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STRENGTHENING TRANSATLANTIC COOPERATION

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Summary: The Mediterranean region has coped well with the international economic crisis, and it is now coming out of it with a satisfactory growth rate. Renewed growth in Mediterranean countries will promote greater regional integration, both with European countries and within the southern Mediterranean. This integration will be driven more by the interests of economic actors than by economic agreements. Nevertheless, trade agreements will play an anchoring role in economic reform and stimulate the liberalization of some sectors, especially services, where vested interests are particularly strong. The deepening of trade agreements with the European Union – however slow - will have an important role in both North-South and South-South economic integration.

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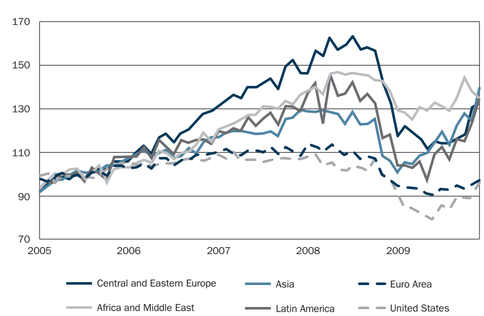
Beyond Free Trade: Mediterranean economic integration after the crisis

by Franco Zallio[1]

International trade has been the international economic crisis' main victim. While world GDP fell by 0.6 percent (and that of developed countries fell by 3.2 percent) in 2009, international trade has slumped (-12 percent in volume terms, and -23 percent in current U.S. dollar terms as estimated by the WTO [2]), recording the worst performance since the end of the Second World War. Since late 2009, a substantial recovery of trade flows has been taking place, but it is insufficient to catch up with pre-crisis levels. Furthermore, the geographical direction of trade flows is changing significantly; as Graph 1 shows, in 2009 emerging markets recorded a lower decline in comparison to that of the rest of the world, and are now exhibiting a more rapid recovery.

Graph 1: International Trade Volume (2005 = 100)



Source: Netherlands Bureau for Economic Policy Analysis, *World Trade Monitor*, February 2010; Deutsche Bank Research.

As noted earlier, the Mediterranean region has coped well with the international economic crisis, emerging from it with satisfactory growth rates. In the World Economic Outlook of April 2010, the International Monetary Fund (IMF) has improved the 2010 growth forecasts for almost all countries in the region, with Lebanon and Turkey showing particularly significant improvement, jumping from 4 to 6 percent and from 3.7 to 5.2 percent, respectively.[3] Furthermore, the IMF expects several countries of the region to have a growth acceleration in 2011: Egypt, Jordan, Israel, Libya, Morocco, Syria, and Tunisia. Due to this positive economic performance and supported by expansionary policies and oil prices' recovery, foreign trade in Mediterranean countries (and, more generally, in Africa and the Middle East as reported in Graph 1) is progressing rather satisfactorily.

Free Trade Agreements in the Mediterranean

Developed and emerging countries are showing an increased interest in the Mediterranean. Of the emerging regions, the most interesting signals come from Mercosur: the free trade agreement the four Latin-American

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[2] WTO, Trade to expand by 9.5 percent in 2010 after a dismal 2009, WTO reports, PRESS/598, 26 March 2010.
[3] Forecasts for 2010 for other Mediterranean countries are as follows: Algeria 4.6 percent, Egypt 5.0 percent, Jordan 4.1 percent, Israel 3.2 percent, Libya 5.2 percent, Morocco 3.2 percent, Syria 5.0 percent, Tunisia 4.0 percent..

member states (Argentina, Brazil, Paraguay, and Uruguay) signed with Israel in 2007 has just entered into force. Negotiations launched in 2008 for a similar agreement with Egypt are about to conclude and could be followed by negotiations with other Arab countries.

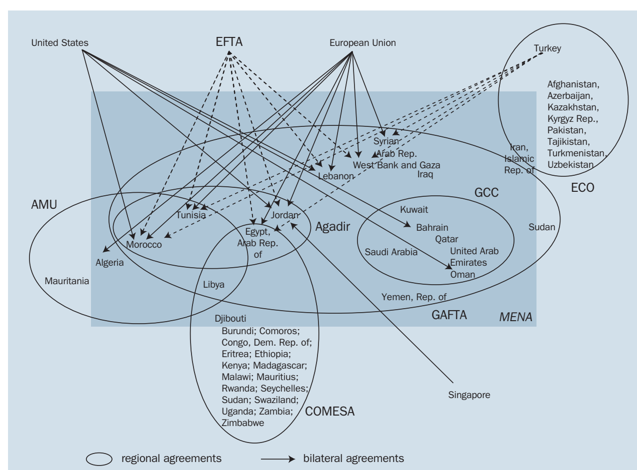
Trade between Mediterranean countries and other emerging regions (particularly Asia) will continue to growing rapidly in coming years. However, the European Union and the United States will still represent the largest share of Mediterranean foreign trade. Together, the two account for about two-thirds of Mediterranean exports and a little less than half of imports. Thus, the evolution of trade policies in Europe and the United States is bound to exert a considerable influence on Mediterranean countries for many years to come.

