EuroMed Economic Cooperation & Governance: Removing the Barriers to Prosperity

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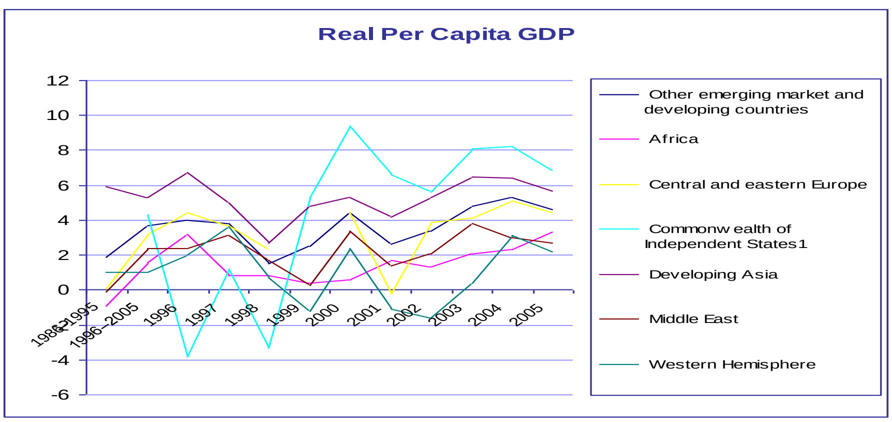
From Barcelona to Baghdad: promises, violence and sorrow

1. The countries and peoples of the Mediterranean and Middle East region are under intense pressure from within and from without. From within, because the MENA region has experienced the low or negligible growth in per capita income growth over the past two decades, with high and growing unemployment rates among a disaffected and young population[1]. On average, the MENA countries grew by -0.1% over the decade of the 1980s and 2.4% over the 1990s[2]. The countries of our region have missed out on the 'roaring nineties', and are facing increased divergence in income, a low adoption rate of new information and communication technologies, a deteriorating environment, and low knowledge acquisition rates[3]. The financial markets of the region remain undeveloped, not playing their role of channeling savings to their optimal uses. The MPC and MENA countries, similar to many emerging market economies, face wide gaps in terms of Public and Corporate Governance compared to their industrialized counterparts. There are clearly problems with public and private institutions, with in many cases, problems with bureaucracy and red tape, corruption, lack of transparency and accountability and a lack of respect of the rule of law. Similarly, the issues related to Corporate Governance issues are yet to be addressed.



(Source: World Development Indicators, 2004)

The history of the Middle East and North Africa has produced societies associated with a distinct set of economic, political, social, and cultural institutions and

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1 Apart from the sad economic performance of the Sub-Saharan region countries which are also facing the onslaught of HIV.

2 Real Per Capita GDP. Ten Year Average (1986-1995) & (1996-2005) IMF, World Economic Outlook. Global Demographic Transition. September 2004.

3 See the Arab Human Development Report, (2003) and (2004).

practices which shape the region's development but which, importantly, do not inherently conflict with the goals of modernization.

The dominance of state-owned enterprises (SOEs), the proliferation of family-owned firms, and the plurality of small- and medium-sized enterprises distinguish the business environment of the Middle East and North Africa from that of the Western, industrialized world which has historically set the standards for corporate governance. These characteristics are not incompatible with the practice of good corporate governance, but they are problematic for standards as currently written.

International guidelines must reflect the realities of doing business in the Middle East, North Africa, and other emerging economies if they are to gain acceptance and be implemented effectively. The on-going process to update the Organisation for Economic Co-operation and Development's twelve principles of corporate governance is one promising step, both for facilitating global adherence to best practices and for helping to build a culture which respects and rewards accountability and transparency, but all reform efforts must originate from local constituencies within the region if they are to truly take root and prosper.

Sound corporate governance practices will attract new, much needed investment to the Middle East and North Africa because they improve management of firms and reduce risk. National institutions, laws, regulations, and practices based on international norms and standards would enable the countries of the region to modernize their corporate sectors, enabling them to attract technology and foreign investment and become internationally competitive. Furthermore, political and sovereign risk would be reduced and economic performance and outcomes would be de-linked from ruling political regimes and a dependence on oil and gas resources.[4]

Comment [ZMZ1]: Estimates show that if only half of the region trade and private investment potential were realized over the next 10 days, significant increases would me achieved at the level of the per Capita GDP Growth. Specifically, expected per Capita GDP could be as high as 4% per year compared to a current 1%. the progress would be fuelled by private investments and from greater productivity!

2. The region has also been living with wars, violent conflicts, and insecurity for most of the post-colonial period. The region is undergoing the throes of the aftermath of the September 11, 2001 terrorist attacks, the war on Afghanistan and the ongoing war on Iraq. The countries and peoples of the region and the Islamic world more generally, are facing discrimination and heightened barriers to trade, capital and labor flows and to the mobility of persons: a form of collective punishment. National security has been used as a justification to roll back achievements in human rights and privacy legislation in both the US, in the EU and internationally. Visibly, the countries of the region and their leadership have not developed adequate strategies and responses to the challenges, accusations and violence visited on the region, nor to the new barriers and discrimination facing the region's peoples and their businesses, and imposed under the banner of security. In turn, the governments of the region have used the same 'justification' of national security and regional insecurity to prevent or delay political, economic and social reform or have become more repressive of freedoms. The failure to develop a strategic response has left the

Comment [ZMZ2]: World bank Report on Trade Investment and Development in MENA (2003) estimated the losses of the region in terms of growth to be 2 to 3 percentage points in the past two decades affecting not only the conflict ridden countries, but their neighbours as well!

[4] See Nasser Saidi. (2004) Improving Transparency & Disclosure: the Second Regional MENA Regional Corporate Governance Forum Publication. June.

countries vulnerable and unable to progress and resolve the main issue facing the area: the Arab-Israeli conflicts.

3. The 10th anniversary of the Barcelona process is looming. Its promise was to generate a shared area of peace, stability and prosperity. To achieve this objective, a major policy instrument is the EuroMed Association Agreement, intended to create a Free Trade Area by end 2010 and the associated MEDA programs. With the signing between the EU and Syria of the bilateral AA[5], all the countries participating in the Barcelona process have now committed to a common set of principles ruling bilateral relations between them and the EU, covering economic, political, diplomatic, social, environmental and cultural matters. Successful implementation of the AA would create a FTA encompassing some 800 million people and the largest regional trading bloc in the world.
4. Ten years after, have the AA yielded the expected benefits for the peoples of the region? The theory and vision is that the AA would lead to greater economic integration, affecting the goods, labor and capital markets, helping to overcome the small size of the Southern Mediterranean markets. The expectation was that trade liberalization, reduced tariff and the easing of non-tariff barriers would contribute to increased international trade between the EuroMed countries. The expansion of markets would generate benefits from lower costs as a result of increased competition and from economies of scale, and provide greater product quality and diversity. Expected market expansion and improved growth prospects would lead to an increase in overall investment and lower unemployment. Foreign direct investment would be attracted to the South, to the Mediterranean Partner Countries (MPC) to benefit from open markets and low cost labor as well as other incentives.

Trade, Investment & Aid: a Story of Non-Integration

5. Reality and developments have not lived up to Barcelona expectations and to the promises of decision-makers on either side of the Mediterranean. If we examine the macro-picture in terms of growth, trade, direct investment, labor flows and other measures of economic and financial integration, the EuroMed partners have not become more integrated. Indeed, neither the ‘roaring nineties’ decade of globalization, nor the EuroMed AA have yielded increased regional or international integration.
6. Trade. The accompanying Table and graph show that although exports and imports have increased between the partners as a result of normal growth, the *share* of EuroMed trade has not increased in the external trade of the partner countries. In 1995, trade (exports plus imports) of the MPC-12 with the EU represented xx% of their total trade, compared to xx% in the year 2000, and xx% in 2003. Similarly, economic forces have led to increased intra-EU trade, with an increase of trade in intermediate goods and increased trade as a result of the progressive removal of market barriers as a result of the creation of the Single Market. The result has been that the share of the EU’s trade with the MPC-12 has stagnated at xx% over the past decade, increasingly in value terms in 2003 and 2004, as a result of higher energy prices. The related feature is that the exports from the MPC-12 tend to be concentrated in labor-intensive and resource-intensive sectors, in goods with slowly growing international markets. To benefit from the AA, the MPC will have to be

[5] The EU-Syria AA was initialled on October 19, 2004 in Brussels. It awaits its confirmation process by the parliaments of the member countries of the EU and Syria.

integrated into the supply chain of EU industry, moving towards higher value-added, higher quality goods, and two-way trade.[6] Similarly, trade in services –the fastest growing component of international trade- between the EuroMed partners has not grown at the same pace as in other countries. The sober assessment is that despite liberalization and the AA, trade has not been an engine of growth for the MPC.

