EU-Libya Trade SIA Project Introduction and Overview

Steven Chaytor
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Study Context

- The Directorate General of Trade (DG Trade) of the European Union is responsible of conducting the EU's commercial policy – Art 133 of the EC Treaty
- *Global Europe: Competing in the World* – WTO and DDA first priority – opportunities for growth beyond multilateral
- New generation of carefully selected bilateral FTAs
- EU FTA's built on deep and comprehensive ambitions

Study Context

- FTAs – substantial and comprehensive – covering broad range of issues: trade in goods, trade in services, trade rules, regulatory cooperation, dispute settlement etc
- Open trade can promote sustainable development, economic growth and social development, however, <u>liberalisation requires strong domestic rules and regulations</u> to ensure environmental and social impacts are positive and sustainable

SIA Framework

- SIA methodological framework established in 1999
- Assess potential impacts on proposed liberalisation on all pillars of development to optimise policy decisions
- Traditional economic impacts (trade, output growth) and non-traditional impacts (social, environmental and development)
- Causal effect of trade policy – and two element s of equal importance, namely:
- <u>Economic, environmental and social assessment:</u> modelling techniques, analytical tools
- <u>Consultation process:</u> dissemination and feedback

SIA Framework

- Economic development and trade involvement varies between countries and each SIA must adapt methodologies suitable to each partner
- SIAs are art of all major EU trade negotiations
- Implemented by external consultants selected on the basis of an open call for tender
- Trade liberalisation impacts in areas such as income, employment, capital investment, equity and poverty, health and education, gender inequality, environmental quality of air, water and land, biological diversity, natural resources etc

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SIA Framework

- All information from the studies, including consultation outcomes, is in the public domain, including the European Commission's formal response to the study
- The results of the study <u>guide</u> EU negotiators in determining best outcome from trade negotiations
- Provide guidelines for the design of <u>possible</u> policy measures to accompany the trade agreement
- Policy responses cover trade, social and environmental areas – to ensure trade liberalisation has necessary supports/safeguards

SIA Procedures

- Inception Report – January 2009
  - Conceptual Framework
  - Methodology
  - Preliminary research
- Civil Society Consultation, Brussels, 30 January 2009
  - Civil Society involvement in Libya
  - Retail and financial services impacts
  - RoW modelling
- Draft Interim Technical Report – 11 May 2009
  - Implementation of methodology and preliminary findings
  - Overall and sectoral analysis

SIA Procedures – Local Workshop

- Local Workshop, Tripoli, 18 May 2009
  - Food and water security, agricultural impacts
  - Immigration impacts
  - Heritage and tourism impacts
  - Recent changes to Libyan tariffs
  - Education and health investment and capacities
  - Link between sustainable development and governance
  - Gender equality – education, public sector, violence
  - UN initiatives– Green cities pilot, SME development, commodity revenue
  - Environmental impact assessments
  - Natural disaster plan

SIA Procedures

- Draft Final Report – 8 July 2009
  - Outcomes and results of assessments
  - Proposals of flanking measures and policy recommendations
  - Summary of consultations
- Civil Society Workshop, Brussels, 16 July 2009
  - Ensure a better understanding and dissemination of results outlined in Draft Final Report
  - Feedback for refinement of key priorities and issues in the Draft Final Report – deadline – **31 July 2009**
- Final Report and briefing document – 21 August 2009

www.eulibya-sia.org

Economic modelling results of the EU-Libya Trade SIA

Joseph Francois, Miriam Manchin, Hanna Norberg

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Objectives of the study

- The purpose of this study was to analyze the effects of a potential FTA between EU and Libya
- For the economic effects, we use global computable general equilibrium (CGE) modeling.

Main framework for modeling

- The analysis has been set up around two scenarios a limited and an ambitious FTA
- Both entails reductions in tariffs, services barriers and lowering of trade costs.
- The results are analyzed in a static setting and in a dynamic setting (with investment related effects taking place)

Overview of main results

- Effects of a potential FTA are small for the EU
- More important effects on the Libyan economy
- Positive welfare effects for Libya are higher in the long run
- The energy sector in Libya is estimated to increase by up to 6 %

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Outline of the presentation

- Background
- CGE Model used
- Macroeconomic results
- Sector specific results
- Conclusions

Background

Current Production structure EU27 and Libya.

Share of Production Attributable to	EU27	Libya
Agriculture, Forestry and Fishing	3	10
Manufacturing and Extraction	22	66
Services	75	24

Source: GTAP (EU27) and government of Libya.

