Background paper for session on

Regional trade integration, TTIP and consequences for the MENA region

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The Middle East and North Africa (MENA) region[1] is economically very diverse, although collectively, the region is best known for producing and exporting oil. The region boasts of a high standard of living and its economic fortunes over much of the past quarter century have been heavily influenced by two factors – the price of oil and the legacy of economic policies and structures emphasizing a leading role for the state. Turkey, which has a per capita GDP of over 1190 USD is the world's 15th largest economy, and a founding member of the OECD (1961) and the G-20 major economies (1999). Turkey and the EU have concurring interests both in terms of means and ends towards their neighbourhoods; most of the countries covered by the European Neighbourhood Policy (ENP)[2] are also part of Turkey's neighbourhood. The vitality of Turkish economy in past decade has had positive spill over effects on the shared neighbourhood in the Southern Mediterranean. Turkey has 17 free trade agreements (including with MENA countries like Egypt, Israel, Morocco, Syria and Tunisia), and 14 more under negotiation.

Turkey and some of the MENA countries also belong to the Euro-Mediterranean (Euro-Med) partnership[3], a key objective of which is the creation of a deep Euro-Mediterranean Free Trade Area, which aims at removing barriers to trade and investment between both EU and these Southern Mediterranean countries and between the Southern Mediterranean countries themselves. Together the region represented 8.6 percent of total extra-EU trade in 2013. Nearly all the Euro-Med countries have working Association Agreements with the EU (with the exception of Libya and Syria), while Turkey has a working Customs Union. These agreements mainly cover trade in goods, and are complemented with a number of additional ongoing negotiations and preparations for future negotiations for deep and comprehensive free trade areas.

The EU policy towards the MENA countries has two main objectives: (a) encourage political and economic reform in each individual country with due respect for its specific circumstances (through the ENP), and (b) encourage regional cooperation among the countries of the region themselves and with the European Union (through the Euro-Med and its financial instrument, the MEDA programme[4]).

[1] The Wold Bank definition of MENA includes: Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Libya, Malta, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, West Bank and Gaza, Yemen.

[2] The ENP was conceived as the European Union's (EU's) alternative to traditional geopolitics. Through the ENP, the EU works with its southern and eastern neighbours to achieve the closest possible political association and the greatest possible degree of economic integration. Today, the ENP includes sixteen countries in the Middle East, North Africa, and Eastern Europe.

[3] Comprising of Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Occupied Palestinian Territory, Syria, Tunisia, Turkey.

[4] The MEDA programme provides financial support to the Union's Mediterranean policy as defined in the Barcelona Declaration of 1995, the latter reinforced in the 2004 ENP. Going far beyond traditional development

EU's engagement with Turkey on the other hand works through the EU-Turkey Customs Union (implemented in 1996) and the Euro-Med partnership, the regional and multilateral co-operation complementing and reinforcing the bilateral approach; Turkey's application to accede to the EU was officially recognized on 12 December 1999, and negotiations started in October 2005. Under the Customs Union (CU) agreement[5] goods can travel between the two entities without any customs restrictions, although the coverage of the CU is limited and excludes key economic areas such as primary agriculture, services and public procurement. Under the CU, Turkey adopted the EU's common external tariff (CET) for most industrial products, as well as for the industrial components of agricultural products, and both the EU and Turkey agreed to eliminate all customs duties, quantitative restrictions and charges with equivalent effect on their bilateral trade.

According to the latest World Bank evaluation[6], the EU-Turkey CU has been a key catalyst in the economic transformation of Turkey over the past two decades and an effective mechanism for deeper economic integration between the two parties. The CU has resulted in a more than four-fold increase in bilateral trade values since 1996 (posting strong year-on-year growth in exports and imports even after the 2008 crisis), deeply integrated regional production networks (leading to intra-industry trade between the partners rising to over 50 percent from around 30 percent in 1995, particularly in motor vehicles, televisions, clothing[7]), and increased financial integration, with EU now accounting for almost 71 percent of FDI inflows to Turkey. Partly as a result of the CU's design, Turkey's main exports to and imports from EU are dominantly industrial (95 percent of all its imports and exports), despite the prevalence of restrictive NTMs that are preventing the free circulation of products such as pharmaceuticals, chemicals, second-hand goods, sugar confectionary, scrap metal and retreaded tires.

