Enhancing Mediterranean Integration

Blanca Moreno-Dodson

"This book is a serious, sober and comprehensive review of North-South relations in the Mediterranean region, drawing extensively on the voluminous literature on the subject. The policy recommendations are sound. The clear and systematic exposition makes the study suitable both as a reference volume and as a guide for teachers and students. The study's emphasis on domestic policies as the main driver of successful integration -- rather than exclusive reliance on formal and shallow trade agreements -- is spot on."

Uri Dadush
Senior Fellow, Policy Center for the New South and Bruegel
Visiting Research, Professor University of Maryland

"This is the ultimate book on the prospects for integration of South-Mediterranean countries in the global economy and is a must-read for anyone interested in the long-term welfare of the region. It brings together, into a coherent frame, recent research on Global Value Chains, trade in services, non-tariff barriers, determinants of FDI, the politics of state and business relations as well as the role of education and environmental policies in reducing inequality. In doing so, this book charts more realistic ways of looking at the old dilemma of how the Southern rim of the Mediterranean can move from being an isolated group of countries, exporting natural resources and people to a large market attracting FDI, new technologies, and finding its place in the evolving global division of labor. This analysis offers a balanced view on the policy changes needed. In Europe, this consists of becoming more open to a deeper integration that gives as much attention to its South as it does its East, and in the South-Mediterranean region, countries need to become more open to an evolution of their governance in ways that foster inclusive and sustainable growth, and increase cooperation among themselves in the provision of regional public goods."

Ishac Diwan
Professor of Economics, Paris Sciences et Lettres, and Ecole Normale Supérieure Paris
Research Fellow, DIAL (Paris Dauphine) and Economic Research Forum
ENHANCING MEDITERRANEAN INTEGRATION

Blanca Moreno-Dodson
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In 1995, leaders from around the Mediterranean met in Barcelona to issue a critically important communique, the Barcelona Declaration. The collaborative document outlined the framework for initiating renewed dialogue among the nations of Southern Europe, North Africa, and the Levant—regions that share a long history—especially dialogue about their common objectives of economic transformation and exchange.

The Declaration’s overarching aim was to bring Mediterranean states together to create an economically integrated area of mutual prosperity. With the launching of this initiative, a new Euro-Mediterranean Partnership was devised to deepen economic cooperation, promote investment, drive technology transfer, boost trade, and strengthen historical bonds at a time when protectionist and nationalist impulses were rising.

Since the announcement of that seminal declaration, much has changed in the worlds of technology and development. In particular, digitalization has permeated every aspect of organizational and business processes and is accelerating changes within industries and markets. It is driving export competitiveness and quickening integration in production networks. Indeed, it was digital technologies that sustained the flow of information, and such economic growth as there was, during the Great Lockdown of 2020 that triggered demand and supply shocks in every region of the world in the wake of the COVID-19 pandemic.

Just as significant a global change as digitalization is the increasing recognition—among governments, organizations, and civil society—of the grave climate-related risks (from insecurity to large-scale regional migrations) that can ultimately be traced back to society’s continued overreliance on the internal combustion engine model that has been contributing to industrial growth for the last 140 years, at the cost of releasing heat-trapping greenhouse gases.

By integrating new development challenges related to climate resilience and digitalization in a new framework of engagement between historical partners, the approach to Mediterranean integration articulated in this book expertly revitalizes the spirit of the Barcelona Declaration for the 21st century, setting out an architecture for cooperation that can boost productivity, drive investment, and reduce the costs of trade without exacerbating the risks of climate change.

Produced by the Center for Mediterranean Integration (CMI) under the leadership of Dr. Blanca Moreno-Dodson, this manuscript highlights a number of policy priorities.
Encouraging and facilitating knowledge sharing, and reinvigorating comparative advantage, lie at the heart of this vision to expanding intraregional trade through an inclusive and climate-resilient growth approach. This mode of engagement centers on drawing upon the technological advances of Northern Mediterranean countries to tap into the abundant, renewable energy sources in Southern states, which in turn would power economic development in both the energy-intensive countries of the North as well as the emerging markets in the South.

The book also articulates how such emerging markets can harness digital technologies to accelerate the diversification of their sources of growth and boost trade within an integrated region. Digitalization has not only significantly reduced transaction costs and raised service sector productivity but also opened up a new path for economic development and integration underpinned by greater knowledge-sharing. In turn, broadening digital access demographically will bring even greater benefits of innovation and technology transfers that will accelerate income convergence within the Mediterranean and ultimately alleviate migration pressures.

Additionally, this book makes a compelling case that policy reforms intended to foster economic integration in the region need to go beyond tariff reduction, welcome as that might be. Effective reforms will need to address the multitude of non-tariff trade barriers, especially in the South, where the ad valorem equivalent costs of non-tariff measures and other trade-related outlays remain relatively high. To further boost trade and economic integration within the union, policies must also address both the exogenous and the endogenous factors that continue to drive up the cost of trade.

It is equally important that decision makers in the region recognize that trade and investment are not an either/or choice for businesses. In this regard, the book rightly advocates a stronger link between investment and trade to increase the export potential of Southern Mediterranean countries and their integration into global value chains (GVCs). In a globalization-driven era of rising GVCs, where efficiency-seeking corporations are looking for the best location from which to produce and export, foreign direct investment (FDI) has become an even stronger complement to trade. To attract more FDI from Northern Mediterranean countries, however, those in the South will have to complement tariff liberalization with sectoral and regulatory reforms to improve the overall business environment and reduce investor uncertainty.

The Mediterranean integration project that was birthed with the creation of the Barcelona Declaration had, and still has, tremendous potential for economic development throughout the region. But certain components of that vision may well have been slightly ahead of their time. By advancing our understanding of how to design and implement reforms that will enable countries to make the fullest use of the power of digitalization to spur innovation and human capital development, this timely volume can help actualize that vision and that potential. If the nations of the Mediterranean act together, this region—with its rich shared history and potential for numerous synergies—can collectively reap the benefits of higher investment, diversified exports, enhanced digital access, and improved climate resilience.

Dr. Hippolyte Fofack
Chief Economist
The African Export-Import Bank
There are few regions in the world where the need for greater integration is as palpable as it is in the Mediterranean. This is because integration has an indispensable role to play in consolidating the region’s thousand-year-old solidarities, promoting economic development both within the region and in its neighboring countries, particularly in Africa, and giving Mediterranean stakeholders their due weight on the global playing field.

The way in which the regional integration question is posed has changed considerably since the first steps were taken in this direction. Today, although the development of trade is still an important vector of Mediterranean integration, trade by itself is no longer enough to catalyze the integration project on a comprehensive socioeconomic scale. We now know that, although trade exchanges lead to gains in overall income, it presupposes fluid reallocations of factors of production among sectors, countries, regions, and social categories that must be rethought, and possibly corrected, from the outset.

Hence the interest in this book, which examines the multiple components of the integration process in the Mediterranean. It provides suggestions for building regional value chains, promoting private investment between countries within coproduction agreements, setting companies on an equal footing, and implementing major projects aimed at the explicit delivery of public goods. The suggested approach, articulated around these different dimensions of Mediterranean integration, is geared towards benefitting the environment and the health of Mediterranean populations, while placing youth and their skills at the center of the transformation.

Jean-Louis Reiffers
Honorary Dean
Faculty of Economics
University of Aix-Marseille
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This book was authored by Blanca Moreno-Dodson, Director of the Center of Mediterranean Integration (CMI), with guidance and inspiration from the representatives of the Oversight Committee members: Egypt, France, Greece, Italy, Jordan, Lebanon, Morocco, Palestinian Authority, Spain, Tunisia, the Provence-Alpes-Côte d’Azur Region, the City of Marseille, the European Investment Bank, the World Bank Group, and the European External Action Service (EEAS).

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UNDERSTANDING MEDITERRANEAN INTEGRATION TODAY

Before the world encountered the virulent COVID-19 pandemic, studies\(^1\) on Mediterranean regional integration had pointed to the existence of a substantial but largely untapped potential to increase not only trade flows of goods and services between the two shores of the Mediterranean but also foreign direct investment (FDI) and the mobility of people.

This vision of regional integration, founded on three interlinked dimensions—trade, investment, and migratory flows—seems to have fallen short of the ambitious objective that was framed by the Barcelona Declaration 25 years ago, and that was subsequently reflected in numerous Mediterranean alliances and initiatives, namely, “turning the Mediterranean basin into an area of dialogue, exchange and cooperation, guaranteeing peace, stability, and prosperity.”

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While advocating the merits of this objective, the CMI has recently attempted to provide an updated and enhanced vision of its meaning in today’s context. Based on a recent analysis, the CMI’s three-pronged approach recommends further reducing and ultimately eliminating tariffs and non-tariff barriers to the trade of goods and services, with particular emphasis on the trade of services. This is because of the positive effects on productivity and job creation associated with services, which often spill over into agriculture and industry, including Information and Communications Technology (ICT).

In parallel, the CMI approach also recommends increasing the mobility of workers and jobs in the Mediterranean region through proactive, regularized migration policies, and increasing other aspects of human capital mobility through, for example, further internationalizing education and promoting e-learning.

Finally, it suggests that promoting investment, private sector businesses, and partnerships that involve parties from both shores will be key to the socioeconomic transformation of the region.

Behind this vision lies the idea that trade liberalization cannot be dissociated from sectoral reforms, and secondly, that removing tariffs and other trade barriers, on its own, will result in economic growth and progress only if other trade restrictions—in critical areas such as transport, infrastructure, regulations, logistics, digitalization, and financial intermediation—are removed. Such restrictions not only increase trade costs but also make diversification and upscaling more difficult, therefore delaying structural transformation which, in turn, decreases opportunities for trade exchanges.

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2. The Mediterranean region is one of the least integrated in the world regarding tariffs and non-tariff measures such as quotas, export voluntary restraints, and technical barriers and requirements such as rules of origin, transport infrastructure, and logistical services. This markedly influences the capacity of Mediterranean countries to engage in international trade. For example, Effectively Applied (AHS) tariff rates are very high compared to the rest of the world: just below 9 percent in all south Mediterranean countries, compared to about 5 percent in the East-Asia and Pacific region, and less than 2 percent in the European Union (effectively applied rates, WITS, 2015). Estimations of non-tariff measures and other trade costs (logistics, transportation, and so on) are typically twice as high among MENA countries than in Western Europe countries. See Jean-François Arvis, Yann Duval, Ben Shepherd, and Chorthip Utoktham, “Trade Costs in the Developing World: 1995–2010,” ARTNeT Working Paper No. 121 (2012), World Bank Policy Research Working Paper No. 6309 (2013), accessed November 1, 2020, available at: https://openknowledge.worldbank.org/handle/10986/12182; PDF version: https://www.unescap.org/sites/default/files/AWP%20No.%20121.pdf.


4. For example, regional solutions such as integrated financial markets, improved access to banking and to financial literacy for individuals, and better access to credit, especially for small and medium-sized enterprises (SMEs), could contribute to developing regional business initiatives. Regional cooperation could be used to implement measures for upgrading financial intermediation.

5. About 50 percent of the total trade costs in the region.
Further, this approach emphasizes that trade liberalization should not be implemented alone but rather in the context of a comprehensive policy package that aims at achieving social and distributive goals, in addition to efficiency gains.

First, the static efficiency gain generated by trading is expected to be accompanied by scale effects linked to the possibility of operating in a larger market, and positive externalities associated with technology transfers and better positioning of the region in Global Value Chains (GVCs). In the long run, this should contribute to a gradual convergence of average salaries among countries, an essential element for social cohesion.

Finally, other accompanying policies must be adopted to mitigate emerging disparities because it is expected that income from factors in the comparative advantage sectors, especially labor, will rise, while income in the other sectors will fall (both in relative and in absolute terms), with clear employment implications.6

It is also to be noted, that given their different geographic locations and land, physical and human capital endowments, not all territories in the region will be equally affected by a reallocation of factors due to trade exchanges. This means that territorial cohesion policies that target vulnerable areas, especially at the municipal and local levels, should be designed as part of the overall policy package.7

Economic efficiency gains associated with trade reforms will also depend greatly on the free mobility of people within the region. Such mobility allows for the acquisition of relevant knowledge, the exchange of ideas, the upgrading of skills, and the transfer of techniques and scientific discoveries. However, without migration policies aimed at managing legal flows,8 including circular migration, and better dialogue (bilateral and multilateral) among countries in the region, the potential of workers’ mobility, both as a determinant of growth and as a social inclusion factor,9 will remain underexploited.

Finally, mobilizing additional investments in the region will require greater support from international partners such as the European Union (EU), and from international financial institutions (IFIs) such as the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), and the World Bank (WB).


7. This has been the case with the European Union, where structural funds targeting some countries and regions act as essential vehicles for the overall integration process and the construction of a common market.


9. In addition, remittance flows constitute an important source of income in origin countries, in some cases larger even than FDI.
Attracting additional investments will also require support from neighboring states. Such support, if provided as part of a proactive, partnership-based, codevelopment approach, could serve as the catalytic factor needed to trigger the transformation of the region. It could materialize through projects of common interest, scaled up to involve countries on both shores of the Mediterranean, East, and West.10

This transformation will also require a coordinated approach to enhance the attractiveness of the Mediterranean region to private foreign investors, especially in countries where the public sector still occupies a relatively large percentage of economic activity,11 crowding out the emergence of smaller privately-owned businesses, preventing competition, and triggering institutional failures.

Regulatory reforms12 as well as measures to improve the overall business environment, and monetary and fiscal (nontax) incentives, as opposed to arbitrary tax exemptions, should be envisaged. In this context, coproduction13 schemes involving small and medium-sized enterprises (SMEs) within the region will be essential for transferring technology and know-how, while also contributing to the creation of jobs.

Overall, the approach points toward further promoting growth through comprehensive trade reforms, while also facilitating the mobility of workers through regularized, non-crisis migration schemes, as well as promoting foreign direct investment (FDI) and cross-country public-private partnerships.

Similarly, to reduce and ultimately eliminate income disparities in line with the goals of achieving social inclusion and territorial cohesion, it will be necessary to provide regional-level public goods that benefit the whole region, and more targeted initiatives aimed at protecting vulnerable income groups (such as refugees, unprotected children, and the unemployed) and less-favored geographic locations (for example, remote, landlocked areas).

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10. This objective will be supported by the Dialogue of the Two Shores, an initiative launched by French president Emmanuel Macron and involving the 5+5 Dialogue group of countries (Algeria, France, Italy, Libya, Malta, Mauritania, Morocco, Portugal, Spain, and Tunisia) as well as international and Mediterranean institutions (AFD, EU, EIB, EBRD, OECD, UFM, ALF and the World Bank). The Dialogue aims at promoting dialogue between civil society and political leaders, and increasing regional cooperation among Mediterranean countries through the implementation of investment projects that promote economic, social, and sustainable development goals in the region.

11. Mainly through state-owned enterprises (SOEs).


13. The idea of coproduction is based on the objective of establishing equal partnerships. It aims to find companies that are open to collaboration on both sides of the Mediterranean, provide them with incentives to work together, and—undoubtedly the most important element—establish the legal framework for this new type of joint venture in collaboration.
PROVIDING REGIONAL PUBLIC GOODS

Regarding the provision of regional public goods, two areas are especially vital for the consolidation of regional integration: human capital and the environment, especially building resilience to climate change. The provision of these two common goods cannot be addressed through a strictly competitive approach. Extensive collaboration between participating nations in these two strategic and highly symbolic areas could make an immense contribution to the region’s future growth paths.

Human capital involves knowledge production—that is, research, the dissemination of ideas through education, and employability gained with the acquisition of know-how—which is directly useful to companies for their technical and professional training goals. Indeed, regional development of human capital is one of the main factors that are likely to determine the success or failure of the Mediterranean integration process. Why? Because it contributes to innovation and to growth, through the development of a knowledge economy, which facilitates human mobility between countries and sectors and enables cultural interaction.

In this vein, student mobility is absolutely necessary to underpin human capital formation. As in the example of Europe, which has created several highly successful cooperation initiatives, programs involving students from all Mediterranean countries should be designed as a norm, in order to facilitate knowledge-sharing throughout the region.

Regarding employability, enhancing the international mobility of academics and students would yield important benefits in research and development by enhancing knowledge flow, stimulating new ideas, developing cooperation for joint research, and motivating innovation. Attracting foreign researchers would also improve local capacity and enhance cooperation among institutions.

It is relevant to mention that closer involvement of well-established European training institutions in teaching students from Eastern and Southern countries could also provide large European companies with a new incentive to invest more heavily in those Mediterranean countries.

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14. This is not meant as a comprehensive list but rather an attempt to highlight two important public goods that can contribute powerfully to the region’s socioeconomic transformation.
15. This is what distinguishes a public good from a commercial commodity. Commercial commodities are dispensable, while public goods are essential.
17. The reason countries such as the Republic of Korea offer scholarships to undergraduate engineering students to study abroad is for them to build their networks in technical fields, and to participate in collaborative programs related to the latest technology.
These developments are essential to ensure progress on a third element—a thirst for knowledge acquisition among young people, particularly in “the sectors of the future,”18 in addition to improving the quality of educational provision and responding to labor market demands, all involved in building human capital.

The second area of focus relates to another essential regional public good: the environment (specifically, the quality of air, water, and land), particularly in response to acute climate change threats, which are especially worrisome in the region. There are numerous natural comparative advantages to be harnessed in the region by using its abundant natural resources and renewable energies. This can be facilitated by integrating environmental policies across sectors.

Extensive prior research indicates that water, energy, and food-related issues are interlinked and interdependent within the region: they cannot be considered separately because of the numerous interactions among them. Together, these three sectors can be essential components of an effective strategy to find solutions to future crises. Proactive environmental policies that integrate these three sectors could also offer significant economic and job creation opportunities in Mediterranean countries.

The energy sector, a truly region-wide public good if there ever was one, offers perhaps the greatest potential. In addition to improving the carbon footprint, investing in renewable energies such as solar and wind can not only foster the emergence of new technological leadership in this sector, but also provide jobs and secure access to affordable sources of low-carbon electricity for all Mediterranean countries, including those in the EU.

Euro-Mediterranean electricity market integration would make it possible to connect countries of the southern shore, which are rich in carbon-free energy resources, to countries of the northern shore, which have a high demand for carbon-free electricity and are willing to pay for it.

A major requirement for a successfully transformed energy sector is that people, homes, and businesses need to be physically connected to those energy sources in the first place. Connectivity is key, but it requires the availability of efficient electricity interconnectors. These, however, are notoriously difficult to finance.

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18. The 2015 CMI report, Economic Transitions in the Mediterranean, made a number of proposals, among them this. The EU should consider financing North/South networks of vocational and technical training institutions to give their faculties and staff opportunities to work together and share best teaching and management practices. The sectors identified are where the jobs of the future will most likely be found, including (i) alternative energy and the environment (green jobs), (ii) healthcare, the paramedical sector, and personal-care services, and (iii) information and communications technologies, and cultural initiatives. See The Center for Mediterranean Integration (CMI), “Economic Transitions in the Mediterranean,” paper presented at UfM meeting, Naples, Italy, October 28, 2014, accessed November 1, 2020, available at https://www.cmimarseille.org/knowledge-library/economic-transitions-mediterranean.
and implement. Regional market integration throughout Europe would expand access to low-carbon supply sources such as hydro reserves (for example, in Norway) and to plentiful solar power in Southern and Eastern Mediterranean countries.

To successfully achieve regional energy market integration, policymakers, energy companies, and regulators from both North and South need to fully embrace the vision and benefits of such integration. Maintaining a network of experts, government representatives, and energy players from around the Mediterranean will be essential to sharing best practices and influencing policymaking.¹⁹

If Mediterranean countries were able to closely cooperate in this area, with the support of the EU and perhaps other multilateral institutions, the likely result would be a highly symbolic resurgence of solidarity among them, accompanied by a significant economic impact.

For similar reasons, it is necessary to promote an integrated regional approach to managing water scarcity,²⁰ which is worsening significantly in the Mediterranean region, one of the world’s most vulnerable regions to climate change.

Water is, par excellence, a global issue. Watercourses flow across countries and even continents, and the factors currently contributing to their depletion, such as climate change, affect the entire planet. In the Mediterranean, the main strategy for tackling water management should be to focus on strengthening collaboration and integration among the different basin countries.

¹⁹. In October 2019, as part of its Mediterranean Forum on Electricity and Climate Change, the CMI jointly published a Briefing Paper with the European Commission titled “Clean Energy for All Europeans” Package: Implications and Opportunities for the Mediterranean.” Authored by Anne Held, Mario Ragwitz and Jenny Winkler of Fraunhofer ISI, with guidance from the CMI, the report outlines a range of options for Southern and Eastern Mediterranean countries to collaborate with EU member states in the areas of energy market integration, efficient interconnectors, and the deployment of renewable energy sources. The paper is available online at: https://www.cmimarseille.org/knowledge-library/briefing-paper-eu-clean-energy-all-europeans-package-use-southern-and-eastern.

²⁰. The World Bank’s 2018 report on water scarcity in the MENA region summarizes how regional cooperation can help achieve sustainable water management:

“At the regional level, cooperation on water can foster greater trust and collaboration. The purpose of this action area is not to promote cooperation for its own benefits but as a means to greater peace and stability in the region (Devarajan 2015). The efforts of the League of Arab States to strengthen water management in the region need to continue. The work by the Arab Countries Water Utilities Association (ACWUA) on benchmarking water utilities and tracking performance of water services across the region will become more valuable as part of the SDGs. Similarly, collaboration between researchers and universities through established and emerging networks, such as the Middle East and North Africa Network of Water Centers of Excellence (MENA NWC), is essential. Finally, non governmental organizations (NGOs), NGO EcoPeace Middle East (Israel, Jordan, and Palestine), as well as international organizations can contribute with knowledge and financial resources to help Middle East and North Africa economies address some of their water challenges.”

Water scarcity, and the insecurity it generates, have been considered for years as drivers of forced migrations, instability, and conflicts in the region. These challenges are expected to worsen in the future. Together with the increasing pressure of a growing population, it is expected that climate change will have a tremendous impact on the water sector over the next 20 years.

This will include a 2–15% decrease in water availability (if temperatures rise by an average of 2°C), and an increase of the water-scarce population (that is, inhabitants who live with less than 1000 cubic meters of water per year) to more than 250 million people.

The water management challenges Mediterranean countries face are remarkably similar, not surprisingly, because they are deeply rooted in inefficient conventional water governance systems and obsolete management practices copied wholesale from foreign countries that faced different issues in a different era.

To meet the region’s future water supply needs, it will be essential to adopt a resilient and integrated regional approach to water management, one that places cooperation at the core of the process. An integrated, collaborative framework that creates an enabling environment for all stakeholders to be heard and included is a prerequisite to developing smart solutions to the region’s multisided water challenges. A greater emphasis will also need to be placed on engaging vulnerable communities and oft-forgotten population groups such as women and youth.

Finally, regarding food, the region offers huge trade potential and economies of scale because of its geographical proximity to both Africa and Europe, and because it has fairly similar resources, consumption patterns, and tastes—especially important in food industries. Additionally, agricultural production has clear positive spillover effects for health and biodiversity and contributes to revitalizing rural areas by offering remote populations income-earning opportunities, which further strengthens territorial cohesion.

One advantage of trade liberalization that the region should exploit is its potential to occupy a competitive position in the market for certain typically Mediterranean food products. This presents an opportunity for the producing countries to create value-added benefits by adopting higher-quality standards and establishing brands, rather than just supplying intermediary products to European distributors who are glad to promote them under their own brands.

The impact of growing water scarcity on agriculture is worrisome as the sector is the main user of water. Reducing the food and energy sectors’ dependence on, and demand for, water should be an overarching objective of water-energy-food policies in this water-constrained region. Transitioning to renewable energy can contribute to making water more available while, at the same time, increasing efficiency.

21. See, for example, techniques using solar energy to desalinize water and to recycle waste products that can be used in agriculture.
reducing CO₂ emissions. To reach this overarching objective, multiple strategies can be developed and implemented to increase nonconventional water supply sources and transform energy systems toward low-carbon solutions. Increasing intersectoral collaboration will be key to addressing the challenges of the water-energy-food nexus. Regional partnerships among national, regional, and global stakeholders would promote development in less advanced economies and trust across countries, leveraging the resources and knowledge needed to develop innovative and inclusive solutions.

In integrating these three sectors—water, food, and energy—the Mediterranean could become a model for the world by promoting the usage of renewable energies to develop solutions to water scarcity, as well as more efficient agriculture practices and production techniques. In turn, more equitable access to water should also contribute to food diversification and to preserving the stability of rural ecosystems, which will be essential for territorial cohesion and climate change mitigation.

**REFLECTIONS IN THE MIDST OF THE COVID-19 CRISIS**

Even though our analysis was conducted before the onset of the COVID-19 pandemic, our approach must internalize its effects, particularly since the Mediterranean region has been greatly affected. Although some countries such as Italy, Spain, and France are being hit harder in terms of human lives lost, no country in the region has been spared its tragic effects and their associated spillovers, including at one point the negative price of oil for the first time in modern history.²²

As every country in the region is applying different measures to combat the unprecedented crisis, each is facing what appears to be a tradeoff between saving lives and saving livelihoods. The global recession that is expected to follow, generated by a double shock on demand and supply, and aggravated by the adverse effects of the health crisis on the population, will require sound monetary and fiscal policy responses to facilitate recovery and, subsequently, stimulate economic growth. Meanwhile, vulnerable population groups²³ greatly need support. Well-targeted measures must be implemented to mitigate losses in per capita income and living standards and, in some cases, even avert a humanitarian crisis.

²² Although the effect of this drop in oil price should be positive for oil-importing countries, their capacity to take advantage of the lower prices is compromised by the weakened remittance flows that are now coming from their nationals residing in oil-exporting countries—yet another sign of interconnection.

²³ The definition of vulnerability varies greatly as a function of specific country circumstances.
Facing a virus that does not respect geographical boundaries, collaboration among countries appears more relevant than ever—especially now that COVID-19’s effects have spread regionally and globally. Although every country must face its own particular set of pandemic effects, dialogue and information sharing in the search for common regional and global solutions are essential.

We must not forget that the links that connect and unite Mediterranean countries should be at the heart of any major response. In the medium term, the crisis may offer an opportunity to circumvent the lives-versus-livelihoods dilemma by promoting economic activities that build on the region’s human capital (see the section, Human capital: education, health, workforce) while also preserving and sustaining the environment (for example, restarting renewable-energy activities that also create jobs).

This is not the time to refocus on purely national, or nationalistic, priorities without looking at their implications for the entire region. On the contrary, genuinely regional responses to the challenges of the post-COVID period would significantly contribute—both symbolically and substantively—to consolidating the momentum of the effort toward Mediterranean integration.

The silver lining in this COVID cloud, if there is one, is that a crisis of national or global proportions often leads to a sense of dislocation—that can create a time-sensitive, once-in-a-lifetime window of opportunity to reconfigure ossified structures, positions, and perspectives, cast off the business-as-usual mindset, shift paradigms, and courageously embrace what might otherwise have looked like excessively radical change. That window will not stay open forever. We must not let this moment pass and thereby fritter away the opportunity—because it came at a very great cost.
The populations of the Mediterranean—understood broadly as countries around the Mediterranean Sea in the Middle East, North Africa, and Southern Europe—share what has been described as “a history built up in layers as thick as those of the history of distant China,” in the words of Fernand Braudel.24

It is in this part of the world that three great civilizations—founded on Christian, Islamic and Orthodox values—come together, have lived through the many twists and turns of history. Despite conflicts, these three civilizations continue to coexist today, no doubt in part because of the deep bonds that link their peoples, their histories, and their economies, bonds that have persisted and, indeed, transcended tensions, squabbles, empires, invasions, and assorted misunderstandings. One can choose one’s friends but not one’s relatives. Mediterranean populations share not only resilient social, cultural, and economic ties but also a common dependence upon the natural environment, and a similar understanding of the relationship between water, soil, and sun.25

Today, however, these states are also stepping into unfamiliar roles and experiencing new influences, especially in relation to Sub-Saharan Africa to the South and the rest of Europe to the North. In the process, they are discovering that the extraordinary speed at which—and the entirely decentralized manner in which—information now spreads and even goes viral is throwing into stark relief the glaring disparities among countries, and awakening mixed reactions toward the impacts of globalization. This in turn is facilitating curiosity about, and access to, both new technologies and know-how, and to distant geographical horizons.

In addition to globalization, two other inescapable forces—the technological revolution and climate change—reinforce the necessity of collaborating proactively in providing Mediterranean regional common goods, particularly in relation to the protection and development of natural resources and human capital.

The stakes are high, yet no coherent response to these developments is possible without a joint approach that respects diverse identities, tolerates differences, and emphasizes cooperation aimed at consolidating and enhancing—the wider Mediterranean region’s prominence within the global space.

The concept of integration is ordinarily understood as "the action or process of combining two or more things in an effective way." When applied to the Mediterranean context, however, it requires a deeper analysis that takes into consideration the developments and challenges currently sweeping the region, and the forces and trends that underlie and drive them.

The first issue, which will be examined briefly here, relates to the matter of common values. Every key player involved in integration will sooner or later be forced to square the circle of shared values. In both North and South, countries must be able to preserve those values that underpin and define their culture and give it its richness, dimensionality, and depth.

That much is beyond argument or controversy. But does this exempt us from the need to reflect on, discover, and name the shared values that should gradually take root and bind us in a new and larger collective identity? The answer must emphatically be no. Because integration—even integration that is confined just to the economic domain—is a powerful catalyst to transformation.

Evidence of this can be found in the principles that have gradually led to collaboration in the region over the years:

• Human rights and human dignity
• Fundamental freedoms
• Peace and the rejection of violence
• Equal opportunities
• Rational thought and the role and probative value of empirical evidence and proof
• Preservation of the ecosystem
• Personal responsibility and accountability

There is little question that certain values, important as they are, are more difficult to adopt and live with on a shared or joint basis. Examples would include the separation of powers, or the freedom of the press. That is not a cause for discouragement or resignation. What it underscores is the need for a genuine, open, and frank discussion about these issues in order to find a regional balance that works for all of us.

Nonetheless, the diversity that constitutes, shapes, and enriches the identities of Mediterranean countries must, for our own sake and for the sake of the

world, be preserved.27 History appears to give evidence that whenever a model has been imported from outside and suggested to Mediterranean populations for adoption, they have almost always attempted to resist it, preferring to preserve their own unique character, regardless of the merits of the model. These unique national identities are shaped not only by domestic life, culture, language, and customs but also by economic models, governance modalities, and institutional structures.

The populations of the Mediterranean have often been reluctant to become entirely functionalized by universal dynamics (commercial, technological, or financial) if those dynamics are beyond their understanding or appreciation. They have opted instead to maintain their own ways of life. However, things are changing. The challenges they currently face are now becoming more acute: economic and social outlooks remain uncertain, populist demands for democratization have been hindered by institutional contexts, and security is becoming a deepening and prevalent concern. It is not always clear, however, whether the goals of integration remain a mere aspiration or rather are regarded as realistic and tangible outcomes.

This means that the driving impulse behind the goal of integration needs to be stated clearly and based on a vision to build a common future, one in which differences are respected, values are shared, and region-wide objectives are pursued together. This common future is likely to be unrealizable without a clear approach to what needs to be aligned with the region’s common goals, and what may remain specific to each country.

In addition to the engagement and ownership of the process by individual countries, the international organizations of which the Mediterranean countries are members can also play an important role as external catalysts, providing support for the bonds and vectors of integration which bring countries together, rather than highlighting the differences among them.

Created in 2009, 11 years ago, the CMI brings together countries and regions in the north and south of the Mediterranean, international institutions such as the

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27. French historian and philosopher Mona Ozouf not long ago wrote:

“In my eyes, unity is unhelpful when it is imposed from above or by a dominant group. It must be constructed on the basis of our multiple belongings. Like Europe, the Mediterranean is a place of immense geographical, linguistic and philosophical diversity, yet diversity has been constantly suppressed throughout our history. The work of literary critic Albert Thibaudet (1874-1936) has convinced me that plurality is always preferable, as freedom always finds a way to burst forth like ‘a wallflower between two stones’ even when the different pluralities contradict one another. I feel a certain tenderness toward this idea: the possibility of arbitration between several different ways of living and feeling. I breathe much more freely when this freedom is preserved. For me, identity isn’t an essence but an eternally unfinished construction. It is a subjective, narrative construction.”

World Bank and the European Investment Bank, and civil society representatives to share ideas on how to realize the Center's primary aspirational goal: Mediterranean regional integration.

This book reflects on what such integration means today in light of contemporary regional and global developments, focusing on the socioeconomic aspects of the Mediterranean regional integration project.

Undoubtedly, the most effective way to strengthen the bonds between Mediterranean societies and avoid disruptive episodes is to stimulate dynamic regional economic development. Integration can help countries to (mutually) benefit from joint assets, promote sustainable growth and income-earning opportunities, and enable countries to improve their living standards and thereby minimize the disparities that build tensions.

Even a cursory examination of history indicates that countries in this region benefitted from their strategic geographical proximity, similarities in culture and language, and other shared strengths, to grow and develop. The region was even a forerunner in regional cooperation coming out of World War II, with the creation of the Arab League in March 1945, which would eventually regroup most of the MENA countries. Euro-Mediterranean partnerships increased North–South trade links with the goal of eventually achieving a European Union-Mediterranean Free Trade Area (FTA). Up until now, however, only bilateral association agreements have been concluded, mainly with a focus on developing North–South trade, while trade within the region itself has remained relatively modest in comparison to the volumes we see in other parts of the world.

Even with the multiplication of Free Trade Agreements (FTAs) and organizations such as the Greater Arab Free Trade Area (GAFTA), the Agadir Agreement, the Arab Maghreb Union, and the Union for the Mediterranean, the regional integration project has not even drawn within shooting distance of—never mind attained—the Barcelona Declaration’s vision to transform the Mediterranean basin into one of “dialogue, exchange and cooperation guaranteeing peace, stability, and prosperity.”

Since Mediterranean integration must be approached in a way that goes beyond trade flows, it is important to also track regional economic progress in other areas. Several distinct phases may be observed. In response to debt and economic imbalances, a phase of modest liberalization occurred in the early 1980s, along with vigorous economic stabilization efforts directed toward addressing macroeconomic imbalances. This period also saw more rigorous management of public accounts, with programs often supported by the World Bank. During that time, also, the awareness of the need to intensify efforts to open up to international trade began to grow.

In the 1990s, closer integration between the countries of the wider Euro-Mediterranean region became a joint objective, and Europe began to play an

increasingly important role. It started with a Mediterranean policy based on classic bilateral cooperation, providing support for macroeconomic stability, and refraining from conditional intervention. In the mid-1990s, with the Barcelona Treaty, Europe’s ambitions grew as it aimed to create “an area of shared peace and prosperity,” leading to a diversification of the instruments used, including loans.

It would be beyond the scope of this book to draw lessons from every such initiative. What is clear, however, is that with the implementation of the European Neighborhood Policy (ENP) for Eastern Europe in 2003, the geographical approach changed considerably, moving from bilateral relationships based on a mutual agreement to a new focus on the development of the region as a whole within a broader framework designed for nonmember states.29

Under this new approach, Europe would offer each of its Mediterranean neighbors access to its internal markets in exchange for certain reforms, on the basis of movements of goods (with a dual strategy built around mutual recognition and harmonization),30 services (involving a precise classification),31 and capital (requiring capital account convertibility and interest rate parity as a cornerstone of macroeconomic policy). However, Europe never adopted a common neighborhood policy with regard to the free movement of people.

European engagement with its southern Mediterranean neighbors was based largely on the implementation of a Free Trade Area (FTA). However, public transfers were relatively low in comparison with the funds allocated to Eastern Europe. This decision focused on the natural interplay of comparative advantages, intended to lead to net economic gains for all partners. Other goals, such as eradicating significant social and regional imbalances, which are difficult to correct within the framework of national institutions, were less prominently placed. Because of this, a comprehensive free trade approach, including social and redistributive aspects, was not explicitly adopted.

30. Two key processes operate here: (i) the mutual recognition of member states’ regulatory frameworks and of national security safety standards means that any product manufactured in compliance with member state legislation can freely enter the market of any other member state, and (ii) harmonization requires regulatory convergence in the areas of legislation and standards, which means navigating the 650,000 technical standards listed by Perinorm, the European standards management organization. It is therefore a complex process that is difficult to impose from the top down, as confirmed by several studies that have concluded that either a voluntary process generated by the private sector, or alternatively, the gradual rollout of mutual recognition agreements, would both be preferable to broad-based standardization.
THREE DIMENSIONS OF FREE TRADE: A CONCEPTUAL FRAMEWORK

**Free trade involves**

I. **Net monetary gain** as a result of the exploitation of each country’s comparative advantages (Ricardo). The price of imports falls while the price of exports rises, a trend mirrored by the market. The reallocation of production factors toward sectors with a comparative advantage rises to a static efficiency gain. This static gain is accompanied by (i) scale effects that are linked to the possibility of operating in a larger market, and (ii) external effects linked to technology transfer and the positioning of Global Value Chains (GVCs) driven by large multinational corporations.

II. **A natural convergence** of the average salaries among countries (Stolper and Samuelson).

III. **An internal redistribution** in each changing country: income from the factors used in sectors of comparative advantage rises (labor in particular), while income from factors located in sectors of comparative disadvantage falls in absolute terms (not only in relative terms), as does employment.

The originality of the European Union (EU) lies precisely in its ability to implement free trade among its members by imposing a common external tariff as a protective barrier (as part of a customs union), while also adopting common institutions and structural funds aimed at reducing disparities. The result has been undoubtedly impressive. The EU has provided its members with a path to convergence that is without precedent in history, despite the limitations posed by the allocation rules governing structural funds (example: a tariff reduction may not have any trade effect in areas where infrastructure or transport obstacles remain). The creation of a large single market was achieved through “top-down” structural policies that imposed significant convergence on all member states. This convergence was intended to render the adjustments more palatable (for example, the Agriculture Common Policy [PAC]) and to promote a dynamic of collaboration through the undertaking of common projects. There can be no doubt that this balance facilitated the successive enlargements of the EU and remains a key component of the European social contract to this day.

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32. This issue gave rise to widespread debate in the 1960s, with James Meade and Jacob Viner taking on a particularly prominent role in defending a universalistic perspective based on fear of trade deflection, in response to the more structuralist, protectionist stance adopted by French and German intellectuals such as Jean Marchal and Ulrich Krengel. The creation of a large single market was achieved through “top-down” structural policies that imposed significant convergence on all member states. This convergence was intended to render the adjustments more palatable (for example, the Agriculture Common Policy [PAC]) and to promote a dynamic of collaboration through the undertaking of common projects. There can be no doubt that this balance facilitated the successive enlargements of the EU and remains a key component of the European social contract to this day.
TOWARD A NEW APPROACH

It is the failure of economic models to consider and address internal redistribution needs, as underlined in the 1941 Stolper-Samuelson theorem,\(^\text{33}\) that raises questions about Mediterranean integration, particularly as a result of the social and regional disparities observed among the countries. When trade liberalization focuses primarily on technical matters, allowing monetary gains to be enhanced, without any linkages with sector reforms, the results tend to be unbalanced and disappointing.

When trade liberalization is framed in such a way that it neglects sectoral aspects, resolving trading gains \textit{ex post} through appropriate redistribution policies becomes more difficult. According to Harvard Kennedy School of Government professor of international political economy Dani Rodrik, this explains current trends toward a return to protectionism and the rise of populism.\(^\text{34}\) Rodrik also attributes the development of right-wing populism (based on culture, identity, and so on) and left-wing populism (based on social inclusion aspects) to the failure to consider the redistributive effects of trade. He writes: “Today the world economy is as open as it has ever been, and the most important challenge it faces is not lack of openness but lack of legitimacy.”\(^\text{35}\)

On the basis of this critical observation, this book aims to identify a renewed approach to Mediterranean integration based on three underpinning objectives:

1. economic efficiency, driven largely by the quest for market liberalization and free trade (through the expansion and deepening of association agreements and other bilateral instruments),
2. gradual convergence of per capita income and living standards among the countries, and
3. \textit{ex ante} inclusion and monitoring of objectives for preventing the social and territorial inequalities that tend naturally to be engendered by free trade.

First, the goal of greater economic efficiency must be pursued by liberalizing both intraregional trade barriers—among MENA countries, intraregional trade rose from 3 percent to 7 percent of total trade between 2000 and 2015—as well as trade barriers with the EU, with whom trade fell from almost 50 percent to 35 percent of total trade between 2000 and 2015. Achieving higher economic efficiency will also require expanding free trade of goods to include services and capital flows in the various locations involved, as well as with the rest of the world. This should include geographical areas whose trade with the Mediterranean has grown substantially in recent years compared to Europe.

The process of liberalization must take place gradually, taking into account the sectoral and regional upheavals it might provoke, by applying additional measures to promote inclusion and reduce the likelihood of social imbalances arising during the process.

\(^{33}\) Stolper and Samuelson, “Protection and Real Wages,” 58–73.

\(^{34}\) These trends are most notable in current relations between China and the United States, in the North American Free Trade Agreement (NAFTA), and so on.

Economic efficiency also greatly depends on the mobility of people because movement brings with it the diffusion of relevant knowledge, the exchange of new ideas, the upgrading of skills, and the transfer of techniques, and an uptick in technological innovations and scientific discoveries.

Second, the goal of convergence demands not only widespread institutional change in the South, but also greater support from international partners, especially the EU, neighboring states, and international financial institutions as part of a proactive, partnership-based, codevelopment approach. This goal also requires a coordinated approach to enhancing the attractiveness of these countries to private foreign investors. This should be based on improving the overall business environment and offering nonfiscal incentives (as opposed to unplanned ad hoc tax exemptions), as well as on coproduction schemes with SMEs, particularly those in Europe.

Finally, the goal of preventing and alleviating the social and regional inequalities inevitably triggered by market liberalization demands bold, far-reaching policies to support projects designed to provide common goods to all—in particular, education, health care, and environmental protection—along with the development of support infrastructure and access to new technologies. In the technology area, special mention can be made of the “Digital Moonshot for Africa,” the World Bank-supported African Union project to bring high-speed Internet to everyone in Africa by 2030. The goal is to reduce disparities and move closer to equalizing living standards, paying particular attention to the additional inequalities created by climate change.

In addition to ambitious, far-sighted policies, decentralized power-sharing and decision-making will be vital. Why? Considering the state of existing mechanisms, it appears highly unlikely that the region can reach its objectives of convergence and inclusion in the coming years by means of strict structural policies imposed by commonly shared, regional-level, central institutions, as the EU managed to do (albeit in a different era with a different set of circumstances). Rather, convergence and inclusion will require more decentralized processes that are based on partnerships between equals both on a regional scale and at the local level. The support of more advanced countries, especially European, will be essential in enabling codevelopment.

Based on these ideas, this book advocates a pragmatic approach. It attempts to identify the interests shared by members of subregions eager to progress together, and by stakeholders with an interest in cooperation. The book will further emphasize the potential of the region’s young people, together with its abundant natural resources and geostrategic location, serving as it does as a crossroads and bridge between the South Mediterranean and Sub-Saharan Africa.

The implementation of these common goals will require fundamental changes to institutional, legislative, and regulatory frameworks at the regional level. This will compensate for the limitations placed on individual action by countries that fail to consider the regional aspects of collective interest.

36. For example, structural reforms of state-owned companies.
CHAPTER 1
THE CURRENT LANDSCAPE OF THE MEDITERRANEAN REGION
After presenting an overview of the current economic situation in the Mediterranean basin, several axes of discussion are proposed and will be further categorized into subtopics, including these:

1. What form or forms could Mediterranean integration take?
2. Are there structural obstacles that thwart strong regional integration and economic development?
3. Can an approach be mapped out that directly involves essential actors of the North and the South?

**DEFINING THE MEDITERRANEAN REGION**

Defining the Mediterranean region is a complex and context-dependent task, in part because of the wide variety and range of factors that the institutions working in the region take into account. Different configurations are possible, depending on the context or institution under consideration. The process does not always follow strict geographical rules. It will, therefore, be necessary first to identify the relevant stakeholders in question before proceeding further.

The Mediterranean region can be defined as

- Countries that are not part of the EU but are part of the Euro-Med partnership (that is, the Barcelona Process): Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestine, Syria, Tunisia, and Turkey (note: Libya is as yet not part of this partnership)
- Countries that are currently part of the “Southern Neighborhood” policy of the EU: Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, and Tunisia (note: Turkey, being part of the EU’s enlargement agenda, is excluded)

**To those two primary definitions, we can add**

- EU countries that face the Mediterranean Sea: Spain, France, Italy, Greece, Malta, Cyprus, and Slovenia
We could further add

- Eastern European countries that are not currently part of the EU but are candidates for membership: Albania, Montenegro, and Bosnia and Herzegovina37 (note: these countries, together with Mauritania, are also part of the Union for the Mediterranean, founded in 2008).

- MENA region countries that work closely with development institutions, most notably the World Bank and the International Monetary Fund (IMF), which includes the Maghreb and Mashreq as well as Gulf Cooperation Council (GCC) countries (note: the definition of the MENA region can vary)38

- Countries that are members of the CMI’s current voluntary membership: Egypt, France (including at subnational levels), Greece, Italy, Jordan, Lebanon, Morocco, Palestine, Spain, and Tunisia

- Finally, since the CMI’s focus is on Mediterranean integration, other nonmember countries in the region are also partners and collaborators, and should therefore not be overlooked

In this book, the term “South Mediterranean Countries” (SMCs) is used in a relatively broad way to mean both North Africa and the “Southeastern Mediterranean” countries.

GROWTH AND CONVERGENCE

If by “working for shared prosperity in the Mediterranean region,”39 we mean a convergence of standards of living in the region, then the economic and financial basket that the Barcelona Process had hoped to deliver—the Declaration’s central objective—has admittedly failed to arrive. Measured in purchase power parity, Gross Domestic Product (GDP) per capita in all South Mediterranean countries is, on a good day, still less than 40 percent of the EU-28 level. Not only that, but its trajectory has been for all intents flat since 1995.

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37. Proposals have been made for the creation of a Wider European Economic Area (WEEA) that could include Serbia, Kosovo, Georgia, Moldavia, Ukraine, Morocco and Tunisia. See, for example, Michael Emerson, “The Strategic Potential of the Emerging Wider European Economic Area,” CEPS Policy Insight No. 2018-5 (2018), https://www.ceps.eu/ceps-publications/strategic-potential-emerging-wider-european-economic-area/.

38. For this book, depending on the relevance of the data, “MENA” will be used to designate all the countries of the Maghreb, Mashreq, and the Gulf (that is, Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Syria, Tunisia, United Arab Emirates, Palestine, and Yemen), as defined by the World Bank. In a more restricted sense, “MENA” will also be used to refer to a subset of these countries that includes only those that have a shoreline on the Mediterranean Sea (namely, Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, and Palestine). These are also called the Mediterranean countries. In some cases, Israel and Turkey are mentioned for comparative purposes.

A comparison with the growth trajectory of Central Europe and the Baltic (CEB) countries yields a startling contrast. Over the 1990s and 2000s, their relative GDP per capita measured in Purchasing Power Parity (PPP) exploded from less than 50 percent of EU-28 standards to 70 percent.

On a brighter note, the African Development Bank (AfDB) has observed that, since 2014, the North African region has been the second-fastest-growing region in Africa (out of five), with growth rate estimates close to 5 percent for 2018 and 2019, driven in good part by Egypt’s growth prospects.

Positive tailwinds over the years, such as oil price increases, have given a little impetus to Algeria and Libya (while signaling their need to diversify). Similarly, Tunisia’s increase in tourism in 2018 was a hopeful sign that international fears about the region’s insecurity had somewhat subsided, but in reality, instability continued to persist.

Sustained economic recovery in the region is still conditioned on factors such as Libya’s ability to restore domestic peace, and the possibility that Egypt, Lebanon, and Jordan will succeed in carrying out economic reforms in response to public discontent.

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**CONVERGENCE WITH THE EU: LITTLE IF ANY**

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<th>GDP per capita, PPP (in constant 2011 international $) of Med countries relative to EU</th>
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<td>Algeria</td>
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Source: WDI, 2018

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40. The World Bank’s classification includes Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

41. In 2018 the Tunisian Tourism Ministry observed that “the number of tourists coming to Tunisian tourist destinations exceeded five million since the beginning of the year until August [2018]. This increases the number of arrivals this season to 17.5 percent, compared to the same period last year.” Tourism Ministry, “More than 5 Million Tourists Visit Tunisia in 8 Months,” Asharq Al-Awsat, August 26, 2018, accessed October 9, 2020, https://english.aawsat.com/home/article/1374046/more-5-million-tourists-visit-tunisia-8-months.
To assess how much progress the Mediterranean region has made toward convergence since the Barcelona Declaration, it is helpful to examine whether the region lags other parts of the world in how vigorously it is participating in the global convergence phenomenon, and hence how quickly it is undergoing convergence. Is it being left behind as other regions converge toward one another under the influence of powerful globalizing processes? And if so, what can be done about it to help take advantage of global interpenetration, fusion, and diffusion of knowledge, skills and technologies?

In a 2019 study, Yu Sang Chang and his coauthors raise the issue of global convergence based on the dynamics observed in the context of globalization. They look at this issue from two classical perspectives, which help to elucidate the process.

42. See Yu Sang Chang, Hann Earl Kim, and Sung Jun Jo, “Do Globalization Indices for 141 Countries Converge Over Time?” Gachon Center of Convergence Research Working Paper No. 2019-01 (2019), accessed October 9, 2020, available at: http://dx.doi.org/10.2139/ssrn.3338319. The authors use the KOF Globalization Index, which is calculated annually from 1970 to 2013. Using a scale of 1 to 100, 100 representing the highest degree of globalization, the index measures the degree to which countries are globalized by disaggregating globalization into three components—economic, social and political—measuring and weighting each of them, and then consolidating those three dimensions into a single composite value. Economic globalization encompasses trade globalization and financial globalization, each equally weighted (50%). Social globalization comprises interpersonal globalization, information globalization, and cultural globalization, each contributing one-third. Economic, social and political globalization are weighted equally. The overall KOF Globalization Index is the average of the de facto and the de jure KOF globalization indices.
(i) the first examines the extent to which countries with lower degrees of globalization in the 1990s have caught up with the leading countries, (ii) the second considers the extent to which inequality between countries, assessed using a synthetic globalization index (including economic, social and political dimensions), has been reduced over time.

