

Gregory T. Papanikos*

**The Euro-Mediterranean Economic Relations:
Towards a Real Free Trade Area**

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* Director, Athens Institute for Education and Research (www.atiner.gr) & General Secretary, Economic and Social Council of Greece (www.oke.gr). Opening Speech at the International Conference on Mediterranean Studies 20-24 March 2008, Athens, Greece organized by the Athens Institute for Education and Research (AT.IN.E.R.) under the auspices of the Greek Ministry of Foreign Affairs. Opinions expressed are personal and should not be attributed to any of the author's affiliations.

I. Introduction: A Real Free Trade Area

Real free trade exists when the supply and demand of all economic activities are not discriminated between national and international. This includes, among others, the market of final goods and services, the market of intermediate goods, the market of raw materials, the labor and capital (financial) market, the new and old technology market, and even the government (state, public) procurement market. The notion of a Free Trade Area (FTA) applied to economic relations between the European Union (EU) countries and the Mediterranean Countries (MCs) is very restricted and primarily concerned with industrial products and some aspects of capital (financial) markets. Starting with the old cooperative agreements of the 1970s and ending with the most recent Euro-Mediterranean Association Agreements (EMAAs), the creation of FTA is too limited. This might satisfy the economic, social, political and security needs of the EU, but it is counter to the economic and the political prospects of the MCs.

There are very good reasons why the EU is not promoting a real FTA with the MCs. In a recent article, Montanari (2007) has developed a two-level game theory approach to explain the conflict of interests at the EU level, which explains the restricted nature of the FTA of the EU with the MCs. He states that domestic lobbies at the EU level account for the failure of boosting Euro-Mediterranean bilateral trade in the years following the European Partnership Agreements (“Barcelona” Process) signed after 1995. Earlier, Fidrmuc et al. (2003) found evidence that trade between some EU countries and MCs is determined by foreign policy concerns and the need to align this policy with the foreign policy of the USA.¹ Thus, domestic and foreign politics prevent the development of a real FTA between EU and MCs. Blending the two, politics and economics,

¹ Similar was the approach followed in the USA under the Bush Administration. Evenett & Meier (2008) have argued that foreign and security policy concerns have influenced USA’s international trade policy making. The differences and similarities in promoting democracy in the area are examined by Huber (2008).

Maggi & Rodriguez-Clare (2007) present an economic theory where politics play the central role in the trade agreement theatrics, emphasizing the role of domestic lobbies.

Why do we need Trade Agreements to start with? The answer is simple. As Harry Johnson (1954) explained, these agreements are needed because their absence will encourage countries to engage in trade wars. It seems that political unions are needed to prevent military wars and FTAs or economic unions are required to prevent trade wars. Why is international trade desired? Trade promotes development and growth and raises the standard of living. It might also promote political stability and democracy. The issue of international trade promoting growth and growth promoting democracy has been well documented in the international economic literature, even though it is far from being non-controversial.

Frankel & Romer (1999) focused on the component of trade that is explained by geographical factors. As they argue, some countries trade more because they are close to well populated countries such as the MCs and the EU countries. They found very consistent results. Trade promotes economic growth and per capita income. They establish that ‘a rise of one percentage point in the ratio of trade to GDP increases income per person by at least one-half percent. Trade appears to raise income by spurring the accumulation of physical and human capital and by increasing output for given levels of capital’.

International trade promotes growth and raises the standard of living. But how does it perform in promoting political freedom and democracy? This question is more controversial. It seems that the evidence is not conclusive. In a forthcoming paper, Acemoglu et al. showed that the apparent correlation between income and democracy is removed by including country fixed effects. However, they found that this correlation does exist in the long run, even though it becomes weaker, and in some cases disappears, when they control for potential determinants of the divergent development paths. What is important is the nature of causality, if it exists. It runs from income to democracy and not the other way

around.¹ This is important to explain the nature of EU-MCs relations. EU should aim at promoting growth in the MCs through trade and political freedom, then democracy will follow. Democracy can be considered a luxury good. Its “consumption” increases with per capita income, and I should add with the equal distribution of income.

A real FTA is a multidimensional and a dynamic process. It has a path that should start with the liberalization of the most important markets, i.e. the markets that will exert the highest economic impact and not with the markets that wield the least political resistance. I argue that if the EU wants to promote a real FTA with the MCs, then they should start with the two markets that MCs would benefit the most: the labor market and the market of agricultural products. If the purpose of the FTA is to promote economic and political development in the MCs, then the focus of any agreement process, bilateral or multilateral, should start with opening up these two markets. Actually, this was the approach followed by the EU itself when the Common Market was established in 1957. It allowed for a free market of agricultural products and the de facto free movement of labor, even for the neighborhood European countries that were not members at the time, such as Greece, Portugal and Spain. All three had non-democratic governments. The results are obvious today at the EU level: high per capita income, political stability and democratic regimes in countries that had experienced wars and dictatorships up to mid-1970s.

