Executive Summary

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Economic integration among the countries of the Maghreb region of North Africa, as well as closer economic ties between the region and the broader world economy, are vital to the prosperity and stability of the region. Currently, the Maghreb countries—Morocco, Algeria, Tunisia, Mauritania, and Libya—trade little with each other. In fact, the rate of trade is one of the lowest in the world. The countries have many nontariff and regulatory barriers in place that impede trade and investment flows. Unemployment is high and, unless action is taken, promises to increase because of a burgeoning demographic bulge in the region. Extremism threatens to further limit economic growth and foreign investment. Economic integration in the Maghreb can help address these challenges by capitalizing on economies of scale, attracting increased investment, and turning the region into a more prosperous and stable economic zone with an improved standard of living for its inhabitants.[1]

The Maghreb countries will need to work together to break down barriers to trade and investment in the region by strengthening the free trade

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1. Speaking at the Peterson Institute for International Economics on May 29, 2008, Deputy US Trade Representative John Veroneau and Assistant Secretary of State Daniel Sullivan both endorsed Maghreb regional integration as a promising path to economic progress and political stability.

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agreements (FTAs) already in place. However, the United States, the European Union, and international institutions, such as the International Monetary Fund (IMF) and the World Bank, are also important to promote economic integration in the Maghreb. Recently, the United States expanded its economic engagement in the region, including through a trade and investment dialogue with Libya and the recent Millennium Challenge Corporation (MCC) grant to Morocco. The European Union already is involved deeply in the Maghreb through the Euro-Mediterranean Partnership. The IMF and World Bank also have valuable experience in the region and continue to facilitate regional economic dialogue. Such efforts have well positioned the United States, the European Union, and international institutions to assist the Maghreb countries in integrating their economies and developing closer ties with the world economy. Now is the time for further decisive action to promote stability and prosperity. The United States and the European Union should complement their bilateral programs with regional initiatives, as there is an opportunity for such initiatives to provide a road map, incentives, and technical assistance to the Maghreb to promote regulatory harmonization and reduce barriers to trade and investment. As the studies described in this book demonstrate, large benefits would flow to the region from such integration efforts—and the costs of nonintegration are high.

This book provides general and sector-specific recommendations as to how the potential benefits of regional integration could best be achieved. It has a dual focus. First it analyzes the gains from closer economic integration among the Maghreb countries. Second it examines the additional benefits from closer economic ties between the region and the world economy, in particular the United States and European Union. The study underlines the need for economic reforms that reduce tariff and nontariff barriers, create a better investment climate, and foster regulatory harmonization, both to increase intraregional economic ties and to enhance the region's attractions for global firms. The study also examines specific economic sectors that may particularly benefit from Maghreb integration.

Political Economy: The Maghreb without Economic Integration

The Maghreb experienced average annual GDP growth of 2.5 percent between 2001 and 2005, a disappointing record compared with that of South and East Asia. Among the various explanations that can be offered, constraining features include rigid economic structures, slow productivity growth, and modest investment levels. Agriculture remains important, especially in Morocco and Tunisia, but agricultural productivity shows few gains. Libya and Algeria derive substantial revenue from oil and gas, a blessing when the price of oil is $140 per barrel but not a source of gain-

ful employment for millions of new entrants to the labor market. Other constraints are very meager levels of cross-border trade and investment within the region. Intraregional trade among the Maghreb countries was only 1.3 percent of their total merchandise trade in 2007, one of the lowest rates in the world. Cross-border investment figures are not reported, but the amounts are small. Tariffs within the Maghreb have been sharply reduced, but individual countries still maintain nontariff and regulatory barriers that impede regional trade and investment flows. Moreover, Maghreb countries do not view their immediate neighbors as markets or sources of supply, largely because each country has its own historical links to the rest of the Arab world, the rest of Africa, and Europe. Political tensions between Algeria and Morocco—which together represent 77 percent of the region's population and 66 percent of the region's GDP—are a major obstacle to economic cooperation in the region.

Unemployment is high, often above 20 percent. Population growth is expected to be high in coming decades, adding more pressure to unemployment figures. The challenge created by this demographic bulge would be better met if tackled at the regional level with the help of international players. Economic opportunities for the growing population of young urban men are few, which can make radical ideologies appealing. Terrorism and extremism are on the rise, and if unchecked, they will undermine political stability—which, along with feeble economic performance, damages the region's ability to attract trade and foreign direct investment (FDI).

