
European Agreements: Models or Obstacles?

The United States and the European Union have strong shared interests in the Middle East. Both have relationships that would derive considerable political benefits from the region's economic integration and growth. Indeed, given proximity, the importance of immigration from the region, and the extensive nature of trading relationships, European interests in the region's development are especially strong. There is, therefore, a strong case for these two economic superpowers to ensure that their approaches are compatible and complementary. In fact, both have announced the intention to form free trade areas in the region as a whole, but each has essentially viewed itself as the hub of that arrangement and they have proceeded with little or no coordination.

In some respects this is not necessarily bad. Competitive liberalization between the economic superpowers could enhance the opportunities for Middle Eastern countries. In particular, if a country can obtain particular market access benefits from one of the superpowers it may be in a stronger position to obtain similar benefits from the other. Israel, for example, was able to use its cooperation agreement with the European Community in the 1980s to strengthen its case for a US-Israel free trade agreement (FTA). Likewise, Egypt's FTA with the European Union provides it with some leverage as it tries to persuade the United States to enter into a similar arrangement. The option to sign with both the United States and the European Union also allows Arab countries to reduce some of the trade diversion that could result from signing with just one, since in many product areas, European and American export products are substitutes. This competition could also help ensure that exporters not simply appropriate the potential rents created from tariff reductions. Simi-

larly, the ability to offer duty-free access to both large markets could help improve the attractiveness of Middle Eastern countries for foreign direct investment motivated by the desire to use them as an export platform.

But there are also serious problems that could result from the coexistence of these two approaches. One area of particular concern relates to divergent systems of rules of origin that could severely undermine some of the potential benefits from the agreements. This chapter describes the EU initiatives, traces their evolution over time, and compares them with those of the United States.

The European Union has had several programs devoted to the region. In the 1970s it unilaterally extended preferential benefits to several Mediterranean countries, allowing duty-free entry for their industrial exports as part of a series of cooperation agreements. In November 1995, the European Union reinvigorated these programs with a major Euro-Mediterranean Partnership (Euro-Med) initiative.¹ In 2004, with its enlargement to 25 members, the European Union sought to deepen its links even further by incorporating these countries into a European Neighborhood Policy (ENP), which also includes countries from Eastern Europe.

One major element in the Euro-Med program was negotiating bilateral FTAs with Middle Eastern countries with a view, ultimately, to linking them in a single free trade area. In the Barcelona Declaration (1995) the 15 EU countries and 12 Mediterranean countries agreed to establish a Euro-Mediterranean free trade area (EMFTA) by 2010. EMFTA was to be achieved by means of Euro-Med Association Agreements (EMAAs) between the European Union and the Mediterranean partners, together with FTAs among the partners themselves.²

The provisions of the individual association agreements vary from one Mediterranean partner to another.³ However, they have several common elements: They establish a free trade arrangement over a transitional period of 12 to 15 years (15 in the case of Egypt) and include provisions relating to intellectual property, competition rules, and economic cooperation. In addition, they provide for political dialogue, commitments to re-

1. In addition to Cyprus and Malta, which have since become full EU members, the 10 Mediterranean partners participating in these arrangements are Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, Tunisia, and Turkey. Libya has had observer status since 1999.

2. Agreements have been signed and ratified by Tunisia (signed in 1995, ratified in 1998), Morocco (signed in 1995, ratified in 2000), the Palestinian Authority (interim agreement signed in 1997), Israel (2000), Jordan (2002), and Egypt (signed in 2001, ratified in 2004). Agreements have also been reached with Algeria (signed in 2001, ratified in 2005) Lebanon (signed in 2002, ratified in 2004), and Syria (2004). Turkey has a customs union agreement; see www.bilaterals.org (accessed September 15, 2006).

