MEDITERRANEAN COPRODUCTION OBSERVATORY

# Investment Dynamic in Mediterranean Countries

## MACRO-ECONOMIC SITUATION

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# MEDITERRANEAN COPRODUCTION OBSERVATORY

*Led by IPEMED and supported by Bpifrance and the Paris Ile-de-France Regional Chamber of Commerce and Industry, the Mediterranean Coproduction Observatory aims at qualitatively analysing Mediterranean investors' strategies, their behaviours, expectations and difficulties to integrate into the local network.*

*The detailed knowledge of industrial and service strategies in the Mediterranean must encourage the development of coproduction and highlight the shared benefits of this model in the distribution of the value chain.*

*The Mediterranean Coproduction Observatory has a mission of observation, follow-up, information and awareness with public authorities as well as Northern and Southern Mediterranean companies, especially future-oriented industries.*

*The works of the Mediterranean Coproduction Observatory are carried out in collaboration by Martin FLEURY and Jean-Philippe PAYET of R.M.D.A. consulting firm as well as IPEMED Production team.*

*This report - the first publication of the Mediterranean Coproduction Observatory - aims at providing an accurate account of the macro-economic situation of seven Southern and Eastern Mediterranean countries (Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia and Turkey) and of the investment dynamics in these countries, especially with the four Northern Mediterranean countries of the sample (Germany, Spain, France and Italy).*

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| **Investment dynamics** | **Observation #10:** FDIs are volatile on both shores. They are very sensitive to the international environment and to the perceived risk.<br>**Observation #11:** FDIs in the South do not produce sufficient added value.<br>**Observation #12:** Nevertheless, the actual risk seems overestimated, especially in SEMCs. |
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# PREFACE BY JEAN-LOUIS GUIGOU

**President of IPEMED**

There is no doubt that Southern and Eastern Mediterranean countries, especially Turkey, Egypt, Jordan, Lebanon and North African countries, boast undeniable comparative advantages in terms of industrialisation:

- Favourable geographic position on the sea journey between Asia, Europe and Americas;
- Geographic proximity of European countries enabling coproduction and a platform position for globalised value chains towards Africa;
- Proximity of large-size markets, especially the European market, with 500 million consumers, and the African market;
- Skilled workforce, increasingly trained with a cost-related comparative advantage;
- Fossil energy for some and a real commitment towards renewable energies for others.

Obviously, if European companies wishing to settle in SEMCs and Southern Mediterranean companies wishing to invest in Europe resort to coproduction (partnership, sharing of added value, technology transfer), then North Africa, Egypt, Jordan, Lebanon and Turkey could become strong economic development centres. To do so, industrials must get rid of the old Southern investment model consisting in taking advantage of cheap and numerous workforce, drawing raw materials with no on-site transformation and making profits that do not benefit local populations.

The implementation of The Coproduction Observatory by IPEMED aims at following thoroughly European and global companies' strategies in SEMCs. The idea is to carry out qualitative analyses on the strategies and the progressive transformation of behaviours between contractors and sub-contractors in view of developing strong partnerships. The key to success lies in the partnership between company managers. Former clients must become new partners.

The current economic situation is favourable to the implementation of this Observatory. On the one hand, with the return to growth, Africa's attractiveness survey carried out by EY shows an increase in foreign investments in North Africa, especially in Morocco and Egypt. On the other hand, China's geo-economic transformation - now favouring local consumption over exportation (see World Bank report) - shows that 85 million jobs should soon leave China. Most of these investments could relocate in North Africa, on Europe's doorstep. The idea according to which North Africa could become "Europe's Mexico" is absolutely realistic. Didier Colignon, associate expert for E&Y is right to say "We must be optimistic. In the long term, investing in North Africa cannot be wrong."

# INTRODUCTION

## CONTEXT AND DYNAMIC

In spite of their geographic and cultural proximity, the economic relations between the European Union (UE) and Southern and Eastern Mediterranean countries (SEMCs) remain limited with respect to their increasing complementarities. Most of them rely on investment in the exploitation of raw materials, manufactured goods and basic services as well as on the exportation of limited added-value resources for southern countries.

The structural changes of competitive advantages and the aspiration to a fair sharing of value show that cooperation could be stronger and more sustainable, in view of an inclusive economic development favouring social cohesion:

- The necessity for European countries to manufacture "top-of-the-range" quality products to stand out from the production of emerging countries. Hence the necessity to expand the value chain and integrate North Africa, which boasts competitive skills and assets.
- In the South, the demographic dynamism and the emergence of middle classes represent a major potential market for European production.
- The population of SEMCs - young and skilled - also represents a major labour pool in the face of the continuously ageing European active population. The cultural proximity between both spaces and the existence of large diasporas can also facilitate acclimatisation and integration.
- Besides, this labour force offers competitive costs that are necessary to get hold of these new markets where purchasing power is still limited.
- Thanks to easy logistics between both areas as well as the strategic geographic position of SEMCs at the border of the huge African market and the increasing needs of the Middle East, these countries are great partners to respond to opportunities now coveted by emerging countries as well as traditional investors.
- Natural resources - especially energy resources - in the South of the Mediterranean, combined with a stronger collaboration in research and development can bring out new major international actors.

In order for such a partnership to last, several conditions and challenges remain to be overtaken:

- Change of paradigm towards the South: considering the South as a partner rather than as a sub-contractor ;
- Diversifying Southern economies to favour long-term development;

- Better dividing the value chain production process to remain competitive and be less vulnerable to localised temporary shocks;
- Ensuring a fair distribution of wealth to economically and democratically stabilise SEMCs, which were shaken by political crises;
- Generating employment and purchasing power for the growing active population and supporting the development of middle classes;
- Ensuring skills and technology transfers towards southern entrepreneurs;
- Favouring workers' mobility ;
- Establishing a political collaboration at the regional and national scales.

## MEDITERRANEAN COPRODUCTION OBSERVATORY

In order to support this mutually beneficial dynamic between the two shores of the Mediterranean, IPEMED has long supported and encouraged coproduction. This commitment is now taking the shape of an Observatory, the objective of which is to:

- Conceptualise and define the coproduction dynamic in order to introduce it into high-level discussions ;
- Follow-up data and publications on this topic ;
- Reveal relevant trends and information on the subject to ensure its promotion,
- Bring ideas and propositions to stakeholders in order to facilitate investments or incentive devices,
- Remove the obstacles to regional integration through North-South and South-North cooperation.

This document is the first one of the Observatory. It aims at assessing the macroeconomic state of the EU/SEMCs economic relation and of the coproduction dynamics by noting the most relevant indicators and observations. Analyses will follow to deepen some topics or/and territorial specificities.

# Definition and parameters

## DEFINITION

In order to develop the concept of coproduction and apply it to the contemporary Mediterranean space, it seems relevant to build on the experience of Asia (Japan/Tigers/Dragons), America (United States/Mexico) and Eastern Europe (Germany/CEEC)[1].

These experiences - which triggered a real and sustainable development in these countries - feature the concentration of complementary production units in a given space. Interactions then enabled to generate synergies contributing to develop productiveness in a dynamic of specialisation and shared added value.

Therefore, the Observatory defines coproduction as the:

"Joint development of a value chain, integrating at least one southern partner and involving long-term investments"

This definition comprises 4 major and indivisible ideas in our context:

1. development of a value chain, in order for coproduction to generate locally added value at each step of its cycle, and therefore for all stakeholders

2. notion of partnership, rather than subcontracting, for a balanced sharing of benefits

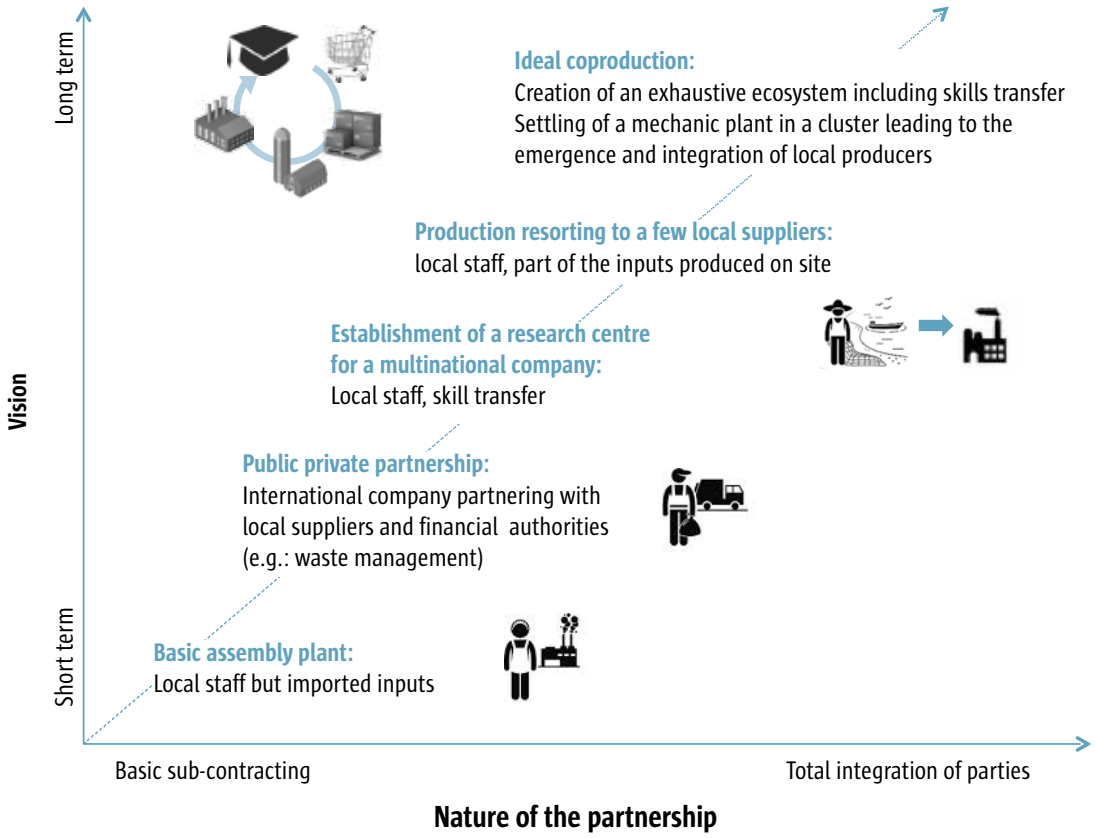
3. integration or at least presence of a southern partner. Therefore, cooperation can either be South/South, South/North, or even North/North

4. sustainable investments, involving long-term planning, implemented jointly with no intention of making "fast money" in the short term.

