



Palestine Economic Policy Research Institute

Associating Palestine with
the European Union :
The Present Framework
And the Way Ahead

By
Nu'man Kanafani

April 2000



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Foreword

During its recent history, Palestine has been affected by political and economic events in Europe more than any other Mediterranean country. After five decades of obliteration from the map of the Middle East, Palestine is now in the process of being reinstated. It is anticipated that the relationship with the European Union will play a substantial role in the implementation of economic reforms required to reintegrate the Palestinian economy with regional and international economies. As the EU acknowledges its responsibility to assist the Palestinian people in the reconstruction process, the need for a clear vision and strategy by the PNA to define rational economic and trade policies with its European partner increases in importance. Palestinian policy makers in the public and private sectors require hard information on actual and potential economic trends in order to achieve defined negotiating goals successfully.

It was in this context that MAS included the potential relationship between Palestine and the EU in its research program on trade policies. This paper presents the current framework between Palestine and the European Union in the form of the Interim Association Agreement (IAA) signed in 1997. The paper includes the historical background to EU agreements with Mediterranean countries, an important discussion of the compatibility of free trade agreements with WTO rules, and the issue of rules of origin as related to commodities.

This publication differs from the standard MAS policy research publications in that it is primarily informative with the aim to provide Palestinian policy makers with a helpful overview of the different elements of the IAA during the interim period. Originally planned for publication in early 1998, it serves as an introduction clarifying the terms of EU-Palestine trade cooperation and background information. A second part is planned to tackle analysis of the implementation of the IAA in practice and to address the focal points of the new agreement. This is particularly important as the interim period is coming to an end and a new agreement is on the verge of being negotiated.

I would like to express my thanks and appreciation to the researcher, Nu'man Kanafani. Thanks are also due to the Technical Assistance Trust Fund (PECDAR) for their financial support.

Ghania Malhis
Director

Publication Standards at the Palestine Economic Policy Research Institute-MAS

The Palestine Economic Policy Research Institute –MAS- engages in the publication of applied research papers and studies related to the Institute’s program in the area of economics and social science and conducted by full or part time researchers.

The Institute abides by the following standards and procedures to ensure the high quality of its research publications:

1. The approved research project should be conducted or supervised by a specialist senior researcher. The research must not have been published previously or submitted for publication elsewhere.
2. The terms of reference of the study are approved by an internal MAS scientific committee (consisting of senior researchers) to ensure accurate goals, appropriate use of scientific methodology and procedures and the timetable for completion.
3. The internal scientific committee supervises the work of the researcher or team of researchers through periodic progress reports.
4. The initial draft of the study is reviewed by the scientific committee for objective content-related amendments to be added to the second draft.
5. The second draft is then submitted for evaluation in accordance with the terms of reference to two or three external academic experts specializing in the subject. Provided that there is a positive evaluation by at least two experts, the researcher is asked to review the study taking into consideration the objective recommendations of these experts.
6. The study is presented for discussion at a public workshop attended by academics, researchers, and representatives from public and private sector institutions related to the subject of the research.
7. Comments and feedback from the workshop are incorporated into the study and the final draft is reviewed by the scientific committee to ensure that the necessary amendments have been made. The study is then edited.
8. Research papers written in English are translated into Arabic and published in both languages. An executive summary in English is attached to research papers written in Arabic.

9. The author is not permitted to reproduce, in whole or in substantial part, from the research published by MAS without the express written permission of the Director of the Institute.

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1. Introduction

The aim of this paper is two fold. *Firstly*, to shed light on the relations between the European Union (EU) and the Palestinian territories in the context of the EU's Mediterranean Initiatives. *Secondly*, to put forward some recommendations related to trade relations in the new association agreement that is supposed to be re-negotiated between the Palestinian National Authority (PA) and the EU in mid 1999. In the process of achieving these two goals, the paper will highlight several issues, including the constraints imposed by the World Trade Organization (WTO) on bilateral free trade area agreements and the EU's elaborate systems concerning the rules of origin and the cumulation principle. Furthermore, the paper will attempt to compare the EU's trade concessions in the current Interim Association Agreement (IAA) with the West Bank and Gaza Strip (WBGS) with the concessions granted to other Mediterranean countries in general and to Israel in particular.

It should be said from the outset that a proper evaluation of the implementation of the EU-PA agreement, signed in 1997, is not possible. This is especially true with respect to the trade clauses in the agreement. The WBGS went through extraordinary political and economic turmoil during the past years, including long periods of total physical blockades. All trade data, even aggregate values of WBGS exports (not to mention actual imports via Israel) are highly speculative and unreliable. The paper shall, therefore, concentrate on the principles that govern EU aid and on the conceptual aspects related to trade concessions within free trade arrangements. The overriding aim is to help Palestinian policy-makers to design a strategy to maximise the potential gains to the WBGS from cooperation with the European Union.

2. Cooperation between the EU and the Mediterranean Countries

The non-EU Mediterranean countries are divided by the European Commission (EC) into sub-regional groups: the Northern Mediterranean on the one hand and the Eastern and Southern Mediterranean on the other. The Northern Mediterranean sub-region includes Turkey, Malta and Cyprus. These countries have had Association Agreements with the European Union since 1963, 1971 and 1973 respectively. The agreements aimed to establish customs unions between these three countries and the EU. Only Turkey has now proceeded to that stage. The customs union between Turkey and the EU went into force at the end of 1995 after a 22-year transitional period since the second Association Agreement in 1973. Cyprus and Malta are following a different path and are currently awaiting the start of negotiations to join the EU. The Eastern and Southern Mediterranean sub-region includes the Mashreq (Egypt, Jordan, Lebanon Syria and the Palestinian Territories), Israel, and the Maghreb (Algeria, Morocco, Tunisia). Libya was excluded from the cooperation frameworks in 1992 following the UN Security Council's boycott decision. Since the aforementioned two sub-regions have had different cooperation approaches with the EU, the following short survey will concentrate on the EU's relations with the Eastern and Southern Mediterranean countries only.

Cooperation between the European Community/Union and the countries on the Eastern and Southern shores of the Mediterranean went through three distinct phases. The Barcelona Declaration of 1995 is the landmark that inaugurated the last phase.

2.1 The First-Generation Agreements

The Mashreq and Maghreb countries have had individual cooperation agreements with the EU since the late 1970s, and some of these replaced earlier trade agreements signed in the 1960s. The agreements concentrated mainly on trade (preferential treatment) and conventional financial and technical assistance. Since then, manufactured products from the Mashreq and Maghreb countries have enjoyed duty-free access to EU markets, with some exceptions for textile and clothing exports, on a *non-reciprocal*

basis. i.e., EU trade concessions were not always counterbalanced by equivalent concessions from the Mediterranean countries. For agricultural exports, the individual trade agreements also provided the Mediterranean countries with some limited preferential access to the EU: reduced tariffs on some agricultural exports and tariff quotas (specified quantities on which the tariff is reduced or eliminated). The fact that Spain, Portugal and Greece were not yet members in the EU allowed the Community at that time to extend, especially to Israel and the Maghreb countries, relatively favourable conditions for exports of traditional Mediterranean produce.

Israel has had a special status among the Eastern and Southern Mediterranean countries in as far as economic relations with the EU are concerned. Since 1975, Israel was closely connected with the EU via a free trade area agreement. After a long transitional period, during which Israeli exports enjoyed generous and non-reciprocal trade preferences, the free trade arrangements became fully operational in 1989. They are now guaranteed reciprocal free access for industrial products. Israeli agricultural produce, on the other hand, is in principle treated like agricultural exports from other Mediterranean countries, i.e., preferential access to specified products with tariff quotas during specified time periods, as we shall see later in this paper.

The first-generation of trade agreements between the EU and Mediterranean countries were open-ended, i.e., without specific time limits on their duration. However, the financial protocols that dealt with the accompanying European financial assistance (in the form of grants from the EU budget and loans from the European Investment Bank, EIB) were set out in five-year periods. There were four Financial Protocols covering the period 1978-1996, the first three of which were in connection with the first generation agreements. The Fourth Financial Protocol was associated with the “New Mediterranean Policy” which will be discussed in the following section. Table 1 shows that the total allocation in the first three protocols (1987-1991) amounted to some ecu 1.3b in the form of grants (and risk capital) from the EU budget and ecu 2b in loans from the EIB. Note that Israel was not allocated grants from the EU budget due to its relatively high standard of development.¹

¹ The Eastern and Southern Mediterranean countries also benefited from EU aid in other budget lines than the financial protocols: food aid (ecu 474m between 1986-95), rehabilitation and refugees (ecu 445m between 1986-95), and emergency assistance (like the ecu 500m allocated in

EU assistance to the Palestinians and the WBGS during the period of the first three protocols was governed by a separate policy. Aid was initially targeted at refugees and was channelled through the United Nations Relief Works Agency (UNRWA). The EU's support programme to the UNRWA started in 1971 under a series of three-year conventions. By 1990, the EU was the largest donor to the UNRWA, contributing some 20% of the Agency's budget. By the mid-1980s the EU Commission was already developing new instruments for aid disbursements with less emphasis on the UNRWA and more on cooperation with the EU's NGOs and local institutions in the WBG. From 1986, a regular aid programme aimed at supporting economic, social and political infrastructures in the WBGS was initiated. The programme also included some preferential trade arrangements for exports from the Territories. The substantial increase in EU aid to the WBGS came only in the mid-1990s with the initiation of the current peace process.

2.2 The EU's New Mediterranean Policy

The second phase in EU-Mediterranean cooperation started in 1991 and is known, in EU jargon, as the "New Mediterranean Policy". The thrust of the new strategy was to support the process of economic reforms and to foster economic and social stability in the region as a whole. The means for this were envisaged as a substantial increase in aid, greater emphasis on regional, cross-country projects, and on cooperation among grass-roots civil society organizations in various countries. These new trends would be developed further during the third phase that came about after 1995. The new policy was implemented in conjunction with the Fourth Financial Protocol (1992/96). A grant worth ecu 230m (and 1800 in soft loans) was committed in that Protocol for the support of various regional projects, particularly at NGO level (the so-called horizontal cooperation). Environmental protection, micro-project investment, demographic and cultural exchange were given priorities in the context of horizontal

1991 to support countries affected by the Gulf War). In 1988, a new financial instrument called the European Community Investment Partners (ECIP) was launched with the aim of promoting mutually beneficial investment projects. During 1988-95, about ecu 35m was committed from this budget line to the Mediterranean countries. Note that these budget lines are not exclusive to the Mediterranean region but are also open to other regions. Furthermore, although the EU's aid lines were numerous, it remains true that EU aid to the Mediterranean region was channelled mainly through the Financial Protocols. See the Cowi Report (1998).

cooperation.² A further 300m was committed in the structural adjustment fund (SAF) to support the process of economic reform in the Mediterranean countries and structural adjustment in the region.³

An unallocable fund is, in ODI terminology, “aid which could not be categorised by sector” (for example support for the fight against drugs and aid for scientific cooperation). Regional and unallocable funds refer to all the Mediterranean and other Middle Eastern countries.

