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Giurisprudenza

2009

Online at <http://mpra.ub.uni-muenchen.de/26087/>

MPRA Paper No. 26087, posted 21. October 2010 / 16:09

The Role of the Euro-Mediterranean Relations Facing the Economic Crisis

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Year 2008: Two Turning Points

The Euro-Mediterranean Partnership, founded in 1995, proceeded at a slow pace for a decade, with little real integrative efforts. The year 2008 will be marked as a turning point. With the intensification of efforts from the European Union, the Partnership was re-launched as the Union for the Mediterranean (UfM) at the Paris Summit for the Mediterranean in July 2008, with a new network of relations endorsed at the Marseille meeting of the Euro-Mediterranean Ministers of Foreign Affairs in November. The renewed initiative is larger and more pragmatic.

The Partnership now includes all 27 Member States of the European Union, along with 11+1 partners on the southern shore of the Mediterranean: Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Mauritania,¹ Syria, the Palestinian Authority, Tunisia, Turkey and Libya (Libya as an observer of the Partnership), as well as five new coastal states of the northern Mediterranean (Albania, Croatia, Bosnia and Herzegovina, Montenegro and Monaco).

The increased number of partner countries adds more scope for the free trade zone project. But also the new approach gives new vitality to the partnership and raises the political level of the strategic relationship between the EU and its Mediterranean neighbours.

The major innovation includes the new *institutional architecture* that contributes to increasing the sense of ownership and empowerment, with two rotating

co-presidencies and a permanent Secretariat based in Barcelona that is responsible for identifying and promoting projects of regional and trans-national value across different sectors. While maintaining the acquis of the Barcelona Process, the UfM offers more balanced governance, increased visibility to its citizens and a commitment to tangible and trans-national projects.

However, the most important innovation is in the *new functionalist approach* in the field of social and economic development. The initiatives are *more concentrated on joint projects* that require specific investments rather than political goals.

A few months later, the American financial crisis grew into a business crisis and led to a loss of confidence that crashed the stock markets worldwide. A considerable number of banks and insurance companies failed in the following weeks. This was the second turning point of the year.

The Impact of the Global Crisis

In front of the positive efforts of the EU, the economic and financial crisis brought negative consequences to the region.

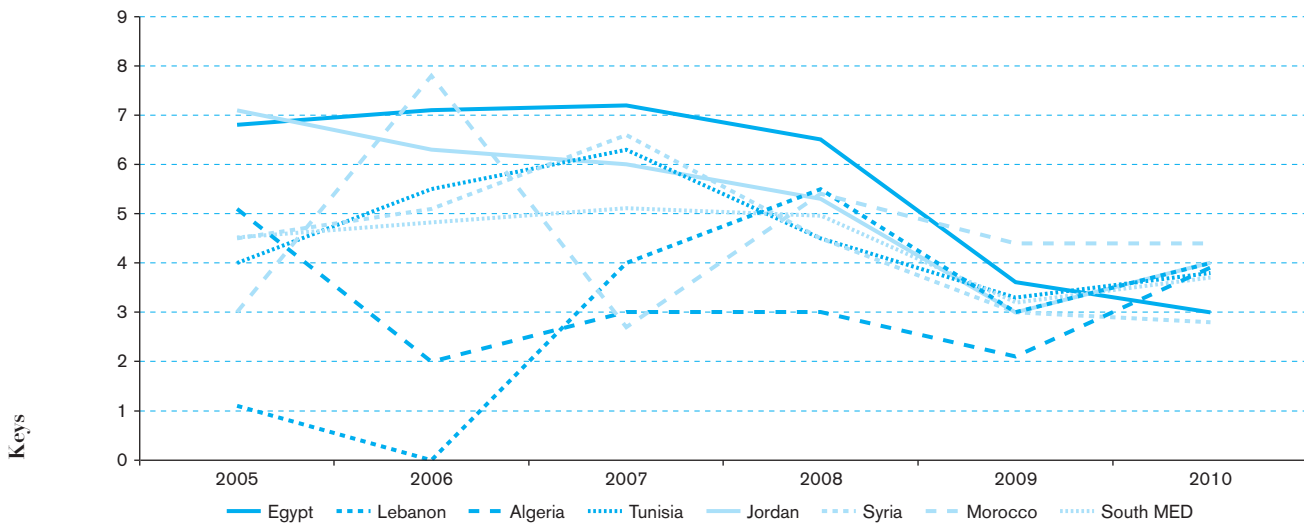
The impact of the crisis has taken the form of:

- A slowdown in global economic growth and a reduction of inflationary pressure, including a decline in the price of many commodities.
- A decline in energy demand and lower oil and gas prices globally.
- A decline in foreign direct investment inflows.
- A decline of worker remittances, in particular from the Gulf.

