

# Euro-Mediterranean Commercial Integration: Unequal Distribution among the Countries

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## The Logic of Trade Integration and Its Shortcomings

Regional integration has a major role to play in expanding trading capacities and facilitating competition and innovation. With the elimination of market-access barriers, the driving force is the increase in trade within regions rather than across them. The concern, in particular in relation to the European region (or bloc), is asymmetry in comparative advantages and disparity in the economic and social size of the two regions and within each region.

How important is trade among Mediterranean countries? How important are the disparities and asymmetries? How relevant is the level of openness within and across the region?

The Barcelona Process is the central instrument for Euro-Mediterranean relations. Initially, 27 parties were involved: 15 European Members and 10 Southern and Eastern Mediterranean States (plus Cyprus and Malta before joining the EU). Launched in November 1995, the Process aimed to establish a common area of peace, stability and prosperity in the Mediterranean. It represented an innovative alliance based on the principles of “joint ownership, dialogue and cooperation” in several areas, including economic and social integration within a Euro-Mediterranean free trade area (EMFTA) by 2010.

With the enlargement of the EU in 2004, the logic and scope of the original institutional framework became unsustainable. One could say that the Process was derailed by a series of internal and external caus-

es. The number of EU members grew to 27, and two new members joined the Mediterranean countries (Albania and Mauritania) to make a total of 39 parties involved following the introduction of the European Neighbourhood Policy (ENP).

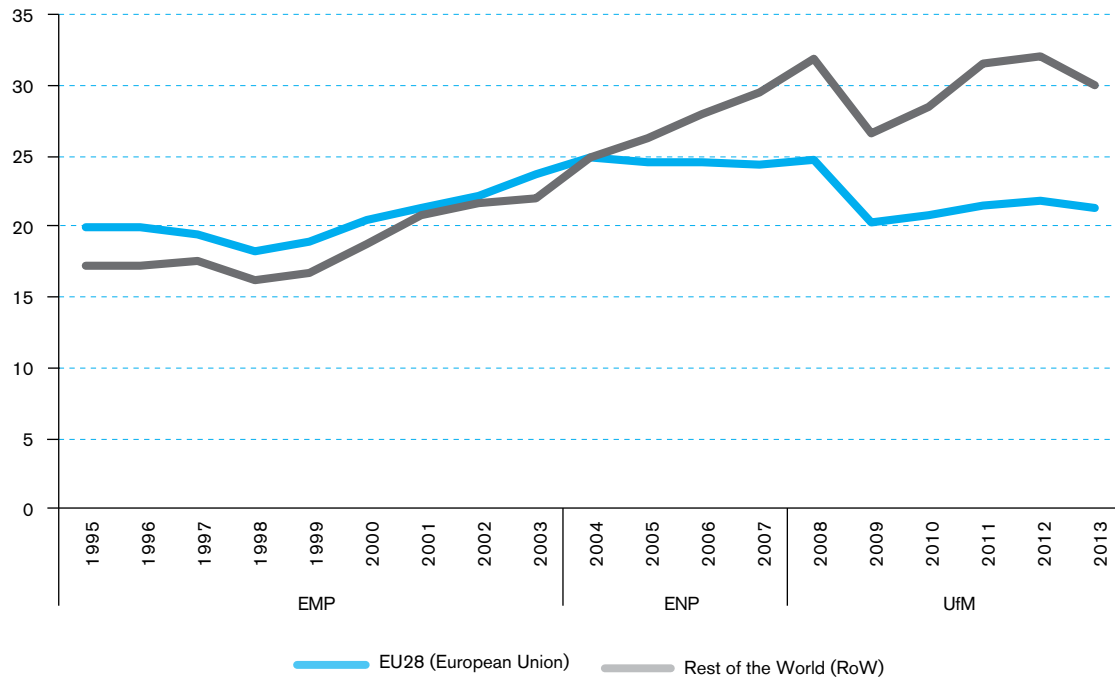
Other causes are more political and institutional. A parliamentary dimension was added in March 2004, while the Agadir Agreement of the same year was instrumental in reinforcing economic integration and supporting the gradual implementation of the EMFTA. In 2005, a migration chapter was added as a fourth key policy area of the partnership, which served more to raise expectations than create effective results. In July 2008, the agreements on the Union for the Mediterranean (UfM) with the extension to five southeast European non-member states and the creation of the Secretariat in Barcelona tried to relaunch the Euro-Mediterranean Partnership.

