FEMISE 2007

FEMISE REPORT ON THE EURO-MEDITERRANEAN PARTNERSHIP 2007

Analysis and Proposals of the Euro-Mediterranean Forum of Economic Institutes

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Coordinators

February 2008

Institut de la Méditerranée

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Introductory Chapter: a glance at the economic and social performance of the Mediterranean Partner Countries

During the first quarter of 2008, the economic performance of the Mediterranean partner countries (MPs) seems to be substantially consolidated. This development is relatively homogenous and, if pursued, can indicate that the MPs are entering a process of per capita income convergence with the European countries. Seizing this phenomena and specifying its causes and fragilities will constitute the topic of this introductory chapter.

However, this early phase of per capita income convergence is not sufficient to eliminate the major risk that threatens the South Mediterranean countries, that is, the generally low level of activity rates and more specifically the problem of youth unemployment. Therefore, a second chapter devoted to a substantial analysis of the issue of employment will follow this introductory chapter. In a third chapter, we will address the issue of liberalization of services, which constitutes the most important source of potential profits in the relative short term.

Some Stylized facts

Similar to other parts of the world, the MPs have been engaged in a process of transition at different levels. This process has three essential aspects: (i) to favour an efficient allocation of factors of production, which will lead the economies to function at the utmost level of their productive capacities (due to the liberalization of goods, services and factors), (ii) to balance total supply and demand in order to avoid macroeconomic imbalances that generate inflation and debts. This implies an extensive tight budgetary discipline and control over currency emission, (iii) to gradually allow the infiltration of a relative worldwide pricing system in the economy through opening up trade and controlling real exchange rates (which requires a certain flexibility of the nominal rate of exchange).

Wherever this process was put in place in a hasty way, it led to a temporary but substantial increase in levels of unemployment, a significant re-allocation of factors between sectors and enterprises and a rise in both interest rates and current deficits. It has been shown from the experience of the countries that joined the EU that this process could lead to a relatively quick rebound and an itinerary of convergence towards the most developed countries, if it is supported by important public grants and a perspective of full anchorage to a more powerful zone. The latter creates positive forms of anticipation that generate considerable foreign investment flows that ensure pursuing a substantial institutional reforms agenda similar to those applied in the reference zone, without any interruptions (acquis com¬munautaire).

As Femise has stressed in several occasions, the MPs are not in this similar position for two reasons. The first is that the fast itinerary is not compatible with the initial state of poverty, and even more with the way this was looked upon in the Arab world. We are effectively dealing here with a region where rates of absolute poverty (below $1 per day) are among the lowest in the developing world (3%), which proves that the notion of poverty is not easily accepted in these societies. However, since 20% of the population live actually with less than $2 a day, these societies are particularly vulnerable to any short/medium term choc, which would diminish their purchasing power (in particular, some universally recommended reforms by international expertise that target labour market and minimum wages). The second reason is that the assurance provided by the Euro-Mediterranean partnership for its action in favour of convergence through transfers of grants was weak and insufficient to eliminate the risks of the implementation of policies that force a progress on the reform agenda.

As a result, the MPs have reached today a kind of intermediary position, where their performance has substantially improved relative to that of the mid-nineties; but has remained limited in terms of its impact on concerned societies and their ability to deal with the challenges ahead over the next twenty years. Concerning reforms, it is clear that these have been quite slow. It would be difficult to assess the reasons for such a pace, whether it is due to over-prudence from those who fear that a faster pace might lead people in power to obscurantist tendencies legitimated by democratic vote, or due to willingness to maintain inefficient rent seeking behaviour.

The only acceptable approach in this case is the following: (i) to set an objective for convergence with reference to the EU, (ii) to set a method that hierarchies reforms in terms of their implications on improving levels of income and living conditions.

The point of view of Femise here is that not any reform based on an impressive agenda is considered good and applicable without considering its impact on the social context. In brief, this approach indicates that eventually the « outcome » of reforms should clearly prevail over the instrument.

Seven key issues characterise the present situation. They are as follows:

- √ Has trade liberalization in goods within the free trade zone framework yielded the expected results?
- √ Is setting a convergence with the EU feasible?
- √ Is this beginning of convergence sufficient to deal with employment needs?
- √ Is the growth scheme sustainable and sufficiently progressive?
- √ How do conditions of macroeconomic equilibrium and resilience capacity to internal and external chocks develop?
- √ What are the external position of the MPs and the nature of their specialisations?
- √ What are the priorities in terms of institutional reforms?

A trade liberalization of goods that has clearly been beneficial

The expected mechanism of the Barcelona process was that trade liberalization will create dynamic effects that would generate positive impacts, in particular on revenues and components of final demand. Studies carried out on the subject have shown that such effects have indeed been realised. This is why it has been notably demonstrated by B. Lucke and R. Nathanson ("Assessing the macroeconomic effects of the Barcelona initiative's liberalization process" Femise Study Nov. 2007) that: with regard to MPs, every 1% reduction in tariff has been matched by a 0.3% growth in the GDP, 0.116% increase in consumption and 0.176% investment growth. Naturally, imports have reacted largely than exports (0.376 versus 0.288) which induced pressure on the trade balance. This phenomenon is very predictable bearing in mind that tariffs reduction is an essential issue for the MPs, which had already access to manufactured goods from the European market when the free trade zone was set up. These relations are solidly established and their strength is considerably higher ex post than predicted ex ante (20 ex ante estimations made on the basis of Calculable General Equilibrium Models –CGEM-were compared in the aforementioned study). This result justifies the approach that had been adopted, which has hardly addressed agricultural products. As a result, non-tariff barriers within the European market have considerably increased over the same period while South-South integration (stipulated by the Agadir Agreement) had not been proactive. Towards the end of this period, trade liberalization in goods was accompanied by a significant increase in direct investment flows to all MP countries without exception (see country figures in Annex 1a).

A beginning of convergence with the EU in terms of per capita income

Per capita incomes of the MPs are starting to converge towards those of the EU. Average annual growth rates reached 5% during 2006-2007, on average, one point higher than the growth rate achieved in the period 1995-2000. These countries are in a demographic transition phase, with average population growth of approximately 1.8% (0.8% in Tunisia, 1.1% in Morocco, 1.5% in Algeria, 1.9% in Egypt, and 2.5% in Syria) against an average of 0.4% in the EU. Hence, they are in a slow path of convergence given the average growth rate of the EU in the same period (2.5%).

One can think that in several of these countries, the GDP growth could be consolidated by the slightest sensitivity to the variations in climatic conditions (except for Morocco) and by various other chocs, especially from oil variations (See macroeconomic summary table below).

This early convergence of per capita income is accompanied by a positive progress in human development indicators; however, current paces still do not suggest that the gap between the different groups of population in terms of living conditions is narrowing. MPs are within the average world levels in terms of human development indicators. Their performances are rated within a higher than average position (between the best

20% and 40%) in terms of average life expectancy and access to utilities (clean water in particular). However, MPs occupy a considerably low position with regard to literacy and activity rates, notably in the case of women. A country by country approach reveals that Morocco and Egypt are considerably behind in terms of the levels of poverty within their populations. On the contrary, Israel has a position closer to that of European countries.

Whatever the view on the limitations on the per capita income indicator, it is clear that this criteria goes hand in hand with human development indicators, the progress achieved in institutional reforms and the activities of the region on the knowledge based economies (see figure below and methodology note in annex 2).

Such progress should not however masks the effects of internal divergence, such

Table I1: Macroeconomic aggregates in the Mediterranean countries

	Growth rate (% annuel moyen)				GDP per capita, PPP $			Unemployement (%)			Budget Balance (% GDP)			
	1995-00	2000-05	2006	2007*	1995	2006	2007*	2000	2006	2007*	1995-2000	2000-2005	2006	2007*
Algeria	3,2	5,0	2,5	4,7	3 874	7 364	7 778	29,5	15,2	14,1	1,6	6,5	14,7	11,2
Egypt	5,4	3,7	6,8	7,1	2 647	4 902	5 254	9,0	9,6	10,1	-1,9	-6,5	-7,9	-7,5
Israel	4,5	2,0	5,2	5,3	17 016	27 719	29 386	8,8	8,4	7,0	-1,8	-3,3	-0,9	0,2
Jordan	3,1	4,9	6,3	5,7	3 526	5 903	6 166	13,7	13,2	13,5	-9,6	-11,2	-7,2	-10,8
Lebanon	2,3	2,8	-1,1	0,3	na	8 015	8 057	n.a.	n.a.	n.a.	-17,9	-14,5	-11,3	-9,5
Morocco	3,6	4,5	7,8	2,5	3 005	5 249	5 345	21,7	9,7	10,2	-3,5	-4,6	-1,9	-2,4
Syria	3,6	3,3	4,4	4,2	3 003	4 178	4 347	11,2	8,5	9,0	-0,2	-1,6	-5,9	-6,8
Tunisia	5,6	4,4	5,2	6,4	4 484	8 571	9 239	15,7	14,3	13,9	-4,5	-3,1	-2,8	-2,9
Turkey	3,9	4,3	6,1	3,9	5 049	9 086	9 554	6,5	9,9	9,7	-7,6	-9,8	-0,8	-2,5
MP	**3,6**	**4,3**	**5,2**	**4,7**	**3 700**	**7 364**	**7 778**	**12,5**	**9,8**	**10,2**	**-3,5**	**-4,6**	**-2,8**	**-2,9**

Source :EIU, January 2008 except 2000 unemployment rates. * Preliminary figures and EIU estimations

	Monetary growth (%, ave. annual rate)				Inflation rate (%)				Investissement rate (%)			
	1995-00	2000-05	2006	2007*	1995-2000	2000-2005	2006	2007*	1995-2000	2000-2005	2006	2007*
Algeria	15,7	19,6	20,6	26,1	10,4	2,2	2,6	4,6	24,4	21,6	21,6	22,4
Egypt	9,9	14,5	15,0	17,4	6,2	4,7	7,7	9,0	18,6	17,3	18,7	21,3
Israel	16,5	6,2	4,9	16,0	7,0	1,6	2,1	0,5	22,8	18,0	17,1	18,4
Jordan	7,1	12,9	12,8	13,4	2,7	2,1	6,2	5,3	25,1	20,1	20,4	20,7
Lebanon	16,6	8,6	7,8	11,0	5,3	2,1	4,0	5,6	27,9	19,6	19,1	19,8
Morocco	9,4	9,2	17,0	11,2	2,6	1,5	3,4	2,1	21,7	22,1	21,1	22,4
Syria	12,2	15,5	7,3	2,7	1,6	2,8	10,0	4,0	21,4	21,0	20,9	21,3
Tunisia	13,6	8,7	11,6	12,0	3,7	2,7	4,5	3,1	24,7	24,4	20,2	19,9
Turkey	87,1	33,3	32,6	8,4	76,5	33,4	10,5	8,7	24,0	21,4	29,8	30,4
MP	**13,6**	**12,9**	**12,8**	**12,0**	**5,3**	**2,2**	**4,5**	**4,6**	**24,0**	**21,0**	**20,4**	**21,3**

Source :EIU, January 2008. * Preliminary figures and EIU estimations

	Current account balance (% GDP)				Debt servicing (% of exports)				Reserves (months of imports)		
	1995-00	2000-05	2006	2007*	1995-2000	2000-2005	2006	2007*	1995-2000	2000-2005	2005
Algeria	3,4	14,4	25,9	23,3	30,9	17,1	23,5	2,9	7,0	20,7	25,0
Egypt	-0,9	1,9	2,3	0,8	10,8	9,1	8,5	6,2	10,2	7,7	7,5
Israel	-3,0	1,3	5,6	3,4	17,2	13,1	10,7	12,1	5,5	6,4	5,9
Jordan	-0,1	-0,0	-13,2	-13,0	13,8	10,2	6,7	6,6	5,6	7,2	5,7
Lebanon	-27,1	-18,0	-7,0	-15,2	14,2	24,1	15,0	18,8	14,8	18,8	20,6
Morocco	-1,2	2,3	3,1	-2,6	26,4	17,0	10,1	8,6	4,8	8,9	9,9
Syria	2,0	4,2	2,7	2,3	5,4	2,9	2,9	3,7	5,1	7,6	8,2
Tunisia	-3,3	-3,0	-2,1	-2,5	16,7	14,4	21,2	15,9	2,6	2,9	3,6
Turkey	-1,5	-3,0	-8,1	-7,3	27,4	39,3	33,9	34,9	4,6	5,2	5,1
MP	**-1,2**	**1,3**	**2,3**	**-2,5**	**16,7**	**14,4**	**10,7**	**8,6**	**5,5**	**7,6**	**7,5**

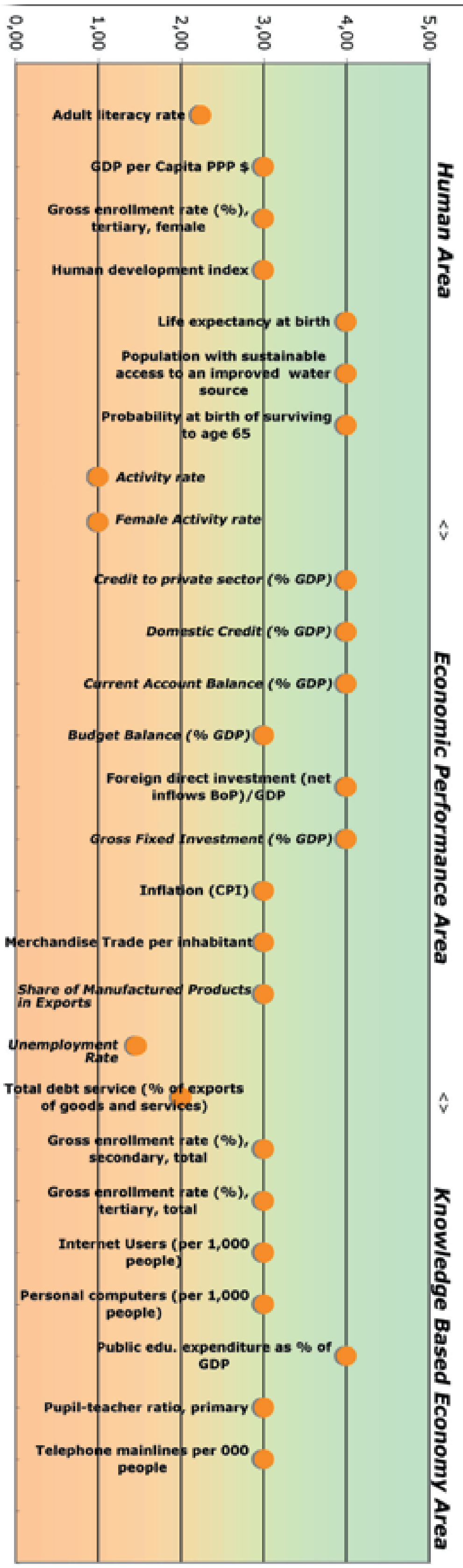
Source :EIU, January 2008. * Preliminary figures and EIU estimations as the speculation in the real estate sector in some countries; the development of services at the expense of small and medium enterprises; the difficulties encountered by compensation policies, especially social policies; and difficulties faced by public factors producers of basic utilities (electricity). All these things could be observed clearly in some countries, such as Lebanon.

Progress to be made to meet employment needs

In chapter II of the present report, we will present a detailed study devoted to the issue of employment. We will indicate here the reasons why this question has been for many years of primary importance for Femise. At a constant activity rate, i.e. without modifications in female employment, or shifts from a large informal sector to the formal one, or modifications in the rate of employment, there is a need to create more than 22 millions of jobs by 2020. The vast majority of these jobs will target the young and hence are essential in maintaining social equilibrium. Moreover, all directives of the international expertise, stimulated by the EU, state that the main objective is to increase female employment and shift workers from the informal sector where they are deprived from social protection towards the formal sector.

If this conserve of labour, which could be mobilized at much higher levels than the 22 millions mentioned above, is effectively used, it could represent a window of opportunity to MPs. One additional job produces an added value to the GDP and provides the public sector with added resources which in turn should entail a more substantial intervention in terms

Figure I1: MPs position according various criteria



Source: F. Blanc and JL Reiffers, Report on the Mediterranean Partners for the WBI, July 2007.

of social compensation and the development of much needed public goods. This will stem the rural exodus and gradually move the country forward into a virtuous circle of growth.

A whole set of developments is necessary here. More essentially, it is crucial that flexibility in job creation with relation to the GDP does not lead to a more dependency on public sector employment as it is still the case today in several MPs. This entails more investments, increased dynamism, the development of medium and small enterprises, more efficient services (especially financial ones), significant activities in order to improve the initial conditions (infrastructure, literacy, education, training, etc.), institutional reforms and a partnership oriented towards the EU in terms of migration.

A pattern of growth that requires an increase in investment rates and productivity to ensure its sustainability

With investment rates close to 21%, MPs investment level is way below that of the South-East Asian countries in their take-off stage (around 28%). Recently, we have observed a considerable increase in foreign direct investments. These were due to the several privatization activities, the development of public-private partnerships and the adoption of market openness (notably dealing with mobile licences, tourist resorts and financial services). However, these types of investment are not intrested in MSE-SMEs (Greenfield investment) and industry. This observation is confirmed by the fact that, in some countries like Morocco, growth and employment are mainly localised in the construction sector (6.5% in 2006) and the service sector (2.5%) against only 1.5% in industry.

Domestic investment has not reached the levels required and has often become an adjustment variable within rigorous budgetary policies set up to avert the effect of chocs. The contribution of national funds to the accumulation of capital is still too limited and banks still need to play more dynamic roles. More notably, the banks' charges in Morocco are well below the European average whilst their profitability is extremely high (cf. M. Chafiki, XIIth conference : 'Euromed on transition', Brussels, 20-21 February 2008). Officially it is noted: "recent developments in the national economy entailed some national savings that do not respond adequately to investment since they were constituted essentially of liquid assets and short-term placements. These savings, which were mostly beneficial to banks, failed to contribute to financing long-tem productive investments (Kingdom of Morocco, draft of Financial law for the budgetary year 2008, Economic and Financial Report p. 69)". A similar phenomenon has prevailed in the Lebanon where banks have largely subscribed to public borrowings, which created a crowding out effects of the private MSE-SME.

Finally, it is worth mentioning that a significant investment growth would have little impact if the overall economy is not dynamic enough. The most striking example is that of Algeria which, due to its hydrocarbon revenues, has recorded rates of investment growth superior to 8.5% over the last four years while the average growth for the same period was only 2.8%. By contrast, Tunisia has had for the same period a 2.8% investment growth against a 5.45% average growth of its GDP (appendix 3 shows the composition of supply/demand balance). Investment therefore is not the only issue here. The pattern of growth requires, mainly, an increase in what economists call the total factor productivity (TFP) which derives from the overall dynamic of the productive combination, the continuous improvement of factors of production and the ability of the economy to channel investment towards more productive sectors.

Indeed, growth of total factor productivity constitutes the most evident indication of the positive response of the economy to openness. FEMISE research has effectively showed that three countries are ahead of others in this: Tunisia, Turkey, and Jordan. The process implies a good flexibility within the system that would allow factor reallocations (With regard to employment in particular) between and within the sectors and between competitive businesses and others. Furthermore, the TFP growth is a measure of the involvement of knowledge based economy that generate growth without important accumulation of capital. Here factors such as innovation, improved organization and quality, the introduction of information technologies, a more highly qualified human resources are considered. All these positive developments (some experts have estimated that for each growth point in TFP generates 4 points of growth in employment) involve a solid strategy and institutional reforms. The country that has shown the best adherence to this strategy is Tunisia through its implementation of 7 technological poles, a re-orientation of student flows towards short professionalized degrees and the development of ICT (communication and information technologies), etc.

This challenge that seems to place this country on a sustainable pattern of growth has the added advantage of facilitating macroeconomic management within a competitive environment. It is possible to maintain a targeted stable real exchange rate, hence competitive, by introducing a greater flexibility of the nominal exchange rate. This will prepare the economy for the convertibility of capital account (which will be beneficial to foreign portfolio investment) and for indexing the salaries (especially the minimum wage) against productivity rather than prices. This virtuous path is more difficult to attain in over-populated countries where initial conditions (mainly illiteracy and poverty) are sill falling behind. This is why in Morocco notably, where TFP growth is weak, the pattern of growth is still based on capital accumulation, inflation targeting, fix nominal exchange rate (which hampers exports once general prices increase due to an internal choc, drought or an external choc, a change in oil prices) and on minimum wages indexed on prices to prevent increase of poverty.

A macroeconomic equilibrium that is currently maintained but threatened by inflationary pressures

Today, MPs control better their macroeconomic equilibrium, which constitutes a significant achievement reached during the 80s and resulting from costly stabilization programmes. On average, the budgetary deficit is below 3% of the GDP. This result however needs to be more specified. A considerable budgetary surplus is recorded by Algeria (around 11.7% in 2007), while deficits being in the order of 10% of the GDP in Lebanon and Jordan and around 7% in Egypt and Syria. On the other hand, Morocco, Turkey, Tunisia and Israel were able to maintain their deficits within the limits set by Maastricht. Unemployment rates are maintained at the level of 10% and tend to decrease, except in Egypt.

However, inflationist pressures are manifested on average of around 4.5%, which is double the rate recorded during the period extending from 2000 to 2005. This figure follows a general trend linked to an increase in the prices of oil, raw materials and cereal products. The current balance has deteriorated only slightly, except in Jordan and Turkey, Lebanon remains a rather special case.

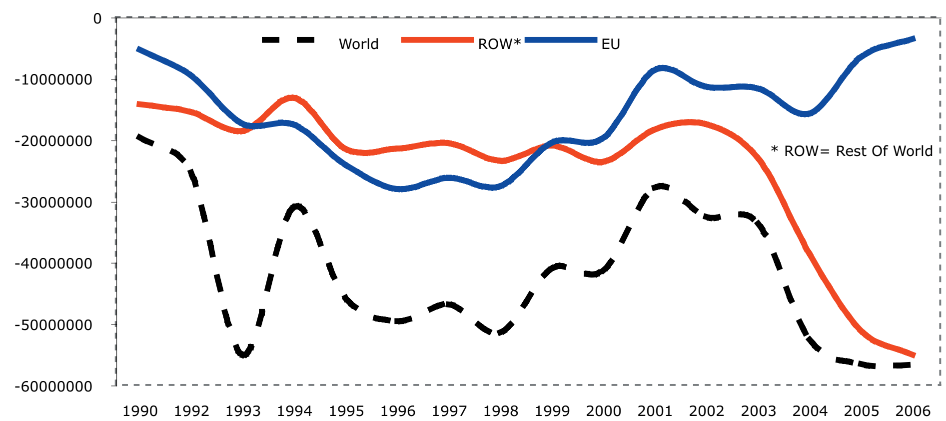
If we consider the decomposition of total demand (see Annex 3), we notice that Egypt, Israel and Syria have managed to keep public consumption under strict control while in Morocco and Turkey it is used as a variable for adjustment and hence is rather volatile. By contrast, Tunisia was able, over the past few years, to maintain its public consumption at an average growth pace of above 5%, due to its pattern of growth. Public investment has also played its more traditional role of choc absorber, insuring a regular growth of private consumption.

We conclude this point by indicating that, on the whole, MPs have shown good levels of resilience against various chocs over the past few years; such resilience essentially translating into initiatives being taken toward consumption and public investment.

An international trade position of the MPs market with deterioration in manufactured goods trade, a slight disengagement vis-à-vis the EU and a limited development of the intra-branch trade

As a whole, the MPs' trade position is improving if we take into account their oil exports. This relatively artificial phenomenon mainly relates to Algeria's trade (cf. graphs below[1]). If oil is excluded from trade, a deficit is marked specially on the trade balance with the Rest of the World (ROW). Turkey alone represents 90% of this deficit. A deeper analysis of the trade deficit with the EU reveals that it is mainly due to capital goods ("machines and transport material") and to consumption of intermediary goods. As for trade deficit with the ROW, it is due to mainstream manufactured goods, where China plays a major role.

Figure I2: Trade deficit of MPs- Total trade (in million $)



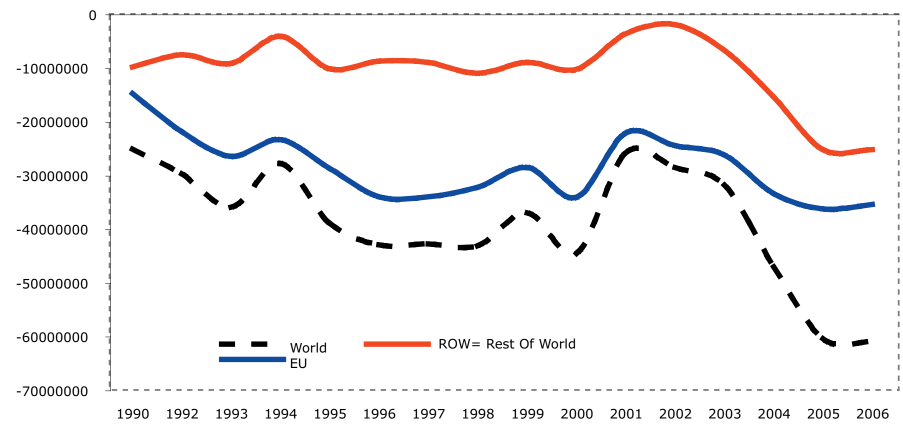
Source: Comtrade – Calculations Institut de la Méditerranée, Nathalie Roux

We have also noted a relatively slight disengagement of trade between MPs and the EU that reflects the arrival of new members to the region. However, this disengagement is less pronounced in East Mediterranean countries (Egypt, Lebanon, Syria and Jordan) which are initially less involved with the EU.

The development of intra-branch trade is a good indicator of the real effect of "Open/Large market". It conveys more refined specializations than those obtained in integrated markets due to the diversification of horizontal and vertical operations, linked to delocalization, to the increase in the size of enterprises, sub-contracting relations and the ability to better differentiate between

Figure I3 : Trade Deficit of MPs (in million $)

Manufactured products



Total excluding Oil

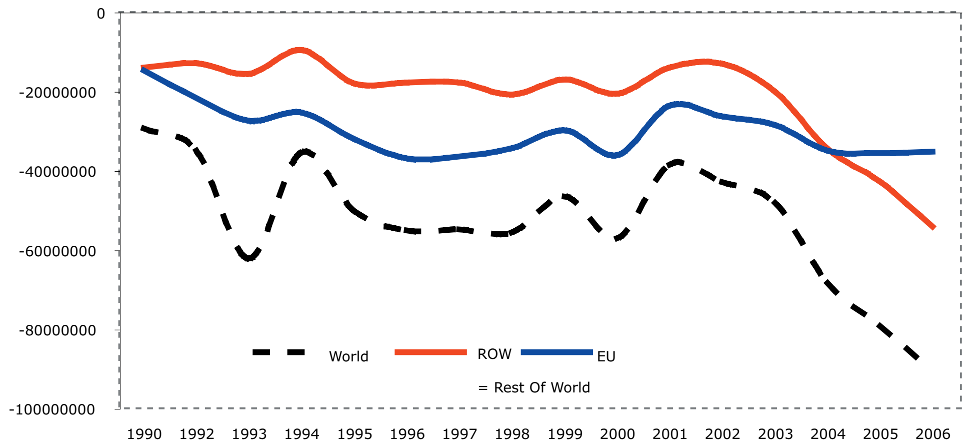
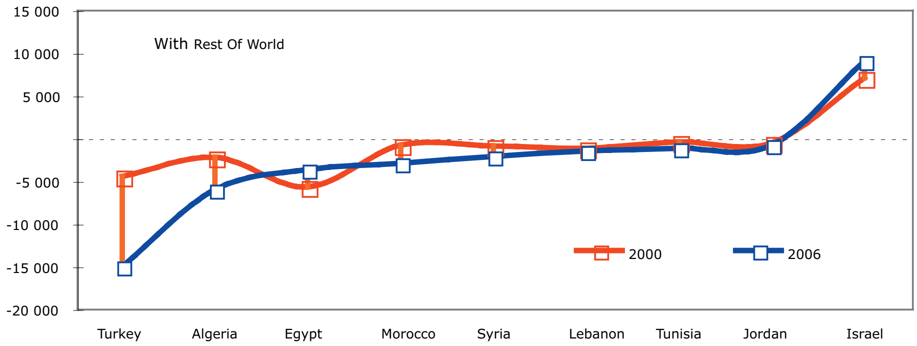
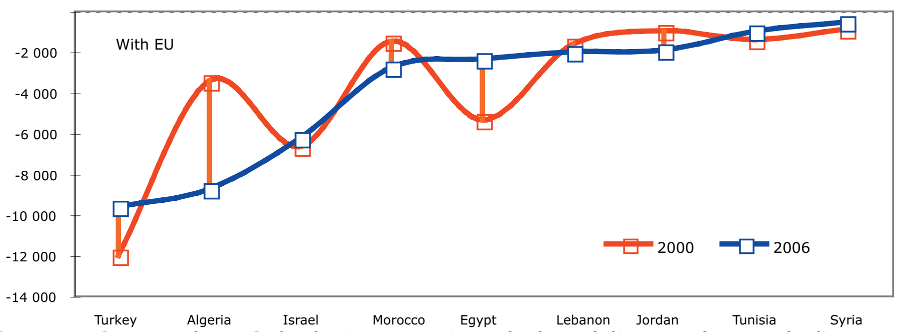


Figure I4: Trade revenues Trend of manufactured products of the MPs between 2000 and 2006 (million $)



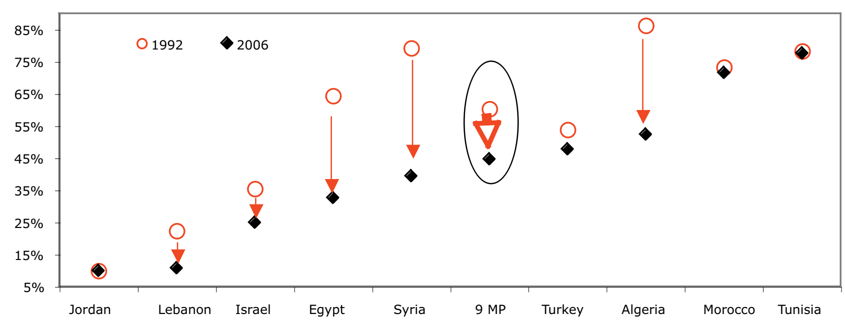


Source: Comtrade – Calculations Institut de la Méditerranée, Nathalie Roux products. However, the permanence of intra-branch exchange (e.g. infrastructural goods versus agricultural and food products) reveals a limited productive interdependency in the region and maintains the traditional specialization model between North and South.

We can see from the figures and table below[2] that intra-branch trade has developed only marginally and that it mainly linked to the relation with the rest of the world rather than with the EU. Globally, the MPs have registered some progress in intra-branch trade with all their partners (ranging from 27.6 to 34.4 for trade with the EU and ranging from 40.7 to 47.2 for trade with the Rest Of World - ROW). However, this progressive trend concerns mostly Turkey and Israel.

Figure I5: Trade engagement of the MPs with the EU 1992-2006 (% trade with EU)

All products, exports



All products, imports

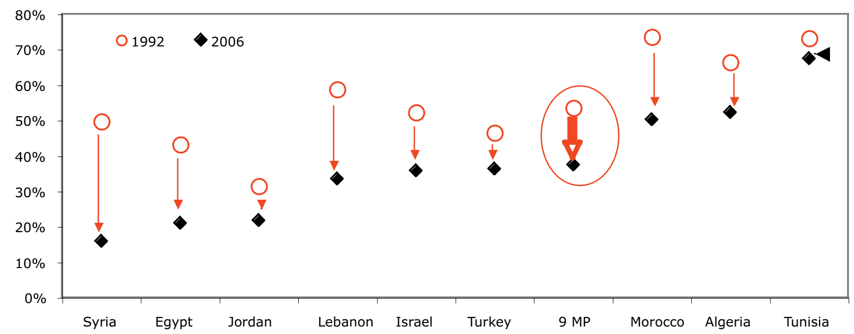
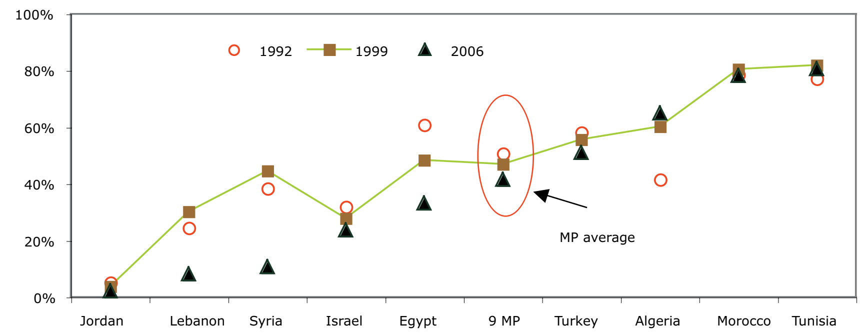
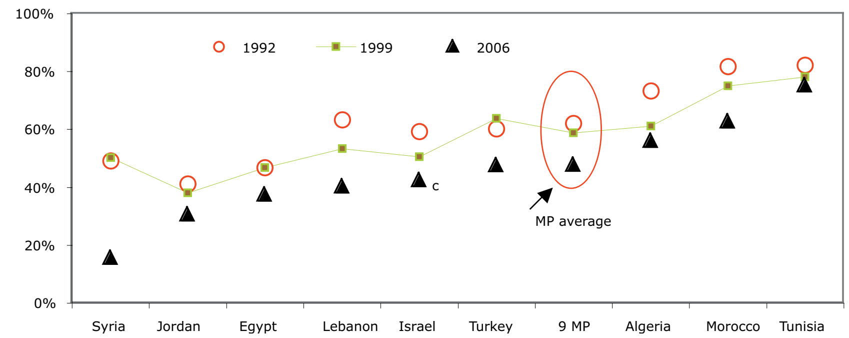


Figure I5bis: Trade engagement of the MPs with EU 1992-2006 (% trade with the EU)

Manufactured products, exports



Manufactured products, imports



Source: Comtrade - calculations of Insitut de La Méditerranée, Nathalie Roux

To conclude this argument, the following points are noted:

- √ Cross-products trade of the MPs with the rest of the world is more reinforced than in their trade with the EU,
- √ Tunisia and Morocco are progressing slowly,
- √ East Mediterranean countries are visibly more oriented towards the rest of the world.
- √ Intra-branch trade between Mediterranean countries is reinforced and is specially well supported by Egypt, Lebanon, Turkey and Jordan while Morocco and Tunisia have reduced their intra-branch trade within the zone. Consequently, limited progress has been achieved on this issue, which could be due to the limited South-South trade that does not benefit from an integrated market between MPs.

The indicators above show that the intra-branch trade of the East Mediterranean

Table I2 – Indicators intra-branch trade of MPs with their main groups of partner countries

MP	Partners	1995-2000	2001-2006	1995	2000	2005	2006
Algeria	World	4,7	3,3	2,9	3,6	1,9	2,6
Egypt		8,8	15,9	9,4	8,6	17,4	16,6
Israel		37,2	44,2	33,2	38,9	48,2	44,7
Jordan		33,6	33,2	31,0	30,4	31,9	30,5
Lebanon		17,3	19,5	15,3	15,6		
Morocco		15,8	19,3	11,4	18,2	19,3	20,3
Syria		9,8	12,7		9,8	11,5	10,7
Tunisia		22,3	27,3	22,9	23,3	28,3	
Turkey		26,4	34,8	22,1	27,5	36,7	22,7
MPs		**37,7**	**45,4**	**33,6**	**39,8**	**45,9**	**39,2**
Algeria	Rest of World	8,1	4,9	3,6	6,3	2,7	2,4
Egypt		12,4	18,0	12,8	12,7	20,7	20,2
Israel		37,3	42,3	32,4	39,5	45,1	43,3
Jordan		36,0	32,9	31,9	36,0	29,8	29,7
Lebanon		19,2	21,8	18,8	15,5		
Morocco		11,0	12,0	11,0	11,1	9,9	10,3
Syria		25,1	13,1		25,1	11,5	9,4
Tunisia		20,6	24,0	19,6	19,1	23,9	
Turkey		30,0	34,2	25,2	30,5	35,1	24,6
MPs		**40,7**	**47,2**	**35,8**	**42,7**	**45,3**	**39,5**
Algeria	EU	2,8	2,4	1,9	3,4	1,5	2,6
Egypt		5,3	8,9	6,0	3,6	11,6	9,5
Israel		29,8	38,8	32,7	32,5	49,2	42,4
Jordan		9,6	7,0	13,8	4,6	2,3	6,5
Lebanon		8,1	6,4	7,5	6,6		
Morocco		16,8	20,5	10,5	18,8	21,7	22,5
Syria		1,1	9,5		1,1	16,7	6,2
Tunisia		21,6	25,2	22,6	22,3	26,6	
Turkey		18,8	27,6	15,2	20,7	30,4	17,0
MPs		**27,6**	**34,4**	**24,9**	**29,6**	**36,5**	**26,5**
Algeria	MPs	13,1	9,5	10,4	5,0	7,0	6,7
Egypt		28,8	35,5	30,1	29,1	32,8	26,6
Israel		17,9	18,4	24,2	5,3	22,8	22,1
Jordan		34,2	28,7	21,8	30,2	28,1	29,3
Lebanon		29,0	34,6	14,7	28,3		
Morocco		23,1	14,5	21,8	13,5	11,3	12,3
Syria			13,8			13,4	9,7
Tunisia		28,7	25,5	25,2	25,3	18,1	
Turkey		13,9	16,1	14,6	12,1	16,8	21,4
MPs		**46,4**	**44,0**	**46,7**	**41,8**	**48,6**	**38,8**

Source: Comtrade – Calculations : Institut de la Méditerranée, Nathalie Roux countries is greater with the rest of the world: Jordan, Lebanon, Syria and Egypt. For Turkey, the indicators are equivalent. The indicators for Morocco show that their intra-branch trade with the EU is higher than with the rest of the world.

Figure I6: Intra-branch trade, average 2001-2006- Comparison of trade with the EU and Rest of the world

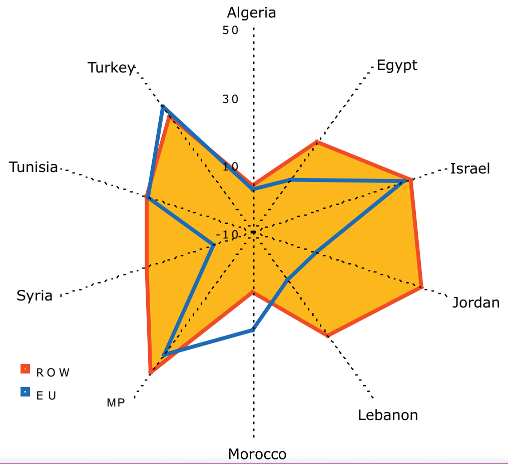
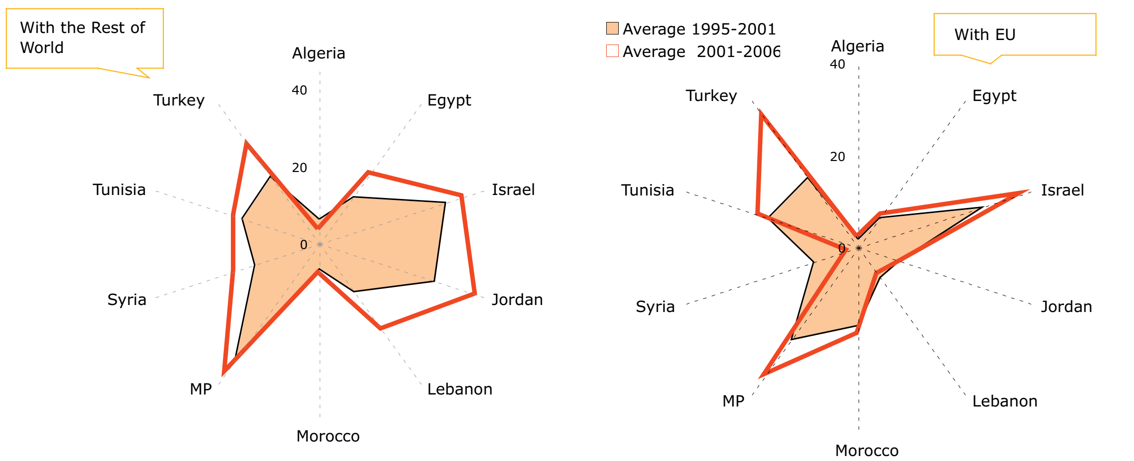


Figure I7: Intra-branch trade trend between the period 1995-2000 and 2001-2006



Source: Comtrade - calculations of Insitut de La Méditerranée, Nathalie Roux

Ongoing reforms in all domains but a hierarchy needs to be specified

MPs have been involved in a long period of reform process that has affected all sectors since the early 90s. These reforms were heavily traced on the European acquis and world practices (notably in the field of finance). In general, the process of reform has been rather slow and the achieved benchmarks tend to place the MPs around the world average, that is, at a level close to those achieved on their economic performance.

The Femise point of view is that given the magnitude of the task and the weak support of the euromed partnership, it has become imperative to set hierarchies within the reforms according to their political and social feasibility and their expected results. Therefore, reforms such as those dealing with governance, those facilitating setting businesses, property rights, improvement in the customs and tax systems efficiency, and enforcement of contracts, these reforms that does not affect employment, can generate large profits at relatively low costs. The same goes for opening network services (financial services, transport, CIT) which, as we shall see below (in chapter 3), may provide opportunities for making considerable profits while making the strategy for opening more efficient.

Even in these sectors, a hierarchy is necessary to account for the heterogeneity of responses of the productive sector to openness. Therefore, in the financial services, for example, not the same solution could be adopted by the country that needs to increase the size of the enterprises in exposed sectors (e.g. the case of Morocco and Lebanon), by the one that have to conduct sectoral reallocation to develop its comparative advantage; or the one where financial intermediation is marked by evident inefficiency. While the general operations of 'mise a niveau' were useful in stimulating reforms, it has now become imperative to consider the heterogeneity of firms and the necessary selectivity of actions. This entails that not all progress achieved on a well developed reform agenda will necessarily lead to a significant progress. In the past, Femise has noted that certain propositions which were part of the vulgate of international expertise were either unsuitable to the concrete case of the country under consideration or potentially carrying serious imbalances. From this point of view, forcing reforms on the labour market (notably by favouring dismissal), or planning a decrease in the minimum wage to reinforce the formal sector, are measures, though certainly useful in fostering competitiveness of firms, that could carry great social risk in contexts marked by poverty and in communities where families tend to be significantly large.

Moreover, and as rightly stated by M.K. Nabli (see "Restarting Arab Economic Reform" in Breaking the Barriers to higher Economic Growth, The World Bank 2007), it is imperative to re-establish the social contract and work on enhancing social democracy. This will allow under-represented groups, young people and the unemployed in particular, to have a saying in the decision-making process. The introduction of the notion of "inclusion" in all strategic choices has become a necessity. This becomes evident through a modification in the forms of governance, more accessible information and better control on the relations between the macroeconomic agenda, structural reforms, development of human capital, and enhancing social and territorial coherence. This constitutes a more in-depth approach implying a necessary more refined analysis. This involve questioning the economic profits and the social effects resulting from approaches that have already been adopted, an elaboration of adapted measures to overcome unavoidable short–term chocs, and a long terms vision that goes beyond the classical compensation. Experiences showed that the quasi-exclusive search for maximum gross monetary profits is not adequately sufficient in a context where social compensations are difficulty maintained due to the necessity to control public budgets and develop competitiveness. There has been ample evidence to demonstrate the inefficiency of centralized and planned approaches, it is hence important to measure the social effects of ongoing openness and growth policies (which is, in other terms, a way of retracing the tradition of economic research). It is equally important to identify directives that lead to better growth and reductions in inequalities and poverty (which is in the research agenda "pro-poor growth"), and to disseminate relevant information and to allow the social democracy to play its role so as to obtain acceptable compromises. This logical contextualization in terms of individual societal environments must be adopted to complete those comparative approaches that have actually allowed MPs to open up to the outside world and onto the market in the 1990s.

Research by the Femise will notably be devoted to this task in the future. It is a delicate exercise; where considering the particularism and the initial conditions should not be in any case an argument to maintain unjustified rents.

Notes

1. There were no data for Tunisia for 2006 or Lebanon for 2005 and 2006. In order to establish global data for all MPs, we had to make approximations about missing figures by rebuilding them on the basis mirror data. To obtain trade figures for Tunisia in 2006, we have: (i) pulled the total trade of Tunisia with all countries of the world for 2005 and 2006; (ii) calculated the growth rate of trade for those two periods and finally (iii) applied these growth rates on the announced trade data of Tunisia. We have reconstructed the data for Lebanon the same way for the two years 2005 and 2006. The total of MPs is then an approximation.

2. The calculation of the indicators of intra-branch trade is based on bilateral trade data with 4 and 5 digits. The base of calculation is at 5 digits. However, the database at the 5 digits level is not complete since it does not take into account the fields that only exist at the 4-digit level. To reconstruct a complete database of trade preserving the detail at 5digits, we integrated the fields that only exist on the lower level detail.
Indice intra-branche de Grubel & Lloyd (GL)

[(Xi+Mi)-| Xi -Mi|/ Xi +Mi]*100

The simple indicator of Grubel and Lloyd measures the share of intra-branch trade in total trade of a given branch i. It varies from 0 (no intra-branch) to 100. The larger it is, the more the intra-branch trade. The total indicator is the average of the indicators by branch; either total or for the manufactured goods.

Chapter I. The Challenge of Employment in the Southern Mediterranean Countries

I. Introduction

This chapter addresses one of the most important challenges facing the Mediterranean Partners Countries (MPs) today, namely that of employment. Indeed, the region has to create sufficient decent and productive jobs at levels not achieved before to absorb the increasing number of new entrants into the labour market. This is due to a large number of unemployed youth, and to the need of a notable increase in women participation in economic activity. In addition, the region has to address the problem of informality, where a growing proportion of the population live and work under unfavourable conditions of low productivity, low incomes and low protection. Finally, the region needs to ensure that migration is a positive sum game for both exporting and hosting countries, rather than a source of brain drain.

Meeting this challenge is not easy. On the one hand, the population pyramid in the region is such that its base (young people) is much wider than the world average. Surely, the rate of population growth has been declining, but past high fertility rates are now making their impact felt. On the other hand, the region can no longer afford to deal with the employment problem through public hiring. The size of the public sector is already considered as too large by most of international experts, given the the need to be highly competitive by international standards to face the globalization.

However, we contend in this chapter that the challenge can be met, provided policymakers take whatever reforms needed capitalizing on the successful experiences of other countries after adjusting them to the initial conditions of the MPs. These reforms would involve making the transition, which has already begun, to a higher level of pro-job creating growth, along with improvements in the working conditions of labour. They also include aligning education systems with the demand for labour in the context of increasingly more diversified economies. And they could possibly involve mutually beneficial exchange of temporary labour migration between the MPs and the EU.

The purpose of this chapter is to contribute to the discussion of the nature and magnitude of the employment problem in the MPs, the root causes of the problem and possible remedies. To be sure, the report does not offer a blueprint for action in every country case; rather it sheds light on the above issues and proposes ideas for further discussion between the parties concerned.

The chapter is organized in four sections:

1. The employment challenge in the context of current and expected demographic trends.
2. The root causes of the highly competitive by international standards.
3. Regional competitiveness, openness and the link between salary determination and productivity.
4. Meeting the challenges: basic ideas for consideration.

II. The nature of the employment challenge and demographic trends

The Mediterranean Partners Countries (MPs) are characterized by a considerable labour force growth, despite the fact that fertility rates have subsided. This is partly because of past high fertility rates and a growing pressure from increasing female employment. The question is whether this phenomenon is a blessing or a curse. The short answer is that it depends on what countries do or not do.

On the one hand, a growing labour force can be a gift if it translates into higher economic growth, if it injects elements of dynamism into the economy, and if it facilitates intra-generational balances (e.g., through pensions). On the other hand, that gift only materializes if countries are able to create sufficient productive employment to absorb job seekers. Should the opposite occur, society becomes a place for a number of contradictions: the young have no incomes when life expectancy is increasing, which makes it difficult to balance pension systems; women face difficulties accessing the labour market as recent comers; and those who cannot afford to be unemployed resort to the informal sector for work under disagreeable conditions.

To size up the magnitude of the problem in the region, this section successively (i) highlights the pressuring factors characterizing the prevailing conditions, (ii) identifies the number of jobs needed over the next 15 years, (iii) assesses the region's capacity to create these jobs in light of past track record, and (iv) evaluates the potential role of migration in filling the gap between the supply of and demand for labour.

II.1 Stylized facts: three factors are pressuring on the labour markets

Employment in the MPs can be characterized by three factors of pressure, illustrated on the basis of the data in Tables 1 and 2:

√ The first factor is the large proportion of the population below fifteen years old, who hope to have an employment opportunity and will increase the

Table 1: Population and Employment in 2005

2005	Total*	In which less than 15 yrs	Share of less than 15 yrs	Working age pop. (15 yrs and +)	Active population 2005** [a]	Employment 2005 **
Algeria	32 853 798	9 740 248	30%	23 113 550	8 320 513	6 845 964
Egypt	74 032 884	24 838 103	34%	49 194 781	20 359 300	18 118 600
Israel	6 724 564	1 867 639	28%	4 856 925	2 740 000	2 493 600
Jordan	5 702 776	2 118 830	37%	3 583 946	1 390 571	1 204 206
Lebanon	3 576 818	1 024 740	29%	2 552 078	1 199 477	1 097 285
Morocco	31 478 460	9 787 867	31%	21 690 593	11 139 725	9 913 296
Palest. A	3 702 212	1 683 840	45%	2 018 372	790 596	578 439
Syria	19 043 382	7 019 470	37%	12 023 912	5 459 562	4 821 757
Tunisia	10 102 467	2 619 677	26%	7 482 790	3 413 100	2 926 700
Turkey	73 192 838	21 361 185	29%	51 831 653	24 565 000	22 046 000
Total MPs	260 410 199	82 061 599	32%	178 348 600	79 377 844	70 045 847

Source: Source: UN Pop. Div. quinquennial estimates and projections, **ILO, LABORSTA Labour Statistics Database : [a]: Active population are employees and unemployed seeking a job* supply of labour. Out of a population of 260 millions, 82 millions are below the age of fifteen that is one person in every three.

√ The second factor is the substantial gap between the number of persons who are likely to seek employment in the near future and the number of formal employment that is currently available (178 million potential active participants compared to currently 70 million jobs). This problem affects all categories of active population including young people, women and workers in the informal sector.

√ The third factor is the size of unemployment, i.e. people that have worked before but are currently unemployed (9.3 million). This corresponds to a regional unemployment rate of 13 percent according to official unemployment rates. This rate does not take into account hidden unemployment and is likely to be underestimated.

Hence, the magnitude of the challenge is daunting when taking into account two figures: the first is the number of persons who are going to seek decent employment (in the formal sector) in the next fifteen years, which corresponds to the people of less than 15: 82 millions (Table 1). The second is the number of persons who could be employed but are not and whom we can consider as seeking or will be seeking jobs: 108 millions (Table 2), which corresponds to the sum of inactive seeking jobs and unemployed.

