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Survival of the Fittest: The First Five Years of Euro-Mediterranean Economic Relations

Tobias Schumacher



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The First Five Years of Euro-Mediterranean Economic Relations*

TOBIAS SCHUMACHER

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## Abstract

The EU's development strategy towards its Southern *near abroad* resembles the development economic *Leitmotiv* of the early Nineties, i.e. the Washington Consensus with its three pillars of macro-economic stabilisation, structural adjustment and liberalisation. Beyond that, however, it rests on the modernisation theoretical basis paradigm developed by Seymour Martin Lipset in 1959. In accordance with the optimistic convergence hypothesis, both the European Commission and the Council of Ministers assume that economic development correlates positively with the creation of democratic structures in the Third Countries of the Mediterranean (TCM). In other words, economic liberalisation, as a prerequisite for both the introduction of Euro Mediterranean Free Trade and the expansion of the Euro-Mediterranean trade exchange, should lead to increasing prosperity as well as to the formation and the widening of middle class actors. These should, in turn, due to their newly acquired participation rights in the economic area, almost inevitably demand further participation in the political realm. Ideally, this would be followed by a political liberalisation process that encompasses the whole Southern Mediterranean area and that will result in a democratisation of all the TCM.

Based on this assumption and the concept of incomplete contracting, this study aims to show two interrelated insights: 1.) that the main goal of the Barcelona Process, i.e. to contribute to the socio-economic development in the TCM, has not been achieved during its first five years; 2.) that the envisaged modernisation theory-inspired spill-over from the economic to the political level was severely hampered. It will be shown that the Euro-Mediterranean trade nexus, which appears as the primary tool for the realisation of the EMP's above mentioned objective, has been adjusted to the needs of EU-European market providers while the asymmetrical structure of Euro-Mediterranean trade—which was already visible during the *approche globale* and the subsequent 'Renovated Mediterranean Policy'—as been further aggravated to the disadvantage of the TCM. The paper concludes with some remarks related to the linkage between the structure of Euro-Mediterranean trade relations and the explanatory power of modernisation theory.



## I. Introduction

With the adoption of the Barcelona Declaration at the Euro-Mediterranean Foreign Minister's meeting in the Catalan capital at the end of November 1995 and the conclusion of the so-called Europe-Mediterranean Association Agreements (EMAA's), the European Union (EU) has re-conceptualised its long-standing political and economic relations with the twelve Third Countries of the Southern Mediterranean (TCM).<sup>1</sup> The objective of the Euro-Mediterranean Partnership (EMP), or the Barcelona Process as it is also known, is to turn the Mediterranean basin into an area of dialogue, exchange and cooperation that guarantees peace, stability and prosperity. According to the Barcelona Declaration, this requires a strengthening of democracy, the respect of human rights, sustainable and balanced economic and social development as well as measures to combat poverty.<sup>2</sup> Apart from conducting a 'strengthened' political dialogue and close cooperation in the cultural, social and human sector, these aims are to be realised mainly through the intensification of bi- and multilateral trade exchange and the establishment of a Euro-Mediterranean Free Trade Zone (EMFTZ) by 2010.

The EU's development strategy towards its Southern *near abroad* resembles the development economic *Leitmotiv* of the early Nineties, i.e. the so-called Washington Consensus with its three pillars of macro-economic stabilisation, structural adjustment and liberalisation (Williamson, 1993). Beyond that, however, it rests on the modernisation theoretical basis paradigm developed by Seymour Martin Lipset in 1959 (Lipset, 1959). In accordance with the optimistic convergence hypothesis (Muno, 2001), both the European Commission and the (General Affairs) Council of Ministers assume that economic development—as it hoped to develop under basket II—correlates positively with the creation of democratic structures in the TCM. In other words, economic liberalisation, as a prerequisite for both the introduction of the EMFTZ and the expansion of the Euro-Mediterranean trade exchange, should lead to increasing prosperity as well as to the formation and the widening of middle class actors. These should, in turn, due to their newly acquired participation rights in the economic area, almost inevitably demand further participation in the political realm. Ideally, this would be followed by a political liberalisation process that encompasses the whole Southern Mediterranean area and that will result in a democratisation of all the TCM.

Based on this assumption, and given the EMP's overarching objective, this study aims to show two interrelated insights: first, that the main goal of the Barcelona Process, i.e. to contribute to the socio-economic development in the TCM, has not been achieved during its first five years; second, that the envisaged modernisation theory-inspired spill-over from the economic to the political level was severely hampered. Furthermore, it will be pointed out that the Euro-Mediterranean trade nexus, which appears as the primary tool for the realisation of the EMP's above mentioned objective, has been adjusted to the needs of EU-European market providers while the asymmetrical structure of Euro-Mediterranean trade—which was already visible during the *approche globale* and the subsequent 'Renovated Mediterranean Policy' (RMP)—has been further aggravated to the disadvantage of the TCM. Hence, it shall be assumed that this is due to the phenomenon of *incomplete contracting*, discernible in all EMAA's, that principally concedes the EU and its 15 EU member states numerous exit-options. Against the background of the heterogeneous interest structures of the 15, the existence of this phenomenon has generated time inconsistency between implemented short-term policies and the long-term and generally agreed objectives of the EMP.

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1 This article focuses on the TCM Algeria, Morocco, Tunisia, Egypt, Jordan, Lebanon, Syria, Israel and the Palestinian Autonomy Areas. Malta, Cyprus and Turkey are formally still members of the EMP. However, for the purposes of this study they will be excluded as the former two will join the EU in May 2004 and Turkey possesses an EU-membership perspective according to article 49 TEU and, thus, is not a part of the EU's development association. Of all the TCM only Syria has not signed an agreement yet.

2 See Barcelona Declaration.

With this in view, the paper is divided as follows: After a cursory explanation of the concept of incomplete contracting, the subsequent section will look into the effects that incomplete contracting has had on the trade dimension of EU-TCM relations between 1996 and 2000. In a second step, the bilateral trade regime's most relevant stipulations in relation to the establishment of the EMFTZ will be sifted out and, with the use of the concept of incomplete contracting, analysed with regard to their impact on economic development, modernisation and democratisation in the TCM. The paper will end with some concluding remarks related to the linkage between the structure of Euro-Mediterranean trade relations and the explanatory power of modernisation theory.

## II. Incomplete Contracting and Time Inconsistency

Embedded in the politico-economic research on transaction-cost approaches and the so-called commitment problem, which attracted the attention of such prominent authors as North, Shepsle and Moe at the end of the 1980s/early 1990s in particular within the context of the new institution economics (North, 1990; Shepsle, 1991; Moe, 1990), the phenomenon of incomplete contracting, as it was mainly described by Williamson and Majone, ought to be seen as the precondition for time inconsistency (Williamson, 1985; Majone, 2001). While the term 'contract' does not only refer to a legal and enforceable instrument, but also includes informal and tacit agreements, incomplete contracting as such embodies the opposite of relational contracting. Under the latter, two contracting parties sign general arrangements—without the use of detailed and concrete plans of action—that guide their relationship. They focus only on general principles, the issue-areas to be included, the competences of each party and dispute-resolution mechanisms.<sup>3</sup> With respect to incomplete contracting, this means that while the parties at the contracting phase may aim at completeness regarding the content of their arrangement, the scope of action, their powers to act and the modes of profit-sharing, this completeness, however, can not really be achieved (Majone, 2001: 67). The incompleteness can be attributed to numerous factors such as the differing bargaining power of the parties, contract-related information deficits on the side of both parties, or to contingencies that were either unforeseen at the time of the conclusion of the contract or that were fully ruled out *ex ante*.

To put it in another way: If an incomplete contract, comprised of exit-options, represents the framework for bi- and multilateral relations, it is very likely, taking the rationality postulate into account, that at least one of the contracting parties is tempted to renege on the agreement. In such circumstances, the latter can either try to modify the already concluded provisions and find ways to re-negotiate them or—if this is not possible—it might feel pressure to partially or fully deviate from the commitment and, thus, counteract it. If such deviant behaviour occurs, it would finally indicate the existence of what Kydland and Prescott have described as time inconsistency (Kydland/Prescott, 1977). According to them:

Time inconsistency occurs when a government's optimal long-run policy differs from its optimal short-run policy, so that the government in the short run has an incentive to renege on its long-term commitments.<sup>4</sup>

According to Majone, this is due to the fact 'that the incentives of policymakers, or contractual partners, in the implementation stage may no longer be the same as their incentives in the planning stage' (Majone, 2001: 67). Consequently, both phenomena, i.e. incomplete contracting and time inconsistency, lead to the same result—the lessening of the credibility of the original arrangement.

