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Political Economy of Egypt's Regional Trade Integration Policy: The Case of Joining the Tripartite Free Trade Agreement

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ABSTRACT

The political signalling of Egypt in 2012 to join the Tripartite Free Trade Agreement (TFTA) emphasised Egypt's interest in being part of this important initiative. The paper addresses the political and economic reasons that could have prompted Egypt to undertake such a decision. Building on the evolution of trade policy in Egypt since the early 1990s and its engagement in unilateral, regional and multilateral paths to liberalise trade, and taking into account the change of the political regime after the revolution on 25 January 2011, the paper investigates the factors that could affect Egypt's decision to join the TFTA. It also analyses other important issues related to these factors, including the expected economic effects, the role of South Africa, experience with the Common Market for Eastern and Southern Africa (COMESA), and the geopolitical aspects of Egypt's decision to join the TFTA. The paper emphasises that although Egypt's joining of the TFTA is essential from a political economy perspective, the extent of economic gains depends largely on the design of the rules of origin and means of co-operation on industrial policies and creation of value chains, especially between Egypt and South Africa.

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ABBREVIATIONS AND ACRONYMS

ASEAN	Association of Southeast Asian Nations
BRCIS	Brazil, Russia, India, China and South Africa
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
ERSAP	Economic Reform and Structural Adjustment Programme
FDI	foreign direct investment
FTA	free trade area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GoE	Government of Egypt
IMF	International Monetary Fund
MFN	most-favoured nation
NTM	non-tariff measure
PAFTA	Pan Arab Free Trade Area
PTA	preferential trade agreement
QIZ	Qualifying Industrial Zones
RoO	rules of origin
SADC	Southern African Development Community
TFTA	Tripartite Free Trade Agreement
UNCTAD	UN Conference on Trade and Development
UNDP	UN Development Programme
WTO	World Trade Organization

INTRODUCTION

Egypt's trade policy has been shaped over many years, driven primarily by political and economic objectives. Over time, changing domestic, regional and international circumstances have had a significant impact on trade policy in Egypt. Since the 1990s Egypt's trade policy has become more open on unilateral, regional and multilateral levels. Diversification of main trading partners was observed in the 1990s, when preferential trade agreements (PTAs) were signed with European, African and Arab countries. The economic and political outcomes of these PTAs differed in terms of gains and losses, yet Egypt did not withdraw from any of them. Rather, the Government of Egypt (GoE) continued to work with its PTA partners to enhance such regional trade arrangements.

The interest in enhancing trade relations with the African continent became more evident when Egypt joined the Common Market for Eastern and Southern Africa (COMESA) in 1998. As with its PTAs, Egypt's decision to join COMESA was shaped by political and economic reasons. Following COMESA's decision to establish the Tripartite Free Trade Agreement (TFTA), the GoE signalled its political interest to also join. To date no clear ex-ante assessment of this decision has been undertaken from a political economy perspective. This paper aims to conduct such an assessment. It takes into account factors including the changing political arena on the domestic level as a result of the new governing regime following the revolution on 25 January 2011 and its consequences on the economic ideology in general and trade policy in particular; the political friction between Egypt and some African countries over the Nile River; and the development of Egyptian trade policy in relation to engagement in other PTAs.

The paper analyses the reasons behind Egypt's decision to join the TFTA from a political economy perspective, and the expected outcomes of such a move. The analysis is supported by desk-work research involving a review of former studies analysing Egypt's trade policy. In addition to the desk work, interviews were also undertaken with senior government officials and Egyptian exporters.

The paper is divided into five parts. The first reviews the evolution of Egypt's trade policy. It identifies the overall trends and different factors that have shaped trade policy over the years, on both economic and political fronts. The second part explores the recent economic and political changes that Egypt has experienced as a result of the revolution on 25 January 2011. It also discusses the economic ideology and related trade policy of the new regime. The third part evaluates Egypt's experience with COMESA, with the aim of identifying the positive and negative aspects for Egypt's engagement in such a PTA. The fourth part analyses the different political and economic interests for Egypt's potential joining of the TFTA. The final part provides conclusions and policy implications.

EVOLUTION OF EGYPT'S TRADE POLICY

In 1991 Egypt adopted an economic reform programme known as the Economic Reform and Structural Adjustment Programme (ERSAP). ERSAP was designed in collaboration with the World Bank and the International Monetary Fund (IMF), and included a trade liberalisation component. In fact, ERSAP was a combination of trade reforms that began in 1986 with a major tariff reform. Over the 1990s, trade liberalisation accelerated with the inclusion of simplification elements, a reduction of maximum rates, and the adoption of shorter lists of exceptions. For example, the maximum tariff rate was reduced from 100% in 1991 to 40% in 1998, with a few exceptions; and the average most-favoured nation (MFN) rate decreased from 42% in 1991 to 26.8% (30.2% with a surcharge and customs service fee) in 1998. As a result, the effective rate of protection decreased significantly over the same period, and a greater degree of tariff uniformity across sectors was realised.[1] There was a gradual shift of using tariffs instead of traditional non-tariff measures (NTMs) such as bans, quotas and negative lists. The initiation of trade liberalisation was driven by ERSAP, which represents an important external pressure aspect in the form of wider economic reforms suggested by the international organisations.

The pace of trade liberalisation on a unilateral basis as a result of pressure from international organisations gained momentum in the 1990s, when Egypt also experienced negotiations in the multilateral arena (due to the Uruguay Round negotiations) as well as the negotiation of several PTAs. In terms of multilateral liberalisation, Egypt has been a member of the General Agreement on Tariffs and Trade (GATT) since 1970 and a member of the World Trade Organization (WTO) since its establishment in 1995, with the status of being a developing country. Joining the WTO has brought more discipline to Egypt's trade policy, where during the Uruguay Round Egypt had 99% of its tariff lines bound. Moreover, several institutions (including laws, regulations and enquiry points) were created to adhere to WTO commitments. Hence, the WTO has encouraged Egypt to complete its trade policy institutional infrastructure. In the field of services, Egypt has undertaken commitments in five out of the 12 main General Agreement on Trade in Services (GATS) sectors (44 subsectors out of the 160 GATS subsectors).[2] These sectors are construction and engineering-related services, financial services, tourism and travel-related services, maritime transport, and telecommunications. It has maintained horizontal commitments, putting constraints on the acquisition of land and hiring of foreign workers, following its domestic laws and regulations. In 2004 Egypt also joined the Information Technology Agreement. However, anecdotal evidence shows that despite the general discipline brought about by adhering to WTO commitments, non-adherance was not uncommon. For example, in 1998 some 12% of the tariff lines (704 tariff lines) applied rates in excess of their bound levels compared with over 200 lines out of a total binding of 267 lines in 1991. Also, Egypt has increasingly moved de-restricted imports into a list of articles requiring quality-control inspection. The trade policy review in 1993 identified 69 items subject to quality control inspection, which increased to 182 items in 1998. Such protectionist measures might reflect the interests of specific lobbies or social concerns that cannot be met in the new environment of tightened policy space imposed by the adherence to WTO rules and regulations.[3] Yet despite such protectionist setbacks, Egypt's general mode of trade policy has remained liberal.

