

TRADE RELATIONS BETWEEN THE EUROPEAN UNION AND THE SOUTHERN MEDITERRANEAN COUNTRIES: PROSPECTS FOR EXPORTS BASED ON THE ENLARGEMENT OF THE EUROPEAN UNION, THE NEW NEIGHBORHOOD POLICY AND THE BARCELONA PROCESS

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1. Introduction

Southern Mediterranean Countries (SMCs) are known to have strong trade relationship with the European Union (EU). Most of the trade of SMCs has been taking place with the EU either for historical or geographical reasons. However, since 1995 several developments have occurred and are likely to have strong impact on this relationship. The Barcelona Declaration of November 1995 heralded a new era of trade relations between SMCs and the EU where free trade areas (FTAs) have replaced the one side concessional agreements that used to prevail since the mid-1970s (following the Cooperation Agreements). Starting 2004, another variable entered into the equation of trade relations between the EU and SMCs. The enlargement of the EU-15 to EU-25 was viewed as having a minor effect on trade relations between SMCs and the EU (see for example El-Shennawy, 2004). Finally, the EU has announced its new European Neighborhood Policy (ENP) which has specifically stated that it takes in consideration the Barcelona Process. However several analysts have perceived the ENP as a threat to SMCs¹.

¹. The European Neighbourhood Policy (ENP) can be perceived as a response to several changes on the global front: firstly, with its latest enlargement, the external borders of the EU have changed and, secondly, the USA's "*Greater Middle East*" initiative has been presented to the G8 in January 2004. The ENP aims to establish an area of prosperity and good neighbourliness, based on the values of the Union. The ENP will contribute to the realization of fixed objectives in the framework of the strategic partnership of the Mediterranean and the Middle East, and will be implemented in the framework of the Barcelona Process and the association accords concluded with each partner country. Views concerning the ENP are widely divided: while some place the Barcelona Process at the centre of the ENP framework, there are fears from the South that the Barcelona Process will be diluted. The ENP switches the framework from a broad cooperation to an attempt to link certain actions to concrete development in national domestic politics. Through its action plans, the ENP incorporates bilateralism and differentiation allowing for both a multilateral and a country-by-country approach, tailoring the EU's relations to specific concerns regarding individual countries, to the countries' needs and to progress made.

This study aims to assess the impact of the three developments (EU enlargement, ENP, and the Barcelona Process) on exports of the SMCs to the EU-25. We intend to focus on four SMCs, namely Egypt, Morocco, Tunisia, and Jordan (the Aghadir countries)². This allows us to have an in-depth analysis of the four countries in their relationship with the EU. The study assesses the impact of the three developments on merchandise exports, differentiating between industrial and agricultural goods, and on exports of services.

The reason we study the impact of the three developments arises from our interest in identifying and differentiating between the effects of each one of them alone which, because of their simultaneous implantation, can mislead the researchers as well as the policy-makers in their vision and analysis of such developments.

We undertake a descriptive analysis using some statistical indicators to see whether the impact of Barcelona differs from that of the enlargement and of ENP or not. Moreover, we apply a gravity model using fixed effects to test whether enlargement has affected the flow of exports from SMCs to the EU or not. Hence, we run two regressions, one using the EU-15 and the other using EU-25. We also analyze the prospects of exports of services from SMCs to the EU under the three developments.

We extend our analysis to investigate the institutional effects of the three developments in terms of affecting exports of SMCs to the EU. For example, we investigate whether the provisions related to harmonization of standards and mutual recognition agreements (which can hinder the access of exports of SMCs to the EU) are the same across the chosen set of SMCs and whether such requirements that are included in the free trade areas (FTAs) following the Barcelona Process have “*spillovers*” in the trade relationship between SMCs and the newly acceding countries to the EU. We apply the same type of institutional approach to the ENP and investigate whether it is likely that such new policy will include issues that are likely to affect trade, or it is rather a policy that has no direct implications on exports of SMCs besides those contained in the FTAs of the Barcelona Process.

The ENP includes countries of a great diversity which are linked neither by history, nor by geography or culture, and hence does not correspond to the spirit of the Barcelona Declaration. There are fears that the ENP would contribute to the disintegration of the Mediterranean identity, hence the Union will have to work on strengthening the Mediterranean Personality of the Barcelona Process to counterbalance the negative effects of the ENP’s predefined relative hierarchy among the Union’s partners.

². The choice of the 4 countries is based on their engagement in the Aghadir free trade area, which is an important dimension in the trade relationship of SMCs with the EU as it enhances their opportunities of market access in the EU. Moreover, data on the 4 countries are available in comparable terms unlike for other Arab SMCs that are not Aghadir members.

The study is divided into four Sections. Following this introduction, Section 2 provides a general overview of trade relations between the EU and SMCs. Section 3 focuses on the institutional comparison of the Barcelona Process, ENP and the enlargement. The main emphasis is on differentiating between the common and different issues in the three institutional setups. Section 4 focuses on studying the effects of the EU enlargement on exports of SMCs to the EU and on analyzing their likely impact on merchandise exports (industrial and agricultural) using a gravity model. Two models are used, one that includes the EU-15 and the other including EU-25. Section 5 is devoted to the assessment of the impact of exports of services of SMCs to the EU-15 and EU-25. A final Section draws conclusions and provides some policy implications.

2. A general overview of trade relations between the EU and SMCs

The interest of the EU in SMCs dates back to the time of its inception. Its contractual relations with SMCs started in 1961 and 1963 with the signing of the Accords of Athens and Ankara respectively, which mainly addressed the formation of Customs Unions (CUs) with both Greece and Turkey. Up to 1975, the European Community (EC) continued signing up a series of CUs, free trade areas (FTAs) and preferential trade agreements with other SMCs. Some commentators assessed the Mediterranean policy of the EC during this period to be of an uncoordinated character. No harmonization was achieved between the contents of these agreements, long-term planning could not be recognized and the agreements were confined to trade matters solely which left the political future of such agreements uncertain (see Shalim and Yannopoulos, 1976). Since 1975 onwards the EC has always tried to harmonize the heterogeneity of its prevailing agreements with the Mediterranean countries by undertaking a global policy toward them. This included the accession to the EC of three Mediterranean countries including Greece in 1981, and Spain and Portugal in 1986. In 1973 an FTA was signed with Turkey followed in 1975 by one with Israel. A set of Association Agreements was signed in 1976 with Maghreb countries including Morocco, Tunisia, Algeria and in 1977 with Mashreq countries including Egypt, Jordan, Syria and Lebanon (Bahadir, 1997). This last set of Association Agreements was characterized by certain common features: they were of unlimited duration, providing trade concessions for exports of the aforementioned Maghreb and Mashreq countries to the EC market with duty free access for most of their industrial products and preferences for agricultural products, and

reciprocal treatment of EC exports to SMCs was not required. Moreover, there was financial assistance provided by the EC to SMCs through Financial Protocols which accompanied the Association Agreements (European Commission, 1995). Additional protocols to mitigate the negative effects of the accession of Spain and Portugal on agricultural exports of SMCs were signed bilaterally with each country.

The EC-SMCs Association Agreements reflected in many cases historical ties such as those stemming from French links with Morocco and Algeria, or a desire to bind the SMCs into the region of EC influence, while simultaneously managing their trade and controlling the pressure of heavy immigration into the EC. The agreements also helped to diffuse criticism over market access especially for the agricultural imports in which EC concessions were made (for a similar argument see Winters, 1993). However, the agreements remained heterogeneous and did not fulfill their main intended objectives where they fell short of controlling illegal migration moves, did not help in improving the economic performance of SMCs and did not achieve the expected development of exports from SMCs into the EC (Ghoneim, 2000). Aid provided through Financial Protocols remained ineffective and short of responding to the challenges (European Commission, 1995). Moreover, pressures from certain EU countries to increase aid allocated for Central and Eastern European countries created a counter type of pressure from Spain, Italy and France to increase aid allocated for SMCs. This resulted in a new policy adopted by the EU “*New Mediterranean Policy*” in the 1990s as part of the widening aspect of the EU trade integration policy in general. Adoption of the New Mediterranean Policy heralded an era where aid was stepped up, a new aid device was put in force (MEDA) and concessions for agricultural SMCs exports increased.

Following the Barcelona Euro-Mediterranean Conference (27 and 28 November, 1995) the EU decided to enter with SMCs in a new type of relationship where Association Agreements were signed³. The main two features of such Association Agreements included the addition of new aspects (political, social security, human and cultural) to the trade and financial aspects, and having a reciprocal relationship in trade, replacing the one-way concessional agreements that used to prevail.