Thus, the definition comprises a broad range of initiatives. However, we will favour the actions featuring the greatest range, integration and vision. Coproduction is an ideal, a model towards which current and future investments must be directed.

1 - See note on this topic for further analysis

**Graph 1. Variety of coproduction initiatives and ideal model**




## GEOGRAPHIC FIELD

In order to enhance trends and presently useful information, the Observatory reduced the sample to 11 countries.

Among the 27 countries of the European Union (UE27), Germany, Spain, France and Italy will be considered and gathered under the label EU4.

Among the 12 Southern and Eastern Mediterranean Countries (SEMCs12), Algeria, Egypt, Jordan, Lebanon, Morocco, Tunisia and Turkey were selected and gathered under the label SMECs7.

*Although it does not belong to the Mediterranean region in a geographical point of view, Germany was integrated to the sample for its major role in Europe and in the neighbourhood policy. By doing so, we will be able to observe the evolutions of the German foreign policy in the Mediterranean, especially its strengthened economic presence in SEMCs (beyond Turkey) and the methods used to do so.*

# 1. HEAVY TRENDS AND PROSPECTS OF ECONOMIC GROWTH

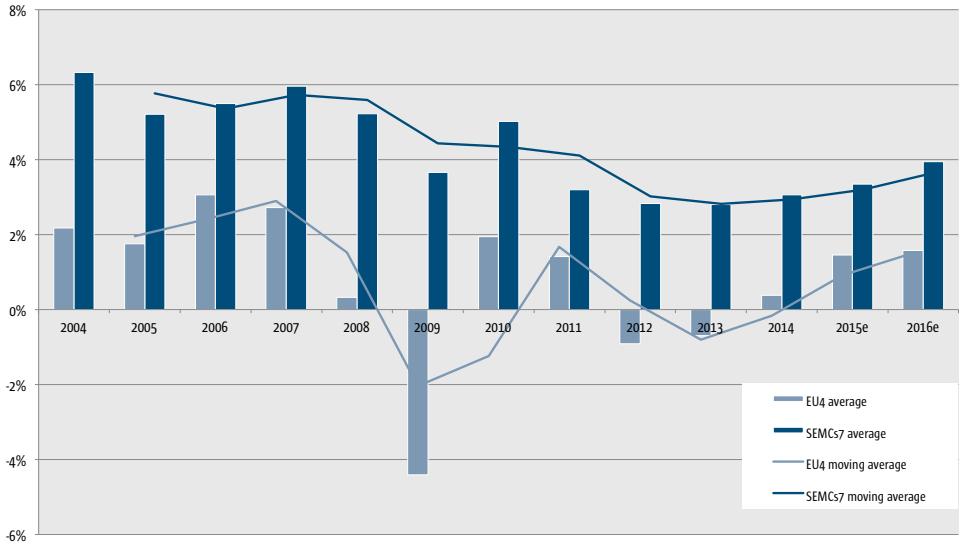
OBSERVATION #1: SEMCs7 maintain a positive growth in spite of recent global and regional crises and prove relatively vulnerable to the European economic situation.

For ten years, both shores of the Mediterranean have been affected by major political and economic shocks. The subprime (2007) and debt (2011) crises undermined the growth of European countries and their economies have not totally recovered yet. The average GDP growth between 2007 and 2014 in EU4 countries is close to zero. Nevertheless, the IMF foresees a recovery in Europe that should bring the growth rate up to 1.5% starting in 2016.

Economic shocks in the North had major consequences for the southern countries most involved in international trade and finance. In certain years, the GDP even decreased like in Turkey and Israel. Even the SEMCs less involved in globalisation remain highly dependent on export European markets (especially in North Africa) and suffer indirect consequences. **Therefore, the EU4/SEMCs7 GDP trend lines evolve in parallel (the moving average of SEMCs7 started decreasing in 2007) with fewer variations in the South, where growth remained around 6% between 2004 and 2007**, and dropped to 4.5% between 2007 and 2010.

The Arab Springs of 2010 and the beginning of the war in Syria in 2011 reduced the growth rate of SEMCs7. This growth rate was halved in ten years, but without ever dropping under 2.8% between 2012 and 2013. The trend should reverse in 2014, which has been confirmed by the IMF.

**Graph 2. Variety of coproduction initiatives and ideal model**



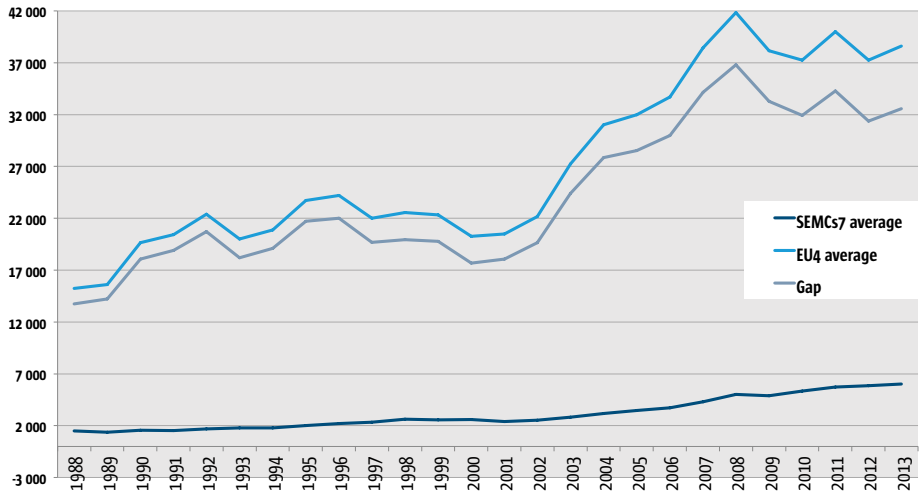

SOURCE : WORLD BANK AND IMF

## OBSERVATION #2: Growth in SEMCs7 remains insufficient to take up the economic and social challenges of sustainable development.

**Even with decent rates, the level of growth of SEMCs7 cannot ensure sufficient job creation and wealth sharing to support the rhythm of sustainable development.**

If we take the example of China, we can see that the country's industrial emergence is the result of 50 years of real GDP growth reaching over 10% per year, combined with a very low demographic growth rate (0.52% between 2004 and 2013). In comparison, GDP per inhabitant in SEMCs7 is growing slowly and will not lead to the sustained progression Asia went through. Besides, even though the gap between EU/SEMCs GDP per inhabitant is closing, this is not due to the increasing development of SEMCs7 but rather to the slowdown in EU4:

**Graph 3. GDP per inhabitant and differences EU4/SEMCs7**




SOURCE: WORLD BANK

Some years, SEMCs7 could compete with the growth rates of great emerging countries, but in an irregular way. Today, this capacity to transform growth into development is limited by targeted markets, the amount of FDIs, uncontrolled inflation and short-term demographic growth:

SEMCs7 mainly produce for the domestic market - still limited in terms of purchasing power - and for Europe - the recession of which made SEMCs7 slow down. This diversification is insufficient and the lack of regional integration prevents companies from setting up large-size businesses and making economies of scale, thus hindering economic growth (see part 4. Trade and regional integration).

In spite of a proactive policy to attract FDIs and the increasing role of Gulf countries, Turkey and BRICs in this field, economic crises in the North and political ones in the South have been weighing on economic flows since 2007.

Nevertheless, the global economic recovery should reverse this trend (see part 5).

The GDP deflator inflation rate (differential between nominal and real GDP) - particularly high in SEMCs undergoing political crises - has been over 10% in average in Egypt and Algeria for 4 years. It fluctuates around 6% in Jordan and Turkey, 4% in Tunisia and under 3% in Morocco and Lebanon. In comparison, Europe, where some countries are likely to suffer from the same deflation, shows an average below 1% over 4 years. Better control of the general price level in SEMCs7 would generate growth.

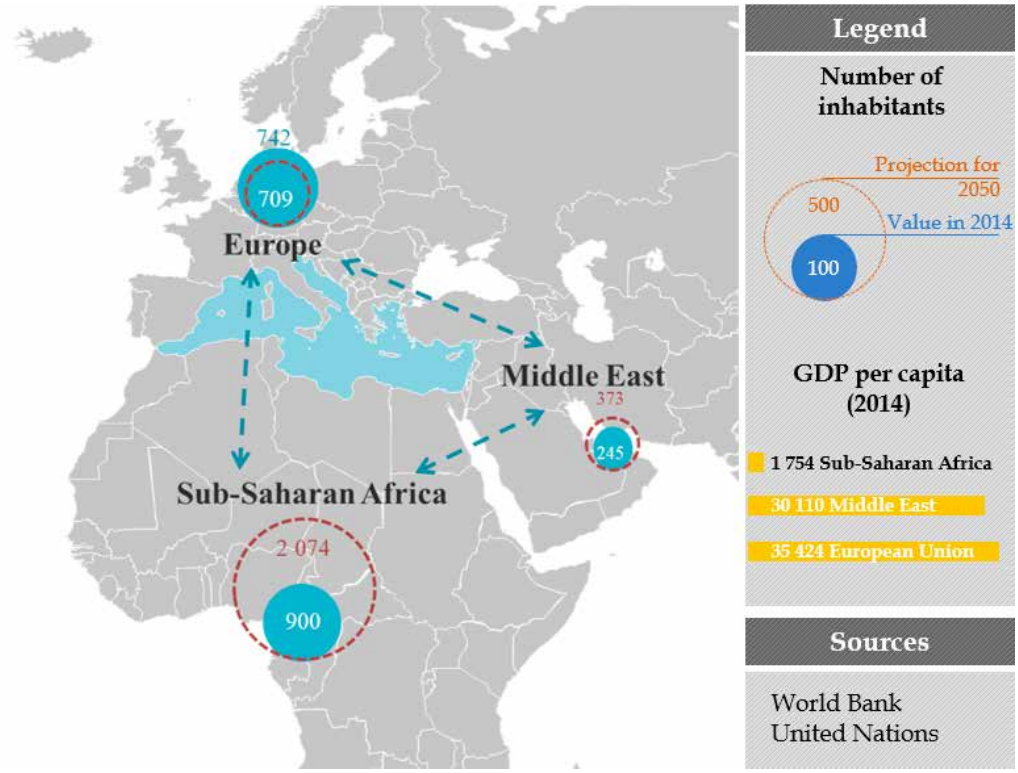
Finally, even though demographic growth will boost SEMCs7' economies in the medium term, dysfunctions can always happen in the short term: adapting training offer to company needs, bridging the gap between new workers and private sector capacities or managing demographic investments to share the profits. In order to quickly solve these dysfunctions, it is necessary to maintain a relatively high economic growth.

