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The Maghreb: Macroeconomic Performance, Reform Challenges and Integration with the EU

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The Maghreb: Macroeconomic Performance, Reform Challenges and Integration with the EU

By Heliodoro Temprano Arroyo

Summary

Since the start of the Arab Spring in 2010, all the Maghreb countries except Algeria have gone through a political transition, a process that in the case of Libya has entailed a civil conflict and, subsequently, the "de facto" temporary division of the country. Nearly five years later, the performance of the Maghreb economies remains much weaker than in the previous ten years.

While prudent policies have allowed Morocco to make substantial progress with economic stabilisation and reform, the other three Maghreb countries continue to be affected by internal conflict or security issues (Libya and Tunisia), the decline in international energy prices (Algeria and Libya, which remain heavily dependent on oil and gas exports) and insufficient progress with structural reforms. Moreover, all these countries, and in particular Tunisia, are very dependent on the EU economy so that the persistent weakness in the latter has continued to limit their capacity to recover.

While Morocco and Tunisia seem determined to pursue their integration with the EU, notably through the signing of Deep and Comprehensive Free-Trade Area agreements, Algeria's regime remains reluctant to do so. Libya, for its part, has not even signed an Association Agreement, reflecting, until 2011, the political isolation of the Gaddafi regime and, more recently, political instability. Also, while Morocco and, especially, Tunisia are on their way to becoming full-fledged democracies, steps in this direction have been much more limited in Algeria and have been interrupted in Libya. In this context, the EU and the international community have been providing substantial financial assistance to both Morocco and Tunisia. The recent refugee crisis in Europe further underlines the importance of restoring political and economic stability in the Maghreb and the supportive role that the EU can play to that effect.

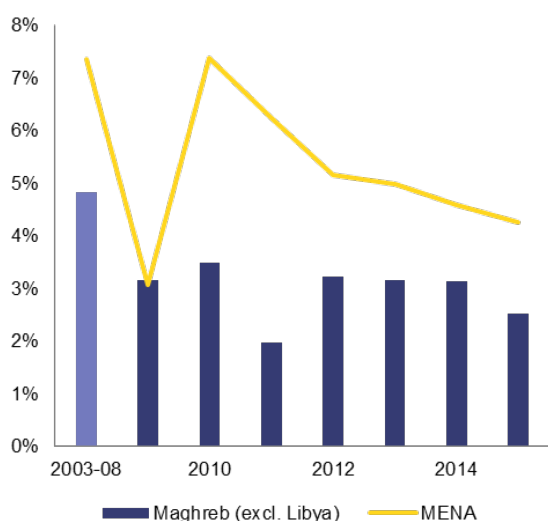
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Recent macroeconomic trends

Reflecting the social turmoil that accompanied the Arab spring transitions, the Libyan conflict and an unpropitious economic environment in the region and in Europe, the **growth performance** of the Maghreb countries has suffered since 2011 (see Charts 1a and 1b). GDP growth in the Maghreb has averaged only 2.1% in 2011-15 (using projections for 2015), compared to nearly 5% in the 6 years before the global financial crisis (2003-2008).¹

Chart 1a: GDP real growth
(simple average, %, excl. Libya)



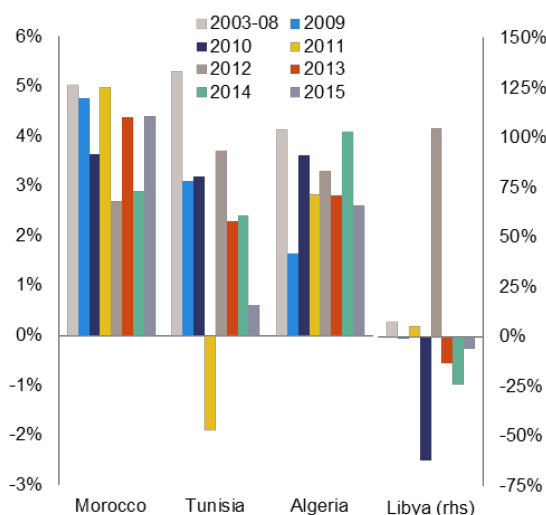
Sources: National authorities, IMF, EC staff estimates

Even if Libya is excluded, the growth performance is much weaker (2.8% in 2011-2015, compared to 4.8% in 2003-2008). Libya's growth performance has been particularly weak and very volatile, reflecting the impact of the armed conflict on oil production, which accounts for about 70% of Libya's GDP, and, since 2014, the decline in international oil prices. While Libya's oil production and GDP recovered sharply in 2012 from the collapse caused by the 2011 war, it has been declining sharply year after year since 2013.

Average growth has also been seriously affected in Tunisia. And the recent terrorist attacks (in the Bardo Museum in May, in Sousse in June and in Tunis in November), with their adverse effects on tourism and investment, are expected to further delay the recovery of economic activity in Tunisia, with GDP projections for 2015 for this country having been revised downwards recently from 3% to about 0.5% of GDP. In Morocco and Algeria, growth has been more resilient but has also

decelerated significantly. With these rates of growth being hardly sufficient to create jobs for the labour market entrants (given high rates of demographic growth), **unemployment** rates in the Maghreb countries have remained high, currently averaging about 12% in the three countries (Algeria, Morocco and Tunisia) for which data was available.

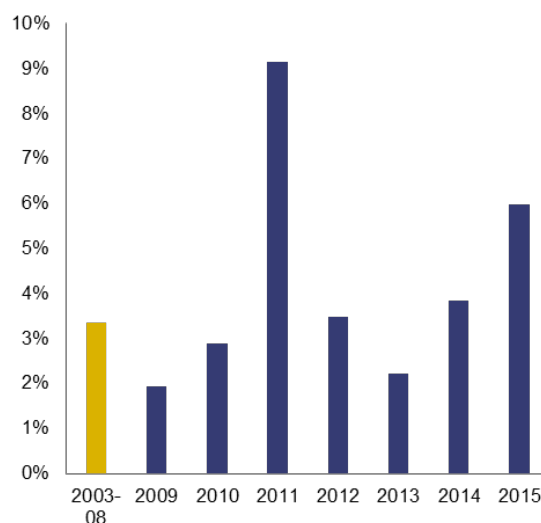
Chart 1b: GDP real growth – by country



Sources: National authorities, IMF, EC staff estimates

In 2011-12, **inflation** in the Maghreb countries accelerated reflecting the increase in international energy and food prices, expansionary government expenditure policies and, in the case of Libya, supply disruptions caused by the military conflict.

