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Embracing Free Trade: The EU's Economic Partnership with Algeria

In recent years the European Union (EU) has concluded a new generation of agreements with its Mediterranean partners as part of a new initiative known as the Euro-Mediterranean Partnership. The following paper takes the example of Algeria and examines the likely impact of the progressive formation of a bilateral free trade area on the participating economies.

The last decade of the 1990s saw the EU taking stock of its links with its traditional partners on the southern and eastern shores of the Mediterranean. Prompted by the shortcomings of its previous development cooperation policy and, more importantly, by its desire to maintain its strong economic position in the region in an increasingly globalised world, the Union launched a new initiative, known as the Euro-Mediterranean Partnership (EMP).[1] It was endorsed by both parties at the Barcelona Conference in 1995.[2] At the heart of this policy approach – with its ambitious and broad coverage of political, economic, and socio-cultural issues – is the principle of partnership that is intended to govern the EU's relationship with the Mediterranean partner countries.

In addition to its multilateral dimension, involving the promotion of cooperation in various sectoral areas of common interest to the region, the implementation of the aims of the EMP are also carried out by means of association agreements. It is within this bilateral framework that Algeria concluded, after protracted negotiations, an association agreement with the EU in April 2002.[3] Its main component is the progressive formation of a free trade area (FTA), which is expected to be fully operational after a twelve-year transitional period. It is set to have, at least in the short run, disruptive effects on the Algerian economy, while it may have the potential to bring benefits in the longer term.

To examine the FTA and its likely impact on Algeria, this paper starts with a succinct background, outlining the nature of, and certain features associated with, the relationship between the two sides. Subsequently, the paper considers the various dimensions of the policy as embodied in the association arrangement with more emphasis on its trade element. Finally, it highlights some of the implications – in terms of costs and potential benefits – consequent upon the liberalisation by Algeria of its trade with the EU.

Facets of an Unbalanced Relationship

Involving two economically unequal actors is the distinctive feature that perfectly characterises the relationship between the EU and Algeria.[4] On the one hand, there is a very much developed and more and more integrated European economy. On the other hand, there is a North African country with its economy still at an early stage of its development and, on the whole, based on exports of mineral products, notably hydrocarbons. Typical of such a relationship – showing evidence of a high degree of asymmetrical interdependence – would be a situation where one partner is little affected by a change in this relationship whilst the other one is significantly affected. This characterisa-

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[1] European Commission: Strengthening the Mediterranean Policy of the European Union: Establishing a Euro-Mediterranean Partnership, Communication from the Commission to the Council and the European Parliament, COM(94) 427 final, Brussels, 19 October 1994; Strengthening the Mediterranean Policy of the European Union: Establishing a Euro-Mediterranean Partnership, Communication from the Commission to the Council and the European Parliament, COM(95) 72 final, Brussels, 8 March 1995.

[2] At the time, this involved the 15 EU countries and Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey, and the Palestinian National Authority. Both Cyprus and Malta joined the EU in May 2004, and Turkey is still negotiating its membership while currently having a customs union with the EU.

[3] The negotiation process was launched in October 1993. This corresponded to Algeria's formally expressing its readiness to engage in talks to conclude an association agreement.

[4] Ahmed Aghrout: From Preferential Status to Partnership – The Euro-Maghreb Relationship, Aldershot 2000, Ashgate Publishing Limited, pp. 14-17.

Table 1
Algeria's Trade with the EU

	2001	2002	2003	2004[a]	2005[a]
Exports					
Value (billion ECU/Euro)	16.2	14.4	14.6	15.3	20.8
% (of extra-EU trade)	1.6	1.5	1.6	1.5	1.8
Imports					
Value (billion ECU/Euro)	7.7	8.3	8.0	9.5	10.4
% (of extra-EU trade)	0.9	0.9	0.9	1.0	1.0

[a] EU-25.

Source: Eurostat: External and Intra-European Union Trade – Monthly Statistics, No. 10, 10 October 2006, pp. 40-41.

Table 2
Trends in Algeria's External Trade

	2000	2001	2002	2003	2004
Exports					
Total exports (million dollars)	20,540	18,319	18,528	24,939	31,882
EU (%)	67.5	64.3	64.0	59.8	54.5
Imports					
Total imports (million dollars)	9,027	9,750	11,809	15,382	20,715
EU (%)	59.6	62.3	57.4	64.5	62.1

Source: IMF: Direction of Trade Statistics Yearbook 2005, Washington, DC 2005, IMF, pp. 51-52.

tion implies that the dependence of one side (Algeria) is clearly much greater than that of the other side (EU). Algeria, as the more dependent and thus vulnerable side, needs the benefits – mainly of an economic nature – from the relationship more than the EU does.

As the less dependent party in the relationship, the EU benefits from substantial room for manoeuvre in initiating changes and minimising (making less costly) the impact of the change on itself. This is because the Union has significant political, economic and other resources at its disposal to do so. Yet as far as the EU is concerned, this does not amount to a lack of interest in the relationship. Migration pressures and energy supplies are areas of clear European interest, and are felt particularly strongly by the southern EU Member States.[5] The economic problems and political instability experienced by Algeria in recent years have been causes for concern in a number of EU countries.

