Trade and Investment Integration of the Maghreb and North Africa and the Middle East

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ABSTRACT

This paper discusses a trade strategy for the Maghreb countries, with a particular focus on regional initiatives, as trade expansion could generate higher and sustained growth rates, and employment. The analysis is based upon identification of the key internal and external barriers that are constraining integration into regional and global markets and discusses how poor design and weak implementation of trade agreements amongst countries in the region limit their impact. This paper argues that Maghreb countries could reap significant benefits from enhancing their integration with regional partners, with the EU and with global markets. This entails careful design of trade policy to ensure complementarity between the three domains of trade policy: unilateral actions, regional trade agreements and the multilateral agenda. Integration needs to be broadly based to include services so as to enhance productivity on an economy-wide basis and to increase the scope for trade and for new employment opportunities. Integration should also be deep to cover key elements of competitiveness relating to issues such as standards, conformity assessment, transport and logistics. Such trade policy initiatives are all the more effective when part of a broad and coherent reform process and bolstered by support for those who bear the brunt of the costs of adjusting to the new, more open regime.

ملخص

تناقش هذه الدراسة استراتيجية التجارة بشأن بلدان المغرب العربي، مع التركيز بصورة خاصة على المبادرات الإقليمية، حيث إن توسع نطاق التجارة يمكن أن يسفر عن زيادة واستمرارية معدلات النمو والعملة. يستند هذا التحليل إلى تحديد الجوانب والموازنة الداخلية والخارجية التي تؤثر حالياً التعاون في الأسواق الإقليمية العالمية، كما يبحث في كيف أن توسيع تصميم ووضع تنفيذ اتفاقيات التجارة فيما بين بلدان هذه المنطقة يؤدي إلى الحد من أثر تلك الاتفاقيات. وتقول هذه الدراسة أن من الممكن لبلدان المغرب العربي أن تنجい منافع كبيرة من تعزيز تكاملها مع: شركائهن في هذه المنطقة، والاتحاد الأوروبي، والأسواق العالمية. ويستدعي هذا توثيق العلاقة في تصميم سياسات التجارة بما يضمن أن عناصر سياسات التجارة الثلاثة يكمل بعضها ببعض، وهي: الإجراءات من طرف واحد، واتفاقيات التجارة الإقليمية، والأجنددة متعددة الأطراف. ويحتاج التكامل إلى أن يكون عروض القاعدة بحيث يشمل الخدمات يعزز الإنتاجية في عموم الاقتصاد وزيادة نطاق التجارة وخلق فرص العمل الجديدة. كما ينبغي أن يكون التكامل عميقاً بحيث يعطي العناصر الرئيسية من القدرة على المناقصة فيما يتعلق بقضايا مثل: المعايير الفيزيائية، وتقييم مدى المطابقة، والنقل، والجوانب اللوجستية. وتمثل هذه المبادرات بشأن سياسات التجارة تحقيق أقصى فاعليتها حين تجري في إطار عملية إصلاح واسعة ومتزامنة ومؤوزة بتآييد ومساندة من الذين يقع عليهم عبء تكاليف الإصلاح والتكيف مع نظام اقتصادي جديد أكثر افتتاحاً.
RÉSUMÉ

Le document discute une stratégie commerciale pour les pays du Maghreb, en mettant un accent particulier sur les initiatives régionales, l’expansion du commerce pouvant être à l’origine de taux de croissance supérieurs et durables ainsi que d’emplois. L’analyse est basée sur l’identification des principales barrières internes et externes qui font obstacle à l’intégration aux marchés régionaux et mondiaux et discute dans quelle mesure la faiblesse de la conception et mise en œuvre des accords commerciaux entre les pays de la région limite leur impact. Le document avance l’argument selon lequel les pays du Maghreb pourraient tirer d’importants avantages d’une meilleure intégration avec leurs partenaires régionaux, avec l’UE, et avec les marchés mondiaux. Ceci implique la conception minutieuse d’une politique commerciale garantissant la complémentarité entre trois domaines : actions unilatérales, accords commerciaux régionaux, et agenda multilatéral. L’intégration doit être généralisée pour inclure les services de sorte à améliorer la productivité de l’ensemble de l’économie et développer le champ d’action des opportunités commerciales et de création de nouveaux emplois. L’intégration devrait également être profonde afin de couvrir les principaux éléments de la compétitivité liés aux questions de normes, évaluation de conformité, transport et logistique. De telles initiatives de politique commerciale sont d’autant plus effectives lorsqu’elles font partie intégrante d’un processus de réforme généralisé et cohérent et renforcées par le soutien de ceux qui assument le gros des coûts de l’ajustement à un nouveau régime plus ouvert.
I. Introduction

This paper is a contribution to the policy debate on trade and investment integration in the three core Maghreb countries (Algeria, Morocco and Tunisia). An important element of such a debate is a clear understanding of the implications and benefits of further integration with regional, European and global markets, the potential adjustments that will arise and how these can best be mitigated. The paper takes up three questions of importance in this context.

- First, why has the Maghreb lagged other regions in the pace of global and regional integration, both in terms of trade and attracting foreign direct investment?
- Second, on the basis of experience in other regions, what conditions support sustained trade expansion?
- Third, what are the key elements for a trade and investment strategy to move forward in effectively integrating regionally, with the EU and other countries in the European neighborhood and globally. How can trade policy help to alleviate the key constraints to trade and growth and therefore contribute positively to sustained employment generation?

The paper argues that these are important issues to be addressed since the status quo is not tenable if trade is to fuel higher rates of growth and employment generation. On the one hand, the structure of economies in the Maghreb is not conducive to sustained export growth. Exports remain highly concentrated on products that are not dynamic in terms of growth of world demand. The Maghreb countries have not been successful in expanding output and exports of more advanced manufactures, partly because of the inability to integrate into global production chains and to attract the associated FDI. There is therefore a pressing need to address the barriers to diversification.

On the other hand, competitive pressures in the key sectors of textiles and clothing are increasing. Firstly, as trade barriers in Europe against imports from China and other large Asian suppliers have been removed with the end of the Agreement on Textiles and Clothing. Secondly, if not more important, competition is increasing from countries integrating into the European neighborhood, such as Ukraine and Russia, which share similar locational advantages to the Maghreb. The current structure of these countries exports of textiles and clothing is much more similar to those of the Maghreb countries than that of the Asian suppliers.

Whilst the costs and the risks associated with lack of effective integration are increasing, there are now significant opportunities that the Maghreb countries can exploit to support trade and attract FDI. The key issue is how to take advantage of the opportunities available from various trade agreements and trade policy options to address the underlying barriers that constrain exploitation of the inherent comparative and competitive advantages in a way that matches administrative capacity and expertise and which does not impose too many simultaneous adjustment shocks? Appropriate targeting, sequencing and timing will therefore
be key themes should the Maghreb countries seek to intensify integration with regional and global markets.

A successful pursuit of international integration has to put together three inter-linked policy domains of trade policy -- unilateral, multilateral and regional policies – into a coherent trade strategy. A key element in such a trade strategy is a careful identification of the barriers to trade. The strategy then needs to leverage measures that will most effectively address those barriers.

- **Unilaterally,** countries should examine their own MFN trade regimes for the impediments to effective import competition in the domestic market. Competition, which if increased, would drive domestic productivity and lead to more rapid growth. In addition, a successful trade strategy will identify constraints that prevent domestic firms from exploiting opportunities in overseas markets.

- A second domain of policy is the multilateral trade negotiations as part of the WTO. The Doha Development Agenda offers perhaps the biggest payoff for developing countries around the world. Multilateral negotiations offer a number of opportunities. Firstly, to obtain reciprocal tariff reductions in key overseas markets. Second, the WTO negotiations encompass sectors, such as agriculture, that are often excluded from other trade negotiations. Third, the WTO is the only forum for building a coherent and consistent set of trade rules across all markets.

- The final element of the trade strategy contains regional and bilateral trade agreements. Currently, trade policy developments of the Maghreb countries are being primarily driven by bilateral agreements. These mandate reciprocal tariff reduction by the Maghreb countries and offer, in the emerging context of the EU’s New Neighborhood Policy, a mechanism to provide free access to the EU Single Market through a process of regulatory harmonization. Morocco has also signed a FTA with the US. Moreover, at the regional level there are a wide array of agreements that in practice are shackled by a lack of transparency, broad sectoral exclusions for industrial products, no liberalization of services, and no attention to deeper integration issues including competition policy, trade facilitation and standards.