The results are presented below:

### Computed Annual Rate of Growth (CARG)

(Normalized index Sigma and Gamma for 5 sub regions 1991-2013)

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<tbody>
<tr>
<td></td>
<td>EAP</td>
<td>ECA/NA</td>
<td>LAC</td>
</tr>
<tr>
<td>Nb. of countries</td>
<td>(16)</td>
<td>(43)</td>
<td>(25)</td>
</tr>
<tr>
<td>CARG synthetic</td>
<td>-2.86%</td>
<td>-3.74%</td>
<td>-1.69%</td>
</tr>
<tr>
<td>CARG social</td>
<td>-2.16%</td>
<td>-1.96%</td>
<td>-1.81%</td>
</tr>
<tr>
<td>CARG economic globalization</td>
<td>2.86%</td>
<td>-3.55%</td>
<td>-1.70%</td>
</tr>
<tr>
<td>CARG political globalization</td>
<td>-2.89%</td>
<td>-5.30%</td>
<td>-0.94%</td>
</tr>
<tr>
<td>CARG synthetic</td>
<td>-0.10%</td>
<td>-0.23%</td>
<td>-1.51%</td>
</tr>
<tr>
<td>CARG social</td>
<td>0.16%</td>
<td>-0.36%</td>
<td>-0.98%</td>
</tr>
<tr>
<td>CARG economic globalization</td>
<td>-0.95%</td>
<td>-0.73%</td>
<td>-1.66%</td>
</tr>
<tr>
<td>CARG political globalization</td>
<td>-0.70%</td>
<td>-0.21%</td>
<td>-0.27%</td>
</tr>
</tbody>
</table>

Source: Chang et al, *Globalization Indices*44

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43. The convergence analysis attempts to examine two basic questions. First, do countries that initially lag in performance measures such as the KOF Globalization Index tend to begin to converge more quickly than the leaders, with the result that they ultimately catch up to the performance of the leading countries? Second, does dispersion of globalization among countries reduce over time? Sigma convergence in the table below indicates the speed of catch-up toward the globalization reference, while gamma convergence indicates the speed in reducing dispersion. If the value of the coefficient of slope is negative and statistically significant, that gives evidence of the catch-up process at work.


44. The World Bank organizes the globe into seven regions: East Asia Pacific (EAP), Europe and Central Asia (ECA), Latin America and the Caribbean (LAC), Middle East and North Africa (MENA), North America (NA), South Asia (SA), and Sub-Saharan Africa (SSA). Because NA has only two countries in it, it is grouped with ECA to form ECA/NA. Similarly, SA, with only 5 members, is combined with SSA to form SA/SSA. This gives the study 5 regional subgroups in all. ECA/NA and SA/SSA each have 43 countries, followed by LAC with 25 countries, EAP with 16, and MENA with 14.
These results can be interpreted as follows:

- Compared with other regions, MENA countries have, since 1991, had the lowest convergence scores in economic terms. The MENA region has converged toward globalization norms to a lesser degree than other world regions, especially the East Asia Pacific (EAP) countries, and secondly, the combined Europe and Central Asia (ECA) and North America (NA) group (ECA/NA). This is an inevitable consequence of the fact that many of the countries driving globalization are in one of these two groups.
- The MENA countries are converging with the ECA/NA group, and the most positive trajectories are those toward economic and political convergence.

Note the following two points, however:

a. In social terms, convergence is less marked in the MENA region (σ), and these countries share a lower capacity for reducing inequality (γ) in social conditions, as compared to EAP countries.

b. Finally, as the study emphasizes, convergence is significantly limited when economic growth slows down: “The annual speed of convergence estimated during the stationary period of 2007 to 2013 was only -1.64% compared to the whole period at -2.04%.”

Additional insights emerge when these results are compared with those obtained when the definition of the MENA region is extended to include oil-producing countries—a very important distinction. During the 1971–2014 period, per capita income disparities were significantly reduced among this expanded group of 19 MENA countries. For example, GDP per capita in 1971 was 4 times higher in the oil-producing countries than in the non-oil-producing countries, compared to just 2 times higher in 2014. Growth volatility was nearly 2 times higher (1.61 vs 0.86) in the oil-producing countries than in the non-oil-producing countries.

### Oil-Producing vs Non-Oil-Producing MENA Countries

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MENA</td>
<td>1094</td>
<td>6.68</td>
<td>18.36</td>
<td>4.39</td>
</tr>
<tr>
<td>Oil countries</td>
<td>746</td>
<td>11.89</td>
<td>24.95</td>
<td>4.11</td>
</tr>
<tr>
<td>Non-oil</td>
<td>348</td>
<td>3.44</td>
<td>12.73</td>
<td>4.90</td>
</tr>
</tbody>
</table>

Source: Malik and Masood, *Economic Growth*
Closer analysis reveals that a) the two groups of countries are both affected by fluctuations in oil prices; b) there are relatively strong links between the two groups primarily as a result of the circulation of people and capital; c) capital and its variations (investment) play a decisive role in the growth process; and d) the overall productivity of factors plays a relatively smaller role. On the whole, income inequality “within” the region defined broadly (19 countries) has shrunk dramatically since the 1970s.

**DEMOGRAPHIC DYNAMICS**

One cannot fully grasp the challenges and opportunities the Mediterranean region faces without looking at its demographic dynamics.

It is well known that a country’s fertility rate tends to fall as incomes rise. This is true of all Mediterranean states, although to varying degrees. For example, Tunisia, with fertility rates around 2 births per woman for more than a decade now, is already well advanced in its demographic transition. By contrast, Egypt, Jordan, and Palestine have fertility rates that are persistently above 3 or 4 births per woman.

**FERTILITY RATES IN THE MEDITERRANEAN REGION**

Source: UN DESA World Population Prospects, 2017
With rates that high, the large numbers of youth currently entering the labor market in SMCs present both a tremendous challenge and a rare opportunity. Indeed, when expressed as a share of the total population, the 20-to 29-year-olds have in recent years been hitting a peak in most of the SMCs, often close to 20 percent of the total population. Even though this share is now starting to decline, in absolute terms, the headcount will keep increasing rapidly, especially in those countries with particularly high fertility rates.

In Jordan and Egypt, it is projected that the population growth rate will remain high (and even higher in Palestine) for the next few decades, but on a different scale. By 2050, it is projected that the populations of Jordan and Egypt will each exceed 150 million people and, when combined, will account for almost half (44 percent) of the entire region’s population growth. What this means is a rapidly growing labor force in Jordan and Egypt, together with the need for more dynamic job creation assisted by strong intraregional trade and investment linkages—including with Southern Europe—as well as linkages to the rest of the globalized world.

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52. This projection of 44 percent represents the "Medium Variant" scenario (out of several scenarios with different starting assumptions) calculated by the United Nations. It is based on the populations of Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, Tunisia, and Turkey.
Population growth rates are expected to begin to stabilize around 2040. Meanwhile, the next several decades will be decisive in determining whether the region will benefit from what experts refer to as “the demographic dividend.” This dividend will be reflected in additional growth and a reduction in the age-dependency ratio.

Young people ages 0–24 years, who currently represent about 50 percent of the MENA region population, will play a central role in shaping the long-term future of the region over the next 20 years. It is essential—that through education, job availability, and social engagement—that this age group be given the means to take bold collective actions with no fear of discrimination based on gender or other traits, in order to ensure that the region benefits from this dividend, which will evaporate by the time the second half of the 21st century gets under way. The window of opportunity is finite and quite likely unrepeatable.

**YOUTH POPULATION GROWTH TRENDS**


53. Based on the populations of Algeria, Bahrain, Djibouti, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, United Arab Emirates, Palestine, and Yemen.
EGYPT'S DEMOGRAPHIC BOOM

Population in their Prime Age (ages 25–54 years) (medium variant case projections after 2015)

- Egypt
- Syria
- Libya
- Lebanon
- Israel
- Tunisia
- Algeria
- Turkey
- Palestine
- Morocco
- Jordan

Source: UN DESA World Population Prospects, 2017

A FAST-GROWING NORTH AFRICAN WORKFORCE

Population in their prime age (ages 25–54 years) (medium variant case projections after 2015)

- Europe- Prime Age (25-54)
- Europe- Share of Prime Age (25-54, %)
- Northern Africa- Prime Age (25-54)
- Northern Africa- Share of Prime Age (25-54, %)

Source: UN DESA World Population Prospects, 2017
HUMAN CAPITAL: EDUCATION AND WORKFORCE

Human capital is not merely a static stock but an ever-changing, multifactor, dynamic variable that is affected by many elements: the availability of schooling, its quality, access to good nutrition, health care, job opportunities for educated men and women, cultural constraints, the quantity and quality of globalization linkages, the level of labor demand from the private sector, and the degree of inclusivity in the reintegration of young people who leave school early and are unable to make a living—the so-called NEETs (Neither in Employment, Education nor Training).

The World Economic Forum’s Global Human Capital Report for 2017 defines human capital as “the knowledge and skills individuals possess that enable them to create value in the global economic system.”54 A key feature of the Report is the Global Human Capital Index (GHCI). The GHCI has four components:

1. **Capacity**: quantifies the existing stock of education across generations
2. **Deployment**: covers active participation in the workforce across generations
3. **Development**: reflects current efforts to educate, train and upskill the student body and the working age population, and
4. **Know-how**: captures the growth or depreciation of working-age people’s skillsets through opportunities (or missed opportunities) for higher value-added work

Employing these metrics, the outcome for SMCs is worrisome. Maghreb countries are among the worst performers, with southeastern Mediterranean countries faring slightly better. The deployment subindex sticks out as one of the worse indicators here. That is not surprising since this index captures unemployment rates, labor force participation rates, and gender gaps, all of which are a huge challenge in these countries. On the other hand, the development subindex, which is often the best score, is positively influenced by high enrolment rates in primary and secondary schools, but negatively influenced by the poor quality of schooling.

<table>
<thead>
<tr>
<th>RANKING (OUT OF 130)</th>
<th>HUMAN CAPITAL INDEX</th>
<th>CAPACITY SUB-INDEX</th>
<th>DEPLOYMENT SUB-INDEX</th>
<th>DEVELOPMENT SUB-INDEX</th>
<th>KNOW HOW SUB-INDEX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Morocco</td>
<td>118</td>
<td>106</td>
<td>121</td>
<td>99</td>
<td>108</td>
</tr>
<tr>
<td>Algeria</td>
<td>112</td>
<td>113</td>
<td>115</td>
<td>82</td>
<td>103</td>
</tr>
<tr>
<td>Tunisia</td>
<td>115</td>
<td>110</td>
<td>127</td>
<td>78</td>
<td>73</td>
</tr>
<tr>
<td>Egypt</td>
<td>97</td>
<td>80</td>
<td>126</td>
<td>86</td>
<td>50</td>
</tr>
<tr>
<td>Jordan</td>
<td>86</td>
<td>46</td>
<td>129</td>
<td>56</td>
<td>45</td>
</tr>
<tr>
<td>Turkey</td>
<td>75</td>
<td>83</td>
<td>108</td>
<td>46</td>
<td>59</td>
</tr>
</tbody>
</table>

Source: World Economic Forum

**Education**

Indeed, in terms of school enrollment rates—essentially, the “quantity” of education—SMCs are generally not far behind European standards, at least in primary and secondary education (see annex 1 and graph 1.1.1 for the main comparative data related to the Euro-Mediterranean region).

In tertiary education, the girls are doing relatively well. For most countries, the gender gap is favorable for women.

However, the relatively high rates of school enrollment serve to conceal the reality of very unequal access to education. Close to 60 percent of the youth in the poorest quintile receive less than 4 years of education in total.

Ultimately, the Maghreb countries are troublingly behind in tertiary education, with enrollment rates ranging from less than 20 percent in Morocco to 40 percent in Tunisia, compared to about 60 percent in Europe.55

The 2019 World Bank Human Capital Index (HCI) brings valuable information to policymakers and makes them more accountable in terms of engaging necessary reforms. The Human Capital Project states:

The HCI measures the amount of human capital that a child born today can expect to attain by age 18. It conveys the productivity of the next generation of workers compared to a benchmark of complete education and full health.56

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### HUMAN CAPITAL AND GENDER IN THE MEDITERRANEAN

**HUMAN CAPITAL INDEX (HCI) RANKING FROM 0 TO 1**

<table>
<thead>
<tr>
<th>Country</th>
<th>OVERALL HCI</th>
<th>BOYS HCI</th>
<th>GIRLS HCI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>0.52</td>
<td>0.50</td>
<td>0.54</td>
</tr>
<tr>
<td>Morocco</td>
<td>0.50</td>
<td>0.49</td>
<td>0.51</td>
</tr>
<tr>
<td>Mauritania</td>
<td>0.35</td>
<td>0.34</td>
<td>0.36</td>
</tr>
<tr>
<td>Tunisia</td>
<td>0.51</td>
<td>0.49</td>
<td>0.53</td>
</tr>
<tr>
<td>Libya</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Egypt</td>
<td>0.49</td>
<td>0.47</td>
<td>0.51</td>
</tr>
<tr>
<td>Israel</td>
<td>0.70</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Palestine</td>
<td>0.55</td>
<td>0.53</td>
<td>0.58</td>
</tr>
<tr>
<td>Jordan</td>
<td>0.56</td>
<td>0.54</td>
<td>0.59</td>
</tr>
<tr>
<td>Lebanon</td>
<td>0.54</td>
<td>0.54</td>
<td>0.54</td>
</tr>
<tr>
<td>Syria</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Turkey</td>
<td>0.63</td>
<td>0.63</td>
<td>0.63</td>
</tr>
</tbody>
</table>

Source: WEF, *Global Gender Gap Report, 2018*

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The labor market

The above results come into a clearer perspective when the basic facts of the Mediterranean region labor market are examined. Labor markets in South Mediterranean countries tend to share several challenges including the low labor market participation of women, and high unemployment rates.

The table below provides insights into the status of women in the workforce, using three types of data:

1. The Participation Gap: the difference between women and men in labor force participation rates (0 meaning no participation of women, and 1 meaning participation equal to men)
2. The Remuneration Gap: the difference in income received (1 being wage equality between women and men)
3. The Advancement Gap: the ratio of women to men among legislators, senior officials and managers, and the among technical and professional workers (1 meaning an equal number of women and men among legislators, senior officials, and managers)

We can see from the table that, in the MENA countries, the participation of women in the labor market tends to be low, with an average score of 0.381 (versus 1.000 for men). Women also tend to be paid less than men when working in the same positions (with an average score of 0.607) and have significant difficulties in attaining higher positions (the advancement gap score is 0.171 average percent, weighted by population).

<table>
<thead>
<tr>
<th>GENDER GAP IN THE MEDITERRANEAN LABOR MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>PARTICIPATION GAP</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Algeria</td>
</tr>
<tr>
<td>Morocco</td>
</tr>
<tr>
<td>Mauritania</td>
</tr>
<tr>
<td>Tunisia</td>
</tr>
<tr>
<td>Libya</td>
</tr>
<tr>
<td>Egypt</td>
</tr>
<tr>
<td>Israel</td>
</tr>
<tr>
<td>Palestine</td>
</tr>
<tr>
<td>Jordan</td>
</tr>
<tr>
<td>Lebanon</td>
</tr>
<tr>
<td>Syria</td>
</tr>
<tr>
<td>Turkey</td>
</tr>
</tbody>
</table>

Source: WEF, Global Gender Gap Report 2018

Additionally, young adults ages 20–24 who have less than 4 years of education, suffer from high youth unemployment, especially among the tertiary-educated. When the gender gap in youth labor participation is combined with the gender gap in unemployment (that is, by looking at the employment rate), it becomes clear that women in South Mediterranean countries (excluding Turkey) are much less likely than men to be employed.

Examining unemployment by the level of education reveals a clear contrast between the SMCs and the Northern Mediterranean (European) countries.

Sources: UNESCO World Inequality Database on Education; IMF staff calculations


59. It is relevant to note that enrollment rates in tertiary education for men in Turkey are the highest in the region (see annex 1, graph 1.2.4).

60. MENAP includes Afghanistan, Egypt, Iran, Iraq, Jordan, Mauritania, Pakistan, Soudan, Tunisia, Palestine and Yemen. Emerging Asia (EM Asia) includes Indonesia, Korea, Malaysia, the Philippines, Taiwan Province of China, Thailand, and Singapore. Emerging Europe (EM Europe) includes the Czech Republic, Hungary, Poland, Romania, Russia, Turkey, and Ukraine.
Even during periods when the latter group has experienced high overall unemployment, unemployment has remained historically relatively low for people with advanced degrees. This is the reverse in SMCs, where unemployment rates for the highly educated exceed 40 percent in Tunisia and Palestine.

This result is driven by two factors:

- On the demand side, poor economic performance and sluggish growth over the last several decades have made it very difficult for the private sector to create enough jobs to keep up with a rapidly growing labor force.
- On the supply side, the relatively poor quality of education has created both a skills mismatch and a skills gap. That is to say, much of the potential workforce simply lacks the requisite skills to be hired (skills gap), and those who do have some skills often try to enter the job market with a skill set that is not only inadequate but also less applicable, less transferrable, and less relevant than it should be, in the light of the market’s current demands (skills mismatch).

Additionally, when one factors in the so-called NEETs—the large numbers of young people no longer in school (often as a result of being abandoned by their family) and neither employed nor in training—it becomes all the more clear that this is an issue that is affecting the entire academic education and training system.

Indeed, as indicated in the following chart, the MENA region has a large number of school dropouts. Among Mediterranean countries, Egypt has the most egregious situation, with 63 percent of children of school age not enrolled in primary education. Palestine, and Jordan, at 52 percent and 48 percent, respectively, are also encumbered by this social issue. In contrast, Lebanon has the region’s highest enrollment rate, with 98 percent of children at pre-primary school age enrolled.

### SHARE OF CHILDREN OF PRE-PRIMARY SCHOOL AGE NOT ENROLLED IN PRE-PRIMARY NOR IN PRIMARY EDUCATION IN 2013, BY COUNTRY

<table>
<thead>
<tr>
<th>Country</th>
<th>Not in school</th>
<th>In pre-primary or primary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yemen</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Djibouti</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iraq</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Egypt</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Palestine</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sudan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Jordan</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Syria</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bahrain</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tunisia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UAE</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Qatar</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Algeria</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kuwait</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lebanon</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>


POVERTY AND INEQUALITY

Recent research, drawing upon several data sources, indicates that the MENA region still has pronounced country-to-country differences in the numbers of people living in poverty. Levels of inequality are among the highest in the world (Alvaredo, Assouad, and Piketty, 2017).63

In financial terms, the top decile (10%) and top percentile (1%) of people in the MENA region enjoy the highest share of total regional income, of all the regions in the world. The top decile control 64 percent of total income in MENA; the top 1 percent command 30 percent (nearly one-third) of total income.

The Gulf states, rather than the southern or eastern Mediterranean countries, are the ones primarily responsible for these stark inequalities. Yet even when the Gulf states are left out of the calculation, there is still more income disparity in the southern and eastern Mediterranean countries than there is in the United States or Europe, with the top decile commanding more than 50 percent of total income.

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POVERTY RATES CALCULATED AT THREE DIFFERENT THRESHOLDS (2017)

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Source: WDI (data for all countries are from 2017, except for Tunisia)

Source: WID.World

### TOP 10% INCOME SHARES, 1990–2016: MIDDLE EAST VS OTHER COUNTRIES

Distribution of pretax national income (before taxes and transfers, except pensions and unemployment insurance) among Equal-split series (income of married couples is divided by 2).

Source: WIR, 2018
INTERNAL AND EXTERNAL IMBALANCES

Since the 2010s, all the SMCs have been burdened with high levels of public deficit, often even higher than those of the Northern Mediterranean countries when they were saddled with the Euro-debt crisis. The public sector’s share of GDP is typically smaller in the SMCs than in European countries. In this regard, the quality of spending is the biggest issue.64 Much has been said about the need to transform the social contract that prevails in many Arab states, but there is significant dissatisfaction with the inefficiency of SMC governments and skepticism about their commitment to providing public services equitably across all social strata.

Tax revenues are often too low to provide adequate funding for social spending, infrastructure, and other priorities; and such spending, as there is, often disproportionately benefits the wealthier segments of society at the expense of the poor.

Reorienting spending away from generalized subsidies and toward public goods, tackling wastage and corruption, and widening tax bases and making them more equitable would certainly be conducive to inclusive growth.65

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>TAX REVENUE (% OF THE GDP)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>-</td>
</tr>
<tr>
<td>Egypt</td>
<td>12.5 (2015)</td>
</tr>
<tr>
<td>Israel</td>
<td>24.6 (2017)</td>
</tr>
<tr>
<td>Jordan</td>
<td>15.0 (2017)</td>
</tr>
<tr>
<td>Lebanon</td>
<td>15.3 (2017)</td>
</tr>
<tr>
<td>Libya</td>
<td>-</td>
</tr>
<tr>
<td>Morocco</td>
<td>21.8 (2017)</td>
</tr>
<tr>
<td>Palestine</td>
<td>-</td>
</tr>
<tr>
<td>Syria</td>
<td>-</td>
</tr>
<tr>
<td>Turkey</td>
<td>17.9 (2017)</td>
</tr>
</tbody>
</table>

Source: World Bank

Regarding external imbalances, it can easily be observed that, in the last few years, a shared feature of South Mediterranean partners has been a current account deficit (except for Algeria, up until the sharp decline in oil prices that

started around 2014), which goes hand in hand with their government budget deficit ("Twin deficits hypothesis").

Current account deficits may lead to short-term capital inflows in countries whose financial systems are not developed enough to absorb or allocate them efficiently. The risk or fear of a sudden stop in capital inflows can force countries to take difficult measures to rebalance their external accounts. (A good example would be the 1997–1998 Asian financial crisis). In this regard, Salman et al (2018) argue that large and persistent external imbalances are a challenge to the MENA region in general but not to the same extent for every country.

Their arguments are in fact borne out. Non sustainability appears to characterize the cases of Algeria and Tunisia, but for countries such as Egypt and Morocco, the evidence of current-account unsustainability is mixed, while for Jordan and Lebanon current account unsustainability is econometrically rejected.

**CURRENT ACCOUNT BALANCE**

![Diagram showing current account balances for various countries over time.]

*Sources: WEO 2018 and WDI*

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66. From national accounting, the current account balance (CA) can be written as the sum of the private savings balance and the government balance: CA = (S-I) + (T-G) where S and I are private savings and investment, respectively, and T and G are public revenues and spending, respectively.


In terms of short-term prospects, the IMF sees some positive developments in the region.

Following three years of decline, exports of oil-importing countries in the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) grew by 6.4 percent in 2017 and were projected to accelerate by 8.4 percent in 2018 and 8.6 percent in 2019. This largely reflects improved external demand, greater exchange rate flexibility (Egypt and Tunisia), gains in competitiveness (Morocco and Tunisia), and a pickup in the prices of phosphates (Morocco and Tunisia).\(^{69}\)

Overall, Salman et al (2018) suggest that although external and internal balances represent a challenge for several South Mediterranean countries, these balances do not seem to justify the great deal of attention paid by many SMCs to fiscal consolidation. Instead, a monetary policy-oriented emphasis on correcting currency misalignments, and a business policy-oriented emphasis on addressing issues of international competitiveness, exports, and foreign investment, would be much more relevant to identifying and resolving major threats to these economies.

**PRIVATE SECTOR DEVELOPMENT: THE BUSINESS ENVIRONMENT**

Some SMCs have in recent years engaged in reforms to improve their business environment. Although some countries have a good ranking, most still compare poorly with other countries of similar income levels, according to the World Bank’s “Doing Business” rankings.

**EASE OF DOING BUSINESS AND COMPETITIVENESS**

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As highlighted in the preceding section, despite the major demographic shift that is occurring in the region, resulting in a gradual but sustained decline in the proportion of youth, the prime working-age population of the MENA region is expected, on average, to keep growing over the next several decades. With the public sector’s limited prospects for increasing employment, the private sector will have to step in and grow rapidly enough to meet the burgeoning labor supply. This will need to take a multi-pronged approach. For instance, opportunities for entrepreneurship and enterprise creation will need to be exploited aggressively and creatively. To enable this, it will be crucial for the MENA region to have the kind of business environment that facilitates the emergence, financing, and growth of a diversity of enterprises that not only need increasingly skilled human capital in order to continue expanding and innovating but also can train and employ them.

It would be oversimplifying the story to say that firms across the SMCs all face the same set of growth issues and constraints, but with that said, political instability seems to be a common challenge that occurs almost uniformly throughout the region—a bit less for Morocco and Jordan than the others. Because the most recent surveys were mainly done in 2013, soon after the “Arab Spring,” it is not surprising that political instability is consistently the number-one negative influence on growth and capacity to do business mentioned by both domestic and international firms doing business in the region.

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70. According to UN projections, Lebanon is the exception in the region, with a prime working age population that is expected to fall gradually after 2020.
Today, the fragility of the political and security situation in the region certainly does not help to attract foreign investment nor develop economic relations across borders.

Other constraints that are common to several countries in the region include the lack of access to finance and, secondly, the existence of a relatively large informal sector whose size and persistence are fueled by the continuing debilitating effects of unfair competition and rent capture.

In their assessment of what is holding back the private sector in the eight Mediterranean countries\(^1\) within MENA, the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), and the World Bank jointly note that small and medium-sized enterprises “typically experience a more challenging environment.”\(^2\) They are more subject to competition from the informal sector, are more credit-constrained, and are sometimes completely disconnected from the banking sector. High-paying jobs in the private sector remain scarce, the report notes. On a brighter side, it observes that “economic fundamentals seem to be at work in the formal private sector,” this being apparent in the fact that “it is the more productive firms that are the most likely to grow.”\(^3\)

### BEST PERFORMING COUNTRIES – 2018 RANKING

<table>
<thead>
<tr>
<th></th>
<th>Algeria</th>
<th>Egypt</th>
<th>Jordan</th>
<th>Lebanon</th>
<th>Libya</th>
<th>Morocco</th>
<th>Tunisia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Doing Business(^4) (World Bank)</td>
<td>166</td>
<td>128</td>
<td>103</td>
<td>133</td>
<td>185</td>
<td>69</td>
<td>88</td>
</tr>
<tr>
<td>Global Competitiveness Index(^5) (World Economic Forum)</td>
<td>86</td>
<td>100</td>
<td>65</td>
<td>105</td>
<td>-</td>
<td>71</td>
<td>95</td>
</tr>
</tbody>
</table>

**Sources:** EBRD, EIB, World Bank and WEF

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71. Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, Palestine, and Yemen.
73. EBRD, EIB, and World Bank, *What’s Holding Back the Private Sector?*
The most cited obstacles to typically encounter companies in SMCs are

- **Political instability**, which sits at the top of the list for all countries except Morocco (where that position is held by corruption)
- **Inadequate access to finance**, indicated as one of the main obstacles in the selected countries
- **Inadequate access to a skilled workforce**, especially in Tunisia, Morocco, and Jordan
- **Corruption and the informal sector**, especially in Morocco and Lebanon, where a particular emphasis was placed on these two factors, with corruption being the main impediment to the development of the private sector cited in Morocco

**TRADE OPENNESS**

Trade openness is often considered the first step toward integration. Lebanon and Jordan are the most open to trade, partly driven by their greater participation in services trade (although it has recently declined somewhat in Jordan, where it was closer to 40 percent during the 2000s). Tunisia and Morocco are also relatively open economies with a strong orientation toward Europe.

However, to better gauge each Mediterranean country’s degree of openness, it is useful to look at their relative position by exploring the relationship between trade openness and the size of the country (as measured by population). The trend shows that smaller countries, as expected, tend to be more open since they must look beyond their small domestic markets to source cheap inputs for producers, product variety for consumers, and expanded market access for exporters.76

By this measure, countries such as Jordan, Tunisia, and Morocco appear to be more open than Algeria, Egypt, and Turkey.

Certainly, some degree of liberalization and openness are thought to have played an important role in the successful development stories of countries such as China and the Republic of Korea, but liberalization and openness are not, by themselves, sufficient. Development depends on many additional factors, including the macroeconomic environment, the quality and capacity of institutions, level of infrastructure, human capital, industrial policies, capital flow regulations, and so on.77

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Finally, one striking fact about the South Mediterranean countries is the extent of under-trading among themselves. This is true both for the North African countries alone, and for the Greater Arab Free Trade Area (GAFTA), which includes the Gulf countries. The following chapters will present more data on the composition of trade in each South Mediterranean country with regards to products and destination.

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It would be highly beneficial for the MENA region to continue promoting greater trade liberalization and diversification, based more on technical advances and the overall productivity of factors. This would require significant progress in human capital, extensive institutional reform, and a deepening of relations with Europe with a view to implementing a codevelopment approach.
CHAPTER 2
NEW AND EXPANDING DIMENSIONS OF REGIONAL INTEGRATION
A recurring theme throughout this second chapter is that regional integration is a multifaceted concept, “a process in which neighboring states enter into agreements in order to upgrade cooperation through common institutions and rules.”

To set the concept of regional integration apart from other terms such as regional cooperation, regional organization, or regionalism, Haas (1970) argues that, “the study of regional integration is unique and discrete from all previous systematic studies of political unification because [it is limited] to noncoercive efforts (...) it is concerned with explaining how and why states cease to be wholly sovereign, how and why they voluntarily mingle, merge, and mix with their neighbors so as to lose the factual attributes of sovereignty while acquiring new techniques for resolving conflicts between themselves.”

Integration can therefore be defined as a process in which “larger groupings emerge or are created among nations without the use of violence.” Such groupings can be said to exist at a variety of different analytical levels. At each level, we can conceive of a number of nations linked to one another in certain salient ways.

For example, their populations may be linked by feelings of mutual amity, confidence, and identification. Or their leaders may hold more or less reliable expectations—which may or may not be shared by the populations—that common problems will be resolved without resorting to large-scale violence. Or a grouping might be defined as an area that is characterized by intense concentrations of economic exchange or the free circulation of productive factors such as labor, capital, and services.

79. There are a number of different definitions of regional integration in the literature, drawing from several of those definitions, the purpose of this analysis is to discover how the different dimensions of regional integration apply to the Mediterranean.
81. Ibid.
“In describing these phenomena, we refer to a social union, a security union, an economic union and a political union that can be said to occur when the linkage consists of joint participation in regularized, ongoing decision-making.”  

The perspective taken here is that international political integration involves a group of nations coming together to regularly make and implement binding public decisions by means of collective institutions and/or processes, rather than using formally autonomous national means.

In the Mediterranean region, integration has been pursued primarily in the form of trade agreements that focus on progressively lowering tariffs for manufactured goods and, to a lesser extent, for agricultural goods and services. The economic rationale has been that trade can bring benefits to all its participants through the exploitation of each nation’s comparative advantages, better access to markets, economies of scale, and increased competition. Yet integration does not consist just of enhancing trade; full integration encompasses many other dimensions, including security, the mobility of people, climate change resilience, the convergence of norms, and so on.

Our present objective is to explore vectors of economic integration that match the specific characteristics and answer to the needs, of Mediterranean countries. In addition to looking at the what of integration, we want to show why it is relevant to the region, and offer recommendations about how it could be achieved over the next several years.

We will first review what the literature says about the why, the potential benefits of regional integration through trade and beyond, then look at the multidirectional aspect of integration opportunities for the Mediterranean region. Chapter 3 will then thoroughly analyze some dimensions of integration that are relevant to today’s context.

**DIFFERENT DIMENSIONS OF MEDITERRANEAN INTEGRATION**

In the 20th century, the role of trade liberalization in integration changed significantly by going beyond trade. Today, although trade liberalization continues to provide the initial impetus, it takes new forms in response to the types of goods traded, development of new services, and links with foreign investors.

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82. Leon N. Lindberg writes: “Political integration implies that a number of governments begin to create and use common resources to be committed to the pursuit of certain common objectives, and that they do so by foregoing some of the factual attributes of sovereignty and decision-making autonomy, in contrast to more classical modes of cooperation such as alliances or international organizations.” (Leon N. Lindberg, “Political Integration as a Multidimensional Phenomenon Requiring Multivariate Measurement,” *International Organization* 24, no. 4 (Autumn 1970): 648–731, accessed October 10, 2020, http://www.jstor.org/stable/2706150).

83. The goal of achieving this broader definition of Mediterranean integration has been the “raison d’être” of the Center for Mediterranean Integration since its inception.
Moreover, the goal of regional integration cannot be justified merely in terms of proximity. It must provide added value in comparison with multilateral and bilateral customs liberalization, while also being compatible with these measures. Integration must also strengthen cohesion in the region, form part of a common long-term project, and produce externalities and dynamics that boost the influence of the participating countries and regions.

In short, integration through trade is a dimension that must be situated in a broader socioeconomic framework that includes from the outset the development of trade in goods and services, together with the links between those trade exchanges and investment, employment, and broader socioeconomic development at the regional level.

Much of the economic literature of the last few decades about “regional integration” has tended to focus on preferential trade liberalization among regional partners, essentially, regional trade integration. However, the growing importance of the knowledge economy, climate change, migration pressures, security, and other new challenges has increasingly directed the spotlight toward other types of regional cooperation that might offer solutions.

Trade liberalization continues to be an important way of integrating countries, especially in the Mediterranean region where there is still much room for improvement in formulating tariff and non-tariff mechanisms for reducing barriers to trade. But the concept of integration has expanded and deepened as new challenges have come to the fore in international relations.

For that reason, this analysis seeks to answer the following questions:

- Why integration at the regional level rather than at multilateral or bilateral levels?
- How has regionalism evolved over time, and to what extent is regional integration through trade still relevant? What are the theoretical arguments underlying its role in promoting economic growth and convergence among partners?
- What other vectors of integration are there beyond trade? Could regional-level trade integration be a vector of cooperation in certain other areas that are not of an explicitly economic nature—in other words, “issue linkages”?

1. TRADE INTEGRATION FOR ECONOMIC DEVELOPMENT AND CONVERGENCE

Trade integration can be a legitimate and vital part of a national development strategy to foster its economic growth, but that does not mean it should be pursued under all circumstances and in any format. In addition, even though unilateral trade liberalization is an option, trade integration often takes the form of bilateral or regional agreements and policies over which countries cannot make unilateral decisions.

According to Selina Jackson, “no country has developed successfully, in modern times, without harnessing economic openness to international trade, investment, and the movement of people,”84 therefore, it is crucial to understand how trade policy contributes to growth and development.

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84. Jackson, “Growth and Development.”
“Harnessing” here also means that, at a national level, countries should implement reforms (specific to their circumstances) that would improve their competitiveness.85

Even if trade policy succeeds in creating new trade flows among partners, this does not necessarily guarantee higher growth.86 Although studies using firm-level data often find that trade liberalization has positive effects on firm performance,87 the empirical evidence for the relationship between a country’s trade policy and its aggregate economic growth is less robust.88 Is it possible to identify and unpack the theoretical underpinnings of the positive effect of trade on growth?

In addition to “traditional gains” from trade creation (that is, static gains from specialization coming from differences in technology or endowments),89 the economic literature has identified other potential channels through which regional (trade) integration affects growth.90 New trade theories underline the fact that the value of regional Free Trade Agreements (FTAs) is not just

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86. Concerning this endogeneity problem, Goldberg and Pavcnik write: “To the extent that there is a positive relationship between trade policy and economic growth, it is not clear whether trade policy leads or lags. Does trade policy lead to higher economic growth or do countries at a certain level of development choose to implement more liberalized trade policy? Alternatively, do countries with less restrictive trade policy in general have economic institutions in these economies that are associated with higher growth?” See Pinelopi Goldberg and Nina Pavcnik, “The Effects of Trade Policy,” CEPR Discussion Paper No. DP11104 (2016), accessed October 10, 2020, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2733077; PDF version: http://www.econ.yale.edu/~pg87/Handbook_GP.pdf.


88. “The more imaginative instruments that have been used to explore causation in cross-country studies have increased the faith that we can have in this relationship, although not, of course, to a position of total certainty and certainly not to be able to state that every trade liberalization by every country will generate growth.” L. Alan Winters and Andrew Masters, “Openness and Growth: Still an Open Question?” Journal of International Development 25, no. 8 (2013): 1061–1070, accessed October 10, 2020, https://doi.org/10.1002/jid.2973.

89. See Ricardian or Heckscher Ohlin-Samuelson models.

the possibility of benefiting from interindustry trade based on comparative advantages, but also of having access to better intermediate goods because of the greater variety, and of using intraindustry trade as a new engine of growth driving the regional integration process.91

Indeed, “a [...] robust finding of the literature on firm productivity is that input tariffs have large negative effects on firm productivity, often much larger than the ones found for output tariffs”92 Amiti and Konings (2007), Khandelwal and Topalova (2011).

This indicates that countries at similar stages of development and economic structures can still gain from trade liberalization.

Discussing the effect of trade policy, Goldberg and Pavcnik93 remind us of the potential dynamic gains of trade policy and suggest some promising areas of future work such as

• the role of price adjustments in changing trade policy
• the impact of trade policy on the performance and organization of firms94
• the effects of trade policy through reductions in secondary distortions or misallocations

The removal of “X-inefficiencies”95 or “secondary distortions” has also been studied. For example, Khandelwal, Schott, and Wei (2013) studied the elimination of an embedded institution that misallocates trading rights, in the case of the Multifibre Agreement with China,96 and found that the misallocation of factors occurred because of distortions such as public overinvestment, subsidies in

inefficient industries, policy capture, and rent-seeking behavior. Jaud and Freund (2015)\textsuperscript{97} found that trade policy indeed affects market structure.

Regional trade agreements can also reduce uncertainty about trade policy by committing countries to a specific trade policy regime on a longer-term basis, which could bring larger benefits than merely reducing tariff rates, especially in a political and economic environment as uncertain as it is the case in the Mediterranean region.\textsuperscript{98}

Endogenous growth theories underline the role of technological progress, the knowledge economy, and the quality of institutions in helping countries to converge (conditional convergence). Regional integration (including but not limited to trade) could help disseminate knowledge and build stronger institutions in developing countries.\textsuperscript{99}

But trade liberalization also has its adverse implications. For example, a reallocation of capital and labor induced by trade, even if it is in some sense proven to be “more efficient,” rarely happens as smoothly as the rosy predictions of some models would have us believe. Some workers are very likely to lose their jobs, and inequalities between rural and urban areas may be exacerbated because certain regions may be negatively affected by the ongoing reallocation while others benefit from and thrive in it.

These adverse effects are even stronger in developing countries because they typically have weaker institutions, fewer and less effective social safety nets, fewer mobility and reskilling programs, and so on. Thus, more attention needs to be given to the mechanisms that are needed to help manage these adjustments and minimize their negative impact on the poor and the vulnerable, who are the least able to pick up from where they left and support themselves after experiencing an adverse shock.\textsuperscript{100}


Also, if the logic of the comparative advantage of different endowments is followed too rigidly, it is possible for a developing country to become trapped in labor-intensive activities or primary commodity exports that have low value added, or engage in pollution-intensive low-tech industries at the expense of the sustainability of its ecosystem and the health of its citizens.

Additionally, regional-level trade agreements (those with a common external tariff or strict rules of origin) can lead to trade diversion:101 that is, substituting regional imports with lower-cost imports from outside the group because of discriminatory tariff liberalization, often leading to losses in efficiency.

In the following sections, we will see that regional integration through the establishment of trade agreements can be part of the effort to improve cooperation in other areas and to commit to better domestic policies, thus fostering sustainable development in the region.

<table>
<thead>
<tr>
<th>TRADE THEORIES</th>
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<td><strong>GAINS FROM TRADE (CAUSES)</strong></td>
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<td><strong>TRAIDITIONAL TRADE THEORY</strong></td>
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<tr>
<td>Specialization</td>
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<td>Economies of scale</td>
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<td>Pro-competitive</td>
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<td>Variety</td>
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<td>Aggregate productivity (through selection/ reallocation)</td>
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<td><strong>TRADE PATTERNS</strong></td>
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<td>Inter-industry</td>
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<td>Intra-industry</td>
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<td>Exporters and non-exporters within industries</td>
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<tr>
<td><strong>DISTRIBUTION</strong></td>
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<tr>
<td>Trade liberalization affects relative factor rewards</td>
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</table>

Source: WTO World Trade Report, 2008

101. To the extent that the current regionalism is relatively outward-looking and seeks to be open to international commerce instead of closed, trade diversion might be kept in check.
2. THE EMERGENCE OF REGIONAL TRADE INTEGRATION

In the years following World War II, starting in 1948 when it went into effect, the General Agreement on Tariffs and Trade (GATT)—eventually replaced in 1995 by the World Trade Organization (WTO)—became the engine of multilateral trade liberalization. There were several multi-year rounds of negotiations, but GATT left open the possibility of establishing regional Free Trade Areas (FTAs).

Regional trade integration can range from the simple removal of tariffs on certain goods to the covering of non-tariff barriers for many goods and services, including investment policies, and ultimately to an entire economic union. This process implies that political cooperation can take different forms (for example, intergovernmental or supranational) according to the preferences of member countries.

The preceding section outlined the potential benefits of trade openness for economic development. Assuming that they are valid, a further question can be asked: what makes regional trade integration more attractive than multilateral agreements? There are several factors:

- Countries participating in regional integration may seek to obtain greater political influence, allowing them to offset the power of other regional agreements based on different development models, and organized around stronger nations—the US, China, and Russia, especially—by increasing their multilateral bargaining power. This is the idea put forward by current advocates of the Wider European Economic Area (WEEA).
- Some countries may want to maintain sovereignty in some domains for which they are too small to exercise influence outside their borders.
- Governments may desire to bind themselves with better economic policies and signal this to foreign investors in order to attract foreign direct investment.
- Governments may want to help neighboring countries to develop in order to create new markets for their own producers, or to create strategic linkages on peace and security to avoid negative spillovers.
- Integrated regions may facilitate access to larger markets, seeking greater efficiency through increased competition and access to foreign technology.
- Regional trade integration may be a reactionary response to the emergence of other regional trade groupings and the fear of being left behind or left out because of the negative impact of trade diversion.

104. Emerson, “Strategic Potential.”
In a nutshell, regionalization of trade seems to offer a good balance between proximity and greater access to markets. Indeed, the effect of distance on trade flows has not disappeared even after tremendous technological advances.

3. REGIONAL TRADE AGREEMENTS (RTAs): FROM TRADE AGREEMENTS TO PRODUCTION-SHARING AGREEMENTS

In the past, the focus of Regional Trade Agreements (RTAs) was on tariff reduction and rules of origin in the trade of goods. Today, many RTAs include provisions on services, investments, technical barriers to trade and competition rules, as well as a host of issues not directly related to trade.106 This trend can be observed in the negotiations of several recent regional or megaregional agreements, each of which has made an attempt of sorts to set global rules. Examples include the Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP), the Comprehensive Economic and Trade Agreement (CETA), and the EU-Japan Economic Partnership Agreement.

Driving this trend is the fact that trade has increasingly taken the form of “production-sharing,” or supply chain trade (“made-everywhere-sold-there”), as opposed to traditional trade (“made-here-sold-there”).107 For Baldwin, supply-chain trade arises when high-tech firms combine their know-how with low-wage labor from developing nations; supply-chain is thus mostly about making things internationally, although international selling is also important.108

This internationalization of production can happen in different ways, either through offshoring (producing abroad) or through new trade of intermediaries embedding foreign technology.

Baldwin adds that “the production-sharing aspects lock in disciplines that facilitate the internationalization of production and 21st century regionalism is not fundamentally about discrimination. It is about undergirding the internationalization of production processes.”109

In this setting, comparative advantages are no longer strictly defined at the national level, or as Del Prete et al (2016) put it, “Entering Global Value Chains (GVCs) is a way to denationalize comparative advantages.”110

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108. Baldwin, “WTO 2.0.”
More specifically, for an emerging-market country, this means that productive internationalization depends upon three things:

• The share of local added value included in its exports, reflecting the mobilization of the entire national production chain for the benefit of the country’s own exports (50 percent in Tunisia in 2015)
• The use of intermediate goods supplied from imports from other countries (18 percent in Tunisia), and
• The use of imported intermediate goods with foreign added value for its exports (32 percent)\textsuperscript{111}

Moreover, what matters is not only the dramatic progress that has been made in reducing transportation costs, but also the Information and Communications Technology (ICT) revolution which "allows production stages to be unbundled and dispersed across international boundaries"\textsuperscript{112} because they reduce communication and coordination costs. We will see later how shifting from shallow to deep integration is necessary to promote this kind of value chain integration at the regional and global levels.

Others have also noted that "developing countries’ share in Global Value Chain (GVC) trade is increasing and that they have begun to shift their participation from the production of final to intermediate goods, moving upstream in GVCs and out of assembly [stage], but there are still big differences among developing countries."\textsuperscript{113}

It is important to emphasize that the creation of GVCs depends largely on the strategy employed by large production and distribution companies. The role of governments is not so much to regulate as to foster a favorable business environment (training, clusters, industrial parks, tariff, and regulatory concessions, and so on). Competition between regional zones that are based less on price (via customs duties) than on conditions to attract investors—particularly relating to regulatory matters and the ease of doing business—requires the underlying dynamics of integration to be reassessed, as this new context also heightens competition within the integrated region.

Involving the dynamic interdependence of productive systems, this situation will, in the future, establish a new set of circumstances requiring delicate tradeoffs and enhanced cooperation policies between key stakeholders. To a certain extent, the circumstances of today challenge regionalization insofar as value chains monopolize almost 60 percent of trade, with the proportion of GVCs growing relative to regional value chains. During the Brexit campaign, comparisons between the benefits and constraints of the EU and this type of direct global opportunity were widely evoked.


\textsuperscript{112} Baldwin, Multilateralising 21st-Century Regionalism.

\textsuperscript{113} Victor Kummritz and Bastiaan Quast, “Global Value Chains in Low and Middle Income Countries,” CTEI Working Paper No. 10-2016 (Centre for Trade and Economic Integration, the Graduate Institute, 2016), accessed October 11, 2020, available at: https://repository.graduateinstitute.ch/record/294806/files/CTEI-2016-10.pdf
LOOKING BEYOND TRADE

We can now turn to look at the different dimensions of regional integration. Recognizing that trade cannot address all development challenges, there is a need to transcend trade, moving toward the provision of regional public goods that otherwise would be underprovided or not provided at all. However, we will also explore how regional trade agreements could provide (i) opportunities for bundling or linking together other types of policies, and (ii) a framework of regional governance which could lock in essential domestic reforms.

1. TRADE CANNOT ADDRESS ALL DEVELOPMENT CHALLENGES

In their 2016 report *Making GVCs Work for Development*, Taglioni and Winkler stress that participating in GVCs does not automatically improve living standards and social conditions in a country. That goal requires not only improving the quality and quantity of production factors and redressing market failures, but also engineering equitable distributions of opportunities and outcomes, including employment opportunities, wage levels, work conditions, economic rights, gender equality, economic security, and protection and preservation of the environment. The internationalization of production processes helps with very few of these development challenges.\(^{114}\) Some of these themes have been, and still are, the focus of CMI’s programs.

Furthermore, trade-based integration alone cannot address all social and environmental challenges, and can even make them worse, especially in the short- to-medium-term, if no mitigating countermeasures are put in place.

For example, the 2007 Sustainability Impact Assessment carried out by the EU Commission for a Euro-Mediterranean Free Trade Area (FTA) raised the following concerns:

- A significant short-term rise in unemployment, which could continue into the long term if not successfully mitigated, particularly for liberalization of EU-MPC (Mediterranean partner countries) trade in industrial products and agriculture, and to a lesser extent for services and South–South liberalization
- A fall in wage rates associated with increased unemployment
- A significant loss in government revenues in some countries, with the potential for consequent social impacts through reduced expenditures on health, education, and social support programs
- Greater vulnerability of poor households to fluctuations in world market prices for basic foods
- The adverse effects of accelerated conversion from traditional to commercial agriculture on the status, living standards, and health of rural women
- Significant local impacts on water resources, soil fertility, and biodiversity in areas of high pre-existing stress

• Higher environmental stress in cities, resulting from declining rural employment opportunities and accelerated rural-to-urban migration
• Higher air pollution and coastal water pollution from more frequent international transport
• Higher waste generation from the greater use of packaging materials

2. MANAGING EXTERNALITIES: SOCIAL, ENVIRONMENTAL, AND SECURITY ISSUES, AS VECTORS OF REGIONAL INTEGRATION

Malik and Awadallah (2011) clearly summarize how regional externalities, which are "situations when the effect of production or consumption of goods and services imposes costs or benefits on others which are not reflected in the prices charged for the goods and services being provided," make the case for a "regional" integrated approach.

One reason why economic fragmentation hinders prosperity is that it leads to the underprovision of regional public goods. A large-scale infrastructure system that facilitates the fluid movement of goods and people across the Middle East is one such public good. A connective infrastructure is likely to benefit everyone in the region, but the financial costs of putting it in place are too high for any single country to bear. This is the classic problem of coordination failure that needs to be solved through a regional collective action of sorts.

Europe has been aware of this danger from the outset and has implemented structural funds aimed at facilitating gradual, long-term adaptation, avoiding the increase of social disparities, and improving territorial cohesion—namely, the Common Agricultural Policy (CAP), the European Social Fund (ESF), the European Regional Development Fund (ERDF), the Cohesion Fund—and assimilated funds such as the European Agricultural Fund for Rural Development (EAFRD), the European Maritime and Fisheries Fund (EMFF), and so on.

