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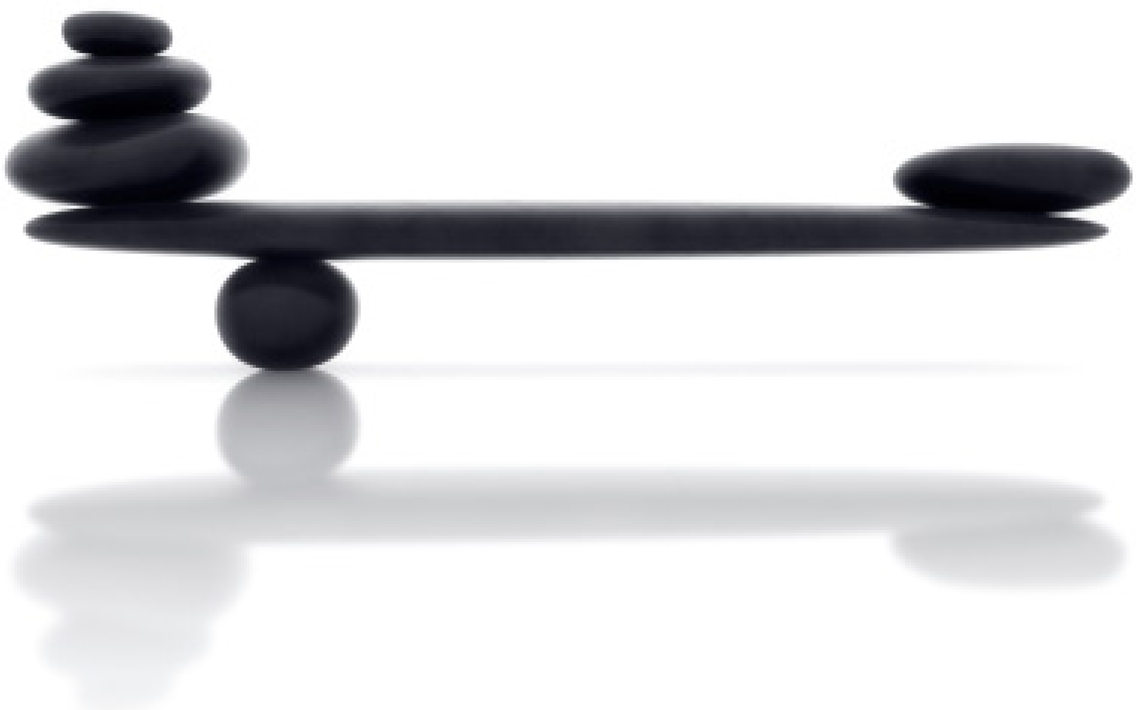
REGIONAL TRADE AND CUSTOMS UNIONS

Sinan Ülgen



center for strategic research
SAM
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The Tunisian and Egyptian economies appeared to be doing fairly well prior to the Arab Spring, with annual growth rates of four to five percent. However, these two nations and other in the Middle East North Africa (MENA) region were lacking inclusive growth. Few in society were seeing the benefits, with much of it being limited to those who had good relations with the government. A key issue for these countries during this democratic transition period is whether or not they can provide hope to their citizens for a better economic future.

Trade will play a major role in economic growth. The current blueprint for trade in the Mediterranean region was set out in 1995 during the Barcelona Process. This Process essentially aimed to create a free trade zone in the Mediterranean, linking the northern part to the southern part by 2010. This regional economic integration was a two-part project involving the formation of a free trade agreement between the North African nations and the EU, and amongst the nations of North Africa. It was hoped that a successful conclusion of these free trade agreements would create a seamless zone for free trade in the region. The free trade agreements between Brussels and North Africa were successfully completed. A host of reasons, primarily political in nature, has prevented similar free trade agreements from occurring amongst the countries of North Africa. This has created a situation economists call a hub and spoke system, with the EU serving as the hub and the individual MENA countries forming the spokes. The hub and spoke system has created an environment where the EU has increased exports to the region with little positive economic impact being realized by the MENA countries, as they lack the ability to export beyond the EU.

In 2009, the World Bank stated "preferential agreements with the EU have not helped MENA countries withstand competition from China and India. They have partially helped maintain their 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." This is a major predicament. The second predicament is the current state of regional economic integration. The share of interregional trade in MENA is around 10 percent, compared with 70 percent in Europe and 50 percent in North America. The Barcelona Process has failed to foster interregional economic integration. The third predicament is that this system of hub and spoke is a disincentive for foreign direct investment. This is due to the complexities of the system of rules of origin that come as a result of these free trade agreements. Foreign investors may be turned off by counties with a complicated set of rules of origin and instead invest in countries that export freely. For this and the previous reasons, there is a need for a full evaluation of this current blue print of regional economic integration. A good example to look at is the agreement that Turkey and the EU concluded in 1995. They concluded a customs union instead of a free trade agreement. The fundamental difference between the customs union and a free trade agreement is the customs union is a more integrated version and it obviates the need for rules or origin. The downside is that both sides of the customs union have to have the same trade policies, creating a loss of independence on certain trade policies in order to achieve greater economic efficiency and ease of trade. The extension of the Turkey-EU customs union to the region would mean the elimination of all rules of origin, elimination of disincentives to foreign direct investment and ensure a better regime for free trade. It would also streamline the process for a country such as Libya to reengage with the world economy. Under the current framework, Libya would need to conclude a free trade agreement with the EU and eleven more with the regional countries in order to enter this space of free trade. A customs union would overcome political difficulties. Morocco and Algeria, for example, would not have to conclude an agreement with the EU to enter the customs union. The downside is that this would lead to an elimination of protectionism. This idea of one, single overarching customs union for the region gets overwhelming positive responses from everyone except for trade officials in the EU, as the status quo benefits them.

The current EU-Turkey customs union only covers manufacturing goals, but that does not need to be the case if it is extended across the region. The customs union can be extended to agriculture or to services. This is not to say there will not be challenges. Morocco is currently facing difficulties in concluding an agreement with the EU on fisheries. Yet, these short-term challenges can be overcome. Additionally, if there is movement for a roadmap for regional economic integration, the countries of the region need to develop accompanying policies to take full advantage of a more liberal, more open trading regime. These fundamental reforms would enable a new sense of entrepreneurship to develop. That would enable people and companies to get access to capital much more easily than in the past. A liberalization of the current banking system, eliminating many of the rules currently connected to lending, must be realized. It is only through true reform that the nations of this region can achieve the full benefit of free and open trade.

Strategic Studies Network Contact Information

strategicstudiesnetwork.org
@StrategicStuNet

Tyler Rauert
Director
rauertt@ndu.edu
@tylerrauert

Fahad Malaikah
Program Coordinator
Fahad.Malaikah.ctr@ndu.edu