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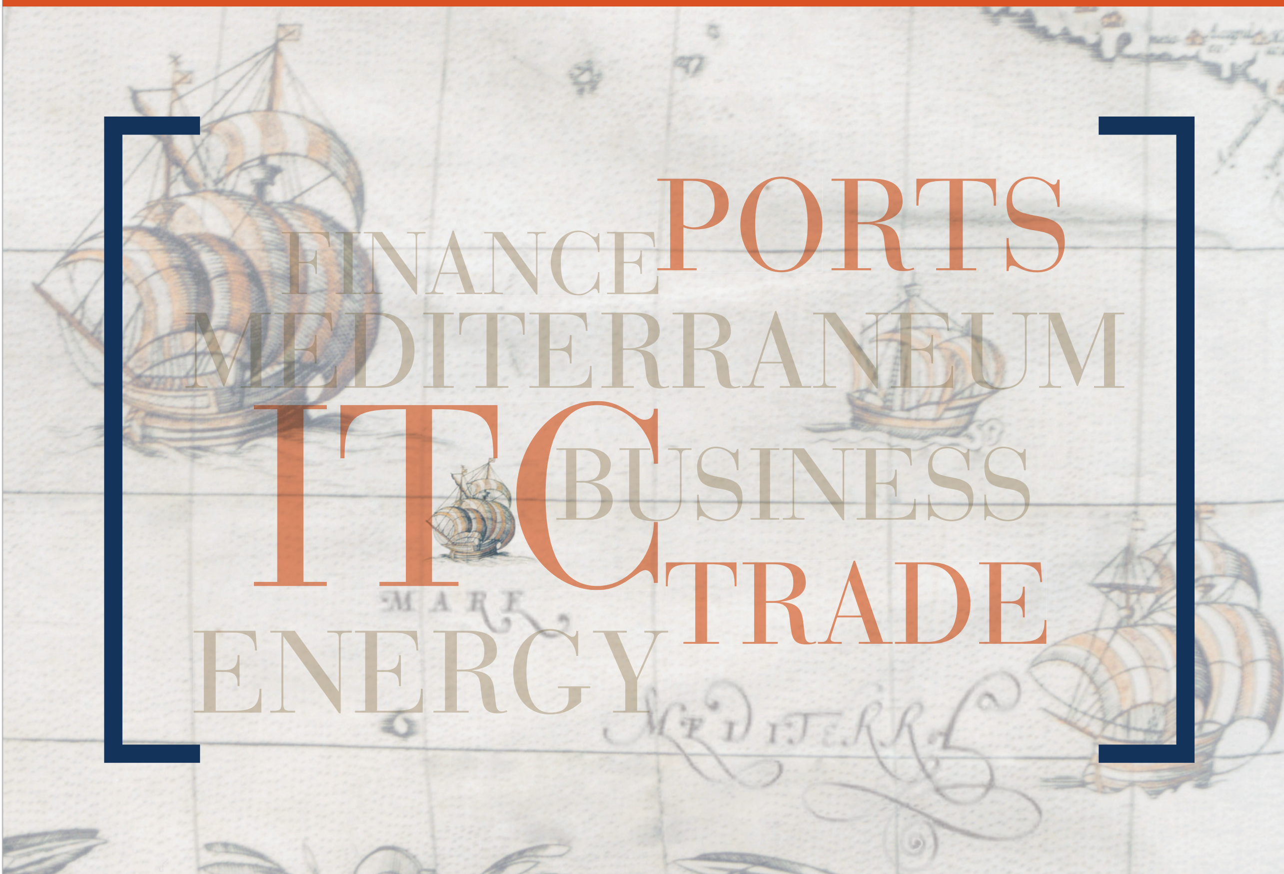
Economic relations between Italy and the Mediterranean area

5th Annual Report

2015



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Acknowledgements

The 2015 Report "Economic Relations between Italy and the Mediterranean area" falls within a wide web project created by SRM and named "Permanent Observatory on the Economy of the Mediterranean" which generated a specialized portal, www.srm-med.com. Its objective is to monitor and study the dynamics and the economic impact engendered by the relations that Italy maintains with the nations belonging to the Mediterranean basin. This project was achieved with the support of the Compagnia di San Paolo to which goes a special thanks from SRM and from all the authors of this research.

