CUSTOMS AGREEMENTS BETWEEN THE EUROPEAN UNION AND THE MEDITERRANEAN PARTNER COUNTRIES. A PROVISIONAL INQUIRY INTO THEIR IMPACT ON TRADE FLOWS AND GDP GROWTH

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1. Introduction

This paper focuses on the economic situation in 9 Mediterranean Partner Countries (MPCs), and assesses the impact of the Euro-Mediterranean Association Agreements (EMAAs). The starting point is the description of the development of the relationship between the European Union (EU) and the Southern Mediterranean countries and mainly of the Association Agreements resulted from the Barcelona Process, paying attention to the Free Trade Area (FTA) to be implemented by 2010 and taking into account the main features of the FTA.

In the second part of the paper I consider the evolution of trade flows between the EU and its MPCs and the changes occurred after the introduction of tariffs' reduction. Hence, the study examines each of the 9 Mediterranean countries allowing for the impact of tariff cutback on trade with the EU.

Finally, the paper centres upon the economic effects of the agreements for the MPCs, arguing that the Euro-Mediterranean trade accords are not sufficient to foster the MPCs economic performances.

The conclusion is that the freeing up of trade flows needs to be accompanied by economic and institutional reforms, able to abolish the fiscal dependency on tariffs and to introduce structural transformation. The Mediterranean countries need, also, to eliminate trade barriers between each other, because only a large regional market can attract foreign direct investment (FDI), which is necessary to produce the required reform.

2. The relationship between the EU and the Southern Mediterranean countries

The EU has a special relationship with some countries in the Southern Mediterranean area. These countries are the 3 Maghreb partners, Morocco, Algeria and Tunisia; the 5 Mashreq partners, Egypt, Israel, Jordan, Lebanon and Syria; and Turkey. Since the 1970s, the EU has, in fact, been linked with most countries of the Mediterranean region by Cooperation or Association Agreements, which provide for preferential trade and incorporate financial protocols.

However, these first agreements did not accomplish the hope of increasing the economic and civil development of the Mediterranean countries, and, on the contrary, the economic conditions of such countries got worse.

In 1992 a second phase of agreements was launched. The aim of the new course was the strengthening of the existing agreements and the elaboration of a new strategy which wanted to implement development projects and economic cooperation activities in the Mediterranean countries. This purpose was accomplished through the use of new programmes like Med-Campus, Med-Invest, Med-Urbs, Med-Media, Med-Techno and Med-Migrations. Also these new programmes were in view of the desired aims, because they collided with the interest of the EU in the protection of its own agricultural produce.

The Barcelona Process, started in 1995, rules the current relations between the EU and the Mediterranean countries. The aim of the Barcelona Process is to achieve the ambitious initiative for the foundation of a new regional relationship. The Mediterranean Partnership is based on two fundamental documents: a Declaration of Principles and a Work Programme. In the Barcelona Declaration, the three main targets of the partnership are:

- to develop the political and security dialogue in order to set up a common area of peace and stability;
- the implement gradually a free trade area, building a zone of shared prosperity through an economic and financial partnership;
- to develop a social, cultural and human partnership, promoting the connections between different cultures and exchanges between civil societies.

Two are the scopes of the Euro-Mediterranean Partnership: the bilateral one that focuses on the Euro-Mediterranean Association Agreements negotiated by the Union with each Mediterranean partners and the regional one, which represents a very innovative aspect of the partnership and includes political, economic and cultural sides.

The most important aim of the Barcelona Process is the establishment of a Euro-Mediterranean Free Trade Area by 2010, through the signing of bilateral agreements between the EU and the 9 Mediterranean partners (Tab. 1).

Tab. 1 – Association Agreements between the EU and the Mediterranean countries

COUNTRY	TITLE OF THE AGREEMENT	STATUS
Algeria COM (2002) 157 final	Euro-Mediterranean Association Agreement	Signed on 22.04.02 *In process of ratification*
Egypt COM (2001) 184 final	Euro-Mediterranean Association Agreement	Signed on 25.06.01 *In force since 01.06.04*
Israel OJ L 147	Euro-Mediterranean Association Agreement	Signed on 20.11.95 *In force since 01.06.00*
Jordan OJ L 129/02	Euro-Mediterranean Association Agreement	Signed on 24.11.97 *In force since 01.05.02*
Lebanon COM (2002) 170 final	Euro-Mediterranean Association Agreement Interim Agreement for Early implementation of trade measures	Signed on 17.06.02 *In process of ratification* *In force since 01.03.03*
Morocco OJ L 70/00	Euro-Mediterranean Association Agreement	Signed on 26.02.96 *In force since 01.03.00*
Syria (*Final text will be soon published on the web*)	Euro-Mediterranean Association Agreement	Negotiations concluded. Initialled 19.10.04 *Council to decide on signature*
Tunisia OJ L 97/98	Euro-Mediterranean Association Agreement	Signed on 17.07.95 *Entry into force 01.03.98*
Turkey OJ L 35/96	Agreement establishing the definitive phase of the customs union	Signed on 06.03.95 *In force since 31.12.95*

Source: European Union (2005).

