

Mediterranean Investment Initiative

Report: Investing in the Mediterranean region,
current trends and future prospects.
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Summary of the report prepared by the 2IM Secretariat,
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Summary

The analyses developed in the report engage solely their authors and do not represent the official position of the founders of 2IM

The Mediterranean Investment Initiative (2IM) was launched jointly by the Caisse des Depots (CDC), the Caisse de Dépôt et de Gestion du Maroc (CDG) and the Institut de Prospective Economique du Monde Méditerranéen (IPEMED). Its aim is to identify ways of stepping up the flow of foreign investment into the countries along the southern and eastern rim of the Mediterranean (PSEM in French), who are partners in the Union for the Mediterranean (UpM).

During the Initiative's inaugural meeting on March 13 2009, three main conclusions emerged from the discussion.

- **Bolstering economic ties between the northern and southern coasts of the Mediterranean is a win-win proposition:** both for the countries on the southern and the eastern flanks of the Mediterranean, which have immense investment needs, and for Europe and investors outside the Mediterranean looking for new growth opportunities. The Euro-Mediterranean Area is increasingly becoming a new area of shared opportunities and growth.
- **Trust is the essential pre-condition for boosting investment in the Mediterranean Area** and trust can only be built through an enhanced partnership, shared responsibility and joint decision-making by investors from all three sides of the Mediterranean.
- **Security of investments** must be shored up.

Participants also agreed on the need to establish **three working groups focusing on the financial framework, the legal framework and the human resources framework of investing**, respectively. The financial framework group was the first to begin its work. Two consultants (Guillaume Alméras and Abderrahmane Hadj Nacer) were tasked with meeting the main stakeholders concerned by investment in the broader Mediterranean Area, expanded to include the countries of the Gulf.

The two consultants prepared a report titled "Investing in the Mediterranean region, current trends and future prospects." The report is based on a series of meetings that took place in Morocco, Tunisia, Syria, Lebanon, Jordan, Egypt, Cyprus, Greece, Malta, Bahrain, the United Arab Emirates and Turkey. It takes stock of the investment picture in the PSEM countries and proposes several instruments to stimulate investments.

Five instruments were specifically identified as a way of enhancing the investment potential of the region. These five instruments include:

- **Providing support to businesses during the initial phase of their creation with a view to ultimately contribute to their expansion;**
- **Developing capital markets in the region through partnerships and convergence;**
- **Bolstering and expanding export and establishment guarantee instruments;**
- **Seeking to achieve greater monetary stability in the Euro-Mediterranean region;**
- **Identifying new coordination mechanisms at the Euro-Mediterranean level.**

The information that follows makes it possible to better understand the choice of the aforementioned instruments.

The consultants' review included a series of interviews in the PSEM countries to Greece. **The review focused particular attention on South-South, East-East and East-South business ties.** Furthermore, interviews were also conducted in the countries of the Gulf.

Numerous interviews with decision-makers have therefore guided the current analysis. For an idea to be included in the report it had to be embraced by several decision-makers and couldn't be rejected by a large number of them. No proposal was taken on board unless it was thoroughly discussed with the various stakeholders. Lastly, no proposal was selected unless several concrete examples proving its feasibility could be furnished.

The analysis is focused on the whole Euro-Mediterranean basin rather than on specific countries. **Priority was given to problems common to several countries, problems for which similar solutions could be found and shared projects envisaged** – even if only a handful of the PSEM countries would embrace such a solution, bearing in mind that the UpM has promoted the notion of projects with ‘variable geometry’. That said, the report does not approach the Mediterranean basin as a homogenous region. The PSEM countries quite clearly exhibit varying levels of economic development and divergent rates of convergence within the Euro-Mediterranean partnership. **Yet on the issue of investment, in spite of their differences the PSEM countries face similar challenges. Indeed a number of initiatives have begun to bring them together in coping with these challenges.**

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It’s worth stressing that this report does not cover the following topics:

- Monetary and fiscal policy of individual states,
- Tapping into local savings and their conversion by the banking sector.
- Nor was it feasible to highlight or identify specific investment opportunities on a country-by-country or sector-by-sector basis.

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The first part of the document examines **the trajectory of private entrepreneurs in PSEM countries**, from their very first steps to their potential access to public savings.

First of all, as in many other emerging markets, the banking sector in PSEM countries still offers a limited choice in terms of investment credits; banks often seem ill prepared in coping with the long-term funding needs of economic agents. To make up for this lack, it’s often necessary to resort to more specialized financing mechanisms, both for the creation and development of businesses and for their direct access to capital markets. As regards the development of businesses, **a market for private equity capital has now become firmly established in PSEM countries**; however since it’s fairly recent, this market isn’t yet fully comprehensive, in particular in the early stages of company development.