It is in the above geo-economic context that this note discusses the current trends and state of global and regional trade integration, trade negotiation initiatives of the EU and the rest of the world, and their consequences for the MENA region in general and high-growth Turkey in particular.

Changing global trade patterns and policies: Implications for MENA region and EU-Turkey relations

Under the ENP and Euro-Med initiatives, the EU works closely with each of its Southern Mediterranean partners to support economic and social transition and reform, which has been subjected to much introspection in the light of the recent Arab uprisings and the recognition that

aid, MEDA aims to support economic transition, to develop better socio-economic balance, to foster regional integration and to gradually create a Euro-Mediterranean free trade area.

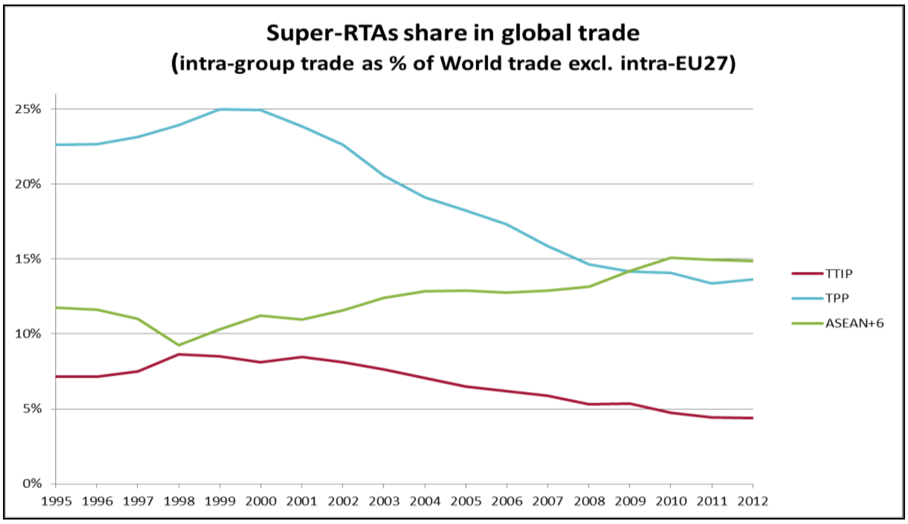
[5] The CU initiated the process to help secure Turkey's full membership in the EU. In addition to providing for a common external tariff for the products covered, the CU requires Turkey to align to the EU *acquis communautaire* in several essential internal market areas, notably with regard to industrial standards and technical regulations. Accession negotiations with Turkey still remains to be concluded, partly due to the incomplete implementation by Turkey of the provisions of the EC-Turkey Association Agreement and the Additional Protocol thereto.

[6] World Bank (2014), 'Evaluation of the EU-Turkey Customs Union', March 28.

[7] The OECD Trade in Value Added analysis also revealed that Turkey's domestic value added content of its exports was 78 percent in 2009, above the OECD average but 11 percentage points lower than its share in 1995, illustrating Turkey's increasing integration into global value chains, driven in large part by its growing diversification into more complex production chains. The foreign content of Turkey's exports was highest in Chemicals and minerals (33 percent) in 2009, followed by Basic metals (32 percent), and Electrical equipment and Transport equipment (both at 30 percent); much of this increase reflected increasing integration into the European value chains. The share of intermediate imports used to produce exports also increased in nearly all industrial product groups. In contrast, in value added terms only 45 percent of Turkey's exports reflect services.

tackling the long term structural issues obstructing reform and good governance in the MENA region require multilateral channels. Among the Euro-Med countries, EU's relationship is the deepest vis-à-vis Turkey, and not only because of the recent CU-induced integration of the regional production networks; Turkey has had close relations with Europe since the Ottoman times. However, the salient features and underlying trends in global trade have undergone marked changes during the last decade, which in turn impact EU's economic relations with its neighbourhood.

