Assessing the EU-Palestine Interim Association Agreement using the Sussex Framework

Anirudh Shingal[1]

27 June 2012

Executive Summary

The EU-Palestine Interim Association Agreement (IAA) entered into effect on 1 July 1997 with an immediate duty free treatment of bilateral industrial trade and duty free quotas for agricultural, agri-business and fishery products. In January 2012, the agreement paved the way for the duty free quota free access of Palestinian agricultural, processed foods, and fish & fishery products into European markets. In this report, we use diagnostic statistical indicators put together by the University of Sussex researchers (hence, the Sussex Fraework) to study both shallow (removal of border barriers to trade) and deep (behind-the-border issues) integration effects of the IAA. Our analysis suggests that the shallow integration effects of the agreement are unlikely to be of much significance to both parties in view of their low trade share in each other's market, the prevailing low tariffs and the dissimilar export structures. On the other hand, the agreement provides a far-reaching coverage to several instruments of deep integration, in particular, standards, competition, investment and trade facilitation. However, anecdotal evidence and investigative statistical analyses suggest that not much progress has been made in this area and significant non-tariff barriers to trade remain on both sides. On the whole therefore, net benefits are more likely to result from a wider geographical coverage in the form of a pan EU-Med preferential trade agreement that includes The State of Palestine (SoP) and from an effective implementation of the deep integration aspects of the current association agreement with the EU.

[1] Senior Research Fellow, World Trade Institute, University of Bern. This report has been prepared for the Palestinian Trade Centre (PalTrade) under a joint ITC-UNDP project. I would like to thank Jean-Sebastien Roure, Shawqi Makhtoub and the entire ITC team for their support. I would also like to acknowledge the extensive use of TradeSift, the Systematic Integrated Framework for Trade Analysis developed at the University of Sussex, in both analysing and visually presenting the data in this report. The usual disclaimer applies.
Address for correspondence: World Trade Institute, Hallerstrasse 6, CH – 3012 Bern, Switzerland.
Email: anirudh.shingal@wti.org.

Table of Contents

List of figures

List of tables

List of annex tables

Background[2]

The EU-Palestine Interim Association Agreement (IAA) entered into effect on 1 July 1997. The agreement, which only covers trade in goods, began with an immediate duty free treatment of bilateral industrial trade and duty free quotas for agricultural, agri-business and fishery products. In January 2012, the agreement paved the way for a duty free, quota free regime for the import of Palestinian agricultural, processed foods, and fish & fishery products into European markets.

Since the foundation of the Palestinian National Authority (PNA), the Paris Protocol (PP) has been the only basis to regulate economic relations between Israel and the SoP. Although it was designated for an interim period only (1994-1999), the PP is still in force till date. The Oslo Agreement, of which PP forms an integral part, gives the Palestinian Liberation Organization (PLO) the right to negotiate and conclude agreements as long as the same import policy is applied in Israel and the West Bank and Gaza. Therefore, the PLO signed several trade agreements in an attempt to improve and flourish the Palestinian economy, the ultimate objective of which was to reduce dependence on a single market and create an enabling business environment.

The PP created a quasi-customs union between Israel and PNA formulated on the free movement of goods between the two markets without any type of tariff and non-tariff barriers; and the adoption of a joint/unified tariff list while giving the PNA the right to determine duties and standards requirements for a list of basic or strategic commodities known as lists A1, A2, and B. Till date however, the tariffs applied on the products in these list is the same as those applied by Israel. In general, with the exception of cars wherein SoP applies a 50% tariff irrespective of the country of origin, Palestinian tariffs are the same as applied Israeli tariffs; for imports from Israel & GAFTA countries, Palestinian applied tariffs are zero.

Strategically, the SoP prioritized signing agreements with countries that had free trade agreements (FTA) with Israel. The underlying logic was to grant Palestinian exports preferential treatment since imports from these countries entered the Palestinian market duty free based on their trade agreements with Israel and the "quasi" customs union between SoP and Israel under the PP. The signed agreements by PLO include the Interim Association Agreements with the EU, EFTA, Turkey, MERCOSUR and FTAs with the US and Canada.

Further, especially with respect to products on lists A1, A2, and B, the PLO signed preferential trade agreements (PTA) with both Jordan and Egypt to strengthen and flourish the Palestinian economy by exercising rights granted under the PP. Israeli Customs, while still in control of external borders for the West Bank and the Gaza Strip, would clear goods imported by Palestinian traders on behalf of Palestinian Customs and then transfer this money to the PNA; 3% of the total transfers is taken by Israel as administrative expenses.

[2] I would like to thank Shawqi Makhtoub for this information.

It is also useful to highlight SoP's membership of the Greater Arab Free Trade Area (GAFTA[3]) which has seen complete trade liberalization amongst 15 of its 17 members since 1 January 2005. Thus, Palestinian traders enjoy duty free quota free access for all goods to and from all Arab countries in GAFTA. Significantly, because SoP has no control on borders and in keeping with its obligation under GAFTA, Palestinian Customs refund the value of customs duties paid by Palestinian importers to the Israeli Customs for goods subject to customs exemption under this Agreement.

With this background, the objective of this study is to evaluate the impact of the EU-SoP IAA using a methodology developed by researchers at the University of Sussex, known as the Sussex Framework.

The Sussex Framework[4]

The Sussex Framework (SF) involves focussing on selected descriptive statistical indicators from which one can draw analytical conclusions well-grounded in economic theory to evaluate the likely effects of a preferential trade agreement (PTA).

Preferential trade liberalisation involves a process of shallow integration, defined as the removal of border barriers to trade, typically tariffs and quotas. The potential net benefits from shallow integration are inherently ambiguous because of the likelihood of both trade creation (which is welfare increasing) and trade diversion (which is welfare reducing). Trade creation arises when more efficiently produced imported goods from a partner country replace less efficient domestically produced goods. Thus, trade is "created" and yields welfare gains. Trade diversion occurs when sources of supply switch away from more efficient non-partner countries to less efficient partner countries. This arises because the less efficient partner countries gain tariff-free access within the PTA, which may therefore enable them to undercut more efficient non-partner countries. Trade diversion therefore reduces welfare. The net welfare impact of a PTA thus depends on the relative size of the two effects.

The SF identifies important rules of thumb, which are used to shed light on the likely shallow integration impact of a trade agreement. These rules of thumb (RTs) are as follows:

1. ***The higher are the initial tariffs/barriers***, the greater are the likely effects on both trade creation and trade diversion. With high initial (MFN) tariffs, the initial distortion is great. This in turn means that in principle there is greater scope for both trade creation and trade diversion as the high tariffs are preferentially removed. Thus if the pre-PTA tariffs were very high, as these are removed it is more likely that the new partner country may be able to

[3] Members comprise Jordan, UAE, Bahrain, Saudi Arabia, Oman, Qatar, Morocco, Syria, Lebanon, Iraq, Egypt, SoP, Kuwait, Tunis, Libya, Sudan and Yemen.

[4] This section draws heavily on CARIS (2007), 'Qualitative Analysis of a Potential Free Trade Agreement between the European Union and India'.

supply the good more efficiently than the domestic economy. The higher the pre-PTA tariffs, the more likely it is that this will be the case and consequently, the greater the possibility for such trade to be created. Moreover, the higher the pre-PTA tariffs, the greater the price reduction arising from their removal, which in turn increases the demand for the good and creates more trade. Each of these processes of trade creation are welfare increasing. However, it is also the case that if pre-PTA tariffs were high, then as they are removed there is a greater possibility of the new PTA partner countries supplying the (tariff free) good cheaper than the excluded countries (on whose exports tariffs are levied). Hence, even though these excluded countries may produce the good more efficiently and cheaply, the good will be supplied by the PTA partner who has preferential access to the market. The higher the pre-PTA tariffs, the more likely it is that this form of welfare reducing trade diversion will occur.

2. ***The greater the number of PTA partners***, the more likely it is that there will be trade creation as opposed to trade diversion, because of the increased likelihood of including more efficient suppliers. As an illustration, suppose that a given trade agreement were to include the maximum number of possible countries. At the limit this would include all the countries in the world, and hence by definition the most efficient countries will have been included. Therefore, including a greater number of countries in a PTA minimises the extent of trade diversion, and simultaneously maximises the likelihood of trade creation.

3. ***Wide differences in comparative advantage*** between partner countries are likely to lead to a welfare improving PTA. Trade creation occurs when there are differences in efficiency and costs across partner countries – hence the PTA enables the partners to source the goods from the most efficient PTA partner. The greater those differences in comparative advantage (and hence in costs across the countries) the greater is the likely gain from trade creation. If SoP is only marginally more efficient than the EU in producing a given good, then the gain to the EU from importing the good from SoP as opposed to producing it itself is relatively small. However, if SoP is significantly more efficient than the potential gains are that much higher. It is worth noting, however, that if the initial tariffs are high then, as detailed in the first rule of thumb, there is also greater likelihood of trade diversion which diminishes the trade creation gains.

4. ***The more similar the product mix*** in the economies concerned and the higher the elasticities of supply, the greater the possibility of trade creation. Recall that trade creation occurs when the importing country produces less of the good itself and instead imports the good from its PTA partner. Suppose that prior to the PTA there was no overlap whatsoever between the two countries' production bundles. If that were the case then the only possibilities for trade creation would arise on the demand side. Conversely, if there is a significant overlap in the goods produced by the partner countries, there is much more scope for switching sources of supply to the more efficient country. Note also that assuming a given degree of overlap in the production structures, the more responsive supply is to the tariff reduction-induced changes in prices, the greater the extent of trade creation.

5. ***The higher the percentage of trade with potential partners***, the greater the possibility of the PTA enhancing welfare. Consider an initial situation where there was very little trade with the potential partner country. This would suggest that in the initial situation, third countries were more efficient suppliers. A PTA is therefore more likely to result in trade diversion under these circumstances. Conversely, if in the initial situation the countries traded significantly with each other, it is more likely that they are each respectively importing from the more efficient supplier, and the chances of trade diversion occurring are lessened.

6. Trade diversion is more likely when partners and excluded countries are close competitors. If it is the case that the partner exports a similar range of products as the excluded countries, then it is clearly more likely that a PTA may result in the partner displacing the exports of one of the excluded countries.

***7. The greater the possibilities for supply chain integration the greater the likely gains*:** Following from RT4, specialization and supply chain integration greatly increases the chances of welfare gains, which are characteristic of deep integration.

8. Greater share of trade in GDP suggests that larger gains are likely: A low trade share in GDP suggests a high degree of protection, which thus points to greater distortions. Thus, a boost in trade to a closed economy will constitute a welfare gain, and the less trade there is, the lesser is the risk of trade diversion.

In addition to shallow integration effects, there may be further welfare gains arising from the induced growth effects stimulated by, for example, productivity growth, increased specialisation, and/or positive externalities between firms, sectors or across sectors (e.g. between manufacturing and services). These gains are more likely to arise in the presence of deeper integration. In contrast to shallow integration, deep integration involves policies and institutions that facilitate trade by reducing or eliminating regulatory and behind-the-border impediments to trade, where such impediments may or may not be intentional. These can include issues such as customs procedures, regulation of domestic services production that discriminate against foreigners, product standards that differ from international norms or where testing and certification of foreign goods is complex and perhaps exclusionary, regulation of inward investments, competition policy, intellectual property protection and rules surrounding access to government procurement.