By and large, a brief comparison of a number of key economic indicators reveals how obvious the asymmetrical dimension of the relationship is.[6] To start with, the GDP of the EU stood at $12,690.4 billion in 2004, compared to $84.6 billion in Algeria, which thus represented about 6.4% of that of the EU.[7] Another trend worth mentioning is that Algeria has a gross national income per capita of $2,280 against the average of almost $22,401 in the Union.[8] In the area of trade, Algeria accounts only for a small proportion of the Union's total external trade in value terms (cf. Table 1). By contrast, the Union has been Algeria's biggest trading partner, absorbing more than 62% of its exports and providing approximately 61% of its imports on average (cf. Table 2).

Main Issues of the Partnership Deal

The EMP policy, formalised at the Barcelona Conference in November 1995, set out to build a space for dialogue, exchange and cooperation that would ensure peace, stability and economic and social development in the Mediterranean region.[9] These ambitions are nothing if not grandiose, and more than a decade since its inception the degree of success on the multilateral side is still not as hoped for.[10] There is no doubt that the task ahead is immense, and the prospects will depend on the economic aspects, which represent the essential component of the policy.[11] Nevertheless, significant progress has been made on the multi-bilateral front – the EU and its Mediterranean partners individually – via the negotiation and conclusion of Euro-

[5] With 73.7% of EU imports from Algeria consisting of energy in 2005, Algeria counts as the Union's sixth largest source in this sector. Cf. European Commission: Bilateral Trade Relations – Algeria, 17 October 2006, http://europa.eu.int/comm/trade/issues/bilateral/countries/algeria/index_en.htm.

[6] Figures mentioned in this paragraph refer to the EU 25 Member States, thus including the 10 members that joined the Union in May 2004.

[7] World Bank: Key Development Data and Statistics, 12 September 2006, http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,menuPK:232599~pagePK:64133170~piPK:64133498~theSitePK:239419,00.html.

[8] Ibid.

[9] Ahmed Aghrout, Martin Alexander: The Euro-Mediterranean New Strategy and the Maghreb Countries, in: European Foreign Affairs Review, Vol. 3, No. 2, 1997, pp. 308-314; Tomas Baert: The Euro-Mediterranean Agreements, in: Gary P. Sampson, Stephen Woolcock (eds.): Regionalism, Multilateralism, and Economic Integration – The Recent Experience, Tokyo and New York 2003, United Nations University Press, pp. 100-134; Fred Tanner: North Africa: Partnership, Exceptionalism and Neglect, in: Roland Dannreuther (ed.): European Union Foreign Policy – Towards A Neighbourhood Strategy, London and New York 2004, Routledge, pp. 135-150.

[10] Haizam A. Fernández, Richard Youngs (eds.): The Euro-Mediterranean Partnership: Assessing the First Decade, Madrid 2005, FRIDE and Real Instituto Elcano; IMF: The Euro-Mediterranean Partnership Ten Years On: Reassessing Readiness and Prospects, 23 June 2006, http://www.imf.org/external/np/speeches/2006/062306.htm.

[11] The final declaration identified three key areas in the relations between the Union and its Mediterranean partners: political and security partnership aimed at a common zone of peace and stability; economic and financial partnership intended to build an area of shared prosperity, especially by gradually establishing free trade; and social, cultural and human partnership designed to encourage exchange and promote understanding between civil societies.

Mediterranean association agreements to replace the cooperation agreements of the mid-1970s.[12]

With Algeria, negotiations were concluded in December 2001, and the two parties signed an agreement on 22 April 2002 in Valencia, Spain.[13] It was approved by the European Parliament in October of the same year, and came into effect in September 2005 after the ratification process by the parliaments of the EU Member States and Algeria was completed.[14] The overall aims of the agreement, as stipulated in Article 1, are to:

- provide an appropriate framework for political dialogue between the Parties, allowing the development of close relations and cooperation in all areas they consider relevant to such dialogue;
- promote trade and the expansion of harmonious economic and social relations between the Parties and establish the conditions for the gradual liberalisation of trade in goods, services and capital;
- facilitate human exchanges, particularly in the context of administrative procedures;
- encourage integration of the Maghreb countries by promoting trade and cooperation within the Maghreb group and between it and the Community and its Member States;
- promote economic, social, cultural and financial cooperation.

Whilst it is clear that the coverage of issues is comprehensive, it is actually the economic and financial dimension that is central to the whole association project. The purpose is the provision for the gradual establishment of a space where the movement of goods, capital and services would be free from all barriers. In terms of trade, "The Community and Algeria shall gradually establish a free-trade area over a transitional period lasting a maximum of twelve years starting from the date of entry into force of this Agreement ..." (Article 6). This zone of free trade would be set up in conformity with the provisions of the multilateral trading system.[15]

With respect to industrial products, Algeria would continue to benefit from free access – that is no customs duties and charges having equivalent effect – to the European market for most of its exports of manufactures. On the other hand, the removal of trade restrictions, tariff and non-tariff barriers, is to take place on a unilateral basis, with Algeria gradually opening its market to products imported from the EU. This process takes place in accordance with the following timetable:

- a first list of products, referred to in Annex 2, for which tariffs and other duties are to be removed upon the entry in force of the agreement (24% of imports);
- a second list of goods, mentioned in Annex 3, for which all duties are to be lifted over a six-year period, starting two years after the entry into force of the agreement (36% of imports);
- a final group of products not listed in Annexes 1 and 2, duties and charges on which will be dismantled over an eleven-year period, starting two years after the entry into effect of the agreement (40% of imports).