The most notable feature of the last decade from a trade policy perspective has been the simultaneous rapid increase in PTAs worldwide and the lack of progress in the Doha Development Agenda (DDA) on the one hand, and yet on the other hand the remarkable resilience of the multilateral trading system and the relatively mild increase in global protectionism despite a marked slowdown in world activity in the immediate aftermath of the 2008 crisis. The faltering Doha Round of WTO negotiations have also led to a renewed focus on large regional trade agreements of super-RTAs, not seen since the North American Free Trade Agreement (NAFTA) was signed in 1994. There are two super-RTAs in the making in Asia-Pacific, namely the negotiations on Regional Comprehensive Economic Partnership agreement (RCEP or the ASEAN+6) and the US-led Trans-Pacific Partnership (TPP), and one in the Atlantic, viz. the Transatlantic Trade and Investment Partnership (TTIP). All have ambitious negotiation targets, and are presented as the alternate means to reset trade rules worldwide and take the multilateral trade liberalisation agenda forward. Given their design and structuring, these negotiations are not being held on a global multilateral basis, although they are being negotiated between rather large and diverse groups of economic entities that together account for over 60 percent of global trade[8] (relative shares of the 3 super-RTAs under negotiation in global trade can be seen in the chart below); this latter feature makes them somewhat multilateral in nature, and are reminiscent of the pre-WTO multilateral trade negotiations of 1950s and 1960s.

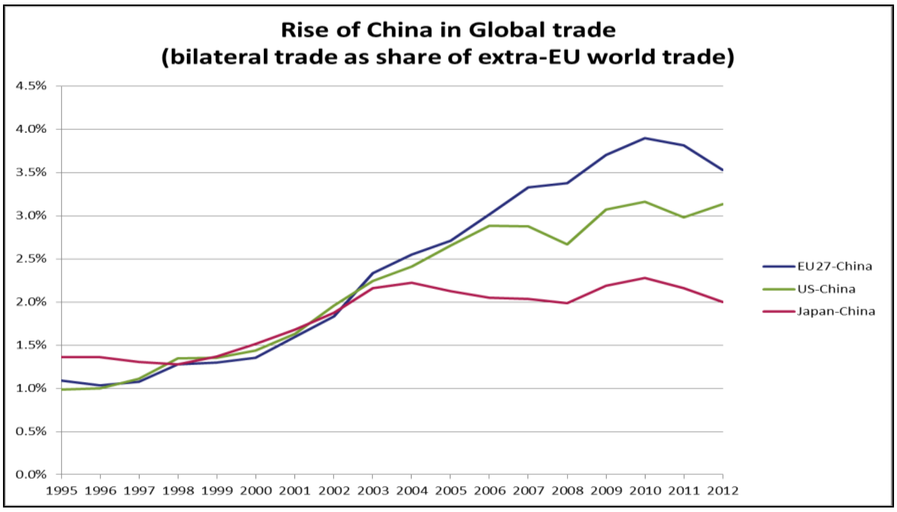


Source: Bruegel, based on UNCTAD data

The four defining elements of the new century trade landscape with significant implications for the Euro-Med region are: First, China's unprecedented integration with the global economy following its accession to the WTO in 2001 has fundamentally changed the dynamics of global trade pattern and relations, catapulting the country as the largest trade partner of almost all major trading nations/blocs, and often at the expense of other trade partners. In 2013, China - exports 14.7 percent, imports 12.9 percent - became the world's second largest trader, surpassing the US for the first time. The chart below shows the dramatic surge in China's merchandise trade with the world's three largest

[8] Extra-EU global merchandise trade was around 50 percent of world GDP in 2012.

traders since 2001. Other studies also reveal that despite NAFTA, the major gainer of the North Americas trade in the past decade has been China[9]. The studies indicate that China's entry to the WTO has had a significant impact on the trade relations in North America, replacing and displacing many of the export strongholds in place before China joined the WTO and after the first stage of the NAFTA (1994-2000).