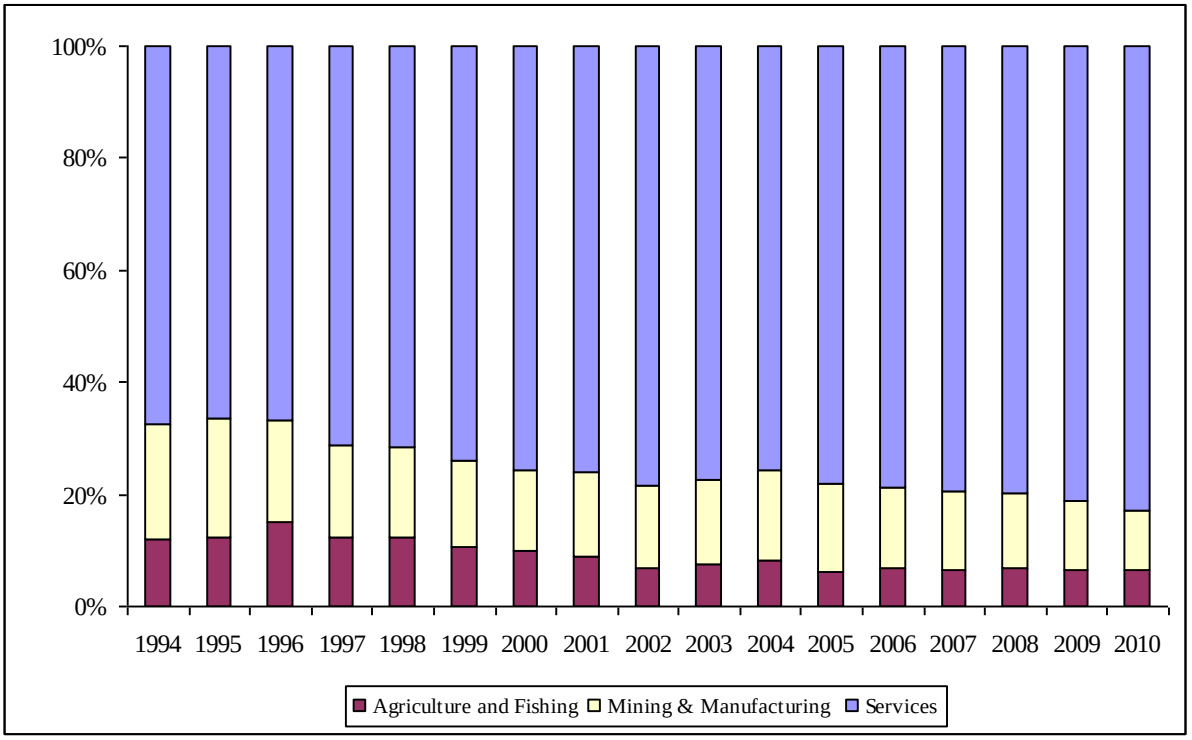
In assessing a PTA it is therefore crucial to first identify the implications arising from the implied shallow integration using the above-mentioned RTs and then build upon this to consider the possible role and importance of measures of deeper integration. To enable this, we divide the report into different sections which revolve around key features of the SF. First, we identify key aspects of the Palestinian economy and their evolution over time. Secondly, we look at existing patterns of trade both by sector and by partner country and use selected SF indicators to identify the likelihood for both trade creation and trade diversion. Lastly, we turn to the issue of deep integration and consider qualitative and quantitative evidence which

can shed light on the potential welfare gains which could arise from deeper integration in the EU-SoP IAA.

A snapshot of Palestinian trade and economic performance

SoP had a GDP of USD 5.7 bn in 2010 in constant prices and the economy grew by 9.3% over 2009-10. The Palestinian economy is predominantly services-based - the sector has accounted for more than 60% of GDP (see Figure 1) and total employment over time. Within services, other services (see Figure 2) constitute the largest share (21% of GDP and 38.3% of total employment in 2010). In view of this sectoral distribution, any agreement involving SoP should cover services. This said, the majority of Palestinian trade is in merchandise goods. In 2010, SoP's total imports of goods and services was USD 5.4 bn of which services imports were roughly only USD 173.3 mn (3.2% of total imports). Similarly, SoP's total exports of goods and services in 2010 were USD 1.4 bn of which services exports constituted roughly 10% (USD 140 mn). Finally, as we shall see in the following section, the geographical distribution of SoP's trade is extremely concentrated with Israel accounting for 75% of the former's total imports and 85% of its exports. Thus, any preferential agreement with SoP at the expense of Israel is likely to result in significant trade diversion for Israel.

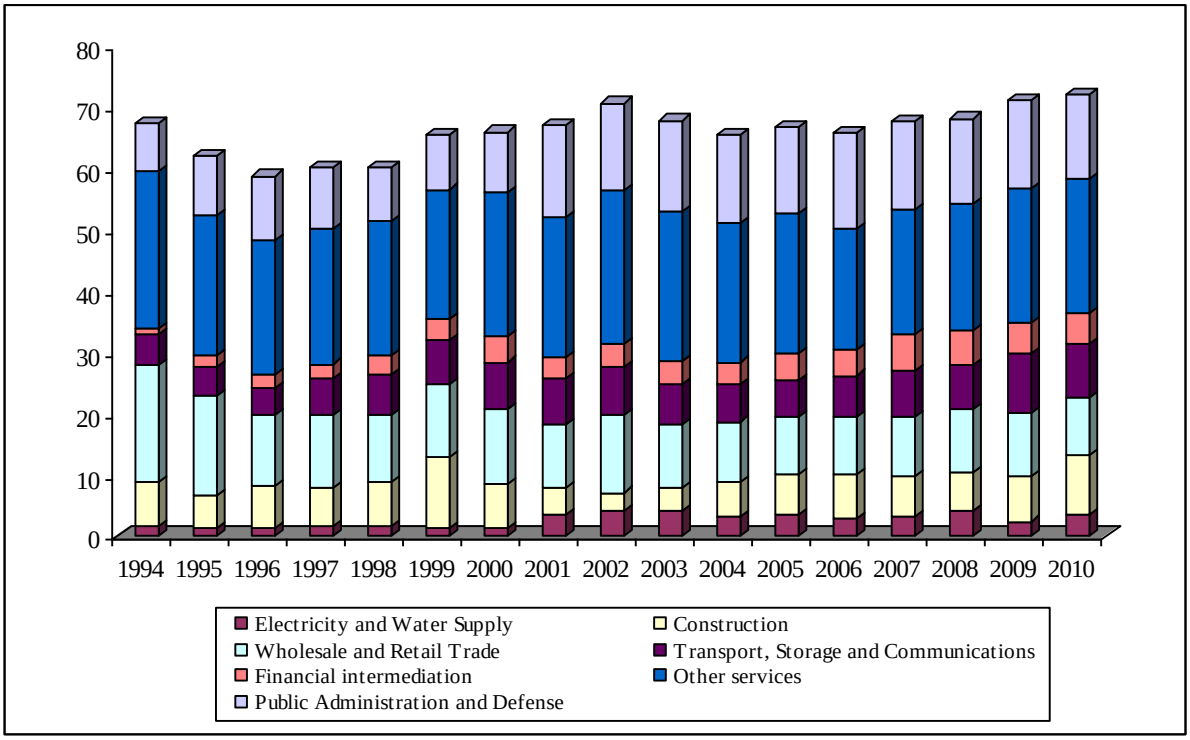
Figure 1: Sectoral distribution of GDP at constant prices (1994-2010)



Source: Palestinian Central Bureau of Statistics

Note: Base year is 2004

Figure 2: Breakdown of services contribution to GDP at constant prices (%, 1994-2010)



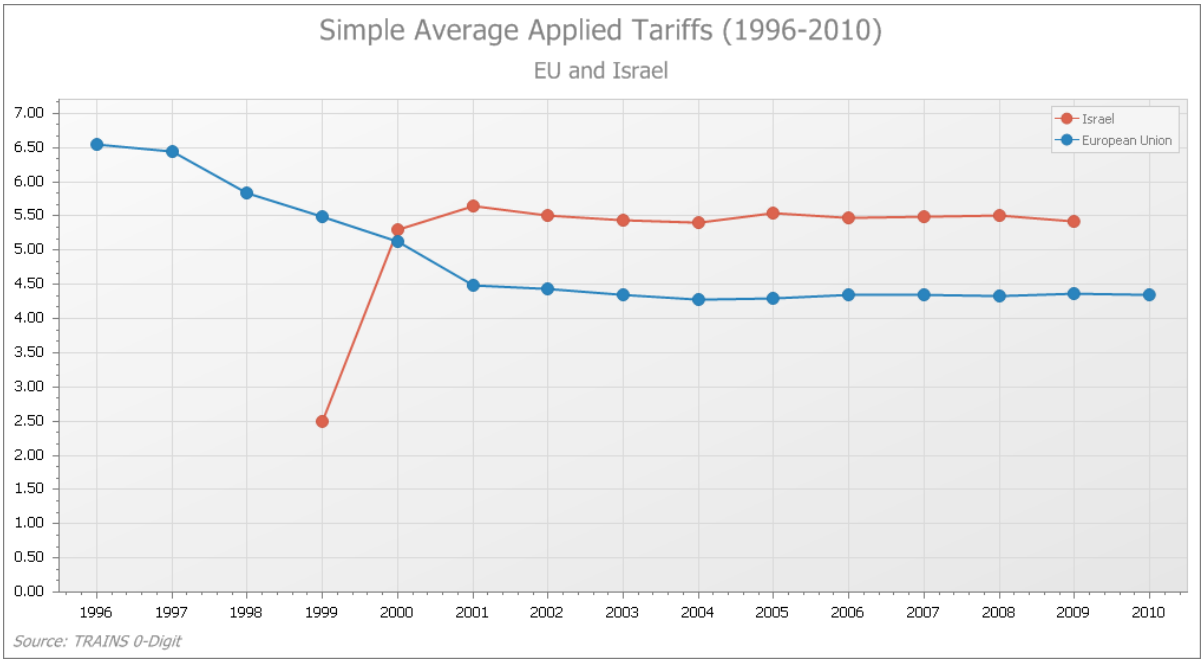
Source: Palestinian Central Bureau of Statistics

Note: (1) Base year is 2004 (2) Other services include hotel & restaurants; real estate activities; professional, scientific and technical activities; administrative and support service activities; education, health and social work; and arts, entertainment and recreation.

Shallow integration effects of the EU-SoP IAA

The first rule of thumb of the SF focuses on the initial tariff and/or trade barrier structure. Given that Palestinian tariffs are the same as applied Israeli tariffs in general, Figure 3 shows the evolution of EU and Israel tariffs over time (simple average AHS, 1996-2010). This figure shows that at the aggregate level, both EU and Israeli tariffs on their global imports are low and almost stagnant since 2000 at around 4.5% for the EU and 5.5% for Israel. This suggests that the extent of trade creation and trade diversion in the IAA is likely to be low.

Figure 3: Evolution of EU and Israel tariffs over time



Source: TRAINS via TradeSift

However, these average tariffs mask significant variations as Table 1 on the comparative tariff profiles on aggregate global imports in these two economies shows. While the minimum tariff rate is zero in both, the maximum tariff rate is 74.9% in the EU and 230% in Israel. As a share of total tariff lines in each case, the number of domestic tariff peaks[5] is 5% in the EU and only 1% in Israel; the number of international tariff peaks[6] is 3% in the EU compared to 1% in Israel. These figures suggest that for certain tariff lines, the extent of trade creation and trade diversion in the IAA is likely to be higher. Further, as Table 2 reveals, Israel's tariff profile and our finding does not change by much if we look at Israel's imports from the EU alone.

[5]Domestic tariff peaks are defined as those exceeding three times the overall simple average applied rate.
[6]International tariff peaks are defined as those exceeding 15%.