*In SEMCs7, the average demographic growth reaches 1.5% per year. Thus, the economic growth profits for 2014 - of about 3% - are halved by "demographic" investments (extending existing services to new populations - quantitative perception). Therefore, the potential consumption of growth profits as regards the improvement of economic and social conditions (improving existing services for all - qualitative perception) only reaches 1.5%.*

## OBSERVATION #3: The emergence of middle classes and the strategic position of SEMCs offer them promising perspectives.

Some of the conditions to transform SEMCs into emerging countries are present. **The emergence of middle classes will boost domestic demand while Africa and the Middle East - the future drivers of growth - are located in the Mediterranean neighbourhood, thus making of SEMCs undeniable strategic partners**.

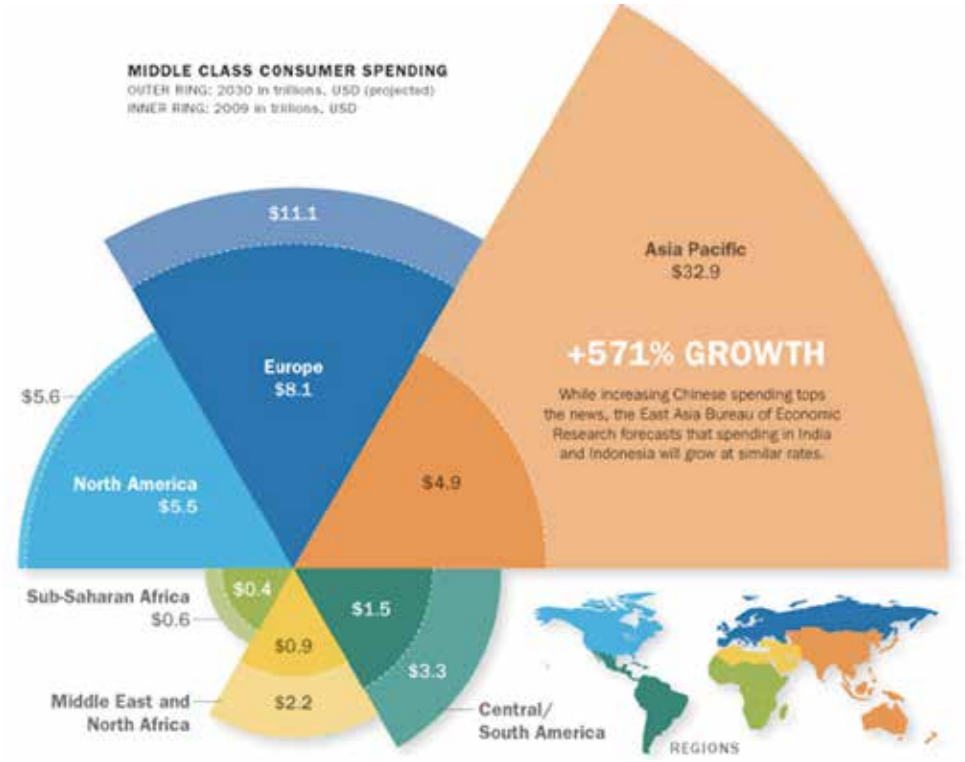
**Map 1. Demographic weight and purchasing power in SEMCs periphery**




After Asia (+571%), "the Middle East and North Africa" is the region where middle class consumption should increase the most by 2030 (+144%).

Coproduction, as well as greater regional integration, are necessary in order to tackle these markets quickly and in the best conditions.

**Graph 4. Estimation of middle classes consumption in 2030**




SOURCE : OCDE 2014

# 2. DEMOGRAPHY AND EMPLOYMENT

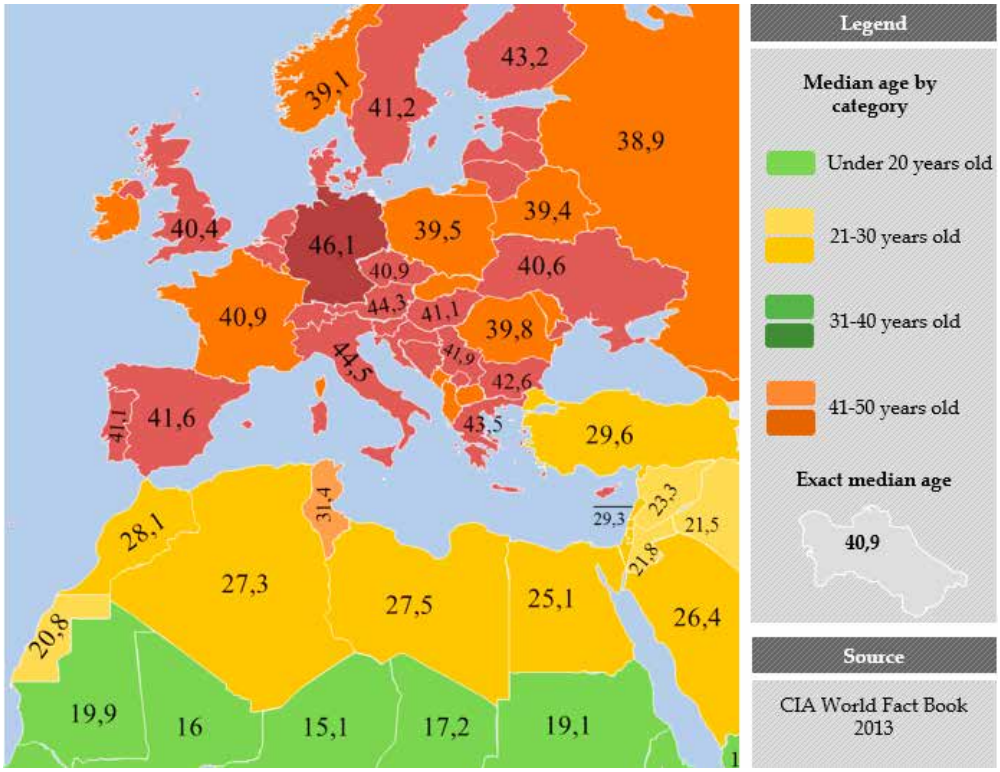
OBSERVATION #4: In the face of ageing Europe and the very young Sub-Saharan Africa, SEMCs12 represent a significant source of increasingly skilled workers.

SEMCs are favoured by their strategic geographic position, but also by the age and qualification of their populations.

In Europe, only a few countries have an average population under 40 years old (Poland, Slovakia, Belarus for instance). It is absolutely not the case of the sample - Germany even reaches 46 years old. Conversely, Sub-Saharan Africa has an extremely young population: in Southern Africa, no country reaches 21 years old in average.

SEMCs seem well located to bring a solution to generation challenges in these two areas. With median age ranging between 25 and 30 years old, their population remains young and active. Their skills, as shows part 6 on competitiveness, converge towards European standards, in terms of basic and superior education as well as professional training.

**Map 2. Median age in the Euro-Mediterranean zone and around in 2013**



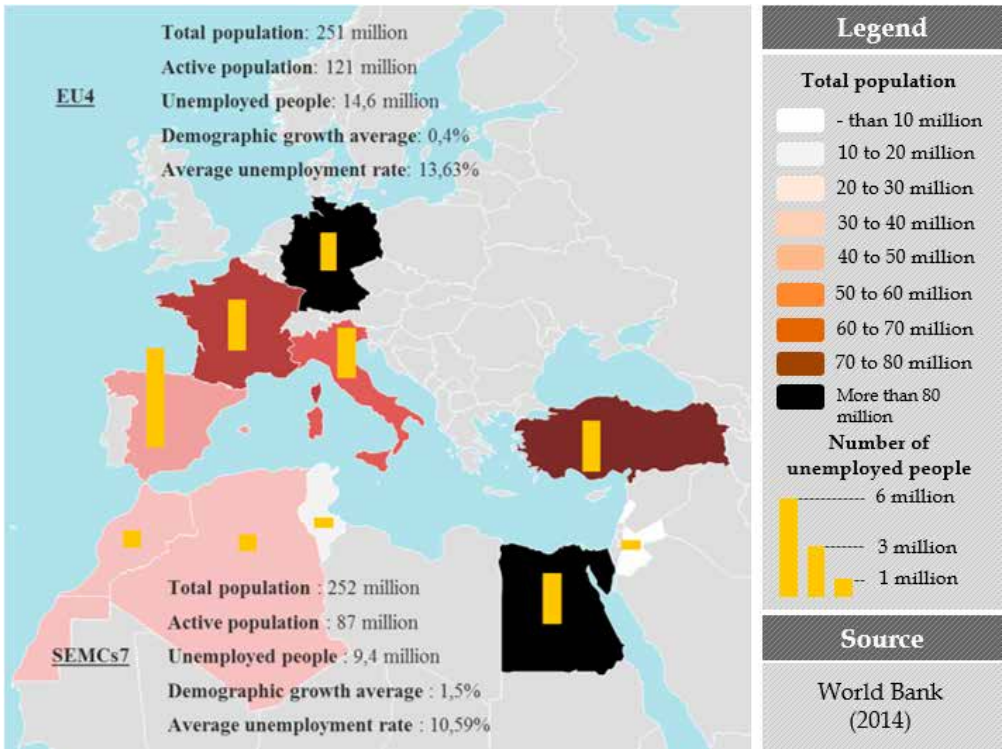
OBSERVATION #5: In SEMCs7 unemployment remains high while the share of active population should increase significantly.

As slower growth affected job creation, unemployment is still significant in SEMCs7, even though it has been decreasing over the last 10 years. Although definitions, calculation methods and statistics reliability differ from one country to another, the World Bank estimates that unemployment affects 10% of the active population, versus 13% in average in EU4. However, it mostly affects young people.

Unless we boost economic activity and carry out continuous actions to train young people to the needs of the labour market, the unemployment rate will keep going up.

