FEMIP
Facility for Euro-Mediterranean Investment and Partnership

2004 Annual Report
Countries of FEMIP operations in 2003-2004

The FEMIP team
A word from the Vice-President

This year – 2005 – which has been designated the “year of the Mediterranean” by the Foreign Ministers and is due to conclude with the celebration of the Xth anniversary of the Barcelona Declaration, it is a great pleasure for me to introduce this very first edition of the FEMIP Annual Report.

FEMIP, which has been operational since October 2002, is the EIB's support facility in the Mediterranean Partner Countries and the most active forum for economic and financial dialogue between the two sides of the Mediterranean. In December 2003, its remit was reinforced and the range of its activities expanded. While this first report focuses in particular on 2004, it therefore seemed appropriate that it should cover FEMIP's activities between 1 October 2002 and 31 December 2004.

As you peruse this document, you will thus be able to see what work the EIB teams have accomplished throughout this period in furtherance of the task entrusted to the Bank by the 35 countries concerned: to give a new impetus to the Euro-Mediterranean economic and financial partnership.

This first review is, however, only an interim report on the progress made towards creating an area of shared prosperity. That, in a nutshell, is the aim of FEMIP, which will press ahead with its efforts in 2005 to support the modernisation and opening-up of economies, promote regional cooperation, encourage the development of private enterprise and foster dialogue with all the parties involved.
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Origin and remit of the Facility for Euro-Mediterranean Investment and Partnership (FEMIP)

The Facility for Euro-Mediterranean Investment and Partnership (FEMIP) is a product of the political will, expressed on both sides of the Mediterranean, to give a new impetus to financial cooperation between Europe and the Mediterranean Partner Countries. In Barcelona, in March 2002, then in Brussels, in December 2003, the EU Heads of State and Government drafted the “road map” for this initiative, the main objectives of which are to promote economic development and political and social stability in the Mediterranean. Capitalising to that end on the 30 or so years’ experience acquired by the European Investment Bank (EIB) in the region, FEMIP gives priority to expanding the private sector and to regional integration projects, while at the same time encouraging economic and financial dialogue between European countries and the Mediterranean partners.

Notwithstanding the boost given in November 1995 to the development of Euro-Mediterranean relations through the launch of the “Barcelona Process”, substantial progress, at least in economic terms, still has to be made. The region remains divided, in particular between the countries that possess oil resources, where reforms are making slow progress, and the other countries, which have made significant headway. It has also suffered from weak regional trade growth and been unable to attract sufficient investors owing to the fragmented nature of its market. It is therefore lagging behind economically to a worrying extent, its economic growth rates in particular being too low to absorb the demand for jobs on the labour market.

In view of these factors it was decided to assign a new purpose to the Euro-Mediterranean economic and financial partnership, by calling for renewed efforts on both sides of the Mediterranean. The Mediterranean countries were thus invited to apply more consistent macroeconomic policies, to accelerate the pace of economic reform and move towards better governance.

Europe for its part undertook to strengthen its contribution in terms of expertise and resources by increasing its lending and focusing on sectors that offer the greatest leverage in order to encourage structural reform and promote private initiatives, whether local or foreign.

The various components of this enhanced package were brought together under FEMIP, whose implementation was entrusted to the EIB. Agreed in principle by the Barcelona European Council meeting (15 and 16 March 2002), FEMIP was launched at the Valencia Euro-Mediterranean Conference of EU and Mediterranean Partner Country Foreign Ministers (22-23 April 2002).

With a view to a free trade zone in 2010, the prelude to the emergence of a Euro-Mediterranean area of prosperity and stability, FEMIP’s activities officially commenced in October 2002 on the basis of the following five priorities:
Facility for Euro-Mediterranean Investment and Partnership

Greeting with satisfaction the results achieved by FEMIP at the end of its first year of activity, the Euro-Mediterranean Finance Ministers sought, at their November 2003 meeting in Naples, to further extend the scope of its operations. This proposal was ratified by the Brussels European Council meeting (12-13 December 2003). FEMIP was reinforced by introducing the following features:

- giving priority to financing the private sector and projects that help to create an environment that is conducive to private investment;
- involving the partner countries in FEMIP’s guidelines and promoting greater dialogue to determine the obstacles to private investment and search for appropriate solutions;
- increasing the presence on the ground by opening representative offices;
- continued lending for infrastructure projects that will encourage economic development and improvements in the quality of life, by extending FEMIP’s remit to cover the health and education sectors;
- increasing the level of lending in the region.

creation of a “special FEMIP envelope” (SFE) to allow higher risk operations in support of the private sector;

establishment of a trust fund to bolster technical assistance and provide equity and quasi-equity finance;

strengthening of political dialogue through annual FEMIP ministerial meetings, whose work is prepared by a high-level committee of experts consisting of representatives of the Finance Ministries and external players;

opening of FEMIP offices in the Maghreb countries.

In accordance with the Brussels European Council Decision, this mechanism will be evaluated next year to enable the European Council of December 2006 to decide on the possible creation of an EIB majority-owned subsidiary.
2004 Highlights

- The Special FEMIP Envelope (SFE) came into being in January 2004 with the decision of the EIB’s Board of Governors to authorise an initial allocation of EUR 100 million in provisions to higher risk operations in the Mediterranean;
- The first meeting of the Committee of Experts was held in Marseille in February 2004;
- The Ministerial Committee met in Alexandria in June 2004;
- The Tunis office was opened in December 2004 (to be followed by the Rabat office in June 2005);
- The Trust Fund was established in December 2004, with the receipt of the first contributions from the EU Member States;
- Overall in 2004, 25 projects for a total of EUR 2.190bn were signed in the FEMIP region, bringing to 54 and EUR 5.025bn respectively the number and volume of projects signed by FEMIP between October 2002 and December 2004;
- In May 2004, the European Commission, the EIB and the World Bank signed a memorandum of understanding aimed at strengthening their coordination in the region;
- At the end of 2004, just over 70 staff were contributing to operations in the region, including some 30 in the FEMIP department alone.
Institutional framework

Building on the experience acquired by the EIB teams in the Mediterranean over nearly 30 years, FEMIP has rapidly expanded.

