Policy Paper

Thinking together for the future of the mediterranean

EURO-MEDITERRANEAN ECONOMISTS ASSOCIATION

EMEA Policy Briefs present concise, policy-oriented analyses of topical issues in Euro-Mediterranean economic affairs, with the aim of interjecting the views of EMEA experts into the policy-making process in a timely fashion.

5+5 Dialogue a mechanism of regional integration and cooperation

ECONOMIC AND DEVELOPMENT CHALLENGES FOR THE REGION

9/October/2016

Rym Ayadi [1]

and

Emanuele Sessa [2]

[1] Rym Ayadi is President of the Euro-Mediterranean Economists Association (EMEA), Director of the International Research Centre on Cooperative Finance (IRCCF) and Professor at HEC Montreal.

[2] Emanuele Sessa is Junior Economist at the EMEA and Associate Researcher at the IRCCF at HEC Montreal.

They both wish to acknowledge the research assistance of Jorge Ruiz, Research Assistant at the IRCCF at HEC Montreal.

Introduction

The increasing political instability and persisting economic crisis experienced on both shores of the Mediterranean Sea is bringing renewed scepticism and increasing mistrust between partner countries. In the Northern shore, EU Member States are grappling with the aftermath of the euro crisis started in 2011, which had particularly severe implications for three out of five economies of 5+5 countries. Italy, Spain and Portugal are battling with a sluggish recovery and persistently high unemployment rates and facing the consistent challenge of managing the severe repercussions of the crisis on some of their leading economic sectors such as banking in Italy or real estate in Spain. These economic difficulties eventually gave rise to the upsurge of inward-looking populist claims and nationalist movements experienced today, substantially fuelled by the currently undergoing refugee "crisis" and the failure to find a satisfactory communitarian response to the management of migrants' flows. In the Southern shore, the MENA countries witnessed the greatest social and political transformations of their recent history, with both the aspirations for democracy of the Arab youth and the rise of Muslim extremism bursting out in a series of uprisings destabilising the region's polities, economies and societies. These dynamics led to the exacerbation of tensions in the region and contributed to the persistence of long-lasting crises such as the Israeli-Palestinian conflict and new conflicts in Syria and in Libya structurally undermining trust between partner countries not only in the region but also beyond. The situation in 5+5 countries such as Libya, where civil uprisings unfolded into an international war theatre and chronic political instability or France, which is suffering from recurrent terrorist threats, attest how these unfortunate developments can worsen regional integration and cooperation prospects in many ways.

To understand the situation in the region these developments should be considered in light of the challenges raised by global mega-trends. The globalisation is enhancing connectedness and interdependence between Mediterranean countries but at the same time favouring the emergence of new dividing lines and related clashes, bearing considerable political challenges along with important economic opportunities. Globalisation entails the partial hollowing out of nation states both upward and downward, as attested by countries progressively integrating in supranational institutions such as the European Union (EU) or the Maghreb Arab Union (MAU) or somewhat disintegrating under the pressure of subnational secessionist movements or in the worst cases armed militias.

This is a simplified picture of a very complex reality of intermeshed integration and disintegration dynamics underlining the importance of creating a new momentum for regional integration and cooperation, in which 5+5 countries could have a leading role. The 5+5 format comprises countries with a positive track record of political and economic cooperation between shores built on political, economic and social ties rooted in the recent history of the region. 5+5 countries come together in more or less advanced forms of North-North and South-South integration under the EU and the MAU, although the latter is suffering from a prolonged stagnation as a result of political and economic blockages between partner countries. In principle, the integration of countries in supranational unions could translate in a more balanced and even a renewed approach to dialogue and cooperation between shores as compared to the Mediterranean region as a whole, where the EU is in the position to favour bilateral formats of cooperation with individual countries of a fragmented MENA region.

In order to become a mechanism of regional integration and cooperation, 5+5 countries must find together effective collaborative solutions to address a series of economic and development challenges resulting in sluggish recovery, little political margin of manoeuvre and the massive challenges these countries are confronted with.

This paper looks into the integration patterns between the 5+5 countries by assessing the most recent evolutions of investment, trade and employment in the region to highlight such challenges and formulates recommendations to pave the way for dialogue and cooperation conducive to tangible results on which to build a new momentum for integration in the region.