To combat the terrorist threat, countries in the region have tightened border restrictions on the movement of people and goods, further reducing commerce and depressing economic activity. The United States and the European Union have encouraged the Maghreb countries to focus on antiterrorism measures, which has had the unintended consequence of taking the spotlight off economic reform. Without faster growth, long-term political stability will remain elusive.

Regional Integration

There have been numerous political attempts to achieve Maghreb integration (see table 3.1 and figure 3.1 in chapter 3). Unfortunately most have not realized their objectives.

The Arab Maghreb Union (AMU), the only initiative that includes all five Maghreb countries, reached a stalemate in 1994 because of cumbersome decision-making rules and political tensions among members. There are recent signs of better cooperation, but much remains to be done.

The Greater Arab Free Trade Area (GAFTA), which includes Libya, Morocco, and Tunisia, has made the most progress. In 2005 the countries created a duty-free zone for all industrial and agricultural goods. Services and investment are excluded, however, and nontariff barriers remain high.

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EU association agreements with Algeria, Morocco, and Tunisia have made good progress in liberalizing merchandise trade (excluding agriculture), but little headway in services and investment. The partners agreed to a series of trade facilitation measures, now in the process of implementation. Libya and Mauritania do not have association agreements, although each country benefits from a special status relative to the European Union.

The Agadir Agreement of 2004 among Tunisia, Morocco, Egypt, and Jordan builds upon other agreements, such as the GAFTA and Euro-Med association agreements, and remains open to countries that sign Euro-Med association agreements and are GAFTA members.

Comparison with Other Regional Initiatives

In both Southeast Asia and Central America, an acute need for regional political stability was decisive in promoting integration. Among the results were the Association of Southeast Asian Nations (ASEAN) followed by the ASEAN Free Trade Area (AFTA), while in Central America, the Central American Common Market (CACM) served as a precursor to the Central American Free Trade Agreement (CAFTA) with the United States. Similar forces are at play in the Maghreb. If it becomes a unified economic region, the Maghreb stands to enjoy enhanced bargaining power regionally and worldwide, particularly with respect to the United States and the European Union.

Both the Southeast Asian and Central American agreements coped with different economic levels among their members and surmounted internal resistance to liberalization. Both regions successfully confronted differences in internal political systems and differences in relative power. That said, external assistance with institution building and trade facilitation was important to advancing the integration process of both regions.

Gravity Model Analysis

Given the Maghreb's small economic size, a gravity model analysis suggests that a full-fledged free trade area among the Maghreb countries would yield a gain in total merchandise trade of some $1 billion. Even this modest figure would almost double the extent of commercial relations within the region and might pave the way for a future deepening of ties. Moreover, the calculated impact on Mauritania's total trade ($122 million) and Libya's total imports (also $122 million) are significant as standalone gains.

FTAs between the European Union or the United States on one hand and the major Maghreb countries (Algeria, Morocco, and Tunisia) on the other seem the most feasible from a political economy standpoint and would

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generate much larger gains. Based on gravity model calculations, total Maghreb trade would expand by $4 billion to $5 billion (3.0 to 4.5 percent) if the European Union and the United States were to separately establish free trade areas with the AMU countries, and by nearly $9 billion (nearly 8 percent) if both were to establish regional FTAs with the AMU countries. This includes increases in exports from the Maghreb to the US and EU markets as well as increased imports from the United States and Europe.

Inward FDI stocks likely would increase substantially if closer economic ties were pursued with the European Union or the United States rather than simply within the Maghreb. In the most ambitious scenario of a possible EU-US-Maghreb free trade area, total Maghreb inward FDI stocks increase by $5.8 billion (75 percent) and total Maghreb outward FDI stocks rise by $3.9 billion. The significant outward FDI stocks indicate that the Maghreb countries would not alone reap the benefits of trade; both the US and European economies stand to gain as well from enhanced integration with the Maghreb region.

If the agreements depicted in these scenarios are implemented, the trade and FDI impacts of Maghreb economic integration can be expected to materialize over horizons of two to five years.