Although the goal of EMFTA was not reached, the benefits for the SEM countries (southern and Eastern Mediterranean) were consistent, as was predicted by the economic literature: greater openness, growth in income and employment and growing expectations for a better future [Baldwin and Venables (2004), Sideri (2001); FEMISE (2010)].

## The Outcomes: a Second-Best Solution

It is well known among economists that trade patterns and comparative advantages are influenced by many factors, including the endowment of resources, institutional factors related to commercial policies and incentives provided to economic agents and institutions. All these factors were part of joint and bilateral negotiations during the various stages of the Barcelona Process. As a ‘second-best’ solution, the outcomes were never going to be ideal for either

CHART 1 MED 11: Export + Import to GDP



side. Some partners retained a dominant position as oil and gas exporters, which protected them from competition. Other partners, however, have similar factor endowments and consequent comparative advantages, both for industrial and agricultural products, making the Partnership very sensitive, particularly in the short term, as it exposes the domestic producers to greater competition from each other.

### Preferential Access

The Association Agreements and Action Plans covered a broad range of issues going well beyond trade, including not only commercial preferences, but more substantial and specific economic incentives and domestic reforms. The validity of this approach has been confirmed by numerous empirical studies that explore the effects of a tariff, or its non-tariff equivalent, reduction. First of all the agreements have offered more opportunities to a greater variety of products (extensive effect) and differentiation; secondly the reduction of transactional costs and tariffs allowed an increase of volume and value of products already traded among

partners (intensive effect). The empirical results have confirmed both effects: a decrease in concentration of products and an increase in trading volumes, which fosters trade integration. [Cipollina, M., Pietrovito, F. (2010); Jarreau J. (2011); Femise (2011)].

### The Larger Openness

The deep-integration approach was instrumental in raising trade openness. Using as an indicator the trade-to-GDP ratio of the 10 SEMs,<sup>1</sup> the index shows that these countries succeeded well in opening their economies to international trade, but the geographical structure may be cause for concern. For the Euro-Mediterranean Partnership the outcome is mixed, in particular for exports from SEMs to the EU. For example, Périddy (2007) finds that EU preferences led to a 20-27% increase in exports from Mediterranean countries over the period 1995-2001, i.e. the period covering the first six years of the Barcelona Process. However, De Wulf and Maliszewska (2009) show that southern Mediterranean exports to the EU have increased by less than their

<sup>1</sup> Israel is not included, despite being a partner in the Barcelona Process, as it has economic, political and social features similar to those enjoyed by advanced countries.

exports to the rest of the world. Both patterns are reported in Chart 1, which shows the openness ratio during the three phases of the Barcelona Process. Taking advantage of EU preferences, SEM partners have built up a more competitive and diversified export capacity. The overall trade openness ratio rose significantly from 18% in 1995 to 28% in 2013. However, it can be observed that the significant contributions to the openness created during the first phase of the EMP have not been sustained by the incentives offered within the ENP and UfM. Since 2004, higher growth rates were achieved with extra-regional partners offering more opportunities to diversify SEM trade flows, in particular in the Gulf area or outside. As of 2013, the share of total trade in GDP for SEM countries exposed to the EU 28 was significantly lower than the previous EMP period, where trade represented only 22% of the value of their GDP compared to more than 30% for the Rest of the World (RoW). (See Chart 1.)

Links through foreign investments typically played a prominent role on this performance, but not enough to explain what happened in the second decade of the Partnership. This review provides several factors: from higher integration through other preferential agreements between Arab countries, including the Agadir Agreement, which seems to have performed reasonably well<sup>2</sup>, to narrower independent initiatives with large trading countries like India, China and also Turkey (a partner in the Euro-Mediterranean partnership).