This paper seeks to discuss a trade strategy for the Maghreb countries, with a particular focus on regional initiatives, by which trade expansion could contribute to raising and sustaining growth rates. The paper starts by highlighting recent trade and FDI performance and argues that, in the light of the need to increase employment and in the face of increasing international competition in key existing markets and products, the current policy mix is unlikely to support the necessary sustained export expansion. The paper then seeks to identify the key barriers that are constraining integration into regional and global markets and discusses how poor design and weak implementation of trade agreements amongst countries in the region limit their impact. Next, the paper discusses key elements of a coherent regional trade strategy to successfully integrate into the European neighbourhood and to enhance trade and investment between the Maghreb countries whilst providing open access to global markets. The rigorous pursuit of economic integration, whilst generating new opportunities for trade, investment, diversification and growth will require a process of adjustment that may have a negative impact in the short term on certain groups. Necessary adjustment will be much easier to achieve in flexible economies and in an environment of growth and expansion. Nevertheless,
the final section of the paper briefly presents a range of measures that can expand opportunities for those adversely affected and policies that can best limit the social impact of reform.

II. The Challenge and Opportunity

The Maghreb countries have experienced lackluster growth rates during the last decade. Tunisia was the best performer with growth at 4.8 percent, but even this was only average for developing countries; the other two countries grew substantially less at 3.2 percent. While Maghreb exports of goods and services have grown at global averages in the last decade, they have not fully realized the growth potential associated with their locational advantages of close proximity to the EU. Their exports have grown at less than half the rate of Turkey, Poland and Hungary in the last decade.

Moreover, the region confronts three looming problems that underscore the need to accelerate growth and to facilitate changes in the structure of production in the coming years.

- First, rapid labor force growth, in the presence of already high unemployment, has created an urgent need for a sustained increase in the number of jobs to absorb the large number of people entering the active population. This will be a major test for a region which has only been able to generate snail’s pace growth in recent decades.

- Second, the three countries are dependent on few export industries. Both Morocco and Tunisia are heavily dependent on clothing exports and, with the end of the ATC and unleashing of China and India as major low-cost producers, it seems likely that these countries will have to take measures to transform their industries to maintain, let alone improve, their competitive position. Algerian exports are dominated by fuels and so diversification of trade must be a crucial element of an employment stimulating growth strategy.

- Third, the re-integration of eastern European and former CIS countries into the global economy and their subsequent move towards closer integration with the EU has created an important source of competition for trade and FDI for Maghreb countries.

The region has important advantages that suggest it could readily manage these transformations and move to a higher trend line of growth. First, the increase in the active population offers the chance to accelerate economic transformation if the challenge can be met in a similar way to that followed by east Asian countries in the 1970s and 80s when facing their own demographic transition. In East Asia sustained growth was driven and bolstered by external openness which facilitated regional economic integration and the large scale inflow of foreign investment. Second, the region’s proximity to the EU and its accessibility via sea and air makes it ideally positioned to pursue a far more diversified range of highly productive economic activities than it is now doing. Finally, regional and bilateral free trade agreements with the EU and, more recently with the US (in the case of Morocco), offer favorable terms of market access that could, given the right policy regime, provide a new impulse to growth. To exploit these opportunities will require that constraints to trade and investment, which have hindered growth in the past, are effectively addressed. We now turn to briefly document the problems currently faced by the Maghreb countries in integrating into regional and global markets.
III. The Current Situation

The Maghreb countries remain amongst the least integrated both regionally and in the global economy. Despite an increase during the 1990s, the share of (non-oil) exports in GDP for Maghreb countries is lower than any other region, excluding the broader MENA region. The contribution of (non-oil) exports to GDP remains less than one third of that of the more dynamic regions of East Asia and Europe and Central Asia. There would appear to be plenty of scope for further integration into the global economy and for exports to be a fundamental driver of growth, as they have been in the more successful regions.

![Figure 1: Maghreb is poorly integrated in the global economy](image)

Trade within the Maghreb region as a share of total trade is the lowest of any region. To some extent this is not surprising since the border between Morocco and Algeria remains effectively closed. Nevertheless, whilst many regions of the world have become more integrated, the Maghreb has remained steadfastly closed to intra-regional cross-border trade (Figure 2). For example, intra-regional trade as a share of total trade in East Asia grew from around 10 percent in 1980 to more that 20 percent in 2003. Of importance is that this increase in regional trade occurred whilst the share of trade in GDP was growing. It is worth noting that, in general, the intensification of regional trade has occurred most strongly in those regions that have been relatively more open to global trade and that often regional trade is stimulated by the emergence of global production chains.
However, Maghreb countries have been less effective than other countries in integrating into global production chains. This has constrained the diversification of exports and limited the expansion of high value added manufacturing activities. Exports of the Maghreb countries remain concentrated on a relatively small number of products and are less diversified than in other countries on the periphery of Europe. For example, the top 10 products\(^2\) exported by Morocco accounted for 78 percent of total exports in 2003. For Tunisia the top 10 products comprised 70 percent of total exports. In Bulgaria and Romania, in contrast, the top 10 export products provided 49 and 58 percent respectively of total exports. For Hungary, 48 percent of total exports are concentrated upon the top 10 products, while for Turkey the corresponding figure is 37 percent.

Figure 3 shows that in a relatively short period the more advanced countries of central and Eastern Europe have seen substantial increases in the share of exports accounted for by engineering and other higher value added manufacturing products. Whilst the importance of these products have increased in the exports of Morocco and Tunisia (but not at all for Algeria) these countries remain considerably behind the central and eastern European countries with less than 20 percent of total exports being more advanced manufactures. The figure also shows how Turkey has successfully increased the share of these products in total exports during the 1990s, such that their share in Turkey’s exports now considerably exceeds their share in the exports of Morocco and Tunisia.

An important factor underlying the inability of Maghreb countries to attract FDI and to integrate into regional production chains is the relatively low level of education in the region. Despite devoting a relatively large share of national income to education, the Maghreb countries exhibit low adult literacy rates and comparatively high teacher to pupil ratios. This suggests a relatively low efficiency of educational expenditure. In Morocco, for example, the adult literacy rate is 45% whereas countries in Eastern and Central Europe have literacy rates

\(^2\) Defined at the 5 digit level of the Standard International Trade Classification.
above 98%, which are comparable to those of the established EU members. Female participation rates in Maghreb countries are also considerably below those in other countries.

The lack of ability to integrate into global production chains in part reflects the lack of effective regional integration that limits the scope for the cross-border movement and two-way trade in parts and components. This contrasts very much to the situation in central and eastern Europe, where a large proportion of the products which are traded intra-regionally are classified in the same categories as the key exports to the EU (see Figure 4), reflecting the relatively free movement of parts and components for engineering products that are exported to the EU. In the Maghreb there appears to be very little cross border trade in components for products subsequently exported to the EU. There is virtually no correlation between intra-regional export and exports to the EU. At the same time, the location decisions of multinationals are crucially affected by the scope for effective sourcing of inputs and the ability to move inputs quickly and cheaply across national boundaries. Trade policy restrictions, slow and inefficient customs procedures, weak transport infrastructure, lack of competition in transport services and poor quality trade-supporting services will tend to undermine any cost advantages that a region may possess and reduce its attractiveness to multinational enterprises when it comes to investment and input sourcing decisions.
The lack of participation in regional and global production changes is reflected in the relatively small inflows of advanced manufacturing related FDI. Figure 5 shows that the Czech Republic, Hungary and Poland are able to utilize a much larger stock of inward FDI than are the Maghreb countries. This relatively large amount of FDI in Eastern Europe entails that these countries have been more successful in expanding the productive base, in diversifying production and exports and in importing more advanced technologies and managerial techniques. This has supported the strong growth performance of these countries in recent years. It is also worth noting the increasing flows that have been going to the initially slow reformers in Eastern Europe: Bulgaria, Romania and now Ukraine. As these countries increasingly align their regulations and business environment with that of the EU they are likely to offer more intense competition for FDI.
The lack of diversification is compounded by the fact that the key export products tend to be products that are not dynamic in terms of growth of world demand. Table 1 shows that the export growth of both Morocco and Tunisia has been driven by the ability to raise market shares rather than being well placed in exporting products that are growing fast. In other words the existing product structure of exports has been a constraint on export growth. Reducing barriers that limit diversification into new products is likely to be necessary for strong export expansion in the future.

