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Degree of Master of International Studies  
(International Area Studies)

“The Impact of Euro-Mediterranean FTA on the  
Economies of Tunisia and Morocco”:  
Comparative Analysis of trade liberalization impact  
Between 1995 and 2017

Graduate School of International Studies  
Seoul National University

Skander MEDAISSI



Skander Medaissi

**“The Impact of Euro - Mediterranean FTA  
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**Between 1995 and 2017**

A thesis presented

By

Skander MEDAISSI

Submitting a Master’s Thesis of International Studies

Graduate School of International Studies

Seoul National University

Seoul, Korea

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# The Impact of Euro - Mediterranean FTA on the Economies of Tunisia & Morocco”:

– Comparative Analysis of trade liberalization impact

Between 1995 and 2017 –

Han Jeong-Hun

Submitting a master’s thesis of Area Studies

August 2019

Graduate School of International Studies

Seoul National University

International Area Studies Major

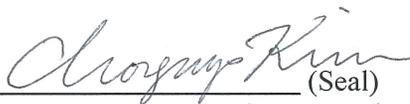
Skander MEDAISSI

Confirming the master’s thesis written by

Skander MEDAISSI

August 2019

Chair Professor Kim, Chong-Sup

 (Seal)

Vice Chair Professor Sheen, Seong-Ho

 (Seal)

Examiner Professor Han, Jeong-Hun

 (Seal)



## **ABSTRACT:**

The European Community launched, in November 1995, a comprehensive and multidimensional initiative known as the Barcelona Process, aimed at strengthening political, economic, and social relations between the European Union states and their neighbors in South Mediterranean Sea. One of the initiatives introduced under the umbrella of this Process is the Euro-Mediterranean Partnership (EMP). Central to this Partnership is the creation of Free Trade agreements between the Community and each MS, and similar agreements between the MS themselves.

The aim of this research is to assess the effects of the Free Trade Agreements on the economies of the signatory countries Tunisia and Morocco from 1995 to 2017 and attempts to explain eventual differences or similarities. The thesis will be following the design of comparative case studies between Tunisia and Morocco. To be precise the study will look at both cases simultaneously and trace the development in each country and analyze how economic variables are to be affected by the implementation of Free Trade Area, trade liberalization and tariff dismantling.

As for the contribution made by this research to the existing literature about the Euro-Med Economic integration process:

- i. Extending the evaluation (critical analysis) from 1995 until the year 201.
- ii. Using updated dataset to evaluate the effects of the Euro MED FTA from the perspectives of South Mediterranean Countries (SMCs).

**Keywords:** Euro MED FTA; Association Agreement; Regional integration; Tariff dismantling; Trade Liberalization.

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## ***LIST OF ABBREVIATIONS***

AA: Association Agreement	GDP: Goss Domestic product
AVE: Ad-Valorem Equivalent	MEDA: Accompanying Measures Program
BD: Barcelona Declaration	MPs: Mediterranean partners
DCFTA: Deep and Comprehensive Free Trade Agreement	MS: Mediterranean States
EC: European Commission	NTBs: Non -Tariff Barriers
EMFTA: Euro-Mediterranean Free Trade Area	PD: Paris Declaration
EMP: Euro-Mediterranean Partnership	RoOs: Rules of Origin
ENP: European Neighborhood Policy	SMCs: Southern Mediterranean Countries
EU: European Union	SMPs: Southern Mediterranean Partners
Euro MED FTA: Euro Mediterranean Free Trade area	TBT: Technical Barriers to Trade
FTZ: Free Trade zone	TEU: Treaty of the European Union
GAFTA: Greater Arab Free Trade Area	TRIs: Trade Restriction Indexes
GCF: Gross Capital Formation	UfM: Union for the Mediterranean
	VAT: Value Added Tax



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## **1. CHAPTER 1: INTRODUCTION**

The Euro-Mediterranean FTA is based on the Barcelona process in European Neighborhood policy. The Barcelona Process, developed after the Barcelona conference in successive annual meeting, is a set of goals designed to lead to a free trade in the Mediterranean region and the Middle East by the year 2010. It has envisioned that an FTA with rules of origin within pan Euro-Mediterranean will be created. It will cover the European Union, the European Free trade area, the EU customs unions, the EU candidate states; the partners of the Barcelona process and at a later stage all of the European Neighborhood Policy partners. The Agadir Agreement of 2004 is seen as its first building block. Further steps are envisioned into the action plans negotiated between the EU and the partner states on the southern Mediterranean shores of the Mediterranean Sea. The initial aim is to create a matrix of free trade agreements between each of the partners and the others, and then a single free trade area is to be formed including the EU partners. For Southern Mediterranean Countries, trade liberalization has been an ongoing process for many decades, starting with the Association Agreement in 1990 and culminating in the launch of negotiations on a Deep and Comprehensive Free

Trade Area in March 2013. Hence, the EU is the first trade partner for Southern Mediterranean countries, representing its first source of imports and its largest market for exports.

Morocco and Tunisia both signed comprehensive integration agreements with the European Union in the early 1990s. These agreements consist of two essential elements increased aid flows and technical assistance in exchange for reductions in trade barriers and other impediments to the flow of goods and investment over a period of 12 years.

Two decades after the launch of the Barcelona Process, the liberalization of trade in industrial products has become a tangible reality: all products from the Mediterranean countries have access to the EU market free of customs duties. Reciprocally, the Mediterranean countries have put in place a process of progressive dismantling of their tariffs.

But since, manufactures products of SMS have already benefited from free access to European Markets after the former trade and cooperation agreements of 1970 and since the new association agreements exclude agriculture products from free

trade, the EMFTAs seems not open up new export opportunity and will amounts to a unilateral trade liberalization by the Mediterranean countries.

The economies of Morocco and Tunisia share many characteristics. In these countries, agriculture is important, the state dominates the economy to varying degrees and the foreign trade regime is generally quite restrictive, despite greater openness to the European Union. The most important structural difference is that Morocco has a planned economy, while Tunisia has a more diversified economy.

So in order to study the effects of EMFTAs, this thesis focuses only on the likely impact that trade liberalization and tariff dismantling, will have on the economic activity of these two Mediterranean States.

### **1.1. Literature Review:**

The EU has always projected itself as a promoter of economic development. As part of its approach towards neighborhood countries, the European Union endorsed a Partnership that incorporates parallel engendering of deep democracy and economic development<sup>1</sup> and prosperity. This is considered as an expansion of its

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<sup>1</sup> Milja Kurki 2012, Democratic futures. Previsioning democracy promotion,

role as a booster of development within its Common Market area, as outlined by the Maastricht Treaty<sup>2</sup>.

However, this policy has not been without critics: for instance, Storey (2006)<sup>3</sup> criticized the Euro-centric trade policy approach towards North African countries. Flint, meanwhile, noted that EU and Western governments, when designing structural programs and trade policies aiming to reforming and developing the Southern Mediterranean states economically, failed generally to take into account the institutional weaknesses inhibiting them.

Mark Langan (2012)<sup>4</sup> argued that the EU's normative approach of development has aggravated the economic asymmetries between the Union and its developing neighbor's country partners.

In order to assess the impact of EU approach on the neighboring countries, various quantitative evaluations related to the Euro med partnership, especially the Barcelona Agreement has been tested. First, ex-ante studies (based on simulations using Computable General Equilibrium models, Suggest the existence of trade

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<sup>2</sup> The European Commission 1992 A Partnership for Democracy and shared with the southern Mediterranean.

<sup>3</sup> The European Union's Trade Policy Response to the Crisis: Paradigm lost or reinforced? Storey, 2006

<sup>4</sup> Mark Langan, 2012: Normative Power Europe in the Maghreb: A Moral Economy Perspective on the Deep and Comprehensive Free Trade Agreements

potential between EU and MP countries as an indicator of the lack of regional integration. Also provides insight into the relationship of trade growth in MP. The sign of this relationship provides information on the ability of a regional agreement to revive economic growth through trade liberalization.

Although there are large differences in results depending on the assumptions considered in the models, almost all studies highlight the positive effects on GDP and the growth of trade in MPs. A significant number of studies suggest a GDP and trade growth assumption of 5%. In fact, the Euro med agreement is expected to boost GDP by 12.2% in Morocco<sup>5</sup> (Philippidis and Sajuan, 2006), and 8.9% in Tunisia<sup>6</sup> (Augier and Gasiorek, 2003). Some simulations give even stronger trade effects: up to 54% for Morocco, 48% for Tunisia and 18% for Tunisia<sup>7</sup>.

Yet, North-South agreements are considered the most promising by the World Bank (2000). Given the differences in factor endowments between partners, this type of agreement would offer the greatest potential for developing the economy.

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<sup>5</sup> Philippidis and Sajuan, An Examination of Morocco's Trade Options with the EU, 2006

<sup>6</sup> Augier, Patricia and Gasiorek, Michael (2003). The welfare implications of trade liberalization between the Southern Mediterranean and the EU. Applied Economics.

<sup>7</sup> Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern The Effects of Multinational Production on Wages and Working Conditions in Developing Countries

A recent study<sup>8</sup> by Bchir, Decreux, Fouquin, (2003) assesses the impact of association agreements on North African countries (Algeria, Egypt, Libya, Morocco, Tunisia) plus Turkey. The study concludes that North African countries have a negative impact in transforming existing asymmetric trade agreements into symmetrical free trade agreements. In case of industrial liberalization (which is the case for current agreements with Tunisia and Morocco), the GDP loss would be - 1.7%. It would be -1.3% only if the agreements were extended to agricultural products, which is not currently the case. This result is mainly due to the fact that liberalization is unilateral, since the European market is already open to exporters from North Africa, and limited to products from the European Union.

Also, a study by Dessus and Suwa (1998)<sup>9</sup>, which measures the impact of the Association Agreement with the European Union on the Tunisian economy using an EGC model, concludes that the agreement has negative impact for Tunisia in terms of GDP and this impact only becomes positive if we make an assumption of externalities on exports linked to the agreement. This can be explained by EU

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<sup>8</sup>Bchir, Decreux, Fouquin, 2003 Libéraliser les échanges commerciaux : quels effets sur la croissance et le développement ? journal Economie et Statistique

<sup>9</sup> Dessus and Suwa ,1998, Development Centre Studies Regional Integration and Internal Reforms in the Mediterranean Area.

exclusion of agriculture from the trade agreements and by multiplying non-tariff barriers under various pretexts to protect its businesses.

Philippe LANGEVIN<sup>10</sup> argues that over the last 25 years (1980-2004), partner countries have benefited little from globalization, whether in terms of per capita income, the development of trade flows or the attraction of foreign direct investment. "According to the most commonly accepted estimates, partner countries must create 2 million jobs over 15 years to simply contain the current unemployment rate. Recent economic projections show that high growth rates can only be achieved by deep regional economic integration".

Overall it becomes clear that, in a globalized economy, the socio-economic challenges facing the Mediterranean countries are large: for them, they have to undertake major structural and modernization reforms in order to progressively gain access to the market economy, adopt international standards in order to be competitive in international markets and to create favorable conditions for the massive job creation called by rapid demographic growth.

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<sup>10</sup> Philippe LANGEVIN (octobre 2006), « Le processus d'intégration économique euro méditerranéenne : Le rôle des services dans l'agro-industrie, l'innovation et les technologies », Université de la Méditerranée. Marseille. P 1- 10.

## **1.2. Aims and Objectives:**

The Maghreb countries have strategic relations with the European Union. The latter holds a monopoly in the volume of trade with the Maghreb countries, according to statistics for the year 2006. Tunisia tops the list with 74.4%, followed by Morocco with 61.2%.

After the launching of the Barcelona Process, the trade liberalization of the industrial products became a tangible reality. All the products coming from the Mediterranean countries have access to the market of the European Union duty-free of customs. Reciprocally, the Mediterranean countries set up a process of progressive dismantling their customs tariffs. The agreements of association comprise commercial provisions which envisage a progressive dismantling of their customs duties. Thus, liberalization became effective for all the industrial products and more than 80% of the imported agricultural produce which enter the duty-free EU or at preferential rates. Reciprocally, 1/3 of European exports of agricultural products profit from tariff preferences in the Mediterranean countries.

The economies of Tunisia, Morocco share many characteristics. In these two countries, agriculture is important, the public sector dominates the economy to

different degree, both have diversified economies and the pattern of the foreign trade is in general rather restrictive, in spite of a larger opening on the European Union. The most important structural difference is that Morocco is considerably larger from a population (exceeds 30 million in Morocco, conversely Tunisia has a population of just over 10 millions) and land area perspective (Morocco 274,461 square miles while Tunisia 63,378 square miles).

The present study proposes to analyze the impact of FTA on the macroeconomic indicators of Tunisia and Morocco as well as on the trade between the two North African countries.

### **1.3. Research Question:**

This thesis specifically will examine the EU–North Africa trade liberalization experience between 1995 and 2017, and enquires whether this process has helped the Mediterranean states transform their economic basis and industrialize as they pursues better social standards for its people.

In sum, this thesis intends to looking at how trade liberalization between the EU and both Tunisia and Morocco would affect the latter's internal economic dynamic and transition effort to achieve greater economic development.

Its main question is:

What is the impact of this alliance between the European Union and the Maghreb countries? Will this association have a positive or negative impact on the economies of the Maghreb countries?

From this main question, we can deduce other questions which are:

- Is the economic partnership a strategic choice for the Maghreb countries, or is it a necessity imposed by the globalization which supposes that the idea of the groupings is a new framework of the contemporary international relations?
- Does tariff dismantling coincide with the anticipated increase in investment and reallocation of factors of production, two of the main intermediate objectives sought by the Barcelona Process?
- Did the destabilizing effects anticipated in the short term on public finances and the balance of payments materialize and weaken major macroeconomic balances?
- Has tariff dismantling begun to have a positive impact on the final objective of the process, the renewal of the growth regime?

Estimating the impact of the free trade area on Tunisia and Morocco's macro-economic situation poses two main methodological difficulties:

1. Most of the expected benefits of the free trade area are indirect and medium and long term.
2. While the costs are mostly direct and short term.

#### **1.4. Hypothesis:**

To answer these question three hypotheses will be tested under two conditions:

H1: Trade liberalization would encourage Tunisia and Morocco to diversify production and industrialize and thus would have a positive impact on their respective economies.

H3: The Economic dependence of Tunisia and Morocco has a positive impact on the level and speed with which they adopt European norms and achieve success in their respective economic development process.