¹ Mauritania has been included in the Union for the Mediterranean although having its coast on the Atlantic and not on the Mediterranean because of its membership to the Maghreb Union.

CHART 1

Real GDP Growth



Source: World Economic Outlook (WEO) (April 2009), author calculations.

- A decline in total expenditure that has affected the financing of investments.
- A decline in export demand and tourism in the region.
- A sharp decline in financial markets.

ately positive and recovery is expected in 2010, led by Morocco, Algeria and Tunisia, largely because of the anti-cyclical policies in support of the domestic demand.

The resilience of the south Mediterranean economies is due to the same factors that limited their economic expansion during the past decade

For the Euro-Mediterranean region, the stakes are high, and in dealing with the global financial crisis, the national governments took initiatives and measures to mitigate the negative consequences. A first assessment of the current policy responses includes the adoption of national short-term measures to stimulate domestic demand, step up investment, ensure deposits in banking institutions and cut interest rates to stimulate the local markets. One can say that the policy responses have, for the most part, concentrated on domestic policy issues to the detriment of the specific international cooperation such as the Euro-Mediterranean Partnership.

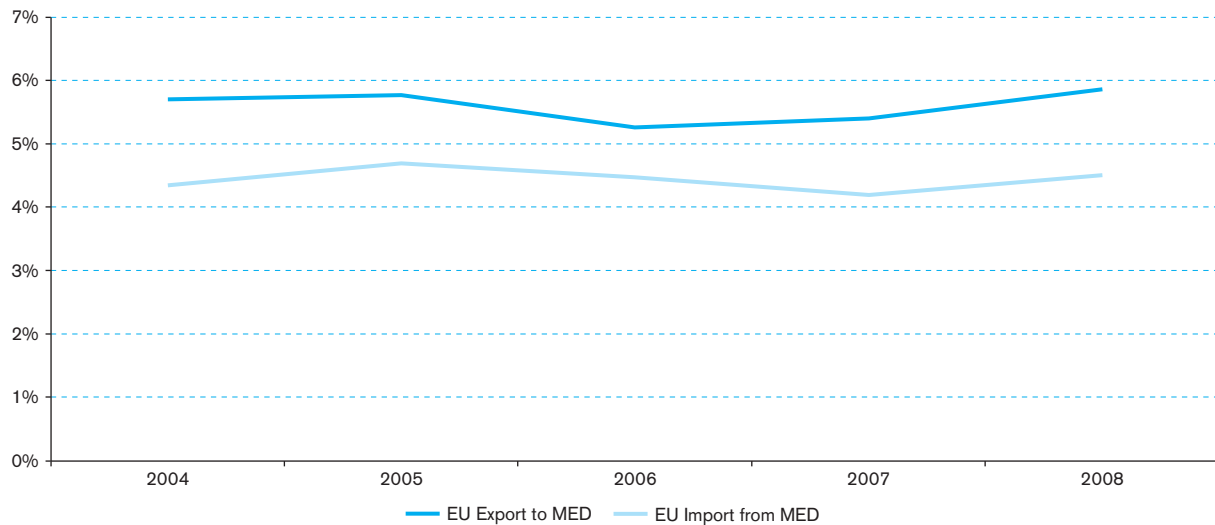
Although the global crisis has left no country unaffected, its duration and intensity cannot be predetermined. Compared with other regions, the south Mediterranean economies continued to show more sustainable growth in the face of rapidly changing external macroeconomic conditions (IMF, 2009). Only at the end of 2008 did the output contract in line with the global slowdown, while Morocco and Lebanon experienced an acceleration of growth. Overall, GDP growth in southern Mediterranean countries is expected to decline sharply from 5.0% in 2008 to about 3.2% in 2009, when the contraction is expected to be similar in the region. The projections are moder-

From the forecast of the international institutions, it appears that two factors have impacted the economy of the MED partners: their reliance on external flows, in particular, their trade linkages to the European countries and other deeply affected high-income countries, and the degree of participation of foreign banks in the domestic financial sector.

