ESTIMATING THE ECONOMIC BENEFITS of Levant Integration

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Preface

This report examines the potential effects of economic integration on the economies of the Levant. The potential gains from a comprehensive regional free trade agreement are substantial and could help the Levant address the daunting twin challenges of reconstructing Syria and creating employment opportunities for the large number of youth entering the labor market over the next decade. Although maximum benefits assume some degree of stabilization of the Syrian and, eventually, Israeli-Palestinian conflicts, the potential gains from even partial integration (such as the recently penned Iraq-Jordan economic agreements) could be the start of a potential takeoff for the region.

Accompanying this report is an online tool—available at www.rand.org/levant-calculator—that allows policymakers and the public to examine the economic dividend from economic integration.

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Economic integration in the Levant—in the form of a comprehensive free trade agreement (FTA) that eliminates tariffs, lowers investment and nontariff barriers, and waives visa requirements—could increase the average gross domestic product (GDP) of the Levant nations by 3–7 percent. This economic expansion would likely create at least 0.7 million to 1.6 million additional new jobs, reducing regional unemployment rates by 9–20 percent—and total job creation might be substantially larger. These estimates are for a potential FTA among Egypt, Iraq, Jordan, Lebanon, Syria, and Turkey—six of the core Levant countries.

Our analysis focuses on the three primary mechanisms—trade, investment, and tourism and travel—through which such a comprehensive FTA is likely to affect these economies. Previous empirical research has demonstrated that reducing tariffs and nontariff barriers enables trade; lowering investment barriers increases domestic and foreign investment; and eliminating visa requirements expands tourism and travel. This existing literature has also established that expanded trade, investment, and tourism and travel each increase GDP.

Figure S.1 reports our estimates of how a comprehensive FTA would change GDP and unemployment for each of these six countries. These estimates are derived from the results in the existing literature, with the figure reporting the net benefits that would accrue through increased trade, investment, and tourism and travel. We report the percentage change in GDP that would result from these increases, and we illustrate the change in unemployment by comparing the current unemployment rate (the “baseline” in the figure) with the estimated unemployment rate resulting from the
FTA. The “cautious” estimates model the benefits of integration as a series of bilateral FTAs while the “optimistic” estimates also factor in the likely benefits from regional coordination—specifically, improved trade coordination, increased political stability, and coordinated promotion of tourism and travel. The overall benefit from integration could be even larger if integration is accompanied by broad domestic reforms and regional coordination in improving shared infrastructure.

Although achieving these projected benefits will require some degree of stabilization of the Syrian conflict and significant coordination among sometimes troubled neighbors, there is now momentum to indicate that such a project could be successful. In 2011, four of these countries—Jordan, Lebanon, Syria, and Turkey—nearly established a customs union patterned after the European Union that would have allowed the free movement of goods and people. Though the political turmoil in the region has prevented further progress, the recent Iraq-Jordan economic agreements—signed in early February 2019—and trilateral Egypt-Iraq-Jordan summit the following month could provide the first steps toward achieving the benefits of Levant economic integration.

We have developed an online tool—available at www.rand.org/levant-calculator—that allows policymakers and the public to examine the economic dividend from economic integration. It allows users to (1) vary key assumptions about the movement of goods, people, and capital and (2) explore different combinations of countries participating in the FTA—even allowing the inclusion of Israel and the West Bank and Gaza. The benefits increase for larger blocs of countries and with reduced restrictions on the movement of goods, people, and capital among these countries. But we recognize that regional integration might start with only a subset of countries and with only partial economic integration: This tool also allows examination of the benefits of these alternative arrangements.

The online calculator is available at www.rand.org/levant-calculator.
The unemployment rate could decrease by over 2 percentage points

A comprehensive trade agreement could increase GDP by up to 7 percent

Baseline unemployment rates are for 2018 (the most recent data available at time of publication).
Introduction

Since the late 1990s, there has been a persistent, though sporadic, effort to deepen economic partnerships in the Eastern Mediterranean,\(^1\) a region often referred to as the Levant. Six core countries of the Levant—Egypt, Iraq, Jordan, Lebanon, Syria, and Turkey\(^2\)—have established a variety of bilateral economic ties, but attempts to establish broader regional economic partnerships have faltered.\(^3\) However, these efforts—particularly the near success of four Levant countries (Jordan, Lebanon, Syria, and Turkey) in signing a regional agreement just before the onset of the Arab Spring—might provide a foundation for integration in this region.

This report examines the potential benefits of economic integration among these six core countries of the Levant. Our analysis focuses on a comprehensive free trade agreement (FTA) that would eliminate all tariffs, lower investment barriers, align regulations to gradually reduce nontariff barriers (e.g., rules of origin),\(^4\) and waive visa requirements. We assume that this integration would establish a single economic zone across all signatories; significantly reduce

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1 In the 1990s, proponents of economic integration concluded that “[i]ncreased commerce and investment will diminish the mistrust that has long divided governments” (Albright, 1997), and that a shift “from a strategy of military superiority to one of economic cooperation” was needed (Peres, 1993, p. 74).

2 Although both Israel and Palestine are part of the core of the Levant, we exclude them from our definition because political obstacles currently block their participation in a trade agreement. Note that this is a modestly expanded definition of the Levant compared with historical definitions that typically exclude most of Iraq and Turkey. For a discussion, see Mansel, 2010, and Harris, 2005.

3 Turkey established FTAs with Syria in 2004, Egypt in 2005, Jordan in 2007, and Lebanon in 2010. Turkey also co-led a failed effort (with Syria) in 2010 to establish a free trade zone encompassing Iraq, Jordan, Lebanon, Syria, and Turkey that would, if successful, eventually evolve into a “Middle Eastern Union” (Walker, 2011).