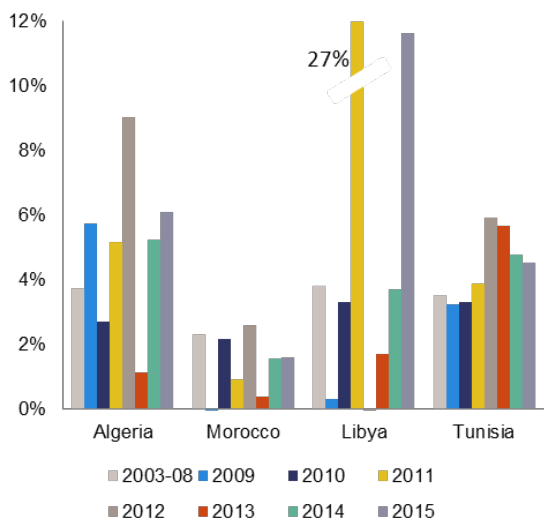
Chart 2a: Inflation – end of year, simple average %, (for 2015, latest monthly data available)



Sources: National authorities, IMF, EC staff estimates

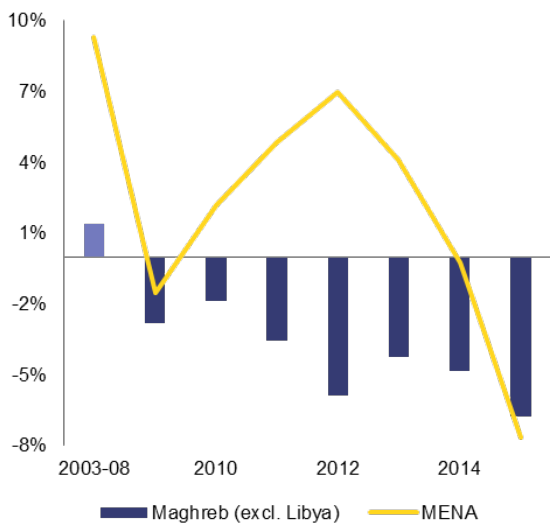
The acceleration was particularly marked in Libya, where year-on-year inflation reached 27% at the end of 2011, but was also significant in Algeria, which finished 2012 at a 15-year high of 9%. Since then, inflation has decelerated to the 4-6% range in Algeria and Tunisia and to the 1-2% range in Morocco (see Charts 2a and 2b). The deceleration observed in 2014-15 was partly due to the decline in international commodity prices. In Libya, by contrast, the disruptions created by the resumption of the war in 2014 have pushed up inflation again (to around 10% by March 2015).

Chart 2b: Inflation by country - end of year %, (for 2015, latest monthly data available)



Sources: National authorities and IMF

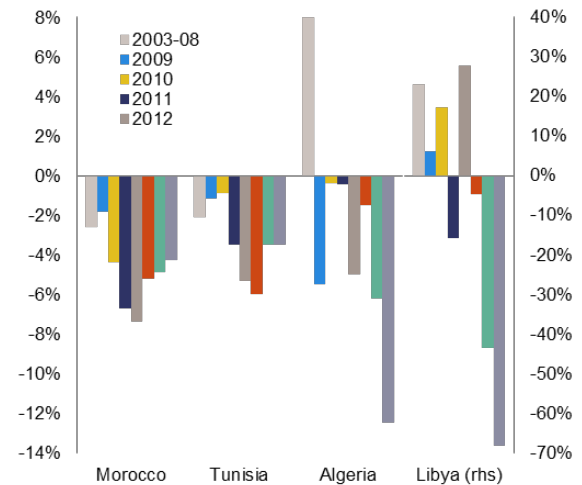
Chart 3a: Fiscal balance (simple average, % of GDP, excl. Libya)



Sources: National authorities, IMF, EC staff estimates

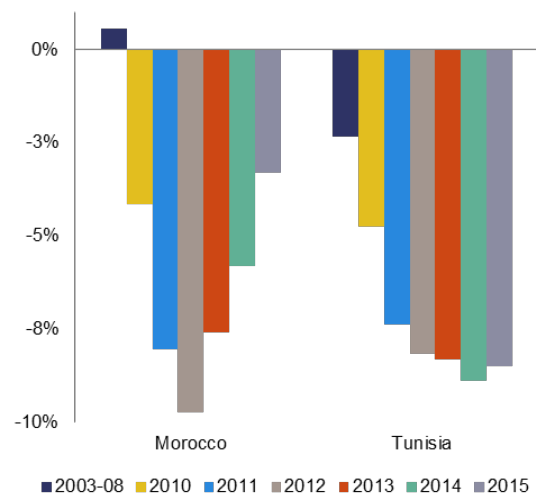
The deterioration in the macroeconomic performance is even more evident if one looks at **the fiscal position and the current account** of the balance of payments (Charts 3a, 3b, 4a and 4b). While in the initial years after the Arab spring revolts (2011 and 2012), higher food and energy prices exacerbated the fiscal and current account deterioration in the oil importing countries (Morocco and Tunisia), the energy exporters also saw their fiscal and external accounts worsen, in the case of Libya due to the impact of the war on oil production and in the case of Algeria due to the expansion of public wages and other current expenditure, as the authorities tried to assuage social tensions.