In general, the quantitative assessments of the impact of the Association Agreements on the welfare gains of SMCs were highly modest (see for example, Brown *et. al.*, 1997, and Konan and Maskus, 1997). The reasons

³. The Association Agreement with Tunisia entered into force in March 1998, the Association Agreement with Morocco in March 2000, the Agreement with Jordan in May 2002 and finally the one with Egypt in January 2004.

behind such expected meager benefits are mainly due to the free access that SMCs already enjoy for most of their industrial exports to the EU, and hence there is no expected increase in market access due to the nature of the Association Agreements, which have been described as shallow agreements in contrast to deep agreements as coined by Lawrence (1996). The expected results are manifested by the modest increase in the SMCs exports' share to the EU out of total exports whose agreements entered into force, namely Morocco, Tunisia and Jordan (see Tab. 1). In fact, SMCs heavily depend on the EU in their trade relations, where 52% of their trade in 2001 was with the EU (European Commission, 2003a).

The Table shows that there has been no significant positive change in the geographical orientation of the SMCs toward the EU between 1980 and 2003. The percentage of exports and imports to and from the EU of the total SMCs remained stable with slight variations. The majority of the countries in Tab. 1 maintained their exports share directed to the EU without great variations around average levels which differed from being relatively high, as the case of Morocco and Tunisia, to moderate, as Egypt and Lebanon, to small as Jordan.

Tab. 2 shows that the SMCs differ significantly in the trade policy adopted, where some countries adopt liberal policies, as Lebanon, and others adopt restrictive ones, as Tunisia.

In addition to the large divergence between trade policies of SMCs themselves there is a large difference between their policies and those adopted by the EU. Tab. 3 identifies the features of some of such differences.

The divergence in trade policies whether among SMCs or between SMCs and the EU indicates that the trade integration process is likely to be difficult as the divergence implies higher transaction costs and, hence, difficulties expected in the process of harmonizing trade policies. It is worth noting that the history of trade relations between the EU and SMCs did not include any trials to harmonize trade policies or closing the widening gap between policies adopted by the EU and those adopted by SMCs. As a result, this widening gap continued to increase by time till the Barcelona Process was put in place.

Tab. 1 – Exports and imports percentage shares of South Mediterranean countries to and from the EU (1980-2003)

Exports to the EU in % of total SMCs exports*					
	1980	1990	2000	2001	2003
MED	51.4	57.1	51.6	52.9	46.7
Maghreb	50.6	73.4	70.5	71.7	65.9
Mashreq	55.8	42.0	56.5	55.9	48.8
Algeria	44.4	69.9	66.5	64.9	59.3
Egypt	50.2	43.4	56.7	55.1	40.6
Israel	50.4	39.9	28.7	29.0	26.9
Jordan	3.5	6.0	6.4	10.8	2.9
Lebanon	n.a.	39.8	30.4	38.8	16.0
Morocco	68.7	73.1	68.9	76.1	68.4
Syria	69.7	46.7	68.3	69.5	46.1
Tunisia	76.5	85.9	88.4	89.2	80.6
Imports from the EU in % of total SMCs imports					
	1980	1990	2000	2001	2003
MED	62.9	58.0	53.4	50.7	45.9
Maghreb	73.2	67.0	71.2	68.3	66.8
Mashreq	52.7	46.5	42.9	40.9	43.3
Algeria	72.8	65.9	62.0	64.8	63.2
Egypt	49.4	47.1	41.6	37.6	34.2
Israel	50.0	56.5	48.4	44.4	40.8
Jordan	52.8	40.9	41.6	43.7	25.1
Lebanon	n.a.	45.2	47.5	47.6	53.5
Morocco	69.6	64.2	75.9	62.9	n.a.
Syria	57.4	51.5	43.5	42.4	31.6
Tunisia	78.4	72.2	76.6	77.9	71.0

(*): It is worth noting that there seems to be a typo in the original source as the Mashreq total is higher than the country with the highest share.

Source: European Commission (2003a); "Economic Review of EU Mediterranean Partners", *European Economy Occasional Papers* (2003), No. 2, January; and European Commission (2005), "10 Years of Barcelona Process: Taking Stock of Economic Progress in EU Mediterranean Partners", *European Economy Occasional Papers*, No. 16, April.

Tab. 2 – Trade policy indicators of South Mediterranean countries

Country	Simple	Simple	Simple	% of	Collected	% of	% of
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Country	Average Applied Tariff Rate in 2002 (WTO database)	Mean Tariff (WDI)	Mean Tariff (WDI)	import duties to total tax revenue (WTO)	tax ratio: % of import duties to total merchandise trade (WTO)	import duties to total tax revenue (WDI) 1990	import duties to total tax revenue (WDI) 2002
Lebanon	5.4%	(1999) 15.3%	(2002) 6.4%	(1997-99) 52.1%	(1997-99) 16%	n.a.	n.a.
Morocco	30.2%	(1993) 64.6%	(2002) 27.7%	(1997-99) 18.7%	(1997-99) 16%	20.3%	n.a.
Syria	19.6%	-	-	(1997-99) 12.4%	(1997-99) 36.4%	8.2%	n.a.
Egypt	19.9%	(1995) 23.3%	(2002) 18.4%	(1995-97) 19.2%	(1995-97) 18.7%	18.9%	n.a.
Tunisia	28.6%	(1990) 28.6%	(2002) 30.2%	(1998-00) 13.6%	(1998-00) 8.4%	n.a.	n.a.
Turkey	n.a.	(1993) 7.5%	(1999) 7.1%	n.a.	n.a.	35.1%	12.5%
Algeria	n.a.	(1993) 20.9%	(2002) 18.8%	n.a.	n.a.	n.a.	12.1%
Jordan	n.a.	(2000) 24%	(2002) 16.2%	n.a.	n.a.	34.7%	20.4%
Libya	n.a.	(1996) 21.8%	(2002) 18.8%	n.a.	n.a.	n.a.	n.a.

Source: WTO website (2005), *World Development Indicators 2004*.

Tab. 3 – Main features of trade policy in the EU-15 and SMCs

Country	Year	Simple mean tariff	Standard deviation of tariff rates	Weighted mean tariff	Lines with international peaks
		%	%	%	%
EU-15	1988	3.7	5.9	3.7	4.1
	2001	3.9	4.9	2.6	2.6
Egypt	1995	25.6	33.2	16.7	53.1
	1998	20.5	39.5	13.8	47.4
Jordan	2000	22.8	16.6	18.6	63.1
	2001	16.2	15.6	13.5	46.1
Lebanon	1999	12.6	9.9	12.0	24.0
	2001	8.3	11.2	12.0	13.0
Morocco	1993	66.6	29.5	45.3	96.8
	2001	32.6	20.5	25.4	79.1
Tunisia	1990	28.4	10.0	26.6	97.3
	1998	30.6	12.6	26.3	91.9

Source: World Development Indicators CD ROM (2003).

The *World Bank Global Economic Prospects* (2005) argues that the EU-Tunisia Association Agreement helped Tunisia to become a successful exporting country, where its exports as a percentage of GDP rose from 20% in 1994 to 25% in 2002. Moreover, it attributes the reduction of its Most Favored Nation (MFN) tariff level from 33% in 1994 to 26% in 2004 to the Association Agreement. The agreement came into force in 1998 after having been signed in 1995. The report argues that the originally high tariff level in Tunisia is likely to result in trade diversion. We view the commentary of the report as more of advocating trade liberalization than reflecting the real impact of the Association Agreement for several reasons. *First*, Tunisia had free access to the EU for its industrial products since 1977 and, hence, the increase in its exports percentage to GDP and its attribution to the better market access offered by the EU, as a result of the Association Agreement, is exaggerated as the Association Agreement is meant to dismantle the tariffs on the Tunisian side rather than on the European side. It is unlikely that the better market access in the form of limited increase in tariff quotas for agricultural products offered to Tunisia, as a result of the agreement, would impact the percentage of exports to GDP by this high amount. *Second*, according to the data included in the World Development Indicators (2004), the average tariff level increased in 2002 compared to 1990; it is still at the 30% level as shown in Tab. 2 and has not decreased, unless the World Bank uses the WTO data for

Global Economic Prospects and World Bank data for its other reports. *Third*, the expected outcome of the Association Agreement is a surge in imports from the EU to Tunisia, which is reflected, though slightly, in Tab. 1, where the percentage share of EU in total Tunisian imports increased from around 72.2% in 1990 to around 77.9% in 2001, and then down to 71% in 2003. In the case of Jordan, we find that the percentage of imports from the EU relatively to the whole world declined as well as the exports percentage.