While the total population is almost the same in EU4 and SEMCs7, the European active population is 50% more significant than that of Southern countries (121 million versus 87 million). If the demographic transition in SEMCs follows that of the EU, in 25 years the labour market should welcome 45 million extra workers in the South.

**Map 3. Population and unemployment in the sample countries**



# 3. FINANCIAL RELATIONS

OBSERVATION #6: EU4 has important financial bonds with SEMCs7, especially in North Africa. However, they scarcely result in structuring and productive investments.

Here, the importance of EU/SEMCs financial bonds is analysed through 3 sources:

- Amount of international fund transfers;
- Official Development Assistance ;
- Foreign Direct Investments coming from considered countries.

Firstly, we can see that the transfer of remittance - mostly from migrants - accounts for most financial bonds. These amounts - considered as counter - cyclical (increasing in recession periods) - address the basic needs of underprivileged populations. According to the African Development Bank, in North Africa 75% of these funds are used immediately by people living on the poverty line. Productive investments account for a small share of these funds.

In this regard, the figures are quite different according to each country. More than 75% of remittances come from Europe for North Africa (87% for Algeria, 73% for Morocco and 81% for Tunisia), against 57% for Turkey (mostly from Germany) and 18%, 4% and 3% respectively for Lebanon, Egypt and Jordan. Morocco is the country receiving the greatest amount of European capitals with over 5 billion dollars, while Jordan receives a minimum of 95 million dollars.

**Table 1. Transfers of remittance between sample countries ($ million)**

| *Emitting countries* \ *Receiving countries* | Germany | Spain | France | Italy | Algeria | Egypt | Jordan | Lebanon | Morocco | Tunisia | Turkey | Sub-total | **World** |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Germany | | 1,060 | 2,074 | 1,088 | 21 | 107 | 64 | 969 | 297 | 125 | 544 | 6,349 | **23,788** |
| Spain | 893 | | 2,763 | 244 | 65 | 22 | 9 | 32 | 1,719 | 9 | 1 | 4,864 | **16,015** |
| France | 903 | 2,815 | | 991 | 1,654 | 166 | 6 | 508 | 2,138 | 1,359 | 94 | 9,730 | **21,370** |
| Italy | 875 | 272 | 1,828 | | 28 | 554 | 16 | 75 | 959 | 392 | 7 | 4,129 | **16,152** |
| Algeria | 6 | 1 | 14 | 4 | | | 18 | 24 | 2 | 2 | | 65 | **191** |
| Egypt | 11 | 3 | 26 | 7 | 1 | | 33 | 45 | 4 | 4 | | 122 | **387** |
| Jordan | 2 | 2 | 4 | 1 | | 1,285 | | 16 | 1 | 1 | | 1,310 | **2,901** |
| Lebanon | 1 | | 2 | | | 500 | 2 | | | | | 505 | **1,181** |
| Morocco | | | 62 | 5 | 17 | | 4 | 7 | | | | 95 | **100** |
| Tunisia | | | 41 | 4 | 12 | | | | 12 | | | 68 | **68** |
| Turkey | 1,537 | 16 | 295 | 11 | 1 | 6 | 6 | 17 | 1 | 2 | | 354 | **4,435** |
| Sub-total | 4,228 | 3,109 | 5,034 | 1,266 | 1,778 | 2,532 | 93 | 722 | 4,836 | 1,768 | 104 | | |
| **World** | **15,802** | **10,990** | **24,760** | **7,715** | **2,020** | **19,612** | **3,757** | **8,899** | **6,962** | **2,314** | **1,128** | | **583,430** |

SOURCE: WORLD BANK - BILATERAL REMITTANCE MATRIX 2014

Therefore, these transfers of remittances are a significant and essential resource for the economic balance of receiving countries, especially of North Africa: increasing demand, improvement of the life of underprivileged people, currency supply. Nevertheless, the share of productive investment remains insignificant while it could solve these problems in the long term, by creating companies and therefore employment and local wealth.

These amounts seem huge, as they far exceed the official development assistance (ODA) granted to SEMCs7. France is the biggest contributor, with 1.5 billion dollars in ODA. Yet the transfers of remittance coming from France are 4 times higher. This ratio is of 2.3 times the ODA in Germany and reaches 18 and 28 times the ODA in Spain and Italy, even though it is much less significant in volume.

**Table 2. Official Development Assistance for sample countries (2013 - $ million)**

| *Receiving countries* | *Emitting countries* | | | | |
|---|---|---|---|---|---|
| | Germany | Spain | France | Italy | TOTAL SENT EU4 |
| Algeria | 8 | 7.65 | 138 | 0.42 | 154.07 |
| Egypt | 277 | 3.6 | 108 | 17 | 405.6 |
| Jordan | 69 | 7.58 | 91 | 2.4 | 169.98 |
| Lebanon | 32.2 | 10.4 | 81.4 | 18.2 | 142.2 |
| Morocco | 121 | 41 | 876 | 11.7 | 1,049.7 |
| Tunisia | 82 | 31 | 169 | 21 | 303 |
| Turkey | 315 | 1.27 | 55 | 0.25 | 371.52 |
| TOTAL RECEIVED SEMCs7 | 904.2 | 102.5 | 1,518.4 | 70.97 | 2,596.07 |
| TOTAL WORLD | 9,451 | 945 | 6,800 | 867 | 18,063 |
| *Share of ODA dedicated to sample countries* | 10% | 11% | 22% | 8% | |

SOURCE: OECD QWIDS 2013

Finally, the share of FDIs from the UE received by SEMCs7 is also quite low. It is quite difficult to determine the origin of FDIs as some large groups sometimes resort to devices lacking transparency based in Luxembourg or the Netherlands.

Nevertheless, the UNCTAD data shows the appetence of Gulf countries and the relatively low flows coming from Europe with regard to the relations between the two zones. With 21% of FDIs destined to Morocco (largest number for a EU4 country), France only invests 705 million dollars each year, that is less than the ODA (876 million). Very low crossed-investments among SEMCs show once again the lack of regional cooperation.

**Table 3. Origin of main investors in SEMCs, share and value in FDI flows**

| Algeria | Egypt | Lebanon | Morocco | Tunisia | Turkey |
|---|---|---|---|---|---|
| Kuwait 23% | UK 34% | UAE 19% | France 21%<br>$ 705 million | Qatar 31% | The Netherlands 23% |
| Spain 17%<br>$ 287 million | Belgium 7% | UK 15% | UAE 13% | France 15%<br>$ 164 million | UK 12% |
| Egypt 17% | USA 6% | France 9%<br>$ 255 million | Saudi Arabia 12% | Austria 13% | Russia 9% |
| USA 13% | UAE 5% | Iraq 6% | USA 11% | Canada 6% | Azerbaijan 8% |
| France 7%<br>$ 119 million | Qatar 3% | Egypt 4%<br>$ 113 million | Kuwait 5% | UK 4% | Germany 8%<br>$ 1,030 million |
| Saudi Arabia 6% | France 2%<br>$ 6 million | | Switzerland 5% | Germany 4%<br>$ 44 million | Luxembourg 6% |
| China 4% | | | Spain 4%<br>$ 134 million | | Italy 6%<br>$ 771 million |
| | | | Italy 3%<br>$ 100 million | | USA 4% |
| | | | Turkey 2% | | France 3%<br>$ 385 million |

SOURCE: UNCTAD 2013 (NON AVAILABLE DATA FOR JORDAN)

Finally, to relate the last two sections and address the South/North relation, the demographic transition will also produce complementarities in terms of funding capacities. The dependence rate is growing in the EU, which directs revenues towards consumption rather than investment. SEMCs7 find themselves in the reverse situation. The dependence rate decreasing, capitals are released and could make up for the investment slowdown in the North.

# 4. TRADE AND REGIONAL INTEGRATION

OBSERVATION #7: In Northern countries, regional integration is playing its role. SEMCs7 are still marginalised exportation partners.

The study of commercial exchanges shows the integration rate in both spaces and the resulting relations and dependences. Thus, one can see that the common European market ensures European companies access to a significant demand and favoured the development of large intercontinental groups capable of competing with the biggest global conglomerates. These foundations enable companies to reach the necessary size to generate investment margins and sufficient guarantees with financial organisms.

Even though they are increasingly diversified with the advent of emerging countries, European exportations remain quite intense among the union's countries. Spain still finds 1/3 of its outlets in EU4, against 1/4 for France and Italy. For Germany - with the most significant and sophisticated exportations - 17% of its clients come from these three countries.

In comparison, European companies only directed little of their commercial capacities towards SEMCs7, the total population of which (252 million inhabitants) exceeds that of EU4 (251 million inhabitants). Their share in the EU4 trade balance ranges between 2.5% for Germany and 7.5% for Spain.

**Table 4. Share of EU4 countries exportations in each area**

| *Exporters* \ *Markets* | UE 4 | SEMCs7 |
|---|---|---|
| France | 28,34% | 5,62% |
| Germany | 16,68% | 2,66% |
| Italy | 26,19% | 6,44% |
| Spain | 32,81% | 7,46% |

SOURCE: THE OBSERVATORY OF ECONOMIC COMPLEXITY 2012

OBSERVATION #8: Conversely, some Southern countries highly depend on the EU for their exportations but infra-regional trade is at a standstill for lack of economic integration.

Today, North African Countries - especially Morocco and Tunisia - highly depend on Europe to export their production. The EU4 countries currently account for 65% of Tunisian exportations, and for 40% in Morocco. The United States attracted Algerian exportations (15% of outlets), although this trend is mainly due to their will to diversify their oil provision. However, the United States are also present in other North African countries, benefiting from the new free-trade agreements.

Egypt and Turkey diversified their outlets so that none of their partners buys more than 10% of exportations. Finally, the Middle East is becoming an increasingly important partner, especially for Jordan and Lebanon.

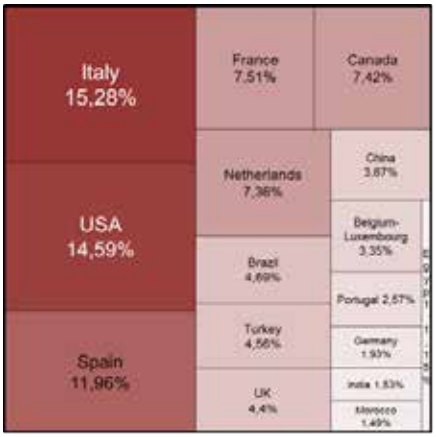
The Centre of Theoretical Analysis and of Economic Data Processing already observed in September 2011, from CHELEM databases, this historical **privileged relation between SEMCs and the EU, and the United States to a lesser extent**. Indeed, the share of exportations towards these destinations remained stable since the 1970's although it could evolve if the products exported by SEMCs moved up the range. There are no major commercial dynamics with emerging countries such as China, India or South Africa for example. Finally, although it is not significant, the Centre observed a regular progression of exportations towards Sub-Saharan Africa since the beginning of the 2000's (even though it only accounts for less than 1% for Algeria, 2% for Tunisia, 2.7% for Turkey, but over 4.5% for Morocco and Egypt).