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3 As an example of relational contracting, Majone names the Treaty of Rome for the establishment of the EEC. See Majone 2001, p. 68.

4 Giandomenico Majone, 'Nonmajoritarian Institutions and the Limits of Democratic Governance: A Political Transaction-Cost Approach', *JITE—Journal of Institutional and Theoretical Economics* 157 (2001), p. 62.

### III. The Europe-Mediterranean Association Agreements as Contractual Basis of Euro-Mediterranean Trade Relations

Due to the differing progress in the negotiations of the EMEA's, trade relations between the EU and the TCM in the five years between 1996-2000 were conducted on non-congruous legal foundations. While in the case of Algeria, Egypt, Jordan, Syria, Lebanon, Tunisia and Morocco, the old cooperation agreements still represented the relevant trade regimes—for the latter two at least until March 1, 1998 and until March 1, 2000 respectively—in early 1996 and in Summer 1997 two interim trade agreements with Israel and the Palestinian Autonomy Areas (PA) came into force.<sup>5</sup> These interim agreements, reflecting the trade stipulations of the EMEA's almost identically, as well as the two agreements with Morocco and Tunisia after their enforcement, still distinguish between agricultural and industrial goods. As was already the case in the cooperation agreements, the Community abstains from applying tariff and non-tariff-barriers on industrial imports coming from the TCM. Nonetheless, under the EMP it has been maintaining the textile and clothing self-restraint agreements which it managed to impose on Morocco and Tunisia in the mid-seventies.<sup>6</sup> While this obviously represents a continuation of the status quo, the fact that all EMEA's commit the TCM to also remove all tariff and non-tariff barriers for industrial goods from within the EU is a novelty with serious consequences as will be shown later.<sup>7</sup> With the exception of Israel, which already had removed all its trade barriers for industrial imports from EU member states in 1989, article 10 and 11 of the new agreements with Morocco, Tunisia and Jordan as well as article 8 of the interim agreements with the PLO granted these four countries transition periods for the dismantling of tariffs (on industrial goods) of a maximum of five (PA) and twelve years respectively (Morocco, Tunisia and Jordan).<sup>8</sup>

In contrast, the contractual arrangements on trade with agricultural and fishery products are more elaborated and also more restrictive. Significantly, the Barcelona Declaration says:

[...] taking as a starting point traditional trade flows, and as far as the various agricultural policies allow and with due respect to the results achieved within the GATT negotiations, trade in agricultural products will be progressively liberalized through reciprocal preferential access among the parties [...]<sup>9</sup>

This formula makes visible that the EU's Common Agricultural Policy (CAP), based on protectionist and non-market economy-related principles, has impeded full liberalisation of agricultural trade with the TCM. Hence, the EMFTZ project focuses on industrial products only and excludes agricultural produce. Two further aspects must be highlighted. First, the Barcelona Declaration refers to traditional trade flows as a basis of assessment for the trade preferences as specified in the EMEA's. Notwithstanding that this provision cannot be justified by any particular economic reason, the reference to 'traditional' trade flows as such is to the detriment of the TCM as their agricultural export contingents already between 1972 and 1990 were massively restricted. Thus, these do not serve as a beneficial starting point for determining new trade preferences in the context of the EMP. The latter's maintenance of the export contingent for Tunisian refined and non-refined olive oil—a product of utmost importance to the Tunisian agricultural industry—or the decrease of the maximum ceiling for Israeli orange exports, exemplify this fairly clearly. While the annual maximum quantity for Tunisian olive oil exports traditionally, i.e. between

5 The cooperation agreements were concluded in the context of the Global Mediterranean Policy between 1975 and 1977.

6 See Appendix I of the EMEA with Tunisia as well as the Agreement in form of an exchange of letters between the EC and Morocco on Article 12 (1).

7 See for example article 8 of the EMEA with Israel and article 4 of the interim agreement with the PLO for the benefit of the Palestinian Authority on the West Bank and the Gaza Strip.

8 See for instance article 11 (4) of the EMEA with Morocco. It allows the Moroccan government (in the event of serious difficulties) to change the timetable for the dismantling of tariff and non-tariff barriers for those industrial goods listed in the annex of the agreement if the bilateral Association Committee gives its approval and if such a change does not affect the overall transition period of twelve years. Note that trade with industrial goods between the EU and the Occupied Territories was already partly liberalised in 1987 with the adoption of the Council regulation 1134/91 (OJ L 112/1991).

9 Barcelona Declaration.

1976 and 1995, amounted to 46,000 tons, the EMP, despite widespread reductions or even the full removal of import duties, has kept a firm hold on this ceiling. For Israeli orange producers the rules of the game have even deteriorated. Since the interim agreement came into effect, they are only permitted to export a maximum quantity of 200,000 tons, which, in fact, represents a decrease of 30% compared with the former 'traditional' ceiling.

Second, the above mentioned provision explicitly mentions that further trade liberalisation for Southern Mediterranean agricultural goods is only possible to the extent that national policies allow so. Although it is not clear whether this formulation refers to the agricultural policies of the EU member states, it must be assumed that, in light of the comparative cost and competition advantages of the TCM-agro-producers, it relates to the market conditions on the Community market. Responsible for the inclusion of this provision were in particular the governments of the Southern European EU member states and, to a lesser degree, those of Germany, Austria and the Netherlands. As this informal alliance stood for a limited expansion of concessions in the field of agricultural trade during the negotiations of the EMAA's, they finally succeeded in breaking the resistance of those Northern EU states that were—and still are—in favour of a more consumer-oriented approach and wider (free) trade preferences respectively.<sup>10</sup> Against that background and in consideration of both the relatively high share of employees in the agricultural sector of many EU states and the importance of the agricultural sector for gross domestic products, it is more than likely that in the immediate years to come there will not be an interest convergence in the Council of Agricultural Ministers with respect to the inclusion of agro-trade into the EMFTZ in the sense of a true '*complete contracting*'.<sup>11</sup>

The absence of a homogeneous intra-Council interest structure related to a common and single treatment of industrial and agricultural products is expressed in the fact that those EU member states that support agricultural free trade were in fact successful in expanding the decrease of tariff-barriers under the EMP to the majority of Moroccan, Tunisian, Israeli, Jordanian and Palestinian agro-exports. However, under the influence of the above mentioned informal alliance, they had to accept that the rather generous reductions of the Common Custom tariff (CCT) were to be restrained by a highly complicated system of non-tariff barriers that targeted every potential Southern Mediterranean agricultural export product. The old practice, already applied during the Global Mediterranean Policy, of a (nowadays full) dismantling of tariff barriers hand in hand with an introduction of restrictive export calendars, export contingents, and reference prices primarily for fruits, vegetables, olive oil, cut flowers, fish and wine, is therefore still discernible in all EMAA's in the form of endless protocols and additional agreements.

That the new trade regimes still exempt the TCM's agricultural products from free trade neither poses a major problem to Israel, with its high degree of industrialisation and its diversified production sector, nor to the PA, with their low export capacities and their concentration on industrial trade.<sup>12</sup> For net agricultural producers like Morocco, Tunisia and Jordan however, and also for Egypt and Syria, once their agreements enter into force, this asymmetrical trade liberalisation will have serious consequences. It makes it extremely difficult for them to implement their cost advantages in the agricultural sector and to realise micro- and macro-economically important growth potentials. This is further hampered by the underlying principle of reciprocity that is now guiding Euro-Mediterranean trade relations. Reciprocity, 'often invoked as an appropriate standard of behaviour which can produce

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10 On the Swedish position, see Tobias Schumacher, 'The Mediterranean as a New Foreign Policy Challenge? Sweden and the Barcelona Process', *Mediterranean Politics* 3/2001, pp. 90. On Northern perceptions of the EMP, see Richard Gillespie, 'Northern European Perceptions of the Barcelona Process', *Afers Internacionals* 37/1997, pp. 65-75.