Table 1: Comparative tariff profiles on world imports, EU and Israel (1996-2010)

Reporter	Year	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
EU	Simple Average	6.55	6.44	5.84	5.49	5.13	4.48	4.43	4.35	4.28	4.29	4.35	4.35	4.33	4.36	4.34
	Weighted Average	5.42	5.14	4.70	4.24	3.54	3.08	3.15	3.15	2.90	2.73	2.75	2.74	2.53	0.00	0.00
	Minimum Rate	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	Maximum Rate	1,006.4	702.2	256.6	506.3	471.0	74.9	74.9	74.9	74.9	74.9	74.9	74.9	74.9	74.9	74.9
	Domestic Peaks	2.7%	2.7%	2.7%	3.6%	3.5%	4.4%	4.5%	5.2%	5.2%	5.4%	5.5%	4.7%	4.6%	4.5%	4.9%
	International Peaks	7.6%	7.3%	6.5%	9.7%	8.6%	3.2%	3.2%	3.2%	3.2%	3.3%	3.3%	3.5%	3.3%	3.4%	3.1%
Israel	Simple Average				2.50	5.30	5.65	5.50	5.44	5.40	5.55	5.47	5.49	5.51	5.42	
	Weighted Average				1.58	2.82	3.10	2.93	2.71	2.54	2.61	2.64	2.76	2.83	0.00	
	Minimum Rate				0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	
	Maximum Rate				250.0	250.0	250.0	250.0	250.0	230.0	230.0	230.0	230.0	230.0	230.0	
	Domestic Peaks				0.6%	0.7%	0.5%	0.5%	0.5%	0.4%	1.1%	1.1%	1.2%	1.3%	1.1%	
	International Peaks				0.8%	0.9%	0.6%	0.6%	0.5%	0.5%	1.1%	1.2%	1.3%	1.3%	1.2%	

Source: WITS via TradeSift

Table 2: Israel tariffs on EU imports (1996-2010)

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Simple Average	0.70	5.19	5.52	5.36	5.31	5.29	5.40	5.35	5.38	5.40	5.34
Weighted Average	0.32	3.23	3.62	3.37	2.95	2.70	2.85	3.11	3.31	3.60	
Maximum Rate	215.0	250.0	250.0	250.0	250.0	230.0	230.0	230.0	230.0	230.0	230.0
Domestic Peaks	0.4%	0.7%	0.5%	0.4%	0.4%	0.5%	1.0%	1.0%	1.1%	1.2%	1.0%
International Peaks	0.6%	0.9%	0.6%	0.5%	0.5%	0.5%	1.1%	1.1%	1.2%	1.3%	1.0%

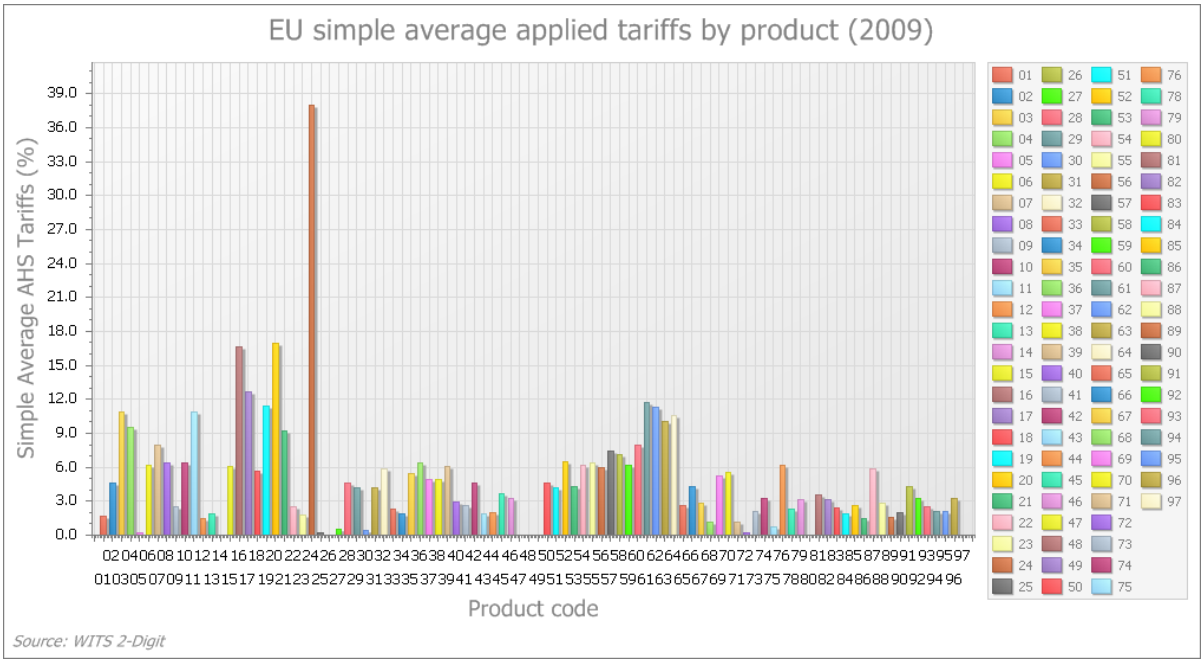
Source: WITS via TradeSift

Exploring the tariff profile further by traded commodity in Figure 4 for the EU, we find that tariff peaks exist for product codes 16 (meat & fish preparations), 20 (fruit & vegetable preparations) and 24 (tobacco) in the case of EU's global imports. Given that the EU grants duty-free quota-free (DFQF) access to all Palestinian exports under the IAA with effect from January 2012, there would be considerable likelihood of there being both trade creation and trade diversion in the EU economy in these sectors.

Similarly, exploring the tariff profile by traded commodity for Israel in Figure 5, we find that tariff peaks exist for product codes 04 (dairy produce), 07 (edible vegetables) and 94 (furniture) in the case of Israel's imports from the EU. This suggests that the existing levels of distortion are quite high in these sectors; therefore, in liberalising Palestinian tariffs on EU exports, there is considerable likelihood of there being both trade creation and trade diversion in the Palestinian economy in these sectors.

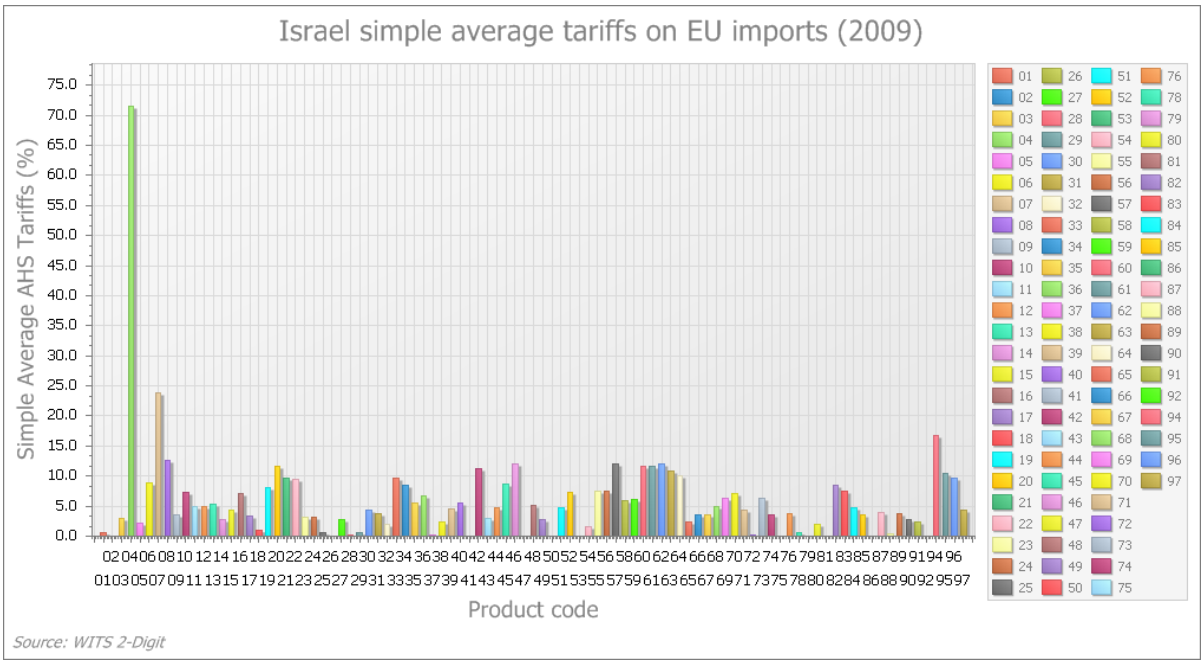
These trade effects also depend on the underlying elasticities of supply and on the extent to which small tariffs impact on differences in competitiveness across countries. This would thus need to be considered in the light of the other rules of thumb.

Figure 4: EU simple average applied tariffs on world imports by product (2009)



Source: WITS via TradeSift
Note: Product description available in Annex Table 2

Figure 5: Israel simple average applied tariffs on EU imports by product (2009)



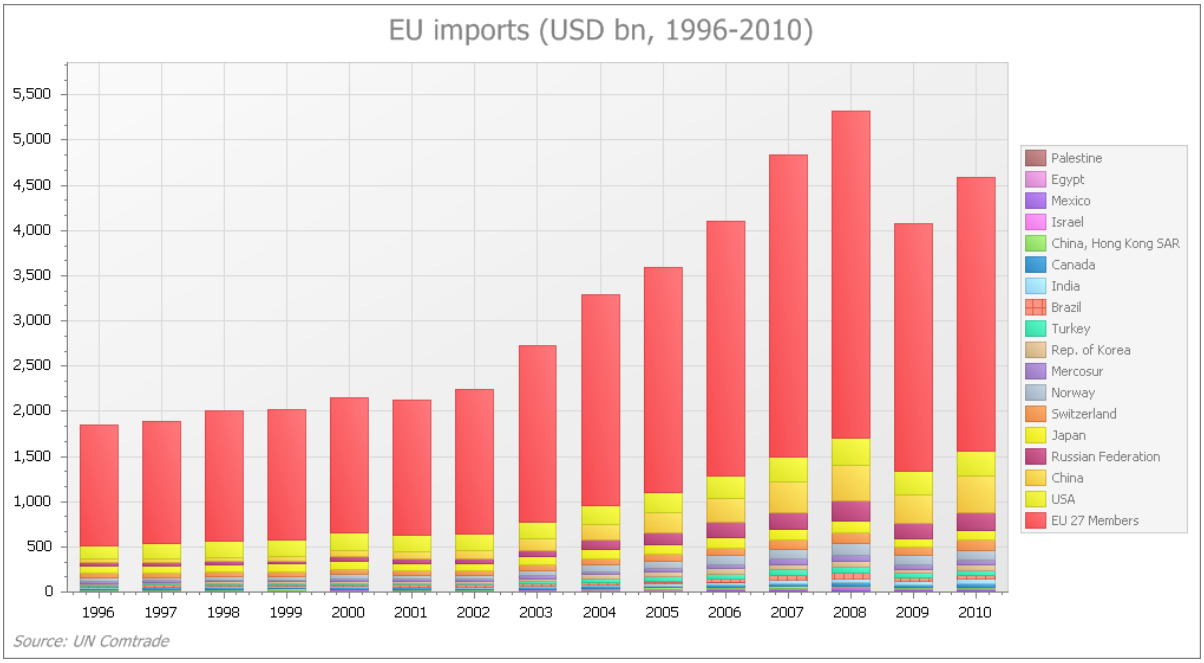
Source: WITS via TradeSift
Note: Product description available in Annex Table 2

Turning next to the number of countries involved in the EU-SoP IAA (RT2), from the perspective of the EU there is clearly only one partner country, while for SoP, the IAA involves 27 countries. In addition, depending on the cumulation arrangements, the IAA could