In terms of regional trade liberalisation, since the mid-1990s Egypt has been engaged in negotiating and implementing a number of PTAs (see Table 1). Such engagement has encouraged the trade policy to shift towards further liberalisation and export promotion. All the PTAs that Egypt has been engaged in have remained confined to free trade areas (FTAs). Egypt also signed a number of other agreements in the 1990s with Arab countries, including Syria, Morocco, Lebanon, Tunisia, Jordan and Iraq.

Table 1: Egypt's engagement in PTAs

Agreement	Date of signing the agreement	Entry into force	Transitional period	Full implementation
PAFTA[a] (FTA)	1997	1 January 1998	8 years	1 Jan 2005
COMESA (FTA)	1998	1999	2 years	2001
EU Association Agreement (FTA)	2001	1 January 2004	16 years	
Agadir[b] (FTA)	2004	6 July 2006	None	6 Jul 2006 (deferred to 2007)
European Free Trade Area (FTA)	2007	1 December 2007	17 years	
Turkey (FTA)	2005	1 March 2007	15 years	
MERCOSUR[c] (FTA)	2010			
Syria (PTA)	not available	1999	None	1999
Morocco (PTA)	not available	1999	5 years	2004
Lebanon (PTA)	not available	1999	None	2003
Tunisia (PTA)	not available	1999	5 years	2004
Libya (PTA)	not available	2007	None	2007
Jordan (PTA)	not available	1999	6 years	2005
Iraq (PTA)	not available	2001	None	2001

a PAFTA represents the Pan Arab Free Trade Area.

b Egypt, Jordan, Morocco, and Tunisia.

c MERCOSUR is an economic and political agreement signed in 1991 and amended in 1994. Its main aim is the establishing of a free trade area among Argentina, Brazil, Uruguay, Paraguay and Venezuela. Bolivia joined in 2012.

Source: Egypt, Trade Agreements Sector, Ministry of Trade and Industry, http://www.tas.gov.eg (non-English website).

PTAs have played an important role in compensating exporters for a number of demand constraints that used to face Egyptian exports. Egypt now has FTAs with almost all of its major trading partners, with the exception of the US, with which Egypt has signed the Qualifying Industrial Zones (QIZ) protocol. QIZ gives Egypt free access to the US market for some of its major exports according to a special arrangement that requires the adherence to specific rules of origin (RoO), in which Israeli components have to be included.[4]

There were several reasons for Egypt's engagement in all its PTAs. These included the change of economic ideology (from import substitution to export promotion); the international and regional mode prevailing in the 1990s, which called for further trade liberalisation; regional and international pressures; and political aspects. In some cases, more than one reason played a role, whereas in others it was one main reason that caused Egypt to join a specific PTA. Generally though, a combination of political and economic reasons has driven Egypt towards being part of a specific PTA.

The PTAs that Egypt has been engaged in have covered mainly trade in merchandise goods. However, liberalisation of trade in services – despite being an integral part of many of the PTAs that Egypt has joined – has not been implemented in any of them. The main reasons for the lack of liberalisation are the delays and difficulties of negotiations associated with modes of liberalisation. This has been the case with the European Union Association Agreement as well as with the Pan Arab Free Trade Area (PAFTA), and to a lesser extent with COMESA. Consequently, the liberalisation of services in Egypt within its PTAs has remained confined to its GATS commitments. All Egypt's PTAs have remained shallow[5] (covering removal of barriers on the borders) and lacking in significant elements of depth (dealing with behind-the-border issues, such as the harmonisation of rules and regulations).

Because Egypt has only been engaged in FTAs, its PTA policy has never faced a serious regulatory challenge arising from overlapping or contradictory regulations. In fact, Egypt has so far aimed at acting as a hub and gateway to a number of neighbouring regional markets, including the European, Arab and African markets. However, there are potential challenges associated with being engaged with both Arab countries which aim at transferring PAFTA to a customs union by 2015[6], and COMESA members whose customs union was launched in June 2009.[7] The basis for Egypt's pursuit of negotiations on both fronts is unclear. Since a country cannot be a member of two customs unions simultaneously, the GoE has always known that at a certain point a clear choice would have to be made. The lengthy negotiations with both PAFTA and COMESA members and several postponements of deadlines have enabled Egyptian policymakers to buy time and signal their political interest in both trading partners.

Trade reform and liberalisation continued in the 2000s with the firm belief by the governing regime that adoption of an export promotion strategy would be the main engine of growth for Egypt. Together with trade liberalisation (see Table 2 for the development of maximum applied tariff rates over time), significant progress has taken place in the institutional set-up designed to support exports and exporters. Rules, regulations and organisations dealing with export procedures have improved (including the adoption of an export promotion strategy, creating a new mechanism for export subsidies, and streamlining customs procedures).[8] The export subsidy mechanism aimed at its inception in 2001 to adopt some sort of a 'sunset' clause, in which subsidies allocated to each sector were due to decrease gradually until they ended completely over a four-year period.

Table 2: Maximum applied tariff rates in Egypt[a] (%), 1986–2013

Year	Maximum applied tariff rate
1986	110
1992	100
1993	80
1994	70
1997	50
1998–2007	40
2008–2013	30

a The maximum applied tariff rate does not include tariff peaks on automobiles, tobacco and alcoholic beverages.

Source: WTO, *Egypt's Trade Policy Review*. Geneva: WTO, 1999; Ministry of Finance, mimeo, unpublished. Cairo: Ministry of Finance, 2008.

However, in 2005 the GoE extended the export subsidy programme to a larger number of sectors and did not apply the annual decrease in the levels of subsidies already allocated. As a result, the amount of export subsidies allocations increased from EGP[9] 250 million in 2002/03 to EGP 2.5 billion in 2008/09, with a widening number of sectors benefiting from export subsidies.[10]

In 2004 the GoE embarked on a new wave of trade liberalisation. This had two main objectives, namely the further reduction of tariffs and rationalisation of tariff structure (to facilitate trade); and the reduction of imports subject to NTMs. As a result, the tariff bands were narrowed from 27 tariff brackets to six; and tariff lines were reduced from 8 000 to 6 000. Moreover, all the surcharges that used to accompany the applied tariff rates were abolished.[11] This resulted in the streamlining of trade procedures, and helped to prevent corruption. Tariff reductions also continued on a unilateral basis, reaching a simple (weighted) average of 20.3% (13.1%) in 2010.[12] The trade and specifically the tariff policy in Egypt started to change significantly after 2000. The tariff policy was no longer used as a main tool to increase government revenues, but instead it was used to enhance exports, to help lift the economy out of its recession, and to achieve social objectives.[13]

Despite such trade reforms and liberalisation, administrative and red tape measures have continued to exist, resulting in increasing transaction costs associated with crossing the borders.[14] Yet there has been a clear bias against import procedures when compared with export procedures, as well as a higher incidence of protection associated with specific types of goods, such as ready-made garments, textiles, agricultural goods and processed food. Moreover, trade policy in the 2000s was used more actively to achieve other social and developmental goals. The use of trade policy in this regard, however, was not always through liberalisation, but rather in several instances reverted to being protectionist. For example, in March 2009 the GoE imposed a ban on cement exports, initially until October 2009 and then until October 2010, owing to increasing domestic demand and as a way of dealing with the cartel behaviour of the cement producers in Egypt. In response to the 2008 financial crisis, the GoE introduced new import tariffs for several products, including cocoa, cigarettes, chemicals, steel products and machineries, while at the same time eliminating import tariffs on others such as yarn, tin, and textiles. The same type of trade policy mix was used in the aftermath of the food crisis in 2008.[15] Hence, the frequent use of trade policy in conjunction with other economic policies to achieve different developmental goals became evident in the 2000s.