As regards capital markets, **the vitality of several stock exchanges in the PSEM countries is too often overlooked, despite the fact that it is currently fueling a number of large-scale alliances**. The potential of capital markets in the region is considerable. Yet Europe is mostly absent from this market. **Not a single major European stock exchange has formed a partnership with those of the PSEM, the way Spain has with several countries of Latin America**: no index has been set up for the Euro-Mediterranean area, along the lines of the ASEAN and ASEAN 40 Indexes. There is no Mediterranean equivalent of the CAC 40.

In general, while commercial banks are indispensable to investment, one is entitled to doubt whether they can play a more immediate role in providing leverage. The PSEM countries have in the meantime developed initiatives in the area of private equity and capital markets, initiatives that are worth shoring up. This explains **the two recommendations on broadening the scope of private equity activity to include the early stages, as well as deepening capital markets.**

1. As regards the resources to be deployed in order to underpin the creation and the initial development of innovative companies, **the notion of know-how hubs would appear to offer relevant opportunities. The aim would be to endow these hubs with a veritable clustering capacity, in order to foster technological expansion**, rather than run the risk of relegating them to the simple role of offshore production and assembly platforms for European industry.
2. The challenge in developing capital markets is to enable companies to have access to non-bank financial resources, to create more investment opportunities for investors, to tap into local savings, to provide guarantees to countries that are recipients of foreign direct investment on its sustainability and its contribution to the local economy. This would in turn enable foreign investors to operate in a more secure regulatory environment. A number of initial advances in the PSEM have pointed the way forward:

- **Link up of stock exchanges, which in turn could offer access to countries outside the region to communicate stock listings and forward market orders** (principle of one-stop shopping):
- **Development of common indices, thus facilitating the emergence of index trackers, or national and international index funds.** Forming large-scale index funds could be done with public funding. A model for this kind of initiative could be found in the framework of “ASEAN + 3”.

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The second part of the report is devoted to foreign direct investment in the PSEM countries, and describes the way the situation has evolved there. **While starting from behind in terms of FDI, from 2000 to 2007 the PSEM countries for the most part caught up** and there is no reason at this stage to believe that the economic crisis will reverse the trends observed up to 2007.

The economic crisis occurred just as an industrial boom was beginning to take form, shedding a new light on the issues of FDI in the PSEM countries. **FDI should indeed be seen against the backdrop of an opening of the PSEM to the world:**

- The flow of FDI has remained stable;
- The sources of FDI are diversifying. European countries are no longer alone in investing in the PSEM. Turkey, countries from the Gulf and from Asia have expanded their presence both to supply local markets and to export.
- The goods produced in PSEM countries are increasingly higher-end, with a growing share of added value, and an increasing contribution of research and innovation as well as a growing reliance on local expertise – local managers accept lower levels of remuneration than in Europe. This diversification and movement towards higher-end production will need to be linked up to the most suitable markets, which won't necessarily be European.

Since generally speaking investment flows follow the movement of business (rather than vice versa), for the benefit of companies from the PSEM it's important not to have export guarantees separated from long-term market-establishment security. This could be a potential third area to explore: **why not consider setting up a joint Euro-Mediterranean export and investment guarantee fund? It would furnish the institutions from PSEM countries operating in this field additional means to: expand their range of services; improve their reinsurance terms and benefit in case of lengthy procedures from advance funds allowing them to quickly repay, partly or in full, their business clients; work more with local banks**, which as a rule in PSEM countries are not yet actively involved in promoting export guarantees.

All of the above – which, as far as we know, has no equivalent in the world – would be even more beneficial when you consider that monetary stability around the Euro-Mediterranean region would be ensured.

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The third part of the report offers a reminder: the PSEM countries haven't been spared by the global financial crisis; they have seen a drop in their foreign currency reserves (a fall in transfers, the dollar tumbling). The crisis could threaten their monetary and financial stability. Some of the PSEM receive imports from the EU that they pay for in relatively stable Euros while they export to the rest of the world in Dollars. A currency war that isn't of the PSEM's doing will spawn a scissor effect that threatens to undermine their economic growth.

To cope with the risk of having the PSEM's foreign currency reserves depleted by the financial crisis, couldn't the EU consider setting up a monetary and financial support mechanism? The goal of achieving the convertibility of PSEM currencies was enshrined by the Barcelona Process. But will it be possible to stabilize the exchange rate of the different PSEM currencies vis-à-vis the Euro or will they turn to the Dollar? The long-term weakness of the Dollar against the Euro, if it persists, could become the main dividing line in the Mediterranean Area, forcing a number of PSEM countries to turn away from the EU.

