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**Building Euro-Med Free Trade Agreement -
How to Improve the Bilateral Management Strategies?**

Working Paper 0804

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1. State of Art: Trade Liberalization between the European Union and Mediterranean Partner Countries in 2008

The goal of trade liberalization between Mediterranean Partner Countries (MPCs) and the EU has been introduced by two bilateral instruments negotiated by the EU and every individual MPC. The bilateral Euro-Mediterranean Association Agreements (EMAA) signed in the EU – an MPC state level settles the measures supporting tariff dismantling, lifting of restrictions on exchange of goods, implementation of free trade area, introduction of internal market mechanisms, private sector development, commitments considering trade in services, direct investments, right of establishment, standards, certification and other.

The newly established European Neighbourhood Policy (2003) offers the Mediterranean Partners closer economic cooperation and integration with the EU, as it gives an open door for the Mediterranean partners to integrate into the single market (without integrating institutions as the rule “everything but institutions” is applied here), and participate in four freedoms¹. The bilateral instrument of the ENP is the Action Plan – an agreement between the EU and a particular MPC consisting of a number of recommendations which should be implemented by a EU’s neighbouring country in order to approximate their national legislation to the European Union’s *acquis communautaire*. In terms of free trade, the ENP offers MPCs “a stake in Internal Market”. However, four freedoms are reduced merely to goods, while services and capital have just come to the agenda (being primarily liberalized by WTO) and labor is at this point excluded.

According to the European Union self-assessment, progress in creating Euro-Med Free Trade Agreement (EMFTA) is not satisfactory, but there are some positive steps undertaken by the EU and the MPCs. First of all, the Association Agreements (AA) which the EU has concluded with all of its Mediterranean partners have entered into force (except for the AA with Syria). In each AA the gradual liberalization of trade in all industrial goods was foreseen which was done asymmetrically. The AAs also included provisions concerning duty-free access for 80% of agricultural exports and stated that agricultural trade liberalization would be realized on a partial and reciprocal basis.² Additionally, Southern Mediterranean countries are involved in

¹ Four freedoms are: free movement of goods, services, capital and, eventually, persons

² A. Asbil, *The Euro-Mediterranean Roadmap for Agriculture, DG Agriculture and Rural Development*, European Commission, 8-9 February 2006, Cairo
<http://www.cndwebzine.hcp.ma/cnd_sii/IMG/pdf/Sustainable_rural_dev.pdf>

the process of economic integration with each other. However, despite progress observed, North Africa is considered the world's least integrated regional market. The Agadir Agreement³ has shown so far mitigated results and only slightly influenced increase in trade flows among the signatory partners. Except for Agadir Agreement Tunisia, Morocco, Israel and Egypt are also signatories of bilateral free trade agreements with Turkey. The issue of regional service trade improvement has received an impetus when negotiations on regional services were launched in Marrakesh in 2007, followed by beginning of bilateral negotiations in 2008. At the moment the level of the EU investments in the Mediterranean region is below its potential, and improvements of terms of trade in services can help increase attractiveness of the region for investors. Regarding the trade between the EU and MPCs – the EU decided to create a pan-Euromed system of accumulation⁴. This was agreed in order to ensure preferential access of products produced in more than one country to the markets of the EU or the MPCs.

Integration into the global economy constitutes an important issue for MENA region which has made efforts to conclude this process effectively. Barcelona Process signatories continue to dismantle tariff rates on the EU industrial and agro-industrial goods. Tariff reduction and its further elimination leads to creation of the Free Trade Agreement (FTA) with the EU by 2010, as it was stated and decided in the Barcelona Declaration. Creation of a FTA requires substantial reforms, and currently most of the MPCs are trying to complete them.⁵ Tariff barriers elimination is, however, not enough to achieve full trade liberalization; this is due to the existence of non-tariff barriers as well as alike-tariff barriers. Those embrace licenses, technical, sanitary, phyto-sanitary, veterinary or component requirements, country of origin certificates, limits, etc. Protection can be achieved by mismatching law or institutions. Additionally, the exchange rate policy can serve this purpose. Other barriers are created by difference in the levels of development, standards of living, culture, level of education etc. In such conditions neither the level of tariffs can be considered as measure of scope of openness of the economy, nor the share of trade in the GDP can serve this purpose effectively. Best measure here, according to the UN specialists, could be ascribed to the share of turnover in the industrial production, which diminishes in post industrial economies and increases in catching up ones. In long term one can foresee that such indicators will equalize.

³ Agadir Agreement – Agreement establishing Agreement Free Trade between Morocco, Tunisia, Jordan and Egypt; signed in 2004 in Rabat; entered into force on 1 January 2006.

⁴ Pan-Euromed system of cumulation means that a fabric produced in Turkey(for example), sewed into a cloth in Tunisia, finished in Morocco can be exported to the EU market with preferential access to this market.

⁵ Dismantlement process has just started in Algeria and in Lebanon it is supposed to start it in 2008.

To sum up, the Southern Mediterranean region needs to look at the trade barriers, not limiting them to tariffs, but including non-tariff barriers such as laws and institutions, licenses, exchange rate regime and policy, level of development, education and culture.

1.2 Non-tariff barriers elimination

Non-tariff barriers are more complicated to be eliminated in comparison with the tariff barriers. They are less visible which is not univocal with the fact that they can effectively protect or rather close the market for imports, as a result increasing prices of goods sold on the market in question. Elimination of non-tariff barriers requires special rounds of negotiations, which can lead towards harmonization of laws, institutions, requirements etc. Knowledge about non-tariffs barriers and their role in blocking trade, increasing domestic prices and freezing structural status quo of a market is relatively limited. This means that reduction of such tariffs has its own requirements. It can either be conducted globally, which means harmonization of laws of all of the WTO members: step by step, field by field, or deeper liberalization in bilateral approach (between the EU and each MPC). Such negotiations are complicated and should bring a specific award for the parties involved. If MPCs cannot at this stage count on the membership in the EU (which does not exclude that such option will be possible in the future), they can negotiate membership in the European Economic Area (“EEA”) with four liberties in trade, capital, people and services (with some derogations). Proposed solution can stimulate their desire to cut and further eliminate the non-tariff barriers. Proposed solutions mean that creation of the EU-MEDA FTA will be a step towards the EEA membership. Such offer imposes some changes in the approach towards EU-MEDA relations on this stage, which can bring meaningful profits to all partners.