| Table 1: Decomposition of export performance |
| Export Performance (non-oil) 1998-2003 |
|----------------|-----------------|-----------------|-----------------|
|                | Structural Effect | Competitiveness Effect | Residual | Total |
| Algeria        | -9.83            | 36.2             | 1.38      | 27.82  |
| Morocco        | -3.84            | 6.13             | -1.77    | 0.52   |
| Tunisia        | -3.19            | 13.61            | -1.52    | 8.90   |

This analysis is based upon a technique called constant market share analysis. The total percentage change in the share of world exports (the right-hand most column) is decomposed into (1) a structural effect reflecting the extent to which export growth has been driven by products with growing world demand, that is maintaining shares of growing markets, and (2) a competitiveness effect reflecting the extent to which overall export growth is the result of increasing market shares. Finally, there is a residual effect reflecting the change in base year shares over the period of analysis.

Export diversification and integration into global markets for manufactured products are hampered by a weak standards infrastructure and few firms with certified quality management systems. Standards are increasingly important in defining competitiveness. In addition to the need to satisfy the mandatory requirements set by the governments of overseas markets, there are a range of voluntary standards the satisfaction of which can be an important element of competitiveness. For example, the ISO 9000 standards relating to quality management systems provide information to buyers concerning the way that companies deal with quality issues. Similarly, the ISO 14000 standards relating to management of environmental issues within a company and standards concerning social accountability are increasingly important in attracting attention from buyers in Western markets. The ability of exporters to satisfy and prove conformity with these requirements is influenced by the nature of standards and technical requirements in their own domestic markets (different standards in different markets leads to market segmentation) and is supported by a set of institutions and services with regard to metrology, testing, certification and accreditation. As will be discussed below, regional cooperation and regional solutions can provide an effective route to removing barriers to trade caused by differing standards.

The Maghreb countries are considerably behind other countries in the region in the number of firms having quality management systems certified as being consistent with international standards. Whilst countries in the region have had some success in introducing systems for compliance with EU safety requirements for key agricultural exports\(^3\), lack of quality management is likely to have limited exports and the scope for attracting sourcing by multinational firms in other sectors. Figure 6 shows the number of companies with ISO 9000 certification in several comparator countries. It is clear that Algeria, Morocco and Tunisia are significantly behind other countries in the region in ISO 9000 certified companies. For

\(^3\) See, for example, Garcia et al (2005).
example, Tunisia has a GDP slightly in excess of that of Bulgaria, while Bulgaria has more than 7 times as many ISO certified companies. A key aspect of ISO 9000 is that companies must adopt a strategy for quality management and then have that assessed relative to international norms and best practices. It is therefore important to encourage and facilitate more companies to focus on, and take responsibility for, the quality of the goods or services they produce. Without this fundamental change of attitude the prospects for generating higher value added activities and of long-run increases in competitiveness will be poor.

![Number of Firms with ISO 9001 (2000) Certificates in 2003](image)

**Source: ISO**

Crucial elements of the business environment remain unfavorable to investment and growth. The extent, to which firms, both domestic and foreign, invest in the Maghreb countries to exploit the opportunities that are available in regional and global markets, is crucially determined by the business climate. Whilst there has been substantial progress in some areas of the business climate, the Maghreb countries still compare unfavorably with other countries in a number of key policy areas. For example, recent Investment Climate Surveys show that Morocco rates well in terms of the number of procedures and the time to start-up a new business but the costs of business start-up are higher than in many other countries in the region. Both Morocco and Tunisia are ranked considerably behind other countries in terms of employment regulations and there remain problems with enforcement of contracts in Morocco.

Inefficient provisions of services acts as a major constraint to exports and competitiveness. Many industrial sectors in Mediterranean countries may well be currently facing negative rates of effective protection since tariffs on industrial goods are being removed with the principal trading partner (the EU) whilst constraints remain which raise the price of service inputs. Producers and exports will find it hard to compete with firms in other countries that are able to use more efficiently provided services inputs. Indeed, the liberalization of services may be necessary for industrial sectors to be able to fully benefit from the direct
opportunities that are made available by the removal of trade barriers. In addition, participation in global production networks requires access to efficient services, especially transport and logistics, telecommunications and financial services.

Just as with goods, liberalization of trade in services can lead to technology transfer and technology spillovers. These can arise both through cross-border provision of services and through foreign direct investment to establish commercial presence. Such technology transfer will be the source of additional growth. Figure 7 shows that foreign ownership is now an important feature of the banking sector in Eastern European countries. Foreign banks have played an important role in the modernization of the sector and the experiences of these countries suggest that foreign participation can increase both the quantity and quality of financial services. Access to cheaper and longer-term financial resources leads to higher net returns to investment and the more efficient allocation of credit supports the adoption of new production technologies and so higher productivity. In the Maghreb, foreign participation in the Banking sector is considerably lower than in many of the eastern European countries.

![Figure 7: Openness is a key element of services reform](image_url)

There is one key difference that distinguishes services from goods liberalization, in terms of their impact on growth. Services liberalization often implies a larger scale of activity in the domestic economy because the simultaneity of production and consumption entails that a local presence is necessary to supply the market. This requires factors of production to move to the consuming country. Further, many barriers in services sectors constrain entry to the market, to not just foreign entrants but also to new domestic providers. Hence, the liberalization of services sectors can result in more competition from both foreign and new domestic firms, which implies a larger scale of activity. It is also worthwhile noting that since services are often labor-intensive; this greater scale of activity can play an important role in absorbing

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5 See Muller-Jentsch, D (2005) for a comprehensive study of trade in services and the potential gains from services liberalization in Mediterranean countries.
workers released as trade protection of import-competing goods is reduced and in attacking general unemployment. Mattoo et al (2001) find that countries with open financial and telecommunications sectors have tended to grow faster than less open countries by as much as 1.5 percentage points. However, the regulatory environment in which services liberalization takes place and regulatory capacity are important. The available evidence suggests that whilst both privatization and competition lead to significant improvements in performance, a comprehensive reform program in which these policies are overseen by an independent regulator produce larger gains.6

IV. Key Constraints to Global and Regional Integration

Why is regional integration so low in the Maghreb and why have these countries been less successful in diversifying their exports and integrating into global production chains? To a large extent the absence of a sustained political process towards regional cooperation has often produced vague plans for economic integration, with the result that the existing agreements, often lacking implementation measures, are rarely put into practice. In the extreme case, the scope for regional integration is completely constricted whilst border crossings between Morocco and Algeria remain closed. We now proceed to look at the key issues of design that appear to lie behind agreements that successfully raise the level of regional integration. First, Box 1 provides a highly stylized summary of the key elements that supported the early stages of European integration. Paramount amongst these was the willingness, of even the previously most protectionist countries, to open up and to participate in mutual economic dialogue and understanding.7

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7 See Pelkmans (1997).
Box 1: Lessons from European Integration: A Stylized Summary

- European Integration was based upon firm foundations in terms of a widespread and genuine commitment to open up and liberalize (particularly in the most protectionist countries, such as France and Italy) backed up by intense and transparent economic dialogue and communication and genuine efforts towards mutual understanding.

- Strong growth in internal trade took place at the same time as external tariff barriers against imports of goods from third countries were being reduced under a series of negotiating rounds of the GATT. This avoided conflicts with other countries in the world and ensured that on balance the initial stage of integration was trade creating rather than trade diverting and therefore led to improved economic efficiency within Europe.

- The strong commitment to integration may have stimulated investment and growth by increasing the size of the available market, by reducing the cost of imported intermediate and capital inputs and by facilitating technological spill-overs between countries.

- Rapid integration in the 1950s and 1960s did not appear to cause substantial problems of adjustment that called into question the broad support for trade liberalization. This reflects 3 factors: that trade expansion occurred mainly through intra-industry trade; the period was one of relatively strong economic growth and low unemployment; European countries created comprehensive social safety nets to protect those who bore the costs of adjustment to the new liberal trading environment in Europe.

