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Challenges and levers for sustainable growth:
Investing in the Mediterranean region three years after the Arab Spring

Introduction

The Southern and Eastern Mediterranean region demonstrates great diversity, in terms of income levels, population, human development, natural resource endowment and economic structures. At the same time, Mediterranean countries face common challenges in improving economic performance, especially within the current political context. GDP per capita in the region increased 25% between 2000 and 2012, a better performance than that of the European Union over the same period (+12%), but one which lags behind other emerging markets (e.g. China: +200%; India: +90%; Sub-Saharan Africa: +80%). Through the combination of low growth and a rapidly increasing working age population, unemployment, especially among the young, emerged as part of a wider problem for the region, featuring weak labour markets with too few and insufficiently attractive employment opportunities. With around 30% of the population aged under 15, millions of young people every year are entering the labour market. One of the region's greatest assets, a dynamic labour force, is at present looking for opportunities which the countries' economies cannot yet provide.

At the heart of these challenges lies the fact that the rate of firm formation in the Mediterranean region is particularly low and that, even when companies are created, they tend to stay small and not grow into large market players. This lack of dynamism has a detrimental impact on employment, including of skilled labour. As public sector job creation is no longer a sufficient solution, the private sector will have to play in the future a greater role in creating jobs. Jumpstarting the equitable and sustainable growth required to make rapid job creation possible is the primary socioeconomic question facing the Mediterranean partner countries (MPCs) today.

Based on the EIB's 35 years of experience in the region, this note aims to stimulate reflection and discussion on key areas which the Mediterranean countries could consider when seeking opportunities for growth and attracting further investment. It looks both at examples of successes which can be extended as well as domains where innovative solutions can be sought. These ideas are suggested as complements to the current work of the EIB, and the Bank will remain an active partner in its traditional sectors of intervention. Furthermore, the ideas themselves are not necessarily new – most are already familiar and many have already been embedded in national strategies. As such, the intention is to be neither exhaustive nor universal, but rather to highlight some of the region's key competitive advantages and opportunities that have not yet been developed to their fullest extent and which the Mediterranean countries and their partners could support further.

1. Investing in infrastructure: creating foundations for growth across sectors

The EIB estimates that over EUR 23 billion of investments are required every year until 2020 in order to meet the Mediterranean region's infrastructure needs, whether for upgrades or new developments. Of this amount, transport accounts for some 47% and energy for 40%. Although such infrastructure investments undoubtedly constitute a significant expense, they also represent a huge opportunity to stimulate the region's economies, not least in terms of both direct and indirect employment creation. Decision makers should view this expenditure not only as 'infrastructure projects', nor as parts of national infrastructure roadmaps, but rather as investments which underpin long-term growth across all sectors of the region's economies. A comprehensive approach to infrastructure could see investment in electricity transmission capacities go hand in hand with energy efficiency measures, and new water treatment facilities as part of a broader water management strategy. Communications infrastructure supports innovative businesses; housing improvements and upgraded road networks can lead to improved energy efficiency, as well as improving the lives of the population; and investments in marine transportation facilities both promote safety and also serve as a focal point for international trade and exchanges, as seen at the port of Beirut, which serves as transhipment hub for the region and has seen impressive revenue growth over past years, in spite of the adverse economic context.

2. <u>Investing in regional integration: expanding the market potential of the region</u>

While most Mediterranean partner countries are relatively open worldwide – with merchandise trade over GDP ratios for the most part well above 50%[1] – the progress of integration across the region has not yet lived up to expectations. Intra-regional trade remains low, affecting the influx of private investment. Nonetheless, frameworks such as the Agadir Agreement between Egypt, Jordan, Morocco and Tunisia demonstrate that cooperation can be upscaled. Deepening regional ties could enhance competition in Mediterranean markets, supporting stability and promoting the region as a large and coherent market for foreign investment. One step towards achieving this success would be to focus on improving the liberalisation of cross-border trade in services: at present, some of the highest barriers are found in professional, financial and transportation services. In order to achieve this, further work is needed to reinforce and standardise regulatory frameworks across the region. Jointly created regional 'services knowledge platforms' are one tool which might help achieve an integrated services market via the development and sharing of best practices across the region.[2] Other opportunities also exist, both for physical connections (trans-regional transport, logistics or communications infrastructure) and also in terms of harmonisation of policies and standards; it is necessary to consider both of these axes equally in order to enjoy the full benefits of regional integration.