#### Condition 1:

The gains from the partnership and the free trade area must be greater than the total cost of the reforms needed to meet the two initial objectives of improving competitiveness and enhancing growth and cohesion. Undoubtedly, the

Mediterranean collaboration augurs substantial gains that raise the question of their financing.

Condition 2:

The partnership zone must be a region of mutual benefit, whatever the measures implemented, economic situation of all parties should not deteriorate are in the area covered by the partnership or outside it. In other words, the results of the partnership must be optimal for each participating country. Thus the Euro-Mediterranean Free Trade Agreement should consolidation the national competitiveness of European as well as MPs countries, and should not slow down growth or make serious social crises.

**1.5. Research Methodology:**

The thesis specifically looked at FTAs in the context of the Barcelona Process and ENP to examine whether trade liberalization is an appropriate strategy that would help the Southern MS economically develop and acquire better opportunities and competitiveness for their enterprises. It intends to take a more direct approach to measuring the impact of trade liberalization on economic indicators, mostly ex-ante

quantified analysis of how free trade area has affected the economies of both south Mediterranean countries Tunisia and Morocco.

First, an analytical framework for the economic development experience in Tunisia and Morocco will be analyzed through applying the determinants of economic development on both MS. There follows an assessment of the economic impact of the Euro-Mediterranean free Trade Areas (EMFTAs), an analysis of trade liberalization effects on economic variables of both Tunisia and Morocco:

1. Impact on trade
2. Impact on the balance of payment
3. Impact on the state and public finances
4. Impact on industry and businesses

Third, some analysis will be elaborated on the South-South component of Euro-Mediterranean Partnership namely its impact on the bilateral trade liberalization between Tunisia and Morocco through using Grubel Lyod Index.

Finally, the essay will seeks to identify the reasons why the gains of this FTA are so limited for the SMP and explore possible national policies and accompanying measures within the framework of EMFTAs could be used to mitigate the negative

economic consequences which may result from trade liberalization and hence strengthen their economic and social sustainability.

This method requires selecting and analyzing very different cases in order to eventually identify similar and overlapping tendencies that can be believed to hold true across the whole SMC. Thus, as the FTA covers ten countries in its Southern Mediterranean region, analyzing all of them is not possible due to the limits of this project. However, it is still possible to understand the flaws of the FTZ by investigate the two most considered advanced cases.

Tunisia is chosen because it is considered to be very cooperative with the EU, first to have concretized the different stages of realization of a free trade zone with the European Union and is now in democratic transition; Morocco, on the other hand, has often been considered as the EU success story and has a stable authoritarian political regime.

Such selection helps to evaluate the impact the FTZ has had on these economies and to which extent the outcomes of this process are similar and overlap.

## **2. CHAPTER 2: ECONOMIC DEVELOPMENT EXPERIENCE (1995 AND 2017):**

In this chapter we will look at two Mediterranean States, TUNISIA and MORROCO, and refers to determinants of economic development theory in order to present a case that the low economic development in both MS is due to the EURO MED FTA. Through provide a theoretical explanation as to why liberalization would encourage Tunisia and Morocco to specialize in producing and exporting agricultural products and light manufactures, both of which are unlikely to reap a substantial added economic value and would prevent the two economies from attaining higher income levels. Thus actual trade liberalization would it be the most appropriate strategy to help MS develop their economies? Or it would inhibit their ability to diversify production and industrialize, which is a prerequisite to a successful developmental transition?

As we have learned, there are three ways to model economic growth: First as an outward shift in the Production Possibility Frontier of the economy, second as a shift to the right in its aggregate supply curve. Third, both factors of production and technology change positively leads to shift in both curves. Therefore, anything that

increases the quantity or quality of factors of production or that improves the technology available to the economy contributes to economic growth.

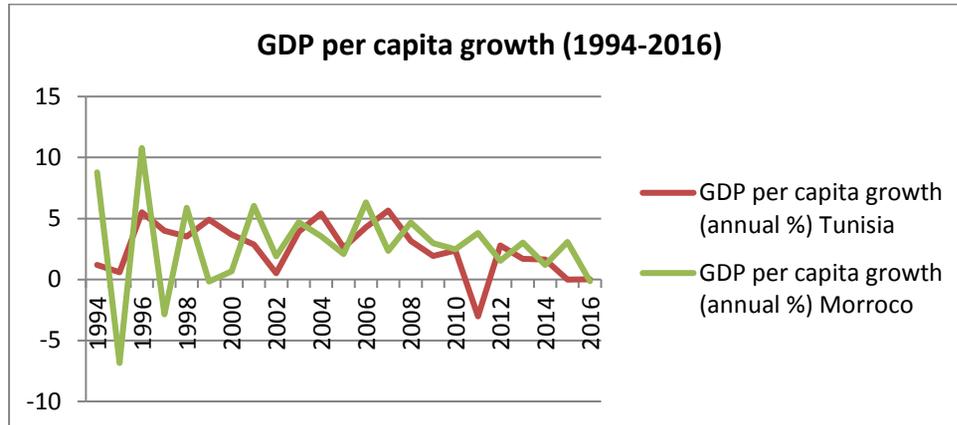
Determinants of economic growth are factors that directly influence the rate of economic growth. These are six major determinants of growth. Two of these are typically grouped under outward shift in PPF and increase in a country's potential output which include economic system & capital formation and natural resources and land area. The other four categories are supply factors which include political stability & corruption, population & human capital, international environment & government policies, and finally conditions in foreign trade & FTA grouped under outward shift in supply curve.

*Table 1: Determinants of Economic Development:*

<b><u>DETERMINANTS</u></b>	<b><u>DEPENDENT VARIABLE</u></b>	<b><u>INDEPENDENT VARIABLES</u></b>					
	<b>ECONOMIC GROWTH</b>	<b><u>OUTWARD SHIFT IN PPF</u></b>		<b><u>SUPPLY FACTORS</u></b>			
		<b>GROSS CAPITAL FORMATION AND ECONOMIC SYSTEM</b>	<b>NATURAL RESOURCES &amp; LAND AREA</b>	<b>POLITICAL STABILITY &amp; CORRUPTION</b>	<b>POPULATION GROWTH &amp; HUMAN CAPITAL</b>	<b>INTERNATIONAL ENVIRONMENT &amp; GOVERNMENT POLICIES</b>	<b>EURO-MED FTA</b>
<b>TUN</b>							
<b>MOR</b>							

## 2.1. Economic Growth between 1995 and 2017:

Figure 1: GDP per capita Growth between 1994 and 2016:



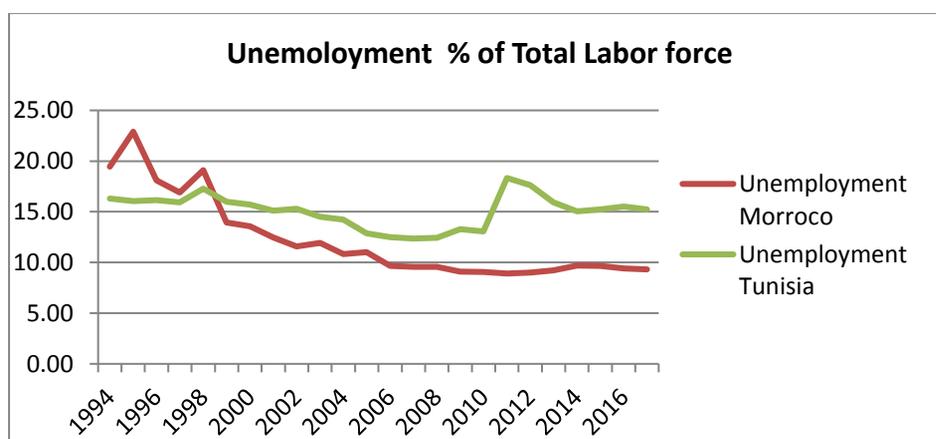
Source: World Bank Data

As shown in Figure 1, during the second half of the 1990s, Morocco's GDP per capita growth has deeply fluctuated, but beginning from 2000 onwards it became more stable. This fluctuation in Morocco's growth during those years can be explained well by a long-lasting drought. Given that agriculture plays an important role in Morocco's economy, so when that sector is experiencing difficulties the effects are felt immediately in the economic performance of the country.

Tunisia, on the other hand, saw relatively stable growth between 1994 and 2009. And there was a sharp drop in 2011 due to the turmoil that Tunisia experienced after the revolution of 14 January 2011.

On average both countries experienced a relatively similar level of GDP per capita growth at roughly 2.5% between 1994 and 2017. This indicator can to certain extent explain the similarity of economic development in Tunisia and Morocco.

Figure 2: Trend of unemployment rate:



Source: World Bank Data

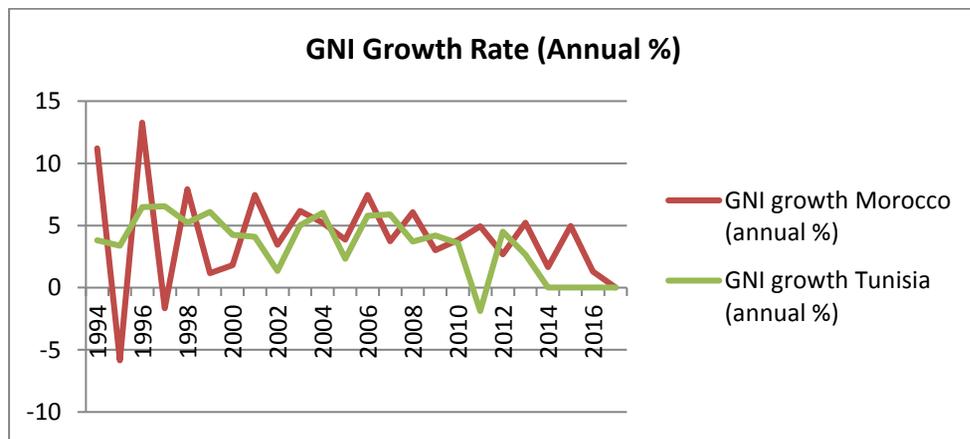
Generally, when unemployment rates is increasing, economic development is more likely to be troubled, while if unemployment rates is falling that can be considered as an indicator for a sound and performing economy.

Over the period 1995-2017, the unemployment shows a plateau trend in Tunisia and a modest downward trend in Morocco.

In Tunisia the unemployment rate remained relatively unchanged between 1996 and 2009. Starting at about 13% in 2010, the rate drastically rose to 18.33% in

2011 only to then fall back to 15% in 2013 and continue to rise steadily during the rest of the period covered by thesis. Meanwhile, Morocco's unemployment rate fell from a high of 23% in 1995 to 9% in 2006. For the next years, until 2017, the unemployment numbers stagnated around that figure.

Figure 3: Gini Index rate between 1994 and 2017:



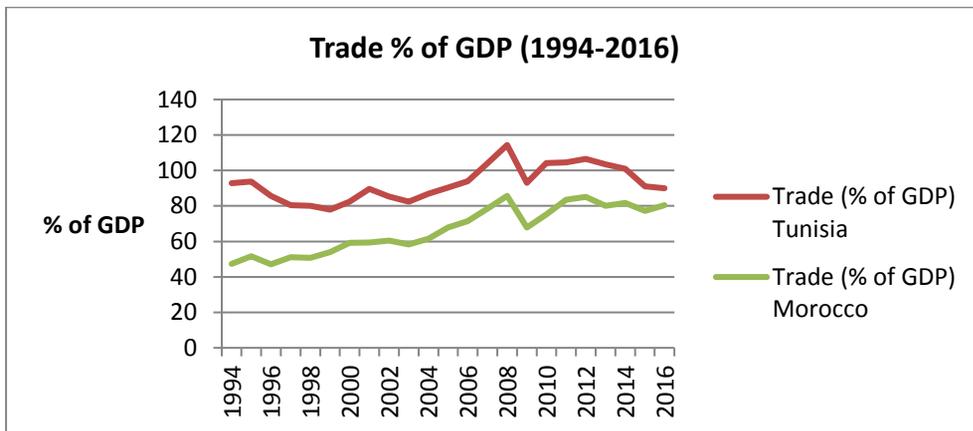
Source: World Bank Data

In Morocco the Gini Index remained almost unchanged, staying around 40, while in Tunisia the Gini Index fall slightly from 41.7 in 1995 to 35.8 in 2010.

In the two cases, the Gini Index does not reveal very much about the level of economic development and also does not show the distribution of inequality, because income inequality between different regions in Tunisia was an important reason behind the rising of 2011.

Economic Liberalization Studies have shown that the level of economic development can be linked to the level of economic liberalization. The basic assumption is that the more open an economy is the more developed it will become. To measure economic liberalization this part looks at volume of trade (as a percentage of GDP).

*Figure 4: Trend of Trade between 1994 and 2017:*



*Source: World Bank Data*

While Tunisia has had a consistently higher trade share; the trend of development does not differentiate too much.

Morocco saw a slow increase of trade from 55% to 60% between 1994 and 2003.

Then in the following years until 2008 the share of trade increased massively to 88%, before dropping sharply down to 68% in the following year.

In Tunisia the development at first looked less positive, dropping from 92% in 1994 to 78% in 1999. Starting in 2002 trade became more important again and by 2008 it made up 114% of Tunisia's GDP. Just like in Morocco, the share of trade dropped sharply to 93% in 2009, therefore, it is likely that it was caused by the same phenomenon. The global financial crisis of 2008 suggests itself as an explanatory factor.

Between 2004 and 2008, Southern Mediterranean exports to and imports from the EU have grown by an average of, respectively, 11% and 8% per year. In 2009, trade registered a strong contraction in account (-20% compared to 2008), but in 2010 the trend start to recover.

The one indicator where notable impact can be observed on the degree of economic development is trade. Euro-Mediterranean total trade was almost €200 billion in 2009 (EU exports to Southern Mediterranean countries was around €114 billion; Southern Mediterranean states exports to the EU totaled €86 billion), representing almost 10% of total EU external trade, and more than 40% of total Southern Mediterranean trade. Given the rising importance of trade beginning from the signature of the Barcelona Process, it makes sense to take a closer look at this

factor and assess its eventual impact. This will be done in the next chapter where the impact of Euro med FTA on the economies of both countries will be assessed.

## **2.2. Gross Capital Formation and Economic System:**

### **2.2.1. GDP Growth and Gross Capital Formation:**

Scholars in neoclassical or exogenous growth theories explained the determinants of the long-run growth. According to Solow neoclassical growth theory, the income per capita growth rate is explained merely by the exogenous rate of technological rate. This theory argues that technological revolution and GCF plays a significant role in economic growth, and the latter cannot be sustainable without advances in technology. Thus, technological advances impact the economic growth that cannot take place unless technological developments are available.

