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e main policy implication of this is unsurprising: more e ort should be made to improve and deepen the existing trade agreements. More importantly, the North African countries need to accelerate domestic reforms. ese reforms are needed anyway to boost economic growth and employment, irrespective of trade agreements, but reform can also work to maximise the bene ts from the agreements.

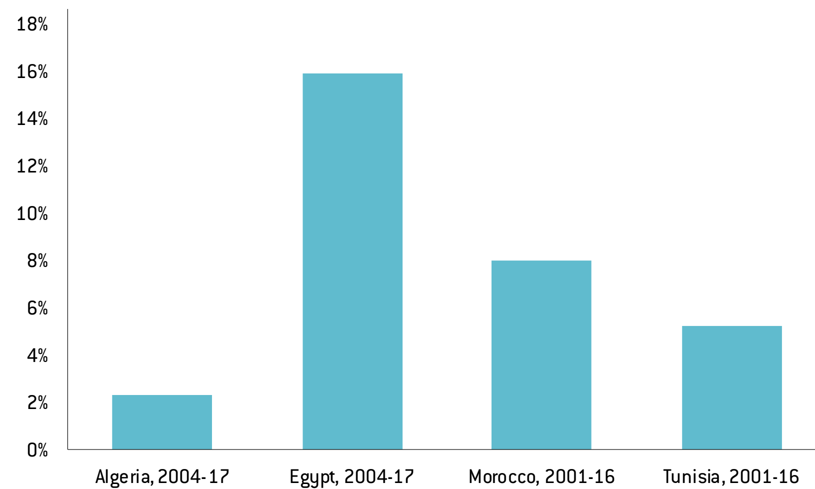
2 The literature takes a dim view of the EU-North Africa agreements

Although the trade regimes of North African countries continue to be ranked among the most protective, they are more liberal than in the past. Trade liberalisation has progressed signi cantly as a result of numerous bilateral and regional agreements, membership of the World Trade Organisation and adoption of its disciplines, and instances of autonomous trade reforms. For example, in Morocco and Tunisia, Most Favoured Nation (MFN) applied tari s (tari s that are applied to all World Trade Organisation members) on non-agricultural products were cut from about 21 percent in 2006 to about 8 percent in 2017. Even against this background, the literature reaches generally negative conclusions when assessing the trade performance of North African countries. Several of the studies nd that current trade volume is well below its potential given the countries' relative sizes, geographic distances from centres of demand, common language and colonial links (Cestepe , 2015). ey also nd that there is a low degree of intra-regional integration, re ecting non-complementary production structures and many non-tari barriers[4]. Associated wdCs0 0 9 180.7087 441.7 (. S)-6EMC /facpplieotd w

Table 1: Trade agreements between the EU and Mediterranean countries

C	Ag ee e g ed	O c a e f ce[1]
T a	J 1995	Dec 1997
I ae	N 1995	

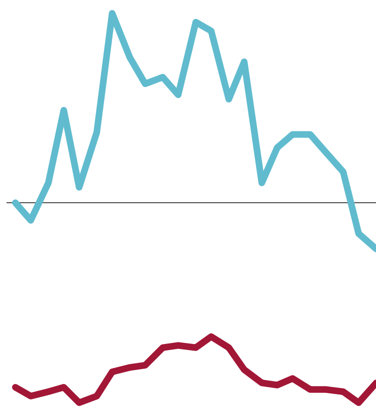
Figure 1: North African countries, average annual growth in exports to the EU (energy included)



Source: Bruegel based on Eurostat.

Figure 2: Bilateral trade balance of Algeria, Egypt, Morocco and Tunisia with the EU, 1994-2016 (% GDP)

Source: Bruegel based on https://wits.worldbank.org/, Comtrade and WDI. Note: Trade is calculated on the basis of the SITC Revision 3 nomenclature.



