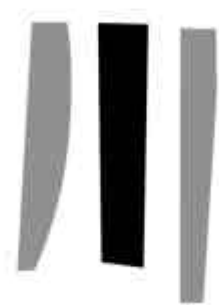


**MALTA, 11 December, 2005,  
XIX Information and Training Seminar for Euro-Med Diplomats**

**“FEMIP’s strengthened role in the Euro-Mediterranean  
partnership”**

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Ladies and gentlemen,

It is a great pleasure and honour for me to be with you today. I would like to thank warmly the Mediterranean Academy of Diplomatic Studies for inviting me here to talk about the strengthened role of the European Investment Bank (EIB), the European Union's long-term financing institution, in the Euro-Med Partnership.

The news and the future

The topic was chosen for this presentation for two reasons:

- It's actual and timely, just after the Barcelona 10 Summit, which recognised the EIB and FEMIP, as a key economic actor in support of the partnership.
- The topic has a dimension going well in the future, as the Union seeks now more than ever a closer cooperation with its Med Partners, after having completed the enlargement in 2004. This was not only the biggest so far, concerning 12 new Member Countries, but also the most complicated, as these countries are

culturally and linguistically very diverse, and furthermore, the majority of them having been adopting the free-economy model only since the early '90s.

**Before going in the topic, let me first present briefly the EIB to you.**

By definition, the EIB is a policy bank in charge of achieving common EU objectives, defined by the Member States; the same Member States that also shape the Barcelona process.

But the EIB is only one instrument to achieve these objectives, working along and together with its EU sister organization, the European Commission.

By definition, the EIB is also a bank – a bank, which follows a project driven approach: Projects stand at the heart of our activity and raison d'être (not economic support or reform programmes) and every single project the Bank decides to co-finance needs to be, on its own, technically, economically and environmentally sound and sustainable. And no exceptions or special treatments are made for "difficult" projects or those located in alleged "difficult regions", such as the Mediterranean.

Therefore, I will limit myself today to share with you some basic experiences, which the EIB has made over the last years throughout its project work in the Mediterranean region. And maybe this operational experience will provide you some insight on the role and place Europe as a whole has or should play in that region.

Private sector development is the single most important vector to promote sustainable economic growth in the Mediterranean region, in particular if focused on the promotion of economic activity of Small and Medium Sized Enterprises - the so-called SME Sector.

In that context, developing and fostering banking activities tailored to the needs of domestic communities or groups of people, which have usually no free access to bank credit, represents a prime concern of the European Union, and hence EIB activities in the Mediterranean region.

In some cases, it works to rely on the use of existing instruments, such as EIB global loans (lines of credit) - a practice, well-tested and refined by the EIB over the last 20 years in other developing regions (i.e. Eastern Europe) -, which benefits not only the private sector SME acting as final beneficiary of the EIB global loan, but can also have a positive "side-effect" to assist and support the overall reform of the banking sector.

But in other cases, existing banking instruments do not work – or not enough. And these cases often materialize (unfortunately) in those countries, where the development of private sector activity is most badly needed and crucial to absorb the rapidly growing young labor force. And in those countries drastic banking sector reforms, as witnessed in the 90's in Eastern Europe, do not appear "à l'ordre du jour" – reforms that would produce a new landscape of domestic and regional banks able to a develop broad based and sound SME lending.

There is no shortage of valid SME private sector projects today, but too few valid banking intermediaries. These bottlenecks must be overcome. And concerted action of all bilaterals and multilateral institutions active in the region must be improved and lead to tangible results.

On our side, the EIB has been mandated by the European Council to set up a dedicated facility that will foster new means to develop private sector lending in the Mediterranean region, it's called FEMIP, which stands for Facility for Euromediterranean Investment and Partnership. This mandate was given to us in 2002, and subsequently reinforced in 2003. Some days ago, the Euro-Mediterranean Summit to celebrate the 10<sup>th</sup> anniversary of the Barcelona Process on 27–28 November 2005 has reaffirmed the commitment of the Euro-Mediterranean partner countries to “achieve an area of shared economic development by: fulfilling the undertaking to achieve a Euro-Mediterranean free trade area by 2010; promoting broad-based equitable sustainable economic development and employment by inter alia pursuing economic reform, supporting efforts to promote domestic and attract foreign investment in the region, enhancing public financial management, strengthening the role of the private sector, improving legal systems, reinforcing industrial cooperation, enhancing equitable access to basic services; developing integrated transport, energy and telecommunications networks and encouraging the objective of establishment of a Euro- med Energy Market. To assess in December 2006 the possibility of the incorporation of an EIB majority owned subsidiary dedicated to the Mediterranean partner countries, on the basis of an evaluation of FEMIP's performance. In this context they welcome the EIB's intention to provide a further tranche of financial assistance to the region in 2006”.