- Protectionism and subsidies towards a particular sector (agriculture) can quickly become entrenched and that political economy factors may render it extremely difficult to adjust and amend such policies. In Europe, by the late 1980s, agriculture, a sector which contributes less than 5 percent of GDP in the EU and which provides a similarly small proportion of total employment, was absorbing around one half of the total budget expenditures of the European Union.

- Protectionist elements will look to alternative policies once tariffs and quotas are removed. The removal of all market segmenting barriers requires attention to a range of regulatory policies that constrain trade. Such deep integration requires a high degree of trust between partners.

- The benefits from regional integration will tend to be larger when services are included, and accompanied by external trade liberalization of the services sector.

One reason for the lack of regional integration is that tariffs, although slightly lower (see Figure 4 where countries that lie below the 45 degree line have reduced their tariffs between 1997 and 2004), remain very high relative to nearly all other countries. Average tariffs in Morocco and Tunisia are close to twice the value of the average for developing countries as a whole. The implications of these high tariffs are:

- Incentives are skewed towards the production of import competing goods and away from exports.

- Exporters have to pay high duties on imported inputs, which constrains their ability to compete on regional and world markets.

- Given the limited effective product coverage of existing regional and bilateral trade agreements, a large proportion of actual and potential intra-regional trade is likely to face very high duties.

- FDI related to global engineering chains, which requires freedom of sourcing of inputs, is discouraged. On the other hand, tariff jumping FDI may be encouraged.

The now large body of evidence relating to regional trade agreements clearly suggests that successful regional agreements are associated with low external tariffs (World Bank (2005)). It is well-known that low tariffs reduce the risk of inefficient trade diversion, whereby

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8 In many cases exporters may be able to request refunds of these duties under duty drawback schemes. However, firms have to incur administrative costs in filing for return of the duty, costs of delays in repayment and uncertainty over repayment.
the regional trade agreement diverts trade to less efficient and higher cost sources of supply. This is clearly an important issue in the Maghreb countries in the context of the implementation of the tariff reduction schedules on imports from the EU. The potential efficiency costs of maintaining high tariff barriers are high relative to the remaining protective impact of the tariff and the small size of the revenue loss from MFN tariff reduction. It is also apparent that low external tariffs are a pre-requisite if a regional trade agreement is to provide a springboard to global markets.

Figure 8: External tariffs remain very high relative to other developing countries

In addition to high tariff barriers the Maghreb countries are characterized by high non-tariff barriers relative to other developing countries (Figure 9). A key feature of the regional agreements of the Maghreb countries is the growing number of over-lapping agreements (see Box 2 for a brief description of existing agreements) at the same time as a “hub-and-spoke” structure exists with the EU. The large number of overlapping agreements in the region results in a complex and administratively burdensome structure (Figure 10). This web of differing trade agreements can tangle administrative procedures and so raise the costs of firms and governments in benefiting from and implementing the agreements. This complexity undermines any efforts towards trade facilitation. There would be significant benefits, in terms of lower administrative costs and scope for improved implementation, from a rationalization of the current overlapping agreements.
Lack of regional coordination entails that the bilateral agreements with the EU have resulted in a hub-and spoke trading system in which trade amongst the spokes remains highly restricted. Such a structure acts to marginalize the spokes, where market access conditions are usually less advantageous than in the hub, which enjoys improved access to all of the spokes. In comparison to more broadly based economic integration between regions, a hub-and spoke structure will tend to offer lower gains, most of which will accrue to the hub. Hub and spoke arrangements tend to attract FDI to the hub and limit the flow of investment into the spokes.

In addition to the complexity of the structure of regional agreements in the Maghreb the very design and weak implementation of agreements severely limits any impact on trade, investment and growth. The key issues are:

- **Lack of transparency**: the complexity of the current regional and bilateral agreements is compounded by lack of transparency and openness on the provisions of the agreements. It appears to be a major challenge for firms in the region to obtain information on whether the product they produce is eligible for preferential access, which agreement would offer the best terms of access and what administrative steps have to be taken to receive reduced duty access to a regional partner.

- **Too many product exemptions**: agreements that are dominated by small positive lists of included products or large negative lists of excluded products tend to be less effective than more broadly based liberalization strategies where the scope for substantial mutual gains are larger.

- **Preferential access limited by licensing requirements**: agreements typically require that goods seeking preferential access obtain not only a certificate of origin but also a license. Even if licenses are freely available, this adds to the administrative burden of complying with the rules for preferential access.
• **Rules of origin vary across agreements and may be restrictive:** differing rules of origin across different preferential agreements increase the complexity of trading. In such a situation it is possible that a product will qualify for preferential access under one agreement but not under another due to differences in the rules of origin. This limits the ability of firms to exploit scale economies and increase efficiency on the basis of a regional and global trade strategy. Agreements with a common rule of origin across products, as is the case for current bilateral and regional agreement between Maghreb countries, tend to be simpler than those with detailed product specific rules of origin, as are used in the agreements with the EU and will be adopted under the Agadir Agreement. Nevertheless, the degree of processing required under the regional agreements (for example, regional content of 40 percent under GAFTA, 60 percent under AMU) may be difficult for many firms to satisfy whilst remaining competitive. That is these requirements may preclude the effective and efficient sourcing of inputs on global markets.

• **Lack of sectoral coverage:** services are excluded from the agreements amongst Maghreb countries. Services are crucial to competitiveness and growth. Trade liberalization is an important mechanism for instilling efficiency in the provision of key services inputs used in the production of goods.

**Lack of deep integration:** in general agreements between Maghreb countries have little or no ambition with regard to issues such as trade facilitation, standards and other regulatory issues. These are important issues that determine the capacity of local firms to effectively integrate into external markets. As we shall argue in more detail below, there are potential gains from cooperative agreements that address the barriers to trade that arise from weak trade facilitation, such as in customs and transportation, and from differences in regulations that segment different national markets.

**Figure 10: Complexity of regional agreements undermines regional trade**
Box 2: Trade Agreements in the Maghreb Region

After early attempts during the 1960s, the process of economic integration in the Maghreb Region stagnated, to be resumed only at the end of the 1980s, when stronger competition was expected from the EU as a result of the completion of the Single Market Program in 1992. The Arab Maghreb Union was created on February 17, 1989, among Algeria, Libya, Morocco and Tunisia. Mauritania joined in 1988. The Treaty of the Arab Maghreb Union has never entered into force. The Parties have not signed the full set of implementation Conventions and Protocols. Ongoing disputes between Algeria and Morocco on the issue of Western Sahara, and political unrest in Algeria, have significantly impaired the integration process. To date, 37 Conventions and Maghreb Agreements have been negotiated within the framework provided by the Union. The official site of the Arab Maghreb Union reports six of them, three of which have been actually ratified, and three of which are still awaiting ratification.

Morocco and Tunisia are parties to the Agreement to Facilitate and Develop Trade among Arab States (1981) and to the related Executive Program (1982). Therefore they have in principle submitted their commercial policies to the decisions set out by the Economic and Social Council of the Arab League in its Resolution on a Pan-Arab Free Trade Area (1997). The combined set of these three documents (the 1981 Agreement and 1982 Executive Program, along with the Resolution of 1997) constitutes the legal foundation for the GAFTA (Greater Free Trade Area), a compact intended to give new impetus to the project of an integrated Arab market.

Through the GAFTA, Member Countries aim at reducing tariffs on trade in manufactured goods by 10 percent each year. Initially, the goal was to bring tariffs to zero by 2008, starting implementation in 1998. However, noting the progress achieved by Member Countries during the transitional period, in the occasion of the September 2001 meeting in Riyadh, the Arab League's Economic and Social Council shortened the phase-out and anticipated the deadline for the completion of the tariff elimination schedule to early 2005.

