

Means and Sectors for Euro-Mediterranean Integration

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Regional integration is a demanding process. It requires eliminating, or at the very least significantly reducing, the transaction costs entailed in the physical, political and institutional barriers in place between the participants. Such barriers impede the integration of multiple production structures into a single, more efficient regional system better able to capitalise on the comparative advantages of its members. In the Euro-Mediterranean case, regional integration could increase the production function of both the Mediterranean Partner Countries (MPCs) and the EU itself. However, in addition to the economic argument, regional integration is also promoted as a tool for achieving political stability, whether through the positive social effects of economic growth or because it creates a web of overlapping economic interests that raises the opportunity cost of conflict.

This article addresses the issue of Euro-Mediterranean integration from a dual perspective. First, it offers an overview of the institutional means of regional integration used to date under the Euro-Mediterranean Partnership and Neighbourhood Policy as the basis for the regional integration process. Second, it examines the structural component of three of the Union for the Mediterranean's sectoral projects, namely, those relating to water, transport and renewable energies. It will argue that physical integration cannot take place in an institutional vacuum and that, for the UfM projects with potential for integration to be scalable, institutional means of regulatory convergence must be established.

Institutional Means of Integration

The obstacles to regional integration are myriad, ranging from tariff and non-tariff barriers to trade in goods and services to obstacles to capital and labour flows, inadequate transport infrastructure, a lack of interconnected power grids and legal and regulatory differences, among others. However, the biggest hurdles in the region are most likely political: embargoes, freezes, closed borders and, in general, intra-regional trade that better reflects political preferences than rational economic considerations (Escribano, 2000). As all of these impediments cannot feasibly be addressed at once, it would seem reasonable to set priorities based on the main bottlenecks seen to be affecting the process. Indeed, the economic literature on regional integration describes an internal logic that tends to manifest in gradual processes designed to eliminate each of these barriers successively: preferential agreements, free trade areas, customs unions, single markets and economic unions. Economic agents recognise these concepts, which make integration processes predictable, credible and measurable. When participants factor them into their expectations, they facilitate integration processes and reduce the costs thereof. If the integration model is confusing, or if it is inconsistently or incompletely designed, the associated reforms will be harder to carry out.

The Barcelona Conference identified one main priority, trade liberalisation, to go hand in hand with economic cooperation, primarily in the form of development cooperation assistance using MEDA funds. Trade liberalisation was understood as a means of laying the groundwork for Euro-Mediterranean integration and of attracting the physical and human capital required for the MPCs' development. Indeed, impact studies of the free trade areas have

linked increases in welfare to the dynamic effects associated with the influx of foreign investment. Steady progress has been made on the free trade agreements contemplated under the Association Agreements, albeit at different speeds. Tunisia's agreement, for example, has already been concluded, and Morocco's will have been concluded by 2012. In contrast, some countries are lagging far behind, whilst others' applications pose considerable problems. Moreover, although the free trade area must indeed be geographically completed with all the MPCs, it must also be completed in two other, equally vital ways. First, the Euro-Mediterranean free trade area does not include agricultural goods and makes only limited provisions for the liberalisation of services. These aspects have been remedied to a certain extent through specific bilateral sectoral negotiations; however, truly free trade has not yet been achieved. Second, the free trade area only operates vertically, that is, between the EU and the MPCs, whilst the southern Mediterranean spokes of its geo-economic structure do not engage in trade amongst themselves.

The results of the free trade area quickly disappointed both its advocates and its opponents. It has neither sparked a virtuous cycle of trade and development, nor led to an economic debacle in those countries that have done most to liberalise trade. However, trade has grown. For example, Spanish trade with the region quadrupled between 1995 and 2009, whilst overall Spanish foreign trade over the same period only doubled. That Euro-Mediterranean trade has grown cannot be denied, although trade balances have remained relatively unchanged and the impact on MPCs' development has been limited. Whilst progress on south-south integration has been negligible, the tools of the free trade agreement have gradually been put into place. Thus, in the sphere of rules of origin, for example, the countries of the Maghreb already allow full cumulation of origin amongst themselves and apply diagonal cumulation with the rest of the pan-European region.