4 Nontariff barriers are the “most important [barrier] to trade” in this region, and include rules of origin, standards and conformity assessment requirements, delays induced by inspection and other processes, and frequency of problems with customs and other authorities (Hoekman and Zarrouk, 2009; and Rouis and Tabor, 2012, p. 19).
existing restrictions on the movement of goods, people, capital, and services; and replicate the successes of regional FTAs elsewhere in the world rather than the historical efforts in the Middle East (e.g., the Pan-Arab Free Trade Agreement), which have been less successful than others throughout the world.5

Our analytical approach examines the three primary mechanisms—trade, investment, and tourism and travel—through which a comprehensive FTA such as the one we discuss is likely to benefit these economies. It is well-established that reducing tariffs and nontariff barriers enables trade;6 lowering investment barriers increases domestic and foreign investment;7 and eliminating visa requirements expands tourism and travel.8 We draw on this existing literature in estimating the benefits of a comprehensive Levant FTA. For example, our estimates for the trade mechanism are based on an analysis of all FTAs signed between 1970 and 2000, and that analysis concluded that FTAs roughly double bilateral trade.9

The analysis is focused on determining how the comprehensive FTA would affect each country’s overall economy, as measured by gross domestic product (GDP), via each of these three mechanisms. Although we rely on the existing academic literature to estimate the GDP equivalency of changes in trade and investment,10 we estimate

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5 FTAs worldwide have been estimated to increase bilateral trade among signatories by 100 percent, on average (Baier and Bergstrand, 2007). In contrast, the Pan-Arab Free Trade Agreement increased intraregional trade by only 20 percent (Harb and Shady, 2016).

6 Reducing these barriers makes it cheaper for countries to trade, thus making it profitable for a greater number of firms to export. This expanded trade reduces the cost of goods and services available to consumers in both countries because the more-efficient producers of a good now determine the market price. This trade is typically disruptive, as we describe later, because new imports resulting from an FTA compete against either domestic firms or imports from other trading partners. For a review of how tariff and nontariff barriers affect trade, see Hoekman and Nicita, 2008.

7 The primary relevant barrier to foreign investment is uncertainty about whether and how investments will be protected. Investment treaties typically “provide clear, enforceable rules to protect foreign investment and reduce the risk faced by investors,” providing foreign investors “either parity with or advantages over domestic investors” (Tobin and Rose-Ackerman, 2005, pp. 2, 5).

8 Simply put, visa restrictions of any kind decrease the total quantity of tourists and other visitors (Lawson and Roychoudhury, 2016).

9 Baier and Bergstrand, 2007.

10 Our estimates of the GDP impacts of expanded trade are based on Frankel and Romer (1999), though there is broad census that trade increases GDP. (For a review, see Ortiz-Ospina, 2018.) We estimate the GDP impacts of expanded investment using a standardized Cobb-Douglas function, which approximates how GDP responds to changes in physical and human capital. Mitra et al., 2015, use an analogous approach.
the GDP effects of expanded tourism and travel directly. Although we recognize that FTAs typically do not benefit all industries equally—in many cases, at least one industry is harmed—we do not assess the potential winners and losers from such an agreement.11 We similarly do not try to estimate the effect of this FTA on inequality within each of the six countries because there is not clear agreement on this effect in the literature.12 Although we do not examine either of these potentially disruptive effects in detail, developing plans to compensate for them is imperative to the FTA’s viability.13

In addition to studying the FTA’s potential aggregate economic consequences, we also estimate its effect on job creation. For this analysis, we rely on existing estimates of the relationship between changes in GDP and employment,14 with our analysis of job creation therefore a derivative of our estimates of the FTA’s effects on GDP. We rely on cautious estimates of the employment effects of growth throughout this report.15

We focus our analysis on an economic bloc that involves Egypt, Iraq, Jordan, Lebanon, Syria, and Turkey. We recognize that the success of an FTA involving these six economies will be affected by progress toward stabilization in Syria and that an eventual Levant-wide comprehensive FTA might begin via a series of bilateral economic

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11 For an accessible discussion of the idea of “winners and losers” from international trade, see Wolla and Esenther, 2017.

12 There is a general consensus that international trade contributes to increased inequality within countries (for a discussion, see Pavcnik, 2017), though a recent FTA-focused study concluded that goods-related FTAs might reduce this within-country inequality (Lee and Kim, 2016).

13 These types of disruptive effects contributed to the failure of at least one comparable regional trade agreement (the East African Customs Union) and difficulties in a multitude of others. For a discussion, see Dreyer and Popescu, 2014.

14 Our estimates of total job creation are less certain than our estimates of changes in GDP because the former rely on an additional assumption about the elasticity of changes in output to changes in employment. This “employment-growth elasticity” depends on “amount of surplus labor and labor force growth rate, the unemployment and labor force participation rates, the level and growth rate of labor productivity, and the structure of production” (World Bank, 2011, p. 35). Our analysis relies on country-specific estimates as described in Chapter 3.

15 For example, there is a wide variation in existing estimates of the employment-growth elasticity in Lebanon, from 0.20 (Robalino and Sayed, 2012) to 0.45 (World Bank, 2011, p. 56) to even as high as 0.80 (Slimane, 2015, p. 688), with the lowest (0.20) and highest values (0.80) suggesting a four-fold difference in the employment effects of growth. In our analysis, we rely on the most cautious estimate of this elasticity that we were able to identify in the existing literature, although the online calculator allows users to vary this assumption.
agreements—such as the one signed between Iraq and Jordan in February 2019. (In addition, given that Turkey is currently in an industrial products Customs Union with the European Union [EU], any FTA that includes Turkey and either Iraq or Syria would require an equivalent FTA between the EU and Iraq and Syria or some other accommodations by the EU.) Furthermore, it is possible that Israel, as well as the West Bank and Gaza (which we refer to as Palestine in this report), might someday be included in an eventual regional agreement if the Israeli-Palestinian conflict can be resolved.

Chapter 2 describes the efforts of nearly a decade ago to establish the Shamgen Agreement (a Levant-wide FTA) and recent efforts to deepen economic partnerships within the region. Chapter 3 describes our analytical approach and provides the primary results for the six countries of the Levant, and Chapter 4 examines the potential value to Israel and Palestine from an FTA that includes those two economies. The final chapter summarizes the challenges to regional integration, describes approaches that these states and the international community might take to help support these nascent efforts, and introduces our online tool that allows policymakers and the public to examine the economic dividend from economic integration in the Levant.

