their economies while attempting to create a viable non-oil economy, whereas in case of Russia, due to the abundance of oil and energy such diversification would seem far less urgent.

This paucity in Oman and Bahrain oil reserves was painfully observed and illustrated during the oil boom when both countries had a falling production and lowering export volumes even at the time of *record-high oil prices*. Beside the above factors, *policy differences* certainly play a role. It was in fact the impact of their policy choices that demonstrated the performance records of Oman and Bahrain representing some sustained rates of growth vis-à-vis their oil-producing counterparts in the Persian Gulf region.⁷⁵²

According to the prestigious Commission on Growth and Development (2008),⁷⁵³ Oman has been classified as the only Arab ‘success story’ with an average growth rate of 7 percent for twenty five years or longer setting itself to be among the only thirteen countries worldwide with such a progress. And similarly, according to an article in World Economic Forum, Bahrain has successfully moved through the first two stages of development creating more diversification into its efficient economy poised for innovation (Lawson 1989).⁷⁵⁴ Interestingly the two countries together are leading the oil-producing nations of the Gulf Cooperation Council (GCC) in terms of *economic performance, progress in reforms, and institutional development*.⁷⁵⁵

⁷⁴⁹ Looney, p. 2.

⁷⁵⁰ Auty and Mikesell, p. 420.

⁷⁵¹ Looney, p. 2.

⁷⁵² Ibid.

⁷⁵³ Commission on Growth and Development. “The Growth Report: Strategies for Sustained Growth and Inclusive Development.” Washington, DC: Commission on Growth and Development, 2008.

⁷⁵⁴ Lawson, F. H. “Bahrain: The Modernization of Autocracy.” Boulder CO: Westview Press, 1989.

⁷⁵⁵ Looney, p. 3.

Benchmarking these two countries in terms of economic growth, we have:

- For the period 1980-2007 Oman has had the highest overall rate of growth followed by Bahrain, the second highest, among the GCC countries;
- These two countries have never experienced a period of negative growth among the GCC countries; and,
- Oman and Bahrain instead have maintained high steady rates of growth, while Bahrain's growth rate has been even accelerating over time.⁷⁵⁶

But the question is what factors have created such relevant success in case of Oman and Bahrain when they are compared with other oil exporters? According to the Commission on Growth and Development (2008: 21) five striking commonalities may be referred to among its thirteen success stories that follow:

- All of these thirteen countries have fully exploited the world economy;
- They could maintain their macroeconomic stability;
- They have a successful record of high rates of savings and investment;
- They also allowed markets to allocate resources; and
- All had enjoyed *committed, credible, and capable governments*.⁷⁵⁷

In brief, they are relatively better integrated to the global economy with their politically stable governments and high levels of growth. More specifically, in analyzing such success stories, we may look at the impacts and interactions of the deep determinants of economic development namely *natural endowments, integration* (trade and other policy reforms), and *institutions*.⁷⁵⁸

9.1.1. OMAN

According to the World Bank (1994);⁷⁵⁹ several elements are playing the main role in the development of an oil economy such as Oman's that has a non-renewable resource to be sold at a price considerably more than its production cost. Firstly; since the public sector has the proprietorship of the resources, it thus

⁷⁵⁶ Looney, p. 3-4.

⁷⁵⁷ Ibid, p. 4.

⁷⁵⁸ Ibid, p. 6.

⁷⁵⁹ World Bank. "Sultanate of Oman: Sustainable Growth and Economic Diversification." WB Report 12199-OM. Washington, DC: World Bank, 1994.

dominates the development process. Secondly, pervasive economic dependence upon public spending of resource revenues would create a private economy with a rent-seeking behavior. And thirdly, as time goes by, the governments shall face the slow down or decline of their economies once such resources are exhausted. From the early stages of development, Oman has taken these factors into consideration in their strategies and has attempted to avoid such problems.⁷⁶⁰

To give a quick history, Oman is a country with the population of 2.5 million with majority Ibadhi sect of Islam in which the choice of ruler would be through *communal consensus and consent* (Oman 2008: 20).⁷⁶¹ Historically speaking, the country was considered the most diversified and developed economy on the Arab side of the Persian Gulf with their fishing industry as well as a broad-based agricultural sector.⁷⁶²

After undertaking the power by Qaboos, he restored control over Southern Dhofar—a vast region that had rebelled against his father’s oppressive rule. Using both economic and military means, he was of the belief that the main cause of the rebellion was the poor economic conditions resulting in the Dhofar rebellion. By 1975, after suppressing the rebellion, he focused on the development issues while establishing modern governmental and administrative institutions. This also included an imperative plan of diversification away from oil. To mention further institutional development, he also initiated a major development plan to upgrade the nation’s educational and health facilities, build a modern infrastructure, and develop the country’s natural resources including natural water resources which was considered a vital prerequisite for continuing on the same path of economic activity and growth.⁷⁶³

Oman launched its development efforts with the belief that the circumstances and conditions for development in each underdeveloped country differ in light of social, economic and political needs of that nation, making as such the vision and philosophy of pragmatic strategies and policies in its economic development programs. Central to this strategy, the important role of oil was considered in the economy according to which petroleum was to be mainly used and wisely invested to the benefit of future generations. This meant that they tried to develop the oil sector in such a way as to maximize the impact of its revenues through effective resource development and allocation policies while trying to lower the dependence of the economy upon oil by creating new sources of national income aimed at accompanying or eventually replacing petroleum revenues (Al-Yousef 1995).⁷⁶⁴

⁷⁶⁰ Looney, p. 6-7.

⁷⁶¹ Oman Economic and Development Strategy Handbook, Fifth Edition, (Updated 2008) Washington, DC: International Business Publications. 2008.

⁷⁶² Looney, p. 7.

⁷⁶³ *Ibid.* p. 8.

⁷⁶⁴ *Ibid.* p. 9: with reference to: Al-Yousef, M. bin M. “Oil and the Transformation of Oman, 1970–1995.”

In other words, the strategy of diversification away from oil became imperative in view of Oman's relatively meagre petroleum reserves and production capacity, plus the fact that it was unlikely for them to make major new discoveries.⁷⁶⁵ In Oman, instead of nationalizing the oil sector, the country attempted to maintain the links with multinational petroleum firms that could in return provide nearly 50 percent of the required capital for the sector's expansion.⁷⁶⁶

Through the countries' *Five-Year Plans*, they had rather a longer term view of economy to envisage that Oman would anticipate much more fully in the international economy. While previous development could be characterized as resource-based and investment-driven, the fifth Five-Year Plan's main attention was to raise efficiency by way of improved governance as well as economic reforms. In the meantime, they seriously worked on deficiencies of the quality of health and education while improving the legal framework governing the private sector investment and business activities.

Furthermore, taking the IMF and World bank assessments seriously they convened a development conference in June 1995 called "Visions for Oman's Economy—Oman 2020 (Allen and Rigbee 2000)."⁷⁶⁷ Thus, guided by the general guidelines of Vision 2020, in 1995, Oman began its development strategies by creating a liberal strategy towards its trade regime with a view to reduce its high dependency on oil and natural gas even though such sectors at the time accounted for 50 percent of its GDP, 65 percent of the government income, as well as 90 percent of its merchandise exports.⁷⁶⁸

As the result of such implementation, the country successfully promoted its downstream industries and tourism; while addressing some structural problems including the privatization of state-owned enterprises. Moreover, it improved education and health services while modernizing infrastructure. The country also established a reserve fund for the use of oil revenues. Overall, the core part of such reforms and activities was mainly pursuing economic liberalization as well as the improvement of governance.⁷⁶⁹ All these confirm the path to institution formation for the inception of development strategies in Oman while investing to build the infrastructures of the country.

Implementing such development strategy resulted in reaching an average annual GDP growth of 5.3

London: Stacey International, 1995: pp. 55-56.

⁷⁶⁵ Looney, p. 8.

⁷⁶⁶ Ibid, p. 10.

⁷⁶⁷ Allen, C. and W. L. Rigsbee. "Oman Under Qaboos: From Coup to Constitution, 1970–1996." London: Frank Cass, 2000.

⁷⁶⁸ Looney, p. 12-13.

⁷⁶⁹ Ibid.

percent from 2000 to 2007 while having an inflation rate lower than other countries of the region. They largely controlled the inflation in recent years while increasing the Omani riyal to US dollar. The country has had surpluses in fiscal position with an annual average of 8.4 percent of GDP for the period 2001–06; as well as external current account with an annual average of 8.6 percent of GDP within the period 2001–07. This increased the country's per capita income to about US\$14,500 as of 2007.⁷⁷⁰

Oman's high rates of growth confirm that economic reforms program coupled with economic freedom have been implemented adequately while attracting more FDIs into its economy. This is the result of conformity with the theory of institutional change as discussed in the opening chapters stipulating that adequate institutions can lead to economic success within a more liberalized economy. As the result, for instance, Oman's investment climate (inflow of FDI) was improved from 208.9 million Omani Rials in 2003 to somewhat 637.7 million Omani Rials in 2006 followed by the 1997 establishment of the Oman Center for Investment Promotion and Export Development. It is worth referring to some legal framework within the government initiatives in bolstering foreign investment including Article 2 and Article 3 of Decree 102/94, as well as Royal Decrees 125/94; 102/94; and 75/21 that together ease FDIs for the purpose of national economic development project while introducing exemptions on tax and licensing.⁷⁷¹

Furthermore, using the Fraser and Heritage indexes of economic freedom, Norton (2002)⁷⁷² suggests that establishing strong property rights would reduce the deprivation of the world's poorest people, whereas having weak property rights in place would in fact amplify such deprivation. Also, according to Grubel (1998)⁷⁷³ economic freedom *inter alia* may bring about superior performance in income levels and human development as well as income growth, while reducing unemployment rates.⁷⁷⁴

Oman successfully launched a long-term development strategy in accordance with the *Vision 1996-2020*. According to that Vision, the contribution of agriculture to GDP is expected to increase from 2.8 percent in 1996 to 5 percent while the manufacturing share of the GDP is to increase from 7 percent to 29 percent by 2020. Moreover, the shares of services and oil and gas will fall from 52.3 percent and 40 percent in 1996 to 47 percent and 19 percent respectively.⁷⁷⁵

⁷⁷⁰ Looney, p. 13.

⁷⁷¹ *Ibid*, pp. 13-14.

⁷⁷² Norton, S. W. (2002). "Population Growth, Economic Freedom, and the Rule of Law." PERC Policy Series, February. Bozeman, MT: Property and Environment Research Center. Available at: www.perc.org/articles/article649.php (accessed 23 August 2012).

⁷⁷³ Grubel, H. "Economic Freedom and Human Welfare: Some Empirical Findings," *Cato Journal*, 1998, 18 (Fall): pp. 287–304.

⁷⁷⁴ Looney, p. 15.

⁷⁷⁵ *Ibid*, p. 14.

Experience and data show that significant progress in economic reforms has been rare in case of oil-producing developing countries. Specifically, an examination published by the Heritage Foundation concerning the ranking of oil-rich countries reveals the status of citizens in oil-producing countries where they live in poverty and under brutal and dictatorial regimes (Roberts and Leahy 2008).⁷⁷⁶ Such factors can be also characterized as the “curse of oil.” Interestingly, Oman and Bahrain are considered as notable exceptions to this rule. Having property rights in place while establishing the rule of law and generating economic growth under such conditions away from the curse of natural endowment is indeed an economic and somewhat political success.⁷⁷⁷

9.1.2. Bahrain

While Bahrain has unique social, political, and economic peculiarities to itself that set it apart from other countries of the Persian Gulf region, it has also adopted development strategies different from that of Oman. In contrast with Oman which has a population of 2.5 million, Bahrain is a much smaller country, with a population of just over 700,000 people. Bahrain began its economic development much earlier than Oman. Unlike tranquil society of Oman, Bahrain has got an indigenous population as divided along class and religious lines. There is also a history of political activism within its native industrial work force which is unique compared with neighboring countries. Moreover, Bahrain’s development strategies have repeatedly shifted over time unlike that of Oman’s which has been rather considered a cohesive, long-term development planning. Nonetheless, to the envy of its regions’ planners, Bahrain has also been able to achieve some level of economic diversification into non-petroleum related activities.⁷⁷⁸

From the early 1930s to the mid-1960s Bahrain as the oldest oil-producing country on the Arabian Peninsula mainly relied upon revenues out of petroleum production and refining which encompassed the greatest part of its income. However, as early as the mid-1940s, there were substantial quantities of crude oil imported from Saudi Arabia in order to keep Bahrain’s main refinery operating profitably (Lawson 1989).⁷⁷⁹

While there has been a shift of strategy for Bahrain to create an economy away from oil dependency, the

⁷⁷⁶ Roberts, J. and D. Leahy. “The 2008 Index: How to Escape the ‘Curse of Oil’.” Washington, DC: Heritage Foundation, 2008.

⁷⁷⁷ Looney, pp. 15-16.

⁷⁷⁸ Looney, p. 16-17.

⁷⁷⁹ Ibid, pp. 17-8, with reference to: Lawson, F. H. “Bahrain: The Modernization of Autocracy.” Boulder CO: Westview Press. 1989.

strategy doesn't really have a single, overriding theme like that of Oman's Vision 2020. What the country did instead was to emphasize on developing different parts of nonoil economy at different points in time. Similar to Oman, during 60s and 70s, financial and services institutions were also established in Bahrain. Relatively, because of the country's well established infrastructure particularly in communications and transportation, as well as regulatory structure, and cosmopolitan outlook, Bahrain has established itself as a hub for many multinational firms in the region. Moreover, the country entered into a free trade agreement with the US in 2005.⁷⁸⁰

Despite some differences in development strategies between Oman and Bahrain, both countries have enjoyed the benefit of having a strong and traditional mercantile class. Like the case of Oman, Bahrain has also set its economy towards more diversification and reforms creating as such an environment conducive to growth. Even though compared with Oman, Bahrain has relatively lower growth rates, but its progress instead has been steadier and is also accelerating.

For the periods of 1980–89; 1990–99; and 2000–07 Bahrain's GDP grew at rates of 3.66 percent, 4.86 percent, and 7.44 percent respectively. The average rate of growth for the period 1980–2000 was 5.17, in contrast with that of Oman's 6.31.⁷⁸¹ As the result of Bahrain's early start of diversification process, it has had a large share of manufacturing in GDP compared with Oman even though Oman's share of manufacturing increased on a yearly basis since 1974 while Bahrain's declined after 1995.⁷⁸²

Due to the same diversification efforts that demand more reliance on external markets (because of the small size of the country), Bahrain has done considerable progress in liberalizing its economy even surpassing Oman. Such economic liberalization encompasses investment and trade freedoms as well as financial and fiscal freedoms. Heritage House's 2008 Index of Economic Freedom (Heritage Foundation 2008)⁷⁸³ (data for 2007) reveals that Bahrain was considered the world's 19th freest economy, while ranking 1st among 17 countries in the MENA region.⁷⁸⁴

FDIs are welcomed in Bahrain while local enterprises or existing government-owned or parastatal companies are well protected in the country. Accordingly there is a comparatively advanced commercial code which is open to outside contract adjudication. GCC nationals can easily own 100 percent of the share of the firms while for non-GCC national there is a limit of 49% ownership within such firms.

⁷⁸⁰ Looney, p. 18.

⁷⁸¹ *Ibid.*, p. 20, and p. 22.

⁷⁸² *Ibid.*

⁷⁸³ Heritage Foundation. "Index of Economic Freedom 2008." Washington, DC: Heritage Foundation, 2008.

⁷⁸⁴ Looney, p. 23.

However, foreign-owned companies may also operate in some cases without having to have a Bahraini partner. There are freedoms on the repatriation of capital or profits, while there is no exchange controls, or no restrictions for converting or transferring funds regardless of their association with an investment.⁷⁸⁵

Overall, there are monetary and financial freedoms in Bahrain with relatively low inflation rate (i.e. 2.8 percent between 2004 and 2006). Accordingly, there existed 368 financial institutions in 2006 when some new business classification rules were introduced by the central bank *aiming to make the financial framework more flexible*.⁷⁸⁶ According to the IMF, Bahrain's financial supervision is ranked as "effective" and its financial regulation are considered modern and comprehensive. Property rights are well established as expropriation is unlikely and property is secure. The quality of improved governance is well seen in both Oman and Bahrain.

In addition, beyond the relatively high economic freedom resulting in superior rates of growth, the factor of "governance" also plays a significant role for such growth and stability. Such pattern is in fact the result of the quality of institutions which account for divergent growth patterns across countries as described by development theorists.⁷⁸⁷

At the broadest level, institutions are mainly concerned with the structure of incentives that promote or possibly impede entrepreneurial services as well as productive investment. According to some empirical studies, generally speaking, in measuring the effectiveness of institutions, there are some factors that play the key role including the respect for the rule of law, contract enforcement, and the protection of property rights.⁷⁸⁸

Some surveys have developed to measure the effectiveness of government institutions. For example, Organizations such as the Political Risk Services Group, the World Bank, and the World Economic Forum have done such measures on an annual basis taking into account some indicators like government effectiveness or bureaucratic quality, regulatory quality, political stability, and democratic accountability, as well as control of corruption. In accordance with such criteria, the MENA region in general and the GCC in particular show weaknesses in institutional capacity as compared with Oman.⁷⁸⁹

⁷⁸⁵ Looney, Robert E. "The Omani and Bahraini Paths to Development: Rare and Contrasting Oil-Based Economic Success Stories." Fosu, Augustin K. "Achieving Development Success: Strategies and Lessons from the Developing World" Oxford University Press, 2013, p. 24.

⁷⁸⁶ *Ibid.*

⁷⁸⁷ *Ibid.* p. 25.

⁷⁸⁸ *Ibid.*, p. 26.

⁷⁸⁹ *Ibid.*

9.1.3. Summary

In sum, what can be surely said is that the economic success in cases of Oman and Bahrain over the last few decades can be attributed to the quality of their governments having superior structure while undertaking reforms and necessary degree of liberalization towards growth and development. The role of proper strategies and more flexible regulatory frameworks are also revealed in cases of Oman and Bahrain even though the above mentioned reforms were somewhat stalled with little progress in 2000s.