In spite of that there are special provisions for this timetable to be revised by both parties to the agreement if any serious difficulties relating to a given product are encountered. In this case the schedule for which the review has been requested may not be extended in respect of the product concerned beyond the twelve-year transitional period (Article 9). Exceptional measures of limited duration may be taken by Algeria in the form of an increase or reintroduction of customs duties pertaining to infant industries or certain sectors undergoing restructuring or facing serious difficulties, particularly if these difficulties result in major problems of a social nature (Article 11).

The stipulations related to agricultural goods do not equate with an immediate and complete liberalisation in this sector. Because of its sensitive nature, especially for the European side, it is stated that "The Community and Algeria shall progressively establish a greater liberalisation of their reciprocal trade in agricultural, fisheries and processed agricultural products of

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[12] Association agreements between the EU and all the Mediterranean countries except Syria – negotiations with Syria were concluded in October 2004 – have now entered into force. For more details, see European Commission: Euro-Med Association Agreements, 9 October 2006, http://europa.eu.int/comm/external_relations/euromed/med_ass_agreemnts.htm.

[13] The full text of the agreement (Protocols, Final Act, Annexes and Declarations) was published in the Official Journal of the European Union, L 265, 10 October 2005, pp. 2-228.

[14] For the entry into force of the agreement, see Official Journal of the European Union, L 292, 08 November 2005, p. 10.

[15] In February 1996 the WTO created the Regional Trade Agreements Committee to examine regional groupings and assess whether they are consistent with its rules. Details can be found in the World Trade Organization: Regional Trade Agreements: The WTO's Rules, 11 August 2006, http://www.wto.org/english/tratop_e/region_e/regrul_e.htm.

Table 3
Breakdown of MEDA I+II (1995-2004)
Commitments and Payments by Country

	Commitments (€ million)	Payments (€ million)	Payments/ Commitments (%)
Algeria	396.8	104.9	26.4
W. Bank and Gaza S.	461.3	386.2	83.7
Egypt	1,039.5	510.5	49.1
Jordan	458.4	350.2	76.4
Lebanon	255.7	104.6	41.9
Morocco	1,337.1	570.7	42.6
Syria	236.7	39.0	16.4
Tunisia	756.6	488.7	64.5
Bilateral cooperation	4,942.1	2,561.4	51.8
Regional cooperation	1,210.8	700.9	57.8
Total	6,152.9	3,262.3	53.0

Source: European Commission: Financial Statistics, 17 May 2006, http://europa.eu.int/comm/europeaid/projects/med/financial/1995-2004.pdf.

interest to both Parties" (Article 13). The lists of these products were provided for in five protocols annexed to the agreement. All things considered, the trade regime to be applied entails a combination of free access for some products and reduced customs duties and tariffs quotas for others. In this context, the limited liberalisation means that, as agreed between both parties, further negotiations would take place with a view to examining the possibilities of granting each other further concessions. Talks are expected to begin five years after the entry into effect of the agreement, i.e. 2010 (Article 15).

In the area of financial cooperation, provision was made for European aid aimed at contributing to the modernisation of Algeria's economy, the encouragement of private investment, the promotion of job-creating activities and the gradual formation and implementation of an FTA.[16] The MEDA programme is the main instrument for managing this financial assistance under the EMP.[17] Its resources, globally determined in advance for the Mediterranean region, are attributed on a bilateral basis within the framework of each partner country's national indicative programme, with part of them intended to support regional projects of common concern as indicated in the Barcelona Declaration (cf. Table 3). The amount of aid is provided in line with the pace and effort of each Mediterranean partner country in accelerating the reform of its economy, including the implementation by Algeria of the objectives of the agreement. The funds made available are in the form of non-refundable aid. These are complemented by financial support provided by the European Investment Bank in the form of refundable loans.

Access Conditions to the European Market

At present what the EU is offering to its Mediterranean partners, including Algeria, is not the setting up of an all-encompassing FTA. By way of illustration, the scope for trade liberalisation in agricultural products is very limited, and the prospect for significant liberalisation depends on the outcome of future negotiations. The liberalisation of trade in services is an objective provided for in the association agreements – the services sector accounts for some 60% of GDP in the Mediterranean countries. However, trade in this sector is not liberalised yet despite the fact that some of these agreements came into effect several years ago – more than eight years in the case of Tunisia.

