The Economic Basket of the Barcelona Process: Outcomes and Perspectives

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Assessing the effectiveness of economic policies and international agreements is always made difficult by the fact that outcomes are the product of a wide array of circumstances and it is normally not possible to ascribe the end result to a single cause. Economists have tried to create statistical experiments based on counterfactuals, in the attempt to isolate specific cause-effect links, but this does not appear to be a very promising approach in the Mediterranean context, except if our interest is strictly academic.

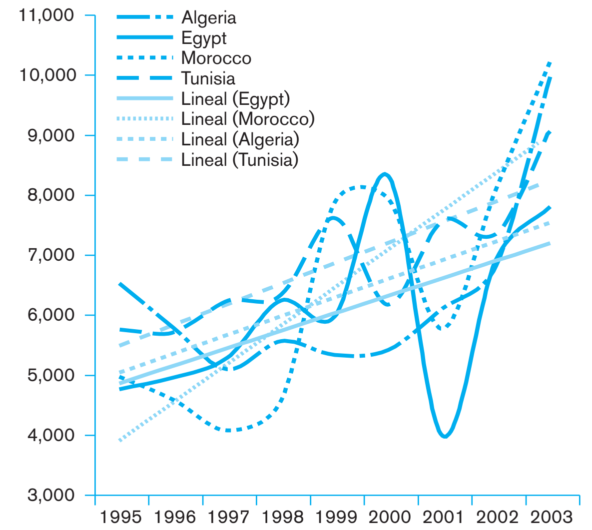
The outcome of the progressive implementation of the economic basket of the Barcelona Process, which is centred on the creation of a Mediterranean Free Trade Area, has been disappointing; indeed we should say extraordinarily disappointing. But then this is likely to be the case in spite of the Barcelona Process and because of persisting negative circumstances in the region. How can we hope for a substantial increase in regional trade and investment – especially in the 'horizontal' trade between Mediterranean partners – that would manifest the success of the Euro-Mediterranean Partnership, when conflicts continue to fragment the region, and illiberal regimes adopt the spirit of Barcelona only reluctantly and to the least extent possible? I will in this article present the disappointing outcomes for trade and investment, but first let us just recall that during this period the Middle East Peace Process was shattered and the second *intifada* broke out – which destroyed the Palestinian economy and seriously damaged Israel's; that economic relations between Egypt and Israel remained in deep freeze; Lebanon has continued under the political control of Syria, which discouraged entrepreneurs from locating there, and Syria only reluctantly and belatedly signed her Barcelona association agreement with the EU, while maintaining a substantially closed economy; that Jordan lived under the menace of war in Iraq; while, at the opposite extreme, Algeria slowly recovered from civil war but remained entangled in a conflict with its immediate neighbour Morocco over the Western Sahara; finally Turkey, which alone accounts for a third of the population and GDP of the entire Mediterranean Partner Countries group (MPC), successfully passed through a very difficult combination of economic and political crisis. The scars, so to speak, of these multiple conflicts are well visible in the trade and investment data and demonstrate, in case it was necessary to do so, that trade and investment cannot be isolated from the political environment.

Furthermore, competitiveness is a relative concept. In order to achieve a successful outcome in the competition for markets and capital it is necessary to offer a competitive environment, i.e. not just a good or improving environment, but one that, for one reason or another, is better than elsewhere in the world. Now, during the first ten years of the Barcelona Process, while progress in the Mediterranean was contrasted and painfully slow, the integration of the ten Central and Eastern European Countries was successfully completed and they became full members of the European Union in 2004; and the Asian economies successfully weathered the crisis of the late 1990's, with China becoming a major global exporter of a wide and growing array of manufactured products, including increasingly of higher technological content.

