



The Political Economy of Governance in the Euro-Mediterranean Partnership

Deliverable No. 2

Working Package I: The Political Economy of Euro-Med Trade

Summary of findings

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Introduction

Euro-Mediterranean trade relations have been the focus of major economic analysis throughout the last few decades (Tovias 1977, Aliboni 1990). Especially since the launch of the *Barcelona Process* in 1995, scholars have developed applied models to quantify the impact of the signed free trade agreements (FTAs) between the European Union and the Mediterranean Partner Countries (MPCs)¹ (Hoekman/Konan 1999, Escribano 2000, Auguier/Gasiorek 2003, Nugent/Yousef 2005). Whereas most of these studies conclude that trade liberalization will increase welfare in both regions, other analyses assess the key significance of integrating these FTAs with each other as well as within the WTO framework (Galal 1997, Zarrouk/Zallio 2000). Finally, several studies concentrate on specific trade liberalization issues like agricultural goods (Akder 1998, Chaherli/El-Said 2000, Bayer et al 2000), services (Ghoneim 2003, Whalley 2004, Rabaud/Montalieu 2006) and labour (Bougroum/Ibourk 2001, Büge 2005). Go-EuroMed Working Package 1 “The Political Economy of Euro Med Trade” focuses on what the EU and MPCs wish to achieve from their trade relations, and how they should realise these aims. Research concentrated on actors, preferences and regulatory and political institutional variables. The objective of this Working Package is to examine the political economy of EU trade policy making towards the MPCs, the international competitiveness of the MPCs, and the prerequisites for a successful liberalisation of trade in services in the Euro-Mediterranean region. Working Package 1 was compiled by Turkish, French and German GO-EuroMed project partners and was coordinated by the latter. The Working Package consists of the following three sections:

Section 1: The European Union’s Trade Policy towards the Southern Mediterranean: Coherence or Chaos?

(Jean Monnet Centre of Excellence Berlin, Germany)

Section 2: International Competitiveness and Foreign Trade Specialization

(Sabanci University Istanbul, Turkey)

Section 3: Trade in Services: How does it work for MENA countries?

¹ We refer to the Mediterranean region as the EU defines it, i.e. encompassing those non EU member states countries which border the Mediterranean (Morocco, Algeria, Tunisia, Libya, Egypt, Jordan, the Palestinian Territories, Israel, Lebanon, Syria and Turkey). The Mediterranean bordering countries Croatia, Bosnia Herzegovina, Serbia-Montenegro and Albania have an especial status (Balkan Pact for Stability) and not part of EUs Mediterranean Policy.

(Laboratoire d'Economie Orléans, France)

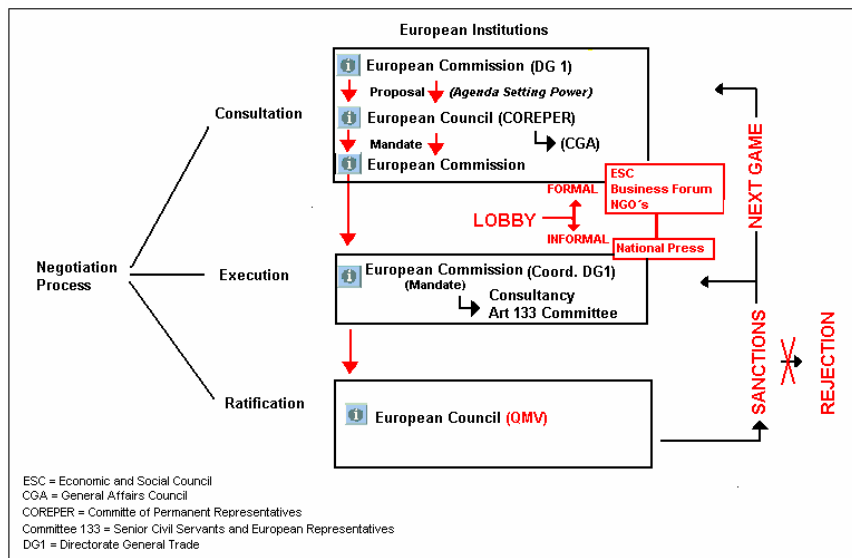
Section 4: Location of Industries in MENA countries, in the EU and NMS: a comparative analysis (Laboratoire d'Economie Orléans, France)

Section 1: The European Union's Trade Policy towards the Southern Mediterranean: Coherence or Chaos?