Member States are allowed to submit a list of industrial products to which special protection can be granted for 3 years during the transitional period. In 1999, Morocco had submitted a negative list of 800 industrial products at the HS 6-digit level, while Tunisia had applied for exemption from the tariff reduction scheme for 161 HS 6-digit products. Most of them belonged to the groups of processed foodstuff, semi-manufactures and consumer goods facing competition with domestic firms (textiles and ready-made clothing, plastics, mechanical, appliances and TV sets, motor vehicles, steel and iron sheets) (Zarrouk and Zallio, 2000). A seasonal schedule has been drafted, comprising a list of agricultural products for which exemption can be sought from the planned tariff /import taxes reductions during the peak harvest season. Limits are set to this allowance however, since the exemption cannot last longer than 7 months –per exemption instance, and 45 months total duration per country- and cannot cover more than 10 products per country, per instance. GAFTA Rules of Origin set the value-added requirement at 40 percent and allow for cumulation, also encouraging future harmonization of preferential rules with those set in the Euro Mediterranean Agreements.

Morocco and Tunisia are also Parties to the Agadir Agreement, a compact within the GAFTA framework, signed by the two Maghreb partners with Egypt and Jordan in 2001, and revamped in 2004, which envisages the creation of a free trade area by 2010. An explicit follow-up to the 13th Arab Summit held in Amman, where Members to the Arab League reaffirmed the need to sustain Arab cooperation for the creation of GAFTA, the Free Trade Area envisaged in the Agadir Declaration and Agreement only concerns the four signatories, although the Treaty is open to accession to other Arab countries. A move in the direction of selective, multi-tier, integration, the Agadir process builds on the existing bilateral agreements among Morocco, Tunisia, Jordan and Egypt and on their vertical partnership with the EU, in the context of the EuroMed process.

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9 Algeria, Morocco and Tunisia are members to the League of Arab States (1945). The project had originally been launched through the Treaty on Transit Trade (1953). Other plans for the creation of an Arab Common Market were initiated in 1964 by Jordan, Syria, Egypt, Iraq and later Libya in 1975.

10 In principle, the Executive Program included in the Declaration provides for the elimination of all non-tariff barriers. However, administrative, monetary and quantitative restrictions are still in force in most Member Countries. Examples include licenses and restriction to imports that are not mentioned in the negative list and cases of exclusion from NTB-free treatment on the basis of provisions of Members’ national banking regulations (Sehebani, 2000). Also, non-tariff taxes that have escaped the tarification process envisaged in the Executive Program are still applied.
Box 2: Trade Agreements in the Maghreb Region (continued)

Tunisia and Algeria have signed a bilateral Convention on Trade and Tariffs in 1981, which was ratified in 1991. The Partners offer each other duty-free access on all products, provided that both a Certificate of origin and import license are granted by the Chambers of Commerce, duly notarized by the Customs Authorities upon verification of compliance with the Rules of Origin as stated in the Convention (which require that at least 50 percent of the total value of manufactured products be obtained from a transformation process performed in the exporting country; this proportion is brought down to a 30 percent if at least 20 percent of the inputs originates from the importing country).

Morocco and Algeria have signed a Tariff and Trade Convention in 1989, theoretically in force since 1990. All types of merchandise transactions should be free of customs duties or of measures having equivalent effect, if the traded products have undergone a transformation valued at least equal to 40 percent of the ex-works price of the good. However, preferential treatment is granted only upon issuance of a Certificate of Origin and an import license, granted by the Department of Commerce of the importing Country.

Since 1999, Morocco and Tunisia are Parties to a Free Trade Agreement, which will be however superseded by the Agadir Agreement, once the four signatories have completed the implementation process. Currently, Tunisian and Moroccan industrial products are granted duty-free access provided that they comply with the Rules of Origin (40 percent ex works price, allowance for bilateral cumulation) and that they carry the relevant certificate, issued by the Chambers of Commerce and notarized by the Customs Authorities. The Agreement and relevant Protocols provide for 7 different lists of products (one of which is a negative list of exempted goods) with specific tariff regimes and phase outs, to be completed by 2008. A provision is included allowing companies to benefit from the most favorable regime under GAFTA Executive Program.

With respect to other Third Countries Tunisia has bilateral agreements with Libya and Mauritania in the Maghreb, and with Egypt, Jordan, Kuwait, and Palestine in the MENA Region. Sudan, Senegal and Niger are also privileged partners through bilateral conventions. Morocco has bilateral agreements with Libya and Mauritania in Maghreb, with Saudi Arabia, Egypt, Jordan, U.A.E. and Iraq in the MENA Region, with Guinea and Senegal in Africa. Tunisia, Morocco and Algeria are also parties to the GSTP, and benefit from concessions through the GSP framework. Morocco has also signed a Free Trade Agreement with the US in 2004. Finally, Morocco has signed a Free Trade Agreements with Turkey in April 2004, followed by Tunisia in 2004.

V. Pursuing Effective Integration

The Maghreb countries have committed themselves to a process of broader and deeper integration with the EU under the individual association agreements that they have signed. The recently announced European Neighborhood Policy, developed to take account of the new realities of the enlarged EU, offers the Maghreb countries the opportunity to strengthen their program of integration with the EU. This will require a deepening of integration and a more pro-active approach to improving market access for agricultural products, for liberalizing services and for removing technical barriers to trade by adopting EU regulations. An implication of expanding opportunities for exporters will be increased competitive pressures on import competing sectors as barriers to trade are removed on a reciprocal basis.

5.1 Integrating into the European Neighborhood

A. Pursue effective liberalization of agriculture

Agriculture remains a key sector in many of the Mediterranean countries and agricultural exports are often an important source of foreign currency. Agriculture is subject to a high degree of distortion throughout the region which severely constrains intra-regional trade.
flows and specialization. The benefits of free trade agreements with the EU are limited by the special status accorded to agriculture. For many of the countries in the region exports of key agricultural products to the EU remain constrained by tariff barriers, and tariff escalation in the EU remains an important constraint upon the development of processed food sectors in the Mediterranean countries. Thus, a key element in promoting trade and growth in the Mediterranean region will be the liberalization of barriers to basic and processed agricultural products. However, a region-wide approach to this issue is required since countries in the region appear to have comparative advantages in similar agricultural products (such as fruit and vegetables) so that bilateral liberalization at different speeds could lead to substantial trade diversion.

**B. Move towards the effective liberalization of services**

Compared to the Association Agreements with the Central and Eastern European applicant countries, the EU’s agreements with Mediterranean countries typically cover services in a much more limited way. Whilst the Association Agreements with the CEECs cover movement of workers, establishment and supply of services, the agreements with the Mediterranean countries are in most cases limited to the multilateral obligations offered under the GATS, particularly to grant reciprocal most-favored-nation treatment in the services sectors covered by that obligation. Although the agreements with Tunisia, Israel, and Morocco aim to "widen the scope of the Agreement to cover the right of establishment of firms" and the liberalization of the provision of services, the method of the implementation of this objective is not set in the agreements, instead "the Association Council shall make the necessary recommendations for the implementation of the objective".

In a number of sectors, liberalization of key services such as telecommunications and finance will entail increased imports and FDI from EU countries whose service suppliers are relatively efficient. *It is also very important that there be reciprocal opening of service markets in the EU for sectors where the Mediterranean countries are relatively efficient.* Whilst the Maghreb countries would benefit enormously from liberalizing there own service sectors, improvements in overseas market access for services that can be provided efficiently by Maghreb countries would offer further broader-based gains and would enhance the employment impact of the reform process.

**C. Standards and integration**

Different standards and conformity assessment procedures in different countries raise the costs of exporting. Producers may have to change their product to be accepted in foreign markets with the associated costs of redesign and of running new administrative systems for control of products for separate markets. This in turn undermines the ability of firms to reap the benefits, in terms of lower average production costs, that arise from larger scales of production.

Mandatory standards can act as barriers to trade, even if that is not the intention of the government concerned. For example, an EU regulation designed to protect human health requires that milk products be produced from the milk of cows milked mechanically. This effectively excludes imports from many developing countries whose farmers have been unable to invest in machinery. There are often significant costs related to conformity assessment for exports to overseas markets. Governments often do not recognize the tests performed in the
exporter’s home market so that exporters have to undertake expensive tests in the foreign market.