In sum, the evolution of trade policy in Egypt shows that trade policy reform turned out to be a complex and dynamic phenomenon, subject to domestic politics and external interests and pressures that were not always trade oriented.[16] Egypt's history of import substitution industrialisation had created vested interests that resisted any reduction of tariff barriers from taking place.[17] However, over time and through the existence of several channels for reform and liberalisation and the rise of a relatively strong export-oriented lobby, the 1990s and 2000s saw a gradual change towards a more liberal environment. Despite these changes, protection among different industries has remained highly diverse, with some industries receiving higher protection than others (nominal and effective) owing to vested interests of specific lobbies and social concerns. The cases of ready-made garments and car assembly are evident examples in this regard.[18] According to existing studies, the process of decision-making in trade policy is highly controlled by the executive authority, which is influenced by business interests, yet the process of influencing the decision-making has been neither clear nor transparent.[19] The business community has never been uniform, and diverse interests are evident, especially between industrialists and importers. With the adoption of import substitution, the huge size of public sector and state-owned enterprises, and the lack of necessary market economy institutions needed to support exports, it was unlikely that exporters would have a significant influence on decision-making in trade policy. However, the implementation of ERSAP encouraged the private sector to play a more active role, and the shift from an import substitution to export-oriented type of economy started to take place gradually over time. The influence of exporters on decision-making backed up by a strong political will to enhance exports has been noticeable since the 2000s.[20] The role of trade policy in achieving social goals continued to be used for both liberal and protectionist purposes.[21]

RECENT ECONOMIC AND POLITICAL FACTORS SHAPING EGYPT'S TRADE POLICY

Political and economic conditions in Egypt have been in a state of flux since the Egyptian revolution took place on 25 January 2011. The revolution itself did not negatively affect the economic conditions in a significant manner. There was no disruption to infrastructure, thanks to the peaceful nature of the revolution, and no significant costs associated with the revolution. Yet the political conditions in the aftermath of the revolution and the severity of the burden of transition have heavily affected economic conditions. Adding to the political factors has been the weak economic management by different cabinets that have been in power before and after the June 2010 presidential election.

The economy has deteriorated on almost all fronts, with no sign of an early recovery owing to the complexity of the political situation and weak economic management. The economic growth rate plummeted from 5.9% in 2009/10 to 1.9% in 2010/11;[22] rising slightly to 2.2% in 2011/12.[23] Unemployment reached the alarming rate of 12.6% at the end of June 2012 compared with 11.8% at the end of June 2011. Net foreign direct investment (FDI) inflows fell from \$6.6 billion in 2009/10 to \$2.2 billion in 2010/11, with a negative growth rate of 67%, and decreased further to \$2.1 billion during 2011/12. The 2010/11 deficit in balance of payments reached unprecedented heights at \$9.8 billion (4.1% of gross domestic product or GDP) compared with a surplus of \$3.4 billion (1.5% of GDP) in 2009/10. International reserves slipped from \$36 billion in January 2011 (covering more than eight months of imports) to \$16 billion in January 2012 (covering less than three months of imports), and still further to \$14 billion in February 2013. The economic outlook is gloomy, even gloomier than forecast by the International Monetary Fund (IMF). For example, the IMF expected a decline of foreign reserves of \$9 billion for 2011/12 in the aftermath of the 25 January 2011 revolution,[24] whereas in reality the reserves declined by almost \$9 billion in only four months.

Tourism receipts have also declined significantly, and prospects for the future remain worrisome owing to the continuing instability of the security situation and a number of incidents that have occurred in all major tourist sites. Egypt's credit rating by major rating agencies has deteriorated several times since the beginning of the revolution, undermining

Egypt's credit worthiness and ability to borrow from abroad. In 2013 Standard & Poor's cut Egypt's credit rating, lowering its long-term credit rating from B- to CCC+, and its short-term rating from B to C. The agency's decision was motivated by concern over the country's ability to meet its financial targets and maintain social peace.[25] As a result, the interest rate on treasury bills increased by almost 2%, making it more burdensome for the government to borrow. This rate was recently reduced by 1% on 4 July 2013.[26] In July 2013 the government's overall[27] budget deficit reached recorded highs of EGP 142 billion ($23 billion), representing around 10% of GDP, excluding foreign and domestic debt service which reached $99 billion. The overall budget deficit recorded EGP 185.5 billion, according to the latest actual figures for 2012/13.[28]

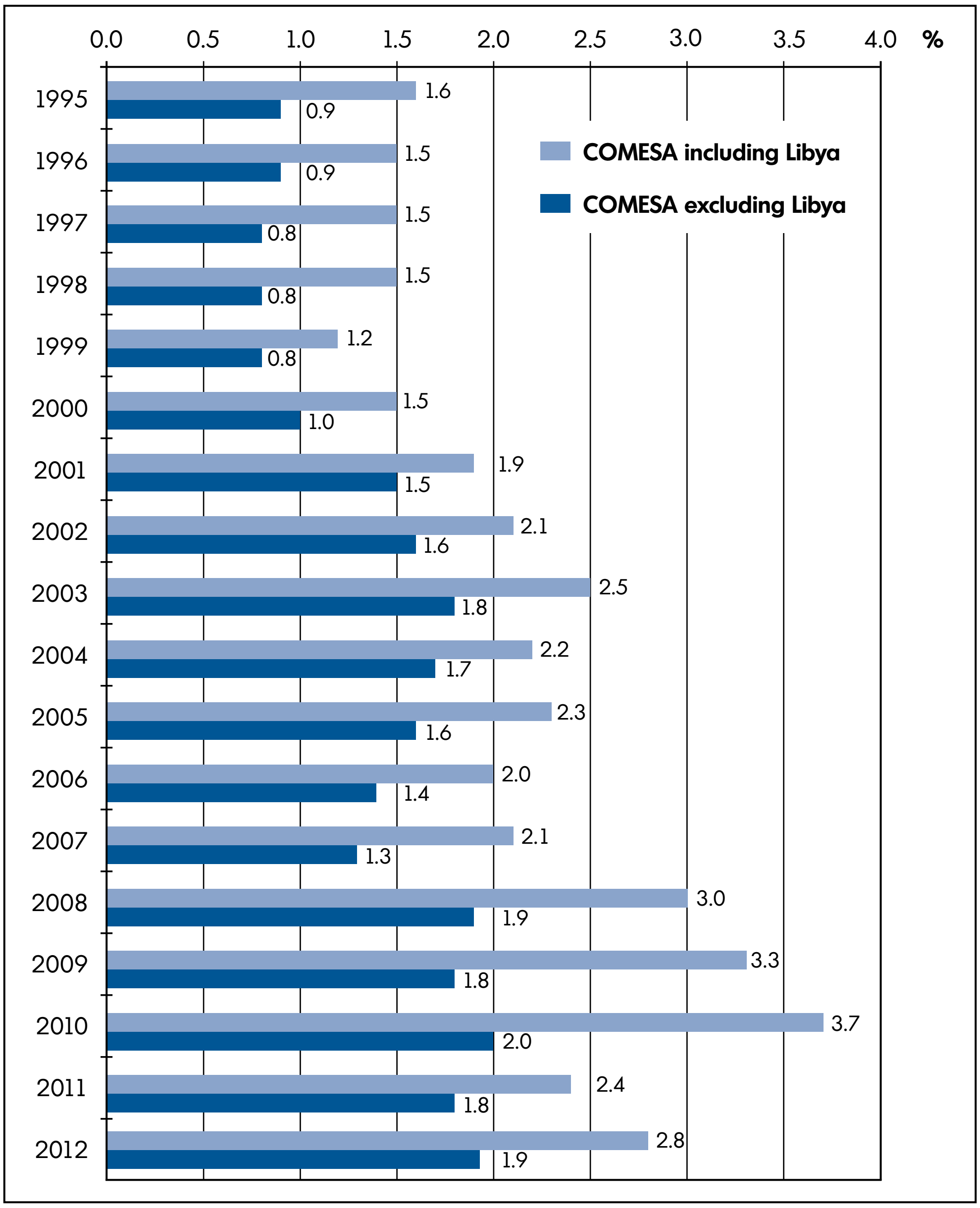
The high degree of uncertainty in Egypt's political arena has in turn affected its economic situation. Uncertainty over the type of new governing regime and how it will deal with the different stakeholders, the future role of the military, and the extent of dominance of political Islam and its associated political parties are all contributing factors. In economic terms, such uncertainty has been translated into capital outflows, depleted foreign reserves, deterred investment, and high-risk premiums and interest rates. The frequent change of governments and lack of security are additional elements that have added to the uncertainty. All of these symptoms have created an economy in a state of turbulence.