Its lending operations are conducted mainly from the Bank's own resources under the Euromed II mandate, which was entrusted to it by the EU Member States. Risk is thus covered by the Guarantee Fund for external actions. The mandate initially amounted to EUR 6.425bn, to be committed over the period 2000-2007, but was increased to EUR 6.520bn after allocation of the balances that had not been used by the Accession Countries prior to joining the Union.

This sum was topped up by a further EUR 1bn, still from the Bank's own resources but without recourse to the Guarantee Fund, under the Euro-Mediterranean Partnership Facility (also known as the “Nice Facility”). Established in 2001 on the recommendation of the Fourth Euro-Mediterranean Foreign Ministers’ Conference (held in Marseille on 15 and 16 November 2000), this facility is intended to finance regional projects and projects in the mutual interest of the European Union and the Mediterranean Partner Countries, particularly in the communications and energy sectors.

Decisions on these financing operations are taken by the EIB’s Board of Directors, on a proposal from the Management Committee. Since FEMIP was set up, however, the beneficiary countries have been involved in defining the lending policy and the broad lines of the Euro-Mediterranean financial partnership. This dialogue is also conducted under the FEMIP Ministerial Committee, which brings together once a year the Finance Ministers of the 25 Member States and 10 Partner Countries.

A technical assistance fund using grant aid allocated by the European Commission under the MEDA Regulation has also been set up under FEMIP. Thus, over the period 2003-2006, a maximum of EUR 105 million may be used for identifying, preparing and supporting the implementation of projects financed by FEMIP. The FEMIP teams assess the relevance of the technical assistance requested, for which contracts are subsequently awarded in accordance with the procedures set out in the “Practical Guide to contract procedures financed from the General Budget of the European Communities in the context of external actions”.

FEMIP also deploys the venture capital allocated by the European Commission under the MEDA Regulation to encourage equity and quasi-equity injections or capital increases for small and medium-sized enterprises in the Mediterranean countries. Over the period 2001-2005, this instrument involved a sum of EUR 140m. Depending on the amount of the allocations, it is the EIB’s Management Committee or Board of Directors that is responsible for taking the relevant decision.

Finally, FEMIP can now draw on the resources made available to it under the Trust Fund. As at 31 December 2004, the contributions pledged by the Member States for the period to the end of 2006 totalled around EUR 30m. Applications for assistance under the Fund are subject to the approval of the Assembly of Donors, on a proposal from the Bank’s Management Committee.

Meeting of the EIB’s Board of Directors
In the context of its environmental objectives, the European Commission subsidises the interest rates of FEMIP loans for its environmental projects, thereby enhancing the economic and financial impact of projects. In 2004, four projects qualified for such interest subsidies, totalling EUR 26m:

- two projects in Morocco, involving the collection and treatment of wastewater in the cities of Fez, Safi and Beni Mellal. These projects will also enable FEMIP to become involved in improving the management of the authorities in charge of sewerage. It is thus pressing ahead with its funding programme for this sector, which has already received six loans for Morocco’s major metropolitan areas;

- a project in Morocco to clean up a power plant in Mohammédia. This project will help to optimise output from the existing power plant, while significantly limiting the environmental impact of its operations throughout the Greater Casablanca region. Pollution levels will thus be brought into line with European standards;

- a wastewater project in Lebanon, entailing the upgrading and extension of the sewerage infrastructure of the two coastal cities of Saida and Sour, 40 and 80 km respectively to the south of Beirut.
Investment climate in the Mediterranean in 2004

In general, the economic and financial situation in the Mediterranean region improved in 2004, although the need for continuous structural reforms remains. Despite a significant increase in oil prices, growth in the region accelerated in comparison to the previous year and reached a regional average of 6.1% (compared to 5.4% in 2003). This upturn was due to strong growth in Turkey (8.5%), which accounts for approximately one third of the regional gross domestic product (GDP), as well as improved economic activity in Israel, Jordan and Egypt.

In 2004 low interest rates prevailed in the major mature economies, accompanied by abundant liquidity. On the other hand, the central bank policy rates generally remained below 5% in most Mediterranean Partner Countries. The two exceptions were Egypt (10%) and Turkey but, owing to continued disinflation, Turkey was able to reduce the rates from 25.5% at the beginning of 2004 to 20% by the end of the year. Global investors’ “search for yield” led to increased capital flows in this region, which benefited from this development via more favourable financing conditions, reflected in relatively low bond spreads.

The favourable international environment was also reflected in low bond spreads for Mediterranean countries’ sovereign debt. Moreover, the spreads of Turkey and Lebanon, which exhibited the greatest spreads in the region, declined over 2004. Turkey thus earned an upgrade in its sovereign rating in 2004, while ratings for other Mediterranean countries remained unchanged.

Growth in the net oil-exporting countries such as Algeria, Egypt and Syria was supported by high oil prices. However, for the majority of the Mediterranean countries, which are net oil importers, the prosperous growth can be explained by higher remittances and by the robust global expansion, which more than compensated for the restrictive effects of higher oil prices.

At least three other specific sub-regional developments also contributed to higher growth and favourable investment prospects:

- Egypt, Lebanon, Tunisia, Jordan and Morocco benefited from increased tourism activity in terms of greater international arrivals as well as higher revenues.
- Improvement in the security situation seemed to positively affect the whole region, but in particular the Eastern Mediterranean, and this will remain a crucial element for further economic development in 2005.

The increase in oil prices did not create inflationary pressures in the area and, owing to the disinflation process in Turkey, the region exhibited a single-digit average inflation rate of 6%. Moreover, in some countries the higher oil prices have not been fully reflected in the Consumer Price Index (CPI) owing to price regulation and/or oil subsidies.

The strong performance of the agricultural sector in 2004 may have lowered agricultural prices and thus allowed price pressures to ease. Also, more credible monetary policies ensured that higher oil prices were not directly reflected in general price increases in the region. Finally, the relative weakness of the US dollar compared to the Mediterranean countries’ currencies kept inflationary pressures in check.
pressures down, particularly in countries where the exchange rate pass-through from US dollar fluctuations is rather strong.