Geographical Area	Imports and Exports in Million $			Variation		Relative Share of World Trade with the MPs		
	1995	**1999**	**2000**	**95/99**	**99/00**	**1995**	**1999**	**2000**
World	198,814	224,014	256,062	13%	14%	100.00%	100.00%	100.00%
Intra-region	8,980	10,622	11,957	18%	13%	4.50%	4.70%	4.70%
With the EU15	104,121	115,511	127,140	11%	10%	52.40%	51.60%	49.70%

Source: Femise

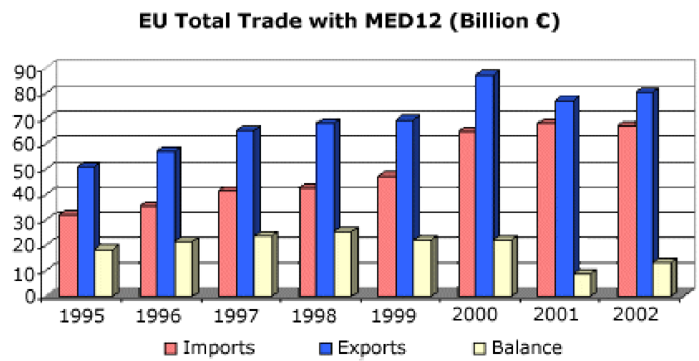


Figure 1: Source EUROPA, European Commission

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Imports	26.6	27.8	28.2	28.0	30.5	32.1	35.3	41.3	42.5	47.2	64.8	68.1	66.8
Exports	33.5	35.0	36.6	43.5	43.9	50.6	56.9	65.3	68.0	69.4	87.0	77.0	79.9
Balance	6.9	7.2	8.4	15.5	13.4	18.5	21.6	23.9	25.5	22.2	22.2	8.9	13.1

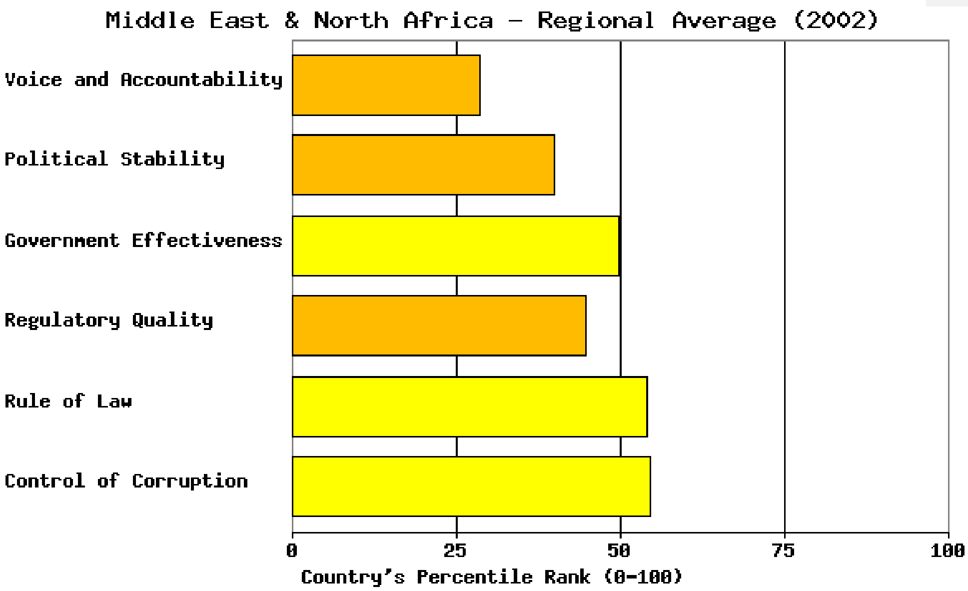
7. FDI. It is also clear that the implementation of the AA has not generated a large increase in FDI towards the MPC-12. Most outward investment by the EU countries has gone towards the accession countries of Eastern and Central Europe in anticipation of their EU membership, as well as to the growth markets of Asia (China and India) and Latin America. The MPC-12 has only attracted a small 0.5%[7] of total FDI.

Comment [ZMZ3]: According to the International Monetary Fund MENA region is only receiving one third of the expected FDI flows for a developing region of comparable size. As a matter of fact, the MENA report estimated FDI inflows to the region to be five to six times higher of their current levels, if the investment climate was more conducive amd exports other than oil were higher. (MENA Development Report).

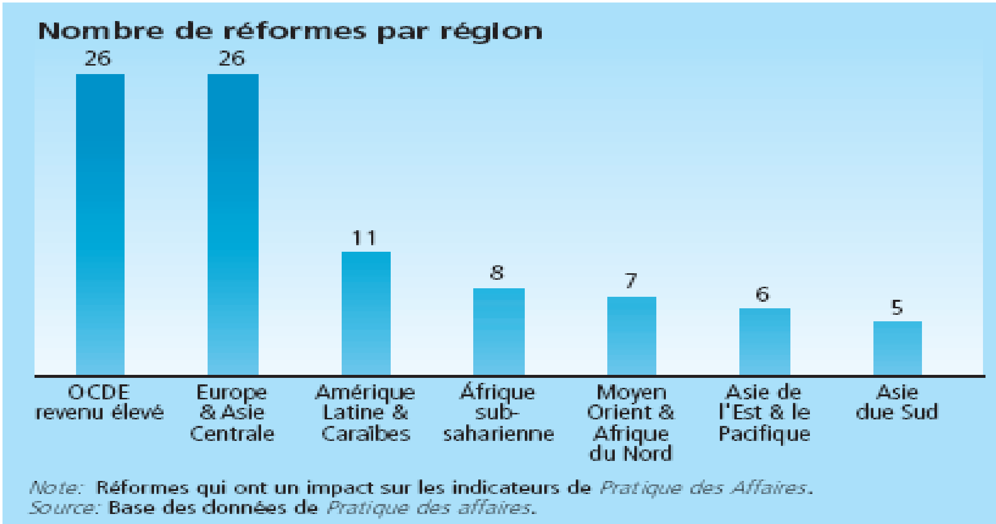
[6] See the paper by A, Chevallier and M. Freudenberg on "The Nature of Euro-Mediterranean trade and the Prospects for regional Integration", in Towards Arab and Euro-Med Regional Integration, edited by Sebastien dessus, Julia Devlin and Raed Safadi, OECD, 2001.

[7] Mena Development Report.

8. Financial investment. The MENA region requires substantial funds for investment in infrastructure, to develop its natural resource base and finance economic growth and job creation. However, the region has not been able to attract funds and resources from the rest of the world. Despite macroeconomic stability in the MPC and the MENA countries over the decade of the nineties, the accompanying Table shows that the MENA countries attracted less than 5% of net private capital flows to developing countries, and less than the SSA countries. The investment climate was not deemed propitious.
   Why are we not able to attract resources, while our own *raw* natural resources are being exploited and human resources are leaving? Corruption, waste, bribery and the lack of transparency add to the multitude of risks to investment in the region and hamper the fundamental socio-economic development and well being of its populations. Transparency International[i], systematic corruption can add 20 to 25% to the cost of government procurement. Further, the quality of the goods and services fails to meet the required standards.