Mirage Model Analysis

The Mirage model is a computable general equilibrium (CGE) model that represents the structure of production and trade in the Maghreb countries and their external partners. The static version of this model (covering only merchandise trade) suggests that free trade, fully implemented only among the Maghreb countries, would only create a small amount of new commerce. However, a regional agreement between the Maghreb countries and the European Union would have a much larger payoff: A regional FTA could increase the exports of Morocco and Tunisia by around 40 percent, and a regional agreement with the United States would have substantial but smaller payoffs.

However, the static Mirage model does not account for the benefits of greater competition and possible returns to scale. A dynamic Mirage model was therefore devised to assess the role of policies that complement merchandise trade liberalization, namely the liberalization of services and trade facilitation, plus the effects of reducing monopolistic barriers and increasing domestic investment. In the most ambitious scenario, an EU-US-Maghreb FTA, the model predicts dramatic changes. Terms of trade losses for the Maghreb countries are offset by productivity gains, resulting in larger exports and higher GDP. The positive GDP impact reaches 10 percent in Libya, nearly 8 percent in Tunisia, 6 percent in Algeria, and around 4 percent in both Morocco and Mauritania. The gains

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from complementary policies and the dynamic payoff from enhanced investment benefit oil-exporting countries to the greatest extent. However, Morocco and Tunisia realize the largest export increases.

Recommendations

This book begins by examining the potential for integration within specific sectors that are particularly important to all five economies: energy, banking and insurance, transport, and food. Then global recommendations are made related to the role of the United States and the European Union in working with any Maghreb partner to promote regional integration through trade and investment agreements.

Sector-Specific Recommendations

Achieving progress on a sector-by-sector basis should prove feasible in the short term and prepare the ground for full liberalization in the medium term. The sector studies contain limited reference to Libya and Mauritania because data are not available, but the recommendations should apply to those two countries as well.

Energy

Energy remains the Maghreb's most significant strategic sector. Sonatrach, Algeria's state oil and gas company, could agree to sell greater quantities of gas to Morocco through the Maghreb-Europe Pedro Duran Farell Pipeline, which runs from Algeria to the Iberian peninsula. Currently Morocco levies a 7 percent transit fee, paid in kind, on the throughput of Algerian gas. At first Morocco sold the gas received as its transit fee to Spanish companies; today Morocco uses some of this gas (about 0.5 billion cubic meters annually) for the Tahaddart combined-cycle thermal plant. Soon Morocco will use all the transit fee gas when the combined-cycle thermal plant at Aïn Beni Mathar is completed. As a confidence-building measure, the state-owned Algerian gas company Sonelgaz should be invited to invest capital in this new venture. If the capacity of the pipeline were increased—thereby increasing the levies—and Morocco were allowed to contract gas from Algeria, Morocco could receive 50 to 70 percent of its estimated gas needs from Algeria by 2020. To boost confidence further, Sonatrach could be invited to invest capital in the underwater section of the Pedro Duran Farell Pipeline. Sonatrach already holds a 50 percent stake in the underwater section of the Trans-Med Pipeline (Enrico Matteï), which has carried gas from Algeria to Italy through Tunisia and under the

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strait of Sicily since 1983. Office National de l'Electricité, the state-owned Moroccan electricity company, had envisaged building a combined-cycle plant to produce electricity at Al Wahda. It proposed to buy gas from the pipeline and pay the same cost and freight that Spanish buyers pay when receiving liquefied natural gas from Algeria. Algeria refused, but this project could be revived and would lead to greater economic efficiencies.

Multiproduct pipelines carrying liquefied petroleum gas, gasoline, and diesel could link different centers of gas bottling and distribution situated on either side of the Algeria-Morocco border. This would not only help to meet local energy needs, but also diminish the extensive smuggling trade in oil and gas products. Pipelines feeding off the current Maghreb-Europe pipeline could be built to supply major Moroccan cities, such as Fez.

Finally, connecting the different north-south gas lines, both current and under construction, could increase by 2020 the volume of trade in the western Mediterranean to 18 million tons of oil equivalent, or 20 percent of all energy requirements in the region.