This further tranche of financial assistance to the region in 2006, named The Barcelona Facility, foresees supplementary resources of EUR 1 500 million, which will enable FEMIP to fulfil its current remits up to mid-2007, earmarked for financing projects pending actual establishment of the new 2007-2013 mandate.

To stand in for the mandate as a transitional measure, the new facility must be made available on terms meeting market demand. In order to ensure that the mechanism is viable while remaining within the EIB's risk management rules, it is envisaged that the Barcelona Facility will be deployed primarily to finance projects presenting an adequate loan grading.

FEMIP has in a way been a victim of its own success, and the rapid depletion of its lending resources was threatening its initial dynamic. However, the new envelope allocated to the Mediterranean for the period 2007-2013 under EU policy will not be in place until the first half of 2007; furthermore, its amount remains contingent upon agreement on the Union's new financial perspectives.

To keep up FEMIP's momentum and allow it to maintain its activity at a level commensurate with both the EU Member States' undertakings and the partner countries' needs, it has therefore become necessary to establish a supplementary envelope as a transitional measure. At its meeting on 27 October 2005, the EIB's Board of Directors signalled its agreement in principle to such an envelope. The Heads of State or Government meeting at the Euromed 10<sup>th</sup> Anniversary Summit took stock of

what has been achieved, recognized the role of FEMIP and confirmed their wish for setting up this new "Barcelona Facility" be set up in order to prepare a new strategy for the many important challenges which lie ahead.

The creation of the "Barcelona Facility" will also raise the profile of the Euro-Mediterranean Partnership, in which FEMIP is the lead player in financing the investment necessary to achieve the priority economic objectives".

Once the Heads of State or Government's invitation to set up a new financing facility has been confirmed, FEMIP will submit to the EIB's Board of Directors a detailed proposal including in particular the corresponding operational procedures. Following endorsement of the facility by the EIB's Governors (the EU Finance Ministers), the supplementary resources will be fully available to maintain the pace of activity in 2006.

FEMIP's activities have evolved considerably in the last two years, both quantitatively and qualitatively. It has lent a total of more than EUR 4.5 billion for investment, encouraging economic development in the region. Features include the introduction of new financing instruments and new forms of assistance, the opening of offices in the field and the formalisation of an active dialogue between European and Mediterranean partners on domestic policy reforms and FEMIP's lending.

In accordance with the decision of the Brussels European Council in December 2003, at the end of 2006 the Member States will, in consultation with the Mediterranean partner countries, evaluate the performance of the reinforced FEMIP and "assess the incorporation of an EIB majority-owned subsidiary dedicated to the Mediterranean partner countries". The meeting of the FEMIP Ministerial Committee (which will once again be paired with a Euro-Mediterranean ECOFIN Council) to be held on 25 and 26 June 2006 in Tunis will constitute the forum for carrying out an in-depth assessment of FEMIP's achievements so far and the prospects for its development.

This political mandate, which offers to the EIB a wide range of new financial instruments and financial means to realize its mission in the Mediterranean region, not only translates the political will of our shareholders – the European Union Member States – to do more in the region and maybe better, but, most importantly, it also indicates the focal point of action: to increase and broaden access to finance for private sector actors in the region. Developing private sector activity constitutes the safest and most efficient tool to achieve the badly needed growth of economic activity and prosperity in the region. This represents the single most important contribution Europe can provide in easing economic and social tensions in the region – an overall objective and policy priority we all have in mind.

But let me also comment on some of our experience with public sector projects, which still represent today the core of our activity in the region.

Most of you will be familiar with some examples of large-sized or regional infrastructure investments that failed in the region, incurred unjustified delays or suffered from mismanagement. After all, there is a widespread understanding that the business

confidence in the MENA region is lower than in other developing regions and that the so-called “absorption capacity” of public sector institutions is low. There appears to be – and this is what we observe as well – a number of elements that discourage private sector investors to participate in public sector infrastructure projects, in particular in times of regional instability. It is for that reason that private sector participation in public sector infrastructure financing has so far been (very) limited.

And therefore, European institutions, such as the EIB, are today mobilized to “bridge” the gap between the local investment needs and available funding. Precisely, because private sector investors tend to shy away from the region when it comes to PPPs in the road sector or IPPs (Independent Power Producers) in the electricity sector.

But the lack of available private financing is not the only obstacle we face today – and maybe we focus sometimes too much on how a project is financed at the risk of neglecting its substance and underlying *raison d'être*.

The long-term success of any infrastructure project rises and falls with the technical, economic and environmental value-added it delivers to its community of users, and the ability to maintain such services at reasonable cost over the project's lifetime.

