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The Euro-Mediterranean Free Trade Zone: Economic Challenges and Social Impacts on the Countries of the South and East Mediterranean

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The Barcelona Process, when it was first introduced in 1995 in the Barcelona Declaration, was a holistic initiative designed to address the issue of creating a shared zone of peace, prosperity and stability in the Mediterranean basin. It drew, of course, on earlier, bilateral initiatives undertaken by the European Union towards the states of the South and East Mediterranean (CSEM) which had been largely economic in nature and, given its overall objectives, it is not surprising that the Barcelona Process itself also highlights the future economic relationship. However, this is not all that it does and, alongside proposals for bilateral free trade areas designed to stimulate industrial activity and trade, there are specific recommendations for multilateral progress in political, security, cultural and social fields. At the same time, the economic dimension of the Process will have quite clear social consequences and it is towards these issues that this discussion is directed.

Linking the Economic Partnership with Other Partnerships

The general objective set by the signatories of the Barcelona Declaration during the Euro-Mediterranean conference of 27–28 November 1995 stated that: 'Turning the Mediterranean region into an area of dialogue, exchange and co-operation guaranteeing peace, stability and prosperity requires a strengthening of democracy and respect for human rights, sustainable and balanced economic and social development, measures to combat poverty and the promotion of greater understanding between cultures, which are all essential aspects of the Partnership.'

This vision can be articulated diagrammatically in the following manner:

Dialogue		Peace		Democracy
Exchange	→ guarantee	Stability	← imply	Economic development
Co-operation		Shared prosperity		Social, human and cultural development

A threefold proposition which can be derived from this diagram provides the foundations for a global Euro-Mediterranean Partnership, as envisaged in the Barcelona Declaration:

- political and security partnership, to define an arena of peace and stability;
- economic and financial partnership, to build an area of shared prosperity;
- social, cultural and human partnership, to develop human resources, promote greater inter-cultural understanding and exchanges between civil societies.

On this basis, the Barcelona Process can now be systematised according to the following diagram:

Outcomes	Means	Mechanisms
Peace	Democracy	Dialogue
Stability	Economic development	Exchanges
Shared prosperity	Social, human and cultural development	Co-operation

The diagram immediately provokes one question, concerning the nature of this approach to the problems of the region – is it intended to be an integrated approach and do the three types of partnership described, although presented separately, provide the foundations of a comprehensive and integrated partnership? In other words, to what extent is the Euro-Mediterranean project coherent and cohesive? This, in essence, is the problem we wish to address.

The Objectives: Are Peace, Stability and Shared Prosperity Separable?

Is the establishment of an area of peace and stability – essentially through political dialogue and with a view to consolidating the rule-of-law, democracy, respect for human rights and fundamental freedoms – separable from the creation of an area of shared prosperity based on free trade and economic and financial co-operation in order to encourage balanced

economic and social development? Similarly, are peace, stability and shared prosperity conceivable without social, human and cultural development being accompanied by economic development, itself based on the rule-of-law where fundamental social rights are respected, including the right to development?

The answer to both these questions has to be in the negative and the object of this paper is to demonstrate that economic and financial development, which are seen in the Process to depend on the establishment of a Euro-Mediterranean free trade zone, are inseparable from the other partnerships to be established in the political, security, social, human and cultural fields. In reality, there are links and dialectical interactions between the various forms of partnership and between the outcomes, means and mechanisms set out in the Barcelona Declaration. What is new in the Euro-Mediterranean approach initiated in Barcelona is that, perhaps correctly, it reveals an integrated and comprehensive joint vision of what must be done. It is, indeed, a statement which is devoid of ambiguity, misunderstanding or inaccuracies, as will be shown later.

The Economic and Financial Partnership

The key to the economic and financial partnership is the creation of bilateral free trade zones in industrial goods, together with five-year protocols providing financial aid to the private sector, under the *Mésures d'Adjustement* (MEDA) programmes, alongside equivalent amounts of soft loan facilities from the European Investment Bank. The key difference between these arrangements and their predecessors is that now South and East Mediterranean countries must abandon their own tariff barriers to European industrial goods and their industrial sectors must now accept unfettered competition with European producers. Turkey and Israel have slightly different arrangements from the remaining South and East Mediterranean countries but the effect is virtually the same.

Creating an Area of Shared Prosperity Based on Free Trade

Beyond a timid reference in the Barcelona Declaration to the debt question, which is of key concern to Mediterranean non-partner states and which will eventually require further dialogue and progress, Euro-Mediterranean partners have agreed on three long-term objectives, together with three different means of establishing a zone of shared prosperity. The agreed objectives and means can be summed up in the table on page 12.

The progressive implementation of the free trade zone is therefore one of the essential, although not exclusive, means of achieving the three declared objectives of:

Objectives	Means
To increase the pace of sustainable economic and social development	Establishment of a free trade zone
To improve living conditions, increase the level of employment and reduce the development gap in the Euro-Mediterranean region	Fostering appropriate economic co-operation and dialogue in the domains concerned
To promote regional co-operation and integration	Substantial increase in EU financial aid to its partners

- speeding up development;
- reducing the development gap in the region; and
- promoting regional co-operation and integration.

By a process of convergence, these three objectives are expected to lay the foundations of an 'area of shared prosperity' (ASP).

In fact, the establishment of free trade in the Euro-Mediterranean region, which is accompanied by diversified and widespread economic co-operation and intensified financial aid, should be the decisive lever enabling the construction of the ASP, according to the Barcelona Declaration. Indeed, it should be stressed that the free trade zone (FTZ) concept, *stricto sensu*, commits its partners to specific means in addition to the progressive principles implicit in its implementation, namely, they must:

(1) pursue policies based on the principles of market economy;
(2) initiate economic adjustment by:
 (a) modernizing economic structures,
 (b) promoting the private sector,
 (c) upgrading the production sector;
(3) initiate social adjustment by:
 (a) modernizing social structures
 (b) mitigating negative effects through
 (c) programmes aimed at the neediest population;
(4) initiate institutional adjustment by:
 (a) setting up an institutional regulating framework favourable to market economy.