Banking and Insurance

Maghreb banks currently hold large amounts of unused liquidity and some of this could be put to productive use. New financial instruments could be created that are recognized and traded in the three countries (Algeria, Morocco, and Tunisia). Inspiration could be drawn from the Asian Bond Initiative and Asian Bond Funds created by ASEAN+3. A North African equivalent to the United Kingdom's Financial Times Stock Exchange (FTSE) index or France's Continuous Assisted Quotation (CAC 40) would help draw financial markets closer. Beyond this, ensuring full currency convertibility, at least for Algeria, Morocco, and Tunisia, would ensure greater transparency and bolster capital markets.

Following the above steps, the reform process could build upon the inevitable privatization of the Algerian banking system, an event that could spark the creation of two or more private regional banks with shareholdings in the three countries. A prime task of these banks would be to encourage and engineer mergers and acquisitions across North Africa. Finally, a Mediterranean financial agency, adequately financed to be triple-A rated, would help to bring these and other initiatives under one roof. EU and US support for the new agency would signal a keen interest in promoting economic development.

Transport

The most obvious measure to promote regional integration is to reopen road and rail services between Algeria and Morocco, which would require only a

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few weeks' work. The frequency of flights between Algiers and Casablanca should also be increased. These steps would turn the border into a manageable line of demarcation, as opposed to the unmanaged area that it is today.

The motorways being built in all three countries need to be connected, both near the coast and inland. Such links would boost trade and investment. Ports could cooperate far more than they do today and promote transshipment, which would insert them more fully in the global value chain.

Regarding air traffic, a joint air safety regulation authority would be a good start. Morocco has adopted an open skies policy. Tunisia is receptive to low-cost carriers. Persuading Algeria to join these efforts would reinforce what is already a very active north-south volume of traffic. Casablanca could become a hub serving West Africa and South America. Algiers could become a hub for North America and the Far East. Meanwhile, the Tunis/Monastir airport could become a favored destination for the mass tourism market.

Agribusiness

Agribusiness offers many opportunities for cooperation in the Maghreb, where patterns of production and consumption are similar and proximity is a potential asset. Economies of scale could be exploited. Vertical integration could draw upon the relative advantages of each country: water in Morocco, energy in Algeria, food processing in Tunisia. Multinational companies already consider the Maghreb as a whole; private food companies operating in the region could be merged. Greater value could be added to luxury products such as dates, olive oil, and camel milk.

Opening up borders would also help to rid the region of smuggling and encourage each government to rationalize product standards as well as subsidies designed to foster food production. Joint policies could be enacted, especially regarding the conservation of water, the protection of a fragile and often overfished coastline, and the further development of agriculture and tourism.

Global Recommendations

EU relations with Maghreb countries are currently governed by the Barcelona Process. The new Union for the Mediterranean is meant to freshly spur regional integration, but the project has been widely criticized. The main concerns focus on the possible duplication of institutions and the dual presidency concept.[2]

2. The dual presidency concept of the Mediterranean Union calls for a representative of a country from the Mediterranean's northern bank (a member of the European Union) and a representative of the southern bank (including the Maghreb) to share the presidency.

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The United States provides financial and technical assistance to the Maghreb through the Middle East Peace Initiative and the MCC. US relations with the Maghreb are summarized in table 13.1 in chapter 13.

Without delving into institutional details, it seems evident that US-EU-Maghreb integration could transform the Maghreb economies by creating new industries and service activities, promoting faster growth and more jobs. We recommend that the United States and the European Union work with their Maghreb partners, flexibly with respect to institutions, but in a manner designed to enhance regional integration. Bilateral trade and investment agreements or regional arrangements can provide the appropriate vehicles.

Tariff Barriers

A Maghreb partner of the United States or European Union should eliminate its own tariffs on selected products imported from other Maghreb countries. Within the General Agreement on Tariffs and Trade, the Enabling Clause could be used to defend the World Trade Organization (WTO) consistency of these provisions.[3] Ideally, tariff preferences granted by a Maghreb country to the United States or the European Union through a trade agreement would be extended fully by that Maghreb partner to its Maghreb neighbors. In practice, however, the Maghreb preferences might be limited to a subset of products covered by a US or EU bilateral FTA.

Rules of Origin

Rules of origin for shipping merchandise through cross-border supply chains can be particularly cumbersome when a country is a partner to several bilateral trade agreements. In the context of the Euro-Med Partnership, Algeria, Morocco, and Tunisia apply full cumulation among themselves and diagonal cumulation with the other pan-European countries. Those provisions should be extended to Libya and Mauritania as well.

