

Investment in the Mediterranean

The Med's moment comes

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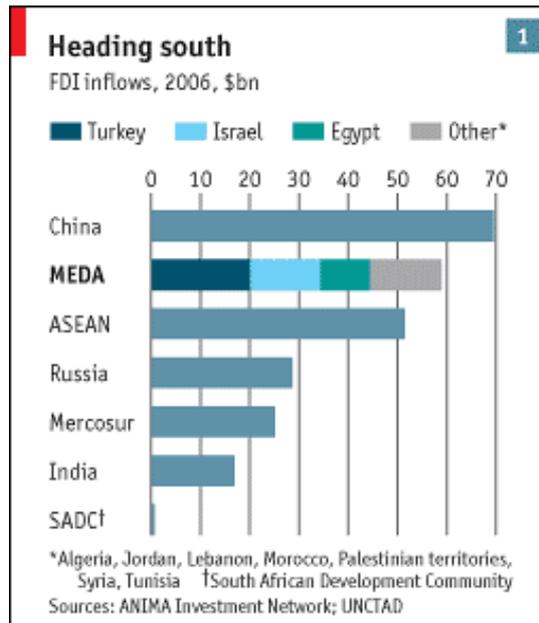
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Globalisation is bringing a wave of money to the Mediterranean



LOOK southward from the southern tip of Spain, across the strait of Gibraltar. There, only 14km (nine miles) away through the slight sea haze, arises the vast construction works of a new seaport to the east of Tangier in northern Morocco. Tanger Med (pictured) opened its first docks last July. Handling 3.5m containers a year, it is already as big as Felixstowe, Britain's biggest port. A second terminal opens this summer, and within seven years its annual capacity will rise to 8.5m. It will be the largest container port in the Mediterranean, not far behind Europe's biggest, Rotterdam (although merely one-third the size of the Asian giants of Singapore, Shanghai and Hong Kong). Similar ports are being finished in Algeria, Egypt, Malta and Tunisia.

One-third of the world's container traffic already passes through the Mediterranean, bringing manufactured goods from China and South-East Asia to Europe and the east coast of America. The Moroccans, spending some €3.5 billion (\$5.5 billion) on Tanger Med, and others along the coast hope that if they build, a big slice of global commerce will come to their shores. Goods will arrive to be broken down into smaller loads and sent around Europe. Manufacturers will set up factories in tax-free zones planned around the docks, bring in components for assembly and serve the huge market across the water.



Already there is substance in the haze. The Mediterranean's southern and eastern coasts are pulling in huge quantities of foreign direct investment, on a scale second only to China among emerging economies (see chart 1). The wave started about five years ago, and now private-equity groups and large investment funds from the oil-rich Gulf states are joining in. Tanger Med is but one mighty symbol that something is stirring along the coastline.

This is not the story usually told about the Mediterranean's poorer coasts. The MEDA ten (a group of southern and eastern economies) have an average income per head of only \$6,200, putting them roughly where western Europe was in 1950 and Romania was in 1975. Even though the gap in GDP per head has been closing, thanks to falling fertility rates as well as relatively faster economic growth, at today's pace it would take almost 160 years for the MEDA ten to catch up with the European Union average. Unemployment is probably between 20% and 30%, even though official figures say it is around 12%.

This last figure helps to explain why Europeans have tended to see the other side of the sea as more of a threat than an opportunity: a source of immigrants, often young and illegal, mainly Muslim and frequently unwelcome. In Italy, Spain and tiny Malta, illegal arrivals are of especial concern. Another reason is nervousness about the region's political health. Work your way around the map below and you will find few true democracies and much instability, actual or potential.



Yet commerce is scarcely a novelty in the Mediterranean. Centuries ago, the Middle Sea was a hub of world trade: to the Romans, it became *mare nostrum*—"our sea"—surrounded by the empire. Now the inflow of foreign direct investment may be reversing a long relative decline in the fortunes of the southern and eastern shores. The MEDA economies have managed to step up their growth rates to 4.4% since the turn of the century. A summit to be held in Paris this weekend may give the Mediterranean's revival a further push.