11 At the time of the Barcelona Conference 3.1% of the total workforce in Germany, 7% in Austria, 4% in the Netherlands, 5.2% in France, 7% in Italy, 8% in Spain, 14.2% in Portugal and 20.3% in Greece worked in the agricultural sector. In Germany the agricultural sector has a share of the GDP of around 1.1%; in Austria the share is 1.4%, in the Netherlands 3%, in France 2.3%, in Italy 3%, in Spain 8%, in Portugal 4% and in Greece 14%.

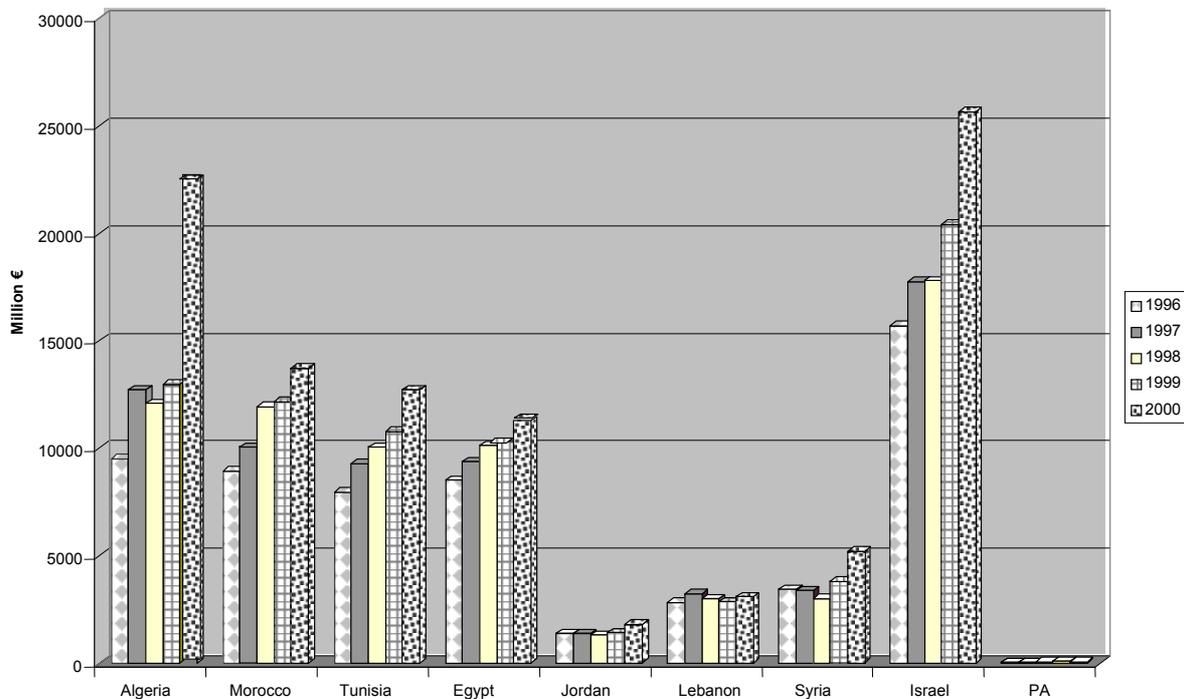
12 The PA's concentration on industrial trade is mainly due to the shortage of land that otherwise might be used for agricultural purposes. Hence, the PA, with the financial support of the EU, the US and Japan, has been advocating the creation of industrial parks like for example in Jenin and the Gaza Strip.

cooperation among sovereign states'<sup>13</sup>, for the very first time legally commits the TCM to remove their custom and non-custom trade barriers for EU agricultural goods and, thus, exposes their domestic markets to stronger competition from EU-European suppliers (Hoekman, 1999: 94).

#### IV. The Effects of Incomplete Contracting on the Development of the TCM's Exports to the EU

The quantitative, absolute volume of all exchange interactions between the EU and the TCM in the period between 1996-2000 has continuously increased. When compared to previous years, the trade volume throughout this five year period shows a new record high for each year with 2000 standing out with an absolute total amount of 96071 Million ECU. This is almost a doubling of the top figures of 1985 and 1994. The overall trade volume is not, however, evenly distributed. Instead, it is, as in earlier phases of the EU's Mediterranean Policy, to a large extent made up by the quantitatively high trade links between the EU, Algeria and Israel respectively, followed by—although at a distance—EU trade with Morocco, Tunisia and Egypt, as can be seen in graph 1.

**Graph 1: Trade volume EU-TCM, 1996-2000**



Source: Eurostat, External and intra-European Union trade—Statistical Yearbook 1958-1999; Monthly Statistics 1/2002.

Graph 1, moreover, contains another important insight. It shows that the trade volume between the EU and *all* TCM has increased, albeit to different degrees. This increase took place irrespectively of whether the old cooperation agreements, an EMAA or an interim trade agreement previously formed the legal framework of bilateral trade relations. The fact that it was obviously irrelevant for the TCM's export performance which trade regime they were allowed to export under is further illustrated by the import and export development of each bilateral relation. Apart from Jordan, all those TCM that were in possession of a new association agreement were able to achieve new export records. In comparison with the highest figures achieved during the RMP in the period 1990-1995, Moroccan, Tunisian and Israeli

13 Robert Keohane, 'Reciprocity in international relations', International Organization 1/1986, p.1.

exports to the EU between 1996 and 2000 were 49.5% (Morocco), 62.9% (Tunisia) and 113.1% (Israel) higher (Schumacher, 1998). In the three-year-period since the entering into force of their interim trade agreement the PA managed to achieve an export growth of 324%, however from a very low level that amounted to only 340.51 ECU in 1996.<sup>14</sup> Considering that neither Algeria, the Lebanon or Syria had a new EMAA during 1996-2000, their increase-rates look even more impressive with 130%, 128.2% and 97.5% respectively. In addition, when the absolute export quantities of the individual TCM's are compared with each other, it is noticeable that Algeria (2000: 16422 Million ECU) and Israel (2000: 9927 Million ECU) stand out, i.e. the two of the TCM with the highest share of industrial production at the GDP. On the EU-European side it is France, Italy, and Greece together with Spain, Belgium and Luxemburg, absorbing a total percentage of at least 46% of the TCM exports annually, that are the main purchasers of TCM exports. In contrast, the importance of Portugal, the Netherlands and Austria as export markets has drastically decreased since 1996, though it must be mentioned that this trend, as far as Portugal and the Netherlands are concerned, already began under the RMP.

Indeed, both the old and the new Euro-Mediterranean trade regimes have had a positive effect for some of the TCM insofar as they resulted in an improvement of the latter's status as EU-trading partners for certain exports.<sup>15</sup> Nonetheless, this positive aspect cannot conceal that neither the share of these TCM's exports nor the share of the other TCM of the EU's total imports from third countries has improved. Also the structure of Southern Mediterranean exports has remained the same, as it still mainly consists of low value-primary goods.<sup>16</sup> As is discernible in table 1, compared to the situation during the *approche globale* and the RMP, the share of imports coming from the TCM of total EU imports—with the exception of hydro-carbonate-exporting Algeria of course—has decreased or stagnated.

**Table 1: Share of EU-Imports from the TCM of Total EU-Imports, 1996-2000 (in %)**

	Algeria	Morocco	Tunisia	Egypt	Jordan	Lebanon	Syria	Israel	PA
<b>1996</b>	0.9	0.7	0.6	0.5	0.0	0.0	0.3	0.9	0.0
<b>1997</b>	1.2	0.7	0.6	0.4	0.0	0.0	0.3	0.9	0.0
<b>1998</b>	1.0	0.7	0.6	0.4	0.0	0.0	0.2	1.0	0.0
<b>1999</b>	1.0	0.7	0.6	0.3	0.0	0.0	0.3	1.0	0.0
<b>2000</b>	1.6	0.6	0.5	0.3	0.0	0.0	0.3	1.0	0.0

Source: Eurostat, External and intra-European Union trade—Statistical Yearbook 1958-1999; Monthly Statistics 1/2002.