Thus, the Barcelona Declaration contains clear statements on free trade adjustment (FTA) which have three different dimensions – economic, social and institutional in nature. Furthermore, there is a specific reference to the social cost of the FTA and to the necessity to minimise it, particularly for the most deprived populations.

As far as economic and financial co-operation is concerned, two points must be stressed because of their direct linkage with the Free Trade Zone (FTZ):

- economic development must be supported both by domestic savings and by direct foreign investment (DFI); this confirms the importance of promoting an environment favourable to the removal of obstacles to such investments;

- reforms of the political-institutional environment and the removal of extra-economic obstacles appear to be implicit conditions for the success of the FTZ. Indeed, as far as financial co-operation is concerned and quite apart from the promise of substantial increases in financial aid, the Barcelona Declaration specifies that: 'sound macro-economic management is of fundamental importance and to this end the partners agree to promote dialogue on their respective economic policies and on the methods of optimising financial co-operation'. It is legitimate to pose the question that sound management, dialogue and the optimization of financial aid could diplomatic references to the dual conditionality inherent in financial, economic and political assistance.

DFI: The Decisive Variable in the FTZ and Politico-institutional Adjustment

The question of DFI is essential in understanding the politico-institutional dimension of the FTA. Indeed, every study of the degree to which the impact of the FTZ over the CSEM area can be predicted shows that an increase in foreign capital flows is often used to highlight the positive aspects of such a zone. The argument is based on the predicted impact that the actual announcement of the creation of a FTZ may have on foreign investors – a phenomenon which has already been observed during the implementation of other FTZs. The significance of this phenomenon must be reduced, however, by the specific nature of the Euro-Mediterranean FTZ since it offers new investors no new economic opportunity when compared to the previous cooperation agreements. Indeed, as far as European and other capital in search of offshore investment are concerned, it does not offer new markets, new fiscal terms or new financial opportunities. The only new element in the FTZ that may have relevance to investors is the political aspect of the increased openness of the Mediterranean economies, as they engage in greater integration within the European economic arena.

As far as these states themselves are concerned, the creation of a FTZ can only be beneficial to the CSEM if three interlinked conditions are fulfilled:

- The official implementation of active macro-economic support measures to upgrade domestic companies and attract foreign investment;
- The success of the upgrading programmes in transforming domestic companies, in order to signal that competitive economic conversion has been achieved; and
- A significant increase of foreign investment, particularly in the form of DFI, directed towards creating the appropriate conditions for the achievement of the desired competitive conversion of the CSEM economies.

In fact, although adjustment will incur costs, the potential gains associated with the FTZ remain largely dependent on foreign investment which will create new activities in competitive areas, thereby compensating for fiscal and social losses inherent in the creation of the FTZ and initiating measures which will upgrade production systems. A recent study based on a quantifiable general equilibrium model, designed specifically to take into account the role of direct foreign investment,[1] clearly showed that a significant decline in the risk premium linked to the inflow of private capital should stimulate a substantial rise in living standards and thus allow for a measurable reduction of migration flows as a result as domestic employment should increase. The calculated fall in the risk premium reflects several factors. It stems, first, from the national commitment implicit in the irreversible character of the FTZ agreement. In addition, positive expectations are associated with integration within the European growth area and there are expectations of greater institutional convergence with Europe, accompanied by an increased level of financial aid and technical co-operation. As a result of these conclusions, the study recommends greater regional integration at the institutional level in order to decrease the risk premium still further and thus increase the flows of DFI. Institutional adjustment and political credibility are therefore at the heart of the investment issue which, in any case, lies at the heart of every argument for the success of FTZs within the CSEM region.

Financial Co-operation and Political Conditionality

A novel kind of dual conditionality seems to have become the new key variable in the field of financial co-operation:

- Economic conditionality relates to the degree of implementation of structural reform measures to which CSEM governments have committed themselves. In future, those who fail to use their budget allocations under the MEDA programme by the end of the fiscal year may lose the balance to another partner whose economic performance, in terms of its commitment to the Process, is deemed more satisfactory.

- Outright political conditionality, which is now allied to economic conditionality, is essentially a new factor in Euro-Mediterranean relations. It relates to human rights and entails the possible suspension of financial aid following a qualified majority decision by the European Union, should human rights violations be revealed.

The problem here, however, is to determine how much deterrence political conditionality can actually generate and to establish to what extent it would provide an effective incentive for CSEM states to commit themselves to political reforms on human rights, fundamental freedoms, the rule-of-law and political pluralism. The extent to which this type of conditionality might buttress the actions of the various actors of civil society, who themselves are striving to establish the rule-of-law and democracy,[2] must also be considered.

Free Trade Adjustment and Politcal-institutional Convergence

The Euro-Mediterranean FTZ proposals, as laid down in the Barcelona Declaration, imply that the participating countries accept the basic principles of a market economy. This means that partners agree to abide by the same rules of trade as apply to all economic actors, institutions and agents. While the rules of free trade can, to a degree, be adapted to allow for to cultural diversity, they also imply a minimum degree of convergence at the level of institutions, in order to guarantee equal treatment for all. Thus, free trade adjustment (FTA) for the CSEM states may, as a precondition, involve the adoption of a minimum level of internal institutional transformation. Moreover, the Barcelona Declaration refers explicitly to institutional adjustment as necessary in order to promote free trade effectively. Free trade rules, in turn, imply political institutional structures which ensure the implementation and the respect of the rules themselves – independent judicial systems and the rule-of-law, political pluralism, financial and political transparency, as well as governmental accountability as the administrator of public property and the legal accountability of its institutions.

Institutional adjustment and minimal political and institutional convergence appear to be an explicit requirement under the terms of the economic basket of the Partnership, given its focus on the creation of FTZs. It is not clear whether the adjustment process undertaken by the CSEM states is expected to occur 'naturally' – as an unavoidable consequence of the very constraints imposed by free trade – whether it will be an objective consequence of the very existence of the FTZ, or whether it will be the product of specific and committed institutional reforms initiated by the CSEM governments themselves. This ambiguity, however, leads to several questions:

- To what extent can political dialogue allow a degree of political and institutional convergence between the partners and what would be the role of the various actors in civil society in this dialogue?