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Lastly, thanks to all of the partners of SRM involved in the MED project, and in particular to GMF, IAI, OECD.

This volume is dedicated to the memory of former President of the Banco di Napoli, Enzo Giustino
for his constant commitment, for years and with conviction,
in support of setting up Euro-Mediterranean of Italy and the South,
and special thanks for his valuable stimuli and input
which allowed for the continuation of this research project

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Part Two

New development directives and strategic infrastructure: Suez and the Gulf

The “Economic relations between Italy and the Mediterranean area” annual report has come to its fifth edition. It is the result of a one-year activity, which once again saw the research team – whom I sincerely thank – engaged in this area which has now become strategic for our country.

Mediterranean does not only indicate a sea, a group of countries or a migration route – as it is sadly too often reported. It is also (and increasingly) a generator of economic growth and opportunities for Italian companies which hunger for the internationalization and thirst for new markets and businesses.

Over five years, the Report has told us how Italy is increasingly projected towards the Mediterranean, but it also showed that its most aggressive economic competitors such as Germany, France, China and the United States also have their interests pinned to the same area. The MENA (Middle East and North Africa) area still has plenty to offer in terms of opportunities for our infrastructure, development and business and we have to seize two big challenges.

Firstly the entrepreneurial challenge, because the companies that internationalize think that these are markets to invest in, to believe in; the 3,000 companies surveyed by SRM and operating in Egypt, Morocco, Tunisia and Turkey are a tangible demonstration that Italian companies want to be present in the Mediterranean.

Secondly the infrastructural challenge, because a country that wants to gain a credible position abroad, both in import and export, must have at its service a logistics system and port of excellence with a capital “E”. Even North African countries are launching growth plans which pivot on ports, aware of its importance for competitiveness.

Good examples of success stories come from Morocco with the port of Tanger Med become a point of reference in the Mediterranean, and Egypt with the enlargement of Suez, realized in only one year, which will allow the transit of double the number of ships and in less time.

But there is another message we want to convey with this year’s report: the Europe / Mediterranean / Suez / Gulf is emerging as an increasingly important route. The Gulf – a region known to most for its oil and gas assets – is now pursuing policies to attract investment even more extreme than in the past, thanks to well-structured Free Zones in a simple and efficiently bureaucratic system. Many Italian companies invested or have economic interests in those areas, and this demonstrates their dynamism and appeal for those who want to do business. The Gulf ports are becoming increasingly strategic, and this will become even greater with the enlargement of the Suez Canal.

Italy can benefit from the strengthening of this route on condition that we work to improve Italian ports and logistics system and stimulate the internationalization of our companies.

These latter points have to become structural policies for our country and no longer occasional solutions. Investing on the basis of geo-economic transformations that are currently going on in the Mediterranean is both excellent foresight and the right choice. Italy already has a considerable port system, especially in the South, and business and manufacturing districts which can be competitive.

The overt ambition to which our Observatory aspires is to become a point of reference for operators, institutions, industry associations, and clearly, for the banking sector – of which SRM is an expression – by providing ideas, analysis and reflections which may offer a contribution in the understanding of the greatness and importance of having a policy which projects us towards the Mediterranean, or better still, a policy "for the Mediterranean". With the South acting as a protagonist.

Paolo SCUDIERI

The 5th edition of SRM's report "Economic Relations between Italy and the Mediterranean area" represents a turning-point for the analysis of the Mediterranean that SRM has been carrying out since 2011, when it established an internal 'Permanent Observatory on Economic Relations between Italy and the Mediterranean'. The Observatory was started thanks to the support and contribution of the Compagnia di Sanpaolo, founder of SRM in 2003, whom we wish to thank together with the Banco di Napoli that encourages us in this research.