The nature of this evolution, is uncertain. Contrary to widespread fears, the international economic crisis has not brought back protectionism. It has, however, strengthened globalization's critics and brought trade imbalances to the forefront, making advanced countries less willing to grant trade concessions. Furthermore, the Greek financial crisis is distracting European countries from focusing on trade negotiations. Meanwhile, a heated debate on trade policy is taking place in the United States—while the promotion of U.S. exports is expected to play an important role in economic recovery and the re-equilibrium of balance of payments, how to promote these exports remains a much-debated issue given the multitude of interests that revolve around the matter. Currently, the debate largely concerns the future of three un-ratified free trade agreements concluded by the Bush Administration with Colombia, South Korea, and Panama the possible renewal of the Trade Promotion Authority, and the signing of new bilateral investment agreements and their connection with trade agreements.

Given the complexity and slowness of the WTO's multilateral negotiations (the Doha Development Round, launched in November 2001, has yet to be concluded), bilateral and regional preferential agreements have become the main tool of trade diplomacy. This explains the proliferation of free trade agreements and the expansion of their contents, from tariff dismantling to non-tariff barriers, services, investment, intellectual property, etc. In February 2010, the WTO was notified on 462 preferential trade agreements, of which 271 were in force.

As Figure 1 shows, Mediterranean countries followed this larger trend, concluding a significant number of trade agreements.[4] A number of those agreements are South-South for they are either, among Mediterranean countries or with other emerging countries. A recent study conducted on regional economic integration[5] has highlighted the limited increase in trade exchanges that can be expected from agreements among Mediterranean countries, such as Agadir or GAFTA. Rather, their main potential is indirect: they allow the cumulation of origin for products to be exported to the EU that use inputs originating from various Mediterranean countries. We will return to this important issue.

Figure 1: MENA preferential trade agreements



Agadir = Agadir Agreement for the Establishment of a Free Trade Zone between the Arabic Mediterranean Nations; **AMU** = Arab Maghreb Union; **COMESA** = Common Market for Eastern and Southern Africa; **ECO** = Economic Cooperation Organization; **GAFTA** = Greater Arab Free Trade Agreement; **GCC** = Gulf Cooperation Council.

Source: World Bank, *MENA Region 2008 Economic Developments and Prospects: Regional Integration for Global Competitiveness*, 2009.

Prospects for the Euro-Mediterranean free trade area

The 1995 Barcelona Conference set 2010 as the target date for the establishment of the Euro-Mediterranean free trade area, but delays accumulated in the course of the following 15 years. Currently, only Tunisia has fully entered the free trade agreement (FTA), limited to industrial products, into force,

[4] Figure 1 refers to North Africa and the Middle East according to the definition of international financial bodies, which excludes Israel and Turkey. Turkey thus appears in Figure 1 as an external partner, while Israel is missing. It should be noted that even Israel has made extensive use of preferential trade agreements— it signed agreements with the United States, the European Union, EFTA, Turkey, Canada, Mexico, and Mercosur.

[5] CASE-CEPS, Economic Integration in the Euro-Mediterranean Region. Final Report, September 2009, http://trade.ec.europa.eu/doclib/docs/2009/october/tradoc_145214.pdf.

while Morocco, Israel, and Jordan are at advanced stages of implementation. Tariff dismantling in Algeria, Egypt, and Lebanon is still at an early phase. In Syria, tariff dismantlement on European industrial products has yet to start; the FTA, initialled in 2004 and again in a revised version in 2008, has not been signed.

Not only has progress been slow, but the impact on trade flows has been modest as well. The above-mentioned CASE-CEPS study on regional economic integration highlights the fact that trade between the EU and Mediterranean countries is already close to its potential level. The trade effects of FTAs are, therefore, limited. Egypt and Tunisia have seen significant improvements in trade with the EU while in some countries the EU share of total trade has declined.

