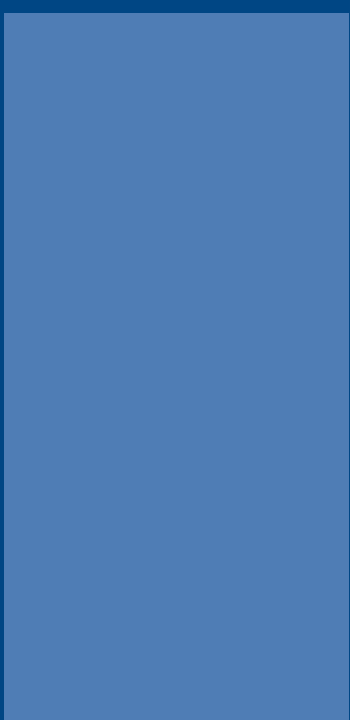




Konrad
Adenauer
Stiftung

SMART DEVELOPMENT STRATEGY FOR THE MAGHREB

STRUCTURAL REFORM, A NEW ROLE FOR THE STATE,
REGIONAL INTEGRATION



SMART DEVELOPMENT STRATEGY FOR THE MAGHREB
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Konrad-Adenauer-Stiftung e. V.

Regional Program Political Dialogue South Mediterranean

Konrad-Adenauer-Stiftung's Regional Programme South Mediterranean is based in Tunis and implements cross-national projects with reference to the South [Maghreb] and East Mediterranean [Mashrek]. Its objective is to strengthen the political dialogue and societal and economic integration in the Mediterranean region and to sustainably promote cooperation and partnership with the European Union.

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Politischer Dialog und regionale Integration im Südlichen
Mittelmeer
Le Prestige Business Center, No. F.O.1
Rue du lac Windermere, Les Berges du Lac
1053 Tunis
Tel: +21670029460
Fax: +216719623811053
<http://www.kas.de/poldimed/en/>

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Authors: Hedi Larbi, Lars Christensen
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Foreword

Fostering economic development in the Maghreb presents an essential element for stability in the Southern Mediterranean region and Europe. For the Regional Program Political Dialogue and Regional Integration South Mediterranean of the Konrad-Adenauer-Stiftung [KAS], facilitating economic progress in the region thus stands as one of the main pillars of our work. The program aims to promote economic development in the Maghreb by providing platforms for dialogue between relevant political and economic actors in the region and beyond to allow for the exchange of best practices and deepened cooperation on key challenges such as youth unemployment and regional economic integration.

Until today and despite numerous initiatives, the Maghreb remains the region with the lowest level of economic integration worldwide. The immense potential for economic growth and development that lies in regional economic integration thus remains unused. Faced with problems of high youth unemployment and slow economic growth, the countries of the Maghreb region should try to find ways to expand their cooperation on these common challenges and to exploit the opportunities offered by deepened economic integration.

The present study “Smart Development Model for the Maghreb: Structural Reform, a New Role for the State, Regional Integration” has emerged as a cooperation project between the Maghreb Economic Forum [MEF] and the KAS Regional Program South Mediterranean. It analyses the status quo of the regional economy and showcases different paths for the future in order to improve regional integration and prosperity. Moreover, it provides an outlook for the next two decades and identifies areas, in which reforms are necessary to find new approaches to inclusiveness and economic growth along the Mediterranean shores.

We could win distinguished academicians and practitioners for this project, which certainly will contribute to a further debate about the ways in which development, reform and integration should relate to each other in the Maghreb. The successful completion of this challenging project is thanks to the commitment of the distinguished authors. I would like to express my gratitude to Hedi Larbi, former Tunisian Minister of Economic Infrastructure and Sustainable Development, and Lars Christensen, Founder and Owner of Markets and Money Advisory, for their forward-looking work on this important issue.

We hope to provide a helpful contribution for the discussion on economic development and integration in the Maghreb and to encourage further work on this question.

Dr. Canan Atilgan
Director, KAS Regional Program South Mediterranean

Preface

In the international development community, it is still widely assumed that globalization and the integration of developing countries into the world economy are tides that lift all boats. The beneficent impact of trade, investment and the international division of labor will tend to benefit all countries – some more, some less, depending on their ability to compete and capitalize on their opportunities.

If this belief applies to the whole of the developing world, it applies double to the Maghreb region in North Africa – countries whose proximity and historical ties to the advanced European countries ease trade, tourism, investment and other forms of mutual contact. And to some extent, this has happened. But over the past three decades, the state-led, top-down development model followed in the region as we show in this study, despite the Maghreb's increasing integration in the world economy, there has been virtually no catching up with the developed economies since the early 1990s.

Lack of integration or openness to foreign trade has been the least of the Maghreb's problems, although it is true that the region's most open economies – Tunisia and Morocco – have done better than their peers. A much bigger concern – indeed, an existential issue for the region and for neighboring Europe – is its high youth unemployment. This “youth bulge” poses a huge sociopolitical risk to Maghreb governments, even as it offers an enormous economic opportunity. Another untapped reservoir of human capital and entrepreneurial talent are women, who participate in the workforce at less than half the rate of the study's benchmark countries [29% vs. 60%].

All these problems cannot be solved by regional integration alone. Recent examples of successful development in Asia, Eastern Europe and Latin America show that proper sequencing is crucial. Structural reforms must come first.

We examine in this report three political responses to this reform challenge, each accompanied by three possible trajectories of growth. This exercise clearly shows what is at stake in the Maghreb. There is the potential to increase incomes and welfare substantially over the next three decades if ambitious structural reforms are implemented. If this opportunity is not seized, the cost will be commensurately high.

If there were any doubts on this score, they were erased by the social and political turmoil of the Arab Spring, which exposed the vulnerability of North Africa's current growth models. They have produced an explosive combination: youth unemployment that is the highest in the world, combined with productivity among the lowest in the middle-income countries. The choice for rulers has seldom been so clear-cut: stagnate and risk instability, or reform and potentially prosper.

This process will also require a new sense of responsibility from governments. It involves transforming the state from an inefficient, interventionist bureaucracy into a transparent, accountable facilitator of development; fostering a business environment that rewards risk-takers, not cronyism and rent-seekers; and unleashing popular energy to turn a disempowered citizenry into a knowledge-based, productive society. In short, what is required is a cultural and behavioral shift – a “new social contract” between governments and citizens.

Obviously, education is one of the keys here. While massive investments in the 1960s and 1970s helped create wide access to schooling across the region, the quality of education has been deteriorating for several decades. The Maghreb countries are not producing graduates or school-leavers ready for good jobs. Cheap labor and fiscal incentives alone have been ineffective at attracting foreign investment. Workers must be productive as well.

Besides education, the public goods that states most urgently need to provide are health care, urban services, transport and communications infrastructure, adaptation to climate change and water management.

None of this means that integration is unimportant or that foreign investment and know-how are unneeded. Indeed, one of the competitive advantages of developed countries is a vibrant policymaking environment – including support institutions such as think tanks, which can be powerful catalysts for change. Cooperation between esteemed partners such as the Konrad-Adenauer-Stiftung (KAS) can help regional organizations such as, the Maghreb Economic Forum, bridge this gap.

The thing about reforms is that they consume huge amounts of political capital. The Maghreb countries would do well not to waste theirs. It may be a long time before such favorable circumstances appear again to narrow the development gap.

Kamel Lazaar
President MEF

Dr. Amel Karboul
Secretary-General MEF

About the Authors

Hedi Larbi is currently an Associate Fellow at the Kennedy School of Government, Harvard University, at the Belfer Center's Middle East Initiative. He most recently served as Advisor to the MENA Vice President at the World Bank. Prior to this, he served as both the Minister of Economic Infrastructure and Sustainable Development and the Economic Advisor to the Prime Minister of Tunisia. Mr. Larbi has over 35 years of professional experience in economic and social development as both a policy advisor and policy maker, with more than two decades of high level work in the World Bank Group, the private sector [in Europe, the Middle East and North Africa], and the Tunisian transition government. Mr. Larbi also has substantial expertise in the areas of public policy, economic and sectoral development strategies, private sector development, infrastructure services, human capital development, public finance and macroeconomic management, infrastructure, and social sectors. He has developed, negotiated and supervised major economic and institutional development programs and public and private investment operations in various social and economic sectors including major infrastructure projects and economic reforms.

Lars Christensen is the Founder and Owner of Markets and Money Advisory and is a Senior Fellow at London's Adam Smith Institute. An internationally renowned Danish economist specialized in international economy, emerging markets and monetary policy, he has over 20 years of experience in government and banking. Mr. Christensen also sits on the Advisory Board of the Maghreb Economic Forum and is currently advising governments in the MENA region on economic policy issues. Mr. Christensen is particularly known for having been Head of Emerging Markets Research at Danske Bank in Copenhagen. In this role he authored numerous path-breaking economic reports on particularly Central and Eastern Europe. In 2006 to 2008, he co-authored a number of reports warning of a coming economic meltdown in Central and Eastern Europe and maybe most famously Mr. Christensen co-authored the report "Geyser Crisis" in 2006, which correctly forecasted a major economic and financial crisis in Iceland.

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Executive summary

Chapter 1 –

Maghreb – Three decades of uneven catching-up

The purpose of this report is to put forward ways to increase prosperity and improve inclusiveness for the populations of the Maghreb region.

Chapter 1 of this report analyzes the region's social and economic development over the past three decades.

Chapter 2 presents scenarios for the Maghreb economies through 2040, focusing on how different levels of social and economic reform produce different outcomes for the region.

Chapter 3 makes policy recommendations drawn from the analysis in Chapters 1 and 2.

The past 25-30 years have brought economic and social progress around the world, as more and more countries make the transition from developing economies to emerging markets or even medium-income and developed economies. This catching-up to a very large extent has been driven by economic reforms, trade liberalization and integration into world markets.

In the case of the North African countries and, more specifically, the Maghreb region, we have seen some economic catching-up. But unlike China or large parts of Central and Eastern Europe, the process has been slower and more uneven.

Unfortunately, between 1990 and today, the Maghreb countries have experienced virtually no convergence with the United States in terms of GDP per capita. However, when examining the entire period, we can distinguish three distinct phases. The 1990s saw these countries fall farther behind the developed economies. Then came a sudden burst of catching-up in 2000-2008. This was followed by another period of regression when the global crisis hit, deepening sharply after 2010 [the Arab Spring] into a significant relative decline.

Looking at countries that started at a similar level of economic development in 1990 [the so-called benchmark group of Panama, Peru, Poland and Romania], we also see a significant underperformance of the Maghreb region in terms of economic growth.

When the Maghreb states are compared to the benchmark group, it is evident that countries like Poland and Romania have made much more progress in economic reforms. This to a large extent explains why the Maghreb region lags behind the benchmark group in economic and social development.

Foreign Trade – better than its reputation

When it comes to foreign trade, there is some disparity among the Maghreb countries. Tunisia stands out as a relatively open economy that has enjoyed fast export growth and effectively targets high-income markets. By contrast, Morocco compares poorly with Tunisia and the benchmark countries, with less openness to trade, slightly lower export growth, and a smaller share of its exports reaching high-income economies.

Even so, the Maghreb countries stack up reasonably well against the Polish benchmark, although Poland has generally performed better on the parameters included in this analysis.

A key weakness – the labor market

The Maghreb region, like many developing countries, suffers from high unemployment rates. Over the past 20 years, Algeria is the only country that has been consistently successful in reducing joblessness. Since the start of the millennium, Algeria's unemployment rate has gone from the second highest in the region to less than 10%. Morocco, too, has seen improvement since 1995, but its momentum has faded over the past decade.

Throughout the period, Morocco has consistently posted the lowest unemployment rate in the region, averaging 11.6%. Tunisia, which started the period with a similar unemployment rate to Morocco's, has done less well.

Both Libya and Mauritania have seen little to no change over the 20-year span, and face persistently high unemployment. As the richest country in the region, Libya stands out because it has utterly failed to convert this wealth into jobs.

If general unemployment is challenging for the Maghreb countries, youth unemployment is an even bigger problem. Demographically, the region faces what is called a youth bulge. This often occurs when a rapid fall in infant mortality is not matched by a decline in the fertility rate, resulting in a shift in the population structure toward the younger age cohorts. The huge number of young people who will join the work force within the next 5-10 years, together with the persistently high rate of youth unemployment, poses a real threat to labor markets. Yet it must also be stressed that the growing labor force presents an unparalleled opportunity for fast economic growth, provided the necessary reforms are implemented.

The Maghreb labor markets also share another unfortunate characteristic: a large gap in participation rates between males and females. The average workforce participation rate for women in the five Maghreb countries was only 26.5% in 2014. In comparison, the average for the benchmark countries was 60%. While participation rates in the Maghreb group have shown some improvement over past 30 years, women are less than half as likely to be employed as in the benchmark countries.

The analysis in Chapter 1 shows there is a close relationship between economic and social development and reforms. In Chapter 2, scenario analysis shows the potential for economic progress if the right reforms are undertaken.

It is important to warn that this scenario analysis should not be mistaken for economic forecasts or country predictions. Rather, the simulations are used to explore potential development paths conditioned by different sets of stylized assumptions.

Three different scenarios are presented in the report.

Scenario 1 - Muddling Through: This scenario assumes that the recent pattern of political and economic development will continue more or less unaltered through 2040. The labor force is projected to grow faster than the population, reflecting current demographic characteristics of the Maghreb countries.

Scenario 2 - Stagnation: As an alternative to the first scenario, we consider a more pessimistic case in which political uncertainty prevents the Maghreb countries from reaching their growth potential. This stagnation scenario assumes that the labor force grows no faster than the population. No important labor market or structural reforms are implemented, and structural unemployment remains high by international standards.

Scenario 3 - Reforms: Finally, a more ambitious scenario for Maghreb growth is considered. The “reforms” scenario assumes that a combination of political stability, ambitious changes in labor and goods markets, and an increasing openness to foreign trade and investment lead to a prolonged period of vigorous economic growth. Obviously, the growth rates posited in this scenario are unlikely to occur without market-friendly initiatives and reforms. However, the associated gains in income and welfare would produce a profound transformation of each of the Maghreb countries.

The three scenarios are associated with very different outcomes. The **Muddling Through** scenario sees moderate growth rates across the region, with GDP per capita roughly doubling over the period. The **Stagnation** scenario features no productivity growth and no increase in employment-to-population ratios. Under these circumstances, GDP per capita increases by a meager 20%-40%. Finally, the **Reforms** scenario involved a very substantial rise in employment-to-population rates. Growth in total factor productivity (TFP) and capital formation reaches levels observed in the East European benchmark countries. Under these circumstances, GDP per capita more than triples.

Chapter 3 – A new path to prosperity and inclusiveness

These numbers clearly spell out what is at stake for the Maghreb countries. If they embark on a successful and sustained growth path, they have the potential to increase incomes and welfare very substantially over the next two or three decades. To achieve this, an ambitious agenda of growth-oriented reforms is required, and more foreign trade and investment must be attracted.

This analysis also presents the cost of not achieving these goals. The foregone gains in income and welfare are huge. With the potential for solid economic growth comes an obligation to create an environment in which this potential can be tapped. Policy proposals are presented in Chapter 3.

Today, the Maghreb is at a strategic crossroads: reform and prosper or keep muddling through and risk instability and global marginalization. The recent Arab uprisings and the social and political turmoil they gave rise to exposed the vulnerability of the development models followed by the Maghreb countries in recent decades. There are challenges aplenty in the region. Youth unemployment, over 25% in 2015, is among the highest in the world. Productivity is among the lowest in middle-income countries. Declining oil revenue and the associated fall in indirect income from jobs, remittances and aid from the oil-rich Gulf states since 2014 have further exacerbated the fiscal and social fragility of the Maghreb countries. Despite some improvements, the business environment is still not yet conducive to private sector development. Slow growth and persistent high unemployment rates put large segments of the population at risk of falling back into poverty.

Yet, the Maghreb has the real assets needed to achieve fast and inclusive growth. These include the region's geographic proximity to Europe and its huge open market; a large, young work force that can be enhanced by access to better education and life-long training; relatively well-developed infrastructure and a growing manufacturing and export base; a thriving tourism sector, and a reasonable endowment in natural resources.

This growth potential can only be tapped if long-proposed structural reforms are carried out. The new social compact proclaimed by the Arab Spring uprisings calls for fundamental changes in political and economic governance. This shift can be achieved by: (i) transforming the state from an interventionist, ineffective and unaccountable bureaucracy into a development facilitator that is efficient, transparent and accountable; (ii) creating a regulatory environment that fosters an entrepreneurial, risk-taking and innovative private sector to replace the prevailing cronyism and rent-seekers; and (iii) unleashing popular energy and creativity to turn a disempowered and state-reliant citizenry into a free, knowledge-based and productive society.

This is a cultural and behavioral shift that Arab societies in general and the Maghreb countries in particular should embrace and strive to implement over the next decade.

The new development strategy and the reforms it entails must forge a new role for the state by realigning it with the objective of building free, inclusive, prosperous and equitable societies. States in the Maghreb should be redesigned to: (i) promote public-private partnerships to bring out the best in each sector and maximize their synergies; (ii) prioritize economic and social policies that enhance human capital, promote private and collective initiatives, and build more inclusive societies and competitive and socially responsible private sectors; and (iii) spur growth and development strategies that protect the environment, use natural resources efficiently and safeguard the interests of future generations. The state should play an important role in areas where it has a proven comparative advantage while focusing on promoting shared prosperity and social cohesion.

Priority reforms for shared prosperity and social cohesion

Disciplined fiscal rules are needed to build stable public finances capable of weathering the difficult regional and global environment. Four such rules can be considered: cap public debt to 60%-70% of GDP; keep the budget deficit below 3.5%, even in difficult years; set limits to annual growth of total, primary and current budget spending; set a floor and ceiling on budget revenue to maximize revenue collection while avoiding an excessive tax burden. These rules should be subject to public debate; once agreed, they should be enacted in law to ensure that successive governments respect the will of the people and avoid populist fiscal policies.

Building a more agile, competent and service-oriented public sector

It is important for the countries to change the mission and behavior of the public sector to become a citizen-centered development facilitator. Among key reform actions, governments should consider: redefining roles in the public sector and related agencies, simplifying administrative procedures, eliminating unnecessary prior authorizations and controls, and contracting out all tasks and services that the private sector can do better; changing human resources policy to attract talented, motivated and empowered staff; setting up a lifelong training policy to ensure the public sector gets the most out of its employees.

Fostering a dynamic, entrepreneurial and competitive private sector

Success here would unleash the creativity and entrepreneurial potential of the population to invest and create productive jobs for all. Among the priority reforms, governments should: enforce formal rules and contracts in a transparent and accountable manner; promote public-private cooperation wherever applicable; create a level playing field by introducing competition and eliminating privileges and exemptions; remove bureaucratic hurdles that increase transaction costs [authorizations, permits etc.];

improve trade logistics, infrastructure and facilitation to promote exports and foreign direct investment (FDI); reform labor regulations to increase flexibility while protecting workers rights and encouraging job creation, especially for women and youth; encourage FDI by building on local competitive strengths, including: human capital and highly skilled labor, infrastructure and logistics, flexible labor markets, a well-functioning financial sector, free capital flows and responsible fiscal and monetary policies.

Developing and implementing national digital strategies

The Maghreb countries should seize the opportunity presented by the digital revolution to leapfrog traditional, gradual industrialization and reap the benefits of modern, service-based economies. These strategies should aim to develop IT infrastructure and promoting access to high-speed Internet to all; train young people and adults who wish to participate in the digital economy; design and implement incentives to investment and adaptation of digital-based approaches in existing or new activities.

Improving education is the only way for the Maghreb countries to reap the dividends of their demographic advantages

Reforms consume huge amounts of political capital and take time to bring results; that makes it vital for governments to avoid the vague and fragmentary measures of the past and focus on priority measures that have a demonstrable impact on quality. These would include raising teachers' standards and qualifications; updating curricula; introducing better evaluation and testing systems; modernizing infrastructure and equipment; improving governance with a particular focus on accountability and school management, and finally, promoting private initiative in education to offer an alternative and alleviate the burden on the public sector.

Restructure public health systems to address current weaknesses, improve access for low income groups and cope with emerging pathology trends

Key reform areas include: enhancing the management and governance of public facilities (hospitals) and resources (personnel, equipment and drugs); setting up and monitoring quality standards and evaluation systems; "depoliticizing" health services by setting up an independent health policy council (or agency) to monitor performance, assess the effectiveness of national health policies and propose corrective measures as needed; upgrading the management, technical and soft skills of healthcare staff through an up-to-date, systematic training program; streamlining patient and administrative procedures through e-health services (including health insurance, drug providers etc.); expanding coverage of low income groups through reliable social safety nets; introducing a reliable funding mechanism to ensure the financial viability of the health system.

Empowering cities to lead local economic development through decentralization and reliable funding arrangements

Helping cities to provide adequate public services to the fast-growing urban population and offering a friendly business environment will unleash local initiative and exploit local opportunities. Key institutional reforms include: implementing a well-sequenced devolution policy, including mechanisms to provide cities with financial resources [local tax revenues augmented by formula-based fiscal transfers from the central budget]; simplifying urban planning and regulations, streamlining land zoning and development procedures; providing local governments with well-trained professionals and managers; encouraging cities to modernize local infrastructure and extend services to underserved urban neighborhoods.

Modernizing and expanding infrastructure and logistics services

While the Maghreb countries do not face the classical infrastructure access gap observed in other developing countries, the poor quality of services, lack of maintenance and substantial future infrastructure needs are serious challenges. Priority actions countries should take include: better allocate spending to ensure new investments are not funded at the expense of maintaining and operating existing infrastructure; improve services through professional management and optimizing operating costs [eliminating the huge losses and leakages in the system]; adopt cost-recovery pricing for public services along with targeted support to deserving low-income groups; use PPP schemes whenever possible to help bridge investment and management gaps; streamline customs and facilitation processes.

Accelerating economic integration within the Maghreb and with the EU

Past attempts translated into free trade agreements that brought few tangible results. Many political factors stand in the way. Countries, and especially their private sectors, should consider opportunistic strategies to promote regional trade and integration. Shifting the focus away from politically sensitive sectors could be one of those strategies, along with investments in existing infrastructure [border crossings, regional road networks, power interconnectors, gas pipelines etc.]. A complementary strategy is to promote investments by private investors from inside or outside the Maghreb to stimulate economic integration. A less conventional but promising integration strategy would leverage the “advanced integration position” offered by the EU to the countries of the region. This would allow the EU to support one of its economic powerhouses, such as Germany, in a partnership with one or two Maghreb countries to implement a growth cluster [or special economic zone]. The selected cluster or “platform of growth and stability” would be governed by a regulatory framework providing incentives for investors and free access to both markets: the Maghreb and the EU. It could be initiated as a pilot program to show the positive impact of economic integration; if successful, it could have a very powerful demonstration effect on other countries.

Adapting to climate change

Recent studies show that the Maghreb is very likely to suffer from climate change. Changes in rainfall will be reflected in more frequent droughts, extreme temperatures and desertification, inflicting severe harm on agriculture and accelerating rural-to-urban migration. Maghreb governments are strongly advised to develop their own climate change strategies and mobilize funding for action plans suited to their countries and aligned with their Nationally Determined Contributions under the UN Framework Convention on Climate Change. In this regard, they should seek technical support from the many institutions that have recently been set up to assist and coordinate regional efforts to mitigate climate change. Likewise, they should tap funding available from the Global Environment Facility, the Green Climate Fund, the Adaptation Fund and the Climate Investment Fund.

Better managing water resources

The regional water deficit or gap between supply and demand has been increasing since late 1990s, and is expected to widen under the combined effect of population growth and climate change. Past methods of managing water resources have also played a role in the growing gap. Historically, the Maghreb countries focused on the supply side of water management through large-scale investments in mobilizing water. This created incentives for inefficient use – especially in agriculture, which uses about 85% of the region's water. From now on, governments need to focus on demand as well as supply, with particular emphasis on combining technical and institutional policies to change behavior and induce more sustainable water use.

In agriculture, governments are advised to: (i) focus on increasing water productivity by investing in modern irrigation methods (drip systems and others) and eliminating water losses between the source and point of use; (ii) use of non-conventional water resources (reuse of processed waste water); and (iii) gradually shift to less water-intensive crops and livestock production; and (iv) closely monitor and regulate groundwater and aquifers to protect against pollution and overexploitation.

In terms of managing demand, policymakers should take an economic view to effectively manage water scarcity and prevent waste and overuse. It is of fundamental importance for the Maghreb countries to gradually increase water prices until they reach the levels of full cost recovery. This is the only way to induce sustainable water-conserving behavior while mobilizing the financial resources needed to invest in conservation and water mobilization projects (e.g. desalination).

Chapter 1:

Maghreb - Three decades of uneven catching-up

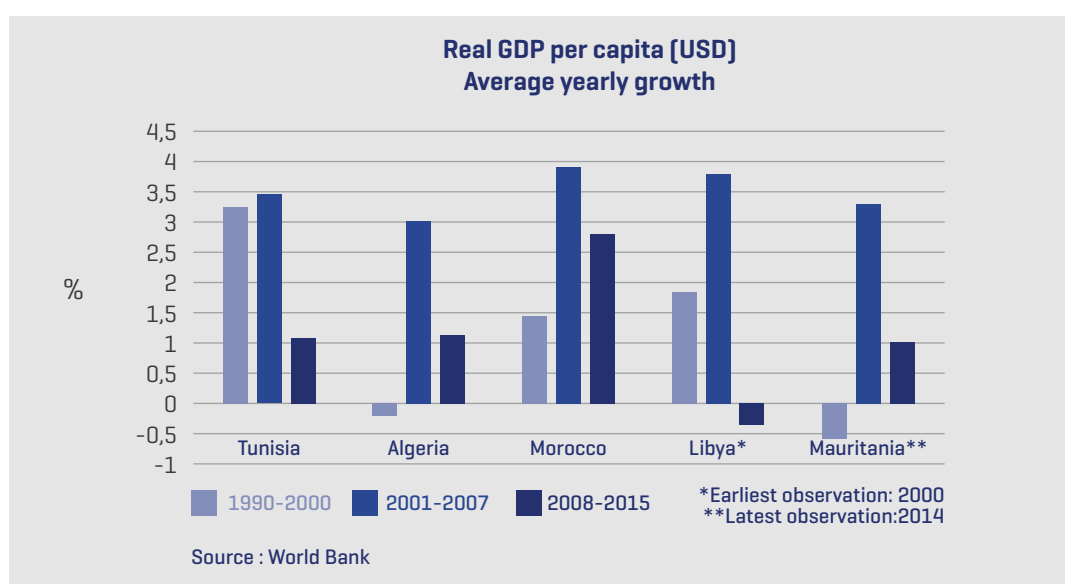
Maghreb - Three decades of uneven catching-up

After the end of communism in Central and Eastern Europe and the opening of the Chinese economy in the early 1990s, we have seen a tremendous catching-up process take place in these economies, driven by significant reforms and trade integration with the rest of the world. Similarly, we have seen reform-driven growth in Latin America and Sub-Saharan Africa, where the global commodity boom in the 2000s also helped boost growth.

The past 25-30 years have brought economic and social progress around the world, as more and more countries make the transition from developing economies to emerging markets or even medium-income and developed economies. In the process, billions of people have been lifted out of poverty. This catching-up to a very large extent has been driven by economic reforms and trade liberalization and integration.

The 2008 global economic and financial crisis caused a certain regression in this process, but the general picture remains more or less unchanged – catching-up continues. In the case of the North African countries and, more specifically, the Maghreb region, we have seen some economic catching-up. But unlike China, for example, or large parts of Central and Eastern Europe, the process has been much slower and somewhat more uneven. In this section of the report, we take a closer look at the economic status and development trajectory of the five Maghreb countries.

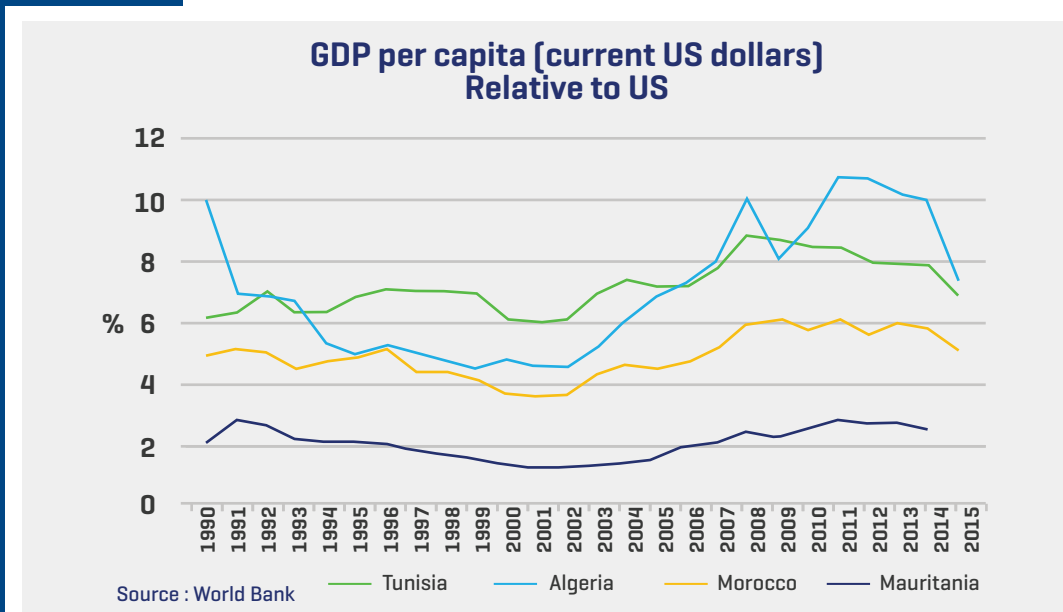
Figure 1.1: Average Real GDP growth



Modest catching-up and major setbacks

When assessing economic convergence, the measure to use is GDP per capita relative to a developed economy such as the United States or the eurozone [measured in the same currency]. This will also be the yardstick here. Our starting point will be 1990, as this is about the time the catching-up process started to accelerate in low-income countries around the world.