The World Bank estimates that trade non-tariff barriers are more substantial in the MENA region than in any other region of the world⁶, “... non-tariff barriers (NTBs) contribute more to the overall trade restrictiveness than pure custom tariffs. NTBs are particularly pervasive and restrictive in labor-abundant MENA countries, while being far less so in the recourse-rich, labor-importing countries from the region. Business surveys suggest that the cost of complying with NTBs is high, more than 10 % of the value of goods shipped.”⁷ The scale of

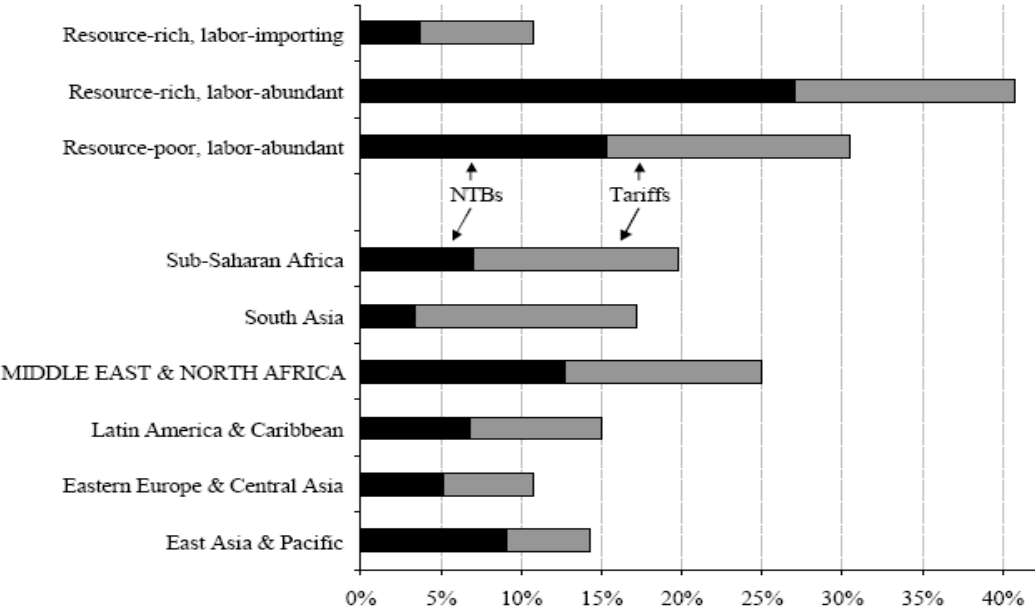
⁶ See *Middle East and North Africa Region. Economic Developments and Prospects*, The World Bank, 2008, p. 58.

⁷ Ibidem.

the problem, in comparison with other world's middle income regions is presented below (Figure 1).

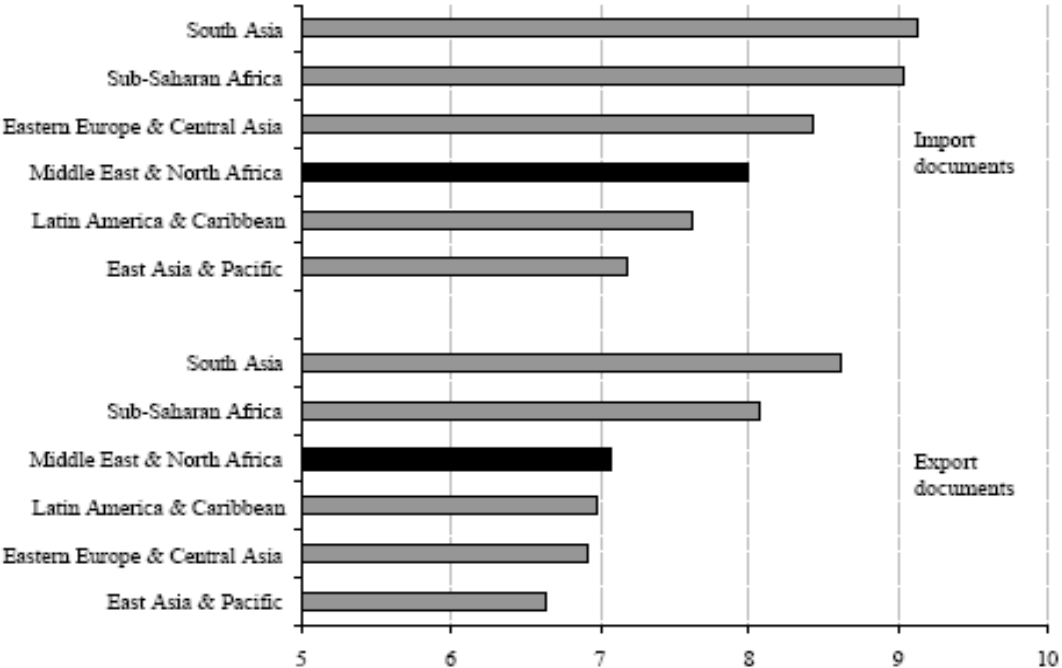
Apart from that, in the MENA countries the intra-regional rules of origin in the MENA region are markedly different from those pertaining in the Euro-Mediterranean partnership; this might make companies, which serve both on the MENA and European markets, run parallel procurement and production to satisfy respective requirements. The World Bank research shows that trade procedures are relatively more difficult and time consuming to undertake in the MENA countries than in other countries with a similar level of income (figure 2 & 3). Despite the fact that MENA governments require on average lighter importing and exporting documentation than their counterparts in low-income Sub-Saharan Africa or South Asia, the number of documents exceeds the averages for middle-income Latin America and East Asia.

Figure 1. Non-tariff barriers are highly restrictive in MENA countries (uniform tariff equivalent, %)



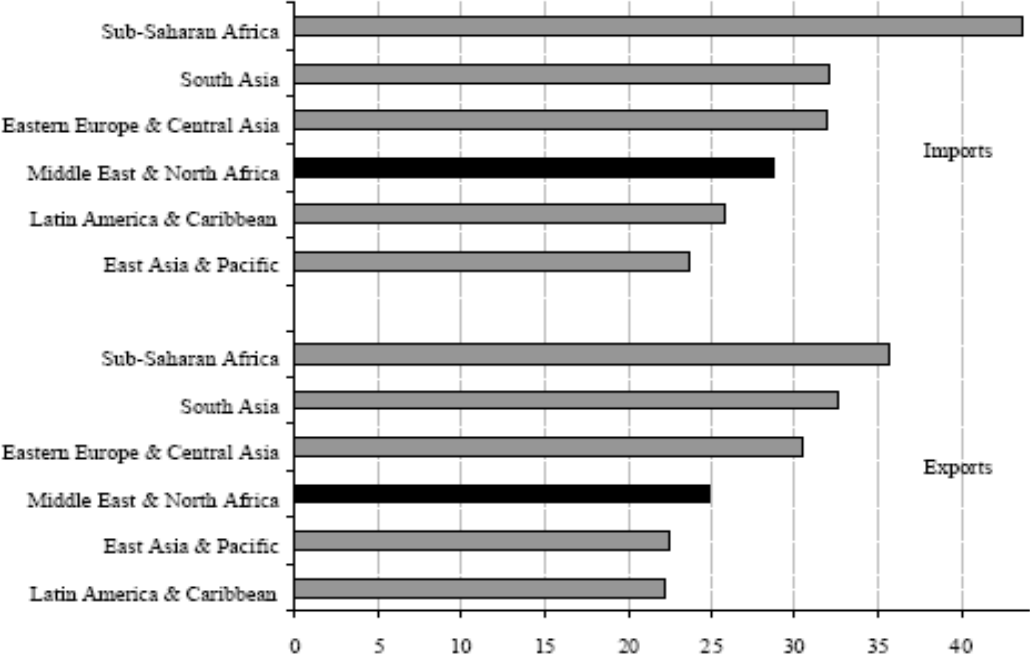
Source: World Bank staff estimates (*Middle East and North Africa Region. Economic Developments and Prospects*, The World Bank, 2008, p. 59).