The European Union began establishing trade relations with its Mediterranean partners in the early 1970s. These relations were initially based on bilateral agreements for preferential market access for agricultural products. However the EU embarked upon setting up a more coherent trade strategy towards its Mediterranean partners by launching the 1995 Barcelona process, including several bilateral Euro-Mediterranean Association Agreements (EMAAs).

The key goal of this German contribution to this Working package is to analyse whether the EU's trade liberalization agendas towards its Mediterranean partners, embodied in each of the individual EMAAs as part of a EuroMed Free Trade Agreement (FTA), are coherent with the FTAs that the EU has signed with other regions of the world (*horizontal coherence*). To answer this question, we first run a comparison between Tunisia's FTA and the EU's FTAs with South Africa and Chile. We find major differences in the scope and depth of trade liberalization between the analyzed FTAs. We then explain this incoherence in the EU's trade policy using two-level-game instruments which assess the interests, preferences and coalitions involved.

Figure 1: The EU Trade Policy Making

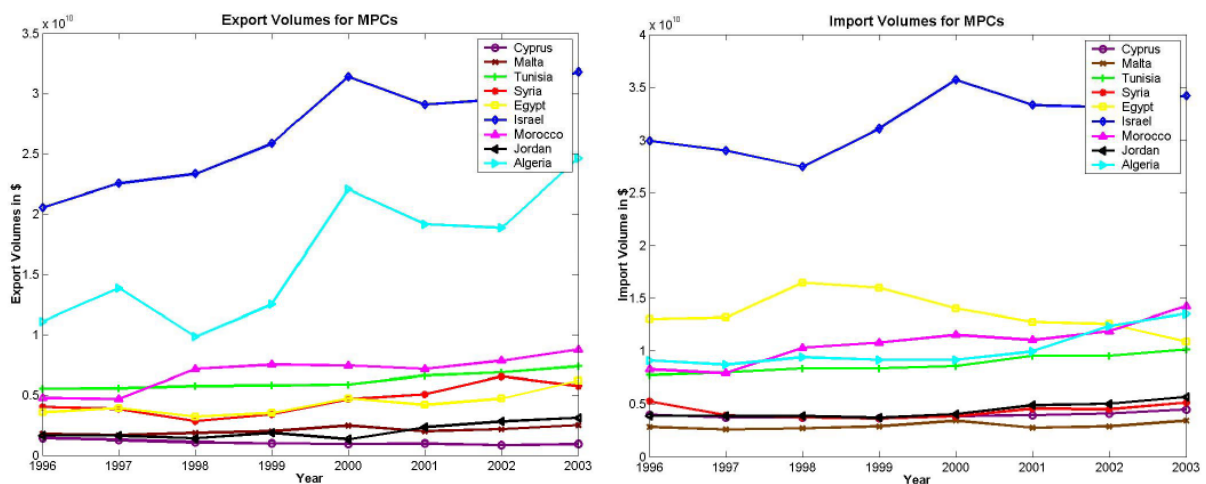


The thesis of this German contribution is that EU trade policy towards the Mediterranean is, on the one hand, volatile as there are strong divergences between the policies of various EU Council Presidencies. On the other hand, it is also far less comprehensive in terms of liberalizing trade as compared with other FTAs between the EU and third countries.

Section 2: International Competitiveness and Foreign Trade Specialization

The analytical focus of the Turkish contribution (reference [B]) is an examination of international foreign trade patterns and the structure of specialization in foreign trade of a number of Southern EMP-partner countries. The international competitiveness of 7 Mediterranean Partner Countries (Morocco, Tunisia, Egypt, Israel, Syria, Jordan, and Algeria), two EU-member states (Cyprus and Malta) and a candidate country (Turkey) is analysed. The structure of specialization in foreign trade of the named countries and the EU-15 was compared for the years 1996 – 2003 (Figure: Development of Total Export and Import Volumes, 1996-2003).

