Critical notes

Helen KAVVADIA: «10 years of the Euro-Mediterranean cooperation: the role of the European Investment Bank (EIB)». Doctoral Thesis, Washington International University, June 2006

By Professor **Const. GE. ATHANASSOPOULOS**
Professor of Panteion University of Social and Political Sciences
and of the University of Athens, (Vis. Prof.),
Ex Ch.L. U.L. Bruxelles, Ex Int. I.I.A.P., Paris

The Mediterrariean Sea has a rich history of encounters between people of various cultural, ethnlc and religious backgrounds. It stands out as the most frequented trade and imigratory route in world history, from Bronze Age seafarers via the Phoenicians, Carthaglnians, Egyptians, Greeks, Romans, Arabs, Byzantines, Catalans, Venetians and Turks to the nations of today.

Today, 37 of these nations - the 27 Member States of the European Union and ten countries and territories on the southern and eastern littoral of this great «inland» sea - have banded together to enhance their common future. This major initiative, the Euro-Mediterranean Partnership -also known as the Barcelona Process - has been celebrating in 2005 the tenth anniversary of its existence.

It was on the 27-28 November 1995 that the Member States of the European Union, 15 at that time, and 12 Mediterranean countries and territories gathered in Barcelona to set the process in motion. The Mediterranean Partners were Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, Tunisia, Turkey, plus Cyprus and Malta, both of whom joined the EU in 2004.

The Barcelona Process is a unique and ambitious initiative, which has laid the foundations of a new regional relationship and represents a turning point in Euro-Mediterranean relations. In the Barcelona Declaration the Euro-Mediterranean Partners established the three main objectives of the Partnership:

1. The definition of a common area of peace and stability through the reinforcement of political and security dialogue (the Political and Security Chapter).

2. The construction of a zone of shared prosperity through an economic and financial partnership and the gradual establishment of a Free Trade Area (the Economic and Financial Chapter).

3. The rapprochement between peoples through a social, cultural and human partnership aimed at encouraging understanding between cultures and exchanges between civil societies (the Social, Cultural and Human Chapter).

The Euro-Mediterranean Partnership has two key dimensions:

Bilateral: the European Union carries out a number of activities bilaterally with each country. The most important are the Euro-Mediterranean Association Agreements that the EU negotiates with the Mediterranean Partners individually: These provide the legal foundation for the Barcelona Process, reflecting the general principles of the Euro-Mediterranean Partnership, but featuring characteristics specific to the the relations between the EU and the individual Partner.

Regional: one of the most innovative aspects of the Partnership is the regional dimension, covering the political, economic and cultural fields. Regional co-operation has a considerable strategic impact as it deals with problems that are common to many Mediterranean Partners while emphasising the national complementarities. Emphasis is also placed on sub-regional integration, particularly with regard to the Maghreb, but also the Mashrek.

The MEDA programme, managed by the European Commission is the main financial instrument of the Euro-Mediterranean Partnership. From 1995 to 2003, MEDA committed €5.5 billion in co-operation programmes, projects and other supporting activities, the regional activities comprising around 15% of this budget. The other important source of funding is the European Investment Bank, the European Union's financing Institution, which has lent €12.2 billion for developing activities in the Euro-Mediterranean Partners since 1995.

The Euro-Mediterranean Partnership is now an established fact, with a daily reality that is shaping the future of the region. Since 1995, the European Union, and the European Investment Bank has been its most important international donor and the Barcelona Process, which came into effect the following year, has recorded significant achievements.

2005, the 10th year anniversary of the Barcelona Process, has been declared by the European Union Ministers of Foreign Affairs, as the YEAR OF THE MEDITERRANEAN. It is the year that this process has been reinvigorated by the European Union's European Neighbourhood Policy (first outlined in March 2003 and confirmed in the Strategy Paper and Country Reports of May 2004) at the Barcelona 10 Summit on 27 and 28 Novembre 2006.

The aim of the present thesis is to assess the role of the European Investment Bank financing in the region in this last 10-year period, as 2005, was the turning point in the Euro-Mediterranean Partnership.

The thesis covers the identity, activity and mission of the EIB, the framework in which it operates in the Euro-Mediterranean Partnership, and reviews the economic context and the operations in the Mediterranean Partner Countries.

It concludes that the creation of EIB's the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) in October 2002 reflected the political will of the EU Member States and the ten Mediterranean Partner Countries to give a new impetus to their economic and financial cooperation: Not only by increasing the volume of lending and introducing pioneering financial products, but also by stepping up collaboration between the two shores of the Mediterranean.