Although an empirical literature has flourished on the technical issues of the agreements (preferences, length of negotiations) an important aspect cannot be neglected: the change of the competitive advantages of the region as a consequence of the fifth enlargement of the EU and the simultaneous accession of the former Eastern Bloc. The effects were significant, as the enlargement and the consequent set-up of the ENP gradually eroded the preferences designed to foster trade and investment integration. Still the UfM initiative has fallen short of expectations. Mostly because of the financial crises between 2008 and 2009, that shaped a significant drop in

external trade, but ultimately due to the shortcomings of its scope based on bilateral incentives.

The evidence may suggest that EU preferences did have some success on the economic front, as trade and investments contributed to more openness and more diversification in their export flows. However the original design has shifted since 2004 to a more 'shallow' integration, due to the complexity of the problems confronting the EU and its partners and the new conflicts within the region that have hampered political and administrative reforms.

## EMFTA remains a dream, an ideal aspiration challenged by other important international players, in particular the Arab Gulf countries, which need to invest and diversify their large financial surpluses

EMFTA remains a dream, an ideal aspiration challenged by other important international players, in particular the Arab Gulf countries, which need to invest and diversify their large financial surpluses. Ultimately, in this competitive geopolitical environment, the efficiency of the conditionality/preferential logic rests on a cost-benefit calculation of the governing elites of the SEM countries. Since there are costs associated to the structural reforms that comply with the implementation of the *acquis communautaire*, the elites of the region may choose to avoid them, preferring to redirect their trade flows to other more mercantilist partners. In the end, the strong export growth and FDI inflows have not been translated into similarly strong economic and social progress and the outcome has been disappointing.

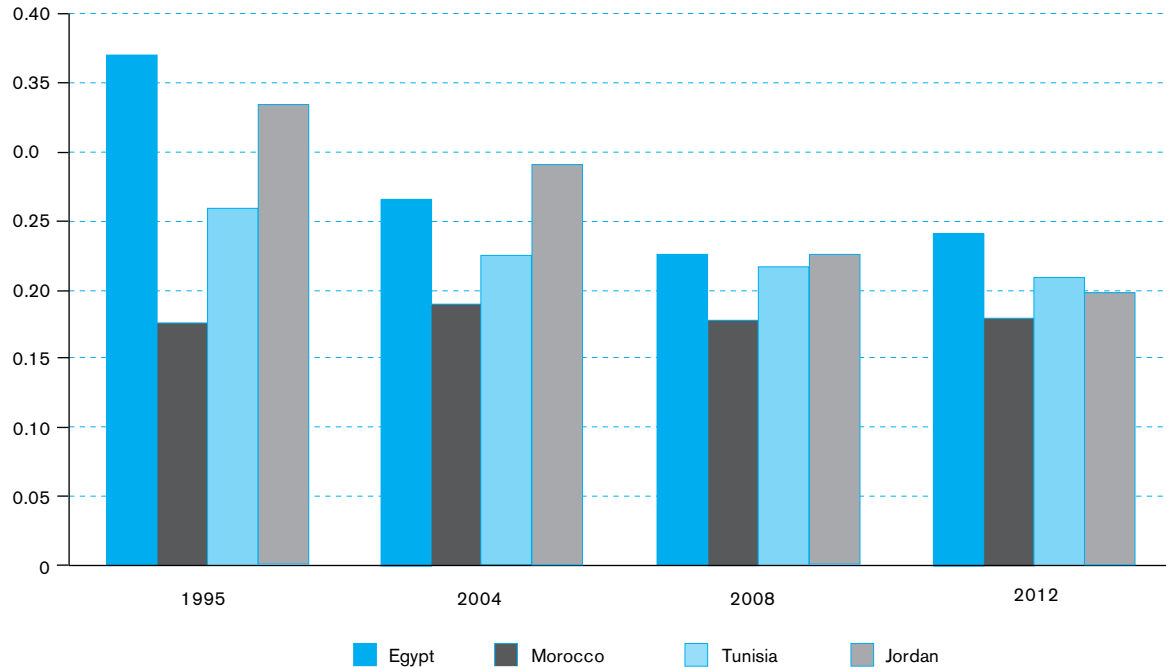
### Product Concentration

Product concentration is another aspect of the asymmetry and vulnerability of the Euro-Mediterranean integration. The concentration of SEM export flows<sup>3</sup> is

<sup>2</sup> Among developing countries, the MENA countries have the highest preferential margin (RPM), which facilitates intraregional trade, at almost 5%, higher than South Asia (4% RPM) or Central Asia (about 1.8%). NICITA (2011).