Egypt, Tunisia and the Palestinian Association Agreements were the three largest EU aid beneficiaries in the Mediterranean during the whole period, with shares of 32% for Egypt and 16% each for Tunisia and Palestine. Table 2 shows that committed aid to the Eastern and Southern Mediterranean countries amounted to some ecu 5.1b during 1968-95. This represents a little less than 9% of the overall aid extended by the EU during the same period (Cowi Report 1998, p.14). The commitment/disbursement ratio for EU aid to the aforementioned countries (excluding Palestine) is close to 80%. The ratio for Palestine is much lower at only 77%. As is usually the case in other parts of the world, the ratio for regional projects is the lowest, a mere 53%. It is worth pointing out here that although any execution ratio which is less than 100% should trigger question marks, these ratios reflect a much better performance than the EU’s aid to the African, Caribbean and Pacific (ACP) countries within Lomé Conventions. Nevertheless, the Cowi report (1998) is within its rights to conclude that:

² MED-URB (cooperation among local authorities), MED-CAMPUS (collaboration among universities), MED-MEDIA (networks for media and other professional institutions), MED-AVICENNA (scientific research & technical development), MED-INVEST, MED-MIGRATION and MED-TECHNO are the 7 horizontal cooperation programmes. It is interesting to point-out that a special report by the EU’s Court of Auditors in 1996 identified “serious irregularity and mismanagement” in the administration of these programmes. Therefore, the European Commission decided at the end of 1995 (in anticipation of that report) to suspend major parts of these programmes. These irregularities were dealt with in detail in the report of the Committee of Independent Experts which lead to the recognition of the European Commission in March 1999.

³ In order to be eligible for aid from the SAF countries must be carrying out reform programmes approved by the IMF/WB along with meeting other economic and social criteria. During 1992-95, a total of ecu 310m was disbursed from the SAF fund: 100m to Jordan, 80m to Morocco, 70 to Algeria, and 60 mill to Tunisia. The EU’s Court of Auditors criticized the Commission for not carrying out budgetary reviews in Algeria and Jordan to assess whether the budgets were consistent with the economic reform programmes and praised the Commission for coordinating closely with the World Bank in the cases of Tunisia and Morocco.

“By April 1997, more than ecu 47m (grants and interest subsidies) plus almost 38m (special loans and risk capital) -or ecu 85m- were still uncommitted from the four protocols for the 7 Maghreb and Mashreq countries. That disbursements compared to commitments are below 100 per cent is hardly surprising given the volatile and unpredictable situation characterising EU aid and international aid in general. Likewise it is not surprising that limited funds from the fourth protocol were still not committed, since it only ended in 1995. But that funds from second and even first protocols were still uncommitted is indeed surprising. This leads to the conclusion that *throughout the 1986-95 period there have been inadequate mechanisms in place to ensure satisfactory financial resource utilization. The system of entitlement was one of the major reasons for less than satisfactory disbursement rates during the protocol period*” (p. 41).

2.3 The Euro - Mediterranean Partnership

The third and current phase in EU-Mediterranean cooperation was initiated in November 1995 with the signing of the Barcelona Declaration, creating a partnership between 12 Mediterranean countries on the one hand and the 15 EU countries on the other. The idea of the partnership, which was first raised in Italy in 1990 within the so-called 5+5 dialogue (five EU Mediterranean countries and five North African countries), was officially born at the European Council meeting in June 1992. The Council singled out the Mediterranean basin as a region of crucial importance to the EU's security and social stability. The overall aim, as envisaged later in the Barcelona Declaration, was to create a framework for political, economic, cultural and social links between the EU and the 12 states - Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Palestine, Syria, Tunisia and Turkey.

The EU vision, more specifically, envisages the creation of a Euro-Mediterranean free trade area by the year 2010. In doing so, the EU would pave the ground for the establishment of a free trade region among its own 12 partners. In other words, by signing free trade agreements with each of the Southern and Eastern Mediterranean countries individually,

the EU wishes to deploy these as leverage to create a regional free trade block among the Mediterranean countries themselves.

Obviously, the first generation agreements between the EU and the Mediterranean countries were much too narrow to facilitate the realization of this geo-strategic and economic vision. Thus, a new framework was called for. It is possible to single out three reasons behind the dramatic shift in the EU's attitude toward the region. *Firstly*, increased acknowledgment of the importance of political stability and economic welfare in the region on the European countries themselves. This was a dominant issue in the early 1990s in connection with the political turmoil in Algeria and the possibility of a large-scale influx of immigrants to Europe. *Secondly*, as some EU member countries were arguing strongly for extending aid and cooperation with Central and Eastern Europe, the Mediterranean EU members were eager to extend the cooperation southward. The report of the Independent Experts (1999) points out clearly that the aim of the Med programmes "was to strengthen political and economic cooperation with the Southern Mediterranean countries in order to counterbalance the aid given to the countries of Central and Eastern Europe". *Thirdly*, a new approach to the EU-Med cooperation was also deemed necessary because the old generation agreements were incompatible with EU commitments within the World Trade Organization (WTO). The incompatibility was particularly acute with respect to *non-reciprocal* trade concessions and the *exclusion* of important sectors (e.g. agriculture) from reciprocal trade liberalization. The EU has committed itself to make all its international trade agreements fully in line with WTO rules by the year 2010. Box 1 elaborates, with some details, on the issue of WTO-compatibility. It is important to be aware of the issues involved because they impose certain constraints on any trade agreement to be signed by the EU, or by any other member of the WTO in future.

Box 1 Compatibility of free trade agreements with WTO Rules

The central pillar of the General Agreement on Trade and Tariffs, GATT (or the WTO) is founded on the principle of the *most-favoured nation* (MFN). The principle, cemented in Article I of the GATT Charter, states that the exports of no two member countries should be treated differently. In particular, any trade concession made to one country must also be simultaneously extended to all other countries contractual to the agreement. By stressing equality of treatment, the principle of MFN was designed to put an end to exclusive trade concessions. Yet, as one would expect, the GATT charter also allows for a number of exceptions from the grand rule of the MFN. There are 3 main means of legal exemption from the rule, whereby trade concessions can be maintained among some countries without extending the same privileges to others:

1. Article XXIV - The Regional Clause:

Countries that wish to forge trade relations may do so provided that they form "substantial" free trade zones within their blocs. Formation of free trade areas, or of higher forms of cooperation such as customs unions, allows countries to adopt a discriminate tariff structure in favour of their partners without running counter to WTO rules. The free trade zones can be between two individual countries, a regional trade group and individual countries, or between regional trade groups. To be WTO-compatible, the free trade agreements must meet four basic conditions:

- a. They should liberalise "substantially all trade" between the signatories. Trade agreements, in other words, should not exclude too many sensitive products from liberalization. In particular, this condition requires that no major sector be excluded from free trade.
- b. The implementation of the free trade agreements may well be gradual but liberalization must take place "within a reasonable period of time". This is defined now by the WTO as a period that "should exceed ten years only in exceptional cases".
- c. The agreements should exhibit reciprocal trade concessions among all the involved parties. This condition is implicit in the nature of free trade agreements in that they are not one-sided preferential concessions.
- d. The agreement must be approved unanimously by all WTO members.

It is important to stress that all these conditions are subject to a certain degree of interpretation. Therefore, the WTO-compatibility of new free trade arrangements is usually an issue of debate until the arrangement is brought to the WTO.

2. *The Enabling Clause:*

The enabling clause allows advanced industrial countries to provide preferential, non-reciprocal and exclusive market access to the products of poor developing countries. The WTO rules legitimize and call for the granting of “differential and more favourable treatment” to developing countries, and the least developed countries in particular. Both the enhanced (super) and the normal (standard) *generalized system of preferences* (GSP) adopted by most of the advanced developed countries, are WTO-compatible on the basis of the enabling clause. However, the preferences provided in accordance with this clause should not exhibit “discriminatory” treatment among the developing countries themselves. Once the criteria of potential beneficiary poor countries are set, then all countries meeting these criteria should be treated equally. Finally, the enabling clause may also be used among the developing countries themselves, but only within the context of regional trade arrangements.

2.3.1 Barcelona Declaration

The Barcelona Declaration inaugurated a new stage in relations between the EU and the Med countries. It calls for the establishment of a “comprehensive partnership among the participants ... through strengthening political dialogue on a regular basis, the development of economic and financial cooperation and greater emphasis on the social, cultural and human dimension, these being the three aspects of the Euro-Mediterranean partnership”.

1. *Political and security partnership.* The aim here is to create a common area of peace and stability, with the possibility of establishing a Euro-Med pact for this purpose in the long run.
2. *Economic and financial partnership.* The overall goal on this front is to create an area of shared prosperity with the following long-term objectives: accelerating the pace of sustainable socio-economic development, reducing the gap in the Euro-Med region, and encouraging regional cooperation and integration. To achieve these objectives, the participants agreed on establishing an economic and financial partnership based on:
 - a. *The progressive establishment of free trade areas.* Free trade agreements between the EU and each of the 11 Med partners to

ensure the establishment of a Euro-Med Free Trade Area by the year 2010. Although no explicit reference to the goal of establishing free trade among the Med countries themselves is made, the Declaration stresses that a key factor in developing free trade will be trade cooperation and trade expansion among the 12 Med partners themselves.

- b. *Economic cooperation and concerted action.* The Declaration lists the specific areas of cooperation on this front. These include elimination of obstacles to the free flow of investment, technology & goods; regional cooperation on a voluntary basis; environmental issues; promotion of active female participation in economic and social life, etc.
 - c. *Financial cooperation.* Increase financial assistance from the EU to the Med countries in order to help them to meet the goals of the Declaration, especially with respect to the adjustments needed in connection with free trade arrangements and regional cooperation.
3. *Partnership in social, cultural and human affairs.* The goals here include development of human resources, promoting understanding between cultures and exchanges between civil societies. Commitment to intensify cooperation to reduce migratory pressures and illegal immigration is also stated.

The Declaration concludes with a detailed work programme to achieve its goals. The establishment of the Euro-Med Free Trade Area is singled out as being “an essential element of the Euro-Mediterranean partnership”. Cooperation here will focus on practical measures to facilitate the establishment of free trade, including harmonizing rules and procedures in customs “with a view in particular to the progressive introduction of cumulation of origin”, harmonization of standards and elimination of unwarranted technical barriers to trade.

