

TECHNICAL UNIVERSITY OF LIBEREC  
FACULTY OF ECONOMICS



Investment In Syria and Arabic Countries

and Their relation with EU

Investice V syrii a Arabských statů a jejich vztah s EU

DP-PE-KPE-200621

Supervisor: doc. Ing. Ivan Jac, CSc.

Number of pages: 74

UNIVERZITNÍ KNIHOVNA  
TECHNICKÉ UNIVERZITY V LIBERCI



3146088516

2006

MOHAMAD KINAN SALKINI

TECHNICAL UNIVERSITY OF LIBEREC  
FACULTY OF ECONOMICS



Investment In Syria and Arabic Countries  
and Their relation with EU

Investice V Sýrii a Arabských statů a jejich vztah s EU

DP-PE-KPE-200621

Supervisor: doc. Ing. Ivan Jac, CSc.

Number of pages: 74

2006

MOHAMAD KINAN SALKINI

TECHNICKÁ UNIVERZITA V LIBERCI  
Univerzitní knihovna  
Voroněžská 132b, Liberec 460 01  
PSČ 461 02

V51/0414

74 s.

ob., tab.

KPE

## ZADÁNÍ DIPLOMOVÉ PRÁCE

(PROJEKTU, UMĚLECKÉHO DÍLA, UMĚLECKÉHO VÝKONU)

Jméno a příjmení: Bc. Mohamad Kinan SALKINI

Studijní program: N6208 Ekonomika a management

Studijní obor: Podniková ekonomika

Název tématu: Investment In Syria and Arabic Countries and their  
relation with EU

### Z á s a d y   p r o   v y p r a c o v á n í :

- 1- Introduction
- 2- Economy in Syria
- 3- Economy in Arabic countries
- 4- Realtion between Syria and EU
- 5- Relation between Arabic countries and EU
- 6- Conclusion





## **CONTENS**

<b>1</b>	<b>INTRODUCTION .....</b>	<b>- 1 -</b>
1.1	THE CHANGING FACE OF THE MIDDLE EAST ECONOMY .....	- 1 -
1.2	THE DEVELOPMENT OF FINANCIAL MARKETS .....	- 3 -
1.3	DISTRIBUTION OF ECONOMIC AND FINANCIAL RESOURCES .....	- 4 -
<b>2</b>	<b>THE ECONOMIC DEVELOPMENT OF THE ARAB COUNTRIES .....</b>	<b>- 6 -</b>
2.1	FOREIGN DIRECT INVESTMENT FLOWS TO THE ARAB WORLD .....	- 7 -
<b>3</b>	<b>FINANCIAL SECTOR REFORMS.....</b>	<b>- 10 -</b>
<b>4</b>	<b>TRADE, FOREIGN DIRECT INVESTMENT AND DEVELOPMENT IN THE MIDDLE EAST AND NORTH AFRICA.....</b>	<b>- 13 -</b>
4.1	INTRODUCTION .....	- 13 -
4.2	MENA'S RECORD IN GROWTH, EMPLOYMENT AND POVERTY .....	- 13 -
	'SOURCE: GLOBAL ECONOMIC PROSPECTS .....	- 16 -
4.3	TRADE AND FOREIGN INVESTMENT PERFORMANCE.....	- 16 -
4.4	TRADE POLICY, INVESTMENT CLIMATE AND GROWTH PERFORMANCE .....	- 24 -
4.5	POTENTIAL GAINS FROM TRADE AND INVESTMENT CLIMATE REFORMS .....	- 29 -
<b>5</b>	<b>ECONOMY AND INVESTMENT IN SYRIA .....</b>	<b>- 33 -</b>
5.1	INVESTMENT LAW NO 10 .....	- 33 -
5.2	AGRICULTURAL PROJECTS .....	- 36 -
5.3	TOURIST INVESTMENT.....	- 37 -
5.4	INDUSTRIAL INVESTMENT .....	- 37 -
<b>6</b>	<b>FOREIGN INVESTMENT IN ARAB COUNTRIES.....</b>	<b>- 51 -</b>
6.1	ALGERIA .....	- 51 -
6.2	BAHRAIN.....	- 51 -
6.3	DJIBOUTI.....	- 53 -
6.4	EGYPT.....	- 53 -
6.5	JORDAN.....	- 54 -
6.6	KUWAIT .....	- 56 -
6.7	LEBANON .....	- 56 -
6.8	MAURITANIA.....	- 57 -
6.9	MOROCCO.....	- 58 -
6.10	OMAN .....	- 59 -
6.11	QATAR .....	- 59 -
6.12	SAUDI ARABIA .....	- 61 -
6.13	SYRIA.....	- 62 -
6.14	TUNISIA .....	- 63 -
6.15	THE UNITED ARAB EMIRATES (UAE) .....	- 63 -





7	SYRIA AND EU.....	- 65 -
8	EU RELATIONS WITH THE ARAB WORLD .....	- 68 -
8.1	INTRODUCTION.....	- 68 -
8.2	EU POLICY INSTRUMENTS.....	- 69 -
8.3	PURSuing REFORM.....	- 71 -
9	CONCLUSION .....	- 73 -



## 1 Introduction

### 1.1 *THE CHANGING FACE OF THE MIDDLE EAST ECONOMY*

During the last five years the economies of the Middle East have been undergoing a process of economic change that for most has been more significant than any since the end of the colonial period some 50 years ago. Throughout the region, governments have been reducing their dominant role in the management and funding of economic growth, and they have been increasing their economies' reliance on the private sector, both domestic and foreign. This is part of the global movement towards market-based economics and away from state planning. The changes occurring in the Middle East may not have been as dramatic as those seen

In the Middle East the impetus for this change has been, and continues to be, economic rather than political. Governments no longer have sufficient resources to generate acceptable rates of growth. In some cases, the reason is that the governments themselves have become too inefficient: Algeria's public sector industries use up vast sums of money on wages and imports but their performance is not improving. In others, it happens because government revenues that were previously large enough to cover a country's economic needs have declined: the oil economies of the Gulf could fund their budgets easily on the basis of oil prices prevailing in this time, but they could not do so with the level of prices seen in the early 1990s. As a result, governments have had to turn to the private sector to cover the shortfall in investment.\*

The enormity of this change should not be underestimated. Although few Middle Eastern governments took on the symbols of Marxism and Communism, which became the hallmark of centrally planned economies, the prevalence of centralization was almost universal in the post-colonial period. Centrally planned economies arose out of two principal sets of circumstances: post-colonial national building and the dependence of an economy on a single resource, usually oil.

Algeria and Tunisia provide examples of governments that took control of their economies with the aim of ensuring that limited resources were allocated in the most efficient manner, or at least in a manner consistent with their own priorities. In Algeria, the rapid build-up of heavy industry generated exceptional rates of growth during the 1960s, to the extent that it was seen as a model for developing countries.

The economies of the Gulf States, which never suffered direct colonial rule (although outside

---

\* Middle East Oil Money and its Future Expenditure. Nicholas Fallon





influence was often all-pervasive), were transformed into centralized economies after the development of oil resources. Oil revenues were responsible for transforming what were previously barren and poor countries into modern economies with vast infrastructures, but the oil revenues were controlled by a single family: the ruling one. Until the late 1980s, little thought was given to economic diversification, so oil remained the only important economic resource these countries had, apart from state reserves, which again were directly controlled by the ruling family.

With the exception of Lebanon, all Middle East economies were centrally planned until the late 1980s. However, the process of economic change in the Middle East has been much slower than in other parts of the world, largely because it was not accompanied by political change. In Eastern Europe, the collapse of the governments and the economies went hand in hand. In Latin America, the resurgence of the private sector has followed the establishment of democracy. However, in the Middle East economic liberalization is usually being implemented by the same government officials and bureaucrats who managed the previous state-controlled system. Economic liberalization is therefore being kept on a short rein

Tunisia under President Ben Ali provides the single example of a Middle East. Country where a policy of economic liberalization has coincided with a change of regime. Tunisia has implemented one of the more successful liberalization programmes in the region, although the country also demonstrates that reform implemented by a centralized regime will always be subject to limitations.

There is therefore an element of doubt as to how far economic reform will progress in the Middle East. Political liberalization in the region is likely to remain tokens for some time to come: unelected advisory councils will not give way to elected legislative bodies and election rigging will remain widespread.

The question of whether economic liberalization is possible in such an environment has been the subject of countless academic studies. It does seem obvious, however, that a government's ability to control its citizens will diminish if those citizens become less dependent on it for their economic welfare. If privately owned Saudi companies are able to rely on the local stock market and commercial banks to fund expansion, rather than having to depend on grants and soft loans from the government, the government's control over the industrial community will be reduced. Similarly, if a government wants to encourage foreign investment, it must show that its legal system will be impartial in the event of disputes. A country where the government controls the judiciary is not attractive to international fund managers. (For that reason, some of the most significant aspects of economic liberalization in the Middle East have involved the introduction of new banking and





credit laws. Egypt, Morocco and Libya provide good examples.)

### **1.2 THE DEVELOPMENT OF FINANCIAL MARKETS**

The important point about Middle East economic reform is that it is driven mainly by the need to raise capital and mobilize savings. The development of the Middle East financial markets is therefore a key element within the reform process as a whole.

Middle East economies can be broadly divided into two categories, the rich oil exporters of the Gulf Co-operation Council (GCC - Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) and the developing countries everywhere else. The exceptions are Libya, which has managed to turn itself into a poor oil exporter, Iran and Iraq, whose populations are so large that their oil exports are insufficient on their own to generate a high standard of living,

In the 1970s and 1980s, the GCC states were capital exporters, placing huge amounts of money in western financial markets. A reduction in oil prices, continuing current account deficits and a consequent fall in investment assets and income made the existing policies of all these economies unsustainable by the early 1990s. Industrial expansion could no longer be funded from current revenue or reserves. As a result, governments had to borrow money or cede to the private sector projects that they would previously have undertaken themselves. Sometimes governments had to borrow for balance of payment purposes.

Since the 1990/91 Gulf War, Saudi petrochemical companies have been raising loans to fund expansion plans. They had done this in the early 1980s when they were first established, but in the 1990s, loan finance accounted for a much greater proportion of the total project cost. Soft loans from government development banks were reduced. In 1994, the Middle East's first build-own-operate-transfer (BOOT) financing was completed by a private sector consortium building a power plant in Oman - the Omani government no longer had the money to fund large infrastructural projects. The consortium raised part of its equity finance through a local public share issue and borrowed some of the commercial finance through local syndication. The Omani government planned to use the BOOT structure to finance - other infrastructural projects.

The developing countries of the Middle East were never capital exporters but they were more able to rely on domestic or regional resources than they are now. The state-owned sector was not as large and so was not such a big drain on the exchequer. In the 1970s and 1980s, these countries received large amounts of aid from the Gulf States. Official aid from Arab aid institutions averaged \$1 0.5bn annually in 1980-83, excluding aid from governments and ruling families, which was not directed through official institutions. When the Gulf States started to experience economic





difficulties they greatly reduced their aid contributions. Over time, the inefficiencies of state industries have taken their toll on developing countries' prosperity. The mobilization of private savings and foreign investment was the only way to secure the resources needed for future growth.

Middle East capital markets remain shallow and their development is proceeding slowly. There is nonetheless considerably more diversification now than there was five years ago. Stock markets and bond markets now play a meaningful role in some economies. Much of the progress that has been taking place in capital markets has been in the developing countries of the Middle East, rather than in the wealthier oil states. Egypt, Morocco and Lebanon have captured the interest of foreign bankers and fund managers in a way that Saudi Arabia, Kuwait and Bahrain have yet to do. This is in large part due to the fact that the latter three markets are virtually closed to foreign capital. However, Egypt, Morocco and Lebanon are also more diversified economies, with industrial and service sectors that will, in time, require a variety of financial products. In contrast, the Gulf States are very one-dimensional economies with commercial sectors that see little need to extend their funding options beyond plain vanilla loans from local banks.

During 1995/96, there were three issues of global depository receipts (GDRs) in the Middle East - the first ever in the region. They were held in Morocco, Lebanon and Egypt. All were oversubscribed. The first was for Beirut-based Banque Audi in October 1995, the second for Banque Marocainne du Commerce Exterieur in April 1996 and the third for Cairo-based Commercial International Bank in July 1996. The amounts raised were \$34m, \$52m and \$120m.

Over the medium term, the developing economies of the Middle East are likely to offer more exciting opportunities to both western investment bankers seeking fee income and commercial bankers looking for high margins. It is in these countries the main growth in Middle East capital market activity will occur. The Gulf states will require loan and project finance for the development of oil and gas resources but movement towards diversified capital markets will remain slow.

### **1.3 DISTRIBUTION OF ECONOMIC AND FINANCIAL RESOURCES**

The most striking feature of the distribution of economic resources in the Middle East is the disparity between wealth and population. The six countries that form the GCC account for one-third of the region's gross national product (GNP) but only 990 of the population. The wealth of the GCC states can be seen from the fact that they had \$135bn deposited with foreign banks at the end of 1995, 57% of all such deposits emanating from the Middle East.

In contrast, the central Middle East region, comprising Egypt, Jordan, Syria, Lebanon and Iraq contains 38% of the population (half of which is in Egypt) but accounts for only 27% of GNP.



The GCC will remain the largest single banking market in the Middle East, although, as already indicated, its significance may start to diminish as countries such as Egypt, Morocco and Lebanon develop their financial markets.





## **2 The Economic Development of the Arab Countries**

The prospects for Arab economic development in the nineties is a highly complex subject that does not easily lend itself to generalizations valid for all countries. As is well known, the countries of the region vary greatly. For the oil countries, development will depend to a very large extent on what happens in the oil markets. Despite intensive efforts to diversify their economies, these countries are still heavily dependent on oil as the major source of income. Other countries may not be so heavily dependent on oil, but a good part of their growth is derived from the oil countries through workers' remittances, development assistance, and Arab investment and trade. Still another group of countries is only remotely affected by the fortunes of the oil countries and is more concerned with developments in the export markets for their principal products. In addition to variations based on oil resources, Arab countries differ a great deal with respect to levels of development, per capita incomes, whether they export or import capital, and the extent to which they follow inward-looking or export-oriented development strategies. These variations complicate the task of assessing development prospects in the current decade.

Nevertheless, it is possible to identify a set of issues that are likely to be of major importance in the context of growth and development. These include the issues covered by the papers presented at the seminar: economic reform, investment and capital flows, intra-Arab labor movements, the environment, the impact of the European Union (EU), and the development of human resources. Obviously this is not the only set of issues that affects Arab economic development in the nineties. Others could have been added to the list. Oil, for instance, is highly indicated. But oil has already been the subject of many seminars. A repeat performance would not have added much that is not already known to researchers and policymakers. At the same time a line has to be drawn on the number of issues that can fruitfully be dealt with in the time assigned for the seminar.

The goals of Arab economic development in the nineties are not difficult to define. As with all developing countries, Arab economic development should satisfy the following terms and conditions:

- It should achieve a rate of growth of GDP exceeding that of the population to ensure a steady improvement in living standards.
- It should provide gainful employment for all comers to the labor market and reduce the stock of existing unemployment, both open and disguised.
- It should be consistent with the imperatives of price stability and external balance.





- It should protect the environment so as to safeguard the quality of life of the present generation as well as the opportunities for development of future generations.
- It should spread the fruits of growth to all segments of society and reduce income gaps both within and among Arab countries.

Development can be said to be successful if it satisfies these terms and conditions. On the basis of these criteria Arab development over the last three decades was less than satisfactory. More precisely, the picture that emerges is something of a mixed bag. A handful of countries were able to make big strides in modernization, institution building, and mobilization of resources, with impressive growth in both quantity and quality. The majority, however, was less successful. The extent to which they will improve their performance depends on their capacity to meet the challenges of the new century

### **2.1 Foreign Direct Investment flows to the Arab world**

Foreign Direct Investment (FDI) flows to developing countries are expected to fall by around 20 per cent this year after rising by 8 per cent in 2001. At around \$1,097 billion, the forecast for this year's FDI reflects expectations of only a moderate acceleration in the global economy, a moderate number of privatisations and less cross-border acquisitions by international companies.

Foreign Direct Investment inflows into the Arab region, rose in the year 2000 to \$4.8 billion, or 76 per cent higher than the \$2.7 billion figure for the year 1999 but still represented only 0.38 per cent of global totals, according to the latest World Development Report of the United Nations Conference on Trade and Development (UNCTAD). While the figure represents a substantial increase in nominal terms, it still falls far short of the \$7.8 billion in FDI that entered the region in 1998.\*

Capital flows into the region increased notably in 1997, reaching \$7 billion, and then rose by 12 per cent in 1998 to \$7.9 billion. As a percentage of the world total, FDI inflows also reached their highs in 1998 when the Arab region accounted for 1.14 per cent of the global total. The figure has since fallen. The region continues to suffer as one of the least attractive FDI recipients, its \$4.7 billion total represents only 56 per cent of that of Africa for the same period and only 18 per cent of the total in Central and Eastern Europe. Moreover, FDI inflows into the Arab region are likely to slow this year in line with global trends and higher regional uncertainty. Any region-specific increases are likely to occur in developed countries, which remain the prime destination of FDI.

---

\* Henry T. Azzam      Jordan Investment Trust (Jordinvest)





While FDI to developing countries as a whole did rise during the year 2000 to \$240 billion, their share in world FDI flows declined for the second year in a row to 19 per cent compared to the peak of 41 per cent in 1994.

Some Arab countries have performed significantly better than others, with Bahrain, Jordan and Qatar reporting average annual FDI growth rates for the period 1986-2000 of more than 30 per cent. However, Algeria, Egypt and Syria reported annual average increases of less than 10 per cent, while Kuwait, Oman and the UAE reported a declining average. Lebanon recorded a 28 per cent decrease in FDI flows in 2000 from the 1999 levels with a smaller decline estimated for 2001, due mainly to worries related to the country's rising indebtedness. Egypt remained one of the most important recipients of FDI flows in the region and saw a higher level of inflows in 2000, rising to \$1.2 billion compared to \$1 billion in 1999. The FDI flows have rapidly diminished in 2001, due to uncertainty associated with the exchange rate of the Egyptian pound and the delay of major privatisation deals. It is estimated less than \$300 million in FDI flows went to Egypt last year and the figure is not expected to exceed \$500 million in 2002.