Figure 2 & 3: Development of Total Export and Import Volumes, 1996-2003



Source: GO-EuroMed Working paper 0603

In order to estimate the trade competitiveness of the countries in question, the following indices were used:

- (i) Revealed Comparative Advantage (RCA) Coefficient
- (ii) Comparative Export Performance (CEP) Index
- (iii) Trade Overlap (TO) Index
- (iv) Export Similarity (ES) Index
- (v) Export Conformity Coefficient (ECC)

The empirical results show that the analysed MPCs, with exception of Israel, exhibit the main economic features of developing countries. Most of the countries in consideration have specialised and seem to own comparative advantage in non-fuel primary commodities. All countries in consideration except Israel have a considerably large export share devoted to labour-intensive manufactures. Tunisia, Turkey and Morocco are in a very strong position in the export of labour intensive commodities. On the other hand, Turkey seems unable to catch up with the EU countries in a short term period, which can be justified by the upward trend. However, a different empirical study covering the period from 1991 to 1996 shows that Turkey greatly improved its trade diversification from the beginning of the 1990s to the beginning of the 2000s (Bahri 2002). An impressive acceleration in diversification can be noted especially after 1996, suggesting that the Customs Union Agreement has had a positive effect on the trade development of Turkey.

Section 3: Trade in Services: How does it work for MENA countries?

The French contribution (reference [C]) surveys theoretical grounds of trade in services applied to the empirical context of the countries from the Middle East and North Africa (MENA). Trade negotiations are currently focused on services as the low level of tariffs on goods leaves little room for further gains from liberalisation. Trade in services, as defined by the General Agreement on Trade in Services (GATS), covers four modes of supply: cross border trade, consumption abroad, commercial presence and presence of natural persons. Thus, deep integration is at stake since trade in services is closely connected with foreign direct investment and temporary movement of workers, which is not the case for commodity trade. In a world of increasing international fragmentation of manufacturing it is necessary to rely on efficient enabling services to attain specialisation in more value-added manufactured products.

Lagging behind emerging countries in manufacturing specialisation, the MPCs crucially need to gain access to efficient services. Therefore, the French project partner drew on a

comparative case study analysis of trade institutions and regulations across countries in the Euro-Mediterranean region.

Impediments to trade in services involve the regulatory framework ('behind-the-border' laws) or non-discriminatory quotas and prohibitions applying equally to foreign and domestic suppliers. Theoretical analysis highlights welfare gains from liberalisation of trade in services, arising from falling prices, tariff income loss for governments and technology transfer from foreign firms. Nevertheless, empirical studies based on computable equilibrium models find limited gains when cross-border trade alone is liberalised. Substantial gains will only be attained when the entry of foreign firms will be broadened. In its application to Tunisia, this result rests upon strong assumptions regarding the breakdown of the initial price-wedge between rent and inefficient technology. Regarding Euro-Mediterranean relationships, although South Mediterranean countries mainly seek to facilitate the movement of natural persons, the EU still makes its most binding commitments to GATS in consumption abroad and commercial presence.

Section 4: Location of Industries in MENA countries, in the EU and NMS: a comparative analysis

The New Economic Geography theory (NEG) states that spatial distribution of activities among nations depends on their degree of economic integration. Upstream highly skilled labour-intensive and increasing-returns services favour location of new manufacturing activities, thus reducing the dependency of economic growth on low-wage costs for southern economies. The second French paper (reference [D]) compares the location of services industries in the Mediterranean Partner Countries and in the EU25. Relying on indicators of concentration, it shows that both services and manufacturing activities are less developed in MPC than in the EU15 or in the New Member States. Currently, services activities appear to be more evenly distributed inside trade areas (EU15, NMS and MPC) than within the Euro-Mediterranean zone. Concentration is time-decreasing when the EU15 is included, reflecting mostly intra-EU15 convergence. Financial intermediation and business services are the most concentrated services activities. Location of services activities differ between the EU and the Neighbourhood European Policy Countries (NEPC) in line with predominance of traditional services in the latter, particularly in the MPC. Insofar as spatial distribution of industries differs between the NMS and the MPC, concentration occurs by waves when economic integration deepens.