Source: Bruegel, based on UNCTAD data

Second, EU expansion into Eastern and Central Europe during the 2000s was another fundamental development that affected the EU-Turkey and EU-MENA trade relationships. Third, EU's MFN tariffs have also been reduced, and the EU has increasingly signed PTAs with third countries (both developing and developed), leading to in particular Turkey facing preference erosion (and losing import shares) in the EU market since 2007, especially as Turkey is sometimes unable to reach parallel agreements with these third countries despite the CU[10]. Finally, as discussed above, the slow progress in the WTO-led multilateral trade liberalisation negotiations has led to a renewed global interest in negotiating meaningful regional agreements, and EU is a party to one of the three super-RTAs currently under negotiation, namely the TTIP, a bilateral comprehensive agreement with the US. This last development is expected to have profound implications for EU's other trade partners, and which has rightly increased concerns about the future of EU-Turkey and EU-MENA trade relations.

Potentially Disruptive Impact of TTIP: Consequences for the MENA region and Turkey

Amid the multiple economic challenges and changing trading relationships, EU trade policy since 2007 took a significant pro-regional turn; EU now has trade agreements with nearly 50 partners. The most notable development of the last decade for EU's regional initiatives has been the market access negotiations with the major developed and developing economies, viz. South Korea, India, Japan, and US. Of all EU's FTAs, however, TTIP has the most potential to disrupt the current trade patterns. No other agreement of the kind exists between two such important partners of comparable economic weight – not even the EU's agreement with Canada, which is the first agreement signed with a G8 member but in which the EU's weight broadly dominates that of its partner.

[9] Peters, Enrique D. and Kevin P. Gallagher (2013), 'NAFTA's Uninvited Guest: China and the disintegration of North American trade', CEPAL Review 110, August.

[10] For example, Turkey has yet to conclude equivalent EU-FTAs with Algeria, South Africa, and Mexico. As a result, Turkish firms do not receive improved access to these markets, while imports from these third countries can enter Turkey duty-free via the EU even in the absence of an agreement.

The TTIP negotiations, started in mid-2013, aims to conclude an ambitious, comprehensive, and high-standard regional trade and investment agreement that offers significant benefits in terms of promoting international competitiveness, jobs, and growth in the partner countries. The TTIP seeks to liberalise, as much as possible, trade and investment between the two partners in the 20 areas that the agreement is expected to cover. Studies estimate that an ambitious and comprehensive agreement could bring significant economic gains for the EU and the US (potential gains depending on level of ambition in the negotiated agreement), while also increasing global income by almost US$ 130 billion annually as a result of increased bilateral trade. However, as much as 80 percent of the total potential gains from the TTIP are to come from cutting costs imposed by bureaucracy and regulations (so-called non-tariff barriers or NTBs), as well as from liberalizing trade in services and public procurement. While the scope and complexity of the potential regulatory issues are also so vast that sceptics are wary, and slippage is already apparent in the proposed negotiation timelines, the fact that the US and the EU account for almost half of global output and a third of world trade alone implies a high potentially negative impact of the TTIP on the non-Members (rest of the world).

TTIP also has the risk of larger potential market access losses for Turkey, by further eroding Turkish preferences in the EU market and diverting trade away from the CU *status quo*. In 2013, the US was still EU's largest trade (exports plus imports) partner (with a 14.2 percent share), followed by China (12.6 percent) and Russia (9.6 percent). Although bilateral EU-US trade is only 4.4 percent of global extra-EU28 trade, given the significant rise of EU's trade with Asian emerging economies (and in particular China[11]) and the largely Asia-Pacific centred global value chain (GVC) production system, the TTIP vide its Members' production and trade networks in the Asia-Pacific may have significant implications for the EU-Turkey and EU-MENA economic relations going forward.

A specific problem emanates from the design of the present EU-Turkey CU and the Association Agreement Euro-Med frameworks, in which the partners have to negotiate separately with countries that enter into FTAs with the EU. This provision works well insofar as liberalization of goods trade is concerned, but might not be satisfactory when other kind of liberalizations - like for services, public procurement or investment protection - are undertaken by the EU in its third country FTAs, as in the TTIP. Since at the moment Turkey/MENA countries cannot participate in TTIP negotiations directly, given its closed bilateral negotiation nature, they will need to not only prioritize FTAs with third-parties but also negotiate them comprehensively, i.e. including services, agriculture, and investment (protection) and other regulations. In the same vein, the EU-Turkey CU/Euro-Med Association Agreements may need to be simultaneously deepened and widened to enhance the degree of trade integration, and thus minimize the negative third-country consequences[12].