- Is it not political dialogue on human rights, together with the rule-of-law, democracy and pluralism, at the heart of the institutional mechanisms by which FTZs are implemented and therefore at the centre of institutional adjustment to free trade?

- Furthermore, can this political and institutional convergence adapt to cultural difference and to differences between the various political systems in the region? Is the search for minimal convergence likely to require that the existing politico-institutional systems of the CSEM be gradually recast in order to make them fit a European model which is now regarded as universal? How much importance should be granted to the universal dimension of such a paradigm and how much to specific local conditions? And what protective mechanisms exist to avoid loss of identity and cultural referents, which, if absent, would lead to the revival of profoundly destabilising and retrogressive reactions in the consequent search for identity?

These questions must be addressed within the political basket of the Barcelona Process and will involve actors from civil society as well. It is worth noting, however, that – contrary to the provisions of the Barcelona Declaration – a communication from the European Parliament and the Commission[3] states clearly that the FTZ is open to any country in the region which accepts the basic principles of market economy and political pluralism. The document highlights the links between the political dimension in terms of stability and security and the economic and social dimensions in terms of development and free trade, for the object is, according to the Barcelona Declaration, to, '... establish an area of stability and security by creating the necessary conditions for sustainable and rapid economic and social development. The most appropriate means of achieving this is to create a Euro-Mediterranean area characterised by free trade.'

In essence, this proposition entails the establishment of stability, peace and security in exchange for free trade accompanied by an improved financial aid package. The FTZ is regarded as a prerequisite to the realization of the objectives of the Barcelona Process and the appropriate instrument for the promotion of an area of shared prosperity, one of the cornerstones in the creation of an area of peace, stability and security. The resulting political equation behind the Process is, in other words: no peace, stability or security without shared prosperity brought about by free trade. Similarly and

conversely, of course, no shared prosperity is possible without peace, stability and security in the Euro-Mediterranean region.

The reference, here, to the linked nature of market economies and political pluralism is quite explicit, as is the similar linkage between politico-institutional reform and economic reform. In the Barcelona Declaration, the formal reference to linkage is blurred and implicit in nhature, nor is it unambiguous and, for this reason, political dialogue will be required to remove such ambiguity. None the less, the political implications of the FTA concept are undeniable and political dialogue must take place if there is to be progress towards the required convergence at the political-institutional level.

Social Costs of FTZ Adjustment

The political implications of the FTZ concept are not the only ones that must be considered if the true consequences of the economic basket of the Barcelona Process are to be properly understood. There are social costs as well.

Economic Consequences and Social Impacts

Since the mid-1980s, most Mediterranean countries have adopted programmes of liberalization and adjustment in order to establish market mechanisms and free external trade, and to encourage private initiative and stimulate privatization. Thus, their progressive integration into the global economy is seen as irreversible. From this perspective, the option of a FTZ with the EU can be seen as a better way of putting down roots in the global economy and is in the nature of structural adjustment, mainly aimed at inducing a substantial effect of growth transfer as well as greater economic efficiency.

However, the establishment of a FTZ with the EU would significantly deregulate existing liberalisation policy mechanisms initiated by the authorities. Indeed, although for most CSEM states the choice of opening to the global economy is strategically irreversible, it is, none the less, endowed with some degree of realism in terms of its implementation. This has to be compatible with the means that can be mobilized to achieve the objective and, above all, implementation must take account of the fragility that characterizes these emerging economies. The FTZ alternative significantly speeds up liberalization, and act as a process initiated without properly identifying or mobilizing means to reduce costs and bring about conditions of success.

The FTZ, in effect, constitutes the trade basket of the Euro-Mediterranean Partnership agreement negotiated between the EU on the one hand, and each of the Mediterranean countries on the other. It has at least four specific characteristics: it is a FTZ between one country on the one hand and a group of countries on the other; between economies with unequal levels of development; between economies with unequal levels of integration; and between economies with unequal levels of mutual protection. These characteristics mean that the FTZ does not fit into the classic pattern of FTZ creation in which two or more countries with comparable levels of development and protection agree on the modalities of trade barrier removal. The implementation of the FTZ in the Barcelona context is therefore characterized by an obvious asymmetry. While the EU is already open to Mediterranean products (except for agricultural and some textile products), the CSEM states are faced with the unilateral dismantling of their protection mechanisms against imports from the EU. Thus, in view of its uniqueness and asymmetry, the implementation of the FTZ – which will be of unequal and uncertain impact on different CSEM states - must be qualified and the results of its impact assessment should be interpreted cautiously.

The analysis of social impact is closely linked with the economic effects of the FTZ, which are particularly evident in the domains of economic activity and public finance. These impacts generate, as responses, challenges the outcome of which will significantly condition the actual evolution and prospects of the FTZ in terms of economic and social development. Because of this factor, any analysis of the process must be speculative rather than prescriptive. However, it should none the less identify the major difficulties and constraints imposed by social parameters which are overwhelmed by economic and financial imperatives.

The creation of the FTZ between the CSEM and the EU requires the unilateral removal of trade barriers directed against European products without reciprocal action by the EU since nearly all manufactured goods from CSEM states already have free access to the European market. The only likely prospect for and increase in exports to the EU is in the realm of agricultural products, once the obstacles to trade have been eliminated. However, the fact that agricultural goods are currently excluded from the FTZ – discussions about their inclusion only began at the start of the year 2000 – nullifies this obvious advantage. Furthermore, the positive commercial effects expected from the creation of the FTZ, as far as manufactured goods are concerned, can only be indirect. For any country in this kind of partnership with the EU, such effects should come from the increased competitiveness associated with the fall in the price of goods imported from the EU and from the adjustments, for the sake of better productivity, generated by the removal of trade barriers.