Yet despite such negative developments on the economic and political fronts, the main economic ideology of the current governing regime and all the influential political parties has remained liberal, but with more emphasis on social equity. Examination of the economic programmes of the different political parties on the scene does not seem to indicate a drastic shift from liberal policies and integration into the world economy.[29] On the contrary, there have been several incidents that emphasise a continuation in this direction. It is clear that none of the political powers has proposed any withdrawal from world economy integration. Thus it is unlikely that there will be a retreat from the liberal trade mode that Egypt has adopted since the mid-1990s. In fact, any such move would have significantly negative political consequences, which no governing regime would be capable of withstanding. However, the economic ills that Egypt is currently experiencing might lead to the possibility of applying safeguard measures following the WTO and PTA rules and regulations, and the establishment of NTMs. The political leadership has undertaken a number of visits in 2012 and 2013 to the East, including China and India, and announced Egypt's desire to collaborate with the BRICS grouping (Brazil, Russia, India, China and South Africa), suggesting the intention of more geographical diversification. It is still too soon to be able to assess whether a reorientation towards other trading partners will take place. In terms of Africa, during the transitional period as well as after the presidential elections, both the prime minister and the president visited several African countries, emphasising the importance of enhancing political and economic ties with the continent. The recent developments that took place in the aftermath of 30 June 2013 and the regime change are unlikely to affect Egypt's positions on strengthening ties with Africa or integrating into the world economy. In other words, the political turbulence is not likely to affect Egypt's orientation towards liberalisation of trade with Africa. If there is any change, it is expected to be in the line of enhancing such relations.

An evaluation of the past record

Egypt joined COMESA in 1998, four years after its establishment in 1994. In 1999 COMESA entered into force an initial tariff rate reduction of 80%; and in 2001 it achieved a 100% tariff reduction of tariffs on imports from other members. Egypt has been part of COMESA's announcement to establish an FTA in 2000 and a customs union in 2009.

Figure 1: Total Egyptian trade with COMESA (%), 1995–2012



Source: Calculations based on UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013.

As a percentage of Egypt's total trade, the share of trade with COMESA members increased from 1.6% in 1995 to only 3.7% in 2010; and to 2.8% in 2012.[30] The increase has been attributed mainly to Libya's joining COMESA in 2005. This increase in trade with COMESA members also turned Egypt's trade deficit with COMESA into a surplus. However, it is important to point out that Egypt's trade with COMESA members when excluding Libya, remains modest (see Figure 1).

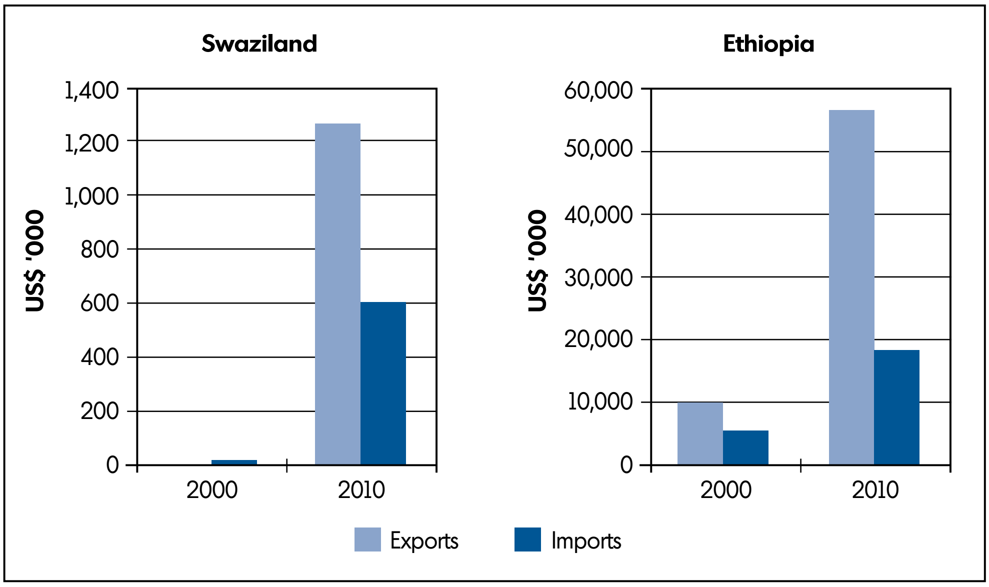
A number of studies indicate that prospects for Egypt's trade with COMESA remain limited. Economic and structural impediments such as low trade volume, transport difficulties, underdeveloped infrastructure, proliferation of NTMs, and red tape measures have hindered Egypt from fully utilising its trade potential with COMESA.[31] COMESA has suffered from a high degree of non-transparency, where the COMESA Treaty identifies several provisions that have not in reality been implemented. Among the most important is the absence of any negative lists in the treaty.[32] For Egyptian authorities, two main problems have been identified according to the interviews undertaken with government officials.[33] The first problem is related to the absence of a clear mechanism required to tackle the problems related to trade remedy measures; and the second is the manipulation of origin of goods imported from COMESA members. In addition, the dual membership of COMESA and other PTAs for some members of COMESA, namely Libya and Sudan, may bring about complications in managing Egypt's regional trade policy. Overlapping of some activities could result in duplication or even inconsistencies. In theory, Egyptian exporters to Sudan have the right to choose between applying the PAFTA or COMESA certificate of origin; however, in reality, they have to follow the COMESA certificate, which is more restrictive owing to a negative list. This negative list has been agreed upon by the governments of Egypt and Sudan, where its 58 items were reduced and in addition tariffs on 12 items were further reduced in 2003. Yet, problematically, such information is not widely shared among Egyptian exporters, and is not even posted on the websites of the concerned ministry in Sudan or on the COMESA website. It is only mentioned on the website of the Egyptian Ministry of Trade and Industry.[34] This implies that trade between Egypt and COMESA members is not completely free as it might be understood from the existing agreement and that there is lack of transparency.