These barriers to trade can be removed through harmonization of regulations and mutual recognition of conformity assessment. These have been actively pursued by the EU in external bilateral agreements, not always in the context of a comprehensive trade agreement. The EU has no formal trade agreement with the US but it does have a mutual recognition agreement (MRA) for conformity assessment of specific products. Under a MRA each country is given the authority to test and certify in its own territory, and prior to export, the conformity of products with the other country’s regulatory requirements. Mutual recognition agreements can be expected to bring a number of benefits. In particular, the expense, time and unpredictability of obtaining approval can be reduced if the product can be tested for conformity in the country of production.

A key feature of the process of Association between the EU and the eastern European countries in the 1990s and early 2000s was the increasing adoption of EU technical regulations (those under the ‘New Approach’)11 and the implementation of conformity assessment systems consistent with EU norms. To assist in achieving this objective the EU provided technical assistance, including "the exchange of experts, the provision of early information especially on relevant legislation, organization of seminars, training activities, aid for the translation of Community legislation in the relevant sectors." The outcome of successful implementation of EU regulations and norms for conformity assessment was access to the EU Single Market, prior to accession.

The Association Agreements with the Maghreb countries are less ambitious. They state that the partner countries should approximate their legislation to that of the EU in the areas covered by the Agreement. However, the way this should be achieved is not covered by the agreements. Indeed, there has been little or no progress towards removing technical barriers to trade between the EU and Maghreb countries. The New European Neighborhood policy of the EU has increased the importance of progress in this area for the Maghreb countries. Firstly, the new policy clearly offers the Maghreb countries the possibility of access to the EU Single Market under sector specific agreements on conformity assessment and the acceptance of industrial products (ACAs) where legislation is harmonized with that of the EU. Secondly, other countries on the periphery of the EU, such as Turkey, Ukraine and Russia, are also being offered the opportunity of access to the Single Market and indeed have started the process of adopting EU new approach technical regulations. If the Maghreb countries lag behind they may find that their companies have greater difficulty gaining access to EU markets relative to competitors precisely in those sectors (especially engineering) which can drive diversification. A common regulatory regime is an important factor influencing the sourcing and location decisions of multinational firms and the producer-driven chains in the engineering and information technology sectors.

What then can countries in the Mediterranean do to ensure that their exporters are able to effectively participate in the European-wide production networks? At the same time there is a need to consider how to dismantle regulatory barriers to trade between Mediterranean

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countries. Firstly, there is a need to modernize standards on a range of exported products. Where feasible it would make sense to adopt EU standards in areas where exports to the EU are important. This is precisely the approach being adopted in the action plans between the EU and the Maghreb countries in which ACAAs can be negotiated in “sectors of common interest”. For example, Tunisia has recently targeted the electricity industry as a sector for priority action to obtain better access for its exports of electrical equipment goods. Arguably, the recent FDI inflows from Japanese and US companies in this sector will also benefit from the future improvement in the business environment for electrical products. The process of harmonization entails improved access for EU produced goods to the markets of Maghreb countries. Consumers are likely to gain from lower priced products and from higher levels of safety and quality. However, firms previously protected by the differences in standards will have to adjust to the new regulations and more intense competition.

There are useful experiences from Eastern Europe that countries in the region could draw upon. An example is provided by Bulgaria, which is well documented by Daskalov and Hadjikolonov (2002)). These authors point to two important steps that Bulgaria took in amending its system of technical rules and regulations and adopting EU rules. Firstly, Bulgaria’s legislators changed the status of Bulgarian standards from obligatory to voluntary. The removal of the obligatory status of the Bulgarski Dargaven Standart (BDS), the Bulgarian State Standard, made it possible for Bulgarian producers to immediately adopt European standards before they were formally introduced as BDS. This was a prerequisite for the adoption of the New Approach of the EU and also avoided the harmonization process being hijacked and slowed down in the procedure of transposition by domestic interests seeking to remain protected behind domestic standards.

The second key development was the practice of adopting European standards before having them translated into Bulgarian. Such a practice drastically speeded up the harmonization of Bulgarian standards with those of the EU. This does place the burden on producers and consumers to translate the EU standards, which de jure have been adopted by Bulgaria’s legislation but de facto, exist only in an electronic database in a foreign language. However, it avoids the situation which initially existed in Bulgaria whereby the majority of the BDS had not been harmonized such that Bulgarian producers who met the BDS could not have obtained a Certificate of Conformity to EU standards even if there had been an operating system of Mutual Recognition for the corresponding group of commodities.

The adoption of harmonized European standards does not in itself remove all of the technical barriers to exports to the EU. In addition, it is necessary to create the necessary institutional mechanisms to establish an appropriate system of voluntary product testing and certification and the accreditation of independent testing and certification bodies (Notified Bodies). This is a necessary step to allow products for export to the EU to be tested for conformity against EU regulations by domestic certification bodies. Notified bodies have to demonstrate the necessary level of independence, impartiality and integrity. The competence of such bodies must be subject to surveillance and regular monitoring. They must employ personnel with sufficient and relevant knowledge and experience. This is an area where the Maghreb countries can request technical assistance from the EU and benefit from the experiences of the eastern European countries in applying best practice approaches and techniques.
D. The need for less restrictive rules of origin

Rules of origin define the conditions that a product must satisfy to be deemed as originating in the country from which preferential access is being sought. The main justification for rules of origin is to prevent trade deflection, whereby products from non-participating countries destined for say the EU market are redirected through free trade partners of the EU to avoid the payment of customs duties. Similar reasoning applies to the need for rules of origin in the EU’s free trade partner. When products are produced in a single stage then the origin of the products should be relatively easy to establish. Proof that the product was produced in the free trade partner should be sufficient. For all other cases the rules of origin define the methods by which it can be ascertained that the product has undergone sufficient working or processing in the free trade partner to qualify for preferential access.

The specification of rules of origin has become particularly important in recent years as technological progress and globalization have led to the increasing fragmentation of the production process into different stages or tasks which are undertaken in different locations. A number of general approaches to origin are available. The simplest way of defining origin is probably change of tariff heading; alternatively there can be rules relating to the amount of domestic value-added or to specific technical requirements that the product may satisfy.

In the EU’s bilateral trade agreements the basic rule that it adopts is that of the change in tariff heading at the 4-digit level of the CN or HS. However, in a very large number of cases this basic rule is supplanted by often restrictive specific requirements. For example, with the basic rule of change in tariff heading a country which imports woven cotton fabric (HS 5208) to produce cotton shirts (610510) would satisfy the rule of origin and qualify for preferential reduction of the tariff on cotton shirts. However, in EU free trade agreements the change of tariff classification is replaced with a requirement that the product have been manufactured from Yarn. In effect this imposes the requirement that two stages of production must be undertaken in the partner or qualifying area to confer origin – not only the sewing together of the fabric but also the production of the fabric itself. Clothing products made in free trade partners of the EU but which are made-up of fabrics imported from third countries, such as China, will not satisfy the EU origin rules and will not qualify for tariff reduction.

Thus, EU trade agreements annexes specify, for listed products, requirements other than change in tariff classification. These other requirements can be a minimum percentage of local value added in the originating country, or a technical requirement that the product undergoes specific manufacturing operations in the country. In a typical agreement, a change in tariff heading is sufficient to confer origin for only about 15 percent of the textile product headings, while for the remaining 85 percent of headings value added and/or specific technical requirements to qualify for preferential access must be met. In the case of clothing, typically for 95 percent of the products categories the rules do not permit change of heading but require specific working and processing. Similarly for footwear, most of the products have to fulfill technical requirements.

EU Association Agreements with Tunisia, Morocco and Algeria, respectively provide for “Maghreb” bilateral, diagonal and, in principle, full cumulation. This treatment is not extended to the other MENA countries that are also part to the Barcelona-ENP Process (Egypt
and Lebanon are entitled to apply bilateral and diagonal cumulation, Jordan, the Palestinian Authority, Syria and Israel have access only to bilateral cumulation). The regime of “Pan-European” diagonal cumulation is granted to Bulgaria and Romania and to Turkey. Macedonia, Croatia and the Western Balkans Countries (Albania, Bosnia and Herzegovina, Serbia and Montenegro) are under bilateral cumulation. However, diagonal and full regimes are applicable only under the condition that trade between EuroMed Partners “is governed by identical rules of origin” (Article 4, Protocol 4 of the Association Agreement between Tunisia and the EU; Protocol 4 of the Association Agreement between Morocco and the EU; Protocol 2 of the Association Agreement between Algeria and the EU). Therefore, in order for the three Maghreb partners to effectively apply full cumulation, a need arises in principle to agree on common rules of origin, identical to those established in each bilateral Association Agreement with the EU.

