US and EU Trade Policy towards the Middle East: A Comparative Assessment
Matthias Matthijs

Trade is fundamental to rebuilding peace and confidence, as trade is usually one of the earliest green shoots to emerge from the dust and the rubble. Trade reconnects people, and by bringing them into contact with markets, gives them an economic stake in a stable society.

Pascal Lamy (2003)[1]

Floating on the bulk of the world's oil reserves and rife with violent ethnic and religious conflict, the Middle East is one of today's most important geostrategic areas in international politics. The region has a long and turbulent history of both close involvement and tense relations with both Europe and the United States. Despite the undeniable and perhaps pivotal role the Middle East holds in current world affairs, its unfulfilled potential as a strong partner in the international trade arena has often been understudied, especially in the economic literature.[2] In recent years, however, both the United States and the European Union have pursued a much more active trade agenda in the region, promoting stronger bilateral and regional trade integration not just for its inherent economic virtues, but also for its potential political merits. In principle, both the EU and the US share the view that fostering economic growth through trade will not only increase economic welfare in the region, but also promote much needed liberal domestic reforms and gradually tame extremist sentiments threatening the relative security of both Europe and America.[3]

Whether initiated by an external hegemon or championed by charismatic regional leaders, the integration of the countries of the Middle East has proved to be a tremendously difficult task. Currently intra-regional trade in the Middle East is among the lowest in the world (even lower than in Africa). In 2004, for example, intraregional merchandise exports totaled just over 5% of the region's total exports. Some observers have suggested that this is due to a clear lack of 'complementarity' of trade in the region, arising from similar production structures. Others point to the fact that most countries are falling short in establishing a functioning and transparent regulatory environment needed for doing business.[4] Furthermore, there are numerous political obstacles on the road towards deeper integration: there is mutual distrust among Arab leaders and the power of vested interests usually works in favor of more statist and inward-looking policies.[5] Given the dismal record of past attempts to move towards deeper political and economic integration, it should therefore be no surprise that there is widespread skepticism among Arabs about the potential success of any new 'pan-Arab' unions.

This article assesses the respective trade policies of the United States and the European Union in their efforts to bring peace and prosperity to the Middle East. It will identify the

[1] Lamy (2003)
[2] Momani (2007)
[3] Looney (2005) and Mandelson (2005)
[4] Fawzy (2003)
[5] Momani (2007)

synergies between their respective policies, as well as the contradictions and areas of potential friction. This is followed by a brief review of the latest trade developments in three specific country cases in the region – namely Jordan, Israel and Egypt – in order to find evidence of the potential merits of both US and European approaches. The conclusion will also outline some of the potential drawbacks of regarding free trade as a solve-all solution.

The American Approach: Two-Speed Bilateralism

America's enthusiasm for enhancing trade ties with the Middle East was reinvigorated after the 9/11 terrorist attacks on US soil. Nine days later, Robert Zoellick – then US Trade Representative – wrote in the Washington Post that "America's trade leadership [could] build a coalition of countries [in the fight against terrorism]," emphasizing that "open markets [were] vital for developing nations, many of them fragile democracies that rely on the international economy to overcome poverty and create opportunity."[6] In 2003, in a speech at the University of South Carolina, President Bush proposed the creation of a comprehensive free trade area between the United States and the Middle East (MEFTA). In order to achieve that objective, the Bush Administration would move first to negotiate comprehensive bilateral trade agreements with the region's countries, with the aim of ultimately "combining these into a single overarching arrangement between the US and the Middle East region as a whole."[7] With MEFTA, the US sought to liberalize bilateral trade and investment with the region, facilitate domestic reforms in many Arab countries and build mutual trust by encouraging regional economic cooperation.[8]

