Euro-Mediterranean Process - Union for the Mediterranean: Macroeconomic and financial developments during the global crisis at the southern rim of the Mediterranean

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Although the global financial and economic crisis hurt economies worldwide, the economies at the southern Mediterranean region have done relatively well to weather this global hurricane. Economic growth in the region has slowed down but the size of the trough of these economies’ business cycle has ultimately been dependent on the length and vigour of domestic economic policy reactions. Escaping from a difficult period featuring soaring food and oil prices the economies of the southern Mediterranean region are faced with new challenges that impact both their real and financial sectors, as negative effects from their real sector spilled over to their financial sectors. This chapter analyzes recent macroeconomic, monetary and financial developments, the use of fiscal, monetary and financial policy instruments, the volatility at their financial markets, trade openness and the imperative need for good governance which is the umbrella under which economic policy instruments are called to operate.

1. Introduction

The implementation of the European Neighbourhood Policy (ENP) in the Mediterranean shore has been under strain over the last couple of years. While soaring food and oil prices imposed enormous pressure on government budgets and spurred a wave of inflationary pressure across the region in 2008, the Mediterranean countries (MED countries\(^2\), for short) started to feel the pinch of the global financial and economic crisis towards the last quarter of 2008 and rushed to come up with economic support packages for the sectors affected. MED countries with stock markets felt the effects of the global financial turbulence with a lag of six months to a year after the moment where the developed countries started their tumble in July 2007. But the biggest shock to the MED economies came from the sharp drop in the world trade that directly affected their economic activity.

Independent of the crisis, the gradual deepening of the ENP was somehow strengthened in 2008 by the development of a new initiative: the Union for the Mediterranean was launched in July, sparking new hopes in the region and attracting a great deal of international attention to this region\(^3\). Overall, MED countries made significant progress in the implementation of the ENP.

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Disclaimer: The views presented are those of the authors and do not necessarily reflect those of the European Commission.

\(^2\) Including Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, occupied Palestinian territory, Syria and Tunisia.

\(^3\) The July 2008 Paris Summit launched the Union for the Mediterranean (UfM) with the objectives of providing a new political impetus to the EU’s critical relationship with its Mediterranean partners, providing greater co-ownership and making this relationship more concrete and visible through regional and sub-regional projects, building on the achievements of the Barcelona Process. The first set of projects to be developed under this initiative include the de-pollution of the Mediterranean Sea, the establishment of maritime and land highways, civil protection initiatives to combat natural and man-made disasters, a Mediterranean solar energy plan, the inauguration of the Euro-Mediterranean University in Slovenia, and the Mediterranean Business Development Initiative focusing on micro, small and medium-sized enterprises.
Action Plans during 2008 and 2009. Major economic reform efforts were recorded, although their future speed, sequence and depth are likely to be affected in the aftermath of the worldwide financial and economic crisis. Some countries advanced trade negotiations, tax and customs reform and competition policy, and kept introducing reforms conducive to improving the business environment. However, as the crisis spread to the real economy, the economic outlook of these economies has significantly changed.

The outline of this chapter is as follows. Section 2 briefly presents the Euro-Mediterranean framework. Section 3 provides an overview of recent macro-economic developments in MED countries. Section 4 then gives a bird’s view of the recent financial and monetary developments, with a focus on the volatility at the stock and exchange rate markets because of the crisis, the turning points in commodity price developments, cross border bank loans and other financial exposure across geographical borders. Thereafter, chapter 5 discusses the progress in trade openness of the Mediterranean countries. Chapter 6 stresses the need for good governance and solid institution building. Section 7 assesses the economic assistance to ENP Mediterranean countries and, finally, section 8 concludes with a set of recommendations applicable regionwide.

2. Tackling economic and financial challenges. An evolving EU architecture

At the time the EU crafted the Euro-Mediterranean Partnership (EMP) economic and financial affairs with the Mediterranean Partner Countries (MPCs) were institutionally addressed by devoting one of its three foundation pillars exclusively to economic relations. The objective was to improve the living conditions by accelerating socio-economic development, creating jobs and raising economic wealth in the Mediterranean region. Economic integration in the world economy was the motto and this was to be achieved through the establishment of a Euro-Mediterranean Free Trade Area by 2010.

Trade integration in the global economy and the conclusion of bilateral FTAs with Mediterranean partners was the strategy to increase South Mediterranean GDP and stimulate job creation. By November 2008, all MPCs had signed and ratified FTAs with the EU and overall trade exchange between the MPCs and the EU had significantly increased, although scores were less impressive in terms of intra-regional trade exchanges among MPCs (see section 5 on trade developments and in particular graph 6). Intra-regional trade remained minor (just 8% of their total trade) and agreements suffered from reticence of the signing countries.

Trade talks under the EMP focused on industrial goods liberalisation. Negotiations over the past decade resulted in tariff-free access for all MPCs manufactured products to the EU market. The EU accepted asymmetric transition periods implying that total tariffs dismantling for EU products would proceed over twelve years, delaying the date for a genuine FTA with MPCs at least until 2015. More modest progress was achieved in liberalising agricultural products, agriculture being a very sensitive issue at both rims of the Mediterranean. Although agreements were signed with some MPCs, the scope for agricultural liberalisation still remains limited, allowing for large exception lists, quantitative restrictions and a broad spectrum of non-tariff barriers.

By its nature, the EMP was established to become a coordinating body for macroeconomic policy responses to challenges in the region. However, by choosing to promote economic integration through trade liberalisation, macroeconomic aspects were relegated. At the time, the economic theory believed in the assumption that GDP growth, economic convergence and job creation
would naturally follow deeper trade integration. Macroeconomic aspects gained more attention when these results did not fully materialise.

In 2004, the EU adopted its European Neighbourhood Policy (ENP) covering the circle of countries at its Eastern and Southern borders. For the MPCs, the ENP came to complement the regional approach promoted by the EMP. Action Plans were bilaterally signed between the EU and the majority of MPCs, including a substantial economic and financial chapter that was meant to become a road map for macroeconomic reforms in the next five years. Action Plans provided space for differentiated national ambitions, allowing countries to proceed at their own pace in economic and financial reforms. Quality rather than quantity targets were established and deadlines avoided.

The ENP promoted the discussion of macroeconomic issues at the bilateral level by introducing several sub-chapters related to fiscal policies, public finance management, monetary policies and labour market reforms in Action Plans. Since then, macroeconomic policy coordination has also been promoted at the multilateral level. In 2007, the European Commission launched the Euro-Mediterranean network of public finance experts, whose objective was to bring together national experts on public finance management in order to share lessons learned in the reform process and exploit synergies within the region. However, the multilateral approach to macroeconomic coordination in the Mediterranean region remains secondary to the efforts deployed on the bilateral basis.