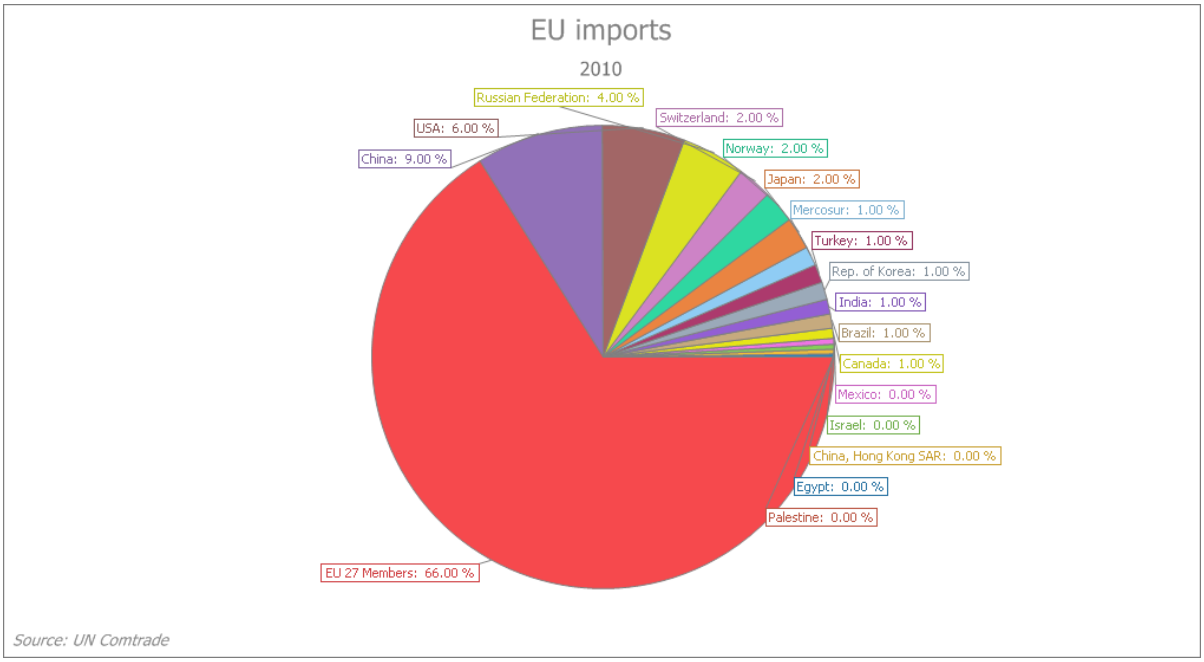
also involve decreasing barriers to trade with all those countries with which the EU has other agreements, such as those in the Southern Mediterranean. Thus it would seem that, for those goods in which the EU does not have a comparative advantage, the IAA increases the likelihood of trade diversion and lessens any trade creation welfare gains. In contrast, for SoP the IAA involves a larger number of partner countries. This indicates greater potential for trade creation. To explore this further we need to look more carefully at the geographical distribution of trade.

The extent to which the partner countries trade with each other prior to the PTA is the essence of RT5. Figure 6 shows the geographical distribution of 89% of EU's global trade both over time and in greater detail for 2010. These figures suggest that the EU is its own most important trading partner (60% of its global trade is intra-EU), followed by the US, China, Russia and Switzerland. From the EU's perspective, SoP and Israel both account for an insignificant share of both exports and imports of goods both over time and in 2010. It is also the case that the EU offers DFQF access to Palestinian exports. All this suggests that the scope for trade creation in the EU from the IAA – be it with regard to production or consumption – is relatively small. Thus for the EU, the shallow integration-induced welfare effects are likely to be small. It is of course possible that growth and expansion of the Palestinian economy and trade in the future may turn the country into a more significant market for the EU as well as a potentially significant supplier to the EU market. For this to happen, however, would require a fairly substantial break from current trends.

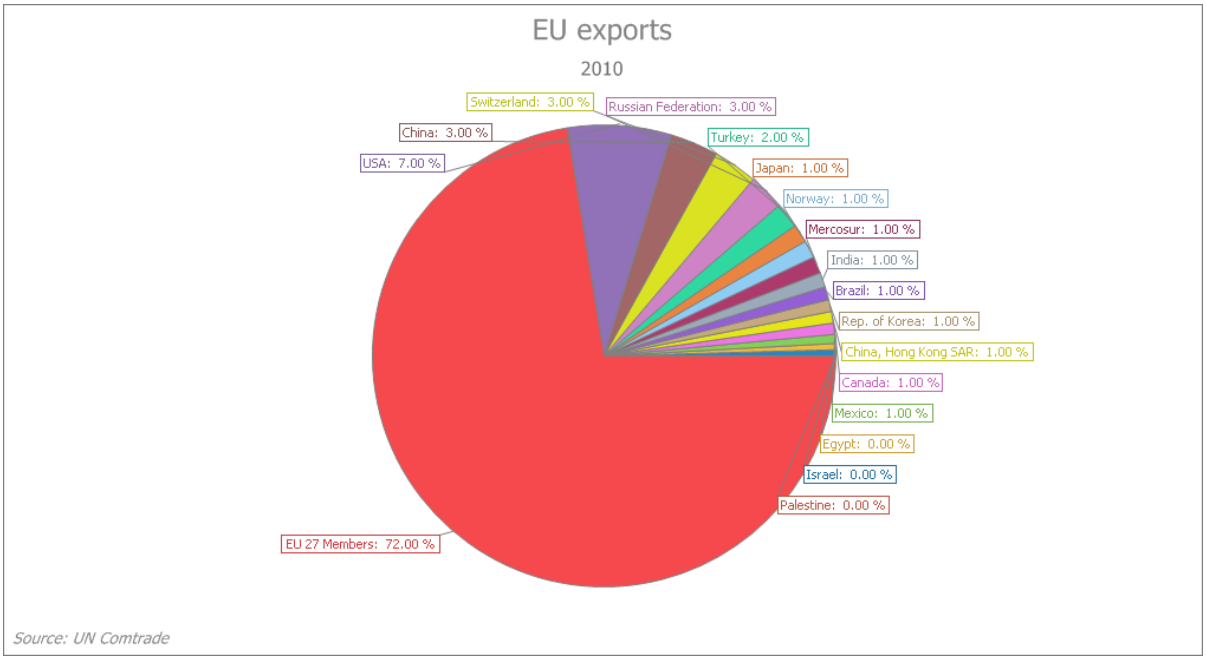
Figure 6: Geographical distribution of EU's trade



Source: UN Comtrade via TradeSift



Source: UN Comtrade via TradeSift



Source: UN Comtrade via TradeSift

Table 3 shows the comparable picture for SoP and reveals that SoP's most important trading partner in 2009 was Israel, which accounted for 73.6% of SoP's imports and 82.7% of its exports. Other major trading partners include the EU (accounting for 9.7% of Palestinian imports) and the GAFTA countries (primarily Jordan) that source 10.1% of Palestinian exports. This geographical distribution is fairly constant even if we look at the period from 2007-09 (Annex Table 1) for which trade data is available for SoP from UN Comtrade. The EU is thus not the most important supplier, which again suggests low possibilities for trade creation for SoP from the IAA.

Table 3: Geographical distribution of SoP's trade (USD mn, 2009)

Partner	Imports	Exports	Share of imports (%)	Share of exports (%)
Brazil	15.74	0.00	0.4	0.0
Canada	2.65	2.66	0.1	0.7
China	161.82	0.01	4.5	0.0
Hong Kong	4.23	0.00	0.1	0.0
EFTA	4.67	0.17	0.1	0.0
Egypt	35.32	2.89	1.0	0.8
EU27	**348.50**	**4.74**	**9.7**	**1.3**
GAFTA	**91.96**	**36.67**	**2.6**	**10.1**
India	15.11	0.00	0.4	0.0
Israel	**2,651.13**	**301.24**	**73.6**	**82.7**
Japan	18.71	0.46	0.5	0.1
Jordan	48.12	27.18	1.3	7.5
MERCOSUR	20.29	0.00	0.6	0.0
Mexico	1.60	0.00	0.0	0.0
Norway	4.67	0.00	0.1	0.0
Korea	50.51	0.00	1.4	0.0
Russia	2.51	0.01	0.1	0.0
Switzerland	0.00	0.17	0.0	0.0
Turkey	113.81	0.05	3.2	0.0
USA	40.36	6.12	1.1	1.7
World	3,600.79	364.29	100	100

Source: UN Comtrade

Source: UN Comtrade via TradeSift

It is also important to consider EU-SoP trade by product category. Looking first at the composition of SoP's trade with the EU, Table 4 below shows SoP's top 10 exports to the EU in 2009 (at the HS 1996 2-digit level) and the corresponding imports. These figures suggest that these top 10 exports account for 99% of SoP's total exports to the EU, thereby pointing to a concentrated export profile. Moreover, just 3 products (stone, plaster, cement articles; vegetable fats & oils; and edible vegetables) account for 84% of SoP's exports to the EU; coverage of these products in the IAA would be vital for any trade creation. Table 4 also suggests that Palestinian imports from the EU in its top 10 export products account for only 10% of its total imports from the EU, which points to a low level of intra-industry trade in these products. The latter shall be explored in detail later for all traded products via the Grubel-Lloyd Index (GLI) to indicate possibilities for deep integration in the IAA.

Table 4: SoP's top 10 exports to the EU (USD '000s, 2009)

Product	Product Name	Imports Value	Imports Share	Exports Value	Exports Share
68	Stone, plaster, cement, asbestos, mica, etc articl...	1,481.6	0.43%	2,375.8	50.13%
15	Animal,vegetable fats and oils, cleavage products,...	473.9	0.14%	937.0	19.77%
07	Edible vegetables and certain roots and tubers	0.0	0.00%	677.6	14.30%
19	Cereal, flour, starch, milk preparations and produ...	14,526.3	4.22%	221.3	4.67%
08	Edible fruit, nuts, peel of citrus fruit, melons	0.0	0.00%	159.4	3.36%
06	Live trees, plants, bulbs, roots, cut flowers etc	0.0	0.00%	112.2	2.37%
69	Ceramic products	16,988.6	4.94%	66.6	1.41%
64	Footwear, gaiters and the like, parts thereof	66.3	0.02%	56.0	1.18%
44	Wood and articles of wood, wood charcoal	1,217.9	0.35%	48.3	1.02%
09	Coffee, tea, mate and spices	0.1	0.00%	39.9	0.84%
Top 10		34,754.6	10.1%	4,694.1	99.0%

Source: UN Comtrade via TradeSift

Looking next at the composition of EU's trade with SoP, Table 5 below shows the EU's top 10 exports to SoP in 2009 and the corresponding imports. These figures suggest that these top 10 exports account for 87% of EU's total exports to SoP, but the top 3 products (vehicles; nuclear reactors; and pharmaceutical products) account for only 59% of EU's total exports to SoP, which points to a more diverse export profile compared to that of SoP. Once again, including these products in the IAA would be vital for trade creation. Table 5 also suggests that EU imports from SoP in its top 10 export products account for only 11% of its total imports from SoP, which again points to a low level of intra-industry trade in these products.

Table 5: EU's top 10 exports to SoP (USD '000s, 2009)

Product	Product Name	Imports Value	Imports Share	Exports Value	Exports Share
87	Vehicles other than railway, tramway	11.74	0.15%	20,312.83	28.62%
84	Nuclear reactors, boilers, machinery, etc	171.24	2.13%	12,671.12	17.85%
30	Pharmaceutical products	0.00	0.00%	8,628.67	12.16%
39	Plastics and articles thereof	41.03	0.51%	6,383.47	8.99%
90	Optical, photo, technical, medical, etc apparatus	267.08	3.32%	6,235.99	8.79%
85	Electrical, electronic equipment	18.66	0.23%	2,036.02	2.87%
19	Cereal, flour, starch, milk preparations and produ...	323.55	4.02%	1,439.80	2.03%
38	Miscellaneous chemical products	0.00	0.00%	1,357.67	1.91%
21	Miscellaneous edible preparations	57.67	0.72%	1,226.24	1.73%
17	Sugars and sugar confectionery	12.22	0.15%	1,167.72	1.65%
Top 10		**903.18**	**11.2%**	**61,459.54**	**86.6%**

Source: UN Comtrade via TradeSift

The results from the analysis above are also corroborated by using the Trade Concentration Index[78] (TCI), which aims to assess the degree of concentration/diversification of a country's export structure. Other things being constant, the more diverse the export structure, the greater are the possibilities for trade creation. Looking first at Palestinian exports to the EU in 2009, the TCI was found to be 0.3 at the 4-digit level and 0.2 at the 6-digit level. On the other hand, the TCI for EU exports to SoP in 2009 was 0.1 at the 4-digit level and 0.075 at the HS 1996 6-digit level. Thus, EU exports to SoP are far more diversified than vice-versa, which, other things constant, suggests greater possibilities for trade creation for the EU compared to SoP.