The biggest challenge facing the region is the fiscal situation, as fiscal imbalances and public debt have grown over the period. Oil-exporting countries exhibited an improvement in their fiscal account balances, but non-oil deficit to non-oil-GDP ratios are very high, which shows that the fiscal situation is heavily dependent on oil revenues. In the countries where energy is subsidised to a certain extent, rising oil prices impose a significant burden on the government budget and thus on consolidation efforts. Such a situation also poses a greater risk of crowding out private investment.

Reducing general government debt remains the most important challenge for countries such as Lebanon (where the debt to GDP ratio reached 177.9% in 2004), Egypt (109.1%), Israel (108%), Jordan (92%) and Turkey (83.3%).

Thus, it is important that countries focus on appropriate and transparent medium-term fiscal rules that will help maintain sustainable government budget balances.

The current account balance reflects the countries’ oil-exporting capacity. Algeria benefited from high oil revenues and thus exhibited a current account surplus of 15.4% as a share of GDP. On the other hand, the current account deficits of the West Bank/Gaza and Lebanon remained high, at 17.5% and 12.2% as a share of GDP, respectively. Owing to the import-sustained growth, Turkey’s current account balance worsened compared with 2003. Jordan and Morocco experienced weaker current account balances, although they remained in surplus. High worker remittances were again an important source of finance in 2004.

In fact remittances play a rather important role in supporting the region’s economic development. They are a more important source of external finance than the combined value of foreign direct investment (FDI) and official aid flows to the region. Since 2000, the main Mediterranean countries have received an average inflow of EUR 11bn, which represents about one sixth of total flows to the developing world.
Owing to beneficial monetary developments, investment capital began to expand in the region at the end of the 1990s, particularly in Tunisia, Morocco, Egypt and Jordan. However, the rate of investment remained rather sluggish. Therefore, it is not surprising that on average remittances represented 3.5% of GNP between 1993 and 2002, while FDI represented only 0.1% of GNP.

The volatility of stock markets and the impact on regional economies after the September 11 2001 attack in the USA influenced both the rate of investment by funds as well as managers’ ability to find new sources of finance. However, some improvement was witnessed after the second quarter of 2003.

For example, Turkey’s EU membership prospects and the Government’s privatisation reforms encouraged FDI inflows, although the country still needs to rely extensively on large short-term capital inflows. The results of the privatisation programmes in Morocco and Jordan have been encouraging. For example, after two successful privatisations – the sale of Morocco’s second GSM licence in July 1999 and a 35% stake in Maroc Télécom (MT) in December 2000 – a number of state holdings are currently lined up for sale (including two sugar plants, a printing firm, a car assembly plant and three banks).

Following the implementation of its privatisation programme in 1987 the Tunisian Government sold off a number of small loss-making firms, but it was not until 1998 that it began to dispose of large profitable businesses, with the sale of four cement factories to European purchasers. Although the programme subsequently slowed down, the Government, encouraged by institutions such as the IMF and the World Bank, quickly moved ahead with bank privatisation. Only three of the 14 commercial banks remain in state hands, though their share of the banking sector remains large. At the same time, the Government has worked hard to encourage the private sector, especially foreign investors, to take up concessions for major infrastructure projects.

The customs, taxation and privatisation reforms are aimed at stimulating domestic economies by raising disposable income and reducing barriers to investment and production. The short-term cost in terms of lower revenue will be offset in the medium term by a widening of the tax net and a more rapid pick-up of economic activity, resulting in increased tax revenues as well as reducing pressure on government spending.

For example, proposed tax reforms in Egypt include a substantial reduction in personal and corporate tax rates, raising the tax threshold and reimbursing sales tax charged on capital goods.

Over the last few years, several countries have made progress in monetary policy reform and capital account liberalisation. However, financial sectors are still dominated by domestic banks and there is little foreign ownership. Heavy state involvement combined with weak institutions tends to prevent the financial sector in the region from providing financial services efficiently.

Although there are some signs of improvement in supervision and regulation in the banking sector (especially in Jordan and Lebanon), the level of non-performing loans remains relatively high. The enforcement of property rights remains relatively weak, which constrains bank lending to SMEs and family-owned companies without a long borrowing history and a successful track record. As a result, lending is biased toward short-term projects, and there is still little in the way of the long-term productive lending that is needed by start-ups and SMEs.
Operations in 2004

In an operating environment that remained generally difficult, FEMIP’s second full year of activity nonetheless proved to be a remarkable one.

Lending and risk capital

The appraisal process got under way on some 30 projects, representing over EUR 3bn of potential financing, while 27 projects were approved by the EIB’s Board of Directors, involving a total amount of EUR 2.888bn. Signatures for the year totalled EUR 2.190bn, corresponding to a 5% increase over the already exceptional volumes achieved in 2003. Disbursements also rose significantly (+36% compared to 2003), reaching EUR 1.4bn. This marked increase amply exceeds the 50% mark of new annual commitments set in recent years.

The trend towards increased financing of private sector operations continued in 2004, with over a third of total lending aimed at supporting SMEs and foreign direct investment in the region. In terms of sector allocation, lending was broken down as follows: EUR 731m (33%) for transport and other infrastructure, EUR 728m (33%) for the energy sector, EUR 545m (25%) for SMEs, EUR 159m (7%) for the environmental sector, EUR 14m (1%) for risk capital operations and EUR 13m (1%) for industry.

To be more specific, in 2004 the following 25 projects were signed:

Morocco

The ONE Parc Eolien de Tanger loan to the Office National de l’Électricité, a borrower well-known to FEMIP, for the financing of a large wind farm to be located in the north of Morocco between Tangiers and Tetouan. The project will exploit the potential of the country’s renewable energy resources and generate electricity for supplying the public grid, thus helping to meet rising demand for power. The development of priority electricity infrastructure and environmental protection can be counted among FEMIP’s goals, in line with the policy of other lenders, such as Kreditanstalt für Wiederaufbau Entwicklungsbank (KfW), which is also co-financing the project.