Summary of Findings

The main argument of the German contribution is that the EU trade policy towards the Mediterranean is a) too volatile as there are strong divergences between the different EU Council Presidencies and, b) too modest when liberalizing trade. Regarding the first argument, as we have seen, EU trade policies towards the Mediterranean partner countries are in permanent conflict between foreign policy objectives (increased stability and prosperity at the Southern border) and domestic policy concerns (protection of agricultural producers and fostering the interests of producers of manufactured goods). Hence, the German contribution to this Working Package comes to the following conclusions:

- **First**, as the presidency of the Council is shaping the EU's trade policy (which according to EU law should be conducted only by the Commission) and constantly shifting priorities, we conclude that a new institutional framework for trade policy making in the EU seems to be necessary.
- **Second**, The EuroMed Partnership is supposed to be a special, unique cooperation forum between the European Union and - as the EU notes - a key strategic region. However, as the analysed case showed, trade preferences offered to MPCs are much lower than those offered to other regions. It is therefore a must to upgrade these preferences and to use them as a benchmark to the preferences offered to other regions.
- **Third**, the Commission is the only gatekeeper of long-term coherence in trade policy towards the Mediterranean. Creating a permanent Barcelona or EuroMed Secretariat with an internally defined agenda and an autonomous management of the resources would encourage participation of Mediterranean countries and be a vehicle to enhance policy coherence and sustainability.
- **Fourth**, agricultural goods should be recognized by the European Union as the most important sector in EuroMed trade relations. Therefore, there should be a stock-taking mechanism for interlinking progress on agricultural liberalization with the progress in other areas (services, investment). By doing so, when blocking trade liberalization, the European agricultural lobby would have to resist strong pressures from other sectors such as industry and finances.

- **Fifth**, the trade strategy of the European Union for the Mediterranean region should be coordinated not only with the WTO, but also with the trade strategies of other regional actors, especially with the US American free trade areas.

Evaluating the competitiveness of the relevant countries, and the measures needed order to close the economic gap between Eastern and Southern Mediterranean countries (ESMCs), the Turkish GO-EuroMed partner comes to the following conclusions: Because of two reasons the emphasized principle of *co-ownership* of the Barcelona Process (consultation and decision making among equal partners) can not operate efficiently (Asseburg 2005). The Barcelona Process therefore faces following main difficulties:

- **First**, parties cannot cooperate as equals on the same ground if there is a remarkable imbalance between the EU/25 and the 10 Mediterranean states concerning their negotiation power. This means that EU institutions are playing a dominating role in the reshaping of relations between of what are, in fact, unequal partners.
- **Second**, the respective EU member states holding the presidency have a great influence on action plans and the distribution of MEDA funds along the ESMCs. As a matter of fact it seems necessary to establish a permanent joint institution with a secretary general or a co-presidency, which should represent the interests of both sides. Another important aspect of Euro-Med relations is that the Arab group coordinated by Egypt underlined its preference for a cooperation characterised by the *ownership-principle*.
- **Third**, the empirical results show that most MPCs have a comparative advantage and possess international competitiveness in the production of primary products and labour intensive commodities. However, the EU/15 has a remarkable comparative disadvantage in these production groups. Hence, the EU will stand to gain relatively more from the Free Trade Area to be established by 2010 if agricultural products remain excluded.
- **Fourth**, in order to improve economic integration it is necessary to create basic conditions for well functioning market economies. In this regard, the last summit meeting to introduce socio-economic reforms improving the environment for foreign direct investment and the establishment of macroeconomic stability and social security is important.

