

Focus on Economics

No. 95, 9th June 2015

North African countries face common economic challenges

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Morocco, Algeria, Tunisia, Libya and Egypt have recently undergone unprecedented political and economic change. The Arab Spring has triggered fundamental upheavals, the further course and results of which are uncertain. The political transition also has economic consequences which, together with a variety of previously existing internal economic problems, pose extreme challenges for these countries. External factors, such as the drop in oil price, add pressure to the current situation. Nevertheless, it also offers some opportunities. If the countries of North Africa improve their economic situation, that will also contribute substantially to their political stabilisation.

The political standstill ended suddenly and unexpectedly

The Arab Spring began in the middle of winter. In December 2010, a Tunisian fruit vendor fatally set himself alight out of desperation and in protest against police harassment. The event triggered widespread demonstrations against the Tunisian government all across the country and spilled over to various North African states and the Middle East in the months that followed.

The repercussions varied widely in the five countries. In **Morocco**, King Mohammed VI promised political reforms. A constitutional amendment confirmed by a referendum curtailed the rights of the King and strengthened democratic principles. In November 2011, early elections brought a change of government. Thus Morocco was able to initiate a largely peaceful social reform that has come to be referred to as a

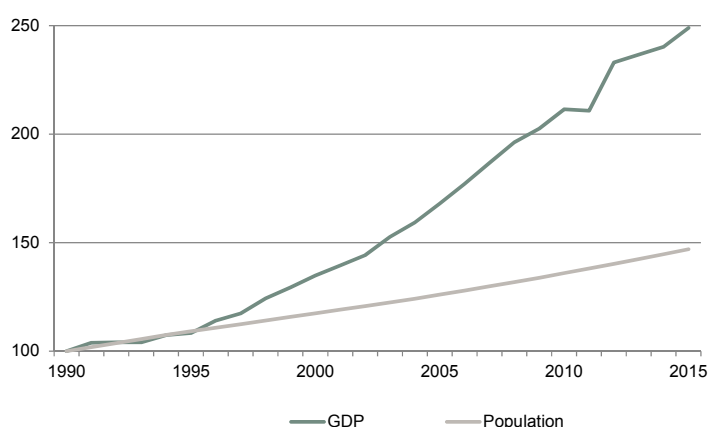
Moderate Revolution. In **Algeria**, the government quickly met one of the demonstrators' key demands by lifting the 19-year-old state of emergency and reforming legislation on political parties and elections, among other measures. Furthermore, President Bouteflika, through a mix of brutal crackdowns (arrests) and financial concessions (subsidies, public sector salaries), managed to hold on to power, so no fundamental political upheaval took place. In **Tunisia**, mass protests led to the deposition and flight of President Ben Ali and to an election for a constituent assembly. In 2014, a new constitution came into effect that is regarded as one of the most modern of the Arab world. Tunisia's democratic transformation is considered successful so far. In **Libya**, the unrest escalated in 2011 into a civil war in which NATO also intervened. Head of state Gaddafi was ousted and killed. Parliamentary elections in 2012 and 2014 failed to bring stability. A new civil war using Gaddafi's

large weapons arsenals has been raging since the summer of 2014. Two factions currently claim to be in power and the terror organisation IS has also made a stronger appearance recently. In **Egypt**, the protests in early 2011 led to the resignation and arrest of President Mubarak. After the subsequent turbulent phase with parliamentary and two presidential elections, as well as a military overthrow, Egypt is now in an unstable transitional phase. The perceived risk is that a similarly repressive system will take hold under President Al-Sisi as in the Mubarak era.

Commonalities between these so diverse countries

The five North African countries are diverse not only politically but also economically (oil exporters vs. importers etc). Nevertheless, they also share major economic characteristics. Among them are the significance of the private sector and items such as the national budget, balance of payments and inflation, as well as demographics and the labour market. The following analysis demonstrates that, unfortunately, these are not common strengths but problems and misguided developments. Without a doubt, they significantly contributed to the dissatisfaction of the population and

Figure 1: Development of real GDP and population in North Africa (Index 1990 = 100)



Source: IMF, United Nations, own calculation

social tensions which subsequently erupted in the Arabellion.

First, it has to be pointed out that the economic data for the five North African countries are not completely reliable, particularly with regard to the labour market and the situation in Libya. Nevertheless, for the purpose of this paper it is sufficient to focus on the longer-term development trajectories and the magnitude of individual indicators.¹

Economic growth: not bad in the longer term, but still unsatisfactory

The cumulative real GDP of the five North African countries has grown quite steadily by around 150% since 1990 (see Figure 1). Although this is not a top result (Developing Asia grew much more strongly, by 530%), it is better than the global average (global GDP +140%) and significantly better than the Advanced Economies (+70%). However, the growth of the North African population of around 50% during the same period puts the region's economic growth significantly into perspective (see Figure 1).

