

Macroeconomic aspects of the Euro-Med Partnership

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1-Introduction (1/2)

- All the seduction of the Barcelona process and now the European Neighborhood Policy (ENP) results from its ambition to establish a large Euro-Med region based on elements that go beyond free trade, the so-called “**stake in the Internal Market**”

- This offer includes specific elements of the European legal frameworks, and case by case and partner by partner negotiations
 - ⇒ This is where we depart far from the notion of deep integration
 - The *modus operandi* of the ENP is fundamentally bilateral ⇒ the regional logic seems to be replaced by a logic of partner by partner negotiation
 - This allows deeper integration with some partners, while only providing simple technical assistance to others



1-Introduction (2/2)

- The merit of the European offer is to depend on a precise group of 2000 Directives which constitute an explicit normative device with the double advantage :
 - to allow an increased access to the European market
 - and a rise in the quality of the implemented techniques of production and institutions

- The drawback is that economic and social incidences for the Mediterranean Partnership Countries (MPCs) will largely decide the feasibility of the transposition
 - Indeed, it is necessary to keep in mind that the transposition of a consequent number of Directives, which means the diffusion of part of “Community acquis”, is not neutral and without consequences on their economies
 - ⇒ In these conditions, it may be useful to have a look at the macro-economic situation of Med countries to determine the concrete conditions of a better insertion of these countries in the Internal market

