EURO - MEDITERRANEAN ECOFIN SENIOR OFFICIALS MEETING
(BRUSSELS, 27 JUNE 2007)

OVERVIEW OF RECENT ECONOMIC DEVELOPMENTS IN MEDITERRANEAN COUNTRIES[1] WITH A FOCUS IN THE FOUR PRIORITY AREAS AGREED BY EURO-MED ECOFIN IN SKHIRAT (JUNE 2005)

BACKGROUND NOTE

EUROPEAN COMMISSION
DIRECTORATE GENERAL ECONOMIC AND FINANCIAL AFFAIRS

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[1] The terms Mediterranean countries or MED countries in this paper refer, if not stated otherwise, to the Mediterranean countries participating in the Euro-Mediterranean Partnership. These are Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and the OPT.

Background

This background note has been prepared by the European Commission as a contribution to the discussions at the first Senior Officials' meeting (Brussels, 27 June 2007), session 1.

The aim of this note is to provide senior officials with an overview of recent economic developments in the four priority areas for reforms agreed upon at the first Euro-Mediterranean ECOFIN Ministerial meeting (Skhirat-Rabat, June 2005): (i) improving the business climate to enable firms to invest, create jobs and expand; (ii) further liberalizing trade and opening the economy, while simultaneously protecting the most vulnerable groups of the population, to increase competitiveness, efficiency and productivity; (iii) upgrading public institutions and governance systems to improve public service delivery, particularly in education, and raise transparency and accountability; while, at the same time, (iv) consolidating macroeconomic stability and public finance management. A first overview of developments in these areas was presented by the European Commission and discussed at the 2nd Euro-Mediterranean ECOFIN Ministerial meeting held in Tunis in 2006. Participating countries mandated thereafter the EC to continue providing this type of analysis in subsequent Euro-Med ECOFIN meetings.

Senior officials are therefore invited to discuss progress made in each of the four agreed priority areas hereto briefly described, and to present a set of jointly agreed conclusions pertaining to this particular session. General conclusions from the SO meeting will be presented for endorsement to the Ministers of Finance at the 3rd Euro-Med ECOFIN Ministerial meeting to be held in Porto on 15 September 2007.

I. Summary of the overall situation in the region[2]

The economies of Mediterranean countries performed well in 2006. Most economies kept on growing at a good pace, with **real GDP** increasing on average by 4.8% in 2006, up from an average of 4.4% in 2005. The economic performance of the Mediterranean region would have been even better if conflicts had not ravaged the economy of two countries, Lebanon and the Occupied Palestinian Territory (OPT). Lebanon's stagnation in 2006 resulted from the damages caused by the military conflict with Israel and the political tensions and uncertainty that ensued. In Palestine, the economy contracted by 8%, after several years of expansion. On a per-capita basis, the region as a whole grew by an average 1% (2.6% excluding the OPT), bringing about an improvement in income levels and reducing the gap with incomes observed in the EU. Accelerated economic growth rates boosted job creation and reduced unemployment for a second year in a row.

Average **inflation** increased in the region during 2006, fuelled by increases in administered prices for transport and energy products in many countries as a result of higher oil prices. Continuing high oil prices resulted in fiscal surpluses in some oil-exporting countries. However, **fiscal balances** also improved in oil-importing countries following renewed efforts in the region towards fiscal consolidation, mainly through public sector reform and tax reform programmes. Improved fiscal balances translated into gradually declining levels of gross government debt in several Mediterranean countries, which, on average, contracted from 84.7% of GDP in 2005 to 81.4% in 2006, a movement in the right direction but still insufficient. Many Mediterranean countries therefore remain quite vulnerable to economic shocks. Finally, the robust growth of the tourism industry in the region, together with record remittances from workers abroad, resulted in marked improvements in the current account balance of several countries, which helped to reduce the overall current account deficit in the region.

Slow but steady progress towards **trade liberalisation** has been taking place in the Mediterranean region since 2000, with some countries being among the world's top reformers over this period. Association Agreements with the EU are now in force in almost all the Mediterranean Partners and their provisions continue to be implemented, although at a variable rate. Regional negotiations towards services and investment liberalisation started in July 2006 with a group of Mediterranean countries, and further progress towards agricultural trade liberalisation was recorded in several countries. In addition, two new European Neighbourhood Action Plans have recently been concluded with Lebanon and Egypt, paving the way towards deeper economic integration with the EU. However, intra-regional economic integration remains a major challenge for Mediterranean countries. Regional agreements continue to be plagued by implementation problems, thus revealing a lack of political commitment towards a more integrated regional market.

Regarding the **business environment**, over the period 2003-2006, reforms in the region as a whole progressed in line with the world average, but performance remained unequal between countries. Egypt and Morocco were among the world's fastest reformers, but progress in other

[2] Reform indicators used in sections 3, 4 and 5 for trade liberalisation, business climate, and public institutions and governance are mainly, although not exclusively, based on the World Bank (2007), *MENA Economic Developments and Prospects. Job Creation in an Era of High Growth.*

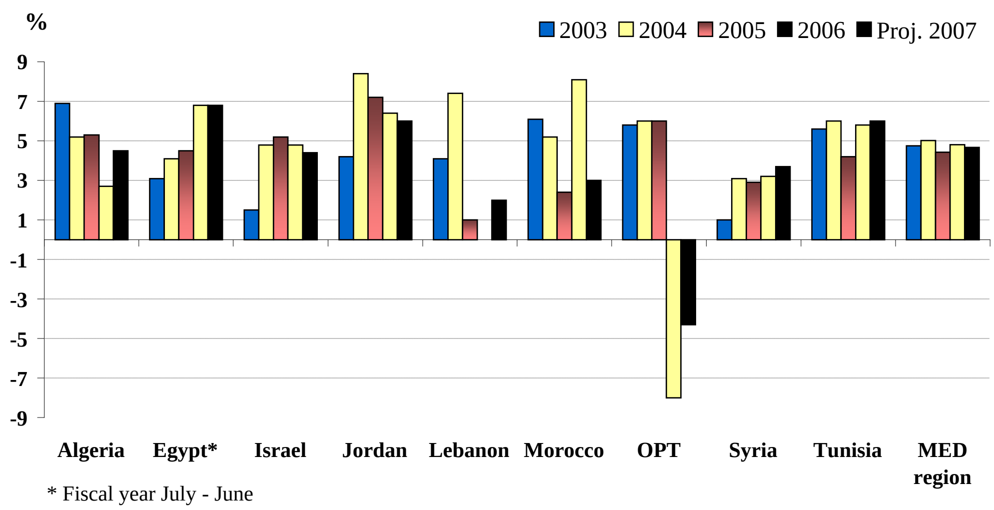
countries was below the world average. The region is progressing at a faster pace than the rest of world in some areas key to improving the business environment, such as contract enforcement and starting a business, but average performance is still poor in others, such as closing a business, licensing requirements and court efficiency in solving commercial disputes.

Improving **governance** systems, a complex multidimensional concept, remains particularly important for the MED region. As a whole, the region performs above the world average regarding the quality of public administration, an area where progress has been particularly fast over the past six years. Countries in the region are also improving public sector accountability, a dimension of governance in which the region ranks poorly compared to others. Despite this progress, however, corruption is a problem, civil society in the region is still underdeveloped, and political debate remains constrained in most countries.

II. Consolidating macroeconomic stability and public finance management

On average, the economies of the Mediterranean countries continued to experience high growth rates during 2006. Strong increases in domestic demand, a substantial economic recovery in the EU leading to a better export performance, and the moderation of oil prices in the second half of 2006 boosted the average **real growth rate** to 4.8% from 4.4% in 2005. However, country-specific analysis reveals a mounting disparity in real growth rates, ranging from a remarkable 8.1% in Morocco — mainly due to its extraordinary agricultural output — to a high, although lower than expected contraction in the OPT of about 8%, reflecting the economic consequences of mounting tensions with Israel following the January 2006 elections (Chart 1).

