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Workshop 20

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***Finance And Economic Development In The Mediterranean Area: The Role Of
Euro-Mediterranean Cooperation***

directed by

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Workshop abstract

Despite recent progress in the modernisation of Mediterranean countries' financial systems, various evidence points to their still insufficient capacity to channel financial resources towards productive investments, and as a consequence, sustain the high rates of economic growth needed in the region to face the challenge of rapidly expanding populations.

The European Union and its member States have long been involved in cooperation initiatives in favour of North-African and Middle-Eastern economies and different instruments have been put in place to support modernisation and economic reforms (MEDA, Neighbourhood Policy Instrument, FEMIP). However, the limited results obtained until now in closing the development gap between the shores of the Mediterranean have stimulated a reflection on the interventions necessary to make the EU's action more effective.

The aim of the workshop is to investigate the connection between finance and development in the Mediterranean area, starting from the analysis of its financial systems

and private sectors and of the current state of the art of reforms in the region. It will then be considered what should be done in order to improve enterprise financing, examining the respective roles of regional policy makers and market players, as well as the potential contribution of major international partners, with particular attention to Euro-Mediterranean financial cooperation initiatives and instruments.

Workshop description

Financial systems and development: key challenges and the reform agenda

In the past few years, the authorities of the Mediterranean region have intensified reforms aimed at addressing the priority challenge for their economies: raising growth rates to the pace needed to absorb the pressure exerted on the job market by a rapidly increasing work force. Significant achievements have indeed been reached in the opening up of these economies to international competition and, to a more limited extent, in improving their business climate. For instance, according to a recent report of the World Bank (*Doing Business 2008*), growth stimulating liberalization measures introduced in Egypt ranked this country as the top reformer worldwide in 2006/2007.

Special attention should be paid in this field to financial intermediation, given its essential role in promoting an efficient resource allocation in support of economic development.

The role of financial intermediation in Mediterranean countries had often been limited, up to recently, to the mere implementation of credit allocation choices made in the framework of central planning economic development models. However, according to the IMF, the recent modernization of these countries' financial systems has shown visible results, helping most of them reach a "medium" level of development, typically in line with that of the respective economic systems¹.

This would suggest that financial systems in the region be now able to channel adequate resources towards productive investments. Yet, some evidence seems to question the effectiveness of the Mediterranean countries' financial systems in accomplishing this task.

Indeed, recent surveys carried out by the World Bank (*Investment Climate Assessments*) among the enterprises of the area show that significant difficulties remain in their accessing credit. According to these surveys, the quota of investments financed through bank loans is among the lowest at a global level: in Algeria and Morocco it reaches 20 per cent; in Egypt less than 10 per cent. The problems of access to credit afflict in particular SMEs. The quota of small enterprises having access to bank loans is 23 per cent in Algeria against 69 per cent for larger enterprises; in Egypt the ratio is respectively 13 and 36 per cent.

The same results are conveyed by World Economic Forum surveys, which assign to the countries of the Mediterranean area low rankings with respect to access to credit, availability of venture capital instruments, and access to stock market financing.

¹ The level of financial intermediation in North-African countries (M2/GDP) is fairly high (68 per cent), as is the ratio between bank deposits and GDP (54 per cent). The private sector credit/GDP ratio is at average levels (40 per cent) in the global rankings.

The insufficient bank financing of the enterprises cannot be adequately explained, at least in the current phase, by scarce liquidity in banking systems: in fact, while the ratio between bank activities and GDP has grown in recent years, the proportion of loans over the total amount of bank activities has shrunk. In short, banks tend to hold liquid activities, deposits in financial institutions and central banks and public debt instruments, instead of financing enterprises.

These critical factors are generally traced to several causes: the supply side shortcomings (for example, the banks' inadequate governance and operational inefficiency, also due to the still relevant role of public property; their limited branch networks) may be compounded by a not completely favourable context (limited development in the capital markets, institutional and regulatory obstacles, high government financing requirements). On the demand side, it must be taken into account that many enterprises, particularly SMEs, face difficulties in proposing fundable projects because of their scarce managerial sophistication.

Looking ahead, the functionality of the region's banking systems could, however, substantially benefit from the reform interventions initiated by the credit authorities of the area (privatizations, improvements of prudential supervision frameworks, strengthening of financial infrastructures).

The significant FDI flows, particularly from Europe, which are being oriented towards the banking sectors of Mediterranean countries, could also generate positive spillovers on these sectors' efficiency levels.

Instruments of the EU financial cooperation and current initiatives

The European Union and its member States have long been involved in cooperation initiatives in favour of North-African and Middle-Eastern economies. In the framework of the Euro-Mediterranean Partnership, launched in 1995, the main financial instruments have been the EU Commission managed aid programme – initially funded through the “MEDA” budget line, now included in the new “Neighbourhood Policy” instrument – and the activities of the European Bank for Investments (EIB): overall, the EU is the main provider of financial assistance in the area, with nearly 3 billion euro a year in grants and loans.

Between 1995 and 2006, the European Commission allocated 9 billion euro to support modernization and economic reforms in Mediterranean countries. New funds amounting to 3.2 billion euro have been allocated to the area for 2007-2010. The sizeable credit interventions of the EIB (channelled, since 2002, through a specific facility called FEMIP) have recently registered a further increase, with 10.7 billion euro allocated for the period 2007-2013, against 6 billion invested between 2002 and 2006 in the nine countries of the South-Eastern shore of the Mediterranean.

However, the limited results obtained until now through the Euro-Med Partnership in closing the development gap between the shores of the Mediterranean have stimulated a reflection on the interventions necessary to make the EU's action more effective. Among future priorities, the need is particularly felt to better coordinate the use of the funds allocated by different EU sources, and strengthen the relationship among various

international institutions operating in the region (e.g., European Commission, EIB, EBRD).

The governments of the EU countries of the Mediterranean have been especially active in supporting a greater EU commitment towards the Southern shore, to be reached also through an adjustment of the financial cooperation instruments. Recently, Italy and Spain have built on the past proposal of creating a Euro-Mediterranean Bank, adapting it to the evolved context and devising a project for the creation of an agency in support of the private sector in the Mediterranean (*Mediterranean Business Development Agency*). On a wider front, the French diplomacy is particularly active in support of the idea of upgrading the Euro-Med partnership into a deeper “Mediterranean Union”. Alongside European initiatives are the requests of the Mediterranean partner countries for a greater “ownership” and a more significant participation in the relevant decision processes.

Issues for discussion

The aim of the workshop is to investigate the connection between finance and development in the Mediterranean area, starting from the analysis of its financial systems and private sectors and of the current state of the art of reforms in the region. It will then be considered what should be done in order to improve enterprise financing, examining the respective roles of regional policy makers and market players, as well as the potential contribution of major international partners, with particular attention to Euro-Mediterranean financial cooperation initiatives and instruments.

The workshop could thus explore the following broad themes:

- The connection between finance and development in the Mediterranean area, with special reference to the role of the private sector;
- The characteristics of the Mediterranean financial systems, and their implications for access to credit by private enterprises;
- Regional capital markets’ characteristics and funding opportunities;
- Innovative instruments and techniques facilitating the access to credit by private enterprises, especially SMEs;
- The role of monetary, credit and fiscal policy in the development of the region’s financial systems;
- Impact of the reforms already undertaken or in process;
- Role of European (and other) FDI in Mediterranean banking sectors for the industry’s development;
- The effectiveness of the current instruments of Euro-Mediterranean financial cooperation and the potential of new projects under discussion.

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