Source: D. Kaufmann, A. Kraay and M. Mastruzzi, 2003: Governance Matters III: Governance Indicators for 1996-2002 (http://www.worldbank.org/wbi/governance/pubs/govmatters3.html)



Net Private Capital Flows to Developing Countries (current US$ billions)

Developing Countries	1997	2001	2002	2003e
Latin America & the Caribbean	114.1	58.1	25.6	47.3
Middle East & North Africa	**7.8**	**7.7**	**6.1**	**-3.8**
South Asia	8.2	4.0	8.0	10.4
East Asia & Pacific	85.8	38.0	55.2	71.0
Europe & Central Asia	52.9	32.2	55.2	62.9
Sub Saharan Africa	17.0	11.3	5.2	12.4
Total	**285.8**	**151.3**	**155.3**	**207.8**

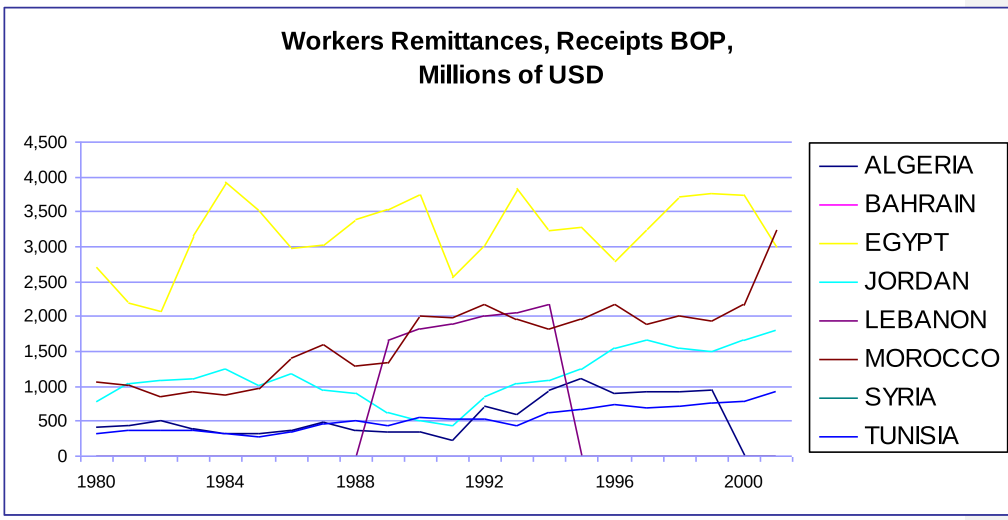
Source: Global Development Finance, 2004

9. The limited evidence we have on the financial markets and investment in the emerging markets of the MPC-12 and of investment by the Southern neighbors in the EU's financial markets, also suggests that financial integration has not increased; this at a time when international financial integration has been growing at its fastest pace in decades. In part, this reflects the lack of development of the Southern partners'

financial markets and their domination by their banking systems and the low expected growth rates in the region's economies. In turn, the limited development of the financial markets implies a lack of availability of financial instruments to promote investment in the region. Financial market development should be a priority for the countries of the region, as well as a major element of EuroMed cooperation[8]. Promoting the development of the capital markets should also be part of an overall effort for corporate sector reform and good corporate governance[9].

10. Following September 11, 2001 increased barriers- such as the Patriot Act and similar legislation- have impeded the economic and financial market integration of the MPC and MENA countries under the guise of combating terrorist finance and anti-money laundering. Along with increased uncertainty and expected losses from the wars on Afghanistan and Iraq, the result was a net private capital outflow from the region.
11. Labor. The trend for labor movements is similar if not worse than that of trade in goods and investment. The revealed preference of the EU has been to attract labor and migrants from the accession countries and from within the EU.[10] The countries of the MPC-12 are –given their demographically young populations and the poor growth performance- labor exporting countries, attracted to the high wage levels available in the demographically ageing economies of the EU. Economic efficiency indicates that both partners would benefit from facilitating the movement of labor towards the EU. The MPC-12 would receive the benefit of remittances and investment in human capital resulting from on-the-job training and education. The EU countries benefit from low cost MPC labor contributing to the pool of social funds for the retirement of the EU's labor force and population.

Comment [MSOffice4]: During 2000 -10, 4.2 million new entrants will join yearly the labour force. The forecasted figure is as twice as high compared to the numbers of the previous decades. (MENA Development Report).



12. The AA policy instruments to achieve the Barcelona promises include the MEDA programs, cooperation and technical assistance and lending from the EIB. Tables 1 and 2 and the accompanying graph (figure 1) reveal that aid and cooperation performance was dismal during the MEDA I program. Indeed, until the introduction

[8] See N. Saidi (2004, a) for a discussion of 'Financial Sector Reform and Development' in the MENA countries and its importance in overall economic reform.
[9] For a recent survey on corporate governance in the MENA countries, with a focus on the issues of transparency and disclosure, see N. Saidi (2004, b).
[10] See the OECD report on "Trends in International Migration", SOPEMI, 2003.

of major reforms in the delivery of aid and cooperation in 2000, the ratio of actually disbursed aid compared to committed, did not exceed some 29% over the period 1995-1999. With reform and the creation of EuropeAid, delivery and disbursement of aid improved, resulting in an increase of the ratio of disbursements to commitments to some 67% over the period 2000-2003. However, the value of the assistance and cooperation was of limited importance compared to MPC GDP to make an impact on growth, unemployment and investment. In addition, the structure of aid –mainly on technical assistance benefiting EU consultants and companies- did not favor investment or linkages in the recipient countries. As a result MEDA aid and cooperation has had a limited impact in achieving the aims of the Barcelona process and its vision. On the other hand, lending by the EIB was more effective, directed at infrastructure and physical assets, leading to an increase in productive capacity.

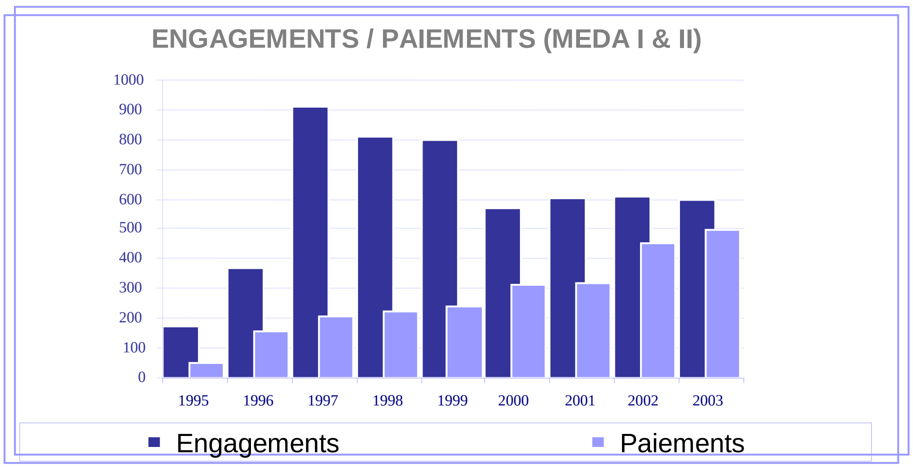


Figure 2: Engagements / Paiements (MEDA I & II)

MEDA I

	1995		1996		1997		1998		1999		1995-1999		% P/E
	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	
Coopération bilatérale													
Algérie	---	---	---	---	41	---	95	30	28	0,2	164,0	30,2	18,40
Cisjordanie/Gaza[1]	3	[1]	20	[1]	41	[1]	5	[1]	42	54	[1]	111,0	48,65
Egypte	---	---	75	0,1	203	1,9	397	88	11	67,1	686,0	157,1	22,91
Jordanie	7	---	100	60	10	40	8	6,8	129	1,6	254,0	108,4	42,67
Liban	---	---	10	---	86	---	---	---	86	1,2	182,0	1,2	0,66
Maroc	30	---	---	0,8	235	31,4	219	41,7	172	53,7	656,0	127,6	19,45
Syrie	---	---	13	---	42	---	---	---	44	---	99,0	0,0	0,00
Tunisie	20	---	120	41,4	138	61,3	19	9,1	131	56,2	428,0	168,0	39,25
Total bilateral	60	0	338	102,3	796	134,6	743	175,6	643	234,0	2.580,0	646,5	25,06
Regional[2]	113	50	32	52,7	115	73,2	66	46,6	154	6,3	480,0	228,8	47,66
TOTAL	**173**	**50**	**370**	**155**	**911**	**207,8**	**809**	**222,2**	**797**	**240,3**	**3.060**	**875**	**28,60**
Ratio P/E		*28,90%*		*41,89%*		*22,81%*		*27,47%*		*30,15%*			

[1] la répartition des paiements entre 1995 et 1999 n'étant pas disponible, se reporter à la colonne de l'année 1999 pour le total des déboursements au cours de cette période.
[2] y inclus l'assistance technique et l'allocation globale

