EXECUTIVE SUMMARY

A central pillar of the Euro-Mediterranean Partnership (EMP) between the 15 Member States of the European Union (EU) and their twelve Mediterranean Partners (MPs) is the creation of a free-trade area (FTA) during the coming decade. If the economic benefits of this FTA are to be maximized, non-tariff barriers will also have to be removed – particularly all frictions and inefficiencies in the regional transport network. The FTA should therefore be complemented by a ‘common transport space’ throughout the Euro-Mediterranean region.

Economic development, trade, tourism, and personal travel in the emerging Euro-Mediterranean free trade area require a smoothly functioning multimodal transport system. More efficient transport would permit the southern Mediterranean countries to increase exports, attract more foreign direct investment, and participate in increasingly complex cross-border supply chains. Since the 1995 Barcelona Conference, where transport was identified as a priority issue, a broad consensus has developed that transport reform should be an integral part of economic adjustment at the national level as well as intergovernmental cooperation at the regional level. The objective of this study is to identify the range of transport policy reforms that would be needed to create a common transport space that spans the two sides of the Mediterranean Sea.

The multimodal transport network includes air transport (chapter 2), maritime transport (chapter 3), land-based modes (chapter 4), as well as intermodal logistics services (chapter 1). Many of the pressing bottlenecks and frictions in the Euro-Mediterranean transport system are policy-induced, rather than due to lack in physical infrastructure. What traders, investors, tourists, and business travelers ultimately care about are the cost, flexibility, and reliability of transport services provided on the basis of the physical infrastructure. These parameters are primarily determined by the way the transport sector is organized. This insight has induced governments worldwide to privatize transport companies, introduce competition in port services and air traffic, modernize regulatory frameworks, and remove bureaucratic frictions.

Several EMP policy documents emphasize the importance of implementing such policy reforms in the Mediterranean region. According to a Commission communication on transport in the Euro-Mediterranean region, for example, ‘software’ measures “should be given priority over ‘hardware’ measures. Many transport bottlenecks […] have their principle causes in ‘software’ rather than ‘hardware’ problems.” The 1997 Lisbon Declaration of Euro-Mediterranean transport policy makers demanded that an evaluation of “alternative solutions to the given transport problem should be made, especially where operational and organizational changes (including private participation) offer viable alternatives to capital-intensive and infrastructure solutions.”

In several southern Mediterranean countries transport reforms are now underway, but a range of economic and efficiency indicators suggest that much remains to be done. Benchmarking of macroeconomic freight costs against best practice suggests that the potential economic benefits of comprehensive transport reforms in the Maghreb and Mashrek countries could be as high as € 3 to 5 billion per year. There are still southern Mediterranean ports where it takes longer to obtain customs clearance for a container than to ship it all the way from Hong Kong. The Lebanese government has sunk $ 450 million into a loss-making airline, while Jordan’s flag carrier accumulated debt of more than $ 850 million, or around 10 percent of the country’s GDP. Before recent reforms, the total economic costs imposed by port inefficiencies in Egypt were estimated to be as high as $ 2 billion annually, and in Algeria private sector sources calculated that the costs
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of customs inefficiencies in the port of Algiers alone amount to $200 million – the equivalent of 14,000 social housing units each year.

On the northern shore of the Mediterranean, the European Union has created a Single Market for transport, which comprises 15 nations and 376 million inhabitants. Air transport for both passengers and cargo has been fully liberalized, the majority of flag carriers and many key airports have been privatized, regulations for ground handling and airport charges have or will be strengthened, air traffic control is being reorganized to create a Single European Sky, and agreement has been reached with ten EU accession candidates to create a European Civil Aviation Area. Road freight has been fully competitive for about a decade, border controls have been abolished, and a vibrant logistics industry is rapidly consolidating across borders. The EU’s strict competition and state aid rules have repeatedly been applied throughout the sector and the Commission has drafted new legislation to introduce competition in port services. In rail transport, a pan-European route network, comprising 50,000 kilometers of track, will be opened to private freight train operators. By the time the Euro-Mediterranean FTA is completed around 2010, the European Single Market for transport is expected to be fully liberalized, privatized, and integrated across national borders. With 10 countries to accede the EU in 2004, this market will soon comprise 25 countries with 450 million consumers.