The current state of the North African countries' economies is, of course, largely determined by the political situation outlined above. This is particularly true of the civil war-torn country Libya, for which we will nevertheless include below the macro-data estimated by the IMF. In general terms, it appears to be appropriate to distinguish between oil exporters (Algeria and Libya) and oil importers (Egypt², Morocco and Tunisia).

The oil exporters are suffering from the oil price decline which began in mid-2014 and for which the IMF is forecasting only a slight increase in the years ahead. Algeria's growth, however, is likely to drop significantly in 2015 (to just 2.5%) and rise again to 3–4% p.a. from 2016, according to the IMF. The low oil price is placing a strain on the national budget – the fiscal break-even oil price (defined as the price that enables a balanced budget) in the oil exporting countries is now considerably higher than the current market price, meaning the national budgets are slipping into deficit.

Similarly, for the North African oil importing countries, the oil price is currently a positive factor (terms of trade benefit). In

2015, they expect to achieve higher GDP growth than in the past years. The economic situation in Europe and the exchange rate are other important determinants for oil importers. The euro area is a significant export market for Morocco and Tunisia in particular, so after suffering from the many years of economic weakness there, they are now hoping for a sustainable recovery. The depreciation of the euro against the US dollar is effectively lifting the Egyptian pound in real terms, causing problems for the Egyptian export industry. Overall, the economies of the oil importing countries have strengthened somewhat again after the very difficult years 2011/12 and their growth rates are likely to hover around 4 to 5% p.a. in the near future.

Problem areas: low share of private sector, national budget and balance of payments, in part also inflation

With respect to these important macroeconomic indicators, the commonality between the countries of North Africa is that each of them is in a worse position than comparable countries, as illustrated by Figure 2 and the following explanation.³

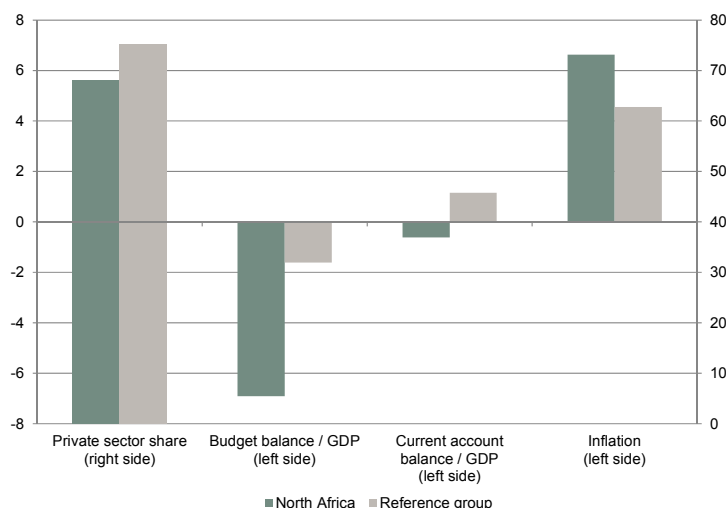
A particularly striking characteristic of the North African countries is the comparatively strong economic dominance of the state. The **share of the private sector in macroeconomic investment** is lower in North Africa than in comparable developing countries. It is true that the cor-

responding data are particularly unreliable, so that the values presented in Figure 2 permit only a rough orientation. Nevertheless, this finding is consistent with the findings of the World Bank⁴, in particular that in North Africa governments allow the private sector comparatively little scope to develop. Private investors are often discriminated when they compete with state-owned companies and with "politically connected firms". This applies particularly to access to credit but also to land acquisition, operating permits and energy supply. According to the World Bank, these observations, which are of concern from a regulatory point of view, apply not only to the period before 2011 but by and large to the present as well. The rather low positions of the North African countries on the Doing Business Index and the Corruption Perception Index confirm this.⁵

With regard to the **national budgets**, in a longer-term analysis the rule in the North African countries has actually been that the oil importers were in deficit while the exporters were in surplus. As mentioned, the latter also entered a deficit recently as a result of the oil price decline. The average budget deficit in North Africa is considerably higher than in other developing and emerging countries. One of the reasons is that the North African governments subsidise energy consumption at significantly higher rates than elsewhere. This is done both

Figure 2: Economic indicators: North Africa in comparison (average 2010–2013/14 in per cent)

See detailed description in Footnote 3.