In the discussion above we outlined how trade creation could occur either on the production side (i.e. trade displacing domestic production), or on the consumption side (increased imports arising from lower partner country prices). The extent to which the former will occur depends on the degree of overlap in production and trade structures across the two economies, and on the differences in relative costs of production between them (RT3 and RT4). To measure the degree of similarity between the two partners, we use the Finger-Kreinin Index (FKI)[9].The FKI is equal to one when the structure of trade (defined by the share of each sector in total trade) across the two partners being compared is identical and is equal to zero when the structure of trade is completely different.

If we compare EU and Palestinian exports to the world, the FKI calculated at the HS 1996 6-digit level for the year 2009 is very low at 0.073. This suggests that in terms of the export structure, the two trading partners are very dissimilar. This would appear to suggest that on the production side there is not much evidence of scope for trade creation.

In fact, if we compare Israeli and Palestinian exports to the EU, the FKI calculated at the HS 1996 6-digit level for the year 2009 is relatively higher at 0.27, which suggests that in terms

---

7 $TCI\ by\ Product_{ij} = \sum_k \left(\frac{x_{ij}}{X_{ij}}\right)^2$ where x_{ij} is country i's exports of product k to country j. The index sums across products the squares of the product shares in country i's exports of product k to country j; the product shares themselves sum to 1. The TCI ranges in value between 0 (completely diversified) and 1 (completely concentrated).

8 The definitions of all statistical indicators used in this report are taken from TradeSift.

9 This is an index which is designed to capture the degree of similarity between a pair of countries either with regard to trade or production structures. Ideally we would like to be able to compute the index on patterns of production as that is the most direct way of addressing the fourth rule of thumb. However, the data is not available. Following common practice we compute the index on the basis of trade flows, and use trade flow similarity as an imperfect proxy for production structure similarity. This index is typically computed at the 6-digit level of disaggregation.

$$FK_{i_1 i_2 j} = \sum_k min\left[\left(\frac{x_{i_1 j}}{X_{i_1 j}}\right), \left(\frac{x_{i_2 j}}{X_{i_2 j}}\right)\right]$$

where i_1 and i_2 to the two source countries and j to the destination country. x^k refers to the trade flow in product k; X to the total trade flow, so x^k_{i1j}/X_{i1j} is the share of product k in country i's total exports to the destination partner (j). x^k_{i2j}/X_{i2j} is the share of product k in the comparator country's (i_2) total exports.

of imports coming into the EU from these two economies, preferential treatment to SoP is likely to divert trade away from Israel towards SoP, but given the low value of the FKI, this trade diversion is also unlikely to be significant.

It is also important to consider the relative competitiveness of producers across the countries in a PTA as suggested by the RT3. This is done by calculating indices of revealed comparative advantage (RCA). The RCA measures a country's exports of a commodity relative to its total exports and the compares this to the world exports of a commodity relative to total world exports[10]. A comparative advantage is "revealed" if RCA > 1. This is because the index shows that the country is exporting a higher share of the good than the share of the good in world exports – hence the country has a comparatively higher share for that good, implying a comparative advantage. Analogously, if the RCA is less then unity, the country is said to have comparative disadvantage in that commodity.

We calculate the RCAs for both SoP and the EU at the HS 1996 6-digit level, which accounts for 5090 different commodities. In this analysis we first compare the RCAs for the top fifteen exporting sectors for each country in Table 6 and this comparison reveals little similarity in patterns of comparative advantage between the EU and SoP. This analysis also reveals that the export structure of SoP (EU) is a lot more concentrated (diverse) with the top 15 sectors at the 6-digit level accounting for 63.5% (18.67%) of SoP's (EU's) total exports. Moreover, the huge RCA magnitudes for SoP suggest that the country seems to occupy a much more important position globally in the export of its top 15 products compared to the EU.

Next we compute the correlation coefficient between the EU and SoP RCAs for all the 5090 products and find this to be 0.005. From this one can conclude that the pattern of underlying comparative advantage between the EU and SoP is considerably different. Where there is overlap in their production bundles, this would appear to suggest some scope for trade creation on the production side. However, as discussed above, there does not appear to be much overlap in this regard (as captured by the low value of the FKI), and thus relatively little scope for trade creation.

We also need to consider the possibilities for trade diversion. While the EU accounted for 9.7% of Palestinian imports in 2009, the majority of Palestinian imports are sourced from Israel, which thus suggests that there is also considerable scope for trade diversion. However it is unrealistic to suppose that the EU is competing here with Israel - this would only be in a subset of products where the EU has a comparative advantage - while across a range of products and suppliers there will be little trade diversion. Nevertheless, China already

10 $RCA_{iw}^{k} = \left(\frac{x_{iw}^{k}}{X_{iw}}\right) \Big/ \left(\frac{x_{ww}^{k}}{X_{ww}}\right)$ where x^{k}_{iw} represents exports of sector k by country i to the world, X_{iw} denotes total exports from country i to the World, capital letter subscripts represent total flows of all goods.

supplied 4.5% of SoP's imports in 2009 and is thus likely to be competing with EU producers. We also compared SoP's imports from the world with SoP's imports from the EU using the FKI, and found its value to be low at 0.27. This too suggests that EU exports into SoP are not in competition with other countries' exports into SoP. Thus, giving the EU preferential access into the Palestinian market would not lead to significant trade diversion arising from the EU-SoP IAA.

The overall conclusion from this discussion, therefore, is that for SoP there are limited possibilities for trade creation. As only 9.7% of SoP's imports come from the EU, the scope for trade creation on the consumption side is relatively limited. Similarly, the lack of similarity between the production structures in the EU and SoP suggests there is little scope for trade creation on the production side. This said, there is limited scope for trade diversion as well, so the net welfare effect for SoP is ambiguous. To the extent that some trade diversion occurs, from the EU's perspective this implies an increase in demand for EU goods arising from the expansion of the EU's exports to SoP. However, whether this entails a net positive welfare effect for the EU will depend on whether the expanding sectors are matched by contracting sectors elsewhere, or whether the expansion is using previously unemployed resources. Of course, there will be gains for the sectors which experience a trade-diverting increase in demand.

From the EU's perspective, SoP accounts for an insignificant share of the EU's exports. Now while the IAA may well serve to increase the share of the EU in the Palestinian market, this is unlikely to cause any significant trade diversion. On the whole, given the existing low share of Palestinian exports in EU imports, there are unlikely to be significant trade effects for the EU from shallow integration under the IAA.

These findings also suggest however that reduction of border barriers to trade is more likely to be beneficial if it is carried out over a wider geographical area in the neighbourhood that would, by definition, also cover a greater share of trade between the concerned partners (as we shall see below, this has also been explicitly recognized in Article 55 of the IIA). Thus, a wider pan-EU Med PTA that includes SoP is more likely to lead to positive shallow integration effects.

Table 6: Comparison of RCAs for the top 15 exporting sectors of EU & SoP (2009)

		Palestine					EU		
Product	**Product Name**	**RCA**	**Export share (PAL-WLD)**	**Export share (WLD-WLD)**	**Product**	**Product Name**	**RCA**	**Export share (EU-WLD)**	**Export share (WLD-WLD)**
680229	Cut or sawn slabs of stone nes	8,943.33	17.06%	0.00%	300490	Medicaments nes, in dosage	1.86	4.25%	2.28%
680221	Cut or sawn slabs of marble, travertine or alabast...	1,002.71	9.26%	0.01%	271000	Petroleum oils&oils obta	0.77	3.31%	4.33%
940421	Mattresses of cellular rubber or plastic	419.65	5.70%	0.01%	870332	Automobiles, diesel engine of 1500-2500 cc	2.25	1.86%	0.83%
392321	Sacks & bags (including cones) of polymers of ethy...	76.14	5.06%	0.07%	870323	Automobiles, spark ignition engine of 1500-3000 cc	1.11	1.56%	1.41%
640199	Waterproof footwear(Wellington) no toe cap, nes	2,626.58	3.84%	0.00%	880240	Fixed wing aircraft, unladen weight > 15,000 kg	2.09	1.17%	0.56%
441520	Wooden pallets, box pallets and load boards	222.22	3.42%	0.02%	870322	Automobiles, spark ignition engine of 1000-1500 cc	1.80	1.03%	0.57%
940350	Bedroom furniture, wooden, nes	50.19	3.31%	0.07%	870899	Motor vehicle parts nes	1.29	0.84%	0.65%
720430	Waste or scrap, of tinned iron or steel	380.10	2.85%	0.01%	852812	Color television receive	1.07	0.69%	0.65%
300390	Medicaments nes, formulated, in bulk	60.53	2.74%	0.05%	870324	Automobiles, spark ignition engine of >3000 cc	0.90	0.62%	0.69%
150910	Olive oil, virgin	58.42	2.08%	0.04%	854230	Monolithic integrated ci	0.34	0.62%	1.85%
760429	Bars, rods and other profiles, aluminium alloyed	34.77	2.04%	0.06%	270900	Petroleum oils, oils from bituminous minerals, cru...	0.10	0.59%	6.06%
720450	Remelting scrap ingots, of iron or steel	1,684.77	1.73%	0.00%	852520	Transmit-receive apparatus for radio, TV, etc.	0.57	0.57%	0.99%
940161	Seats with wooden frames, upholstered nes	17.39	1.71%	0.10%	300210	Antisera and other blood fractions	1.24	0.55%	0.44%
151550	Sesame oil or fractions not chemically modified	1,152.36	1.42%	0.00%	844390	Parts of printing machinery and ancillary equipmen...	1.11	0.51%	0.46%
721399	Bars&rods,iron/na st irr	213.07	1.26%	0.01%	847330	Parts and accessories of data processing equipment...	0.61	0.49%	0.81%
Top 15 exports			63.50%	0.43%	**Top 15 exports**			18.67%	22.58%

Source: UN Comtrade via TradeSift

Deep integration[11]

In considering the impact of the EU-SoP IAA, it is important to consider not just the implications of the removal of tariff barriers, but also the implications of the removal of non-tariff barriers and the opportunities for positive or deeper integration. These may deal, for example, with regulatory harmonisation, with investment rules, with liberalisation of services, and with measures of trade defence. The welfare gains from a process of deeper integration are likely to be considerably higher than those derived simply from a process of shallower integration. The possible range of further gains often associated with deeper integration include: technology transfer and diffusion both through trade and foreign direct investment (FDI); pro-competitive gains from increasing import competition in an environment of imperfect competition, which may also allow greater exploitation of economies of scale in production; the increased geographical dispersion of production through trade that supports (i) exploitation of different factor proportions for different parts of the production process (Ricardian efficiency gains) and/or (ii) local economies of scale through finer specialization and division of labour in production (Smithian efficiency gains); and externalities arising from institutional changes that lead to wide increases in productivity.

It is more likely that the potential for deeper integration gains will be achieved the greater is the realisation of a "common economic space" as a result of a PTA. This common economic space requires both removal of barriers to trade that operate beyond borders (e.g. discriminatory taxes and regulations) and action to undertake common policies needed for dealing with the existence of public goods and externalities. Of course, the impact of deep integration will clearly depend on whether the norms adopted are appropriate — i.e., generate positive externalities and promote trade. Broadly speaking, adopting appropriate standards is synonymous with finding the appropriate intuitional framework for dealing with externalities.

Instruments of deep integration in the IAA

The EU-SoP IAA includes provisions on the following instruments of deep integration:

Trade remedies (safeguards and anti-dumping duties): Articles 20-23 of the IAA lay down the procedures for imposing trade remedies. According to Article 22, "The measures shall be non-discriminatory and be eliminated when conditions no longer justify their maintenance." Further, "The safeguard measures shall be notified immediately to the Joint Committee and shall be the subject of periodic consultations within that Committee, particularly with a view to their abolition as soon as circumstances permit." (Article 23)

Competition: Articles 30-32 of the IAA lay down elaborate rules prohibiting any practice (except in the case of agricultural and fishery products), including public aid, that prevents,

[11] This section draws heavily on CARIS (2007), 'Qualitative Analysis of a Potential Free Trade Agreement between the European Union and India'.

restricts or distorts competition and/or leads to abuse of dominant position (though SoP was allowed to use public aid for developmental purposes until 31 December 2001). Any such practice is to be assessed on the basis of criteria resulting from applying the EC's competition rules. Further, "Each Party shall ensure transparency in the area of public aid, inter alia by reporting annually to the other Party on the total amount and the distribution of the aid given and by providing, upon request, information on aid schemes."