Contrary to what many critics of the EMP process argue, we think that cooperation on economic and financial issues has delivered some positive results. The EMP has been a platform for negotiating central economic issues, particularly the ones linked to the process of trade liberalisation; and under the ENP, the majority of MPCs have been implementing macroeconomic reforms which have already produced significant results in terms of improved economic stability in the region. Steady average growth rates of around 5%, contained inflation, reduced and/or contained public deficits and better management of public debts, are all positive outcomes linked to reforms. Past and current reform efforts are thus paying off.

In the next section we will present the major recent economic developments in MPCs, putting them into a longer perspective, so economic trends can be established on the basis of the data gathered over the last four years. It will follow that in many MPCs almost all macroeconomic variables have been evolving rather positively, including unemployment and inflation, and have helped these countries to stay put in their efforts to weather the global storm.

3. Macroeconomic developments

The sharp drop in world trade that started at the end of 2008 was not immediately felt in the Mediterranean region. The MED countries kept their imports from abroad at the same level as before, but started feeling the pinch of the strong drop in demand for their goods from the developing countries a little later (see Graph 1). MED countries’ falling exports were paramount in slowing down the domestic economic activity. However, the extent to which the different MED countries took measures to avoid or to anticipate the slowdown of their economic activity differed
widely. This section analyzes the immediate impact of shrinking trade volumes on the real sectors of the economy across the MED countries.⁴

Graph 1: Global world trade versus MENA region trade

[Graph showing trade volumes comparison]

Source: Central Planning Bureau in The Netherlands.

Real GDP growth: MED countries have been growing steadily at an average rate close to 5% until the global crisis hit the world at the end of 2007. Although recession widely spread among developed economies, in 2008 MED economies grew at an average of 5.4% and managed to keep positive growth rates in 2009, reaching a regional growth average of 3.4% (graph 2). The low exposure of their financial markets to financial turbulences and their low integration in the international economy helped them to cushion the impacts of the shock.⁵ Growth rates, although positive, were nonetheless inferior to those in 2008, particularly in Egypt, Tunisia, and Israel. Economic growth in oil-exporting countries was largely driven by hydrocarbon revenues and the boost to private sector investment financed by FDI inflows from neighbouring Arab countries. Oil-importing countries also registered impressive growth rates reflecting growth in non traditional sectors, abundance of liquidity and strong domestic demand.


⁵ Within the Med region Israel has always been an exception in that its financial and banking system proved relatively robust despite its high integration with the global economy, free capital mobility and the extensive international trade and financial flows. Notwithstanding some stress in the lending rates and the equity and corporate markets, the functioning of the financial system was not severely impaired. This is the result of the prudent banking practices, the increased transparency and the longstanding implicit government guarantees that anchored confidence.
The situation of these economies however radically weakened as the global economic and financial crisis spread to the real economy, as follows from leading indicators (Graph 3). Basically all the main drivers of economic growth in the region showed the first signs of weakness: oil revenues quickly contracted in oil-exporting countries, FDI from the Gulf countries fell, and the European demand took a serious hit with several EU countries already in recession. Most MED countries needed to rely more upon domestic demand to be able to sustain growth in 2009. In the case of Syria and Jordan, a positive stimulus was derived from fast-rising import demand from neighbouring Iraq, which is undergoing a rapid reconstruction. All countries in the region faced lower growth in 2009, although the reasons vary. Oil exporters got hit quickly; plummeting oil prices reduced government revenues drastically, held back ambitious infrastructure plans, and greatly reduced growth projections; trade surpluses contracted, limiting the future ability of these governments to cope with social challenges and unemployment. Oil importers (Tunisia, Jordan, and Morocco) welcomed cheaper oil; trade deficits narrowed and pressure on budgets eased since governments employed fewer resources to finance oil subsidies; however, trade dependence on economies in recession also brought about a contraction in growth.

Unemployment rates: The MED region has the highest, albeit decreasing, levels of labour force growth (3.4% per year: 2000-2005, 3.0% per year: 2005-2010) than any other region in the world, except sub-Saharan Africa. Labour force growth remains high, increasing the pressure for job creation. Consistently high average growth rates have been translated into falling average unemployment rates (2004: 13.8%, 2008: 11.9%), narrowing the gap with other developing regions. However, unemployment rates remain persistently high at rates equal or above 9% in all MEDs (excluding Israel). The employment gains made during 2008 were lost in 2009 due to the shrinking growth rates in the region, the economic recession in most European countries, and

These figures exclude Libya, for which unemployment rates are only available for 2007.
the depressed growth in the Gulf countries which traditionally absorbed a large part of MED countries' migration.

**Budgetary position:** Overall, the average general government budget has been contracting steadily for the last four years. MED countries abandoned an average surplus close to 0.3% of GDP in 2008 to plunge to an average budget deficit neighbouring 5% in 2009.

Graph 3: Short term indicators of GDP-growth

Most countries in the region have experienced a weakening in their budgetary positions. In oil-exporting countries fiscal positions remained solid (+9% in Algeria and +24.6% in Libya), in 2008 owing to buoyant oil export revenues. Among oil-importing countries, budget balances improved marginally mainly as a result of better fiscal revenue performances. This was the case in Morocco, which registered a small surplus (0.1% in 2008), and in Tunisia, which managed to reduce its budget deficit thanks to mounting efficiency in tax and customs administration. Subsidies continued to substantially impact on public finances in 2008 in some MED countries, with direct food and oil subsidies accounting for an estimated 4% of GDP in Tunisia, 5% in Morocco, and 9% in Egypt.

However, budget balances deteriorated in all MED countries in 2009. The average budget deficit dropped to 4.6% from a surplus of 0.3% in 2008. Oil-exporter Algeria registered budget deficits for the first time in a long period, while for the rest of the countries the current budget deficits are likely to deepen in variable intensity (from slight changes in Egypt to more pronounced deteriorations such in the case of Morocco, Jordan and Syria). Gloomy forecasts for budget deficits are the result of declining oil prices combined with the first fiscal responses of some MED economies to the crisis.
MED countries responded to the first impact of the global crisis by putting in place fiscal stimulus packages geared toward job-creating infrastructure investment (Egypt, Jordan and Morocco), supporting domestic SMEs and employment (Tunisia) and reactivating the sectors affected by the crisis. Although the timeliness of these measures can hardly be contested, there is always the risk that fiscal expansions might have negative repercussions in the medium run from a further widening of fiscal deficits.