Chart 1 - Real GDP growth rate



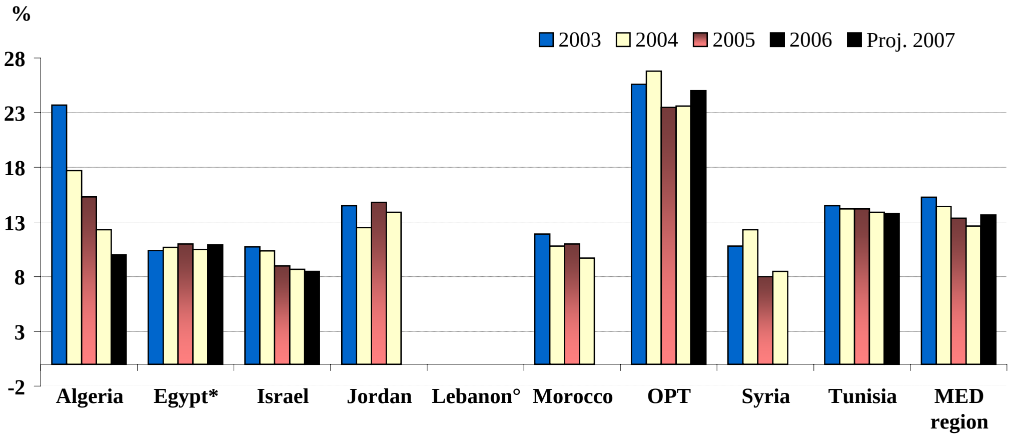
Source: IMF.

Excluding the OPT and Lebanon, where conflict triggered economic recession in the former and stopped growth in the latter, all Mediterranean countries experienced positive growth rates in 2006, with oil-importing countries, particularly Morocco, Egypt and Tunisia, leading the growth-accelerating group of economies in the region. Growth in these countries was due not only to a favourable economic environment, but also to extraordinary tourism revenues, remittances and

FDI inflows. Strong rates of growth in Mediterranean countries have led to a fairly small increase in income levels in the region. On a per-capita basis, real GDP grew on average only at 1.0% in 2006

Accelerating economic growth in the Mediterranean countries has boosted job creation and a decline in **the rate of unemployment** (chart 2).[3] The average unemployment rate declined for the second time in a row to 12.6% in 2006, down from 13.4% in 2005 and 14.4% in 2004, even though the labour force grew by 2.2% and 2.5% in 2005 and 2006, respectively. However, despite raising employment growth, unemployment in the Mediterranean region remains high. The problem is particularly acute among the young and the qualified, with mounting frustration among graduate cohorts because of limited job opportunities.

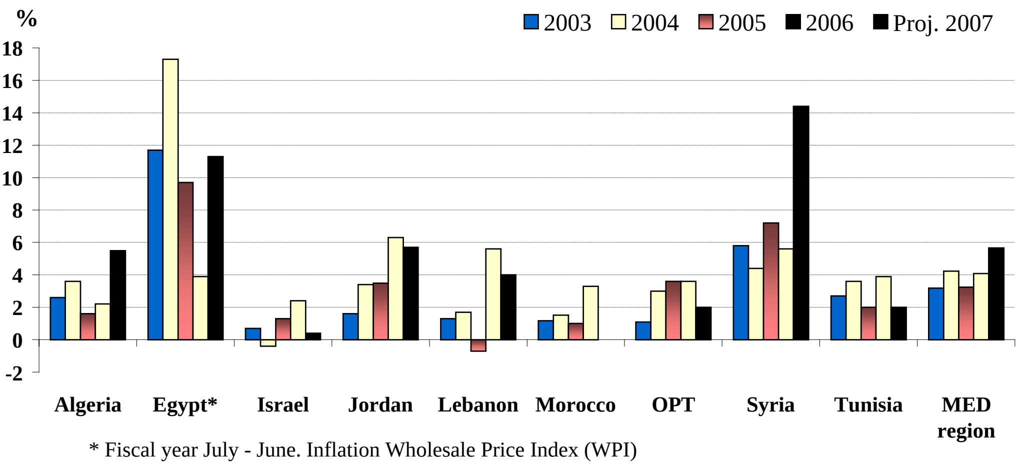
Chart 2 - Official Unemployment Rate



* Fiscal year July - July.
° Data are not available.

Source: IMF.

Chart 3 - Inflation rate



* Fiscal year July - June. Inflation Wholesale Price Index (WPI)

Source: IMF.

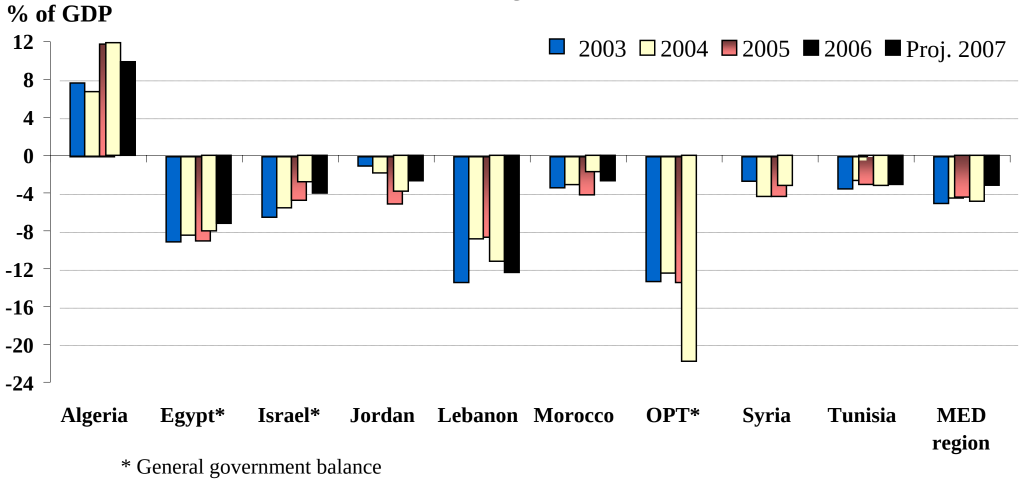
[3] The average unemployment rate projection for 2007 is strongly biased by the lack of available estimates in more than 50% of countries considered and by the high estimates of unemployment rates in the OPT in 2007.

Average inflation (see Chart 3) remains subdued, but increased in 2006 to 4.1% from 3.2% in 2005. The greatest changes in the region year-on-year were recorded in Lebanon and Egypt. The conflict in Lebanon greatly disrupted economic activities, causing prices to soar and inflation to jump to 5.6% in 2006 from a previous -0.7% in 2005. Following a significant improvement in 2006, inflation in Egypt accelerated sharply during the fiscal year 2007 (starting in July 2006) due to increases in the administered prices for fuel, accelerating economic activity and the impact of bird flu on food prices. Higher consumer prices in 2006 in Jordan, Morocco and Tunisia also reflected government efforts to reduce price subsidies and increases in administered prices for transport and energy products.

The average **general government deficit** deteriorated slightly in 2006, standing at 4.9% of GDP, up from 4.4% in 2005. However, the average data are strongly biased by the emergence of a major fiscal crisis in the OPT in 2006. Excluding the OPT from the average leads to a more favourable picture, with the average fiscal deficit contracting to 2.8% of GDP in 2006 from 3.3% in 2005 (chart 4). Indeed, a majority of Mediterranean economies improved their fiscal balance, with oil-importing countries surprisingly leading the way, particularly Morocco (1.7% in 2006, down from 4.0% in 2005) and Israel (2.8%, down from 4.6%).
In Morocco, fiscal consolidation is the result of a combination of successful reforms on several fronts: a fundamental restructuring of the public administration (including a voluntary retirement programme, which has helped to curb the wage bill), wide-ranging improvements in the budget management system and substantial reform of the tax system to stabilise revenues and improve the fiscal system. This combination bodes well for the long-term sustainability of fiscal consolidation and its impact on growth.