<sup>3</sup> Values of the Herfindahl-Hirschman Product Concentration Index computed by UNCTAD as a measure of dispersion of trade value across the exporters' products.

CHART 2 Concentration of Exports to EU27



well known, especially regarding natural resources or labour-intensive manufacturing. Particularly high values indicate the exporters' dependency on few products or on few trading partners, but also the potentially high benefits from the reduction of trade barriers. Moreover, diversification helps to mitigate the effects of negative trade shocks especially when product varieties and foreign markets are not perfectly correlated and the negative shocks in some areas may be offset by positive shocks in others.

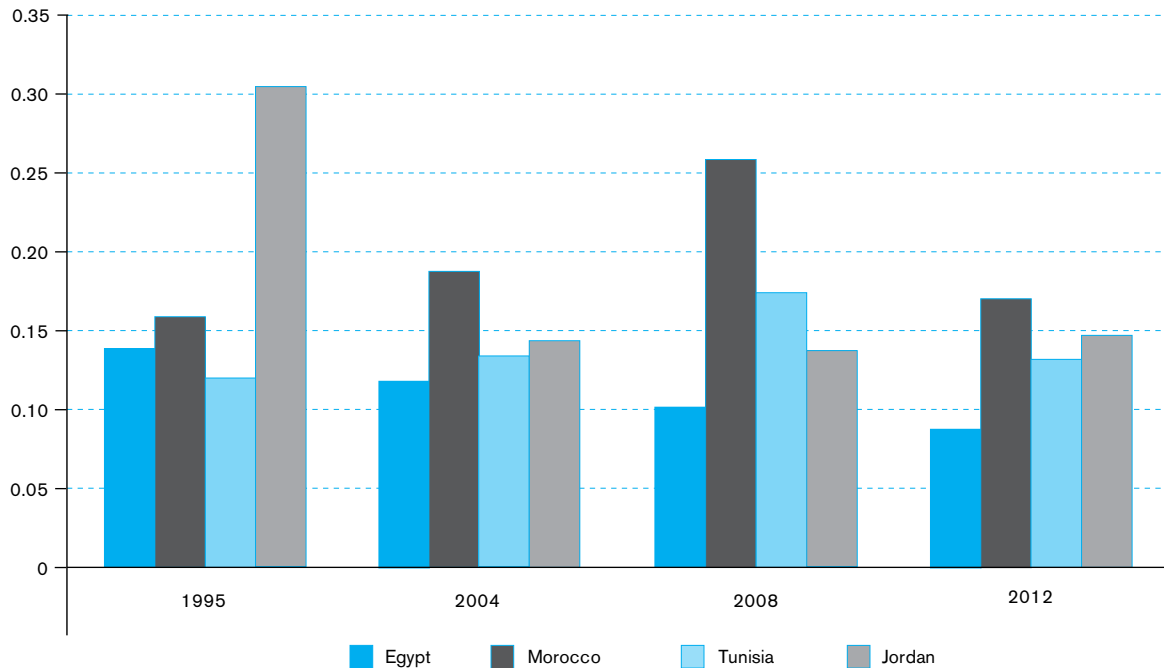
Measured over time, as in Chart 2 and 3, a fall in the index is an indication of greater diversification in the SEM's export structure. Two decades of Mediterranean cooperation reveals that product differentiation based on comparative advantages increased in most countries in the region. There are, however, some differences when we compare the concentration of SEM exports to both EU and Arab countries of the MENA region. The GAFTA preference system seems to be more generous than the EMFTA, as the level of concentration, although decreasing, remains higher for Tunisian, Egyptian or Jordanian exports to the EU, compared to a more diversified structure when trading with the MENA countries.

The economic transformations have gone in the right direction, reducing disparities and creating new opportunities. Additional benefits from this process are

the result of the industrial relocation of European enterprises, creating new sectors that sustained the positive relationship between export growth and diversity. In addition, the evidence confirms that greater diversification stabilises export earnings and generates positive spillovers and externalities for competition and employment. [Alessandrini S. (2014)]. (See Chart 1 and Chart 2.)