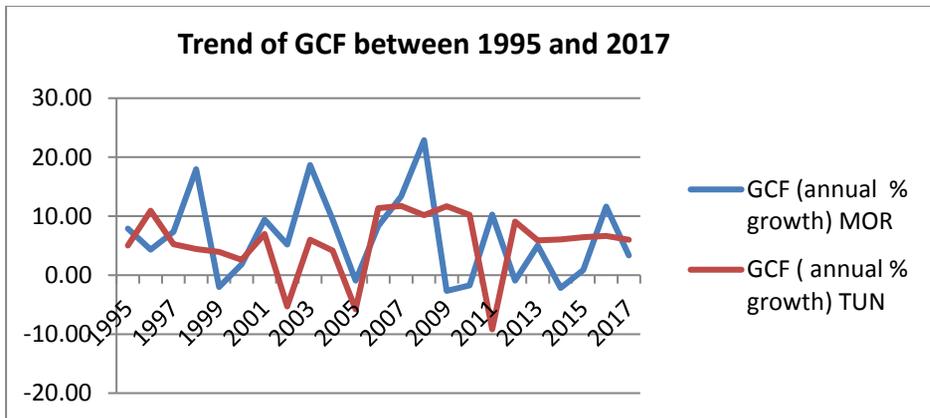
*Table 2: Gross capital formation between 1995 and 2017*

<b>Country Name</b>	<b>Morocco</b>		<b>Tunisia</b>	
<b>Years</b>	<b>GCF (constant 2010 million US\$)</b>	<b>GCF (annual % growth) MOR</b>	<b>GCF (constant 2010 Million US\$)</b>	<b>GCF (annual % growth) TUN</b>
1995	11285.84	7.89	5075.33	5.03
1996	11774.17	4.33	5630.63	10.94
1997	12641.91	7.37	5925.37	5.23

1998	14914.97	17.98	6187.36	4.42
1999	14613.89	-2.02	6433.00	3.97
2000	14878.74	1.81	6600.06	2.60
2001	16275.10	9.38	7061.81	7.00
2002	17117.69	5.18	6686.75	-5.31
2003	20307.79	18.64	7088.35	6.01
2004	22213.69	9.39	7381.93	4.14
2005	22011.74	-0.91	6953.68	-5.80
2006	23839.40	8.30	7744.64	11.37
2007	27028.92	13.38	8653.53	11.74
2008	33211.92	22.88	9532.02	10.15
2009	32325.61	-2.67	10647.56	11.70
2010	31763.06	-1.74	11738.46	10.25
2011	35029.58	10.28	10660.08	-9.19
2012	34703.04	-0.93	11628.61	9.09
2013	36438.43	5.00	12314.32	5.90
2014	35637.94	-2.20	13314.86	6.03
2015	35946.62	0.87	13996.47	6.42
2016	40134.29	11.65	14001.22	6.67
2017	41488.34	3.37	13318.33	6.02
<b>Average GCF</b>	<b>25460.12</b>	<b>6.40</b>	<b>9068.45</b>	<b>5.41</b>

*Source: The WORLD BANK Data Bank*

Figure 5: Gross Capital Formation Trend between 1995 and 2017:

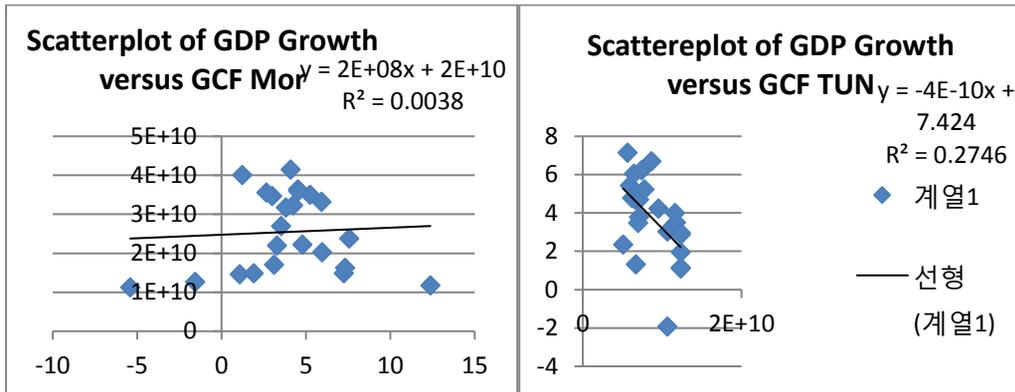


Source: The WORLD BANK Data Bank

Gross Fixed Capital Formation in Morocco increased to 41488 US\$ Million in 2017 from 40134 US\$ Million in 2016. Gross Fixed Capital Formation in Morocco averaged 25460.12 US\$ Million with average annual growth rate of about 6.40 % from 1995 until 2017, reaching an all-time high Growth rate of 11.65 % in 2016 and a record low Growth rate of -2.20 % in 1999 and 2014. Tunisia's Gross Fixed Capital Formation was reported at 13318.33 USD Million in Dec 2017. This records a decrease from the previous number of 14001.22 USD Million for Dec 2016. Tunisia Gross Fixed Capital Formation data, averaging 9068.45 USD Million with an average annual growth rate of 5.41 % from 1995 to 2017. The data reached

an all-time high Growth of about 10% between 2006 and 2010, a record decline of -9 % in 2011 and stagnation at around 6% between 2014 and 2017.

Figure 6: Correlation between GDP growth and GCF:



Source: The WORLD BANK Data Bank

The aim of this part is to determine the impact of domestic investment on economic growth in Tunisia and Morocco during the period of 1995 to 2017.

According to the results, we find that there is a positive impact of domestic investment GFCF on economic growth in Morocco (GDP Growth MOR = 3.403 + GCF \* 2.096 the coefficient value is in the positive range), then that indicates the relationship between the variables is positively correlated, or both values increase or decrease together; however, there is negative relationship between domestic investment and economic growth in Tunisia: GDP Growth TUN = 7.423 + GCF \*

( -4.223) then that indicates that the relationship between the variables is negatively correlated, or as one value increases, the other decreases.

This is due to the importance of the geographical location of Morocco. The Moroccan government also encourages investors to invest and trade on their land by providing them with the convenience and ease of procedures. In addition, Morocco is a politically stable country with laws in force.

The technological development witnessed by Morocco has helped the owners of factories and companies to excel in their work by improving the quality of production and marketing and at all other levels.

### **2.2.2. Economic System:**

*Table 3: Break down of Tunisian Economic Activity by sector:*

<b>Breakdown of Economic Activity By Sector</b>	<b>Agriculture</b>	<b>Industry</b>	<b>Services</b>
<b>Employment By Sector (in % of Total Employment)</b>	13.7	42.6	43.7
<b>Value Added (in % of GDP)</b>	9.6	26.7	63.7
<b>Value Added (Annual % Change)</b>	2.5	-1.5	0.6

*Source: World Bank, Latest Available Data 2017.*

Agriculture is a key sector of the Tunisian economy. It accounts for 10.1% of the GDP and employs nearly 15% of the workforce. This performance is the consequence of the large-scale support and modernization efforts made within the

framework of the country's development policy, as well as the regulation of agricultural and rural activities.

Industry represents 28.3% of the GDP and employs one-third of the workforce. The textile industry has been relatively hit by Asian competition. The country's industrial sectors are predominantly export-oriented.

The local economy is largely orientated towards services, which account for 61.6% of the GDP, including the booming sectors of ICT (Information and communication technologies) and tourism. The service sector employs nearly one-half of the country's workforces. Tourism, which suffered from terrorist attacks that hit the Tunisian soil, started to recover in 2017.

The economic system of the country presents several facets. It is characterized by a large opening towards the outside world. France remains the primary trade partner (supplier and customer) of Morocco. France is also the primary creditor and foreign investor in Morocco.

Since the early 1980s, the Moroccan government has pursued an economic program toward accelerating real economy growth with the support of the International Monetary Fund, the World Bank, and the Paris Club of creditors. The country's currency, the dirham, is now fully convertible for current account

transactions; reforms of the financial sector have been implemented; and state enterprises are being privatized.

*Table 4: Composition of Moroccan Economic Activity by sector:*

<b>GDP - composition by sector</b>	<b>Agriculture:</b>	14.8%
	<b>Industry:</b>	29.10%
	<b>Services:</b>	56%

*Source: World Bank, Latest Available Data 2017.*

## **2.3. Land Area and Natural Resources:**

### **2.3.1. Land Area:**

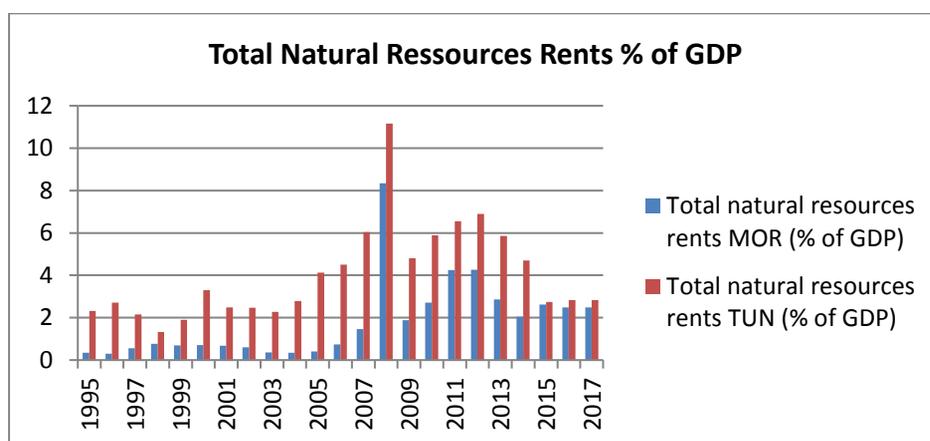
With reference to the neoclassic growth theory “land input has a marginal effect on economic growth and may even have a positive effect with the constant input in technology and other factors of production”. Some analysis indicate that most of time in growth regressions, land inputs show up as a leverage to economic growth. Economies with abundant land area can lease industrial land at lower prices to attract investors or enhance national revenues by leasing land to finance infrastructure and urbanization which can reflect increasing investment and promotes large-scale economic growth. Therefore Land input is an important factor for governments to compete for economic growth. From this perspective

Morocco's economy seems to be more favored than Tunisian economy.

From this perspective, with 446,550 km<sup>2</sup>, Morocco seems to be more favored in terms of land area than Tunisia which lays over 163,610 km<sup>2</sup>.

### 2.3.2. Natural resources:

Figure 7: Trend of natural Resources rents between 1995 and 2017



Source: World Bank Data.

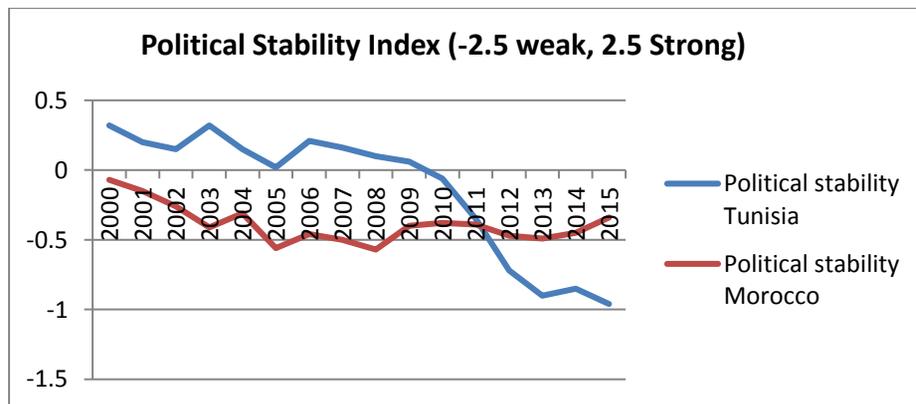
According to the World Bank development indicators database, In Morocco the total natural resources rents in percentage of GDP were established at around 2.4794 % in 2016. The average value between 1995 and 2017 was 1.96 percent with a minimum of 0.25 percent in 1994 and a maximum of 10.46 percent in 1974. The average value for Tunisia during the same period was reported at 5.3 percent with a minimum of 0.32 percent in 1972 and a maximum of 15.19 percent in 1980.

Although it seems to be obvious that natural resources rents have a positive impact on economic growth, through improving national revenue and wealth, many researches have resulted to ambiguous outcomes. It has been shown that several countries rich in natural resources have experienced low economic growth and vice versa. Still the key challenges concern government policies and effectiveness to turn resource rents into a leverage to boost economic growth rather than a detriment of development.

## 2.4. Political Stability and Corruption:

### 2.4.1. Political Stability:

Figure 8: Political Stability Index between 2000 and 2015



Source: The GlobalEconomy.com, World Bank.

Although it was a downward trend, until 2009, Tunisia was more stable politically than Morocco. Its Political Stability Index was 3.7 in 1995 and 0 in 2009. But since 2011 there was a sharp decline in the index that reached -1 in 2015 and this due to destabilization after the revolution and the collapse of authoritarian political regime. Over the period 1995-2016, the average value for Tunisia was -0.16 points with a minimum of -0.99 points in 2016 and a maximum of 0.32 points in 2000. While, for Morocco it's established at -0.35 points during the same period with a minimum of -0.57 points in 2008 and a maximum of 0.31 points in 1998.

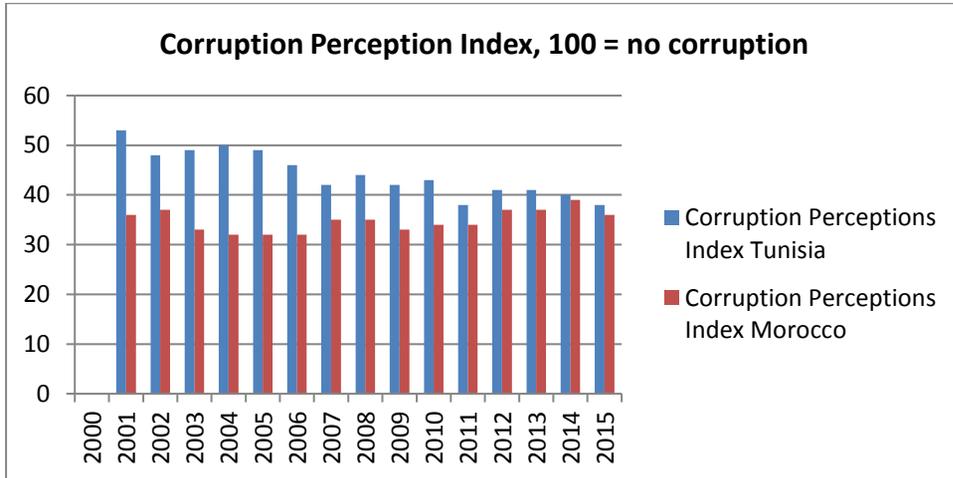
#### **2.4.2. Corruption:**

Corruption is considered to be a strong obstacle for growth and development. The academic literature finds that corruption has negative effect on economic performance and growth, especially through political instability (accounts for about 53% of the total effect) and also through reducing the share of private investment and the level of human capital. "A one-unit increase in the corruption index reduces the growth rate by 0.545 percentage points"<sup>11</sup>.