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16 Our analysis does not try to estimate the economic effects of Syrian reconstruction nor the broader “peace dividend” of potential improved relationships between Israel and Palestine. For Syria, our analysis assumes that reconstruction efforts—Independent of the economic integration process—return Syria to its preconflict level of GDP at the end of a decade. For Israel and Palestine, we do not factor in the broader dividends from a solution to the Israel-Palestine conflict other than those directly attributable to economic integration—i.e., we do not consider the trade benefits offered in the Arab Peace Initiative, larger reductions in domestic instability from resolution of the conflict, and other additional elements discussed in depth in Anthony et al., 2015.

17 “Jordan, Iraq Agree on Oil Supply as Trade Accords Go into Effect,” 2019.

18 To avoid ambiguity, we use the term Palestine to refer to the area of the West Bank and the Gaza Strip, as defined by the 1949 Armistice Line, and the term Palestinians to refer to the inhabitants (except for the Israeli settlers) of the West Bank and Gaza; Arabs residing in Israel are included in our analysis of the Israeli economy. We are not making any assumptions about the future internal political arrangements in Palestine, and thus will not make reference to any political entities in this territory (e.g., the Palestinian Authority created as part of the Oslo Accords). This approach follows that used by Anthony et al., 2015, p. xxii.
We focus our analysis on an economic bloc that involves Egypt, Iraq, Jordan, Lebanon, Syria, and Turkey.
Regional Integration: Precedent and Momentum

In 2010, four countries of the Levant—Jordan, Lebanon, Syria, and Turkey, which have been called the “Levant Quartet”—began a historic process to deepen the integration of their four nations. Together, they established the Close Neighbors Economic and Trade Association Council and began a process that would result in the free movement of goods, capital, and people among these four economies. This plan was referred to as the Shamgen Agreement (Shamgen) because it was intended to eventually be a Levant-wide project (Sham-) patterned after the European Union’s Schengen agreement (-gen).¹

The seeds of Shamgen date to 2003, when Syria and Turkey began discussing the possibility of an FTA.² The motivations were both economic and political. Syria was looking for a regional partner-

¹ See, for example, Bülbül and Çeviker, 2012. Note that the Schengen agreement was focused on only the movement of people among European signatories while Shamgen encompassed the movement of goods, people, and capital.
² The first “economic missions” started in 1999, in the wake of the Adana accords, and the countries established a Joint Economic Commission “that facilitated trade agreements and sponsored events” (Phillips, 2011, p. 37). Economic initiatives reportedly started to proliferate during 2002, even though “[o]nly after Damascus agreed to sever all connections with the PKK [Kurdistan Workers’ Party] was a variety of measures adopted to encourage commercial expansion, including a transportation agreement designed to boost rail, sea and air links and a memorandum of understanding that reinvigorated the long-dormant Joint Economic Committee” (Lawson, 2010).
ship that would facilitate modernization, provide a counter to Muslim Brotherhood influence, and supplement and balance its alliance with Iran. For Turkey, Syria emerged as a key ally in its efforts to counter the threat posed by Kurdish nationalists in the wake of the U.S. invasion of Iraq.\(^3\) The Syrian-Turkish FTA, signed in 2007 and modeled after an agreement that Syria had been negotiating earlier with the EU,\(^4\) began to have an effect almost immediately, with Turkish companies investing in Syria to take advantage of cheaper energy and labor and a sharp increase in bilateral trade.\(^5\) And in 2009, Syria and Turkey agreed to visa-free movement of their people.\(^6\)

The deliberate process to expand this economic partnership to include Jordan and Lebanon—and hence establish Shamgen—started in 2007. The motivation for this expansion was again both economic and political. From an economic perspective, these expanded partnerships reflected a “Turkish need for economic expansion” while its partners were looking for opportunities to address domestic socioeconomic challenges.\(^7\) Politically, this partnership would allow Turkey to solidify its role as a regional mediator, Jordan to deepen its ties with its neighbors, and Lebanon and Syria to normalize relationships with their partners. Both the Jordanians and Lebanese proved eager to join, and the Shamgen project was launched in 2007 at a meeting hosted by Italian Prime Minister Sil-

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3 Phillips, 2011, p. 36.
4 In 2003, Syria and the EU were negotiating an FTA that ultimately collapsed. The exact same text was used for the Syrian-Turkish FTA, which reportedly created some problems because Turkey and Europe are very different.
5 Annual growth in bilateral trade was in excess of 30 percent for the 2007–2011 period, compared with approximately 10 percent for preceding years (authors’ analysis based on International Monetary Fund 2018).
6 Phillips, 2011, p. 36.
vio Berlusconi in Milan. At this meeting, the partners established a series of ministerial committees that would begin the process toward establishing Shamgen.

In July 2010, the Levant Quartet established the Close Neighbors Economic and Trade Association Council with the “free movement of capital, goods and people” as a “medium-term objective,” along with a High-Level Strategic Cooperation Council to oversee the project.8 In the meantime, the four partners established a series of limited agreements: Turkey established bilateral FTAs with Jordan (in 2009) and Lebanon (in 2010); Turkey, Syria, and Jordan established a visa-exemption agreement in 2009; and Turkey and Lebanon established a visa-exemption agreement in 2010.9 These bilateral arrangements would prove a key mechanism in the 2010 agreement, which would gradually expand “all existing bilateral agreements to cover the four countries.”10 In addition, by late 2010, economic ties between Iraq and Turkey had been largely restored, with both the

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9 Yılmaz, 2011.
Iraqi and Turkish governments taking action to sustain and deepen economic ties.\textsuperscript{11}

Shamgen faltered in 2011 with the onset of the Arab uprisings and ultimately collapsed because of the civil unrest in Syria and the resulting sanctions imposed by the international community.\textsuperscript{12} However, it was a project with aspirations beyond just the Levant, and its leadership had imagined expanding to include Iran and Iraq. Some had even mentioned Israel and Palestine—and though that aspiration was perhaps “more emotional than practical,”\textsuperscript{13} both Jordan and Turkey had trade relationships with Israel that might have been leveraged for this expansion.