**Table 5. SEMCs7 main exportation partners**

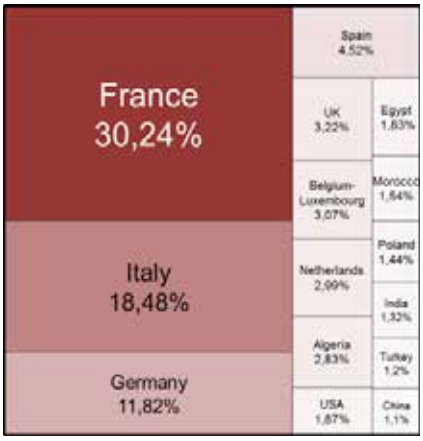
| Algeria | Egypt | Jordan | Lebanon | Morocco | Tunisia | Turkey |
|---|---|---|---|---|---|---|
| Italy 15.28% | Italy 8.02% | Iraq 13.43% | South Africa 13.21% | France 17.8% | France 30.24% | Germany 9.19% |
| United States 14.59% | United States 7.87% | United States 12.98% | Switzerland 16.97% | Spain 15.35% | Italy 18.48% | Iraq 6.73% |
| Spain 11.96% | India 6.44% | India 12.14% | Saudi Arabia 6.96% | Brazil 5.79% | Germany 11.82% | Iran 6.1% |
| France 7.51% | Germany 4.71% | Saudi Arabia 8.52% | UAE 6.88% | India 5.47% | Spain 4.52% | United Kingdom 5.44% |
| Canada 7.42% | Saudi Arabia 4.65% | Free zones 8.46% | Syria 5.83% | Italy 3.89% | United Kingdom 3.22% | United Arab Emirates 5.05% |
| The Netherlands 7.36% | Turkey 4.5% | Lebanon 3.81% | Iraq 4.17% | Germany 3.74% | Benelux 3.07% | France 4.43% |

**Graph 5. "Treemap" representation of SEMCs7 main exportation partners**

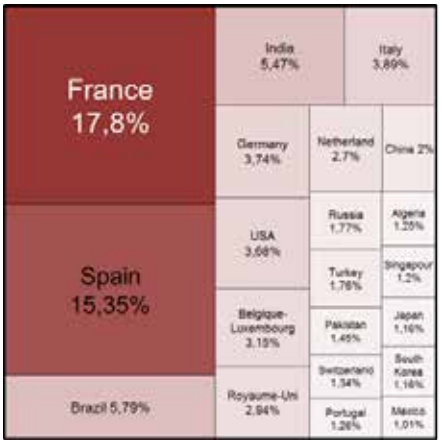
**Algeria**



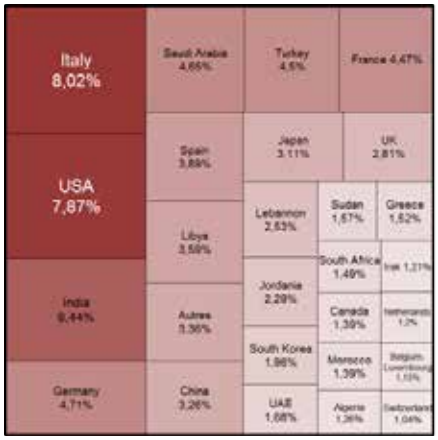

**Tunisia**



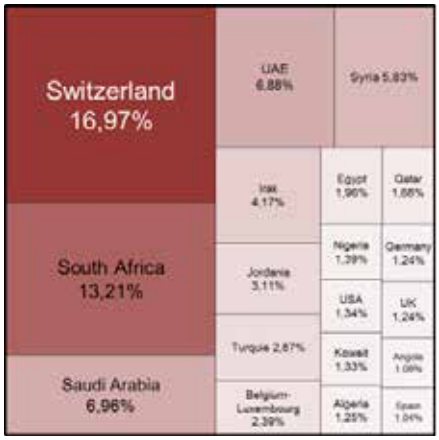

**Morocco**



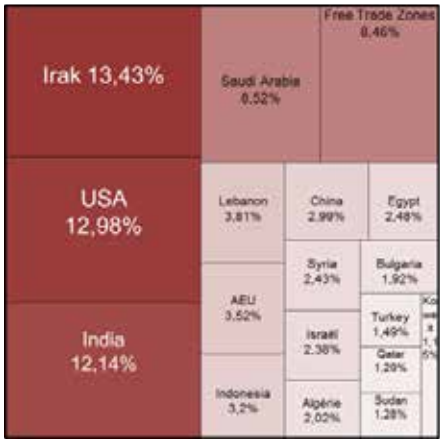

**Egypt**




**Lebanon**




**Jordan**




**Turkey**


SOURCE : THE OBSERVATORY OF ECONOMIC COMPLEXITY (MIT MEDIA LAB) 2012

Finally, in spite of geographic proximity, exchanges among SEMCs7 are extremely low and their integration into world trade quite limited, as shows the number of effective agreements.

**Table 6. Number of effective bilateral and multilateral agreements**

| | Germany | Spain | France | Italy | Algeria | Egypt | Jordan | Lebanon | Morocco | Tunisia | Turkey |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Bilateral agreements | 127 | 70 | 93 | 78 | 28 | 73 | 41 | 40 | 45 | 34 | 69 |
| Multilateral agreements | 50 | 50 | 50 | 50 | 6 | 11 | 9 | 6 | 8 | 8 | 15 |

SOURCE : CNUCED

Therefore, in the face of an underdeveloped domestic market and an almost non-existent regional market, SEMCs7 are highly vulnerable to regional great powers. From a microeconomic point of view, without opening themselves to greater markets, national companies will not be able to generate sufficient economies of scale to be globally competitive in the long term.

OBSERVATION #9: In SEMCs7, manufactured and mechanical products have progressively replaced agricultural products in terms of exportations, yet the technological sector remains backwards.

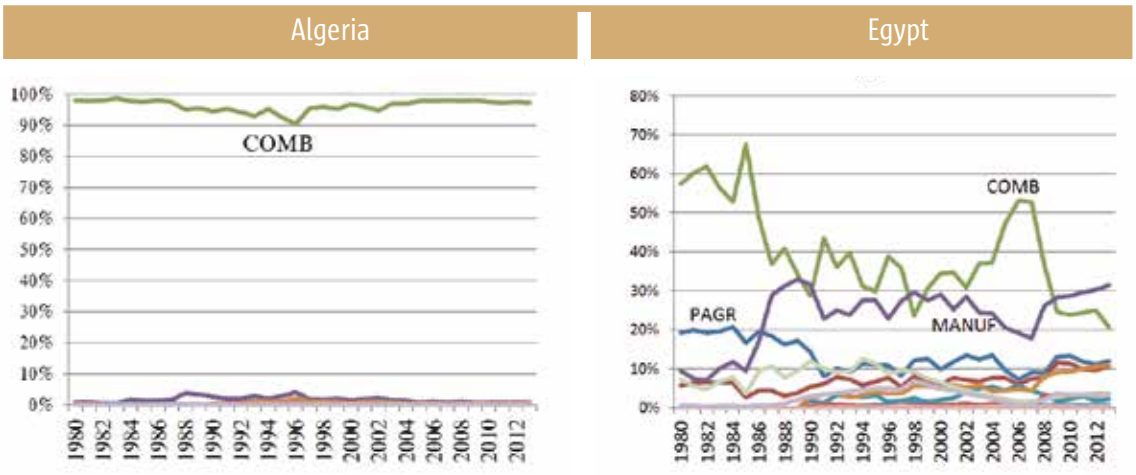
Two trends of imported products appear, depending on the presence of hydrocarbons in the country:

1/ In the case of countries exporting little or no oil (Jordan, Lebanon, Morocco, Tunisia, Turkey), exportations mostly comprised agricultural production for a long time. Then, between 1980 and 2000, manufactured products gradually emerged as main exportation channels. Since the 2000's, one can observe the increase in transport equipment exportations, at the expense of textile, but not exceeding 20% of the trade balance. High added-value industries (chemistry, pharmaceuticals, electronics...) remain under 5% of the exported production, even though they progress in value.

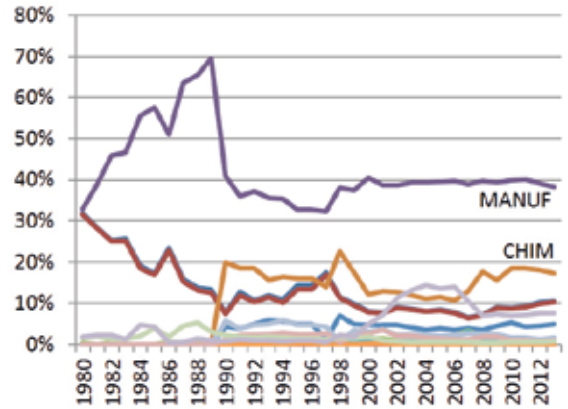
**Generally speaking, for these countries, sectors are actually developing. They are constantly progressing towards higher added-value products, but at a quite slow pace.**

2/ Countries with hydrocarbons seem to have postponed diversification as long as possible (Egypt), or have not started it yet (Algeria). For the former, oil and agricultural products lost ground in the 1980's in favour of manufactured products. However it was followed by a stagnation in the nature of exportations. As for Algeria, it still exclusively depends on its hydrocarbons production. No industry seems to be able to take over if the production and/or price were to predict the decline of the extractive industry.