3. The content of the Barcelona Process agreements

In this Section we shall examine the provisions of the Barcelona agreements with regard to the establishment of a free trade area, which is defined in each of the bilateral agreements.

Although the agreements are negotiated bilaterally between the EU and each of the Mediterranean partners, they have a number of common features. Their goals are as follows:

- reciprocal free trade in most manufactured goods;
- a move to preferential and reciprocal access for agricultural products in the longer-term;
- a gradual liberalization of trade in services and capital flows.

The agreements will be implemented over a multi-year period, but whereas the liberalization of trade in industrial goods will follow an established timetable, the freeing of trade in the agricultural sector is not well defined. The timetable of opening up capital flows and trade in services is not fixed as well.

From the late 1970s, in the field of trade, the Mediterranean countries benefited by the elimination of European tariffs on most industrial imports, but the MPCs did not remove their trade barriers. With the establishment of a FTA by 2010, the MPCs are obliged to give tariff and quota free access to industrial products originating in the EU and to allow a partial liberalization of agricultural produce.

Hence, we can note that in the new cooperation agreements, the changes introduced concern the new reciprocity, that obliges the MPCs to grant the same concessions to the EU, that are already granted to themselves. As noted above, the Mediterranean countries already experienced largely tariff free access to the EU market under the EU's Generalized System of Preferences.

Another important development consists in including capital movements and trade in services in the obligations of the agreements. Yet, the most innovative characters of these agreements are to support the intra-Mediterranean integration and to aim at implementing a free trade area also between the Mediterranean countries themselves.

The agreements also establish an aid for MPCs economies and tend to harmonize rules for improving the access to EU markets, in particular for a number of agricultural commodities.

At first, trade liberalization will probably lead to a welfare loss for MPCs because of the removal of tariffs revenue but, on the other hand, the MPCs will get a gain owing to the reduction of their import prices.

Free trade agreements with MPCs need, at the same time, to honour the 1994 GATT[1] rule which requires "*the duties and other restrictive regulations of commerce are eliminated on substantially all the trade*" and to take account of European regulations on CAP and Common Fisheries Policy. This issue has been settled by the EU by considering that a free trade area as such implies only a liberalization of 90% of total bilateral trade flows. Thus, the EU is able to maintain border protection for agricultural commodities and fisheries, granting, at the same time, very low or zero tariffs on most industrial products. In this way the EU reaches 90% of liberalization, by freeing up only the 60% imports of agricultural produce. However, this behaviour allows the MPCs to protect their own sector and to liberalize only 90% of their imports.

Cioffi and Dell'Aquila (2004) in their work argue that trade policies adopted for fruit and vegetables after the Uruguay Round Agreement on Agriculture have not increased EU trade partners' opportunities in the agriculture sector.

We can, therefore, say that the Association Agreements with the Mediterranean countries do not implement a free trade area in the normal sense of the term, because the free trade in agricultural produce, in capital and in services has not been fully implemented. We can only hope that the provisions of a future liberalization will be fulfilled.

4. Trade flows between the EU and its Mediterranean partners

In this Section of the paper we shall focus on the impact of tariffs reductions following the entry into force of the bilateral Association Agreements between the EU and each MPC. Since from Tab. 1 it is clear that a number of these agreements, while signed, has not been yet implemented, we will take into account the different situations.

From Tab. 1 we can observe that all the countries in the region have signed Association Agreements, except for Syria, for which negotiations have been by now simply concluded. However, it has taken 10 years to reach this stage, and many of the country agreements have been signed only recently. As a consequence, progress has been slow in achieving the aims of the Euro-Mediterranean Agreements.

Because of the delay in the entry into force of the agreements, the reforms implementation, as to the tariffs reduction, the rationalization of public finance and the privatization effort has not been as successful as initially hoped. In fact, the growth performance of MPCs has improved but not as

[1]. Article XXIV.

much as it would have been necessary to significantly improve the region's living standard and to reduce unemployment and poverty.

In our study we shall measure the impact of trade flows of Mediterranean countries with the EU, compared with the trade of these same countries with the entire world; the aim is to show the relevance of EU's markets for MPCs economies' performance.

Fig. 1 shows the evolution of MPCs trade flows with the EU and the rest of the world in years 1995-2004.