Trade expansion

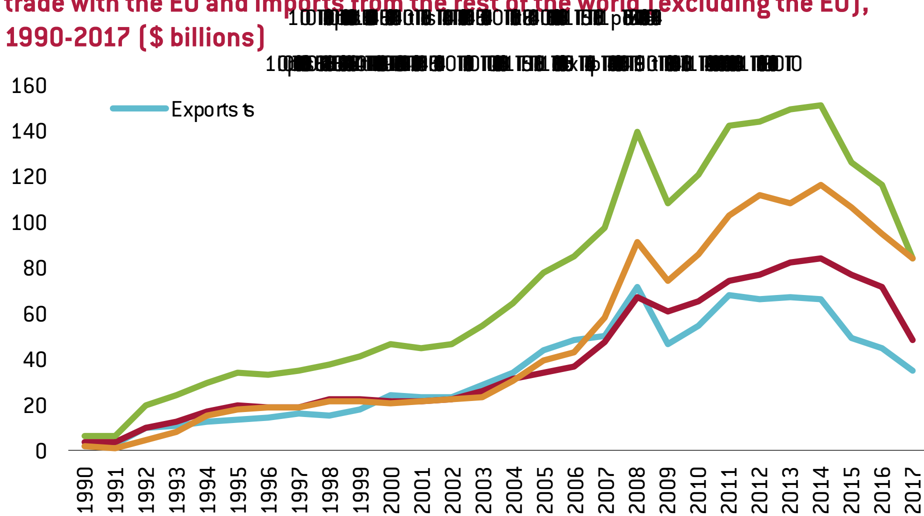
Well-established theories of tari s and of the costs and bene ts of trade agreements point to the expansion of trade between the parties, not bilateral trade balances, as the most important single indicator to measure the gains of trade liberalisation. When a small country lowers tari s to zero unilaterally, the price of imports falls by the amount of the tari , favouring consumers and rms that import parts and raw materials for producers. is gain, the largest immediate bene t of liberalisation, is measured approximately by the tari multiplied by the volume of imports. e losses associated with unilateral MFN trade liberalisation consist of tari revenue, equal to the tari multiplied by the initial value of imports, and the decline in domestic production of the imported products, measured approximately by the decline in

the volume of domestic production of the imported product multiplied by the tari [8]. Standard theory shows that because importing is cheaper than producing at home, the gains to consumers are greater than the losses to domestic producers and the loss of tari revenue. e gains from tari reduction accrue even when the tari is reduced unilaterally, without reciprocation by trading partners.

e gains and losses from a bilateral trade agreement can be calculated in the same way as the unilateral MFN elimination of tari s with two important di erences. First, there is the additional gain of increased exports in the partner's market(measured approximately as the increase in the volume of exports to the partner multiplied by the tari as previously applied by the partner). Second, there is the cost of granting tari preferences to the partner where the partner is not the most e cient producer of that product, known as trade diversion. is is measured approximately as the tari multiplied by the reduction of imports from third parties.

us, the net gains from a bilateral trade agreement will be unambiguously positive if there is little or no apparent trade diversion, and the gains are likely to be greater the greater the amount of trade generated between the partners. Figure 3 shows that North Africa's trade with the EU grew rapidly in the wake of the agreements, and so did its imports from outside the EU, indicating signi cant trade creation and suggesting no trade diversion. Some North African countries, most notably Morocco, have reduced their MFN tari s in recent years with a view to limiting trade diversion. Figure 2 also shows that, while North Africa's imports from the EU grew more rapidly than its exports to the EU, the former grew far less rapidly than imports from outside the EU. e e ect of the Arab Spring is evident in the sharp deceleration and then decline of trade in recent years.

Figure 3: Trade performance of North African countries: exports, imports and total trade with the EU and imports from the rest of the world (excluding the EU), 1990-2017 ($ billions)



Source: WITS, Comtrade. Note: total trade is calculated in accordance with SITC Revision 3 nomenclature.