Figure 1.2: Relative Real GDP since 1990



In 1990, GDP per capita in Mauritania was only 2% of the U.S. level, compared with Libya's approximately 30%. Algeria [10%], Morocco [5%] and Tunisia [7%] were somewhere between these two extremes.

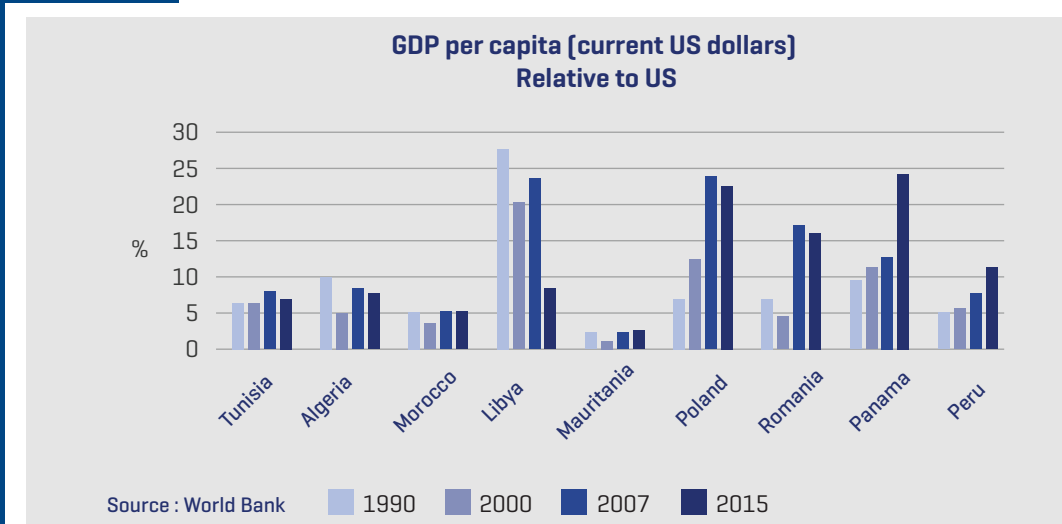
Fast-forward to 2015, and one can see that there has been virtually no convergence with the U.S. in GDP per capita. However, when examining the entire 25 years, we can distinguish three distinct periods. The 1990s saw these countries fall farther behind the developed economies. Then there was a sudden burst of catching-up in 2000–2008. Another period of regression followed when the global crisis hit, deepening sharply after 2010 (the Arab Spring) into a significant relative decline.

Benchmarking the Maghreb to other transitional economies

It is one thing to examine the performance of the Maghreb countries on their own, but if one wishes to study the convergence and transition process, it is equally important to look at other countries that once were on a similar level of economic development.

We have chosen to focus on four "benchmark countries" whose GDP per capita in 1990 was in a similar position to that of the "core" Maghreb countries – Algeria, Morocco and Tunisia – relative to the U.S. The four countries are Panama, Peru, Poland and Romania. All have seen impressive catching-up from an initial level of 5–10% of U.S. GDP. Economic growth in these four countries has been sustained and rather even over almost three decades, supported by economic reforms and trade integration.

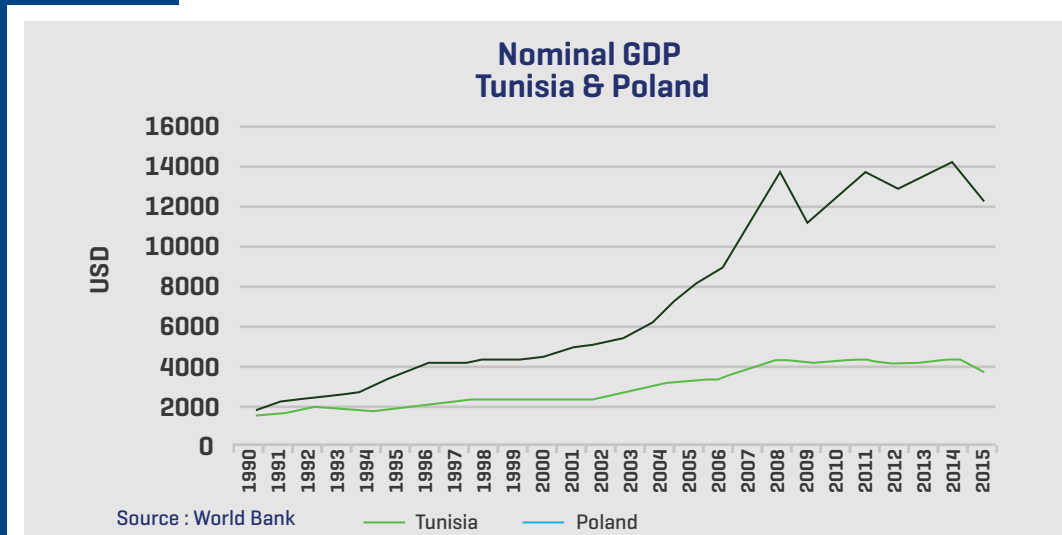
Figure 1.3: Relative Real GDP – Benchmark comparison



If we compare the economic performance of these benchmark countries with their Maghreb counterparts, it is very clear that the latter's performance over the past 25-30 years has been much less impressive.

Take, for example, the case of Tunisia and Poland. In 1990, the two countries were at nearly the same level in terms of GDP per capita [measured in U.S. dollars]. Today, Poland's GDP per capita is more than three times bigger than Tunisia's. It is particularly notable that this discrepancy reflects Poland's consistent outperformance of Tunisia [and the other Maghreb countries] over nearly the entire period.

Figure 1.4: Nominal GDP – Tunisia and Poland



A similar picture emerges when we look at the entire group. Panama, Peru, Poland and Romania – which all started from similar levels in 1990 – today have GDP per capita significantly above the Maghreb countries.

By studying and comparing how these benchmark countries developed, we can draw some important lessons for reforms in the Maghreb going forward.

Barrier 1: Lack of reforms

There is no doubt that a precondition for sustained development is that countries undertake economic, political and social reforms to ensure a well-functioning and open market economy.

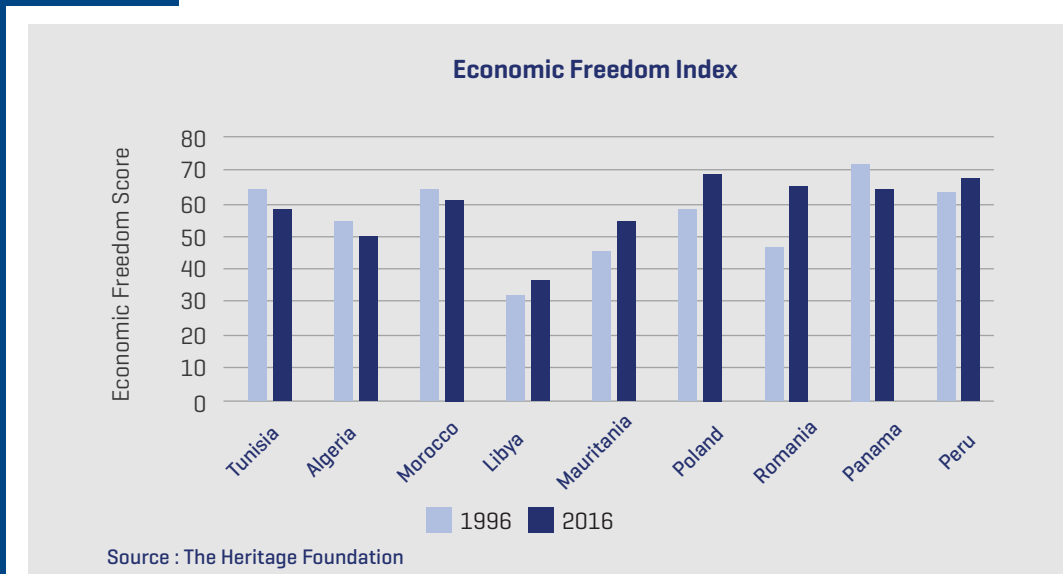
Historically, the Maghreb countries have had state-dominated economies, marked by restrictions on foreign investment and trade and a large state-owned sector. In that sense, their closest analogues may be the former communist economies in Central and Eastern Europe, and even some Latin American economies.

In this part of the analysis, we compare reform in the Maghreb countries with our benchmarks – Poland, Romania, Peru and Panama. Our examination will be based primarily on the Heritage Foundation’s Economic Freedom Index, which ranks countries based on their degree of economic liberalization and openness in different areas.

Maghreb’s lost decade

A review of the Economic Freedom Index over the past decade reveals little progress on reform. In fact, when one compares the level of freedom today [2016] with conditions 20 years ago, the picture that emerges is one of regression.

Figure 1.5: Economic Freedom Index



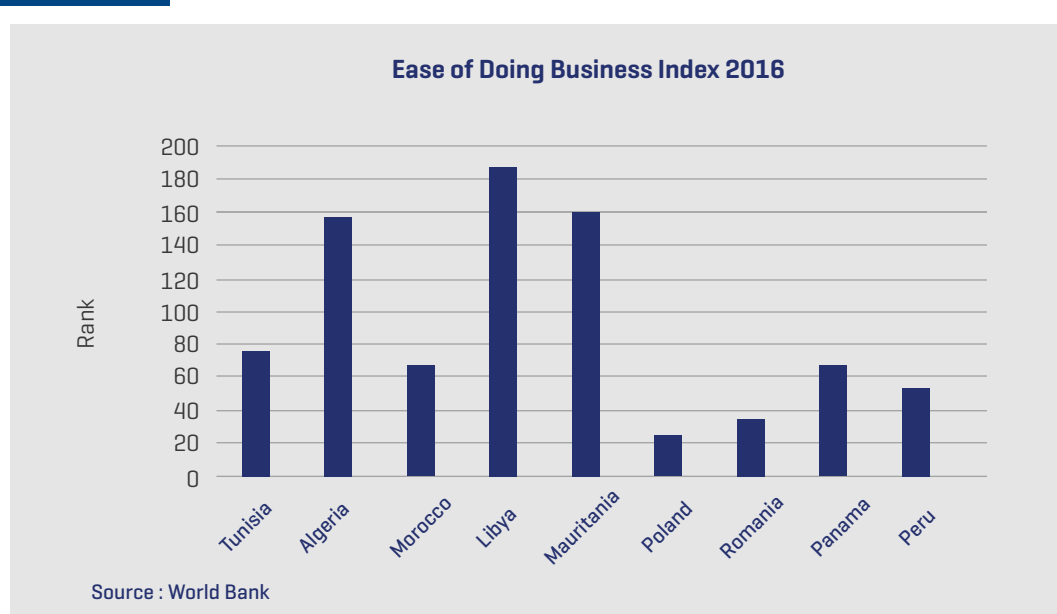
Firstly, the level of economic freedom today is consistently lower in the Maghreb countries than in our benchmark countries.

Secondly, while there has been sustained improvement in the benchmark countries – particularly in Poland and Romania [likely driven by EU accession requirements] – we have seen backtracking on reforms in the Maghreb countries. In the “core” Maghreb – Algeria, Morocco and Tunisia – there is less economic freedom today [as measured by the Heritage Foundation index] than a decade ago. This undoubtedly helps explain the Maghreb countries’ economic underperformance over this period.

Mauritania is the positive outlier, as there has been some reform progress in this country over the past decade. That does not change the fact that Mauritania’s overall level of economic freedom is disappointingly low, however.

A similar picture emerges in the World Bank’s yearly Ease of Doing Business survey.

Figure 1.6: Ease of Doing Business Index



Here we see a significantly higher level of economic liberalization in our benchmark countries – most notably Poland and Romania – than in the Maghreb countries. The Ease of Doing Business ranking is particularly worrying for the traditionally state-dominated economies of Algeria, Libya and Mauritania. Morocco and Tunisia rank closer to our benchmark countries, but they still fare significantly worse than Poland and Romania – the two most successful countries in terms of post-1990 economic growth.

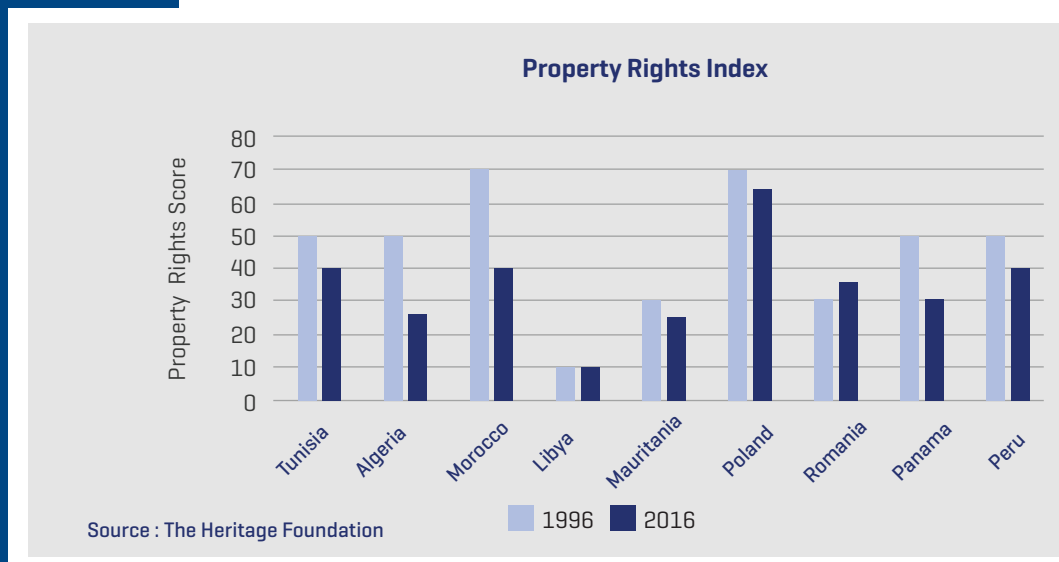
Barrier 2: Weak protection of property rights

A well-functioning market economy depends on respect for the rule of law and private property. Unfortunately, legal systems across the Maghreb give weak protection to individual rights, while the region’s uneven transition to democracy has stalled or even reversed progress toward strengthening the rule of law.

The Economic Freedom Index’s sub-index for property rights shows low levels of protection in all Maghreb countries. Even more worrying, the index has dropped over the past decade throughout the region.

That said, the best-performing Maghreb countries – Morocco and Tunisia – afford property rights protection on par with the benchmark countries. The single exception is Poland, where individual property rights enjoy extremely strong protection.

Figure 1.7: Property Rights Index



Among many negative consequences, the weak protection of property rights makes it harder for small businesses to raise capital, as the Peruvian development economist Hernando de Soto has stressed¹. This is because insecure property cannot be used as collateral.

Investment

In the following section, we analyze investment in the Maghreb countries over the past three decades. Peru will serve as a benchmark, because investment developments in that country roughly match the average in the benchmark group over this period.

Figure 1.8 depicts the development of total fixed investments. Generally, investment growth in the Maghreb countries has lagged behind Peru's over the past 30 years. Investments in Peru have grown at an annual rate of more than 10% for most of the period, and in some years by more than 20%. By contrast, Maghreb countries have managed investment growth of 5%-10%, except Mauritania, whose data are excluded due to their extreme volatility. The other four Maghreb countries have tracked each other quite closely over this period in terms of investment growth.

The past decade appears to be a departure from this pattern, as Peru did not separate itself so clearly. At certain points – notably in the late 1980s and early 2000s – Peru's investment growth was weaker than the Maghreb's. At other times – the mid-1980s, mid-1990s and 2005-2009 – it was much stronger. The Maghreb countries closely mirrored each other except for Algeria, which began to lag behind noticeably.

¹ De Soto, Hernando. *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*. Basic Books, 2000.

Figure 1.8: Investment growth

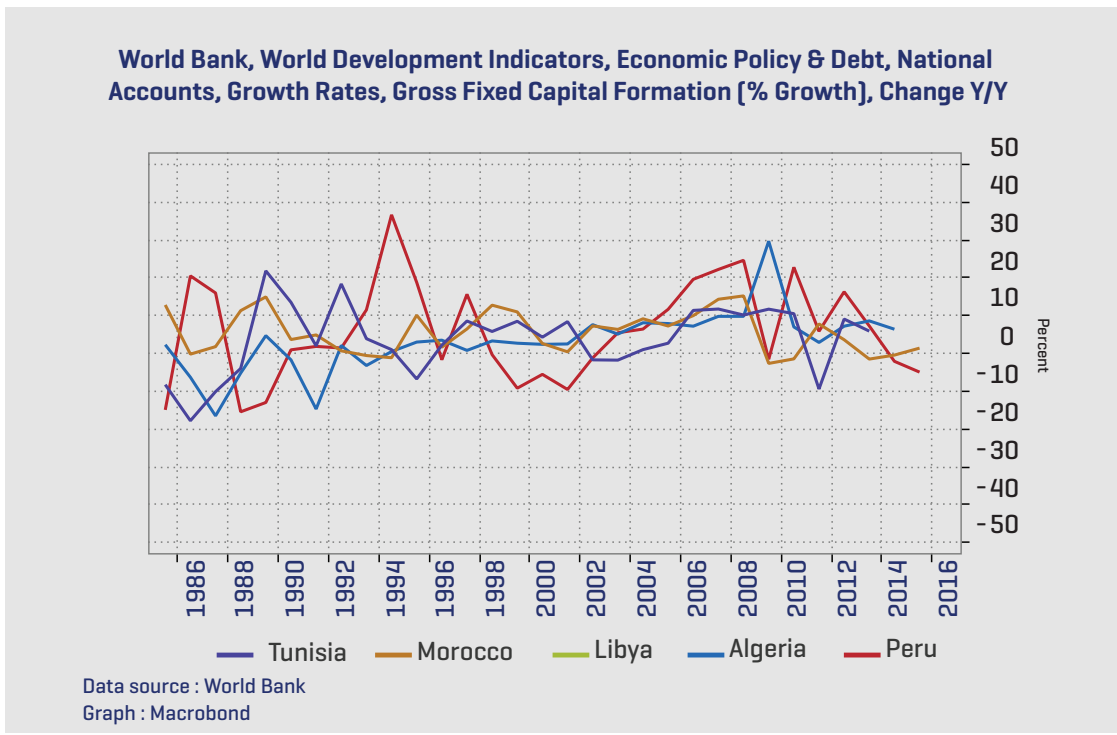


Figure 1.9 shows changes in the share of GDP spent on fixed investments. Over the past 10 years, Algeria, Mauritania and Morocco have spent a substantially larger share of their GDP on investment than Peru, while Tunisia has spent about the same. The first three countries devoted about 30-40% of GDP to fixed investments, while Tunisia allocated about 20-25%. Algeria, Mauritania and Morocco have been increasing the share of GDP devoted to investment, while Tunisia's has remained stable. Mauritania has historically invested less than Algeria, Morocco and Tunisia, but has far outstripped the others over the past several years.

Figure 1.9: Investment share

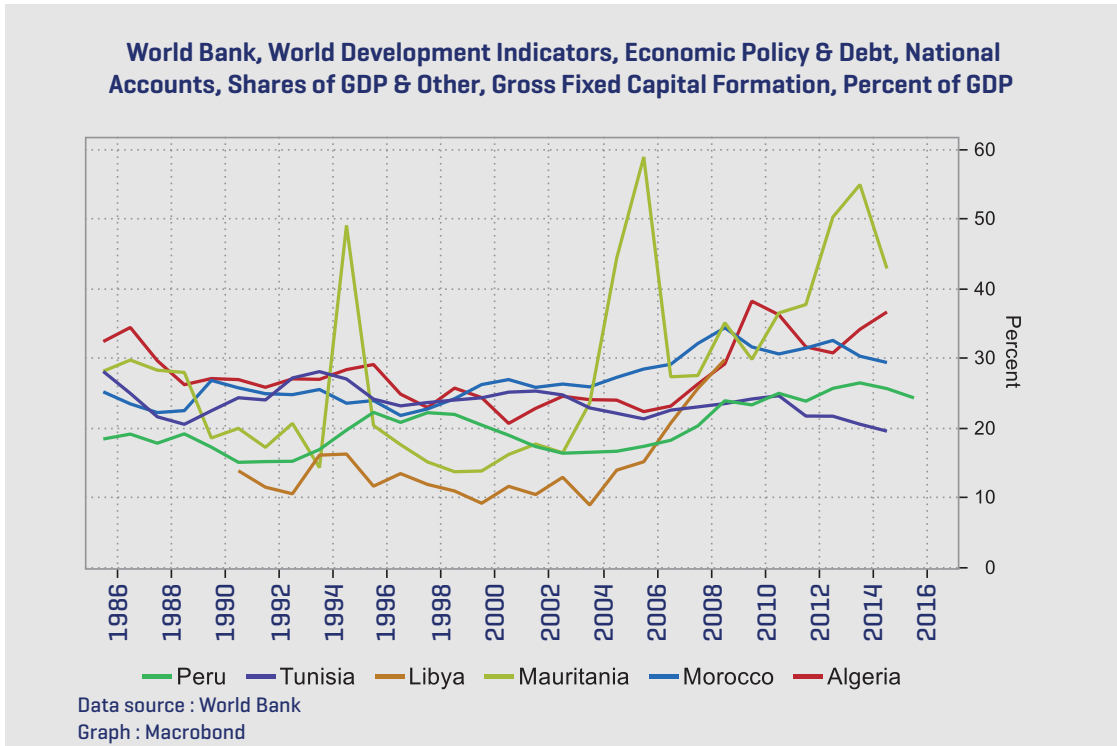
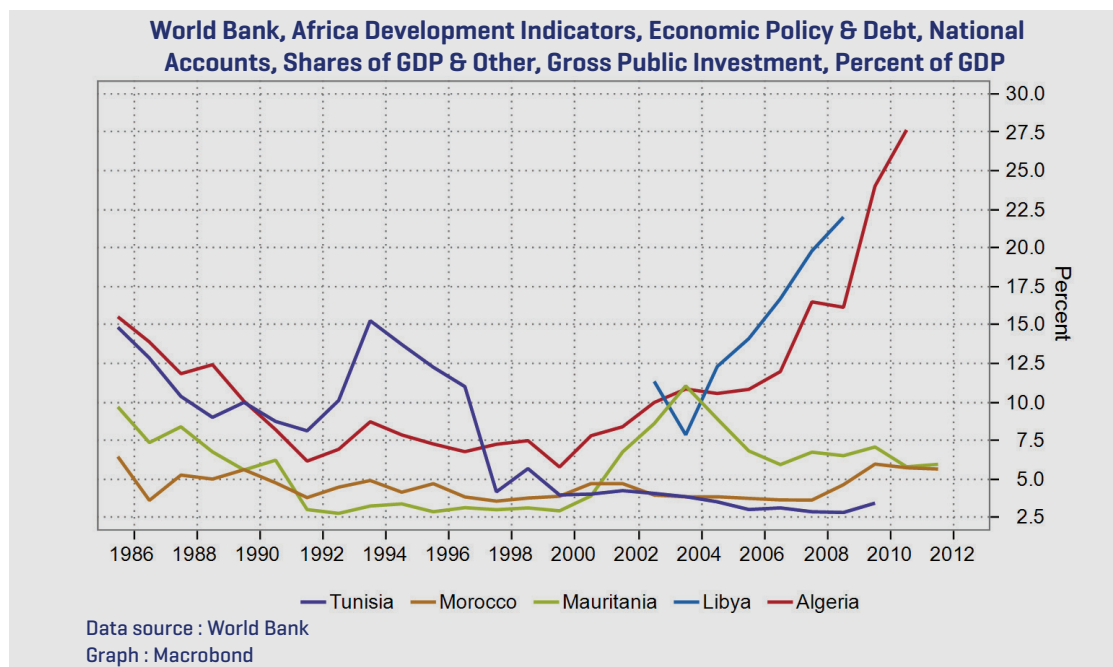


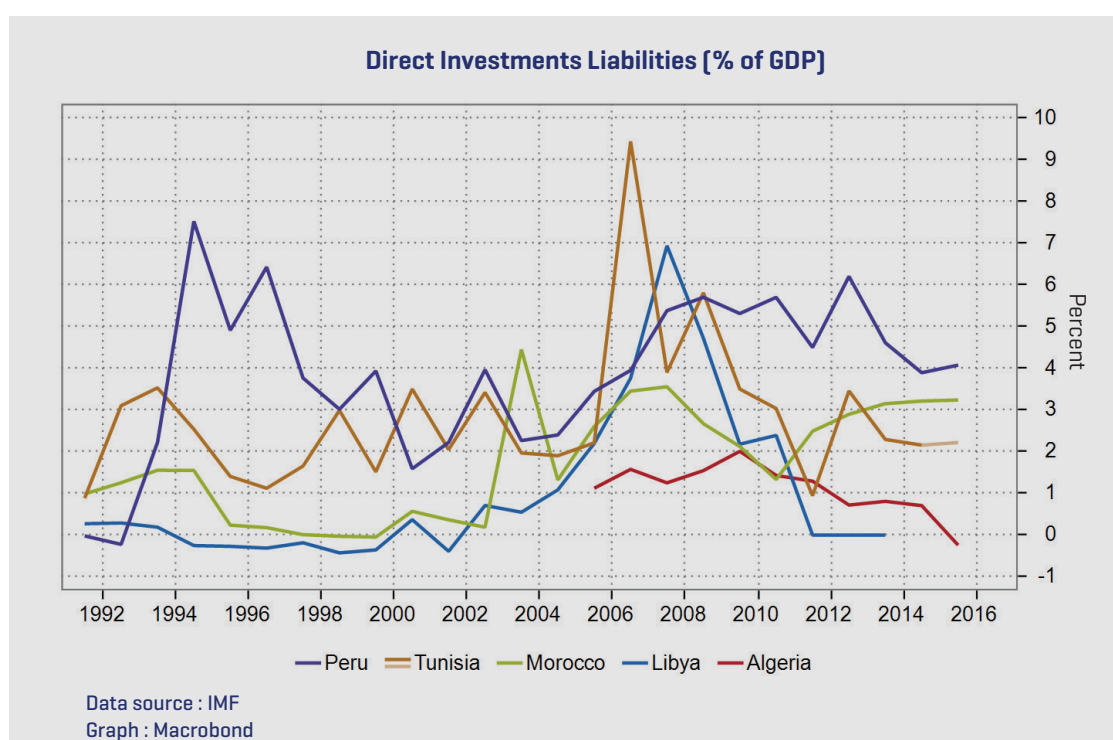
Figure 1.10 shows changes in the share of GDP spent on public investments. Unfortunately, there is no comparable data for Peru or the other benchmark countries. Algeria spent most among the Maghreb countries, with this figure rising to nearly 30% in 2010. By comparison, Mauritania and Morocco spent around 5% of GDP on public investments.

Figure 1.10: Public investment share



Interestingly, Algeria has attracted less FDI than Mauritania, Morocco and Tunisia [Mauritania has been left out because only a few high data points were available]. Overall, the Maghreb countries have attracted less FDI than the benchmark country, Peru, as illustrated in Figure 1.11. This applies to the past 10 years and most of the preceding two decades.

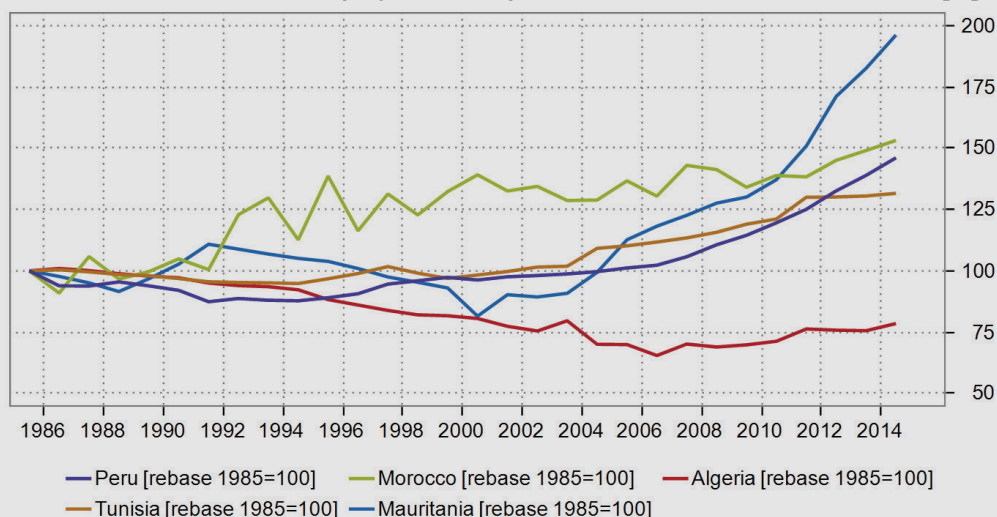
Figure 1.11: Inward foreign direct investments



Finally, we examined the capital-labor ratio. Over the past 10 years, Mauritania and Tunisia have grown more capital-intensive, mirroring Peru. In Morocco, the ratio has been stable over this period, while it has fallen slightly in Algeria. In the latter country, however, there have recently been signs that this decline may be reversing.