3. Implementation of the agreements is overseen by Euro-Mediterranean Conference of Ministers of Foreign Affairs and the Euro-Mediterranean Committee for the Barcelona process (the Euro-Med Committee).

spect human rights and democracy, and cooperation relating to social and cultural affairs and migration.⁴

The trade component of the association agreements requires the European Union to (1) establish permanent market access for industrial imports from Mediterranean countries into the European Union, and (2) liberalize trade on 60 percent of EU agricultural imports from the Mediterranean countries.⁵ It should be noted, however, that with the exception of textiles and apparel, most of the EU barriers to industrial products had already been lifted in the earlier cooperation agreements. In addition, the level of agricultural imports was extremely constrained by the high barriers to trade that the European Union imposes through its Common Agricultural Policy, so that the 60 percent number is less than it seems. Indeed, the agricultural liberalization undertaken by both sides in the agreements is small, and a complex system of tariff quotas and preferential tariff rates remain in effect.⁶ The agreements do, however, require the Mediterranean partners to undertake significant new liberalization with respect to industrial products. They must dismantle their tariffs on imports of nonagricultural products from the European Union, which are often high, and implement specific institutional reforms in areas such as rules of origin, standards certification, protection of intellectual and industrial property rights, and competition policy.⁷ In addition, while the agreements also contain expressions of intent to promote investment, trade in services, and government procurement rules, they provide no new binding commitments.

United States–European Union Comparison

There are some noteworthy differences between the US and European approaches. As indicated in the previous chapters, even if motivated by political goals, the US agreements are narrowly focused on freeing trade and investment. By contrast, the Euro-Med agreements construct an inte-

4. See The Euro-Mediterranean Partnership, Association Agreements, <http://europa.eu.int> (accessed February 9, 2006).

5. Although fresh agricultural products are almost excluded from the agreements, processed foods are included in product groups with the longer transition period (up to 12 years for total tariff abolition).

6. The agreements generally state that five years after the agreements are signed, further negotiations on agriculture shall take place, but no time limit is set for when they must be concluded.

7. Goods that will first experience tariff abolition are generally intermediate and capital goods that are not produced in the Mediterranean countries and have the lowest average tariffs, while consumer goods and products with the highest tariffs will be liberalized more gradually. This may mean that in the short run the agreements may actually increase effective [protection.]

grated framework in which the economic partnerships are complemented by partnerships in politics and security, on the one hand,⁸ and social, cultural, and human affairs, on the other. This broader European approach has the virtue of providing a comprehensive framework that could include many dimensions of reform, but it also runs the risk of politicizing the trade and economic relationships. By contrast, the US approach is more conducive to putting the economic and political relationships on distinctive tracks, although the United States has not always done this.

Second, the US approach has thus far been exclusively bilateral, although the stated goal is for eventual integration. By contrast, in addition to the country-specific bilateral agreements, the Euro-Med initiative includes a plurilateral process to collectively address common goals. More recently, in the ENP, the European Union has turned explicitly to measures designed to enhance regional integration. Third, the US approach does not provide for extensive grants of aid, although in some cases there are financial commitments to enhance domestic capacity. By contrast, the EMAA initiative was accompanied by a substantial development program called the Middle East Development Agreement (MEDA), which funded projects that support the implementation of the agreements. According to dell'Aquila and Kuiper (2003), the MEDA establishes a single allocation for the entire Mediterranean area. It was endowed with 4.6 billion euros for 1995–99, three times the former level of funding for aid to these countries.⁹ MEDA II made 5.35 billion euros available for 2000–2006.¹⁰ Again, the inclusiveness of the EU approach has advantages and disadvantages. The links between aid and economic reforms are quite controversial and much depends on the conditions under which the aid is disbursed. Sometimes financial assistance can be used to facilitate adjustment to trade, but it could also serve to reduce the pressures on governments to reform, particularly since money is fungible, if the funds are used for activities that would be undertaken anyway. Fourth, the countries involved in the US and EU initiatives overlap but are different. Notably, the US approach includes Gulf Cooperation Council (GCC) countries (such as Oman, United Arab Emirates, and Bahrain) acting independently. By contrast, the EU approach includes Turkey (Cyprus and Malta having now become full EU members) but does not include GCC countries, as the European Union has a separate and long-standing initiative to negotiate a FTA with the GCC as

8. The political and security partnership seeks to establish a common area of peace and stability by strengthening political dialogue and the observance of basic principles such as human rights, the rule of law, and democracy.