The both countries have still long way to go on the way of such reforms processes in view of achieving some governance structures like those of the advanced industrial nations.⁷⁹⁰ There is obviously a significant democracy gap (voice and accountability) in case of these two countries, but the wave of their successful growth seems appealing in comparison with other authoritarian states (cf. Dimitrov 2008).⁷⁹¹ Whether additional reforms are needed to attain the future growth, is to be seen in the years to come.⁷⁹²

Even though Oman and Bahrain have shown significant development records, the sustainability of their growth is questioned in view of the instability that exists in most of the rentier economies. In case of Oman for instance, due to its “institutional underpinnings” there are a number of reasons for optimism. Despite the dominant role that oil has in the country’s economy, Oman has been able to successfully manage its economy by simply avoiding many socioeconomic patterns that exist among rentier states.⁷⁹³

In short, policies and strategies bringing improvements through economic freedom as well as good governance were mainly among the determining factors that set Oman and Bahrain apart from their neighbors creating their superior growth records as such. Besides, these two countries have not as much suffered the curse of their natural resource endowment mainly because of an important factor they have in common: they both seem to have enough oil to do some good but not too much to do some damage.⁷⁹⁴

Lastly, what can be said about Oman’s and Bahrain’s successful record is that along with perseverant development plans and economic reforms they both seem to have been able to establish well-performing institutions to get their economies as much away from the oil dependency while investing on infrastructures and towards furthering attempt for economic diversification.

⁷⁹⁰ Looney, p. 29.

⁷⁹¹ Dimitrov, M. “The Resilient Authoritarians,” *Current History*, January 2008; 107 (705): pp. 24–29.

⁷⁹² Looney, p. 29.

⁷⁹³ *Ibid.*

⁷⁹⁴ *Ibid*, p. 32.

9.2. Tunisia's Development Experience

The case of Tunisia also reflects the significant role of diversification and human development on the one hand, and proper development strategies on the other to help the country's economy on its path to success. According to the IMF; Morocco, Egypt, and Tunisia were all hailed as success stories in the 1990s, but it was only Tunisia that could continue its path towards development while achieving a remarkable record in growth at a sustained pace, as its average GDP growth rate exceeded 5 percent in the 1990s, while achieving human development including health and education in particular for women. Enhancing Tunisia's trade sector (exports) coupled with diversification was the main factor to make the country an *international* success while raising the human capital was responsible for the country to achieve *domestic* success.⁷⁹⁵

Benchmarking Tunisia's development strategy with its neighboring countries or the ones with similar level of development in other parts of the world (i.e. Sub-Saharan Africa- SSA) confirms its remarkable success. The existence of political will particularly for national education and women's rights was a key factor for this success. Besides, Tunisia successfully managed to go through the phases of reforms and trade liberalization during the second half of 1980s and early 1990s without leaving fiscal deficits as the result of reducing or eliminating trade restrictions.⁷⁹⁶

In short, several socioeconomic indicators show that Tunisia has relatively performed better than the average middle-income country. However, in order to better observe such success and accomplishments we ought to take in to consideration its several years of progress. Tunisia's per capita income (PPP value) shows a significant increase from US \$3,763 to US\$5,730, that is considered a 53 percent increases in the course of two decades. Such progress far exceeds in comparison with the other two Maghreb countries confirming a regional achievement for Tunisia.⁷⁹⁷

As indicated above, Tunisia's development strategy mainly focused on three areas: (i) enhancing the diversification of its economy as well as exports; (ii) more investment in human capital;⁷⁹⁸ and (iii) empowering women by getting them more into the workforce. There are of course some spillover effects for the above interlinked areas having brought more economic and social dimensions to the Tunisian

⁷⁹⁵ Balamoune-Lutz, Mina; "Tunisia's Development Experience: A Success Story?" In Fosu, Augustin K. *Achieving Development Success: Strategies and Lessons from the Developing World*. Oxford University Press, 2013; P. 1-2.

⁷⁹⁶ *Ibid*, p. 2.

⁷⁹⁷ Balamoune-Lutz, p. 3.

⁷⁹⁸ *Ibid*, p. 6.

society. For the period 1970-2003, Tunisian time series data shows the significant correlations that exist between institutional quality, human development measures, trade indicators, as well as income. Accordingly, there is a positive correlation between income and the indicators of human capital (literacy, life expectancy, and the share of women in the labor force).⁷⁹⁹

According to Ghali and Mohnen (2004),⁸⁰⁰ there are three main phases in Tunisia's development. The first was between 1961 to 1970 which was characterized by high growth rates and public investments over infrastructure, human resource development and agriculture. The second phase began from 1971 to 1986 showing a "mixed economy", involving more of private sectors in manufacturing. And the third phase from 1987 on, that is characterized by structural adjustment efforts witnessing important trade and financial liberalization along with its accession to the GATT membership.⁸⁰¹

The record of Tunisia's success indicates the country's achievement with an overall good economic performance since the mid-1980s. During this period in particular, the country in fact deepened the process of its diversification parallel to the period of structural adjustments. Such an achievement took place exceptionally deepening economic diversification despite the fact that usually the rapid liberalization and reforms coupled with adjustment program would in fact limit a country's ability to diversify its economy (see UNECA 2007).⁸⁰² The process of diversification in Tunisia, like many other African states, began after its dependence from France in 1956 and picked up during 1980s.⁸⁰³

According to the UNECA 2007 Economic Report on Africa, the periods from 1960s and 1970s is characterized by many diversification policies which aimed at strengthening economic autonomy. Besides, a second period from 1980s reflecting the post-independence economic policies shows that macroeconomic stabilization policies have been also in the core part of attention geared to long term development while focusing on short-term goals.⁸⁰⁴

However, there have been two major challenges on the way of Tunisia's development strategy. To develop a manufacturing sector a country basically needs raw materials coupled with well-developed power sources (energy) as well as large markets; both of such factors were rather in limited supply in

⁷⁹⁹ Balamoune-Lutz, pp. 5-6.

⁸⁰⁰ Ghali, S. and P. Mohnen. "The Tunisian Path to Development: 1961-2001." Paper presented at the Conference on Scaling up Poverty Reduction: A Global Learning Process and Conference, 25-27 May, Shanghai, 2004.

⁸⁰¹ Balamoune-Lutz, p. 8.

⁸⁰² United Nations Economic Commission for Africa (UNECA). "Economic Report on Africa: Accelerating Africa's Development through Diversification." Addis Ababa: UNECA, 2007.

⁸⁰³ Balamoune-Lutz, p. 8.

⁸⁰⁴ *Ibid*, p. 9.

Tunisia. In fact for many years Tunisia was only depending on its textile and leather, as well as food products. Despite the well performance in textile during 1980s and 1990s, Tunisia started to enhance the diversification process and export into other products including further production and export of mechanical, chemicals, electric, and electronic equipment. A flow of FDIs then supported the above efforts leading to the creation of 1980s investment codes while liberalization and privatization programs were being implemented.⁸⁰⁵ This period of enhancing trade and deepening diversification has been quite effective in Tunisia's economic success. As the result, since the mid-1980s, Tunisia and Morocco are the two countries in North Africa with the most consistent positive average growth rates in merchandise exports.⁸⁰⁶

Beyond other Arab and Muslim endeavors, Tunisia, took two remarkable steps, shortly after independence from France, in tackling the issues concerning "women" and "education". Firstly, it significantly reduced gender inequities by instituting some laws that were less unfavorable to women, as for example the laws concerning marriage and divorce, or laws related to the right to vote and stand for election. And secondly, the country attempted to improve human development with a particular emphasis on education. Moreover, the country had more success in comparison with the other countries in Maghreb in poverty reduction within both urban and rural areas, while working on education as a national priority. It seems that this strategy has paid off and contributed significantly to Tunisia's development. Ghali and Mohnen (2004: 2) contend in this regard that:

"While growth and poverty reduction in Tunisia were driven largely by the economic reforms of the late 1980s, they were augmented and reinforced by the pursuit of economic and social policies that focused on improving individual and collective welfare, especially in education, health, and social assistance."⁸⁰⁷

In brief, social policy adopted by Tunisia has had an effective role in bringing about the country's success through undertaking economic reforms while enhancing exports and diversification of its economy, as well as human capital including health, education, and female participation. They have also upgraded the labor force quality while facilitating collective action.⁸⁰⁸ Indeed human capital had a major role in the fruitfulness of Tunisia's development strategy and the success of the diversification process as well as the manufacturing sector. Moreover, the country's geographical location is another positive advantage among

⁸⁰⁵ Balamoune-Lutz, p. 9.

⁸⁰⁶ *Ibid*, p. 10.

⁸⁰⁷ *Ibid*, p. 15.

⁸⁰⁸ *Ibid*.

the good initial conditions. Located in the southern Mediterranean region, the country has a climate apt for tourism and agriculture. Such proximity with Europe has been significant for trade and attracting FDI particularly with countries such as Italy and France. These two countries had a share of export to Tunisia consisting about 60 percent of Tunisia's total exports in 2005.⁸⁰⁹

In short, Ghali and Mohnen (2004) mainly attribute Tunisia's successful experience to the following factors:

- (i) Successful implementation of economic reform and stabilization programs as undertaken since the mid-1980s;
- (ii) Having more emphasis and focus upon social policy including health, education, social security, and helping the poor;
- (iii) Establishing a decline in population growth; and
- (iv) The continuation of investing in basic infrastructure.⁸¹⁰

In other words, the spillover effects and the linkages between the three main policy areas namely human capital, economic policy as well as social policy have been crucial in delivering the success of Tunisia's development experience. According to Balamoune-Lutz (2008),⁸¹¹ findings show that when income per capita, diversification indicators, along with adult literacy and the share of women in the labor force as well as fertility rates are co-integrated, then, within the long-run relationships and short-run dynamics, this would create a stable long-run relationship among such variables as trade, income, and human development in Tunisia.⁸¹²

Two main reasons can be asserted for the success of Tunisia's development strategy: (1) political economy of Tunisia (reforms and interest groups i.e. civil societies and the status of a new social contract as explained in the opening chapters), and (2) political stability of Tunisia.⁸¹³

Nevertheless, Tunisia is now facing some challenges threatening the viability of its development strategy for the future. First, it has a high unemployment rate (around 15 percent in recent years) in particular

⁸⁰⁹ Balamoune-Lutz, pp. 15-16.

⁸¹⁰ Ibid.

⁸¹¹ Balamoune-Lutz, M. "Time Series Behaviour of Trade, Human Development and Income in Tunisia," Mimeo. Jacksonville, FL: University of North Florida, 2008.

⁸¹² Balamoune-Lutz, Mina; "Tunisia's Development Experience: A Success Story?" In: Fosu, Augustin K. *Achieving Development Success: Strategies and Lessons from the Developing World*. Oxford University Press, 2013, p. 16.

⁸¹³ Ibid, pp. 16-18.

among educated Tunisians. Secondly, there is a high regional inequality within the country, particularly between rural and urban areas having more poverty in rural areas (King 1999).⁸¹⁴ It is therefore incumbent upon the country to reduce such poverty in rural areas by increasing the expenditure on social programs, health, and education. And thirdly, even though Tunisia's financial sector has been liberalized in the course of the liberalization and reform programs during the late 1980s and early 1990s, yet the country has not been able to effectively mobilize significant domestic savings.⁸¹⁵

There are three main lessons that can be learned from Tunisia's experience. The first is Tunisia's success in reducing fertility rates, as they are generally high in Arab and African countries. The second lesson would be the implementation of social reforms that can practically support economic reforms. And third lesson concerns the role of political stability in Tunisia. It is interesting to note that in general, Tunisia has been politically stable despite the fact that the country is not very strong in its political institutional quality or in terms of democratic institutions.⁸¹⁶

Overall, what can be concluded is that Tunisia's development strategy on diversifying its production while increasing trade, exports, and human development along with gender equality have brought the fruit of success to the country. According to Bechri and Naccache (2003: 39),⁸¹⁷ the Tunisian experience proves how social modernization could be crucial in improving the standards of living as well as in isolating traditional groups while rallying the support of women, trade unions, and the liberal fringes of the population. Hence, the role of interest groups and political economy in shaping development policy in Tunisia are undeniable.⁸¹⁸ And of course all such factors of success can help Tunisia more integrate into the regional and global economy i.e. through PTA agreements like the Arab Maghreb Union (AMU).

More into the empirical analysis, World Bank update (2018)⁸¹⁹ on Tunisia's economic outlook confirms the continuation of the above trends as the economic growth expanded modestly by 2.7% in 2018. This rate of growth would be mainly through "sustained services growth and agriculture as well as strengthening the sectors of tourism, phosphate and manufacturing." The World Bank also predicted a gradual pick up on the growth for 2019-20 reaching 3.5% during this period which could be the result of bringing structural reforms as well as greater security and social stability. According to the above source

⁸¹⁴ King, S. J. "Structural Adjustment and Rural Poverty in Tunisia," Middle East Report, 1999, 210: pp. 41-43.

⁸¹⁵ Balamoune-Lutz, "Tunisia's Development Experience: A Success Story?" p. 19.

⁸¹⁶ Ibid, p. 20.

⁸¹⁷ Bechri, M. and S. Naccache. "The Political Economy of Development Policy in Tunisia." Tunisia: GRP/ERF, 2003.

⁸¹⁸ Balamoune-Lutz, "Tunisia's Development Experience: A Success Story?" p. 21.

⁸¹⁹ The World Bank; "Tunisia's Economic Outlook- April 2018." Retrieved from: <http://www.worldbank.org/en/country/tunisia/publication/economic-outlook-april-2018>

(the World Bank), Tunisia's inflation, however, increased to 6.7% in 2018, which is the result of the dinar depreciation, and the price increase of some products including fuels, tobacco, and telecom. Moreover, in accordance with the World Bank estimation; the unemployment rate remained high at 15.5% for 2017 despite having a low labor force participation of 50% mainly due to weak participation of women (28%). This confirms that the challenge still exists in respect to the deprivation of interior regions as well as the women work force. This is while the rate of unemployment among the university graduates has also increased from 15% in 2005 to 23% in 2010 and 31% in 2017. Interestingly however, the official poverty rate has been decreased as it was 15.2% in 2015 down from 20.5% in 2010 and 23.1% in 2005.⁸²⁰

9.3. The United Arab Emirates (UAE)

In analyzing the de facto development strategy of the United Arab Emirates, among the effective and relevant factors we can address the political structure of the country in which the economic power is concentrated mainly in the hands of the rulers of the seven emirates forming the UAE on the one hand, and the rules and policies designed to ensure cooperation from the local or native UAE citizens, on the other. Some sovereign wealth funds have been established emanating mainly from the oil revenues where the balance can also be used to spur domestic investments mainly in tourism and industry. The UAE has adopted liberal policies for using foreign expertise and skills in domestic industry while showing some tolerance in respect to the importation of unskilled workers in order to fuel the growth of the domestic economy.⁸²¹

About fifty years ago, the localities constituted a region forming the current UAE with few economic activities which primarily included pearl fishing along with some trading activities. These localities represented low physical and human development indices while there were sparsely populated. Infrastructure was poor; trained professional and education levels were low, while there were only a few roads and hospitals. However, the discovery of oil had tremendous effects on the development of the region in 1950s and early 1960s. Possessing almost 10 percent of the current reserves of the world's crude oil, the country generated a booming economy with a major economic force particularly within tourism industry, investments through its sovereign wealth funds, and large companies like Dubai Ports.⁸²²

⁸²⁰ The World Bank; "Tunisia's Economic Outlook- April 2018." Retrieved from: <http://www.worldbank.org/en/country/tunisia/publication/economic-outlook-april-2018>

⁸²¹ Nyarko, Yaw: "The United Arab Emirates: Some Lessons in Economic Development", In *Achieving Development Success* by Augustine K. Fosu, Oxford University Press, 2013, p. 1.

⁸²² Ibid, p. 2.

Furthermore, like that of Tunisia, the UAE also successfully achieved a *political stability* and *forceful economic development* by adopting strategies in using the oil revenues to hire foreign or guest workers. This mainly included high-skilled labor primary from the West and low-skilled workers from Asia in particular India. The UAE adopted a *free market economic plan* making it one of the major countries as such on the international playing field. The economy of the UAE has grown with an annualized real rate of 5.5 percent within almost forty years since independence, as well as a roughly 6.1 percent over the past two decades (Figure 9.3.A.). Adopting proper managerial strategies and effective policies shifted the country away from the poverty to an economic success in less than fifty years.⁸²³

Figure (9.3.A.) Real GDP since Independence: UAE



Source: World Bank, World Development Indicators (Various Years)

More recent data as shown in Table (9.3.) and Figure (9.3.B.) from two different sources confirm the continuation of the same trend of increase in GDP of the country after the periods shown in the above figure. Overall, the two figures and the table certainly show that the United Arab Emirates has continued on the same successful path of growth during the past two decades. After a short period in 2009 during which the country suffered the financial crisis resulting in the lower GDP, almost swiftly the level of growth accelerated in the following years. Considering per capita GDP, the UAE would be considered as one of the richest nations in the world usually ranking among the top twenty countries or even among the

⁸²³ Nyarko, pp. 2-3.

countryeconomy.com

Evolution: Annual GDP United Arab Emirates

Date	Annual GDP	GDP Growth (%)
2017	380,000M.\$	0.8%
2016	348,743M.\$	3.0%
2015	358,135M.\$	5.1%
2014	403,137M.\$	4.4%
2013	390,108M.\$	5.1%
2012	374,591M.\$	4.5%
2011	350,666M.\$	6.9%
2010	289,787M.\$	1.6%
2009	253,547M.\$	-5.2%
2008	315,475M.\$	3.2%
2007	257,916M.\$	3.2%
2006	222,117M.\$	9.8%
2005	180,617M.\$	4.9%

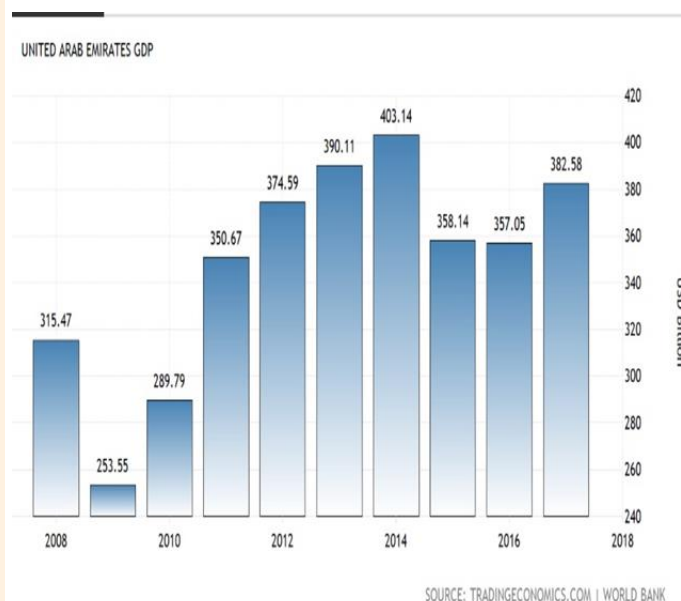


Table (9.3.) UAE GDP

Figure (9.3.B.) UAE GDP by World Bank

top five. According to the UN human development index, the UAE is placed among the developed countries. Similar to the patterns of the previous success examples, the UAE has also been able to establish its economy moving away from the dependence on oil.