FEMIP's main objective is to promote economic development and stability in the Mediterranean region - so generating employment, reducing emigration from the southern countries and fostering growth on both sides of the Mediterranean. For this reason, it focuses primarily on private sector development and the creation of a favourable climate for investment.

In three years, FEMIP has established itself as the «Euro-Mediterranean development bank», with investments totalling more than EUR 7.2 billion over the period 2002-2005.

To boost the momentum of the partnership and encourage the participants' sense of ownership, FEMIP also provides a forum for exchange and dialogue between the two shores of the Mediterranean through local offices in Cairo, Rabat and Tunis, the organisation of meetings and sectoral working groups that present their findings to the annual meeting of the Finance Ministers of the 37 Euro-Mediterranean countries, which has developed to a «EUROMED ECOFIN».

In the current situation, private sector is the major driver of economic growth in the MPCs. Private investment clearly harbours the greatest growth potential, and to give it the necessary boost each State must define its priorities and pace of reform according to its own needs, competitive advantages and socio-economic imperatives. It is FEMIP's task to underpin these developments with diversified financial products and technical assistance. The aim is to enhance the attractiveness of a country and prepare the ground for investors. FEMIP's priority is therefore the development of the private sector. In 2005, 51% of the EUR 2.2. billion lent was channelled into the private sector, either for financing large-scale industrial projects or supporting SME investment via local banks.

FEMIP attaches particular importance to this segment as only a strong and dynamic private sector can generate the jobs needed each year to provide the new entrants into the labour market with employment opportunities, thereby transforming the regions' growing population into a genuine asset for its future.

To achieve this, it is not only necessary to provide financing for projects but also to foster the development of an investment-friendly environment by supporting economic reform and modernisation and assisting the creation of basic infrastructure.

FEMIP is placing increasing emphasis on investment in the so-called social sectors such as health, education, training and housing.

For strengthening the economies of the MPCs, FEMIP strives also for the transfer of expertise, seeking to diversify FEMIP initiatives beyond traditional lending operations by developing a technical assistance component. Between 2003 and 2005, contracts for nearly 50 operations totalling EUR 70 million were signed. These consisted of grants aimed at helping our public and private sector partners to strengthen their medium and long-term management capacity as well as to improve the quality of their investment and enhance its development impact.

To encourage this dynamic, FEMIP focuses on modernising the banking sector in the partner countries, since the problem of how to tap savings for the long-term financing of the economy is common to them all. We are therefore enabling local banks to build up their capacities with technical assistance, helping them to refinance with medium and long-term credit lines and supporting their efforts to develop financial products with a strong leverage effect, such as investment capital, leasing, micro-credit, etc.

There are of course other factors that will contribute to the region's economic growth, such as the remittances of migrant workers. A study that we recently published showed that over EUR 7 billon is «officially» transferred from Europe to the Mediterranean countries every year (or EUR 12 to 14 billion if «unofficial» transfers are taken into account), exceeding both foreign direct investment and official development assistance to the region. However, these remittances are not handled by banks, a fact which considerably inflates the transfer costs (up to 16% of the amount sent) and prevents intermediate tapping by the banking system for developing appropriate products for migrants or improving the banks' refinancing costs. For this reason, FEMIP intends to take steps, based on research, to raise the awareness of the authorities in the partner countries and the banks with which it works, in order to make better use of this windfall to finance the economy.

In order to achieve this, greater cooperation between the southern Mediterranean countries is though necessary. Namely South-South integration, will be a key driver of economic growth. Trade between the southern countries accounts for only 5% of their GDP. To give you an example, Algeria is Morocco's sixteenth supplier, while Morocco is only Algeria's thirty-fifth! Progress has certainly been made in particular with the Agadir Agreement, which is expected to create a market of over 100 million people-but the integration of the region is far from being a reality. In these circumstances, it is essential to develop effectively integrated sub-regional groups (for instance, by extending the trans-European transport, energy and communications networks) and to think in terms of a Euro-Mediterranean area, whose overall activity accounts for 20% of global GDP.

In 1995, the launch of the Barcelona Process signalled the beginning of the Euromed partnership. Ten years later, at the Barcelona Summit in November last year, a number of critics described this meeting as a failure. In 1995 this initiative was set in the context of great hopes for peace. It is though at the economic and financial level-that the process becomes most meaningful and has already made great advances.

FEMIP now provides finance worth EUR 2 billion a year. The region has enormous potential for development in terms of both its human and natural resources and its extremely rich cultural heritage, and has already succeeded in creating vital momentum.