The issue of whether PSEM currencies should be pegged to the Euro is worth raising and discussing. It could be implemented as part of a system of swaps with the ECB, to be used in particular when certain atypical market conditions prevail, or which could be similar to the system of guaranteed credit lines (“flexible credit lines”) that the IMF has just set up for countries like Mexico. Such a topic is outside the scope of the current report. To stay on the subject matter of investment, we might limit ourselves to suggesting that **Euro-Mediterranean monetary cooperation** could be deployed in two ways:

- 1) Underwriting currency exchange risks for long term capital resources raised by investors in PSEM currencies;
- 2) Enabling institutional and private investors in PSEM countries to gain access, in the framework of certain projects, to financing in Euros on the best available terms: for the benefit of its trading partners the EU could thereby ‘offset’ the high cost of the Euro against the Dollar by lowering the expense of raising capital in its currency.

The challenge in linking up the central banks of the countries in question to work in close coordination would not only be to facilitate investment, but also to reassure investors in the event of a crisis that could undermine the macro-economic fundamentals of the PSEM countries and raise the specter of a run on their currencies.

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Given the sheer scale of financing needs in PSEM countries, new opportunities for Euro-Mediterranean cooperation are becoming apparent. Part four of the report examines the financial instruments and the coordinating structures needed to promote investment in the Mediterranean region. Why is the timing right at this moment?

- Because Europe has no other choice but to seek out dynamic regions of economic growth near its borders.
- Because taken individually, the PSEM countries don’t have the means to cope with monetary risks, market-access risks, long-term FDI risks, and export risks.
- Because this opportunity to enhance North-South cooperation in investment-related matters should not be overlooked in a period of recovery from the global economic crisis.

In this context, is it worthwhile to consider **the creation of a Mediterranean Development Bank** – a project that has continued to crop up regularly over the past few years?

The report points out firstly that any additional funds that could be earmarked by the EU to finance investment in the PSEM countries will remain well below the level of current needs. **The aim cannot be to bring together sufficient amounts of capital to finance the investments needed for the development of the PSEM, but rather to give them the means to raise capital themselves and attract the additional financial resources that they need.** It’s necessary to move from an aid-based approach to one geared towards defining concrete projects first, then financing them by attracting both public and private investors – in particular the sovereign funds of the Gulf states, even if the availability of this source of financing shouldn’t be overestimated.

Sustainable Euro-Mediterranean partnerships will from now on take the form of flexible alliances rather than institutionalized arrangements. The ideas explored in the present report are intended to bring about a broader mobilization of investors by expanding and shoring up a number of existing financial instruments, such as capital markets, which are crucial but inadequately developed to play their part in leveraging investment resources and in attracting investors. To achieve this, **state support may prove to be necessary, more in the form of provision of guarantees and underwriting than through direct financing – a function similar to that carried out by the EIF in the EU.** In that case a coordinating and supervisory role will have to be played by the agency extending guarantees on a Euro-Mediterranean scale.

A multilateral body would therefore be entrusted with guiding, coordinating and supervising the various State-sponsored measures and commitments undertaken in the framework of projects implemented within the UpM. Such an entity could quite easily be the UpM secretariat itself. Donors, such as the EIB, would lend their expertise and could directly steer the public component of European financing. But other investors, both public and private, could also be called upon to participate, including from outside the region. Both groups of

stakeholders will need to decide whether an operational structure should be set up that would act as general contractor, in charge of issuing labels to the various projects, designing their legal and financing arrangements and ensuring their management. This structure would act on behalf of the Secretariat and could be administratively attached to it, while at the same time liaising with donors and investors assembled for specific projects: coming from different public and private contexts, these investors could become associates within a kind of Trust that would itself designate the aforementioned structure as its trustee. The main advantage of this type of scheme would be to ensure an integrated management of projects within a multi-lateral framework, while serving as an umbrella to draw together the various investors interested in financing such projects.

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It's clear that the proposals that have emerged here point towards a break with any attempt at centralization; **rather, the idea is to strengthen and coordinate the actions of various multilateral stakeholders, both public and private.** Furthermore, the goal is to refrain from yet another policy of aid provision. Instead, the idea is to gain leverage through the extension of guarantees rather than by means of subsidies, to foster financing rather than to finance directly. Lastly, the aim is to promote cooperation along a South-South axis as much as a North-South one.

The five recommended areas are complementary. They assemble the full range of various types of investment finance, from private equity to capital markets and encompass the various stages in the investment process, from simple commercial prospecting to the concrete establishment of a business, from creating a company to capitalizing it on the stock exchange, all the while connecting the national context to regional opportunities.

A program of work could be defined to cover five main initiatives that would correspond to each one of the five recommended areas: each initiative would strive to bring together the specific stakeholders concerned within the Euro-Mediterranean Area, without necessarily trying to enlist all the countries or stakeholders, nor gain their endorsement.