Source: IMF, World Bank, own calculation

through transfer payments and by exempting energy from taxation. As recently as in 2011, energy subsidies in Egypt, for example, were a very high 66% of state revenue (in the other four countries between 13 and 35%). This policy is questionable, among other things because it is not so much the poor who benefit from it but primarily those who are better off, which is contrary to the official aim. On the positive side, Egypt, Morocco and Tunisia have used the recent oil price decline to reduce these subsidies. However, fiscal reform remains a very important topic on the economic-policy agenda of all five countries.

The cumulative **current account deficit** of the North African countries has continuously deteriorated since 2010 and has been negative on balance since 2013. In stark contrast with this, the overall group of developing and emerging countries has even generated a small surplus on average. At present, the current account deficit of the oil exporter Algeria is particularly noteworthy (as well as Libya, reportedly), a reflection of the oil price decline. The balance of payments situation in the oil importing countries is far from extremely critical (least of all in Egypt). Nevertheless, two aspects need to be kept in mind. First, the current account balance comprises not only the movement of goods – the balance of trade of all oil importing countries is in deficit – it also includes the movement of services. For Egypt, Morocco and

Tunisia this means the important tourism sector, which is particularly sensitive to violence and internal unrest. Second, current account deficits in the order of 9% of GDP (Tunisia in the years 2012 to 2014) make a country dependent on volatile capital inflows. Whether they enter a country when it is in a fragile political and economic situation that has reduced its attractiveness for foreign direct investors and earned it a lower rating on the international capital markets is far from certain.

In the past years, the average annual **inflation rate** in North Africa was 6 to 7%. It has been quite low in Morocco but at times reached a double-digit level in Egypt. The decline in oil price provided less relief on the price front than one would expect because in many areas the administrated prices were not lowered; instead, governments seized the opportunity to reduce energy price subsidies (see above). Currency devaluations and an expansionary monetary policy drove up inflation, which in North Africa is higher on average than in other comparable countries. A depreciation of the magnitude shown is detrimental as it impacts negatively on investment activity, among other things, and exacerbates disparities in the distribution of wealth. The main victims of inflation in North Africa (at present, particularly in Egypt) are the poor groups of the population as they have insufficient market power to protect themselves against rising prices

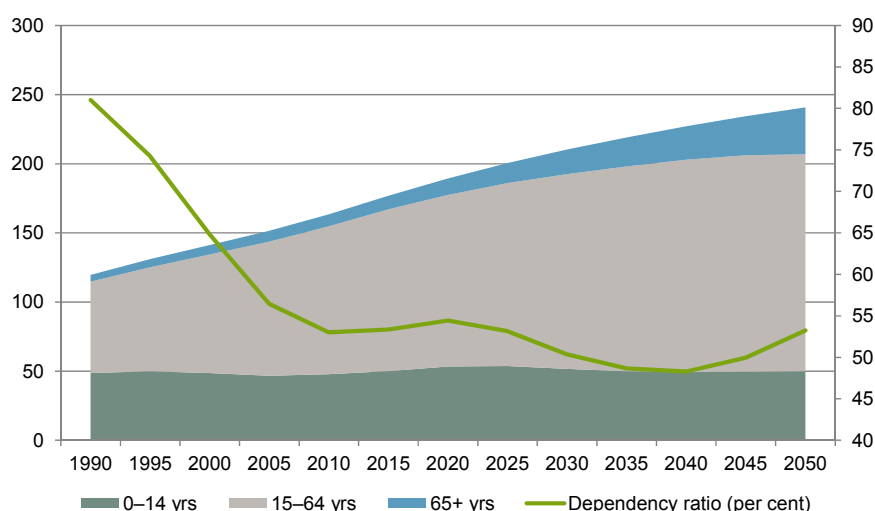
of goods, for example through wage increases.

Demographics and labour market

Demographic development and the labour market are extremely important determinants for understanding the current economic and political situation and assessing North Africa's future prospects. The high population growth since 1990 has already been mentioned. By the year 2050, the population will double from 120 million to 241 million people compared with 1990 (UN estimate). The population of the five North African countries is thus growing considerably faster than the global population. Figure 3 shows further important demographic trends. In 1990, the five countries had a very young population. These young people are now entering the job market and the share of older people (aged 65 and over) is still low but growing continuously. Demographers describe this situation with what is known as the dependency ratio, defined as the cumulative percentage of young and old people in relation to the number of available workers (aged 15 to 64 years). Where the dependency ratio is low, a high number of goods and services can be produced to meet current needs while money can be saved and invested, thus increasing the capital stock, which expands the possibilities for future production and consumption. This constellation is referred to as "demographic bonus". However, unless the employable workers can actually be employed productively, this bonus does not translate into a "demographic dividend". If a country fails to make good use of the favourable time window of a declining dependency ratio, it will be ill-prepared for the phase when the society starts ageing. In the five North African countries, the decline in the dependency ratio is likely to continue until around 2035–40 (see Figure 3), after which time the ratio will rise again due to the increasing ageing of the population.