Tanger Med is a point of arrival for foreign investors. The leading shipping and port companies, such as Maersk and DP World will have terminals there. This February Renault and Nissan started preparing the ground for a huge car factory costing €600m. The Franco-Japanese alliance aims to build low-cost cars and vans not just for Europe but for markets around the world, mostly in emerging economies where the basic Renault Logan has already proved a winner. Annual output will start at 200,000 vehicles, but will double within a few years.

Twenty years ago, Europe's car industry stopped building new factories in low-wage Spain and Portugal, and turned to eastern Europe, including Turkey. The step across the Med, to a country where wages are one-fifth of what they are on the northern shore, is of great significance. Competitors will watch and may follow. Morocco has already attracted car-parts firms such as Leoni (from Germany), Valeo (France) and Clarcor (America). For 50 years Europe's car factories have shipped in labour from Turkey and north Africa to their factories in Germany and France, and invested little to the south. Now the capital is moving to the labour: the mountain is moving to Muhammad, if you will.

Things have been stirring on the poor side of the sea since 2000, albeit painfully slowly. In 1995 the EU started what is known as the Barcelona Process, intended to forge a Mediterranean free-trade area by 2010. By and large, that is happening through bilateral agreements between the southern countries and the EU. Sadly, the southerners' political conflicts and lack of will to act in concert—they do not even trade much with each other—meant that each country was dealing alone with the Europeans. That has cost them. For example, industrial products can move across the sea tariff-free, but agricultural products from countries such as Morocco are still subject to EU tariffs.

Piecemeal as it is, the political and economic partnership offered by the EU has prompted change to the south. According to Bénédicte de Saint-Laurent, director of ANIMA, a network of inward investment agencies for the MEDA countries, it has prompted economic, financial and fiscal reforms which have made their economies much more open and more transparent. Inflation has come down from an average above 20% to around 5%. Debt has come down from 80% of GDP to around 60%, budget deficits from 5% to 3%. This has been fuelled by rises in receipts from tourism and remittances from migrant workers in Europe, as well as oil and gas revenues. The fiscal squeeze may not have done much for the region's poor, but for the first time governments have the means to build better roads and houses, which are much needed.

Europe has also injected capital into the MEDA countries: around €8.7 billion between 1995 and 2006, plus loans worth €15 billion from the European Investment Bank and partners such as the World Bank under a programme known as FEMIP (Facility for Euro-Mediterranean Investment and Partnership). Between 2007 and 2013 another €14.9 billion is due to be sent as EU aid, with €8.7 billion from FEMIP. If that seems generous, an analysis by ANIMA suggests that at €8.30 per person up to 2006 and €12 up to 2013, it is minuscule compared with the hundreds of euros per person showered every year on eastern European countries before they joined the EU, and tinier still next to the structural funds lavished on Ireland, Greece and Portugal. But the EU's involvement could be about to rise.

On taking office last year the president of France, Nicolas Sarkozy, launched his own plan for a Union for the Mediterranean. This was sold as a way of resuscitating the Barcelona Process—although its true purpose may have been to offer Turkey a consolation prize instead of membership of the EU. At first Germany's chancellor, Angela Merkel, took a dislike to it, seeing in it a new club without the EU's northern members but paid for with EU (ie, mainly German) money. Now it is within the purview of the EU, Ms Merkel seems more at ease with Mr Sarkozy's scheme, which has been diplomatically renamed "The Barcelona Process: Union for the Mediterranean". This weekend in Paris Mr Sarkozy, whose country now holds the European presidency, will hope to put more flesh on his idea.

The EU's clout and money are probably necessary to get the new union going. But there is a risk that European governments will concentrate on immediate questions of security and migration rather than on measures to boost the economies of their southern neighbours (which in turn may improve security and limit northward migration). In June Benita Ferrero-Waldner, the EU's commissioner for external relations, told the European Parliament that real projects were needed to bring about economic solidarity. But she could cite only the promotion of fast sea-routes and a motorway linking the Maghreb (in the west) with the Mashrek (Egypt and the eastern shore). This weekend's meeting, however, may produce a plan for closer integration. Despite the Franco-German row, observers such as Mr de Saint-Laurent credit Mr Sarkozy with breathing life into the flagging Barcelona Process.