The ONE – Dépollution Centrale Mohammédia project involving extending the life of a coal-fired steam-cycle power plant and upgrading flue gas and wastewater treatment facilities at the Mohammédia power plant, located on the Atlantic coast north of Casablanca. The project will meet electricity demand at a competitive cost by extending the economic
The Assainissement Villes Marocaines – Fes and Assainissement Villes Moyennes projects involve the financing of water treatment infrastructure in the cities of Fez and Safi and Beni Mellal respectively. Both projects will contribute to a substantial improvement in public health and the environment in the cities concerned. Accordingly, they both benefit from an interest subsidy.

Tunisia

The Voiries Prioritaires III and IV projects for the upgrading of the urban road network of Greater Tunis and the governorates of Monastir and Médénine form part of the priority programme for enhancing the existing network to assist the country’s economic and social development, while at the same time improving the quality of life in the conurbations concerned. They complement the road schemes already financed by the Bank since 1994, which focused on programmes to upgrade and extend priority roads in Greater Tunis and in the main towns of the country’s road network.

The Algerian Cement Company Spa (ACC) received in 2004 a USD 15m FEMIP loan to co-finance the expansion of its cement plant, located near M’Sila, 240 km south-west of Algiers.

ACC, a subsidiary of the leading Egyptian group Orascom Construction Industries (OCI), is the only private sector cement producer in Algeria. The construction of the M’Sila plant, successfully implemented on a greenfield site over the period 2002-2004, had already benefited from loans and mezzanine finance made available by FEMIP.

The follow-up investment was co-financed in close coordination with other international financial institutions (the International Finance Corporation (IFC) and Deutsche Entwicklungsgesellschaft (DEG)), local and international commercial banks (Caisse Nationale d’Epargne et de Prévoyance (CNEP), Citibank-Algeria, Citibank International London) and Eksport Kredit Fonden-EKF, most of which had also participated in the financing of the first production line. The continued involvement of the lenders demonstrates their lasting confidence in the role of private sector investors in Algeria and the opportunities available to them.

ACC is also an exemplary South-South private sector investment, building on the experience of the OCI group and bringing together Egyptian, Algerian and European investors for the development of an industry that is crucial to the Algerian economy. It ties in with the objectives of FEMIP, which aims to liberalise Mediterranean Partner Country economies and strengthen economic cooperation within the region.

The investment will generate major economic benefits for the Algerian economy. Its aim is to meet the huge demand in the country for cement and concrete for housing construction, for which a pressing social need currently exists in Algeria’s main urban centres. In addition, this expansion will create employment, use local raw materials and replace imports, hence enabling the country to make appreciable hard currency savings.

Algerian Cement Company

life and improving the technical performance of existing coal-fired generating units. By reducing flue gas emissions and the production of solid waste, the project will have a substantial positive environmental impact. It will thus help to improve the environment in the Casablanca region, the country’s largest urban and economic centre. Accordingly, the loan will carry an interest subsidy from the EU budget.
The EUR 71m Infrastructures Logement Social loan, granted to Holding d’Aménagement “Al Omrane”, a development company specialising in urban areas earmarked for social housing construction, represents a first for FEMIP in the social housing sector outside the Union. It will help to improve the living conditions of Moroccan households by financing primary infrastructure in residential districts that suffer from a lack of basic amenities and in new urban development areas. Through this loan to Al Omrane, FEMIP will help to eliminate shanty towns, upgrade slum areas and alleviate the social housing shortage in Morocco.

The project comes under the “Cities without Slums” programme, which aims to build 100 000 low-cost dwellings a year. FEMIP has developed a coordinated approach with (i) Agence Française de Développement (AFD), which is currently preparing a complementary scheme, (ii) the World Bank, which is developing a project to support institutional reform in this sector, and (iii) the European Commission, which will include the eradication of shanty towns among its priorities for 2005 and 2006. Through this project, FEMIP will contribute to the achievement of one of the United Nations’ Millennium Development Goals: to ensure environmental sustainability by significantly improving the lives of at least 100 million slum dwellers by 2020.

The Assainissement du Site de Taparura project is intended to clean up the Taparura site in the coastal area of the city of Sfax, the largest economic centre and main source of industrial employment in southern Tunisia, which has suffered for years from a serious pollution problem owing to the intense industrial activity in this region. The project forms part of a wider action programme put together by the Tunisian authorities to tackle the primary sources of pollution in the region and will help create a favourable climate for private investment and boost economic development, one of FEMIP’s financing priorities.

The CPSCL Global Loan in favour of Caisse des Prêts et de Soutien des Collectivités Locales for the financing of infrastructure investment by Tunisian local authorities exemplifies FEMIP’s continuing resolve to support priority local socioeconomic infrastructure projects via reliable local financial partners. The project is being financed in close cooperation with the World Bank and AFD and is part of the reform process of Tunisian local authorities currently being financed.

The SNCFT IV loan to the Société Nationale des Chemins de Fer Tunisiens, which is to finance capital investment involving the creation of a rail link for gypsum waste disposal and the continuation of the programme for upgrading the country’s rail network, will have a beneficial environmental impact and help modernise the country’s basic transport infrastructure, making it safer and developing communications with Algeria. The African Development Bank (AFDB) is co-financing this project.

Egypt

A loan to EgyptAir, FEMIP’s second project with the Egyptian national carrier, for the acquisition of seven new Airbus A330-200s. The project
The **Facility for Euro-Mediterranean Investment and Partnership** • Facility for Euro-Mediterranean Investment and Partnership

The **Associations de micro-crédit II Global Loan** is the second EUR 10m line of credit made available by FEMIP to the major Moroccan microfinance institutions (MFIs) over a period of 18 months. The project has taken the form of a ‘global loan’, i.e. the facility is open to several associations, which will be served according to their needs, size and ability to manage growth, for the financing of a very large number of underlying microprojects.

Through the use of risk capital resources, FEMIP has been able to provide a long-term loan in local currency (as MFIs cannot bear foreign exchange risks). Moreover, in view of the particular non-profit nature of the borrowers, their development stage (microfinance really started in Morocco only six years ago) and the strong developmental impact of microfinance, the interest rate of the facility has been set at the best possible market rate, i.e. the yield on government bonds of the same duration.

