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NORTH AFRICA'S EXPORT ECONOMIES AND STRUCTURAL FRAGILITY

THE LIMITS OF DEVELOPMENT THROUGH EUROPEAN VALUE CHAINS

Shamel Azmeh and Abeer Elshennawy

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Abstract

Over recent decades, three North African economies – Tunisia, Morocco and Egypt – have been regional pioneers in adopting integration in global value chains as a path to economic development and transformation. Reflecting their geographical proximity to Europe, preferential access to the EU market, and large wage gap between them and European economies, each have emerged as important locations for labour-intensive activities in European value chains in the garments, electronics and automotive sectors. Reflecting the range of incentives offered, the coastal areas in the three economies witnessed a relatively large influx of foreign and domestic investment. As a result, the three economies experienced important economic transformation processes with an increase in their manufacturing sectors, manufacturing jobs and manufactured exports. Notwithstanding this relative success, the reliance on low-cost labour as a source of competitive advantage, in addition to these economies and their firms' weak position in European value chains, has limited the wider economic and social benefits of this growth and also left these countries in a structurally fragile position vis-à-vis shifts in the European market. This fragility was illustrated in recent years following the global economic crisis and the European debt crisis on one hand, and the protest movements of the Arab Spring on the other. In recent years, the exhaustion of this low-cost platform model has driven a divergence in the three economies with Morocco succeeding in upgrading its position in a number of European value chains while Egypt and Tunisia have been forced to maintain competitiveness though successive currency devaluations.

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Introduction

Non-oil economies in the Middle East and North Africa have long faced serious economic development challenges. Contrary to some of their resource-rich neighbours in the region, non-oil states lack the resources to enjoy high levels of income and to build relatively stable rentier-based political regimes.[1] As a result, building economic models that can achieve economic growth, create jobs and enable broader social development has always been a fundamental challenge facing their ruling elites as their political survival partially depends on the ability to deliver such outcomes.

This working paper focuses on three North African economies that, to different extents, fit this analysis: Egypt, Tunisia and Morocco. Despite having varying degrees of natural resources (in some cases substantial amounts), the economies of those countries cannot survive through the exports of natural resources and their political elites are not in a position to build a political economy based solely on these resources. Instead they face the constant challenge of delivering economic and social outcomes to help maintain their political power.

The strategy adopted in Egypt, Tunisia and Morocco has experienced important shifts throughout the twentieth century and the first two decades of the twenty-first century. Following independence from France and Britain, the three countries adopted state-led models of development, similar to many other newly independent states at the time. Towards the end of the twentieth century, however, reflecting broader global shifts related to the end of the Cold War and the dominance of more liberal economic thinking, these North African economies moved toward a liberal economic policy that focused on trade liberalisation and on promoting export-oriented industrialisation. Benefitting from proximity to the EU, historical business and trade linkages with European countries such as France, Spain and Italy, and preferential market access to the European market through the European Neighbourhood Policy (ENP), the three North African economies experienced a degree of growth in manufactured exports. As a result of their ability to integrate into EU-focused production networks, they experienced an increase in exports of labour-intensive industries such as apparel and electronics, with most of the production concentrated in special economic zones that are located in their respective coastal regions, which enable quick access to Europe.

Despite the relative success of this export-based economic model in boosting manufactured exports, the ability to build sustainable development through integration with EU-dominated global production networks has been limited. This paper argues that as a result of the three economies' high dependency on the EU, and their weak position within European-oriented production networks, they are in a structurally fragile position that undermines the sustainability of their economic model. These challenges were important factors in exacerbating economic and social problems that Egypt, Morocco and Tunisia experienced towards the end of the 2000s, subsequently contributing to their respective protest movements, known as the Arab Spring.

[1] Rolf Schwarz, 'The Political Economy of State-Formation in the Arab Middle East: Rentier states, economic reform, and democratization', *Review of International Political Economy* 15/4 (2018), pp. 599–621.

The rest of the paper is structured as follows: section two discusses the rise of export-oriented development as the dominant political economic regime in Egypt, Tunisia and Morocco; section three examines the structural fragility of these economies in relation to their position in EU-dominated global production networks; and section four discusses the trends that followed the Arab Spring and the search for alternative economic models in the region.

Export-Oriented Industrialisation and Integration in European Production Networks

Despite important differences, Egypt, Morocco and Tunisia all gained independence with economic structures and linkages that were not very different from the colonial core-periphery international division of labour. Despite some level of manufacturing and earlier efforts to industrialise,[2] the three countries were largely exporters of raw materials and agricultural products to the European market and importers of manufactured goods. European capital, and Europeans, were key in the economies of the three countries in finance, trade, agriculture, services and other sectors.

State-led Development in North Africa

Following independence, the three countries adopted strategies inspired by the state-led developmental approach, which was popular among newly independent states in the 1950s, 1960s and 1970s. These strategies combined various policies, including the nationalisation of private firms, an emphasis on the role of the state in setting up state-owned enterprises, import substitution trade policies and capital controls, as well as the role of development banks in directing investments. The nature of these policies, the political conditions under which they were implemented, and their duration, however, differed in each context. We now provide a very brief overview for each of the three cases.