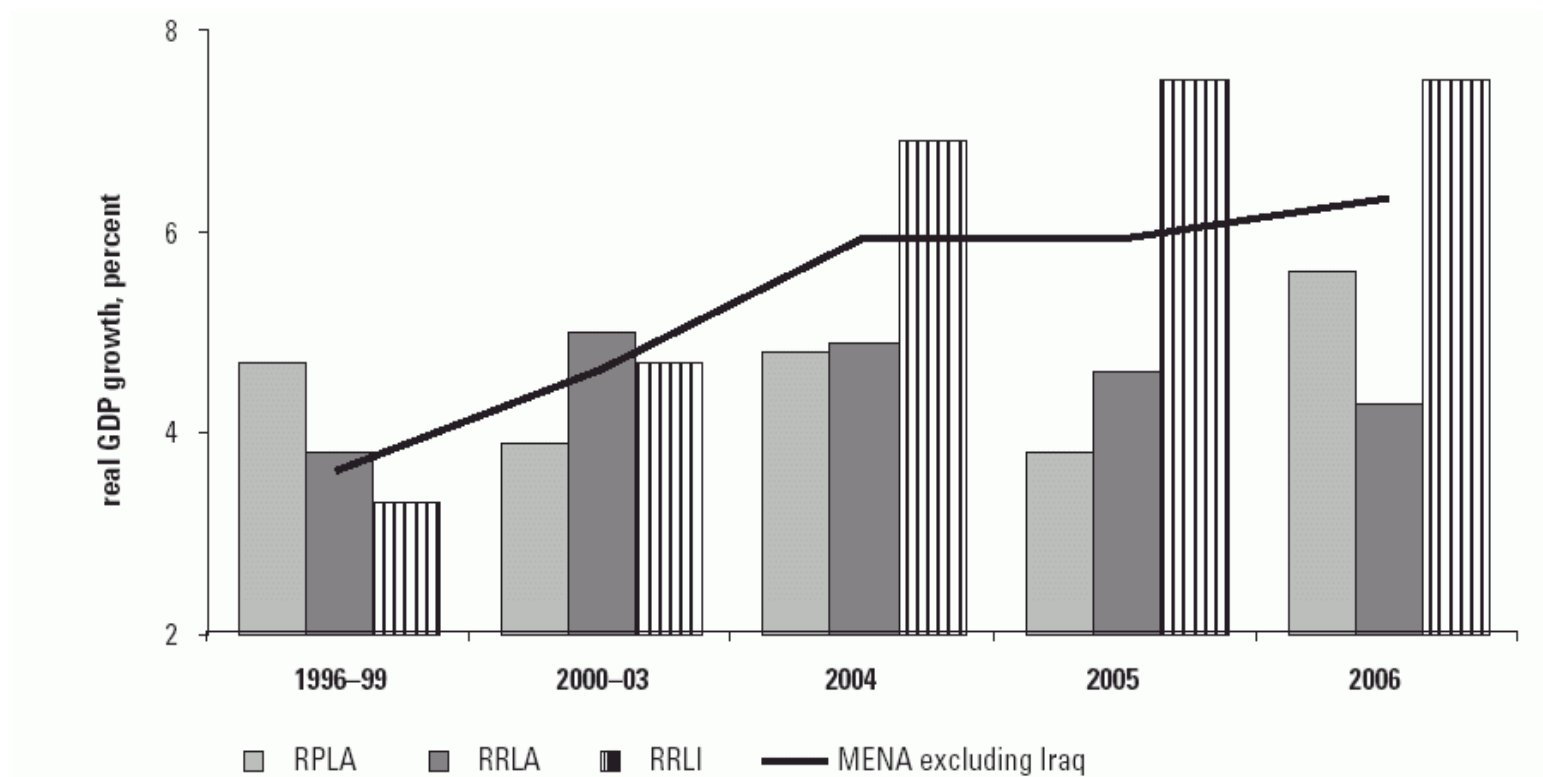


2-Overview of recent economic outcomes (1/4)

- During the last few years, the Middle East and North Africa (MENA) region has turned in strong economic performances, driven, to a large degree
 - by high oil prices and a favorable global environment
 - But also by reform policies that, though gradual, are generally on the right track

- Growth in the region continues to be robust for the 4th year in a row (**Figure 1**)
 - Real gross domestic product (GDP) increased by 6.3% in 2006, up from 4.6% during the 4 years of the decade
 - Given the rapid demographic expansion that characterizes most countries in the region, growth on a per capita basis was less buoyant, reaching 4.2% in 2006, but still significantly higher than the 2.6% reached in the early years of 2000

Figure 1-Regional growth steps



Source: National agencies, World Bank.

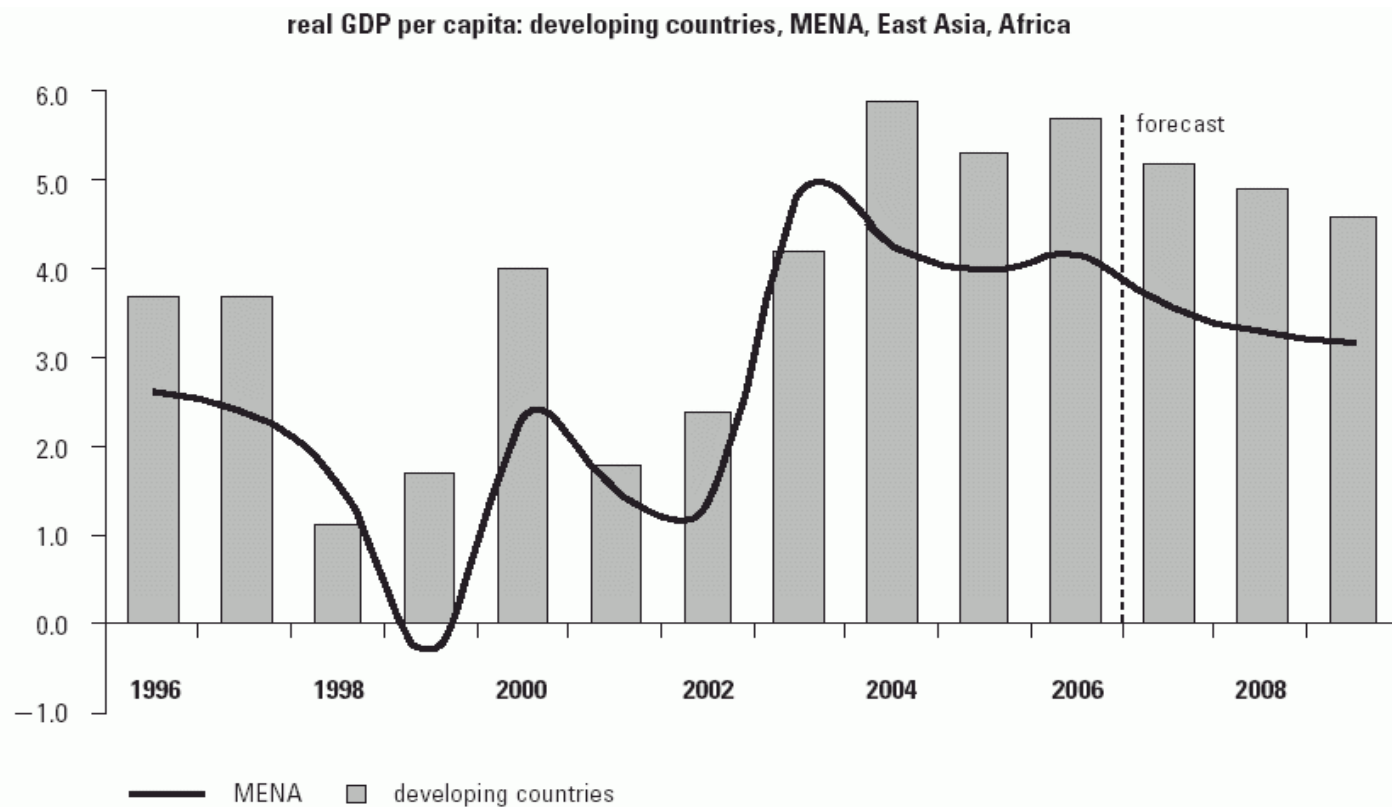
Note: RPLA = resource-poor, labor-abundant; RRLA = resource-rich, labor-abundant; RRLI = resource-rich, labor-importing. For details of MENA country groups, see footnote 1.