FTAs' achievements should not be measured purely in trade terms but also, perhaps mainly, in terms of improvement in the overall economic climate of Mediterranean countries, including factors such as the acceleration of economic reforms, liberalization, attractiveness for foreign investors and industrial restructuring. From this point of view, free trade agreements have had a clear positive impact that could be strengthened in the coming years through a progressive deepening of agreements, which are slowly moving from simple free trade for industrial goods to the so-called "deep integration" that entails a normative and regulatory convergence in priority areas (competition, investment, standards, public procurement, intellectual property, etc.). In the case of deep integration, trade effects would be very high; according to the aforementioned study, in the unlikely case of an integration between the EU and Mediterranean countries as deep as the current one between the EU-15, trade could multiply by three or four times.

In recent years, the deepening of existing free trade agreements between the EU and Mediterranean countries has been promoted through ad hoc bilateral negotiations. Negotiations with Egypt, Israel, and Morocco were closed, leading to greater liberalization of agricultural products, food, and fisheries. Negotiations have since been launched for services liberalization and the right of establishment with Egypt, Israel, Morocco, and Tunisia; negotiations with Jordan will soon be launched as well. In 2009, Israel signed an agreement related to conformity assessment of industrial products, a protocol to resolve trade disputes was signed with Tunisia and initialled with Jordan, Lebanon, and Morocco; negotiations are in process with Egypt, Israel, and the Palestinian Authority. Finally, last December, trade ministers from the Union for the Mediterranean (UfM) committed to "the launch beyond 2010 of bilateral negotiations on a package of non tariff and regulatory issues," whose timing and scope "will take into consideration the specific situation of each Southern Mediterranean partner."

This process of "progressively turning the existing Euro-Mediterranean Association Agreements into deep and comprehensive Free Trade Agreements"—as defined in the conclusions of the Trade Ministerial Conference—will advance slowly, hampered by the reluctance of many Mediterranean countries, by European uncertainties, and by the political difficulties facing the UfM[6]. Yet, Euro-Mediterranean economic integration is likely to proceed, for it is supported by growing economic interests that will connect the two shores of the Mediterranean.

Geographical proximity to and economic growth in Mediterranean countries play an even greater role than trade agreements in promoting integration, and Mediterranean countries are becoming more important for European firms striving to emerge from the international economic crisis. Energy and transport cost containment, the search for cheap labor, growing internal demand in Mediterranean countries, ambitious public investment schemes in the oil-producing countries of the region, and the deepening of economic reforms (now well established even in Syria, the most reluctant of countries) are key factors that will promote integration and that favor progressive liberalization of services and normative approximation with the EU. This will reduce transaction costs in the region, an essential step to avoid wasting the above-mentioned potentials.

The U.S. Role

For the United States., economic relations with Mediterranean countries are, and will remain, much less significant than they

[6] Next UfM summit, scheduled for June 7, has been postponed to November 2010 due to growing tensions in the Near East

are for the European Union. Arguably, free trade agreements between the United States and the Mediterranean countries of Israel, Jordan, and Morocco have had more political than economic significance. The agreement with Israel, dating back to 1985, was the United States' first free trade agreement. Above all, it was a way to support an ally suffering from a severe financial crisis (in 1984, Israeli inflation exceeded 400 percent and public debt reached 266 percent of the GDP) and helped the nation reorient its outdated productive structure. The agreement, coupled with drastic reforms to the Israeli economy, led to favorable results: Israeli exports to the United States equalled $2.1 billion in 1985, less money than the aid provided by the United States ($3.4 billion), while Israel has exported $18.7 billion to the American market in 2009[7], seven times the value of the U.S. aid received, which has decreased even in nominal terms ($2.6 billion).

Other agreements, such as one with Jordan that entered into force in 2004 and one with Morocco in 2006, reflected political motives similar to the agreements signed with two Gulf countries, Bahrain and Oman. They are all part of an initiative launched in 2003 by the Bush administration to reward the friendly countries in the region by providing easier access to the American market through the creation of a U.S.-Middle East Free Trade Area. The initiative appears to be at a standstill after negotiations with the United Arab Emirates were suspended in 2006, while the strictly trade-related interest of the agreements remains limited. In fact, U.S. exports to Jordan and Morocco have totaled just $1.2 and $1.6 billion in 2009, respectively. Additional benefits stemming from the non-trade-related clauses of the agreement remain quite limited; for example, the Moroccan agreement grants national treatment for public procurement rights to U.S. firms that are not enjoyed by European counterparts.