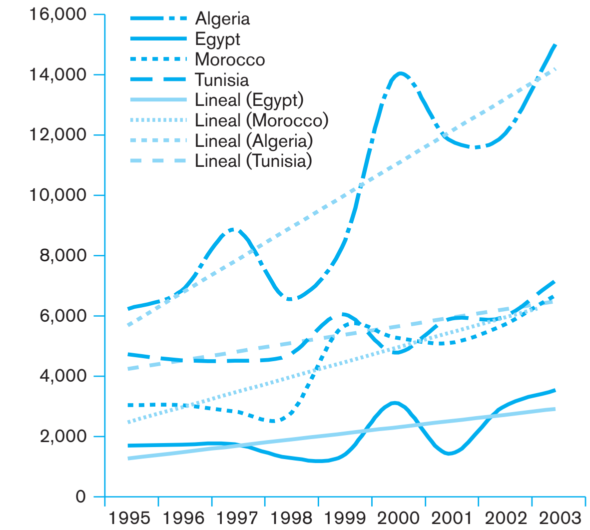
Shall we add that during this decade the European economy has turned in on average rather modest results, and the Lisbon objectives have been missed by a wide mark – meaning that the European market – although certainly very large and capable of accommodating potentially much larger exports from the MPC– has not been very dynamic. To the extent that growing trade is the result of the delocalisation of existing European companies, the lack of dynamism in the market simply means that the process will be slower, and competition from other regions implies that European companies may delocalise outside the Mediterranean.

In short, the Barcelona Process has been confronted with such a broad array of negative circumstances that we have no difficulty at all in explaining the disappointing outcome. The Barcelona framework remains a necessary, if not sufficient, condition for establishing a Mediterranean area of peace and prosperity; the execution of it may be improved, and the scope of the liberalisation should be further extended. But unless other circumstances improve, first and foremost with respect to domestic governance and the peaceful and pragmatic solution of regional conflicts, it is unlikely that economic activity will truly flourish.