### Geographical Differences

The traditional division into four sub-regional groups has not changed. One could say that the 'hub-and-spoke' approach has reinforced this feature with new priorities and geopolitical preferences. Excluding Turkey and Israel for their specific policy aspirations and size, the southern-eastern divide of the Mediterranean region has been strengthened. Egypt, Jordan and Lebanon have promoted comprehensive reform programmes and have achieved more progress in integration with Arab countries and some Asian economies, while Morocco and Tunisia have made important steps toward greater trade integration with the EU. The European Union remains the main trading partner for five of the 11 countries participating in the Barcelona initiative. Europe 28 receives more than



40% of their total exports. Two of them are major oil exporters (Algeria and Libya) and three are traditional partners (Morocco, Tunisia, and Turkey). Excluding the oil producers, the other partners indicate a gradual diversification to other industrial countries (benefitting from preferential treatment or FTA) or to the Gulf region. The most notable change here is the decrease in Egypt's export share. In 2013, the European Union accounted for just 29.3% of its exports compared to 54.5% in 1995 and 36.5% in 2008. This diversification is very significant and confirms the greater attraction for the Arab partners, which accounted for 32% of Egyptian exports in 2013, reflecting the overall extra-regional orientation of this country, despite the Agadir Agreement.

On a more disaggregated level one can also observe the change of the EU's perception and commitment to the Mediterranean Partnership. The direction of trade, in particular SEM exports to Europe, has changed over the course of the last 20 years due to new geopolitical priorities among the SEM partners, as well as changing interests among European importers. Chart 4 shows the share of MED 10 exports to the five major European partners (Italy, France, Germany, Great Britain and Spain).

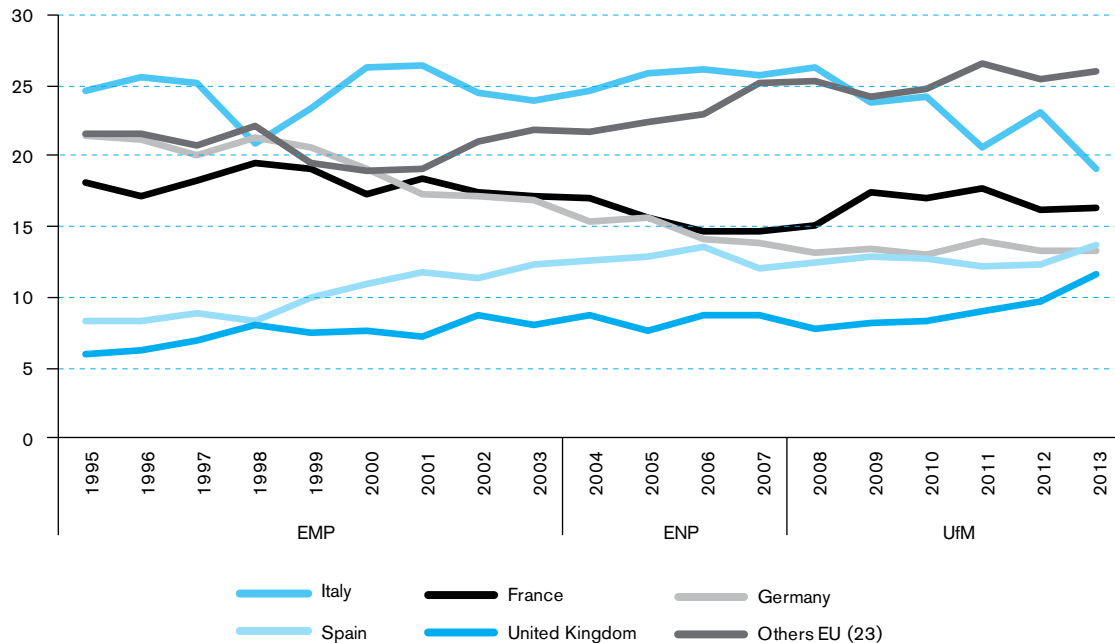
From the beginning of the partnership, Italy and Germany were the two main export destinations for the

region (more than 20% each), with France in an intermediate position and Spain and United Kingdom in a more secluded location (less than 10% each). The degree of concentration was thus very high, with an absorption of the other 23 European countries of only one fifth of the EU's imports.