Intellectual property: "The Parties 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." (Article 33) Further, "The implementation of this Article shall be regularly reviewed by the Parties."

Government procurement: "The Parties agree on the objective of reciprocal and gradual liberalization of public procurement contracts." (Article 34) The Parties must also ensure non-discrimination with respect to the conditions under which commercial State monopolies procure and market goods. (Article 31)

Investment: Article 39 includes provisions for investment co-operation to enable the creation of a favourable and stable investment environment in West Bank and Gaza. "This will entail the development of (i) harmonized and simplified administrative procedures; (ii) co-investment machinery, especially for small and medium-sized enterprises (SMEs) of both Parties; and (iii) information channels and means of identifying investment opportunities."

Standards and conformity assessment: Article 40 lays down that "the objective of cooperation will be to narrow the gap in standards and certification." This will take the form of "(i) the promotion of the use of Community technical regulations and European standards and conformity assessment procedures; (ii) raising the level of conformity assessment by Palestinian certification and accreditation bodies; (iii) discussing mutual recognition arrangements, where appropriate; (iv) cooperating in the field of quality management; and (v) developing structures for the protection of intellectual, individual and commercial property, for standardization and for setting quality standards."

SMEs: Article 42 includes provisions for SMEs to create an enabling environment in local and export markets through "(i) the promotion of contacts between enterprises, in particular through recourse to the EC's networks and instruments for the promotion of industrial cooperation and partnership; (ii) easier access to investment finance; (iii) information and support services; and (iv) enhancement of human resources with the aim of stimulating innovation and the setting-up of projects and business ventures."

Trade Facilitation: This includes provisions on improving transport (Article 46), information infrastructure and telecommunications (Article 47) and customs cooperation (Article 52). The objectives of cooperation include "aid for restructuring and modernizing roads, ports and airports; improved passenger and freight services both at bilateral and regional level; the establishment and enforcement of operating standards comparable to those prevailing in the

EU; to facilitate collaboration in the field of telecommunications policy, network development and infrastructures for an information society; and to allow for information exchange on standardization, conformance testing, and certification in information and communications technologies." Article 48 includes provisions on energy cooperation and "support to operations designed to facilitate the transit of gas, oil and electricity, and applied research into data bank networks in the economic and social sectors linking" European and Palestinian operators. The provisions on customs cooperation envisage the following forms of cooperation: "exchange of information and training schemes; simplification of controls and procedures concerning the customs clearance of goods; introduction of the single administrative document and a system to link up the partners' transit arrangements; technical assistance provided by experts from the EC; and mutual assistance on customs matters."

Sector focus: Similar to the sectoral focus in the EC-Cariforum EPAs, the EU-SoP IAA also includes provisions aimed at targeted sectors to enable their development through cooperation. These sectors include:

- Financial services (Article 43): to encourage the strengthening and restructuring of the Palestinian financial sector and to improve Palestinian accounting, supervisory and regulatory systems of banking, insurance and other parts of the financial sector
- Agriculture and fisheries (Article 44): provisions for modernization of infrastructures and of equipment; the development of packaging, storage and marketing techniques; and the improvement of distribution channels (with a focus on closer relations on a voluntary basis between business groups and organizations representing trades and professions; technical assistance and training; harmonization of phytosanitary and veterinary standards; and cooperation among rural regions and exchange of experience and know-how concerning rural development)
- Tourism (Article 51): to improve the knowledge of the tourism industry and ensure greater consistency of policies affecting tourism

Regional cooperation with the Mediterranean: Article 55 stipulates the Parties to "encourage operations designed to develop cooperation between the SoP and other Mediterranean partners, through technical support." The emphasis would be on "promoting intra-regional trade; developing regional cooperation on the environment; encouraging the development of the communications infrastructure required for the economic development of the region; and strengthening the development of youth cooperation with neighbouring countries."

Foreign direct investment

FDI plays an important role in generating additional gains from deep integration because it is an important channel for productivity change via technology and know-how transfers, quality improvement and specialisation. The SoP has created a framework of economic laws to encourage and support foreign and local investment in SoP. The implementing agency is the Palestinian Investment Promotion Agency (PIPA). These laws have been drafted to help protect potential investors from undue risk and to promote the profitability of their

investment. The "Law on the Encouragement of Investment in SoP Law No. (1) of 1998" and amendment to this in the "Presidential Decree No. (2) for the year 2011" encourage capital investment in all sectors of the Palestinian economy by both local and foreign corporations registered to do business in SoP.

As things stand, SoP does not have an investor-specific dispute settlement system in place, though a mechanism has been applied by a committee formed by both public and private sectors to manage any related issues. The existing investment laws thus form the main source for all investor-specific disputes. Moreover, preferential treatment is not accorded to any partner.

Total investment in SoP in 2010 and 2011 was USD 510 and USD 542 mn, respectively of which, domestic investment accounted for an overwhelming majority (93 and 97%, respectively). The major sectors attracting domestic investment were public equities, real estate and telecom accounting for 29, 24 and 20% of total domestic investment, respectively, on average over 2010-2011.

FDI, on the other hand, contributed only 6.7 and 3.3% of total investment in 2010 and 2011 (USD 34 and 18 mn, respectively). Telecoms in 2010 and SMEs in 2011 attracted almost all this FDI followed by financial services (USD 1 mn in 2010). Over the last five years, Qatar & Kuwait have been the pre-dominant sources of this FDI with a value of USD 25 mn. The other significant sources have been the EU and UAE at USD 1.4 and 1 mn, respectively.

These figures suggest that the role of FDI as a channel of deep integration is rather limited in SoP at the moment. Moreover, the EU is not a huge investor in the Palestinian economy. This said Article 39 of the IAA does include definitive provisions for investment cooperation, effective implementation of which would be crucial for FDI-induced deep-integration effects to fructify.

Intra-industry trade

A key indicator of existing deep integration is the degree to which intra-industry trade (IIT) is taking place. IIT is defined as the simultaneous import and export of goods of the same kind. The standard measure of IIT is the Grubel-Lloyd Index (GLI) introduced by Grubel and Lloyd (1975)[12]. It measures the overlap of imports and exports at a given aggregation level. Unlike the FKI, the IIT index can be calculated at the disaggregated level for individual sectors, sub-sectors or products. On the basis of these calculations, a summary measure which averages across the selected sectors (or sub-sectors or products) can also be calculated. The value of the GLI ranges between 0 and 1, with higher values indicating greater IIT and potential for deeper integration.

The GLI for trade between countries i and j in good k, is given by:

[12] Grubel, H.G.and P.J. Lloyd (1975). *Intra-industry trade: the theory and measurement of international trade in differentiated products*. New York: Wiley.

$$GL_{ij}^{k} = 1 - \left(\frac{\left| x_{ij}^{k} - m_{ij}^{k} \right|}{x_{ij}^{k} + m_{ij}^{k}} \right)$$

where x^{k}_{ij} and m^{k}_{ij} denote exports and imports from/by country i to/from country j of commodity k.

The GLI across all goods is given by

$$GL_{ij} = \sum_{k} GL_{ij}^{k} \left(\frac{x_{ij}^{k} + m_{ij}^{k}}{X_{ij} + M_{ij}} \right) = 1 - \frac{\sum_{k} \left| x_{ij}^{k} - m_{ij}^{k} \right|}{X_{ij} + M_{ij}}$$

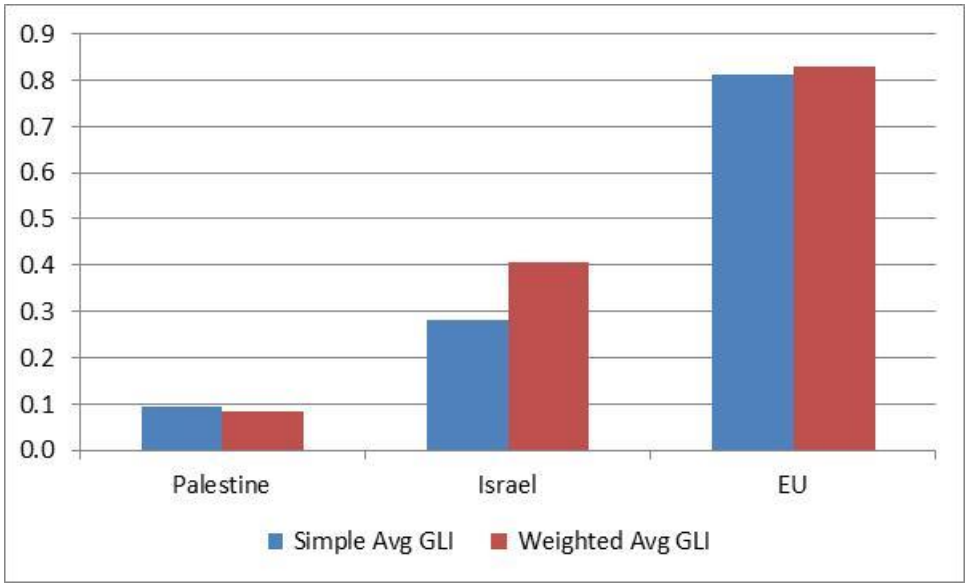
which averages the GLI across all goods. The average GLI can either be weighted by the share of each good in total trade between country i and country j, as in the above formula, or it can be an unweighted average.

The GLI measures what proportion of trade is 'overlapping'. Looking first at the extreme cases, if all the trade in sector k is one-way trade, so either x^{k}_{ij} or m^{k}_{ij} is zero, then GL^{k}_{ij} =0; similarly, if all the trade in every sector is one-way trade, then GL_{ij} = 0 i.e. all trade is 'inter-industry' trade. At the other extreme, if trade in sector k is equal in both directions, i.e. x^{k}_{ij} = m^{k}_{ij}, then GL^{k}_{ij} =1; and if trade in every sector is equal in both directions, then GL_{ij} = 1 i.e. all trade is 'intra-industry' trade.

Additionally, the rate of growth of IIT is also an indicator of the potential for further deep integration. Broadly, IIT takes three forms. First, it is the exchange of similar goods (with the same trade heading) of roughly similar qualities and prices; secondly, it is the exchange of similar goods of different qualities and prices; thirdly, it is the exchange of goods within a trade classification that represents a vertically integrated supply chain (parts for finished or partly finished goods). Each of these represents a way in which economic integration can encourage the niche specialisation that generates productivity gains. These gains represent the main advantages of deep integration and compensate for any losses to trade diversion from shallow integration.

Figure 7 reports the simple average and weighted average GLI for the EU, Israel and SoP in 2009 looking at each country's trade with the world. These results show that SoP lags well behind both countries, especially the EU, in the extent of its two-way trade with the world.

Figure 7: Comparative GLI for EU, Israel & SoP global trade (2009)



Source: UN Comtrade via TradeSift

Next we look at the extent of deep integration in SoP's trade with the EU. Figure 8 shows the simple and weighted average GLIs over 2007-09 while Annex Table 2 reports the disaggregated sectoral GLIs over the same time period. The extremely low level of the EU-SoP GLI (less than 0.01) confirms the story from the RCA indicators of little direct overlap between EU and Palestinian trade patterns and competitiveness. This said the slight rise in these levels over 2007-09 also underlines the potential for increased IIT, especially if standards and technical barriers to trade were reduced as part of the implementation of the IAA.