Chart 3b: Fiscal balance – per country (% of GDP)



Sources: National authorities and IMF

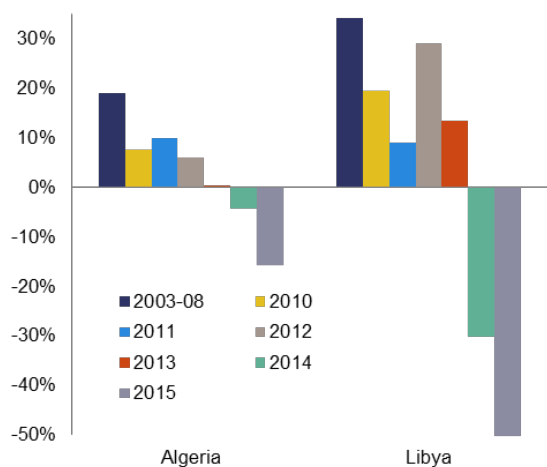
Chart 4a: Current account balance – Net oil importers (% of GDP)



Sources: National authorities, IMF, EC staff estimates

Only Morocco has managed to turn around since 2013 the fiscal and balance of payments positions through a combination of bold fiscal reforms and other measures (see next section), in the context of a precautionary IMF programme. Tunisia also took some adjustment measures under a programme supported by the IMF, the EU and other donors, but was much more hesitant in its implementation and continues to face (also due to its security threats) significant fiscal and balance of payments challenges.

Chart 4b: Current account balance – Net oil exporters (simple average, % of GDP)



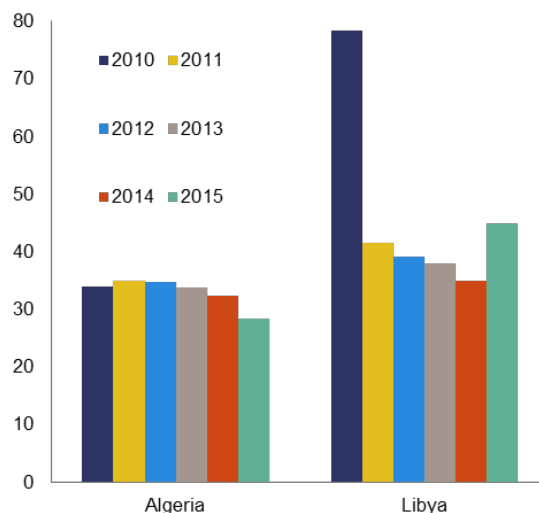
Sources: National authorities, IMF and EC staff estimates

In the case of Algeria and Libya, where gas and/or oil revenues represent the bulk of fiscal and export revenues,² the recent decline in oil and gas prices, in combination with the disruption (Libya) or stagnation (Algeria) of oil production, has contributed to produce a tremendous swing in the fiscal and current account positions.³ These two countries, which used to run huge (often in the double digits) fiscal and current account surpluses, have recorded in recent years (and are projected to record in 2015) large deficits. The same decline in energy prices that is hurting Algeria and Libya since 2014 is, however, helping to ease fiscal and balance of payments pressures in Morocco and, to a lesser extent, Tunisia.⁴

While both Algeria and Libya dispose of a very comfortable cushion of foreign exchange assets and enjoy a low level of indebtedness (see Charts 5 and 6), their recent fiscal and balance of payments trends are clearly unsustainable, particularly to the extent that we may be entering a protracted period of low oil prices.

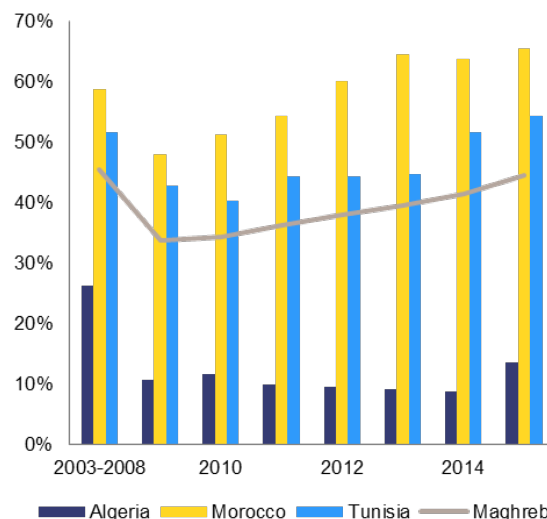
Take Algeria. It held at the end of 2014 about USD 191 billion in official foreign exchange reserves (equivalent to about 32 months of imports) plus the equivalent of about USD 55 billion within its Oil Stabilisation Fund, and its public and foreign debt ratios are in the single digits. But because its oil production has been declining or stagnant since 2006 while its domestic consumption of hydrocarbon products continues to expand (supported by its generous energy subsidies), its hydrocarbon exports have been falling in volume.

Chart 5: Gross international reserves – Oil exporters (in months of next year's imports)



Sources: National authorities and IMF

Chart 6: Gross public debt (% of GDP)



Sources: National authorities and IMF

In combination with the recent decline in hydrocarbon prices, this has produced a fiscal deficit in Algeria of about 6% of GDP last year, and the

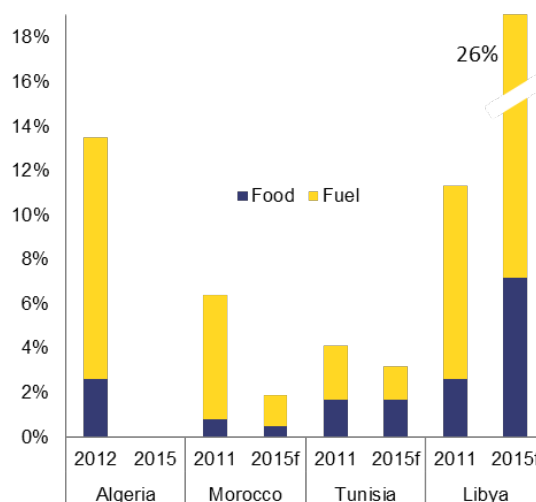
deficit is expected to nearly double this year. This also pushed the current account into a substantial deficit last year, for the first time in 15 years. Algeria has been financing this deterioration largely by running down its official foreign exchange reserves (which are projected to decline by USD 21 billion between the end of 2013 and the end of 2015) and by using its Oil Stabilisation Fund (by another USD 22 billion during that period). And the IMF, in its latest Article IV Consultation report for Algeria, projects these large fiscal and current account deficits to persist well into the end of the decade.⁵ This is clearly unsustainable. Algeria needs to invest more in hydrocarbon exploration (which may also require easing access by foreign investors) and reform the expensive energy subsidy system to both rein on the fiscal deficit and encourage energy savings.