Table 1: MEDA I

MEDA II

	2000		2001		2002		2003		2000-2003		% P/E
	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	Engagements	Paiements	
Coopération bilatérale											
Algérie	30,2	0,4	60	5,5	50,0	11,0	41,6	15,8	181,8	32,7	18,0
Cisjordanie/Gaza	96,7	31,2	---	62,2	100,0	80,6	81,1	60,3	277,8	234,3	84,3
Egypte	12,7	64,4	---	62,5	78,0	25,7	103,8	56,9	194,5	209,5	107,7
Jordanie	15	84,5	20	10,9	92,0	49,7	42,4	46,9	169,4	192,0	113,3
Liban	---	30,7	---	2,0	12,0	5,7	43,7	24,1	55,7	62,5	112,2
Maroc	140,6	39,9	120	41,1	122,0	101,9	142,7	102,4	525,3	285,3	54,3
Syrie	38	0,3	8	1,9	36,0	8,5	0,7	10,1	82,7	20,8	25,1
Tunisie	75,7	15,9	90	69,0	92,2	89,5	48,7	69,3	306,6	243,7	79,5
Total bilatéral	408,9	267,3	298	255,1	582,2	372,6	504,7	385,8	1.793,8	1.280,8	71,4
Regional[1]	159,8	48	305,3	62,7	29,4	81,4	95,6	111,9	590,1	304,0	51,5
TOTAL	**568,7**	**315,3**	**603,3**	**317,8**	**611,6**	**454,0**	**600,3**	**497,7**	**2.383,9**	**1.584,8**	**66,5**
Ratio P/E	*55,44%*		*52,68%*		*74,23%*		*82,90%*				

[1] y inclus l'assistance technique et l'allocation globale

Table 2: MEDA II

Barcelona II: A New Awakening

The EU has been writing history over the past 16 years since the demise of the Soviet Union through major structural reforms: the creation of a single market, adoption of a new currency, a new constitution and expansion through the accession of ten new members. It has announced a new Neighborhood Policy. Where does this leave the Mediterranean partners? It is clear that we need a new vision and to borrow a phrase from Mao Ze Dong, "a Great Leap Forward", a New Awakening. We have to break down the barriers to trade, investment and market links, both physically and 'virtually'. The new basis for economic cooperation, the new awakening, should be based on the vision of an integrated market covering the region extending from Northern Europe to the South of the Arabian Peninsula, to Yemen and Oman. The strategy should be one of creating competition, providing access, building networks and institutional reform. We need to revise the approach & instruments, to regenerate hope in the EuroMed partnership. How do we move forward? The building blocks include:

1. Expansion of the scope of the AA to encompass services, investment, labor movements and migration, financial markets and 'deep integration'; that is the harmonization of laws and institutions.
2. Develop and integrate the infrastructure and networks of the Mediterranean and the Arab region into an expanded Trans-European Network (TEN).
3. Foster the regional integration of the Arab countries through effective implementation of the Greater Arab Free Trade Area (GAFTA) and an Arab Common Market, (ACM).
4. Expand the EuroMed the AA to include the GCC and other Arab countries.
5. Create a framework for private sector participation in fostering economic integration and in infrastructure.
6. Promote financial market integration & the creation of a Regional Reconstruction & Development Bank.

The impact of EU enlargement on the Mediterranean Partners.

The admission of ten new members into the EU as of 2004, will significantly impact the EuroMed Partnership. The consequences will be felt in varying intensities at the level of trade exchange, capital flows, labour markets and Aids. The new 74.5 million inhabitants joining the EU bring along with them, imbalances at the level of the population growth, level of wealth, unemployment and investment climates as well as serious demand for the EU limited funds.

The highest price that the MENA region might have to pay comes in terms of investments. Higher level of productivity and enhanced investment environments, let along low transaction costs, especially in intra regional trade and exchange constitute members preferential advantages vis-à-vis the MPCs. Association Agreements between the EU and the MPCs are less binding than the membership or accession commitments. Some differences in requirements and regulations as noted at the level of GATS and the EuroMed Agreements add up to the complexity of the case. Hence, granting MENA countries unconditional free entry and increasing aid levels seems rather inaccessible.

The EU enlargement impact on trade is of a lesser extent. Extended markets and larger consumers base are appealing. Yet, the region is only set to reap benefits from new markets if serious reforms are undertaken at the level of tariffs and non-tariff barriers. Liberalized services sectors across the regions are vital. Their effect will spur on the macroeconomic level, prompting higher productivity. Naturally, Outward Processing Trade(OPT) would favour service oriented economies for higher quality and lower associated costs; candidate countries have indeed experienced a considerable growth (went up from 10.4% in 1989 to 17.9% in 1993) in OPT as percentage of total exports to EU compared to a negligible .1% increase for the same period in the case of the MPCs.

Labour flow remains the most controversial; the region has the highest levels of annual growth in labour force, estimated at 3.4% per year in 2000-10, twice the expected growth rate in other developing countries. New markets and new job creation constitute good news to the region, yet these income sources are unstable and rarely channelled towards economic development and job creation in one’s country. Workers remittances often put inflationary pressure and cause uneven distribution of wealth among citizens!

The EU is structured around the vision of becoming “the most competitive and dynamic knowledge based economy in the world in 2010”, the challenges are numerous, but it could definitely be in our region best interest to achieve first and foremost deep integration.

(Source: Femise Contribution to the 7th Annual Meeting of Experts on Economic Transition in the Southern Mediterranean Countries, 23 and 24 April 2003.

Trade, Investment and ‘Deep Integration’

The Association Agreements are designed to create a EuroMed free trade zone by 2010. This shallow integration between the EuroMed partners –by reducing or eliminating tariffs and quotas and simplifying customs clearance procedures- while important, will not result in major gains in welfare and efficiency. The EU is already the main trade and economic partner of the Mediterranean countries. The additional gains from further liberalization of trade in goods will be limited. The stimulation of competition is more important than the generation of trade in achieving the economic and political objectives that the EuroMed countries set for themselves in Barcelona in 1995. To be beneficial to the MPC, economic integration should include services and investment and labour flows.

1. For the MPC countries, a number of studies have found that liberalizing trade in services could be more important than liberalizing trade in goods in increasing economic growth, productivity and welfare[11]. To benefit from the complementarities existing between the EuroMed economies, the partners should move to liberalize trade in services and allow the freedom of establishment of firms. This will require privatization, since SOEs tend to dominate the services sector in the MPC. There is little doubt that liberalization of trade in services will lead to large gains from trade and will be a spur to economic growth in the EuroMed zone.
2. The EuroMed partners need to create a multilateral framework to facilitate the movement of labour between their countries. This would be an important policy change favouring the efficiency of the labour markets, but also address the social and humanitarian issues that are increasing as a result of the renewed rise of nationalism in Europe and translating into increased barriers, and outright discrimination.
3. Create a framework to encourage private sector investment in the MPC. The framework of laws and regulations relating to the rights of establishment, property rights, labour laws, taxation, incentives to promote investment, and the principles and practice

[11] See Hoekman and Messerlin, (2001) and D. Konan (2002).

underlying corporate governance, all play a role in creating a favourable 'investment climate'.[12] The MPC countries face a 'governance gap' compared to the industrial countries. A recent survey by the World Bank developed six indicators of governance and reveals that the MPC and the MENA countries are below the world median in nearly all categories, with the exception of 'government effectiveness', as a result of good performance in the GCC. However, on the other indicators related to democratic representation including political stability, voice and accountability, and control of corruption and bribery, the MPC and MENA countries under-perform. Improving public and private corporate governance is a long term investment in building and reforming institutions. Democracy and institutions, rule of law and regulations and regulatory agencies cannot be imported. However, historical evidence shows that the process can be facilitated. This is the lesson from the acceding countries of the former Soviet Union, which internalized the EU's "acquis communautaire". Conforming to international codes and standards provides a process for establishing good governance by the MPC.

In effect, the EuroMed partners should establish a process of 'deep integration', leading to the harmonization of laws and regulations, negotiate *mutual recognition agreements* (MRAs) of international and EU norms and standards, as a mechanism to reduce production and transactions costs, based on the requirements of future membership of the MPC in the WTO, to permit the operation of markets, access to international markets, development of trade in goods and services in all markets, freedom of establishment and investment in all sectors. Such 'deep integration' going beyond trade policies, underlies the successful transition of the countries of Eastern and Central Europe, has had an important impact on the quality of and commitment to government reform and economic policies.

'Deep integration' with the EU is part of the answer to the governance gap in the MPC and MENA countries. 'Deep integration' between the EuroMed partners –as the Association Agreements call for- necessitates strong policy coordination and imposes an agreed policy framework among and between our countries. It reduces the freedom of action of politicians and deters them from reneging on international agreements, because such actions reduce a country's external credibility and prospects of gaining from international trade and investment.