The value added of FEMIP’s operation in this sector appears to be fourfold: (i) it will encourage the growth of microfinance in Morocco and hence contribute to poverty reduction and the promotion of female emancipation; (ii) it will provide the best MFIs with quasi-commercial resources, thereby encouraging them to move from the initial stage, where most of the activity has to be financed by grants – to the maturity stage, the MFIs become self-sustainable financial institutions; (iii) it will demonstrate to potential lenders (including Moroccan commercial banks or the local financial market) that these MFIs are creditworthy borrowers, who are able to pay interest and repay debts; (iv) it will set a high standard of transparency by requiring the beneficiary MFIs to be assessed every year by a specialised rating agency, hence encouraging other MFIs that would like to be eligible for financing to follow suit.

Jordan

**The Regional Gas Pipeline** in Jordan concerns the construction of an on-shore gas pipeline system that will be part of the overall restructuring of EgyptAir and will contribute to the modernisation and harmonisation of its fleet, leading to lower operating costs and improved service quality. The loan will also indirectly benefit the environment via energy savings and lower emissions, since the project involves the use of more efficient technology, promoted under EU policy on climate change.

**The Talkha and El Kuriemat Power Plants** loan to the Egyptian Electricity Holding Company (EEHC), one of FEMIP’s largest borrowers in Egypt, is supporting the construction of two new natural gas-fired combined-cycle power stations. The project will meet growing electricity demand at a competitive cost using modern combined-cycle technology with a relatively low environmental impact. The high thermal efficiency of the plants will also contribute to the rational use of energy in Egypt.

**The Private Sector Development Global Loan** is intended to finance small and medium-sized investment projects undertaken by private sector companies in Egypt, with a particular focus on SMEs. The global loan finance will help to enhance the availability of long-term funding on attractive conditions to the Egyptian banking sector to finance private sector investment. Eligible sectors include a wide range of industries as well as value-added service sectors, including tourism and food processing.
The Damietta LNG project involves the construction of a liquefied natural gas (LNG) plant and related storage and export facilities with a production capacity of 4.9m t/a LNG, representing one of the world’s largest single LNG trains. The project is located in the industrial port of Damietta, on Egypt’s Mediterranean coast.

The project will be carried out by a joint venture involving two leading European energy companies (Union Fenosa and ENI) and Egyptian companies, which will share in the benefits of the gas liquefaction on an equal basis. The project aims to make efficient use of natural gas reserves in Egypt and to facilitate the export of gas to Europe, thereby contributing to the regional integration of energy networks in the Mediterranean and helping to increase and diversify energy supplies to Europe by providing a new source of natural gas for the EU market.

The loan underpins FEMIP’s support for Egypt’s new role as a prominent oil and gas-producing country, the main benefits to Egypt being increased foreign exchange earnings, the participation of domestic companies in profitable projects involving major investment, the transfer of international technologies and technical skills, job creation and further industrial and economic development.

The loan, financed to the tune of 50% under the Mediterranean Partnership Facility, provides a good illustration of the use FEMIP can make of this Facility. By supporting private sector development in the form of long-term finance for a project of major interest to Egypt and the European Union in the energy sector, the loan fully complies with the criteria set out for the Facility.

Lebanon

The Apex Multi-Sector Global Loan, which targets a selected pool of private commercial banks serving multiple segments of the fragmented Lebanese market, follows two “dedicated” Apex Global Loans approved and signed in 1998-1999. The new Apex GL will co-finance new investments or extension, modernisation or rehabilitation projects carried out in Lebanon by the private sector in the industrial and services sectors, including agro-industry, tourism, health, higher education, IT and the knowledge-based economy.

The South Lebanon Wastewater project entails the upgrading and extension of the sewerage infrastructure of two coastal cities in southern Lebanon. The project will complement investments supported by other institutions (the World Bank, AFD and the EC) and will help improve the quality of life of the local population and enhance Lebanon’s attractiveness as a location for tourism and commerce. Owing to transport Egyptian natural gas to major power plants and industrial consumers throughout the country. The project is a first step towards a major interconnection project in the region and, by bringing together an Egyptian investor with a Jordanian project, a prime example of South-South cooperation. The project is further motivated by the respective economic development interests of Egypt and Jordan, enabling Egypt to add to its foreign exchange reserves by increasing its exports of natural gas and allowing Jordan to diversify its energy supply away from oil.
The EUR 200m Bosphorus Tunnel loan to the Republic of Turkey for the financing of the first fixed-rail connection of the European and Asian networks across the Bosphorus Straits is the first tranche of a larger facility of up to EUR 650m approved by the EIB, which will be phased over the period of the project’s construction.

The project will connect the two railway lines of the Pan-European Transport Corridor IV, which currently terminate on either side of the Bosphorus, by means of a tunnel. This tunnel will provide the trans-European rail networks (TENS) with access to Asia and is of crucial importance for the integration of Turkey with the European Union and the development of the Union’s transport network.

The project will reduce air and noise pollution by enabling a major shift from road to rail and alleviating congestion on the road network. Located in metropolitan Istanbul, the rail link will also provide a long-sought mass transport system for the city’s 11 million inhabitants, overcoming a natural barrier that divides the city in two.

It is also a good example of the catalytic role FEMIP can play in helping to co-finance major infrastructure projects. Its loan finance will be complemented by funding from the Japanese Bank for International Cooperation (JBIC) and the Republic of Turkey.

Syria

The Deir Ali Power Plant project, FEMIP’s largest-ever loan in Syria, entails the construction of a 750 MWe natural gas-fired combined-cycle power plant located at Deir Ali, 25 km south of Damascus, generating base-load electricity to meet increasing domestic demand. The project is a priority investment for the Syrian Ministry of Electricity and FEMIP’s first project in Syria aimed directly at supporting the Government’s decision to gradually switch from oil-based to gas-based electricity generation. The project also has an authentic regional dimension given its long-term reliance on regional gas.

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It is also a good example of the catalytic role FEMIP can play in helping to co-finance major infrastructure projects. Its loan finance will be complemented by funding from the Japanese Bank for International Cooperation (JBIC) and the Republic of Turkey.