The evidence is certainly consistent with the idea that, during the first decade of the partnership, Germany gradually fell into an intermediate position in MED 10 exports, despite its stronger integration with Turkey, which acts as a gateway for investors and exporters to reach parts of the Middle East and Mediterranean. The second notable trend is the increased interest and orientation of Spain and the United Kingdom with growing market shares. The French position is partly aligned with German interests, before recovering positions and voice during the ENP and after proposing the creation of the UfM. Exports from SEM countries suffered after 2009 not only because of the drop in oil prices, but also due to the contraction of European domestic demand. Italy maintained its leading position as the main destination, although its market share declined almost 5 percentage points between 2009 and 2013, while the shares of Spain and the United Kingdom continued to perform more robustly.

Considering that the enlargement of the European market after 2004 did not create favourable condi-

CHART 4 MED 10 to EU 28: Percentages



tions for further integration between the two shores of the Mediterranean, it is worth noting the exception of Turkey: its share of total EU imports increased along with its role as a Euro-Asian and Mediterranean gateway that enjoyed growing bilateral exchanges with SEM countries.

The initial distribution of trade flows, among top importers and small niche countries, is now converging to a more diversified shape. These features underline an alternative interpretation of the Euro-Mediterranean Partnership; despite the poor results in encouraging greater integration between the two regions and inability to prevent contrasts and tensions in Southern Europe, the ENP has offered the legitimisation for more (un-balanced) economic relations to the central and northern countries of Europe, so that their cumulated share of MED 11 exports absorbs a quarter of European imports (up from 20% at the end of the nineties). (See Chart 4.)

### Weak Interregional Integration

If the ambitions are to stimulate sustainable development in SEM countries the 'hub-and-spoke' integration approach revealed quite controversial difficulties for the partners on the eastern shore.

Chart 5 shows the trade links among the southern and eastern shores of the Mediterranean Basin. The degree of integration is measured by the share of exports, which is very low; well below its potential. The subregions are under-traded in particular for the AMU (Arab Maghreb Union) and North Africa (which includes Egypt and Libya) with an export value of less than 5% of total exports. Some positive changes can be observed after 2004, including an increase in intra-regional exports, which is particularly promising for the AMU, and the doubling of the index value from 2004 and 2013. This is very different to the expansion of trade with the MENA 19: the integration index reached 20% of total exports in 2013 from 12% in 1995. (See Chart 5.)

The evidence is clear: integration forces and trade liberalisation are supported by an extra-regional model which is less ambitious. Several features are shared by most of these countries. Tariff barriers were gradually reduced over the two decades, while non-tariff barriers and rules of origins were eased with the application of the cumulative rules of origin specifically stated within the Agadir Agreement and GAFTA. The progress has been slow and the region remains economically divided, with the lowest level of intra-regional trade and economic integration

compared to other regional arrangements. Non-tariff barriers and rules of origin continue to distort relative prices and restrict trade within the SEM region, as emphasised by Augier et al. (2013) and Ghoneim (2012). The second impediment is the concentration of their exports and their substitutability, which restrict specialisation and further trade. Thirdly, the lack of integrative infrastructures and facilities, including poor and corrupt administrations, increases cross-border costs.

### Growing Trade Imbalances

Among the risks introduced by the Euro-Mediterranean policies, the economic literature has reported the increased trade deficit caused by the dismantling of trade barriers. The ex-post evidence shows a quite different evolution, in part due to the dynamics of oil prices. The partner countries differ considerably: on the one hand, two countries are oil exporters that accumulated significant surpluses over the two decades; the other partners have been able to manage a bilateral deficit that has never exceeded the sustainability level, as the merchandise trade deficit has been compensated by non-trade elements of services and private transfers, specifically tourism and remittances.