8 For a precise exposition see, for example, Krugman (2008).

Caveats

rate about 1 percent slower than the lower middle income average. A similar calculation for Algeria suggests that the return of capital was even lower than in Morocco. A historical look at Tunisia and Egypt suggests that they used capital more e ectively than Algeria and Morocco, but their domestic savings rates were far lower and both countries exhibited high and di cult to sustain global current account de cits, which have led them to resort to the International Monetary Fund to nance their balance of payments.

e risk that trade liberalisation might cause large adjustment costs, protracted unemployment and unsustainable current account de cits can provide valid grounds for pacing trade liberalisation, which of course also entails delaying the gains from increased trade. However, these obstacles do not negate the arguments in favour of the agreements. Instead, they show that the main issues that need to be addressed are the domestic causes of investor reticence, labour and product market rigidity, and weak competitiveness. As it happens, the EU-North Africa agreements did envisage immediate liberalisation by the EU but long implementation periods, over a decade or so, for the North African nations. However, their domestic reform processes have not yielded the hoped-for results.

Unfavourable investment climate

An extensive literature has shown that there is no automatic ('unconditional') convergence in income level between rich and poor countries, even when trade between them is liberalised – underscoring the importance of domestic conditions and reform (Sachs , 1995; Rodrik, 2011). In extreme cases, where a country is beset by profound political upheaval and investor uncertainty, as during extended periods during the Arab Spring or during the protracted civil war in Algeria, it is unlikely that investors in the export sector will take the risk, even if trade liberalisation causes the currency to devalue and provides easier access to imported parts and raw materials. Nor, in the event of trade liberalisation, are investors likely to take the risk of upgrading the import-competing sector to face the in ux of competitive products from abroad.

Various measures of progress in domestic reform, such as the World Bank's *D B* and the World Economic Forum's *C R*

Figure 6: Global Competitiveness Index, 2007-17

Source: Bruegel based on World Economic Forum, the *Global Competitiveness Index* (GCI) dataset 2007-17. Note: The GCI investigates 12 aspects of competitiveness: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market e ciency, labour market e ciency, financial market development, technological readiness, market size, business sophistication and innovation. The score ranges from 1 to 7 (best). LE10 includes the 10 countries that joined the EU in 2004: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

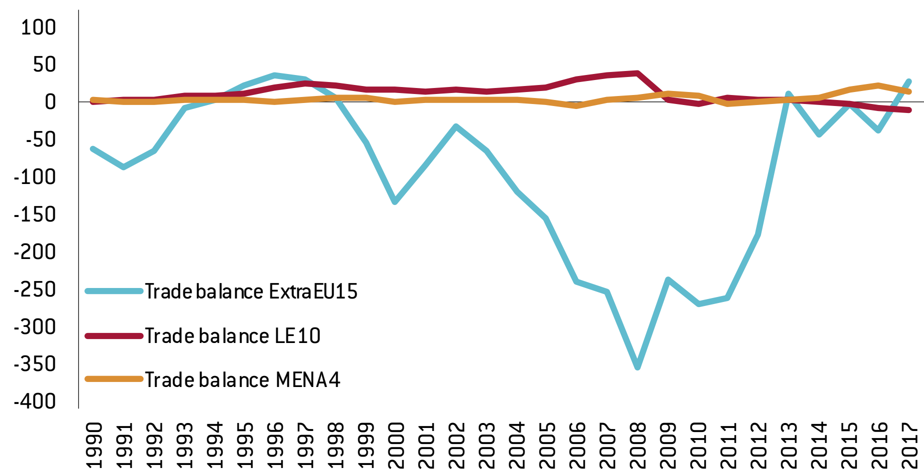
It should be noted that the North African country averages shown in Figures 5 and 6 mask significant differences between Algeria, which is ranked among the lowest-scoring countries in the world by both the World Bank's *D B* report and the World Economic Forum's *C R*, and Tunisia, which is ranked near the median. Morocco, which is the highest ranked North African country by both organisations (rank 69-70), is ranked higher than comparable lower middle income countries. Egypt is also ranked very low (115-128) relative to its income level.

A difficult international environment

In addition to domestic impediments, four developments external to the North African region and to the agreements have clearly dampened the region's export performance: low growth in the EU, the accession process, China's rise and the end of the Multifibre Arrangement.