The above observations do not apply to all countries of the MPs equally since they differ in their demographics and their capacity to create jobs. Israel, for instance, has marked itself clearly by its different demographic structure and labour dynamics. Moreover, while Morocco, Turkey and Tunisia have progressed in terms of rate of activity of their populations, Algeria, Egypt and the Palestinian Authority have not. In terms of unemployment, a similar pattern emerges, with 50 percent of the total number of unemployed persons (9 million) concentrated in just 3 countries: Algeria, Egypt and Morocco. If Turkey is added, their share jumps to 80 percent.

Table 2: Activity in 2005

2005	Working age pop. (15 yrs and +)* [1]	Active population 2005** [2]	Nb of inactive [3]=[1]-[2]	Activity rate (%) [2]/[1]	Unemployed [4]	Unempl. Rate (%) [4]/[2]	Inactive and unemployed [3]+[4]
Algeria	23 113 550	8 320 513	14 793 037	36%	1 474 549	18%	16 267 586
Egypt	49 194 781	20 359 300	28 835 481	41%	2 240 700	11%	31 076 181
Israel	4 856 925	2 740 000	2 116 925	56%	246 400	9%	2 363 325
Jordan	3 583 946	1 390 571	2 193 375	39%	186 365	13%	2 379 740
Lebanon	2 552 078	1 199 477	1 352 601	47%	102 192	9%	1 454 793
Morocco	21 690 593	11 139 725	10 550 868	51%	1 226 429	11%	11 777 297
Palest. A	2 018 372	790 596	1 227 776	39%	212 157	27%	1 439 933
Syria	12 023 912	5 459 562	6 564 350	45%	637 805	11%	7 202 155
Tunisia	7 482 790	3 413 100	4 069 690	46%	486 400	14%	4 556 090
Turkey	51 831 653	24 565 000	27 266 653	47%	2 519 000	10%	29 785 653
Total MPs	178 348 600	79 377 844	98 970 756	45%	9 331 997	13%	108 302 753

*Source: * UN Pop. Div. quinquennial estimates and projections, **ILO, LABORSTA Labour Statistics Database*

II.2 Necessary job creation in the region in the next 15 years

On the basis of the demographic forecasts of the United Nations (median scenario, table 1 in annex), the first factor pressuring on the employment will be relieved, as the region will experience a reduction in the share of the less than 15 years to 27% of the total population. The additional good news is that since 2000 the MPs managed to stabilize the situation in the formal labour market by creating sufficient jobs to absorb the new flow of job seekers. By 2020, and in order to preserve the current activity and unemployment ratios, it will be necessary to create 22.5 million new jobs, which corresponds to an annual growth rate of 1.9% over 15 years (see Table 3).

However, preserving the current rates of activity and unemployment will translate into an increase in the number of unemployed that will be exceeding 12 million persons (half of those will be in Egypt and Turkey) in 2020, whereas the number of the non-active population in working age will increase to more than

Table 3: The number of new jobs to create in 2020 to maintain the ratios of activity and unemployment unchanged

2020	Total Employment 2020	To create 2005-2020	Share (%) in employment 2005	No. of unemployed	Inactive of 15+
Algeria	8 892 917	2 046 953	29,90%	1 915 441	19 216 175
Egypt	24 570 872	6 452 272	35,61%	3 038 643	39 104 175
Israel	3 231 130	737 530	29,58%	319 278	2 743 046
Jordan	1 797 275	593 069	49,25%	278 150	3 273 608
Lebanon	1 363 371	266 086	24,25%	126 973	1 680 600
Morocco	12 802 303	2 889 007	29,14%	1 583 844	13 625 681
Palest. A	998 460	420 021	72,61%	366 210	2 119 299
Syria	7 227 151	2 405 394	49,89%	955 982	9 839 058
Tunisia	3 587 904	661 204	22,59%	596 288	4 989 120
Turkey	27 983 306	5 937 306	26,93%	3 197 403	34 609 956
Total MPs	**92 454 688**	**22 408 841**	**31,99%**	**12 378 211**	**131 200 718**

Table 4: The number of new jobs to create in 2020 with an increase of the activity and decrease of the unemployment

2020	Total Employment 2020	To create 2005-2020	Share (%) in employment 2005	No. of unemployed	Inactive of 15+	Av. Annual growth rate 2005/2020 (%)
Algeria	16 282 304	9 436 340	137,84	1 131 925	12 610 304	5,95
Egypt	36 178 834	18 060 234	99,68	2 515 106	28 019 749	4,72
Israel	3 412 940	919 340	36,87	237 263	2 643 251	2,11
Jordan	2 900 780	1 696 574	140,89	201 659	2 246 593	6,04
Lebanon	1 719 603	622 318	56,71	119 545	1 331 796	3,04
Morocco	15 190 814	5 277 518	53,24	1 056 046	11 764 968	2,89
Palest. A	1 889 356	1 310 917	226,63	131 346	1 463 267	8,21
Syria	9 773 434	4 951 677	102,69	679 437	7 569 320	4,82
Tunisia	4 974 687	2 047 987	69,98	345 834	3 852 791	3,60
Turkey	35 678 278	13 632 278	61,84	2 480 308	27 632 079	3,26
Total MPs	**128 001 030**	**57 955 184**	**82,74**	**8 898 467**	**99 134 119**	**4,10**

130 millions. Both figures indicate that keeping the ratios as they are is highly unsatisfactory.

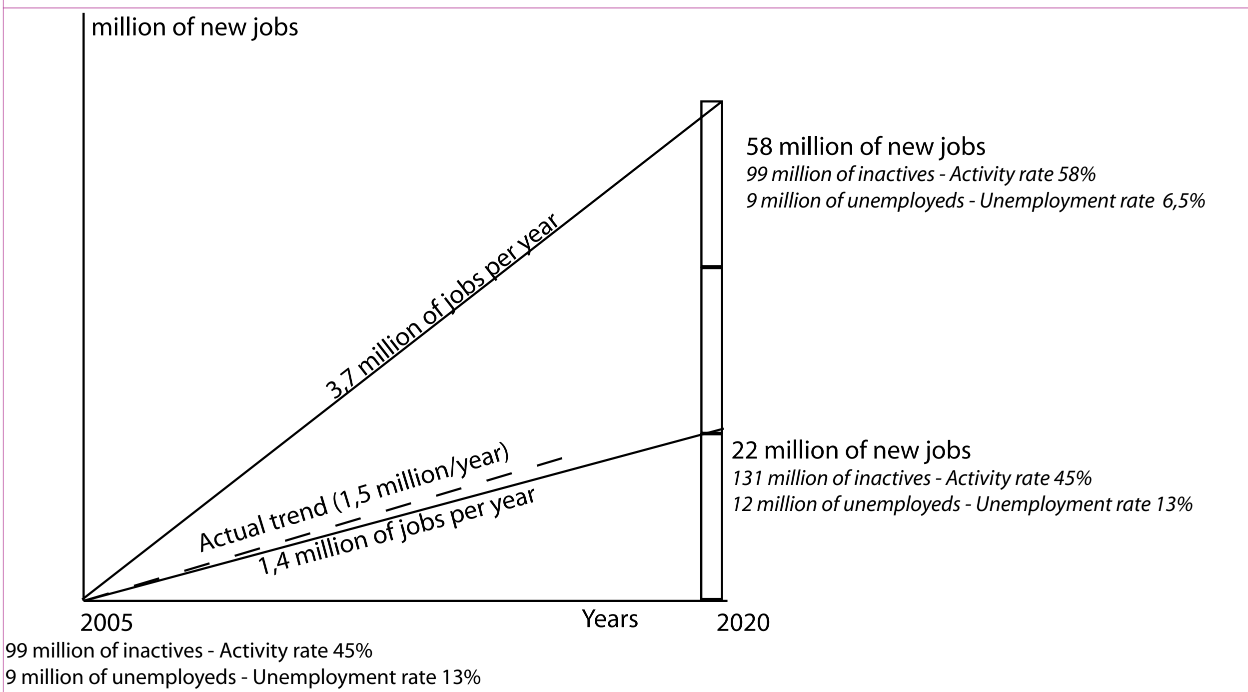
As regards the unemployed persons, an objective aiming at cutting the regional rate by 2 (that is 6.5%) would imply the creation of 28 million new employments (jobs), which amounts to an annual employment growth rate of 2.3% during 15 years. But, to improve simultaneously the situation on both elements of tension, that is an objective of maintaining the absolute number of active and unemployed to approximately 108 million persons, it would be necessary to add to this decrease in the unemployment rate, an increase in the activity rate to reach 58% (the highest regional rate in 2005 is that observed in Israel of 56%). It will imply that the MPs would be capable of creating 57.9 million employments (jobs) in 15 years that is an annual average regional rate of 4.1% during 15 years (see figure below).

II.3 Are current trends compatible with these needs?

The beginning of the decade marked a period of success for the MPs, during which they managed to create annually more than 1.5 million jobs (except Jordan and Lebanon), a number slightly superior to the 1.4 million jobs per year necessary to maintain the current ratios of the labour market, which is translated into a decrease of the unemployment. Only two countries still have to raise the rhythm, Morocco and Turkey, which they are currently achieving in the past few years.

Nevertheless, one must underline two restrictions: (i) that this trend is compatible with the employement needs only ifthe activity rates do not change, in particular, the female activity rate; (ii) this trend needs that the contribution of one growth point of jobs will be maintained, while taking into account that jobs are mostly created in the public sector.

Figure 1 : Objective of Job creation (2005-2020)



These recent achievements are however insufficient to improve on the two main factors of pressure (number of the non-active and unemployed persons), which will require the creation of 3.7 million jobs per year over 15 years. Only two countries are currently at a sufficient level: Algeria and Israel, whereas Tunisia is getting close. On the contrary, considerable efforts have to be made in Egypt and Morocco in particular, while Turkey has marked a special character since the beginning of the decade.

II.4 Can migration offer a solution that could relieve a "Euro-Mediterranean labour market"?

Such demographic pressure in the South, considered as a push factor, naturally raises the question of people's circulation. Given the relation between Europe and the Mediterranean countries, two factors drive migrants towards this shore: the increasing gap between the revenues and the very different conditions of life, including the problems related to employment, adding to this the historical political and economic ties between the two shores. Secondly, whereas demographic trends in the south imply an excess in the supply, inverse trends are taking place in the north, in some sectors of the labour market today, but which seems to be generalized in the near future creating the need of a migration of «replacement».

However, the issue of people's circulation continues to collide with a set of sociological and political considerations that cannot be ignored. It is equally difficult to think that all those who wish to immigrate to the EU can do so, than to think that migratory flows can be blocked. As a result, it is important to consider this issue in the context of a joint approach based on gradual actions that would ensure the optimization of these movements in a cooperative way, where both shores find their interests from the labour market points of view.

This report will stick to an objective presentation of the main facts about migration in the euromed context, that

Table 5: Actual creation rate and creation rate that should be achieved

	Actual Period			Maintain ratio		Maintain absolute no.	
	Actual Period	**Average growth rate (%)**	**No jobs/yr**	**Average growth rate (%)**	**No jobs/yr**	**Average growth rate (%)**	**No jobs/yr**
Algeria	2001-2005	7,06%	577 217	1,76%	136 464	5,95%	629 089
Egypt	1997-2003	2,28%	412 389	2,05%	430 151	4,72%	1 204 016
Israel	2000-2005	2,34%	58 364	1,74%	49 169	2,11%	61 289
Morocco	2001-2005	1,53%	151 501	1,72%	192 600	2,89%	351 835
Palest. A	2001-2004	4,64%	26 866	3,71%	28 001	8,21%	87 394
Syria	1991-2002	3,65%	176 065	2,73%	160 360	4,82%	330 112
Tunisia	2000-2005	2,77%	81 134	1,37%	44 080	3,60%	136 532
Turkey	2000-2005	0,43%	94 195	1,60%	395 820	3,26%	908 819
Total MPs			**1 577 732**		**1 436 646**		**3 709 086**

Source: Authors' calculations based on UN Pop. Div. quinquennial estimates and projections, ILO and national statistical institutes is to say: (i) the consequences of demographic trends in Europe; (ii) the level and the main destinations of the current flows from the MPS; (iii) the main economic impacts of migration for the MPs.

The context of migration between Europe and MPs

In Europe, there are two major trends that are taking opposite directions to those of the South Med Countries:

(i) The demographic trend is creating an aging population in Europe; the retirement age (64 and above) is increasing four times more than the working-age population (ages 15–64). In 2005, the proportion of active population (15-64) has been estimated at around 68.2% and the proportion of young population (0-14) at 16.7%, The total labour force will fall by approximately 66 million people between 2000 and 2050 and the European population will decrease by the year 2030.

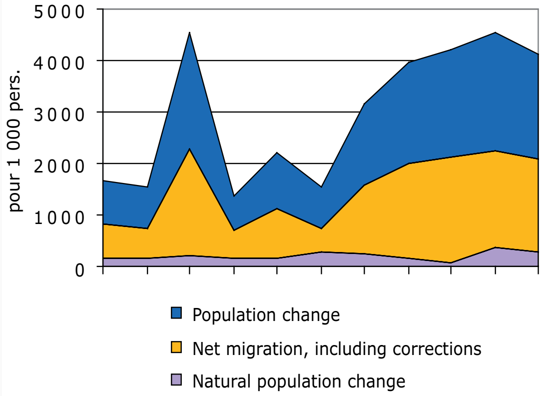
(ii) The labour market is following a positive trend. According to recent releases of Eurostat, employment rate of the EU-27 rose to 64.4% in 2006 (up from 62.2% in 2000). Unemployment rate went down to 7.9%. The whole European economies performed better than expected in 2006, what should create about 9 million new jobs over the period 2006-2008, bringing the unemployment rate further down to 6.7% by 2008.

Therefore, the actual tendency is set so forth: employment rate is increasing, more jobs are created and the European population (and specially the active population) is decreasing. So unless more people are added to the active population, there will be jobs left unfilled. This will create two pressures in Europe: (i) in the short term (and currently happening in some sectors), there will be shortage of workers, both unskilled (such as in the Spanish case) and skilled labour; (ii) in the medium term, Europe will suffer an increase in dependency ratios (inactives on actives), that is expected to create public financial disequilibrium in the problem of financing the retirement.

The decreasing natural trend of the population seems unable now to fill this gap that could be naturally filled by net migration since migrants increase the number of workers relative to the retirees (Figure 2). Europe has been on average a net importer with net estimate migrants of 1.78 million. This overall figure hides large differences among countries, varying from being net exporter such as Poland and Netherlands to being high level importers such as Spain (Annex 2). Since the demographic structure of the accession countries is similar to that of current EU members, the likelihood that migrants from these countries could fill this demographic gap is low.

In the MPs, the regional conditions and the opportunities offered elsewhere have increased migration in the past decade.

Figure 2: The growth of the population in the European Union at 27



Source: Authors' calculations based on Eurostat migration flows database, 2007

Legal migration contributed in 2005 by 4% of the world migration up from about 3% in 1990. The region is an overall net exporter (with the exception of Israel and Jordan), with the absolute number of migrants reaching 300 thousands in the period of 2000-2005. In 2005, 3.9% of the MPs populations were migrants, which are considered a high rate compared to the world average of 2.9% (Annex 3).

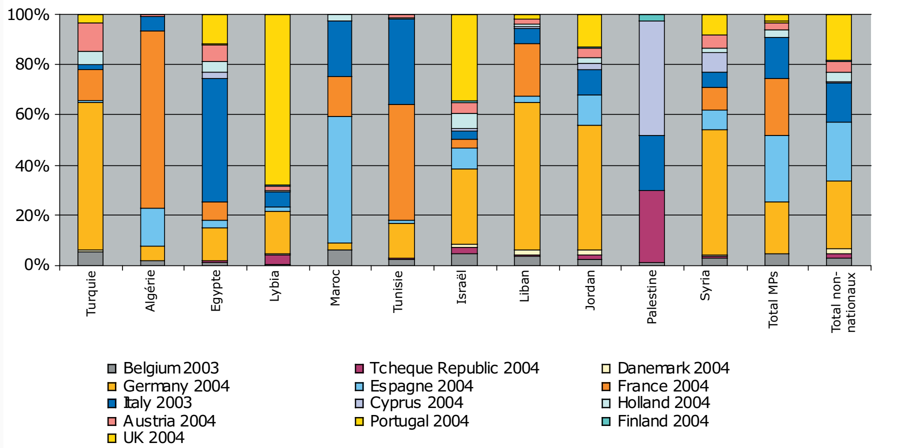
For the Mashreq countries, the Gulf region has been the major migrants destination after the oil boom in the 70s, but this trend has substantially decreased after the mid 80s crisis, followed by the Gulf war in the nineties and 2004. Moreover, given that most of the migrants from the Mashreq countries are workers in the agricultural and unskilled labour, the hosting gulf countries tend to replace them by cheaper labour from East and South Asian countries. As a result, migration from the Mashreq to Europe has increased as evidenced by Egyptian emigration of which 30% are residing in OECD countries (Italy being the main host). On the other front, most migrants from the Maghreb countries are residing in Europe. Morocco is the highest exporter of migrants to Europe, in 2004, more than half of Moroccan migrants entered Spain (Moroccans constitute 90% of the migrants from the region). France receives the highest number of migrants from Algeria, Morocco and Tunisia, while most Turkish migrants reside in Germany.

Economic impact of migration

On the economic front, migration represents for the MPs an important source of external revenues and has been able to alleviate labour market pressures and reduce unemployment (especially among the young and educated) this would translate into fewer jobs needed.

Remittances represent one of the largest sources of external funding for MPs, surpassing FDI inflows (Annexes 4 & 5). They contribute with about a half in the Balance of Payment current accounts. They are also a source of revenue that can increase the economic level and consumption of families at home. These transfers can be directly linked to the process of job creation, if these funds are invested in a business activity. Unfortunately most of the remittances in the MPs are either consumed or are invested in non-productive activities such as real estate or directed to the informal sector.

Figure 3: Share of MPs Migrants Flow in Selected EU Countries (2004)



Source : Eurostat migration flows database, 2007

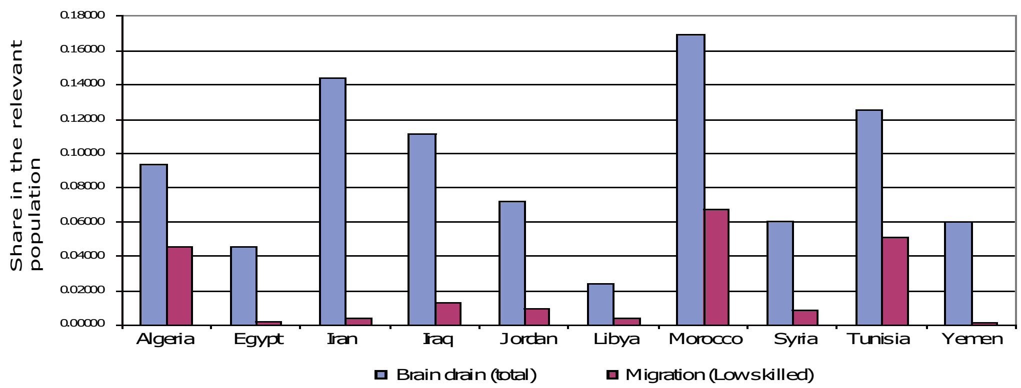
In general, the composition of migration may cause market distortions and may create shortages in some sectors. In the MPs, where the labour force is abundant and diversified, the outflow of part of this labour force does not seem to create these imbalances on the overall[0] nor affecting the domestic wages. The main problem for the sending countries lies in the migration of graduates "brain drain". It is in fact a loss of human capital that the region could have benefited from if it had offered them the right jobs, decreasing the long term capacities of development. The problem of "brain drain" reaches a high level in MPs. If the share of MPs migrants in the population is 1 point of percentage more than the world average, the share of brain drain is 4 points more than the world average (9% as opposed to 5%)[1]. Most of MPs are concerned[2]: Lebanon has the highest emigration rate of skilled workers in the MPs (ranking 27 out of 195 studies countries); Egypt and Jordan have high selection rates[3] (59 and 56% respectively); Tunisia and Morocco show high emigration rates of their highly educated workers compared to those born in their home countries.

Despite the theoretical evidence that free movement of persons should lead to efficiency gains and increase global income 25 times more than that accrued from free movement of goods and capital flows[3b]. It is still challenged with a set of political and sociological considerations that cannot be ignored. In fact, despite the increasing flows of migrants and a reorientation toward EU, the expected gains in the extremely sensitive euromed context, can only be reached by cooperative schemes of concerted and progressive co-operative actions that would ensure the optimization of these movements, where both shores find their interest from the labour market points of view.

III. The root causes of the problem

The inability of MPs to create sufficient productive and decent jobs to cope with the current factors of pressure lies fundamentally in the nature of economic growth and its sources. In general, economic growth (and employment) is affected by the quantity of factors of production (capital and labour), the speed with which these factors are accumulated as well as their quality and the way they are combined and managed to produce a given level of output. Low levels of factor accumulation, poor quality and

Figure 4: Migration and Brain drain across the MENA in 2000



Source: K. Sekkat et, al. Brain Drain and Human Capital in the MENA, (work in progress) inefficient management of these factors lead to low job creating growth and modest increases in Total Factor Productivity (TFP). On most of these dimensions, the MPs could do better.

As will be discussed below, investment levels are relatively modest compared with other fast growing countries. There is a mismatch between education and the demand for labour. Moreover, the informal sector is relatively large and entails the engagement of a large segment of the population in suboptimal activities, which are typically characterized by low productivity, low incomes, poor working conditions and limited labour protection against illness and old age.

In the remainder of this section, we begin by analyzing the relationship between past economic growth and employment. We then address the following issues successively: (i) the adequacy of domestic and foreign investment; (ii) the quality of the human capital and education, (iii) the effects of the presence of a large informal sector.

III.1 The growth-employment relationship in the MPs

One way of assessing the capacity of an economy to create jobs from a given economic growth rate is to look at the elasticity of employment with respect to production. This ratio is an evaluation of the job creation that corresponds to each point of GDP growth. By this measure, the region does reasonably well. Figure 5 below reports the employment elasticity with respect to output (measured in percent) over the period 1990-2005 for 50 developing and industrialized countries, including the MPs.

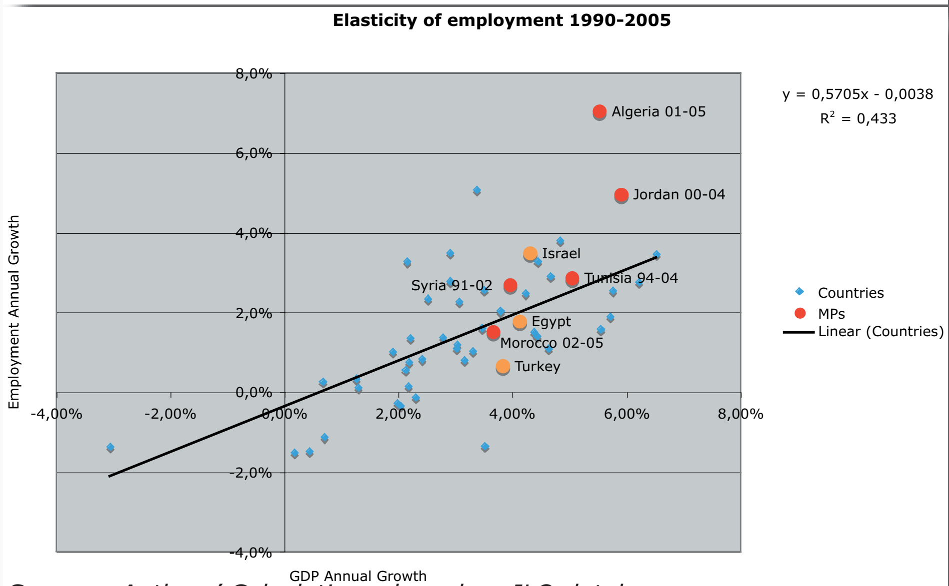
In general, the data show that higher economic growth correlated positively with job creation. With respect to the MPs, the following observations can be made:

√ The performance of some of the MPs over these past 15 years is in line with the average relation for the entire sample. This observation applies to Morocco, Egypt and to some extent Turkey, which are the most populated among the MPs.

√ Others, such as Algeria, Jordan and to a lesser degree Syria show even larger employment elasticity than the average for the entire sample.

√ The MPs exhibit however a large variance in the elasticity of employment with respect to eco-

Figure 5: Elasticity of employment with respect to production over the period 1990-2005 for 50 countries and MPs



Source : Authors' Calculations, based on ILO database.

nomic growth. Egypt, Israel, Morocco, Syria and Turkey have a relatively close average of annual GDP growth rates ranging between 4 and 5%, but their rates of job creations is very different ranging from 0.7% to 3.5%.

On the face of it, the MPs have been able to squeeze a high level of employment out of their economic growth. However, it would be misleading to accept this conclusion at face value. The region is known, as will be discussed below, to absorb a large proportion of secondary school and university graduates in government jobs. Given that these jobs contribute little to GDP growth, observed high employment elasticities do not reflect efficient use of labour. Similarly, informality is increasing in some of these countries, which reinforces the point.

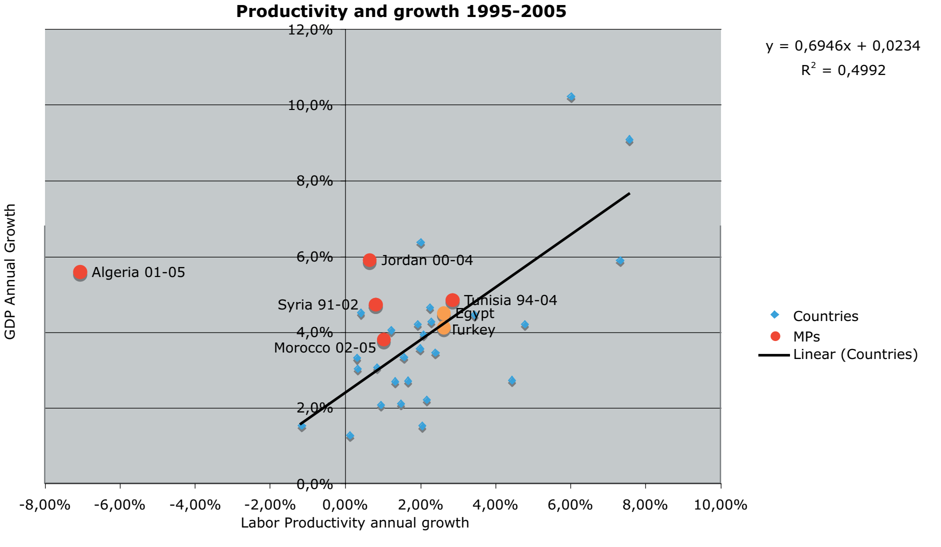
The relationship between productivity (of labour) and economic growth can further support the interpretation of the employment elasticity in the MPs as shown in Figure 6. In this respect, the heterogeneity among the MPs is large. On one hand Jordan, Morocco and Syria, which have almost the same modest gains in productivity (from 0.6 to 1% per year), experienced annual GDP growth rates of 5.9%, 3.8% and 4.7%, and annual job creation rates of 5%, 1.5% et 3.7% respectively. On the other hand, Egypt, Tunisia and Turkey, which had higher productivity growth rates (ranging from 2.6 to 2.9% a year between 1995 and 2005), have annual GDP growth rates of 4.5%, 4.9% and 4.1%, and annual job creation growth rates of 2%, 0.9% and 1% respectively.

Finally, a number of studies have attempted to estimate TFP change in the MENA region and with some focus on certain countries in the MPs. The results are not favourable in general[4]. These findings can be summarized as follows:

√ There is little growth of the TFP on average (around 0.4% and in some cases negative growth). Countries that had the highest TFP growth are Turkey, Tunisia and Jordan, while growth in other countries was driven basically by an increase in the human and physical capital.

√ The contribution of factor accumulation to growth shifted in MPs in favour of labour

Figure 6: Relation between GDP growth and labor productivity growth over the period 1995-2005 for 50 developing and industrialized countries and MPs



Source: Authors' Calculations based on ILO laborstata and WDI of the World Bank since the 80s. In Jordan and Turkey, the accumulation of capital continues to contribute in a superior way than that of labour but the gap is reduced. For the others, the labour factor contribution to growth became larger than that of the capital for the period 1991-1997, while it was the opposite for period 1970-1980.

√ Positive TFP changes are particularly important for employment generation in the MPs, as a growth of 1% of TFP would create 2% growth in employment. Contrast this with another estimate, which suggests that the effect of a 4% of investment growth would lead to a 1% increase in employment.

Box 1: The Total Factor Productivity

Total Factor Productivity is the part of GDP growth that is not explained by capital and labor growth. To understand the phenomenon, one can give the following very schematic illustration. By supposing that the shares of capital and labour in the production are the same, and that the two factors increase by 2.5% per year, 3 cases are possible:

√ In the first case, there is no growth of TFP, the growth of the GDP is 5% and is totally explained by the growth of the factors.

√ In the second case, the TFP drops by 1%, i.e. we face to a productive system which is in entropy. The growth will be 4%. This could be found in case of bureaucratic systems where the injection of capital or labor is translated to a fall of productivity.

√ In the third case, the TFP increases by 1%, which is the most favorable dynamic systems. The growth of the GDP is 6%, which means that by an effect of organization (mobility, flexibility, innovation, just in time, knowledge economy); the growth is higher than that reached by the only contributions of the growth of the factors.

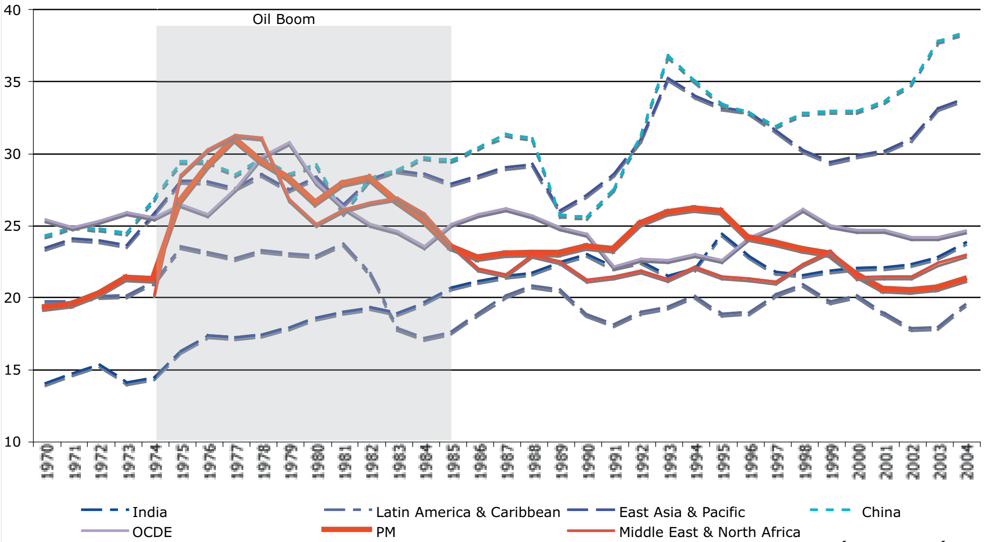
In short, although the quantitative relationship between economic growth, productivity and employment in the MPs, are close on the overall, the patterns observed show substantial individual variations. This reflects the differences in the strategies adopted by the MPs, in particular those related to policy interventions in the labour markets (or the lacking of these policies in some domains) and how the economy generates TFP gains.

III.2 Adequacy of domestic and foreign investment

Past experiences of strong economic convergence have taken place in countries with an investment/GDP ratio of around 30%. In comparison, the MPs since the 80s have only been able to invest on average close to 20-25% (see Figure 7). Moreover, the gap between the MPs and other countries has been widening over time. Since this trend has taken place in the context of a large growth of the active population in the MPs, it has led to one of the lowest capital/labour ratios in the world[5]. Thus, the MPs have not mobilized the necessary level of investment to attain high enough growth rates to provide their population with sufficient productive jobs.

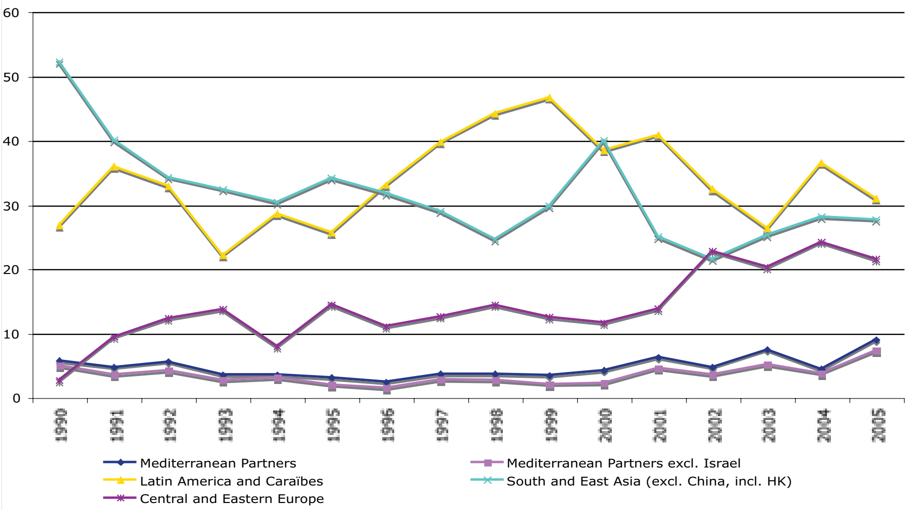
Nor have the MPs been able to compensate the deficiency of low domestic savings and investment by attracting sufficient foreign direct investment (FDI). As shown in Figure 8, the region scores very modestly compared to emerging countries in Latin America and East Asia in particular. Moreover, whatever FDI the region gets, most of it is concentrated in certain countries. In 2005, for example, Turkey alone accounted

Figure 7: Evolution of the ratio Fixed investments to GDP in several regions



Source: WDI, Banque Mondiale, 2006, calculation N. Grand Institut de la Méditerranée.

Figure 8: Share of MPs in the FDI to developing countries



Source : UNCTAD, WIR

for 34% of the total FDI inflows in the MPs.

Beside the low level of investment, its distribution between the public and private sectors and allocation across sectors make a difference for employment generation. Thus, if the weight of public investment to total investment is relatively high, as in the MPs, crowding out private investment is a real possibility. Surely, some public investment, for example in basic infrastructure and education, is necessary for crowding in private investment. However, public investment in activities in which the private sector can perform better leads to a waste of scarce resources and diminished capacity to compete internationally and create productive jobs. Similarly, the allocation of investment, both public and private, to traditional sectors along inherited comparative advantage is not likely to enable countries to benefit from diversification and the opportunities offered by globalization. Such a policy will narrow the export base, as observed in the MPs, thereby diminishing the potential creation of new, dynamic and productive jobs.

III.3 The mismatch between education outcomes and labour market demand

Over the past three to four decades, the MPs made remarkable progress on many fronts related to human capital. Starting from very low levels of enrolment at all levels of education, especially of girls, high illiteracy rates and poor quality education, the region consistently allocated as much as 5% of GDP or about one fifth of the government budget to education. As a result, almost all eligible children are now enrolled in schools, a larger fraction than ever before are enrolled in secondary and higher education, illiteracy has come down, and gender parity is essentially achieved. The average number of years of education in the population is now only one year below the average for emerging economies in Asia and Latin America.

Notwithstanding this progress, there is a mismatch between education outcomes and the demand for labour in some of the MPs. As shown in Table 6, a large percent of the labour force, in this case of secondary education, end up in the unemployment column. This problem is more acute in Egypt, Algeria and Morocco. In Jordan and Tunisia, the proportion of the labour force with secondary education and no jobs is essentially the same. But even then, the relatively high percent of unemployment among these graduates indicate that investment in human capital goes unrewarded.

Table 6: Distribution of the Labour Force and the Unemployed by Education in selected MPs economies

Country	Proportion of labor force with secondary education or above	Proportion of unemployed with secondary education or above
Egypt	42.0	80.0
Morocco	16.4	29.6
Jordan	45.1	43.6
Algeria	20.0	37.8
Tunisia	42.6	42.5

Source: World Bank, The Road Not Traveled: Education Reform in The MENA region, 2007 p.5 part III and Yasmine Nader, ERF

Table 7: Distribution of University Students by Field of Study in selected countries (percent, most recent year)

	Year	Education and Humanities	Social Sciences	Medicine	Scientific, Technical, & Engineering	Others
Algeria	2003	16.4	38.2	7.1	18.0	20.2
Egypt	1995	35.0	41.2	7.4	10.2	6.1
Jordan	2002	30.0	26.0	10.0	30.0	4.0
Lebanon	2003	21.2	38.8	8.5	25.7	5.8
Morocco	2003	27.6	47.8	3.9	18.3	2.3
Syria	1994	29.2	28.2	11.5	25.3	5.8
Tunisia	2002	22.0	27.0	7.0	31.0	13.0
WBG	2003	42.4	33.4	5.6	18.1	0.4
China	1994	22.8	9.4	8.9	46.8	12.1
Korea	2002	23.4	20.4	7.3	41.1	7.9
Malaysia	2002	20.0	27.0	4.0	40.0	11.2
Philippine	2002	20.0	31.0	9.0	24.0	16.0
Thailand	1995	12.2	59.7	5.9	17.6	4.7
Argentina	2002	10.0	35.0	10.0	14.0	31.0
Bolivia	2000	26.0	33.0	17.0	16.0	8.0
Chile	2002	20.0	35.0	9.0	32.0	5.0
Colombia	1996	17.1	43.2	9.1	28.5	2.2
Mexico	2002	15.0	42.0	8.0	32.0	4.3
Peru	1991	13.0	42.1	11.4	24.3	9.2

Sources: UNESCO Statistical Yearbook 1998 and UIS database and Yasmine Nader, ERF

Beside the loss in GDP growth, high unemployment also has negative effects on social stability.

Another limitation of the education systems in the MPs is that they tend to focus more on the study of humanities and social sciences than science and engineering. In more than half of the MENA countries, about two-thirds of the students major in humanities. This pattern of enrolment is the opposite of what is observed in East Asia, and to a lesser extent in Latin America (See Table 7). To the extent that modern development requires technological innovation and adaptation, the education systems in the MPs would benefit from a shift in education toward more science and engineering.

The previous pattern of enrolment is historically consistent with the government policy of absorbing most university graduates in civil service jobs, since in many countries of the region, the rapid expansion of secondary and higher education was accommodated by employment in the public sector at relatively high wages rather than by increasing demand for higher educated labour by a dynamic private sector. This tends to disadvantage private sector against public sector and create anti-productive bias. In particular and in the actual situation, a widespread public employment led to a suboptimal use of labour and has created expectations which could not be fulfilled by the private sector. As a result, rent seeking behaviour, in particular among graduate are frequent, due to the contrast between the benefits, social protection and wage difference offered by the public vs. the private sector, thus lowering the capacity of countries in the region to create productive jobs. In summary, there are here two important effects: (i) private sector is non-attractive and cannot get the competences it needs; (ii) graduates with higher education have interest in waiting for a public job (by joining the unemployed) or in migrating towards external labour markets and finding jobs that are compatible with their education.

This leads to a low level of TFP in the region, that is not a result of poor quality in the countries' educational systems (the progress in fundamental indicators as literacy clearly demonstrate), but of a mismatch in the allocation of labour factors which leads to achieving only a small fraction of the TFP potential.

III.4 Widespread informality

For a host of reasons, the size of the informal sector in the MPs is relatively large. According to the ILO (Figure 9 below), the average percent of informal employment relative to total employment is above 40 percent. This observation applies to Algeria, Egypt, Morocco and Tunisia. It also applies to both men and women, although the percent is somewhat higher for men.

The rise of informal employment is partly the result of the limited working opportunities in the formal sector relative to the proportion of the inactive population in the working age. In part, it is the natural result of the fact that those who opt to work in the informal sector tend to be poor and cannot afford to be "unemployment". In fact, the relatively high levels of the minimum wages in some MPs influence in a way the firms' behaviours with respect to employment.

In some odd way, this outcome can be desirable. It provides society a mechanism to deal with poverty and a remedy against social instability. It accords the labour market some flexibility. And it may serve as an incubator before firms and individuals join the formal sector, by benefiting from successful accumulation. That would suppose nevertheless a great mobility between informal and formal that unfortunately hardly exists in the MPs.

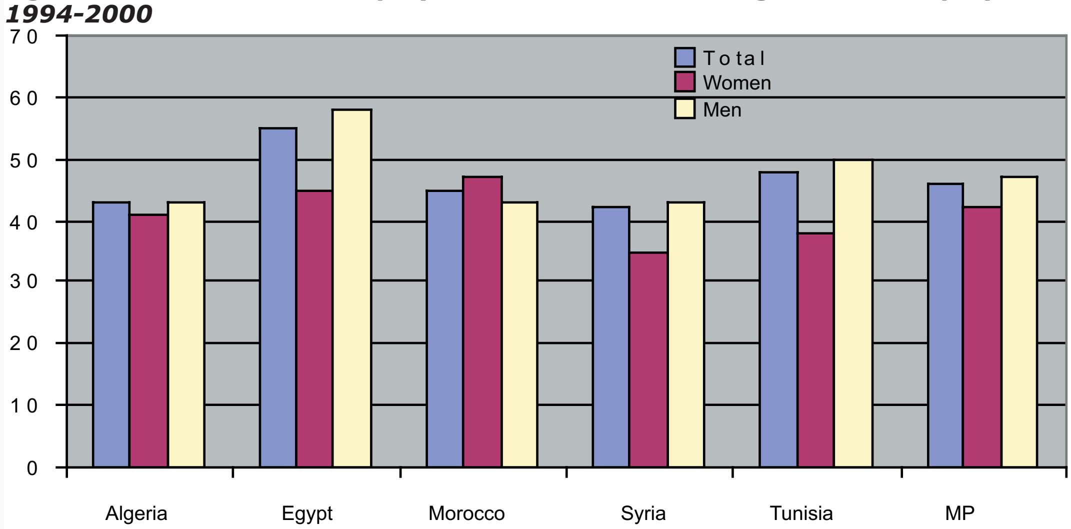
The experience of the MPs is mixed however, with the positive effects of informality outweighed by the negative ones. This conclusion is illustrated by a few examples, as seen by different economic agents.

√ From the perspective of individuals, research on the informal enterprises in the West bank and Ghaza Strip shows that these enterprises play a significant socio-economic role of a 'safety valve' by absorbing shocks to the national economy[5b]. It also acts as a poverty alleviation device for household members who lost their jobs or couldn't have access to the formal labour market. On the negative side, most of the employment created in the informal sector is far from 'decent jobs' as defined by the ILO. In particular, these jobs often lack social protection. In Turkey, 35% of the male wage earners and 35% of the female wage earners do not have any social security coverage, working in the informal sector (without speaking of the percentage of self-employed who are not covered by social security, even much higher: 42% for men and 82% for women, cf. Tansel, 1998).

√ From the perspective of firms, informality has benefits, mostly in terms of regulations flexibility. Informal firms avoid the administrative and investment costs of access to the formal sector, and the costs of staying in it. They avoid paying taxes and labour related costs as well as costly bureaucratic procedures. On the other hand, there are drawbacks: firms in the informal sector have limited access to modern technologies, capital and government provided goods and services.

√ From the perspective of governments, informality represents a kind of an automatic mechanism for social

Figure 9: Informal Sector Employment as a Share of Non-agricultural Employment, 1994-2000



Source : ILO, 2002

stability, which is at the same time less expensive. In return, the public budgets are deprived of fiscal resources and the effects of reforms tend to be moderate as they do not impact a sector that lies outside the legal system.

When all these perspectives are added up, the impact of informality on economic activity is not favourable. One study on the informal sector in Tunisia argues that the larger the size of the informal sector, the more persistent is unemployment. Creating more jobs in the informal sector can delay policy reforms to deal with unemployment now and may aggravate unemployment in the medium run because of the low returns on investment in the informal sector and the needs for public capital to provide public services. In addition, because the informal enterprises in the region tend to be micro, small and medium enterprises, they typically operate at low levels of productivity and use traditional methods of production (Femise study on the MSEs in four countries: Egypt, Lebanon, Morocco and Turkey). And they typically lack access to finance, government contracts, and the protection of the law from abuse by local officials.

For what concerns employment, the presence of a large informal sector raises three main difficulties: (i) a large proportion of the economic agents (employed and employers) are de facto out of the active policies sphere (ii) the created employment is mainly for survival and is far from the "decency" criteria; (iii) informality creates a kind of low productivity trap that pressure on the whole economic system.

IV. Competitivness, openness and labor market policies

The openness of an economy can potentially increase productivity through 4 channels: The first is related to the scale effects which are derived from the market enlargement, and as a result of global demand[6]. The second is derived from the increased competition and as a result the reallocation of factors of production from the least to the most efficient enterprises. The third is related to the market pressure that causes inefficient firms to exit and more efficient firms to enter. Finally, openness can have additional benefits from the reallocation of factors between sectors.

To explore the interaction between openness, competitiveness and labour market policies in the MPs, this section addresses the following issues: (i) the compatibility of the current pattern of specialization in the MPs with openness, (ii) the appropriateness of wage policies from the point of view of reconciling international competitiveness and social concerns, and (iii) the extent to which policies and institutions can meet these objectives.

IV.1 The compatibility of the pattern of specialization and employment with openness in the MPs

The strategy of openness, adopted by the MPs in recent years, requires a relatively high degree of mobility of resources, including workers. The question is to know to what extend the current specialization is able to maximize the trade potentials and whether the MPs enjoy such flexibility or not.

Drawing on the most recent database on the structure of employment collected by the ILO for 50 countries, including the MPs and reported in Table 8, the following observation can be made:

- √ The MPs continue to employ a large fraction of the labour force in agriculture. This sector alone accounts for one third of the total labour force, which is 10 percentage points above the average of the countries in the larger sample, (excluding China).
- √ Only Turkey and Tunisia employ a comparable percentage in the manufacturing sector to those observed in the sample of 50 countries. Otherwise, manufacturing employment in the remaining MPs is less than 14 percent of total employment.
- √ With respect to services, the proportion of tradable professional services is lower in the MPs than in the rest of the sample, while the proportion of the non-tradable services and administration are over-represented.

Thus, the current structure of employment in the MPs has to change to benefit from openness. The size of non-tradable sectors, especially public services, is still large compared to the tradable sectors. Moreover, the agriculture and services sectors, which are absorbing most of the employment, remain non-liberalized, both at the local and the international level. The manufacturing sector is relatively small. Given the sectoral distribution of MPs, the openness implies a large transfer of jobs from the non-tradable

Table 8: The most recent structure of employment by sector in the MPs (percent)

Isic Rev. 2	Algeria	Egypt	Jordan	Morocco	Syria	Tunisia	Turkey	MPs*	Sample
Year	2004	2003	2004	2005	2002	2004	2005		2005
Agr. Hunting, Forestry, Fishing	20,7	29,9	4,1	45,4	30,3	16,2	29,5	30,0	18,6
Mining and Quarrying	1,7	0,2	0,9	0,4	*Manuf*	1,2	0,5	0,6	0,4
Manufacturing	10,9	10,9	14,2	11,6	13,7	19,4	18,5	14,2	14,3
Elect., Gas and Water Supply	1,0	1,3	1,4	0,3	*Manuf*	*Manuf*	0,4	0,7	0,6
Construction	12,4	7,4	9,1	7,1	13,2	13,3	5,3	8,0	6,8
Wholesale and Retail Trade and Restaurants and Hotels	17,2	13,5	16,9	16,7	15,0	10,9* *Trade only*	20,6	16,8	20,8
Transport, Storage and Communications	5,6	6,3	8,1	3,8	5,5	5,6	5,1	5,4	5,6
Financing, Insurance, Real Estate and Business Services	1,8	3,0	4,7	1,3	1,3	13,3 ** hotels and other incl.*	4,0	3,3	9,0
Community, Social and Personal Services	28,5	27,5	40,0	13,2	21,0	19,1	16,1	21,1	23,7
Autres	0,2	0,0	0,6	0,0	0,0	1,0	0,0	0,1	0,2
Total	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100
Public Admin. and Defence; Compulsory Social Security	14,2	11,2	16,8	Nd	Nd	Nd	Nd		
Sources	ILO	ILO	DOS, 2004 Census, JOR+non Jord	ILO	ILO	Total employ., RGPH 2004	ILO	Femise	China excl.

sectors to tradable sectors with comparative advantages.

Within the manufacturing sector, the MPs also exhibit little diversification. In fact, the five industries listed in Table 9 account for the bulk of employment in manufacturing. And out of these 5 industries, textile-clothing and leather account for most of the employment. In 2003, both sectors accounted for about 50 percent of total employment in manufacturing in Morocco and Tunisia, 37 percent in Turkey and 30 percent in Egypt. In comparison, paid-workers in this sector in China in 2003 were about 20 % of total paid-employment in manufacturing.

Looking at the evolution of competitiveness of the manufacturing sectors over time can be revealing, especially in terms of the relationship between the unit value of exports, labour productivity and per capita income[7]. An increase in the unit value of exports can be considered as an indicator of improved productivity and quality of products, which may or may not be translated into wage increases. Either way, the increase in the unit value of exports constitutes improved terms of trade that would translate into an increase in the quantity and quality of imports, notably of equipment. The result is an increase of TFP if the substitution from capital to labour is not too large. Consequently, if the ratio of productivity to salary per head evolves positively, wages are not affected by openness. On the contrary, a simultaneous decrease of the unit value of exports and the productivity can indicate that the re-allocation does not improve the efficiency, which threatens the quantity and the quality of employment.

By examining the trends of these indicators for the period 1995/97 to 2000/03 (Annexes 6 figures), it is clear that MPs are not taking advantage of trade liberalization. Only a few sectors exhibit an increase in the unit value of exports. Except for Jordan and to some extent Tunisia, productivity is either negative or low, putting pressure on the incomes of employees.

In the clothing sector, Tunisia maintains the unit value of its exports, which is effective. However, this is

Table 9: The main sectors of employment in 2003 (in % of the wage-earning industrial employment)

	Textile, Clothing, Leather	**Metal. items**	**Chemistry**	**Alim, drinks, tobacco**	**Metal industry**
Egypt	29,8%	14,5%	13,7%	30%	6,1%
Jordan	17,1%	16%	15,4%	21,5%	2,7%
Morocco	48,8%	14,3%	8,4%	15,3%	1%
Tunisia	51,9%	16,7%	5,9%	11%	1%
Turkey (*)	37%	21,5%	10,1%	15 ,7%	5,4%
Bulgaria	32,4%	23,3%	8,7%	17,3%	3,9%
Romania (**)	17,2%	66,2%	-	0,8%	-
Russia	9,1%	35%	4,5%	20,5%	10,5%
Ukraine (*)	8,4%	33,6%	9,9%	18,8%	14,8%
China	19,9%	33%	15,1%	8,2%	7,6%

(*) Turkey and Ukraine 2001 (**) Romania 2000
Source: Unido – Calculation Institut de la Méditerranée

achieved at the expense of wages per head. The same is observed in Turkey, but to which is added a declining unit value of exports. The case of Jordan is different. The quasi-stability of the unit value of exports is accompanied by (or derived from) strong productivity gains. The ratio productivity/salary per head is increasing, while maintaining competitiveness prices. At the same time the quality of employment in the sector is improving (by means of better remuneration).

IV.2 Labour cost and salaries: untie the knot

In the context of globalization, competitiveness is affected by the cost of labour. If real wages' evolutions follow that of labour productivity and adequate exchange rate policy is implemented, price competitiveness is preserved. In the MPs, where accelerated growth of per capita incomes is a necessary objective, productivity cannot be considered as an obstacle to the decent jobs creation, but rather a way to increase real wages without affecting the competitiveness of the economy.