In fact, the country has been able to manage such rapid economic transformation by forming a relatively effective political structure. In other words, political as well as economic institutions have progressed hand in hand which is a key factor in bringing the relative success even though the absence of *well-developed democratic institutions* is still being felt in the UAE. As explained earlier, according to Acemoglu and Robinson, inclusive political and economic institutions should go hand-in-hand in order to bring about the kind of economic success that is intended thus deterring the extractive institutions.

Historical facts suggest that many of the current population living within the borders of the UAE are mainly the descendants of Bedouin tribes, as such forming the independent principalities (emirates). These emirates have been mostly ruled by a single family from the 1800s up until now.⁸²⁴ Looking at the long line of ruler sheikhs reveals that different emirates of today's UAE are monarchies whose historical

⁸²⁴ Nyarko, p. 5.

roots date back to almost 200 years ago. For example, the Nahayan family has ruled since 1761 in Abu Dhabi, the Maktoum dynasty has ruled Dubai since 1833. Nonetheless, the traditional ruling system coupled with some innovative policies could create a certain degree of cooperation from the citizens.⁸²⁵

Even though foreign investors are welcome to the UAE, all businesses outside the economic zones would require a 50 percent ownership by locals. Moreover, foreigners can rent the lands only from the owners who are primarily Emirati citizens. The concept of local citizenry and property rights are defined as such within the system. Furthermore, total foreign ownership of a business can be accepted as long as such ownership is located within the export promotion zones.⁸²⁶

Overall, the UAE is considered the third largest economy in the MENA region with a relatively high growth. For example, its GDP was over US\$150 billion in 2006 trailing behind Saudi Arabia and Iran but still ahead of Algeria, Egypt and Israel. In terms of GDP per capita, the UAE is comparable with Italy, Japan and Singapore and in the region it lags only behind Qatar.⁸²⁷

Furthermore, creating sovereign wealth funds has been an important economic strategy adopted by Abu Dhabi to invest a great amount of resources in a well-diversified asset portfolio outside the country. For example, the Abu Dhabi Investment Authority (ADIA) is considered as the main sovereign wealth fund of Abu Dhabi in addition to a smaller one called the Mubadala; both to be invested within the country and outside the country. The principal goal as mentioned in the mission statement of Mubadala mainly refers to the achievement of sustainable economic benefits for Abu Dhabi through different business ventures and in partnership with local, regional, as well as international investors.⁸²⁸

Comparing ADIA with that of Mubadala reveals the basic strategy of Abu Dhabi that is to acquire huge savings out of oil resources in foreign assets primarily gained by ADIA, coupled with aggressive local infrastructure as well as industrial activities similar to that of Mubadala. Such investments have triggered large projects for the country i.e. the government's attempts to establish branches in Abu Dhabi of the Louvre Museum of France, NYU and Masdar Institute of Science and Technology of MIT, as well as the Guggenheim Museum of Modern and Contemporary Art in a Frank Gehry commissioned building.⁸²⁹

In contrast with Dubai, Abu Dhabi with its larger oil reserves has been greatly converting its oil reserves

⁸²⁵ Nyarko, p. 6.

⁸²⁶ *Ibid.*

⁸²⁷ *Ibid.*, p. 7.

⁸²⁸ *Ibid.*, p. 9.

⁸²⁹ *Ibid.*, p. 10.

into sovereign wealth funds being eventually invested outside of the economy. With its excellent infrastructure, Dubai focused to become the trade and tourist mecca of the region by establishing an enabling business-friendly environment aimed at attracting many foreign companies. Furthermore, Dubai has mainly developed domestic infrastructure projects as well as its real estate to achieve a major service economy in which tourism and a large financial and re-exports sector play the key role.⁸³⁰ The development of labor policy was also a key factor in bringing success to the economy of the whole UAE.

The UAE has shown so far a flexible strategy including tolerance towards the influx of foreign labor. Nonetheless, the UAE's immigration and labor policy seems problematic, as it has been based on the conscious decision to accept as many as workers that they need even though on a temporary basis. Such policy seems far from perfect on the ground that many of such foreign workers are still on temporary visa and without any prospect of citizenship. This can be a major concern affecting the stability of the society in which the majority of the residents are on the bottom of the economic ladder without having basic citizenship rights. This may grow problematic by becoming the source of political agitation in the future.⁸³¹ Moreover, there are foreign residents forming a significant part of the UAE society who lack a status of citizenship even though many of such people have spent most of their lives in the UAE. Obviously, in case of an economic downturn, there may be demands for a change in the residency laws.⁸³²

Besides, as mentioned earlier, there seems to be more vulnerabilities or challenges to the system of government in which the monarchy itself would be the first issue with an absence of well-developed democratic institutions. Such vulnerabilities can be more intensified causing anxiety within the society particularly with the development of an educated middle-class Emirati where incomes and literacy levels rise. The Squabbling within the royal family may also lead to civil strife similar to downfalls of the mineral-rich African nations.⁸³³

Beside the immigration and the system of government, the third challenge for the UAE would be the issue of dependence on oil. Will the country be able to wean itself away from oil in view of having new and cleaner technologies that reduce the market demand for their so called "dirty oil"? Fourthly is the issue of domestic investment which would be a concern in an economy whose significant fraction is depended on the sovereign wealth funds. And finally, the infrastructure of the country would be also under question as to whether the local infrastructure can bear the strain of the neck-breaking levels of investment?

⁸³⁰ Nyarko, p. 11-12.

⁸³¹ *Ibid*, p. 12.

⁸³² *Ibid*, p. 15.

⁸³³ *Ibid*, pp. 13-14.

Accordingly, housing prices are going up while inflation is increasing; together with the depreciating US dollar they may be an additional source causing discontent among the immigrant workers.⁸³⁴

To summarize; the de facto development of the UAE has been at a political level through the hierarchy of the rulers of seven emirates that constitute the UAE and by the rules and policies that actively engage the local citizens of the country. Sovereign Wealth Funds have been a major source of accumulating the oil revenues to be invested in tourism and industry. The UAE has shown a liberal policy in using the foreign experts and skilled workers for its domestic industry along with exerting tolerance towards the importation of unskilled workers. Such strategies and policies have achieved some success partly because of the social buy-in of the native population of the UAE along with its relative peace and stability atmosphere. Besides, the country's relative pro-Western stance has brought some protection.⁸³⁵

However, there seems to be some potential challenges both within the internal political system of the UAE and in the region including possible collapse of the oil market with investment bottlenecks, etc., plus some other issues concerning the large foreign population of unskilled workers who reside in the UAE.⁸³⁶ One strategy undertaken as a solution would be granting temporary visas to the foreign labor especially skilled workers while stipulating that they have to leave the country within a certain time. In addition, guest workers reaching the age of 60 would lose their visas and are obliged to return home.⁸³⁷

There are many lessons and insights that can be learned from the UAE experience. Such lessons can be applicable in particular for oil-producing countries in Africa and other countries in the MENA region. These lessons and experiences may include: the significance of social buy-in and the importance of political stability; the use of savings for foreign investments to cushion for the future, in particular when there is locally speaking a limited absorptive capacity; also, open strategies dealing with the issue of foreign labor both skilled and unskilled.⁸³⁸ As examples, some countries such as Djibouti and Rwanda have been seeking replication through some of the UAE's development strategies and projects as lessons.

More into details the next conclusive section elaborates on the factors that have brought such success stories for the above mentioned four countries in MENA taking into account some empirical and analytical approach thus rendering lessons to that end.

⁸³⁴ Nyarko, p. 14.

⁸³⁵ *Ibid*, p. 15.

⁸³⁶ *Ibid*, p. 16.

⁸³⁷ *Ibid*, p. 15.

⁸³⁸ *Ibid*. p. 16.

9.4. Conclusion: Lessons from the Successful Countries in the MENA Region

The above sections can render insights to some overall successful development models and lessons to be learned from the MENA region. The Middle East and North Africa is a vast region with diverse group of countries that include some very poor and some very rich. From this angle of welfare, according to Imed Drine,⁸³⁹ the region can be divided into three main country-groups, with somewhat different economic structures. Accordingly, the first group includes the oil-producing countries namely; Saudi Arabia, Iran, Kuwait, UAE, Qatar, Oman, Bahrain, Libya, and Algeria, whose economies greatly depend on petroleum.

The second group has relatively more diversified economies including Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia. Indeed, these countries of the second group are more deeply integrated into the global economy. And the third group is comprised of the poor countries of the MENA region including Sudan, Yemen, Mauritania, Djibouti, Somalia, and Comoros.⁸⁴⁰ This latter group is facing some serious social and economic problems due to their inadequate social and economic structures.⁸⁴¹

Even though, the overall performance of the region has been low, there are a few countries in the region that adopted appropriate strategies in harmony with the constantly changing international environment. Among those countries, as explained throughout this chapter, we can refer to Bahrain, Oman, Tunisia, and the United Arab Emirates (UAE) that all offer incredible useful insights.

Countries in the MENA region represent a wide spectrum of welfare while they differ in respect to their natural resource endowments and economic evolution and structure. Nonetheless, they share the commonality of cultural heritage and history. The geopolitical significance of MENA has bestowed a unique position upon the region throughout the history. In fact, such position has served as the main cause for the region to become the world leading economic power for the period starting from the seventh century to the thirteenth century (See Table 9.4.A.). Although the MENA region doesn't carry that weight of leadership anymore, it still possesses the unique position as it is located at a junction between Europe, Africa, and Asia. Such locality has bestowed the largest heritage relationship to MENA in respect to all other regions of the world implying as such that the MENA region is still considered the focal point of attention in the global arena.⁸⁴²

⁸³⁹ Drine, Imed; "Successful Development Models: Lessons from the MENA Region." In *Achieving Development Success: Strategies and Lessons from the Developing World*. By Augustine K. Fosu, Oxford University Press, 2013.

⁸⁴⁰ *Ibid*, p. 1.

⁸⁴¹ *Ibid*.

⁸⁴² *Ibid*, p. 2.

Table (9.4.A.) GDP per capita from the first to the nineteenth century (1990 international Geary-Khamis US\$)

Year	1	1000	1500	1600	1820
Latin America	400	400	416	438	636
Asia	433	447	554	557	604
Africa	472	425	414	422	420
Western Europe	576	427	772	889	1,202
MENA	517	527	485	453	532

Source: Maddison (2003).

Another factor representing such a high profile for MENA would be the key economic role that it plays in the global economy. From this angle, there are two essential factors making the MENA region the main geopolitical flashpoint of the globe: Firstly, the region contains the world's major oil reserves, and second, it possesses considerable financial resources. Furthermore, some experts predict that the MENA region in the decades to come would be among the most vital areas of the world where renewable energy such as solar energy shall be exploited (Müller-Steinhagen, and Trieb 2007).⁸⁴³

After the independence era in the mid-twentieth century, some independent countries of MENA formed the region's new architecture beginning a new era. In this new era, there were serious concerns for the MENA region regarding national industry of the states which were to be geared into specific interests of their own, as well as development strategies concerning education and health systems. Moreover, during the 1970s, some post-colonial development plans were financed through natural resources to step up *the quality of life for the citizenry*. As such, the majority of the countries in MENA invested in major infrastructure projects, as well as health and education. Yet at the end of that decade the economic performance gradually began to decline.⁸⁴⁴

Nevertheless, it didn't take long that many countries of the region launched economic reforms program by

⁸⁴³ Drine, Imed; p. 3. With reference to: Müller-Steinhagen, H. and F. Trieb. "Renewable Energies in the MENA Region: Potential for Sustainable Energy Provision and Export to Europe." Oberpfaffenhofen: German Aerospace Center, DLR, Institute of Technical Thermodynamics, 2007.

⁸⁴⁴ Ibid, p. 3.

late 1980s to accord with major international institutions including the World Bank as well as the International Monetary Fund (IMF) aimed at further privatization and trade liberalization so as to improve trading capacities of the countries and to attract foreign direct investment (FDI). Such attempts in many countries of the region were fruitful improving the economic growth while making such economies more adaptable to the international environment. Nonetheless, except for few, there are still serious challenges to most of the countries' social infrastructures and on the way to the political and inevitably economic institutions within the MENA region.⁸⁴⁵

MENA's total surface area is 14.8 million km², which makes it 44 percent larger than China, or 3.8 times the size of the European Union, while it has a population of about 381 million people which constitutes about 6% of the world population (World Bank 2014). Moreover, the above total surface would be 9 percent of the world's total surface while holding 61 per cent of the world's known oil reserves plus 21 percent of its natural gas.⁸⁴⁶

This first portion of chapter (9) shed light on four countries in MENA as regional models of economic success and development. Oman, Bahrain, Tunisia, and the UAE proved their relative success as the result of establishing political stability, women's empowerment (particularly in case of Tunisia), and expanding on economic diversification of trade and production (exports). Oman, Bahrain and the UAE had better performance in terms of GDP growth in the whole region especially in view of higher share of the manufacturing sector in their GDP. Good management of the oil incomes coupled with a higher level of economic freedom were additional factors to explain such success. In case of Tunisia, despite its relatively limited natural resources, the important economic reforms undertaken by the country as prescribed by international institutions such as IMF and the World Bank helped the country to expand on its export-oriented manufacturing sector while shifting investment from non-tradable goods to tradable goods (Table 9.4.B.).⁸⁴⁷

As shown in the following Table (9.4.B.), the GDP growth in all of the four success economies have significantly increased from the first decade 1990s to the next decade (2000-8), while the share of the manufacturing sector (manufacturing value-added) particularly in Bahrain, Tunisia, and the UAE have been above the MENA average. In other words, the above four countries have been able to successfully sustain their GDP growth for the two decades despite the high volatility of oil income. As indicated, political stability, good management and equitable distribution of oil incomes, along with proper social

⁸⁴⁵ Drine, lmed, p. 3.

⁸⁴⁶ Ibid.

⁸⁴⁷ Ibid, pp. 5-6.

Table (9.4.B.) Measures of Economic Development

	GDP Growth (1990-99)	GDP growth (2000-08)	Manufacturing, value added (% of GDP) (2000-08)
Bahrain	3.87	6.48	19.05
Oman	2.79	5.36	8.29
Tunisia	2.16	4.85	17.72
United Arab Emirates (UAE)	5.13	6.75	13.06
Middle East & North Africa (MENA)	1.84	4.74	12.01

Source: World Bank (2009).

policy (i.e. in Tunisia) and diversification have played the key role in bringing their success.⁸⁴⁸

Also, the following Table (9.4.C.) shows that the above four successful countries have recorded higher changes (between 1980-2005) on human development (above the MENA average) while having better performance on their GDP per capita. Such a successful performance is in fact the result of their social policies as well as governance effectiveness aimed at reducing inequality and improving social cohesion.⁸⁴⁹ This Table (9.4.C.) in fact illustrates the positive results in changes of both GDP per capita as well as in Human Development Index for the period 1980-2005. In other words, for each of the four countries, it gives the total amount accumulated resulting in positive changes on GDP per capita while having positive changes as well on HDI Index for the above period.

Overall, despite all such success that has been achieved in terms of human development and economic stability, the MENA region in general, including these four countries; are facing some challenges. These challenges briefly include:

- 1- Heavy reliance on foreign markets and the lack of ability to create and adopt new technologies, knowledge, and innovation as the main drivers of economic growth;
- 2- Having high unemployment rates, and;
- 3- Having weak institutions and political deficiencies.⁸⁵⁰

⁸⁴⁸ Drine, pp. 5-6.

⁸⁴⁹ Ibid, p. 8.

⁸⁵⁰ Ibid, pp. 8, 9, 10.

Table (9.4.C.) GDP per capita and Human Development

	GDP per capita changes in US\$ (1980-2005)	HDI changes (1980-2005)
Bahrain	9,645	+ 0.178
Oman	6,768	+ 0.267
Tunisia	1,519	+ 0.214
United Arab Emirates	3,344	+ 0.167
MENA	1,556	+ 0.166

Source: World Bank (various years) and UNDP (2010).

Using a cross-section data through a regression analysis, the relationship has been examined between per capita GDP and human development index in high, medium and low human development countries.⁸⁵¹ Interestingly, the human development index shows the highest sensitivity to changes in per capita GDP in case of low human development countries. This is while an “inverted U” type relationship between these two variables (HDI and per capita GDP) seems valid for medium human development countries.⁸⁵² In a simple term, compared to the low human development group, the *rank correlation* between the two variables is proved to be higher in high and medium human development countries. However, regression results show that the HDI is most sensitive in respect to per capita GDP in low development countries.

Among the above-mentioned challenges, the third challenge is particularly important for which the governments should establish proper economic and political institutions through ameliorating the investment climate, strengthening the rule of law, while combating corruption. A new social contract coupled with political will, can make better governance possible. Accordingly, the private sector should be encouraged to improve youth employment while developing the financial sector, which together can increase economic efficiency.⁸⁵³ Moreover, unlike the past experiences, complete reforms can take shape within the framework of the new social contract with better participatory quality. In other words, top-down policies in the hands of the ruling elites and foreign technocrats need to be abolished as they have mainly contributed to a sense of disconnectedness between the reformers and society at large (Nadgrodkiewicz 2008).⁸⁵⁴

⁸⁵¹ Islam, Sadequl. “The Human Development Index and Per Capita GDP.” *Applied Economics Letters*, Vol. 2, 1995.

⁸⁵² *Ibid*, Abstract.

⁸⁵³ *Ibid*. p. 11.

⁸⁵⁴ Nadgrodkiewicz, A. “The Challenge of Economic Reform in the Middle East and North Africa.” CIPE Report. Washington, DC: Center for International Private Enterprise, 2008.