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Benchmark (2007) levels of import protection, applied tariffs (% per sector)

	EU imports from Libya	Libya's imports from the EU
Primary production	1.7	4.0
Energy	0,1	4.0
Processed Foods	5.0	4.0
Chemicals	0.6	4.0
Manufacturing	0.1	4.0
Construction	2.5	30.0
Trade and Distribution	14.9	30.0
Transport	5.7	30.0
Other Commercial Services	14.9	30.0

Source: EU tariffs are from GTAP/MacMAPS/WITS database.
Data on Libya are from the IMF and OECD.

Bilateral Trade Patterns, in Millions of Euros (and percent share)

	EU imports from Libya	Libya's imports from the EU
Primary production	5.5 (0.0%)	83 (1.5%)
Energy	23 984 (94%)	824 (15.2%)
Processed Foods	6 (0.0%)	364 (6.7%)
Chemicals	400 (1.6%)	348 (6.4%)
Manufacturing	270 (1.1%)	2 822 (52%)
Construction	11 (0.0%)	102 (1.9%)
Trade and Distribution	211 (0.8%)	48.5 (0.9%)
Transport	216 (0.8%)	202 (3.7%)
Other Commercial Services	134 (0.5%)	602 (11%)
Other Services	177 (0.7%)	19 (0.3%)
TOTAL	**25 413**	**5 414**

Source: EUROSTAT, IMF, and WITS data on trade

CGE Model

CGE model

- Data are based on Libya, World Bank, COMTRADE, EUROSTAT, IMF, and GTAP data sources.
- The model itself is the IIDE Computational Equilibrium Model (the ICE Model).
- The model employed is a global, multi-regional, multi-sector general equilibrium model.
- In each region, there is a representative household
- On the production side, firms use domestic production factors (capital, labor and land) and intermediate inputs form domestic and foreign sources to produce outputs

CGE model cont.

- Factor markets are competitive, and labor and capital are mobile between sectors but not between regions.
- We model sectors as a mix of Armington demand and monopolistic competition
- Prices on goods and factors adjust until all markets are simultaneously in (general) equilibrium.

Trade liberalization scenarios

		Assumptions		
Nr.	Description	Goods	Services	Trade facilitation
1	Modest FTA Agreement	90 % bilateral tariff reductions	50 % bilateral services reduction	1 % of the value of trade
2	Ambitious FTA Agreement	97 % bilateral tariff reduction	75 % bilateral services reduction	3 % of the value of trade

Macroeconomic results

Summary of Real Income Effects in Millions of Euros, with corresponding change as percent share of GDP in parenthesis.

	Modest FTA		Ambitious FTA	
	Static effects	Dynamic effects	Static Effects	Dynamic Effects
EU27	334 (0.0)	1 929 (0.0)	276 (0.0)	2 876 (0.0)
Libya	72 (0.8)	289 (3.5)	154 (1.8)	514(6.1)

Source: GTAP database, version 7.

Other Macro Economic Effects: Libya, percent change

	Modest FTA		Ambitious FTA	
	Static effects	Dynamic effects	Static Effects	Dynamic Effects
Percent change in real wages, unskilled labor	-0.2%	1.3%	1.4%	3.8%
Percent change in real wages, skilled labor	-0.5%	1.1%	0.6%	3.1%
Weighted average of absolute change in unskilled labor	1.3%	1.5%	1.7%	2.1%
Weighted average of absolute change in skilled labor	1.2%	1.5%	2.5%	2.7%
Percent change in value of bilateral exports	2.9%	6.1%	2.7%	7.8%
Percent change in value of bilateral imports	15.8%	14.2%	17.8%	15.3%

Source: GTAP database, version 7.