Graph 4: Fiscal revenues and expenditures and exports and imports of goods

Lower oil prices have made it possible for oil-importing MED countries to embark on fiscal expansions, although these have been variable in size: Egypt, Morocco and Jordan and Israel. Some MED countries are better prepared than others to stave off the crisis. In Morocco, years of fiscal reforms efforts have contributed to create the necessary fiscal space to respond to external shocks without incurring in huge public deficits. In contrast, the announced fiscal expansion will further widen the fiscal deficits in some countries (Jordan), therefore increasing budget pressures and the weight of the public debt.

It is difficult to judge whether recent policy measures are commensurate with the scale of the problem. Most MED countries have announced that fiscal measures will be temporary in nature but have let the window open for extensions. In the short-run, the scope for counter-cyclical fiscal policy will be determined by several factors such as MED countries’ appetite for external financing through international borrowing, the expected volume of privatization revenues, and their current levels of debt. In the current context of scarce liquidity in international markets, borrowing may be an expensive option, and privatization revenues will drop as foreign investors behave conservatively and delay buying decisions. Naturally, the main oil exporters will have a bigger margin of manoeuvre to enhance the scope of the fiscal response, but they should closely monitor the speed at which foreign reserves might get depleted, particularly given the extent of decline in foreign demand.

In the long-run, MED economies would need to reduce the dependence on a few commodity exports by diversifying the productive fabric. This would require massive public investments in
infrastructure, education, health and renewable energy sources (solar and wind). The fact that most MED countries are sticking to announced public investment programs should be welcomed.

Graph 5: Current account in 2009 in comparison with previous years

Improved fiscal balances helped reduce the burden of public debt in all MED countries in 2008. The regional gross public debt average stood at 57.3% of GDP in 2008, steadily declining since 2004 (80%). In 2009 it increased slightly to 60.6%. Country analysis reveals that debt-to-GDP ratios have been reduced across the region. Oil exporters have used oil revenues to repay the debt and oil importers have managed to reduce the debt burden by lowering their public deficits. However, the countries showing high levels of debt (Egypt, Israel, Jordan and Lebanon) will face mounting difficulties to keep reducing the debt stock. Indeed, the privatization revenues that helped to keep public deficits on check contracted at the light of the break on privatization processes brought about by the current international credit crunch.

However, the situation changed in 2009, with government revenues falling sharply in most MED countries and government expenditures soaring (see Graph 4). On average, revenues in the MED countries fell by 4 percentage points, from 35% of GDP in 2008 to 31% in 2009. Expenditures rose from 34% of GDP in 2008 to 40% of GDP in 2009. Consequently, budget balances deteriorated. The absence of strong automatic stabilizers may entail that these fiscal developments have medium to long-term repercussions, among others on economic growth.

Current account: Excluding Libya from regional averages, the region continues to display a negative average current account balance. The high volatility of oil and commodity prices has greatly affected trade balances, resulting in a substantial deterioration of the current account balances in all MED countries in 2008 (excluding Libya and Jordan). Country analysis reveals that in Algeria it has heavily contracted to from 19.6% of GDP to 3.2% of GDP over the 2008-09

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7 Oil is becoming an economic asset in a growing number of economies in the region (in Egypt and Tunisia oil represents 20% and 15% of total export revenues in 2008, respectively).
period in 2009. In Libya the current account surplus also plummeted from 40.7% to 16.8% of GDP over the same period. In oil-importing countries, the combination of growing imports (fuelled by high oil prices and strong domestic demand) and declining exports (as the external demand from main trade partners –the EU and the USA- started to contract) explains the substantial weakening of current account balances, particularly in Jordan, Lebanon and Morocco, indicating how sensitive these countries are to oil price movements and how dependent they are on a small number of trade partners.

MED countries have traditionally financed large trade deficits by using tourism and remittances revenues. In 2008, total gross remittances inflows for Egypt, Lebanon, Jordan, Tunisia and Morocco reached USD27 billion, three times as much as in 2000. However, the slowdown in European economic growth is already weakening both sources of revenue: the potential earnings of emigrants and their ability to remit wages to their home countries, and the tourism sector, a vital job creator and economic driver in Egypt, Tunisia and Morocco which greatly rely in European demand. In Morocco, tourism revenues and remittances have declined in 2008 by 3.5% and 2.4%, respectively. This was also the case in Lebanon, with remittances markedly decreasing as labour demand in the Gulf region contracted. In Jordan, remittances decreased by 6% during the last quarter of 2008, although they increased at an annual basis. These negative developments intensified in 2009.

From the previous section, it follows that the MED countries are and will be under strain due to the global crisis. And although the financial sector of the developed economies was the eye of the hurricane, the developing economies are hurt at first more in the real sector. But, in return, there might be negative spillovers from their real to their financial sectors. Monitoring of the financial developments is thus crucial for policy makers in order to conduct the policies timely and adequately.

Although far less developed than the developing countries, most MED countries have developed stock markets going up to more than 100% of GDP in market capitalization. Most financially integrated in the developed economies in this respect is Israel. In order to measure investors’ uncertainty, Box 1 compares the strong movements in the stock markets and the high volatility across the MED countries.

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8 The Med region has received the largest amount of worker's remittances relative to its GDP in the world during 1996-2006.
9 Jordan is an exception. Tourism revenues are holding up (+6% in 2008 accounting for 8% of GDP).
4. Financial and monetary developments

Since the start of the global financial turmoil in July 2007, until their peak in the period July 2007-July 2009, the Jordanian stock market increased by 94% (see table in Box 1), and also Egypt’s by 65% and the Lebanese stock market by 79% still gained significantly. Since this date, until June 2009, stock markets in the EU and the US dropped continuously, up to 60% and 53% respectively. Both, the stock markets in Egypt and Israel, lost similarly. Where Israel due to its high degree of financial integration moved in line with the EU and US, Egypt coupled far later with the negative trend that started in July 2007.\textsuperscript{10} From peak to trough, also Jordan, Lebanon, Morocco and Tunisia lost tremendously.

Higher volatility in the markets, caused by the global financial and economic crisis, follows from the moving standard deviations of the share price indices (see graphs in Box 1). Egypt, Jordan and Israel rank highest in terms of the increase in volatility. In the period January 2007 until June 2009 the Israeli volatility peaked in December 2008, like the volatility at the stock markets in the EU and the US. Investors’ uncertainty in Egypt remained relatively constant, until March 2009. This development aligns with the developments in the real sector in Egypt. The increase in volatility in the share prices of the stock markets of Lebanon, Morocco and Tunisia was more muted, due to the relatively lower degree of financial development and integration. In sum, stock markets tumbled drastically in the MED-region where some stock markets show a high degree of investors’ uncertainty though some months later than in the developed economies.