2-Overview of recent economic outcomes (2/4)

- However, MENA is now growing at a rate that is nearly 75% of that of other developing countries (9.4% in East-Asia; 8.6% in South Asia) (**Figure 2**)
- The per capita income of Med countries (with the exception of Israel) lags significantly behind that of southern European EU MS
- Due to some extent to the lower diversification of Med economies, but also as a result of geopolitical tensions in the region, the variability of their growth rates has been significantly higher than that of their European neighbors, making it all the more important for these countries to have recourse to risk-sharing opportunities, such as foreign capital flows
 - The dispersion of growth across MENA's diverse group of economies remains wide from 12% growth in Qatar in 2006 to a decline of the same magnitude in the West Bank and Gaza
 - This is due not only to :
 - the fundamental split between oil-dominant and more diversified economies of the region
 - but also to the economic policy and attitudes toward reform
 - as well as to the present set of geopolitical tensions carrying strong direct and indirect effects across regional economies

Figure 2-Per capita growth in MENA and in low- and middle income countries



Source: National agencies, World Bank projections.



2-Overview of recent economic outcomes (3/4)

- While world trade has grown at 8 percent per year in the past decade, trade in the Middle East and North Africa (MEDA) region grew at only 3 percent
- Moreover, the region's economic relationships with the rest of the world remain dependent on oil and natural resources, tourism, and labor migration, while other regions have become links in global production chains in technology, manufacturing, and other dynamic sectors
- A major consequence of this failure to integrate with the rest of the world has been a slower economic growth and high unemployment by comparison with other developing countries