3. <u>Investing in renewables: harnessing the region's energy potential</u>

Sustainable, long-term economic growth in the Mediterranean region requires that countries diversify their energy sources. Despite their enormous potential, Jordan, Morocco and Lebanon import 95% or more of their energy consumption, and only Algeria and Egypt are net energy exporters.[3] Renewables could provide a further export opportunity for several countries, providing that suitable infrastructure is developed. Alongside their environmental benefits, renewable energy (RE) projects have the capacity to create additional jobs by virtue of their relatively high labour intensity compared to traditional energy projects. These jobs may be expected not only in project implementation but also upstream in the local manufacturing sectors, including high-tech developments. As for any long-term investment project, the maintenance of these facilities, vital for their sustainability, can also provide further opportunities for skills development and employment. Public policy is crucial for the development of the RE sector: currently, high subsidies on traditional energy sources are in fact raising the gap between the price of renewable and non-renewable power, hindering private sector investment despite the region's abundant natural endowment, notably in terms of solar and wind energy. It must be acknowledged that some countries, such as Egypt, Morocco and Tunisia, have recently raised prices. Positive impacts are also resulting from the exchange of good practices between the EU and the Mediterranean countries, as under the programmes led by the MEDENER association of energy regulators. Progress in this respect is testament to the implication and commitment of the Mediterranean countries.

[1] Data extracted from World Bank "Merchandise trade (% of GDP)", available via http://data.worldbank.org/indicator/TG.VAL.TOTL.GD.ZS
[2] "Trade Integration as a Way Forward for the Arab World", World Bank (2011)
[3] Data extracted from World Bank "Energy imports, net (% of energy use)", available via http://data.worldbank.org/indicator/EG.IMP.CONS.ZS

Further incentives for investment could include fiscal and financial benefits (e.g. state guarantees), regulatory improvements (establishing predictable regulations, creating independent regulators) and market-based instruments (favourable grid access for RE, smart grids, long-term guaranteed feed-in tariffs).[4]

4. Investing in agriculture: moving up the value chain of agribusiness

By improving the productivity of their agricultural resources, Mediterranean partner countries could improve food security while at the same time promoting sustainable economic growth. This requires a reassessment of the whole value chain of agricultural products and a refocusing on “modern agrotechnologies, information, infrastructure, skilled people and improved rural-urban linkages”.[5] Part of any such reassessment should be a consideration not only of the impact of agriculture on climate change, but also the long-term impact of climate change on agriculture, in order, for instance, to avoid over-reliance on single crops. At present, agriculture is the biggest consumer of water in the Mediterranean region. An integrated water resource management approach (IWRM, focusing on managing demand within the available resources, rather than being based solely on supply management) should be adopted in order to improve the efficiency of water use. Meanwhile, investments in infrastructure should be accompanied by upgraded maintenance efforts in order to ensure the sustainability of both new and old components of the water system. Other projects could be developed in partnership with industry players such as those in the organised retail sector, which suffers from wastage estimated at up to 29% of perishable crops due to an insufficiently developed cold chain.[6] Elsewhere, investments in processing and packaging facilities would lead to higher-skilled jobs and would allow the region to benefit from a greater share in the value added of its often famous foodstuffs (such as olive oil). This requires investments in both physical capital as well as in development of the required business skills, including in the fields of market research, product development and packaging. Agribusiness incubators – perhaps integrated into a wider entrepreneurial incubation system – could be one way of supporting this growth. Earlier in the chain of business creation, there is an important role to be played by microfinance and the setting-up of cooperatives to provide support for small producers. A parallel factor in marketing higher value products is to improve regulation and awareness of quality standards, including the use of regional labelling, such as the Geographical Indication recently created for Morocco’s argan oil. This label is just one outcome of a European Commission-funded study into the argan industry, which has demonstrated the potential of agriculture to facilitate progress across domains including women’s lives, worker organisation, research, the environment, local development and regulation.