- **Fifth**, the ESMC need to increase technology transfers to overcome the shortcomings of their trade balance. The main driving force behind this growth will be attracting more foreign direct investment, which requires stronger economic stability. Improving competitiveness in this area depends upon three levels: firm level, industry level and national macroeconomic policies. Although national macroeconomic stability is one of the main determinants of successful trade policy, firms have to take initiatives to invest in close cooperation with multinational companies (MNCs), upgrade and improve productivity, quality of human resources, and on-time delivery. This adjustment to changes in the rules of the game for operating in domestic and international markets remains a sine qua non for managers.

Beginning in the early 1980s, analyses of implications of liberalisation of trade in services are still in their infancy. Further research is needed, both to update information about policy regimes across Euro-Mediterranean countries and to assess the economic gains from opening services markets. Therefore, broadening collaboration between southern Mediterranean academics due to their knowledge and expertise of local markets and EU academics specialised in trade issues would bring fruitful results. Such collaboration could draw on a common methodology to assess barriers to trade in services (Dee 2005). Insofar as domestic regulations play such a role in services, the interrelations between the IMF's and the World Bank's macroeconomic adjustment policy recommendations and the EU's and multilateral commitments to liberalize trade in services deserve more attention. The French Go-EuroMed partner comes to the following conclusions:

- **First**, considering MPCs' current situation, reforming institutions, in particular administrative practices, is a prerequisite for successful liberalization of trade in services: sequencing matters. In contrast to the assertions of international organisations, using commitments to liberalise services as a signal to attract foreign investors will still be difficult if corruption and red tape remain the rule.
- **Second**, due to weak export interest and prevailing non-border protection, reciprocity plays less of a role in services for MPC. As it would offer deeper integration, with regard to advances of Single Market, a regional trade agreement between EU and the Mediterranean Partner Countries should be preferred to WTO agreements.

- **Third**, asking for full liberalisation of trade in services in the MPCs is demanding as some EU members are still lagging behind in terms of openness to competition in some service markets themselves. Furthermore, straightforward trade liberalisation is not always necessarily the best way: gradualism matters.
- **Fourth**, regarding negotiation, developed countries, in particular EU countries could accept a give-and-take package: authorising temporary “immigration” of some clearly defined types of workers from MPC, conditional to both the rate of unemployment in that sector, economic outlook and binding commitment to migrants return home after a pre-defined time period.
- **Fifth**, mutual recognition of qualifications, technical standards and prudential regulation should be preferred to harmonisation in these areas in order to widen market access in services.
- **Sixth**, the EU should still give financial assistance to the MPCs to build institutions. Therefore, funding the MPCs should remain a priority within the ENP.
- **Seventh**, cooperation between academics and universities from both sides of the Mediterranean Sea should be promoted.

The comparative analysis of location of Industries in MENA countries, in the EU and the New Member states comes to the following conclusions: The EC should provide assistance to MPC national statistical institutes to improve the availability and the quality of their statistics. Indicators of services concentration show that, despite increased economic integration, the MPC have not yet caught-up with the EU25. Therefore, the EU should support MPC efforts to strengthen their enabling services sector. Insofar as key enabling services develop by waves, some southern Mediterranean countries may lag behind others. The EC should carefully seek to avoid such increases in inequalities within the MPC. Hence this second French article proposes three policy recommendations:

- **First**, the EC (EUROSTAT) should provide assistance to MPC national statistical institutes to improve the availability and the quality of their statistics, in particular in employment and value added. Lack of data is an obstacle to making a good assessment of the state of development of MPC services activities.
- **Second**, when it comes to enabling services, growth in such highly skilled labour-intensive and increasing-returns activities is a precondition for a sustainable economic development as they provide an incentive to agglomerate, not only for other services firms but also for manufacturing industries. Indicators of services

concentration show that, despite increased economic integration, the MPC have not yet caught up with the EU15 or with the NMS. Consequently, the EU should support MPC efforts to strengthen their services sector, in particular in enabling services. The southern Mediterranean partners should remain a priority in the Neighbourhood European Policy (NEP).

- **Third**, insofar as key enabling services develop by waves, some southern Mediterranean countries may lag behind others. The EC should carefully seek to avoid such increases in inequalities within the MPC.