For example, the data available for the EU-Turkish trade generally suggest that there has been considerable trade creation, but little trade diversion. This may not continue going forward, given the changing economic and trade dynamics of the new century. An added complication here emanates from the increasingly important role that GVCs play today in determining production location, trade and investment flows across the world, as well as in setting trade rules and product and operational

[11] China accounted for 12.6 percent of EU gross merchandise trade in 2013 (exports 8.6 percent, imports 16.7 percent), up from 5.2 percent in 2000.

[12] For example, the institutional realities of the EU do not allow Turkey, as a non-member, a seat at EU's TTIP negotiations with US. Nevertheless, without adequate Turkish participation, there is a potential risk that rules of origin may be introduced on goods entering Turkey from the EU. Given the dearth of analyses on the impact of regulatory convergence on third countries (e.g. erosion of trade preferences, trade diversion, etc.), it is not clear however at what point the negotiations will need to open up to other trading partners in order to avoid retaliation.

standards (including private standards) to suit the needs of globalized production and logistical systems. The role of new trade and investment rules in this modern regime of global supply chains will necessarily differ from the past, and even lead to changes in the future of global trade relationships. Coping with this change calls for advance preparedness, both in terms of crafting competitive domestic trade policies and also completing the necessary regulatory reforms at home to ensure compliance with existing and future EU regulations in key economic sectors, while recognizing that globalization (in particular the GVC-centred variety of this age) is best served by multilateralism, irrespective of the many short-term economic benefits that regionalism offers. Clearly, however, much will depend on the credible threat of economically meaningful discriminatory outcomes that the TTIP can actually create within a definite timeline (i.e. ability to complete and implement an ambitious pact before the WTO Doha agreement is signed).

Other geo-political realities of 2014

On the other hand, the non-economic imperatives of regional and multilateral trade policy and engagement are also gaining importance. Given the MENA region's strategic role as the world's main energy hub and a source of plentiful renewable energy resources, and particularly in view of the recent developments vis-à-vis Ukraine and Russia, consideration will likely be given to closer cooperation between the EU and Euro-Med partners on energy and to the value of opening negotiations on Chapter 15 on energy in order to provide an adequate regulatory framework. The role of Turkey as an energy hub for Europe has often been emphasized: if the EU is to access gas from the Caspian region (EU gas import diversification strategy), Turkey is deemed a necessary part of the equation. A recent EU Parliament document stressed on the importance of involving Turkey in the process of shaping Europe's energy policy, underlining the fact that the need for addressing climate change, renewable energy and energy efficiency priorities demand that the potential for cooperation between the EU and Turkey on green energy issues is explored[13].

The possibility of increasing imports of natural gas and other clean energy from the MENA region to reduce EU's dependence on gas imports from Russia will also not be treated lightly. In this, again, Turkey's instrumental transit role is further emphasized by the prospects of higher oil and gas exports from MENA in the coming decades. The International Energy Outlook 2013 Reference case for 2010 to 2040 indicates that the largest production increases in natural gas will occur in non-OECD Europe and Eurasia (18.9 trillion cubic feet). Brussels has made it a priority to diversify its gas supplies, but Europe's options are limited. The new Strategic Dialogue between the EU and Turkey will thus play an important role in this regard, as Turkey's location makes it a natural bridge between the EU and the MENA. Turkey is thus expected to be a transit country for the new Southern Energy Corridor of the EU, which will need to rely on a steady supply of gas from common neighbors. It is an open secret that the US uses trade and investment policies as instruments of its larger foreign policy. In that vein, the geo-political merits of EU's trade agreements in the region is not likely to be ignored.

[13] http://www.europarl.europa.eu/sides/getDoc.do?type=MOTION&reference=B7-2014-0241&language=EN