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Prospects for Future Euro-Mediterranean Trade

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Introduction

Recent policies guiding economic and trade relations between the European Union (EU) and countries of the Mediterranean were aimed at creating an area of shared prosperity. The process started in the late 1970's with the establishment of Cooperation Agreements between the EU and many countries of the Mediterranean region. The goal was to create a free trade area. This initiative gained speed in the mid-1990's with the launch of the Barcelona Process (1995) which eventually upgraded most of these Cooperation Agreements into Association Agreements (AA). These AAs sought the gradual elimination of tariffs on a substantial share of trade between its signatories. At the same time, the EU supported the signing of bilateral agreements between countries of the Mediterranean in order to enhance South-South integration.

Now, more than ten years after the first AA came into effect, it might be interesting to evaluate how these agreements have influenced regional trade and to suggest policies and approaches that would assist these AAs to move from the "shallow integration" process (based simply on tariff reductions) towards "deep integration", which will benefit from greater coordination and harmonization of economic policies and trade standards. *

Reducing Tariff Levels

Tariff levels have fallen as a result of the Free Trade Agreements (FTAs). Tariffs indicate levels of protection, and hence, distortions within an economy. They also represent the potential scope of new trade flows expected to result from their dismantlement. These new trade flows can result in trade diversion or trade creation. Trade diversion reduces welfare as it attracts imports from a high cost producer that due to lower tariffs, becomes competitive in the destination market. Trade creation is welfare enhancing as it promotes trade from a less costly supplier. Which of these effects will predominate can only be determined by looking at cost structures across different origins and trade with preferential and non-preferential partners. Analysis shows that between 1995 and 2008 Most Favoured Nation (MFN) tariffs dropped at varying rates across countries. In Albania, Lebanon and Tunisia they dropped by half while in countries that already had low tariffs (e.g. Israel and Turkey) they fell very little. In Algeria, Egypt, Mauritania, Morocco and Tunisia the MFN tariffs were high in 1995 and fell only by about one third. As such they are still rather high. Therefore, for these countries the future effects of preferential liberalisation will be substantial.

Preferences and utilization

Tariff preferences are only useful if they can be applied. In most Mediterranean countries with AAs, about 80% or more of exports came in duty free. For Jordan this was only 70%. Yet up to 10% of exports (18% for Jordan) paid import duties in the EU despite the fact that preferential tariffs were zero. This may be due to the fact that tariffs are very low and the preference exceeds the cost of obtaining the certificates of origin (or having these certificates accepted at the point of importation).

Trends in regional growth

Contrary to previous expectations for the FTA, the growth of MED exports to and imports from the EU in the early 2000s was slower than from other regions.

- Annual export growth from the Mediterranean countries to the EU between 1996 and 2006 was 10.8% lower than the 16.5% growth of exports to the rest of the world. A partial explanation for this includes (i) in 1995 industrial exports from the MED region to the EU were already substantially free of tariffs under the earlier Co-operation Agreements (ii) preferences into the EU market for MED countries have remained largely unchanged in the last decade and were already relatively generous (iii) the period under investigation was one of rapid liberalisation for the rest of the world and (iv) during this period the EU granted preferential access to its market to non-MED countries as well.

*This E-Brief is based on a much larger report – Luc de Wulf, Maryla Maliszewska et al. "Economic Integration in the Euro-Mediterranean Region" published in CASE Network Report series No.89/2009

Table 1: Evolution of Weighted Average MFN Tariff by Country

Country	'95	'96	'97	'98	'99	'00	'01	'02	'03	'04	'05	'06	'07	'08
Albania			14.4				11.2	8.35			7.36		5.86	
Algeria			16.9	17.2			15.1	12.9	11.9		11.66	11.9	11.6	
Egypt	16.6			13.7				13.7		13.0	13.7			8.86
EU	4.38	4.35	3.78	3.43	2.94	3.15	3.27	3.24	2.89	2.74	2.72	2.59	2.56	
Israel										2.71	2.6	2.64	2.52	2.61
Jordan						18.9	12.1	12.6	11.3		12.02	9.34	9.22	
Lebanon					11.5	16.9	8.23	6.26		5.33	5.55	5.54	5.59	
Libya		21.2						25.1						
Mauritani							9.92					7.15	10.0	
Morocco			17.3			25.4	24.6	24.4	24.8		19.86	18.2	17.9	
Syria								15.5						
Tunisia	27.3			25.6				26.3	22.	22.4	19.65	19.		
Turkey	6.74		5.6		5.35				4.3		3.84	3.9	4.38	

Source: Own calculations based on Trains (coverage varies due to data availability).