Patterns of economic integration in the 5+5 countries

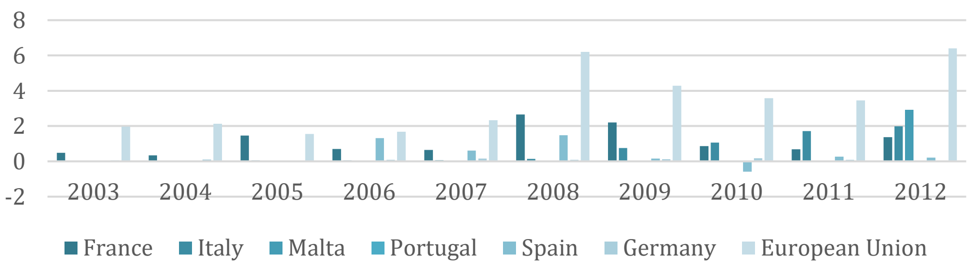
In what follows a brief overview on FDI, trade and employment patterns is presented and assessed.

FDI stock and outflow from the EU to the rest of the world have been rather variable in the last decade. FDI outflows experienced a timid recovery following the downturn in 2008-2010 in concomitance with global financial and euro crises but fell sharply again in 2014 due to large disinvestments in traditional partner countries. FDI stock amounts to an average €112 billion in 2014 as compared to €564 billion in 2007. MENA countries experienced the same trend although with much smaller numbers, exception given for Morocco where the stock of FDI reached $444 million in 2014 after averaging $438 million in the period comprised between 2007 and 2014.

In overall, the MENA region is not attracting large amounts of FDI as compared to other regions of the world such as Asia that attracts an average of $400 billion per year. According to the OECD, the trend of FDI attracted by MENA has decreased from $64 billion in 2010 to $45 billion in 2013, whereas for countries such as Libya, Tunisia or Morocco and Libya the average amounts are only ranging between 1 and 2 billion dollars per year. These trends are decreasing for Tunisia and Libya and increasing for Morocco, which is benefitting from relative political stability as compared to their neighbours experiencing important political and social transformations following the turmoil of the so-called Arab Spring.

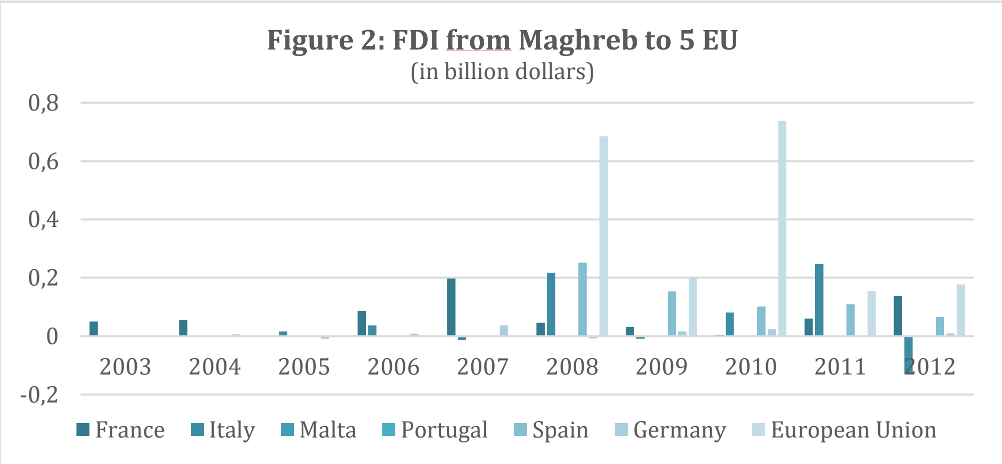
France, Italy, Malta, Portugal and Spain have been decreasing their FDI overall but in 2012 some signs of recovery were registered as far as investments directed towards their Maghreb in counterparts are concerned.

Figure 1: FDI from 5 EU to Maghreb
(in billion dollars)



Source: Authors compilation from public sources (European Commission, UNDP and others)

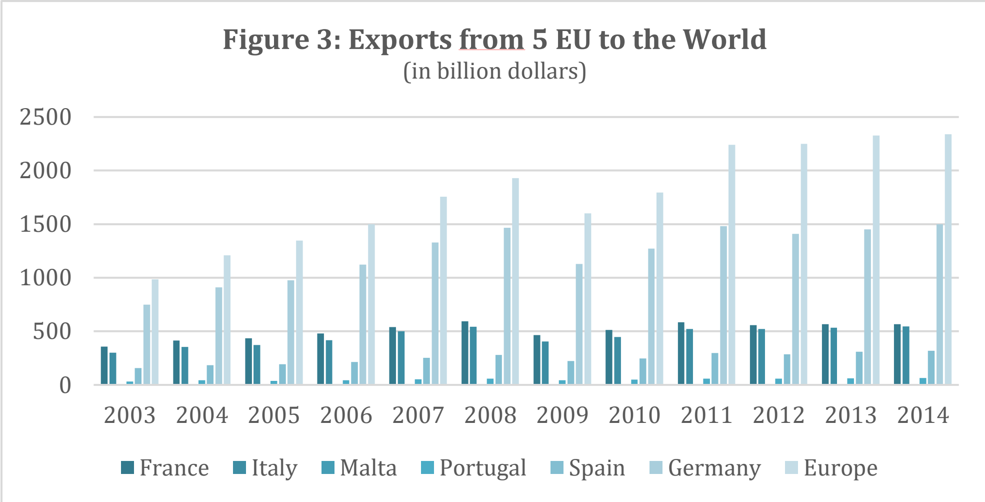
In turn, FDI outflows from Morocco, Algeria and Tunisia to their European counterparts, although traditionally very low, did not show any sign of recovery and in some cases even decreased. This trend is particularly strong in the case of Libya and Mauritania, which experienced important decreases in both inflows and outflows of FDI from their European counterparts in the same period.