The EU's strategy has been to continue advancing up the integration ladder without first having exhausted the initial stage of free trade. It is proposing a model of deep integration, the Neighbourhood Policy, based on MPCs' regulatory and institutional convergence along the lines of the EU acquis. The only way to move forward is to skip the customs union stage (the EU only has such a union with Turkey, and it does not include agricultural products) so as to progress

towards a peculiar model of single-market-sans-customs-union, a potentially similar status to that of non-EU countries in the European Economic Area or Switzerland. The incentive? Full participation in the European single market. However, so far this model has lacked the credibility that would make it attractive to the southern partners, except for those countries seeking to move more quickly up the integration ladder with the EU, such as Morocco with its advanced status. This multi-track approach is considered a disincentive to south-south integration. Moreover, the proliferation of bilateral trade agreements in the region greatly complicates the application of the rules of origin, which are crucial to further integrating the MPCs in new production phases of international industrial networks.

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Fifteen years after the Barcelona Conference, Euro-Mediterranean integration stands at a crossroads. The rate of integration remains slow, and its sectoral and regulatory scope is insufficient. At the same time, however, with a few dramatic exceptions, such as Palestine, the economic situation of the MPCs has tended to improve, providing a more conducive framework for moving up the integration ladder. Macroeconomic balances have improved considerably, offering MPCs more leeway in terms of their economic policy to react to external factors, such as the financial crisis or rising food and oil prices. This has been true even though the crisis has dispelled a certain sense of complacency by showing just how fragile the main balances are (Galal and Reiffers, 2009). There have also been microeconomic reforms outside the sphere of trade, such as the privatisation and opening up of public services to the private sector, although these have been undertaken more cautiously and only in the most reform-minded countries. In any event, these steps have borne fruit, and in recent years growth in the MPCs has risen sharply and, above all, become less volatile, registering robust rates year after year,

ranging from 3% to 6%, although differences remain between countries.

Despite this progress, foreign investment has not yet begun to flow in sufficient quantity to enable the qualitative leap deemed to be necessary in the Mediterranean. The results of institutional reform have been more modest, and more varied from country to country, than those of trade liberalisation and macroeconomic stabilisation. Although certain economic governance indicators have gradually tended to improve in some countries, it has not been enough to unleash the presumed investment potential of the Mediterranean, with its comparative advantages in terms of geographical proximity to the EU, trade liberalisation and abundant labour. The offshoring seen in other regions, such as Mexico or Southeast Asia, has not occurred, despite the cost-cutting potential for European companies of looking to their Mediterranean neighbourhood as an export platform for the most labour-intensive processes in their value chains. The inability of existing tools (Association Agreements and Neighbourhood Action Plans) to attract the hoped-for investment gave rise to the UfM. It is a new approach that is mainly based on physical integration through the financing of major structural projects with a potentially high impact on other sectors: sustainable water management and de-pollution of the Mediterranean, the establishment of land and maritime highways, civil protection initiatives, the Mediterranean Solar Plan, a Euro-Mediterranean University and the SME development initiative. It is explicitly hoped that these projects will have the externality of forging physical links between countries as a complement to the trade integration of markets, which has been sluggish among the MPCs themselves. The main goal, however, is to keep the regional dynamic of the Euro-Mediterranean Partnership alive in the face of the trend toward different tracks implicit in the Neighbourhood Policy.

Physical Integration and Structural Projects: Water, Transport and Renewable Energy

The key question is to what extent the new focus on project-based physical integration can round out trade and regulatory integration. In theory, the Association Agreements have cleared away many of the trade obstacles that existed in 1995, whilst the Neighbourhood Action Plans have provided a pathway and a mechanism, however modest, for achieving regula-

tory convergence. The MPCs' economies are more open and stable today: some countries have begun to undertake, if not yet complete, the necessary microeconomic and institutional reforms, and foreign investment in these more reform-minded countries has begun to reach the critical mass that will pave the way to new projects. The economic environment is probably more conducive today to implementing these large-scale projects, and the MPCs' production systems better positioned to benefit from them. However, the outcome will depend on both the nature of the projects themselves and the conditions under which they are implemented. Aside from the civil protection initiative and the Euro-Mediterranean University, the other projects all have clear and considerable economic potential, although the SME initiative falls beyond the geo-economic scope of this article.

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The first project aims to provide a well-defined regional public good: de-pollution of the Mediterranean. Regional cooperation is clearly required to achieve more sustainable management of the Mediterranean Basin's water resources, especially on the southern shore. A long list of intermediate objectives have been identified, ranging from improving water quality to reducing pollution levels, increasing water management efficiency, balancing supply and demand, conserving and restoring natural environments and adapting to climate change (Aciman, 2009). As with the Solar Plan and the transport initiative, the approach has focused on the industrial and engineering dimensions of specific, more or less scalable projects that are likely to generate different degrees of production chains. The debate has mainly centred on how to finance and identify investments, primarily in projects to increase savings and efficiency, urban sewage treatment and desalination plants. All of this would improve access to a basic resource – water – whilst at the same time reducing pressure on it, resulting in decreased pollution of the Mediterranean Basin.