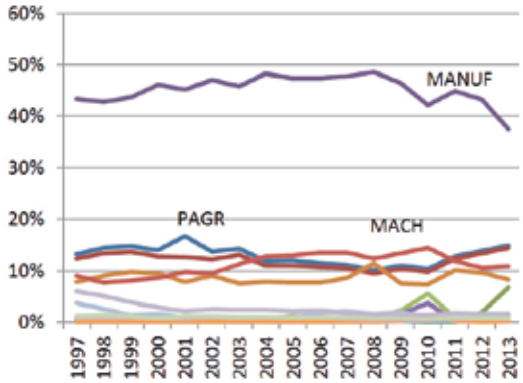
**Graph 6. Nature of exportations since 1980 for SEMCs7 and share of exportations by product type**



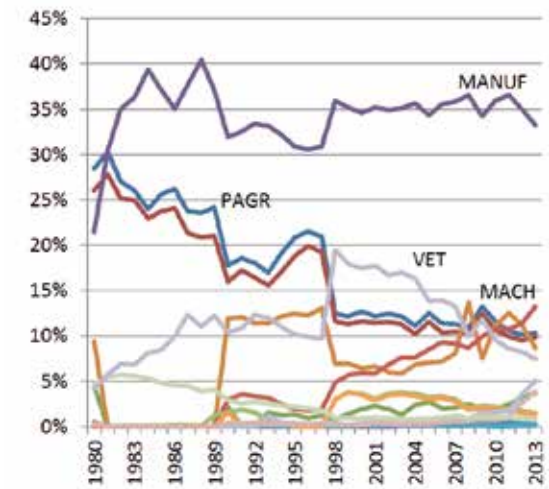
## Jordan



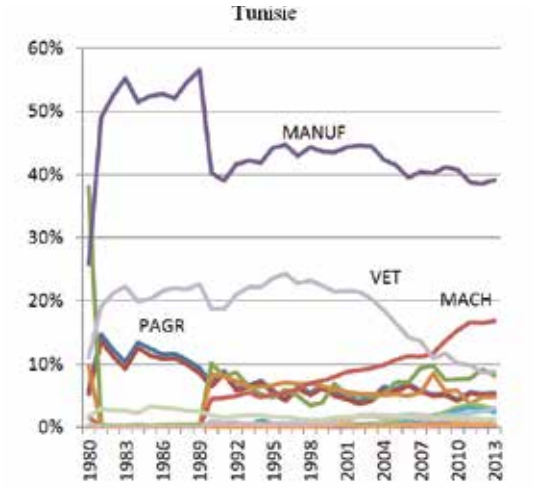

## Lebanon



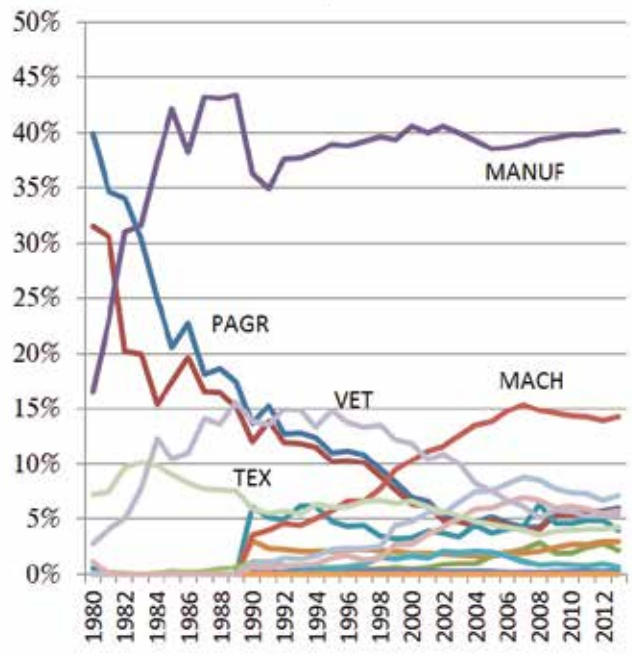

## Morocco




## Tunisia




## Turkey




SOURCE : WORLD TRADE ORGANISATION

## Legend

| | |
|---|---|
| Agricultural products | PAGR |
| Foodstuffs | PALI |
| Fuels and extractive industries | COMB |
| Manufactured products | MANUF |
| Iron and steel | FA |
| Chemical products | CHIM |
| Pharmaceuticals | PHARMA |
| Machineries and transport equipment | MACH |
| Office equipment and connector engineering | EBC |
| Data processing electronic equipment | METD |
| Telecommunications equipment | TELECOM |
| Integrated circuits and electronic components | CICE |
| Transport equipments | TRANSP |
| Automotive equipments | AUTO |
| Textile products | TEX |
| Clothes | VET |

# 5. INVESTMENT DYNAMICS

OBSERVATION #10: FDIs are volatile on both shores. They are very sensitive to the international environment and to the perceived risk.

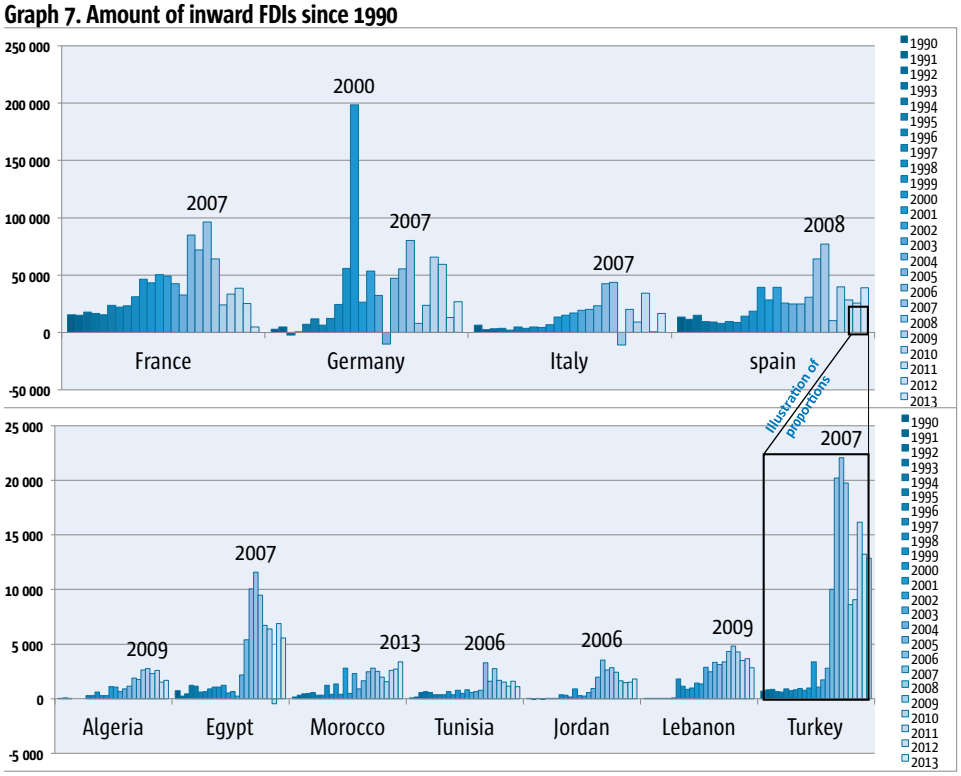
The variations in Foreign Direct Investments highly depend on the global political and economic context, and therefore on companies' trust and stability.

The crises of 2000, 2007 and 2011 hindered inward and outward FDIs in Europe. The same went for SEMCs7 where the raise in FDIs observed since 2000 suddenly stopped in 2007, with no short term recovery. Countries that went through the Arab Spring have difficulty to return to a growing dynamic.

The global economic slowdown affected both zones of the study, even though SEMCs are less integrated into global economy and European FDIs do not exceed 50% of the total amount (see table 3). **Therefore, SEMCs did not play a role of safe-haven after 2007, as the decline in European FDIs was not compensated by investments from other regions.** Even so, the Arab Springs quickly put an end to these hopes.

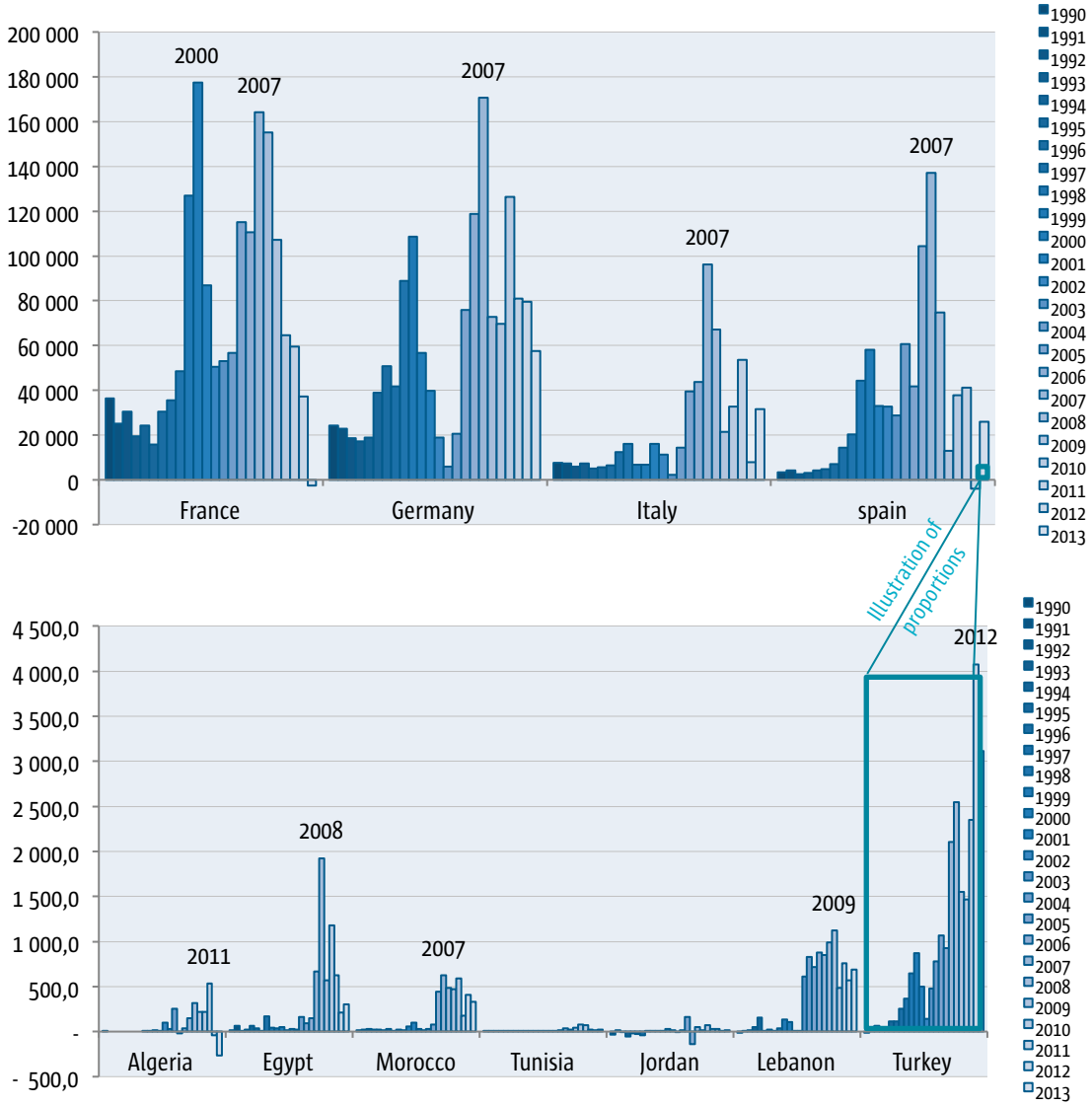
One must also note that the value of inward FDIs in SEMCs is not yet sufficient to drive a quick economic development, even if the trend of the early 2000's seems to show that an acceleration is possible. As for outward FDIs in SEMCs, they are quite insignificant. At best, their highest value corresponds to the lowest values of EU4.