Source: Authors compilation from public sources (European Commission, UNDP and others)

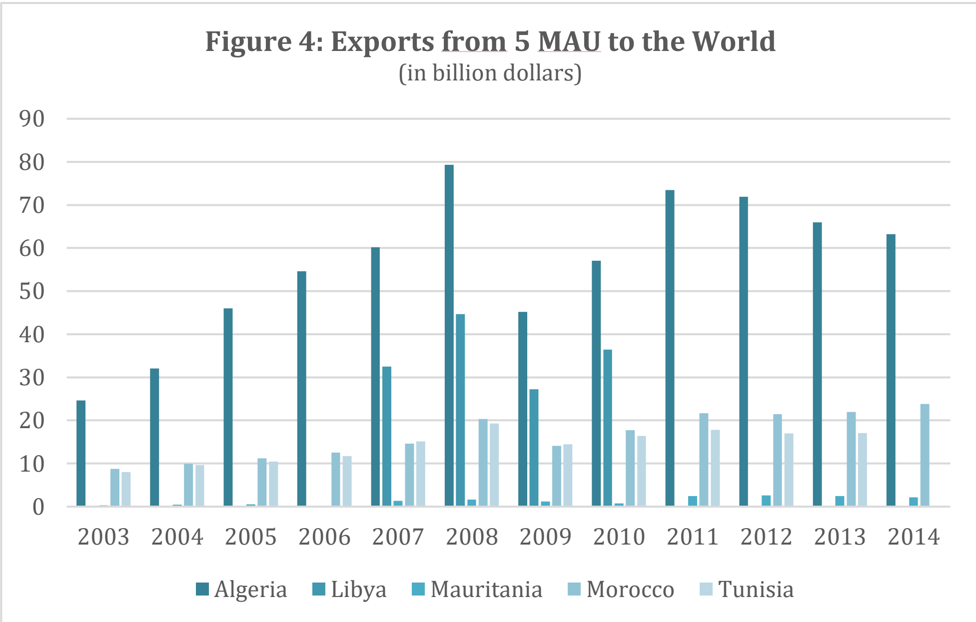
EU 28 position in terms of exports and imports to the rest of the world throughout the period has been rather stable between 2 and 2.5 trillion dollars with Germany accounting for the lion share and France, Italy, Portugal and Spain managing to maintain their relative shares. Germany and Italy since 2012 register a trade surplus while other countries have accused a trade deficit until 2011. MENA countries experienced divergent paths according to the nature of their economy, with resource-rich countries registering a trade surplus throughout the period (Algeria and Libya) and the others suffering a trade deficit until recently (Mauritania, Morocco, Tunisia).

5+5 countries are experiencing diametrically opposed trends as far as export and import performance are concerned. France, Italy, Malta, Portugal and Spain exports to the rest of the world continuously increased in the last decade with only a slump during the years of the global financial and economic crisis in 2009-2010. Algeria, Libya, Mauritania, Morocco and Tunisia exports to the rest of the world increased before the global financial and economic crisis before experiencing a sharp fall and a steady decrease following a timid recovery in 2010-2011. This decrease is at least partly due to the negative consequences on the economy of the Arab Spring and the resulting widespread instability and related uncertainty.