9. Actual MEDA payments turned out to be only 29 percent of the funds allocated because of complex and cumbersome negotiations.

10. The efficiency of the system has improved, and 77 percent of these funds were actually disbursed.

a whole.¹¹ This could mean that the countries that ultimately become members of the Middle Eastern free trade area that Europe is promoting could differ from those that the United States is contemplating. Finally, the coverage and nature of the commitments of the US and EU agreements are significantly different, as can be seen in table 4.1, which compares the US and EU agreements with Morocco. The US agreements are clearly deeper and more comprehensive, with more inclusive arrangements for services, foreign investment, and agriculture, although these differences are could narrow if the more recent ENP is successful.

Euro-Med Agreements

The Euro-Med agreements were disappointing. Indeed, the time it took to negotiate, ratify, and implement them was suggestive of a lack of enthusiasm by some participants. For example, while the EU-Egypt agreement negotiations were launched in November 1995, the agreement was only signed in 2001 and came into effect in June 2004—almost a 10-year process.

The agreements provided little in the way of liberalizing agriculture, a key export sector for several Mediterranean economies. Since they already enjoyed duty-free access to the European Union, export interests in the Mediterranean countries had little to gain in the form of new opportunities. This deprived Mediterranean countries of the ability to use the agreements as an opportunity for mobilizing export industries to promote liberalization and reform.

Second, the failure to cover services and investment limited the usefulness of the agreements. These issues are particularly important for making headway in introducing regulatory reforms, improving the environment for entrepreneurship, and attracting foreign capital.

Third, the original agreements were bilateral in nature and their rules of origin did not provide for diagonal cumulation.¹² Only value added in each partner and the European Union could be used to meet eligibility for duty-free access under the agreement.¹³ This had the effect of creating

11. In 1989 the European Union signed a cooperation agreement with the GCC that includes commitments from both sides to enter into negotiations on a FTA. These were initiated in 1990 but soon reached a standstill. In 1999, the GCC issued a declaration to create a customs union, and negotiations with the European Union resumed in March 2002. The 13th round of these EU-GCC FTA negotiations took place in November 2005 in Brussels, and both parties have conveyed their commitment to close them as soon as possible (<http://europa.eu.int>).

12. Bilateral cumulation permits inputs from a partner country to be counted toward domestic or regional value-added requirements. Diagonal cumulation permits inputs from third countries that have similar rules of origin to count toward regional value-added requirements. Full cumulation allows processing that is performed anywhere within a group of countries with the same set of rules of origin to be counted as domestic value added within the originating country.

13. The agreements with the Maghreb countries did allow full cumulation.

Table 4.1 Comparison of Euro-Med and US-Morocco agreements

Item	Euro-Med	US-Morocco
Industrial products	Included	Included
Transition: Industrial products	EU immediate; Morocco 12–15 years	US immediate; Morocco nine years
Agriculture	European Union: limited (about 60 percent of imports, plus preferences with tariff quotas) Morocco: Very limited; some duty reductions within tariff rate quotas (TRQs)	United States: phaseouts up to 18 years Preferential TRQs, Morocco: Phaseout on products most sensitive over 25 years; additional TRQ preferences expand over time
Intellectual property rights	World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)	TRIPS plus
Antidumping and safeguards	WTO rules	WTO rules
Competition rules	Outlaws collusion/abuse of dominant position distorting competition in trade	Not covered
State aid/subsidies	Must not distort EU-Morocco trade but allowed for public or policy goals	WTO rules
Government procurement	Consultation with aim of further liberalization	Most central government purchases; majority of regional and municipal governments
Services	General Agreement on Trade in Services (GATS) plus possibility of further liberalization	Negative list approach; sectors covered by Morocco include audiovisual, telecommunications, distribution, construction, finance, insurance, and e-commerce
Standards	Aim at reducing differences and mutual recognition	WTO rules