Box 2: Wages Indexing Policy

The MPs follow currently two main models for wages indexation:
The first scheme reflects the indexing based on consumer price level (such as the case of Morocco). This scheme aims at maintaining the living standard. The control of inflationary shift involves an inflation target strategy and a fixed nominal exchange rate pegged to a basket of currencies. The main difficulty with this scheme is the risk of appreciation of the local currency in real terms that induces a loss of price competitiveness, which contradicts the initial objective.

The alternative scheme is indexing the wages based on the productivity gains, at the same time, the exchange rate policy target a real fixed exchange rate with (such as the case of Tunisia). Here, competitiveness depends primarily on the real factors. This virtuous scheme is at the origin of progress achieved by Tunisia.

The example of Egypt and Morocco illustrates perfectly the situation of most of the MPs. In Morocco, enterprises surveys estimate that the level of wages (including charges)[8] is high relative to the productivity per head. Half of the Moroccan enterprises interviewed confirmed this. Consequently, many enterprises try to by-pass the regulation, notably by staying in the informal sector (cf. «Economic memorandum of the country, Morocco », World Bank, in March, 2006). The fact that informality allows to bypass the wages legislations is confirmed by surveys done in Egypt (and Turkey). In terms of wages, comparisons between formal and informal sectors in Egypt showed that most of private formal workers (73%) have a daily salary ranging between LE 10 and LE 50, while around 68% of the informal salaries-workers earn a daily salary between LE 5 and LE 10. A study on wage earners, self- employed and gender in the informal sector in Turkey showed that the salary per hour of the formal sector is on average 35% higher than that of the informal sector[9].

The MPs context here is important. Under constraints of competitiveness, the economic logic would conclude to the need to decrease minimum wages in real terms. This would affect

Box 3: Minimum wage-country cases

All MPs have adopted minimum wage policy as implied by law, but not all of them are binding. Since many employers use temporary or informal contracts or work in the informal sector, this minimum wage policy is adopted by very few firms.

Algeria*: The (SMA) is negotiated between the government, labour unions and the employers. Its level is based in principal on the consumption prices, national average production and the economic conditions.*
Egypt*: Minimum wage in Egypt was set at LE 116 per month before the new law. The National Council for Wages set an annual increase in the Egyptian minimum wage at a minimum of 7% of the basic salary upon which social insurance contributions are reckoned. However, the law grants the establishment the right to refer its individual case back to the Council in case it is impossible to finance the set annual increment due to economic difficulties. The decision should be made within 30 days. It is to note that in the case of Egypt, the increment is not influenced by the consumer price index (CPI) that is perceived as non-indicative of the real inflation rate in the case of Egypt.*
Jordan*: The first national minimum wage was introduced in 1999 amid much controversy. The minimum wage was set at JD70 monthly across the board, and four years later the government announced a JD15 raise in minimum wage.*
Morocco*: 77,26 dh per day SMIG - 50 dhs per day SMAG*
Syria*: For many years, the urban minimum wage remained unchanged at 1,250 Syrian Pounds per month. As a result, the real value of the minimum wage declined and became essentially non-binding by the end of the 1990s. However, in 1999, the minimum wage was raised to 2,000 Syrian Pounds per month and in 2004 it was raised again to 3,500 Syrian Pounds per month (approximately US$70). At current levels, the minimum wage is binding for the lowest paid workers. In 2002, less than 5 percent of the full-time workforce earned wages that were less than 3,000 Syrian Pounds per month and less than 10 percent earned 4,000 Syrian Pounds or less per month*
Turkey*: A committee composed of government representatives and worker and employer organizations meets to establish the minimum wage at the latest every two years. However, rapid inflation has compelled more frequent adjustments (usually once or twice a year). The minimum wage is set by the day. Weekly, monthly, hourly or per piece wages are determined according to this daily rate. The minimum wage applies to all branches of economic activity, but is separately determined for workers younger than 16 years and those older. Although there is no exact indexation between the minimum wages of those younger than 16 and those older, the former is about 85 percent of the latter.*

the private sector real wages, which should mainly translate into improving competitiveness. Then, with a dynamic effect this should decrease the informal employment since the gains of informality will be reduced[10].

This mechanism does not take place, because of two problems: First, the development of the informal sector as a flexibility tool to face heavy legislations minimizes the impact of the evolution of the minimum wage on the population (formal and informal active persons). Secondly, the salary has another social dimension that is directly linked to poverty. The average size of MPs households is higher than in Europe (in Morocco, the average household accounts for 6 persons, that is one and a half time the size observed in Bulgaria or in Rumania) and mostly includes only a single paid worker. In Morocco, it was found that a 5% decrease of the real minimum wage will drag 400 000 people below the poverty line. Evidently and given the context of the MPs and their development objectives, the real wages are de facto rigid downward and the channels to optimise on their levels are in the productivity gains (and/or exchange rate policy), within a framework of an openness strategy that implies a large competitiveness constraint. But, this assumes the existence of a coherent global functioning policy framework.

IV.3 Do the institutions and policies in the MPs maximize the benefits of openness, especially in terms of employment?

If the dynamic of job creation of the MPs is not sufficient, it is important to study in what way the institutional context contributes to this and what would be the main orientations to improve the current situation. The evidence is that macroeconomic policies, labour markets laws and related institutions have an impact on the job creation potentials, since they affect the allocation of resources, as well as the smoothness and the speed of this allocation. The remainder section will address successively what relates to the macroeconomic reforms and what concerns more specifically the labour market.

IV.3.1 Macroeconomic reforms: a framework that is yet to be optimized to benefit from globalization

All the MPs chose to adopt macroeconomic openness and to rely on trade to develop their economies. The first step, in which they have succeeded, was the establishment of a stabilized macroeconomic environment without large imbalances. Given this achievement, the following step is the implementation of policies and adopting reforms related to trade, investment, the business climate and governance that would match the openness strategy. On this front, a lot is still to be done.

The MPs have made good progress in terms of trade reforms. According to a study of the World Bank (Economic Prospects, 2007), most of the MPs are now ranked among the best half of the world in terms of reducing tariffs barriers and dismantling non-tariffs barriers. Those progress followed bilateral and regional agreements adopted by the MPs. Egypt, Jordan and Lebanon progress in terms of trade reforms is remarkable (Annex 10a). Despite this progress, MPs protection policies remain high (Annex 10b). Moreover, the transaction costs, poor infrastructure and communications have added to the cost of trade.

The business environment of the MPs is still not very encouraging for new firms to start up their business. The MPs have not progressed in this area, according to the World Bank doing Business reports most of them are ranked in the lowest categories notably Algeria, Egypt, Morocco and Syria. Jordan, Lebanon and Tunisia are better placed and Israel and Turkey are among the top 50s. Business regulatory and financial sector reforms are progressing very slowly and some areas have not witness any progress such as the judiciary system. The importance of the public sector is also pointed out as weighting on the private sector attractiveness.

There is no adequate business environment without good governance and well defined roles of the public and private sectors. According to the World Bank measurement of governance[11], countries of the MPs are lagging behind the rest of the world in terms of quality of public governance (accountability, transparency, corruption, inclusiveness). Also, in terms of public administration (efficiency of bureaucracy, rule of law, protection of property rights, corruption, quality of regulations, etc.), the region in general is also lagging, and its performance worsens the higher the GDP per capita of the country. Whereas in terms of public accountability (respect of civil rights, transparency, openness of political institutions and participation, etc.) the whole region is at the end of the ranking. Of course those benchmarks are always considered cautiously, but they do testify a kind of negative overall perception of the international operators. This is translated for instance on the poor performance of FDI. As demonstrated by a FEMISE study (FEM2115), the FDI ratio can be doubled in some countries such as Egypt and Turkey, if the level of political risk is reduced. Tunisia and Egypt would be chief gainers (with one percent increase in FDI ratio) if the level of risk decrease to be the same as Switzerland.

IV.3.2 Reforms of labour codes: key issues in a specific context

The logical issue to be addressed next is to know if the regulations of the labour markets Mediterranean are also at the origin of frictions that hinders the process of job creation and prevent an optimal functioning as an open economy. The debates on the flexibility of the labour laws, even within the European countries, show how much the issues related to labour markets are strongly linked to the functioning of the societies. Reforms should be made while taking into account the economic, political and social contexts of these laws, according to their degree of sensitivity. These reforms can be done by improving rapidly on the issues that can accelerate the adjustment and which do not have direct impact on the individuals, while addressing cautiously the other more sensitive issues and taking enough time on the dialogue.

While progressing on the reforms of the labour laws, two important facts have to be taken into consideration:

√ Activity ratios that we have observed indicate finally that «the labour markets» concern only a relatively small part of the population. The size of the informality is important in at least two ways: (i) general laws, that are mostly considered as adding rigidity to the functioning of the labour market, only concern a minority of the working age population, hence the flexibility of the legal system is then a step to consider; (ii) the informal sector plays as «reserve of flexibility» which could be mobilized when the incentive to move to the formal market would be considered profitable.

√ Employment in the public sector has certainly decreased, but it still considered particularly attractive considering the large benefits it offers relative to the private (lifetime employment, higher remuneration, and larger social coverage). Several surveys indicate that the graduates prefer to delay their entry to the labour market to obtain jobs in the public. It is indeed the kind of phenomenon that tends to hinder the transformation of the individual progress in collective gains. Besides, considering the large percentage that these jobs represent, the gap in the benefits between private and public employment tends to reduce even more the number of population that is concerned by the common legal frame. It is observed that public employment encountered important modifications in productive term, such as in Egypt, since employment decreased more in the «State owned enterprises” that have been massively privatized, than in the administrations, weighting also more on the global production.

In the logic described above, notably on how to increase the mobility of factors, it is clear that the regulations that address both the labour market and the fluidity of the economic framework must be improved as fast as possible. Within this measure, reforms to reduce the delays to create an enterprise and the bureaucratic procedures (number of forms to fill), improving the bankruptcies management, reducing the durations of commercial courts disputes, decreasing the minimum legal capital to start-up a new business, facilitating obtaining credits, in particular by training banks staff and decreasing the credits amount (see Best practice box of Egypt, Annex 8). It is clear that this type of actions do not directly concern the employee status but they will increase the mobility, accelerate the reallocation potentials so as to take more advantage of the expected openness dynamic effects. They are, as explained, able to create gains in terms of factor productivity while improving the potentials of a better organization of available resources, without basically affecting the sensitivities related to the MPs context.

Then, there are the questions that relate to the employee status, for example the nature of the employment contracts that are obviously more sensitive. The well established idea is that the MPs have less flexible labour markets on this front. Hiring and firing procedures are not flexible by international standards in the MPs regions. The still low job creation and the long term unemployment have made hiring and firing flexibilities hard to achieve. Many firms in MPs rely on temporary and even informal (unregistered) contracts. In Morocco for example, in 2000 more than 20% of the employed in the small and medium enterprises worked with temporary contracts (25% for female employees). This percentage reach 35% for large enterprises (it doubles for female employees; Cf. World Bank). The 2003 labour code meant to partially reduce these figures, by permitting short term contracts (1 year) for newly established firms or for new production lines, these can be renewed one more time, after that it becomes a permanent contract. The new labour law of Egypt (2003) was more flexible, as it allows a type of contracts with defined duration which could be unlimitedly renewed, without having to transform them into permanent contracts (as was the case in the earlier labour law). In Israel, government enacted a law that regulates temporary contracts to a definite period of 9 months, after which, it becomes mandatory to hire the employee full time. The law is still not enforced due to problems of monitoring. It is to mention that most temporary contract salaries were below the minimum wage.

From the enterprises point of view, it is evident that the competitive context requires more flexibility in favour of hiring and simplifying the dismissals, by introducing temporary contracts and by being less rigid. The general trend adopted by the MPs is mainly oriented towards facilitating hiring, even through temporary contracts and subcontracting. This leads to a beneficiary dynamic to the development that should increase foreign capital attraction and enhance small firms to enter the formal sector. In fact, it improves the mobility between sectors. It also increases the elasticity of employment relative to output. In other words, this kind of flexibility is directly linked to the job creation objective. Nevertheless, it creates some debates especially within the labour and trade unions that could raise the fragility of the situation, but that in a way accepted.

However, the flexibility of dismissing remains limited. The problem here is more complicated and sensitive. Most countries of the region either prohibit dismissal for economic reasons or make it administratively difficult. In Morocco and Tunisia (and to some extend Egypt), dismissed workers have the right to appeal which could be costly to the enterprises specially that the legal process is unpredictable in this case. Some firms get around this by making employees sign undated letters of resignation, which are held in reserve in case layoffs are required. It is evident that facilitating the dismissal has to be made with extreme precautions and in a strategic framework specially that the labour markets are loaded with a historical large share of public employment that continues to be attractive to most workers, and where under-activity is socially destructive. A more cautious approach would be to increase the attractiveness of the private formal sector by substantially improving the social protection, the insurance on loss of jobs and process of finding new jobs. These efforts will be more productive on the collective front.

V. Meeting the employment challenge: some key issues

To conclude this chapter that addressed the issue of employment in the South Mediterranean region, we would first remind here of the key issues that characterize the employment creation in the region, before getting into details on the issues related to the activity of women, the formalization of the economy, the adequacy of the education and training to the labour needs and the coordination of migration policies.

V.1 The need for an overall strategy

The current situation is characterized by: (i) a low activity ratio, leading half of the working age population outside the labour market; (ii) a high regional unemployment rate among the active persons; and (iii) a large population of less than 15 years that will be joining the labour markets seeking employments in the coming 15 years. The current economic performances of the MPs that are sensibly progressing since the year 2000 are not able to deal with these pressures. In fact, the current performance in terms of job creation needs to be doubled in order to prevent the increase in the number of persons that are concerned by the employment problems.

As highlighted throughout the chapter, there is a set of factors that are currently at the origin of the insufficient rate of job creation in the MPs. These factors are mainly related to inherited national historical strategies, in particular: (i) the role of the public sector, notably as an eventual last resort employer, (ii) the domestic investment rates that are insufficient and not efficiently oriented; (iii) the mismatch between the education and training of the work force and the needs of an under-sized private sector, despite the progress at the educational level; (iv) a large informal sector that is characterized by low productivity, low incomes, fragile working conditions and insufficient employees protection. All these elements converge towards a self-sustained sub-optimal use of the capacities of the MPs leading to weak productivity gains. However, successful stories of development suggest that international competitiveness generates productivity gains that will be derived from the capacity of an economy to adjust. Provided a coherent legal framework, these productivity gains enhance an improvement in the global level of activity, and consequently of employment. Moreover, this process generates a significant income growth that corresponds to the needs of development of the MPs (ie. income convergence and employment creation).

To deal with this challenge, the MPs have to adopt a strategy of adjustment that takes into account the particular social context. Hence, employment policies have to be handled in a precautious way. Some general measures or policies that are directly related to the employment market and are likely to improve the system vitality, seem to be easy to reform. Other measures that relate directly to the status of employees are also to be investigated in a very precise way and so as to benefit from the democratic support. This general frame is an endogenous virtuous process in which the economy is able to generate sufficient productivity gains, in openness logic. These gains will enhance the activity of the economy and will increase the real wages without negatively affecting competitiveness.

For this process to take place it is important to act on certain more specific vectors. We will address here those related to the human factors.

V.2 Encouraging the women to take part in the labour market

Independently of any ethical question, encouraging women to participate in the labour market is a need, so as to increase the particularly low activity rates of the MPs. In order to achieve that, the adopted strategies should be accompanied by a number of policies aiming at: (i) first of all, eradicate her illiteracy; (ii) preparing women to join the labour market by designing special vocational training programs to suit her needs, either in rural or urban areas (handicrafts, agriculture, micro enterprises, etc.); and (iii) ensuring a good working conditions in the formal public/private sector and certain flexibility to meet her social and household needs. Moreover women need to be aware of the potential gains that their participation will achieve on the individual, the household and national levels (see Box Best Practice in Annex 11: Algeria and Box Best Practice: Turkey).

√ Fighting illiteracy, most of the MPs governments has taken serious steps to improve this situation by designing special target programs for females especially in the rural and poor areas. In Tunisia for example, the National program for adults' education has for objective to reduce illiteracy to less than 18% (now at 37% for females), 49.8% of the enrolled in this program is girls between the age of 14 and 20 years. Incentives are given in some countries to encourage families especially in the rural areas to send their girls to school. Such as establishing schools for girls only, linking the education of these girls to their environment (such as done in some schools in rural areas of Egypt), giving indemnity to families that have children in schools (including girls) and providing subsidies for the food and transportation (such as in Algeria, 2000 AD for each child in school given to 3 million child in deprived areas annually).

√ Specially designed programs and vocational training are put in place to increase the competence of women in the labour markets and encourage them to participate actively. Training of women to work in the handicrafts industry especially in the rural areas has been very beneficiaries. In Morocco, the agricultural vocational program targeted for young rural and non-educated (or with a minimum level of education) has engaged between 2001 and 2005 a large number of people, in which 12% are girls (see Annex 11 Box Best Practice: Tunisia).

Women entrepreneurs represent a high share in the informal market. But in many cases and given the high competitiveness of the market, they are isolated and have problems accessing the markets and micro credits. The role of NGOs and women associations in this area is essential. The creation of specific funds to grant women micro credits have been a success in Turkey (with the assistance of KOSGEB) and Tunisia (National Solidarity Fund-FSN and Tunisian Solidarity banks-BTST). These funds do not require the classical guarantees that are require by normal banks. The Association of Algerian Women (AFCARE) have taken some actions to improve the image of women entrepreneurs including education, training, creating of networks, also the role of the National Council for women in Egypt has improved a lot on the image of Egyptian women (see in Annex11 Box Best Practice: Egypt)

√ Improving the working conditions for women is a minimum basic right to keep up her dual roles in the society. Equal salary schemes as those of men are essential. In Tunisia, women wages in the agriculture sector has been adjusted to match those of men, (female workers salaries were 15% less than those of men). Most of MPs give some flexibility to women such as maternity leaves, flexible working hours for working mother with young children, etc.. In Turkey there is project law specially designed for women that forbids the dismissal of women because of their pregnancy but provide her with legal maternity leaves and flexible hours.

V.3 Reducing the size of the informal sector

The main question that the informal share raise is whether or not its existence is beneficial to the economic dynamic and in particular job creation. In fact, the debate is ongoing, illustrating the MPs dilemma of quantity versus quality of jobs created (World Bank, 2007).

In general, the rationale for formalization includes macroeconomic, microeconomic and social factors:

√ On the macroeconomic level, the presence of an informal economy results in forgone revenues and an underestimation of the revenue base. It can be considered that the already existing high tax rates compel micro and small entrepreneurs to operate informally. Thus if the tax rates were lowered to reasonable levels, more enterprises would be willing to act formally. Although the informal sector plays a vital role in generating employment opportunities, a large segment of these enterprises are of a low productivity nature. Integrating the informal activities into the formal economy would help improve their productivity levels by offering them necessary technical support programs. The presence of the informal sector leads to the provision of inappropriate indicators for macro-policy decisions and in general, macro-policies are less effective given the existence of an informal economy.

√ On the micro-economic front, the presence of an informal economy provides an opportunity for distortions in resource allocation. Thus, informal firms can draw demand away from formal firms since they are likely to offer goods and services at a lower price. Also, as a result of the credit dilemma that firms in the informal sector face, these enterprises tend to focus on short-term, which reduces propensity to invest and accumulate the capital.

√ Finally, many scholars view the informal economy as contributing to the collapse of social norms, but the question that is often raised is whether or not the informal economy is actually a cause or an effect of unacceptable morals. On one hand, we find that workers in this sector suffer from injustices and poor levels of working conditions that would somehow make their illegal practices justified but on the other hand, behaviours like free-riding and its possible severe consequences confirms the informal sector role in degrading social norms.

It is interesting to estimate the cost-benefit value of the formalisation. This was done by a study for Egypt where the costs and benefits of formalization was calculated in two contexts[12]: (i) without any reforms of the actual legal framework or (ii) with a set of reforms to make formalization rewarding to entrepreneurs.

The point is that formalization will work only if from entrepreneur's point of view and from the society's perspective as a whole, the value of the firm in the formal sector is greater than the corresponding value of the same firm in the informal sector. This process of formalization affects different groups differently. It will most likely benefit entrepreneurs and governments according to which taxation regime will be imposed on formalized firms and workers since they will start benefiting from social insurance and better wages. The only uncertain impact is on consumers who will probably start paying a higher price for the same product after formalization.

The numerical simulation compares the estimated private value of the "typical firm" in the informal sector under continued informality and the corresponding value of the same firm under formalization. The results in the first case i.e. with the actual legal framework, lead to losses for both entrepreneurs and consumers, sustaining the actual large scale of informality. Aggregating the results across all firms in the informal sector indicate that formalization without reform would lead to a loss of resources to society equal to LE 6.5 billion, or 1.0 percent of GDP every single year.

However, adopting appropriate and comprehensive reforms, the simulation lead to positive aggregated results across all firms in the informal sector, generating an annual increase of 1.3 percent of GDP, every single year. Entrepreneurs would gain 1 percent of GDP, workers 0.7 percent of GDP and government

1.3 percent of GDP. Consumers will be worse off by 1.7 percent of GDP, but the loss is reversed by the benefits from improved product quality and of being either workers or entrepreneurs. The cost of formalization to taxpayers (citizens) is estimated at no more than 0.04 percent of GDP.

V.4 Improving the employment of a better educated population

The general education is not the only mechanism of development of the human capital and a better conciliation of the education with the needs of the labour market has to reflect on the knowledge-base notions, on the role of vocational training and training and on the issue of diplomas as recognition of capacity.

Higher education should not be the only benchmark and a lot should be done at the level of secondary education as well. Readjusting the contents of the school curriculum which do not correspond currently to the needs of the labour market is an action that needs to be implemented. Also setting up the constitution of a basic pedestal, what a young person, for instance at the end of the compulsory education, has to accumulate as knowledge, would be an important step forward. Given the size of the informal and the existence of poverty, certain strata of the population, such as the young and the women, were not able to follow schooling in a successful way. The interest of such a pedestal notably lies in the possibility of creating alternative mechanisms that intend to adjust these missed out educations. Some pressure has to be put on establishing specialized schools (just like the schools of the second chance in Europe) which correspond to the needs of these populations, to answer their needs of specific qualifications could be attractive with a clear objective of an employment at the end of the period of training.

The role of specialized and commercial technical trainings is also essential. Obviously, the technical fields are still considered mainly as a second option for those who have no access to the university general fields. In principal, on the contrary these are important elements that can construct the link between education and employment needs of the economy and when they function properly can supply more jobs in the private sector than in general channels. But, the general university channels are often considered more prestigious. Moreover, given the size of employment in the public administrations, which is due to the large gap of advantages provided by this sector compared to the private one, the choice of joining the public sector is a rather rational one from the point of view of the young. Hence, it is important to revaluate short-term technical education.

The continuous vocational training is a determining tool that allows the persons to progress and to put in value their experiences, which will encourage their mobility. From this point of view, centers of professional training in the MPS suffer several weaknesses (Kirchberger, on 2005, Femise on 2006).

The private sector must be encouraged to invest in the technical education. The profit of a private investment in this case is twofold. First, it means the use of advanced educational methods and adapted equipments. Second, it allows the student to have a customized education on the concerned private sector jobs, strengthening fundamentally the link between the education and the quality of the human capital on the labour market. An identical effort must be applied in the training (vocational training), currently they are financed by contributions from the employers and the employees in several MPs. These financing mechanisms are mostly looked upon as additional taxes and not investment.

Finally remains the question of the relation between the diplomas, that are supposed to give a certain level of general knowledge and the competence that is the capacity to do something in a satisfactory way in a given concrete situation. This relation is important to adapt to a certain job offer and requires an increasing mobility. The objective is to evaluate the competence obtained with regard to the diploma. This is particularly important in an economy that has a large informal sector. This implies first to identify the technical and professional competences that should be recognized by a formal system of accreditation, to set up the corresponding diploma/competence and the validation procedures (including of the professional experience).

V.5 Coordinating cooperative migration schemes

As it has been underlined throughout the report, it is important for the cohesion of these societies that the level of development and rhythm of convergence increase substantially, given the demographic context of the MPs and migratory flows.

In the euromed context, migration is a multidimensional issue that could be beneficiaries for the north and south if sufficient dialogue and cooperation are put in place, notably to reduce the asymmetry of information that is leading to the current mismatch between the two shores, while taking into account the sensitivity of the issue.

Currently, governments of the MPs have adopted different policies towards migra-

Table 10: Nature of migration policies in the Mediterranean Partners countries

	Immigration policy			Emigration policy	
MPs	**Overall level**	**Highly skilled workers**	**Integration of non-citizens**	**Overall level**	**Encouraging return**
Algeria	Maintain	..	..	No intervention	Yes
Egypt	Lower	Maintain	Yes	Maintain	Yes
Morocco	Lower	Maintain	Yes	Maintain	Yes
Tunisia	No intervention	No intervention	No	Raise	No
Israel	Raise	Maintain	Yes	Lower	Yes
Jordan	Lower	Lower	No	Raise	No
Lebanon	Lower	No intervention	No	Lower	Yes
Palestine	-	-	-	-	-
Syria	Maintain	..	..	Lower	..
Turkey	Lower	Raise	No	Maintain	No

Source: UN, department of Economic and Social Affairs, population division, 2006
Notes: Governments policy on immigration: Overall level: Governments policies regarding the current overall level of immigration into the country. It is coded into four categories: to raise the level of immigration; to maintain the level of immigration; to lower the level of immigration; and no intervention

tion (table 10), varying, on the overall level, from policies that encourage emigration from the country ('raise') such as in Tunisia and Jordan[13] to policies that discourage emigration ('lower') such as in Lebanon, Israel, Palestine.

Moreover, some MPs governments have established migration agencies[14] that should have an important role to play in reducing this information asymmetry that leads to imperfect contracts and a strong mismatch of the quality. The migrant (here the employee) doesn't have enough information about job opportunities available outside his home country so as to match it with his skills and qualifications, nor is he fully aware of the corresponding regulations, responsibilities or rights. Similarly the employer in the receiving country does not have credible information about all the potential qualifications that are seeking employment from outside. This asymmetry is naturally one of the main reasons behind the mismatch of the supply of labour from the MPs and the demand emerging from Europe. Statistical tools are needed to overcome this problem. Another fundamental issue related to the efficient management of migration is the question of recognition of diplomas and other qualifications to insure that immigrants are working at their competence level, to avoid loss in terms of income and skills.

On the other side of the Mediterranean, the EU countries have adopted restrictive immigration policies since the 70s, but large number of migrants (legal, illegal and asylum seekers) has managed to enter the EU, creating a problem of illegal migration (around half a million of illegal migrant enter EU every year)[15]. The EU has decided that a new approach to manage the migration was necessary. A 'Policy Plan on legal migration' issued in December 2005, confirmed the need of 'highly skilled labour' to fill the EU countries market needs. A roadmap was traced for four years (the map included further analysis, discussions and consultation) which should put the migration issue on top of the EU-Med agendas, starting in 2006 by a dialogue. The main objective is to better manage migration flows by a coordinated approach which takes into account the economic and demographic situation of the EU. The immigration policy will have for main objective to fight illegal migration, while recognizing the EU needs of migrants in certain sectors and regions in order to deal with its economic and demographic needs. Moreover, the Commission is working on becoming a more attractive destination to highly qualified workers (that still prefer US, Canada and Australia), by setting up a one-stop shop for potential workers and issuing a 'European blue card' a single work and residence permit giving access to a range of socio-economic rights, but each country of the EU will decide the number of migrants. In addition to avoid the brain drain and its negative effects on the sending countries, it will set standards to limit active recruitment. To insure integration of legal wanted immigrants, the Commission will make sure that they have the same rights as EU citizens.

The question of the migrations which ends this chapter reveals at what point the economic interdependence must develop at the same rate as the human interdependence, the fruit of old proximities where the culture, the functioning of the institutions and the geography play important roles. These elements show that, in the euro-Mediterranean region, we are going more and more towards a paradigm of cohabitation.

Notes

0 Jordan, experienced shortage of unskilled labour in the agriculture sector, which was filled by migrants from neighbouring countries (e.g. Egypt).

1 This figure is for the whole MENA countries but it can give an indication for the MPs, since most brain drain migrants are originating from this region.

2 The study is conducted by Docquier and Marfouk in 2004 compiling OECD data on emigration stocks by educational attainment in 1990 and 2000

3 The proportion of skilled emigrants in the total emigrants stock

3b Rodrik, Dani.. "Feasible Globalizations" Cambridge, Mass.: National Bureau of Economic Research Working Paper Series 9129.

4 For ex. Makdisi, Fattah, Limam, « Determinants of Growth in the MENA countries », 2000; Sekkat, « The sources of Growth in Morocco », 2003, and most recently S.A Pissarides, M.A.Véganzonès-Varoudakis, « Labor Markets and Economic Growth in The Mena Region », World Bank 2005

5 S.L. Baier, G.P. Dwyer, R. Tamura 2002, «How important are Capital and TFP for Economic Growth».

5b Esim, Simel and Eileen Kuttab. 2002. "Women's Informal Employment in Palestine: Securing A Livelihood Against All Odds", Background Paper for the 9th Forum of ERF, Cairo

7 The industrial data are issued from the international bases of the UNIDO (Indstat 3 rev2 2006). The unit values of exports are calculated using COMTRADE by observing the rules of equivalence between nomenclature of trade (SITC) and nomenclature industrial used by UNIDO (ISIC rev2), by N Roux, Cefi. A software was conceived to carry out calculations of the unit values of exports and which allows (1) to clean the base, (2) to reconstitute missing values and (3) to calculate the unit value by large aggregate industries

8 The level of charges in the wages (including social security, illness, …) is also considered as high for countries of this level of development. For instance, in Morocco and Tunisia they represent 25% of the wage bill and in Algeria, social security cost alone represent more than 36% of the labour cost.

9 Gender discrimination of wages in informal : Among the female workers, the log hourly wage of the covered wage earners is about 80 percent higher than that of the uncovered wage earners (Tansel, 1998).

10 Agenor, El Aynaoui : « Labor market policies and unemployment in Morocco : a quantitative analysis » World Bank 2003 et FEMISE 2004, « Profile pays Maroc »

11 Based of 22 indicators including rule of law, corruption control, public sector efficiency, ..etc. many of which are subjective.

12 Galal, 2004. "The Economics of Formalization: Potential Winners and Losers from Formalization in Egypt"

13 Overall, there are only 11 countries in the world that adopts this policy (including those 2 MPs).

14 Such as the Office National Algerien de Main-d'Oeuvre in Algeria (1962), the office de la Formation Professionelle a l'Etranger in Tunisia (1969) and the Minsitry of Manpower and Emigration in Egypt (1996)

15 European Commission Estimates

Chapter 2: Liberalisation of services*

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This chapter deals with the role of the services in the Euromed integration region, and the impact of their liberalisation. It is organised in three section :

1. the first section is a general overview of the service and network industries, and concentrate on the framework of the liberalization in the euromed context.
2. the second section aims at providing a picture of the services sector in five MENA countries with a focus on "backbone" services sectors, considering that efficient backbone services are essential because of their impact on transaction costs in trade in goods and services.
3. the third section focus on the implications of liberalization of irade in services and network industries. It considers the quantification of barriers to trade in services and network industries and assesses the effects of liberalization in banking, telecommunications, maritime freight transport, electricity and natural gas in the MENA countries.

I. Framework for Services Liberalization

Services cover a broad range of industries, encompassing network industries such as electricity, natural gas, and communications; other intermediate services such as transport, financial intermediation, distribution, construction, and business services; and services destined for final consumption such as tourism and travel, recreation, education, health, and environmental services.

Services for a long time were believed to be nontradable. Technological changes over the past two decades have made trade in many services feasible, increasing the importance of services in international trade. The propositions regarding the gains from freer trade is said to apply to both goods and services. But the types and forms of liberalization of services are quite different from those of liberalization of merchandise trade. Barriers to the flow of goods typically arise as customs, and other physical restraints on trade are administered at national borders. Thus, for goods trade, most discussion of liberalization focuses on tariffs and on non-tariff barriers. On the other hand, barriers to trade in services are typically regulatory in nature, and outcomes of services liberalization depend heavily on the regulatory environment.

The World Trade Organization (WTO) General Agreement on Trade in Services (GATS) distinguishes between four modes of supplying services trade: cross border supply, consumption abroad, commercial presence, and movement of individuals.[1] This typology was used to negotiate and undertake the commitments during the Uruguay Round of GATT/WTO (1986-1993). Liberalization of trade in services involves the reduction of regulatory barriers to market access and discriminatory national treatment across all four modes of supply between the countries. The focus is to ensure that existing regulations do not discriminate against foreign participation in the market. Moving to a nondiscriminatory regulatory regime can require significant changes in how the sector is currently regulated. Another key policy area that comes under the spotlight in the liberalization of the sector is the treatment of foreign direct investment

(FDI) and temporary movement of labor to provide services in another country, and thus Modes 3 and 4 of GATS.

Commercial presence is a key mode of supply for services, and developing countries have historically placed significant restrictions on FDI (mode 3) in order to encourage domestic ownership of capital, limit repatriation of profits, and increase the linkages of the multinational firm with upstream suppliers. Barriers to service provision may operate through entry barriers to local markets, rules on conduct, regulations on the number and size of competitors in a market, and in other ways. But liberalization requires that foreign service providers enter the national market for the service itself with no restrictions. Thus, full liberalization of the commercial presence mode of supply would outlaw most of these measures in the services sectors. With increased FDI inflows countries will experience increases in physical capital, human capital, but more importantly in technology upgrading productivity

Similarly, with restricted or segmented labor markets, large effects can come from services liberalization if such liberalization becomes an indirect mechanism for liberalizing factor markets (mode 4). This is a central issue for the poorer developing countries who have long pushed for liberalization of immigration controls in OECD countries, since global services liberalization may be a vehicle for them to achieve this end. If the movement of individuals is temporary, then both the host and home country will gain. For exporting countries, the financial and knowledge benefits would be greatest if service suppliers return home after a certain period abroad, and for importing countries, such temporary movement should create fewer social and political problems than immigration.

Countries often have little interest in each other's regulatory regimes or have little confidence in their quality. As a result, they are reluctant to adapt their own regimes where necessary to facilitate cross-border activities. If each country has different regulations in place and does not recognize qualifications in a foreign firm's home country, then the national qualification costs become cumulative costs, as firms in the sector in order to enter the foreign markets will have to incur costs to comply with the qualification criteria (compliance costs) of each country. As long as these costs are country-specific, they may become prohibitive hampering trade and investment. Thus qualification costs could be decreased substantially if countries would accept some international norms as regulations.

In principle countries can choose to liberalize a service sector unilaterally and derive efficiency gains. But unilateral liberalization may be constrained by three types of issues. First, a country cannot on its own gain improved access to larger foreign markets. Second, a country may face difficulty increasing competition. Finally, a country may lack the expertise and resources to devise and implement the appropriate domestic regulatory policies. Hence a country should in general seek multilateral or regional liberalization rather than achieve unilateral liberalization.

Multilateral engagement through negotiations under GATS could help. However, for these negotiations to be fruitful, the parties have to recognize mutual interests in reciprocal liberalization. Recognizing these potential mutual gains will allow reciprocal "concessions" that benefit both. But this will require global cooperation which is in general not easy to achieve.

The above considerations reveal that countries intending to liberalize services trade unilaterally have to adopt at least the international rules in the relevant service sectors such as e.g the 'Basel Core Principles' in the banking sector. On the other hand adoption of WTO rules may lead not only to efficiency gains in the country but also to improved access to larger foreign markets within the context of multilateral liberalization, and it will also help the foreign establishments by making the task of complying with the domestic regulations in different countries less costly.

In recent years the number of regional free trade agreements (FTAs) and customs unions promoting trade in goods has increased significantly. Many provide for free trade in goods but also include some measures to facilitate trade in services. Such agreements could lead to substantial gains from liberalization of trade in services. But even here there is caution on both sides in cases when one of the parties is a developing country and the other a developed country. In developed countries there is caution towards trade liberalization mainly because of the associated greater liberalization of the movement of individuals (Mode 4 of GATS). On the other hand there is caution in the developing world towards liberalization of the sector reflecting the concern that any future regional liberalization of the sector will be largely one sided in the results it will yield. Their belief is that in regional services liberalization developed country service providers will gain significantly improved access to developing country service markets, but the converse will likely not happen. But developing country service providers have to realize that in order to achieve improved access to developed country service markets, they have to harmonize their regulatory frameworks to those of the developed countries, since the regulatory regimes in developed countries are in general more stringent than those in developing countries.

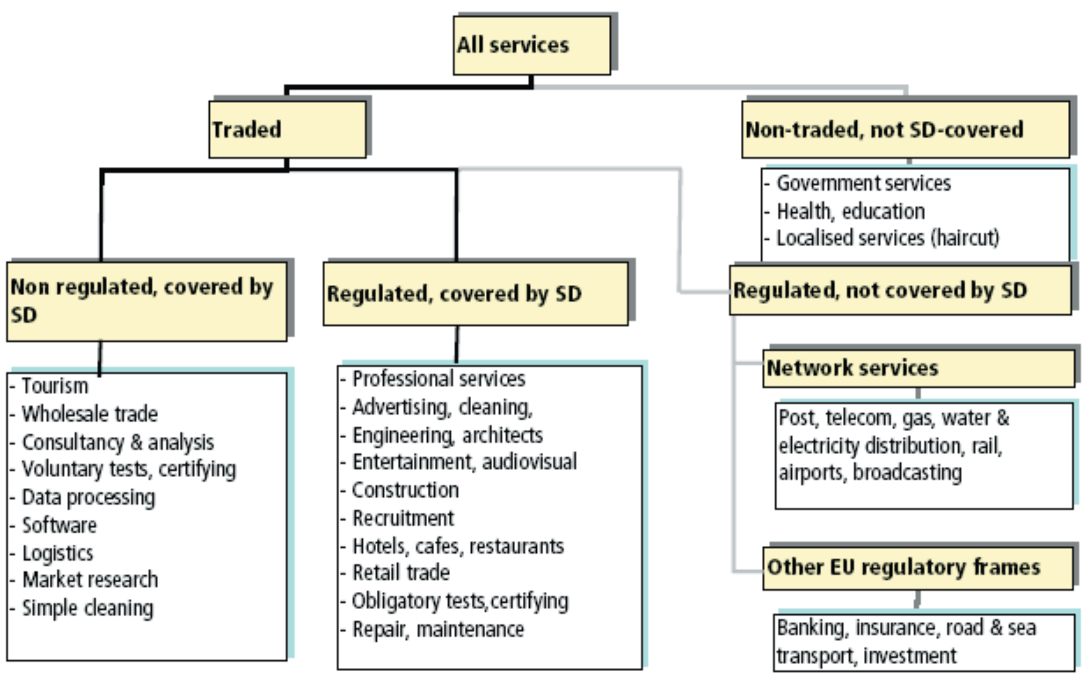
Services are generally classified into traded and non-traded services (Figure 1). The traded services are further divided into regulated and non-regulated traded services. Among the regulated services we have the key backbone services such as network, financial and maritime transport services, which are needed to connect the country's businesses to global production networks and capture more investment flows while reducing the cost of trade in goods and services. In the EU these are all sectors regulated by specific directives. On the other hand professional services such as accounting, legal and engineering services are regulated but are covered by the European Commission's Services Directive (SD) 2006/123/EC. Finally, services such as tourism and wholesale trade are non-regulated sectors covered by the SD. In the case of traded and regulated services covered by SD the chances for developing countries of having access to EU markets are slim without mutual recognition of professional qualifications and standards.

The EU's 2004 European Neighbourhood Policy (ENP) initiative presents an opportunity to deepen the market integration of the Southern and Eastern neighbouring countries of the EU with the EU and increase their participation in global production networks. The ENP offer covers a wide range of policy issues. It includes enhanced preferential trade relations through implementation of the remaining agenda of the Association and Partnership Agreements, a "stake" in the EU Internal Market, the progressive participation in a number of EU policies and programs as well as increased financial and technical assistance. The perspective of progressively participating in the Internal Market is the most far-reaching aspect of the ENP. The objective is to gradually create an economically integrated space, with free movement of goods, services and factors of production between those countries and the EU.

Unlike the EU accession process, which required the accession candidates to harmonize their regulations with the EU by adopting the entire acquis communautaire, countries without accession prospects could implement only those regulatory changes that were expected to result in large benefits and had low costs. In other words, the Mediterranean Partners (MPs) could adopt, as emphasized by Hoekman (2007), not the whole acquis but part of the *acquis*, "a la carte", and, through this partial harmonization, share the benefits associated with the relevant elements of the EU's Internal market.

But this policy has changed recently. According to European Commission (2006) deeper economic integration with the ENP partners will be central to the success and credibility of the ENP policy. From the latest communication of the Commission we note that the EU aims for deep and comprehensive free trade agreements (FTAs) for all ENP partners including the behind the border elements such as technical norms and standards,

Figure 1: Traded and Non-traded in EU



Source: Kox et Lejour (2006)

sanitary and phytosanitary rules, competition policy, enterprise competitiveness, innovation and industrial policy, research cooperation, intellectual property rights, trade facilitation customs measures and administrative capacity in the area of rules of origin, good governance in the tax area, company law, public procurement and financial services. The deep FTAs will cover all trade in goods and services between the EU and ENP partners including those products of particular importance for the partners and will include strong legally-binding provisions on trade and regulatory issues. The associated Action Plans, that will be implemented over 3 years, has a wide coverage spanning both economic and non-economic fronts. They foresee negotiation of an agreement in services, development of a favourable investment climate, and integration of partners into Trans-European transport and electricity networks.

In this chapter we concentrate mainly on key backbone services such as natural gas, electricity, telecommunications, financial services, and maritime freight transport services. In each case we concentrate first on the role of international forces. Such global regulations help the foreign establishments by making the task of complying with the domestic regulations in different countries less costly. While the harmonization of domestic regulations to those at the global level will help the foreign establishments to have greater access to the domestic markets, the harmonization of domestic regulations to those at the EU level, which are stricter than those at the global level, will help the domestic service providers to have improved access to the EU service markets. The chapter is structured as follows. While section 1 considers the regulations prevailing at the global and EU levels for network industries, section 2 does the same for banking services, and section 3 for maritime transport services. Finally, section 4 discusses issues related to services covered by the European Commission's Services Directive.

I.1 Network industries

For almost a century network industries were organized as state monopolies mainly because of three reasons. First, there was a belief that such industries were natural monopolies so that there was only space for one undertaking in the market. This view was based on the observation that sectors, such as telecommunications, natural gas and electricity were subject to large economies of scale and that network infrastructures were very hard or even perhaps impossible to duplicate. Thus, these industries were governed by exclusive rights to certain monopolies. Second, monopolies were granted the exclusive rights in return for the understanding that they provide universal service. There was thus a kind of contract between governments and the concerned monopolies, which would provide their services throughout the territory including loss-making areas, to all customers, with a given level of quality and without discontinuity, thereby ensuring social and geographic cohesion. The provision of universal service would certainly have a cost, but the monopoly granted to these firms would allow them to cross-subsidize profitable services with loss-making ones and still make a profit. Third, because of the importance of these industries from strategic, economic and political viewpoints governments believed it was important to consolidate them in one firm, which they controlled. Governments tried to control these industries as they felt the need to control basic infrastructures in case of war or major crisis, as these industries employ large number of workers and represent a significant part of the GDP, and as state monopolies were often part of the administration or had closed links with public authorities (See Geradin, 2006).

In the late 1970s the basic tenets of the monopoly model started to be challenged because of major technological developments. It was emphasized that provision of universal service did not necessarily require the maintenance of public monopolies cross-subsidizing unprofitable market segments with profitable ones. Cross-subsidization was considered as an imprecise funding mechanism, which distorted competition. Other methods of financing, such as targeted subsidies from general taxation or the creation of compensation funds could be used to contribute to the costs of providing universal service. Second, industry organizations in sectors subject to fierce international competition argued that they were largely penalized by the high costs of essential production inputs of telecommunications, natural gas and electricity which were provided by public monopolies. If these sectors were to remain competitive in the face of the globalization of the economy, the network services industries had to be liberalized as competition would bring lower prices and better quality of service. Third, consumers started to complain about the poor performance of public monopolies, as consumer prices tended to be high and the quality of service poor. They claimed that competition was the best way to induce better prices, improve quality of service, and stimulate innovation. Fourth, early experiences of liberalization in the United States and the United Kingdom convinced many governments that the liberalization model based on the opening of network industries to competition combined with regulation through independent agencies was workable and could provide positive economic results.

The section is organized as follows. While section 1.1 considers the liberalization of the natural gas sector, section 1.2 concentrates on the study of liberalization of the electricity sector. The section concludes with the analysis of liberalization of the telecommunications sector in section 1.3.

I.1.1 Natural Gas

Natural gas is a fossil fuel of a primary source of energy. It is a mixture of hydrocarbon compounds including methane, ethane, propane, butanes and pentanes. However, the primary component of natural gas is methane. Methane is highly flammable, burns easily and almost completely, while it emits very little air pollution. As such it is considered an environmentally friendly clean fuel. It is also a very safe source of energy when transported, stored and used. Because of its specific gravity lower than that of air, natural gas rises if escaping, thus dissipating from the site of any leak. It is also economically more efficient than other energy sources as only about 10 percent of the natural gas produced is wasted before it gets to final consumption.

Experiences of liberalization in a large number of countries including USA and UK reveal that efficiency in natural gas supply can be attained through competitive markets, where prices reflect the costs of marginal supply, and that such a market would be one where no company holds and/or exercises significant market power, where prices reflect the costs of marginal supply and where gas is available to anyone anywhere willing to pay the competitive market price. The political and regulatory challenge of market liberalization is to remove the market power, without causing the market or existing players to fail during transition. Hence, the ideal is to have:

- √ A market where there is full competition in production, wholesaling and retailing natural gas, and where gas can be freely traded between producers, wholesalers, retailers and consumers.[2]
- √ An interconnected transmission and distribution system with clear rules for third party access (TPA) by all prospective participants. Where pipeline capacity is in competition, capacity is tradable and transmission prices are set by reference to the market. Where natural monopoly exists, clear rules for reference pricing are available and disclosure arrangements and legal remedies are available at an economic and timely manner to redress concerns.
- √ Arrangements in the transmission, distribution and retail sectors that provide confidence in the market where cross-subsidizing is not occurring in vertically integrated organizations.
- √ A market where clear market signals encourage the efficient allocation of resources along the gas supply chain by providing information to market participants through flexible pricing arrangement, contracts of variable length, efficient gas trading mechanisms, and the scope for commercially negotiated settlements.

But countries often face difficulties satisfying these optimality conditions. Consider the condition requiring full competition on the production side. This condition cannot be satisfied for a large number of countries which have limited domestic sources of gas production. In those cases countries rely on gas imported via pipelines from other countries and/or on shipped liquefied natural gas (LNG)[3]. When a country is dependent on imports from a limited number of countries liberalization of the gas industry in the home country could conceivably leave home country gas consumers worse off, as a single buyer of gas in the importing country could conceivably exercise countervailing power against any market power exercised by gas sellers in the exporting country. Fragmenting the buying side of the market might enhance the market power of the gas sellers. Thus, there is strong need to have regulation at the global level through e.g. GATT/WTO commitments, and agreements among a group of major natural gas exporting and importing countries such as the Energy Charter Treaty.

I.1.1.1 World Trade Organization Provisions

The first question that needs to be answered is whether trade in natural gas is subject to 'General Agreement on Tariffs and Trade' (GATT) and the associated multilateral agreements on trade in goods such as the ‘Agreement on Subsidies and Countervailing Measures’ or subject to the GATS. Until recently, natural gas business has been dominated by vertically integrated suppliers directly engaged in the extraction, refining and distribution of oil products, leaving small margins for separate services activities. As such trade in natural gas was subject to GATT rules. But gradually, natural gas companies went through a process of downsizing and outsourcing, and activities that were previously performed in house were gradually and more frequently contracted to specialized service companies. Nowadays, energy-related activities are commonly regarded as included within the scope of energy services when they are performed by an independent services supplier and not by a vertically integrated manufacturer. The test for the GATS to apply would be that no title on the gas be passed to the contractor, even though his remuneration might be fixed as a percentage to the profit. On the other hand it has been maintained that the production of primary and secondary energy does not constitute services subject to the GATS, but results in goods, whose trade is subject to the GATT, as the production service is incorporated in the value of the good produced.

In the past energy goods have been treated for a long time as being outside the scope of reach of GATT rules, by relying on the general exception relating to the conservation of exhaustible natural resources and on the national security exception. The decline in oil prices and consequent reduction in the importance of scarcity considerations in the formulation of economic policies have led countries to treat energy goods like other commodities and therefore subject them to the GATT multilateral trade rules. On the other hand, cross-border trade in energy services encounters market access, national treatment, and other regulatory barriers and restrictive business practices by incumbent operators controlling transmission and distribution networks. In the case of gas transmission services Article VIII would require Members to ensure that the incumbent monopoly in a given market does not act in a manner inconsistent with most favoured nation (MFN) and with the Member’s specific commitments in that market, and that the monopoly supplier does not abuse its monopoly position in services markets outside the scope of its monopoly, which are the object of specific commitments under the GATS.[4] Furthermore, the GATT Article V specifies that there shall be freedom of transit through the territory of each contracting party that all charges and regulations shall be reasonable and cost based.

I.1.1.2 Energy Charter Treaty

The Energy Charter Treaty (ECT) was developed on the basis of the European Energy Charter of 1991[5]. It was signed in December 1994 and entered into legal force in April 1998. The fundamental aim of ECT is to strengthen the Rule of Law on energy issues, by creating a level playing field of rules to be observed by all participating governments, thus minimizing the risks associated with energy-related investments and trade. The roots of the Treaty date back to early 1990s, when the end of the Cold War offered an unprecedented opportunity to overcome the previous economic divisions on the European continent. The incentives for mutually beneficial cooperation between

East and West were especially clear in the energy sector. Russia and many of its neighbours were rich in energy resources but needed major investments to ensure their development, whilst the states of Western Europe had a strategic interest in diversifying their sources of energy supplies, thus reducing their potential dependence on other areas of the world. There was therefore a recognized need to ensure that a commonly accepted foundation was established for developing energy cooperation between the states of the Eurasian continent. On the basis of these considerations, the Energy Charter process was born.

The ECT provides the broadest multilateral framework of rules in existence under international law governing energy cooperation. It is a legally-binding multilateral instrument. It contains rules on the protection of foreign direct investment, rules on energy transit, rules applying GATT provisions to non-WTO Members in the energy sector, a mechanism for the settlement of disputes between governments and between governments and private investors, rules on transparency, and an obligation for governments to have and enforce competition laws.

I.1.1.3 EU Regulatory Framework

For several decades before 1980s, energy sector was not considered in the EU integration process except in terms of a limited-coordination of nuclear policy and coal restructuring and some measures aimed at improving the security of oil supply. Until the mid-1980s, the natural gas industry was subject to various government regulations and controls, which significantly affected all levels of the industry— extraction, production, import, transport, distribution and prices. The traditional paradigm dominated the gas industries and there was hardly any harmonization of the laws or rules in the sector across the Western European countries. In 1988 the European Commission published a review of the obstacles to the creation of a single market in energy in a Communication entitled "The Internal Energy Market: Commission Working Document". The Working Document led to a radical reform of the EU energy sector, and proposed that (a) exclusive transmission concessions should be checked to see how to facilitate the free movement of natural gas whilst maintaining a high level of security of supply, (b) transmission or distribution undertakings should be allowed direct access to the resources in question, and (c) the prospect of extending direct access to resources to large industrial consumers should be considered.