The intense commercial relations of our country with the countries of the southern and south-eastern Mediterranean, the many Italian companies that invested in this area and the investment opportunities offered by these countries represented the heart of SRM's research about the Mediterranean in recent years. This fifth edition of the report marks a further progress in the analysis of SRM because it broadens its view not only on trade relations and on the presence of Italian companies in these markets, but also on the dynamics of maritime trade and the importance that some major infrastructure – such as the expansion of the Suez Canal – can have on the entire geo-economic structure of the Mediterranean. This objective of analysis led SRM to extend its scope to the Gulf countries which play an increasingly central role, both for their function as maritime-port hub and for the growing relevance of their economies.

In addition, these countries are reconsidering their future experimenting alternative approaches for growth that will shun dependence on oil revenues and will throw them into a future of more sustainable development. In this path, the diversification of economic and productive system is a key step.

It also opens up a vaster horizon for the research of SRM, which corresponds, from an organizational point of view, to the unification within the same area of research of the Observatory on maritime economy and the Observatory on the economy of the Mediterranean. Therefore, this new, richer work – more comprehensive than the previous ones and with new insights for the interpretation of the economic dynamics – is the result of the synergy between these two areas and of the relative skills of researchers.

The structure of the report changed as well: this edition is composed of two parts; a first, general part – *The economy and trade relations* and a second monographic part dedicated to the *New development directives and strategic infrastructure: Suez and the Gulf*.

Entering into the merits of the content of each chapter; Chapter I offers the usual update on the trade flows of Italy and of its international competitors with the Med Area.

At the end of 2014, Italian foreign trade with the Med Area amounted to €48.3 billion. Amongst the Mediterranean countries SRM monitored, Turkey remains the first trading partner, with €15.5 billion, followed by Algeria, with €8.1 billion exchange (down from €10.5 billion in 2013) and Libya, with which Italy in 2014 experienced a trade worth €6.8 billion (a figure in sharp decline compared to €10.9 billion in 2013). It is worthy of note that a significant share of trade between Italy, Libya and Algeria consists of energy products (mainly crude and refined oil and gas), 80% and 50.4% respectively. More generally, the impact of the energy component on Italy's trade with the 10 countries of the Med Area is one third of the total, while for competitor countries the energy sector has a lower weight and in no case does it exceed 20%.

Economic growth in these countries – a subject dealt with in chapter II of the report – was particularly strong in the period before the global financial crisis of 2009. Afterwards, the effects of the financial crisis and the political turmoil that affected many of the countries on the southern shores of the Mediterranean led to a significant slowdown in growth rates in most countries of the area.

Political instability and theaters of war dominate the scenario in some countries (Libya and Syria in particular); while other countries, such as Egypt, seem to overcome the difficulties and indeed they go towards new paths of development with significant investments in infrastructures. Along with these factors, two other important elements that are marking the current political situation in most of the MENA countries emerge. Firstly, the trend in oil prices which raises serious problems of balance in the state budget, as well as in political stability for those countries in which oil revenue is the main source for state finances. Secondly the recent agreement between Iran and the group of countries "5 + 1" (the five permanent members of the Security Council of the United Nations and Germany) on nuclear power; not all countries in the area supported the agreement, an element that might introduce risks of renewed tensions.

Despite the factors listed, the overall GDP growth in the MENA countries in 2015 is expected at still around the rates of 2014 (2.5% compared to 2.6%) but it is expected to recover in 2016 reaching 3.8%. As for Turkey, the main trade partner amongst the countries analyzed, consensus forecasts indicate an increase in real GDP by 3% in 2015 (compared to 2.9% in 2014) and 3.2% in 2016. The appendix of the chapter presents some explanatory sheets on the models of development and the growth prospects of five of the countries analyzed: Turkey, Egypt, Israel, United Arab Emirates and Iran. The same countries are the focus of Chapter III which deals with Italy's role as a supplier of manufactured products.