Another problem associated with COMESA in general has been the lack of fully functioning trade-remedy measures. For example, up to the end of 2001 COMESA did not include proper trade-remedy provisions (anti-dumping, countervailing, injury to industry, etc), and members had the discretion to devise their own measures in addressing what they considered to be major market disruptions, despite there being a number of articles addressing such issues (eg Articles 51, 52, 53, and 54 of Chapter 6 of the COMESA Treaty). As revealed by interviews,[35] this has been the case with Egypt when faced by a surge of imports from Mauritius and Kenya. The GoE reverted to bilateral talks with the Kenyan authorities to reintroduce duties on these products. Egypt was also engaged in bilateral talks with Kenya to stop the surge of Kenyan tea imports. Kenya also imposed a safeguard measure against sugar by a quantitative restriction. The restrictions were imposed without any investigation being undertaken to determine the extent of industry injury and the causal link between imports and the affected industry. Such unilateral measures, as long as they are not institutionalised, can dampen trade and increase the lack of transparency.

COMESA's impact on employment generation and poverty reduction in Egypt is difficult to identify owing to the extremely low share of Egyptian trade with COMESA members, idle implementation of its provisions related to labour movement, and delays in agreement on trade in services. Moreover, Egyptian exports to COMESA countries are not necessarily labour intensive, hence minimising their potential impact on employment generation and poverty reduction. COMESA, as with most of the South–South PTAs, lacks the necessary depth of integration aspects that, if applied, could have a significant impact on developing trade.

The existence of a number of countries that do not apply any tariff reductions (eg Swaziland) or others that apply partial reductions (eg Ethiopia) is not expected to have a significant impact on reducing Egypt's potential gains from COMESA, owing to the limited trade already taking place between Egypt and these countries. For example, the volume of trade between Egypt and Swaziland has remained as low as $3,000 in 2000 and $1.3 million in 2010 for exports; and $5,000 in 2000 and $593,000 in 2010 for imports (see Figure 2). With Ethiopia trade has also remained low, at $10 million in 2000 and $56.7 million in 2010 for exports; and $4.8 million in 2000 and $18 million in 2010 for imports (see Figure 2). In addition, the tariff revenue loss expected to arise from Egypt's joining COMESA has been considered to be minimal for three main reasons. The first is the low percentage of Egyptian imports from COMESA as a percentage of Egypt's total imports. The second is the extensive lowering of the MFN tariff rate in Egypt, meaning that tariff revenues do not constitute a significant contribution to government revenues.[36] The third reason is the nature of the majority of Egyptian imports from COMESA, which has been concentrated in raw materials, where tariffs by nature are considered relatively low when compared with tariffs on intermediate and final goods.

Figure 2: Egypt's trade with selected COMESA members ($'000), 2000–10



Source: UNCTAD, UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013.

Egypt's main imports from COMESA remain highly concentrated in raw materials. Its exports, however, are diversified, and include manufactured products (eg electricity cables), pharmaceutical products, processed food, and aluminium products (see Table 3).

Table 3: Egypt's trade structure with COMESA, 2012

Trade Flow	Exports to COMESA		Imports from COMESA	
Items	**Value ($'000)**	**%**	**Value ($'000)**	**%**
Total all products	**1,841,641**	**100.0**	**958,746**	**100.0**
All allocated products (SITC [a] 0 to 8 + 961 + 971)	1,827,239	99.2	958,736	100.0
Primary commodities, excluding fuels (SITC 0 + 1 + 2 + 4 + 68)	544,764	29.6	860,014	89.7
Food items (SITC 0 + 1 + 22 + 4)	443,760	24.1	518,501	54.1
Food, basic (SITC 0 + 22 + 4)	426,169	23.1	445,317	46.4
Beverages and tobacco (SITC 1)	17,591	1.0	73,184	7.6
Agricultural raw materials (SITC 2 less 22, 27 and 28)	29,967	1.6	4,916	0.5
Ores and metals (SITC 27 + 28 + 68), of which:	71,037	3.9	336,597	35.1
Non-ferrous metals (SITC 68)	60,688	3.3	330,439	34.5
Fuels (SITC 3)	16,133	0.9	68,419	7.1
Manufactured goods (SITC 5 to 8 less 667 and 68), of which:	1,266,342	68.8	30,303	3.2
Chemical products (SITC 5)	317,643	17.2	2,673	0.3
Machinery and transport equipment (SITC 7)	154,449	8.4	2,618	0.3
Iron and steel (SITC 67)	110,494	6.0	7,952	0.8
Textile fibres, yarn, fabrics and clothing (SITC 26 + 65 + 84)	65,042	3.5	1,945	0.2

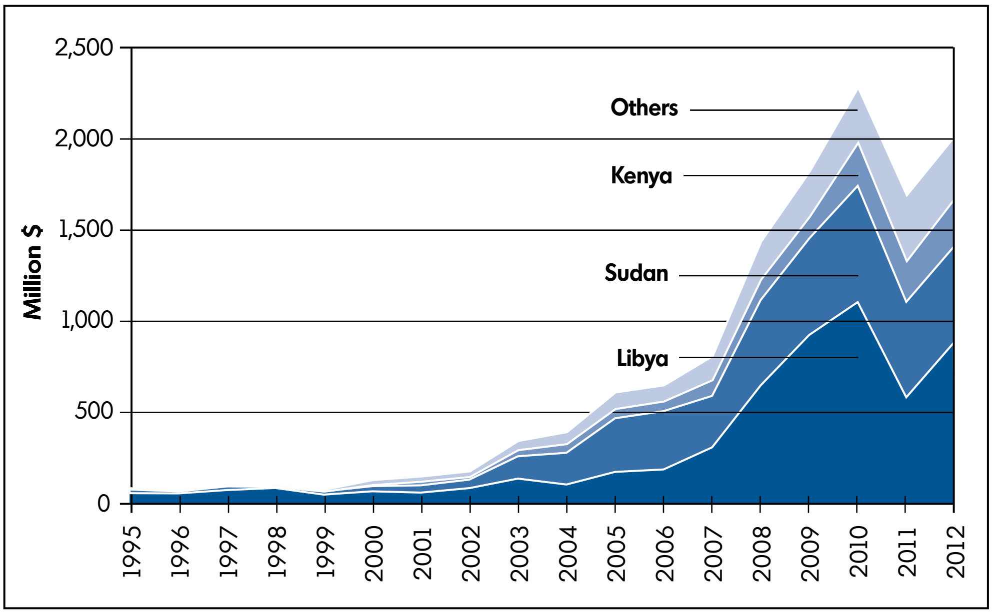
a SITC (Standard International Trade Classification) represents a statistical classification of the commodities entering external trade, and is designed to provide the commodity aggregates requited for purposes of economic analysis and to facilitate the international comparison of trade-by-commodity data.