Figure 2. Trade procedures in MENA are cumbersome (Number of documents required)



Source: World Bank staff estimates (*Middle East and North Africa Region. Economic Developments and Prospects*, The World Bank, 2008, p. 60).

Figure 3. Trade procedures in MENA are time consuming (Number of days required)



Source: World Bank staff estimates (*Middle East and North Africa Region. Economic Developments and Prospects*, The World Bank, 2008, p. 60).

While considering trade barriers, it is also worth analyzing the level of the Logistics Performers Index (“LPI”)⁸, as inconvenient logistics is one of the factors influencing the transaction costs in a negative way. Unfortunately, most of the MENA countries score below the level of logistics performance that would be expected from their level of income, that is, only Jordan and Tunisia meet or exceed the average for countries in their income group. The most serious logistic challenges are observed for the resource-rich labor-abundant group of countries, with pronounced gaps in logistics competence followed by cargo tracking and tracing.⁹ “Logistics chain analysis suggests that transport and non-transport logistics costs of export commodities from the MENA region range from 7% to 25% of landed product prices. Significant gains could be reaped from overhauling the regulatory regime for the trucking sector, increasing competition in port and air freight services, reorienting customs authorities towards trade facilitation, and developing cross-border transit procedures similar to the Transport International Routière (“TIR”) carnets model.”¹⁰

1.2 Exchange rate uncertainty

Exchange rate can serve as a tool which can either open wider or increase protection of the economy, all depending on the introduced regime of exchange rate and exchange rate policy. Generally, appreciation of the exchange rate widens the scope of openness, while depreciation acts in the opposite way. The same can be said about the currency pegs used in the exchange rate policy. In their case the level of exchange rate of the currency used as a peg acts in the same manner as depreciation or appreciation of the national currency. Such occurrence can be labeled as invisible changes of currency value, as pegged currency follows the value of the peg. If the peg is composed of a basket, it is enough that one of the currencies loses value, while the remaining ones stay at the unchanged value level. Such a situation results in the increase of protection of the market with peg used¹¹.

Exchange rate values have impact not only on the competitiveness of exported and imported goods, as well as on the scope of openness of the economy, but they are also taken into

⁸ LPI was developed by the World Bank in 2007. It is based on a world-wide survey of global freight forwarders and express carriers. LPI makes it possible to compare the situation of countries across a broad set of transport and trade facilitation dimensions. Richer countries are in a position to devote more resources to investments in transport infrastructure, inter-agency coordination, and staff training. For this reason, they in general show lower trade transactions costs than poorer economies. (*Middle East and North Africa...*, op.cit., p. 60-61).

⁹ *Middle East and North Africa...*, op.cit., p. 61.

¹⁰ Ibidem.

¹¹ J. Ziemiński, K. Żukrowska, *Konkurencja a transformacja w Polsce. Wybrane aspekty polityki gospodarczej*, (*Competition and transformation in Poland. Selected aspects of economic policy*), SGH. Warszawa 2004, s. 69-90.

account by the investors, and finally they have impact on the size of the transfers from abroad from sources such as the EU budget, IMF, World Bank or Investment Bank. All mentioned occurrences decide that with increase of international trade and capital transfers, followed by transfers of remaining production factors (people, salaries, pensions, insurances), there are conditions for increased support for a single world currency¹².

The uncertainty related to exchange rate volatility might be conceived as additional non-tariff barrier to trade in goods and services. The exchange rate regimes operating *de facto* in most of the MENA countries are the conventional fixed peg arrangements. It means that the countries peg their currencies within margins of $\pm 1\%$ or less vis-à-vis another currency or a basket of currencies, where the basket should be formed of the currencies of major trading or financial partners and weights should reflect the geographical distribution of trade, services or capital flows. From the point of view of the exchange rate risk, such a currency peg is very advantageous, as it limits the potential exchange rate fluctuations against the pegged currency.¹³ However, most of the MENA countries have pegged their currencies more or less continuously to the US dollar, although more of their trade is typically with the EU countries rather than with the US. The emergence of the Euro and the EMU means that there is now, for the first time, a substantial and viable alternative anchor currency for these countries.¹⁴ For this reason, the authorities of these countries should consider the desirability of a peg to the Euro. An alternative exchange rate regime, such as regional currency unions, can also be taken into consideration, nevertheless not as a serious proposal. Decision about choosing a solution in this area requires specific knowledge including the fact that integration among economies representing differentiated level of development is more advantageous to both groups of partners: those representing higher and those representing lower level of development in comparison with integration of equally developed economies, if they are in catching up stage development¹⁵.

¹² K. Żukrowska, *Currency union and the challenge of global economy*, w: *Meeting Global Challenges*, Working Papers Institute of International Business University of Gdansk, 2008, s. 202-219; K. Żukrowska, *Transformation of World Economics Management: From Political Bipolarity to Financial Dualism*, EADI Conference, June 2008, Geneva.

¹³ However, it is necessary to point out that when economies mature, the advantages of exchange rate flexibility appear to increase. Developing countries – particularly those with less exposure to short-term capital flows – may benefit from pegging their exchange rates to gain credibility and discipline fiscal and monetary policies. But relatively developed emerging market economies with open capital accounts appear to gain from exchange rate flexibility (R. Duttagupta, G. Fernandez, C. Karacadag, *From Fixed to Float: Operational Aspects of Moving Toward Exchange Rate Flexibility*, IMF, July 2004).

¹⁴ D. Cobham, G. Dibeh (eds.), *Monetary Policy and Central Banking in the Middle East and North Africa*, European University Institute, March 2007.

¹⁵ K. Żukrowska, (ed.), *Zróżnicowanie rozwoju jako impuls pro wzrostowy w gospodarce światowej (Differentiation in development as a pro-growth impuls)*, SGH 2008, s. 215.

It is easier to eliminate tariff barriers in the process of FTA creation, which does not necessarily eliminate trade barriers in a market and can be considered as stimuli for structural changes and growth. In most cases, the creation of a FTA is followed by liberalization of capital flows. In conditions when asymmetric liberalization is applied, such solutions stimulate structural changes which result in changes of trade structure. Postponement of capital liberalization in such conditions freezes old, traditional and non-effective trade structure. Traditional trade structure brings about pressure on agriculture liberalization which, if it takes place without structural changes in production, again can be considered as a factor that freezes the old economic structure of a less developed economy.

