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The Middle East and the EEC: An Analysis of Trade Flows

by Rodney Wilson, Durham*

The Middle East has become the largest external supplier of imports to the European Community, and is also the EC's largest export market. Rising oil prices have not only affected the value of EC imports from the Middle East, but have also ultimately determined the ability of the Middle Eastern states to pay for Community exports. What are the prospects for the continuing growth of trade between the Community and the Middle East? What would be the effect of a fall in oil prices or of a decline in the EC's dependence on Middle Eastern oil?

The economic links between the Middle East and the European Community have steadily increased since the Community's inception in 1958, both in terms of trade and financial flows. In this present analysis, attention is focused on visible trade, but other flows have become equally crucial for the European Community, and to a large extent these offset the visible trade deficit. Such items include invisible earnings for the provision of financial services, shipping receipts, tourist spending and remittances by migrant labour, the latter including outflows representing the repatriated earnings of Turkish workers in the Community, and inflows from European professional workers, such as engineers working in the oil-rich states of the Middle East. Of even greater significance than invisibles on the current account are capital account movements, as the magnitude of recycled petro-funds has risen considerably in recent years, representing not only short-term bank deposit holdings, but also investments in equities, bonds and property by Middle Eastern governments and financial institutions.

The Middle East has become the largest external supplier of imports to the European Community, accounting for over 12 per cent of the total by 1980¹. As much of the Community's trade is between member states, however, it is the extra-area imports² which are a more relevant consideration in relation to external trade partners. By the late 1970s imports of Middle Eastern origin amounted to around one fifth of all Community imports from external sources, compared to a figure of 16 per cent for imports from the United States, and 4.6

per cent for imports from Japan, the third largest single supplier. The Middle East is also the European Community's largest export market, accounting for around 13 to 15 per cent of total extra-area exports in the late 1970s, or around 6 per cent of total exports when intra-area exports are taken into account. The extra-area export figure must be compared with a figure of 12 per cent for the United States, and a mere 2 per cent for Japan.

The question arises as to whether the rise which there has been in trade between the Middle East and the European Community is sustainable, or if it merely reflects the oil price rises of 1973-74 and 1979, which would suggest a long-run contraction if oil ceases to be as important as at present. The latter outcome would have important implications, not merely for European Community imports, but also for exports, and perhaps ultimately for the structure of export industries and employment. A further question concerns the balance of trade between the European Community and the Middle East, and whether the present deficit will continue, and indeed if there are signs that the European Community states have been successful in reducing the deficit.

Import Trends

In order to answer these questions it is necessary to examine both the import and export trends of the Middle East with the European Community. Table 1 shows the growth of Community imports from the Middle East in

¹ All trade figures refer to the Community of 9, including pre-1973 figures.

² Imports from non-Community sources, the "area" referred to being the European Community.

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value terms, with an impressive rise in the total shown over the whole 1958-1980 period, and an increase in every recent year except 1978. Allowing for inflation, the rise is less impressive of course, but the proportion of European Community extra-area imports from the Middle East has doubled over the whole period, reflecting the growing dependence of the Community on Middle Eastern oil. Saudi Arabia alone supplied over forty per cent of all these imports from the Middle East, the other countries being ranked in Table 1 according to their relative importance in 1980. The main increase in the share of extra-area imports originating in the Middle East appears to have been, as might be expected, during the 1969-77 period, the initial rise in the early part of the period resulting from income growth in the European Community, and a consequent increase in demand for petroleum. The marked change between 1973 and 1977, however, can be directly attributed to the quadrupling of oil prices, as the volume of imports actually declined over the period. Since 1977 the share of Middle East imports as a proportion of extra-area imports has stagnated, partly as a result of the lack of domestic economic growth in the European Community, but also because of a fall in oil prices in real terms until 1979. The second round of major oil price rises in 1979 in fact failed to raise significantly the share of Middle Eastern imports in European Community extra-area imports, to some extent as a result of the increasing use of non-oil substitutes, but more

importantly because of the Iranian revolution, and the substitution of non-Middle Eastern supplies for Iranian oil.