The importance of the EU Association Agreements framework is that it provides an answer –albeit incomplete- to the issues of governance. The 2004 Nobel Prize in Economics was awarded to two economists, Ed Prescott and Finn Kydland for their pioneering work on the importance of preserving dynamic consistency in the design of economic policy, on the importance of having strategies and policies that are credible and time-consistent, on the importance of policy-makers reputation. The implementation of the AA and multilateral trade liberalization –as in entry into the WTO- are important because they impose agreed policy frameworks and constrain the unilateral action of politicians and special interest groups, leading to improved governance through international benchmarking and monitoring.

Integrated Infrastructure is the Basis for Economic Integration

The success of modern economies and societies owes much to the overcoming of physical obstacles to communication and access to markets and trade. The EuroMed countries should invest to link and integrate the physical networks that underlie and facilitate trade, the

[12] See the discussion in N. Saidi (2004, b) and in the OECD (2004).

The European Neighbourhood Policy

The European Neighbourhood Policy (ENP) comes as a response to the changes that the EU has been witnessing since its creation. These transformations are not only expected to continue but to intensify as a result of an increasing number of joining, accessing and partnering countries.
Having espoused security and prosperity promotion as the main objective, ENP is set to be the instrument enabling the successful establishment of "Wider Europe" by bringing about enhanced full coordination and cooperation. The various signed bilateral agreements have of course initiated coordination, yet ENP promises to go far and offer country specific tailor solutions.
Our region falls within the scope of ENP coverage. The European Neighbourhood Policy will build on the bilateral and regional achievements. It will bring further enhancements and will facilitate full integration at the country and regional level.
In line with the ENP vision and aspirations, cooperation will cover the following different items.

1. Infrastructure interconnection projects to include creation of trade networks, gas and electricity networks, rail roads and maritime transport
2. Environment where as topics such as water resource management and waste prevention will be covered
3. Justice and Home Affairs, new borders including short sea-crossing require border management to safeguard the region against cross border crimes and cooperate to fight against illegal immigration, to name a few
4. Trade, regulatory convergence and socio-economic development, higher and enhanced cooperation to guarantee a smooth transition into a completed Euro-Mediterranean Free Trade Area. Enhanced cooperation is a priority and extends from dialogue on social policy, to public health, to liberalization of services…)
5. People to People projects, undertakes the human dimension whereas safeguarding human rights and promoting youth organizations rank high.

The region will also profit from the continued financial and technical supported by the European Neighbourhood policy.

Source: European Neighbourhood Policy, Strategy Paper

mobility of factors of production and direct investment. These include: air, rail and road transportation, energy, oil and gas pipelines, and modern ICT networks.
The economic integration of the MPC should be based on an integrated infrastructure and networks. The countries of the Southern Mediterranean and the Arab hinterland have an underdeveloped transport (air, road and rail), energy (oil, gas, and electricity), water, and information and communications networks. Even in the relatively well-endowed countries of the GCC, the existing infrastructure has aged –embodying technologies of the 1970s and 1980s- and needs replacement, development and modernization. In the non-oil countries and non-GCC oil producers, existing infrastructure is inadequate to serve the needs of modern economies and societies and fast-growing populations and labor forces. More generally, the infrastructure is, typically, managed by State Owned Enterprises (SOEs), resulting in high cost, inefficient enterprises unable to provide the private sector and the general public with adequate services. The region lacks the infrastructure, its interconnectedness, its quality and density. The result is a high cost of infrastructure services and logistics leading to high

production costs of goods and services and to a low quality of final services to consumers, whether households or businesses. In turn, small markets protected by import-substitution policies and the absence of a performing, high density and quality infrastructure has reduced the extent of diversification of economic activity in the Arab countries, and prevented the development of trade in intermediate and processed goods. An important consequence is that the structure of production and trade in the Arab countries remains highly concentrated in labor-intensive and high resource content, low value-added products, with limited vertical specialization.

The absence of infrastructure also extends to cross-border infrastructure. Poor quality logistics negatively affects trade in goods and services, tourism and the movement of people and has resulted in a growing ‘digital divide’ with the developed countries. The other characteristic is that communications and transport infrastructure, such as it is, is largely designed for extra-regional, North-South, contact and inter-action with former colonial powers. The result is poor intra-regional infrastructural services and communications. It is easier and most frequently cheaper to contact the West from any capital in the region than to establish communication within the region!

Trade competitiveness is strongly affected by the cost of logistics. Trade between the MPC-12 and the Arab countries more generally, is impeded by inefficient trade logistics; bureaucratic procedures, time consuming transit procedures, bribery, corruption and customs clearance all lead to high logistics costs which substantially reduce the volume and value of trade. A recent study on trade logistics in the MENA countries[13] finds that logistics costs can vary from 7% to some 55% of the landed price of exported goods depending on the per unit value of the goods (see the accompanying table)!. It is not surprising that our export performance is lacklustre!

Similarly, a recent study shows that there is strong positive relation between the share of total exports that is driven by vertical specialization and the quality of infrastructure. Vertical specialization is sensitive to trade barriers and infrastructure quality and cost of infrastructural services.[14] The bottom line is that poor quality and costly infrastructure services and other barriers have prevented regional integration and economic integration with the EU and the rest of the world. We are not benefiting from geography and proximity of the EU. What should be done?

[13] “Global links to regional networks: trade logistics in MENA countries”, by Julia Devlin and Peter Yee, Paper Presented at the Fourth Annual Mediterranean Development Forum Held in Amman, October 6-9, 2002

[14] See H.K. Nordas, “Vertical specialization and the quality of infrastructure”, WTO, Staff Working Paper ERSD, December, 2003.

Table 5: Logistics Costs for MENA exporting firms (US$)

	YEMEN			EGYPT		JORDAN	
	Tuna	Coffee	Banana	Garments	Potatoes	Garments	Okra
Non-Transport Logistics Costs							
Ordering and other admi cost	25	25	25	60	60	90	40
Load/unload	462	526	159	560	14,000	2,200	110
Capital carrying cost in transit	21	1,830	3	996	591	2000	1.35
Capital carrying cost in storage	10	4,238	2	670	295		0.25
Storage cost	370	1,800	40	475	800	240	25
Shelf-Loss in Transit/Storage	4,800		520	90	3,750	50	100
Filing loss& damage claims	25	25		30			
Safety Stock/Stock-Out Cost							
Emergency shipment cost	2,772						
Subtotal	8,459	8,444	749	2,881	19,496	4,580	268
Transport charges							
Truck	1,167	950	590	400	19,200	4,400	210
Airfreight	12,348			7,000		19,000	1,925
Ship		1,700		3,800	8,400	9,200	
Subtotal	13515	2650	590	11,200	27,600	32,600	2,135
Logistics Costs as % Landed Price	54.9	7.2	23	15.4	26	6.7	48

Regional Infrastructure Investment for Regional Growth

The EuroMed partners should invest massively in infrastructure within the countries of the MPC-12 and integrate them with the EU's infrastructure and networks. Such investments, which will break down barriers and reduce logistics costs, are likely to create large benefits from economies of scale and generate high returns to investment. They should be the basis for the creation (see below) of a *EuroMed Reconstruction and Development Bank*. Three major infrastructure networks should be envisaged: (a) Energy: electricity, oil and gas; (b) an Integrated Information and Communications (ICT) EuroMed network; and (c) an Integrated Payments Network.

The so-called **Trans-Euro-Mediterranean Networks (TEN),** to ensure gas and electricity interconnections South-South and South-North in the region have been identified as a clear priority. The Euro-Mediterranean Energy Forum program and action plan should be accelerated to:

- Create the **Mediterranean Electricity Ring** which will link all the countries of the Euro-Med process. The ring should be further integrated to link with the countries of the Gulf.
- A **EuroMed oil and gas link** should be a priority, with oil and gas pipelines linking the EU with oil and gas producing countries of North Africa, Egypt and the Gulf. At the moment planned pipelines by-pass the Mashrek countries to pass through Turkey. The East Mediterranean gas link currently under construction should be extended to Iraq and Iran with terminal ports in Lebanon and Syria, and integrated with the Azerbaijan to Turkey pipeline.
- Create a **EuroMed integrated road and rail network** to be linked to the integrated transport network, developed for the Mashrek, Integrated Transport System in the

Arab Mashrek (ITSAM) [15]. The importance of the railroads is that they would link the Arab Mashrek countries with Europe and with the Arab countries of the Gulf, reducing transport costs and enhancing the overall integration of the region, allowing the efficient transport of goods and people throughout the area. Two strategic transport projects should be given priority on both the bilateral and regional level: road and rail transport. Briefly:

a. The "**International Roads in the Arab Mashreq**" which has been long delayed.
b. The rail network should be re-developed with two projects:
    - The '**Berlin to Baghdad' railway** would link the heart of Europe to the centre of the Arab world, passing through Eastern and Central Europe and through Turkey and the Arab Mahsreq
    - The "**Hejaz' railway**, took 8 years to build with about 7000 soldiers at a cost of about US$16 million in 1908. With new superior technologies it would cost about US$300 million today and deliver fast, reliable transport services. It would link Turkey to the Arab Mahsreq and the GCC.