However, it should be considered that the time elapsing since the entry into force of the agreement (1999) and latest data available (2003) does not allow us to undertake sound analysis of trade flows and of the impact of the Association Agreements. It should be also noted that the size of SMCs with respect to the EU is not significant. Total GDP of SMCs (after excluding Cyprus, Malta and Turkey) represents around 8.9% of the total GDP of the EU and PPP per-capita income of SMCs reaches around 39% of the PPP per-capita income level of the EU (European Commission, 2003*a*), and SMCs' exports (Turkey is included) represent around 6-7% of the EU market share (European Commission, 2005)⁴. This implies that SMCs markets did not represent a significant dimension in the EU strategic trade framework whether if measured by GDP or by GDP per-capita.

It is premature to estimate the relative impact of the Association Agreements on the direction and magnitude of trade from SMCs. We expect, following economic theory, that imports from the EU are likely to increase as a result of the high MFN tariff level maintained by some countries and the effect of trade diversion (Tunisia, Morocco and Egypt), which is not necessarily the case with other countries that have low MFN tariffs, such as Lebanon and Jordan. Moreover, we do not expect a surge in EU exports' percentage to total exports as a result of the Association Agreement because the percentage is already high in the case of Morocco and Tunisia. We might expect an increase in the cases of Egypt and Lebanon as their exports are more geographically diversified than Tunisia and Morocco and, hence, the EU might offer a better market access and increase its trade relations after full implementation of the agreement. We do not expect the same to happen with Jordan that has a biased geographical trade orientation toward the US and has signed an FTA with it; hence it is likely that the options of opening up new markets for its products are equal in the two largest world-wide markets. The same is likely to happen, though to a lower extent, in the case of Morocco that has signed an FTA with the US. The less likely possibility of diverting trade from the EU to the US is a result of the strong historical ties between

⁴. It is worth noting that Turkish exports represent the lion's share of SMCs' exports to the EU (see European Commission, 2005).

Morocco and the EU, geographical proximity, language spillovers (French speaking), and hence it is unlikely that the Moroccan FTA with the US (which carries political motivations) might significantly divert trade away from the EU to the US.

Some specialists have raised the point that the Association Agreements have helped SMCs to maintain their market share in the EU, and that without such agreements SMCs would have probably lost their market shares in the EU⁵. Although this point of view might be appropriate from the first look, our analysis that focuses on the time period (1995-2005), reveals a different story. During the period of research 1995-2005 none of the external developments that might have affected negatively the market share of SMCs exports to the EU, including the enlargement process, the deepening of the EU policies or the implementation of the ENP, have taken place. In fact, the enlargement process took place in 2004 and hence its impact on SMCs market share is likely to be felt afterwards. Moreover, most of deepening policies adopted by the EU following the Single Act have already taken place before the period of analysis, and hence the likely impact of restricting imports from SMCs should have taken place before 1995. Finally, the ENP that has been recently announced, did not have the chance to affect the market share of SMCs during the time period under study. In fact, despite that the EU has remained the largest trading partner for SMCs, its weight decreased in the last decade after remaining broadly stable during the 1980s. Overall trade of SMCs with the EU fell from 58% of total MED⁶ trade in the period 1980-90 to around 52% in 2000 (European Commission, 2003a).

3. Institutional comparison of the Barcelona Process, ENP and the enlargement regarding their effects on exports of SMCs to the EU

3.1 The Barcelona Process

The Barcelona Process which was announced in 1995 aimed at replacing the past attempts at strengthening trade relations between the EU on the one hand and SMCs on the other, besides heralding a new mode of cooperation in trade relations where trade concessions were replaced by reciprocal preferential treatment. The Barcelona Declaration formed the basis for a new EU policy that aimed at widening and deepening its regional trade integration. It used the former prevailing Cooperation Agreements as the basis, while

⁵. This point was raised in a discussion with Ahmed Galal.

⁶. MED countries include in addition to SMCs, Cyprus, Malta and Turkey.

altering the inflexible and inefficient system of financial cooperation into a more flexible system (MEDA). It was announced that by the year 2012, when the Barcelona Process achieves all its aims of concluding the EU agreements with the 12 SMCs (ranging from FTAs with SMCs under study to accession of Cyprus and Malta and a customs union agreement with Turkey, which is to be replaced in the future by the accession of Turkey), the largest FTA in the world will be created. Moreover, the Barcelona Declaration differed from its predecessors in its aim of enhancing intra-regional initiatives and cooperation in a broad range of sectors. In fact, the policy of promoting intra-regional cooperation consists of 3 Chapters defined in the Barcelona Declaration, namely: (1) the Political and Security Chapter, (2) Economic and Financial Chapter and (3) Social, Cultural and Human Chapter. As reported by the European Commission (2003a), over the period 1995-2003, seven meetings of the 15+12 Foreign Ministers have taken place, together with 16 meetings of sectoral Ministers. These meetings have launched a number of joint cooperation initiatives, financed through the MEDA regional program.

Although the Association Agreements signed between the EU and SMCs on a bilateral basis signaled the start of a new era that accommodates to changes in the world trading system, we observe that the EU has rather opted for a shallow type of integration. Aspects of deep integration were absent from the Association Agreements despite the announced intentions of the EU to have deep agreements. Literature assessing the shallow type of agreements emphasized that they are not likely to bring much benefit to SMCs (see volume edited by Galal and Hoekman, 1997; Kheir-El-Din *et. al.*, 2001; and Radwan and Reiffers, 2005).

If we focus on the Association Agreements and their articles, we find that they either were vague concerning deep integration aspects or postponed them to future negotiations. For example, harmonization aspects were replaced by cooperation in the fields of standards, whereas negotiations on services liberalization were postponed to future dates. Cooperation in different fields (related to customs, standards, rules and regulations) was the main mode where even the type of cooperation was left vague. This might reflect the EU preference toward the gradual approach in its Regional Trade Agreements (RTAs) compared to the US approach that prefers *ex ante* adjustment to reach deep integration before entering into any RTA. However, the EU has adopted toward SMCs such a gradual approach since the 1970s and has never improved on it by moving into deep integration aspects despite its move toward deeper integration whether within itself or with new acceding countries, including for example Turkey.

Moreover, the Barcelona Process resulted into four similar RTAs with SMCs under study. Nevertheless, and despite the conventional wisdom that argues that such agreements were highly similar, we find that this has not always been the case.

If we compare the aspects of deep integration mentioned in the Association Agreements with those of the EU agreements signed with Central and Eastern European countries (CEECs) that became members in 2004, we find that there are large similarities in terms of the fields of cooperation but rather with weak or shallow aspects. For example, in the EU-Poland agreement Articles 68 and 69 concerning the approximation of laws mentions the following:

CHAPTER III – Approximation of laws

Article 68

The Contracting Parties recognize that the major precondition for Poland's economic integration into the Community is the approximation of that country's existing and future legislation to that of the Community. Poland shall use its best endeavors to ensure that future legislation is compatible with Community legislation

Article 69

The approximation of laws shall extend to the following areas in particular: customs law, company law, banking law, company accounts and taxes, intellectual property, protection of workers at the workplace, financial services, rules on competition, protection of health and life of humans, animals and plants, consumer protection, indirect taxation, technical rules and standards, transport and the environment.

It therefore specifies what “appropriate action is”. As for agreements with the 4 SMCs, the Association Agreements are similar but with slight but significant differences in wording.

The EU-Tunisia and the EU-Morocco agreements are the most explicit. They are identical and read as follows:

Article 40

1. The Parties shall take appropriate steps to promote the use by Tunisia (Morocco) of Community technical rules and European standards for industrial and agri-food products and certification procedures.

2. Using the principles set out in paragraph 1 as a basis, the Parties shall, when the circumstances are right, conclude agreements for the mutual recognition of certifications.

and Article 5 – Cooperation in standardization and conformity assessment

The Parties shall cooperate in developing:

- (a) use of Community rules in standardization, metrology, quality control and conformity assessment;
- (b) updating of Tunisian (Moroccan) laboratories, leading eventually to the conclusion of mutual recognition agreements for conformity assessment;
- (c) bodies responsible for intellectual, industrial and commercial property and for standardization and quality in Tunisia (Morocco)⁷.

And finally we find that the EU-Egypt text is less explicit about adoption of EU norms:

Art 47 – Standardization and Conformity assessment

The Parties shall aim to reduce differences in standardization and conformity assessment.