Extraordinary oil revenues have also helped Algeria to maintain a fiscal surplus, amounting to 11.9% of GDP in 2006, which could have been even higher if the government had not subsidised oil prices and allowed for extraordinary expenditure. In sharp contrast with the regional trend in 2006, the fiscal situation collapsed in the OPT with the public deficit standing at 21.8% of GDP, up from an already worrisome 13.3% in 2005.

Chart 4 - Central government balance

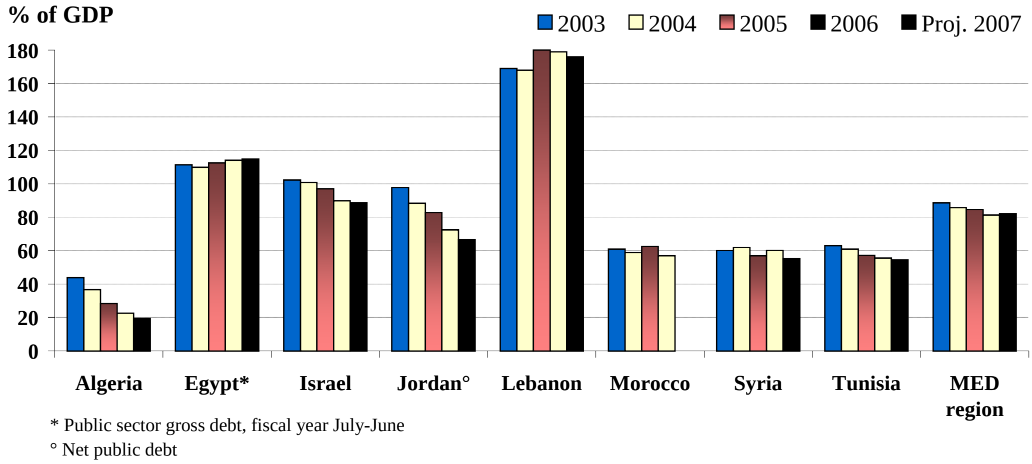


Source: IMF.

Last year's improvements in the fiscal balances of some Mediterranean countries have translated into gradually declining levels of gross government debt in Jordan, Israel and Morocco (chart 5). Consequently, the average gross public debt in the region contracted to 81.4% of GDP in 2006 down from 84.7% in 2005, but still remains too high, particularly when compared with the current average gross public debt of 19.4% of GDP in countries to the East of the EU.[4] Behind the regional average, however, there is a wide variation from country to country. Public debt is by far the highest in Lebanon at 179% of GDP in 2006, followed by Egypt at 114% of GDP in 2006, a level considered to be one of the main constraints on economic growth. At the other extreme, Algeria has substantially reduced its outstanding debt using its oil revenues.

Although progress is being made, the combination of a high public debt and a high budget deficit remains a challenge, particularly in Egypt, Israel, Lebanon and Jordan.

Chart 5 - Total gross public debt

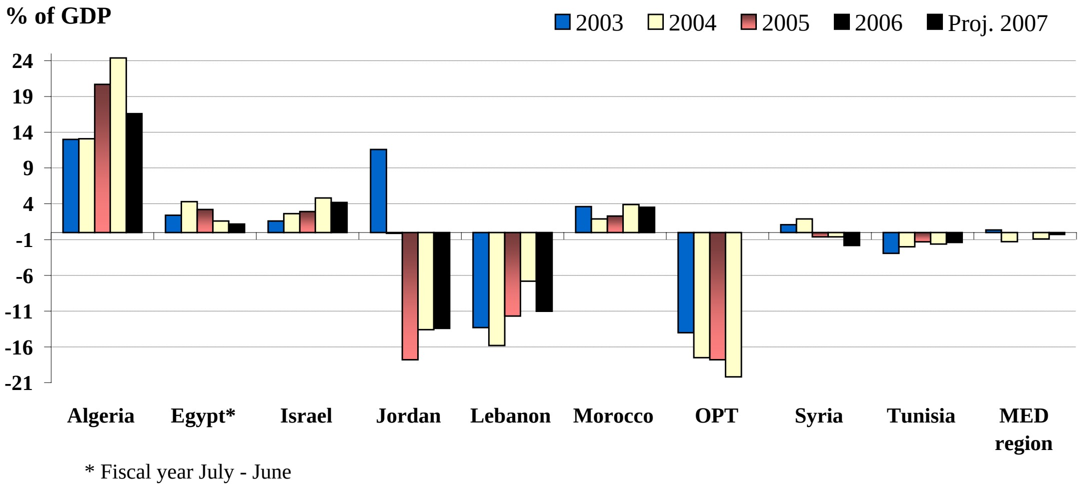


Source: IMF.

During 2006, the evolution of the **current account balance** in many Mediterranean countries was favourable. The average current account deficit nearly halved to 1.2% of GDP from 2.2% in 2005. This figure conceals a wide variation between countries (Chart 6). Boosted oil revenues in oil-exporting Algeria translated into growing current account surpluses (2006: 24.4%; 2005: 20.7%; 2004: 13.1%). However, the expected deterioration in the current account balances of oil-importing countries did not materialise. Negative trade balances in Morocco and Egypt were offset by record tourism revenues (about 9% of GDP in Morocco and 7.6% in Egypt) and growing remittance inflows, resulting in current account surpluses in both countries (3.9% and 1.6%, respectively). In contrast, high current account deficits were recorded in Jordan, Lebanon and the OPT, with the deficit in the latter now over 20% of GDP mainly due to the limited ability of Palestinian traders to export and due to banking restrictions affecting transfers to the Palestinian Authority. In Lebanon, the military conflict sharply reduced exports and revenues from tourism, although increased transfers and a radical drop in imports helped to limit the increase of the current account deficit in 2006.

[4] The eastern neighbours of the EU under the ENP are Azerbaijan, Armenia, Georgia, Moldova, Ukraine and Russia. See also the overview of this region in the next chapter.

Chart 6 - Current account balance



Source: IMF.

Declining public deficits and gross government debt levels in some Mediterranean countries are intimately related to their efforts to improve their **budget and fiscal management systems**. Progress in this field has been seen mainly in Morocco[5] and Jordan. In the former, fiscal transparency has been increased by improving access to financial information, control over the processes involved in preparing and executing expenditure and the quality of financial data. In Jordan, the establishment of a single treasury account, the modernisation of the budget classification and strengthening of the budget processes have been key elements in the reform of a public finance management (PFM) system. However, few signs of progress can be detected in the remaining countries. In some countries, high oil revenues have acted as a deterrent to public expenditure reforms; in others, the difficult political environment has even reversed some past reforms, as in the case of the OPT, where the single treasury account was discontinued and modern internal audit and control methods were suspended.

The overall situation with respect to PFM in the Mediterranean region points to the need for action to meet the transparency standards of international best practices. Short-term reforms should aim for the gradual expansion of budget coverage and monitoring, the modernisation of government accounting, improvements in financial reporting during the execution of budget law, and the evaluation of fiscal risks.

III. Improving the business climate to enable firms to invest, create jobs and expand[6]

Creating the number of jobs needed to cope with growing populations and rising numbers of entrants in the labour market greatly relies on maintaining and accelerating the current rates of

[5] Since the end of 1990s, Morocco has embarked on a process of PFM modernisation. Progress has been achieved in implementing: i) a new performance-based budget approach by, among other things, increasing the transparency of budget laws; and ii) an MTEF, including better quality of financial information and improved access to this information.

[6] This section contains information on all MED countries excluding Israel. Overall, Israel outperforms all other countries in the region in an index measuring the ease of doing business. Including Israel in the regional averages would have greatly distorted the general trends described in this section.

economic growth and on pursuing further reforms to improve the business environment. This is all the more important in a context characterised by the limited ability of the public sector to further generate employment and by reinforced controls over migration.

