



# MNA Knowledge and Learning ...Fast Brief



## An Assessment of Changes in Cross-Border Trade: Costs in the Pan-Arab Free Trade Area, 2001-2008

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**Introduction:** Regional integration is a major feature of the trade policy strategies of all countries in the Middle East and North Africa. An important vehicle to achieve greater integration of Arab countries was the agreement to form the Pan Arab Free Trade Area (PAFTA) in 1997 under Arab League auspices.<sup>2</sup> Under the PAFTA all tariffs on goods of Arab origin were to be removed by January 1, 2008, which was subsequently brought forward to January 1, 2005. More recently, signatories of PAFTA have launched efforts to extend integration efforts to encompass trade and investment in services, and to increase efforts to deal with non-tariff measures restricting trade flows.

**PAFTA Implementation:** Little is known about the extent to which the provisions of PAFTA have been implemented. Regular monitoring of implementation is important for policymakers to be able to assess the effects of the agreement. It is also a precondition for action to be taken if necessary to address specific problems concerning the operation of the agreement. Absent information on the extent of implementation it is difficult for governments to either respond to concerns on the part of consumers, workers and businesses regarding the impacts of PAFTA or to make a compelling case that PAFTA has led to greater cross-border trade among Arab states. For example, it is sometimes reported in the trade press that PAFTA has not been implemented

fully because customs officials do not accept that goods satisfy PAFTA rules of origin (for goods to be eligible for zero tariff status they must have at least 40 percent Arab content) and therefore continue to levy tariffs.<sup>3</sup> More generally, it may be the case that specific policy measures or other factors unrelated to trade policy impede trade independent of implementation of the specific provisions of the PAFTA. As trade agreements are implemented and specific trade barriers are removed other constraints to trade become relatively more important. Having up-to-date information on what these constraints is a necessary condition for policymakers to decide whether and how they might best be removed.

**Survey on Costs of Cross-Border Trading:** A primary source of information on the extent and type of constraints that affect cross-border trade are the firms that import and export, both those that are in the business of distribution and intermediation, and those that produce goods and either want to sell their output in other countries or want to import parts and inputs that they use to produce their goods or services. This Brief summarizes the results of a survey of trading firms in 9 PAFTA members through which information was collected on the extent to which the costs of trading across Arab borders have declined since PAFTA was implemented. The survey spans official trade and tax policies, the administrative requirements and burdens that confront traders, and the costs/quality of transport infrastructure.

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<sup>2</sup> PAFTA is often also called the Greater Arab FTA (GAFTA) in the English-language literature.

<sup>3</sup> A key element of the Agadir free trade agreement between Egypt, Jordan, Morocco and Tunisia is the adoption of the Pan-Euro-Mediterranean Protocol of Origin, allowing countries to benefit from diagonal cumulation and thus facilitating trade.

The survey is designed to allow comparisons with an earlier survey of bilateral trading costs among Arab countries undertaken in 2001. The purpose of that survey was threefold: first, to generate information on trading costs and other trade policies that impose burdens on intra-regional trade and investment in the MENA region; second, to shed further light on the operations of the prevailing intra-regional trade agreements that have been concluded by many of the countries in the MENA region; and, finally, to identify the most important factors in intra-regional investment decisions as well as the perceived constraints to investment in MENA countries by the investors who took part in the survey.

The results of the 2001 survey were reported in Zarrouk (2001, 2003). It revealed that the cost of getting goods across borders averaged 10 percent of the value of goods shipped. Next to bureaucratic red tape, customs clearance procedures were the most important source of non-tariff trading costs, with the average company spending 95 man-days per year resolving problems with customs and other government authorities. Excessive delays resulted from lengthy processes of clearance and inspection, the number of documents and signatures needed to process a trade transaction, and the frequency of problems with customs and other government authorities.