2.3.2 The MEDA Budget Line

In order to meet its financial obligations set out in the Barcelona Declaration, the European Council (Cannes 1995) allocated a total reference amount of ecu 4,685m as aid grants for cooperation with the Med partners during 1995-1999. The Council also decided to allocate funds from the European Investment Bank (EIB), amounting to ecu 3,900m, as loans to the countries of the region.

On an administrative level, the EU decided to establish a single new budget line, MEDA, to replace all earlier aid lines to the Med countries, including the four Financial Protocols (the last of which expired in October 1996). More than 70% of the total reference amount of aid, i.e., ecu 3,425m out of 4,685m, is allocated to the MEDA budget line.⁴

The Council Regulation (EC 1488/96) of July 1996, referred to as “the MEDA Regulation” specified the rules and guidelines that govern the practical management of financial aid.

The MEDA Regulation specified the areas in which financial support is to be used:

- I. Support for economic reform. This includes two headings:
 - a. Support for economic transition and the establishment of the EU-Med free trade area. This include job creation, private sector development, promotion of investment and cooperation with the EU, and updating economic infrastructure.
 - b. Support for structural adjustment, including programmes for the alleviation of the negative social effects which the process of adjustment may cause (potential beneficiary countries must meet certain economic criteria to qualify for this aid).
- II. Support for achieving a better socio-economic balance. This includes activities aimed at improving the participation of civil society in planning and implementing development measures, provision of social services, the fight against poverty, strengthening democracy and human rights, cultural cooperation, reducing illegal immigration and drug trafficking.
- III. Regional cross-border cooperation, including regional cooperation between Med partners, regional infrastructure projects, a regional regularity framework, and Euro-Arab dialogue.
- IV. Good governance, including institution building and the promotion of civil society.

The Regulation stresses: that all forms of support shall take due account of promoting the role of women in economic and social life, as well as paying attention to environmental considerations. Furthermore, the

⁴ The remaining aid is allocated under various lines, including ecu 532m carried over from the four Protocols, ecu 322m for cooperation with Turkey, 165m to UNRWA and the rest to support the Middle-East peace process (Cowi Report 1998, p.10).

Regulation pointed out that beneficiaries of EU aid may include not only states and governmental institutions, but also local authorities, regional organizations, agencies, local or traditional communities, private operators, associations and NGOs.

The MEDA approach and Regulation introduced two new aspects in EU aid disbursement that were not previously known during the period of the Protocols.

National and Regional Indicative Programmes (NIP) and (RIP)

The idea behind the introduction of the NIP and RIP, already well known from the Lomé Conventions, is to facilitate the full involvement of EU partners in policy formulation and decision-making with respect to aid allocation. On behalf of the Commission, the EU Council passed a decision on guidelines for preparing NIPs as a key rolling-plan document in which the overall goals of the Barcelona Declaration are consolidated in relation to each country's needs. NIPs covering 3-year periods should be established (in liaison with the EIB) to define priority sectors for support. The programmes shall include indicative amounts (overall and by priority sector) and list criteria for funding the programme. The NIP is foreseen as a comprehensive document in the sense that a complete overview of Commission-financed activities in the country in question is established. As pointed out earlier in connection with the areas of support, the MEDA Regulation establishes a link between the conclusion of Association Agreements and the aid package. In other words, the NIPs are to be drawn up taking into account the particular needs of the Med partners in preparing for free trade.⁵

Coordination between the partner countries, the Commission and EU Member States is also foreseen, since the indicative programmes will concentrate on a limited number of priority sectors to be fixed in dialogue with these parties and other donors. The process is summarised as follows: After the adoption of indicative plans, financing proposals for projects and programmes are prepared and presented before the MED Committee.⁶ The Committee issues its opinion, subsequent to which the Commission

⁵ To this end, assistance will be given in the following fields: development of legislation and institutions necessary for a competitive market economy, creation of an appropriate legal and administrative framework, trade facilitation including assistance in the field of customs and indirect taxation, harmonisation of standards, and development of the financial sector.

⁶ The MED Committee (also known as the article 11 committee) is the management committee for the EU-Med aid

negotiates a funding agreement with the partner government. The agreement constitutes a necessary legal document that sets out the obligations of the signatories. It specifies the objectives, the project management structure, implementation procedures and monitoring and evaluation procedures, and includes a detailed budget. As such, it should be used as a management tool.

The RIP is intended to complement and reinforce the NIPs in line with the goals set out in the Barcelona Declaration. Therefore, the objectives, means, and activities listed in the RIP are under the same three headings as those in the Declaration. About 10% of total MEDA resources are reserved for the RIP, which should be linked to the NIPs to ensure that they complement each other. The process of drawing up the RIP is similar to that of the NIPs, with the exception that the Euro-Med Committee is charged with approving it.⁷

Performance vs Entitlement

As pointed out earlier, one of the special features of the financial protocols in the early cooperation agreements is that “funds should be used until exhausted”. This implied that although financial protocols were concluded for specific periods, they remained active indefinitely as long as funds were not totally exhausted. Funds were considered, as the Cowi Report (1998, p.14) puts it, as the de facto entitlement of the beneficiary country, and once allocated could not be withdrawn or used for other purposes. This system was changed in the MEDA.

The entitlement system has resulted in the unsatisfactory situation whereby funds from the first, second and third protocol were still neither committed nor disbursed up to the start of the MEDA in 1995. The system of "entitlements" has been changed with the MEDA Regulation and the “Indicative and Performance” based funding. The idea here is basically to allow for the re-allocation of funds on the basis of the actual performance of the beneficiary countries. The MEDA Regulation speaks of a "reference amount" and not of actual allocations to individual countries. The NIP may be amended taking into account experience acquired and progress achieved by the Mediterranean partners, i.e., may be revised in accordance with implementation performance.

⁷ The Euro-Med Committee is the main body in charge of following up the Barcelona process. It meets on a quarterly basis at ambassadorial level and is chaired by the EU president. It consists of the Troika, Med partners, the EU's Council Secretariat and the EU Commission. The RIP within MEDA for 1997-99 was approved in December 1997.

Although the performance-based system has yet to be made fully operational with clear and detailed performance criteria for each country, the idea behind it and the NIP is apparent: beneficiary countries should resume the lead responsibility vis-a-vis the EU, the donor. Recipient countries are called upon to play a very active role in aid planning and implementation. The clearer the goals, the links between them and planned activities and the more transparent the follow up, the faster and the larger the commitment from available MEDA resources would be.

2.4 Implementation of the Mediterranean Initiative

The Barcelona Declaration specified the means to achieve its overall goals. These include multilateral dialogue, bilateral Association Agreements (intended originally to be ready by 1997-98), improved financial aid from the EU, along with intensive cooperation among the Mediterranean countries themselves. Progress on realising these goals has been slow and not totally successful.

2.4.1 The Association Agreements

Association Agreements had already been negotiated and signed between the EU and 5 Med countries: Morocco (February 1995), Tunisia (July 1995), Israel (Nov. 1995), the Palestinian Authority (February 1997) and Jordan (April 1997). Negotiations for similar agreements are going on with Egypt (although with some serious difficulties), Lebanon, Algeria and Syria (the negotiations only started in June 1998 after a long delay in granting a mandate to the EU Commission to initiate the process). The agreement between the EU and Israel is a renewal of their 1975 FTA agreement.⁸ The EU Agreement with the Palestinian Authority is an interim agreement, which is supposed to be replaced by a “standard” Association after the end of the transitional period envisaged in the Oslo process.

All the Association Agreements incorporate an almost standard Euro-Mediterranean free trade area arrangement. To ensure compatibility with the WTO, the arrangements are “interim”, in the sense that they are

⁸ The old FTA agreement achieved the duty-free export of Israeli manufactured goods to the EU by 1977 and duty-free export of EU manufactured goods to Israel in 1989. In that agreement, the EU had already granted Israel major concessions with respect to agricultural exports, estimated to cover about 70% of EU agricultural imports from Israel.

designed to prepare the countries for the year 2010 when full reciprocal free trade in manufactured goods will be achieved. The agreements do not exclude any major sector from trade liberalization. The Euro-Med free trade agreements have the following common characteristics:

Non-agricultural goods: Exports from the Med countries to the EU enjoy immediate free access, with a few exceptions (textile and clothing) on which the EU will lift all restrictions on a progressive basis. Imports of industrial products from the EU to the Med countries will be fully liberalised according to a calendar stretching over a transitional period (up to the year 2012).

Agricultural commodities and processed agricultural products: The scope of liberalization is quite restricted here. The EU's trade concessions (with respect to imports from the Med countries) are product-specified with limited volume and a very narrow timetable. Beyond these specified products, the EU retains the right to impose "components" on a long list of major agriculture produce (on all produce covered by the EU Common Agricultural Policy). The Med countries are also allowed to protect their own agriculture, provided that imports from the EU shall not be subject to additional tariffs and restrictions than those in force before the agreements. Existing tariffs on specific agriculture imports are recognized. The provisions on the trade in agricultural products are to be renegotiated soon after the year 2000.

It was argued by some economists that the replacement of the old agreements with their non-reciprocal trade concessions by the new reciprocal free trade arrangements, the Med countries would be worse-off, at least in the short-run. Lecomte (1998, p.20) argues that the increase in imports, by the Maghreb countries in particular, from the EU will be very large while the increase in their exports will be limited. This would result in putting both the balance of payments and domestic industrial firms at risk. He suggests that 60% of the Maghreb's industrial firms are incapable of competing with European products unless significant technological and marketing upgrading is realized by 2010.⁹

⁹ One should not underestimate the fact that the significant trade concessions extended by the EU to the Med countries in the early agreements were progressively eroded by the extension of the same concessions to other countries (through multilateral trade liberalization under the WTO). The ACP countries have witnessed such an erosion in a dramatic way although the EU's "nominal" trade concessions in the Lomé Conventions were not changed.

Another interesting issue here is the effect of the free trade area agreements between the individual Med countries and the EU on regional trade. As pointed out earlier, the EU's vision is that its individual agreements will act as a leverage to establish a regional free trade block around the Mediterranean. Or, to use the terms of modern trade theory, Europe (the hub) intends that once free trade is established with each of the Med countries (the spokes), the spokes would then be linked together to form a regional free trade block. Whether this is a plausible vision depends on whether the political and economic weight of the EU can counterbalance the political and economic obstacles which hindered the realization of this project in the past. However, until the regional framework is in place, the process of individual relations between the hub and spoke brings with it trade discrimination in favour of the EU and against the products of other countries in the region. This is paradoxical indeed.¹⁰

2.4.2 Multilateral and Bilateral Dialogues

The Barcelona Declaration led to numerous meetings on various subjects of common interest, including security strategies, industrial law, banking policy, environmental matters, audio-visual technology, health, and religious and cultural issues. These meetings were held at expert levels and were therefore able to deal with problems that do not usually receive due attention in the political dialogue. The multilateral political and strategic dialogue was less successful. A second ministerial meeting in Malta in 1997 found participants unable to agree on a form of words on the Middle East peace process. Morocco cancelled a meeting of industry ministers in the autumn of 1997 due to setbacks in the peace process. Talks to establish a "zone of peace and prosperity", as called for under the Barcelona accord, are also going very slowly. It is becoming increasingly clear that the realization of the implicit regional goals in the Barcelona Declaration is conditional on breaking the deadlock in the Middle East peace process. Although the EU is now playing a more active role in the peace process, it is hampered by the lack of a common foreign policy. Nevertheless, it is still maintained that Barcelona provides a forum to discuss the problems facing the Mediterranean basin.