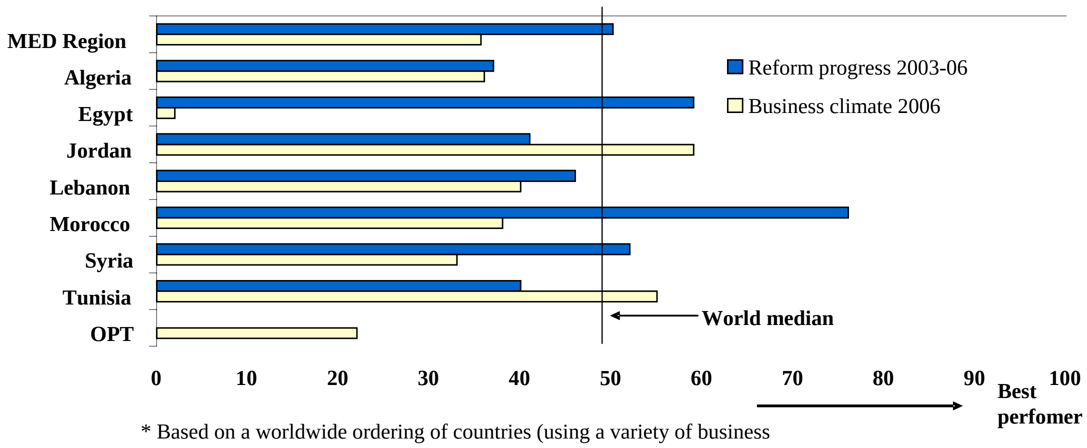
For the last three years, the **progress** made by the region in reforming the business environment has been in line with the world average,[7] with reforms concentrating on easing the conditions for starting a business and enforcing contracts. This points to the need to pursue efforts in other areas that remain the greatest obstacles for doing business, such as high licensing requirements and inefficient courts. Within the region, the reform efforts were led by Morocco followed by Egypt and Syria, all performing above the world average.

Overall, however, the Mediterranean countries remained under the world average in 2006 in an index measuring the **business environment,**[8] even showing a slight deterioration compared with the situation in 2005. The region still has a few countries ranking among the least business-friendly in the world (Egypt, Syria, the Occupied Palestinian Territory and Algeria). Country-specific analysis shows that only two countries in the region, Jordan and Tunisia, perform above the world average — replicating the situation in 2005 — although their overall performance has deteriorated compared with the situation in 2005, particularly in Jordan, which has lower scores on every indicator in 2006, in stark contrast with the marked improvement in 2005. Year on year, improvements were recorded only in Morocco and Egypt, which reflects their strong reform efforts over the last three years, well above the world average, particularly in the case of Morocco (chart 7). The performance of all the other countries in the region deteriorated in 2006 compared with 2005, the greatest regressions being recorded in Jordan, the OPT and Algeria.

[7] That is to say that these countries ranked on average in the 50th percentile with regard to business environment reform in the period 2003-06, surpassing the reform efforts in other regions such as East Asia and South Asia and high-income OECD countries.

[8] The current status of the business environment in 2006 is measured using a business environment index combining the information contained in ten business environment indicators: 1) ease of starting a business; 2) ease of closing a business; 3) ease of employing workers; 4) ease of enforcing contracts; 5) ease of registering property; 6) ease of paying taxes; 7) degree to which investors are protected; 8) ease of dealing with licenses; 9) ease of getting credit; and 10) ease of trading across borders. The index is expressed as a cumulative frequency distribution, with 100 reflecting "best policies" worldwide and 0 representing "worse policies" worldwide. World Bank (2007) *MENA Doing Business 2007.*

Chart 7 - Business environment in 2006 vs. regulatory reform 2003-2006*



* Based on a worldwide ordering of countries (using a variety of business environment indicators), and expressed as a cumulative distribution function ranking economies from 0 to 100 (best).
Note: Reform progress 2003-06 for OPT is not available.

Source: World Bank, 2007.

One of the fundamental factors behind the poor business environment in Mediterranean countries is **highly restrictive labour market regulation**. Although labour market restrictions decreased in the region in 2006, employing workers remains difficult, particularly in Morocco and Egypt. Region-wide, reform efforts have largely focused on improving the ease with which workers can be hired by expanding the power of businesses to employ temporary workers, but restrictions on firing workers still remain in place.[9] However, the situation in the region varies widely: Morocco still imposes extremely strict regulations on hiring workers (ranking 100th) but has relaxed regulations on firing workers. In 2006, Tunisia and Syria relaxed the rules on hiring workers, although Tunisia still has very rigid labour regulation, nearly the strictest in the region, only behind Morocco. However, improving the flexibility of labour markets is not just about changes in the ease with which workers can be hired and fired. Some Mediterranean governments are serious about labour market reforms aimed at stimulating the role of the private sector in employment generation. Morocco's recent labour market reforms should help ease the current rigidity of employment,[10] particularly when the effects of the new labour code come to fruition. Tunisia's recent National Economic and Social Pact, under which real wages will follow productivity growth in the non-oil sector, might also increase the competitiveness of the economy and boost job creation.

Substantial reform efforts have been undertaken in the Mediterranean region during the last three years to improve contract enforcement and the ease of starting a business**,** with some Mediterranean countries performing well above the world average. As regards **contract enforcement**, Egypt, Jordan and Morocco have been among the top reformers since 2003, but

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[9] This is the case with Syria and Egypt, where there are no problems hiring workers (ranking 0 in an index measuring the difficulty of hiring) but greater obstacles to firing workers (50th position for Syria and Egypt with a ranking of 100th, meaning total rigidity). Indeed, under Syrian law, only the Prime Minister can fire public sector workers, who make up 90% of the employed population. Firing for redundancy in Egypt is still illegal.

[10] The voluntary retirement programme introduced by the government in 2005 aims to encourage public officials to move to the private sector, thus mitigating pressure on the public sector. Other measures to boost the dynamics of the labour market include, for instance, the Moukawalati programme aiming to create 30 000 SMEs by 2008 and the reorganisation of the Agency for Employment Promotion (ANAPEC).

enforcing contracts still remains very difficult in half of the countries considered.[11] As for the **ease of starting a business**, Morocco and Jordan are leading the efforts in the region. The former has reduced the number of procedures, the average time and the average minimum capital for starting a business, resulting in a sharp increase in business start-ups. In 2005, Egypt established a 'one-stop shop' to reduce the time and number of procedures and cut registration fees for new businesses by 40%, which has facilitated investment. In 2006, however, three-quarters of the countries in the region still ranked in the bottom third of countries worldwide in the ease of starting a business. Furthermore, Mediterranean countries still have a long way to go to reduce the time and cost of **closing a business.** Overall, the reform efforts in the region are well behind the world average, far short of those undertaken by OECD countries. Lebanon has been at the head of the reformers for the last three years in closing businesses, but progress seems to have come to a standstill in Jordan and Syria over the same period. During 2006, only two countries improved their ranking world-wide compared with the situation in 2005: Tunisia and Algeria, with the later having reduced the time needed to close a business from 3.5 years to 2.5 years. Tunisia, in the 90th percentile, remains one of the best countries worldwide for closing a business. Improved bankruptcy laws in Egypt should allow this country to significantly ease business closure procedures in the near future.

Mediterranean countries are also pursuing efforts to strengthen the efficiency and prudential standards in the financial sector, which will make it easier for the private sector **to get credit**. Reform efforts have mainly been undertaken by those countries with the lowest scores to date. In Morocco, for instance, banks have developed internal rating systems and now store credit information on a centralised database common to all credit institutions; Tunisia has also improved its credit appraisal techniques. Algeria has modernised its payment system and introduced performance contracts in public banks and Egypt is implementing a broad financial sector reform, including the privatization of some state-owned banks.