(table continues next page)

Table 4.1 (continued)

Item	Euro-Med	US-Morocco
Aid, economic development cooperation	MEDA grants to support all Euro-Med agreements	Not covered
Other provisions	Political dialogue; social and cultural cooperation; democratic principles and respect for human rights; scientific, technical, and technological cooperation	Not covered
Rules of origin	Extensive (see tables in chapter 4)	Extensive (see tables in chapter 4)
Investment	Not covered	Almost full rights of establishment, national treatment
Labor and environment	No new commitments	Commitments to enforce own laws, not to weaken laws or rules to attract trade or investment
Dispute settlement	Association council by "decision" or by arbitration binding on both parties; no time limit or enforcement procedures	Dispute panels with open public hearings; enforcement mechanisms include suspending trade concession or monetary assessment

a hub-and-spoke arrangement that placed the Mediterranean countries at a competitive disadvantage to the European Union. It also discouraged Mediterranean countries from using each other's products as inputs, thereby actually reducing the incentives for intraregional trade. Value added in the European Union could qualify for duty-free access to any Mediterranean country, but value added in each country could qualify only for sales to the European Union. Investors seeking to service the entire region would therefore find it more attractive to operate in the European Union than in any single Mediterranean country.

Fourth, the agreements did make some progress in establishing new competition policy rules, but apparently made insufficient progress to allow for eliminating the antidumping rules. More generally, they failed to cover other key elements for trade such as sanitary and phytosanitary standards, technical regulations, and conformity assessment.

Finally, it is questionable whether the agreements have an adequate enforcement mechanism. The Euro-Med agreements only allow for suspen-

sion of privileges for violation of an “essential element” of the agreement that refers to elements of the United Nations Charter such as violations of human or political rights. There is no way to withdraw trade concessions in the event of lack of compliance with the commitments to economic reforms. Disputes are handled by an Association Council comprising both European and Middle Eastern partnership members. A majority of votes within the Association Council is required to take action against a non-compliant country, but given the diverse interests of the council, a majority may not be possible to realize.

These weaknesses are apparent in numerous appraisals that have been undertaken of the agreements. In fact, several papers produced prior to implementation exposed some of these design flaws. In a computer simulation of the agreement between Tunisia and the European Union, Brown, Deardorff, and Stern (1997) concluded that Tunisia would gain little or nothing in the short run and could experience significant adjustment problems stemming from labor and capital movements. They argued that Tunisia should not expect large inflows of foreign direct investment (FDI) without taking additional action. Similarly, Page and Underwood (1997) emphasized that substantial growth benefits would not accrue to either Morocco or Tunisia unless they undertook complementary measures such as generalizing their trade liberalization, improving their investment climates, and adopting policies to accelerate productivity growth. The inadequate coverage of the agreements was also viewed as a problem. In particular, Hoekman and Djankov (1997) emphasized that gains could have been far more significant if the agreements had included services and foreign investment and had encouraged privatization.

Empirical work exploring the impact of the agreements appears to confirm these pessimistic forecasts. The agreements appear to have had minimal effects on trade, investment, and reforms. For example, Péridy (2005d) uses a gravity model to explore the impact of EU preferences on Mediterranean exports. He does find that the earlier unilateral preferences granted to Mediterranean countries were effective in boosting exports by between 20 to 27 percent. But this effect occurred in the 1980s, and the effects have declined over time. The more recent measures under Euro-Med appear not to have increased trade.

The results on FDI are similarly disappointing. In the years immediately after the signing of agreements, Tunisia, Morocco, and Jordan all experienced a decline in the amount of FDI attracted to their economies relative to their GDPs and their worldwide share in FDI (El Hedi Lahouel 2001). More broadly, the data on reforms in general and regulatory policy in particular that were reviewed in chapter 2 do not indicate significant permanent improvements in these policy areas in the aftermath of the signing of the association agreements.¹⁴

14. Other attempts to measure progress toward economic reform efforts also indicate that progress has been slow. See Dasgupta, Keller, and Srinivasan (2002).