A relevant factor at play when discussing (cross-border) investors’ behaviour is the role of the exchange rate. On top of the volatility of shares, there is the volatility of the exchange rate for those investors that own foreign currencies. These investors run the double risk, as they first have to exchange their own currency for the currency of the country where they want to make their investments (currency risk) and thereafter the risk of the investment. As Jordan and Lebanon have a fixed peg at the dollar, their stock markets may be safer for institutional or other investors that trade in US dollars. The extent, to which exchange rate volatility plays a role for investors, depends however on many more factors.

From Box 2 follows that in the period January 2007 until June 2009 the domestic currency of Algeria, Egypt, Jordan, Lebanon and Syria vis-à-vis euro recorded maximum jumps in one week of around 10%, reflecting a depreciation of 10%. The biggest drops was, e.g. for Egypt, 6.8% which reflects an appreciation of the Egyptian pound vis-à-vis the euro. This reflects that currencies depreciated sometimes strongly and rather quickly. Apart from Morocco and Tunisia, that pursue monetary policy of a basket in which the euro dominates, the weekly depreciations and appreciations of the domestic currencies of the MED countries were smaller vis-à-vis the US dollar. By and large, a similar reasoning holds for the peaks and troughs of the daily changes in the bilateral exchange rates with the euro and US dollar.

The development of the volatility in the exchange rate markets during the financial crisis (up until June 2009) is visualized in the graphs in Box 2. The peak of the volatility is clearly in 2009, for all countries. This holds for both, the bilateral exchange rates with the euro as well as with the US dollar. On a positive note, the volatility starts decreasing at the end of the period under investigation here, which may indicate that the financial situation is getting better.

The rather developed stock markets of Egypt, Israel, Jordan, Morocco and Tunisia became gradually more volatile as the global financial crisis intensified and translated in a global economic crisis at the end of 2008. The most financially integrated country in the MENA-region – Israel – mimicked the stock markets developments in the euro area and the US (see the synchronicity of the green line in first graph and yellow and grey lines in third graph). Other countries, like Egypt, but also Jordan and Lebanon, reached its peak in stock market volatility later, in the course of 2009.
Box 2  Exchange rate volatility during the global financial crisis

Developments in exchange rates during 1 January 2007 and 24 June 2009

<table>
<thead>
<tr>
<th>Country</th>
<th>Maximum change (day-on-day, in %)</th>
<th>Minimum change (day-on-day, in %)</th>
<th>Maximum change (week-on-week, in %)</th>
<th>Minimum change (week-on-week, in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>3.6</td>
<td>-7.0</td>
<td>11.8</td>
<td>-4.9</td>
</tr>
<tr>
<td>Egypt</td>
<td>3.9</td>
<td>-2.9</td>
<td>10.5</td>
<td>-6.8</td>
</tr>
<tr>
<td>Israel</td>
<td>4.5</td>
<td>-3.2</td>
<td>6.0</td>
<td>-5.2</td>
</tr>
<tr>
<td>Jordan</td>
<td>3.9</td>
<td>-2.7</td>
<td>10.7</td>
<td>-6.5</td>
</tr>
<tr>
<td>Lebanon</td>
<td>3.8</td>
<td>-2.7</td>
<td>7.6</td>
<td>-6.5</td>
</tr>
<tr>
<td>Libya</td>
<td>4.2</td>
<td>-4.5</td>
<td>1.8</td>
<td>-3.6</td>
</tr>
<tr>
<td>Morocco</td>
<td>1.2</td>
<td>-1.5</td>
<td>10.6</td>
<td>-2.7</td>
</tr>
<tr>
<td>Syria</td>
<td>3.8</td>
<td>-1.3</td>
<td>10.6</td>
<td>-13.5</td>
</tr>
<tr>
<td>Tunisia</td>
<td>1.5</td>
<td>-1.2</td>
<td>-13.5</td>
<td>-7.0</td>
</tr>
</tbody>
</table>

Note: A positive (negative) sign indicates a depreciation (appreciation) of the domestic currency.

Volatility exchange rates
(3-months moving standard deviation of the weekly percentage changes)

Exchange rate volatility significantly increased from 2007 to 2008, and even doubled or tripled in 2009 in comparison with 2008. This holds for the bilateral exchange rate with the euro (see left graphs) as well as for the bilateral exchange rate with the US dollar (right graphs).

NB: Exceptions are the dollar exchange rate of Jordan and Lebanon as these are fixed pegs.
While the volatility of the stock markets reflects an increasing uncertainty by investors which could lead to a further slowdown in economic activity, government policies of stimulus packages and loosening monetary policy will be conducive to boost economic activity and reduce uncertainty. This can in return stabilize stock market investments.

Although the volatility of a domestic currency can hamper financial investments, and via this channel also investment opportunities of businesses that attract funds from the stock exchange, flexible currency regimes can be helpful from the macroeconomic perspective in several respects. For instance, price stability is for most countries more easily within reach under flexible exchange rate regimes. More volatility in exchange rates is therefore not to be associated with bad developments or bad policies, but an increase in volatility over time is *ceteris paribus* evidently a sign of more movements and thus uncertainty in the markets.

One positive externality of the latest developments is that the global crisis has decelerated the trend of soaring consumer prices. High oil and food prices had been pushing up inflation in the commodity importing countries, such as in Egypt, Jordan and the occupied Palestinian territory, but also in the other MED countries that face a relatively lower level of inflation. In August 2008 CPI-inflation reached almost 24% in Egypt and in September 2008 18.5% in Jordan (year-over-year).

In the wake of the global crisis, lower world demand for commodities has brought commodity price inflation significantly down (see Box 3), and this decline has been transmitted in domestic prices in the MED countries. Although in comparison with peer economies still at a high level, CPI-inflation in Egypt came down by more than 10 percentage points from its peak (to 10% in May 2009). Also inflation in Israel and Tunisia more than halved.

The lower inflation increases purchasing power for households and businesses, which would normally lead to growth of demand for products and services and thus stimulate economic activity. But, in Jordan and Morocco the declining trend in inflation has been so steep that these economies run the risk of getting into a deflationary spiral. This is not conducive for economic growth as consumers spending might be delayed with a view to the lower price opportunities in the future.

Further easing of fiscal or monetary conditions may be needed to avoid this downward spiralling trend of lower consumer spending which contributes negatively to economic activity, which lowers prices and which in turn leads to lower consumer spending. Contrasting these developments is the rising inflation in Algeria (see green line in Box 3), as the lower global food prices have so far not been transmitted into the domestic prices.

While some MED countries have already implemented fiscal stimulus packages to boost economic activity, also the monetary authorities started easing monetary policy. In sharp contrast with the soaring price developments in the years 2007 and 2008, monetary policy rates could be reduced as inflation rates were coming down which was the right conduct of monetary policy in the time of slowing or even stagnating economic activity.