The labour market figures⁶ illustrate that the five countries are not doing enough to translate their demographic bonus into a demographic dividend. The official unemployment rate is 11.6% on average. Although the relevant statistics are of limited reliability,⁷ a comparison with the

Figure 3: Population in North Africa 1990-2050: age structure (in millions, left side) and dependency ratio (in per cent, right side)



Source: United Nations

average value of all developing countries (5.5%) highlights the magnitude of the problem. The employment situation of young people is particularly precarious, with youth unemployment at a very high level of 30%. The problem is further exacerbated by the inadequate labour participation rate (people of working age who are economically active), which stands at 51% on average in the five countries. This is significantly less than the 67% average of all developing countries, a rate that is even outperformed by East Asia's high 75%. The cause of the low labour participation rate in North Africa is the extremely low share of women (24% compared with 52% in all developing countries and 67% in East Asia). These figures show that the five countries are far from realising their labour force potential.

Finally, the skills mismatch is another unsatisfactory characteristic of North Africa that is currently being discussed. A very large number of people with tertiary qualifications work for the government where they are overqualified for

their positions and poorly paid. Without a doubt, this is related to the dominant status of the state sector mentioned above. At the same time, however, many jobs are performed by underqualified workers who fail to meet the job requirements, compromising businesses in their productivity and reducing their competitiveness.

These labour market problems are an important cause of the tense social and political situation in North Africa and thus indispensable for understanding the Arab Spring.

Regional cooperation and support from the EU

At political and economic level, the countries are cooperating with each other in the framework of the African Union, the Arab Maghreb Union and the Arab League. However, some of the relations are strained, for example between Morocco and Algeria because of the conflict over Western Sahara, and in connection with the significant flow of refugees from Libya. With the exception of

Libya, the countries entered into association agreements with the EU in the 1990s and have supplemented them with further agreements since 2011. The EU largely allows free trade with them and finances development projects. The "European Neighbourhood Policy", which also extends to Libya, is currently being reviewed and will be modified at the end of 2015 if appropriate. German bilateral development policy supports the region under a special initiative.

Conclusion

Political stabilisation and democratisation in North Africa in any case will (naturally) depend on general policy reform but to a great extent on improving the economic situation as well. This discussion paper identified common economic problem areas which are also starting points for remedial action. The countries are receiving support from outside but they hold the most important key to improving their future prospects in their own hands.

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¹ The economic data presented here were sourced from reputable international institutions, such as the IMF or UN, but obviously they provide only a limited description of the economic reality. The political upheavals in North Africa have also weakened the efficiency of local statistics agencies. Besides, the massive recent flows of refugees and the return of labour migrants cannot be identified with statistical precision, nor can their economic impacts thus be measured. These limitations apply less to the years prior to 2011, although the data are only partially reliable for that period as well.

² Egypt's goods exports consist one third of crude oil. At the same time, however, the country is importing oil and has been a net oil importer since 2011.

³ In this analysis, average values of the North African countries were compared with those of a reference group of countries. The average values apply to the period of 2010–2013/14 and are GDP-weighted. The lack of reliable data made it necessary in part to work with estimates. The reference group of countries was composed, as far as possible, of middle income countries (MICs) according to the World Bank classification, which also include the five North African countries. Some compromises were necessary here as well, such as alternatively using the sub-group of lower MICs or all developing and emerging countries where data on MICs were lacking. No data are available for North Africa on the private sector's share of GDP (unlike, for example, for the countries of Central Asia, for which the EBRD has determined the corresponding values). For this reason we used the share of the private sector in annual gross fixed capital formation as an alternative.

⁴ Schiffbauer, M. et al.: Jobs or Privileges: Unleashing the Employment Potential of the Middle East and North Africa. World Bank Report No. 88879-MNA, Washington DC 2014.

⁵ While Tunisia and Morocco are still reasonably mid-field for these governance indicators, Egypt, Algeria and Libya in particular obtained poor to extremely poor rankings.

⁶ The labour market figures indicated here are based on International Labour Organization statistics. The average values given are GDP-weighted and apply to the period of 2010–2013.

⁷ Capturing employment relationships in these countries is difficult. Besides, there is little incentive for people to register as unemployed because unemployment support is low.