GRAPHIC 1 North African Partners Imports from the EU 25



GRAPHIC 2 North African Partners Exports to the EU 25

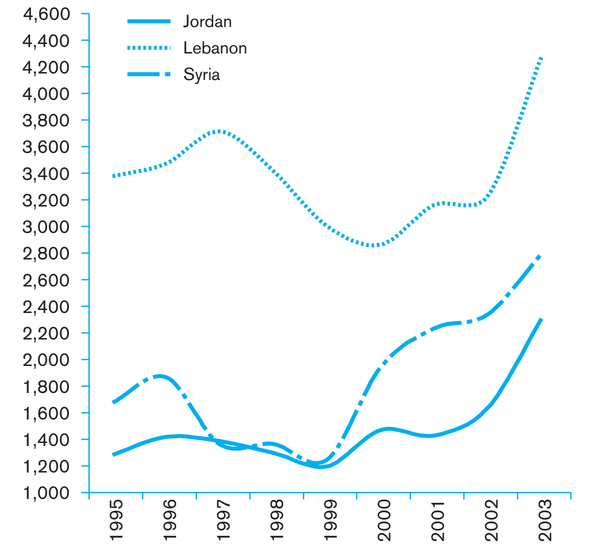


The Outcomes

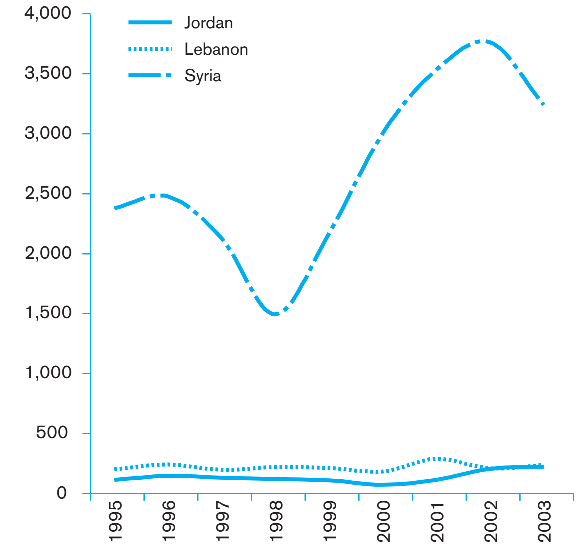
We first present the record with respect to trade, distinguishing between subgroups of countries for purposes of clarity. Graphics 1* and 2 represent the imports and exports from and to the EU25 for the North African Partner countries, i.e. Morocco, Algeria, Tunisia and Egypt.
The level of imports of these four countries is similar, notwithstanding the very different size of the respective economies. The variability in imports is striking and undermines our confidence in the trend lines, which nevertheless indicate an overall tendency towards increased imports from the EU, notably for Morocco.
Exports are also variable, although less so. Here, Algeria clearly outweighs the other partners and shows a much steeper rising trend, due primarily to increasing exports of oil and natural gas and improving terms of trade (increasing prices). The increase in Moroccan exports is also quite impressive (please note that the scale of grahphic 1 is different from the grahphic 2: Moroccan exports have grown much more than imports) while the record of Tunisia and Egypt is not so satisfactory.
Graphics 3 and 4 show results for the Eastern Mediterranean Arab partners, i.e. Jordan, Lebanon and Syria. No separate results are available for the Palestinian Territories.
We note that imports of these three partners from the EU25 appear to have declined until 1999 or 2000: they have remarkably recovered since, but it is too early to detect a trend. As for exports, the oscillations of Syrian exports are directly related to oil prices: Syria is in any case bound to become a net importer of oil very soon, so that physical exports are likely to decline. Exports from Jordan and Lebanon are flat and close to non-existent.
Finally, with respect to Turkey and Israel, the two most advanced and diversified economies in the Mediterranean, we observe two strikingly divergent results. For Turkey, notwithstanding the crisis well reflected in the dip in exports in 2001, the outcome is clearly one of rising imports and spectacularly rising exports. For Israel, in contrast, both flows appear to be essentially stagnating.
The evidence we have presented so far demonstrates that the Barcelona Process, in combination with multiple other factors, has led to divergent outcomes for individual countries. While Turkey, at one extreme of the basin, and to a lesser extent Morocco, at the opposite extreme, clearly have benefited of the process of trade liberalisation, the evidence for the remaining countries is mixed. Consequently, trade convergence with Europe has also been diversified. Over the 1995-2003 period, five countries increased their imports from the EU25 as a share of their total imports; these are primarily Algeria and Morocco and to a much lesser extent also Lebanon Tunisia and Turkey. The rest of the Mediterranean countries have increased their imports from other parts of the world more rapidly than from the EU25.
With respect to exports, countries for which exports to the EU25 have grown as a share of total exports are only three: that is Cyprus – by a very large margin – Morocco and Turkey. All other Mediterranean Partner Countries have increased their export diversification away from the EU25 – to an extent that is sometimes puzzling, such as in the case of Malta.
It should be noted that this outcome is not necessarily negative. In some cases, it may be said that reliance on exports to Europe is excessive and some greater diversification is warranted. Tunisia, for example, is very closely integrated with the EU from both imports and exports. However, at the opposite extreme we find that the EU simply is not a relevant

*Source of the graphics: UNCTAD, Handbook of Statistics on line, http://www.unctad.org. Data in millions of dollars.

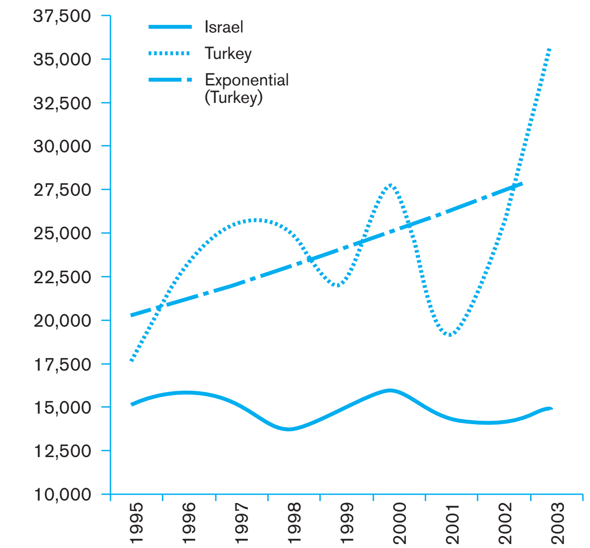
GRAPHIC 3 **Eastern Mediterranean Arab Partners Imports from the EU 25**