Although these transfers did affect the allocations of factors and therefore exerted downward pressure on economic efficiency in the strict sense, they involved a careful tradeoff between (lower) efficiency and (higher) equity that Europe has been able to manage successfully, with visibly positive results. With the impact of trade liberalization having already achieved a certain momentum, it is clear today that policies on the more dynamic aspects of integration (research funds, Erasmus, and so on) are essential in order to resist fragmentation.

More precisely, game theory helps us understand the kind of problems that can arise when it is known ahead of time that one’s action will affect the action of others.

Two well-known situations that are particularly relevant are

- The Prisoner’s Dilemma type of game, where each state, in pursuing its self-interest, imposes costs on the other state regardless of the policy that other state chooses
- Coordination games, where each state imposes costs or benefits on the other state, contingent upon the particular policy the other state selects

In the case of the Mediterranean, issues such as migration, climate change, security, gender gaps, and high youth unemployment all have the potential to affect neighboring countries in direct or indirect ways.

Furthermore, a vision of regional organizations as relevant units of decision-making for tackling major contemporary social issues is gaining ground in the world of ideas and policies of several regional organizations (see authors such as Bob Deacon, Nicola Yeates, and L. van Langenhove).118

Riggirozzi (2017) argues that “regional organizations are moving away from traditional market-based goals to embrace issues of welfare,” and that there is a need to explore how to “[leverage] regional approaches in dimensions important for human development, such as health, education, and the environment.” 119

What strengths, advantages, or benefits would a regional-level approach to such policies bring, compared to a national or global-level approach?

Yeates summarizes the benefits as follows. Regional-level approaches
- “Amplify the voices of smaller and developing countries in global social and economic policy
- Galvanize support for and foster ownership of regionally defined rules and standards
- Pool resources and risks to help scale up social protection, health and education and, better respond to disasters and other calls on humanitarian and development aid
- Create platforms and fora for members to discuss key priorities for regional action and to work out context-specific responses
- Harness the economic, fiscal and social benefits of intra-regional trade in support of regional social policy priorities”120

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Riggirozzi and Yeates (2017) trace the evolution of regional-level approaches toward enabling these benefits, particularly in southern regional organizations.

Among other things, they mention the following in particular:

- The Economic Community of West African States (ECOWAS), which has established a regional court of justice adjudicating on national labor rights.
- The Union of South American Nations (UNASUR), which has been driving initiatives to expand entitlements to health care, by supporting universalization of provision at the country-level, and to social security, by promoting the portability of entitlements.
- The Association of Southeast Asian Nations (ASEAN) Social Charter.
- The Social and Economic Council of the Southern Common Market (MERCOSUR).
- The Integral Plan for Social Development of the Andean Community.
- The South Asian Association for Regional Cooperation (SAARC) Poverty Alleviation Fund.

It should be noted that the Union for the Mediterranean (UfM) does not focus solely on trade. Rather, it hosts regional dialogue platforms, supports projects, and provides the political framework for meetings on thematic areas that include “Social and Civil Affairs,” “Water and Environment,” and “Higher Education and Research,” among others. Two of the three pillars of the Barcelona Process were respectively based on “Political and Security Partnership: Establishing a Common Area of Peace and Stability” and “Partnership in Social, Cultural and Human Affairs: Developing Human Resources, Promoting Understanding between Cultures and Exchanges between Civil Societies.”

Additionally, Riccardo Trobbiani, in his study of the EU’s cultural diplomacy and policy of cooperation with its southern neighbors, notes that the EU often has high ambitions but, just as often, lacks a clear strategy and the means to achieve them. Programs are often short-term and “not endowed with resources that are proportional to the ambitious objectives of the Euro-Mediterranean partnership.”

3. REGIONAL TRADE INTEGRATION AND COOPERATION

Although regional integration is, at its core, an agreement between two or more countries to cooperate and collaborate to achieve mutual goals (Mattli, 1999), integration, as a number of researchers have pointed out, goes well beyond...
cooperation. They stress that regional cooperation does not necessarily rise to the level of regional trade integration (at least through the prism of trade).124

These researchers argue that providing the regional public goods that are required for large-scale challenges such as climate change and security does not require countries to actually engage in formal regional trade agreements.125 They nonetheless do recognize that there may be several reasons why “it might be easier to conclude cooperative agreements among countries if they are members of RIAs” (regional integration arrangements). Those reasons include the following:

Regional integration through trade implies some degree of cooperation because it provides some common rules, regulations, and institutions on the economic level. This in turn creates a dynamic of trust and further political cooperation (the functionalist view).

RIAs contribute to building institutions and embedding cooperation agreements in a wider framework of collaboration. Additional issues display more tradeoffs and make it easier for each country to benefit from negotiations.

Research has explored the linkages between trade policies and other policies for the environment, security, and human rights, which are not directly trade-related (in contrast to trade-related measures such as tax, subsidies, and intellectual property rights policies).

The following types of linkages have been identified:126

- **Enforcement linkage:** if a violation of an agreement in area A is punished with sanctions in area B
- **Negotiation linkage:** if agreements in areas A and B are negotiated jointly (that is, in the context of a single bargain), rather than as separate bargains
- **Participation linkage:** if the threat of sanctions in area A is employed to encourage participation in an international agreement in area B

Linkages between trade and noneconomic issues are apparent in the provisions included in trade agreements across the world and notably among Euro-Mediterranean partners, whose association agreements often contain provisions on human rights, the environment, education, cultural cooperation, and other areas of civic life.

A serious drawback, however, is that most of these provisions are not legally binding or enforceable, which arguably nullifies their power to elicit compliance.


In this context, it is significant to note that the Pan-Arab Free Trade Agreement (PAFTA), launched in 1997, was from the outset limited to tariff liberalization on goods and agriculture.

In a similar way, the agreements of the Association of Southeast Asian Nations (ASEAN) are limited to tariff liberalization on goods and investment policy.

This is not a random coincidence. It is apparent that there is a natural form of “first stage” integration that develops around trade, in contrast to a more extensive, subsequent, and deliberate form of integration that involves structural policies. In the Euro-Mediterranean region, the reality is far removed from the latter form because of the widely held implicit belief that trade development can naturally lead to integration.

The challenge to go beyond trade to forge other forms of integration is understandable given the absence of any political agreement on Euro-Mediterranean integration. Numerous obstacles remain in terms of FDI and migration, in connection with trade (see annex 2 on FDI). There is, thus, a need to take a more proactive stance on ambitious common public projects, develop networks among countries, and supply public goods that cannot be funded by individual countries. In this form of integration, mobilizing key stakeholders is an essential step of critical importance.

It should equally be noted that recent studies do not systemically link agreements across policy areas. Rather, integration gains are affected by interdependency (for example, the impact of a change in trade taxes on the environment, or its impact on the costs and benefits of environmental taxes) and the asymmetry of issues. Examples of such asymmetry of issues include asymmetry (i) on the severity of self-enforcement constraints; (ii) on the relative bargaining position of governments; and (iii) on the degree of excludability in the efforts for cooperation, and hence the severity of the free-riding problem in participating.

**NUMBER OF PROVISIONS EMBEDDED IN TRADE AGREEMENTS**

<table>
<thead>
<tr>
<th>Agreement</th>
<th>Years (or date)</th>
<th>Obligations outside WTO mandate</th>
<th>Provisions under WTO mandate</th>
<th>of which legally enforceable</th>
</tr>
</thead>
</table>

**Source:** WTO RTA contents, 2011

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More precisely, interdependency between issues may imply gains from enforcement linkages only, and asymmetries across issues imply potential gains from all types of linkages.

For example, could migration issues, together with the EU’s request that SMCs control their own borders better, strengthen the bargaining power of SMCs in negotiating economic agreements?

Note that the 2016 “Jordan Compact,” which among other things simplified the rules of origin in exchange for better access to education and employment for Syrian refugees, is a form of policy linkage between trade and refugee management. However, the results have not been as impactful as expected because of some other structural constraints blocking the hiring of foreign workers. Panizzon (2017) proposes to generalize this tool by tying the EU’s Generalized Scheme of Preferences (GSP) for trade to refugee protection standards because such protection standards could even “become key guarantees against backsliding over non-refoulment.”

What about linking Deep and Comprehensive Free Trade Agreements (DCFTAs) and Mobility Partnership issues? Some have suggested that such linking might help unblock the negotiations in, for example, Tunisia, thereby ensuring that questions on the free movement of not only capital, goods, and services, but also of people are included.

This reasoning is reiterated in a recent policy brief from the CEPII (Centre d’Etudes Prospectives et d’Informations Internationales). The brief argues that because trade is an area of direct interaction between countries with ongoing negotiations, it is well positioned to serve also as a platform to leverage coordination on exchange rates or on social, environmental and fiscal rules as well as a range of other policy objectives. Besides, lowering barriers to trade may amplify the effect of the regulatory practices of one country on its partners, and thus encourage a leveling down of good practices. These complementarities, therefore, call for cooperation.

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However, linking too many issues may very well make it harder to reach a consensus that could lead to hammering out an agreement because of:

- Excessive complexity and negotiation costs (depending on whether negotiation costs are fixed and high, or alternatively, linked to the number of issues treated)
- Difficulty in enforcing agreements (for example, whether there is an international institution and/or a judicial system able to adjudicate over several areas of expertise relevant to an agreement)
- The perception of excessive intrusion and interference with national sovereignty

The CEPII suggests a few principles when including nontrade provisions in trade agreements, such as:

- Basing the approach on minima and guarantees, which has the effect of maintaining a balance between, on the one hand, limiting excessively large gaps in practice and, on the other, leaving room for maneuver with countries that wish to express their national preferences
- Focusing on verifiable commitments
- Establishing a link with existing sector policy objectives, such as the labor and environmental policies

Regarding the third principle, CEPII notes: “It should be more easily understood and accepted that commercial benefits should be foregone when they conflict excessively with other objectives. In other terms, this means wondering whether further [liberalizing trade] is really desirable without agreements on basic principles. After all, trade is an instrument, not a policy objective per se.”

At the operational level, this implies that the national and international institutions responsible for trade negotiations must coordinate with organizations charged with human development as well as social and territorial equity. Given specific institutional mandates, such coordination could take place through the inclusion of sectoral policy issues in the trade negotiations. Concrete suggestions are provided in the following chapters in reference to public goods.

These suggestions demonstrate the importance of clarity with regard to the degree of integration targeted and the corresponding type of cooperation. While there are bridges between the various levels, it is important to distinguish between them: a first level that focuses on trade; a second level related to the regulatory framework (for example, a customs union, standards); a third level dedicated to creating linkages among trade, FDI, and human mobility; and a fourth level related to common voluntarist policies aimed at internal and external

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134. In this regard, we might highlight the difference in approach between the GATT/WTO and UNCTAD, which operate side by side in Geneva. GATT/WTO focuses purely on trade, while UNCTAD, which takes a broader perspective on trade, employs an approach that stresses the linkages between trade and development, a remnant of the intellectual legacy developed by Latin American dependency (dependencia) theorists during the 1960s.
convergence. The linkages among these four negotiation levels represent the greatest challenge that any kind of regional integration is likely to face.

The specific contribution of regional integration, in comparison with bilateral or multilateral trade liberalization, must be to aim for convergence in all its forms and to improve social and regional balances within partner countries. These issues should be raised at the level of the integrated region as a whole.

4. REGIONAL INTEGRATION AND DOMESTIC COMMITMENT

An important question is whether integrating economies through the creation of Free Trade Areas (FTAs) can itself drive reforms—one being public sector transformation—in individual countries.135 This argument is also presented by Richard Baldwin: “It is likely that Regional Trade Agreements (RTAs) are allowing Southern nations with weak institutions to use the RTAs to make their domestic pro-offshoring reforms more credible.”136

His conclusion is that partners are not primarily exchanging market access when they sign RTAs. Rather, they are locking in disciplines that foster offshoring and the 21st century trade that comes with it.

In pithy language, Baldwin neatly sums up the essence of the shift from the 20th century bargain with trade to that of the 21st century. The 20th century, he says, was “from my market for yours”, 21st century trade is “to Northern factories for Southern reform.” In future trade agreement negotiations, formulating clear rules and transparent expectations, and creating an effective implementation mechanism, will be two key prerequisites for success.


See also Hoekman and Messerlin: “Regional cooperation can provide a mechanism to ‘lock-in’ a reform path through pre-commitment to specific targets or outcomes” and “a major factor determining the relevance of any integration strategy will be to what extent it will be used by governments to pre-commit to actions aimed at reducing the role of the State.” Bernard Hoekman and Patrick Messerlin, “Initial Conditions and Incentives for Arab Economic Integration: Can the European Community’s Success be Emulated?” World Bank Policy Research Working Paper No. 2921 (2002), accessed October 11, 2020, available at: https://openknowledge.worldbank.org/handle/10986/19233.

In summary, regional trade integration can help Mediterranean countries stimulate trade and investment, but the largest gains are likely to come from domestic reforms. On the other hand, those domestic reforms are likely to be easier to implement if they are framed regionally.

**MULTIDIRECTIONAL INTEGRATION**

After decades of rapid globalization, which started to slow down only in 2008, we may now be in a new era that can be described as one of strengthened regionalization. What this means is that the internationalization of trade is increasingly concentrated in blocs such as the Association of Southeast Asian Nations (ASEAN), the North American Free Trade Agreement (NAFTA), and the Southern Common Market for South America (MERCOSUR). These trading blocs allow neighboring countries to benefit from mutual proximity and complementarity.

In this regard, attempts at integration around the Mediterranean Sea include a juxtaposition of institutions and bilateral or regional trade agreements with varying scope and depth. But several factors—for example, the lack of a common vision and long-term strategy, weak political will, and insecurity in the region—have stalled or shifted discussions mainly toward cooperation on security and migratory flows using a narrower approach.

It is legitimate to ask where a new impetus for integrating the region could originate from. Should the Euro-Mediterranean partnership be revived through further bilateral deep and comprehensive trade agreements? Or through more commonly shared, structural policies?

Should the Mediterranean countries of the southern rim first concentrate on building structural cohesion among themselves before making another attempt to integrate with the rest of the Euro-Mediterranean region?

Does looking to East and South Asia offer a more promising outlook (for example, the China "Belt and Road" Initiative)? What about integrating around a vertical axis that runs from Europe to Africa through the Mediterranean? [we offer some insights about these questions in the following sections. Let’s first look at the Asia question.]

1. **THE EU’S POSITIONING IN GLOBAL TRADE**

The EU continues to remain a major partner of most Southern Mediterranean countries (except Jordan, Lebanon, and Palestine), but comparing trade relationships between 1995 and 2017, the EU’s relative importance as a trade
partner has been declining (except for Tunisia and Morocco, which are strongly oriented to European markets). Asia is indeed an increasingly significant trade partner of the Levant countries of the Mediterranean (see figures below).

TRADE PARTNERS OF SOUTH MEDITERRANEAN COUNTRIES IN 1995

![Graph showing trade partners of South Mediterranean countries in 1995.]

Source: UNCTAD Stat

TRADE PARTNERS OF SOUTH MEDITERRANEAN COUNTRIES IN 2017

![Graph showing trade partners of South Mediterranean countries in 2017.]

Source: UNCTAD Stat

De Ville and Reynaert (2010) defend the view that “the EU meets with competition from other international actors, like the US, Russia, China, and the Gulf countries. Their economic interests in the region, and in the case of the US and the Gulf Cooperation Council (GCC), their own trade initiatives, interfere with the EU’s efforts to create a Free Trade Area (FTA) with the Mediterranean.”

Since Asia is an increasingly important trade partner for a good part of the Mediterranean region, this book analyzes that perspective by illustrating the destinations of the Mediterranean exports going to this large continent.

The figure below helps us see that this is partly driven by the rise of trade links with Gulf countries and with China. To keep things in perspective, however, bear in mind that the surge of imports from China far outweighs any exports of the Mediterranean countries to Asian destination markets, although this is true to a lesser extent for the Gulf countries.
A. A long history of Euro-Mediterranean relationships

The history of Euro-Mediterranean relationships far predates the 1995 Barcelona Process (also called the “Euro-Mediterranean Partnership”). It is relevant to mention this here in order to provide a historical perspective on efforts undertaken so far. Following decolonization, bilateral agreements were signed as early as 1961 with some SMCs.

In 1972, a Global Mediterranean Policy (GMP) was adopted by the EU, providing ready access to European markets for industrial goods (with some concessions for specific agricultural products), financial aid, and some political oversight of agreements through committees and cooperation councils. After some initial fits and starts, the relationship began to gain momentum from 1989 onward, when the European Commission produced a document titled “Toward a New Mediterranean Policy.” This document led to the adoption of a New Mediterranean policy in 1990 and eventually to the 1995 Euro-Mediterranean Partnership negotiated in Barcelona.

The push for Euro-Mediterranean integration during the 1990s coincided with the emergence of a consensus around the view that North–South integration holds great promise for developing countries. In principle, regional arrangements of this type can solidify past reforms, guarantee future access to a large market, and stimulate growth through increased foreign direct investment, more intense competition, and more rapid technological diffusion.

Additionally, given the weakness of intraregional South Mediterranean relations, one way to view North–South bilateral agreements is as an intermediary step to promoting such South–South integration. The lack of integration among SMCs is thought to be an obstacle to harnessing the full gains from North–South integration.


143. 1963 for Turkey with the “Ankara Association Agreement,” and 1965 for Lebanon with the “Trade and Technical Cooperation Agreement.”


Meanwhile, noting that South–South integration may not be currently feasible for political reasons, the vision is that economic gains from North–South integration will help to build a foundation for southern countries to liberalize, and provide incentives for them to embrace the necessity of economic reforms. In other words, integration should act as a catalyst. Ideally, South–South integration and North–South integration in the Mediterranean region would be pursued simultaneously, with the understanding that they are complementary policies that will bring maximum benefits if implemented jointly and noncompetitively.

Indeed, one of the Barcelona Process’s ultimate objectives—to have been achieved by 2010—was to turn the Association Agreements (the so-called “vertical” North–South agreements) and the Free Trade Agreements among the Mediterranean members (the so-called “horizontal” South–South agreements) into a deep and comprehensive Euro-Mediterranean FTA.146

However, the optimism of the early days seems to have receded. Observers such as Kebabdjian (2006) and others147 are critical of this process. According to Kebabdjian, the EU’s goal is not to create an economic region, or even to consolidate its sphere of influence, but to organize a “zone of indifference.” In other words, this is simply a strategy of “containment” focusing on trade and security so as to avoid bad spillovers from the South. In practice, what should have been a Euro-Mediterranean Free Trade Area is currently composed of a dozen bilateral Free Trade Agreements (FTAs) called Association Agreements (AA) (see below).

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145. Note that this is the “ultimate objective” only for the economic and financial pillar. The Euro-Mediterranean Partnership was established with two other pillars: “Definition of a common area of peace and stability through the reinforcement of political and security dialogue” and “rapprochement between peoples through a social, cultural and human partnership aimed at encouraging understanding between cultures and exchanges between civil societies.” These are also relevant aspects of regional integration, although one may ask if the sociocultural pillar has received as much attention from policymakers.


The UfM is expressly designed to push the focus of relations between Europe and North Africa away from the most sensitive political areas...The UfM rolls back the Euro-Mediterranean Partnership’s acquis [accomplishments] on democracy and human rights...The EU has moved further and further away from seeking ‘a ring of well governed states’ on its southern edge and toward seeking a ‘ring of firmly governed states’...The EU’s ‘ring of friends’ is in truth a ‘ring of citadels’...The EU underestimates the fragility of the relationship between populations and regimes. (Kristina Kausch and Richard Youngs, “The End of the Euro-Mediterranean Vision,” International Affairs 85, no. 5 (2009): 963–975, https://doi.org/10.1111/i.1468-2346.2009.00841.x.)

Kebabdjian and others use the term “hub-and-spoke” regional integration to capture the idea of an arrangement in which the SMCs (the spokes of the wheel) are not well connected to one another (and hence not united) but the central hub is connected to all the spokes and can monitor each of them from a strategic vantage point. They argue that the level of integration and engagement between the EU and the Mediterranean countries differs, and often by a significant margin, across partners.\(^{148}\)

With the European Neighborhood Policy that the EU launched in 2004, the EU all but confirmed this approach of differentiating across partner countries, transforming itself effectively into a modality of regional governance, the authors argue. Through its financing arm—the European Neighborhood Instrument (ENI)—the EU has adopted a “more funds for more reform” strategy, which enables it to exert more influence over the region by supporting countries that cooperate.

**The Association Agreements**

One common basis for all Mediterranean partners are the Association Agreements (AAs).\(^{149}\) Although they are not all identical, they generally provide free access to the EU for manufactured goods from Mediterranean exporters, and a gradual dismantling of tariffs for better EU access to Mediterranean markets. The AAs also contain provisions, though limited, for service liberalization following the General Agreement on Trade in Services (GATS) principles for World Trade Organization (WTO) members or more detailed rules for those, such as Algeria and Lebanon, that are not members.

AAs were originally mostly silent on issues such as public procurement, intellectual property rights, and technical barriers to trade; and the agriculture


1. Ongoing conflicts in Libya and Syria continue to provoke significant emigration and broader instability in the region. They have no functioning government and the EU has no meaningful relationship with them.

2. Jordan and Lebanon have both been severely weakened by the conflict in Syria, having withstood an unprecedented influx of refugees, in the case of Lebanon more than 25 percent of its population. Any relationship with the EU is dominated by their need for urgent humanitarian assistance.

3. Ongoing tensions between Israel and Palestine have thwarted effective engagement around the issue of integration and impeded the progress of high-level UfM meetings on the subject.

4. Algeria and Egypt have retained or returned to strong authoritarian regimes, cautious of broader engagement with the EU.

5. Tunisia and Morocco are the only countries to have emerged from the political changes of 2011 with obviously more open government, although in Morocco, it is not totally clear that Mohammed VI is willing to completely relax his control over the political system.

sector remained very protected. However, ongoing negotiations may yet add sectoral agreements to the AAs in some of these domains (for example, agriculture, dispute settlement, and services).\(^{150}\)

Finally, even if a Euro-Mediterranean Free Trade Area were to be established, the Sustainability Impact Assessment carried out by the EU Commission\(^ {151}\) in 2007 indicates that it could help to deliver large economic benefits to both the EU and Mediterranean Partner Countries (MPCs), but only if carried out as part of a comprehensive development strategy in each of the partner countries, in combination with measures to achieve fuller economic integration across the region as a whole. This could potentially include social and environmental policies.

### EURO-MEDITERRANEAN ASSOCIATION AGREEMENTS

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<tr>
<th>COUNTRY</th>
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<td>Tunisia</td>
<td>Signed</td>
<td>July 1995</td>
<td>March 1998</td>
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*Source: European Commission*

### B. The Euro-Mediterranean relationship today

At present, the Union for the Mediterranean (UfM) seeks to reaffirm its commitment to regional cooperation and to supporting projects that contribute to regional stability, human development, and integration.

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One advancement brought about by this institution is the increased co-ownership of the integration governance process through a North–South copresidency. The UfM also has a Parliamentary Assembly (PA-UfM) that “holds at least one plenary session per year and comprises 280 members, equally distributed between the northern and southern shores of the Mediterranean.”152 It provides some degree of democratic control and legitimacy, but the resolutions and recommendations it adopts regarding Euro-Mediterranean cooperation are not legally binding.

Still, there are contrary opinions, such as Grant (2011), who highlighted a lack of focus on private sector development in the Barcelona Process as well as the UfM, both of which he says are overly state-focused.153 The UfM is, however, evolving, and has now included a bottom-up process, making project support one of its three main missions (the other two being support for political forums and for dialogue platforms).154

Regarding trade integration, Jarreau (2011)155 undertook a review of the empirical literature on the effect of the Euro Partnership and found that the

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See also Timo Behr, Regional Integration, chap. 3.2.1. Behr himself cites several authors and their arguments:
- “The principle of co-ownership does challenge the methods used by the EU in external relations (...)” because it may weaken the EU’s ability to persuade its southern partners to address their social, economic and political problems differently.” Rosa Balfour, “The Transformation of the Union for the Mediterranean,” Mediterranean Politics 14, no. 1 (2009): 99–105, accessed on October 13, 2020, available at: https://doi.org/10.1080/13629390902747491.
- “Although the EU will continue to pursue a more ‘normative agenda’ through the European Neighborhood Policy (ENP), in the future this will be done in isolation from the broader regional context and the potential economic carrots and leverage that the UfM could potentially provide.” Kausch and Youngs, “End of the Euro-Mediterranean Vision.”
- There is a risk that “the intergovernmental nature of the UfM is destined to reflect the conflictual situation in the Middle East without any filter whatsoever,” thus blocking any kind of negotiations and progress. Roberto Aliboni, “The Union for the Mediterranean: Evolution and Prospects,” Instituto Affari Internazionali, speech at the University of Teramo, December 5, 2009, accessed on October 13, 2020, available at: http://www.iai.it/sites/default/files/iai0939e.pdf.
154. “The UfM identifies and supports concrete regional cooperation projects that enhance partnerships and interactions in the region between promoters, partners and beneficiaries through the scaling up effect and development of innovative initiatives. The UfM acts as a catalyst of projects, accompanying promoters throughout the project lifecycle and enhancing regional dialogue to create synergies for partnerships.” From “What We Do,” Secretariat of the Union for the Mediterranean website, accessed on October 13, 2020, available at: http://ufmsecretariat.org/what-we-do.
results are mixed: slightly positive at best for South Mediterranean countries, whose imports from the EU increased while their exports did not progress because the EU previously had a low external tariff.

In fact, the figure below shows that the value of exports from the SMCs to the EU has declined and so did the share of their total exports to the world (from 54 percent to 45.5 percent). However, this is not the case for EU exports to its Southern neighbors. Another apparent feature is the asymmetry of trade relationships: the EU still represents a big export market for SMCs (especially the Maghreb), but less than 4 percent of total EU exports are directed toward them.
According to the UfM, the 2017 trade flows in the Euro-Mediterranean region were distributed as follows:

- 90 percent within the EU
- 9 percent between the EU and its Southern neighbors
- 1 percent among the Southern neighbors

Comolet et al (2013) have studied the prospective benefits of several potential future scenarios of trade liberalization in the Mediterranean region: for example, between the EU and SMCs versus within the SMCs, partial versus total liberalization, and goods versus goods and services. Their model assesses "the cost of the non-Mediterranean" trade integration in terms of liberalization of tariffs only, which unsurprisingly leads them to find low gains. They also point to the lack of integration in the area of Foreign Direct Investment (FDI) and the lack of "productive integration" of EU firms. Finally, because of the assumptions of perfect markets and exogenous technology in the kind of model they use, the approach overestimates the static gains of trade but underestimates the dynamic gains of trade.

The EU has ongoing negotiations for a Deep and Comprehensive Free Trade Area (DCFTA) with Morocco and Tunisia, but the negotiations with Morocco, initiated in 2013, have been at a standstill since April 2014. For its part, the talks with Tunisia have made no progress since April 2016. As the DCFTA name suggests, this kind of trade agreement seeks to comprehensively harmonize regulations in certain identified sectors, and to extend integration to trade to the new sectors including the agriculture sector and services, investment policies, and so on.

One key feature of those negotiations is their asymmetrical relationship when one takes into account the differences in the level of development of the countries involved. Indeed, to avoid high implementation costs and alleviate distributional shocks in the short term, it is essential to encourage gradual convergence tailored to each country’s unique profile.

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157. The 2015 CMI conference presentation, “Economic Transitions in the Mediterranean,” emphasized that current trends in globalized production structures "provide Southern Mediterranean countries with unprecedented opportunities for moving-up in the Global Value Chains (GVCs) and creating new job opportunities for qualified young people." First, segmented activities of manufacturing industries are being brought back onshore in the region. Second, business services, especially high value-added services such as R&D, and design and marketing, account for a growing share of manufacturing value chains. See CMI, Economic Transitions.


Note also how Messerlin, Emerson, Jandieri and Le Vernoy define DCFTA: “The DCFTA should be conceived as a process in which the EU acquis [achievements] is absorbed through an integrated sequence of sets of commitments selected for being in line with the economic interests of the EU partner.” Patrick Messerlin, Michael Emerson, Gia Jandieri, and Alexandre Le Vernoy, An Appraisal of the EU's Trade Policy towards Its Eastern Neighbours: The Case of Georgia (Brussels: Centre for European Policy Studies, 2011), accessed on November 1, 2020, available at: https://www.ceps.eu/download/publication?id=69708pdf=EU%20Trade%20Policy%20toward%20Georgia%20e-version.pdf.
It is just as essential that the declared intent to implement an adapted and tailor-made approach that fits each country’s circumstances be more than just empty talk or a half-hearted commitment, Van der Loo insists.\footnote{Van der Loo, “Enhancing the Prospects of the E.U.’s Deep and Comprehensive Free Trade Areas in the Mediterranean: Lessons from the Eastern Partnership,” CEPS Policy Brief (June 2015), accessed on November 1, 2020, available at: https://www.ceps.eu/download/publication/?id=89678pdf=GVdL_MedDCFTAs_0.pdf.}

The Mediterranean countries should be careful not to overburden themselves with EU legislation that will not directly result in additional market access or is not relevant for their economic reforms. Nevertheless, the EU should still use the DCFTAs as instruments to promote its legislation in the area of sustainable development (for example, environmental protection and social policies)\footnote{This is reflecting the possibility of bundling “noneconomic” policy with trade agreements, as mentioned in section 2.1.2.c.} but leave room for flexible adaptations.

Van der Loo also advocates for budget support with clear conditionalities in the form of fundamental institutional reforms such as the rule of law, an independent judiciary, and anticorruption policies, stressing that implementation and enforcement will not be possible without such foundational democratic structures in place. Therefore, an implementation strategy needs to be developed jointly among the partner countries.

Concerning the long-term vision for integrating the Mediterranean countries, Van der Loo argues that the EU must not use the “carrot stick” of full adhesion and membership as a tactic to induce economic and political change that reflects EU standards.\footnote{In contrast to the full economic integration to the EU (formal membership), the DCFTA format has its limits:}

- Limited access to the EU agri-food market
- Limited access to EU funding
- No participation in designing the common rules
- (and) unconditional acceptance of the EU acquis

Northern countries have a role to play in promoting a coproduction approach by adopting a “win-win” economic cooperation model based on shared added-value and technologies between the rims of the Mediterranean Sea.\(^{164}\)

In summary, the South should not be viewed as a place from where the North can obtain cheap natural resources and benefit from cheap labor to then re-export high value-added products back to those same southern countries. Rather, increasing amounts of foreign direct investment from the private sector, including small and medium-size enterprises, can represent a long-term source of jobs and knowledge diffusion for the local southern economies. This necessitates, as Jolly (2014)\(^{165}\) puts it, a “[move] from a commercial strategy to a genuine industrial policy.”

Despite the challenges, the region offers tremendous potential. According to Rym Ayadi and Emmanuele Sessa,\(^{166}\) the Euro-Mediterranean region experiences an increasing heterogeneity where the active contribution of people, civil society, and policy makers, as well as synergetic policies, are built on existing areas of agreement between distinct, yet, related countries.

Taking a step in the right direction, the 10th Union for the Mediterranean Trade Ministerial meeting, held in March 2018—eight full years after the previous meeting—decided on an action plan: “Sectoral cooperation—among others in the automotive, textiles and clothing, environmental goods and services, as well as information and communication technology areas—was endorsed,”\(^{167}\) of which implementation and the involvement of the private sector both remain to be seen.

2. REVIEW OF REGIONAL INTEGRATION AGREEMENTS

As discussed in the preceding section, the Euro-Mediterranean Partnership has mainly established a “hub and spoke” core/periphery relationship between the EU and the SMCs. One difficulty the SMCs face in restructuring this relationship is the lack of intraregional integration among themselves,\(^{168}\) and hence a lack of international collective bargaining and economic power. Worse, Jolly (2014)\(^{169}\) argues that this type of bilateral relationship “has tended to increase non-cooperative games, as each nation is committed to negotiating advantages with its neighbors on its own.”


\(^{165}\) Jolly, Regional Integration.


\(^{169}\) Jolly, Regional Integration.
This section will review the existing regional agreements among the SMCs, seek to explain why they have not been successful in defragmenting the region, and finally give some suggestions that could improve the prospect of cooperation.

A. Regional agreements in the South

The current lack of integration in the South and East Mediterranean region stands in contrast with its history of proactive regional initiatives. The Arab League was created as early as 1945 and currently has 22 members, representing almost the entire MENA region. The League’s purpose is to encourage member states to draw closer to one another, to coordinate member states’ political activities with the aim of facilitating close collaboration among them, to safeguard their independence and sovereignty, and to consider in a general way the affairs and interests of the Arab countries.170

In terms of economic integration, the region has known several initiatives of which the Greater Arab Free Trade Area (GAFTA), or Pan-Arab Free Trade Area (PAFTA), is the most significant in terms of participants.171 It was created in 1997 and focused on tariff removal in intra-PAFTA trade. It also has provisions for services, trade, and investment policies, as well as non-tariff barriers to intra-PAFTA exchange, but little progress has been achieved in these areas. Adding to that is the absence of a supranational institution to resolve disputes and harmonize standards and rules of origin, making this agreement rather shallow. Hoekman (2016) argues that the prospect of a customs union and a common market is not credible in this case because of the strong resistance states have against ceding any sovereignty.172

Before PAFTA in 1997, there was the Arab Maghreb Union (composed of Algeria, Libya, Mauritania, Morocco, and Tunisia), created in 1988, but it is currently not operating, as the cooperation has completely stalled due to political disagreements.

A report by the Peterson Institute for International Economics (PIIE) on Maghreb integration stresses that—partly reflecting political tensions and insecurity in some countries—closed borders “have pushed trade flows, routes and logistics toward a north south pattern, increasing reliance on the European Market.” This represents a loss for local entrepreneurs who cannot develop their knowledge of the neighboring markets and their consumer tastes and requirements.173

171. Algeria, Bahrain, Egypt, Iraq, Kuwait, Lebanon, Libya, Morocco, Oman, Qatar, Saudi Arabia, Sudan, Syria, Tunisia, and the United Arab Emirates.
The Agadir Agreement, which was signed in 2004 in Rabat, Morocco and entered into force in March 2007, aimed at establishing a free trade zone between Morocco, Tunisia, Egypt, and Jordan (which were already members of GAFTA), as a step toward fulfilling the vision of the Barcelona Process, but also to harmonize macroeconomic and sectoral policies.\footnote{174} It has eliminated tariffs on agriculture and industrial goods as well as non-tariff measures, and its participating countries must respect commitments of the General Agreement on Trade in Services (GATS).

It is considered a potential steppingstone to a Euro-Mediterranean Free Trade Area. However, because of the Arab Spring, little occurred in the 2010s. In 2016, however, ministers of foreign trade finally met. They approved the entry of Lebanon and Palestine and signed several additional protocols and memoranda of understanding on a range of issues including competition, intellectual property, and the institutional functioning of the ministers’ commissions.

B. The symptoms: regional and global integration

Behar and Freund (2011) and Freund and Portugal-Perez (2015)\footnote{175} have shown that GAFTA and the Agadir Agreement have somewhat stimulated trade in non-oil-goods, leading to a situation where the extent of undertrading intraregionally is declining faster than undertrading externally, although overall intraregional integration remains below potential (see also Bhattacharya and Wolde, 2010).\footnote{176}

Moreover, in terms of intra-industry trade, the authors find that, contrary to East Asia and Europe, the MENA region has been mostly left out of the process of supply-chain trade integration.

Similarly, for investment flows the lack of an integrated market in the South Mediterranean [subregion] coupled with the complicated set of rules of origin serve to displace foreign investments to the North. A foreign investor established in Europe can easily serve all the MENA markets whereas a MENA investor remains handicapped, by the loopholes in the set of bilateral trade agreements among MENA countries, as well as the added complication of the rules of origin.\footnote{177}


However, we should bear in mind that most of the studies presented above encompassed the entire MENA region or the Pan-Arab Free Trade Area (PAFTA) agreement, which includes the Gulf Cooperation Council (GCC) countries. Although GCC countries are not part of the Mediterranean partnership, they represent an important reference for the analysis.

For example, El-Rayyes (2007)\textsuperscript{178} finds that between 2000 and 2006, intra-MPC (Mediterranean Partner Country) trade increased faster than trade with the EU or the world (see first table below), and this is even clearer when Turkey and Israel, which represent a large share of MPC trade with the EU (see second table below), are removed.

The author recalls that this rapid increase may not be as impressive as it initially appears because it “partly reflects the fact that trade between these countries started from a low base.” Then, computing the Intensity Trade Index, he disputes the idea that MPCs are dramatically undertrading among themselves.

Finally, it is important to consider the integration with the neighboring GCC countries, which may be more focused on capital and labor, as opposed to trade. GCC countries are rich in capital (from oil revenues) and poor in labor, while the opposite is true for MPCs.\textsuperscript{179}Hence the high flows of people and capital between those regions. In this one sense, the MENA region has indeed experienced some kind of integration.

\begin{table}
\centering
\begin{tabular}{|l|c|c|c|}
\hline
\textbf{MPCs EXPORTS (US$ BILLION)} & 
\multicolumn{2}{c|}{\textbf{2000}} & \textbf{% CHANGE} \\
\hline
MPCs to world & 108.3 & 252.66 & 133 \\
MPCs to EU & 54.6 & 118.80 & 118 \\
Intra-MPCs & 6.2 & 16.67 & 169 \\
\hline
\textbf{ARAB MPCs EXPORTS (US$ BILLION)} & 
\multicolumn{2}{c|}{\textbf{2000}} & \textbf{% CHANGE} \\
\hline
Arab MPCs to world & 48.7 & 120.69 & 148 \\
Arab MPCs to EU & 30.38 & 57.92 & 91 \\
Intra-Arab MPCs & 1.34 & 7.53 & 462 \\
\hline
\end{tabular}
\caption{MPCs Imports (US$ Billion)}
\end{table}

\begin{table}
\centering
\begin{tabular}{|l|c|c|c|}
\hline
\textbf{Source: IMF Direction of Trade Statistics} & 
\\hline
\end{tabular}
\end{table}


C. Diagnosis: challenges to further South–South integration

This relatively low level of integration among South Mediterranean countries can be explained by some of their specific characteristics and current challenges.

Looking at past experiences and seeing that “South–South Free Trade Agreements (FTAs) may hinder multilateral liberalization by creating or supporting uncompetitive, import-substituting industries,”\textsuperscript{180} there are arguments for being skeptical about the effectiveness of such regional agreements.

One hurdle in the way of regional integration is that potential gains for merchandise trade are low because the SMCs already compete in the same kind of export markets and thus do not have many comparative advantages to exploit for interindustry trade.\textsuperscript{181}

Participation in Global Value Chains (GVCs) through intra-industry trade might offer better prospects, but this again entails an effort to improve the export base of manufactured goods and enhance comparative advantage on the basis of specialization.

According to a 2014 African Development Bank (AfDB) report, compared to ASEAN countries, SMCs’ productive structures provide far fewer opportunities for intra-industrial complementarities: their industrialization is less advanced (...) and also the electronics and mechanics sectors play a minimal role compared to heavy industry and especially textiles-garment.\textsuperscript{182}

As previously stated, another difficulty is the lack of a “common” long-term vision among southern regional partners. What is the end goal for Arab countries? And what kind of integration do they want: customs, common market, economic, monetary, or cooperation in a few targeted areas?

Political instability at home following the Arab Spring and other related security issues have contributed to putting regional integration projects on the back burner. Also, as indicated before, the fear of loss of sovereignty may be too strong for many political leaders and populations, as has recently been observed in the EU with Brexit. Finally, the lack of common institutions could make it harder to harmonize trade rules and to settle disputes between countries.

D. Promising vectors of regional integration

Hoekman and Sekkat (2010) recommend that SMCs “[focus] cooperation efforts on specific policy issues where there are clearly defined benefits for specific groups/stakeholders” and “[improve] the transparency of status quo policies, their impacts, and the implementation of regional integration Initiatives.”183 This argument echoes what de Melo and Panagariya (1992) recommended in arguing that regionalism should be limited to cooperation on matters that have an obvious regional dimension. Roads and other transportation networks are obvious examples: they may not be profitable for two nations individually, but they may become profitable if financed jointly. Other examples are educational institutions, information-sharing, and regional environmental problems.184

Moreover, an advantage for South–South integration comes from the evidence that “greenfield investments in MENA are significantly more sensitive to cultural ties between the investing country and the host country than other regions: religious and linguistic links foster investments in these countries more than in any other region.”185 Sekkat (2014)186 has found that “intra-Arab Foreign Direct Investment (FDI) is much higher than what can be deduced from current empirical models” and that “human capital, quality of institutions, infrastructure and openness hardly affect intra-Arab inflows while they normally affect non-Arab inflows.” He provides two explanations: (i) that “a large share of intra-Arab FDI is provided by government or related entities which obey specific regional strategic considerations” and (ii) that “cultural similarity allows Arab investors to use informal socio-cultural networks, and thus to be less sensitive to so called FDI fundamental determinants than non-Arab investors.”

Finally, we should not forget that even with all the similarities MENA countries may share, there is also great heterogeneity (for example, in political structure, level of stability, endowments in natural resources, and thus in economic diversification, and so on). Because of this, it is unlikely that regional integration can be achieved at the Greater Arab Free Trade Area (GAFTA) level in the short term. A 2014 World Bank report187 recommends a variable-geometry approach

toward deeper trade integration "which allows sub-groups to move faster than the whole group or move to a deeper form depending on country-specific conditions." For example, in the case of the Levant (Egypt, Turkey, Jordan, Lebanon, Iraq, Syria, and Palestine), the trade complementarities index is relatively high, comparable to index levels among countries that have historically formed successful regional trade agreements. This indicates that they could move toward deeper integration and benefit from their comparative advantages.

Another recent paper urges that to evolve into a successful subregion, Eastern Mediterranean countries must develop a cooperative and stable security architecture that will center, at least in the beginning, on two particular issue areas: energy security and Jihadist terrorism. These are areas on which the interests of the various states in the Eastern Mediterranean subregion are expected to converge.

As for the Union for the Mediterranean, it is of the view that such subregional initiatives (for example, the Agadir Agreement) could also be valuable "milestones (rather than millstones) on the path toward wider regional integration and cooperation by leading and showcasing practical progress."

188. “The trade complementarity index indicates to what extent the export profile of the reporter matches, or complements, the import profile of the partner. A high index may indicate that two countries would stand to gain from increased trade, and may be particularly useful in evaluating prospective bilateral or regional trade agreement.” From World Bank, “WITS Trade Indicators and Trade Outcomes,” accessed November 1, 2020: https://wits.worldbank.org/trade_outcomes.html; PDF of User Manual: http://wits.worldbank.org/WITS/docs/TradeOutcomes-UserManual.pdf.

189. The World Bank report WITS Trade Indicators and Trade Outcomes uses the term “Eastern Mediterranean region” to refer to Cyprus, Egypt, Greece, Israel, Jordan, Lebanon, Palestine, Syria and Turkey.


3."VERTICAL AFRICA" AS A RELEVANT APPROACH FOR INTEGRATION

An emerging vision for North–South regional integration is to extend this process to a continental scale—from Europe to South Africa. In this setting, the Mediterranean would no longer be at the margin of the logic of integration but at its core, being ideally positioned as a hub for EU-Africa relations. This integration would not be based on a "core-periphery relationship" but on an approach based on coproduction and complementarity. It would entail coming to regard Southern countries as partner countries, integrating North–South chains with technology transfers, and sharing value-added activities (for example, transforming local raw materials in the South), and so on.

As much as this might initially sound like a far-fetched pipedream, this idea—backed by the Mediterranean World Economic Foresight Institute (IPEMED), a Euro-Mediterranean think tank, and its foundation, La Verticale Afrique–Méditerranée–Europe (AME)—seems to be gaining traction, especially in the light of recent events. These include statements by French President Emmanuel Macron; Germany’s push for Africa-EU cooperation during

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Earlier that year, on April 1, during the presidential campaign, Macron had said: “We will not simply recreate a new Mediterranean policy, we will build a path of freedom and responsibility extending from the other side of the Mediterranean across the whole of Africa.” President Emmanuel Macron, transcript of a speech at a gathering at Marseille, April 1, 2017, accessed October 29, 2020, available at: https://en-marche.fr/articles/discours/meeting-macron-marseille-discours.

Barely two weeks later, in an interview with Le Monde, Macron announced: I want to establish an ambitious partnership between France, Europe, the Mediterranean and Africa that strengthens our mutual interests in all areas—climate, trade, employment, innovation, security and stability—as well as relations between states. This partnership will be based on African and French stakeholders: intellectuals, NGOs, diasporas from France and Africa, companies. ("Emmanuel Macron, Son Programme Afrique: ‘Je Veux Mobiliser Plus de Financements pour les PME Locales,’ “ interview, Le Monde, April 12, 2017, https://www.lemonde.fr/afrique/article/2017/04/12/emmanuel-macron-son-programme-afrique-je-veux-mobiliser-plus-de-financements-pour-les-pmelocales_5110340_3212.html.)
the 2017 June meeting of the G20; the 5th African Union-European Union Summit held November 29–30, 2017 in Abidjan, Cote d’Ivoire, and the resulting final declaration defining strategic priorities; and the choice by the Euro-Mediterranean Forum of Institutes of Economic Sciences (FEMISE) to select “Multilateralizing Regionalism” as the main theme of its 2018 annual conference in Malta, the same country where an EU-Africa summit on migration took place less than three years earlier. Finally, there is the renewed focus of the French Development Agency (AFD) on Africa—which in 2017 represented 50 percent of AFD’s financial commitments—and its decision to adopt a unified continental approach to Africa instead of splitting it into North Africa and Sub-Saharan Africa.

Additional reforms need to be implemented before we reach the kind of cooperation and integration envisioned by the Mediterranean World Economic Foresight Institute (IPEMED). More importantly, at a time when the benefits of globalization are being questioned, we need to reflect on the relevance of the Verticale Afrique – Méditerranée – Europe (AME) integration.

Jean-Louis Guigou, president of the IPEMED, argues that the world can be viewed as an orange, of which each segment represents one vertically integrated area. More specifically, the AME axis lies in between the North American axis and the East Asian axis, both of which are by far much more integrated.


198. One can observe some divergence with Guigou’s “orange” in Richard Baldwin’s analysis, found in “Multilateralising Regionalism: Spaghetti Bowls as Building Blocs on the Path to Global Free Trade from the World Economy,” The World Economy 29, No. 11 (2006): 1451–1518, accessed on October 14, 2020, available at: http://dx.doi.org/10.1111/j.1467-9701.2006.00852.x. Given sufficient imagination, one could see the world in 2010 as three perfectly formed trade blocs—one in Europe, one in North America and one in East Asia. This would be wrong. Only one of the Big-3 is actually a bloc (the EU is a customs union). The other blocs are basically matrices of bilateral deals with minimal institutional integration. Matrices of bilateral deals with minimal institutional integration. Regional blocs, he additionally argues, are “fuzzy and leaky.”
The AME region is home to 2 billion people and, by 2040, an estimated 3 billion. This means there are new markets to be found and tremendous growth potential for Northern firms that come in with a nonexploitative mindset to “coproduce” with Southern partners—not penetrate, dominate and conquer virgin markets.

There is a realization that assisting Africa to develop and create jobs locally is, in the end, the most effective way to control migratory flows, in a similar fashion to what has been done for eastern European countries. It is no longer labor that migrates toward capital but capital that moves toward the populations.199

Over and above migration, there are common challenges to be addressed at the interregional level, especially terrorism, climate change, and unemployment. There is a resurgence of the concept and importance of proximity: we are not yet at the “end of geography” (Michael Greig, 2002). Competition is not limited to just finding the lowest costs, but there is a willingness among firms to relocate to areas of better quality-control, easier transportation, and fewer monetary and political risks.

Moreover, the knowledge economy and innovation thrive best when they can take advantage of proximity in the exchanges. Overall, integration at the Africa-Mediterranean level could strike a good balance between the advantages to be gained from opening an economy and cooperating with other countries (new markets, economies of scale, and more economic opportunities, complementarities, managing spillovers and common challenges at the relevant levels, and so on), while maintaining cultural closeness and more control along the value chain to ensure that products match quality requirements and consumer tastes in the partners’ markets.

A. Integration beyond the Mediterranean

A Boston Consulting Group (BCC) report published in May 2018 underscored the fact that although there are still obstacles and geographical fragmentation in Africa, economic integration is accelerating as FDI, exports, and tourism increase in the region.

Also, the World Bank report, *Defragmenting Africa: Deepening Regional Trade Integration in Goods and Services*, highlights “the enormous scope for increased cross-border trade in Africa and the reasons why such opportunities are not being exploited” because of the fragmentation of markets with the high transaction costs of trading across borders.

If a recognition emerges that AME regional integration is logical and desirable, what could be some of the steps to get there?

The following four considerations are especially vital:

• **Coordinated efforts:** There is no lack of competent and well-resourced development institutions, ranging from the World Bank (WB) and the European Investment Bank (EIB) to the African Development Bank (AfDB) and the Islamic Development Bank (IsDB). The issue is not a lack of institutions or resources, but rather the fact that coordination among them needs to improve.

• **Frequent communication:** Creating a fixed-location, permanent forum where heads of state and/or cabinet ministers can gather for consultations between the EU, the UfM, and the African Union would be highly instrumental in facilitating frequent and convenient communication.

• **A strategic planning core:** Among the available resources, the AME is the perfect structure for use as a headquarters of sorts, a command center for strategic planning of the overall integration project (without, nevertheless, overcentralizing the distribution of authority).