In 1994 the Hydrocarbons Licensing Directive 94/22/EC was adopted. The principle objectives of the Directive are to set up common rules to ensure that (i) procedures for granting authorizations to prospect or explore for and produce hydrocarbons are open to all entities that possess the necessary capabilities, (ii) authorizations are granted on the basis of objective, published criteria, and (iii) the conditions under which authorizations are granted are known in advance by all entities taking part in the procedure. Next, in 1988 the Gas Directive 98/30/EC was adopted. The aim of this directive has been to establish common rules for the transmission, distribution, supply and storage of natural gas. The directive requires accounting unbundling for vertically integrated network companies[6]. Integrated gas companies are required to keep internal accounts for their natural gas transmission, distribution, and storage activities as if they were separate businesses. The aim of this requirement is to ensure non-discrimination and fair tariffs to avoid cross-subsidization and the distortion of competition.

Member States implemented the 1998 Gas Directive at different speeds. Most Member States elected to go beyond the minimum requirements; a few however did not. To address the problems with the uneven implementation of the 1998 Gas Directive, a new Gas Directive, Directive 2003/55/EC, was adopted in 2003. The new regulatory framework has repealed the first legal framework on gas replacing it with a more detailed framework, and an enhanced role for national regulatory agencies (NRAs) in its implementation and further development. With the new Directive the EU is forcing the establishment of national regulatory authorities, which have as a minimum, the task of ensuring non-discrimination, effective competition and the efficient functioning of the market, as well as monitoring, the results of which are to be published in an annual report. The new Directive has two principal aims: first, to increase quantitative market opening and bring about full liberalization by 2007; second, to enhance qualitative regulation and bring about more uniformity and coordination of national regulation. The Directive stipulates legal separation for the transmission system operators (at the latest by July 1, 2004) as well as distribution system operators (at the latest by July 1, 2007), if they belong to vertically integrated undertakings. With the legal unbundling of the companies for the transport of natural gas and the sale of natural gas the EU is hoping to prevent discrimination strategies, cross-subsidies and distortion of competition. In this way the energy seller should have significantly easier access to the distribution networks.

The 2003 Gas Directive improved also on the rules of the previous Directive on third party access (TPA) to the transmission network. A major obstacle to the completion of the internal gas market has been the shortcomings of the regime for network access. Under the previous regime a choice was given to Member States between negotiated and regulated TPA. The results from the operation of the negotiated option proved unsatisfactory. The new Directive seeks to address this problem with its clear advocacy of regulated third party access. This provision is intended to promote network access to new market entrants more effectively than either the negotiated form of access or the weak form of regulatory access contained in the previous Directive. TPA to transmission and distribution networks is to be provided on the basis of published and regulated tariffs, and tariffs have to be cost reflective. For storage facilities access is to be either on a negotiated or regulated basis or both. For access to upstream pipeline networks the regime continues to be separated out to give Member States discretion over the arrangements adopted. Finally, exemptions from TPA may be granted for major new gas infrastructure investments such as international interconnectors, LNG, and storage facilities.

According to the 2003 Gas Directive, gas market is required to fully open up so that from 1 July 2004 all non-household gas customers are free to choose their energy suppliers, and household customers are to follow from 1 July 2007. Consequently, the legal monopolies remaining after the previous gas Directive should cease to exist and distortions of competition on energy-intensive goods markets should come to an end. There are also strengthened provisions on Public Service Obligations (PSOs) and a raft of consumer protection measures to support requirements for handling complaints and protection of household consumers against misleading sales practices and unfair contract terms.

The 2003 Gas Directive was later complemented by the Gas Regulation, Regulation (EC) No 1775/2005. It expanded on the several of the provisions in the Directive, and set rules on transmission of gas between Member States. The regulation introduces qualitative minimum requirements for access to transmission systems (network tariffs, third party access services, capacity allocation, transparency, balancing and trading of capacity rights). Community legislation is supplemented by other binding and non-binding instruments, such as Community guidelines (under the Gas Regulation), voluntary guidelines developed within ERGEG[7] and the Madrid Forum[8] and technical standards prepared by EASEE-gas[9,9b].

I.1.2 Electricity

Electricity is a non-storable commodity, which must be generated at the instant it is consumed, and some generation capacity must always be kept in hot and cold reserve form in order to be able to respond immediately to a sudden increase in demand or an unexpected failure of a plant. The quality of electricity measured by voltage magnitude, frequency, and continuity of supply must continually be maintained within tight operational limits. Furthermore, demand for electricity is not constant and demand fluctuates considerably by the time of day and season. The supply and demand, including the technical losses and illicit utilization, must be kept in an exact balance over the whole period of operation.

Supply chain linking the generation and customer services has four distinct vertical stages: (i) generation, (ii) transmission, (iii) distribution and (iv) retail and wholesaling. Electricity generation may be based on various fuel types, such as oil, natural gas, coal, nuclear power, hydro power, renewable fuels, wind and solar power. Main characteristics of the electricity generation sector are their capital intensity, stranded costs and long lead times. Different generating technologies exhibits different cost structures. The main components of the electricity generation cost are capital investments, fuel costs, and operating and maintenance costs. The first term is generally known as the “fixed costs”, while the others are “variable costs”. Electricity generation is generally regarded to exhibit increasing returns of scale at low levels of production and constant returns to scale otherwise, as such it is considered as potentially competitive. On the other hand transmission is the business of transferring electricity from generation side to customer side over the high voltage system. Transmission business also involves the commitment of a large number of generators dispersed at various locations in the grid in order to maintain the system voltages and frequency at nominal levels and to prevent system breakdown. Transmission is a natural monopoly, because competition in transmission would result in duplication of the existing transmission system which is practically not needed. Next consider the distribution system which is the part of the infrastructure where electricity service is carried out to customers at medium or low voltage levels. Like transmission system, it is considered to be a natural monopoly, since competition would similarly entail duplication of the existing set of the medium or low voltage system. Finally, supply of electricity is the activity of carrying electricity to the end-users. In principle, supply activity is carried out in two alternative forms; wholesale or retail which have rather different characteristics in terms of competition. Wholesale activity is based on full competition, while the retail activity is partially regulated by the regulatory authority. Retail activity includes connecting/disconnecting, metering, reading, billing, toll collecting, and marketing activities.

One of the basic results of welfare economics is that resources in the economy will be allocated efficiently as long as prices equal marginal costs in competitive markets. Extending this result to the electricity sector we note that under marginal cost pricing all plant types producing electricity can recover their costs from market based pricing, as long as plant mix and plant capacities are correct. Thus, electricity generation can be managed though competitive markets by developing new energy trading mechanisms such as energy pools, where prices will be set equal to their marginal costs.

Efficiency gains in generation cannot be shared with the customers if the transmission system suffers from inadequacy of transmission capacity. Sufficiency of transmission capacity and coordination between the generation and transmission systems is vital to ensure the integrity of the supply service. Considering the electric network as a set of final nodes (generators and consumers) and intermediary nodes (transformers), connected by lines, one can compute the optimal dispatch of the system. The analysis reveals that optimal solution can be achieved through nodal pricing, which is a system of marginal cost pricing, where the difference in prices at each node reflects costs arising because of congestion and losses in the transmission system. When resulting revenues under Nodal pricing do not cover the overall cost incurred by the operations of the system, the part of the cost not covered is to be collected through either by Ramsey Pricing or by two-part tariff.

I.1.2.1 Conditions for Successful Liberalization of Electricity Markets

The study of the experiences of liberalization in a large number of countries reveal that successful liberalization in the electricity sector requires a suitable market structure within which effective competition can be fostered. Generally, this involves restructuring the sector by unbundling vertically integrated activities and reducing their horizontal concentration. The aim of vertical unbundling is to separate the potentially competitive generation and supply activities from the transmission and distribution, which are mainly natural monopoly activities. The aim of horizontal separation is to create enough effective competition in generation and retail activities, where economies of scale favor competition. On the other hand, effective separation of generation and transmission activities is crucial for achieving competition in the wholesale electricity markets as this will help prevent anti-competitive behavior by incumbent generators and ensure non-discriminatory access to transmission system by all market participants. Similarly, unbundling the supply and distribution activities is important for an effective retail competition. Restructuring often involves horizontal splitting of incumbent generation companies or merging of retail companies to change market concentration to theoretically and empirically competitive levels. In order to facilitate competition in generation in the short run and encourage new entry in the long-term, it is important to prevent high levels of concentration in the existing markets.

Establishing wholesale and retail electricity markets is essential for liberalizing the sector. Wholesale market design needs to take account of various technical, economic, and institutional issues associated with pricing, contracts, scheduling, balancing, and system congestion, taking account of the specific conditions of the sector. Market participation and efficiency requires sufficient liquidity. Standardized contracts help liquidity, stability and facilitate investment to deliver adequate generation capacity. In the long run, new entry in generation and supply, and interconnections with other systems is expected to increase competition in the market.

Establishing an initially competitive market structure requires government initiative. Regulation can be very good at policing a competitive system, but it is difficult for regulators to engineer changes in market structure following liberalization. Maintaining competitive markets requires that the incentives for new entry are correct. The regulator needs to establish clear rules for the wholesale market and to minimize regulatory uncertainty. Where competitive and monopoly stages remain integrated, the regulator must ensure that there is real and non-discriminatory access to transmission and distribution systems for the generating companies and suppliers. Regulated third-party access (TPA) has proven the most effective and widely used approach to the provision of system access.

The main perceived effect of privatization is that the pursuit of profit by private owners will lead to efficiency improvement and cost saving. Many reforming countries have sold off public enterprises or allowed new private entry. An increase in sector-wide ownership diversity can also facilitate direct competition in the generation and supply activities and yardstick regulation of systems by comparative performance. However, privatization is not a prerequisite for liberalization. In theory, competition and incentive regulation can be applied to publicly owned enterprises. However, there is significant evidence that privatization does deliver benefits, especially when combined with effective restructuring, competition, and regulation.

I.1.2.2 World Trade Organization Provisions and Electricity Market Reform in European Union

The economic benefits of deeper integration of electricity markets among a group of countries could be substantial. First, cross-border power transfer for emergency support and peak demand would allow countries to lower expensive reserve margins. This would reduce investment needs and increase capacity utilization. Second, economies of scale, different load profiles, and complementary energy endowments could give rise to further gains from trade. Third, private investors would be willing to invest more in large markets. Fourth, regional power markets could facilitate domestic reforms in the countries under consideration, especially the introduction of competition. But achievement of deeper integration requires cooperation among countries. So far multilateral trade negotiations within the context of WTO have played a negligible role to achieve cooperation for deeper integration. Important impediments to cross-border trade in electricity and market integration arise from regulatory issues such as vertical integration, conditions of network access, and state-owned monopolies. These policy issues are not yet sufficiently addressed under the GATS framework. Since geography matters a lot in the electricity sector, deeper forms of integration can only be achieved between neighbours at the regional level. Cooperation among countries have been achieved at the regional level, in particular in the EU.

In 1985, the European electricity sector had a very stable market structure. In some countries, this took the form of large state-owned monopoly enterprises such as the Electricité de France (EdF) in France and the Central Electricity Generating Board (CEGB) in the United Kingdom (UK). In others, such as Sweden and Norway, there was a mixture state and municipal ownership, and in Germany and Spain, there was substantial private sector ownership, with some companies part private and part state owned. But across Europe, electricity companies had monopoly power supported by legal protection as in the UK, or government supported contracts between companies as in Germany. The companies were not subject to threat of entry, and international trade did not exist.

In 1988 the European Commission, in the context of the creation of the Single Market published a review of the main obstacles to the creation of a single market in energy. According to Communication entitled 'The Internal Energy Market: Commission Working Document' (COM (1988), 238 Final) the main obstacles to the creation of an internal market were as follows: (i) national monopolies in some member States in the import and export of electricity; (ii) in all Member States undertakings had been granted exclusive or special rights in connection with transmission and/or distribution of electricity at a national and/or local level; (iii) a statutory right of access to the electricity grids owned by others existed only in a few Member States; and (iv) the electricity distribution monopolies contributed towards the creation of captive markets.

Liberalization attempts in the EU started in late 1980's. In 1990 the Commission drew up the Price Transparency Directive 90/377/EEC and the Directive on the Transit of Electricity through Transmission Grids 90/547/EEC. Although the Member States supported the idea of liberalization and increasing competition in energy markets, there was much less agreement on the appropriate mechanism, the manner and timing of their introduction. Finally, an agreement was reached in 1996 on a timetable for liberalization and each member state was given a choice between the three alternatives for access. The agreement culminated in the European Parliament's Electricity Directive 90/92/EC. Thus, it took the Commission seven years of negotiations to convince the related parties of the need for liberalization and increased competition in the electricity sector.

The general aim of the Electricity Directive of 1996 is to establish common rules for the generation, transmission, and distribution of electricity. It sets out rules for the organization and functioning of the electricity sector, access to the market, criteria and procedures applicable to call for tender, the granting of authorization, and the operation of systems. But various problems emerged during the application of the Electricity Directive of 1996. In March 2001, the European Commission issued a Communication assessing the progress in the development of the internal market for electricity and the effects of the implementation of the 1996 Directive and proposed a series of amendments. It took a few more years to adopt the new Electricity Directive 2003/54/EC.

The 2003 Electricity Directive aims to achieve, by July 2007 at the latest: (i) unbundling of the transmission and distribution system operators from each other and from the rest of the system, (ii) free entry to generation sector, (iii) monitoring of supply competition, (iv) full market opening, (v) promotion of renewable sources, (vi) strengthening the role of the regulator, and (vii) a single competition based European market. Furthermore, the Directive was to be implemented by all member states no later than July 1, 2004. Member states are required to ensure that the system of TPA that they implement is based on published tariffs, is applicable to all customers, and is applied objectively and without discrimination among system users. It applies to both transmission and distribution. The Directive emphasizes legal unbundling. Regarding the regulatory authority, the Directive requires the member states to charge one or more competent bodies with the function of regulatory authorities, and sets out a minimum set of functions for the regulatory authority.

In addition to the electricity Directive of 2003 the Regulation (EC) No 1228/2003 on Conditions for Access to the System for Cross Border Exchanges in Electricity in the Internal Electricity Market was published in 2003. The Regulation is directed at the increasing cross border trade in electricity. The increase is to be achieved by the establishment of a compensatory mechanism for transit flows of electricity, the setting of harmonized principles on cross border transmission charges, and procedures for the allocation of available interconnection capacity and establishment of new interconnection capacities by Transmission System Operator in the event of system congestion problems[10].

I.1.3 Telecommunications

The telecommunications industry is at the forefront of the information age. Whereas wireline telephone communication was once the primary service of the industry, currently wireless communication services and cable and satellite program distributions make up an increasing share of the industry. Before the digital revolution the local network was a classic natural monopoly. Economies of scale argued for a single network provider. After the digital revolution, the advantages of a single provider rapidly decreased. If large increases in transmission capacity and switching are needed, new entrants do not need to duplicate these facilities in order to enter, provided that they can interconnect with the existing network. The regulatory issues are primarily those of ensuring that where competition is efficient or desirable, that it can happen, and where not, the natural monopoly facilities are properly regulated.

Since telecommunications is an inherently transnational technology, the development of telecommunications has required substantial cooperation and agreement between nation states at different levels, including cooperation for adherence to certain technical and operational standards. International cooperation has taken place within the context of International Telecommunications Union (ITU) and negotiations under the World Trade Organization (WTO). On the other hand regional cooperation is discussed within the framework of EU integration.

I.1.3.1 International Telecommunications Union

The ITU grew from cooperation between European states in the 1850s on the working of the telegraph system. It was concerned at first only with telegraphy, but over time it became involved with telephony and radio. The International Telegraph Union became the ITU in 1932, and ITU became a specialized agency of the United Nations system in 1947.

One of the major issues to be settled within ITU concerns the issue of how revenues for international traffic would be divided between participating states. The issue has been resolved by the 'International Accounting Rate System' and the principles of its operation are contained in Article 6 of ITU's International Telecommunications Regulations. The system works as follows. When an international call is made, the call is jointly carried by the telephone company in the country where the call originates (home country) and by the telephone company in the country where the call is terminated (foreign country). The collection rates are paid by consumers to the company in the home country where the call originates. However, a payment is also due to the telephone company in the foreign country where the call terminates. This payment, made by the telephone company of the home country is based on the 'accounting rate' that is negotiated between the two countries. Under the accounting rate system a particular country will have a different negotiated rate with every other country. If the call volume from the home country to foreign country balances out so that the incoming and outgoing minutes of calls to and from the foreign country are the same, then there is no payment due to either country. On the other hand if the minutes would not balance, then a settlement payment would have to be made from the country sending more calls to the other country. The settlement payment is calculated in general by multiplying the net difference in call volume by one-half of the accounting rate. Thus, imbalances between the number of incoming and outgoing calls were then settled by the originating carrier with the greater traffic agreeing to pay a settlement rate to the other carrier, and collection rates were impacted by the level of accounting rates negotiated between countries. This system worked quite well when the carriers were monopolies in each country and traffic volumes were comparatively low.

As US liberalized its telecommunications sector it became increasingly dissatisfied with the ITU accounting rates system. The deregulation of domestic system in the US did not help much with international tariffs, since US carriers had to negotiate with mainly monopoly public carriers in other countries. These monopoly carriers had an incentive to keep accounting rates high, thereby generating a trade surplus in telecommunications. There was no incentive for those carriers to lower prices and they could pass on their higher prices to US consumers. Since US citizens tend to make more calls than they receive, the accounting rates system began to produce large deficits for the US. Over recent years there has been significant pressure for the international rate system to be reformed. As a result of these developments the international accounting rate system is gradually disappearing in its current form to be replaced by a multitude of different arrangements reflecting the state of liberalization in Member States technological development, and the commercial positions of the respective parties.

I.1.3.2 World Trade Organization

The history of telecommunications has largely been a history of the ITU and the monopoly providers of telecommunications within states. Under the ITU system states and their monopolies coordinated on the development of telecommunications policy and regulation. But in 1994 this system took a dramatic turn, when telecommunications was brought into the trading regime of the Final Act of the Uruguay Round of trade negotiations. The shift from the ITU to the WTO is significant, because under GATS states have committed themselves to progressive liberalization of basic telecommunications[10b]. The Final Act contains the GATS, which contains an Annex on Telecommunications, an Annex on Negotiations on Basic Telecommunications, and a Decision of Ministers to establish a Negotiating Group on Basic Telecommunications (NGBT).

The Annex on Telecommunications establishes obligations for governments to ensure access to and use of public telecommunications transport networks and services. Once a country agrees to liberalize within the context of the WTO, the Annex requires that public telecommunications system be accessible to foreign service providers for domestic and international service provisioning. Governments must ensure that foreign suppliers have access to and use of private lease circuits, and that they can (i) purchase or lease and attach terminal or other equipment interfacing with public networks, (ii) interconnect private leased or owned circuits with public networks, or with circuits leased or owned by another service supplier, and (iii) use operating protocols of the service supplier’s choice, provided they do not disrupt the telecommunications transport networks and services to the public generally. The annex imposes obligations of transparency of conditions of access and use, including tariffs, terms and conditions, and specifications of technical interfaces with the public networks and services. Access should be non-discriminatory, which embraces both the most favoured nation (MFN) and national treatment (NT) principles.[11] Service providers should be permitted to attach terminal equipment to the public network; interconnect private circuits and utilize any operating protocols that do not interfere with the availability of the public network. Members may only impose conditions that are necessary to safeguard the public service responsibilities of the suppliers of public networks, to protect the integrity of the network, or to comply with a member's commitments in its Schedule.

At the conclusion of the Uruguay Round ministers adopted a decision to enter into further voluntary negotiations on the liberalization of trade in the provision of basic telecommunication network and services.[12] These negotiations closed successfully on 15 February 1997. The agreement, commonly referred to as the 'Basic Agreement on Telecommunications', consist of a series of commitments and lists of exemptions from Article II concerning basic telecommunications by 69 Members. The 'Basic Agreement' has been seen as the most significant development in the global liberalization of the telecommunications market. The commitments, constituting the Fourth Protocol, encompassed market access, foreign direct investment, and, for the majority of Members, adherence to a set of pro-competitive regulatory principles.

One unique feature of the Fourth Protocol was the adoption of a 'Reference Paper' as an additional commitment incorporated into the Schedules. The Reference Paper comprises a set of definitions and principles on the regulatory framework governing the provision of basic telecommunications. The principles address particular objectives for the establishment of a pro-competitive regulatory regime, rather than the mechanisms or processes for their achievement. As such, the Reference Paper represents an important body of international legal principles for the telecommunications sector, of considerably greater significance than the ITU constitutional principles. However, unlike the Annex on Telecommunications, the Reference Paper attains legal status only to the extent that WTO members have incorporated it in their schedules of commitments under the GATS. For those countries the principles are enforceable before the WTO Dispute Settlement Body.

Recognizing that the right to interconnect is the most important competition safeguard in a network industry, the Reference Paper creates a requirement for measures to permit interconnection of competing suppliers of public telecommunications transport networks and services at any technically feasible point in the network, under non-discriminatory terms and conditions, in a timely fashion, and on terms, conditions and cost-oriented rates that are transparent, reasonable, having regard to economic feasibility, and sufficiently unbundled so that the supplier need not pay for network components or facilities that it does not require for service to be provided. The Reference Paper requires the public availability of information regarding licensing criteria, the processing periods, and terms and conditions as well as reasons for denial of a license. Furthermore, the Reference Paper requires the establishment of an 'Independent Regulator', independent in the sense that the regulator must be separate from and not accountable to, any supplier of basic telecommunications services and that its procedures and decisions shall be impartial with respect to all market participants. In addition the Reference Paper requires that a supplier who, alone or with others, constitutes a 'major supplier' must be subject to 'appropriate measures' to prevent anti-competitive practices, whether current or future.

Whilst the Reference Paper addresses 'ends' rather than 'means', its influence has been considerable at both a national and international level. First, as part of the Schedules of Commitments, the Reference Paper represents a Member State commitment to which foreign service providers may refer. Second, over time national legislators are likely to reflect and incorporate such principles into domestic law. Third, the Reference Paper represents a baseline from which any future multilateral negotiations will depart.

I.1.3.3 EU Regulatory Framework

Since its inception in the mid-eighties, EU telecommunications policy has focused on two main objectives: economic efficiency and guarantee of universal service. In 1987 the Commission issued a Green Paper which set out a Community-wide program for action in the telecommunications sector in pursuit of these objectives. The achievement of these aims has been pursued through the application of a set of complementary principles: market liberalization and harmonization of conditions for a common regulatory framework.

Following the publication of the Green Paper the Commission has adopted a series of Directives in order to insure the liberalization of the sector. As recently as 2002 the EU has introduced the Framework, Authorization, Access, and Universal Service Directives and Local Loop Unbundling Regulation, the purpose of which is to provide a common regulatory framework and competition principles and practices for the electronic communications sector in the EU comprising telecommunications, media and information technology services.

The Framework Directive (2002/21/EC) emphasizes the independence of the national regulatory authority (NRA) which has to be guaranteed by member states, the right of appeal against NRA decisions, mechanisms for ex-ante regulation to be imposed on significant market power[13], market definition and market analysis procedures, and NRA's duties to resolve disputes within four months when negotiations on access and interconnections fail. On the other hand the Authorization Directive (2002/20/EC) abolishes individual licensing and moves to a system of general authorization according to which, older licensing schemes for different telecommunications services, i.e. public voice and data providers, and facilities-based and resale providers have been removed. According to the Authorization Directive the member states may at most require a notification from the undertaking. Other than the notification no permissions or other administrative barriers to entry can be imposed, and time limits are to be observed by the administration to finalize the applications.

The access to the network elements and associated facilities is regulated by the Access Directive (2002/19/EC) and the Unbundled Access to the Local Loop Regulation (No. 2887/2000). The Access Directive establishes the rights and obligations of operators regarding interconnections and/or access, and defines the objectives of and the procedures for the NRAs on mandatory access scheme. According to the Directive, private negotiations between undertakings for interconnections cannot be restricted by Member States, operators except for those having significant market power (SMP) cannot be obliged to discriminate between different undertakings for equivalent service, operators are obliged to negotiate interconnection when others ask for it, and NRAs can impose, when necessary, obligations on an operator to facilitate interconnections. The obligations may be imposed only on objective, transparent, proportionate and non-discriminatory basis. Finally, NRAs can impose additional measures related to access on operators with SMP by the permission of the EU Commission. Likewise, the local loop unbundling regulation aims at facilitating access to the least competitive segments of the liberalized telecommunications market. It is recognized that the new entry to the fixed line infrastructure is very difficult and that the existing infrastructures have been financed by means of state-controlled monopolies, using public funds. In the framework of Regulation No. 2887/2000, notified operators are obliged to meet reasonable requests for unbundled access to the local loop under transparent, fair and non-discriminatory conditions. According to the regulation, the NRAs have the responsibilities to identify 'notified operators' (NO) as those that have significant market power in fixed public telephone networks, to ask from NOs to publish a reference offer for unbundled access to their local loops and related facilities, and to supervise NOs with regard to a cost based pricing and a transparent, fair and nondiscriminatory unbundled access provision for other operators to the local loop.

Since, according to the EU *acquis*, only firms with SMP can be regulated, the same principle applies in the case of telecommunications services. National regulatory authorities are first supposed to define the relevant markets. In each relevant market, firms with SMP are to be determined. In case of SMP, price regulation needs to be implemented by the NRA. There are mainly two types of price regulation, namely price cap regulation and the rate of return (or cost plus) regulation. In case of price cap regulation, the regulator determines a 'reasonable price' for the base year and then for the following years follows a CPI inflation – x percent adjustment on the base years price. In contrast, the rate of return regulation has been found to have certain drawbacks. First, the NRAs are cautious about the cost figures reported by the firms, and secondly it is emphasized that for the firm there is little incentive to improve productivity and cut costs. The trend in the EU has been towards implementing price regulation based on long run incremental cost approach which reflects current costs of the facility used and creates incentives for incumbents to invest.

Universal Service is defined in the 2002 *acquis* as the provision of a defined minimum set of services to all end-users at affordable prices. The EU sees universal service as an obligation on its member states. However, care is taken not to distort the market mechanism while safeguarding the public interest. Where NRAs consider that the universal service may represent an unfair burden on undertakings designated to provide universal service, the net costs of its provision should be calculated, and a mechanism should be introduced in order to compensate that undertaking under transparent conditions from public funds and/or to share the net cost of universal service obligations between providers of communications services.

I.2 Liberalization of banking services

In a large number of low and middle-income countries entry into the banking sector was for a long time tightly controlled by regulatory boards that limited the ability of providers to offer a full range of banking services and also limit market access. In those countries banks were the main source of domestic financing for governments. Many developing countries had high reserve, liquidity and portfolio requirements that necessitated significant holdings of cash and government bonds. Banks were used to finance government expenditures directly, and also for directing credit to preferred ends, which often included political supporters of the government circles. Lately, objectives such as boosting economic development, preventing and mitigating costly crises, and protecting consumers became important policy goals, and liberalization of banking services is considered an essential tool to achieve these objectives. It is emphasized that an efficient and well-regulated banking sector leads to the efficient transformation of savings to investment, ensuring that resources are deployed wherever they have the highest returns; and facilitates better risk-sharing in the economy. It enhances efficient capital reallocation, bringing tremendous benefits to consumers.

A crucial impediment to the efficient functioning of the banking system is asymmetric information, a situation in which one party to a financial contract has much less accurate information than the other party, and asymmetric information leads to adverse selection and moral hazard. As a result governments in order to ensure the safety and soundness of the banking system establish regulations. Supervisors monitor banks to see that they are complying with these regulations and not taking excessive risk. Banking regulations can be analyzed under seven headings: (i) restrictions on banks, and on links to commerce, (ii) entry restrictions and exit rules, (iii) capital requirements, (iv) supervisory powers, (v) safety net support, (vi) market monitoring, and (vii) government ownership. In general each country has different set of regulations and supervisory practices in place, and they often have little interest in each other's regulatory regimes or have little confidence in its quality. If each country has different regulations in place and does not recognize qualifications in a foreign bank's home country, then the national qualification costs become cumulative costs, as banks intending to establish abroad will have to incur costs to comply with the qualification criteria of each country. We now turn to considerations how these qualification costs could be decreased if countries would accept some international norms developed by the Basel Committee and also during multilateral negotiations under WTO. Thereafter we consider the EU rules and regulations.

I.2.1 Global Regulations

The Basel Committee, established at the end of 1974 by the central-bank Governors of the Group of Ten countries, formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them. In 1988, the Committee introduced a capital measurement system commonly referred to as the Basel Capital Accord (Basel I). Basel I primarily focused on credit risk, the risk of loss due to a debtor's non-payment of a loan or other line of credit, and required banks with international presence to hold capital equal to 8 percent of the risk-weighted assets. Although Basel I was intended for internationally active banks, it quickly became a de facto standard around the world. Developing country regulators, who were actively attempting to move away from direct controls to a more modern system of prudential regulation, began to follow the evident best practice in industrial countries embodied in Basel I. In 1996 an important amendment to the framework took place, when an additional capital charge was introduced to cover market risk in banks' trading books.[14] With the 1997 Amendment to the Capital Accord banks were required to measure and apply capital charges in respect of their market risks in addition to their credit risks, and market risk was defined as the risk of losses in on and off balance sheet positions arising from movements in market prices. The risks subject to this requirement are the risks pertaining to interest rate related instruments and equities in the trading book, and foreign exchange risk and commodities risk throughout the bank.

In the wake of Mexican crisis of 1994 it was understood that capital requirements alone were not sufficient to ensure safe and sound banking. As a result the Basel Committee issued its 'Core Principles for Bank Supervision' in 1997. Over time the Basel Core Principles (BCP) became accepted as best practice for bank supervision around the world. The core principles which are 25 in total are grouped under following headings: (i) preconditions for effective banking supervision (principle 1), (ii) licensing and structure (2-5), (iii) prudential regulations and requirements (6-15), (iv) methods of on-going supervision (16-20), (v) information requirements (21), (vi) formal powers of supervisors (22), and (vii) cross-border banking (23-25). The principles regarded as minimum requirements are to be supplemented where necessary by other measures, and should be applied in respect to the supervision of all banks. The core principles propose minimum standards for licensing, ownership transfer and liquidation. They also suggest prudential rules and requirements, supervision methods, and information and disclosure requirements for both domestic and cross-border activities.

To facilitate implementation and assessment, the Basel Committee in October 1999 developed the "Core Principles Methodology". In June 1999, the

Committee issued a proposal for a revised Capital Adequacy Framework. The proposed capital framework consists of three pillars: minimum capital requirements, supervisory review of an institution's internal assessment process, and effective use of disclosure to strengthen market discipline as a complement to supervisory efforts. The crises in East Asia led to the creation in May 1999 by the IMF and the World Bank of the Financial Sector Assessment Program (FSAP), whose goal is to assess the primary stability and developmental issues in countries' financial sectors. Virtually all FSAPs have included an assessment of countries' compliance with the BCP.[15]

Notwithstanding the consensus among regulators, shortly after its completion Basel I began to be criticized because of its narrow focus. As a result the Basel Committee devoted several years to revising the Capital Accord, and announced Basel II in June 2004, for implementation by the end of 2006 in G-10 countries. Basel II consists of three pillars: (i) minimum capital requirements, (ii) supervisory review process, and (iii) market discipline.

Basel II, Pillar 2 is very largely encompassed by the Basel Core Principles, and hence there is very little new in Pillar 2. On the other hand Basel II, Pillar 3 focuses largely on the appropriate disclosure of bank capital and capital adequacy. While Basel I and BCP's did not make specific reference to what banks must disclose to the public, the focus of Pillar 3 is on reporting rather than disclosure to the market. It is thus new. But it is in Pillar 1 where most of the innovation of Basel II lies. In Basel II the minimum capital to risk-weighted asset requirement of 8 percent remains unchanged. The numerator that defines the acceptable types of regulatory capital is largely unchanged from Basel I. The core modifications in Basel II are to the denominator that defines risk-weighted assets. The credit risk measurement methods are more elaborate than those in Basel I. The new framework proposes for the first time a measure for operational risk, while the market risk measure remains unchanged. Basel II provides different approaches that can be used to obtain a risk weighting of assets, with the key difference being that in the simpler approaches, risk weights are taken from those of export credit agencies or rating agencies such as of Standard & Poor, whereas in the more sophisticated variants, banks' internal models can be used to derive default probabilities and even the loss given default. Importantly, a large part of the Basel II documentation is devoted to the use of banks' internal models.[16]

In addition to the international norms developed by the Basel Committee we have also the rules developed under WTO. In this context the GATS contains certain obligations such as the MFN principle, national treatment and market access.[17] But, like any other trade agreement, the GATS contains exception provisions, which allow WTO Members to depart from their obligations or commitments under the agreement in very specific circumstances. One of those exception-type provisions is the so-called "prudential carve-out", which allows WTO Members to take measures for prudential reasons, including for the protection of investors, depositors, and for preserving the integrity and stability of the financial system. Under the GATS, prudential regulations is dealt with by paragraph 2 of the Annex on Financial Services, and non-prudential regulation to pursue various public policy objectives other than that falling under trade restrictions concerning market access or national treatment by Article VI of GATS. Trade restrictions concerning market access or national treatment is dealt with by Articles XVI and XVII of GATS. Thus, GATS allows Members to take measures for prudential reasons.

I.2.2 Regulatory Framework in the European Union

In the EU progress in harmonization came in 1973 with the adoption the directive «The Abolition of Restrictions on Freedom of Establishment and Freedom to Provide Services for self-employed Activities of Banks and other Financial Institutions». It contributed to establishing a single banking market. It required member countries to comply with the «national treatment» principle. However, despite this effort toward harmonization, the existence of capital controls and a lack of coordination among the different bank regulatory and supervisory authorities meant that banks operating in different member countries remained subject to different rules. This situation led to further attempts to achieve greater harmonization of bank regulations and supervisory practices among member countries. In 1997 the First Banking Directive 77/780/EEC was adopted. Essentially, this directive set the rules for expansion across national boundaries within the EC by adopting the concept of "host country rule". Under host country rule, expansion is possible. However, a foreign bank or branch is required to gain permission from the supervisory authorities in the host country before they are allowed to operate in the host nation. According to the First Banking Directive, banks and branches were typically regulated by each host country's regulatory agency.

The cornerstone of the single market program is the Second Banking Directive (SBD), which was adopted in 1989 by Council Directive 89/646/EEC. The SBD has three major components. First, it defined exactly what is meant by "banking". The banking activities permitted in the EU cover all major commercial and investment banking activities, implicating the endorsement of universal banking. Thus, according to the SBD credit institutions can engage besides the traditional commercial banking activities in all forms of transactions in securities, including transactions for their own account or for the account of customers in all types of security, participation in share issues, and portfolio management and advice. The second component of the directive is the principle of home-country control, or mutual recognition. According to this principle each country acknowledges the regulation of its partners and accepts service provision by foreign institutions as if they were domestic entities. Hence, banks are regulated by, and conform to, the regulation and legislation of their home country. If a bank does business in another EU nation, the regulatory authorities of the host nation recognize the primacy of the home nation. Finally, the third component of the SBD is the concept of a "single passport". Mutual recognition of the single banking "license" eliminates the need for EU banks to get a local banking charter from the host country for branches and/or bank products that are permitted by their home country bank regulations. A bank licensed to do business in any EU nation is allowed to do business in any other EU nation on whatever basis it considers most advantageous. The host nation is not allowed to impose any barriers to such action.

To ensure that the single passport does not lead to a situation in which the regulations and supervisory practices in a member country are so lax as to undermine the safety and soundness of the entire banking system in the EU, the SBD also limits the scope for regulatory competition among countries. Therefore, the SBD introduces essential supervisory requirements related to sound administrative and accounting procedures, the initial capital necessary for authorization and the execution of activities, and the supervision of holdings of banks in sectors outside the banking business. Finally, concerning the banks' holdings in non banking institutions we note that the SBD introduces two limits. First, a credit institution may not have a qualifying holding exceeding an amount of 15 percent of its own funds in such an undertaking. Second, the amount of all holdings in such undertakings may not exceed 60 percent of the own funds of the credit institution.

Because of the crucial role of capital in banking, the EU promulgated a series of directives intended to ensure that all banks in the EU had the same capital standards. The Own Funds Directive (89/299/EEC) harmonized the definitions of own funds for all credit institutions in the EU to ensure the comparability of prudential ratios of EU banking organizations, and the Solvency Ratio Directive (89/647/EEC) harmonizing minimum solvency requirements for credit institutions in the EU addressed the issues related to credit risk. The Directive on the capital adequacy of investment firms and credit institutions (93/6/EEC), called the Capital Adequacy Directive (CAD), sets out the minimum capital requirements for credit institutions and investment firms for the market and other risks associated with their trading activities. The CAD directive was amended by directive 98/31/EEC (CAD2), and lately by the Capital Requirements Directive, comprising Directive 2006/48/EC and Directive 2006/49/EC. The latter Directive translates Basel II into EU legislation and applies Basel-type provisions to investment firms and domestic credit institutions as well as to international banks. Unlike Basel II, which addresses internationally active banks, CAD 3 will be applied to all credit institutions in the EU. The directive will take effect in 2007, with the most sophisticated approaches being available from 2008.

The EU recognizing that an unacceptable concentration of risk can occur if a bank has what is deemed to be an excessive degree of exposure with a client or group of connected clients, has accepted the Directive on Monitoring and Controlling Large Exposures of Credit Institutions (92/121/EEC). This Directive regulates the supervision of large exposures of credit institutions, sets limits on exposures of credit institutions, and sets limits on exposures as a large percentage of reserve funds. On the other hand the EU issued with the Council Directive 94/19/EC a Deposit Guarantee Scheme Directive to be effective on July 1, 1995. The directive, designed to increase the confidence and stability of the financial system, made it compulsory for every EU member state to establish a deposit insurance fund, and for credit institutions to join this insurance plan. On the other hand the Council Directive on the supervision of credit institutions on a consolidated basis (92/30/EEC) provided a framework for the supervision of the consolidated financial situation of a credit institution the parent undertaking of which is a financial holding company. In addition, the Council Directive on the annual accounts and consolidated accounts of banks and other financial institutions (86/635/EEC) provided special accounting rules for the financial sector. It described the standardized form of balance sheet and profit-and-loss accounting, as well as rules for the valuation of certain assets. Lately, The Directive 2000/12/EC relating to the taking up and pursuit of business of credit institutions consolidated the various Directives mentioned above with the aim of compiling them under a single publication. As a result of these development the single market in banking seemed to have been achieved at the end of 20th century.

I.3. Maritime freight transportation

Maritime transport services consist of three types of activities: (i) international maritime transport, that is, the actual transportation service performed once the commodity is on board of a ship in a country until the moment when the vessel reaches the destination port of a different state; (ii) maritime auxiliary services, that is, any activities related to cargo manipulation in ports and on ships; and (iii) port services, that is, activities related solely to ship management in ports (See Fink et al., 2002).

Due to differences in commodity types as well as technological improvements in the shipping industry, international maritime freight transport has developed specialized branches. For instance, a clear distinction must be drawn between liner shipping and bulk shipping. Liner shipping including container ships is regular shipping with set schedules in different harbours published in advance. The capital-intensive character of liner shipping, particularly container shipping, has led to a substantial degree of concentration. On the other hand, non-liner shipping carrying unpacked dry carriages or liquid cargoes is performed irregularly and is provided on a demand basis predominantly by specialised bulk carriers. Compared to liner shipping there is less concentration in bulk shipping, and there are substantial number of small owners with fleets of one or two vessels. While non-liner tankers and bulk carriers dominate in terms of trade volume, liner vessels are far more significant in value terms since they tend to carry relatively high-value and low-volume cargoes.

A principle organizational feature of the liner sector is the ability of operators to enter into co-operative arrangements and agreements with the organization of "conferences". Closed conferences not only set freight rates, which apply to all members, but also allocate cargo quotas and restrict membership, while open conferences merely set the freight rates on a specific route. Conferences usually cause increases in shipping rates and establish market power for their members, thereby restricting the entry of newcomers and delaying improvement in the quality of shipping services, and the prevalence of conferences flows directly from the exemption they enjoy under the antitrust laws of the US, EU and many other countries. On the other hand the bulk traffic is organized as a spot market, and contracts are allocated on an extremely competitive basis. Hence, bulk shipping services and related freight rates respond to market developments and to supply and demand pressures.

Turning to consideration of maritime auxiliary and port services, we note that seaports offer many different services. Seaport activities are divided into (i) infrastructure, (ii) services provided by ports which require the use of the infrastructure, and (iii) coordination between different activities performed at ports. Infrastructure consists of the infrastructure within ports (berths, quays, docks and storage yards) and the superstructure (sheds, fuel tanks, office buildings, cranes, van carriers, trastainers). Besides the provision of basic infrastructure for the transfer of goods between sea and land, ports provide numerous services, such as pilotage, towing, tying, cargo handling, freezing, administrative paperwork, permits, cleaning, refuse collection and repair facilities to ships. Since there are many different activities being performed simultaneously within the limited space of port areas, there is a need for an agent to act as coordinator to ensure the proper use of common facilities, and to oversee safety of port facilities. In most seaports, these functions are performed by the port authority, which are usually public, although in some cases private, organizations.

There are mainly three organizational modes for seaports. Under the so-called 'landlord ports' system, the port authority owns and manages port infrastructure, and private firms provide the rest of port and maritime auxiliary services. Private firms are able to own superstructures and operate assets pertaining to infrastructure by concession or licensing. Under a 'tool ports' system, the port authority owns both infrastructure and superstructure, but private firms provide services by renting port assets through concessions or licenses. Finally, under the 'service ports' regime, the port authority owns assets and supplies services by directly hiring employees.

I.3.1 International Regulations

The shipping industry is controlled by a web of international regulations and practices, which can be classified under two broad headings: (i) regulations related to commercial operations and practices, and (ii) regulations related to rights and obligations of states and to safety and environmental regulations.

Regulations related to commercial operations and practices include shipping-specific economic policy regulations, ship registration conditions, cargo reservation/cargo sharing provisions, cabotage laws, cargo liability regimes, national security measures, competition legislation, and seaport industry. These regulations reflect a more pragmatic rationale, aimed at giving effect to government policies, the achievement of economic or national objectives, and ensuring national participation or simply regulating commercial activities. While some regulations (such as competition or antitrust laws) are intended to free up the market, others distort or interfere with the market to some degree.

In the case of liner shipping, the basic regulatory framework among OECD countries consists of "The Code of Liberalization of Current Invisible Operations" (the Code) and "The Common Shipping Principles". Under the Code, members are obliged to eliminate restrictions on current invisible transactions and transfers relating to maritime transport operations such as harbor services, repair, and chartering. On the other hand "The Common Shipping Principles", adopted by the Council of OECD in 1987, lays down a common approach to international shipping policy and practices among OECD members based on the following principles: (i) the maintenance of open trades and free competitive access to international shipping operations, (ii) coordinated response to external pressure, based on full consultations among member countries, (iii) the role and recognition of governmental involvement by member countries to preserve free competitive access and the provision of choice to the shippers, and (iv) a common approach to application of competition policy to the liner shipping sector.

An important category of barriers applied to international maritime transport has been the various cargo reservation schemes. To counteract the anti-competitive actions of liner conferences at the multilateral level, the United Nations Convention on a Code of Conduct for Liner Conferences was adopted in 1974. The so-called UN Liner Code, applies only to liner conferences in trades between contracting states, and embraces a self-regulatory philosophy for "closed" conference shipping operations. The Liner Code is best known for its cargo sharing formula of 40:40:20, which suggests that cargo between member countries be divided, with 40 percent of cargo being carried by vessels of the country of origin, 40 percent by vessels of the country of destination and 20 percent by cross-trading vessels. It should be noted that the 20 percent figure, and therefore the "40:40" is recommended only.

In an effort to reserve the largest possible share of the country's seaborne trade, foreign firms are sometimes restricted from entering, or operating in, the domestic market. Ships engaged in cabotage, referring to transportation of commodities between ports of the same country, have been required to be manned by the country's own citizens, either wholly or majority owned by domestic nationals, built at domestic shipyards, or registered under the national flag. In return, owners operating ships on cabotage routes have not had to compete with foreign flag vessels.

Finally, it should be noted that negotiations on maritime transport services at the WTO aimed to improve commitments in international shipping, auxiliary services and access to and use of port facilities through elimination of restrictions within a fixed time scale. Although negotiations were scheduled to end long time ago, little progress has been achieved until now. Participants failed to agree on a package of commitments. Lately, the talks have resumed. As of 2007, some commitments exist in certain countries' schedules covering the three main areas of the maritime services.

The regulations on safety and environmental protection are generally based on U.N. conventions such as the UN Convention of the Law of the Sea of 1982 (UNCLOS), and various IMO conventions such as the 'International Convention for the Safety of Life at Sea' (SOLAS), 'International Convention for the Prevention of Pollution from Ships' (MARPOL), 'International Convention on Load Lines', and the 'International Convention on Standards of Training, Certification and Watchkeeping for Seafarers'.

On the other hand the 'Paris Memorandum of Understanding (MOU) on Port State Control', adopted in 1982, aims at eliminating the operation of substandard ships through a harmonized system of port state control. Ships are selected for inspection according to the Paris MOU targeting system. Only internationally accepted conventions are enforced during port state control inspections. When serious deficiencies are found, the ship is detained. The captain is instructed to rectify the deficiencies before departure. On the other hand, flag states which are not a party to conventions receive no more favourable treatment. The results of each inspection are recorded in the central database, which is located in Saint Malo, France. Their periodically updated black-grey-white lists, which show the degree of riskiness of individual ships from different flag states, became one of the major indicators of safeness and environment-friendliness of national shipping fleets within the last decade.

Because of the unique character of seafaring, most maritime countries have special laws and regulations on seafarers. On the other hand, the ILO has adopted over 60 maritime labor standards during the past 87 years. The standards adopted specifically on seafarers cover a multitude of questions including minimum age of entry to employment, recruitment and replacement, medical examination, articles of agreement, repatriation, holidays with pay, social security, hours of work and rest periods, crew accommodation, identity documents, occupational safety and health, welfare at sea and in ports, continuity of employment, vocational training and certificates of competency. Among the ILO conventions, one of the most important international labor agreements is ILO Convention N. 147. According to this Convention, board ships must be similar to those required by ILO standards regarding safety and health, social security, and living and working conditions of seafarers. Additionally, ILO Convention 180, adopted in 1996, aims to promote the health and safety of workers, improve maritime safety and protect the marine environment. The Convention establishes limits on seafarers' hours of work or rest on board ship, requiring a maximum of 14 hours work per day and 72 hours per week for seafarers on board ship, with minimum rest periods of 10 hours daily and 77 hours weekly.

I.3.2 EU Rules and Regulations

EU maritime transport legislation aims to apply the EC Treaty's principle of free movement of services to the EU's sea transport industry and its compliance with competition rules. Thus, it aims to improve the functioning of the internal market in maritime services by promoting safe, efficient, environmentally sound and user-friendly maritime transport services. The maritime transport acquis relates to market liberalisation, technical and safety standards, security, social standards, and state aid control in the context of the internal maritime transport market.

The main international rules that regulate commercial operations and practices, and safety at sea have been transposed into the Community law, ensuring that they have legal force and uniform application throughout the Member States. In this context we note that almost all EU-15 Member States subscribe to OECD's "Code of Liberalization of Current Invisible Operations" and "Common Shipping Principles". Regarding the United Nations Convention on a Code of Conduct for Liner Conferences we note that the Community is not a party to the Code, since the Code by providing for the allotment of freight on the basis of national shares was held to be contrary to the Treaty of Rome. With the adoption of Regulation (EC) No 1419/2006 shipping conferences will become unlawful on trades to/from ports of the Community at the end of a transitional period expiring on 18 October 2008. Furthermore, we note that the EU countries have ratified the UN Convention on the Law of the Sea (UNCLOS), and they have joined the 1973 MARPOL Convention, amended in 1978, the 1974 SOLAS Convention, and the LOAD LINES conventions. The EU-15 countries have also subscribed to "Paris Memorandum of Understanding on Port State Control", "International Convention on Standards of Training, Certification and Watchkeeping for Seafarers", and the ILO conventions including Convention N.147 and Convention 180.

When considering the EU rules and regulations on maritime transport services we note that real progress toward the realization of a common maritime transport services market free of restrictions was achieved in the EU during 1980s and 1990s. The 1986 maritime package consisting of a bundle of four EC Regulations enabled the freedom to provide services to the maritime transport sector. The four regulations (Council Regulation (EEC) No 4055/86, No 4056/86, No 4057/86, and 4058/86) are the basic regulations related to commercial operations and practices in the EU. In addition the Council Regulation (EEC) No 3577/92 regulates cabotage. According to the Regulation freedom to operate between two ports in the same Member State is offered to all Community shipowners, but not to third country shipowners.

It is noteworthy that the Commission has taken steps regarding port policy as well. In 2001, the Commission adopted the Communication "Reinforcing Quality Service in Sea Ports: A Key for European Transport". The cornerstone of this Communication was a proposal for a directive concerning market access to port services the principles and objectives of which were confirmed by the 'White Paper on Transport'. After almost three years of inter-institutional legislative process, at the end of the Conciliation procedure, the European Parliament rejected the compromise text. The Commission, believing it necessary in the interests of operators, authorities and consumers to introduce specific and clear rules on access to the port services market, decided to bring forward a new proposal. The objective of the proposal is to ensure freedom to provide port services or carry out "self-handling" at sea ports for EU providers of port services, subject to certain objective and relevant constraints such as space or capacity available at the ports; the development policy of the port; maritime traffic security or safety requirements at certain ports; protection of the environment; and "public service requirements".

Turning to EU regulations on safety at sea we note that Council Directive 95/21/EC, passed in June, 1995, aims to improve maritime safety in Community waters by banning substandard shipping. On the other hand Council Directive 93/75, signed on September 13, 1993, establishes minimum requirements for vessels bound for or leaving Community ports and carrying dangerous or polluting goods. Regarding the regulations on environment we note that Council Regulation (EC) No 2978/94 of November 1994 governs the implementation of IMO Resolution A.747(18) on the application of tonnage measurement of ballast spaces in segregated ballast oil tankers, and Regulation (EC) No 417/2002 aims to reduce the risk of accidental oil pollution in European waters by speeding up the phasing-in of double hulls. In addition the Directive 2000/59/EC on port reception facilities for ship-generated waste and cargo residues seeks to reduce the discharges from ships using ports in the Community of ship-generated waste and cargo residues into the sea especially illegal discharges.

I.4. Liberalization of other services in the EU

In the EU network industries, financial intermediation services and transport services were regulated, as discussed above, by specific directives of the EU. But what about services such as accounting, legal, engineering, tourism and wholesale trade services?