FEMIP's contribution to the economic and financial achievements of the MPCs so far, together with the clear determination on both sides, show that the means to move towards a genuine Euro-Mediterranean economic community are availabe. The process of convergence between the northern and southern economies has however now to be intensified. This is clearly a major challenge for the EuroMed societies, but one which is necessary to meet for stability and prosperity in the region, mainly in view of the demographic pressures of the MPCs, and the migration waves possibly to be created in case the economic and social gap between the Euro- and the Med areas increases.

The mere historic review of the EIB, a bank that lends far more than the World Bank, and its role in the European integration can be of use in assessing also its role outside the European Union, and in particular in the EuroMed integration.

The EIB was created at a time when large market imperfections gave a strong backing for a public bank. Market imperfections still prevail in developing countries and provide justifications for the creation of regional public banks. Also the creation of integrated economic spaces such as a EuroMed area and other regional groupings justifies a regional public bank with the mission to support an integrated infrastructure and assistance to poorer regions and countries. This is perhaps the main lesson from the EIB.

However, a remarkable feature of the evolution of EIB activity is that when market imperfections prevailed lending of the Bank was relatively small and rising fairly slowly. When a well performing capital market developed activities of the Bank grew more rapidly (of course, at the same time the EU enlarged, eligibility was widened, and external mandates multiplied). The question therefore is what would be the optimal mandate of the Bank in a performing financial market environment? Or, otherwise said, what are remaining market imperfections?

For the classic reasons of asymmetric information problems, the risk market is still tainted with major imperfections, particularly for non-rated companies for which credit derivatives are still underdeveloped. Commercial banks are charged with a capital cost when taking risk under the Basle capital requirements. It could therefore be argued that in such an environment the role for a public bank might more pertinently be seen in assuming risk rather than the flow of funds.

The actual development of the EIB in the MPCs with FEMIP is moving in the right direction. FEMIP is constantly moving in more risk taking operations, and develops for this purpose special products (risk capital). As the EIB is very capital rich, the present role distribution should be put on its head: banks provide funds and the EIB assumes the risk. This could also be a more useful role for public sector banks in regional groupings of developing countries, though a more traditional public bank role may be desirable, where there are large financial market imperfections or missing financial markets eg for financing infrastructure.

An unresolved issue is subsidiarity. This is less of a problem in financially constrained economies where even for perfectly sound projects funding may not be available at any cost. When funding is available at some cost it may be useful to define benchmarks to settle the subsidiarity applicability.

The thesis has highlighted the significant role of EIB in borrowing and lending in local currencies, which helps develop local and regional capital markets and reduces foreign currency mismatches for borrowers.

Since its beginning, European integration has been accompanied by the creation of major financial mechanisms. Such mechanisms and the resulting financial transfers were seen as both an economic and political condition for making economic integration effective and equitable. These mechanisms included both grants (through the Structural Funds) and loans (mainly through the European Investment Bank) and most recently risk capital and guarantees (European Investment Fund).

FEMIP is equipped for its activity in the MPCs with all the above elements: grants are provided by the European Commission, risk capital and in the future guarantees are to be provided by an Investment Fund aiming at comprising activity currently under the Trust Fund and the Risk Capital facility, whereas straight forward lending remains the bulk of the EIB operation in the region.

As in the case of European Integration, as well as in the new effort for EuroMed integration, these financial mechanisms had two major aims: (1) reducing income differentials within the relevant region, ie European Community (and later Union), and the EuroMed area, between countries and regions, particularly those resulting from trade liberalization, and (2) allocating major financial resources to facilitate the functioning of an increasingly integrated market, for example by financing inter connection of national metworks in transport and telecommunications. Whilst other aims have later been added, these two have remained central.

It is important to stress that very large - and overall growing - resources have been allocated in Europe consistently for these aims. To an important extent this dynamic has been driven by the relatively poorer countries, which during the negotiations for their joining the Community have put as a pre-condition the creation, or sharp increase of, grants and loans. The first such case was when Italy -before joining the EEC- pressed in the mid 50's for the creation of the European Investment Bank have contributed also to the sustained dynamic of financial transfers.

The thesis's ends with the conclusion that FEMIP has established itself as the «Euro-Mediterranean development bank» and that each regional integration process differs, but it seems clear that the broadly very successful European experience of financial mechanisms to support trade (and increasingly broder) integration may have interesting and important lessons for the EuroMed, as well as other regional integration processes, particularly those involving developing countries.

These closing remarks have proven the author's good insight and understanding of the Euro-Med issues, and have been hinting one full year in advance the recent political developments in the region, as announced by the newly elected President of the French Republic, N. Sarkozy who has been proclaiming his intention to support the creation of a EuroMed Union, and a EuroMed Bank based on the model of the EU and the EIB.