Transport flows in the region are characterized by some general patterns. First, the majority of cross-border traffic flows through maritime and air chains, especially in the countries of North Africa. Second, traffic tends to be heavily concentrated on few key ports, airports, and land-corridors. Third, about 50 percent of MP trade is conducted with the EU and South-South trade is limited to 5 percent of the total. One policy implication is that reforms and investments should be concentrated on a network of priority ports and airports, as well as a backbone network of roads and railroads. Another key implication is that maritime and air chains deserve specific attention.

Chapter 1: Transport Logistics and Multimodal Transport

A variety of technical innovations have transformed the global logistics industry beyond recognition. Unitized cargo, and especially containers, dramatically reduced the costs and time needed for modal transfer and thus door-to-door transport. Information technology permits the real-time tracking of shipments, satellite-based fleet management, electronic data interchange between the multiple parties involved in trade transaction, or a matching of demand and supply through online market places. Sophisticated port equipment and modern container vessels that can carry 6,000 containers are turning the shipping industry into a high-tech business.

At the same time, the third-party logistics industry is evolving rapidly. Freight forwarders have long acted as intermediaries that bundle different transport services and handle paper work on behalf of their clients. Increasingly, integrators offer all transport services in-house, reducing what can be up to 40 different steps in a transport chain to as few as a dozen. Express carriers in particular have perfected this business to offer overnight, time-definite delivery across the world. Additional value-added logistics services include warehousing, reverse logistics, or light assembly. As the boundaries between freight forwarders, integrators, carriers, and even postal operators blur, the race is on to be among the few dominant players in a consolidating industry.

This logistics revolution has been driven by the explosive expansion of global trade as well as the transformation of the way goods are manufactured and distributed. Trends like global sourcing, just-in-time production, ever shorter product- and time-to-market cycles, and the outsourcing of individual production stages have created ‘a global conveyor belt’. Supply-chain management permits extended supply and distribution networks to be organized as ‘virtual companies’.
increasing sophistication of these systems and the elimination of buffer stock have allowed leading companies to reduce total logistics costs by 50 percent in less than a decade.

These changes in global goods and transport markets have profound implications for the integration of developing countries in the international economy. As individual production stages are becoming geographically footloose and supply-chains ever more sensitive to transport-related disruptions, access to state-of-the-art transport services is a key determinant for the competitiveness of individual firms and entire countries. Tunisia, for instance, recently lost a bid for a factory by a German car part manufacturer for logistics reasons. A $12 million investment and 1,700 jobs went to Romania instead, because the one day time saving in each direction was vital for an industry reducing order-to-delivery cycles from nine to six days. Transport users no longer ‘move goods but manage flows’ and transport policies need to reflect these realities.

Southern Mediterranean countries are currently poorly integrated in international supply chains and comprehensive transport sector reforms are required to avoid further marginalization. Many of the state-owned ports, shipping lines, airports, airlines, and logistics companies that dominate transport markets in the region have found it difficult to adapt to the changing needs of their clients. More private sector participation, competitive dynamics, and regulatory reforms are needed to provide a framework for the development of a modern logistics industry. Modal interfaces, port hinterland connections, and logistics-related banking and insurance services need to be improved while documentation requirements and red tape ought to be minimized.

Many of the most severe bottlenecks stem from cumbersome border-related controls, especially customs. In Egypt, around 1,500 tariff lines are subject to product standards and depending on the product category, different forms must be submitted to several agencies. In Jordan, 51,000 import transactions were subjected to tests by the standards institute in one year, even though only 65 (or 0.1 percent) failed the tests. It is not uncommon for cargo imported through ports to require five to ten days for customs clearance. In countries like Morocco or Lebanon, customs reforms have worked wonders and most MPs have now started to tackle border-related frictions.