To ensure that all projects supported by the Bank benefit from the “best value for money” is a key objective the Bank pursues on all its projects - creating the necessary conditions to achieve this goal forms an integral part of the Bank's mission as financing institution of the European Union.

To sum it up, attracting a critical mass of international companies to bid for strategic infrastructure projects that are able to propose innovative and sustainable business solutions to investment needs represents the single most important challenge for infrastructure projects in the MENA region today.

And we do notice progress - there are an increasing number of project promoters that are well aware of the importance and responsibility they have in securing a fair and transparent international bidding process, in the interest of the project.

I can therefore only invite all of you, in particular all corporates present here today, to consider more closely also project opportunities in the Mediterranean region, even if at first sight the project location or promoters do not appear on your strategic business plan map.

Successful project work in the Mediterranean region is an iterative and gradual process, which is built on mutual understanding and lot of practical experience. The learning process of “best industry practice” in the region will not come over night, and certainly not only through support programmes sponsored by the European Union, but through every single European industry and manufacturer, which decides to embark on a business relationship in the region.

It takes more than political road maps and EU institutions to promote economic development in the region. Corporates and investors across Europe must put the region

on their business maps too. For the MENA region, our region – Europe – represents already today the biggest trade partner. And it is in the common interest of all stakeholders that we, the Europeans, take a decisive and leading role in assisting Mediterranean Partner Countries in their economic development process.

### **Current trends and prospects in the Mediterranean region**

The outcome of the Euro-Mediterranean Partnership, ten years after the launching of the initiative through the Barcelona Process, is nuanced. Significant progress has been made along some of the Partnership's dimensions – as measured for instance by the increased financial cooperation, the conclusion of negotiations for association agreements with almost all Mediterranean Partner Countries (MPCs), progress in policy design and structural reforms, as well as a recent improvement in the investment climate. But much remains to be done to achieve the proposed creation of a zone of shared prosperity on the two sides of the Mediterranean.

As a matter of fact, over the last ten years the gap in living standards between the two sides of the Mediterranean has grown wider. This development is particularly unsettling as MPCs face the challenge of accommodating a rapidly growing young population, which faces limited job opportunities in an anemic economic environment. Currently, unemployment affects 15 percent of the labor force in the Mediterranean region, with a significantly higher incidence among the young and first job seekers. Existing projections suggest that by 2015 nearly 20 million people in the region might be unemployed. These figures not only show the urgency in improving economic conditions in the region, but also suggest that during the last ten years some opportunities have been missed by MPCs. This holds particularly true when the MPCs are compared with the Central and Eastern European countries acceding the European Union, which during the same period took advantage of their own form of association with the EU to record significant progress towards economic convergence with their Western neighbors.

The lack of economic dynamism that is prevalent across most of the region is due to a variety of structural bottlenecks, giving rise to poor investment climates. In international comparisons of economic competitiveness, MPCs rank typically at the bottom, with their economies exhibiting rather rigid labor markets, weak investor protection and poor access to credit, among other weaknesses. Furthermore, despite considerable progress towards greater involvement of the private sector in economic activity, most MPCs still show signs of the statism that dominated those economies in a not so distant past. Public sectors are typically large – and inefficient – and large expenditure levels coupled with difficulties in raising appropriate tax revenues have resulted in large public sector deficits and government debt. This development model resulted in limited economic diversification as well as in only partial and fragmented integration with the world economy. More broadly, that model also contributed for the still below par governance standards prevailing across the region, as highlighted for example by typically weak regulatory legislation and the lack of an independent judiciary.

Despite these impediments, however, recent developments are more encouraging and prospects for the region have improved. At the conjunctural level, the region has benefited from favorable global economic and financial conditions, lifting growth in the

region to 6.1 and 4.3 percent in 2004 and 2005, respectively, while a similar robust performance is projected for 2006. Furthermore, although oil prices are pushing up economic activity in the three MPC net oil exporters – Algeria, Egypt, and Syria – growth is evenly distributed across the region, with particular emphasis on the strong economic recovery taking place in Turkey. Most macroeconomic aggregates are reasonably well balanced. Despite a recent slight pickup in inflation in a couple of countries, 2005 consumer price increases appear to be in single-digits for all MPCs, with the possible exception of Syria. In addition, there has been no significant deterioration in fiscal deficits across the region, even if Algeria's generous oil-related tax revenues and the stabilization program currently taking place in Turkey mostly drive the improved regional average. These factors, combined with stronger workers' remittances, politically-induced grant flows in some countries, and a recent pickup in tourism, have contributed to an improvement in the external current account position of the region, which has shifted into a surplus over the past four years, though some countries still display sizeable deficits.