Tovias and Ugur (2004) explain why these agreements have not been effective. They argue that although in principle the European Union could have used aid as an inducement for reforms, the actual agreements left countries too much room for discretion to ensure that the money would be used to enhance economic reforms. In addition, the authors point to the limited concessions made by the European Union on agricultural processed food and rules of origin, thereby not allowing the mobilization of domestic political support for reform. Likewise, Hoekman (2005) concludes that a compelling case cannot be made that the Euro-Med agreements have had a significant economic impact.

European Neighborhood Policy

The European Union itself implicitly recognized some of the inadequacies in the Euro-Med agreements by launching two major new initiatives, one aimed at deepening the agreements and improving the links between programs and aid, and a second at improving the rules of origin. Having concluded most of the bilateral association agreements, and enlarged the European Union itself to 25 members (with the addition of two Mediterranean countries, Malta and Cyprus), the European Union launched a new program to facilitate integration with both southern and eastern countries, the ENP mentioned earlier.¹⁵ The program builds upon the integrated framework of the Euro-Med agreements in that it includes not only trade but also social and political collaboration. Like Euro-Med, the approach again proceeds in part on a country-by-country basis. However, it is explicitly designed to recognize differences in capacities and strategies among countries. This involves initially issuing a country report and then constructing an action plan with each country that sets out priorities in two broad areas of governance and economic and social policy.¹⁶ The approach also involves explicit provisions to reinforce the agreements with technical and financial assistance designed to address the priorities laid out in the jointly negotiated action plan. The aim is to closely condition and monitor aid to these agreed-upon actions.

The ENP also calls for even deeper trade integration including

- facilitating freer trade in industrial products through convergence with EU laws and regulatory standards;
- convergence toward EU sanitary and phytosanitary regulations to promote freer trade in agriculture; and

15. Neighborhood countries include Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, Syria, Tunisia, and Ukraine.

16. As of 2005, reports had been issued for Egypt and Lebanon.

- institutional reform to facilitate service and investment liberalization, including strengthening regulatory policies and independent enforcement agencies in areas such as competition policy, financial markets regulation, and taxation.

While some of the program will focus on specific country priorities, it will also seek to maintain the momentum toward an EMFTA. At a meeting in Luxemburg in May 2005, for example, the Ministers of Foreign Affairs from the EU and the Euro-Med countries reiterated their commitment to the goal of establishing an EMFTA by 2010. To this end, the ministers recommended the elaboration of a roadmap that would include liberalization of services, enhancement of investment, liberalization of agricultural products, approximation of technical legislation in the area of standards and conformity assessment, and expansion of South-South trade links in the Mediterranean region.

The EU approach raises some important questions. In the case of the US agreements, the incentive to adopt deeper integration measures is stimulated by the prospect of gaining market access to the United States. In the case of the European Union, however, it is unclear what the element of reciprocity will be with respect to adopting EU law (the *acquis*). For the Central European countries, the great reward for adopting these elements was full membership in the European Union, but unless they believe particular norms and rules will increase market access for their products or will promote their own economic development, why should the Mediterranean countries adopt them? As Hoekman (2005, 16) notes, “integration for its own sake or the adoption of the ‘EU model’ will not necessarily be beneficial, and even if it is, may not be a priority at a given point in time.” He emphasizes the need, therefore, for each country to determine its own development strategy.

Pan-Euro-Med Cumulation

The second complementary initiative involves establishing a pan-Euro-Med system of cumulation of origin to allow producers to cumulate processing made in different countries in the region. This allows these countries to obtain preferential treatment more easily and avoid the impact of the rules of origin in diverting trade away from regional input producers. To establish such a system, it is necessary (1) that the countries involved have FTAs with one another; (2) that the FTAs use identical rules of origin; and (3) that identical administrative procedures are used to ensure that the rules are applied in the same way.¹⁷ Preferential trade between the Euro-

17. A fourth provision does not allow the payment of duty drawbacks. This avoids the creation of an incentive to use inputs that are imported from outside the area and then ship them across the border duty free.