However, global food inflation has stopped its decreasing trend (see graph in Box 3). In case this trend continues, which becomes very likely should the economies of the developed economies grow again within a couple of quarters, the MED countries may again become trapped in the situation of a high inflation that is hard to combat. For this reason, measures to increase product market flexibility and unblock downward price rigidities would be welcomed.
Box 3  Developments in commodity and consumer price inflation during the financial crisis

Commodity prices

Source: ECOWIN Reuters.

Falling consumer price inflation

Note: The first period refers to the month with the highest CPI-inflation y-o-y during last year.
Although some of the emerging and developing economies in the region have seemingly been less affected by the global crisis because of their less deep and less integrated financial systems these economies are in other respects more vulnerable to shocks. By and large, their public debt is high and their financial buffers are low\textsuperscript{11}. In this context it is fair to distinguish between the oil-exporting MED countries, Algeria and Libya, and the oil-importing MED countries. Financial and economic exposure indicators visualize the sharp contrasts between these two country groups (lower part of Box 4). Algeria and Libya have accumulated significant foreign exchange reserves thanks to their abundant production and exports of hydrocarbons. On average their reserves stand at more than 100\% of their GDP. The existence of these reserves guarantees stability, e.g. for intervening in the money markets in case of sharp exchange rate depreciations of the domestic currency. By contrast, the average foreign exchange rate reserves to GDP ratio of the other MED countries is only 20\%.

Related to this comfortable reserve position are favourable trade surpluses and external debt positions of the oil-exporting countries. On the contrary, the oil-importing countries run trade deficits, which have to be compensated by tourism income, remittances and FDIs in order to show a minor positive balance of payments. Algeria and Libya have been able to pay off their external debt, resulting in average external debt-to-GDP ratio down to 10\%.

Financial development and integration are uneven between oil-importers and oil-exporters, but less so than in the case of trade balances and external debt. Algeria has no stock market, and Libya only just started one, while companies in Egypt, Jordan and Lebanon and to a lesser degree in Morocco, Tunisia and the occupied Palestinian territory have contributed to the private sector development by investing the funds they obtained via their domestic stock markets. Also, the companies and households in these latter countries have been able to make more ample use of bank loans. The loan-to-deposit ratio in the oil-importing countries is almost twice the ratio in the oil-exporting countries in the MED region.

Bank loans from domestic and foreign banks to the non-banking sector increased during the last years in Egypt, Israel, Lebanon and Morocco, among others (see graphs in upper part of Box 4). In Lebanon these amounted even up to 15\% of GDP in 2008. The lack of liquidity in the international banking sector stopped this upward trend, temporarily.

Box 4  Cross border bank loans during the financial crisis and other financial indicators

Bank loans to the non-banking sector (from BIS-reporting banks) decreased sharply in Egypt, Israel, Lebanon and Morocco at the end of 2008.

Financial and economic exposure indicators
2008, as % of GDP, unless otherwise indicated

The oil-importing MED countries have trade deficits, relatively low foreign exchange reserves and relatively high external debt while they receive modest income from tourism, net remittances and net FDI. Positively, their private sector obtains a reasonable amount of loans from banks (which follows from the relatively high loan to deposit ratio) and attracts a reasonable amount of funds via the stock exchange (see stock market capitalization). These funds are conducive to for economic growth and job creation.
5. Trade liberalisation and economic opening

Trade flows have been among the first macroeconomic indicators that signalled the affection by the crisis. World trade volume grew by 4.4% in 2008 at nearly half of the average annual growth of 8.6% over the period 2004-2007. Data for 2009 points to a strong decline in world import volumes (-10%), a situation that can be aggravated as recession spreads among advanced economies.

While the global contracting demand would affect all categories of MED countries alike, the costs of falling trade are getting unevenly distributed across the MED region. As export revenues declined among the MED economies' main trade partners (EU and the US), their imports followed suit, therefore affecting the growth prospects of the countries that are more EU trade dependent, such as Morocco, Tunisia, Libya and Algeria. In countries with a more diversified set of trade partners, the trade impact may not become as radical since import demand from emerging economies is still holding. Oil economies are also suffering from the dramatic fall in oil and primary commodity prices that intervened during the second half of 2008, with export revenues dropped sharply in 2009.

Since trade is a crucial engine of growth in the MED region, countries have been reacting to declining trade flows. In Syria, the authorities have recently adopted a series of measures aimed at protecting the Syrian industry. In Egypt, the temporary export bans on rice and cement have been extended or re-established in 2009. Algeria is reconsidering the schedule for tariff dismantling that it agreed at the moment the Association Agreement was signed with the EU. Although these are rather isolated movements, their ability to spark a protectionist wave across the region cannot be underestimated. If other countries follow, the overall trend towards trade liberalization that has been observed during the last years could be compromised.

During 2008, MED countries continued to implement the provisions of the Association Agreements, including the dismantling of tariffs on industrial products under the Free Trade Agreements (FTAs). Although trade liberalisation in goods will not be achieved with all partners by 2010, a critical mass of industrial and agricultural liberalisation will be completed by this date, while agreed dismantling schedules will continue to be implemented later on. Two countries, Tunisia and the occupied Palestinian territory, have a fully effective and implemented FTA with the EU. Trade tariff dismantling continues in other MED.

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12 A total of 25 measures have been adopted in February 2009. They include reduction on fuel prices, reduction on the price of cement, the stop of the use of purchasing quotas, and the set of minimum prices for importing cloths (European Commission, DG TRADE).
13 The EU concluded bilateral Association Agreements with all Med partners apart from Syria, but this is likely to be concluded in 2009.
Graph 6: Exports of the MED countries to the EU, Africa, Middle East and other regions

Source: IMF Dots.

The final objective of the EU is to establish a fully-fledged EuroMed regional FTA by 2010, implying an expansion of the coverage into other areas such as services and investment, further liberalisation for (processed) agricultural and fisheries products, and the establishment of a dispute settlement mechanism. Bilateral negotiations on the liberalisation of services and the right of establishment have been launched so far with Egypt, Israel, Morocco and Tunisia but they make progress at a different pace. Negotiations on agricultural, processed agricultural and fisheries products have been concluded with Egypt Israel and Morocco continue with Tunisia. Discussions are on-going on negotiations in industrial standards and conformity assessment with the objective to negotiate Agreements on Conformity Assessment and Accreditation (ACAAs) with the aim to encourage industrial integration and give MED partners a stake in the internal market.