The above mentioned are just the examples showing that opening the market in terms of tariff-elimination, which is the main goal of the bilateral negotiations between the EU and MPCs (limited to industry, less to agriculture and even less services), is not enough. In order to profit even from the EMFTA in industry or agriculture, MPCs need to push for more liberalization in services – with the EU or within the WTO, and introduce more domestic reforms. The EU has always declared that these will be the most important element in its initiatives – both the EMP and the ENP. The results are so far not satisfactory. The reasons for that can be found in the negotiation process – the internal situation of both partners, changing external conditions in the world economy, the choice of negotiation forum and topics. The whole negotiation process be analyzed in the forthcoming chapters in order to present some recommendations regarding the improvement of the negotiation strategies and outcomes of actors who try to build the Euro-Med Free Trade Area.

2. The EU in 2008 – Opportunities and Threats for the Future EU-Med Relations

If one examines mutual relations between the EU and the MPCs, the fact that both opportunities and threats appear in the 2008 seems to be obvious. The EU is scared of further enlargements or steps alike enlargement. Similar scared attitude towards opening can be seen in the case of Mediterranean partners, despite the achieved results in the growth rate of the new EU MS. Thoughtful analysis of the facts can bring big changes here. There is a need to replace threats and interpretations by naked facts and draw conclusions from them. All breaking news needs time to be accepted and approved. The situation in this case is not an exception from this pattern.

2.1 Linking EU to the external and internal policies

Substantial number of the EU observers¹⁶ underline the fact that on one hand, the EU so far internal competitiveness agenda (Lisbon Strategy) has been obtaining greater influence on more and more EU policies (also trade policy), and on the other hand, there is a tendency within the EU for strengthening Member States against the European institutions. This tendency can lead towards more defensive and inwards looking EU external strategies – both at such multilateral forum like the WTO or bilateral agreements negotiations with its Partners.

According to the European Commission, all external actions should refer to “European interests and way of life”¹⁷. Such attitude can be traced in the Conclusions of the European Council in December 2007¹⁸, and a number of the EC documents where it is explicitly stated that the Lisbon Strategy¹⁹ is being widened by an external dimension. In practice, it is often understood that globalization and international competition coming from the developing countries threaten not only the European position in the global market, but also the “European way of life”. Thus, the EC proposes that “the European interest needs to be specifically defined, strongly articulated, stoutly defended, and vigorously promoted [...]”²⁰ What does it mean for any EU external action in the future and for the MPCs which bilaterally and regionally will be negotiating with the EU? The EU may even more clearly determine its position by its internal and sector interests articulated by different veto players, also those within the EC. Thus the EU dominance in negotiations with developing countries might get even stronger. If the European Council and European Commission give precedence to European interests referring to the Lisbon Strategy and global challenges which are becoming so persistent in all the EU documents (climate change, energy and food security, international competition), then other policies including external trade, development and foreign policies might become more dependent on the “new EU agenda”.

All of those global challenges are trans-border ones and some of them can be used as additional negotiation issues by Southern Mediterranean policy-makers while negotiating future agreements with the EU. Libya and Algeria are both already playing their cards using the situation on the energy markets – Algeria hesitates as far as preparing its Action Plan

¹⁶ Among them EU Commissar for Regional Policy Danuta Hübner and MEP Jan Olbrycht.

¹⁷ A. Michalski, *The EU as a Normative Power – Making the Lisbon Strategy’s External Dimension Work*, in: *Think Global Act European, The Contribution of the European Think-Tanks to the French, Czech and Swedish Trio Presidency of the European Union*, 2008, pp.260-266.

¹⁸ Brussels European Council, Presidency Conclusions, 14 February 2007, point 39.

¹⁹ E.g. European Council, *EU Declaration on Globalization*, Summit on 14 December 2007.

²⁰ European Commission, *The European Interest: Succeeding in the age of globalization*, COM(2007) 581 final, Brussels 3 October 2007.

within the ENP, and Libya is getting closer to starting negotiations of its Association Agreement within the Barcelona Process. Despite the fact that Algeria's position works disadvantageously as far as the whole ENP is concerned, we may consider it as a call towards the EU for more partnership and giving its Partners and Neighbours the voice in implementing the ENP and the EMP. All this means a better position in access to the EU external aid and improvement if international status decides e.g. about FDI inflows. Other countries could also start using the new EU agenda in getting more from the two initiatives. The environment policy is one potential field for strengthening cooperation related to common project across the MPCs, together with rural development schemes that would support the South Mediterranean farmers after the liberalization proceeds. These issue-linkages are particularly important in the context of the results of the Sustainability Impact Assessment ("SIA")²¹. The main results of the SIA claim that the EMFTA will generate only small gains in regional economic welfare, but great social and environmental costs in the Southern Mediterranean countries, as well as big dislocations in South European agriculture. None of the EU initiatives towards MPCs has so far taken into account the challenges described above. And it must be underlined that none of the MPC government has declared its position on the SIA so far. Why is the Commission not aiming at those challenges? Is such an attitude correct and well founded or is it just typical negligence, which often occurs in politics? Obviously this kind of EU behavior greatly diminishes EU credibility as far as its development policies are concerned. This lack of credibility can be seen as a factor discouraging potential partners from more commitments towards reforms declared in the ENP Action Plans, and a potential threat towards more constructive and partnership-based relations between the two shores of Mediterranean.

²¹ Sustainability Impact Assessment (SIA) – study commissioned by the European Commission and conducted by Manchester University, leading a consortium including the UN Economic and Social Commission for West Asia.

2.2 Union for the Mediterranean

In May 2008 the European Commission adopted „Barcelona Process: Union for the Mediterranean”, a program for multilateral partnership.²² It was also a subject of the Presidency conclusions in June 2008.²³ Its aim is to revive and reinforce regional relations, and give better visibility to the European policy towards Mediterranean.²⁴ New institutional solutions are designed to strengthen cooperation and give new impetus to the reforms. It is seen as a new forum and opportunity for southern countries, too. With the French presidency of the EU in the second half of the 2008 we may expect some changes in the EU Mediterranean policy and a new phase in the Partnership. Work program prepared by France is a proof of a new impulse that will encourage a process leading to quicker development of regional relations, with trade liberalization.²⁵ In spite of the criticism and hesitation of some of the EU MS and MPCs concerning this proposal, the European Commission revealed the framework of the future structure. It included the creation of the secretariat as well as permanent committee of Euro-Mediterranean representatives. In order to upgrade political relationship within the Mediterranean cooperation, the initiative foresees biennial summits of heads of governments managed by established co-presidency and annual foreign affairs ministerial meetings, sector ministerial meetings as well as senior officials and Euro-Med Committee meetings. A joint secretariat will be established to promote and follow up projects, and the permanent committee of Euro-Mediterranean representatives is presumed to work in Brussels. The Euro-Mediterranean Assembly was established in order to complement the inter-parliamentary dimension of the Union. All parts of the new structure are assigned to support and meet the goals of the Barcelona process²⁶.