Saudi Arabia, has been the largest beneficiary of Foreign Direct Investments among the Arab countries, accounting for 21 per cent of the total FDI coming to the region. The kingdom has embarked on a campaign to encourage Foreign Direct Investment following the enactment of a new foreign investment law in early 2000. Since then, the Saudi Arabian General Investment Authority has approved some \$10 billion in new foreign investment licences. Only a small portion of that money have actually flowed into the kingdom by the end of 2001. Significant progress has also been made in the initiative to open the gas industry to foreign investment, however sizeable investment flows are unlikely to occur before 2003.

Foreign Direct Investment in Jordan totalled around \$300 million in 2000, and \$350 million in 2001, more than three folds the level recorded in 1999. FDI in the Kingdom was boosted by several privatisation deals carried in the past two years and various investor friendly initiatives taken by the government. The Qualified Industrial Zones are estimated to have received more than \$200 million and additional foreign direct investments are expected as regional and international institutions position themselves in the country to benefit from the Free Trade Area signed with the US. Furthermore, the Kingdom is going ahead with various BOT projects in water, gas, oil and electricity

Looking forward, the recent improvements in the region's macroeconomic fundamentals, along with the opening up of the oil and gas sector in several Gulf states to foreign investors and the continued commitment of several Arab states to privatisation and the implementation of BOT





projects will act as a further stimulus to foreign direct investment in the region. However, several obstacles still need to be tackled. These include among others privileged state enterprises, bureaucracy and red tape, weak economic growth, absence of entrepreneurial culture and the failure of countries of the region to connect to the global economy.

To promote FDI, Arab countries should develop clear investment promotion laws consistent with international best practice, have one central agency responsible for all matters related to FDI placing it above ministerial rivalry and bureaucratic constraints. They also need to have in place sound regulatory framework that protects fully the rights of investors and introduce reforms on the corporate tax system to make it internationally more competitive. Finally FDI inflows go to countries that have no restrictions on capital movement and a transparent exchange rate mechanism that facilitates the free flow of capital and the repatriation of profits and investments.



### 3 Financial sector Reforms

As in other developing countries, the reform challenges in the financial sectors of many Arab countries include three key elements:

- 1) Rationalizing the rates of return structure supporting the mobilization and allocation of loan able funds;
- 2) Deepening money and capital markets in the formal sector of the economy
- 3) Strengthening prudential regulation and supervision.

The financial sector in many Arab countries has been characterized by strict controls over rates of return, supplemented by quantitative limits on the overall and sectoral allocation of credit. This system grew out of the desire, inter alia, to prevent usurious rates and to provide mechanisms for channeling credit to particular sectors deemed to be a national priority (heavy industrial and export-oriented sectors). In many cases, however, the system of strict controls over rates of return and quantitative credit allocations has contributed to financial disintermediation, currency substitution, and credit rationing of productive activities-particularly with an over expansionary budgetary stance. In addition, the channeling of subsidized credit to certain sectors has resulted in investments in financially questionable projects, with recurrent funding requirements and a growing portfolio of impaired bank assets. Accordingly, several Arab countries have embarked on a process of financial liberalization as part of their financial sector reforms.

In some of the Arab countries, the first steps toward financial liberalization have included the implementation of greater flexibility in rates through the use of prescribed ceiling and floors (Morocco), subject in some cases to timely changes in view of developments in international financial markets (Qatar). In other countries, the initial phase focused primarily on deposit rates. Eventually; however, most of these countries have also substantially liberalized their rate structures (Algeria, Bahrain, Egypt, Jordan, Morocco, Tunisia, and the United Arab Emirates) and taken steps to terminate preferential credit arrangements for public enterprises (Tunisia). In some countries where the banking system has been burdened by a large portfolio of nonperforming assets, the government has moved to strengthen the financial integrity of the banking system by exchanging a portion of these assets for government obligations (Kuwait) and recapitalization through direct budgetary transfers (Egypt).

The beneficial impact on financial intermediation of the liberalization of the rate structure also depends on a concurrent move away from quantitative credit restrictions and toward indirect





monetary control instruments. Accordingly, steps have been implemented for increased reliance on reserve requirements (Morocco), elimination of prior central bank approval for bank credit (Tunisia), and modifications to the rediscount mechanism to render it more sensitive to market conditions (Egypt). Nevertheless, several countries remain encumbered by administrative credit allocation mechanisms that, respond weakly to risk/return considerations.

Improving the financial intermediation process in Arab countries also requires a deepening of money and capital markets. This deepening would provide for a wider range of domestic financial instruments-thereby allowing for a shift in portfolio incentives away from both acquiring physical assets (including for consumption purposes) and from holding foreign financial assets. At the same time, it would strengthen the institutional basis for indirect monetary control instruments thereby also strengthening the allocation of loanable funds.

For most Arab countries, the development and deepening of money and capital markets is an important challenge. In several cases, it involves renewed efforts at institution building. Some Arab countries have had money markets in operation for several years but their effectiveness has been constrained by the absence of inter bank transactions (Algeria), limited central bank rate flexibility in intervention operations (Morocco), and restraints on financial sector participation (Algeria and Morocco). These constraints are being addressed, complemented by the introduction of new financial instruments and auctioning procedures for short-term government securities. Similarly, efforts are under way in certain countries to strengthen existing capital markets, including through improvements in trading, reporting, and accounting systems.

Financial liberalization may under certain circumstances involve increased risk for the soundness of the financial system, which also implies contingent liabilities for public finances, particularly in the context of explicit public sector safety net arrangements. Accordingly, steps to liberalize and deepen the financial system, must be accompanied by an appropriate strengthening of prudential regulatory and supervisory practices. The emphasis in Arab countries has been primarily on improving the regulation and supervision of commercial banks. Among recent steps were the introduction of minimum capital and/or net-worth requirements (Algeria, Egypt, Jordan, Morocco, and Oman) and minimum liquidity ratios (Qatar).

Expected guidelines have been issued for improved classification of loans according to risk and provisioning standards (Algeria, Bahrain, Egypt, Morocco, and Tunisia) and for portfolio concentration to individual single customers, and on account of foreign exchange transactions (Algeria, Egypt, Morocco, Qatar, and Tunisia). In most of the Arab countries, steps have been taken to strengthen on-site and off-site surveillance, and to improve and standardize accounting practices.





Despite these advances, the need to continue improving the prudential regulatory and supervisory regimes is recognized, as well as extending it to non bank financial institutions. This issue takes on added importance in the context of efforts toward the international harmonization of prudential regulatory and supervisory practices, particularly in the context of the Basle Committee's guidelines. Indeed, regulatory strengthening is critical if Arab financial Institutions are to compete on an equal and effective footing in financial markets that have become increasingly globally integrated and interdependent.



## **4 Trade, Foreign Direct Investment and Development in the Middle East and North Africa**

### ***4.1 Introduction***

The plan of the chapter is as follows. In Section 2, I review the development performance of the MENA\* region and show that it has been trapped in a slow growth and high unemployment situation since the early 1980s. In Section 3, I review trade and foreign investment links and show that the region has not participated significantly in the huge growth of trade and investment flows that have taken place in the last two decades. In Section 4, I connect these two sets of observations through a review of international evidence linking growth and employment to trade openness and investment climate. The review shows that openness and investment climate are complementary in their effect on development performance. Indeed, a good investment climate is a pre-requisite for obtaining the full benefits of an open trade environment. I briefly assess the investment climate in the MENA region and conclude that, despite some improvements in the last two decades, the region still lags in this respect. Finally, in Section 5, I simulate the expected impact on growth and employment of further trade and investment integration for the region.

### ***4.2 MENA's Record in Growth, Employment and Poverty***

Figure 1 provides a view of growth performance in the MENA region between 1978 and 2000. This extended perspective allows one to see both the oil-price-supported boom of the 1970s and the slow growth trend thereafter. For the past decade, the average growth rate of the region has been around 3.3 percent per annum. This translates into a per capita growth rate of around 1.2 percent.

---

\* MENA, Middle East and North Africa Arab countries



GDP growth Rate, MENA 1963-2000

(Algeria, Egypt, Kuwait, Oman, Morocco, Saudi Arabia, Syria, Tunisia)

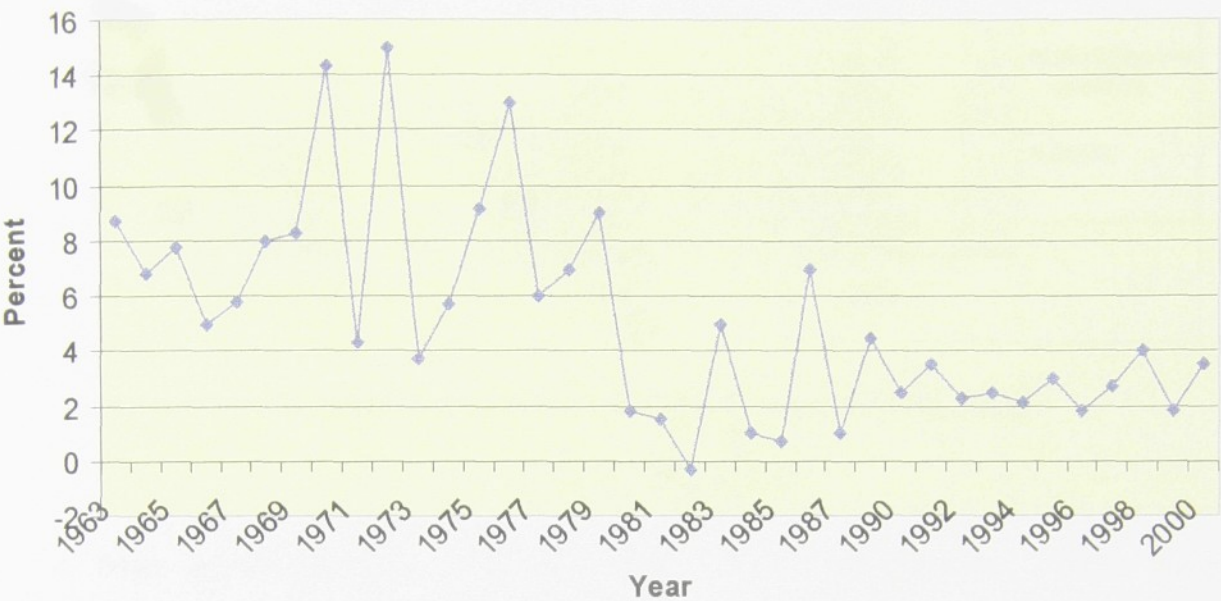


Figure 1, Source: World Bank data and statistics

Figure 2 provides a comparison of MENA's growth during the 1990s with that of other regions. The MENA region's per capita growth rate of 1.2 percent is worse than that of such regions as Latin America, South Asia and East Asia. It is better only than that of sub-Saharan Africa and the Europe/Central Asia region. The latter spent most the decade in the throes of a wrenching transition away from state-dominated economies.

Comparative per capita growth rates (1990-2000)

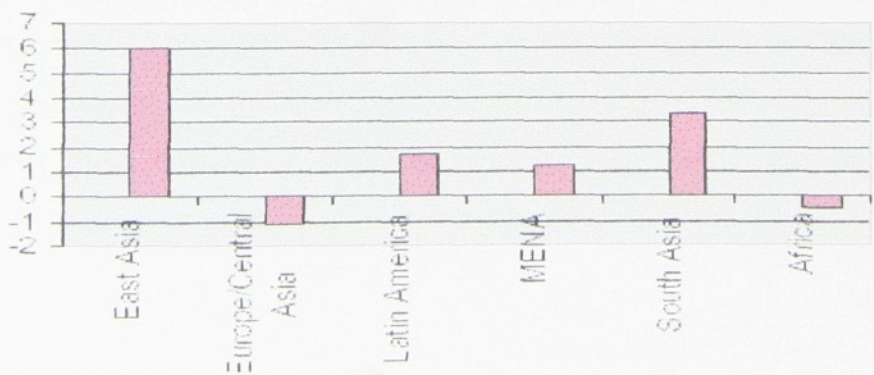


Figure 2: Comparative per capita growth rates (1990-2000) Source: World Bank

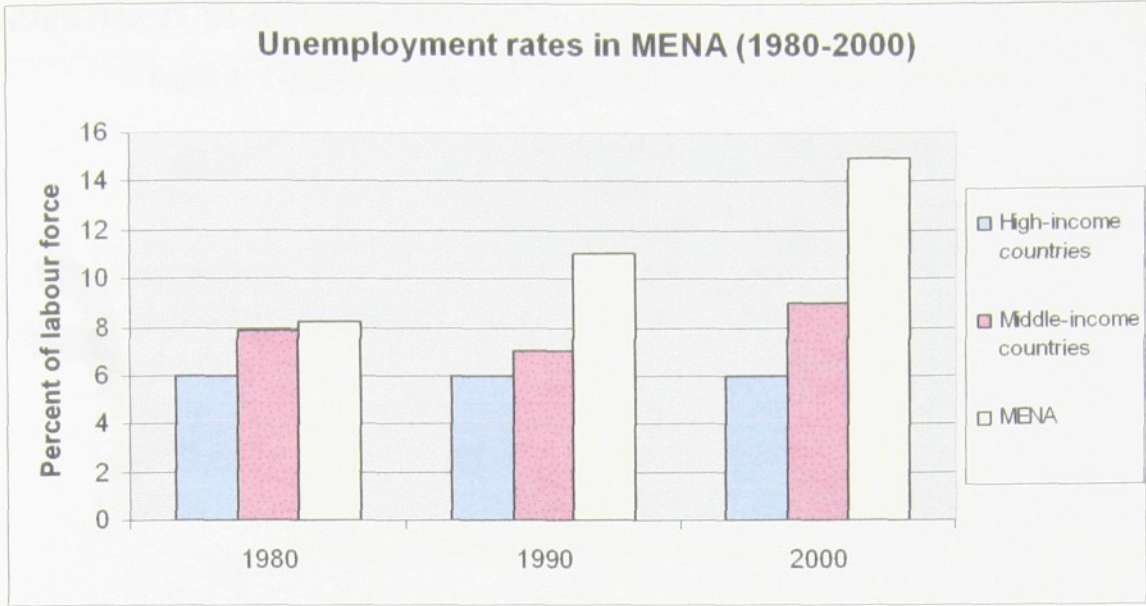


Figure 3: Unemployment rates in MENA (1980-2000)

Source: World Bank

A Weak growth has been reflected as well in high unemployment. While there is a demographic aspect to this, in that the region's fertility rates have been relatively high, there is no denying that slow overall economic growth has meant that the demand for labor, especially in the private sector, has failed to keep pace with the large numbers of people joining the labor force. Figure 3 shows how serious the problem of unemployment has become in the region. The average unemployment rate is over 14 percent currently with some countries, such as Algeria, featuring rates as high as 29 percent. Finally, it is instructive to consider the region's performance in poverty reduction. Here the region appears to have done much better than its growth and employment situation would suggest (see table 1). Measured by the \$1 per person per day criterion, the region's poverty rate is around 2.8 percent currently. This is the lowest in comparison with other regions. Measured by the \$2 criterion as well, MENA fares comparatively well although the absolute rate of poverty jumps to around 24 percent. However, the trend over time is not comforting. Between 1990 and 2000, there was an increase in poverty (by both criteria). If weak growth persists over the next decade or so, the poverty rate will continue to increase and the region will begin to look much worse in comparison with its own past as well as with several other regions.





Table 1: Comparative poverty reduction performance (1990-2000)

	\$1 poverty index		\$2 poverty index	
	1990	2000	1990	2000
East Asia	29.4	14.5	68.5	48.3
Europe/Central Asia	1.4	4.2	6.8	21.3
Latin America	11	10.8	27.6	26.3
MENA	2.1	2.8	21	24.4
South Asia	41.5	31.9	86.3	77.7
Africa	47.4	49	76	76.5

*Source: Global Economic prospects*

### 4.3 Trade and Foreign Investment Performance

#### 4.3.1 Trade performance

Overall trade. Countries in the region differ significantly in relative endowments of natural resources and labor. Some are resource-poor with abundant labor-Egypt, Jordan, Lebanon, Morocco, and Tunisia. Some are resource-rich with abundant labor-Algeria, Syria, and Yemen as a special low-income case. And some are labor importing and resource-rich-the GCC countries. Despite the diversity of country characteristics trade outcomes are fairly common throughout the region. The past two decades have largely featured missed opportunities in trade integration-worse for the resource-rich and labor -abundant countries, and somewhat better among the resource-poor countries, with the GCC falling in-between. The MENA region clearly failed to ride the wave of globalization that began in the mid -1980s. While world trade rose by around 8 percent in the 1990s, MENA's trade with the world rose by only 3 percent.\*

Non-oil exports. A significant portion of the trade of the MENA region is made up of oil and oil-related products whose value fluctuates with the price of oil. To fully appreciate the role of policy in determining exports, it is necessary to focus on the performance of the non-oil component of exports. Figure 6 shows that while overall merchandise exports have fluctuated between 32 percent and 17 percent of GDP, most likely depending on the price of oil at any given time, non-oil exports have stayed at a steady and low rate of around 7 percent of GDP since the early 1980s.

There is no evidence that the non-oil exports sector has grown systematically to offset the relative

---

\* The Middle East and North Africa Region: The Challenges of Growth and Globalization 2004



decline of oil exports since the mid-1970s and form a substantial new base of export earnings for the region. Whatever policies have been introduced over this period have clearly not succeeded in generating a higher ratio of non-oil exports.