Tunisia

Following independence in 1956, Tunisian politics was dominated by the Neo-Destour party which led the independence movement from France. The Neo-Destour party brought different elements of Tunisian society into the struggle for independence, namely the bourgeoisie and the organised labour movement; particularly the main trade union, known as the Union Generale des Travailleurs Tunisiens (UGTT). At the helm of Tunisian politics for the decades following independence was President Habib Bourguiba, in office from independence until 1987. Throughout this period, Tunisian economic policy shifted substantially with Bourguiba adjusting and reacting to domestic and international changes.[3] The state elite initially adopted a strategy that combined import substitution with the promotion of the private sector through favourable laws, tax incentives and credit

[2] Eric Davis, *Challenging Colonialism: Bank Misr and Egyptian Industrialization, 1920–1941* (Princeton, NJ: Princeton University Press, 2014); Eva Bellin, 'Tunisian industrialists and the state', in I. W. Zartman (ed.), *Tunisia: The Political Economy of Reform* (Boulder, CO: Lynne Reinner, 1991), pp. 45–66.
[3] Emma Murphy, *Economic and Political Change in Tunisia* (London: Palgrave Macmillan, 1999).

mechanisms.[4] Nonetheless, the limited success of this policy led to a more state-led development approach especially in the period from 1961 to 1969 when Ahmed Ben Salah, who was previously the general secretary of the UGTT, was appointed as a Minister of Planning and Minister of Finance and given the task of developing a plan for the Tunisian economy.[5] In 1962, Tunisia adopted its first economic plan which aimed to adopt a state-led development model through the increasing role of cooperatives and through state-owned enterprises.[6] This programme of state-led development was, however, abandoned within a few years due to internal opposition from important elements of the Tunisian elite and external opposition to Ben Salah's efforts to create agricultural cooperatives on land obtained, purchased or confiscated, from former French colonists.[7] Ben Salah's dismissal in 1969 effectively ended the Tunisian state-led development experience.

Morocco

Following independence from France in 1956, Moroccan politics was dominated by competition between the two political actors who played a key role in the struggle for independence: King Mohammed V and the Istiqlal Party. The Istiqlal Party brought a broad range of social groups into the independence struggle but was divided economically between a more radical left-wing faction supported by trade unions and student organisations, and another more economically conservative wing.[8] King Mohammed V, on the other hand, emerged as a prominent national figure, especially after his return from exile by the French. Political instability in Morocco continued for decades with conflicts between the royal Palace, the political parties, the military and the security apparatus. This led to a number of major constitutional changes in the country in the decades following independence.[9]

Economic policy in Morocco remained relatively liberal with less adoption of state-led development models. Yet at certain points the influence of state-led industrialisation strategies was evident. In 1958, following a series of political crises and failure to form a government, a politician from the left wing of the Istiqlal Party, Abdallah Ibrahim, was appointed by King Mohammed V as Prime Minister. Ibrahim adopted an ambitious economic plan that aimed to limit Morocco's dependency on the French economy, in terms of trade and capital, and resolved to foster industrialisation. These principles were reflected in the economic transition plan of 1958 (Plan biennal d'équipement 1958–1959) which aimed to rupture economic relations with the former colonial power and to promote

[4] Bellin, 'Tunisian Industrialists and the State', pp. 45–66.
[5] Jeffrey Cason and Gregory White, 'The State as Naïve Entrepreneur: The political economy of export promotion in Brazil and Tunisia', *Policy Studies Journal* 26/1 (1998), pp. 46–68.
[6] Gregory White, *A Comparative Political Economy of Tunisia and Morocco: On the Outside of Europe Looking In* (Albany, NY: State University of New York Press, 2014).
[7] Cason and White, 'The State as Naïve Entrepreneur'; Dirk Vandewalle, 'From the New State to the New Era: Toward a second republic in Tunisia', *Middle East Journal* 42/4, (1988), pp. 602–20.
[8] Richard Pennell, *Morocco Since 1830: A History* (London: Hurst, 2000).
[9] Lise Storm, *Democratization in Morocco: The Political Elite and Struggles for Power in the Post-Independence State* (London: Routledge, 2007).

industrialisation and the processing of raw materials.[10] The Bureau d'Etudes et de Participations Industrielles (BEPI) was created with a mandate to develop Moroccan industry through setting-up or contributing to manufacturing firms in areas where private enterprises had not entered, sometimes through partnerships with foreign firms, and a national economic development bank was also established.[11]

The Ibrahim government, and its broader economic programme, was, however, short-lived and Ibrahim was dismissed in 1960. In subsequent decades, the Moroccan state maintained an important economic role, partially as a result of its control of phosphate exports in which Morocco was the leading world supplier. In the 1970s, the state expanded its economic role through the process of Morrocanisation through which Moroccan ownership of a large number of firms was required.[12] Throughout this process, and despite signing an association agreement and a cooperation accord with the EU, the Moroccan state maintained a high degree of control over external trade.[13] This situation began to change in the early 1980s when a collapse in phosphate prices, amongst other factors, led to the adoption of trade liberalisation in Morocco as part of broader process of structural adjustment.[14]

Egypt

Compared to Morocco and Tunisia, Egypt adopted a far stronger state-led development strategy with the country becoming the prototype of 'Arab socialism' in the 1950s and 1960s, during the rule of Gamal Abdel Nasser.[15] Contrary to Tunisia and Morocco, where the private sector maintained a strong economic role throughout the economic shifts, the role of the private sector in the Egyptian economy in the early 1960s was smaller as the Egyptian state adopted a large-scale nationalisation programme.

While elements of import-substitution industrialisation began earlier, these policies became part of a broader state-led development strategy following the 1952 military takeover by the Free Officers Movement.[16] Over subsequent years, the new Egyptian regime adopted a comprehensive strategy for economic change that began with land reforms and expanded into a broader nationalisation programme. The latter included the Suez Canal and a large part of private and foreign enterprises in Egypt such as banks, insurance com-

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[10] Alain Piveteau, Khadija Askour and Hanane Touzani, 'Les trajectoires d'industrialisation au Maroc: une mise en perspective historique', *Document de travail* 2 (2013).

[11] Jane Perry Clark Carey and Andew Galbraith Carey, 'The Two Developing Worlds of Morocco: A case study in economic development and planning', *Middle East Journal* (1962), pp. 457–75; Jean-Francois Clement and James Paul, 'Morocco's Bourgeoisie: Monarchy, state and owning class', *MERIP Middle East Report* 142 (1986), pp. 13–17.