The assessment of quantitative effects associated with the creation of a FTZ cannot be dissociated from the macro-economic policies which accompany the elimination of customs barriers. There are significant variations between the impacts depending on the hypothesis used to justify

the FTZ concept. The hypothesis requiring official implementation of recessive supporting macro-economic measures – reductions in public spending or currency exchange rate adjustment – suggests that the overall effects on economic activity will be weak. They are likely to lead to general economic stagnation accompanied by differentiated sectoral growth, thus demonstrating the need for industrial restructuring and for labour relocation into more competitive sectors, with a overall increase in unemployment. Alternatively, the adoption of active macro-economic supporting measures designed to control the potential adverse effects of the FTZ might, for example, compensate for the loss of fiscal earnings due to the removal of trade barriers by a rise in indirect taxation or lead to positive adjustments to growth through a substantial increase in foreign investment. In this case, it should be noted that:

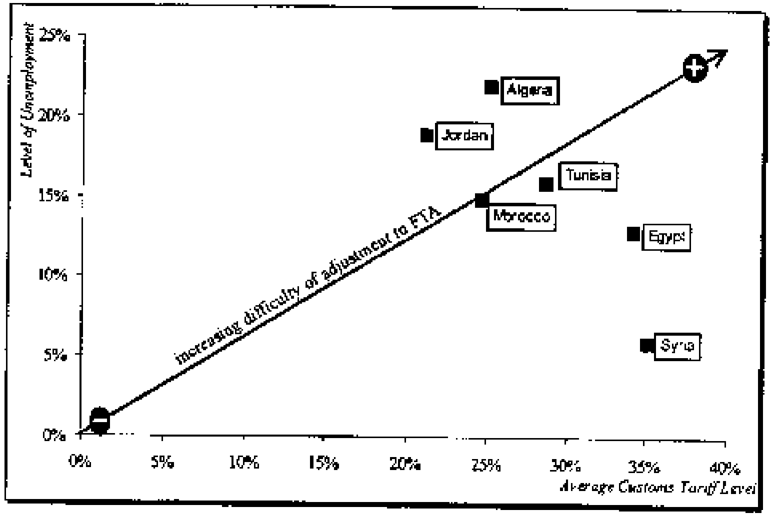
- Increasing indirect taxation whilst compensating for falls in customs revenues will generate side-effects which might severely affect economic growth. These could include price increases leading to a fall in investment and domestic demand as well as job losses, particularly for industries supplying the local market. Economic recession will cause a drop in fiscal revenues, as a result of the reduction in the tax base, even if there have been increases in tax rates, and thus increase unemployment. At the same time, such a recession would stimulate structures and mechanisms for spontaneous redeployment of labour by redirecting significant elements of the sector-based labour force.

- However, such macro-economic consequences could be reversed if adjustment was carried out with the help of capital inflows in the context of existing budgetary and monetary policies. Results obtained from the study of the impacts of the FTZ on the Tunisian economy[4] show accelerated growth, in response to substantial additional investment absorptive capacity in some sectors, together with falls in the rate of unemployment and growth in fiscal revenues.

The Social Impact of the FTA

The impact of a FTZ on economic activity and employment is, therefore, highly variable and depends on the capacity of the partner country to attract and mobilize a substantial flow of direct foreign investment. The effectiveness of this, in turn, will depend on the absorptive capacity of its industrial structure in handling significant variations in investment flows. The main challenge is to achieve economic flexibility in the transitional phase of trade liberalisation while preserving macro-economic equilibrium. During

FIGURE 1
DIFFICULTIES OF CONVERGENCE TO FREE TRADE



Source: Statistics: IMF & World Bank (1993–95)

this transitional phase, no country in a FTZ partnership with the EU can afford merely slow or moderate growth. The effort needed to succeed is made all the greater because its initial situation is characterised by wide-ranging protection mechanisms and a high rate of unemployment. The following graph, which plots average rates of customs tariffs (the protection indicator) horizontally and the rate of unemployment (the social indicator) vertically, illustrates the difficulties attached to the removal of protection barriers which has led to a loss of activities and jobs in six CSEM countries.

In the case of Tunisia, the portion of industrial production (approximately 10 per cent of GDP) threatened by the removal of tariffs on to imports from the EU has been estimated at 60 per cent of the total. Half of this output represents activities which are genuinely competitive in nature, whilst the remainder are protected and offer no real comparative advantage. This protection, following the establishment of a FTZ with the EU, can no longer be sustained and output can only be sustained if 30 per cent of national industrial activity is transferred into the competitive sector. This, in turn, will require that one third of the industrial sector will have to be abandoned, whilst another third will have to be redeployed into the third of the sector which is genuinely competitive in nature. This challenge will require a profound

change in the nature of the Tunisian economy and poses two important questions: to what extent is this formidable redeployment of productive resources possible for a competitive re-conversion of the Tunisian economy to take place? To what extent will the 'competitive third' remain competitive? In evaluating the answers to such questions, it should be borne in mind that they will will not take into account the additional stimulating effects of accompanying reform measures which will be implemented during the twelve-year transitional period provided for in the introduction of the FTZ.

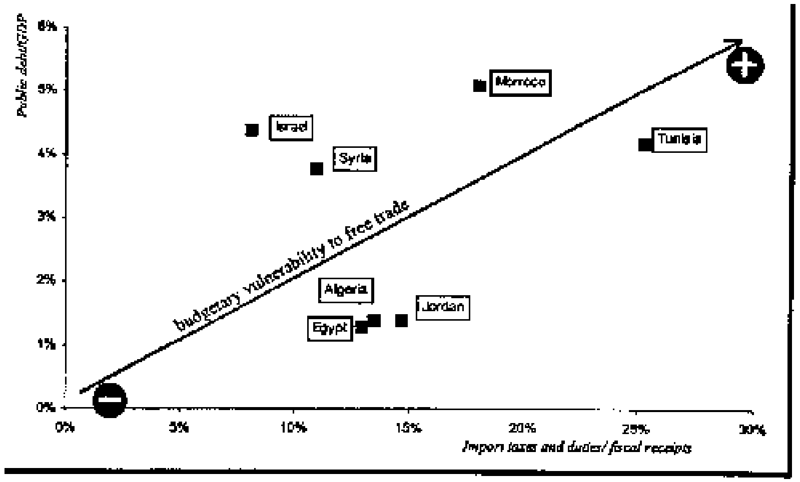
For the CSEM states, the social impact of trade barrier removal is considerable. Over one quarter of the labour force currently employed in industrial activities which are increasingly unviable will have to be transferred to more competitive and profitable activities. Even if training programmes made it possible to achieve this tremendous movement of labour, the problems associated with the creation of competitive activities would still pose a problem. Currently, the main source of competitive activity for manufacturing industry in the CSEM region is the textile and clothing sector. In fact, competitiveness in this sector is really only sustained by preferential agreements with Europe. The sector will, therefore, have to undergo profound change if it is to survive, not just the establishment of the FTZ, but also the dismantling of the multi-fibre agreements which currently give it its competitive edge.