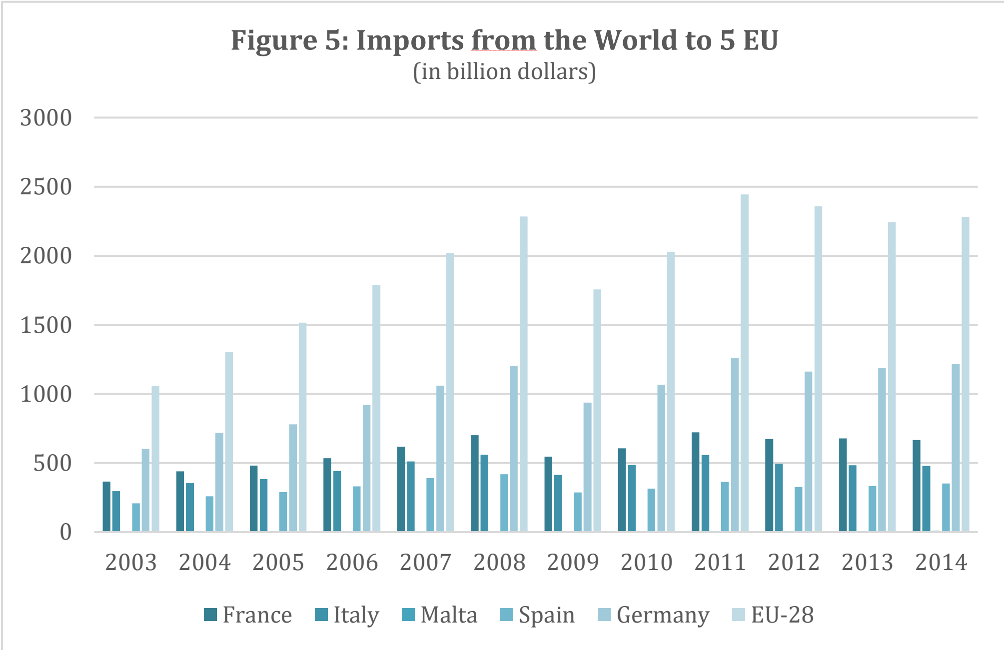


Source: Authors compilation from public sources (European Commission, UNDP and others)

In turn, France, Italy, Malta, Portugal and Spain imports from the rest of the world increased before the crisis and then stabilised while Algeria, Libya, Mauritania, Morocco and Tunisia imports increased continuously throughout the period with limited effects of the economic crisis and political turmoil on the figures.



Source: Authors compilation from public sources (European Commission, UNDP and others)

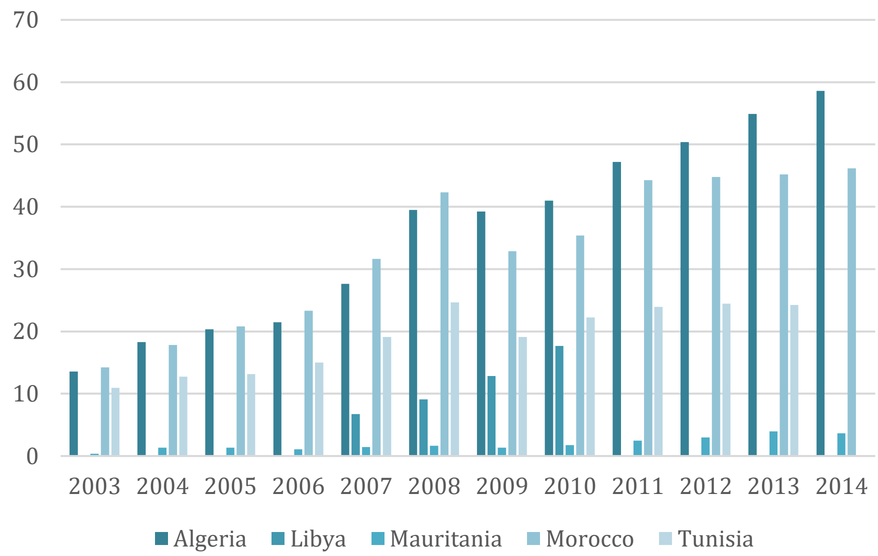


Source: Authors compilation from public sources (European Commission, UNDP and others)

As far as relations between 5+5 countries are concerned, the trade balance mirrors the characteristics of the MAU economies resulting in the EU registering a substantial deficit with resource-rich Algeria and Libya and a more or less substantial surplus with Mauritania, Morocco and Tunisia. EU trade deficit with Algeria and Libya increased steadily before the global economic crisis and regional political turmoil and oscillated from year to year ever since, conditioned by the chronic instability in Libya and some political blockages with Algeria. EU trade surplus with Mauritania, Morocco and Tunisia slightly increased over the period particularly in the case of Morocco having experienced a steady increase of its trade deficit with the EU from average $2 billion in 2003 to almost $10 billion in 2013.