Sector specific results

Change in Sector Output, Libya

		Modest FTA		Ambitious FTA	
	Share of 2007 Total VA	Static Effects	Dynamic Effects	Static Effects	Dynamic Effects
Primary production	9.5%	-0.8%	0.9%	-0.3%	2.4%
Energy	57.4%	0.7%	4.3%	0.3%	6.1%
Processed Foods	1.3%	-2.0%	0.4%	-1.8%	2.1%
Chemicals	1.7%	-1.9%	-0.4%	-0.7%	1.8%
Manufacturing	6.8%	-2.5%	-2.3%	0.6%	0.9%
Construction	3.0%	5.0%	3.0%	7.5%	4.5%
Trade and Distribution	10.1%	-0.4%	1.5%	0.4%	3.4%
Transport	2.8%	-0.8%	0.2%	-2.3%	-0.8%
Other Commercial Services	4.6%	-4.0%	-2.3%	-8.2%	-5.6%
Other Services	2.8%	0.0%	1.0%	0.5%	2.0%

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Percent Change in Aggregate Exports, EU27

		Modest FTA		Ambitious FTA	
	Share of 2007 Total Exports	Static Effects	Dynamic Effects	Static Effects	Dynamic Effects
Primary production	1.7%	0.0%	0.0%	0.0%	0.1%
Energy	2.8%	0.3%	0.3%	0.1%	0.1%
Processed Foods	5.4%	0.0%	0.0%	0.0%	0.0%
Chemicals	15.1%	0.0%	0.0%	0.0%	0.0%
Manufacturing	54.4%	0.0%	0.0%	0.0%	0.0%
Construction	0.6%	0.2%	0.4%	0,4%	0.4%
Trade and Distribution	1.7%	0.0%	0.0%	0.1%	0.1%
Transport	4.7%	0.0%	0.0%	0.1%	0.1%
Other Commercial Services	11.9%	0.0%	0.0%	0.0%	0.1%
Other Services	1.8%	0.0%	0.0%	0.0%	0.0%

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Percent Change in Aggregate Exports, Libya

		Modest FTA		Ambitious FTA	
	Share of 2007 Total Exports	Static Effects	Dynamic Effects	Static Effects	Dynamic Effects
Primary production	0%	5.9%	3.9%	7.8%	7.8%
Energy	90%	2.7%	2.3%	6.3%	7.9%
Processed Foods	0%	12.0%	12.0%	17.6%	20.4%
Chemicals	2%	6.6%	7.2%	7.9%	9.3%
Manufacturing	1%	4.5%	10.1%	6.1%	13.1%
Construction	0%	2.2%	3.4%	2.5%	4.3%
Trade and Distribution	2%	7.8%	10.6%	8.4%	11.4%
Transport	2%	3.7%	5.7%	3.8%	5.8%
Other Commercial Services	1%	8.1%	12.3%	9.2%	14.1%
Other Services	2%	0.9%	0.0%	0.5%	-0.7%

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Percent Change in Aggregate Imports, Libya

		Modest FTA		Ambitious FTA	
	Share of 2018 Total Imports	Static Effects	Dynamic Effects	Static Effects	Dynamic Effects
Primary production	3.2%	5.1%	8.3%	4.1%	6.8%
Energy	7.4%	53.8%	59.4%	49.8%	53.0%
Processed Foods	8.1%	7.4%	9.5%	5.6%	6.6%
Chemicals	6.1%	10.3%	12.6%	10.3%	12.5%
Manufacturing	50.1%	17.8%	16.2%	15.3%	12.4%
Construction	2.0%	20.8%	43.0%	17.8%	37.7%
Trade and Distribution	1.5%	7.9%	23.7%	8.6%	25.0%
Transport	5.3%	5.9%	13.2%	8.4%	17.4%
Other Commercial Services	15.6%	3.9%	9.0%	4.0%	9.2%
Other Services	0.6%	7.3%	18.6%	9.4%	15.3%

FDI effects

- Based on supplemental modeling:
  - Gravity analysis of FDI response to EU FTAs, combined with analysis of FDI-productivity interactions
- Results point to positive (up to 5%) output gains linked to productivity:
  - Likely to overstate actual effects.
  - Data sources for this analysis are crude at best, wrong at worst, so scope for FDI analysis is not very robust.

Conclusions

- Results indicate that the FTA would increase welfare in both Libya and the EU
- The effects for the EU would be very small
- Income effects for Libya would be much more significant, as would investment effects
- Libya would benefit the most over the longer run and if the FTA would be more ambitious implying higher reductions in barriers to trade in goods, services and trade facilitation measures as well.