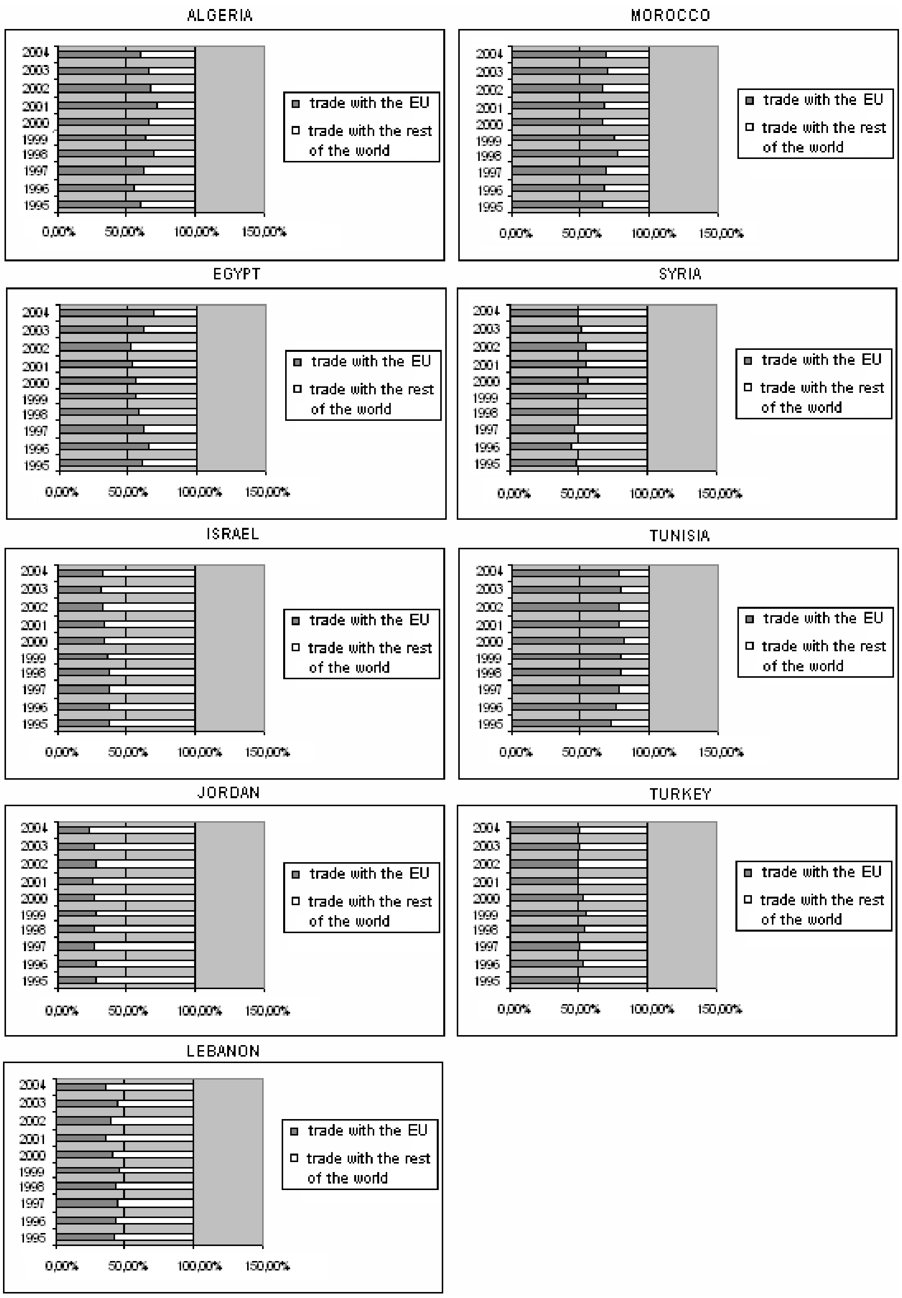
In Fig. 2 and 3 we have compared the trade flows of the Mediterranean area with the two regions, respectively for imports and exports.

Looking at the figures we can appreciate the great importance covered by the EU markets in trade with the Mediterranean countries and *vice versa*. In fact, when the EU was founded in 1957, colonial relations between some countries of the Mediterranean Southern side and a number of European countries were still alive. Since the middle of the 1960s, the EU has been developing a Mediterranean policy essentially based on preferential trade agreements. Thus, the relationship between the EU and the Mediterranean countries has always been characterized by a strong bias towards trade links. Despite limits in their implementation, these agreements shaped, alongside privileged trade relationships, new common interests.

Indeed, Péridy (2005) in his empirical investigation on the Euro-Mediterranean Partnership impact shows that MPCs' trade with the EU has significantly increased in the last decades, thanks to the implementation of several preferential agreements.

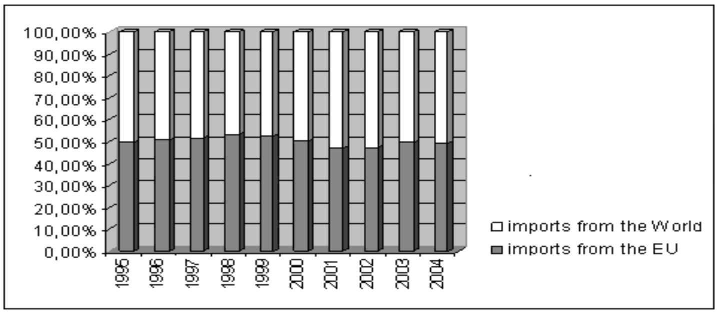
In order to identify which are the Mediterranean countries that are trading the most with the EU, we will use a Trade Intensity Index (TII). This Index unveils the intensity of trade flows between two countries, based on factors such as their global importance in world exports and imports.