[12] Clement and Paul, 'Morocco's Bourgeoisie'.

[13] White, *A Comparative Political Economy of Tunisia and Morocco*.

[14] Ibid.

[15] Thomas Richter and Christian Steiner, 'Politics, Economics and Tourism Development in Egypt: Insights into the sectoral transformations of a neo-patrimonial rentier state', *Third World Quarterly* 29/5 (2008), pp. 939–59.

[16] John Waterbury, *The Egypt of Nasser and Sadat: The Political Economy of Two Regimes* (Princeton, NJ: Princeton University Press, 1983).

panies, shipping companies, natural resources and heavy industries.[17] During this period, Egypt attempted to build capital intensive industries using state planning to allocate economic resources. While the private sector was initially permitted to keep operating in the 1950s, nationalisation deepened in the early 1960s to include any private firm with twenty-five employees or more.[18] Egyptian trade during this period shifted as Egypt expanded its trade linkages with the Soviet Union and eastern European states, often through bilateral trading agreements.[19]

The Nasserite economic programme ran into difficulties in the late 1960 and in the 1970s and, under President Anwar el-Sadat, Egypt began a gradual economic liberalisation process that transformed the Egyptian economy.[20]

The North African *Infitah* and Shift to Export-led Development

While Egypt, Tunisia and Morocco followed different routes after independence, toward the end of the century, all three converged on a strategy focused on global integration, the attraction of foreign direct investments, trade liberalisation and limiting the role of the state in the economy: policies that became known generally in the Arab world as the *infitah* ('openness' or 'open door') policies. These changes were partly driven by the structural adjustment programmes (SAPs) that were signed between indebted countries and the International Monetary Fund (IMF) in the 1980s. By the 1990s, Egypt, Tunisia and Morocco were portrayed as the 'success stories of the IMF' in the region and beyond.[21]

Across the three economies, any influences of import-substitution industrialisation (ISI) and state-led development were replaced with the language of promoting exports, trade liberalisation and the private sector as the new engine of growth and development. From an external trade perspective, the three countries adopted trade liberalisation, capital liberalisation and currency devaluations in order to remove the 'distortions' constraining firms from exploiting the country's comparative advantage.[22] To promote exports, states were encouraged by experts and international organisations to set-up export processing zones that offered incentives to private firms including tax holidays and special labour regimes.

These *infitah* policies in North Africa coincided with broader organisational shifts within the global economy and specifically, within the countries on the other side of the Mediterranean in Europe.

[17] K.V. Nagarajan, 'Egypt's Political Economy and the Downfall of the Mubarak Regime', *International Journal of Humanities and Social Science* 3/10 (2013), pp. 22–39, Waterbury, *The Egypt of Nasser and Sadat*.
[18] Marvin G. Weinbaum, 'Egypt's infitah and the politics of US economic assistance', *Middle Eastern Studies* 21/2 (1985), pp. 206–22.
[19] John Waterbury, 'The "Soft State" and the Open Door: Egypt's Experience with Economic Liberalization, 1974–1984', *Comparative Politics* 18/1 (1985), pp. 65–83.
[20] Ibid.
[21] Karen Pfeifer, 'How Tunisia, Morocco, Jordan and even Egypt became IMF "Success Stories" in the 1990s', *Middle East Report* 210 (1999), pp. 23–7; Bradford Dillman, 'The Political Economy of Structural Adjustment in Tunisia and Algeria', *The Journal of North African Studies* 3/3 (1998), pp. 1–24.
[22] Pfeifer, 'How Tunisia, Morocco, Jordan and even Egypt became IMF "Success Stories" in the 1990s'.

At the global level, relationships between developed and developing economies were beginning to shift away from the core-periphery relationship that had dominated earlier periods. This relationship centred on developing economies exporting raw materials to advanced economies, where transformative manufacturing activities took place. A new 'international division of labour' began to emerge in the 1970s.[23] This reflected structural shifts in the production regime, as firms became increasingly able to separate different parts of production and locate these to different sites, giving rise to a new more flexible production system.[24] As a result, corporations based in the advanced economies started to divide their production activities between different locations and to outsource some activities to other firms while maintaining overall control of the production process. For some low-cost locations, these shifts provided an opportunity to attract labour-intensive activities and to enter manufacturing value chains.[25] These changes were reflected in important changes in global production and trade. For the United States, locations such as northern Mexico and east Asia became important spaces for the outsourcing and offshoring of labour-intensive activities. For the advanced economies in western Europe, locations such as Turkey, parts of central and eastern Europe, and North Africa emerged as ideal spaces for these economic activities as those regions provided substantially lower labour costs in addition to geographical proximity and logistics links.

One of the early manifestations of these economic shifts in North Africa was the system of 'outward processing' in the European textile and apparel industry. Considering the importance of the industry in terms of job creation and the growing competition from low-cost producers in Asia, European corporations faced the need to lower their production costs by tapping into a ready supply of low-wage workers, particularly for the labour-intensive apparel production (contrary to the more capital-intensive textile production). As a result, these European economies, and other advanced economies, followed a controlled approach to the liberalisation of trade in textile and apparel. This approach allowed growing imports of these products within limits, while also aiming to control the source of fabrics and other inputs used in imported clothing items.

North Africa was well placed to benefit from this outward processing regime. Proximity to Europe meant that fabrics and inputs could be quickly shipped to North Africa where they could be processed and then sent back to Europe. Tunisia and Morocco – unlike Egypt, which was less incorporated into the outward processing regime – became important outward processing locations for European textiles by offering incentives to apparel factories facilitating European imports of fabric and inputs. While German and French

[23] Folker Fröbel, Jürgen Heinrichs and Otto Kreye, *The New International Division of Labour: Structural Unemployment in Industrialised Countries and Industrialisation in Developing Countries* (Cambridge: Cambridge University Press, 1980); Rhys Jenkins, 'Divisions over the International Division of Labour', *Capital & Class* 8/1 (1984), pp. 28–57.