Libya has also been financing its large fiscal and balance of payments deficit by running down rapidly its huge foreign exchange reserves. The foreign exchange reserves held by the Central Bank of Libya (CBL) are estimated to have declined from a recent peak of USD 121.9 billion in September 2013 to USD 85.2 billion at the end of February 2015. Since June 2014, the country, which remains embroiled in a civil conflict, has been divided in two areas with two different governments: the east of the country, led by the government located in the city of Bayda, and the western part, led by the government based in Tripoli. The extreme jihadist group known as the Islamic State or Daesh has also been able to establish a base in eastern and central Libya since late 2014 and threatens the control of the key oil-export terminals of Sidra and Ras Lanuf. However, three important economic institutions continue to operate (although not without difficulties) at national level, playing a relatively neutral role and ensuring a minimum of economic cohesion and stability.⁶ These are the CBL, the Libyan Investment Authority (which holds an important volume of official foreign assets stemming from the accumulation of oil income) and the National Oil Company. While each of the rival governments has adopted its own budget for 2015, the CBL is playing some of the functions of a ministry of finance, notably by ensuring the payment of public wages and other transfers across the country. Meanwhile, Libya's oil production is estimated to have declined to less than 400,000 bpd by September 2015, compared to more than 1.6 million bpd before the 2011 conflict.

Economic reform challenges

Among the four Maghreb countries, **Morocco** is the only one that has been implementing in recent years bold structural reforms aimed at consolidating the fiscal accounts, improving the investment climate and raising sustainable growth, while moving to a more inclusive growth model. Particularly impressive has been the reform of the price subsidy system, which mostly applied to petroleum products but also to some basic foodstuffs (wheat flour and sugar). Reflecting the three-fold increase in oil prices from 2000 and 2012, the subsidy bill had almost tripled (from 2½% of GDP to over 6½% of GDP) during this period, accounting in 2015 for almost the entire fiscal deficit of Morocco. To address this problem, Morocco has gradually but markedly cut down subsidies on petroleum products, and has introduced a partial indexation of domestic retail prices on diesel, gasoline and fuel to world prices.⁷

Chart 7: Food and fuel subsidies (% of GDP)

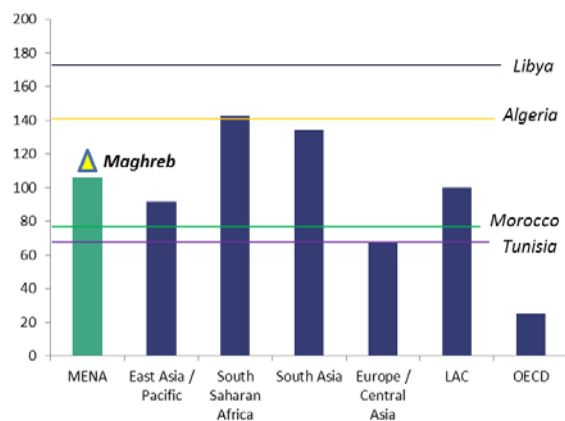


Sources: National authorities and IMF

Thanks to this, but also to the decline in international oil prices, Morocco's total subsidy bill declined to about 4% of GDP last year and is expected to further shrink to about 2% of GDP this year (see Chart 7), implying that subsidy reform has been the main contributor to Morocco's successful fiscal adjustment since 2013. To mitigate the impact of subsidy reform on the poor and certain economic sectors, Morocco has introduced or reinforced a number of social programmes (including in health and education) and has provided support to the transportation sector, one of the most affected ones.

Morocco's fiscal adjustment has also been underpinned by serious tax reforms, which have built on the recommendations of the national tax conference ("assises nationales sur la fiscalité"), organised in April 2013. These tax reforms aim at broadening the tax base and reducing tax expenditures while making the tax system more equitable.⁸ Morocco is also taking steps to reform the pension system in order to ensure its long-term viability, including the announcement last year of a parametric reform. It has adopted last year a new organic budget law strengthening the budgetary framework, *inter alia* through the establishment of a "golden rule" limiting new net borrowing to the financing of capital spending. Other key structural reforms adopted by Morocco's include: the reinforcement of banking regulation and supervision, measures to ease the cost of doing business and thus improve the business climate and the overhaul of its employment support programmes. Morocco's progress in strengthening the investment climate is reflected in a position in the World Bank's Doing Business indicators that is significantly better than the average of the Middle East and North Africa (MENA) region (Chart 8).

Chart 8: Doing Business indicators
(higher score represents worse performance)



Source: World Bank

This does not mean that Morocco has tackled all its structural reform challenges. It has not. But the point is that its approach to economic reform in recent years has been consistent and perseverant and, as a result, the country is beginning to reap the benefits. Key remaining challenges include, as in other countries in the region, fighting unemployment (notably among young people) and increasing participation rates (notably among women), improving the quality of education and female enrolment rates,⁹ reducing poverty rates and promoting regional development. Also, Morocco has

scope for diversifying its economy so as to reduce its dependency on the agricultural, phosphate and tourism sectors.