Fig. 1 – Evolution of trade flows



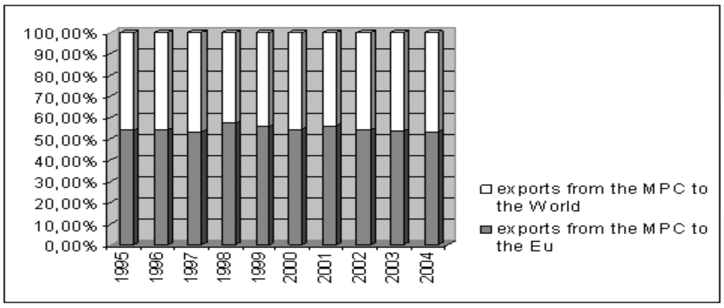
Source: Author’s calculation on Eurostat and WTO database.

Fig. 2 – Comparison between imports of MPCs from EU and from the world (million of ecu/euro)



Source: Author's calculation.

Fig. 3 – Comparison between exports from MPCs to EU and to the world (million of ecu/euro)



Source: Author's calculation.

This Index has been in use since the 1940s[2] in several studies regarding international trade.

The Trade Intensity Index can be separately defined both for exports and for imports. Concerning the former, Export Relative Intensity (XRI) is given by:

[1] $$XRI = (X_{ij}/X_i) / (M_j/W)$$

As to the latter, Import Relative Intensity (IRI) equals to:

[2] $$IRI = (M_{ij}/M_j) / (X_j/W)$$

[2]. Brown (1947); Kojima (1964); Drysdale and Garnaut (1982); Anderson (1983).

In Eq. [1] and [2] X*ij* shows the exports from *i* to *j*, X*i* the total exports of country *i*, M*j* the total imports of country *j*; M*ij* are the imports of country *i* from country *j* and W means total international trade.

If the Trade Intensity Index takes a value of 1, the trade flows of the country are proportional to the weight of such a country in international trade; a higher index reveals, instead, trade flows of a greater extent than justified by the country's involvement in world trade, while an index lesser than 1 means that the country's trade is less than its participation in global trade.

This index has only a limited explanatory value when it is used to assess trade in a single point of time, since it does not include all the elements that influence trade flows. However, if we examine index changes over time we can follow the evolution of trade intensity between two selected countries.

In our study we have computed the Trade Intensity Index in the year in which the Barcelona Process was lunched in order to fix a starting point for considering trade flows between each MPC and the EU; then we have estimated the Index in 2003 for bringing into the light the changes.

Tab. 2 illustrates the trade flows conditions between the EU and the different MPCs. In 1995 the Trade Intensity Index shows that, as regards to exports, Egypt, Tunisia and Morocco were the countries that traded more intensively with the EU; trade links with Jordan, instead, were at a minimum. From this we can infer that only a number of countries took real advantage from the setting up of the EU preferential tariff treatment from the 1970s.

Tab. 2 –Euro-Mediterranean trade intensity (2003)

	Intensity of exports		**Intensity of imports**	
	1995	**2003**	**1995**	**2003**
Algeria	3.50	10.09	3.27	3.41
Egypt	4.70	3.05	3.02	3.27
Israel	1.81	3.54	2.31	1.87
Jordan	0.57	0.55	2.00	1.88
Lebanon	1.66	0.30	2.41	2.74
Morocco	4.32	4.17	3.34	3.37
Syria	3.61	7.20	2.07	2.47
Tunisia	4.53	4.61	3.73	3.90
Turkey	3.16	4.60	2.66	2.42

Source: Author's calculations.

Concerning imports, the picture is quite different: the index clearly reveals a more homogeneous position of the Mediterranean countries with a score that varies from 3.73 of Tunisia (the highest) to 2.00 of Jordan (the smallest).

As regards 2003, Tab. 2 shows that among the MPCs those countries that trade more intensively with the EU are Algeria, Tunisia, Syria and Morocco, but, in general, all of them reveal a privileged trade relationship with the EU. The index clearly unveils that the only countries that have a less intense trade with the EU, on the exports side, are Jordan and Lebanon.

As to imports, data show a substantial stability of trade flows. If for 6 countries the Trade Intensity Index grows up, for the other 3 we can observe a reduction. However, changes in the index are quite limited.

By contrast, from the exports side we note important differences for some countries. Algeria and Syria, in fact, show a strong increase of the index whereas Egypt and Lebanon record a decrease.

We can conclude that the intensity of trade flows between MPCs and the EU changed interestingly over the years. Even if, for some countries, changes were not very significant, for others index increases mean a real deepening of commercial relations with the EU. Therefore, the agreements occurred since the 1970s have represented, for the MPCs, an opportunity to increase their trade relationship with the EU.

5. Impact of tariffs reduction

Before 1995 the unweighted mean of MPCs customs duties was of 29.8 but, as Tab. 3 shows, after 1995 there has been a little reduction. We can also note that the more developed areas have tariffs rates lower than the poorest ones' and that the MPCs average is higher than the mean of the Sub-Saharan Africa.

