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European Union–Developing Country FTAs: Overview and Analysis

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Summary. — This paper explores the complex structures of recent free-trade agreements (FTAs) between the European Union and developing countries, surveys the main factors determining their economic effects, and presents quantitative simulations of the effects of these agreements. Limitations of product coverage substantially reduce the potential benefits of the agreements compared to full bilateral free trade, while only the Mexico, Chile, and Turkey agreements have trade related commitments which are wider and deeper than the preferential reduction in tariffs. In the case of Egypt, existing levels of protection mean that it is moving toward regional free trade with many domestic distortions still in place, producing a significant loss for the Egyptian economy.
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Key words — free-trade agreements, CGE modeling, European Union, developing countries

1. INTRODUCTION

The Uruguay Round Agreements and the creation of the WTO have strengthened the multilateral trading system. At the same time, however, there has also been a proliferation of free-trade agreements (FTAs) in the world economy. The European Union has been the major driving force behind the spread of FTAs in the developing world in recent years. A combination of economic and political factors (including greater peace and stability in the EU hinterland, support for democratic reforms and the furthering of trade and investment liberalization in developing countries, and accessing new markets for EU exports), have motivated the European Union to conclude such agreements. For developing countries, the attraction has been preferential access to the large EU market and the prospect of increased EU aid.

Against this background, this paper undertakes an analysis of the complex structure of these agreements and surveys the main factors determining their economic effects. It then presents a simulation of the quantitative effects of five European Union–developing partner FTAs (South Africa, Mexico, Chile, MERCOSUR, [1] and Egypt) and the customs union agreement in industrial products with Turkey. Five of these agreements have been concluded (South Africa, Mexico, Chile, Turkey, and Egypt)

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while the one with MERCOSUR is, at the time of writing, still being negotiated. It stresses the likely economic effects on the trade, welfare, and economic structure of both parties of these preferential trading agreements, as well as the impact on third countries. The quantitative analysis is built around the Global Trade Analysis Project (GTAP) computable general equilibrium model and database (version 5.0) with an aggregation of 29 regions and 24 sectors. [2] Previous studies on the effects of EU-FTAs using GTAP 5 or CGE models, such as those on South Africa (Lewis, Robinson, & Thierfelder, 1999; McDonald & Walmsley, 2003), Turkey (Alessandri, 2000; Harrison, Rutherford, & Tarr, 1996), and Egypt (Dessus & Suwa-Eisenmann, 1998) have assumed full liberalization between the partner countries. This paper goes beyond the literature and simulates two alternative policy scenarios within the model: (a) the actual European Union–developing country FTA and (b) a full European Union–developing country FTA (expanded to include the products currently excluded in the actual FTA) [3] and examines (a) in relation to (b).

Section 2 discusses some key characteristics of the EU's trade agreement partners. Sections 3 and 4 chart the spread of European Union–developing country FTAs since the mid-1990s and analyzes key aspects of the agreements. Sections 5 and 6 present the modeling results on the overall effects of the trade agreements, and compare them with full free trade.

2. CHARACTERISTICS OF THE EU'S TRADE AGREEMENT PARTNERS

The discussion starts with a brief examination, using the GTAP 5 data (based on 1997), of the key characteristics of the EU's trading agreement partners. As shown in Table 1, collectively the MERCOSUR economies (dominated by Brazil) are the largest economy among the six agreement partners. Mexico follows this some way behind. Chile and Egypt are the smallest, whereas Turkey and South Africa fall in between these extremes. It is noteworthy that the total GDP of the six economies combined amounts to about a quarter of the GDP of the European Union.

At the same time, there is a significant variation in the production structures of the six agreement partners. MERCOSUR and Mexico are the most industrialized whereas Chile is by far the least. All the agreement partners have significant service economies (making up around half of the GDP). Chile and Turkey have the largest agriculture and food processing sectors while the others have significant shares of agriculture and food processing sectors. By comparison, the EU's economy is dominated by services and, to a lesser extent, manufacturing while its agricultural and food processing sectors have declined and account for a negligible share of the economic activity.

The individual developing countries are relatively small trading partners for the European Union and even when combined only account for 3.7% of total EU exports and 2.9% of total EU imports (*IMF Direction of Trade Statistics, 2001*). In contrast, the European Union is a major export market for most of the agreement partners. Hence, the European Union accounts for 54.6% of exports in Turkey, 43.6% in Egypt, 28.6% in South Africa, 25.2% in Chile, and 23.8% in MERCOSUR (Table 2). Mexico, with a particularly high reliance on the US market (accounting for 90.7% of Mexico's exports), is an exception with only 3.4%. On the import side, Turkey, South Africa, and Egypt have particularly strong ties with the European Union (with between 37% and 50% of their imports from the European Union) while the

Table 1. *GDP shares*

Country/region	GDP ($bn)	Agriculture (%)	Processed food (%)	Mining (% shares)	Manufacture (%)	Services (%)
South Africa	139.1	4.2	7.0	5.0	28.8	55.1
Mexico	388.8	7.3	9.5	3.8	34.2	45.2
Chile	76.1	8.7	12.0	3.9	23.5	52.0
MERCOSUR	1,134.7	7.9	10.1	1.3	34.3	46.2
Turkey	192.4	11.4	8.3	0.8	26.6	52.8
Egypt	70.2	13.2	4.6	3.8	27.5	50.8
European Union	7,958.0	2.8	5.5	0.4	29.1	62.3

Source: GTAP 5.

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