While most transport sector reforms will have to take place at the national level, cross-border cooperation will also be needed. Priorities should be a harmonization of customs procedures and product standards, juxtaposed controls at border crossings, and coordinated facilitation measures along main land corridors. A large number of international conventions to facilitate cross-border trade and transport exist, which the MPs could ratify and implement. Of 16 key United Nation transport facilitation conventions, for example, Italy ratified 16 and France 15 – compared to only 4 in the case of Algeria and 5 in the case of Tunisia. Donor funding for physical infrastructure should focus on a network of key ports and airports, as well as a backbone network of roads and railroads. Moreover, it could be made conditional on complementary policy reforms.

Chapter 2: Air Transport

In the multimodal transport system of the region, air transport plays a critical role for the transport of passengers (including tourists) and high value-added, time-sensitive goods. In terms of weight, only 1 percent of trade between the two sides of the Mediterranean is being conducted by air, but in terms of value it is around 15 percent. While a mere five million people arrive in the MPs by sea each year, the figure for air transport is more than 40 million. With tourism receipts in the 12 MPs amounting to more than $20 billion annually, cheap and efficient air transport is vital.

One important reform challenge is the restructuring and eventual privatization of airlines. Some MP flag carriers, such as Tunis Air or Royal Air Moroc, are well managed, but most still underperform. Load factors of virtually all MP airlines, for instance, were below the world average, often by 10 to 20 percent. The comprehensive restructuring of Royal Jordanian, which for many
years incurred heavy financial losses, provides general lessons for other countries. Regarding privatization, state-ownership in MP flag carriers still averages 95 percent, while virtually all Latin American and most European flag carriers are now in private hands. An example for how regulatory reform can induce even state-owned airlines to excel is Emirate Airlines. Operating in the open skies environment of Dubai, without subsidies or protection, Emirates has won more than 150 quality awards and makes profits of about $ 100 million per year.

The liberalization of licensing rules and traffic rights will be needed to foster competition and greater private participation in air transport. Several MPs have started to dismantle the exclusivity rights granted to flag carriers and issued licenses to private operators. Most of these, however, remain niche players and the incumbents continue to influence sector policies. In Egypt, the tourism industry has long complained about the grip of EgyptAir on the market and a special aviation minister was recently appointed to oversee reforms. In Morocco, express carrier DHL lost an important contract after it was refused regulatory permission to operate a larger aircraft. One market segment where liberalization is far advanced in the southern Mediterranean is charter traffic. While this is a good start, MPs should follow the EU example and remove regulatory distinctions between scheduled and non-scheduled services, by liberalizing the latter.

Market access, frequencies, and many other important parameters in cross-border traffic continue to be governed by bilateral air service agreements (ASAs) between governments. Several MPs have started to relax the provisions in the ASAs they negotiate in an effort to increase flexibility and competition. The most far-reaching reforms to date took place in Lebanon, which recently adopted an open skies regime. Inside the EU Single Market, all ASAs have been abolished, and on behalf of the 15 EU countries the Commission recently negotiated the creation of a European Civil Aviation Area with ten accession candidates. This will liberalize air traffic rights and oblige all signatories to generally adopt EU rules and regulations in the air transport market.

While liberal amendments to existing ASAs should be a short-term priority for MPs, the eventual transition to open skies regimes and a regional civil aviation area would be desirable. The positive effects of such liberalization are well documented. Between 1997 and 1998, six Latin American countries that entered into open skies agreements with the United States saw traffic levels rise by an average of 21 percent, while other markets in the region barely grew. A Commission report found that ticket prices on routes with two operators were 5 to 17 percent cheaper, and with three operators prices were 10 to 24 percent lower than on monopoly routes.

Other items on the regulatory reform agenda in the air transport market are the liberalization of ground handling, transparent regulation of airport fees and slot allocation, as well as the reform of air traffic control. Costs related to airports and air traffic control can account for up to a quarter of airline expenses. Evidence shows that transparent regulation of monopolistic activities and the introduction of competition in ground handling can reduce these costs significantly. The EU has formally liberalized ground handling, but competitive dynamics have been slow to unfold. With draft legislation on the regulation of airport charges blocked by some EU member states, the Commission relied on general competition rules to counter anticompetitive abuses. In air traffic control, the work of Eurocontrol and the planned creation of a Single European Sky could provide guidance for cross-border coordination in the Euro-Mediterranean.