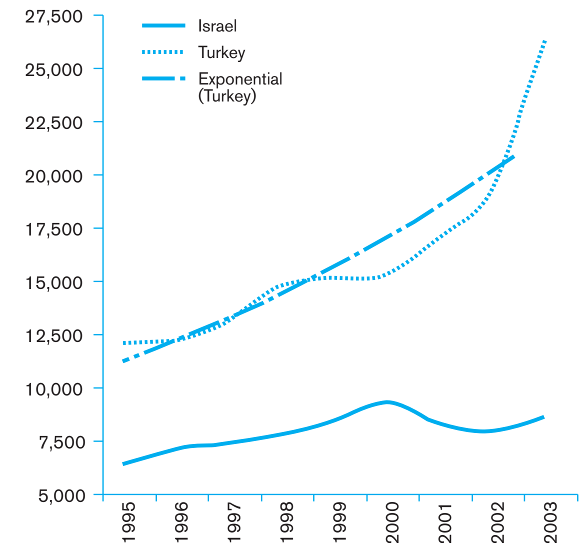
GRAPHIC 4 **Eastern Mediterranean Arab Partners Exports to the EU 25**



GRAPHIC 5 **Israel and Turkey Imports from the EU 25**



GRAPHIC 6 **Israel and Turkey Exports to the EU 25**

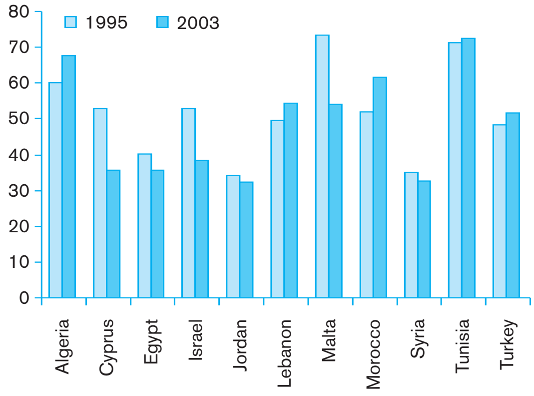


market for Jordan, and not very important for either Israel or Lebanon.

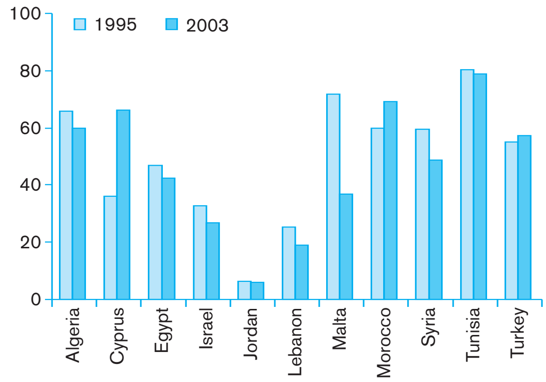
These outcomes appear to strongly support the shift from a primarily regional approach, characteristic of the Barcelona Process, to a primarily bilateral approach, such as is envisaged by the new European Neighbourhood Policy. The latter is a rationalisation of existing outcomes: some countries are, for a variety of reasons, capable of successfully interacting with Europe in a context of regional and global liberalisations, others lag behind. We should therefore concentrate on those countries that can benefit from proximity and integration with the Union, while searching for a more effective approach towards the others.