The social impact of the FTZ on the countries of the southern Mediterranean also has consequences for public finance, since customs revenues constitute an important budget resource for them. 'Budget vulnerability' to free trade and the difficulty for public finances to comply with the condition imposed by the FTZ because of the implied loss of revenues are reflected in the importance of customs revenues for fiscal balance and for public finance. The following graph illustrates the sensitivity of public finance to free trade for seven CSEM countries:

Countries such as Tunisia and Morocco, whose budgetary situation is difficult, with budget deficits often above to 4 per cent of GDP and a large portion of revenues depending on income and import taxes, have to make particularly intense efforts to reallocate budgetary resources to internal activities. This can only be done if two conditions are fulfilled; firstly thorough fiscal reform is essential and, secondly activities likely to generate fiscal revenues must be developed. Yet these requirements are not easily reconcilable with profound industrial change and labour redeployment that must involve, *inter alia*, the provision of tax incentives.

For most CSEM states, the loss of tax revenue implicit in the establishment of a FTZ with the EU, represents between 10 and 20 per cent of tax revenues. This presents government with a dilemma for it will be tempted to adopt a spontaneous policy of demand control which would result

FIGURE 2
BUDGETARY VULNERABILITY TO FREE TRADE (1995)



Statistical source: IMF.

in one of two outcomes: either government spending will be reduced or direct and indirect taxation will be increased. In the first case, the fall in customs revenues generated by the FTZ must translate into a considerable reduction of public expenditure. Yet, since government spending is a prerequisite for the creation of new productive resources, a policy of public expenditure cutbacks is both incompatible with the principle of encouraging investment and inappropriate in a context of industrial redeployment induced by the removal of trade barriers which will necessitate more sustained budgetary support. Thus, reaction to such a fall in tax revenue involving public expenditure reduction would only lead to general recession. From a dynamic perspective, such a recession would generate less fiscal revenue and therefore further aggravate the consequences of this negative type of budget management.

In the second case, where the fall in tax revenues stimulates a search for other compensatory tax resources through increasing indirect taxes, the consequences would be similar, although the means would be different. Indeed, increases in indirect taxation lead to demand control and thus to restrictions on investment, production and employment. Even if the FTZ had no effect over activity in a context of demand control – an unrealistic hypothesis – the fiscal loss compensation induced by the removal of tariff barriers will require raising rates to a level incompatible with political and economic realities. In short, regardless of the impact of trade barrier removal

on public expenditure, there is a considerable risk that government expenditure on welfare will fall. In Tunisia, in the past, measures have been taken to minimise such consequences. The implementation of a structural adjustment programme at the end of the 1980s – which could have produced similar fiscal consequences – had no social cost because of the government's policy of social sector protection. This, however, led to a 14 per cent rise in public social expenditure in real terms, from 47.5 per cent of budget expenditure in 1987 to 52.5 per cent in 1993.[2] The establishment of the FTZ will, therefore, offer a new challenge in the domain of fiscal adjustment and social sector protection.

Emigration and Debt

In essence, this issue will involve furthering active co-operation in promoting human resources in the Euro-Mediterranean region. International migration is today, particularly in the Euro-Mediterranean context, an undeniable and fundamental fact of society, both in the country of origin and in the host country. Indeed, the migrant's virtual break from his or her country of origin is compounded by the difficulties or impossibility of integration in the new host country. The migration issue, therefore, is at the heart of the imposed interdependence across the Mediterranean, which has been difficult for partners in the North and South to accept, even though they are 'condemned' by history and geography into being strategic neighbours and having to cooperate in their efforts achieve development. This raises some important questions:

- how can the static or short term vision narrowly focused on migration as a security issue be avoided?
- how can a holistic vision of social integration across the Mediterranean be developed as a crucial dimension of cooperative relations between the Barcelona partners?
- why should the migration issue be the main bone of contention in such interdependent relations?
- could the issue of international migration be considered in the long term, as a historical and shared responsibility for the Barcelona partners which is also one of Europe's instruments for the promotion of human resources in countries of origin. Would it become the key to sustainable and shared development in political solidarity across the Mediterranean and thus a guarantee of stability and security for all?
- what would be the predictable effects of the FTZ on migration flows?

Migratory Pressure, the FTZ and Economic Convergence

Simulation models suggest that it will be difficult to guarantee a significant reduction in migration flows as a result of the establishment of the FTZ. The theoretical proposal that free trade, accompanied by substantial financial assistance, is an alternative to emigration can only be seriously considered to be an adjustment mechanism in the long term.[5] The underlying hypothesis here, which is often implicit, is that free trade (accompanied by significant foreign capital inflow) will contribute to the reduction of the income gap between Europe and the CSEM region and thus should reduce migration flows significantly. It is therefore a legitimate question to ask to what extent the economic partnership exemplified by the FTZ, together with economic and financial co-operation would stimulate economic convergence, in terms of a reduction of the lag in development in the South which would therefore deter further emigration? The gamble of economic partnership in seeking to build an area of shared prosperity is ultimately at the heart of the problem of economic convergence in the long term.