A real FTA will first promote trade in the markets that will have the higher long run multiplier effect on economic development in the MCs. At a second stage, this real FTA will promote the opening up of all other markets, leading to higher economic growth and higher per capita incomes for all people in the MCs. Finally, at a later stage, the increase in growth and per capita income will establish democratic institutions within an

¹ In a recent paper, Doucouliagos & Ulubasoglu (2008) examined whether democracy caused economic growth. They surveyed 84 empirical studies. They concluded that democracy does not have a direct impact on economic growth.

environment of political freedom. It seems that the causality of the effects cannot run the other way around: first political development and then growth and trade. The EU attempts to reverse this “natural” causality. The result is easily predictable: neither trade nor democracy. This apparent failure of the EU-MCs relations is discussed in the next section.

II. The failure of Free Trade Agreements between EU and MCs

Free Trade Agreements is a category of a Preferential Trade Agreement in which tariffs are reduced between the partners of the FTA but maintained against the outside countries. FTA can be considered as the first step toward more integrated economic relations such as a customs union, common market and economic union. The most successful example of a FTA that led to further economic integration is the European Union itself; however, this is the exception rather than the rule. Other early attempts, such as the Latin American Free Trade Area and the East African Customs Union, have had little impact and were actually abandoned. Even in Europe, the European Free Trade Area (EFTA) and the Council for Mutual Economic Assistance (COMECON) have failed. Today, most of these countries have become members of the European Union. It seems that preferences are given to FTAs rather than multilateral trade negotiations. The world is shaped by regional FTAs, such as the North American Free Trade Area (NAFTA), the Association of Southeast Asian Nations (ASEAN), the Asian-Pacific Economic Cooperation, etc. FTAs have been signed by the hundreds, particularly in the last two decades.¹ Bergstrand et al. (2008, p. 1) report that “...today the number of economic integration agreements exceeds 300 – and counting!” The majority of these agreements are FTAs, instead of PTAs, customs unions, common markets or economic unions.

How do FTAs perform in trade creation as opposed to trade diversion? Krueger (1999) raises two sets of questions on the impact of FTAs in

¹ For a list of the FTAs, see the <http://ptas.mcgill.ca/Pages%20ptas/A-Z/A.htm> prepared by McGill University.

general. First, what impact FTAs have, if any, on trade, production and consumption patterns of the partner countries. Second, what is the effect of FTAs if any, on multilateral trade liberalization? The empirical evidence shows that trade creation by FTAs exceeds any trade diversion that might be generated for the rest of the world.

What is the nature of the failure of FTA between EU and MCs? The reason already mentioned is the reversion of the causality. EU wants first political freedom and democracy for MCs, and then trade liberalization. The remaining of this section examines the more recent development of EU's Mediterranean policy, the European Neighborhood Policy (ENP) and the proposal made by France to create a Mediterranean Union between selected EU countries and MCs. The next section goes one step further and raises the question of whether the EU's preoccupation with politics and security is actually a disguise to restrict trade.

The "Barcelona" process started in 1995 with a mission to establish an FTA between EU and MCs by 2010. The results so far have not been so encouraging. Actually, as Montanari (2007) states, bilateral trade expressed as a percentage of both EU and MC total trade has even decreased. His study attempts to explain why this happens based on a theoretical framework that analyses EU's lobbying process.

The EU-MCs relations are not limited to the creation of an FTA but encompass a wide range of issues. As Hoekman (2007, p.2) states, EU's relations with MCs "...are commitment to common values, including democracy, the rule of law, good governance and respect for human rights, and complementing binding treaty-based cooperation with extensive financial and technical assistance". The economic ingredients of the "Barcelona" process go beyond the simple trade liberalization and include the right of establishment and supply of services, competition, regional integration and socio-economic, cultural and financial cooperation. In 2004, a new policy initiative was launched: the European Neighborhood Policy (ENP). According to the EU's Strategy Document "[t]he European Neighbourhood Policy will reinforce existing forms of regional and

subregional cooperation and provide a framework for their further development. The ENP will reinforce stability and security and contribute to efforts at conflict resolution”, CEC (2004, p. 4). This new policy initiative is consistent with the previous approaches that emphasize political and security issues over trade liberalization and economic development issues. This new policy initiative involves the adoption of Action Plans that aim at a wide range of subjects such as (a) political dialogue and reform (b) economic and social cooperation and development (c) trade related issues, market and regulatory reform (d) cooperation on justice, liberty and security (e) sectoral issues such as transport, energy, information society, environment, research and development and (f) the human dimension: people-to-people contacts, civil society, education, public health, etc.

