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The Role of FDI in the Success of Trade Liberalization between the European Union and the SEMCs

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Abstract: ***Europe has long had a comprehensive Mediterranean approach. Conceived at the end of the 1960s, this approach led to the signing of the Free Trade Agreement (FTA) between the European Union (EU) and the Southern and Eastern Mediterranean Countries (SEMC) in 1995. One of the objectives of this agreement is the attractiveness of FDI. This article aims to analyze and explain the context of association with the EU as well as the role of FDI in the success of this agreement.***

Keywords: Trade openness, FTA, EU, SEMC

1. Introduction

1.1 The EU-SEMC association context

From the end of the 1960s, there was the signing of a panoply of trade agreements with the EU in which several countries on the southern and eastern shores of the Mediterranean benefited, in a non-reciprocal way, from free access for their industrial products and preferential access for their agricultural products. Historically, the links between the European community and the SEMCs are situated in a regionalist perspective of preferences and non-reciprocity which takes into account international asymmetries. Indeed, after a first wave of agreements concluded with the SEMCs in the 1960s without an overall project, the European Community defined a global Mediterranean policy in the early 1970s which led to a new generation of agreements. These agreements are part of the Generalized System of Preferences (GSP) of the community set up in 1971 and which allows the entry of industrial products from the SEMCs free of customs duties within the limit of quantitative ceilings without reciprocity for European exports to these countries. Then, the mid-1970s agreements with the SEMCs further improved this generalized system of preferences by removing the ceiling on duty-free imports. The SEMCs also benefited from a more favorable textile regime than the multifibre agreements to which countries in the rest of the world, particularly Asian countries, were subject.

The multilateral liberalization which marked the beginning of the 1990s and especially with the birth of the WTO, put an end to the preferences granted to the countries of the South and East of the Mediterranean since 1972. These have become incompatible with the new WTO rules. In 1995, the signing of the Euro-Mediterranean partnership agreement represented the most important event in foreign policy, especially for the SEMCs. In fact, for the first time since its creation, the EU has defined a global integration project vis-à-vis its South.

Free trade agreements are signed between the European Union and 12 countries in the South and East (Algeria, Palestinian Authority, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia and Turkey). Eight SEMCs are affected by this new 1995 free trade area with the EU because Malta, Turkey and Cyprus have already been in a customs union since 1977, 1996 and 1998 respectively. For Israel, there is free trade with the EU. EU in industrial matters since 1988.

Today, these free trade agreements signed with the EU are situated in a new context of globalization and the rise of a new regionalism. The main objective of the Barcelona agreements is to build new bases for the relationship between the European Union and the 12 southern and eastern Mediterranean countries that are not members of the union in a new context of globalization and deep regional integration within the European space.

Today, fifteen years after the launch of the Barcelona process, the liberalization of trade in industrial products has become real. Indeed, all products from the SEMCs enter the European market totally free of customs duties. Conversely, the SEMCs have implemented a process of progressive dismantling of their customs tariffs. Thus, it is a question of total liberalization for the industrial products of the SEMCs and a liberalization for more than 80% of the agricultural products which enter the EU free of customs duties or at preferential rates. Conversely, 1/3 of European exports of agricultural products benefit from tariff preferences in the Mediterranean countries.

However, the Euro-Mediterranean free trade agreements also have costs linked, essentially, to the drop in revenue based on customs duties (these revenues represent for Tunisia almost 1/3 of its budget) and to competition from European products. Conversely, such agreements reduce import costs and increase negotiating capacities within the WTO, in particular to reduce non-tariff barriers (Beckouche (2006)).

In addition, various studies have shown that the advantages in terms of trade flows are very limited. Indeed, the industrial products of the SEMCs, which are already very few, are also not very competitive compared to their

European counterparts. This worsens the trade deficit of these countries. In this context, Kebabdjian (2002) assumes that the deterioration of the trade balance of the SEMCs must be offset by a massive influx of capital “FDI is a key issue for the success of free trade”.