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<sup>11</sup> Mo, Pak Hung, Corruption and Economic Growth, March 2001, pp. 66–79.

Figure 9: Corruption perception Index between 2000 and 2015



Source: The GlobalEconomy.com, World Bank.

Over the period of 2001-2015, Tunisian average value of corruption index was established at 44 points with a minimum of 38 points in 2011 and a maximum of 53 points in 2001. While the average value for Morocco during the same period was 35 points with a minimum of 32 points in 2004 and a maximum of 39 points in 2014.

## 2.5. Population growth and human Capital:

### 2.5.1. Population Growth versus GDP Growth:

The relationship between population growth and economic growth is controversial, in that low population growth in high-income countries is more likely to create

economic problems while high population growth in low-income countries may slow their development.

Many analysts argue that “economic growth in high-income countries is likely to be relatively slow in coming years in part because population growth in these countries is predicted to slow down considerably”<sup>12</sup> (Baker, DeLong, & Krugman, 2005). Others argue that “population growth has always been problematic as more people will consume and use more of the finite resources available”<sup>13</sup> (Daniel W. Linden, 2017).

Economic growth can be measured by changes in a country’s GDP which can be decomposed into two parts: population and economic elements (population \* GDP per capita). In that  $\text{Economic growth} = \text{Population growth} + \text{GDP per capita growth}$  (Thomas Piketty, 2014)<sup>14</sup>.

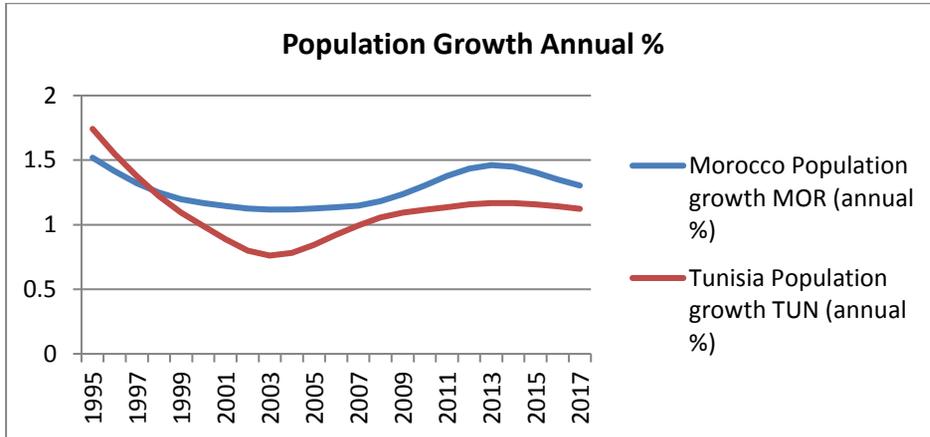
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<sup>12</sup> Dean Baker, J. Bradford DeLong and Paul Krugman, 2005, Asset Returns and Economic Growth

<sup>13</sup> Daniel W. Linden, 2017, Examining the occupancy–density relationship for a low-density carnivore

<sup>14</sup> Thomas Piketty, 2014, Capital in the Twenty-First Century, p. 72

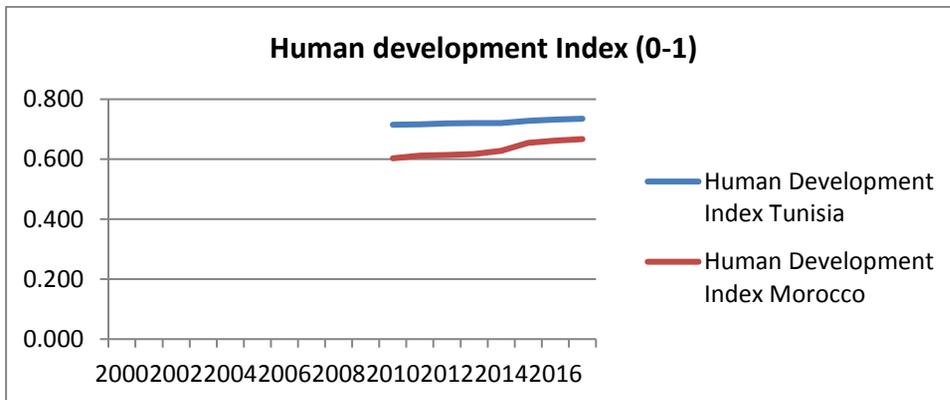
Figure 10: Population Growth between 1995 and 2017



Source: World Bank Data.

### 2.5.2. Human Capital:

Figure 11: Human Development Index

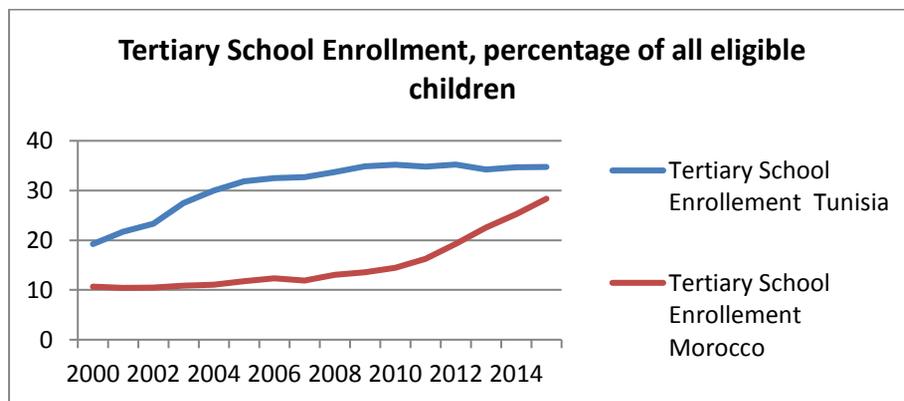


Source: The GlobalEconomy.com, World Bank.

Between 2000 and 2017 The Human development index shows an average value of 0.72 points for Tunisia with a minimum of 0.653 points in 2000 and a maximum

of 0.735 points in 2017 (the global ranking is 95). While it's established at an average value of 0.585 points for Morocco with a minimum of 0.526 points in 2000 and a maximum of 1.4 .667 points in 2017. (Global raking is 121 over 181 countries).

*Figure 12: Tertiary School Enrollment in Tunisia and Morocco between 2000 and 2015*



*Source: The GlobalEconomy.com, World Bank.*

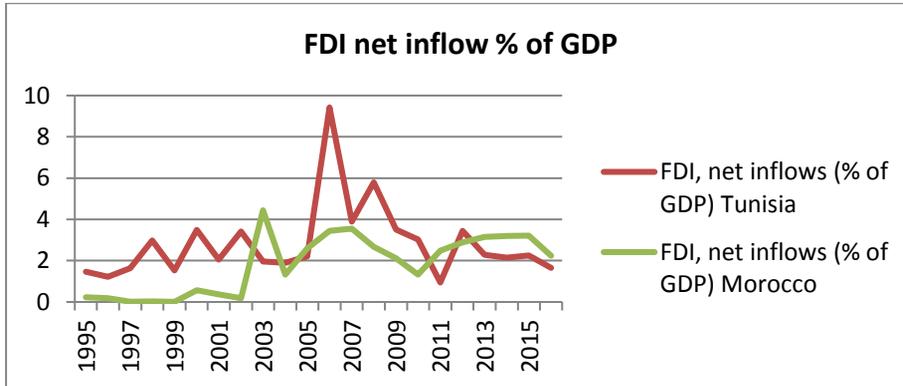
Between 2000 and 2015, this indicator show an average value of 15.96 % for Tunisia with a minimum of 19 % in 2000 and a maximum of 35.22 percent in 2012, (ranked 52). While it show on average 10.38 % for Morocco with a minimum of 10% in 2000 and a maximum of 31.96 percent in 2016. Global ranked 53 over 81 countries.

Many recent studies findings approve that there is a very strong correlation between technology advancements, human capital investment, and economic growth. In that long term investment in human capital can clearly help grow economies and this effect has the potential to be a changer especially in world increasingly globalized. In this perspective if we look for example to the top 25% of countries that have improved human capital over the last 25 years, and we compare them to the bottom 25 % of countries that have not invested enough in developing human capital over the same period; the difference in economic growth is as high as 1.25% of GDP per year, and that connection is going to be more powerful as the economy becomes more digitized and requires more sophistication. And this is not all because otherwise, if population does not get the education necessary they are going to find themselves in an economy where they cannot compete and that's going to be a source of instability, conflict and violence going forward.

## **2.6. International Environment and Government effectiveness:**

### **2.6.1. International Environment:**

Figure 13: Trend in FDI net inflow between 1994 and 2017



Source: World Bank Data

Foreign direct investment has played a small role in both countries. In Tunisia the share of FDI fluctuated between 1% to just over 3% until 1998. By 2003 it decreased and remained steady at just 2% until 2005, but then rose dramatically to fewer than 10% in 2006. By 2009 this share dropped down to 3.5% and by 2011 to 1%. Again the global financial crisis is likely to be the cause for the downturn in the years 2008 and 2009 and the revolution for the downturn in 2011. Meanwhile, Until 2002 FDI made up less than 1% in Morocco. Not counting the spike in 2003 (4.4%), the share of FDI rose steadily to 3.8% in 2007, before dropping to 2% in 2009. Since 2011 it starts to rise benefiting from the decrease in Tunisia.

At this stage it is difficult to make a statement about the observable development. Whether the rise of FDI in both countries after 2002 related to the opening of their

respective economies, given that it happened in a similar time period in both countries or it may just be related to the global market developments.

### 2.6.1.1. Evolution of FDI in Morocco:

*Table 5: Evolution of FDI Flows (Millions of US Dollars)*

Years	1990-1995 (annual average)	1996-2000 (annual average)	2000	2001	2002	2003	2004	2005-2010 (annual average)	2010-2015 (annual average)
<b>Morocco</b>	428	564	423	2808	481	2314	853	1230	1390

*Source: World Bank (2015), Executive Summary - International Finance.*

Relying mainly on the national privatization program launched in 1993, Morocco has attracted relatively large flow and increased foreign capital. The contribution of FDI to gross fixed capital formation (GFCF) thus improved significantly, from an annual average of 5% between 1990, 1995 to 17.6% between 1999, 2004. FDI flows vary however, year-on-year because of Morocco's difficulties in developing an independent dynamic of privatization operations. In the medium term, the gradual decline in privatization could therefore lead to a decline in FDI flows. Thus, foreign exchange earnings were established according to the Exchange Office at \$ 1.6 billion in 2004, a decrease of 41.8% compared to 2003. In total,

foreign investment income contributed in 2004 to 3.2% of GDP and 13% of GFCF compared to 5.7% and 24.3% respectively in 2003.

The increases observed in FDI flows were notably made possible by the dynamics of integration into the world economy initiated at the turn of the 1990s. Thus, the convertibility of the Dirham was established in 1993 and the country joined the GATT in 1987.

In 1996, an association agreement was concluded with the European Union. A free trade agreement was also signed in June 2004 with the United States and is expected to come into force in 2006. In addition, Morocco is negotiating several "South-South" trade agreements.

A free trade agreement with Jordan, Egypt and Tunisia was signed in February 2004. Likewise, a free trade agreement was signed with Turkey in April 2004. In addition, Morocco has established incentives to attract FDI flows such as:

- The structural adjustment program adopted in 1983;
- The privatization process launched in 1989.
- The Investment Charter promulgated on November 8, 1995 (replacing the 1983 Investment Code) which includes measures to reduce the cost of investment and allows the free transfer of invested foreign capital and capital gains performed.

- The creation in 2002 of the 16 Regional Investment Centers. They are intended to provide business start-up aid as well as investment aid and regional promotion to investors. These centers aim to make the region a space for promoting national and international investment.

Historically, because of relatively low labor costs, manufacturing industries are the largest investment item. Indeed, Morocco has primarily tried to specialize in the reception of FDI related to subcontracting activities in the textile / clothing and electrical and electronic construction and even automotive sectors. At present, more and more FDI flows are moving towards service activities (call center especially) and tourism because of its proximity to the EU.

#### **2.6.1.2. Evolutions of FDI in Tunisia:**

The dynamics of Tunisia's integration into the international economy began in the 1970s following a change in the legislation on FDI and the gradual introduction of tax incentives, notably after taking on charge by the State (total or partial) of social contributions for a period of 5 years.

With the adoption of the Structural Adjustment Plan (SAP) in 1986, the liberalization of the Tunisian economy has greatly increased: price freedom, privatization program, openness to trade, convertibility of the currency and

freedom of movement of capital. Since the implementation of the SAP, other measures have been decided:

- Creation of free zones in 1992.
- Code of Investment Incentives in 1994.
- Integration in the WTO and accession to various multilateral treaties, for example the Association Agreement with the EU signed in July 1995.

*Table 6: FDI indicators in Tunisia (1994 - 2016)*

Years	1994	1995	1996	1997	1998	1999	2000	2005	2010	2015	2016
FDI / GDP (%)	3.4	1.8	1.4	1.9	3.4	1.8	4	2.4	3.9	2.4	2.3
FDI / FBCF (%)	12.7	7.6	6.2	7.8	13.6	7	15.2	9.3	15.4	10.1	10.2
FDI / External capital inflows	20.6	13.5	11.3	14.7	31.5	14.8	28.7	18.8	27.8	21.6	18.7

*Source: Annual Reports Central Bank of Tunisia.*

Internal liberalization and external liberalization reforms have led to changes in FDI flows. Thus, the movement of FDI will experience strong growth from the

beginning of the seventies followed by a slight deceleration at the end of this decade and a recovery in the early eighties (Zouari & Sboui, 2004)<sup>15</sup>.

This acceleration in FDI flows can be explained in part by the dynamics of the textile industry. From the mid-eighties, movements in FDI flows will be much more irregular. During two periods, significant increases will take place: in 1991 - 1992 firstly because of specific investments in oil exploration and the gas field then in 2000 due to the increase of investments benefiting the sector of industries manufacturing (privatization of two cement plants acquired by Portuguese and Italian developers).