This approach might explain the substance of the failure of FTA. Trade liberalization requires an opening up process until the elimination of tariffs. It demands free movement of final goods and services and the free movement of factors of production. As far as the MCs are concerned, the agricultural market and the labour market should be given first priority, and all the others would follow. Opening up these two markets will have trickle down effects on trade liberalization in other markets such as the industrial products. The increase in trade will promote economic development, economic growth and elevate the standard of living of people of the MCs. This bright economic prospect will bring pressures from within for political freedom and democracy. This is the sequence of events. If the sequence were reversed, as the EU does, then nothing is achieved. One might also argue that the EU does not really want an FTA because internal and external political pressures prevent the implementation of a real FTA. The emphasis on political freedom, security and democracy is an excuse rather than a real concern. This issue is further discussed in the next section.

III. Is Democracy Promotion a Disguise to Restrict Trade?

The issue of democracy has become an important argument in the process of opening up the economy and promoting economic growth and development. The fundamental question is whether democracies have different public policies than non-democracies. Two schools of thought have been developed in answering this question. There are those that consider the voting mechanism as an important determinant of policy choices and policy paths. The second school considers the political regime of secondary importance once the country's economic and demographic variables are taken into consideration. How does democracy or non-democracy affect the country's international trade policy? In an empirical study of comparing democratic and non-democratic regimes, Mulligan et al. (2004) have found that it does not make any difference. Thus, opening up trade is not affected by the existence of a democratic regime. Interestingly, what they found is that older and richer countries have more open trade policies, but they do not elaborate further on this issue. It might be the case of the causality of the impact. Older countries became richer because of their trade policy.

The non-European Mediterranean countries have a long and rich history of wars, political instability, foreign occupations and spells of economic development and stagnations. There are many reasons why this was the case; both internal and external. It goes beyond the scope of this note to account for the reasons why this has occurred. Kuran (2004) provides a brief overview of the historical stagnation in the Middle East. It is important to note that a similar process of long periods of wars and economic underdevelopment was experienced by the western world. Kuran (2004, p. 82) summarizes the transformation of Western Europe by making three observations. First, economic and political developments including the establishment of democratic regimes took many centuries. Just to mention again that the new Mediterranean members of the EU (Portugal, Spain and Greece) had dictatorships up until the mid-70s.

Second, the enforcement of the rule of law demanded huge struggles between rulers and citizens. This gave rise to independent institutional mechanisms to check the abuses of power by royalty and even by “democratically” elected governments. Judicial independence was achieved, if it even has been achieved, through a struggle with the executive power. Third, social classes such as workers’ movements, landowners, and merchants have played an important role in establishing mechanisms that guarantee political stability and democracy. These long processes of political developments and the establishment of democracies came after the establishment of well developed economies with high and relatively stable levels of economic growth and a considerable rise in the standard of living. I tend to accept that this is almost a mechanical causality; something like a “natural” law.

Trade → Economic Development → Economic Growth → Standards of Living → Political and Institutional Developments → Democracy

The Middle East region has failed to take advantage of the expansion of world trade and foreign direct investment. Explanations offered are many: historical, political, cultural, religious and economic. Many mention the trade barriers, i.e. high tariffs impede trade and the inflow of foreign investment. Many emphasize the political instability in the region. For example, Yousef (2004, p. 106-107) claims that political instability in the region prevented the inflow of foreign direct investment and the development of trade. But interregional trade existed in the area for centuries (if not for millenniums) in the midst of political instability and wars. Again, the causality is at question. Do wars decrease trade, or does the great economic potential of the area create wars to secure the trade of important raw materials?

Today, the Mediterranean area faces two economic problems that create an environment in which political instability and wars can thrive. Both have deteriorated since the 1950s. First, it is the high rates of

population growth. For 50 years, from 1950 to the end of the century, the region had the highest rate of population growth, averaging three percent per annum, with the exception of sub-Saharan Africa (Yousef, 2004). High population growth created a “surplus” of labor in the 1990s who could not find employment. This explains the high pressure to migrate to the EU and other countries. Restricting such flow creates illegal migration and/or political instability and civil wars in the region. A real FTA must involve the free flow of labor. This will also ameliorate another parallel problem of keeping up with labor standards. Imposing international labor standards does not solve the problem for the MCs. Free labor migration yields faster results for the workers themselves, with a very low transaction cost of monitoring and enforcement. Imposing labor standards might be considered as another disguise to restrict trade. Brown (2001, p. 109-110) summarizes the proposal of international labor standards as follows:

“For those motivated by humanitarian concern over the plight of workers in low-income countries, it is an uncomfortable reality that trade sanctions levelled against countries with poor labor practices may well hurt the very workers who are the intended beneficiaries. Moreover, it is by no means clear that attempts to use trade sanctions to enforce labor standards will strengthen either trade or labor standards, at least not in a world of strong political lobbies. Heterogeneous labor standards across the world are a legitimate source of policy concern. But it seems unlikely that the appropriate policy response is to seek a single set of universal labor rules”.