This is undeniably a major problem and one whose resolution would directly benefit the people of the south in terms of quality of life, in addition to being a key factor for ensuring balanced regional development in the MPCs. However, these projects also require improvements in the institutional environment for water management in MPCs, including the need to reflect on the resource's opportunity cost in order to incentivise savings. Moreover, for these projects to serve a structural purpose, efforts must be made to ensure that the benefits are distributed efficiently and equitably, for example, to ensure that they accrue to rural regions as well as urban ones and, within both, to those areas with the most pressing water needs. In any event, except for a few low-impact, cross-border projects, the potential for integration would seem to lie more at the national than intra-regional level. Though the objective is a regional public good, the solutions are local and, at first glance, unlikely to have any significant spillover effects on Euro-Mediterranean integration.

The MPCs' geographical location makes them natural candidates to serve as logistics hubs between Asia, Africa and Europe

The projects to create and improve land and maritime highways are more clearly aimed at boosting regional integration. They seek to enhance Euro-Mediterranean integration by addressing transport costs, in particular on the southern shore, but also between it and the European Union. The projects range from railways and roads to improving maritime safety; however, the greatest short- and medium-term potential lies in promoting ports and logistics. Globally, the MPCs' geographical location makes them natural candidates to serve as logistics hubs between Asia, Africa and Europe. At the sub-regional level, these projects reduce transport costs by eliminating the bottlenecks arising from the lack of such infrastructure and are thus critical for regional production integration. Locally, they create business opportunities in the offshore services and transport sectors. Unlike water management, which has a direct impact on people's quality of life, these types of projects are geared more towards enhancing the competitiveness of the MPCs' production structures (specifically, the total factor productivity), encouraging the emergence of logistics

hubs and facilitating their integration, along with that of southern Mediterranean industry in general, into the European and international value chain.

From a political economy perspective, these types of initiatives tend to provide more benefits to those segments of the population that are more deeply involved in industrial export activities. They would therefore strengthen such groups' capacity to make their preferences known in the sphere of internationalisation. However, their impact as a factor on regional structuring will ultimately depend on how they are approached. An international port would do more to facilitate regional production integration between MPCs and the EU than sub-regional integration among the MPCs themselves, which would probably benefit more from more modest improvements in land routes and border-crossing points. However, Euro-Mediterranean integration should not be sought at the expense of structuring the MPCs' own territory, which is essentially a local issue. Returning to the previous example, an improvement in the rural transport network would significantly contribute to regional integration, allowing rural communities to trade and connect with the rest of the country and their Mediterranean neighbours.

Finally, the Mediterranean Solar Plan consists of a series of projects to promote the deployment of renewable energies in the MPCs. Despite the plan's misleading name, its contents span the full array of renewable energy technologies – primarily wind and concentrated and photovoltaic solar power – as well as increased energy efficiency. The plan aims to generate electricity from renewable sources both for domestic consumption by the MPCs and for the export of green energy to the EU. The MPCs have major wind and solar potential, and non-oil-producing MPCs are facing serious energy restrictions and long-term projections of growing demand. For their part, EU member states are bound by the new renewable energy directive to meet the 20/20 target (20% renewable energy by 2020). As many of them may have trouble meeting it, the directive provides for the possibility of cooperation between member states and third-party countries to import green energy under relatively restrictive conditions.

The Solar Plan has several facets. In addition to investment in the sphere of generation (wind and photovoltaic farms and solar thermal plants), it includes several strict requirements. Many have regional implications and significant potential at the structural level. As one of the articles in this yearbook specifi-

cally discusses the Solar Plan as a means of integration, this article will simply highlight certain key aspects.¹ First, it calls for the construction of long-distance high-voltage transmission lines to export green energy to Europe with minimal transmission losses. At present, there are only two operational Euro-Mediterranean power grid interconnections: the one linking Spain and Morocco by way of the Strait of Gibraltar and the low-capacity interconnection between Turkey and Greece. Second, it reinforces the goal of completing the Mediterranean energy ring, which would be a true example of regional cooperation; specifically, it would have strong potential to enhance integration in the Maghreb. Third, renewable energies are highly grid-intensive and would require the development and modernisation of the MPCs' electrical grids, which would benefit consumers in the south. Finally, and above all, the deployment of renewable energies requires the implementation of a clear regulatory framework that offers sufficient compensation throughout the transitional period required for them to become competitive.