¹⁰ It should be pointed out that other trade arrangements lead to different effects. For example, Turkey's customs union agreement with the EU (March 1995) implied automatically that Turkey's trade with the other Med countries is incorporated under EU trade arrangements with these countries. In other words, Turkish products are not disfavoured relative to those of the EU.

2.4.3 Financial Aid

Although the MEDA budget line was designed to replace the earlier Med financial protocols, the protocols (due to the entitlement procedure) were not actually phased out. It was decided to implement the MEDA on a parallel level with the protocols until the funds were exhausted.¹¹ MEDA was designed to cover the period 1995-1999, but only started officially in 1996 after the EU Council approved the MEDA Regulation in July 1996. Actually, the Regional Indicative Programme under MEDA started as late as 1997. Table 3 cites the committed amounts of aid to the Med countries from the MEDA budget line exclusively.

The total reference amount allocated to MEDA is euro 3.4b. Some 90% of this are committed on a partner by partner basis (from which Israel, Cyprus and Malta will not benefit) and the remaining 10% of resources are reserved for regional activities under the RIP. This leaves about euro 3b available for the NIPs. As seen in Table 3, some 75% of this is already committed during 1996-98, but this probably overestimates the performance because some of the committed resources are from the EIB and not only from the EU budget. Only one-quarter of the committed amount was disbursed during 1996-98. It is premature at this stage to assess MEDA performance, but judging from the actual figures of disbursement so far and the fact that the amount allocated in MEDA is larger than that in all four financial protocols put together, the omens are not very encouraging.

Let us, before ending this section, look at total EU aid to the Palestinian AA. The Palestinian Authority is, as one of the signatories to the Barcelona Declaration, eligible to receive MEDA funds. Furthermore, the Palestinians also benefit from other special budget lines, some of which were established in 1986 in accordance with a guideline issued by the EU Council. Special budget lines were introduced (B7-406 and B7-701, later B7-420) for direct aid to the Palestinian AA. The EU had also set aside euro 500m for the Palestine Territories for the period 1994/98, half to be disbursed as grants (50m ecu per year) and half as loans from the EIB.

¹¹ Up to 31 December 1996, some 28% of the commitments in the Third Protocol were still unpaid. The ratio for the Forth Protocol was as high as 77%. Some 76 projects financed from the First and Second Protocols (1978-186) were not yet closed by the end of 1996. (Special Report No. 1/98. Official Journal C 089, 31/3/98)

As seen in Table 4, total EU commitment to the WBGS amounted to euro 321m during 1996-98. Some 20% of this came from MEDA and the rest from other budget lines. Actual disbursement was a little less than two-thirds of this committed amount, which is relatively high compared with other recipient countries of EU aid.

3. The EU-PA Interim Association Agreement (IAA)

The Interim Association Agreement on Trade and Cooperation between the European Union and the PLO for the benefit of the Palestinian Authority (PA) in the West Bank and Gaza Strip was signed in February 1997. Unlike other Med Association Agreements, the EU-PA Agreement is an interim one for a period of five years. The whole accord will be reviewed “no later than May 1999”, timed with the end of the interim period envisaged in the Oslo Agreements.¹² The IAA is a standard Mediterranean Association Agreement that envisages the gradual establishment of free trade with respect to manufactured products and provides for limited and reciprocal preferential arrangements for trade in agricultural commodities.

3.1 The Main Body of the Text

The EU-PA Association Agreement consists of 6 titles, 3 annexes, 3 protocols and 10 joint declarations (see Box 2). The main body of the document with respect to free trade arrangements and financial cooperation, can be summarized in the following points:

Industrial Products

Imports into the EU of products originating in the WBGS shall be allowed free of customs duties or of any other charge having equivalent effect, with the exclusion of some processed agricultural products (listed in Annex 1) on which the EU can maintain an “agricultural component” (Art 4, 6 & 7). The PA may retain, for the duration of the agreement (5 years), customs duties on specific manufactured goods (listed in Annex 2). However, these duties may not be higher than their levels on July 1st 1996. For products listed in Annex 3, the PA may impose fiscal charges not exceeding 25% of the value, but these should be reduced gradually and abolished after 5 years (Art 7 & 8). Some flexibility regarding the PA’s implementation of these articles is provided for. Furthermore, the PA is

¹² Only the sections on trade and trade-related matters are interim in other Med Association agreements (usually for 5 years). This is because trade arrangements in all Med agreements are designed to prepare countries for the year 2010 and WTO-compatible free trade in manufactured goods.

allowed to adopt “exceptional measures of limited duration to introduce, increase or re-introduce customs duties” in connection with infant industries or sectors experiencing serious difficulties, “particularly where those difficulties entail severe social problems” (Art 10). However there are restrictions on the duration, level and extent of coverage of such customs duties.

Agricultural products

Greater liberalization shall progressively be established in trade with agricultural products between the EU and WBGS:

Box 2. Euro-Mediterranean Interim Association Agreement on trade and cooperation between the EU and the PA	
Preamble	(Arts. 1-2)
Title I	Free movement of goods (Art. 3)
	Chapter 1 Industrial products (Art. 4 -10)
	Chapter 2 Agriculture and fishery products (Arts. 11-14)
	Chapter 3 Common provisions (Arts. 15-26)
Title II	Payments, capital, competition, intellectual property and public procurement
	Chapter 1 Current payment and movement of capital (Arts. 27-29)
	Chapter 2 Competition, intellectual property and public procurement (Arts. 30-34)
Title III	Economic cooperation and social development (Arts. 35-55)
Title IV	Cooperation on audio-visual & cultural matters, information and communication (Arts. 56-60).
Title V	Financial cooperation (Arts. 61-62).
Title VI	Institutional, general and final provisions (Arts. 63-75).
Annex 1	List of processed agricultural products on which the EU can retain an agricultural component.
Annex 2	List of processed agricultural products on which the PA can retain customs duties.
Annex 3	List of industrial products on which the PA will apply the schedule for tariff dismantling (as clarified in Article 8, 2).
Protocol 1	Arrangements applicable to imports into the EU of agricultural products originating in the WBGS (with one annex).
Protocol 2	Arrangements applicable to imports into the WBGS of agricultural products originating in the EU (with one annex).
Protocol 3	Definition of “originating products” and methods of administrative cooperation (39 articles and 4 annexes).
Final Act	10 Joint Declarations (e.g. Declarations with reference to Articles 33, 55, 58, 67, and 70, as well as on special support programme to Palestinian industry and on cumulation of origin), and an agreement in the form of an exchange of letters (referring to fresh cut flowers).

- ✧ Exports from the WBS: the *ad valorem* import duties on specific products (listed in Protocol 1) shall either be eliminated or reduced within the limit of specific quotas. Exportation of some of these quotas is also confined to specific seasonal periods.
- ✧ Exports from the EU: import duties on five product lines (listed in Protocol 2: live and frozen bovines, cheese, flour and feed preparations) shall be either eliminated or reduced for specific quotas.

The Agreement asserts that the Joint Committee shall examine the possibility of introducing further concessions in agricultural trade “on an orderly and reciprocal basis” (Art 14).

Payments and capital movements

No restrictions on payments for current or capital transactions or on movements of capital relating to direct investment shall be imposed. However in cases of serious balance of payments difficulties, either of the parties may adopt restrictions (for limited duration) on current transactions.

Competition, public monopolies, public procurements and intellectual rights.

Public aid which distorts, or threatens to distort, competition by favouring certain undertakings or production of certain goods, as well as monopolistic practices, are declared to be “incompatible with the proper functioning of the Agreements” (Art 30). However, the PA is allowed to use public aid to tackle specific development problems, but this should be phased out by the end of 2001. Trade distorting measures in favour of public enterprises with exclusive and special rights are also to be phased out by that date (Art 32). The parties agreed on the objective of reciprocal and gradual liberalization of public procurement contracts and that they shall “grant and ensure adequate and effective protection of intellectual, industrial and commercial property rights in accordance with the highest international standards, including effective means of enforcing such rights” (Art 33).

Economic and social cooperation

The scope agreed upon under this heading (Title III) is quite important because this sets the overall framework for the NIP for the WBS and accompanying financial support from the EU. The aim here is to support the PA’s effort to achieve sustainable economic and social development.

The focus shall be primarily on a) sectors suffering from internal difficulties or affected by the overall process of liberalization, b) areas likely to bring the economies of the EU and WBGs closer together, and c) projects designed to enhance intra-regional cooperation. Due regard of environmental and ecological balances shall be taken into account in the implementation of various projects. The Agreement refers to various areas of cooperation, specifying the goals in each case. Areas of cooperation include industry, agriculture, transport, energy, tourism, social development, investment promotion, cooperation in the areas of standardization, statistics, compatibility of laws, and financial services. Special emphasis is placed on supporting small and medium-sized enterprises in various sectors. Regional cooperation is also stressed and one of the Joint Declarations attached to the agreement asserts that bilateral cooperation is “complementary to the regional cooperation taking place in the context of the Euro-Mediterranean partnership”.

Financial cooperation

To achieve the objectives of the Agreement, a financial package is to be made available to the PA. The focus here will be on a) responding to the economic repercussions of introducing the free trade area, notably upgrading and restructuring industry, institutions which promote trading links, and promoting reforms designed to modernize the economy, b) supporting policies in social sectors, upgrading economic and social infrastructure and promoting private investment and job creation activities, services and urban/rural development, c) setting up and developing institutions necessary for the proper working of Palestinian public administration (Art 61).

Institutional set-up

A Joint Committee has been established to follow up the implementation of the Agreement and to upgrade cooperation as described in the text. The Committee shall meet annually and takes (by mutual agreement) binding decisions on both parties. Procedures for the settlement and arbitration of disputes are specified (Art 67). The document states that the Agreement shall apply “to the territory of the West Bank and the Gaza Strip” without further specification (Art 73) and that: “No later than 4 May 1999, negotiations shall commence with a view to concluding a Euro-Mediterranean Association Agreement” (Art 75).