The dominance of oil in the import trade of the European Community with the Middle East is illustrated in Table 2, with petroleum and petroleum related products accounting for 91.4 per cent of total imports from the Middle East in 1980. For the Arab OPEC producers of the Middle East, Saudi Arabia, Iraq, Libya, Kuwait and Qatar, the proportion exceeds 97 per cent, and in the case of the United Arab Emirates, the proportion is only lower because of the re-export of non-oil goods of Iranian origin through the trading port of Dubai. The greater proportionate share of non-oil goods in Iranian exports partly reflects the poor state of the country's petroleum industry following the revolution, but it is also caused by the resilience of the traditional craft sector in general, and exports of high quality woven carpets in particular. What is perhaps more surprising is the high share of petroleum exports for the non-OPEC minor oil producers of the Middle East, Egypt and Syria. Much of Syria's trade is in fact re-exports through the pipelines originating in Iraq and Saudi Arabia, but Egypt's trade represents indigenously produced oil, mainly from the fields in and around the Gulf of Suez. Even Israel, which has not been an oil producer since the handback of Western Sinai to Egypt, exports some refined petroleum products to the European

Table 1
Main Middle Eastern Sources of EEC Imports

	1958	1963	1969	1973	1977	1978	1979	1980
Saudi Arabia	343	325	980	3,708	12,806	9,940	14,265	24,520
Iraq	525	672	711	951	4,077	4,534	5,968	7,909
Libya	11	342	1,973	1,986	3,863	3,275	4,876	6,373
United Arab Emirates	—	—	—	732	3,067	2,567	3,117	4,375
Kuwait	918	1,005	1,154	1,662	2,690	2,991	4,526	4,036
Iran	399	505	738	2,289	7,473	6,760	4,346	2,771
Egypt	77	137	157	193	703	945	1,183	1,746
Israel	69	167	291	460	1,000	1,186	1,350	1,599
Qatar	87	70	171	388	830	752	870	1,475
Turkey	117	244	294	578	820	836	942	996
Syria	71	155	69	106	604	509	611	930
Oman	—	—	—	108	145	193	159	352
Sudan	72	112	109	134	215	210	168	166
Total	2,689	3,734	6,647	13,295	38,293	34,698	42,381	57,248
Middle Eastern imports as proportion of extra-area imports (%)	11.4	11.2	12.7	15.8	22.3	19.4	19.4	21.1

Note : Values in million European Currency Units (ECUs) at current prices. 1 DM = 0.24 ECUs, 1958; 0.30 ECUs, 1973; 0.38 ECUs, 1977; and 0.40 ECUs, 1980. Trade with Jordan and Bahrain excluded as worth under 100 million ECUs.

Source : Eurostat Monthly External Trade Bulletin, Special Number 1958-1980, Office of Official European Community Publications, Luxembourg, July 1981, Table 1, pp. 30-32.

Table 2
EEC Petroleum Imports from the Middle East, 1980

	Petroleum	Petroleum related products	Petroleum and related products as proportion of total imports (%)	Proportion of extra-EEC crude oil supplies (%)
Saudi Arabia	23,629	346	97.8	34.9
Iraq	7,874	—	99.6	11.6
Libya	5,799	378	96.9	8.6
UAE	3,945	50	91.3	5.8
Kuwait	3,449	451	97.9	5.1
Iran	1,926	362	82.6	2.9
Qatar	1,451	—	98.4	2.1
Egypt	1,241	160	80.2	1.8
Syria	692	187	94.5	1.0
Oman	311	—	88.3	0.4
Israel	—	81	5.1	—

Note: Columns 1 and 2: values in millions of ECUs.

Source: Eurostat Supplement to Monthly External Bulletin, European Community Trade in Petroleum and Petroleum Products, Office of Official European Community Publications, Luxembourg, November 1981, p. 39.

Community, mainly to Italy. Only Turkey and the Sudan, of the countries cited in Table 1, export no oil to the Community, the former exporting some agricultural produce and a limited range of textiles, while the latter exports mainly cotton, although it is a less important producer than Egypt.

Export Growth

The increase in European Community exports to the Middle East mirrored the oil import changes up to the mid-1970s, with export proceeds covering around half the import bill as the figures in the bottom row of Table 3 show. After 1973 as a result of the oil price increases and the increased import payments, the proportion of payments which exports covered might have been expected to fall. In practice however, the proportion of export receipts to import payments actually rose, from 47.4 per cent in 1973 to 74.8 per cent by 1978, which was a remarkable export success for the European Community. Exports to the major oil suppliers at that time rose at a particularly impressive rate, from a mere ECUs 420 million in the case of Saudi Arabia in 1973 to over ECUs 5,659 million by 1978, while for Iran, then the largest Middle Eastern export market, the increase was from ECUs 1,381 million to 5,912 million during the same period. Meanwhile the Middle East's share of the European Community's extra-area exports almost doubled over the same years, as Table 3 also shows.