Follow the money

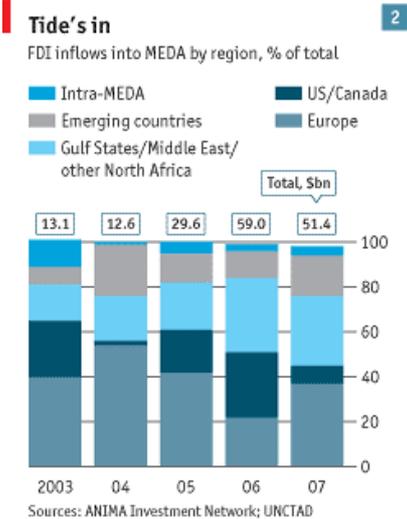
Whatever happens at a political level, the economic signs are encouraging. There is a groundswell of foreign direct investment in the region. According to figures collated by ANIMA, the southern and eastern shores of the Mediterranean are now attracting more investment than other emerging economies such as India, Mercosur or southern Africa; only China catches more. That raises three questions: where is it coming from; where is it going; and who is investing?

For the first time the MEDA countries as a whole are punching their weight in terms of inward investment: they have about 4% of the world's population and are now getting a slightly higher share of investment flows. Inward investment has grown sixfold in six years.

The leading recipients have been Turkey, Israel and Egypt. The prospect of entry into the EU has fuelled Turkey's five-year inward investment boom, though political difficulties and the slow pace of accession to Europe may explain a recent slowdown. Israel, with its hyper-educated technical workforce, boosted by arrivals from the former Soviet Union, has been a happy, high-

tech hunting ground for American investors. Renault have moved in too, to make electric cars. Egypt's political stability and economic reforms since 2004 have attracted investment too—notably the €12.9 billion purchase in December last year of Orascom Cement by Lafarge of France, paid for in Lafarge shares. Behind these leaders, Algeria and Morocco have each seen inward investment grow tenfold since 2002.

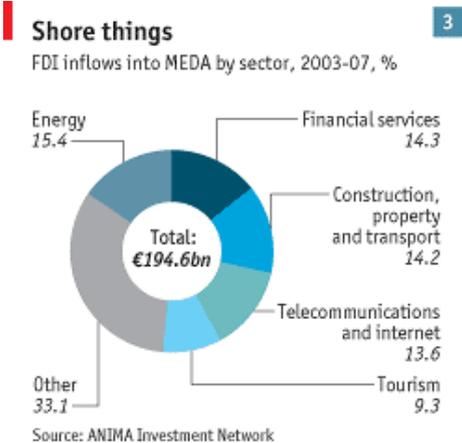
To be sure, there are downs as well as ups: the dotcom bust curbed American investment in Israeli technology; and first estimates for 2007 show a fall of about \$8 billion across the region, caused by fewer mega-projects in tourism and property, a slowing of privatisation and fewer purchases of Israeli firms by American ones. A plan by Agrium, a Canadian company, to build a \$1.2 billion fertiliser factory in Egypt was halted by local business rivals and environmental protests. Even so, says ANIMA, the number of investment projects is still running at around 800 a year.



Behind this groundswell lie several factors. The boom in energy and raw materials has brought in oil and gas explorers but also investors in petrochemicals, fertilisers and cement. The maturity and saturation of European markets is another reason to look south. Privatisation of banks and telecoms firms has also attracted investors, notably from the Gulf. The recent strength of the euro against the dollar should help too. Safran, a French aeronautical firm, is directing investment to Morocco to escape the pain of the strong euro. It is a big supplier to Airbus, which has made it clear that it expects its suppliers to price in dollars. EADS Socata, another subsidiary of Airbus's parent company, has also invested directly in Morocco for the same reason.

The source of the funds has changed in the past five years (see chart 2). Europe still accounts for about 40%, but North America's share has shrunk from 25% to around 10%. Meanwhile the portion coming from the oil-rich Gulf states has risen from 16% to over 30%. More intriguingly, the share of emerging economies such as Brazil and India has climbed from 8% to around 20%.