Cooperation in this field shall focus in particular on:

- (a) rules in the field of standardization, metrology, quality standards, and recognition of conformity, in particular as regards sanitary and phytosanitary standards for agricultural products and foodstuffs;
- (b) upgrading the level of Egyptian conformity assessment bodies, with a view to the establishment, in due time, of mutual recognition agreements in the area of conformity assessment;
- (c) developing structures for the protection of intellectual, industrial and commercial property rights, for standardization and for setting quality standards.

As seen from treating the issue of approximation of laws in the field of technical standards, they were mentioned as a precondition for Poland's integration, and became loosely worded in the Association Agreements with SMCs ranging from being more explicit in the case of Tunisia and Morocco, where industrial and agro-food products have been identified, to less explicit where it is only cooperation in the case of Egypt, despite that they all fall under the Barcelona Process.

The example provided about the wording of approximation of laws shows the continued heterogeneous approach adopted by the EU toward SMCs and its lack of a unique approach on handling such issues in different countries. If we follow time sequence of concluding the agreements, it might be the case that the EU was rather ambitious in terms of deep integration as the article of Tunisian and Moroccan agreements is evident, and then it became less ambitious by the time of signing the agreement with Egypt.

In conclusion, the Barcelona Process provided no additional deep aspects whether when compared to the agreements signed between the EU and CEECs or when compared with its predecessors, the so-called Cooperation Agreements. The ultimate result of such shallow integration is likely to have a

⁷. http://europa.eu.int/comm/external_relations/euromed/med_ass_agreements.htm

negative impact on SMCs export market access to the EU. The reason for this statement is embedded in the continuous evolution of technical and sanitary requirements that the EU is introducing, while SMCs lack the technical and financial capabilities to adopt them. Among such issues that have been raised lately by the EU was the adoption of traceability system in food products since the beginning of 2005. SMCs lack all the capabilities that enable them to adopt such new system. This is not to say that the EU did not help SMCs in aspects related to harmonization. On the contrary, we find that the EU has helped the Egyptian government in harmonizing its standards with the European ones through the MEDA funds allocated to Egypt. However, what is observed is the lack of targets to be met and the fragile flexible system of harmonization that, although easier to negotiate for SMCs, is likely to block the European markets in front of SMCs exports in the future if such deep aspects of harmonization were not carefully addressed.

3.2 The enlargement process

Studies that have dealt with the impact of the enlargement on SMCs are scarce and there has been consensus that the impact of the enlargement on SMCs is negligible. The studies have reached the conclusion, based mainly on the fact that the newly acceding countries are small and suffer from aging populations, that the impact of diverting trade from SMCs or stopping the legal migration flows is not expected. Moreover, the new market opportunities for SMCs in such markets are not large due to the limited size of those countries. However, one aspect that has been rather neglected from the analysis is the impact of diverting financial resources away from SMCs to the newly acceding countries. Though the EU has emphasized that the enlargement is not likely to divert the financial resources devoted to SMCs as a result of the enlargement and has announced the increase of funds allocated to SMCs in light of the ENP, we mention below some of the facts that throw doubts on such claims. For example, as stated by the European Commission, the EU's direct pre-accession financial assistance to the candidates of Central Europe has more than doubled from 2000 to 2006 through various financial assistance programs as Phare⁸ and two new pre-accession programs, ISPA (pre-accession structural instrument, covering transport and environment investment) and Sapard (the structural adjustment program for agriculture and rural development). The total amount of such assistance programs reached

⁸. The Phare program has operated since 1989 with the main aim of helping the countries in the accession process and implementation of the *acquis communautaire*.

more than 3.12 billion euros annually (European Commission, 2001). In addition to such sources of funding, the European Investment Bank (EIB) is engaged in co-financing several programs with Phare, beyond its own lending programs, which amounted in 1999 alone to 2.17 billion euros with a loan potential of 16 billion euros over the period 2000-2007, *i.e.* on average 2 billion euros per year as revealed in Tab. 4 (European Commission, 2001). It is worth noting that the amount of finance allocated for acceding countries is not proportional to the relative size of their economies. For example, the acceding countries have a GDP that is roughly half of the countries included in the ENP initiative and no doubling of resources have ever been announced to SMCs. Similarly, the funding for other newly acceding countries increased, when in 2000 EU agreed on providing pre-accession assistance of 95 million euros for Cyprus and Malta over the period 2000-2004. Similarly, the EU doubled its financial assistance to Turkey, absorbing 15% of the funding allocated for SMCs, in addition to 50 million euros dedicated for structural reforms, institutions building and investment in the *acquis communautaire*, besides the eligibility for EIB loans (European Commission, 2001).

Tab. 4 – EU financial assistance to applicant countries (billion euros)

Category	2000	2001	2002	2003	2004	2005	2006
PHARE	1.5	1.5	1.5	1.5	1.5	1.5	1.5
SAPARD	0.5	0.5	0.5	0.5	0.5	0.5	0.5
ISPA	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Post Accession	-	-	6.0	8.0	11.0	13.0	15.0
Total EU spending on enlargement	3.0	3.0	9.0	11.0	14.0	16.0	18.0

Source: European Commission (2001), *The European Union: Still Enlarging*, Brussels.

3.3 The European Neighborhood Policy (ENP)

The literature on the impact of the ENP on SMCs is scarce. Hence we depend on our interpretation and judgment of the European Commission

documents related to this aspect. As announced by the European Commission in 2002, the aim of the ENP is «*to provide a framework for the development of a new relationship which would not, in the medium-term, include a perspective of membership or a role in the Union's institutions. A response to the practical issues posed by proximity and Neighborhood should be seen as separate from the question of EU accession*» (see European Commission, 2003c).

Such new approach was welcomed by the European Council when in the Thessaloniki European Council in June 2003 it endorsed the communication from the Commission entitled “*Wider Europe – Neighborhood: A new Framework for relations with our Eastern and Southern Neighbors*”, and announced that it looks forward to build on this communication together with the Commission (European Commission, 2004a).

Moreover, as asserted by an EU official, the ENP differs from accession as it ensures sustainability of the stability and prosperity that the EU aims at through its enlargement process (Verheugen, 2003). In other words, the ENP is mainly enacted to ensure the success of the enlargement process. *The reaction of the EU official confirms what has been asserted by the European Commission in its documents that ENP is not an initiative by itself but rather a complement to the enlargement to ensure its success.* Hence, the emphasis on the issue of accession is of great importance where the EU is signaling that the ENP does not, by any means, pave the road for accession. As a first reaction, we can interpret this emphasis as that within ENP there will be no pressure on harmonization or deep integration, which are preconditions for accession (this is in line with the weak and vague language used in the Association Agreements regarding harmonization of rules and regulations). The ENP can be better viewed as *à la carte* type of agreement which offers the partners of the EU the opportunity to pick and choose among the different EU institutions to align with and hence have a better stake in the internal EU market. In other words, it gives the partners the freedom to deeply integrate with the EU on the policies and rules of the *acquis communautaire* that the partners believe are relevant to them (see European Commission, 2003d). Contrary to the past attempts of the EU policy toward SMCs, where further coordination and streamlining was always asked for in its treatment of SMCs (see Section 2), the ENP adopts a different approach based mainly on differentiation between countries. This might be a major shift of the EU policy toward SMC, where several announcements have been made on the need to adopt a more coherent approach toward such countries. Now the EU by adopting the ENP announces a completely new approach that is opposite to its past modest attempts in its trade relations with SMCs. ENP, though has

diverted from the approach of coordinating EU policy toward SMCs, still adopts the progressivity approach, where in fact it has extended its flexible terms in this regard. The basic idea of the ENP is built on the fact that each EU partner is aware of its own capabilities, institutions, priorities, and demands of harmonization with the EU which are reflected in each partner specific Action Plans. Action Plans in the view of the European Commission are «*political documents drawing together existing and future work in the full range of the EU's relations with its neighbors, in order to set out clearly the overarching strategic policy targets and benchmarks by which progress can be judged over several years. They should be concise, complemented where necessary by more detailed plans for sector-specific cooperation*» (Verheugen, 2003). The Action Plans should include specific benchmarks set by SMCs, which replace the traditional conditionalities. However, benchmarks are not confined to the *acquis communautaire*, but can rather extend to adoption and ratification of international agreements related to political, economic and social aspects.