While **Tunisia** has also adopted a meaningful strategy for macroeconomic stabilisation and economic reforms, supported by the USD 1.74 billion Stand-By Arrangement approved by the IMF in June 2013 and assistance from the World Bank, the EU and other donors, implementation has often been slower than programmed, partly reflecting the complex political transition and the security problems the country has been going through. This strategy includes, in particular, measures to rehabilitate the key state-owned banks, strengthen banking supervision, reform the energy subsidy and tax systems, and improve the investment climate (including by adopting a new investment code and new public procurement, competition and bankruptcy legislation). To respond to the concerns expressed by society during the 2010-11 revolution, the programme also envisages measures to strengthen and better target the social safety net, support employment creation and promote the development of the poor regions of the country. Some encouraging steps have been taken to cut fuel and electricity subsidies and to recapitalise public banks (with the adoption by Parliament, although with an important delay, of the related recapitalisation law last August). Also, some tax reforms have been enacted in order to limit an abusive access to the "régime forfaitaire", improve the progressivity of the personal income tax and harmonise the tax treatment of the offshore and onshore sectors. And the government formed in February 2015, following the October 2014 parliamentary elections, intends to pursue these tax reform efforts by adopting some of the recommendations of the national tax consultations concluded last year. But much of the reform agenda remains to be implemented.

The fear that reform implementation could destabilise Tunisia's fragile economic and political situation often led the interim governments that ran the country during the transition to postpone difficult measures, and the situation created after the recent terrorist attacks risks weakening the resolve of the new government to move ahead with the economic reform agenda when its implementation is most needed. To ease a tense social situation, which has often resulted in strikes and work stoppages that have damaged productivity in the public sector and in some key export sectors such as mining, the

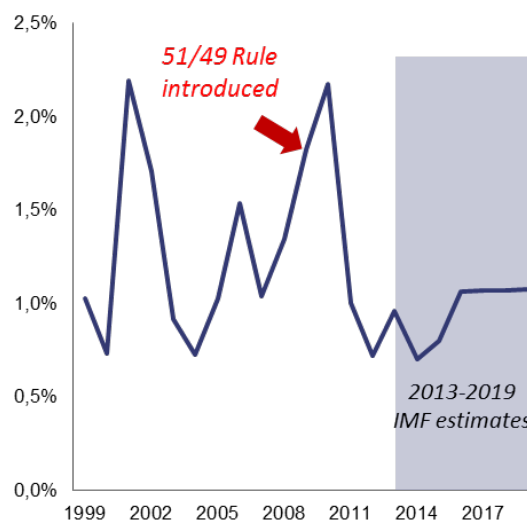
authorities have allowed a significant increase in public sector employment and wages, and have delayed part of the fiscal adjustment. This has been financed by the under-execution of the capital spending budget and, more recently, by the savings related to lower energy prices, as well as through borrowing (both from official creditors and from the international capital markets). But this situation is not sustainable. Tunisia's fiscal and balance of payments disequilibria remain very large, while its debt ratios have considerably deteriorated in recent years (although from manageable levels). Moreover, the country's macroeconomic vulnerability has increased as a result of the ongoing security threats. In this context, Tunisia must not delay further the reforms that will restore fiscal sustainability, improve the investment climate and support the development of a vibrant private sector, including by facilitating access of Small- and Medium-Sized Enterprises to finance. The launching of the negotiations on a Deep and Comprehensive Free Trade Area (DCFTA) with the EU in October 2015 is an encouraging development since this agreement should help stimulate foreign investment, notably from the EU, by putting in place a market-friendly and predictable regulatory framework. Tunisia must also implement the labour market and educational reforms needed to reduce unemployment and increase participation rates, as well as measures to promote regional development in the poorest governorates of the hinterland, the rural south and the north-west, where unemployment rates tend to be much higher.¹⁰

The cases of **Algeria and Libya** are even more challenging. Gaddafi's regime had kept a tight grip in the economy, with few key sectors having been open to privatisation. And after the 2011 revolution, Libya's political instability has, by and large, prevented progress with structural reforms. In the case of Algeria, the main impediment seems to be the reluctance of the Algerian regime to abandon an economic model based on the production and export of hydrocarbons, a protective trade and investment regime, and the overwhelming role of the state in the economy. In both countries, the result is insufficiently diversified economies that are very exposed to the vagaries of international oil and gas prices (as illustrated by the current situation), an anaemic private sector and underdeveloped financial systems dominated by a few banks and where capital markets are nearly inexistent. In addition, as other MENA countries, both Libya and Algeria have dysfunctional labour markets and educational

systems that, in combination with other factors (including cultural), produce high unemployment rates and low participation rates. Libya's insufficiently qualified workforce often makes it difficult for companies to find qualified and experienced staff, having to resort to foreign workers. Both countries also lack modern and well-targeted social safety nets. Instead, they largely rely on generalised and very costly energy subsidy systems, a natural political choice in countries with abundant fossil energy sources but a key underlying factor behind the unsustainable fiscal positions revealed by the recent decline in oil prices. At a time when Morocco and Tunisia are cutting down significantly their price subsidies, Algeria and Libya continue to be among the countries in the world that spend a largest share of their GDPs in subsidies (with Libya having even increased this share in recent years, reflecting the collapse of GDP), and this despite the decline in oil prices (see Chart 7).¹¹

Both countries also score very poorly in the main surveys of business conditions and competitiveness, even when compared to other Southern Mediterranean countries. Chart 8 shows their poor scoring in the World Bank's Doing Business Indicators. Algeria's heavy tax, customs and other regulations impose a significant compliance burden on enterprises, which discourages investment and encourages the development of a large informal sector.

Chart 9: Algeria – Net FDI
(in % of GDP)



Sources: National authorities and IMF

Foreign investment is also discouraged by restrictive regulations, in particular the infamous 51-49 rule introduced in 2009, which sets a minimum Algerian

shareholding of 51% for companies in most sectors, as well as public procurement rules requiring foreign tenderers to set up investment partnerships with Algerian companies to adhere to a 25% domestic preference margin.¹² There is evidence that these regulations have had a negative impact on foreign direct investment (FDI) inflows into Algeria (see Chart 9, which shows a significant decline in the post-2009 trend in FDI inflows compared to the pre-2009 trend).