[24] Adam Tickell and Jaime Peck, 'Accumulation, Regulation and the Geographies of Post-Fordism: Missing links in regulationist research', *Progress in Human Geography* 16/2 (1992), pp. 190–218; Winfred Ruigrok and Rob Van Tulder, *The Logic of International Restructuring: The Management of Dependencies in Rival Industrial Complexes* (London: Routledge, 2013).

[25] Gary Gereffi, 'Global Commodity Chains: New forms of coordination and control among nations and firms in international industries', *Competition & Change* 1/4 (1996), pp. 427–39.

firms were the first European firms to use this system in the late 1970s and 1980s, firms from other countries followed suit in subsequent years: Italy, in the case of Tunisia, and Spain in the case of Morocco. As a result of this system, Tunisian and Moroccan exports of apparel to the EU increased rapidly while imports of fabrics and other inputs in the other direction increased simultaneously. In the case of Egypt, similar growth in exports to the EU took place, but often from inputs sourced from elsewhere, such as Turkey and Asia, or from Egyptian textiles.

In addition to apparel, similar growth in manufactured exports to Europe took place in sectors such as electronics, automotive parts and components, and footwear. In addition to manufacturing, services exports experienced growth in some North African economies with activities such as call centres servicing the French market in the cases of Tunisia and Morocco, and the UK market in the case of Egypt.

The Economic Results of Export-Oriented Industrialisation

Export processing zones in North Africa became key manifestations of this new economic geography. These zones offered incentives related to taxation, tariffs and imported inputs, in addition to limiting restrictions on capital flows and repatriated profits. In Tunisia, for example, the 'offshore regime' that was put in place as early as 1972 provided exporting firms with tax exemptions from company tax, tariffs on imported inputs and machinery, lower income tax for foreign staff employed in these companies and no restrictions on repatriation of profits.[26] The majority of these zones were located near Egypt, Tunisia and Morocco's coastal areas with easy access to ports. Locations included Alexandria, Port Said and Cairo in Egypt, Sfax, Monstair, Sousse, Tunis and Bizerte in Tunisia, and Tangier, Casablanca, Fes and Kneitra in Morocco (see Figure 1).

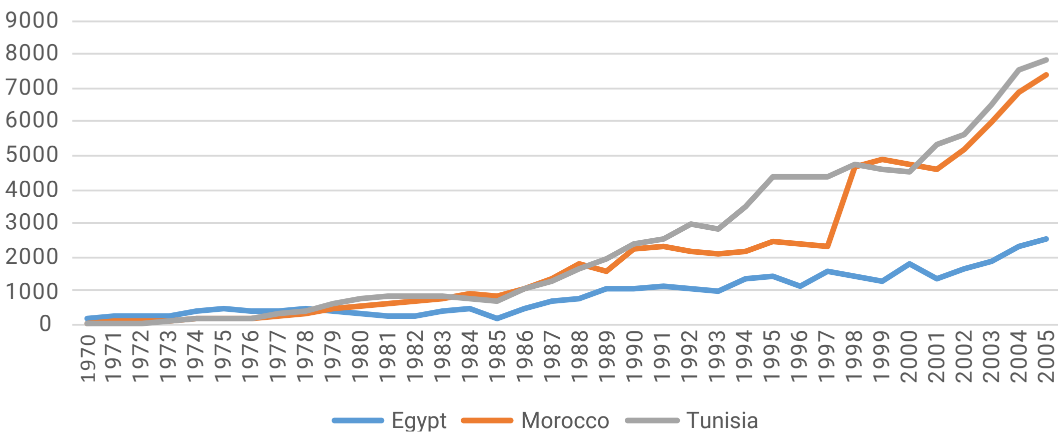
[26] Charlotte Jacobson and Sara Lindberg, 'An Evaluation of the Offshore Regime in Tunisia', *Lund University Student Papers* (2005). Available at http:/lup.lub.lu.se/student-papers/record/1337697 (accessed 3 September 2020).

Figure 1: Key Industrial/Export Processing Zones in North Africa

Source: Compiled by the authors

In terms of overall performance, the strategy of export-oriented industrialisation adopted in the three North African economies had positive impacts in terms of growth in exports, especially in the manufacturing sector (Figure 2).

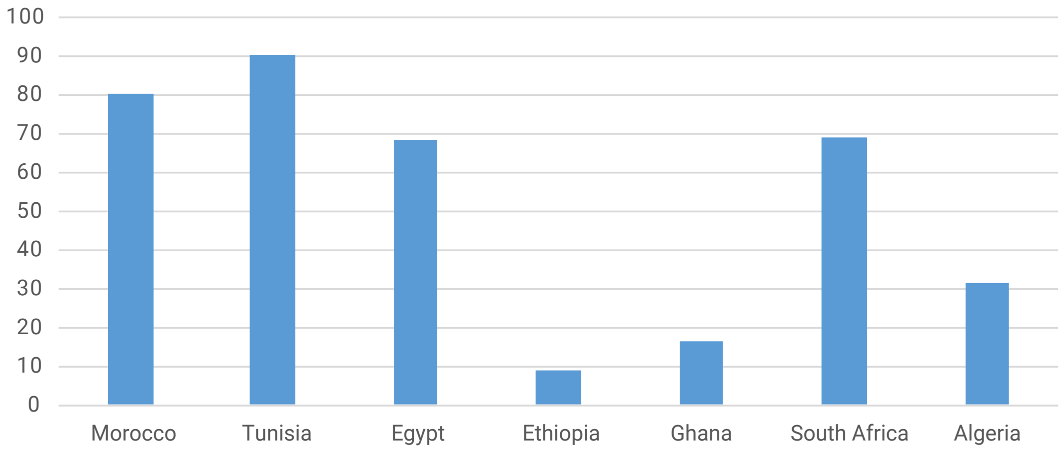
Figure 2: Manufacturing Exports of Egypt, Tunisia, and Morocco, US$ million



Source: UN Comtrade

As a result, important changes in the structure of the exports of the North African economies took place, with a rapid increase in the share of manufactured goods in total exports, compared to elsewhere in Africa (Figure 3).