To a certain extent, one can see that the resilience of the south Mediterranean economies is due to the same factors that limited their economic expansion during the past decade. Excluding Morocco and Tunisia, exports or trade openness of these economies generally have low value added in terms of contribution to GDP. Hence, the share of Euro-Mediterranean exports to the EU (European imports) remained broadly stable between 4% and 5%, while import continued to increase near to 6%, expanding the trade deficit. On large measure, weak and unbalanced trade

CHART 2

Share of EU Import from and EU Export to Euro-Mediterranean Countries



Source: author calculations.

integration simply reflects the weak performance of the preferential agreements.

Adding the role of foreign direct investment (FDI) inflows in the region, their contribution has not been a source of economic growth to the same degree as Central Europe or Southeast Asia.

Moving to the domestic front, the most optimistic indicator is assured by total private investment, which continued the positive performance of the past decade. This clearly indicates that there is little room for further deterioration. Therefore the realistic situation of the Euro-Mediterranean region points to a resilient economy that resisted well the adverse external shocks.

Structural Problems

As analysed in a recent Economic and Social Commission for Western Asia (ESCWA) report, although in the last decade investment activities have transformed production structures in the construction, manufacturing, telecommunications, financial and service sectors, their impact is limited and fragile (ESCWA, 2009). Indeed, reform measures taken by the central banks increased the efficiency of the banking sector, and the proof is that they remained

isolated from the banking problems occurring in international markets. However, the rest of the economy of the southern partners is not immune to crisis; undoubtedly, their persistent structural weaknesses may lead to negative consequences on jobs in the manufacturing sectors and on export activities that will face a stronger competition.

One can see that part of the job redundancies have been absorbed by the informal sector, which is closely connected to the formal sector in various ways through markets for goods and factors, but this does not help the chronic employment pressure and the vulnerability of labour markets.

Hence, the question is: how can the Mediterranean governments maintain growth and avoid job losses? How could the regional partnership support it?

The issue is how the UfM can address the transformation of their economic model and modify the structural weaknesses behind it. Diversification of domestic production and export remains the priority issue, as envisaged by several documents and recommendations.² The quality of growth is the main concern. In the past decades, economic growth has relied more on consumption growth than physical investment in the composition of domestic demand. This particular characteristic has to be redressed in the next expansion, since worker remittances and capital inflows, in

² FEMISE. *FEMISE Report on the Euro-Mediterranean Partnership 2007*. 2008; FEMISE. *The Euro-Mediterranean Partnership, 10 Years After Barcelona: Achievements and Perspectives*. Report coordinated by Samir Radwan and Jean-Louis Reiffers, Marseille: Institut de la Méditerranée, February 2005. Available at: www.femise.org/PDF/Femise_T2005gb.pdf; WORLD BANK. *Export Diversification in Egypt, Lebanon, Jordan, Morocco and Tunisia, Volume II: Main Report*, January 2007.

the form of portfolio and FDIs, are factors that are external to the region and are expected to become more uncertain over the near term. External support should place more focus on domestic investments and diversification to non-oil exports, which progressed slowly and unevenly, depending upon the sector and the country. Then, in the present context, the export-led strategies may be prevented from facing the negative impact of contracting European demand.

Structural employment gap is the second problem of the region. In 2008, the employment-to-population ratio in the Middle East was 46.6% and in North Africa 45.7%, compared to the average 65% of the Organisation for Economic Co-operation and Development (OECD), and these indicators have only increased by around 2% in the past ten years. This low employment-to-population ratio is usually associated with low participation of women and youth in work and a policy response is needed to avoid increasing differences and further deterioration (International Labour Organization –ILO, 2009).

