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Trade asymmetries in the Mediterranean basin

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ABSTRACT

The paper examines the evolution of European Union's trade asymmetries across the Mediterranean basin, by highlighting the impact of the 1995 Barcelona convention's free trade agreements. Asymmetry is gauged by measuring the speed of trade openness convergence paths between the Mediterranean North and South. The EU's Southern Mediterranean partners' reaction to their free trade agreements is examined with a series of convergence tests, accounting for endogeneity and instrumenting with spatial geographic matrices and geopolitical dummy variables. It is revealed that following the European Union's 1995 free trade initiatives the trade asymmetry between Middle Eastern and North African countries and their Northern counterparts becomes more asymmetric, ratifying Prebisch-Singer's empirical hypothesis.

1. Introduction

The efficacy of regional free trade agreements (FTAs), the main drivers of *regionalisation* (Frankel, 1997), is undergoing considerable scrutiny. Some scholars assert that FTAs can spur economic growth (for example, Ben-David & Loewy, 1998; Wacziarg & Welch, 2008) while others discuss a number of theoretical and empirical finding contrasting this view (see among others, Deraniyagala & Fine, 2001; De Wulf & Maliszewska, 2009). The last thirty years have witnessed a dramatic growth of regional trading blocs in all of the five continents. Insofar as World Trade Organization's efforts to abort trade barriers on a global scale are unsuccessful, there is an ongoing emergence of regional trading agreements (Crawford & Fiorentino, 2005). Empirical evidence asserts that these tariff-reduction agreements assist convergence of its member countries, provided that its trading partners are not considerably divergent in terms of technology and endowments (see Ben-David & Loewy, 1998; Grossman & Helpman, 1990; Lane, 2001). A part of this literature argues that higher trade openness can be associated with higher output volatility (Frankel & Romer, 1999; di Giovanni & Levchenko, 2009). However, there is also a growing stream of academic literature providing evidence of the negligible or negative role of trade openness on changes in inter country growth (see De Wulf & Maliszewska, 2009; DeJong & Ripoll, 2006; Slaughter, 2001).

Regional free trade agreement positive effects can be counterweighted by the extent to which free trade diverts supply sources from competitive non-partner to less efficient member countries. The Euro-Mediterranean Free Trade Area (EMFTA) is the European Union's (EU) effort in the mid-90s to promote a relax tariffs¹ in the Mediterranean basin. However, it has not managed to favourably shift the

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E-mail addresses: konstantinos.konstantaras@yahoo.com (K. Konstantaras), dionisis.philippas@essca.fr (D. Philippas), Konstantinos.Syriopoulos@zu.ac.ae (C. Siriopoulos).¹ The Global Mediterranean Policy instituted in October 1972 granted free access of the Mediterranean partner countries industrial goods to the European Economic Community including Greece and Turkey (1962), Israel (1964 and 1970), Lebanon (1968), Spain (1970), Malta (1971), Cyprus (1973) and Egypt (1973), allowing for agricultural commodities, textiles and a few other exceptions (Bicchi, 2006).<http://dx.doi.org/10.1016/j.jeca.2017.12.002>

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balance of trade and the flow of foreign investment capital between the EU and most of the Middle Eastern and North African (MENA) Euro-Mediterranean Partner (EMP) countries. It is argued that its failure comes as the result of insufficient policy tools, including shallow tariff and quotas elimination, without structural assimilation or deeper integration² (Anderson & van Wincoop, 2003; De Wulf & Maliszewska, 2009; López-Cálix, Walkenhorst, & Diop, 2010).

Historically, the Mediterranean basin has functioned as a trade and civilization exchange where the historical cultural and social ties across the Mediterranean nations facilitate an understanding of the terms of trade. On the other hand, a number of social, political and economic milestones could have had a great impact on trade integration and mask the posited reaction of EMPs towards the EMFTA. They can act as catalysts, intensifying or disrupting trade flows, as evidenced by European Monetary Union's driven trade deepening among member states. These include geopolitical events (e.g., the Seven-Day War), individual shifting characteristics (most notably immigration), institutional changes (such as the European Monetary Union) and country-specific economic shocks. Recently, the European sovereign debt crisis has intensified its contagion towards emerging and developing economies via international trade (Claessens & Kose, 2013), driving tighter budgets in the EMP countries. Not surprisingly, the EMFTA has faced criticism (see among others, De Wulf and Maliszewska (2009), López-Cálix et al. (2010)). The point most often raised in the critique is the necessity for deeper integration to deliver widespread benefits. In a nutshell, through the mere elimination of tariffs and quotas and without structural assimilation, the EMFTA is supposedly as likely to enhance as to diminish member states' welfare. Given the ongoing establishment of trade blocs in different geopolitical regions of the world, the question whether regional growth is promoted within EMFTA becomes more interesting.