### Exports (as percent of GDP) for MENA countries

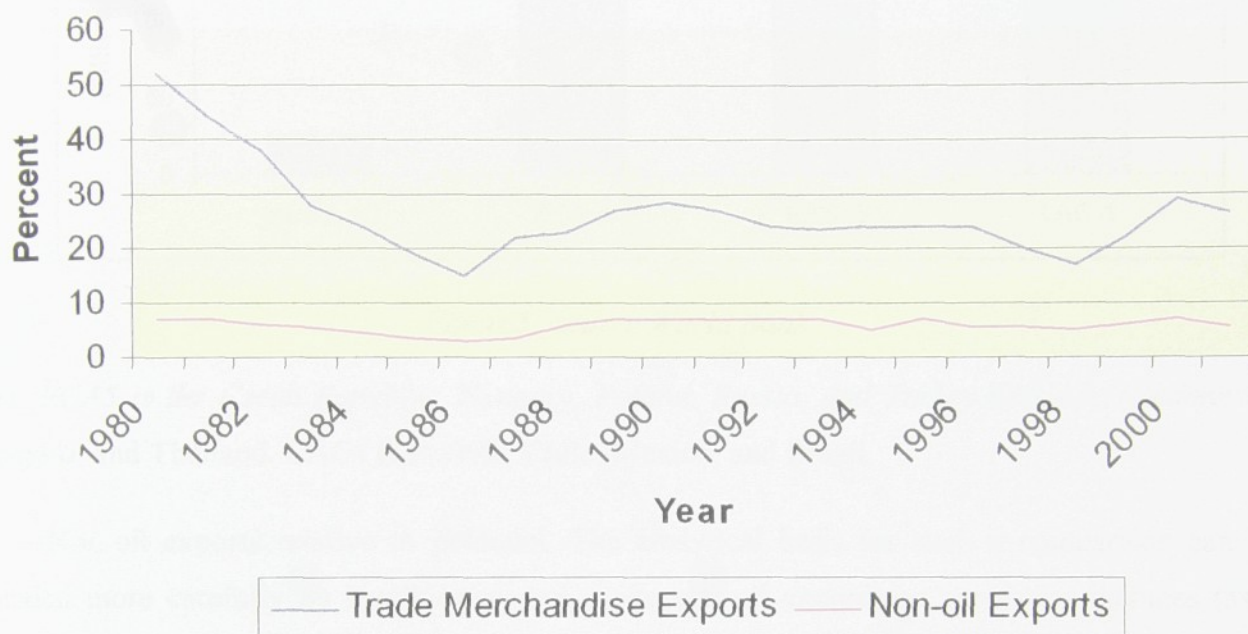


Figure 4 Source: World Bank

Another way to measure trade performance is to compare across regions. Figure 7 provides such a comparison in the case of non-oil exports. Total non-oil exports of the MENA region amounted to about \$28 billion in 2000 (excluding re-exports). For a middle-income region with nearly 300 million people and with good resource endowments, this is a small fraction of potential. Finland, with 5 million people, has almost twice the non-oil exports of the entire MENA region. And Hungary and the Czech Republic, with populations of about 10 million, each had greater non-oil exports than the region. Non-oil exports of the MENA region are vastly smaller than those from other subregions with similar populations and resource endowments. For example, a group of five Eastern European countries-the Czech Republic, Hungary, Poland, Russia, and Turkey, with a similar population of 270 million-had non-oil exports of \$151 billion, five times more than MENA's. Three Southeast Asian countries-Indonesia, Malaysia, and Thailand-had non-oil exports of \$197 billion, seven times more than MENA's. And four Latin American countries-Bolivia, Chile, Mexico, and Brazil-had non-oil exports of \$213 billion, eight times more than MENA's.



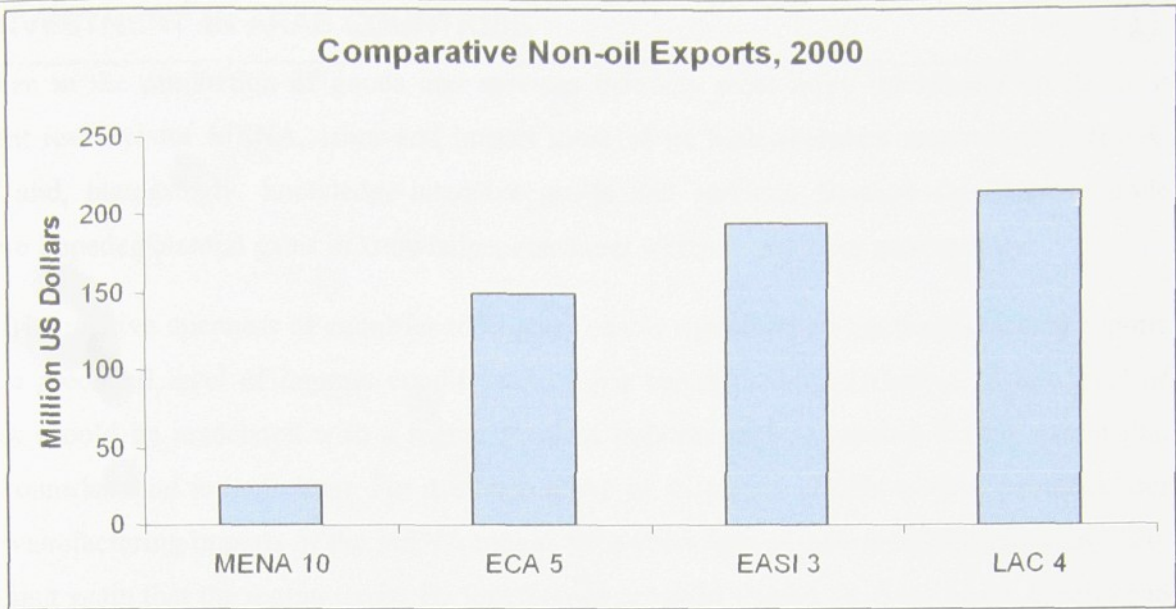


Figure5, Source World Bank

Note: ECA5 is the Czech Republic, Hungary, Poland, Russia, and Turkey. EASIA3 is Indonesia, Malaysia, and Thailand. LAC4 is Bolivia, Chile, Mexico, and Brazil.

Non-oil exports relative to potential. The analytical basis for such a comparison can be extended more carefully by conditioning per capita non-oil exports on per capita incomes (as a proxy for overall skills and institutional endowments that influence the capacity to export)-and on natural resources endowments (measured by the value of resource-based exports, mainly oil and minerals) and population. For some 42 mostly middle-income countries (including the MENA countries), the results suggest a strong positive association of per capita non-oil exports with per capita incomes, a negative association with natural resource endowments and population size. That is expected, since higher skills and institutional endowments should support higher exports, while greater natural resource rents should show up in less intensity of effort to export non-natural resource exports. And larger countries tend to trade less. For the MENA countries, their non-oil exports are, on average, one-third of their predicted levels. Only Jordan and Morocco had exports close to what would be predicted. The world's three biggest under-performers are MENA countries (Algeria and Egypt), and the other MENA countries are all under-performers.

Manufactured imports relative to potential. Trade has impacts much bigger than those captured by export performance. When firms can get imported inputs at world prices and quality, the knowledge embodied in goods and services is transferred from the rest of the world to the domestic economies-the productivity and knowledge enhancing spillover of trade. When consumers can buy goods and services produced more efficiently in the rest of the world, they benefit from lower prices and better quality. But the biggest benefit of trade is that it allows countries to





specialize in the production of goods and services that rely most more intensively on its most abundant resource-for MENA, labor-and import more of its least abundant resource-for MENA, capital and, increasingly, knowledge-intensive goods and services. Barriers that impede trade therefore impede potential gains in knowledge, consumer welfare, and labor productivity.

The relative openness of countries to imports can be measured by comparing actual imports versus a predicted level of imports conditioned on per capita incomes (where a higher level of incomes should be associated with a higher level of imports) and population (to the extent that larger countries tend to trade less). For the same group of 42 mostly middle-income countries, per capita manufacturing imports of the MENA region were about half of their predicted levels in 2000, confirming again that the region trades far less than its potential (figure 8). Once again,Algeria and Syria have extremely low actual levels of imports, implying relatively closed trade regimes. Others also fall surprisingly below predicted levels, including Egypt, Jordan, Saudi Arabia, Morocco, and Tunisia. Only Lebanon is more open than expected.

Manufactured imports relative to potential. Trade has impacts much bigger than those captured by export performance. When firms can get imported inputs at world prices and quality, the knowledge embodied in goods and services is transferred from the rest of the world to the domestic economies-the productivity and knowledge enhancing spillover of trade. When consumers can buy goods and services produced more efficiently in the rest of the world, they benefit from lower prices and better quality. But the biggest benefit of trade is that it allows countries to specialize in the production of goods and services that rely most more intensively on its most abundant resource-for MENA, labor-and import more of its least abundant resource-for MENA, capital and, increasingly, knowledge-intensive goods and services. Barriers that impede trade therefore impede potential gains in knowledge, consumer welfare, and labor productivity.

The relative openness of countries to imports can be measured by comparing actual imports versus a predicted level of imports conditioned on per capita incomes (where a higher level of incomes should be associated with a higher level of imports) and population (to the extent that larger countries tend to trade less). For the same group of 42 mostly middle-income countries, per capita manufacturing imports of the MENA region were about half of their predicted levels in 2000, confirming again that the region trades far less than its potential .Once again,Algeria and Syria have extremely low actual levels of imports, implying relatively closed trade regimes. Others also fall surprisingly below predicted levels, including Egypt, Jordan, Saudi Arabia, Morocco, and Tunisia. Only Lebanon is more open than expected.





Trade in Services. The MENA region has been losing world market shares in exports of services. In contrast, comparators in both East Asia and Pacific and Eastern Europe and Central Asian regions have more than doubled their world market shares.

Tourism, the main service export of the MENA region, has fluctuated between 3 and 4 percent of GDP during the 1990s. Some other regions have done better. Eastern Europe and Central Asian region (ECA4), a competing destination for tourists from Europe, had a threefold increase in the share of tourism receipts to GDP, overtaking all other regions. Also, while world tourism trade has expanded fivefold in the last 20 years, MENA's market share has declined from 3.4 percent in 1987 to around 2.6 percent in 2000. But with a favorable endowment of world heritage sites and a home to some of the world's key religions and civilizations, the tourism potential of MENA region remains significant. Regional conflicts may have discouraged tourists from visiting in larger numbers, but infrastructure and marketing efforts have proved successful in some countries, such as Jordan.

MENA's share of world exports of services

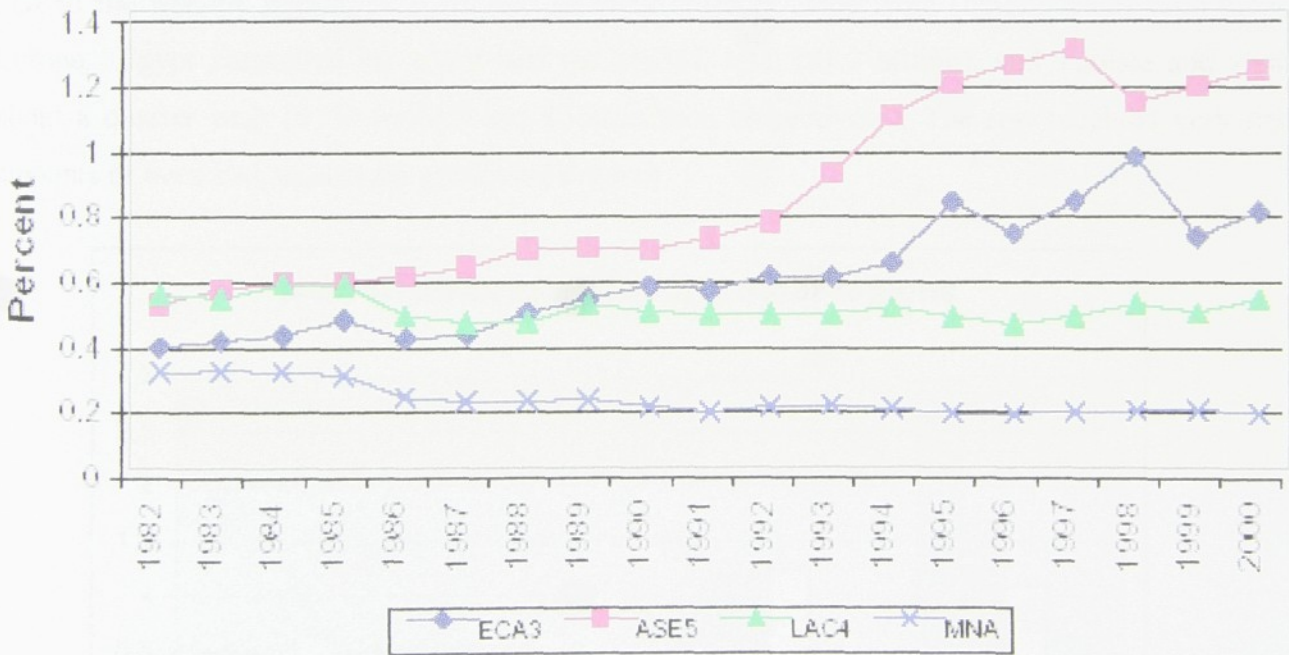


Figure 6: Source: World Bank, 2003, Notes: ECA 4 is Czech Republic, Turkey, Poland, and Hungary. EA5 is China, Indonesia, Republic of Korea, Malaysia, and Thailand. LAC4 is Argentina, Brazil, Chile, and Mexico

#### 4.3.2 Foreign Direct Investment Performance

The MENA region is not well connected with global investment and production chains. This is evident from the limited role played in the region's economies by foreign direct investment and





by trade in parts and components. Integration with global private capital flow markets has also been relatively stagnant in sharp contrast to comparable country groups. Net FDI inflows to MENA (measured as a share of PPP GDP) were consistently less than half a percentage point of GDP for most of the period. In the early 1980s this put MENA roughly on par with comparable groups. But in the next 15 years, the average of the other comparators had risen to between 1.0 to 2.5 percent while MENA continued to trail at around 0.5 percent.

The MENA region, excluding the Gulf countries, received net inflows of foreign direct investment (FDI) of about \$2.2 billion in 2000—slightly more than 1 percent of the \$158 billion to all developing countries, and one-sixth of their share (7 percent) in the GDP of all developing countries. The group of five Eastern European countries (Czech Republic, Hungary, Poland, Turkey and Russia) together received some \$19 billion, nine times more than MENA. The three East Asian countries (Malaysia, Philippines, and Thailand) received more than \$8 billion in inflows, four times more than MENA. And the group of four Latin American countries (Bolivia, Chile, Mexico, and Brazil) received about \$50 billion, more than 22 times the inflows to the MENA region. These comparisons provide some indication of the huge potential for expanding inflows of FDI to the MENA region. A large part of these inflows came from (neighboring) high-income Europe. Egypt accounted for about half the MENA total (\$1.2 billion), and Tunisia and Jordan about a quarter each (\$750 million and \$560 million respectively). The rest received very small amounts or even had significant outflows (Yemen)

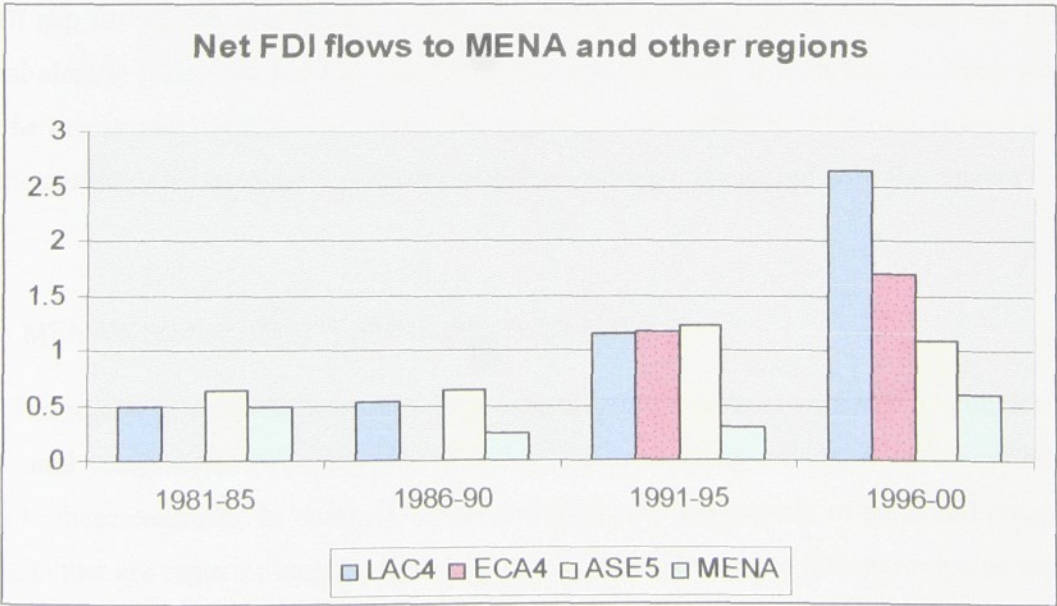


Figure 7, Source: World Bank 2003. Notes: ECA 4 is Czech Republic, Turkey, Poland, and Hungary. EA5 is China, Indonesia, Republic of Korea, Malaysia, and Thailand. LAC4 is Argentina, Brazil, Chile, and Mexico





Potential for foreign direct investment. The potential for higher inflows by country can be determined by conditioning FDI inflows on non-oil trade performance (measured by non-oil export to PPP GDP ratios), natural resources, and population. FDI inflows are known to be closely related to trade flows, so the predicted levels of FDI should be associated with trade. Natural resource endowments often also lead to higher levels of foreign investment, albeit of a different type of flows. And size may matter, with larger countries expected to receive higher investment inflows (market-seeking investments), but because this is already accounted for by measuring FDI inflows relative to GDP, the residual population variable may or may not be significant. The results for 42 countries are pretty much in accord with expectations: trade and natural resources raise FDI flows, but size turns out to be a negative influence. How do the actual inflows of FDI to MENA countries look in relation to expected inflows, once non-oil trade, natural resources, and population are factored in? Firstly, only Jordan, Lebanon and Tunisia (small resource-poor countries) do as well or slightly less than expected. Morocco is a surprise in how little it receives in FDI inflows (at least for 1998-2000); Egypt receives more, possibly given its larger size, but still well below expected levels. Second, among the countries with large natural resource endowments, Saudi Arabia is the only country that receives relatively high FDI led by its oil sector. All the larger oil-producing countries (Algeria, Syria, and Yemen) receive very low FDI relative to expected levels. Third, for the MENA countries as a whole, FDI inflows are only about half what they should be receiving. In comparison, Chile receives three times as much FDI as expected and the Czech Republic twice as much. Others such as China, Brazil and Argentina receive FDI inflows four to five times their expected levels. The FDI gap for MENA also shows investment climate barriers in these countries, since the gap in potential already takes into account their very low non-oil trade. If their non-oil trade were higher and if the investment climate were better, the region should expect FDI inflows at least four to five times the current level-or some 3 percent of GDP on average, compared with the current 0.5 percent of GDP