In general, the main obstacles continue to be political and, in a related vein, institutional and regulatory. Regional competition tends to limit cooperation and ensure the continuance of fragmented production systems. Nevertheless, the few experiences with bilateral cooperation to date show that regional cooperation is feasible. In the Maghreb, Tunisia and Morocco have made progress on cooperation in the area of port infrastructure and fly-over rights; Tunisia has plans for a deep-water port at Enfidha to be directly linked with Tanger-Med in Morocco, and both countries have agreed to liberalise transport. This notwithstanding, much, if not most, of the steep transport costs borne by MPCs can probably be attributed to institutional shortcomings. If these are not remedied, the impact of any new infrastructure may fall short of expectations. Customs procedures continue to be cumbersome, despite improvements in countries such as Morocco and Tunisia; impediments to the provision of cross-border transport services are widespread; and shipping procedures are quite costly.

Something similar can be seen in experiences integrating power grids. Morocco, via Spain, is the only MPC that is interconnected with the EU. Within the Maghreb, Tunisia and Algeria are interconnected, and Algeria plans to connect to the European grid via

Morocco.² However, as with transport, the institutional obstacles cannot be overcome with infrastructure alone. Technical aspects, such as the lack of harmonisation of technical standards, and regulatory aspects, such as those concerning payment and compensation mechanisms, must also be factored in. Moreover, in the sphere of energy, national preferences tend to have an important security component, which can affect the regional balance. For example, oil-importing MPCs are wary of increasing their dependence on exporter neighbours whom they see as geopolitical competitors. This may be why the UfM project focuses on renewable energies: the integration of conventional energy sources is daunting (even within the EU) and project participants prefer to follow a less sensitive and less institutionally defined path. Nevertheless, what would truly serve to structure the region's energy market would be to complete the Euro-Mediterranean gas and electricity rings and to take steps toward the establishment of a Euro-Mediterranean Energy Community.

The institutional obstacles cannot be overcome with infrastructure alone

As seen above, although these projects have the potential to contribute to the region's economic integration, how much they ultimately do so will largely depend on how they are oriented and implemented. If the physical investments and enhanced infrastructure are widespread and accompanied by improvements in the respective institutional frameworks and knowledge and technology transfers, they will greatly contribute to structuring the Euro-Mediterranean space. In contrast, if they are seen as major projects carried out in isolation from the regional environment at large, unable to spark regional, production or technology chains, they may come to be viewed as a failed experiment. And if they fail, it will be impossible to justify them even as a plan to promote certain European industries and engineering sectors. The Mediterranean has a long history of grandiose projects and cathedrals in the desert; however, prestige projects cannot be carried out at the expense of other, equally important projects better suited to structuring the

¹ See also Marín and Escribano, 2009.

² Red Eléctrica Española is cooperating with grid operators in the Maghreb to synchronise its grid.

economic space at the local and national levels. This is true even if these projects are implemented with EU financing, or, more accurately, precisely because they are.

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Finally, and regardless of the integration prospects of the sectoral projects considered here, sectors with equal or greater potential for regional integration and a potentially higher impact are needed. First, a more multi-track and proactive approach could be taken to foster the development of certain industrial sectors. Multiple studies have identified industrial and service sectors and branches with strong potential in the MPCs. Several could be used to structure sub-regional industrial networks, especially in the agricultural, automobile, electronics and textile industries (Abdelkrim and Henry, 2009; Ghilès, 2008). One interesting approach would be to encourage integrated cross-border sectoral clusters through training and the transfer of know-how and technology. Second, the agricultural sector and rural world are glaringly absent from the initial drafts of the projects announced to date. The most inclusive projects and those most able to provide structure to the Euro-Mediterranean space will probably be those based on rural development and agricultural modernisation, which are inexplicably missing from the UfM and have great potential with regard to integration. As for the rest, the UfM's physical approach has allowed institutional reforms to fall by the wayside. Although less tangible, these reforms are, in the end,

what will sustain the production structure. Wide-ranging reforms, such as those relating to the justice system or public administration, may be preferable to the creation of institutional enclaves in the electrical, logistics or water management sectors. In short, in addition to identifying, financing and managing projects, physical integration requires institutional convergence to ensure that they have a spillover effect on the region at large and that there are competitive sectors ripe for integration.

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