There is, however, a solution: a real FTA which will permit unimpeded access to labor markets of the advanced countries. How does the EU approach this problem? Instead of opening up its borders to absorb this excess supply of labor, it reverses the argument and sees this supply as a threat to its security. Joffe (2008, p. 159) puts it very clearly:

“Migrants, in addition to their economic and humanitarian identities, began to be seen as potential threats to European order at both the national and the Community levels on the assumption that they could also be the transmission trains of violent ideologies of conflict from North Africa and, to a lesser

extent, from the Middle East into Europe. To that extent, the EU and the United States shared a common concern”.

The second problem relates to the structure of economic development of the area. The rich countries of the area are those that export oil. The rest of the countries are rural depending on agricultural production. For these countries, the only solution is the opening up of these markets so that they can obtain better prices.

The opening up of the labor and agricultural markets should be the subject of negotiations to establish a real FTA of the MCs with the EU. The migration of labor to the EU will alleviate the population pressure and create enough remittances to instigate economic development in the area. Similarly, the opening up of the agricultural products market will generate enough income for the poor rural residents of the MCs and may create a surplus that, along with the immigrants’ remittances, can start a process of economic development. If the EU really wants to help the area to develop, they should implement an FTA with the entire region, giving them free access to its own labor and agricultural markets. This is the solution. Security and political concerns can be taken care of once the area enters into a process of sustainable economic growth. Claiming that democracy should come first masks the real problem, i.e. the creation of a real FTA. There is, however, a considerable short-run economic and political cost that the EU must bear, but the long-run benefits for both regions far exceed these costs. The EU needs political leadership, with long foresight, taking into consideration the long term benefits of boosting trade in the markets that do matter for the MCs. Raising other issues should be considered as a disguise to their unwillingness to bear the short run cost of creating a true FTA.

Unfortunately, the new approach to EU-MCs relations that started in 1995 with the “Barcelona” process makes the creation of bilateral FTAs conditional on democratic reform. This democratization process that is dictated from outside is a contradiction in itself. Democracy must be developed from within. If it is a luxury good, then growth and the rise of

standards of living must come first. Sustainable political freedom and democracy can be implemented once growth has been achieved. The EU policy makers, for whatever reasons, have accepted a reverse process. Writing on the EU's democracy promotion in the Mediterranean Basin, Youngs (2002, p. 41) affirms that:

“... the architects of Mediterranean policy during the latter half of the 1990s insisted that the new commitment to democracy promotion also reflected a genuine reassessment of European interests. Political liberalization was, they maintained, now seen as the best means of engendering both stability and moderation in the Mediterranean, and of **helping to generate the economic growth** that would eventually ease **migratory pressures**” (emphasis added).

This revealed policy objective is based on information obtained by interviews with a number of EU policy makers. It is obvious that the approach followed by the EU is of reversing the “natural” causality of the process. The question is whether this is a genuine assessment of the process or a disguise to avoid a real FTA, given that such an agreement has a short-run economic and political cost for EU countries. This question cannot be answered.

The recent initiative by France to create a Mediterranean Union is consistent with the approach of the “Barcelona” process. France, holding the Presidency of the Council of the European Union for the first half of 2008, has pushed this idea very hard, and it has included it in an Annex of the Presidency Conclusions of a recent meeting of the Council of the EU, in Brussels, on 13-14 of March 2008. It states that:

“The European Council approved the principle of a Union for the Mediterranean which will include the Member States of the EU and the non-EU Mediterranean coastal states. It invited the Commission to present to the Council the necessary proposals for defining the modalities of what will be called “Barcelona Process: Union for the Mediterranean” with a view to the Summit which will take place in Paris on 13 July 2008”.
 (“Presidency Conclusions”, Council of European Union, 1998, p. 19)

Very little should be expected from such initiatives, if the aim is to create a real FTA. As I said, this should include free movement of labour and opening up the EU's market for agricultural products.

IV. Conclusions

I argued that a real free trade between EU and MCs should start from the most important markets of the MCs, such as the agricultural market and the free flow of labor. Politically, this may not be feasible at the EU level because of internal and external pressures, but MCs can develop only if trade opens up in the markets and the positive impact is maximized. A true FTA will promote the opening up of all markets and the creation of a Mediterranean zone with free flow of goods and services. This will give rise to economic development, economic growth and a rise in the standard of living. It is then, and only then, that democracy can be established in the MCs. Democracy is a luxury good. It requires high per capita income, equally distributed among the people of the region. EU policy makers should take this very seriously; otherwise they can be criticized that their security and democracy concerns are used to cover up their unwillingness to create a true FTA.

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