Turkey

The Industrial Sector IV Global Loan in Turkey is a follow-up to the EIB’s earlier highly successful industrial sector global loans signed in 2001 and 2003, which leveraged more than EUR 1bn of private sector project investment, creating some 10 000 additional jobs in the country. The global loans will be channelled through five Turkish partner banks, including three “new” ones, to small and medium-sized private sector projects in the industrial, services and tourism sectors. The “new” partner banks will also be supported by a long-term technical assistance contract designed to foster their penetration of the SME market and strengthen their long-term project lending capabilities, representing FEMIP’s first allocation to Turkey of grant financing from the FEMIP Technical Assistance Support Fund.
to SMEs in the industrial, tourism and services sectors in the form of loans or leases. This will be FEMIP’s first leasing facility arranged for SMEs in Turkey. Leasing, which is developing in Turkey, is seen as an ideal form of longer-term financing for smaller SMEs. In addition, this operation will further diversify its support for the Turkish financial sector by including a number of private sector commercial banks and specialised leasing companies as intermediaries.

The Bursa Light Rail Transit System loan will complete the light rail transit system of Bursa, Turkey’s fourth largest city. The project will help to deal with transport problems in one of the biggest urban centres in Turkey as well as create a healthier environment for some 1.2 million inhabitants and promote further economic development. The project is co-financed with KfW as well as with commercial banks.

Regional operation

AfricInvest Fund (the “Fund”) is a regional private equity fund operating in a number of northern and sub-Saharan African countries. The idea behind the Fund was to capitalise on links forged by the lead manager, the Tunis-based Tuninvest Finance Group, which had previously been providing technical assistance to several private equity teams located in each of the Fund’s target countries. It is therefore a particularly interesting example of South-South partnership. The Fund’s management structure consists of several local “investment advisers”, one in each country of operation. Each local team produces its own project pipeline and conducts most of the due diligence, but benefits through different channels from the experience of all the other partnering teams. This innovative concept enables AfricInvest to be SME-focused and regional at the same time, thereby mitigating the risks.

The current size of the Fund is EUR 25m. FEMIP participation from risk capital resources amounts to EUR 5m and has taken the form of a “Silent Partnership Agreement”, whereby its participation is limited to investments made by the Fund in the Mediterranean Partner Countries only (de facto Morocco, Algeria and Tunisia).

FEMIP intervention has enabled the Fund to reach the critical size necessary for its launch. The Fund has so far demonstrated its ability to invest at a rapid pace, having approved five projects, for a total amount of EUR 5.3 million, in its first six months of activity. This positive start should allow the promoters to attract new investors for a second financial closing due to take place in the second half of 2005.
**FEMIP technical assistance**

2004 was the FEMIP TA Support Fund’s first full year of operation. By the end of that year, 20 technical assistance contracts totalling EUR 13.8m had been signed. This represents an extremely rapid rate of commitment, considering that TA operations under FEMIP did not actually start until September 2003 and taking into account the time needed to prepare and comply with the tendering procedures for TA operations. While the geographical breakdown was quite homogenous (Maghreb 38%, Near East 37% and Turkey 25%), over 70% of the funds was allocated to the infrastructure, environment, water and wastewater sectors, reflecting to a large extent the Bank’s traditional areas of activity in the region. However, direct private sector support, aimed mainly at strengthening the lending capacity of intermediary banks for global loan operations and setting up new investment funds, already absorbed one quarter of all TA resources, thus reflecting FEMIP’s new priority. This emphasis on direct private sector support is set to continue over the course of 2005.

Although it is too early to draw conclusions concerning the impact of TA activity on FEMIP’s lending operations, as only a small number of technical assistance schemes have already started, a few observations may already be made:

- The TA component provides FEMIP with a strong instrument to improve the quality and development impact of its lending operations in the Mediterranean region. As a consequence, FEMIP has become more proactive and selective with regard to future investments, with a clear focus on private sector development and its enabling environment. At present, FEMIP is considering strengthening investment operations’ links with clearly defined

**In September 2003 FEMIP signed with the Syrian Arab Republic the “SME Fund” project, an apex global loan facility of EUR 40m from the Bank’s own resources. The SME Fund is FEMIP’s first global loan in Syria and, in line with the Facility’s objectives, its first operation in support of private sector development in that country. The loan is thus to be considered a pilot scheme in Syria, aiming at providing long-term foreign currency funding for SME investment projects based on modern banking industry practice.**

The SME Fund provides a good illustration of the use FEMIP has made of the EC-funded FEMIP TA Support Fund, having benefited from a EUR 2m TA grant. The request for advisory services was made by the Ministry of Finance of the Syrian Arab Republic in the context of loan negotiations, with a view to expanding medium and long-term financing of private sector investments projects in Syria through domestic lending institutions. The TA project envisages the provision, under a pilot approach, of technical assistance to the SME Fund Management Unit (“FMU”), a team of experts familiar with both the domestic banking and SME market in Syria and best industry practices for SME credit appraisal.

The TA aims to contribute to the capacity building of the FMU by transferring to the local members of the unit best industry practice in the fields of SME project appraisal and lending techniques. Accordingly, one of its goals is to achieve full disbursement of allocated funds under the global loan to SMEs within three years of the TA contract signature.
sector policies, thus putting more emphasis on sustainability, development and job creation. To this end, cooperation with other international institutions is being developed and/or strengthened.

The use of technical assistance increases the ability of the Mediterranean countries and promoters to better prepare investment operations and improves their ability to both manage and supervise those operations. It helps to avoid typical problems such as delays, cost overruns and other blockages. More generally: (a) in the short and medium term, it helps improve disbursement rates for lending operations; (b) in the medium and long term, it contributes towards further developing FEMIP’s portfolio of sustainable investment projects in the region.
FEMIP portfolio overview

An analysis of its portfolio some 27 months after FEMIP was launched in October 2002 confirms that the main financial goals of the Facility, both qualitative and quantitative, have been achieved. These focused on gradually increasing FEMIP’s lending to some EUR 2bn per annum, compared to the previous yearly level of some EUR 1.4bn (itself an increase on the average yearly commitments of EUR 1.1bn made during the period 1997-2000), while simultaneously devoting additional financing resources towards private sector development, including enhancement of the “enabling environment” in which the private sector can prosper.