I.4.1 The 2004 Commission Proposal

The first proposal of Services Directive, covering accounting, legal, engineering, tourism and wholesale trade services, was presented by European Commission in January of 2004[18]. It is also known as "Bolkestein Directive". This was a so-called framework or "horizontal" proposal, which would establish a general legal framework applicable in principle to all services (subject to some exceptions). The proposal summary states that "it is part of the process of economic reform launched by the Lisbon European Council with a view to making the EU the most competitive and dynamic knowledge-based economy in the world by 2010. Achieving this goal means that the establishment of a genuine internal market in services is indispensable." Furthermore it says that "the objective of the proposal …. is to provide a legal framework that will eliminate the obstacles to the freedom of establishment for service providers and the free movement of services between the Member States, …"[19] The proposal identifies two specific types of situations where obstacles to trade in services are significant. First, "when a service provider from one EU country wishes to establish himself in another EU state in order to provide his services". Second, "when a service provider wishes to provide a service from his Member State of origin into another Member State, particularly by moving to the other Member State on a temporary basis." Thus, the Directive proposal provided a legal framework to eliminate obstacles to freedom of establishment of service providers and to free movement of services. It gave the providers and recipients of services a legal framework that allowed them to exercise these important freedoms.

There were three major categories of instruments proposed to achieve a genuine internal market for services.

First, in order to promote freedom of establishment the proposal called for administrative simplification measures, particularly involving the establishment of "single points of contact".[20] Moreover, it laid down certain principles for authorization schemes, in particular relating to the procedures for granting of authorizations. It included an obligation to assess the compatibility of certain other legal requirements, provided that the principles of non-discrimination, necessity and proportionality were respected. Complex, lengthy and costly authorization and licensing procedures was therefore expected to disappear mainly due to restrictions on the number of documents required and the introduction of electronic procedures.

Second, in order to eliminate the obstacles to the free movement of services, the proposal called for country of origin (*CoO*) principle, with certain derogations. According to this principle a service provider is subject only to the regulations of the country of origin (in which he is established) and other member states may not restrict services provision from this provider. In other words *CoO* principle implies that once a service provider is operating legally in one Member State of the EU, it can market its services in other Member States without having to comply with further rules in the host countries. This principle eliminates discriminatory requirements based on nationality or residence. The *CoO* became the most controversial issue for many EU members. Free movement of services should also mean that recipients should have the right to use services from other EU members without being hindered by restrictive measures imposed by their country. The Proposal called also for setting the rules regarding the case of posting of workers by service provider[21].

Third, the Bolkestein Directive proposed some instruments aimed at increasing consumer protection by setting some rules increasing mutual trust between EU members. It proposed inter alia harmonization of legislation in order to guarantee equivalent consumer protection among member states[22].

The approach adopted by the proposal entailed fast removal of barriers which could have been dismantled easily. For the others barriers, the proposal foresaw launching of a process of evaluation, consultation and complementary harmonization of national regulatory systems for service activities. The proposal called therefore for measures promoting the quality of services, such as voluntary certification of activities, or cooperation between the chambers of commerce. There was also a call for encouraging codes on certain questions, including in particular commercial communications by the regulated professions.

The Bolkestein proposal was a framework Directive, and did not aim to establish detailed rules or to harmonize all the rules in all service sectors of the EU members. This was left to specific sectoral directives. Its scope was limited and some sectors were clearly excluded from the proposed regulations. Namely, financial, electronic communication and network services such as post, telecom, electricity distribution, rail airports and broadcasting) were not covered by the proposal. Yet, the scope of regulated (such as professional services, engineering, construction, retail trade) and non regulated services (such as tourism wholesale trade, data processing, logistics) covered by the proposal was very substantial.

I.4.2 The 2006 Services Directive

The draft Bolkestein Directive has run into strong and widespread opposition. The proposal was subject of intense public debate, and has been taken up by the European Parliament. The Parliament discussed about 1600 amendments to the proposal and governments of several countries opposed some elements of the proposed directive. This debate has focused to a large extent on the "country of origin principle"[23]. The other concerns related to the idea that conditions and standards for workers will not be affected in any way and to the exclusion from the scope of the Directive of sectors such as health and publicly funded services of general interest.

Formal concerns regarding *CoO* principle have been explained by Micossi (2006). The "proposed directive envisages a shift from the prevailing system of mutual recognition to general application of the CoO rules, with a list of derogations. This proposal has proven the most controversial, perhaps not without reason since it entails that services provided by residents of other member states would have direct access to all national markets of the Union without any scrutiny by national authorities; the responsibility of supervising service providers would belong to the member state of origin."[24]

In economic terms one can argue that the *CoO* principle favors the service provider. It could set up operations in the EU State with the most liberal social regulations and use this country as a base from which to operate in all other Member States while avoiding their more restrictive regulations[25]. To avoid relocations and an increase in unemployment, there is a risk that Member States will embark upon a race to establish the least strict regime and dismantle their existing systems for protecting consumers and workers. A feared implication, as expressed by some countries, is that service providers from member states with lax labor protection would be free to import their workers and labor laws in the host country, thus undermining the more 'cohesive' social protection systems. Thus, not surprisingly the most vivid opposition to the proposed directive, and especially to CoO principle, came from countries like France, Germany, Belgium or Austria. The other countries, among them U.K., Ireland and majority of NMS supported main provisions of the Bolkestein proposal.

The final amendments to the Services Directive (2006), accepted in December of 2006, were very significant. The changes were done with respect to (i) modifications regarding interpretation free movement of services, (ii) the scope of the Directive and (iii) rules concerning posted workers. The "country of origin" principle has been dropped as going too far. Instead two other concepts have been introduced: (i) freedom of establishment for providers of services and (ii) free movement of services (respectively chapters III and IV of the Directive). Freedom of establishment for providers means that the access to a service activity shall not be subject to an authorization scheme unless: (a) the authorization scheme does not discriminate against the provider in question; (b) the need for an authorization scheme is justified by an overriding reason relating to the public interest; and (c) the objective pursued cannot be attained by means of a less restrictive measure, …[26]. In the similar way, the freedom to provide services is interpreted as "the right of providers to provide services in a Member State other than that in which they are established". If access to provision of services is subject to compliance with any requirements it should respect the principles of (i) non-discrimination, (ii) necessity (the requirement must be justified for reasons of public policy, public security,….) and (iii) proportionality (the requirement must be suitable for attaining the objective pursued)[27]. Thus, services providers are subject to regulations and requirements of the country of destination and not of origin.

The Parliament amendments excluded the following services from the scope of the Directive: (i) electronic communication services, (ii) transport services, including urban transport, taxis and ambulances as well as port services, (iii) financial services (such as banking, credit, insurance and re-insurance, occupational or personal pensions, securities, investment funds), (iv) audiovisual services, (v) gambling activities (including lottery and betting transactions) (vi) social services in the areas of housing, childcare and support to families; (vii) taxation matters, those activities that are connected with the exercise of an official authority in a member state (including notaries) and (viii) public and private healthcare services provided by health professionals to patients, including pharmaceutical services. The provisions regarding rights of posted workers have also been dropped. In order to reassure that the new law does not undermine more 'cohesive' social protection systems in article 1.6 it is stated that "This Directive does not affect labor law, that is any legal or contractual provision concerning employment conditions, working conditions,…" Thus, the new Directive has been more diluted in comparison to the Commission proposal. It takes a long term horizon. Directive should lead to gradual liberalization in provision of services. It should lead to a mix of measures involving targeted harmonization, administrative cooperation, and the encouragement for the development of codes of conduct on specific issues.

Notes

1 'Cross-border supply' is analogous to trade in goods, and arises when a service crosses a national frontier, for example, air or maritime transport across borders, purchase of software or insurance by a consumer from a supplier located abroad, and legal advice from abroad given by letter or telephone. On the other hand 'consumption abroad' occurs when the consumer travels to the territory of service supplier, for example, purchase of tourism, education, health services, and a visit to a law office abroad. While 'commercial presence' involves foreign direct investment, for example, when a foreign bank, telecommunications or electricity firm establishes a branch, subsidiary or plant in the territory of another country, 'movement of individuals' occurs when independent service providers or employees of a multinational firm temporarily move to another country for business consulting or construction.

2 When some objectives deemed desirable from a social point of view may not be achieved through competition, public service obligations (PSO) can be imposed by public authorities on the natural gas undertakings as least distortive measures.

3 LNG allows natural gas to be shipped and stored in liquid form, meaning it takes up much less space than gaseous natural gas. When natural gas is cooled to a temperature of approximately -260°F (-161 ^{0}C) at atmospheric pressure, it condenses to a liquid form called liquefied natural gas (LNG). One volume of this liquid takes up about 1/600th

the volume of natural gas. LNG weighs less than one-half that of water, actually about 45 percent as much. LNG is odorless, colorless, non-corrosive, and non-toxic. When vaporized it burns only in concentrations of 5 percent to 15 percent when mixed with air. Neither LNG, nor its vapor, can explode in an unconfined environment. Since LNG takes less volume and weight, natural gas is liquefied for ease of storing and transporting.

[4] The MFN principle imposes on member countries the obligation not to discriminate among foreign services and service suppliers.

[5] See the website www.encharter.org.

[6] Basically, there are four kinds of unbundling: ownership, legal, management and accounting unbundling. Accounting separation is the weakest form, in which a company keeps different accounts for its system and for its competitive activities, and must charge the competitive businesses the same fees for using the system as it charges third parties. This is intended to prevent cross-subsidies between the system and the competitive activities. Management separation requires that different people are responsible for the system business and the competitive activities, and that the system business cannot pass on information about rival concerns. Legal separation goes further, with a completely separate legal entity to run the system. Even in this case, however, staff working for the system business will be aware of the financial interests of their parent organization and its competitive activities, and may take decisions to further these. Only the full ownership separation, when the system is an independent organization, rather than a subsidiary, can completely remove the incentive to favor one market participant over others.

[7] The European Regulators Group for Electricity and Gas established by Commission Decision of 11 November 2003 (OJ 2003 L 296/34).

[8] In the European Gas Regulatory Forum (Madrid Forum) participants include national regulatory authorities, Member States, the European Commission, network operators, gas suppliers and traders, consumers, network users, and gas exchanges.

[9] The European Association for the Streamlining of Energy Exchanges, a group made up of representatives of different gas actors, provides Common Business Practices for technical harmonization

[9b] On September 17, 2007 European Union officials proposed new legislation that aims to break open the EU's energy market, making it more competitive and less dominated by national monopolies. The Commission aims the separation of production and supply from transmission networks. It prefers ownership unbundling, but also proposes a second option, the «independent system operator» which makes it possible for existing vertically integrated companies to retain network ownership, but provided that the assets are actually operated by a company or body completely independent from it. Furthermore, the Commission requires the effective unbundling of transmission system operators and supply and production activities not only at national level but throughout the EU. In addition, the Commission proposes measures to strengthen and guarantee the independence of national regulators in Member States. The Commission proposes to establish an Agency for the Cooperation of National Energy Regulators, with binding decision powers, to complement National Regulators. This will enable the EU to develop a real European network working as one single grid, promoting diversity and security of supply. The Commission proposes also a new European Network for Transmission System Operators. Finally, the Commission aims at improving the legislative framework to facilitate third party access to key infrastructures, to increase transparency on the market, to enhance market integration and to improve access to retail customers. The EU plan still needs approval from national governments and lawmakers.

[10] On September 17, 2007 European Union officials proposed new legislation that aims to break open the EU's electricity market, making it more competitive and less dominated by national monopolies. The Commission has made it clear it wants legislation to include a drastic measure: break up companies such as Electricité de France to spur more competition. Amid resistance from France and Germany the Commission proposed a second, less stringent «independent system operator» option. That path would place control of transmission networks in independent hands but wouldn't affect their ownership. On the other hand the harsher «ownership unbundling» option would force companies that own both transit networks and the utilities that sell energy to consumers to split off one of those businesses. Furthermore, the Commission proposes measures to strengthen and guarantee the independence of national regulators in Member States. The Commission proposes to establish an Agency for the Cooperation of National Energy Regulators, with binding decision powers, to complement National Regulators. Furthermore, the Commission proposes a new European Network for Transmission System Operators. Finally, the Commission aims at improving the legislative framework to facilitate third party access to key infrastructures, to increase transparency on the

market, to enhance market integration and to improve access to retail customers. The EU plan still needs approval from national governments and lawmakers.

[10b] Basic telecom service encompasses local, long distance and international services for public and non-public use.

[11] The MFN principle as emphasized above imposes on member countries the obligation not to discriminate among foreign services and service suppliers. On the other hand the NT principle imposes the obligation not to discriminate between foreign services and service suppliers and national services and service suppliersl.

[12] GATS, Annex on Negotiations on Basic telecommunications.

[13] The undertakings are said to have significant market power (SMP) as long as the market share of the undertaking is equal to or larger than 25 percent.

[14] Banks classify their assets and off-balance-sheet items under one of the two following categories: banking book and trading book. Most medium- and long-term transactions are held in the banking book and are subject to regulatory capital requirements for the credit risk arising from these transactions. On the other hand the trading book consists of positions in financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book. The trading book includes most derivatives such as financial futures, interest rate and currency swaps, options on securities, etc, and it is subject to capital requirements for market risk.

[15] See http://www.imf.org/external/np/fsap/fsap.asp.

[16] For the latest documentation on Basel II see Bank for International Settlements (2006)

[17] MFN exemptions could have been sought at the time of the acceptance of the GATS Agreement and for acceding countries at the time of date of accession. They are contained in country-specific lists, and their duration must not exceed ten years in principle. They are negotiable principles meaning that WTO members can decide voluntarily to what extent they will allow foreign_participation in their markets and under what conditions with respect to the four modes of supply.

[18] European Commission (2004), p. 3.

[19] Ibidem.

[20] At this point a service provider should be able to complete all administrative procedures by electronic means.

[21] Articles 24 and 25 of the Proposal.

[22] It refers inter alia to the obligations concerning information, professional insurance, settlement of disputes, and exchange of information on the quality of the service provider.

[23] C. McCreevy , Statement to the European Parliament on Services Directive, European Parliament Plenary Session, Strasbourg, 8 March 2005

[24] Micossi (2006), p.5

[25] For example, administrative simplification could undermine standards which ensure the correct operation of health care systems (such as requirements relating the minimum number of employees, mandatory prices, limits set on the basis of a minimum geographic distance). This could undermine health care cover system of some countries.

[26] Services Directive (2006), chapter 4, Article 9.

[27] Services Directive (2006), chapter 4, Article 16.

II. The Role of Services as the Factor of Integration of Euromed

(section by Fabien Bertho & Patrick Messerlin)

This Part aims at providing a picture of the services sector in five MENA countries (hereafter MENA5) with a focus on "backbone" services sectors. Efficient backbone services are essential because they are a key component of transaction costs in trade in goods and services – such as efficient maritime transport for trade in goods, efficient air transport for foreign and domestic tourists, telecommunications needed by all sectors, including for offshored activities in IT enabled services (call centres, business process outsourcing, etc) efficient banking sector, in particular for channelling inward FDI and allowing their optimal domestic allocation, etc.

Connecting economies is particularly crucial in modern economies characterized by the fact that taking full advantage of the international labour division relies on ever more fragmented productive processes. Barriers in backbone services may consist in physical constraints (a lack of interconnection between national grids or networks). But they are also largely regulatory. Enhancing the tradability of such services requires thus regulatory reforms and a mix of cooperation and competition – "deeper integration" – between countries.

II.1. The importance of services and network sectors in five MENA countries

The section briefly presents the GDP and employment structure in goods and services in the MENA5, and its evolution during the last decade. This description can hardly be useful if it is not accompanied by a comparison of the MENA5 with other countries. Such an approach requires to define "reference groups" of countries to which one could compare the MENA5 countries. What follows uses two reference groups.

The first reference group is defined mostly by economic criteria. A possibility would have been to use the lower-middle income developing countries group, as defined by the World Bank. However, such a reference group would have imposed too strong data limitations. Moreover, its attraction (the fact that it relies on a large number of countries) is also a weakness to the extent that many countries included in such a reference group do not share some important specific features of the MENA5 (for instance, size, landlocked situation, etc.). As a result, the paper is using a more narrowly defined reference group constituting in seven countries (hereafter G7): Bulgaria, Colombia, Dominican Republic, Paraguay, Peru, Romania, and Thailand. Table 1 shows that the G7 countries are the closest countries that can be found in the current world from the MENA5 in terms of size (GDP, be in constant US dollars or at purchasing power parity, and population) and GDP per capita. They also share similar important geographical features for backbone services. For instance, Turkey and Thailand are key regional hubs in terms of airports and communications, Jordan and Paraguay are landlocked countries. Lastly, the G7 group includes two EC Member States which have only very recently acceded to the EC, hence have remained in this respect close to the MENA5 situation until the mid-2000s.

Of course, such a comparison should be taken with great care. In particular, Table 1 shows that the reference countries do not share the same economic history, as illustrated by the different growth rates over the two last decades. The MENA5 GDP growth rates are higher than the G7 growth rates. But, the growth rate of their GDP per capita offers a contrasted picture. Over the last 20 years (1985-2004), the MENA5 annual growth rate per capita is almost identical to the corresponding growth rate of the G7 group (1.5 percent). But, over the last decade (1995-2004) it is one percentage point higher – a reflection of a combined lower demographic growth rate and a higher GDP growth rate. This recent evolution induces to focus on the importance of the quality in education for the MENA5 countries in the long term – a young but poorly or inadequately educated population may be an handicap to future growth that could be as severe as an older and declining population (as best illustrated by Bulgaria).

That said, limiting the comparison exercise to economic criteria would miss the important fact that the MENA5 are linked to the EC by many agreements – hence are inevitably influenced by the EC acquis communautaire. As the regulatory framework is critical for services sector, it is thus important to build another reference group (hereafter G6) constituted by six new EC Member States (Czech Republic, Estonia, Latvia, Slovenia and Slovakia).

As shown by Table 1, there are substantial differences in terms of growth level and growth rate between the G6 and MENA5 countries. All the G6 countries are notably richer than the MENA5. The MENA5 GDP growth rate is much higher than the G6 growth rate (twice higher) over the two last decades (1985-2004) and similar over the last decade (1995-2004). The growth rate of GDP per capita is similar over the last twenty years, but the G6 growth rate of GDP per capita is almost twice the MENA5 growth rate of GDP per capita.

Table 1 : The five MENA countries and the "Reference Groups"

	Reference groups	GDP (2004) (USD) [a]	GDP (2004) (PPP)	GDP Growth [a] 85-04	GDP Growth [a] 95-04	Population (millions)	GDP per capita (PPP) 2004	GDP per capita GDP Growth [a] 85-04	GDP per capita GDP Growth [a] 95-04
Turkey		229225	553811	4.1	3.8	71.7	7724	2.2	2.1
Thailand	G7	150077	505332	6.1	2.5	63.7	7933	4.8	1.5
Egypt		117249	304920	4.2	4.7	72.6	4200	2.2	2.7
Colombia	G7	93886	311831	3.2	1.8	44.9	6945	1.3	0.1
Czech Republic	G6	62612	182659	1.1	2.5	10.2	17937	1.2	2.7
Peru	G7	60886	148902	2.3	2.9	27.6	5395	0.4	1.3
Hungary	G6	53776	155096	1.3	3.6	10.1	15399	1.6	3.8
Romania	G7	46937	180739	-0.1	1.9	21.7	8329	0.1	2.4
Morocco		40200	126739	3.3	4.1	29.8	4253	1.6	2.7
Slovakia	G6	24190	72430	1.7	4.3	5.4	19251	1.5	4.2
Tunisia		23126	73527	4.2	5.1	9.9	7427	2.5	3.9
Dominican Rep.	G7	21789	60394	4.4	5.4	8.8	6863	2.7	3.8
Slovenia	G6	21688	38406	2.3	3.8	2.0	13437	2.3	3.8
Bulgaria	G7	15265	61901	0.5	1.6	7.8	7936	1.2	2.5
Jordan		10476	25731	3.6	4.3	5.4	4765	-0.3	1.3
Latvia	G6	10368	25673	0.9	5.6	2.3	11148	1.5	6.7
Paraguay	G7	8238	28902	2.4	1.2	6.0	4817	-0.3	-1.3
Estonia	G6	6954	17180	1.2	5.7	1.3	12773	1.8	6.6

Source: World Development Indicators, World Bank. Note: [a] in million constant 2000 US dollars.

The services sectors: GDP and employment shares and labor productivity

Table 2 splits the whole services sectors in two major components.[1] The "core services" include the key backbone services. By contrast, the "other services" is a mixed bag of largely non-tradable services (housing, government services and a large chunk of "other other services") and commercially-oriented services (the rest of "other other services"[2]). As a result, what follows focuses on the core services.

Table 2 provides several interesting observations in terms of the level and structure of the GDP shares of services. The GDP share of the core services divides the MENA5 countries in two sub-groups. The GDP share of the core services in Egypt, Morocco and Tunisia is notably smaller than the average share of the G7 group, but tends to be higher once compared with the average share of the G6 group. Turkey and Jordan exhibit shares higher or much higher than the average shares for the G7 and G6 (respectively) groups. But there is a key difference between these two MENA5 countries. Jordan's specificity in services mirrors another specificity – a minimal agricultural sector. By contrast, the Turkey's core services share coexists with large agricultural and industrial sectors.

Second, the MENA5 GDP share of the "other services" is notably larger than the corresponding average G7 share, and much lower than the average G6 share, with the exception of Morocco which is closer to the G6 group in this respect – hence very different with the four other MENA5 countries.

Looking at all the services, all the MENA5 countries but Jordan exhibit GDP shares slightly smaller than the average G7 share, and much smaller than the average G6 share – with the exception of Turkey in 2004. In other words, the four MENA5 countries seem to have a "constrained" services sector in size and structure (because of the core services with respect of the G7, and of the other services with respect to the G6). Jordan exhibits an always much bigger ("developed") share for all the services, a feature that Turkey shows in 2004.

Looking at the evolution of the GDP shares of services sectors, the split of the MENA5 countries in two sub-groups observed above remain verified. Egypt, Morocco and Tunisia exhibit a stagnant or declining share for the core services (a feature exhibited also by the G7 and

Table 2 : The Gross Domestic Product structure by kind of economic activity (% of GDP)

	Egypt [a]		Morocco		Jordan		Tunisia		Turkey		G7 [a]		G6	
Sectors	1994	2004	1994	2004	1994	2004	1994	2004	1994	2004	1994	2004	1994	2004
Agriculture, fishing & forestry	16.9	15.1	18.5	19.4	5.4	2.8	14.4	14.3	15.4	11.6	12.3	10.8	5.9	3.9
Mining, quarrying & fuel	8.2	12.6	1.8	1.7	2.9	2.7	4.5	4.0	1.4	1.2	6.8	8.2	1.4	0.7
Manufacturing industries	17.2	18.3	17.0	19.7	15.8	18.8	21.3	20.2	22.0	20.9	19.3	21.1	23.9	23.7
Electricity, water & gaz	2.1	1.9	7.6	4.3	2.4	2.6	2.1	1.6	2.9	3.4	2.2	2.8	5.0	3.6
Construction	5.2	4.1	4.3	5.1	8.4	4.7	5.7	5.8	6.8	3.7	6.8	4.7	6.1	5.9
Total agri. & industry	**49.6**	**52.0**	**49.4**	**50.2**	**34.9**	**31.6**	**48.1**	**45.9**	**48.4**	**40.8**	**47.4**	**47.5**	**42.3**	**37.8**
Commerce, rest. & hostels	17.8	13.9	19.8	14.8	10.6	10.4	18.1	16.9	19.6	21.2	18.4	17.0	13.8	14.1
Transport, comm. & storage	10.8	9.7	6.0	7.7	14.6	16.7	8.7	10.4	13.2	14.8	7.5	7.7	9.1	9.7
Finance, insurance & banking	3.8	7.7	..	0.0	18.6	19.6	5.1	3.9	3.0	5.2	10.9	9.1	5.4	4.1
Core services	**32.3**	**31.3**	**25.7**	**22.4**	**43.8**	**46.7**	**31.8**	**31.2**	**35.8**	**41.1**	**36.9**	**33.8**	**28.3**	**27.9**
Housing	1.7	3.5	..	0.0	..	4.7	..	3.8	3.3	4.4	..	..	12.2	15.0
Governement services	7.8	10.2	12.2	16.5	18.8	18.8	15.4	15.1	8.9	10.2	..	..	14.0	15.8
Other other services [b]	8.5	3.0	12.7	10.9	2.5	-1.8	0.5	4.1	3.7	3.6	..	..	3.2	3.5
Other services	**18.0**	**16.7**	**24.9**	**27.4**	**21.3**	**21.7**	**20.1**	**23.0**	**15.8**	**18.1**	**15.7**	**18.7**	**29.4**	**34.3**
All services	**50.4**	**48.0**	**50.6**	**49.8**	**65.1**	**68.4**	**51.9**	**54.1**	**51.6**	**59.2**	**52.6**	**52.5**	**57.7**	**62.2**

Sources: Arab Monetary Fund, Eurostat, CEPALSTAT, Institut National des Etudes Statistiques de Roumanie, Bank of Thailand, State Institute of Turkey.
Note: [a] Includes adjustments described in footnote attached to the text. [b] For description, see text.

G6 groups). Jordan and Turkey exhibit increasing GDP shares for the core services, while Turkey show the same evolution for the "other" services, as it is the case for the G6 group.

Table 2 allows a last important observation. There is no clear evidence on a positive or negative correlation between changes in the core services share and changes in the manufacturing GDP share. In the case of Egypt, Morocco and Turkey, the two shares evolve in opposite directions, suggesting an increased specialization in one of these two activities (manufacturing for Egypt and Morocco, services for Turkey). In the case of Jordan, both shares are increasing, suggesting a more complex evolution pattern.

Table 3 presents the available data on employment and labor productivity in the services sector. The share of employment in services (which, as expected, increases slowly in almost all the countries examined) does not suggest the same breakdown among the MENA5 than the above examined sectoral shares. This time, Egypt and Turkey are relatively close, while Jordan and Morocco are at each of the two extremes. By contrast, the apparent labor productivity in services puts Turkey as the extreme upper end of the spectrum (Egypt and Morocco having very close productivity) with a labor productivity twice higher than the other MENA5 and G7 countries, where the labor productivity is very similar. Turkey is the only MENA5 country with an apparent labor productivity close to the average productivity observed in the G6 countries, if one does not take into account Slovenia which is in a different league.

In short, the MENA5 countries appear often in an intermediate situation between the G7 and G6 groups. The G7-driven comparisons tend to split the MENA5 countries into two groups. Egypt, Morocco and Tunisia tend to have a smaller, less growing (even stagnating) services sector than Jordan and Turkey

Table 3: Employment and labour productivity in services

	Employment in services (% of total employment)			Labour Productivity [c]	
	2000	2003		2000	2003
Egypt	49.1	50.4		5503.3	5442.3
Jordan	72.7	74.2		..	..
Morocco	32.0	35.9	[d]	5679.1	5769.2
Tunisia	..	..		..	..
Turkey	40.0	43.4		11856.8	11949.4
Bulgaria	45.5	57.1		4448.0	4606.8
Colombia	73.3	60.2	[e]	4482.3	4410.7
Dominican Rep. [a]	55.8	63.0		..	..
Paraguay [b]	51.4	52.7		..	..
Peru	74.4	78.6		..	..
Romania	32.9	35.3		5016.2	6151.5
Thailand	31.0	34.5		..	..
Czech Republic	54.8	54.8	[f]	10271.2	11409.9
Estonia	59.5	60.1		8182.9	9687.9
Latvia	60.1	59.4	[g]	9087.3	7933.2
Hungary	58.7	58.9		10234.6	..
Slovenia	52.3	50.8	[h]	27629.1	24749.7
Slovakia	56.1	56.2		11220.0	9965.4

Source: World Development Indicators, International Labor Organisation.
Note: [a] Year 2002. [b] Year 1999. [c] Value added in services (constant USD 2000) divided by labor force in services. [d] Labor productivity for 2000. [e] Labor productivity for 2001. [f] Labor productivity for 2004. [g] Labor productivity for 2002. [h] Labor productivity for 1999.

that are close – for different reasons – to the G7 group. The G6-driven comparisons show substantial differences with the MENA5, although less pronounced for Jordan and Turkey (depending the criteria).

All these results can be interpreted in terms of tradable and non-tradable services. As suggested above, the core services are largely tradable. Small and stagnant shares in these sectors raise the question of whether there is enough openness to foreign competition in the MENA5 countries, a question to be addressed now.

MENA5 services trade: an aggregate view

Is the MENA5 core services sector (the only one that could be notably influenced by competition from foreign services providers) opens to the world markets influence? This question can be usefully divided in two. Is the core services sector of each MENA country more (or less) open to foreign competition than the country's goods sector? Is it more (or less) open than the core services sector in the G6 and G7 countries?

Table 4 provides three trade-based ratios allowing to assess the openness of the services sector (that is, de facto the core services sector) compared to the goods sector of the same country. The ratios of "trade openness" (exports plus imports in percent of GDP for 2004) and of "import penetration" (imports in percent of domestic consumption defined as the GDP minus exports and plus imports for 2004) give a first sense of the exposure to foreign operators through international trade. They both show a (often much) lower exposure to foreign trade for the core services sector than for the products sector.

Shifting from comparisons within countries to comparisons between countries, Table 4 suggests an exposure to the world trade in services of the MENA5 countries higher than the exposure observed for the G7 group, but relatively close to the one observed for the G6 group.

Table 4: Openness to foreign competition: goods and services, selected countries

	Border trade: Goods		Border trade: Services		Inward FDI flows [c]		Inward FDI stock [f]	
	Trade Openness [a]	Import Penetration [b]	Trade Openness [a]	Import Penetration [b]	Goods and services [d]	Services [e]	per capita	per labor
	1	2	3	4	5	6	7	8
Egypt	39.6	23.8	28.2	10.6	1.9	21.1	390	1263
Jordan	97.8	48.8	36.9	22.0	5.9	..	935	2775
Morocco	52.6	30.8	20.3	7.0	4.1	25.9	756	2052
Tunisia	77.5	41.9	20.0	6.7	2.9	5.3	1688	4398
Turkey	52.2	29.0	10.9	3.4	1.4	..	585	1583
Bulgaria	96.9	50.2	29.7	14.5	9.3	51.7	1185	2949
Colombia	34.2	16.3	6.4	4.1	4.1	55.2	805	1642
Dominican Rep.	74.9	43.5	25.6	6.3	4.1	91.6	588	1359
Paraguay	116.9	61.8	18.2	5.6	1.3	50.5	197	421
Peru	32.2	14.5	6.7	3.7	2.6	..	568	1190
Romania	71.0	36.6	9.9	6.2	5.2	..	1101	2321
Thailand	110.8	54.3	26.0	14.3	1.8	..	880	1583
Czech Republic[g]	110.6	55.1	16.7	8.1	7.2	62.0	5834	10479
Estonia	128.6	62.1	42.1	17.6	11.6	79.9	9194	16275
Latvia	81.6	42.3	21.7	9.1	3.7	..	2093	3697
Hungary	114.0	56.8	20.3	10.1	5.1	..	6112	12781
Slovenia	101.5	50.7	19.0	8.4	2.4	..	4040	7944
Slovakia [g]	136.2	67.8	19.4	9.4	6.2	..	2845	5102

Sources : World Development Indicators. UNCTAD for Inward FDI.
Notes: [a] exports plus imports in % of GDP. [b] imports in % of domestic consumption. [c] FDI: foreign direct investments.
[d] Inward FDI in % of GDP (averages 2000-2005). [e] Inward FDI in services in % of inward FDI in goods and services (three last available year
[f] FDI stock per capita (2005). [g] Border trade for 2003.

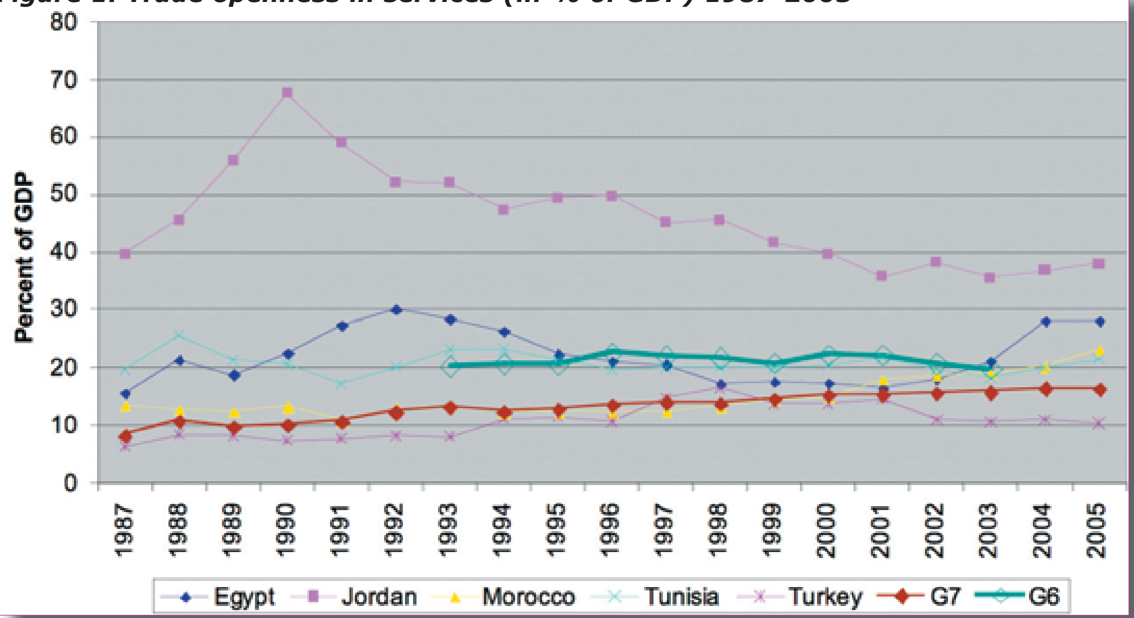
At this point, an historical perspective over the last two decades is useful. Figure 1 on the trade openness ratio from 1987 to 2005 suggests a kind of "normalization" of the MENA5 economies since the late 1980s. If, in the early years, the MENA5 tended to be characterized by a higher trade openness in services, compared to the G7 reference countries (Jordan being the most extreme case). But, the MENA5 countries exhibit trade openness ratios closer to those of the G7 reference group in the last years of the period. The comparison with the G6 group is difficult due to the lack of data for a substantial number of years, but the difference seems smaller.

That said, a smaller openness ratio in services (compared to goods) based on border trade is not very surprising. As recognized since a long time by the economic literature, most services require the services providers to be close to the consumers – for simultaneity reasons (a service should be produced when it is consumed) or for many other obvious reasons (language, tradition, etc.). As a result, looking at the openness only in terms of border trade gives a very incomplete view.

A more complete view should thus include data on foreign direct investments (FDI). Table 4 presents four FDI-based openness ratios. The GDP share of the inward FDI in goods and services in the MENA5 is half the average shares observed for the G7 and G6 countries. And the share of inward FDI in services compared to inward FDI in goods and services in the MENA5 is even much smaller than the corresponding average shares for the G6 and G7 countries.

Table 4 provides two last interesting ratios for assessing the role of FDI in the domestic economies. The FDI stock ratios per capita and per employment are the closest indicators of the capital-labor ratio that is an important variable in explaining comparative advantages in the long run. The MENA5 countries exhibit ratios that are higher than the G7 countries ratio, but much smaller than the G6 countries ratio.

Figure 1: Trade openness in services (in % of GDP) 1987-2005



In sum, evidence suggests that the openness of the MENA5 services sector to the world economy is lower than the goods sector openness of the MENA5 countries, and lower than the openness of the services sectors of the G7 countries and (less clearly) of the G6 countries.

An indirect look at barriers to services trade

Is the smaller services exposure to foreign FDI the result of domestic anti-competitive regulations in the MENA5 economies? Part I has mentioned the available estimates giving a direct answer to such a question. It is interesting to complete them by the indications on the barriers to business provided by the Doing Business database set up by the World Bank.[3] These indications do not specify whether the barriers are discriminatory or not. But, these barriers tend to be discriminatory with respect to foreign operators because most of them are imposed on new business – and foreign business is mostly new.

Table 5 presents four regulatory indicators expressed in terms of countries ranking (columns 1 to 4). Column 1 focuses on regulations dealing with trading across borders (import and export procedures) and estimates their restrictiveness via the number of documents, the time necessary for complying to the procedures, and the costs to import and export per container. If this indicator captures well the regulations imposed on trade in goods, the three other indicators focus on investment-related procedures, namely protecting investors, getting credit, and registering property. They thus apply to goods and services as well.

Table 5 provides a clear lesson. For the MENA5, rankings are notably higher in

Table 5: Regulatory barriers in goods and services, selected countries

	Country ranking				Cost-related indicators		
	Goods	Goods and services			Goods		Goods and services: re-gistering pro-perty costs [b]
	Trading across borders	Protecting investors	Getting credits	Registering property	Cost to imports [a]	Cost to exports [a]	
	1	2	3	4	5	6	7
Egypt	81	118	159	140	1049	1014	5.9
Jordan	77	118	83	109	955	720	10.0
Morocco	77	118	143	44	1500	700	4.4
Tunisia	39	151	101	71	600	770	6.1
Turkey	77	60	65	53	735	513	3.2
Bulgaria	102	33	33	64	1201	1233	2.3
Columbia	128	33	83	55	1773	1745	3.5
Dominican Rep.	53	135	33	126	990	770	5.1
Paraguay	116	46	48	47	1077	685	2.0
Peru	92	15	33	31	820	800	3.3
Romania	34	33	48	114	1200	1300	1.9
Thailand	102	33	33	18	1042	848	6.3
Czech Republic	39	83	21	57	833	713	3.0
Estonia	6	33	48	22	640	640	0.7
Latvia	28	46	13	82	965	965	2.0
Hungary	72	118	21	101	1137	922	11.0
Slovenia	81	118	13	5	1107	1070	2.0
Slovakia	106	46	48	97	1050	1015	0.1

Source: Doing Business 2007. [a] US dollars per container. [b] In percent of property value.

the investment-related regulations than for the border trade-related regulations. In other words, it strongly suggests that services (mostly covered by the three investment-related indicators) are more regulated than products (largely covered by the first indicator). Interestingly, this is the converse pattern that prevails in the G7 countries. It is harder to interpret the differences between the MENA5 and G6 countries because the G6 group is much more heterogeneous than the two others – raising interesting questions with respect to the depth of the Single Market.

Lastly, Table 5 presents regulatory indicators in terms of costs (columns 5 to 7). They provide several interesting additional observations. First, costs to exports are not negligible – they have roughly the same magnitude than costs to imports. Second, the MENA5 ratio of the costs to imports relative to those on exports is smaller than the corresponding (close) ratios of the G6 and G7 countries. Lastly, the only available direct cost estimates in services (registration property costs as a percent of property value) are substantially higher (by 70 percent) in the MENA5 countries than in the G6 and G7 countries – except in Turkey where their level is close to the G6 and G7 level.

II.2. Services liberalization in the MENA countries

Part III deals with empirical estimates of services liberalization. As a preparatory step, this section presents a positive analysis of what could be achieved based on reasoned (arguably crude) estimates of the trade agreements (with a marked services dimension or not) signed or under consideration. The section is organized as follows. First, it presents general arguments suggesting that, contrary to the case of trade in goods, bilateral (regional) agreements may play an important role, complementary of the WTO role. Second, the current situation in terms of bilateral agreements of the MENA5 is examined. Lastly, the section presents a tentative assessment of the current situation.

A few preliminary general observations

Liberalization in services is not an easy task, as amply illustrated by the slowness of progress in building up the services European Single Market. There are two main reasons explaining the difficulties in liberalizing services. First, one still lacks the appropriate legal instruments. Regulations are a much more crucial factor in determining the comparative advantages of domestic services providers than in determining the competitive advantages of domestic producers of goods. This well known observation has an often neglected consequence. Imposing the host country regulations to foreign services providers may look non-discriminatory (it seems to deliver "national treatment") but it is yet a severe handicap for the foreign services providers because a notable source of their comparative advantages is embedded in their home country regulations. This factor is one of the main reasons explaining why harmonization is largely abandoned as an approach to liberalization – harmonization is unable to open markets in services simply because it imposes a "one size fits all" norm that in reality fits no firm.

As a result, mutual recognition has been viewed as "the" alternative. But, in fact, mutual recognition has also limited capacities to deliver the European "Single Market". The reason is that mutual recognition still requires the harmonization of certain "core" rules. Ideally, an harmonization limited to core regulations would be minimal. But, in fact, trade negotiators try hard to introduce in the core rules the key regulations essential for the comparative advantages of their domestic services providers (and possibly those detrimental to the comparative advantages of their competitors). By doing so, they make difficult for services providers to go very far in the partners' markets.

The EC Services Directive was among the very first European Directives to try to introduce massively the last possible legal instrument of liberalization in services – the principle of the country of origin. This principle means that each services provider can operate under the regulatory framework of its own (home) country, hence that it is able to exploit fully the comparative advantages drawn from the firm and country combined sources.

The second major difficulty in services liberalization is that, much more than in the case of goods, such a liberalization requires and relies heavily on unilateral decisions from the country. This point echoes the wide differences observed above among the G6 countries, despite after a decade of implementation of the acquis communautaire.

This limit is reinforced by an often neglected feature of the regulatory reforms associated to services liberalization – namely their dynamic nature. In the case of trade in goods, once-for-all tariff reductions are enough to trigger more competition (if they are not annihilated by increased non-tariff barriers, of course). For most products, pre-liberalization markets (even in small developing countries) include several firms, meaning that the collusive nature of such markets is fragile (often it does not even exist). As is well known, it is quite different in most services sectors. As a result, services liberalization requires a permanent review of the existing regulations for better adjusting them to the ever evolving markets (often characterized by an expanding scope of varieties of services, with each variety running the risk of being quickly dominated by a dominant service provider). All these features cannot rely on an once-for-all action (as in goods) but they require almost permanent regulatory reforms. In turn, such a dynamic process requires "trust" among trading partners. A country cannot be satisfied with the mere static dismantlement of the existing barriers by its trading partners in a given service. It has to trust its trading partners not to establish new barriers, but also, above all, to enact and to enforce a continuous flow of pro-active and pro-competitive regulatory reforms in the years to come.

All these conditions do not make the WTO the best place for liberalizing services. Plurilateral agreements among countries willing to initiate a liberalization process look a better alternative. Such plurilaterals can be initiated within the WTO. Others can be initiated in the context of preferential trade agreements (PTAs) negotiated outside the WTO forum. That puts the PTAs at the core of the discussion on services liberalization – the WTO remaining (still crucial) task being to "bind" and expand the plurilaterals. Interestingly, these arguments are echoed by Table 6 which shows that the MENA5 countries did go very far in binding the existing commitments in services, except Jordan. The most frequently bounded services by the MENA5 are tourism, financial services, business services, and distribution.

The situation of the MENA5 countries

Some MENA countries are among the last ones to join the WTO. Algeria, Iran, Iraq, Lebanon, Libya and Yemen are still among the 30 remaining observers, though Iraq and Iran have recently shown some intent to speed up their accession negotiations. This divide among the MENA countries in two groups – the WTO Members and the others – has always made more difficult the PTA exercise in the region.

Table 7 summarizes the preferential agreements notified to the WTO. Because of the MENA great divide on the WTO membership, the agreements are not all those which exist (for instance, GAFTA is not mentioned). However, the WTO-notified agreements are likely to be the most far-reaching ones in terms of content, binding and coverage. In this respect, they probably give a good sense of what is going on in terms of PTAs in the region, particularly in services.

Table 7 provides six observations. First, 36 out of a total of 211 WTO notifications involve MENA countries, and 22 out of these 36 PTas involve the MENA5 countries examined – a very large share, compared to the GDP or trade shares of these MENA countries. Second, a handful of the MENA-related PTAs date back from before 1995, often a sign of shallow integration. Third, only four of the PTAs involve two MENA countries, none of them being neighbours – in other words, the existing web of PTAs clearly reveals MENA countries' tendency to discriminate against their neighbours. Fourth, the vast majority (27) of the PTAs are related to the web of EC PTAs, as best illustrated by Turkey. Because Turkey has a customs union with the EC, it has strong incentives to duplicate ("echo") the EC initiatives in terms of PTAs. Fifth, all but one of these PTAs are bilaterals, and all but one are free trade agreements – that is, almost all these bilaterals are likely to be imperfect agreements riddled with

Table 6: Main service sectors bound under the the GATS (2002)

	Egypt	Jordan	Morocco	Tunisia	Turkey	WTO [a]
Business		×	×		×	71%
Communications		×	×	×	×	68%
Construction	×	×	×		×	51%
Distribution		×				36%
Eduction		×			×	32%
Environmental		×	×		×	37%
Financial	×	×	×	×	×	73%
Health/social		×			×	33%
Tourism	×	×	×	×	×	88%
Recreational		×				43%
Transport	×	×	×		×	58%
Total	4	11	7	3	9	

Source: Mueller-Jentsch [2004].
Note: [a] Percentage of WTO members with sector commitments.

built-in trade barriers. Lastly, only three bilaterals have clear services provisions – all of them with the US as the partner of MENA countries.

Assessing the present situation

The crucial question is how to assess these agreements. This requires to look at the two basic economic theories about PTAs. The first one relies on the Vinerian concept of trade creation and diversion. The second one is based on the optimal tariff literature. As none of the MENA countries can be considered as a "large" economy (indeed, a vast majority of the PTAs in the world are driven by "small" countries) this second source of analysis seems irrelevant in the MENA world.

What follows relies thus on the Vinerian approach. High preferences distort trade flows because they induce consumers to buy goods from inefficient production sources located in the two countries rather than goods more efficiently produced in the rest of the world. The higher the MFN tariffs (hence the preferences) the more distorted the bilateral trade flows are likely to be, the higher the costs of the bilateral (compared with a multilateral liberalization) are likely to be for consumers of the products imported from the trading partner, and the higher is the likelihood of the bilaterals of collapsing (or of being unused or useless).

Since the late 1980s, many countries (including the MENA5) have lowered their MFN tariffs. Logically, that should have triggered a loss of interest in bilat-

Table 7: Bilateral and plurilateral trade agreements notified to the WTO, 15 september 2006

A. Bilateral Agreements

Signatory	Signatory	Year	Coverage	Type	"Echoes"
Algeria	EC	1976	Goods	FTA	EC-Med
Bahrain	USA	2006	Goods	FTA	
Egypt	EC	2004	Goods	FTA	EC-Med
Israel	Bulgaria	2002	Goods	FTA	EC-Med
Israel	Canada	1997	Goods	FTA	
Israel	EC	2000	Goods	FTA	EC-Med
Israel	EFTA	1993	Goods	FTA	EFTA-Med
Israel	Romania	2001	Goods	FTA	EC-Med
Israel	USA	1985	Goods	FTA	
Jordan	EC	2002	Goods	FTA	EC-Med
Jordan	EFTA	2002	Goods	FTA	EFTA-Med
Jordan	USA	2001	Goods	FTA	
Lebanon	EC	2003	Goods	FTA	EC-Med
Morocco	EC	2000	Goods	FTA	EC-Med
Morocco	EFTA	1999	Goods	FTA	EFTA-Med
Morocco	USA	2006	Goods	FTA	
Palestine	EC	1997	Goods	FTA	EC-Med
Palestine	EFTA	1999	Goods	FTA	EFTA-Med
Syria	EC	1977	Goods	FTA	EC-Med
Tunisia	EC	1998	Goods	FTA	EC-Med
Tunisia	EFTA	2005	Goods	FTA	EFTA-Med
Turkey	Bosnia	2003	Goods	FTA	EC-Balkans
Turkey	Bulgaria	1999	Goods	FTA	EC-Med
Turkey	Croatia	2003	Goods	FTA	EC-Balkans
Turkey	EC	1996	Goods	CU	EC
Turkey	EFTA	1992	Goods	FTA	EFTA
Turkey	FYROM	2000	Goods	FTA	EC-Balkans
Turkey	Israel	1997	Goods	FTA	EC-Med
Turkey	Morocco	2006	Goods	FTA	EC-Med
Turkey	Palestine	2005	Goods	FTA	EC-Med
Turkey	Romania	1998	Goods	FTA	EC
Turkey	Tunisia	2005	Goods	FTA	EC-Med
Bahrain	USA	2006	Services		
Jordan	USA	2001	Services		
Morocco	USA	2006	Services		

B. Plurilateral Agreements

GCC		1984	Goods	PTA	

Source: WTO Secretariat, Website.

erals for two reasons: lower MFN tariffs generate reduced preferences, and they subject the pre-existing bilaterals to a painful 'erosion' of the initially granted preferences.

How then to explain the continuing attraction to bilaterals in a world with more moderate average applied MFN tariffs? First, it may reflect the fact that tariff cuts made since the late 1980s are far from perfect. High tariffs and/or non-tariff barriers have been kept on a substantial range of goods, hence ensuring high preferences for non-liberalized products. Second, most tariff cuts of the two last decades have been done in terms of applied tariffs, not 'bound' tariffs. (Under WTO rules, only bound tariffs cannot be raised without compensating the affected trading partners, hence the importance of WTO negotiations on bound tariffs.) Today, bilaterals may thus offer limited preferences on applied tariffs, but they may still offer notable or high preferences on bound tariffs, hence shifting the risk of tariff increases to the countries without preferential market access.

Third, the two last decades have witnessed a shift of interest towards trade in services and freer international investment flows. The current WTO framework is loosely structured with respect to services liberalization, and it has a minimal set of provisions on investment in services, and none in goods. That said, bilaterals on trade in services and investments may be attractive for the same reason that pre-1990s bilaterals were for trade in goods: the existence of high preferences. Hence they may be doomed to the same fate since today, most services are highly protected in most countries, as was the case for goods before the 1990s. The magnitude of this problem depends on whether discriminatory practices are hard to embed in services and investments bilaterals.

What follows tries thus to estimate the risks of trade diversion by giving a sense of the remaining high (applied or bound) tariffs and high barriers to trade in services. Tables 4 and 5 above give such a sense for the MENA5 countries themselves. The two Tables show large pockets of protection in the MENA goods and services sectors, suggesting that the producers of goods and services of the MENA trading partners have many large opportunities to extract rents (if they are efficient by the world standard) or transfers (if they are relatively inefficient by the world standard) from the consumers of the MENA5 countries. In sum, the existing bilaterals enforced by the MENA5 countries hurt the MENA5 consumers at the benefit of the producers of the MENA trading partners.

Table 8 looks at the symmetrical question. Do the bilaterals enforced or considered by the MENA5 countries reveal the same feature in the MENA partners' economies? In other words, do these bilaterals offer profitable trade diversion "opportunities" to the MENA5 producers of goods and services in the short run – at the cost of painful adjustments to preference erosion in the long run?

Table 8 presents thus the features of the MENA5 partners in bilateral deals, and the corresponding features for Chile and Singapore as a way of comparison. Column 1 gives the number of co-signatories of the bilaterals involving these countries. Columns 2 and 3 show the

GDP shares of the MENAs' trading partners in world GDP (both at current and PPP exchange rates) giving a sense of the market coverage of the possible preferences related to the size of the trading partners involved in existing and future bilaterals. Combining the coverage indicator with indicators focusing on the level of preferences gives a sense of the magnitude (that is, the coverage times the level) of the expected preferences.

Columns 2 and 3 reveal a striking difference between Egypt and Morocco on the one hand, and the other MENA countries on the other hand. That Egypt and Morocco have a bilateral with the EU and the US (a fact for Morocco, a possibility for Egypt) means that they have access to a large share of world GDP, that is, of the world markets. By contrast, the other MENA5 countries have access to only one third of the world markets (the EU and the EFTA). In particular, the fact that Turkey duplicates the EC bilaterals brings very limited additional market access. From this point of view, a FTA with the US would be much more profitable for Turkish producers.