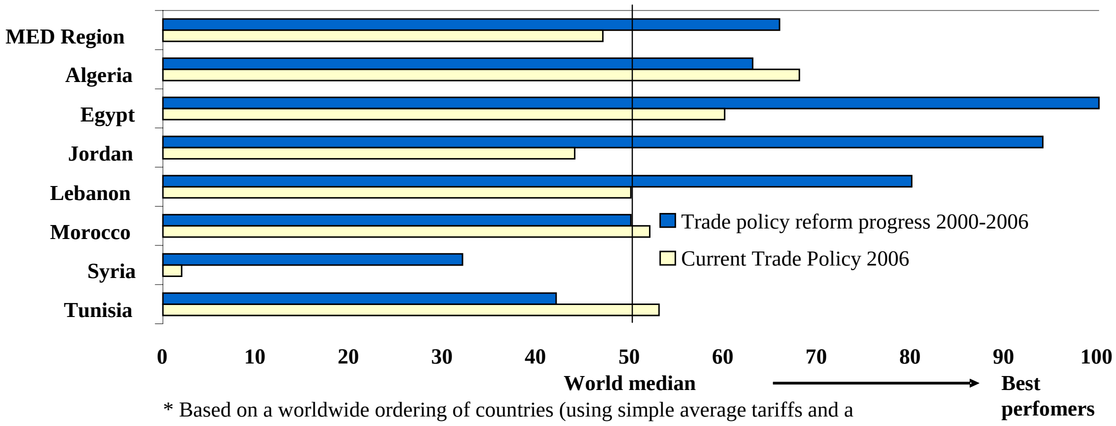
IV. Further liberalizing trade and opening of the economy, while simultaneously protecting the most vulnerable groups of population, to increase competitiveness, efficiency and productivity

Overall, there has been slow but steady **progress towards trade liberalisation** in the region since 2000, with Mediterranean countries doing significantly better than the world average in adopting more open trade policies (chart 7). In the last six years, for example, Mediterranean countries have managed to narrow the gap with the rest of the world as regards tariff barriers: while in 2000 they had the **highest level of protection in the world** (with simple average tariffs[12] standing at almost 23%, way above the world average of 13.6%), by 2006 average tariffs had fallen considerably to 16.8%, highlighting the growing efforts to moderate the average tariffs applied to goods[13] (see Table 1 in annex). From 2000 to 2006, Egypt abolished import fees and surcharges incompatible with GATT, Jordan joined the WTO and Algeria significantly reduced its maximum tariff rates and rationalised its tax and tariff structure, all of which puts them at the

[11] The average time to enforce a commercial contract in the region is 640 days, among the highest in the world, with Egypt and Syria being the extreme cases (1010 and 872 days respectively) and Tunisia scoring best (21 days).
[12] This reflects Most Favoured Nation (MFN) tariffs.
[13] In 2006, the MED region nevertheless again topped the world trade protection list, which reflects the rapid average world progress in this area.

forefront of trade policy reformers in the region. Tariff reductions also continued in Syria, although it has not yet ratified the Association Agreement with the EU.

Chart 8 - Current trade policy vs. reform progress 2000-2006*



* Based on a worldwide ordering of countries (using simple average tariffs and a variety of indicators, respectively), and expressed as a cumulative distribution function ranking economies from 0 to 100 (best).

Source: World Bank 2007.

Trade liberalisation implies, however, much more than reducing tariff barriers. Several milestones in the opening of trade have been reached in the region over the last six years: some Mediterranean countries (Morocco, Israel, Egypt, and Jordan — in July 2006) have adopted the **new Pan-Euro-Mediterranean Protocol of Origin,** which extends the pan-European system of origin cumulation to the Mediterranean region; **Association Agreements** with the EU have entered into force in Algeria, Morocco, Jordan, Lebanon and Egypt, adding to the existing agreements with Tunisia and the OPT;[14] and **Action Plans under the European Neighbourhood Policy (ENP)** have been agreed with Jordan, Morocco, the OPT, and Tunisia. Lebanon and Egypt have recently adopted their Action Plans (in January and March 2007, respectively), paving the way towards deepened economic integration with the EU.

In spite of these efforts, trade in the Mediterranean region is still burdensome in terms of time, costs and the number of procedures involved in trading across borders, with Syria and Algeria topping the list in 2006 on an index measuring difficulty in trading. Nevertheless, progress in **trade facilitation** accelerated in the region during 2006. Egypt, Jordan and particularly Syria have reduced both the number of days and documents needed for imports, and Syria has also reduced the number of days and documents for exports (although still remains among the most difficult countries worldwide to trade with). Trade facilitation efforts have not gone unnoticed by private investors in the region. **FDI in Mediterranean countries** soared in 2006, largely driven by the surpluses generated by the oil-boom revenues in the Gulf countries. Total expected inflows amounted to USD 23 billion in 2006, 35% up from 2005 and more than doubling the levels in 2004. Israel and Egypt accounted for the bulk of the increase, with Egypt receiving over USD 6 billion in the 2006 fiscal year and expecting over USD 8 billion in 2007. FDI reached a record USD 2.8 billion in Jordan in 2006, while Morocco and Tunisia too saw substantial, although declining, FDI inflows in the same period, with Lebanon also receiving a fair share of

[14] The Association Agreement with Syria remains to be put into force.

FDI during the first half of 2006. Gross capital inflows, mainly from Arab Gulf countries, grew by 171% compared to the same period in 2005, reaching USD 6.3 billion.

During 2006, all Mediterranean countries continued to **implement the provisions of the Association Agreements**, including the dismantling of tariffs for industrial products under the free trade agreements (FTAs). New prospects for further trade liberalisation opened up at the Fifth Euro-Med Trade Ministerial Conference in March 2006. A first wave of Mediterranean countries, including Morocco, Tunisia, Israel, Jordan, Lebanon, Egypt and the OPT, opened negotiations with the EU **to expand the present FTA coverage to include services and investment liberalisation**. Negotiations at regional level started in July 2006 on standard provisions for a future services and investment protocol to form the basis for bilateral negotiations. The Trade Ministerial Conference also served to confirm the intention of the Mediterranean countries to deepen **agricultural trade liberalisation** as agreed in the Rabat roadmap. In 2006, progress was made in this area by Morocco, which started negotiations with the EU towards progressive liberalisation of trade in agricultural, processed agricultural and fisheries products, though with some exceptions. Similar negotiations had already been concluded with Jordan, with the agreement entering into force in January 2006. During 2006, Egypt presented a full list of products due to be liberalised in early 2007 and reduced tariffs on processed agricultural products.

Trade openness has exposed Mediterranean countries to increased international competition. A recent study[15] on the **impact of the expiry of the WTO Multi-Fibre Agreement** (MFA) presents evidence indicating that some Mediterranean countries highly depend on the textile and clothing sector (Tunisia, Morocco, Jordan and Egypt) have experienced a drop in their share of the EU export market.[16] Since the removal of the remaining MFA quotas, textiles and clothing exports to the EU by Tunisia, Morocco and Jordan to the EU have declined by 5.8%, 7.4% and 13%, respectively. Egypt, whose exports are well diversified geographically between the EU and US markets, managed to maintain textile exports to the EU, with just a marginal decline of 1% in the value of textiles and clothes. On the other hand, Egypt and Jordan have both performed strongly in the US market after MFA removal. In 2005, exports to the US from the two countries increased by 8% and 13%, respectively, reflecting their preferential access to the US market through their Qualified Industrial Zone Agreements. Tunisian exports to the US also increased in 2005 after the removal of quotas (15.5%), in contrast with a decline of over 20% in Moroccan exports during the same period.

In sharp contrast with the efforts undertaken by Mediterranean countries to increase their integration with the rest of the world, **economic integration within the Mediterranean region** is still no more than embryonic and has so far failed to deliver the expected results. Regional initiatives to deepen South-South economic integration, such as the Agadir agreement,[17] continue

[15] Morocco, Tunisia, Egypt and Jordan after the end of the Multi-Fiber Agreement: Impact, Challenges and Prospects, World Bank, 2007

[16] The impact on the textile and clothing exports of these countries would have been greater if the EU had not reimposed quantitative restrictions on Chinese exports in 10 product categories in June 2005 in accordance with the safeguard provisions of China's WTO accession agreement. In July 2005, the US also reimposed quotas on China in six strategic product categories.