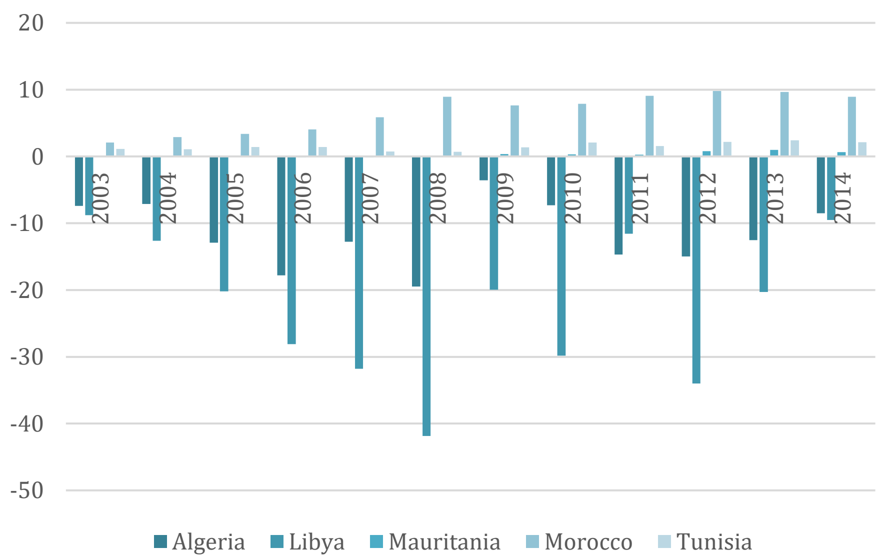
EMEA Policy Briefs present concise, policy-oriented analyses of topical issues in Euro-Mediterranean economic affairs, with the aim of interjecting the views of EMEA experts into the policy-making process in a timely fashion.

Figure 6: Imports from the World to 5 MAU
(in billion dollars)



Source: Authors compilation from public sources (European Commission, UNDP and others)

Figure 7: Trade balance EU with 5 MAU
(in billion dollars)

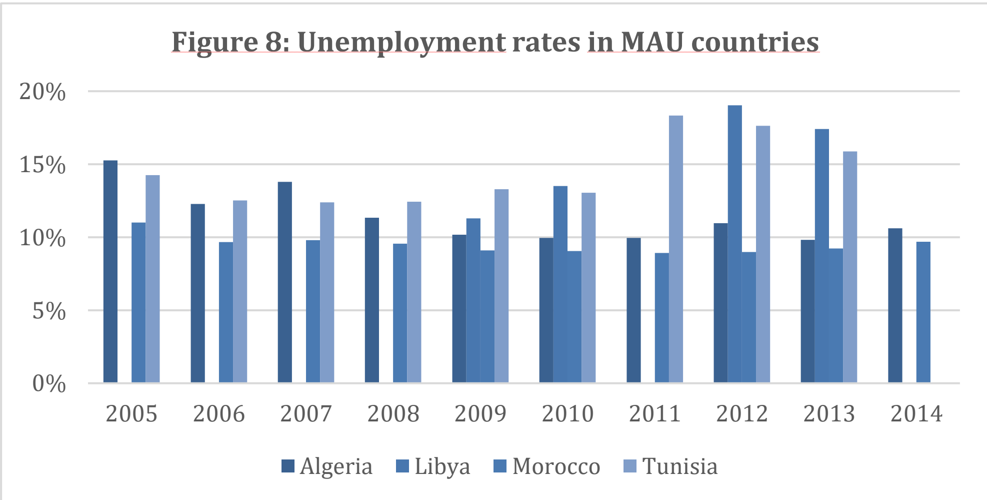


Source: Authors compilation from public sources (European Commission, UNDP and others)

EMEA Policy Briefs present concise, policy-oriented analyses of topical issues in Euro-Mediterranean economic affairs, with the aim of interjecting the views of EMEA experts into the policy-making process in a timely fashion.