The United States and any of its Maghreb partners, starting with Morocco, could negotiate agreements similar to the qualified industrial zone (QIZ) program that the United States has with Egypt and Jordan. The QIZ agreement allows duty-free entry to the United States for Egyptian goods

3. In a decision titled "European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries," the Appellate Body ruled that the Enabling Clause did not require countries to grant identical tariff preferences to all developing countries, but instead required that the level of preference be based on the specific development, financial, and trade needs of the developing countries in question. Available at www.ejil.org (accessed April 15, 2008).

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produced in a QIZ that uses Jordanian inputs.[4] In the same spirit, QIZs for other Maghreb countries, starting with an extension of the US-Morocco FTA, could help the Maghreb integrate regionally and with the global economy.

As a larger-scale version of the QIZ concept, the United States could allow for the cumulation of inputs across the Maghreb in meeting rules of origin. This approach could be coupled with a requirement that Maghreb countries lower their own tariff barriers for shipments within the region.

Aid for Technical Assistance and Capacity Building

In a World Bank study, Allen Dennis shows that the benefits of a regional trade agreement among Middle East and North Africa countries could be tripled if accompanied by meaningful trade facilitation measures;[5] detailed models for Morocco and Tunisia suggest that flexibility in capital, labor, and land markets would increase the payoff from trade liberalization six-fold.[6] Existing rigidities in factor markets include delays in securing finance, controls on land and construction, and restrictions on majority ownership by foreign firms. These econometric findings reflect the poor business climate that prevails throughout the Maghreb. According to the World Bank report, *Doing Business 2008*, which compares regulation and reforms in 178 economies, the Maghreb does not shine: Algeria, Morocco, and Mauritania rank in the bottom third and Tunisia barely makes the top half.[7] Mauritania is the lowest ranked Maghreb country. Among Mauritania's business handicaps are an inflexible labor market, low educational attainment, and extreme corruption and taxation levels.[8]

By emphasizing reform, the European Union has done a great deal to improve the business climate in Eastern Europe. Through the framework of the Union for the Mediterranean, it might do the same for the Maghreb.

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4. To qualify, a good must be "substantially transformed" and must have at least 35 percent of its value added in the QIZ factories.

5. Allen Dennis, *The Impact of Regional Trade Agreements and Trade Facilitation in the Middle East North Africa Region*, World Bank Policy Research Working Paper 3837 (Washington, February 2006).

6. Allen Dennis, *Trade Liberalization, Factor Market Flexibility, and Growth: The Case of Morocco and Tunisia*, World Bank Policy Research Working Paper 3857 (Washington, March 2006).

7. Libya is not included in the World Bank report.

8. Enterprise Surveys Country Profile: Mauritania, *World Bank Enterprise Surveys*, 2006, available at www.enterprisesurveys.org (accessed April 20, 2008).

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Bilateral US and EU trade agreements with individual countries could likewise contribute. A modest starting point would be systems for independent administrative and judicial review of customs determinations.

Investment and service-sector reforms are particularly important.[9] To this end, the United States and the European Union should encourage harmonization of regulatory regimes throughout the region to the highest possible standards. One practical step might be to create an institution to coordinate regulation across the region. This institution would seek to ensure that rules established by each Maghreb country meet minimum criteria, paving the way for a process of either mutual recognition by neighboring countries or general harmonization.[10]

In addition, the United States and the European Union should promote sector-specific investment and regulatory reforms, for service sectors in particular. The Euro-Med Partnership is seeking to complete the integration of electricity markets in the Maghreb.[11] As of now, only a few countries (Algeria and Tunisia) have linked their electricity grids. Morocco and Algeria are setting up a joint venture that would link the Algerian power grid to the European Union via Morocco.[12] The ultimate goal is to connect all North African countries to the single EU energy market. The project would facilitate electricity generation at low-cost plants and reduce outlays for spare capacity. A trans-Maghreb power grid would also provide energy security for the region. Similar benefits could be achieved for natural gas in both production and distribution.

Maghreb partners also could be asked to open their insurance and leasing sectors, not only to US and EU firms, but also to other Maghreb countries. To this end, regulatory regimes for insurance and leasing should be harmonized across the Maghreb.