- Integrated ICT Infrastructure. The MENA countries have to bridge the digital divide. In particular, they need to undertake substantial investments in the ICT infrastructure of their economies and societies. Investment in telecommunications and in broadband technologies will be critical in the economic integration of the EuroMed area. This calls for integrated high speed broadband technologies networks to be established. This would enable the MENA countries to harness the powers of modern ICT for economic and social development, for e-Services, e-Government, and e-Society. A '**EuroMed Info-Route**' should be developed in parallel to the Mediterranean Electricity Ring and integrated with European ICT networks.
- **Payment System Integration**. Economic integration in the EuroMed requires the support of a modern, efficient payments infrastructure that will underlies trade, investment and economic links. The successful introduction of the Euro implies a reduction in transactions costs, both within the EU and cross-border. The monetary authorities and finance ministries, should work at the set-up of a **MedPayments system**, which would (a) unify the payments systems of the MPC, and integrate them into the EuroSystem. In particular, I advocate the extension of the EU TARGET system to the MPC, to create a **Med-TARGET** system. This would form the basis of a new payment system, allowing and facilitating the use and adoption of the Euro.

The envisaged infrastructure program, likely to extend over a generation, would develop and strengthen the links of the EuroMed countries, lead to a strong expansion of trade and private sector investment, raise economic growth in the EuroMed area, create jobs and raise labour and total productivity growth. Regional infrastructure investment should be considered a Regional Public Good and be considered a policy priority and undertaken through a public-private partnership of the EuroMed partners.

[15] See "The Role of the ESWA in Promoting Trade and Transport Facilitation in the ESCWA Region", by Nabil Safwat, 2002.

Regional Integration: Expanding the EuroMed AA Partnership

The signing of the AA between Syria and the EU in October 2004 completes the set of agreements with the initial Barcelona process participants. However, geo-political realities have changed since 1995. We should leverage on the existing agreements in two strategic directions.

First, **the Arab countries should enter into negotiations to sign AA agreements among each other**. There are a number of important benefits.

One, it is politically and economically incongruous that we have signed far-reaching, bilateral, strategic agreements encompassing trade, political, diplomatic, social and cultural issues with the EU, without doing as much between the countries of the region; the AA including agreements on 'rules of origin', harmonization of tariff systems, agreements on non-tariff barriers and other impediments to trade, without doing so with the Arab countries, where negotiations have been ongoing for several decades! Specifically, we should prevent the emergence of a trading and investment system that would give preferences to the EU beyond the commitments made between any two partners. This would lead to the emergence of distortions in the regional pattern of production and trade. Two, inter-Arab AA would consolidate and strengthen the achievement of the GAFTA. Three, such agreements would be a stepping-stone towards an Arab Common Market, leading to a breakdown of the variety of barriers facing the emergence of a market economy in the Arab countries and leading to economic diversification, renewed economic growth and prosperity. Fourth, it would reduce the potential emergence of a 'hub-spoke' effect, whereby the EU countries emerge as a central hub for the location of economic activity and investment, whereas the Mediterranean partners would be 'spokes' for consumption and limited ancillary economic activity.

Second, given that the Arab countries are committed to implementing the GAFTA and establishing Regional Trading Agreements –as in the Agadir agreement- the EU should seek to expand the geographic scale of the AA to encompass the other Arab countries, including Iraq, the GCC and Yemen. Along with the signing of inter-Arab AA, this would be a major force in favour of increased regional integration and would create the institutional mechanism and links for the regional integration of infrastructure.

Financing mechanisms for economic Integration

The creation of an integrated EuroMed economic zone cannot be successful without a supporting financial mechanism, including grants and financial transfers. The Barcelona process, accordingly, established the MEDA programs (MEDA I and MEDA II), accompanied by lending by the EIB. By the same token the US 'Greater Middle East' free trade proposal fails to address the concerns of the MENA countries, not least because it does not provide for an underlying financial support mechanism. Adjustment to trade liberalization, structural reform and transition to a market economy –including a reduced role of the State and increased private sector participation- in the MPC, the requirements of financing large scale infrastructure projects to support the regional integration of the MPC and EuroMed integration, necessitate the set-up of a Regional Public Bank for reconstruction and development, a **Euro-Mediterranean Investment Bank (EMIB).** This could emerge from incorporation of the EIB's FEMIP (Facility for Euro-Mediterranean Investment and Partnership), the important initiative created by the

Comment [ZMZ5]: The EIB has extended more that 3,445 Million Euro over the period 2000-2003. Furthermore, As of November 2003, the EIB external lending ceiling was increased for Mediterranean countries by 2.180 Million Euro. (Strategy Paper).

Barcelona European Council,[16] which provides special priority to the development of private-sector economic activity and to projects contributing to the creation of a favourable climate for private investment (See figure 2 & 3).

The EU's own successful regional integration and the central lesson from the EIB's experience confirm the importance of a large and dynamic public bank to support integration and convergence processes[17]. EMIB would work with the EIB, the various Arab Funds and other international organizations to increase the financing of regional infrastructure projects: infrastructure and info-structure as major factors in fostering physical and communication links, reducing transactions costs, lowering transport and communication costs, foster intra-Arab trade and investment, bringing the region into the digital age, and generating economic growth.

[16] In March 2002.

[17] See the working paper by S. Griffith- Jones, A. Steinherr and A.T. Fuzzo de Lima, "The European Investment Bank: A useful inspiration for emerging countries?" presented at the Seminar on Regional Financial Arrangements, UN, July 2004

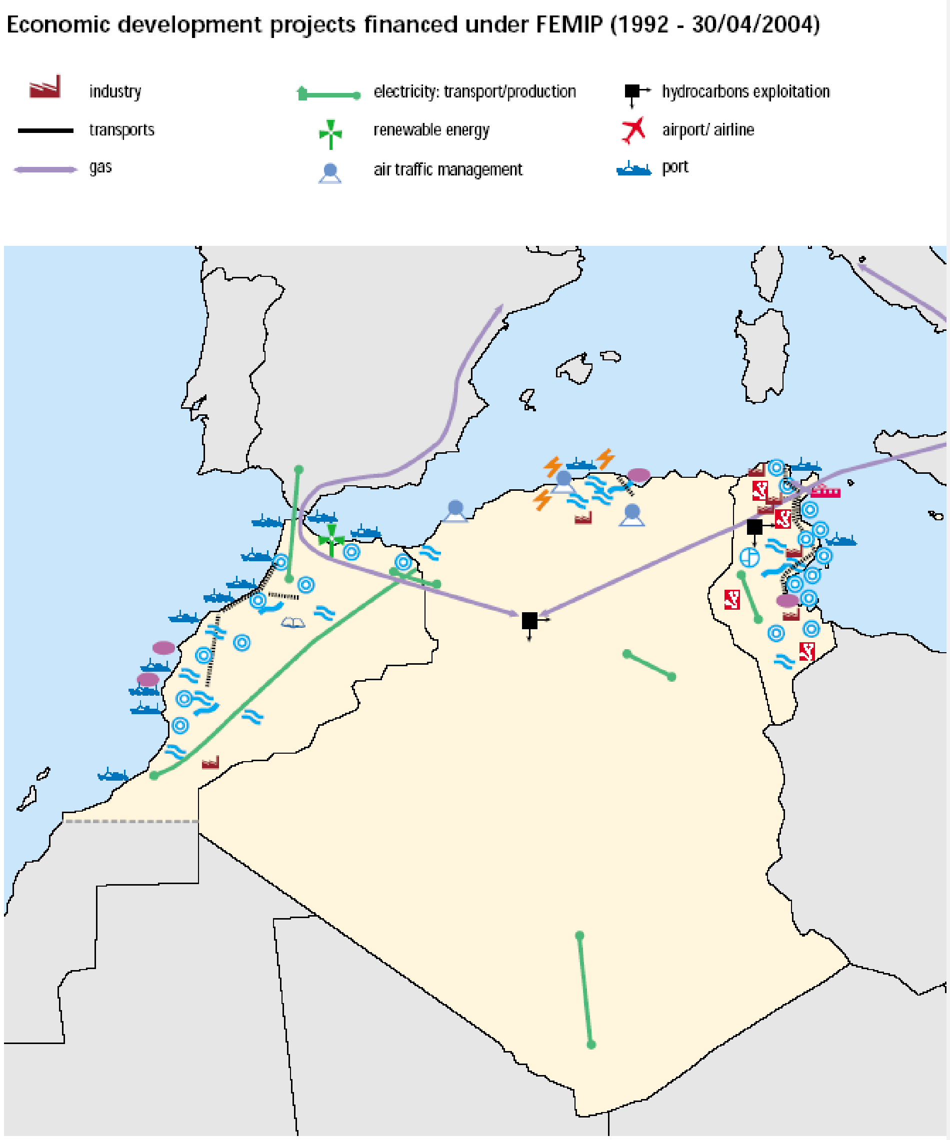


Figure 3: Economic Development Projects Financed under FEMIP (92 - 04), (Source: EIB REPORT)