Source: Calculations based on UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013.

Egypt's main trading partners in COMESA have remained highly concentrated in Libya and Sudan, where Egyptian trade with these two countries is more than four times the amount of trade with the rest of the COMESA members. The only other COMESA member that has a significant amount of trade with Egypt is Kenya, although this represents just one-ninth of the value of trade recorded with Libya, and one-fifth of Egypt's trade with Sudan (calculations are based on figures published by the COMESA Secretariat for 2009).

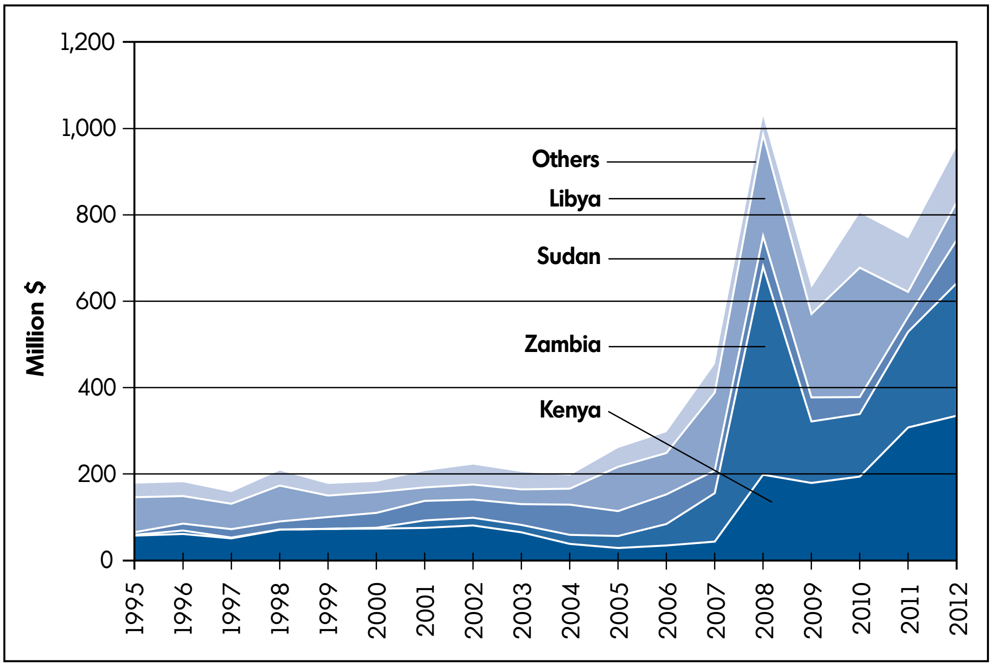
Figure 3 shows that most Egyptian exports to COMESA are highly concentrated in Libya, Sudan and Kenya.

Figure 3: Egypt's exports to COMESA trading partners ($), 1995–2012



Source: UNCTAD, UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013 .

Figure 4: Egypt's imports to COMESA trading partners ($), 1995–2012



Source: UNCTAD, UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013.

Despite the modest trade gains expected from Egypt's COMESA membership, its political gains are substantial. The suppressed conflict around the Nile River water could be a major reason behind Egypt's desire to join COMESA. When strong economic ties exist the political tension is less likely. In theory, PTAs can act as a catalyst to reduce political frictions for at least three reasons. First, the increased economic interdependence between countries involved in a PTA creates a form of joint welfare objective, which in turn strengthens political pressures against going to war. Second, PTAs help to enhance the awareness of governments and people of other members of the PTA's cultural, political and social institutions, which in turn encourages mutual trust. Third, PTAs reduce the probability of trade friction, which in turn lessens the likelihood of political friction, especially when PTAs secure access to the partners' supplies of strategic raw materials (as evidenced by the case of French access to German resources, mainly steel).[37]

Empirically, there are several incidents where PTAs have acted to reduce conflict or to eliminate it. Apart from the classic case of France and Germany within the context of the European Economic Community, intraregional conflicts also occurred among the five founding members of the Association of Southeast Asian Nations ASEAN[38] before it was formed. These conflicts were eliminated after its formation. The same story is repeated in the case of MERCOSUR, which reduced the tension between Argentina and Brazil. The Economic Community of West African States also played a role in enabling its members to develop co-operative behaviour that allowed them to address mutual security concerns.[39]

Moving to a customs union

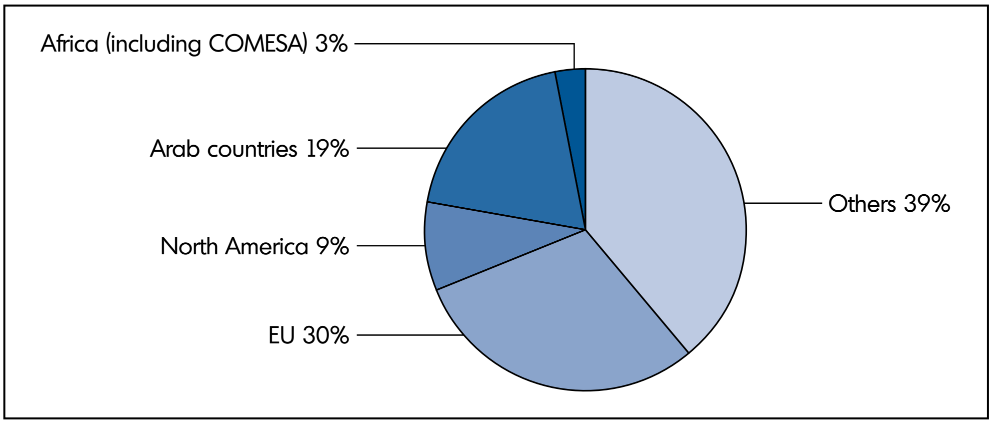
Egypt has been an active participant in the ongoing negotiations within COMESA on its transformation into a customs union. COMESA announced the move in 2009, with the aim of concluding the transformation within three to five years. However, the average suggested tariff structure to be adopted by COMESA, which is characterised by high effective rates of protection (eg a zero tariff rate on raw materials, 10% tariff rate on intermediate products, 25% tariff rate on final products), does not seem to fit the tariff structure currently adopted in Egypt. In fact, the current Egyptian tariff structure is more liberal with less effective rates of protection.

COMESA's move towards becoming a customs union represents several problems for Egypt. First, it will require Egypt to adopt a more protectionist stance in its trade with the rest of the world. The second problem is associated with Egypt's engagement in PTAs outside the African region (see Table 1), which will not only complicate the adjustment of its tariff structure, but will probably lead to its withdrawal from such PTAs. Egypt's engagement in only FTAs has allowed it to be a member of several of these while retaining its own flexibility in designing its trade policy, and especially its tariff structure. Any engagement in a customs union (whether COMESA or another one) will restrict such options and can have several negative repercussions on Egypt's trade interests.