In brief, alongside the implementation of effective reforms; good management of oil income while achieving political stability ought to be learned as the big lessons from the above four success stories. What they suggest is the fact that such successes could not be materialized without economic freedom, political stability, as well as a balanced model of development with effective social policy where a social contract can be defined through relatively egalitarian distribution of wealth and inclusive accessibility of good public services. And to reach that end that is to achieve a proper social contract, political reforms play the key role for sustainability of development processes in the countries of the MENA region.⁸⁵⁵

In fact, findings from World Resources Institute confirm that most countries in MENA suffer from political instability and bad governance which are deemed to be the result of their inefficient human and institutional development. Accordingly, the region is considered to be below the world level in respect to political instability and government effectiveness. When it comes to corruption, the majority of the countries in MENA rank poorly. It is worth mentioning however, that the Corruption Perceptions Index has consistently ranked Bahrain, Oman, Tunisia, and the UAE much above the region's median.⁸⁵⁶ Similarly the overall Government Effectiveness Index in case of these four successful countries confirms to be above the MENA average (See Table 9.4.D. next page).

Figure 9.4. MENA including Mashreq & Maghreb Sub-regions in the North & West of the GCC



⁸⁵⁵ Drine, lmed; p. 11.

⁸⁵⁶ Ibid, p. 8.

Table (9.4.D.) Human and Institutional Development in MENA Countries

	Life expectancy at birth, females (2000-05)	Literacy rate, all adults (2007)	Corruption perceptions index¹ (Transparency International) (2006)	Government effectiveness index² (2007)	Political stability and absence of violence index³ (2007)
Algeria	72.2	75.4	3.1	-0.52	-1.18
Bahrain	76.5	88.8	5.7	0.41	-0.28
Comoros	65.1	75.1		-1.8	-0.4
Djibouti	54.9			-0.98	-0.05
Egypt	72	66.4	3.3	-0.44	-0.77
Jordan	73.1	91	5.3	0.27	-0.29
Kuwait	79.2	94.5	4.8	0.2	0.4
Lebanon	73.2	89.6	3.6	-0.61	-2.09
Libya	75.7	86.8	2.7	-1.07	0.47
Mauritania	64	55.8	3.1	-0.68	-0.33
Morocco	71.8	55.6	3.2	-0.07	-0.52
Oman	75.9	84.4	5.4	0.38	0.76
Qatar	75.3	93.1	6	0.06	0.81
Saudi Arabia	74	85	3.3	-0.18	-0.59
Sudan	57.8	60.9	2	-1.18	-2.3
Syria	74.9	83.1	2.9	-0.88	-0.61
Tunisia	75.1	77.7	4.6	0.46	0.1
UAE	80.5	90	6.2	0.86	0.76
Yemen	61.8	58.9	2.6	-1.02	-1.48
MENA	73.2	83.75	3.3	-0.44	-0.77

Notes: ¹ Units, 10 = least corrupt, 0 = most corrupt;

² Units: -2.5 worst governance, 0 average, 2.5 best governance;

³ Units: -2.5 worst governance, 0 average, 2.5 best governance

9.5. Patterns of Economic Failure

As we learn from the experiences of successful nations some of which were presented above, beyond the regional boundaries, in a global context, there are also countries that can render lessons as the result of their governments taking a wrong path away from a desirable development through their failed policies and strategies. This section turns to some examples of this kind while trying to find some common threads as to the patterns of failed economies.

9.5.1. The Case of Iran

During the Pahlavi dynasty that ruled Iran from 1925 to 1979, the country was drastically transformed from a small agrarian economy into a booming one having significant developments in both manufacturing as well as oil production.⁸⁵⁷ After the Islamic revolution, however, Iran's economy never got a proper shape even though different attempts were done at different stages. For example in 1990s, the country's leaders tried some privatization having many assets end up either with the Islamic Revolutionary Guard Corps (IRGC) the so called *Sepah* as one of the most powerful economic actors in the country, or with religious charities.⁸⁵⁸ Accordingly, the extremist and populist stance of Mahmoud Ahmadinejad finally brought the kinds of policies which devastated Iran's economy by fueling inflation just as the sanctions began simultaneously.

Under the current situation where the country has been experiencing some sporadic strikes at different levels of educational and trade union sectors along with wide-spread protests in different cities, Reza Pahlavi, the Crown Prince and the eldest son of the late Shah of Iran, Mohammad Reza Pahlavi, has become relatively more active on the political scene while Iran is witnessing tremendous pressures particularly on the political and economic fronts due to the failure of negotiations on the modality of Iranian nuclear program followed by deep US-led economic sanctions on Iran.

Since it is perceived by the majority of the Iranians that Reza Pahlavi as an exile-based opposition is mainly being supported by the U.S., this has perhaps given the upper hand to the Islamic regime's propaganda to grasp the majority views of the Iranian population thus warning for such transformation. Iranian people have unpleasant historical memories from the intrusion of the three powers (the USA, the UK, and the former USSR) that occupied Iran during the World War (II) despite the fact that the country

⁸⁵⁷ Noueihed, Lin. "Iran's economy." Bloomberg. 6 August 2018.

⁸⁵⁸ Ibid, (The Background).

had proclaimed neutrality status in the war; to the toppling of the democratically elected Prime Minister Mohammad Mossadegh in 1953; two main incidents having direct involvement of the US government.

After the revolution of 1979, it is perhaps fair to say that Iran's economy has been wrecked by revolution, war, as well as conflicting ideologies. During 1980s and 1990s when President Rafsanjani along with so called "the pragmatists" realized the country needs to increase the domestic production, they tried to expand the size of the economy mainly through an increase in the oil production and export. In fact, Iran's economy has been zigzagging from one policy to another since the Khomeini decade that established the so called religious institutions for the elites to have direct hands in all factors of economy and politics.⁸⁵⁹

From the ancient civilization era marked by the glory of Persia to the present day modern Iran, the country has been the rivalry field between the East and the West. The Persian Empire was formed and developed mainly by four dynasties that reigned before the invasion of Islam namely the Achaemenian, Seleucid, Parthian, and Sassanian with their glorious days experiencing historical successes and failures. Nonetheless, the themes of governance and culture from that era are still relevant today as they were in the ancient past.⁸⁶⁰

Accordingly, Zoroastrianism as the religion and philosophy of the ancient Iran had the driving influence on the moral and material life of the Iranians along with their kings. The faith of Zoroastrianism takes into account the three commands of *Good Thoughts, Good Words, Good Deeds* in its pivotal vision and teaches one God (Ahura Mazda) instead of many; a God who is just and beneficent rather than a God of vengeance, and a common moral code for all to live by, that is based on truth, immortality and final judgement.⁸⁶¹ Hence, it may be said that the faith of Zoroastrianism has profoundly influenced Judaism, Christianity and Islam.⁸⁶²

Prophet Zoroaster (also known as Zarathustra) was born sometime between the tenth and seventh centuries B.C. and as such, the faith of Zoroastrianism had already taken its historical roots at the time when Cyrus the Great, the founder of the Persian Empire, was born. Thus, coinciding two great figures, the first a religious figure, and the second the greatest political-military genius both occupied the cradle of the Iranian nation in the same era. In Zoroastrianism, social justice plays the pivotal role on the belief that the battle between good and evil is ultimately for the betterment of society thus carrying a powerful

⁸⁵⁹ Mackey, Sandra. "The Iranians: Persia, Islam, and the Soul of a Nation." A Dutton Book, Penguin Publishing, 1996, p. 359.

⁸⁶⁰ *Ibid.* p. 14.

⁸⁶¹ *Ibid.*, pp. 15-16.

⁸⁶² *Ibid.*, p. 17.

message that the religion is not only spiritual but also political. As such, the creations of both Zoroaster and Cyrus practically blended with one having religious nature while the other political.⁸⁶³ Nevertheless, it is fair to say that such blend didn't leave the slightest means of force upon other conquered nations to follow such beliefs. On the contrary, they were left with liberty to choose their faith in accordance with their will and creed. "Zoroaster gave Cyrus's earthly realm a soul and Cyrus gave Zoroastrianism a body."⁸⁶⁴ Centuries later, with the invasion of Islam, the faith of Mohammad crossed the borders of Iran thus falling under the influence of Persian culture. Accordingly, it was in fact the Persian culture that led the Islamic Empire into its golden age encompassing the eighth through the tenth centuries.⁸⁶⁵

Such glory of Persia was being reminded during the reigns of Pahlavi(s) amid the political upheavals and challenges that existed both in the domestic sphere of Iran as well as the regional and global rivalries. Interestingly, during the Iranian Constitutional Revolution, the rivalry or adversaries between Britain and Russia turned these two countries into allies as the German plan to build a railroad across the Middle East to the Persian Gulf was deemed a threat to India according to Britain, while Russia was still grappled with the aftermath of its losing war on Japan, its Asian rival.⁸⁶⁶ Despite the Anglo-Russian Agreement of 1907 that was merely paying lip service to Iran's independence and territorial integrity, the two powers divided the country into British-Russian spheres of interest. As the result, Britain took the South; Russian took the North, thus leaving Iran with the neutral zone in the middle that included Tehran.⁸⁶⁷

According to Sandra Mackey, although Reza Shah and his Son, Mohammad Reza (Pahlavi Dynasty) accomplished much for Iran following the reigns of Qajar dynasty, they lost touch with the Shia aspects of Iranian culture and accordingly failed to bring about the just rule. She believes that the *farr* (splendor) of Reza Shah lived only in his *nationalism*. Whereas his son's mistake was the establishment of the absolute rule coupled with cultural alienation even though their strategy even failed to secure the nation against foreigners.⁸⁶⁸

However, according to the Shah of Iran,⁸⁶⁹ despite the turmoil and chaos that had struck the world including the Middle East as the consequence of the World War, their dynasty could victoriously transform Iran into a modern age opening the gates towards the great civilization. He believed that the

⁸⁶³ Mackey, pp. 15-16-17.

⁸⁶⁴ *Ibid*, p. 17.

⁸⁶⁵ *Ibid*, p. 41.

⁸⁶⁶ *Ibid*, p. 161.

⁸⁶⁷ *Ibid*.

⁸⁶⁸ *Ibid*, p. 186.

⁸⁶⁹ Pahlavi, Mohammad Reza (Shah); translated from his book "Answer to History," 1980.

Americans had the intention to topple him from power since 1974. He asserted in his book *Answer to History* that his policies in respect to the oil prices had worried the big oil companies, and the west had become apprehensive concerning his ambition in breaking the status quo that they had imposed upon Iran. He goes on to say that the more victorious he was becoming on such policy, the more anxious the westerners became with mounted animosity towards his regime in particular when he decided to increase the price of oil in early 1970s. To the Shah of Iran, the 1979 revolution was a way for the west to revenge on him and his country as he believed such revenge severely took place by the help of the most fanatic, back-warded, and regressive segment of the Iranian society.

Soon after the revolution, President Ronald Reagan in his campaign for presidency defended the late Shah of Iran and called it “a blot on our record,” as the United States did not try to keep him from being overthrown. According to him, the Shah was a “stalwart ally” who was not that far out of line with his people and who also carried the US load in the Middle East for quite some time;⁸⁷⁰ thus criticizing the Carter administration for leaving such a blot on the American record.

This was not the first occasion for the Americans to confess their undercutting or betrayal plan. The nationalist and secular movement of Mohammad Mossadeq’s government, the democratically elected Prime Minister to the Shah of Iran, was also undercut by the Anglo-American coup in 1953. Mossadeq was a lawyer trying to define the oil reserves of the country towards the benefit and welfare of the Iranian people by nationalizing the oil industry. Hence, he put tremendous efforts on his national policies in a voice quivering with passion between 1951 and 1953 during the intellectual heirs of the Constitutional Revolution seeking to reconcile national independence with that of constitutional monarchy.⁸⁷¹

Overall, in the course of the Iranian history, the attempts to fuse the transcendentalism of religion and the realism of politics have not been achieved either in ancient Persia or in Shia Islam under the first four Caliphs. There has been a deep and perpetual tension between the transcendental and the mundane, as well as the spiritual and secular nature of religion and politics which has covered a great portion of Iranian history and society.⁸⁷² Although the Iranian Revolution in 1979 had a propelling movement based on “ideology,” after four decades of the full imposition of a governance based on Velayat-e Faqih (The Rule of the religious Jurisprudent), as the boldest attempt to subject all the economic, political, social and

⁸⁷⁰<https://www.upi.com/Archives/1984/10/21/President-Reagan-defended-the-late-shah-of-Iran-Sunday/9049467179200/>

⁸⁷¹ Mackey, p. 187.

⁸⁷² Ibid, p. 378.

cultural aspects of the society to the transcendental ideal to be the “government of God,”⁸⁷³ the Islamic regime has not been able to even secure or preserve the most fundamental values of the society that well existed before such revolution.

According to Mackey, neither the Shah nor the Ayatollahs have been able to devise the kind of government that could be capable of meeting the demands, needs and yearnings of the people. As the result, the Pahlavi dynasty that attempted to construct a country defined by Persia and kingship is gone. In the meantime, Khomeini’s Iran based on Islam and political clerics has been surviving within the grip of menacing economic, social, cultural, and political tensions⁸⁷⁴ leaving no legacy but an absolutely failed quest for justice.

Soon after the victory of 1979 Revolution, Iran under the Islamic Republic defined its foreign policy based on the motto originated in the time of Muhammad Mossadeq as so called *Neither the East, Nor the West*. Nonetheless, four decades after that principal claim, Iran finds itself obliged both politically and economically leaning towards the eastern powers including Russia and China.

Fairly to speak, the Shah’s idea for the “Island of Stability” had been well established before the 1979 revolt with a prominent insight along with development plans that could define a well-position as well as a constructive role for Iran to play not only in a regional context but also at a global development level in both realms of economy and politics. However, with the emergence of the so-called Islamic Revolution following the 1970s oil crisis, things drastically changed not only for Iran, but also creating a destabilizing situation and a quagmire that affected the whole region along with its consequences upon the rest of the world.

9.5.1.1. Iran’s Economy, and the Sanctions

Iran’s economy has been squeezed for a decade by the U.S. and other major allies in forcing the country to rein in its nuclear program.⁸⁷⁵ Indeed Iran’s nuclear capabilities have been the core-part of global discussion for the last two decades. Although the Iranian leaders have long insisted on the position that the country is not pursuing nuclear weapons and is merely looking to use the energy for “peaceful

⁸⁷³ Mackey, p. 379.

⁸⁷⁴ Ibid, p. 380.

⁸⁷⁵ Noueihed, Lin. “Iran’s Economy.” Bloomberg, August 6, 2018. Available at: <https://www.bloomberg.com/quicktake/irans-economy>

purposes,” its uranium enrichment along with a long history of deception have created mistrust.⁸⁷⁶ Nonetheless, Iran could reach an agreement with the six global powers (5+1) in 2013 called the Joint Plan of Action also known as the Geneva interim agreement which eventually led to an April 2015 framework agreement followed by a final agreement in July 2015 called the Joint Comprehensive Plan of Action (JCPOA).

According to Noueihed, the above process of agreement created an opportunity for Iran to recover as the deal creates aperture for the country for relief from heavy economic sanctions that have crippled its oil exports diminishing its economy. On 8th May 2018, the new US President Donald Trump announced that he was withdrawing the United States from the agreement calling it “worst deal ever.” Under the agreement which was signed between Iran and the U.S., China, France, Russia, Germany, the UK, and the European Union (5+1); Iran is allowed to maintain its ability to enrich uranium for peaceful purposes while retaining about 5000 centrifuges capable of separating the uranium-235 isotope from uranium ore.⁸⁷⁷ Accordingly, Middle East powers including Israel and Saudi Arabia have been strongly criticizing the agreement, believing that it would empower the theocratic regime in Tehran to the detriment of regional security.

Upon Trump’s decision to withdraw from the deal in mid-2018, a new wave of sanctions were imposed in stages, which had previously been suspended, more tightening the Iranian oil exports as the backbone of its economy. The fact is that the country had almost risen out of recession as the result of the nuclear agreement regaining its economic growth mainly from oil exports which surged as sanctions were eased. In addition to the imposition of the above sanctions, the U.S. sanctions on the financial sectors of Iran including the majority of its banks have never been lifted making it hard for foreign companies to do any business in Iran. Accordingly, the investment climate and the economic situation of the country in general are worsened as the result of the re-imposed U.S. sanctions while punishing multinationals doing business in Iran.⁸⁷⁸

From January 2018 the United States prescribed two stages of the 90-day wind-down periods, the first finished in August 6, 2018 thus having President Trump issue Executive Order 13846 (E.O.) of August 6, 2018, “Re-imposing Certain Sanctions With Respect to Iran” which in fact re-imposes relevant provisions of five Iran sanctions E.O.s that were revoked or amended by E.O. 13716 of January 16, 2016. The

⁸⁷⁶ Tirone, Jonathan. “Iran’s Nuclear Program.” Bloomberg, May 8, 2018. Retrieved from: <https://www.bloomberg.com/quicktake/irans-uranium-enrichment>

⁸⁷⁷ Ibid.

⁸⁷⁸ Noueihed, Lin (Bloomberg): <https://www.bloomberg.com/quicktake/irans-economy>

second wind-down period or the 180-day in fact ended in November 4th 2018 starting a new wave of effective sanctions targeting the Iranian oil exports.⁸⁷⁹ It is noteworthy that Iran experienced a similar “wind-down” during 2012-2015 on the same issue of nuclear program resulting in having Iran’s economy shrunk by 9% per year, while having crude oil exports fall from about 2.5 million barrels per day (mbd) to about 1.1 mbd. Under the circumstance, Iran could not repatriate more than \$120 billion in Iranian reserves held in banks abroad.⁸⁸⁰

The UN Security Council Resolution 2231 also maintain the nonbinding U.N. restrictions on Iran’s development of nuclear-capable ballistic missiles while having a binding ban on its importation or exportation of arms for years to come. Nonetheless, Iran continues to import or export such arms supporting regional armed conflicts. This has been the strong trend of the country even during the international economic sanctions that took place for the period 2010-2015.