As the war in Syria seemed be winding down, regional integration got a fresh boost from a major trade deal between two of the former Shamgen countries. On February 2, 2019, Iraq and Jordan signed a series of economic agreements designed to expand trade. These agreements—which provide Jordan access to cheap oil, provide Iraq access to electricity, and facilitate joint ventures (e.g., the joint industrial city, the Basra-Aqaba pipeline)—are intended to restore

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{11}] Turunc, 2011, p. 42.
\item[\textsuperscript{12}] Kurtaran, 2011.
\item[\textsuperscript{13}] Author conversation with participant in Shamgen negotiations.
\end{itemize}
\end{footnotesize}
economic ties between the two countries.\textsuperscript{14} This partnership reflects the simple reality that both nations are actively seeking agreements that “create jobs, spur economic growth and improve public services.”\textsuperscript{15} But like the partnership between Syria and Turkey that was the foundation of Shamgen, this one also reflected a political calculus by the two nations; for example, King Abdullah’s historic visit to Iraq in January 2019 focused on domestic and regional political and security matters as much as it did economic ones.\textsuperscript{16}

This new partnership between Iraq and Jordan could also prove to be the nucleus of broader economic integration. A tripartite Egypt-Iraq-Jordan summit in Cairo in March 2019—the first international trip by Iraqi Prime Minister Adel Abdul Mahdi in his role as prime minister—laid a foundation for new economic and security cooperation, both bilateral and trilateral.\textsuperscript{17} Furthermore, recent outreach by both Lebanon and Turkey—for example, a visit by President Michel Aoun to Iraq that similarly focused on economic and security issues,\textsuperscript{18} or promises of investment and expanded trade by the Turkish Foreign Minister\textsuperscript{19}—suggest that there is again growing momentum for a regional economic project, this time centered around the reconstruction of Iraq (and, potentially, Syria).

\textsuperscript{14}“Jordan, Iraq Agree on Oil Supply as Trade Accords Go into Effect,” 2019.
\textsuperscript{15}“As the Threat of ISIS Recedes, Iraq Looks to Its Neighbors to Spur a Recovery,” 2019.
\textsuperscript{16}“King’s Historic Visit to Baghdad Signals ‘New Phase’ in Jordanian-Iraqi Relations,” 2019. For example, one observer indicated that the agreement would “allow Iraq to access Jordanian military know-how in building its own military capacities” (“As the Threat of ISIS Recedes, Iraq Looks to Its Neighbors to Spur a Recovery,” 2019).
\textsuperscript{17}“Iraq, Egypt, Jordan’s Joint Statement of Cairo Summit,” 2019.
\textsuperscript{18}Al-Salhy, 2018.
\textsuperscript{19}“Ankara Offers $5bn Credit for Turkish Companies Rebuilding Iraq,” 2019.
Estimating the Benefits from Integration

Our approach for estimating the benefits from integration focuses on the opportunity costs—the missed economic benefits—resulting from the lack of economic integration in the region. Political conflicts and crises, and the resulting uncertainty, have restricted international trade, investment, and the movement of people. The estimated benefits of a comprehensive FTA result from a reduction in these restrictions.

Our analysis focuses on the following three mechanisms:

1. **Trade in goods and services:** A comprehensive FTA would increase trade by removing tariffs and reducing other nontariff restrictions on trade (e.g., rules of origin, preshipment inspections).

2. **Domestic and foreign investment:** Local and international investors and businesses will seek to take advantage of the larger market for goods. Improvements in domestic and regional political stability will also enable new investment.

3. **Increased tourism and travel:** The elimination of visa restrictions would increase travel throughout the Levant and create new opportunities for collaboration in tourism.
Figure 3.1 provides an overall summary of how economic integration would benefit the nations of the Levant via these three mechanisms. For each mechanism, our estimates are based on previous assessments of the consequences of trade agreements in the Levant or in other analogous contexts. For example, our estimates for the trade mechanism are based on an academic study that measures the trade impact of all FTAs signed between 1970 and 2000.¹

¹ Baier and Bergstrand, 2007.
As illustrated in Figure 3.1, our analysis focuses on estimating potential changes in the GDP of these six core countries of the Levant. We focus on GDP, which is a measure of the total output of an economy, because it provides a proxy for the health of an economy and most existing analyses of the effects of economic integration have used GDP as an outcome. In addition, our analysis also reports the likely consequences of integration on job creation, relying on previous estimates of the relationships between changes in GDP and changes in employment.\(^2\)

Throughout this report, we provide both cautious and optimistic estimates of the likely effect of this comprehensive FTA. The cautious estimates model economic integration as a series of bilateral FTAs and ignore the benefits from the broader regional partnership. Our optimistic estimates factor in these anticipated larger benefits from the regional program.

Although the comprehensive FTA itself will require some specific domestic reforms, our analysis is deliberately cautious in that it does not include the potential value of any broader domestic reforms that might accompany regional integration. These additional domestic reforms might include, for example, improved national transport infrastructure or improved regulations for businesses and investment.\(^3\) Our estimates also do not take into account any potential improvements in regional infrastructure (e.g., energy systems), which would be costly and difficult to implement but might have large economic dividends.\(^4\)

\(^2\) Given our intent to produce estimates that are cautious overall, we use the lowest estimated value that we were able to identify for each country. These values are as follows: Egypt, 0.58 (Baduel et al., 2017, p. 9); Iraq, 0.27 (Al-Alaak et al., 2014 p. 127); Jordan, 0.55 (Abdih, Gamba, and Selim, 2014, p. 16), Lebanon, 0.20 (Robalino and Sayed, 2012, p. 14); Syria, 0.58 (Slimane, 2015); and Turkey, 0.20 (Akçoraoğlu, 2010).


