International and Intra-Regional Trade

Theory of International Trade
External trade is said to be the “engine” of development. Trade generates foreign exchange to finance industrialization. Historically, the Middle East has been known as the “cross-roads” for trade between the East (China, India, Persia, and Arabia) to West (Asia Minor and Europe). Today, the ME & NA is a major exporter of natural and human resources to the West, and a large importer of capital and consumer goods from it.

The theory of international trade is based on the Principle of Comparative Advantage. Accordingly, countries must specialize in production of commodities in which they are the least opportunity cost producers, and exchange those with high opportunity cost imports. Free trade will mutually benefit both trading partners.

The Vent for a Surplus Principle of international trade is more applicable to the ME & NA. Accordingly, countries with surplus natural resources, in excess of present and future conceivable domestic needs, might exploit these resources and export the surplus. In this theory, there is no opportunity cost in exporting the primary products, since nothing is given up. For example, Saudi Arabia, with no extra reserves and current average production levels, has nearly 100 more years to export crude oil at a low marginal cost.

Both of these principles prescribe that the ME & NA must continue to rely on exportation of primary products and importation of finished capital and consumer goods. So, industrialization through trade does not seem to be as critical so long as there is an effective demand for their exportable products.

Industrialization through International trade
International trade can facilitate industrialization. An economy can attempt to industrialize through “import substitution” or “export promotion.” Using the import substitution strategy, and “infant industry” is establish to reduce reliance on imported manufacturing goods. Tariffs and quotas against less expensive foreign goods protect the industry. With heavy investment and specialization, the industry aims at achieving “economies of scale” evident by declining average production costs and prices. After satisfying the domestic demand, a surplus of these products are exported to regional and international markets. Export promotion is a strategy that takes advantage of comparative advantage. It produces and exports commodities that the economy can produce a low opportunity costs. Gradually, the economy moves to a higher-level product mix from the technological shelf to create markets for its exportable products.

International Trade Performance
These international trade strategies may pro or anti-trade-biased. Pro-trade biased growth implies that a country’s degree of openness [i.e., (export + imports) / GDP] is increasing. This means that countries are opening up by exporting of primary products (e.g., Algeria and Egypt) or trading manufacturing commodities (e.g., Turkey, Tunisia). Anti-trade-biased indicates that the openness index is declining. This means that countries are using protectionist policies to establish import-
substituting industries (e.g., Iran, Israel).

Countries following the Vent for a Surplus Principle by exporting primary products and importing finished goods suffer from terms-of-trade (i.e., export price index / import price index) deterioration and trade deficit (exports < imports) when their export prices do not increase as rapidly as their import prices (e.g., Egypt, Iran, Morocco). This has been the case through out the 1980s and 1990s because demand for primary products is more “price elastic” than finished goods. Countries using the import-substitution strategy for industrialization, which requires importation of expensive capital goods, tend to suffer from terms-of-trade deterioration and trade deficit (e.g., Turkey, Tunisia).

Governments of most countries have export “diversification” as a policy objective. The idea is to reduce reliance on primary product exports and achieve economies of scale in import-substituting finished goods. As shown in Figure 8.6, the non-oil countries of Israel, Tunisia, Turkey, Jordan, and Morocco as well as Egypt and Syria have been able to reduce their share of primary product exports over a two-decade period. Among these countries, Israel and Turkey have substantially increased their value of manufacturing exports.

**Intra-regional Trade**

By and large, the flow of trade is between ME & NA and Developed Countries (Europe, United States, and Japan). This pattern of trade is explainable by the “vent for a surplus” theory and import-substitution strategy. As a consequence, intra-regional trade has been small. Nevertheless, intra-Arab trade has been growing as several non-oil countries export manufacturing products to oil producing nations. If Arabs remove the boycott against Israel, intra-regional trade can significantly expand. Among regional economic arrangements, Organization of Petroleum Exporting Countries (OPEC), Organization of Arab Petroleum Exporting Countries (OAPEC), Organization of Islamic Countries (OIC), and Gulf Cooperation Council (GCC) have been successful to promote economic advancement.