• **Building on the past:** A number of significant building blocks—among them the Cotonou Agreement, which expires in 2020—have already been laid. The region, rather than imagining that progress lies in starting afresh with great fanfare and lofty statements, would be better served by doing the not always glamorous work of taking full ownership of those past building blocks, reviving

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Economic Partnership Agreements (EPAs) are trade agreements between the EU and various African regional blocs (plus Pacific and Caribbean countries) that have been recently implemented, are currently in negotiation, or are in the process of being adopted. Their explicit purpose is to use trade as a tool to promote development by:

- Providing access to the EU market (quota and tariff removal on goods, assistance to comply with norms, standards, and rules of origin to better source inputs)
- Promoting investment and value chains (increased incentives for Foreign Direct Investment (FDI) and domestic investment, development of new industries and diversification, lower costs of inputs and better competitiveness, and helping to make it possible for African countries to open more gradually in order to protect certain vulnerable sectors)
- Encouraging trade within African regions (joining smaller markets in already-existing African regional agreements, making sure that the choice of integration comes from African countries themselves, and then providing assistance for the technical and policy aspects of economic integration)
- Fostering sustainable development (including guidelines on labor rights, environmental issues, democratic principles, and so on)

This is the “ideal” framework proposed by the EU. However, negotiations for a regional EPA with West African countries have thus far faced the skepticism of countries like Nigeria. There are also concerns that if regional EPAs fail, there will instead be an even greater fragmentation of agreements with the EU, making it even harder for African countries to evolve toward custom unions.
B. Integration within Africa today

Finally, we must highlight some significant developments, which seem to be converging to signal that Africa could become a major integrated region in the near future:

1. Three African regional economic communities—the Common Market representing Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC), and the East African Community (EAC), represent a total of 26 countries and 600 million people—for which negotiations were launched in 2011 and an agreement was signed in 2015. The three regional communities aim at deepening economic integration through programs such as the “harmonization and improvement of functionality of regional trading arrangements and programs; enhancement of trade facilitation; joint planning and implementation of infrastructure programs; free movement of business-persons.” Tunisia officially joined the COMESA on the occasion of the Heads of State and Government Summit, July 18–19, 2018. As such, it is also now part of the Tripartite Free Trade Area earlier.

2. The Africa Continental Free Trade Agreement (AfCTA): An unprecedented new African Continental Free Trade Area (AfCFTA) was signed on the 21st of March 2018. It offers an opportunity for Mediterranean and sub-Saharan African countries to simplify and harmonize their non-tariff measures—especially the restrictive export-related measures and technical barriers. Real income gains from full implementation of the AfCFTA have been conservatively estimated at 7 percent by 2035. Mediterranean countries directly participating in the AfCFTA, such as Morocco, Egypt, and Tunisia, could each gain around 5 percent each.

It has been signed by 44 of the 55 African Union member states (including all the North African countries, but not Nigeria, which is Africa’s largest economy), and constitutes, for now, the basis of further negotiations (on tariffs, but also legal requirements, rules of origin, investment and intellectual property rights, and so on) to eventually create a single market for goods, services, and the movement of persons in order to deepen the economic integration of the African continent. This could be a milestone toward integration with the EU, which is currently implementing EPAs with African regional groups.

3. The 4500km trans-Saharan highway from Algiers to Lagos, most parts of which have been completed, reinforces possibilities for trade within Africa. However, regulations regarding customs and border crossings should be agreed upon to make this new road a convenient route for transporting and trading goods across countries.

206. COMESA 2018 Pre-Summit Bulletin.
207. For more about the Tripartite Free Trade Area, visit: http://www.sadc.int/about-sadc/continental-interregional-integration/tripartite-cooperation.
4. Finally, Morocco is positioning itself as a logistical hub between the Euro-Mediterranean Partnership region and Africa, capitalizing on its transport infrastructure, which includes the massive Tangier Mediterranean port. As part of this strategy, the government in 2017 officially requested to join the Economic Community of West African States (ECOWAS). Another step toward Morocco positioning itself as a Euro-Mediterranean-African hub is the participation agreement between Morocco’s Banque Centrale Populaire (BCP) and the African Development Bank (AfDB) to promote intra-African trade.208

In summary, recent progress has been made to reduce barriers to trade and business involving African countries.209 These developments indicate that Mediterranean integration should be conceived in a broader context to refer to both European partners in the North and African nations in the South. The greatest potential for integration can be found in the vertical Europe-Mediterranean-African axis.


209. In 2017, only 16% of African merchandise exports were directed to other African countries, representing only 0.37% of total world trade (UNCTAD).
CHAPTER 3
CURRENT CHALLENGES:
FROM SHALLOW TO DEEPER INTEGRATION
Southern Mediterranean Countries (SMCs) share multiple commonalities. They are geographically and culturally close to one another. They also tend to face similar structural challenges.

Essentially, all of these countries face two types of socioeconomic issues. The first relates to the challenges of managing a fragile macroeconomic and social balance under the burden of the “twin deficits”; a fiscal deficit created by domestic overspending and a current account deficit created by the trade imbalance of importing more than the country exports. The twin deficits make the SMCs population’s living conditions highly sensitive to currency devaluations and exchange rate fluctuations. This, combined with fragile social protection systems that lack resilience to external shocks, imposes enormous hardships on millions of people in the region.

The second type of socioeconomic issue the SMCs face is the challenge of undertaking longer-term structural developments such as the promotion of institutional reform, the fostering of competitive, transparent markets, the creation of international trade openness, the maintenance of an improved business climate to attract foreign capital, and the proper functioning of the labor market.

Reflecting on these challenges, this chapter will address the following issues:

- The need for a shift from shallow to deep integration
- The role of services and the digital economy
- The most necessary of the public sector reforms
- The role of regional integration in triggering economic transformation through diversification and upscaling

Studies have repeatedly stressed that a mere liberalization of trade among SMCs may not reap great rewards or resolve the above-mentioned issues,
if not accompanied by substantial structural reforms in each economy.\textsuperscript{210} Furthermore, the previous chapter presented the argument that these domestic reforms are likely to be easier to implement if framed regionally.

RESTRICTIONS TO TRADE OF GOODS AND SERVICES

The Mediterranean region faces a pivotal challenge: shifting from so-called “shallow integration” to “deep integration.”\textsuperscript{211} This, at a bare minimum, means going beyond the usual tariff rate reductions and tackling the more difficult but more rewarding and further-reaching tasks of removing non-tariff measures (NTMs), harmonizing regulations, and improving the business environment by rationalizing competition policy, securing investors rights, streamlining public procurement, and putting in place other requisites of a facilitating business environment.

Deep integration also means extending trade measures to services and investment policies, and fostering the mobility of factor markets—capital and labor, for instance. Deep integration seeks to examine and streamline not only “at the border” regulations but also those “beyond the border” regulations that can lead to market fragmentation.

Péridy and Roux (2012)\textsuperscript{212} have stressed that trade gains from the Euro-Mediterranean partnership are small because the region has not gone the extra mile to engage in deep integration. Other research has reached similar conclusions for the Pan Arab Free Trade Area (PAFTA) as well as for the Maghreb region.\textsuperscript{213} The figure on the next page shows some impact channels associated with Deep and Comprehensive Free Trade Agreements (DCFTAs), including positive spillovers into the economic development of partner countries.

Here are some of the reasons for the slow progress on this front. Countries have stopped making progress in negotiations within the Arab Maghreb Union (AMU). Indeed, by its nature, deep integration involves regulations affecting many interests and entails asking sensitive questions about national sovereignty, as well as concerns that Northern Mediterranean countries seek to impose their regulations on developing countries.

\textsuperscript{210} Fawzy, “Arab Economic Integration,” 20.
\textsuperscript{212} Péridy and Roux, “Why are the Trade Gains So Small?” 571–596.
Chain Analysis of the DCFTA Impact Channels

Safe and Stable EU-Mediterranean Neighborhood

Objectives
- Political association
- Economic integration without membership

Other Titles:
- Political
- Security
- Sectoral
- Financial, etc.

DCFTA

Trade Aspect
- Import tariffs
- Rules of origin

Deep Aspects
- Non-tariff barriers

Comprehensive Aspects
- Approx. to EU law

First-order effects
- EU financial and technical assistance
- Cost of trade
- Prices
- Exports

Second-order effects
- Imports
- FDI
- Jobs
- Productivity
- Tax revenues
- Real income
- Quality of life
- Prices
- Quality and safety
- Diversity
- Competition
- Efficiency

Source: Adarov and Havlik, 2016. 214

214 Adarov and Havlik, “Benefits and Costs of DCFTA.”
Concerns over the distribution of gains from integration across and within countries, a desire to retain national sovereignty, and the potential adjustment costs resulting from increased competition may explain the weak implementation capacity of the signatories and lack of enforcement mechanisms accompanying the agreements (little commitment from institutions).²¹⁵

In addition, governments may not always have the human resources and institutional capacity to manage all the complex aspects of deep integration.

Nonetheless, the Ministerial Declaration of the Union for the Mediterranean (UfM) Trade Ministers meeting in March 2018 indicates that political leaders are increasingly aware that there is still a lot of “potential to be unlocked” from regional integration, and several initiatives have been discussed and supported.²¹⁶

Here, some avenues for strengthening integration are explored.

1. BEYOND THE BORDER POLICIES

A. The decreasing relative importance of tariffs

This section will present how the bulk of trade costs have shifted from tariff to non-tariff barriers and beyond-the-border policies. By these terms we mean not only traditional non-tariff measures (for example, quotas, voluntary export restraints, and technical barriers and requirements), but also other trade facilitation²¹⁷ measures (for example, rules of origin, transport infrastructure, logistical services, and so on).

With the expansion of Global Value Chains (GVCs) and vertical integration in which goods frequently cross borders to be used as inputs, reducing tariffs matters significantly for a country to be able to take part in international trade. However, even if trade agreements have been focused on tariffs on manufactured goods, as indicated above, the Mediterranean region remains one of the least integrated in the world.

Indeed, one can see that the Effectively Applied Tariff (AHS) rates are all below 9 percent, with Algeria providing the highest protection. Overall, AHS rates in MENA are lower than in South Asia, Sub-Saharan Africa, or Latin America, but higher than in East Asia and Pacific, or the European Union.

The wedge between the AHS and Most-Favored Nation (MFN) rates²¹⁸ tells us the extent to which a country trades with partners that are part of a preferential

²¹⁵. Fawzy, “Arab Economic Integration.”
²¹⁶. The March 19th Declaration, third paragraph, states:
Ministers recognized that some partners wish to modernise these agreements to extend their scope and increase the degree of reciprocal liberalisation, including agriculture and fishery products, and services and investment as well as to deepen the commitments on key rules governing trade policy in the 21st century to contribute to a sustainable development in the region. Ministers also recognised the interest of other partners in the UfM to take a gradual approach towards the implementation of deeper and more comprehensive trade relations amongst them. (European Union, Ministerial Declaration of the Union for the Mediterranean (UfM) Trade Ministers (Brussels: March 19, 2018) http://ufmsecretariat.org/wp-content/uploads/2018/04/Ministerial-Declaration_trade.pdf.)
²¹⁸. MFN tariffs are what countries promise to impose on imports from other members of the WTO, unless the country is part of a preferential trade agreement (such as an FTA or a customs union). These agreements are reciprocal: all parties agree to give each other the benefit of lower tariffs.
For example, the large difference between AHS and MFN for Morocco and Tunisia stems from the fact that they trade significantly with the EU, with whom they also have an association agreement.

TARIFF RATES: AHS AND MFN WEIGHTED AVERAGE (%) 2015

Source: WITS, 2015

It is assumed that a country will use the preferential tariff rate, if it exists, rather than the Most-Favored Nation (MFN) rate (the “preference utilization rate”), whereas this is not always the case because of issues of rules of origin or other requirements.

Finally, though there is still some margin to further reduce tariff rates among Mediterranean partners, there are other more important obstacles elsewhere. Sheperd (2011) has estimated ad valorem equivalent costs from non-tariff measures and other trade costs (logistics, transportation, and so on), and has shown that they are typically twice higher among MENA countries than they are in Western Europe. Moreover, Maghreb countries have lower trade costs with Europe than among themselves.219

Similarly, using the “ESCAP World Bank (WB): International Trade Costs” from the work of Arvis and Shepherd (2013),220 we present the same matrix of trade costs with a finer breakdown and for the year 2014. We can see, as expected, that trade costs for agriculture are much higher than for manufacturing. It also shows the heterogeneity of costs within the Mediterranean region and even within subgroups (for example, Maghreb and Mashreq).

In their calculations, the trade costs are related to both exogenous and endogenous (that is, policy choice) factors, including

- Geographical distance
- Transportation costs
- Shared features such as language, history, borders, and participation in the same economic community
- Logistics performance (cost, delay, reliability), border control and transit system
- International connectivity (air, maritime, and terrestrial services)
- Tariffs

219. See table on the next page.
## 2015 Bilateral Trade Costs

### Average Percentage of Additional Trading Costs for Trading Goods Between Two Countries

<table>
<thead>
<tr>
<th>Sector</th>
<th>Tunisia</th>
<th>Morocco</th>
<th>Algeria</th>
<th>Lebanon</th>
<th>Jordan</th>
<th>Turkey</th>
<th>Egypt</th>
<th>Palestine</th>
<th>FR/IT/SP</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tunisia</strong></td>
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<tr>
<td>Manufacturing</td>
<td>115,904,636</td>
<td>54,006,617</td>
<td>168,204,646</td>
<td>177,464,263</td>
<td>109,378,776</td>
<td>133,922,204</td>
<td>177,692,123</td>
<td>115,384,468</td>
<td>68,066,1885</td>
</tr>
<tr>
<td>Agriculture</td>
<td>180,657,4242</td>
<td>201,352,636</td>
<td>474,759,986</td>
<td>280,801,026</td>
<td>197,139,512</td>
<td>235,402,403</td>
<td>197,139,512</td>
<td>121,679,7172</td>
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<tr>
<td><strong>Morocco</strong></td>
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<tr>
<td>Manufacturing</td>
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<td>156,742,259</td>
<td>182,467,314</td>
<td>99,878,1799</td>
<td>130,507,654</td>
<td>375,291,752</td>
<td>70,075,023</td>
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</tr>
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<td>Agriculture</td>
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<td>285,590,624</td>
<td>279,306,769</td>
<td>225,509,864</td>
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<td><strong>Algeria</strong></td>
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<tr>
<td>Agriculture</td>
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<td>317,681,171</td>
<td>385,376,701</td>
<td>511,817,123</td>
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<tr>
<td>Manufacturing</td>
<td>95,594,513</td>
<td>121,441,323</td>
<td>115,364,480</td>
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<td>128,872,459</td>
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<tr>
<td>Agriculture</td>
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<td>203,836,823</td>
<td>143,549,812</td>
<td>..</td>
<td>..</td>
<td>210,242,058</td>
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<td><strong>Jordan</strong></td>
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<tr>
<td>Manufacturing</td>
<td>108,361,473</td>
<td>116,026,041</td>
<td>105,812,195</td>
<td>155,764,646</td>
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<tr>
<td>Agriculture</td>
<td>215,877,321</td>
<td>169,757,817</td>
<td>129,003,083</td>
<td>186,128,906</td>
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<td><strong>Turkey</strong></td>
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<tr>
<td>Manufacturing</td>
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<td>75,326,937</td>
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<tr>
<td>Agriculture</td>
<td>215,877,321</td>
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<td><strong>Egypt</strong></td>
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<td>Agriculture</td>
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<tr>
<td><strong>Palestine</strong></td>
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<td>352,433,288</td>
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<tr>
<td>Agriculture</td>
<td>425,164,255</td>
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<td>425,164,255</td>
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<tr>
<td>Manufacturing</td>
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<td>..</td>
<td>44,051,625</td>
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<tr>
<td>Agriculture</td>
<td>65,622,059</td>
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<td>..</td>
<td>65,622,059</td>
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</table>

Source: ESCAP-World Bank Trade Cost Database\(^{221}\)

\(^{221}\) The Comprehensive Trade Cost indicator reflects the average percentage of additional trading costs for trading goods between two countries. For example, on average, for all tradable manufacturing goods between Tunisia and Morocco, additional costs will be of approximately 115 percent of the value of goods. The database can be found at: [https://www.unescap.org/resources/escap-world-bank-trade-cost-database#](https://www.unescap.org/resources/escap-world-bank-trade-cost-database#).
For the Asia and Pacific region, it was estimated that, in 2014\textsuperscript{222}

- Less than 10 percent of trade costs were related to tariffs
- Between 0 and 30 percent of trade costs were due to natural costs (such as geographical and cultural factors)
- The remaining 60 and 80 percent of trade costs were generated by non-tariff policy measures, including indirect costs of trade procedures, maritime connectivity and services, business (regulatory) environment, currency fluctuations, and availability and use of ICT services

For MENA, Shui and Walkenhorst (2010)\textsuperscript{223} indicated that the region had the highest trade costs, and at least half of these came from non-tariff measures (NTMs) (see figure below).

### TARIFF AND NON-TARIFF MEASURES

![Uniform tariff equivalent (%)](image)

**Sources:** Shui and Walkenhorst, 2010


See also UNESCAP, “Trade Facilitation and Paperless Trade Implementation in Asia: Highlights from UNESCAP’s Research,” presentation at 10\textsuperscript{th} East Asian Institutes Forum “Global Value Chains (GVCs) and East Asian Economic Integration,” October 9, 2014. See also United Nations ESCAP, Trade Facilitation and Paperless Trade: State of Play and Way Forward for Asia and the Pacific, ESCAP Studies in Trade and Investment No. 8 (2015), https://doi.org/10.18356/04abbc74-en; PDF version available at: https://pdfs.semanticscholar.org/gf7ee/95881e35238d4869e57e7d1a1c83dcd186.pdf.

See also UNESCO, “Trade Facilitation and Paperless Trade Implementation in Asia: Highlights from UNESCAP’s Research,” presentation at 10\textsuperscript{th} East Asian Institutes Forum “Global Value Chains (GVCs) and East Asian Economic Integration,” October 9, 2014. See also United Nations ESCAP, Trade Facilitation and Paperless Trade: State of Play and Way Forward for Asia and the Pacific, ESCAP Studies in Trade and Investment No. 8 (2015), https://doi.org/10.18356/04abbc74-en; PDF version available at: https://pdfs.semanticscholar.org/gf7ee/95881e35238d4869e57e7d1a1c83dcd186.pdf.

Looking more closely at the countries represented in the figure below, we see that within the Mediterranean region, the costs related to imports and exports are quite even across the countries. Except for Lebanon, the costs of imports tend to be slightly lower than exports.

The Pan-Arab Free Trade Area (PAFTA), established in 1997 among countries of the Arab League, does not include an investment and service trade policy; also, it does not cover Sanitary and Phytosanitary Standards (SPS) or Technical Barriers to Trade (TBT), and there are no dispute settlement mechanisms. Additionally, “specific standards, lengthy bureaucratic and administrative procedures at the borders, and high transit fees, are still reported as costly and lengthy procedures.

Lack of trust in the certificates of standards and rules of origin prepared in member states are also considered important barriers to intra-PAFTA trade.”224 Ebaidalla and Mustafa (2018)225 test this idea empirically for those Arab countries (members of the Arab league) and confirm that “beyond-the-border constraints are responsible for a considerable gap between potential and actual trade among Arab countries.”226

Thus, “the policy measures that are likely to be most conducive to value chain integration, are those that promote deep integration, including trade facilitation (like transport services and customs procedures), services liberalization, competition policy, investment, intellectual property protection and dispute settlement” (Baldwin 2013, Orefice and Rocha 2013).227

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224. World Bank, Over the Horizon: A New Levant.
More precisely, since the governments may not have the political and technical capacities to implement reforms on all those fronts simultaneously, they should prioritize cooperation in areas that are not too sensitive to sovereignty issues and where “economic payoffs to joint action are significant,” with “clear winners that will mobilize in support of implementing and sustaining the reforms” (that is, Mattli’s “demand condition” for integration).228 In this regard, a key area is “trade facilitation, through reforms in key services (public and private) that lower trade transaction costs.”229

The “Trading Across Borders” indicator from Doing Business230 is calculated from the time and costs of border and documentary compliance for exports and imports. Looking at the relative position of SMCs, we can see that performances in this area differ widely within the region. On one side, Jordan, Morocco, and Tunisia clearly do better than countries with similar levels of income. On the other side, Algeria, Egypt, and Lebanon are underperforming.

TRADING ACROSS BORDERS—DISTANCE TO FRONTIER (DTF) (100 = BEST)

Source: Doing Business, 2018

228. Mattli, The Logic of Regional Integration.

229. Hoekman and Sekkat, “Arab Economic Integration.” Hoekman also writes:
A necessary condition for reducing N.T.M.-related trade costs is that negatively affected interest groups have sufficient incentives to sustain the focus and effort needed to ensure implementation of reforms. The challenge is to identify areas where there are clear ‘win-wins’ in the sense that groups in the different countries involved have strong incentives to push for cooperation by their governments to implement desirable reforms, and to put in place mechanisms through which such groups can hold their governments accountable for results (Hoekman, “Intra-Regional Trade”).

230. In 2019 the “Trading Across Borders” indicator from Doing Business was changed to an “Ease of Doing Business” score that combines measures with different units such as how long it takes to set up a new company, and how complicated property transfer procedures are. Despite the obvious improvements made to the indicator, the geographical dimension is now less well represented than with the “Trading Across Borders” indicator.
However, this measure from Doing Business is only one aspect of trade facilitation, and rankings might differ if it is examined from another angle.

In any case, Bourdet and Persson (2014)\textsuperscript{231} found that trade facilitation could lead to substantially increased export volumes and export diversification for SMCs. Specifically, they estimated that improving export and import procedures to the best-practice level prevailing in the region could increase the value of SMC exports by 34 percent\textsuperscript{232} and the number of products they export by 21 percent.

Intending to attract foreign investment, several countries in the MENA region have granted extensive regulatory and tax concessions to foreign companies in comparison with those accorded to domestic companies. Although this has produced significant results in terms of exports, it has also created a dual productive system in which “offshore” exporting companies are treated differently, and better, than “onshore” companies that work almost entirely in the domestic market.

Additionally, public authorities often limit offshore companies’ access to the domestic market, which exacerbates the dualization of the productive system because it does not foster positive spillovers and technology transfer. In such circumstances, there are few linkages and thus few ripple effects, little knowledge transfer, and few positive externalities between the offshore and onshore sectors. This has created a need for significant change to the tax regulations, as in Tunisia.\textsuperscript{233} In addition, because of the extensive tax concessions, significant tax revenues have been lost, which may have further contributed to fiscal instability and the weakening of the social contract between the state and civil society.

**B. Rules of origin**

Rules of Origin (ROOs) constitute another potential technical barrier (or facilitator). They define the technical criteria\textsuperscript{234} that determine whether a product qualifies for duty-free, or other preferential, access, under a given trade agreement. The concept has become increasingly important with the development of GVCs and has been extended to encompass the idea of “diagonal accumulation” of ROOs. This has become an appropriate operational tool for managing multiple bilateral trade agreements between participants in an integrated regional area, and segmentation of production sites for each component in the GVC.


\textsuperscript{232} Bourdet and Persson offer a warning about the potential increase in the value of SMCs. However, “it is worth reiterating that, owing to the lack of time-series variation in the data, these results should not be taken too literally, and should be seen only as indicative of what the magnitude of effects might be.”

\textsuperscript{233} These trade facilitations must not be limited to the offshore sector as in Tunisia; they should also be applied to the onshore sector. It is important to note that, with this aim in mind, the Tunisian government on January 1st, 2019 made the decision that it impose a 13.5 percent tax on the offshore sector by 2022; it is currently completely tax-free. The onshore sector will continue to be taxed at the same rate.

\textsuperscript{234} Rules of Origin (ROOs) can become, in some cases, a binding constraint that inhibits freer trade.
The cumulation of Rules of Origin (ROOs) is an exception to the principle that goods must be obtained entirely from the exporting country or have been sufficiently processed there to be considered to have “originated” from that country. As a result of cumulation, it is now possible to treat the goods produced by a free trade partner in the same way as those originating from the exporting country. For a producer or exporter, it becomes profitable to use materials originating from free trade partner countries.

An example of bilateral cumulation

Clothing is manufactured in country X using imported fabric and sewing thread originating from country Y. With regard to the cost of producing the clothes, the share of value of the imported fabric is 50 percent and that of the sewing thread is 1 percent. For the clothes to be considered products originating from country X for export to country Y, it is essential that the list of working and processing operations show that the value of materials imported from a third country does not exceed 40 percent of the exporting factory price.

In this case, products can be declared as originating from a particular country only through bilateral cumulation. The imported fabric must be a product originating from country Y. For the manufacturer, it is therefore more profitable to use fabric originating from countries X or Y rather than fabric originating from a third country.

An example of diagonal cumulation

The imported fabric must originate from a contracting party to the Euro-Mediterranean system. For the manufacturer, it is therefore more profitable to use fabric originating, for example, from Morocco or a contracting party to the Euro-Mediterranean system than fabric originating from a third country.

In essence, to be eligible for duty-free trading conditions, the product has to meet requirements for the minimum value-added in the country of origin, often around 50 percent. However, this minimum may be achieved by accumulating lesser amounts of value added in supply chains across two or more states. For example, in the case of textiles, the yarn may be produced in state X, exported to state Y where it is woven into fabrics, and on to state W where it is made into garments, before being exported to state Z as a finished product.
Each single stage of the production process might not meet the minimum value-added requirement for tariff-free market access, but when the entire value-added chain is cumulated, it does meet the requirement.

Some changes were introduced in the Euro-Mediterranean partnership in 2012: “The system of Pan-Euro-Mediterranean cumulation of origin allows for the application of diagonal cumulation between the EU, European Free Trade Association (EFTA) States (Iceland, Liechtenstein, Norway and Switzerland), Turkey, the countries that signed the Barcelona Declaration, the Western Balkans and the Faroe Islands. It is based on a network of Free Trade Agreements (FTAs) having identical origin protocols. Those origin protocols are being replaced by a reference to the Regional Convention on pan-Euro-Mediterranean preferential rules of origin (PEM Convention). A single Convention will facilitate the on-going revision of the PEM rules of origin aiming at modernizing and simplifying them.”235

The Convention brings together the pan-European cumulation system created in 1997—consisting of the EU (then the EC), the European Free Trade Association (EFTA), the Central Eastern European Countries (CEEC), and Baltic States—and its enlargement to Euro-Med countries and the pan-Euro-Mediterranean cumulation system of origin in 2005 in a single agreement. This will minimize the risk of creating a “spaghetti bowl”—or jumble—of different sets of rules in the region.

In addition, the EU and EFTA apply full cumulation of rules of origin with Algeria, Morocco, and Tunisia. Also, in 2016, the EU simplified ROOs with Jordan for production that takes place in one of 18 designated industrial areas and Special Economic Zones (SEZs), and which, hires a minimum percentage of Syrian refugee workers in the production facilities (initially 15 percent and increasing to 25 percent in year 3).

Finally, in March 2018, at the 10th Union for the Mediterranean Trade Ministerial Conference, ministers agreed “on a set of modernized rules of origin for the region and to finalize on that basis the text of the revision of the Pan-Euromed Convention on Rules of Origin (ROO) by end 2018. The new rules are simpler, easier to follow, and more adapted to regional value chains than those under the previous convention. They will make the life of economic operators, especially Small and Medium Enterprises (SMEs) easier and ensure value creation in the region.”236

But even with simpler and more harmonized Euro-Mediterranean ROOs, South-South trade could remain difficult because of the overlapping of other FTAs, which have their own rules—for example, PAFTA, the Common Market for Eastern and Southern Africa (COMESA), Economic Community of West African States (ECOWAS), and others.237

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236. UfM, “Union for the Mediterranean Promotes Trade.”

237. Timo Behr, “Regional Integration,” 100.
C. Technical barriers to trade

Technical Barriers to Trade (TBT) through a variety of technical regulations and quality standards can, as the name suggests, be an obstacle to trade between countries. However, in many cases such regulations are legitimate as they ensure that products respect certain environmental, health and security standards that are essential for protecting a country’s population.

In this regard, it is important to emphasize the vast body of technical standards governing access to the European market (of which there are more than 600,000), which raises the issue of the technical competencies available in Mediterranean countries to enable access to this market, as well as the cost of acquiring them. The numerous directives stipulating the procedures for accessing different parts of the EU’s internal market further complicate matters. This explains the relatively weak European engagement toward Mediterranean countries with regard to foreign trade, in comparison with the rest of the world.

A tool that the EU is proposing to its Southern partners is the addition of protocols to existing Association Agreements, called “Agreements on Conformity Assessment and Acceptance of Industrial Products” (ACAAs). These enable a mutual recognition of technical standards for the desired sectors, making certification and clearance procedures much easier, thus saving time and money.

Van der Loo (2016)²³⁸ argues that Mediterranean countries which negotiate such agreements with the EU “will have to find a balance, on the one hand, between approximating to the EU acquis in order to integrate into a section of the EU Internal Market and to modernize their economy and, on the other hand, maintaining the right to regulate and not to overburden their economy with EU legislation that will not directly result in additional market access or is not useful for their domestic reform agenda.”

D. Transport infrastructure and logistical efficiency

Being able to efficiently move physical goods across and within borders is essential to participating in global or regional value chains. This depends on several factors, including the quality of transport infrastructure, the quality of logistic services, and the regulation at the border for compliance of exports and imports. Luo and Xu (2018)²³⁹ review the literature on the linkages between infrastructure and development and point to the essential role infrastructure plays in enabling and facilitating participation in GVCs and economic upgrading, even if it is not sufficient by itself.

In SMCs, efforts have been made to improve “hard” infrastructure, and additional investment would be welcomed to develop a Trans-Mediterranean Transport

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²³⁸ Guillaume Van Der Loo, “Mapping out the Scope,” 42.
Network\textsuperscript{240} (see for example the completion of the trans-Maghreb motorway). A joint report by the World Bank and World Trade Organization (WTO) on the role of trade in ending poverty\textsuperscript{241} highlights the importance of sub-national infrastructure in complementing such region-wide projects, noting that “the trade-related barriers along the agricultural supply chain from producer to consumer are complicated, especially at the first stages of the supply chain.”

In the area of “soft” infrastructure—for example, regulations and services that facilitate trade with efficient logistics—there is arguably a larger margin for improvement. In addition to building physical infrastructure, it is also essential to increase the performance of operators and managers handling the logistics platforms, through capacity building. Also, a key pillar of the Regional UfM Transport Action Plan for the period 2014–2020 is to tackle regulatory reform and the issue of convergence in all relevant transport sectors.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{logistics.png}
\caption{OVERALL LOGISTICS PERFORMANCE AND INCOME INDEXES (5 = BEST)}
\end{figure}


\textsuperscript{241} World Bank Group and WTO, \textit{Role of Trade in Ending Poverty}. 
The World Bank has also created a Logistics Performance Index (LPI) from surveys and other quantitative data that can be used to compare countries.\(^{242}\)

In comparing across country groups,\(^{243}\) we find that the SMCs’ performance slightly exceeds that of Southern countries in Asia and Sub-Saharan Africa, but is well below that of East Asia and Pacific, or Europe and Central Asia, or the Gulf Cooperation Council countries, which have the highest score. Taking the average score for the entire MENA region would not be a good indicator for the South Mediterranean region, given the large heterogeneity between those two sub-groups.

When comparing across countries using their level of income (see figure above), we find that the LPI score is indeed positively correlated to income. By this measure, we can see that only Egypt and Turkey are, relatively speaking, over-performing, while Algeria, Jordan, Lebanon, Morocco, and Tunisia are, relatively speaking, moderately underperforming. Not surprisingly, as an FCV (Fragility, Conflict, and Violence) country, Libya posts the lowest performance.

\(^{242}\) The Logistics Performance Index (LPI) can be found at: https://lpi.worldbank.org/about.

\(^{243}\) The six country groups are ECS: Europe and Central Asia (including high income); SAS: South Asia; GCC: Gulf Cooperation Council; SSA: Sub-Saharan Africa; LAC: Latin America and Caribbean. South Med: Algeria, Egypt, Jordan, Libya, Lebanon, Morocco, Syria, Tunisia, and Turkey.
RELATIVE PERFORMANCE OF MEDITERRANEAN COUNTRIES
BY SUBCATEGORIES OF 2018 LPI INDEX (5 = BEST)

Hoekman and Zarrouk (2009) surveyed six subcategories of the index—Customs, firms across PAFTA countries and found that “significant progress has been made since 2000 to remove tariff-related barriers to intra-PAFTA trade in goods, including customs-clearance-related procedural burdens, so that the relative importance of transport- and logistics-related costs have risen.” The two economists argue that creating a regional network regulatory agency to oversee network services such as electricity, telecommunications, railways, and air transport could be an important step to improve the situation.244

Finally, upon comparing the performance of the Mediterranean countries in each of the Infrastructure, International Shipments, Logistics Quality and Competence, Tracking and Tracing, and Timeliness subcategories (Hoekman and Zarrouk) it appears that Eastern Mediterranean countries (including Egypt and Turkey) perform better than Maghreb countries in almost all subcategories.

These findings are nuanced by more recent results: comparing the Logistics Performance Index (LPI) between 2007 and 2018 for customs, most Mediterranean

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countries may have backslid. The table and graph below show that Mediterranean countries greatly lag the rest of the world in the category of Customs Logistics, but are also underperforming in the other five dimensions of the LPI.

LOGISTICS PERFORMANCE INDICATORS, 2018
WORST 3 RANKS - LPI

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<tbody>
<tr>
<td>Algeria</td>
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</tbody>
</table>

Source: World Bank

EFFICIENCY OF THE CUSTOMS CLEARANCE PROCESS

LPI index “Customs” 2018

Source: World Bank

245: According to UN data, out of a total of 193 countries, Turkey slid down from 33rd to 58th, Jordan from 54th to 88th, Tunisia from 39th to 107th, and Morocco from 101st to 115th. Only Algeria and Egypt improved—48th to 138th and 122nd to 77th, respectively. Lebanon, going from 107th to 106th, registered little change.
Indeed, the low quality of the transportation infrastructure, and of the accompanying logistical services that are associated with trade, prevent national markets from cooperating with each other and with the rest of the world, negatively affecting the development of the regional economy. As Malik and Awadallah (2011)\footnote{Malik and Awadallah, “Economics of the Arab Spring,” 32.} argue, the “absence of a vibrant private sector is also a regional failure, not simply a failure of individual countries.” They add that Arab countries are abnormally fragmented despite obvious assets such as sharing a common culture, language, and a rich trading civilization; and being well positioned geographically “at the crossroads of major sea and trading routes with easy access to Europe, Africa and the near East.”

This lack of linkages is detrimental to the MENA region’s economy for several reasons already mentioned earlier, including for example low market size that prevents the private sector from benefiting from economies of scale, lower competitive pressure, the fact that monopolies and rent-seeking behaviors are easier to maintain there; and the undersupply of regional public goods.

An adequate transportation system is essential to reducing trade costs, in addition to increasing productivity. As such, building regional transport infrastructure with an efficient multimodal logistics system is a prerequisite for strengthened regional integration. The World Economic Foresight Institute (IPEMED) argues that, given the complementarities between the Maghreb countries’ networks, a railroad transport could further contribute to Euro-Mediterranean integration, even though currently 95 percent of the exchange of goods goes by sea, 4 percent by road, and 1 percent by railroad.\footnote{IPEMED, "Bilan 2006–2016: Un Système de Transports Intégré: des Idées pour Agir," IPEMED website, May 20, 2016, accessed October 30, 2020, available at: http://www.ipemed.coop/fr/nos-projets-r16/transports-c154/bilan-2006-2016-un-systeme-de-transports-integre-des-idees-pour-agir-a2789.html.}

When political conditions allow for it, priority should be given to opening road and rail services between Morocco and Algeria, thereby reducing the incidence of smuggling across the border, and avoiding a situation in which each country (including Tunisia) invests in independent infrastructure (and thus, in a sense, reinventing the wheel) rather than pooling their resources and benefiting from economies of scale. Moreover, Morocco’s neighbors could benefit from the Tangier-Mediterranean economic zone and the large port built in 2007. If it is well connected it could become a major regional hub facility that will improve the competitiveness of all firms participating in global value chains.

Air transportation can also play a major role in the promotion of tourism in the region. Morocco’s Open Skies agreement with the EU has brought in new airlines and led to a reduction in travel costs, making Mohammed V airport a potential hub for northern and West Africa.

A word of caution is offered by Schiff and Winters (2002): “There is a common perception that forming a Regional Integration Arrangement (RIA) needs to
be accompanied by additional expenditure on intra-RIA infrastructure. This is perfectly possible, but is, perhaps surprisingly, not always needed. Higher investment in regional transport infrastructure may be unjustified because the increase in regional trade may be the result of trade diversion and facilitating this by reducing its costs could just increase its economic burden.  

2. THE LIBERALIZATION OF THE SERVICES SECTOR AND DIGITAL ECONOMIC INTEGRATION

As economies become more digitalized and connected, services are projected to represent an increasing share of the value added produced across the world. It is difficult to grasp the precise regional impact of this phenomenon due to the widely criticized “catch-all” nature of services. This makes it hard to isolate the sector and to regulate it in a strategic manner internationally. The growing digitalization of human interactions, the development of artificial intelligence and robotization, and the knowledge economy, as well as social services—social and sustainable economy, health care, culture—demand greater care when assessing statistical data and regulatory information about the services sector.

As a result of the development of the digital economy, we are increasingly faced with interpersonal relations which partly elude the rigidity of productive dynamics and give rise to less localized innovations that the regulatory environment may allow to develop. The digitalization of services also affects the agility of Mediterranean societies, as well as their creativity and influence.

A simple look at the data does not seem to show an explosion of trade in services: it represents 45 percent to 80 percent of total trade in Mediterranean countries such as Lebanon, Jordan, Egypt, and Morocco, which is much higher than in other regions. The following sections of the book will show that efficient service provision is crucial in many ways.

Moreover, the Global Value Chains World Development Report 2017 notes that the weight of services in trade has been underestimated because of the way we measure trade (as gross quantities). When we measure trade in value added terms, we see that services are gaining ground and coming close to one-half of all exports, even though restrictions in the service trade remain high in some countries. This is because services are “links in Global Value Chains (GVCs)” and represent a large source of input for exported goods.

248. Schiff and Winters, “Regional Cooperation.”
249. Services include Information, Communications and Technology (ICT) services, a sector that has become highly transformational in today’s markets.
SHARE OF SERVICES IN WORLD EXPORTS (PERCENTAGE OF TOTAL EXPORTS OF GOODS AND SERVICES)

Source: UNCTAD

SHARE OF SERVICES IN WORLD EXPORTS OVER TIME

A. The specifics of services: remaining restrictions and limited tradability

Just as reductions in transport costs galvanize trade in goods, reductions in communication costs and the digitization of services are transforming the international trade of services. However, services tend to be more affected by non-tariff measures (such as domestic regulations, barriers to entry, opaque public procurements, and so on) than goods are.

Indeed, contrary to goods, “the supply of many services is possible only through the simultaneous physical presence of both producer and consumer.”251 Hence, this limited tradability is closely related to the ability to attract FDI—where the service provider establishes a commercial presence in the country (Mode 3 of GATS)—and also related to the mobility of people (where the service provider temporarily moves—Mode 4 of GATS).252

The graphs below show that the Mediterranean region is performing poorly in terms of openness to trade in services for each sector. Hoekman writes that “the non-storability of many services often will require a foreign firm to invest or otherwise establish a physical presence in an importing market to provide a service. This in turn subjects the firm to local regulation and the prevailing business environment.”253 It has been suggested, at least for the banking and telecom sectors, that restrictiveness in the possibility of establishing a commercial presence, with cost inefficiency effects, is the most critical feature (Bottini, Marouani and Munro, 2011).254

“The Services Trade Restrictions Index (STRI) is a measure of the restrictiveness of an economy’s regulatory and policy framework with respect to trade in services. It quantifies the information from the Services Trade Restrictions Database (STRD) and provides a comparison based on services trade policies, cross-border supply, commercial presence, and natural persons. It ranges from 0 to 100, where 0 indicates that none of the restrictions underlying the index is applied, and 100 means that the sector is completely closed to foreign services and service suppliers.”255

252. Trade of services, however, is not be limited to Modes 3 and 4 of GATS.
253. Hoekman, “Intra-Regional Trade.”
255. The Services Trade Restrictions Index (STRI) can be found at: https://www.worldbank.org/en/research/brief/services-trade-restrictions-database.
The Mediterranean region, however, is not homogeneous in terms of service trade restrictiveness (see figure below). The conclusion of Hoekman (2016) is valid for Mediterranean countries when he says that "professional and transport services tend to be the most restricted sectors in the MENA region; the latter will have negative consequences for the efficiency of logistics-related services; the former affects the productivity performance of firms in general, given that professional services are one channel for the diffusion of knowledge regarding good practices (management consulting, accounting, legal services, and so on)."

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256. Hoekman, "Intra-Regional Trade."
Ezzat and Aboushady (2018) reviewed each MENA country’s regulatory policies for the telecom sector (see table below) and concluded that, as confirmed by the Service Trade Restrictions Index, the sector is now open to foreign investment following its partial liberalization in the 1990s and 2000s.

### MENA TELECOM SECTOR SUMMARY 2010: REGULATION, PRIVATIZATION, AND COMPETITION

<table>
<thead>
<tr>
<th>REGULATORY AUTHORITY (CREATION YEAR)</th>
<th>PRIVATIZATION OF THE MAIN INCUMBENT OPERATOR</th>
<th>BTA SIGNED</th>
<th>COMPETITION LEVEL IN FIXED TELEPHONE MARKET</th>
<th>COMPETITION LEVEL IN MOBILE CELLULAR MARKET</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALGERIA</td>
<td>State owned</td>
<td>No</td>
<td>Monopoly</td>
<td>3 Operators</td>
</tr>
<tr>
<td>BAHRAIN</td>
<td>Partially private</td>
<td>No</td>
<td>More than 6</td>
<td>3 Operators</td>
</tr>
<tr>
<td>EGYPT</td>
<td>Partially private</td>
<td>Yes</td>
<td>Monopoly</td>
<td>3 Operators</td>
</tr>
<tr>
<td>IRAN</td>
<td>Partially private</td>
<td>No</td>
<td>Monopoly</td>
<td>3 Operators</td>
</tr>
<tr>
<td>JORDAN</td>
<td>Fully private</td>
<td>Yes</td>
<td>2 Operators</td>
<td>3 Operators</td>
</tr>
<tr>
<td>KUWAIT</td>
<td>State owned</td>
<td>No</td>
<td>Monopoly</td>
<td>3 Operators</td>
</tr>
<tr>
<td>LEBANON</td>
<td>State owned</td>
<td>No</td>
<td>Monopoly</td>
<td>Government owned Duopoly</td>
</tr>
<tr>
<td>MOROCCO</td>
<td>Privatized</td>
<td>Yes</td>
<td>3 Operators</td>
<td>3 Operators</td>
</tr>
<tr>
<td>oman</td>
<td>Partially private</td>
<td>No</td>
<td>2 Operators</td>
<td>2 Operators</td>
</tr>
<tr>
<td>QATAR</td>
<td>Partially private</td>
<td>Yes</td>
<td>2 Operators</td>
<td>2 Operators</td>
</tr>
<tr>
<td>SAUDI ARABIA</td>
<td>Partially private</td>
<td>No</td>
<td>2 Operators</td>
<td>4 Operators</td>
</tr>
<tr>
<td>TUNISIA</td>
<td>Partially private</td>
<td>Yes</td>
<td>2 Operators</td>
<td>3 Operators</td>
</tr>
<tr>
<td>TURKEY</td>
<td>Partially private</td>
<td>Yes</td>
<td>3 Operators</td>
<td>3 Operators</td>
</tr>
<tr>
<td>YEMEN</td>
<td>State owned</td>
<td>No</td>
<td>Monopoly</td>
<td>4 Operators</td>
</tr>
</tbody>
</table>

Source: Ezzat Riham (2015)

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Overall, research suggests that for the Levant (Egypt, Turkey, Jordan, Lebanon, Iraq, Syria, and Palestine), “benefits from services’ trade liberalization will certainly be larger than those deriving from goods’ trade liberalization. These issues need to command greater attention among regional policy makers.”

This logic could be extended to the whole Mediterranean region because services are taking an increasingly larger share of the economy, where previously rather too much focus was put on the trade of goods.

This is not surprising. Good service quality is crucial because it is at the crossroads of many activities for several reasons:

- Services are an important component of trade-of-goods-related costs, through transportation and logistics.
- Services are extensively used in the industrial sector and thus contribute to its competitiveness.
- Services should be valued on their own merits in terms of the potential creation of jobs and productivity growth with the emergence of high tech and ICT services.

A key question concerns the need for a regional or concerted approach to services reform. Hoekman and Messerlin explain it this way: “The incentives to pursue such reforms are large, and other parts of the world have implemented service sector reforms on a unilateral basis. However, progress in this area has been slow in MENA countries, suggesting there are political economy constraints that are still binding. To become an engine of regional integration, the joint pursuit of service reforms will have to be an effective vehicle to help overcome political economy resistance to unilateral reforms.”

B. Harnessing the potential of services and the digital economy as new sources of growth diversification

Traditionally, theories of structural change and economic development have highlighted the role the manufacturing sector plays in moving resources and labor from the non-tradable sector, with its low productivity, to the high-productivity tradable sector, in order to spur growth in developing countries.

Because exporting firms are more exposed to competition, they tend to invest more in research and development (R&D) and experience greater productivity and technological improvements than the rest of the economy. Harvard economists such as Ricardo Hausmann, Cesar Hidalgo, and Dany Rodrik have done a lot of research on the economics of transition through structural change.
and on how the complexity of a country’s economy, relative to its income level, can be predictive of its future growth.261

A 2018 report from the African Development Bank (AfDB) points out that such a structural change has been slow in coming in North Africa for the past decade because most of the productivity gains are realized within sectors. Some reasons might be related to “problems of quality of education and an inefficient use of human capital,” or the “concentration of exports in low-value-added activities and in sectors with few possibilities of technological innovation.”262

Rodrik also stresses the role of industrial policies in achieving any major economic transition. For example, they can be used to overcome market failures in developing countries: “In environments that are rife with uncertainty and with technological and informational spillovers, markets under-provide investment in non-traditional products. The appropriate role for industrial policy is to fill in this market incompleteness by subsidizing investments in new products.”263 This can work well if governments are willing to let “loser firms” die (typically, by ending bail-outs and subsidies).264
Due to ongoing technological change and the growth in ICT, the emergence and digitalization of the knowledge economy represent a new path for economic development, shifting resources from manufacturing to services.

We can already see that patterns of development in Sub-Saharan Africa have not been quite the same as in North Africa, with more rapid urbanization and growth of services. Furthermore, the April 2018 World Economic Outlook (WEO) supports Rodrik’s analysis and the observation that “compared with economies that developed earlier, the manufacturing employment shares of many developing economies have peaked at lower levels” (see above). This has been called the “Adding Up Problem” by which what is true at the level of the individual country may not hold in the aggregate. Putting things simply, “if a number of economies all try to expand their exports of labor-intensive manufacturing, who will do the importing?”

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The manufacturing sector used to experience more technological progress (and thus productivity gains) than the services sector, hence provoking skepticism that a higher share of employment in services would trigger growth. Fortunately, the development of ICT, business, and financial services with higher productivity levels than manufacturing has made robust economic growth possible without having to industrialize to the same levels as the East Asian Tigers. But keeping a rising share of employment in high-productivity sectors, and converging to the international frontier, are not straightforward. The SMCs may be constrained by a lack of skilled workers and/or lower domestic demand for those kinds of services.

As argued in a 2018 World Bank MENA Economic Monitor update: “The MENA region has [a] fast-growing pool of university graduates and a heavy penetration of social media and smartphones. Combining them could serve as the foundation for a digital sector that could create much-needed private sector jobs for the youth over the next decade.”

### ACCESS TO TELEPHONE SERVICES IN MENA

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>NUMBER OF MAINLINES PER 100 PERSONS (1995)</th>
<th>NUMBER OF MAINLINES PER 100 PERSONS (2011)</th>
<th>NUMBER OF CELLULAR LINES PER 100 PERSONS (2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALGERIA</td>
<td>4.16</td>
<td>8.50</td>
<td>98.99</td>
</tr>
<tr>
<td>BAHRAIN</td>
<td>25.19</td>
<td>20.89</td>
<td>127.96</td>
</tr>
<tr>
<td>EGYPT</td>
<td>4.38</td>
<td>10.56</td>
<td>101.08</td>
</tr>
<tr>
<td>IRAN</td>
<td>8.52</td>
<td>37.12</td>
<td>74.93</td>
</tr>
<tr>
<td>JORDAN</td>
<td>7.23</td>
<td>7.35</td>
<td>118.20</td>
</tr>
<tr>
<td>KUWAIT</td>
<td>23.48</td>
<td>18.26</td>
<td>175.09</td>
</tr>
<tr>
<td>LEBANON</td>
<td>12.96</td>
<td>20.32</td>
<td>79.52</td>
</tr>
<tr>
<td>MOROCCO</td>
<td>4.19</td>
<td>11.05</td>
<td>113.26</td>
</tr>
<tr>
<td>OMAN</td>
<td>7.61</td>
<td>10.10</td>
<td>168.97</td>
</tr>
<tr>
<td>QATAR</td>
<td>24.47</td>
<td>16.52</td>
<td>123.11</td>
</tr>
<tr>
<td>SAUDI ARABIA</td>
<td>9.30</td>
<td>16.50</td>
<td>191.24</td>
</tr>
<tr>
<td>TUNISIA</td>
<td>5.84</td>
<td>11.49</td>
<td>116.93</td>
</tr>
<tr>
<td>TURKEY</td>
<td>22.30</td>
<td>20.66</td>
<td>88.70</td>
</tr>
<tr>
<td>YEMEN</td>
<td>1.23</td>
<td>4.33</td>
<td>47.07</td>
</tr>
<tr>
<td>MENA AVERAGE</td>
<td>11.49</td>
<td>15.26</td>
<td>116.07</td>
</tr>
<tr>
<td>LOW &amp; MIDDLE INCOME COUNTRIES</td>
<td>3.67</td>
<td>11.03</td>
<td>77.33</td>
</tr>
<tr>
<td>OECD MEMBERS</td>
<td>44.84</td>
<td>43.19</td>
<td>106.67</td>
</tr>
</tbody>
</table>

Source: World Development Indicators, 2014

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A digital economy could also have positive implications for the management and access of healthcare and education both in urban and in rural areas. The World Bank “Digital Development” Global Practice states that “ICTs have the potential to boost economic development in many ways, including: improved services to citizens through e-government projects, job creation in the creative and high-tech industries, additional trade flows, and opportunities for small producers from developing countries to link up to Global Value Chains (GVCs). Broadening digital access will bring even greater benefits from innovation, entrepreneurship, and job creation.”269

Overall, “studies have shown that the gap between MENA economies and fast-growing economies is the performance of the services sector.”270 One reason is that “related investments in education, information infrastructure, research and development (R&D), and innovation have been insufficient or inappropriate in most MENA countries.”271 A key question is how thinking within a regional framework can help increase investment in such public goods.