Figure 1.12: Capital-labor ratio

Penn World Table, "National Accounts Based Variables, Capital Stock at National Prices, Constant Prices"/"Real GDP, Employment & Population Levels, Number of Persons Engaged"



Data source : Penn World Table
Graph : Macrobond

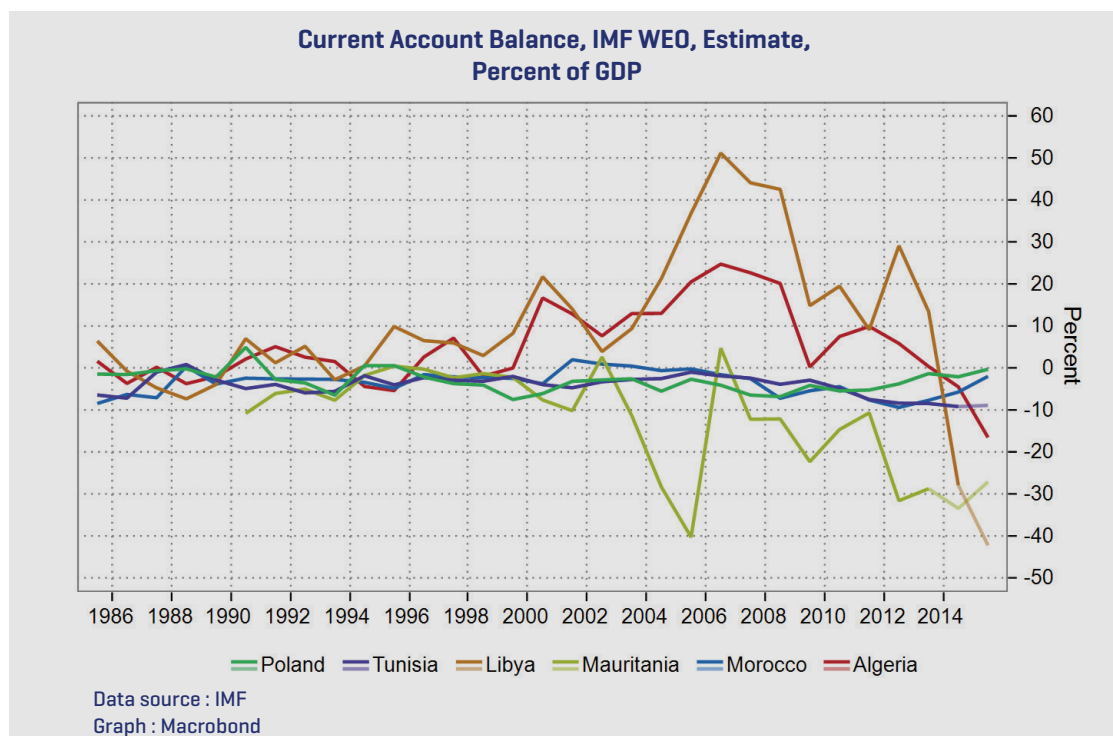
In conclusion, the Maghreb countries generally spend more on investments than Peru, although their investment growth has been slower during the past decade. The bulk of investments are private. However, the Maghreb countries have done worse in recent years in terms of attracting foreign direct investments. They resemble Peru in becoming more capital intensive.

Trade

In the following section, we examine foreign trade in the Maghreb countries over the past three decades. Poland serves as the benchmark in this part of the analysis, because it most closely represents the average of the benchmark country group over this period.

Developments in the current account balance are illustrated in Figure 1.13. The commodity exporting countries – Algeria and Libya – stand out with persistent large current account surpluses, which reach the double digits in most years. By contrast, the other three Maghreb countries, along with the benchmark Poland, have mostly posted current account deficits, i.e. they have been net international borrowers.

Figure 1.13: Current account balance



Libya, Mauritania and Tunisia are more open to trade than Poland and the other two Maghreb countries, as can be seen in Figure 1.14 below. Since about 2000, the first four countries have increased their openness to trade gradually. Algeria and Morocco also followed this path initially, but stopped doing so over the past 5-10 years. Lately, these two countries have even shown tentative signs of becoming more closed economies.

Figure 1.14: Trade openness

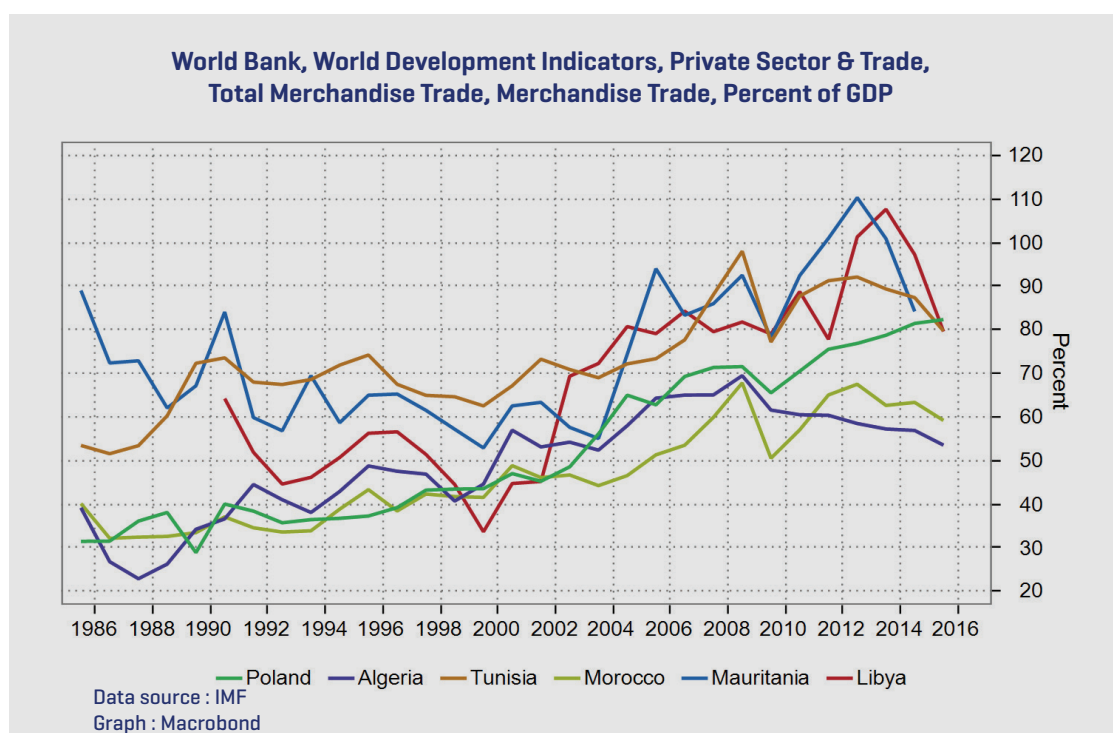


Figure 1.15 shows that export growth in Morocco and Tunisia has been on par with Poland, while Algeria and Mauritania lag. Mauritania is again quite volatile, showing extremely fast growth at times.

Figure 1.15: Export growth

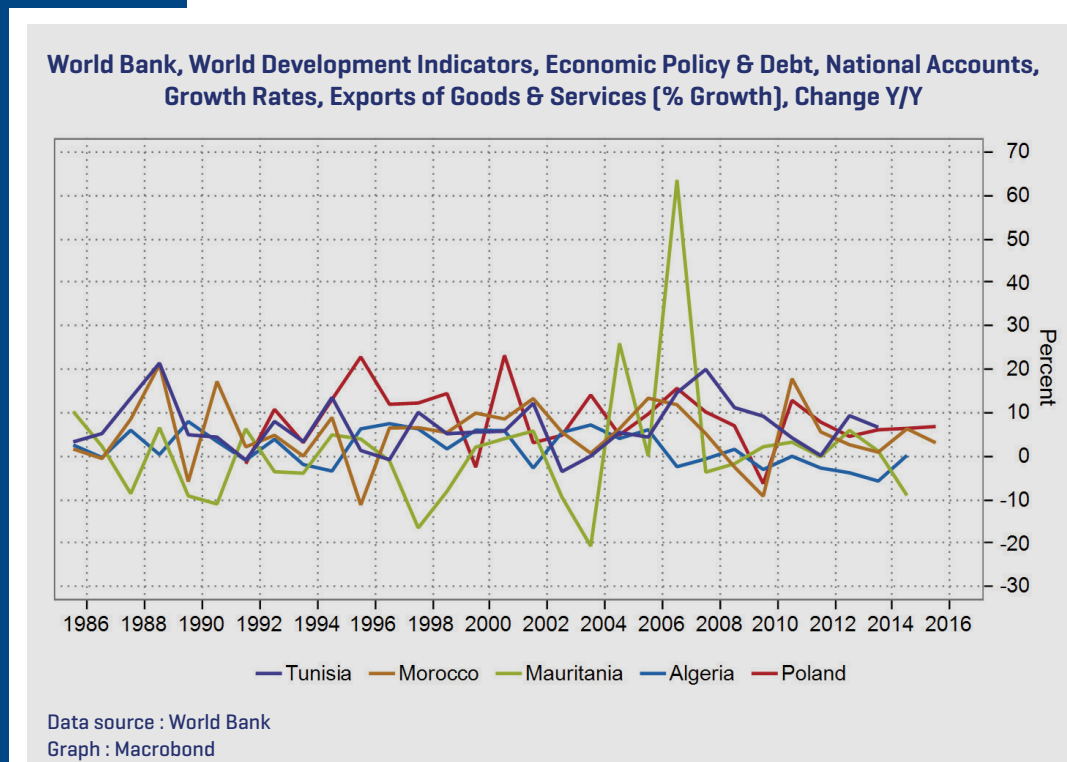
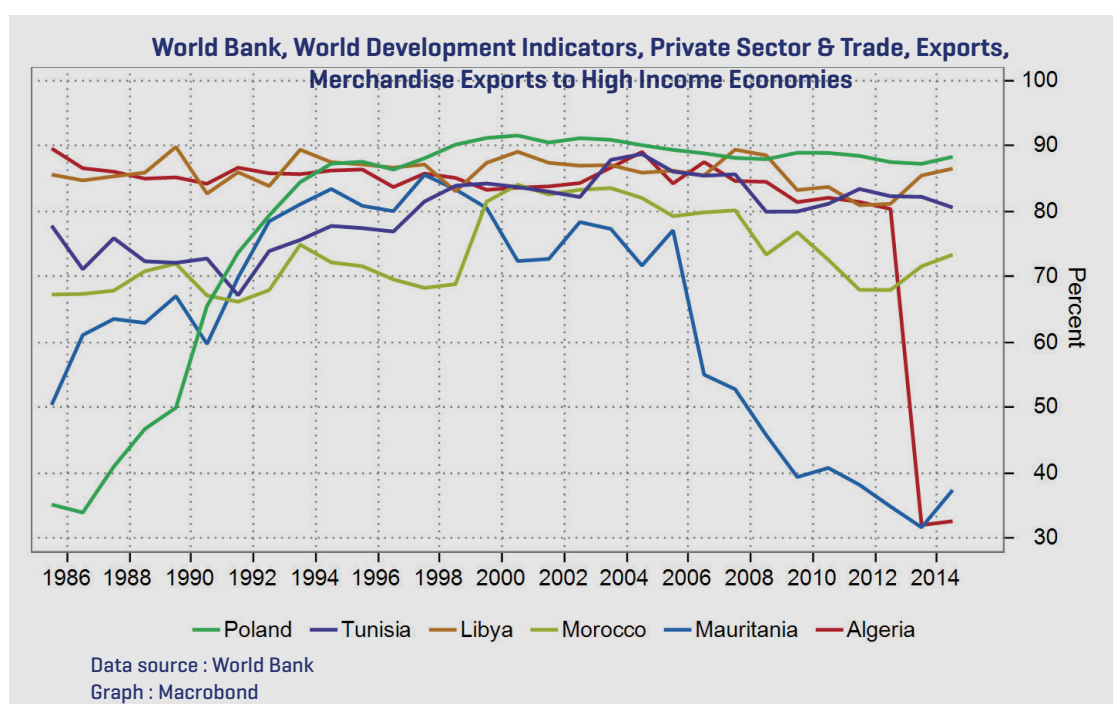


Figure 1.16 shows the share of goods exports going to high-income economies. Poland, the benchmark country, sends the biggest share of its exports to these more development trading partners. The only Maghreb country that comes close is Libya. Tunisia and, until recently, Algeria also sell a relatively high percentage of their exports to high-income economies. Mauritania and Morocco lag noticeably behind.

Figure 1.16: Share of goods exports to high-income economies



To conclude, there is some disparity among the Maghreb countries when it comes to foreign trade. Tunisia stands out as a relatively open country that has enjoyed fast export growth and effectively targets high-income economies. By contrast, Morocco compares poorly with Tunisia and Poland, with less openness to trade, slightly lower export growth, and a smaller share of its exports reaching high-income economies. Overall, the Maghreb countries stack up reasonably well against the Polish benchmark, although Poland has generally performed better on the parameters included in this analysis.

Labor market overview

This section presents an overview of the labor markets in the Maghreb countries since 1995. Chapter 3 of the report will expand on the subject by considering possible structural reforms.

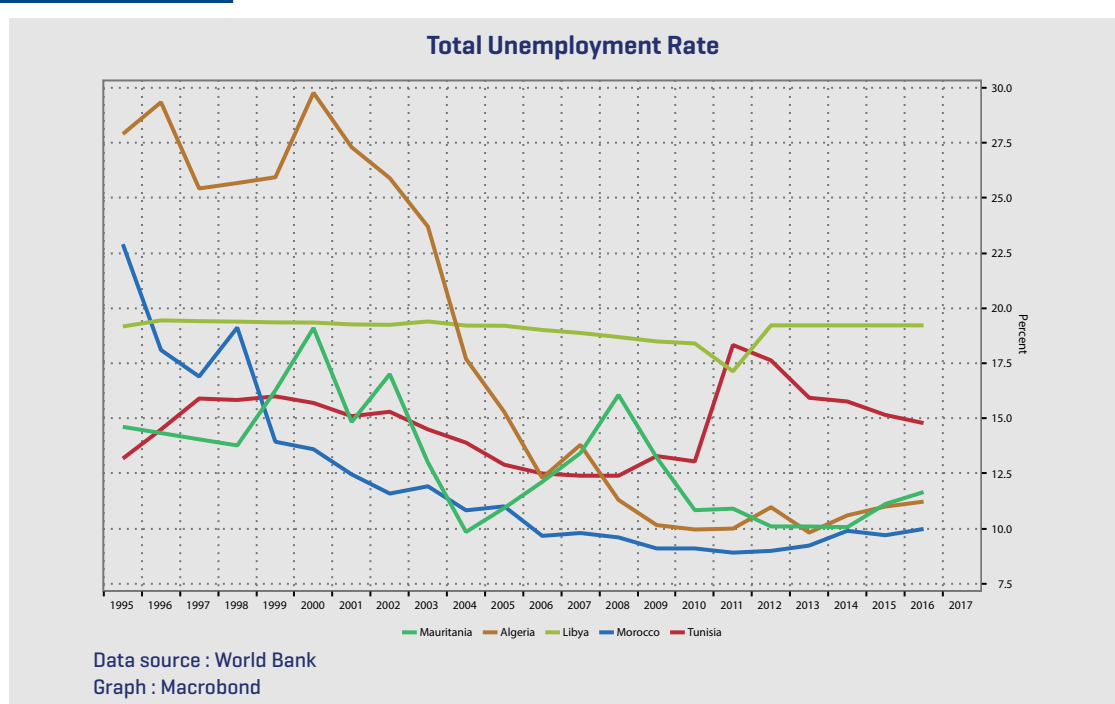
Persistent unemployment

The Maghreb region, like many developing countries, suffers from high unemployment rates, as shown in Figure 1.17 below. Over the past 20 years, Algeria is the only country that has been consistently successful in reducing the unemployment rate. Since the start of the millennium, Algeria's jobless rate has gone from the second highest in the region to less than 10%.

This was of course aided by favorable oil prices, and Algeria now faces the challenge of maintaining its success in a world of cheap oil and gas. Morocco, too, has seen an improvement since 1995, but its momentum has faded over the past decade.

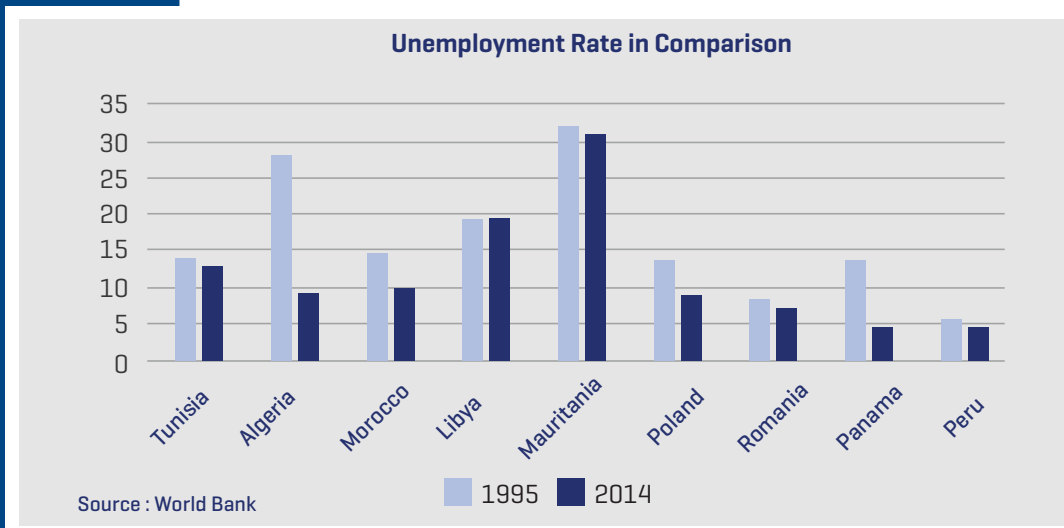
Throughout the period, Morocco has seen a fall in unemployment, posting the lowest unemployment rate in the Maghreb region since 2005. Tunisia, which started the period with the lowest unemployment rate has done less well. While Libya has seen little to no change over the 20-year span and faces persistently high unemployment, Mauritania has experienced considerable volatility with an overall downward trend. As the richest country in the region, Libya especially stands out, since it has utterly failed to convert this wealth into jobs.

Figure 1.17: Unemployment in the Maghreb



Compared with labor markets in the benchmark countries, the Maghreb region has underperformed. Only Algeria and Morocco have managed to lower their unemployment rates close to Poland's. The rest of the region has moved very little. The example of Panama shows how much room there is for improvement. In 1995, the Panamanian jobless rate was similar to Tunisia's and Morocco's. Today, unemployment has fallen by two-thirds. While Figure 1.18 shows a wide variation in initial values, it clearly demonstrates the absence of significant improvement in Libya, Mauritania and Tunisia.

Figure 1.18: Unemployment – Benchmark comparison

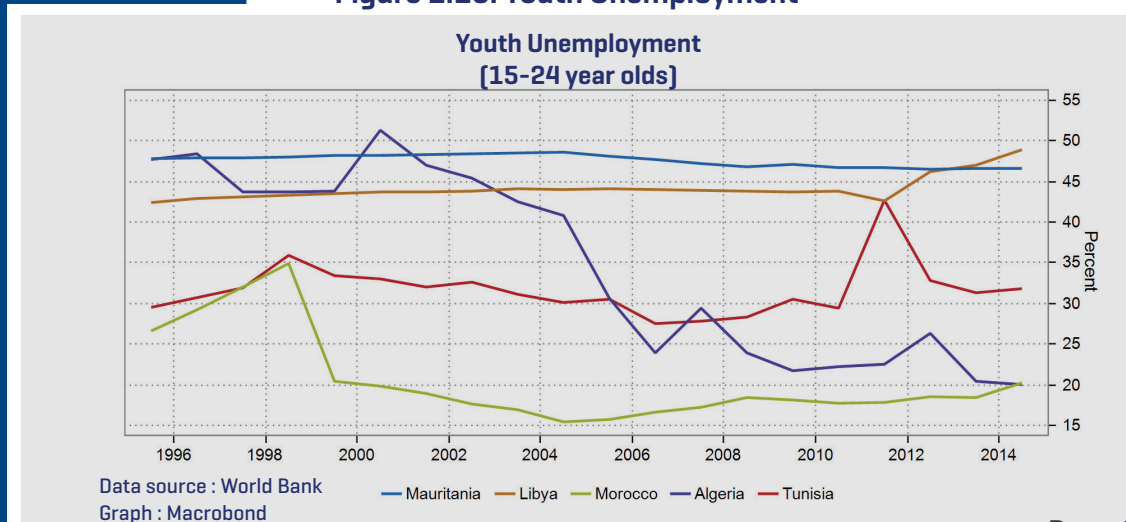


Youth Unemployment

If general unemployment poses a challenge in the Maghreb countries, youth unemployment is an even bigger problem. Demographically, the region is facing what is called a youth bulge. This often occurs when a rapid reduction in infant mortality is not matched by a decline in the fertility rate, resulting in a shift in the population structure toward the younger age cohorts. As shown in Chapter 3, Table 3.1., 25%-30% of the population in the Maghreb countries are below the age of 15. The huge number of young people who will join the workforce within the next 5-10 years, together with the persistently high rate of youth unemployment, poses a real threat to labor markets. Yet it must also be stressed that the growing work force presents an unparalleled opportunity for fast economic growth, provided the necessary reforms are implemented.

Figure 1.19 presents youth unemployment since 1995. While rates range from 20% to just below 50%, the basic trend is clear. Youth unemployment is significantly higher than the general unemployment rate. Algeria and Morocco are again the top performers, but strikingly, only Algeria has managed to reduce joblessness among young people since the late 1990s. Everywhere else, there has been stagnation or even regression, showing how badly the region needs faster economic growth and quality jobs.

Figure 1.19: Youth Unemployment



Gender Inequality

Besides persistently high unemployment, Maghreb labor markets share another unfortunate characteristic: a large gap in participation rates between males and females. Figure 1.20 illustrates the share of women between the ages of 15 and 64 who hold full-time jobs outside the home.

Average workforce participation for women in the five Maghreb countries was only 26.5% in 2014. In comparison, the workforce participation in the benchmark countries averaged 60%. While participation rates in the Maghreb have shown some improvement over the past 30 years, women are less than half as likely to be employed as in the benchmark countries.

Algeria seems to be an outlier in the region, even though its literacy rate for women matches Tunisia's [see Table 1.1] and the expected years of schooling for Algerian females exceeded that of males in 2009². This shows an Algerian labor market that has real difficulty absorbing women.

Figure 1.20: Labor Force Participation Rate – Females

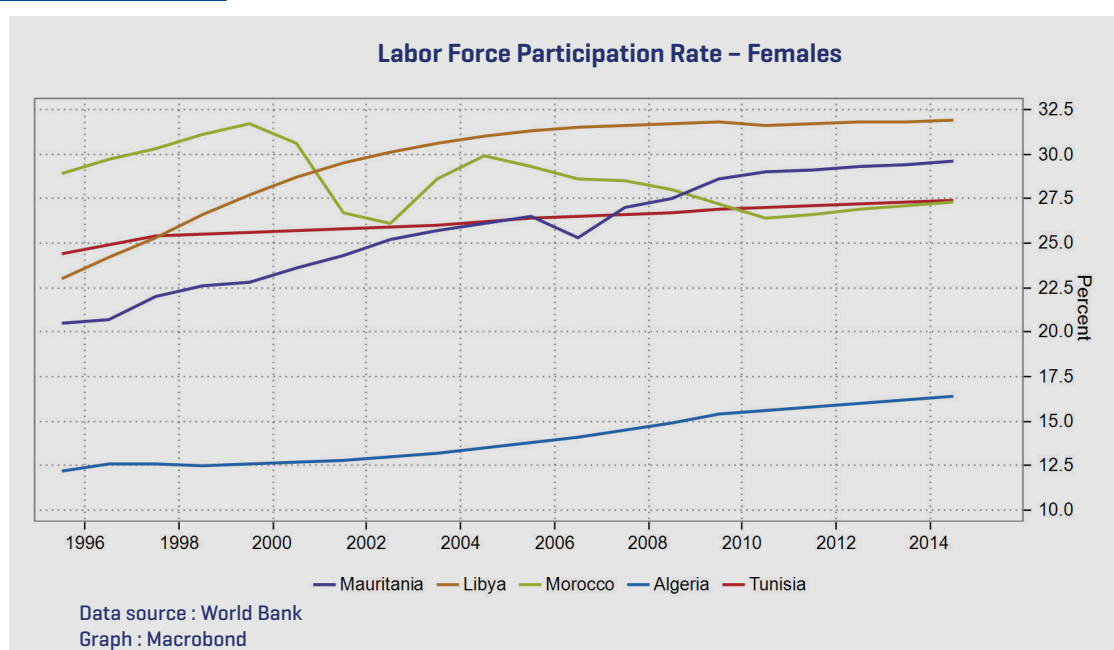


Table 1.1: Literacy Rate – Females

	Tunisia	Algeria	Morocco	Libya	Mauritania
Literacy Rate Females age 15+ [%]	72.8	73.1	62.0	85.8	41.6

Source : World Bank

Labor Freedom

While slow or stagnant economic growth and demographic changes are the decisive factors for unemployment in the Maghreb region, another aspect worth considering is labor freedom. The Labor Freedom Index from The Heritage Foundation measures regulatory and legislative impediments to employment in a given country on a scale from 0 to 100. The index serves as an indicator of structural barriers and flexibility in a given labor market. It consists of six equally weighted components :

² World Bank, Africa Development Indicators

³ <http://www.heritage.org/index/labor-freedom>

Ratio of the minimum wage to the average value added per worker

Hindrance to hiring additional workers

Rigidity of working hours

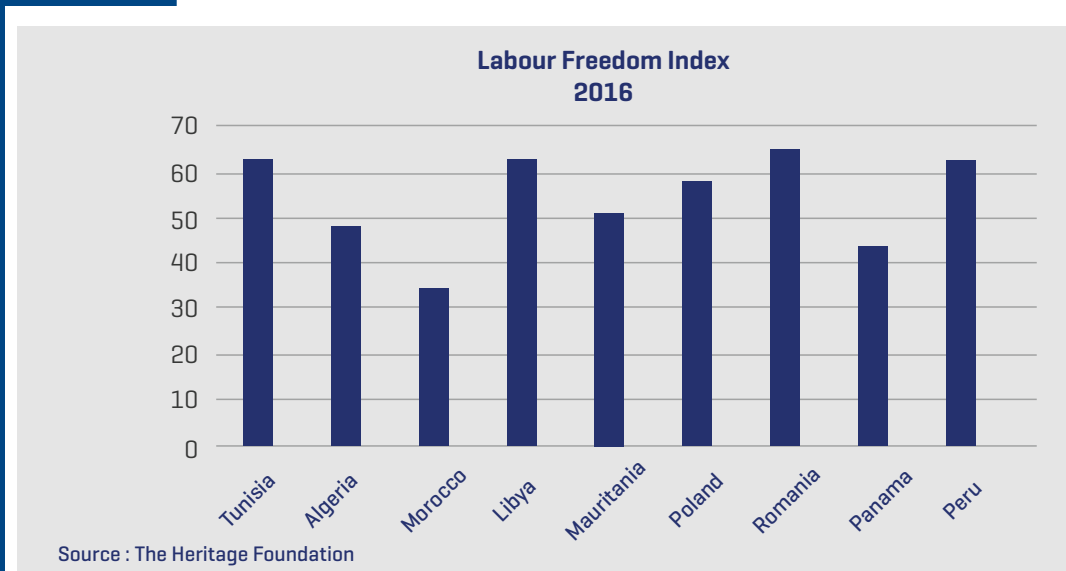
Difficulty of firing redundant employees

Legally mandated notice period

Mandatory severance pay

The Labor Freedom Index scores for the Maghreb region and the benchmark countries are presented in Figure 1.21 below. For comparison, the highest scores in 2016 were posted by the United States and Singapore, with 91 points each. The world average was 59.72.