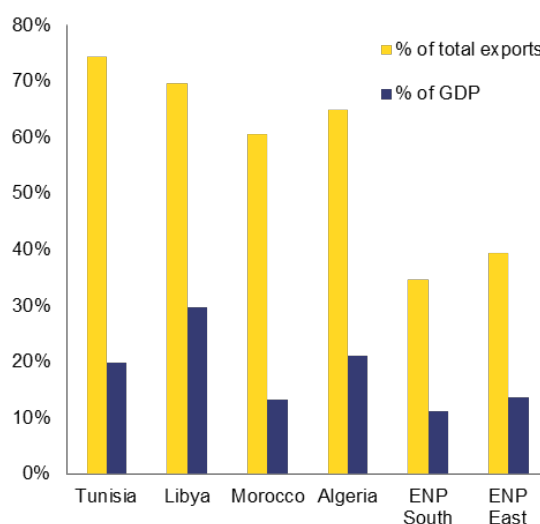
In sum, both Algeria and Libya have ample scope for improving economic performance through liberalisation, private sector development and diversification but the necessary reforms continue to be postponed.

Economic integration and relations with the EU

One thing the four Maghreb countries have in common is their relatively high dependence on the EU market.¹³ They are actually among the countries of the EU's neighbourhood that conduct the highest shares of their **trade** with the EU (see Chart 10). Libya and Tunisia, with about 70% of their merchandise exports directed to the EU, representing 20% to 30% of their respective GDPs, are by far the neighbouring countries that are most exposed to developments in the EU economy. No wonder Tunisia was so affected by the euro area crisis. Morocco and Tunisia, which have important **tourist sectors** accounting for about 7-10% of their GDPs when including ancillary sectors, also depend heavily on the EU for their tourist receipts, with

European citizens representing about 40% of their tourist arrivals (see Table 1). Europe is also by far the main destination for migrant workers from the Maghreb and, therefore, the main source for their inflows of **worker remittances**, as well as the main source of **foreign investment and official aid flows**.

Chart 10: Value of exports to the EU, 2013



Sources: IMF, EC and national authorities

The relatively high exposure of the Maghreb economies to the EU is also illustrated by recent **empirical studies** that show that, among the MENA countries, the Maghreb countries are relatively more dependent on the EU's economic cycle, whereas the Mashrek countries tend to be more sensitive to economic developments in the Gulf Cooperation Council (GCC) countries, with which they have closer economic and financial links.¹⁴

Table 1: Exposure to the EU in remittances and tourism, 2014

	Remittances from EU as a	Tourism Revenues as a		Incoming Tourists
	% of GDP	% of Total Exports	% of GDP	from EU (% of Total)
Morocco	6,3	35,7	6,5	40,0
Tunisia	4,9	12,8	7,0	48,0
Algeria	1,0	-	-	-
Libya	0,0	-	-	-
ENP South (1)	2,1	16,3	5,8 (2)	23,9
ENP East (1)	1,3	5,4	3,0 (2)	18,3

Source: National authorities, IMF and European Commission staff estimates

(1) Average figures compiled with 2011 data; (2) Average figures composed of selected countries

This high exposure to the EU economy partly reflects the failure of the Maghreb countries to further develop trade and financial flows among themselves, a problem that is seen in the MENA

region more widely, as well as their insufficient exploitation of the trade opportunities offered by the emerging markets of Asia and other regions.

As underlined in the Communication of 2012 of the European Commission and the EU's High Representative for Foreign Affairs and Security Policy on regional integration in the Maghreb,¹⁵ the EU has been trying to encourage economic integration among the Maghreb countries, including by supporting the **Agadir Agreement** and helping to finance its Amman-based Secretariat. It also does so through the EIB's financing of infrastructure projects, some in the context of its Trans-European-Networks initiative. The **Pan-Euro-Mediterranean system of cumulation of origin**, although covering the whole of the Mediterranean basin countries, should also encourage intra-regional trade and investment among the Maghreb countries.

Given this high degree of economic integration, migration flows, geographical proximity and geopolitical importance for the EU, it is not surprising that the EU has tried to develop strong institutional, economic and political relations with the Maghreb countries. But the results have not been homogeneous. In 1995, the EU launched the so-called **Barcelona Process**, which aimed at creating an area of free trade and political and economic cooperation with the countries of the Mediterranean basin. As part of this initiative, **Association Agreements**, including bilateral free trade agreements for industrial products as well as reciprocal preferential access for agricultural products at a later stage, were signed with Tunisia in 1995 (the first Mediterranean country to do so), Morocco in 1996 and Algeria in 2002 (see Table 2). In the case of **Morocco**, this was followed by the signing in 2010 of an Agreement on Agricultural, Processed Agricultural and Fisheries Products, and by the launching in March 2013 of negotiations on a

DCFTA, of which four negotiating rounds have been completed. These DCFTAs, which the EU has also offered to Egypt, Jordan and Tunisia (among its Mediterranean partners) and has already concluded with Georgia, Moldova and Ukraine (among its Eastern neighbours), aim at liberalising also trade in services and public procurement markets and the eventual full participation of the partner countries in the EU's Single Market. They require an ambitious degree of harmonisation of regulations in areas such as competition, intellectual property rights, investment protection, industrial standards, and sanitary and phytosanitary measures. **Tunisia** has also completed the preparatory ("screening") process for a DCFTA and the negotiations were launched in October 2015. As partners of the **European Neighbourhood Policy** (ENP) launched by the EU in 2004, Morocco and Tunisia have also concluded with the EU multi-annual Joint Action Plans aimed at promoting economic and political reform, as well as economic integration and regulatory harmonisation with the EU. The ambitious bilateral relation the EU is building with these two countries has also been symbolised by the granting by the EU to Morocco of "Advanced Status" in 2008 and the agreement with Tunisia in 2014 on a so-called "Privileged Partnership", as well as by the conclusion of so-called Mobility Partnerships between the EU and these two countries.

The very significant progress achieved with, and high degree of ambition set for, the partnerships with Morocco and Tunisia contrast with the much more limited progress made with Algeria and, especially with Libya. Obviously, this partly reflects political factors, including, in the case of Libya, political instability.