SERVICES AND GDP PER CAPITA GROWTH

<table>
<thead>
<tr>
<th>Services value added (% of GDP)</th>
<th>Log real GDP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>50</td>
<td>3.3</td>
</tr>
<tr>
<td>53</td>
<td>3.5</td>
</tr>
<tr>
<td>55</td>
<td>4.0</td>
</tr>
<tr>
<td>57</td>
<td>4.5</td>
</tr>
<tr>
<td>59</td>
<td>5.0</td>
</tr>
<tr>
<td>60</td>
<td>5.5</td>
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<tr>
<td>62</td>
<td>6.0</td>
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<tr>
<td>64</td>
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<td>66</td>
<td>7.0</td>
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<tr>
<td>68</td>
<td>7.5</td>
</tr>
<tr>
<td>70</td>
<td>8.0</td>
</tr>
</tbody>
</table>

Source: World Bank

Could we envisage in the Mediterranean region a middle path to growth sustained by industrialization while harnessing the potential of ICT to support services in the agriculture sector and enhance their productivity?


271. This issue is actually not new since the report quoted here, Knowledge Economies in the Middle East and North Africa Toward New Development Strategies, written in 2002 and edited by Jean-Eric Aubert and Jean-Louis Reiffers, is nearly two decades old. Nonetheless, the diagnostic on lagging investments in those domains remains relevant. The report is available at: https://books.google.fr/books?id=IM_vusM9sN8C8-printsec=frontcover&hl=fr&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.
C. The importance of services for industrial competitiveness

Services such as access to energy, finance, distribution, and business services are extensively used as inputs in the industrial sector. Therefore, getting services of a better quality and at a lower price affects positively the competitiveness and export performance of the industry.272

“A country that maintains high barriers to trade in services, and does not have a supportive business environment for investment, effectively taxes its firms and impedes their ability to be or become competitive on world markets. If there are both high tariffs on imports of intermediate products and barriers to trade and investment in services, this will negatively affect the prospects for firms to connect to international production networks and global supply chains.”273

To take full advantage of the technological revolution, improvements could include

- Interconnectivity through high-speed internet infrastructure at a regional or sub-regional level
- Opportunities for the mobile application and software markets to grow beyond national borders and create greater value added at a regional level, benefiting from larger economies of scale
- Extending trade agreements to services while adapting the regulatory environment.274

3. SERVICES: BACKBONE OF TRADE FACILITATION AND SUPPLY CHAIN INTEGRATION

As in the case of transport and logistics mentioned earlier, it is not merely hard infrastructure that matters, but also the quality of transport and logistics services that accompany it, along with digital services such as internet- and mobile device-based money transfer platforms. These services can thus “have a high payoff in facilitating further liberalization of trade of goods by enhancing the ability of firms to compete on world markets.”275 In other words, “ICT services are an enabler of complex supply chain integration.”276

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274. Hoekman and Messerlin point out that “one element of such cooperation could include the establishment of regional regulatory agencies to oversee network services (telecommunications, electricity, railways, and other critical “backbone” activities).” Hoekman and Messerlin, “Initial Conditions and Incentives” P. 25-29.
275. Ibid.
The liberalization of research, education and training services, the development of partnerships among the institutions that provide these services, and the facilitation of human mobility also play a central role in determining patterns of growth. The Mediterranean countries are still characterized by a growth model that is largely based on capital accumulation and an abundant supply of labor with skills not always adapted to the needs of the labor market. It is this labor force, and the concessions granted in relation to it, that currently attract FDI, often limited to assembly-line and other lower-end activities, as highlighted by recent studies based on company surveys in Morocco and Tunisia especially.279

<table>
<thead>
<tr>
<th>SECTOR</th>
<th>ACCOUNTING</th>
<th>EGYPT</th>
<th>MOROCCO</th>
<th>TUNISIA</th>
<th>TURKEY</th>
<th>BULGARIA</th>
<th>ROMANIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting</td>
<td>56</td>
<td>56</td>
<td>27</td>
<td>79</td>
<td>75</td>
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<td>37</td>
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<tr>
<td>Legal Services</td>
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<td>47</td>
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<td>73</td>
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<td>Air Transport</td>
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<td>40</td>
<td>0</td>
<td>39</td>
<td>44</td>
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<td>10</td>
<td>2</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Insurance</td>
<td>28</td>
<td>35</td>
<td>26</td>
<td>29</td>
<td>14</td>
<td>17</td>
<td>18</td>
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<tr>
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<tr>
<td>Retail</td>
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<td>6</td>
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<tr>
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<td>51</td>
<td>54</td>
<td>26</td>
<td>11</td>
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</tr>
</tbody>
</table>

Source: Jafari and Taar (2014), based on World Bank S.T.R.I. data278

The liberalization of research, education and training services, the development of partnerships among the institutions that provide these services, and the facilitation of human mobility also play a central role in determining patterns of growth.

The Mediterranean countries are still characterized by a growth model that is largely based on capital accumulation and an abundant supply of labor with skills not always adapted to the needs of the labor market. It is this labor force, and the concessions granted in relation to it, that currently attract FDI, often limited to assembly-line and other lower-end activities, as highlighted by recent studies based on company surveys in Morocco and Tunisia especially.279


This is reflected in a relatively low contribution of Total Factor Productivity (TFP) and innovation to growth.

Similarly, there are delays in the creation of a knowledge economy, which Jean-Louis Reiffers and Jean-Eric Aubert describe as requiring “the development of ICT and related services creating the necessary infrastructure, as well as an educated, creative population, a climate of innovation encouraging the expression and dissemination of new ideas, and, more generally, an economic and institutional context which is favorable to the spirit of entrepreneurship and modernization.”

CHARACTERISTICS AND RESPONSIBILITIES OF THE PUBLIC SECTOR

In many regards, transitioning to a deep form of regional integration depends heavily on the transformation of the public sector.

1. THE CENTRAL ROLE OF THE PUBLIC SECTOR

If we focus on a single indicator, the Human Development Index (HDI), the legitimacy of the state and of public services partly lies in facilitating rising levels of human development that are resilient to crises. In the Mediterranean countries, the ranking remains relatively low in comparison with other regions with a similar per capita gross national income (GNI).281

PRINCIPAL COMPONENTS OF HDI IN 2018

<table>
<thead>
<tr>
<th>RANK</th>
<th>COUNTRY</th>
<th>HUMAN DEVELOPMENT INDEX (HDI) (VALUE)</th>
<th>LIFE EXPECTANCY AT BIRTH (YEARS)</th>
<th>MEAN YEARS OF SCHOOLING (YEARS)</th>
<th>GNI (PER CAPITA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>85</td>
<td>Algeria</td>
<td>0.754</td>
<td>76.3</td>
<td>8.0</td>
<td>13.8</td>
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<tr>
<td>115</td>
<td>Egypt</td>
<td>0.696</td>
<td>71.7</td>
<td>7.2</td>
<td>10.3</td>
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<tr>
<td>95</td>
<td>Jordan</td>
<td>0.735</td>
<td>74.5</td>
<td>10.4</td>
<td>8</td>
</tr>
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<td>80</td>
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<tr>
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<tr>
<td>159</td>
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<td>95</td>
<td>Tunisia</td>
<td>0.735</td>
<td>75.9</td>
<td>7.2</td>
<td>10.2</td>
</tr>
</tbody>
</table>

Source: United Nations


281. The UN Human Capital Index covers a total of 174 countries.
MENA countries face two types of demands which are sometimes difficult to reconcile, given an overarching goal to maintain and improve the living conditions of the population. Governments must (i) on the one hand, facilitate economic efficiency by creating a regulatory framework and incentives to encourage the greatest possible freedom of the private sector in a dynamic, competitive environment; and (ii) on the other hand, be proactive in exercising their sovereign functions, protecting the social justice contract, promoting inclusive development, and, in the case of integration, through trade, working to mitigate the impacts of the adjustments that sectors and geographical areas inevitably experience as a consequence of trade liberalization.

Moreover, the state occupies an extremely strong symbolic position in Mediterranean countries due to its role as a national identifier at the time of independence, and this remains highly present in the popular consciousness. In the years following the 2011 Arab Spring, there has been a return to centralized authority in some countries led by the army (particularly in Egypt), an issue still playing out today in Algeria. While significant progress has been made, democracy in its conventional forms is still struggling to flourish in the region.

This is exacerbated by rather worrisome social conditions, which have prompted the state to intervene in numerous ways. The idea that the size of the state hinders the development of private employment because it offers a “public sector wage premium” is becoming increasingly less irrelevant.

In a recent study of the 22 MENA countries, Zafiris Tzannatos, Ishac Diwan, and Joanna Abdel Abal\(^{282}\) conclude that the Rate of Return to Education (RoRE) in wage terms is, for men, not linked to a public sector premium. However, it has a slight benefit (9 percent) for women, which is positive, considering the female employment rate in the MENA region is among the lowest in the world.

In total, the average for the MENA region shows a RoRE that is

- Lower compared to other regions, with an additional year of schooling adding around 5.4 percent to labor earnings, compared to a world average of 7 percent;
- Particularly low for secondary education (3.5 percent) followed by tertiary education (8.9 percent); both being almost half the respective world averages (6.9 percent and 16.9 percent)
- High for primary education (9.4 percent) which is almost equal to the world average (10.3 percent)
- Higher for women than for men (nearly 8 percent versus 5 percent)
- Higher in North Africa/ Maghreb than in the Middle East”

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These results prompted the authors to conclude that there should be more policy emphasis on the reasons driving low labor demand, especially for higher skills, in the region.

Low labor demand depresses wages and reduces the incentive to invest in education. Personal development strategies among young people are inadequate because they focus too little on acquiring and boosting human capital. These findings may be explained specifically by the fact that, in the MENA region, the longer people have studied, the more likely they are to be unemployed.

With a view to promoting regional integration, it can therefore be concluded that there is a greater need to improve the efficiency of public services through evaluation, decentralization/deconcentration, and mobility, rather than focusing merely on questioning their size.

While it is legitimate to discuss a range of relevant factors—including the pace of the liberalization of trade in goods and services in regional integration, the need for political agreements that allow the movement of capital and people, and the development of structural convergence policies—there is one area that needs to evolve in order to ensure the success of regional integration: clarifying the roles that the private and public sectors should be playing, and resolving the ambiguities that continue to blur the boundaries of that relationship.

A. A vital transformation of the public sector

The large place that state-owned firms continue to occupy in the regional economy, and the rent-seeking behavior for which major politically well-connected private-sector firms are often justifiably labeled as enablers of “crony capitalism,” reinforces the need to transform the role of the public sector. The entrenched system of crony capitalism is one of the features of the Mediterranean regional landscape that could constrain unilateral reform in such domains as the liberalization of the services sector and more generally, impede the development of countries’ competition policies.

As noted in the 2017 Euro-Mediterranean Forum of Institutes of Economic Sciences (FEMISE) report, “Arab States in transition have inherited hybrid economic systems of moderate performance—part crony and part informal—reflecting a governance system based on political and economic exclusion.


284. Hoekman and Messerlin, “Initial Conditions and Incentives.”
Regulations and institutions have been tilted towards accommodating the interests of the politically connected rather than serving the purpose of productivity gains and jobs creation."

From this perspective, if regional integration adopts common rules, it may need to address the most salient issues: the exclusion of political opponents for the benefit of those close to the government, which leads to the protection of the rights of monopolists, preferential access to privatization, public tenders, and the granting of regulatory concessions. This naturally limits any opening up of the private sector, renders joint ventures less transparent, and reduces the attractiveness of the business environment.

Moreover, a concentration of economic activity around a small number of families that are close to the government, may continue. As Diwan et al\textsuperscript{285} report, in Egypt there are about 500 companies controlled by approximately 32 businessmen with high-level political connections, the majority of whom have previously held a political office. It is important to note that this concentration has intensified following the recent phase of economic liberalization, to the detriment of small-and-medium-sized businesses.

Also, the data suggest that in the MENA region, the political characteristics are important in determining whether a country can privatize its public banks. Specifically, countries that are politically unstable and riskier are less likely to privatize their state-owned banks, while countries that have greater accountability to voters and a high-quality level of regulatory standards are more likely to privatize their state-owned banks.

The crony capitalism that develops after the breakdown of the social contract in which the state provided its citizens with jobs and socioeconomic benefits, in exchange for limited public participation and official accountability,\textsuperscript{286} calls for a redefinition of the role of the public sector. The public sector should not be viewed as merely an undesirable actor in the economy, but as the potential promoter of a good economic and institutional environment to help the private sector become the engine of growth and job creation.

Therefore, “transformation of the public sector should not be used as a code word for shrinking the amount of public spending per se, but to encourage a shift in the allocation and use of resources that will crowd-in the private sector, and offer protection to vulnerable people, rather than politically connected firms.”


In some cases, this "facilitator" role should be complemented by proactive industrial policies or the use of public-private partnerships for identified sectors and projects of strategic relevance.

2. THE POLITICAL ECONOMY OF REGIONAL INTEGRATION

There are close links between the political and economic dimensions of regional integration. For Kebabdjian (2004), Mediterranean regional integration cannot be understood without talking about the institutions that make the markets work.

Mattli (1999) gives us a political economy framework with two conditions which help us assess whether integration is likely to succeed:

- The Supply Side condition under which political leaders are willing and able to accommodate demands for regional institutions at each step of the integration process: this is more likely to receive support from political leaders if such a move is expected to improve their chances of retaining power. Another sub-condition is the presence of a regional leader who can resolve coordination problems.
- The Demand Side condition, under which market players stand to gain from integration and thus provide advocacy and support for it.

On the one hand, free trade and transitions to market economies, by nature, tend to benefit some new agents, and this new stratum of society sees in free trade a means to tackle clientelistic relations and rent-seeking behavior from the old ruling class (that is, the "demand condition" emanating from private sector advocacy). Conversely, it follows that the fragmentation of the region through the use of physical and policy barriers has a vital political function for local elites seeking to preserve their hold on power by allocating monopoly rights to insiders and by channeling rents to favored groups.

Malik and Awadallah (2011) develop this argument further, saying that "private sector not changing the underlying distribution of development is not simply a matter of improving the investment climate, reducing the cost of doing business, offering cheap credit, or introducing market-friendly economic reforms. It is also a political issue, since the private sector can create income streams independent of the patronage network of the regime thereby challenging the ruler’s position."

287. Gérard Kebabdjian, “Economie Politique du Régionalisme: Le Cas Euro-Méditerranéen,” Revue Région et Développement, No. 19 (2004): 152–184, accessed October 16, 2020, available at: https://pdfs.semanticscholar.org/0513/14df66676d0d47b28f88dbdbb1a1079954a.pdf. Kebabdjian also recognizes the possibility that the opposite argument might be true—that regional integration may merely be a means to preserving the status quo by seemingly complying with the tenets of economic liberalism in order to continue receiving support from Europe.

288. Mattli, The Logic of Regional Integration.

289. A similar analysis between the politics and the economics of regional integration was done by Malik and Awadallah, “Economics of the Arab Spring.” See section VI of that analysis, “Can Demography Change the Political Calculus?”

Eibl and Malik (2016) tested this hypothesis by looking at the case of Egypt’s partial liberalization policies at the time when the country’s Association Agreement (AA) with the EU entered into force in 2004. They found that the reductions in tariffs in sectors dominated by politically-connected players were “compensated significantly more by new Non-Tariff Measures (NTMs) than non-crony sectors.”

This is in line with arguments previously made by researchers such as Kebabdjian (2004) and E.M Mouhoud (2012), who have pointed out that a shallow type of regional integration, such as the bilateral Association Agreement in the Euro-Mediterranean Partnership framework, could have been used to preserve the status quo by seemingly adhering to economic liberalism and thus continuing to get support from Europe.

Thus, Malik and Awadallah (2011) argue that, to the extent the Arab Spring has economic power (that is, the “supply condition” of Mattli, 1999), the political incentives of the Arab leading class might not be aligned with opening regional markets.

That leaves us with a “regional integration-private sector development” conundrum where it seems that

(i) “Only through a regionally integrated merchant class ... a stable constituency for economic and political reform will emerge” (and thus enable private sector development).

(ii) On the other hand, a stronger and independent private sector is needed to create a more vigorous constituency championing and greater economic access across the region.

In this context, we recall the work of Hoekman and Sekkat (2010), quoted above, who recommended that countries’ “[improve] the transparency of status quo policies, their impact, and the implementation of regional integration initiatives,” for which existing frameworks such as the UfM, the Arab League, or the Agadir Agreement could be used. Within these institutions, efforts could be made to strengthen the implementation capacity of agreements, monitor the process of regional integration, and provide data and analyses to spread awareness of the greater cost of non-integration.


3. A NEW EMERGING ROLE FOR THE GOVERNMENT RELATED TO REGIONAL INTEGRATION

A. The state as regulator and facilitator

The kind of structural reforms aimed at reducing the inefficiency of markets (for example, more flexibility of labor markets, taxation that avoids too many distortions, and so on), as well as the business environment, must be accompanied by other public policies that promote broad access to education and provide social safety nets for workers.

A 2018 report by the International Monetary Fund (IMF) 294 highlighted key challenges that governments of the MENA region need to overcome to enable higher inclusive growth. In terms of fiscal policies, current subsidies seem to benefit disproportionately the richest, while the tax instruments in place are considered as being regressive and their administration not transparent. On the expenditure side, service provision is characterized by its inefficiency while also being inequitable in the way it affects different segments of the population.

Although the fiscal space available varies per country, overall regional fiscal policy efforts should be geared towards domestic resource mobilization in a fair and transparent manner, while reallocating expenditures toward productive projects that can benefit the population including the most vulnerable.

In terms of competition policy, although its causal impact is harder to identify, at a macro level, the literature 295 has highlighted various channels by which competition can trigger faster productivity growth (through market selection or within firm improvements).

At a regional level, Hoekman and Sekkat (2010) argue that “reducing market segmentation for goods, services, and factor markets can help improve productivity performance and expand overall employment, by encouraging new entry and investment, especially by Small and Medium-sized Enterprises (SMEs).” 296

Yet Tunisia, one of the first MENA countries to implement competition laws, and a competition authority (creator of the Competition Council in 1995), is not performing particularly well in the Global Competitiveness Index (95th out of 141 countries in 2017) nor in the Doing Business reports (88th out of 190 countries in 2018). Most of the other SMCs have at later stages also voted in competition laws, albeit with mixed success.

These developments highlight several facts:

- Sometimes the law may have been enacted with some reluctance and without full commitment following external pressure (for instance, the requirements of the WTO, or other trade agreements) and is, moreover, a “legal transplant” from more...

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296. Hoekman and Sekkat, “Missing Links.”
advanced countries. However, the law might not be adapted to local conditions, and it may not be implemented in order to benefit the population.

- Competition law is necessary but not sufficient: other factors such as the promotion of competition culture, regulatory reforms, the rule of law, the availability of the resources needed by competition authorities will impact its effectiveness.

How, then, should the reforms be sequenced? Should having a competition law and authority take priority over fixing other issues first? Frédéric Jenny argues that creating a legal authority supervising competition should be a priority, even if it does not have enforcement capabilities right from the start, because it can play an essential advocacy role for competition and contribute to changing the mindset of the government and the population on this topic.

For example, the quality of governance is certainly important to support a strong economy. Beverelli, Fiorini, and Hoekman (2015) have specifically found that the potential economic benefits from more openness in the services’ trade regime, as mentioned earlier, will depend strongly on the quality of governance and related institutions.

How can a regional approach help individual countries to improve their competition policy?

In the SMCs, the idea of regional action to help countries converge on best standards is not new. For example, although most of these declarations remain little more than ink on paper, Article 2 of the Agadir Agreement states that two of its goals are

1. “To unify the public and private economic policies of the Member States in areas dealing with: external commerce and agriculture, industry, the tax system, the financial system, services, customs and that which facilitates competition among the Member States.”

2. “To bring closer the economic legislations of the Member States in hopes of producing an adequate climate for the conditions of merger between the Member States.”

The role for advocacy mentioned earlier could be considered to include at a regional level the creation of a “common competition authority that would identify private collusive arrangements and public policies that restrict competition on regional markets” and also “increase the transparency of government policies, including assessments of the economic effects of regulations and other policies that limit competition. Such information is a necessary condition to mobilize national constituencies that are negatively affected by such policies.”

B. The state as co-creator

The role that the state can play within the economic space can go well beyond that of a mere “facilitator” of markets. While the government is ensuring

300. Hoekman and Messerlin, “Initial Conditions and Incentives.”
301. Hoekman and Sekkat, “Missing Links.”
compliance with basic regulations and a level playing field for the private sector, it can at the same time be an active player and wealth creator, through industrial policies\textsuperscript{302} that involve partnering with the private sector.\textsuperscript{303}

**Creating successful public-private partnerships\textsuperscript{304}**

Since sectors such as transportation, logistics, telecommunications, and energy are essential to promoting regional trade integration and adaptation to climate change, international aid and limited public resources will not be enough to meet the increasing need to finance public projects.

In this context, public-private partnerships (PPPs) may provide a way to increase investment on a national and regional scale, thereby attracting corporations and institutional investors who are attracted by the project size and potential returns, but also want the security of sovereign government participation. Another advantage of PPPs is to urge the government to focus on its primary role as promoter and maintainer of the economic environment as well as a provider of externality-oriented services such as education and health care, and to leave tasks linked to the development of infrastructure to specialized private companies.

Finally, by allocating the risk of construction and operation to private stakeholders, PPPs may induce them to control costs, deliver on time, and take into account the overall lifetime cost of the infrastructure. For such reasons, PPPs can generate invaluable efficiency gains.

However, this does not mean that PPPs are miracle solutions; if poorly designed, they can prove to be costly in the long run\textsuperscript{305}—all the more so since the implementation of PPPs faces obstacles in several different sectors that must be overcome. Among the potential political, financial, legal, and operational barriers identified by the Organisation for Economic Co-operation and Development (OECD),\textsuperscript{306} the most prevalent in the MENA region involves legal and institutional aspects.

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\textsuperscript{302} The concept of “industrial policy,” which fell out of favor for a number of years, appears to be returning to the forefront of development thinking. For example, the UNCTAD World Investment Report 2018 is titled “Investment and New Industrial Policies” (\textit{see} https://unctad.org/system/files/official-document/wir2018_en.pdf).

\textsuperscript{303} A leading advocate of the role of the state as an active player in the economy is the economist Mariana Mazzucato. Two of her books that expound this position are \textit{The Value of Everything: Making and Taking in the Global Economy} (London: Allen Lane, 2018); and \textit{The Entrepreneurial State: Debunking Public vs. Private Sector Myths} (Anthem Press, 2013; revised edition published by PublicAffairs, 2019).

\textsuperscript{304} Public Private Partnerships (PPPs) is not limited to a single definition. Rather can be thought of as occupying any point on a continuum from pure public delivery all the way to full privatization. The OECD (2008) defines a PPP as an agreement between government and one or more private sector partners (which may include the operators and the financiers) according to which the private partners deliver the service in such a manner that the service delivery objectives of the government are aligned with the profit objectives of the private partners and where the effectiveness of the alignment depends on a sufficient transfer of risk to the private partners.…A core principle for a successful PPP is that each risk should be allocated to the party that is best able to manage or mitigate that risk—the party that has the greatest influence over the probability that the event occurs, or if the risk event does occur, has the ability to mitigate its impact at lowest cost.


\textsuperscript{306} ibid.
It is nevertheless possible to define some conditions for success:

- Focus on functional outcomes rather than detailed technical specifications in order to maximize the opportunities for private companies to innovate and apply their expertise.
- Create and implement favorable legal and technical frameworks, apply the rule of law, protect property rights, and formulate clear rules for dispute resolution where needed.
- Create Public-Private Partnership (PPP) central units in the ministries that have the resources to manage the transactions and terms of the contracts,

Source: OECD, 2014

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which can be complex. As government officials demonstrate working integrity for the common good, responding to solid demands rather than political motivations, and striving to find a balance between private and public benefits.

- Recognize that PPPs, because of the complexity of the contracts, have a low level of flexibility and, therefore, may not adapt very well to sectors that are undergoing rapid technological change, which is associated with unpredictable risk.

### CASCADE FINANCING: A NEW APPROACH FOR DEVELOPMENT BANKS

Traditionally, PPPs have been bilateral contracts between a private concession operator and a government agency, while multilateral development banks offer financing to projects that may not attract private funding but are expected to have a high development impact.

Aware that limited public budgets and development funds cannot meet the financing needs of developing countries, in 2017 the World Bank Group (WBG) presented a new strategy known as “Maximizing Finance for Development.” Its premise was that development banks and government spending can “crowd in” private sector investment, especially from largely untapped long-term institutional investors.

**When a project is proposed, the “cascade” algorithm for making the decision is the following:** “Is there a sustainable private sector solution that limits public debt and contingent liabilities?”

- If the answer is “Yes” promote such private solutions
- If the answer is “No” ask whether it is because of
  - Policy or regulatory gaps or weaknesses If so, provide WBG support for policy and regulatory reforms.
  - Risks If so, identify and assess the risks and see whether WBG instruments can address them (offers of guarantees, risk-sharing instruments…). If one concludes that the project requires public funding, pursue that option.

Another possible model for development banks is to change them from "originate-and-hold" banks to "originate-and-distribute" banks for PPPs projects. However, there are concerns that public and private interests may not necessarily be aligned, and doubts remain that guarantees given to the private sector may not always lead to inclusive projects targeted at those with the greatest need. If PPPs are selected based only on high returns, there is a risk that the government’s already limited resources for providing services such as health, education, and basic infrastructure will be crowded out and reduced, especially services that target the poor, the excluded, and the marginalized.308

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The figures below clearly show that, in 2017, SMCs dramatically increased their number of infrastructure projects that involved private participation. This is particularly true in the energy sector, and except for 2013, renewable energy has driven this trend since 2012.

Efforts to sharing best practices at a regional level and to building the capacity of governments to design and use PPPs will enable Mediterranean countries to accelerate their switch to renewable energy.

**INFRASTRUCTURE (PPI) IN SOUTH MEDITERRANEAN COUNTRIES**

**TOTAL INVESTMENTS FOR PPP PROJECTS IN THE ENERGY SECTOR IN SOUTH MEDITERRANEAN COUNTRIES**

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309 South Mediterranean countries with PPI data on the bar chart are Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia, and Palestine.
Smart industrial policies

Theoretically, market imperfections—asymmetry of information, spillovers, and so on—make the case for a government to pursue industrial policies, broadly defined as policies that stimulate specific economic activities and promote structural change not specifically targeted at the industrial sector.

But in practice, finding the right kind of policy and implementing it does not always happen, for example, because the government lacks the information it needs to identify relevant sectors and markets to target, or there is a risk of rent-seeking and corruption. East Asian countries such as China, Taiwan, and South Korea have applied industrial policies of different kinds, yet it is difficult to find a cross-country study that empirically shows a clear causal effect of industrial policy on growth.

Rodrik (2008), nonetheless, argues that industrial policy is an essential tool of a country’s development strategy and can work under some conditions: 310

- “Embeddedness”: not adopting a top-down approach but rather ensuring close cooperation between the government and the private sector to identify the binding constraints markets face. Some of the specific mechanisms might be a Deliberation Council, Supplier Development Forums, Diaspora Associations, Sectoral Round Tables, and Private Public Venture Funds.
- “Carrots and Sticks” (to safeguard the private sector from bureaucratic capture): industrial policy needs to offer incentives to firms to invest and innovate, but it also needs to stop supporting projects and firms that fail. The key issue is not to pick winners but to let losers go. This requires government assistance and good monitoring as a condition.
- Accountability: how to make certain the bureaucrats are not diverting resources to themselves? Independent agencies, transparency, a figure championing the policy, are among the instruments needed.

Regional organizations, Rodrik argues, can actively support research and innovation in strategic areas through funding facilities. An example would be Horizon 2020 for the EU, which also funds Mediterranean projects such as the Partnership for Research and Innovation in the Mediterranean Area (PRIMA). 311

Metcalfe (1995) gives the following definition of a national system of innovation: “a set of distinct institutions which jointly and individually contribute to the development and diffusion of new technologies and which provides the framework within which governments form and implement policies to influence the innovation process. As such it is a system of interconnected institutions to create, store, and transfer the knowledge, skills and artefacts which define new technologies.”


311. The overarching mission of Partnership for Research and Innovation in the Mediterranean Area (PRIMA) is to “achieve, support and promote integration, alignment and joint implementation of national R&I programmes under a common research and innovation strategy to address the diverse challenges in water scarcity, agriculture, food security.” PRIMA, “PRIMA in Brief: Who We Are,” PRIMA website, accessed October 31, 2020, http://prima-med.org/about-us/prima-in-brief.
Ramadan and Slimane (2017) further argue that such a system of innovation could also be set up at a sub-regional level (for example, the Maghreb) to implement a coordinated policy that could build on similarities (labor costs, potential growth of markets, geographical and cultural proximity, and so on).\textsuperscript{312} Also, in SMCs where youth unemployment is high, even among individuals who have completed tertiary education, strengthening links between firms and universities could foster a better alignment between the demand and supply of labor.

During the 24th annual conference of the Economic Research Forum, a session discussed how lessons of the Asian experience with industrial policy might be applied within the MENA region. The case of South Korea was discussed, with some of the conditions converging with the three preceding criteria given by Rodrik. However, opinions diverged on the feasibility of industrial policies in the region. For example, Diaa Noureldin of the American University in Cairo was skeptical, mainly because he believes that MENA countries (and South Mediterranean countries in general) may not have the institutional quality required to identify binding constraints or to avoid excessive capture of rents, and that “the disruptive nature of today’s technology and its rapid advancement...leaves shorter windows for state-driven innovation policy to bear its fruit.”\textsuperscript{313}

**REGIONAL INTEGRATION THROUGH DIVERSIFICATION AND UPSCALING**

1. WHY ARE DIVERSIFICATION AND UPSCALING PRIORITIES FOR REGIONAL INTEGRATION?

A common feature among many countries that have grown rapidly over the last few decades is their integration into the global economy through increased trade and FDI. Integration into GVCs is likely to have contributed to the productivity growth in these countries, based on international knowledge and technology flows channeled through trade, FDI, and/or international migration.

As for Mediterranean countries, they (although not all to the same degree) have structural weaknesses such as

- Over-reliance on an extremely small number of sectors (especially for resource- and oil-rich countries)
- A predominance of subcontracting in value chains (for example, exporting extractive industry products and basic manufacturing products without further processing and/or the adding of value)
- Unpredictable vulnerabilities to climate change


In view of this, it is essential for the region to implement policies and strategies to diversify their economies and go up the value chain to alleviate their vulnerability to variations and fluctuations in demand and commodity prices, and to escape the middle-income trap. In particular, Mediterranean countries could take advantage of the emergence of the knowledge/digital economy and the opportunity it represents for service sector-led structural growth.

Echoing Rodrik (2005)\(^{314}\) in his remarks that “igniting economic growth and sustaining it are somewhat different enterprises,” the World Bank MENA Economic Monitor of April 2018\(^{315}\) suggested that the focus should not be on diversification itself as an end goal for its own sake, but rather on the economic transformations required to get there, and what needs to be done to sustain this process.

### A. Different dimensions of diversification

There are several dimensions of diversification—of trade, products, employment, fiscal revenue, and so on.

**Concerning trade, increasing exports can come from two main sources:**

- Breaking into new products or into new geographical markets (“extensive margin”); this is commonly what most people mean by diversification. It is related to the concept of “economic complexity”\(^{316}\)—how much of the knowledge in a society gets translated into the products or “upsaling”—with a focus on how a country can move up the value added ladder for products that are relatively close to its existing product space.\(^{317}\)
- Improving the quality and quantity of existing exports (the “intensive margin”).

**Or to use the Humphrey and Schmitz (2002) typology,\(^{318}\)** we can distinguish between the following types of economic “upgrading”:

- Process upgrading: transforming inputs into outputs more efficiently by reorganizing the productive system or introducing superior technology
- Product upgrading: moving into more sophisticated product lines (which can be defined in terms of increased unit values)

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314. Rodrik, “Growth Strategies.”
316. This concept is championed by the Harvard Center for International Development.
• Functional upgrading: acquiring new functions, or abandoning existing ones, in order to increase the overall skill content of activities
• Chain upgrading—firms moving into different value chains

The first type of upgrading is linked to the intensive margin; the other three are more about the extensive margin (that is, diversification).

B. Extensive or intensive margins: which is a better strategy?

Several studies carried out in the past decade suggest that the primary source of export growth in developing countries has been increases in existing bilateral trade flows (the intensive margin). As for the extensive margin, promoting diversification of existing products into new markets is likely to be more effective as a growth stimulus, and arguably easier to achieve, than focusing on developing new products for export to new markets.

Kowalski et al (2015) emphasize the view that focusing on capturing a growing share of domestic value added in exports puts a country at risk of “[missing] the point that the volume of the activity may matter just as much as the domestic share of the value of the product.” They add that “whilst it is indeed true that assembly activities often represent a very small share of the value of the final products being assembled, it is also true that important benefits can be derived from specializing in assembly activities and performing them on a large scale. What is important, from the point of view of the firm, is therefore the value that is created from its economic activities and not the share that the firm occupies in the value of the final product.”

Source: Kowalski et al, “Participation of Developing Countries”

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319. This fourth type of economic upgrading is discussed in Kowalski et al, “Participation of Developing Countries.”

320. See, for example, Newfarmer et al, eds., Breaking into New Markets, and Kowalski et al, “Participation of Developing Countries.”
For example, Germany and South Korea, which are generally considered to have highly successful export industries, have lower domestic value-added shares in their exports than any of the SMCs. Of course, they have industries which take part in the high value-added part of the production chain, so this is not to say that upgrading the quality of production and climbing up the added-value chain is not a worthy goal for SMCs. But the point being made is that focusing solely on the share of domestic value added in exports is not always necessarily the best strategy because this share tends to decrease as countries increase their participation in GVCs.

**THE WEIGHT OF DOMESTIC AND FOREIGN VALUE ADDED IN EXPORTS**

<table>
<thead>
<tr>
<th>DVA (as share of GDP)</th>
<th>FVA (as share of GDP)</th>
<th>Share DVA (of total exports)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015 South Korea</td>
<td>2015 Germany</td>
<td>2015 Israel</td>
</tr>
<tr>
<td>2015 Turkey</td>
<td>2015 Lebanon</td>
<td>2015 Tunisia</td>
</tr>
<tr>
<td>2015 Jordan</td>
<td>2015 Morocco</td>
<td>2015 Egypt</td>
</tr>
<tr>
<td>2015 Algeria</td>
<td>2015 Egypt</td>
<td>2015 Algeria</td>
</tr>
</tbody>
</table>

Source: UNCTAD-Eora Global Value Chain Database

**DOMESTIC VALUE SHARE IN TOTAL EXPORTS (2015)**

Source: UNCTAD-Eora Global Value Chain Database
Thus diversification (through the extensive margin) and growth (mainly through the intensive margin) are not necessarily equivalent but can play complementary roles. The former can be a good policy for economic resilience (resistance to shocks) because it mitigates the risks faced by an economy that is dependent on only a few products or trading partners. Indeed, overall, the MENA region is too heavily dependent on three sectors: agriculture, natural resources (gas, oil, phosphate), and tourism. Yet all three of these sectors are currently threatened by climate change, shocks in demand, and security risks.

Additionally, there are several potential channels for diversification (extensive margin) to impact growth:

- It can unleash productivity-inducing externalities.
- It can facilitate progressively more rapid movement into higher value-added production.
- It may contribute to less elite misappropriation of rents, which tends to be associated with a narrower economic base.
- It may provide more opportunities in global markets, which present economies of scale and competition among a greater number of productive firms.

2. WHAT IS THE CURRENT SITUATION IN SPECIFIC MEDITERRANEAN COUNTRIES?

A. Economic and employment structure and its evolution over the last 25 years

In truth, there is no such thing as a typical Mediterranean economic structure. Mediterranean countries do not all appear to undergo rapid structural change by expanding the contribution to growth coming from the farming industry. Morocco still has about 13 percent of its Gross Domestic Product (GDP) coming from the agriculture sector, which represents 37 percent of employed people in 2018, according to the World Bank. These workers and their families are particularly vulnerable to the effects of climate change.

Additionally, as mentioned in a previous section, the reallocation of labor toward services rather than industry, as the peak share of employment in industry, may have already been reached in most cases. Tunisia’s share of labor in the industry sector has stayed slightly above 40 percent for the last two decades, while a 13 percent reduction of labor in the agriculture sector has coincided with an equal increase in the services sector. This phenomenon can also be clearly observed in South-Eastern Mediterranean countries.

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321. Dependence on only a few exports such as oil or minerals can be detrimental to an economy when rents are captured and not reinvested. Pritchett and others (2002) have argued that rents from primary commodities are associated with poor governance. Collier and Hoffler (2002) have noted that they are also associated with civil wars as opposing groups struggle to gain control of the state and capture resource rents.

322. For example, from 1991 to 2018, the share of people employed in the agriculture sector in China dramatically decreased, from 55 percent to 16 percent, but decreased only from 41 percent to 37 percent in Morocco.

323. See WDI: Employment in agriculture (percentage of total employment) (modelled ILO estimate) (SL.AGR.EMPL.ZS).
B. Trade structure, comparative advantage, and their evolution over the last 20 years

In terms of economic complexity, using the Economic Complexity Index (ECI), there is a clear schism between North and South Mediterranean countries. In the South, Turkey has continued to raise the complexity of its exports throughout the last 20 years.

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B. Trade structure, comparative advantage, and their evolution over the last 20 years

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the last 25 years, and Tunisia has progressed too. But apart from those countries, it does not appear that “knowledge intensity of the products exported” has improved in other countries.

The economic complexity of exported products has progressed only in a few countries326 and worsened in others. However, there has been some progress in the number of intermediary goods exported (see figures below).

**ECONOMIC COMPLEXITY OF MEDITERRANEAN COUNTRIES**

![Graph showing economic complexity of Mediterranean countries](image)

*Source: ECI, Observatory of Economic Complexity, MIT*

The Hirschman Herfindahl (HH)327 index, as an indicator of export diversification through the dispersion of trade value across an exporter’s partners, confirms the progress of South Mediterranean countries between 2000 and 2014. With the exception of Jordan, the countries have somewhat diversified their exports in terms of reaching new market destinations. However, Tunisia, and to a lesser extent Morocco, still have the highest HH index, which reflects their heavy focus on exporting to a few European countries, the main one being France.

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327. The Hirschman Herfindahl index is a measure of the dispersion of trade value across an exporter’s partners. A country with trade (export or import) that is concentrated in a very few markets will have an index value close to 1. Similarly, a country with a perfectly diversified trade portfolio will have an index close to zero.
Regarding product diversification, not all countries in the Mediterranean are in the same situation. Jordanian and Lebanese exports were already fairly diversified in the 1990s, but since then, industrial diversification has not increased rapidly. These two economies rely heavily on service exports, which represent close to 50 percent and 80 percent of Jordanian and Lebanese exports, respectively (see annex 3). The apparent overreliance of Lebanon on services is a concern, although it has diversified the kind of services it offers: while the travel and tourism sector represented almost the entirety of services exports in the early 2000s, other services such as insurance, finance, and activities linked to ICT have expanded, accounting for 46 percent of exports in 2016.

Jordan and Lebanon’s Revealed Comparative Advantage (RCA) Indexes—services excluded—logically reflect the composition of their export products, since it measures whether a country exports proportionately more products of a given sector than the rest of the world (in which case the RCA is superior to 1, and the country has a comparative advantage in that sector). Jordan has comparative advantages in minerals, chemicals, textiles, and clothing; and Lebanon in food products, vegetables, metals, wood, stone, and glass. However, these figures do not take into account the service sector, where Jordan, and especially Lebanon, are more advanced than any of the other SMCs.

Source: WITS Database

328 The apparent sudden surge of service exports in Lebanon in 2002 comes from the lack of data on traded services before that date.
Tunisia’s and Morocco’s export structures are more diversified than Egypt’s but less so than Turkey’s. In Tunisia, we can see that the textiles and clothing sector, even if still dominant, is being replaced by electronics and machinery. In Morocco, we can see a recent increase in exports of transport vehicles.

Looking at their revealed comparative advantages (see annex 3) in comparison with the ones of Egypt and Turkey, they appear to be rather similar. Vegetables, textiles and clothing (and footwear for Morocco and Tunisia), and minerals stand as sectors where the RCA is the highest. Egypt also has more natural resources such as stone, glass, and fuels, but its economic structure is more diversified than in the cases of the Gulf states, Algeria, and Libya.
In oil-exporting countries such as Algeria and Libya, the shock of downward oil prices since 2014 has put a strain on revenues and public finance sustainability (energy accounts for 60 percent of the state budget and 95 percent of total export revenues in Algeria). Moreover, the oil sector cannot be a sustainable source of enough jobs to absorb the growing workforce, since the energy industry is typically highly capital-intensive.

Their revealed comparative advantage only confirms the lack of diversification in these economies. Resource-rich countries often launch plans for diversification (for example, Algeria’s 2014-2019 five-year plan), but the reality and the measures taken rarely match the declared ambitions.

### Revealed Comparative Advantages of Algeria and Libya (2016 and 2010 Respectively)

![Graph showing revealed comparative advantages of Algeria (2016) and Libya (2010) across various sectors.]

**Source:** WITS database

### C. The Mediterranean’s main trading partners over the last 20 years

Since the launch of the Barcelona process in 1995, the value of traded goods involving Mediterranean countries has significantly increased. However, this increase is more linked to an intensification of trade across the globe than to a surge in regional trade. Indeed, exports between the EU and its Southern neighbors\(^\text{329}\) have stayed around 2–2.5 percent of total world exports for the past 20 years. There have, however, been a few significant developments concerning the change in patterns of trade among Mediterranean partners and with other regions (see annex 3 for the amounts).

Intraregional exports in the SMCs are still weak (less than 10 percent of their total, and less than 4 percent if only the Maghreb is considered) but have nonetheless gradually increased.

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\(^{329}\) For all the following figures and statistics, South Mediterranean countries and their Southern neighbors include Algeria, Egypt, Jordan, Lebanon, Libya, Morocco, Syria, Palestine, Tunisia, and Turkey.
This is partly driven by the role of Turkey, which has increased its trade flows with countries in the region quite substantially.

Although exports to and imports from the EU tripled in value between 1995 and 2016, they decreased as a share of total South Mediterranean exports and imports—from 56 percent to 45 percent, and from 49 percent to 38 percent, respectively. Instead, China has greatly strengthened its position with the South Mediterranean countries, growing from 1.6 percent to 11 percent of their imports during the same period; in return, however, the SMCs export little to China (less than 3 percent of their total exports).

Finally, trade with Sub-Saharan Africa still represents a very minor part of total South Mediterranean imports and exports (1.12 percent and 2.3 percent respectively).

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330. UNCTAD database
At the country or subregional level, one can see that the Maghreb countries (and Turkey to a lesser extent) are rather oriented toward Europe (see annex 3), whereas the Levant countries trade more with Eastern (primarily Gulf) countries.

D. Degree of integration of countries into Global Value Chains

First, in terms of integration in trade in general (GVC or not), as underlined throughout this book, the performance of the SMCs is not great. Behar and Freund (2011), controlling for standard determinants of trade such as country size, income, and distance to partner markets, found that a typical MENA country exports less than half—and as little as one quarter—of its potential.331 Similarly, Bhattacharya and Wolde (2010) also concluded that a typical MENA country exports much less than what it should, given the fundamental trade determinants.332

To determine the degree of participation in value chains, economists use two main indicators calculated from Inter-Country Input Output-tables:

- The foreign value-added share (FVA), or “import to export.” This measures the share of a country’s exports that consist of inputs produced in other countries. This is often referred to as the backward linkages, or participation in the downstream sector.
- The Indirect Value-Added Exports (DVX) or “export to reexport” indicates the share of a country’s value-added exports embodied as intermediate inputs in other countries’ exports. This is often referred to as forward linkages or participation in upstream sectors.

One type of linkage is not necessarily better than the other. For example, participating upstream in GVCs can be a good thing if it consists of “knowledge assets at the beginning of the value chain and most of the value added is in fact created in those stages,”333 but not so good if the country’s exports are mostly primary resources extracted without further refinement. In short, downstream participation is usually an indication of better integration in GVCs.

Del Prete et al (2016)334 studied data on the participation of North African countries in GVCs, and found that they had been increasingly relying on GVC-related trade, even though this remains quantitatively low, while Hoekman notes that “relative to what is predicted based on fundamental factors such as GDP, the share of manufacturing in G.D.P., and proximity to a global industrial hub, value chain participation in many MENA countries is below what is predicted by fundamentals.”335

331. Behar and Freund, “Trade Performance of the Middle East.”
332. Bhattacharya and Wolde, “Constraints on Trade.”
334. Ibid.
The situation of other MENA countries is heterogeneous. Libya and Egypt have mainly forward linkages that come from their hydrocarbon exports. Kummritz and Quast’s (2016) analysis joins the conclusions from Del Prete et al (2016) in finding that “Tunisia is mainly integrated through backward linkages and assembly tasks but is moving up the value chain.” To them, “this is evidence that especially North Africa with its proximity to the European Global Value Chain (GVC) hub can link into and benefit from GVCs.”

Morocco’s success story with the aerospace and automotive industries is largely anecdotal but nevertheless presents some persuasive evidence. Algeria is highly enmeshed in GVCs, but this is somewhat deceptive because it is mainly through forward linkages coming from hydrocarbon exports that are later used as intermediate goods in other countries.

It is also in the interest of Europe to develop its value chain integration with MENA because this could lower its production costs, improve its competitiveness, and accelerate its transition to even higher value-added activities.

Another indicator with the capacity to represent the level of a country’s participation in GVCs is the amount of FDI it receives (see annex 2), because GVCs are often linked to the production strategies of international firms. A caveat, however: it all depends on the type and quality of FDI. For example, Lebanon and Jordan receive the most FDI yet are the least integrated into GVCs. One reason is that, in these countries, FDI targets mainly the real estate sector—representing almost 80 percent of FDI in Jordan between 2003 and 2011 (see figure below).

Bilateral data would be able to refine the analysis, but one plausible reason for high FDI inflows into these two countries is their close relationship with Gulf Cooperation Council (GCC) countries, which has increased their investments thanks to external commercial surpluses over the years. While FDI into North Africa displayed a positive increase dynamic during the years preceding the 2008 global crisis, it has since then plummeted in the wake of the crisis. A more worrisome fact is that their recoveries remained subdued during the following decade, probably in large part because of investors’ uncertainty and fear of possible political instability after the Arab Spring spread through the region. In contrast, FDI to South-East Asia (and to Latin America to a lower extent) quickly recovered after the crisis.

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338. The figure is taken from the draft background note titled “Recent FDI Trends in the MENA Region,” written for discussion during the LAS-OECD Regional Conference and MENA-OECD Regional Investment Working Group, which took place December 9–11, 2014 in Cairo, Egypt, under the auspices of the MENA-OECD Investment Programme. A PDF copy of it is available at: https://www.oecd.org/mena/competitiveness/Draft%20Note_FDI%20trends%20in%20MENA_Dec.%202014.pdf.
3. WOULD A REGIONAL APPROACH HELP COUNTRIES REALIZE THEIR POTENTIAL?

First, economic diversification can strengthen a country’s economic resilience but it should not, by itself, be considered as a quick and easy strategy to promote sustainable economic growth. It is a long-term investment that requires considerable political will.339

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In addition, Arezki et al maintain that “countries should shift their focus from the end goal, namely diversification, to how to get there—that is, on the transformation process.”

What are some measures to accompany this “transformation process”? There is no clear consensus but getting the fundamentals right is likely the best way. Diversification requires shifting resources across sectors and/or investing in new economic activity.

This is unlikely to happen unless the economic environment allows for the competitive production of goods and services, which in turn requires

- Macroeconomic stability
- A supportive regulatory and institutional framework
- A suitable business environment that can help new entrants (streamlining procedures, reducing barriers to competition, improving access to finance, and so on); and
- Investments in human capital and the quality of education

This brings us back to our main argument about how regional integration can serve as a lever for economic transformation. We argued earlier that integration can be a catalyst to domestic reform and public sector transformation. In addition, we will see how capitalizing on regional networks to attract FDI and develop GVCs can help countries carry through their economic transformation.

A recent Euro-Mediterranean Forum of Institutes of Economic Sciences (FEMISE) report studied the determinants of economic “complexification”—which means a diversification away from exporting basic products through technological progress and upscaling—and found that while the fundamental factors mentioned above matter, the regional context and the performance of neighbors also greatly affect a country’s own economic complexification. This view is summarized in the phrase “It takes a competitive region to make a competitive economy,” used in a recent World Bank report on integration in Latin America. In other words, “the forces of geography imply that pro-growth global integration cannot be achieved without building a strong neighborhood.”

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343. Péridy et al, Complexification of Production.
This argument is also made by Adeel Malik in “A Requiem”—“I would argue that the Arab world cannot effectively globalize unless it regionalizes first”—and again in Diversification of Middle Eastern Economies: “National diversification plans that disregard regional linkages in development are doomed to fail.” The argument is also made by Nadim Ahmad and Annalisa Primi in “From Domestic to Regional to Global: Factory Africa and Factory Latin America?” in World Bank et al, Global Value Chain Development Report 2017, chap. 3.
A. The role of Foreign Direct Investment in Value Chains: Regional Value Chains (RVCs) and Global Value Chains (GVCs)

This subsection explores five interrelated questions:

1. What are the determinants of attracting FDI into a region such as MENA?
2. What are the links, if any, between FDI and GVCs?
3. Do FDI and GVCs offer technology spillovers?
4. What are the conditions for successful GVC participation in promoting development?
5. Can the MENA diaspora be mobilized to help build regional networks?