Figure 1.21: Labor Freedom Index

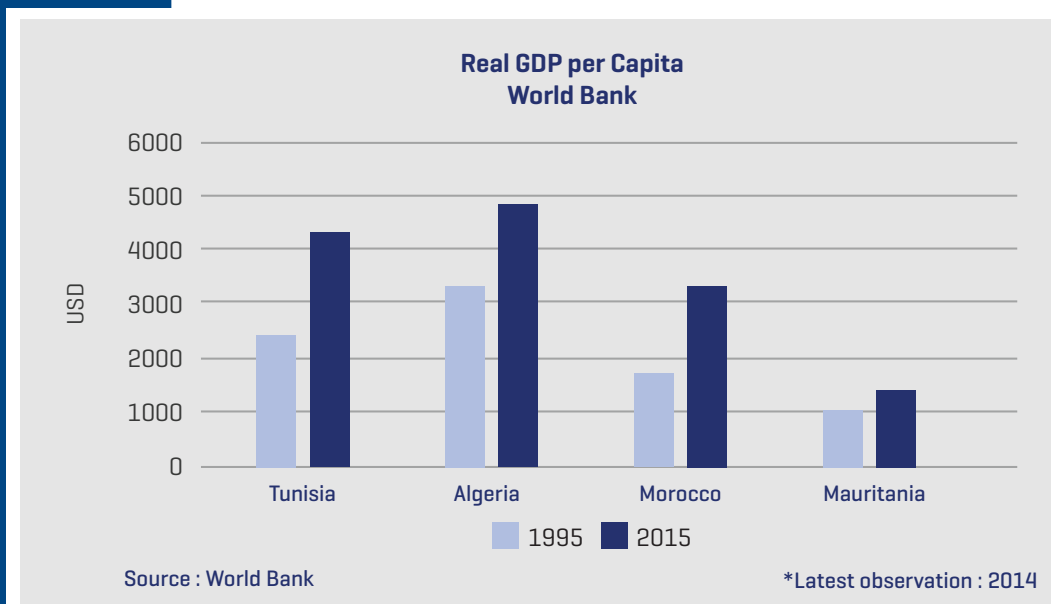


Social Development in the Maghreb region

Economic and social development often go hand in hand. While measuring social development is not a simple task, there are several indicators that offer comparability between countries. This chapter will examine social progress in the Maghreb countries over the past 20 years, while offering a comparison with the benchmark countries. While the economic catching-up process of the Maghreb countries has not been overwhelming, the standard of living in the region has improved.

To understand a country's social development, its economy must also be considered. As previously illustrated, all the Maghreb countries have underperformed the benchmark group in terms of economic growth. Figure 1.22 shows GDP per capita in four Maghreb countries in 1995 and 2015. Note that Libya is missing from some parts of this chapter due to the lack of available data. While GDP per capita does not directly measure a population's standard of living, it serves as a good proxy for social development. Historically, there has been a high correlation between GDP and social development.

Figure 1.22: Output per capita – then and now

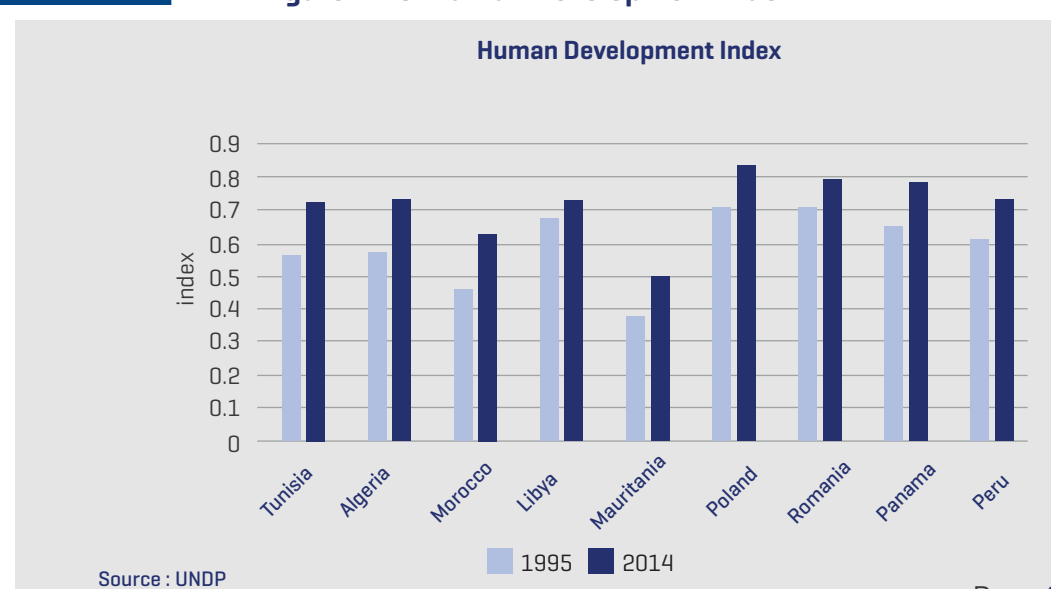


In terms of real GDP per capita as measured in USD, Morocco has experienced the greatest relative rise over the 20-year period with 88% growth, followed by Tunisia at 71%. This compares with 122% for the benchmark country, Poland, over the same period. Mauritania clearly underperforms with 29% growth. This has not been an extraordinary performance by the Maghreb economies. However, the region has still shown improvement in several social development indicators.

Human Development Index

The Human Development Index (HDI), released yearly by the United Nations Development Programme (UNDP), is a more advanced measure of social development. It combines Gross National Income (GNI) per capita, life expectancy and education to track the human development of a country. Instead of narrowly focusing on economic growth, this metric includes measures of health and skills in gauging a country's development. Countries are grouped into four tiers of human development based on quartiles of HDI rank: very high, high, medium, and low. Figure 1.23 below presents the HDI scores for the Maghreb and benchmark countries.

Figure 1.23: Human Development Index



The Maghreb countries have evidently bettered their HDI scores. Tunisia and Algeria now rank in the High Human Development quartile. Morocco is in the Medium group, while Mauritania remains stuck in the bottom quartile of the 188 countries in the HDI ranking. Libya has made little progress. While it ranked highest among all Maghreb countries in 1995, Libya has now been overtaken by Tunisia and Algeria. Nearly all Maghreb countries score below average in their respective Human Development tiers, except for Mauritania, which matches the average in the Low Human Development tier. Nonetheless, Tunisia, Algeria and Libya all score above the average HDI for Arab nations. Table 1.2 presents the average HDI score as well as the average of two selected components for the four human development tiers in 2014.

The benchmark countries outscore the Maghreb region in HDI with one exception. Algeria now ranks higher than Peru by a fraction, after posting an inferior score in 1995. Poland is the overall leader and the only one of nine countries ranked in the top quartile. While the Maghreb countries have not yet caught up with the benchmark countries, they have shown reasonable improvement. Their lower starting point should also be taken into consideration.

Table 1.2: HDI and selected component averages

Tier	Human Development Index	Expected years of schooling	Life expectancy at birth
Very high	0.896	16.4	80.5
High	0.744	13.6	75.1
Medium	0.630	11.8	68.6
Low	0.505	9.0	60.6

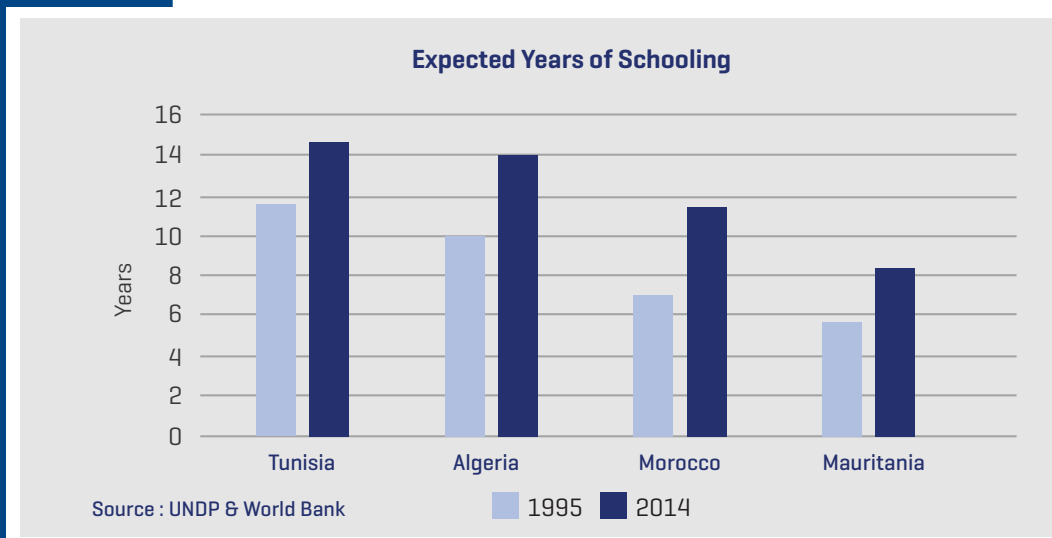
Source : UNDP

Education level and participation

One dimension of the Human Development Index is education. Education undoubtedly plays a vital role in social and economic development. Besides allowing the population to develop skills and augment income, an educated work force also brings essential productivity enhancements. The education index in HDI is split between expected years and mean years of schooling [18 years being equivalent to a Master's degree in most countries].

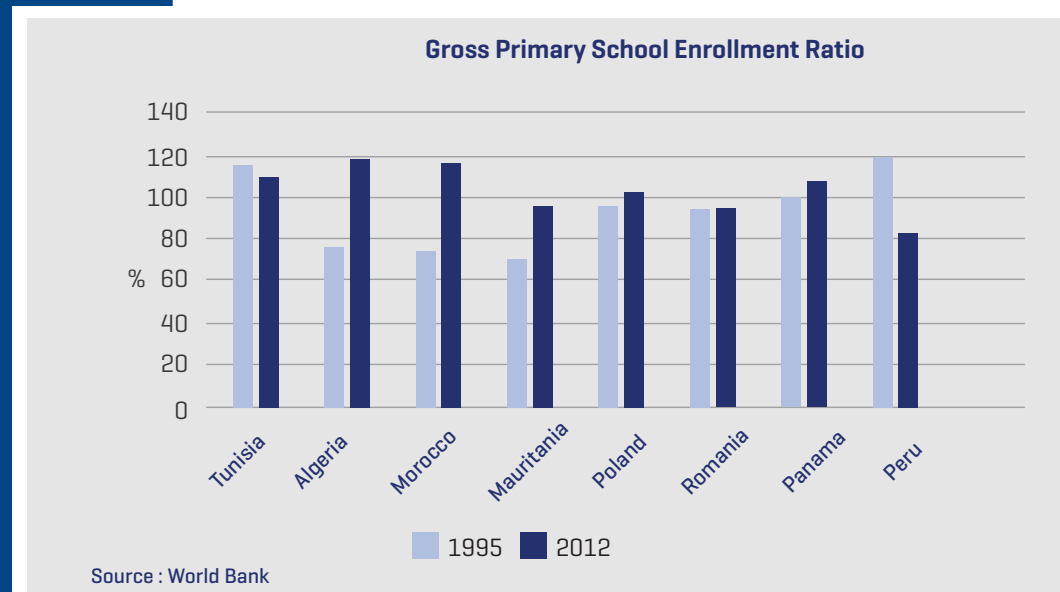
Figure 1.24 shows that all four Maghreb countries increased expected years of schooling throughout the period. Tunisia and Algeria now both exceed the average in their tier of human development. Morocco and Mauritania, on the other hand, remain below average in their tier.

Figure 1.24: Expected Years of Schooling



Another measure of educational development is the gross enrollment ratio. This measures the number of pupils enrolled in primary school, regardless of age, as a percentage of the school-age population. Note that the share can be greater than 100%, since some pupils may be outside the normal age range.

Figure 1.25: Primary School Enrollment

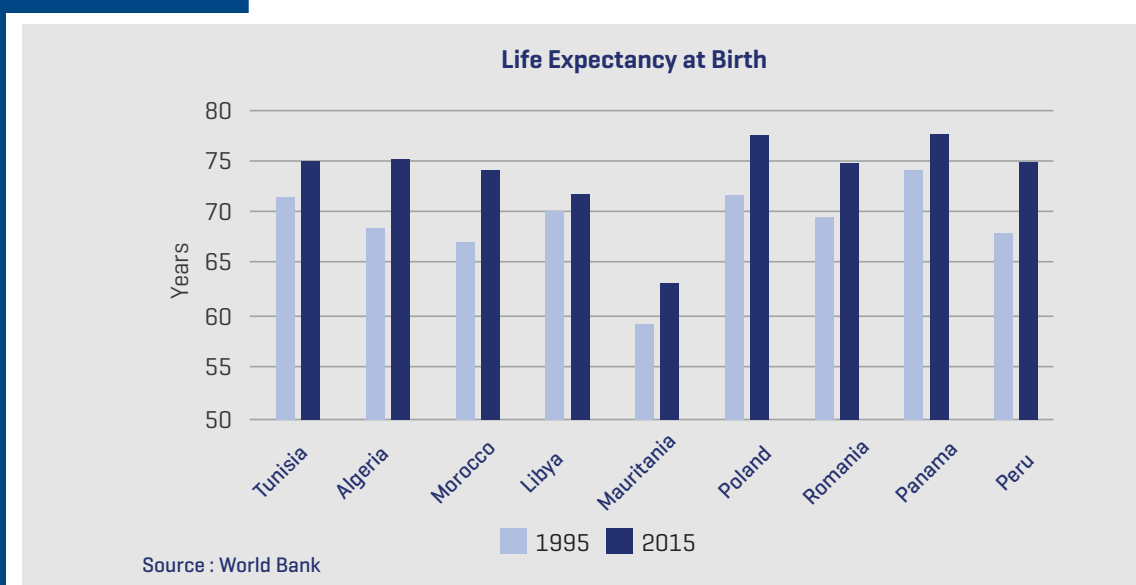


There have been significant improvements in the ratio of primary school enrollment for most of the Maghreb countries. Morocco and Mauritania have made the most progress. All Maghreb countries except Mauritania now have gross enrollment ratios above 100%. This indicates that educational catching-up is taking place, as adults who did not receive a basic education are now enrolled in primary schools. This contributes to lifting the general educational level in the country.

Life expectancy

Another dimension in the Human Development Index is life expectancy. Developed countries with a high standard of living generally enjoy high-quality health services, which contribute to longer life expectancies. Pharmaceutical innovations grant further health benefits to rich and poor countries alike. The introduction and distribution of new medicines and treatments over the 20-year period provided a solid foundation for improvements in life expectancy worldwide. Access to health care and medicine, as well as economic development, all lead to longer lifetimes for a country's inhabitants. Income and life expectancy are positively correlated, although as a country becomes more prosperous, lifestyle diseases such as diabetes also increase.

Figure 1.26: Life Expectancy at Birth



Inspecting the “before” and “after” picture of life expectancy over the past 20 years, we discover that Algeria and Morocco have posted notable increases, of 7 and 7.5 years, respectively. This is despite their having started at a lower initial life expectancy than Libya or Tunisia. Every Maghreb country except Mauritania now has a higher life expectancy than the global average of 71.4 years⁴.

Mauritania is the clear outlier, with an average life expectancy of 63.2 years in 2015.

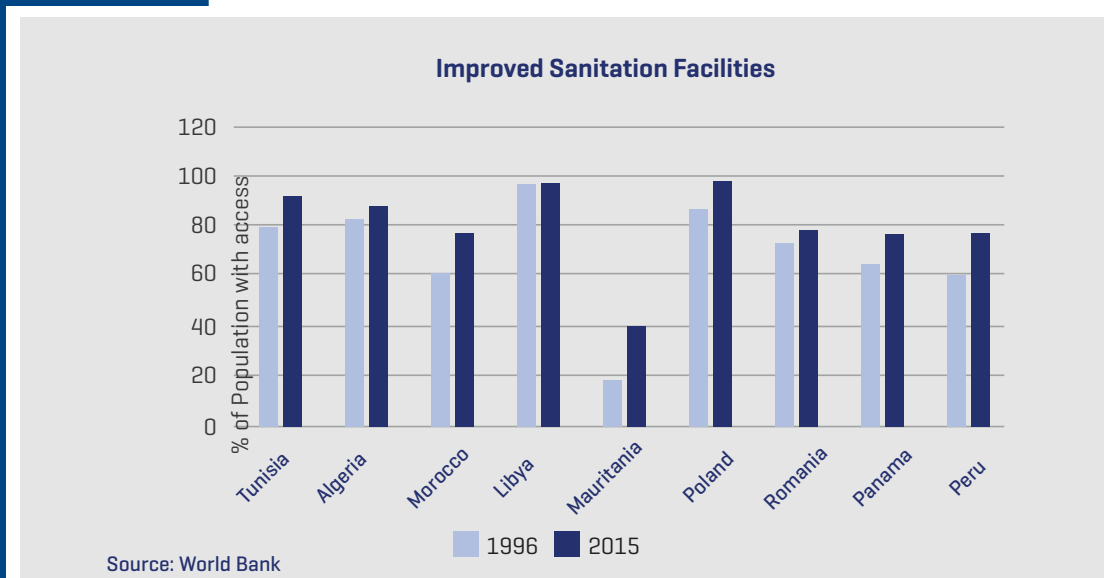
The entire Maghreb group falls short of Poland and Panama in terms of life expectancy. However, Tunisia and Algeria have already surpassed the benchmark countries of Romania and Peru. It should be noted that Poland and Panama both enjoyed a relatively high life expectancy in 1995. If we consider the absolute change over the 20-year period, Algeria and Morocco have experienced the greatest improvement, followed by Peru.

⁴ http://www.who.int/gho/mortality_burd_en_disease/life_tables/en/

Sanitation

One factor that affects the life expectancy is access to sanitation facilities. Decent sewage systems and indoor plumbing have a great effect on the public health and thus on life expectancy. The more developed a country, the larger share of its population has access to decent sanitation. Figure 1.27 presents the percentage of the population with access to sanitation facilities.

Figure 1.27: Access to Sanitation Facilities



The chart shows definite progress across the Maghreb region. In 1996, both Tunisia and Algeria scored higher than the benchmark group, except for Poland. This relative performance is unchanged in 2015. Morocco has also improved and now matches Panama and Peru. Mauritania doubled the share of its population with access to sanitation facilities, but still lags far behind the rest. Only 40% of the country's inhabitants have access to proper sewage systems, which might very well be a strong contributing factor to the low life expectancy. Libya, with a high score at the start of the period, experienced virtually no change.

Access to improved water

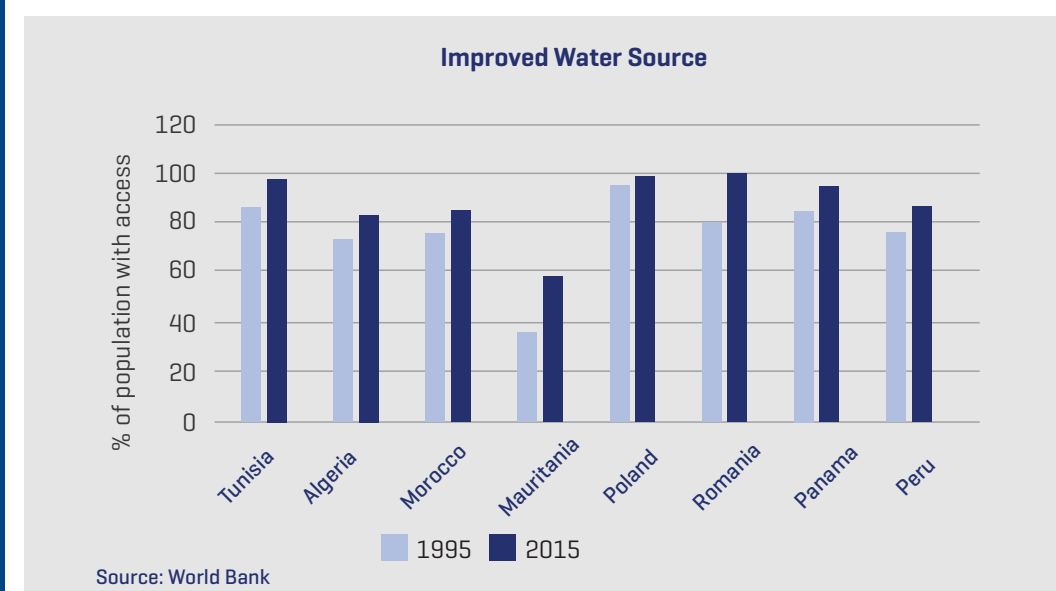
One more indicator of social development is access to an improved water source. This includes piped water in homes as well as public taps and protected wells. Access to clean water undoubtedly grants several health benefits. In a similar fashion to improved sanitation facilities, it helps increase the average life expectancy.

Figure 1.28 [below] makes it evident that the Maghreb has made relatively little progress in this category. Tunisia is the only country where access to improved water exceeds the global average of 91%. It is also the only Maghreb country that matches the benchmark group, although Algeria and Morocco both come close to Peru. Surprisingly, Algeria is the only country that has experienced a deterioration in access to improved water sources.

In 1995, it had the highest score of 91.2%, only to see this number fall to 83.6% in 2015. Both Morocco and Tunisia have overtaken Algeria over the 20-year period. Mauritania is again the black sheep in the family, with only 59% of its population having access to improved water.

Chapter 3 will elaborate further on the challenges of water scarcity and sanitation in terms of infrastructure and logistics.

Figure 1.28: Access to Water Source



This chapter has identified several structural weaknesses. First, it is notable there has been virtually no catch-up with the developed economies since the early 1990s – contrary to what we have seen in Central and Eastern Europe. Compared with peers at a similar stage of economic development in 1990 – what the report calls the benchmark countries of Panama, Peru, Poland and Romania – we also see that the Maghreb region has significantly underperformed in terms of economic growth.

The Maghreb economies' most notable structural weakness is their labor markets, which are plagued by problems of social inclusion, very high youth unemployment and serious gender inequalities.

Other structural weaknesses include excessive regulation, which hampers economic growth, and faulty institutions, which breed a lack of respect for the rule of law and weak protection of property rights.

There is no doubt that these serious structural challenges significantly lower economic growth rates across Maghreb countries.

In the next chapter, three scenarios will be analyzed to shed light on the potential impact of economic reforms and the extent to which economic growth has been hampered by their absence.

Maghreb 2040 Outlook

The following chapter discusses the growth potential of the Maghreb countries from 2016 through 2040. It is important to state from the outset that what we present should not be mistaken for economic forecasts or predictions. Rather, the simulations are to be interpreted as potential development paths conditioned by different sets of stylized assumptions. They are entirely abstracted from a range of economic shocks that are likely to affect the Maghreb countries, but which cannot be predicted today. We first describe the three different scenarios under consideration and discuss the assumptions associated with each. We then analyze each country in detail.

Three scenarios for Maghreb growth

It is no overstatement that the past two or three decades have witnessed profound changes in all the Maghreb countries. This makes any medium- or long-term economic forecasting for these countries fraught with uncertainty. To address these issues at least in part, we present three different scenarios for economic development in the Maghreb.

Scenario 1 - Muddling Through: This scenario projects that the recent pattern of political and economic development will continue more or less unaltered through 2040 [except for Libya, where we assume the present political turmoil will be resolved in the near future]. In the *Muddling Through* scenario, the labor force is projected to grow faster than the population itself. This partly reflects the demographic profile of the Maghreb countries, which is dominated by the younger age cohorts, facilitating a rapid expansion of the working-age population. In addition, it is assumed that Maghreb governments will be successful in implementing reforms aimed at increasing labor force participation and/or reducing the structural rate of unemployment, thus contributing to employment growth. More precisely, it is assumed for each country that the labor force will grow 1.5 times faster than the total population. In turn, population forecasts were obtained from the World Bank for each of the five countries. Except for Mauritania, the Maghreb countries have experienced declining growth rates in their working-age populations over the past 10-15 years. The *Muddling Through* scenario anticipates a reversal of this trend, with workforce growth returning to the levels observed in the 1990s. The reversal is assumed to take place over the first five years of the simulation horizon, after which employment growth stabilizes at 1.5 times the annual population growth rate projected by the World Bank.

In the *Muddling Through* scenario, Total Factor Productivity (TFP) growth is assumed to be a moderate 1 % each year in all Maghreb countries. This number is already quite high by historical standards, since these countries have seen little if any TFP growth in recent decades. However, that very lack of progress points to a substantial untapped potential for productivity growth. If this potential is to be realized, political stability is essential to attract foreign capital investments, which can greatly enhance the productivity of Maghreb workers and firms.

It is assumed that TFP growth accelerates from zero to 1 % during the first five years of the scenario, and then stabilizes at an annual rate of 1 %.

Finally, the growth rate in capital stock is assumed to range between 5 and 7 % on average across the five Maghreb countries. This is broadly in line with historical standards, in keeping with the idea underlying the *Muddling Through* scenario. While these numbers are not overly optimistic, they do require a degree of political stability that fosters long-term planning and investment by businesses. The assumed growth in capital formation is consistent with a share of gross fixed capital formation to GDP of 20-25% across the Maghreb countries, although somewhat lower in Libya. These numbers are consistent with the past few decades, except for Mauritania, which has seen even higher numbers. Growth in capital stock is assumed to slow slightly over time, reflecting the transition toward a higher level of economic development.

To combine these assumptions into a simulated path for GDP growth, we assume a production function of the well-known Cobb-Douglas form. The income share pertaining to labor is $\frac{2}{3}$, the standard for most countries. Using data for the current labor force, current capital stock and current output for each of the five countries, we obtain an estimate of the current level of total factor productivity.⁵ We then feed in the paths for TFP, capital stock and employment resulting from the assumptions outlined above, and thus obtain the implied path for GDP.

Under the assumptions associated with the *Muddling Through* scenario, the implied average annual GDP growth rate varies between 3.5% and 4% for Libya, Tunisia, Morocco and Algeria, while reaching 5.5% for Mauritania [whose projected population growth is roughly double that of the other countries]. This scenario entails GDP growth close to the regional average over the past few decades. For all countries, our assumptions imply that GDP growth will peak in the first half of the 2020s, when the transition periods of labor force and TFP growth are completed. Thereafter, the observed growth rates decline slightly as projected population growth slows, in keeping with World Bank forecasts.

For all countries, real GDP per capita roughly doubles over the simulated horizon from 2016 to 2040. In addition, the employment-to-population shares, which for 2016 vary between 29% and 33% across the five countries, rise to between 33% and 37% in 2040. Altogether, the Maghreb countries would enjoy almost two and a half decades of sustained moderate growth under this scenario, bringing very important gains in income and welfare levels across all five countries.

Scenario 2 - Stagnation: As an alternative to the first scenario, we consider a more pessimistic case in which political unrest prevents the Maghreb countries from reaching their growth potential. We label this the *Stagnation* scenario.

⁵ For Libya and Mauritania, we were unable to obtain reliable data for current capital stock. Instead, we assume that these two countries have ratios of capital to output similar to the average of the three remaining countries, and use this to compute an estimate of capital stock.

It is assumed that the work force grows no faster than the population. No important labor market or structural reforms are passed, and structural unemployment remains high by international standards. The projected population growth rates are around 0.5% to 1% for four Maghreb countries (the exception being Mauritania at 2%) on average over the period 2016-2040. This demographic expansion is likely to produce a certain level of GDP growth even in the pessimistic *Stagnation* variant. By definition, this scenario assumes that the employment-to-population ratios remain at their current levels.

As for total factor productivity, we assume zero growth in all Maghreb countries until 2040. As mentioned above, realized TFP growth has been meager in most Maghreb countries in recent decades. Under a scenario in which these countries continue to be plagued by political turmoil, things are unlikely to improve, even if investment levels remain amenable.

Capital formation is assumed to grow at annual rates of between 3% and 5% in 2016-2040. While political unrest may cause lower or even negative growth rates over short intervals of a year or two, sustained periods of *stagnation* or negative growth in capital formation have not occurred in the Maghreb countries in recent decades (a possible exception is Libya since 2011, but reliable data are not available). The assumed rate of capital growth is within the range observed in the Maghreb countries in the recent past, although it is somewhat on the low side. The resulting ratios of gross fixed capital formation to GDP are generally around 15-20% for all five countries throughout the period; this is below historical levels, confirming the pessimism of the “Stagnation” scenario. As in the *Muddling Through* scenario, the growth rate of the capital stock is assumed to decrease slightly over time.

Using the same Cobb-Douglas function described above, we arrive at the implied levels of average annual GDP growth in the *Stagnation* scenario. These range from 1.5% to 2.5% for the entire period in four of the Maghreb countries; Mauritania’s implied rate is again somewhat higher, at 3%. Even this pessimistic scenario anticipates continued economic expansion, driven largely by population growth and capital formation. It should be stressed, however, that while the Maghreb countries can achieve non-negligible income growth without political stability and growth-oriented reforms, very large potential income gains are foregone under this scenario. Compared with the *Muddling Through* scenario, itself not very ambitious, the implied level of GDP in the *Stagnation* scenario is 30% to 40% lower in 2040. While all countries more than double their GDP per capita in the *Muddling Through* scenario, cumulative growth in the *Stagnation* variant is only 20%-40%, depending on the assumptions made for each country. These numbers highlight the substantial gains to be reaped in coming decades, while also showing the perils associated with a lack of political stability and ambition.

Scenario 3 - Reforms: Finally, we consider a more ambitious scenario for Maghreb growth. The *Reforms* scenario envisages that a combination of political stability, ambitious changes in the labor and goods markets, and an increasing openness to foreign trade and investment lead to a prolonged period of vigorous economic growth.

Needless to say, the growth rates observed in this scenario are unlikely to occur without market-friendly initiatives and reforms. However, the associated gains in income and welfare would entail a profound transformation of each of the Maghreb countries.

