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# A Faster, Better Route to Economic Integration Across the Mediterranean

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An alternative approach to the current economic integration roadmap for Middle East and North Africa (MENA) countries would provide a significant opportunity for EU-Turkey-MENA cooperation while substantially improving the economic outlook for the Southern Mediterranean countries. The goal of economic integration between the southern part of the Mediterranean and Europe is currently being pursued through the gradual implementation of a web of bilateral free trade agreements (FTAs). This is the legacy of the Euro-Mediterranean Barcelona process, which initially foresaw the establishment of a free trade zone across the Mediterranean by 2010. The way forward envisaged the conclusion of FTAs first between the EU and individual MENA countries, and then among MENA countries themselves in order to create a large, seamless free trade area around the Mediterranean. The first part of this vision was gradually and successfully implemented—the EU has initiated and concluded FTAs with all of its Mediterranean neighbors except for Libya.

The second part of this project, namely the establishment of FTAs between MENA states, has been somewhat less successful due to the continuing existence of political barriers between a range of MENA countries. Only the Agadir Agreement covering Egypt, Jordan, Morocco and Tunisia was able to establish an intraregional FTA compatible with EU rules of origin.

The economic impact of this regional design is more troubling. Although trade between individual MENA countries and the EU has flourished, the multilateral FTA model has done little to improve trade and investment among MENA countries. Intraregional trade as a share of total MENA trade remains at 10 percent, paling in comparison to 70 percent for the EU and 50 percent for North America.[1] The hub-and-spoke structure—with the EU as a hub and individual MENA countries as spokes—that this blueprint has created also acts as a disincentive to interregional trade and investments. There is evidence that these agreements have significantly increased MENA countries' imports from the EU, but have had no positive impact on their exports to the EU. EU-MENA trade remains lopsided. In other words, the chief impact of these agreements has been to open Arab markets to European exports.[2] A 2009 World Bank study goes further by suggesting that these agreements have actually harmed MENA countries' overall trade competitiveness. The report states that "preferential agreements with the EU have not helped MENA countries withstand competition from China and India. They have partially helped maintaining a market in Europe, but the EU rules of origin may currently impede MENA's further export growth…Preferential agreements have locked MENA producers into production structures that shelter them from competition and handcuff their ability to source inputs from other locations."[3]

A similar argument can also be advanced for investments. The lack of an integrated market in the South Mediterranean coupled with the complicated set of rules of origin serve to displace foreign investments to the North. A foreign investor established in Europe can easily serve all the MENA markets whereas a MENA investor remains handicapped by the holes in the set of bilateral trade agreements among MENA countries as well as the added complication of the rules of origin.

Under these conditions, a fundamental rethink of the economic integration blueprint between the North and South of the Mediterranean cannot and should not be avoided. The Barcelona decision to establish a seamless zone of free trade across the Mediterranean can certainly be maintained. What needs to be challenged is the contrived mechanics of forcing individual MENA countries to first negotiate FTAs with the EU and then among themselves. Logistically speaking, it is a nightmare. Each MENA state wishing to join the EuroMed free trade zone has to painstakingly negotiate eleven separate FTAs—one with the EU, one with Turkey, and nine with the remaining MENA countries. All in all, 121 separate trade agreements (eleven agreements for each of eleven countries) will have to be negotiated, signed and ratified for the eventual establishment of the EuroMed free trade zone.

A much more practical and economically superior alternative would be to extend the current trade integration model between Turkey and the EU to MENA countries.[4] Ankara and Brussels established a full-fledged customs union at the end of 1995. As a result, trade in manufactured goods has been liberalized between the two. In addition, Turkey adopted the EU's common trade policy. Trade between Turkey and the EU is now carried out in almost exactly the same way as intra-EU trade. There are no complicated rules of origin that act as a disincentive to trade or investments. The customs union arrangement has, moreover, helped the Turkish economy to improve its competitiveness. The adoption of the EU's trade policy lowered import barriers and forced Turkish manufacturers to compete globally.

Extending the Turkey-EU customs union to MENA countries would achieve a number of important goals. It would, first, obviate the need to conclude separate agreements among MENA countries in order to bring about the EuroMed free trade zone. Each MENA country would only need to join the Turkey-EU customs union. The customs union arrangement would then start to extend across the Mediterranean. A single agreement would be sufficient for any new country to join this zone as opposed to eleven separate agreements which are needed at present.

The introduction of customs union rules would also dissolve the adverse hub-and-spoke system between the EU and MENA countries and eliminate the need for rules of origin. These changes would, in turn, eliminate all types of disincentives to capturing foreign direct investment. Under these conditions, there would be no tariff-based differences for exporting to the Europe and the MENA region from anywhere within the region. As a result, foreign investors might be more willing to invest in MENA countries in order to take advantage of their lower costs of production.

The customs union alternative would also provide a sound solution to the problem of incentivizing intraregional MENA trade. Once a MENA country joins the Turkey-EU customs union, it can start to trade freely with all the other MENA countries that previously joined the customs union area—without the restraining impact of the rules of origin. Unlike the current system, finally, a customs union solution would cease to condition free trade between individual MENA countries on the conclusion of an agreement between these countries. The customs union solution therefore also provides an option to overcome the political obstacles to free trade in the region.

The main challenge of shifting to a customs union arrangement lies in ensuring that MENA countries remain competitive vis-a-vis the rest of the world. They would indeed lose the tariff protection afforded by the current system of free trade agreements with the EU. They would also lose their trade policy independence and the ability to freely conclude trade agreements with third countries. But as the World Bank study has demonstrated, the current system has not helped these countries to gain international competitiveness. On the other hand, the Turkish example clearly shows that the customs union arrangement and the process of tariff liberalization, which was introduced gradually, helped Turkish industry to acquire global competitiveness. The best antidote to lack of international competitiveness has really been the introduction of competition in protected markets. In this respect, the outcome of the WTO Doha Round of talks will also be instrumental. The successful conclusion of the Doha Round would lead to further dismantling of tariffs in WTO member states. This would facilitate the adoption of EU-Turkey tariff levels by MENA countries.

Turkish and EU policymakers should engage in a substantive dialogue on the extension of the Turkey-EU customs union to the MENA region. As part of its review of the European Neighborhood Policy, the European Commission may consider the preparation of a study on the feasibility of extending the Turkey-EU customs union to the entire MENA region. As argued, extending the Turkey-EU customs union has the potential to substantially enhance the economic integration and, therefore, the economic future of the whole region. This opportunity should not be squandered due to misplaced confidence in the current Barcelona blueprint for economic integration between the North and the South of the Mediterranean.

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1. See “Trade Integration in the Middle East and North Africa”. The World Bank (March 2010).

2. See “How Europe should douse the Arab firestorm” by Nasser Saidi in Europe’s World (Summer 2011).

3. This warning was reiterated almost literally in a recent World Bank report as well. Please refer to “Economic Integration in the Mashreq” (2010). The World Bank.

4. Charles Grant. “A new neighbourhood policy for the EU”. Centre for European Reform Policy Brief (March 2011). See also Uri Dadush and Michele Dunne. “American and European Responses to the Arab Spring: What’s the Big Idea?” *Washington Quarterly*, Fall 2011.