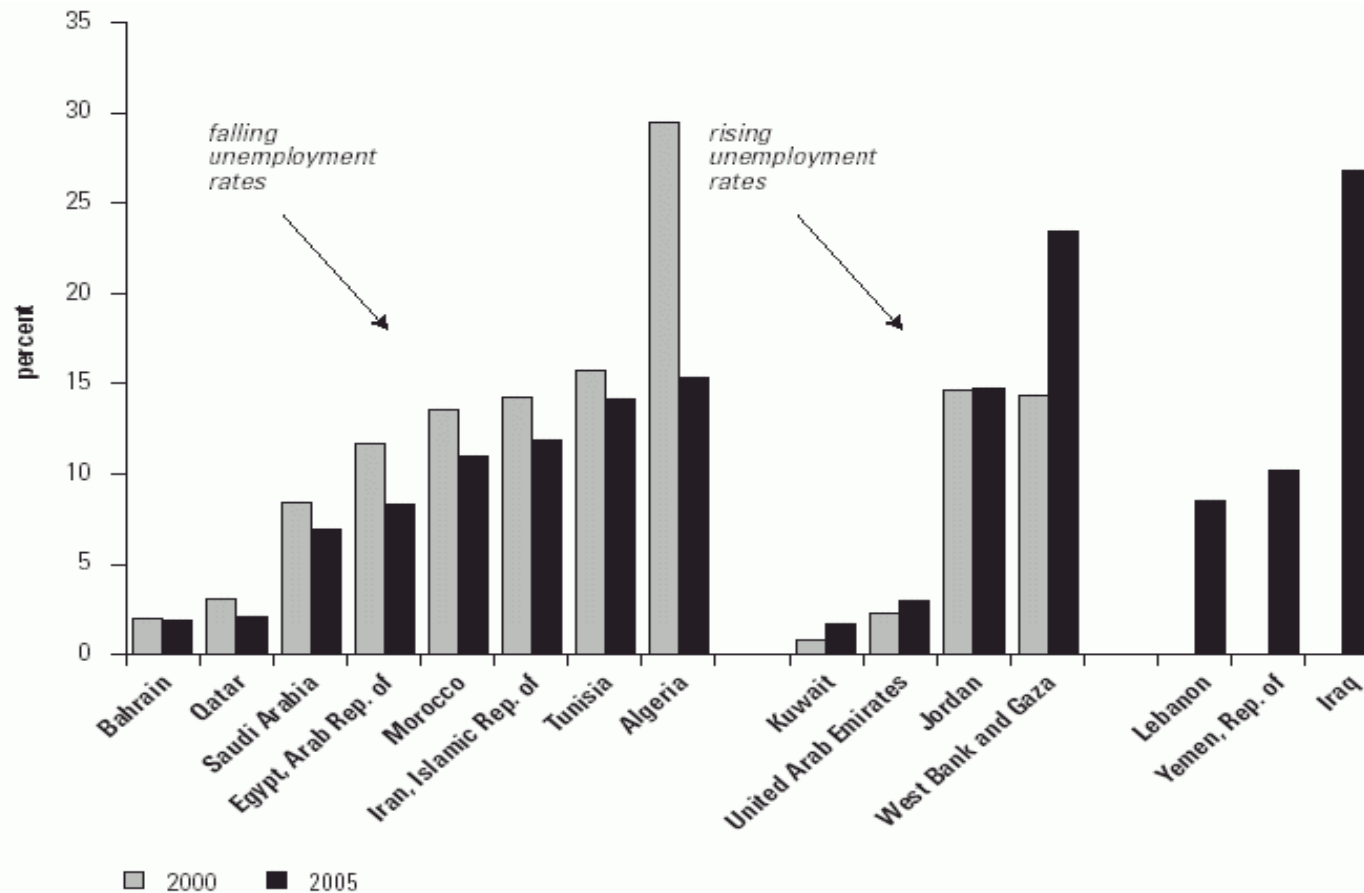
2-Overview of recent economic outcomes (4/4)

- Perhaps the greatest single issue facing the economies of the Middle East and North Africa (MENA) is the challenge of employing its people
 - While the region is heterogeneous in terms of development in the labor market...
 - ...the majority of the region has been characterized by high levels of unemployment (**Figure 3**) especially among the young and educated and in some cases by declining real wages as well

- The problem of job creation for the MENA region is staggering
 - At least some 60 million jobs need to be created over the next 10 years just to keep pace with new entrants to the job market (**Figure 4**)
 - Such an accomplishment was not even accomplished by the high performing East Asian economies during the height of employment growth periods

- Expanding trade and private investment offers the best hope for generating the requisite growth and jobs. This effort requires moving decisively away from relying on the public sector and protected national economies as the main engine of growth to relying more on open economies and a competitive private sector
 - But the margins are limited (average rate of openness of Med countries is 36%, even 64% for Jordan. By comparison, EU-25 excluding intra-EU trade is 12%)