Tab. – 3 Simple average of tariffs

Tariff protection in different areas	After 1995
MPCs	21.1
European Union	3.5
Latin America and Caribbean	10.7
South Asia	27.7
East Asia and Pacific	11.4
Sub-Saharan Africa	20.0

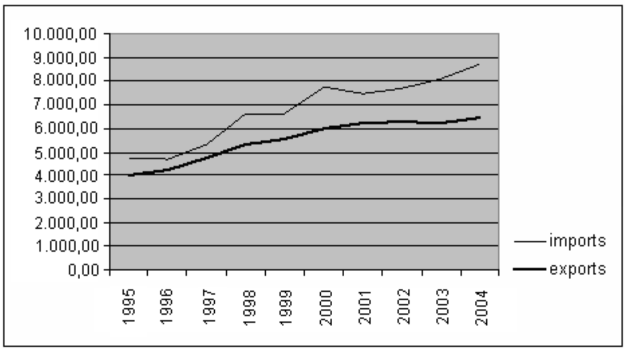
Source: World Development Indicators (2001).

In any case, from 1995 to 2005 tariffs on industrial product have fallen in the MPCs. At the beginning of the Barcelona Process, in 1995, the level of customs duties was not uniform, because there were countries, such as Israel, with an average of 8% and countries, such as Morocco, with a mean of 64%. In addition the highest tariffs were not homogeneous: Turkey had, for example, a highest rate of 38% and Egypt of 160%.

Out of the MPCs 5 economies (Morocco, Tunisia, Egypt, Algeria and Jordan) were characterized by very high rates of customs duties, which have been cut down at different paces. Between the countries with very high rates, we can individuate different situations.

In ten years from 1993 to 2003 Morocco strongly reduced its customs duties. As a result, an increase of imports took place, with a couple of exceptions (see Fig. 4). However, overall Morocco has still very high tariffs rates, with a simple mean of 27.3% and a highest rate of 50%. Hence, this situation can influence future import flows not allowing a constant increase in it.

Fig. 4 – Morocco's trade with the EU (million of ecu/euro)



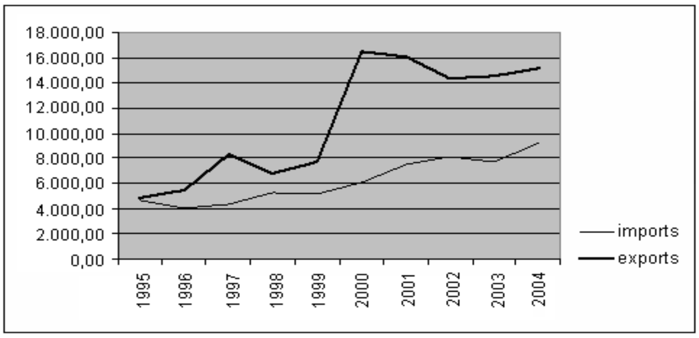
Source: Eurostat (2005).

From the export point of view, we know that Morocco was already characterized by largely tariff free access to the EU market under the EU's Generalized System of Preferences; in Fig. 4 we can observe that the course of exports is quite regular, with a slight upsurge, from 1995 to 2004.

Algeria, Tunisia and Egypt preferred a slower reduction of customs duties: from 1993 to 2003 Algeria and Tunisia cut down their tariffs by 6 points and Egypt decreased them by 8 points.

Concerning Algeria we can observe, in Fig. 5, that in the years from 1995 to 2004 there was an irregular increase of exports. The upsurge of imports, following from the decreasing of tariffs, is, instead, slow but constant over the years. This was probably due to the fact that Algeria still has high customs duties, with a simple average of 18% and a highest rate of 30%.

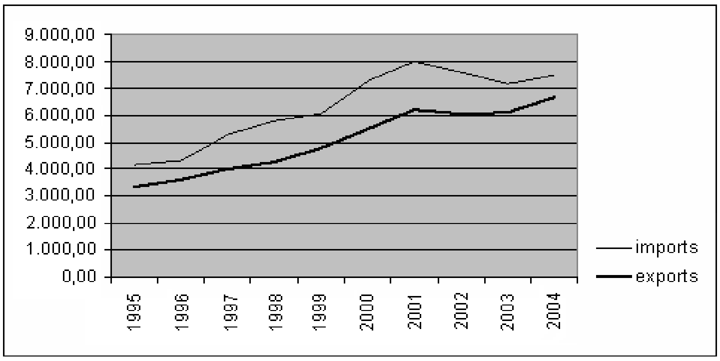
Fig. 5 – Algeria's trade with the EU (million of ecu/euro)



Source: Eurostat (2005).