[17] The Agadir agreement aims for the establishment of a free trade area (FTA) between Morocco, Tunisia, Jordan and Egypt.

to be hampered by implementation problems such as aspects related to the exclusion of some agricultural and processed agricultural products, and the modalities to address non-tariff barriers. Some countries have made efforts to improve regional integration, such as Syria, which has signed twelve cooperation agreements with Iran in several areas ranging from energy to agriculture, and Jordan, which has negotiated a free trade agreement with the Gulf Countries including areas such as insurance and banking, agricultural products and the movement of persons.
Clearly, these attempts to deepen regional integration are steps in the right direction, because they help facilitate the movement of goods and services and improve the attractiveness of the region for foreign investors. But the economic benefits of opening domestic markets to neighbours would be much higher if trade liberalisation were to go beyond just free trade in goods and services. This is a key premise of the ENP, which advocates **economic integration including "behind-the-border" issues** such as addressing non-tariff barriers and progressively achieving comprehensive convergence in trade and regulatory areas, such as technical norms and standards and trade-facilitating customs measures, among others.[18] Indeed, boosting the competitiveness of the region will increasingly depend on this type of reform, rather than on comparative advantages based on pay differentials among unskilled workers. Overall, behind-the-border trade reforms have been slow to emerge in the region mainly because they touch upon areas traditionally used as last resorts to protect domestic markets. However, some progress has been seen in Egypt, Algeria, Morocco and Tunisia in the area of customs administration, particularly in the simplification of procedures.

V. Upgrading public institutions and governance systems

Governance is a very complex concept encompassing multiple dimensions, including the rule of law, controlling corruption, public sector efficiency and public participation, among others. Countries make efforts to improve the governance of the public sector because empirical evidence suggests that macroeconomic reforms have a greater chance of success in boosting economic growth and job creation when they take place in the right context, i.e. when they are put in place by a competent and clean public administration and when citizens can hold politicians accountable for the results. Indeed, cross-country growth accounting studies conclude that differences in the quality of the institutional framework explain a large part of the differences in economic development.[19]

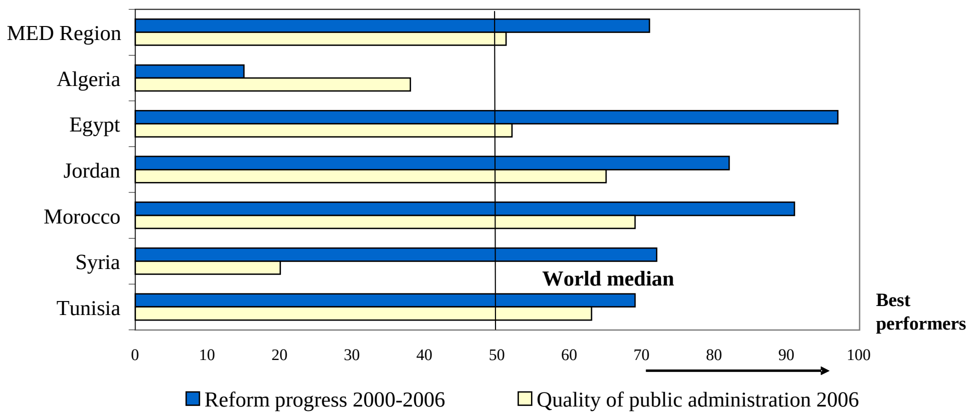
The ultimate goal of governance reforms is to build capable and accountable states that can devise and implement sound policies, provide public services, set the rules governing markets, ensure oversight of how public resources are used, and subsequently support development and economic growth.[20] The Mediterranean countries have made considerable efforts to **improve the internal accountability of their governments**, notably by increasing the quality of their public administration. The current status of the Mediterranean countries as measured by an index for the quality of the public service shows that, on average, the region ranks nearly on a par with the world average, with Morocco, Jordan and Tunisia enjoying the best public administrations in the region, well above the world average (chart 9). Some Mediterranean countries are among the

[18] See the Communication from the European Commission on strengthening the ENP, COM (2006) 726 final, 4 December 2006.
[19] See Barro and Sala-i-Martin (1995) and Hall and Jones (1999).
[20] *Strengthening World Bank Group Engagement on Governance and Anti-corruption*, World Bank 2007.

world's top reformers and have made substantial efforts to improve the **effectiveness of public administration**. Morocco and Egypt are both making faster progress than 90% of countries worldwide, backed by a strong government commitment towards improving the quality of services delivered by the public administration.[21] However, public administration reform is a slow process that will only show results over time: reforms to bureaucracies generally take quite a while to improve government performance.

Progress is still needed on other indicators of the quality of the public administration, such as the degree of **transparency** that governments exhibit towards the general public. For instance, no Mediterranean country guarantees citizens the right to information and some countries even repress that right. Public access to national accounts has improved, however: the Ministers of Finance in most countries have eased access to key economic and financial information and substantially shortened the delays in making updates available. However, the lack of economic transparency is still a problem in Mediterranean economies, particularly in the banking sector. Substantial bank assets are still controlled by state-owned institutions, a situation that undermines competition, increases the opacity of bank operations and often leads to excessive and misused government spending. Efforts to improve banking efficiency and to control corruption in lending by privatising state-owned banks and passing banking regulatory laws aimed at increasing the transparency of banking operations (public disclosures of financial data, for instance) have been recently undertaken by Morocco,[22] Egypt,[23] Algeria[24] and Jordan.

Chart 9 - Quality of public administration in 2006 vs. reform progress 2000-2006*



* Based on a worldwide ordering of countries (using a variety of governance indicators), and expressed as a cumulative distribution function ranking economies from 0 to 100 (best).

Source: World Bank, 2007.

[21] In Morocco, the public administration reform put in place in 2003 has helped improve the efficiency of public service delivery and public service management. More details on this reform are given in the section dealing with fiscal developments.

[22] Morocco has restructured two major state-owned banks, the Crédit Immobilier et Hôtelier (CIH) and *Crédit Agricole du Maroc* (CAM). Following restructuring efforts, two leading financial institutions, the Moroccan *Caisse de Dépôt et de Gestion* and the French *Caisse Nationale des Caisses d'Epargne Française*, now participate in the capital of the CIH.

[23] Egypt has announced plans to privatise the Bank of Alexandria in 2007. Further privatisation of state-owned enterprises is planned to continue in the fiscal year 2007 at a similar pace as in 2006.

[24] The privatisation of the first public bank, the Crédit Populaire d'Algérie, is planned in the short term and two other banks, *Banque Nationale d'Algérie* and *Banque Locale de Développement*, have been identified as candidates for privatisation.

Controlling corruption is another indicator of the quality of the public administration. Public administrations that combat corruption effectively are generally more attractive to foreign investors and can thus count on additional resources to spur growth. However, perceived levels of corruption are still high in the majority of Mediterranean countries. In 2006, only two countries in the region, Israel and Jordan, scored above the world average in a corruption perception index.[25] Compared with 2005, scores deteriorated in most Mediterranean countries with substantial improvements recorded only in Algeria and Lebanon (which however continue to score under the world average). The notable deterioration in the perceived level of corruption in Jordan might be the result of a delay in adopting some of the provisions in the UN Convention against Corruption, such as establishing an anti-corruption commission, whistle-blower protection and freedom of information laws. However, Jordan's performance in 2006 should not mask its positive overall performance in the fight against corruption over the last decade. A relative liberal stance on political and social affairs and numerous new laws based on international standards still makes Jordan the cleanest country in the region (coming only after Israel).