- European imports into the Mediterranean countries rose by an annual rate of 7% versus 13% for imports from the rest of the world. Overall, the degree of tariff dismantling in terms of the amount of trade that has been liberalized was fairly heterogeneous across countries. For Israel 95% of the tariff lines applied to EU imports have zero tariffs (8 years after the agreement came into force). In Morocco only 51% of tariff lines were completely duty free for the EU (8 years after the agreement came into force).

Potential for trade expansion

A review of previous trade gravity models indicates that current MED5 (Egypt, Morocco, Tunisia, Jordan, Israel) exports to the EU are close to their potential levels. They suggest that deeper integration, one that involves reduction of non-tariff barriers and greater harmonization of trade related standards and procedures, could lead to significant export growth from the Mediterranean region to the EU. Some estimates even indicate that exports to the EU and imports from the EU could triple or quadruple if Euro-Med countries reach levels of integration typical for the EU15. A re-estimation of the gravity model suggests that the FTA between the EU and the Mediterranean countries has contributed to higher levels of trade only in the cases of Egypt and Tunisia. There is no evidence of substantial increases in EU trade with Morocco, Jordan and Israel but evidence suggests a fall in EU trade in the case of Lebanon and Algeria. These two countries signed their AA only recently and it may be too early to detect any substantial impact on trade flows. Also, in the case of all MED countries, but particularly in the case of Tunisia, the FTAs have led to the expansion of exports to and imports from non-member countries.

When it comes to inter-regional trade, MED countries trade very little with one another. Therefore, the potential for growing South-South trade is not great. Only 6.9% of Mediterranean country exports under consideration were absorbed by other Mediterranean countries, while only 5.8% of their imports originated in that region. This was despite the fact that trade during the period did benefit from arrangements of the 1998 Pan Arab Free Trade Area (PAFTA) which liberalised nearly all tariff lines amongst its signatories. Even though trade between the MED economies is very low, it is exhibiting positive growth.

Prospects for trade expansion following further trade liberalization.

Prospects for Mediterranean trade expansion can be investigated using two approaches. First, trade analysis has shown that countries with similar trade structures have a greater scope for trade expansion. Another way of estimating the potential for trade creation is to compare exporting structures across countries, as a proxy for comparing production structures for which data is difficult to obtain. Similarities in export structures would suggest potential for intra-industry trade. This line of research is driven by global experience suggesting that the gains from specialising at the intra-industry level are likely to outweigh the gains from specialising at the inter-industry level. Analysis found that the MED partners' exporting structures, while still highly dissimilar, are becoming increasingly uniform. This is a necessary if not sufficient condition for the emergence of niche specialisation or Intra- Industry Trade (IIT).

Second, despite the AAs, the Mediterranean region does not yet attract the kind of EU investment flows that other European neighbours have been able to attract. Foreign Direct Investment (FDI) is still very much resource-based and market-seeking. As shown in the World Bank scores for business climate, many MED countries (with the exception of Tunisia, Turkey and Israel) score rather low suggesting great possibilities for improvement. This would certainly enhance the region's attractiveness for FDI.

Policy recommendations

There are a number of measures that could strengthen the process of trade integration between the EU and the Mediterranean,

Measures required for deep integration related to market access include:

- FTAs should have broader coverage to include agriculture, processed agricultural and fisheries products, as well as services;
- The FTA should roll out a smoothly functioning Pan-Euro-Med system of rules of origin that follow the principles of diagonal cumulation,
- Countries should harmonize technical, sanitary and phyto-sanitary standards and institute the necessary procedures to ensure that these standards are met by exporters and that standard certifications are accepted by the importing country.

Measures highly recommended to improve the business environment and promote deep integration include:

- Strengthen the trade and investment facilitation mechanism (TFM) so that it goes beyond providing market access information, early warning, and complaint register and discussion forums. This would imply that it be tasked with promoting awareness of the advantages of the Association Agreements to the business community, monitor progress with the implementation of the FTA Agreements and the technical and financial assistance promised by the EU and its use in the Mediterranean Partner countries;
- Systematically review the customs and trade procedures with a view of remedying identified detected shortcomings. Elements that appear to deserve special attention include the consistent implementation of the WTO valuation agreement, improved post-clearance audits and support for the protection of intellectual property rights;
- Implement and support measures to improve competition policy, enhance transparency and competition in government procurement and strengthen the capacity of the MED countries to monitor violations of intellectual property rights and react appropriately;
- Identify the principal obstacles to investment and support an action plan to remedy any shortcomings;
- Creation of "One Stop Shops" where investors can obtain relevant information that will guide their decision to invest or trade with the country.

While highly desirable and contributing to deep integration these measures should aim at better coordination, harmonization and emulation of EU best practices, but not necessarily at full implementation of the *acquis communautaire.*

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