Amongst the ten countries of the Med Area – those traditionally monitored by SRM – Turkey, Israel and Egypt are the countries with the highest value of trade with foreign countries, excluding the energy component, and thus represent the more attractive destinations for Italian products. On the United Arab Emirates – the fourth sheet in the two chapters – SRM developed a specific piece of work that will be published shortly and whose summary is contained in chapter V of this Report. The study concerning the Emirates is a novelty in the analysis usually carried out by SRM on the Mediterranean, in fact it includes a wider look that reaches the Gulf countries and its port facilities. The Emirates are the main commercial hub of the region and the first trading partner of Iran. A country with nearly 80 million inhabitants which, after the improvement of its relations with the West, may enjoy a progressive lifting of the trade embargo against it and consequently increase its weight in the world trade. These are, primarily, the target countries on which Italy will have to concentrate its commercial efforts.

The analysis carried out in chapter III is specifically concerned with the potential of the Med Area as a market for Italian production. In 2014 Italy's market share on the export of manufactured products in the Med was 6.6% and showed the highest value in the

Mechanical sector (12%). Compared to the other three European competitors (Germany, France and the UK) Italy holds a market share in manufacturing which exceeds that of France and the UK and is only lower than that of Germany. At a sector level, our country maintains a leading position in the metals sector and in that of the *Made in Italy*, while it is only second to Germany in Mechanical and Intermediate products.

Amongst the Med countries, Turkey and Israel are relatively more accessible for Italian companies; the first thanks to a customs agreement with the EU, facilitating the entry of European goods into the country, the latter because compared the others it is more conducive in terms of business operations.

As regards the South of Italy, the Med represents an important export market; its incidence on the total amount of the manufacturing exports is higher than that of the Center-North (8.5% in the South against 6.9% in the Center-North).

The monographic part of the report intends to inaugurate a new cycle for the Observatory focusing on the Mediterranean. The studies and the topics chosen by the research group will be gradually directed to supplement the part consolidated over the years concerning trade relations with foreign countries, with that focussing on transport and maritime logistics, cornerstones of the other SRM's Observatory, the one dealing with maritime economy.

The new style of the Med Report will imply a broader and more strategic vision of the opportunity that this area can offer to Italy. These are opportunities which should be seized by Italian ports, airports, dry ports and related companies as well.

Chapter IV, *New strategies: the rise of the Mediterranean-Suez-Gulf route* introduces the logic contained in the monographic part and illustrates the two novelties from the Observatory, which have been addressed in greater detail in the explanatory sheets: firstly, the extension of the analysis to the Gulf region, which is considered one of the most promising areas in the world for the future growth of Italy; secondly, the introduction of the subjects of transport and logistics, which represents the close integration between the MED and Maritime Observatories of SRM.

Chapter V entitled *Enlarged Mediterranean: Gulf countries and the United Arab Emirates*, represents a first step of analysis on the Gulf area, which begins with the United Arab Emirates (UAE). It is an analysis of the economic structure of the country with particular reference to trade with foreign countries, maritime strategies and sea trade routes as well as the phenomenon of Free Zones. It also addresses the presence of Italian companies in the UAE, an estimate of the revenues that these companies realize, and their growth potential analyzed through their budget.

The report shows that the United Arab Emirates as well as the whole area of the Gulf, have already taken a leading role in the international economic scenario, in terms of infrastructure and enterprises. In fact, the country is appealing not only for the policies related to well-equipped Free Zones and facilitations for the companies that decide to set up a business there, but also for its strategic connotations due to international ports and top-tier logistics that encourages trade networking and business relationship with both the Middle and Far East, and the Mediterranean.

The UAE proposes as the pivot of the new Suez-Mediterranean-Gulf route which, in turn, seems to be a transit area in relation to the two global hubs: the East Coast of the United States and Europe on the one hand, and China and the Far East on the other hand.