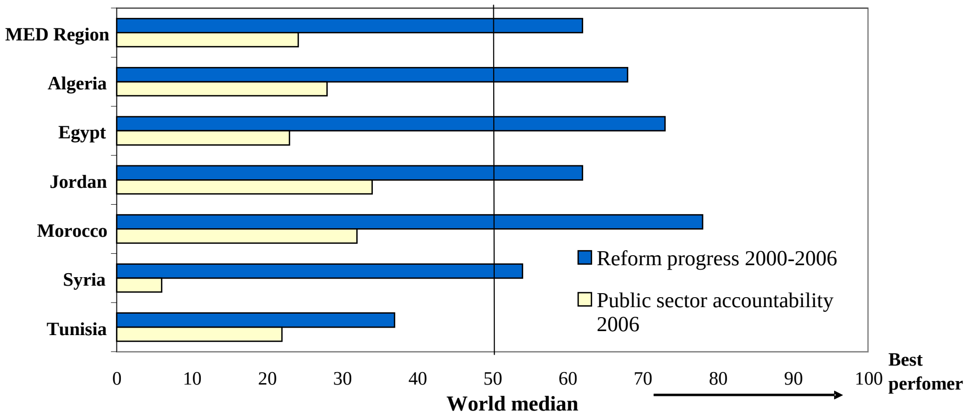
However, the country scores should be interpreted with caution, as they are based on current perceptions. The domestic reforms currently ongoing in some Mediterranean countries will take time to affect future scores, which may hide somewhat present efforts to combat corruption. Indeed, several countries are taking serious steps to limit the extent of corruption within their public administrations. In April 2005, Morocco announced a plan to fight corruption, including one measure requiring all senior office holders to make a formal disclosure of their assets and net worth before and after holding public office. In early 2007, the Moroccan government also adopted a law on money laundering and consolidated transparency in the process of awarding government contracts. In January 2006, Algeria enacted an anti-corruption law, including a code of conduct for public servants and protection for whistle-blowers. In contrast, other countries have not made enough progress in this field; for instance, the OPT has not yet adopted a national anti-corruption strategy and anti-corruption measures have been intermittent.

The protection of property rights and other **regulations affecting the business environment**, such as the ease (or difficulty) of enforcing contracts are also the responsibility of public administrations. The reforms carried out by Mediterranean governments to improve the conditions under which the private sector operates have been analysed in detail in the previous section and make a fundamental contribution to economic governance. On average, efforts to improve the legal framework for commercial activities have intensified in the Mediterranean region. Progress in easing conditions for contract enforcement has been recorded in some countries (Egypt, Jordan and Morocco), although reform efforts slowed down in the region in 2006. Registering property remains particularly difficult in Algeria, Egypt and the OPT, seriously hindering the role of the private sector as the future main source of employment generation in the region. The transparency of financial markets and institutions is also important to the private sector because this largely determines the framework in which it carries out its activities. In general, major financial sector reforms have been under way in some Mediterranean countries since 2000, including the reduction of government involvement in the financial sector and the modernisation of the banking sectors. Morocco has recently approved a new banking law

[25] The Corruption Perception Index produced annually by Transparency International ranges between zero (very corrupt) and ten (clean).

to help reinforce the supervisory and regulatory work of its Central Bank (BAM). Algeria modernised its payment system in 2006 and strengthened the supervision of public banks, mainly through on-site inspections. In contrast, financial sector reforms are still embryonic in Egypt and Syria, which are still dominated by state-owned banks.

Chart 10 - Public sector accountability in 2006 vs. reform progress 2000-2006*



* Based on a worldwide ordering of countries (using a variety of governance indicators), and expressed as a cumulative distribution function ranking economies from 0 to 100 (best).

Source: World Bank, 2007.

In line with the improvements made in the Mediterranean region as regards internal accountability, the last six years have also seen substantial progress in **external accountability,** i.e. public oversight of politicians and policy-makers. On average, Mediterranean countries have done substantially better than the world average in improving government accountability, heading the reform efforts worldwide (chart 10). Morocco and Egypt again lead the region: in February 2006, the Moroccan parliament adopted a new Political Parties Law, which has helped to consolidate the credibility and efficiency of political parties and institutions. Also during 2006, Egypt pushed forward democratic reforms by holding a referendum on 34 constitutional amendments. However, the reform efforts of recent years continue to contrast greatly with the absolute ranking of Mediterranean countries in terms of public sector accountability, which was on average the lowest world-wide. Jordan enjoyed the highest ranking, slightly above the bottom third (34th percentile), but still well below the world average. Syria continues to be an extreme case in the region (6th percentile), not having seen any progress in public sector accountability over the last six years. In general, reforms to strengthen political accountability through political competition and the transparency and regulation of political parties are conspicuous by their absence. Mediterranean countries have not made sufficient effort to open up the political space and allow for greater accountability in public policy. Restrictions on civil liberties, opposition parties and civil society organisations are still widespread in Mediterranean countries. In Algeria, for example, public demonstrations are frequently banned and the right to strike has disappeared. Region-wide, journalists are still sentenced to prison on charges of criticising the government, violating therefore the freedom of the press. Reforms to ensure a more accountable public sector are therefore badly needed in the region.

VI. Concluding remarks

Overall, 2006 can be considered a good year for the Mediterranean region. Economic growth accelerated with the support of a favourable external environment. Greater demand in export markets enhanced the export performance of many countries in the region (particularly in the tourism sector), which boosted economic growth, generated employment and helped to maintain the declining trend in average unemployment rates in the region.

Notwithstanding recent accomplishments, job generation remains one of the major challenges in the Mediterranean region, particularly in the light of two main factors: on one hand, many countries in the region are involved in fiscal consolidation processes making it increasingly difficult for governments to absorb labour market entrants by expanding public employment; on the other hand, growing restrictions on immigration into neighbouring EU countries are increasingly limiting the ability of Mediterranean economies to export unemployment, thus making it all the more necessary to speed up urgent reforms to increase the flexibility of labour markets and encourage the role of the private sector in domestic job generation.

As pointed out in this document, many encouraging results are emerging in the four areas studied. Some Mediterranean countries are reforming fast, faster than any other country in improving aspects of the business environment and improving the quality of their public administrations. Some are determined to stick to planned macroeconomic reforms aimed at enhancing the role of markets, fostering fiscal consolidation and further integrating within the global economy, with the ultimate objective of achieving higher growth rates. However, others are still riding the wave of the oil boom, which is already showing signs of slowing with the stabilisation of international oil prices. The current high global growth and the acceleration of the economic activity in the EU, the Mediterranean region's main trading partner, offer a favourable environment to accelerate macro and structural reforms.

The EU, as a privileged partner of the Mediterranean region, is committed to spare no effort to help reformers in the region to maintain and accelerate the current rate of reforms and to persist in efforts to persuade late reformers of the benefits of progressively engaging in this process. Long-term growth prospects throughout the region continue to depend on the progress made in building sustainable conditions for stronger economic growth and job creation through implementing broad-based structural reform. Through a renewed European Neighbourhood Policy, the EU can now use a wide range of instruments to stimulate and support reforms. But, ultimately, it is up to the Mediterranean countries to decide whether this is the right path to follow. The EU hopes that this document would help senior officials to think about the costs and opportunities of reforms and decide on the best available reform path for their countries.