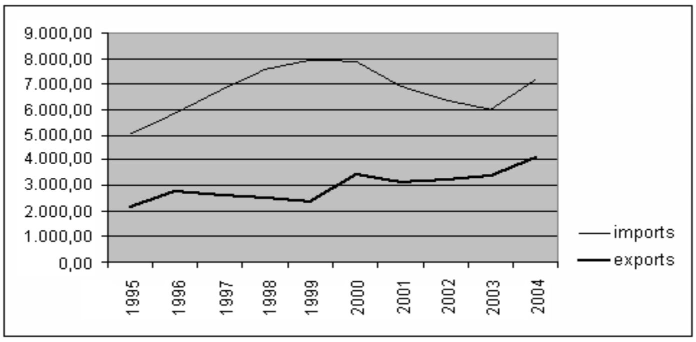
Regarding Tunisia and Egypt (Fig. 6 and 7, respectively) we must stress on irregular increasing of imports. Even though, both countries lowered their duties, their tariffs are still high. For Egypt the simple average is 19.5% and the maximum is 135%; Tunisia records a simple average of 22.4% and a highest rate of 43%. In addition, export development from 1995 to 2004 is uneven.

Fig. 6 – Tunisia's trade with the EU (million of ecu/euro)



Source: Eurostat (2005).

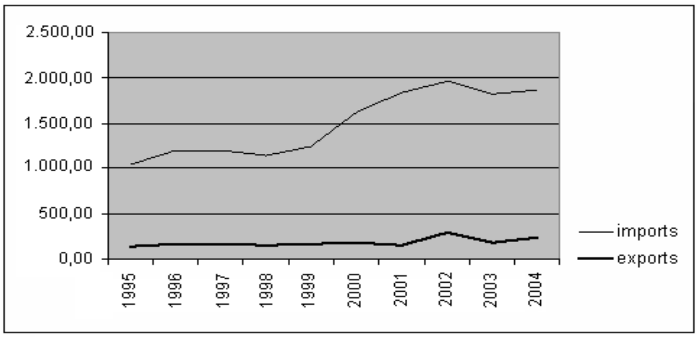
Fig. 7 – Egypt's trade with the EU (million of ecu/euro)



Source: Eurostat (2005).

Jordan, instead, cut down its tariffs by over 9% between 2000 and 2003, and this produced a substantial increase of imports from Europe, with some ups and downs however (Fig. 8). In the aftermath of such developments, Jordan's duties record a simple average of 12% and a highest rate of 30%.

Fig. 8 – Jordan's trade with the EU (million of ecu/euro)



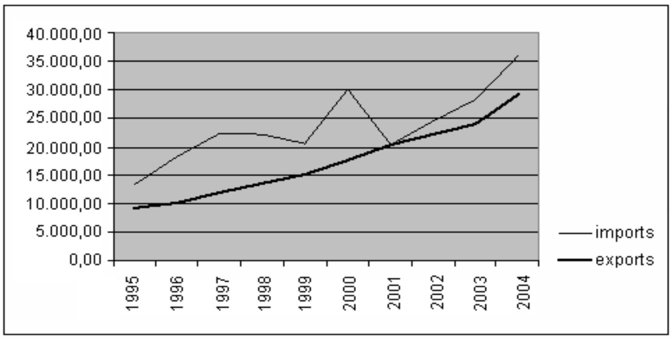
Source: Eurostat (2005).

Turkey, Lebanon and Israel started with low customs duties. Israel had an average of 8% and cut down its tariffs of 4%; Turkey an average of 9.2% and a reduction of 5.2%; Lebanon an average of 9.6% and a cut of 4%. Now these 3 countries have the lowest customs duties of the area, but their highest rate is anyway too high: 100% for Israel, 75% for Lebanon and 83% for Turkey[3].

From Fig. 9 we can observe the regular growth of exports from 1995 to 2004 and, at the same time, the uneven course of imports.

[3]. Note, however, that the position of Turkey is quite different from the other countries' since it signed a custom union agreement with the EU in 1995.

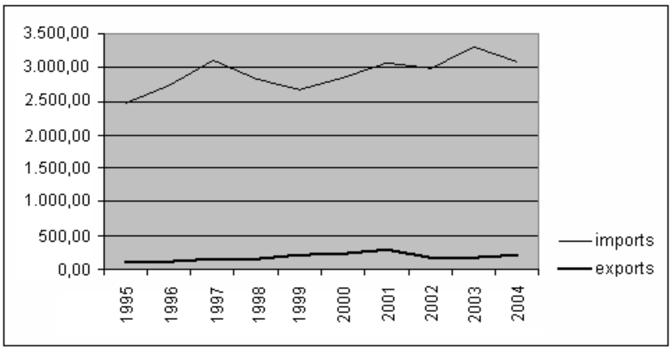
Fig. 9 – Turkey's trade with the EU (million of ecu/euro)



Source: Eurostat (2005).

In Fig. 10, for Lebanon, we can observe the great gap between imports and exports in the period 1995-2004. Both flows show uneven performances.

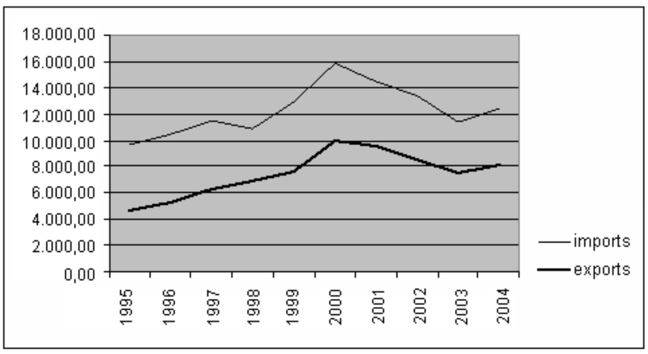
Fig. 10 – Lebanon's trade with the EU (million of ecu/euro)



Source: Eurostat (2005).