Italy is geographically in the middle of the Mediterranean and at the center of this route, and proved itself as a primary trading partner of the UAE. Besides, Italian companies have permanent establishments and strategies for the local market.

The prospects of the UAE's domestic market are very interesting; in particular, in the sectors defined in the Report as typical of the "Made in Italy". Our country currently holds a market share of 5.3% on the imports of the Emirates – equivalent to that of its three main European competitors as a whole – and is positioned at the top end of the market, leaving the eastern productions at the lower end.

In these production sectors a growth in demand from the UAE by more than 10% annually over the next three years is expected, especially for some products like jewellery and fashion in particular.

The South of Italy might benefit too from this incremental demand (over US $1 billion more than the current levels) as it now only covers 3% of the Italian "Made in Italy" products sold on the UAE market, less than a half of all Southern Italian manufacturing exports to the world (7.5%).

The South, with its port and logistics system and with its manufacturing excellences (the "4A" that SRM has mentioned several times in his research: Agribusiness, Aerospace, Automotive, Apparel-Fashion) might be able to seize the opportunities arising from the Gulf markets more than other regions of Italy. However, works are needed on the port system to consolidate and strengthen the infrastructure and to equip the ports in order to accommodate larger ships and make the mechanisms more suitable for intermodality.

Along with this, more targeted policies to support internationalization are needed so as to promote those prestigious sectors of Italy, increasingly acknowledged and sought-after in the UAE, together with leaner red tape and regulations which facilitate the realization of the works and investment.

Chapter VI analyzes the economic impact of one of the most important infrastructure projects realized this century: the expansion of the Suez Canal. It will affect naval traffic and trade positively, representing an opportunity to grasp for enterprises and for shipping companies. The first will have the chance to count on more rapid cargo shipping and therefore on better processes of internationalization, the latter will be able to streamline routes and logistic systems. The new Canal is not just a huge infrastructural project, it is also expected to become a center of economic commercial and logistics interest for the whole of Egypt through the realization of the Suez Canal Corridor Area Project.

All this will increase the centrality of the Mediterranean, which already circulates 19% of world traffic of goods and whose traffic increased in the past 15 years by more than 120%. In addition major port investments are being implemented in the various countries of the basin (for example, Tanger Med, Piraeus, Algeciras, Valencia). The circulating fleet in transit in the Canal (already 17,000 ships per year) is also likely to increase with the growing presence of large ships and big players; as a matter of fact, one should be reminded that the vessels of the 2M (Maersk, MSC) and Ocean Three (CMA CGM, UASC, CSCL) alliances travel in the Mediterranean. Other major container shipping companies are using 20,000 TEU ships on many routes of interest for Italy such as Asia-Med and Gulf-Med.

According to the authors, the presence of the mega ships and the investment of competitor ports must lead the Italian ports, with those of the South at the head of the queue, and especially those of transshipment, to invest in infrastructure, technology and logistics to avoid losing market share, and above all to grasp the new opportunities that will arise from the enlargement of the Canal.

Thereafter, the relaunch of Italy and of the South should imply the reorganization of the port system which is placed at the center of the development agenda of the country. In addition, attention should be paid to the new traffic of the Canal, which may be brought about in the short, medium, and long term, along with stronger trade and economic relations with Egypt and, more generally, with all the Med countries being established.

The analysis contained in this 5th Report, therefore covers a wide range of topics on which the monitoring of SRM is constant throughout the year. We believe that our work on these themes may be a point of reference for anyone – entrepreneurs and institutions – who consider the Mediterranean an area of strategic interest and for the SRM members, including Intesa Sanpaolo whose presence in the area under consideration is growing. The hope is still that – once the stage of socio-political turmoil will be over – business relations between the two shores of the Mediterranean will return to grow at a rapid pace, following the logic of co-development, which has been consistent for the past five years, inspires our work on the Mediterranean.

Massimo DEANDREIS

PART ONE

THE ECONOMY AND TRADE RELATIONS

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