The underlying requirement under which new FTAs are to be established is that they must cover "substantially all trade" among members. This WTO rule means that reciprocal trade liberalisation should be wider in scope. This is a matter which the European Commission seems well aware of since it states that, "It will be harder than ever before to limit the coverage of a free trade agreement. In other words, the exclusion of a major component of bilateral trade would result in the agreement being in contravention of WTO rules."[18] Nevertheless, the ambiguity surrounding the wording of WTO rules, by not referring to sectors to be included and the transitional period of time allowed for the full implementation of the FTA, may have provided the EU with some degree for manoeuvre. It may have enabled the EU to exclude the immediate liberalisation of agricultural trade and certain manufactured products. As far as textiles and clothing are concerned, these have gradually been integrated into WTO discipline

[16] According to article 79 of the agreement, the scope of this cooperation should apply to the following: facilitating reforms aimed at modernising the economy; upgrading economic infrastructure; promotion of private investment and activities generating employment; offsetting the effects on the Algerian economy of the progressive introduction of a free trade area, in particular where the upgrading and restructuring of industry is concerned; accompanying measures for policies implemented in the social sectors.

[17] Meda = Mésures d'accompagnement financières et techniques. The MEDA I for the period 1995-1999 accounted for €3,435 million. The funding of MEDA II for the period 2000-2006 amounts to €5,350 million. Consisting mainly of grants, the MEDA programme also includes the financing of risk capital and interest rate subsidies related to loans granted by the European Investment Bank. This programme will be replaced by a new financial instrument, the ENPI (European Neighbourhood Policy Instrument), and will come into force in early 2007. Common for both the EU's southern and eastern neighbours, the ENPI will be endowed with €14.9 billion for the period 2007-2013.

[18] European Commission: Commission Concludes Evaluation of Free Trade Agreements, in: Press Releases, IP/95/215, Brussels, 8 March 1995.

since the beginning of 1995.[19] With all restrictions terminated on 1 January 2005, this group of products is normally no longer subject to quotas under a special regime outside normal WTO rules, but is now governed by the general rules and disciplines embodied in the multilateral trade system.

The fact that the agreement does not envisage the wide-ranging trade liberalisation of farm produce is indicative of the sensitive nature of this sector, which continues to be sheltered under the Common Agricultural Policy.[20] Mariann Fischer Boel, Commissioner for Agriculture and Rural Development, was reported to have said that, "The liberalisation of agricultural trade would bring considerable benefits for both sides, helping to generate growth, create jobs and boost investment. Of course, we must proceed gradually and take account of the genuine sensitivities surrounding certain products."[21] As such, to steer the negotiations for further reciprocal liberalisation, a Euro-Mediterranean roadmap for agriculture was recommended for adoption at the Foreign Ministers' meeting held in Luxembourg in May 2005. The process would involve a high degree of trade liberalisation for agricultural, processed agricultural and fishery products. Yet taking account of the particular sensitivity of some products does not rule out the possibility of their exclusion for the reason that their liberalisation can have detrimental social and economic consequences. Consequently, the task ahead does not look easy given the difficult compromises to be made on both sides (the EU and its individual partners) to conciliate their respective interests. From the EU perspective it is vital that progress is made on this issue to achieve wider trade liberalisation as the agreed deadline of 2010 for a Euro-Mediterranean Free Trade Area (EMFTA) approaches.[22] This will be concomitant with the ongoing negotiations within the framework of the WTO, which began in early 2000.[23]

The market access conditions provided for in the association agreement with Algeria cannot be equated with generous trade concessions for this country's exports – more than 60% of its agricultural trade is done with the EU. For the time being, they are no more than a "reconfirmation" of previous concessions. The 1976 cooperation accord already offered Algerian manufactured goods free entry into the European market. On account of the structure of its exports, dominated by oil and gas products, and unlike its neighbours (Morocco and Tunisia), Algeria has not reaped substantial benefits from this preferential treatment. Concerning agricultural products, limited improvements to market access have been granted and are in the main concerned with increased quotas for certain specific products. Again, it is expected that these concessions might have an adverse effect on the agricultural sector in Algeria. In addition to the discrepancy in the level of protection (40% to 70% in the EU and 4% in Algeria) that may place this sector at a disadvantaged position *vis-à-vis* that of the Union, there will in all probability be an increase in the already existing trade deficit (evidently in the EU's favour). In contrast, Morocco and to a lesser extent Tunisia, with their agricultural exporting potential, might benefit as the EU pledged to embark upon further liberalisation in this sector.

The Downside: Transitional Costs

The FTA between Algeria and the EU is to be phased in over a twelve-year period, commencing with the entry into force of the association agreement. As the process is set into motion, Algeria will have to open up its market to European products, something that would more likely have a number of adverse effects on its economy.

The dismantling of tariff and non-tariff barriers to trade amounts, in actual fact, to an erosion of the unilateral preferential treatment Algeria derived benefit from under its 1976 cooperation agreement with the EU. Thus the present association pact marks a shift from one of a preferential nature towards a more balanced relationship based, albeit gradually, on reciprocal trade concessions.[24] With Algeria unilaterally liberalising, this results in a loss of tax duties, leading to the shrinking of a relatively significant source of revenue for the Algerian economy. In this context, there are different sets of figures being put forward regarding the size of this loss, ranging from 400 million dollars

[19] Hanaa Kheir-El-Din: Implementing the Agreement on Textiles and Clothing, in Bernard M. Hoekman, Aaditya Mattoo, Philip English (eds.): Development, Trade, and the WTO – A Handbook, Washington, DC 2002, World Bank, pp. 186-194.