One policy area in air transport where reforms are gathering considerable momentum in the southern Mediterranean is airport privatization. Egypt has successfully issued several private concessions for secondary airports and is contemplating private participation for a new terminal in Cairo. The privatizations of the airports in Algiers, Beirut, Cyprus, and Malta are planned or under preparation, while Tunisia would like to see a private investor build a new $ 400 million airport. To date, however, none of the major airports in the MPs has actually been privatized and before such disposals occur, adequate regulatory regimes ought to be put in place.
Chapter 3: Maritime Transport

Especially in North Africa, the majority of cross-border transport flows through ports. Ports are a major bottleneck in maritime chains and streamlining their operations is an obvious reform priority. As entry points into a country, ports are not only the place where cargo changes modes, but also the place where it ‘hits the administration’. The transfer and clearance of goods through ports can involve up to 50 documents. Goods change hands several times and with at least half a dozen parties involved, multiple transfers of ownership titles, insurance certificates, letters of credit, invoices, customs forms, and administrative documents are inevitable.

While the complexity of port operations has always created frictions, current sector structures are increasingly at odds with rapidly changing technical and economic requirements, such as containerization or the demand for just-in-time delivery. Most ports in the MPs continue to be managed by public port authorities, with ill-defined incentive frameworks and insufficient accountability. Exclusivity rights, unregulated monopolies, collusive practices, and labor problems hamper competition and undermine efficiency. These problems plague ports worldwide, but reforms in the MPs are lagging behind regions such as Latin America or Europe. The Baltic Sea, where port reforms and maritime trade play an important role in regional integration between the EU and transition countries, could be an interesting precedent for the Mediterranean.

In accordance with international best practice, a key priority will be a separation of regulatory and commercial functions through the creation of landlord ports, especially in large ports. This implies a three-tier institutional structure: the government remains in charge of sector policy and planning, autonomous port authorities manage and regulate ports, while private companies provide commercial services. The landlord port model is becoming the norm in the EU and a survey found that 88 of the world’s 100 largest ports have adopted this operating structure. In the MPs, landlord ports basically do not yet exist. For smaller ports, the tool port model, with the port authority owning the equipment and renting it to private operators, is more appropriate.

For modern container terminals and certain bulk cargo terminals, vertical integration of port management and service provision is needed for operational efficiency. In these cases concessions should be given to private operators, with a competitive tender and transparent regulation preventing the extraction of monopoly rents. Egypt, for example, has issued concessions for a container terminal in East Port Said, for a petroleum terminal in Alexandria, and for a port in a new industrial zone at the southern end of the Suez Canal. In East Port Said alone, private investment commitments amount to $480 million. Morocco has granted a 20-year concession for a coal terminal to a private power plant operator and has long toyed with plans for a private container terminal in Tangier. In 1999, Lebanon issued a concession for a container terminal in Beirut, but the investor subsequently pulled out. To date, none of the large existing ports in the southern Mediterranean has been privatized.

Competition between ports can also induce efficiency improvements, but it requires overlapping hinterlands. Several MP ports, especially in the Middle East, would be well placed to serve catchment areas in neighboring countries. In practice, however, regulatory restrictions, and especially the disruptions caused by controls at land borders, prevent this from happening. In Egypt, one of the few MPs where several large domestic ports share a potentially contested hinterland, state-ownership and decreed prices restrict competition. This contrasts with Europe where a customs union, the removal of border controls, and efficient hinterland connections bring ports from different countries into direct competition with each other.
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An important reform item in maritime transport, facilitated by the introduction of landlord ports, is the introduction of private participation and competition in port services. A wide range of services is being provided to ships and cargo and many of them lend themselves to such reforms. There is no economic justification for public sector involvement or exclusivity rights in services, such as general cargo handling, warehousing, bunkering, banking, and insurance services or for restrictions to the operation of shipping agents and freight forwarders on port premises. Ideally, the role of the port authority should be to issue licenses to private operators and to create a level playing field for competition. Exceptions are pilotage, tug services, port security, and health services for which public provision, or at least strict but transparent regulation, is required.

