ENHANCING EURO-MED ASSOCIATION THROUGH FDI
(The Case of North African Countries)

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EURO-MED PARTNERSHIP: OPPORTUNITIES AND CHALLENGES

In view of the current geopolitical context and uncertainty that characterizes the region, the creation of a Mediterranean free tread area appears increasingly necessary for all countries of the region. The high unemployment rate, the stagnation of average per capita income (which is less then 10 times the European average) and increasing poverty, means that rapid growth is vital for economic and political stability of the whole region. For South-Mediterranean economies to achieve high rate of growth and positive changes in productivity, depend heavily on their capacities to integrate into the world economy and the Euro-Mediterranean free trade Area. For unlike in the 1970s and early 1980s labour migration and official aid and credit will not be the future engine of growth, instead, increased exports will be needed to finance development.

Although most econometric models indicate that the integration of a smaller economy into a larger one should result in substantial payoffs, most developing countries find, in reality, that opening up to international trade and FDI in not sufficient to achieve their development objectives. Without a dynamic enterprise sector, a country will not be able to take advantage of trade and investment opportunities. Indeed, the most important element in the integration process of the South Mediterranean economies is related to the enormous amount of technical and financial help that is required by domestic firms in the region. When the rules of the game changed after more than 25 years of functioning in a closed economy, local entrepreneurs found it difficult to operate in a more open and competitive environment. One of the main subjects of discussion these days in the region is how raise the level of productivity and competitiveness in existing firms. Among other things, this will require proactive policies and programmes aimed at increasing the transfer of technology and information as well as improving access to financial, infrastructural and export markets.

Beyond the specific costs associated with fiscal adjustment, the euro-med association agreements will result in high adjustment, costs affecting all the economies of the south-med in the short term. For example in terms of the extent of labour displacement, estimates range from around 3% in morocco to 9% in Tunisia and to more then 12% in Algeria and, Egypt[1] . As for the gains in the long term, they are estimated to be on average in the region of 2% increase in the GDP growth. However these grains do not accrue automatically and independently of the policies and programmes in place, including technical and financial assistance to be provided by the European Union partner and FDI inflows to the region.

South-Mediterranean countries expected that the European Union will provide substantial financial and technical support to partially compensate for the necessary structural adjustments and incentives for European firms to invest in the region so as to upgrade their economies and eventuality improve there competitiveness and living standards for their citizens. In other words south-med. countries expected to in the long-term to share prosperity and stability with the European Union.

“Respect for social cohesion is another decisive factor of economies development that must not be neglected; otherwise there is a risk of creating even more internal inequalities and this aggravating a situation of exclusion which is often at the basis of popular rejection of reform”[2] . Consequently we

[1] Mustafa Nabli: “ The fiscal Dimension of the Euro-Mediterranean Challenge”, http://www.worldbank.org/mdf/mdf1/dimensio.htm.

[2] - Commission of the European communities, (2001), *Annual Report of the MEDA programme 2000* (Brussels).P.17

may ask how much aid and supportive action to increase technology transfer and FDI inflows to their South-Med partners?

In financial terms, the MEDA programme constitutes the principal instrument of financial aid with the objective of facilitating and smoothing the transition to competitive and globally integrated economies. In reality the E.U financial commitments have been much less than their South-Med partners' expectations and effective needs.

Compared to a total commitment of less than 4.2 b euros for the whole period 1995-2000, estimates for morocco alone exceed 4 b euros to carry out structural adjustments and upgrade its economy. Furthermore the ratio of payments to commitments during the same period was extremely low: around 29.2%[3.] In absolute terms, average yearly per capita payments amounted to less than one euro!

Despite the introduction of the new MEDAII Regulation in November 2000, both commitments and payments remain much lower the South-Med countries' needs. However, it must be born in mind that the MEDA programme was conceived as a supportive mean and consequently South-Med countries should enhance their capacities to attract FDI inflows so as to overcome the main constraints they face in carrying out the transition.

The Impact of the Euro-Med Partnership on FDI Inflows to North-African Partners

North African countries are centrally located in close proximity to the markets of Europe, Africa and the Middle East. This presents an opportunity to serve as a hub for transport and other services, as well as export platform. Preferential access to the European market gives their economies an edge over those of other developing countries. While the expectations that free trade with Europe will lead to rising FDI from Europe among decision makers, it should be pointed out that the reverse could well occur, since European enterprises dealing with individual North African countries may prefer to locate in Europe from where they might have better access to all the markets. Hence the so called hub-and-spoke problem may arise. Thus it is in the interest of the North African countries to remove the various constraints to regional chid so as to succeed in their linking process to Europe and the global economy.