Reflecting the successful implementation of ambitious labor market reforms, we assume that employment grows 2.5 times faster than the population, with a phase-in period of 10 years.⁶

As a result, the employment-to-population ratios across the Maghreb countries rise to between 37% and 44% by 2040, well above the current levels of 29%-33%. While these ratios are still well below most advanced economies, they are not far from the current levels of Turkey and Bulgaria. A trajectory of this kind would lift the Maghreb countries to a new stage of labor market development.

In this optimistic scenario, it is assumed that total factor productivity grows at an annual rate of 2.5 %. While this number is very ambitious by Maghreb standards, it is in line with observed average TFP growth in several East European countries [e.g., Poland, Romania and the Baltic states] during the two decades after the fall of communism. With the adoption of a credible set of growth-oriented policies in a stable political environment, the Maghreb countries could aspire to a similar performance, although we assume that TFP growth needs 10 years to accelerate from zero to 2.5 % [making the average annual growth rate over the entire period somewhat lower than 2.5 %].

As for capital stock, the Reform scenario anticipates annual growth rates on the order of 7% to 10% for all Maghreb countries. This is in line with some of the highest capital growth rates recorded in the region [Morocco, Tunisia and Algeria] in the mid- to late 2000s. It is also largely consistent with observed average growth rates in the benchmark countries of Panama, Peru, Poland and Romania⁷. While they are ambitious, these assumed growth rates are not unrealistic, reflecting the trajectory of successful historical experiences in the Maghreb and elsewhere.

Unsurprisingly, the *Reforms* scenario produces impressive GDP growth rates when these assumptions are plugged into the Cobb-Douglas production function. On average during the period through 2040, GDP growth ranges from 5.5% to 6.5% per year for four of the Maghreb countries, with Mauritania's fast-growing population allowing for even faster growth of 7.5%. The pace of expansion peaks in the second half of the 2020s, after labor market reforms are implemented and TFP growth accelerates. Thereafter, economic growth slows along with projected population growth.

⁶ For Mauritania, we multiply the population growth rate only by a factor of 2.

⁷ This benchmark group is chosen by selecting countries whose GDP in 1990 [in USD and adjusted for purchasing power parity] was close to the average of the Maghreb countries. These four countries were roughly at the same stage of economic development in 1990 as the Maghreb countries [with the exception of Mauritania] but have generally outperformed since then.

Growth rates in the *Reforms* scenario match the most successful years observed in recent Maghreb history, especially during the 2000s. While it may seem overly ambitious to assume that GDP growth rates will stabilize at such high levels, it is important to remember that the conditions described above are not unrealistic. Here the experience of the benchmark group is instructive. On average, Poland, Romania, Peru and Panama experienced average real GDP growth of almost 5% per year from 1989, the year communism fell in Eastern Europe, until the onset of the financial crisis in 2008. Importantly, these four benchmark countries did not enjoy the same demographic tailwinds that the World Bank projects for the Maghreb countries through 2040. This confirms that their growth potential may be even higher than that of the benchmark countries.

Implied 2040 GDP in the Reform scenario is as much as 65% to 85% higher than in the Muddling Through scenario. All Maghreb countries would see their total output per capita more than triple from 2016 to 2040; for Mauritania, it almost quadruples. These numbers once again confirm the vast and largely untapped growth potential of the Maghreb region. They highlight the gains accruing to its peoples if this potential is harnessed in the decades to come.

Summing up, we have envisaged three potential growth paths for the Maghreb countries through 2040. The *Muddling Through* scenario sees moderate growth rates across the region, with GDP per capita roughly doubling over the period. The *Stagnation* scenario features no productivity growth and no increase in employment-to-population ratios. Under these circumstances, GDP per capita increases by a meager 20%-40%. Finally, we have outlined a *Reforms* scenario in which employment-to-population rates increase sharply, and where growth in TFP and capital formation matches levels observed in various benchmark countries. Under these circumstances, GDP per capita more than triples.

These numbers clearly spell out what is at stake for the Maghreb countries. If they embark on a successful and sustained growth path, they have the potential to triple their income and increase welfare very substantially during the next two or three decades. To achieve this, an ambitious agenda of growth-oriented reforms is required to attract more foreign trade and investment. Among other things, this requires the kind of political stability that has not always been typical of their recent past. This analysis also clearly presents the cost of not achieving these goals. The foregone gains in income and welfare are huge. With the potential for solid economic growth comes an obligation to create an environment in which that potential can be tapped.

The Maghreb countries surely possess the former. It is time for them to deliver on the latter.

Country focus: Morocco

We now take a closer look at each of the Maghreb countries, beginning with Morocco. Apart from Mauritania, Morocco is the poorest, as measured by GDP per capita. According to the IMF's World Economic Outlook (October 2016) and the World Bank, GDP per capita in Morocco in 2016 was close to 3,000 USD (in current prices). Roughly 33% of the country's 35 million inhabitants were employed in 2016.

In the *Muddling Through* scenario, employment is assumed to grow 1.5 times faster than population growth, which the World Bank projects will average 0.8% in 2016-2040. By 2040, the employment-to-population share will have increased to 0.36. TFP growth is assumed to be 1%, while the average growth in capital formation is 7% – not far from the observed average in Morocco since the early 1990s. The implied average annual growth rate in GDP is 3.9% over the entire period. By 2040, GDP per capita will have risen to almost 6,400 USD in constant prices. Real GDP per capita more than doubles.

In the *Stagnation* scenario, employment grows no faster than the population, while TFP does not grow at all. Capital formation is still assumed to expand at an annual rate of 5%. GDP expands by 2.2%, producing an increase in GDP per capita to almost 4,200 USD in constant prices, some 39% above 2016.

Finally, under the *Reforms* scenario, we assume that employment grows 2.5 times faster than the population. TFP growth reaches 2.5% after a phase-in period, while the average growth rate in the capital stock reaches 10%, matching Morocco's performance during several years in the 2000s. The resulting GDP growth rate is 6.4% – higher than observed in the recent past, but in line with several years in the first decade of the current century. Under these circumstances, GDP per capita jumps to about 11,300 USD in constant prices by 2040, or more than three times its current level.

Figure 2.1: Morocco – GDP growth outlook

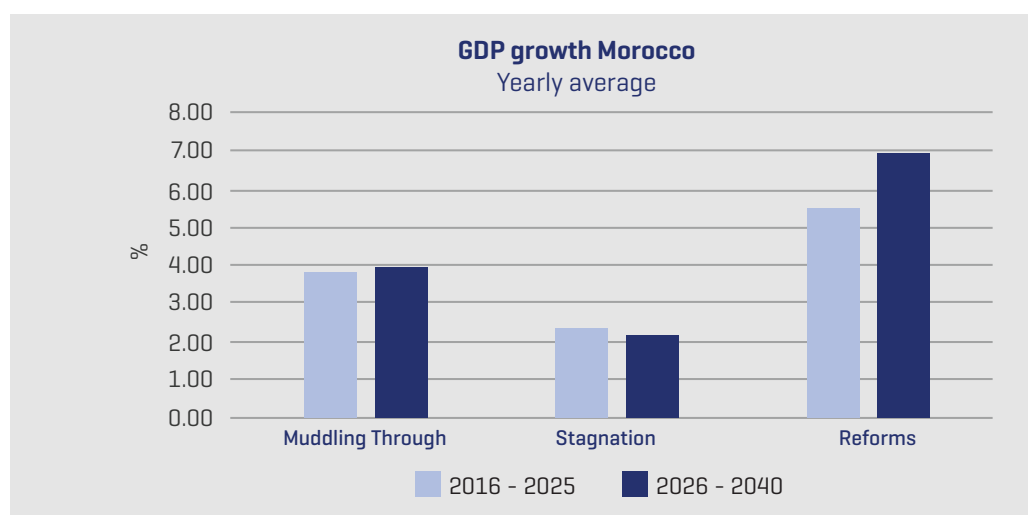
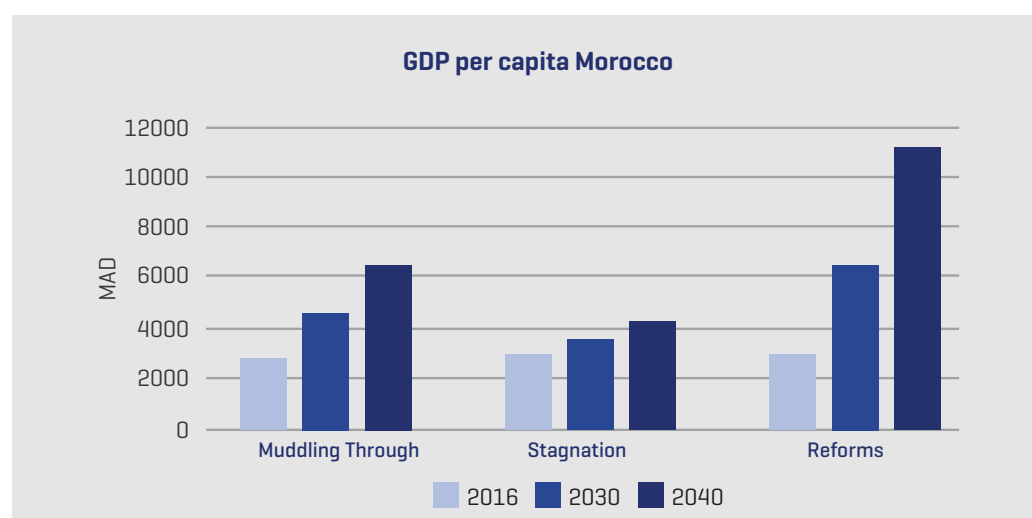


Figure 2.2: Morocco – GDP per capita outlook



Country focus: Tunisia

Tunisia is somewhat richer than Morocco, with GDP per capita slightly below 3,700 USD in 2016. The population of the country, at 11 million, is less than a third of Morocco's. Projected population growth is similar in the two countries, averaging 0.6% for Tunisia in 2016-2040. The Tunisian employment-to-population ratio is around 0.31, in part due to higher unemployment than in Morocco. As these two countries share many characteristics, the assumptions made for Tunisia in each scenario differ only slightly from those for Morocco.

In the *Muddling Through* scenario, the growth rates of employment and TFP match Morocco's, while capital formation growth is slightly lower, at 6%. This difference is imposed to reduce the share of capital formation in GDP, which historically is lower in Tunisia.

As a result, the average GDP growth rate of 3.4% is also slightly lower than Morocco's. This still allows GDP per capita to rise to about 7,400 USD in constant prices by 2040, while the employment-to-population ratio reaches almost 34%.

Likewise, the *Stagnation* scenario shows similar growth rates in employment and TFP, and a slightly lower 4% growth rate in capital formation. This implies meager average GDP growth of 1.7%, bringing GDP per capita in 2040 to about 4,900 USD in constant prices, an increase of roughly 30%.

Finally, the *Reforms* scenario sees employment and TFP growth rates on par with Morocco's, while capital formation grows by 8% on average – a rate Tunisia equaled and even exceeded in the late 2000s. Over the entire 2016-2040 period, GDP growth averages 5.4%, while the employment-to-population ratio climbs to about 37%. In this scenario, Tunisian GDP per capita rises to 12,000 USD in constant prices by 2040, securing vast improvements in income and welfare for the entire population.

Figure 2.3: Tunisia – GDP growth outlook

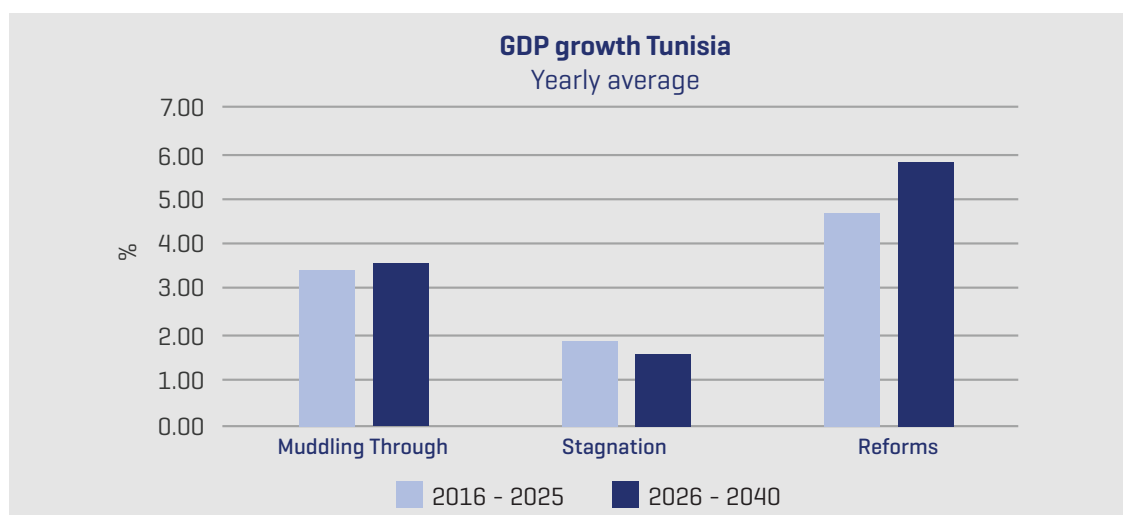
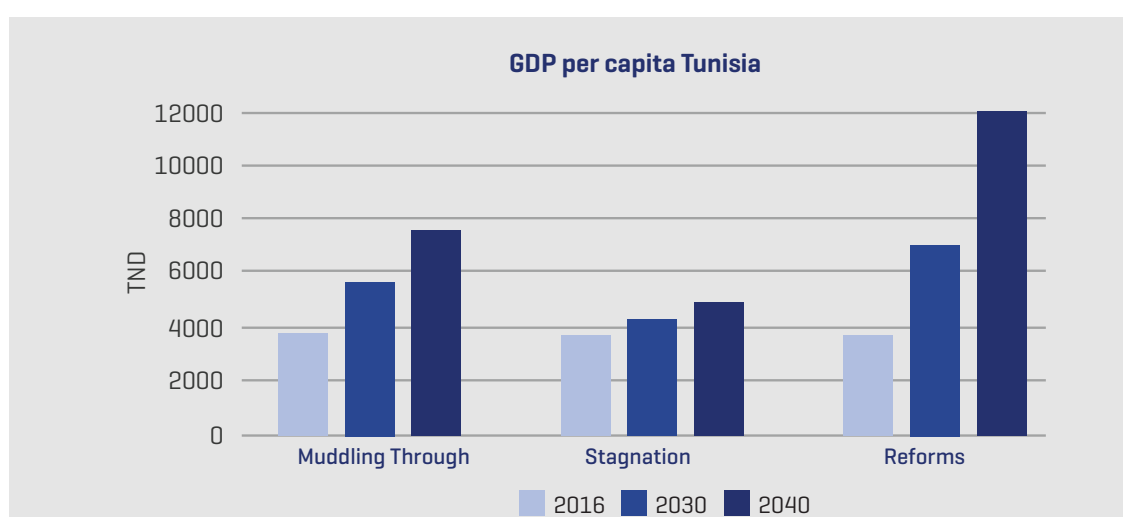


Figure 2.4: Tunisia – GDP per capita outlook



Country focus: Algeria

Though larger in size and population (40 million) than neighboring Tunisia and Morocco, Algeria is less densely inhabited.

It also displays the lowest initial employment-to-population share (less than 29% in 2016) of all the Maghreb countries. Nonetheless, the country is the second wealthiest in the group after oil-rich Libya, with GDP per capita in current prices reaching almost 4,100 USD in 2016. In addition, Algeria is projected to benefit from faster population growth (1.1% annually) over the simulation period than all other Maghreb countries except for Mauritania.

Under the *Muddling Through* scenario, TFP and employment growth rates are assumed to match those in Morocco and Tunisia, while capital formation grows at 6% on average. Benefitting from faster population growth, Algeria's GDP would thus expand at an average rate of 3.9%, slightly higher than observed in the country's recent past. The employment-to-population rate would reach 32% by 2040, while real GDP per capita roughly doubles, to 8,200 USD in constant prices.

The *Stagnation* scenario features growth rates in employment, TFP and capital formation matching Morocco's. Given the difference in projected population growth, Algeria achieves a slightly higher pace of real GDP growth at 2.4%. GDP per capita climbs to 5,600 USD in current prices, an increase of 35%.

In the *Reforms* scenario, Algeria's TFP and employment growth rates again match its neighbors. Growth in capital formation has varied substantially in the past, making assumptions more uncertain. We assume an average rate of 9%, implying a capital formation-to-output ratio at or above 30% throughout the simulation period, matching that of the past 6-8 years. In this scenario, Algeria's real GDP expands at an average annual rate of 6.5%, allowing GDP per capita to reach 15,000 USD in constant prices by 2040. The employment-to-population ratio would reach 0.39 by 2040.

Figure 2.5: Algeria – GDP growth outlook

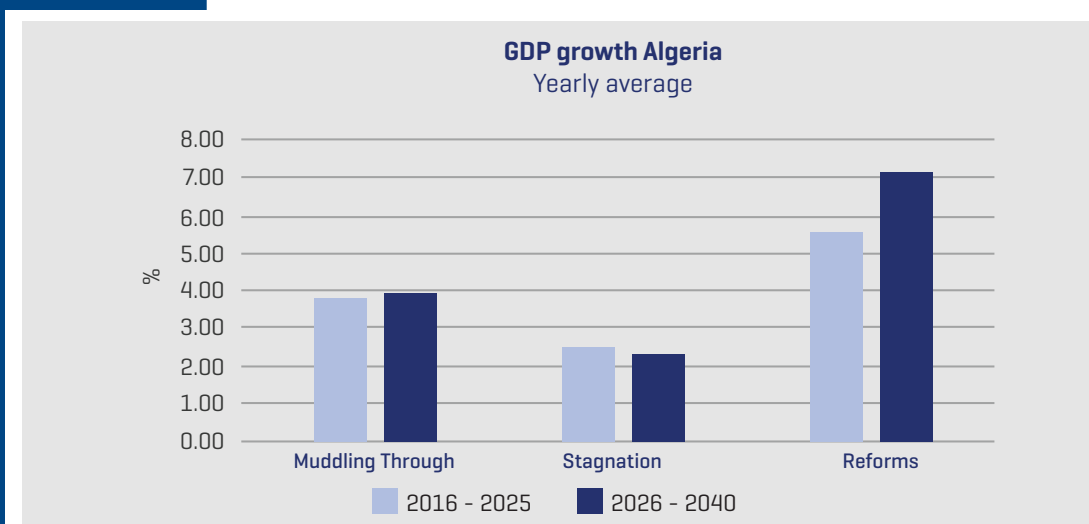
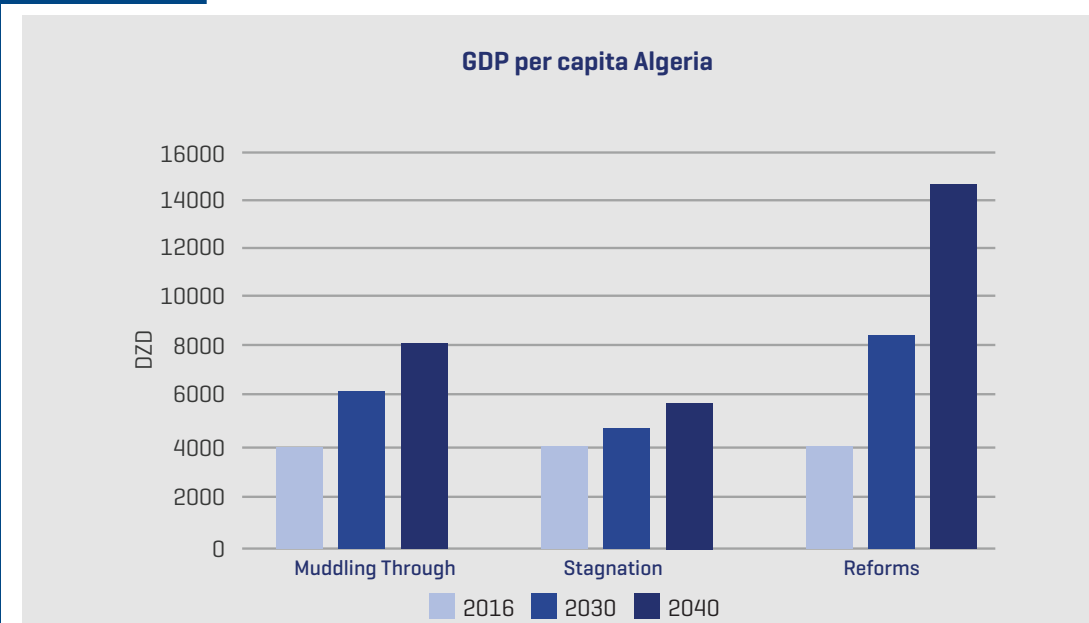


Figure 2.6: Algeria – GDP per capita outlook



Country focus: Libya

While economic projections are notoriously plagued by high degrees of uncertainty, this goes double for Libya in its current situation. Predicting short-term political outcomes is not the aim of this analysis. Therefore, in our simulations we describe the growth potential of Libya under various circumstances, always assuming that the current political turmoil will be resolved soon. If unrest persists, Libya will of course take longer to embark on the growth trajectories we discuss.

Owing to its abundant natural resources, Libya is the richest Maghreb country. Back in 1980, it was the wealthiest country in Africa, with a GDP per capita comparable to many OECD countries. By 2016, Libya had slipped down the wealth rankings. Recent official figures are shrouded by uncertainty. GDP per capita amounted to about 6,200 USD in 2016, for a population of roughly 6.3 million. Population growth is projected at 1% on average until 2040.

In the *Muddling Through* scenario, assumptions about TFP and employment growth resemble those for other Maghreb countries. Capital formation is assumed to average 5%, somewhat lower than elsewhere. This reflects Libya's historically lower ratio of capital formation to GDP compared with other Maghreb countries, although recent, reliable data from the country are hard to come by. Our assumption ensures that this difference is reproduced in our simulations. The resulting growth rate of Libya's real GDP is 3.4%. The employment-to-population ratio increases from an initial 0.33 to 0.37 by 2040. GDP per capita reaches 11,300 USD in real terms, making Libya the only country not to double its GDP per capita in the *Muddling Through* scenario.

Similar considerations lead us to assume a growth rate of capital of just 3% in the *Stagnation* scenario, while TFP and employment growth rates match those in the other countries. This results in average real GDP growth of just 1.6%, raising GDP per capita to around 7,300 USD in 2016 prices.

Finally, in the *Reforms* scenario, along with standard assumptions about TFP and employment growth, we assume that capital formation grows at an average of 7%. This implies GDP growth of 5.7% on average. The employment-to-population ratio climbs to 0.44. In this scenario, Libya's GDP per capita increases to around 19,000 USD in constant prices.

Figure 2.7: Libya– GDP growth outlook

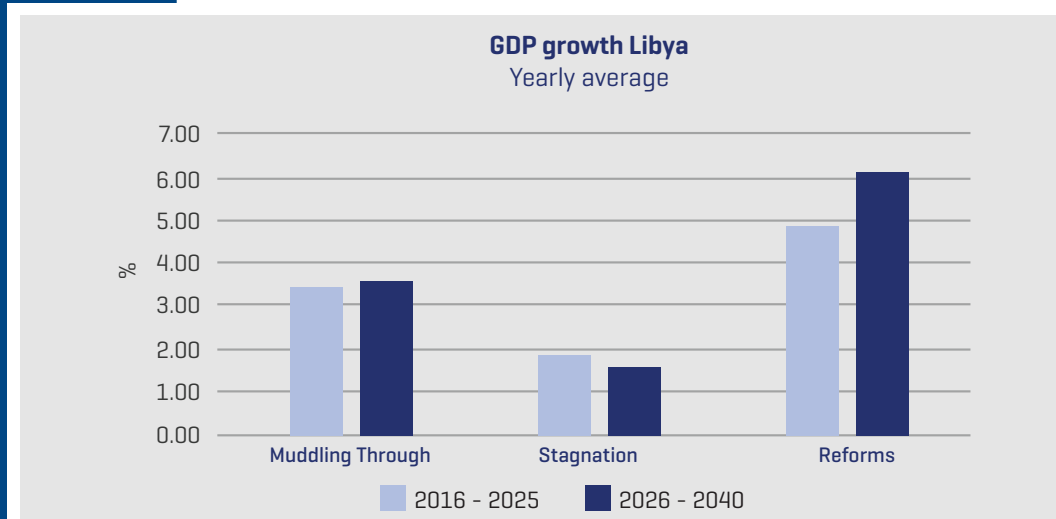
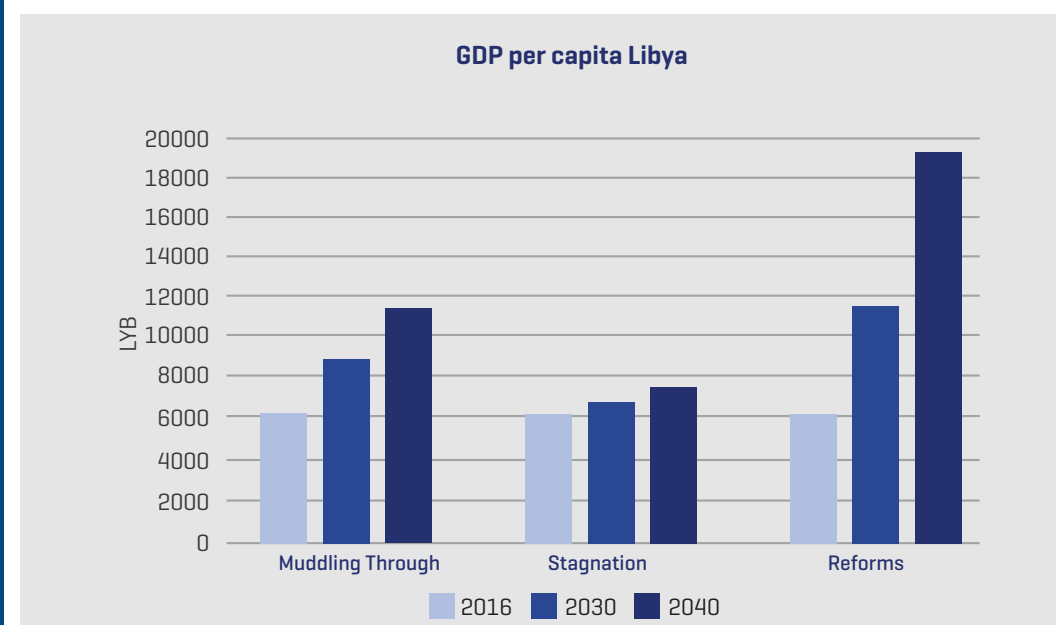


Figure 2.8: Libya – GDP per capita outlook



Country focus: Mauritania

Of the five Maghreb countries, Mauritania is by far the least prosperous, with a GDP per capita of 1,100 USD in 2016. It also has the smallest population, at 4.2 million, but is projected to grow much faster than the rest, at an average annual rate of 2.1% in 2016-2040. Its employment-to-population ratio is quite low, at about 0.29 in 2016.

Mauritania enjoys strong tailwinds from its projected population growth. Thus, while TFP and employment assumptions are in line with those of other countries, as is the assumed growth rate in capital formation [7%], the implied growth rate of Mauritania's real GDP reaches 5.2% even in the *Muddling Through* scenario. Such growth rates are by no means unprecedented in the country's recent economic history. The employment-to-population ratio would increase to 36% by 2040. In the *Muddling Through* scenario, GDP per capita reaches almost 2,400 USD in constant prices.

Even in the *Stagnation* variant, our assumptions imply that Mauritania can sustain average annual GDP growth of roughly 3%; this number is low compared with recent GDP figures. Population growth is again the main driver, although capital formation is expected to grow by 5% on average. This scenario highlights that even without labor market reforms and productivity improvements, Mauritania is likely to grow. However, its GDP per capita in 2040 would increase by only 25% in real terms, to 1,400 USD.

In the *Reforms* scenario, TFP growth is assumed to reach 2.5% per year, as in the other countries. Employment expands at twice the rate of population growth. While this factor was 2.5 elsewhere in the Maghreb, a similar assumption in Mauritania would entail employment growth of more than 5% per year, which is probably too extreme. In line with our assumptions, the population-to-employment share rises to 0.43, a very substantial increase from the initial level of 0.29. We further assume TFP growth reaching 2.5% and capital formation growth 10% annually, in line with the other countries. These assumptions go with an average GDP growth of 7.8%. By 2040, they imply Mauritanian's GDP per capita will be close to 4,300 USD in constant prices, or almost four times higher than in 2016.