The Bush administration thus favored a "bottom up" approach to regional economic integration in the Middle East.[9] By first negotiating bilateral trade deals, the US could negotiate wide-ranging trade agreements with those countries that were most able and willing to engage, using the economic carrots to reward those countries in the region who were staunch allies in the "war against terror."[10] Given US frustration with the slow progress of multilateral "top down" trade agreements – through collective negotiation with many participants where foot-draggers can continually stall the process, such as with APEC of the FTAA – the bilateral approach allowed the US to tailor the details of the agreements to particular bilateral circumstances. The clear advantage of the MEFTA is that it thus allowed for the conclusion of deep and far-reaching agreements – such as those with Jordan, Egypt, Bahrain, Morocco and Oman – that almost certainly could not have been negotiated with universal Arab participation. On the other hand, the cost of the approach is that it creates a labyrinth of overlapping trade regimes that often build walls which could significantly complicate full integration.[11]

---

[6] Zoellick (2001)
[7] Lawrence (2006b)
[8] Yousef (2004)
[9] Schott (2004)
[10] See Looney (2005)
[11] Lawrence (2006a)

The European Approach: Reluctant Regionalism

From its inception in the 1950s, the European Union has placed a high priority on establishing and maintaining close links with its neighbors in the Mediterranean and the Middle East. Europe's ancient links with its immediate neighborhood found new expression in the "Euro-Mediterranean Partnership" created in 1995.[12] Better known as the "Barcelona Process," the agreement identified three areas of enhanced cooperation between both regions: security and stability, cultural exchange, and economic and financial issues. It was envisioned that the EU would sign free trade agreements with ten countries by 2010 – Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, Tunisia, and Turkey – eventually leading to a Euro-Mediterranean Free Trade Area (EMFTA). Brussels' approach would be both bilateral (with association agreements) and multilateral (with future working groups).[13] However, the Barcelona Process was fundamentally flawed from its inception, given that it could not offer the countries from the Middle East and North Africa the same sticks and carrots as it could to the post-communist countries of Eastern Europe, because of the absence of potential EU membership for most of those countries, with the exception of Turkey. As a result, the EU's "à la carte" approach failed to trigger those economic reforms that were most sensitive politically, and the overall pace of reform has been very slow.[14]

Again, it was September 11 that renewed EU interest in the region and reinvigorated the Barcelona Process. Given its geographical proximity to the region the European Union realized that the spread of Islamist militancy and the growing unrest of its own Muslim minorities, was a potentially explosive situation which needed to be addressed in the short term. In its 2003 *Security Strategy report*, the EU underscored the link between domestic economic reform, international trade and security, stating that "trade and development policies can be powerful tools for promoting economic reform."[15] To foster intraregional trade and economic policy harmonization, the EU supported the Agadir Agreement in 2004, which established a free trade agreement between Jordan, Tunisia, Egypt and Morocco. The Agadir Agreement was meant to be the beginning of a greater Middle East free trade area which goes well beyond the removal of tariffs and quotas.[16] The rationale behind Agadir was that integration would be easier to achieve with a core of countries, while others could join later when they were ready. The EU also developed a system of pan-European 'rules of origin' permitting diagonal cumulation among regional members with an FTA that uses European rules of origin.[17]

[12] European Commission Delegation to the USA (2004)
[13] Momani (2007)
[14] Lawrence (2006b)
[15] European Union (2003)
[16] Momani (2007)
[17] Lawrence (2006b)

EU and US Policies: Synergies and Conflicts

The US and the EU share the same broad goal of trying to promote economic development in the Middle East and promote political and social reform. In many respects, both approaches to trade are complementary and will tend to strengthen each other. While the bilateral US trade agreements tend to be much more comprehensive, and cover a broad range of economic issues, the EU agreements deal with numerous non-economic issues and exclude services, investment, and have serious limitation when it comes to agriculture. By both US and EU, Middle Eastern countries are encouraged to create a business enabling environment and adopt international standards and norms.[18]

The European Union's two-way trade with the Middle East was worth $155 billion in 2004, which is nearly three times the trade of the United States with the region. Geographic proximity clearly matters, and there is growing evidence that international trade has become much more regional than global. For most countries in the region, the *economic* relationship with Europe will therefore always be more important than the one with America. Forced to choose, Arab countries will probably follow EU rules, limiting the potential regional impact of a US agreement.

