

# Global Value Chains Diagnostic

## The Southern and Eastern Mediterranean region (Egypt, Jordan, Morocco and Tunisia)<sup>1</sup>

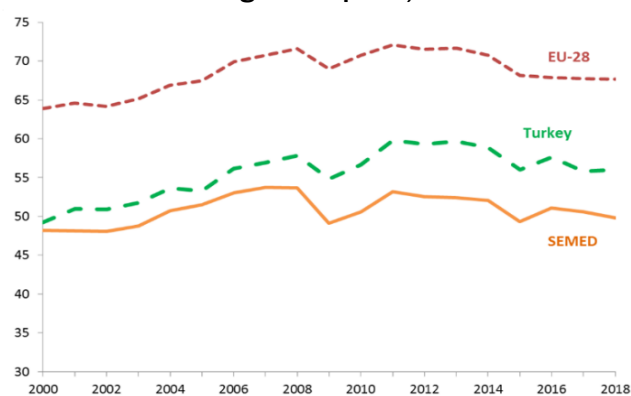
- The level of global value chain integration of the region is low, with 50 per cent of SEMED's exports having some value chain linkages
- Morocco, Tunisia, Jordan and Egypt are found to have comparative advantage in horticulture, chemical, manufactured and textile products
- Global value chains offer unexploited opportunities for the four countries to accelerate export and income growth
- The countries have potential to improve the overall business and economic environment in order to attract foreign investors, enhance participation in global value chains and support upgrading along GVCs

### Mapping the integration in GVCs

Since the mid-1990s, the inter-connectedness of the global economy has accelerated, through ever more complex trade relations and global value chains throughout the production and distribution process.

The level of integration into global value chains (GVCs) of the Southern and Eastern Mediterranean (SEMED) region is rather low and significantly below the EU-28 and comparator Turkey (Chart 1). GVC integration has also stalled in recent years similarly to the global trend.<sup>2</sup> Around half of SEMED's exports have value chain linkages (forward and backward linkages in exports).<sup>3</sup>

Chart 1: GVC participation (as per cent of total gross exports)



Sources: UNCTAD-EORA (2019), EBRD and authors' calculations

On aggregate, the region's integration has moved upstream in the last 20 years, i.e. the region is now selling relatively more production inputs to other countries than buying from them for their own production of exports.

<sup>1</sup> This note was produced by Olivia Riera from SEP/EPG and Philipp Paetzold from OCE. The analysis was supported by the [Value Chain Competitiveness Programme](#), implemented by the European Bank for Reconstruction and Development and financed by the European Union. The views expressed in this note are those of the authors only and not necessarily those of the EBRD or the EU.

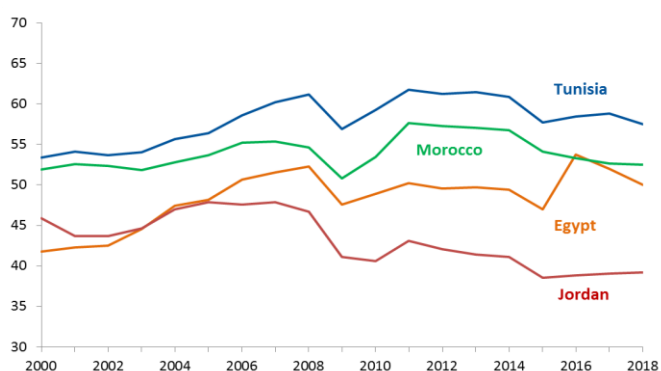
<sup>2</sup> Global value chain integration is the sum of foreign value added (FVA) & domestic value added embodied in 3<sup>rd</sup> countries' exports (DVX). The residual part of exports value consists of domestic value added with no GVC linkages.

<sup>3</sup> Forward linkages in GVCs are raw materials and intermediate goods used in other countries export production, whereas backward linkages are imported inputs used for domestic production of exports.

GVC integration differs within the region (ADD LINK [GVC country diagnostic – Egypt](#); [GVC country diagnostic – Jordan](#); [GVC country diagnostic – Morocco](#); [GVC country diagnostic - Tunisia](#)).