Figure 8: Simple and weighted average GLI for EU-SoP trade (2007-09)

Source: UN Comtrade via TradeSift

Assessment of non-tariff barriers (NTB) to trade

An assessment of "behind-the-border" issues and regulatory impediments is necessary to evaluate the possibilities for deep integration in a PTA. Unfortunately, the EU's Market Access Database does not provide any information on market access barriers in SoP. Similarly, there is no readily accessible data[13] on impediments that Palestinian exporting firms face in European markets. We therefore need to rely on anecdotal evidence on assessing NTBs in this section. It is also useful to point out that provisions targeting most of the "behind-the-border" issues are already included in the IAA, however no clear implementation mechanism for these has been provided for in the agreement.

On the subject of standards, anecdotal evidence gathered from PalTrade suggests that while new standards have not been introduced, about 2000 standard EU classifications have been adopted in 2011 that include all products in the following sectors: electricity and electronics, chemicals, food industries, metal and engineering and construction.

The major products stated to be affected by standards-related barriers include stone & marble, steel doors and pharmaceutical products. The costs of meeting European standards are stated to be in the range of USD 100 to USD 20,000 depending on the product (examples given include bricks testing USD 100, water plastic pipes USD 8000 and steel doors USD 15000) and these are costs that are generally borne by the firms themselves. Moreover, around 2% of Palestinian firms are stated unable to meet these standards.

In terms of conformity assessment, anecdotal evidence suggests that while new conformity and testing facilities have not been created, a new EU-funded project is likely to start at the end of 2012 to develop Palestinian laboratories as part of developing the Palestinian Standards Institute in general. It is important to mention that as of now, the EU does not recognize Palestinian laboratory certificates or test results. There is also no mutual recognition agreement between the EU and SoP in this area.

Another way of assessing NTBs in these markets is to look at Revealed Market Access (RMA) indicators. For any given country, the RMA compares the level of market access into a particular economy with a comparator economy (e.g. the EU's access to SoP compared with its access to Israel). The level of exports into a given market will, in good part, depend on the size of that market. So in comparing exports across two markets we need to control (or normalise) for this. In our analysis, we do this on the basis of the total level of their imports[14].

An RMA greater than 1 indicates that the normalised value of exports for a given product is greater in one market relative to the other market and conversely for values of the index less than one. While the RMA controls for the level of demand in the receiving country through

[13] The ITC is in the process of compiling this information on the basis of survey responses which should be useful from the perspective of this report.

[14] $RMA^{k}_{i\,j_1 j_2} = \left(\frac{x^{k}_{ij_1}}{x^{i}_{jk_2}}\right)\left(\frac{\sum_i M_{j_2}}{\sum_i M_{j_1}}\right)$ where k is the industry, i is the origin country and j_1 and j_2 are the destination countries.

total imports, there are various other reasons which might result in trade in particular products being relatively higher to one market than another. These factors may depend on the nature of the product in question but can also include distance, previous colonial ties, common language, levels of trade facilitation and the existence of trade barriers especially NTBs. If we choose the source and destination countries carefully, we can also control for most of the other geographic and historical factors so that significant differences in market access between two destinations (RMA values significantly less or more than 1) are either product-specific or due to NTBs.

For the purpose of our analysis, we provide three different sets of comparisons and look at RMA indicators in each case:

(i) The EU's exports to SoP compared to Israel: The RMA values for the EU's top 10 exports to SoP at the HS 1996 2-digit level are reported in Table 7 and reveal that the RMA is significantly less than one for all of the EU's top 10 exports to SoP compared to Israel. This shows that the EU is exporting much less to SoP than it is to Israel in the same product categories. Given that distance between the source and destination countries is comparable in both cases (i.e. EU-SoP are as distant as EU-Israel) and we provide results at the product level, these values suggest the presence of significant market access barriers for EU exports in SoP.

(ii) The EU's exports to Israel compared to SoP: In this case, we reverse the comparator country and find that the EU is exporting much more to Israel than it is to SoP in the same product categories. The RMA values for the EU's top 10 exports to Israel at the HS 1996 2-digit level are reported in Table 8 and show that the RMA is significantly greater than one for all of the EU's top 10 exports to Israel compared to SoP. In fact, the top 7 product categories in Table 8 include the top 6 product categories in Table 7, which shows that the EU's top exports to both these countries are in virtually the same product categories and thus, these results do not depend on the choice of these categories. Once again, given comparable distance between the source and destination countries in both cases, this table suggests the presence of significant market access barriers for EU exports in SoP.

(iii) SoP's exports to the EU compared to the World: Finally, we compare Pal-EU exports to Pal-World exports, assuming that the costs in terms of distance for Palestinian firms exporting to the EU are similar to the costs of exporting to the rest of the world. The RMA values for SoP's top 10 exports to the EU at the HS 1996 2-digit level are reported in Table 9 and reveal that the RMA is significantly less than one for all of SoP's top 10 exports to the EU compared to the World. This suggests that SoP is exporting much less to the EU than it is to the World in the same product categories. Assuming that we successfully control for the effect of distance in our choice of the destination countries, these results suggest the presence of significant market access barriers for Palestinian exports in the EU.

Table 7: RMA values for top 10 EU exports to SoP (2007-11)

		Avg. 2007-11		
Product	**Product Name**	**RMA**	**EU exports to PAL (% share)**	**EU exports to ISR (% share)**
87	Vehicles other than railway, tramway	0.20	28.0%	15.9%
84	Nuclear reactors, boilers, machinery, etc	0.07	18.0%	15.1%
39	Plastics and articles thereof	0.12	9.3%	4.3%
30	Pharmaceutical products	0.13	8.9%	4.6%
90	Optical, photo, technical, medical, etc apparatus	0.13	7.7%	4.9%
85	Electrical, electronic equipment	0.02	3.5%	8.8%
19	Cereal, flour, starch, milk preparations and produ...	0.20	3.0%	1.5%
18	Cocoa and cocoa preparations	0.40	3.2%	0.6%
10	Cereals	0.25	2.3%	0.3%
38	Miscellaneous chemical products	0.06	1.7%	1.6%
Top 10 EU exports to Palestine			**85.6%**	**57.7%**

Source: UN Comtrade via TradeSift

Table 8: RMA values for top 10 EU exports to Israel (2007-11)

		Avg. 2007-11		
Product	**Product Name**	**RMA**	**EU exports to ISR (% share)**	**EU exports to PAL (% share)**
84	Nuclear reactors, boilers, machinery, etc	16.3	15.6%	17.5%
71	Pearls, precious stones, metals, coins, etc	9,291.0	15.3%	3.2%
85	Electrical, electronic equipment	129.9	10.3%	4.7%
87	Vehicles other than railway, tramway	5.4	9.3%	24.4%
39	Plastics and articles thereof	9.2	4.2%	8.4%
30	Pharmaceutical products	8.6	4.1%	7.9%
90	Optical, photo, technical, medical, etc apparatus	11.4	3.8%	7.0%
27	Mineral fuels, oils, distillation products, etc	241.9	3.4%	0.8%
29	Organic chemicals	424.5	3.3%	0.7%
48	Paper & paperboard, articles of pulp, paper and bo...	35.9	2.1%	1.7%
Top 10 EU exports to Israel			**71.3%**	**76.1%**

Source: UN Comtrade via TradeSift

Table 9: RMA values for top 10 Palestinian exports to the EU (2009-11)

		Avg. 2007-09		
Product	**Product Name**	**RMA**	**PAL exports to EU (% share)**	**PAL exports to WLD (% share)**
68	Stone, plaster, cement, asbestos, mica, etc articl...	0.11	52.8%	38.4%
15	Animal,vegetable fats and oils, cleavage products,...	0.22	23.3%	7.2%
07	Edible vegetables and certain roots and tubers	0.23	9.1%	4.0%
08	Edible fruit, nuts, peel of citrus fruit, melons	0.52	6.3%	3.0%
19	Cereal, flour, starch, milk preparations and produ...	0.33	2.6%	0.9%
44	Wood and articles of wood, wood charcoal	0.02	0.9%	5.0%
69	Ceramic products	0.05	0.9%	1.2%
06	Live trees, plants, bulbs, roots, cut flowers etc	0.04	1.2%	0.3%
25	Salt, sulphur, earth, stone, plaster, lime and cem...	0.02	0.3%	1.2%
09	Coffee, tea, mate and spices	0.05	0.4%	0.6%
Top 10 Palestine exports to the EU			**97.7%**	**61.8%**

Source: UN Comtrade via TradeSift

Conclusion

This report has used diagnostic statistics from the Sussex Framework to evaluate the effect of the EU-SoP IAA. Our analysis suggests that the shallow integration effects of the agreement are unlikely to be of much significance to both parties in view of the low trade share in each other's market, prevailing low tariffs and the dissimilar export structures. To that extent, a wider geographical coverage in the form of a pan EU-Med PTA that includes SoP is more likely to lead to positive shallow integration effects and the underlying logic of this also forms the basis of Article 55 of the IAA. On the other hand, the current agreement provides a far-reaching coverage to several instruments of deep integration, in particular, standards, competition, investment and trade facilitation. Unfortunately there are neither publicly available databases on deep integration issues on both sides nor enough information on the implementation of such provisions in the IAA, which makes it difficult to analyse the impact of the agreement along this dimension. This said, anecdotal evidence and investigative statistical analyses in this report suggest that not much progress has been made in this area and significant non-tariff barriers to trade remain on both sides. It therefore becomes imperative to target these behind-the-border issues and regulatory impediments to realize welfare gains from the IAA. On the whole therefore, net benefits are more likely to result from a wider geographical coverage in the form of a pan EU-Med PTA and from an effective implementation of the deep integration aspects of the current agreement.

Annex Table 1: Geographical distribution of SoP's trade (USD mn, 2007-09)

	2007		2008		2009	
Partner	**Imports**	**Exports**	**Imports**	**Exports**	**Imports**	**Exports**
Brazil	9.8	0.0	18.8	0.0	15.7	0.0
Canada	5.2	0.2	1.8	0.3	2.6	2.7
China	143.8	0.1	126.0	0.0	161.8	0.0
Hong Kong	2.7	0.0	2.5	0.0	4.2	0.0
EFTA	35.5	0.1	53.9	0.2	4.7	0.2
Egypt	27.5	0.6	23.5	1.0	35.3	2.9
EU27	**250.8**	**18.1**	**289.1**	**8.1**	**348.5**	**4.7**
GAFTA	**78.2**	**29.1**	**81.9**	**43.2**	**92.0**	**36.7**
India	12.6	0.0	12.4	0.0	15.1	0.0
Israel	**2,307.9**	**294.6**	**2,767.7**	**332.8**	**2,651.1**	**301.2**
Japan	103.1	0.1	17.0	0.2	18.7	0.5
Jordan	44.8	23.2	52.2	32.3	48.1	27.2
MERCOSUR	13.1	0.0	21.1	0.0	20.3	0.0
Mexico	2.2	0.0	0.9	0.0	1.6	0.0
Norway	0.2	0.0	1.1	0.0	4.7	0.0
Korea	12.9	0.0	27.7	0.0	50.5	0.0
Russia	8.0	0.0	16.2	0.0	2.5	0.0
Switzerland	35.3	0.1	52.8	0.1	0.0	0.2
Turkey	82.0	0.5	68.5	0.5	113.8	0.1
USA	24.3	3.4	37.7	3.6	40.4	6.1
World	3,141.3	347.6	3,568.7	389.9	3,600.8	364.3
Source: UN Comtrade						

Source: UN Comtrade via TradeSift

Annex Table 2: Sectoral GLIs for SoP's trade with the EU (2007-09)