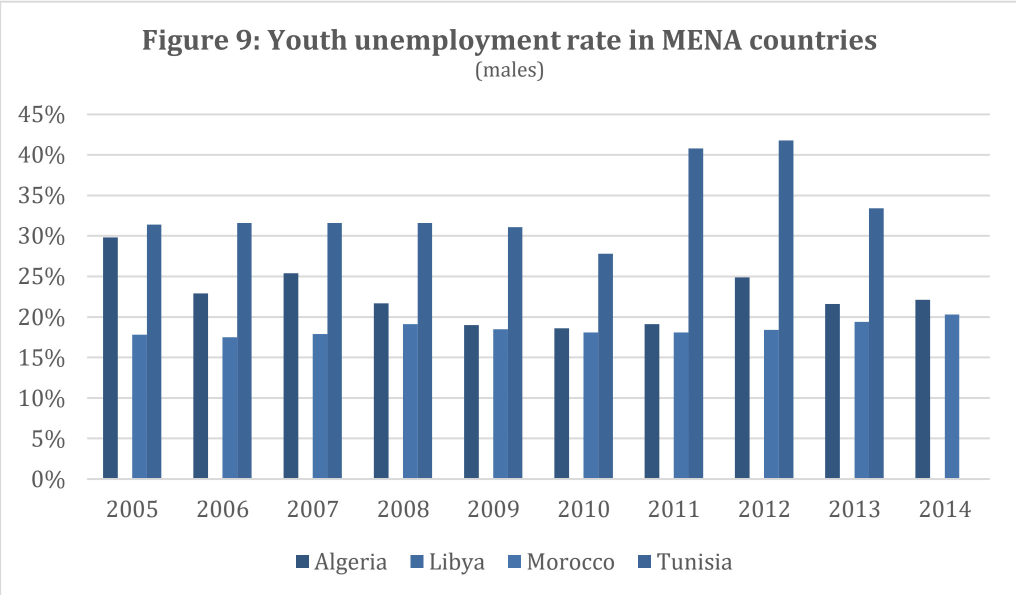
The EU signed bilateral Association Agreements under the European Neighbourhood Policy (ENP) with Tunisia in 1995, with Morocco in 2000 and with Algeria in 2002, while Libya and Mauritania remained outside most of the structures of the ENP. The Association Agreements aim at enhancing political association and economic integration and most provisions are laid down to set the ground for trade liberalisation. These provisions had a series of implications on FDI and trade between EU and MAU countries. On the one hand, EU support to measures aimed at improving market conditions and regulations in Morocco and Tunisia might have favoured the increase of FDI inflows. On the other hand, although there is a lack of ex-post evaluations on the effects of trade agreements on the Moroccan and Tunisian economies, evidence suggest that these agreements might have favoured the increase of the two countries' trade deficit. In the frame of these agreements, negotiations for the establishment of Deep and Comprehensive Free Trade Areas (DCFTAs) are currently undergoing with Morocco and Tunisia, although clouded by rising concerns about the potential adverse effects of trade unbalances between the EU as the world's largest single market and individual MAU economies with serious economic difficulties.

These difficulties include above all rising inequalities and chronic unemployment. Algeria, Libya, Morocco and Tunisia experienced persistently high unemployment rates averaging 11% in the period comprised between 2005 and 2015, with peaks around 18% in Libya and Tunisia in the years following the political turmoil of the Arab Spring.

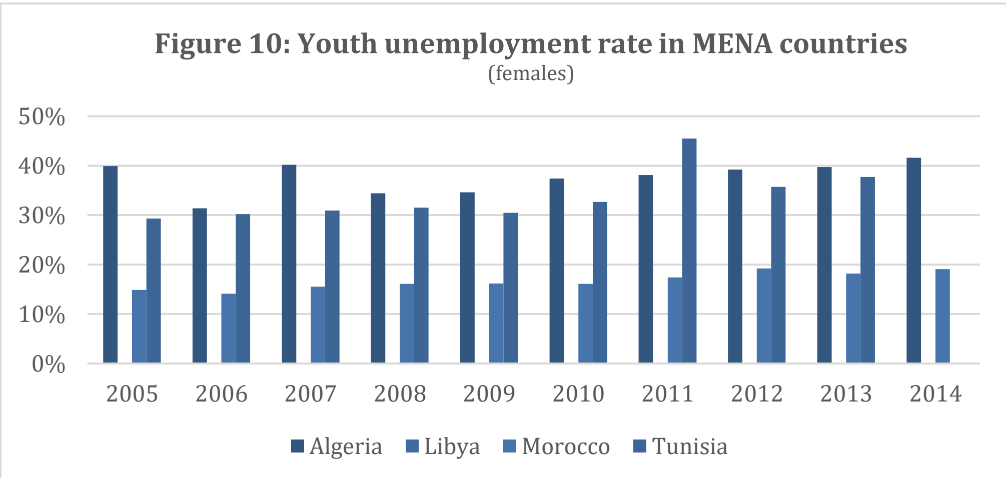


Source: Authors compilation from public sources (European Commission, UNDP and others)

Unemployment rates for the youth and more particularly young females in the region remained substantially higher throughout the whole period, averaging 20% in Algeria and Morocco and 30% in Tunisia. In the latter country, youth unemployment rates soared over 40% in the 2011 and 2012 because of the uprising having led to the fall of the Ben Ali regime and the transition to democracy. Unemployment rates for young females did not show any notable sign of decrease over the period, stalling between 30% and 40% depending on the country or even slightly increasing since the Arab Spring in some cases.