It is expected that the framework of the “Union for the Mediterranean” initiative will put special attention to issues such as setting up common objectives related to environmental policy; transportation routes; solar energy for Mediterranean region; cooperation between

²² Commission of the European Communities. *Communication from the Commission to the European Parliament and the Council. Barcelona Process: Union for the Mediterranean*, Brussels, 20/05/08, COM (2008) 319 (Final).

²³ Council of the European Union, *Presidency Conclusions*, Brussels, 20 June 2008, 11018/08 CONCL 2, p.18.

²⁴The list of nine states has been extended and now includes: Mauritania, Morocco, Algeria, Tunisia, Libya, Egypt, Jordan, Palestinian Authority, Israel, Lebanon, Syria, Turkey and Albania.

²⁵ French Presidency of the Council of the European Union, *Work Programme*, 1 July – 31 December 2008. Europe taking action to meet today’s challenges, www.europa.eu/ue2008.fr

²⁶ *Barcelona Process: Union for the Mediterranean. Commission adopts proposals to enhance the partnership between the EU and its Mediterranean neighbours*, Press Releases, Reference: IP/08/774, 21/05/2008.

scientific and academic scholars in the area on agriculture and fisheries; development cooperation on maritime security.

The list of priorities indicates that measures aimed at fostering the EMFTA will not be addressed by the Union in the first place. It means that bilateral dimension of the Barcelona Process and the ENP might have crucial importance for negotiating trade liberalization. However, the initiative of the Union carries new challenges for development of the ENP as well as the EU development of external relations with other countries and regions. Such institutional process of widening and deepening relations with one region would have a significant impact on other EU's partners and neighbours. Thus, the EU Southern members could be less interested in the development of other dimensions of Union' neighbourhood policy. Due to the establishment of the Southern country co-presidency and the selection of a Southern host country for joint Secretariat, the remaining EU members could consider their priority policy to be excluded or neglected. Therefore there is a question on relations between Northern and Southern societies and enhancement of other directions of the ENP.²⁷ What is more, although the Union for the Mediterranean develops the regional dimension of the Barcelona Process, its influence on changing role of MPCs in bilateral negotiations with the EU and is to be seen. Egypt, co-chairing the inaugurating summit in Paris (13th July), can serve as an example. There are also signals of ongoing talks as bilateral negotiations on trade liberalization in services have been launched with Egypt, Morocco, Tunisia and Israel, and some sector agreements were concluded (like agreement to further liberalize trade in agricultural and fishery products between the EU and Egypt and Israel; according to the Rabat Euro-Mediterranean Road map for Agriculture). A third round of trade talks between Egypt and the EU was to begin on the December 5, 2007, but it was postponed due to the two sides' differing approaches: the Egyptians wanted bilateral talks, while the Europeans wished to negotiate simultaneously with all Agadir partners. In any case, talks will be held in the framework of the ENP. Under the EU-Egypt ENP Action Plan of March 2007, negotiations will identify and adopt supporting measures to ease access to the export markets by, among other tools, approximating technical legislation and increasing cooperation in international marketing standards for all raw and processed agricultural goods.²⁸

²⁷ There is also unresolved problem related to leadership of the initiative, however France, as a country which presently holds the EU Presidency and as an initiator of the "Union", seems to be a natural candidate to take on the role. Nevertheless the situation can change when the Lisbon Treaty with new rules related to external representation of the EU comes into force.

²⁸ Under the plan, this will come with aid of 558 million euros in 2007-10, which in turn should also help attract lending for investment of 250-300 million euros, for a total of over 800 million euros.

Summing up, if the MPCs want to play a role of a partner in the Barcelona Process, they should start using its different dimensions – multilateral, regional and bilateral – in a co-ordinated way in order to achieve more gains and fulfill their goals and not only the EU policy ones. Such policy would be even more strengthened by deeper involvement of MPCs in liberalization of trade on a global level – within the WTO.

2.3 The EMFTA and current WTO negotiations

All the EU initiatives towards the MPCs focus on trade and development, which are strictly combined with the goals of the WTO Doha round of negotiation (Doha Development Agenda – DDA). Those initiatives can accelerate, as the EU and the WTO members are close to a new agreement on agriculture trade liberalization. Most of the MPCs are members of the WTO²⁹, however, as many authors stress, they are lagging behind the commitments made within the GATS. Not only is a number of sectors subjected to GATS disciplines limited, but also the commitments made are very shallow - Tunisia has bound only 3 out of 11 possible sectors, Egypt 4, Morocco 7, and Jordan 11. Among the most frequently bound sectors there are: tourism and financial services, (by four of the eight Arab MPCs), followed by communications, construction, and transport services (bound by three countries each). With respect to services, the EU would like to start with financial services, IT, transport and energy. Some of the services, after having the multilateral basis, could be further deepened on a regional or bilateral basis. Generally, binding a greater number of sectors and deeper commitments on the side of MPCs could be treated as “an important signal to investors, it can externally anchor domestic reforms, and it discourages vested interests to lobby for trade protection”³⁰. An ambitious deal on services is a goal of the EU, but significant progress would be made only when there is a movement in agricultural and industrial market access although some reports³¹ show that more could be gained, by both developing and developed countries, from a 25% cut of the barriers in services than from a 70% tariff cut in agriculture

²⁹ Except Algeria, Lebanon, Libya and Palestinian Authority who gained the status of Observer and Syria which is treated as Accession working party.

³⁰ D. Müller Jentsch, *Deeper Integration and Trade in Services in the Euro-Mediterranean Region, Southern Dimension of the European Neighbourhood Policy*, World Bank, 2005, p. xvi.

³¹ Y. Decreux, L. Fontagné, *A Quantitative Assessment of the Outcome of the Doha Development Agenda*, CEPII, 2006, http://trade.ec.europa.eu/doclib/docs/2006/june/tradoc_129124.pdf, K. Anderson, W. Martin, D. van der Mensbrugge, *Doha Merchandise Trade Reform: What's at Stake for Developing Countries?*, World Bank Policy Research Working Paper 3848, February 2006, http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/02/15/000016406_20060215164859/Rendered/PDF/wps3848.pdf.

in the North and a 50% cut in the South³². The most important condition of such liberalization is the value added component. The higher this component, the shorter time a country needs to catch up. This is why liberalization of industrial trade is more important than liberalization of agricultural one. It does not matter that catching up economies do not have competitive industry, because with foreign direct investment (FDI), they will create it. The same problems were discussed in case of Poland and other East and Central European economies when they were opening up with the EU.

The processes of forming the EMFTA as well as the WTO multilateral negotiations undergo simultaneously and have mutual effect on each other. In negotiation on services, intellectual property rights, government procurement and agriculture, the EU would seek commitments beyond the provision approved under the WTO rules. If there is consent within the MPCs, the parties can agree for inclusion of the Singapore issues (investment protection, competition policy, transparency in government procurement and trade facilitation) into the agenda of bilateral negotiations. The sector which may exceed the provisions within the WTO is services, especially in such cases where the EU's law is more developed than the WTO's – e.g financial services, ICT. Progressive and reciprocal liberalization of trade in services would contribute to mutual benefits, while services would account for around 75% of employment in the GDP in the EU and around 60% of the GDP in the Southern Mediterranean countries³³. The most difficult sector for negotiations is agriculture. Mutual agricultural trade is to be liberalized on a partial and reciprocal basis. Almost 80% of the EU Mediterranean agriculture products imports are at zero duty and slightly more than 20% of MPCs imports from the EU are at zero tariffs³⁴. The EU-EMP trade in agriculture is asymmetrical in favor of the latter.

