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MEDPRO Newsletter

Thinking Ahead for the Mediterranean

MEDITERRANEAN PROSPECTS

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New regional context in the South Mediterranean: What economic reforms for the future?

Dr. Rym Ayadi, Senior Research Fellow, CEPS and Overall MEDPRO Coordinator

Precarious economic, social and political conditions were the root causes of the massive rallies that began in Tunisia and spread to the rest of the Arab world; calling for an end to decades of repression, corruption and inequality. These calls must lead to radical changes in the region and to profound political and social-economic reforms that will take decades to accomplish.

The main challenge will be to integrate the social and political aspirations of citizens in the new socio-economic model currently under construction, and to redefine its pillars to ensure sustainable wealth creation and fair and inclusive distribution. Since the 1980s, the region embarked on a series of economic reforms aimed at increasing growth and supporting economic diversification through macroeconomic stabilisation, opening up to foreign competition and private sector development. All these reforms are laudable and must continue, but with more emphasis on inclusive growth and social inclusion. It is widely known that these reforms were pushed for by the International Monetary Fund (IMF) and World Bank (WB) under the structural adjustment programmes triggered by unsustainable levels of foreign debt in the region. Even if the adjustment programmes were successful in curbing external debt in several countries, the outcome may be disappointing when looking at the growth of per capita income – at an average rate of 2.2% during the period, particularly when compared to the growth rate of 5-6% in East Asian economies. Besides relatively poor growth performance, these reforms have chiefly failed to translate into wider economic and social gains in a region where the population grew from 185 to 382 million between 1980 and 2010, comprising 30% youth (and largely educated) unemployment rates.

Similarly, economic diversification has failed to materialise. In 2010, approximately 30% of the region's labour force was still concentrated in agriculture, oil rents accounted on average for 12% of the region's GDP while private sector investment stood at 10% of GDP. Income distribution remained unchanged and sometimes further concentrated while poverty rates remained constant at 20% across the period. These gaps largely nourished the frustration of an overwhelmingly young population, increasingly concentrated in areas with poor health care, education, water and power infrastructure. Continuing state interference in the region's economies prevented the emergence of a private sector capable of absorbing labour market newcomers, exacerbating already high unemployment pressures that stemmed from inadequate education and training infrastructures. As a result, a large proportion of the youth was and still is left to choose between turning to informal economic activity and emigration.

Given this backdrop, what are the potential economic reforms that could be envisaged to achieve sustainable socio-economic outcomes and ultimately to fulfil the aspirations of people who simply seek equal conditions for a better life? Countries in the region will have to face the challenge of creating and redistributing growth. MEDPRO research has forcefully shown that long-term growth continues to be determined by sustained foreign direct investment (FDIs), trade, stable macro policy and a developed financial market, in particular the capital account openness. These factors underpin the importance of deeper integration with neighbourhood countries and regions, including the EU.

Economic reforms must in turn continue to offer the necessary conditions to attract and ensure quality FDIs, maintain fiscal discipline, manage growing current account imbalances, offer meaningful support to a private sector (in particular micro and small and medium-sized enterprises) capable of absorbing a growing young workforce and promoting innovation. They must also take into account the need to tackle the critical issue of matching labour demand and supply skills and maximise return on education.

Regional/local development and governance is another important domain where convincing policy answers are sought and must be implemented to tackle the structural problem of regional inequality. More inclusive development policies cannot be produced by an overly centralised system. The previously neglected social infrastructures will have to be developed at regional versus local levels to enhance economic performance and hence provide new opportunities to the private sector to emerge. In turn, the creation of robust income redistribution schemes puts fiscal policies and policies to boost productivity at the core of future economic strategies, requiring innovative solutions to deal with the overblown informal sector. Ultimately, policies must be turned towards growth creation and redistribution, job creation and social inclusion.

On an international level, prospects of low growth in the Southern Mediterranean countries' key commercial partners (such as the EU) call for diversification and the strengthening of genuine regional markets in the south, along with Turkey, the Gulf Cooperation Council (GCC) countries, Sub-Saharan Africa (SSA) through deepening the commercial, monetary and financial ties. They should also look further afield than their immediate neighbours and reinforce cooperation with the Brazil, Russia, India and China (BRICS), for example. Europe's economic positioning and role will undoubtedly continue to be privileged because of natural ties and its proximity to the South Mediterranean countries. However, the financial and sovereign debt crisis suffered by Europe may have dire consequences, not only on the internal market but also on the South Mediterranean countries that are economically and commercially dependent on EU demand. Notwithstanding these realities and despite the uncertainties surrounding the political situation in the South Mediterranean region, the EU has the political and economic instruments to contribute to the consolidation of the new socio-economic development model in the region. Clearly, the new regional context promises the beginning of a fundamental change in the political/social and economic reality of the southern Med region with new rules of the game being devised.