Exports to the non-oil states such as Turkey, Israel and the Sudan were of course less buoyant, in fact in real terms exports stagnated, and after 1977 the trend

was downward even in current prices. These countries all experienced balance of payments problems themselves due to the oil price rises of 1973-74, and the consequent negative income effects through their terms of trade adversely affected their ability to purchase European Community exports. These factors, together with the rapid rise in exports to the Middle Eastern oil producers, resulted in significant changes in the relative importance of the non-oil producers. Israel was the second most important Middle Eastern destination for European Community exports in 1973 for example, but by 1977 it had fallen to eighth rank, a place that Turkey was to occupy the following year, compared to being third largest customer in 1973. Such changes have inevitably affected the European Community's economic perceptions regarding the Middle East.

The Iranian revolution had an immediate adverse effect on European Community exports to the Middle East, by bringing economic chaos into what had been hitherto the Community's main export market in the region. Exports to the other oil producers remained buoyant however, especially those to Saudi Arabia, Libya and Iraq, which became the major customers for the Community. This was, nevertheless, still insufficient to compensate for the loss of the Iranian market and overall there was a slight reduction in European Community exports to the Middle East in 1979, even in current prices, although in real terms the shortfall was much more serious. The dramatic fall in European Community exports as a proportion of imports from the Middle East in 1979, however, was also partly caused by the effect of the second round of oil price rises on import payments, but the loss of much of the Iranian market probably accounted for more than two thirds of the decrease.

The export problems associated with the demise of the Iranian market illustrate the problems for the European Community of overdependence on a single Middle Eastern export market. Iran alone in 1978 accounted for almost 23 per cent of all European Community sales to the Middle East, while Saudi Arabia accounted for almost 22 per cent of export sales. By 1980 the Saudi Arabian share had risen to over 23 per cent, while the share of Iran had fallen to 10 per cent. Given Saudi Arabia's ambitious development plans and apparent stability, prospects for Community exports continue to be encouraging, but more uncertainty must remain over export prospects in Libya, which accounted for 13 per cent of Community exports in 1980, and Iraq, the destination for over 12 per cent of Community exports, and the war between Iraq and Iran remains a worrisome factor. European Community exports to the

Middle East, however, do not have the problem of overdependence on a single community, unlike Middle Eastern exports to the Community. Most European Community exports comprise manufactured goods, machinery, capital equipment and supplies for the construction industry, and the prices of these items are much less volatile than those of primary commodities such as oil, even despite the supposed power of OPEC. Despite the sharp deterioration in the European Community's terms of trade with the Middle East in 1973-74 and again in 1979, the long-run underlying trend has been for manufactured goods to appreciate in price vis-à-vis primary commodities, including oil.

Predicting the future price trends in oil vis-à-vis the price of manufactured goods is far from being an easy task, so many factors are involved in determining the price of oil on both the supply and demand sides. Nevertheless oil prices not only affect the value of European Community imports from the Middle East, but also affect European Community exports by ultimately determining the ability of the Middle Eastern states to pay for Community exports. If oil prices fall however, the effect on European Community exports is likely to be less marked than the impact on import savings, and the time lags may be greater before any effects work their way through to Community exports, whereas the effect on the Community's imports bill is more immediate.

Firstly, the ambitious development plans for industrialisation and social infrastructure represent long-term commitments on the part of the oil-exporting countries, which cannot easily be scaled down in response to short-run petroleum price falls, and the temptation is inevitably to borrow to cover import payments, rather than to abandon parts of projects which are in the process of being completed. Secondly, Saudi Arabia and the less populous Gulf states have substantial official reserves to carry them over any short-term adverse balance of trade movements, and large amounts of funds have been placed overseas, not only in short-term deposits in Western financial markets, but also in longer-term bonds, equities, and property as already indicated. The income from these investments is becoming an important invisible current account item in the balance of payments of many Middle Eastern states. Kuwait, for example, in the second half of 1981, earned more from investments overseas than from oil revenues, although admittedly this was partly due to historically high interest rates in international financial markets, together with falling oil sales and prices.