While port reforms are the most pressing issue in maritime transport, the shipping market also deserves some attention by policy makers. Generally, the shipping industry is highly international and competitive. Different cargoes – such as dry and liquid bulk, general cargo, or containers – constitute specific market segments as they involve different types of terminals and vessels. General cargo traffic, especially container and RoRo (roll-on, roll-off) traffic plays a key role for the flow of manufactured and high value-added goods. An enabling policy framework for these trades, as well as for transshipment activities, should be ensured.

Chapter 4: Land-Based Transport and Other Sector Issues

Efficient hinterland connections for ports and airports, as well as smooth traffic flows along a backbone network of roads and railroads are priorities in land-based transport. As far as regional cooperation is concerned, the identification of physical and policy-induced bottlenecks along these corridors and a coordination of facilitation measures are obvious priorities. With land-borders a major source of disruptions, a streamlining of procedures, juxtaposed controls, adequate staffing and physical facilities are needed.

Roads account for the vast majority of land-based freight transport and the effective regulation of the trucking industry is an important policy issue. In most MPs, the industry is dominated by the private sector and quite competitive, but further deregulation of prices and market access would enhance efficiency. In cross-border haulage, a harmonization of standards for equipment and personnel, as well as the liberalization of cabotage and rights of establishment would be desirable from an economic point of view. In fact, all these policies were key elements of road freight reform in the EU since the late 1980s. Overloaded trucks do significant damage to roads, and a violation of safety and environmental rules creates negative externalities. As in maritime and air traffic, modern and strictly enforced technical, environmental, and safety regulations are thus called for.

In rail freight, the restructuring of state-owned companies tends to be the policy measure with the largest efficiency effect. In this mode, opportunities for the introduction of private participation and competition are more limited. Morocco has implemented a comprehensive and successful restructuring program in recent years that other MPs should be looking at. Most MP railway companies lack modern commercial management and many are incurring heavy losses. Overstaffing and the outsourcing of maintenance work to the private sector are other issues to be addressed. The facilitation of equipment and personnel transfer at border crossings, and the opening of key routes to private freight operators could also yield significant benefits.

Customs reform is one of the items on the policy agenda for which the payoff in terms of transport facilitation is highest. In this regard, the Lebanese experience with customs reforms can provide some useful lessons. With the help of donor assistance, the government streamlined procedures from 13 to 4 steps, and reduced the number of forms from 26 to 1. A tariff reform simplified the nomenclature and brought it in line with international standards. A computer
system was rolled out to permit electronic data entry and processing and to collect more reliable and real-time statistics. All border-related rules were summarized in one table and all checks are to be performed at the same time. In the first two years of reforms, the number of shipments cleared without inspection quadrupled from 10 to 40 percent, the average tariff rate collected remained constant, and clearance times declined from six to four days.

The wide range of mode-specific, intermodal, national, and cross-border reform measures discussed in this study address bottlenecks and frictions in the regional transport system. Together they would amount to the creation of a common transport space, in complementarity to the Euro-Mediterranean FTA. A far-reaching package of economic and transport sector reforms in Mexico allowed this country to reap the full benefits from its participation in the North American Free Trade Area. Another precedent for the catalytic role the transport sector can play in the process of regional integration is the gradual extension of the EU Single Market for transport to the accession candidates of Eastern and Central Europe. This report argues that a large pool of international experience and best practice exists to guide the decisions of policy makers and the assistance of donors in the Euro-Mediterranean region.

With most of the Association Agreements now signed, the implementation of the free-trade area and the reform of the transport system are moving center stage. There are encouraging signs of reform in several Mediterranean Partners, but much remains to be done. The ultimate objective of the transport system is to provide fast, reliable, and flexible transport services at low cost. This requires an enabling policy environment to allow for the seamless integration of different modes into a multimodal system, effective competition between service providers, the elimination of bureaucratic frictions, and greater private sector participation. The reform agenda for the transport sector is clear. It is now up to governments and donors to effectively implement it.