\(^4\) As an example, our estimates do not factor in the potential benefit of regional integration in the energy sector. Expanding intra-Levant energy trade and leveraging and expanding existing but underutilized infrastructure could expand regional GDP by 0.8 percent (equivalent to $12 billion in 2016). This increased energy trade will likely account for both trade in natural gas—with hydrocarbon-rich Iraq exporting natural gas to Jordan, Lebanon, Palestine, and Syria—and improved regional electricity systems to facilitate short-term trades during peak seasons (World Bank, 2014, p. 144). This analysis, which is not included in the main results in this report, is based on the assumption that increased energy trade—in conjunction with domestic reforms to improve pricing and payment discipline—would reduce electricity shortages by 50 percent, which was ranked by private-sector firms in the region as the second greatest obstacle that they faced (World Bank Group, undated).
Expanded trade could expand GDP by as much as 3% with new economic opportunities creating as many as 670,000 new jobs.
Reducing existing trade barriers among the six primary Levant states—barriers that are currently among the highest in the world—is estimated to increase GDP by at least 1.5 percent, potentially creating some 340,000 new jobs over a decade. However, expanded trade could expand GDP by as much as 3 percent, with the new economic opportunities creating as many as 670,000 new jobs.

Our cautious estimates model the benefit that would accrue from a series of bilateral FTAs. Based on this previous evidence, we assume that bilateral trade between states without an existing trade treaty will double and that trade between states with existing trade agreements will also grow substantially. We assess that these estimates

5 The Middle East has the most restrictive trade regimes of any world region: The tariff barriers are the second highest in the world (second only to South Asia), and the region suffers from both high nontariff barriers (e.g., rules of origin, standards and conformity assessment requirements) and weak infrastructure (Hoekman and Zarrouk, 2009; and Rouis and Tabor, 2012, pp. 18–20).

6 This reflects our cautious estimate. Both our cautious and optimistic estimates assume that bilateral trade increases gradually over a ten-year period and achieves its new level by the tenth year. Bilateral trade data are from the International Monetary Fund (2016), and our estimates assume that bilateral trade during the first year of the agreement for each state pair is equivalent to the maximum historical bilateral trade between those two states. A gravity model—which models bilateral trade as a function of GDP and which we estimate using data for only these eight economies (see, for example, Anderson and van Wincoop, 2003)—is used to interpolate bilateral trade for postconflict Syria and for states without recent bilateral trade (e.g., Israel and Lebanon).

7 Estimates of the GDP impacts of trade rely on a trade-to-GDP multiplier, which is the arithmetic relationship between a change in trade and a change in GDP. This larger estimate assumes that the trade-to-GDP multiplier is 1 (each $1 of new trade increases GDP by $1; the more cautious estimate we provide assumes a value of 0.5 (each $1 of new trade increases GDP by $0.50). Existing evidence suggests that even this larger value of 1 is cautious, as this section discusses in more detail.

8 Baier and Bergstrand, 2007, estimates—in an analysis of all FTAs signed between 1970 and 2000—that an FTA between two states roughly doubles bilateral trade after ten years.

9 We assume that bilateral trade among the four countries that are signatories to the 1997 Pan-Arab Free Trade Agreement—Iraq, Jordan, Lebanon, and Syria—expands by two-thirds. This assumption is based on the observation that the Pan-Arab Free Trade Agreement increased trade among these countries by only 20 percent (Harb and Shady, 2016), which is substantially below the doubling of trade that follows the “average” FTA. Our assumption is equivalent to assuming that the two treaties, the Pan-Arab Free Trade Agreement and the comprehensive Levant FTA studied here, together achieve this doubling as the two-thirds expansion in trade is on top of the 20 percent historical increase. For other existing bilateral trade agreements, we assume that bilateral trade increases by a more modest 25 percent. This assumption is based on the observation that regional FTAs increase trade more than bilateral FTAs (see, for example, Kozo, 2006), though the assumed value of 25 percent is relatively arbitrary because we are not aware of any analyses that systematically compare regional FTAs with bilateral ones.
represent the minimum possible economic effect because these states exhibit a high degree of trade complementarity—that is, the key exports of one Levant state are frequently an important import of one of the other states—and we use a cautious assumption about the relationship between growth in trade and growth in GDP. Our estimates are comparable with, although slightly more cautious than, other estimates and approaches.

The state-specific effects of integration via trade are illustrated in Figure 3.2. The cautious value corresponds to our minimum aggregate estimate of a 1.5-percent increase in GDP, and the optimistic estimate uses a less conservative assumption about the GDP impacts of increased trade. The economies where regional trade is already important despite weak or no existing trade agreements—Iraq, Jordan, Lebanon, and Syria—stand to benefit the most from expanded trade, with GDP growing by 5 percent or more.

10 World Bank, 2014, pp. 15–16.
11 Frankel and Romer, 1999, p. 394, estimates that the trade-to-GDP multiplier is in the range of 0.85 to 1.97 but that “a rise of one percentage point in the ratio of trade-to-GDP increases income per person by at least one-half percent.” For our cautious analysis, we assume that the ratio is 0.5.
12 See, for example, Ianchovichina and Ivanic, undated.
13 Specifically, the optimistic estimate assumes that the trade-to-GDP multiplier is 1 while the cautious estimate assumes a multiplier of 0.5, which is the minimum reported by Frankel and Romer, 1999.
NOTES: The cautious estimate assumes that the trade-to-GDP multiplier is 0.5, bilateral trade doubles for state pairs without existing agreements, and trade increases by 67 percent for state pairs included in the Pan-Arab Free Trade Agreement and by 25 percent for all other preexisting trade agreements. The optimistic estimate assumes that the trade-to-GDP multiplier grows to 1, doubling the overall estimated GDP impact of trade.
New investment activity—domestic and foreign—could expand GDP by as much as 1.5% with new economic opportunities creating as many as 410,000 new jobs.
New investment from local and foreign investors taking advantage of new opportunities offered by the larger market is estimated to increase GDP by 1 percent, potentially creating 280,000 new jobs over a decade.\textsuperscript{14} If the political process requisite for economic integration also reduces political instability, the potential net job creation could surge to nearly 410,000 from new investment activity alone. We model the two because the full benefits of investment—which includes a bet by capital owners that the government will not take their investment away or that violence will not destroy it—will come through increased political stability.