5. Investing in tourism: diversifying into heritage, culture and hospitality

Already, travel and tourism is significant for the Mediterranean region, for instance with a direct contribution to GDP of around 9% in both Lebanon and Morocco and almost 7% in Egypt (some USD 17 billion) in 2012, despite the political instability in the region, which has a direct negative effect on the tourism sector.[7] This impact can be increased even further if countries are able to augment their traditional offer of recreational tourism with higher value tourism, whether based on the historical and cultural heritage of the region or other services. As highlighted by the FTF Medinas 2030 study,[8] the development of heritage sites, such as

[4] Supplementary information from “OECD Renewable Energies in the Middle East and North Africa”, OECD (2013)
[5] “Report of the Regional Agro-Industries Forum for the Middle East and North Africa”, Food and Agricultural Organization of the United Nations (2012). Technologies in agro-industries can range “from simple technologies such as single-product drying, to more complex technologies such as irradiation of formulated products.” (“Agribusiness and Agro-Industrial Strategies, Policies and Priorities for achieving Pro-Poor Economic Growth in the Mena Region”, Food and Agricultural Organisation of the United Nations (2012))
[6] Ibid.
[7] Data extracted from World Travel & Tourism Council “Travel & Tourism Direct Contribution to GDP”, available via http://www.wttc.org/research/economic-data-search-tool/
[8] “Pre-Operational Study on the Rehabilitation of Historic City Centres (Medinas) in Southern and Eastern Mediterranean Towns”, EIB FEMIP (forthcoming)

historic medinas, brings not only revenue to a country but also broader economic value. This economic value, as well as elements such as a sense of national and cultural identity stemming from authentic surroundings, which is often greater than the pure financial gains, must be considered by authorities when assessing such projects. A further option for diversification in the Mediterranean countries is medical tourism. In a well-managed system, the investments in infrastructure and personnel which are required to meet the needs of tourists can bring benefits to both domestic and foreign patients. The economic scope for this sector is great: in Jordan, for example, an estimated USD 600 million in revenue was generated from the over 100,000 non-Jordanian patients treated in the country's hospitals in 2001.[9] The cross sector nature of all these initiatives – from heritage development to medical tourism – requires governments to adopt a coordinated approach (e.g. involving tourist organisations in urban development plans; ensuring suitable access for medical patients when developing airports etc.) It may therefore be appropriate to establish national bodies to coordinate and promote these activities, as well as to provide a central contact point for visitor queries.

6. Investing in the media sector: driving regional innovation

One of the main trends in media markets worldwide is that of a shift from traditional print and television media to interactive online services. Although at present, advertising spend in the Mediterranean region remains largely focussed on the traditional sector, the sector is growing at an impressive rate (some 37% p.a., to reach USD 2.8 billion in 2016)[10] and the high penetration of fixed and mobile broadband in the region makes it well-positioned to take advantage of this shift. This potential is heightened by the fact that similar sociocultural heritage shared by the region's some 300 million people creates a vast potential consumer base. Furthermore, the relative youth of the region's population could enhance the adoption and rapid propagation of new media technologies. All this creates scope for innovative companies to introduce new services across the region, which could soon be exported beyond its borders, with concomitant opportunities for hardware and infrastructure providers. In this context, companies and regulators must embrace and understand the convergence of media technologies. The broader relationship between media and other areas of the economy should also not be ignored: media, advertising and online commerce are now intrinsically linked, providing further opportunities for growth and regional integration. Venture capital financing to support this emerging sector is crucial.