[20] OECD: Preferential Trading Arrangements in Agricultural and Food Markets: The Case of the European Union and the United States, Paris 2005, OECD, pp. 17-64.

[21] European Commission: EU to open farm trade talks with Euro-Med countries, in: Press Releases, IP/05/1419, Brussels, 15 November 2005.

[22] José-María Garcia-Alvarez-Coque: Agricultural Trade and the Barcelona Process: Is full liberalisation possible?, in: European Review of Agricultural Economics, Vol. 29, No. 3, 2002, pp. 399-422.

[23] For the background to the multilateral negotiations, see the World Trade Organization: Agriculture: The Current Negotiations, 18 October 2006, http://www.wto.org/english/tratop_e/agric_e/negoti_e.htm.

[24] Ahmed Aghrout, op. cit., p. 150.

to one billion dollars as indicated by Algeria's former foreign minister, Abdelaziz Belkhadem.[25] However, in view of the EU's important share in Algeria's total imports (cf. Tables 1 and 2), the fiscal cost is expected to rise steadily in accordance with the progressive implementation of the FTA.

Amongst the policy measures that can be considered to make up for this loss of revenue is the tightening of budget control, either by curbing public expenditure or increasing direct taxation.[26] Reducing public expenditure is a risky option, as this will aggravate the already existing social hardship, eventually leading to serious social instability. Though it has a social cost as well, the second policy measure seems to be the one being currently pursued. Recent programmes of fiscal reform have targeted, among other things, domestically based taxes, including the extension of the value-added tax to various sectors and the fight against tax evasion.[27]

The size of imports from the EU is another area where the abolition of trade restrictions could have an impact. It is predictable that their levels in overall consumption might increase as a result. The requirement for further investment will see a rise in imports of raw materials and capital goods from Europe. The positive side of this will be reflected in reduced production costs. Local consumers will also be inclined to acquire imported products; a preference that may be explained by the incapacity of local products to compete in terms of quality and prices. This expected rise in imports is going to affect Algeria's balance of payments since for the moment there is little Algeria can export to the European market outside hydrocarbons. And a major transformation of Algeria's export structure is unlikely to occur in the near future. Prospects for a diversification of exports, be they manufactured or farm products, are not only a matter of new investments in the export sector, but also more importantly that of enhancing these products' competitive edge. For a while the major concern will be the strong competition of European goods in the local market. So far the reaction has come from the *Forum des Chefs d'Entreprises* (FCE) which, in order to promote domestic products, launched a campaign in 2002 by calling on Algerians "For the future of our children, consume Algerian" (*Pour l'avenir de nos enfants, consommons algérien*).[28] Like in Tunisia a few years ago, this appeal is justified on the premise that the preference for local products would contribute to the protection of jobs in the country.

The exposure to EU competition will have an impact on the country's industrial fabric. Going through a complex phase of restructuring, this sector has, for a longer period of time, been kept under high levels of tariff protection. The process of adapting to this competitive environment would inevitably drive out a number of industries, especially those condemned to fail whatever the type and degree of support they may be provided with. Although there are no available statistics about the firms that will experience serious difficulty in withstanding competition, it is quite clear that sectors such as textiles and clothing, leather, food-processing, steel, mechanical and electrical industries will bear the brunt of this trade liberalisation.[29]

Many more efforts are definitely needed to restructure the economy and bring the infrastructure into line with that of Europe. Both Morocco and Tunisia have, since 1996, embarked upon programmes to upgrade their infrastructure and local companies, known as "*la mise à niveau*". In Algeria, this process was begun with the setting up of the Fund for the Promotion of Industrial Competitiveness (*Fonds de Promotion de la Compétitivité Industrielle*) in 2000 with an allocation of 5,651 billion Algerian Dinars (AD) (about $70 million) for the period 2001-04.[30] As of October 2004 out of the 293 enterprises which had applied for support from this funding institution only 191 firms were judged eligible.[31] At this pace it is obvious that Algeria is still trailing behind when compared, for instance, to Tunisia ($2 billion allocated for the upgrading of 2,007

[25] El-Moudjahid (Algerian daily), 08 January 2002; El-Khabar (Algerian daily), 08 January 2002.

[26] Gérard Kebabjian: Element d'une Prospective Euro-Méditerranéenne, in: Robert Bistofli, Edouard Pisani (eds.): Euro-Méditerranée: une région à construire, Paris 1995, Publisud, p. 90; Le libre-échange euro-maghrébin: une évaluation macro-économique, in: Revue du Tiers Monde, Vol. 36, No. 144, 1995, pp. 747-770.

[27] According to Algeria's former minister of finance, Abdelatif Benachenhou, this evasion was estimated to be in the region of AD100 billion in 2004 ($1.5 billion); reported by Liberté (Algerian daily), 16 March 2005.