What is more, this development has serious consequences for the TCM as the EU is still the main export market for at least half of all Southern Mediterranean exports. It is in this light that it must be claimed that the new trade regimes had a rather ambivalent effect in the five-year-period during 1996-2000. In the case of Israel, they merely reflect the trend towards diversification of Israeli export targets that began in the early nineties. In the Tunisian and Moroccan case, the EMAA's have either resulted in a further export expansion (Tunisia) or have simply confirmed the trend that started in 1998 (Morocco).<sup>17</sup> Indeed, this might be interpreted as a sign of the dynamic intensification of the bilateral trade exchange (Rhein, 1999, 14). However, given that in 2000, already 80% of Tunisian exports and, after an increase

14 Not included in this figure are those goods that were exported via Israel.

15 These exports are fish, crab-fish and molluscs, vegetables, fruits, semiconductors, transistors, diodes, cathodes and micro-switchings (Morocco), medical and pharmaceutical products, organic chemicals, synthetics in primary forms, telecommunications, picture and sound technique, non-metal minerals (Israel), fertilizers (Tunisia, Morocco, Israel, Egypt), inorganic chemicals (Israel, Morocco), aerospace equipment (Algeria, Morocco), clothing equipment (Tunisia, Morocco). Due to the EU's energy dependency Algeria, Egypt and Syria, although they did not possess an EMAA during the period between 1996-2000 were among the ten most important hydro-carbonate suppliers to the EU.

16 Only Israel's export structure is marked by both agricultural and high quality non-agricultural goods.

17 Whereas the EU in 1997 absorbed 60.7% of all Moroccan exports, this figure until 2000 constantly rose to 74.3%.

of 12%, 74.3% of Moroccan exports went to the Community market, this asymmetrical trade dependency is a highly perilous tendency that strongly hampers both any efforts to diversify exports and to find new markets outside the EU. A similar development can also be identified with respect to Syria and the Lebanon, if only on the basis of the old cooperation agreements. While the orientation of Syrian exports towards the EU had already been on the increase since 1990, they reached a new maximum value in 2000 with the EU absorbing 65% of all Syrian exports. In the case of Lebanese exports to the EU, the latter represented a share of 16% of all Lebanese exports in 1996, i.e. shortly after the introduction of the EMP, but rose to 25.6% at the end of 2000.

While Egyptian and Algerian exports to the EU, despite some fluctuations, during the same period amounted to 39% and 63% of their total export volume, thus substantiating the EU's position as their most important trading partner, the Community is of less importance to the Jordanian and Palestinian export industry. Although Jordan has not reached the record of 1993 its absolute EU-specific exports have almost constantly increased. The percentage of those exports that are allotted to the EU, however, after the considerable increase-rates between 1995 and 1997 decreased until 2000 to a meagre 3.3%. Even worse, the average share of Palestinian exports reached not more than 0.2%. Consequently, it can be concluded that the new interim trade agreement neither contributed to break the unbalanced Palestinian export dependency on Israel nor did it sustain the originally higher share of 0.7% that the Palestinians achieved in 1995 without any trade arrangement at all.<sup>18</sup>

## V. The Effects of Incomplete Contracting on the Development of the TCM's Imports from the EU

To make the Euro-Mediterranean trade picture complete, it is necessary to include both the import-development and the development of the trade balance. From the TCM's perspective, the latter is sobering, as, with the exception of Algeria and Syria, none of them since the start of the EMP was able to either even out the negative trade volume or to turn it into a surplus.

**Table 2: Trade Balance EU-TCM, 1996-2000, in Mio. Ecu**

	<b>Algeria</b>	<b>Morocco</b>	<b>Tunisia</b>	<b>Egypt</b>	<b>Jordan</b>	<b>Lebanon</b>	<b>Syria</b>	<b>Israel</b>	<b>PA</b>
<b>1996</b>	-5449	466	706	2955	1018	2590	-622	5131	0.037
<b>1997</b>	-4008	578	1269	4118	1025	2941	-672	5236	0.036
<b>1998</b>	-6823	1270	1489	5070	979	2666	63	3969	0.069
<b>1999</b>	-7777	1067	1249	5541	1079	2453	-497	5158	0.088
<b>2000</b>	-10320	1714	1799	4418	1440	2594	-1666	5804	0.069

Source: Eurostat, External and intra-European Union trade—Statistical Yearbook 1958-1999; Monthly Statistics 1/2002. EEC Special Trade.

Despite the fact that Algeria and Syria, due to their capital intensive hydro-carbonate exports, managed to keep their positive trade balance,<sup>19</sup> the EU has once again found a way to use both the old cooperation agreements and the new trade regimes to its own advantage. The EU products exported between 1996-2000 into the Southern Mediterranean area do not only massively exceed the TCM's absolute exports in the same period but also almost without any exception the absolute amounts of goods that the EU had exported during all earlier phases of its Mediterranean Policy until 1995. It is in particular the increase of the absolute exports to the PA that stand out. Of all exports to the TCM, exports to the Occupied Territories in the West Bank and Gaza are the only ones that have doubled between 1997 (37251.27 ECU) and 2000 (74439.05 ECU).

18 According to PALTRADE the average export share of Israel amounts to 95%. See [www.paltrade.org](http://www.paltrade.org)

19 This was possible despite a reduction of their percentage of the total exports and an increase of their imports from the EU.

The expansion of the EU's absolute exports, however, is not accompanied by an increase of the TCM's export share of the EU's total exports to non-EU countries. Instead, since 1996 their share amounted to a minimum of 5.4% and a maximum of 5.9% with Israel being the main recipient. Within the EU all member states, with the exception of Portugal, markedly increased their absolute exports to the TCM while the share of exports going to the Southern Mediterranean has grown particularly strong in the EU's youngest members, Sweden, Finland and also Greece (Eurostat, 2000). It must be pointed out that when distinguishing between the EU exports in the five year-period 1996-2000, industrial goods as well as agricultural produce dominate with the latter having been marked by a strong increase. Against the drop that the majority of export quantities of Southern Mediterranean agro-goods in the context of the EMP have either decreased or stagnated, the increase of imports of food and agricultural products weighs heavily for the TCM. This is mainly because it shows that their decade-old food dependency on the EU has still not improved. Table 3 expresses this imbalance with regard to the most important agricultural products very clearly:

**Table 3: Trade Development EU-TCM of Selected Agricultural Goods, in 1000 Ecu**

	Animal livestock				Milk and eggs			
	1992		1997		1992		1997	
	exports	imports	exports	imports	exports	Imports	exports	Imports
<b>Algeria</b>	11	25297	-	11131	-	346317	-	258521
<b>Morocco</b>	181	19327	42	18344	428	38840	-	24278
<b>Tunisia</b>	212	9254	82	14147	22	32870	-	28188
<b>Egypt</b>	1461	17956	1392	12690	37	92973	1311	72653
<b>Jordan</b>	14	4595	-	7422	37	36569	5	47432
<b>Lebanon</b>	30	16652	31	103993	44	57257	79	101215
<b>Syria</b>	-	2978	-	1289	20	25224	83	28710
<b>Israel</b>	1622	3440	2400	4890	4916	12643	4030	20816
	Grain				Fruits and vegetables			
	1992		1997		1992		1997	
	exports	imports	exports	imports	exports	Imports	exports	Imports
<b>Algeria</b>	1996	348224	-	289546	22385	36219	17153	63903
<b>Morocco</b>	121	180836	199	130812	664274	11937	569032	15488
<b>Tunisia</b>	417	34747	956	116273	62674	7603	50379	18209
<b>Egypt</b>	1064	64143	839	197596	103031	27997	111102	45397
<b>Jordan</b>	70	25823	2	11199	2338	4155	9019	5868
<b>Lebanon</b>	280	23053	129	36487	3087	13599	3861	15681
<b>Syria</b>	31	89002	3752	9052	5458	4412	4815	5274
<b>Israel</b>	8122	127607	7527	266357	472346	81235	407343	78874

Source: Femise 1999.