A further factor which results in some degree of stability in European Community export sales to the Middle East is that many deals are worked out on a

medium- or long-term contract basis. Final goods for retail sale can of course be easily curtailed in the short run, but purchases of intermediate and capital goods are usually made on a longer-term basis, and although orders can be cancelled, most Middle Eastern customers, especially those in the state sector, do not want to get a bad reputation for their treatment of suppliers. If they did, those submitting tenders in the future would build in a higher premium for risks, merely adding to Middle Eastern import costs. In any case, major contracts are frequently financed through long-term borrowing from the Euro-markets, either by syndicated bank credits or bond issues. This ensures the stability of project finance, and most Middle Eastern governments encourage their state sector agencies to make use of such markets, as they welcome an independent evaluation of the financial viability of the projects being undertaken. This is a major reason why the Middle Eastern oil-exporting countries use the Euro-markets as intermediaries, both depositing and borrowing funds rather than financing projects directly themselves from government revenues.

The Trade Balance

The European Community has run a visible trade deficit with the Middle East since its inception in 1958, the magnitude of which has increased from ECUs 1.276 billion in 1958 to over ECUs 26 billion in 1980 in current prices as Table 4 shows. The most marked increases came in 1973-74 and 1979, reflecting the oil price increases of those years, and the loss of a major part of the Iranian market after the revolution in the case of 1979, as already discussed. The largest visible trade deficits are, not surprisingly, with the major oil suppliers, Saudi Arabia alone accounting for almost two thirds of the total deficit in European Community trade with the Middle East in 1980. The Community, however, runs a substantial surplus with the more highly populated states of the Middle East which have more diversified economies and absorb more imports. The Community has enjoyed a visible trade surplus with Egypt and Turkey since its inception, and more recently trade with Iran has also moved into surplus, as the Teheran government has been unable to cut its import bill in line with its falling oil revenues. The European Community's trade with Israel, Syria and the Sudan has also consistently been in surplus, except for a few years in the early 1960s in the case of Syria. The reduction in the trade surplus with Israel in 1980 partly reflected the continuing favourable export performance of that country, but also a cut-back in imports from the European Community due to the domestic budgetary constraint by the Jerusalem government.

FOREIGN TRADE

In the context of the Euro-Arab dialogue it has sometimes been argued that the European Community's trade deficit with the oil-exporting countries has to some extent been offset by Community exports to the more populous Middle Eastern states, which the oil producers have aided through intra-Arab or intra-regional recycling of petroleum revenues. The figures in Table 4 illustrate that the surpluses with states such as Egypt and Syria are small, however, in relation to the size of the deficits with the oil exporters. Furthermore all new official assistance from the oil exporters to Egypt, the main non-OPEC absorber of EEC exports in the region, ceased after the Camp David accords and the peace treaty with Israel. Arab private investment transfers have admittedly continued into Egypt, as have remittances from Egyptians employed in the Gulf and Saudi Arabia, but these are not of major economic significance from the point of view of European Community exports, despite their importance for Egypt itself. In addition, financial flows between the Arab oil states and Turkey have been minimal in spite of the rhetoric concerning Turkish-Arab collaboration; indeed the transfer of funds from the Community's own European Investment Bank into Turkey has exceeded inflows from the Arab world. It can also be argued that Turkey would have been able to import more from the European Community if its own deficit with the Arab oil producers had not increased so substantially.

Admittedly however, it was only after 1977 that Turkish imports from the European Community started to decrease seriously, and whether this was caused by oil payments problems or by rising debt and the resultant service charges, must remain a question for debate.

A useful measure of the European Community's deficit problem with the Middle East is given by taking the deficit as a proportion of exports. This measure, which is cited in Table 4, also gives some indication of visible export performance, although of course it can exaggerate the deficit problem as it ignores capital account movements³. Between 1958 and 1973 the deficit of the European Community with the Middle East fluctuated between about 90 per cent in good payments years and 110 per cent in poor years of the total value of Community exports to the region. After the 1973-74 oil price rise, when it might have been expected to increase sharply, the indicator in fact fell to below one third of its 1973 value by 1978 as Table 4 shows. This demonstrates that while the European Community's deficit problem with the Middle East may have worsened in absolute terms in both current prices and real amounts, in relative terms the problem was diminishing,

³ Movements in this measure are inversely related to the export to imports proportion cited in Table 3, as when exports are increasing as a proportion of imports, the trade deficit as a proportion of exports falls, and conversely when exports are falling as a proportion of imports, this measure rises.