[28] The details of this campaign can be found in Lettre du FCE (Algiers), 18 December 2002, pp. 1-3; as for Tunisia's experience, see Arabies (Paris), 107, November 1995, p. 34.

[29] Liberté-Economie (Algerian weekly), 31 March – 06 April 2004.

[30] The establishment and aims of the fund were provided for in the Finance Act 99-11 (Article 92), 23 December 1999; see Journal Officiel de la République Algérienne: Vol. 38, No. 92, 1999, p. 56.

[31] Ministry of Industry (Algeria): Programme de la Mise à Niveau des Entreprises 2005, 16 July 2006, http://www.mir-algeria.org/miseaniveau/dispojuri.htm.

companies).[32] Thus in the absence of a well-defined and properly sustained strategy, one wonders how Algeria could carry out the upgrading of its industry in a successful way. Conveying its apprehensions, the FCE cautioned that, "Without substantial aid from the authorities the association agreement is likely to be synonymous with the end of national industry".[33] The government's decision to earmark something like one billion AD yearly over a six-year period starting from 2006 might not prove adequate if no additional resources are mobilised, and other alternatives – such as privatisation and partnership schemes with foreign investors – are contemplated.[34]

It is also the case that the liberalisation of trade and the necessary reforms will have social implications, especially in terms of labour displacement.[35] The upgrading process of local industries will result in job losses. In order to raise the competitiveness of domestic businesses, the reduction of labour costs is one policy option that can be adopted. This will not only make the prospect for job creation less likely in the short-term, but will also worsen the existing unemployment problem.[36] More than 400,000 jobs had already been lost as hundreds of public companies were dissolved in previous years. Some sources have estimated the number of job losses following the implementation of the FTA with the EU at 58,000, affecting all sectors albeit unevenly.[37] Taking into consideration the effect this problem could have on the country's social stability and economic growth, policy measures are required to improve the labour market situation. Using the substantial oil and gas earnings, the government has counted, and continues to count, on its massive investment plans to expand, amongst other things, public sector jobs.[38] Certainly, the rate of unemployment has decreased, but it remains to be seen how productive and sustainable the jobs being created are.

[32] Data on Tunisia as reported by Lettre du FCE, 11, May 2002, p. 3.

[33] Le Jeune Indépendant (Algerian daily), 16 February 2005.

[34] This financial package was announced by the minister in charge of small and medium-sized enterprises and craft industry; quoted in L'Expression (Algerian daily), 16 February 2005.

[35] Sébastien Dessus, Julia Devlin, Raed Safadi: Towards Arab and Euro-Med Regional Integration, Paris 2001, OECD.

[36] The government claims that the unemployment rate has decreased from 29.5% in 1999 to 15.3% at the end of 2005, and is expected to fall to less than 10% by 2009; cited in El-Moudjahid, 21 March 2006.

[37] Liberté-Economie (Algerian weekly), 31 March – 06 April 2004.

[38] The first economic recovery plan (2001-2004) was allocated \$7 billion and the second one (2005-2009) \$55 billion.

The Hoped-for Gains

Liberalising trade with the EU will unquestionably entail transitional costs. For the Algerian authorities this fact does not seem to be a source of major concern since the agreement is presented "as a strong stimulus for the Algerian economy".[39] Notwithstanding the costs involved, the process of "anchoring" Algeria into the European economic space may impact positively on its economy. Welfare gains are not, nevertheless, expected in the immediate future, and any potential benefit, in the long-term obviously, remains to a greater extent dependent on how the reforms proceed.

Algeria has embarked upon important economic reforms, and the results accomplished so far have, on the whole, restored the country's macro-economic stability. Without a doubt, this is a prerequisite for growth, foreign investment, and expanding trade, but in itself is not sufficient if not followed by further deep structural and institutional reforms.[40] Therefore there is still much to be done to move to a truly open market-based economy. In this respect, the formation of an FTA has, as its ambition, more than the security or even the improvement of access to the European Market. The benefits of locking in policy reforms via the liberalisation of trade *vis-à-vis* a major trading bloc (EU) can prove helpful by enhancing the credibility attached to the reform agenda.[41]

With the EU acting as a policy reform anchor, it would seem rather difficult for Algeria, as well as other Mediterranean partners, to attempt to reverse the reform process. In view of the binding nature of the association agreement and the explicit conditionality attached to its implementation – access to European aid and other forms of assistance – non-compliance may result in the EU retaliating. In addition to the cost to be incurred, there is the risk of losing that element of credibility, which may not be easy to regain in the future. The credibility gained through the linkage to the EU, by supporting and sustaining the reforms, could contribute to the improvement of Algeria's economic

[39] La Tribune (Algerian daily), 16 February 2005.

[40] IMF: Managing Director Rodrigo de Rato's Statement at the Conclusion of his Visit to Algeria, in: IMF Press Release, 05/49, 02 March 2005.