3.2 Definition of Originating Products

The IAA asserts that, to be eligible for free trade treatment, industrial and agricultural products should comply with the “Rules of Originating Products” set out in details in Protocol 3. This Protocol is a standard document that the EU attaches to all its free trade area agreements. It defines the conditions under which a product can be labelled as an originating product from the partner country and therefore qualify for preferential treatment in the EU. All sorts of preferential trade arrangements, short of customs unions, require rules to secure that the goods eligible for preferential trade treatment truly originate in the relevant country. These rules are designed basically to deny goods produced by a third country from receiving any preference when they are exchanged by the two partner countries. Since most locally produced goods incorporate various amounts of imported inputs, the rules usually specify a maximum levels of ‘foreign’ inputs in domestic goods, (or minimum domestic inputs) beyond which the goods fail to qualify for preferential treatment.¹³

Protocol 3 defines the rules by which goods qualify as originating products. These rules fall within *four* basic general categories (see Waight 1997):

Firstly, certain types of products automatically meet the origin rule by virtue of being ‘wholly obtained’ locally. Such commodities comprise agricultural and mineral products. These are considered wholly obtained even when some of the inputs used in their production are imported. The basic rule here is that when the commodities are harvested or mined in a country, then they are ‘wholly obtained’ there.

For all other products which are not wholly obtained, certain rules of origin are applied based on the idea that imported inputs should undergo “sufficient processing” in the relevant country. This ‘sufficiency’ is measured against the following criteria.

¹³ An identical document to Protocol 3 in the IAA is included (as Protocol 4) in the EU-Israel Association Agreement as well as in other Med Associations. The rules of origin are usually the most difficult part of free trade area negotiations. The fact that these rules cover 200 pages in the agreement between the US and Mexico is an indication of their detail and importance. More than one-half of the text of the EU-Israel Association Agreement is devoted to the definition of the rules of origin. It should be noted that there are not yet internationally agreed-upon general rules of origin. The Kyoto Convention of 1974 is the only international agreement which explicitly dealt with the issue of origin, without enforcing comprehensive rules.

Secondly, imported materials are considered to have been sufficiently processed domestically if the end product is classified under a four-digit tariff heading different from the heading of any of its imported material inputs. In some cases, specific imported inputs of the same tariff heading as the output are not permitted to be used.

These two rules above, relatively simple and straightforward as they may be, are quite stringent. The second rule allows, in fact, for only a very limited use of imported inputs in the manufacturing process. Therefore, different and less restrictive rules are applied for some other goods.

Thirdly, the rules here stipulate that a specific stage in the production process of the goods concerned should take place in the partner country in order to qualify the product for the condition of origin. This rule is called the ‘processing requirements’. For example, the rules of origin for cotton fabric specify that two distinct production stages should take place in the partner country: the transformation of cotton into yarn and of yarn into fabric. For shirts, the two stages are from yarn to fabric and from fabric to shirts. Thus, regardless of added value criteria, if the two specified stages in the production process are not taking place in country X, then the EU will not consider the product as originating from this country and the goods fail to qualify for duty-free entry under the free trade arrangements.

Fourthly, the last type of rule of origin refers to the usual value-added requirements. This stipulates the maximum amount (as a percentage of the ex-works price of the finished product) of imported material allowed in the value of final products. For example, letter pads (with the tariff heading of 4820) qualify as an originating product when the value of imported material used in their production does not exceed 50% of the *ex-works price* of the letter pads. The ex-works price is “the price paid for the product ex-works to the manufacturer in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials used, minus all internal taxes which are repaid when the product obtained is exported” .¹⁴

Summary

¹⁴ This is close to the ‘factory-gate price’ and therefore is neither the fob, cif or other commercial invoice price. The concept attempts to avoid the serious problems concerning the reference point of the share of value added: should the value added refer to the price of goods or to the cost of their production? Usually the reference is the price because of the difficulties in obtaining accurate information about production costs. However, the price-based calculation corresponds usually with bias due to the presence of severe market distortions. (cf. Krishna and Kruger 1995).

In order to qualify for preferential free trade treatment, selected goods and commodities should satisfy certain rules of origins. Almost all basic commodities meet the requirements by virtue of being ‘wholly obtained’ in the partner countries. This is the case, for example, of all chapter 01 and chapter 03 (live animals and live sea products in the CN tariff-code).¹⁵ The second general rule specifies that when imported inputs are used in production, the finished product will qualify as originating if it has a different four-digit tariff heading than any of the imported inputs. This is the case for example of chapter 02 and 04 (edible meats and dairy products) in the EU Med Association Agreements. Other rules of origin refer to the specific stage in the production process (as for example with item 2707, mineral oils, where the process of oil refining must take place in the partner country). Finally, the last type of rule refers to the share of imported inputs in the value of the finished product. This is the case, for example of CN1801 (chocolates), where the value of imported materials from chapter 17 (sugar) should not exceed 30% of the ex-works price of the chocolates.

There are some exceptions to the rules of origin. In certain cases, goods continue to be eligible for preferential treatment even without meeting the stringent requirements on origin. One such exception is incorporated under what is known as the “cumulation” principle. Cumulation, in short, refers to the situation where the value-added on goods made in several countries would be “cumulated” together and considered as being made in one country. In this sense, a product would be taken as a ‘national’ or originating product from the country that exports it even if actual value-added made in that country is less than the required minimum. There are three types of cumulation: *bilateral*, *diagonal* and *full* cumulation. Box 3 elaborates in details of EU cumulation procedures.

¹⁵ The CN code is the EU 8-digit classification code (see EU Official Journal: L142 of June 6, 1995).

Box 3. Cumulation of origin of goods

The three types of cumulation are the following:

Bilateral Cumulation: this allows for cumulation between the EU itself and countries with which the EU has free trade agreements. When a partner country imports semi-finished products from an EU country, processes them further and re-exports them to the EU, the EU's contribution in the value-added is considered as originating from the country itself. Clearly, the aim of bilateral cumulation is to encourage further cooperation among trade partners. It should be noted that this operates in reverse as well: EU imports from the partner are considered as if they originate from the EU when used in products that are re-exported to the partner (Art. 4 in Protocol 3 of the EU-PA Agreement).

Diagonal Cumulation: this allows for cumulation among a particular group of countries which are collectively granted preferential trade provisions by the EU. Inputs originating from one country may be further processed in another (from within the same group) and the value-added be cumulated together to benefit from preferential treatment when exported to the EU. This aims to encourage trade and complementary treatment among the members of the preferential regional groups. Diagonal cumulation incorporates the bilateral as well, i.e., cumulation among various regional partners and the EU (thus the name diagonal).¹⁶

Full Cumulation: this type of cumulation is found in the most advanced preferential trade agreements (such as that between the EU and EFTA countries). Full cumulation incorporates the two types above as well as the cumulation of work and production processes: the whole production process which takes place in a partner country is considered as if it is taking place in the EU itself. The following examples clarify further the various types of cumulation.

Examples¹⁷

EU rules of origin for shirts are of a process requirement type. To qualify for duty-free entry into the EU, shirts should be a) locally sewn from fabric, and b) the fabric locally manufactured from yarn.

Bilateral cumulation: if shirts are sewn in Palestine from fabric imported and produced in the EU, the shirts will qualify to enter duty-free. Thus, although

¹⁶ When diagonal cumulation takes place, the country of origin is taken as the one that adds the greatest value-added to that particular product.

¹⁷ The examples build upon an idea and data provided by Waight (1997).

only a single stage in the production process took place in Palestine, the other stage in the EU is looked upon as if taking place in Palestine. The fabric should also have been produced in the EU from the pre-yarn stage. If shirts are sewn in Palestine from fabric imported from Japan (or imported from the EU but not manufactured there from the pre-yarn stage) they do not qualify as duty-free and should pay 12.5% customs (as of 1996).

Diagonal cumulation: this allows shirts sewn in Palestine from fabric manufactured in, say Jordan out of yarn imported from Egypt, to enter the EU duty-free. This is provided that a regional free trade area is agreed upon which incorporates all the involved countries.

Full cumulation: when an EFTA country imports fabric from the EU and use it to make shirts, the shirts will have duty-free access to the EU. This is the case even if the imported fabric is not of EU-origin, i.e., is not manufactured in the EU from the pre-yarn stage. The EFTA countries are treated in the same way as the EU countries treat each other in this respect.

The EU-Med Association Agreements treat each Mediterranean country (including the Palestinian AA) as a separate customs territory. This implies that, while bilateral cumulation between each of them and the EU is present, diagonal cumulation is not yet in force. This has dramatic consequences with respect to WBGS relations with Israel, as discussed in section 3.

As with other Med-Association agreements, the EU-PA Agreement deals explicitly with the potential of regional ‘cumulation’ (adding-up) of the rules of origin, i.e., of allowing products produced in different Med countries to qualify for duty-free entry into the EU. Article 25 in the IAA asserts that “The Joint Committee may decide to make the necessary adaptations to this Protocol with a view to the implementation of cumulation of origin as agreed in the Declaration adopted at the Barcelona Conference”. The idea of cumulation will be discussed later in detail. It is sufficient to stress here that the Article cited basically aims to open the door for a regional Med free trade area, using the individual EU-Med agreements as leverage for a regional cooperation framework among the Med countries themselves. One of the EU’s Declarations attached to the IAA makes this point very clear: “In line with political developments, if and when the PA and one or more Mediterranean countries concluded agreements to establish free trade among themselves, the EU is prepared to implement cumulation of origin in its trade arrangements with those countries.”

4. The Compatibility of the Interim Association Agreement with the Oslo Accords

The scope of the PA to enter into international agreements is set out in Article IX of the Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip of September 28, 1995 (Oslo II). This Article states that:

The PLO may conduct negotiations and sign agreements with states or international organizations for the benefit of the Council in the following cases only:

1. economic agreements, as specifically provided in Annex V of this Agreement;
2. agreements with donor countries for the purpose of implementing arrangements for the provision of assistance to the Council;
3. agreements for the purpose of implementing the regional development plans detailed in Annex IV of the Declaration of Principles or in agreements entered into in the framework of the multilateral negotiations; and
4. cultural, scientific and educational agreements.