#### 4.3.3 MENA's participation in global production chains

The region as a whole has a very large negative trade balance with OECD countries in trade in parts and components (\$14 billion), with imports accounting for about 15 times the value of exports to these countries. In contrast, China and Malaysia had exports of parts and components to the OECD that are twice as large as their imports. The MENA region thus participates very little in global production sharing, exporting primarily low-value finished goods, and importing parts and components for an inefficient manufacturing base—typical of inward-looking import-substitution economies





Table 2: The relative importance of parts and components in MENA countries

Country	Value of parts and components in OECD trade (\$ million)				Share of parts and components in all manufacture (%)			
	Exports		Imports		Exports		Imports	
	1988	2000	1988	2000	1988	2000	1988	2000
Algeria	6	7	943	994	2.6	2.8	23.5	18.7
Bahrain	39	24	156	208	19.6	6.9	18.1	16.5
Egypt	19	54	1279	2142	4.3	3.1	23.5	24.7
Iran	8	18	941	1311	1.7	2.2	21.1	25.6
Jordan	25	21	301	276	20.2	8.5	21.0	18.4
Kuwait	42	8	437	505	38.0	3.9	15.4	17.0
Lebanon	3	9	80	242	1.5	3.5	7.6	11.8
Libya	10	6	560	369	3.8	1.6	16.3	21.3
Morocco	33	105	421	1231	2.1	2.5	14.4	19.2
Oman	22	45	208	330	8.3	14.0	15.2	18.8
Qatar	6	17	115	300	11.1	3.7	16.6	20.4
Saudi Arabia	73	213	1941	3298	3.6	7.1	13.5	19.0
Syria	1	9	148	338	4.5	2.7	16.2	21.5
Tunisia	72	332	330	859	5.5	7.4	15.8	14.4
United Arab Emirates	31	208	714	2919	12.2	10.9	16.7	20.8
Yemen Rep.	2	1	61	105	47.0	6.7	15.5	19.6
<b>MENA</b>	391	1078	8635	15430	5.2	5.7	17.1	19.9
Labor-abundant, resource-poor	151	521	2411	4751	4.2	4.7	18.6	19.3
Labor-abundant, resource-rich	17	35	2094	2748	2.4	2.5	21.4	21.9
Labor-importing, resource rich	171	508	3133	7057	6.1	8.4	14.5	19.7
<b>Memo Items:</b>								
China	379	25409	2237	16091	1.9	11.9	11.1	25.6
Japan	34212	51583	5373	17268	20.4	20.3	13.5	21.1
Republic of Korea	2841	15720	5077	11128	6.7	18.3	19.4	17.6
Malaysia	452	11526	1241	6959	7.7	22.5	18.8	23.1
Singapore	4425	9584	4492	10877	32.8	23.4	25.1	22.9
Taiwan, China	5231	21369	4265	11208	11.5	24.3	17.2	17.1

Source: World Bank





#### 4.4 *Trade Policy, Investment Climate and Growth Performance*

##### 4.4.1 Trade Protection

Of the many factors that affect trade outcomes, price-related ones are usually among the most important. The prices of tradable goods and services are strongly affected by tariff levels and non-tariff barriers as well as by real effective exchange rates which are themselves influenced by macroeconomic policies and conditions. In general, trade protection is high for the developing countries in MENA relative to their income levels. Comparing over regions and over time, we find that MENA trade barriers have been the slowest to come down, and there have been episodes as well of reversals in policy during the 1990s. Exchange rate misalignments, in several countries and over significant periods, have also affected trade performance.

High protection. Trade protection can be shown by a variety of measures reflecting tariff rates and the tariff equivalents of non-tariff barriers. Table 2 presents data for MENA and several comparator groups using several different measures whose derivations are described in the notes to the table. All the measures show a similar ranking. Key results include: o

- Average nontariff barrier protection is higher in MENA than in other lower-middle-income countries; indeed, it is higher than in all other regions of the world except for Latin America.
- Average MENA trade protection measured in terms of Anderson-Neary Ideal Measure is one-quarter above the comparable average for lower middle-income countries; it is also higher than in all other comparator groups.
- Tunisia and Morocco have among the highest protection rates in MENA (and the world) despite several reform episodes since the early 1980s while Egypt has the highest dispersion of tariff rates
- On the positive side, Oman and Saudi Arabia, two oil-rich countries, have lower protection than the average for upper middle-income comparators.



Table 3: Trade protection indicators for MENA (most recent year)

	Simple Average	Weighted Average	Standard Deviation	NTB Coverage	Anderson-Neary Ideal Measure
Algeria	22.4	15.0	14.3	15.8	20.0
Bahrain	8.8	..	..	..	..
Egypt	20.5	13.8	39.5	28.8	19.0
Iran	4.9	3.1	4.2	..	..
Jordan	16.2	13.5	15.6	0.0	..
Lebanon	8.3	12.0	11.2	..	22.2
Morocco	32.6	25.4	20.5	5.5	25.9
Oman	4.7	4.5	1.2	13.1	4.4
Saudi Arabia	12.3	10.5	3.1	15.6	11.0
Syria	21.0	..	..	..	..
Tunisia	30.1	26.3	12.6	32.8	19.2
<b>MENA</b>	<b>16.5</b>	<b>13.8</b>	<b>13.6</b>	<b>15.9</b>	<b>17.4</b>
<b>ECA4</b>	<b>12.9</b>	<b>7.2</b>	<b>18.3</b>	<b>12.4</b>	<b>3.5</b>
<b>LAC4</b>	<b>12.2</b>	<b>12.9</b>	<b>6.9</b>	<b>48.4</b>	<b>13.9</b>
<b>EA5</b>	<b>11.3</b>	<b>8.3</b>	<b>17.9</b>	<b>13.5</b>	<b>6.0</b>
<b>LMIC</b>	<b>15.3</b>	<b>12.5</b>	<b>15.0</b>	<b>13.4</b>	<b>13.2</b>

Source: World Bank

Notes: Tariff rates used are most favored nation tariff rates. Non-tariff barrier coverage refers to the number of tariff lines that have at least one non-tariff barrier. The Anderson and Neary ideal protection measure is the uniform tariff rate that must be applied to the free-trade regime as a compensating variation to return welfare to most recent year of observation. The comparators are ECA4 (Czech Republic, Turkey, Poland, and Hungary), LAC4 (Argentina, Brazil, Chile, and Mexico) and EA5 (China, Indonesia, Thailand, Malaysia, and Republic of Korea). LMIC refers to lower middle income countries (with GNI per capita in the range \$746-\$2975). The comparator numbers are simple averages of the data for the respective countries they represent

With respect to non-tariff barriers, the typical experience in recent years is one of improvement. In Tunisia, extensive quantitative restrictions (affecting some 90 percent of domestic output) have progressively been reduced (textiles, passenger cars, agricultural products) in the 1990s. In Morocco, most quantitative restrictions have been eliminated. In Algeria, quantitative restrictions have been reduced although temporary reversals occur and prior authorization lists still exist for some items. In Jordan, removal of quantitative restrictions was the main item of trade





liberalization in 1988 and reduced coverage from 40 percent to 7 percent of production; most remaining quantitative restrictions have been eliminated since 1995. In Egypt, import licensing was eliminated in 1993 and the scope of quantitative restrictions progressively reduced. In Lebanon, some import licensing and multiple authorizations remain. Syria has several lists of goods with import eligibility requirements (public sector, private sector, and 2 negative or banned lists) with a general licensing requirement for all imports

#### 4.4.2 Exchange Rate Management

During the past three decades, many MENA countries experienced substantial overvaluation of their real exchange rate-around 29 percent a year from the mid-1970s to the mid-1980s, and 22 percent a year from the mid-1980s to 1999. In general, the extent of overvaluation did not seem to have significantly decreased during the 1990s contrary to the experience of Latin American, African, or Asian economies

Table 4: Average exchange rate misalignment and volatility

1975–80/84 (depending on country)	Misalignment (Percent per year)	Volatility
MENA	29	7.9
Latin America	20	11.2
Africa (CFA)	61	12.7
Africa (non-CFA)	29	11.3
South Asia	43	13
South East Asia	10	5.4
<b>1985–99</b>	<b>Misalignment</b>	<b>Volatility</b>
MENA	22	12.4
Latin America	10	12.9
Africa (CFA)	28	14.5
Africa (non CFA)	13	16
South Asia	15	8.3
Southeast Asia	5	8.6

Source: Nabli and Veganzones-Varoudakis, 2002.

For the MENA region as a whole, exchange rate policy explains losses in competitiveness and in manufactured exports. Real exchange rate overvaluation has reduced, on average, the ratio of manufactured exports to GDP by 18 percent a year. Manufactured exports, which averaged 4.4 percent of GDP from 1970 to 1999, could have reached 5.2 percent of GDP if no overvaluation had taken place. These losses were more concentrated in the 1970s and 1980s than in the 1990s, due to the higher overvaluation of the currencies during those two sub-periods.





Finally, a significant reason for the persistent misalignment and over-valuation of exchange rates is the prevalence of pegged or fixed exchange rate practices. Most MENA countries have had de facto or formal pegged nominal exchange rates, with only some recent changes towards floating exchange rates (as in Egypt in 2003). This is related to a general fear of floating. While there may have been gains in terms of reduced inflation, the trade-off clearly has been to hurt GDP growth and exports.

### 4.4.3 The Investment Climate in MENA

International comparisons suggest that the MENA region lags most other regions in regard to investment climate considerations. The region tends to have relatively high transaction costs for starting, operating and closing businesses. The following list provides a summary account of some relevant issues for which more detailed information can be found in World Bank (2003):

**Starting businesses.** The cost of legally registering a new business is influenced both by the number of steps required and the number of days required to fulfill necessary procedures. When measured as a ratio of per capita income, this cost is higher in MENA than in most other regions.

**Contract enforcement.** When ranked along a procedural complexity index the MENA region has the second highest score among seven regions for which the relevant data have been compiled (World Bank, 2004). This index covers both the number of procedures required in contract enforcement actions as well as the number of days. Difficulties and delays in contract enforcement are often cited by foreign investors as a significant impediment to investment.

**Air transport.** Despite some progress, the regulatory reform of air transport in MENA is still at an early stage. Services remain largely provided by state-owned airlines and airports, with competition restrained by restrictive licensing regimes for domestic flights and international air service agreements. Efficiency indicators-such as freight and passenger capacity use suggest that MENA carriers fall short of international standards by an estimated 15 to 20 percent.

**Telecommunications.** Many developing countries have liberalized their telecommunications sectors in the last two decades, with Latin America in the lead closely followed by South Asia and East Asia and the Pacific. But regulatory reform in telecommunications has been slow in MENA, where markets remain on average less competitive than in other developing countries. Lower-cost telecommunications could help improve the weak position of MENA countries in global production networks, boosting the region's participation in global trade. Evidence from developing countries over the 1990s suggests that the share of manufactured exports in GDP increases with improvements in the overall quality of telecommunications.





**Power.** In MENA the power sector is still dominated by vertically integrated public monopolies with poor financial health, low operating efficiency, and extensive government interference. Regulatory frameworks are not characterized by independence, transparency, and accountability. Regulatory and operational functions are not sufficiently separated to assure potential private investors and new entrants that the future policy developments in the sector will be fair and competitively neutral. Until the end of the 1990s MENA's reform scorecard in the industry was very low, ahead only of Africa.

**Financial Services.** Most MENA countries embarked on financial sector reform only in the 1990s, almost two decades after East Asia and Latin America. Banking systems were state-dominated and excessively regulated-and they remain so in Algeria and Syria, where state-owned banks still account for more than 95 percent of domestic bank assets. In some cases state-owned banks have extended soft loans to loss-making public enterprises, creating contingent liabilities for the public sector and credit bottlenecks to private sector investment. Foreign bank presence remains limited

#### 4.4.5 Conflict and the Investment Climate

The investment climate of a country, or region, for that matter, is clearly affected not just by the domestic policy context discussed in the preceding sections but also by what one might call the geopolitical context. This is reflected most directly in the incidence of conflicts, wars, and politically-inspired trade and investment barriers such as sanctions. The geopolitical context is likely to have been very important in shaping the manner and extent to which the MENA region has been able to participate in world trade and investment.

Persistent conflict reduces the scope for trade and investment and thus lowers growth. In the MENA region, frequent conflicts and militarization are related to the absence of a lasting peace settlement in the region, but also to several interstate and intrastate conflicts. These events raise the risk perceptions and willingness to invest in the region from both domestic and foreign sources. A recent comparative study of conflict-affected developing countries and a control group on countries not affected and that the numerous effects include slower GDP growth, falling trade, sharply reduced tourism, macroeconomic instability, large security expenditures, higher fiscal deficits and inflation, and the crowding out of education and health spending. The compounded effects appear to be a sharp slowdown in GDP growth in the pre-conflict stage (-1% GDP growth change) and an even sharper decline during conflict (-2%). Given the extent and duration of conflict in the MENA region, the effects are possibly even greater. Other research suggests strong contemporaneous negative spillover effects of conflict on neighbors, with such effects as high as those of the conflict





within a country, with the contiguity or nearness (length of common border) a key factor. These appear to work through general contagion as much as through other channels (such as trade or labor migration or capital flows). When conflict does end, there is a sharp rebound in economic activity (+3% GDP change)-signaling the positive effects that end of persistent conflict might have in the MENA region.

#### **4.5 *Potential Gains from Trade and Investment Climate Reforms***

We have seen in earlier sections that the MENA region exhibits trade and investment integration ratios that are substantially below the potential levels estimated on the basis of their income and population levels. We have also seen that growth and employment can rise significantly if the investment climate is improved and more trade is enabled. In this section, we simulate the effect of the region's moving from its current level of trade and investment integration to a higher level.

We start with the assumption that the region achieves about half its trade and investment potential over 10 years. This would raise the non-oil export ratio of the region from about 6 percent of GDP to about 13 percent by the end of 10 years--reaching roughly half the average ratio of non-oil exports to GDP of all developing countries today. The non-oil export growth rate underlying this scenario is about 15% a year, nearly twice the expected world export growth, but the increase in MENA's share of that market remains very small because of the very low starting levels. Merchandise imports, now 20 percent of GDP, would also be expected to rise by about 7 percentage points over the decade (with incremental financing of additional imports from higher non-oil exports and higher FDI).

The effect would be to raise merchandise trade ratio from about 46 percent of GDP (2003) to about 58 percent over a decade (2013)-and non-oil merchandise trade from about 26 percent of GDP to about 39 percent. The 50 percentage gain in non-oil merchandise trade ratio over the decade would be a substantial gain and about half of the average (100 percent) increase for fast-integrating developing countries in the 1990s. FDI inflows are correspondingly assumed to rise by some 2.5 percentage points of GDP, and private productive investment rates (inclusive of FDI) by some 7 percentage points of GDP (from the current 12.5 percent of GDP to about 20 percent of GDP).

*Impact on growth.* These broad assumptions are useful for calibrating the likely impacts on growth and productivity with an aggregate source of growth model. The MENA region has three basic sources of growth other than exploiting oil or other non-reproducible assets more intensively): deepening capital investment per laborer, deepening human capital per laborer, and increasing total





factor productivity. If policies are reasonably successful in achieving the trade and investment outcomes described above and a reasonably modest turnaround in productivity growth of about 1.4 percent a year is achieved as a result of greater trade, the net effect would be to raise annual growth from about 1.4 percent per capita in the 1990s, to about 4 percent per capita in the coming decade. This is consistent with the experience of other countries in the world, where correspondingly faster growth was achieved with greater trade and investment orientation\*

**Potential for faster GDP growth, accumulation and productivity from trade and investment climate reforms in MENA, 2003–13 \***

	Physical capital		Human capital		Total factor productivity		Growth of GDP per labor (labor force weighted)		Growth of GDP per-capita	
	1990s	2003–13	1990s	2003–2013	1990s	2003–13	1990s	2000–13	1990–00	2003–13
MENA	-0.3	2.4	1.2	1.2	-0.2	1.4	0.7	3.0	1.4	4.3
East Asia	8.4	..	0.7	..	3.2	..	7.0	..	7.1	..
South Asia	3.3	..	0.9	..	0.9	..	2.7	..	3.2	..
OECD	2.0	..	0.6	..	0.4	..	1.6	..	2.1	..
World	4.8	..	0.7	..	1.6	..	3.9	..	4.7	..

Table 5: Source: World Bank

The 1990s were marked by a fall in capital per laborer in MENA primarily because of low and falling rates of growth in private investment relative to the growth of the labor force. With gains in trade intensification and major improvements in the investment climate, faster growth in private domestic investment and foreign direct investment can be expected to lead to a significant improvement in capital deepening. Given a fast-expanding stock of labor force (of about 3.4 percent a year), achieving such gains will be difficult but critical. Historically, capital per laborer has increased in the region by as much as 7.9 percent per annum in the 1970s (driven by public investment), slowed to 2.1 percent per annum in the 1980s and collapsed to negative levels in the 1990s. Therefore, business climate reforms to elicit a more robust private investment response are likely to be central to the success of trade reforms in the MENA region. Moreover, the shift from public to private investment will be critical.

Improving total factor productivity is also a key driver of growth. It is reasonable to hypothesize that the total factor productivity gains from opening trade and investment would be

\* Source: World Bank, 2003, Note: All growth estimates by regions and world are labor force weighted. GDP per-capita growth rates differ from GDP per labor growth rates because of differences between labor force and population growth rates”....” means not projected





significant. Opening trade would improve productivity by encouraging shifts in resources to more productive and internationally competitive activities (the stock effect), by improving the access to higher quality inputs, and by spillovers from foreign direct investment and greater competition. World Bank staff estimates suggest, for example, that fast-integrating countries obtained an additional 1 percent of GDP from productivity gains compared to only 0.6 percent among slow-integrating countries (World Bank, 2003, p.53). For the next decade, therefore, it is reasonable to assume that TFP gain of 1.4 percent per laborer will be achieved in the MENA region, reversing the negative TFP growth of the previous two decades, as the region's economies open up to trade and private investment.

**Impact on employment.** The employment effects of GDP growth at about 6 percent annual rate resulting from faster trade integration and improvement in investment climate are likely to be substantial. Faster GDP growth will itself generate equivalently faster growth in employment. However, technological progress and productivity growth assumed will mean that the gains will be distributed more widely, and that employment growth will therefore be at a slower pace. Moreover,

Likely real wage increases will also dampen employment growth as firms respond to higher wages.

Offsetting these pressures will be greater labor-intensity of production driven by greater trade-orientation of the production structure. The net effects of these factors is employment growth of up to 4.5 percent a year. This would be adequate to absorb the new entrants to the labor force and cut unemployment rates by half over the next decade.