9. Paloma Anós Casero and Ganesh Kumar Seshan, *Is There a New Vision for Maghreb Economic Integration?* World Bank Report 38359 (Washington, November 2006).

10. For details on a worldwide version of this institution, see Mike R. Gadbaw, Proposal to Create a WTO Center for Global Regulatory Excellence (paper presented at the Eight Annual WTO Conference by the British Institute of International and Comparative Law, London, May 13–14, 2008).

11. In December 2003 in Rome, Algeria, Morocco, Tunisia, and the European Commission (as nonparticipant promoter) signed a protocol of agreement for the progressive integration of the electricity markets of the three Maghreb countries into the EU electricity internal market. The long-term objective is to sign a Euro-Maghreb energy community treaty that would also include Libya and Mauritania. See "Establishment of the 'Rome Euro-Mediterranean Energy Platform' within the Framework of the Euro-Mediterranean Energy Cooperation," decree of the Ministry of Productive Activities of the government of Italy, October 15, 2004, available at http://ec.europa.eu (accessed on March 23, 2008).

12. "Algeria Plans Power Export to Spain Via Morocco," Reuters, May 10, 2008.

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The United States and the European Union could extend so-called fifth freedom rights to air carriers based in the region,[13] provided the home nations accorded similar rights to other carriers based in the region.

Capacity-building efforts and technical cooperation could be done through instruments similar to the Economic and Technical Cooperation (Ecotech) agenda of the Asia Pacific Economic Cooperation (APEC) arrangement. The Ecotech agenda was created to support the Bogor Goals for open trade and investment.[14] The United States and the European Union could provide assistance for a similar harmonization of standards throughout the Maghreb. One possible precedent is the US-ASEAN trade and investment framework arrangement (TIFA) applied to pharmaceutical and agricultural products.

While much of the Maghreb transportation infrastructure is good, the United States and the European Union could encourage the World Bank to launch selected projects to improve ports, airports, roads, and pipelines. Technical and financial assistance for transportation infrastructure should focus on transnational networks. In this spirit, in April 2008 the 10 Western Mediterranean countries—Portugal, Italy, Spain, France, Malta, and the five AMU members—signed a memorandum of understanding introducing a series of infrastructure projects, including a high-speed train and a motorway across North Africa.[15]

Improving the Efficiency of Intraregional Shipments

A final significant issue to be addressed is the need to decrease the time and cost of shipments between Maghreb neighbors and with the rest of the world. With US or EU encouragement and assistance a Maghreb country might agree to streamline its customs procedures to ensure faster release of goods, not only for goods arriving from the United States or Europe, but also for goods arriving from Maghreb neighbors. New procedures should strictly follow the principles of the Kyoto Convention, which state that customs authorities must maintain formal consultative relationships with importers and that custom formalities must be specified in national legislation and be as simple as possible. Consistent with these principles, Maghreb customs authorities should permit express shipments by qualified traders

13. Fifth freedom rights are the rights of an airline based in one country to land in another country, drop off some passengers and pick up others, and continue traveling to a third country, rather than returning to the home country.

14. Six priorities were identified: developing human capital, fostering safe and efficient capital markets, strengthening economic infrastructure, harnessing technologies of the future, promoting environmentally sustainable growth, and encouraging the growth of small and medium enterprises.

15. "Transport Infrastructure in Western Mediterranean," Agence Europe, April 19, 2008.

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and open all borders for certified truckers. The authorities should publish applicable laws and regulations on the Internet and permit electronic submission of customs information before shipments arrive, whether by land, sea, or air. Maghreb partners should apply risk management principles for customs control so that officers only inspect shipments that are considered medium or high risk. In addition, the Maghreb partners should allow broker guarantees to cover potential duties and taxes while goods are in transit through a country. This element is essential if firms are to take advantage of improved transportation management across the region. Were goods to be diverted or lost, the issuer of the guarantee could compensate the host country for duties or taxes that ought to have been paid.

Conclusion

Economic integration would allow Maghreb countries to reap significant trade, investment, and welfare benefits. Some measures to promote integration can be implemented relatively easily in a short period of time and would provide immediate gains for each of the Maghreb countries. Others will need to be approached with a longer time frame and with help from third parties through technical and financial assistance. The starting point is for Maghreb countries to work together, and with their trading partners and international organizations, to build an integrated and stable regional economy.

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