With respect to foreign direct investment (FDI), the record of the Barcelona Process is also quite mixed. The graphic below plots incoming investment from the rest of the world, not just for the European Union. But this is not so much important, as the aim of the Barcelona Process was to encourage investment from anywhere, not just from the Union. We observe very wide oscillations – which is more normal for investment flows than for trade – whose immediate political causes are possibly quite evident, but leave us nevertheless with a very uncertain picture. Thus, it is clear that investment in Israel may have collapsed in 2000 because of the second *intifada* – but it had been rising for barely two years beforehand. Similarly, investment in Turkey and Morocco col-

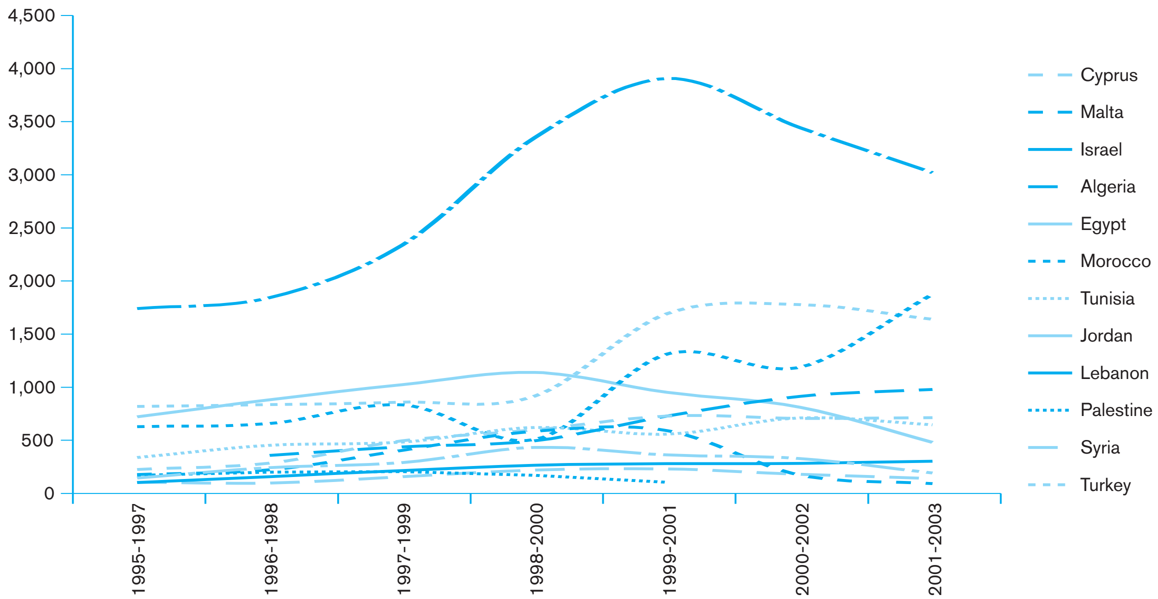
GRAPHIC 7 **Share of EU 25 in total imports of Mediterranean Partners**



GRAPHIC 8 **Share of EU 25 in total exports of Mediterranean Partners**



GRAPHIC 9 **FDI (inward) in millions of dollars (3-year moving averages)**



lapsed after September 11, but it had been significantly higher for just one year before. We are hard put at discerning any clear rising trend from the above data.

To facilitate the search for an underlining trend, we can dampen short-term oscillations through the use of a three-year moving average. The results are plotted in graphic 9.

Here a rising trend is clear at least for Morocco, to a lesser extent Algeria (primarily attributable to investment in oil and gas) and Tunisia. For Israel and Turkey we may say that a potential clearly exists but in both cases negative factors are also at work. For the rest of the countries, the picture is bleak.

Perspectives

As we look into the future, Europe is faced with some difficult dilemmas.

- Oil and gas prices have been rising rapidly since 2003. This will have a strong impact on trade and investment figures in coming years. The value of exports from Algeria and Libya will increase rapidly, giving the impression that they are benefiting from the process – while in fact this will be merely an appearance. Egypt and Syria will also see their terms of trade improve. However, Algerian and Libyan oil and gas may also be attracted towards the US market – for reasons of their quality – leading to a decrease in the intensity of inter-Mediterranean exchanges. The concentration of exports of these countries on a limited spectrum of products will increase.
- Unless regional conflicts are solved – not just the Middle East conflict but all regional conflicts – there is little hope of establishing an area of peace and prosperity. The region will remain

fragmented and trade and investment will suffer. A functionalist approach is not to be discarded, but to expect that increased trade will facilitate conflict resolution is entirely illusory. The resolution of conflicts must precede the expansion of trade which in turn may consolidate peace.