Exporting more merchandise goods and manufactures will create new jobs. Just over the next five years, if the MENA region can achieve 15 percent real annual non-oil export growth for the region with improved policies, this would boost the region's non-oil exports to about \$60 billion, from the present level of \$28 billion (excluding re-exports). And this could generate some 2 million additional jobs directly in such non-oil export activities and another 2 million indirectly, as domestic goods and services supply inputs to these activities, and from the multiplier effects on domestic final demand. So closing even a small part of the export gap could generate some 4 million jobs over five years from direct trade effects alone. This simplified projection abstracts from a much more complex set of factors, but the magnitude is indicative of the potential.

Examples abound of the effects of expanding trade on jobs. For Mexico, thanks to the NAFTA and radical economic reforms, trade more than tripled, from \$82 billion in 1990 to about \$280 billion in 1999, making it the seventh largest trading nation in the world and resulting in a





rapid pace of job creation in manufacturing. From 1994 to 1999, manufacturing employment grew at almost 16 percent per annum, at almost twice the pace recorded in the pre-NAFTA years of 1985-1993. Job creation has also been strong in export processing zones in Mauritius, the Dominican Republic, and El Salvador . Indonesia is another country that had a major trade and investment policy reform produce employment benefits in the mid-1980s. Manufactured exports and FDI boomed as did manufacturing employment. Indonesia is especially relevant to some MENA countries in that it was a resource-dependent economy until the mid-1980s, when it found a new engine of growth in manufactured exports (Iqbal 2002). Within the MENA region, Tunisian exports of textiles and clothing have boomed in off-shore companies supplying foreign markets, and employment in these industries increased steeply. Morocco is another example of a country that gained significantly from an initial burst of economic reforms in the early 1980s. Manufacturing sector employment and exports rose sharply in the early 1980s in response to a series of trade and investment liberalization measures (World Bank, 2003). But the Moroccan boom faltered in the 1990s as the impact of the initial reforms package dissipated and macroeconomic policies allowed the real effective exchange rate to appreciate, hurting both exports and employment in manufacturing.



## **5 Economy and Investment in Syria**

Since the late 1980's, the Syrian government has passed a series of laws encouraging investment in a number of sectors.

Initially, legislation concentrated on projects with government participation in the fields of agriculture and tourism. In 1991, a more general investment law was passed, inviting local, Syrian expatriate and foreign investors to become active throughout the economy. Projects approved under the law enjoy a number of privileges including relaxed import and foreign currency restrictions, extensive tax holidays and improved repatriation regulations for investments by non-Syrians.

Since its introduction four years ago, Investment Law No 10 has become the cornerstone of the Syrian government's drive towards greater private sector involvement in the economy.

While Western companies have until now been rather hesitant to take advantage of Investment Law No 10 on their own, an increasing number of joint-ventures between Syrian and foreign companies are preparing to start production in the framework of the law.

With recent investments by Gray Mackenzie, Glaxo and Nestle, it appears that direct Western investment has finally begun to find its way into Syria.

### **5.1 INVESTMENT LAW NO 10**

Both Syrian citizens (resident and expatriate) and foreigners are permitted to invest under the provisions of the law. Although the government has stated that it is open to applications for all types of investment, the following areas are explicitly referred to as being affected by the law:

All types of agricultural projects, including food processing

- industrial projects, except in the small number of areas that remain reserved for the public sector
- . transport projects

Each project application is considered on its own merits, but a number of factors are mentioned as influencing an application's chance of being approved. The project ought to:

- Be in line with the aims of the state's development plans
- utilize local resources





- contribute to economic growth and create jobs
- utilize modern machinery and advanced technology

The law also requires the fixed assets of a project to be worth a minimum of S£10m or its equivalent in foreign currency, valued at the "Neighboring Countries' Rate" (around US\$240,000). Exceptions to this requirement can be made on the basis of a Prime Ministerial decision.

### A. Administration

Two new institutions have been established to deal with the administration of Investment Law No 10. The Higher Council of Investment (HCI) comprises the Prime Minister, two deputy prime ministers, seven ministers and the head of the investment bureau. It is charged with assessing project applications, issuing licenses and all other basic decisions affecting projects under the law.

The Investment Bureau (IB) is the office charged with the day-to-day administration of the law. It is instructed to implement decisions of the HCI and deals with investors' general requests and complaints. All other government departments and authorities are also explicitly requested to present the required help and facilities to investors and to answer any queries of the IB within the space of one week.

### B. Corporate Entities

Investments under the investment law can take three types of corporate identity:

- Private sector limited liability companies
- Private sector shareholding companies

Mixed-sector companies with a minimum of 25 per cent of capital contributed by the state

### C. Privileges and Exemptions

Once approved, all types of company established under Law No 10 enjoy a number of exemptions, privileges and guarantees. These apply to the following areas:

### D. Imports

Law No 10 permits the import of all fixed and working capital required for investment projects, including goods normally subject to import restrictions such as cars'. To avoid fraud, the



ministry in whose area of responsibility the project falls reserves the right to determine the quantity and types of import required by individual projects. Rules regarding the direct import from the country of origin are also waved. The law distinguishes between three types of imports:

- fixed capital, including machines, equipment, means of transport needed to serve the project and other materials necessary for establishing, expanding and developing the project
- cars
- working capital

All imports in category (a) are exempted from all taxes, stamp duties, as well as local and customs duties. Imports in all three categories are restricted to uses for the purposes of the project and cannot be sold in local markets or exported abroad except with the HCI's expressed permission.

### E. Profits and Taxation

All projects established under the law are granted a holiday from taxation on profits, dividends and real estate. The duration of the holiday depends both on the type of company and the percentage of its production exported. Mixed sector companies are exempted from taxation for a period of seven years from the start of production. Other firms enjoy a five-year tax holiday from the start of production, but companies exporting more than 50% of their production are granted an additional two years' tax exemption after the expiry of the initial five

If more than three years pass between the project being approved and the start of production, this period is deducted from the tax holidays described above. The day after the approval of the project has been announced in the Official Gazette is taken as the beginning of the establishment period.

### F. Foreign Currency

Projects are expected to be self-financing in their hard currency transactions, be they imports of fixed and working capital or expenses. As a result, investors need to cover all hard currency expenses from the original capital committed in foreign funds, or through hard currency export earnings. Loans from foreign or local banks can be utilised in raising the project's capital, but hard currency loans from Syrian banks are unavailable.

To facilitate transactions, a number of prevailing currency restrictions has been waved. Investors are permitted to open foreign currency accounts with the Commercial Bank of Syria,





transferring 100 per cent of the project's capital in hard currency as well as hard currency loans obtained abroad to this account. Although 75% of the company's export earnings can be transferred to this account, the firm is required to exchange the remaining 25% into local currency at the "Neighboring Countries' Rate". Companies involved in agricultural production are permitted to retain 100% of export earnings. All expenses of the project are to be paid from this account. Interest rates on this account are calculated in line with the London Inter Bank Offered Rate. Investors are also technically allowed to take out loans in local currency from state sector banks

Traditionally, a very lenient approach has been taken to hard currency funds already present in the country, provided they are used for investments under the law.

### G. Repatriation

Foreign nationals and Syrian expatriates are permitted to re-transfer capital committed to investment projects in Syria five years after their investment in the project. Funds re-transferred abroad in hard currency are not to exceed those brought into the country. Hard currency

**Capital gains** are therefore technically impossible. Capital gains in local currency are subject to taxation.

Should an investment project run into unexpected difficulties, the investor is permitted to re-transfer his funds six months after the initial investment.

Profits are allowed to be transferred abroad on an annual basis. Foreign investors are allowed to insure their funds at the Inter-Arab Investment Guarantee Corporation or any other establishment with the approval of the Syrian authority concerned.

Foreign experts and technicians employed in projects are allowed to transfer 50% of their net wages and 100% of their end-of-service indemnities abroad in hard currency.

## 5.2 *Agricultural Projects*

Investment projects in the agricultural sector continue to be governed by the provisions of Legislative Decree No 10 passed in 1986.

Unlike projects under the newer investment law, companies established under Decree No 10 are required to have public sector participation amounting to at least 25% of share capital. Traditionally, the public sector's contribution has consisted of state land made available or the purposes of the project.



After initial widespread interest in the law which led to the establishment of seven new agricultural shareholding companies in the late 1980's, no new projects have been established in recent years.

Currently, only four of the original seven companies remain actively involved in agricultural activities and observers do not expect a further expansion of projects under the Decree.

Projects established under the law enjoy a number of privileges and exemptions including:

- The permission to import machinery, vehicles, materials and all equipment necessary for the execution of the project, with the exclusion of items subject to import restrictions.
- Exemptions from customs duties on such imports. A tax holiday on corporate profits for a period of seven years, counted from the first year of profitable operations.
- Exemptions from prevailing hard currency regulations and the right to open foreign currency accounts with the Commercial Bank of Syria. Up to 70% of income can be deposited in foreign currency.

### **5.3 Tourist investment**

While car rental and transport companies are primarily governed by Investment Law No 10, other projects in the tourism sector, including international standard hotels, are covered by investment encouragement provisions contained in Resolution No 186 of 1985.

Projects are granted exemptions from all taxes and duties normally due on tourist installations. They are also permitted to import construction materials, machines, cars and other equipment free of customs

Duties, provided that the total value of these imports does not exceed 50% of the value of the total investment. Projects are exempted from corporate income tax for a period of seven years. Thereafter, income tax is payable at 50% of the normal rates.

International standard hotels are also granted import licenses on foodstuffs not normally permitted to be imported. Price regulations are not applied on restaurants and facilities within the hotels.

### **5.4 Industrial investment**

Those industrial projects that do not require the repatriation of hard currency funds continue to benefit from exemptions granted in Law No 103 of 1952. Documentation requirements under the





law are considerably less restrictive than under Investment Law No 10 and a wide range of industrial firms operate and expand in the framework of the law.

Private industrial firms are granted a six-year exemption from the taxes on income on real estate and moveable capital assets. They are furthermore granted a tax holiday on corporate income tax of three years from the start of production.

### 5.4.1 Taxation

#### Overview

The principal forms of taxation in Syria are:

- Corporate Income Tax
- Personal Income Tax
- Tax on Income from Real Estate
- Tax on Income from Moveable Capital Assets
- Additional taxes and surtaxes include the following:
  - War Effort Tax
  - Stamp Duty
  - Property Registration Tax. Local Administration Tax
  - . Sales Tax

Syria maintains a territorial tax system in which taxes are generally levied on profits realised on Syrian soil. While foreign companies merely exporting to Syria are generally not subject to local taxes, firms with operations that go beyond straight trade may find themselves subject to some from of local taxation.

#### a) Legal Basis

Legislative Decree No 85 of 1949, as amended, contains the core of the Syrian tax law. Most common tax questions and other issues are treated at great length in letters and directives subsequently issued by the Ministry of Finance. Against the background of Syria's increasingly complex involvement with foreign. Companies, not all situations that foreign businesses might find



them selves in are, however, always sufficiently explained. Often, there are simply no precedents, and much is left to the discretion of the tax authorities.

Not only as a result of this, taxation has traditionally been among the major sources of problems between the local authorities and foreign companies.

### Accounting Procedures

Shareholding and limited liability companies are required to prepare the following:

- A company balance sheet
- A profit and loss account
- An inventory of the company's assets and liabilities
- An annual report on the company's activities

In the case of shareholding companies, a financial statement must be submitted to the firms' auditors and the Ministry of Supply and Interior Trade at least thirty days before the annual general meeting is due to be held. Shareholding companies with a nominal capital in excess of S£.500,000 must publish financial details in at least two daily newspapers.

No special accounting practices are detailed in the tax law. In general, accounts should clearly indicate profits realized from a company's Syrian operations. Accounting books and financial statements must be kept in Arabic and stamped by the court. Unified accounting procedures are issued for all public and mixed sector companies.

### b) Requirements

An independent auditor, licensed by the Ministry of Supply and Interior Trade, must be appointed by all Syrian shareholding and limited liability companies. Since 1992, certain other firms are also required to have their financial statements audited by a Syrian certified accountant:

- Syrian companies affiliated to foreign firms
- Syrian firms with foreign affiliates
- Agencies representing foreign firms
- Wholesalers who import the majority of goods sold by them
- Companies with capital exceeding S£.1, 000, 000





### c) Accounting Principles

No special accounting principles have been issued by the tax authority and in general, international accounting standards are accepted in Syria. The Syrian Association of Certified Accountants has issued ten basic accounting principles which are based on international standards.

#### 5.4.2 Corporate Income Tax

Corporate income tax is payable on net profits of self-employed individuals and corporate entities arising from sources or activities in Syria. The tax is levied on a company's or individual's total income from all industrial, commercial and non-commercial activities, as well as income from those sources not covered by taxation on moveable capital assets, wages and salaries and the lump sum tax levied on the deemed profits of small businesses.

Taxable income therefore includes income from the sale of fixed assets, rental income (except from real estate) and agency profits. As shareholding companies' net profits are taxed before distribution, no corporate income tax is payable on dividends or on interest accruing from bank deposits.

##### a) Legal Basis

The legal basis for corporate taxation is the Income Tax Law contained in Legislative Decree No 85 of 1949, as amended. Rates were last adjusted in Legislative Decree No 20 of 1991. Despite regular alteration, the law remains vague, and much is left to the discretion of the appropriate tax authority.

##### b) Tax Rates

Corporate tax rates currently range from 10% to 45%. Flat rates are charged on certain types of companies:

- Industrial shareholding companies (32%)
- Other shareholding companies (40%)
- Limited liability companies (42%)

Confer OVERVIEW - THE SYRIAN TAXATION SYSTEM for details. Tax rates are subject to a War Effort Tax as well as a Local Administration Tax. Both are calculated as a percentage of the corporate tax to be paid. War Effort Tax is currently set at 30% of the total corporate income tax. The level of Local Administration Tax depends on the location of the



company:

- Damascus City (5%)
- Damascus Suburbs (7%)
- All other areas (10%)

c) Fiscal Year

Corporate income tax is chargeable on net profits derived in the previous financial year. In general, the Syrian financial year begins on January 1st and ends on December 31st. This can be altered by Ministerial Decree in cases where the nature of the company's operations requires it. Public sector companies rarely deviate from the official financial year,

d) Exemptions

The following entities are exempted from corporate income tax:

- Industrial establishments for a period of three years from the date of their establishment
- Private hospitals licensed by the Ministry of Health
- Private educational institutions
- Companies engaged in air or sea transport
- International class hotels for a period of seven years
- Deluxe and first class hotels, as well as deluxe restaurants and other gastronomic establishments for a period of five years
- Agricultural companies engaged in the sale of products grown or bred on their own land
- Various types of agricultural and consumer cooperatives
- Reserves taken out of profits by industrial establishments intended for an enlargement of their operations. Such amounts should not exceed 10% of annual profits after deduction of general expenses and before the deduction of any other reserve amount. They should also be invested within two years as from the date of their being taken into the reserve. Amounts not spent within this period are taken as profits for the ongoing year and are subject to income tax.





### e) Deductions

In the calculation of taxable income, the following deductions are permissible:

- Rents of premises used for the purposes of the business. Where the taxable company or individual is the owner, the property's annual rental value, as estimated by the tax authority, is deductible,
- Wages, salaries, entertainment and staff training expenses
- Premiums on insurance policies or social security payments covering the employees
- Interest payable on loans taken out for the purposes of the business
- Reserves intended for the payment of end-of-service indemnities or pensions
- Taxes and duties payable in Syria and paid in the previous financial year. This excludes the income tax itself and tax on income from real estate
- Maintenance on fixed assets if this does not increase their value

In addition to these specific deductions mentioned in the tax law, all general expenses necessary for the conduct of the business are deductible. Dividends and transfers to tax-free reserves are not deductible.

### f) Depreciation

Depreciation of all fixed assets employed in the generation of income is deductible, including formation and start-up costs. While acceptable depreciation rates are not specifically mentioned in the tax law, subsequent notifications by the Ministry of Finance indicate that depreciation must be calculated on a straight-line basis. Total depreciation must not exceed cost.

Typical depreciation rates range from 8-12% for industrial machinery, 10-15% for electronic equipment and 15-20% for vehicles. Start-up costs are depreciated at 20%. If capital is subject to exceptional wear and tear, higher rates might, be agreed to be the tax authority.

### g) Non Deductibles

The following items are not permitted to be deducted

- Sums intended to be employed as capital, or sums spent on the improvement of assets, with the exception of normal maintenance charges included in the general expenses
- Amounts taken into any kind of reserve
- Personal expenses by or payments to the owner(s)/ shareholder(s) / partners, which are taken as a remuneration for the management of the enterprise



### h) Losses

Losses incurred in one financial year may be carried forward into the next year and deducted from profits accrued. If the profits realized in that year are not sufficient to cover such losses, the balance can be carried forward up to the fifth year from the year in which the loss was incurred.

### i) Documentation

Companies are required to notify the tax authority of Profits or losses realized in the preceding financial year by the 31st May in the case of shareholding and limited liability companies, and by the 1st May in the case of all other chargeable corporate entities. In special circumstances, the Ministry of Finance may extend these deadlines by up to 60 days. Companies are required to submit the following documentation:

- a summary statement of the profit and loss account .
- a copy of the balance sheet
- full detail of sums taken out of profits for depreciation
- all bank statements, inventory sheets, correspondence, receipts and other documents supporting the accuracy of the tax declaration

Traditionally, great emphasis has been put on the provision of adequate documentation.

### j) Payment

Income tax is payable within 15 days of the submission of the tax statement. Firms have two months to pay any additional taxes that are levied.

### k) Assessment

Unless the Tax authority rejects a company's tax return, the tax assessment will be based on the figures provided by the company.

Where the authority disagrees with a firm's assessment, it will make provisional adjustments as it sees fit. The company is then notified of the alterations, and the basis on which the new tax charge has been calculated. The authority's assessment remains provisional for a period of thirty days, during which the company has a right to appeal.

### l) Appeals

Appeals about official tax assessments should be made to the Tax Imposition Committee (TIC). Objections are studied by the committee which notifies the company concerned of its decision and collects the appropriate tax charge. Further appeals against the TIC's decision can be lodged with a so-called Revision Committee. The Revision Committee's decision is final.

Companies have the right to collect the difference between the amount decided upon by the





RC and the amount previously collected in cases where they differ.