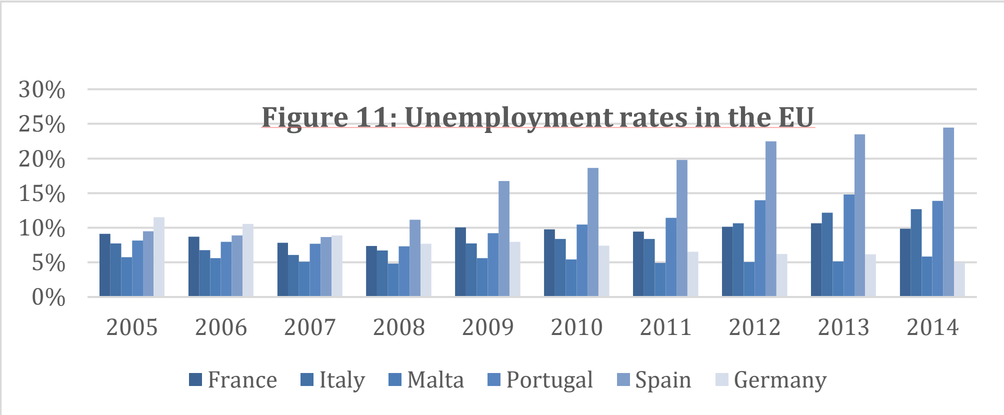


Source: Authors compilation from public sources (European Commission, UNDP and others)



Source: Authors compilation from public sources (European Commission, UNDP and others)

In the EU, the situation is not much rosier with unemployment rates increasing from below 10% in 2005 up to 25% in Spain, 15% in Portugal and 13% in Italy in 2015. In all countries under consideration except for Malta the rates increased sharply and steadily since the onset of the global financial and economic crisis in 2008. The situation is particularly striking in Spain and Italy, where unemployment rates were still on the rise in 2014 with no sign of stabilisation or timid recovery as compared to France or Portugal.



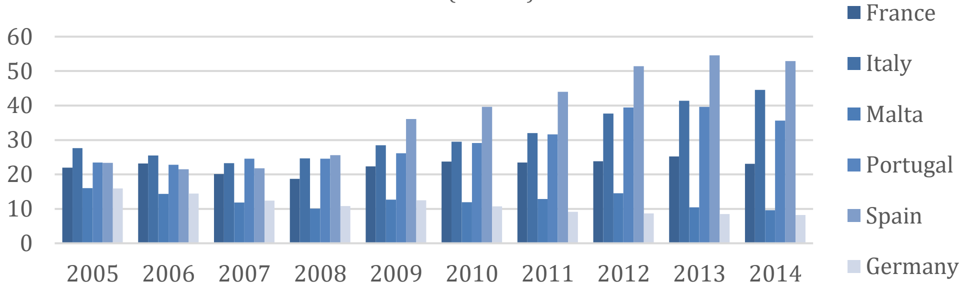
Source: Authors compilation from public sources (European Commission, UNDP and others)

In the case of EU countries also, youth and female unemployment are much higher and experienced a steady increase in the years following the economic crisis, with some timid signs of recovery registered only in 2014. Youth unemployment rates exceeded 50% in Spain and peaked over 40% in Italy and Portugal, while they remained relatively stable throughout the whole period in France and Malta at a much lower level. A notable difference between EU and MAU countries is that female unemployment rates are not substantially different from male rates.

Source: Authors compilation from public sources (European Commission, UNDP and others)

These figures show that the so-called jobless growth phenomenon, that is, output growth not accompanied by substantial employment creation, is a reality in 5+5 countries independently from the shore considered and must addressed as a common challenge in political dialogue.

Figure 13: Youth unemployment in the EU
(females)



Economic and development challenges

The figures discussed in the previous section depict a situation of persistent difficulties and serious challenges for the economies of 5+5 countries, with widespread instability in MENA countries translating into migratory pressures on EU countries battling with a timid recovery. This situation calls for regional integration policies effective in countering disintegration pressures on polities regardless the shore. These policies will have to address structural unbalances in the economy of the region while dealing with a series of present challenges tightening the margin of manoeuvre for political action.

In order to be a mechanism for regional integration, 5+5 countries must create the conditions for integration of their job markets and the effective management of migration flows between job markets, something particularly delicate but also crucial considering the employment situation in the region.

The chronic problem with unemployment and in particular youth unemployment in both EU and MAU countries is at the roots of instability in the region. Unemployment fuels migration flows from MAU economies failing to create sufficient employment opportunities for their youth towards EU countries experiencing severe political hurdles in relation with these migration flows. On the other hand, chronic unemployment is a fertile soil for the radicalisation of hopeless youth and fearful public opinion in countries shaken by terrorist threats.

In light of a demographic situation opposing an aging population in the EU and a rapid population growth in MAU countries, migration of young workforce from one shore to the other could represent the solution to a structural problem more than a conjunctural problem without a solution. However, this would require the management of migration flows based on circular schemes built on a mid-to-long term perspective, whereas most if not all EU governments are pressured to find short-term solutions by the rise of populist movements voicing the fears of large segments of the population concerning the integration of immigrants in a delicate social and economic context. EU countries of the 5+5 dialogue are indeed battling with serious socio-economic problems hampering their recovery and fuelling fears about the integration of immigrants in the social and economic tissue of the host countries.