In light of this asymmetry, it becomes obvious that the EU is still far away from achieving the objective as stated in the various EMAA's, namely to contribute to 'the expansion of harmonious economic and social relations between the Parties'<sup>20</sup>. That the EMP and the newly concluded association agreements create a 'climate conducive to the development of their economic relations, in particular in the fields of trade and investment'<sup>21</sup> must be strongly questioned. Irrespective of whether trans-

20 Article 1 (2) paragraph 3 of the EMA with Morocco.

21 Preamble of the EMA between the EU and Tunisia.

Mediterranean trade is based on the old or the new association agreements, the decade-old pattern of Euro-Mediterranean trade, primarily benefiting EU-European export companies due to the contractual inclusion of exit-options into the EMP *acquis*, still continues to exist. In addition, it has substantiated the TCM's status as 'reliable' and 'secure' purchasers of both EU-subsidised agricultural surpluses as well as of high-quality industrial goods that do not face any major competition.

## **VI. Incomplete Contracting and the Euro-Mediterranean Free Trade Zone**

As this study has hitherto shown, Euro-Mediterranean trade relations between 1996 and 2000 were conducted on the basis of incomplete contracting and to the disadvantage of the TCM. In light of the guiding assumption, the following sections, however, will concentrate on the main stipulations regarding the establishment of the EMFTZ and their short- and long-term effects on economic development, modernisation and democratisation. The focus is on the compatibility of the EMFTZ with the relevant GATT-rules and on the external effects of the EMFTZ. This is followed by an analysis of the impact of the dismantling of tariffs on the markets, the state budgets and the investment climate, and, finally, by a critical discussion of the rules of origin and the contractually agreed transition periods.

### ***The GATT-Conformity of the Europe-Mediterranean Association Agreements and the Euro-Mediterranean Free Trade Zone***

As is widely known, all EMAA's comprise provisions that stipulate the creation of bilateral free trade zones until 2010. However, the current international GATT regime which has been in effect since the conclusion of the Uruguay round, still considers free trade areas as a deviation from the Most Favoured Nation Clause. They are only permitted under certain circumstances that are specified in article XXIV GATT. According to article XXIV 7(a) GATT, free trade areas must be notified with the WTO and, according to article XXIV 7(b), can be further examined by the contracting parties of the GATT and the WTO committee for regional trade agreements, respectively. Article XXIV 8(b) says that it has to be the objective of a free trade area to eliminate 'substantially all the trade between the constituent territories in products originating in such territories' within an appropriate time. In accordance with the fifth paragraph of article XXIV 'appropriate' is usually defined as ten years. An exception to that time limit is only possible if the parties concerned can sufficiently justify the reason of the required extension. With the exception of the EMA with Israel and the interim trade agreement with the PLO, all other EMAA's stipulate a transition period of twelve years in the field of industrial trade. With regard to agricultural trade all EMAA's contain two almost identical provisions. These are exemplarily expressed in article 16 and 18 of the Moroccan EMAA. They provide both the Community and the respective TCM to gradually implement greater liberalisation of their reciprocal trade in agricultural and fishery products and, from January 1, 2000, to assess the situation with a view to determining the liberalisation measures to be applied by the Community and the TCM.

Whereas the TCM's elimination of market access barriers over a period of 12 years might be justified by both the TCM's status as developing countries, by the EMP's goal to gradually integrate them into the world economy and with a reference to article XXIV (5)c,<sup>22</sup> article 16 and article 18 are marked by their incomplete state. Notwithstanding that January 1, 2000 has been determined as the starting date for a new assessment although the EMAA's with Morocco and Jordan had not even entered into force at that point, they are vague, lack any hint of concrete liberalisation measures with respect to article XXIV 8(b) and avoid any reference to a possible liberalisation period. Indeed, at first sight and in light of their incompleteness they give the impression of being in conformity with the GATT as they do not explicitly exclude the possibility to establish a free trade zone in the agricultural sector and, thus, to eliminate

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22 Article XXIV (5)c GATT states that 'any interim agreement referred to in sub-paragraphs (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.'

‘duties and other restrictive regulations of commerce’ on ‘substantially all the trade’.<sup>23</sup> However, this is not the case. Instead they lack any legally binding indication that the exemption of agro-goods from free trade is only a temporary provision to last for less than ten years. In addition, given the protective treatment of non-industrial goods by the EU, it is very likely that the exclusion of agricultural products from free trade will go beyond the ten-year GATT formula (Lannon, 1997: 799).

### ***The Tariff Discrimination of Non-Members of the Euro-Mediterranean Free Trade Zone***

Article XXIV points to another aspect closely related to the creation of free trade arrangements (Wyatt-Walter, 1995: 79): in the context of the establishment of regional free trade areas, trade barriers for non-members of the zone must not be raised. Although this has not yet happened in the context of the EMP, the TCM’s unilateral dismantling of tariff and non-tariff barriers for EU-European industrial imports is discriminatory to the extent that non-members of the EMFTZ are still faced with the originally (higher) custom duties and, thus, comparatively higher export prices. As the EMFTZ obviously stands in sharp contrast to forms of ‘open regionalism’, Southern Mediterranean purchasers of import goods will most likely substitute their original non-EU providers for those suppliers that are based in the EU and that can make full use of the free trade provisions. According to the insights of external trade theory, this will almost automatically lead to a deterioration of the competitiveness of non-EMFTZ members on the TCM’s markets as well as to a diversion of trade flows and an expansion of imports from the EU respectively. Moreover, it will also increase the TCM’s trade dependence of the EU and aggravate both their negative trade balance and their strained balance of payments.

Apart from these effects, the dissimilar tariff treatment of imports from EU-suppliers and from third countries implies additional macro- and micro-economic cost potentials. Assuming that importers from within the Maghreb or Mashreq region before the entering into force of the EMFTZ provisions have purchased their imported goods from the cheapest supplier on the world market and not from the usually more expensive competitor from within the EU, products of the latter become less costly once the abolition of tariffs is completed. In reality, however, import companies as well as the national economies are faced with higher factor-costs since the original (comparatively higher) price for the imported good has not changed. In this context Bernard Hoekman, a World Bank economist, explains:

By not discriminating across potential trading partners, domestic firms and consumers will be allowed to buy goods and services from the most efficient suppliers, wherever they are located. By granting preferential treatment to specific countries, trade *diversion* may occur—the elimination of tariffs may induce consumers and firms to source from suppliers located in a partner country that are less efficient than those located in non-member countries.<sup>24</sup>

To the disadvantage of TCM importers, EU-exporters are also given the chance to exploit the tariff dismantling and raise the prices for their industrial exports to the extent that they would lie considerably above the original prices but still below the prices of competing non-EMFTZ members.<sup>25</sup> Even if the TCM tried to counteract such a possible exploitation by increasing their export volume to the EU it would be rather unlikely that they could compensate for these rising costs. The old cooperation agreements already allowed the tariff-free export of Southern Mediterranean industrial goods and did not result in a considerable increase of industrial exports. Additional (compensatory) exports to countries outside the EU are also problematic as their import barriers for goods from the TCM remain in place. As a consequence, it can be concluded that with the introduction of the EMFTZ

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23 Article XXIV 8(b) GATT.

24 Hoekman, 1999, 89.

25 However, the extent of these increasing relative costs and the obvious allocation problems must be seen in a relative light, since the EU—as mentioned above—with the exception of the PA already is the TCM’s most important supplier. On that point, see also Ghesquiere 1998, p.12 and Nienhaus 1999a, p. 99.

project the terms of trade have deteriorated for the TCM and also for those third countries that aim to export to the Southern Mediterranean area.