Although it has a relatively favorable administrative and legislative framework for hosting FDI, Tunisia receives only a modest share. Thus, Tunisia's record in world FDI and investment in developing countries hardly exceeded the respective values of 1.1% and 3.2% recorded in 1982. Moreover, the share of FDI in GDP remains low with an average rate of 2.5% for the period 1994-2001. The cumulative flows by Tunisia remain low compared to the countries of South-East Asia.

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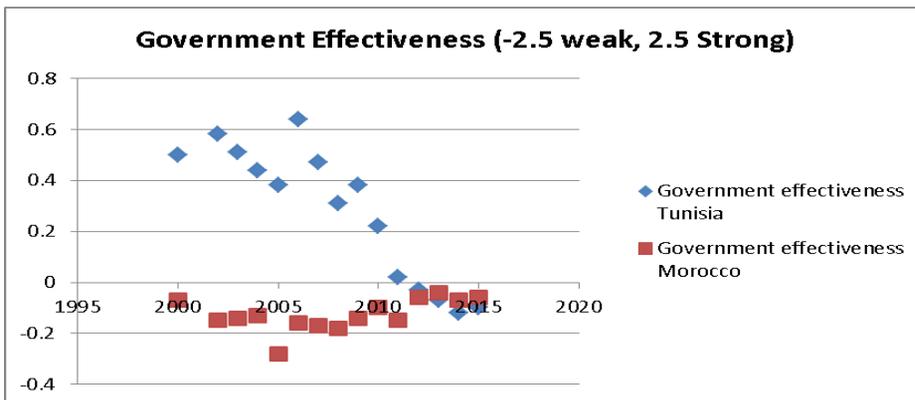
<sup>15</sup> Sonia Zouari and Faouzi Sboui, Investissements directs étrangers et processus de désendettement dans le contexte de mondialisation: le cas de la Tunisie, 2004.

Geographically, capital inflows are mainly of European origin, with a steady increase from France and Great Britain, the emergence of Italy, and the deterioration of the Netherlands and Spain. The Arab countries (especially those of the Gulf) occupy the second rank. The share of the United States remains modest and irregular.

At the sectorial level, hydrocarbons having been one of the first sectors to attract FDI since 1994 are in decline due to lack of potential reserves. The rest of FDI is oriented towards services (tourism and real estate) and to a lesser extent to manufacturing industries.

### 2.6.2. Government Effectiveness:

Figure 14: Government effectiveness 1995 and 2015



Source: The GlobalEconomy.com, World Bank.

Over the period 1995 – 2011 Tunisian government has been more effective than Moroccan Government. The average value for Morocco during that period was -0.12 points with a minimum of -0.28 points in 2005 and a maximum of -0 points in 1998. While the average value for Tunisia during the same period shows 0.27 points with a minimum of -0.21 points in 2016 and a maximum of 0.64 points in 2006.

But beginning from 2011, government effectiveness index of Tunisia declined steadily and this can be explained by the turmoil that the country has experienced since February 2011 which has been accompanied by a change of political regime.

### **3. CHAPTER 3: INTER REGIONAL IMPACT OF EMFTAs:**

In this chapter we will focus on the assessment of the impact of the Euro-Mediterranean free Trade Areas (EMFTAs) on the two SMCs economy, through analyzing the trade liberalization effects on some economic variables of both Tunisia and Morocco:

1. Impact on trade: here we will be using a gravity model taking export and imports of both countries as Dependent variables.
2. Impact on the balance of payment
3. Impact on the state and public finances
4. Impact on industry and businesses

#### **3.1. Impact on trade:**

##### **3.1.1. Gravity Model: Export and Imports as Dependent Variables:**

To assess the effects of EUROMED FTA in it's both dimensions (Vertical and Horizontal trade liberalization) we use a gravity equation of bilateral trade flows in its extended form.

The Dependent variable used in this estimating equation are bilateral imports and exports flows that covers the period between 1995 and 2017 of the two

Mediterranean states: Tunisia and Morocco that are considered as the most advanced among the MENA countries in trade liberalization with the European union as well as with each other (low level of economic development and trade). While, the Independent (explanatory) variables include among others two dummy variables related to trade liberalization process:

1. Euro MED FTA: indicating the free trade agreement with EU: North-South cooperation (vertical trade liberalization).
2. AMU: indicating Agadir bilateral trade agreement between the two North African countries: South-South cooperation (Horizontal trade liberalization).

***Estimating Equation:***

*Equation 1: Estimating Equation: Trade Values as independent variables*

$\ln VT_{ijt} = \sum \beta_k RTA_{ijt} + \alpha_1 \ln GDP_{it} + \alpha_2 \ln GDP_{jt} + \alpha_3 \ln Distance + \alpha_4 \ln Language + \alpha_5 \ln Contiguity + \alpha_6 \ln Colony + \varepsilon_{ijt}.$
--

Where: Parameter Estimates (coefficients)

***In VT<sub>ijt</sub>***: refers to the value of trade, imports and exports respectively between country i and country j in year t. Available on UN COMTRADE database period 1995-2017.

**RTA  $ijt$ :** is a dummy variable indicating whether countries I and j are both the members of a bilateral or a multilateral regional preferential trade agreement in year t.

**In  $GDPijt$ :** Log GDP in country i and country j in year t, Available on World bank Database and cover the period between 1995 and 2017.

**Contiguity  $ij$ :** a dummy variable indicating whether the two countries have common border or not (1 if the two countries share common border and 0 if not).

**Language  $ij$ :** a dummy variable indicating if the two partners have common language (1 if they have common language, 0 if not).

**Colony  $ij$ :** a dummy variable indicating if the two partners have a colonial relationship (1 or 0).

**$\varepsilon_{ijt}$ :** Error term of regression.

**$\beta_k > 0$ :** In general effective FTA increase bilateral trade between both trading partners.

**$\alpha_1$  and  $\alpha_2 > 0$ :** It is predictable that trade flows increase with the size of economy of partners.

**$A_3 < 0$ :** serve as proxy for transportation costs; the model presumes that bilateral trade flows are negatively to the distance between the partners.

$\alpha_4$ ,  $\alpha_5$  and  $\alpha_6$ : serve respectively as a proxy for transaction costs and cultural ties. Hence they influence positively the bilateral trade between partners.

**Empirical results: Fixed effects estimates for bilateral exports and imports**

*Table 7: Fixed Effects Estimates for Bilateral Imports and Exports of Tunisia and Morocco*

<b>Coefficient</b>	<b>IMPORTS</b>		<b>EXPORTS</b>	
	<b>Morocco</b>	<b>Tunisia</b>	<b>Morocco</b>	<b>Tunisia</b>
EU-AA	0.378***	0.279***	-0.387	-0.273
	[0.10]	[0.09]	[0.10]	[0.11]
AMU	1.292**	0.283	1.714***	0.459*
	[0.52]	[0.34]	[0.48]	[0.24]
Morocco-Tunisia	-0.451	-0.227	-1.69	-0.182
	[0.28]	[0.19]	[0.34]	[0.17]
GDPi (partner)	0.924***	1.617***	0.849**	1.017***
	[0.18]	[0.24]	[0.13]	[0.23]
GDPj (reporting)	0.91***	-0.642	0.467	0.498
	[0.33]	[0.41]	[0.30]	[0.44]
DISTANCE (ij)	-0.792	-0.831	-1.484	-1.543
	[0.04]	[0.04]	[0.05]	[0.05]
CONTIGUITYij	0.793***	0.804***	-0.0533	-0.0624
	[0.11]	[0.11]	[0.12]	[0.12]
COLONY (ij)	0.304***	0.261**	0.683***	0.648***
	[0.11]	[0.10]	[0.12]	0.499
LANGUAGE (ij)	0.855***	0.683***	0.882***	0.799***
	[0.06]	[0.06]	[0.06]	[0.06]
Constant	-38.09	-14.18	-33.00	-32.27
	[7.29]	[8.64]	[6.61]	[9.24]
Number of Observations	1432	1176	1358	1051
R-squared	0.82	0.83	0.84	0.8
F test for Fixed Effects: Error	5086	821.7	957.9	7665

**Notes:**            **\*\*\* $p < 0.01$ , \*\* $p < 0.05$ , \* $p < 0.1$**

The estimation results show that imports and exports of both countries Tunisia and Morocco are deeply influenced by the Euro MED FTA. However, the estimated parameters on the indicator variable show positive sign in case of imports (Morocco=0.376, Tunisia = 0.279) and negative sign in the case of exports of SMS to EU (Morocco=-0.367, Tunisia = -0.263). This indicates that even though the EURO MED free trade area with UE enhance the development of trade between the EU and SMC, it's ambiguous since the development is unbalanced in favor of EU industrial products exports due to the opening markets and tariff dismantling of Tunisia and Morocco. Also this indicate the presence of barriers, on the EU side, that restrict agricultural trade, in which both SM countries have comparative advantage, and the UE still subsidizing it's agriculture product.

As for bilateral trade flows displayed through the Union Arab Maghreb agreement parameter show positive sign but still insignificant which indicate that trade among SMC still not as developed as predicted.

Overall, this model show that trade liberalization with EU was effective only in leveraging European exports to these two countries and not only does not contribute much for increasing the latter's exports to EU, but also had a negative

effect on the development of their industrial activity, things that lead to an increasing unemployment. This suggests that the EU is the main beneficiary from Euro Med FTA.

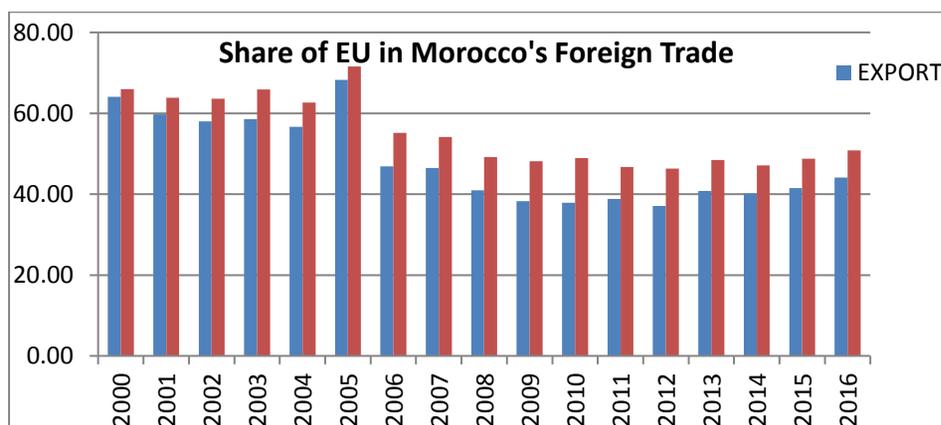
Unlike Tunisia, Morocco's main exports to the EU are agricultural products and textiles (European Commission - DG Trade, 2011). Finding an alternative market for these goods may be difficult, thus it is in both North African States economic interest to be on good terms with Europe and comply with EU regulations in order to further trade relations.

The main reasons why Tunisia and Morocco has been unable to realize greater economic development and higher living standards is the emphasis on trade liberalization as a component of the developmental process. It posited that the EU-SMCs scenario lent credence to the idea that liberalization encouraged specialization in agricultural commodities and goods whose production did not require a highly skilled labor force or technological sophistication, and hence would not reap a substantial economic value added to the MS. This is in line with the assertions of structural change theory, which insists that transforming an economy's productive capacity via industrialization and increased manufacturing is a prerequisite to successful development.

### 3.1.2. Impact on trade Balance:

#### 3.1.2.1. MOROCCO:

Figure 15: EU share in Morocco's foreign trade



Source: The GlobalEconomy.com, World Bank.

The European Union (EU) is Morocco's main trading partner, accounting for 59.3% of its foreign trade in 2006, compared to 60.1% in 2005. This group absorbs 72% of Moroccan exports compared with 74.3% in 2004 and supplied about 52.8% of its imports.

Morocco's trade balance with the European Union, which is structurally deficit, reached 27.9 billion dirhams in 2006. With the exception of the surplus with respect to Great Britain, at 2.3 billion of dirhams, trade with other members of the European Union in 2006 showed high trade deficits, especially vis-à-vis Italy (7.8 billion dirhams), Germany (6.5 billion dirhams) and France (3.7 billion dirhams).

Despite the increase in Morocco-EU trade in recent years, Morocco's share of overall EU trade has remained relatively stable (0.7% in 2006 against 0.75% in 2000).

Morocco is the 31st trading partner of the European Union (36th supplier and 26th customer of the EU). Moreover, this share remains below the levels reached by other Latin American countries, in this case Brazil (1.7%), or by some Asian countries like South Korea (2.4%), India (1.8%) and Hong Kong (1.3%).

Regarding the geographical structure of Morocco's trade with the EU, France remains by far the largest trading partner (accounting for 17.1% of total trade, followed by Spain (11.5%) and Italy (6.4%). On the Moroccan exports side to the European Union markets, France is ranking as the leading client in Morocco exports, absorbing 28% in 2006, second Spain (21%), after comes Great Britain (6.9%) and Italy (4.8%).

Concerning the product structure, it is worth noting the structural transformations of Morocco's exports to the European Union. The share of primary products fell sharply from 29.2% in 2001 to 24.2% in 2006, when the share of manufactures declined from 69.3% to 63.3% respectively between 2001 and 2006. For its part, exports of manufactured products rise to 0.6%. As for the structure of Morocco's

imports from the EU, these remain dominated by manufactured products, with 77.2% of the total in 2006.

Within this category, the machines and transport equipment are Morocco's main EU imports (26.5% and 9.7% respectively).

As regards exports, the European Union's share of Morocco's total exports has remained relatively stable, while on the import side the weight of the European Union has gradually decreased (52.4% in 2006) against 57% in 1996). Among the EU countries, France and Spain are Morocco's main partners, holding respectively 28% and 21% of exports and 17% and 12% of imports.

This suggests from the outset that the weight of the European Union as a leading trading partner has changed only slightly from the years preceding the conclusion of the Association Agreement. However, such a simplistic approach does not make it possible to effectively measure the real impact of free trade with the European Union. To do so, it is necessary to refer to the ratio of exports to GDP, considered as an indicator for evaluating the "creation of trade" effect; it rose from 13.9% to 16% between 1996 and 2017. For its part, the ratio imports / GDP has increased between the two periods, from 15% to 21.3%. Such an evolution reflects a relative substitution of European products for those from the rest of the world.