First, following a period of recovery in the wake of the 1991-93 recession, EU growth

Figure 8: EU15 bilateral trade balances with MENA4, the 10 countries of the 2004 EU enlargement and the rest, 1990-2017 ($ billions)



Source: Bruegel based on https://wits.worldbank.org/, Comtrade. Note: total trade is calculated in accordance with SITC Revision 3 nomenclature. EU15: pre-2004 EU members. LE10 = 2004 EU enlargement countries: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

Figure 8 shows that the EU15's trade balance with the 10 central and eastern European countries of the 2004 EU enlargement increased following their accession. e trade balance of these economies with the EU turned into a small de cit as those countries have adjusted. Meanwhile, the EU's trade balance with the rest of the world fell into a large de cit, which has returned to balance in the wake of the nancial crisis, as domestic demand slowed, especially in southern Europe.

Figure 9: EU15 bilateral trade balance with the 10 countries of the 2004 enlargement, with Bulgaria and Romania (2007 enlargement) and Croatia (2013), 1995-2017 ($ billions)

Source: Bruegel based on WITS, Comtrade. Note: LE Bottom5: the five poorest 2004 enlargement countries (Estonia, Slovakia, Lithuania, Latvia and Poland) based on average PPP adjusted GDP per capita (1995-2016 or 1995-2004) reported by WDI. LE Top5: the five richest 2004 enlargement countries (Cyprus, Czech Republic, Malta, Hungary, Slovenia). Dashed lines represent post-accession trade balances.

Figure 9 shows that all countries that have joined the EU since 2004 have seen a continuing trade de cit with the EU15, with the notable exception of the ve countries with average

PPP adjusted GDP per capita higher than $23,000 (1995-2016) (Cyprus, the Czech Republic, Hungary, Malta and Slovenia), which had de cits at rst, followed by surpluses[9].

Since the North African countries were poorer than the countries that have joined the EU since 2004 in the respective periods, it is perhaps not surprising that their trade balances followed a pattern similar to those of the poorest new EU members. Moreover, trade complementarity indices[10] suggest that Morocco, for example, competes with most of the newer EU members, although less so than China and some of the largest East Asian economies. e index is not a perfect measure of complementarity because it does not take into an account the potential consequences of the distance between the countries and other factors that might impact trade ows.

e largest eastern European EU countries – the Czech Republic, Poland and Hungary – and non-EU eastern European countries with no free trade agreement with the EU – Belarus, Moldova and Ukraine – all outpaced their Mediterranean partners in export growth between 1997 and 2007. e Czech Republic, Poland and Hungary's average export growth was 18 percent, while for Belarus, Moldova and Ukraine it was 23 percent, versus 12.7 percent for the Arab countries with EU trade agreements. e same divergence held for imports from the EU. Arab countries' imports from the EU grew by less than 10 percent between 1997 and 2007, while those of the three eastern European EU countries and the three non-EU countries countries grew by 14.6 percent and 20.1 percent respectively. is divergence occurred despite the fact that the Arab countries roughly matched the eastern European groups in aggregate growth, which should – all other things being equal – have made them equally attractive to the EU as trade partners.

ird, North African countries, along with the rest of the world, have experience a large shift in world trade patterns and sharp declines in their export shares as a consequence of China's emergence. From 1992 to 2017, China's share of world trade increased from about 3 percent to about 13 percent. is has translated into substantial adjustment costs and has had distributional consequences, the e ects of which are mostly visible in the industries/ rms that are highly exposed to foreign competition.