In relative terms, Tunisia is the most integrated and Jordan the least integrated country. Egypt’s GVC integration increased from 42 to 50 per cent between 2000 and 2018 (Chart 2). In absolute terms, Tunisia had the highest GVC exports per worker amounting to US\$ 1,800 in 2018, whereas Egypt had only US\$ 400 of GVC exports per worker. In between are Jordan and Morocco with around US\$ 1,000 of GVC exports per worker.

**Chart 2: GVC participation SEMED countries (as per cent of total gross exports)**



Source: UNCTAD-EORA (2019), EBRD and authors’ calculations

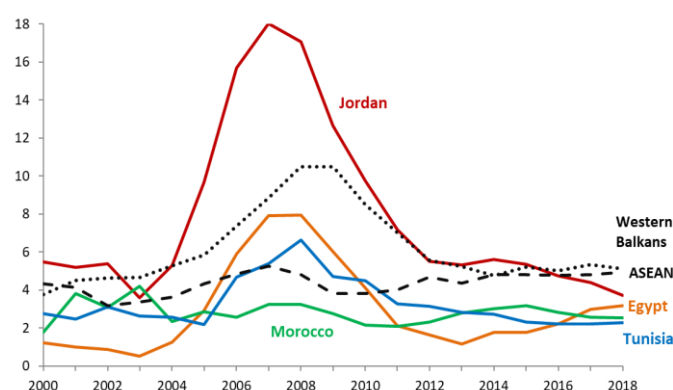
## Drivers of GVC participation

GVC participation is multifaceted and diverse across countries. Structural factors such as the wealth of natural resources, the size of the domestic economy and being part of large free trade zones such as the EU are important determinants of GVC integration and the type of linkages (backward and forward linkages). There are also drivers of GVC participation that have shown to improve and promote global value chain integration. Most commonly emphasized drivers of GVC participation in the literature and surveys are (1) Foreign Direct Investment (FDI) and trade policy, (2) logistics, (3) access to finance, (4) skilled labour force and production standards, and (5) regulatory and business environment.

## FDI and trade policy

The SEMED region received high levels of FDI inflows in the 2000s with Jordan being the largest recipient. These FDI inflows have accompanied the strong GVC integration of the countries during this period. Still, other emerging markets experienced stronger FDI inflows to GDP than the SEMED region in recent years (Chart 3). Particularly high FDI regulatory barriers are found among SEMED countries compared to the average of OECD countries, with restrictions in FDI in services such as distribution, wholesale, transport and professional services, being the highest.

**Chart 3: FDI inflows (% of GDP, 3y moving average)**



Source: UNCTAD-EORA (2019), EBRD and authors’ calculations

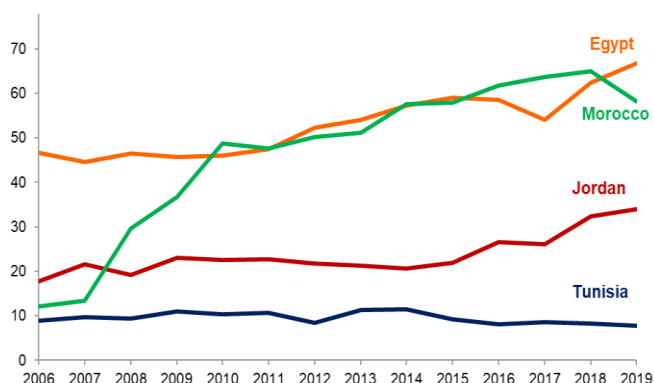
The overall trade environment among SEMED economies is still cumbersome. Despite liberalisation of tariff rates in the last decade, applied tariffs on manufactured products are still among the highest in the world and non-tariff barriers are commonly found in all four countries. Countries in the region are signatories of numerous trade agreements and have all preferential access to the large EU market and for Jordan and Morocco even to the U.S., but they are often shallow, not covering investment, standards and intellectual property rights (exception of FTA between Morocco and the US, which is quite comprehensive). Free trade agreement focusing solely on duty free access to markets can foster trade in final goods, but are often insufficient to promote trade in value chains that relies to a great extent on foreign investments, harmonisation of standards and protection of intellectual property rights.

All four countries are also in need of trade facilitation improvements, as firms report customs and trade regulations as major obstacles, in particular in Egypt and Jordan. Consequently, only a small share of firms show trade linkages with only the most productive firms being able to export. While both the intensive and extensive trade margins have improved in the four countries in the last decade, they all present significant scope to increase their exports, by exporting more of their existing products to new markets and by exporting more products.