Let us take the first question.

(i) Determinants of attracting FDI into the region (see also annex 2)

When we discussed the transformation of the public sector, we mentioned how governance and the institutional framework could be important factors in attracting FDI. And to the extent that regional integration enables access to larger markets and ensures fairer competition (by promoting the rule of law, property rights, guarantees for investments, and so on), it too could attract higher levels of FDI and thus accelerate economic transformation.

The World Bank’s 2017/2018 Global Investment Competitiveness Report surveyed multinational corporations to identify what weighs the most in their decision to carry out FDI in developing countries (see figure below). The leading factors were political stability and security, the legal and regulatory environment, and the size of the domestic market. Regional integration can play a positive role in achieving each of these goals.

Another 2018 research study focused on the MENA region\textsuperscript{347} found evidence suggesting that “as far as institutional context is concerned, democratization, lack of corruption, business freedom, compliance of rule of law, ease of doing business, political stability and reducing violence would foster Foreign Direct Investment (FDI) into the region.” Two unexpected findings were that, one, improving institutional quality is more likely to spur FDI in MENA oil producers; and two, that reducing corruption in MENA non-oil producers may reduce the number of foreign investments.

This result may be explained by the fact that the oil production of those MENA countries is so high and their dependence on FDI so low that governments have not developed special ties with multinationals while in other countries abundant in natural resources, nondemocratic governments have given special treatment to foreign investors.” This hypothesis is apparent in the case of Tunisia (see graph below) where a transitional regime may have difficulties in attracting FDI in the short term because political stability is still weak.

FDI in the South Mediterranean region is additionally deterred by the level of violence in neighboring countries. Research suggests that “investors consider more likely the contagion of violence to neighboring countries within MENA compared with other regions in the world.”\textsuperscript{348} This highlights the powerful effect of negative spillovers and the need for a coordinated response to promote security in the region.

\textbf{(ii) Links between FDI and GVCs}

FDI can act as a source of knowledge and technology spillovers for a local economy. FDI also offers the advantage that it is often a long-term investment, compared with other capital flows of a speculative nature, so it limits the risk of a crisis sparked by sudden capital flights. Rather than bringing positive spillovers through indirect channels, FDI can, by design, be a means to transfer technologies and upscale the value chain for the receiving country. Thus, FDI, Baleix writes, can be an “important source of development and welfare improvements for host countries by fostering economic growth, productivity, technology diffusion, Global Value Chain (GVCs) participation and, employment.”\textsuperscript{349}

A 2015 report by OECD reaffirmed the important links between FDI and GVCs: “According to the United Nations Conference on Trade and Development (UNCTAD), an estimated 80 percent of global trade now occurs within international production networks of multinational companies. FDI is vital for Small and Medium sized Enterprises (SMEs), as their natural predisposition...”\textsuperscript{347} Baleix, “Foreign Direct Investment in MENA.”

\textsuperscript{348} Ibid.

\textsuperscript{349} Ibid.
is to join GVCs indirectly as upstream suppliers to exporters.”\(^{350}\) Additionally, a 2013 UNCTAD report indicates that “countries with a greater presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs and to generate relatively more domestic value added from trade.”\(^{351}\)

(iii) Technology spillovers from GVCs and FDI

As mentioned earlier in this section, intra-industry trade and participation in GVCs—which may entail engaging with multinational firms at the technological frontier—have the “potential to generate greater learning and technological spillovers that enhance productivity”\(^{352}\) than just broad trade openness. “Value chains are characterized not only by tight links between firms at different stages of the production process; their success also hinges on the quality of the products delivered by firms involved in the process and the efficiency with which these products are delivered across different stages of production. (…) The learning potential and knowledge flows appear to be greatest in countries that join at intermediate stages of production, where interaction with suppliers and buyers is highest.”\(^{353}\)

Baldwin (2015) even asserts that “GVC participation is now the fast-track to industrial development. Joining a GVC allows nations to export goods they never

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The recent efforts of ASEAN countries in terms of regional integration and FDI liberalization are likely to have contributed to the tremendous increase in both intra and extra FDI flows in the ASEAN area. This means that in addition to direct effects on the domestic economy (in terms of employment, production and trade), this surge in FDI is likely to give rise to strong indirect effects, especially productivity spillovers which strengthen the profitability and the competitiveness of the domestic economy.


\(^{353}\) Ibid., 96.
Similarly, Kummritz et al (2017) find that GVC integration increases domestic value added, but they also show that this is contingent on the right set of policies.355

Keller (2009) provides a typology of the technology spillovers that can come from FDI and international trade, noting that “firms that engage in international trade and FDI tend to [be] larger and more productive than firms that only operate domestically. Thus, the latter may be able to raise their productivity by interacting with foreign firms”.356

- Local workers may receive new skills and learn about advanced foreign technology that they can use when they change firms or start their own business (in short, FDI spillovers through labor turnover).
- Spillovers to other firms within the same industry may occur through business operations (horizontal FDI spillovers).
- The multinational firms may buy inputs from local suppliers and provide them with technology at prices below market value (backward vertical technology spillovers).
- Technology diffusion may occur from multinationals to downstream firms (forward vertical technology spillovers).

These are all inward FDI spillovers—new knowledge and learning coming in as multinational firms introduce and disseminate new technology within the host country. But there are also outward spillovers, where the multinational company itself learns about and acquires new technologies from its host-country partner firms.

As a recent International Monetary Fund (IMF) report argues, this means that “technology leaders themselves benefit from each other’s innovation, [underlining] the production and diffusion of knowledge and technology as a key mechanism through which globalization delivers global benefits.”357

In the context of Mediterranean integration, outward spillovers show that, beyond financial returns on investment, Europe also has other things to gain from directing FDI toward middle-income countries of the Mediterranean.

357. IMF, World Economic Outlook: Cyclical Upswing.
Not surprisingly, several SMCs have recognized the value of creating industrial zones designed to become major platforms for local firms to participate in GVCs or RVCs. There are several examples of these initiatives in the region. One of the best known is Morocco’s Tangier economic free zone.

Such zones aim to attract investment from international firms—often including fiscal incentives for relocating—thereby gathering in a single concentrated area what could be called one-stop “clusters” of efficient logistics platforms, service providers, research centers and other relevant facilities, with the expectation of creating not only the convenience of proximity but also positive synergies and collaborations.

Ferragina et al (2018) conducted an empirical study of agglomeration and spillover effects in Italy, Tunisia, and Turkey, and found that there is indeed a positive effect on output and productivity. However, the presence of positive spillovers originating from foreign firms could be seen only in the case of Turkey. Italy and Tunisia appeared not to benefit from them. The section below raises a few other issues related to successful participation in a global value chain.

(iv) Conditions for a successful GVC participation in promoting development

After having discussed the very significant potential of GVC integration, some caution is in order.

Developing countries that engage in this kind of trade as a strategy for development can end up reaping low benefits under certain conditions, especially the following three:

• If only a small fraction of the value added is benefiting the country
• If the conditions for technology and know-how dissemination are not present
• If the project or trading relationship generates substantial or sustained negative impacts on the environment or on social conditions

As mentioned earlier, deep integration (including border and beyond-the-border measures) is an enabler of GVC trade. Thus, countries with inadequate national

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policies and a poor institutional and/or political environment may not gain (in the form of upgrading or increasing the value added produced domestically) as much from their participation in it. Kummritz et al (2017) tested 10 policies, for which they found that participating in GVCs had a positive interacting effect on domestic value added, varying according to the position occupied by the firm in the supply chain as either buyer or seller.360

Five years earlier, Farole and Winkler (2012)361 identified three more conditions that boost the likelihood that firms in the host economy will benefit maximally from FDI spillovers, particularly in the area of productivity.

The three conditions are:

• High FDI spillover potential. This is more likely to happen when a large share of the FDI-financed output is sold to the domestic market and uses a large share of local inputs, especially for low- and medium-productivity firms.
• Greater absorptive capacity of domestic firms. A lower technology gap would positively affect export behavior.
• An improved national and institutional environment. Spending on education, trade openness, and access to financial markets matter most, but the effects fade out as the productivity level of firms increases.

In sum, the effectiveness of FDI as a strategy for development is not guaranteed. It depends on a range of factors, including the heterogeneity of local firms’ productivity, the institutional environment, the foreign firm’s ownership structure (the degree to which it involves local partners), how much technology and know-how are being disseminated from the foreign firm to local firms, how environmentally-friendly the project is, and what kind of social impact it is having.

In light of certain limitations of the FDI attractiveness policy strategy—especially its relatively weak spillover benefits for the rest of the host-country economy—the authors of a recent paper argue in favor of the MENA region developing

360. Kummritz et al, "Economic Upgrading through Global Value Chain Participation." Ten policies target the following three areas: (i) investment and trade flows, (ii) the business climate, including financial and labor markets, (iii) as well as the quality of output and input factors. While (i) and (ii) target more GVC entry and stronger GVC integration, (iii) focuses more directly on upgrading. We focus on a country’s infrastructure, connectivity, investment and trade policy, business climate and institutions, financial and labor markets, education and skills, product standards and innovation, labor standards, social standards, and environmental standards.

a coproduction model centered on equal-based, collaborative partnerships between Southern small and medium-size enterprises and industries (SMEs and SMIIs), on one side, and European SMEs and SMIs on the other.

It is no longer a question of just participating in GVCs, the authors argue, but also building regional value chains (RVCs) that are based on equal partnerships and actively promoted by the public authorities. Governmental measures to facilitate and encourage this kind of coproduction partnerships should focus on simply creating and maintaining a favorable business climate for all aspirants, rather than on trying to micro-manage the economy by providing differentiated fiscal incentives.362

(v) Developing regional networks

If MENA countries earnestly wish to climb up the value-added ladder, they will need to put together a comprehensive strategy that creates an all-encompassing climate, including access to goods and services, effective logistics, a good business environment, and several other fundamentals.

That, in light of the realities of the region, is, frankly speaking, a tall order. It is entirely achievable—at least among certain MENA countries—but it is a vision that could take some time to realize. Meanwhile, entrepreneurs who are struggling to cope with institutional gaps, fragmented markets, and the weak mechanisms that are typically encountered in the support systems of a developing economy may find that regional networks can help them to identify opportunities and pursue business activities in international markets. Networking, in other words, can contribute to regional integration along the value chains and help the private sector discover and seize new opportunities for growth.

Mobilizing the diaspora363

The Mediterranean diaspora, if mobilized, could help provide such a network. Indeed, diasporas, far more than being just a source of remittances for family members in their originating country, can act as “ambassadors” to strengthen the links between their originating and host countries.364


They can

- Serve as a channel of information for Mediterranean exporters to acquire a better understanding of the tastes and preferences of target populations
- Transfer knowledge, know-how, and FDI
- Transfer other intangibles, for example, knowledge of standards, healthcare practices, unspoken rules of social etiquette, fertility rates, gender-based rules, and so on
- "Facilitate immigrants' integration into the host countries and promote local development in their countries of origin"365

In a world where the stock of competences is not limited by spatial boundaries, Djeflat (2012)366 invites us to get rid of the idea that diasporas represent a sunk cost to their native country, a “lost generation,” to borrow Gertrude Stein’s famous phrase. This is not to trivialize the seriousness of the brain drain issue for developing countries, but rather that the MENA region should consider its diasporas as a reservoir of knowledge that is not otherwise easily accessible, allies and agents who can serve as “eyes” and “ears” for MENA-based entrepreneurs because they are already deeply embedded in the very markets the entrepreneurs are seeking to enter.

All of this presupposes that competences can quickly flow to wherever they are needed without hiccups, which in turn implies that national policy makers need to think carefully about mobility issues and incorporate them into their development strategy.

Artal-Tur (2018)367 makes the case for reinforcing vicinity ties (among countries) at a regional level, speeding up the process of integrating just-arrived immigrants, opening up job access to highly skilled immigrants, and giving young immigrants access to education.


Mejri and Ramadan (2016)\textsuperscript{368} show that personal, local, and international networks have a significant impact on SMEs’ access to the resources they need for their ongoing internationalization, especially when access to bank financing is hard. Levratto and Ramadan (2016)\textsuperscript{369} report that a lack of support is the number-one barrier to internationalization most often cited by Moroccan SMEs, followed by a lack of information.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{smdc-diag.png}
\caption{South Mediterranean Countries’ Diaspora in Europe}
\end{figure}

\textit{Source:} UN DESA Population Division, 2017

It is clear from this analysis that encouraging strategies for national and international partnerships can facilitate the internationalization of technology-based SMEs.

Whereas Southeast Asian countries tend to have capitalized well on their large diaspora as part of their developing strategies, Mediterranean countries have yet to fully take advantage of this potential engine of economic integration and development. With the increasing prominence of the knowledge economy, a


country’s ability to retain and attract talent, establish networks, and harness the human potential of their diaspora is now an essential and integral component of their development.

Export promotion agencies (EPAs) and business fora

EPAs, which provide support to businesses, can also contribute to regional integration. They seek to address market failures stemming from the fact that gathering information on foreign markets (on consumer preferences, technical requirements, and so on) is costly, and a private firm is not likely to take on those costs when other competing firms are likely to benefit from it (that is, informational externality).

Well-known examples of EPAs include

- ExpoLink in Egypt
- Business France
- Tunisian Export Market Access Fund (FAMEX)
- The EuroMed Helpdesk

FAMEX was set up by the World Bank and operated between 2010 and 2015 to give grants and technical assistance to [...]. It has been estimated that 1 dollar invested in the fund resulted in 20 more dollars of exports. However, there were diminishing returns, and a few years after the intervention, the effect disappeared.

The EuroMed Helpdesk was developed jointly by the European Commission and the International Trade Centre (ITC), which "provides up to date and free of charge information for businesses looking to export, is expected to help boost EU intra-Mediterranean trade."

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370. Writing about export promotion agencies, Daniel Lederman, Marcelo Olarreaga and Lucy Payton state:

The services offered by export promotion agencies (EPAs) can be divided into four broad categories: 1) country image building (advertising, promotional events, but also advocacy); 2) export support services (exporter training, technical assistance, capacity building, including regulatory compliance, information on trade finance, logistics, customs, packaging, pricing); 3) marketing (trade fairs, exporter and importer missions, follow-up services offered by representatives abroad); and 4) market research and publications (general, sector, and firm level information, such as market surveys, on-line information on export markets, publications encouraging firms to export, importer and exporter contact databases).


What organizations exist or could exist at a regional level for networking and export promotion among MENA countries?

In any case, EPAs have not always been a successful experience in developing countries (especially in MENA),\(^\text{374}\) and research\(^\text{375}\) has explored some basic requirement for EPAs to be effective:

- A program of exporter committees composed of firms in similar industries should encourage cooperation in research, marketing, and promotion, rather than trade shows and trade missions.
- EPAs should target firms with new products and/or those entering new markets.
- Support should be given for a maximum of 2–3 years so that it does not turn into a subsidy.
- Programs should be submitted for external evaluation.
- Agencies work best when they are subject to a mix of public and private

See also the table below for other examples across MENA.

<table>
<thead>
<tr>
<th>ECONOMY</th>
<th>AGENCY NAME</th>
<th>DATE OF CREATION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>ALGEX</td>
<td>1997</td>
</tr>
<tr>
<td>Egypt</td>
<td>EPCC</td>
<td>1997</td>
</tr>
<tr>
<td>Jordan</td>
<td>JEDCO</td>
<td>2003</td>
</tr>
<tr>
<td>Lebanon</td>
<td>IDAL</td>
<td>1994</td>
</tr>
<tr>
<td>Malta</td>
<td>Malta Enterprise</td>
<td>2004</td>
</tr>
<tr>
<td>Morocco</td>
<td>CMPE</td>
<td>1981</td>
</tr>
<tr>
<td>Oman</td>
<td>OCIPED</td>
<td>1996</td>
</tr>
<tr>
<td>Palestine</td>
<td>Paltrade</td>
<td>1999</td>
</tr>
<tr>
<td>Syria</td>
<td>EDPA</td>
<td>2009</td>
</tr>
<tr>
<td>Tunisia</td>
<td>CEPEX</td>
<td>1973</td>
</tr>
<tr>
<td>Yemen</td>
<td>Yemen Export Supreme Council</td>
<td>1997</td>
</tr>
</tbody>
</table>

Source: Cruz, Ledermann and Zoratto, 2018.\(^\text{373}\) Data from the 2010 World Bank EPAs Survey


\(^{374}\) Daniel Lederman, Marcelo Olarreaga, and Lucy Payton found that for every dollar invested in EPA did not bring any statistically significant results in additional dollar of exports for the MENA region. See “Export Promotion Agencies.”

management (an important share of the executive board should come from the private sector, and/or a relatively large share of private sector funding).

- A single strong EPA is more effective than a proliferation of them (hence, the potential gain from a regional-level EPA).

In Latin America, EPAs seem to have positively helped new firms to enter the export market and survive (the extensive margin) but have had no significant effect on helping existing exporting firms to increase their exports (the intensive margin). This is consistent with the fact that EPAs usually help reduce the fixed costs of entry into foreign markets.

However, Jaud and Freund (2015) find that for MENA, “the effects [of EPA] apply primarily to small firms that represent a tiny fraction of aggregate exports and cannot address key weaknesses at the top. In other words, ground-level policies may work, but they are not game-changers.”

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CHAPTER 4

AN INTEGRATION STRATEGY FOR ECONOMIC AND SOCIAL ADVANCEMENT IN THE MEDITERRANEAN
The previous chapters have demonstrated the importance and complexity of the challenges facing countries participating in regional integration. Each of the issues evoked must be considered in a dynamic context involving several policy areas and characterized by a certain sequence.

This chapter will attempt to examine the dynamic context surrounding the issues of economic integration in the Mediterranean and propose a number of strategic dimensions to be considered in the context of the CMI’s agenda.

The key point is that, under the current setting, it is difficult to imagine a cooperation strategy along the lines that Europe adopted for itself when it moved from wide-ranging sectoral cooperation (the European Coal and Steel Community) to a customs union, then to a single market, and finally to the economic union led by large commonly shared institutions that we currently know as the European Union.

This is not to say that, in the longer term, the populations bordering the Mediterranean could not attempt a Euro-Mediterranean venture by taking a similar path. Having found further reasons to come together, they perhaps could. Today, however, the political context does not appear favorable to a realization of a more ambitious Euro-Mediterranean integration approach, even though some of the EU’s projects and strategies of association do include Mediterranean countries such as Morocco and Tunisia.

In addition, numerous initiatives have been implemented since the Barcelona Declaration and the proliferation of sub-regional and bilateral agreements may be adding another layer of hindrances standing in the way of creating commonly shared institutions. At this time, it is difficult to envisage the formation of a fully-fledged Mediterranean region union that is moving toward deeper integration and working to coordinate trade of goods and services (and their corresponding standards), extending human capital mobility, and designing structural policies that are conducive to cohesion.

378. Particularly those initiatives resulting from the Barcelona Process and the EU neighborhood policy.
Indeed, as previous sections have shown, the Mediterranean region’s political context has changed dramatically in recent years. No longer is the free movement of final goods or services, or the protection of a deep and comprehensive free trade area (DTFTA) through a common external tariff, the be-all and end-all of integration. Other dimensions of integration that are now seen as fundamental, include the creation of conditions that attract foreign direct investment (FDI), integration into global value chains (GVCs), and the creation of the regional value chains (RVCs) that enable generalized upgrading, including among relocated foreign companies.

If we compare the functioning of the Association of Southeast Asian Nations (ASEAN) with the approach to integration used by the EU to incorporate the Eastern European countries (compare annexes 4 and 5), we see that, in Asia, economic transactions form the driving force behind the rapid increase in investments from large conglomerates—initially Japanese, then later South Korean and Chinese conglomerates—making vigorous, business-driven progress, in both large-scale direct investment and in trade flows. This has motivated closer cooperation in a somewhat form-flowing function (see annex 5).

In contrast, in Europe, function has largely followed form, with de jure expansion policies prescribing the way and setting the course. As a result, both trade and factor mobility have taken place within a protective pre-established framework that, at least with the benefit of hindsight, has proven to be not only protective but also relatively restrictive.

One strength of the European approach, nevertheless, is that in terms of social convergence at the regional level, the outcomes appear to be unquestionably superior to those of the ASEAN community.

In this respect, the graph below and its corresponding table (see annex 5)—which show the main income distribution indicators for the years after 2010—clearly reveal that the model followed by the ASEAN countries in the analysis (Malaysia, Indonesia, Thailand, and the Philippines) may have contributed to aggravate income disparities within these countries, at least in the short-term.

### INCOME DISTRIBUTION INDICATORS (AVERAGE 2010–2019)

FOR FOUR MEDITERRANEAN COUNTRIES (ALGERIA, MOROCCO, TUNISIA, AND JORDAN) AND FOUR ASEAN COUNTRIES (MALAYSIA, INDONESIA, PHILIPPINES, AND THAILAND)

![Graph showing income distribution indicators for Mediterranean and ASEAN countries](image-url)

**Source:** CMI
However, the numbers above may overestimate the effect of the ASEAN integration model because it is possible that they also reflect the income inequality effects of the ASEAN region’s rapid growth, against the slower, steadier, and less volatile growth rates in Mediterranean countries during the same period.

We are not implying that income inequality issues do not exist in the Mediterranean region. They most certainly do. We are simply observing that, had the Mediterranean region experienced the rapid pace of growth seen in the ASEAN region, the differences in the income disparity within the two regions might well be smaller. In addition, income distribution is only one of the factors that can lead to social disparities; there are other important factors, related to social protection and empowerment of the population, which also trigger inequalities and disparities in the living standards of the population.

The upshot of all this is that Mediterranean countries, the object of our analysis, must adapt to the new dynamics of integration, as described above, improve their business environments and attractiveness to foreign and national investment, and strategically decide how to enter regional and global value chains (GVCs).

The motivation for integration should not be based only on downstream benefits as has been the case of Asia. It should instead focus on, one, linking small and medium-sized enterprises (SMEs) and small and medium-sized industries (SMIs) to large companies, multinationals, and GVCs; two, participating in the development of far-reaching projects and initiatives (a cornerstone of the EU approach that is clearly visible in Europe today); and three, above all, attempting to maintain social and regional balances in line with these countries’ long common histories.

To explore this suggested approach, we will focus on three key strategic areas:

1. maximizing the natural outcomes of liberalizing trade of goods and services through deeper integration
2. enhancing the status of the integration project by focusing on two areas that represent multiple practical as well as symbolically important effects: human capital and the environment, and
3. improving the level of financial intermediation

### EXTENDING AND OPTIMIZING INTERNATIONAL TRADE LIBERALIZATION

#### 1. COMPARISONS AND LESSONS FROM OTHER PARTS OF THE WORLD

Bown et al\(^{381}\) compared regions in terms of integration, the cost to trade, and other factors. The following figures are taken from their 2017 publication. They show that MENA countries were relatively less involved in GVCs in 2011 than other regions and made little progress in the 20 previous years.

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379. It is worth noting that the ASEAN Strategic Action Plan (2016–2025) identified as one of its priority objectives the need to assist in the internationalization of SMEs by promoting their integration into GVCs.

380. The importance of the Erasmus university mobility program, and the role of regional and social funds in Europe, are regularly reiterated.


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One reason is the lack of progress with intraregional integration and networks of production that would support such regional and global value chains (RVCs and GVCs).

Secondly, the volumes of trade flows in the Mediterranean are quite sensitive to distance, even when the countries are trading among themselves, because of market fragmentation, together with a lack of solid institutions, and insufficient soft and hard infrastructure, all of which are backbones of trade.
THE ELASTICITY OF TRADE FLOWS WITH RESPECT TO GEOGRAPHIC DISTANCE, BY REGION AND BY PARTNER

The figure below, also taken from Bown et al, compares the scope of regional and/or bilateral trade agreements around the world with those the EU has made with Mediterranean partner countries. A few preliminary insights can be drawn:

- The North American Free Trade Agreement (NAFTA) and the EU are two regional agreements that stand out not only by the scope of what is contained in the agreements but by their ability to create the institutions to make the integration process legally enforceable.
- The Pan Arab Free Trade Agreement (PAFTA) and the Association of Southeast Asian Nations (ASEAN) appear to be both rather limited in their ambition. This is in line with what was discussed previously about PAFTA, but is much more paradoxical for ASEAN given the importance of intraregional trade and the complex supply chains that exist there, as indicated above.
- The Southern Common Market (MECOSUR) is in an intermediary or middle position, being historically deeper than other Latin American regional trade agreements (RTAs) before the 1990s, but not as deep as the EU or NAFTA agreements.
- In contrast with the EU’s own internal trade agreements, most of the EU’s bilateral agreements with Mediterranean countries contain many provisions (including non-economic ones in areas such as human rights, cultural cooperation, environmental legislation, and so on) but only a relatively small number of them are legally enforceable (except for the accords with Bosnia, Lebanon, and Montenegro).
As we further examine some cases of regional integration and some drivers of success or failure, we must keep in mind the specific context and characteristics of each region and ask what is transferable to the Mediterranean case, rather than proposing a wholesale "transplant" from the best-performing region.

2. MAIN GOAL: MAINTAINING SOCIAL AND REGIONAL STABILITY

Given the importance that Mediterranean populations attach to the need to attain or maintain equitable social and regional balances, the apparent evidence throughout the region of resistance to further liberalizing trade of goods and services and to encouraging FDI may be attributable to the failure of policymakers to explicitly acknowledge the likely implications of integration on income, social disparities, and the scale of those disparities.

Several changes may be required to remedy this situation. First, in the preparatory negotiations, policymakers should seek to involve institutions that represent the most affected sectors, representatives of the regions, social services, and potentially NGOs and other stakeholders. Additionally, the unique characteristics of Mediterranean countries, combined with limited mobility within the region, make it difficult to relocate factors to sectors and regions that do not offer comparative advantages. Therefore, in the absence of large cohesion funds (as they were and still are in the EU), it is imperative that policymakers take social and regional aspects into consideration.

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382. The World Trade Organization’s World Trade Agreements database does not have more recent data for the entire Mediterranean region.
It is also relevant to note that, while databases have proliferated, they do not allow for matching records in trade in goods and services, as observed in World Trade Organization (WTO) data (ComTrade data), with data outlining business changes, as recorded in company surveys.

The few studies that have been carried out on this subject (see, for example, Caroline Daymon)\(^383\) have encountered difficulties in obtaining company data and matching them with commercial data. They must instead draw from general datasets of wages and income distribution. Based on these data, Daymon concludes that “in the MEDA countries,\(^384\) greater trade liberalization may help to stimulate growth but may also exacerbate inequality. It must therefore be supplemented by proactive measures to address import revenues, improve governance, and enhance the real allocative efficiency of public spending, combined with policies promoting investment.”\(^385\)

Second, the goal of attracting foreign investment should not be pursued necessarily by providing tax incentives. Such measures may lead primarily to activities such as the assembly of subsystems and the production of basic components. Various studies demonstrate that attracting foreign investment requires dynamic engagement from host countries aimed at providing an improved overall business environment. Scaling up requires also a genuine investment policy to allow the national production system to benefit from it.

A recent study of Morocco and Tunisia reveals that scaling up is a complex process involving lengthy negotiation, in which the countries involved are more than mere passive stakeholders. Morocco and Tunisia have highlighted their assets and the aspects contributing to their attractiveness.

Their offer a highly pragmatic business environment that has several main features:

- property fora that meet international standards, as part of a number of dedicated industry fora benefiting from free-trade zone status

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384. “The MEDA Regulation is the principal instrument of economic and financial cooperation under the Euro-Mediterranean partnership. It was launched in 1996 (MEDA I) and amended in 2000 (MEDA II). It enabled the European Union (EU) to provide financial and technical assistance to the countries in the southern Mediterranean: Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, the Palestinian Territory, Syria, Tunisia and Turkey.” “Meda Programme,” EUR-Lex, accessed November 3, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Ar15006. In 2005, MEDA II was replaced by the European Neighborhood Policy, which also included Eastern European and Eurasian countries. The participants in that policy are: Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, the Palestine, Syria, Tunisia, and the Ukraine.

385. Participants in trade negotiations are limited to specialist departments from the ministries of finance and international trade, often without consulting those charged with social and regional equality. It is therefore important that the latter are included in preparations for negotiation, which should then be presented to Parliament so that any planned compensatory measures can be debated if necessary.
• a financial partnership with the state to cover setup costs up to 10% of the total investment;
• support from local banks working with SMEs in the sector
• logistical infrastructure on sites undergoing construction
• fiscal incentives
• trained skilled labor to meet the needs of the projects, and
• legislative reforms to help control costs and delivery times

Third, it is important to avoid the dualization of the production system by paying particular attention to SMIs/SMEs throughout the territory, whose development is an essential precursor to social and regional cohesion. In addition, integration should allow them to establish equal partnerships with their peers within the region and in Europe. The idea of coproduction is based on this objective. It aims to find companies that are open to collaboration on both sides of the Mediterranean, provide them with incentives to come together, and, undoubtedly the most important element, establish the legal (protective and enforcement) framework for this new type of joint venture.

Given that this type of relationship may be affected by differences among partners, a regional legal framework, supported by a specifically dedicated arbitration body, may be necessary. Progress on coproduction is unquestionably the best way to combine free trade with balanced territorial development. The notion of equal partnerships is also critical in bolstering integration as a natural instrument harnessing the will to cooperate of grassroots stakeholders.

HUMAN CAPITAL AND THE ENVIRONMENT: TWO SECTORS WITH MULTIPLE RATIONALES AND A COMMON SCOPE

1. INTEGRATION THROUGH KNOWLEDGE, EDUCATION, AND SKILLS-BUILDING

A. Producing and promoting knowledge in an integrated manner

Researchers today must seek to develop up-to-date knowledge in the context of a global information and communication system that can now be engaged in real time as a result of modern digital technology. However, three changes are required in order to make this possible: (i) a hard-core research foundation structure supported by sustainable funding, (ii) researchers trained to the highest level in their disciplines, beginning with excellence in their initial training and, subsequently, supported for studying or working abroad at the corresponding

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level; and (iii) dissemination of the concrete outcomes of their work with a focus on the context of their country’s economy, in conjunction with other research structures, using an interdisciplinary approach.

This presumes the existence of dedicated digital platforms linking companies, scientific institutes, industrial centers, and other special areas, as well as a national innovation system designed to lead to the development of a knowledge economy.

In the Mediterranean, the regional integration process will help stimulate such a knowledge economy. How?

In practical terms, integration would facilitate the mobility of students and knowledge within the Euro-Mediterranean space as part of “Erasmus-style” programs, and the development of a system of scholarship funding for doctoral and post-doctoral training. This would provide talented young researchers with direct access to the best research centers around the region, while allowing them greater autonomy within their home institutions upon return, or even the creation of new, multi-country institutions, leading to more favorable working conditions and remuneration at a level that makes it attractive for them to abandon the option of working abroad in favor of returning home to help build up their region.

In a recent lecture, world-renowned infectious diseases microbiologist Didier Raoult, who was born and raised in Senegal, explained that whenever he hosts an African student through a doctoral or post-doctoral scholarship program, that student, upon returning to their home country, almost immediately creates a research agenda in collaboration with Raoult’s own laboratory. Raoult says he is often able to provide them with technical assistance and expensive sophisticated equipment at no cost once it has been amortized. It is this kind of partnership between institutions on both sides of the Mediterranean that should be developed further.

In a number of Mediterranean countries, some of the best researchers aspire to work in central government positions and/or choose prestigious European institutions, while others relocate to the Gulf countries because of the lower salaries in their home countries and the depreciation of their national currency.

Finally, besides essential change at the national level, a genuine regional ecosystem for knowledge production with sustainable funding could allow a large number of new activities to be developed. Progressing toward a true knowledge economy requires time, along with a thorough evaluation of projects,

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387. Since 2008, Didier Raoult has been the director of URMITE (in English, Infectious and Tropical Emergent Diseases Research Unit), collaborating with CNRS (National Center for Scientific Research), IRD (Research for the Development Institute), INSERM (National Institute of Health and Medical Research) and the Aix Marseille University, in Marseille. His laboratory employs more than 200 people, including 86 highly active researchers who publish between 250 and 350 papers a year and have produced more than 50 patents. Raoult has also been involved in the creation of, to date, eight start-ups. (From “Didier Raoult,” Wikipedia, accessed October 19, 2020, https://en.wikipedia.org/wiki/Didier_Raoult).
in order to bring unfruitful programs to an end. Should it be successful, however, Mediterranean-based scientific innovation would add immense value to the region.

**B. Regional integration and education**

Research is not the only area that could benefit from greater integration. The entire educational process, involving all educational institutions, should also be engaged in drawing benefits from integration.

The following benefits could emerge from a framework of cross-border education and student mobility:

- Higher-education institutions could obtain valuable additional revenues from international students’ tuition fees.
- More broadly, the influx of international students could help generate expenditure in the host countries in areas such as housing, transport, tourism, food, etc.
- Partnerships would help diversify the programs available to local students and improve both the quality and the relevance of teaching programs to the needs of the labor market. As has already been stated, students could also benefit from high-quality programs in more advanced countries, and then return to their home country to serve as domestic academics and help prevent an exacerbation of the “brain drain.”
- With better mutual recognition of qualifications at a regional level, a cooperation agreement for students mobility, accompanied by partnerships between universities, could expand domestic access to post-secondary education and then build international networks, which are crucial for innovation systems.

This type of integration can contribute to addressing the main issue currently facing education in the region—the need to better interlink its three main functions: personal development, socialization, and employability:

(i) **personal development**, in this case the availability of preschool education, the quality of primary schooling, and direct contact with other cultures.

(ii) **socialization**, which is conferred by a diploma and depends largely on the quality of education acquired. The results of the PISA tests suggest that MENA countries must improve quality, which will be made possible by large European universities and schools accepting to move beyond the creation of (often profitable) sub-brands staffed by teachers on short-term contracts.

388. The countries of the Maghreb, which dedicate more than 5 percent of Gross Domestic Product (GDP) on average to education/training (6.6 percent in Morocco – 20th out of 144 countries, 4.3 percent in Algeria – 77th out of 144 countries, and 6.2 percent in Tunisia – 27th out of 144 countries), are near the top of the middle-income countries in terms of education and training. This is reflected in equally satisfying gross enrolment rates in primary, secondary and tertiary education. However, this significant financial commitment yields positive impacts that fall below expectations when compared with the aforementioned countries. With the usual caveats regarding international benchmarks, the most commonly used quality-of-education indicators—the Global Innovation Index, the Global Competitive Index (GCI) and the TIMS and PISA tests—rank the countries of the Maghreb significantly lower than their financial commitment to education would lead one to expect. According to the Global Competitive Index, in 2014–2015, the three countries of the Maghreb were all ranked somewhere between 72nd and 87th, out of 148 countries, based on generally low scores.
There is a need, therefore, for genuinely equal partnerships to be implemented over the long term, which should focus not only on the governing bodies of universities that gather at annual conferences but also on teaching teams and teacher training.

(iii) **employability**, which requires a balance between general education and specific skills training. In this regard, the concept of "competency" has emerged alongside that of "certification" over the last 10 years. The latter allows access to the next level via an overall average taken across a large number of subjects, and has two limitations: it does not guarantee the acquisition of a true skillset that would be valued by companies, and second, it leads to a proliferation of degree courses at universities to meet the increasingly specific demands of the labor market.

This link between basic general education and the acquisition of targeted skills comes at a high financial cost, which is often beyond the budget of training institutions in the Mediterranean. One example of this is the proliferation of specialized master’s degrees all over Europe, and even the creation of a post-Baccalaureate guidance system across more than 400 courses in some countries.389

A remarkably low proportion of young people currently express a wish to continue their studies beyond compulsory education. The reason for this is clear: the Mediterranean region is the only region in the world where the probability of unemployment rises with additional education.

In this context, the World Bank has stated that the international mobility of academics and students yields important benefits in terms of research and development, as it enhances knowledge flows, stimulates new ideas, develops cooperation for joint research, and fosters innovation. (...) Attracting foreign researchers improves local capacity and enhances research cooperation between institutions. Countries such as Korea fund scholarships to undergraduate engineering students studying abroad to increase networking in technical fields and to develop cooperative programs concerning the latest technology.390

It is relevant to note that a closer involvement of large European training institutions could provide major European companies with a new incentive to invest more heavily in value chains in Mediterranean countries. These developments are essential to ensure progress on the third element (in addition to the quality of educational provision and labor market demands) involved in building human capital: instilling a thirst for knowledge among young people.

389. This is the case in France, for example, where “Parcoursup” offers 400 courses from which students who have completed the Baccalaureate can choose.
The 2015 CMI report on economic transitions in the Mediterranean gives some proposals:

The EU could finance the creation of North/South networks of vocational and technical training institutions so that their faculty and staff can work together to share best teaching and management practices.

The sectors concerned are where the jobs of the future will be found, including

(i) alternative energies and the environment (green jobs)
(ii) healthcare, the paramedical sector, and personal-care services, and
(iii) information and communication technologies, and cultural industries

The EU could conclude research agreements with the SMCs to enable their research labs to take part in EU research programs. As a supporting measure, financing, for instance, 1,000 postdoctoral students, would have a rapid and powerful impact on research labs and spark the development of rich South-North research partnerships.

In terms of cooperation in the region, there exists a Western Mediterranean Forum on Higher Education, Research and Innovation within the “5+5 Dialogue” (whose members are Algeria, France, Italy, Libya, Malta, Mauritania, Morocco, Portugal, Spain, and Tunisia). This platform, which gathers ministers of education together, proposes concrete collaborative programs/actions in-line with up-to-date priorities of the Dialogue 5+5 Member Countries in the field of research, innovation, and higher education.

One of the goals outlined in their 2015 Valetta action plan was “promoting mobility of students, researchers and entrepreneurs between Africa and Europe,” for example, by encouraging joint research projects, student exchange programs (through Erasmus+, which has set one of its three key actions as the “cooperation for innovation and the exchange of good practices,”) and/or the harmonization of standards, degree requirements, and qualifications in higher education.

Other associations, initiatives, and programs are currently contributing to strengthening the availability and quality of education and scientific research across the region.

They include

• The Mediterranean Universities Union (UNIMED): As its name indicates, it is an association of 112 universities from 23 Mediterranean countries.

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391. CMI, Economic Transitions in the Mediterranean.
392. Even earlier, in 1976, a Convention on the Recognition of Studies, Diplomas and Degrees in Higher Education in the Arab and European States Bordering on the Mediterranean was adopted. Additionally, in 1978 a Convention on the Recognition of Studies, Diplomas and Degrees in Higher Education in the Arab States was adopted. However, there is certainly a wide implementation gap.
394. South-Mediterranean countries are not qualified as “programme countries” but rather “partner countries.” As such they can take part in only some of Erasmus+ actions, and are subject to specific conditions. See “Who can take part?” Erasmus+ website, accessed October 19, 2020, https://ec.europa.eu/programmes/erasmus-plus/about/who-can-take-part_en.
It aims to “develop research and education in the Euro-Mediterranean area to contribute to scientific, cultural, social and economic cooperation”, and does so through activities such as:

- the promotion of mobility in the Euro-Mediterranean region for students, researchers, and academic staff
- technical assistance for the enhancement of quality assurance in university education
- thematic subnetworks to foster scientific cooperation within specific fields

**Erasmus+**: This is the European Union’s program for education, training, youth and sport. It has 33 European “program countries;” South-Mediterranean countries, considered as “partner countries” are subject to specific conditions. The three goals of Erasmus+ are:

- Mobility of individuals
- Cooperation for innovation and exchange of good practices, and
- Support for policy reform

Concerning partner countries, Erasmus+ conducts the following activities:

- **International Credit Mobility (ICM)**: Since 2015, Erasmus+ has allowed short-term mobility to Europe for students, researchers, and staff from other parts of the world. This two-way mobility allows students to attend a foreign university for 3–12 months and obtain credits, which are then recognized at the sending institution as part of their degree.

- **Erasmus Mundus Joint Master’s Degrees**: EU-funded scholarships to master’s degree students from around the world that cover tuition, travel, and a living allowance. The programs last from 1 to 2 years, during which participants study in at least two different European countries.

- **Capacity-building for higher education**: Lasting from 2 to 3 years, this initiative aims at modernizing and reforming higher education institutions, developing new curricula, improving governance, and building relationships between higher education institutions and enterprises.

**The Euro-Mediterranean University (EMUNI)**: Established in 2008, EMUNI is an international association of universities headquartered in Slovenia. It defines itself as an international institution, which gathers expert knowledge and experience of the Euro-Mediterranean countries and thus contributes in a significant way to the creation of a unified, integrated Euro-Mediterranean higher education and research area.

**C. Regional integration and professional training**

As SMCs seek to upscale the quality of their final products or inputs in the value chain, regional integration needs to be based on the kind of skilled labor that can produce these goods and services.
Aboushady and Zaki (2018)\textsuperscript{398} have explored the nexus between exports, innovation, and the demand for skilled labor for nine MENA countries\textsuperscript{399} and their results suggest “that becoming an exporter increases the probability of adopting new technologies, which, in turn, increases the demand for skilled labor.” Their conclusion indicates that more open trade policies without serious steps toward enhancing the quality of education and vocational training to respond to the needs of the labor market are less likely to yield significant outcomes.

Similarly, Del Prete et al (2016)\textsuperscript{400} have found that, for North African firms, participation in GVCs is linked to better performance. Some part of this, of course, is due to the fact that the most productive firms self-select into GVC activities. But they also find that, besides this, these firms tend to increase their productivity after joining GVCs. A word of caution, however, the authors also find that the ability to get such improvements relies on specific characteristics, such as an adequate level of quality and compliance with international standards, along with specialized skills.

Given the extent of the issue, there is a need for solid cooperation among Mediterranean countries, which could perhaps take place within regional subgroups. With this in mind, in 2015 the Luxembourgish Presidency of the EU proposed that the CMI join forces with UfM (the Union for the Mediterranean) to prepare a professional training development project in the Maghreb. It should be emphasized that this, still latent, project\textsuperscript{401} would be based on close cooperation between the three countries involved: Algeria, Morocco, and Tunisia. All three would cooperate on the overall management of the project and specialize, in particular, in two or three professional training sectors in collaboration with their partners.

This would benefit all three countries and their students: Morocco could focus on training for the automobile industry, the energy sector, renewable energy, the environment, and paramedicine, with Algeria specializing in agriculture and agribusiness, ICT, energy, and electricity. Tunisia has expressed interest in selecting construction, particularly for the energy sector, ICT, and teacher training.

Extending this type of horizontal cooperation, with assistance from Europe and International Financial Institutions (IFIs), could play a substantial role in enhancing the future attractiveness of the Mediterranean countries as destinations for foreign investment, enabling investment in activities that are better positioned in GCVs and RVCs, and energizing the Mediterranean integration effort through a progressive, collaborative approach.


\textsuperscript{399} Most of these countries could be qualified as “Mediterranean.” The nine countries are: Djibouti, Egypt, Israel, Jordan, Lebanon, Morocco, Tunisia, Palestine, and Yemen.

\textsuperscript{400} Del Prete, Giovannetti and Marvasi, “Global Value Chains.”

\textsuperscript{401} Pilot project relating to the initiative proposed by the Luxembourgish presidency of the EU at an informal European Council meeting in Luxembourg on July 16, 2015. The project is entitled “Youth Employment Initiative via Professional Training and Skills Development in the Maghreb Countries.”
Human capital improvements in the region can be achieved through the involvement of all stakeholders at play, including education institutions (from pre-school to tertiary), policymakers, and IFIs. However, it bears stating that policies need to be informed by concrete analysis of the current status of education in the region, including quality, access, and other vital issues such as the internationalization of tertiary education. Regional dialogue needs to be enhanced, and regional networks such as the University Governance Screening Card (UGSC) ought to be key components of this dialogue.

2. A REGIONAL RESPONSE TO CLIMATE CHANGE TO STRENGTHEN ENVIRONMENTAL RESILIENCE

The Mediterranean is one of the most environmentally vulnerable regions in the world. It is affected by water shortages, frequent droughts, a food production deficit, and the adverse effects of rising sea levels among others. Péridy et al (2013) have used temperature and precipitation data to show that climate change has affected and will continue to negatively affect the process of economic convergence.

Fortunately, the region has many assets with which to address the climate change challenge. It has some of the best resources in the world for decarbonizing the energy sector, and potentially, the carbonless energy resources to meet the region’s own needs as well as those of its northern shore neighbors. However, developing this potential quickly enough to meet the objectives of the Paris Agreement will require regional market integration and cross-border cooperation.

As highlighted by several pieces of research, the linkages between water, energy, and food are multiple, complex, and evolving. Those relationships

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402 In 2020 CMI has published a report titled The Internationalization of Tertiary Education in the Middle East and North Africa that will outline the benefits of internationalization, assess the current state of internationalization of tertiary education institutions across MENA, and provide some policy recommendations. The report, which is available in Arabic, French and English, can be found at: https://www.cmimarseille.org/knowledge-library/internationalization-tertiary-education-middle-east-and-north-africa

403 The University Governance Screening Card (UGSC) is a benchmarking tool developed by the World Bank and CMI to assess the extent to which tertiary education institutions are following governance practices aligned with their institutional goals and international trends. It has been successfully implemented in more than 150 tertiary education institutions in eight MENA countries and four European countries. For more information, see World Bank, Benchmarking Governance as a Tool for Promoting Change (Washington, DC: World Bank, 2013), accessed October 19, 2020, https://openknowledge.worldbank.org/handle/10986/16249; and https://www.cmimarseille.org/highlights/university-governance-screening-card-version-2-launched-palestinian-territories.

need to be taken into account when addressing the climate change threat in the region. Moreover, how they are addressed is likely to have an effect on the success of regional integration. For instance, water availability is a driving factor in the localization of productive activities and human settlements, affecting trade. Agriculture and food production systems play a key role in valuing water and using it more productively. Energy and agriculture compete for land and water, but the energy transition required to reach the objectives of the Paris Agreement would release water for the other sectors. Finally, the agriculture sector can and should be a source of raw materials for bioenergy.

If the Mediterranean region could integrate these three sectors—energy, water and food—it could become a model for the world by promoting the use of renewable energies to find solutions to water scarcity, as well as more sustainable agriculture practices and production techniques. In turn, more equitable access to water would also contribute to food diversification and to the stability of rural ecosystems, which is essential for territorial cohesion and climate change adaptation.

Additionally, addressing environmental and climate issues effectively will require technologies and expertise that create new industries, new sources of value, and new jobs. But if Mediterranean countries succeeded in cooperating closely in this area, with support from the EU and perhaps major multilateral institutions, this would likely trigger a highly relevant resurgence of solidarity among them and a genuinely novel model of codevelopment.

The next three sections will examine in turn Energy, Water, and then Food.

A. Energy

Energy is a fundamental input into all economic activity and, indeed, the very wellbeing of a population. The sector is global by nature, although the recent movement toward decarbonization is resulting in the emergence of decentralized solutions for electricity production. The electricity sector is evolving toward a hybrid market, in which large-scale production facilities serving large cross-border markets coexist with smaller, decentralized units located closer to consumption centers.

The second important element to consider when analyzing regional energy market integration is the role of geopolitics, which affects trade patterns worldwide, but particularly so in the Mediterranean where political factors have often been powerful enough to hamper regional cooperation to a remarkable extent.

The third important element is that the energy sector, by its very nature, can have severe detrimental effects on global warming: the sector is responsible for 80 percent of CO₂ emissions in the region, air pollution—it releases SO₂, particulates, and other pollutants—problems with water availability and quality, and ecosystem issues in general: the sector uses vast amounts of land that are therefore not available for other purposes, and generates waste that can be gravely harmful if not handled properly.
The energy sector is particularly well-suited to the implementation of a bottom-up approach to Mediterranean deep integration and trade liberalization because energy is predominant in trade exchanges in the region, particularly between the EU and SMCs. (Over the last two decades, energy has on average represented more than half of SMC exports to the EU). The Euro-Mediterranean energy relationship\textsuperscript{405} dates back to the 1970s when a gas pipeline connecting Algeria to Italy, via Tunisia, was built and the Global Mediterranean Policy (GMP) was launched to institutionalize relations between the EU and SMCs, mainly on general economic and commercial issues. Since then, more than 7,000 kilometers of gas pipelines have been constructed across the region, establishing multiple multi-country connections. Oil pipelines and liquefied natural gas (LNG) facilities have also proliferated all around the Mediterranean, mostly the result of bilateral state-to-state and company-to-company projects between producers in the SMCs and importers in Europe, while the GMP has had only limited success.

With the 2007 Limassol Declaration, the focus of the Euro-Mediterranean partnership shifted from hydrocarbons to electricity and renewables, where sustainable development figured prominently. The idea of exporting solar electricity from the Sahara, although not new, gained momentum when the first EU Renewable Energy Directive was being prepared.

In 2008, the UfM revived the idea of a multilateral commitment, this time with an intergovernmental framework based on the principles of co-ownership and variable architectures, while maintaining the legitimate interests of any UfM member.

The 2008–2012 period saw a flurry of initiatives in addition to the UfM Mediterranean Solar Plan (MSP), such as Desertec, Dii, and Medgrid, to connect the southern and northern sides of the Mediterranean, when it seemed that many EU countries would face difficulties in meeting their commitments under the Directive.

However, most of these initiatives subsequently went into hibernation, and cooperation mechanisms with the SMCs did not receive strong support from the EU, either because it was assumed that 2020 targets would be met from their own Renewable Energy Sources (RES) resources (in part because of stagnant demand), or because other mechanisms such as statistical transfers or cooperation mechanisms with other EU countries had been identified as of higher priority.