Figure 3: Share of Manufacturing in Total Exports, 2015



Source: United Nations Industrial Development Organisation (UNIDIO)

Structural Fragility in North Africa's Development Model

The export-oriented strategy resulted in the growing share of trade in the three economies and their reorientation from exporters of raw materials and agricultural products into manufacturing locations for exports to Europe. As discussed in the previous section, this strategy brought a number of economic benefits in terms of expanding the manufacturing sector and increasing the share of manufacturing in total exports.

Yet despite this relative success, the strategy has not succeeded in creating dynamic economies capable of producing sustainable economic and social development. The reliance on low cost labour as the main comparative advantage and the dependency on the EU in terms of market access, technological capabilities, capital, and value chain capabilities placed the three economies in a structurally fragile position in terms of their future development. In the earlier period of export-oriented development, a large source of this fragility was the lack of predictability about market access to the EU. In 1977, for instance, Egypt, Morocco and Tunisia all faced quantitative restrictions on their textile exports to the EU.[27] Despite higher certainty of market access as a result of stronger free trade agreements with the EU, dependency on Europe remained a source of structural fragility of their export-oriented development strategy. This dependency has been one of the drivers for Morocco and Egypt to seek stronger economic relations with the US. This has included a free trade agreement (FTA) between Morocco and the US, as well as a preferential market access agreement, known as the Qualifying Industrial Zones (QIZ), between Egypt and the US. Nonetheless, other geopolitical factors were also key in the making of these agreements.[28] We first outline the sources of this fragility and then discuss some of its manifestations.

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[27] Richard Pomfret, 'Protectionism and Preferences in the European Community's Mediterranean Policy', *The World Today* 38/2 (1982), pp. 60–5.

[28] Shamel Azmeh, 'Trade Regimes and Global Production Networks: The case of the qualifying industrial zones (QIZs) in Egypt and Jordan', *Geoforum* 57 (2014), pp. 57–66. Gregory White, 'Free Trade as a Strategic Instrument in the War on Terror?: The 2004 US-Moroccan free trade agreement' *The Middle East Journal* 59/4 (2005), pp. 597–616.

Structural Fragility in the North African Economies

The dependency on the European market, particularly in the case of Tunisia and Morocco, is understandable to a degree. The EU is one of the largest consumer markets in the world and the three North African economies enjoy important advantages in it in terms of proximity, market access and business linkages.

Nonetheless, the high level of dependency on the EU is a source of fragility. By 2008, the EU accounted for 60% of Moroccan exports and 72% of Tunisian exports. Egypt's exports were more diversified, but the EU was still by far the top export destination for Egypt, accounting for a third of the total. Importantly, within the EU, there is a high level of dependency on specific markets. For Morocco, two countries alone – France and Spain – accounted for 65% of exports to Europe, while the top five European destinations accounted for 84%. For Tunisia, again just two countries – France and Italy – accounted for 68% of their exports to Europe, while the top five destinations accounting for 91%. Egypt had a relatively more diversified pattern with Italy and the Netherlands accounting for 45% of total exports to Europe, and the top five destinations together accounting for 80%. In particular, all three were heavily dependent on Spain, Italy, and France, who together accounted for 54% of Egyptian exports to Europe (and 19% of their worldwide total), 72% of Moroccan exports to Europe (42% to the world), and 75% of Tunisian exports to Europe (54% to the world).

Over recent decades, this fragility was illustrated as the three North African economies were affected by economic shifts in Europe and changes in the external policy of the EU.

Economic Changes in Europe and the Enlargement of the EU

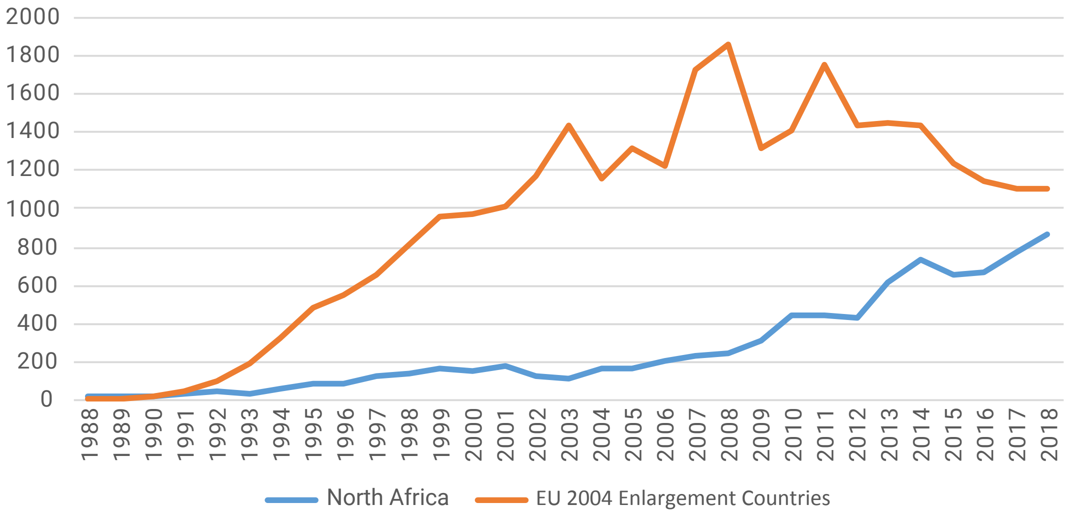
In recent decades, Europe has experienced important geo-economic changes, including the end of the Cold War and the enlargement of the EU. These factors had important economic implications for the North African economies as they led to shifts in trade and capital flows for key EU partners. The integration of former socialist eastern European economies into a Western economic model had important implications for the outsourcing processes described earlier, as it opened up new low-cost spaces for western European firms to invest in or outsource to. Similarly, successive waves of EU enlargement had similar effects on trade and investments. Freedom of movement within the EU lowered the cost of labour for western European firms and locations such as Poland, the Czech Republic and Slovakia, among others, became attractive locations for German investments. These shifts, however, were not permanent as multiple factors affected decisions to relocate and invest. The initial cost advantage of some eastern European economies, for example, was eventually exhausted either by their integration into the single currency 'Eurozone' or as a result of the gradual convergence of wages with the rest of Europe, as a result of migration outflows and capital inflows.