In view of the available data, it is clear that the potential of the Association Agreement between the European Union and Morocco to create additional trade flows is far from being achieved. Morocco's share of the Union's markets is still below the levels reached by other countries, although they do not benefit from geographical and cultural proximity in the same way as Morocco.

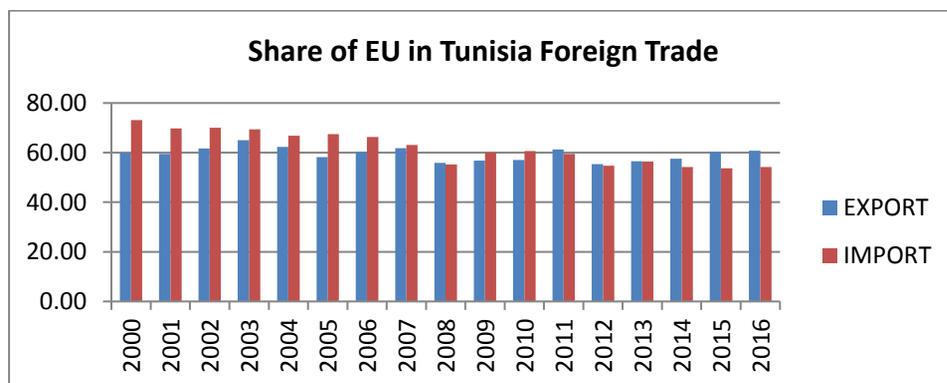
Several factors can be used to explain such a situation, including:

- The limited nature of trade liberalization which only concerned equipment and intermediates, for which Morocco has few competitive advantages to expand its market share, in the absence of positive effects of investments in terms of technology transfer.
- Moroccan exports appear to be already evolving to their potential level, thus necessitating an acceleration of ongoing reform projects, particularly those aimed at improving institutional competitiveness and strengthening the exportable supply.
- The growing weight of foreign competition opposing any possible expansion of exports. This limitation is reinforced by the absence of a dynamic specialization model capable of generating a greater adaptation to European import demand.

- The integration approach adopted revolves around a sectorial complementarity that generates little added value and that does not encourage the spread of technical progress and the transfer of know-how.

### 3.1.2.2. TUNISIA:

Figure 16: EU share in Tunisia foreign trade



Source: The GlobalEconomy.com, World Bank.

Tunisia's foreign trade both in terms of exports and imports was already heavily concentrated on the EU long before the free trade agreement. In the 1990-1995 period preceding the agreement, exports to the EU were around 80% of total Tunisian exports, while imports were around 73% of the total value of Tunisia's imports. Since manufactured exports already enjoyed free access to the European market under cooperation arrangements dating back to the mid-1970s, no further

direct effect on the export side can be expected. The EU's share of Tunisian exports has not changed after the free trade agreement, stabilizing at around 80%.

The EU's share of Tunisia's imports has not increased either, even showing a percentage point decrease since 1996. The overall import-to-GDP ratio, which can be roughly considered as an indicator of trade creation, has been almost stable between the periods preceding and following the Free Trade Agreement from 41.4% to 41.6% , which represents a minor change.

The analysis of changes in imports by liberalized list of products also reveals no significant effect or creation or diversion of trade., the imports of capital goods included in List 1 increased at almost the same rate as the GDP, reaching a stable ratio of 9.8 to 9.7%. The EU share remained constant at about 72%, which is more or less the same share as for total imports. Imports of raw materials and intermediate goods more or less followed growth in GDP and again we found no effect of creation or diversion of trade.

On the other hand, the value of consumer goods in terms of GDP rose faster than GDP in the period following the free trade agreement. In 2001 this ratio reached even more than 16%. This can be interpreted as a trade creation resulting from the reduction of tariffs for goods that have been liberalized since 1996 for list 3 and

since 2000 for list. However, these considerations must be qualified by distinguishing between on the one hand, consumer goods imported under the "off shore" regime which are actually intermediate goods processed on the spot and re-exported as finished products (textiles, leather products and automotive equipment) and, on the other hand, goods intended for the national market . This distinction is valid for the years 2000 and 2001.

The ratio of total imports of consumer goods to GDP rose from 13.8% in 2000 to 16.1% in 2001. Almost 75% of this increase is due to the offshore sector and the remaining 25% relates more specifically to the indoor market.

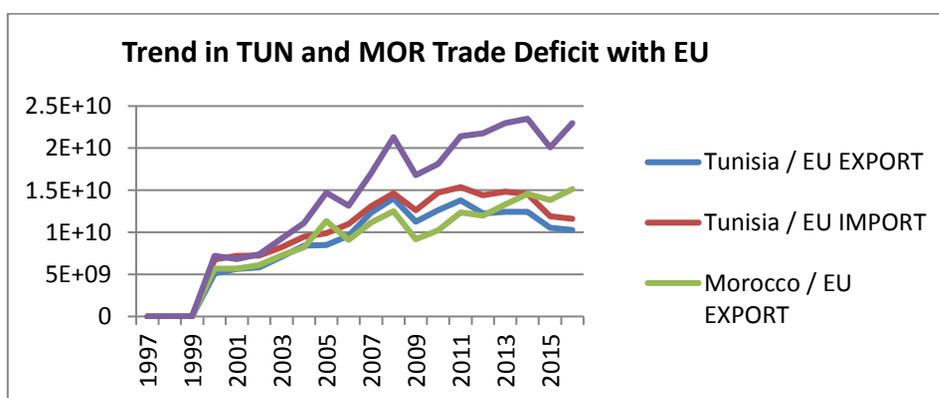
It therefore appears at the end of the day that during the most recent period there was indeed a trade creation effect for this category of products, but most of this creation is in fact due to the rapid expansion of offshore activities rather than strong growth in imports for the local market.

An important conclusion that can be drawn from this analysis is that there has been no noticeable effect of trade creation or diversion in the first six years of the Free Trade Agreement (1996-2001). The modest increase in the ratio of imports of consumer goods to GNP only occurs in the last two years of our study (2000-2001).

One of the reasons for the lack of a significant effect of trade creation is probably that liberalization has long been limited to capital and intermediate goods that had few substitutes for domestic production.

### 3.2. Impact on the balance of payment:

Figure 17: Trend IN Tunisia / Morocco Trade with EU



Source: The GlobalEconomy.com, World Bank.

In Tunisia, the trade evolution was marked, over the period between 1999 and 2017, by a progress in imports (on average +13.3%) which was accompanied by a less sustained increase in exports (on average +5.8%). But since 2012, trade deficit, was widened by more than 3 billion dinars or 35.2%, coming to 11,635 MTD compared to 8,604 MTD a year earlier. The rate of coverage dropped consequently by 5 percentage points, down to 69.5%.

Analysis of Morocco's trade balance shows, a sharp widening in the deficit of the

balance of Trade beginning from 2005. Thus the deficit of current account balance in % of GDP increased from -0.92 % in 2005 to -8.78 % in 2017.

The analysis of the evolution of Moroccan and Tunisian balances of payments since the entry into force of the association agreements reveals the first three following lessons:

- In Tunisia, export growth was concomitant and of the same magnitude (4 points of GDP) as that of imports, allowing the trade deficit to remain around 11 GDP points. But beginning from 2015 it start to deepen and aggravate.
- Deterioration in the country's external position: In Tunisia, the current account deficit has been increased which has led to tensions on the foreign exchange reserves that materialized starting from 2011. Morocco's position is however more comfortable, with foreign exchange reserves exceeding 10 months of imports (compared with only 4 months in 2000). In Tunisia, the level remains low (3 months of imports).
- Marked currency depreciation: All these developments took place in the presence of real depreciation of the currency since the real effective exchange rate of the Tunisian dinar has depreciated over the period and also the dirham, which had appreciated by 20% between 1991 and 2000 have depreciated by 5%.

### 3.3. Impacts on the state:

#### 3.3.1. Morocco:

The tariff dismantling process under the Association Agreement with the European Union is resulting in a progressive reduction of customs duties on imports of industrial products from the European Union. This process raises implications for Moroccan public finances. Thus, when the association agreement with the European Union came into force in 2000, Morocco's public finances were still dependent on customs revenue, which represented around 3% of GDP, which is above average emerging countries. Since then, customs revenue as a percentage of GDP has declined steadily to almost 2% in 2006. However, this decline has been gradual over the entire period of implementation, unlike the case of Tunisia which has exposed to a sharp fall in customs revenue at the beginning of the decommissioning period.

Table 8: Evolution of budget revenues (in% of GDP)

	2000	2001	2002	2003	2004	2005	2006
- Tariffs	2,9	2,9	2,7	2,2	2,3	2,4	2,1
- Lack of revenue from customs duties	0,2	0,3	0,3	0,5	-	0,8	1,0
- Tax revenue (excluding customs duties)	14,0	15,2	15,3	15,3	15,5	16,9	17,6
- Budget deficit	-4,7	-2,4	-4,1	-3,1	-3,0	-4,0	-1,7

Source: Ministry of Economics and finance, Morocco, 2007.

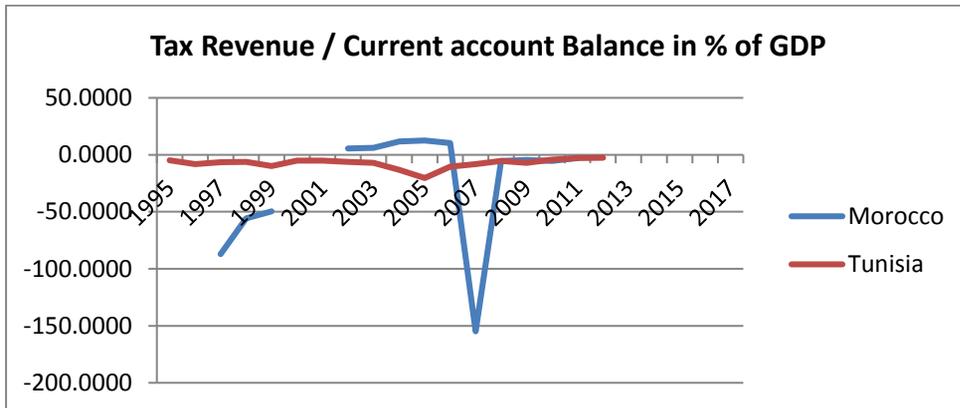
As regards the budget deficit, it has remained generally under control in recent years, particularly because of the good performance of the customs-free tax revenue, in line with the overall favorable trend in national economic activity, which largely offset the shortfall in terms of customs revenue.

Starting from a worrying situation of public finances (budget deficit exceeding 4% of GDP in 2000), of which a large part of the revenue consists of customs duties and taxes, Morocco has made a great effort to reorient its budgetary resources towards the interior activities. To this end, it has embarked on a major tax reform aiming, to rationalize and broaden the tax base and strengthen control mechanisms.

### **3.3.2. Tunisia:**

In Tunisia, tariff dismantling has resulted in a rapid and sharp reduction in customs revenue: equivalent to 4.6 percentage points of GDP in 1995, they represent only 2 points of GDP in 2002. Over the same period, the apparent taxation of imports (ratio of tariffs collected to import amounts) increased from 10.5% to 4.4%<sup>18</sup>.

Figure 18: Revenue and budgetary balances (in % of GDP) in Tunisia and Morocco



Source: The GlobalEconomy.com, World Bank DATA.

Trying to estimate how much revenue had Tunisia and Morocco lost when letting EU-originating imports enter duty-free, the result is quite significant and explain much of the anxiety manifested by these countries during the negotiations period. As a percentage of GDP, the revenue lost during the period of 1995 and 2017, is equivalent to 6 percent in Tunisia (24.3 percent of total government revenue) and less important in Morocco with 1.5 percent of GDP (5.4 percent of total government revenue).

### 3.4. The impact on the industry:

#### 3.4.1. Morocco:

The Moroccan economy presents the structural features of a weakly industrialized economy. Representing more than 95% of the Moroccan industrial fabric, SMEs (Small and Medium Enterprises) have deficiencies related simultaneously to their production capacities, their investments and the jobs they offer, which only partially reflect their numerical importance.

Of the 7,737 largest industrial units that make up the country's industrial fabric, in 2004, 7,214 were small and medium-sized enterprises, which accounts for 93.2% of the total number of enterprises. According to the Statistics of the Ministry of Employment, this proportion remained broadly stable between 1992 and 2004 and this stability is also true in most industrial branches.

However, while the pace of SME creation has been slow during the 1990s, the latter has become more pronounced since the beginning of the year 2000s. This break can be explained by the acceleration of the liberalization reforms of the economy which have made access to markets and funding more easily for domestic firms. The considerable growth of foreign direct investment (FDI) has also played

an important role. Indeed, it has favored the development of many local industrial enterprises, mainly in the framework of subcontracting activities.

In fact, FDI and liberalization reforms have not produced the same impact in the different branches of the economy. They accentuate the heterogeneity of the fabric of SMEs. The table below indicates in particular that these companies are divided into several large strata that contribute to the formation of the industrial fabric. The number of industrial units with fewer than 50 employees is by far very large (79.9%) relative to those employing 50 to 99 employees and to SMEs with 100 to 199 employees. SMEs employing less than 50 people represent more than 3/4 of Moroccan industrial units. This proportion remained almost stable during the period 1992-2004. In second place are SMEs with 50 to 99 employees (12.3%), while SMEs with 100 to 199 employees represent 7.8%.

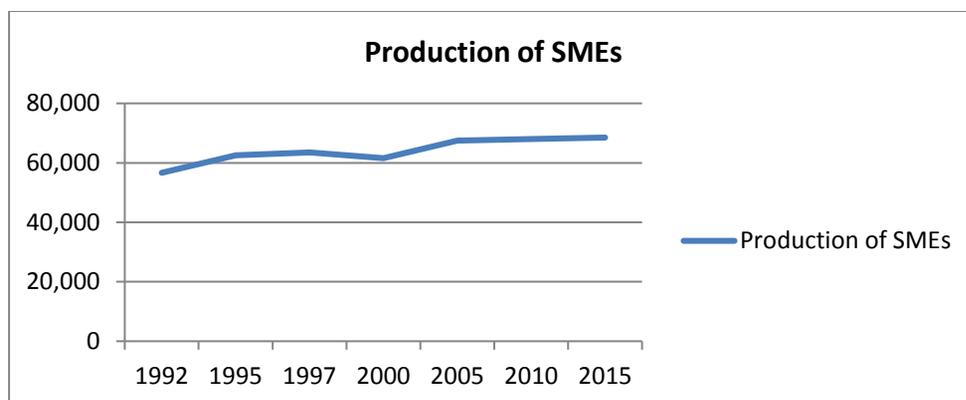
*Table 9: Number and share of Moroccan SMEs by workforce*

Years	SME < 50		SME from 50 to 99		SME from 100 to 199		SME < 200	
	Number	In %	Number	In %	Number	In %	Number	In %
1992	4374	73,1	698	18,4	482	7,7	5554	91,5
1995	4434	73,4	1190	18,7	491	8,1	5624	93,2
2000	4365	76,8	290	18,2	346	5,7	5795	96,0
2005	4819	74,0	717	10,9	492	7,6	6021	92,5
2010	4906	74,9	698	10,6	469	7,1	6073	92,5
2015	5765	79,9	884	12,3	565	7,8	7214	93,2

*Source: Statistics of the Ministry of Employment, Morocco.*

The remarkable preponderance of SMEs in terms of numbers is far from reflecting their productive capacities. Indeed, the added value created by these units has never been able to reach half of the total industrial production of the country.