pean Union, the Central and East European countries, and the European Free Trade Association (EFTA) countries was brought under such an arrangement in 1997, thereby resulting in a single free trade area throughout Europe.¹⁸ A manufacturer can now use any originating input (raw material or component) from the entire area in the manufacture of finished products, without running the risk of losing free trade status if it is exported within the area. The conclusion of the association agreements, along with FTAs between Mediterranean countries (the Agadir Agreement, Tunisia-Turkey, Morocco-Turkey, etc.) now paves the way for implementation of cumulation among several Mediterranean partners. On October 11, 2005, the Council of the European Union adopted the amended protocols on rules of origin annexed to the various association agreements.¹⁹ The system will be effective among countries that have concluded FTAs with the EU and EFTA countries and with each other.²⁰

If this pan-European rule of origin system succeeds, it could stimulate trade and regional integration. According to estimates by Augier et al. (2003), a lack of cumulation among the Mediterranean countries has dampened bilateral trade among them by 40 to 45 percent. By contrast, allowing for cumulation will enable industrial sectors to become more efficient through greater access to inputs and better ability to create large-scale operations. Augier et al. (2003) estimate that extending cumulation will help increase production by 2 to 3 percent and generate an additional 0.5 percent of welfare gains due to higher levels of production and trade.²¹

US and EU Rules of Origin

If the European plans are actually realized, they would give rise to a set of intra-Arab FTAs all based on European rules of origin. This has serious implications for an eventual Middle Eastern FTA centered around the United States because, as indicated in table 4.2, the US and EU rules are quite different with respect to tariff classification changes, minimum value added, and administrative procedures.

18. These common rules of origin in Europe entered into force on January 1, 1997, and applied in the European Union, EFTA member countries (Norway, Iceland, Liechtenstein, Switzerland), and in the Czech and Slovak Republics, Hungary, Poland, Slovenia, Romania, Bulgaria, Estonia, Latvia, and Lithuania.

19. See "Customs: Council approves new European-Mediterranean cumulation of origin zone," Document IP/05/1256, <http://ec.europa.eu>.

20. The new system will be applicable between the European Community and Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, West Bank and Gaza Strip, the European Economic Area (EEA) and EFTA countries (Iceland, Norway, and Switzerland [including Liechtenstein]), Romania, Bulgaria, the Faroe Islands, and Turkey (including coal and steel and agricultural products).

21. These benefits are net of any trade diversion that might occur.

Table 4.2 Comparison of rules of origin regimes

Feature	United States	European Union
Eligibility criteria	<p>(a) wholly grown, produced, or manufactured in a Party;</p> <p>(b) imported directly from one Party into the other Party; and</p> <p>(c) minimum domestic content of 35 percent of the value of the article</p>	<p>(a) wholly obtained in the territory; or</p> <p>(b) products that have undergone sufficient working or processing</p>
Definition of “wholly” grown, produced, manufactured, or obtained	Entirely grown, produced, or manufactured in a Party	Reserved for primary industries (i.e., product must be a mineral, plant, or animal/fish that has been grown and harvested there)
Criteria for goods that are not “wholly” obtained to qualify as “originating”	<p>Substantially transformed into a new commercial product that results in a change in the tariff classification for product. The degree of change varies by product:</p> <ul style="list-style-type: none"> ■ Some require changes at the subheading level (HS-6 digit) while others require more substantial changes at the heading level (HS-4 digit). ■ US-Morocco agreement contains specific transformations required for textiles and selected agricultural and industrial goods. 	<p>Specific requirements for products at the heading level (HS 4-digit). Some combination of:</p> <ul style="list-style-type: none"> ■ manufacture from materials that are not in the same tariff heading; ■ specific processing requirements; ■ value of all the nonoriginating materials does not exceed 40 to 50 percent of the price of the final good
Cumulation	Bilateral: Up to 15 percent of the 35 percent requirement can be met with inputs from the United States	Bilateral Diagonal for countries that sign appropriate regional trade agreements among themselves
Domestic content requirements	Domestically sourced materials and processing costs must be no less than 35 percent of the appraised value of the good	Costs of nonoriginating materials must not exceed 40 to 50 percent of the “ex works price” of the good