### m) Deemed Profits

Many smaller local firms and professionals pay corporate income tax on the basis of deemed profits. Profits are estimated on a five-year basis, but reassessments are made at an earlier date if the taxpayer's turnover increases by more than 25%.

### n) Penalties

Penalties are imposed on firms that fail to submit tax returns, financial statements or make accounting books available.

Companies are sent notification of the legal position by the authorities. If a firm fails to comply within ten days, the tax department will make its own assessment based on a minimum level of twice the highest profit level of the company over the previous five years. In addition, the authorities will impose a penalty of 20% of the tax charge. Firms can have the penalty reduced to 10% if they submit the required documents within a further ten days. If this submission is accepted, an annual interest of 10% is charged.

Strict penalties are imposed at this stage if the tax department rejects the submission. In this case, profits are judged arbitrarily and a large additional penalty is imposed. Fines of between S£5,000 and S£50,000 and prison sentences can be imposed on parties found to be in contravention of the law.

## 5.4.3 Taxation of foreign Firms

### a) Taxable Foreign Firms

In general, foreign companies are classified as resident or non-resident and taxed accordingly. Resident firms are taxed as Syrian firms and subject to corporate tax procedures and rates as outlined above. Non-resident firms are charged a withholding tax on income generated on Syrian soil.

### b) Resident Firms

Foreign firms are considered resident if they have concluded more than one supply or service contract in Syria in the course of one year, or if they have concluded a contract the execution of which takes longer than twelve months. Income tax at resident levels is also chargeable if foreign firms



- maintain a local branch office
- have established a local office for the purposes of a project
- have registered with the Ministry of Economy and Foreign Trade
- are party to a contract that entails the performance of civil works
- have assigned part of their activities under a contract to another foreign firm
- carry out their business at the offices of another company
- undertake certain administrative steps, including the hiring of employees, rental of real estate and registration of a PO. Box

### c) Non-Resident Firms

This tax bracket applies to all foreign firms that conclude contracts for the supply of materials or the provision of services, including construction projects, that take less than a year to execute. It is also applied to the royalty income of foreign trade-mark holders from under-license production in Syria. Taxation consists of;

- Non-resident income tax levied at 17.5% of 75% of the contract value or profits realized
- Local Administrative Tax at 5-10% of the income tax
- War Effort Tax at 30% of the income tax

### d) conversion

For the purposes of tax assessments, the value of contracts in foreign currency is converted into Syrian pounds at the "Neighboring Countries' Rate" of S£.42: US\$.

### e) Collection

Taxes owed by non-resident firms are collected at source from the contracting party or the licensee, as appropriate.

### f) Other Taxes

Local or foreign employees involved in the execution of a foreign company's contract are subject to Syrian personal income tax. If foreign experts who are not normally employed by the foreign company are hired for the purposes of the project, these, too, are subject to local personal





income tax.

### g) Tax Returns

Resident foreign companies are required to submit a tax return on April 30th after the end of the financial year in the case of limited liability companies, or on May 30th in the case of shareholding companies.

### h) Stamp Duties

Firms must pay a stamp duty amounting to 0.624/0 of the value of each contract signed in Syria. .

### i) Place of Taxation

Taxes are incurred at the location where the taxable business activity was carried out, normally the Syrian office. In the case of companies with more than one office, a single tax charge is made on the total profits of all branches of the company. In general, taxes are incurred at the location of the head office. For companies with a head office abroad, charges are made on the branch in Damascus or the largest Syrian branch in terms of profits.

## 5.4.4 Personal Income tax

Like corporate tax, personal income tax is territorial. It therefore considers all income generated from services or employment rendered in Syria taxable, whether the person taxed is officially resident in Syria or not.

### a) Taxable Income

In the calculation of gross taxable income, all salaries, wages, allowances, bonuses, gratuities and other benefits in cash or kind are taken into consideration. Taxable income therefore includes overtime compensation, food and housing allowances, as well as other fringe benefits. Benefits provided on the premises of the employer, such as food and health-care, are, however, not considered taxable.

### b) Exemptions

Diplomats and non-diplomatic foreign staff of embassies and consulates, as well as servants in private houses and members of the Syrian army and police are exempted from personal income tax.



### c) Deductibles

All transport and other expenses incurred in the course of carrying out one's employment are generally deductible. Insurance premiums deducted by the employer are excluded from taxable income.

### d) Exempt Amounts

The first S£100 of the taxpayer's monthly salary are exempt from taxation. Further minor exemptions are made for children beyond a family's second child.

### e) Rates

Personal income tax rates range from 5% to 12.5%. The tax payment is subject to a 15% War Effort Surtax.

### f) Foreign Currency

Income received in foreign currency is converted at the "Neighboring Countries' Rate" of S£52: US\$.

### g) Payment

Personal income tax is deducted from an employee's monthly gross taxable income by the employer. Payment to the tax authority is due every six months, Le. in the case of a normal January to December fiscal year, by July 15th and January 15th. Employers have to submit tax declarations on payment of their employees' income tax. From the latter, no documentation or payment is required.

## 5.4.5 Tax on Income from moveable capital assets

### a) Taxable Income

Tax is chargeable on income from profits, interests, arrears, lots, premiums of reimbursement and other income in cash or kind derived from:

- Bonds and loans issued by companies and all other corporate bodies established in Syria .  
Debts covered by mortgages. Stocks and loans and other public bonds issued by
- Syrian municipalities and foreign governments
- Shares, founders' shares and dividends of





- shareholding companies and all other bonds and loans by companies not established in Syria
  - All other types of deposits and guarantees . Lottery tickets
- b) Exemptions

The following items are exempt from taxation on moveable capital assets:

- Interest payments on savings deposits held with banks or public savings institutions
- Interest and gains derived from investment bonds
- Interest payments on deposits held with the Commercial Bank of Syria
- Dividends paid by Syrian shareholding companies

c) Rates

A unified flat tax rate of 7.5% is levied on income from moveable capital assets.

#### 5.4.6 Other taxes

a) Income from Real Estate

Income from the rental or sale of real estate is taxable at rates between 17-60%. The taxable income is the rental-or sales value of the property, as estimated by the Ministry of Finance. In the case of rental contracts concluded with non-Syrians, the actual rent specified in the contract is taken as the taxable base. Here, the maximum tax rate reaches 40%. All taxation is payable by the owner of the property.

b) Consumption Tax

Under Law No 18 of 1991, a consumption tax of between 5-10% is levied on a variety of luxury services and goods, such as restaurants and jewellery.

c) Property Registration Fee

The sale, transfer and inheritance of real estate is subject to a property registration fee of 10% of the estimated value of a property, as estimated by the Ministry of Finance. Fees are payable by the buyer or assignee.



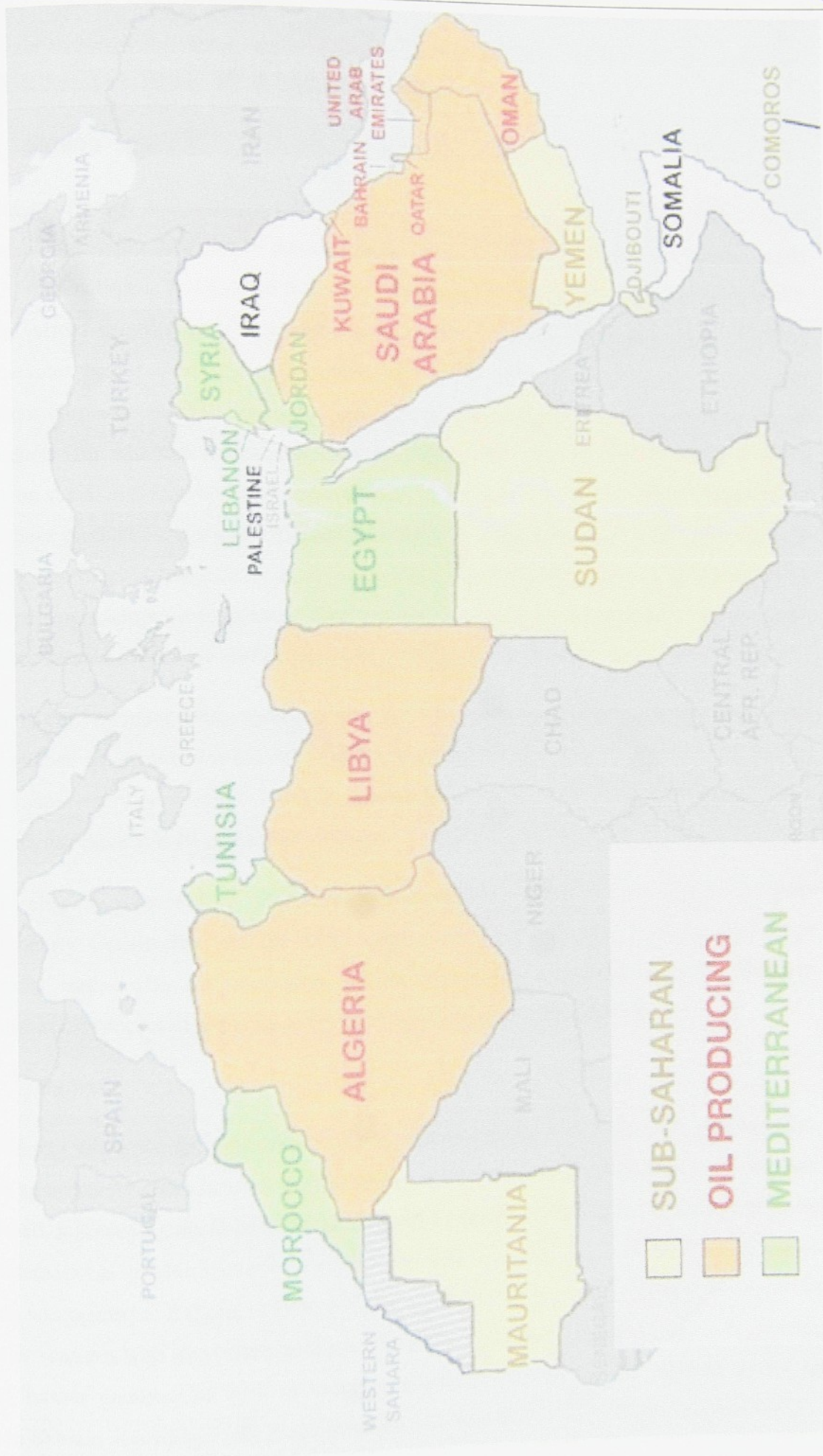
### 5.4.7 Double Taxation treaties

As mentioned above, Syrian tax legislation is territorial and only taxes income arising from contracts or sources on Syrian soil. In general, double taxation problems are therefore unlikely to arise. In case a foreign company is taxed in both Syria and its home country, tax relief ought to be sought in the company's home country.

Currently, Syria has treaties for the avoidance of double taxation treaties with Rumania, Cyprus, the Czech Republic and India. As an exception to the territorial principle, companies from these countries with offices in Syria are taxable in their home countries even on profits realized on Syrian territory.

A regional agreement for the prevention of double taxation exists between Syria and a number of Arab states, including Jordan, Sudan, the United Arab Emirates, Egypt, Iraq and Yemen.









## 6 Foreign investment in Arab countries

### 6.1 *Algeria*

Seeking to diversify and modernize the Algerian economy, the government has embarked on an aggressive liberalization program to attract foreign direct investment. A new investment code that treats Algerian nationals and foreign investors equally has been promulgated. The code offers new investors various benefits, such as a three-year exemption from the value-added tax (VAT) on goods and services acquired locally or imported, an exemption on property taxes, a 2-5 year exemption from corporate income taxes, the right to pay three percent in customs duties for 30 different products (for which duties are normally between 25-45 percent) and the right to pay a lower ceiling on social security for Algerian employees. The incentives are even more attractive for companies whose production is export-oriented. For instance, companies exporting 100 percent of production are completely exempt from taxes, while those exporting 50 percent of their production receive a 50 percent exemption from taxes. Furthermore, foreign investors settled in the free trade zone of Bellara, located at the new port of Djendjen, will be exempt from taxes and customs duties.

Other initiatives include the abolition of a list of over 80 previously illegal imports, the removal of almost all export restrictions, and the lowering of the income tax rate for foreign technical and supervisory personnel to a flat 20 percent. In addition, in 1998, tariffs in Algeria were lowered to between three and 40 percent ad valorem.

Concerning the protection of intellectual property rights, Algeria is a member of the Paris Industrial Property Convention and the 1952 Convention on Copyrights. Algerian legislation protects patents, trademarks, and copyrights, and its enforcement is considered to be adequate. Algeria is also in the process of applying to the World Trade Organization (WTO).

### 6.2 *Bahrain*

Continuing the government's drive towards diversification of the domestic marketplace, Bahrain has aggressively encouraged foreign investment. In 1991, the Bahrain Development Bank was established, followed by the Bahrain Marketing and Promotion Office in 1992, with both meant to attract international private-sector investment. An office of the UN Industrial Development Organization was opened in Bahrain in 1996 with the aim to attract foreign investment resources for realizing joint ventures with local entrepreneurs. The government has announced that it is planning to overhaul further commercial laws in order to guarantee foreigners full freedom to set up companies in Bahrain according to the recommendations of the World Trade Organization (WTO).





Bahrain offers the highest standards of financial regulations, efficient procedures, and political stability to foreign investors. A bilateral investment treaty with the United States came into force in May 2001 and now, in addition to imposing no personal or corporate taxation or restrictions on capital repatriation, the government liberalized land and other laws to allow 100 percent foreign ownership of many types of companies. The government is clearly actively pursuing further liberalization of the economy. A Supreme Privatization Council was established in March of 2001 to speed privatization and a new Economic Development Board headed by a prominent private businessman was established. In June 2001, a new commercial code was passed to further improve conditions for foreign investment. Bahrain also took a bold step in December 2001 in pegging the Dinar to the dollar in anticipation of serious efforts to establish a common currency for the GCC countries.

Foreign investment has been primarily encouraged in sectors that are export-oriented and do not compete directly with local producers. Encouraging regulations allow 100 percent foreign ownership of new industrial ventures or service companies with their regional headquarters located in Bahrain. The government also allows the establishment of representative offices or branches of foreign companies without local sponsors. Joint ventures allow for up to 49 percent foreign ownership, and individual expatriates living in Bahrain for more than one year can buy up to one percent of any publicly-listed Bahraini corporation.

Foreign firms receive the same investment incentives available to Bahraini companies, including personal corporate tax exemption, no restriction on capital and profit repatriation, and duty-free access to GCC member states for products manufactured in Bahrain. Manufacturing investments receive the following incentives: electricity rebates, 100 percent rebate of customs duties for the first five years for all industries, export credit facilities, and tariff protection (subject to the approval of the National Committee and Tariff Protection).

Large-scale infrastructure projects and major purchasing decisions are directed by the Ministry of Works, Power, and Water, which extends invitations to select pre-qualified firms. For construction projects, firms must be registered with the Ministry of Works, Power, and Water, and in the case of smaller contracts, individual ministries and departments direct the pre-qualification process.

Two free trade zones exist in Bahrain, used for the temporary storage of imported goods set for re-export. Mina Sulman, Bahrain's major port, provides a free transit zone to facilitate the duty-free import of equipment and machinery. In late 2001, the Great Lakes Dredge & Dock Company (US) won a dredging and reclamation contract to develop the new Sheikh Khalifa port at Hidd. The





second free zone is located in the North Sitra Industrial Estate. Raw materials intended for processing in Bahrain and machinery imported and stored by Bahraini-owned firms are also exempt from duty. The government of Bahrain continues to offer incentives to international firms to establish light and heavy manufacturing operations on the island, making use of its strong transport and communications infrastructure. This is in accordance with Bahrain's overarching plan to encourage foreign businesses to use Bahrain as a regional operational base.

### **6.3 Djibouti**

The government hopes that donor countries will extend the estimated \$13.7 million needed for the ICT initiative outlined above. There is potential for successful investments in port services and telecom. Aid projects and privatizations are two other portals for foreign investment in Djibouti. The state is planning to off-load a 49 percent share of Djibouti Telecom soon.

Direct foreign investment from international organizations like the World Bank has increased, although it is largely contingent on structural reform. The UNDP has promised limited funds in the past to contribute towards financing agriculture and livestock breeding programs, decentralizing the economy, and developing a free-trade zone. USAID provided \$8.7 million last year, and will put up another \$3 million to improve the main airport, air traffic control, and strengthen border control.

The fishing sector has room for development; Djibouti's 195-mile coastline on the seafood-rich Red Sea is underutilized. The country also needs more light industries. As a market for imported goods, 95 percent of foodstuffs are imported, predominantly from France, Ethiopia and Gulf countries. Djibouti also re-exports many food and beverage goods to other African countries. The provision of water resources is a crucial development need in Djibouti and the government is considering building a desalinization plant.

Most foreign investment in Djibouti today arrives by way of its port, with Ethiopia and Somalia being the largest participants. Djibouti is a member of the Common Market of Eastern and Southern Africa (COMESA) which removed all internal tariffs and barriers among member states in 2000.

### **6.4 Egypt**

A key policy for the Egyptian government has been to encourage foreign direct investment by reducing tariffs (by 5 to 55 percent) and setting up several new and amended bills. Law 8 of 1997 allows 100 percent foreign ownership, secures the right to remit income earned in Egypt and





to repatriate capital, and guarantees against confiscation and nationalization. Another provision of Law 8 was the removal of a list of categories requiring approval by the government before direct investments could be made. It created a "positive list" in 16 distinct fields, such as agriculture-related projects, industry and mining, oil and gas, tourism, housing, infrastructure, financial leasing, and computer software and systems. It has also introduced areas of partial tax and importation exemption. For example, firms investing in the tourism sector are exempt from corporate, commercial, and industrial profit duties and taxes on movable assets and imported supplies for a period of five years, while projects in the South Valley area are exempted from taxes for a period of twenty years. The government also grants privileges associated with free zones in Egypt, including tax exemption for all articles, equipment, and machinery necessary for operation.

Companies Law 3 of 1998, amending Law 159 of 1981, covers investors in any sector not provisioned for by Law 8, including shareholders, joint stock and limited liability companies, and representative and branch offices. Under this law, companies may have 100 percent foreign ownership provided that 49 percent of the shares are offered to Egyptians upon inception. Capital Markets Law 95, adjusted in 1998, also gives foreign investors full access to the capital market and the stock exchange and provides a regulatory framework for financial sector reform. Banking Law 155 of 1998 permits 10 percent foreign ownership of Egyptian companies allows foreign bank branches to deal in Egyptian currency and to receive equal national treatment and tax benefits.