*Figure 19: Evolution of the production of the SMEs between 1992 and 2015(In MDH)*



*Source: According to figures from the Ministry of Trade and Industry, Kingdom of Morocco, 2004.*

SME production has grown at an insignificant pace. This is due in particular to the weakness of the financial structures of these units which only marginally allow them to make the necessary efforts to modernize them. Investment in capital goods, which is the condition for higher productivity, represents a small fraction of the self-financing capacity of these companies, which are often destined to deal with very short-term problems (cash management, research, etc.). However, there is a

strong relationship among small firms, more than anywhere else, between the volumes of value added the level of the profit margin, the investment effort and the successful industrial companies.

Regarding the contribution to employment, Moroccan SMEs offer less than 43% of the jobs created in 2004, a percentage much lower than the share of these companies in the industrial fabric. The category of stable jobs created in SMEs fell between 1997 and 2017, from 51% to less than 43%. This decline is mainly due to lower investment in these firms.

#### **3.4.2. Tunisia:**

Investment has increased in Tunisia countries to reach a level of 26% of GDP between 2000 and 2015, a significant improvement of the situation in 1995-1999: + 2 points of GDP.

This overall increase in the level of investment since the implementation of the Barcelona Process between the period 1995-1999 and the period 2000-2015 mask two opposite developments:

- Non-government investment has grown significantly: an increase of GDP in both countries between the two periods.

- The growth of private investment materializes both the improvement of the business environment and the financing conditions.

*Table 10: Investment rate in Tunisia (in% of GDP)*

	<b>1995-1996</b>	<b>1997-1999</b>	<b>2000-2015</b>
<b>Local Investment</b>	<b>23,7</b>	<b>25,0</b>	<b>25,8</b>
<b>Public Investment</b>	<b>5,9</b>	<b>5,4</b>	<b>4,6</b>
<b>Private Investment</b>	<b>17,8</b>	<b>19,6</b>	<b>21,2</b>

*Source: Statistics of the Ministry of Finance, Tunisia, 2017.*

In contrast, government investment contracted by 1.3 percentage points of GDP between the two periods. The drop in public investment reflects the fiscal rationalization efforts undertaken by the two states, which have notably reduced their investments in the transport sector, a sector that is essential for improving the business environment.

- A progressive reallocation of the factors of production: the information provided by the National Institute of Statistics of Tunisia shows that a process of reallocation of factors of production is underway in the Tunisian industrial sector, they indicate the following tendencies:

- Capital growth appears to be much higher (61%) than that of jobs (2%), indicating an increase in the capital intensity of production in the Tunisian industrial sector. This development is in line with the objective of increasing the productivity of industrial production;
- Companies with more than 100 employees concentrate a growing share of the factors of production: they created jobs over the period unlike smaller companies and the growth of their investments was much more sustained;
- Some reallocations of the factors of production take place between the industrial branches. The chemical industries, for example, are cutting jobs and cutting investment, while the electricity industries are creating jobs and investing. If these analyzes deserve to be refined, they leave in any case appear that a structural decomposition of the Tunisian productive apparatus is taking place.

## **4. CHAPTER 4: INTRA REGIONAL IMPACT OF EMFTAs:**

In this chapter we will focus on the inter-industry trade index of the Maghreb countries (Tunisia and Morocco). By applying The Grubel and Lloyd index, we try to investigate the degree of inter-industry trade between countries; will be calculated from the tables for exports and imports of industrialized products from 1997 to 2017. First, we will analyze the nature of trade between the two Maghreb countries on the one hand and the European Union on the other.

### **4.1. Creation of the Arab Maghreb Union (AMU):**

The declaration establishing the Arab Maghreb Union (AMU) was signed in Marrakech on 17 February 1989. Initialed by Mauritania, Libya, Tunisia, Algeria and Morocco, the UMA aims to:

- Strengthen the bonds of fraternity that unite Member States and their people
- Achieve the progress and prosperity of the societies that compose them and defend their rights.
- Contribute to the preservation of peace based on justice and equity.
- To work progressively towards the free movement of persons, services, goods and capital.

The proclamation of the UMA, which had already been envisaged in a premonitory speech made in 1958 in Tangiers by King Mohammed V, responds to the concern to strengthen the links of economic complementarity in the Maghreb and reduce the isolation of these countries members. In parallel, two conventions have been concluded by the Maghreb countries.

The first, on the exchange of agricultural products, was signed on 23 July 1990 and provides:

- Progressive building between the contracting parties of a customs union with a view to realize a common North African agricultural market.
- The exemption of agricultural products traded, of local origin and provenance, customs duties and taxes having equivalent effect imposed on imports, with the exception of taxes on local production in each country of the union
- Establishment of a Food Safety Commission to draw up lists agricultural products exempt from any tariff measure.

The second convention concerns commercial and tariff aspects, concluded on March 10, 1991 between the UMA countries, and deals with:

- The exemption from customs duties, taxes and charges having equivalent

effect imposed on the importation of traded products, of origin and of local origin.

- The exemption of traded products, of origin and local origin, and defined in lists, of all non-tariff measures.

As an extension of the Marrakech declaration, several bilateral free trade agreements have been concluded between Tunisia and Morocco.

The agreement signed between Morocco and Tunisia, which entered into force on March 16, 1999, provides for the creation of a free trade area between the two parties during a transitional period that ended on December 31, 2007. The tariff dismantling scheme is designed according to the sensitivity and the nature of the products appearing in the lists annexed to the agreement.

The benefit of preferential tariff treatment is reserved for products which satisfy the rules of origin and the rule of "direct transport" rule, which refer to the convey products directly from the exporting country to the importing country, without passing through a third country.

#### **4.2. Calculation of the GRUBEL and LLOYD index:**

The Grubel & Lloyd index shows the degree of inter-industry trade between countries. In this section I will Apply this indicator to exports and imports of industrial products (1997 to 2017) of both Tunisia and Morocco.

*Equation 2: Grubel and Lloyd index*

$$GL_t = [(X_i + M_i) - |X_i - M_i|] / (X_i + M_i)$$

where

$X_i$ : exports of product  $i$ ;

$M_i$ : imports of the product  $i$

$t$ : the year considered

$GL_t$  is such that its results are between [0 and 1]. When it reaches 0, the specialization is Inter-branch. When it tends to 1, it is intra-branch.

For example for the year 2004, in Morocco the index will be calculated as follows:

$$GL = [(6\,384,73 + 6\,477,31) - |6\,384,73 - 6\,477,31|] / [(6\,384,73 + 6\,477,31)]$$

$$GL = [(12\,862.04) - |-92.58|] / (12\,862.04)$$

$$GL = [12\,769.46 / (12\,862.04)]$$

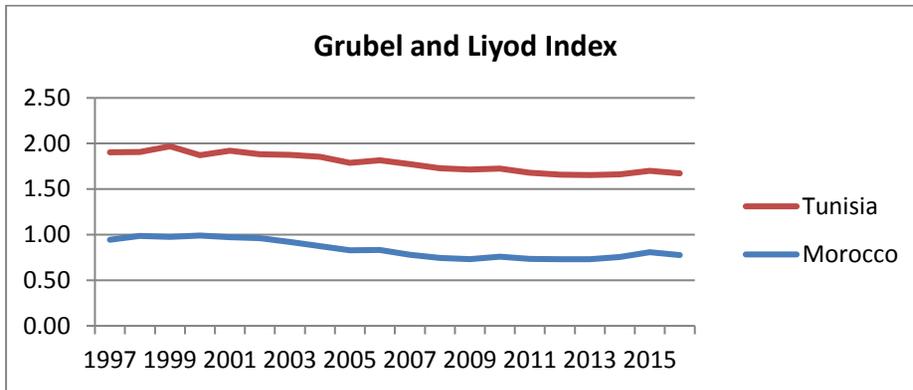
$$GL = 0.99$$

In this case the index is approximately 1; we can conclude the existence of intra-industry trade in Morocco. The indicator thus gives the share of intra-industry trade in relation to the value of total trade of the product under consideration.

*Table 11: Evolution of the Grubel and Lloyd index (Industrial products)*

	Morocco	Tunisia
1997	0.94	0.96
1998	0.98	0.92
1999	0.97	1.00
2000	0.99	0.88
2001	0.97	0.95
2002	0.96	0.92
2003	0.92	0.96
2004	0.87	0.98
2005	0.83	0.96
2006	0.83	0.98
2007	0.78	0.99
2008	0.74	0.99
2009	0.73	0.98
2010	0.76	0.97
2011	0.74	0.94
2012	0.73	0.93
2013	0.73	0.92
2014	0.76	0.90
2015	0.81	0.89
2016	0.78	0.89

Figure 20: Evolution of the Grubel and Lloyd index for industrial products



*Source: World Bank data.*

The situation for Morocco and Tunisia is almost identical; since the value of the Grubel and Lloyd index is almost the same for both countries and tends to 1. This similarity is the result of the development of an efficient manufacturing base in Morocco and Tunisia (textile in particular), countries that have been able to take advantage of customs preferences granted by the European Union in the context of outward processing trade. That is to say the privileged orientation of trade between Morocco and Tunisia with the European Union has developed a similarity of productive structures in these two countries.

This situation has even generated fierce competition between Morocco and Tunisia in their relations with the European Union. Indeed, 68% of Tunisian exports are in

industries where Morocco also has a comparative advantage in the European market.

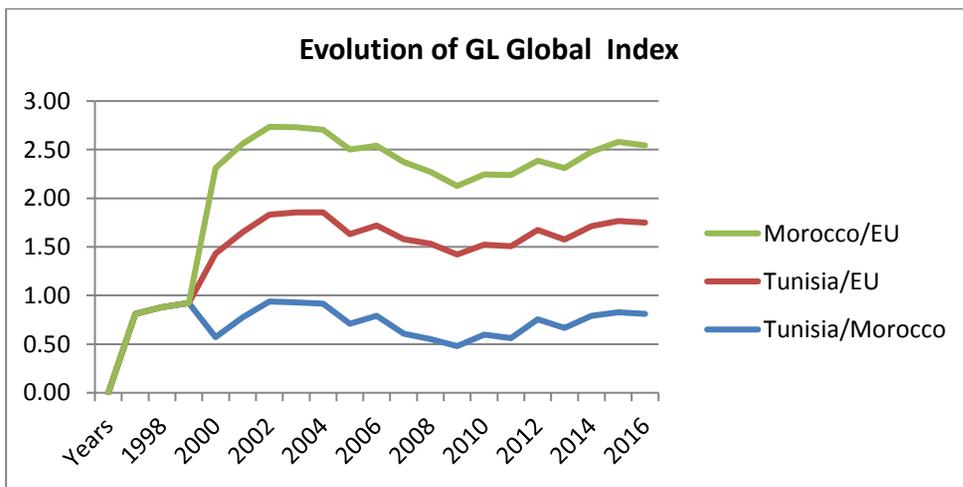
While multiple shortcomings seem to constrain the potential for regional integration, their elimination would require a strong political will for cooperation, in a context where characterized by regionalism and globalization as well.

*Table 12: Evolution of the Global Grubel and Lloyd index*

<b>GL Global index</b>			
	<b>Tunisia/Morocco</b>	<b>Tunisia/EU</b>	<b>Morocco/EU</b>
Years			
1997	0.81	-	-
1998	0.88	-	-
1999	0.92	-	-
2000	0.57	0.86	0.88
2001	0.77	0.88	0.91
2002	0.94	0.89	0.90
2003	0.93	0.93	0.88
2004	0.92	0.94	0.85
2005	0.71	0.92	0.87
2006	0.79	0.93	0.82
2007	0.61	0.97	0.79
2008	0.55	0.98	0.74

2009	0.48	0.94	0.71
2010	0.60	0.92	0.72
2011	0.56	0.95	0.73
2012	0.76	0.92	0.71
2013	0.67	0.91	0.73
2014	0.79	0.92	0.77
2015	0.83	0.94	0.81
2016	0.81	0.94	0.79

Figure 21: Evolution of the Global Grubel and Lloyd index



*Table 13: Intra-industry trade indicators*

	<b>1995</b>	<b>2000</b>	<b>2005</b>	<b>2008</b>	<b>2009</b>
<b>Morocco/EU</b>	10,52	18,76	21,69	22,10	20,56
<b>Tunisia /EU</b>	22,58	22,30	22,66	28,19	27,47

*Source: FEMISE Report 2010.*

Overall, there is a significant improvement in intra-industry trade shares between the two periods 1995-2000 and 2000-2009, with a greater increase in this type of trade with the rest of the world.

While the general trend is to improve intra-industry trade shares, it is mainly with partners in the rest of the world that intra-trade levels branches are the most significant. However, we note that the two countries closest to the EU, Tunisia and Morocco, develop this type of trade more strongly with their European partners.

Finally, over the past 15 years, MPs have slightly improved their performance in terms of expanding the range of products exported and bringing export structures closer to the global average. However, taking PM individually does not show the same results. Tunisia diversifies its export basket. Similarly, during the same period, Morocco's export structures are moving closer to global average structures.

## **5. CHAPTER 5: OUTCOMES AND POLICY RECOMMENDATION:**

In this chapter, we will present the preliminary findings of the study with interpretation by using some review of Literature and researches and answer the research questions, approve or reject the research hypothesis and provide some recommendations for future studies and policies.

### **5.1. Preliminary Findings:**

1. Current Account deficit and unbalanced impact on trade: the chronic trade deficit engendered by the trade liberalization has induced a permanent deficit in the balance of payment in MPCs. That suggests that EMFTA serves only the interests of the EU.
2. Public expenditure and budgetary vulnerability: The Euro Med Free trade area decreased the state revenues through loss in tariffs receipts and increase public expenditure. To run the increased public deficits, government trying to fill the gap they borrowed money from international markets and organizations (IMF or world bank) which explain the rise of debt rate during the last decade and also by rising the indirect taxes on consumption, things that reduced the real

disposable income of the population and effected negatively the income distribution.