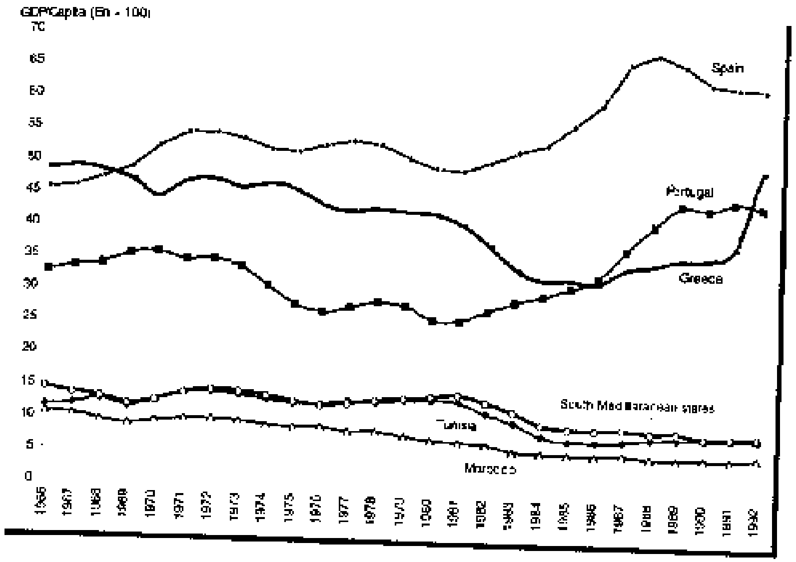
The Euro-Mediterranean issue initiated by the EU can be summed up in the following diagram:-

Disparities		**Migration pressure**		**PROBLEMS**
		∇		
Poverty Unemployment	➔	Side effects; Criminality Drugs Extremism	➔	Instability Insecurity Tensions
Dialogue		**Growth and convergence**		**GUARANTEES**
Partnership Co-operation	➔	∇ Reduction of migratory pressure	➔	Stability Security Peace

This issue was not a predominant concern during the integration of such countries as Greece, Spain and Portugal into the EU. Data on these countries show a significant, if gradual, tendency towards economic convergence. Indeed, an examination of the evolution of the GNP per capita (at purchasing power parity 'PPP' and with an index where 100 corresponds to the weighted average in EU countries) shows that for Portugal, the index rose from 26.3 before joining the EU (average for 1980–84) to 36.4 in the early 1990s (average for 1990–93). Spain experienced the same convergence (the indices for the same period are respectively 49.8 and 60.6). In the case of Greece,

convergence was only observed from the beginning of the 1990s. The following table and figures illustrates the observed trends (detailed data can be found in the annex):

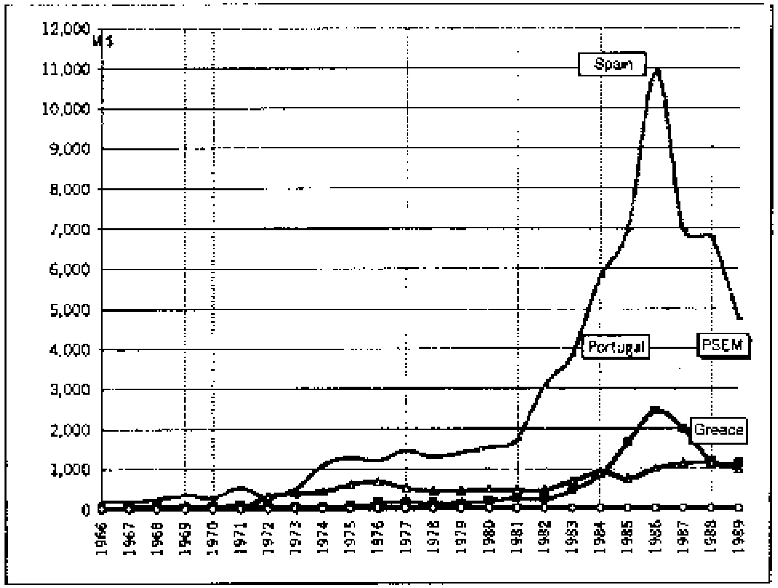
FIGURE 3
EVOLUTION OF PPP GNP PER CAPITA (BASE 100 = EU AVERAGE)



In the CSEM region this convergent tendency was observed between 1975 and 1985, probably as a result of the co-operation agreements signed in the mid-1970s. However, there was a clear divergence after 1986, although it seems to have been stabilised over the last few years. The CSEM GNP per capita index fell from 20 in 1985 to 15 in 1993 as an average for the CSEM region as a whole as individual states registered varying degrees of deterioration which reflected the income gaps between the two sides of the Mediterranean.

The case of Portugal provides a good illustration of this process. Since its integration within the EU, its gradual economic convergence has been accompanied by considerable inflows of foreign capital. DFI rose from $157 million to $1,300 million and there was a fourfold increase in net global flows, from $1,074 million in 1980 to $4,431 million in 1993. The data for the CSEM states shows that, in terms of net global flows or in terms of DFI, the results are alarming (except for Turkey). There has, in effect, been capital drain and the stagnation or reduction of DFI flows. The following table illustrates the comparison between the net flow of DFI towards three EU countries (Spain, Portugal and Greece) and those attracted by the CSEM region during the period from 1970–93. The evolution of net global transfers towards the CSEM region(for the six countries for which data are available) between 1980 and 1993 is illustrated in the following table:

FIGURE 4
EVOLUTION OF NET DFI FLOWS (in million US$)



In 1993, global net transfers for the six countries under study represented less than one third of those of Portugal ($4.4 billion). Is the Euro-Mediterranean Partnership going to change this situation? Will the achievement of economic convergence run the risk of provoking a veritable meltdown amongst European partners as far as external capital flows, especially in DFI, are concerned? There is no way of knowing what the future will hold in this respect.

Debt or Debt Swaps – Human Resource Promotion

The data provided in the annex show that, apart from efforts to improve debt service terms, several CSEM states experience negative net transfers which affect their ability to attract the resources necessary to stimulate investment and job creation so as to reduce unemployment and minimise potential emigration. The following table illustrates the deterioration of the debt situation in five countries in the South Mediterranean region.