However, it is worth noting that full cumulation for Maghreb, without full—and in some cases even without diagonal- cumulation for the other Southern Mediterranean partners may still be trade distorting. Also, wide implementation deficits and different take-ups by Member Countries, with respect to both intra-Maghreb/GAFTA and EU Association Agreements may make the construction of a unified system of cumulation even more difficult. This may well imply postponing the reaping of expected benefit from increased market access to the EuroMed Free Trade Zone. Otherwise said, the benefits of preferential access to the EU for Maghreb exporters of final goods that incorporate substantial amounts of potentially “originating” regional inputs will not be realized as the creation of a Region-wide scheme for ROOs consistent with the EU ROOs is further postponed.

The EU should consider extending full cumulation to the whole group of EuroMed Partners. However, such extension would be of no use if the Mediterranean Partners still chose to defer the implementation of their respective Association Agreements, and if the ROOs provisions in the existing Maghreb horizontal Agreements were not made compatible among each other and with the EU ROOs. Needless to say, the lack of implementation of most of these Agreements (Maghreb bilaterals, UMA, several GAFTA chapters), often based on even the very absence of executing Protocols, is also a question that should be addressed, once consistent Rules of Origin have been agreed on by the Maghreb, and, hopefully, by the other MENA Partners to the EuroMed Process.

Administrative procedures should also be harmonized in the horizontal Agreements among Maghreb Partners or at least they should be made compatible with those provided for in the Association Agreements (EUR1 Certificate) so as to grant a symmetric application and enforcement of the provisions on rules of origin. When the cost of proving origin is high compared to the available tariff reduction, when customs legislation and procedures do not

12 In principle, Turkey would not need ROOs, being a member of the Customs Union. However, ROOs between the EU and Turkey are still in force in agricultural (bilateral cumulation), coal and steel sectors, (“Pan-European” diagonal cumulation) which are outside the scope of the Customs Union.

13 The situation has become complicated by the EU’s review of its rules of origin under the GSP. A major element of the EU policy towards rules of origin over the past 2 decades has been the creation of a ‘Single List’ of processing requirements applied across all trade agreements. An important issue for the Maghreb countries is whether changes in the rules of origin under the GSP may lead to changes in the rules of origin under other agreements and in particular to monitor whether the Maghreb countries would benefit from any changes to the rules of origin that currently govern their preferential trade with the EU.
facilitate the task of exporters to provide the EU customs authorities with proof of the “originating product” status for their shipments, Maghreb exporters may pay full duties on their otherwise duty-free merchandise. Producers in central and Eastern European Partner Countries (notably Romania and Bulgaria) and their associated importers in the EU have resorted to Outward Processing Trade14 as a means to escape both the substantive requirements of extremely stringent EU ROOs and the administrative costs of proving the domestic origin of their goods (especially apparel not made directly from yarn, as required by the applicable EU ROO).

5.2 Invigorate Regional Integration

Increasing integration with the EU to more effectively exploit the benefits from the EU neighborhood policy can be supported and complemented by a coherent policy of effective regional integration. As we saw earlier, trade flows between Maghreb countries are very small and a range of studies suggest considerable potential for trade expansion.15 This potential will be enhanced if the Maghreb region becomes attractive for the location of activities within regional and global production networks. An expansion of such activities is also likely to drive two-way trade in components, that is the growth of intra-industry trade. If regional trade expansion is driven by such intra-industry trade then the adjustment costs of integration will be limited.

**Exploit gains from trade and specialization.** Regional trade agreements can have positive or negative effects on trade depending on design and implementation. Previous initiatives in the Maghreb region have had little impact. The opportunity now exists in the context of broader European integration to enhance the design and to effectively implement regional integration. The broader policy context in which an RTA is designed and implemented is crucial. Agreements designed to complement a general program of economic reform have been most effective in raising trade. When RTAs have tended to be fruitless, it is often because of the lack of a coherent program of reform. A careful and coherent program of reform is likely to offer new opportunities to those adversely affected by the removal of a particular trade barrier.

For an RTA itself, the ingredient most important to success is low trade barriers with all global partners. Most-favored-nation (MFN) liberalization, which creates more trade, is the fastest and most efficient way to increase intraregional trade. In addition, agreements that minimize excluded products expand the scope for positive net benefits through competition and trade creation. Nonrestrictive rules of origin are also important so that local firms can effectively source materials at the lowest cost. Such rules of origin are an essential element of agreements that expand both regional exports and exports to the rest of the world.

**Improve ability to attract FDI and integrate into global production chains.** By increasing the size of the relevant market, effective integration may make a region more attractive to multinational firms as a destination for FDI. The available empirical evidence

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14 The processing of EU inputs under a special customs regime based on temporary exportation.
15 See, for example, World Bank (2003), Nugent (2002) and Al-Trash and Yousef (2000). The forthcoming World Bank Country Economic Memorandum for Morocco concludes, on the basis of a gravity modelling exercise, that “normal economic relationships with Algeria would boost goods exports by a factor of 32.”
suggests that RTAs can have significant effects on FDI, especially in regions with low inflation, strong institutions and that are open to trade.\textsuperscript{16} In addition, effective regional integration may enable local firms to better integrate into global production chains by allowing for the free movement of parts and components through and between regional partners.

\textit{Limit impact of hub-and spoke relationship with EU.} An effective regional agreement amongst the Maghreb countries would mitigate the current hub-and spoke relationship with the EU and would allow for the development of common positions on issues to be negotiated with the EU and hence a stronger negotiating position compared to negotiating individually. Evidence suggests that regional integration amongst eastern European countries helped to increase trade and to limit the emergence of a hub and spoke relationship with the EU. In recent years the growth of intra-regional trade has exceeded that of trade with the EU for a number of eastern European countries.\textsuperscript{17}

Regional integration would also enhance the coherence of participation in the European neighborhood. In other words, the gains from participating collectively are likely to be larger than those from participating individually. For example, each country in the Maghreb can pursue agreements on conformity assessment and acceptance of industrial products to provide access to the EU Single Market. The benefits from the adoption of EU legislation would be enhancing if the products covered were also able to move freely between the Maghreb countries through the signing of similar agreements on acceptance.

\textit{Exploit the benefits of deeper integration.} The removal of tariffs and quotas is a key feature of regional trade agreements, but trade policies are only one element—and often a relatively minor one—of the overall costs of trade. Because logistical, institutional, and regulatory barriers are often more costly than tariffs and generate no offsetting revenue, cooperative governmental efforts to improve customs procedures, minimize the trade distorting impact of standards, and reduce transport costs may have a higher payoff than reciprocal reductions in overt trade policy barriers. This is because the reduction of such cost raising barriers saves real resources and will tend to raise productivity across a wide range of activities (for example, trucks that make more deliveries to the port are more productive which leads to lower trade costs and higher output of exportable activities).

When RTA membership is part of a broad program of economic liberalization in which the objective is to attract international investment as much as to promote trade, a broad set of regulatory issues becomes paramount. In certain cases, institutions at the regional level will provide for the most effective solutions, relative to both the multilateral and national levels. RTAs can effectively promote dialogue and implement coordinated responses. Indeed, progress often requires coordinated actions; for example, joint customs inspections must be allowed, common rules for transport must be established (including vehicle weight restrictions), and test results from partners’ laboratories must be accepted. RTAs can provide a forum to enhance trust among trade partners that genuinely wish to move forward on these and other fronts.

\textsuperscript{16} See, for example, Levy Yeyati et al (2002).
\textsuperscript{17} See, De Bendictis, L et al (2005).
Regional integration can help promote more efficient and effective customs operations. While there is much that countries can do individually to improve customs procedures, there is also scope for regional initiatives to modernize customs. Contacts fostered by regional agreements can generate a mutual understanding of each other’s problems and difficulties and can engender the sharing of best practices and positive experiences among members. This exchange is likely to be more relevant and better accepted inside the regional group of developing countries than examples from countries who are much more advanced and who face very different implementation issues.