Table 3
Main Middle Eastern Destinations of EEC Exports

	1958	1963	1969	1973	1977	1978	1979	1980
Saudi Arabia	80	87	306	420	4,557	5,659	6,392	7,283
Libya	62	151	406	901	2,583	2,623	3,388	4,146
Iraq	165	109	156	222	1,765	1,915	2,667	3,816
Iran	316	257	692	1,381	5,387	5,912	2,267	3,211
Egypt	193	298	280	398	1,682	1,821	2,324	3,105
United Arab Emirates	—	—	—	187	1,544	1,600	1,790	2,079
Turkey	182	272	434	949	2,157	1,563	1,588	1,821
Israel	153	230	631	1,134	1,484	1,634	1,777	1,676
Kuwait	96	129	230	236	1,236	1,300	1,353	1,474
Syria	86	65	113	214	858	800	1,053	1,245
Sudan	65	134	91	122	481	481	401	473
Oman	—	—	—	72	384	304	382	394
Qatar	15	15	25	67	382	355	417	392
Total	1,413	1,747	3,364	6,303	24,500	25,967	25,799	31,115
Middle Eastern exports as proportion of extra-EEC exports (%)	6.4	6.1	6.9	7.8	14.9	14.9	13.3	13.9
EEC Middle East exports as proportion of imports from the Middle East (%)	52.5	46.8	50.6	47.4	64.0	74.8	60.9	54.3

Note: Amounts in ECU millions.

Source: As Table 1.

FOREIGN TRADE

although that is not to underestimate the magnitude of recycling needed on the capital account. After 1978 the deficit started to increase again as a proportion of export proceeds, reflecting both the loss of major Iranian export sales as shown in Table 3, and the second oil price rise, which has also been discussed above.

The European Community's deficit with the Middle East is expressed as a proportion of the Community's total deficit with non-Community states in the bottom line of Table 4. This proportion can exceed 100 per cent if the deficit with the Middle Eastern region is relatively worse than the deficit with all other geographical areas outside the Community. The proportion declined in the early years of the Community up to the mid-1960s, partly as a result of falling oil prices, but in the late 1960s it rose, due to the Community's improving trade situation with other areas, notably the United States, rather than because of the dynamics of its Middle Eastern trade. The 1973-74 oil price increases not surprisingly resulted in the deficit with the Middle East almost doubling in relation to the size of the overall deficit, and the percentage stayed high until 1978. Again, this reflected the marked improvement in the Community's trade position with other regions rather than developments in Middle Eastern trade, as although the deficit with the Middle East declined, the turnaround in Community trade with other areas was even more rapid.

By 1979 European Community trade appeared to have entered a new phase, however, as despite the increasing deficit which the oil price rises of 1979 brought in trade with the Middle East, the Community's deficit with other extra-area sources of imports was increasing even more rapidly. The deficit with the United States alone doubled from ECUs 8.8 billion in 1979 to over ECUs 17.7 billion in 1980, while the deficit with Japan rose from around ECUs 5 billion in 1978 and 1979 to about ECUs 8 billion in 1980. As a result the Middle Eastern deficit actually declined as a proportion of the overall Community deficit. The evidence suggests therefore that the second round of oil price increases of 1979 was only a minor contributory factor to the European Community's external trade deficit problems of the late 1970s and early 1980s, and that a more significant factor was a shift in its pattern of trade in industrial goods with its main non-European developed trading partners. To a considerable extent the United States and Japan were trying to solve their own oil payments problems by running a trade surplus with the European Community, just as the Community itself to a minor degree was trying to make up for its trade deficit with OPEC by running a trade surplus with those populous Middle Eastern states with a higher propensity to absorb imports.