Domestic or Regional Content

The United States requires that originating value added account for a minimum share of the net cost of production. Originating value added is defined as the sum of materials plus processes. On the other hand, the European Union imposes a maximum on imported content levels as a share of the ex works price. The US minimum domestic content requirement for Jordan is 35 percent, where domestic content is defined as materials plus processing costs, while the EU-Jordan agreement limits the maximum import content to 30 to 50 percent, depending on the product involved.

Changes in Tariff Classification

A quarter of the tariff lines within EU agreements do not require any tariff changes, while the majority of those lines where changes are required are at the heading level. The US approach is more stringent, with a higher share of chapter heading changes. A change at the chapter level requires a greater amount of processing and transformation than a change at the heading or subheading level. The Euro-Med agreements allow further flexibility through their “soft rule of origin,” which allows 20 to 50 percent of the inputs to be from the same category heading as the final good. They also tend to provide two different criteria for conferring origin, one of which is a change in tariff classification, while the other might be a technical or input requirement. Only one of the two criteria needs to be met in order, which provides producers with even greater flexibility.

Cumulation

The United States’ regional trade agreements only permit bilateral cumulation, while the Europeans now allow for diagonal and full cumulation.

As reported in table 4.3, the Australian Productivity Commission (2004) has developed an overall measure of the restrictiveness of rules of origin taking account of product-specific requirements relating to changes in tariff classification, regional content, and sector-specific rules and manufacturing requirements. The measure also considers the rules for cumulation and administrative costs. Kephart (2005) has applied the approach to recent US agreements. The results indicate that the rules for the North American Free Trade Agreement (NAFTA) were the most restrictive, but they also indicate that the pan-European measures are actually more restrictive than the US-Morocco and US-Bahrain agreements. The approach also confirms the argument in the previous chapter that US-Jordan and US-Israel rules are the most liberal, and that they are significantly more liberal than those of US-Morocco and US-Bahrain.

Table 4.3 Rules of origin restrictiveness ratings

Criterion	NAFTA	Pan-Europe	US-Israel	US-Jordan	US-Morocco	US-Australia	US-Bahrain	CAFTA-DR
Primary/product-specific								
Change in tariff classification	0.20	0.10	0	0.10	0.05	0.10	0.05	0.10
Regional value content								
Percent of originating material	0.06	0.08	0.04	0.06	0.04	0.04	0.04	0.06
Formulation of percentage criteria	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Production costs for domestic content	0.01	0	0.01	0.01	0.01	0.01	0.01	0.01
Treatment of raw materials	0.01	0	0.02	0.01	0.01	0.01	0.01	0.01
Qualifying production costs	0	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Nonoriginating valuation	0.02	0.01	0.02	0.01	0.02	0.02	0.02	0.02
Specified manufacturing process test	0.05	0.05	0	0	0	0.05	0	0
Sector-specific rules	0.10	0.05	0	0.05	0.08	0.10	0.08	0.08
Supplementary/regimewide								
Cumulation	0.03	0.01	0.03	0.02	0.05	0.05	0.05	0.02
Provisions beyond cumulation	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
Duty drawback	0	0.05	0.03	0.03	0.03	0	0.03	0
Outward processing	0.03	0	0.03	0	0	0	0	0
Location of manufacturing process	0.03	0.03	0.03	0.03	0.03	0.03	0.03	0.03
Degree of certainty	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Administration costs	0.03	0.05	0	0.05	0.05	0.05	0.05	0.03
Rigidity	0.05	0.05	0.05	0.03	0.01	0.03	0.01	0.02
Total	0.67	0.53	0.31	0.28	0.43	0.55	0.44	0.44

NAFTA = North American Free Trade Agreement

CAFTA-DR = Central American Free Trade Agreement–Dominican Republic

Sources: Australian Productivity Commission (2004); Kephart (2006).