Figure 2.9: Mauritania – GDP growth outlook

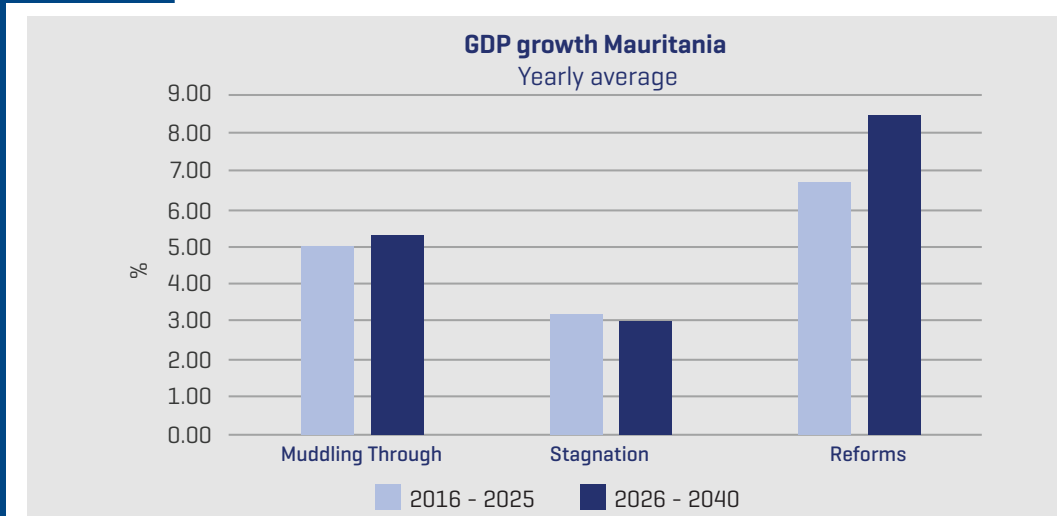
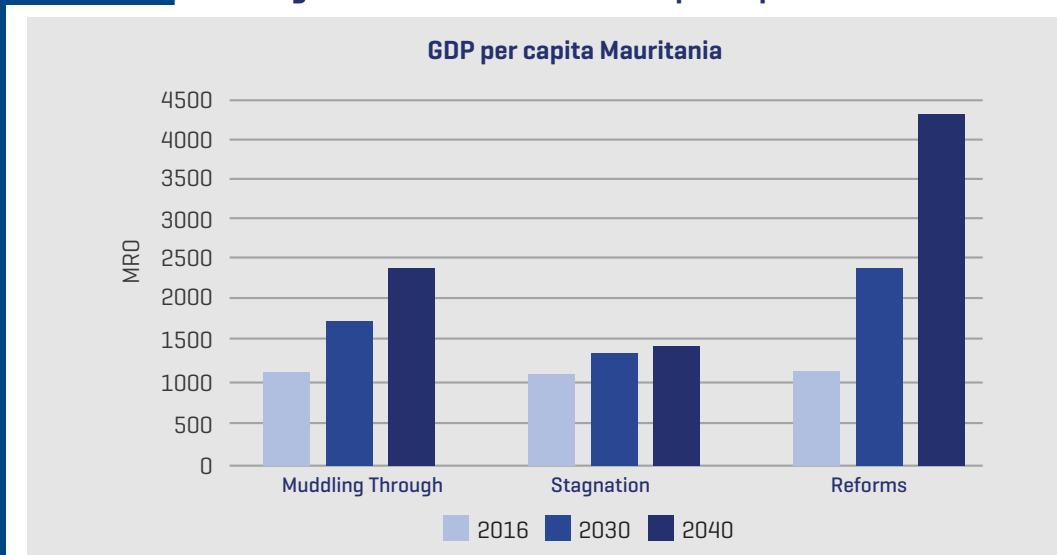


Figure 2.10: Mauritania – GDP per capita outlook



Chapter 3:

A New path to prosperity and inclusiveness

A new path to prosperity and inclusiveness

Challenges and opportunities

The Maghreb is at a strategic crossroads: reform and prosper or stagnate and risk instability. While countries like Morocco and Tunisia have been catching up with the industrialized world, with their populations enjoying per capita income growth above the G7 average from 1989-2016⁸, the recent Arab Spring uprisings and the social and political turmoil they unleashed exposed the vulnerability of the development models pursued by the Maghreb countries over recent decades. Indeed, since mass protests broke out during the Arab spring in early 2011, growth in the region almost halved, slowing from an annual average of 4.5% in the 2000s to 2.5% in 2011-2015. It is estimated that the economic impact of the uprisings has shaved an average 1.6 percentage points off GDP growth in the Maghreb countries, compared with their performance during the previous decade. Poverty resumed an upward trend after steadily declining for almost 20 years. Unemployment, especially among youth, also soared in the 2011-2015 period.

The region confronts pressing social and economic challenges. These include slow economic growth and persistent unemployment, especially for young people; rising inequality between social strata and regions; a slow pace of economic transformation and industrial development; lack of competitiveness; low regional and global integration; climate change, especially its expected adverse impact on the region's water and food deficits; and fast unplanned urbanization and security problems. These daunting issues must be tackled in a difficult political environment, both domestically [amid simmering social and political discontent and rising fiscal stress] and at the regional level [where conflicts and geopolitical risks are expanding].

The Maghreb has the world's highest youth unemployment rate. Despite some structural transformation in the 1990s and 2000s, most of the Maghreb economies are still mired in low value-added activities. Total factor productivity is among the lowest in middle-income countries [MICs]. The social and fiscal fragility of these states has been further exacerbated by a decline in oil revenue since 2014, which has diminished the associated rent either directly [Algeria] or indirectly through a declining employment, remittances and aid from the oil-rich Gulf countries. While extreme poverty has been in decline across the Maghreb, large segments of the population are at risk of falling back into poverty due to persistently high unemployment and slowing economic growth since 2010.

According to the World Bank, the region's youth unemployment rate reached 25% in 2015, the highest in the world, and its young population is still growing rapidly [see Table 3.1]. In fact, the Middle East and North Africa [MENA] is one of the most youthful regions in the world, with a median age of 22 years compared with the global average of 28. Meanwhile, 38% of its 18- to 29-year-olds are unemployed [as opposed to 24% of those 30 and older].

⁸ Transition for All: Equal Opportunities in an unequal world, EBRD Transition Report, 2016, chart 1.13, p. 17.

Young people aged 15-24 constitute approximately one-fifth of the population in Algeria, Libya, Morocco and Tunisia. Yet, economic growth rates are too low to create enough quality jobs to this age cohort. The result is a lack of prospects, social discontent and a sense of deep malaise palpable among youth.

Extreme poverty has been tackled with some success, but inequality is perceived as high and the gender gap is among the world's widest. Poverty and unemployment rates in the Maghreb are unevenly distributed across age, gender and geography [World Bank report 2016]. The gender gap is a key issue. Despite reforms in some countries, indicators suggest that women in the Maghreb countries remain economically, politically and socially disadvantaged in relation to men. Although literacy and educational attainment has improved tremendously among women, joblessness is high, especially among young women. Growing youth unemployment was found to be one of the key causes of the uprisings in 2011. Disenfranchised youth are also easy prey for recruitment campaigns by radical groups. Ensuring equal access to economic opportunities should be an imperative across the Maghreb countries. This cannot be realized, however, without addressing long-standing institutional and structural issues – i.e., without implementing an ambitious reform agenda.

Table 3.1: North Africa's Populations at a Glance

	Population mid-2016 [millions]	Population mid-2030 [millions]	Births per 1,000 population	Deaths per 1,000 population	% of population Ages < 15	% of population Ages 65+	% urban	Total Fertility Rate
Algeria	40.8	50.6	26	5	29	6	71	3.1
Libya	6.3	7.4	20	5	30	5	79	2.4
Mauritania	4.2	5.7	31	8	40	3	60	4.2
Morocco	34.7	38.1	20	6	25	6	60	2.4
Tunisia	11.3	13.1	20	7	24	8	68	2.4

Source: Population Reference Bureau, 2016 World Population Data Sheet

The private sector is weak due to a difficult business environment and strong state intervention. Most firms in the Maghreb are of small to micro size [94% of private companies]. The business environment and extensive state intervention, along with structural issues, are still impairing broad-based economic growth. While the 2017 Doing Business Report indicates improvements in their rankings, Morocco [ranked 68 out of 190 countries], Tunisia [77], and more worrisome Algeria [156], Mauritania [160] and Libya [188] all lag far behind many of their developing middle-income peers. Three out of the region's five economies are near the bottom of the ranking.

This shows that much remains to be done to promote the Maghreb's private sector and stimulate its economic potential. Antiquated regulations, lack of innovation, insufficient access to credit, red tape and corruption all make it harder to start and grow a business. With few exceptions, the Maghreb region has failed to position itself in an increasingly interconnected global economy. Strengthening its relative competitiveness will be crucial for the Maghreb to achieve inclusive, sustainable economic growth.

Political instability and social tension have become serious obstacles to development. Shallow political reforms, slow economic development, and social exclusion are driving discontent. The Maghreb's ongoing economic and social crisis [2010-2016] dates back to the 1990s. The Arab Spring uprisings of 2011 fed on unmet expectations for political and economic reforms. The uprisings forced governments to stem the tide of social demands and political instability through more [Tunisia] or less [Morocco, Algeria] sweeping political reforms and expansionary fiscal and social policies. However, closer analysis shows that the seeds of the crisis were embedded in the absence of in-depth structural reforms of economic policies, which governments of the region kept postponing. In this sense, the uprisings were inevitable: they simply would have occurred at different times and perhaps in different forms, depending on the country. It is therefore important for the Maghreb countries to draw the lessons from these popular awakenings, and convert the current crisis into an opportunity by undertaking the necessary reforms. Their main aim should be to build inclusive, prosperous societies through open, fast-growing, diversified and competitive economies.

There is potential for fast and inclusive growth. Most Maghreb economies possess important assets. Their geographic proximity to Europe and its large open market offers a unique opportunity for countries to exploit to the mutual benefit of the entire Mediterranean area. The Maghreb has a large, young work force with adequate skills that can be enhanced through education and professional training. There is well-developed infrastructure, burgeoning manufacturing and export capabilities [illustrated by extremely fast export growth in Morocco and Tunisia], a well-developed tourist sector and reasonable endowments of natural resources [oil and gas in Algeria and Libya, phosphate in Morocco and Tunisia, iron ore and fisheries in Mauritania]. However, this potential can only be tapped if long-term structural reforms are implemented fully. Such reforms could unleash the population's entrepreneurial energy and connect the region with the rest of the world, allowing it to benefit from the global markets while avoiding some of their adverse effects. Examples of how successful reforms can generate shared prosperity and improve living conditions abound. The East Asian economies – especially South Korea, Taiwan, Hong Kong, and Singapore – illustrate the variety of development strategies a country can pursue. While their specific policies and instruments differ, they share similar objectives and development approaches. Each leveraged the opportunities offered by global markets to build competitive and fast-growing economies by undertaking needed structural reforms, enhancing the quality of human capital, and offering an excellent business environment for domestic and foreign investors. Obviously, the Maghreb countries cannot simply imitate the Asian tigers. Each country has its own institutional environment and political economy constraints. However, one can at least reflect on and be inspired by successful development strategies.

For example, it seems clear from the example of the Asian tigers that a competent and strategically-minded state and a vibrant private sector are essential to successful development. Many other institutional ingredients are also needed, but without those two pillars it would be difficult for any country to prosper.

Toward a new social contract

The path to prosperity for the Maghreb region requires a new social contract and a strong reform agenda. To achieve the fast, sustainable and inclusive growth outlined in Chapter 2's reforms scenario, the Maghreb countries must undertake structural reforms. It will be impossible for these states to tackle the challenges they face without a fundamental strategic change in their social contract. The relationships and interactions between states, the private sector, civil society and the people should be revisited with the aim of building more equitable, productive and well-governed societies. The key reforms that could help address this fundamental challenge are presented below.

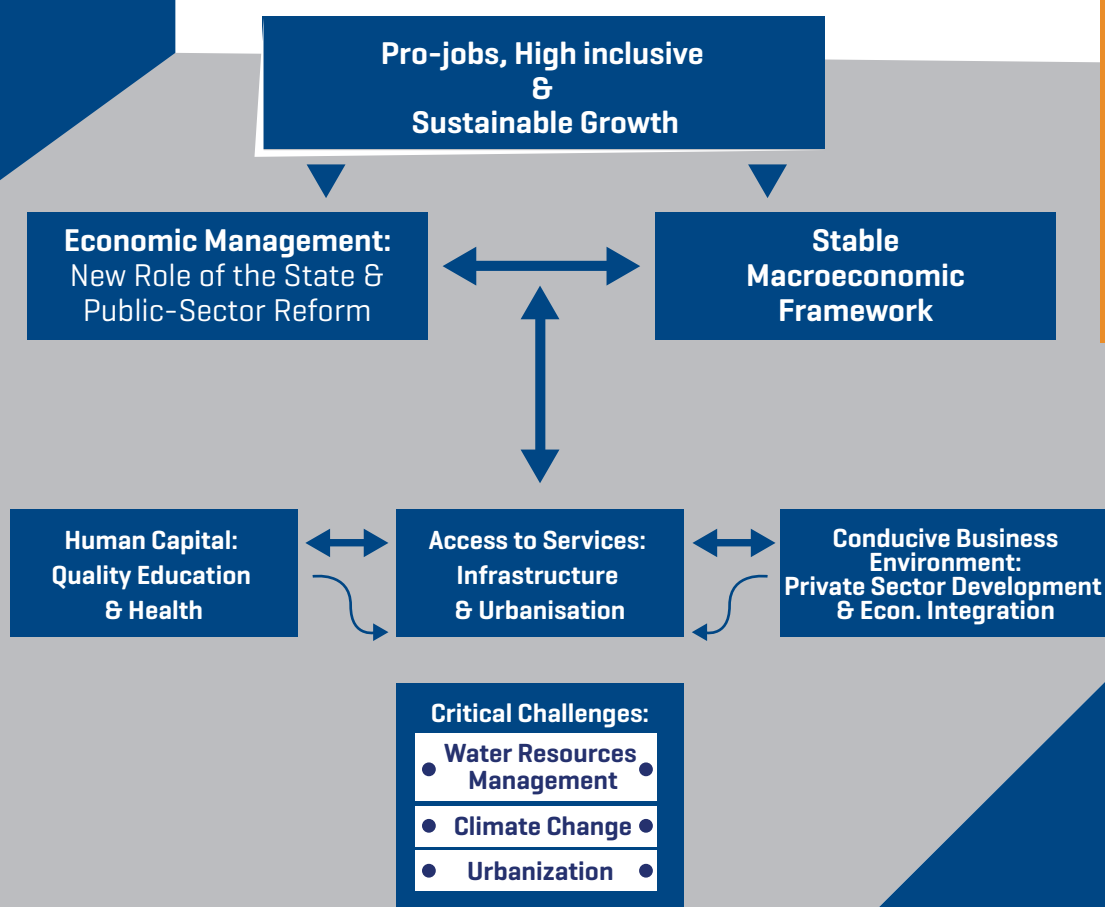
The new social contract calls for a profound change in the institutions and governance practice. The changes demanded by the Arab Spring uprisings require: (i) transforming the state from an interventionist, ineffective, and unaccountable bureaucracy into a development facilitator that is efficient, transparent, and accountable; (ii) creating a regulatory environment conducive to an entrepreneurial, risk-taking, innovative private sector to replace the prevailing cronyism and rent-seeking; and (iii) unleashing popular energy to effect a behavioral shift from a disempowered, state-reliant citizenry to a free, knowledge-based society.

Maghreb countries – and Arab societies in general – should embrace this fundamental cultural and behavioral change over the next decade. The incremental, state-led reform agendas of the past were mainly driven by ruling elites whose primary aim was to ensure social peace and strengthen their power base. Eventually, this led to the Arab Spring uprisings, which exposed the fragility of Arab states and their political and economic systems, raising questions about their survival and the future of millions of their citizens. The time has come for Arab societies to abandon the narrow path of state-led reform aimed at preserving crony interests and elite power if they wish to break with centuries of stagnation and decline and catch up with modern, developed societies. This fundamental change, hoped for by millions of ordinary people, has yet to be publicly debated within the Maghreb societies. Such a debate is needed to articulate the objectives, scope, and methods for implementing reforms. Governments that commit to reform should encourage an open public discussion, in order to forge a common understanding of what constitutes a productive and inclusive society and what needs to be changed to achieve this objective.

A new role for the state

Guiding principles for redefining the state's role in the Maghreb countries. The proposed new social contract and development strategy will require the Maghreb states to reorient themselves toward new objectives. The role of the government should be redesigned to: (i) promote private-public partnerships to bring out the best in each sector and maximize their synergies; (ii) prioritize policy changes that enhance human capital, promote private and collective initiatives, and build more inclusive societies; and (iii) promote human rights and select development strategies that stress environmental protection and better use of natural resources.

Key Pillars of The New Development Strategy



Maghreb states must play a much more strategic and developmental role than in the past. A new strategic role for Maghreb governments in the 21st century should consist of setting the agenda and creating a conducive environment for development, rather than being directly involved in delivering goods and services that can be better provided by other actors (NGOs, the private sector, etc.). This leadership and regulatory role should be performed in a transparent, accountable and effective manner. No developing country has ever achieved social and economic advancement without a committed, credible, and capable state that respects the rights of its citizenry and works with civil society and the private sector.

States should not seek to do everything. Maghreb states should be driven by the key objective of ensuring security, economic prosperity, and social justice through the most efficient use of national resources. The state's role should therefore be restricted to services that only it can provide, such as security, law enforcement, economic and monetary policy, and extending social protection to vulnerable and low income groups. States are better placed to provide public infrastructure and services in an equitable manner and to supervise a level playing field for private sector development and job creation.

The state should retain a central role where it has a proven comparative advantage. The state's most useful role is to foster private initiative and help unleash creativity by providing public services, transparent regulations and decent social protection for those in need. The leading role of states in the Maghreb in recent decades, and the limitations they have imposed on free initiative, militate in favor of this urgent change.

The imperative of a stable macroeconomic framework

The macroeconomic situation, especially fiscal deficits, has severely deteriorated after the Arab Spring uprisings and the oil price fall of mid-2014. In Libya, the disruption of oil production and the ongoing civil war have led to a free fall in real GDP and a huge fiscal deficit. It will take years to redress the fiscal situation given the current high level of public spending, narrow tax base, and low oil prices. Tunisia, for example, has managed only less than 2.2% annual growth since 2011, with political and social instability during the transition accounting for much of this poor economic performance. Making matters worse was an expansionary fiscal policy, which over the past five years has disrupted Tunisia's fiscal framework and created serious financial instability. In 2011-2015, Tunisia's budget deficit topped 5% of the GDP, the public wage bill more than doubled to 43% of total expenditure, and public debt soared from about 42% of the GDP in 2010 to 60% in mid-2016. Revenue was initially boosted through tax hikes, but has been leveling off since late 2015.

Algeria, after a long period of fiscal ease provided by high oil and gas revenue, posted a record budget deficit in 2015 and was forced to cut expenditures after energy prices slumped. Morocco successfully managed the political aftershocks of the Arab Spring, but felt its economic brunt. In 2011-2015, the country's economic growth slowed to less than 2.5%, its budget deficit stayed above 5% of the GDP and its public debt soared to 65% of the GDP. With oil prices expected to stay low in coming years, labor migration to the region's oil producing states will be limited, depriving Morocco, Tunisia, and Mauritania of much-needed remittance income. Likewise, the poor growth outlook in Europe – North Africa's biggest trading partner – will affect exports, foreign investment, and tourism in the Maghreb countries. A change in the political economy of the region favoring populist policies and weakening the decision-making power of technocrats could further exacerbate an already unsustainable fiscal situation.

To weather the difficult global environment, North African countries should adopt disciplined fiscal rules. Fiscal stability is necessary (though not sufficient) to generate high growth and start inflecting the employment curves in the region. Fiscal rules impose a long-lasting constraint on policy through ceilings on the budget deficit, the wage bill, spending growth and public debt. This implies that limits set on fiscal policy cannot be changed, except on rare occasions. Rules aim to correct distorted incentives, help governments contain pressures to overspend, and build fiscal space in good years to absorb shocks and permit a counter-cyclical response in bad years. Given the poor condition of public finances and high social demands in the Maghreb countries, governments should focus on strengthening their fiscal frameworks together with necessary structural reforms (see below). Fiscal rules will help ensure the responsibility and sustainability of public finances.

Four main types of fiscal rules are usually considered, depending on the budgetary aggregate they seek to constrain. Countries usually use one or a combination of the following four rules. [i] Debt rules set an explicit limit for public debt as a percentage of the GDP. This type of rule is, by definition, the most effective in terms of ensuring convergence to a debt target and is relatively easy to understand and communicate. Depending on a country's circumstances, a relatively high limit of 60% to 70% is usually recommended. It is worth noting that the debt level does not respond solely to changes in fiscal policies. Thus, it is usually the trend in the debt ratio that should be regularly monitored. [ii] Budget balance rules constrain a variable that affects the debt ratio and is largely under the control of policymakers. Such rules provide clear operational guidance and can help ensure debt sustainability, provided they are well-specified. [iii] Expenditure rules set limits on total, primary or current spending. Such limits are typically set in absolute terms or by capping year-on-year growth; occasionally, they can be expressed as a percentage of the GDP or over a specified time horizon (typically 3 to 5 years). They directly define the amount of public resources that may be used by the government, and thus are generally easy to monitor. Combined with the debt and budget balance rules, expenditure rules offer a practical tool to determine the scope of fiscal consolidation when needed and better prioritize public spending. [iv] Revenue rules set limits [ceilings and floors] on revenue and are aimed at boosting revenue collection and/or preventing an excessive tax burden. Most of these rules are not directly linked to the control of public debt. They are especially useful for oil-rich countries, because they restrict the use of "windfall" revenue for additional spending.

Reforming the public sector

Building a more agile and service-oriented public sector. This is a necessary step to change the role of the state. Fundamental change will be required in the discourse not only of the political elite, but also of the key economic and social actors.

Governments, with the support of civil society, should lead this cultural change and show strong commitment to the institutional reforms that undergird it. Key among these reforms is economic governance and public sector management. Governments in the region are advised to embrace a service-oriented, entrepreneurial public sector whose priority is to provide quality public services and help people achieve their own economic, social and cultural objectives within the existing laws and regulations. It is crucial to recognize and quickly address the crippling inefficiencies of public sectors in the region.

Changing the public sector's mission and the behavior.

There must be a major shift toward service-oriented, citizen-centered institutions and away from the old process-driven, control-oriented bureaucracies that stifled initiative and bred frustration and mistrust in public institutions. The first step is to realign the role of the public sector with the new mandate of the state. This includes clarifying or redefining the role of public institutions, simplifying their workflows, eliminating lengthy procedures, reducing the number of prior authorizations and administrative controls, and outsourcing all tasks and services that the private sector and NGOs can deliver more efficiently.

Attracting talented, motivated and empowered staff.

A second important reform consists of defining a new public sector staffing strategy along with appropriate human resource management policies. The aim would be to attract talented, highly competent professionals to public affairs. New policies should include: merit-based hiring and promotion of civil servants; attractive compensation and remuneration systems; lifelong training in modern management, strategic thinking, policy analysis, negotiating and all the necessary public policy and management skills needed for an agile, efficient public sector. These reforms are not routine or straightforward. They should be designed and implemented in a participatory, transparent way. Appropriate sequencing is a critical in an environment hostile to reform and especially in light of the poor administrative capacity of the Maghreb states. Resistance to change will be the most important challenge to overcome. Prior consultation, open participation, good communication, and – most importantly – determined leadership can overcome resistance to change and curtail the bureaucratic culture of the status quo.

Building a dynamic private sector

Unleashing creativity and entrepreneurial potential.

Together with a strategically-minded state and a stable fiscal framework, a transformed business environment is needed to unleash the energy, creativity, and entrepreneurial skills of the population. The ultimate objective is to boost domestic private and foreign direct investment (FDI), improve productivity, and create quality jobs. Key initiatives to improve the business environment would include (i) enforcing the rule of law and contracts; (ii) improving access to financing; (iii) enforcing free and fair competition regulations; (iv)

eliminating bureaucratic hurdles (authorizations /permits); [v] reducing transaction costs, especially for logistics and infrastructure; and [vi] reforming labor regulations. Currently, barriers to entry and healthy competition are numerous. Some are due to government policies and others to discriminatory practices in drafting and enforcing rules and regulations. This type of environment has restrained the emergence of a dynamic, risk-taking private sector in the Maghreb countries.

Aligning incentives and enforcing rules. There is no doubt that without a well-developed private sector, dedicated long-term strategies, and a leadership committed to properly carry them out, high growth and rapid job creation will not take place. In this context, a strategy based on private sector-led growth will require more private investment, higher productivity, and greater diversification of the economy to boost exports and withstand global competition. For this to happen, the incentives and expectations of entrepreneurs must align with these requirements. Three key priorities can help make the private sector more dynamic: [i] eliminate the prevalence of informal rules; [ii] get rid of the discretionary administrative practices and corruption that drive up transaction costs across the region; and [iii] ensure a level regulatory playing field to stabilize the business environment and build trust in public policies and institutions. These measures should be undertaken in collaboration with the private sector. Most countries of the Maghreb have initiated similar reforms, but the pace and quality of implementation leave much to be desired.

Promoting public-private cooperation with clear accountability mechanisms in the public sector. It is essential to simplify the regulatory system, enforce regulations in a rule-based and transparent manner, increase banking competition (liberalizing the sector and making entry easier for new investors), and improve the legal and regulatory standards and the institutions that enforce them. More generally, it is crucial for a healthy business environment to have transparent and accountable public institutions at all levels. All countries of the region have investment laws with incentives for private investments. Most of these laws look good on paper, but suffer from poor implementation and a lack of periodic evaluation and adjustment. Their effect is drive industrial choices and investor behavior so that they align at least partially with the government's development objectives. Instead, we recommend that governments introduce regular independent reviews and evaluations of investment policies, adjusting them as needed to achieve the intended effect.

Fostering competition and eliminating privileges. Many analysts stress the importance of revamping existing regulations to foster competition⁹ and reduce opportunities for rent-seeking. Governments can encourage entry in all sectors of the economy by removing formal and informal barriers to competition and by promoting transparency. This is a prerequisite for the emergence of a more diversified and entrepreneurial private sector.

⁹ From Privilege to Competition, World Bank Report, MENA [2009].

Here again, greater transparency and accountability of public institutions that interact with the private sector and regulate markets is crucial.

Promoting equal opportunity for women. As reported in the Doing Business 2017, restrictions on women starting a business or obtaining financing occur more often in the MENA economies. Most frequent are restrictions on enforcing contracts. To increase the ease of doing business and unleash the entrepreneurial capabilities of men and women in the Maghreb countries, it is imperative that these restrictions be lifted. Additionally, according to this same report, North Africa has the biggest gap between regulatory efficiency and regulatory quality. If properly implemented, these reforms could help create a better business environment, attracting more productive investments and creating badly needed jobs.

Using low labor costs and fiscal incentives to attract FDI is ineffective. Even before the Arab Spring, with sporadic exceptions (Morocco in the mid-2000s and Tunisia in early 2000s), the Maghreb countries were struggling to attract foreign investors. Compared with middle-income countries, especially in East Asia, FDI stagnated between 2% and 3% of the GDP in Tunisia and Morocco, and never exceeded 4% in the best years. The Arab uprisings further compounded investor flight, even from comparatively peaceful Morocco. FDI inflows fell from USD 4.7 billion in 2014 to USD 4.2 billion in 2015, although the country remained Africa's third largest recipient of foreign investment in Africa during those years. During Tunisia's transition (2011-2015), FDI declined by more than 40% to USD 1.1 billion in 2015. Except for the energy sector, FDI remains marginal in Algeria, Libya and Mauritania. European firms have been the leading investors in the Maghreb, due to historic relationships and the geographic proximity to Western Europe.

Attracting quality FDI by developing a real competitive edge. As mentioned above, past policies to attract FDI favored rent-rich sectors such as natural resources (energy, mines) and real estate, and to a lesser extent, tourism and low added-value manufacturing (especially in Morocco and Tunisia). In the latter sector – labor-intensive manufacturing – FDI has remained relatively marginal, accounting for just one-fifth of all investment inflows to the region. With the ongoing digital transformation and intensive automation of the industry, most Maghreb countries, especially those not rich in resources, can expect to attract even less FDI unless they change course and adopt more up-to-date investment policies. In addition to the reforms mentioned above, the Maghreb countries should focus on creating a real competitive edge in specific industries. This means investing in high-quality human capital and infrastructure, implementing flexible labor regulations respectful of employee rights, opening up the financial sector, encouraging the free flow of financial capital, and following sound fiscal and monetary policies.

Governments of the region should target types of FDI that promote technology transfer, innovative management and structural changes allowing industries to move up the value-added chain.

Digital transformation: An opportunity to leapfrog traditional industrialization

Joining the digital revolution could help the Maghreb countries to catch up faster. A new transformation of industry, dubbed the digital or fourth industrial revolution, is taking place around the world. It uses digital platform-based business models and processes to create more value and higher-quality goods and services, capitalizing on rapid changes in information technology. This opportunity should be seized by the Maghreb countries to leapfrog their development. Governments, businesses, and citizens around the world are already competing to seize the opportunities digital technology offers. The rise of mobile banking, the “Uberization” of urban transport, e-commerce and other platform-based business are only a few examples of this new wave, which many developing countries have caught and used to create new social and economic values. According to the UN E-Government Development Index, Tunisia has the most open government in Africa, but ranks only 72nd globally. Morocco has developed a national strategy for the digital economy, but Algeria is just getting started. Much remains to be done if the Maghreb’s population is to benefit from the opportunities and services that the digital transformation has to offer. From health to education to business, financial services, weather information, agriculture and public services, the digital economy can bring tremendous benefits and contribute to growth and job creation.