In the present context, the export-led strategies may be prevented from facing the negative impact of contracting European demand

The position of youth in labour markets still suffers disproportionately from a deficit of work opportunities. The Forum of Euro-Mediterranean Economic Institutes (FEMISE) report urged for a more positive strategic view (Institut de la Méditerranée, 2007). Economic growth has not created jobs for the growing number of entrants into the labour market (Chaaban, 2008). Typically, governments in the region resorted to public employment as a mean of absorbing the new entrants, while passively encouraging migration. The economic slowdown is certainly not helping the region and it may accelerate demands for economic and social progress within the region.

Finally, the high level of unemployment is the third characteristic of the region. Especially in North Africa, progress has been made in reducing the unemployment rate in recent years, from a peak of 14.2% in 2000 to 10.3% in 2008, in line with robust GDP growth rates in the range of 4.5%-6.5%. Nevertheless, the unemployment rates in many Middle Eastern and

North African economies continue to resist as the highest levels in the world.

Facing these structural problems, the hardships posed by the crisis are not entirely negative. Typically, major reforms take place in times of crisis and therefore the economic slowdown gives the opportunity to rethink the existing development paradigms and to accelerate the pace of economic and institutional modernisation.

The Mediterranean Response to the Global Economic Crisis

The European response is the Union for the Mediterranean that calls for increased economic coordination between regions and countries. The UfM emphasizes the need for close coordination between the two shores of the Mediterranean, giving greater flexibility in assisting southern Mediterranean countries to support the sectors at risk and in need of support. Pragmatically, the UfM has identified five priority projects which are at the heart of the of Partnership's efforts, some of them already under execution in the framework of the Barcelona Process:

- The de-pollution of the Mediterranean Sea.
- The establishment of maritime and land highways.
- Civil protection initiatives to combat natural and man-made disasters.
- A Mediterranean solar energy plan.
- The Mediterranean Business Development Initiative focusing on micro, small and medium-sized enterprises.

The mechanisms to reduce the negative effects of the global economic crisis are stated in the priority projects agreed by the Heads of State and Government in the Paris Declaration. Through the Euro-Mediterranean relations, the implementation of these projects will support, in principle, the expansion in demand among the partner countries, making the development process not only more sustainable but also more inclusive across the southern shore.

The common interests and problems would make it easiest to reach and maintain agreements through the cooperative approach. The economic slowdown provides the opportunity to promote the needed technological and human resources development.

Other strategic aims have been identified and can be easily reached in the context of regional cooper-

ation, in particular concerning water, energy, environment, agriculture, communication and educational resources. Not by chance, Jordanian Prince Hassan bin Talal³ has suggested “a cross-country social pact with value of legal accord for an equitable distribution of resources and the investments to pass from consumption to production, integrating jobs and wealth with human development.”

In this context, the original objective to create a free trade zone between the 10 Mediterranean countries and the EU needs to be preserved as a strategic goal.⁴ From this regional perspective, economists and policy makers have stepped up proposals of strengthening and enhancing the multilateral arrangements set up under the Paris Declaration, proposing that “a common Euro-Mediterranean economic area requires, in the medium term, the integration of the southern economies in the Lisbon Strategy, by extending certain sectoral policies, related to research, development, economy and knowledge, to the Mediterranean countries.”⁵

Leaving apart the shallow or deep integration concepts that have confronted researchers since the start of the Barcelona Process,⁶ there is now an urgent need for measures that will boost investment in public infrastructure with a trans-national character and pull the regional integration processes out of their current stagnation.

For these reasons, the UfM continues to stress the importance of the “Invest in the Mediterranean” concept with the purpose of boosting the size and quality of the Euro-Mediterranean investment and trade, building sustainable businesses, and contributing to the sustainable economic development of the region. It also urged the development of a marketing plan for available investment opportunities, with the active and positive contribution of private and public businesses. The focus is on efficiency-seeking industrial restructuring investment especially through export

promotion and stronger human capabilities, in order to build supply capacities across the countries in the region. The resilience of trade flows suggests that trade facilitation infrastructure along with physical infrastructural connectivity should be supported. Public investments or public-private partnerships (PPPs) are also intended to address the needs in particular for waste recycling, water treatment, water efficiency, energy and investment in alternative energy sources.

The commitment to the priority projects may also assist in supporting greater trade and economic cooperation between southern states⁷ after the slow start of the Agadir Agreement. Options to strengthen south-south trade include increasing financing from regional development banks –or Facility for Euro-Mediterranean Investment and Partnership (FEMIP)– to compensate for losses of FDI inflows and contraction of export to Europe.