Other reasons identified for the failures of Dii, MSP, and other ambitious Mediterranean integration initiatives include underdeveloped legal and regulatory frameworks, weak grid infrastructures (in particular, the lack of interconnectivity between the two shores), lower than expected socioeconomic benefits, high upfront costs, combined with the lack of financing mechanisms, high fossil fuel subsidies in SMCs, energy policies that gave priority to domestic renewables over electricity imports, and electricity surpluses in EU countries. However, since then, the EU CO₂ emissions reduction targets for 2030 have grown increasingly stringent, first with the 2030 climate and energy framework, adopted by the European Council in October 2014, and more recently under the proposed Climate Law, to enshrine into legislation the EU’s political commitment to becoming climate neutral by 2050.406

Today, the objective of carbon neutrality can be reached only with a massive scale-up of renewable energy. Regional electricity market integration across the Mediterranean would not only give the EU access to a vast and almost limitless source of renewable energy but also increase the flexibility of interconnected power systems.

To accommodate a high level of renewable energy, power systems need to have the flexibility to cope with sudden unexpected variations in renewable energy supply and to balance electricity markets in real time. Large integrated regional power systems, including renewable sources, are more flexible than smaller ones, as solar and wind resources are more likely to be available.

In short, the interest in Mediterranean electricity market integration is evolving from economic-efficiency reasons to decarbonization priorities.

406. The “Clean Energy for All Europeans” package is the legal and regulatory framework for EU climate and energy policy for the period 2021–2030. In July 2019, jointly with the European Commission, CMI published a report on this package highlighting its implications and opportunities for Mediterranean countries. The report, which is available in Arabic, French and English, can be found at: https://www.cmiarseille.org/knowledge-library/briefing-paper-eu-clean-energy-all-europeans-package-use-southern-and-eastern; the English-language PDF is available at: https://www.cmiarseille.org/sites/default/files/newsite/english_version_online.pdf.
Experience around the world indicates that although full regional integration of neighboring electricity markets and the creation of regional power pools can take decades to realize, the good news is that partial integration that enables countries to begin reaping some of the benefits of a regional electricity market can happen relatively rapidly.

The rate of progress is likely to depend on many factors, a key one being the institutional capacity for integration and the existence of a supranational institution to coordinate, monitor, and guide the overall effort. Integration could start in simple forms such as cooperation for reserve-sharing and mutual help in case of an emergency and later evolve to more elaborate integration schemes, with multi-country power systems, technical and regulatory harmonization, formal common power exchanges, converging market design, and competitive trade across borders.

Regional power pools often start with a small number of countries and expand over time as success attracts more participants. In the case of the SMCs, a realistic interim target might be the creation of an integrated Maghreb electricity market (or at least integrating the power systems of Morocco, Algeria, and Tunisia as a start), given that the Maghreb Electricity Committee (COMELEC) already fulfills some of the functions of a power-pool-type coordinating entity. The process could be similar to the one under way in South East Europe, where the West Balkan countries—seven of which are Mediterranean countries—are at an advanced stage of integration with the EU single energy market.

North Africa has all the characteristics needed to become a clean-energy hub serving the integrated EU-Mediterranean energy market, possibly including part of Sub-Saharan Africa in the longer term. The region has a strategic geographical location, rich resource endowments, a diversified mix of energy sources, and even a modicum of physical-transmission infrastructure sufficient to get started. The development of such a hub would make the Mediterranean region a bridge between the European and African continents, making energy a key driver of the “Vertical Africa—Mediterranean—Europe (AME)” discussed in previous chapters.

Reaching carbon neutrality, however, cannot be achieved by relying on renewable energy alone. Resorting to renewable energy requires intense electrification of final energy use because very few end-user processes and equipment can use renewable energy directly. The problem is that some sectors are difficult to electrify, including cement manufacturing and some segments

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of the transport sector (maritime and air transport, long-haul commercial road transport, for example), and it is known that hydrogen can be used as an alternative energy carrier to decarbonize those end-use sectors.

“Green” hydrogen can be produced by the electrolysis of water using renewable-based electricity, with no carbon emissions. In addition, hydrogen is an effective storage option to increase the flexibility of power systems. The EU Green Deal, indeed, sees hydrogen as key to reaching carbon neutrality. North Africa, together with the rest of the MENA region, has been identified as a favorable location to supply Europe with green hydrogen. Hydrogen, therefore, could become a new driver of Mediterranean energy market integration, possibly through “production-sharing” agreements, which are a source of deeper integration, rather than mere trade agreements.

In summary, regional energy market integration and cooperation between Europe and the Mediterranean are crucial to unleashing the region’s solar potential for the purposes of cost-effective climate change mitigation. Successful regional energy market integration will require substantial physical infrastructure (the “hardware” of regional integration, as it were) but this will not be enough.

The “software” of regional integration includes compatible market design, interoperability of power systems, coordination of wholesale markets, preferably joint balancing markets, flexibility assessments, adequate management of interconnection capacity, regulatory convergence, harmonization of pricing principles, and tariff setting, including subsidy removal.

The process can take years and will require appropriate national and regional institutions, but it can be approached and managed in stages. For any of this to be possible, policymakers, energy companies, and regulators from the North and the South of the Mediterranean will need to fully embrace—and push for—the benefits of Euro-Mediterranean electricity market integration.

Maintaining a network that brings together development community experts, government representatives, and business-sector energy players from around the Mediterranean is essential in order to share best practices and to influence the policymaking process.

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409. The EU Recovery Plan, announced as this report goes to press, proposes a budget of up to €30 billion for clean hydrogen.
410. The Border Carbon Adjustment being discussed under the EU Green Deal may become a barrier to trade between the South and the North, and therefore to regional integration.
411. Oseni and Pollitt, Promotion of Regional Integration.
412. The CMI Mediterranean Forum on Energy and Climate Change is a learning and discussion platform that brings together countries, international organizations, regulators and electricity companies with the purpose of supporting the Mediterranean region’s transition into a low-carbon economy by disseminating knowledge on how to achieve low-carbon growth, and by raising awareness of the benefits of Mediterranean energy market integration. See the Mediterranean Forum on Energy and Climate Change website: https://www.cmimarseille.org/programs/mediterranean-forum-energy-and-climate-change.
B. Water

In the Mediterranean, it has become an urgent matter to promote an integrated regional approach to managing water scarcity, especially now that it has been aggravated by shocks generated by climate change. Such climate shocks are likely to have a severe impact on most of the Mediterranean’s water basins, inducing reduced runoff and groundwater recharge, increased irrigation requirements, conflicts among users, and the increased risk of overexploitation and quality degradation. The goal should be to develop a comprehensive water management model centered on strengthening collaboration and integration among the different basins in the region.

Water usage is, by definition, an international issue because watercourses flow indiscriminately across national borders, and because the factors that contribute to water depletion, including climate change, are global. Indeed, water scarcity and insecurity within various countries of the Mediterranean region have now become drivers of regional-level and continental-level forced migrations, instability, and conflicts.

This phenomenon is likely to worsen in the future because the region continues to be among the world’s most vulnerable to climate change. Together with demographic growth, the effects of climate change will have a tremendous impact on the water sector over the next 20 years, including an estimated decrease of water availability of 2 to 15 percent (in the case of a 2°C increase in temperature) and an increase of water-scarce populations (that is, inhabitants who live with less than 1000 cubic meters of water per year) to more than 250 million.413

The water management challenges faced by all the Mediterranean countries are broadly similar in nature, as they are deeply rooted in the inefficient conventional water governance systems and management practices established in many countries across the region. To meet the region’s future water supply needs, it is essential that governments adopt a resilient and integrated water sector approach at the regional level while making cooperation the core of this process. Indeed, an integrated cooperative framework that creates an enabling environment for all stakeholders—governments, civil society organizations (CSOs), water utilities, municipalities, research institutions, and youth organizations—to be heard and included is a prerequisite to ensuring a water management approach that succeeds in the long term.

Moreover, strong emphasis needs to be placed on engaging and bringing into the conversation vulnerable communities and traditionally forgotten actors, especially women and the youth. Such multi-stakeholder platforms would play an important role in bridging the gap between science and policy, and between engineering logic and popular sentiments. This would strengthen partnerships among all actors and facilitate the exchange, production, and dissemination

of knowledge—South–South as well as North–South—thereby preparing the region to cope effectively with future droughts.

In the SMCs, the agriculture sector dominates water use, taking up about 75 percent of water consumption, compared to only 25 percent in countries of the northern shore. Not only that, but the proportion of irrigated land is increasing rapidly. Although on average it accounts for only 25 percent of cultivated land in the Mediterranean, in countries like Egypt, Lebanon, and Greece it exceeds 70 percent. The trend toward more efficient irrigation systems, possibly powered by solar energy, does not automatically induce water conservation because it can instead merely encourage a switch to more water-intensive crops.

The current water constraints, on the other hand, may well induce a specialization in crops that are less water-intensive, and a reliance on imported substitutes for food products that require large amounts of water (resulting in what has come to be called the “virtual water trade”). To factor in another variable, the wider adoption of a Mediterranean diet—increasingly recognized around the world as one of the healthiest—that is based on locally produced food could lead to overall water conservation.

It is undoubtedly true that technological solutions to water conservation exist today that can either increase water availability, such as desalination or make its use more efficient, such as drip irrigation. But it is difficult to imagine commercializing these technologies on a large enough scale to address more than a relatively small portion of the region’s water scarcity problem. Making the region’s water systems and water usage sustainable will almost certainly require a more fundamental solution that combines marked behavioral changes among water users with technologically oriented solutions such as water conservation irrigation techniques, multi-scale storage, and unconventional water sources such as recharged wastewater or desalinized sea water.

It will be important to identify ahead of time and minimize the possible detrimental environmental impacts associated with some of these technological solutions, such as soil contamination, coastal ecosystem degradation, or greenhouse gas (GHG) emissions (for instance, when desalination uses fossil fuels) in order not to make the solution worse than the problem.

The challenge of water demand management cannot depend only on finding solutions for its efficient use. It also requires the economic and social enhancement of existing water resources, and a genuine effort to take into account the needs of ecosystems, in particular, to ensure water flow to wetlands, many of which are of international importance.

It needs to be borne in mind, however, that managing and enhancing these water resources in a sustainable way will likely be complicated by the transboundary nature of many basins and aquifers, a phenomenon common to many Mediterranean countries.

Transboundary problems to some degree require transboundary approaches. The World Bank’s 2018 report on water scarcity in the MENA region contains a summary of what regional cooperation could bring to the achievement of
sustainable water management. It states: “At the regional level, cooperation on water can foster greater trust and collaboration.

The World Bank is supporting regional cooperation across the Middle East and North Africa. As part of its regional strategy, it is promoting regional cooperation around water and other regional public goods and sectors, such as energy and education. The purpose of this action area is not to promote cooperation for its own benefits, but as a means to greater peace and stability in the region (Devarajan 2015).”

The efforts of the League of Arab States to strengthen water management in the region need to keep pace. The work by the Arab Countries Water Utilities Association (ACWUA) on benchmarking water utilities and tracking the performance of water services across the region becomes more valuable as part of the Sustainable Development Goals (SDGs). Similarly, a collaboration between researchers and universities through established and emerging networks, such as the Middle East and North Africa Network of Water Centers of Excellence (MENA NWC), is essential.

Finally, international organizations and nongovernmental organizations (NGOs), including the regional (Israeli, Palestinian, and Jordanian) NGO EcoPeace Middle East, have important contributions to make with state-of-the-art study-based knowledge and financial resources to help MENA countries address their water challenges.

With the same perspective, the CMI has been promoting a regional approach to managing climate change-aggravated water scarcity in the Mediterranean. This is based on an integrated approach to tackling water management in the region, by focusing on water-smart solutions that can also create job opportunities for the youth.

C. Food

In the agriculture sector, the Mediterranean region offers huge trade potential and economies of scale because of its geographical proximity to international markets, similar resource bases, and common consumption patterns, which is an especially important thing in food industries. Agricultural production has clear positive spillover effects for regional public goods such as water, health, and biodiversity. One of the main advantages of trade reforms in the region should be the possibility of occupying a competitive position for certain typically Mediterranean products, for example, olive oil. This could allow Southern and Eastern Mediterranean countries to reach for and attain higher quality standards and to create global brands, rather than just supplying intermediate products to European distributors who then promote them under their own brands.

The agricultural sector is very sensitive to the impact of climate change. Current approaches to food production, which rely on ever-increasing inputs of land, water, and fertilizer, may no longer be suitable in the near future owing to global warming. In addition, the allocation of water to agriculture will likely face increased competition from high-value uses in the industrial and urban sectors.

414. World Bank, Beyond Scarcity.
Urbanization will exacerbate water competition between cities and agriculture, requiring major efficiency improvements in agricultural water use. The cost of producing crops might rise as groundwater levels drop, and the costs of pumping deeper water increase. Increased exploitation of groundwater for food production will require more energy, potentially resulting in higher greenhouse gas emissions if fossil fuels are still being used rather than renewable energy.

Given the food and water constraints of the South of the Mediterranean, there are no plans to develop bioenergy crops there, in contrast with countries on the northern shore, which have developed biomass energy and production of liquid biofuels.

The impact of growing water scarcity on agriculture is worrisome, with the sector being the main user of water in the region. In a water-constrained MENA, reducing the demands of the food production and energy sectors for water should become the overarching objective and direction of the region’s water-energy-food policy.

Transitioning to renewable energy would ameliorate the water scarcity component of the crisis, while also curbing CO₂ emissions. To reach this overarching objective, there are multiple strategies that can be developed and implemented in order to increase nonconventional water supplies and transform energy supply systems into low-carbon solutions.

Increasing intersectoral collaboration will also be key to addressing these water-energy-food nexus challenges. Regional partnerships with other national, regional, and global actors foster development and trust across the Mediterranean, giving the partners the opportunity to leverage the resources and knowledge needed to develop comprehensive, innovative and inclusive solutions.

UPGRADE FINANCIAL INTERMEDIATION BY DEVELOPING RELATIONSHIPS OF COORDINATION AND COOPERATION

The availability of affordable external finance is essential to the development of a private sector that creates jobs. In particular, SMEs—including micro-enterprises—offer the best opportunities for job creation but, ironically, they are also the ones struggling the most to obtain credit or other sources of financing. Rocha et al (2011) analyzed a survey on bank lending to SMEs in the MENA region and found that SMEs represented just 5 percent of total loans in Egypt, 6 percent in Palestine, and 10 percent in Jordan. Other SMCs ranged from 15 percent to 24 percent. The authors also observed consistently across countries that MENA banks complain primarily about SME opacity and about the weak financial infrastructure (lack of reliable collateral, weak credit information systems, and weak creditor rights (Rocha et al 2011, 9).

The Doing Business “Getting Credit” indicator confirms the prevalence of issues linked to inadequate creditor rights and lack of information. This weak financial infrastructure, perceived as risky, leads bankers to demand prohibitive guarantees and focus on the value of collateral assets—as if already anticipating the project’s failure—instead of realistically evaluating the project and weighing its risks. The result is that a lot of the liquidity from deposits remains unused. This also poses issues of inclusiveness and gender gaps because women, for example, often do not have land ownership rights that they could use as collateral.

Source: Doing Business 2020, World Bank
Chaffai and Coccorese (2018)\textsuperscript{416} estimate that banks, for their part, could reduce their costs and/or increase their revenue if they adopted better managerial practices and, especially, better technologies. As their chart shows, inefficiencies represent a significant percentage of total foregone revenue in the region, close to 15 percent in Jordan.

\begin{figure}
\centering
\includegraphics[width=\textwidth]{foregone_revenue_by_country.png}
\caption{FOREGONE REVENUE BY COUNTRY}
\end{figure}

\textit{Source:} Mohamed Chaffai and Paolo Coccorese op.cit

On the demand side, however, firms in the region do not report being more credit-constrained than in other developing parts of the world. De Lima et al (2016)\textsuperscript{417} explain this by arguing that many firms are not actively seeking credit—and therefore not keenly aware of its unavailability—because they are simply disconnected entirely from the banking sector and do not apply for any loans, instead claiming to have sufficient capital, or lowering their business expectations, or surviving with what they have. The authors write that “prevailing banking systems have led firms to adjust their expectations and production strategies to an environment in which they do not consider banks as an option, or that they have limited growth opportunities.”

At the level of individuals, the reality is that whether from a financial institution, family and friends, or a savings club, few South Mediterranean citizens are borrowing to start operating or expanding a farm or business.

Additionally, in many countries of the region, fewer than one in two individuals ages 15 or older own a bank account or some other financial account.


\textsuperscript{417} EBRD, EIB, and the World Bank, \textit{What’s Holding Back the Private Sector?}
Sub-Saharan African countries also have traditionally had problems with access to financial services, but in the last few years, many of them have increased their use of mobile money to the point that they now use financial services at higher levels than SMCs (see annex 6).

FINANCIAL ACCESS IN SOUTHERN MEDITERRANEAN COUNTRIES

Among MENA countries themselves, there are large inequalities in access to financial services that are related to gender, income level, education level, geographical location, and other factors.

GAPS IN ACCESSING FINANCIAL SERVICES IN THE MENA REGION

Sources: World Bank, 2017 and authors’ calculations
1. IMPROVING ACCESS TO FINANCE FOR FIRMS AND INDIVIDUALS

Most, if not all, Mediterranean countries consider the reform of their financial system as a top priority, but what contribution can regional integration make to this? Can the less developed financial markets in the region also benefit from integration? Or are there hurdles they must first negotiate in order to leverage the advantages of regional integration?

There are a number of pathways and options:

- By allowing investors to hold more diversified portfolios of financial assets, greater regional integration could create economies of scale and offer better access to capital for companies.
- Financial institutions should benefit from wider horizons, larger banks, more developed securities markets, and a wider range of financial products. This would improve the balance between supply and demand, as well as offer risk diversification and lower interest rates.
- The establishment/entrance of foreign (regional) banks could raise standards and allow new financial products to be introduced—for example, new mortgage and leasing instruments—because they would bring with them more advanced expertise and risk management techniques.

However, for such far-reaching changes to develop and take root across a regional group or subgroup, it will require the removal of restrictions on cross-border movements of capital and an agreement to limit the trade-offs among the different rates of return in the region.

The goal would therefore be to create an integrated financial services market in which investors and all other operators engaged in business activity in the regional market (i) are subject to a uniform, coherent set of rules governing financial transactions, (ii) have undifferentiated access to all financial instruments and services; and (iii) benefit from fair and equal treatment when they decide to operate regionally.

In the Maghreb countries, integration of banking structures and financial markets is already broadly underway. Currently

- there are branches of Moroccan banks in Tunisia (for example, AXIS Capital, a branch of the Banque Marocaine du Commerce Extérieur—BMCE) and a branch of the Moroccan banking group Attijari Bank.


• there are branches of Tunisian banks and financial institutions in Algeria (for example, Tunisia Leasing, a brand of Tunisia Leasing Group and Amen Leasing, a branch of Amen Bank)
• there is the Tunisian-Libyan Bank (BTL) in Tunisia, a branch of BTL in Tunisia (North Africa International Bank–NAIB)
• there is also an Algerian investment bank in Tunisia (International Market Bank–IMB)

In addition, the Moroccan and Tunisian authorities have signed a Memorandum of Understanding on the cross-border supervision of Moroccan bank branches in Tunisia.

Finally, the rapid growth of the Moroccan and Tunisian stock markets, although still underdeveloped, is a telltale sign of strong demand for active capital markets in the region. According to Moroccan authorities, after considering the potential risk linked to exchange rates, there has been some convergence between interest rates in securities markets in Morocco and Tunisia. Morocco and Tunisia have also electronically linked their stock markets. Further market liberalization would almost certainly encourage deeper capital integration.

2. THE ROLE OF FINTECH

As shown by the mobile phone financial services in the Sub-Saharan Africa example (annex 6), new technologies in finance can increase financial inclusion. The International Monetary Fund’s April 2018 *Regional Economic Outlook* for the Middle East, North Africa, Afghanistan, and Pakistan (MENAP) states that several countries (Egypt, Lebanon, Jordan, Pakistan) are beginning to embrace financial technology (fintech) to increase financial inclusion.420

In early 2016, Jordan became the first country in the region to implement interoperability of mobile money services after the successful launches of Mahfazti in January and Zain Cash in March of that year. Both services are connected to JoMoPay, a central switch owned by the Central Bank of Jordan that enables cross-network transfers between the services, as well as interoperability with the country’s broader payment infrastructure.421

More generally, the aim is to promote the practice of using banking services and to familiarize young people with the financial culture by allowing them to hold a current account and reducing the use of cash, in particular. This process of familiarization with banking practices adopted by several central banks and banking associations also aims to encourage greater use of the full range of tools available (savings, loans, insurance contracts, investments, etc.).

Jordan is one of the most advanced countries in the region on this front. The Central Bank of Jordan (CBJ) has announced its plan to boost its financial inclusion basis among youth, targeting 2 million Jordanian youths 18–25 years old to make use of the banking sector’s various financial services.

Efforts to improve the legal framework to strengthen monitoring and resilience and to enhance the skills and capacity of key players in the financial system are also being undertaken. Capacity building for banks to improve their credit risk assessment would be helpful to those interested in lending to SMEs without putting their financial stability at risk.

This development is likely to give rise to an increase in financial intermediation, which is necessary to prompt financiers to move away from the easier option of concentrating their funding in hard infrastructure projects that benefit from government guarantees.
CHANGING THE ROLE OF THE PUBLIC SECTOR AND PROMOTING DEEPER INTEGRATION

The Role of the Public Sector in Promoting Integration

In the Mediterranean region the governments and, more specifically, public policy will continue to play a key role in economic development, given their active involvement historically. However, significant changes are required. In a context in which private-sector initiatives are increasing in strength and scale, it will be important to reinforce the rules that deter “crony capitalism,” which has been identified by several experts as a significant issue in several Mediterranean countries.

Regional integration can play an important role in promoting good practices as countries establish appropriate rules and jurisprudence. All of the surveys consulted by the author on the region’s business climate demonstrate that perceptions of corruption constitute the most severe obstacle facing private operators.

Recent years have highlighted the important role that governments in the region can and must play in promoting and maintaining social equilibrium and in balancing urgent, short-term economic decisions with longer-term development objectives.

In today’s globalized world, it has been demonstrated that initiatives aimed at further integrating markets by, for example, lowering trade costs and encouraging the mobility of people have net benefits at the individual-country level but may also be accompanied by certain negative effects, at least temporarily, for some segments of the population. Hence the need to emphasize the role of the public sector in providing safety nets in the form of education, health, microfinance, social protection, etc., while the private sector leads the creation of new jobs.

The government must continue to act as an economic regulator and promoter of inclusive growth by ensuring that the disparities that often tend to appear with trade liberalization are somehow corrected through parallel social counter-actions, support for innovation, labor market flexibility, and incentives geared toward new types of activities that are socially and environmentally responsible.

The critical factor is not the size of the state, nor the level of public sector wages. Indeed, in the case of female employment, females (after other variables have been accounted for) earn relatively low wages across the board, indicating that
the public sector, quite aside from the issue of bloat, actually has a problem with insufficient wages, at least for women. Rather, the most critical factor is the effectiveness of the region’s public institutions, which typically are excessively centralized, inadequately empowered, insufficiently accountable, and more often than should be the case, of questionable motivation. This, together with the fact that the outcomes of their actions are rarely properly evaluated, and implies that credible allegations of public-sector underperformance can conveniently be dismissed as merely anecdotal and unsupported by objective data.

Trade in the 21st century is increasingly departing from the traditional exchange of goods and services, and toward deeper trade integration, which follows less conventional channels.

**Toward Deeper Integration**

This approach is particularly relevant in the Mediterranean region. First, the region remains one of the least integrated in the world in terms of trade volumes. This partly reflects a shallow type of integration with many non-tariff restrictions, inducing high costs to trade. Targeted areas of improvement for deeper trade integration include clearer and more efficient rules of origin, better infrastructure and services in the field of transportation and logistics, closer harmonization of technical requirements, better management of customs, and the greater use of sanitary and phytosanitary (SPS) measures, among others.

Second, the largest socioeconomic gains might not necessarily come from trade of goods but from integration in other markets, particularly services, energy, labor, and capital. Since reinforcing the links between trade and investment can increase income opportunities and youth employment, deeper integration would contribute to providing regional public goods in the form of enhanced human capital mobility (as opposed to distress-induced economic migration), an energy transition toward decarbonization and circular economy, and greater security in the region.

Deeper trade integration requires much more “beyond-the-border” change than simple tariff cuts. An objective of drawing the most benefit from trade liberalization and participation in GCVs may incentivize individual countries to commit to sound domestic policies in an integrated manner (catalyzing beyond-the-border change). This leads to a virtuous dynamic of circularity.

Regional trade integration cannot work its miracle among its participant countries if they do not implement domestic reforms that promote a better economic and business environment, and yet such domestic reforms are likely to be easier to implement if they are framed regionally. The domestic reforms will be difficult to undertake without a regional structure, but the structure of regional relationships and arrangements requires a foundation of domestic reforms in order to come into action or to have an impact.

Cooperation in areas such as governance, migration, and climate change does not necessarily have to go hand in hand with trade liberalization, but it might be facilitated by the institutional framework and the trust among stakeholders.
that negotiations on trade agreements may provide linkages between trade negotiations and deeper sectoral transformation.

To achieve the type of deeper integration that would really transform the Mediterranean region, it would be necessary to use more bottom-up, rather than top-down approaches to promote an integration scenario where the private sector drives supply-chain integration, including South–South integration. Business communities need to be mobilized to play an advocacy role, identifying areas of cooperation that promise clear joint benefits regionally.

This does not need to happen in the traditional framework of a trade agreement, such as the Pan Arab Free Trade Area (PAFTA), although it may be used as an “umbrella to pursue measures that are more piecemeal or à la carte.” North–South deep trade agreements with Tunisia and Morocco, such as the EU Deep and Comprehensive Free Trade Areas (DCFTAs) with Georgia, Moldova, and Ukraine, might have more relevance if they involve local institutions and draw lessons from what has been successfully done in the Central and Eastern European countries (CEE).

Progress in addressing barriers to trade may be facilitated if the value chain pathway used by commercial businesses is applied to identifying desirable policy reforms and priorities for cross-border or regional cooperation. Again, this does not need to occur in the framework of a formal trade agreement or existing Arab integration initiative such as Pan Arab Free Trade Area (PAFTA). Developing internal logistics chains (transport in particular), mainly between Southern countries, may also be necessary to reduce trade costs.

Today, after several criticisms and a “globalization backlash” in some parts of the world, it seems many countries are still interested in pursuing regional integration.

The Mediterranean approach could further build on several existing initiatives:

- South-East European countries of the Mediterranean (Bosnia and Herzegovina, Albania, and Montenegro), which are somewhere in the process of applying for membership in the EU—they are also currently part of the UfM—could further contribute to the integration of the larger Mediterranean region.
- The creation of an African Continental Free Trade Area (AfCFTA), signed on March 21, 2018 and including North African countries, reminds us of the potential benefits of adopting a wider strategy of EU-Mediterranean integration that extends to the whole of Africa (“La Verticale Africa-Med-

422. The Greater Arab Free Trade Area (GAFTA) is a pact of the Arab League that has been in force since 2005. It aims to create an Arab Free Trade Area, a market of more than 300 million people, a gradual reduction of tariffs (10 percent per year), and the elimination of non-tariff barriers. Of the 22 Arab League member states, 19 signed the pact in 1997 in Amman, Jordan.

423. The three Deep and Comprehensive Free Trade Areas (DCFTAs) are three free trade zones established between the EU and each of three countries—Georgia, Moldova, and Ukraine, respectively. They allow these countries to access selected sectors of the EU single market, and grant EU investors investing in those sectors the same regulatory environment in the associated country as they would have had in the EU.

424. The Mediterranean signatories include Algeria, Egypt, Libya, Morocco and Tunisia.
Cooperation agreements among SMCs such as the Agadir Agreement and the Arab Maghreb Union (AMU)—which although not always very active nevertheless still exist—could be revitalized, strengthened, and revised in light of present-day global and regional transitions.

- Trade arrangements such as EU trade integration with SMCs, currently handled mainly through bilateral relations—Association Agreements or Deep and Comprehensive Free Trade Agreements—could be further pursued.

Meanwhile, relations between the two rims, which are presently coordinated through a myriad of organizations, but most notably the Union for the Mediterranean and the 5+5 Dialogue, could further contribute to enhancing cooperation.

Finally, what, if anything, is applicable from the multilateral approach taken by the WTO? Will such a framework give more of a voice to developing countries? How will it affect Mediterranean countries and their links with the more advanced countries?

These movements of multidirectional integration suggest a rethinking of the relations between Europe and the SMCs as a gateway to Africa and the East, with a longer-term vision. A few remaining issues can be raised for the purpose of this analysis.

If a new coproduction approach could be put in place so that European countries would consider SMCs as partners, as opposed to producers of low-value-added goods, and SMCs would remove the remaining obstacles to trade diversification and investments, such an approach would allow for the transfer of technology and know-how and further enhance the potential of the less advanced countries in the Mediterranean.

If the end goal is a fully integrated North–South free trade area (FTA), what are the best steps for getting there? For example, are bilateral or subregional agreements milestones or in fact millstones to regional integration? In other words, will the multiplication of agreements have the effect of putting barriers in the way of unified and regional integration? Or are they necessary, incremental, intermediary steps to showcase success in manageable portions and progressively generate rising levels of trust?

Mediterranean countries could also use the various currently existing institutional frameworks—such as the UfM, the Arab League for all the MENA countries, and the 5+5 Dialogue—to strengthen the implementational basis of agreements, monitor the progress of regional integration, provide data and analysis to spread awareness of the cost of non-integration, and build a region-wide constituency.

Finally, what types of institutions are necessary to sustain the deeper form of integration? Should we rely on intergovernmental decisions only, or do we need to create supranational bodies? While the responses need to be provided at the sector level, the launching of additional regulatory bodies could also be envisaged, together with industry initiatives such as the creation of power exchanges, gas trading platforms, or multi-country stock exchanges. This could be instrumental in the articulation of a new approach to Mediterranean integration.
A renewed process of integration in the Mediterranean region will imply building further linkages between Mediterranean states and the EU, as well as within the Mediterranean region, to consolidate past achievements and reinforce collaboration among countries. As the integration process continues to progress, it should entail further cooperation in policy making, in order to build alliances along the key dimensions identified in this book. Lowering tariff and non-tariff barriers to trade should apply not only to goods but equally to services, which are key to economic transformation, industry productivity, and insertion into regional and global value chains.

To be effective, integration will also require institutional reforms and significant progress on logistics chains. Moreover, it will naturally lead to specialization in certain products and concentrations in some countries, which will have to be anticipated. This will also entail linking trade policies to the removal of obstacles that increase trade costs, especially transport constraints and inefficiencies along the logistics chain. Instrumental in this respect would be regional collaboration in order to oversee network-based services such as telecommunications, electricity, and railways, as well as harmonized regulations affecting trade and investment.

It is also crucial at this stage to create the necessary conditions to attract foreign direct investment on the basis of a now improved business environment, the region’s strategic location, and regional economies of scale, as opposed to each country engaging individually with firms that are shopping for special fiscal treatment.

To mitigate the uneven effects that trade liberalization may have on the social and regional space, it would be advisable to establish links between trade negotiations and the institutions and agencies in charge of social policies and regional equilibria.

Countries should cooperate to enable foreign companies present in their national territory to scale up from module assembly and construction operations to higher-level design and coordination operations as part of more sophisticated production chains. The key factors here would be raising the skill levels of the local workforce, creating research and development centers that specialize in particular fields, and using local subcontractors at the appropriate level. Participation in GVCs must extend to SMEs. This implies technological upscaling among SMEs, facilitated by government incentives and support from local banks specializing in offering credit to smaller companies. More generally, the development of SMEs will be a key element of the region’s long-term integration strategy because it will allow the effects of integration to be widely disseminated throughout the region. It will also promote the creation of a more complex productive fabric, based on the differentiation of products, the consolidation
of the presence of foreign investments, and the possibility of overcoming the natural limits of SME activity through coproduction with foreign companies.

Programs focusing on SMEs should be rolled out and coordinated to achieve a range of important goals:

• developing and standardizing regulatory concessions, thus reducing the complexity and time required to obtain a license and leave the informal sector
• facilitating lending for investment by reducing collateral requirements and providing public guarantees for certain profitable SMEs
• developing microcredit and improving the business environment more generally by enhancing the effectiveness of public institutions
• simplifying taxes and regulations
• addressing corruption

It would also be helpful to develop coproduction partnerships between European and South–Eastern Mediterranean companies in the region, as well as collaboration schemes among companies in the South, for instance, in the area of renewable energy and hydrogen.

The role of start-up initiatives that use digitalization and new technologies to develop alternative business models should be acknowledged and enhanced. Such start-ups need adequate infrastructure support at the regional level for them to grow and scale up, building on the many advantages the region offers. Again, while individual states should support those companies through their own regulatory frameworks, including in the financial sector, coordinated actions among Mediterranean countries would be needed for these businesses to operate regionally.

To transform the role of the state into a promoter and regulator, and improve its efficiency, certain public services could be decentralized by entrusting them to regional and/or municipal governments and deconcentrating others by broadening the responsibilities of the relevant public institutions present at the local level. The goal would be to allow regional and local interests to be better integrated into national strategies, and elected officials to be held accountable more effectively.

Meanwhile, deconcentration would be particularly necessary in areas, such as professional training, where large public training institutions could achieve more independence from their corresponding Ministry’s subdirectorates. The same may be said for universities and public research institutions. Such deconcentration would facilitate cooperation among institutions in the region, but still under the supervision of the central governments.

Overall, raising the effectiveness of public services would require further delegation of responsibility at subnational levels, based on good practices used by countries participating in the integration process. There is also a need for greater participation from communities (especially business communities) directly affected by regional integration, and for the use of existing institutional networks to design a path to integration that is gradual and regularly evaluated. Finally, to restore the social contract, the type of inclusive dialogue that governments must promote should allow for the genuine involvement of civil society in the decision making process. In particular, universities, academicians, research institutes, NGOs and youth organizations should be brought into the
desired transformation process by allowing them to present their own initiatives and join forces with partners that have similar objectives in the region.

In summary, as governments and regional institutions aim at increasing synergies and at exercising more influence over the formulation and implementation of policy measures, they would benefit enormously from creating generous and inclusive space for civil society groups to participate and contribute their value.

Besides efforts to broaden and improve the mix of participating stakeholders, regional action also needs to focus on two areas in particular that are crucial to regional consolidation: human capital and the environment, in a broad sense that includes climate and natural resources, with a focus on building resilience to climate change. These two strategic areas, both of which carry multi-layered implications, are not only highly symbolic but also capable of making an immense contribution to the future of regional growth. However, this will require extensive collaboration among the participating nations and sustained commitment to a codevelopment approach.

In both cases—human capital and the environment—collaboration-based knowledge will need to be generated, shared, and finally applied with creativity and care, because the quality of knowledge produced, and the carefulness and insight with which it is applied, will ultimately make a substantial difference in economic value added, including the pace of integration into regional and global chains. This, however, will require partnerships among research, education, and training institutions and companies that are embarking on new ventures.

Student mobility too is necessary in addressing human capital formation because it underpins it. Europe, which has created several highly successful cooperation programs, should engage closely in this process. Codevelopment with European countries, and among the Southern–Eastern Mediterranean countries themselves, must be the norm because neither of these two public goods—human capital and the environment—can be addressed through a strictly competitive approach. This is what distinguishes a public good from a commercial commodity, commercial commodities being dispensable and public goods being essential.

Human capital is involved in knowledge production, that is, research, the dissemination of knowledge through education, and employability gained through the acquisition of knowledge and globalized values, which is directly useful to companies in terms of technical and professional training.

Indeed, regional development of human capital will be one of the main factors that determine the success of the integration process, first, because it spurs economic growth through the development of a knowledge economy and innovation. Second, it facilitates human mobility between countries and sectors, while cross-fertilizing ideas and work ethic values. And third, it enables cultural interaction, which ultimately facilitates deeper-level communication.

Regarding the second area of focus, the environment, which includes climate and natural resources as well as water, energy, and food, it must be seen as part of the solution, otherwise, it will be at the heart of future crises.

As indicated in the book, more integrated environmental and climate policy, anchored in the water-energy-food nexus, and implemented across countries, would
facilitate the leveraging of comparative advantages such as the region’s abundant sunshine, plentiful land, and access to the sea. Moreover, how those linkages are addressed is likely to have an effect on the potential success of regional integration.

In the energy sector, regional integration in other parts of the world has been an enabler of decarbonization and has facilitated the energy transition. Adopting a Mediterranean-wide approach to decarbonization would not only provide a cost-effective climate change solution but also give rise to a local industry based on technology transfer, which would be a source of value-added and job creation. For instance, cooperation between the EU and North Africa could result in coproduction in the South of the Mediterranean, using green hydrogen technology from the North. Green hydrogen is a new energy carrier that could deliver carbonless energy to markets all around the Mediterranean, and beyond.

The management of the complete water cycle needs to consider the needs and evolution of the energy and agriculture sectors, which would themselves be affected by Mediterranean integration, thereby impacting trade patterns.

Comprehensive planning and the use of economic instruments to manage the natural resources and environmental sectors are likely to constitute the best approach to avert crises and make the region more resilient to climate change. A coordinated approach across sectors and across countries is needed.

Furthermore, the digitalization trend discussed earlier will have important implications for the sector, especially energy, since it tends to facilitate intrasectoral integration, decarbonization, the development of bilateral contracts, and peer-to-peer trading.

Finally, financial inclusiveness, which remains modest in the South Mediterranean region, needs to be promoted. Regional solutions such as integrated financial markets, improving access to banking and financial literacy for individuals, as well as better access to credit, especially for the private sector including, SMEs, could be instrumental to the development of regional business initiatives.

Regional cooperation should be used to implement measures for upgrading financial intermediation. Led by the central banks, this approach, based on incentives and regulatory developments, would involve collaboration on common actions.

Although they are situated in between some of the most developed and least developed countries in the world, many countries in the Mediterranean region need to increase the maturity of their financial sectors. This should address the lack of a financial culture among a sizeable part of the population, and improve the size and practices of banks.

If more SMCs emulated the action taken by some countries to familiarize the national population with the region’s banks and stock markets, more loans could be issued, and a wider range of financial products could be offered.

In recent years, credit cooperative and microlending initiatives have also become more widespread; these should be encouraged because they help SMEs to develop and contribute to a socially responsible economy. One measure which would help to speed up progress in this area would be to develop Fintech by enhancing the possibilities of online account management.
The Mediterranean Post-COVID-19: Crisis or Opportunity?

The Mediterranean region was hit by the COVID-19 pandemic with even higher intensity than other parts of the world. A double shock—the pandemic and the precipitous drop in oil prices—came at a time when economic performance was already below potential and had not fully recovered from a series of shocks since 2008, creating a number of pre-existing vulnerabilities. Growth rates were already low, and new and unexpected challenges are now testing the resilience of the region. The pandemic and the moves to contain it, together with the 2020 oil price slump, and volatility in other commodity prices, have created severe trade interruptions and losses, exacerbating the economic downturn.

Mediterranean countries have revised growth downward by more than two percentage points, with the region slipping into a deep recession in 2020. The growth contraction comes at a time when the region still faces structural impediments, as highlighted in prior sections of this book, that have affected its regional integration prospects.

Yet for all that, the crisis can also be seen as an opportunity to revamp integration, which could, in turn, help stimulate growth. With the potential risk of protectionism and inward-looking policies, comprehensive trade integration, as discussed earlier, could become the new source of growth and stability that the region needs.

Mediterranean countries have the potential to harness the power of a supranational regional integration agenda to shape and promote key national reforms. According to Bown, regional integration is needed to help developing


economies benefit from a pro-growth global integration agenda by building a much-needed stronger regional neighborhood.

A regional trade agenda focused on removing non-tariff measures (NTMs) and promoting regionally traded goods (RTGs)—notably the finance, telecom, energy/electricity, and digital markets—could facilitate the domestic reforms of structures and arrangements that currently hinder growth paths at the country level. This would lay the foundation for expanding regional trade integration as a stepping-stone to a deeper integration of the Mediterranean countries into the global economy.427

Post-COVID-19, trade responses could focus on a reallocation of production factors toward sectors previously neglected in some countries, such as the digital economy. For example, boosting e-commerce could serve as a trade accelerator and an important means to overcome the physical barriers imposed by COVID-19. In particular, leveraging e-commerce for service sectors hit hard by the crisis could become a source of growth and inclusive deepening of the digital economy in the region. Similarly, reforms and enhancements to building infrastructure and e-commerce strategies could seize the benefits of online commerce.

Revitalizing trade integration measures should be accompanied by policies aimed at boosting the provision of regional public goods to prevent further disparities. In this context, human capital solutions in the areas of public education and health could act as economic and social buffers, while also promoting trade of services.

In particular, telemedicine and online tertiary education could be further developed to better respond to the needs of the population regionally, while also resulting in job creation.

Additional investments in digitalization represent a strategic choice. Widespread access to digital technology would open up more inclusive and sustainable growth opportunities, helping the most disadvantaged regions and integrating a larger share of the population into economic life.

Concerning the health sector, with a health system saddled with weak infrastructure and a lack of adequately trained staff, especially in the rural areas, digital technology could enable (i) remote consultations and prescriptions for simple diagnoses, preventative counseling, and detection of serious diseases; (ii) the dissemination of basic care and practices to be followed; and (iii) the expansion and improvement of medical care despite economic and geographical

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barriers, by connecting even far-flung health centers with major hospitals and connecting hospitals to one another.

Similarly, in the education sector, e-learning could promote the much-needed mobility of knowledge among the youth in the region, allowing students to complete international diplomas without necessarily having to travel. It could also open up additional possibilities for more advanced studies abroad and job connections when the crisis has ended. Reforms in education and vocational training, as explained in detail in the book, will be needed to develop new skills for young people, both digital and interpersonal.

Environmental responses (energy, water, and food security) could be given priority during the recovery and stimulus phases, while carbon-intensive activities should be postponed or completely abandoned. Despite its catastrophic effects on economies and populations, the COVID-19 pandemic has led to some beneficial environmental results, such as reduced air pollution in cities, cleaner water in the sea and rivers, and, especially, reduced greenhouse gas emissions. CO₂ emissions are expected to drop by 8 percent in 2020, or nearly 3 gigatonnes, a reduction never before observed in history.

This reduction, admittedly, is due mostly to a steep decline in energy consumption. But a second factor is the rising share of renewable energy, as fossil fuels have been hit particularly hard by the COVID-19 crisis. The emission reduction, however, was essentially due to the economic recession, and only marginally because of behavioral or structural changes in energy consumption.

A rebound in emissions will be difficult to avoid when the economies recover unless such a rebound is contained through ambitious and well-targeted green stimulus packages. This is the time to articulate such packages.

One of those ambitious packages is the recently announced 2020 EU “Repair and Prepare” recovery package. It allocates 25 percent of the stimulus budget to climate-friendly measures to prepare for the carbon neutrality target for 2050 and emphasizes that cooperation with neighbors will be key to success. As we saw in the earlier energy section, above, this package is a source of opportunities for the Mediterranean because it gives priority to renewable energy and to a new energy carrier, hydrogen, which will be supplied by Southern and Eastern Mediterranean countries.

In addition, regional energy market integration will facilitate renewable energy scale-up. The type of low-carbon investments promoted by the EU recovery package will also have positive effects beyond the energy and environment sectors by creating jobs, increasing industry competitiveness, and building a healthy economy more resilient to global shocks such as pandemics and climate change.

The current crisis offers a great opportunity to further harmonize the strategies of the Southern and Eastern Mediterranean countries in key sectors such as health, education, digitalization, and energy transition plans. These sectors have links, effects, and ramifications that transcend national frontiers, again a testimony of the relevance and critical importance of Mediterranean integration. All these issues deserve further study.

The CMI is committed to pursuing and implementing this agenda, thanks to the support of its members—Egypt, France, Greece, Italy, Jordan, Lebanon, Morocco, the Palestinian Authority, Spain, Tunisia, Provence-Alpes-Côte d’Azur Region, City of Marseille, the European Investment Bank (EIB), the World Bank Group (WBG), and the European External Action Service—and numerous technical partners. Further work is envisaged in areas related to public goods in the Mediterranean region, including health and food security, particularly in response to the COVID-19 pandemic.

In addition, with youth and gender at the heart of its strategy, the CMI will continue to rely on its network of young practitioners, researchers and experts to influence policymaking and contribute to transforming the region and making it more resilient to shocks.

Finally, in the context of the Dialogue of the Two Shores, the CMI’s goal, as part of its mandate, is to accompany its analytical work and knowledge-sharing agenda with direct support for project incubation and implementation, and to facilitate the dialogue between regional project promoters and financial institutions and investors.

This is done through the recently launched digital platform for the “Dialogue of the Two Shores” hosted at the CMI. The platform can be accessed via the electronic address: www.dialoguedeuxrives.fr
ANNEX 1
KEY DATA ON EDUCATION AND EMPLOYMENT

1.1. EDUCATION

FIGURE 1.1.1 SCHOOL ENROLLMENT RATES IN TERTIARY EDUCATION ACROSS GENDERS (%), 2012

Source: World Bank data, 2017

1.2. EMPLOYMENT

FIGURE 1.2.1 EMPLOYMENT GENDER GAPS

Source: WDI, ILO estimates
FIGURE 1.2.2 GENDER GAPS IN UNEMPLOYMENT

Unemployment rate, 2017

Gender gap (female unemp/ male unemp)

Source: WDI, ILO estimates

FIGURE 1.2.3 BREAKDOWN OF GENDER GAP IN EMPLOYMENT

Calculated from unemployment, employment and labor force participation rate for males and females aged 15 years or older

- Employment gap exclusively using different unemployment rates (that is, if the labor participation rate of women were equal to that of men)
- Employment gap exclusively using different labor force participation rates (that is, if the unemployment rate of women were equal to that of men)

Source: WDI, ILO estimates
**FIGURE 1.2.4 UNEMPLOYMENT BY LEVEL OF EDUCATION**

![Bar chart showing unemployment by level of education for various countries](chart1.png)

Source: WDI

**FIGURE 1.2.5. AVERAGE YOUTH UNEMPLOYMENT 2011-2017 (% OF TOTAL LABOR FORCE AGES 15-24)**

![Bar chart showing average youth unemployment for various countries](chart2.png)

Source: WDI, ILO estimates
ANNEX 2
FDI IN THE MENA REGION

The Organisation for Economic Cooperation and Development (OECD) provides a detailed definition of foreign direct investment (FDI): Direct investment is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor.

The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The “lasting interest” is evidenced when the direct investor owns at least 10 percent of the voting power of the direct investment enterprise.429

Direct investment financial transactions (flows) and positions comprise mainly three types of financing: i) acquisition or disposal of equity capital; ii) reinvestment of earnings that are not distributed as dividends; and iii) intercompany debt (payables and receivables, loans, and debt securities). FDI flows consist of various types of investments, including greenfield investments, mergers and acquisitions, and intracorporate loans. Data presented here on FDI inflows for each country are drawn from the International Monetary Fund (IMF) and OECD balance of payments data.

**Greenfield FDI:** Greenfield investments are a category of FDI in which direct investors typically establish new enterprises in the host country. Greenfield investment, therefore, involves the provision of fresh capital, as opposed to reflecting a transfer in ownership of existing assets (mergers and acquisitions). Data on greenfield investment transactions used in this book originates from “FDI markets”, which obtains its data from corporate announcements and news reports.

Figures on greenfield investment do not necessarily reflect equity investments alone and may also contain debt financing. Because of the different sources and

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methodology used for overall FDI and greenfield FDI, the figures for the two categories are not one-on-one comparable.

**FDI in infrastructure:** Figures on cross-border investment in infrastructure were obtained from the World Bank Private Participation in Infrastructure (PPI) database which provides data at a project level. For each project, the Participation in Infrastructure (PPI) database provides information on the total investment amount, the sector, and the home countries of the equity investors.

FDI inflows received by countries in the MENA region in 2017 accounted for just 1.7 percent of their GDP, compared to 3.5 percent for EU countries—more than twice. More troublingly, the attractiveness of the MENA region, already only modest, has actually decreased in the last decade in comparison with other regions in the world.

Since the 2008 financial crisis, followed by the Arab Spring and armed conflicts in Syria, Libya, and Yemen, FDI in the MENA region fell to 25 billion dollars in 2015, a 68 percent drop from its 2008 peak (figure 2.1). While the situation differs by country, with Egypt attracting 49 percent more FDI in 2015 than in 2014, FDI inflows reached historical lows across the region in 2015.

By comparison, in 2005 FDI inflows to the MENA region, as a proportion of GDP, exceeded average FDI flows to other emerging and developed countries. In the last 10 years, this ratio has now fallen below the level of both of these groups of countries (figure 2.1).

**FIGURE 2.1 FDI INFLOWS IN SOUTH MEDITERRANEAN COUNTRIES (% GDP)**

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Source: UNCTAD
The decrease is not surprising because the main countries of origin, including European countries and the US, were deeply affected by the 2008 financial crisis. Moreover, political risk and insecurity are typically the top factors multinational companies consider when investing in developing countries (political stability and security are critical for 50 percent of investors, just ahead of the legal and regulatory environment). During the 2005–2015 period, the MENA region suffered two-thirds of the terrorist attacks occurring around the world, while political instability remained a major concern.

A more detailed analysis of five countries in the South-Eastern Mediterranean region (Algeria, Morocco, Tunisia, Egypt, and Libya) in the 1990–2017 period (see figures 9 and 10) reveals, however, a strong average growth in net FDI inflows since 2004. This suggests a change in the model of internationalization and the introduction of outsourcing as part of value chains to deliver final products in these particular five countries. This is reflected in a considerably larger foreign capital stock, which reached significant levels by the end of 2017 (Algeria US$29 billion, Egypt $110 billion, Libya $18 billion, Morocco $63 billion, Tunisia $29 billion).