Regional cooperation can support modern and efficient transport and logistics services. As countries seek to diversify their trade into more sophisticated agricultural and manufactured products, logistics requirements become more important—and more costly. To compete in international markets and function within global production chains, firms need not only low transport costs and efficient ports, but also short transit times, reliable delivery schedules, appropriate storage facilities, and security. Indeed, trade liberalization—whether unilateral, multilateral, or regional—may have a very muted economic impact in the presence of very high transport costs, weak logistical services, and long delays to clear customs. Conversely, in the presence of high trade barriers there may be little reason for traders to lobby for improvements in transport. And trade restrictions that limit quantities may undermine the incentive to invest in improved transport and trade facilitation services. Hence, actions to improve transport and reduce trade barriers are often complementary. Integrating fragmented markets can make infrastructure projects more viable, and thus promote a virtuous cycle of integration and growth. RTAs can provide a forum for the discussion and definition of norms and harmonized rules that are often necessary for effective implementation. Involvement of the private sector in these discussions is often a prerequisite for effective action. Finally, negotiating transport issues in a regional forum can act to depoliticize issues.
There is increasing awareness in the three Maghreb countries of the importance of trade and transport facilitation. Indeed, it is an important contribution to the competitiveness, and a condition of economic integration with the European markets. Indeed a seamless and fast supply chain is needed for those countries to be part of the European production circles as well as to develop into new markets.

The ongoing reforms and investments have produced some tangible results by addressing procedural constraints and physical bottlenecks. Moroccan customs modernization program has dramatically reduced the time needed to cross the border; Morocco has also been investing in key infrastructure (toll roads and ports). Tunisia simplified and automated trade procedures, which resulted in a three fold increase in productivity at the border. However, there are still many gaps, especially when it comes to the quality of logistics services. Maghreb countries do not always compare well in terms of performance with their direct competitors in Eastern Europe, which generally have lower cost in trade logistics.

Facilitation is primarily the target of unilateral policies and reform. As the trade patterns of the three countries depend on separate routes, there is no short term gain in integrated policies. However, there are substantial medium and long term gains in sub-regional approach.

The possibility of transit may not only spur regional trade but also favor the diversification of trade route to Europe and markets. Integration is also likely to create economies of scale in the delivery of services and reach the quality level desirable development. For instance the trucking sector in each country is obsolete and cannot offer the level of services needed by foreign and local manufacturers. A bigger market may catalyze the emergence of a modern sector. Integration will also help attract the logistics operators from Europe, who finds the market too fragmented and in turn develop a solid service base to export oriented activities in the three countries.

Regional trade agreements can build trust and facilitate progress on standards and conformity assessment. Effective solutions to problems arising from different standards require a high degree of dialogue and trust among trading partners. RTAs, while not the only path to trust, tend to promote dialogue and communication, which in turn build trust. Such trust needs to be nurtured through openness and transparency when new national regulations are being considered. RTAs also can provide a favorable negotiating environment and so reduce politicization in standard disputes among members, making it easier to find common solutions for the removal of non-tariff barriers. The interactions that take place in an RTA often improve institutional relationships between the different standards bodies of member countries—and sometimes even between the institutions of individual countries. These close relationships allow obstacles to be overcome in informal ways, circumventing cumbersome formal interventions.

In the short-run the greatest gain is likely to come from improvements in the testing, certification, and accreditation institutions to underpin greater enforcement capacity. Initiatives that improve these institutions are likely to have large payoffs. RTAs can contribute to better conformity assessment first, and most simply, by facilitating dialogue and the sharing of technical knowledge. More ambitious initiatives can build regional accreditation bodies to increase efficiency and enhance the reputation of local certification bodies in the global market. An open regional market for laboratory services can lead to cheaper yet higher quality testing on the basis of specialization and economies of scale.
VI. Facilitating Adjustment

Economic integration as part of a broad program of economic reform and the associated reduction of barriers to trade, whilst offering new opportunities for exporters and for economic diversification will entail a process of adjustment that will adversely affect certain economic actors, at least in the short-run. Indeed, this adjustment is an inevitable and necessary part of the process by which resources move from less efficient, previously protected sectors, to more efficient uses in exportable sectors and services sectors. This process of adjustment will be easier to achieve in an environment of growth and expansion. If trade liberalization is accompanied by technological upgrading, increasing inflows of FDI and increasing efficiency in the services sector there is more likely to be a positive impact on growth. In a dynamic economy new opportunities become more readily available. At the same time, governments are better able to support and facilitate adjustment, for example through training programs, and provide assistance to limit the social impact of liberalization in a climate of sustained growth.

In addition, the following measures that can maximize new opportunities and limit the adverse impacts of liberalization\textsuperscript{18}:

- **Improve the flexibility of labor markets**. Economies with sluggish labor markets tend to gain least from trade liberalization.

- **Improve human capital** to make the region more attractive to FDI and to allow for greater integration into regional production networks. There is substantial scope to increase the efficiency of spending on education to raise literacy rates and to benefit from higher female participation rates.

- **Improve the efficiency of services sectors**. First, services liberalization will offer new opportunities for employment. Figure 11 shows that in Eastern Europe, employment in financial and business services grew strongly following liberalization. Second, improving the efficiency of services will enhance competitiveness and support employment in other sectors. Finally, the financial sector plays a crucial role in facilitating the exploitation of new opportunities by channeling financial resources to new activities and facilitating individuals to participate in markets and trade.

\textsuperscript{18} See Hoekman and Smarzynska Javorcik (2004)
• **Aggressively pursue improved market access overseas.** This will enlarge export opportunities. As suggested above, this can be achieved with neighbours, with the EU and countries in the broader European neighborhood, such as Turkey, Ukraine and Russia as well as multilaterally through the WTO.

• **Ensure effective competition policy and discipline on state aids.** These regulatory interventions will be important to ensure that it is consumers that benefit from the reduction of trade barriers. In addition, effective enforcement of competition laws and on state aids is essential to ensure a level playing field for firms and that investments made to exploit new trade opportunities are not undermined by collusive agreements and state subsidies.

• **Support labor adjustment.** This appears to be the most effective way in which governments can intervene to support adjustment, through unemployment insurance, retraining schemes and health insurance. Interventions can be targeted towards those on the lowest incomes and the less-educated, typically those who are least able to bear the costs of adjustment.

**VII. Conclusions**

The Maghreb countries face substantial challenges to modernize and diversify their economies and generate sustained growth and employment generation. At the same time there are significant opportunities to exploit the inherent advantages in the region and to leverage trade to play a key role in driving growth. On the other hand, increasing global competition in the current dominant export sectors and the fact that other countries in the EU neighborhood are integrating with the EU and competing for trade and investment, entail that the costs of failure to integrate will rise. The alternate scenario is further marginalization from global
markets and failure to capture the growth potential offered by rising trade and investment flows.

This paper argues that the Maghreb countries could reap significant benefits from enhancing their integration with regional partners, with the EU and with global markets. This entails careful design of trade policy to ensure complementarity between the three domains of trade policy: unilateral actions, regional trade agreements and the multilateral agenda. In addition integration needs to be broadly based to include services to enhance productivity on an economy-wide basis and to increase the scope for trade and for new employment opportunities. Integration should also be deep to cover key elements of competitiveness relating issues such as standards and conformity assessment and transport and logistics. Trade policy initiatives are all the more effective when couched in a broad and coherent reform process and bolstered by support for those who bear the brunt of the costs of adjusting to the new more open regime.

Regional integration can play a crucial role not only by increasing trade opportunities but also by making the region more attractive for FDI and the location of activities linked to global and regional production chains. The key elements in a strategy to enhance regional integration are likely to be:

- Reduce the complexity of the current system of overlapping trade agreements
- Enhance transparency so that firms can easily access information on relevant market access conditions and the administrative requirements for preferential access
- Reduce external protection to drive domestic productivity, allow the effective sourcing of inputs, increase the incentive to export and minimize the risks of costly trade diversion
- Limit product exemptions and include services.
- Reduce the administrative costs of obtaining access to neighbors markets by removing licensing requirements and reducing the costs of complying with rules of origin
- Develop trust and dialogue to enable cooperative solutions, where relevant, to issues such as transport and standards.
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