**Graph 7. Amount of inward FDIs since 1990**




SOURCE : CNUCED

**Graph 8. Amount of outward FDIs since 1990**




SOURCE : CNUCED

*Note : The rise in inward and outward FDIs in Turkey in the 2000's corresponds to the resumption of growth and the economic stabilisation due to the beginning of the negotiations on Turkey's entry into the EU - all these factors encouraging investment.*

## OBSERVATION #11: FDIs in the South do not produce sufficient added value.

Even though the data available on the nature of FDIs could be more detailed and homogeneous, the sectors attracting investments are not necessarily those creating the most wealth locally, except in Turkey where "manufacture", "finance" and "energy" lead the market.

**Table 7. Share of main investments by sector in SEMCs (2013)**

| Algeria | Egypt | Lebanon | Morocco | Tunisia | Turkey |
|---|---|---|---|---|---|
| Industry 68% (including oil) | Oil 60% | Trade, Industry 32% | Real estate 38% | Energy 35% | Manufacture 35% |
| Construction industry 8% | NICT 11% | Services 30% | Tourism 14% | Telecoms 30% | Finance 19% |
| Transport 8% | Manufacture 6% | Media 15% | Industry 11% | Manufacture 21% | Energy + renewable 16% |
| Tourism 5% | Finance 1% | Real estate and construction 9% | Holding 7% | Financial sector 9% | Trade 14% |
| Services 4% | Construction 1% | Technology 9% | Trade 5% | Tourism and real estate 3% | Mines 5% |
| Telecoms 2% | | Tourism 6% | Major works 5% | | |

SOURCE: UNCTAD (NON AVAILABLE DATA FOR JORDAN)

Algeria and Egypt seem to attract investors mostly for their hydrocarbon resources. In other SEMCs of the sample, even though energy seems to have great prospects in Tunisia and Turkey, real estate and trade still account for significant shares of FDIs, at the expense of future-oriented and innovative sectors.

## OBSERVATION #12: Nevertheless, the actual risk seems overestimated, especially in SEMCs.

Although the situation has been quite eventful since 2010 in the considered zone - economically in the North and politically in the South - the excessive media coverage of events occurring in SEMCs affected their image and hid the local economic dynamism.

Yet, the economic foundations and development perspectives are quite encouraging and the alleged threats are beyond reality. **As regards the financial, security and environmental risks, the gaps are not always significant nor always in favour of EU4 countries**. The tables under show indicators enabling to put the situations into perspective.

**Table 8. Assessment of the financial risk (survey with company managers of each country)**

| | Germany | Spain | France | Italy | Algeria | Egypt | Jordan | Lebanon | Morocco | Tunisia | Turkey | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank financial stability[2] | 5,3 | 4,2 | 5,4 | 4,4 | 3,4 | 4,2 | 5,2 | 5,8 | 5,6 | 3,5 | 5,7 | 4,8 |
| Regulation of fund exchange[3] | 4,8 | 4,2 | 5,0 | 3,8 | 2,2 | 3,5 | 4,7 | 3,5 | 4,5 | 3,7 | 4,6 | 4 |

SOURCE: WORLD ECONOMIC FORUM - EXECUTIVE OPINION SURVEY 2014 (GRADE OUT OF 7)

**Table 9. Assessment of the security risk (survey with company managers of each country)**

| | Germany | Spain | France | Italy | Algeria | Egypt | Jordan | Lebanon | Morocco | Tunisia | Turkey | Average |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Cost of terrorism for businesses[4] | 5.5 | 5.0 | 4.6 | 5.6 | 3.8 | 2.4 | 5.0 | 2.6 | 5.4 | 3.3 | 4.0 | 4.3 |
| Cost of criminality for businesses[5] | 5.2 | 5.2 | 4.3 | 4.3 | 4 | 2.5 | 5.1 | 3.6 | 5.3 | 3.6 | 4.5 | 4.3 |
| Organised crime[6] | 5.5 | 5.5 | 4.9 | 3.3 | 4.3 | 3.5 | 5.6 | 4.5 | 5.7 | 4.2 | 4.4 | 4.7 |
| Reliability of police services | 5.9 | 5.8 | 5.3 | 4.8 | 4.1 | 3.3 | 5.3 | 2.8 | 4.9 | 4.1 | 3.6 | 4.5 |
| Company ethics | 5.6 | 3.8 | 5.1 | 3.6 | 3.7 | 3.9 | 4.6 | 2.9 | 4.2 | 3.9 | 4.0 | 4.1 |

2 – Question asked: In your country, how would you assess the soundness of banks?
3 – Question asked: In your country, how effective are the regulation and supervision of securities exchanges?
4 – Question asked: In your country, to what extent does the threat of terrorism impose costs on businesses?
5 – Question asked: In your country, to what extent does the incidence of crime & violence impose costs on businesses?
6 – Question asked: In your country, to what extent does organized crime impose costs on businesses?

**Table 10. Assessment of the environmental and climate risk in sample countries**

| | Word Risk Index | Exposure to natural disasters | Population vulnerability | Lack of reaction | Lack of adaptation |
|---|---|---|---|---|---|
| Algeria | 7,63% | 15,82% | 22,93% | 77,02% | 44,76% |
| Morocco | 6,80% | 13,25% | 27,92% | 75,71% | 50,40% |
| Tunisia | 5,47% | 12,45% | 21,02% | 75,51% | 38,36% |
| Turkey | 5,34% | 12,25% | 20,54% | 67,57% | 42,67% |
| Lebanon | 5,01% | 11,14% | 20,21% | 70,00% | 44,61% |
| Jordan | 4,75% | 10,53% | 22,03% | 68,79% | 44,44% |
| Italy | 4,48% | 13,85% | 17,27% | 54,41% | 25,39% |
| Spain | 3,20% | 10,23% | 16,08% | 52,00% | 25,74% |
| Germany | 3,01% | 11,41% | 15,41% | 37,73% | 25,97% |
| France | 2,69% | 9,25% | 16,13% | 43,29% | 27,83% |
| Egypt | 2,29% | 4,72% | 21,34% | 77,86% | 46,48% |

*Very low*
*Low*
*Average*
*High*
*Very high*

SOURCE : WORLD RISK REPORT 2014 (UNU – EHS)

# 6. COMPETITIVENESS AND COPRODUCTION

OBSERVATION #13: The reforms started in SEMCs rather converge towards EU standards. A complementarity can now be observed in terms of technology and access to markets.

SEMCs are standardising the basic conditions for the exercise of business towards EU standards, which now materialises in the results of major international indicators.

For instance, each year the World Economic Forum draws up a global competitiveness index of countries based on 3 categories: basic production conditions, their efficiency and innovation, split up in 12 indicators.

**Category 1: Factors (or factor competitiveness)**

1. (Public and private) institutions
2. Infrastructures and production factors
3. Macro-economic stability
4. Health and primary education

**Category 2: Efficiency (or efficiency competitiveness)**

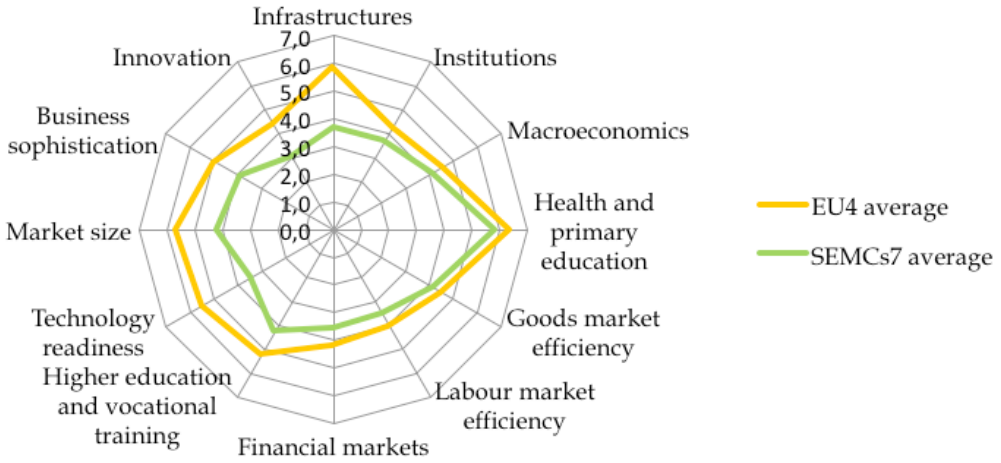
5. Higher education and professional training
6. Efficiency of product market
7. Efficiency of labour market
8. Financial market maturity
9. Technology appropriation
10. Market size

**Catégorie 3 : Innovation (or innovation competitiveness)**

11. Business sophistication
12. Innovation

By comparing the results obtained by EU4 and SEMCs7 countries, it is quite clear that the gap is very small for most pillars of the first two categories. Although the EU keeps a clear competitive advantage in terms of infrastructures, higher education, technology appropriation and market size, SEMCs almost boast the same results on institutions, macroeconomic environment, primary education, health and on the efficiency of product, labour and finance markets.

