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The Euro-Mediterranean Partnership: Policy and Research Issues*

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The Euro-Mediterranean Partnership (EMP), launched at the Barcelona Conference in 1995, represents a renewed involvement of the EU with its Mediterranean Partner Countries (MPCs).¹ The partnership covers political, economic and social aspects. Establishment of a Mediterranean Free Trade Area (FTA) by 2010 is its focal point. The partnership consists of two elements: Association Agreements (providing the institutional framework for cooperation and trade liberalisation), and financial support through the MEDA programme (a financial support programme providing funds for easing structural adjustments in the MPCs).

The EU and the MPCs have different stakes in the EMP. The MPCs are a minor (potential) market for the EU. For the EU the establishment of the FTA should therefore be seen as part of its security strategy: increasing stability at its southern border by promoting economic growth, and fostering links between the two regions. For the MPCs the EU is a major trading partner and the FTA would offer a major increase in trading opportunities. The EMP can also serve as a way of locking-in structural reforms of the MPC economies that would be difficult to achieve otherwise. Whether the EMP will achieve its aims depends on the way the EMP is implemented, and on factors affecting the performance of MPC economies.

Domestic causes of the poor growth record of MPCs

MPCs are faced with a poor growth record (tracking behind achievements of comparable other countries), high population growth, and high current levels of employment. As a result their economic growth is not able to absorb the growing working population, creating concerns for social stability and migration. Their lagging economic growth can be attributed to three causes: high dependence on oil exports and remittances, high protection of the domestic market and excessive state interference in the economy.

Oil exports and remittances are important sources of foreign exchange for a number of countries, distorting their economy by boosting domestic demand ('Dutch disease'). The resulting appreciation of the exchange rate promotes investments in non-traded sectors while reducing investments in the traded sector. A second factor takes the form of high protection rates. The MPCs are among the

most protected regions of the world, in contrast to the global trend towards reduced protection. Their domestic firms are sheltered from international competition, reducing incentives for efficiency improvements. This high protection in combination with a focus on non-traded sectors with an inflow of non-trade foreign exchange resulted in a production structure that is not internationally competitive. A third factor is the extensive influence of the state on the economy through an over-staffed public sector and a dominant presence of state enterprises. Booming oil revenues in the 1970s and 1980s further stimulated public sector expenditures.

Asymmetric liberalisation achieved by the EMP

By reducing protection the EMP affects only one cause of lagging economic growth, thus limiting its contribution to spurring economic growth in the MPCs. The contribution of the EMP is further reduced by a limited scope of liberalisation and the structure of the agreements. A major difference with earlier agreements is the reciprocal nature of trade liberalisation in the EMP. Due to earlier agreements, a good share of MPC manufacturing exports has had free access to EU markets since the 1970s. Industrial trade preferences in the EMP are therefore in effect unilateral liberalisations by the MPCs. At the same time liberalisation of agricultural trade and trade in services is very limited. In a nutshell the EMP is thus reduced to simply opening the closely protected MPC markets to manufactured goods from European producers.

Apart from an asymmetry in the extent and pace of liberalisation, the EMP has a geographical asymmetry. Although the Barcelona declaration calls for the establishment of a Mediterranean FTA, the EMP consists of bilateral agreements between the EU and individual MPCs. The result is a hub-and-spoke structure favouring EU producers. This structure reduces the scope for MPCs to attract FDI, and leads to an unequal distribution of benefits from liberalisation between the EU and MPCs. Furthermore, the different pace at which agreements are concluded could give some MPCs a head start in creating a more competitive production structure. Future South-South integration (for example through GAFTA or the Agadir agreements) could then lead to an unequal distribution of the costs and benefits among MPCs, creating political tensions.

¹ The EMP gathers, besides EU members, three candidates to EU membership (Cyprus, Malta and Turkey) and nine countries negotiating new EuroMed Association Agreements (Tunisia, Morocco, Israel, Palestinian Authority, Jordan, Egypt, Lebanon, Algeria and Syria).