Action Plans are thought of as a means of bringing closer EU neighbors to the EU, based on defining a set of priorities agreed upon jointly and incorporated in such plans. Action Plans aim at covering two broad areas: “*first*, commitments to specific actions which confirm or reinforce adherence to shared values and to certain objectives in the area of foreign and security policy; *secondly*, commitments to actions which will bring partner countries closer to the EU in a number of priority fields” (European Commission, 2004*b*). The Action Plans’ main target is to gradually provide the neighbors a stake in the EU’s internal market. They cover a wide range of areas ranging from political dialogue and reform to trade, to justice and home affairs; energy, transport, information society, environment and research and innovation; and social policy and people-to-people contacts (European Commission, 2004*b*). These plans are not expected to be identical; however they will be based on a common set of principles. They will be differentiated to take into account several variables including the existing state of relations with each country, its needs and capacities, as well as common interests. A system of monitoring implementation of the Action Plans will be designed using bodies under the auspices of the existing Partnership Agreements. The progress in implementation will decide on its renewal. If progress was impressive, further actions might be undertaken to develop bilateral relations between the EU and its neighbors, including the possibility of new contractual links which could take the form of European Neighborhood Agreements (ENA), whose scope would be defined in light of the progress in meeting the priorities set out in the Action Plans (European Commission, 2004*b*). The EU

has decided to use the Action Plans as the point of reference for designing its assistance targeted to its neighbor countries. As stated in the communication of the Commission (2004b) «*The Action Plans will provide a point of reference for the programming of assistance to the countries concerned*». This implies that the aid allocated to each country will differ based mainly on the plan it has adopted. Although we believe this should be a major determining variable in the EU's system of allocating funds, it should not be the only factor. As mentioned above, the Action Plans are designed on a different basis taking into consideration the level of development and existing capacities in each country. Hence, a modest Action Plan would imply fewer resources. As a result, neighboring countries would negotiate ambitious Action Plans that might be beyond their capacity of implementation to have more assistance, or might negotiate modest Action Plans due to their limited ability of implementation and, hence, the end result will be getting less assistance although they are in need of it. Linking Action Plans to level of assistance provided as the sole variable is definitely wrong; however it should be considered among other factors that help to upgrade the level of development in the neighboring countries. As of March 2005 Country Reports and Action Plans have been completed with the first group of 7 countries (Moldova, Ukraine, Morocco, Tunisia, Jordan, Israel and the Palestinian Authority).

The Action Plans were approved by the Commission in December 2004 and have now to be endorsed by the Council and approved by the relevant association or Cooperation Council. Implementation of the Action Plans will be monitored through sectoral sub-committees as well as economic dialogues. These mutually agreed upon Action Plans specify reform objectives for each of the SMCs as well as the EU support. Country Reports have also been finalized for a second group of countries (Egypt, Lebanon, Armenia, Azerbaijan and Georgia). In the economic field, particular emphasis is put on progress in the establishment of a fully functioning market economy through structural reforms as well as macroeconomic stability. Tab. 5 shows the status of ENP implementation in SMCs.

Tab. 5 – ENP, state of play in SMCs as of 2005

	Country Reports	Action Plan
Algeria	-	-

Egypt	Yes	-
Israel	Yes	Yes
Jordan	Yes	Yes
Lebanon	Yes	-
Morocco	Yes	Yes
Tunisia	Yes	Yes
Syria	-	-
WB&G	Yes	Yes

Source: European Commission (2005), "10 Years of Barcelona Process: Taking Stock of Economic Progress in EU Mediterranean Partners", *European Economy Occasional Papers*, No. 16, April.

As mentioned by the Commission, the only binding aspects set *ex ante* in the trade relations between the EU and SMCs is the *institutional and contractual arrangements* of the Association Agreements. The ENP is an additional channel to further integrate deeply with the EU, which remains optional.

The financial instrument of the ENP is still not yet fully worked out. Reviewing the documents of the Commission shows that there is an emphasis on the fact that the ENP will provide additional sources of finance and will not be at the expense of other existing instruments already functioning (*i.e.* MEDA). Other EU documents showed that the EU has opted for utilizing the existing frameworks for implementing the ENP where, for example, it will use the MEDA instrument to implement the ENP up till 2006. Starting 2007, the creation of a special ENP instrument will be put in place (European Commission, 2003d) "*European Neighborhood and Partnership Instrument*" (ENPI). The ENPI will replace existing geographical and thematic programs covering the countries concerned. In September 2004 the Commission proposed to the Parliament and the Council a regulation establishing ENPI with an allocation of 14.9 billion euros for 2007-2013. The ENPI will replace TACIS, MEDA and other regional programs covering the EU neighboring countries. The Action Plans will act as the reference for drawing assistance priorities. It has always been emphasized that the ENPI will also support EU-Russia strategic partnership (European Commission, 2005).

Another document reviewed showed that the European Commission foresaw that the implementation of the ENP using the existing modes of finance requires around 955 million euros over the period 2004-2006⁹. As for

⁹. The total sum of 955 million euros is to be provided from various programs representing 700 million euros from INTERREG, 90 million euros from PHARE, 75 million euros from TACIS, 45 million euros from CARDS and 45 million euros from MEDA.

2007, the ENP has a different regional agenda, based on which the ENP financial instrument and funds will operate. Reviewing the European Commission documents showed that most of the emphasis of the ENP has been on helping Russia and the countries of Western Balkans to transit to market economy and democracy. The second important issue is signaling that Western Balkan countries can be eligible EU members in the future. As asserted by the European officials *«In the East, Russia is of course much more than a neighbor, since it is a strategic partner; but it is also a neighbor»* (Verheugen, 2003). Finally comes the Mediterranean region where the issue of land borders is of less significance but, as mentioned by the Commission *«further regional and sub-regional cooperation and integration amongst the countries of the Southern Mediterranean will be strongly encouraged»*. In fact, the importance of South-South integration has been previously emphasized by the Barcelona Declaration and hence from the announcements of the Commission it seems that there is no stake for including SMCs in the ENP. Including SMCs is rather a political slogan to avoid negative consequences if such countries felt that the EU has diverted its attention away from them. This is also reflected in the modest amount allocated from MEDA for ENP implementation when compared to other programs as mentioned above.

There are additional expenses not taken in consideration that are expected to attract EU funds and divert them away from SMCs. For example, following the communication of the European Commission (the European Commission adopted on 25 July 2001 an Action Plan for regions bordering on applicant countries [COM(2001) 437]; where 23 regions in Austria, Finland, Germany, Greece and Italy were involved), it has earmarked 305 million euros for 2002 and 2003 for the EU regions on the borders of the acceding countries (see European Commission, 2003b). Moreover, the ENP itself even before being put in place is already experiencing an enlargement process, thus further diverting the attention away from SMCs. The ENP was originally limited to the 4 Western Balkan countries, Russia and 10 Mediterranean countries. Following the Brussels European Council of 17-18 June 2004 this list has been extended to include the 3 countries of the Southern Caucasus (Armenia, Azerbaijan and Georgia).

The EU has been trying to comfort the SMCs by announcing that they want to strengthen their relationships under different umbrellas. The Thessaloniki European Council (June 2003) expressed the conviction that the EU must strengthen its partnership with the Arab world. The European Council invited the Commission and the High Representatives to formulate a

work plan taking full account of the existing policies and programs and in particular the Barcelona Process and the ENP.

Hence, it seems that the ENP is likely to divert the focus of the EU away from the closer SMCs, despite the repeated assertions by the EU, that this will not affect its relationship with them. This conclusion is based on the following:

- ❖ replacing the MEDA, which has been designed to cover the needs of SMCs, by a new instrument that is broader in its coverage, is likely to lessen the influence of SMCs in negotiating their financial needs with the EU;
- ❖ Russia's economic, political and strategic role is likely to absorb the attention of the Commission and divert it away from SMCs. Sharing borders with the EU does play an important role in EU decisions and this is observed in the inclusion of additional countries, namely Armenia, Azerbaijan and Georgia, although they were not included from the beginning of the ENP initiative.

The carrot that the EU holds for the ENP countries is a stake in its internal market or, as described by the EU officials, an extension of the four freedoms of the EU including goods, services, capital, and labor (Verheugen, 2003).

We believe that the ENP will not bring much to SMCs. The reason is that it does not add much to the Barcelona Process and has no strong enforcing mechanism that can push forward the deep integration aspects. As stated by the communication of the European Commission (2004b) *«In the South, the ENP will also encourage the participants to reap the full benefits of the Euro-Mediterranean Partnership (the Barcelona Process), to promote infrastructure interconnections and networks, in particular energy, and to develop new forms of cooperation with their neighbors. The ENP will contribute to develop further regional integration, building on the achievements of the Euro-Mediterranean Partnership, notably in the area of trade. It will reinforce efforts to meet the objectives of the European security strategy in the Mediterranean and the Middle East»*. All such issues have been previously mentioned in the Barcelona Process, besides they are vague targets that include anything and everything.