The re-imposition of the above sanctions while having foreign companies leave Iran so as to avert being penalized, have worsen the economic situation of the country so far. The decreases in Oil export and devaluation of the Iranian currency (Rial) are obviously evident. However, it is uncertain how far Iran’s economy would be damaged; could it go as far as the damages of the years 2010-2015 or even get worse? Such uncertainty is mainly the result of the European Union and other countries’ decisions by which they opposed the U.S. exit from the JCPOA merely to keep the economic benefits of the JCPOA flowing to Iran. If the European and other major trading partners would be unable to avert the heavy burden of the re-imposed U.S. sanction, it would create an opportunity for Iran to cease participating in the JCPOA.⁸⁸¹

Other signatories to the JCPOA that are Britain, France, Germany along with Russia and China seem to be lenient in supporting Iran’s economy in view of supporting the moderate government of Rouhani. An analogy suggests that if Iran integrates more into the global economy, this would create an incentive for the country to more abide by international norms including the nuclear agreement. But skeptics believe that an Iran with stronger economy under the current regime would be even more dangerous, as it can better support for example the Syrian regime under Bashar-al-Assad as well as militant groups like that of Hezbollah, Yemen’s Houthi rebels or Iraq’s Shiite Muslim militias.⁸⁸²

⁸⁷⁹ Department of the Treasury (U.S.); “Iran Sanctions.” Resource Center, Available at: <https://www.treasury.gov/resource-center/sanctions/Programs/pages/iran.aspx>

⁸⁸⁰ Congressional Research Service; “Iran Sanctions.” September 26, 2018; Summary: <https://fas.org/sgp/crs/mideast/RS20871.pdf>

⁸⁸¹ Ibid.

⁸⁸² Noueihed, Lin. “Iran’s economy.” Bloomberg, August 6, 2018.

The fact is that apart from the sanctions which has undoubtedly imposed heavy burden on economies such as Iran's with significant impacts, Iran's economy is also suffering from its domestic mismanagement along with its deficient political institutions. Nevertheless, according to a report based on 2016 GDP estimates, and 2017-2019 growth projections from the World Bank; Iran's economy has overall proved to be considered a strong economy in particular within the regional context in MENA. In accordance with the above-mentioned sources; Iran, despite all such burdens as described due to the political upheavals, is still marked among the first 16 major countries where the global growth is happening.⁸⁸³

Accordingly, China is well on the top of the contribution to the global economy with growth estimated somewhat 6.5% percent for 2017 and 6.3% in both 2018 and 2019. Interestingly, about 35.2% of global GDP growth will come from China during this period making the country's economic output \$2.3 trillion higher.⁸⁸⁴ In accordance with the above-mentioned source (IMF and the World Bank); overall, the following countries contribute as much as 1% or more to global growth: South Korea (2.0%), Australia (1.8%), Canada (1.7%), UK (1.6%), Japan (1.5%), Brazil (1.2%), Turkey (1.2%), Mexico (1.2%), Russia (1.0%), and Iran (1.0%).⁸⁸⁵

Hence, beyond any regional cooperation, Iran, as a major regional power, possesses an economic capacity with enormous potentials. However, the question is how far such great potential has been managed away from oil dependency. And what strategies should be taken by the government to actualize such an economic potential for the betterment of the country, its people, and eventually the region?

Interesting to note that even before the US turnabout, the nuclear deal was not able to deliver the return that Iranians hoped for; let alone more sanctions have been imposed. Depreciating the Iranian Rial forced the Iranian Central Bank to impose some capital controls while businesses and individuals were being panicked as the result of the unclear situation. Moreover, such depreciation caused great inflation adding to public anxiety.⁸⁸⁶ This is while the lack of access to finance has been problematic for many businesses thus creating a secondary "under table" black market to transfer money. The situation looks like an economic war in which the ordinary people have to endure the great burden. Foreign investment climate would thus change for worse despite "Rouhani's rosy projections," affecting as such the main sectors like the oil and gas and the manufacturing in particular.

⁸⁸³ Desjardins, Jeff. "Chart: Where is Global Growth Happening?" Visual Capitalist, June 2017. Available at: <http://www.visualcapitalist.com/chart-global-growth-happening>

⁸⁸⁴ Ibid.

⁸⁸⁵ Ibid.

⁸⁸⁶ Noueihed, Lin. "Iran's economy." Bloomberg. 6 August 2018.

Following the Iranian student protests of July 1999, and 2009 Iranian presidential election protests; during the last days of 2017, some social unrest and anti-government protests took place out of the economic grievances in which at least 21 people died. Ever since, there have been some sporadic demonstrations in different cities in Iran coupled with trade union's strikes. More recently, one of the deadliest wide-spread protests took place in November 2019 as triggered by 2-3 times raising of petrol prices overnight. Nikki Haley, the former U.S. Ambassador to the U.N. previously said that Iran's economy increasingly is financing for the suppression of its own people while supporting the conflicts and wars outside its borders. According to her; this is in fact what infuriates the Iranian people against the government.

9.5.1.2. Iran and the alarming Venezuelan model

In early January 2018, Steve Hanke⁸⁸⁷ measured Iran's annual inflation rate which was about 78% being its "implied annual inflation rate." By implied annual inflation he means the actual rate of inflation in the market which is not announced publicly, but instead they announce some official annual inflation rate. At the time of such published data, the value of US dollar in the Iranian market was calculated at 39000 Iranian Rials.

In the second measurement by Hanke in June 2018, after a swift fluctuation of the US dollar and the Iranian Rial where the US dollar was less than 100.000 Rials, the inflation rate hit the level of 210%, and in September 2018 it hit another all-time high reaching (244%). According to Hanke, the implied annual inflation rate at that time (9/4/18) could reach 268% (See Figure 9.5.1.3).

At the present time, the depreciation of national currency in Iran has gone through two big fluctuating waves of increases; first to something around 150.000 Rials and even close to 200.000 Rials for each dollar. It is noteworthy that the value of a US dollar before the Islamic Revolution of 1979 was a fixed rate of 70 Rials for each dollar. According to Reza Taghizadeh, the 30% decrease on the value of the national currency in less than five days, resembles the economic and banking situation of Iran to that of the Venezuela's pattern.⁸⁸⁸

Reza Taghizadeh a political analyst, and a professor at the University of Glasgow, is of the belief that the

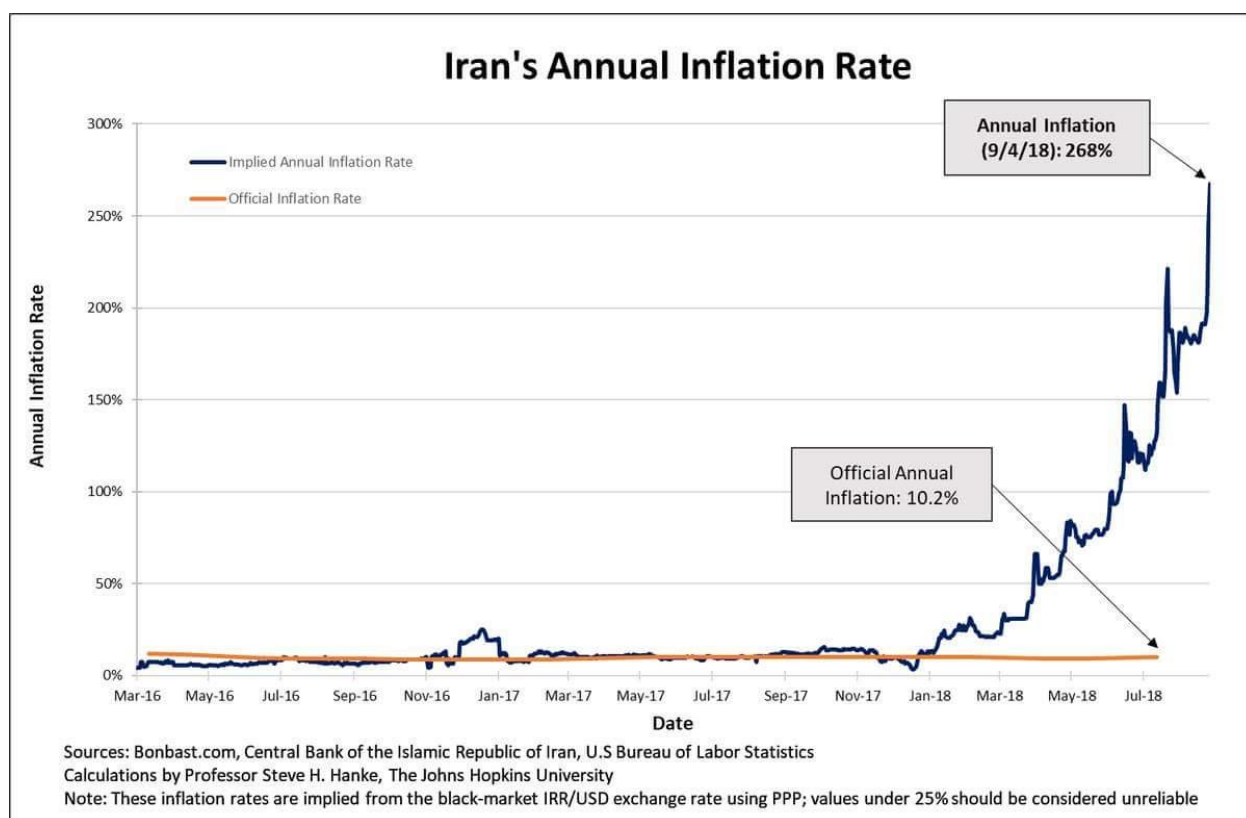
⁸⁸⁷ Professor of Economics at John Hopkins University.

⁸⁸⁸ Taghizadeh, Reza. "Iranian economy following a Venezuelan Pattern as the inflation rate surpassed 240 percent.": درصد ۲۴۰ و نزولایی شدن اقتصاد ایران با عبور تورم از مرز ۲۴۰ درصد Retrieved from: <https://iranintl.com/%D9%86%D9%88%DB%8C%D8%B3%D9%86%D8%AF%DA%AF%D8%A7%D9%86/%D8%B1%D8%B6%D8%A7-%D8%AA%D9%82%DB%8C%E2%80%8C%D8%B2%D8%A7%D8%AF%D9%87>

continuation of such pattern can have devastating consequences for the Iranian economy. His assertion is based on the fact that Venezuela experienced a harsh economy under Hugo Chavez who irregularly increased the salaries and financial assistance in the country, basically increasing the Venezuela's foreign debts with a significant decrease in production. Same strategy is being followed so far by his successor Nicolas Maduro through the policy that rejects any political dissent and oppositions which would all create a "two-poles" society within Venezuela while diminishing its economy. The political stand-off between Venezuela and the west following its election of 2019 is an obvious example approving such disparity within the Venezuelan society.

Venezuela is a country with immense natural resources including gold and diamonds while having also 297 million barrels of crude oil reserves, twice of that of Iran's, making the country possess the largest oil reserves in the world. As such, Venezuela's oil revenues exceed that of Iran's, as for example, it reached 62 billion dollars for the last year. Nonetheless, its exclusive public sector economy has made Venezuela's economy 179th country in terms of economic openness dropping it to the last row among the 32 Latin American countries. Moreover, Venezuela has a population of about 30 million people (35% of Iran's population) while spreading 2.5 million Venezuelan refugees to his neighboring countries that had

Figure 9.5.1.3. Iran's Annual Inflation Rate



to ease their border regulations to help such people among whom many have been in desperate need of food and medicine. Also, it is noteworthy that “Bolivar” the national currency of Venezuela has lost its value as much as 99.99 percent in the past few years, to mention its value soared from 3500 units for each dollar to the amount of 108000 units for each US dollar during 2016-2017. The inflation rate for 2015 was 111% in Venezuela which was increased to 254% in 2016 and with a progressive increase reached the level of 1078% in 2017.⁸⁸⁹ For the year 2018, the inflation rate in Venezuela started from 13000% and it was estimated that it would be reaching 1000.000% by the end of the year!

The above situation in Venezuela would simply lead to the collapse of the economy in the country making the income level uncountable under the current circumstances. According to Taghizadeh, Venezuelan phenomenon is not just something peculiar to the current situation in the Iranian economy destroying the country’s national currency and destroying the wealth of a nation, but there are five other examples that stand on the first line of economic failure. These include the “Southern Sudan, Zimbabwe, Somalia, Uzbekistan, and Sierra Leon.” The common axis among such countries like that of Iran, is that they are put in the inclusion of the US economic sanctions while going through economic punishments as prescribed by the UN resolutions, an effective instrument what Mahmoud Ahmadi-Nejad called the “scrap papers!”⁸⁹⁰

To elaborate on the national currency depreciation; the South Sudan, for instance, has lost 75% the value of its “pound” vis-à-vis the US dollar and proportionately in front of the main world currencies. Another example would be Zimbabwe, the country that lost the value of its “dollar” as its currency vis-à-vis US dollar during 2015 after toppling Robert Mugabe’s regime which lasted 37 years in power. Thus, the value of Zimbabwe’s currency reached in that year to 35 trillion units for each US dollar urging the government of Zimbabwe to print the bank note thus having 100 trillion Zimbabwean dollar for each note. National currencies of the other three countries that are Somali “Shilling”, Uzbekistan “Som”, Sierra Leon “Leon” are currently suffering as the result of having Venezuelan disease while, for example, the people in these countries have to even carry their money in the gunny bag or briefcases!

Beside the above-mentioned countries that are in the front-line of economic collapse similar to Venezuela and Iran, Turkey and Russia are also facing economic hardship while depreciating their national currencies as the result of the US sanctions against their economies. However, the difference in the cases of Russia and Turkey is that they have been able to maintain their export and production levels.

⁸⁸⁹ Taghizadeh.

⁸⁹⁰ Ibid.

Reza Taghizadeh is also of the belief that, the case of Iran similar to that of Venezuela could force the country towards an economic crisis (or even total collapse). And falling on such a path of crisis; even taking more flexible measures such as acceptance of FATF (Financial Action Task Force on Money Laundering) in the Iranian parliament in spite of the will of its Supreme Leader, or emancipation of currency exchange transactions by creating the “secondary market” for such purpose, or merely nominal battle with corruption would not be able to save the country’s economy from the upcoming crisis.⁸⁹¹ His conclusion states that; in fact Iran’s crisis has gone out of economic framework entering a political phase, thus demanding a solution of the kind. Perhaps the bloody repression of the wide-spread protests across the country that took place in November 2019 upon the government’s decision to sharply raise the petrol prices (200-300% overnight) would be another instance reaffirming the above claim.

9.5.1.3. Iran and the Middle East

To summarize and conclude; during the Pahlavi dynasty and before the emergence of the Islamic Revolution in 1979, Iran was making tremendous efforts to establish a noble and constructive role for itself in the regional as well as global domain. In that era, a splendor attempt was being exercised to establish a reasonable sense of nationalism with the true identity marked by the historical glory of Persia, while grasping stabilizing strategies in a regional sense.

During the reign of the last Shah of Iran, the country’s modernization and development plans continued to positively define a noble role and a constructive position for Iran over the regional issues as well as the global matters. Accordingly, the Shah’s goals and ideas could effectively contribute to the regional stability while placing the national economy among the top technological nations at a global level. His policies and ideas over the OPEC may be considered an example for materializing effective regionalism.

However, having followed an infernal war of attrition with Iraq (1980-88) along with different stages of imposed sanctions on Iran to this day, the revolution has brought not much for the country but a wrecked economy filled with serious social problems accompanied with high levels of poverty and corruption while having merely established the failed quest for justice. As the result, the kind of nationalism whose vitality could guarantee and protect the national interests of the country was sacrificed, demolished, and rather replaced with some Islamic ideological aspirations and dogmatic idealism that practically lead to the emergence of terrorism, extremism, and insecurity in particular within the region and beyond.

⁸⁹¹ Ibid (from the same article by Taghizadeh), 6th September 2018.

Hence, the role of Iran under the Islamic Republic along with its regional rivals degraded to mainly enflaming the sectarian tensions and conflicts while fueling proxy wars thus destabilizing the entire region. The case of Iran today certainly demands a drastic change of policy and strategy in its both national as well as regional frameworks. For a country as propounded, influential and powerful as a regional⁸⁹² and global player like Iran, such a shift of policy and practice needs to go beyond the reconstruction of its economy embracing its political agenda. In such a circumstance, I propose, the momentum can be gained as an opportunity for the country to embark on a wide-scale project of institutional change in developing new economic and political institutions hand in hand.

In the present days under the so called ‘maximum pressure’ campaign on Iran, to render a solution; whether to attain a change in the Islamic regime’s behavior (if at all feasible), or the complete regime change policy... and, whether a trend of republicanism or a constitutional monarchy; what matters the most is that *Democracy, Inclusiveness, and the Rule of Law* ought to be envisaged in view of establishing national and regional institutions.

Under such banner then, a dynamic economy away from oil dependency can be successfully structured as characterized by an adaptable degree of diversification. In that case, petroleum and natural resource endowment in such economies would be considered as the wealth of their nations instead of playing the role of the curse in the hands of the extractive institutions.

The above agenda should be viewed as the main goal to achieve not only for the Iranian people but for all other nations across the Middle East and North Africa region. In other words, in fact a new social contract along with a new set of inclusive economic and political institutions should emerge and be based in the region, whose fundamental theory and purpose were previously conveyed in the opening Chapters.

Only with such a prospect, historical glories and rich cultural values attributable to Iran and the Middle East (MENA) can be revived and flourished within the national and regional spheres. And as such, the MENA region can effectively contribute towards the process of global development as well. Certainly the educated diaspora and opposition groups may play a role in delivering the above objective so as to achieve a successful transformation. Reza Shah transformed Iran from the Qajar inefficiency by introducing all-encompassing institutions of modernity. Such a move is needed to dislodge the system on the path to sustainable development and the rule of law defining a new role for Iran and the Middle East.

⁸⁹² “*Iran’s Networks of Influence in the Middle East*” is a major research dossier (2019) by the International Institute for Strategic Studies (IISS), a global think-tank. Through this 18-month long study involving field work, interviews and open source analysis; Iran, ahead of its rivals, is projected as the most influential country in the Middle East.

9.5.2. The Countries Inflicted with War and Conflict; Cases of Syria, Yemen, Iraq, and Libya

9.5.2.1. Syria

The Syrian economy is based on services, agriculture, oil and industry. Its economy was doing relatively well before the break of the civil war in 2011 and it was on its way to thrive. Syria's GDP increased from 21.83 USD billion in 2003 to 59.15 USD billion in 2010.⁸⁹³ Syria's per capita GDP was 4058 US Dollars in 2010. Negative impact of the crisis and the civil war continue its burden on the economy of Syria, so as to take a heavy toll on the life of its people while devastating its economy. The displacement of the people as the result has been huge as for example more than 6.1 million people, including 2.5 million children, are internally displaced with a flood of 5.6 million officially registered refugees.⁸⁹⁴

Unfortunately, the social impact of the civil war is huge while affecting the health care and education, housing and food pushing many people into poverty and unemployment. This crisis has negatively affected Syria's external balances as the result of the disruptions of trade thus causing a rapid depletion of country's international reserves. The World Bank Group was assisting Syria before the civil war with their development programs including the human development, private sector development, social protection as well as environmental sustainability, whereas, after the crisis, the above contributions and activities by the Bank were all halted.