The Growth Drivers

It is evident that the UfM supports the domestic growth drivers. To this end, the renewed goals of the regional trade agreement should be focused on the internal demand as a key source of development. One of the ways to increase the domestic demand is to enhance the purchasing power of the poor sections of society, which include poor and small farmers; micro, small and medium enterprises and those belonging to the informal sector, through provisions of adequate developmental incentives. The need for clean water, affordable and safe food and housing are among the main challenges facing these countries. Of course, these are medium-term objectives, while the economic slowdown requires immediate anti-cyclical reactions. The response to the crisis, as it has been suggested, should be made generating domestic

³ HRH Prince Hassan bin Talal’s speech at the first annual West Asia-North Africa (WANA), Amman, 19 April 2009. *The Jordan Times*, 21 April 2009.

⁴ Recommendation of the Euro-Mediterranean Parliamentary Assembly (EMPA), by Mr. Mohammed M. Abou El Enein, Chairman of the EMPA Economic Committee and member of the People’s Assembly of Egypt, Brussels, 16 March 2009.

⁵ Proposal made by the new Moroccan think tank Amadeus Institute with the “Tangier Declaration,” released at the MEDays “South Forum for a New Mediterranean,” 26-28 November 2008.

⁶ DESSUS, Sébastien; DEVLIN, Julia & SAFADI, Raed. “Towards Arab and Euro-Med Regional Integration.” Paris: OECD Development Centre, 2001; EUROPEAN COMMISSION. *The Euro-Mediterranean Partnership and the Single Market*. 23 September 1998. COM 538 final; HOEKMAN, Bernard. “Free Trade and Deep Integration. Antidumping and Antitrust in Regional Agreements.” World Bank Policy Research Working Paper 1950, July, 1998; MOMANI, Bessma. “The EU, the Middle East, and Regional Integration.” *World Economics*, Vol. 8, No. 1, January-March 2007

⁷ “Arab economic integration can be achieved only by strengthening economic agreements and updating them in line with changing global and regional conditions,” comment by the UAE Minister of Economy, Sultan bin Saeed Al Mansouri, at the Arab Economic Council summit in Doha on 29-30 March 2009, *UAE Interact*, 26 March 2009.

demand with massive investments in social infrastructure, like health and education and in transport infrastructure by targeting in the labour-intensive activities (Handoussa, 2009). This option is particularly important in light of the fact that the problems of unemployment and working poor are expected to deteriorate further due to the present crisis.

In the same vein, reality obliges the southern economies to ensure the achievement of an effective governance that can improve the implementation capacity and increase efforts to increase the funding of productive investments, including Small and Medium-Sized Enterprises (SMEs).

The pragmatic approach of the UfM gives more focus on the four basic concerns of the southern partners: SMEs, high unemployment, increasing environmental strains and inefficient transport infrastructures

In order to contrast the limited results obtained until now through the Barcelona Process, the mechanism needed to achieve post-crisis takeoff and to encourage trans-national investments in the Mediterranean is the rapid implementation of the above infrastructure projects.

In the short term, it is a sort of Keynesian measure to support the domestic demand, but the outcome that really matters is the long-term socio-economic development. With this in mind, the pragmatic approach of the UfM gives more focus on the four basic concerns of the southern partners: SMEs, high unemployment, increasing environmental strains and inefficient transport infrastructures. The priority is to support the economic and social infrastructures, which are a crucial factor in modernizing the region and boosting employment and, ultimately, increasing productivity. Joining their efforts, south Mediterranean governments should increase in the short-term their investment expenditure, especially in infrastructure,

to compensate for the shortage of efficient private investment, the temporary contraction of FDI inflows and the job losses, which are the immediate effects of the present global crisis. Since foreign investors, from Europe and the Gulf, have become more selective and more demanding in terms of returns, the region could be a significant opportunity since the growth rate expectations are much higher than in Europe. For the region, providing access to basic infrastructure will support SMEs and potentially support all infrastructure-related activities, which is the most important priority.