### Logistics

Given the difficulties in road transportation and the high cost of air freight, maritime transport is crucial for the four economies. In particular, Tunisia is in need of port infrastructure improvements, since its container port traffic has not been rising since 2008. Contrary, Morocco has multiplied by five its container port traffic between 2008 and 2017 due to major improvements of its port infrastructure capacities. Egypt also exhibits high shipping connectivity, which was further strengthened in the last two years with the construction of the second Suez Canal line. Jordan rather faces a dilemma in terms of logistics, since road transportation remains difficult due to ongoing regional conflicts and the country only having access to the Red Sea via the port of Aqaba. However, shipping connectivity has slightly improved due to improvements in port infrastructure in recent years (Chart 4).

**Chart 4: Linear Shipping Connectivity Index (2006=100, Maximum)**

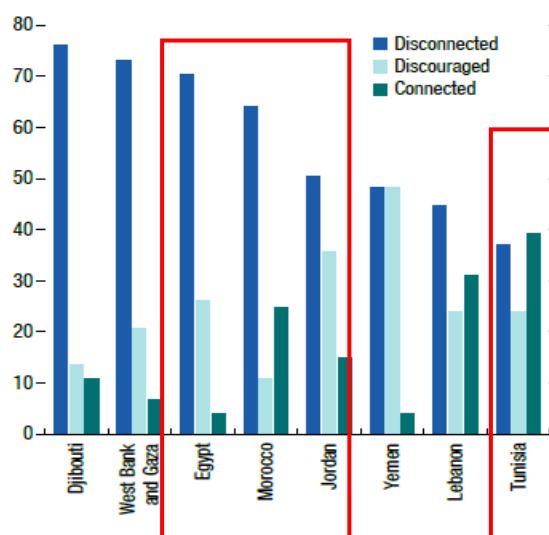


Source: UNCTAD (2019), World Bank (2019), EBRD and authors' calculations

### Access to finance

Access to finance remains a key constraint for firms, in particular for SMEs in the SEMED region. They have the lowest concentration of loans to GDP in the world, while credit tends to be skewed towards large corporations. Firms in Egypt show the highest share of disconnection with the financial sector, whereas firms tend to have better credit relationships and show a higher share of connection in Morocco and Tunisia (Chart 5). Without sufficient access to finance, firms are often unable to enter global value chains, increase production and improve production standards.

**Chart 5: Firms' credit relationship with the financial sector (% of firms disconnected, discouraged or connected to financing)**

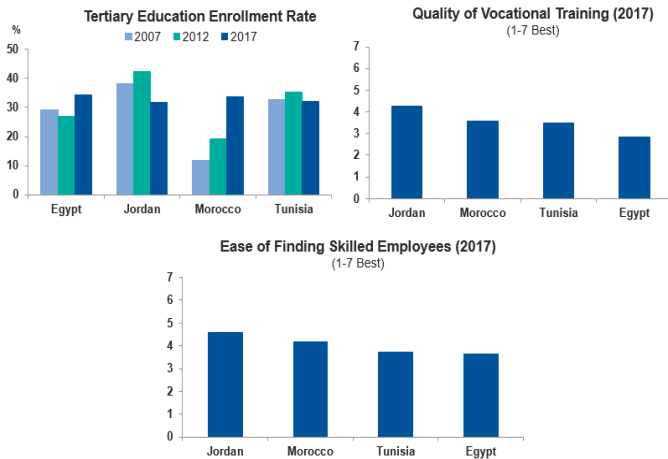


Source: IMF (2018)

### Skilled labour force

The performance of the region in terms of skilled labour provision and quality of vocational training is middling. The rate of tertiary education enrolment has improved but remains well below OECD average. Firms lack skilled labour force due to skills mismatches at the graduate level, schools with poor curricula and lack of vocational and technical training schools (in particular in Egypt) (Chart 6).