There is also the risk that many Middle Eastern countries will find themselves in the middle of transatlantic trade disputes. The problem stems from the Bush administration's announcement that "countries seeking free trade agreements with the United States must cooperate with Washington on foreign policy and security issues."[19] One example of this is the reluctance of the US to move forward with the US-Egypt FTA because Cairo refused to support the US WTO challenge to the EU's moratorium on genetically modified food.[20]

Evidence from Jordan, Israel and Egypt

Jordan is the poster child of Washington's free trade strategy. Jordanian exports to the US increased from a mere $72 million in 2000 to an amazing $1.27 billion in 2005, with exports so large that the bilateral trade balance shifted from a Jordanian deficit of $239 million in 2000 to a surplus of $624 million in 2005.[21] However, these numbers do not accurately reflect the US free trade agreement. The lion's share of Jordan's increased exports came from the Qualified Industrial Zones (QIZs) – specific areas whose outputs enjoy duty-free and quota-free access to the US market if they are produced with a minimum of 8 percent of Israeli inputs.[22] These QIZs have attracted huge amounts of investment from Asian manufacturers seeking to circumvent US quota restrictions. Since these manufacturers import most of their inputs from Asia, job creation in Jordan has been

[18] Ibid.
[19] Looney (2005)
[20] Oxford Analytica (2003)
[21] Lawrence (2006b)
[22] EIU (2007), Jordan Country Report

disappointing. Also, with the end of the Multi-Fiber Agreement, most of those companies will gradually relocate back to China and India.[23]

Israel has distanced itself more and more from its Arab neighbors. It has managed to turn itself into a high-tech country which is not very different from your average Western EU economy. Israel's political governance and technical rules and regulations have become very similar to those applied by the EU. Also, Israel is more deeply integrated with Europe through scientific and cultural exchanges, similarities of work-consumption patterns than any other country in the Middle East.[24] In many ways, if peace could be achieved between Israel and the Palestinian Territories, Israel could become an ideal trade partner for its Arab neighbors. But real prosperity can only be achieved if there is a lasting peace. Unfortunately, ever since the Second Intifada, EU exports to the Palestinian territories have dropped on average by a catastrophic 26% per year. Between 2000 and 2003, Israeli trade with the European Union fell on average by 10%.[25] More recently, Israeli exports have rebounded, with the US buying a larger share of Israeli exports, even though the EU as a whole remains Israel's main export market.[26]

Egypt signed a QIZ Agreement with the United States in 2004 which allows the country to gain non-reciprocal, duty-free access to US markets for products containing at least 11.7 percent Egyptian and 11.7 percent Israeli components.[27] The Egyptian government views the QIZ as a 'quick fix' to prevent job-shedding in the textile sector and as a stepping stone to a direct bilateral trade agreement with the United States. However, US mistrust about Egypt's law enforcement regime has delayed the start of negotiations for a US-Egypt agreement. Moreover, the Bush Administration's plan for a broader Middle East free trade area will gradually undermine the QIZ framework and divert investment toward countries that achieve bilateral preferential agreements with the United States. Although the QIZ provides a modest boost in exports and a chance to salvage market share in a labor-intensive industry, it mainly functions to remove the Arab taboo against conducting business openly with Israeli firms. In this sense, it has been argued that the political achievements and economic gains from the QIZ Agreement will be rather limited.[28]

Where do we go from here?

It should be emphasized that free trade can be no panacea. It is doubtful that US or EU trade policies can quickly deliver the desired political results. In the short run, opening markets tend to go hand in hand with serious economic dislocations – what economists call "adjustment costs" – such as job losses in certain industries, bankruptcies and social hardship. These costs are politically crucial and could increase the number of disaffected Muslim populations, raising the terrorist threat. Also, if the FTAs are seen as

[23] Looney (2005)
[24] Cameron (2005)
[25] Mandelson (2005)
[26] EUI (2007), Israel Country Report
[27] EUI (2007), Egypt Country Report
[28] Yadav (2007)

disproportionately benefiting the US or Europe, they will have the opposite effects by strengthening the overwhelmingly negative perception of Western-led globalization.