### ***The Impact of the Tariff Dismantling on Markets, State Budgets and the Investment Climate in the TCM***

Even if the above mentioned price-increases would not occur and even if input-costs for imported means of production and intermediate products became cheaper, the creation of the EMFTZ is bound to have a negative effect on the markets of the TCM. The reduction of input-costs principally offers chances to lower the production costs of a particular good, to let customers benefit from these cost-cuttings and, thus, to increase demand. However, this increase may trigger a decline in demand for those local products that do not rely on external input-factors, or that use input-factors which come from third countries still being exposed to custom duties. These producers are neither in possession of the relevant financial and technical resources nor do they have the necessary expertise to adjust their products to the changed market conditions.<sup>26</sup> In a best-case scenario this, in turn, will result in a partial release of the workforce and in a production reduction. In the worst case, however, it could lead to the closure of production centres. Such a development also cannot be ruled out in those cases where imported high-value industrial products directly compete with local goods. E.g. in the case of Morocco and Tunisia, independent studies of the OECD assume that the introduction of free trade will eliminate around 60% of the local industries. Such a development, in turn, will irrefutably aggravate the existing socio-economic problems (Schumacher, 2002a) and widen the rising employment in the informal sector (Chourou, 1998).<sup>27</sup> In addition, it will increase the migration pressure which in particular the Southern European EU states need to see reduced. Although to a much lesser extent, similar risks can be detected in the agricultural trade sector. In light of the reciprocity which the TCM have granted the EU in the agricultural sector, it cannot be ruled out that local agro-producers, faced with highly subsidised and artificially cheap EU agricultural imports, will be put under severe competition pressure at the beginning of the partial liberalisation and, hence, be confronted with a loss of their comparative cost and competition advantage.<sup>28</sup>

Additional problems relate to the complete dismantling of tariffs on industrial imports. As can be seen in table 4, with the exception of Israel, import duties are an important income source for all the TCM to finance their state budgets.<sup>29</sup>

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26 See also Nienhaus, 1999b, p. 508. Of all industrial enterprises in the TCM, family-led manufacturing businesses with less than ten employees amount to 42% in Tunisia, 50% in Morocco and Israel, 88% in Lebanon, 89% in the Occupied Territories, 93% in Jordan and to 95% in Egypt. They absorb between 20% and 45% of the overall workforce and produce 10%-25% of the GDP. They are all characterised by low capital provision, the use of family members as workforce, the use of low-technology-intensive means of production, a business management based on family structures and the phenomenon of informal borrowing.

27 In studies of both the World Bank and the European Commission it is in particular the rising competition pressure on the local industries that is considered as principally positive. According to their line of argumentation, the rising competition pressure will result in a break-up of inefficient monopolies and oligopolies, and will lead the governments to implement economic reform steps.

28 The cost and competition advantage will not fully disappear as imports from within the EU are also exposed to import quotas.

29 Data for the Occupied Territories are not available.

**Table 4: Income from Custom Duties in the TCM, 1997**

	Custom Duties		Custom Duties on EU Imports	
	% of total income tax	% of total GDP	% of total income tax	% of GDP
<b>Algeria</b>	23.4	2.7	15.2	1.8
<b>Morocco</b>	17.6	3.7	9.2	1.9
<b>Tunisia</b>	29.8	3.5	21.7	2.6
<b>Egypt*</b>	17.1	3.6	6.8	1.4
<b>Jordan</b>	31.6	5.1	15.2	2.5
<b>Lebanon**</b>	56.9	6.8	36.7	4.4
<b>Syria**</b>	13.9	2.4	6.8	1.2
<b>Israel</b>	0.5	0.4	0.3	0.2

Source: FEMISE 1999, 24. \* = 1995; \*\* = average 1994/96.

In particular the fiscal structure of Jordan, Tunisia and Algeria are largely based on customs duties. In the case of Lebanon, customs duties even account for almost 57% of its tax revenue. If tariff barriers for industrial imports from the EU were now eliminated within the envisaged twelve-year transition period this will lead to massive income losses which negatively impact upon the TCM's GDP and their state budgets. Furthermore, if the tariff elimination results in a diversion of the import demand in favour of European goods, a further cut of customs' revenues, aggravating the income losses, must be expected. Whereas Israel, that already dismantled its tariffs for EU-European industrial imports in 1989, is able to compensate for these (minor) losses without any major difficulties, they pose an enormous fiscal political challenge to the Lebanon.

In principle, the TCM in order to counterbalance these losses must either find other income sources or cut costs in their unproductive and expensive public sector. The latter option can be carried out by wage- or job-cuts. Of course, both measures immediately lead to substantial cost savings. Nonetheless they have the potential to provoke a deterioration of the customer's purchasing power as well as a rise of political costs. Due to the dismissal of the hitherto privileged technocratic and bureaucratic clientele, these political costs might occur in the form of a decrease of elite loyalty. In contrast, the first option, i.e. to open other income channels, includes the alternative to either incorporate all layers of society into the tax system or to raise direct or indirect taxes.<sup>30</sup> Even though all these steps seem to be comprehensible from a macroeconomic point of view they would, however, have a counterproductive effect. In light of the low salary structure and the high unemployment rates, a tax rise and an expansion of the tax base would not only have negative effects on the consumption in the TCM. In light of their colonial past both measures would be politically extremely difficult to carry through. The majority of Mediterranean Arab societies would most probably blame the EMP and interpret such steps as a 'new stage of neo-colonial relations characterized by unilateral exploitation' (Kienle, 1998: 10). In addition, they would jeopardize the interests and prebends of the middle and upper classes, i.e. of those parts of society that serve the autocratic regimes as clientele networks and a power basis.

Another important aspect within the context of the tariff dismantling is pointed out by economist Volker Nienhaus. Whilst the Southern Mediterranean markets' high level of protection definitely offered companies in the industrial sector—protected against foreign competitors and by making use of the low salary structure—incentives to invest in the TCM in order to supply the relevant market free of any import duties, the introduction of the EMFTZ could trigger the opposite effect (Nienhaus, 1999b: 510).

30 The use of the value-added tax system is relatively new to the TCM. Whereas Israel introduced it already in the beginning of the 1980's, Morocco introduced it in 1986, Tunisia in 1988, Egypt in 1991, Algeria in 1992 and Jordan as well as the PA in 1994.

As they will lose the strategic advantage of the previously protected markets and, hence, have to face EU competitors, the chances are rather high that companies from non-EU countries will either close their production facilities once the dismantling of tariffs has been completed, or they will relocate them to those European countries that offer a similar wage structure or even more favourable economic and political basic conditions and that will also be included in the EMFTZ. Arguably, such compensatory locations would most likely be the Central and Eastern European EU accession states. Eventually, the consequence would be a net-outflow of foreign direct investments (FDI) generating new lay-offs which, in turn, are bound to have a negative effect on the socio-economic situation in the TCM. That the outflow of FDI could hardly be avoided and that the EMFTZ will not lead to an increase of FDI (Ghesquiere, 1998: 7) is further substantiated by four points.

First, based on the assumption that the provision of favourable investment conditions in the TCM is mainly the task of the ruling regimes (Sideri, 2000: 8)—that had already failed to comply with this task during the implementation of the structural adjustment programmes of the World Bank and the IMF at the end of the 1980s and early 1990s—all actual statistics reflecting the investment risks in the southern Mediterranean do not point to a major improvement. FDI inflows are fully liberalised only in Egypt, Jordan and Lebanon whereas outflows are subject to strong restrictions particularly in Algeria and Syria. Moreover, the liberalisation measures, as they are required in the EMP's second basket, as well as the ongoing tight economic situation in the TCM, considerably reduce the scope of action and the spending capacity of the political elites with regards to the creation of potential investment incentives.

Second, with programmes like FEMIP, ECIP, MED-partenariat, MED-enterprise, BC-Net (Business Corporation Network), BRE (*Bureau de Rapprochement des Entreprises*), Euro-Info-Correspondence Centre, Business Centre und Europartenariats, the EU can hardly be said to be in possession of a fully-fledged investment-specific resource system. Due to its low financial provisions, its strong concentration on the transmission of information and since it is little-known, this somewhat emerging system is deficient and could not yet pave the way for considerable investment decisions and joint ventures. In addition, both the Barcelona Declaration and the EMEA's are incomplete as they do not contain binding provisions relating to FDI in the TCM. Also the character of all implemented measures within the framework of MEDA was rather similar with the sectoral investment programmes applied by the World Bank (Hunt, 1999: 28). Given that the latter were met with widespread disapproval by most of the TCM and that they have not resulted in an improvement of the investment climate, the effect of the EU policies must be questioned even more (Kienle, 1998: 7).