Is the EU-Mediterranean integration scenario the way forward?

Dr. Luc De Wulf, Center for Social and Economic Research (CASE, Poland), WP5 leader

The 'Arab Spring' has brought with it extra political uncertainty that has long-term implications for the socio-economic conditions of the South Mediterranean region. Several fundamental economic factors transcend these short-term uncertainties however, and, if correctly identified, can guide policy-makers towards measures that can generate and sustain economic growth, which itself is a prerequisite for reducing the high levels of unemployment that prevail in the region.

The rapid population growth experienced in the region gives greater urgency to the adoption of growth-promoting policies so as to create jobs for the unemployed and the new entrants into the labour force. The research undertaken in this Work Package (WP5) has clearly identified a number of key factors that would positively impact on the economic performance of the region in the period up to 2030 and beyond. First, a stable macro-economic framework, characterised by low inflation, is a must, and requires the containment of fiscal deficits that would avoid pressures for their monetisation, and therefore undue monetary expansions. Second, an open economy can increase external competitiveness and help to attract technology-enhancing foreign direct investment. This will require greater integration into the world economy – with the EU, within the Mediterranean region itself and with the rest of the world. To achieve this goal, a further dismantling of tariffs (shallow integration), a lowering of non-tariff measures (deep integration) and the adherence to competitive exchange rates are needed. Third, improving the quality of institutions would improve the business environment for private sector operators, as well as for the delivery of quality public services provided by the government. The scenario that focuses on deeper integration with the EU by possibly learning from the EU-Turkey customs union (CU) could substantially enhance these growth-promoting factors.

Finding a favourable solution to the present deep fiscal crisis that plagues the EU will strengthen the dynamism that is expected to emerge from deeper MED-EU integration. A well-designed and implemented EU assistance strategy to the Southern Mediterranean countries in the context of the recent political events in the region could also promote the growth factors mentioned above. Better regional integration, as well as greater integration with the rest of the world, including the USA and fast-growing emerging markets such as China, India and Brazil, could also have a very positive impact on economic and social trends in coming years. The business-as-usual scenario would not be disastrous but would be a missed opportunity, while the pessimistic scenario would lead to lower growth and steadily growing unemployment; definitely an explosive situation that should be avoided at all costs.

What determines long-term growth post-Arab Spring?

Dr. Leonor Coutinho, Cyprus Center for European and International Affairs (CCEIA, Cyprus)

To talk of long-term growth in the Southern Mediterranean in the midst of 'Arab Spring' turbulence is not a straightforward thing. The uprisings in the region may either leave scars on the economy that are long to heal, or, conversely, bring about structural changes that could put these economies onto a more favourable growth path. It is, however, somewhat premature to argue for one outcome or another. The question that this strand of the MEDPRO research strives to address is: what drives the region's long-term growth under the unstable political conditions brought about by the Arab Spring? The empirical evidence reached in this research points to the key role of economic integration in fostering growth in the region. Although there is no evidence that closer ties to the EU would be preferred to closer ties to other world regions, the EU is a close industrial neighbour of the South Mediterranean, and is a natural candidate for enhanced partnership. Equally, FDI inflows help to explain differences in growth. The Arab Spring, however, has brought a great deal of uncertainty to the region about business conditions, which may remain unresolved for some time.

Increased and long-lasting instability is likely to result in the withdrawal of foreign companies and deter others from tapping into the market; hence in the short term the most pressing priority is to regain political stability. Moving beyond the current crisis, macroeconomic policy continues to be central. It is important to ensure the sustainability of fiscal policy so as to contain the monetisation of government deficits and inflation, while channelling fiscal resources to areas that are proved to be growth-enhancing, such as education. Notwithstanding this, one of the main challenges is perhaps that of absorbing a large pool of potential workers into productive employment activities. Employment strategies that rely on expanding low-productivity public sector employment are likely to impose strains on public finances, which could ultimately lead to the monetisation of government deficits and inflation. Instead, improving the conditions for private sector development should be the key to breaking up a possible inflation-unemployment trade off. This may include initiatives to ease labour and product market rigidities. Improved migration policies in Europe could also play a part in solving this problem.

Shallow versus deep EU-Mediterranean integration: What benefits?