From Fig. 11 we note that, for Israel, the reduction of tariffs from 1999 has fostered an increase in imports for a first span of time with a subsequent reduction in the following years. In addition exports develop unevenly.

Fig. 11 – Israel's trade with the EU (million of ecu/euro)

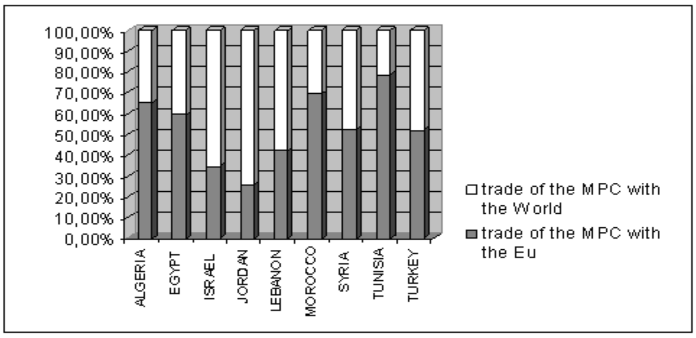


Source: Eurostat (2005).

We can conclude that differences between the MPCs are still very marked, although the dispersion in rates has been reduced. Moreover, Mediterranean countries impose, still today, high customs rates for food and drink, manufacture of tobacco based products (except Lebanon), clothing (except Lebanon), and leather.

Processing the data analyzed above (Fig. 12) we find that among the MPCs, Tunisia stands as the main trading partner of the EU. The last EU's trading partners are Jordan, Lebanon and Israel, probably because their agreements have been in force only for a few years. Algeria is a good trade partner for the EU despite the fact that the Association Agreement has been just signed but not yet ratified. Turkey, in its turn, is only a junior partner of the EU, notwithstanding the establishing of a customs union with the EU.

Fig. 12 – MPCs: trade with the EU and with the rest of the world (1995-2004)



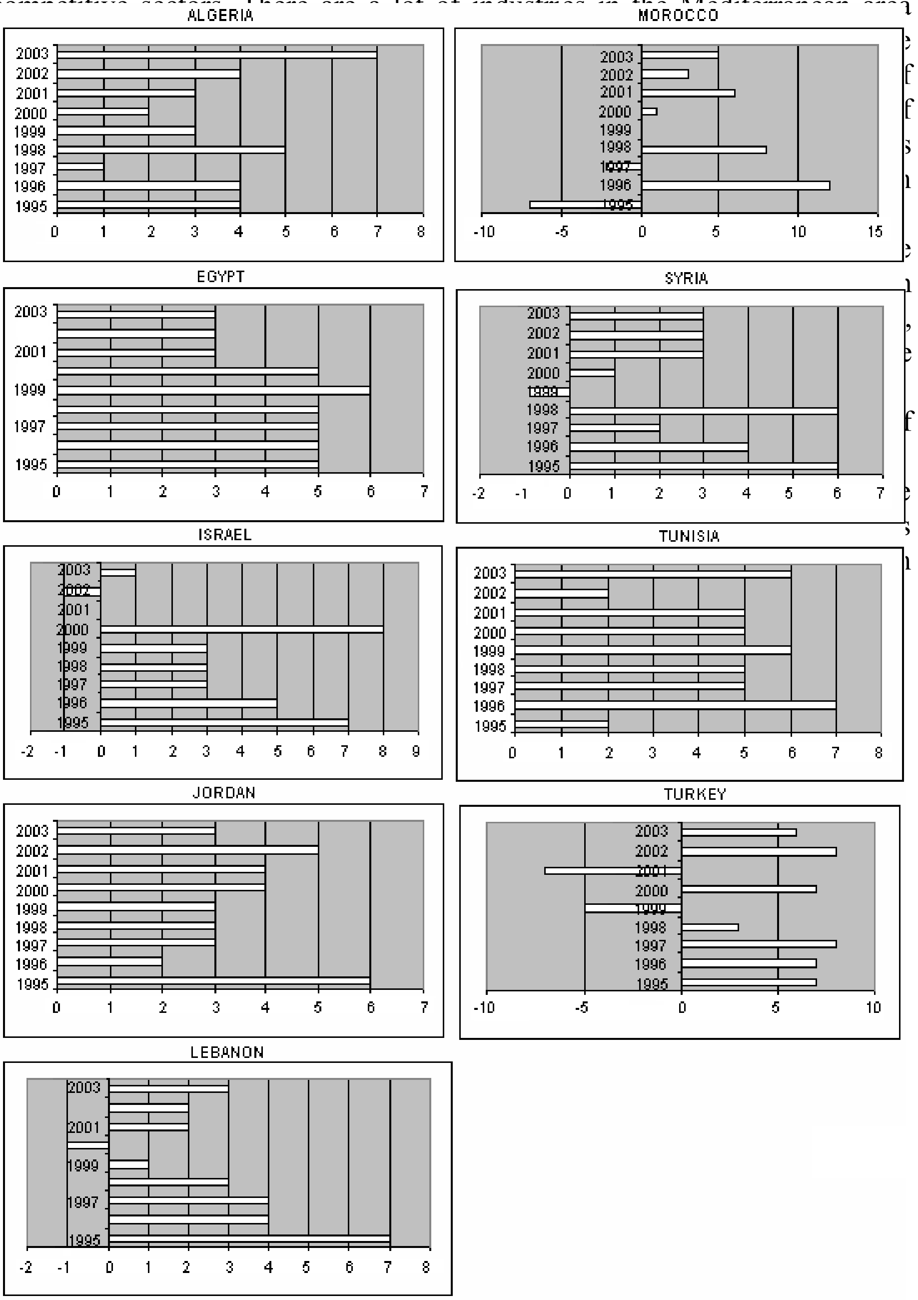
Source: Author's calculations.