Our cautious estimates assume that integration increases both domestic and foreign investment and that the magnitude of this effect is comparable with what has occurred in other preferential trade agreements.\textsuperscript{15} Although reaping this benefit will likely require meaningful domestic reform,\textsuperscript{16} new investment resulting from economic integration might have a greater effect than suggested by historical experience because a lack of high-quality investment—specifically, investment in productive sectors—has been a key constraint on growth and job creation for decades.\textsuperscript{17}

\textsuperscript{14} Our cautious estimate assumes that domestic investment as a share of GDP increases by 0.45 percentage points for each new trade partner and that this investment increases the total physical capital stock by the equivalent amount. This result is based on Tobin and Rose-Ackerman, 2005, p. 29, which finds that bilateral investment treaties increase domestic investment by this amount. Mirroring our assumptions for the trade impacts (see the section on trade), we assume that the benefit for country pairs that are signatories to the Pan-Arab Free Trade Agreement is two-thirds of this benefit and that country pairs with other existing trade agreements receive one-fourth of this benefit.

\textsuperscript{15} Although it is well-established that regional integration can also increase foreign investment—for example, Büthe and Milner, 2008, p. 750, finds that bilateral FTAs increase foreign investment as a share of GDP by 0.22 percentage points—we assume, in the spirit of producing cautious estimates, that the estimates of Tobin and Rose-Ackerman, 2005, capture this effect. We note that both Farla, de Crombrugghe, and Verspagen, 2016, p. 6, and Omri and Kahouli, 2014, p. 261, find that domestic investment increases by $0.60 for each dollar increase in foreign investment, suggesting that foreign investment would contribute to roughly one-third (0.22 * 0.6/0.45) of the observed change in domestic investment. Interestingly, the size of the investment effect resulting from integration does not seem to be affected by the size of the bloc resulting from these agreements (see, for example, Büthe and Milner, 2014), although there are some analyses that suggest otherwise (see, for example, Jaumotte, 2004).

\textsuperscript{16} See, for example, World Bank, 2014 (p. xxx).

\textsuperscript{17} International Monetary Fund, 2016. Although investment in Israel has been more robust than in its Arab neighbors in the Levant, such investment remains low in comparison with other nations at a similar level of economic development (see, for example, Ben-David, 2013).
Our optimistic estimates make the added assumption that the comprehensive FTA reduces political instability, which would increase domestic and foreign investment. Although this effect is more modest than the direct effects of integration, increased stability will still provide meaningful economic dividends because several states in the Levant have experienced and continue to experience unusual political instability.

The state-specific effects of integration via investment are reported in Figure 3.3. Iraq stands to receive the greatest benefit—with GDP expanding by more than 2 percent as a result of increased investment—although Egypt and Turkey would each see expansion by at least 1.5 percent. Expanded investment resulting from the new trade agreements accounts for an average of 75 percent of the benefit, and the countries with the greatest political instability (Egypt, Iraq, and Syria) exhibit the greatest relative benefit from increased stability.

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18 We assume a 75-percent reduction in political instability, which is arbitrary but consistent with the notion of an increasingly stable region imagined for this comprehensive FTA.
19 Büthe and Milner, 2008, p. 750, estimate that each one-point reduction in their measure of instability would increase foreign investment as a share of GDP by 0.0153 percentage points. These authors measure political instability as the sum of the eight measures of domestic political instability reported in the Cross-National Time-Series Data Archive (Databanks International, 2017). We assume that the total capital stock increases by $1 for every $1 in increased foreign investment associated with reduced instability, though this likely understates the total effect: Farla, de Crombrugghe, and Verspagen, 2016, and Omri and Kahouli, 2014 demonstrate that each $1 of foreign investment is associated with a $0.60 increase in domestic investment.
20 Estimates reported in Büthe and Milner, 2008, p. 750, indicate that each additional trade agreement is equivalent to an approximate three standard deviation change in political instability.
21 We are specifically referencing the composite measure of instability used by Büthe and Milner, 2008, which factors in the number of assassinations, general strikes, guerilla warfare (insurgency) events, government crises, purges, riots, revolutions, and anti-government demonstrations. Three of the countries (Egypt, Iraq, Syria) have political instability three standard deviations above the average in 2011–2016, and Turkey is more than two standard deviations above the average. The assessments of political instability in these four countries are driven by three categories: guerilla warfare, riots, and anti-government protests.
### FIGURE 3.3
Investment-Related Effects of Levant Economic Integration

<table>
<thead>
<tr>
<th>Country</th>
<th>Percentage change in GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turkey</td>
<td>3%</td>
</tr>
<tr>
<td>Lebanon</td>
<td>2%</td>
</tr>
<tr>
<td>Jordan</td>
<td>1%</td>
</tr>
<tr>
<td>Egypt</td>
<td>0%</td>
</tr>
<tr>
<td>Iraq</td>
<td>0%</td>
</tr>
</tbody>
</table>

**NOTES:** The cautious estimate is based on the assumption that gross fixed capital formation as a share of GDP increases by 0.45 percentage points for each new trading partner (Tobin and Rose-Ackerman, 2005). The optimistic estimate makes the additional assumption that political instability is reduced by 75 percent. Data on the capital stock are from Feenstra, Inklaar, and Timmer, 2015. GDP and gross fixed capital formation are from the World Development Indicators database (World Bank, various years), and political instability data are from the Cross-National Time-Series Data Archive (Databanks International, 2017). Estimates of the capital stock of Palestine are from Anthony et al., 2015, p. 61. Estimates of Syrian GDP combine the 2007 data available in the World Development Indicators with the observation in World Bank, 2017, p. 17, that GDP has fallen by two-thirds during the conflict, and estimates of the capital stock combine the World Development Indicators’ preconflict data with estimates from Egel et al., 2017, on the magnitude of the total destruction of physical capital wrought from the conflict ($24 billion).
Expanded tourism and travel could expand GDP by as much as 2%. With new economic opportunities, creating as many as 570,000 new jobs.
Tourism and travel are critical components of the economies of the Levant, accounting for 11 percent of regional GDP.\textsuperscript{22} We estimate that a comprehensive FTA would increase average GDP by at least 0.3 percent, potentially creating 90,000 new jobs, as a consequence of new economic opportunities related to tourism and travel.\textsuperscript{23} And if the states of this newly forming economic bloc could coordinate effectively in promoting tourism and travel, this sector alone could create nearly 570,000 new jobs.\textsuperscript{24}