Third, the Barcelona Declaration and the EMEA's alike regard regional cooperation between the TCM as a key factor in the context of the EMFTZ project. At the same time, however, they conceive the sectoral EMFTZ only as a vertical construct. In other words: Whilst industrial trade between the fifteen EU member states and those of the TCM that have ratified an EMEA or an interim trade agreement is conducted on the basis of abolished tariff and/or non-tariff barriers, this does not apply to the horizontal level, i.e. to trade between the TCM themselves. Whereas the EMEA's state that regional cooperation should be promoted, the Barcelona Declaration simply stipulates that it shall be envisaged on a 'voluntary basis'. Hence, the only noticeable initiative in this regard is the so-called Mediterranean Arab Free Trade Area (MAFTA), better known as the Agadir Process.<sup>31</sup> Initiated on May 8, 2001 and finally concluded on February 25, 2004 by the governments of Morocco, Tunisia, Egypt and Jordan in the Moroccan capital of Rabat, it is the objective of MAFTA to abolish all existing trade barriers between the four signatories and to provide economic actors within the area with common rules regarding certificates of origin, standards and specifications, intellectual property, dumping and mechanisms to resolve trade disputes. The EU, however, did not play a major role in the setting up of MAFTA. Although having been present in Rabat through Commissioner Chris Patten and

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31 In 1997 the so-called Greater Arab Free Trade Area (GAFTA) was formally established by the governments of 14 Arab states. Due to inner-Arab rivalries, the slow implementation of the dismantling of tariffs and insufficiently defined rules of origin GAFTA, nowadays comprised of 15 member states, has not yet made any real progress.

the representative of the current Irish Presidency of the EU, Patrick O'Connor, it was only visible in so far as it gave its principal consent and as it pledged 4 million € to be funded under MEDA.

That the EMP does not formally commit the TCM to intra-regional free trade leads to what has been described in international economic relations as the *hub-and-spokes* phenomenon. This means that companies aiming at serving the Southern Mediterranean markets do not have an incentive to invest locally or to maintain existing production facilities unless the tariffs between the TCM are removed. Instead, from an external trade perspective, it is more worthwhile to serve the TCM (the *spokes*) free of any trade barriers from a location within the EU (the *hub*).

Fourth, notwithstanding the insights of modern neo-liberal theories that particularly emphasise the knowledge of cultural aspects as one of the central preconditions for successful and sustainable investment activities (Fukuyama, 1995), the Barcelona Declaration and the EMAA's ignore the differing social norms and cultural, local and mentality-related conditions on the markets of the TCM. In light of the fact that personal ties and grown client based relationships determine market access in the private sector to a large extent, the EU with the EMP has missed another opportunity to sensitize potential European investors towards this problem. Hence, particularly medium-sized companies still have massive reservations as regards investing in the TCM, and fear high transaction costs.

Overall, it becomes apparent that not only net welfare gains related to the regional and the Euro-Mediterranean economic and trade development have failed to materialize. Also the optimistic assessment put forward by the European Commission in its communication of March 8, 1995 that 'the perspective of a Free Trade Zone Europe-Mediterranean increases the attraction for private European investments' (COM(95) 72final) was proven to be wrong. This was finally admitted by the Commission itself in September 2000 (COM(2000) 497final) and also is underlined in table 5.

**Table 5: Foreign Direct Investment in the TCM from the EU-Member States, in Million Ecu**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
<b>Algeria</b>	10	8	11	13	4	10	6	4	0	1
<b>Morocco</b>	258	298	370	188	215	240	966	336	884	266
<b>Tunisia</b>	127	450	562	452	253	221	325	600	345	804
<b>Egypt</b>	204	354	421	1056	457	501	786	960	667	n.D.
<b>Jordan</b>	-10	31	-29	2	10	12	318	n.D.	n.D.	n.D.
<b>Lebanon</b>	2	3	5	6	27	63	132	n.D.	n.D.	n.D.
<b>Syria</b>	n.D.	n.D.	150	211	76	70	71	73	247	n.D.
<i>Israel</i>	243	444	509	363	471	272	735	698	1251	2167
<b>PA</b>	n.D.	n.D.	n.D.	n.D.	-1	35	7	27	20	n.D.

Source: European Commission/eurostat: Euro-Mediterranean statistics 1/2000 and 1/2001

n.D. = no data available

Any future increase of this low level—in total only 2% of EU-European FDI flow into the Southern Mediterranean—is additionally hampered by the EMAA's specific and incomplete design of the rules of origin.

### ***The Cumulation of Origin of Regional Input-Factors***

Principally, free trade agreements between at least two parties contain rules of origin that in a very detailed and technical language specify those export products for which preferential treatment, i.e. customs free treatment shall apply. As is widely known, rules of origin presuppose that the traded goods are fully manufactured in the country participating in the free trade area, and, thus, make sure that they fall under the jurisdiction of the granted preferences. In order to consider goods that are

partially comprised of imported input-factors, three different forms of cumulation of origin can be distinguished (Tovias, 1997: 105). The first form, i.e. *bilateral cumulation*, implies that in order to benefit from the application of the removal of tariffs, it is irrelevant whether the used input-factors were exclusively produced in country A or country B. The second form is *diagonal cumulation*. In the case that at least three countries A, B, C establish a free trade area, diagonal cumulation allows for a product from country A, to be exported to country C to fall under the freedom of tariffs although it is comprised of input-factors from country B. As a consequence, the product is treated as a product from country A despite the fact that it contains parts that were manufactured in country B. The third form, *full cumulation*, expands the freedom of tariffs to such an extent that in order to make use of the preferences it is finally irrelevant whether a traded product from country A is further manufactured or enriched in country B or C. Under such circumstances it is possible to relocate production capacities without losing the granted freedom of tariffs for the respective good.

Looking at the association agreements, however, it becomes apparent that the TCM originally were only granted bilateral cumulation. As a consequence, Moroccan producers, for example, while manufacturing a certain product may use input-factors from any EU country without being forced to prove the ‘sufficient transformation’ of these commodities. Hence, there is no need to declare the product as Moroccan before it can be exported to the EU’s market. That the EMAA’s and the interim agreement with the PLO do not go beyond bilateral cumulation does not only contradict the EMP’s objective to promote intra-Southern Mediterranean trade. It is also counterproductive as regards the envisaged dynamisation of foreign direct investment in the TCM. In the relevant politico-economic literature there is unanimous agreement about the fact that the granting of diagonal cumulation would lead to a strong increase of intra-regional and sub-regional trade between the TCM and have a positive effect on the competitiveness of their industrial goods (Nienhaus, 1999a and Tovias, 1997). The latter can be explained by the fact that producers in the TCM can make use of those comparative cost and competition advantages that may exist for certain materials in one or more of the TCM’s and, thus, have the chance to improve the market position of their goods in relation to competitive EU-European products. Furthermore, diagonal cumulation would have the potential to integrate the TCM into a net of interdependencies. It is needless to point out that such a net could also generate political synergy effects as far as the EMP’s overall goal is concerned, i.e. to transform the Mediterranean area into a zone of peace and stability.

However, it is particularly under the conditions of bilateral cumulation that these chances will be missed and producers from the Southern Mediterranean will be forced to produce their input-factors themselves at a higher rate even though they could be acquired from another of the TCM to a better price. Arguably, this substantiates the hub-and-spokes character of the EMFTZ as those companies located within the EU are in a position to benefit from access to all the TCM and their price-worthy intermediate goods, while access is denied to entrepreneurs possessing production facilities in the Southern Mediterranean.

That the EMAA’s only contain bilateral cumulation is due to the lack of a homogeneous interest structure in the EU. Whereas the Commission repeatedly argued in favour of diagonal cumulation, the Council of Ministers since 1995 was confronted with a coalition of veto-players on the one hand and supporters of an expansion of the rules of origin on the other. As textiles and processed food products from the TCM producers would benefit from diagonal cumulation, in the Council government representatives from all those EU countries that possess major production capacities in these sectors fear stronger competition from third countries.

Although the conclusions of the Cannes European Council of June 26-27, 1995 mention that cumulation between all parties concerned should be ‘gradually introduced’,<sup>32</sup> protectionist governments managed to succeed with their position. Surely, they had to accept that the German EU Presidency in its formal conclusions of the Euro-Mediterranean Foreign Minister’s meeting in

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32 See Bulletin of the EU, supplement 2/95.