In addition, MED countries have agreed to pursue efforts towards the opening of domestic markets beyond free trade in goods and services. In this optic, the establishment of deep and comprehensive free trade agreements (DFTAs) covering all trade in goods and services between
the EU and its MED partners as well as strong legally-binding provisions on the implementation of trade and economic regulatory issues, will be negotiated between the EU and interested MED partners, such as Morocco, and potentially Tunisia and Egypt. Economic integration in the MED region has been nurtured by the conclusion of a network of FTA among Southern MED countries. The Agadir agreement, which aims at establishing a FTA between Morocco, Tunisia, Egypt and Jordan, entered into force in May 2007. Notwithstanding the existence of positive lists of products exempted from customs duties, the four countries accepted the principle of a full liberalisation of their trade of goods. Agadir is also endowed with the Pan EuroMed set of rules of origin, therefore providing for diagonal cumulation of origin between 41 trade partners. Its implementation was until recently hindered by certain national sensitivities concerning the trade of agricultural products or vehicles, but in July 2008 the Ministers of Trade reached an agreement concerning the trade of vehicles. Other countries having signed a FTA are Israel and Jordan. In addition, Egypt, Israel, Morocco, the occupied Palestinian territory, Syria and Tunisia have signed bilateral agreements with Turkey; however, these are limited in scope since they cover essentially trade in goods, which renders the liberalisation exercise incomplete, and limits their positive impact in terms of commercial exchanges and potential GDP growth.

The commitment of MED countries towards deeper South-South economic integration needs to be pursued if the region wants to keep attracting Foreign Direct Investment (FDI) particularly in the traditional sectors boosting job creation. The MED region will face increased competition to attract FDI given that the current worldwide financial and economic crisis has halted international investment in 2008, with FDI flows declining by 22% from a historical record of USD1.8 trillion in 2007. The fall in global FDI has been fuelled by two factors: a reduced capability of firms to invest due to limited access to financial resources, and a reduced propensity to invest due to grim economic prospects, particularly in developed countries that have been hit hard by economic recession (WEF, 2009).

Although the crisis has not spared the MED region in terms of FDI, MED economies have stood firm so far despite a relative slowdown of inward FDI. In 2008 the region continued attracting close to 500 projects, but FDI inflows contracted by 6.5% (USD38 bn in 2008 down from USD41 bn in 2007). Egypt and Algeria were the regional champions and attracted USD10.9 bn and USD7.6 bn, respectively, which in the case of Algeria is a major improvement in comparison to past years. In contrast, Israel and Tunisia experienced a sharp FDI slowdown (50% and 75%, respectively). When expressed as a share of GDP, Jordan and Lebanon recorded the highest net FDI in the region (11.8% and 24.7%, respectively). Lebanon maintained its position as favourite destination of total FDI from the Gulf countries over the 2002-08 period (no less than 30%), which has resulted in FDI-to-GDP ratios doubling over the last four years. In Egypt, although FDI volumes were resilient in 2008, FDI strongly contracted in 2009.14

The combined effect of the global liquidity crisis and falling oil prices has been having a great impact in the Gulf countries, resulting in decreasing volumes of FDI directed to the MED region. Investments in the real estate sector, which have long been privileged by Gulf investors, halved in 2008 amounting to just 19% of the total FDI for 2008.15 Productive investment has also been scaled down. The space left by Gulf countries in 2008 has been filled by European investors (mainly the UK, France, and the Netherlands) which occupy now the first position by issuing 41% of FDI inflows (compared with 17% originating in the Gulf economies). In addition, Europeans

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14 Egypt financed over one hundred projects in 2008 (e.g. concession of the Ein Sokhna port, Red Sea, to UAE’s).
15 Some projects have survived despite the credit shortage, such as Saudi Arabia’s Snasco project in Algeria, and Qatar’s Diar projects in Egypt but some others were just cancelled.
FDI is vital for the region. But current sectoral distribution of FDIs needs to be adjusted. Very often FDI is overly concentrated in large-scale real-state and tourist projects that provide little local added-value, do little to stimulate the utilization of domestic factors of production, and have great negative environmental impacts; moreover, this concentration is increasing year after year. For FDI to make a difference, MED countries need to intensify efforts to attract "quality FDI inflows" conducive to the strengthening and diversification of the industrial fabric according to national priorities, and to finance the large infrastructure needs that are still hampering the economic activity.  

For the European industry, the MED region offers possibilities given the weak European domestic market situation. MED economies offer competitive production costs, represent new markets and have banking systems that have been relatively spared from the crisis. But for FDI to fully materialize, MED countries may want to reinforce efforts to improve the business environment and the attractiveness to foreign investors. The recent adoption of a new law of FDI in Algeria pushing foreign groups operating on its soil to re-invest locally part of the profits made, or Libya's threats about nationalising foreign oil companies may not be the right steps to attract further FDI to the region.

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16 The potential number of jobs created per each million euro invested widely varies across economic sectors. It is highest for the electrical consumer goods (50), and automotive (41) and low for tourism (8) and very low for telecom (1) and energy (1).
6. Public institutions and governance systems

The effect of the impact of the efficiency of public institutions and quality of governance on a country's overall socioeconomic development and its competitiveness in the global economy should not be underestimated. Next to this, many other factors play a role. Despite advances in several key areas of the economic reform agenda under the ENP, such as trade negotiations, tax and customs reform, and improvements in the business environment, there has been a notable standstill in democratic reforms and human rights standards. The recent communication from the European Commission on the implementation of the ENP emphasizes the overall lack of progress on governance issues in the MED region in 2008 (see European Commission, 2010).

Low commitment to political reform was observed in Egypt. Despite significant progress in safeguarding women's and children's rights and in promoting access to primary education and healthcare, much remains to be done in the area of human rights and fundamental freedoms. Jordan made progress in penitentiary reform, transparency and the fight against corruption, but no significant advances were noted as regards the independence of the judiciary and the freedom of association. In Lebanon, progress in the fields of human rights, judicial reform, social sector reform, and administrative reform has also been slow. Several reforms could not be enacted as a result of a long political stalemate and legislative blockage. On the other hand, Morocco's and Tunisia's efforts in the area of social policy have produced satisfactory results in terms of health care, schooling, poverty alleviation and the protection of women's rights. The dialogue with the EU intensified on the fight against terrorism and organised crime. However, persistent deficiencies in the functioning of the judiciary constitute a risk for reforms, and the rule of law has to be strengthened in both countries. Freedom of association and expression, and freedom of the press are yet to be made a reality.