3. Asymmetrical interdependence: Trade liberalization has encouraged both countries to specialize in producing agriculture products, primary commodities and elementary labor-intensive and resource-based manufactures that requires low technology intensity such as textile; things in which the two economies already enjoys a comparative advantage. Hence the two countries did not succeed to achieve specialization transition towards producing more sophisticated manufactures with higher economic value-added.

4. Depreciating currency: The deterioration of the current account balance has decreased terms of trade in MP and as a mean to counterbalance the loss competitiveness in the local markets they devaluate their currency against Euro. This has generate inflation and let to a restrictive monetary policy.

5 Increasing unemployment rate: job destruction due to a continuing rise in imported industrial products that substitute goods previously produced locally. Also experiencing permanent competitive pressures by foreign firms, they tend more and more to replace permanent jobs with temporary one.

6. Many small and medium enterprises have been forced to quit the market by the flow of cheaper imports and also by lack of competitiveness.
7. Aggravation of the economic gap between SMPs and European Union and the gap of income levels among the two countries income class.
8. No effect on foreign direct investments (FDI), one of the main goals expected and sought by south Mediterranean countries.
9. Rapid rise in external indebtedness and the existence of financial and trade imbalances.

## **5.2. Shortcomings of EURO-MED FTA:**

Despite trade liberalization, the integration between EU and SMCs, remains incomplete and superficial because of not only the level of tariffs applied by MPs to EU imports that still significant but also because of , persistent protection of agriculture, presence of significant NTBs, restrictive rules of origin and lack of liberalization of services.

S.1.Progress towards tariff liberalization is too slow in the Maghreb countries:

Table 14: Average rates applied by the Maghreb countries in 2009

	<b>Tariffs with the rest of the world</b>	<b>Tariffs with the EU</b>	<b>Quote part of duty free line</b>
<b>Tunisia</b>	22.2	18	39.2
<b>Morocco</b>	8.2	3.6	51

*Source: FEMISE Report.*

This table provides some insight into the progress made by the Maghreb countries in terms of tariff liberalization. The first column is a perspective on the average tariffs charged by MPs to all countries. Morocco has also made progress, while Tunisia is moving more slowly.

To some extent these results explain the limited effects of the Barcelona Agreement. In other words, the slow rate of tariff elimination in the MP leads to a limited margin of preference for EU imports into the MP markets. As a result, the observed effects of the Euro Med FTA are much smaller than the potential effects identified by many scholars.

S.2.The protection of agriculture leads to losses of efficiency:

As liberalization of agriculture is excluded from the Euro Med FTA, protection remains strong in the MPs and in the EU countries. In fact, Table 15 shows

significant average tariffs, particularly in Tunisia but also Morocco. More important than tariffs, NTBs in agriculture remain at particularly high levels. Indeed, the calculation of "Trade Restrictiveness Indexes" by Kee et al. (2009)<sup>16</sup> suggests that:

- (i) NTBs protection is far superior to tariff protection;
- (ii) in agriculture, TRIs are generally higher than those of manufactured products;
- (iii) In the MPs the NTBs are particularly high compared to the tariff protection, especially for Morocco and Tunisia (following table).

*Table 15: Trade Restriction Indexes (TRIs) for Tariffs and NTBs*

	<b>Tariffs and NTBs</b>	<b>Tariffs only</b>
<b>EU</b>	0.45	0.08
<b>Tunisia</b>	0.94	0.1
<b>Morocco</b>	0.71	0.09

*Source: FEMISE Report.*

### S.3. Non-tariff barriers remain high in MPs

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<sup>16</sup> Hiau Looi Kee, 2009, ESTIMATING TRADE RESTRICTIVENESS INDICES

As shown above, the elimination of tariffs does not mean the elimination of commercial protections. Indeed, the Barcelona Agreement does not take into account the elimination of NTBs, as MPs still apply strong global protection.

To illustrate this statement, Kee et al. (2009)<sup>17</sup> recently calculated the ad-valorem equivalent (AVEs) of NTBs in 91 countries worldwide. The main results are presented in table no. It is striking that PM has significant AVEs for NTBs. For example, in Tunisia and Morocco, NTBs have an average of around 40% in tariff equivalent. If we add these AVEs to persistent tariff protection vis-à-vis the EU, the overall protection is 60%.

*Table 16: Tariff protection in agriculture (%)*

	<b>Tariff Average Rate</b>	<b>Tariff maximum Rate</b>
<b>EU</b>	n.a	n.a
<b>Tunisia</b>	49	889
<b>Morocco</b>	23.1	227

*Source: FEMISE Report.*

S.4.The specific impact of Technical Trade Barriers:

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Technical Barriers to Trade (TBTs) seem to be a major obstacle to trade, as Michalek (2005)<sup>18</sup> demonstrates. According to this author, unlike CEECs, only a small portion of MP exports are subject to regulation. This partly reflects the inability of MPs to comply with technical regulations or standards applied in the EU. In any case, the existence of substantial TBTs leads to trade distortion in PM-EU trade, the result being that potential gains from economic integration cannot be exploited.

S.5. the rules of origin are often restrictive:

Rules of origin (RoOs) define the conditions that a product must meet to be considered as coming from the country for which preferential access is established. The main justification for RoOs lies in the prevention of commercial deflection, a process allowing a product from a non-participating country to enter the EU through free trade partners with the EU in the purpose of avoiding paying customs duties. However, according to several authors, the ROOs are sometimes restrictive and lead to significant costs and a commercial reduction within a Preferential Commercial Zone (Breton and Manchin, 2003<sup>19</sup>). However, the restrictions

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<sup>18</sup>Jan Michalek, 2007 Comparative analysis of importance of technical barriers to trade (TBT) for Central and Eastern European Countries' and Mediterranean Partner Countries' exports to the EU

<sup>19</sup> Breton and Manchin, 2003, Preferential Rules of Origin

associated with ROOs also depend on the specification on accumulation, which can be bilateral, diagonal or complete.

S.6. the services were excluded from the Barcelona Agreement:

Services initially excluded from the Barcelona Agreement are another aspect of the failure of integration between the EU and the MPs. The lack of liberalization of services is also a major obstacle to commercial gains. In fact, Togan and Michalek (2007)<sup>20</sup> show a significant effect on GDP, especially for Tunisia. However, since the early 2000s, some progress has been made by MPs in two areas. First, they initiated an improvement in liberalization through engagement with GATS. Then, the initiation of regional negotiations in 2006 for the liberalization of services with the EU should progressively improve the situation on condition that an agreement is concluded and implemented.

S.7. the lack of true horizontal integration (GAFTA):

As suggested by several authors, MPs may be in a position to benefit from more vertical integration (with the EU) provided that horizontal integration (with other MPs) is also achieved (Puga and Venables, 1997, Péridy and Bagoulla, 2010b). This can be explained by the fact that integration between MPs should improve the

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<sup>20</sup> Togan and Michalek, 2007, Why are the Trade Gains from the Euro-Mediterranean Partnership so Small

efficiency of production processes in this area (through segmentation of markets, economies of scale, appropriate industrial location and other efficiencies). This should then increase gains throughout the Euro med area, through upstream / downstream spillover effects. However, despite real efforts by MPs to reduce tariffs in the GAFTA zone, it is clear that south-south regional integration is far from being achieved. There are still many obstacles.

#### S.8. Specialization in MP is constantly based on low added value products:

The MP exports still focus on low value added products. Despite a recent improvement by increasing the technical content of products, progress towards level improvement is too slow. Many researches highlight the role of education and research in explaining the economic success of some countries in terms of growth and convergence. For PM, although their average growth performance over the last decade is slightly higher than that of the EU15 (around 3%), several authors argue that some MPs have not clearly engaged their convergence towards EU per capita levels (Guétat and Serranito, 2010<sup>21</sup>), except Tunisia. This raises the question about the causes of this phenomenon. Though, the innovation gap between EU countries

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<sup>21</sup> Guétat and Serranito, 2010, Rattrapage technologique et convergence : un test par les séries temporelles dans le cas des pays de la région MENA

and MPs is a major factor explaining the process of convergence between these two zones<sup>22</sup>.

### **5.3. Policy Recommendation:**

The investigation of the effects of EURO MED Free Trade Agreement and the identification of the main obstacles to these effects being limited, lead to the following recommendations:

1. MPs must complete their tariff elimination vis-à-vis EU products. Be that as it may, the completion of tariff elimination in the coming years is expected to generate additional gains in trade and social assistance, gains that are lacking today.
2. Priority must also be given to the removal of non-tariff barriers (NTBs). Indeed, the MPs are posting significant NTBs; especially Morocco NTBs represent around 40% of tariff equivalent. Tunisia occupies an intermediate position, that is to say close to the world average (13%). In addition, the EU must also reduce its NTBs to MPs since the EU's tariff equivalent is also important (13%).
3. Among the different kind of NTBs that can be reduced, technical barriers to

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<sup>22</sup> Nicolas Péridy, 2010, Un modèle généralisé des déterminants des migrations internationales.

trade can be eliminated by moving towards mutual recognition or adoption of EU technical regulation.

4. The issue of liberalization of agriculture has long been debated. It has become a political problem. The level of protection (including NTBs) is currently very high, not only in MPs (where trade restriction indices are 0.94 in Tunisia) but also in the EU (0.45). Greater liberalization in agriculture would:
  - a) Produces more profitability and gains in terms of social assistance;
  - b) Stimulate comparative advantages and therefore exports, particularly in Morocco, which enjoys a significant comparative advantage for these products;
  - c) Reduce the migratory pressure of seasonal workers (insofar as domestic production would be possible on a larger scale in MPs before export to the EU).
5. Liberalization of services is needed to increase profitability and welfare gains from the Barcelona Agreement. Despite significant progress in the last decade in terms of liberalization, significant progress remains to be

made. Morocco can make greater efforts in liberalizing strategic service companies that the government still controls. In addition, the issue of currency control, which acts as a cross-cutting barrier, should be investigated. Finally, a specific agreement with the EU seems necessary to create a real FTA including services.

6. The gap in innovation between the EU and the SMC countries prevents them from converging on EU GDP standards. As a result, Regional integration and trade liberalization are necessary but not sufficient conditions to stimulate growth in MPs and facilitate the process of convergence. Therefore, Mediterranean governments should prioritize education, innovation and, human capital.
7. SMCs euro centric trade policy approach makes them very dependent to the European context and extremely influenced by its crisis and shocks. Therefore MS should diversify their cooperation trying to shape new horizons of effective cooperation, where they can implement effective trade agreements, benefit more and achieve their industrialization process, for instance Latin American and Asian countries.

#### **5.4. CONCLUSION:**

Having studied the impact of trade liberalization in the two SMC Tunisia and Morocco, shortcomings of the Euro MED Free trade area have become clearer. We have found that while trade liberalization with the EU in the form of new Association Agreements was on average effective in raising their bilateral imports from the EU at the same time it did not contribute positively to the expansion of their exports to the EU as well. This has led to chronic current account deficit.

The negative and statistically significant coefficients on the two countries indicators evidence the presence of trade restrictions on exports to the EU. This suggests that the EU member states are the main beneficiaries of the FTA, due to the opening of the MS markets only to industrial products while keeping the EU markets closed to imports of agricultural goods from MPS. And as we have seen through the analysis of the evolution of the Grubel and Lloyd index, bilateral trade between these countries remains at a very low level. This suggest that Free trade agreements with the Maghreb countries thus have costs related to the fall in revenue based on customs duties, to competition from European products; they

generate transitional costs in the short term. The trade balance of the Maghreb countries have deteriorated during the last five years and it required an influx of capital to offset the current account deficit.

Under these conditions, the Euro-Maghreb partnership is largely dependent on Europe's ability to open its markets, including the agricultural market, since the creation of the FTA is not only intended to intensify trade but also to develop a production area through enhancing offshoring of economic activities and a sustaining the movement of capital flows towards private companies.

Despite extensive trade liberalization, the economies of Tunisia and Morocco have performed very poorly in the last 10 years and income inequality has worsened.

In general we can argue that EMFTA, with the only objective of free movement of industrial goods, is not in the interest of SMS at their actual state of economic and social development unless it's accompanied by an implementation of complementary measures such as export promotion policies, strategic investment in structural change, protection of infant industry and supportive exchange rate policies. In other words, sensible management of trade, to achieve a balance

between the growth of exports and imports so as to avoid balance of payments deficits, to identify and encourage new areas of comparative advantage, and to practice a mixture of tariffs and subsidies for infant industry in order to protect them...

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## 국문초록

1995년 11월, 유럽연합은 남부 지중해와의 정치, 경제, 사회적 관계를 강화하기 위하여 포괄적이고 다차원적인 발의안으로서 바르셀로나 프로세스를 의결하였다. 본 연구는 바르셀로나 프로세스의 산하 안건들 중 하나인 지중해 파트너십, (유럽 - 지중해 파트너십)에 관한 것이다. 지중해 파트너십 (EMP)의 핵심은 해당 지역의 번영을 촉진하고 사회경제적 발전을 이룩하기 위하여 유럽공동체(유럽 연합)와 (각지중해 국가) 간 자유무역 협정을 체결하는 것과 장기적으로 MS 간에 이와 유사한 협정을 체결하는 것에 있다.

본 연구에서는, 자유무역협정이 1994년부터 2017년에 튀니지와 모로코에 미친 경제적 효과를 Pan-Arab Free Trade Area (PAFTA), 아가디르 협정 (the Agadir Agreement)에 의한 효과와 대조하여 평가하고자 한다.

본 논문은 튀니지와 모로코 간 비교 사례연구의 모형을 사용한다. 각국의 발전 상황을 추적하고, 무역 자유화 및 관세 철폐를 통한 자유 무역 지대로의 이행이 각국 경제 변수에 끼치는 영향을 분석하는 것이 이 연구의 목표이다.

이 연구가 Euro-Med 경제 통합 과정에 관한 기존 연구에 기여한 내용은 다음과 같다.

- i) 2017년까지 평가(비판적 분석)를 확장한다(1995년에서 2017년 사이).
- ii) 업데이트된 데이터를 통해 남지중해 국가(SMCs)의 관점에서 유로 MED 무역 협정의 효과를 평가한다.

**주요어:** 유로 지중해 자유 무역 협정; 협회 계약; 지역 통합; 관세 철폐; 무역 자유화.

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