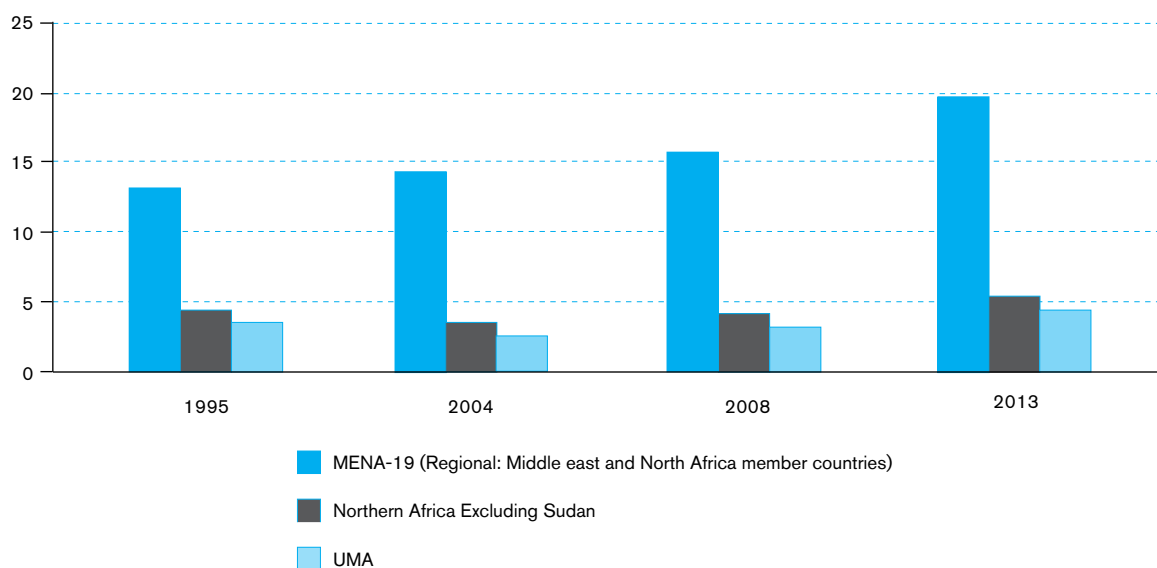
Turkey is a special case, as it changed its focus from an import-substitution system to an outward-oriented growth one. The trade deficit was sustained for a long time with non-trade surplus flows. However, the multidimensional characters of the current global crises had a negative effect on its exports, so that since 2010 Turkey shows an average trade deficit with the EU of over \$20 billion per year.

However, it is equally interesting to observe the changes in the EU's bilateral trade balances. The traditional trade deficit of SEM countries and the related dichotomy shaping Europe's external relations worsened from 2004 to 2008: Italy, Spain and the United Kingdom remained net importers of energy products and generated a growing deficit due to high oil prices and the growth of their economies. Soon after their economies went into recession in 2009, trade deficit fell sharply to lower levels. The exception is the UK that continued to run consistent deficits with the region.

Across the other European countries, exchanges generated a surplus that, for the large exporters, did not exceed \$5 billion annually. What is interesting to observe is the growing neo-mercantilist propensity to accumulate trade surpluses from the Central European countries (over \$14 billion in 2013), that led to a move away from the spirit of the initial agreement inspired by the principles of shared prosperity,