Hence, in setting the agenda for 2009, the UfM should stress the need for legislation coordination in the partner countries, especially in the priority sectors for investment. In addition, it is necessary to continue to follow up on the progress made in implementing the projects on local development and in supporting the institutions that reach the real economy. Therefore the main objective of FEMIP, the financial arm of the European Investment Bank (EIB) to assist the economic development of the Mediterranean partner countries, is to become the key player in supporting the private sector with loans and equity participation to fill the shortfalls capability of partner countries.

As for the funding, having decided to rule out any increase of the EU budget, the financial resources available are the previous commitments of the Barcelona Process and the European Neighbourhood Policy (ENP) resources for the new coastal states. In total, the EU Commission aid funds amount to 3.2 billion euros for the 2007-2010 period. The credit interventions of the EIB (channelled through FEMIP) have registered a further increase, with 10.7 billion euros allocated for the period of 2007-2013, against six billion invested between 2002 and 2006. It is evident that the magnitude of the funding is not adequate to the development needs of the partners (Martín, 2009). So the proposal had to convey the vision to the PPP model to mobilise additional funding and in particular increase private financial resources for regional projects.⁸

The second driver is the tourism sector. Among the merits of the Barcelona Process is the encouragement of travel and tourism, which compensate the structural deficit in trade flows registered by the region

⁸ The first equity capital was launched in Alexandria on 30 April 2009. InfraMed Fund aims to raise more than one billion euro in equity capital and it is led by France's Caisse de Depots, Italy's Cassa depositi e prestiti, Morocco's Caisse de Depot et de Gestion and Cairo-based investment bank EFG-Hermes. The four institutions have already committed 400 million euro. The purpose of InfraMed is to be an equity investor in primarily greenfield projects to build urban, energy and transport infrastructures.

with the EU. Revenues from tourists visiting Mediterranean countries have risen by a factor of 2.4 over the last decade and increased by a factor of 1.8 between 2000 and 2006. At the end of the period, tourism accounts for almost 50% of total revenue from services from the EU countries (EUROSTAT, 2008). Tourism is an export industry that represents between 8% and 25% of the GDP depending on the country; therefore, it requires the proper incentives. The economic impact in the Mediterranean region is visible and tangible and can be seen in terms of its contribution to the GDP with the effect of increasing the development of Mediterranean economies and contributing to social stability, not least by providing more job opportunities and better prospects for the growing and young labour force.

Tourism is currently going through a difficult phase due to the economic recession, with the result that governments need to take immediate action to forestall short-term negative effects without resorting to *palliative* measures that could have negative effects on the region's delicate environment.

The action plans of the UfM consider several initiatives supporting the sectors, including the initiative envisaging the de-pollution of the Mediterranean, as well as the initiatives of the maritime and land highways. The Mediterranean Solar Plan is also a means to increase access to efficient energy. So all these initiatives may be greatly beneficial for the tourist industry in the region. In term of organisation, following the same path of the Euro-Mediterranean Network of Investments Promotion Agencies (ANIMA), a sort of platform joining the investment promotion agencies across the Mediterranean, the Euro-Mediterranean Parliamentary Assembly (EMPA), has also called to set up a body that would promote sustainable tourism in the Mediterranean region and also act as a forum that brings stakeholders together to discuss common problems and exchange the best practices and ideas. Ultimately it will serve to coordinate the marketing of the region as a whole, especially in new markets.

The third driver is the SME sector, which has been recognised by the Paris Summit. SMEs represent the vast majority of productive activities in the Euro-Mediterranean region, and its competitiveness and ability to respond to the globalization, as well as the current crisis, depends on the capacity of these companies to expand and innovate. The crisis has changed the political priorities and SMEs are finally recognised

for their relevant contribution in the economy, as a source of growth and sustainable jobs.

The Mediterranean Business Development Initiative is clearly centred on the economic and trade aspects that will answer these needs. In this context, setting up suitable financial instruments in connection with the local financial systems is one of the ways to take up the challenge of growth in the Mediterranean. The ad hoc initiative will assist the existing entities in partner countries operating in support of SMEs by assessing the needs of these enterprises, defining policy solutions and providing these entities with resources in the form of technical assistance and financial instruments. The initiative is based on the contributions by countries from both sides of the Mediterranean that will be made on a voluntary basis. For this reason it is difficult to identify clearly the amount of financial resources that will be mobilised.

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