1.2 FDI: a crucial role in the success of free trade in the SEMCs

Several economists insist that FDI plays a crucial role in the success of the free trade process (Alfredo (2020)). This is largely explained by the trade deficit generated by this agreement. Thus, a massive entry of FDI recommended especially in the export sectors can correct this deficit. In addition, these FDIs will contribute to a technological transfer allowing them to modernize their local structures and thus the take-off of their economy (Dupuch, Mouhoud and Talahite (2014)). Thus, the Mediterranean countries, like the majority of developing countries, have opened up their markets through the signing of association agreements with the EU awaiting a massive influx of FDI: "Thanks to the free trade, the priority is to promote the attractiveness of capital to boost investment, develop scientific and technical partnerships. . . Attractiveness involves the creation of a large dynamic market” (Michalet (1997)). Before the signing of the free trade agreement with the European Union, Kebabdjian (2004) assumes that European FDI flows to these countries were below expectations. Indeed, these flows could not exceed 2% throughout the 1990s and their presence is limited to the relocations (or vertical investment) of activities with low added value and which have little real training effect. Dupuch, Mouhoud and Talahite (2014) refer this low attractiveness of the SEMCs to the weak integration between the SEMCs themselves, which hinders free access to the markets for European investors. Thus, according to Kebadjian (2004), this partnership between the North and the South is supposed to be an opportunity for the SEMCs in the sense that they will benefit in addition to transfers of technology and financial aid to especially massive flows of IDE. Moreover, one of the objectives most targeted by the 1995 Barcelona agreement, according to Kebabdjian (2004), is the provision of a framework of stability to stimulate the entry of FDI. For its part, the EU, through these free trade agreements, seeks to guarantee its investors legal certainty as well as a stable, fair and duly regulated environment in which they can trade. European investors, like the majority of investors, seek to exploit the advantage of offshoring in terms of low production costs, the quality of the workforce, the development of infrastructures, etc., by producing in a host country with a view to exporting the goods produced to foreign countries. For this, the host countries, those of the SEMCs, should be open to international trade. This strategy corresponds to a vertical strategy that goes well with the characteristics of the SEMCs which have very limited markets (with the exception of Egypt and Turkey) to motivate horizontal multinationals to set up in their national territories. Thus, the European multinational firm adopting a vertical strategy will split its value chain into different activities and will locate each function of the company in the country offering the best production conditions. Subsequently, the subsidiary present in each of these small countries offering the best conditions, especially in terms of labor costs, will export its intermediate products, either to its parent company, or to other subsidiaries established in other countries. Thus, the small country will serve as an export platform for the subsidiary to its counterpart or to the parent company. Thus, the current intensification of the international decomposition of the production process necessarily requires complete trade openness. It is, moreover, thanks to this growing trade openness that intra-firm trade has had an unprecedented boom: "currently, more and more companies are organizing their production on a global scale and thereby generating a growing trade via exchanges between their subsidiaries” (Barbet (2019)). In 2006, the OECD estimated that intra-firm trade represented about a third of international trade for developed countries. The growing openness of the SEMCs to international trade through membership of the WTO and above all the signing of the free trade agreement with the EU will therefore encourage the development of vertical FDI which goes well with their characteristics. They will also tend to increase the foreign trade of these countries, in particular their exports. It is this type of vertical investment that is targeted by the attractiveness policies of these different countries. They try to present favorable sites for this type of investment by allowing it to minimize its production cost as much as possible.

However, the Euro-Mediterranean liberalization agreements have not resulted in the intensification of FDI inflows into the SEMCs (Aoudia (2015)) if we compare the situation of this group of countries to the countries of Southern Europe. South or East. Indeed, for the periods following their accession to the EU (81-85) and (86-92), Spain and Portugal had seen the share of FDI in their GDP increase by around two points percentage.

The problem, according to Michalet (1997)), is the narrowness of the markets of the SEMCs which cannot constitute real reasons for the establishment of multinationals, especially those adopting a horizontal strategy. Moreover, aware of the importance of a vast southern Mediterranean market, the EU has not failed to insist, on several occasions, on the importance of greater South-South economic integration in order to develop the regional trade on the one hand, and to attract more capital on the other. Indeed, for foreign investments, setting up in a country is all the more interesting when it allows easy access to neighboring markets. This is becoming increasingly important for economies with restricted markets like those of the SEMCs.

The EU can, at this level, promote a process of integration between the SEMCs through monetary support leading to cooperation agreements through support for liberalization which facilitates the circulation of goods and factors of production. Moreover, aware of the importance of a vast southern Mediterranean market, the EU has not failed to insist, on several occasions, on the importance of greater South-South economic integration in order to develop the regional trade on the one hand, and to attract more capital, on the other hand. Indeed, for foreign investments, setting up in a country is all the more interesting when it allows easy access to neighboring markets. This is becoming increasingly important for economies with restricted markets like those of the SEMCs.

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In this context and aware of the importance of the size of the market which plays against them, four Mediterranean countries (Egypt, Jordan, Morocco and Tunisia) have made commitments in this direction by signing the Agadir agreement in 2004. Indeed, by constituting a large market and displaying a liberal orientation, the SEMCs are today capable of attracting quality investments that generate growth. These FDIs can facilitate job creation, technology transfer and above all non-debt financing of their economies. In fact, for Moran (1998), the impact of FDI simply involves improving the investment climate in the host countries. Thus, a liberal investment climate can help generate more positive spillovers since it can be more attractive to dynamic and scale-generating FDI using the most advanced technologies and best managerial practices. It is, moreover, for this reason that the SEMCs have opted for openness in the hope of having a significant flow of FDI that in the long term would enable them to generate growth: "In the SEMCs, however, the main impediment to economic growth may well be low FDI" (Benassy and Fontagné and Lahreche (20011)).

2. Conclusion

In this article, we have tried to analyze the trade openness of the SEMCs at the end of the 20th century through the signing of a free trade agreement with the EU. We have also shown that the establishment of a specific regional framework aims, in addition to easier and more efficient access to the international market, to attract more FDI. They will be dedicated to facilitating this access but also to participating in the economic growth of these countries. Indeed, these FDIs will allow these countries to create jobs, transfer technology, improve competitiveness, etc.

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