CHART 5

## Intra-Regional Integration\*

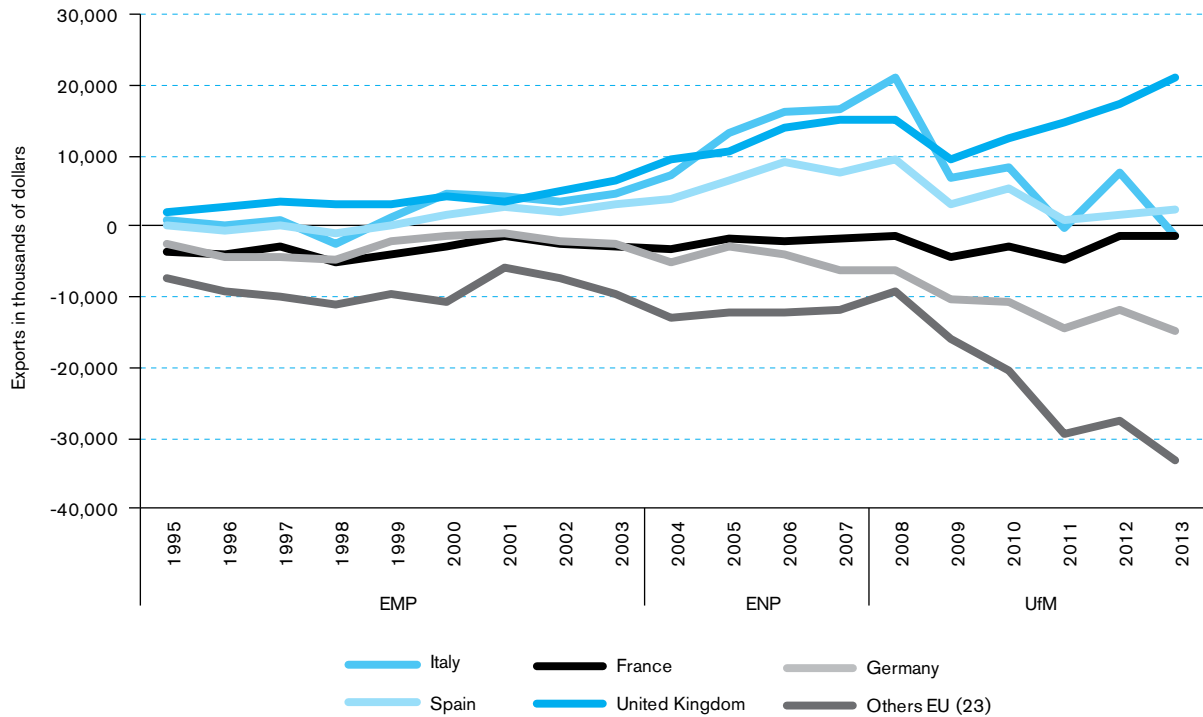


\* MENA-19 includes the following countries: Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Syria, Tunisia, Turkey, UAE and Yemen.



CHART 6

MED 10 Regional Balance: Growing Disparities



joint ownership (i.e. jointly-defined policy) and common development.

Not surprisingly, the outcome of the UfM was the increase of the bilateral trade surplus of Germany and 23 other countries (here aggregated in Chart 6), compensating the trade deficit of the three countries of the southern littoral. This may be justified by the export market diversification of the SEM countries underlined above, but it also reflects the diverging trends within EU countries. Of course, these patterns may not be interpreted as the sole consequence of the UfM partnership agreements, but certainly oppose the abstract concepts of integration and solidarity among countries, and contrast with the mercantilist approach of the economic agents when they enter the international markets. These recent patterns demand an explanation, since they reveal the nature of the market that has been established on the northern shore of the Euro-Mediterranean region: it strengthens the 'hub-and-spoke' logic and weakens the growth potential. This is a direct contrast with the original aims, namely, to use the bilateral and regional (South-South) trade to strengthen the potential for growth, differentiate production and create an integrated regional area.

## Conclusions

SEM countries need to create millions of jobs in order to accommodate the rapid expansion of the labour force in the region. The problem today is the sense of frustration emerging from the results of 20 years of regional integration: low per-capita GDP growth, growing employment problems, undocumented migration and still higher tariffs that are twice those of the emerging economies. The Euro-Mediterranean project has changed its character and has become increasingly fragmented, while the South-South integration through GAFTA and the Agadir Process remains weighed down by a lack of political commitment and serious structural impediments. Despite its economic crisis, Europe should continue to open its own markets to products from the region. Europe should also realise that the initial proposal to create a free trade zone in the wider Mediterranean area has failed, but that the actual bilateral approach in negotiating with partner countries is not a win-win solution. It reinforces a core-periphery approach rather than sustaining a true and sustainable region-wide integration among the SEM countries. We may expect these initiatives to send the right signals to



encourage trade openness -the goal- and identify the measures which are needed to give these countries prospects for economic progress. The Arab springs of 2011 and today's migration flows have made it increasingly clear that the region has a potential of young and educated citizens; they are asking for opportunities, they need policies and perspectives of social and inclusive development. The resistance to modernisation, the timid reforms, often late in their enforcement, all contribute to reducing opportunities and sustaining instability.

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