Fourth, a related external shock was the end of e Multi bre Arrangement (MFA) in 2004. e Arrangement had governed the international trade in textiles and clothing[11] since 1974, setting quotas for each country. Quotas were fairly broad, covering a wide range of products, and were speci ed not in terms of the values but in terms of the physical quantities (Harrigan and Barrows, 2009). Figure 10 shows that as quotas were removed progressively, China's share of textile and clothing exports increased almost vefold from about 7 percent in 1990 to 33 percent in 2017. China's share increased massively during the nal phase of quota reductions (Brambilla , 2010), but the largest increase in Chinese textile and clothing exports took place from 1991 to 1992. At the same time, the share of the four North African countries declined only slightly. Still, while North African textile and clothing exports were roughly equivalent to a quarter of Chinese exports in 1990, by 2017 North African textile and clothing exports were equivalent to only about 5 percent of Chinese textile and clothing exports. Meanwhile, textiles and clothing shares in the total manufacturing exports of the North African countries and China have been declining.

9 is is in line with the analysis of Papazoglou (2006), who attempted to quantify the potential gains of the 2004 enlargement. Both EU and accession consumers and producers were bene ciaries, but import growth relative to the export growth was higher for countries that were initially less integrated with the EU.

10 Trade complementarity index for each individual year can be obtained using the following formula:, where x is the value of exports of product k from reporter country i, and X is country i's total exports. Partner country j's value of imports of product k is given by m, and its total imports value is denoted by M. A score of 100 points to the ideal trading partner. Computation performed at HS 2 digit level by WITS build in tool.

11 Textiles and clothing includes textile bres, yarn/fabric/articles, and apparel/clothing/accessories, which correspond to 26, 65 and 84 two digit categories of the SITC Revision 3 nomenclature respectively.

Figure 10: Selected economies, textile and clothing exports, shares of total textile and clothing exports

Source: Bruegel based on https://wits.worldbank.org/ and Comtrade.

Slow diversification

Against the background of political uncertainty, weak competitiveness and a challenging

diversified, though the growth of market share of EU imports has been limited or mostly negative for some product categories. At the same time, Egypt increased its market share in petroleum goods, historically a major export sector for Egypt. In recent years, however, the most significant increase occurred in Egyptian exports of electrical machinery to the EU, with the growth rate reaching 80 percent.

Weaknesses of the present trade agreements

Given the asymmetric nature of the trade liberalisation required by the agreements, it is surprising that the North African countries did not receive more as a [illegible] for allowing the EU unrestricted access to their markets for manufactured products. This could have come in four main areas: agriculture, liberal rules of origin, labour mobility and increased assistance and incentives to strengthen competitiveness. In fact, while there was reciprocation in each of these areas, commitments made by the EU were less than what could have been expected. Since the original agreements were concluded, there has been further improvement in the agreements in some areas, especially in agriculture with Morocco and Egypt and on the rules of origin throughout the region. Financial assistance to Morocco and Tunisia increased after the Arab Spring but remains modest in relation to the size of those economies.

A[illegible] tariffs of five to 20 percent typically protect fruits and vegetables in the EU. An entry price system for those fruits and vegetables the EU deems particularly 'sensitive', such as oranges and lemons, provides an even higher degree of protection for those products. Though the North African Countries enjoy some preferential access in agriculture, all exporters to the EU have to contend with extensive subsidies provided to EU producers. While increasingly decoupled from production under recent reforms, there nevertheless help cover overhead costs for EU agriculture. According to the OECD, EU support for farmers accounted for 24 percent of gross farm receipts and around 50 percent of value added, on average, annually in the late 2010s. For North Africa, access to the EU is especially important for goods such as fruits, vegetables and vegetable oil. The North Africa agricultural sector supports a significant part of GDP and an even larger share of employment. For example, in 2016, agriculture accounted for about 11 percent of value-added in Egypt and 13 percent in Morocco. In addition, it accounted for 25 percent and 37 percent of employment respectively in these two countries[12].

In both Egypt and Morocco, the deepest poverty occurs in rural areas, implying that the restrictions on agricultural trade have much more severe social implications than their export or GDP shares might suggest. In addition, barriers to agricultural exports in their most important market reduce the ability of North African countries to promote agricultural processing industries, which could also help tackle underemployment in rural areas. Were the North African countries able to compete with the EU on an even playing field, agriculture's share of domestic value-added would almost certainly be significantly larger and rural poverty correspondingly lower.