In sum, while trade agreements provide opportunities, they never guarantee results. The current US and EU initiatives are a step in the right direction, but need to be accompanied with domestic reform and the establishment of trade enabling regulatory and business environments. Currently, however, it seems that the negative fallout from the Iraq war and the ongoing tensions between Israel and its neighbors far outweighs any political benefits that could come from Europe's or the US' free trade agreements.

The author is adjunct professor Economics and Political Economy at the School of Advanced International Studies of Johns Hopkins University in Washington, DC.

<u>Sources:</u>

Cameron, Fraser (2005), "Promoting Political and Economic Reform in the Mediterranean and the Middle East," *European Policy Centre* (Brussels)

Economist Intelligence Unit (2007), *Country Report: Egypt*
_______________ (2007), *Country Report: Israel*
_______________ (2007), *Country Report: Jordan*

European Commission Delegation to the USA (2004), The EU, the Mediterranean and the Middle East: A Longstanding Partnership, *EU Focus* 1 (1), May 2004

European Union (2003), *A Secure Europe in a Better World – the European Security Strategy* (Brussels: EU)

Fawzy, Samiha (2003), "The Economics and Politics of Arab Economic Integration," in Ahmed Galal and Bernard Hoekman (eds.), *Arab Economic Integration* (Washington, DC: Brookings University Press)

Hoekman, Bernard (2005), "From Euro-Med Partnership to European Neighborhood: Deeper Integration à la Carte and Economic Development," *ECES Working Paper* 103 (July). Cairo: Egyptian Center for Economic Studies

Hoekman, Bernard and D. Konan (2005), "Economic Implications of a US-Egypt FTA," in Galal and Lawrence (eds.), *Anchoring Reform with a US-Egypt FTA* (Washington, DC: Peterson Institute for International Economics)

Lamy, Pascal (2003), "Middle East Trade: an EU Perspective," Speech for the *World Economic Forum*, Amman (23 June 2003)

Lawrence, Robert Z. (2006a), “Middle East Trade Agreement: A Circle of Opportunity?” *Peterson Institute of International Economics* (Washington, DC)

Lawrence, Robert Z. (2006b), “Recent US Free Trade Initiatives in the Middle East: Opportunities but no Guarantees,” *Kennedy School of Government* (Harvard University), RWP06-050

Looney, Robert (2005), “US Middle East Economic Policy: The Use of Free Trade Areas in the War on Terrorism,” *Mediterranean Quarterly*, summer 2005

Mandelson, Peter (2005), “EU Trade Policy and Stability in the Middle East,” Speech by the EU Trade Commissioner at *The Hebrew University* (19 May 2005)

Momani, Bessma (2007), “The EU, the Middle East, and Regional Integration,” *World Economics* 8 (1), January-March 2007

Oxford Analytica (2003), “WTO Suffers from New Security Agenda,” 15 July

Peridy, Nicolas (2005), “Trade Prospects of the New EU Neighborhood Policy: Evidence from Hausman and Taylor’s Models,” *Global Economy Journal* 5 (1), Article 7

Rivlin, Paul (2003), “A Threatening Opportunity: President Bush’s Proposal for a Free Trade Agreement with the Middle East,” Jaffee Center for Strategic Studies, *Tel Aviv Notes*, No. 78

Schott, Jeffrey (ed.) (2004), *Free Trade Agreements: US Strategies and Priorities* (Washington, DC: Institute of International Economics)

Sharp, Jeremy M. (2005), “The Broader Middle East and North Africa Initiative: An Overview,” *CRS Report for Congress* (February 15, 2005)

Yadav, Vikash (2007), “The Political Economy of the Egyptian-Israeli QIZ Trade Agreement,” *The Middle East Review of International Affairs* 11 (1), Article 11, March

Yousef, T. M. (2004), “Development, Growth and Policy Reform in the Middle East and North Africa since 1950,” *Journal of Economic Perspectives* 18 (3), pp. 91-116

Zoellick, Robert (2001), “Countering Terror with Trade,” *Washington Post*, 20 September 2001