The survey that is the basis of the present brief replicated the main questions asked in the 2001 survey but goes beyond it by including specific questions relating to the implementation of the PAFTA and the relative importance of certain trade policies that are sometimes reported to be problematical (such as rules of origin and enforcement of product standards). The survey results indicate that PAFTA has led to a significant decline in the relative importance of tariffs and related trade policy instruments as a barrier to intra-Arab country trade. Today, transport-related infrastructure and a lack of trade facilitation are ranked as the most important constraints to trade. Thus, the survey reveals substantial satisfaction with implementation of PAFTA tariff liberalization. It also suggests that further action to reduce the trade costs

associated with enforcement of standards and other non-tariff policies is needed.

## Survey Results

*PAFTA Benefits:* The main findings of the survey are that a majority of respondent companies are of the view that they have benefited from PAFTA. These benefits stem in particular from the removal of tariffs on intra-PAFTA trade. The survey also reveals a marked improvement in customs clearance-related procedures, with a substantial decline in the number of required documents and signatures, a significant reduction in the variance of clearance times, and fewer firms reporting having to make irregular payments. A minority of respondents reported having problems with rules of origin (13 percent), and substantially fewer than those perceiving customs valuation and enforcement of product standards to be a problem (around 30 percent on average, with significant variation across countries).

*Tariffs and Non-tariff Barriers:* In 2001, tariffs were ranked as one of the most important barriers to intra-regional trade; in 2008 they were ranked last. Instead, costs associated with administrative red tape and weaknesses in transport-related infrastructure services (real trade costs) are ranked as the most important constraints. Thus, the survey confirms recent analytical studies that conclude that the magnitude of Arab trade flows is significantly lower than it would otherwise be as a result of high real trade costs. It suggests that from a policy perspective efforts to facilitate trade and reduce the incidence of non-tariff measures deserve priority.

If such actions are implemented in a nondiscriminatory fashion – apply to and benefit all trade, independent of origin – potential trade diversion costs will be avoided. Overall levels of trade restrictiveness of a number of the countries in the region remain relatively high. This reduces the competitiveness of firms and the real incomes of consumers. PAFTA-based initiatives to lower non-tariff measure related real trade costs offer an opportunity to lower overall levels of trade restrictiveness in a way that

does not generate trade diversion.<sup>4</sup> Regional cooperation to reduce trade costs can help stimulate both intra-regional and trade with rest of world. The policy challenge is to identify what types of policies should be given priority attention and how regional cooperation in the PAFTA context can best be used to complement national efforts to facilitate trade.

*Surveys as a monitoring tool:* The survey is an example of the type of monitoring that is needed to determine whether trade commitments are implemented and to identify where policy actions are needed to further reduce the costs of trade, thus improving competitiveness. An annual process of monitoring of the type implied by the survey – bringing in the private sector not only as a source of information but as a partner – can help to build public support for the process of regional integration and taking actions to reduce trade costs and enhance competitiveness. To be most effective, the data collected on implementation of PAFTA could be merged with information on the overall trade restrictiveness of the policies that are applied by countries as well as other country-level data on trade and logistics costs/performance (such as the Logistics Performance Index and the Trading Across Borders indicators in the *Doing Business* report). These data – most of which have been compiled by the World Bank Institute in the World Trade Indicators database could be the basis for periodic engagement between governments and private sector on the “state of integration of regional markets”.

**Next Steps:** The focus of the survey that was summarized in this note was on trade in merchandise. Policies affecting trade in services and the movement of factors of production (labor, capital) are important for regional competitiveness and welfare as well. Indeed, for some countries in the region services trade is as or more important than trade in goods. PAFTA members have identified services as an area for deeper cooperation. Much less is known about policies affecting trade and investment in

services than about policies affecting merchandise trade. The type of data collection and monitoring exercise reported here for merchandise could also be undertaken for services. Templates that can be used for this purpose have been developed by the World Bank’s Development Research Group and have been implemented on a pilot basis in a number of Arab League member countries. The same is true for diagnostic tools to assess trade and transport facilitation performance of specific ports/border crossings and transport routes/corridors. Combining these tools into a regular process of monitoring and assessment of trade incentives and performance would help governments benchmark performance and identify priority areas for action, at both the national and the (sub-)regional level.

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<sup>4</sup> Countries with high average MFN tariffs can reduce potential trade diversion costs generated by PAFTA by reducing external levels of protection.