EVOLUTION OF FOREIGN DEBT

(Weighted average rates)

	1970–79	1980–89	1990–94
Tunisia			
Debt ratio	40%	59%	60%
Debt service ratio	14%	25%	24%
Mauritania			
Debt ratio	92%	193%	209%
Debt service ratio	26%	23%	26%
Morocco			
Debt ratio	40%	98%	80%
Debt service ratio	23%	45%	36%
Algeria			
Debt ratio	47%	40%	58%
Debt service ratio	20%	48%	71%
Egypt			
Debt ratio	66%	114%	88%
Debt service ratio	20%	31%	23%

The result is that CSEM states face and increasingly severe dual reality reflecting:

- Constraints in:
  - education-training-employment provision
  - debt servicing

- and consequences in:
  - unemployment (leading to potential emigration)
  - negative net transfers

The constraints are clearly inter-linked and, in the long-term can only be effectively managed through partnership arrangements across the

Mediterranean in which debtor and creditor cooperate. This will require that the following two objectives are achieved within the framework of such a partnership over the long-term:

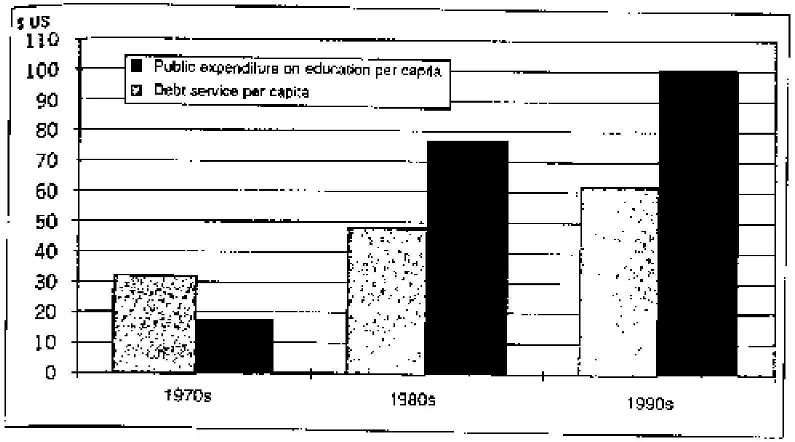
- A rapid termination of net outward financial transfers from CSEM states and a significant reallocation of capital flows towards development based on human resources promotion.

- Partial or total debt cancellation or debt rescheduling over a thirty year period, which is the probable length of time before the reduction in demographic growth rates currently occurring manifests itself in the productive sectors of the economies in most CSEM states, so that there will be a real downturn in the level of additional employment demand. This will mean that debt service obligations could be reduced to a level compatible with a productive investment growth rate which, in turn, would satisfy employment demand and lead to a gradual reduction in absolute levels of unemployment.

In fact, both propositions would require agreement on the recycling of a substantial portion of the debt with the express purpose of promoting human resource development, in other words, the substitution of human resources promotion for debt. The necessary negotiations would deal with a dual concern. First, it would facilitate economic recovery in debt-ridden countries which are also experiencing net outward financial transfers, despite the counter-measures that may have been adopted. Second, it would give human resource development a prominent role in the new partnership, thus contributing to a reduction of the social cost of free trade and, in consequence, reducing the propensity for emigration from the South. Under current conditions, any consideration of the pattern of evolution of CSEM state social sector expenditure will demonstrate that there is, at best, stagnation and, in some cases, regression in real terms as a result of increasingly heavy debt servicing obligations. The available data (see annex) shows that, in three of the southern Mediterranean countries (Morocco, Tunisia and Egypt), per capita public expenditure on education, which in the 1970s was equivalent to almost twice the amount per capita spent on servicing, fell to only 60 per cent during the first half of the 1990s. Figure 5 illustrates this pattern.

External debt recycling in the CSEM region could be used to contribute towards the creation of a Euro-Mediterranean fund for the promotion of human resources where management principles and mechanisms should involve actors within civil society and should be negotiated between the partners on both sides of the Mediterranean. The objective of such a fund would be to contribute to:

FIGURE 5.
PUBLIC EXPENDITURE FOR EDUCATION AND DEBT SERVICING



- the creation of productive employment opportunities, particularly in regions subject to strong migration pressures;
- the support of family planning policies;
- competitive economic restructuring in the CSEM region, since professional training must play a predominant role in transformation and reallocation of factors of production, particularly the industrial labour force.[7]

Professional training should be designed within the overall framework of labour qualification and mobility, since it concerns the whole of southern Mediterranean labour-force, whether in countries-of-origin or in host-countries. Thus, controlled and organized migration into European countries would allow for proper immigrant training programmes designed to facilitate eventual repatriation and the creation of micro-enterprises networks in countries-of-origin based on appropriate technology and commercial knowledge transfer. It would also provide trained managers for enterprises seeking to relocate into the CSEM region. Economic *rapprochement* across the Mediterranean, however, can only be completely successful if factors of production such as capital *and* labour are allowed to move freely within the Mediterranean region. Of course, this is not currently possible because of anxieties inside Europe over the social and political implications. As a result, during the transitional phase of the creation of a Euro-Mediterranean economic arena, a dynamic vision of the emigration issue, as suggested here, would encourage a renewal of migration flows (which Europe will increasingly need as its own population ages). This could be organized so as to provide improved efficiency of control and training, in order to contribute to competitive economic re-conversion in the countries of the southern Mediterranean, while maintaining migration within the limits compatible with the EU's economic and social imperatives. In this respect, it would be interesting to examine closely the German experiment of the early 1970s, which offered vocational training to Portuguese workers residing in Germany.[6]

Finally, quite apart from considerations of immediate interest or ideological preconception, perhaps international migration should be viewed as a vector of social change and cultural interdependence. After all, the integration of migrant communities in host-countries is introducing profound social modification which raises questions about the fundamental values of European society, such as secularism, citizenship, and identity. It is stimulating a search for new patterns of social cohesion through the enlargement of the ethnic and cultural bases inside Europe itself. Immigration may thus may be contributing to the birth of a new European sense of citizenship, despite the immediate problems it may face. At the same time, the migrant experience of European cultural and political values may also act as a catalyst for the transition towards democracy in their countries-of-origin.