Formulating national digital strategies and action plans is imperative. These strategies should focus on providing education and IT training; introducing e-government, e-health, and other online public services; supporting digital start-ups; and assisting manufacturing and service industries that lend themselves to partial or full automation. South Korea’s strategy is often referred to as a model for developing countries. The government deployed its strategy over several decades, with the long-term vision provided by key ministries and backed by strong political commitment. Eventually, these efforts resulted in near-universal internet access and the creation of highly efficient, global digital firms that included such industry leaders as Samsung. The Maghreb countries should devote some of their effort to building institutional capacity in digital planning and management, promulgating modern legislation as necessary, and promoting incentives to encourage investments in digital technologies and training. Pilot projects can be developed in many sectors, including e-government and e-public health.

Developing IT infrastructure and promoting universal access to high-speed internet. This entails investing in infrastructure, mobilizing resources, sustaining political momentum, educating populations in the use of digital tools, and training IT specialists to meet the market's needs. To achieve inclusive usage, governments should provide Internet access free of charge or at a very low cost to low-income groups. It is also important to close the current divide between relatively well-connected cities and rural areas.

Improving human capital and promoting social inclusion

Improving education and health services to exploit demographic advantages. The Maghreb region has the highest Human Development Index, life expectancy, school enrolment, and GNI per capita in Africa.¹⁰ It should build on these achievements to further improve its human capital and turn it into a more dynamic productive asset and an engine for economic and social development. In this context, reforming the education sector, building a vocational training and lifelong learning society, expanding access to high-quality public health care, and streamlining social policies should be the region's key priorities. Below, we focus on the two key components of human capital – education and public health.

The Maghreb enjoys very favorable demographics with an ample supply of young, educated labor. As mentioned above, the Maghreb countries have not yet properly used their abundant pool of human capital. Workforce participation is low while unemployment – especially among young people and women – has remained high for decades. Two key factors underlie this unfortunate situation. Misguided economic policies have constrained growth and job creation. An inappropriate educational model and poor management of the education sector in general led to steady deterioration of quality at the primary, secondary/vocational, and tertiary levels. Similar reasons explain the generally poor quality of health care and other social services, which in some countries [Morocco, Mauritania, and Libya] has produced dismal outcomes.

Improving the Quality of Education for All

Improving education is one of the Maghreb's most important and urgent challenges. Education is the mother of all reforms in North Africa, with the greatest power for transformative development. There is a wealth of empirical evidence showing the essential role of quality education in driving economic growth and social inclusion. Since winning independence in the early 1960s, the Maghreb countries invested massively in education. As a result, except for Mauritania and to a lesser extent Libya, countries in the region succeeded in making primary, vocational, secondary and tertiary education available to most of the population. However, educational quality, which was reasonable over the first two decades of independence, has been deteriorating ever since. The most recent international testing (TIMSS and PISA) attests to low quality even among countries [Tunisia] reputed to have good educational systems.

¹⁰ African Economic Outlook 2016 – Sustainable Cities and Structural Transformations, African Development Bank, 2016, figure 4.5

Maghreb countries participating in these tests ranked in the bottom 10. In the just-published PISA 2015, Algeria and Tunisia scored in the bottom five of 74 participating countries. These measures consistently indicate that Maghreb students have very low achievement levels, with less than 0.7% rated as advanced or high performers. Clearly, the region is not producing consistently well-trained graduates endowed with the knowledge and skills required for good jobs or for life in general.

The key educational issues are institutional and structural.

The consensus among specialists and researchers is that education in the Maghreb suffers above all from (i) very low investment in early childhood education; on average, less than 35% of 5-year-olds in urban areas and next to none in rural areas have been exposed to preschool or early education (3+ years old); (ii) teaching methods emphasize schooling over learning – memorizing, rote learning, and imparting information dominate instead of developing critical thinking, learning skills, and competencies; (iii) low preparedness and professional skills of a large share of teachers at all levels; (iv) weak student assessment and evaluation systems; (v) outdated curricula and instructional materials; (vi) poor governance structures and accountability mechanisms, including insufficient expertise to evaluate policies and formulate corrective measures.

Six strategic shifts are necessary to enhance education outcomes for all.

To achieve the critical objective of quality enhancement, policymakers in the Maghreb countries should rethink their education strategies and initiate major strategic shifts: from quantity to quality, from input to learning results, from traditional rote learning to skills development and critical thinking, from a rigid to an adaptive curriculum, from teachers as school keepers and information providers to learning facilitators and skills developers, and from bureaucratic to result-oriented governance focusing on change at the classroom and school level. Transforming the region's education systems for the better will be hard and take time. These strategic shifts and underlying reforms must be properly designed and executed if the Maghreb countries are to provide their people with the skills and capabilities required by the knowledge-intensive economies of the 21st century. Only with highly educated, adaptive, fast-learning populations will the Maghreb countries have a chance to achieve fast growth while maintaining social stability.

Improving the quality of education requires proven methods.

There is much empirical evidence of countries that failed to reform their education sector because they took the wrong approach. Consequently, the few successful reform experiences provide valuable lessons for policymakers in the Maghreb countries to draw upon. Successful reforms have generally been part of a broader educational strategy that emphasizes accountability. Typically, they enjoy strong and consistent leadership, are well-sequenced and launched at the "right" moment. This difficult chemistry can be achieved as follows.



The strategy should be anchored in a clear and technically sound diagnosis of the educational system's problems, which should be widely disseminated to attract social partners and start building public support. The costs of doing nothing or marginally changing the status quo (as has been the case for years) should be clearly identified, in part by comparisons with other countries (the media is attracted by bad news).

It is important to be specific about the objectives. A clear definition must be provided of what is meant by "quality education." The objective should be expressed in terms of final outcomes and goals, such as quantifiable student achievements. It should be tangible, measurable, reasonable, desirable and feasible. This is necessary to create and engage a "constituency base" in support of reforms.

Education reform must transform the way teachers work in the classroom. Transforming the educational system means convincing teachers to change their practice. Methods must be found to secure the active and constructive participation of teachers and other relevant stakeholders in the design and definition of the reform agenda. The goal is to convince teachers to believe in the reforms and to feel that they are part of the reform process, including sharing in the final success. Key to reform at the school level is the leadership role of school directors. They must be transformed from administrators to strategic leaders of change. They must be supported and provided with the means to introduce change at the school level efficiently.

There should be clear rules for participation. The key is to start with a first draft encompassing a diversity of views and suggestions. The aim should not necessarily be to reach a consensus, which could lead to deadlock and frustration. At the same time, making the rules transparent through published regulations and agreements helps to create good will. Ambitious reforms are built on institutions and official rules, not on individuals and informal arrangements.

Incentives must be provided to motivate participants and reward them in transparent ways.

The success of complex reforms depends on the willingness of political leaders to invest political capital and enlist the support of key actors in the education sector.

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The reform process must be given time to adapt to changing circumstances.

The use of external monitoring and evaluation systems can be a powerful force for change. Evaluation criteria must be well designed [reliable, objective, technically measurable] to provide information on the current status and progress of reforms to the general public.

Regular communication with the public and sector stakeholders can minimize resistance to change and bring everybody on board. Choosing the right place to start also increase the chances for success, by instilling confidence that it is possible to transform a sector that has long remained static.

Prioritize changes that transform schools into results-oriented delivery systems. The focus on schools and classrooms has the greatest potential to improve learning outcomes. It puts teachers and school managers at the center of the reform process and empowers them to lead and sustain the reform momentum, reaping quick wins by rapidly implementing a few important measures they are best positioned to identify. Given the scarcity of resources and the cost of bureaucracies, focusing on the school level helps concentrate effort on actions that will involve and benefit students, teachers and principals. Priorities include teacher standards and qualifications, curriculum reform, evaluation and testing, infrastructure and school management.

Improving teacher qualifications. This is the cornerstone of any educational reform aimed at improving quality. Teachers' initial training will increasingly rely on universities [specialized education schools or teachers' colleges are nonexistent in Maghreb countries] to ensure that revised pedagogical methods are based on research and scientific evidence. Currently, teachers are trained in-house after initial training in subject proficiency at the university level. This has some advantages in terms of exposure to the profession, but also encourages the replication of old methods, which are passed on from one generation of teachers to the next. The reform will consist of policy changes and specific programs to improve the professional skills and status of teachers. This entails focusing on standards and certification, competitive recruitment and promotion, attracting high-caliber graduates to the teaching profession, training to improve methods and enhance professional development, and designing incentive and remuneration policies to improve teacher performance and working conditions. These new standards and certification policies, training, and tutoring would apply to both public and private schools.

Reforming and updating the curriculum. Equipping Maghreb students at all levels for the 21st century requires imparting a set of cognitive and non-cognitive skills. In addition to the basic learning and technical skills traditionally offered by educational systems, fast-changing technologies and labor markets require students to be highly productive, able to communicate clearly, solve complex problems, learn on their own, adapt and innovate in response to new demands, and master the power of new technologies. These new demands require radical curriculum reforms in many countries. Policymakers in the Maghreb countries should embrace this opportunity to modernize the curricula in their educational systems. The new content should be competency-based, with a clear distinction between generic competencies to be taught in all schools, disciplinary competencies that should make up the bulk of the secondary curriculum, and professional competencies in vocational education at all levels.

Curriculum improvements should focus on key knowledge and skills. This includes learning standards or objectives they are expected to meet; courses and lessons that teachers teach; assignments and projects given to students; books, materials, presentations, and readings used in a course; and tests, assignments, and other methods used to evaluate student learning. There is a general belief in most countries that intensive use of information and communication technology (ICT) can transform education systems, both in terms of access and quality. There is no evidence to support the conclusion that ICT has improved the quality of learning outcomes. ICT can accelerate quality improvements if it is part of a wider effort to reform curricula. High-performing countries (in PISA and TIMSS tests) and advanced countries reputed for the quality of their educational systems can offer lessons and guidance on how to reform and update curricula. It is important to note that adopting good learning standards will not in itself improve learning quality. It is simply a mechanism by which policymakers and school leaders can attempt to make improvements.

Systematic evaluation and assessment of student achievements is critical. Maghreb countries have always had their national assessment programs and tests. However, these are different from standardized assessments. National exams are used mainly for selection purposes and thus occur at the end of educational cycles. Their results are not comparable from year to year. Standardized tests are comparable over time and among schools (or school districts). Their main goal is to provide feedback on school performance relative to their peers and national goals. These tests should be given early in a cycle to allow time for remediation. Feedback to schools requires a commitment to making the results public.

Standardize tests and assessments. In the mid-2000s, some countries adhered to international standardized tests (PISA and TIMSS) to benchmark the performance of their education systems against other countries, especially those in the OECD. National tests will need to be revisited, not only to take account of the new curricula, but most importantly to make them more comprehensive and suitable for evaluating the performance of all the components in the education system. In addition to assessing the learning achievements of students, a well-designed evaluation system should provide information to schools, parents and policymakers on the quality of learning and individual progress. Standardized assessment tests will increase the accountability of schools and the entire education system. Likewise, a strong, standardized national assessment system can be used to evaluate the performance of teachers and school managers and hold them accountable for the learning quality of their students. In view of their central role, countries should engage in building reliable and comprehensive national evaluation systems to measure the quality of their education systems and implement timely policy reforms to keep improving educational outcomes.

Upgrading education infrastructure and equipment. Despite tremendous investment efforts over many decades, most schools and universities in the Maghreb countries are poorly equipped. Many primary schools, especially in the rural areas and small towns of Mauritania and, to a lesser extent, Morocco, are overcrowded and run-down. The culprit is the lack of a maintenance culture and poor management of public assets. There is an obvious paradox in a political discourse calling for large investments in ICT and local e-education, when existing curricula are outdated and even minimal physical comforts for students and teachers are unavailable. Each country should implement a national program to repair and upgrade educational infrastructure and equipment at all levels. In many cases, funding is available but implementation is too slow or ineffective. Countries need to recognize that their capacity to implement large investment projects is limited and that central supervision of thousands of small rehabilitation and maintenance projects makes no sense. Countries are advised to build up their implementation capacity at the regional and local levels and develop priority investment programs. This would send a strong signal that education is a national commitment and help build support for reforms that will be resisted by many vested interests.

Enabling school managers and holding them accountable. As mentioned above, the commitment of school managers (directors, headmasters or principals) is crucial to sustain an ambitious reform agenda. Traditionally, in the Maghreb countries, experienced teachers are appointed school managers with no prior training or professional development in management. Yet, they are entrusted with very important and complex governance responsibilities requiring leadership skills and professional qualifications they have acquired. In the context of the proposed reforms, recruitment and professional development policies for school managers are

vital. Appropriate training should be developed and provided as part of a teacher's normal professional development. A performance evaluation system should be applied to school managers, holding them accountable for their schools' results and rewarding good performers.

Expanding early education, especially for low-income children. There is a wealth of empirical evidence that early childhood education is the best investment to prepare for and multiply the chances of better learning outcomes for all students, thus leading to dramatic reductions in school failure. Today, however, the Maghreb countries – except Tunisia and, to a lesser extent, Algeria – have one of the lowest childhood education enrollment rates (about 20%) in the world. This means most children enter basic education poorly prepared. Maghreb policymakers should urgently introduce policies to at least double the rate of childhood enrollment over the next 10 years. The new policies should set regulatory requirements (quality standards, curricula, facility standards, educator qualifications, private sector and NGO participation as service providers, central-local government coordination, social support to children from low-income households) and funding to ensure equal access to early childhood education.

Encouraging private sector participation. Given the low quality of public education, the private sector has evolved from a remedial system (for those who fail) to an alternative in most Maghreb countries. Governments should encourage private education to alleviate the burden on the public sector's limited resources, but also because private schools are usually a source of innovation and often of excellence, as evidenced by secondary and higher education in Morocco and Tunisia. Governments need to consider private education as an integral part of the system, with private schools participating in standard assessment tests and exams. Their teachers and principals will should be professionally certified and receive on-the-job training and mentoring. Participation in standardized tests is an efficient way to address the risk of unequal quality, since parents and students will tend to choose the best-performing schools. To address the risk that high-quality private institutions may cater to the upper class only, scholarships can be provided for deserving but disadvantaged students. Most education ministries already have very strict regulations for private education. While some pedagogical standards (such as teacher certification and core curricula) are needed, they should be flexible enough to leave space for innovative practices.

Providing Quality Health Care and Ensuring Financial Viability of Health Services

Improving access and quality of public health for all. North African countries have invested significantly in developing public health services since the 1970s. According to the UN Economic Commission for Africa, investments in medical insurance, vaccination, access to water and better nutrition have resulted in lower infant and maternal mortality, longer life expectancy and increased labor productivity.

Algeria, Libya, and Tunisia are among the 20 countries recording the biggest jump in the Human Development Index between 1990 and 2012. These countries have adopted cross-sectoral approaches to get increased benefits from health, education, and potable water initiatives at an opportune time of demographic transition. However, health care in the Maghreb countries also suffers from many weaknesses, including inefficient management, deteriorating quality and unsustainable funding in the public health services, low coverage of low-income and unregistered workers, regional disparities in public health coverage and quality, and poor regulation and supervision of private healthcare providers. For example, because of the narrow health insurance coverage [restricted to employees in the formal sector] in countries like Morocco and Mauritania, access to basic health care is very low among the uninsured population. Their out-of-pocket payments for health services are among the highest in the developing countries.

Moreover, recent studies show increasing pathologies in most Maghreb countries. A combination of three factors – rapid socioeconomic development, evolving lifestyles, and demographic changes leading to an increase in the juvenile population and an aging adult population – has given rise to new consumption patterns, new diseases, and new needs. For instance, obesity has emerged as a healthcare issue, driven by changes in consumption and lifestyle brought about by higher incomes. Similarly, as the region ages, pathologies such as cancer, hypertension, and diabetes are becoming more common. HIV/AIDS has also emerged as a key concern [see box 3]. Meanwhile, in Tunisia and to a certain extent in Morocco, health services have the potential to become a major export sector, and could thus contribute to the economic objective of job creation and inclusive growth. In the past decade, private health services in Tunisia have succeeded in attracting significant business from neighboring countries, especially Libya, where public health care has virtually collapsed. Private medical and paramedical services can help leverage the public sector and meet the rising demand for health services. This presents an important opportunity for North African countries to diversify their economies and develop high value-added services.

Restructuring public health systems to address emerging pathologies. Given the disparities among and within countries, it is difficult to suggest specific policy reforms that would apply to all. Rather, we propose a few guiding principles and priorities for each country to consider when designing their national health action plan. In devising strategies for restructuring, the following goals should be kept in mind: good governance and management of public resources, equal access to public health services across regions and socioeconomic groups, sustainable funding, private-public cooperation, and complementarity.

Improve governance and stop deterioration of quality. It is crucial to review current health policies and readjust them to meet new challenges. Key areas of focus should be improving management and governance of public facilities (hospitals) and resources (personnel, equipment, and drugs); setting up and monitoring quality standards and evaluation systems; and ensuring priority is given to preventive health services. On the institutional front, it is recommended to set up an independent health policy council (or agency) to monitor sector performance, assess the relevance of national health policies and propose reforms and corrective measures as needed. The goal is optimal use of public resources and high-quality health services for all. Alternatively, in case there is resistance to creating a new agency, a dedicated, well-staffed policy department could be set up at the health ministry.

Exploring new arrangements to increase public sector productivity. So far, the management of public facilities has been entrusted to experienced physicians or health professionals with little to no managerial experience or education. New management and governance arrangements for public facilities should be considered to address this long-standing, outdated approach. Professional health management firms can be competitively hired to manage public facilities to specific quality standards and operational costs. Alternatively, if contracting out is not an option (due to resistance from employee unions or other vested interests), policymakers should consider implementing a management policy action plan, including: [i] competitive recruitment of qualified managers to run public health facilities according to performance criteria; [ii] developing and implementing standards to regularly assess the performance of each facility and hold its management accountable on an objective basis; [iii] deploying an up-to-date training program to upgrade the management, technical and soft skills of health-sector employees; [iv] streamlining patient procedures and administrative processes through e-health services and an effective IT system covering all hospital activities; [v] setting up an effective internal control mechanism (internal audits) run by competent auditors and subject to external supervision (operational audits of financial, technical and management performance, compliance with quality standards and governance requirements, etc.)

Expanding health coverage across regions and groups. Ensuring that people in remote areas have access to public health services is important in building a more cohesive and equitable society. Expansion of coverage should target low-income groups (through targeted social safety nets), informal sector employees and the self-employed. Private providers, under specific regulations, should be included in health insurance schemes that allow for flexible and gradual enrollment.

Sustainable funding is crucial. Financial constraints and poor management account for the dismal quality of health services in the region, affecting first and foremost the poor.

Adequate cost recovery mechanisms should be put in place for public providers, but only after management performance has improved. This will prevent patients from bearing the cost of organizational inefficiency. Financial mechanisms [vouchers, direct cash transfers, etc.] are needed to help low-income groups.

Promoting private sector participation. Encourage private providers will leverage the public sector's efforts and create an export engine for high value-added services. Most public health facilities are overcrowded, not necessarily due to insufficient capacity, but frequently because of poor organization and very low productivity. The private sector can alleviate the burden on the state budget and leverage public capacity. As part of their economic diversification strategy, some countries [Tunisia] have the potential to export health services. The greatest market potential is to be found the Maghreb region itself, where demand is rapidly increasing. Private providers in Tunisia have attracted growing numbers of patients from Libya and Africa. Finally, as with the education sector, the top priority is to continuously improve professional skills through better education and lifelong learning throughout the entire health sector.

Urbanization and infrastructure: Smart cities that work for development

Fast urbanization offers challenges but also opportunities to accelerate development. Today, urbanization, through economic agglomeration plays a critical role in supporting growth in developing countries. Urban areas contain less than 55% of the world's population but produce 70% of the global GDP. By 2050, 70% of world's population will be living in urban areas and more than 85% of the global GDP will be created there. Thriving cities enjoy stronger economic growth, a better quality of life, and greater creativity. In the next decades, 90% of urban growth will take place in the developing world, posing daunting challenges to provide such services as transportation, sanitation, energy and water supply, waste management, health care, education, and culture. However, if properly managed, urbanization can deliver tremendous economic, social, and environmental benefits due to higher productivity and greater concentration of economic activities.

The Maghreb benefits economically and socially from rapid urbanization. Cities in the Maghreb are among the world's fastest-growing, after the Sub-Saharan African countries. Urbanization rates exceed 67% in Libya, Tunisia, and Algeria and are approaching 60% in Morocco and Mauritania. Growth in the urban population is projected to accelerate in coming years. More than 10 cities of the region will have more than 1 million inhabitants by 2020, and that number will probably double by 2050. The enormous demand created by fast urbanization for many complex services should not be viewed solely as a challenge. This overlooks the unique capacity of cities to mobilize funding, organize social services, and create an institutional and regulatory environment that unleashes private initiative.

Most of all, cities can take full advantage of economic agglomeration [which concentrates skilled labor, innovative talent, research capacity and a wide range of service providers in dense, compact networks] to create economic opportunities for all.

Use decentralization policies to empower cities to lead local economic development. To face the challenges and reap the benefits of fast urbanization, the Maghreb countries should adopt well-tailored decentralization policies and allocate adequate resources for cities to plan and manage urban development. With the notable exception of Morocco, the administrative systems in the region are still highly centralized, with weak and underfunded local governments. Through a territorial reform and regional and local elections held in 2015, Morocco leads the region with a pragmatic decentralization process. It combines a reasonable devolution of powers and service provision to local governments with adequate and transparent funding [local tax revenue is supplemented by formula-based fiscal transfers from the central budget]. Tunisia is following suit with its newly adopted constitution that provides for full-fledged fiscal decentralization and regional de-concentration. This new policy will enable local authorities to lead economic and social development in a coordinated way, with adequate resources. Other countries of the region would do well to follow this path.

Building a business environment to unleash local initiative. Cities in the Maghreb should plan their development to provide high-quality services, often in conjunction with the private sector. Good zoning and infrastructure – including an adequate supply of developed land, social housing, public transportation systems, roads, local and international high-speed bandwidth, utilities, sanitation and social services – will over time reduce the informal arrangements typical of most cities of the region. Such measures would also help eliminate land speculation, protect the environment, attract private investment and create jobs.

Emulate successful peers by embracing the smart cities model. This trend, already noticeable in the Maghreb region, is for now limited to a few large cities. The Moroccan cities of Casablanca and more recently Tangier, with its growing automotive industry, display some signs of becoming growth engines. Algiers, Tunis, and to a lesser extent Sfax also have the potential to become successful economic hubs due to their large consumer base and dense agglomeration of sophisticated services.

Smart cities need capable managers. The powers and capacities of municipal governments need to be enhanced to get results. From fighting pollution to dealing with traffic congestion, improving living conditions, and fostering the right business environment, capable management teams are needed to run city affairs and implement smart urban development. Dedicated city management training programs should be designed and deployed as soon as possible to fill the huge skills gap observed even in the region's large cities.

It is important for governments to initiate and support those efforts through increased funding and twinning programs with more advanced cities inside and outside the region.

First-class city managers, regulatory policies, fiscal decentralization, effective local tax management and fiscal transfer, urban planning and land use management, and effective delivery of public services should become the fundamental pillars of the new Maghreb's urbanization agenda. If properly managed, these reforms offer tremendous development opportunities that can help Maghreb countries address the daunting challenges of job creation, social inclusion, and political stability they have been confronted with for many decades. Over the next 30 years, it is estimated that the total capital stock in urban infrastructure, including social housing, will have to be increased by 50% to meet future demand. This challenge can be turned into an enormous opportunity if the right policies and leadership are put in place.

Infrastructure and logistics

Maghreb governments are aware that infrastructure plays a crucial role in economic growth and job creation. What is needed is to translate this awareness into a commitment to appropriate reform measures to meet the growing demand for infrastructure services and preserve existing stock in good condition. Modernizing and expanding the capacity of the region's infrastructure and logistics services is crucial for economic competitiveness and better living conditions. Except for Mauritania, the Maghreb is endowed with well-developed utility networks (water, energy, and telecommunications), roads, ports, and airports. Large sums have been invested in developing this infrastructure. The household connection rate to the electricity grid is 90% or more; access to potable water and sanitation services is above 70%. The penetration of mobile telephony has reached the level witnessed in industrialized countries. Paved roads represent 60% to 70% of the total road network. While Mauritania is still lagging behind, Morocco has made an enormous effort and caught up with its neighbors over the past two decades. In some respects, the Moroccans have even taken the lead, especially in renewable energy (solar and wind) and large capacity ports.

Maghreb countries do not face the infrastructure access gap seen in other developing countries. Even so, rapid urbanization and structural changes in the economy have generated a strong demand for infrastructure services that most governments in the region are struggling to satisfy. Beside the growing demand, problem areas include inadequate maintenance, unequal regional distribution and access (especially in weaker regions within each country), wasteful use of energy and water, and inefficient logistics and border facilitation (resulting in bottlenecks at ports, airports, and border crossing points). Exclusive of urban infrastructure indicated in the previous section, investment needs in infrastructure and logistics over the next 10 years amount to

roughly 9% of the Maghreb countries' GDP. Maintenance of existing infrastructure accounts for approximately one-third of this total.

Developing public-private partnerships (PPP) to help bridge the maintenance and investment gap. Except for Morocco, PPP schemes have not been implemented in North Africa. While legislation is in place in all countries, governments should develop their own capacity in terms of expertise, regulations, and transparent procedures to attract private investors. In addition, it is recommended to gradually phase out subsidies on water and energy and allow private sector provision of these utilities. Direct cash transfers and other social safety net schemes would be a more effective way of compensating low-income groups for unsubsidized prices. They would also significantly reduce the fiscal burden of subsidies while creating space for more infrastructure investment and maintenance. In planning new infrastructure, governments should factor in the global threat of climate change, which will severely affect all Arab countries. New infrastructure should be more resistant to natural disasters and less damaging to the environment. Investing in renewables, especially in solar energy (where the Maghreb enjoys a significant comparative advantage thanks to its climate and desert terrain), and adopting demand-based water resource management will help the region generate cost-effective clean energy while reducing the water deficit it will soon face. Finally, it is important for the Maghreb countries to build regionally integrated infrastructure networks (power grids, roads, railroads, gas pipelines etc.) to foster economic cooperation among countries of the region.

Technological advances offer new opportunities to optimize infrastructure usage. Maghreb countries are encouraged to adopt and make good use of the new digital technologies. Mobile technologies, fiber optics and satellite systems are already increasing infrastructure efficiency and improving demand management. They can be used to control power grids, meter electricity and water use, monitor road capacity, and manage public transport and logistical chains. This helps reduce infrastructure costs and enhances competitiveness.

Streamlining customs and facilitation. Trade facilitation and logistical performance are poor in most of the Maghreb countries. All are poorly ranked on the global logistics index except for Morocco, which is far from a star performer. Consequently, both the nominal and effective costs of trade handling and processing are high within each country and on their international borders. Facilitation – customs and other administrative clearances at border crossings, including ports and airports – is cumbersome, lengthy, and expensive. Attempts to address this important issue have usually met with bureaucratic obstruction and little success. Building on the experience of successful peers, it is highly recommended that the Maghreb countries adopt a computerized facilitation and clearance system designed to handle trade data and accelerate the clearance process at border crossings. Prior streamlining and simplification of clearance processes will leverage the benefits of automated facilitation.

Liberalizing port handling, freight transport and logistics services (including development of logistics platforms) will go a long way toward improving efficiency and reducing costs, thus enhancing the Maghreb economies' competitiveness.

Accelerating economic integration

The Maghreb countries are not yet economically integrated.

While senior officials and policymakers recognize that economic integration and open trade with the broader world economy can drive growth and job creation, Morocco, Algeria, Tunisia, Mauritania, and Libya trade little with each other. Instead, the Maghreb countries direct their trade relations toward Europe, which absorbs more than 60% of their total trade. Intraregional trade has accounted for less than 2% of their combined GDP and 3% of their total trade over the past decade, one of the lowest such ratios in the world. The low volume of intraregional trade and resulting lack of economic integration contrasts with the political discourse of regional leaders. This reveals the dysfunction of the Arab Union of the Maghreb (AUM) and several free trade agreements concluded among countries of the sub-region (the Tangier agreement), between the sub-region and the rest of the Arab world (GAFTA), and between some countries of the sub-region (Libya, Tunisia, and Morocco). Mauritania is the least integrated state in the Maghreb, while Libya and Tunisia are at the opposite end of the spectrum, exchanging about 30% of their total trade.

Maghreb economic integration is an unfulfilled political dream. Most policymakers and private sector actors consulted in this study still hope to see some progress toward more economic cooperation in the region. They believe that the economic integration of the Maghreb countries has been studied intensively by every regional, bilateral, national and multilateral institution. The impediments to economic cooperation and the solutions to overcome them are well known by every country. All of these studies and our own research concluded that the Maghreb has not made progress toward economic integration over the past three decades due to: (i) persistent political conflicts and competition between the two biggest countries, Morocco and Algeria; (ii) lack of economic diversification and structural transformation, which trapped these economies in low value-added, labor intensive activities such as basic textile and assembly manufacturing (evident in Morocco and Tunisia, the region's most open economies); (iii) heavy reliance on oil resources, especially in Algeria and Libya, leading these countries to put their money in large infrastructure projects or imports of goods and services that cannot be produced by the neighboring economies; and (iv) most importantly, a lack of political will to enforce the many bilateral and regional trade agreements.