6. Impact of trade liberalization on the macroeconomic situation

As already said, the EU decided to set up a Free Trade Area (FTA) for industrial products by 2010 with the MPCs in order to help this region to increase economic development and to improve standards of life. The Mediterranean area is, in fact, characterized by a low regional GDP and by its dependency on trade.

However, the liberalization of trade causes, as a consequence, the loss of import tax and MPCs need to replace this loss of income with other fiscal measures. In MPCs customs duties usually generate from 10% to 30% of the total tax revenue, whereas in industrialized countries the customs duties revenue is approximately 1.2%. Therefore, in order to avoid the increase of fiscal imbalance it could be useful to replace customs duties with other source of revenue, like VAT, personal income and corporate taxes. We know that, in the short run, EU funds can finance the revenue gap, but in the long run it will be necessary to resort to a more stable and sustainable strategy.

The liberalization of trade is frequently linked with some adjustment costs, but the question is how much time it takes to reallocate resources towards competitive sectors. There are a lot of industries in the Mediterranean area



Source: Author's elaboration on World Bank data.
Tab. 4 – GDP growth (annual %)

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Algeria	4	4	1	5	3	2	3	4	7
Egypt	5	5	5	5	6	5	3	3	3
Israel	7	5	3	3	3	8	0	-1	1
Jordan	6	2	3	3	3	4	4	5	3
Lebanon	7	4	4	3	1	-1	2	2	3
Morocco	-7	12	-2	8	0	1	6	3	5
Syria	6	4	2	6	-1	1	3	3	3
Tunisia	2	7	5	5	6	5	5	2	6
Turkey	7	7	8	3	-5	7	-7	8	6

Source: World Bank data (2005).

Algeria, Egypt, Jordan and Tunisia show the better performance notwithstanding the non-uniform coming into force of the different agreements. Surprisingly enough, Turkey, which is linked by a customs agreement with the EU, presents the worst situation with too heavy recessions, by the decade 1990-2000 turning points.

However, in assessing the liberalization impact on the macroeconomic framework it should be added that free trade agreements represent for MPCs only a first step towards a much more integrated and dynamic economy. Trade development represents by sure an incentive to the introduction of reforms aimed at increasing countries' growth achievements. But, civil and structural reforms are also necessary in order to complement the general economic and administrative performance.

7. Concluding remarks

The main aim of the EU in promoting the Association Agreements with the MPCs was to deepen relations with the Mediterranean countries in order to improve wealth and security on both sides of the Mediterranean region. MPCs, in their turn, signed the accords because they represented for them an opportunity to develop their economies and to encourage an overall reform effort.

The prospective gains for the EU in signing agreements can be very strong, deriving from the hope of a substantial growth of traditional European exports.

From the partner countries point of view, the benefits are less obvious. As we have stressed in this paper, in the transitional period it is likely for them to incur in limited gains and even in a loss of welfare.

In any case it is evident that trade liberalization must keep up with the introduction of economic and civil reforms, since FTA is only one of the several elements that can foster development. Among them the need to maintain financial stability has to be highlighted in order to merge civil and administrative reforms with a concrete fiscal control.

In addition, the link between trade protection and the involvement of the governments in the Mediterranean economies must be overcome, removing the financing of inefficient state enterprises, which provokes a distortion of economic incentives.

Achievement of the development goals aimed at by the MPCs through FTAs with the EU depends also on their attitude to attract new and significant investment from the rest of the world in order to finance sectors connected with external trades. It is indeed for that reason, to attract FDI, that MPCs should introduce important reforms regarding the role of the government, the judicial and administrative practices, privatization and the right of establishment.

In conclusion we can stress that the road to development is a long way: even if the MPCs have began a slow reform process, the path for a complete macroeconomic stabilization and trade liberalization is still far from the final goal.

However, we may be confident that the introduction of trade liberalization will strengthen the need for launching deeper structural reforms. Even if progress so far has been quite slow, the interdependency between different elements of the reform process allows us to expect a stronger commitment to attain the MPCs' real potential growth.

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