Annex

Table 1 - Mediterranean countries: main economic indicators

	2003	2004	2005	2006 prel.	2007 proj.
Real sector					
Real GDP growth (% change)					
Algeria	6.9	5.2	5.3	2.7	4.5
Egypt	3.1	4.1	4.5	6.8	6.8
Israel	1.5	4.8	5.2	4.8	4.4
Jordan	4.2	8.4	7.2	6.4	6.0
Lebanon	4.1	7.4	1.0	0.0	2.0
Morocco	6.1	5.2	2.4	8.1	3.0
OPT	5.8	6.0	6.0	-8.0	-4.3
Syria	1.0	3.1	2.9	3.2	3.7
Tunisia	5.6	6.0	4.2	5.8	6.0
MED region	***4.7***	***5.0***	***4.4***	***4.8***	***4.7***
Nominal GDP (USD, billion)					
Algeria	68.0	85.0	102.4	124.1	137.2
Egypt	81.4	78.8	89.5	103.3	111.8
Israel	0.1	122.5	129.8	137.1	142.1
Jordan	10.2	11.4	12.7	14.3	16.0
Lebanon	19.8	21.4	21.4	22.6	23.5
Morocco	49.8	56.4	58.9	65.9	62.6
OPT	3.2	3.6	4.1	4.5	4.4
Syria	22.7	24.7	27.3	29.4	30.3
Tunisia	25.0	28.1	28.7	29.2	29.5
MED region (sum)	***280.2***	***432.0***	***474.8***	***530.4***	***557.4***
GDP per-capita (USD)					
Algeria	2136	2627	3097	3698	4027
Egypt	1197	1137	1265	1432	1520
Israel	17802	18560	19248	19878	19150
Jordan	1961	2131	2317	2544	2778
Lebanon	5657	6114	6114	6457	6715
Morocco	1656	1887	1944	2145	1989
OPT	1221	1372	1398	1271	
Syria	1285	1360	1464	1534	1542
Tunisia	2531	2811	2829	2924	3180
MED region	***3938***	***4222***	***4408***	***4654***	
Inflation (average, %)					
Algeria	2.6	3.6	1.6	2.2	5.5
Egypt	11.7	17.3	9.7	3.9	11.3
Israel	0.7	-0.4	1.3	2.4	0.4
Jordan	1.6	3.4	3.5	6.3	5.7
Lebanon	1.3	1.7	-0.7	5.6	4.0
Morocco	1.2	1.5	1.0	3.3	
OPT	1.1	3.0	3.6	3.6	2.0
Syria	5.8	4.4	7.2	5.6	14.4
Tunisia	2.7	3.6	2.0	3.9	2.0
MED region	***3.2***	***4.2***	***3.2***	***4.1***	

Table 1 - Mediterranean countries: main economic indicators (continued)

	2003	2004	2005	2006 prel.	2007 proj.
Social indicators					
Unemployment rate (%)					
Algeria	23.7	17.7	15.3	12.3	10.0
Egypt	10.4	10.7	11.0	10.5	10.9
Israel	10.7	10.4	9.0	8.7	8.5
Jordan	14.5	12.5	14.8	13.9	
Lebanon	n.a.	n.a.	n.a.	n.a.	
Morocco	11.9	10.8	11.0	9.7	
OPT	25.6	26.8	23.5	23.6	25.0
Syria	10.8	12.3	8.0	8.5	
Tunisia	14.5	14.2	14.2	13.9	13.8
MED region	***15.3***	***14.4***	***13.4***	***12.6***	
Fiscal sector					
General government budget balance (% GDP)					
Algeria	7.8	6.9	11.9	11.9	9.9
Egypt	-9.0	-8.3	-8.9	-8.0	-7.2
Israel	-6.4	-5.4	-4.6	-2.8	-4.0
Jordan	-1.0	-1.7	-5.0	-4.3	-2.7
Lebanon	-13.3	-8.7	-8.5	-11.2	-12.4
Morocco	-3.3	-2.9	-4.0	-1.7	-2.7
OPT	-13.2	-12.3	-13.3	-21.8	
Syria	-2.6	-4.2	-4.2	-3.2	
Tunisia	-3.4	-2.5	-3.1	-3.2	-3.1
MED region	***-4.9***	***-4.3***	***-4.4***	***-4.9***	
Total gross public debt (% GDP)					
Algeria	43.8	36.6	28.4	22.6	19.5
Egypt	111.4	109.9	112.5	114.1	114.8
Israel	102.3	100.9	97.0	89.9	88.7
Jordan	97.7	88.5	82.8	72.4	66.7
Lebanon	169.0	168.0	180.0	179.0	176.0
Morocco	60.9	58.8	62.7	57.0	
Syria	60.1	61.9	57.0	60.2	55.2
Tunisia	63.0	60.9	57.3	55.6	54.5
OPT	n.a.	n.a.	n.a.	n.a.	
MED region	***88.5***	***85.7***	***84.7***	***81.3***	
External sector					
Current account balance (% GDP)					
Algeria	13.0	13.1	20.7	24.4	16.6
Egypt	2.4	4.3	3.2	1.6	1.2
Israel	1.6	2.6	2.9	4.8	4.2
Jordan	11.6	-0.1	-17.8	-13.6	-13.4
Lebanon	-13.3	-15.8	-11.7	-6.8	-11.0
Morocco	3.6	1.9	2.3	3.9	3.5
OPT	-14.0	-17.5	-17.8	-20.2	
Syria	1.1	1.9	-0.6	-0.6	-1.8
Tunisia	-2.9	-2.0	-1.3	-1.6	-1.4
MED region	***0.3***	***-1.3***	***-2.2***	***-0.9***	***3.0***

Table 1 - Mediterranean countries: main economic indicators (continued)

	2003	2004	2005	2006 prel.	2007 proj.
FDI (net,% GDP)					
Algeria	0.9	0.7	1.0	1.2	0.9
Egypt	2.8	2.6	3.9	5.6	6.5
Israel	3.4	1.4	4.3	6.6	2.1
Jordan	4.2	5.4	10.0	6.8	9.1
Lebanon	8.7	10.9	12.3	12.0	7.6
Morocco	4.9	3.0	5.2	4.7	
OPT	n.a.	n.a.	n.a.	n.a.	
Syria	0.7	1.1	2.0	2.5	
Tunisia	2.2	2.1	2.5	9.5	
MED region	***3.5***	***3.4***	***5.2***	***6.1***	
External vulnerability					
External public debt (% GDP)					
Algeria	34.3	25.7	16.8	4.3	3.8
Egypt	36.1	37.9	32.4	30.3	25.0
Israel	63.3	61.0	61.3	57.6	58.7
Jordan	74.5	66.2	56.1	49.8	44.2
Lebanon	79.0	86.0	89.0	90.0	89.0
Morocco	26.4	23.1	22.2	19.7	
OPT	n.a.	n.a.	n.a.	n.a.	
Syria	18.1	19.7	25.0	22.6	
Tunisia	64.8	63.8	57.2	56.8	55.7
MED region	***49.8***	***48.6***	***44.7***	***41.4***	

Note: These statistics correspond with the main economic indicators in the country articles. For details, see the country articles. Unless otherwise stated, the reported "MED region" statistics are simple averages.

Table 2 – Current trade policy and trade policy reform

	Current trade policy	Trade policy reform progress	Average tariff	
	2006	***2000-2006***	***2000***	***2006***
Algeria	68	63	24,0	18,7
Egypt	60	100	21,4	9,1
Jordan	44	94	23,1	11,8
Lebanon	50	80	10,7	5,4
Morocco	52	50	30,5	26,2
Syria	2	32	21,0	19,6
Tunisia	53	42	29,1	26,9
MED	***47***	***69***	***23,8***	***16,8***
World	***50***	***50***	***13,6***	***9,8***

Source: World Bank 2007.

Table 3 - Current business climate and business climate reform

	Current business climate		Business climate reform indices
	2005	***2006***	***2003-06***
Algeria	38	36	37
Egypt	1	2	59
Jordan	63	59	41
Lebanon	42	40	46
Morocco	37	38	76
OPT	26	22	
Syria	34	33	52
Tunisia	56	55	40
MED	***37***	***36***	***50***
World	***50***	***50***	***50***

Source: World Bank 2007.

Table 4 – Current status of governance and governance reform progress

	Quality of public administration		Public sector accountability	
	2006	Reform progress 2000-2006	2006	Reform progress 2000-2006
Algeria	38	15	28	68
Egypt	52	97	23	73
Jordan	65	82	34	62
Lebanon				
Morocco	69	91	32	78
Syria	20	72	6	54
Tunisia	63	69	22	37
MED	***51***	***71***	***24***	***62***
World	***50***	***50***	***50***	***50***

Source: World Bank