		2007			2008			2009		
Product	**Product Name**	**GLI**	**PAL imports from EU (%)**	**PAL exports to EU (%)**	**GLI**	**PAL imports from EU (%)**	**PAL exports to EU (%)**	**GLI**	**PAL imports from EU (%)**	**PAL exports to EU (%)**
01	Live animals	0.00	0.36%	0.00%	0.00	0.09%	0.00%			
02	Meat and edible meat offal	0.00	0.04%	0.00%	0.00	0.09%	0.00%			
03	Fish, crustaceans, molluscs, aquatic invertebrates...	0.00	0.24%	0.00%	0.00	0.07%	0.00%			
04	Dairy products, eggs, honey, edible animal product...	0.00	0.57%	0.00%	0.00	1.49%	0.00%			
06	Live trees, plants, bulbs, roots, cut flowers etc	0.00	0.01%	0.00%				0.00	0.00%	2.37%
07	**Edible vegetables and certain roots and tubers**	0.72	0.22%	3.90%	**0.86**	**0.16%**	**7.51%**	**0.00**	**0.00%**	**14.30%**
08	**Edible fruit, nuts, peel of citrus fruit, melons**	**0.67**	**0.15%**	**9.18%**	**0.16**	**0.02%**	**6.75%**	0.00	0.00%	3.36%
09	Coffee, tea, mate and spices	0.00	0.65%	0.00%	0.42	0.09%	0.82%	0.00	0.00%	0.84%
10	Cereals	0.00	0.97%	0.00%	0.00	1.59%	0.00%	0.00	1.00%	0.00%
11	Milling products, malt, starches, inulin, wheat gl...	0.00	0.29%	0.00%	0.00	0.42%	0.00%	0.00	0.29%	0.00%
12	Oil seed, oleagic fruits, grain, seed, fruit, etc,...	0.02	0.40%	0.10%	0.00	0.51%	0.00%	0.02	0.46%	0.29%
13	Lac, gums, resins, vegetable saps and extracts nes	0.00	0.04%	0.00%	0.00	0.00%	0.00%	0.00	0.02%	0.00%
14	Vegetable plaiting materials, vegetable products n...	0.00	0.00%	0.00%						
15	**Animal,vegetable fats and oils, cleavage products,...**	**0.60**	**0.36%**	**26.77%**	**0.52**	**0.13%**	**12.84%**	**0.67**	**0.14%**	**19.77%**
16	Meat, fish and seafood food preparations nes	0.00	0.18%	0.00%	0.00	0.14%	0.00%	0.00	0.09%	0.00%
17	Sugars and sugar confectionery	0.00	0.37%	0.00%	0.00	0.25%	0.00%	0.00	1.29%	0.00%
18	Cocoa and cocoa preparations	0.00	1.80%	0.00%	0.00	0.92%	0.00%	0.00	1.31%	0.00%
19	Cereal, flour, starch, milk preparations and produ...	0.01	4.09%	0.61%	0.04	2.83%	2.03%	0.03	4.22%	4.67%
20	Vegetable, fruit, nut, etc food preparations	0.24	0.13%	0.55%	0.00	0.01%	0.00%	0.00	0.09%	0.00%
21	Miscellaneous edible preparations	0.00	1.06%	0.00%	0.00	1.05%	0.00%	0.00	1.24%	0.00%
22	Beverages, spirits and vinegar	0.00	0.04%	0.00%	0.00	0.02%	0.00%	0.00	0.63%	0.00%
23	Residues, wastes of food industry, animal fodder				0.00	0.00%	0.00%	0.00	0.00%	0.00%

24	Tobacco and manufactured tobacco substitutes	0.00	1.21%	0.00%	0.00	2.17%	0.00%	0.00	0.61%	0.00%
25	Salt, sulphur, earth, stone, plaster, lime and cem...	0.48	0.07%	0.66%	0.86	0.04%	1.09%	0.00	0.06%	0.00%
26	Ores, slag and ash	0.00	0.00%	0.00%						
27	Mineral fuels, oils, distillation products, etc	0.00	1.00%	0.00%	0.00	0.29%	0.00%	0.00	0.66%	0.00%
28	Inorganic chemicals, precious metal compound, isot...	0.00	0.06%	0.00%	0.00	0.05%	0.00%	0.00	0.10%	0.00%
29	Organic chemicals	0.00	2.21%	0.00%	0.00	1.08%	0.00%	0.00	1.20%	0.00%
30	**Pharmaceutical products**	0.00	3.89%	0.00%	**0.00**	**9.47%**	**0.22%**	**0.00**	**5.88%**	**0.37%**
31	Fertilizers	0.00	0.16%	0.00%	0.00	0.05%	0.00%	0.00	0.14%	0.00%
32	Tanning, dyeing extracts, tannins, derivs,pigments...	0.00	1.08%	0.00%	0.00	0.92%	0.00%	0.00	0.82%	0.00%
33	Essential oils, perfumes, cosmetics, toileteries	0.00	3.52%	0.00%	0.00	1.81%	0.00%	0.00	3.14%	0.00%
34	Soaps, lubricants, waxes, candles, modelling paste...	0.00	0.88%	0.00%	0.13	0.28%	0.69%	0.01	0.63%	0.21%
35	Albuminoids, modified starches, glues, enzymes	0.00	0.53%	0.00%	0.00	0.47%	0.00%	0.00	0.38%	0.00%
37	Photographic or cinematographic goods	0.00	0.00%	0.00%	0.00	0.00%	0.00%	0.00	0.01%	0.00%
38	Miscellaneous chemical products	0.00	2.06%	0.00%	0.00	1.85%	0.00%	0.00	2.77%	0.00%
39	Plastics and articles thereof	0.00	4.64%	0.00%	0.01	3.77%	0.81%	0.00	3.00%	0.00%
40	Rubber and articles thereof	0.00	0.55%	0.00%	0.00	0.46%	0.00%	0.00	0.42%	0.00%
41	Raw hides and skins (other than furskins) and leat...	0.00	0.00%	0.00%	0.00	0.01%	0.00%	0.00	0.01%	0.00%
42	Articles of leather, animal gut, harness, travel g...	0.00	0.01%	0.00%	0.00	0.00%	0.00%	0.00	0.01%	0.00%
43	Furskins and artificial fur, manufactures thereof							0.00	0.00%	0.00%
44	**Wood and articles of wood, wood charcoal**	0.05	0.99%	0.73%	**0.32**	**0.75%**	**5.12%**	0.08	0.35%	1.02%
45	Cork and articles of cork	0.00	0.01%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
46	Manufactures of plaiting material, basketwork, etc...	0.00	0.00%	0.00%				0.00	0.00%	0.00%
47	Pulp of wood, fibrous cellulosic material, waste e...	0.00	0.11%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
48	Paper & paperboard, articles of pulp, paper and bo...	0.00	1.47%	0.00%	0.00	0.87%	0.00%	0.00	1.21%	0.00%
49	Printed books, newspapers, pictures etc	0.00	0.74%	0.00%	0.02	0.22%	0.06%	0.00	0.36%	0.00%
52	Cotton	0.00	0.03%	0.00%				0.00	0.09%	0.00%
54	Manmade filaments	0.00	0.13%	0.00%	0.00	0.02%	0.00%	0.00	0.00%	0.00%
55	Manmade staple fibres	0.00	0.02%	0.00%	0.00	0.00%	0.00%			

56	Wadding, felt, nonwovens, yarns, twine, cordage, e...	0.00	0.37%	0.00%	0.00	0.18%	0.00%	0.00	0.19%	0.00%
57	Carpets and other textile floor coverings	0.00	0.42%	0.00%	0.00	0.54%	0.00%	0.00	0.42%	0.00%
58	Special woven or tufted fabric, lace, tapestry etc	0.00	0.02%	0.00%	0.00	0.01%	0.00%	0.00	0.01%	0.00%
59	Impregnated, coated or laminated textile fabric	0.00	0.07%	0.00%	0.00	0.02%	0.00%	0.00	0.02%	0.00%
60	Knitted or crocheted fabric	0.00	0.08%	0.00%	0.00	0.04%	0.00%	0.00	0.04%	0.00%
61	Articles of apparel, accessories, knit or crochet	0.00	0.01%	0.00%	0.03	0.04%	0.02%	0.00	0.02%	0.00%
62	Articles of apparel, accessories, not knit or croc...	0.02	0.13%	0.05%	0.00	0.13%	0.00%	0.00	0.07%	0.00%
63	Other made textile articles, sets, worn clothing e...	0.00	0.18%	0.00%	0.00	0.14%	0.00%	0.00	0.14%	0.00%
64	Footwear, gaiters and the like, parts thereof	0.29	0.02%	0.11%	0.12	0.00%	0.22%	0.92	0.02%	1.18%
65	Headgear and parts thereof	0.00	0.00%	0.00%	0.00	0.01%	0.00%	0.00	0.00%	0.00%
66	Umbrellas, walking-sticks, seat-sticks, whips, etc	0.00	0.00%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
68	**Stone, plaster, cement, asbestos, mica, etc articl...**	**0.41**	**0.46%**	**55.42%**	**0.29**	**0.29%**	**59.83%**	**0.77**	**0.43%**	**50.13%**
69	**Ceramic products**	**0.00**	**6.26%**	**0.31%**	0.02	4.41%	1.37%	0.01	4.94%	1.41%
70	Glass and glassware	0.24	0.28%	1.23%	0.00	0.12%	0.00%	0.01	0.25%	0.09%
71	Pearls, precious stones, metals, coins, etc	0.00	0.04%	0.00%	0.00	0.04%	0.00%	0.00	0.04%	0.00%
72	Iron and steel	0.00	1.04%	0.00%	0.00	1.26%	0.00%	0.00	3.11%	0.00%
73	Articles of iron or steel	0.00	1.80%	0.00%	0.00	1.38%	0.00%	0.00	0.45%	0.00%
74	Copper and articles thereof	0.00	0.09%	0.00%	0.00	0.06%	0.00%	0.00	0.08%	0.00%
75	Nickel and articles thereof	0.00	0.00%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
76	Aluminium and articles thereof	0.00	1.89%	0.00%	0.00	1.06%	0.00%	0.00	0.72%	0.00%
78	Lead and articles thereof	0.00	0.00%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
79	Zinc and articles thereof	0.00	0.00%	0.00%	0.00	0.00%	0.00%	0.00	0.00%	0.00%
80	Tin and articles thereof				0.00	0.00%	0.00%	0.00	0.02%	0.00%
81	Other base metals, cermets, articles thereof	0.00	0.00%	0.00%	0.00	0.01%	0.00%	0.00	0.00%	0.00%
82	Tools, implements, cutlery, etc of base metal	0.00	0.50%	0.00%	0.01	0.35%	0.07%	0.00	0.46%	0.00%
83	Miscellaneous articles of base metal	0.00	0.44%	0.00%	0.00	0.37%	0.00%	0.00	0.52%	0.00%
84	**Nuclear reactors, boilers, machinery, etc**	**0.00**	**11.94%**	**0.00%**	**0.00**	**7.80%**	**0.54%**	**0.00**	**10.51%**	**0.00%**
85	**Electrical, electronic equipment**	**0.00**	**9.39%**	**0.00%**	**0.00**	**5.26%**	**0.00%**	**0.00**	**10.35%**	**0.00%**

86	Railway, tramway locomotives, rolling stock, equip...	0.00	0.00%	0.00%						
87	**Vehicles other than railway, tramway**	**0.00**	**23.10%**	**0.00%**	**0.00**	**25.80%**	**0.00%**	**0.00**	**30.86%**	**0.00%**
90	Optical, photo, technical, medical, etc apparatus	0.00	2.75%	0.00%	0.00	15.54%	0.00%	0.00	2.73%	0.00%
91	Clocks and watches and parts thereof	0.00	0.02%	0.00%	0.00	0.00%	0.00%	0.00	0.01%	0.00%
92	Musical instruments, parts and accessories	0.00	0.00%	0.00%	0.00	0.01%	0.00%	0.00	0.01%	0.00%
94	Furniture, lighting, signs, prefabricated building...	0.00	1.08%	0.00%	0.00	0.52%	0.00%	0.00	0.72%	0.00%
95	Toys, games, sports requisites	0.38	0.05%	0.37%	0.00	0.01%	0.00%	0.00	0.01%	0.00%
96	Miscellaneous manufactured articles	0.00	0.24%	0.00%	0.00	0.12%	0.00%	0.00	0.17%	0.00%

Source: UN Comtrade via TradeSift