Our cautious estimates for the effect of integration on tourism and travel relies on a simple observation: Visa restrictions reduce the amount of tourism.\textsuperscript{25} In addition, economic integration could create new opportunities for collaboration in tourism, spurring enhanced growth in this sector; for example, effective coordination in promoting tourism likely contributed to the rapid growth in this sector in Southeast Asia.\textsuperscript{26}

\textsuperscript{22}We developed this estimate based on the state-specific total contributions of trade and tourism to GDP as reported by the World Travel & Tourism Council, 2018 (see the reports for Egypt, Iraq, Israel, Jordan, Lebanon, Syria, and Turkey). Data for Palestine were not available from this source, so we estimated this using data available from the World Tourism Organization, 2018. Specifically, we assumed that this total contribution variable is proportional to the “Inbound Tourism Expenditure over GDP” variable available in the World Tourism Organization data, and we estimated the Palestine value based on the ratio of the two variables for Jordan.

\textsuperscript{23}This estimate assumes that all bilateral visa restrictions are removed and that the elimination of each visa restriction is associated with a 0.8-percent increase in aggregate tourism. This estimate is based on Lawson and Roychoudhury, 2016, Table 2, which finds that a one-point increase in the authors’ “Ease of Travel for Foreigners” measure increases tourism by 1.5 percent. Because there are 187 countries in the authors’ linear index, each additional visa restriction would correspond to a \(1.5 \times \frac{100}{187} = 0.8\) percent change in tourism. Note that this estimate is modest, with each of the countries experiencing a 6-percent (on average) increase in tourism. Other estimates suggest that FTAs could have much larger effects (see, for example, Saayman, Figeni, and Cassella, 2016).

\textsuperscript{24}This assumes that integration increases the annual growth rate in tourism by 1 percent, in addition to the one-time increases in tourism income associated with the elimination of visa restrictions.

\textsuperscript{25}Requiring a visa has been shown to reduce tourism from a given country by 70 percent (Lawson and Roychoudhury, 2016). This might underestimate the impact of the FTA: restrictions on trade in goods and services (which will also be reduced as part of the comprehensive FTA) also reduce tourism (World Bank, 2014, Chapter 8). This approach is likely to particularly underestimate the benefit for Israel and Palestine, where tourism has been stifled by, respectively, conflict and Israeli-imposed restrictions (Anthony et al., 2015, pp. 28, 31–32; and Fleischer and Buccola, 2002).

\textsuperscript{26}Coordination among countries in the Association of Southeast Asian Nations likely contributed to the rapid growth rate in tourism in those countries. Their tourism growth rates have outperformed the rest of the world by 2.5 percentage points (Wong, Mistilis, and Dwyer, 2011, p. 883).
The state-specific effects of integration from tourism and travel are illustrated in **Figure 3.4**. The elimination of bilateral visas within the regional bloc—assuming that all six economies are included—is anticipated to increase GDP by around 0.5 percent in each state. Regional cooperation dramatically increases the outcome. The relative benefit of regional cooperation for Jordan is particularly large because its visa restrictions are more permissive than its neighbors, and it benefits less from visa liberalization.

If the states of this newly forming economic bloc could coordinate effectively in promoting tourism and travel, this sector alone could create nearly 570,000 new jobs.
FIGURE 3.4
Tourism- and Travel-Related Effects of Levant Economic Integration

Percentage change in GDP

NOTES: The cautious estimates assume that the elimination of each bilateral visa restriction is associated with a 0.8-percent increase in aggregate tourism (authors’ estimates based on Lawson and Roychoudhury, 2016, Table 2). The optimistic estimate makes the additional assumption that regional coordination increases growth in the tourism sector by 1.0 percent per year. Data is from World Travel & Tourism Council, 2018, and World Tourism Organization, 2018.
An Israeli-Palestinian Dividend?

The potential economic dividend from the resolution of the Israeli-Palestinian conflict has long been offered as an incentive to both parties in the conflict. Economic “inducements” were a central tool used by the United States to facilitate the Oslo process,1 and were similarly a key component of the Arab Peace Initiative, in which the nations of the Arab League offered to normalize economic and political relationships with Israel in exchange for peace. In 2015, a study by the RAND Corporation estimated that peace through a Two State Solution—including the benefits from increased trade throughout the region as envisaged by the Arab Peace Initiative—would increase Israeli GDP by 5 percent and Palestinian GDP by 44 percent.2

Our analysis suggests that the benefits of an Israeli-Palestinian peace would be significantly higher if it also offered a pathway for those two economies to join a comprehensive Levant FTA. When our estimates of the benefit of a comprehensive FTA are combined with the other dividends from peace detailed in RAND’s previous analysis, the net benefit to Israel increases to more than 9 percent of GDP and the net benefit for Palestine increases to more than 60 percent.

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1In this case, it was direct foreign assistance rather than the potential dividend from peace. Although these inducements reportedly “provided momentum to the peace process, underwrote practicalities, and smoothed over periodic crises in the negotiation,” they “did not bring either side to the table” nor did they prevent the collapse of the process (Lasensky, 2004, p. 211).

2Anthony et al., 2015, pp. xlv–xlvi.
of GDP.\textsuperscript{3} Integrating Israel and Palestine into this FTA would also create substantial benefit for the rest of the Levant, creating an additional 310,000 new jobs across the FTA’s other six members—equivalent to a 20-percent increase in the FTA’s benefit.