Columns 4 and 5 focus on industrial tariffs, the first key instrument that could determine the level of preferences in trade in goods in the partners' markets (agriculture is excluded from all the bilaterals from the beginning). Low applied average tariffs suggest that partners in the bilaterals have kept relatively few peak tariffs, hence that they offer limited opportunities for preferences. With high applied and bound tariffs, such opportunities are more likely. Columns 4 and 5 reveal that there are few opportunities of trade diversion that could be expected by MENA producers, independently from the fact that the MENA5 countries have a bilateral with both the EC and the US, or only with the EU – simply because the EU and US bound and applied tariffs are similarly low. (Indeed, a more detailed analysis would show higher tariff peaks in the US than in the EC.)

Columns 6 and 7 focus on non-tariff barriers, the other key instrument that could determine the level of preferences in trade in goods. As there is no direct measure of such barriers, Table 8 relies on the ranking of the co-signatories of the MENA5 countries in two respects: the ease of trading across borders and the ease of dealing with licenses, as estimated by the Doing Business database [World Bank 2006]. Rankings are crude indicators (there may be a much bigger difference between the first and

Table 8: PT as enforced, signed, under negociation or consideration by MPs

	Number of partners [a]	Market size [b] at current USD	Market size [b] at PPP USD	Average industrial tariff: bound	Average industrial tariff: applied	Regulatory ranking: trading across borders	Regulatory ranking: dealing with licences	Regulatory ranking: ease of doing business	Regulatory ranking: registering property	Regulatory ranking: protecting investors
	1	2	3	4	5	6	7	8	9	10
Egypt [c]	1	31.0	21.2	3.8	3.9	42.5	59.9	34.5	62.6	57.1
Egypt [d]	2	61.2	42.9	3.6	3.3	27.3	41.8	19.2	37.1	31.8
Jordan	3	32.7	22.0	4.1	3.9	43.6	60.9	34.9	62.9	60.5
Morocco	3	62.8	43.7	3.8	3.3	27.4	41.5	19.0	36.6	32.9
Tunisia	2	32.7	22.0	4.1	3.9	43.6	60.9	34.9	62.9	60.5
Turkey	11	33.6	23.3	5.3	4.4	44.0	64.3	36.7	65.1	60.8
Chile [e]	20	79.0	70.4	8.0	5.5	34.1	70.8	41.5	39.6	46.3
Chile [f]	9	81.6	77.7	10.3	6.4	43.2	77.8	49.4	45.5	45.1
Singapore [e]	10	48.5	39.3	9.2	4.8	35.8	41.7	28.0	35.3	16.7
Singapore [f]	12	90.6	81.2	9.0	5.7	40.0	68.9	43.5	42.3	41.0

Sources: World Bank World Development Indicators and Doing Business [2007]. WTO Trade profiles [2006].

Notes: [a] Counting the EC and EFTA as one country. [b] GDP (in USD, 2004) as a share of world GDP. [c] with the EC. [d] Including the PTA under consideration with the US. [e] PTAs signed. [f] PTAs signed and under negotiation or consideration.

second ranking than between the second and third ranking, or vice versa). But the MENA countries which have signed a bilateral with the US face a notably lower ranking – mirroring the better ranking of the US regulations.

Columns 8 to 10 of Table 8 deal with services and investments. They use rankings of indicators from the Doing Business database already mentioned. The services dimension is captured by the global indicator of the ease of doing business in the co-signatories, whereas the investment dimension is reflected by the quality of property registering and investors' protection in the co-signatories. These indicators give the same results than those related to non-tariff barriers (for the same reasons, namely the more pro-competitive US regulations in these matters).

Notes

1 The data on GDP structures of Arab countries are drawn from the Arab Monetary Fund (AMF) website. Data on Egypt required adjustments. The shares of the "Commerce, restaurants & hotels" and of "Finance, insurance & banking" sectors exhibit strong and converse disruptions in 2004. A detailed analysis of the disaggregated data from the Ministry of Economic Development of Egypt suggests errors of aggregation in these sectors from 1994 to 2003 on the AMF web-site. More precisely, the sector "Finance, insurance & banking" included the sub-sector "Wholesale and retail trade" that has to be included in the sector "Commerce, restaurants & hotels". Table 1 data take into account the appropriate corrections.

2 That is, sewage and refuse disposal, sanitation and similar activities, recreational, cultural and sportive activities, private households with employed persons, and other services activities.

3 Doing Business provides quantitative indicators on business regulations and the protection of property rights. The database allows comparison between 175 countries. To make the data comparable across countries, the indicators refer to a specific type of business.

III. Implications of Liberalization of Trade in Services and Network Industries

Studies of the measurement and impact of impediments to trade and investment in services in MENA countries are rather rare.[1] Yet, to design successful reform strategies it is crucial that the effects of liberalization of services, in particular those in the context of the EU's Neighborhood Policy, be analyzed thoroughly. To do that, we first need to quantify the trade barriers in services prevailing among the EU and MENA countries, and then using these measures of trade barriers asses quantitatively the effects of liberalization of services trade in those countries.[2] The present study is structured as follows. While section 1 considers the quantification of barriers to trade in services and network industries, section 2 assesses the effects of liberalization in banking, telecommunications, maritime freight transport, electricity and natural gas in the MENA countries. Finally, section 3 assesses the implications of liberalization.

III.1. Quantifying barriers to trade in services and network industries

The simplest and most common approach to measuring the barriers to trade in services refers to frequency measures developed by Hoekman (1996). Next we consider the approach adopted by the Australian Productivity Commission discussed by Findlay and Warren (2000). Finally we consider the gravity approach developed by Francois (1999).

III.1.1 Hoekman's Approach to Estimating the Tariff Equivalents in Services

Hoekman (1996) constructs frequency ratios on the basis of commitments scheduled in the GATS. He considers the four modes of supply of the GATS: (i) cross-border supply, (ii) consumption abroad, (iii) commercial presence, and (iv) movement of natural persons. According to the services sectoral classification list of the WTO (MTN.GNS/W/120) there are 155 non-overlapping service sectors. Since for each sector there are four possible modes of supply a total of 620 such openness/binding factors (commitments) exist for each member country.

The core rule of GATS is - like in the traditional GATT - the principle of nondiscrimination, which has two components, the Most Favored Nation (MFN) rule and National Treatment (NT) principle. The first one means that products supplied from different WTO countries should be treated equally at the market of importer (Article I of GATT).[3] The NT clause (Article III of GATT) requires that foreign goods - once they have satisfied border measures – should be treated no less favorably than "like" goods produced domestically.[4]

In the GATS, in contrast to GATT, the coverage of NT is applied only to sectors listed in country's schedule of commitments, and only insofar as existing measures are not exempted. In addition the GATS agreement introduces the concept of market access. Its scope is determined by a positive listing of sectors in the WTO schedules of commitments. A specific commitment is an undertaking to provide market access and NT for the service activity in question. Thus, specific GATS commitments have a similar effect to a merchandise tariff binding — they are a guarantee that the conditions of entry and operation in the market will be non-discriminatory and not be changed for foreign suppliers.

As commitments scheduled in GATS apply to NT and market access separately, there are potentially 1,240 data cells for each Member (620x2).[5] Commitments were then classified into three categories, and each category was assigned a numerical score, as follows:

- √ If no restrictions were applied for a given mode of supply in a given sector ("none" in GATS jargon), a value of 1 was assigned;
- √ if no policies were bound for a given mode of supply in a given sector ("unbound" in GATS jargon), a value of 0 was assigned; and
- √ if restrictions or limitations were listed for a given mode of supply in a given sector ("bound" in GATS jargon) , a value of 0.5 was assigned.

The value of these indicators was chosen so as to allow aggregation across sectors and countries. The higher the number, the greater is the implied extent of openness-cum-binding. Using these scores, Hoekman calculated three indicators: (i) the number of sector/mode of supply combinations (cells) where a commitment was made (as a share of the maximum possible, 620 for market access and 620 for national treatment); (ii) the "average coverage" of each schedule of commitments, defined as the arithmetic mean of the scale factors allocated to each cell; and (iii) the share of "no restriction" commitments in (a) a Member's total commitments, and (b) relative to the 155 possible sectors of the classification list. The higher the number, the more "liberal" service regime is in the country.[6]

While the original purpose of these coverage indicators was to quantify GATS commitments, Hoekman argued that they could be used to generate information on the relative restrictiveness of policy regimes pertaining to service industries by assuming that the coverage of each country's schedule is an indicator of its policy stance. He used the frequency ratios as a starting point for estimating country-specific "tariff equivalents" of the relative degree of discrimination of foreign services provider across countries and sectors. Here, he arbitrarily defined a set of benchmark "guesstimates" of tariff equivalents for each sector. These are judgemental set of benchmark tariff equivalents for individual sectors to reflect the degree to which market access to these sectors are restricted. A value of 200 percent was chosen for the sectors where access tended to be prohibited by most countries, and which did not appear in most schedules such as maritime cabotage, and voice telecommunications; while values between 20 percent and 50 percent were assigned to sectors where access was less constrained (e.g. hotels and restaurants). Each country and sector was then assigned a value related to that benchmark. For example, the financial services sector (excluding insurance) was assigned a tariff equivalent of 50 percent. The "tariff equivalent" of a given country was then obtained by multiplying this guesstimate by $(1-(x/y))$, where x is the weighted coverage for each sector per country and y is the total coverage possible for each category. Thus, if the most restrictive country worldwide had restrictions equivalent to a 200 percent, then a country with a Hoekman index of 0.1 would have a tariff equivalent of 180 percent (i.e., 0.9 times 200). Hoekman (1995) when reporting the results of calculations for 26 sectors and 49 countries used the information on market access commitments and not those on national treatment.

The importance of Hoekman's contribution is acknowledged in the literature, and the indices have been used in many empirical studies. There are certainly some clear advantages of Hoekman indices. Firstly, they cover all sectors and a very large group of countries. Secondly, it is fairly easy to apply the Hoekman approach to the new WTO members states undertaking new GATS commitments. His approach requires no specific country and sectoral field studies.

To present the basics of the three approaches to determination of barriers to trade in services comparable we consider the banking sector in Turkey. Calculations by Hoekman's approach reveal that the value of Hoekman's index is 0.875 and that the tariff equivalent in the sector is 6.25 percent (50 times 0.125).

III.1.2 Australian Productivity Commission's Approach to Estimating the Tariff Equivalents in Services

A more elaborate restrictiveness measure than that of Hoekman has been constructed for different service industries by the Australia's Productivity Commission (APC), in collaboration with the University of Adelaide, and the Australian National University. To develop these indices, the actual restrictions on trade in a service industry are compiled from specifically designed questionnaires using a number of different sources. These restrictions are then assigned scores and grouped into categories, each of which is assigned a numeric weight. These scores and weights are based on subjective assessments of the costs of restrictions to economic efficiency. Finally, the sectoral indices are computed using these scores and weights.

To clarify the essentials of this approach consider again the banking sector, and follow the approach of McGuire and Schuele (2000). The authors, calculating restrictiveness index values for different countries, divide the restrictions into two groupings: those affecting 'commercial presence' and other restrictions called 'restrictions on ongoing operations'. Whereas the first group indicate the restrictions on the movement of capital, the latter group is modeled as restrictions on trade in banking services. The commercial presence restriction grouping covers restrictions on licensing, direct investment, joint venture arrangements, and the permanent movement of people. The other restrictions grouping covers restrictions on raising funds, lending funds, providing other lines of business, expanding banking outlets, the composition of the board of directors, and the temporary movement of people. The authors assign weights to these variables and obtain first restrictiveness index values for the two categories and then the overall restrictiveness index values for the economies considered.[7] Kalirajan et al. (2000) use this information to study the effects of restrictions in the banking sector on the performance indicators. Kalirajan et al. (2000) note that banks provide a wide range of financial services including deposit-taking, lending, insurance and securities. But they emphasize that although banks are diversified entities, their core business remains the matching of depositors and lenders. Thus, the price of banking services can be measured by the net interest margin (NIM), the difference between the interest rate banks charge on their loans and the rate they pay on their deposits. Restrictions on trade in banking services is expected to increase the interest margin or the price of banking services. The effect of these restrictions in the banking sector on the net interest margin is analyzed by Kalirajan (2000) econometrically. Given the econometrically estimated relation between the price of banking services and restrictions on trade in banking services, the tariff equivalent of restrictions in a particular country can be estimated.

The calculations by the Australian Productivity Commission approach for banking services by Kalirajan (2000) reveal that as a result of restrictions in the banking sector net interest margin in 1997 relative to the free trade net interest margin increases by 31.541 percent in the case of Turkey and by 5.32 percent in the case of the EU. One could thus infer that the net interest margin in Turkey will decrease from its base value in 1997 by 26.22 percent when Turkey would adopt and implement the EU rules and regulations on banking services. Recently, Togan (forthcoming) has estimated the tariff equivalents in Turkish banking sector using the same approach for the year 2005, and he reports that the tariff equivalent during 2005 has decreased substantially after the introduction of reform measures in the country following the 2001 financial crisis, and that it amounts to 3.73 percent.

III.1.3 Gravity Approach to Estimating the Tariff Equivalents in Services

The basic methodology for estimation of services barriers by the gravity approach involves the estimation of sector-specific gravity equations, which relate the bilateral trade flow from country *i* to country *j* to the exporting and importing countries' GDP per capita, populations in the two countries, distance between the two countries, trade barriers, and a set of country dummies such as adjacency, common language, and regional trading arrangements (e.g. EU membership).[8] Using the econometrically estimated gravity equation and a measure of the elasticity of substitution for the service sector under consideration we obtain the tariff equivalent of barriers to trade in the respective service sector.[9] The main issue with the gravity model is related to the non-availability of data on bilateral sectoral trade flows in services for a large number of countries. Essentially, there are three sources of data on bilateral trade flows in services. The GTAP database provides crosssection dataset of world bilateral service trade flows for 2001.[10] Second, we have OECD data on bilateral trade flows in services among the OECD countries.[11] Finally, we have the EU EUROSTAT on EU members' trade in services.[12] While Park (2002) uses the GTAP database, Walsh (2006) makes use of the OECD data.

Park (2002) who has estimated tariff equivalents for seven services in 28 countries reports that the tariff equivalent of barriers to trade in banking services in Turkey equals 38.7 percent.

III.1.4 Comparison of the Tariff Equivalents of Barriers to Trade in Turkish Banking Services by Different Approaches

The above considerations reveal that the estimates of tariff equivalents of barriers to trade in banking services in Turkey vary considerably with the approach adopted. The estimate amounts to 6.25 percent according to Hoekman's approach, 3.73 percent according to Australian Productivity Commission's approach, and 38.7 percent according to gravity approach. But, there are some serious problems with two of these approaches.

Consideration of Hoekman's indices reveal certain weaknesses. First, the indices do not assign weights to entry barriers based on their differential impacts on the economy. Since all limitations receive the same weighting (0.5), minor impediments are treated exactly the same as almost complete refusal of foreign entry into a domestic market. Second, the indices are constructed on the basis of the GATS schedules of commitments, many of which do not provide an accurate description of the actual barriers. The indices reflect the level of commitments which were made by the member countries some time ago, and as a result they in general do not show the present real level of restrictions in particular service sectors. In several sectors the current level of liberalization is exceeding the level of liberalization when the schedules of WTO commitments were undertaken. Thus, present average levels of tariff equivalents can be quite different from Hoekman's guess estimates, even assuming that they were initially correct. Third, considering an unscheduled sector as being completely closed to new entry does not give a clear picture of the situation either. It may well be the case that actual practices are more liberal than commitments, and therefore the indices may be overstating the degree of protection. Finally, the absolute level of indices depends very much on "benchmark guesstimates" of tariff equivalents of the most protectionist countries. For example the guess estimate for non-life financial services is 50 percent, while for life insurance is 200 percent. In consequence the average sectoral level of all countries depends mainly on the level of guess estimate. Thus, they rather reflect relative restrictiveness among countries and not the absolute level of sectoral tariff equivalents and such estimates cannot be directly used in liberalization simulations where the information about the absolute level of protection is required.

When trying to estimate the tariff equivalents in services in the MENA countries we note that the gravity approach has certain weaknesses. First, the bilateral GTAP data is constructed using various data sources and balanced against the input-ouput tables and balance of payments data. This dataset is aimed at computable general equilibrium (CGE) analysis and is not meant to be used in econometric studies, since many missing data points are estimated using various techniques and do not necessarily resemble real service flows. Moreover, GTAP data is a one-period only which rules out its use from panel analysis. Second, data on bilateral sectoral trade flows in services between the MENA and OECD countries is limited and there are no data on trade among the MENA countries. Hence, the estimation of tariff equivalents countries by the gravity approach for MENA may lead to biased results.

The most appropriate approach for estimating the tariff equivalents in services in the MENA countries seems to be the Australian Productivity Commission's approach. Table 1 shows the tariff equivalents of barriers to trade in various service sectors and network industries prevailing in the latter half of 1990's in Turkey and the EU. The estimates derived by the Australian Productivity Commission's approach have been obtained from Findlay and Warren (2000), Doove et al. (2001) and the website of the Australian Productivity Commission. Note that in the case of telecommunications services and electricity the estimate of the tariff equivalent for the EU refers to the estimates of Finland and United Kingdom, the two countries following liberal policies with the lowest values of tariff equivalents. The table also shows the tariff equivalents in Turkey estimated by Togan (forthcoming) for the year 2005. Finally, the last column shows the tariff equivalents for Turkey that are used in the present study when evaluating the effect of liberalization of services and network industries within the context of EU integration.

Estimates of the tariff equivalents for banking, telecommunications and maritime transport obtained by Achy et al. (2002) for Egypt and Morocco are reported in Table 2. The estimates for Tunisia reported in the same table have been obtained from Konan and Maskus (2006) for banking and maritime services, and from the Australian Productivity Commission's website for the telecommunications sector. Unfortunately there are no estimates of tariff equivalents available for Egypt, Morocco and Tunisia for electricity and natural gas.

III.2. Implications of liberalization

Since the MENA countries are trying to liberalize the service sectors mainly by following the EU approach to liberalization, we consider the case where the MENA countries will align their regulatory

Table 1: Tariff Equivalents of Barriers to Trade in Services and Network Industries in Turkey and the EU (percent)

	Turkey End of 1990's	EU End of 1990's	Net Effect End of 1990's	Turkey 2005	EU 2005	Net Effect 2005	Tariff Equivalent in Trade with the EU used in this Study
Banking	31,5	5,3	26,2	3,7	-	-	26,2
Telecommunications	33,5	0,0	33,5	2,7	0,0	2,7	33,5
Maritime Transportation Services	-	-	-	-	-	193,5	193,5
Electricity	20,7	0,0	20,7	-	-	-	20,7
Natural Gas	-	-	-	59,6		59,6	59,6

Source: Own calculations reported in Togan (2007), Findlay and Warren (2000) and Doove et al. (2001)

frameworks to those prevailing in the EU. As representative MENA countries we consider Egypt, Morocco, Tunisia and Turkey and concentrate on the effects of liberalization in the sectors of banking, telecommunications, maritime transport, electricity and natural gas. To present the basics of the approach adopted in our analysis as simple as possible we concentrate on the analysis of the effects of liberalization in the banking sector of Turkey. The approach is then applied to other sectors in Turkey and to the sectors of banking, telecommunications and maritime transport in Egypt, Morocco and Tunisia in a similar way.

To study the economic effects of EU integration in the banking sector we compare the situation of the Turkish economy in the base case with the case when Turkey adopts and implements in the banking sector all of the rules and regulations of the EU. As the 'base case' we consider the Turkish economy with rules and regulations as they have prevailed during the latter half of 1990's, when Turkey did not yet introduce the EU rules and regulations in the sector. Next we consider the case when Turkey implements in the banking sector all of the rules and regulations of the EU. Here we abstract from explicit consideration of problems of implementation over time, and assume that once the *acquis* is adopted, liberalization of the sector will be achieved. This is a grand simplification, but it permits the analysis and comparison to be performed rather easily.

From Table 1 we know that tariff equivalent of barriers to trade in banking services in Turkey with the EU as of end of 1990's is 26.22 percent, indicating that with complete liberalization in trade with the EU the price of banking services will decline by 26.22 percent. Given this change in the price of banking services resulting from the change Turkey's regulatory regimes, one can compute the change in Turkish consumer surplus as a measure of the welfare effect of EU integration from information on the consumer demand schedule for the services under consideration[12b]. But banking services are intermediate commodities for business users that are used in the production of other commodities. Therefore, prices of other commodities in the economy will change as a result of the change in the price of banking services. To study the welfare effects of EU integration, one has to consider not only the change in consumer surplus due to changes in the price of banking services but also the changes in consumer surpluses due to the changes in the prices of other commodities.

To analyze the effect of the change in price of banking services on the prices of other commodities we consider the 1998 Input-Output table for Turkey, which consists of 97 sectors, and where banking is sector no. 84. Next we derive the equilibrium

Table 2 : Tariff Equivalents of Barriers to Trade in Services in Egypt, Morocco and Tunisia (percent)

	Egypt	Morocco	Tunisia
Banking	11,77	30,00	30,00
Telecommunications	11,78	25,23	157,08
Maritime Transportation Services	102,00	72,00	50,00

Source : Achy et al. (2002), Konan and Maskus (2006), and www.pc.gov.au.

prices of the other 96 commodities as a function, among others, of the price of banking services[13]. Using the new equilibrium prices of the 97 commodities obtained after the liberalization of the banking sector we determine the effect of liberalization on consumer welfare[13b]. Hence, with the new price of banking services, we observe that the welfare of the Turkish society will increase by 1.8576 percent. Given that consumption formed 80.834 percent of the 1998 Turkish GDP, the percentage change in welfare of the society is equivalent to 1.502 percent increase in real GDP as shown in Table 3.

Here we have to emphasize that during the 1990s Turkey lacked competent supervisory authorities, a regulatory framework, legal and institutional infrastructure, and in addition the prevailing prudential regulations were poorly enforced. In February 2001 the country faced a financial crisis. The loss of income and wealth and the associated social and political stresses created in the country have been unprecedented. GNP contracted in 2001 by 9.4 percent and the loss in employment is put at more than 1.4 million. The cost of the crisis in the banking sector alone has been estimated as $53.2 billion by Steinherr, Tukel and Ucer (2004), i.e. 35.9 percent of Turkish GDP. It is argued that if Turkey had adopted the legislative, regulatory and institutional framework inherent in the Basel Core Principles or those of the EU banking system during the 1990's, and had also implemented and enforced these rules, then the banking crisis would not have occurred in the first place, and if it did then the cost of the banking crisis would have been much smaller than $53.2 billion. Considering the figure of 6.86 percent for the annual real interest rate we note that the annual cost of the currency crisis amounts to US$ 3.65 billion.[14] Turkey would not have incurred this cost if it had adopted and implemented the legislative, regulatory and institutional framework of the EU banking system at the beginning of the 1990's. Noting that GDP in 2006 has amounted to US$ 403.19 billion, the annual welfare gain from adopting the EU rules of not incurring currency crisis can be thus calculated as 0.9 percent of GDP.

The welfare gain of adopting the EU rules and regulations in the banking sector can then be calculated as the sum of the gain from not encountering currency crisis amounting to 0.9 percent of GDP and the price effect amounting to 1.502 percent of GDP. Thus the total welfare effect of adopting the EU rules and regulations in the banking sector can be calculated as 2.402 percent of GDP. Using the same approach for other sectors and other countries we note that the percent

Table 3 : Effect of Liberalization of Services on GDP in Egypt, Morocco, Tunisia and Turkey (percent)

	Egypt	Morocco	Tunisia	Turkey
Banking	0,807	0,323	0,518	2,402
Telecommunications	0,074	0,234	1,145	0,448
Maritime Transportation Services	0,213	0,295	0,009	0,514
Electricity	-	-	-	0,522
Natural Gas	-	-	-	0,067

Source: Own calculationsr

change in GDP in Egypt, Morocco and Tunisia as a result of liberalization of banking, telecommunications and maritime transport services will increase by the amounts indicated in Table 3.

The results for Turkey indicate that the most important service sector can be identified as the sector for which the benefits measured in terms of the size of the percentage effect of liberalization on GDP is the highest. By this criteria the priority sectors are banking, electricity, maritime transport, telecommunications, and natural gas. It is interesting to note that the banking sector turns out to be the most important sector in terms of the benefits not only for the Turkish economy

Table 4: Information on Bank Structural, Supervisory and Deposit Insurance Variables

		Egypt	Morocco	Tunisia	Turkey	Old EU	Greater Value Indicates
1. Bank Activity Regulatory Variables							
(a)	Securities	2	2	2	2	1,3	more restrictive
(b)	Insurance	2	2	3	2	2,5	more restrictive
(c)	Real Estate	3	3	3	2	1,9	more restrictive
(d)	Overall Activities Restrictiveness	7	7	8	6	5,7	more restrictive
2. Financal Conglomerate Variables							
(a)	Banks Owning Nonfinancial Firms	3	3	3	2	1,9	more restrictive
(b)	Nonfinancial Firms Owning Banks	2	2	2	2	1,9	more restrictive
(c)	Non-bank Financial Firms Owning Banks	2	2	2	2	1,9	more restrictive
(d)	Overall Financial Conglomerates Restrictiveness	7	7	7	6	5,7	more restrictive
3. Competition Regulatory Variables							
(a)	Limitations on Foreign Bank Entry/Ownership	3	3	3	3	3,0	less stringency
(b)	Entry into Banking Requirements	8	8	8	7	7,0	greater stringency
(c)	Fraction of Entry Applications Denied	100,0	0,0	0,0	57,7	7,1	
	Domestic Denials	100,0	0,0	0,0	71,4	6,4	
	Foreign Denials	100,0	N/A	0,0	41,7	18,3	
4. Capital Regulatory Variables							
(a)	Overall Capital Stringency	2	5	5	3	4,5	greater stringency
(b)	Initial Capital Stringency	3	2	3	3	1,8	greater stringency
(c)	Capital Regulatory Index	5	7	8	6	6,3	greater stringency
5. Official Supervisory Action Variables							
(a)	Official Supervisory Power	14	12	13	14	9,6	greater power
	Prompt Corrective Power	6	6	6	6	0,7	
	Restructuring Power	3	3	3	3	2,1	greater power
	Declaring Insolvency Power	2	1	1	2	1,1	greater power
(b)	Supervisory Forbearance Discretion	0	0	0	1	2,1	greater discretion
(c)	Court Involvement	2	1	1	1	1,5	less discretion
(d)	Loan Classification Stringency (Days)	630	630	630	635	630,0	less stringency
(e)	Provisioning Stringency (percent)	170	170	170	170	248,8	greater stringency
(f)	Diversification Index	2	1	0	1	1,4	more diversification
6. Official Supervisory Structural Variables							
(a)	Supervisor Tenure (Years)	N/A	10,0	10,0	8,0	8,7	
(b)	Independence of Supervisory Authority - Political	1	0	0	0	0,4	greater independence
(c)	Independence of Supervisory Authority - Banks	1	1	1	0	0,5	
(d)	Independence of Supervisory Authority - Fixed Term	1	0	1	1	0,7	
(e)	Independence of Supervisory Authority - Overall	3	1	2	1	1,6	greater independence
(f)	Multiple Supervisors	0	1	0	0	0,1	
7. Private Monitoring Variables							
(a)	Certified Audit Required	1	1	1	1	0,9	
(b)	Percent of 10 Biggest Banks Rated by International Credit Rating Agencies	80	70	100	90	79,3	
(c)	Percent of 10 Biggest Banks Rated by Domestic Credit Rating Agencies	10	0	50	0	9,1	
(d)	No Explicit Deposit Insurance Scheme	1	1	1	0	0,1	more private supervision
(e)	Bank Accounting	4	4	2	4	3,6	more informative bank accounts
(f)	Private Monitoring Index	9	9	7	8	7,6	more private monitoring
8. Deposit Insurance Scheme Variables							
(a)	Deposit Insurer Power	N/A	0	N/A	2	1,3	more power
(b)	Deposit Insurance Funds-to-Total Bank Assets (percent)	N/A	0,8	N/A	N/A	0,4	
(c)	Funding with Insured Deposits (percent)	N/A	73	N/A	37	39,7	more moral hazard
(d)	Various Factors Mitigating Moral Hazard	N/A	2	N/A	1	2,0	more mitigation of moral hazard
	Government-Owned Banks	64,7	35,0	42,7	31,8		
	Foreign-Owned Banks	13,3	20,8	15,7	3,5		
	Privately Owned Banks	22,0	44,2	41,6	64,7		
9. External Governance Variables							
(a)	Strength of External Audit	7	6	7	7	6,3	better strength of external audit
(b)	Financial Statement Transparency	6	6	3	6	5,0	better transparancy
(c)	Accounting Practices	1	0	1	1	0,2	better practices
(d)	External Ratings and Credit Monitoring	2	1	2	1	1,6	better credit monitoring
(e)	External Governance Index (4 components)	16	13	13	15	13,5	better corporate governance

Source: Barth et al. (2006)

but also for the Egyptian and Moroccan economies. Hence the sector deserves to be considered in more detail.

Table 4 summarizes the banking sector regulations in the MENA countries and the EU-15 prevailing in 2003. The figures in the table have been derived from information on official responses to a set of comprehensive and detailed questions, both quantitative and descriptive. The answers to questions by official authorities have been converted to indices describing different dimensions of ways in which countries regulate and supervise banks. All indices reported in Table 4 are based on data given in Barth et al. (2006). The last column in the table reports what higher values of indices indicate. The figures reported in the table show that MENA countries have to introduce further measures to liberalize their banking sectors.

Table 5 shows how compliant the Tunisian banks are with the Basel Core Principles for effective banking supervision. The Tunisian banks are compliant with 10 out of 25 principles, and they are materially noncompliant with 6 principles including credit policies, loan evaluation, money laundering, consolidated supervision, remedial measures, and supervision of foreign establishments. Similar considerations apply to Moroccan banks as reported by the IMF (2003).

Banking as emphasized in Part II is a sector where efficient functioning of the sector cannot be achieved through uncontrolled competition. A crucial impediment to efficient functioning of the sector is asymmetric information, which leads to adverse selection and moral hazard. The sector needs to be regulated. But in general each country

Table 5: Results of the Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision

	2006 Assessment
1. Objectives, autonomy, powers and resources	
1.1 Objectives	Compliant
1.2 Independence	Compliant
1.3 Legal framework	Compliant
1.4 Enforcement powers Largely	Compliant
1.5 Legal protection	Compliant
1.6 Information sharing Materially	Largely Compliant
2. Permissible activities	Compliant
3. Licensing criteria	Compliant
4. Ownership	Compliant
5. Investment criteria	Compliant
6. Capital adequacy	Largely Compliant
7. Credit policies	Materially Noncompliant
8. Loan evaluation	Materially Noncompliant
9. Large exposure limits	Compliant
10. Connected lending	Largely Compliant
11. Country risk	Not Applicable
12. Market risks	Largely Compliant
13. Other risks	Largely Compliant
14. Internal control and audit	Largely Compliant
15. Money laundering	Materially Noncompliant
16. On-site and off-site supervision	Compliant
17. Bank management	Compliant
18. Off-site supervision	Largely Compliant
19. Validation of information	Compliant
20. Consolidated supervision	Materially Noncompliant
21. Accounting standards	Compliant
22. Remedial measures	Materially Noncompliant
23. Global consolidated supervision	Not Applicable
24. Host country supervision	Not Applicable
25. Sup/foreign establishments	Materially Noncompliant

Source: IMF (2007)

has different set of regulations and supervisory practices in place, and the countries often have little interest in each other's regulatory regimes or have little confidence in its quality. If each country has different regulations in place and does not recognize qualifications in a foreign bank's home country, then the national qualification costs become cumulative costs, as banks intending to establish abroad will have to incur costs to comply with the qualification criteria of each country. To reduce the qualification costs international norms have been introduced, and best known international norms are the Basel Core Principles for effective banking supervision. Hence, countries intending to liberalize their banking sectors should give priority to achieve compliance with the Basel Core Principles for effective banking supervision. Deeper integration of the sector could be achieved through greater involvement of foreign banks. As more foreign investment enters the country, more MENA banks will begin to pay attention to corporate governance, and professional management. As EU banks are supervised by their home regulator, they are a vehicle to import better regulation. That, in turn, will attract more foreign investment. After achieving compliance with Basel Core Principles for effective banking supervision the MENA countries could try to adopt at a later stage the EU legislation. The main reason is that this part of the *acquis*, as emphasized by Emerson et al. (2006), is highly complex and geared towards sophisticated financial markets. Since the cost of adjustment to the EU banking *acquis* in MENA countries would be quite high, active convergence could be achieved at a later stage.

Similar considerations will apply to maritime freight transport sector. Since maritime transport is inherently international in character, and vessels on most voyages have to operate under the regulatory requirements of many jurisdictions, there is an inherent need for harmonization across countries. The countries have to harmonize their rules and regulations to international rules and regulations which are classified as (i) regulations related to commercial operations and practices, and (ii) regulations related to rights and obligations of states and to safety and environmental regulations. From the first set of rules and regulations the countries should adopt those international rules and regulations that will lead to increased competition in the sector. The second set of rules and regulations have to be observed at any cost. Active convergence with the EU maritime freight transport sector *acquis* could be achieved again at a later stage, as immediate convergence with the EU *acquis* would be extremely costly for the MENA countries.

The problem is quite different in the network industries. Consider first the natural gas sector. Due to increasing gas demand of the enlarged EU and declining domestic gas supplies, the EU faces growing import dependency over the next decades. Neighbouring regions to Europe are endowed with substantial reserves and resources which should theoretically allow to satisfy the EU demand increase in the medium to long term. Gas production from the Mediterranean region has continuously increased in the past twenty years or so, and is expected to increase further in the future. With the enormous export potential of Algeria, Libya and Egypt we note that existing transportation routes will probably remain the most important in the near future, and that they will be expanded.[15] Security of supply and hence transit issues will probably remain prominent in the minds of European policy makers. The natural gas sector reform in the southern Mediterranean region is still in its infant stage and far behind Europe. The market structure and policy framework in those countries continues to be dominated by vertically integrated, state owned monopolies. The EU is fully aware of the fact that developing new gas corridors is not possible in a conflicting international context. Therefore, it has launched several important initiatives including the European Neighborhood Policy aiming to foster stability, dialogue and cooperation between the EU, energy suppliers and transit countries. EU is pushing for full application of the Energy Charter Treaty which, it believes, would increase investors' confidence. In this sector the MENA countries could potentially contribute to increasing efficiency in the sector by adopting the EU natural gas sector *acquis* and following liberal FDI policies.

In the electricity sector the problem is to have a suitable market structure within which effective competition can be fostered and monitored by an independent regulator. The EU electricity sector *acquis* could be helpful in this respect, as it has been the case in Turkey. The adoption of the EU *acquis* together with the liberal FDI policies adopted helped considerably to attract investments of multinational corporations in the Turkish electricity sector. As foreign investment enters the country, Turkish companies are beginning to pay more attention to corporate governance and professional management. That, in turn, is attracting more foreign investment. Moreover, there are substantial gains from being a part of the large European single market in electricity. Mueller-Jentsch (2005) emphasizes that the economic benefits of deeper integration of electricity markets could be substantial for MENA countries because of the following reasons. First, cross-border power transfer for emergency support and peak demand would allow countries to lower expensive reserve margins. This would reduce investment needs and increases capacity utilization. Second, economies of scale, different load profiles, and complementary energy endowments could give rise to further gains from trade. Third, private investors would be willing to invest more in large markets. Fourth, regional power markets could facilitate domestic reforms in the MENA countries, especially the introduction of competition.

Similar considerations will apply in the case of telecommunications, where the aims of increased efficiency and guarantee of universal service could be secured by adopting and implementing the EU telecommunications *acquis* as it has been the case in Turkey.

The above considerations reveal that the EU *acquis* may not be a panacea for all the service sectors and network industries as the cases of banking and maritime transportation revealed. In the cases of electricity, natural gas and telecommunications the adoption of the EU *acquis* would be beneficial for the MENA countries. But in the cases of banking and maritime transportation it would be more advantageous to adopt the international rules and regulations first, and adopt the EU *acquis* at a later stage. Such a strategy will help to attract larger amounts of inward FDI to the MENA countries. This investment, plus the greater role played by foreign investors in the management of MENA companies, will be a major factor in reinforcing the move toward better corporate governance.

The above considerations and the discussion on institutional aspects presented in the previous part of the study can now be used to answer the following set of four questions:

√ What are the services that should be considered as priorities in the partnership between the EU and MENA countries that may lead to a deep free trade area, and what are the associated costs and benefits for the Mediterranean partners?

√ What are the necessary institutional reforms that would optimize the beneficial effects in the Mediterranean partners? How can they be designed considering the distance of the national legal framework from the "*acquis communautaire*"?

√ Do action plans take into account these evolutions/reforms (agendas, budget, etc.)? Is it necessary to develop/modify them? What specialization in the services can be envisaged in medium- long term at the Euromed level (reciprocal comparative advantages? role of foreign direct investments?) What are the incidences on the rules that govern the circulation of persons and the movements of capital?

√ What are the difficulties raised by the compatibility WTO/GATS/ Euromed.

Since the first question has already been answered above to a large extent we turn to the second part of the question regarding the estimation of the costs of liberalization. Unfortunately, this is an extremely difficult question to answer, and the answer will vary from sector to sector. In the case of network industries there is no need to estimate the change in producer's surplus as each sector under consideration prior to reforms in each of the countries was run by a monopoly. Under monopoly there is no supply curve and hence the welfare effect can be measured by estimating the relevant change in consumer's surplus only plus the change in pure profits of the monopoly[16]. But the answer is more complicated in the cases of maritime freight transportation and banking sectors. In the case of maritime transport the cost of adjustment to regulations related to commercial operations and practices could be studied by the change in producer's surplus using econometrically estimated supply function for the sector in each country. But, the estimation of the costs of adjustment related to EU safety and environmental regulations is more demanding. The adoption of the EU safety and environmental regulations by MENA countries may lead to scrapping part of the merchant fleet in each country. Hence keeping even the supply constant at its pre-liberalization level may require substantial amount of investment in the merchant fleet[17]. Similar considerations would apply in the banking sector, where the adoption of EU regulations would require substantial amounts of investment in human capital over considerable period of time[18]. It was mainly because of these costs of adjustment why we have advocated the adoption of international rules and regulations promoting increased competition in the related sectors. Finally, note that Konan and Maskus (2006), when analyzing the impact of services liberalization in Tunisia using a computable general equilibrium (CGE) model, estimate that 3.7 percent of the labor force will change sector of employment as a result of liberalization, but real returns to labor will increase by 2 percent. The highest change in employment will occur in financial sector, followed by insurance, transportation and distribution sectors.

Regarding the second question we note that the question has already been answered above and in Part I of the present study. Turning to the third question we note that in 2005 a framework protocol for negotiations on services was agreed in the Euro-Mediterranean Partnership context (European Commission (2005)). This envisages employing the GATS structure, i.e., a positive list approach to determining the sectoral and substantive coverage of commitments. The objective is that negotiated commitments will apply on a regional (Euro-Mediterranean) "MFN" basis. The protocol also calls for "progressive alignment" with the *acquis* in the area of services. In 2006 the launch of Euro-Mediterranean negotiations on the liberalization of trade in services and the right of establishment was announced at the Ministerial Meeting (European Commission (2006)). According to Ministerial Declaration the negotiations will aim progressively and mutually to liberalize trade in services and of the right of establishment among all participants, the Euro-Mediterranean Framework Protocol on the liberalization of trade in services, agreed at the Istanbul Euro-Mediterranean Ministerial Conference in July 2004, will be a template that would guide the negotiations, and the future agreements will be compatible with WTO rules, and in particular with Article V of the GATS.

Hoekman (2007) notes that a positive list approach to scheduling commitments has the advantage of allowing flexibility in terms of what sectors to include and what types of commitments to make. But a major disadvantage of the approach is that it generates only limited transparency of policy. He therefore advocates the formation of European Neighborhood Policy (ENP) services monitoring and policy dialogue/assessment body[19].

To benefit fully from the ENP, the MENA countries must have a clear strategy and identify what elements of that strategy can and should be addressed through the ENP Action Plan. Finally, it should be emphasized that the EU could increase the incentives for domestic reform in MENA countries by granting meaningful additional access to its markets—especially for services (mode 4). But, the scope for the EU to make concessions on mode 4-access is likely to be quite limited given the political sensitivity associated with labor movement. It seems that there are no chances for immediate liberalization of natural persons neither between MENA and EU countries nor among MENA states. The fierce discussions in Europe regarding Bolkestein proposal demonstrated that free movement of services providers, having companies in other countries, can not be realized immediately in united Europe of 27 members. The country of origin principle in services has been regarded as going too far. Also, the freedom of establishment for providers of services and free movement of services have been accepted after lengthy discussions, despite treaty provisions regarding free flow of services. Perhaps liberalization can be done only through the temporary movement of natural service providers. Despite these limitations, MENA countries could gradually adopt confidence building measures, in line with the approach used in the Services Directive. The Directive calls for measures promoting the quality of services, such as voluntary certification of activities, or cooperation between the chambers of commerce. There was also a call for encouraging codes on certain questions, including in particular commercial communications by the regulated professions. These measures should raise quality of services supplied to MENA markets and enable - in the long term perspective - gradual liberalization of EU imports in "standardized" services.

Finally, turning to the last question of GATS negotiations we note that there are problems with diverging nomenclatures of services and limited availability of trade statistics. The Uruguay Round commitments were not always precise in terms of their scope and usually very limited in developing countries. In the Doha Round countries negotiate bilaterally by submitting requests (usually highly ambitious) to others that in turn bring forth a response of conditional offers (mostly minimalist). This results in "negotiating drift" in which little is expected and less is offered (Matoo 2005). By now many governments exclude all sectors from their offers what provokes a snow ball effect: the more numerous are the exclusions, the higher is the vulnerability of governments to domestic lobbies with vested interests and the fewer are the possibilities for trade-offs between WTO members (Jara and Domoinquez 2006).

It seems, that MENA countries are also unwilling to present meaningful offers, even in cases where actual practices are more liberal than existing commitments. This reluctance reflects fear that liberal offers may undermine negotiating position in the future. It also reflects a fear regarding unknown implications of trade liberalization commitments. Matoo (2005) proposes that "*the international development community should establish a mechanism, funded by public and private donors, to provide policy advice and to diagnose and remedy inadequacies for developing countries that are considering making liberalizing commitments".*

This sort of advise can probably by provided by EU experts to MENA governments.

Some less developed countries also ask for „emergency safeguard mechanism" similar to WTO Agreement on Safeguards applied to trade in goods. Such a safeguard should reduce reluctance towards liberalization. On the other hand, it can not be applied to all modes of supply (and especially mode 2: commercial presence and FDI). MENA countries, submitting their offers, should in principle pay attention to services offers of the EU. More far reaching offers of Mediterranean Partners, can pose a problem in the case of future regional agreements on services liberalization with EU.

If MENA countries would have to reduce the access to their markets as a result of such regional agreements then it could cause a problem of compensation for other WTO members.[20] Here again policy advice from EU experts could be useful.

Notes

[1] See e.g. Konan and Kim (2004), Konan and Maskus (2006) and Achy et al. (2005).

[2] For an excellent survey of various issues related with services see Hoekman (2006).

[3] The Free Trade Areas and Customs Unions (art XXIX of GATT) are major accepted exceptions to the MFN treatment.

[4] The national clause is applied with respect to internal taxation and other regulation. For discussion of core principles of GATT see Hoekman and Kostecki (2001).

[5] The number of entries varies among the countries, since many sectors are not included in the list of commitments of a large number of countries.

[6] The scope of GATS commitments for developed countries is usually much larger than for developing ones. In the sample analyzed by Hoekman (1996, p.40) the average coverage of bound sectors-modes was 35.6 percent for developed and 10.9 percent for developing countries.

[7] For the calculation of restrictiveness index values in more detail see Kimura et al. (2003).

[8] The gravity equation can be specified as:

$$\ln M_{i,j} = a_1 + a_2 \ln PCY_i + a_3 \ln PCY_j + a_4 \ln POP_i + a_5 \ln POP_j + a_6 \ln Distance_{ij} + a_7\, Adjacency_{ij} + a_8\, Language_{ij} + a_9\, FTA_{ij} + a_{10}\, NTB_j + e \ ,$$

where $M_{i,j}$ represents import of a particular service from country i into country j, PCY_i represents per-capita income in country i, POP_i is population in country j, and $Distance_{ij}$ is distance between country i and country j. The dummy variable *adjacency* indicate whether countries i and j are adjacent (common border or not), *language* whether countries i and j share the same language, and FTA_{ij} whether both countries are members of the Free Trade Area. Finally, NTB_j measures the level of non-tariff barriers of the importing country j. For alternative specifications of the gravity equation see Francois et al. (2003), Park (2002) and Walsh (2006).

[9] The tariff equivalent is calculated using the relation:

$$T = [\, M_p / M_{FT} - B_p / B_{FT} \,]^{1/-e}$$

where T denotes the power of the tariff equivalent (1 + t), M_p and M_{FT} are the predicted and free trade levels of imports of the service in country j respectively. M_p is based on the gravity model prediction of imports, and M_{FT} is calculated as the predicted level of trade when all barriers to services trade were abolished. On the other hand, B_p and B_{FT} are the predicted and free trade levels of imports of the service under consideration in the benchmark country respectively, and the benchmark country is to be the country with the lowest level of restrictions. Finally, e denotes the elasticity of substitution. See Francois et al. (2003), Park (2002) and Walsh (2006).

[10] GTAP refers to Global Trade Analysis Project at the Department of Agricultural Economics at Purdue University.

[11] See the "OECD Statistics on International Trade in Services", Volumes I and II.

[12] These data have been made available only recently.

[12b] Consumer surplus measures the amount consumers gain from a purchase by the difference between the price he actually pays and the price he would have been willing to pay.

[13] In the Turkish 1998 input-output table there are 97 sectors where banking services is sector 84. Let A be the 97x97 matrix of input coefficients. Given A, form the 96x96 input matrix B by deleting the 84th column and 84th row referring to the banking sector. Denote by e the 84th row of A where the 84th column element has been deleted. Let p be the 1x96 price vector of the 96 commodities excluding the banking services sector and va the corresponding 1x96 unit gross value added vector. The price equation can be written as p = p B + p_t e + va, where p_t denotes the price of the banking services. Hence we have p = p_t e $(I-B)^{-1}$ + va $(I-B)^{-1}$. Thus, given the price of banking services that will prevail in Turkey after it adopts and implements the EU rules and regulations, p_t, we determine the equilibrium prices of the other 96 commodities from the above equation, assuming that there is no change in the unit gross value added vector, va.

[13b] Given the equilibrium price vector p form the 1x97 price vector as π = (p p_t). Let CON be the 96x1 consumption expenditure vector obtained from the 1998 input-output table by deleting the value of consumption of banking services sector and con_t the value of consumption of banking services. Form the 97x1 consumption vector as

$$CONS = \begin{bmatrix} CON \\ con_t \end{bmatrix}.$$

Noting that initially all base year prices equal unity in the Input-Output table we can express the value of total consumption expenditure evaluated at base prices as C = u CONS, where u denotes the 1x97 unit vector. The value of total consumption expenditure evaluated at the prices that will prevail after Turkey adopts and implements the EU rules and regulations in the banking services sector is then given by C* = π CONS. The effect on consumer welfare can now be calculated as

$$(C - C^*) \times 100 / C^*.$$

[14] We determine the foreign interest rate from Eurobond issues of the Turkish Treasury. The average rate of return on Turkish US$ Eurobonds during the time of issue was 10.13 percent in 1998, 12.08 percent during 1999, 11.61 percent in 2000, 11.35 in 2001, 10.66 percent in 2002, 10.08 in 2003 and 8.06 percent in 2004. By deflating the nominal return figures by US CPI inflation rates observed during the following period we obtain as the average figure for the time period 1998-2004 7.84 percent, and for the time period 2002-2004 6.86 percent. In the calculations we set the value of foreign real interest rate as 6.86 percent.

[15] Algeria, one of the most important gas exporters to Europe, holds some of the largest gas reserves around the Mediterranean Sea. Its proven gas reserves are given at 4580 bcm as of 2004, and gas production during the same year has amounted to 80 bcm/year. The country has a well established pipeline transport system linking the gas fields in the extreme south east region to the giant field hub of Hassi R'Mel and to the LNG plants of Arzew and Shikda, to Italy via the Enrico Mattei Gasline and to Spain and Portugal via the Pedro Duran Farrel Gasline. The two lines have jointly carried 35.8 bcm in 2004, for total exports of 60.7 bcm. The capacity of these two lines is planned to be increased by about 15 bcm/year with the addition of compressors. Currently, the state owned Sonatrach owns and operates the entire gas network including the LNG facilities. However, according to the new Hydrocarbon Law activities related to transportation by pipeline may in the future be carried out by any company having been granted an assignment given by the Energy Ministry. Sonatrach will keep its present pipeline assets, but it will have to open access to third parties and offer non discriminatory tariffs.

Libya is considered a highly attractive oil province due to its low cost of production, high quality of its oil, and its proximity to European markets. Libya's gas reserves are estimated at 1500 bcm in 2004. The state owned NOC has traditionally concentrated on discovering and developing oil structures, but is now devoting more attention to natural gas. Recently, Libya has been making efforts to bring in as many foreign investors as possible. But there is considerable uncertainty about the exploration and production prospects as the country has not yet come up with a long promised Petroleum Law offering foreign companies appropriate incentives. The backbone of the gas sytem distributes gas from the Sirta basin to the Marsa El Brega LNG plant and through 1172 km coastal gasline for domestic consumption. More recently, the eastern section of this pipeline has been constructed along the Mediterranean coast between Marsa El Braga, Zueitini and Benghazi. The 600 km subsee Greenstream gas pipeline, connecting Libya to Sicily in Italy, has been inaugurated in October 2004. The capacity of this pipeline is 8 bcm/year.

With proved gas reserves estimated at 1869 bcm in 2004 Egypt has a great potential for more oil and gas discoveries. Current gas production of 32 bcm is set to increase substantially in the coming years. The country has started to export gas in 2003 thanks to a pipeline to Jordan. This link is expected to bring gas also to Syria and Lebanon, and eventually Turkey. The exports amounted to 1 bcm in 2004.

[16] However, in network monopolies in developing countries, especially state-run, the high level of prices is not necessarily a result of profit-maximizing strategy but frequently of a bad management and general inefficiency together with a lack of fear of competition. Thus, the loss of monopoly profit due to service liberalization may not be of great importance.

[17] It may be also argued, however, that not carrying out this investment soon may result in future loss due to the environment damage. Analysis of environmental costs of not pursuing the EU policy goes beyond the scope of this research.

[18] The costs of adaptation to EU goods' standards for new member states from Central Europe were analyzed in the project FEM-22-03. It appeared that these costs were spread over time and relatively minor in relation to potential production, export and welfare gains.