For countries such as Egypt, Tunisia and Morocco, which had been reliant on Europe for decades without being part of the EU – 'on the outside looking in' as Gregory White puts it[29] – these shifts forced them to react and adapt to the changing calculus of European firms, whether investors or buyers.

[29] White, *A Comparative Political Economy of Tunisia and Morocco*.

Some of these impacts can be seen at specific points in certain industries. With automotives, for example, the German industry passed through a phase of restructuring in the 1980s. Part of this involved the outsourcing of wage-sensitive and labour-intensive component production to lower-cost locations. One such component was wiring harnesses. Tunisia and Morocco started to attract some investment in this area due to their low labour costs, their proximity to Europe and their favourable trade policy environment. The opening of eastern European economies in the early 1990s, however, provided new highly competitive locations. While North African exports grew at a modest rate, rapid growth in the 1990s and the first half of the 2000s took place in eastern Europe, especially in Poland, the Czech Republic, Hungary and Slovakia. Nonetheless, as those economies joined the EU – driving their wages up – production in eastern Europe declined, and was accompanied by an expansion in North African exports from Morocco, Egypt and Tunisia (Figure 4).

Figure 4: German Imports of Wiring Harness, US$ million



Source: UN Comtrade

Changes in European Trade Policy

From a trade policy perspective, Morocco, Tunisia and Egypt all enjoy privileged positions regarding access to Europe. When all three North African economies obtained their duty-free access to the European market, very few other countries in the world enjoyed the same, while average tariff rates across Europe were relatively high. In recent decades, however, this privileged position has been eroded by a number of factors. Firstly, the general rate of tariffs levied by the EU on imports have declined. Between 1990 and 2017, the weighted mean of applied tariffs imposed by the EU declined from 4.8% to 1.79% (according to the World Bank). Despite this overall decline, preferential market access to the EU remains an important advantage as tariffs, and other non-tariff barriers, are still high on specific products.

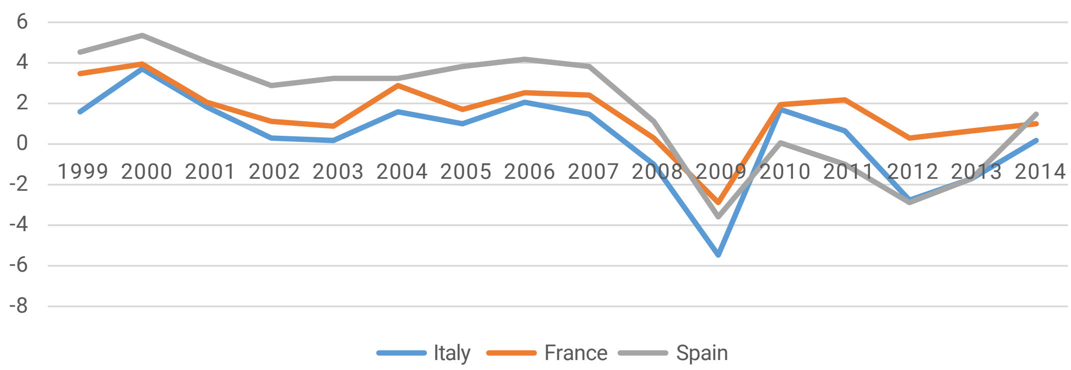
In addition, the number of other countries enjoying similar market access has increased. For decades, the EU, similar to other advanced economies, offered preferential access to its market either via reciprocal free trade agreements or non-reciprocal preferences programs such as the Generalised System of Preferences (GSP). In recent years, a growing number of countries have enjoyed such access. The EU has reached a number of free trade agreements with partners such as Vietnam, which compete with North Africa in sectors such as apparel and electronics. Furthermore, through the Everything but Arms (EBA) initiative that entered into force in 2001, the EU has offered duty-free access to some of the least developed countries (LDCs). As a result, countries such as Bangladesh now enjoy duty-free access to the European market with arguably fewer conditions than Europe's North African partners, as the latter have to comply with rules of origin requirements (RoOs). A common complaint by North African apparel firms today, for example, is that they are forced to use expensive European and Turkish fabrics in their exports, as a result of RoOs, while their Asian competitors can use cheaper Indian or Chinese fabrics. In recent years, the share of North African exports in the EU apparel market has declined vis-à-vis the share of Asian exporters such as Bangladesh. Another example is the shift in EU imports and investment that followed the implementation of a customs union with Turkey in 1996.

Through these changes, the three North African economies have lost in recent years, to a degree, their positions as 'privileged partners' of the EU.

The Economic Crisis of 2008 and its Aftermath

This North African structural fragility was further revealed followed the global economic crisis of 2008, and particularly the subsequent European debt crisis. While the global economy as a whole suffered from the crisis, key European Mediterranean trading partners such as Italy, France and Spain were particularly affected. After positive GDP growth in previous years, these large western European economies experienced substantial economic shrinking in the period 2009–13, especially Italy and Spain (Figure 5).