Table 2: Main agreements between EU and Maghreb countries

	Association Agreement	Trade Agreements	ENP
Morocco	- Signed in 1996, entered into force in 2000.	-DCFTA ⁽¹⁾ negotiations started Apr-13: 4th round completed. - Agreement on Agricultural, Processed Agricultural and Fisheries Products signed in 2010; entered into force in 2012	- Advanced status since 2008 - Latest Action Plan adopted for period 2013-2017
Tunisia	- Signed in 1995, entered into force in 1998	- DCFTA negotiations to start Oct-15 -Free Trade Area since 2008	-Privileged Partnership since 2014 -Latest Action Plan adopted for period 2013-2017
Algeria	- Signed in 2002, entered into force in 2005.	- In process of accession to WTO, supported by EU	- Protocol signed in 2014 to participate in EU programmes - No Action Plan (consultations launched in 2012)
Libya	- Currently no agreement stipulating relations.	- None	- Eligible for funding under ENI - Special EU Envoy

Sources: National authorities, IMF and European Commission
(1) DCFTA = Deep and Comprehensive Free Trade Area agreement

While, as noted, **Algeria** signed in 2002 an Association Agreement, some of its provisions in the area of trade liberalisation have not been implemented, partly reflecting Algeria's reluctance to do so, which actually led it to request in 2012, and obtain from the EU, the temporary suspension of some of the liberalisation measures foreseen under the Association Agreement.¹⁶ This partly reflects the Algerian authorities' scepticism about the benefits of trade and investment openness, which, as noted, contributes to the maintenance of a state-dominated and protected economy. Algeria has also not agreed yet on an ENP Joint Action Plan with the EU, although consultations on the first such plan were launched in 2012. In the case of **Libya**, institutional relations with the EU are still in its infancy: no association agreement has been negotiated yet and Libya had until recently remained de facto out of the ENP and had not benefited from the EU's cooperation assistance, reflecting the political isolation of the Gaddafi regime. After the fall of this regime, political instability in the country has continued to complicate relations. An EU office was opened in Tripoli in November 2011, but it had to be evacuated to Tunis in July 2014 as the conflict between the authorities in Tripoli and the internationally recognised government, based in Al-Bayda, erupted.

This marked difference in the intensity of institutional relations with the EU between Morocco and Tunisia, on one hand, and Libya and, to a lesser extent, Algeria, on the other, goes hand-in-hand with important differences in the size and variety of **financial assistance provided by the EU** (see Table 3). Indeed, Morocco is the largest recipient of EU financial assistance in the Southern neighbourhood and Tunisia the second beneficiary in per capita terms. Since 2011, Morocco has received about EUR 2.8 bn of EU assistance (including EIB lending) while Tunisia has received EUR 2.1 bn and was the main beneficiary of the **SPRING** and **UMBRELLA** programmes, which provide a top-up of the assistance from the European Neighbourhood Instrument (ENI) for countries showing good progress with political and economic reforms (the "more-for-more principle" introduced by the 2011

revision of the ENP). Tunisia has even benefitted from the EU's Macro-Financial Assistance (MFA), an exceptional instrument of financial support for countries undergoing severe balance of payments difficulties and having an IMF arrangement. An MFA operation in the amount of EUR 300 million, in the form of a medium-term loan, was approved by the EU for Tunisia in May 2014, of which a first tranche of EUR 100 million was disbursed last May and the second one (of the same amount) was disbursed in early December 2015. A second, similar operation is currently under discussion. It would be linked to the successor arrangement that the authorities intend to negotiate with the IMF (the current Stand-By Arrangement expires at the end of 2015) and should help Tunisia overcome the macroeconomic shock produced by the recent terrorist attacks and ensuing security situation. Morocco and Tunisia are also among the main beneficiaries of EIB loans in the entire neighbourhood.

By contrast, Algeria and, in particular, Libya, have received little financial assistance from the EU so far. Since 2012, Libya is eligible under the ENI, the **SPRING** and **UMBRELLA** programmes and EU humanitarian assistance but disbursements from these instruments to Libya have until now been rather limited.

The EU has also been cooperating with Morocco, Tunisia and, to a much lesser degree, Libya as part of the **G-7's Deauville Partnership initiative**, aimed at supporting the Arab spring countries. Algeria is not covered by this initiative. The EU has also supported the **expansion of the activities of the EBRD** to the Southern and Eastern Mediterranean, which has led to the accession of Tunisia to the EBRD in 2011 (Morocco was already a member of the EBRD) and to the declaration of both countries as full countries of operation. Libya has applied to join the EBRD and has been accepted as EBRD member but the process of subscription of its capital share has been interrupted by the country's recent political instability.

Table 3: EU financial assistance, 2011-2014 (EUR millions)

	Libya	Morocco	Tunisia	Algeria	TOTAL
ENI/ENPI ⁽¹⁾	68	779	409	198	1.454
SPRING (2011-2013)	5	128	155	10	298
UMBRELLA (2014)	0	20	50	0	70
EIB loans + private equity (Commitments)	0	1.870	1.138	0	3.008
Humanitarian aid ⁽²⁾	32	0	9	39	80
MFA	0	0	300	0	300
TOTAL (in EUR billions)	105	2.797	2.061	247	5.210
TOTAL (in EUR per capita)	17	85	189	6	58

Sources: European Commission and EIB

(1) ENPI covers 2011-2013, ENI covers 2014

(2) Amount for Algeria is for Saharawi crisis

Concluding remarks

This Economic Brief has argued that the macroeconomic performance of the Maghreb countries has weakened considerably since 2001, partly reflecting political and external economic factors but also, with the exception of Morocco, because of a failure to implement the necessary adjustment measures and structural reforms. Tunisia has also put in place an appropriate economic policy strategy, but implementation has been slow and hesitant. The situation in Libya is particularly critical, with the country expected to record in 2015 its third consecutive year of deep recession and continuing to deplete at a rapid pace its foreign exchange assets. While Algeria has managed to maintain positive economic growth, the refusal of the regime to liberalise and open the way to the development and diversification of the private sector, together with politically-driven expansionary fiscal policies, are impinging on its macroeconomic performance. The recent decline in international oil prices is helping reduce Morocco's and, to a lesser extent, Tunisia's macroeconomic imbalances but is also hitting Algeria and Libya strongly, as net exporters of hydrocarbons, revealing the extent of their underlying fiscal imbalances and other structural deficiencies.