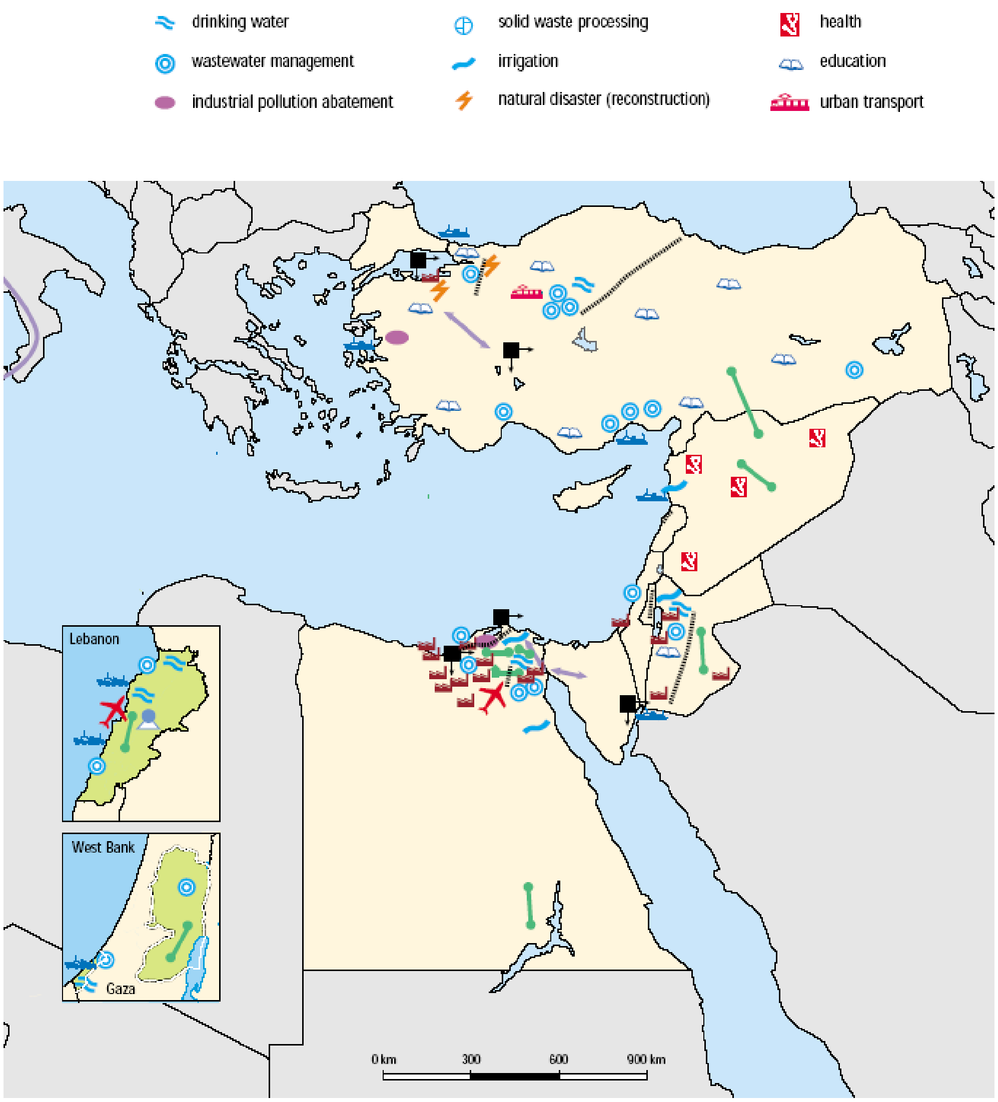


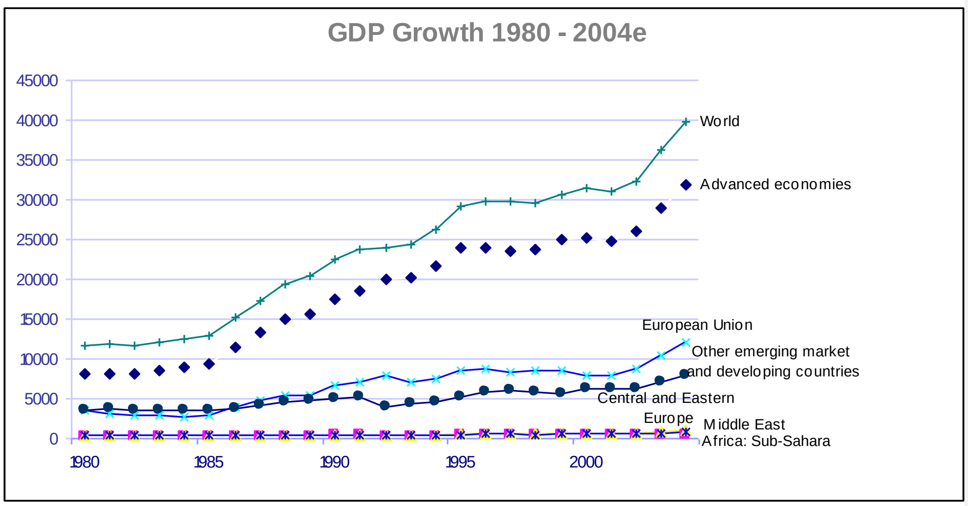
Figure 4: Economic Development Projects fnanced under FEMIP (92-04), (Source: EIB Report)

Final Remarks

We stand at a burning cross-road in the Middle East with two different directions and potential outcomes. In one, there is a continuation of the US-led 'war on terrorism', which portends a continuing cycle of violence, wars and destruction. A continuation of the war on terror will create divisions between Europe and its Southern neighbours and the Islamic world, hewing away at the historic links and common values that have established proximity and interdependence. This is not in Europe's strategic interests.

It is unlikely under such a scenario that the MENA region will achieve the Barcelona process promise of an area of 'peace, stability and prosperity'. The latter will not be achieved in a world where double standards are accepted –in particular in the application of international law and resolutions- and in the absence of a lasting resolution of the Arab-Israeli conflicts and the end of the tragedy for the Palestinian people.

The other, is a 'welt anschaung', a vision developed of a region that is 'deeply' economically integrated with the EU, potentially forming the largest market zone of the world. It is a zone where barriers to prosperity and riches, physical and virtual, will have been eliminated. Where our children –whether from Oman or Sweden- can interact, trade, invest, work, without barriers. The vision is realistic and within our grasp. The resources, technology, knowledge are at our disposal. We need the leadership, the institutions and efficient mechanisms to carry out the vision. It requires courage, determination and long-term commitment. Our children and future generations will not forgive us if we do not steer in that direction. We owe it to them to try.