Beyond the human toll (casualties and forced displacement), the productive factors of the economy have been damaged resulting in disrupting economic activity. For example, the cumulative GDP loss is estimated at \$226 billion from 2011 to 2016.⁸⁹⁵ This has diminished economic connectivity, disconnected networks and supply chains while reducing incentives to pursue productive work. Accordingly, the longer this conflict lasts, the more difficult it shall be to recover the economy as the impact and consequences would persist.

Besides, the refugee crisis as the result of this conflict has had significant impact on its neighboring countries including Lebanon and Jordan where estimates report the proportion of Syrian refugees at 25% and 10% of these countries' populations respectively. This is while a huge number of refugees have been also displaced into the European countries in particular Germany. Beside such direct impact of the war, there have been sanctions imposed on the country thus restricting trade with i.e. the Arab League, the

⁸⁹³ The World Bank: <https://www.worldbank.org/en/country/syria/overview>, 11 Oct. 2018.

⁸⁹⁴ The World Bank: (<https://www.worldbank.org/en/country/syria/overview#1>), 11 Oct. 2018.

⁸⁹⁵ Ibid.

European Union, Canada, Australia, Japan, Turkey and the United States...

Hence, the Syrian economy had shrunk 45 percent as estimated by July 2013 as the result of the outbreak of the Civil War. Unemployment became fivefold, while the value of the Syrian currency dropped to one-sixth of its pre-war value, and overall the public sector lost something like USD \$15 billion.⁸⁹⁶ By the end of that year (2013) the UN estimated a total economic damage of \$143 billion as the consequence of the Syrian civil war.⁸⁹⁷

Overall, the decline in the Syrian economic and its GDP as well as the increase in poverty made the World Bank Group reclassify the country as an International Development Association-eligible one, which emphasizes the sheer scale of the damage incurred on Syria's economy.⁸⁹⁸ The regime's economic policy is set to protect its myriad interests away from adequate property rights and the rule of law along with the corrupted government institutions (extractive political/economic institutions) thus creating a mire of fiscal situation where they would be mainly reliant on Russian loans as well as Iranian financial supports.⁸⁹⁹

9.5.2.2. Yemen

Yemen was considered a relatively poor country in the region with an economy mired in poverty and corruption. Even before the conflict began in Yemen, the country suffered from mismanagement and corruption thus depleting natural resources including oil and water which all exacerbated underdevelopment and chronic poverty. Hence, basic services have been difficult to access including water, electricity and health care.⁹⁰⁰ The conflict that began in 2015 aggravated the situation in Yemen resulting in a situation and an economy that cannot be stabilized without significant international assistance.

Initially the North and South Yemen were united as the Republic of Yemen in 1990, but the ongoing conflict between two factions divided the country into two nations as such raging a civil war. Such division includes the incumbent Yemeni government led by Abdrabbuh Mansur Hadi on one hand; and

⁸⁹⁶ Barnard, Anne (13 July 2013). "Syria Weighs Its Tactics As Pillars of Its Economy Continue to Crumble." *The New York Times*.

⁸⁹⁷ UN highlights economic damage of Syrian conflict Public Finance International.

⁸⁹⁸ *Ibid* (Barnard, Anne).

⁸⁹⁹ <https://www.heritage.org/index/country/syria>

⁹⁰⁰ 2018 Index of Economic Freedom (<https://www.heritage.org/index/country/yemen>).

the Houthi militia on the other each claiming to constitute the Yemeni government, along with their supporters and allies.⁹⁰¹ Moreover, Houthis have got the control of Sana'a whereas forces loyal to Mansur Hadi took control of Aden. The fact is that the ongoing war has pushed the economy into collapse resulting in a humanitarian catastrophe while causing an influx of refugees to the neighboring countries similar to that of the Syrian case. Obviously such an ongoing civil war on one of the least developed Arab countries of the region has basically stalled any major effort in modernization as well as integration into the world economy.⁹⁰²

Political turmoil has affected the oil and gas exports and fiscal situation bringing into view the cost of the war and the collapse in oil and tax revenue. According to 2018 Index of Economic Freedom; millions of Yemenis are at the risk of a fatal famine while the limited fiscal resources of the country are being spent mainly on the military and public-sector wages. Layoffs are quite common with stifling of the business enterprises leaving 80% of the Yemenis population in swift need of humanitarian assistance. This conflict would also deter trade and investment where the economy is largely cash-based with major domination of the government.⁹⁰³ Although, in late 2018, Yemen's economy somewhat experienced signs of stabilization with recovery of oil and gas production, economic prospects in 2019 and beyond look uncertain depending greatly on the political and security situations. Macroeconomic stability could be gained if reconciliation efforts in the south would succeed.⁹⁰⁴

9.5.2.3. Iraq

Iraq's economy seems to be recovering after the last three years carrying lots of strains and hardship. After the significant defeat of the ISIS in Iraq at the end of 2017, there has come an opportunity to rebuild the infrastructure of the country while providing jobs and services to its people. The World Bank estimates something like US\$88 billion as the cost of post-ISIS reconstruction. At the International Conference for the Reconstruction of Iraq, the amount of US\$30 billion has been made in form of loans and guarantees. The World Bank is basically in Iraq to support its government over its efforts to reinstate citizens' trust by way of adopting inclusive economic growth, while creating jobs as well as the provision of basic services. The main goal of such program is further engagement of the private sector, job creation,

⁹⁰¹ Orkaby, Asher (25 March 2015). "Houthi Who?" Foreign Affairs. Archived from the original on 27 March 2015. Retrieved 25 March 2015.

⁹⁰² 2018 Index of Economic Freedom (Background): <https://www.heritage.org/index/country/yemen>

⁹⁰³ Ibid.

⁹⁰⁴ <http://www.worldbank.org/en/country/yemen/publication/economic-update-october-2019>

social protection as well as the recovery of the economy through a reconstruction plan.⁹⁰⁵

A positive outlook of Iraq's economy confirms that overall the GDP growth has returned to a positive 2.5% (1.9% as updated by the World Bank source in October 2018 and it is expected to further increase in 2019 as the agreement expires).⁹⁰⁶ Accordingly however, it is further estimated that from 2020 the increase in oil production would be marginal reducing the overall growth due to the fact that the government would not be able to attract investment in the oil sector.

As the result of the internal conflict with the ISIS, there has been increase in poverty rate (18.9% to 22.5% from 2012 to 2014) along with a decrease in Labor Force Participation (from 32.5% to 27.4%) in the same period. A significant rise in unemployment rate is also observed particularly within the poorest households while the rate for the affected ISIS area has been doubled.⁹⁰⁷

According to the World Bank, Non-oil growth has shown a strong rebound at 5.2 percent in 2018, mainly as the result of the growth in agriculture, industry, and services. The Inflation rate increased from 0.1 percent in 2017 to 1.7 percent in July 2018. Due to the new securing conditions away from previously ISIS threats, an opportunity has risen with a positive outlook for Iraq where the overall GDP growth is expected to rise to 6.2 percent in 2019 while it can be sustained by higher oil production.⁹⁰⁸ Growth was estimated to be 4.8% at the end of 2019 while it is expected to increase to 5.1% in 2020 and down to 2.7% in 2021. This is mainly due to the weakening prices and exports in the oil market.⁹⁰⁹

9.5.2.4. Libya

The Libya's economy is highly depended on oil revenues composing over 95% of export earnings as well as 60% of its GDP.⁹¹⁰ In view of its small population (6.375 million-2017), such oil reserves have recorded one of the highest nominal per capita GDPs in the continent of Africa. In fact, Libya has seen some incredible growth rates in the last two decades creating a development that was halted due to the Libyan Civil War. For example, a growth rate of 10.6% was estimated in 2010 for the country while due

⁹⁰⁵ "The World Bank in Iraq." 11 Oct. 2018: (<http://www.worldbank.org/en/country/iraq/overview>).

⁹⁰⁶ "Iraq's Economic Outlook" April 2018. Retrieved from:

(<https://www.worldbank.org/en/country/iraq/publication/economic-outlook-april-2018>)

⁹⁰⁷ Ibid.

⁹⁰⁸ "The World Bank in Iraq." 11 Oct. 2018: <http://www.worldbank.org/en/country/iraq/overview>

⁹⁰⁹ The World Bank. "Iraq's Economic Update, October 2019." Retrieved from: <http://www.worldbank.org/en/country/iraq/publication/economic-update-october-2019>

⁹¹⁰ Libya; OPEC (Organization of Petroleum Exporting Countries); Retrieved 5 May, 2018.

to the civil war, the country's economy was contracted by 62.1% in 2011. Nonetheless, soon after the war, the country could rebound by 104.5% in 2012, but crashed again following the Second Libyan Civil War. Libya's per capita PPP GDP stood, as of 2017, at 60% of its pre-wars level.⁹¹¹

Despite the impact of the civil war, global oil recession and international sanctions against Libya overall the country has witnessed the fantastic growth rates that have been unsustainable. As such, the GDP per capita shrank by 40% during the 1980s. Nonetheless, for the country's relative successful diversification and integration into global economy, the current GDP per capita cut further deterioration to just 3.2% in the 1990s.⁹¹²

Libya is an OPEC member and is considered to hold the largest proven oil reserves in Africa. During the second half of 2017 that some political and security arrangement was reached, a new atmosphere away from tension emerged for the country to have a record of over-doubling its production of oil with a growth up to 26.7% after four years of recession. The situation changed however in the first half of 2018. There should have been a growth of 7.2 percent in GDP for the second half of the year.⁹¹³

In case of Libya in particular, like in other MENA countries, if security and political stability is reached, the country can have a positive prospects away from internal conflicts and fiscal pressures. As such, the long-term goal for the country can be stretched towards development of the institutions susceptible for a more diversified market-based economy, while broadening the economic base beyond merely the oil and gas sector. Establishing such institutions shall lead to more vibrant and competitive economy while involving the private sector to boost job creation, health and education under a sustainable development. Moreover, democratization can be constructed in parallel to the management of oil reserves with a view to create citizenry voice within the political structure of the country. Hence, oil revenues can be managed in such a way to benefit all the citizens equally while serving the interests of the country.⁹¹⁴

9.6. Summary

To summarize, this chapter (9) delved into the reasons behind the success and failure of economies in MENA taking into account such determining factors as the quality of institutions, the governments'

⁹¹¹ Libya; OPEC (Organization of Petroleum Exporting Countries); Retrieved 5 May, 2018.

⁹¹² "Report for Selected Countries and Subjects." www.imf.org. Retrieved 2018-10-06.

⁹¹³ "The World Bank in Libya." 1 Oct, 2018. Retrieved from: <http://www.worldbank.org/en/country/libya/overview>

⁹¹⁴ Ibid.

policies and strategies in respect to trade and investment as well as improving infrastructures within and beyond the borders making such economies more susceptible for regional cooperation. A reasonable degree of liberalization coupled with political stability in the successful economies has been witnessed to attain a sustainable development. In contrast, countries inflicted with war have lost many of such opportunities for growth and development.

The overall human and institutional development was illustrated in case of the MENA countries through Table 9.4.D. which included the government effectiveness index. A relatively more recent data is shown on the following page on Figure (9.8.A.). According to the definition “Government Effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government’s commitment to such policies.”⁹¹⁵ Moreover, the percentile rank is to show the country’s rank among all countries as covered by the aggregate indicator that is; 0 means the lowest rank and 100 correspond to the highest rank. Figure (9.8.A.) indicates such index in particular for the four failing economies mired in internal conflicts namely Iraq, Syria, Yemen, and Libya ranking the lowest in that diagram while reiterating the fact that the UAE, Qatar, Bahrain, and Oman are the first four countries ranking the highest index in this regard.

On the contrary, the above four failing economies are shown in the second diagram marking a significant high record in their Transparency International Corruption Perceptions Ranking (Figure 9.8.B.). The Corruption Perceptions Index (CPI) is an index that has been published annually by Transparency International since 1995. According to such index, countries are ranked “by their perceived levels of public sector corruption, as determined by expert assessments and opinion surveys.” Such corruption is in fact defined through the CPI as “the misuse of public power for private benefit.” This Figure (9.8.B.) is also illustrating that the same four countries with successful economies (the UAE, Qatar, Bahrain, and Oman) are ranking the lowest on the corruption index. Iran doesn’t represent a striking performance on either indicator particularly on corruption perceptions index in which ranks immediately after the four failed countries (namely after Libya, Iraq, Syria, and Yemen).

In view of the lessons that can be learned from the successful countries of MENA, economic openness and diversification; infrastructure investment policies; with less dependency on oil and foreign markets can expand such success to the rest of MENA. Integration can promote innovation, growth and tech. know-how while institutional reforms can overcome the structural weaknesses and political deficiencies.

⁹¹⁵ <http://datacatalog.worldbank.org/government-effectiveness-percentile-rank>

Figure (9.8.A.) Government Effectiveness (Percentile Rank among All Countries Range 0-100)

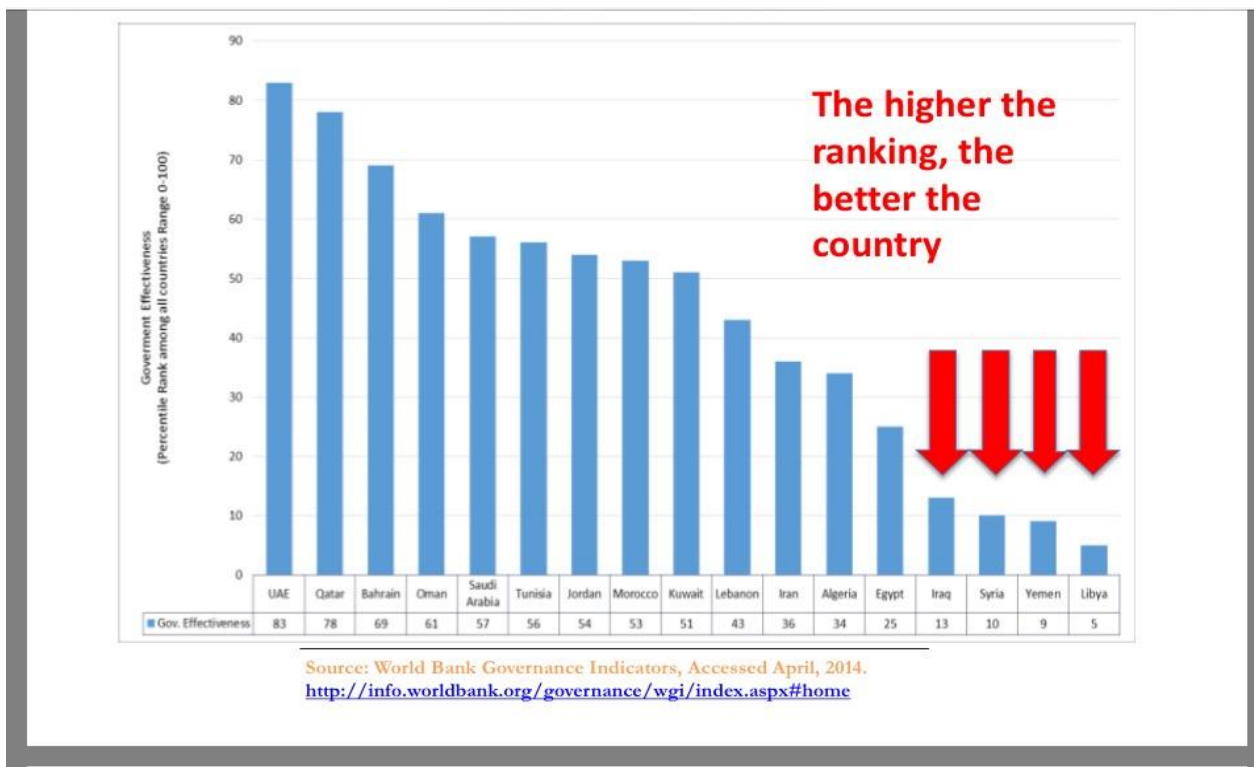
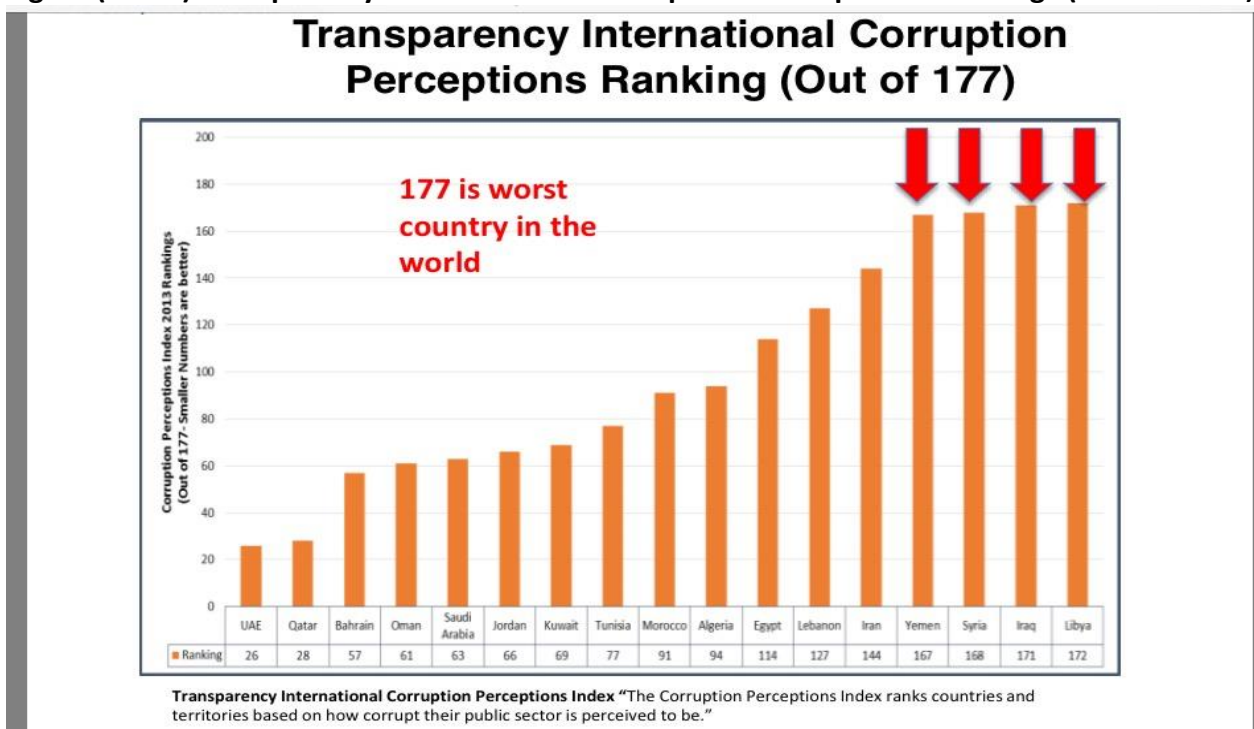


Figure (9.8.B.) Transparency International Corruption Perceptions Ranking (Out of 177)



Source: Transparency International Corruption Perceptions Index, Accessed April 2014.
<http://cpi.transparency.org/cpi2013/results/>

Chapter (10): Concluding remarks

10.1. From Institutional Economics towards a New Social Contract for MENA

The focal point of this dissertation has been on the important role of institutions in delivering economic success when they are coupled with proper policies and strategies which all together may proposedly lead to the formation of a new social contract in particular for the MENA region. Moreover, as the economic openness with trade liberalization are pursued under an incremental institutional change along with properly managed development plans, integration as the option and solution to many regional problems have been discussed throughout this dissertation firstly at a regional level and consequently as a contribution to the global economy.