The European Community has in recent years felt compelled to try to evolve a common position amongst

Table 4
Trade Balance of EEC with Middle Eastern States

	1958	1963	1969	1973	1977	1978	1979	1980
Egypt	116	161	123	205	879	876	1,141	1,359
Turkey	65	28	140	371	1,337	727	646	825
Iran	-83	-248	-46	-908	-2,086	-848	-2,079	440
Syria	15	-90	44	108	254	291	442	315
Sudan	-7	22	-18	-12	266	271	233	307
Israel	84	63	340	674	484	448	427	77
Oman	-	-	-	-36	238	111	223	42
Qatar	-72	-55	-146	-321	-448	-397	-453	-1,083
United Arab Emirates	-	-	-	-545	-1,523	-967	-1,327	-2,296
Libya	51	-191	-1,567	-1,085	-1,280	-652	-1,488	-2,227
Kuwait	-822	-876	-924	-1,426	-1,454	-1,691	-3,173	-2,562
Iraq	-360	-563	-555	-729	-2,311	-2,619	-3,301	-4,093
Saudi Arabia	-263	-238	-674	-3,288	-8,249	-4,281	-7,873	-17,237
Overall deficit	-1,276	-1,987	-3,283	-6,992	-13,793	-8,731	-16,582	-26,133
Deficit as proportion of EEC exports to the Middle East (%)	90.3	113.7	97.6	110.9	56.3	33.6	64.3	84.0
Deficit as proportion of extra-area deficit (%)	82.2	40.0	103.0	192.4	185.0	194.3	69.6	55.5

Note: Positive amounts indicate EEC trade surpluses, negative amounts deficits. Amounts in ECU million.

Source: As Table 1.

its members towards the Middle East, partly as a result of geo-political considerations of the sort that resulted in the Venice Declaration, but also because of its dependence on Middle Eastern oil supplies, financial flows and, increasingly, export markets. Originally the main pre-occupation was Turkey, with which an association agreement was signed as early as 1963. A new agreement was drawn up in 1970 providing for Turkey's eventual accession to the Community by 1992, one motivation behind this agreement being the Community's desire to balance Turkey's aspirations with those of Greece, which has now entered the Community. Just as there was an emphasis on being even-handed in Turkish and Greek matters, the Community has also tried to balance its dealings with the Arab states and Israel, seeking to avoid political offence. Thus when a cooperation agreement was signed with Israel in 1975, moves were also made towards the Arab states, and similar separate agreements were signed with Egypt, Syria, Jordan and Lebanon in 1977.

Under the cooperation agreements bilateral co-operative councils have been established to review Community trade with each of the Middle East states covered, and the agreements have been liberal in providing for reductions in the Community's external tariff on certain goods. Tariffs have not been a major issue in Community imports from the Middle East however, as petroleum was exempt, but the co-operative agreements have been restrictive in imposing ceilings on imports of refined products and petrochemicals, designed basically to protect the Community's own downstream petroleum activities. An even more restrictive policy has been adopted with respect to manufactured or processed products from the Middle East, most of which have been put on the Community's "B" import list, which implies not only low quotas, but also rigorous inspection supposedly for the

sake of quality control. This categorisation has affected not only some of the new industrial goods which Middle Eastern countries seek to export, such as aluminium products in the case of Egypt, and phosphate fertilizers in the case of Jordan and Syria, but also traditional products such as cotton yarns and other woven cloths, and even leather goods in the case of Lebanon. Agricultural products are subject to the Community's variable levy system, including rice and bran from Egypt, and tariffs remain on imports of citrus produce from Israel, the tariff level being determined by the extent of the Community's own production in particular citrus products and its members' need for protection.

Cooperation Issues

Middle Eastern states argue that these policies are unfair in two main respects. Firstly, they hinder the diversification of Middle Eastern exports to the Community, and they are designed to prevent a greater proportion of value added being contributed by the petroleum exporters themselves. Secondly, the greatest restrictions are applied on exports from countries with which the European Community already runs a trade surplus such as Egypt and Turkey. In the long run it seems that if present policies continue, the prospects for continuing growth of trade between the Community and the Middle East do not appear promising, especially if petroleum declines in importance. The major constraint on greater Community exports to the large potential import absorbers in the Middle East such as Egypt and Turkey is these countries' supplies of foreign exchange. Unless the cooperation agreements really result in trade liberalisation, the present dominance of oil will continue, and although the Community's energy saving policies may ultimately help in import savings, the export base which has now been built up in the Middle East may also be threatened.

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