[41] Paul Collier, Jan W. Gunning: Trade Policy and Regional Integration: Implications for the Relations Between Europe and Africa, in: The World Economy, Vol. 18, No. 3, 1995, pp. 395-398; Alfred Tovias, Mehmet Ugur: Can the EU Anchor Policy Reform in Third Countries? An Analysis of the Euro-Med Partnership, in: European Union Politics, Vol. 5, No. 4, 2004, pp. 395-418.

environment and the promotion of its investment climate.

In actual fact, the increase of foreign capital inflow, primarily in the form of foreign direct investment (FDI), is one key benefit Algeria wants to reap from its open trading regime with the EU. FDI almost characteristically brings additional resources such as technology, management know-how and access to export markets, which a country like Algeria greatly needs to boost its economic development.[42] The endorsement of the EMP policy and the credibility conferred upon the reform programme could help make Algeria a good location for would-be investors. For the duration of this transitional phase, the government seems determined to implement an ambitious programme to privatise all publicly owned companies.[43] In doing so, the resort to foreign financing, particularly in the form of direct investment, promises to be extremely crucial in reinvigorating and modernising the poorly managed and underperforming public sector.

Algeria's performance in terms of attracting FDI reveals that it has not witnessed the comparatively steady and sustained flow of investment experienced by Morocco and Tunisia.[44] Nonetheless, this trend appears to have changed in recent years (2002-2005), as the country started to record relatively increasing levels of FDI inflows (cf. Table 4). A large part of these inflows has, however, targeted the oil and gas industry with moderate proportions going to other sectors such as telecommunications.[45] With Algeria's FDI stock standing at $8.3 billion in 2005, it is still below those of its closest neighbours, $22.8 billion in Morocco and $16.9 billion in Tunisia.[46] Also its ranking of 109 according to the UNCTAD FDI Performance Index for the year 2005, is indicative of the need for further efforts to improve the country's pro-business image.[47] The fact is that FDI flows towards the Mediterranean countries, taken as a whole, are extremely weak, accounting for less than 1% of the world total, and more or less the same can be said about European investment in these countries. As Peter Mandelson, EU Trade Commissioner, commented, "The EU still invests less than 2% of all its foreign investment in your economies, despite the fact that we are neighbours."[48] Hence it is imperative and in the interest of the EU to promote the conditions necessary for a real takeoff of its investments within the Mediterranean region.[49]

Table 4
Comparison of FDI Inflows into Algeria
($ billion)

	1990-2000 (annual average)	2002	2003	2004	2005
Algeria	0.282	1.065	0.634	0.882	1.081
Morocco	0.580	0.534	2.429	1.870	2.933
Tunisia	0.452	0.821	0.584	0.639	0.782
Developing economies	134.7	163.6	175.1	275.0	334.3
World	495.4	617.7	557.9	710.8	916.3

Source: UNCTAD: World Investment Report 2006 – FDI from Developing and Transition Economies: Implications for Development, New York and Geneva 2006, UNCTAD.

European investment in Algeria also remains contingent on the dynamic effect of the reform agenda, including the implementation of free trade with the EU. It is also the case that for Algeria to become a more attractive location for investment, it has to work, together with its neighbours, towards greater integration of their respective economies in a larger Maghreb market. Potential foreign investment may well be determined by the "hub-spoke" effect. Maintaining trade barriers among them whilst setting up FTAs with the EU could lead foreign investors to locate their business in the "hub" (EU) that gives them access to all the "spokes" (Maghreb countries) rather than the other way around. This is because they only have access to the domestic market within which they decide to invest.

[42] Joel Bergsman, Xiaofong Shen: Foreign Direct Investment in Developing Countries: Progress and Problems, in: Finance and Development, Vol. 32, No. 4, 1995, pp. 6-8; Padma Mallampally, Karl P. Sauvant: Foreign Direct Investment in Developing Countries, in: Finance and Development, Vol. 36, No. 1, 1999, pp. 34-37.

[43] About 1,200 state-owned enterprises are to be sold off except those considered "strategic", such as Sonatrach (hydrocarbons), Sonelgaz (gas and electricity) and Sntf (railway transport). An overview of the conduct and results of the privatisation programme can be found in Ahmed Aghrout, Mohamed Bouhezza, Khaled Sadaoui: Restructuring and Privatization in Algeria, in: Ahmed Aghrout (ed.): Algeria in Transition: Reforms and Development Prospects, London and New York 2004, RoutledgeCurzon, pp. 120-135.

[44] Ahmed Aghrout, Michael Hodd: FDI in North Africa: A Comparative Perspective, in: Sima Motamen-Samadian (ed.): Capital Flows and Exchange Rate Risks in Emerging Markets, London 2005, Palgrave, pp. 115-132.

[45] Hakim Meliani, Ahmed Aghrout, Ammar Ammari: Economic Reforms and Foreign Direct Investment in Algeria, in: Ahmed Aghrout (ed.): Algeria in Transition..., op. cit., pp. 87-101.

[46] UNCTAD: World Investment Report 2006 – FDI from Developing and Transition Economies: Implications for Development, New York and Geneva 2006, UNCTAD.

[47] The UNCTAD FDI Performance Index is the ratio of a country's share in global FDI flows to its share in global GDP.