Dr. Ahmed Farouk Ghoneim, Center for Social and Economic Research, CASE, (Poland), Cairo University (Egypt);
Prof. Nicolas Peridy CASE, Université de Toulon Var (France)

The research findings reveal that strong trade creation is expected from deep integration, indeed the elimination of Non Tariff Measures (NTMs) is expected to lead to strong trade gains. With regard to imports, the expected increase ranges from about 25% in Morocco and Tunisia to 60% in Algeria. The other countries are in intermediate positions, showing import increases that range from 32% (Lebanon) to 39% (Egypt and Jordan). Export increases, although significant (35%) are smaller than import increases, however, because the NTMs applied by the EU to MED countries' exports are lower than those applied by MED countries to their own imports. The main reason is that almost no progress has been made so far concerning the reduction in NTMs. Trade gains due to deep integration can also been reinforced further through the potential reduction in trade and logistics costs: in the optimistic scenario, import increases are expected to amount to up to 30% for Morocco and 45% for Algeria. Export increases are even greater. In any case, the trade gains are particularly significant for the countries that show the greatest inefficiencies in their logistics, i.e. Algeria, Egypt and Morocco, although the latter country has made significant progress in the past few years. Conversely, simple tariff removal is expected to produce a moderate or limited import increase, except in Algeria, and to a lesser extent Tunisia. For these countries, import increases are estimated to amount to 59% in Algeria and 42% in Tunisia. Egypt and Morocco show moderate import increases due to tariff removal (about 30%). For the other countries (Lebanon, Jordan, Israel and Turkey), only a limited import increase can be expected from further shallow integration, since the potential gains have been almost fully achieved due to past tariff liberalisation, both multilaterally (GATT) and regionally (the Barcelona agreement). The effects of tariff removal concerning MED countries' exports are also small, because most of their partners in the Euromed area have already removed their tariffs.

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What future for foreign direct investments (FDI) in the South Mediterranean?

Prof. Khalid Sekkat, FEMISE, Université Libre de Bruxelles (ULB, Belgium)

The prospects of FDI evolution in the region were assessed under four scenarios: i) continuation of present trends, ii) further integration with the EU, iii) less integration with the EU but greater regional integration and iv) no integration. Under the first scenario, the ratio of FDI to GDP decreases slightly in all countries but Jordan, where the decrease is relatively important. Under the second scenario, the ratio increases in all countries. The increase is the highest (almost 2 percentage points) in Jordan and non-negligible in Egypt, Israel and Tunisia (above 0.6 percentage points). Under the third scenario, the increases are less important but remain non-negligible in Egypt, Israel and Tunisia (above 0.3 percentage points) and economically significant in Jordan (around 0.9 percentage points). Finally, the fourth scenario shows a perceptible decrease in all countries. The most affected economy is Jordan (-4 percentage points) followed by Egypt, Israel and Tunisia (around -1.5 percentage points). The deterioration being much greater than the improvements under the other scenarios, the results support the necessity of vigilance with respect to reforms, in particular

What diagnosis and future for monetary policies in the South Mediterranean?

Prof. Sami Mouley, Associated Consultant, Institut Tunisien de la Compétitivité et des Etudes Quantitatives (ITCEQ, Tunisie), Université of Tunis Al Manar (Tunisia)

Although the monetary and exchange rate policies are relatively homogenous in the Southern Mediterranean countries, the degrees of progress are different in practice. Price stability is the final objective of monetary policies; however, recourse to alternative approaches based on the targeting of the monetary basis and credit aggregates is cited as an intermediary objective in some cases. The transition to a formal inflation-targeting regime is rendered slower in some cases by subsidies and price administration mechanisms (i.e. in Algeria, Egypt, and Libya). Oil-producers have particularly restrictive monetary policies to absorb excess liquidity as it arises. These characteristics often result in inflation remaining dependent on energy and food prices, as well as on tensions arising from internal demand. The operational independence of central banks is limited, except in Israel, Morocco, and Turkey. On public debt management, most countries lack a coherent stock market for publicly-issued debt. Energy subsidies make the government budgets of oil-importers particularly sensitive to international price fluctuations. Raising interest rates as counter-cyclical budgetary policies and the pro-active management of public debt is present in countries such as Morocco and Tunisia. Our evidence for the Maghreb countries shows that partial convergence of monetary policies in particular in terms of the stabilisation of inflation rates remains an open option for a transitional phase where financial integration is low.

What prerequisite for financial development in the Southern Mediterranean countries?