Table 4.4 Comparison of rules of origin requirements
(share of tariff lines)

Required change in tariff classification	North American Free Trade Agreement	Pan-European
None	0.5	25.0
Subheading	4.4	2.8
Heading	40.1	57.8
Chapter	54.4	14.2

Source: Estavadeordal and Suominen (2003).

Countries do not all trade the same products. Thus, these measures, which capture average impacts, might not accurately indicate the actual restrictiveness of the rules for particular partners. To measure the sectoral degree of restrictiveness, the restrictiveness index developed by Estavadeordal and Suominen (2003) is used. This index is based on a subjective assessment of the restrictiveness of sector-specific rules of origin on a scale of 1 to 7, where 7 is accorded to the highest degree of restrictiveness.

Table 4.4 confirms that based on the current composition of exports, the EU rules provide slightly greater market access than would NAFTA rules. The European Union offers slightly less restrictive rules of origin in key categories such as mineral products, chemicals, and textiles and apparel. The exceptions are for high-technology sectors such as machinery and electronics and for sectors such as agriculture. As a result, countries that export more high-technology goods, such as Israel, would actually be better off with US rules of origin. However, caution must be used when interpreting these results because it is difficult to separate cause from effect; that is, it may be that the relatively more relaxed EU rules of origin have contributed to export volumes in these sectors.

These differences in rules of origin applied by the United States and the European Union clearly pose a problem for the eventual integration of the Arab region in a manner allowing for full realization of the potential benefits. Moroccan exporters, for example, will have to meet different rules when selling in the European Union and the United States. They would be able to cumulate import inputs from other Agadir countries, but not count these toward fulfilling their US requirements. Likewise, European value added would count toward European exports, but not for those to the United States, and US value added would not count toward meeting EU requirements. It is conceivable that quite different systems of production and input use would be required. In their current state, therefore, not only would the systems contribute to administrative costs, but they clearly would prevent producers from operating efficiently.

The United States indicated in its agreement with Oman that its eventual intention is to emulate the European Union and allow for diagonal cumulation. But in order to do this, the United States would have to emulate the European Union in requiring regional FTAs using US rules of origin. It would be extremely problematic for the Mediterranean countries to operate their FTAs; in principle they could allow goods to meet either US or EU rules of origin, but the administrative complexity would be quite considerable.

One option would be for the United States to concede implicitly that the European Union has gained a first mover advantage and to allow cumulation among partners that have FTAs with the United States, as long as they meet the European-type rules of origin in their FTAs. This approach would have the merit of allowing for regional integration, although it would of course reduce the advantage granted to US textile producers from the cumulation in the original agreement. Even better still would be a simpler common system based on straightforward rules such as those in the US-Israel FTA.

Concluding Comments

It is widely acknowledged that the Euro-Med association agreements were an inadequate approach to freer trade between the European Union and the Mediterranean region. They have had weak effects on trade, investment, and domestic reforms. Nonetheless, the agreements were the first steps in an ongoing process that can now be deepened and improved. In particular, the European Union has taken the lead in implementing a pan-Euro-Med system of cumulation that could lead to more trade both with the European Union and among the Mediterranean partners. As the Agadir Agreement demonstrates, it could also serve as a stimulus to additional FTAs in the region. The European Union has also embarked on the ENP that aims at deeper integration with agreements to cover investment and services and other initiatives that help bring about regulatory convergence based on EU practices and norms. If these approaches are successful, they too could help regional economic integration. If nations in the region adopt similar (European) regulatory practices, this should promote their integration with each other as well as with the European Union. There are other areas where deeper US FTAs could make a similar contribution, particularly with respect to issues that the EU agreement does not cover. However, the EU rules of origin present particular challenges to the prospect of a Middle Eastern FTA. In particular, they are somewhat more restrictive than those in several of the US agreements with Middle Eastern countries, and perhaps more importantly, they are different. As a result, the region runs the risk of developing into the proverbial spaghetti bowl, in which producers are forced to produce at less than optimum efficiency.