The third problem with COMESA becoming a customs union is Egypt's engagement in other negotiations with PAFTA members to achieve the same goal. It is not possible for a country to be a member of two customs unions at the same time. Yet Egypt has been negotiating with both COMESA and PAFTA. Although there is no economic logic behind its simultaneous engagement, this could be attributed to political motivations. Egypt does not want to lose the political momentum of being part of Africa or the Arab world, and hence it has been negotiating on both fronts. However, when the time of entry into a customs union comes, Egypt will have to choose between the two, and by choosing one it will have to sacrifice being part of another, which can have serious political and economic consequences. Taking into account the preferences of Libya and Sudan further complicates Egypt's decision, especially in light of Libya and Sudan experiencing turmoil due to the Arab uprising in Libya and the division of Sudan into North and South Sudan in July 2011. A recent unpublished study by the joint facilitation committee of the foreign trade and the RoO committees of the Federation of Egyptian Industries identified that Egypt, Libya and North Sudan have stronger economic ties with Arab countries than with African countries, owing to substantial trade, migration, remittances and investment flows. The study emphasised that despite the three countries not yet disclosing their political preference in terms of which customs union to join, their stronger economic ties with their Arab partners are expected to affect their decision.[40]

Hence in evaluating Egypt's experience in its engagement with COMESA, it is evident that Egypt's trade with COMESA has remained modest in absolute and relative terms (see Figure 5). The significant increase in Egypt's exports to COMESA and the turn of the trade balance from a deficit to a surplus was only achieved after Libya joined COMESA. The lack of depth and proliferation of several obstacles – including NTMs, inefficient infrastructure and modest transport – have hindered the benefits that could have accrued to Egypt from joining COMESA. Egypt has not experienced substantial FDI inflows as the gateway to Africa (see Figure 6). Political friction over the Nile basin and distribution of Nile water was not reduced as expected. On the contrary, tensions have increased significantly in the last few years, especially with Ethiopia's recent establishment of the Renaissance Dam and a number of African countries (four out of the nine Nile basin countries)[41] signing the Entebbe Agreement, which entails a new sharing strategy of the Nile water, despite strong opposition from Egypt and Sudan.

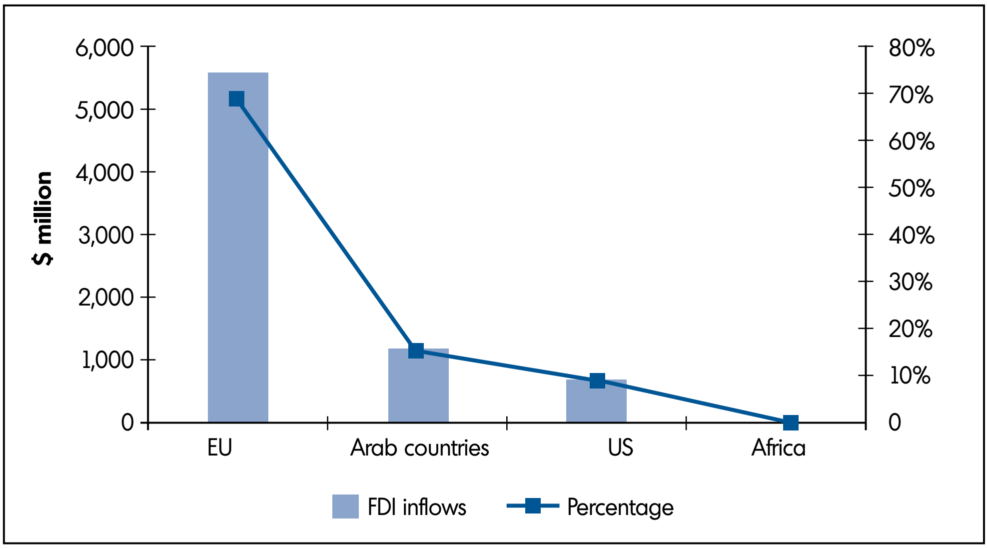
Figure 5: Egypt's trade with major partners (%), 2011



Note: Percentages do not total 100% owing to rounding.

Source: Egypt, Ministry of Industry and Foreign Trade, Egyptian International Trade Point, Egypt's Foreign Trade with Economic Blocs, http://www.tpegypt.gov.eg/Arabic/TradeStatistics.aspx (non-English website), accessed 4 July 2013.

Figure 6: Egypt's FDI inflows, 2011



Source: Central Bank of Egypt Statistics, http://www.cbe.org.eg, accessed 4 June, 2012.

POLITICAL AND ECONOMIC INTERESTS FOR EGYPT JOINING THE TFTA

Egypt is the second-largest economy among the 26 economies envisaged to join the TFTA. Its GDP represents 17.8% out of the total TFTA GDP, surpassed only by South Africa, whose GDP represents 38.7%.[42] This section discusses the different economic and political arguments that could be raised when trying to evaluate Egypt's joining of such a new initiative.

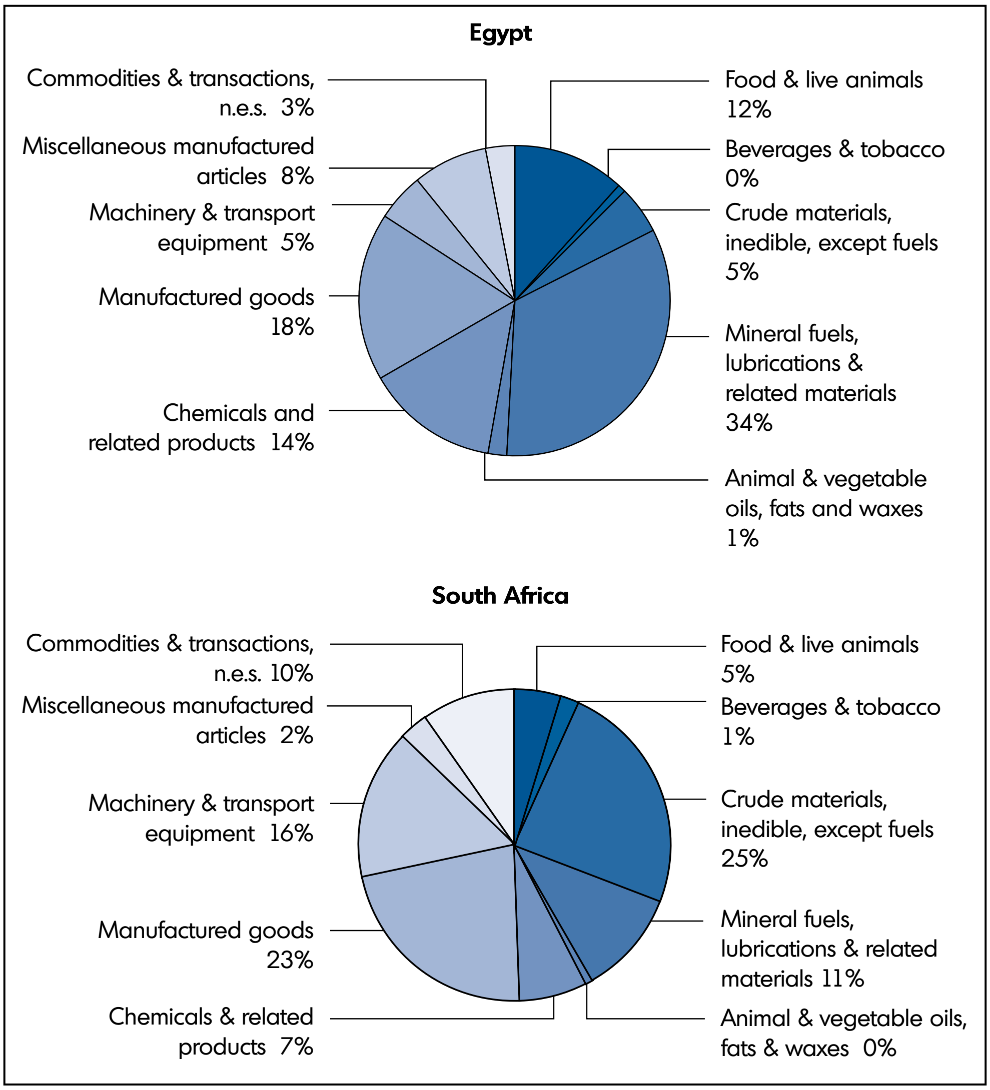
A main reason behind the idea of establishing the TFTA is the need to avoid the multiple, overlapping membership that exists for several members of the three PTAs, namely COMESA, the Southern African Development Community (SADC) and the East African Community (EAC). For example, out of the 26 members of the new envisaged tripartite agreement, 13 members are already members of two regional groupings.[43] This, however, has not been the case with Egypt, which is neither a member of SADC nor the EAC. Hence, despite the importance of such a factor for most of the countries engaged in the new initiative, it is not a motivating factor for Egypt. In fact Egypt's joining members of the EAC in a new PTA should not represent a problem, as all EAC members are COMESA members with the exception of Tanzania. Moreover, of the 15 members of SADC, eight are already members of COMESA. In other words, Egypt joining the TFTA does not create any threat to the existing trade pattern; nor does it imply extending the market for Egypt's exports, as the majority of SADC and EAC members are already members of COMESA. The only exception in this regard is the case of South Africa, which will be discussed below.