Further development of trade liberalization depends on the outcome of the WTO Doha round or further proliferation of regional and bilateral preferential trade agreements. Regional agreements have always liberalized trade deeper than the global ones. Until now, agreements with fewer participants generally were cutting barriers deeper between its participants than those with bigger number of participants. Perhaps at this stage of international relations it could have been changed. There is an additional argument in favour of such solution.

³² Euroactive, The WTO Doha Development Round, Published: Tuesday 1 August 2006.

³³ Services and investment liberalization in the Euro-Mediterranean Region,
<http://trade.ec.europa.eu/doclib/docs/2006/march/tradoc_127733.pdf>

³⁴ A. Asbil, The Euro-Mediterranean Roadmap for Agriculture, DG Agriculture and Rural Development, European Commission, 8-9 February 2006, Cairo
<http://www.cndwebzine.hcp.ma/cnd_sii/IMG/pdf/Sustainable_rural_dev.pdf>

Liberalization should integrate economies representing different levels of development as integration among poor but equally underdeveloped economies does not work. Equal development only makes sense while integrating economies are developed. At this point we can ask what might happen if no agreement is reached in Doha Development Round and what kind of impact it would have on the EMFTA? Will the WTO multilateral trading system remain the basis for world trade or will regional trade agreements dominate international system? If the Doha round fails, there will be less opportunity for significant trade reform in developed as well as developing countries. However, if it succeeds, the new multilateral agreement on agricultural would create bigger opportunity for producers of fruits and vegetables in the MPCs; domestic support would be cut in the EU and other developed countries; and no export subsidies would distort international trade. If there was successful conclusion of non-agricultural market access (NAMA), there would be more trade opportunity for Mediterranean products including fisheries, further liberalization of trade in services and adoption of substantial trade facilitation procedures, such as reduction of administrative and technical barriers to trade. As it was mentioned above, non-tariff barriers constitute one of the biggest obstacles to trade in Mediterranean products therefore there is strong need for adoption of appropriate rules on multilateral level.

As a result of the suspension of the Doha round negotiation there are pending questions on further opening up of markets in agriculture, industry and services. How can MPCs and other developing countries make the most of new trading opportunities and what kind of economic effects the DDA would have on these countries? According to the research undertaken by the team from Trade, Equity, and Development project at the Carnegie Endowment in Washington, “among developing countries, about 90% of the gains from Doha negotiation outcomes would come from liberalization of trade in manufactured goods. Most developing countries will benefit from liberalization of trade in manufactured goods, with China gaining the most and Asian countries gaining more than Latin American and African countries”³⁵.

Negotiations always require specific approaches. Nevertheless, utilization of strategies applied by current EU member states may turn out not to be the best possible choice. East Central European states were using the strategy that was successful in case of Spain, Portugal or Greece. All mentioned states have joined the European Communities in different stages of integration. In other words, since that times the depth of integration has changed. In case of

³⁵ *Winners and Losers: Impact of the Doha Round on Developing Countries*, ed. S. Polaski, Carnegie Endowment Report, March 2006.

MPCs the depth of integration has not been different, but the level of international integration and liberalization has been higher. This creates new conditions for MPCs to negotiate their terms of future cooperation with the EU.

Summing up the above discussions, we may draw following conclusions and at the same recommendations, both for the EU representatives and the MPCs for developing their common liberalization agenda:

Linking trade and not trade issues

The ambitious goals of trade liberalization between two regions (EU and MPCs) can only be achieved when both the most crucial and difficult negotiation fields - agriculture and services - become a subject of real concessions on both sides. However, bringing more issues to the negotiation table can be, especially for the MPCs, crucial factor that would decide on strengthening their bargaining power against the EU. The environmental and energy arenas, as well as agriculture development schemes are potentially to be the crucial aspects as regards to the strategic interests of the EU and the MPCs. MPCs searching for more access to the EU market should raise their interest in wider EU agenda in order to find more arguments supporting their development aims.

More coordination and consistency in liberalization policies of the MPCs

The EU policy towards the MPCs evolves and brings new ideas to the mutual cooperation. The Union for Mediterranean is just one example of such initiatives. If the MPCs want to play a role of a partner in the Barcelona Process, they should start using its different dimensions – multilateral, regional and bilateral – in a co-coordinated way in order to achieve more gains and fulfill their goals and not only the EU policy ones. The EU on the other hand should be aware of the fact that bringing a larger number of initiatives is not necessarily advantageous, especially from the point of view of consistency and coherence of EU actions in the region.

Selection of a forum for further liberalization

Liberalization should be preceded, notwithstanding it will be conducted globally, sub-regionally, regionally or bilaterally. Selection of a level for liberalization of particular type of goods, services can however be decisive for effectiveness of the liberalization process at

particular time and in a particular context.³⁶ Generally, the more institutionalized negotiation fora, the more effective – i.e. deeper and wider is the liberalization process. Bilateral negotiations can usually go further, deeper liberalizing trade. Multilateral negotiations have to take into account the possibilities to liberalize the weakest partners, but if it succeeds, the results will be more stable. Nevertheless, there is more and more evidence that liberalization among economies representing differentiated levels of development is stimulating growth in those more developed and in those less developed, changing their branch structure³⁷. It is important in what sequence the liberalization is done. In case of MPCs, first agreements should be signed with developed economies but FTAs should be created regionally first, as bigger market attracts more FDI.

3. EMFTA - Negotiation Process and its Outcomes

Examining the Barcelona Process in more detail, one has to proceed using three criteria: bargaining outcomes that depend on the setting of negotiations, the actors' bargaining power, and the choice of bargaining issues. National governments of both the EU member states and the MPCs serve as gatekeepers for bargaining issues. This role ensures that only those policy issues are subject to international disputes which will not undermine the entire Barcelona Process, resulting in a total breakdown of negotiations. Some issues, however, which are important in the long-term might not yet have been negotiated, or there may be areas of issues where actors have been unable to achieve considerable progress³⁸.

As it was mentioned in the previous chapter, the outcomes of the negotiation process depend on the MPCs' ability to arrange for side payments, package deals and other items of trade-off to counter the EU's bargaining power. So far, the whole negotiation process was concentrated on the issues of agriculture and industrial goods, whereas services have just started to be on the agenda. It will be interesting to see how the interactions between those two areas will be shaped by both negotiating partners – the EU and MPCs.

³⁶ C. L. Davis, *Setting the Negotiation Table: The Choice of Institutions for Trade Disputes*, Princeton University.