- The Barcelona "offer" must be improved, most notably through the inclusion of agricultural products. The progressive, yet decisive, liberalisation of agricultural imports into the EU is an essential condition to improve Mediterranean Partner Countries' exports, widen their domestic market and create conditions for faster industrial growth and competitiveness. This can be of special importance for Morocco, Tunisia, Egypt, and of course Turkey – less so for the remaining countries.
- The European Neighbourhood Policy (ENP) approach based on bilateral action programmes and positive conditionality is a rationalisation of existing outcomes. It is, in this respect, realistic and pragmatic, but it may lose sight of the benefits of regional integration. The Barcelona Process has always been accused of fostering a "hub and spokes" model, integrating ever more closely the Mediterranean partner countries with the Union, while discouraging "horizontal" integration. Europe has frequently and consistently rejected this view in words and intentions, but the outcome is exactly what was feared. We can aim at further increasing trade with Tunisia, which already sends to the Union 80% of her exports; Morocco, for whom the figure is 70%; or Turkey that depends on the Union for 60% of her exports. Yet clearly the potential is limited, especially if the Union will remain a slow growth area. The alternative of stimulating higher growth and mutual exchanges between the Mediterranean Partner Countries is clearly much more attractive, but appears to be extraordinarily elusive.

What is in store for the coming decade is, in a sense, quite clear:

- Turkey will be engaged in the process of becoming a member of the EU, which may be concluded in 2015. In this case, we may say that one third of the problem will be solved: this is, in fact, the 'weight' of Turkey by GDP or population over the total of the Mediterranean Partner Countries.
- Israel will be able to take advantage of the ENP, and pursue its ambition of developing with the Union a relationship similar to that of Switzerland or Norway, although relations may remain difficult at times in the absence of a resolution of the conflict with the Palestinians.
- Morocco will continue emphasising bilateral relations with the Union in the context of the ENP and might reap some acceptable results, especially if agricultural imports are liberalised.

For the remaining countries, a clear strategy is difficult to detect. Emphasis on political and governance conditions is likely to increase, and is indeed necessary. With reference specifically to the tools that may be included in the economic basket, priority should be given to policies that support the birth and consolidation of a new entrepreneurial class, capable of challenging the crony capitalists that are in symbiosis with the incumbent regimes.

In this respect, a first fundamentally important line of attack would envisage the targeting of credit facilities to small and medium enterprises. In most Arab Mediterranean Partner Countries access to credit remains in the hands of government-owned and politically controlled banking institutions, which are an essential tool for power holders to select winners in the private sector on the basis of political allegiance. Establishing transparent credit institutions, which will offer credit to smaller entrepreneurs, is a priority.

A special effort should be made to work with migrant entrepreneurs in Europe, encouraging them to start new business ventures in their home countries. The EU should mobilise this social group by facilitating their access to credit and capital, their organization in formal associations capable of formulating and promoting policy agendas relevant to their countries of origin and providing assistance for establishing business ventures there.

With respect to foreign direct investment, it may be time to revisit an article that Albert Hirschman wrote in 1969 (Princeton Essays in International Finance no. 76, November 1969; reprinted in Hirschman, "A Bias for Hope" Yale University Press, 1971), provocatively entitled "How to divest in Latin America, and why." In that classic piece, Hirschman argued that American multinational corporations should be wise enough to divest some of their investment in Latin America, in particular in infrastructure, to satisfy the nationalist feelings of the host countries – at the time nationalisation was very much a frequently heard word.

The point is especially relevant with respect to investment in utilities and infrastructure, as well as to facilitate privatisations. These are areas in which there are huge unsatisfied investment requirements.