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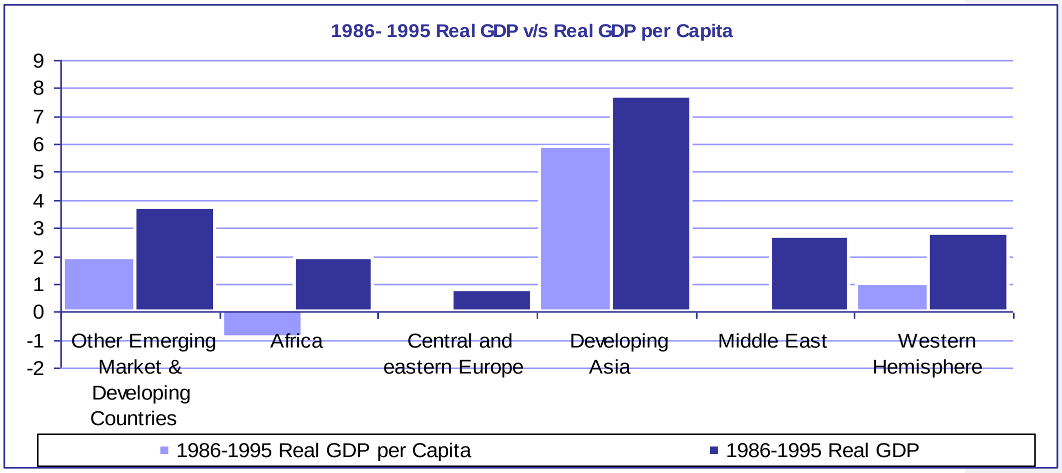
Appendix

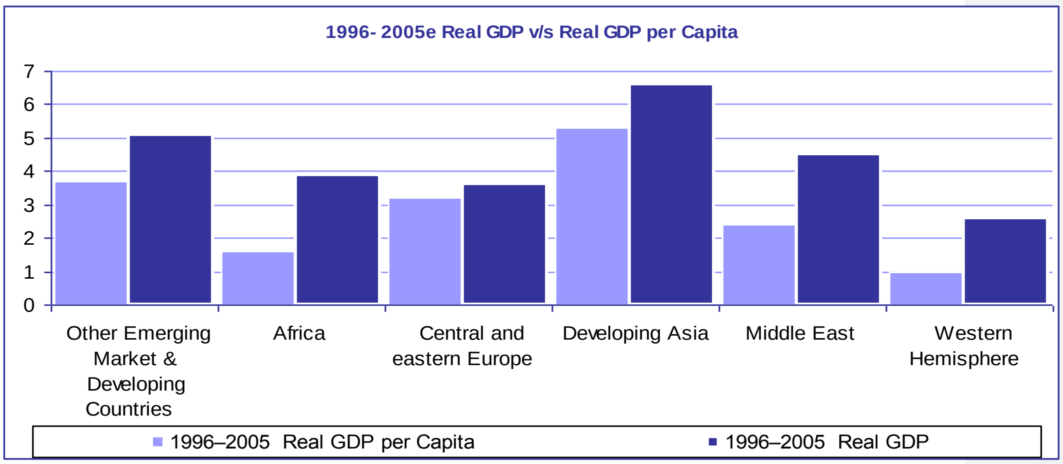
10.7 NG7 – East Mediterranean Gas Ring

- 10.7.1 Arab gas pipeline from Egypt (NG7b)

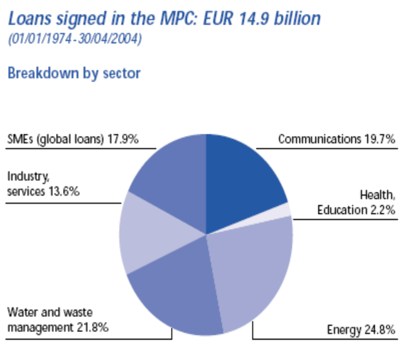
Mediterranean Partner	Conclusion of Negotiations	Signature of agreement	Entry into force
Tunisia	June 1995	July 1995	March 1998
Israel	September 1995	November 1995	June 2000
Morocco	November 1995	February 1996	March 2000
Palestinian Authority	December 1996	February 1997	July 1997
Jordan	April 1997	November 1997	May 2002
Egypt	June 1999	June 2001	Ratification pending
Algeria	December 2001	April 2002	Ratification pending
Lebanon	December 2001	June 2002	Ratification pending
Syria	April 2003	October 2004	Ratification pending

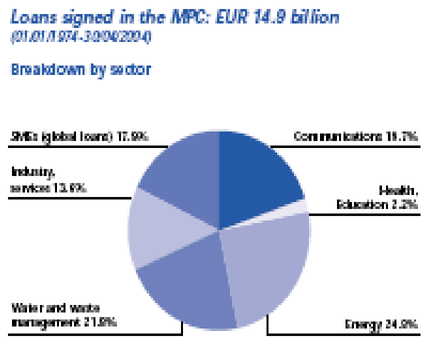
(Source: www.transparency.org)





Source: World Development Indicators





Breakdown by region

Region	Current year (in EUR)	Past 5 years (in EUR)
European Union	26,174,501,924	169,033,777,103
Article 18	188,834,298	991,223,790
Accession Countries	103,000,000	2,739,700,000
Mediterranean countries	821,498,958	7,096,205,558
Africa, Caribbean, Pacific countries + OCT	219,872,073	2,038,240,185
South Africa	100,000,000	751,800,000
Balkans countries	311,000,000	1,330,000,000
Asia and Latin & Central America	207,943,995	1,898,548,436
Commonwealth of Independent States	0	25,000,000
Total Amount	28,126,651,248	185,904,495,072

(Source:www.eib.org, 05/2004)

Breakdown by country

Country	Current year (in EUR)	Past 5 years (in EUR)
Algeria	12,498,958	829,000,000
Egypt	60,000,000	1,202,718,800
Gaza / West bank	0	31,000,000
Israel	0	0
Jordan	100,000,000	215,696,758
Lebanon	45,000,000	75,000,000
MED Countries	0	9,500,000
Morocco	0	960,000,000
Regional - North Africa	0	0
Syria	0	380,000,000
Tunisia	99,000,000	1,197,290,000
Turkey	505,000,000	2,196,000,000

EU trade balance with MPC: surplus since 1990
EU trade with Mediterranean partners countries (EUR bn) (Source: www.europa.eu.int)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Imports	26.6	27.8	28.2	28.0	30.5	32.1	35.3	41.3	42.5	47.2	64.8	68.1	66.8
Exports	33.5	35.0	36.6	43.5	43.9	50.6	56.9	65.3	68.0	69.4	87.0	77.0	79.9
Balance	6.9	7.2	8.4	15.5	13.4	18.5	21.6	23.9	25.5	22.2	22.2	8.9	13.1

FDI FLOWS From 1970 to 2003 (Source: UNCTAD)

COUNTRY_GROUP	YEAR / INDICATOR	1970	1980	1990	1995	2000	2001	2002	2003
World	FDI inflows	13032.04	54985.56	208646.5	335734.2	1387953	817573.9	678750.9	559575.5
	FDI outflows	14157.31	53683.12	242056.9	358235.4	1186838	721501.3	596487.4	612201.2
European Union	FDI inflows	5126.56	21316.61	96773.8	114559.9	671417.4	357440.9	374000.1	295154.2
	FDI outflows	5071.97	23811.73	130480.2	159715.9	806150.6	429158.9	351181.1	336993.6
Algeria	FDI inflows	47	348.67	40	0.01	438	1196	1065	633.8
	FDI outflows	2	33.62	4.69	4.24109	18	9	99.8	14.2
Egypt	FDI inflows	0.68	548.29	734	595.2	1235.4	509.9	646.9	237.4
	FDI outflows	0.00001	7	12	34.2	51.2	12.4	27.8	20.7
Morocco	FDI inflows	20	89.42	165	332	215.3667	2824.551	480.6907	2279.27
	FDI outflows	0.00001	38.72162	13	12	58.44376	97.05388	28.38321	11.62477
Tunisia	FDI inflows	16	246.4771	90.45111	322.6	778.8	486.4	821.3	583.9
	FDI outflows	0.00001	0.00001	0.3	3.4	1.7	0.3	0.5	1.4
Jordan	FDI inflows	0.00001	33.83	37.65	13.31	786.6	100.28	55.85331	378.6
	FDI outflows	0.00001	3.06	-31.48	-27.3	4.65	9.31	24.96474	2.6
Lebanon	FDI inflows	0.00001	-12.16	6.45	35	297.8	249.3	257.3	358
	FDI outflows	0.00001	0.00001	-15.9813	6.39316	124.6318	91.83398	73.88732	96.78438
Occupied Palestinian Territory	FDI inflows	0.00001	0.00001	0.00001	122.6	62	20.2	0.00001	0.00001
	FDI outflows	0.00001	0.00001	0.00001	129	213.3	379.5	0.00001	0.00001
Syrian Arab Republic	FDI inflows	-0.1	-0.04	71.46	100	270	110	115	150
	FDI outflows	0.00001	0.00001	0.00001	0.00001	0.00001	0.00001	0.00001	0.00001
Turkey	FDI inflows	58	18	684	885	982	3266	1038	575

FDI outflows	0.00001	0.00001	-16	113	870	497	175	499