Although it would be premature to draw conclusions at this stage, an analysis of FEMIP activity over the last two years shows an increasing appetite for FEMIP loans in the region. In addition, the portfolio demonstrates a clear emphasis on the private sector, which accounts for close to 40% of the total.

In terms of geographical distribution, the portfolio appears well balanced, with each of the three main FEMIP regions (i.e. the Maghreb, the Near East and Turkey) accounting for approximately a third of the overall volume.

With over 60% of the portfolio, the infrastructure sector continues to be the main focus of FEMIP activity. This is in line with FEMIP’s recognition of this sector’s key role in creating the necessary environment for a prosperous and burgeoning private sector. FEMIP support for infrastructure in the region appears to be almost equally divided between energy (comprising power and gas projects) and transport (roads, ports, railways, urban transport, aircraft).

The financial services sector accounts for around 20% of the portfolio. Within this category, which comprises global loans targeting SMEs - the development of which is one of FEMIP’s key objectives - as well as risk capital operations, global loans account for the bulk of the lending. Risk capital operations show a di-

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FEMIP cumulative signatures:
breakdown by country (2002-2004)

- Regional 0.1%
- Egypt 24%
- Jordan 3%
- Lebanon 2%
- Syria 6%
- Tunisia 14%
- Algeria 6%
- Turkey 34%
- Morocco 11%
versified range of beneficiaries, ranging from regional investment funds to local microfinance institutions.

Lending to industry, targeting a diverse range of industrial sectors (cement, steel, automotive, etc.), accounts for 10% of the portfolio and can be considered, for the most part, as direct private sector support. The balance relates to lending to the environmental (mostly wastewater) and human capital (education and healthcare) sectors, both of which count among FEMIP’s priority objectives.

The overwhelming majority of loans were signed under the Euro-Med II mandate. This is also true for Turkey, where close to half of the loans extended over the period under consideration were signed under the Euro-Med II mandate, the other half being divided between the Pre-Accession Facility (PECO), the Special Action Programme (SAP) and the Turkish Earthquake Rehabilitation and Reconstruction Assistance (TERRA) mandate.

**FEMIP cumulative signatures: breakdown by sector (2002-2004)**

- Financial sector 19%
- Energy 27%
- Industry 10%
- Environment 5%
- Transport and other infrastructure 34%
- Health and education 5%

**FEMIP cumulative signatures: breakdown by mandate (2002-2004)**

- EuroMed II 78%
- Art. 18 Facility 5%
- SAP (Turkey) 6%
- PECO (Turkey) 8%
- TERRA (Turkey) 3%
Enhanced dialogue with the Mediterranean Partner Countries

Right from the word go, FEMIP wanted to involve the representatives of the beneficiary countries in its lending policy guidelines through constructive discussions on economic, financial and sectoral matters. To begin with, these discussions were conducted within a Policy Dialogue and Coordination Committee (PDCC), which brought together representatives of the European and Mediterranean partners twice a year. When FEMIP was reinforced, it was decided to take this a step further and establish a fully fledged FEMIP Ministerial Committee, which, for the first time, provides the 35 Euro-Mediterranean Finance Ministers with a formal framework for discussing reforms that will help the region to develop and appropriate accompanying measures. The work of this “Mediterranean Ecofin Council” is prepared by a high-level group of experts. FEMIP is also endeavouring to promote greater dialogue with all those involved in the Euro-Mediterranean financial partnership.

The institutional dialogue

In order to promote economic dialogue between the Member States and the Mediterranean Partner Countries, the establishment of the reinforced FEMIP was accompanied by the organisation of biannual meetings attended by experts delegated by the Finance Ministers of the EU countries and the Mediterranean Partner Countries, but also by external experts from recognised business or academic circles. Delegates from other international institutions active in the region, in particular the World Bank, the International Monetary Fund, the International Finance Corporation and the African Development Bank, as well as the European bilateral development financing institutions (EDFIs), are also involved in these meetings.
The FEMIP Experts’ Committee met for the first time on 16 and 17 February 2004 in Marseille. Two topics were on the agenda: the first session dealt with privatisations and the participants looked into the specific case of public sector enterprises, then into that of services, on the basis of the experience of a number of Mediterranean Partner Countries but also in the new Member States; the second session was concerned with access to finance for private enterprises, seen from the point of view of both financial institutions and private enterprises themselves.

The recommendations of the Marseille Experts’ Committee meeting served as a basis for the discussions of FEMIP Ministerial Committee, which met for the first time in Alexandria on  June 2004. This FEMIP ministerial meeting was also the first to be held following enlargement of the European Union.

The Experts’ Committee’s second meeting was held in Amsterdam on 25 and 26 October 2004. Two topics were on the agenda: (i) water and sewerage – to examine the role of the private sector and the appropriate financial instruments for developing the water sector in the Mediterranean countries; and (ii) transport, in particular the possibility of creating a Euro-Mediterranean transport network, with a view to both development and management and from the angle of possible private sector involvement.

The practical proposals resulting from these discussions, together with those of the Experts’ Committee meeting held in Luxembourg on 7 and 8 March 2005 (on modernising banking and financial markets in the Mediterranean and on innovative financing instruments), will serve as a basis for the work of the Ministerial Committee meeting scheduled to take place on 19 and 20 June 2005 in Morocco.

FEMIP plays an active role in the coordination of meetings and official events that are a regular feature of the Euro-Mediterranean Partnership, including:

- the Euro-Mediterranean Conferences of Foreign Ministers (Naples, 3-4 December 2003; Dublin, 5-6 May 2004; The Hague, 29-30 November 2004);
- the first Euro-Mediterranean Parliamentary Assembly (Athens, 22-23 March 2004);
- the Euro-Mediterranean Conference of Industry Ministers (Caserta, 4 October 2004);
The development of relations with the private sector and civil society

Since FEMIP gives priority to the financing of private investment, it was important to pursue an active policy of communication and information aimed at business circles on both sides of the Mediterranean in order to make them aware of the opportunities offered for finance and support. To that end, every year FEMIP organises conferences on specific subjects, in partnership with the local trade associations, and is careful to ensure that they are held in both northern and southern Mediterranean countries. Thus, in 2004 FEMIP promoted conferences on:

- "The development of enterprise, an essential dimension of the Moroccan economy", Casablanca, 16 January 2004;
- "The development of the private sector in the Mediterranean Partner Countries: the role of the EIB", 22 January 2004 in London, organised with the Middle East Association in collaboration with the British government agency UK Trade & Investment;
- "Promoting private sector development in Syria: the role of the EIB", Aleppo, 6 December 2004, in cooperation with the Aleppo Chamber of Industry, and Damascus, 8 December 2004, in cooperation with the Federation of Syrian Chambers of Commerce;
- "Stimulating investment in the Mediterranean – FEMIP’s role", Madrid, 16 December 2004, organised in cooperation with the Spanish Confederation of Business Organisations.