A Tentative Conclusion

For most CSEM states, integration into the Euro-Mediterranean arena will be costly, difficult and hazardous. Yet it will also provide a genuine opportunity for economic modernisation and restructuring which will better equip them to face the challenges of globalisation. Adjustment to such new situations also implies a substantial investment in human resources, infrastructure, the organization of production and institutions. The financial resources needed for these changes will exceed the capacities of the states involved and European participation is therefore essential. Such participation could occur in two ways:

- on a passive, short-term basis via compensation for the reduction of customs revenues as a result of the FTZ policy; or
- on an active, long-term basis via the financing of measures to improve national competitiveness, so that DFI, particularly from Europe, will be encouraged.

Another important facet of European support for CSEM economic restructuring would be the easing of trade constraints on agricultural produce and the food industry Since the FTZs introduced through the Barcelona

Process are restricted to industrial free trade, agricultural products are excluded. Their access to EU markets is still heavily constrained by quotas, customs tariffs, export schedules, target prices and quality standards, even though negotiations on liberalizing such restrictions began at the start of the year 2000. The social impact of these restrictions are crucial for they exclude the poorest social groups in the CSEM region who will not benefit from the FTZ as a result.

Conceptually, the Euro-Mediterranean Partnership project stems from a liberal vision. Yet, liberalism cannot be partial and discriminatory, for it will then contribute to regional destabilization instead of promoting a dynamic of progress. The Euro-Mediterranean Partnership project is also based on principles of co-operation and partnership, so that a permanent concern for equity must govern relations among partners, rather than considerations of balance of power. The construction of the Euro-Mediterranean region fits within a pattern of historic evolution. It is not merely an option but reflects that irreversible and inevitable evolution of regional economies as a result of liberalization which provides the only opportunity for creating regional stability, prosperity, and durable economic development. During its construction, a period of transition is necessary and inevitable and temporary negative outcomes may be difficult to avoid, even if they can be predicted in spheres such as industrial activity, public finance, employment, wages and revenues. The partners to the project must seek to mitigate such outcomes, they must try to shorten the transitional period, thus minimizing economic and social costs and optimizing the advent of genuine regional prosperity.

NOTES

1. D. Cogneau and J. Christophe, *Intégration régionale, investissements directs et migrations dans l'espace euro-méditerranéen: Enseignements d'un modèle d'équilibre général calculable*, Athens, 31 Oct. – 1 Nov. 1996.
2. 'Is this not a double-edged sword?', asks Fathia Talahite rightly, 'since by linking human rights to aid there is a real danger that the significance of this struggle may be corrupted and subjected to economic and financial pressures. Does the institution of a currency in a mechanism which, through aid, enables the EU to exert unilateral control over recipient countries, not run the risk of perpetuating relations of dependence, perverting the profound significance of human rights and delaying the day when this problem will be effectively acted upon by the societies concerned', *Maghreb-Machrek*, No.153, July–Sept. 1995.
3. Communication from the European Parliament and Council Commission: *Renforcement de la consolidation politique méditerranéenne de l'UE, établissement d'un partenariat euro-méditerranéen*, Brussels, 19 Oct. 1994.
4. See G. Kebabdjian, A. Mahjoub, H. Zaafrane et al., *Etude prospective de l'impact sur l'économie tunisienne de la mise en place d'une zone de libre-échange avec l'Union européenne*, COMETE, CEPEX, Nov. 1994.
5. See World Bank, *République Tunisienne, Allégement de la pauvreté: Bâtir sur les acquis pour préparer l'avenir*, April 1996.
6. 'The temporal horizon of the simulation models relied upon here does not allow for a full

understanding of the effects of free trade. This limitation is all the more worrying when one considers that potential migrants' anticipations of increased income and of job prospects in their country of origin constitute a critical factor in their decision to emigrate', G. Tapinos, 'La libéralisation des échanges et ses effets sur l'économie, l'emploi et les migrations dans le bassin méditerranéen', OECD, Athens, 31 Oct. – 1 Nov. 1996.

7. Two propositions made during the Barcelona Euro-Mediterranean forum of should be considered in this context: first, the creation of a Euro-Mediterranean in-service training institute; second, the establishment of an economic observatory for new communication technologies to be applied to education, professional training and scientific research in the Euro-Mediterranean.
8. See Luis Alberto Garcia Ferrero Morales: 'La création d'emplois au Maghreb dans la perspective d'un partenariat euro-maghrébin'. Second meeting of economic and social representatives from the countries of the Arab Maghreb Union and the European Community, Tunis, 8-10 Sept. 1993.

3

Foreign Investment and the Rule of Law

GEORGE JOFFÉ

> *En matière de régime des investissements étrangers, la plupart des PTM (pays tiers méditerranéens) ont adopté, depuis la fin des années 80, des codes d'investissements simplifiés offrant d'importants avantages fiscaux. Ces codes sont la plupart du temps reliés aux programmes de privatization. Mais la conversion radicale à l'accueil des investissements étrangers succède à plusieurs décennies de méfiance ... et les avantages maintenant proposés sont comparables à ceux de nombreux pays en développement. Il n'y a pas sur ce terrain d'avantage particulier.*[1]

This statement, from a respected French commentator on the Mediterranean and on economic affairs, accurately sums up the current attitude towards the legal status of investment in the South Mediterranean region. However, the problems facing the private investor are far more complicated than he indicates. It is usually assumed that direct private foreign investment and portfolio equity investment, both of which fall under the rubric of 'foreign investment',[2] respond simply to the financial climate that exists in receiving countries. In fact, the situation that persuades an investor to invest is far more complex and the weighting given to different investment destinations and to different factors affecting investment varies from situation to situation. One highly important consideration is the legal status of institutions and of the political and economic environment in the investment destination under consideration. In this respect, the Middle East and North Africa has a series of acute problems to address if foreign investment is to reach the proportions sought within the Barcelona context. As mentioned above, two of the most important considerations relate to investor distrust and comparative advantage. Despite new and simplified investment codes designed to encourage the foreign investment decades of foreign distrust over political interference in the economic process and ideologies of state supervision have still to be effectively countered. In addition, these new investment codes have usually been produced to encourage the privatization of state assets but will