[19] Action Plan and the ENPI are the main mechanisms used to implement the ENP. The action plan is agreed (negotiated) jointly with the EU; covers a 3 to 5 year time span; and will be accompanied by greater monitoring of progress and "tied" or conditional technical and financial assistance. Aid is provided through ENPI. Monitoring of the implementation of the Action Plan takes place in the bodies established by the Association Agreement, including specialized subcommittees. The Association Council remains the central body of the bilateral relationship, and continues to engage in regular political dialogue

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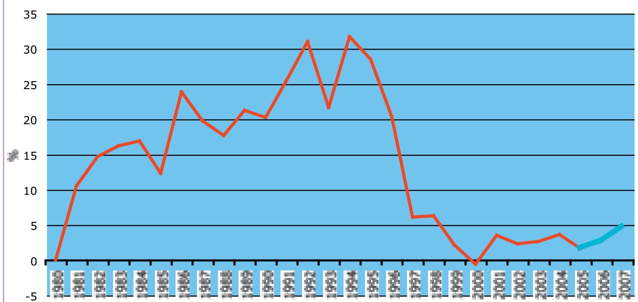
ANNEXES

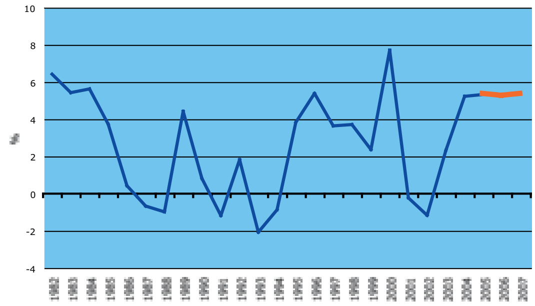
Annex 1: Macroeconomic trends in the 10 MPs (source EIU)

Algeria

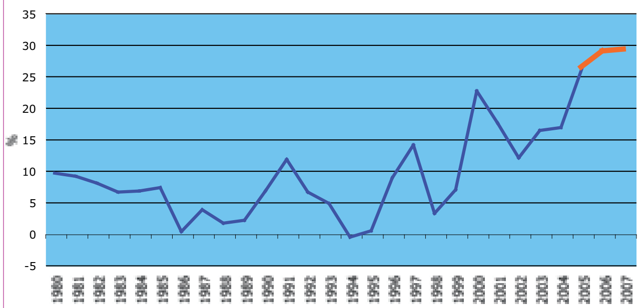
Inflation



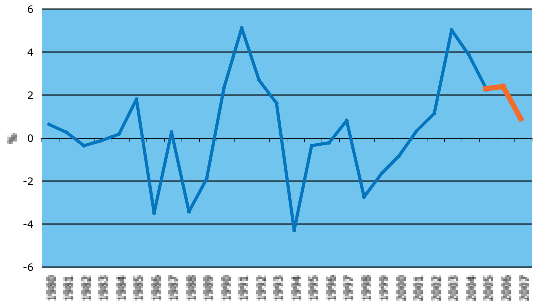
GDP real growth rate



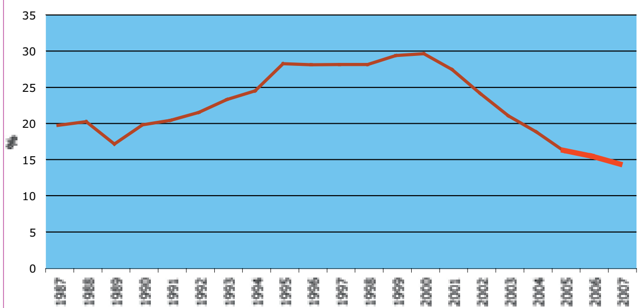
Trade balance/GDP



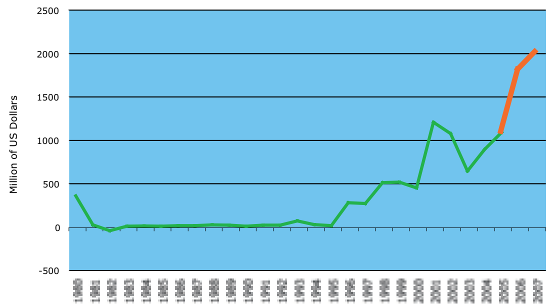
Current account balance/GDP



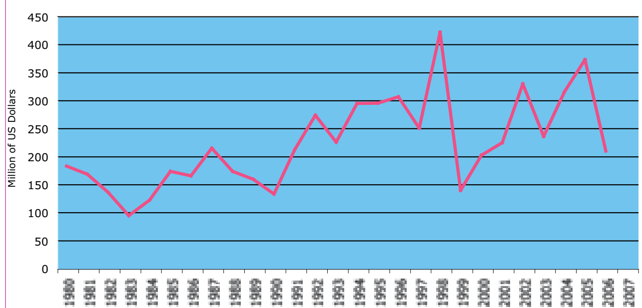
Unemployment Rate



FDI Inflows



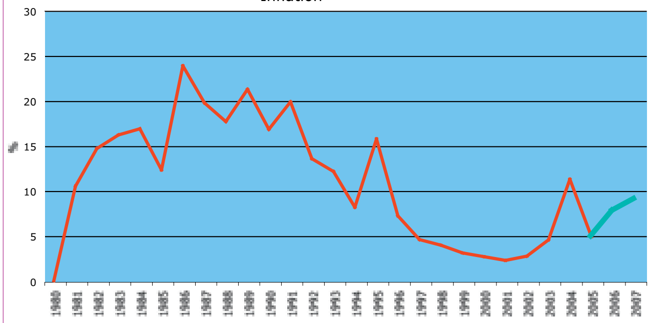
Official Assistance Flows (OA, ODA and OOF)*



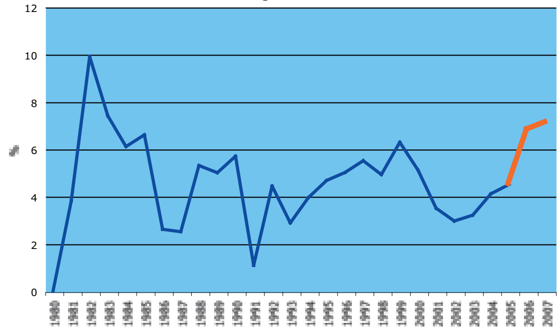
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Egypt

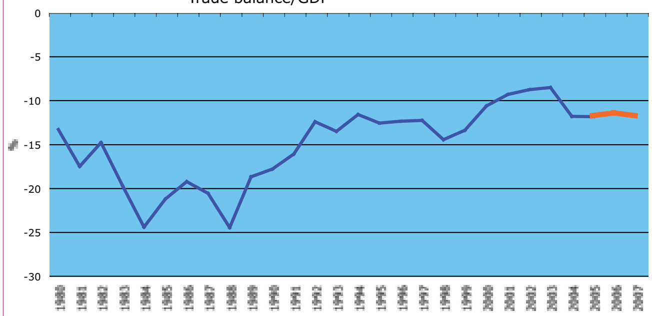
Inflation



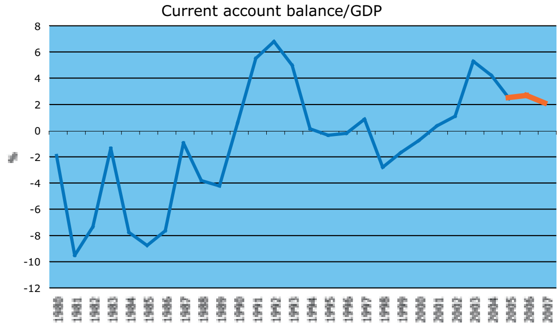
GDP real growth rate



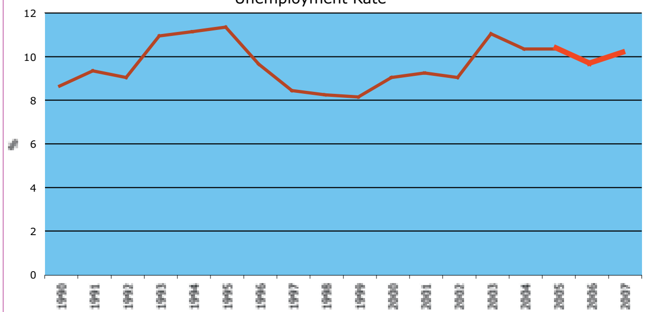
Trade balance/GDP



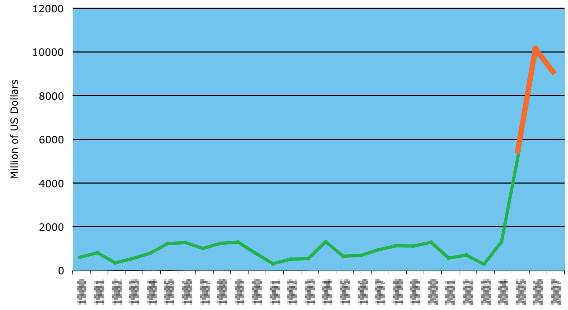
Current account balance/GDP



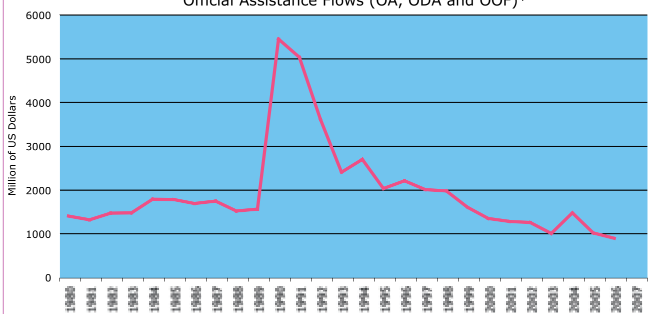
Unemployment Rate



FDI Inflows



Official Assistance Flows (OA, ODA and OOF)*



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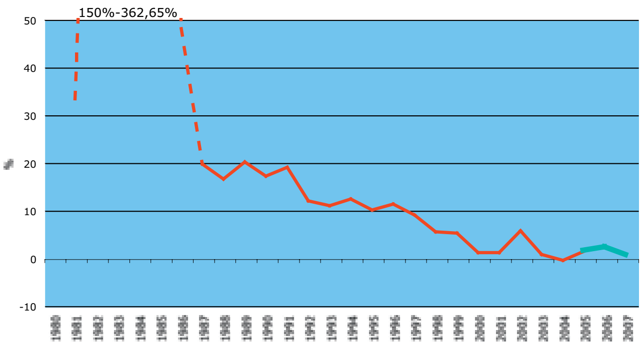
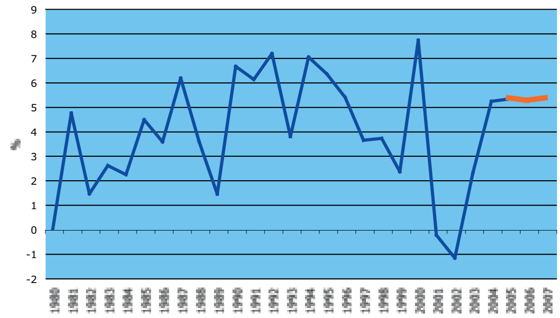
Israel

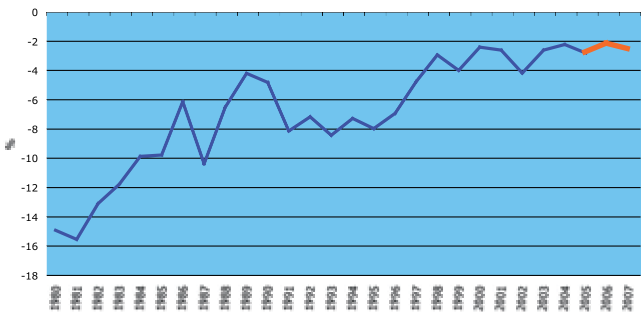
Inflation



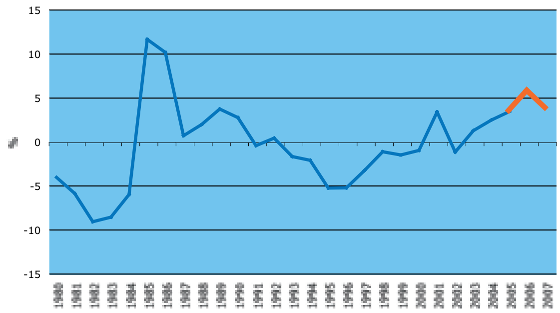
GDP real growth rate



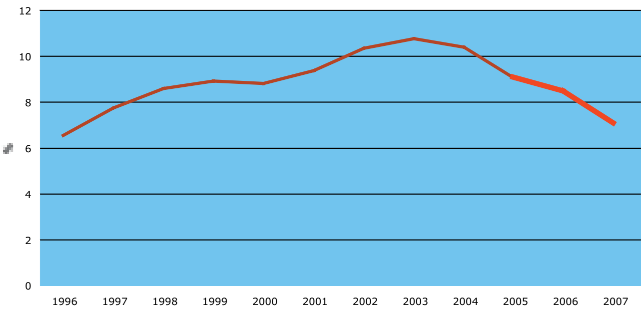
Trade balance/GDP



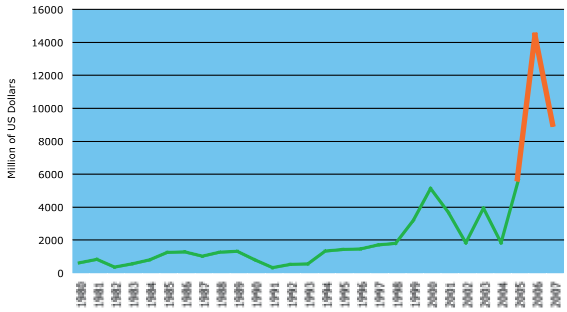
Current account balance/GDP



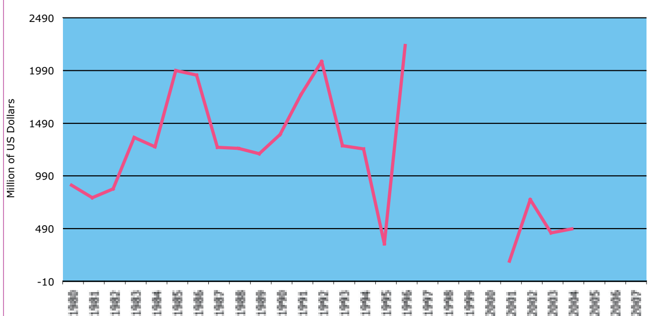
Unemployment Rate



FDI Inflows



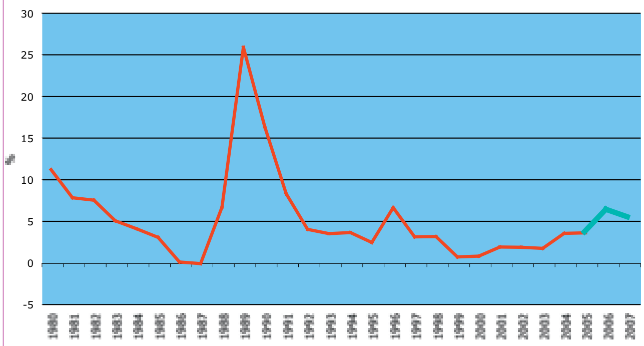
Official Assistance Flows (OA, ODA and OOF)*



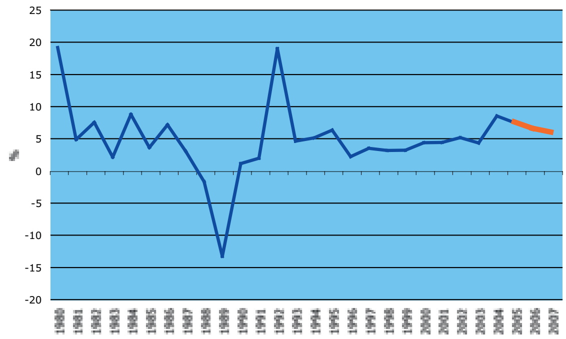
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Jordan

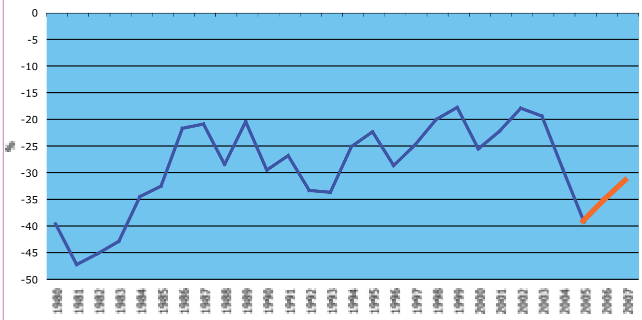
Inflation



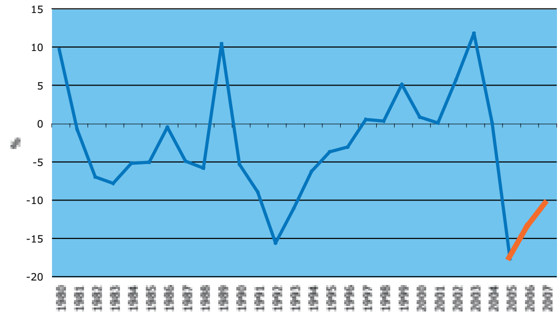
GDP real growth rate



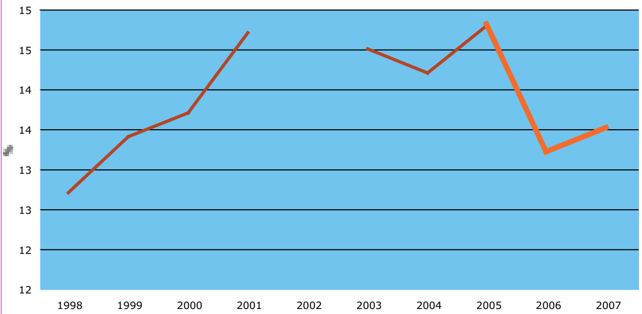
Trade balance/GDP



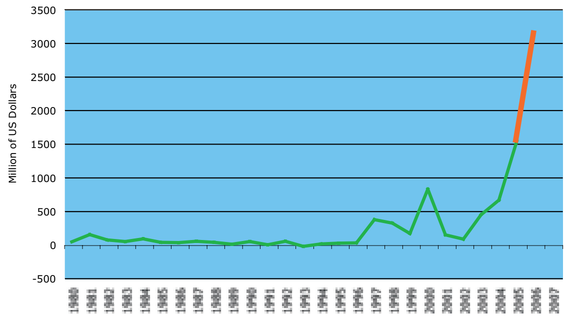
Current account balance/GDP



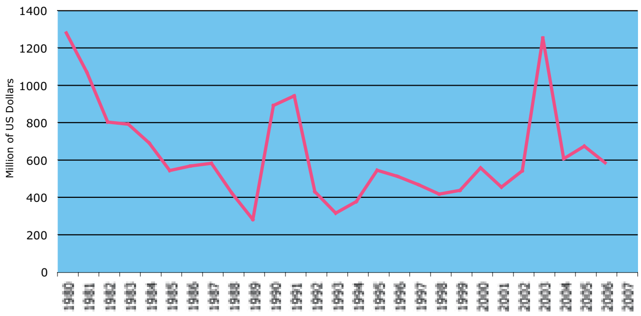
Unemployment Rate



FDI Inflows



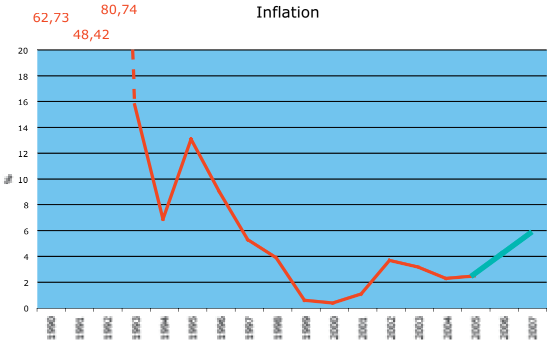
Official Assistance Flows (OA, ODA and OOF)*



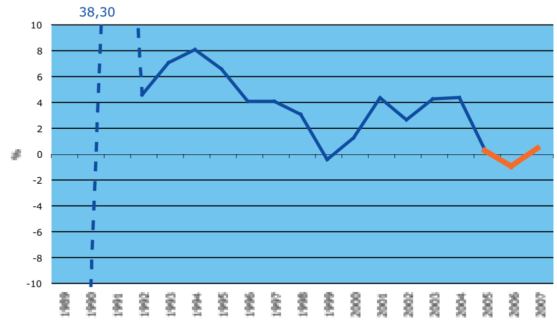
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Lebanon

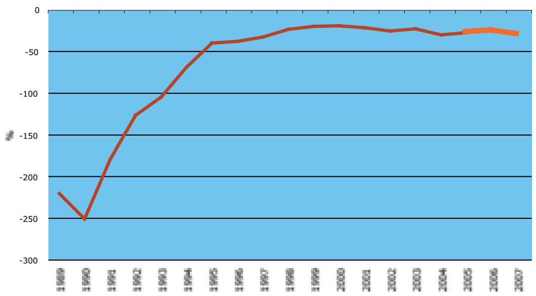
Inflation



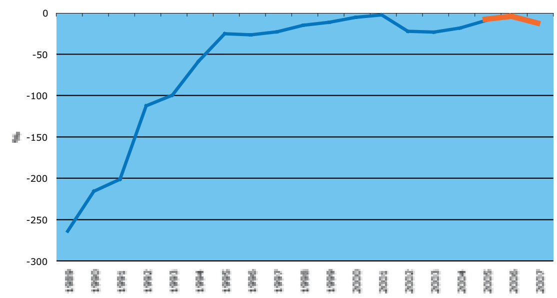
GDP real growth rate



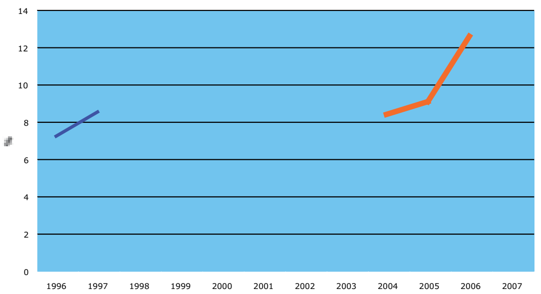
Trade balance/GDP



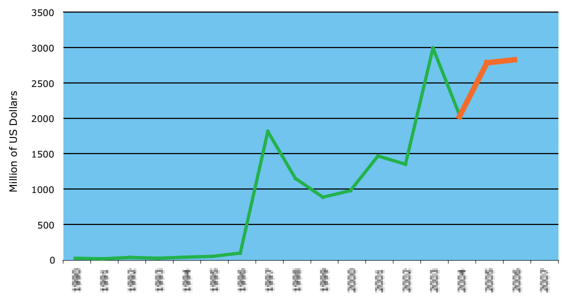
Current account balance/GDP



Unemployment Rate

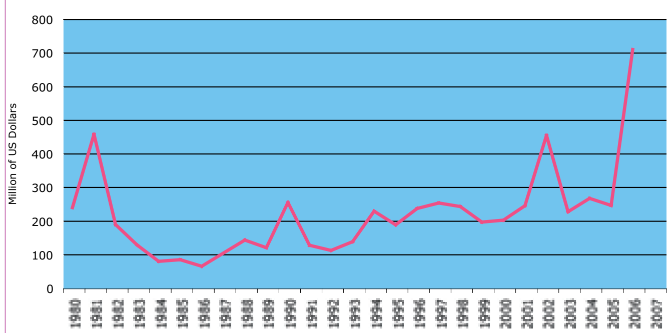


FDI Inflows



Sources: EIU and Femise

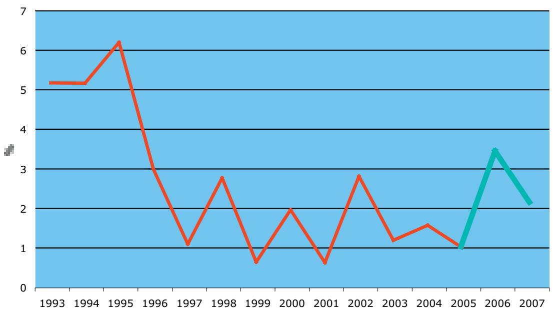
Official Assistance Flows (OA, ODA and OOF)*



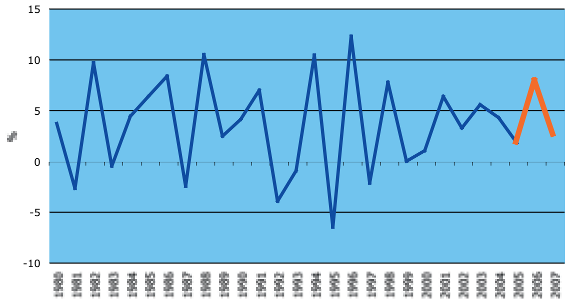
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008; World Bank, WDI 2004 et WDI online.

Morocco

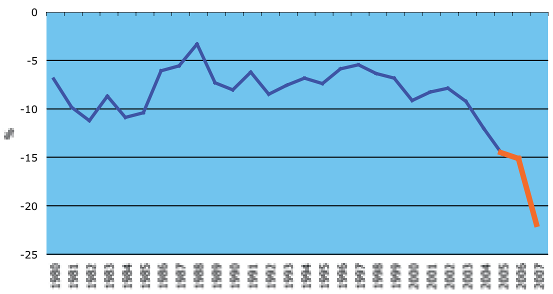
Inflation



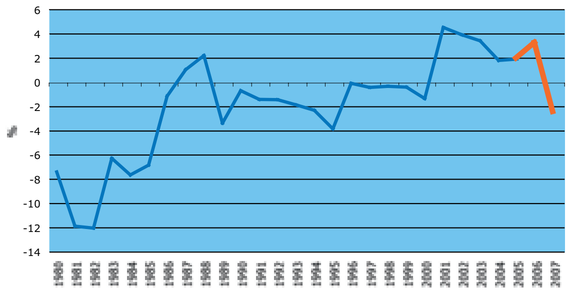
GDP real growth rate



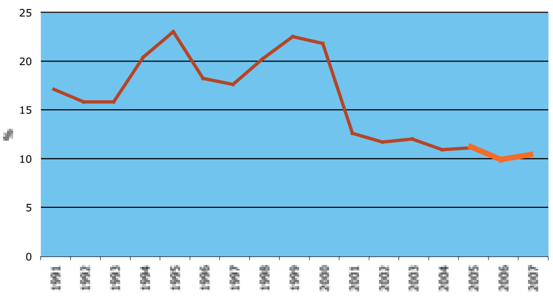
Trade balance/GDP



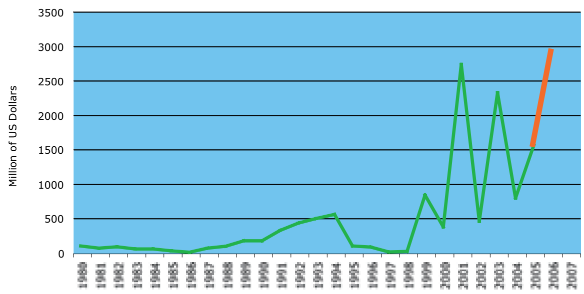
Current account balance/GDP



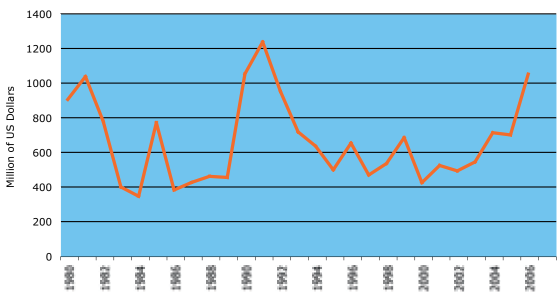
Unemployment Rate



FDI Inflows

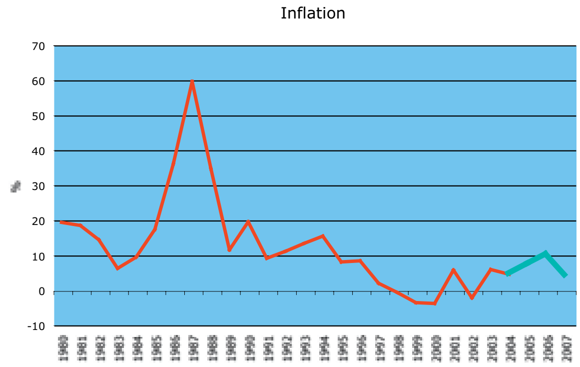


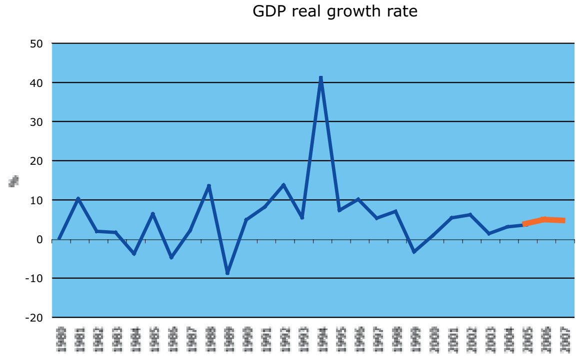
Official Assistance Flows (OA, ODA and OOF)*

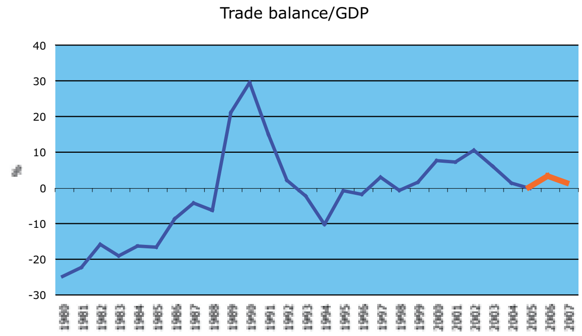


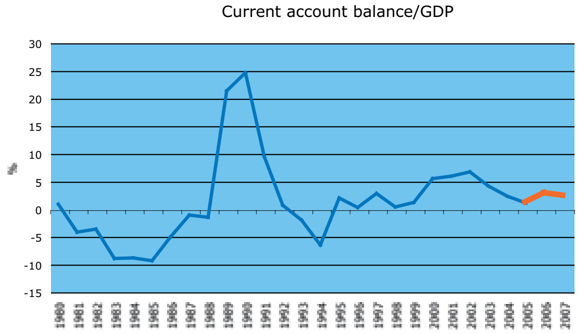
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

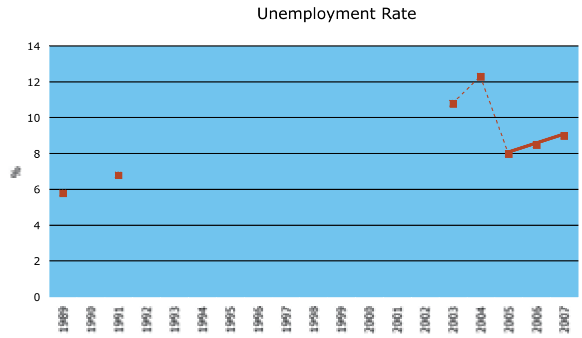
Syria

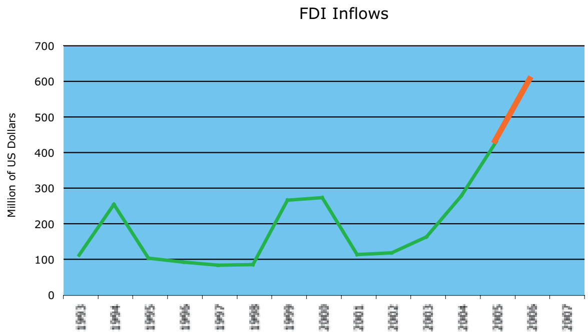


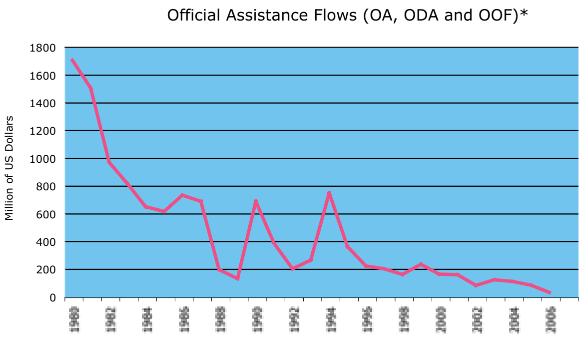








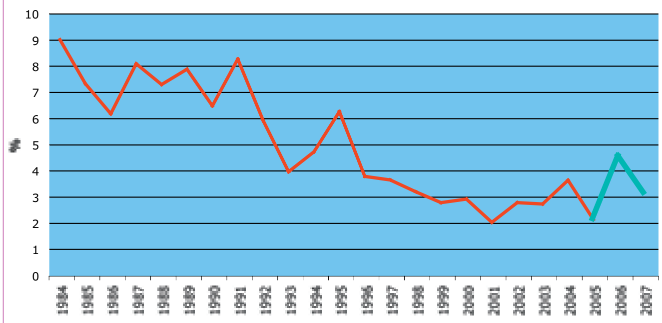




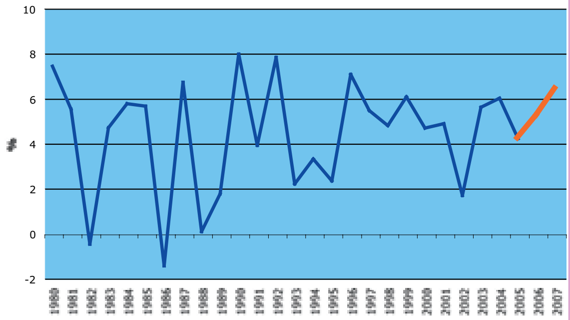
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Tunisia

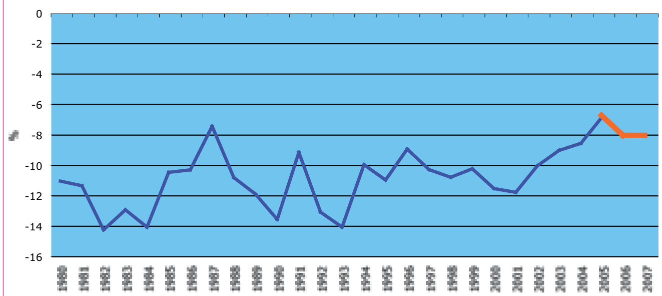
Inflation



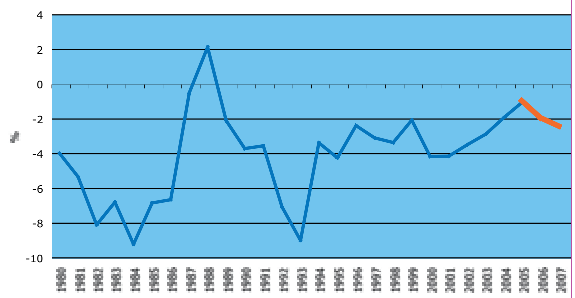
GDP real growth rate



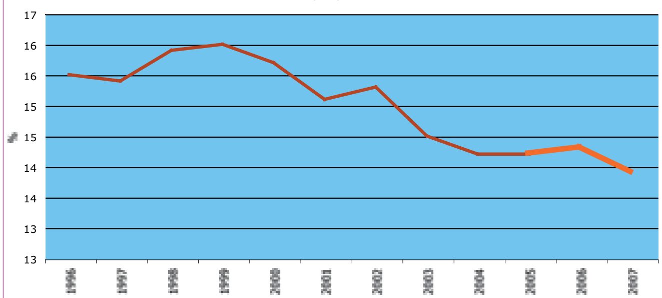
Trade balance/GDP



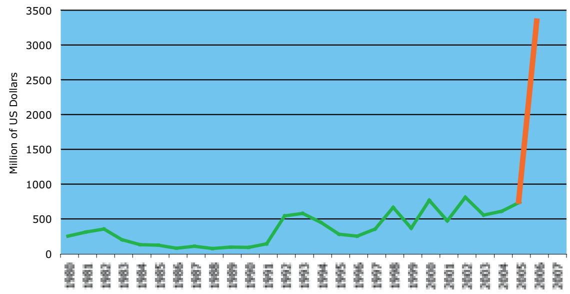
Current account balance/GDP



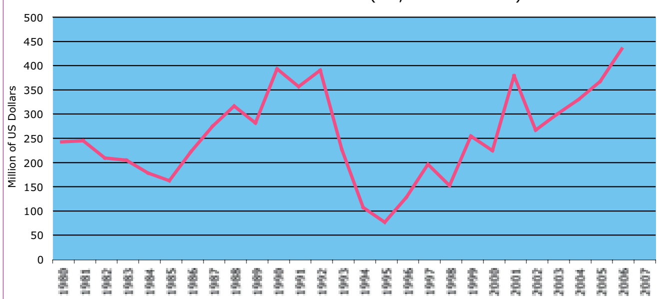
Unemployment Rate



FDI Inflows



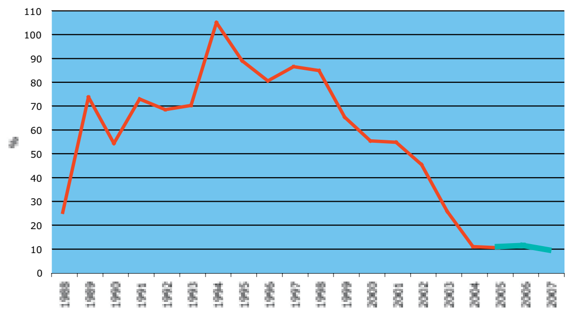
Official Assistance Flows (OA, ODA and OOF)*



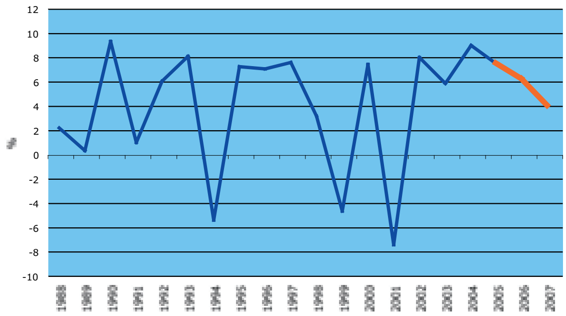
Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Turkey

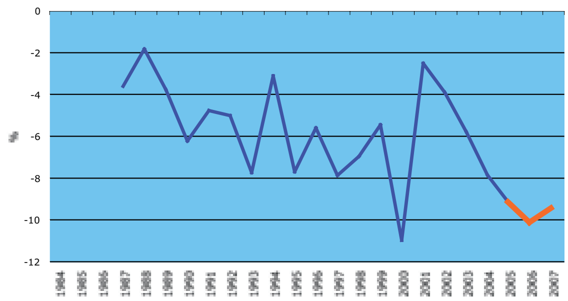
Inflation



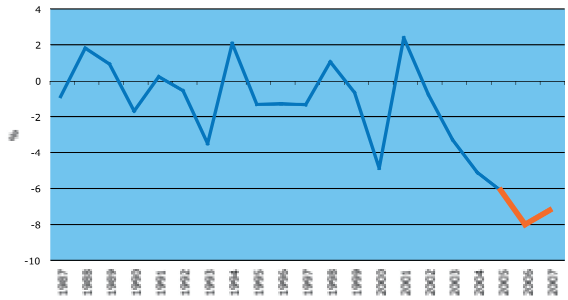
GDP real growth rate



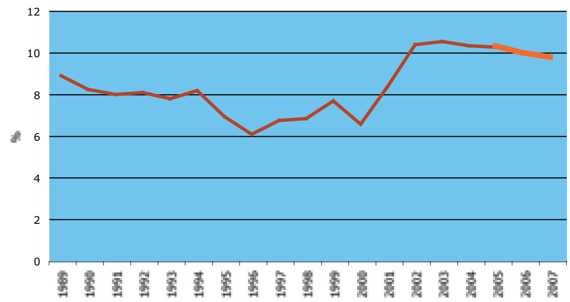
Trade balance/GDP



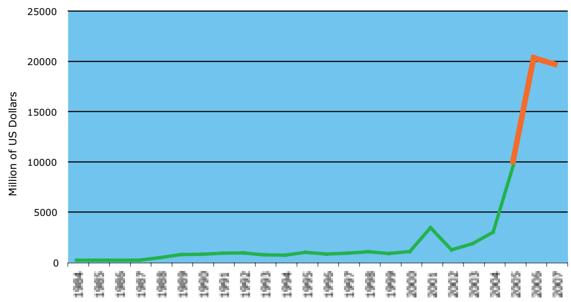
Current account balance/GDP



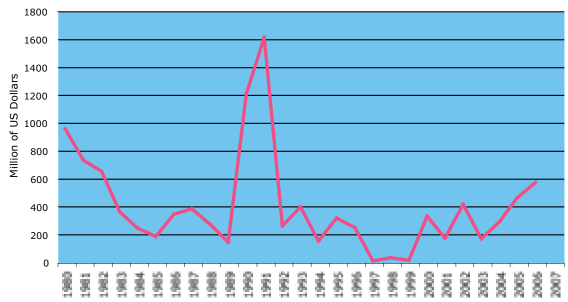
Unemployment Rate



FDI Inflows



Official Assistance Flows (OA, ODA and OOF)*



Sources: EIU February 2008; *Assistance Flows (Official Developement Assistance, Official Assistance and Other Official Flows): OECD, DAC database, February 2008.

Annex 2 : Multicriteria Analysis Methodology

The methodology used here was described in Aubert, Reiffers, "Knowledge Economy in the MENA region" World Bank Institute 2003, as well as in several Femise reports. On the basis of selected equally-weighted criteria, the benchmark classes the MP comparatively to the developed and developing countries: to obtain a classification of 5 means that the country is among the 20% best performers on this criterion. A note of 4 locates the country behind these best performers countries, in the 20% following ones. The note of 3 means that the country is classified in accordance to the average of the other countries, etc. Having a note of 1 classifies the countries in the 20% worst performers. The 27 selected criteria (cf. below) do not stick to the only Knowledge Based Economy, but seek to seize three dimensions: human development, economic performances of the society and the Knowledge Based Economy.

List of Criteria (2005 or more recent available data)

Human Area

1 Adult literacy rate
2 GDP per Capita PPP $
3 Gross enrollment rate (%), tertiary, female
4 Human development index (UNDP)
5 Life expectancy at birth
6 Population with sustainable access to an improved water source
7 Probability at birth of surviving to age 65
8 Activity Rate
9 Female Activity Rate

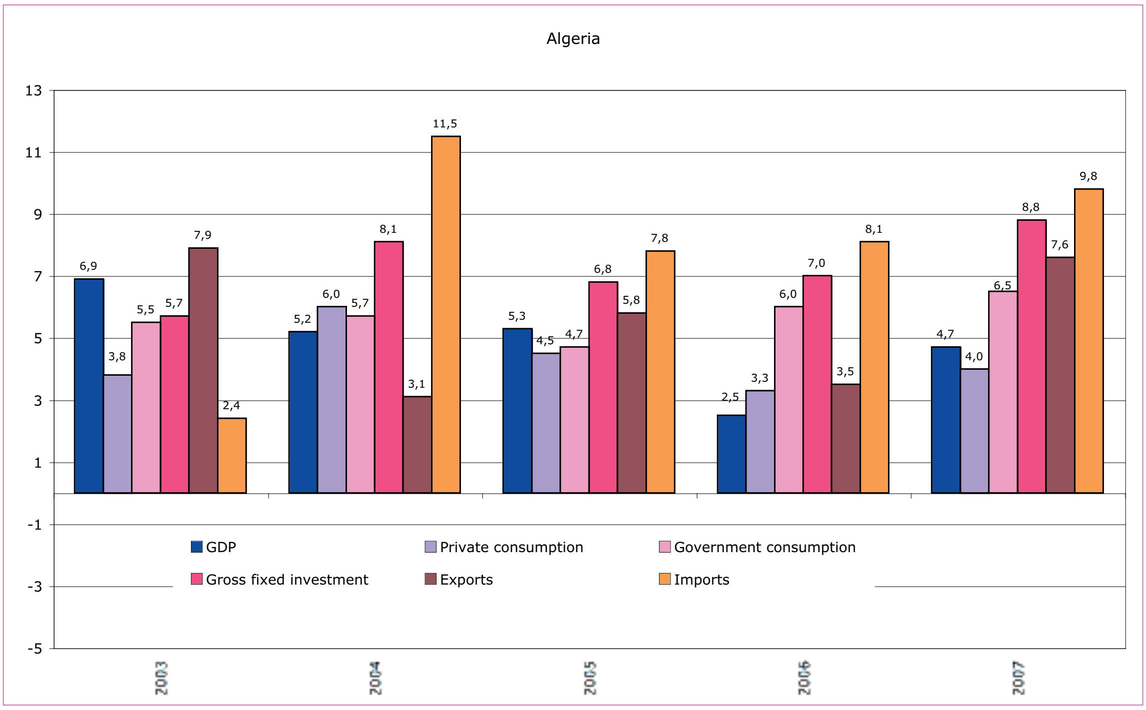
Economic Performance Area

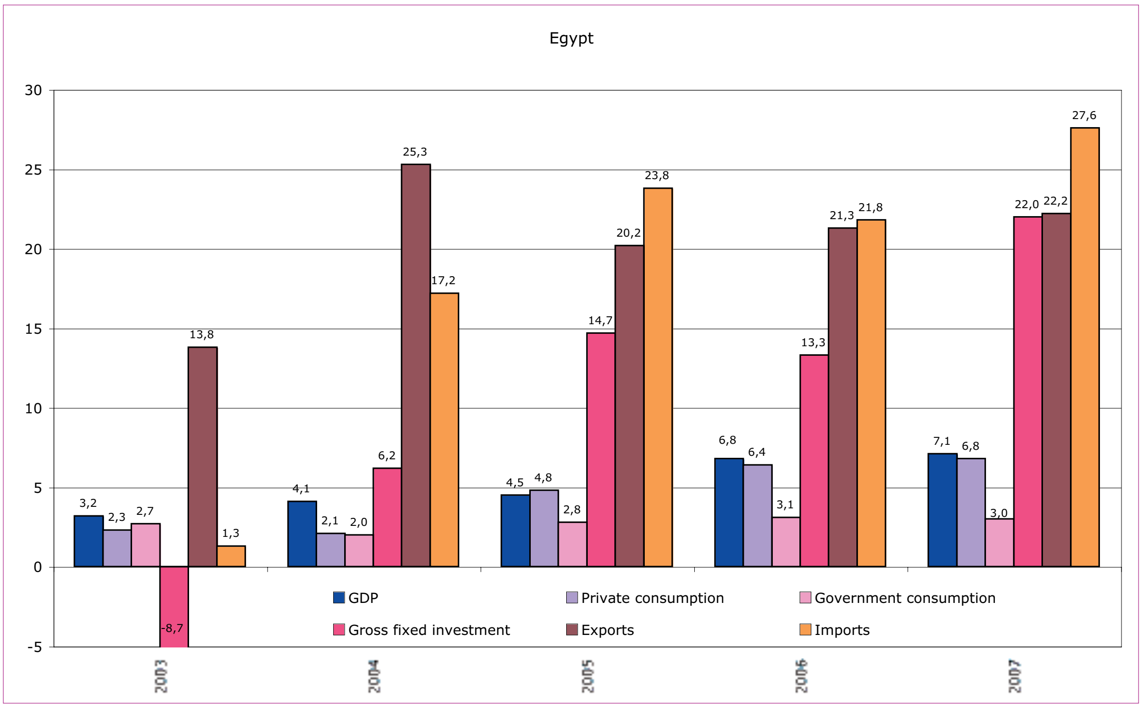
10 Credit to Private Sector (% GDP)
11 Domestique Credit (% GDP)
12 Current Account Balance (% GDP)
13 Budget Balance (% GDP)
14 FDI on GDP (net inflows BoP)
15 Gross Fixed Investment (% GDP)
16 Inflation (CPI)
17 Merchandise Trade per inhabitant
18 Share of Manufactured Products in Exports
19 Unemployment Rate
20 Total debt service (% of exports of goods and services)

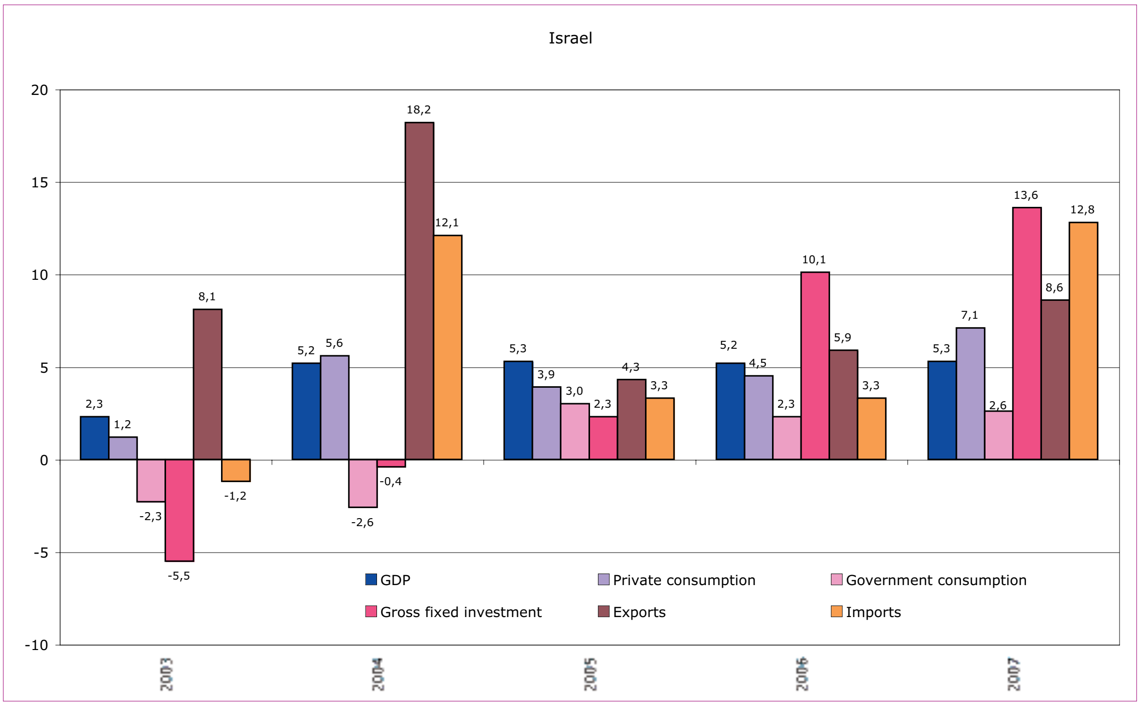
Knowledge Based Economy Area

21 Gross enrollment rate (%), secondary, total
22 Gross enrollment rate (%), tertiary, total
23 Internet Users (per 1,000 people)
24 Personal computers (per 1,000 people)
25 Public education expenditures as % of GDP
26 Pupil-teacher ratio, primary
27 Telephone mainlines (per 1,000 people)

Annex 3: Origin of growth in the 10 MP (source EIU)