Some experts (Hoekman, 2005) view that the ENP provides a way to deepen the existing Association Agreements. Given the criticisms against the Association Agreements for their shallowness, the ENP offers the SMCs to deepen their relationship with the EU based on *à la carte* approach. However, we believe that the Association Agreements contained the necessary

provisions for such deep integration but were rather postponed to the future or worded vaguely. The ENP has an advantage of making such issues precise based on the Action Plans agreed upon jointly between the EU and the neighboring countries. Nevertheless what remains to be decided is the implementation method or answering the “*how*” question. We believe that the EU, building on the reservoir of experience it has accumulated in its enlargement process, is capable of handling each case following its specific nature. Reviewing the EU documents shows that the vague wording of cooperation and harmonization in the field of customs and technical regulations still prevail. There has been emphasis on progressivity, however what worries us is the general and far from tailored approaches that the EU Commission mentions in its communications, which will be just repeating the same provisions of the Association Agreements.

To sum up, we believe that the institutional differences between the Barcelona Process and the ENP are rather minor. However, one main aspect is that the Barcelona Process has focused the EU policy toward SMCs, whereas the ENP approach is rather of diverse nature. Institutional aspects of the EU enlargement are absent from the Association Agreements with SMCs. Furthermore, the impact of the enlargement on exports of SMCs has been assessed to be meager, at least in the short run, but this is not likely to be the case in the long run. In Section 4, we undertake an econometric analysis to test whether SMCs exports are likely to be affected by the EU enlargement or not.

4. Impact of enlargement on SMCs’ merchandise exports to the EU

El-Shennawy (2004) showed that the impact of the EU enlargement is not likely to affect the Egyptian economy significantly whether in terms of capital inflows, labor movement or trade relations. On the positive side, the enlargement implies for Egypt a wider market enabling it to make use of economies of scale. On the negative side, the enlargement could displace Egyptian exports in the EU market by exports from the newly acceding countries and could divert the capital inflows that used to be directed to SMCs. This has also been confirmed by other studies where one study showed that the amounts of funds allocated from the EU to SMCs under MEDA reaches around 14 euros per-capita compared to 545 euros per-capita for funds allocated to newly acceding countries (Handoussa and Reiffers, 2003). However, a better in-depth analysis carried by El-Shennawy (2004) showed that the Export Similarity Index of Egypt with newly acceding countries

differs significantly; hence it is not likely that enlargement will crowd out Egyptian exports. Yet, this does not apply to the other three countries under study, which have a relatively high Export Similarity Index with the newly acceding countries that has increased over time. As shown in Tab. 6a and 6b, the Export Similarity Index calculated at 2-digit level HS code is relatively high for SMCs and newly acceding countries. Moreover, the Export Similarity Index for Jordan increased over time with 6 newly acceding countries and decreased with 4, whereas in the case of Morocco it increased with 5 and decreased with 3. Tunisia is the country with the highest score in terms of its Export Similarity Index, increasing over time with 7 newly acceding countries and decreasing only with 3, whereas Egypt's Export Similarity Index decreased with 7 and increased with 3. This implies that there is a large threat from the enlargement process for displacing SMCs exports, with the exception of Egypt, unless either SMCs or the newly acceding countries change their export profiles. Additionally, El-Shennawy (2004) identified that there might be a larger threat for displacing exports of services from Egypt (and hence the other SMCs) to the EU especially in tourism (see also Handoussa and Reiffers, 2003). Export opportunities in the markets of the newly acceding countries for Egypt are scarce due to the lack of complementarity (the same applies to other SMCs). As for agricultural exports, the effect cannot be easily determined. On the one hand, enlargement implies adoption by more countries of the Common Agricultural Policy (CAP) that is protectionist by nature and hence may affect negatively agricultural exports of SMCs. On the other hand, the different seasons of agricultural production might imply that the EU will not increase its level of protection against SMCs exports. Tab. 6a and 6b show the Export Similarity Index between SMCs and newly acceding countries. As seen from the Table, the structure of SMCs' exports does not differ significantly from that of newly acceding countries and it has further increased over time in the case of three SMCs and decreased only in the case of Egypt.

Tab. 6a – Export Similarity Index Matrix (average 1995)

	EG	JO	MA	TN	CY	CZ	EE	HU	LV	LI	MY	PL	SK	SL	TR
EG	1.00														
JO	0.22	1.00													
MA	0.28	0.37	1.00												
TN	0.31	0.31	0.49	1.00											
CY	0.29	0.32	0.36	0.38	1.00	1.00									
CZ	0.29	0.34	0.24	0.35	0.38	0.61	1.00								
EE	0.35	0.33	0.35	0.42	0.39	0.65	0.60	1.00							
HU	0.35	0.35	0.33	0.38	0.46	0.52	0.62	0.49	1.00						
LV	0.26	0.29	0.28	0.31	0.38	0.58	0.70	0.60	0.58	1.00					
LI	0.43	0.40	0.37	0.47	0.44	0.29	0.27	0.36	0.24	0.28	1.00				
MT	0.14	0.18	0.22	0.27	0.30	0.66	0.68	0.65	0.53	0.71	0.33	1.00			
PL	0.37	0.36	0.36	0.46	0.43	0.74	0.57	0.64	0.48	0.56	0.27	0.66	1.00		
SK	0.30	0.35	0.24	0.33	0.34	0.70	0.64	0.69	0.52	0.57	0.37	0.64	0.62	1.00	
SL	0.28	0.35	0.27	0.34	0.41	0.48	0.45	0.49	0.44	0.51	0.27	0.54	0.49	0.43	1.00
TR	0.34	0.33	0.46	0.47	0.45										

Source: Authors' calculation based on COMTRADE Database.

Tab. 6b – Export Similarity Index Matrix (average 2003)

	EG	JO	MA	TN	CY	CZ	EE	HU	LV	LI	MY	PL	SK	SL	TR
EG	1.00														
JO	0.28	1.00													
MA	0.26	0.52	1.00												
TN	0.29	0.53	0.70	1.00											
CY	0.29	0.45	0.29	0.33	1.00	1.00									
CZ	0.23	0.30	0.30	0.37	0.42	0.60	1.00								
EE	0.27	0.36	0.38	0.46	0.36	0.71	0.57	1.00							
HU	0.21	0.33	0.32	0.36	0.36	0.40	0.58	0.36	1.00						
LV	0.27	0.36	0.28	0.33	0.31	0.46	0.59	0.45	0.50	1.00					
LI	0.42	0.42	0.37	0.49	0.44	0.40	0.46	0.52	0.26	0.34	1.00				
MT	0.14	0.26	0.31	0.39	0.26	0.73	0.66	0.62	0.48	0.60	0.39	1.00			
PL	0.28	0.34	0.33	0.41	0.44	0.72	0.57	0.56	0.45	0.49	0.35	0.71	1.00		
SK	0.28	0.30	0.28	0.37	0.53	0.74	0.64	0.64	0.48	0.48	0.38	0.77	0.68	1.00	
SL	0.20	0.38	0.29	0.36	0.45	0.55	0.49	0.47	0.46	0.51	0.35	0.59	0.57	0.53	1.00
TR	0.34	0.44	0.47	0.49	0.45										

Source: Authors' calculation based on COMTRADE Database.

For capital inflows, El-Shennawy (2004) concluded that most factors that underline the attraction of FDI are largely available in the newly acceding countries when compared to SMCs. Such factors include political stability, rule of law, availability of skilled labor, larger market size, and hence in the short run the pattern of FDI is not likely to change much but in the long run the patterns are likely to divert away from SMCs to newly acceding countries. The accession process is likely to strengthen such factors in newly acceding countries and hence increase their relative attraction of such funds when compared with SMCs. In fact, as reported by the European Commission, the diversion of FDI toward newly acceding countries has already started. The newcomers have benefited from a wave of investment by EU companies in the automotive, retails, banking, energy and telecommunications sectors. For example, Volkswagen of Germany has taken over the Skoda vehicle group in the Czech Republic, France Telecom is a shareholder in the Polish operator TPSA, retail chains based mainly in France, Germany, the UK, Belgium and the Netherlands have set up supermarkets all across Central and Eastern Europe (European Commission, 2003*b*).