³⁷ K. Żukrowska (red.), *Zróżnicowanie rozwoju jako impuls pro wzrostowy w gospodarce światowej*, SGH 2008, s. 215.

³⁸ Jean Monnet Centre of Excellence, Freie Universität Berlin, *GO-EuroMed-The Political economy of Euro-Mediterranean Governance, Specific Target Research Project, Stage II Summary*, February 2008, p.12.

3.1 Liberalizing Agriculture ³⁹

One of the latest developments in the Euro-Med trade relations, which is EU-Egypt preliminary agreement announcing free access to Egypt's market for around 90% of EU agriculture and fisheries exports and to EU market for 70% of Egyptian exports, shows that bilateral liberalization is progressing (despite the stalemate at the WTO). On the other hand, the fact that this agreement limits access to the EU market for Egyptian tomatoes, cucumbers, artichokes, grapes, garlic, strawberries, rice and sugar, processed tuna and sardines, shows that the pace is slow and still “Mediterranean” agriculture goods where MPCs have a significant comparative advantage are excluded from bilateral liberalization. None of the bilateral agreements – neither the AA nor the AP - speaks clearly about the liberalization in agricultural sector. The AA contains provisions on liberalization of industry trade and the AP focuses on the issues concerning sanitary and phyto-sanitary standards or environmental policy. Further reducing the EU's agricultural tariffs, tariff quotas, farm subsidies and other Common Agriculture Policy (CAP) instruments is highly dependent on the EU hot debate over the CAP reform, EU agricultural commitments and the WTO rising food prices (“food security”)⁴⁰. The rising prices have already imposed introducing some short term measures which are also supporting the liberalization of agriculture markets.⁴¹ EU agriculture regime is, however not the only factor that leads to increases of the food prices. The second one is the target of EU energy and climate package which is increasing biofuels usage by 10% by 2020. These two processes are a great challenge for the whole EU and they denounce very bitter negotiations among not only the EU member states, but also within the EU. What could be indeed seen recently is that the problems with veto players⁴² are not only important when analyzing the domestic level of a game, but also on the European level - veto players cannot only be found within the governments of particular EU or MPCs, but also within the EC – e.g. the situation between Barnier and Mandelson⁴³. Therefore the EC should not be treated as one body with one interest and objective, but as a consistent of a number of veto players.

³⁹ A. Tovias, *Is The European Neighbourhood Policy Directed To Its Mediterranean Partners Coherent?*, Global Europe Papers 2008/10.

⁴⁰ Riots in Egypt as an example.

⁴¹ These measures embrace: reducing buffer stocks and export refunds and suspending import duties on almost all cereals.

⁴² Veto players are individual or collective decision makers whose agreement is required for the change of the status quo.

⁴³ The row between Michael Barnier and Peter Mandelson is a sign of lack of common approach within the EU to issues such as the reform of its agriculture policy or tackling new global challenges such as climate change, energy security, the global food crisis.

At the moment it is hard to predict if the MPCs would become winners or losers of those developments in the EU agriculture policy. On the one hand, if the proposal of Barnier would gain more support and regional models of protecting farmers from different external shock would be introduced, some parts of MPCs' societies would gain and be strengthened – so would be the farmers in the EU. Increasing protectionism in agriculture could reduce the “zone of agreements” on both sides in this sector making negotiation of any further concessions more difficult. This would have an impact on the negotiations in services sector and lessening the “issue-linkage” tactics.

3.2 Liberalizing Services

There are several arguments deciding about importance of liberalization of services trade in Europe. Services have high share of value added which means that they have impact on the dynamics of the standards of living improvement by increasing salaries. Not liberalized services (non-tradable) become one of the main internal sources of inflation in Europe, which is caused by limited completion in this specific market. The other source can be ascribed to hikes in raw material and food prices. The liberalization of trade in services could bring substantial gains, as services usually account for a large share of GDP and are important inputs into the production of most goods. Moreover, services liberalization in preferential arrangements carries fewer risks of income losses than preferential merchandise trade, because the elimination of the most common services restrictions does not cost the government revenues, so that there are no trade diversion effects.⁴⁴ However, services liberalization is likely to be considerably more complicated than tariff reform, as it requires establishment of a carefully designed regulatory system and appropriate safeguard mechanisms, and sometimes involves a painful privatization process⁴⁵.

The existing regional integration agreements usually do not include services trade or if they do, this it is only to a limited extent. Hence – surprisingly – intra-regional differences in regulations, restrictions on currency convertibility and limits on the physical movement of persons are at present creating a situation in which it is often easier for MPC services providers to operate in countries outside the region, e.g. Western Europe, than within.⁴⁶ The considerable development of services exports which started in 2001 should motivate the MPCs to reform their institutions and implement administration procedures in order to enable

⁴⁴ *Middle East and North Africa...*, op.cit., p. 63.

⁴⁵ *Ibidem*.

⁴⁶ *Ibidem*, p. 64.

at least partial liberalization of trade in services. The official inclusion of the services trade in the bilateral AA with the EU seems to be necessary to speed up the process. A give-and-take package for both sides could be a good solution in this case, that is, trade in agricultural products asked for by MPCs could be exchanged for trade in services desired by the EU⁴⁷.

However, when looking at the declared interests of the EU and MPCs as far as the services liberalization is concerned, there seems to be more divergence than convergence. MPCs have their comparative advantage in Mode 2 (consumption abroad) and Mode 4 (movement of natural persons). Even if the EU would be more reluctant to liberalize Mode 2, it will be difficult for the EU to liberalize labor-intensive services – not accepting the whole Bolkenstein directive. It is so because of EU Old Member States' fear against service providers from New Member States which is a sign of the EU capacity and negotiation “resistance point” in this area. Although the ENP document states that “free movement of persons is not in the agenda for the foreseeable future”, some measures regarding temporal movement of people could be introduced via bilateral negotiations, even not with the EU, but with particular Member States.

Nevertheless, there are several arguments in favor of services liberalization both within the EU (the Bolkenstein directive) as well as in relations with third states. First of all, lack or limited liberalization keeps the prices of services high. Secondly, lack or limited competition keeps the costs of production in this specific sector high, which can be used as an argument that high costs explain high prices. Nevertheless, both could be lowered by liberalization. Thirdly, low prices mean more consumption as elasticity of demand is high in this area. Fourthly, increased consumption means more jobs. Fifthly, non-tradable services are one of the sources of inflation, in parallel with growing raw material prices. Sixthly, non-tradables have much higher value added in comparison with industrial products, which means that they help to accumulate more, what in turn leads to higher standards of living.

As it was stated above, the MPCs hardly develop their comparative advantages in the services Modes other than 2 and 4. Among the services sectors that are considered as possibly bringing more positive results than the WTO could do, there are air transport and electricity, electricity regulators, customs authorities, the mutual recognition of professional qualifications and IT-enabled services. Some of them should be developed more on a regional basis (within the Union for Mediterranean) – e.g. transport, electricity. However, IT enabled services are an

⁴⁷ D. Müller-Jenksch, *op. cit.*, p. 39.

example for possible bilateral agreements preceded by the reforms that could be introduced and supported via the ENP Action Plans and by ENPI financial means.