Stuttgart in April 1999 included a paragraph whereby it emphasised the importance of cumulation of origin with regards to the TCM's integration into the world economy, and also the possibility to introduce full cumulation.<sup>33</sup> This formulation, however, is not precise and not seen by them as politically or legally binding. Nonetheless, one exception was acceptable to all fifteen member states. The EMAA's with Morocco and Tunisia contain cumulation rules that are limited to a potential cumulation within the Maghreb thereby excluding all the other TCM.<sup>34</sup> This exception is not the expression of a temporary interest convergence in the Council. Instead it is due to the fact that similar stipulations that were already included in the old cooperation agreements with the three Maghreb countries were not used in the past and, hence, not considered as important.<sup>35</sup>

It is only very recently that the EU-15 have eventually managed to agree on the revision of the much-debated cumulation rules though it must be pointed out that this adjustment is part of the EU's efforts to bring in line and harmonise its future policies towards its 'new neighbourhood'. As a consequence, trade ministers at the Euro-Mediterranean trade ministerial conference in Palermo at the beginning of July 2003 endorsed the new Protocol on rules of origin which finally allows extension of the pan-European system of cumulation of origin to the 12 TCM.

### *The Transition Periods*

The contractually agreed transition period of twelve years is highly problematic. On the one hand it is the low development level of most of the TCM and the negative effects of trade liberalisation, as outlined above, that indicate that the Southern Mediterranean markets may not be able to withstand the harmonisation pressure, and that a period of twelve years is too short.<sup>36</sup> On the other hand it is in specifically the graduality of the liberalisation process that may turn out to be counterproductive: In order to compensate for the loss of tax incomes that may occur in the case of those products whose custom tariffs will be dismantled during the first years of the EMFTZ, governments of the TCM could be tempted to additionally subsidise and/or protect those goods that are supposed to be liberalised at the end of the liberalisation period.<sup>37</sup> This, however, would either lead to welfare losses as it would keep companies artificially alive although they are actually not competitive. Or a major opportunity would be missed to use this transition period to adjust and adapt companies to the changing market situation, thus avoiding shock therapy which otherwise might be unavoidable once the EMFTZ has entered into force. This could lead to the postponement of political costs—in the form of resistance of the economic actors concerned against the actual liberalisation—and, thus, to misleading investment signals. In other words: urgently needed FDIs would not flow into (then protected) enterprises although some of them might have been principally attractive investment targets.

Notwithstanding the economic logic of the transition period's duration it is furthermore discernible that the Barcelona Declaration's target date for the implementation of the bilateral EMFTZ, i.e. 2010, will be missed. As all the TCM, with the exception of Israel and the PA, are given a twelve-year-period to dismantle their external tariffs, 1998 would have been the date for all agreements to enter

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33 See Euromed Synopsis 50, April 16, 1999: '22. Ministers stressed the central role that cumulation of origin has to play in enhancing effective economic integration in the region. They called for all necessary measures to be taken to ensure that a system with identical rules of origin opens the way to full cumulation throughout the Euro-Mediterranean area as soon as possible.'

34 See article 4 of title II of Protocol No. 4 of Morocco's EMAA.

35 See for instance article 1(2) of Protocol No. 2 of the EC's Cooperation agreement with Morocco.

36 Please note that the original association agreement with Greece contained a transition period of 22 years whereas in the case of the Customs Union agreement between the EU and Turkey and Cyprus a transition period of 32 and 30 years respectively has been agreed.

37 Except for the EMAA with Israel, all other EMAA's grant the TCM the maintenance of state subsidies during the first five years of the liberalisation process.

into force if 2010 was to prove maintainable. However, except for the association agreement with Tunisia, by then no other contract was ratified or even signed.

## VII. Conclusion

As has been outlined, the EMP and the EMFTZ project in their current design and structure are not viable palliatives to improve the micro- and macroeconomic conditions in the TCM in the short- and mid-term. Apart from the fact that their design is adjusted along the needs of EU-European producers of industrial goods, the EMFTZ, when analysed against the background of the EMP's second basket's overall objective and the EMP's other development-oriented goals, is characterised both by a remarkable ambivalence as well as by clear *incomplete contracting*.

On the one hand, the EMFTZ in its current conception risks to contradict the normative stabilisation objective, understood as a triggering and maintenance of a sustainable socio-economic development in the TCM. As has been shown, there is a relatively high risk that the implementation of the EMFTZ brings about massive disadvantages for the vast majority of the TCM's societies and that the latter might consider the costs of adaptation as too high. One potentially negative effect is an increase in social imbalance which, in turn, could lead to social unrest and thus a deterioration of the already unstable socioeconomic conditions (Nienhaus, 1999b: 517). On the other hand, however, the EU by using the EMFTZ seems to give priority to the support of the political and economic steering elites over the normative objectives, democratisation and strengthening of civil societies. In the context of the EMFTZ project this problem is expressed by the fact that the implementation of the liberalisation measures is closely linked to the willingness of both the ruling regimes and their client-oriented networks. They, however, are not at all interested in a broad political and economic liberalisation and, in contrast to other societal actors, stand a good chance of surviving and even benefiting from the modernisation process. The increasingly growing competition pressure will only be withstood by those companies that possess sufficient export capacities and that have the means to adapt themselves to the changing economic climate and market conditions. Clearly, these are not the many small and medium-sized enterprises (SME) but rather those companies whose economic elites, due to their cooptation through the political elites, have the relevant financial and technical resources at their disposal.

Moreover, with the exception of Israel, in all the TCM the political and bureaucratic elites and their family networks openly act as entrepreneurs and, hence, in contrast to the non-coopted SME, can benefit from the capacities of the state apparatus. This is, of course, also the case when state monopolies are opened up and prepared for privatisation. In such a case lay-offs of existing overcapacities are extremely likely. However, they do not concern the political and economic elites as they are the ones—the Moroccan industry conglomerate *Omnium Nord Africain* which is owned by the Filali family is a prime example in this context—who possess the financial means to acquire the privatised objects. The former state monopolies are thus transformed into private monopolies as the ownership structure and the property rights remain, as a matter of fact, the same as before. In the words of Kienle:

The impact of economic liberalization moreover is limited by the creation of enterprises by the rulers and their relatives, who thus transform their political capital into economic capital. Economic liberalization stops where it affects captive markets or elite profits. This truncated economic liberalization even reinforces—or at least consolidates—the dominant position of the rulers which it is sometimes supposed to weaken. The influence and the power that they lose through the contraction of the public sector comes back to them through their own private enterprises.<sup>38</sup>

This observation leads directly to the modernisation theoretical basis paradigm which the EMFTZ is implicitly based upon. That the Council of Ministers and the Commission in the context of the EMP in all their documents and writings that were published between 1994 and 2000 link the EMFTZ project with Lipset's (optimistic) findings is not only problematic but even unjustified. Whilst numerous

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38 Kienle 1998, p. 13.

quantitative studies of the last forty years, written by such prominent scholars such as Oberndorfer, Huntington/Dominguez, Hadenius, Russett/Monsen/Sirowky/Inkeles and Przeworski/Limongi, have shown that there hardly is a causal linkage between economic and political development,<sup>39</sup> this study has shown that the creation of democratic structures in the TCM is reduced by the EMP to a by-product of macrosociological and macroeconomic structures. Therefore, Przeworski's and Limongi's rather generally formulated criticism of the determinism of modernisation theoretical approaches and their analytical neglect of the role of political actors in democratisation processes applies to the EMP's second basket too (Przeworski/Limongi, 1997: 176). Furthermore, neither the Barcelona Declaration nor the association agreements specify 'development'. Instead, they give the impression of being based on a universally valid development concept which aims for the realisation of democratic conditions, the rule of law and the institutionalisation of a market economy. This impression, however, is misleading. Whereas there may be a common understanding over these development norms within the EU they are neither shared by the political and societal elites in the TCM nor do they consider the cultural and socioeconomic specifics in the Southern Mediterranean.

Finally, even in the case that causal relations between economic development and democracy do exist, it could be shown that this linkage in the context of the implementation of the EMFTZ did not materialise during 1995-2000 due to the strong influence of the phenomenon of incomplete contracting. Hence, the optimism as regards the democratisation and economic modernisation in the area between Rabat and Damascus that was particularly discernible in Europe when 'Barcelona' was inaugurated is not justified.

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39 See Muno 2001, p. 13.

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