Dr. Rym Ayadi, Senior Research Fellow, CEPS, WP6 leader and Overall MEDPRO Coordinator

With the exception of one or two countries (i.e. Israel and Turkey) current measures show that the financial systems of the South Mediterranean countries are unable to provide adequate funding opportunities to private enterprises. Empirical analysis of the determinants of financial development shows that a concurrent availability of strong legal institutions, good democratic governance and financial reforms could have a substantial positive impact. Beyond this simple common point, the determinants of well-developed financial systems are divergent across different measures. For loans to the private sector, an expansive public debt tends to lower credit growth significantly and persistently, implying a clear confirmation of the "crowding-out" hypothesis. For deposits, inflation has a negative impact on deposits; however, having an open capital account could offset these effects. An open capital account may induce a freer flow of external funding and the improved allocation of financial resources. However, as the global financial crisis of 2007-09 has amply demonstrated, at least from the perspective of developing countries, an open capital account can also invite macroeconomic instabilities through sudden stops or reversals in funding and the ensuing currency and financial crises. It is thus appropriate to ask whether the liberalisation policies that have been implemented in the region have given rise to beneficial economic outcomes, or whether they have caused even more instability.

The EU-Turkey customs union: What lessons for the South Mediterranean countries?

Prof. Subidey Togan, CASE, Université de Bilkent (Turkey)

The EU-Turkey Customs Union (CU) of 1995 has been a major instrument for integration into the EU and global markets, offering powerful tools to reform the Turkish economy. It has credibly locked Turkey into a liberal foreign trade regime for industrial goods and holds a promise of Turkey's participation in the EU internal market for industrial products. As a result, Turkish producers of industrial goods have become exposed to competition from imports and they operate in one of the largest free trade areas, if not the largest, for industrial products in the world. They are now protected by tariffs from external competition to exactly the same extent as EU producers are and as such face competition from duty-free imports of industrial goods from world-class pan-European firms. In return, Turkish industrial producers have duty-free market access to the European Economic Area (EU-27 and EFTA).

Fifteen years have passed since the formation of the EU-Turkey CU. Fulfilling the requirements of the CU has been quite challenging, however. Turkey has introduced major reforms. But it has faced difficulties in fulfilling the requirements of the CU, in particular when trying to eliminate the technical barriers to trade (TBTs) in trade with the EU, adopting and implementing the EU's competition policy provisions on state aid and ensuring adequate and effective protection of intellectual property rights. In these cases, the process of fulfilling the requirements of the CU, even after 15 years, is not complete.

One lesson that can be taken from the Turkish experience is that trade liberalisation achieved through a preferential trade agreement such as the EU-Turkey CU can successfully move the economy from a government-controlled regime to a market-based one. Another issue is related to the existence of political will to reform the economy. In Turkey there was political will to achieve the goal of EU economic integration on the path to becoming a full member of the EU. As a result, Turkey – besides opening up its markets to industrial goods imports from the EU, accepting the common customs tariff (CCT) and adopting all of the preferential agreements the EU has concluded with third countries – has also accepted the EU's custom provisions, the EU's harmonisation approach for the elimination of TBTs, the EU's competition policy, the EU's intellectual property rights acquis and the EU's commercial policy regulations. Although the administrative costs of implementing the requirements of the CU have been quite substantial, it has incurred these costs with the hope of becoming a full member of the EU. Moreover, there was almost no resistance to the integration process on the part of the Turkish public. Other countries may not have the prospect of EU membership, but those countries may still be interested in integrating with the EU in order to achieve relatively high but sustainable economic growth, measured by growth in real per capita income. In such a case, the country could try to sign an FTA with the EU, but adopt only those policies of the EU that may be termed pro-growth.

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MEDITERRANEAN PROSPECTS

Past events

Brussels Scientific Meeting: On 22nd and 23rd September 2011, MEDPRO researchers discussed their work progress and in particular the reference and alternative scenarios in view of the recent upheavals in the South Mediterranean.

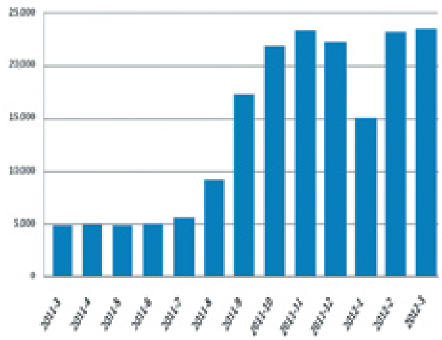
Stakeholders Engagement Group meeting: On 30th November 2011, MEDPRO Work Package leaders and external experts gathered in IEMed's headquarters in Barcelona to discuss interim research results and fine-tuning the draft scenarios based on external experts' views.

Forthcoming events

MEDPRO Athens Scientific Meeting: on 31 May–01 June 2012, researchers will discuss the final versions of the MEDPRO reference and alternative scenarios.