Trade unbalances between northern and southern countries of the EU translate into structural deficits for the latter difficult to sustain without concomitant productivity gains. These unbalances may continue growing because of structural characteristics of the euro area but also differentials in the pace of economic recovery. Increasing public debts and fiscal deficits in countries such as Italy or Spain limit their margin of manoeuvre for stimulating the economy and the cleaning up of their banking sectors put a heavy weight on their recovery.

Trade unbalances are an even more serious problem when it comes to relations between northern and southern countries of the Mediterranean. These unbalances are rooted in the differential of trade integration between northern countries and southern countries themselves. Indeed, while all barriers to North-North trade were brought down with integration in the EU single market, South-South trade still suffers of a series of barriers and runs below potential, this notwithstanding the signature of the Greater Arab Free Trade Area (GAFTA) in 1998 and the elimination of most tariffs in 2005[1]. As regards to the MAU, no tangible progress in trade liberalisation has been achieved because of economic and political blockages. This means that as for now, trade relations organised based on bilateral relations between North-North and South-South trade unions is difficult to envisage, although such a set-up might prove effective in limiting trade unbalances as compared to the spaghetti bowl of bilateral agreements between the EU as a whole and individual partner countries.

These trade unbalances bear the challenge of enhancing South-South trade integration while negotiating more symmetric trade agreements built on complementarities between trade partners and aimed at creating synergies

1 Jordan, Tunisia, Egypt and Morocco established a free trade area under the so-called Agadir Agreement signed in 2004 but since joined the GAFTA.

conducive to employment creation. These goals are crucial for the region but increasingly difficult to pursue for politicians of EU and MAU countries alike. In a context of serious security and instability issues shedding away foreign investment, particularly in the case of Libya as far as 5+5 countries are concerned, the attention is shifting from trade agreements to security and mobility partnerships. The contagion effects in the region are manifold and further complicate an already rather grim picture pushing the different countries to adopt inward-looking positions.

In this delicate context the 5+5 forum can represent a crucial laboratory for regional integration. The situation in 5+5 countries is emblematic of the developments and challenges of the region as a whole but at the same time can be singled out for the somewhat more stable political relations between partner countries. The situation in Libya is currently one of the most problematic in the region and achieving to manage its contagion effects at a regional level could pave the way for similar initiatives of the sort. These effects are particularly alarming for neighbouring Tunisia, country undergoing a delicate transition of democracy crystallising all the hopes and fears of EU countries concerning the future in the region and in that sense a key political player for any mechanism of integration in the region.

Conclusions

In this paper, the economic integration patterns in 5+5 countries have been overviewed and the related challenges highlighted to shed light on the conditions under which the 5+5 forum could represent an effective mechanism for regional integration and cooperation.

These challenges include above all the chronic issue of youth unemployment in the countries, which must be dealt with structural reforms in the labour market and increasing domestic investments in support of the private sector in MAU countries and measures to address the sluggish economic recovery in EU countries. The unemployment situation is tightly linked with the increase of migration flows and the difficulties of integrating migrants into the social and economic tissue of host countries as well as the problem of radicalisation and the threats it poses to countries regardless the shore. The current focus on the establishment of security and mobility partnerships between the EU aiming at containing inflows of migrants on its territory and MAU countries incapable of creating opportunities for their youth in their own economies should be based on a comprehensive approach to employment creation, radicalisation prevention and circular migration. This would enable for solutions on the short and the mid-to-long run to be integrated in an effective manner.

As far as trade is concerned, notwithstanding the difficulties experienced in the latest negotiations, EU and MAU countries would both profit of enhanced South-South integration and more balanced trade agreements between integrated wholes as compared to the current situation of intermeshed agreements, still rather unilateral in nature. First, this would require MAU countries to engage in political efforts to relaunch their format of political association and cooperation, now suffering from multiple blockages and de facto isolating the countries in their trade relations. Second, this would require the EU to reconsider the establishment of DCFTAs, constructed on rather unilateral interests and values notwithstanding a recent revision of the ENP in the sense of enhanced co-ownership, in favour of symmetric agreements based on complementarities and potential synergies in trade relations.

Tangible results on the above mentioned areas of dialogue and cooperation could prove effective in paving the way for regional integration based on common responses to given challenges and synergetic solutions to the interrelated issues underlying such challenges. The 5+5 dialogue brings together a combination of two less heterogeneous wholes as compared to other formats of Euro-Mediterranean cooperation and in this vest it is the better placed to overcome certain scepticisms and related blockages.

This paper was originally published as an IEMED policy study accessible on http://www.iemed.org/publicacions-fr/historic-de-publicacions/policy-studies/the-5-5-dialogue-as-a-mechanism-of-integration-and-regional-cooperation