The Union should create a policy to encourage more significant inflow of direct investment from European enterprises, but also set the stage for the eventual reduction of their role to the benefit of national investors down the road. This is especially important in the context of privatisation of the main utilities, and of investment in infrastructure or large housing schemes, which are unlikely to take place unless a satisfactory solution is found. It is universally recognised that the investment requirements of the Arab Mediterranean Partner Countries in these three areas (utilities, infrastructure and housing) will be very large in the coming decades, and the failure of ensuring the required funds may constitute a substantial obstacle to growth. The Union is already engaged in this area through the European Investment Bank (EIB) and its FEMIP facility which, however, only provides credit and cannot provide equity.

National investors in the Mediterranean Partner Countries do not have the financial means and know-how that is required to successfully bid for privatisation of major enterprises, or engage in the realisation of large, discontinuous infrastructure projects. On the other hand, the potential foreign (or, as sometimes it is called, 'strategic') investor will resent obligations to surrender all or part of its ownership position if the project is successful.

Launched at the same time as the Oslo Agreements of 1993, which no doubt contributed to the general atmosphere of eagerness surrounding its creation, the Barcelona Process was at the outset welcomed with unprecedented enthusiasm. This undoubtedly also explains why it is now suffering from the extremely negative development of the situation in the Middle East and recent assessments of its role have been at best lukewarm. The political aspect is stagnating and there is no clear responsibility for this; the Mediterranean Countries (MC) cannot manage to overcome important regional disagreements (not to mention, of course, the Arab-Israeli conflict since 1995). In fact, and despite progress made at national levels, the Partnership in the regional sphere can today be summed up essentially by its economic aspect which, inevitably, has a certain effect on the overall assessment of its impact.

In the economic sphere, it has not produced the revolutionary changes which had been anticipated. If actions are judged only in terms of their results, it must be stated that economic convergence has not progressed, as is undeniably summed up by the increasing divergence of per capita income between the EU of the 15, the new member states and the MC: the gap is widening (cf. S. Radwan, JL Reiffers, "FEMISE report on the central issues and prospects for the Partnership." February 2005). It is not that the Partnership is responsible for this, but, once again, it has not been able to reverse the trend, even though this is exactly what the countries of the South had been hoping for. The initial idea was based on achieving and maintaining macroeconomic stability, as a first step towards structural modifications in the socio-economic sphere, which opening up national economies would supposedly bring in its wake. Stability and openness to trade were supposed to lead to various automatic consequences that would allow progress towards higher stages of convergence. The assessment of the reality has been lukewarm because, although the Partnership has undoubtedly reinforced stability and the MCs have made constant progress in macro-economic management, enabling them to avoid crises (unlike a certain number of other regions), it has not been possible to press ahead with the decisive stages that would have symbolised a change of economic rhythm in the eyes of outside observers or in the daily lives of the people.

Among the many reasons for this disappointing result, two appear essential, particularly from the perspective of seeking to break with this lack of economic dynamism.

Firstly, the Partnership has not been particularly binding or effective. The plan was that the process would ensure the external credibility of the MCs in the eyes of the international community, leading to flows of private finance, particularly in the form of FDI (Foreign Direct Investment), which would have completed the picture and set a virtuous circle in motion. However, during these ten years the establishment of a more binding admission process has operated in favour of the credibility of Eastern Europe, to the detriment of the MC, although the latter were in theory at a similar level of develpment and in the same area of interdependence. In fact, in 10 years, the landscape of Euromed relations has changed extraordinarily, moving from a 15+12 relationship to 25 EU + 3 candidates + 6 potential candidates + 16 neighbours (9 of which are Mediterranean).This change in the starting conditions has damaged one of the main cogs in the Partnership mechanism. The role of external anchorage itself is decisive for the psychology of those operating in the market. Although there has been considerably lower growth than in more dynamic regions, Europe has shown its extraordinary capacity to create convergence when it carries out "in-depth integration." Its political project has had economic consequences because the economy is now a matter of credibility and anticipation. The construction of the Union of 15 has shown this without fear of possible contradiction. In the same way, it is the credibility of the rapprochement with the Union that has led to a considerable degree of commitment by all the agents involved in the emergence of the Eastern European countries, a commitment which has allowed all reforms to be pursued continuously, despite a public opinion which had been reticent for some time. By contrast, the vagueness today surrounding the position of the Mediterranean Countries with regard to Europe is an important comparative handicap, having a negative effect on the economic dynamism of the region.