Chronic conflicts create an unfavorable climate for integration. Political tensions between Algeria and Morocco – which together represent about 80% of the region's population and two-thirds of its GDP – are a major obstacle to

regional cooperation. These protracted conflicts have paralyzed economic cooperation and cross-border private initiatives. Policymakers' attention has been diverted from local markets, further reinforcing their attachment to their historical trade relationships with Europe and pushing them to focus on new commercial ties with more distant partners in the Middle East and Africa. As a result, the political will to sustain the region's many free trade and economic cooperation agreements has never gone from words to deeds. Consequently, even if import tariffs have been reduced and in many cases eliminated, non-tariff barriers (rules of origin, health, and technical standards) and complex cross-border facilitation have stood in the way of economic integration.

One way to address these political obstacles and pave the way for rapid integration is to accelerate structural transformation and economic diversification. There is ample evidence that trade and cooperation grow faster among economically diversified, fast-growing countries. If the Maghreb countries can climb up the value chain ladder – through structural transformation and institutional reforms – they will not only grow, create jobs, and become more attractive to investors, but they will also diversify and widen their spectrum of tradeable goods and services. They will have a larger basket of intermediary and final goods of medium to high-added value (beyond raw materials and low-added value products) to offer each other and their European partners. This is a much more appealing and practical way to promote integration than the old approach of wishful advocacy and illusory promises of investing billions in infrastructure programs. By diversifying and becoming more productive and competitive, the Maghreb countries would have a better chance to accumulate knowledge and leverage the ongoing digital transformation. This would allow them to leapfrog the traditional model of gradual industrialization, better position themselves in the global value chain, and offer a highly competitive business environment to global and regional investors.

The Maghreb countries currently export a narrow range of products compared with other regional blocs. When energy and natural resources are excluded, the region's few exports are mostly of low added value. While Libya and Algeria export mainly oil and fuels and Mauritania specializes in fisheries, iron ore, and copper, Tunisia and Morocco are the only two countries where manufactured goods (chemicals, machinery, and equipment parts) make up the bulk of exports – 72% and 66%, respectively. Most of these products are destined for Europe and in low demand in other Maghreb countries.

Economic integration in the Maghreb can be complemented by a sectoral approach. Until the political environment becomes conducive to economic integration, countries of the Maghreb should identify and exploit existing win-win opportunities. A good start would be the energy sector, which lends itself to regional cooperation. Multiproduct pipelines¹¹ carrying liquefied petroleum gas, gasoline and diesel could link bottling and distribution

¹¹ Brunel, Claire, and Hufbauer, Gary Clyde: *Maghreb Regional and Global Integration: A Dream to Be Fulfilled*, Peterson Institute for International Economics, 2008.

centers on both sides of the Algeria-Morocco border. This would not only help meet local energy needs, but also diminish extensive fuel smuggling. Similar arrangements could be made in other areas where illicit trade thrives, including Tunisia's borders with Algeria and Libya. In addition to the economic advantages it brings, this type of intra-regional trade would help resolve serious trafficking and security issues and curtail funding to radical groups.

Other sectors can become catalysts for integration. Initiatives in transport, agribusiness, banking and insurance, including closer cooperation between financial institutions, offer opportunities for encouraging regional trade and financing in local currencies. The example of Moroccan banks established in Tunisia is worth replicating in other countries. Logistics, communications, information technology and agribusiness are other promising areas for private sector cross-investments to serve the entire Maghreb market.

Roads offer opportunities for cooperation between Algeria and Morocco. Every study of the regional transportation network has identified important missing road links; Libya and Tunisia are now building highways to ease cost-effective movement of goods and people between the two countries. Investments and reforms in the transportation sector, even if done on a country-priority and piecemeal basis, still contribute to regional integration. Reopening road and rail services¹² between Algeria and Morocco would do much to knit together the region's two biggest economies. Similarly, cooperation in the Information and communications sector, building on the ongoing digital transformation, could tremendously enhance integration of the Maghreb countries.

The power sector is a driver for regional integration. Many interconnection projects have allowed Maghreb countries to hook on to their neighbors' transmission grids. However, these interconnectors' low capacity permits only emergency and peak exchanges. To further integrate the regional grid, several expansions of capacity are planned, including the North Africa-Middle East-Europe Mediterranean Power Pool to connect the power grids of Algeria, Morocco, Tunisia, Libya, Egypt, Spain, and the Middle East. While this ambitious project has yet to materialize, it is worth considering a more gradual approach of connecting countries on a paired basis, as was the case with Tunisia and Algeria or Tunisia and Libya. The above examples show that there are "low cost" opportunities for regional cooperation in a variety of infrastructure sectors. Yet, the performance of these sectors must still be improved through comprehensive reforms, including introducing greater competition, restructuring state-owned utilities, and modernizing the regulatory framework.

Promoting joint investments is another way to boost economic integration. Cross-investments led by the private sector already established in one or two countries can help pave the way for more regional investments and increasing trade. Currently, Tunisian private investors are investing with their counterparts in the Algerian manufacturing sector to

¹² Brunel, Claire, and Hufbauer, Gary Clyde: *Maghreb Regional and Global Integration: A Dream to Be Fulfilled*, Peterson Institute for International Economics, 2008.

meet the needs of both markets. These initiatives should multiply until shared interests among business communities both within and outside the Maghreb region reach critical mass, spurring positive change in political attitudes and policies toward integration.

Maghreb countries would gain by boosting trade. The first step should be to support the development of a few export champions. A recent study¹³ showed that the Maghreb's top 1% exporters are significantly smaller, on average, than those in other regions. MENA countries have not yet succeeded in nurturing a group of export champions that could become models for other companies of the region. A closer look at the composition of global trade¹⁴ shows that MENA in general and the Maghreb could export a larger share of manufactured goods and services. Excluding oil and natural resources, MENA's 400 million people export roughly the same amount as the 8.37 million inhabitants of Switzerland.

Governments should accelerate the trade reform agenda. Reforms applied to intra-regional trade would give a tremendous impetus to the Maghreb's economic integration, into the global economy as well. No such integration can take place without the following measures: [i] simplification of rules of origin, especially for intra-regional trade; [ii] reform of customs and simplification/automatization of cross-border facilitation; [iii] appropriate monetary policies to allow for a competitive real exchange rate to help local firms gain access to new markets; [iv] improving the business environment to facilitate the entry of technology or innovation-driven firms and to attract foreign investors who can help develop export champions; and [v] new industrial policies to promote innovation, diversification, and better use of advanced technologies.

A more voluntarist partnership between Europe and North African countries. Instead of waiting until reforms are implemented and partnership negotiations make progress, the European Union or some of its leading members, such as Germany, could take the lead by entering a results-oriented partnership with one or more Maghreb countries. Its concrete results over a reasonable time would demonstrate the mutual benefits of such partnerships, show what needs to be done next, and encourage policymakers on both sides of the Mediterranean to support a voluntarist approach to economic integration. This innovative approach to the EU-Maghreb economic partnership was initially developed by the Konrad Adenauer-Stiftung [KAS] in a June 2016 policy note [Partnership for Reform with North Africa] by Christian E. Rieck, Gunter Rieck Moncayo and Olaf Wientzek. It advocates three guiding policy principles for a reform partnership between the EU and North Africa to deepen integration and enable self-sustaining growth.

¹³ Freund, Caroline, and Jaud, Méliè: *Champions Wanted – Promoting Exports in the Middle East and North Africa*, World Bank, 2015.

¹⁴ Chauffour, Jean-Pierre: *From Political to Economic Awakening in the Arab World: The Path of Economic Integration*, World Bank, 2012.

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The first principle is to incentivize reforms in North Africa by, for instance, gradually opening the EU's (or a particular member country's) agricultural market or reducing subsidies on certain products. Exports of North African produce to the EU would provide opportunities for growth and jobs, helping reduce the flow of migrants to Europe and increasing capital accumulation and investment locally.

The second recommendation is for the EU to support the membership of all North African states in the World Trade Organisation (WTO), with a long-term aim of integrating these countries into a common European economic area.

Third and most importantly, the EU should help create "development clusters" consisting of "special economic zones that can lead the way in the reforming of economic institutions and standards and in which [the] EU [would] provide particular support for investments through guarantees and other measures"¹⁵.

Political obstacles may slow the push for integration. While the two first suggestions in the KAS policy note are important, they may take years to materialize, if ever. Gradually opening the EU's agricultural markets may succumb to the bloc's cumbersome decision-making process, which requires all member states to agree. The recent halt of negotiations with Morocco testifies to the high sensitivity of the EU farm sector. The second suggestion would require North African countries to be both willing and able to join the WTO quickly. Given the current vogue for protectionism and criticism of globalization, it would require tremendous political courage for North African governments to enter a round of negotiations to enter the WTO with EU support.

Development Clusters (DC) could provide the best platform for growth and stability. However, the third suggestion may hold huge potential. The objective of this approach is to overcome the political impediments and lengthy negotiations of a full-fledged EU-North African integration process, by limiting the application of a full integration agreement (regulating goods, services, capital, etc.) to a few areas. Such a pilot program might yield relevant policy lessons that could later be scaled up and applied to other areas, even on the state level when warranted. This method has the merit of avoiding political resistance on both sides. If the clusters succeed in boosting growth and jobs creation in the North African countries, they could serve as a showcase of the benefits of economic cooperation with the EU. "Through this geographical restriction and due to their 'experimental nature, measures for the integration and networking of these clusters between each other and with the European Union can be implemented, which would not be possible at a state level due to political considerations [or] limited resources," the KAS authors noted. They recommended designating one or two special economic zones in each country (starting with Tunisia, Algeria, and Morocco). The areas should be compact and designed to host a set of complementary economic activities [clusters], including a full range of services

¹⁵ Rieck, Christan E., Moncayo, Gunter Reick, Wientzek, Olaf: Partnership for Reform with North Africa, Konrad Adenauer Stiftung, 2016, p.1.

[training, research and development, marketing support, etc.).

DCs should have a special legal status to attract domestic and European investors. Regulations in the special economic zones should prefigure (and align with) those obtaining in the EU, allowing for free trade between the EU and the DC. “Development clusters are intended to take on an experimental role in relation to external policies between the affected states,” according to the KAS note. Host countries should ensure the clusters are well-serviced and provided with a regulatory framework conducive to domestic and foreign private investors. The necessary infrastructure must be built to connect the development area with utilities, ports, airports, etc. For its part, the EU should create special incentives for its companies to invest in the DCs. These could take a variety of forms, including simple rules of origins, investment guaranties [or creating a subsidiary claim to a European guaranty when direct guaranties don’t exist in some member countries], and financing provided by the European Investment Bank [EIB] or the European Bank for Reconstruction and Development [EBRD]. Support for strategic investment projects in North Africa could also be implemented through the European Fund for Strategic Investments [EFSI].

Exploring the value of Development Clusters. Though special economic zones are not new and have been undertaken in many countries, the concept deserves to be refined, developed and tested in the Maghreb. In terms of refinement, a few important ideas may be considered. Because of the obviously unequal interest in North African countries among EU members, it seems more practical to have one or more “lead countries” on the EU side to promote the concept of DCs there. Germany seems to be best placed to lead this initiative. Its perceived political neutrality in the region, investment experience in the local manufacturing sector [especially in Morocco and Tunisia], well-developed industry, and good reputation for economic performance and labor relations predispose Germany to be a respected and credible model. The idea of developing one or two DCs in each of three North African countries [Algeria, Morocco, and Tunisia, as mentioned above] deserves to be examined. On the one hand, it would be good to test the concept in different institutional environments to acquire regional experience and spur competition. On the other hand, focusing on a single country and only one cluster would yield faster results [in terms of investment, growth, jobs, and exports] and create a showcase for the concept to be rapidly scaled up. Indeed, by concentrating investment in one country and one DC, the required critical mass of investment could be mobilized much more rapidly and if the effort was spread thin over several countries. Time is of the essence when it comes to structural transformation and reforms.

Cluster selection is important. This issue concerns not just the choice of activity or industry, but also of the place on the value chain or technology that is to be promoted.

There is a trade-off between low added value, labor-intensive clusters, and medium-to-high added value activities. The latter will help create the quality jobs that are badly needed to employ the region's many highly educated, unemployed young people. They will also promote intra-regional trade by diversifying the supply of goods and services in demand in North Africa. The final decision on clusters should also consider the strategies of investors, who have a better knowledge of market needs.

A possible way forward. Once a decision is made to develop the DC concept, we recommend [i] sharing the idea with selected North Africa countries [policymakers, development institutions, the private sector and interested social groups] and high-level EU decision-makers, collecting their views, suggestions, and recommendations on possible next steps; [ii] exploring with the EU – especially with Germany and one or two other member states committed to further development in the southern Mediterranean – the possibility of piloting this integration concept in one or two countries; [iii] carrying out a feasibility study of the DC concept to address important policy and practical issues, including private sector concerns on regulations, incentive systems and trade logistics and infrastructure; potential clusters and sectors that could be considered for each country [comparative advantages and market demands over 10-15 years]; institutional arrangements with regard to the development and management of the DC area(s), in particular the opportunity to contract out management to the private sector; potential locations and criteria for site selection; primary evaluation of potential sites; financing needs and sources of financing; and economic, financial and social analysis of the overall project to help decision-makers make a final choice.

Adapting to the threat of climate change

The MENA region is already suffering from the consequences of climate change. Although North Africa contributes little to global emissions of carbon dioxide, their adverse effects are expected to severely impact the economies of the Maghreb. The coasts, where most large cities and economic activities are located, are likely to suffer from rising sea levels, while desertification and changing rainfall patterns threaten the agricultural sector and water resources. More frequent droughts are already being felt in all the Maghreb countries, most recently in Morocco, and extreme temperatures could severely harm local farm production. Heat stress already causes 2,000 fatalities a year in North Africa, and this number is projected to multiply in the decades to come. Pollution is being felt in congested areas, and recent studies suggest that natural disasters resulting from climate change could hamper regional development, disproportionately affecting the poorest. Rural dwellers are particularly at risk. A recent study by the African Development Bank noted that rapid urban demographic growth will inevitably magnify the negative impact on urban ecosystems.¹⁶ To make matters worse, the adverse effects of climate change on agriculture will fuel rural-to-urban migration.

¹⁶ African Economic Outlook 2016 – Sustainable Cities and Structural Transformations, African Development Bank, 2016.

Developing and implementing national climate change strategies. With help from the Global Environment Facility, the Green Climate Fund, the Adaptation Fund, and the Climate Investment Fund, governments in the region should elaborate their own climate change strategies and mobilize funding to implement resilience action plans suited to their countries and aligned with their Intended Nationally Determined Contributions under the UN Framework Convention on Climate Change [UN FCCC]. Efforts to “green” regional economies should be redoubled to protect decades of economic progress. This would entail focusing on water and food security, supporting sustainable and connected cities, encouraging the energy transition to renewables, and protecting the most vulnerable communities from climate-related shocks (as recommended by the World Bank). While mitigation efforts have received the bulk of climate financing, it is increasingly important for the Maghreb countries to invest in adaptation (including climate-smart agricultural practices) to prepare for a future in which climate change’s adverse effects are amplified. Adaptation and mitigation policies should prioritize energy generation and access; transport; buildings, cities, industries and appliances; land use; food, water and health; infrastructure and built environment; and ecosystems and ecosystem services.

The challenge of Water Scarcity

The Maghreb’s fresh water resources per capita are among the lowest in the world and declining. Water resources have decreased by two-thirds during the past 40 years and are expected to fall by another 50% by 2050. In addition, 90% of the region’s land is classified as arid, semi-arid or dry sub-humid, while 45% of the total agricultural area is exposed to salinity, soil nutrient depletion, and wind or water erosion. At the same time, agriculture consumes about 85% of the available fresh water in the region.

Climate change is expected to adversely affect meager water resources. The poorest countries and most vulnerable people, particularly in rural areas, will suffer most. There are now less than 1,000 m³ of renewable water resources per person per year in MENA, compared with 4,500 m³ in the East Asia-Pacific countries and 9,000 m³ in the United States. The region contains two of the most water-stressed countries in the world (Jordan and Yemen). The Maghreb countries are expected to start experiencing a water deficit in the coming decade. Competing demands from agriculture, industry, a growing population and rapidly expanding cities are putting immense pressure on scarce water resources. Climate change is projected to further aggravate the current water deficit. Reduced rainfall and longer droughts will take their toll, and the region will struggle to meet the basic demand for water. This challenge is even more daunting because MENA and the Maghreb depend more on food imports than any other region in the world. This increases their exposure to any global price shocks. For every 2-degree Celsius rise in average temperatures, rainfall in MENA and the Maghreb is projected to decline by 20%-40%. Increasing water scarcity is expected to cut economic growth by a cumulative 6 to 14

percentage points of the GDP through 2050. The impact will vary, with agriculturally-based economies suffering more. Poorer communities with fewer resources will have the hardest time coping.

Drastic policy change is needed to ensure adequate water supplies. In the past decades, the Maghreb countries have responded to scarcity primarily by investing heavily in infrastructure. Water supply coverage has increased remarkably. More than 80% of the population has access to clean water and improved sanitation. Most countries have completed major investments in water storage infrastructure and expanded irrigation systems. Furthermore, most Maghreb countries have started applying nontraditional water technologies such as desalination, wastewater reuse and dripping systems for agriculture irrigation. However, these investments have not always been accompanied by the necessary institutional and policy changes to induce efficiency and change user behavior. Focusing on supply-side policies created incentives for inefficient water use, especially in agriculture. The following recommendations combine supply and demand policies, with special emphasis on the need to use technical and institutional policies to change behavior and encourage more sustainable practices.

Countries should plan for an inevitable transformation in agricultural water use. Population growth and climate change inevitably will reduce the amount of water available to agriculture, which is the main consumer of water in the region. Farmers will either be forced to adapt when their aquifers become depleted or the supply of surface water becomes too unreliable, or the transition can be managed and mitigated to some extent through policies to increase water productivity, introduce modern irrigation methods [drip systems and others], and make better use of unconventional water resources [reuse of improved waste water]. A wide range of actionable measures can be implemented, including: adapting crops and agricultural production to minimize water needs, using efficient irrigation systems, reducing water losses between source and point of use, lining and covering irrigation canals to curb evaporation, timely maintenance of pipelines, pumps and other equipment, and close monitoring of groundwater and aquifers to guard against pollution.

Enhance water resources management by adopting new technologies and best practices. New technologies can help achieve high levels of water efficiency by substantially reducing physical losses, producing desalinated water and re-using improved wastewater. Priority actions include: minimizing water losses in the distribution system [such losses are high in most countries], ensuring effective maintenance of infrastructure in urban and rural areas, expanding sanitation and wastewater collection and treatment facilities, better management of water storage infrastructure [dams and reservoirs], supporting installation of household water conservation devices, and developing the recycling and reuse of drainage water.

Adopt an economic view of water efficiency and governance. Policymakers should take an economic view of water efficiency to manage scarcity. So far, water tariffs have been well below the recovery cost of production and distribution. Low prices and weak collection by public operators lead to overconsumption and enormous waste of resources. In many countries [Australia, Chile, the UK, etc.], pricing tools were used to change consumption behaviors directly, or to induce households, firms, and farmers to invest in water-conserving technologies. Generally, higher prices can help promote a sustainable long-term trajectory of demand that is more sensitive to water availability constraints. It is crucial for the Maghreb countries to gradually increase water prices until they achieve full cost recovery. This will be an unpopular but necessary step to induce culture change and secure the revenue needed to invest in the water savings projects mentioned above. The social implications of the new pricing policy can be properly addressed through social protection mechanisms to shield poor households and small farmers.

Enhanced institutional performance is a prerequisite for efficiency measures. Maghreb countries have made major progress in improving the performance of their water institutions. Yet, there is tremendous scope for further improvement. Great efficiency gains and financial savings can be achieved by expanding public-private partnerships, introducing management contracts where possible, and promoting users' associations, especially in rural areas, to better manage local water resources and promote the use of the water-savings technologies.

Conclusion

This report has focused on identifying the main economic and social challenges faced by the Maghreb countries and putting forward a new development strategy for building prosperous, inclusive, fast-growing and competitive societies.

The Maghreb countries suffer from structural weaknesses setting them behind many middle-income countries.

In Chapter 1, a review of past development performance benchmarked the Maghreb countries against other economies on a similar level of income and development two to three decades ago, but which have since then followed a more successful economic, political, and social trajectory.

Several structural weaknesses were identified. First, it is notable there has been essentially no catch-up with the developed economies since the early 1990s – contrary to what we have seen, for example, in Central and Eastern Europe. Compared with peers at a similar stage of economic development in 1990 – what the report calls the benchmark countries of Panama, Peru, Poland, and Romania – we see also that the Maghreb region has significantly underperformed in terms of economic growth, especially per capita. The Maghreb countries' per capita GDP growth lagged behind most of the benchmark countries by more than 3 percentage points per year over the 1990s and 2000s. The most notable structural weakness of the Maghreb economies is their labor market, characterized by problems of social inclusion, very high youth unemployment, and serious gender and regional inequalities.

To investigate possible futures for the Maghreb economies, three development scenarios were analyzed. Chapter 2 presented these alternative scenarios, exploring possible economic trajectories for the region and individual countries.

The key differentiating factors between these scenarios are governments' willingness and capacity to implement political and economic reforms, and the geopolitical conditions and intensity of conflicts in the Arab region. There is ample evidence that regional conflicts had slowed development by increasing the perceived risks for investors and discouraging reforms that might even temporarily disrupt political and social stability. These scenarios are not forecasts, but rather a simulation of possible growth paths based on different assumptions, with the implementation of reforms as the key variable.

A *Muddling Through* scenario assumes no significant policy changes and a continuation of the slow pace of reforms witnessed in the past two decades. Moderate growth rates accompany this scenario, with GDP per capita roughly doubling over the period [2016-2040].

A *Stagnation* scenario extrapolates the economic performance of the past six years [2011-2016].

Given ongoing social tensions, political instability, and very fluid geopolitics following the Arab uprisings of 2011, this scenario is associated with no productivity growth, a marginal increase in employment-to-population ratios, low levels of private investment, and no structural transformation. Under these circumstances, GDP per capita in 2016 increases by a meager 20%-40%, depending on the individual country. This scenario, like the *Muddling Through* one, highlights the dire social and political consequences of poor or even mediocre economic performance over several decades.

Not only would political and social stability throughout the region be seriously threatened by masses of unemployed young people, but illegal emigration flows to Europe would grow dramatically. This would involve huge economic and political costs to the Maghreb countries' European partners.

The third, *Reforms* scenario, assumes that once the turmoil generated by the Arab Spring uprisings and misguided external interventions recedes, the Maghreb countries – supported by their European partners – realize the survival and stability of their countries depends on fiscal and structural reforms. The reform agenda should be comprehensive, ranging from setting a new social contract that redefines the role of the states, to improving governance, reforming the public sector, developing the private sector, and enhancing the quality of human capital through education and social services. Growth rates in each country are assumed to approach, and in some instances exceed, their historical highs as a growing work force finds employment and (in the case of skilled workers and university graduates) quality jobs. Employment-to-population ratios rise sharply, while growth in total factor productivity [TFP] and capital formation reaches levels observed in some of the Eastern European and Latin American benchmark countries.

Structural transformation in the Maghreb economies would gradually deepen and high value-added activities multiply, supplanting the prevailing low technology, low value-added industries.

Under this scenario and its implicit broad reform agenda, GDP per capita more than triples by 2040, the unemployment rate halves, and poverty declines to an all-time low in all countries of the region. The scenario analysis shows that economic and social reforms have the potential to dramatically increase incomes, lifting the Maghreb economies out of the low and non-inclusive growth trap they have been stuck in for decades.

The reform agenda underpinning this optimistic scenario is outlined in detail in Chapter 3. This chapter recalls the key challenges the Maghreb countries have been facing for at least the past two decades, which have been exacerbated by the recent Arab Spring uprisings. These challenges include: below-potential economic growth; high unemployment, especially for women and youth; an underdeveloped private sector; burdensome and complicated regulations; an interventionist state; ineffective institutions and bureaucracies; and poor regional integration, to name just a few. The bulk of Chapter 3 examines key reforms the Maghreb countries should undertake to achieve inclusive fast growth and build productive societies.

Policy recommendations are anchored into a proposed new development strategy. Its aim is to fundamentally change the social contracts of these countries. It is proposed that each Maghreb country establish a new social contract to (i) transform the state from an interventionist, ineffective and unaccountable entity into a development facilitator that is efficient, transparent and accountable; (ii) create a regulatory environment conducive to private entrepreneurship, risk-taking, innovation, and competition to replace the prevailing cronyism and rent-seeking; and (iii) unleash popular energy and creativity by initiating a behavioral shift from disempowered, state-reliant societies to a free, knowledge-based, productive citizenry. The new social contracts can be designed in a participatory process bringing together states (governments), civil societies and the private sector to debate the new role of the state and key stakeholders.

In the context of these new social contracts, the Maghreb states will have to propose and implement a wide-ranging reform agenda to deliver on their contractual commitments to the people to foster prosperity, inclusiveness, social justice and freedom. The reform agenda, detailed in the Chapter 3, encompasses the following tasks:

- Redefine the state's role to focus on setting development strategies and implementing policies that ensure security, protect the environment and natural resources, promote private initiative, enhance human capital, and build more inclusive societies.

- Adopt disciplined budget rules and maintain stable fiscal frameworks. Fiscal stability is necessary (though not sufficient) to generate high growth and jobs, especially for young people.
- Reform governance to address crippling bureaucratic inefficiencies and build a service-oriented, entrepreneurial public sector whose key objective is to provide quality public services and help people achieve their own economic, social, and cultural objectives within the laws and regulations. Recruiting and retaining new talent by merit-based promotion, training programs, and draconian simplification of administrative procedures are among the priority changes to undertake.
- Support the private sector to encourage domestic and foreign investment, improve productivity, and create jobs. Key reforms should focus on improving the business environment through better law enforcement, easier access to finance, fewer bureaucratic hurdles, and reformed labor codes.
- Develop and implement national strategies for the digital revolution. These strategies should focus on improving quality education and training in information technology (IT), promoting e-government and online public services such as e-health, and support to start-ups in the IT sector as well to manufacturing and service industries that lend themselves to partial or full automation.
- Build quality human capital through reform of the education and health services. This will allow the Maghreb to take full advantage of the region's demographic dividend, turning it into a productive force and a strong engine for economic and social development. The reform should concentrate on improving the quality of education and vocational training, expanding access to high-quality public health care, and streamlining social policies.
- Promote decentralization and empower cities to lead local economic development. In view of the Maghreb's rapid urbanization, governments are advised to adopt well-tailored decentralization policies and allocate adequate resources for cities to plan and manage their development. Cities are more productive and more attractive for investors if they are well-planned, well-managed, and well-resourced to provide high-quality urban services and a competitive business environment.
- Enhance infrastructure and logistics services. The combination of growing demand and insufficient maintenance require the Maghreb countries to dedicate more attention, money and management resources to infrastructure. Partnering with private sector could ease the strain on capacity and funding, both in short supply in most countries of the region. Promoting trade will require major improvements in logistics services and border facilitation. This can be achieved by streamlining and simplifying clearance processes, liberalizing port services, and promoting private logistics platforms.

- Promote trade, especially among the Maghreb countries and with the European Union. More determined trade integration should be pursued by a two-pronged strategy. Within the region, the Maghreb countries should honor existing trade agreements, invest in regional infrastructure, and encourage cross-border investments by the private sector. Trade with the EU can be expanded through a voluntarist approach to partnership and integration. As initially proposed by the Konrad-Adenauer-Stiftung, voluntary policies would include the gradual opening of the EU's internal market to farm products from the Maghreb; support for the Maghreb states joining the WTO with the long-term aim of integrating these countries into a common European economic space; and most importantly, promoting "development clusters" subject to EU regulations. The EU or its lead members would provide leadership and financial support for the development of these clusters.

- Design and implementing national climate change strategies. In view of the expected adverse impact of climate change on the region and especially coastal cities, governments should elaborate their climate change [CC] strategies and mobilize adequate funding [Green Fund, CC Fund, etc.] to implement resilience and adaptation plans suited to their countries and aligned with the global development objectives.

- Develop and implement a new strategy for managing water resources. The Maghreb is among the most water-stressed regions in the world. Climate change, demographic growth, and economic needs, especially those of agriculture, will further exacerbate water scarcity. Shortages may become more frequent than in the past. A new water management strategy should focus more on demand and less on the supply side, which has been the only priority of the Maghreb countries over the past 40 years. In the future, priority should be given to reducing water losses in the distribution systems, pricing water provision on an economic basis (recovering costs in full while directly compensating deserving groups), investing in and deploying new technologies for water use in agriculture, encouraging use of unconventional water resources (e.g. reuse of improved waste water), and promoting applied research to help identify new crops and products that minimize use of water.

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