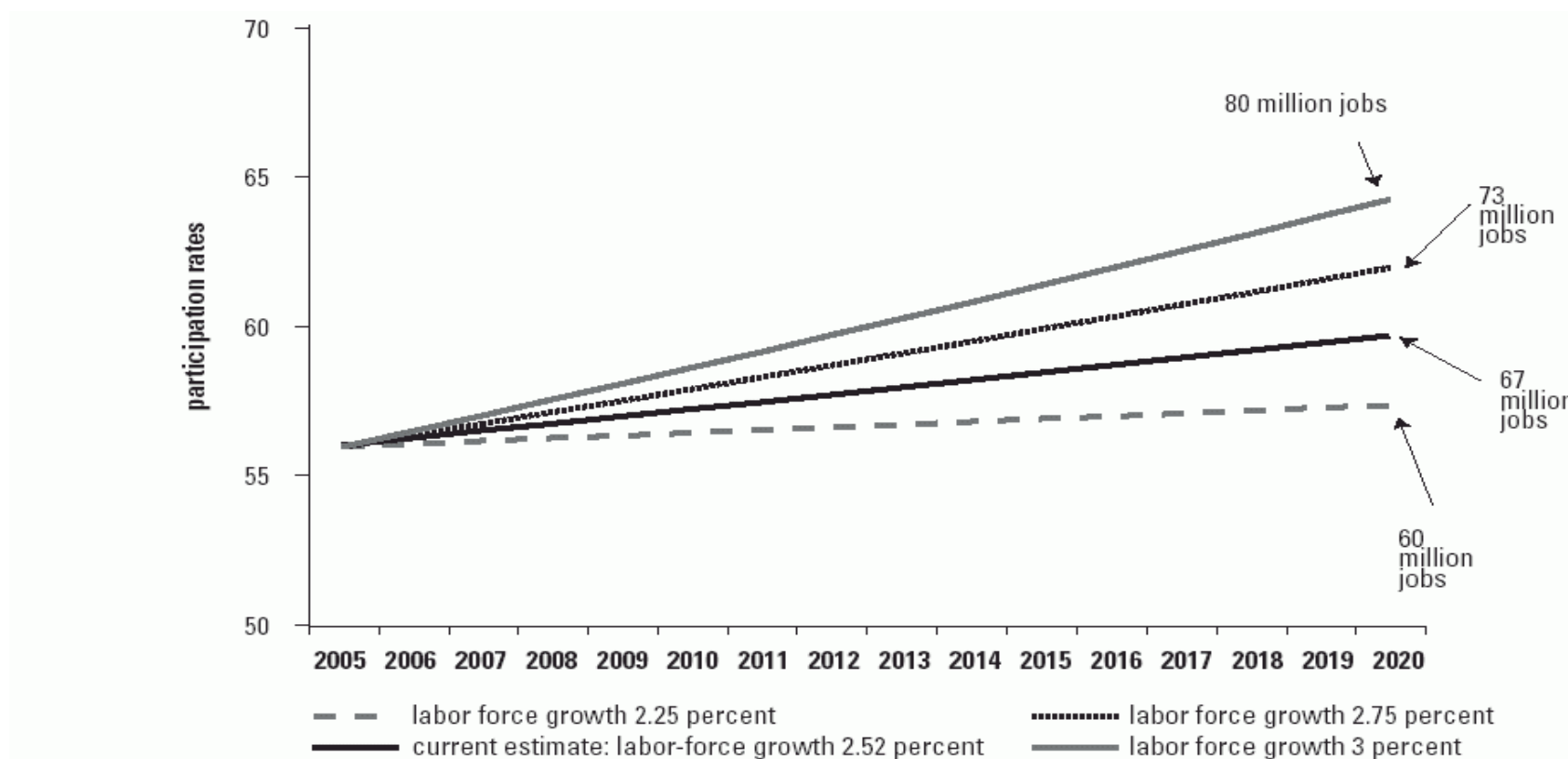
Figure 3-Unemployment rate 2000 and 2005




Source: World Bank staff estimates based on ILO (2005, 2006a); national sources.

Note: Earliest and most recent available in the period.

Figure 4-Job creation requirements and changes in labor force participation rates




Source: World Bank staff estimates based on ILO 2005.




3-Need to reconcile the fight against poverty and budgetary discipline in the context of soaring oil prices (1/5)

- One of the main components of the fight against poverty in the MPCs is price control or subsidies for sugar, cereals, etc... and petroleum products
 - The cost of this policy ranged from 1.3% of GDP in Morocco to 5% in Egypt and 14.7% in Syria in 2006/07
 - Egypt, for instance, is the second importer of wheat behind Brazil notably because of an increasing disparity between its rising population and limited agricultural lands mainly dedicated to the export of fruits & vegetables
 - The rise in the prices of petroleum and basic commodities (+27% in one year for bread, 40% increase for oil and 20% for milk) other than fuel since 2005 increases the cost of this policy
 - As a result, many MPCs are under strain (especially because many Med countries have their currency pegged to the \$)
 - Because of its generous food and fuel subsidies, Egypt, for instance, had to tap its foreign reserves in 2008 to help pay for the spiraling cost of wheat imports
 - Price control may help maintaining inflation but it causes a dangerous disequilibrium in public finance




3-Need to reconcile the fight against poverty and budgetary discipline in the context of soaring oil prices (2/5)