Figure 5: GDP Growth Rates of North Africa's Key Mediterranean Partners



Source: The World Bank

This decline had important impacts on their trading partners. From 2008 to 2013, the total imports of France, Spain and Italy declined by 18.2%. For North African economies, 2008–9 saw a sharp drop in exports to Mediterranean partners, with exports to those countries declining by 22.6% for Egypt, 18.2% for Morocco and 19% for Tunisia.

The Implications of Structural Fragility in the North African Economies

The structural fragility caused by dependency on the EU and low-cost labour as a source of comparative advantage has had important wider implications for the economies of North Africa.

Despite an expansion in manufactured exports, Egypt, Tunisia and Morocco have all largely failed to upgrade their position in European production networks and have remained specialised in cost-sensitive low-technology and low value-added products. The majority of firms exporting to Europe from the region are dependent on their European partners for designs, key technologies, working capital and sourcing of inputs. Such reliance weakens the ability of those firms to generate more value and to show higher resilience vis-à-vis the shifts in the behaviour of European firms.

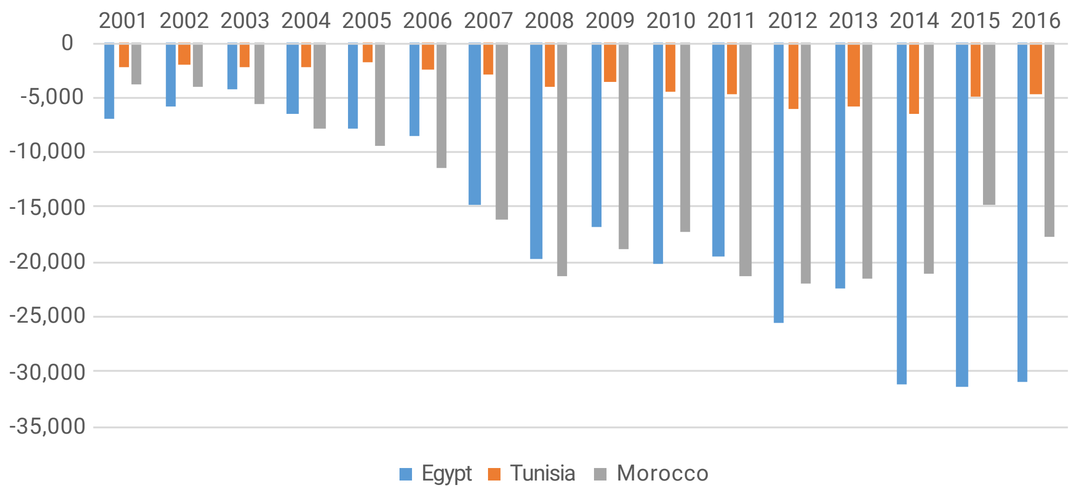
North African economies have further struggled to create domestic or regional linkages between foreign investment and domestic markets and supply chains. Unlike East Asia, where regional production networks underpin the position of the region in the global economy, North African economies have developed much weaker regional trade and production networks due to their reliance on European patterns for sourcing of components and due to the significant logistical barriers that still limit regional trade within North Africa. In fact, in some cases, the regulatory regimes under which the export sector was created, such as the offshore regime in Tunisia, have hindered the ability to create domestic linkages by creating barriers to trade between the exporting sector and the rest of the economy. From the perspective of European firms, the North African economies represent alternative production locations rather than a complementary or integrated economic zone.

As a result of this reliance on European firms, their lack of capability and the limited extent of regional networks, North African firms continue to occupy a fragile position in their production networks, leaving them vulnerable to shifts in European trade policy and sourcing and investment strategies of European firms. Similarly, due to their reliance on low-cost labour and their limited technological capabilities, these firms are vulnerable to technological changes in their industries. Today, for example, the expansion of automation in manufacturing places economies that are solely reliant on their low labour costs in a risky position.[30] Furthermore, the three North African economies, with the exception of recent developments in Morocco that we will discuss shortly, have not been successful in attracting economic activities that require longer term commitments in terms of capital investment, with these often entailing higher levels of technological capabilities and facilitating the ability to build domestic and regional linkages.

[30] Dani Rodrik, 'New technologies, Global Value Chains, and Developing Economies', *National Bureau of Economic Research* No. w25164 (2018).

As a result of these dynamics, Egypt, Tunisia and Morocco have all struggled to increase the value-added in their exports and to diversify beyond being processing and assembly platforms for the EU. In fact, some indicators suggest that the share of domestic value-added in the exports of some of the important sectors in North Africa has declined in recent years. In electrical equipment, for instance, the share of domestic value-added in Tunisian exports declined from 58.4% in 2005 to 51.1% in 2016, while Morocco experienced a decline from 62.8% to 57.5% (according to the OECD-WTO trade in value added database).[31] At a macro level, the failure to expand, diversify, and increase the value-added in exports resulted in a widening trade deficit in goods starting in the mid-2000s (Figure 6).

Figure 6: Net Trade in Goods, US$ billion



Source: World Bank

Another result of this mode of shallow export-oriented development has been the failure to expand the economic benefits of export-oriented industry beyond the coastal pockets of the industrial zones. This concentration has resulted in widening gaps between these regions and the interior in terms of employment and wages. Some of these gaps date back to previous historical periods, including the changing economic geographies of these economies during and before colonialism. The export-oriented strategies adopted in recent decades have reinforced and, in some cases, expanded those gaps, with unemployment and poverty rates in the interior governorates substantially higher than those in coastal regions.[32]

[31] Data for Egypt is not provided in this database.

[32] Larbi Sadiki, 'Regional Development in Tunisia: The Consequences of Multiple Marginalization', *Brookings Doha Centre Report* (2019).