Since institutions are defined as “the rules of the game” and classified under the formal rules and informal constraints (custom) or humanly devised constraints, they can shape the human interaction by structuring incentives that play a key role in human exchange and transactions within social, economic as well as political spheres. Hence, the role of formal rules or laws and policies are salient in shaping such interactions within the society at large, and notions such as property rights and the rule of law become significant within such structure. If we choose a polity away from a proper social contract in which economic models are fully developed within the public choice literature, the result would be at best a system of Mafia or a Leviathan in Douglass North’s term to employ its terminology. According to Hobbesian Leviathan however, instead of having a distributive system, we just have an enabling one by attracting efforts away from killing and stealing towards productive activities.

When such Mafia has grabbed the power, the state and its polity would become a tool for the redistribution of wealth and income.⁹¹⁶ And according to Acemoglu and Robinson, this would create persistent extractive institutions both within the political and economic spheres while having that redistributive corrupted system act in favor of the chosen elites in the society.

To exemplify, beyond the economic reasons, we saw a growing dissatisfaction among some societies in the MENA region that erupted in revolution in four countries while causing popular protests in others. Such dissatisfaction had root in the socio-political struggles within such nations to gain voice and political

⁹¹⁶ North, Douglass C. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990.p. 140.

accountability despite the fact that they seemingly showed some strong and improving economic conditions.⁹¹⁷ The answer and solution to such political upheavals and social unrest can be traced in *the social contract* that has failed to meet the rightful demands of the people despite delivering some favorable indicators within the realm of their economies. The existing social contract under the despotic and authoritarian regimes in the Middle East and North Africa left not much room for dissent while denying human rights particularly to some groups within their societies.

The old social contract could not accommodate jobs in particular for the youth and women while the private sector was not developed enough to absorb such group of unemployed people including the educated groups. Finding jobs has been exhaustive in face of corrupted system in such countries as it has been more based on connections rather than merit.

Under such circumstance, only friends and families of the elites and autocrats could benefit through the monopoly rents created at the hand of the public sector. They had hands in public and even private firms generating profits to these people. Regulations had been designed in such a way to benefit such firms while restricting foreign investment in sectors in which they were involved including transport, banking and telecommunications. This raised prices for inputs of the exporting sectors and as the result made them less competitive globally.⁹¹⁸ This trend would directly affect the economy with insufficient growth and consequently with no solution or response to the army of unemployed people.

As a solution, Schaefer and Cooter prescribe a model expounding that a bundle of laws particularly property, contract, and business law can bring about the desirable growth when such bundle is coupled with the necessary degree of liberalization. Stressing on the public information they believe public debate and discussion, as well as criticism can create an atmosphere to increase accountability which then can dampen favoritism, nepotism, and corruption. On the contrary, an atmosphere favorable to state officials can easily divert secret investments towards their cronies.⁹¹⁹ This latter is what happened in those countries in MENA during the Arab Spring thus erupting revolutions.

In case of these countries, in a broader term; a new social contract was needed to define a more transparent political system in which the public sector would no longer be the main employer. Hence, private sector should be involved with a view to boost competition and create jobs along with some

⁹¹⁷ Devarajan, Shanta. "What is the social contract and why does the Arab world need a new one?" 11/12/2015: <http://blogs.worldbank.org/arabvoices/what-social-contract-and-why-does-arab-world-need-new-one>

⁹¹⁸ Ibid.

⁹¹⁹ Schaefer, Hans-Bernd; and Cooter, Robert D. "Solomon's Knot: How Law Can End the Poverty of Nations." Berkeley Law, December 2011, Chap. 13, p. 22.

incremental reforms and changes at all levels. Security needs to be back in the region while the countries in conflict settle their issues. In short, the main message sent by such revolution across the region is the demand for change.⁹²⁰

A new social contract can help define the route for democratizing the political systems within the MENA region to be apt for new voices and accountability. Presenting different theories of social contract in the theoretical part of this dissertation (Chapter 1), has had the aim of reaching the most suitable form of government away from the hierarchy of corruption. Not merely as “the only game in town”, but democracy seems to work as the most legitimized form of government which can bring about the kinds of progress and development each society needs including the political agenda for the MENA region.

A good start for such a change would be to work on institutions. It doesn't have to happen overnight. Such transition can take an incremental change and take place over time. It is certainly a difficult task to deplete such hierarchy from the extractive institutions and replace them with new vibrant inclusive institutions to reflect plurality of voices and political accountability under a proper social contract. However, in view of the correlation between such institutional transformation and the social contract that itself is comprised of an important set of institutions, embarking on a new social contract could be a good and feasible beginning for such transformation.

The successful revolutions that paved the way for further inclusive institutions share a commonality of “empowering a fairly broad cross-section of society.” As such, the gradual institutional changes in North America, England (during the 19th century), as well as in Botswana after independence confirm that such changes in fact welcomed the idea of pluralism away from the extractive institutions held by the narrow elites. Pluralism that is crucial to inclusive political institutions demands that the political power would be fairly and widely held in society thus breaking the mold of extractive institutions through democratic means which requires a process of empowerment.⁹²¹

According to Acemoglu and Robinson, in this process, media can have an effective role in empowering a broader segment of society into more durable political reforms.⁹²² Only in such manner the revolutions of the kind can be fruitful in creating the inclusive institutions, otherwise such political revolutions may

⁹²⁰ The World Bank; “MENA ECONOMIC MONITOR: Towards a New Social Contract.” April 2015, p. 22.

⁹²¹ Acemoglu, Daron; and Robinson, James A. “Why Nations Fail: The Origins of Power, Prosperity and Poverty.” Crown Publishing Group, N.Y., 2012, p. 458.

⁹²² Ibid, p. 461.

create more hardship and destruction, thus causing their success far from certain.⁹²³ The Bolshevik revolutions failed for example despite advertising its aim so as to replace the exploitative economic system of Tsarist Russia with that of a more efficient and just system to bring prosperity and freedom which never happened as claimed; on the contrary it created a much more repressive system with extractive institutions. Exactly same experience was repeated in case of the Iranian revolution of 1979, or similar situations in other places such as China, Cuba, and Vietnam.

Therefore, the institutions are the key to deliver the answer, and the establishment of inclusive institutions may be a good start coupled with political will away from corruption and extractive mind-setting. As Douglass North concludes, by establishing and improving such adequate institutions we would have a promising picture in depicting the future. Such institutional framework can certainly help us do better even though we may never have definitive answers to all our questions.⁹²⁴

In short, a development triangle has been introduced in the core part of this thesis theory and methodology co-relating three important theoretical factors of development namely *Regionalism*; *Institutionalism*; and *Social Contract (Constitutionalism)* through which together a sustainable development can be achieved. Freedom can blossom in its all social, economic and political aspects when it is well defined under the banner of a proper social contract particularly in case of developing countries (i.e. MENA) for which regionalism, integration, and establishment of the rule of law have a long way to go towards development. Therefore, it is certainly worthwhile to attempt for such progress while working on laws and institutions in societies in particular for the MENA region, assuring that inclusive institutions would definitely reward such efforts in the long run. As Baron de Montesquieu well stated; “In the infancy of societies, the chiefs of the state shape its institutions; later the institutions shape the chiefs of state.”⁹²⁵ The better we shape the institutions with inclusiveness, the better off we shall be for the future.

10.2. The Problem of Socio-Economic, and Political Costs

In a world with increasing phenomena urging towards globalization and economic integration, there are many problems of socio-economic as well as political nature that emerge among the countries particularly

⁹²³ Ibid, p. 458.

⁹²⁴ North, Douglass C. “Institutions, Institutional Change and Economic Performance.” Cambridge University Press, 1990. P. 140.

⁹²⁵ Baldwin, Richard; and Wyplosz, Charles. “The Economics of European Integration.” Third Edition, McGraw-Hill, 2009, p. 47. Also available at: https://www.brainyquote.com/quotes/montesquieu_390169

within a regional context. The geographical and economic proximities or in cases of many countries the political bondage between and among the countries may cause harm and damages in different spheres whose solution demands a high level of cooperation or bargaining at a regional level.

Ronald Coase in his famous article, *The Problem of Social Cost*,⁹²⁶ deals primarily with economic problem of externalities which was later known as the Coase theorem thus arguing that when we make the costs of information and transaction low, this will allow the market to produce an efficient solution to the problem of nuisances regardless of the fact as to where the law places the liability for the nuisance.⁹²⁷ What Coase is trying to achieve through his article is the process of establishing proper institutions in society while urging legal scholars including the judges to take into consideration the economic effects as well as the process of bargaining about rights beyond the context of litigation.

The Coase theorem served as the triggering basis for the establishment of the discipline and movement of Law and Economics thus furnishing the foundation for the economic philosophy of such discipline. Accordingly, the theorem describes the economic efficiency of an economic allocation or outcome in the presence of externalities. Later on, the theory of institutional economics emerged that has formed the core part of my approach throughout this dissertation.

This section attempts to expand the vision represented in *the problem of social cost* beyond the boundaries of geography and micro-economics thus viewing problems at a regional and macro-level in order to reflect the emanating problems in a broader spectrum encompassing not only the social aspects but also the political ones. In simple term, regional integration is important for development as are the establishment of property rights in the domestic spheres. As such, having clearly specified property rights would be crucial to engage in mutually beneficial negotiations between the relevant governments.

Coase elaborates through different English legal cases and statutes to show that legal rules could be justified by way of a cost-benefit analysis and those nuisances which are considered as the fault of one party vi-a-vis the other are in fact symmetric conflicts between the interests of the two parties. For example in the case of *Sturges v. Bridgman* the confectioner's machinery would cause nuisance to the neighboring doctor whose consulting room is located right next to the confectioner's kitchen...or in the case of *Bryant v. Lefever* the problem of smoke nuisance due to the lack of chimney smoking etc. In these instances the legal rules are justified to the extent that they would be able to allocate rights to the most

⁹²⁶ Coase, Ronald. "The Problem of Social Cost." First Published in 1960. *Journal of Law and Economics*, Vol. 56, No. 4. (November 2013)The University of Chicago Press for the University of Chicago Law School, pp. 837-877.

⁹²⁷ Ibid (Coase), Retrieved from: <http://www.britannica.com/biography/Ronald-Coase#ref239345>

efficient right-bearer.

In a more complex scenario where the cost of market transactions are taken into account, then the role of institutions and institution-building would become salient through which the market transactions could be institutionalized. Even in such examples at micro-economic level, Coase illustrates that reaching a satisfactory view on policy is greatly dependent on our study as to realize how in practice the market, firms, and governments would handle the problem of harmful effects.⁹²⁸ In the cases involving high market transaction costs, economic activity can be directly influenced by the courts. And in such circumstances, the courts should take into consideration the economic consequences of their decisions.

The Coase theorem can also be expanded at a macro-economic level particularly taking into account the regional status of the groups of countries within a geographical area. In such circumstances however, the view would be broadened beyond simple look of cost-benefit encompassing other issues of political and cultural nature where institutions and the new social contract (in case of the MENA region) can play the key role in alleviating such problems.

Environmental issues, living conditions due to climate changes, and the influx of refugees running to a neighboring country or other parts of the world due to the problems of war, conflict, or political circumstances in those countries would be examples of this kind that encompass a broad range of issues from economic disasters to political problems. Here the necessity to cooperate and economic-wise integrate would be of essence like that of bargaining situation in micro-level so as to achieve the status of the delimitation of rights for the participating parties. From this angle, the role of the courts at a regional level should be discussed as it was exemplified in chapter (6) in different cases of regional communities for the economic integration in Africa.

The same idea of “public interest” should be on the forefront of the regional cases and the community courts that are in fact judging the cases at a higher level. Moreover, such bargaining power or political negotiation and accords would be determined by defining relational issues in the integration processes that was well covered in chapter 6 on the African integration. In that example, the role, status and significance of community courts were also illustrated. At a regional level when forming integration, the overall interest or “public interest” ought to be the criteria for the countries coming together for cooperation. As such, one dimensional “trade-diversion” would not be the only focal point of interests when political considerations are also in mind through viable regional plans with a view to the future.

⁹²⁸ Ibid, p. 853.

According to Pigou's discussion, the owner of the factory with smoky chimney is entitled to some bounty in order for him to be induced to install smoke-preventing devices, or according to the modern economists such owner should be taxed. In a broader scale similar advantages would emerge in case of economic integration particularly for the resource-poor countries i.e. in the MENA region upon which all countries including the resource-rich countries can and should perceive a better region in peace and stability under the shadow of regional cooperation and integration. Such consideration, like the case of the European Union, with a supranational entity, highly takes into account the idea of "general good" or the "public interest" within its regional context as in the Coase's stand point. From this upper view, the issue of development in its both domestic and regional aspects ought to be considered for a viable future. As explained, this idea of "general good" can well be consolidated through a proper social contract featuring the viability.

The extent to which such integration can or should progress would be covered in the next section. Ronald Coase finishes his essay by suggesting a practical approach where policy changes are examined starting with current situations. This also set the empirical approach in this essay towards a new social contract and regional integration in MENA while considering the status quo as the first step to begin with.

According to Coase; exercising a right is always associated with a loss elsewhere that is resulted out of such exercise. For example, the inability to cross land, to park a car, to build a house, to enjoy a view, to have peace and quiet or to breathe clean air, are imposed upon us to exercise some rights in the public domain.⁹²⁹ To apply this to the subject of this dissertation that is integration, there is such logic of gains and losses which can direct the policy-making to choose options with more of constructive regional consequences than restricting to the sheer interest-looking of statehood. Coase believes that we should regard for the overall or *total effect* when devising and choosing between social arrangements. Such strategy should also be in fact the predominant view in respect to the regional cooperation or integration thus solving the overall problems of socio-economic as well as political nature.

In other words, *development* in particular within a regional context should be the core part of the attention that is the inherent *public interest* or *general good* which may be defined and acquired within the contexts of a new social contract and regional integration for the MENA region. Moreover, such regional attempt can act as an impetus to encourage the development of stronger national institutions by providing the administrative and legal basis similar to the cases of the EU, or MERCOSUR and NAFTA.⁹³⁰

⁹²⁹ Coase, p. 877.

⁹³⁰ Page, Sheila. "Regionalism among Developing Countries." Overseas Development Institute, London, 2000, p. 288.

Defining development as the core part of the regional strategy, according to an UNCTAD analysis, regional integration has a positive impact on economic growth and development as well as lowering within-country inequality in member countries. In this respect, regional integration has long been a tool in trade promotion, and in case of the developing countries trade agreements have helped determine national trade policy and thus it has been able to potentially amplify the impact of trade on development.⁹³¹

In a broader sense, such development in cases of the developing countries can pave the way to achieve the kind of freedoms that is necessary for dynamic societies, which according to Amartya Sen,⁹³² can lead to further development and progress both for individual as well as the society at large. In fact, it is within such framework of freedoms and liberty that a new social contract can be born to be beneficial to all.

Schaefer and Cooter put this differently to express that; nurturing such freedoms (including economic freedom) may lead to economic growth which can then bring about democracy. Democracy in return can help the purpose of development and that of the social contract. According to them, there is a causal chain running from growth to democracy. Economic innovation would demand the development of new ideas that especially come from educated people. As such, a sustained growth may be obtained by a combination of economic freedom as well as educated workers together creating a cascade of innovations.⁹³³ However, in this process, law is essential for the economic freedom to have fruitful results bearing out sustainable growth and established democracy. Hence, to promote growth and to achieve that democratic environment, such economic freedom needs to be legalized within developing countries. And to that effect, state rules (formal institutions) as well as social norms (informal institutions) together can strengthen each other like the strands in a rope. In other words, experiencing growth is associated with some commitment among its beneficiaries in respect to the rules and norms that produce it. This is a brief sketch as to the important role that law can play in ending the poverty of nations.

10.3. Economic Integration and Examples of Success

Recently there has been more favorable assessment of economic integration and its effects in respect to developing countries. Accordingly, regionalism can lead to net trade creation as long as a great degree of

⁹³¹ DiCaprio, Alisa; Santos-Paulino, Amelia U.; Sokolova, Maria V. "Regional trade agreements, integration and development." UNCTAD Research Paper No. 1, July 2017, pp. 1 and 5.

⁹³² Sen, Amartya Kumar. "Development as freedom." PUBLISHED BY ALFRED A. KNOPF, INC. 1999.

⁹³³ Schaefer, Hans-Bernd; and Cooter, Robert D. "Solomon's Knot: How Law Can End the Poverty of Nations." Berkeley Law (Preliminary Manuscript) , December 2011, Chapter 15 (Conclusion), p. 3.

trade liberalization is considered along with the view of reducing cost-creating trade barriers that simply have a major role in wasting resources.⁹³⁴ From this point of view, regional economic integration is in fact a precondition, rather than an obstacle, for the contribution to the global economy. Besides, forging towards regional integration can act as an incentive to improve the national institutions while making them more susceptible for a regional accord. In this process however, a similar harmony should be exercised between the two levels of regional integration and those of multilateral or global trading system and the international laws including GATT's and WTO's.