- MPCs can be divided into 3 groups :
 - Those opting for a budgetary discipline after suffering important deficits are able to do so because the GDP growth rate remains high (>5%), such as Israel, Jordan and Turkey.
 - Their deficits in real terms are gradually being reduced
 - Those who stimulate their economies by either developing the non-petroleum sector, such as Algeria or by supporting the rise in growth rates such as Egypt (2.9% in 2002 as compared to >7% in 2007)
 - Those who are committed to budgetary discipline but are facing increased difficulties in controlling their expenses like Morocco and Tunisia
 - Expenses have increased in 2006 by 18.5% in Morocco and 8% in Tunisia as compared to a progression of revenues of 13.3% and 6.4% respectively
- Problem : if too divergent : will be less able to respond to (a)symmetric chocks (one of the teaching of the EMU)




3-Need to reconcile the fight against poverty and budgetary discipline in the context of soaring oil prices (3/5)

- Most Med countries are considering abandoning price controls which can be replaced by other policies that would be accurately target the poor populations and help them more accurately
 - Problem : this measure is not popular (growing frustration, even violence)
 - It is also difficult to manage, especially as abandoning price controls could lead to important macro-economic disequilibrium at a time of increasing inflationary pressures and structurally high unemployment levels
 - But no other choice as such policy is difficult to maintain as it contributes to increase their debt (+ aggravated by ageing population, rising interest rates, insufficient growth, serious unemployment, widespread tax evasion, etc...)
 - Rigidities of expenses (debt interest, ...) and the difficulty in increasing revenues (inefficient tax collection, exemptions, ...) are problems that require costly restructuring, esp. since the rise of interest rates makes developed countries more attractive in terms of investments at the expense of Med countries where the risk factor is higher



3-Need to reconcile the fight against poverty and budgetary discipline in the context of soaring oil prices (4/5)

- The revision of the budgetary expenditures structure is urgent as interest rates are increasing
- This makes developed countries more attractive in terms of investments at the expense of emerging countries such as MPCs where the risk factor is higher
- The financing needs of Med countries are met at present because
 - the amount of petrodollars available is high
 - oil exporting countries have a much more reasonable expenditure behavior than during the previous periods of soaring prices
- Thus financing conditions in the world capital market are still favorable, but short-term interest rates are increasingly affected by American rates and the cost of financing deficits
 - thus the debt of Med countries is negatively affected



3-Need to reconcile the fight against poverty and budgetary discipline in the context of soaring oil prices (5/5)

- Factors to restore equilibrium in the balance of payments remain unchanged
 - They are based on services and capital transfers (tourism, remittance revenues of expatriates and aid) but the structural weakness continues as a result of the volatility of these revenues :
 - Tourism revenues are strongly dependent on the political climate in the region
 - Remittances are important esp. for Morocco and Egypt, but it is difficult to determine how far they impact growth and unemployment (**Table 1**)
 - International aid is still about 20% of the trade balance but it is continuing to decline
- These traditional methods of funding still make it possible to avoid a serious disequilibrium, but do not lead the regional dynamics to the required level, especially in terms of employment

Table 1-Major remittance corridors-outflows (billion euros)

Remittance corridors	2006	2005
Spain → Colombia	1.3	1.0
Spain → Ecuador	1.2	1.0
Germany → Turkey	0.8	0.8
France → Portugal	0.8	0.9
France → Morocco	0.8	0.8
Italy → Romania	0.8	0.7
Spain → Bolivia	0.7	0.5
Italy → China	0.7	0.9
UK → India	0.6	0.6
UK → Ireland	0.6	0.6
Italy → Philippines	0.5	0.2
Portugal → Brazil	0.3	0.3
France → Algeria	0.3	0.3
Greece → Albania	0.3	0.2
Belgium → Morocco	0.2	0.2

* in order of officially recorded flows in 2006

Source : Eurostat



4-Shock absorption and free trade : achievements and challenges of Euro-Med partnership (1/4)

- Effective inclusion of Med countries in international trade should cushion the negative effects of the oil price increase on external equilibrium and growth
 - This could be done directly by an increase in total demand and indirectly through improved productivity and competitiveness
 - A study by Frankel & Romer in 1999 on links between greater integration of a country in trade, economic growth and income levels of the region or world showed that a 1% point increase in trade/GDP ratio increases the per capita GDP by 0.5%
 - But the nature of these links depends on several variables : human capital, capacity to absorb new technologies, investment levels, etc...
 - The experience of the East countries has shown that powerful positive effects may result, mainly through exports
 - The openness of MPCs, notably encouraged by the Barcelona process should have had the same impact on their growth and employment
 - Furthermore, diversification of exports should have cushioned the effects of internal and external shocks on their economy
 - However, up to the present, these effects have been insufficient and blockages seem to emerge facing the phase of international trade insertion