The Arab Spring and the Search for New Routes for Development

The three North African economies were at the heart of the protest movement that swept the Arab world in 2011, which became known as the Arab Spring. While Egypt and Tunisia received more media attention as a result of large-scale protests that led to the ousting of their presidents, Morocco also experienced widespread upheaval during 2011 and 2012.[33] In all three countries, political and economic issues were intertwined as driving factors of these movements. During this period, while media attention was focused on the capital cities, protests and strikes also took place in other parts of the country. These included the underdeveloped interior regions, including small towns and rural areas where issues such as unemployment and poverty were key. It also included locations important for the export sector, such as the industrial zones and associated logistical infrastructure, where mobilisation of workers through strikes and protests took place. Mobilisation of workers in those areas preceded the 2011 protests and continued in subsequent years.

Maha Abdelrahman argues that it is difficult to separate and prioritise demands around political rights from economic issues in these protest movements.[34] While true, the protest movements can be seen partially as outcome of the exhaustion of the economic development model adopted in the three countries in previous decades. In particular, the protest movements reflected the inability to expand processes of industrialisation beyond the coastal regions, the failure to achieve economic and social upgrading in production networks, and the structural fragility of these networks, as illustrated by the impact of the global economic crisis and the European debt crisis. This fragility was illustrated with the impact of the protest movement and the subsequent political instability on the position of those economies in European-dominated production networks. In the crucial apparel sector, for instance, Tunisian exports to Europe declined from US$3.7 billion in 2008 to US$2.1 billion by 2016. In addition to the protest movement and the general political instability, the 2015 terrorist attack in Sousse, an important export location, created difficulties for Tunisian firms in terms of their relationships with European buyers.

In subsequent years, there was a significant divergence between the economic performance of Morocco on the one hand and Egypt and Tunisia on the other hand, particularly in relation to foreign investments and the position of these economies in global networks of production. For Egypt and Tunisia, deepening political instability further limited their ability to move beyond reliance on low-cost labour as a source of competitiveness. As orders from buyers declined and foreign investment into manufacturing slowed down, the two economies resorted to devaluation as a strategy to increase exports and limit widening trade deficits. Those devaluations, in turn, contributed to sharp increases in the inflation rate and thus further contributed to political unrest. Between 2009 and 2017, Egypt experienced double-digit consumer price inflation in seven years including a rate

[33] Koenraad Bogaert, 'The Revolt of Small Towns: The meaning of Morocco's history and the geography of social protests', *Review of African Political Economy* 42/143 (2015), pp. 124–40

[34] Maha Abdelrahman, 'A Hierarchy of Struggles? The "economic" and the "political" in Egypt's revolution', *Review of African Political Economy* 39/134 (2012), pp. 614–28

that was higher than 29% in 2017. While lower than Egypt, Tunisia has also experienced high inflation rates in recent years.

Morocco, however, was able to escape a similar fate of downward competitiveness pressure. Buoyed by its image as the 'stable country in North Africa' amongst foreign firms, it emerged as an increasingly attractive location in the region. In a number of industries, Morocco has succeeded in strengthening its position and attracting foreign direct investment in recent years, particularly in the automotive industry with assembly plants for Renault, Peugeot and Ford. Such activities entail long-term commitment by the investing firms, as assembly factories have long capital payback periods. This success has also been attributed to the more sophisticated industrial policy Morocco had adopted in recent years.[35]

The relationship with the EU remains the key economic issue facing the three economies. While the share of EU destinations in each's total exports declined following the global economic crisis, the European debt crisis and the Arab Spring, this share has started to rise again in the last few years, although it is yet to return to 2007 levels. At the same time, further integration with the EU is on the table through the Deep and Comprehensive Free Trade Area (DCFTA) agenda. The DCFTAs aim to update the existing free trade agreements between the EU and North Africa and to focus on issues such as regulatory harmonisation. However, negotiations with Egypt and Morocco for DCFTAs have been paused, for various reasons, while they are still ongoing with Tunisia.

Conclusions

Tunisia, Morocco, and Egypt have been amongst the early adopters of free trade policies in the developing world, with the aim of boosting economic development through export-oriented industrialisation and their integration in global value chains. Benefitting from factors such as proximity and linkages to the European market and preferential access to it, these three North African economies, especially Tunisia and Morocco, have developed into low-cost export processing platforms for the EU economy by attracting labour-intensive activities in sectors such as apparel and electronic equipment. This strategy has succeeded in boosting the manufacturing exports of these economies and in achieving a degree of industrialisation. Nevertheless, we argue that the reliance on low-cost labour as a source of competitive advantage, in addition to the weak position of those economies and their firms in European value chains, has left these economies in a structurally fragile position. This fragility was illustrated in recent years following the global economic crisis and the European debt crisis on one hand, and the protest movements of the Arab Spring on the other. The low-cost platform model was exhausting itself with the changing dynamics in the EU economy as well as in the North African economies in question.

[35] Auktor Georgeta Vidican and Tina Hahn, 'The Effectiveness of Morocco's Industrial Policy in Promoting a National Automotive Industry', *German Development Institute / Deutsches Institut für Entwicklungspolitik Discussion Paper* 27 (2017).

In the wake of the Arab Spring, the three economies have struggled to meet growing internal political and economic demands within the limits of their export-oriented model of development. The governments of Tunisia and Egypt have pursued a devaluation path to encourage competitiveness, increasing domestic unrest. Morocco, on the other hand, has managed to boost its economic upgrading by strengthening its position in European networks of production, benefitting from its relative political stability and more sophisticated industrial policy.

The search for alternative models of development is taking place in a rapidly changing international political economy. The rise of protectionism in some of the advanced economies, questions surrounding the future of the international trading regime, and the expansion of automation in manufacturing, all raise important challenges for the future of the economies of Egypt, Morocco and Tunisia.

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Tunisian employees work on a wiring harness for vehicles in the factory of the German car parts supplier Draexlmeier in Siliana, Tunisia, 28 April 2015. Photo: RAINER JENSEN/dpa

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