Although energy is an important draw for investors, it accounts for less than one-sixth of the whole (see chart 3). Banking (led by European banks) has not been far behind. Industries such as telecoms, chemicals, metalworking, tourism and car parts continue to attract dozens of deals a year across the region. Europeans have been buying homes by the thousand. Many are long-term residents rather than tourists.



The inward investors can be grouped into four types, according to Mr de Saint-Laurent. The first might be called "offshore" investors. These are firms attracted by deposits of oil and gas in places such as Algeria, Libya, Morocco and Tunisia. They are offshore in that they ship in all their labour, equipment and supplies. They pay the state for the resources they extract, but have little further effect on the local economy. The second group consists of European companies, led by the French but also including the Spanish and Italians. Reflecting their colonial histories, the French and Spanish tend to be found in the west, the Italians farther east. These investors usually form joint ventures or buy local small and medium enterprises, if only because such partners are needed in the Islamic Arab cultures of the region.

Third comes a new group, the Gulf funds. Their billions tend to go to the huge resorts springing up along the coast. Investors from Dubai have a €10 billion project in southern Tunisia, a €3 billion development in Algeria and €600m site in Morocco. With them come Spanish builders, such as Sacyr Vallehermoso, which see on the southern shores of the Mediterranean an opportunity to recreate the old boom on the Costas back home. These investors have something in common with the offshore oil-and-gas brigade: often, not much spills over into the local economy besides low-paid jobs for cleaners and waiters.

The fourth group, also newcomers, are perhaps the most interesting: investors from emerging markets. Several Indian companies have set up shop in the region. Tata has invested in motor manufacturing and outsourced information-technology work in Morocco. Wipro Technologies, a computer-services firm, also does IT work in the region. Ranbaxy Laboratories, a drugmaker, has factories there. Gujarat State Fertilisers and Coromandel Fertilisers from India are investing in a Tunisian factory to make phosphoric acid from the rich local reserves of phosphorus. South Korean investors also pop up, for instance with a car-parts factory in Tunisia and hotels in Syria. These industrial investors have no qualms about taking over local companies with thousands of employees—meaning that they are thoroughly integrated into the local economy, and their activities have a big knock-on effect.

The region's boosters would also like to attract more money from a fifth group of increasingly interested investors: private-equity funds. The rapid increase in foreign direct investment flows is encouraging, because they indicate the region's attractiveness to international capital: the export markets it can serve, wage costs and so forth. Increased interest from private-equity groups in small and medium enterprises would be a measure of these investors' confidence in the entrepreneurship on offer around the Mediterranean.

In 2007 private-equity funds had a remarkable year in emerging markets, with 204 funds raising \$59 billion, about 80% more than in 2006. Around 140 funds are reckoned to operate in the south and east of the Mediterranean, plus another 181 in Israel (which is a case apart, because of the virtual integration of its economy with America in general and Silicon Valley in particular). But the funds are starting to spread throughout the region, with 18 in Morocco (\$846m invested), ten in Egypt (\$611m), nine in Tunisia (\$64m) and nine in Turkey (\$1.2 billion). The trend, however, has been to go for project finance rather than investments in smallish companies.

Med revival

The falling away of the countries on the Mediterranean's southern and eastern shores from their European neighbours has been sad and wasteful. Algeria once was the breadbasket of the Roman empire; today it is the biggest wheat importer in Africa. Many things hold the region back, not least bad infrastructure, poor education and dysfunctional politics. The new economic hope is not evenly spread: foreign direct investment is swallowed disproportionately by Egypt, Israel and Turkey.

The boom in energy and raw materials should give many countries a start in building their economies up. If foreign investors do no more than harvest the oil and gas and leave, the region may simply stall again. What is needed is more of the joint-ventures and industrial projects represented by firms such as Safran and Renault-Nissan. But the real test will be whether the region's economy can be broadened and deepened. Then clearer shapes may emerge through the haze across the strait.

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