This paper takes an alternative view on EMFTA's failure. It focuses on the development of trade asymmetries across the Mediterranean in the period before and after the Barcelona Declaration in 1995 which launched the EMFTA, employing aggregate trade openness to proxy their strength (Arestis, Desli, Pelagidis, & Chortareas, 2012). Blecker (1996) structural model of North-South integration suggests that following trade liberalization economic asymmetries prevail in the medium-to long-run. In the short run, assuming elastic demand for traded goods, additional flows are shifted towards the new trading partners. In the medium term asymmetric trade prevails as the increased exports of Northern goods does not apportion an equivalent raise to Northern workers' income to stimulate demand for Southern goods. In the long run, liberalized foreign capital inflows increase structural asymmetries in the form of an uneven development between the North and the South.

This theoretical result is empirically supporting the Prebisch-Singer hypothesis (Prebisch, 1950; Singer, 1950) according to which the developing countries' reaction to regionalisation efforts from technologically advanced exporters is to reduce their trade openness via substituting their manufacturing imports (Mollick, Torres, & Carneiro, 2008). High income countries have the ability to educate themselves as they grow and endogenously to accumulate the knowledge upon which these efforts are made. The same argument can be also used as an explanation for regional differences - the fact that low income regions do not have previous experience and knowledge for efficient investments (Siriopoulos & Asteriou, 1998).

Should the Prebisch-Singer hypothesis be true in the case of EMFTA, its failure could be the result of country-level trade policy reaction to EU's effort to penetrate in the technologically disadvantaged EMP coastal markets. In this respect, the EU's faltering regionalisation efforts in the Mediterranean expose the weakness of *internationalization* and *Europeanization* as defined by Kleinknecht & Wengel, 1998. Trade asymmetry should become more apparent in the case a formerly congruent trade openness path between EU and the EMPs, during the 1970s, is disrupted following the EMFTA implementation. We show that this asymmetry is consistently confirmed, employing the typical Barro and Sala-i-Martin (1992) convergence regressions and a dynamic panel framework. To the degree EMFTA promotes trade asymmetry as opposed to strengthening trade ties it is not only trade that is hampered but also stability and security in the area.

From a trade policy perspective, trade convergence, if delivered, should be easier to materialize on the Mediterranean basin capitalizing on a common coastal border, cheaper sea transportation and non-tariff measures (NTMs) (Anderson & van Wincoop, 2004). On the other hand, a number of significant social, political and economic milestones could act as catalysts, intensifying or disrupting trade flows, as for example is evidenced by European Monetary Union's (EMU) driven deepening of trade between EMU member states (Mongelli, Dorrucci, & Agur, 2005). These include geopolitical events (the Seven-Day War), individual shifting characteristics (most notably immigration), institutional changes (such as the European Monetary Union) and country-specific economic shocks. Recently, the European sovereign debt crisis has intensified its contagion towards emerging and developing economies via international trade (Claessens & Kose, 2013), driving tighter budgets in the EMP countries. Therefore, our tests should take these events into account and decouple their impact from aggregate trade openness' asymmetry. We suggest that relying on the Prebisch-Singer hypothesis, EU regionalism has not extended to the south following the 1995 Barcelona Declaration agreements due to the growingly asymmetrical distribution of resources between the European and African Mediterranean borders. The faltering convergence between Mediterranean north and south portrays the negative reaction to openness from EU's orchestrated efforts to liberalize trade. Our findings indicate that trade openness convergence portray that the majority of EMPs reacted to the EMFTA by diverging their trade openness away from the EU.

The remainder of the paper is organized as follows. The next section presents the proposed methodologies and presents the empirical results. The last section provides a discussion of the findings and concludes.

² Deep integration maximizes the economic benefits from trade liberalization and circumvents the tariff measures (NTMs) (Cadot, Saez, & Maliszewska, 2010). Deep integration moves the neighbours from *negative* integration (i.e. total removal of trade obstacles) towards a process of *positive* integration (trade convergence). The expectations are (among others) an increase in the trade share, an increase in factor movement, competition policy, an increase in industry outputs, dissemination of knowledge, cycle synchronization, foreign direct investments and service regulations, environmental and labour standards, and so on.

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