FIGURE 2.2 FDI INFLOWS IN THE MENA REGION COMPARED TO OTHER REGIONS

The decrease is not surprising because the main countries of origin, including European countries and the US, were deeply affected by the 2008 financial crisis.

Moreover, political risk and insecurity are typically the top factors multinational companies consider when investing in developing countries (political stability and security are critical for 50 percent of investors, just ahead of the legal and regulatory environment). During the 2005–2015 period, the MENA region suffered two-thirds of the terrorist attacks occurring around the world, while political instability remained a major concern.

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The predominant type of investment in this region of the world is the so-called “greenfield” investment, which accounts for more than 80 percent of FDI. Greenfield investment leads to the creation of new companies and represents a significant inflow of capital. It is, therefore, highly sensitive to the degree of risk in the destination country. Foreign investors are tempted to drastically reduce their investment when political instability intensifies, or at least to downsize their projects and focus their investment in limited geographical areas. Given the heightened perception of risk, typically only the most highly profitable projects would be selected.
Investment in physical infrastructure is also severely affected, although it continues to represent a relatively low proportion of investment in the region because it requires a guarantee of long-term relations with the destination country and a long-lasting collaboration with the ruling government.

In 2017, the countries in the MENA region with the highest levels of FDI were Jordan (5.1 percent of GDP) and Lebanon (4.8 percent of GDP). The source countries for FDI are European countries, with France and the UK leading investment in the region, followed by the US and the United Arab Emirates. Cultural and historic relationships and ties thus remain crucial despite the recent emergence of new stakeholders.

FDI in oil-producing countries in the MENA region (which produces more than 32 percent of the world’s oil) comes from distant countries such as China, India, and Japan, which are interested in the extractive industries. The value they put on the resources they seek represents an incentive that compensates for geographical distance, while FDI channeled to non-oil-producing countries in the region is primarily used to reduce the costs linked to trade. Investment in natural resources appears to be less affected by heightened political risk or the emergence of conflict because these risks are often inherent to the countries concerned. However, FDI that targets oil-producing countries does not yet represent a significant proportion of overall FDI inflows to the MENA region.

FDI is becoming an essential source of funding for MENA countries because of its impact on employment, economic growth, and technology transfer, as well as related developments that accompany investments (for example, investment areas in Tangier, Morocco, and Berges du Lac, Tunisia). Indeed, from 2014 to 2016, after remittances and official development assistance, FDI represented the third-largest source of external funding in MENA countries.

It has dramatically modified the urban landscape and now appears indispensable because of the endemic lack of national funding from the underdeveloped banking and financial sectors. There is, however, a concern that fiscal and regulatory exemptions that are linked to offshoring (in Tunisia especially) lead to the dualization of the productive system.

When FDI has spillover effects into the local productive system and leads to higher-level operations, it will become an essential vector for the development of MENA economies, not only from a financial perspective but also from that of improving competitiveness by facilitating technology transfer, mobilizing local companies, and upscaling assembly operations. This will be the challenge to beat in the coming years.

The training of human capital, the inclusion of foreign trade, and the implementation of favorable conditions for companies to develop often go hand in hand with inflows of foreign capital. These beneficial effects derive from contractual relationships between local and foreign companies and from a drive
among local companies to emulate foreign firms (Alfaro, 2006).\(^{431}\) The arrival of a major international contractor is often sufficient to create a whole new sector that did not previously exist in the destination country.

The manufacturing sector appears to experience the largest job creation and economic growth spillover effect resulting from incoming FDI (Alfaro, 2003).\(^{432}\) Besides its expected impact on economic growth, FDI can also play a role in addressing environmental issues because it often brings in the knowledge that is linked to sustainable development technologies and social issues by creating the conditions for more inclusive growth, for example, by encouraging female employment.

The MENA region has one of the world’s lowest rates of company creation in the formal sector: fewer than one company for every 1,000 people of working age is created yearly, compared to about five in OECD countries. This suggests that a significant proportion of SMEs work in the informal sector in these countries, leading to a negative impact on growth. The sharp and persistent dichotomy between the onshore and offshore sectors hinders the development process. Indeed, the large companies in the offshore sector in MENA countries absorb a significant proportion of subsidies and fiscal concessions, whereas SMEs, which represent 95 percent of private companies and are significant creators of employment, are excluded from such assistance.

A new model of coproduction between companies from the developed countries and MENA SMEs should allow small and medium size companies to join the formal sector, benefit from cooperation with foreign companies, and their knowledge.

However, FDI is not perfectly benign: problems such as the deterioration of the balance of payments in destination countries because of profit repatriation, increased competition on national markets, the tendency toward growing over-depency of destination economies on foreign companies, and environmental damage caused as a side effect of the extraction of natural resources have negative impacts that need to be addressed for FDI to be fully beneficial to destination countries. For their part, destination country structures must be sufficiently developed to allow technology transfer.

Studies (World Bank, Enterprise Survey) show that local high-growth companies with the highest levels of job creation, although they represent only a small proportion of the total number of companies, are better able to integrate the positive externalities of FDI. They are particularly capable of integrating foreign technology.


On the other hand, medium-sized companies in developing countries have a low capacity for absorbing the positive effects of FDI and instead are severely penalized by the introduction of greater competition from foreign firms on the national market.

By improving the capacity of local companies to absorb the positive effects of FDI, MENA countries will obtain greater benefits from FDI. These benefits will catalyze new contractual relationships between foreign and local companies. Foreign companies struggle to identify counterparts with which to collaborate. Coproduction is thus an effective way of extending FDI’s benefits to MENA countries. A forthcoming study of the Mediterranean World Economic Foresight Institute (IPEMED) that aims to identify “gazelles” for coproduction in Tunisia is indicative of progress in this area.

Destination country governments must do more to address issues of asymmetrical information and to implement policies capable of capturing more of the positive effects of FDI, such as a more flexible labor market to allow reallocation of the factors of production, the creation of clusters, or an incentive system to encourage foreign companies to invest their profits in the country.

OECD’s FDI Restrictiveness Index measures the restrictiveness of a country’s rules, taking into consideration the foreign ownership threshold, screening and authorization mechanisms, and restrictions on the employment of foreigners. The lower the number, the better. In 2017, the Index was calculated for three countries in the MENA region: Israel (0.12), Tunisia (0.17), and Jordan (0.23), displaying far higher levels of restrictiveness than the average score of OECD countries (0.07), and demonstrating that there are still significant obstacles to FDI in the region.

Finally, a country with a skilled labor force and adequate technology and infrastructure may be sufficiently attractive to FDI without the need to make over-the-top concessions such as granting exorbitant tax incentives. However, even after the challenge of attracting FDI has been solved, the spillover benefits of FDI to the destination country are far from automatic. They cannot be taken for granted. A lot still depends on the level of development of the destination country and its political, economic, and social structures.
ANNEX 3
TRADE IN MEDITERRANEAN COUNTRIES

FIGURE 3.1 TRADE OPENNESS IN THE MEDITERRANEAN REGION

Data: Imports + exports as a percentage of GDP, World Bank, 2017
Source: Mediterranean Growth Initiative
FIGURE 3.2 TRADE BALANCE IN THE MEDITERRANEAN REGION

Data: External balance on goods and services (exports minus imports as percentage of GDP), World Bank, 2017
Source: Mediterranean Growth Initiative

FIGURE 3.3 INTRA-MEDITERRANEAN TRADE

In 2017, only one quarter of all trading by Mediterranean nations was with other Mediterranean countries.

Source: Mediterranean Growth Initiative
FIGURE 3.4 INTRA-MEDITERRANEAN TRADE PER CAPITA, 2017

Trade in goods and services with other Mediterranean countries per person

Bosnia and Herzegovina
$3,682

Italy
$7,511

Turkey
$1,850

Libya
$10,640

Montenegro
$3,565

Croatia
$7,430

Morocco
$1,730

Tunisia
$3,178

France
$7,109

Algeria
$1,590

Albania
$3,058

Greece
$5,090

Syria
$859

Palestine
$2,052

Egypt
$416

Israel
$3,895

Spain
$8,026

Lebanon
$2,003

Malta
$16,438

Slovenia
$17,633

Cyprus
$8,438

Data: UN Comtrade
Source: Mediterranean Growth Initiative
FIGURE 3.5 TOP EXPORTS BY VALUE

<table>
<thead>
<tr>
<th>Country</th>
<th>Export Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Footwear</td>
</tr>
<tr>
<td>Algeria</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>Electrical energy</td>
</tr>
<tr>
<td>Croatia</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Cyprus</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Egypt</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>France</td>
<td>Airplanes and other aircraft</td>
</tr>
<tr>
<td>Greece</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Israel</td>
<td>Precious metals, stones and pearls</td>
</tr>
<tr>
<td>Italy</td>
<td>Medicaments packaged for retail sale</td>
</tr>
<tr>
<td>Lebanon</td>
<td>Sauces and seasoning</td>
</tr>
<tr>
<td>Libya</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Malta</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Aluminum</td>
</tr>
<tr>
<td>Morocco</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Palestine</td>
<td>Building stone</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Medicaments packaged for retail sale</td>
</tr>
<tr>
<td>Spain</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Syria</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Turkey</td>
<td>Metals and gold</td>
</tr>
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</table>

FIGURE 3.6 TOP IMPORTS BY VALUE

<table>
<thead>
<tr>
<th>Country</th>
<th>Import Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Albania</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Algeria</td>
<td>Wheat and cereals</td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Croatia</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Cyprus</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Egypt</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>France</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Greece</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Israel</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Italy</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Lebanon</td>
<td>Vegetables</td>
</tr>
<tr>
<td>Libya</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Malta</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Morocco</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Palestine</td>
<td>Electrical energy</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Spain</td>
<td>Crude oil and petroleum minerals</td>
</tr>
<tr>
<td>Syria</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Refined petroleum oils</td>
</tr>
<tr>
<td>Turkey</td>
<td>Gold and metals</td>
</tr>
</tbody>
</table>

Data: UN ComTrade (2018: Croatia, Egypt, Greece, Israel, Montenegro, and Slovenia; 2017: Albania, Algeria, Bosnia and Herzegovina, Cyprus, France, Italy, Lebanon, Morocco, Spain, Tunisia, and Turkey; 2016: Malta and Palestine; 2010: Libya and Syria)

Source: Mediterranean Growth Initiative
**FIGURE 3.7 TOP TRADING PARTNERS OF MEDITERRANEAN COUNTRIES**

<table>
<thead>
<tr>
<th>GERMANY is a top exporter to</th>
<th>CHINA is a top exporter to</th>
<th>ITALY is a top exporter to</th>
<th>TURKEY is a top exporter to</th>
</tr>
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<tbody>
<tr>
<td>France</td>
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<td>Tunisia</td>
<td>Libya</td>
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<td>Italy</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spain</td>
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<td>Greece</td>
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<td>Slovenia</td>
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</tr>
<tr>
<td>Croatia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bosnia and Herzegovina</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SYRIA is a top exporter to**

- Lebanon

**SPAIN is a top exporter to**

- Morocco

**SERBIA is a top exporter to**

- Montenegro

**ISRAEL is a top exporter to**

- Palestine

**GREECE is a top exporter to**

- Cyprus

*Source: Mediterranean Growth Initiative*

---

**FIGURE 3.8 TOP TRADING PARTNERS OF MEDITERRANEAN COUNTRIES**

<table>
<thead>
<tr>
<th>ITALY is a top importer from</th>
<th>GERMANY is a top importer from</th>
<th>FRANCE is a top importer from</th>
<th>USA is a top importer from</th>
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</thead>
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<tr>
<td>Albania</td>
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<td>Spain</td>
<td>Israel</td>
</tr>
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<td>Algeria</td>
<td></td>
<td>Italy</td>
<td>Malta</td>
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<tr>
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<td></td>
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</tr>
<tr>
<td>Greece</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Libya</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**SPAIN is a top importer from**

- Morocco

**LIBYA is a top importer from**

- Cyprus

**ISRAEL is a top importer from**

- Palestine

**CONGO is a top importer from**

- LEBANON

*Source: Mediterranean Growth Initiative*
### FIGURE 3.9 DESTINATION OF EXPORTS AND ORIGIN OF IMPORTS

WORLD DEVELOPMENT INDICATORS (WDI) FOR GDP CURRENT DOLLARS

<table>
<thead>
<tr>
<th></th>
<th>TO EU 1995</th>
<th>TO GCC 1995</th>
<th>TO MPC 1995</th>
<th>TO SSA 1995</th>
<th>TO WORLD 1995</th>
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<td></td>
<td></td>
<td>19882</td>
<td></td>
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<td>791</td>
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<td>12893</td>
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<tr>
<td><strong>TOTAL MPC</strong></td>
<td><strong>44157</strong></td>
<td><strong>136762</strong></td>
<td><strong>1865</strong></td>
<td><strong>17492</strong></td>
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<td><strong>304651</strong></td>
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*Source: IMF DOTS trade data*
### Exports (% of Total Trade)

<table>
<thead>
<tr>
<th>Region</th>
<th>1995 TO EU</th>
<th>2016 TO EU</th>
<th>1995 TO GCC</th>
<th>2016 TO GCC</th>
<th>1995 TO MPC</th>
<th>2016 TO MPC</th>
<th>1995 TO SSA</th>
<th>2016 TO SSA</th>
<th>1995 TO WORLD (as share of GDP)</th>
<th>2016 TO WORLD (as share of GDP)</th>
</tr>
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<td>Levant</td>
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<td>1.1</td>
<td>2.2</td>
<td>13.8</td>
<td>14.4 (a)</td>
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<td>5.3</td>
<td>22.9</td>
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</tr>
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<td>8.1</td>
<td>4.5</td>
<td>20.8</td>
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<td>6.9</td>
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<td>Palestine</td>
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<td>6.9</td>
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<td>0.5</td>
<td>0.1</td>
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<td>0.5</td>
<td>2.4</td>
<td>23.0</td>
<td>21.3 (a)</td>
</tr>
<tr>
<td>Algeria</td>
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<td>0.1</td>
<td>5.6</td>
<td>9.5</td>
<td>0.2</td>
<td>0.2</td>
<td>22.4</td>
<td>18.4</td>
</tr>
<tr>
<td>Libya</td>
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<td>14.0</td>
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<td>0.1</td>
<td>33.3</td>
<td>NA</td>
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<tr>
<td>Morocco</td>
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<td>64.9</td>
<td>1.4</td>
<td>1.0</td>
<td>7.2</td>
<td>6.9</td>
<td>1.8</td>
<td>5.8</td>
<td>12.7</td>
<td>22.0</td>
</tr>
<tr>
<td>Tunisia</td>
<td>80.4</td>
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<td>11.8</td>
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<td>2.3</td>
<td>32.1</td>
<td>30.7</td>
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<tr>
<td><strong>Total MPC</strong></td>
<td>56.0</td>
<td>44.9</td>
<td>2.4</td>
<td>5.7</td>
<td>7.1</td>
<td>8.7</td>
<td>0.9</td>
<td>2.3</td>
<td>16.3</td>
<td>15.5 (a)</td>
</tr>
</tbody>
</table>

**Sources:** IMF DOTS for trade data. WDI for GDP current dollars

**Reader:** In 2016, 38.9 percent of Levant exports, 64.8 percent of Maghreb exports, and 44.9 percent of all MPC exports were directed to the EU.

**Note:** Libya and Syria excluded because no data on GDP were available for 2016.
FIGURE 3.10 SHARES OF EXPORTS WITHIN GROUPS OF THE MEDITERRANEAN PARTNERS

- Intra-MPC exports
- Intra-Levant exports
- Intra-Maghreb exports

% of each subgroup total exports

Source: UNCTAD

FIGURE 3.11 TOTAL TRADE AND NON-OIL PRODUCTS FOR THE 10 MEDITERRANEAN PARTNERS

- Total IO Med Partners Trade Balance with EU
- Non Oil IO Med Partners Trade Balance with EU
- Non Oil IO Med Partners Trade Balance with World
- Total IO Med Partners Trade Balance with World

Source: ComTrade. P. Augier et al, op. cit.
ANNEX 4
THE EU’S APPROACH WITH ITS NEIGHBORS: THE CASES OF CENTRAL EASTERN EUROPE, SOUTH-EASTERN EUROPE, AND THE CURRENT EASTERN PARTNERSHIP

With the dissolution of the USSR and the Eastern bloc in 1991, trade relations with Western Europe grew rapidly, leading to the signing of bilateral Associations Agreements and establishing the Central European Free Trade Area (CEFTA)\(^\text{433}\) in 1992. Incidentally, this expansion of trade relations between Western Europe and Central and Eastern Europe (CEE) is one of the factors “[leading] Mediterranean nations most dependent upon the EU’s market to seek bilateral FTAs”\(^\text{434}\) and to pursue the vision of the 1995 Barcelona Process.

However, the EU’s integration strategies toward its Eastern neighbors is very different from its approach to Southern Mediterranean countries. While trade and economic links have steadily strengthened between the EU and CEE to the point of full community membership in 2004 (see graph below), this is much less the case with its South Mediterranean partners, with the possible exception of Turkey, whose adhesion to the EU has been under consideration (although recent developments have brought this process to a pause).

As for the “Eastern Partnership” (EAP) component of the European Neighborhood Policy (launched in 2009 and composed of the EU together with Armenia, Azerbaijan, Belarus, Georgia, Moldova, and Ukraine), full EU adhesion is not yet on the agenda, but it will be interesting to follow the path of this partnership as it evolves and compare it to that of the partnership with the UfM.

\(^{433}\) CEFTA originally included Poland, Hungary, Czech Republic and Slovakia, and then extended gradually to other eastern countries. The CEFTA membership ends when a country become member state of the EU. Thus, this agreement now includes mainly Balkan states not yet part of the EU.

\(^{434}\) See Baldwin and Low, Multilateralising Regionalism. This is the “domino effect” argued by Baldwin and Low, or the integration response described by Mattli in The Logic of Regional Integration.
Returning to the process of the adhesion of the Central and Eastern European (CEE) countries to the EU in 2004: Integration with the EU, interestingly, has strengthened rather than diverted trade integration among CEE countries. Indeed, intraregional exports increased from 15 percent to 20 percent between 2004 and 2016, while the EU’s trade with partner countries also expanded (see figure 4.2).

Initially, intraregional trade—that is, trade within Central and Eastern Europe (CEE)—was underdeveloped, and CEE countries sought primarily to foster ties with the West. However, after integration into the EU in 2004, intra-CEE trade expanded dramatically—two and a half times higher in 2007 than in 2003, for example.

This cannot be explained by lower tariffs since free trade was established prior to 2004, but studies have shed some light on the possible reasons:

- The elimination of non-tariff measures which act as trade barriers with the accession to the EU (for example, less border waiting time and fewer customs procedures, lower technical barriers, lower legal and information costs, and lower political risks)\textsuperscript{435}

Sándor Richter writes: "Most of the exports of the Central European Transition (CET) countries\textsuperscript{436} are generated by subsidiaries of multinational corporations from the EU-15 and other developed countries. These subsidiaries are linked by intracompany trade, sourcing and selling, in the CETC region."

Thus, “the CETC region has been upgraded both as a target for sales and as a host of potential cooperation partners for production.”

Germany was a key actor in the integration of these countries, by outsourcing part of the value chain of its industry which then benefited its own domestic producers with cheaper intermediate goods.

In a nutshell, in “Regional Trade Integration in the Middle East and North Africa,” Richter argues that “the successful revival of intraregional trade in Central Europe was conditional upon these countries’ close integration with the EU.”

Regarding the policy implications for MENA, he and others point out that full EU membership is not available to them as it was for Western and Central Eastern European (CEE) countries—and now for South Eastern European countries. But provisions to facilitate deep integration with the EU could work in a similar way as it did for CEE countries by attracting FDI and changing the “networking strategy of the multinational companies located in the region.”

Additionally, in “Regional Trade Integration,” Richter recognizes that while the economic preconditions of a stepped-up intra-MENA trade are quite clear, the political, social, and cultural implications are less so. Increased competition would have winners and losers as well, with different balance by countries, regions, social strata, industrial and service sectors, enterprise size, and so on.

Hoekman (2016) adds that “experience with Deep and Comprehensive Free Trade Agreements (DCFTA) with countries of the Eastern Partnership (EAP) suggests that to be effective in generating improved trade conditions for firms, there is a need to tailor them to the specific institutional circumstances."


438. See for example, Van der Loo, “Enhancing the Prospects.”


441. Hoekman, Potential Catalyst for Growth. See also Van der Loo, “Enhancing the Prospects.”

442. The EAP countries—Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine—are part of the European Neighborhood Policy. Three of them—Georgia, Moldova and Ukraine—currently have a DCFTA with EU. See, for example, a description of EU-Ukraine DCFTA.
of a partner country and for flexibility in both the substance and sequencing of implementation of reforms.  

In addition to this, the Eastern European countries have benefited from public transfers from the EU institutions, allowing them to mitigate the effects of adjustments and reallocations of factors linked to trade liberalization. Moreover, human mobility around Europe has led to wage convergence despite issues raised by the status of posted workers, and the technical standards of the internal market have improved the quality of products substantially. These factors, along with significantly higher rates of GDP growth than the rest of Europe (especially in Poland), are playing a central role in consolidating the EU today.

443. This also is the recommendation of Adarov and Havlík:
In the light of these circumstances, the wiwi study proposes a range of policy recommendations for the beneficiary countries as well as for a revised EU Neighbourhood Policy, emphasising the need for a gradual transformation with strategic sequencing of reforms to alleviate social costs of transformation, with priorities given to the access to the EU market, improvements of the business environment, promotion of FDI and integration in GVCs, efforts to increase the awareness of the specific DCFTA regulations in the private sector, as well as continued targeted financial and technical support from the EU institutions and other donors with strict conditionality of aid and continuous monitoring of progress at national and regional levels. (Adarov and Havlík, “Benefits and Costs of DCFTA”)
5.1 A PRIVATE-SECTOR DRIVE LEADING TO INTEGRATION THROUGH TRADE BASED ON UNILATERAL CUSTOMS DISARMAMENT

East Asia is known for its well-developed supply chains and extensive intraindustry trade targeted at specific sectors and industries within the region, collectively known as “Factory Asia.” Yet the East Asian “model,” if it can be called that, is unique because this interdependence has emerged without any real regionalism (that is, preferential trade liberalization). The Association of Southeast Asian Nations’ Free Trade Agreements (ASEAN FTA) (AFTA), concluded in 1992, is rarely used by firms because countries in the region have unilaterally chosen to lower their tariffs even below most-favored-nation (MFN) rates. It is geographical proximity, factor price differences, and the network of regional multinationals that have enabled unilateral measures to lead to a regional supply chain trade.

The experience of ASEAN also highlights the role of Japan as a regional leader to drive integration. Again, this is one of the supply conditions that Walter Mattli gives in his book The Logic of Regional Integration: Europe and Beyond. It is a role that the EU could play not just by providing technical assistance but by engaging its firms in investing in SMCs and creating production networks there rather than considering it primarily as an export destination.

Indeed, in East Asia the impetus for regional trade has come from the private sector without much in the way of institutional arrangements, leading to de facto rather than de jure regionalization. For example, because of rapid wage growth in Japan, it started offshoring labor-intensive stages of production to nearby East Asian countries—aka the “hollowing out” of the Japanese economy. This process subsequently extended to Korea, Taiwan, Singapore, and Hong Kong.

In his book, Mattli lists a number of these private institutional arrangements that are driving integration, in particular:

- Supplier networks: linkages between final producers and providers of intermediary inputs among different affiliates of a parent company, or between affiliates of firms that have long-standing relationships
• Supplier cooperation clubs organized by Japanese assemblers, but which include non-Japanese suppliers as well, and which aim to “promote trust and linkages among club members and increase the flow of information to enhance organizational and productive efficiencies”
• Japanese general trading companies called “sogo sosha,” which are “large scale diversified intermediaries between buyers and sellers”
• The Chinese diaspora, family-owned firms, who represent a large share of the private sector in some ASEAN countries, and who foster FDI and trade within the region through the ethnic networks and common norms that they share, which help reduce risk and information costs

The unbundling of production even accelerated after China joined the world economy and was admitted into the WTO. ASEAN countries have conducted a “race to the bottom” by reducing their tariffs to attract these offshoring investments.

**FIGURE 5.1.1 PLACEMENT OF JAPANESE PLANTS IN EAST ASIA**

![Graph showing the placement of Japanese plants in East Asia]

**Note:** The figure shows the sum of plants in the auto and electrical machinery industries.
**Source:** Fujita and Hamaguchi (2006), (original based on data from Kaigai Shinshutsu Kigyo Soran various years).

In part triggered by the China-ASEAN FTA (ACFTA)—signed in 2002 and taking full effect in 2010—the region has experienced a domino effect: Japan and Korea started negotiations on the bilateral level and on a broad FTA level with members of ASEAN and many other agreements. In particular, the ASEAN-India Free Trade Area, the Comprehensive Economic Partnership for East Asia, the ASEAN-Australia-New Zealand Free Trade Area, and, since 2012, negotiations for the Regional Comprehensive Economic Partnership that has regrouped ASEAN countries and the six states with which ASEAN has existing Free Trade Agreements (FTAs), have been signed, leading to a “noodle bowl” of trade agreements.
Baldwin (2008) raises some concerns about this model of regional integration, and for three reasons:

1. Each nation’s industrial competitiveness depends on the smooth functioning of “Factory Asia.”
2. Unilateral tariff-cutting is not subject to WTO discipline (“binding overhang”).
3. There is no “top-level management” to substitute for WTO discipline, that is, to ensure that bilateral trade tensions—tensions that are inevitable in East Asia—do not spill over into region-wide problems because of a lack of cooperation and communication.444

This changed with the 2008 ASEAN Charter, which serves as a firm foundation in achieving the ASEAN Community by providing legal status and an institutional framework for ASEAN. It also codifies ASEAN norms, rules, and values; sets clear targets for ASEAN; and presents accountability and compliance.445

### 5.2 PROGRESS ON FOUNDING COMMON INSTITUTIONS

As we saw earlier, lowering tariffs is necessary but not a sufficient condition for a deep integration that would allow participation in complex GVCs. Part of the answer is that the ASEAN FTA (or AFTA) and the unilateral tariff cuts do not fully represent the effort that would be required to attain the integration in the region.

ASEAN was created in 1967 and has seen several initiatives besides AFTA to deepen ties between member countries. For example:446

- The ASEAN Framework Agreement on Services (AFAS), signed in 1995 to liberalize services offered by service suppliers from other ASEAN member states. It initiated negotiations on key sectors, enabling deep integration in


areas such as air transport, business services, construction, financial services, maritime transport, telecommunication and tourism services. The mandate has since expanded to cover all service sectors.

- **The ASEAN Investment Area (AIA) Council.** Established in 1988, it oversees ASEAN investment policy which, since 2009, has become the ASEAN Comprehensive Investment Agreement (AIA).
- **Negotiations on a Mutual Recognition Arrangement (MRA)** which, since 2001, has been helping the Mode 4 consisting of temporary movement of service providers. It includes service sectors such as physicians, dental practitioners, nurses, architects, tourism operators, hoteliers, engineers, and other professions.
- **The 2003 Roadmap** for Monetary and Financial Integration in ASEAN (RIA-FIN). It is an important milestone of financial integration, although other initiatives have since then sprung up, such as the ASEAN Banking Integration Framework (ABIF) in 2014, “[allowing] banks meeting certain criteria to have greater access to other ASEAN markets and more flexibility in operating there,” and the ASEAN Insurance Integration Framework (AIIF).

At an ASEAN meeting in Kuala Lumpur in 1997, the representatives adopted ASEAN Vision 2020. This ultimately led to the ASEAN Community 2015 (AC15), a transformative agenda that is built on three pillars of cooperation.

These pillars of cooperation are now part of a new blueprint vision for 2025, with specific targets and timelines:

1. **The ASEAN Economic Community (AEC):** The outlined vision covers extensive topics such as trade of goods, service, capital, mobility of people, competition policy, taxation cooperation, consumer protection; sectoral cooperation on transport, ICT, energy, e-commerce, food, tourism, healthcare, and science. It also covers establishing an ASEAN network of public-private partnership (PPP) agencies and stakeholders—legal firms, companies, financial institutions—in ASEAN member states to share experiences and collaborate on joint projects.

2. **The ASEAN Political-Security Community (APSC):** The APSC blueprint states: The members of the Community pledge to rely exclusively on peaceful processes in the settlement of intraregional differences and regard their security as fundamentally linked to one another and bound by geographic location, common vision and objectives. It has the following components: political development; shaping and sharing of norms; conflict prevention; conflict resolution; post-conflict peace building; and implementing mechanisms.

3. **The ASEAN Socio-Cultural Community (ASCC):** The ASCC blueprint reads: The ASCC is committed to opening a world of opportunities to collectively...
deliver and fully realize human development, resiliency, and sustainable development through Member States’ cooperation on a wide range of area, including culture and information, education, youth and sports, health, social welfare and development, women and gender, rights of the women and children, labor, civil service, rural development and poverty eradication, environment, transboundary haze-pollution, disaster management, and humanitarian assistance.450

What lessons can we draw for Mediterranean integration? It is unlikely that Mediterranean countries will go through the same process of unilateral tariff liberalization and private sector-led demand for integration that East and South-East Asia have employed since the 1980s.

However, recent developments in ASEAN toward strengthening institutional capacity may serve, in certain ways, as a useful example for Mediterranean countries because they provide a framework for a deeper cooperation approach where enforcement and monitoring are incrementally strengthened, while maintaining an intergovernmental governance structure that does not provoke a push-back from governments, who might be worried about losing too much sovereignty.

A word of caution here: these developments are the declared ambitions of the ASEAN Secretariat, but one can legitimately review them with a degree of skepticism about the achievement of the ASEAN community vision by 2025.

Researchers such as Yu (2017)451 and Bhattacharyya (2010)452 argue that further improvement of infrastructure in the region faces major challenges due to the lack of effective mechanisms for coordination and dialogue on regional integration through funding infrastructure projects and that “integration has reached a critical stage where further advances will require the development of a region-wide political institution.”

It must be said that the challenges the region has faced historically are not all that different from the current situation in the Mediterranean. Recall that ASEAN “started as a political organization in response to intraregional conflict” with communist regimes, guerrilla wars, and large refugee flows.453

450. ASEAN Socio-Cultural Community (ASCC) Blueprint 2025, accessed November 3, 2020, from which this is taken, can be found at: http://asean.org/asean-socio-cultural.
In comparing the process of South-East Asian regionalization to African regionalization efforts, an African Development Bank (AfDB) report also points out that ASEAN countries were very similar in terms of “income levels, interventionist and protectionist traditions, diversity and antagonism between neighbors.”

**5.3 EFFECTS ON INEQUALITY**

Besides issues relating to their respective political circumstances, what finally differentiates the Mediterranean countries from ASEAN countries is the relatively higher importance attached in the former to maintaining social cohesion through a more equal income distribution. This requires much greater involvement from the state and lower mutual trust in the benevolence of downstream development and value chains made up of large companies. As the inequality indicators for several MENA and ASEAN countries in the table below show, the Gini coefficient—a lower figure means more equal—for the selected Mediterranean countries is far lower (with the exception of Morocco, where it has remained the same since 1990) than the Gini in selected ASEAN countries where it has remained the same or increased. This observation is reinforced by the difference between the proportion of income held by the richest 10 percent and that held by the poorest 10 percent.

**Figure 5.3.1 Percentage Income of the 10% Richest**

<table>
<thead>
<tr>
<th>Country</th>
<th>Gini 1990/2013</th>
<th>Variation Since 1990</th>
<th>% Income of Richest 10%</th>
<th>Variation Since 1990</th>
<th>% Income of Poorest 10%</th>
<th>Variation Since 1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>35.33</td>
<td>less</td>
<td>23</td>
<td>less</td>
<td>4</td>
<td>more</td>
</tr>
<tr>
<td>Egypt</td>
<td>30.75</td>
<td>less</td>
<td>27.8</td>
<td>less</td>
<td>4</td>
<td>equal</td>
</tr>
<tr>
<td>Jordan</td>
<td>33.6</td>
<td>less</td>
<td>27.5</td>
<td>less</td>
<td>4</td>
<td>more</td>
</tr>
<tr>
<td>Morocco</td>
<td>40.7</td>
<td>equal</td>
<td>32</td>
<td>more</td>
<td>2.7</td>
<td>equal</td>
</tr>
<tr>
<td>Tunisia</td>
<td>35.81</td>
<td>less</td>
<td>25.6</td>
<td>less</td>
<td>3.2</td>
<td>more</td>
</tr>
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<td>46.25</td>
<td>equal</td>
<td>31.1</td>
<td>less</td>
<td>2.3</td>
<td>more</td>
</tr>
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<td>Indonesia</td>
<td>38.14</td>
<td>more</td>
<td>29.5</td>
<td>more</td>
<td>2.9</td>
<td>less</td>
</tr>
<tr>
<td>Philippines</td>
<td>43.04</td>
<td>more</td>
<td>43.2</td>
<td>equal</td>
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<td>less</td>
</tr>
<tr>
<td>Thailand</td>
<td>39.26</td>
<td>less</td>
<td>28.4</td>
<td>less</td>
<td>3.0</td>
<td>more</td>
</tr>
</tbody>
</table>

Source: “Perspective Monde”
Data: Université de Sherbrooke, Canada, 2019
Gini average for selected SMCs = 35.238
Gini average for selected ASEAN countries = 42.498

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454. African Development Bank, *Regional Integration in South-East Asia.*
455. When the Gini coefficient equals 100, income distribution is completely unequal. The closer it is to zero, the more equal the income distribution is.
ANNEX 6
ICT PENETRATION IN THE MENA REGION

The digital revolution has been underway in the MENA countries for the last 15 years, but Information and Communications Technology (ICT) remains poorly distributed across the region. Nonetheless, the region has laid the necessary foundations for developing a digital economy, and young people are regularly trained in new digital technologies.

The sophistication of digital infrastructure and equipment lags not only the advanced nations but even other emerging world regions. For example, internet speeds are slow, few users have access to broadband, and hardware, software, and service prices remain relatively high in relation to purchasing power.

As shown in graphs 6.1 and 6.2, with the exception of the number of mobile subscribers per 100 inhabitants, where the MENA region reached 120 in 2018—the same level as high-income countries—other statistics (such as the number of fixed broadband subscribers, bandwidth capacity in bits per internet user in 2018 and the average number of electronic transactions per capita in 2015) indicate a significant lag between the countries in the region and the developed countries. In the region, 80 percent of the unbanked population have a mobile telephone, but only 7 percent have a mobile money account.

FIGURE 6.1 HIGH MOBILE PENETRATION BUT LIMITED BROADBAND ACCESS

Sources: The Economist Intelligence Unit, the 2018 Inclusive Internet Index, and the World Bank
FIGURE 6.2 POOR QUALITY INTERNET CONNECTIONS AND ALMOST NONEXISTENT ELECTRONIC PAYMENTS

However, because they are averages, these overall figures conceal significant disparities between MENA countries: some have extensive access to ICT and benefit from the positive externalities of the digital economy, while others have acutely limited access.

The Gulf states are among the better-performing countries in the region: Dubai appears to be the driving force of the region and will no doubt be the first country in the world with access to 5G before long. In 2017, US$560 million were raised to fund 260 start-ups, while the highly ambitious Vision 2021 plan forecasts the emergence of smart cities. Electronic payments and e-commerce are well developed in Dubai because of the presence of numerous foreign company headquarters and employees of multiple nationalities, as well as the importance of the Dubai Financial Center.

Meanwhile, in 2018 Saudi Arabia had internet connection rates of almost 100 percent and a mobile equipment rate exceeding 150 percent, and more than 70 percent of the population used social media. The Gulf states, including Saudi Arabia, the United Arab Emirates, and Qatar in particular, are investing huge sums of money in artificial intelligence (AI), and 67 percent of users in these countries claim to be highly satisfied with AI customer service.

A significant number of start-ups using AI have already emerged in the UAE, such as Comae Technologies, which works with the Dubai police to develop forensic AI-based solutions, and Cognit, which supplies companies with decision-making power in the form of cognitive computing.

Figure 6.3 highlights the difference in fixed broadband use in 2017 between Yemen and Iraq, on the one hand, and the Gulf states, on the other.
Next in order after the Gulf states, the Maghreb countries are at an intermediate level: Among them, Morocco is the most advanced digital economy, ranking first among the North African countries, with a Network Readiness Index score of 3.9, placing it in 78th out of 139 countries, and ahead of Tunisia, which placed 81st in the world in 2016. Egypt is in the 96th place, while Algeria is far behind, in the 177th place on the global scoreboard.

Morocco, the Maghreb’s digital economy leader, also takes first place within the region in the “growth of technology sector” rankings, with 10 percent growth in 2018, followed by Egypt. Morocco also has the highest share of technological exports in the region, representing 45 percent of the total in 2018. In 2018, the first optical fiber factory in Africa and the Middle East opened in Tangier following investment exceeding 200 million dirhams ($54.5 million).

In December 2017, Morocco created a digital development agency to coordinate activity to increase the presence of ICT in the economy. Algeria, with the poorest ICT performance in the region, nonetheless, trains 20,000 IT engineers and technicians each year and has 120,000 km of optical fiber cables.

Although somewhat lagging in comparison with other emerging regions, the Maghreb countries are fully aware of the importance of developing the digital economy to meet future challenges. For example, the governments of the Maghreb countries are making progress on the creation of a regulatory framework to promote ICT.
Improving access to ICT, particularly in countries outside the Gulf, is a real challenge.

In sectors such as health, education, the environment, and a reforming public sector, digital technologies are now a fundamental lever for growth and job creation in the economies of the Mediterranean region.

In addition, these technologies represent a key vector for regional integration because information technology allows networks of economic and human relations to be established among countries in the region, even if remote or landlocked, freeing people from the constraints of geographical distance and isolation. ICT allows the restructuring of geographical space and relations among territories by facilitating the networking of resources, computers, people, and organizations. These technologies can therefore also play a central role in the inclusion of underdeveloped regions of MENA countries, which are currently excluded from the development process.

The democratization of access to communication media resulting from the implementation of the new information technologies is an important step forward for MENA countries, especially for the integration of its lower-income and marginalized populations. Communication among countries via social media and other internet content is helping create a sense of unity and belonging in a region whose countries are geographically or culturally diverse.

The new communication media will also enable civil society in the region to understand, endorse, or even question public decisions taken by their respective governments, building trust, accountability, and a sense of civic democratic responsibility for the affairs and direction of one’s own country.

Access to information and increased transparency resulting from the introduction of ICT are essential steps in fostering the regional integration process. Indeed, populations must be able to understand, discuss, envision, question, and ultimately coalesce around the concept of integration in all of its fundamental dimensions if it is to be realized in a way that makes it effective.

Moreover, ICT will allow the states of the region to unite around joint projects aimed at creating companies of sufficient size to make a place for themselves in a digital market already occupied by large companies from developed countries. The Orange Group, for example, has offices in Morocco, Tunisia, Egypt, Jordan, and Iraq, where it already has 55 million subscribers and employs 2,500 people.

Although the creation of digital companies requires substantial funding, there is a realistic chance for MENA countries to pool those funds by joining forces to attract investment. The challenge of transitioning to a digital economy must be taken up by every country in the region to avoid progressively widening gaps opening up among them, hindering the process of regional integration.
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ABIF</td>
<td>ASEAN Banking Integration Framework</td>
</tr>
<tr>
<td>AfCFTA</td>
<td>African Continental Free Trade Area</td>
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<tr>
<td>ACAA</td>
<td>Agreement on Conformity Assessment and Acceptance of Industrial Products</td>
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<tr>
<td>ACUWA</td>
<td>Arab Countries Water Utilities Association</td>
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<tr>
<td>AEC</td>
<td>ASEAN Economic Community</td>
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<tr>
<td>AfDB</td>
<td>African Development Bank</td>
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<tr>
<td>AIA</td>
<td>ASEAN Investment Area</td>
</tr>
<tr>
<td>AMU</td>
<td>Arab Maghreb Union</td>
</tr>
<tr>
<td>AME</td>
<td>Africa-Mediterranean-Europe (La Verticale Afrique - Méditerranée - Europe)</td>
</tr>
<tr>
<td>APSC</td>
<td>ASEAN Political-Security Community</td>
</tr>
<tr>
<td>ASCC</td>
<td>ASEAN Socio-Cultural Community</td>
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<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<tr>
<td>BTA</td>
<td>Bilateral Trade Agreement</td>
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<tr>
<td>CAP</td>
<td>Common Agricultural Policy</td>
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<tr>
<td>CBJ</td>
<td>Central Bank of Jordan</td>
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<tr>
<td>CEB</td>
<td>Central Europe and the Baltics</td>
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<tr>
<td>CEE</td>
<td>Central and Eastern Europe</td>
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<tr>
<td>CEFTA</td>
<td>Central European Free Trade Area</td>
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<tr>
<td>CEPII</td>
<td>Centre d’Études Prospectives et d’Informations Internationales</td>
</tr>
<tr>
<td>CETA</td>
<td>Comprehensive Economic and Trade Agreement</td>
</tr>
<tr>
<td>CMI</td>
<td>Center for Mediterranean Integration</td>
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<tr>
<td>COMESA</td>
<td>Common Market for Eastern and Southern Africa</td>
</tr>
<tr>
<td>CSO</td>
<td>Civil Society Organization</td>
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<tr>
<td>DCFTA</td>
<td>Deep and Comprehensive Free Trade Area</td>
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<tr>
<td>DVX</td>
<td>Indirect Value-Added Export</td>
</tr>
<tr>
<td>EAC</td>
<td>East African Community</td>
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<tr>
<td>EAFRD</td>
<td>European Agricultural Fund for Rural Development</td>
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<tr>
<td>EAP</td>
<td>Eastern Partnership</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>ECA</td>
<td>Europe and Central Asia</td>
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<tr>
<td>ECOWAS</td>
<td>Economic Community of West African States</td>
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<tr>
<td>ECSC</td>
<td>European Coal and Steel Community</td>
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<tr>
<td>EEA</td>
<td>European Economic Area</td>
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<tr>
<td>EFTA</td>
<td>European Free Trade Association</td>
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<tr>
<td>EMFF</td>
<td>European Maritime and Fisheries Fund</td>
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<tr>
<td>EMUNI</td>
<td>Euro-Mediterranean University</td>
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<tr>
<td>ENP</td>
<td>European Neighbourhood Policy</td>
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<tr>
<td>EPA</td>
<td>Export Promotion Agencies</td>
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<td>EPAs</td>
<td>Economic Partnership Agreements</td>
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<tr>
<td>ERDF</td>
<td>European Regional Development Fund</td>
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<tr>
<td>ESF</td>
<td>European Social Fund</td>
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<tr>
<td>FCV</td>
<td>Fragility, Conflict and Violence</td>
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<tr>
<td>FEMISE</td>
<td>Euro-Mediterranean Forum of Institutes of Economic Sciences</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>FTA</td>
<td>Free Trade Agreement/Free Trade Area</td>
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<tr>
<td>FVA</td>
<td>Foreign Value-Added</td>
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<tr>
<td>GAFTA</td>
<td>Greater Arab Free Trade Area</td>
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<tr>
<td>GATS</td>
<td>General Agreement on Trade in Services</td>
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<tr>
<td>GCC</td>
<td>Gulf Cooperation Council (officially, the Cooperation Council for the Arab States of the Gulf)</td>
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<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GMP</td>
<td>Global Mediterranean Policy</td>
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<tr>
<td>GVC</td>
<td>Global Value Chain</td>
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<tr>
<td>HCI</td>
<td>Human Capital Index</td>
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<tr>
<td>HDI</td>
<td>Human Development Index</td>
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<tr>
<td>ICT</td>
<td>Information and Telecommunications Technology</td>
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<tr>
<td>ITC</td>
<td>International Trade Centre</td>
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<tr>
<td>ICM</td>
<td>International Credit Mobility</td>
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<tr>
<td>IFI</td>
<td>International Financial Institution</td>
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<tr>
<td>IMB</td>
<td>International Market Bank</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPEMED</td>
<td>Mediterranean World Economic Foresight Institute</td>
</tr>
<tr>
<td>LPI</td>
<td>Logistics Performance Index</td>
</tr>
<tr>
<td>MENA</td>
<td>Middle East and North Africa</td>
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<tr>
<td>MENAP</td>
<td>Middle East, North Africa, Afghanistan, and Pakistan</td>
</tr>
<tr>
<td>MENA NWC</td>
<td>Middle East and North Africa Network of Water Centers of Excellence</td>
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<tr>
<td>MFN</td>
<td>Most-Favored Nation</td>
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<tr>
<td>MPC</td>
<td>Mediterranean Partner Country</td>
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<tr>
<td>MERCOSUR</td>
<td>(South American) Southern Common Market</td>
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<tr>
<td>Acronym</td>
<td>Full Form</td>
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<tr>
<td>MSP</td>
<td>Mediterranean Solar Plan</td>
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<tr>
<td>NAFTA</td>
<td>North American Free Trade Agreement</td>
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<tr>
<td>NEET</td>
<td>Not in Education, Employment or Training</td>
</tr>
<tr>
<td>NTM</td>
<td>Non-Tariff Measure</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>PAFTA</td>
<td>Pan-Arab Free Trade Area</td>
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<tr>
<td>PIIE</td>
<td>Peterson Institute for International Economics</td>
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<tr>
<td>PPP</td>
<td>Public Private Partnership</td>
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<tr>
<td>PPP</td>
<td>Purchasing Power Parity</td>
</tr>
<tr>
<td>PRIMA</td>
<td>Partnership for Research and Innovation in the Mediterranean Area</td>
</tr>
<tr>
<td>RCA</td>
<td>Revealed Comparative Advantages</td>
</tr>
<tr>
<td>RES</td>
<td>Renewable Energy Source</td>
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<tr>
<td>RIA</td>
<td>Regional Integration Arrangement</td>
</tr>
<tr>
<td>ROO</td>
<td>Rule of Origin</td>
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<tr>
<td>RoRE</td>
<td>Rate of Return to Education</td>
</tr>
<tr>
<td>RTA</td>
<td>Regional Trade Agreement</td>
</tr>
<tr>
<td>RTG</td>
<td>Regionally Traded Goods</td>
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<tr>
<td>RVC</td>
<td>Regional Value Chain</td>
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<tr>
<td>SAARC</td>
<td>South Asian Association for Regional Cooperation</td>
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<td>SADC</td>
<td>Southern African Development Community</td>
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<tr>
<td>SDG</td>
<td>Sustainable Development Goal</td>
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<tr>
<td>SME</td>
<td>Small and Medium-Sized Enterprise</td>
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<td>SMC</td>
<td>South Mediterranean Country</td>
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<tr>
<td>SMI</td>
<td>Small and Medium-Sized Industries</td>
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<tr>
<td>SPS</td>
<td>Sanitary and Phytosanitary Standards</td>
</tr>
<tr>
<td>STRI</td>
<td>Services Trade Restrictions Index</td>
</tr>
<tr>
<td>TBT</td>
<td>Technical Barrier to Trade</td>
</tr>
<tr>
<td>TFP</td>
<td>Total-Factor Productivity</td>
</tr>
<tr>
<td>TPP</td>
<td>Transpacific Partnership</td>
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<tr>
<td>TTIP</td>
<td>Transatlantic Trade and Investment Partnership</td>
</tr>
<tr>
<td>UfM</td>
<td>Union for the Mediterranean</td>
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<tr>
<td>UNIMED</td>
<td>Mediterranean Universities Union</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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<tr>
<td>WBG</td>
<td>World Bank Group</td>
</tr>
<tr>
<td>WDI</td>
<td>(World Bank) World Development Indicators</td>
</tr>
<tr>
<td>WEEA</td>
<td>Wider European Economic Area</td>
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<tr>
<td>WEF</td>
<td>World Economic Forum</td>
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<tr>
<td>WEO</td>
<td>World Economic Outlook</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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</tbody>
</table>
The Center for Mediterranean Integration (CMI) is a multi-partner platform where development agencies, governments, local authorities, and civil society from around the Mediterranean convene to exchange knowledge, discuss public policies, and identify the solutions needed to address key challenges facing the Mediterranean region. The current members are Egypt, France, Greece, Italy, Jordan, Lebanon, Morocco, the Palestinian Authority, Spain, Tunisia, Provence-Alpes-Côte d’Azur Region, the City of Marseille, the European Investment Bank, and the World Bank Group. The CMI also includes the European External Action Service (EEAS) as an observer.

Web: www.cmimarseille.org
Facebook: CMI Marseille
Twitter: @cmimarseille
“This book is a serious, sober and comprehensive review of North-South relations in the Mediterranean region, drawing extensively on the voluminous literature on the subject. The policy recommendations are sound. The clear and systematic exposition makes the study suitable both as a reference volume and as a guide for teachers and students. The study’s emphasis on domestic policies as the main driver of successful integration -- rather than exclusive reliance on formal and shallow trade agreements -- is spot on.”

**Uri Dadush**  
Senior Fellow, Policy Center for the New South and Bruegel  
Visiting Research, Professor University of Maryland

“...This is the ultimate book on the prospects for integration of South-Mediterranean countries in the global economy and is a must-read for anyone interested in the long-term welfare of the region. It brings together, into a coherent frame, recent research on Global Value Chains, trade in services, non-tariff barriers, determinants of FDI, the politics of state and business relations as well as the role of education and environmental policies in reducing inequality. In doing so, this book charts more realistic ways of looking at the old dilemma of how the Southern rim of the Mediterranean can move from being an isolated group of countries, exporting natural resources and people to a large market attracting FDI, new technologies, and finding its place in the evolving global division of labor. This analysis offers a balanced view on the policy changes needed. In Europe, this consists of becoming more open to a deeper integration that gives as much attention to its South as it does its East, and in the South-Mediterranean region, countries need to become more open to an evolution of their governance in ways that foster inclusive and sustainable growth, and increase cooperation among themselves in the provision of regional public goods.”

**Ishac Diwan**  
Professor of Economics, Paris Sciences et Lettres, and Ecole Normale Supérieure Paris  
Research Fellow, DIAL (Paris Dauphine) and Economic Research Forum