**Graph 9. Radar comparative analysis of competitiveness factors for each zone**




SOURCE: WORLD ECONOMIC FORUM GLOBAL COMPETITIVENESS REPORT 2014/2015

The competitiveness convergence on factors and efficiency as well as innovation complementarities show that coproduction is of great interest.

These dynamics can redistribute the value chain by highlighting mutual competitive advantages while enhancing skills and capital transfers in common market strategies. Therefore, the position of EU4 and SEMCs7 on the global competitiveness index shows that complementarities are now optimal for coproduction operations to succeed.

The existing tools implemented to support the economic activity of SEMCs can also reinforce their competitiveness assets and use coproduction as a lever to optimise investments in the categories where they lie behind:

- Public or public/private investments in infrastructures and higher education;
- Coproduction to favour professional training, technology appropriation, business sophistication or access to broader markets.

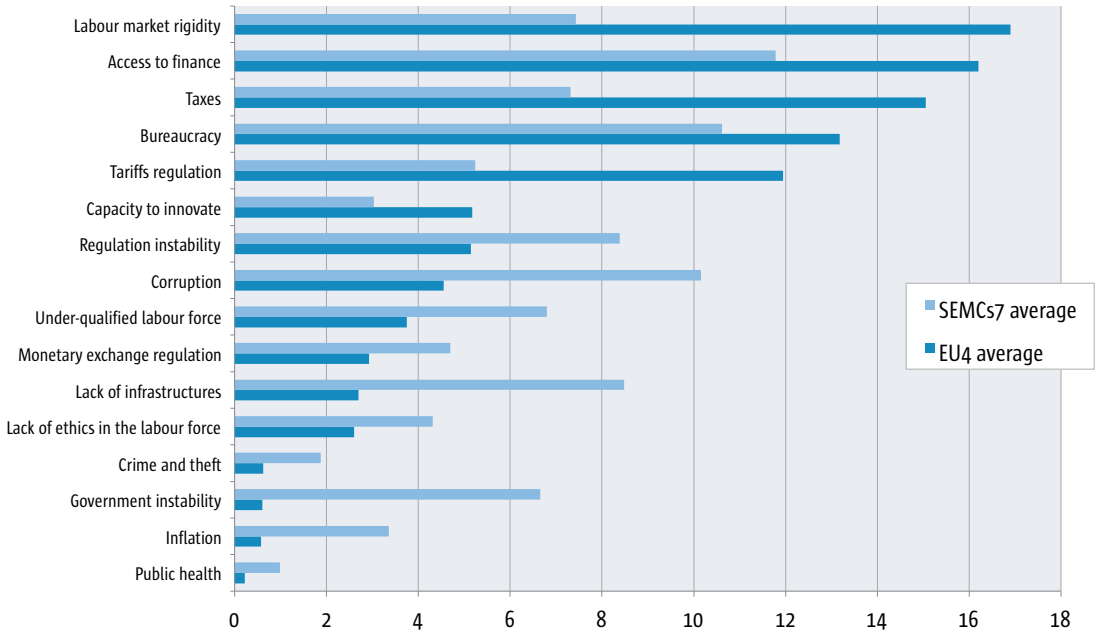
OBSERVATION #14: In spite of continuous efforts, obstacles to the effective functioning of business must still be overcome to make of SEMCs7 real emerging countries.

Theoretically, the conditions are in place to exploit the EU/SEMCs complementarity, with mutual advantages. However, obstacles still hinder investment decisions and the capacity to do business serenely, in spite of a real political will to find solutions. In the barometer of the World Economic Forum, created at the same time as the competitiveness index, EU company managers firstly criticise the inflexible labour market (17%) as well as the tax rate (15%) and the price regulation (12%). They are also limited by access to funding (16%) and by the administration red tape (13%).

To a lesser extent, SEMCs7 have difficulties to access funding (12%) and with the administration (red tape 10% and corruption 10%). 8% of managers also mention the instability of regulations and the lack of infrastructures, which will represent potential risks if they are not solved in the medium term.

The graph below shows the opinion of industrials in their respective countries for 16 commonly cited obstacles. The difficulties of EU4 managers exceed that of their SEMCs7 counterparts for the first 6 categories, linked to the excess and inflexibility of established rules and procedures. On the contrary, other categories, featuring temporary dysfunctions, worry more southern managers.

**Graph 10. Main obstacles cited by company managers in each zone**




SOURCE: WORLD ECONOMIC FORUM GLOBAL COMPETITIVENESS REPORT 2014/2015 – OCCURRENCE PERCENTAGE OF THE OBSTACLES CITED BY COMPANY MANAGERS

These results can be compared with the World Bank Doing Business ranking showing that EU4 countries have the most difficulties in the categories "issue of building permit", "ownership transfer" and "tax payment". As for SEMCs7, they have difficulties with "issue of building permit", "loan approval" and "resolution of insolvency".

Besides, international collaboration and people's mobility is also an issue for companies, their employees and investors.

## OBSERVATION #15: In the meantime, competitiveness cluster strategies are emerging and helping reinforce the business environment.

Southern Mediterranean countries are aware that they need to welcome FDIs to boost growth. Therefore, they made significant efforts to reinforce the attractiveness of their economies. Then, in order to develop a greater added-value production via coproduction, these countries implemented a more sustainable policy of innovative research and competitiveness, by associating cooperation spaces and sharing means and synergies between actors and value chains[7].

These competitiveness centres, growth centres or clusters are quickly developing thanks to public authorities and the private sector, especially in Morocco and Tunisia where about fifteen specialised sites are currently active. Clusters can concern traditional or cutting-edge sectors.They aim at influencing technologies and innovations in value chains for all local and foreign companies. These common and shared strategies ensure the successful integration and globalisation of exchanges.

In Morocco, the interest in government clusters started in the 2000's. The Spatial Planning Authorities investigated on Local Productive Systems (LPS). Most of these LPS belonged to the manufacture and industrial sectors. This study was launched to support high-potential technological clusters. In 2006, the Pacte Emergence was created. It targeted key sectors for which Morocco featured competitive advantages. In 2009, the "Initiative Maroc Innovation" [Innovation Morocco Initiative] strategy reinforced this pact. It features specific objectives aiming at driving Morocco towards the market of high added-value products. Today, the State supports 6 clusters and could potentially support 5 more.

Morocco is a model in southern Mediterranean countries as in Algeria clusters are spontaneous and not (yet) supported by the State. However, the Algerian government recently implemented the Schéma National d'Aménagement du Territoire 2025, aiming at launching competitiveness clusters to modernise its territory. Once they are effective, these frameworks will supervise and encourage high-added value sectors - like ICTs and biotechnologies - to catch up.

Tunisia recently followed the Moroccan dynamic. In 2008, the 2016 Industrial Strategy was created, on agribusiness, textile and the new information and communication technologies. In order to boost the emergence of innovative clusters, the UNIDO and the AFD massively supported Tunisia's Mechatronic Cluster.

As for Lebanon, it focuses on creative industry clusters. The UNIDO noted 12 clusters and supports two of them.

7 – This section is based on the recent quality works carried out by Paulette Pommier for IPEMED in North Africa. For more information, see document « Clusters au Maghreb, vers un modèle de cluster maghrébin spécifique » (Clusters in North Africa, towards a specific North African cluster model), Paulette Pommier, IPEMED, July 2014.

In spite of a slight delay in cluster creation, Egypt followed the dynamic through the "EU-Egypt Innovations Clusters" initiative and by joining the UNIDO programme "Clusters in Cultural and Creative Industries in the Southern Mediterranean".

Finally, although there are no national cluster programmes in Turkey at the moment (according to the European cluster observatory), in 2008 the Turkish government implemented a law to support Research and Development in the ITC and electronic sectors by offering tax benefits to innovative private actors in these sectors. Regional development agencies are also in charge of developing dedicated programmes (in the agribusiness, including organic, aviation and health).

**Table 11. Active clusters and similar growth centres by sectors in SEMCs7 (developing projects excluded)**

| Agribusiness | Textile and clothing | Metal and electronic material | NITC | Environment | Other |
|---|---|---|---|---|---|
| APAB (Cluster of Algerian Beverage Producers) | Alexandrie Cluster | CE3M (Mohammedia Mechanic Mechatronic and Electronic Cluster) | Maroc Numeric Cluster | EUNIC Jordan (European Union National Institutes for Culture) | Bourj Hammound Jeweller's Cluster |
| Bouira olive oil Cluster | Amman Cluster | MMC (Morocco Micro-Electronics Cluster) | Metutech | Solar Cluster | Tripoli Furniture Cluster |
| Agadir Haliopole | C2TM (Moroccan Technical Textiles Cluster) | CMT (Tunisian Mechatronic Cluster) | | EMC Cluster | Ostim Medical Cluster |
| Tantan Oceanopole Cluster | MDC (Moroccan Denim Cluster) | | | Renewable Energies Cluster | Ostim Defence Industries Cluster |
| Dairy Products Cluster | CTT (Tunisian Technical Textile Cluster) | | | | |

SOURCES: IPEMED AND COMPLEMENTARY RESEARCH

In order to develop this strategy and bring together Mediterranean countries, inter-cluster cooperations are being created. Agreements between Southern countries (on mechatronic, textile and energy sectors in North Africa) are currently being considered, while North-South initiatives are also developing. The Euro-Mediterranean Matchmaking Platform aims at encouraging inter-cluster cooperations. Other organisations, such as the European Cluster Observatory, create databases and events in order to match supply and demand. All these ideas and actions must be encouraged and intensified.

# CONCLUSION

This macroeconomic analysis is based on facts. It aims at highlighting objective and documented trends. The 15 observations will serve as a reference for our works in order to assess the coming evolutions.

Even though obstacles still hinder mutually beneficial partnerships, the idea is to bring together the two shores of the Mediterranean via coproduction. Nevertheless, these conditions have not led to a SMEs collaboration dynamic yet. In spite of successful experiences, partnerships still depend on the geopolitical situation and opportunities need to be highlighted.

The examples of Japan - the flying geese paradigm led to global development all over Asia - of Nafta, where new maquiladoras are boosting job creation, or of Germany, which collaborated with CEECs thus boosting their economy and maintaining a strong national industry, show that this strategy would benefit both areas.

The EU and SEMCs have a real opportunity to create a partnership strategy. Indeed, if they do not achieve anything in the short term, other countries will reap the benefits, which could be less profitable for economies and populations in the long term.

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