MEDPRO website: Visits in 2011

The MEDPRO website has seen a large number of visits since September 2011; reaching almost 25,000 in November 2011 and February 2012.



MEDPRO dissemination

MEDPRO Coordinator speaks at conferences. MEDPRO Coordinator Dr. Rym Ayadi gave a number of speeches in recent months at high-level meetings as part of the dissemination of MEDPRO research. Most recently, she spoke at University Paris Dauphine on the 02 February 2012 on the socio-economic challenges facing the region post-Arab Spring and at the German Marshall Fund of the United States High Level Mediterranean Strategy Group in Naples, on 29 February–02 March 2012 on the future of the financial sector in the Mediterranean post-Arab Spring.

MEDPRO links to external networks. The MEDPRO coordinator established new collaborations in terms of exchange of research and dissemination with euro-Mediterranean research institutes, such as Euromesco, CIHAM and Plan Bleu; Euro-Mediterranean Foundations, namely the Anna Lindh Foundation and other related FP7 research projects e.g. AUGUR and EU-BORDERREGION.

MEDPRO publications

Free download at www.medpro-foresight.eu

Challenges Arising from Capital Account Liberalisation in the Countries of the South Mediterranean Region; Sami Mouley; Technical report

Shallow vs. Deep Integration in the Southern Mediterranean: Scenarios for the Region up to 2030; Ahmed Farouk Ghoneim, Nicolas Péridy, Javier Lopez Gonzalez and Maximiliano Mendez Parra; Technical report

The Role of Monetary Policies and Macroeconomic Convergence in the Development of Financial Systems in South Mediterranean Countries; Sami Mouley; Technical Report

Determinants of Growth and Inflation in Southern Mediterranean Countries; Leonor Coutinho; Technical report

The EU-Turkey Customs Union: A Model for Future Euro-Med Integration; Sübidey Togan; Technical report

Algeria's Failed Transitions to a Sustainable Polity: Coming to Yet Another Crossroads; Hakim Darbouche; Technical report

What Scenarios for the Euro-Mediterranean in 2030 in the Wake of the Post-Arab Spring?; Rym Ayadi and Carlo Sessa; Policy brief

MEDPRO in a nutshell

Title	MEDPRO – Prospective analysis for the Mediterranean Region
Funding Scheme	Collaborative Project (CP): small or medium-scale focused research project
Coordinator	Dr. Rym Ayadi Centre for European Policy Studies (CEPS)
Duration	1 April 2010 – 31March 2013 (36 months)
Contact e-mail	medpro@ceps.eu
Short Description	MEDPRO explores the challenges the countries in the South Mediterranean region, from Morocco to Turkey, will have to cope with in the coming decades. The project will undertake a foresight analysis to consider the interactions between development and Euro-Mediterranean cooperation in the fields of geopolitics; demography; education; social protection; energy; climate change; trade and finance. The outcome of this exercise will be to provide the best scientific underpinning for future policy decisions to be taken at both domestic and EU level within the European Neighbourhood Policy (ENP) and Union for the Mediterranean frameworks (UfM)
Partners	16 (13 countries)
Consortium	Centre for European Policy Studies, **CEPS**, Belgium; Center for Social and Economic Research, **CASE**, Poland; Cyprus Center for European and International Affairs, **CCEIA**, Cyprus; Fondazione Eni Enrico Mattei, **FEEM**, Italy ; Forum Euro-Méditerranéen des Instituts de Sciences Economiques, **FEMISE**, France ; Faculty of Economics and Political Sciences, **FEPS**, Egypt; Istituto Affari Internazionali, **IAI**, Italy; Institute of Communication and Computer Systems, **ICCS/NTUA**, Greece; Institut Europeu de la Mediterrania, **IEMed**, Spain; Institut Marocain des Relations Internationales, **IMRI**, Morocco; Istituto di Studi per l'Integrazione dei Sistemi, **ISIS**, Italy; Institut Tunisien de la Compétitivité et des Etudes Quantitatives, **ITCEQ**, Tunisia; Mediterranean Agronomic Institute of Bari, **MAIB**, Italy; Palestine Economic Policy Research Institute, **MAS**, Palestine; Netherlands Interdisciplinary Demographic Institute, **NIDI**, Netherlands; Universidad Politecnica de Madrid, **UPM**, Spain; Centre for European Economic Research, **ZEW**, Germany
Website	www.medpro-foresight.eu
EC Funding	2,647,330€
EC Scientific Officer	Dr. Domenico Rossetti Di Valdalbero (Project Officer)