### **6.5 Jordan**

An investment law passed in 1995 eased restrictions on international investments, allowing foreign investment in all projects and sectors, removing maximum foreign shareholding limits, and reducing minimum capital requirements. Investors also have the right to repatriate capital, profits and dividends in any convertible foreign currency.

Foreign companies are able to participate in public shareholding companies with the approval of the Council of Ministers. Investors may open branches in Jordan after they have obtained a contract. Foreign companies wishing to register a regional office in Jordan receive certain customs duty exemptions including the exemption of tax on the salaries of non-Jordanian employees.

Privatization of formerly state-owned firms and potentially viable services should continue to attract foreign investment to Jordan. In May 2000, Parliament passed a new privatization law establishing a Privatization Council to oversee the overall divestment strategy and to decide on the use of proceeds. The law requires at least some proceeds to go to infrastructure projects, social





programs and to support workers affected by the privatization process. Up to 15 percent is to go towards infrastructure and social sectors and by 2000 dedicated proceeds gave the government about \$38 million.

The privatization drive began in earnest with the landmark 25-year lease agreement the kingdom reached in 1999 with an international consortium for the expansion and operation of Jordan's primary freight railway line, Aqaba Railway Corporation (ARC). ARC is currently considering tenders for expansion and renovation works. The restructuring of Royal Jordanian Airlines in July 2000 has also been successful. The way is now clear, pending recovery in the travel and airlines sector, for the sale of a 49 percent stake in the national airline to a private buyer. In addition, five new companies earmarked for 100 percent sale were created out of Royal Jordanian's assets. Catering operations were divested in August 2001, with Alpha Airports Group PLC of the UK acquiring a 51 percent interest and a further 29 percent interest acquired by Alpha's local partner, Eastern Investment and Development company. Royal Jordanian retained the remaining 20 percent interest.

Furthermore in 2000, both the Water Authority of Jordan and Jordan Cement Factories, the largest cement producer in the kingdom, were privatized. Also positive were the returns recorded in 2001 by the Amman area's joint utility venture with France's Lyonnaise des Eaux. In addition, oil sector privatization also went forward with the May 2001 engagement of a consultant to design a privatization process for Petra Drilling Company, which is fully owned by the government's investment arm. The National Electric Power Company was divided into three separate units in preparation for future privatization, while private BOT power schemes have proceeded apace. In the telecommunications sector, France Telecom has committed to substantial investment in the Jordan Telecommunications Company. Further, in 2001 the government investment arm, Jordan Investment Company, sold off holdings in Jordan Radio and Television Corporation, Jordan Press Foundation, Jordan Paper and Cardboard and Jordan Duty Free. Discussions kicked off in 2002 regarding a sale of shares in the Jordan Phosphates Mines Company and the Hong Kong and Shanghai Banking Corporation (HSBC) was awarded a six-month contract to consult on the 26 percent sale of shares for the Arab Potash Company.

Jordan is continuing to encourage foreign investors to enter its Qualifying Industrial Zones (QIZ), which were established in 1998. Companies operating in the QIZ are allowed duty-free entry to the US market if they can meet certain requirements, including securing joint Jordanian-Israeli input into their products. To qualify for a QIZ, 35 percent of the product must derive from materials produced in the QIZ, and the Jordanian and Israeli partners will each contribute one-third of the





direct costs of production. QIZs have already led to several multi-million dollar joint ventures between Jordanian and American firms that have generated thousands of jobs.

In addition to the QIZs, the government has developed the Aqaba Special Economic Zone (SEZ). Within the zone, investors enjoy a range of privileges including full freedom from customs duties, a 5 percent income tax and 7 percent retail tax, compared with the 13 percent now in force in the rest of Jordan. The government estimates that the zone could attract as much as \$6 billion in investment, with tourism, information technology, industry, trade and services all expected to benefit from the predicted surge in investment. Although insurance rates shot up after the September 2001 attacks on the US, they have subsequently declined and Aqaba activity should rebound with the global economy.

### **6.6 Kuwait**

In a major reform, the assembly in 2001 passed the "Foreign Direct Investment Act", a new investment law authorizing foreign-majority ownership in joint ventures and 100 percent foreign ownership in certain industries. Among other things, the act eased restrictions on foreign banks, provided long-term protection to foreign investors against nationalization or confiscation, and eliminated the requirement for foreign companies to have a Kuwaiti sponsor or partner. It also exempts foreign-majority owned companies from local agent requirements and authorized ten-year tax holidays for new foreign investors as well as land grants and duty-free import of equipment.

However, most incentives are linked to the percentage of Kuwaiti labor employed. It did not open the upstream petroleum sector, but petrochemical joint ventures were permitted. Limits to 49 percent participation were retained for banks while insurance remains closed to foreign investment and real estate investment is restricted to GCC nationals.

In 2001, a return to the pre-1998 pattern of divestiture was signaled as the Kuwait Investment Authority sold 24 percent of its holding in Mobile Telecommunications Company to the public via the Kuwait Stock Exchange, reducing its equity in MTC from 49 percent to 25 percent

### **6.7 Lebanon**

Lebanon offers one of the most liberal investment climates in the Middle East. It has traditionally enjoyed a free-market economy and a laissez-faire commercial tradition. In order to fund the reconstruction programs, the Lebanese government offers incentives to attract foreign and domestic investment, including low income tax rates for individuals and corporations. The distribution of dividends has a maximum of ten percent for corporations and five percent for





individuals. Foreign enterprises need not obtain government permission to invest in Lebanon; any concern may set up in Lebanon as long as it complies with all national commercial regulations.

Lebanon does not discriminate between Lebanese nationals and foreign investors - except in the case of real estate investment. There are no restrictions on the movement of capital, capital gains, remittances, or dividends. Likewise, there are no restrictions on the conversion of foreign currency or precious metals, foreign exchange, or capital movements. Tax exemptions of 6-10 years are offered for industrial firms setting up operations in rural areas. Ten-year tax holidays are offered in the Beirut and Tripoli port free zones as well. Incentives are also given to firms floating shares on the Beirut stock exchange. The sectors most amenable to foreign investment are industry, agriculture, tourism, and information technology.

The government is just beginning the process of privatization in telecommunications, utilities and air transport. The first public offering came in January 2003 when the government took its first step towards the privatization of the telecommunications sector by auctioning off the management of two GSM networks.

Foundations are being laid for the sale of stakes in the electricity sector. The government is currently considering a plan that would turn the state's Electricite du Liban (EDL) into a joint-stock company, and issue a tender for management and 10-15 percent in equity. Sources within the state-owned Middle East Airlines say that privatization of the airline could begin by late 2006, that the airline was ready to privatize but that the timing would depend on the international investment climate. The Beirut and Mount Lebanon Water Authority has announced that it has begun looking for a strategic partner from the private sector to take over management.

### **6.8 Mauritania**

As part of the government's program to attract foreign trade, it offers an open foreign investment code that guarantees fiscal incentives, tax holidays, transfer guarantees, and joint venture opportunities. Other than vehicles, which receive a special tax rate, and essential goods, which are taxed at 5 percent, the average tariff rate for imports is 10 percent. The Mauritanian government has also simplified its customs procedures. The value-added tax rates are zero percent for exports, 5 percent for essential goods imports, 14 percent for luxury goods, and 5 percent for locally produced goods. The new investment code exempts foreign investors from all customs duties on equipment and goods imported for export-oriented start-ups, guarantees free transfer of convertible currencies earned from new investments and set up a "one stop shop" (guichet unique) for governmental formalities.





Foreigners may invest in all economic sectors and are entitled to hard currency for imports payments that assist with the operation of their business, the ability to transfer foreign capital and professional income of foreign employees, protection of vested interests, and equal treatment under the law.

A member of the Organization of African Intellectual Property, Mauritania is subject to relevant international treaties concerning intellectual, artistic, and industrial property rights and patents.

Sales of state-owned enterprises are another portal for foreign investment. The World Bank is recommending that the government offer more of the 78 percent state-run SNIM to foreign and local private investors, although no timetables have yet been set. In 2002, the government did preparatory work to privatize Somelec, but the poor investment climate returned less than satisfactory offers. The IMF and Mauritania have subsequently decided to defer the sale until the global investment environment is more favorable. A World Bank program, the Telecommunications and Postal Reform Program, is expanding access to communication and information services, which includes the privatization of the telecommunications sector.

### **6.9 Morocco**

Due to the initial success in privatization and the strength that new offerings gave the Casablanca Bourse, Morocco was the recipient of 60 percent of total FDI to Africa in 2001, about \$3 billion. Some \$51.2 million came from the US, with more than half aimed at the industrial sector. However, investment went down in 2002 when none of the planned IPO's went through.

Morocco offers various investment incentives, such as partial or total exemption from corporate taxes, VAT taxes, and import duties. Special incentives are also available to encourage companies to comply with environmental protection laws, or install environmental protection equipment. Moreover, foreign investment is allowed in all aspects of the private sector, with the exception of agricultural land. Ownership of real estate by foreign investors is permitted. The government has already selected two foreign companies to build and operate an electrical generation facility that would sell electricity to the state electric utility.

Recent large investments have been made by Telefonica of Spain and Telecom Portugal as part of a consortium of local and foreign partners who paid a total of \$1.12 billion for the second of two mobile telephone licenses, and in 2001, the massive \$2 billion stake taken by Vivendi Universal in Maroc Telecom. Coca-Cola made a further \$90 million investment in its purchase of bottling plants at Fez and Marrakech. In the tourism sector, Accor Hotels, the French hotel chain,





and Majestic Hotels of the United Kingdom have also made, or committed, substantial investments.

Until 2000, Morocco was believed to have only an insignificant 1.8 million barrels of oil. Then Lonestar, an independent producer from the US, made a discovery in Talsint that indicates the presence of up to 100 million barrels of oil. The Moroccan government is eager to explore territory for further reserves, especially offshore. In October 2001, Morocco signed two offshore exploration deals with TotalFinElf and Kerr-McGhee. These are the first deals signed offshore Western Sahara, and provide the first push into the politically sensitive area, which may potentially contain more precious energy resources. There are nine other blocs currently under exploration, both offshore in the Atlantic and Mediterranean and on land in the center of the country at Labrouj and south of Rabat. Firms involved in exploration include Conoco, Shell, TotalFinElf, Kerr-McGee, Vanco, Anschutz, Enterprise Oil, Lonestar, Taurus Energy, and Energy Africa.

### **6.10 Oman**

Oman's tax laws have been eased considerably within recent years. Investors are allowed to own majority stakes in Omani companies, with a cap of 70 percent being offered for foreign investors in large industrial projects. Additionally, 100 percent ownership is granted in specific cases by the Development Council for projects capitalized above \$1.3 million.

Oman's tax code, which previously taxed foreign companies much higher than locally owned companies, was also revised to provide national treatment to more foreign investors. The tax rate for national companies and public joint venture companies with no more than 49 percent direct ownership is 7.5 percent provided that 40 percent of shares are publicly traded on the Muscat Securities Market. The tax ceiling was also lowered to a maximum of 30 percent, which applies to companies with up to 90 percent foreign ownership. The government also grants five-year tax holidays to newly established industries, with a possible one-time renewal.

Import duties are about five percent, except on essentials, which are exempt, and some protected locally produced items. Employers pay a wage tax of seven percent of basic salary for foreign workers and eight percent for Omanis. One key issue in employment in Oman has become the effort to nationalize the workforce, and companies that do not meet government targets set differentially by sector are subject to fines.

### **6.11 Qatar**

Qatar offers ten to twelve years in tax holidays for foreign investors. Wholly-owned foreign firms are permitted to operate in the country. Companies that invest in Qatar's industries enjoy





exemptions from taxes on income, electricity, water, and power facilities. Joint ventures involving foreign partners almost always take the form of limited liability partnerships. Common practice has excluded foreigners from owning property or investing in privatized public services, but foreign investors have been allowed to own up to a 25 percent stake in steel, fertilizers, and petrochemical industries. Due to legislation in 2000, foreign investors can own up to 100 percent of a company in areas such as agriculture, industry, health, education and tourism. Previously, only 49 percent foreign ownership had been allowed. The new law also exempts foreign companies from paying taxes for a period of ten years, and allows the importation of equipment and materials that are not readily available within the country tariff-free. By law, a local agent or representative acts as a sales channel for promoting products and services in the local market. Qatar is a member of the World Trade Organization (WTO).

With rapidly improving relations within the GCC and moves towards a liberalized and common market, there should be expanded opportunities for foreign investment. Further, the government is aggressively pursuing plans to privatize a variety of services and industries over the next five years, which will provide significant opportunities for foreign investors. Municipal cleaning services are to be handed over to the private sector by the end of 2002, while ground handling, duty free and catering services at Doha International Airport have already been handed over to the 50 percent privately owned Qatar Airways. Partly state-owned Qatar Navigation's monopoly of port services was broken in May 2001 when the government issued a decree allowing private companies, including foreign ones, to bid for contracts. Medical services are already privatized and the government is encouraging the private sector to establish more hospitals.

The government is also seeking to offload industrial assets; the Qatar Steel Company (QASCO) will be the first candidate. The government intends to offer a 45 percent stake in the steel monopoly to investors, including foreigners. The state-owned Qatar National Hotels Company (QNHC), which runs the Doha Sheraton, the Marriott, and the Ritz Carlton hotels as well as the Doha Club and the beach resort of Messaieed, will be privatized in the next couple years. September 2001 saw the establishment of the first independent water and power project, Ras Laffan Electric Company. A joint venture with US-based AES Corp, the majority interest is held by the American company. Currently under construction, it will have a generating capacity of 430 MW, rising to 750 MW within three years, and should produce 40m gallons/day of water. This project is to be a first step in a liberalization of the sector with plans announced in June 2001 to set up two private companies for the transmission and distribution of gas and electricity.





## 6.12 Saudi Arabia

The kingdom's government encourages foreign direct investment, particularly investment that is tied to joint ventures with Saudi partners. The Saudi General Investment Authority (SAGIA) has been created to handle the liberalization of investment, improve the investment climate, and approve investment proposals. In 2002, the investment authority handed out licenses for \$4.78 billion in projects to US companies. Currently, the Supreme Economic Council is encouraging foreign investment in communications, insurance, culture, electricity distribution, and advertising, including granting new rights to foreign newspapers to open branches in Saudi Arabia.

In May 2003, Chairman of SAGIA Prince Abdullah laid out the long-term foreign investment situation from the Saudi point of view. He stipulated that the kingdom needed \$6,7 billion in foreign investment over the next 20 years, divided into the following sectors: \$140 billion in infrastructure projects, 116 billion for the electricity sector, 92 billion in petrochemicals, 88 billion for water, 60 billion in telecommunications, 53.4 billion for tourism, 50 billion for the natural gas sector, 28.3 billion for agriculture, and 10.7 billion each for information technology and education. In the near term, Prince Abdullah has indicated that the kingdom will look for \$20 billion dollars annually in the water, railway, and electricity sectors alone.

An investment law from 2000 allows 100 percent foreign-owned ventures in the kingdom, and lowers corporate taxes on them to 30 percent. Officials are now considering lowering that amount further. Wholly owned foreign companies can apply for SIDF loans. Foreign investors are promised the same benefits, incentives and guarantees as are given to Saudi individuals and companies. The legislation also protects the property of foreign investors from confiscation and guarantees repatriation of profits and principle. SAGIA has streamlined the process to apply for projects, and can now grant licenses within thirty days of receiving an application.

Wholly foreign-owned firms are eligible for a wide range of investment incentives, including advantageous utility rates, land in the industrial estates at low rents, treatment as domestic producers for government procurement contracts, and custom duty exemptions on capital goods and raw materials.

Offset programs have become a permanent fixture of regional economics. These programs have sought to remedy the costs incurred by purchases of foreign technology not available in the country. In the offset agreement, a certain percentage of a contract's value is reinvested into the purchasing country's economy. In order to facilitate and structure the offset phenomenon, the Saudi Arabian government formed the Saudi Economic Offset Program (EOP). It has been a means to





encourage joint ventures between foreign companies and Saudi private sector companies. Investing companies have enjoyed favorable investment incentives, as well as support from the Saudi government. For instance, low cost of oil and gas inputs can be obtained, and electricity prices are the lowest in the world. Investing companies have access to cheap labor and minimal business taxes and custom duties. Import duties for raw materials, intermediate goods, spare parts, and machinery are generally waived.

Current government plans aim to float stakes in the following concerns in the near future: Saudi Telecom, Saudi Electric Company, Saudi Arabian Airlines, Saudi Basic Industries Corp (SABIC), Saudi Mining (Ma'adin), the Saudi Postal Authority and the National Commercial Bank

### **6.13 Syria**

Syria's liberalization program resulted in the conversion of foreign economic policy from import substitution to an export-led strategy. Decree #186 encouraged foreign investment in the tourism sector; Decree #10 expanded privatization by allowing joint private investment, especially in the agricultural sector; and Law #10 implemented far-reaching trade liberalization initiatives.

The Higher Council for Investment must approve all investment opportunities created by US businesses. The government must own a passive 25 percent, usually land, in all ventures. Projects are more likely to be approved if the planned investment exceeds 10 million Syrian pounds, uses local resources, imports high technology, and correlates with government development initiatives. ExxonMobil and Nestlé have already secured approval from the Syrian government for investment projects in oil and food processing, respectively.

The United States government currently imposes export controls on trade with Syria based on antiterrorism legislation. US trade regulations apply to all national security-controlled goods and technical data if it is destined for military end-use. Some affected items include aircraft, helicopters, engines and related spare parts, heavy-duty tractors, mobile communications equipment, specialized telecommunications systems, and specified forms of fertilizers and phosphates. President Bush has announced to Congress that he is opposed to the imposition of economic sanctions against Syria, in particular the recently purposed "Syria Accountability Act," which would enact economic sanctions against Syria for its alleged connection with groups such as Lebanon's Hizbollah.