7. Investing in entrepreneurship: developing skills for employment creation

Despite its population resources, the Mediterranean region's firm formation rates are among the lowest in the world. The foundation and growth of MSMEs in the region would stimulate rapid job creation and also lessen the risk of losing creative talent through emigration. To achieve this goal, it is vital to establish a business environment which promotes private sector activity: according to the Doing Business Report, the quality of the regulatory environment in all the region's countries, apart from Israel and Tunisia, is below the world median.[11] Further action is therefore required in all areas, including financing (improving access to both debt and equity financing, especially small-scale microfinance and scale-up funds), business regulation (creating legislation to facilitate entrepreneurship, decriminalising bankruptcy, ensuring equal treatment of all applicants) and the general environment (promoting positive cultural attitudes to entrepreneurship, providing suitable infrastructure etc.) Another important mismatch exists in the field of education, in which students are not sufficiently well-endowed with the practical skills required to create and manage their own business. Developing appropriate education programmes for entrepreneurs would not only benefit start-ups, but could also serve to promote innovative thinking in the established sectors. Local actors are already taking steps to facilitate the necessary developments to

[9] "Country Cooperation Strategy for WHO and Jordan 2008–2013", World Health Organization (2010)
[10] Data from AME Info (http://www.ameinfo.com/online-advertising-rockets-37-growth-mena-345249)
[11] "Doing Business", http://www.doingbusiness.org, World Bank/IFC (2013)

allow the youth in the region to fulfil their aspirations of creating businesses.[12] Indeed, in some cases, young people are both the source and the target of market opportunities, for instance in the creation of innovative tools to help job seekers and recruiters meet via mobile technology. What is needed now is for these promising local initiatives to be scaled up throughout the region, in a holistic and partnership-based approach, where individual efforts would be intensified and accelerated by cross-regional cooperation. A mechanism for sharing progress being made in the region would be an initial step towards this goal.

8. Investing in the region's diaspora: increasing productivity of migrants' remittances

If the youthful domestic population is one of the region's competitive advantages, another is its large diaspora. In contrast with the global trend, migrants' remittances in the Mediterranean countries can be many times the level of Foreign Direct Investment (FDI), reaching up to 20% of GDP, and thus making them a vital source of foreign exchange.[13] Indeed, Morocco, Egypt, Lebanon and Jordan are among the top ten recipients of remittances worldwide. Although remittances are most frequently used for immediate household consumption, government policies (both in sending and recipient countries) can improve their economic productivity. One route is to facilitate more efficient and less expensive transmission of remittances by improving the networks used to make payments. This may require partnerships between local and foreign banks and potentially legislation to liberalise payment networks. Such an approach has the added benefit of encouraging development of the domestic banking system, both for receipt and also for onward investment of these payments. Another option is to guide remittances into longer-term investment projects. This may be achieved, for instance, via pooling instruments or programmes which encourage expatriate graduates to return home after some years to invest their capital in local businesses, thereby promoting both knowledge and capital transfer.

Conclusion: a nexus between investment and policy across the region

The above discussion presents a selection of levers to be explored by the Mediterranean countries. Even from this non-exhaustive list, it is clear that the region is endowed with extensive opportunities to promote employment and sustainable growth. The Mediterranean region is still at a stage where growth in GDP/capita is creating noticeable new markets. The region's population, including a high percentage of young, ambitious and educated individuals, constitutes both a resource to utilise in manufacturing growth and a source of market demand, but investments are required in human capital in order for this underlying resource to flourish. As the countries develop the options available to them, a holistic approach is required: the prospects of the region rely on the ability to create a nexus between investments in physical (infrastructure) and human capital, on the one hand, and a regulatory and policy environment which is favourable to such business initiatives, on the other. The EIB FEMIP stands ready to apply its expertise in collaboration with the partner countries in order to develop whichever of these levers of growth they might choose to explore further.

[12] As an example of these aspirations, a 2009 Global Entrepreneurship Monitor report found that 58% of active Tunisians were interested in starting a business within 3 years.
[13] "Study on improving the efficiency of workers' remittances in Mediterranean countries", EIB FEMIP (2006)