Despite the fact that most North African countries have signed their association agreements worth the E.U only very recently, experiences of Tunisia and Morocco suggest that these agreements have not so far resulted in substantial FDI inflows from Europe, especially when cross-border acquisitions and mergers are excluded. "FDI [to Tunisia] in 2000 more than double the figure for 1999, yet it is inadequate when one takes into account that a third of this sum is the result of privatization, and another third represents investments in oil and gas partnership concessions. As a result …. foreign promoters invested only…1% of GPD"[4].

This also applies to Morocco as figures in tables1, 2 &6 in the annex show. Furthermore, FDI in both countries are heavily concentrated in the primary sector and low-value added industrial sectors, especially textiles (see tables 2& 4 in the annex).

In contrast to Tunisia and Morocco, FDI inflows to Algeria have sharply increased since 2000. The main origins of these investments are the USA and Egypt (see tables 5&6 in the annex). However most of these inflows went to the hydrocarbon sector. As for the share of the European Union, especially France, in total FDI inflows to Algeria, it has substantially improved during recent years. Despite these recent improvements in the inflows of FDI to Algeria, its sectoral destination does not so far correspond to the real needs of the recipient economy, as they have neither stimulated local production capacity and supply nor resulted in employment creation and revenue generation outside the oil and gas sector. Furthermore, export of non-hydrocarbon goods and services have stagnated or declined while imports have sharply increased.

[3] - Ibid. P.12.
[4] - Ibid.P.47.

"Therefore, openness has not resulted in poverty reduction. Thus, the conventional wisdom that persistent poverty is due to the low level of trade integration with the global economy must be reassessed".[5]
Consequently, the essential policy issue is not simply integration into the global market but how to improve the composition of the exports building competitive and dynamic export capability through improved productive and supply capacities. The small size and isolation of local enterprises make it difficult for them to access essential factors of production both inside and outside their domestic economy. This building competitive advantage requires continuous investment, especially in skills and information.
Despite these weaknesses, foreign investors could increase chances for domestic enterprises to realize trade and investment opportunities through partnership, networking, training and exchange of information on best practices, and this helping in building competitive advantages, rather than relying on comparative advantages. Investment projects with foreign participation could lead to the development of human capital, technology transfer, increasing linkages with global networks innovation.

At the enterprise level, the vast majority of North African countries suffer from low productivity, poor products quality or design, and limited ability in problem sowing in repairs and maintenance. Improvements in these areas are essential for increasing the possibility of local firms' integration into international networks. Foreign participation ether through equity or non-equity arrangements and joint ventures in local firms may speed up their level of competitiveness and integration into the world market.
FDI, also, complements trade by enabling countries to gain from international specialization by expanding the size and scope of markets, and by providing access to the trading and importation networks of global companies. Moreover FDI could contribute to upgrading exports, by shifting from low skill and low-value added exports to high value added ones.
Foreign firms may facilitate diffusion of production technology and managerial practices that lack local firms. Furthermore, foreign operators though their linkages to local sapphire could give rise to positive externalities, thus removing constraints that limit at present sub-contracting locally, as most local firms are SMEs which generally lack operating technology and organizational and managerial capability, and having difficulty in meeting the quality standards and delivery targets required by foreign firms.

The contribution of FDI to the development of the technology capability of local firms could be enhanced. However proactive policies, including support to domestic firms in the form of technological and manufactured services and incentives or seed funds to provide for technology upgrading should be undertaken. Finally the long term objective of deepening linkages with foreign firms should be integrated with the global science and technology networks.

Studies on the impact of FDI on exports and technology transfer in Egypt show conclusively that the impact was extremely weak: "In Egypt there does not appear to be a close association between FDI and exports"[6)] and that. "The surveyed companies did not feel that theirs affiliation with foreign companies particularly benefited the formation of linkages with local suppliers"[7] .This may be so because the country lacks appropriate strategies and policies at both macro and micro levels that provide local firms with the possibility of access to finance, technology and business services and greater linkages between foreign firms and local suppliers.

[5] - UNCTAD (Secretariat), March 2003, *Enhancing the contribution of the indigenous private sector to African development- Opportunities for African-Asian cooperation*, UNCTAD, Geneva. P.27

[6] - UNCTAD , 1999: *Investment Policy Review-Egypt*, UNCTAD, Geneva, P.12
[7] - Ibid, P.16

Conclusion:

In the light of capital mobility and labour immobility, FDI inflows to the South Mediterranean countries could contribute to upgrading exports, creating jobs and wealth and improving skills. These in turn lead to the achievement of the main objectives of the Euro-Med partnership which are: Shared prosperity and social and political stability in the whole region. However to increase FDI flows from Europe to their southern partners proactive policies that encourage such flows are required. The Euro-Med. Partnership is likely to enhance FDI flows to South Med. Countries and performance in their economies in its own right only if the northern partner is willing to enforce investment encouraging “club rules”. This seems to be very likely as the northern partner has a major interest in the alleviation of pressures to migrate and in the stability of the whole region. Furthermore, the removal of constraints to intra-regional trade in the south is a key component of successful linking to Europe and the global market. Otherwise the so-called hub-and-spoke problem may arise as the hub (the E.U) sucks firms and investment out of the spokes (the south-med partners).