Though Syria has been liberalizing its economy, foreign investment has not been as strong as had been hoped for. Foreign investment stood at \$47.6 million in Syria in 1999, accounting for only 0.77 percent of total foreign investment in the Arab world. The obsolete laws and strict administration that are currently in effect in Syria discourage foreign trade. There has been talk of





reforms recently, which are going to be necessary to attract more investment in the Syrian economy

### **6.14 Tunisia**

Both the IMF and foreign investors have taken notice of Tunisia's economic reforms designed to attract foreign investment. Despite an international economic slowdown and the precarious regional political milieu, the flow of foreign investment to Tunisia has been constant. Approximately two thousand foreign firms are currently operating in Tunisia.

France, Tunisia's largest provider of FDI in 2002, increased investments 66 percent over 2001 to over \$141 million. According to the Tunisian-French Chamber of Commerce, 978 French companies now operate in Tunisia. France, with next largest investors Italy, Portugal, Germany, and the US brought total FDI up 50 percent in 2002 over 2001 to over \$760 million. Half of this increase was due to the sale of centrally owned assets, part of Tunisia's efforts towards increased privatization.

Due to agreements with the EU, the country has been attracting European firms who have been exporting light manufacturing to Tunisia.

Recently, there was a relaxation of a previous policy that discouraged foreign investment in service industries. The sectors with significant barriers remaining are finance, petroleum refining and production, and the national airline, electricity, water, and telecommunications.

Al Quds Al-Arabi newspaper reported in January of this year that Tunisian officials are anticipating an increase in foreign investment totaling over five billion dollars over the next five years. Much of that income may come from the sale of government assets in the energy sector.

### **6.15 The United Arab Emirates (UAE)**

UAE laws and regulations governing foreign investment are fairly conducive to foreign investment. While tariffs in the UAE stand at 4 percent on average, over 75 percent of imports enter the UAE duty-free and there are no tariffs on exports. Each emirate has its own customs authority, but a national committee formulates general policies. Outside the free trade zones, foreign firms must work through a UAE sponsor. To bid on federal projects, a company must be 51 percent UAE-owned. These rules do not apply to defense contracts or other projects where there is no local company to provide goods and services required.

The emirates have been promoting job creation for the growing native workforce, especially through national employment mandates. At the national level, banks have been urged to increase the





proportion of national employees to 40 percent by 2006 from the current average of 12 percent in 2003. The "Emiratization" program has proven difficult in some areas due to local employment preferences and higher salary costs relative to some segments of the job market.

Concerning the protection of intellectual property rights (IPR), the government has made greater efforts to enforce existing laws pertaining to intellectual property: a copyright law, a trademark law and a patent law. According to industry estimates, efforts to combat computer software piracy have been successful. The UAE leads the region in terms of its use of legal software, which in 2001 stood 59 percent in comparison with 22 percent in Qatar and 23 percent in Bahrain. The UAE is now recognized as a regional leader in fighting computer software piracy with new, stringent copyright laws and anti-piracy organizations.



## 7 Syria and EU

Syria is the only Mediterranean country with which an Association Agreement is not yet in force. It was initialed in October 2004. The EU is Syria's biggest trading partner, accounting for over 40% of its trade in 2003 and 2004. 85% of EU imports from Syria were energy, making the country the EU's 9th largest source of energy imports. With a total trade with the EU of €5 billion in 2004, Syria ranks as the EU's 48th trading partner.

- BILATERAL TRADE RELATIONS

The biggest share of the EU imports from Syria concerns energy (86%). Due to a decrease in energy imports, however, Syria's trade surplus with the EU shrank to €331 million in 2004.

- Trade in goods

In 2004 the EU imports from Syria notably energy (85%). The remaining 14% consist mainly of textiles and agricultural imports. EU exports to Syria are principally composed of machinery and transport equipment (38%) mineral fuels (16%) and chemical products (13%).

- Services and Foreign Direct Investment (FDI)

Regarding services and investment, the conclusion of the Association Agreement is set to significantly increase two-way transactions. The current Co-operation Agreement does not contain any provisions in these areas, and the Syrian economy has remained relatively closed.

- BILATERAL AGREEMENT

The European Union's policy towards the Mediterranean region as a whole is governed by the Euro-Mediterranean Partnership, launched at the 1995 Barcelona conference between the European Union and its 10 Mediterranean partners. The Barcelona Process involves extending free trade across the Mediterranean region through a network of bilateral Association Agreements between the EU and individual Mediterranean partners together with free trade agreements between the partners themselves, with the aim of creating a Euro-Mediterranean Free Trade Area by 2010.

- Association Agreement

The Co-operation Agreement in force between Syria and the EU dates from 1978. Negotiations on the new-generation Euro-Mediterranean Association Agreement were concluded and the agreement initialed in October 2004. However, the signature has not yet taken place.





The Association Agreement, once in force, will complement current provisions for duty-free access to the EU market for manufactured goods. The agreement requires Syria to open up its market gradually over a period of 12 years, by reducing and ultimately dismantling tariffs. Regarding agriculture and services, liberalization is planned in progressive stages.

Mediterranean partners have been invited to open negotiations on deepening liberalization of trade in agriculture, including processed agricultural and fisheries products, and to launch liberalization in trade in services and investment. Syria could participate in these negotiations once the Association Agreement enters into force.

- Institutional framework

Each Association Agreement is overseen by regular ministerial (Association Council) and senior official (Association Committee) level meetings. With regard to Syria, these structures, together with a Sub-committee for Industry, Trade and Services, in the trade domain, (as well as other committees, in the following areas: internal market; transport, environment and energy; research and innovation; agriculture and fisheries; and in matters of justice and security) will be established in due time, once the Association Agreement enters into force.

Association Council decisions are available on the Commission's Prelex website.

- The MEDA programme

Syria joined MEDA co-operation in 2000, and a total €93 million was allocated to it for 2000-2004. Programmes financed under MEDA focused on the modernisation of, among others, the health sector, public administration, higher education and strategic sections of the private sector. The National Indicative programme 2005-2006 (NIP) for Syria allocates €80 million to the country, including €18 million which is conditional on the signature of the Association Agreement.

- The new ENP framework

In due time, EU-Syria co-operation could also be pursued within the context of the new European Neighborhood Policy. The ENP will support and complement commitments taken in the Association Agreement and Euro med regional context.

A new financial instrument common for both the EU's southern and eastern neighbours will enter into force in early 2007, replacing the MEDA, TACIS and CARDS programmes. The European Neighbourhood Policy Instrument - ENPI - will be endowed with €14.9 billion for 2007-2013.



- SOUTH-SOUTH INTEGRATION

A major challenge facing Syria, as well as other Mediterranean countries, is the lack of economic diversity. To help bring about change, an essential component of the Euro-Mediterranean Partnership is the pursuit of greater economic integration in the Mediterranean region. Several steps aimed at helping Syria drawing benefits from economic integration with other countries in the Mediterranean region have already been taken in the Euromed partnership.

One of these steps is the agreement to enable the Pan-Euromed cumulation of origin, extending the existing Pan-European rules to Mediterranean countries. When applied, the system will generate new opportunities for operators to intensify the flow of trade in certain goods and to benefit from further regional integration.

- WTO

Syria applied for WTO membership in October 2001, with hardly any progress ever since. In September 2005, Syria renewed its request to pursue WTO accession.





## 8 EU relations with the Arab World

### 8.1 INTRODUCTION

The Thessaloniki European Council (19/20 June 2003) expressed the conviction that the EU must strengthen its partnership with the Arab World. The European Council invited the Commission and the High Representative to formulate a work plan taking full account of existing policies and programmes and in particular the Barcelona Process and the New Neighbours Initiative. This document responds to the invitation of the Council and outlines ways to achieve a better articulation and strengthening of EU relations with the countries concerned.

The Arab countries cover a wide region. From the Gulf to the Maghreb there are differences in social structure, natural resources, geography, economy and political constitution, but a rich cultural and historic legacy provides a common heritage for the 22 signatory parties of the Arab league Charter. Moreover, substantial Arab populations live in Europe and elsewhere and their identity and concerns are important factors in our relations with the Arab World. Many of these countries are close neighbours of the EU. Trade and migratory links are strong. Their development and prosperity have deep implications for the EU.

The challenges facing the Arab world have been extensively analysed. In particular, UNDP's Arab Human Development Report of 2002 and the follow-up report in October 2003 have measured the development of the Arab region in relation to other regions and found that the Arab world is lagging behind, economically, socially and politically. The World Bank report on enhancing governance in the Middle East and North Africa underlines the weaknesses of governance in the MENA region. These reports highlight the need for reform and conclude that the Arab societies need to review, restructure and reinforce governance. In this respect, the education systems have a crucial role to play. Education is fundamental to improve Arab countries' prospects for development in today's world. The key to enhancing human development and giving employment opportunities is improved quality, accessibility and equity in education and training. This is particularly important for the empowerment of women to enable them to exercise their full capabilities in Arab societies. Through different instruments the EU is already contributing to the Arab countries' efforts in addressing many of these issues.

The Israeli-Palestinian conflict deserves a special reference. It is a unifying and mobilising political factor in the Arab World. The overall implications of the Israeli-Palestinian conflict go beyond its territorial limits and result in the further spread of insecurity. Restoration of stability and order in Iraq is also an essential element for achieving international security.





### 8.2 EU POLICY INSTRUMENTS

---

Relations between the Arab World and the European Union reflect the complexity and the diversity of countries and situations. There is no single framework for partnership. The EU provides financial assistance in co-operation programmes with all Arab countries except GCC Member States and Libya. And it is also developing a programme of cooperation with the Arab League.

With the Mediterranean Arab countries, Europe has a partnership which covers political and security dialogue, economic relations, including the creation a free trade area, and social and human relations, a dimension that is of fundamental importance in the spirit of the Barcelona Declaration. The creation of a free trade area, with the conclusion of Association Agreements embodying the principle of combining free trade with substantial financial support for promoting modernisation, are important aspects of the Barcelona Partnership. The Association Agreements and the Euro-Mediterranean Partnership promote legislative reforms and regulatory convergence.

When the negotiations with Syria are concluded, the EU will have free trade agreements with all Mediterranean partners and the North-South free trade framework will be in place. The promotion of intra-regional trade and the South-South dimension should be further advanced.

Relations with this group of countries will be further enhanced within the Wider Europe framework. This initiative emphasizes the necessity for concrete, measurable reforms with the objective to give Mediterranean partners a stake in the EU four freedoms.

The EU's relations with Israel and the Palestinian Authority fall within this group of countries. In order to contribute better to the solution of the Arab-Israeli conflict, the Council appointed an EU Special Representative to the Middle East Peace Process. He contributes to the definition and implementation of EU policy on this issue and maintains permanent dialogue with all the relevant international actors involved in the Peace Process.

EU-Libya relations could enter a new phase after the lifting of UN sanctions. The participation of Libya in the Euro-Mediterranean Conference of Energy or in the Conference of Mediterranean Fisheries Ministers, are examples of potential areas of co-operation with Libya. Libya's participation in the Barcelona Process would constitute a crucial step towards normalising relations with Europe and all Mediterranean Partners. For this it is essential that Libya accepts the full acquis of the Barcelona Process. Consideration will be given in this context to how to incorporate Libya into the "Neighbourhood policy" (Wider Europe).





With the GCC, the focus has so far been on trade and economic relations. The Cooperation Agreement with GCC covers a number of areas of economic cooperation; EU and GCC also have political dialogue meetings. Negotiations for a free trade agreement are still in progress. Both sides should make efforts to overcome remaining obstacles since they have strong underlying interests in reciprocal trade and investment. The major challenges for the GCC region are consistent and comprehensive political development towards a more open society, and economic diversification.

With Yemen and the five Arab countries in the ACP framework (Comoros, Djibouti, Mauritania, Somalia, and Sudan) the focus is on development co-operation. The priority is the eradication of poverty and human development, in particular food security, health and education. Relations with Yemen are conducted in the framework of a Co-operation Agreement and should develop with a more structured political dialogue and increased focus on collaboration in the fight against terrorism and the protection of human rights. Relations with ACP Arab countries are governed by the Cotonou Agreement covering countries in Africa, the Caribbean and the Pacific. Among ACP Arab countries Sudan and Somalia are particularly affected by instability and poverty.

In Iraq, after the fall of the regime of Saddam Hussein, the following will be essential for the success of the reconstruction efforts: an adequate security environment, a strong and vital UN role, a realistic schedule for the handing over of political responsibility to the Iraqi people, and the setting up of a transparent multilateral trust fund to channel support from the international community.

As seen, the EU has a series of instruments at its disposal for its relations with the Arab world. Two of these instruments are solidly founded: the Barcelona process (and its enhancement through the Wider Europe initiative) and the ACP framework. They allow for both a multilateral and a country-by-country approach, tailoring the EU's relations to specific concerns regarding individual countries, to the countries' needs and to progress made. On the other hand, EU relations with GCC, Yemen and Iraq are less developed. The economic and social characteristics of these countries call for instruments different to the programmes used within the Barcelona framework. Recent developments point towards the need to establish a regional stability strategy for this group of countries which, with the addition of Iran, could be defined as the "Wider Middle East". From a strictly political point of view, relations with the ACP belong to a different set of problems. There will then be two main lines of action for the EU in its relations with the Arab countries, the Mediterranean line and the Wider Middle East.





### 8.3 PURSUING REFORM

Taking into account the full variety of instruments in place, the strategic focus on political, economic and social reform should be built around the following main elements:

- Political reform: encouraging good governance, the rule of law, democratisation, and promotion of human rights;
- Economic reform: trade liberalisation between and within EU and the Arab world;
- Cultural dialogue and social reform: diversify media outlets, promote gender equality, modernise education, and promote religious and cultural dialogue.

With the Mediterranean Partner countries, these objectives will be taken forward through a more effective implementation of the Barcelona Process goals, within Association Agreements and the development of the Wider Europe/New Neighbourhood Initiative. Reflection may be needed on the merits of developing a regional strategy in the future for the Gulf region, including Iran, Iraq, the GCC and Yemen.

#### 8.3.1 Economic Reforms

The long-term objective is, through co-operation, to introduce economic reforms to enable the countries to participate more fully in the global economy and create employment opportunities for the new generations.

The EU should:

- Continue trade liberalisation in the Euro-Mediterranean Partnership context with further liberalisation of agriculture and services and the full incorporation of regional cumulation of origin; Conclude and implement the EU/GCC free trade agreement; promote co-operation with GCC countries on issues such as the creation of a GCC single currency, or a GCC common commercial policy and single market.
- Foster south-south regional integration and support initiatives such as the Agadir declaration and the Maghreb Arab Union. Promote the progressive establishment of regional free trade arrangements, such as the linking of EU/MED and EU/GCC free trade agreements, including Yemen. Sustain economic and related administrative reform in Yemen and promote Yemen's integration in its region;
- Promote the approximation of the regulatory frameworks with those of the EU. Regulatory





approximation is one of the primary objectives of the neighbourhood policy in the Wider Europe initiative; foster energy, transport and telecommunication network interconnections and linkages with the Trans-European Networks;

- Taking advantage of the experience of the Euro-Mediterranean regional co-operation, develop selected networks for Wider Middle East co-operation;
- Develop a long-term approach for social, economic and political reconstruction in Iraq in a regional context. In the light of developments in 2004, develop a comprehensive medium-term strategy for EU relations with Iraq in line with the conclusions of the Brussels European Council of 16-17 October 2003.



## 9 Conclusion

The MENA region has been traveling along a slow growth and high unemployment trajectory over the past two decades. To pull out of this path, the region needs to make three shifts in its sources of growth: from oil to non-oil sectors, from public state-dominated to private market-oriented investment, and from protected import-substitution to export-oriented activities. Intensifying trade and private investment is at the core of all three shifts.

The region has good potential for expanding trade. Exports other than oil are a third of what they could be given the characteristics of the region. Openness to manufacturing imports is half of what would be expected. Increasing its share of world trade be possible for at least three reasons. The present level of the region's presence in world markets is small and an increase is unlikely to be resisted among major trading partners. Competitiveness based on low wages is possible, since wages in the region are fairly low, in the bottom half of world wages. However, for competitiveness to be sustainable, overall trade policy and investment climate considerations will have to be improved. And finally the region is close to a high -income region, across the Mediterranean to the EU, which can potentially be a source of high demand for certain regional products.

MENA countries also have great potential for attracting more investment from abroad and encouraging more private investment at home, both crucial in trade and development. If exports other than oil were higher, and in a better investment climate, domestic private investment in traded goods and services would be much higher. And the FDI inflows that the region could expect would be four to five times what they are today-some 3 percent of GDP, up from an average of 0.6 percent. On the other hand, the region remains subject to a geopolitical context featuring high levels of tension and conflict which can discourage foreign investment and even trade.

Nevertheless, if only half the region's trade and private investment potential were realized from about 1 percent to about 4 percent a year-half from more private investment and half from the greater productivity that openness would encourage.

Expanding trade also holds the promise of substantial dividends in job creation, for export opportunities would add millions of jobs. For example, if the region can achieve faster non-oil export growth of about 15% a year over the next 5 years, this would probably be sufficient to generate some 4 million jobs or 4 percent of the labor force, directly and indirectly in the export sectors alone. The employment effects are however, conditional on there being a more favorable investment climate in the region





With EU the Commission and the High Representative believe that it is necessary to raise the level of ambition in Europe's relations with the Arab World. The existing frameworks have to be further developed and complemented taking account of the different situations of the countries concerned. The Euro-Mediterranean Partnership will grow through the Wider Europe strategy. On the other hand, thought should be given to the development of a Wider Middle East strategy, to allow the EU to better confront the security challenges of this region and to promote the necessary reform processes. Consultation and co-operation mechanisms for enhanced political dialogue on conflict prevention and crisis management, the fight against terrorism, and the proliferation of WMD should be enhanced. Finally, the EU should increase coherence between existing instruments bearing in mind the European Security Strategy and enhancing focus on promoting reform. The follow-up to the European Security Strategy and the development of the Barcelona/Wider Europe process constitute the frameworks in which these objectives should be further pursued

## Sources:

World Bank

Arabic Economic Integration, Saad Hasan Jasim 1999 Bagdad

Economic Reform in Arab Countries, El-Erian Mohamed 1996

International Trade, Nigel Grimwade. ISBN 0-415-00397-0The Middle East and

North Africa Region: The Challenges of Growth and Globalization 2004

Middle East Oil Money and its Future Expenditure. Nicholas Fallon

Ministry of Finance-Syria

Ministry of economic

[www.google.com/search](http://www.google.com/search)

Henry T. Azzam ,Jordan Investment Trust (Jordinvest)

Collected Information from Arabic's magazines 2003-2005

<http://ar.wikipedia.org/>