According to the Global Competitiveness Report (UNCTAD, 2009) inefficiency of government bureaucracy is consistently cited by entrepreneurs as hampering business environment in the MED countries. Corruption is also mentioned among the five most problematic factors for businesses in Morocco, Syria, Algeria and Libya. Inadequately educated workforce (Egypt, Jordan, Syria, and Libya) and inadequate supply of infrastructure (Syria, Libya, Morocco and Israel) present yet another challenge to the national policy makers. According to the Global Competitiveness Index (GCI)17 governance of a country is assessed by information factors such as the trust of the public in public institutions, the judicial independence, the efficiency of the legal framework, transparency and the strength of auditing and reporting standards (see graph 7 for an illustration).18 Of all MED countries, Tunisia, Jordan and Israel are perceived to have the more efficient institutions.

Tunisia, ranking 36th on overall GCI, institutions are one of the country's major competitive advantages (22nd), with the high public trust of politicians (16th), transparent policies (15th) and a favourably assessed efficiency of government spending (2nd). Jordanian institutions are also assessed rather positively (27th), with transparency of government policymaking somewhat

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17 GCI measures the overall competitiveness of a nation on over 100 indicators grouped into 12 pillars covering areas such as institutions, macroeconomic stability, health and education, labour and financial markets as well as issues related to inequality, gender bias, mobile phone and internet subscribers. The rankings are based on the Executive Opinion Survey (EOS) completed by top management business leaders around the world. GCI 2008-2009 is available for 134 countries, and for all but Lebanon and the oPt in the MED region (see Schwab and Porter, 2009).

18 As these are limited measures of governance and because of a strong business bias (reflected in the questions of and the respondents to the underlying survey, EOS), the GCI should be used cautiously as a governance indicator.
Note: The indices “public trust of politicians”, “judicial independence”, “efficiency of legal framework”, “transparency” and “strength of auditing and reporting standards” are sub-indices of the index “institutions” (see the top of the graph). The higher the scale on range of 1 (bad) to 7 (good), the better the country ranks in comparison with the other 134 countries in the sample. Source: WEF, Schwab and Porter, 2008-09.

lagging behind (49th). In Israel, public institutions have received a more critical assessment, with increasing concerns about inefficient government spending (60th) and a deteriorating public trust in politicians (61st).

Egypt and Syria rank higher on institutions overall (52nd and 54th respectively), but Morocco (61st) receives a better assessment on favouritism in decisions by government officials, efficiency of government spending, burden of regulation. Transparency of government policymaking is flawed in Syria (106th), Libya (100th) and Algeria (112th). In the latter, it is also coupled with a low public trust of politicians (the region’s lowest 72nd), suggesting the relations between the government and the civil society need to be enhanced. In Egypt, Syria, Libya and Algeria, the quality of education and efficiency of goods, labour and financial markets remain weak, hampering their socioeconomic development. Upgrading its institutional environment should be one of the top priorities of Algeria.

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19 Jordan’s GCI (48th) is influenced by the country’s weak and deteriorating macroeconomic position due to a growing budget deficit and resultant debt level (111th).
20 Israel’s GCI, high at 23rd, and the MED highest, is largely due to outstanding performance on innovation (6th) and business sophistication (23rd).
Many countries in the region have strengthened the legal and institutional framework for combating corruption, which in some cases proved instrumental to radically improve the business environment. All but Syria have ratified the UN Convention against Corruption (UNCAC). Some have national anti-corruption laws. Jordan, a leader in efforts to promote the implementation of UNCAC, tops the ranking of the Arab MED countries based on the 2008 Corruption Perception Index, improving its score from 4.7 to 5.1 since the previous assessment. The 2008 CPI shows lower perceived levels of corruption in Algeria (3.2), Libya (2.6) and Tunisia (4.4). For Lebanon (3.0) and Morocco (3.5), the CPI remained unchanged. Perception of corruption worsened for Egypt (2.8), Israel (6.0), and Syria (2.1).

7. Is EU’s assistance to MPCs commensurate with their economic challenges?

The EU has invested vast sums of financial and human resources into responding to the challenges facing the MPCs. The MEDA II Regulation was the main EU financial instrument of the EMP during the 2000-06 period and the EU made over €5 billion available for its support. This amount was complemented by Member States’ support to MPCs with a contribution of €10 billion over the same period. The vast majority of MEDA II financial resources (40%) was devoted to supporting economic reforms, including trade and private sector development, outpacing the amount devoted to infrastructure (21%) and to social sector (19%). The objective was to develop and strengthen competitive MPC economies and to integrate them into the world economy. A variety of instruments were used: budget support to promote and accompany systematic reforms, technical assistance programmes, and twinning to strengthen institutional capacity. These efforts have produced positive results. A recent evaluation assessed the impact of the MEDA II program on the socio-economic objectives as stated in the second pillar of the Barcelona Process and concluded that many positive developments have been observed in MPCs in terms of increased economic stability, competitiveness and trade (European Commission, May 2010).

The EC’s interventions: i) helped MPCs to better formulate and implement the reforms agreed in the economic road map. The quality and the continuity of the EU-MPCs economic dialogue increased the ownership perception and produced more sustainable results. ii) supported comprehensive structural and sector reforms rather than specific sets of activities by transiting from project support to budget support; and iii) managed to stimulate trade opening and trade liberalisation, and contributed to improve the business environment and the competitiveness. It worked better when the EU aligned its interventions with other multilateral institutions, increasing the political credibility and backup of reforms.

EC’s support for economic reforms, notably with intensive recourse to budget support in the countries where it was possible, has effectively promoted changes in MPCs, and there is ample evidence supporting this statement in the past section devoted to recent economic developments. Several countries have improved the sustainability of their public finance and the resilience of their macro-financial aggregates to external shocks as a result of the implementation of economic reform programmes supported by international donors, including the European Commission.

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21 Recent ratifications took place in Tunisia (September 2008), Israel and Lebanon (February and April 2009 respectively). Syria signed UNCAC in December 2003.
22 The 2008 Corruption Perception Index produced annually by Transparency International looks at perceptions of public sector corruption in 180 countries and is a composite index that draws on 13 polls and surveys from 11 independent institutions. Countries are ranked on a scale from zero (high levels of perceived corruption) to ten (low levels of perceived corruption). The occupied Palestinian territory is not included in the assessment due to lack of data.
However, the convergence of living standards, the increase of exports from the MPCs to the EU, and the intensification of intra-regional trade that would be necessary to reach the objective of shared prosperity have not taken place at the expected pace, notwithstanding the increased financial resources. Economic convergence between both rims of the Mediterranean still remains an issue. In 2008 the average GDP per capita in the EU-27 (in PPP terms) was still five times the average GDP per capita in MPCs. Were the current annual average growth rates to be maintained at around 5-6%, the economic catching-up process to reach 50% of the EU’s average GDP per capita would take decades (estimates by Go-EuroMed range from 22 years for Lebanon to 111 years for Jordan). This clearly proves that although MPCs are growing steadily, they do it at insufficient rates for closing the prosperity gap and in a rather non sustainable manner since economic growth is not generating enough jobs to prevent unemployment rates from growing.