Trade Sustainability Impact Assessment (SIA) of the EU-Libya Free Trade Agreement

Assessment of Impacts

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Libyan Economic Characteristics

- highest income per capita of Mediterranean developing countries
- oil and gas industry – 72% GDP, 2% workforce
- public services – 7% GDP, 55% workforce
- exports – 97% oil and gas
- imports – manufactures and food (44% of food consumption)
- increasing integration into world markets

Libyan Social Characteristics

- highest UNDP Human Development Index of Mediterranean developing countries
- highest UNDP Gender Development Index of Mediterranean developing countries
- wide-ranging social security system, subsidised food
- 2.9% population growth rate, 85% urban
- unemployment at least 13%
- immigrant labour 10% of workforce

Libyan Environmental Characteristics

- over-consumption of sustainable water resources
- salinity of aquifers, corresponding threats to biodiversity
- use of fossil water through Great Man Made River
- pollution and solid waste management issues typical of the region
- weak environmental regulation

Overall Impacts - Economic

- static welfare gain modest
- potentially larger gains in the long term
- output increases in construction and energy, decreases in other sectors
- 2% of the workforce moves between sectors during the adjustment period
- manufacturing imports increase by 30% of domestic production, processed food by 16% of domestic production

Overall Impacts - Social

- most sectoral employment changes small enough to be accommodated fairly smoothly
- increased demand for immigrant labour (construction industry)
- fall in food prices (short term, possibly long term)
- potential for small but adverse gender effects in agriculture, positive in tourism

Overall Impacts - Environmental

- small decline in industrial pollution (short term)
- longer term increase associated with economic growth
- needs for stronger regulation

Agriculture

- higher imports, lower production
- potential for increased exports to EU restricted by water supply constraints
- small increase in rural-urban migration
- increased dependence on food imports
- mixed environmental effects, adding to needs for stronger regulation

Fisheries

- possible increase in exports to EU (uncertain competition from Asia)
- overfishing of tuna already a serious concern throughout the Mediterranean
- need for stronger joint regulation

Processed foods

- significant rise in imports, potential for a significant fall in domestic production
- domestic industry hampered by water constraints for domestic agriculture
- small fall in consumer prices
- environmental impacts beneficial but small

The energy sector

- considerable potential benefits to EU and Libya from closer cooperation in the sector
- accelerated expansion of oil industry would add to environmental impacts and to needs for stronger regulation
- large potential for solar energy exports to EU
- potentially major contribution to reducing climate change through solar energy cooperation

Key service sectors 1

Telecommunications

- further development important for dynamic development of the economy

Financial services

- pressure on domestic industry, potential for longer term growth; successful liberalisation strongly dependent on strong regulation

Key service sectors 2

Construction services

- potential for significant gains, particularly if agreement includes increased mobility of Libyan workers to Europe.
- increased demand for migrant labour in Libya
- increased pollution impacts, need for stronger regulation.

Distribution services

- Potentially large EU retail penetration, decline in small traders, overall decline in employment

Deeper integration 1

Investment

- large long term benefit dependent on effective technology transfer
- need for balance between attracting investment and control of strategic industries

Public procurement

- mixed effects for different types of contract

Competition

- need for stronger national competition laws and policies tailored to Libya's own evolving needs.

Deeper integration 2

Intellectual Property Rights

- beneficial impacts for infrastructure and major current industries
- potentially adverse impacts for diversifying into other high technology sectors

Trade facilitation

- large benefits from domestic facilitation measures, with significant scope for cooperation and technical assistance

Policy recommendations 1

Trade measures

- Trade and Sustainable Development Chapter in the FTA
- staged approach to liberalisation of environmentally sensitive sectors
- accelerated liberalisation and trade facilitation for environmental goods and services
- staged timing of liberalisation of financial services
- investment measures to include specific provisions for the involvement of Libyan firms
- selective public procurement measures
- competition policy measures appropriate for Libya's specific needs
- provision of market information and assistance to EU SMEs

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Policy recommendations 2

Cooperation measures

- solar energy development
- conservation of Atlantic tuna
- Libyan mise à niveau programme
- strengthen regulation of the telecommunications industry and gradual convergence with EU standards.
- strengthen environmental regulation in Libya
- promotion of modern irrigation and water conservation techniques

Domestic measures in the EU

- continued efforts to increase coherence between EU policies on climate change and energy supply

Policy recommendations 3

Domestic measures in Libya

- sustainable tourism strategy
- strengthen environmental regulation
- national strategy for sustainable development
- natural disaster plan
- strengthen financial services regulation
- mise à niveau programme targeting SMEs
- strengthen strategic planning for diversification of the economy
- reform regulation of the retail sector
- strengthen social programmes related to migrant labour
- promotion of modern irrigation and water conservation techniques
- rural social programmes (gender focus)
- amend provisions for food subsidies