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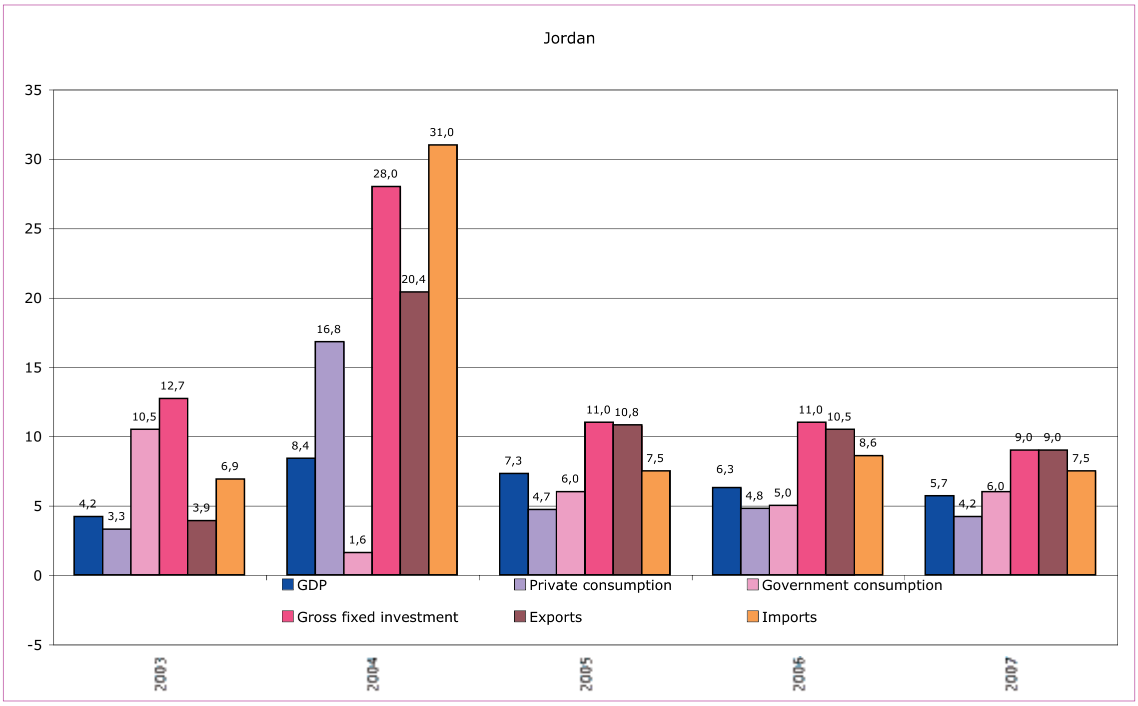
10,1
5,9
3,3
5,3
7,1
2,6
13,6
8,6
12,8
GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
2003
2004
2005
2006
2007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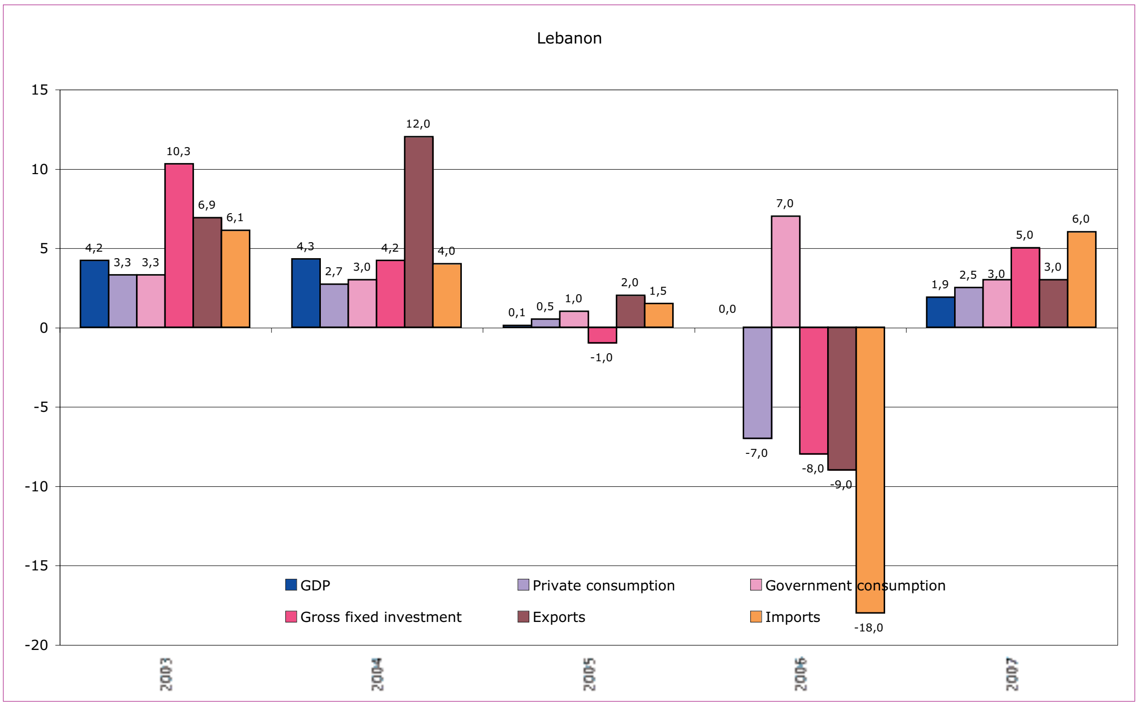
GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
2003
2004
2005
2006
2007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GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
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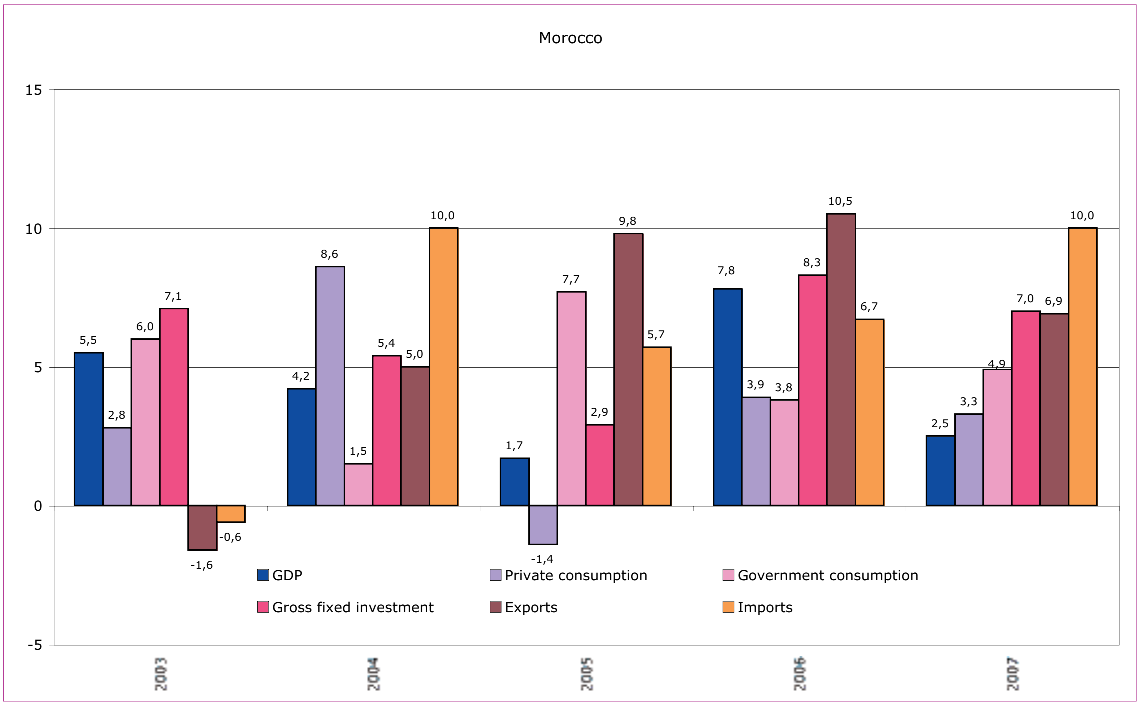
2007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GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
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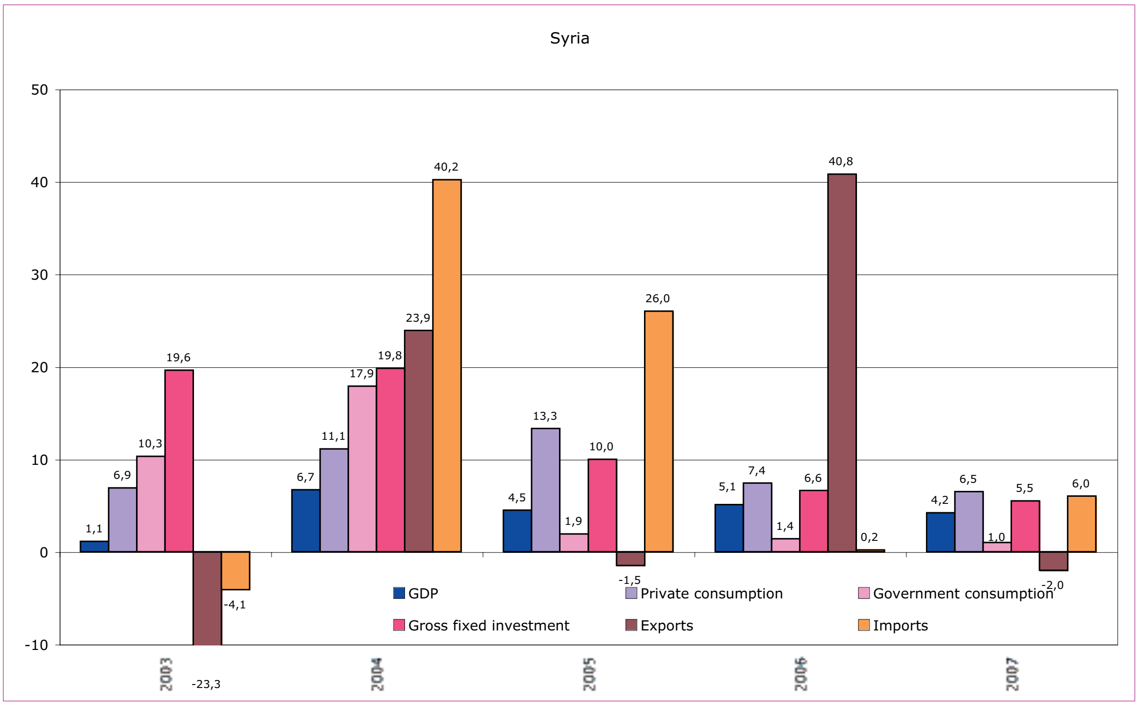
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GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
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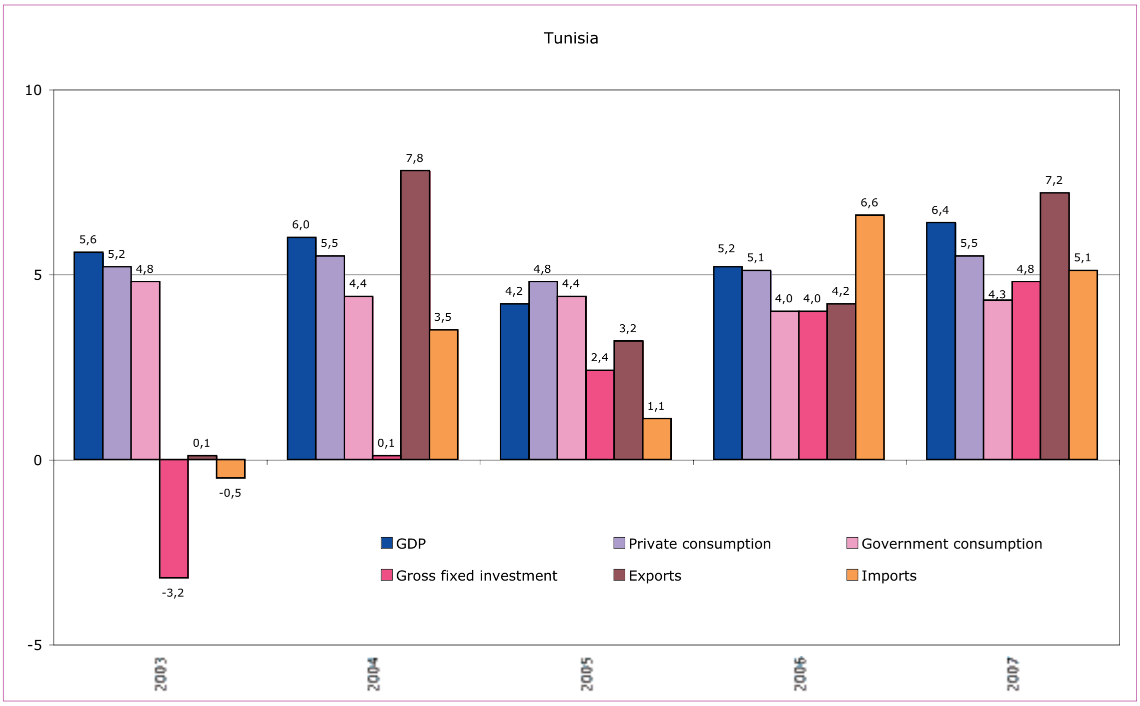
2007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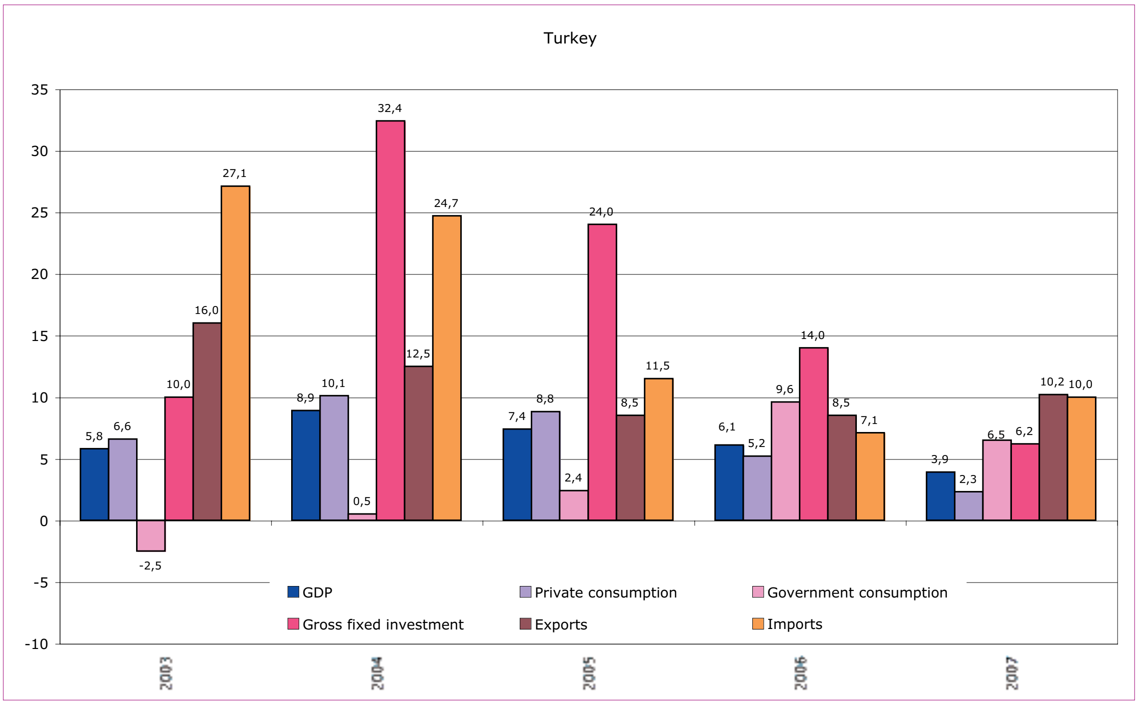
GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
2003
2004
2005
2006
2007



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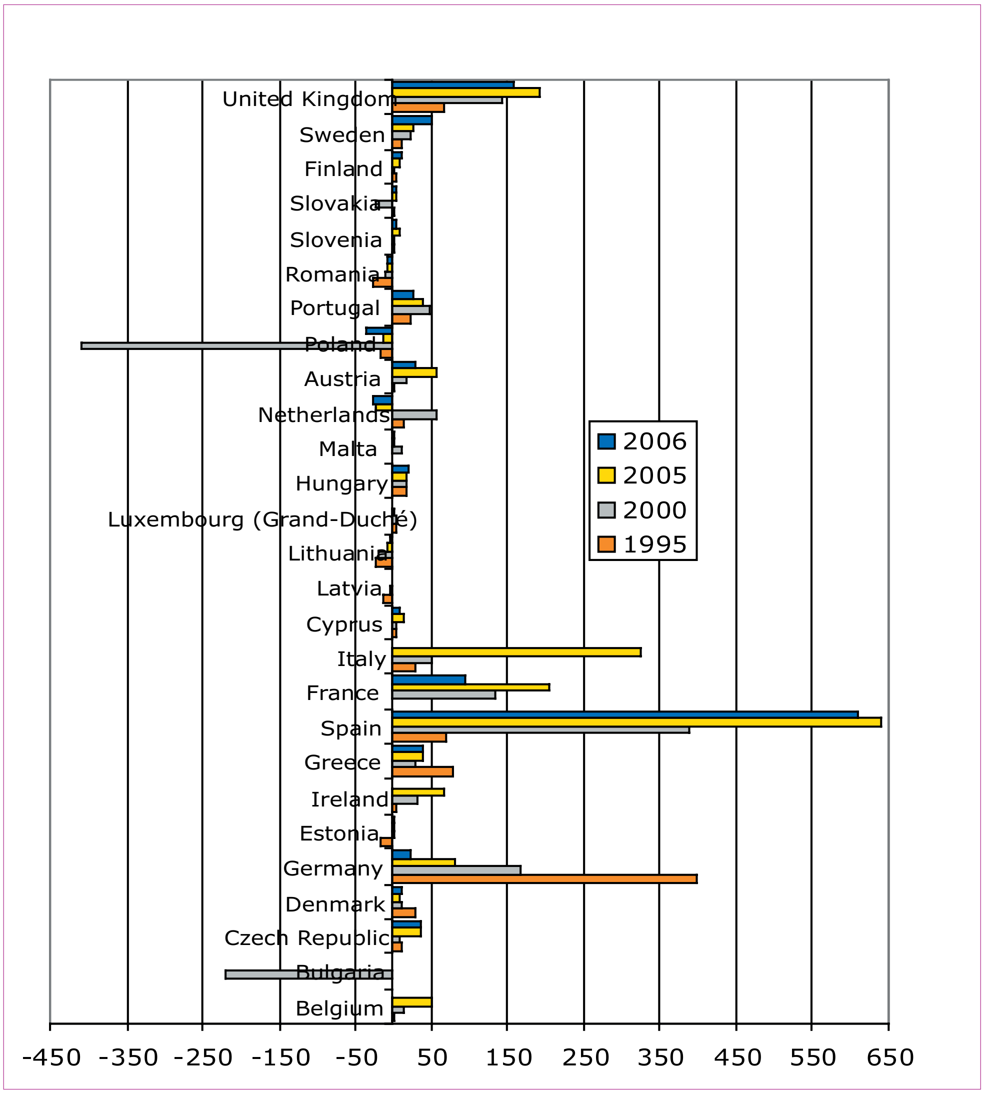
3,9
2,3
6,5
6,2
10,2
10,0
GDP
Private consumption
Government consumption
Gross fixed investment
Exports
Imports
2003
2004
2005
2006
2007

Annex 4: Total Population and the evolution of the Working Population

2020	Totale Population (Median scenario)	In which less than 15 yrs	Share of less than 15 yrs (%)
Algeria	40 624 196	10 599 663	26
Egypt	94 833 729	28 120 040	30
Israel	8 295 522	2 002 068	24
Jordan	7 555 606	2 206 574	29
Lebanon	4 139 575	968 631	23
Morocco	38 326 921	10 315 093	27
Palest. A	5 693 658	2 209 689	39
Syria	26 029 379	8 007 188	31
Tunisia	11 603 673	2 430 361	21
Turkey	86 774 180	20 983 515	24
Total MPs	**323 876 439**	**87 842 822**	**27**

Source: UN Pop. Div. quinquennial projections, median scenario

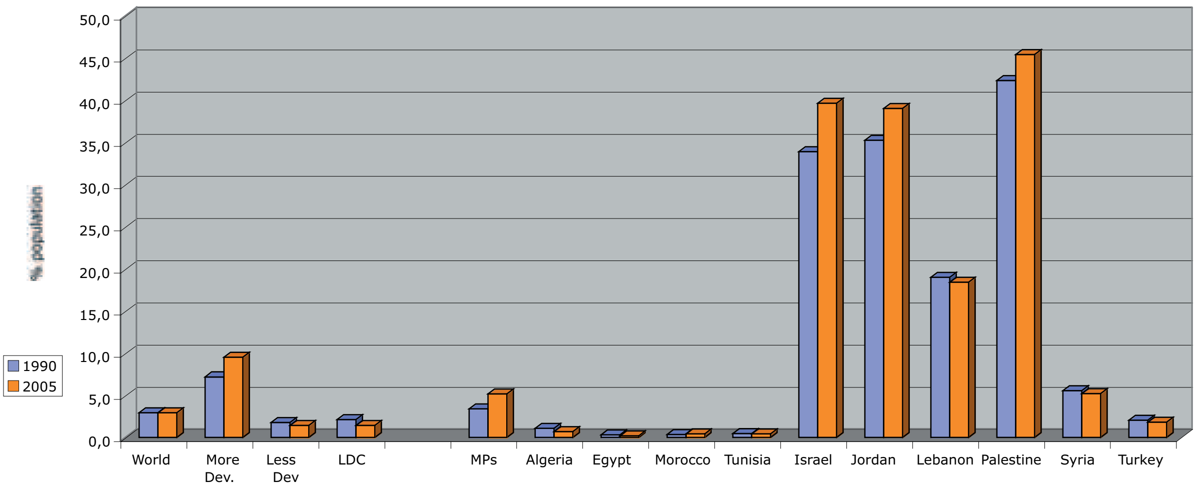
Annex 5: Net Migration Flows in the EU-27 (per 1,000)



Source: Eurostat, 2007

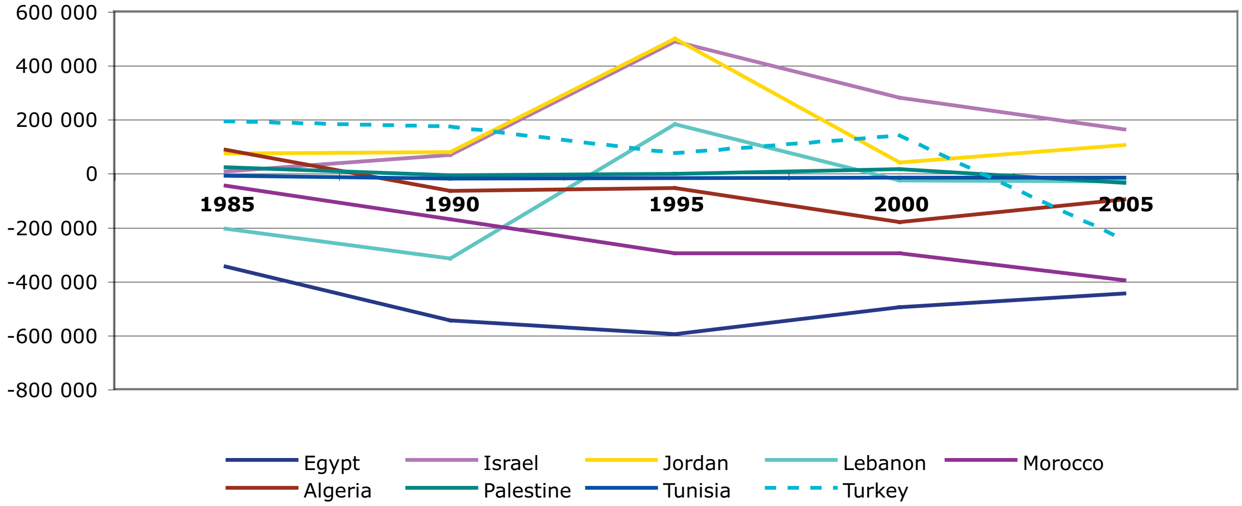
Annex 6 : Migrations stock and flows in MPs

Migration Stock in MPs (% of population), 1990 and 2005



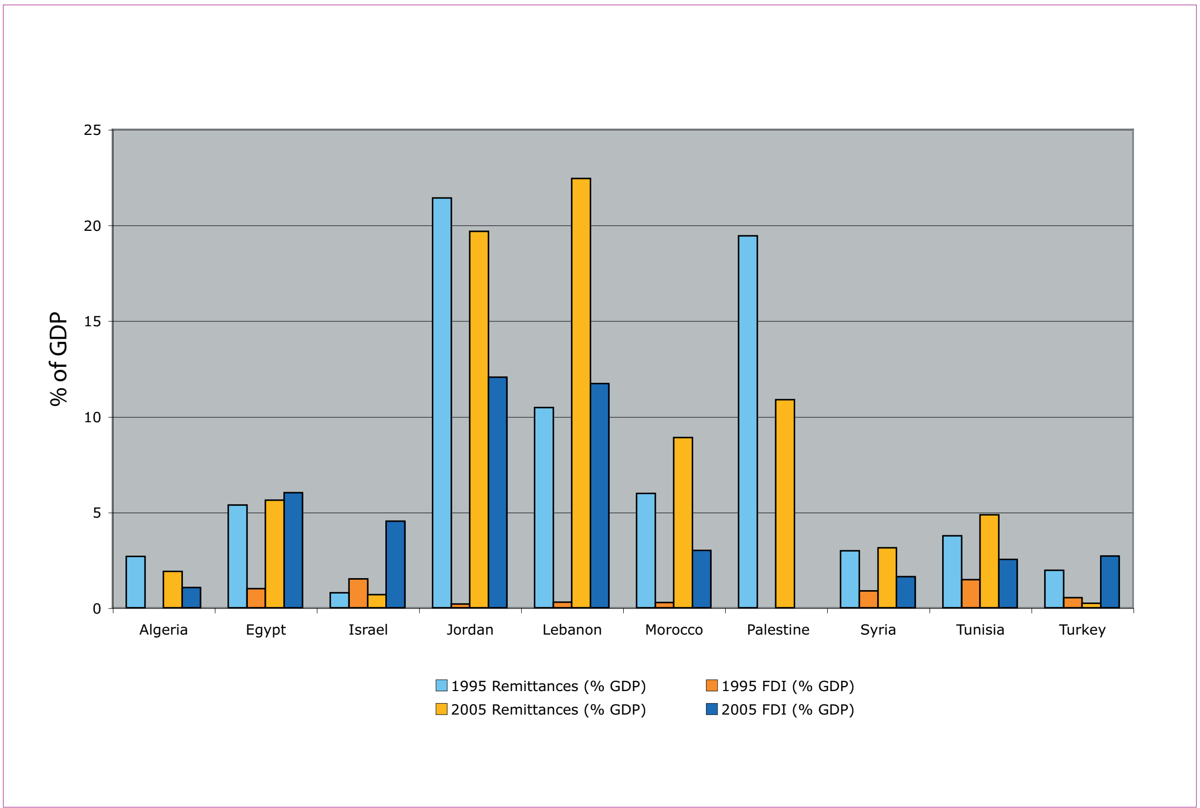
Source: UN, population division, International Migration 2006

Net migration Flows for MPs, 1990-2005



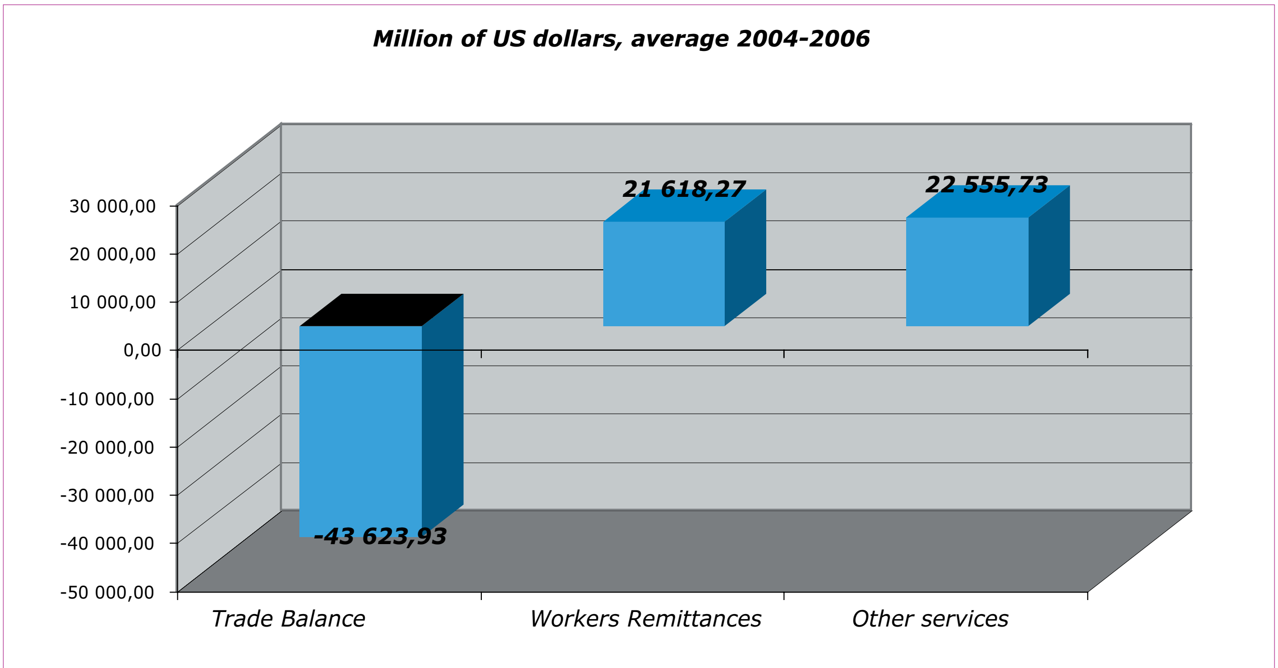
Source: WBI, 2007
Note: net migration is the difference between inflows and outflows of migration in a given country.

Annex 7: Remittances & FDI as % of GDP in MPs



Source: WBI, 2007

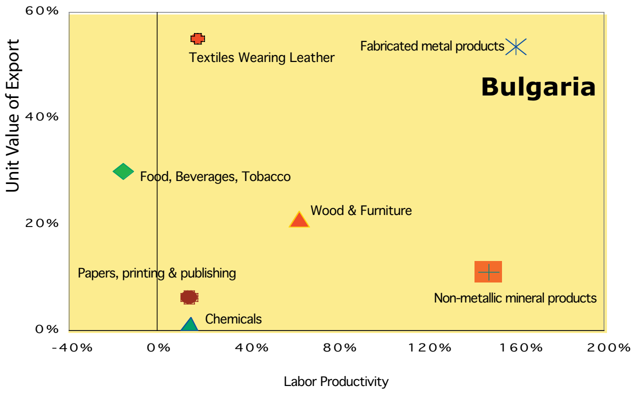
Annex 8: The equilibrium mechanism of the current account for the 10 MPs

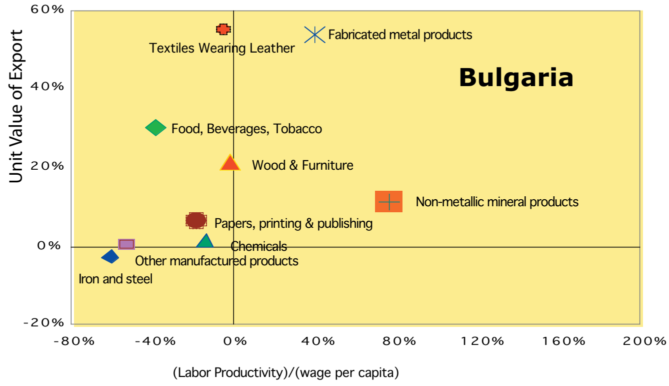


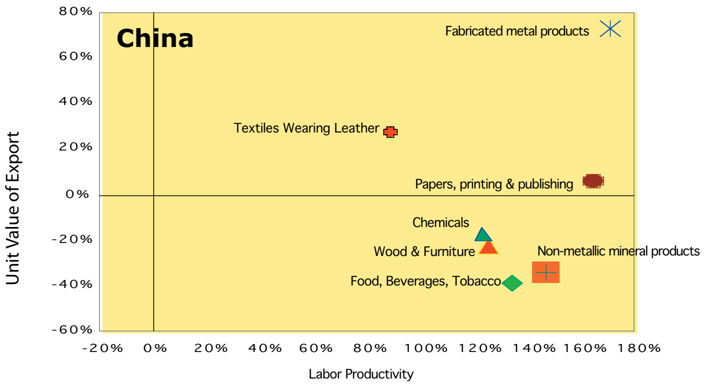
Source: EIU

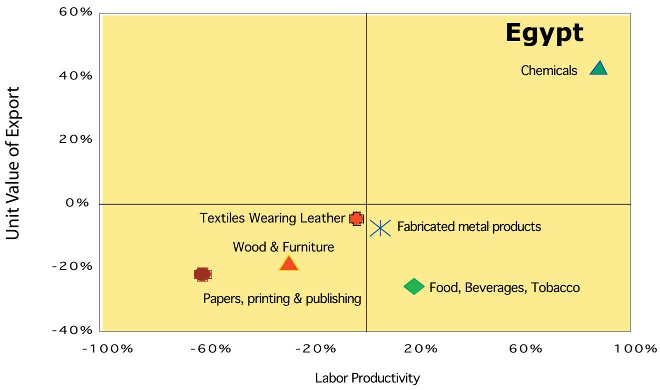
Annex 9: Unit Value of Export, productivity and wages per capita

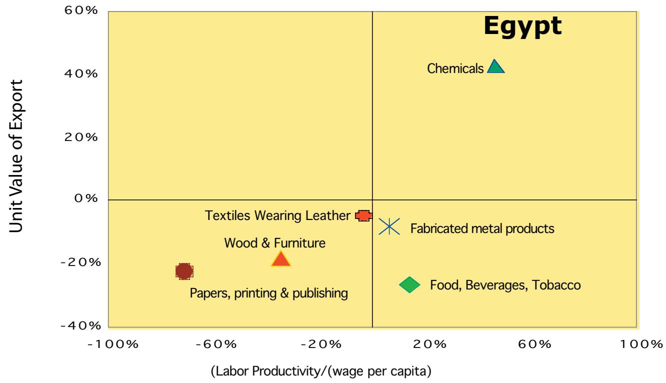
Evolution of the unit value of exports and the productivity between 1995/97 and 2000/03 per large sectors	Evolution of the unit value of exports and the ratio productivity /wage per capita between 1995/97 and 2000/03 per large sectors

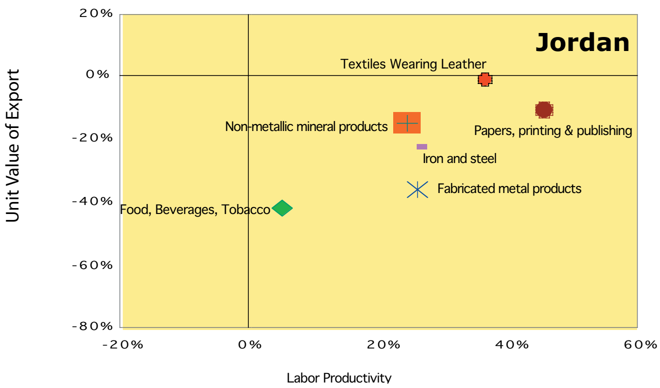


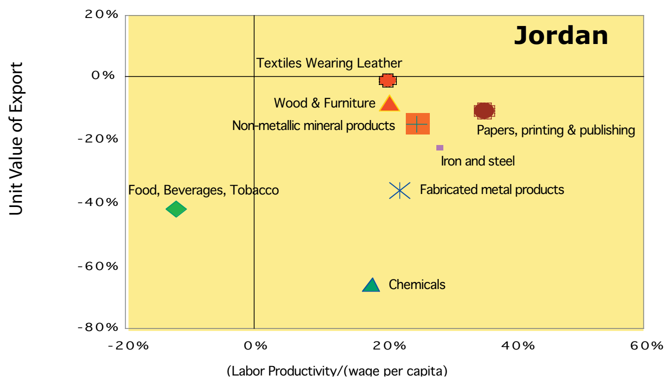


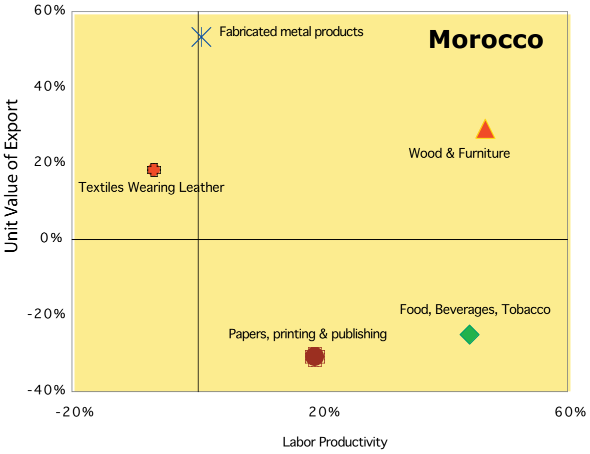


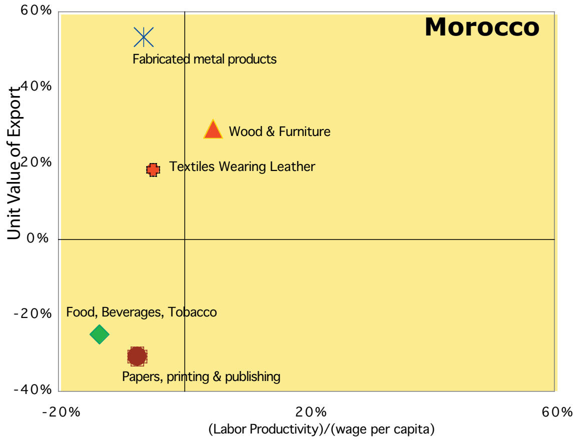


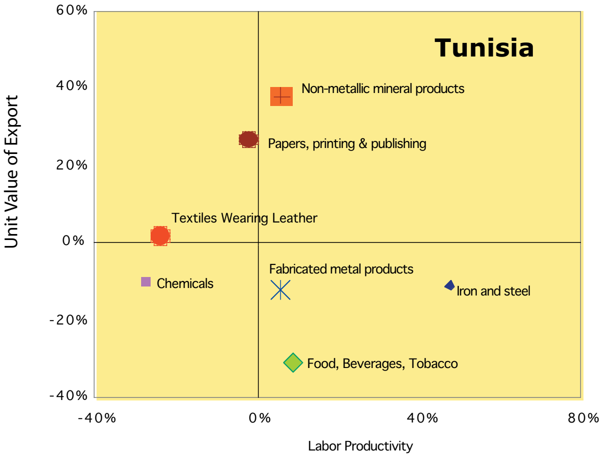


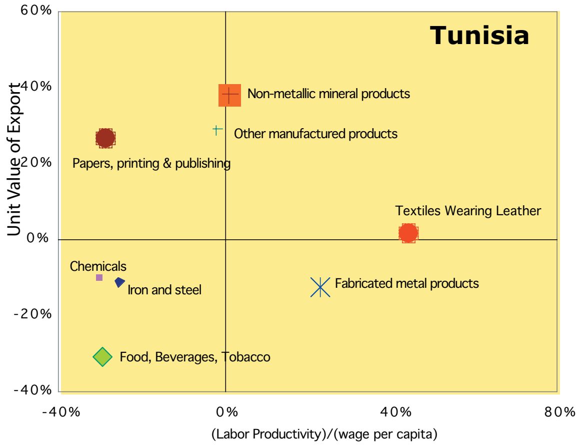


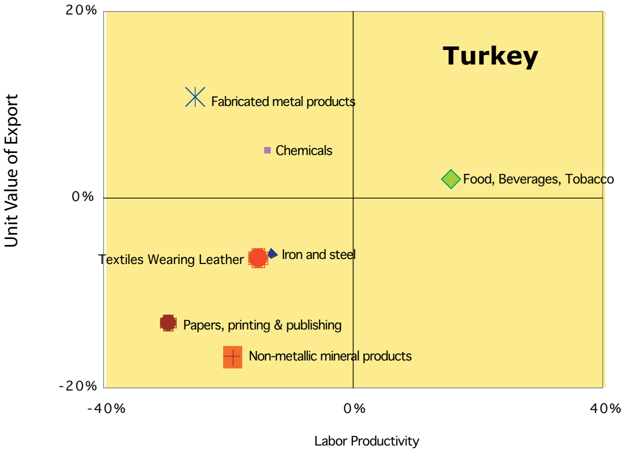


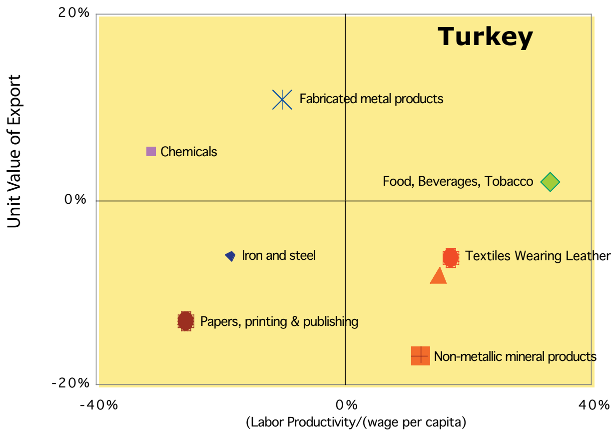

Morocco
Fabricated metal products
Wood & Furniture
Textiles Wearing Leather
Food, Beverages, Tobacco
Papers, printing & publishing
60%
40%
20%
0%
-20%
-40%
-20%
20%
60%
Unit Value of Export
Labor Productivity

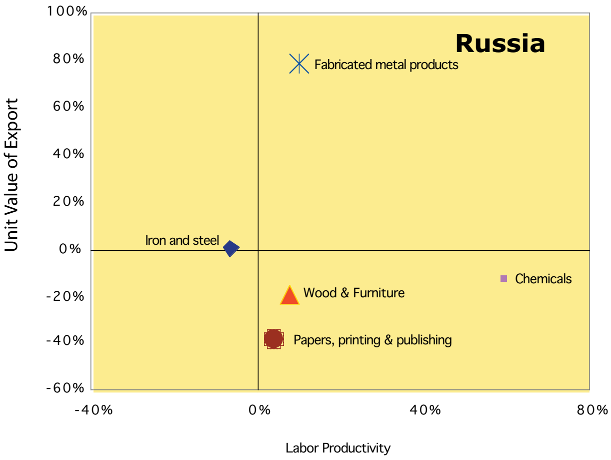

Morocco
Fabricated metal products
Wood & Furniture
Textiles Wearing Leather
Food, Beverages, Tobacco
Papers, printing & publishing
60%
40%
20%
0%
-20%
-40%
-20%
20%
60%
Unit Value of Export
(Labor Productivity)/(wage per capita)

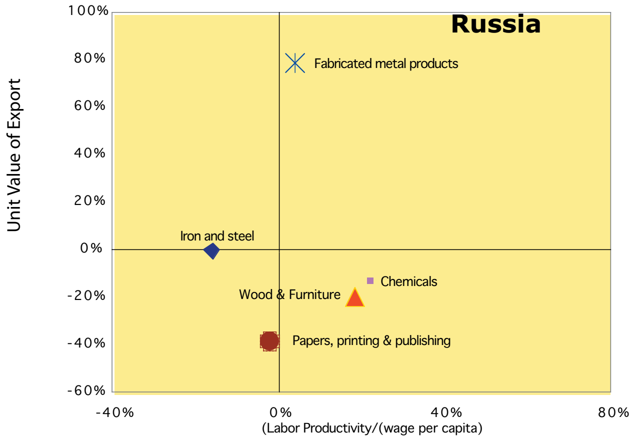

Tunisia
Non-metallic mineral products
Papers, printing & publishing
Textiles Wearing Leather
Chemicals
Fabricated metal products
Iron and steel
Food, Beverages, Tobacco
60%
40%
20%
0%
-20%
-40%
-40%
0%
40%
80%
Unit Value of Export
Labor Productivity


Tunisia
Non-metallic mineral products
Other manufactured products
Papers, printing & publishing
Textiles Wearing Leather
Chemicals
Iron and steel
Fabricated metal products
Food, Beverages, Tobacco
60%
40%
20%
0%
-20%
-40%
-40%
0%
40%
80%
Unit Value of Export
(Labor Productivity)/(wage per capita)


Turkey
Fabricated metal products
Chemicals
Food, Beverages, Tobacco
Textiles Wearing Leather
Iron and steel
Papers, printing & publishing
Non-metallic mineral products
20%
0%
-20%
-40%
0%
40%
Unit Value of Export
Labor Productivity


Turkey
Fabricated metal products
Chemicals
Food, Beverages, Tobacco
Iron and steel
Textiles Wearing Leather
Papers, printing & publishing
Non-metallic mineral products
20%
0%
-20%
-40%
0%
40%
Unit Value of Export
(Labor Productivity/(wage per capita)


Russia
Fabricated metal products
Iron and steel
Chemicals
Wood & Furniture
Papers, printing & publishing
100%
80%
60%
40%
20%
0%
-20%
-40%
-60%
-40%
0%
40%
80%
Unit Value of Export
Labor Productivity


Russia
Fabricated metal products
Iron and steel
Chemicals
Wood & Furniture
Papers, printing & publishing
100%
80%
60%
40%
20%
0%
-20%
-40%
-60%
-40%
0%
40%
80%
Unit Value of Export
(Labor Productivity/(wage per capita)

Annex 10a: Trade-policy reform progress, 2000–06

	Current trade Policy 06	Trade policy reform progress (00-06)
Algeria	68	63
Egypt	60	100
Jordan	44	94
Lebanon	50	80
Morocco	52	50
Syria	2	32
Tunisia	53	42
Regional	averages	(unweighted)
MPs	47	86.9
East Asia & Pacific	53	40
Europe & Central Asia	50	64
Latin America & Caribbean	64	57
High-income/OECD	84	61
South Asia	28	41
Sub-Saharan Africa	26	22
World	50	50

Source: Global Economic Prospects, 2007
a. Current trade-policy status reflects country's current placement in a worldwide ordering of countries, based on four major categories of trade-policy indicators available in 2006, expressed as a cumulative frequency distribution, with "100" reflecting the country (countries) with the most open trade policies and "0" reflecting the country (countries) with the most closed trade policies.
b. Reform progress reflects the improvement in a country's rank between 2000 and 2006 in a worldwide ordering of countries, based on the simple average tariff (the only trade-policy indicator widely available in 2000) expressed as a cumulative frequency distribution, with 100 reflecting the country (countries) that exhibited the greatest improvement in rank and 0 reflecting the country (countries) that exhibited the greatest deterioration in rank.
— = data not available.

Annex 10b: Tariff and non-tariff protection in the region, 2000 (or closest year available)

	Simple average Tariff	Nontariff Barrier coverage
Algeria	24.0	17.5
Egypt,	21.4	28.7
Jordan	23.1	48.6
Lebanon	10.7	24.1
Morocco	30.5	9.1
Syrian	21.0	—
Tunisia	29.1	33.1
Regional simple average		
MPs	22.8	26.9
Sub-Saharan Africa	15.8	4.7
East Asia and Pacific	10.7	19.6
Europe & Central Asia	9.5	9.5
Latin America & Caribbean	13.4	30.0
South Asia	17.6	13.6
High income OCED	4.3	25.7
World	13.6	17.6

Source: Global Economic Prospects, 2007
a. Nontariff barrier coverage refers to the proportion of tariff lines that have at least one core nontariff barrier (quantitative restriction).

Annexe 11: Labour Policies oriented to encourage Women participation

As a result of the national plan aiming at integrating women in the labour markets, Algeria, has managed to increase the rate of activity of women from 8% in 1999 to 15% in 2006 (check figures and add labour force %). The promotional mechanisms of job creation have included specific policies for female participation as part of the national plan of "setting up a strategy to encourage the professional insertion and job creation". The following are some the programs adopted and achievements of women: (i) Emplois salariés d'initiative locale (ESIL) where 70% were women; (ii) Contrats de pré emploi (CPE) has created 112 thousands new jobs where 85% have been filled by women; (iii) the micro enterprise organization (ANSEJ– CNAC) have funded projects where 17% were initiated and established by young female entrepreneurs.

Furthermore, to prepare women to enter the labour market, the Algerian government with the help of the civil society has established programs and created centers for vocational training for women. Specially designed training programs for household female, handicrafts and women working in enterprises have encouraged women to participate. Also the double objective of alleviating poverty is also achieved with programs designed to especially vulnerable women in rural poor areas and with difficult social conditions.

The government has established 500 investment projects in the agriculture sector and rural development where females benefit from some credits given the agricultural acquisition. Also, the Caisse nationale de l'artisanat has established specially designed projects for handicraft women. 160 micro enterprises generating 480 jobs have been created in 2004 by women within the framework of 'unemployed –promoters' programs.

Box : Access of women to micro credits in Egypt

Increasing the participation of Egyptian women in the micro and small enterprise sector is important for the government given the role that they are already playing in this sector. The government adopted a number of activities and policies to enhance this role for women in the micro sectors using the following mechanisms: (i) Social development fund: this funds grants credits to small and micro enterprises, but the access of female entrepreneurs to these funds has decreased indicating the need to include the social aspect so as to attract more women; (ii) Productive Families Program, this program is one of the major programs designated for women entrepreneurs. It has contributed to a large extend to improve the condition of life of poor families. This program is specially designed for artisans and handicrafts work where 1.5 million families have profited from its funding and the services they provide in terms of education and training, many of those families are led by women. This program is financial support by the government, the social fund, NGOs and the private sector. This project assures credits, market access by organization expositions (permanent and seasonal), technical training to its members; (iii) other programs exists that promote the micro and small sectors and specially those related to women through the National Council of women. .

Box: Tunisia gives specially designed training to meet the women needs

Tunisia have intensified in the past decade its policy towards promoting the rights and the economic independence of women, giving her incentives to join the labour markets and ensuring good working conditions and having access to good training to respond to the market needs. Only in 2000 Tunisian married women have been granted the right to work without having to take their husbands formal approval.

In the objective of giving incentives to employment of women, several programs are designed to help the Tunisians integrate in the labour force (public or private) in general. Women have presented 45.1% of the beneficiaries of these programs.

The National Fund for Employment (Fonds National de l'Emploi (FNE)), created in 2000, finances activities to develop the qualifications of job seekers, a large number of women benefited from these activities (e.g. 7,364 of graduated women have benefited from specialised training in IT and multimedia, other have benefited from training in telecommunications, and others benefited from educational sessions. Also, the forum of Tunisian productive women "Hirafiyet''(artisans) have helped women in this forum to efficiently integrate in the market with their products.

Moreover the promotion of female entrepreneurs has been an important aspect of the economy. Women are benefiting form a specially designed training program in the framework of 'creating enterprises –entrepreneurs training' that helps in the creation of new micro enterprise, providing training on how to manage them and how to handle market regulations.

Box: Turkey: the participation of women in an export oriented market.

The economic policies adopted 10 years ago and their socioeconomic implications have had important consequences on female employment in Turkey. The export-oriented growth policies applied since the 80s have weakened the labour market and its capacity to create jobs which have affected female employment. Female participation in Turkey was on the decline, due to the internal migration and urbanization (women left the agriculture sector and had no jobs in the urban areas or joined the informal market).

The general administration plan started with gathering information about those women that was disseminated to the appropriate persons who have designed targeted polices to integrate those women in the labour markets to specific sectors.

In 1999, the employment Agency has revised their strategies and had as objective to decrease unemployment and increase the capacities of the active population. In 2002, 18% of job seekers were women; 9% of the unemployed that found jobs where women.

The law ensures equality between males and females in terms of access of work and of salaries. It forbids any discrimination because of gender or because of pregnancy and provides maternity leaves and flexible hours of mothers with young children. It forbids the work of women in certain difficult physical conditions.

In general, equality of chances for women for education and employment is granted.

Source: FEMISE 2007. « Le renforcement du role des femmes dans la societe », Questionnaire d'Istanbul pour les pays Euro Méditerranéens