\textsuperscript{3}This current analysis includes only trade with the Levant and not the broader Arab world; it does not include the benefits of enhanced labor integration between Israel and Palestine, territorial control, or access to water; and it ignores the “direct costs” of the conflict between Israel and Palestine studied in Anthony et al., 2015. The additional benefit to Israel is likely to be at least $4 billion more than estimated in this current report (the benefit from increased Palestinian labor and 50 percent of the benefit of Arab world trade) and the comparable benefit for Palestine is $2 billion (direct costs plus the benefit from control of territory and access to water) as reported in Anthony et al., 2015, p. xxxiv–xxxv.
Realizing the Promise

Our estimates of the benefits of integration are large, with cautious estimates suggesting that GDP could expand by more than 7 percent and that more than 1.6 million jobs might be created. However, past efforts to deepen Levant integration have faltered because economic integration is inextricably linked to, and subsumed by, the broader regional conflicts. Although the prospect of shared economic prosperity has long been envisaged as a “dividend” from regional peace and cooperation, realizing these benefits requires collective action for regional prosperity.

Regional integration has, and should be, correlated with regional security cooperation. This was certainly the trend in the evolution of the European Union. It was also the case in the early Shamgen discussions and in the more-recent Iraq-Jordan economic agreements and trilateral Egypt-Iraq-Jordan summit. Trade and business are jeopardized by war and conflict, and the costs of conflict for this region have been severe. Most dramatically, the conflict in Syria has wiped out some two-thirds of Syria’s economy, but the Israeli-Palestinian conflict costs more than $3 billion a year and those costs could grow dramatically if the conflict degrades further. Resolving

1 This two-thirds decrease reflects a 93-percent decrease in activity in the hydrocarbon sector, which accounted for 12 percent of Syrian GDP before the conflict, and a 52-percent contraction in the non-oil economy because of “destruction of infrastructure, reduced access to fuel and electricity, low business confidence, and disruption of trade” (estimates of damage are from World Bank, 2017, p. vii; hydrocarbons as share of overall preconflict GDP is from Gobat and Kostial, 2016, p. 10). As mentioned earlier, our analysis assumes that Syrian GDP returns to preconflict levels by the end of a decade.

2 Anthony et al., 2015, p. xxxiv, finds that the opportunity costs of the status quo, compared with the two-state solution, is $32.5 billion over a decade. If the conflict degrades, that opportunity cost could reach as much as $85 billion over a decade.
these conflicts while pursuing economic integration and cooperation could be the start of a potential takeoff for the region.

Despite the region’s modern legacy of conflict and poor governance and its many political faultlines, a shared history and geography can inspire leaders and people of the region to envision a more peaceful and prosperous future. Two practical steps can be taken to support ongoing, organic efforts at Levant economic integration. A first step is to encourage more-expansive discussions of regional engagement, building on the Shamgen experience, and, more recently, the Iraq-Jordan-Egypt trade agreements. A dialog about the benefits of a shared economic future should complement inclusive political and cultural exchanges and feature direct engagement with policymakers and outreach via traditional media and social media, providing information in a format that is transparent and accessible to a broad variety of audiences.

A second step is to work with these countries to adequately plan and prepare for the new opportunities that Levant economic integration will bring, especially for postconflict development and reconstruction in Syria and the region. Short-term economic disruption as a consequence of increased movement of goods, people, capital, and services is inevitable.3 Facilitating deliberate planning involving representatives from government, industry, labor organizations, and other groups can help these countries prepare for potential disruptions and maximize the benefits of integration.

To support this planning process, we have developed an online tool—available at www.rand.org/levant-calculator—to make the results in this study accessible to policymakers and the public. This tool allows users to vary key assumptions about the movement of goods, people, and capital and explore different combinations of countries participating in the FTA, including Israel and Palestine.

This tool, illustrated in Figure 5.1, has three primary goals. The first is to allow users to explore alternative arrangements for a potential comprehensive trade agreement in this region. The benefits of integration increase for larger blocs of countries and with reduced restrictions on the movement of goods, people, and capital among

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3The FTA between Jordan and Turkey is a cautionary tale in this regard. See, for example, Ghazal, 2017.
FIGURE 5.1
Online Tool for Assessing the Economic Value of Levant Economic Integration

The online calculator is available at www.rand.org/levant-calculator.
these countries. But we recognize that regional integration might start with only a subset of countries and with only partial economic integration. This tool allows examination of the benefits of these alternative arrangements.

The second goal is to provide complete transparency about the analysis underlying the results in this report. Our results, however cautious, suggest that the benefits from integration are large. The tool explains each of the key underlying assumptions and allows users to vary those assumptions, thus exploring how the net benefit will change. It thus provides a novel approach for users to understand how and why the benefits from economic integration will accrue.

The final goal of this tool is to allow users to explore the benefits of more-optimistic assumptions about economic integration in the Levant—including a larger Levant and one with greater coordination in trade, investment, and tourism and travel.
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Economic integration in the Levant—in the form of a comprehensive free trade agreement (FTA) that eliminates tariffs, lowers investment and nontariff barriers, and waives visa requirements—could increase the average gross domestic product of the Levant nations by 3–7 percent. This economic expansion would likely create at least 0.7 million to 1.7 million additional new jobs, reducing regional unemployment rates by 8–18 percent—and total job creation might be substantially larger. These estimates are for a potential FTA among Egypt, Iraq, Jordan, Lebanon, Syria, and Turkey—six of the core Levant countries.

The authors have also developed an online tool that allows policymakers and the public to examine the economic dividend from economic integration. It allows users to (1) vary key assumptions about the movement of goods, people, and capital and (2) explore different combinations of countries participating in the FTA—even allowing the inclusion of Israel and the West Bank and Gaza, the latter two of which are referred to as Palestine. The benefits increase for larger blocs of countries and with reduced restrictions on the movement of goods, people, and capital among these countries. The authors recognize that regional integration might start with only a subset of countries and with only partial economic integration: The tool also allows examination of the benefits of these alternative arrangements.

The online calculator is available at www.rand.org/levant-calculator.