Restrictive rules of origin and limited cumulation can restrict North African countries' effective market access to the EU. Until quite recently diagonal cumulation existed across only some countries[13] and rules of origin (ROO) under the agreements with the EU differed across the North African countries. The ROOs for Egypt were not the same as those for Tunisia and Morocco, for example. Adherence to specific and complex ROOs placed a burden on exporters who might not be familiar with the specific rules and requirements. The Pan-European-Mediterranean (PEM) ROO system, introduced progressively since 2010, intended to remedy many

12 [illegible]

13 The agreement with Maghreb countries allowed limited cumulation. Diagonal cumulation refers to the use of inputs from other member countries towards the value-added target.

have very limited provisions relating to public procurement. The EU-Morocco agreement, for example, states only that the parties shall set as their objective a reciprocal and gradual liberalisation of public procurement contracts. Though the association agreements require that North African countries' laws approximate EU standards in areas such as technical rules and standards and services, no binding requirement exists. Meanwhile, business surveys reveal that international investors view the inadequacy of North African countries' judicial systems and the weakness of their investment codes as a major obstacle.

Given the highly cartelised nature of important sectors in North Africa, competition policy is especially important. But, as in other areas, while some of the EU-North Africa association agreements commit partners to introduce competition legislation similar to that of the EU, others contain only a very general statement of intent. Under the agreements with Morocco, for example, the country commits to 'import' EU legislation where it could touch upon trade with the EU (Szepesi, 2004).

Intended in part to remedy these weaknesses, the EU is currently negotiating Deep and Comprehensive Free Trade Agreements with Morocco and Tunisia, on which progress has been slow for political and technical reasons.

3 Conclusion

This brief review of the EU-North Africa trade agreements points to some fairly evident policy conclusions.

The single most important factor determining the region's growth and stability is what the North African countries do themselves. Their domestic reforms will ultimately determine regional success or failure. Though changes in market access and trade rules are essential, the necessary domestic reforms range much wider. To incentivise these reforms, and to gain increased and more predictable access to Arab markets, foster the region's security and therefore its own, reduce the likelihood of large disruptions in oil markets, and avoid periodic waves of refugees clamouring for help, the EU must offer concrete things. The assumption must be that, if reforms succeed, diversification will follow and trade structures will become more complementary. In turn, these will promote regional integration.

The ideal is to aim for complete free trade between the North African countries and the EU, combined with low tariffs on goods from the rest of the world. One possible exception will relate to imports of certain agricultural products which enjoy large subsidies in the EU and which the North African countries will be allowed to protect with countervailing duties or subsidies, to be renegotiated over time as the EU's agricultural subsidy regime evolves. Even though most agricultural support in the EU is decoupled from production, it is nevertheless distortive to some degree because it encourages farming that might not occur otherwise.

This also implies that the North African countries should aim to converge towards the EU's low external tariff, thus substantially lowering their average MFN tariffs on goods from the rest of the world. Such a process will also provide an incentive to other large trading partners to support the transition in various ways, and would also reduce trade diversion. It is possible that this process of internal and external liberalisation could result in a [illegible] or [illegible] customs union between the EU and the North African countries, similar to that between Turkey and the EU, and removing the need for origin certification, even if such a scenario appears far-fetched at present.

Further liberalisation of the North African countries' foreign investment regimes should also be part of deeper agreements. This should be done to a degree comparable to that of the EU, allowing all comers to enter the services market and other markets, with a limited negative list. Clearly, barriers to entry into service sectors deter inward FDI in those sectors.

The North African countries should also commit to undertake far-reaching behind-

the-border reforms. A possible guide to these reforms is the EU rule book (the [illegible]). e reforms required could draw on the experience of the accession countries that subsequently became EU members, allowing for longer implementation periods and with wide scope for modi cation to re ect the less advanced capacity and lower incomes in North African countries.

In addition to unfettered access to its markets the EU should in return, establish a generous quota for the temporary movement of skilled workers (known as Mode 4 provision of

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