4-Shock absorption and free trade : achievements and challenges of Euro-Med partnership (2/4)

- 3 points need to be underlined :
 - 1st, an analysis of the development of trade between MPCs and the EU on the hand, and the rest of the world on the other hand indicates that
 - The growth of trade in Med countries is marked by a greater increase of imports than exports and by a re-organization of partners, in favor of countries from the rest of the world rather than European partners
 - The trade integration between Maghreb countries and the EU is increasing while links with the Mashrek countries (Lebanon, Jordan and Syria) seem to be slowing down
 - This phenomenon seems positive insofar as it is more a reflection of the enhanced value of the improvement of the economies in the international markets, which was encouraged by the agreements signed with the EU rather than a lack of dynamism in EU-Mashrek relations



4-Shock absorption and free trade : achievements and challenges of Euro-Med partnership (3/4)

- 2nd, it raises the issue of the trade potential offered to MPCs at the EU as well as the world level so as to determine the integration margins that exist for these countries
 - Studies confirm the trend of growing importance for Med countries of non-European trade partners
 - Trade integration of Med countries at the global level is slower than that of other developing countries just as regional integration is, and this despite signed agreements
 - Besides it seems that FTAs with the EU favor delocalization, trade diversification and higher-end production lines
 - Thus, Tunisia and Morocco are certainly comparable in terms of structure of exports in the textile sector, but the 2 countries are not so well inserted in delocalization circuits of European production
 - Therefore the main challenge for Med countries is to find other domains of competitiveness that can attract the establishment of European enterprises



4-Shock absorption and free trade : achievements and challenges of Euro-Med partnership (4/4)

- 3rd, the argument that is most often brought up to explain the slow pace of trade integration is the poor quality of institutions in MPCs countries
 - The capacity to absorb new technologies through the establishment of foreign firms, investments and importing intermediary goods, crucially depends on the level of education of the population and is subject to threshold effects : there should exist a minimum level of education beyond which the economy would be capable of absorbing new imported technologies
 - Trade intensity between 2 countries depends tangibly on the quality of institutions more than on the degree of similarity of their institutions
 - Institutions matter !



5-Elements of conclusions (1/3)

- Med partner countries who since the 70s were linked to the EU by the Union's Mediterranean policy, then by the renewed Mediterranean policy (beginning of the '90s), followed by the establishment of the Euro-Mediterranean partnership, Barcelona declaration (1995), and ENP (2004) are not, with exceptions involved in a truly dynamic convergence with the EU
 - Lower per capita income
 - Demography in transition but significant growth of active population
 - Stronger rigidity in the adjustment of the labor market
 - Lack of accession progress in South-South integration
 - Delays in institutional reforms
 - Strong reticence in accepting heavy adjustments which affect poverty
 - Bearing in mind the lack of sufficient funds for convergence



5-Elements of conclusions (2/3)

- The analysis made indicates, however, that important progress was realized in macro-economic stabilization and resistance to initial internal and external shocks
- Under the impulse of the Partnership, the Med countries managed to generate several economic gains that have supported their macroeconomic dynamics in a context of the tremendous oil price hikes and the rise in interest rates
- From a macro-economic point of view, this recent development of the main aggregates in the MPCs can be seen in 2 ways :
 - It emphasizes the resilience of Med economies to external shocks which would otherwise have had more serious consequences some years earlier
 - But it also contributes to adding more stress on the Med countries' budgets, since oil and raw materials prices are often subsidized or controlled so as to protect the under-privileged classes. This illustrates the limits of present budget policies and, by the same token, the need to improve the capacity of med countries to seize the opportunity of free trade and the conclusion of several agreements, esp. with the EU
 - Prospects for sustaining growth at these or higher rates over the coming years depend on advances in structural reforms and will prove a substantial challenge for policy-makers



5-Elements of conclusions (3/3)

- On the whole, it is evident that the actual trend does not envisage a convergence with the EU or the growth rates that are indispensable for providing work to new entrants in the labor market
- The proposed EU contribution to this situation is a NP that places on the same level countries with very few points in common between them (especially demographically, in terms of capita income, industrial development, qualified persons)
- Only by virtue of being neighbors to the EU they are offered a stake in the internal market, but it is up to each country to determine its parameters