According to Sheila Page; the above harmony can form a basis for development, because the development of regional institutions would require or encourage further strengthening of national institutions with the robust administrative and legal basis.⁹³⁵ The European Union is a good example of this kind in which supranational institutions are well developed. To a lesser degree MERCOSUR can be another example as described in this dissertation, as well as NAFTA where such developing structure is deemed important. Similar developmental efforts should also be taken into consideration for MENA with a view to improve national and regional institutions while building the infrastructure in behind-the-border policies and strategies where the region has a huge potential and a long path to strive for development.

According to the empirical analysis (Sakamoto 1969, p.283-284; Abdel Jaber 1971, p.256; Axline 1977, p.85; and Khazeh and Clark 1990, p.318); when it comes to developing countries in particular like the ones in the MENA region, more of the emphasis should be placed upon dynamic effects rather than static effects of regionalism when evaluating the desirability of economic integration.⁹³⁶ Krugman's New Regionalism or the dynamic effects of economic integration, takes into view parameters that go beyond the one-dimensional views of Viner's or Venables' that mainly focus on trade-creation v. trade diversion.

Moreover, the particular advantages of PTAs are also revealed as an effective means to achieve world economic welfare thus bringing new dynamism into the current integration developments. Interestingly, according to Linder (1966, p.39) and Axline (1977, p.85) trade diversion may even translate into import substitution over a wider area, and increase levels of investment and economic growth because the integrated region has been enabled to overall spend higher proportions of its foreign exchange on imports

⁹³⁴ Matthews, Alan. "Regional Integration and Food Security in Developing Countries." FAO 2003, Rome, The Executive Summary; pp. vii-viii. Available at the following link: http://www.fao.org/tempref/GI/Reserved/FTP_FaoRlc/old/prior/comagric/negocia/documentos/food_dceng.pdf

⁹³⁵ Page, Sheila. "Regionalism among Developing Countries." *Overseas Development Institute*, London, 2000, p. 288.

⁹³⁶ Hosny, Amr Sadek. "Theories of Economic Integration: A Survey of the Economic and Political Literature." *International Journal of Economy, Management and Social Sciences*, May 2013, p. 151.

of capital goods.⁹³⁷

Overall, from a broader spectrum we may also conclude that the presence of favorable political and economic factors combined would be an important factor for achieving success over an economic integration scheme. The examples of success in particular within the MENA region (see chapter 9), all reflect their relatively open economic policies along with presence of necessary political will for institutional change and reform. Such policies in a way endorse the regional integration in view of reaching a more economic stability and prosperity along with regional security.

On the contrary, illustrating the patterns of economic failure, we see countries which act based on extreme nationalism or protectionism in both economic and political front. Such examples of failure are mainly based on the authoritative and despotic governments with a particular group of elite taking control of the resources along with political adventurism resulting in a weak economic performance. Of course, nationalism within a reasonable context can be apprehended and bring success into the economic and political spheres only when it is blended with reasonable open policies designed for democracy in which inclusive institutions can be nurtured away from the closed vicious circles dominated by the extractive institutions.

The question arises as to whether there should be a limit in pursuing the integration policies, the process of globalization and expanding towards global integration, or that of democracy? The answer is yes. Dani Rodrik in his book examines as to how such tension should be managed between national democracy and global market.⁹³⁸ According to Dani Rodrik; to reconstruct the world economy, we have three options; we may restrict democracy in view of minimizing international transaction costs towards deeper integration and globalization while disregarding the economic and social whiplash that enhancing global economy occasionally creates. Or, we can also choose to limit globalization, with a hope of establishing democratic legitimacy at home. And finally, we may globalize democracy, at the cost of nationhood and that of national sovereignty⁹³⁹ (Figure 10.3.).

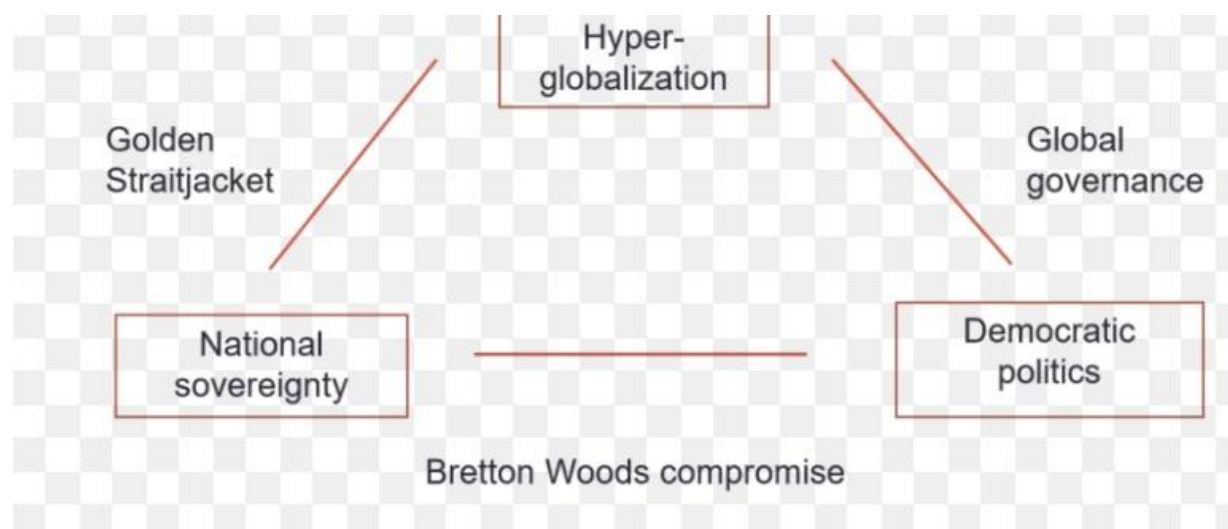
Obviously we cannot have the above three factors at once. If we choose deep economic integration thus moving towards hyper-globalization, plus that of democracy, then we should give up on the nation state or national sovereignty. In case we choose to keep the nation-state or consolidate national sovereignty

⁹³⁷ Ibid, pp: 150-151.

⁹³⁸ Rodrik, Dani. "The Globalization Paradox: Democracy and the Future of the World Economy." Oxford University Press, 2011; Chapter 9 (The Trilemma): pp. 200-201.

⁹³⁹ Ibid.

Figure (10.3.) The Political Trilemma of the World Economy (Pick Two, Any Two)



coupled with deep economic integration (further globalization), then we should forget the democracy. And finally, if we are to keep the nation-state combined with that of democracy, then it would be at the cost of deep integration or globalization. In a way, Dani Rodrik is in fact warning of a hyper-globalization in his work, which may incur losses to legitimate democracy and national sovereignty of states.

Besides, acknowledging and implementing such necessary constraints on globalization and global integration for the extreme case (hyper-globalization) shall create an atmosphere by which we may enhance the operation of national democracies by way of envisaging global rules and international law.⁹⁴⁰ As such, the role of international law and regulations are revealed in achieving legitimate national democracies. According to the Princeton political scientists Robert Keohane, Stephen Macedo, and Andrew Moravcsik, in fact, both the quality and legitimacy of democratic practices may be enhanced through *well-crafted external rules*.⁹⁴¹

Hence, Rodrik is in fact suggesting a kind of “smart globalization” or a controlled global integration in order to enhance national democracy. It is within such democratic atmosphere; according to Rodrik, that countries can exercise their legitimate right in protecting their own social arrangements, regulations, and institutions.⁹⁴² This latter reconfirms the fact that institutions and social contract ought to be designed peculiar to the needs of the countries i.e. in the MENA region as discussed throughout this dissertation. Rodrik rightfully stipulates that trade is considered a *means to an end not an end in itself*. As such,

⁹⁴⁰ Rodrik, Dani. “The Globalization Paradox: Democracy and the Future of the World Economy.” Oxford University Press, 2011, pp. 205-206.

⁹⁴¹ Ibid.

⁹⁴² Ibid, Chapter 11: p. 240.

globalization [and integration as a means to achieve it], should also be treated as an instrument by which we can achieve the overall goals that societies seek namely prosperity, stability, freedom, and quality of life.⁹⁴³ Indeed, such a set of arrangements can create a larger voice in particular for developing nations.

In view of the fact that MENA is considered as one of the least integrated regions of the world, there is a huge space and opportunities for the region to go a long way on the path of regional integration while building infrastructure, enhancing trade facilitation and expanding on institutions for further democratization. As reiterated, such trend should be followed as a complementary process to that of the global integration. Economic integration in the MENA region can act as an incentive for the policy makers of the region to address some critical development challenges while improving their institutions towards an inclusive growth and better economic performance.

Therefore, under the banner of regional cooperation and integration the main challenges can be addressed in view of boosting growth, creating jobs, and fostering diversification while attracting FDIs through a better enabling environment for both domestic and foreign trade and investments. These have been mainly the trends pursued by the successful countries of the region in particular Oman, Bahrain, the United Arab Emirates (UAE), and Tunisia (see chapter 9).

For MENA, a regional cooperation is urgently needed to settle the conflicts and civil wars while creating an atmosphere in which a deeper economic integration can progress. Such progress can entail the improvement of transport and trade logistic systems, strengthening of infrastructure, harmonization of institutional arrangements and practices, and improvement in behind-the-border policies and regulations that impose a burden on business activity. All this can broaden the scope of trade activity in the region and contribute to the prosperity of the region and the development of global economy.

Under such cooperative environment where regional peace has been achieved, a model of integration was suggested (chapter 7) in which like-minded states would use their common trends of culture, language, and proximities to form three sub-regions under the Greater Middle East and North Africa; namely Mashreq countries, Maghreb countries, and the GCC in the Persian Gulf. According to this model, a community-based framework like the African Union combined with the ASEAN's open regionalism (including the IPN markets) are suggested for the countries in MENA while learning from other regional arrangements and experiences taking into account their well-developed institutions i.e. in the European Union and other regional integration schemes as presented in PART (II) of this dissertation.

⁹⁴³ Ibid.

10.4. Moving Forward with Better Policies and Strategies

Achieving development success and inclusive growth for the MENA region by adopting better policies and proper strategies have also been the objective of this dissertation. Although the MENA region comprises 5.5 percent of the world's population and 3.9 percent of the world's GDP, its share of non-oil world trade is only 1.8 percent.⁹⁴⁴ This requires a large expansion through fostering diversification while boosting job creation and growth. Thus, the opportunities and challenges for deepening economic integration were discussed in this dissertation in respect to the MENA region and beyond.

Beyond expanding on trade and investment, the need for better connectivity, cross-border trade facilitation, building strategic infrastructure networks as well as the vital importance of logistics services were discussed so as to make more efficient border crossing facilities along with better monitoring and harmonizing of customs performance. Moreover, the effective roles of Preferential Trade Agreements (PTAs) were presented in acting as a stepping-stone towards further global market integration (see Chapter 7).

MENA is considered a rich region in the world with plenty of natural resources. More than 60 percent of the world's proven oil reserves (mainly in the Persian Gulf) and half of gas reserves are located in this region. Having such abundance of natural resources including oil with its highly susceptible fluctuations in international prices, it represents nearly 85 percent of merchandise exports of the region.

Such dependency is in fact the curse of natural resource endowment that can reduce the scope of economic diversification while creating Dutch disease and hurting overall a country's growth prospects and job creation⁹⁴⁵ (Chapter 8). The region can overcome this situation by fostering greater diversification in which the role of policies are significant. For example we can refer to the role of fiscal policy in supporting such diversification, while properly managing the impact of the real exchange rate on manufacturing as well as the competitiveness of the tradable services in MENA. As such, a consistent and transparent fiscal policy is needed to reduce instability while building the fiscal space needed to invest in core infrastructure and human capital, with an attempt to create a favorable environment to expand diversification. Regional integration can lead to greater diversification in the MENA region with welfare

⁹⁴⁴ Rouis and Tabor. "Regional Economic Integration in the Middle East and North Africa: Beyond Trade Reform." The World Bank, 2013, p. xix.

⁹⁴⁵ With reference to: Diop, Marotta, and de Melo. "Natural Resource Abundance, Growth, and Diversification in the Middle East and North Africa: The Effects of Natural Resources and the Role of Policies." The World Bank, 2012.

gains particularly for the resource-poor countries while urging the resource-rich nations in the region to go beyond trade i.e. through MFN treatment and trade liberalization as well as attracting foreign investments (FDI).

The MENA region suffers the most from high poverty rates particularly in the most vulnerable economies coupled with weak job prospects especially for the young people, along with persistent inequalities of opportunity.⁹⁴⁶ Nonetheless, according to the OECD, despite the global financial crisis, the MENA region registered a record of progress in dynamic economic growth and investment rates in the first decade of this century. This was mainly as the result of important reforms undertaken by many governments to enhance economic openness, diversification, private sector development as well as institutional reform.⁹⁴⁷ Thus, continuation of the same trend is encouraged by improving the situation through adopting better policies and strategies taking into view more inclusive growth and economic integration in MENA.

Fardoust in his book highlights the significant role that the most powerful and major players of the region could play, namely Saudi Arabia, Egypt, Iran, and Turkey, in spearheading stabilization in the region while addressing the root causes of regional problems. Hence, the foremost would be to settle the costly conflicts of the region, while acting away from poor economic performance. As such, they should use the substantial natural, human, and financial assets of the region more efficiently by adopting economic and social policies that can lead to a rapid and inclusive economic growth for the entire region.⁹⁴⁸

Accordingly; a four pronged strategy is recommended in particular for each of the major regional players. In brief; settling regional tensions and conflicts through diplomacy, undertaking major institutional reforms to deter impediment to economic growth and investment are essential. Also, heavy military expenses should be used, instead, to reduce unemployment and be rather invested in the core infrastructures including health and education, energy, and water. Finally, the countries need to expand on trade and regional cooperation coupled with consolidating ties with major global growth poles.⁹⁴⁹

Furthermore, along with suggesting a Mini-Marshall Plan for the region involving the World Bank, the IMF, the UN, and other relevant regional development agencies for the purpose of the reconstruction of the region, it is also recommended for the regional economic powers to create and shape an *infrastructure*

⁹⁴⁶ OECD; "Better Policies for Inclusive Growth and Economic Integration in the MENA region." 2016, Foreword.

⁹⁴⁷ Ibid, p. 1.

⁹⁴⁸ Fardoust, Shahrokh. "Economic Integration in the Middle East: Prospects for Development and Stability." Middle East Institute Policy Paper, June 2016, p. 31.

⁹⁴⁹ Ibid.

*and development bank for the MENA region.*⁹⁵⁰

The OECD is also recommending similar reforms for the purpose of strengthening the rule of law and to include more inclusive and open approaches in designing policies and services, while building effective safeguards to fight corruption as well as modernizing the machinery of governments.⁹⁵¹ Open government principles and creating an environment for public scrutiny of the government is also suggested by availing the public access to transparent information. While combatting corruption, modernized justice institutions need to be built to serve the people with the aim of providing more citizen-centered justice and legal services.⁹⁵²

Accordingly, in the integration processes for the MENA region, upgrading activities in both regional as well as global value chains coupled with quality investment may boost trade and investment potentials at both regional and national levels from which a successful integration can emerge. Hence, attracting the FDIs would be among the key recommendations while deepening market access through trade and investment agreements. Moreover, regulatory and administrative obstacles should be reduced thus opening the field for such trade and investment with a view to upgrade activities in GVCs (Global Value Chains). More attempts are also needed to foster regional and global integration through enhancing alignment between domestic legal and regulatory frameworks and those of international trade and investment agreements.⁹⁵³

Similar to the World Bank, the OECD is also urging for necessary investment on the infrastructures within the countries in the MENA region and beyond the public sources of the governments. It is thus recommended that the private sector would be encouraged to invest in building such infrastructure through different domestic and regional projects. The main objective of such *de-risk infrastructure projects* would be to make the MENA region more attractive to the global investors by way of widely using PPPs (Public Private Partnerships). This can be considered as one of the core parts of the new social contract as suggested for the MENA region.

⁹⁵⁰ Fardoust (Middle East Institute), p. 35. Note: Interestingly this idea was in fact initiated by the Shah of Iran in a meeting with the IMF and the World Bank in Tehran in February 1974 where the Shah suggested for an equivalent of a Marshal Plan for developing countries to be financed jointly by The Organization of Petroleum Exporting Countries (OPEC) and the industrialized countries. As such, the fund would be managed by the World Bank and the IMF while its governance would be split between the industrialized countries, OPEC and developing countries. The Shah's proposal was never materialized in view of the Saudi Arabia's frosty reception and the USA dismissive reaction. For details see: Kapur, Devesh; Lewis, John P.; Webb, Richard C. "The World Bank: Its First Half Century: History (Vol. 1). Washington, DC: Brookings Institution Press, 1997, p. 974.

⁹⁵¹ OECD; "Better Policies for Inclusive Growth and Economic Integration in the MENA region." 2016, p. 5.

⁹⁵² *Ibid.* p. 9.

⁹⁵³ *Ibid.* p. 21.

In view of the water scarcity in the MENA region, sound water governance with proper management are needed while considering water security as one of the main factors to be geared into economic and urban development policies along with the application of the OECD policy guidance for investment in clean energy.⁹⁵⁴ Furthermore, public policies and services should considerably include women and youth into their agenda⁹⁵⁵ while raising the quality and performance of education in the MENA region including the vocational education and training.⁹⁵⁶

Integration is not just about profit but more of cooperation; general good and prosperity; inclusive growth and justice. The case of MENA in particular with its current status highly demands such cooperation in which the stronger and richer countries should consider the general good for the whole region with a viable attempt to build their future. After all, there were such considerations that brought the European Union into existence as a model of success in which integration continuously acts as the propelling force to unite the European continent both politically and economically.

Reconstructing the future, in particular for MENA, is an objective that can be achieved together through regional cooperation, agreements and eventually integration to be aligned with the global development and progress. Those countries that develop with such philosophy shall prevail with progressive success bringing better life with prosperous future not only for their people but also for the neighboring countries under the promising shadow of peace and security; sustainable development; and the spirit of cooperation, justice and hope. To that effect, I finish this dissertation with an expression from Cyrus the Great who once said: “Success should always call for showing greater Kindness, Generosity, and Justice; only people lost in the darkness treat it as an occasion for greater greed.”⁹⁵⁷

⁹⁵⁴ OECD: “Better Policies for Inclusive Growth and Economic Integration in the MENA Region.” Better Policy Series, October 2016, p. 28.

⁹⁵⁵ *Ibid*, p. 29.

⁹⁵⁶ *Ibid*, p.33.

⁹⁵⁷ Xenophon’s *Cyrus the Great: The Arts of Leadership and War*. Translated by Larry Hendrick, 2006.

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