The Article makes clear that, as far as import and trade policy are concerned, the PA's Association Agreement with the EU (or with any other third party) should be in line with the framework laid down in Annex V of Oslo II agreement. This Annex contains the Protocol on Economic Relations between the PLO and Israel, known also as the Paris Protocol.¹⁸

The PA has already signed a number of trade agreements with different countries, the most comprehensive of which are with the EU and Jordan. The Palestinian-Jordanian trade agreement of January 1995 has a long-term aim to achieve a free trade area for all goods. In the short term however, the agreement establishes duty-free trade for specific goods

¹⁸ The Paris Protocol allows the PA to set its own customs duty and other import charges on specific imports from third countries. The imports are specified in three Lists A1, A2 and B. Imports of goods listed in A1 and A2 are subject to quantitative restrictions as well as to specification with respect to the country of origin. There are no quantity restrictions on imports of goods from List B, but these imports should meet Israeli standards and specifications. Apart from these three Lists, PA customs duty and other import charges should be no less than those applied by Israel.

only. The PA has agreed to exempt customs duty on 77 products originating from Jordan (Lists 1&2), while Jordan agreed to exempt or reduce customs duties on a total of 60 products originating from the WBS. Lists 1 & 2 in the PA-Jordanian trade agreement are in line with the lists of goods over which the PA has competence in the Paris Protocol.

Israel argues that, unlike the PA-Jordanian agreement, the PA- EU agreement is a breach of Article IX of Oslo II. Israel maintains that the Article does not permit the PA to enter into independent trade agreements of the Mediterranean Association type. This is mainly because Med-Association Agreements, with the incorporated free trade arrangements, imply contractual relations between two independent entities with defined geographic sovereignty. The PA-Jordanian agreement, Israel maintains, is not a free trade agreement between entities with implied borders, but a protocol, a trade agreement limited to lists and specific quantities in conformity with the provisions set out in the Paris Protocol. The trade protocol between the PA and Jordan does not imply territorial definition of the WBS, nor an exercise of independent decision-making on the part of the PA other than that specifically provided for in the Paris Protocol.¹⁹ The root of the problem is founded in the Paris Protocol and other PLO-Israeli Agreements. Although "economic ties with other markets" were recognized, the practical enactment has revealed sharp differences concerning the scope of PA decision-making with regard to many central issues, including relations with third parties. Not surprisingly, the differing interpretations reflect the conflicting political goals and economic interests of the two sides.

The argument, seen from a purely technical perspective, is about the type of trade regime envisaged by the Paris Protocol between Israel and the WBS. Is it a full customs union? The answer is probably no, if only because of the PA's right to have its own import policy with respect to the three Lists. Actually, the term 'customs union' does not exist in any of the signed documents between the two parties. The question which remains is whether the PA is allowed to set its own import policy with third parties.

¹⁹ Israel informed the WTO Council on Trade in Goods, on July 22, 1997, that it had reservations about the EU-PA Interim Association Agreement. Since all free trade agreements should be unanimously accepted by all WTO members before becoming internationally recognized, the issue was sent to the WTO Panel for review. In February 1998, the Israeli Foreign Ministry's deputy director-general for economic affairs, Victor Harel, voiced his concern at the European Council's call for the full and rapid implementation of the EU-PA agreement. He argued that this would encourage the contravention of the Paris Protocol.

The PA and EU argue that the deviations from the standard rules of customs unions in the agreement with Israel are of major significance and permit the WBGS to be legally identified as a separate ‘customs territory’.²⁰ The problem is complicated because the trade regime envisaged in the Paris Protocol is without parallel and does not fit into any standard, recognized form of economic cooperation.

Israeli concerns are understandable. The EU-PA Association is a *de jure* instrument which recognizes the Palestinian and Israeli markets as separate and the WBGS as an international trading entity. Free trade accords, under WTO rules, are deals between autonomous customs territories. Thus, by signing a free trade agreement with the PA, the EU is indirectly cementing the separate status of the WBGS.²¹

The Israeli position is not regarded as legally sound by EU member states. The European countries (EU and EFTA) as well as Canada, have chosen to use the scope provided in the Paris Protocol to formalize trade relations with the WBGS. They maintain that the autonomy legally assumed by the PA makes the Israeli claim of the existence of a single “customs envelope” during the transitional period invalid. The EU has clearly stated that it wishes the PA to be on an equal footing with other Mediterranean countries in the Barcelona program.

On a more practical level, however, the issue for Israel boils down to whether the PA has offered more trade concessions to the EU than the EU already has in its free trade agreement with Israel. The following section illustrates that this is hardly the case. First, the important distinction between ‘customs envelope’ versus ‘customs territory’ should be explained.

4.1 The Issue of Cumulation

The economic motives behind Israeli opposition to the EU-PA trade accord should not be underestimated. Recognition of the WBGS as a

²⁰ According to Article XXIB:2 of GATT, a customs territory is any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of the trade of such a territory with other territories.

²¹ This explains the significance of the US decision to “extend” its free trade area agreement with Israel to incorporate the WBGS rather than signing a new separate trade agreement with the PA.

separate customs territory should, in principle, put an end to Israel's practice of "smuggling" products from the illegal settlements (and East Jerusalem) into international markets as products from Israel proper. During the years of occupation, WBGS markets were *de facto* integrated with the Israeli market. This implied that the WBGS market was open to Israel's free trade partners (the EU and US) and that goods produced in the WBGS could, in theory at least, automatically benefit from Israeli free trade arrangements with other countries. Products from Israeli settlements in the WBGS also benefited from duty-free entry into the EU and other markets. The existence of what may be termed as 'forced cumulation' gave Israel a sort of legitimacy to export goods produced in the WBGS, and thereby from the settlements despite the fact that the international community does not recognize them as part of Israel.²²

The EU expressed dissatisfaction with Israel's lack of adherence to the terms of agreement and made it clear that products from the settlements are not eligible for duty-free entry into the EU. A similar view was also expressed recently by Canada.

The long-term EU vision for the Mediterranean is of a free trade region where various forms of cumulation of origin among all the Med countries would be allowed. Furthermore, all EU Med Association Agreements openly state the possibility of introducing the principle of cumulation between two or more Med countries in future.²³ In the current case, this requires a formal agreement on the issue among the three concerned parties: the EU, Israel, the PA.

Naturally, the cessation of *de facto* and 'forced' cumulation between Israel and the WBGS has some negative effects on the Palestinian economy as well. In fact, Israel claims that Palestine has more to lose than Israel. The Palestinians stand to lose considerable job opportunities because of the high dependency of manufacturers on Israeli semi-finished products and many WBGS manufacturers work on a sub-contracting basis for Israeli exporters (textiles and shoes). Neither the WBGS products that use

²² Article 7 in the EU-Israel Association Agreement states that "The provisions of this chapter [Chapter 1, Basic Principles for Free Movement of Goods] shall apply to products originating in the Community and in Israel...". The same principle is re-asserted in Article 83: "This Agreement shall apply...to the territory of the State of Israel".

²³ One of the EU's Declarations attached to its Agreement with Israel states that: "In line with political developments, if and when Israel and one or more other Mediterranean countries conclude an Agreement to establish free trade among themselves, the European Community is prepared to implement cumulation of origin in its trade arrangements with those countries".

substantial Israeli inputs, nor Israeli products assembled or sewn in the WBSG would qualify for duty-free entry into the EU.

However, the political implications at stake for the PA are far too high. Therefore, the PA would most probably insist on the proper implementation of the agreements, especially the rules of origin. The issue is also of major significance for the EU. Israel's case is particularly weak here and the Israeli Government would probably attempt to arrange a trade-off deal between accepting the EU-PA accord in return for maintaining the *status quo* with respect to the rules of origin and cumulation.

5. Trade Concessions in the Interim Association Agreement Relative to other Med Agreements

The aim of this section is to present the specific trade concessions incorporated in the IAA and to assess their potential value to the WBGS economy. The concessions will be compared with those between the EU and Israel in their Association Agreement. The PA has had an opportunity to choose between extending the EU-Israel agreement to formally cover the WBGS (as the US did) or to negotiate and sign a separate agreement with the EU. Notwithstanding the obvious political significance of the latter, the fallback position for the new PA trade arrangements should be the Israeli arrangements themselves. In other words, EU trade concessions to the WBGS should not be less than those granted by the EU to Israel. However, the quasi-customs union between the WBGS and Israel imposes strict limits on the potential benefits from the extra-concessions granted to the WBGS with respect to imports from the EU.

5.1 Industrial Products

The EU-PA trade arrangements are interim arrangements incorporating asymmetrical treatment with respect to manufactured goods. The non-reciprocal character is limited to a transitional period in order to comply with WTO rules. The Agreement envisages that a full reciprocal free trade area with respect to industrial goods will be established in 2001. There are two examples of the lack of reciprocity in the agreement:

- ✧ The PA is allowed to levy fiscal charges (not exceeding 25% in value) on specified products originating from the EU. These products are listed in Annex 3 of the Agreement. The charges shall be gradually abolished over a transitional period of five years from the date of entry into force of the agreement (Article 8). The same Article provides for some flexibility but stresses that the transitional period can be extended only by a maximum of one year. Annex 3 includes six goods: candies, chocolate, biscuits, chips and snacks, terry bathrobes and towels.

- ✧ Infant industries: the PA may take exceptional measures to “introduce, increase or re-introduce” customs duties in connection with “infant industries”, sectors undergoing restructuring or sectors experiencing serious difficulties. Customs duties in these circumstances should not exceed 25% in value and they are limited to a period of five years (Article 10).

Trade arrangements with respect to manufactured products between the EU and Israel are now considered to be fully reciprocal and symmetrical. As pointed out earlier, the current EU-Israel agreement builds upon the earlier free trade agreement signed in 1975. Israel received substantial non-reciprocal concessions from the EU during a long transitional period, including the right to protect its infant industries. Israel’s right to levy tariffs on European products which compete with its own domestic products was extended up to 1998, i.e., for 10 years beyond the originally envisaged transitional period.

Both the Israeli and Palestinian free trade arrangements are subject to the stringent EU rules of origin, which have potentially positive political consequences but also negative economic effects on the WBGS. The delicate issue of cumulation is not tackled in the IAA. However, the EU trade concessions in connection with WBGS industrial imports are meaningless under the current trade regime between the territories and Israel. Concessions related specifically to relaxing the conditions of origin on WBGS manufactured exports would be far more meaningful and significant. This should be undertaken in an imaginative manner to maintain the ‘political’ gains from them and reduce negative economic effects on the WBGS economy.

5.2 Processed Agricultural Products

The EU provides generous support to farmers in the form of high prices for produce, along with other support. The EU’s support scheme known as the Common Agricultural Policy (CAP), covers agricultural commodities as well as agricultural products which are “products of first-stage processing directly related to products of the soil”. The commodities and products which are incorporated under the CAP are cited in the Treaty of Rome, the EU’s constitution, and are explicitly excluded from all EU free

trade arrangements with other parties. This is also the case in all EU-Med trade agreements, including the agreements with Israel and Palestine.²⁴

Agricultural products are usually subject to two different types of charges upon entry into different countries: the 'agricultural component' and customs duty.²⁵ Both agreements with Israel and the PA reserve the right of the EU to impose agricultural components on 26 main product lines (with 4 digit CN customs classifications). The lists are attached as Annex 1 and Annex II to the EU-PA and EU-Israel agreements respectively. The IAA binds the level of charges that can be imposed on these goods. Article 7 in IAA states that: "The PA may retain for the duration of the agreement customs duties on imports and charges having equivalent effects not higher than those in force on 1 July 1996". No such constraint is imposed on Israel's agricultural component (except for the restrictions imposed on Israel in relation to its commitments within the WTO).