Secondly, the pivotal point of the Euro-Mediterranean economic partnership – the liberalisation of trade – has had a only limited effect: (i) because all regions in the world have also followed the movement towards dismantling tariffs, which has diluted the considerable effort by the MCs; (ii) because the effort has essentially affected North-South relations, while development has been less important among the MCs. Also in this area, the Partnership had relied on the appearance of an induction effect and this has not happened; (iii) because the effort has essentially been on tariffs in a period when trade policies are, above all, based on non-tariff elements like regulations; (iv) because liberalisation has been focused on industrial products, while agricultural products, where the MCs have a comparative advantage, have been left to one side. Simple trade liberalisation and policies focused exclusively on the supply side have therefore been incomplete instruments, while improvement in the supply side cannot derive only from openness. The considerable effort that has been made towards the solvency of macroeconomic management has probably played down other channels. Here, the areas of finance, infrastructures, industrial policies and the demand side would be the main aims or areas concerned with the regional dimension that would allow economies of scale to be achieved, transaction costs reduced and, in total, the capacity of the supply side to be improved, instead of taking into account more direct effects which would therefore be less likely to be undermined by unforeseen events.

In the economic sphere, the Partnership is not a failure. Overall, the main achievement is to have been able to revive the Mediterranean identity and to have made possible a general raising of awareness of the lost ground that needs to be recovered, and the development and reforms necessary to reach this. However, the balance achieved today in the region is obviously insufficient and, for this reason, the Partnership cannot claim to have been a success. To consider such a situation acceptable would leave the Euro-Mediterranean vulnerable to widespread attacks. For Femise, it is therefore clear that a change of momentum is essential for the Partnership, and that this must be based on the experience of these first ten years.

The concept of Neighbourhood Policy is an instrument that could have the positive effect of extending the perspective of the Barcelona Process, which was based above all on tariff removal. It could provide a chance to achieve "deeper integration" in the European economic space, an instrument which could provide just the right way of eliminating the vagueness in Euro-Mediterranean relationships, as long as care is taken not to dilute the spirit of the Partnership with too much variable geometry. But the European Neighbourhood Policy (ENP), a basically bilateral instrument, will only be able to play its role if, in the Mediterranean, it offers an overall multilateral range (in fact, a set of regulations allowing access to the single European space) and if it contributes to facilitating the achievement of all this through the transfer of structural funds. This is the price at which Barcelona-ENP coexistence will be possible, leading to a new momentum for the Partnership. An effective solution would be an institutional consolidation of the Partnership within the ENP, with assured resources. More specifically, it should make it possible to provide a better structure for economic dialogue between the Union and the MCs, in order to strengthen the regional and subregional dimension of the Partnership; to develop Mediterranean infrastructures and the interconnection of Euro-Mediterranean infrastructures; to put into practice the option of transforming the Euro-Mediterranean Investment and Partnership Facility (FEMIP) into a Mediterranean subsidiary of the European Investment Bank (EIB), and to increase the opening up of Community funds to Euro-Mediterranean projects.

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BOT schemes achieve the purpose of a "planned" phase-out of the foreign investor, but they are generally more expensive.

This leads to the importance of supplementing the FEMIP facility at the EIB with a solid investment banking function. The EIB should be placed in a position whereby it had the possibility of acquiring equity in new projects or privatisation of existing enterprises, in association with a European strategic investor, with the clear mandate of progressively disposing of these holdings in an orderly fashion on the local equity market.

This approach would serve several purposes at the same time: it would eliminate the argument for slowing down the privatisation process, based on the insufficient availability of national investment funds; it would stimulate transparency and good corporate governance; it would support the development of local capital markets; and finally it is likely to encourage the repatriation of migrants' savings and reduce the incentive for capital flight.

Last but not least, it would greatly facilitate the realisation of projects that are prerequisites for the envisaged free trade area to be real and effective.