This approach directed at entrepreneurs and financial institutions that are already operating or planning to set up in the region has also taken the form of active involvement in the following events:

- the conference on "Finance and business in the MENA region", 24 November 2004 in Frankfurt, organised by the German-Arab Chamber of Commerce and Industry;
- the 18th European Finance Convention, 2 December 2004 in Palermo.
FEMIP partnerships

EMIP cooperates with the European Commission and the International Financial Institutions (IFIs) as well as the European Development Finance Institutions (EDFIs) through regular consultation, project co-financing and joint participation in working groups. This activity has gained significant momentum during the last two years.

In May 2004, the European Commission, the EIB and the World Bank signed a joint Memorandum of Understanding aimed at enhancing coordination of their activities in the Mediterranean Partner Countries. This agreement formalises a relationship that is already strong and fruitful, both in operational and policy terms, and will lead to a more focused and complementary approach at all levels from programme implementation through to aid programming and overall policies, helping to prevent duplication of effort and competition while facilitating a focus on the Partners’ respective strengths. Particular attention is directed to identifying potential linkages between policy and investment initiatives.

Progress recorded in 2004 under the first work programme of joint activities includes:

- a joint country approach involving both Tunisia and Jordan. For Tunisia, information on the relevant national country assistance strategies was exchanged. Coordination of the technical assistance programme has been conducted in a limited number of areas (support for technology parks, private sector participation in infrastructure) where the three institutions are actively involved or are considering new operations. Regular exchanges and meetings have also been held to explore opportunities for cooperation in several sectors, including higher education and vocational training, water, transport, urban development and tourism. For Jordan, there is ongoing collaboration between the three institutions, notably in education and transport;
- collaboration with other countries: consultations took place on the Morocco and Lebanon Country Assistance Strategies;
- technical collaboration and technical assistance for private sector development: there is ongoing coordination between the three institutions’ country teams on water, particularly in Tunisia.

Signing of Memorandum of Understanding between the EIB, European Commission and World Bank – Brussels, May 2004
In October 2004, FEMIP attended for the second time the MDBs’ Round Table Meeting on Trust Funds Administration, hosted this year by the African Development Bank in Tunis. Trust Fund Managers and Administrators from the World Bank, the Inter-American Development Bank, the European Bank for Reconstruction and Development, the International Finance Corporation and the AfDB Group took part in the meetings.

In 2004 FEMIP also started discussions with the Commission and the AfDB with a view to finalising a Memorandum of Understanding on an enhanced strategic partnership for cooperation in the countries of Africa.

In the context of the existing EDFIs-EIB Framework Agreement on Financial Co-operation discussions have started on the finalisation of a letter of intent aimed at:

- promoting joint financing of projects and programmes within private sector development;
- further strengthening institution-wide coordination to ensure complementarity, cohesion and coordination and promoting joint activities;
- promoting joint technical work and policy dialogue and enhancing the link between analysis and investment initiatives at all levels.
Organisation and staffing

Presence in the field

As part of the action taken to reinforce FEMIP, the decision to open three offices in the region, thus establishing a direct presence in the field, was also taken. In October 2003 the Cairo “regional” office, the EIB’s first office outside the EU, was opened. This was followed in December 2004 by the official inauguration in Tunis of FEMIP’s first “local” office, which became fully operational at the beginning of January 2005. FEMIP’s second “local” office is due to open in Rabat, Morocco, in June 2005. The role of FEMIP’s representative offices includes, among others, tasks such as: ensuring coordination with local authorities, borrowers, the banking sector and lenders, helping to identify new projects, especially those focusing on the private sector, monitoring projects and facilitating the implementation of FEMIP technical assistance.

Increased support for private sector activities

The FEMIP Department is responsible for managing all projects and other EIB activities in the Mediterranean Partner Countries. To that end, it draws on the services of the Bank’s Projects, Legal, Risk Management, and Finance Directorates for their input into the analysis and monitoring of operations and the disbursement of funds. It also avails itself of the services of the Bank’s non-operational support Directorates (Human Resources, Information Technology, etc.).

Following the restructuring approved by the Board in December 2004, the FEMIP Department comprises (i) three divisions – two geographical and one horizontal – responsible for operations; and (ii) one horizontal unit, responsible for policy and institutional matters. The two geographical divisions are responsible for both private and public sector lending in their respective countries of operation, while the horizontal division manages the Bank’s risk capital and technical assistance activities throughout the region. While the previous set-up saw a concentration of private sector activities within one division, the restructuring of the Department has led to a wider involvement of all FEMIP operational staff in the identification and execution of private sector projects.

At the end of 2004, just over 70 staff were contributing to operations in the region, including some 30 in the FEMIP department alone. New recruitment, within the budget, is expected to take place in 2005 to meet the need for additional staff following the implementation of the “Reinforced FEMIP”, in particular insofar as the reinforcement of technical assistance, risk capital and monitoring activities is concerned.
Annex 1 - FEMIP organisation chart

(1) Following the reorganisation of the FEMIP department, this new structure was put in place as of 1 February 2005.

(2) To be inaugurated in June 2005.
Annex 2 - List of projects signed (01/10/02 - 31/12/04)

<table>
<thead>
<tr>
<th>Name</th>
<th>Region</th>
<th>Country</th>
<th>Nature of operation</th>
<th>Sector</th>
<th>Amount signed €m</th>
<th>FEMIP TA</th>
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(1) The FEMIP TA Support Fund actually became operational in the second half of 2003.