The EU has also faced fierce resistance from MPCs to implement some core politically sensitive reforms such as, for instance, the overall dismantling of trade tariffs, the gradual elimination of inefficient subsidy schemes, and the overhaul of the judiciary system. In addition, tangible benefits to the populations of MPCs in terms of poverty reduction have been hard to materialize. Many interventions have helped to improve the management of national institutions and the economic resilience to external shocks, but these improvements have not always been passed onto the final beneficiaries.

MEDA programme’s successor, the European Neighbourhood Partnership Instrument (ENPI) was endowed with €12 billion of budgetary grants for the 2007-13 financial framework period. This is 32% more than the €8.5 billion allocated in the previous 2000-06 period (divided between the ENPI’s two predecessor instruments: MEDA and TACIS). Of these €12 billion, only the country programmes for the Southern Mediterranean countries account for almost €3 billion.

The ENPI also includes two new features: i) the Governance Facility with an allocation of €300 million which has rewarded partner states with additional funding on the basis of an evaluation of the good performance in the implementation of the Actions Plans; and ii) the Neighbourhood Investment Fund (NIF) with an allocation of €700 million which has provided grant money to leverage lending and investment resources from International Financial Institutions (IFIs), particularly the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD). For MPCs, the NIF coexist with the Facility for Euro-Mediterranean Investment and Partnership (FEMIP), which gives the EIB access to European Commission (COM) budgetary resources. Indeed, the EIB has been managing three different types of funds made available by the EU (technical assistance, interest rate subsidies, and risk capital) in order to create bridges between the EIB banking activities and the economic objectives of the EMP. In addition, the EIB has committed to lend from their own funds amounts comparable to the ENPI’s grant totalling €12.4 billion for the 2007-13 period, out of which €8.7 billion to the MPCs.

By the volume of funds mobilized by the ENPI and the bilateral approach to economic reforms institutionalized by the ENP we can reasonably expect that some MPCs will seize the opportunity to reform faster in order to maximize their chances to fully benefit from deeper integration in international markets. Some others will hesitate between deeper integration and the risk of increasing macroeconomic vulnerabilities.
So far, no substantial evaluation of the impact of the ENPI has been carried out. Critics claim that the EU has devoted insufficient financial means to achieve the declared goals of promoting a common prosperity area and accuse the EU of lack of commitment to the Mediterranean region. This statement does not hold in light of the importance of the past EU assistance to the MPCs and at the volume of resources committed under the ENPI. The EU invested half of the ODA to the Mediterranean region over the period 2000-2006, totalling USD 15 billion (of which USD 5.5 billion from the COM and USD 9.5 billion from the EU Member States).

However, achieving growth and transforming growth into an engine for economic development is not just merely function of pumping financial resources into EMPs. Several features would need to be improved in order to achieve the intended objectives of the EMP:

1. The issue of coordination. The EU is a key development actor in the Euro-Mediterranean area, but many others donors are also present in the region, which raises major issues or coordination between the EU and these lending/investment agencies. Some attempts of coordination took place between the COM and the World Bank at the time when the Actions Plans were drafted but a more formal operational alliance has not grown to life in spite of the benefits that their combined leverage could present. Joining forces among donors would prevent MPCs playing donors against each other and would make a stronger case for policy-shaping.

2. The issue of the institutional framework. A bulk of literature on aid effectiveness has revealed that unless economic aid finds a fertile ground, it will most likely be wasted and unable to achieve the intended objectives. Fertile ground implies that MPC economies need a more favourable environment, first and foremost improving institutional governance by becoming accountable to the public and improving the business environment where the private sector can flourish, establish economic growth and jobs.
8. Conclusions

While facing several fierce external shocks to their economies in the recent past, such as the soaring global commodity prices, the countries at the southern Mediterranean rim have been on the right track in reforming their economies. However, the most recent shocks related to the global economic and financial crisis are breaking trends. Economic growth is slowing down, and job losses are following. Opting for the appropriate policies is difficult, not least in view of the fact that these economies are relatively vulnerable. The risk of fiscal unsustainability, the relatively weak private sector, the high unemployment rates, and weak automatic stabilizers, the shallow financial sectors that hampered the rise of economic activity and thus welfare levels in the past, and the lack of buffers make it a real challenge to make the right choice of policy measures to mitigate or even reverse the impact of the global crisis on their economies.

Maintaining positive growth rates in the years to come will depend, more than ever, on sound economic policy choices. MED countries will need to keep creating favourable conditions to attract investments, provide job opportunities and increase productivity and exports. Economic openness, more than ever, will be conducive for the domestic economies, be it not in the short term than in the medium term. This entails further efforts to integrate in regional and international markets, keep their markets open, diversify exports and markets, implement investor friendly reforms, and assess the cost and benefits of current expenditure policies. By deepening the economic and financial integration, rather than by isolating from international markets the MED region can reap the benefits of globalisation. The risks and challenges embedded in deeper economic integration can be balanced by introducing buffers in the form of strengthened supervisory and financial regulations and compensatory measures for the sectors most likely to be touched by increased international competition.

And although countries might not be particularly inclined to undertake further reform efforts in times of uncertainty, there may be a window of opportunities to implement some fiscal policy measures, e.g. on the better targeting of commodity subsidies, the flexibility of good markets or tax collection (see Albers and Peeters 2009). The lower oil prices are a golden opportunity to undertake a serious reconsideration of inefficient food and oil subsidy schemes across the region. Their removal, when politically feasible, or their gradual phasing out, can provide more leeway for the fiscal authorities for discretionary spending. New and more efficient mechanisms to protect the more vulnerable layers of these societies need to be developed so the impact of the crisis does not fall disproportionally on them. As for monetary policy, countries where Central Banks have undertaken reform efforts that have strengthened the prudent management and governance of domestic banks are in a better position to weather the global financial storm. Bank’s provisions of liquidity and monetary easing are helping the economies of Egypt, Israel, Morocco and Tunisia by making capital more accessible to private banks in a bid to stimulate lending. However, Central Banks would need to carefully monitor inflationary pressures before injecting more liquidity into their economies in a bid to further stimulating the economy. A proper balance between fiscal and monetary policies needs to be crafted on a case by case basis.

Last but not least, governance and improvements in the institutional framework should remain high on the agenda. The legal framework should ensure sufficiently independent public institutions. In addition to this, excessive bureaucracy and red tape is to be suppressed, transparency and trustworthiness to be augmented and operations have to become efficient, to prevent fraud and mismanagement.
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