**Chart 6: Skilled labour provision**

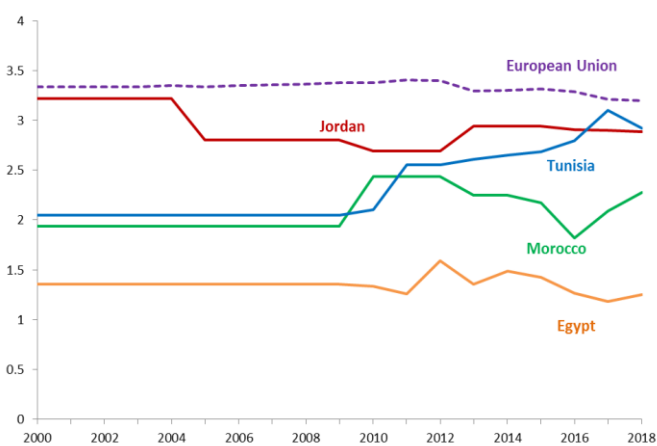


Source: UNDP (2018), World Economic Forum (2019), EBRD and authors' calculations

### Governance and business environment

There is significant room to improve governance and to strengthen the regulatory and business environment. Political and macroeconomic stability, together with a sound regulatory environment are found to be critically important for private investment. Getting credit, paying taxes, trading across border and enforcing contracts are business issues in almost all SEMED countries. Their performance in terms of quality of institutions and transparency of laws with predictable enforcement is low (Chart 7). Limited quality and missing international standards and certifications are also often an issue, as they effectively prevent access to more advanced markets including the EU.

**Chart 7: Transparent laws with predictable enforcement (Index 0-4)**



Source: World Bank (2019), Varieties of Democracy (2019), EBRD and authors' calculations

### Conclusions and policy recommendations

GVCs offer unexploited opportunities for the four countries to accelerate export and income growth. SEMED countries have a varying degree of integration into Europe's vibrant GVCs and all could benefit from strengthening it. In particular, given their proximity to the EU market, SEMED countries could benefit from a recent trend in diversification of value chains and nearshoring of production facilities, encouraged by new technologies, the need to strengthen resilience in global supply chains and the flexibility gained by being closer to final customers ([Case study: Opportunities from diversification and promotion of resilience in GVCs](#)).

Morocco, Tunisia, Jordan and Egypt are found to have a comparative advantage in exports of horticulture, chemicals, crude materials, electrical machinery and textile products. But despite all four countries being part of the free trade area with the EU and benefiting from relaxed rules of origin (diagonal cumulation allowed for production of goods between all four countries and the EU), intra-regional is rather non-existent with only two per cent of total trade being within the region.

Having a comparative advantage across similar product groups often results in direct competition between the four countries, but also offers opportunities to facilitate regional value chain integration by specialising in different stages of selected value chains and exploit untapped complementarity of product groups, provided political will. This can be fostered by addressing gaps in infrastructure and transportation linkages, by putting standards harmonisation into practice and by reducing non-tariff and administrative barriers between the countries.

Together with political and macroeconomic stability, ensuring a friendly business environment is key to continue to attract foreign investors and develop business partnerships in the SEMED region. This can be achieved by horizontal reforms aimed at cutting red tape, improving governance (such as improved dispute settlement procedures, clearer property rights and removal of discriminatory policies) and facilitating investment in services, particularly transport and logistics. Further trade liberalisation and deepening of trade agreements should be pursued, not least because export competitiveness is linked to having access to competitively-priced intermediate goods and services. The creation of a level playing field for all companies should also be

promoted by reducing regulatory and trade barriers, including avoiding local content top down targets that can be detrimental to firms' competitiveness.

Ultimately, policy makers in Morocco, Tunisia, Egypt and Jordan should aim at supporting upgrading along GVCs, i.e. moving up the value chain and capturing more value-added. Beyond investing in trade facilitation and export promotion, one avenue is to support linkages of foreign firms with both local suppliers and training institutes and universities; to develop a skilled labour force that matches the demand of the industry. In parallel, the absorptive capacity of local firms should also be strengthened, (i) by supporting them in complying with international standards and accreditation norms, (ii) by strengthening skills and capabilities of the workforce through better targeted education and vocational training and (iii) by supporting the adoption of new technologies and innovation. The most in need of such activities are SMEs in the region that are often financially constrained and would particularly benefit from support along the areas highlighted, together with improved access to finance.

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### **Further information is available to supplement this factsheet:**

- **GVC country diagnostic - Egypt / Jordan / Morocco / Tunisia**
- **GVC case study: Opportunities from diversification and promotion of resilience in GVCs**