Non-coherent policies

Agricultural liberalisation could provide an important impetus to general economic growth in the MCPs, by reducing poverty (generally located in the rural areas), and by increasing (rural) employment. It could therefore make an important contribution to achieving the security aims of the EU. In practice, however, agricultural trade liberalisation is dominated by domestic policy concerns; the EU is not granting any noteworthy new concessions in agricultural trade. This implies that the current complex structure of agricultural tariffs and non-tariff barriers is being maintained to protect EU producers of 'Mediterranean' products. The MCPs mimic this behaviour by maintaining their high protection on staple foodstuffs. The net result is an effective lack of liberalisation of agricultural trade. Liberalisation of the flow of natural persons could also contribute to economic growth in MCPs, since remittances play an important role in their economies. The EMP, however, does not offer anything beyond the results obtained through GATS, implying an absence of liberalisation of services.

The limited scope of the liberalisation achieved through the EMP, and especially the lack of agricultural liberalisation, have strong implications for the effects of the EMP. Excluding agriculture blocks an avenue for increasing (rural) employment and economic growth, both of which could ease the impact of reduced tariff income from unilateral liberalisation of manufacturing trade by MCPs. At the same time disbursement of MEDA funds (meant to ease the transition) is only a third of the commitments, and the implementation of MEDA shows serious shortcomings. EU policies towards the Mediterranean region can therefore be characterised by a strong contradiction between foreign policy objectives (increased stability and prosperity at the Southern border) and domestic policy concerns (protection of agricultural producers and fostering the interests of producers of manufactured goods).

Policy issues

In light of the above, the following policy issues can be identified:

- *Coordination of domestic and foreign policy interests.* Foreign and domestic EU policies towards the MCPs are currently conflicting. Explicitly considering conflicting objectives would foster the consistency of EU policies, and would support development of alternative policies satisfying the multiple objectives of the EU.
- *Design of policies to support structural changes in the MCPs.* Liberalising trade reduces high protection levels in the MCPs, but it also has strong implications for government tariff revenues. The EU should take the structural features of the MCPs into account to avoid unwanted side-effects (such as social unrest) and to be more effective in stimulating economic growth.
- *Promotion of south-south integration.* To achieve the aim of a prosperous and secure Mediterranean region, South-South integration should become an integral part of the EMP.

Research issues

To support the formulation of policies that account for the political and economic reality on both the EU and MPC side, the following research issues can be identified:

- *The extent and impact of non-trade barriers (NTBs).* The increasing importance of NTBs for trade in food (e.g. vertical integration of production, grade and quality standards) implies on the one hand that the impact of agricultural trade liberalisation could be limited. On the other hand, they provide an opportunity for designing policies that promote integration of MPC agriculture in European chains, possibly promoting agricultural growth within the limits of the current protection structure.
- *Contribution of liberalisation with the EU to economic growth in the MCPs.* Taking promotion of economic growth in the MCPs as the aim of the EMP, limited insight is currently available on how the EMP interacts with MPC policies and structural features of MPC economies. Most existing studies focus on the (lack of) liberalisation on the EU side, while limited insight is available on the structure of protection on the MPC side, their trade agreements with third parties (notably the US) and the impact of their policies on economic growth and poverty reduction. Furthermore, the different pace at which agreements are being concluded with the MCPs may affect the distribution of costs and benefits when establishing a Mediterranean FTA.
- *Regional impact of liberalisation in the EU and possible links with eastward expansion.* Liberalisation of trade with the MCPs will have a negligible impact on the EU as a whole. The main opposition to liberalisation stems from Southern EU producers who will face increased competition. At the moment there is no insight into which regions will be negatively affected by a liberalisation of agricultural trade with MCPs. Furthermore, the eastward expansion of the EU possibly offers new markets for the southern EU producers, which could offset the negative impact from liberalisation with the MCPs. Such a linking of South and Eastward expansion could make establishment of a Mediterranean free trade more feasible politically.

* This Policy Brief is based on ENARPRI Working Paper No. 2, *Which Road to Liberalisation? A First Assessment of the Euro-Mediterranean Association Agreements*, Crescenzo dell'Aquila and Marijke Kuiper, September 2003.

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