The agreement with Israel is thus the only one that carries some economic relevance for it has facilitated cooperation with peace partners. The free trade agreement has, in fact, been partially extended to Egypt and Jordan by granting preferential treatments to joint industrial activities with Israel in 2004 and 1998, respectively. These are carried out in the so-called "Qualifying Industrial Zones" (QIZ), where production has duty-free access to the American market as long as it complies with rules of origin, requiring, inter alia, that a given quota of the final product has an Israeli origin. While QIZ have had considerable success in significantly increasing Egyptian and Jordanian exports to the United States, they are limited in sector terms as they mainly cover textiles.

Recently some proposals suggesting some revisions were put forward in the U.S. in an attempt to bring its contents in line with most recent agreements and to make the most effective use of some of its aspects (expanding, for example, the range of products allowed in the QIZ, and eventually launching a similar program in Turkey, focusing on textiles or food and beverages).[8] The 1985 agreement is, in fact, so limited in scope that the official document is just 20 pages long, compared to the U.S.-Singapore FTA's 642 pages. In particular, the agreement with Israel does not include services, investment, or intellectual property, and it contains very simplified rules of origin. On the other hand, some Israeli voices[9] have expressed doubts about the suggested revision, fearing a hardening of terms (especially on the highly controversial issue of intellectual property) and a complication of the rules of origin, whose simplicity has facilitated the partial extension of the agreement to Egypt and Jordan.

Given their modest economic relevance to the United States., Mediterranean countries are bound to play a very limited role in the complex decision process of U.S. trade policies. Developments in bilateral political relations will be the decisive factor in modernizing the agreement with Israel and deciding whether to launch trade talks with Turkey, another important U.S. trade partner in the region.

South-South integration

Trade relations between the European Union and Mediterranean countries will therefore exert major influence on economic integration in the Mediterranean region and between Mediterranean countries themselves. While the direct potential of South-South free trade agreements is rather modest, their indirect effects should not be forgotten for they are potentially significant thanks to the cumulation of origin foreseen by Euro-Mediterranean free trade agreements. The so-called "diagonal cumulation" of origin allows local inputs

[7] Figures for 2008, preceding the international economic crisis, are even better: $22.3 billion; in the same year U.S. exports to Israel were equal to $14.5 billion, before declining in 2009 to $ 9.6 billion; source: U.S. Census Bureau.

[8] Edward Gresser, Update the Israel Free Trade Agreement, Democratic Leadership Council, April 2010, http://www.dlc.org/documents/IsraelFTA.pdf.

[9] Arie Reich, "Is it Time to Update the 1985 US-Israel Free Trade Agreement, in View of EU Neighborhood Policy?", Begin-Sadat Center for Strategic Studies Perspectives Papers on Current Affairs, no. 84, June 29, 2009, http://www.besacenter.org/docs/perspectives84.pdf.

from different countries within the Euro-Mediterranean free trade area to benefit from duty-free access to European markets, thus promoting industrial integration between Mediterranean countries. As noted in the first issue of this series of briefs, Turkey—thanks to the low cost and high quality of its products—could become an important supplier of inputs and intermediate goods to Mediterranean countries producing industrial goods for duty-free export to the EU. The large number of free trade agreements signed by Turkey (see Figure 1, to which the free trade agreement signed by Turkey and Jordan in December 2009 should be added), will be valuable, especially given the imminent adoption of a single regional convention on rules of origin, which will replace the protocols annexed to various free trade agreements in the current Pan-Euro-Mediterranean area (EU, EFTA, Turkey, Mediterranean countries). This will also allow for the extension of the diagonal cumulation to the Balkans and thus significantly benefit Turkey, which has ongoing free trade agreements with Albania, Bosnia-Herzegovina, Croatia, FYROM, and Montenegro.[10]

Conclusions

Economic growth in Mediterranean countries will promote greater regional integration, both with European countries and within the Mediterranean region. This integration will be driven more by the interests of economic agents than by trade agreements. Nevertheless, the latter will play an anchoring role for economic reforms and stimulate the liberalization of some sectors (especially services) where vested interests are particularly strong. The deepening of trade agreements with the European Union—however slow—will have an important role in both North-South and South-South economic integration.

[10] With the exception of FYROM, the mentioned Balkan countries are part of the UfM.

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