Based on the above analysis we conclude that the enlargement process in the short run is not likely to affect the trade patterns between the EU and SMCs due to several factors including the relatively small size of the newly acceding countries. However, the prospects of trade relations in the long run are likely to change if we include the financial variable into account (whether in terms of financial aid or FDI), and the increasing similarity of export structures between SMCs and newly acceding countries. Financial resources directed to the newly acceding countries are by and large exceeding those directed to SMCs. As a result, the institutional setup and different aspects of competitive advantage are likely to be further enhanced in newly acceding countries when compared to SMCs. Hence, despite that the enlargement process in the short run might not be negatively affecting the SMCs, the prospects for the future differ and tilt toward diverting trade as a consequence of diversion of financial flows away from SMCs to the newly acceding countries. Some might argue that outsourcing activities and niche specialization programs which are proliferating all over the world are likely to keep the competitive advantage in terms of cheap labor in SMCs with respect to newly acceding countries, which are likely to suffer from increasing costs due to the catching up process adopted by the EU to narrow down the differences in living standards. Although this might be true to a large extent, it remains highly dependent on the ability of SMCs to compete with other regions in the world such as China and South-East Asia. Given the competitive advantage that China and South-East Asia enjoy in a wide array

of goods and services whether in terms of cheap productive labor or higher technology, it is not likely that SMCs will have an advantage except when geographical proximity plays a role, as it is the case for agricultural products or some niches of textile industry where the time factor is crucial. However, even in those two cases, the restrictive agricultural trade policy adopted by the EU and the weak status of ports and high transaction costs related to transport, in the case of textiles, throw doubts on the ability of SMCs to retain their relative preferred position when compared with the South-East Asian countries or China.

It is worth noting that the enlargement process is still ongoing and hence the additional potential acceding countries are likely to draw much of the attention of the EU as well as of foreign investors. Beyond Bulgaria, Romania, and Turkey, there are other potential future members that are the countries of the Western Balkans region consisting of Albania and the former Yugoslav countries of Croatia, Macedonia, Bosnia-Herzegovina and Serbia-Montenegro. Such countries enjoy the same advantages of SMCs in terms of cheap abundant labor. The continuing enlargement process is likely to weaken the prospects of enhancing trade relations between SMCs and the EU as the probability of displacing their exports by potential new members becomes higher and the process of intra-EU specialization increases, crowding out the dependence on SMCs exports of goods and services.

In order to examine the effect of the enlargement process on exports of SMCs, we use two regressions based on gravity models with fixed effects where panel data are used for 4 SMCs, namely Egypt, Morocco, Tunisia, Jordan. The first model includes the EU-15 and the second one the EU-25. Comparing the results of the two models enables us to determine the impact of enlargement on SMCs' exports directed to the EU. We expect *a priori* that, if coefficients do not change in magnitude and significance, then, enlargement does not have an effect on SMCs' exports. However, it should be noted that the results we obtain are static and only capture short-term rather than long-term effects. This is important to emphasize as the gravity models used are based on the assumption that trade patterns will not change and they hence investigate potential level of exports of SMCs directed to EU-15 and EU-25 without taking in consideration scale effects, change of trade regime, or other reforms that might have been adopted by the newly acceding countries. Despite the fact that depending on such historical data might not reflect reality, however, we believe that it gives an indication of the expected effect of enlargement in the short run, since most of the acceding countries have started to undertake economic reforms in the early 1990s and hence any changes in their newly adopted economic policies should have been reflected

in their trade patterns and should have been effective during the time frame we depend on (1993-2003).

Despite the fact that gravity models have often been criticized for their lack of theoretical underpinnings, they seem to perform quite well in empirical analysis and are therefore well suited for policy analysis. Two important factors are taken into consideration while constructing the model in order to avoid biased and misinterpreted parameter estimates. These are: likely heterogeneity of trade flows across countries that should be accounted for in the model; in addition, time is expected to have a significant impact on bilateral trade flows. Hence, to capture these effects, a pooled time-series fixed effect model is used. The time period covered extends from 1993 to 2003.

The dependent variable is exports (*EXP*) of SMCs to the EU-15 in model (1) and to the EU-25 in model (2). The explanatory variables are: domestic and target country GDP per-capita, and distance.

The data used are obtained from the World Bank. Distance is taken from the World Atlas as the shortest road distance in kilometers between the capital of each of the exporting countries and Paris, the capital of France (available at: <http://www.worldatlas.com>).

The basic form of the implemented gravity equations concerning exports of the SMCs to the EU-15 and EU-25 during 1993-2003 is as follows:

$$[1] \quad \text{Exp}_{ijt} = a_0 + a_1\text{GDP}_{it} + a_2\text{GDP}_{jt} + a_3\text{DIST}_{ij} + U_{ij}$$

where:

Exp_{it} is the volume of exports from country (*i*) to country (*j*) in year (*t*). Country (*i*) is considered as each of the 4 exporting SMCs in both models. However country (*j*) is considered EU-15 in model (1) and EU-25 in model (2).

GDP_{it} is the domestic country (*i*) GDP per-capita in year (*t*). GDP_{jt} is the target country (*j*) GDP per-capita in year (*t*).

DIST_{ij} is the distance in kilometers between the capital of each of the SMCs (*i*) under consideration and Paris *j*.

U_{ij} is the error term, which is assumed to be uncorrelated across observations.

Estimating equation [1], we obtained the following two equations for models (1) and (2), respectively (see the Appendix for a detailed description of the obtained results):

Model (1)

$$\text{Exp(Egy-Eu15)} = -58997923 - 501.9337\text{GDP(Egy)} + 5.578997\text{GDP(EU15)Egy} + 18318.43\text{Dist(Egy-EU15)}$$

$$\text{Exp(Jor-EU15)} = -40590117 + 321.3734\text{GDP(Jor)} - 0.058474\text{GDP(EU15)Jor} + 11898.95\text{Dist(Egy-EU15)}$$

$$\text{Exp(Mor-EU15)} = 7.95\text{E}+08 - 330.4185\text{GDP(Mor)} + 0.913520\text{GDP(EU15)Mor} - 436321.2\text{Dist(Mor-EU15)**}$$

$$\text{Exp(Tun-EU15)} = 2.36\text{E}+08 + 401.3940\text{GDP(Tun)} + 4.130564\text{GDP(EU15)Tun} - 157446.4\text{Dist(Tun-EU15)**}$$

** : Significant at 99%.

Model (2)

$$\text{Exp(Egy-Eu25)} = -36484993 - 573.6092\text{GDP(Egy)} + 4.505544\text{GDP(EU25)Egy} + 11402.63\text{Dist(Egy-EU25)}$$

$$\text{Exp(Jor-EU25)} = -42872089 + 363.0743\text{GDP(Jor)} - 0.014259\text{GDP(EU25)Jor} + 12550.70\text{Dist(Jor-EU25)}$$

$$\text{Exp(Mor-EU25)} = 8.31\text{E}+08 - 737.3678\text{GDP(Mor)} + 1.132459\text{GDP(EU25)Mor} - 456255.7\text{Dist(Mor-EU25)**}$$

$$\text{Exp(Tun-EU25)} = 3.24\text{E}+08 + 59.28785\text{GDP(Tun)} + 3.128805\text{GDP(EU25)Tun} - 216578.8\text{Dist(Tun-EU25)**}$$

** : Significant at 99%.

It appears, when comparing the results of the two models, that they are almost identical. This means that the enlargement did not affect the volume of exports from SMCs to the EU yet, which seems to support the previously stated conclusion in Section 3 that the effect of enlargement is neutral in the short run. The results also show that the geographical proximity of Morocco and Tunisia are the only significant variables affecting the exports flows to the

EU. It should be noted that the results of the model are in line with our conclusions mentioned in Section 3 and that the model cannot anticipate the impact of enlargement in the long run.

5. Prospects for trade in services

The prospects for regional integration in trade in services are more promising than the prospects for merchandise trade whether between SMCs and the EU or even among SMCs themselves. Some analysts argue that SMCs do not appear on the list of the most important developing countries trading in commercial services, with the exception of Egypt (as an exporter) (see, for example, Zarrouk, 2000; and WTO website, 2004), and hence they are weak in terms of services trade. However, analyzing the data we find that there are some prospects for different initiatives of liberalizing trade in services due to the comparative advantage enjoyed by SMCs, as shown in Tab. 7.

Tab. 7 – Revealed comparative advantage of services exports in selected SMCs (2001)

	Egypt	Tunisia	Morocco	Jordan
Transport	1.4	1.05	0.82	0.87
Travel	1.38	1.91	2.04	1.74
Communications	1.19	0.21	2.63	
Construction	0.93	1.66		
Computer & Information Technology	0.1	0.23		
Insurance	0.09	0.28	0.24	
Financial Services	0.19	0.32		
Other business services	0.82	0.42	0.38	1.11
Recreational and social services	0.41			

Source: UNCTAD (2003), *Handbook of Statistics*.