Table 1: FDI flows to Morocco by Geog. Origin (1996-2002) (Million of Dirham).

Region	1996	1997	1998	1999	2000	2001	2002
World of which	2851.3	11477.4	4420.5	16260.7	4997.7	32486.1	5875.8
E. Union	77.3%	57.8%	60%	89%	82%	95.3%	77%
N. America	3%	26%	7.3%	6.3%	0.2%	3%	6.6%
Developing Eco.	12.7%	7.6%	18%	2.6%	6%	1.4%	14%

Source: Calculated by the authors from statistical table published by UNCTAD (2003), UNCTAD WID Country Profile; Morocco, UNCTAD, Geneva, P.7.

Table 2. FDI flows to Morocco by Sector (%).

	1996	1997	1998	1999	2000	2001	2002
Total of which	100	100	100	100	100	100	100
Primary	8.4	55.6	9.5	2.6	20%	0.2%	4
Secondary	48.3	12	42.6	22	16	7	20
Tertiary	38.7	31.5	46.2	74.8	65.8	92.8	73

Source: Ibid, P.6.

Table 3: FDI flows to Tunisia by Geog. Origin (1994-2002) (Millions of $ & %).

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total world of which	535.9	322.6	279.6	365.3	668.1	367.9	778.8	486.4	821.3
Europ.Union	457.0 85%	225.9 70%	161.0 57.8	228.1 62%	519.8 77.8%	199.3 54.9%	565.7 72.6%	274.6 56.4%	545.9 66.9%
U. America	62.4	61.9	62.2	106.1	66.8	56.5	105	91.5	70.5
Developing Eco.	6.8	25.0	50.4	14.9	49.0	67.1	54.5	73.0	181.4

Source: Calculated from UNCTAD statistical tables, published by UNCTAD (2003), UNCTAD WID Country Profile; Morocco, UNCTAD, Geneva, P.7.

Table 4: FDI flows to Tunisia by Sector (1992-2002).

Sector	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Total of which	583.5	656.1	535.9	322.6	279.6	365.3	668.1	367.9	778.8	486.4	821.3
Primary	521.7 79.5%	621.3 94.7	488.2 91%	259.5 80.4%	171.2 61.2%	246.0 67.3%	178.7 26.7%	166.6 45.3%	238.7 30.6%	233.6 48%	308.2 37.5%
Secondary	17.5 3%	14.8 2.4%	13.8 2.6%	25.6 8%	50.8 18.7%	77.7 21.3%	460.1 68.8%	166.5 45.3%	501.8 64.4%	174.4 35.8%	179.7 21.9%
Tertiary	17.5%	3%	6.4%	11.6%	20%	11.4%	4.5%	9%	5%	16%	38.7%

Source: Ibid, P.8.

Table5: **Main Investors in Algeria (Thousands of US $ in current prices).**

Years / Country	1998	1999	2000	2001	Total
USA	256891	89882	205664	354369	906806
Egypt	51	3	100	362992	363146
France	76656	137460	49472	80413	344001
Spain	16209	16373	35596	152867	221045
Italy	92820	11800	9282	34383	148265
Germany	20062	7836	66509	37791	132198
Holland	2812	623	1308	71944	76687
UK	36015	2001	14206	23254	75476
China	16648	2787	21092	8818	49345
Belgium	14602	571	4484	12384	32041

Source: UNCTAD; 2003; Investment Policy Review, Algeria.

Years / Country	90	91	92	93	94	95	96	97	98	99	2000	2001	2002	Annual average		As a % of Gross Fixed Capital Formation				
														85-95	99-02	85-95	1999	2000	2001	2002
Algeria	40	80	30	-	-	-	270	260	501	507	438	11%	1065	17	7414	01	4.3	3.8	8.6	8.1
Tunisia	76.3	125.5	515.8	56.2	432	264.3	236.3	339.1	651	350	752	457	795	260	613	7.5	7.0	15.2	9.3	15.0
Maroco	165	317.5	422.5	491	551	335	357.4	1071	333	849.5	420.6	2824	419.4	237	1199.3	3.9	16.5	5.3	37.2	4.8
Egypt									924	1076	1235	510	647	924	864	7.0	5.2	5.2	3.4	4.6
Africa									8928	12231	8489	18769	10998`	3556	-	3.9	11.8	8.8	19.4	8.6
Developing Cs.																4.4	14.3	14.6	12.7	10.5

Table 6 : **FDI Inflows to North African Countries that Signed Association Agreement With The E.U (Millions of $ and %).**

Source: UNCTAD World Investment Report 2003, and country Fact Sheets