In return, Israel is allowed to retain agricultural components on nine product lines (Annex IV), while the PA is allowed to retain customs and other charges on five product lines only (Annex 2). Unlike Israel, the PA is denied the right to impose customs on WBGS imports from the EU of ice cream, alcohol and spirits obtained from grapes and egg albumin. Furthermore, while Israel maintained the right to "enlarge the list of goods to which this agricultural component applies provided the goods are other than those listed in Annex V and are included in Annex II" (Art 9), no such right is granted to the PA.

Trade concessions with respect to processed agricultural products refer to reduction of the agricultural component and/or reduction of tariff. Israel is committed to provide concessions on the agricultural component on six product lines: ice cream, alcohol and sprits obtained from grabs, pasta and various types of bread with or without dairy products (Annex VI table 2). In return, the EU offers concessionary agricultural component on 11 Israeli products: sweet corn, chocolates, food prepared from cereals, and bread and pastry (Annex VI table 1). A 30% reduction of the EU agricultural component on these products (within a limited annual quota)

²⁴ Note that the exclusion of these agricultural and processed goods works in both ways, i.e., with respect to export to and import from the EU. In as far as exports to the EU are concerned, the EU-Israel agreement adds one extra item to the exclusion list: albumins in various forms (Annex I).

²⁵ The 'agricultural component' is calculated on the basis of the difference between the prices of the agricultural products used in the production of a certain product and the prices of imports of the same products from third countries. The component may take the form of a flat amount or an ad valorem rate (Art 9 of EU-Israel Agreement).

is applied on almost all of these products. Israel and the EU have also agreed not to impose agriculture components on 13 European products (when imported by Israel) and one Israeli product when imported by the EU.

Table 5 below summarizes trade concessions in terms of the number of product-lines and shows that no concessions on the agricultural components are adopted in the IAA, either with respect to import or export. Although neither the range of products nor the level of concessions envisaged between the EU and Israel in this particular area may be of great significance to the economy of the WBGS, the absence of similar concessions in the IAA is, nevertheless, peculiar. The quasi-customs union arrangements between Israel and the WBGS implies in reality that whatever trade concessions Israel made to the EU, these are automatically extended to the EU over the WBGS territories. Therefore, when these trade concessions are not balanced by preferential treatment to WBGS products, the PA would be making one-sided concessions. This will be the case especially when the EU trade concessions to Israeli exports are bound by quotas. When concessions are not tied to specific quotas, the asymmetrical treatment would negatively affect direct trade relations between the EU and WBGS, leading to a diversion of exports and imports.

The point is that since all trade concessions which are provided by Israel to the EU are automatically also extended by the PA, then EU trade concessions should be the same to both parties. In other words, if the EU-Israel trade agreement is fully reciprocal, then if the EU trade concessions to the WBGS are less than those extended to Israel, the EU-PA agreement would be seem to be non-reciprocal in favour of the EU!

5.3 Agricultural Products

The treatment of trade concessions related to agricultural commodities shall be divided into two parts, first with respect to imports from the EU, second with respect to trade concessions offered by the EU when importing these commodities.

Exports from the EU

The PA agreed to extend reductions of import duties, within specific tariff quotas, on six agricultural commodities when imported from the EU. The similar list in the EU-Israel agreement include 82 items (both figures are based on 6 digit CN code, see Table 5).²⁶ The list for the WBGS includes live bovine, frozen bovine boned meat, flour of common wheat, preparation for animal feed, cheese and curd. A part of the US \$4 duty per kg on cheese and the duties on the other five items are eliminated within the tariff quotas. Cheese and curd is also the only item that can be found in both the Israeli and Palestinian lists (with the same duty of \$4 per kg). The other five EU products guaranteed concessionary duties when imported into the WBGS are not included in the list for Israel. The great majority of the EU commodities which can be exported to Israel with some duty concessions cannot be found in the list for the WBGS.

Exports to the EU

EU trade concessions with respect to agricultural imports is the main area of interest, particularly to the WBGS. This is not only because this is where the WBGS comparative advantages presumably lie, but also because agricultural trade is the least liberalised and concessions in this area still make a considerable impact. The EU's agricultural trade concessions are strictly limited: they refer only to a reduction of *ad valorem* customs duties on specific produce within limited seasonal time-periods (to reduce the risk of competition with domestic produce). Also, in order to safeguard the European market and maintain the initiative in EU hands, the limited trade concessions are incorporated in an elaborate and complicated framework.

²⁶ The CN-code is the Combined Nomenclature Customs Code. It consists of eight digits. When the code is preceded by 'x', this means that the code and the description of the items are to be taken together when determining the items which benefit from the concessions.

A standard protocol in all EU-Med free trade agreements is devoted to “the importation into the EU of agricultural products”. The Protocol includes a table like the following:

(1) CN Code	(2) Description	(3) Reduction of the MFN customs duty, %	(4) Tariff Quota (tonne)	(5) Reduction of duty beyond the tariff quota %	(6) Reference quantity (tonne)
xx	Tomatoes (1.2-31.3)	100%	-1200	60%	1,000
yy	Strawberries (1.11-31.3)	100%		0	-

The first column refers to the CN code number of the product concerned. The second column cites the name of the product along with the specific time period during which the concession on imports into the EU is applied. For example, WBGs exports of tomatoes benefit only during a two-month period: from February 1st to March 31st.

There are three categories of commodities in the table:

Firstly, commodities for which a tariff quota is specified (as strawberries in the table). The WBGs can export a tariff quota of 1,200 tonnes (column 4) on which the tariff will be reduced by 100% as indicated in column 3 (relative to that imposed on imports from other WTO members). Note that this concession is extended only when the EU imports strawberries during the November-March time period. The tariff on any quantity exceeding the 1,200 tonnes (or imported other than during November-March) will be reduced by the percentage cited in column 5 (no reduction for strawberries).

Secondly, commodities for which a reference quantity is specified (as in the case of tomatoes in the table). Imports of these benefit also from the tariff reduction cited in column 3. However, should the volume of imports exceed the reference quantity, the EU may transfer this reference quantity into tariff quota. In this case, the quantity imported in excess of the quota will be charged customs duty as indicated in column 5.

Thirdly, commodities for which neither tariff quota nor reference quota is specified. Here, the EU may fix a reference quantity for the product concerned if it “establishes that the volume of imports ... threatens to cause difficulties to the Community markets”.

Over 17 agricultural commodities originating from the WBGS benefit, in one form or another, from the aforementioned types of concessions when exported to the EU (Protocol 1). The list of these commodities is reproduced in table 6 below. The EU-Israel agreement provides preferential treatment to 59 agricultural commodities originating from Israel. Table 6 also cites the trade concessions granted by the EU to Israel on the same 17 items that are included in the IAA.

Of course, the range and scope of agricultural production is far wider in Israel than in Palestine, thus the difference in the number of commodities as well as in the volumes. Yet, it is still surprising that some traditional WBGS produce (or potential exports) cannot be found in the IAA list and, therefore, are not granted concessionary treatment on exportation to the EU. These include, for example, new potatoes, cherry tomatoes, table grapes, plums, apricots and orange juice. It is remarkable that all of these products can be found in the Israeli list. An agricultural economist, de Pascal (1996) in a study sponsored by the EU itself, recommended adding a long list of extra WBGS agricultural produce to receive preferential treatment from the EU. His list is reproduced as an appendix to this paper. Only one item from that long list (wild onion) was actually included in the signed IAA agreement. The tariff-quotas/reference quantities cited in the IAA for various products are also not impressive. De Pascal recommended that tariff quotas for cut flowers and strawberries should be increased to 4000 tonnes each from the proposed levels of 1500 and 1200 tonnes in the agreement. He also recommended an increase in the reference quantity for lemons by around 90% to 1500 tonnes.

To compare EU trade concessions on the same 17 items in various Med agreements, it can be seen from table 6 that tariff quotas are fixed for two WBGS products only (cut flowers and strawberries) while they are fixed for almost all the 17 products in the case of Israel. This reflects a more flexible treatment of the WBGS, taking into account uncertainty about how much the territories are actually able to export. The time periods during which exports are permitted are more or less the same for Israel and the WBGS. The more favourable time-periods awarded to Israeli tomatoes and aubergines are balanced by more favourable treatment of WBGS vegetables and fruits (071080 and 2001 2090). Also, the tariff treatment is the same for the major products in the lists (citrus, onions, melons, aubergines). The reduction on duties on tomatoes (beyond the tariff quota/or reference quantity) is 60% for the WBGS but is zero for Israel. This is, once again, balanced by an inverse treatment of

strawberries. Various types of vegetables (070960, 071080, 09042039 & 200190) originating from the WBGS are more favourably treated upon exportation to the EU (beyond the undetermined reference quantities).

Table 7 cites EU preferential treatment of the same 17 products in the free trade agreements with Tunisia and Morocco. In these cases also, WBGS exports of the vegetables cited above are more favourably treated. However, some important produce (oranges, mandarins and lemons) are granted better trade concessions in the agreements with Tunisia and Morocco than in the IAA. The time periods are also more favourable for Tunisia than for WBGS with respect to tomatoes, aubergines and courgettes.

It is possible to conclude that preferential treatment by the EU of WBGS agriculture produce is more or less in line with the concessions granted by the EU to the same products originating from other Mediterranean countries, and from Israel in particular. This is somewhat surprising given EU rhetoric on the importance of supporting economic development in the self-ruled territories.

To be fair, one should point out that the EU confronts a peculiar dilemma. It is attempting to have two separate free trade agreements with two entities between which the trade regime is neither clearly defined nor perfectly transparent. Therefore, any extra trade concessions to WBGS exports may turn out to be extra concessions to Israeli products. On the other hand, all EU international trade agreements are usually built on the basis of actual levels of trade flows. For example, when Tunisia and the EU negotiate the volume of tariff quota on oranges, the discussion would be based on the actual level of EU imports of Tunisian oranges. However, actual WBGS exports to the EU are negligible. The PA argues, quite rightly, that this situation is due to deliberate Israeli policies and should not be taken to mean that the EU markets are insignificant for Palestinian produce. Actually, some WBGS agricultural commodities have been reaching the EU as Israeli products. The PA also argues that securing outlets to lucrative markets can be an important incentive to expand production and exports.²⁷

²⁷ The production and export of turkey meat is a case in point. Although considerable EU concessions are given to Israeli turkey meat, none are given to the WBGS. The WBGS does not currently produce turkey meat but the potential for this is thought to be high (interview with PARC). Israel prohibited turkey farming in the WBGS throughout the years of occupation to protect its own producers.