Only through inclusion of services into the liberalization agenda between the EU and MPCs, the two sides will be able to move with the liberalization agenda. However, some studies⁴⁸ stress that linkage between issues encouraging trade liberalization occurs only when veto players in each issue-area are band-wagon into it. In the case of EMFTA, it is rather hard to see e.g. farmers or financial services providers on both shores of Mediterranean supporting deeper liberalization at the same time. The most advantageous situation would be when the voices of financial sector on the EU side and farmers on the MPCs side would be strengthened in relation to the EU farmers and MPC financial sector. This could also be supported by strengthening EU Trade and Development Commissioners against EU Agriculture Commissioner and Agriculture Ministers in the Member States. Thus, the lower the degree of domestic opposition veto-players, the more probable is that efficiency improving policies will be introduced. The experience of East Central Europe shows that semi-finished goods and labor - intensive production has less advantages for a country which wants to catch up in a short period. The most advantageous model is to come as quick as possible to the branch/economic structure which is a copy cat of developed economies.

Summing up the above, discussions we may draw following conclusions and at the same recommendations both for the EU representatives and the MPCs for developing their common liberalization agenda.

⁴⁸ J., Morales-Ortiz, *Domestic Veto Players and Trade Liberalization: the United States, the European Union, and the Cairns Group Negotiating Positions from the GATT Uruguay Round to the WTO Doha Ministerial Meeting*, 2005.

Priority of liberalization areas within EMFTA

Services should be recognized by the European Union as the most important sector of the EuroMed trade relations. Therefore the progress on services liberalization should be interlinked with progress in other areas i.e. agriculture, industry, investment. Thus, the European agricultural lobby would have to adhere to strong pressures from other sectors such as industry and finance to more commitments in agriculture in exchange for more commitments in services on the side of MPCs. However, the existing regional integration agreements usually do not include services trade or if they do, that it is only to a limited extent. The official inclusion of the services trade in the bilateral Association Agreements with the EU seems to be necessary to speed up the process.

Priority of different modes of services

MPCs need to push for more liberalization in services – with the EU or within the WTO - and introduce more domestic reforms. The sector which may exceed the provisions within the WTO is services, especially in such cases where the EU's law is more developed than the WTO's – e.g. financial services, ICT. As it was highlighted, the MPCs hardly develop their comparative advantages in the services Modes other than 2 and 4 (consumption abroad and presence of natural persons). Among the services sectors that are considered as possibly bringing more positive results than the WTO could do, are air transport and electricity, electricity regulators, customs authorities, the mutual recognition of professional qualifications, IT-enabled services. Some of them should be developed more on a regional basis (within the Union for Mediterranean) – e.g. transport, electricity. However, IT enabled services are an example for possible bilateral agreements preceded by the reforms that could be introduced and supported via the ENP Action Plans and by ENPI financial means. Therefore liberalization should be done in the sphere of industrial goods, capital flows, and services, and followed by agricultural products and labor movement.

New global challenges - new issues in negotiations

The MPCs should use the argument of growing food prices that affect their economies and societies, in order to strengthen their bargaining power against the EU countries regarding the agriculture issues. On one hand, the CAP reform will influence the future of FTA and therefore needs careful steps in the common position of Commissioners for Agriculture, Development and External Relations and Trade. On the other hand, economically more

efficient outcome might be reached by a strong agricultural reform pressure from both sides, produced by exogenous shocks like a growing world market demand and the liberalization talks within the WTO agricultural negotiations. However, in order to broaden the debate and include more policy arenas (e.g. environment and rural development issues) to the negotiations between the MPCs and the EU, the MPCs' negotiators need to strengthen their capacity and use more domestic support since as different evaluations suggest, the "negotiation capacity of states seeking to join trade pacts actually increases as pressure groups play active roles in this process"⁴⁹.

Fair free trade between the EU and Med countries

Fair free trade means not subsidized and liberalized trade i.e. trade without barriers for accessing any market. Fair trade does not mean that all trade has to be liberalized at the same time. The MPCs' catching up economies are interested in liberalizing trade of industrial goods, lowering the barriers for agricultural goods as well as for sensitive goods. Sensitive goods according to our findings are such goods which have started the first technological revolution and stayed protected since then, despite all changes which have taken place in the economy. They lose competitiveness because they are labor intensive and costs of labor are high in developed economies and much lower in the developing ones. Nevertheless, if sensitive production is moved to catching up economies, which gradually happens, this does not help much the catching up economies. All sensitive production is labor intensive and this means that it has relatively small share of the value added. For developing economies it is better (in their interest) to build their industry upon field with much higher value added component than textiles, cloths, shoes and leather.

Summary

As many academics put it, the Barcelona Process is not really multilateral; rather it is *bi-multilateral*, whereas it is negotiated between a multilateral entity – the EU – and a single partner country. It means that not only is the EU a political organism which consists of 27 countries, but also the European Commission is a European institution that consists of 28 Directorates General.

In order to enhance the role of the MPC partners and limit the EU-centrality of the ENP actions and instruments (this belief is hindering the willingness and engagement of some

⁴⁹ Riad Al-Khoury, *Vying for Position*, Al-Ahram Weekly on-line, 27 December 2007 - 2 January 2008, Issue No. 877.

countries and partners to engage in the EU initiatives), some kind of “de-centered integration” approach is needed.⁵⁰ What would that mean in the context of bilateral institutions between the EU and MPCs? New regional institutions declared within the Union for Mediterranean should be firstly set up and MPCs should use these fora for streamlining issues important for them. What is necessary here is a reasonable plan of how to use the opportunities which are created by close institutional ties with the EU and put those ideas into life. The experience of the East and Central European states, which is unique, can until now be used as a road map for the MPCs.

More MPC - centrality in terms of EMFTA could be introduced by “simple” granting MPCs access to the EU markets for agricultural products in parallel to the liberalization of trade in services. However, it calls for more negotiations within the EU and concessions on the side of cherished groups like farmers which might be difficult, especially now in the face of so much attention towards the problems of food prices.

Together with the deepening of relations within the ENP scheme, there is clear evidence that some laggards in liberalization (Algeria, Libya) are benefiting from different EU initiatives and interests. The main rule of the EU approach towards the MPCs – the differentiation principle - may lead to decreasing consistency of policy towards creation of the EMFTA. Moreover, it appears that lack of a clear leader in liberalization processes might negatively influence the whole process. In the past the EU was using “leaders” in order to push for more involvement on the side of the partner countries (e.g. that was the case in the 2004 EU enlargement process). In this sense, differentiation principle in completing the EMFTA should not be seen as a process characterized by “different countries – different needs – different goals” but considered as a process of “different-countries – different needs – one goal”.

⁵⁰ D. Bechev, K. Nicolaidis, *Integration without Accession: the EU's Special Relationship with the Countries in its Neighbourhood*, St Antony's College, University of Oxford, October 2007.

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