In 2001, Arab countries (including SMCs) initiated a separate agreement on liberalizing trade in services on a regional basis. The agreement had a condition for Arab countries, which are members of the WTO to have GATS+commitments. In 2004, the first round of negotiations based on a request/offer approach was initiated. In general terms, Arab countries showed enthusiasm in liberalizing trade; however it is too early to assess the outcomes of this round of negotiations. Other studies (Fischer, 1993; Zarrouk, 2000) have emphasized that labor movements are the most evident and important

feature of regional integration in the Arab world. We believe that the economic prospects for such movements are quite promising, however the political and social problems likely to arise might limit the potential of increased integration depending on this mode (mode 4) of liberalization if trials are undertaken to regulate it. On the other hand, it is evident that less trade frictions are likely to arise from liberalizing services on a regional basis when compared to agricultural trade (due to the large number of sensitive products) and to manufactured trade (due to problems related to rules of origin and sensitive products as textiles). The reasons for this optimistic view arise from the nature of liberalizing trade in services where the layoff of labor due to liberalizing services is much less than in the case of liberalizing goods, and the absence of loss in tariff revenue that accompanies liberalizing trade in goods (see Ghoneim, 2003). Moreover, there is a strong belief that inefficient services (due to the lack of competition arising from non-liberalization) affect negatively the competitiveness of merchandise exports (see, for example, Hoekman and Djankov, 1997).

If we focus on the role of Association Agreements, enlargement and the ENP we find the following.

- The Association Agreements have not brought much to the issue of liberalization of trade in services. In the related articles the agreements postponed further liberalization than GATS commitments 5 years after the entry into force of the agreements. In 2005 several talks and rounds about deepening the liberalization of trade in services between the EU and SMCs have taken place. The outcome is not yet revealed, but it is very likely that deeper and/or wider commitments will take place. Moreover, the Arab GATS+agreement is likely to reinforce the aspect of regional liberalization of trade in services. What remains problematic is the mode 4 aspects related to movement of labor. It is not likely that the EU will be flexible in negotiating this aspect that is of great importance in some sectors as construction. Hence, the labor-intensive services that require the movement of labor are likely to face problems in liberalization. However, any further regional liberalization of services, in general, is likely to have positive spillover effects on SMCs economies as they are likely to create new jobs, reduce transaction costs, or both.
- As for the enlargement process, the trade in services is likely to be negatively affected as mentioned by some studies (El-Shennawy, 2004; Handoussa and Reiffers, 2003). It was perceived that the enlargement

process is a threat to SMCs where some services provided by the newly acceding countries are likely to displace services provided by SMCs. We believe that this might be true only in tourism and for certain niches, however in general the nature of competition in services differs from that in goods and the threat mentioned by El-Shennawy (2004) is exaggerated. The prospects for exporting services from SMCs to the enlarged EU are more promising than the prospects of merchandise exports, especially in business related services, communications and construction. Our judgment is based on the comparative advantage enjoyed by SMCs in such services and the fact that geographical proximity is not likely to affect exportation of such services to the EU in the case of business related services and communications which depend more on technology and lower labor costs than on geographical proximity. Moreover, importing services from the EU by SMCs is likely to lower the transaction costs of doing business in SMCs, which can enhance further their competitiveness (Ghoneim, 2003).

- The ENP provides an excellent chance for SMCs to deepen their services relations with the EU based on the *à la carte* approach. Moreover, any structural changes required will be supported by the availability of funds and can further enhance the presence of SMCs exports of services in the EU. This is one of the few advantages we see that the ENP is likely to bring and that is easy to be achieved as long as the SMCs include them in their Action Plans.

6. Conclusion and some policy implications

The study attempted to investigate the effect of the Barcelona Process, enlargement, and the ENP on SMCs. Our analysis has shown that in general there are no major differences, at least in their impact, of the three developments on merchandise exports of SMCs in the short run. This has been confirmed by the regression analysis showing that the enlargement process is not likely to affect the exports of SMCs.

The study has highlighted several issues, namely:

1. the Barcelona Process has not achieved its targets and has not overcome the pitfalls of the EU policy toward SMCs in the past;
2. the enlargement process is not likely to negatively affect the exports of SMCs to the EU in the short run; however in the long run the case is

- different and there is a larger threat of displacing SMCs exports to the EU;
3. the ENP represents a potential threat for SMCs in terms of diverting the financial flows from SMCs to the other countries included in the ENP initiative, especially those likely to accede to the EU;
 4. the prospects for liberalization of trade in services are more promising for SMCs than merchandise goods and the potential to be reaped is huge.

We believe that our analysis remains short of many aspects and hence our assessment of the different developments might be biased. The reason is that short time has elapsed since the real effective implementation of the three developments, and hence our assessment anticipates what is expected to happen in the future rather than depending on assessment of actual implementation. However, what we pinpointed is the institutional failures in the three developments where we showed that the Barcelona Process remained shallow, and that the ENP main objective is to secure the EU enlargement process based on the wording of several European Commission documents. We believe that there is a continued trend of diverting the attention of the EU away from SMCs. Hence we are not optimistic regarding the three main developments impacts on SMCs.

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Appendix

Output of Model (1)

Dependent Variable: EXP?
 Method: Pooled Least Squares
 Date: 11/07/05 Time: 22:37
 Sample: 1993-2003
 Included observations: 11
 Number of cross-sections used: 4
 Total panel (unbalanced) observations: 43

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EGY--GDPEGY	-501.9337	752.5951	-0.666937	0.5105
JOR--GDPJOR	321.3734	6450.284	0.049823	0.9606
MOR--GDPMOR	-330.4185	3680.281	-0.089781	0.9291
TUN--GDPTUN	401.3940	2531.649	0.158550	0.8752
EGY--GDPEU15EGY	5.578997	4.124640	1.352602	0.1874
JOR--GDPEU15JOR	-0.058474	4.796942	-0.012190	0.9904
MOR--GDPEU15MOR	0.913520	11.41361	0.080038	0.9368
TUN--GDPEU15TUN	4.130564	11.13706	0.370884	0.7136
EGY--DISTEGY	18318.43	63222.38	0.289746	0.7742
JOR--DISTJOR	11898.95	215225.5	0.055286	0.9563
MOR--DISTMOR	-436321.2	61872.89	-7.051896	0.0000
TUN--DISTTUN	-157446.4	66068.25	-2.383087	0.0245
Fixed Effects				
EGY--C	-58997923			
JOR--C	-40590117			
MOR--C	7.95E+08			
TUN--C	2.36E+08			
R-squared	0.979110	Mean dependent var		2658299.
Adjusted R-squared	0.967504	S.D. dependent var		2072352.
S.E. of regression	373573.4	Sum squared resid		3.77E+12
Log likelihood	-602.7365	F-statistic		115.0437
Durbin-Watson stat	1.858560	Prob(F-statistic)		0.000000

Output of Model (2)

Dependent Variable: EXP?
 Method: Pooled Least Squares
 Date: 11/07/05 Time: 22:17
 Sample: 1993-2003
 Included observations: 11
 Number of cross-sections used: 4
 Total panel (unbalanced) observations: 43

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EGY--GDPEGY	-573.6092	755.4543	-0.759290	0.4543
JOR--GDPJOR	363.0743	6441.237	0.056367	0.9555
MOR--GDPMOR	-737.3678	3663.279	-0.201286	0.8420
TUN--GDPTUN	59.28785	2468.350	0.024019	0.9810
EGY--GDPEU25EGY	4.505544	3.511166	1.283205	0.2103
JOR--GDPEU25JOR	-0.014259	4.053308	-0.003518	0.9972
MOR--GDPEU25MOR	1.132459	9.634526	0.117542	0.9073
TUN--GDPEU25TUN	3.128805	9.208574	0.339771	0.7367
EGY--DISTEGY	11402.63	68565.24	0.166303	0.8692
JOR--DISTJOR	12550.70	212574.0	0.059042	0.9534
MOR--DISTMOR	-456255.7	76874.09	-5.935104	0.0000
TUN--DISTTUN	-216578.8	59811.89	-3.620999	0.0012
Fixed Effects				
EGY--C	-36484993			
JOR--C	-42872089			
MOR--C	8.31E+08			
TUN--C	3.24E+08			
R-squared	0.978658	Mean dependent var		2606211.
Adjusted R-squared	0.966801	S.D. dependent var		2049539.
S.E. of regression	373435.4	Sum squared resid		3.77E+12
Log likelihood	-602.7206	F-statistic		112.5561
Durbin-Watson stat	1.842687	Prob(F-statistic)		0.000000