6. Recommendations

- ✧ It is important to stress from the outset that the economic problems of WBGS are not exclusively confined to the issue of access to the outside world and EU markets. Access was/is the most urgent issue during past and still current turbulent relations with Israel. However, once the blockade is lifted, the real problems of the WBGS will certainly appear in the absence of capacity to produce items for eventual export, i.e., to produce a variety of goods in a competitive manner. Within this overall perspective, the integration of the aid package with the trade arrangements in the Med-Initiative must be of vital importance to the WBGS. The main purpose of such integration is not merely, as stressed in Barcelona Declaration, to help the country to restructure as EU goods gain free access to domestic markets, but rather to finance a programme for the re-establishment of productive capacity. The negative effects of EU (plus US and Israeli) free access to WBGS markets have actually taken place during the past three decades through the *de facto* annexation with the Israeli market. The need to integrate the EU's aid package with trade arrangements for the WBGS implies a deliberate strategy which combines aid to establish or revive productive activities with trade concessions. The basis of such an approach can already be found in the Joint Declaration of Support for Palestinian Industry attached to the IAA.

- ✧ This approach requires that the PA formulate an overall comprehensive vision of where financial aid (both from the EU and from other sources) should be used. Eligibility for receiving EU aid, as described earlier, has changed dramatically. The old concept of entitlement is replaced by performance. Bilateral contractual arrangements have been replaced by a system where funds can be adjusted, during the budgetary period, both within and between bilateral NIP and RIP. Efficiency in implementation and in attaining pre-determined goals are now important criteria for the allocation (or withdrawal of previously allocated) funds. The beneficiary country is therefore called to play an important role. Unfortunately, the Med countries in general, and the PA in particular, are not fully aware of the serious implications of this new approach (see. Cowi Report, p xii). The drawing-up of a NIP is an exercise in

formulating a future overall vision of development. Implementation and follow-up are indispensable to aid disbursement. The EU should assist the PA in training specialized teams in various key ministries as a means to secure a minimum chance of success for its new approach in aid. The training should concentrate on project formulation, project assessment, follow-up and, not least, on the art of coordination. Taking into account the importance of NGOs and private sector organizations in this new scenario, the role of PA teams should include coordination among public institutions as well as between the public and private bodies. The type of skills most required, also once aid comes to an end, is learning how to formulate credible projects, how to coordinate among various agents/interest groups, and how to be accountable for achievements. Without compromising the relevance of the projects stipulated in the overall development strategy, the support of teams would be to maximize aid disbursement and to extend WBGS involvement and benefits from the RIP. Such rigorous activities to capture aid and to deploy it productively in accordance with a national strategy, would make it possible to identify possible shortcomings by the EU with respect to disbursement procedures as well as with the volume of aid.

- ✧ The question of whether it is more beneficial for the WBGS to sign a separate agreement with the EU or to be incorporated under EU-Israel arrangements is a moot issue. For Palestinian policy makers, the political significance of being an independent actor in the Euro-Mediterranean scene outweighs any other considerations. The fact that the separate agreement triggered the technical issue of cumulation, leading the EU to reaffirm its position that settlements in the WBGS are not part of Israel, is testament to its political significance. In addition, a separate agreement is also more beneficial for the WBGS because Israel is not eligible to receive bilateral grants from the MEDA. Furthermore, Israel has already had its long transitional period before adopting an almost reciprocal trade arrangement with the EU. Yet, PA negotiators should keep in mind that the EU-Israel agreement must be their fallback position. Almost all trade concessions granted by Israel to EU products are also automatically granted by the WBGS. Therefore, EU trade concessions to the WBGS should not, in principle, be less than the concessions granted to Israel.

- ✧ The real significance of trade concessions with respect to EU manufactured exports to the WBGS in the IAA agreement is questionable indeed. What benefits can the WBGS gain by having the right to impose 25% tariff on some EU goods, when these goods can enter tariff-free into the WBGS via Israel? Clearly, trade relations between the WBGS and Israel impose limits on the real significance of any concessions extended to the WBGS (with respect to imports from the EU). The PA should not extend more favourable concessions to EU exports than those already granted to the EU by Israel otherwise the EU-PA agreement would become incompatible with the Paris Protocol governing economic relations between Israel and the WBGS. These two aspects stress that any future agreement between the WBGS and the EU should take the trade regime between Israel and Palestine as a basic point of departure. As long as a semi-customs union exists between the WBGS and Israel, restrictions on EU manufactured exports in the EU-PA agreement are meaningless. On the other hand, if EU agricultural products are treated differently in the EU-PA agreement than in the EU-Israel agreement, then Israel would have a case in challenging the agreement as incompatible with its own trade regime with the WBGS. In short, under the current trade regime with Israel, PA negotiators should not concentrate on granting or withholding trade concessions to EU exports but on EU trade concessions to WBGS exports.
- ✧ Although it is hardly conceivable to envisage that the WBGS should extend more favourable concessions to EU agricultural produce than those extended by Israel, this is possible in principle without violating the terms of Paris Protocol. The Protocol allows the PA to grant special trade concessions to EU agricultural exports as long as these are found in List A2 (List A1 is for WBGS imports from Arab countries and List B does not contain agricultural or food products). However, it is not advisable for the PA to use the relatively small quotas of A2 for concessionary arrangements with the EU. These quotas are greatly in demand in PA trade agreements with neighbouring countries where reciprocity is usually unavoidable.
- ✧ The crucial area of interest must be EU trade concessions to WBGS exports and this is where trade negotiations between the EU and the PA should concentrate. PA delegates should seek favourable treatment for WBGS exports to the EU through easing the stringent

restrictions on origin for manufactured exports and better trade concessions to agricultural commodities.

- ✧ One of the problems related to EU trade concessions to the WBGS was the uncertainty about what and how much the WBGS could export to the EU. Actual performance since the signing of the IAA has not helped to clarify approximate guidelines in this respect. Therefore, future EU-PA agreements are bound to be formulated under the same degree of uncertainty as the IAA with respect to commodities and quantities. As argued previously, the range of WBGS agricultural exports granted preferential treatment is surprisingly limited in the IAA. Also, the concessions, tariff quotas and seasonal conditions on the limited number of commodities do not reflect particularly special treatment of the WBGS. PA negotiators should work on three fronts: to widen the range of products which receive preferential treatment, to increase the volume of tariff quotas and to improve the level of concessions. In a few cases, an effort should also be made to adjust the time-periods during which preferential trade is applicable (for example, adding December and the first half of January for the export of aubergines). PA delegates need access to as accurate and detailed statistical data as possible on WBGS production and consumption. This is a real challenge, especially in the absence of explicit trade-flows between the EU and the WBGS. In practice, delegates must secure preferential access for products that the WBGS may not currently be producing but which can /will be produced in future. De Pascal (1996) proposes the introduction of an “evolutionary clause” in the agreement, whereby tariff quotas would be allowed to increase gradually from one year to another. He suggested this “staging mechanism” with respect to three products: strawberries, strawberry jam and juice, and cut flowers. PA delegates can strengthen their case by dropping demands related to restrictions on EU manufactured exports and to greater restrictions on EU agricultural exports than those already in place between the EU and Israel. Eventually, the idea of a conditional increase in tariff quotas may be contemplated: a commitment from the EU to increase the quotas once specified development schemes are carried out and production has increased. Finally, it is crucial to understand that the ability of WBGS to fulfil the tariff quotas, even those which are already envisaged in the IAA, requires reconstruction of the whole export infrastructure. Thus, the need to integrate aid with trade arrangements as referred to earlier.

- ✧ One of the major concerns of the EU when offering relatively generous concessions to WBGS agricultural exports would probably be the fear that these will ultimately benefit Israeli rather than Palestinian farmers. This is a legitimate concern that requires particular assurances from the PA. Although the issue of fungibility (that allowing greater WBGS exports to the EU may give Israeli produce a larger market in the WBGS) cannot be totally avoided, PA demands for more favourable treatment should be supported by convincing guarantees with respect to the authenticity of the rules of origin. The challenge for the PA is to demonstrate to the EU that its procedures for documenting the authenticity of the origin of WBGS produce will be a model of absolute transparency and professionalism.

- ✧ On the issue of the rules of origin and the delicate issue of cumulation, the EU have used the opportunity of recognizing the WBGS as a separate customs territory to prohibit Israel from extending EU preferential treatment to products from the settlements. The EU has chosen to implement that prohibition in an indirect manner, denying the possibility of cumulation between the WBGS and Israel rather than directly on the basis of the internationally recognized borders of the State of Israel. That choice implies, unfortunately, that Palestinian manufacturers will also be punished. The cumulation issue puts the PA delegates in a serious dilemma. On the one hand, and until a satisfactory political arrangement is achieved, it is vital to insist that the cumulation principle should not be applied between Israel and the WBGS, as long as this means that products from settlements cannot enter EU markets. On the other hand, absence of cumulation probably has considerable adverse effects on the WBGS economy since it covers all exports with a relatively high proportion of Israeli inputs, including the important sub-contracting activities. A discussion as to why the EU has chosen this indirect route rather than the more direct argument based on clear international conventions, is outside the scope of this paper. The insistence on non-cumulation actually undermines the core principle of the Med-Initiative that envisages a regional Mediterranean Free Trade Area. Based on these arguments, it is conceivable for PA delegates to request measures to shelter the WBGS economy from the negative effects of the EU approach. A substantial reduction in the percentage of domestic value added required in a WBGS product is an example of such a measure. In

this sense, a sort of one-sided cumulation between WBGS and Israel (but not the settlements) would be allowed. Furthermore, several experts have pointed out that the benefits to developing countries from EU preferential treatment are severely impaired by the complexity of the rules of origins and the stringency of standards, health and minimum quality requirements. These are general problems that are regularly discussed in various forums. PA delegates should keep an eye on current Lomé negotiations where the EU is expected to make some revision and simplification of the rules of origin with respect to the Least Developed Countries.

- ✧ The EU is not totally open-handed in granting preferential treatment to its trade partners. With respect to WTO as well to the need for the EU to be consistent with various trade partner, concessionary measures to the WBGS are bound to be of a temporary nature. Most preferential margins will automatically decline as the momentum of world trade liberalization proceeds in coming years. The experience of the ACP countries shows clearly how the process of international trade liberalization deprived them of most of the preferential privileges they had earlier with the EU. Palestine should learn from this and ensure that trade privileges are no longer simply breathing intervals to build competitiveness, but rather guaranteed opportunities lasting forever.

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