[48] European Commission: Mandelson's Address to the 5th Euro-Med Trade Ministerial, in: Press Releases, SPEECH/06/196, Brussels, 24 March 2006.

[49] Anima (Euro-Mediterranean Network of Investment Promotion Agencies): Invest in the Mediterranean, 12 September 2006, http://www.animaweb.org/index_home_en.php?lang=eng&id=4.

In addition to the "vertical" dimension of trade liberalisation – that is between the EU and individual Mediterranean partners – the EMP similarly aims to encourage free trade between these partners themselves.[50] In this way, the Barcelona Declaration considered that, "cooperation on a voluntary basis, particularly with a view to developing trade between the partners themselves, is a key factor in promoting the creation of a free trade area." Enhancing regional trade between Algeria and its neighbours has not been very successful, as demonstrated by the failing Arab Maghreb Union (AMU), a regional grouping created in 1989.[51] It seems that the EMP, launched more than ten years ago, has not had any serious impact on the Maghreb countries with regard to promoting their intra-regional trade within the AMU framework, or even on a bilateral basis. For instance, intra-Maghreb trade accounted for less than 2% of their external trade in 2004. On the contrary, the Arab-Mediterranean Free Trade Agreement between Egypt, Jordan, Morocco and Tunisia signed in February 2004, and the conclusion of other bilateral FTAs – such Morocco and Turkey, Tunisia and Turkey, and Israel and Jordan – may reflect the momentum imparted by this policy.[52] By boosting "horizontal" integration and preparing economies for complete trade liberalisation throughout the region, regional arrangements of this type are perceived as building blocks in the process that is predicted to lead to the formation of the future EMFTA.[53]

The issue of promoting these sub-regional blocks is to be facilitated through the Pan-Euro-Mediterranean rules of origin, which will determine the access to the European market.[54] In other words, the extension of the pan-European system of cumulation of origin to all Mediterranean partners might be instrumental in fostering trade exchanges and developing economic cooperation, especially the potential for closer intra-industry links. It should be borne in mind that the Maghreb countries (Algeria, Morocco and Tunisia) already have this provision included in their agreements with the EU, yet it is not implemented.[55] At this point it remains to be seen how the extension of this system can bring about any change to the prevailing situation.

Concluding Remarks

Algeria's association agreement with the EU represents a turning-point in the future development of the relationship between the two parties. Its ultimate aim is the establishment of a balanced relationship, with trade as its core component. Thus non-reciprocal preferential access, granted under the previous cooperation agreement, is to be replaced by fully reciprocal treatment, as the FTA is progressively implemented. This means that the new arrangement would definitely result in an erosion of the preferential trade status Algeria has formerly enjoyed in the European market. At the same time as Algeria continues to benefit from the security of access for its exports it has to open its market to European goods by gradually removing all trade barriers.

This process of unilateral liberalisation amounts to a serious challenge. Given the high levels of protection of the economy and the currently limited potential for diversified exports (except hydrocarbons), it is inevitable that Algeria will, for some time to come, experience a hard time adjusting to the new reality of reciprocal free trade. With varying degrees of effect, the cost is to be felt in terms of reduced fiscal revenues, disappearance of parts of the local industry and labour displacement. Both the EU and Algeria are, nonetheless, placing high hopes on the positive implications that would be induced by the agreement. This optimism as to the expected results would, in fact, be conditioned by the progress of the reform programme, the mobilisation of appropriate resources and the nature and degree of EU support to accompany this phase of transition. Without effective commitment on both sides, the whole operation may perhaps be a risky business, with the weak partner bearing most of the burden.

[50] Sébastien Dessus, Julia Devlin, Raed Safadi, op. cit.; Brigid Gavin: The Euro-Mediterranean Partnership – An Experiment in North-South-South Integration, in: INTERECONOMICS, Vol. 40, No. 6, 2005, pp. 353-360.

[51] Ahmed Aghrout, Keith Sutton: Regional Economic Union in the Maghreb, in: The Journal of Modern African Studies, Vol. 28, No. 1, 1990, pp. 115-139; Robert Mortimer: The Arab Maghreb Union: Myth and Reality, in: Yahia Zoubir (ed.), North Africa in Transition: State Society and Economic Transformation in the 1990s, Gainesville 1999, University Press of Florida, pp. 177-191.

[52] The Arab-Mediterranean Free Trade Agreement, known as the Agadir Agreement, aims to establish an integrated market of more than 100 million people with a view to providing new attractive opportunities for trade and investment in the countries involved.

[53] Petros Siousiouras: The Euro-Mediterranean Free Trade Zone: Prospects and Possibilities, in: Mediterranean Quarterly, Vol. 14, No. 3, 2003, pp. 112-121.

[54] European Commission: Council approves new European-Mediterranean cumulation of origin zone, in: Press Releases, IP/05/1256, Brussels, 12 October 2005.

[55] A document (Circular of 13 July 2005) emanating from the Algerian customs services stated that this provision is not applicable for the time being; reported by El-Watan (Algerian daily), 05 September 2005. In the same way, Algeria has yet to endorse the recently approved new Protocol on the Pan-Euro-Mediterranean system of cumulation of origin.