The Maghreb countries are among the countries in the EU's neighbourhood that exhibit the highest degree of economic integration with the EU. The EU has facilitated this through its initiative to conclude association and free trade agreements with the Southern Mediterranean countries. Morocco and Tunisia intend to upgrade the association agreements

signed in the 1990s through the conclusion of DCFTAs. By contrast, Libya has not even signed a first generation of association agreements, while Algeria has been reluctant to fully exploit the potential of the association agreement signed with the EU in 2002, let alone consider more ambitious forms of integration such as a DCFTA. At the same time, intra-regional trade integration among the Maghreb countries remains limited, despite the Agadir Agreement, thwarting the realisation a significant economic potential.

Reflecting progress with political reform and closer political affinity with the EU, the EU's economic and financial cooperation with Morocco and Tunisia is much more developed than that with Algeria and Libya. In fact, Morocco and Tunisia are the two countries in the Southern Mediterranean with which the EU is developing stronger links, both in terms of trade agreements and EU financial assistance. Algeria and Libya are at the opposite end, standing out as the two Southern neighbouring countries (together with Syria currently) with which the EU's relations are less developed, even if the EU has been making efforts in recent years to provide an impulse to its relations with both of them.

Improved economic performance in the Maghreb requires, first and foremost, addressing the political factors that are impinging on that performance (resolving the conflict in Libya and reunifying the country, as the ongoing peace negotiations try to do; addressing security threats in Tunisia; easing the grip of the state and moving ahead with political reform in Algeria). But it also requires the adoption of stability-oriented macroeconomic policies and appropriate structural reforms (in the case of Libya

as soon as the political situation allows it). Otherwise, macroeconomic vulnerabilities, sub-par growth performance and a failure to move to a more inclusive and job-friendly economic model (including from a regional development perspective) risks weakening social support for political reforms and/or feed into political instability. Morocco is moving, as noted, in the right direction on the economic front (even if still faces significant economic reform challenges and has quite some way to go to complete its political transition). The other countries can and should do the same. Last but not least, economic performance would be supported by efforts to foster increased economic integration and cooperation among the countries of the Maghreb.

The EU's policies in the region should help countries in these endeavours, although they require some political preconditions to be met and their effectiveness depends on the willingness of the Maghreb countries to reform and engage with the EU, including their willingness to harmonise key legislation and to open up their economies to trade and capital flows with the EU. The new context created by the recent refugee crisis in Europe further underlines the importance of restoring political stability and security in the Maghreb region, while creating the conditions for sustainable growth and prosperity. It also highlights the important role the EU can play to support this process.

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Endnotes

¹ In this Economic Brief the term "Maghreb" covers Algeria, Libya, Morocco and Tunisia. This contrasts with "the Greater Maghreb" concept, which also includes Mauritania as well as the contested territory of the Western Sahara.

² In 2014, hydrocarbon revenues represented about 95% of Algeria's merchandise export revenues and about 98% of Libya's. They represented about 60% of Algeria's fiscal revenues and about 93% of Libya's.

³ For the fiscal challenges posed to oil exporters by the recent decline in oil prices, see IMF (2015b), Chapter 4.

⁴ Tunisia also produces and exports oil and, as a result, its net oil trade balance (-4.4% of GDP in 2014) is much less negative than that of Morocco (-10% of GDP in 2014) and, therefore, benefits also less than the latter from the decline in international oil prices.

⁵ See IMF (2014a).

⁶ See Toaldo (2015).

⁷ See IMF (2015a), Box 2, p. 18.

⁸ They include the review of income tax and VAT rates, an increased taxation of the agricultural sector, a better enforcement of tax payments by the self-employed and liberal professions, and improvements in tax administration.

⁹ Morocco continues to score poorly in quite a few education indicators. See European Commission (2011).

¹⁰ In 2014, the unemployment rate in the interior averaged 23%, compared to 15% in Tunis and 10% along the coastal strip. Efforts made since 2011 to increase public investment in the poor regions have not been very successful, reflecting poor investment project selection and management as well as absorption constraints in the beneficiary regions.

¹¹ Concern about the rising cost of energy subsidies led the Tripoli-based government to announce in June 2015 a plan to slash the subsidies on gasoline and diesel by tripling their prices and to provide, instead, a cash transfer to Libyan families. On the challenge of subsidy reform in the MENA countries, see IMF (2014b).

¹² The authorities are, however, increasingly aware of the negative impact rule 51-49 has had on FDI inflows and are considering easing it to some extent (following the recommendations issued in 2013 by a special Committee on Foreign Direct Investment).

¹³ See European Commission (2013), Chapter III.1.

¹⁴ See, for example, World Bank (2011), Mohaddes and Raissi (2011), Cashi, Mohaddes and Raissi (2012), IMF (2012) and European Commission (2013) pp. 75-78.

¹⁵ "Supporting closer cooperation and regional integration in the Maghreb: Algeria, Libya, Mauritania, Morocco and Tunisia", Joint Communication of the European Commission and the High Representative of the European Union for Foreign Affairs and Security Policy to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 17.12.2012, JOIN(2012) 36 final.

¹⁶ The EU-Algeria Association Agreement foresees (Article 9) the gradual creation of a free zone for industrial goods within 12 years from its entry into force. For two lists of products, including 1095 and 1850 tariff lines, respectively, Algeria had been given 7 years (until September 2012) and 12 years (until September 2017) to dismantle tariffs. At Algeria's request, however, the EU agreed in July 2012 to extend these liberalisation schedules. Algeria has also requested a joint evaluation of the effects of the Association Agreement after 10 years of application, arguing that it has not brought to it the expected benefits.

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