In addition to favorable short-term developments, there has also been progress in the areas of policy design and structural reforms. With a series of aggressive measures in the areas of trade, taxes, and subsidies, and launched plans to restructure the financial system, privatize most state companies, modernize the fiscal accounts, and strengthen monetary policy, Egypt is the latest arrival to the group of reform-minded countries in the region. The decisive expansion of such a group appears to have helped strengthen the regional investment climate and have contributed to a progressive increase in private capital flows to the region since 2001. This, in conjunction with the stronger external current account positions has led to a substantial rise in foreign exchange reserves, which have increased by over 70 percent since 2001, albeit, in some cases, from very low levels. While this robust overall external position provides some breathing space and could therefore work as a negative incentive for the reforming impetus, it is probably more than offset by the scale and depth of the economic problems in the region.

Against this background, it is imperative that MPCs take the opportunity afforded by a stable macroeconomic environment and strong external positions to advance reform efforts and further strengthen the investment climate. This becomes all the more urgent due to the emergence of powerful new Asian competitors in the main export markets of MPCs – the EU. While requirements differ from country to country, the region taken as a whole would benefit from reforms aimed at strengthening private sector activity, further integrating the region into the world economy, strengthening fiscal positions, deepening financial markets, improving governance, and adjusting the role of the state in the economy. Reform efforts will need to be accompanied by strong social support mechanisms as well as a strengthened Euro Mediterranean partnership.

**However, favorable cyclical conditions have strengthened MPCs more recently**

Despite some of these inherent weaknesses, there has been an improvement in economic conditions in MPCs over the past few years, reflecting primarily cyclical conditions. In particular, improved global conditions since 2002 have helped strengthen

regional growth. After a disastrous 2001, where the MPC economies shrank by 0.9 percent overall, growth has been consistently above the 4 percent mark, recording a sizeable 6.1 percent in 2004. While this performance will not be repeated in 2005 – current projections indicate a growth rate of about 4.3 – prospects for 2006 suggest a small acceleration in activity. Growth has been particularly robust in Algeria, Jordan, Tunisia, and Turkey – due to a surge in private investment and consumption – but activity levels are robust throughout the region. This holds true even for non-oil exporting countries – a breakdown of the aggregate growth rate between oil and non-oil exporting countries shows that differences between the two groups are relatively small.

Stronger workers' remittances, politically-induced grant flows, and a recent pick up in tourism have also led to an improvement in the overall external current account position for the region, which shifted into a small surplus (0.6 percent of GDP) for the 2001-05 period. This is in contrast to the 1995-2000 period, when the annual current account to GDP ratio registered a deficit of over 2 percent of GDP on average. While this performance is mostly driven by Algeria's large surpluses (it should exceed 20 percent of GDP in 2006), it should be recognized that Turkey's large deficits pull the average in the opposite direction. Strong economic recovery in Turkey over the past few years has been supported by a surge in domestic spending, which has swelled imports and widened the current account deficit to 5.1 percent of GDP in 2004 and 5.8 percent in 2005, despite a small growth slowdown during the current year.

### **And some progress on policies and reforms have been made**

At the same time, a number of countries in the region have improved macroeconomic policies and have engaged in more serious structural reforms, resulting in a more favorable investment climate. Thus, while each country in the region is setting its own agenda, MPCs are generally moving towards improved macroeconomic policies, focusing on fiscal reforms, enhancing monetary and external policies, and advancing structural reforms. As a result, the macroeconomic environment has become more stable, with noticeable declines in inflation throughout the region. Only Egypt has seen somewhat of a pickup in inflation over the past couple of years, reflecting the feed trough effect of the recent devaluation of the Egyptian pound.

### **The EU's Euro-Mediterranean Partnership as an opportunity for growth**

The Partnership calls for an establishment of a Euro-Mediterranean Free Trade Zone by 2010, within the framework of free trade agreements (FTA) and other trade arrangements, in order to offer opportunities for trade and growth to Mediterranean countries. Trade liberalisation with the large and geographically close EU market is a natural and logic option for such a group of small economies – the GDP of the largest one, Turkey, is equal to that of Denmark.

Achieving the expected gains from trade, however, will require a wide range of accompanying domestic economic reforms aimed at preparing for increased competition, to which Mediterranean countries are committing themselves under the

Partnership. A crucial component will be making room for development of the private sector in economies that have so far been dominated by the public sector by means of privatisation, reducing red tape, modernising the legal system, etc. But equally important will be the harmonisation of standards, which are an integral part of the trade agreements, policies aimed at obtaining sustainable macroeconomic stability, redressing deficiencies in infrastructure, improving human capital and increasing the efficiency of financial markets.

Such structural reforms appear to be a prerequisite in order to both raise domestic savings and attract the foreign direct investment (FDI) so as to finance the substantial investment requirements involved in the transition to freer trade. To this end, the EU is offering considerable financial assistance (grants from the Commission and loans from the EIB).