A second reason for the establishment of the TFTA is to overcome the problem already prevalent in COMESA, the SADC and the EAC, where not all of their members apply full FTA treatment within their groupings to other members because of their developmental status.[44] One aim of the TFTA is to streamline such an awkward situation. This could bring substantial intraregional trade increases and boost trade for some of the members. Again though, this is not the case for Egypt, which, as discussed, has limited trade with almost all COMESA members, including those countries which do not apply full FTAs, such as Ethiopia and Swaziland. The good news, in terms of TFTA countries locking in the highest level of tariff liberalisation achieved in January 2012 and automatically extending it to the rest of TFTA members,[45] might signal high levels of tariff liberalisation. However, not for a country like Egypt which has already applied a 100% reduction for its trade within COMESA and has a relatively low MFN rate when compared with other countries in the region. However, it should be noted that this assessment remains static in nature, whereas if the time dimension is included, there might be additional gains for Egypt as well as for other COMESA members arising from increased trade and investment. For example, the gains expected to arise from the extension of the market size under the TFTA – given the relatively developed position of Egypt in terms of its manufacturing sector and its geographic proximity to Europe, Africa and some parts of Asia – can increase substantially, which can help Egypt to become a major hub of investment for the TFTA.[46] It is important to emphasise that the gains expected to arise for Egypt and other TFTA members will depend heavily on the agreed upon scheme of tariff liberalisation. So far it is not clear whether Egypt will negotiate with other TFTA non-COMESA members on a bilateral basis or whether COMESA as a whole will negotiate with SADC and the EAC. This issue is of crucial importance, as negotiations involving any reversal on commitments made by any member could lessen the expected benefits for Egypt in this regard.

A third reason is the proliferation of NTMs, weak infrastructure, limited human capacity, lack of full implementation of institutional measures as safeguard measures, and energy and water challenges.[47] The TFTA aims to overcome such obstacles through co-operation among member countries on these issues. It is worth mentioning that these are the same challenges facing COMESA, which so far have not been overcome. This is in line with Egypt's interest, and perhaps the engagement of other new influential members, such as South Africa, can encourage the tackling of such issues as well as the desire of all potential members to overcome the institutional deficiencies in their old existing PTAs.

A fourth reason is the role played by South Africa in the region and its impact on Egypt. In this regard, economic and political dimensions need to be considered. Regarding the economic dimension, South Africa is among the seven members of the SADC that are not members of COMESA. This implies two things; the first is associated with the influence of South Africa on its close neighbours (eg Lesotho, Botswana, Namibia), where the engagement in a new PTA is unlikely to change the economic dominance of South Africa in such countries.[48] The second is associated with the competition expected to arise between South Africa and Egypt in the new TFTA, as the largest two economies. A comparison between the export structure of the two countries reveals a number of similarities (see Figure 7). However, as demonstrated by Tables 4 and 5, Africa in general is not a main trading partner for Egypt and South Africa. This suggests that any fierce competition between the two countries over the potential TFTA market is unlikely.

Figure 7: Export structure for Egypt and South Africa, 2012



Source: Calculations based on UNCTADStat database, http://unctadstat.unctad.org, accessed 6 July 2013.

Table 4: Egypt's major trade partners (%), 2011

Breakdown in Egypt's total exports by main destination	Share (%)	Breakdown in South Africa's total exports by main destination	Share (%)
1. EU (27)	30.7	1. EU (27)	22.3
2. India	7.2	2. China	13.4
3. Saudi Arabia	6.3	3. US	9.0
4. US	5.8	4. Japan	8.2
5. Turkey	4.8	5. India	3.6

Source: WTO, *Country Trade Profiles*, April 2013, http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E, accessed 7 July 2013.

Table 5: Egypt's major trade partners (%), 2011

Breakdown in Egypt's total imports by main origin	Share (%)	Breakdown in South Africa's total imports by main origin	Share (%)
1. EU (27)	29.1	1. EU (27)	30.6
2. US	10.4	2. China	14.2
3. China	9.2	3. US	8.0
4. Kuwait	4.5	4. Japan	4.7
5. Turkey	4.2	5. Saudi Arabia	4.5

Source: WTO, *Country Trade Profiles*, April 2013, http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E, accessed 7 July 2013.

When analysing its potential engagement in the TFTA there is no major threat for Egypt from the existence of a strong trading partner such as South Africa. It is unlikely that the trade surplus that Egypt has achieved with COMESA can turn into a deficit, as Egyptian exports in such markets cannot be easily displaced by South African ones since they are highly concentrated in Libya and Sudan, where geographical proximity and historical ties play an important role. As for the fear of direct importing from South Africa increasing and displacing Egyptian products, it is worth noting that Egypt's trade balance with South Africa registered a surplus in 2011 that amounted to EGP 5.6 billion.[49] A third important economic potential gain that can be attained, however, cannot be analysed – namely the cumulation of RoO and enhancement of value chain type of activities between Egypt and South Africa. This potential is dependent on the design of the RoO and the possibility of cumulation, as well as the design of the industrial policies in both countries, and the flexibility and willingness of industrialists to enter into new industrial and trade relations with their counterparts in the other country. On the political economy front, the impact on Egypt can go both ways. On the one hand, collaboration of the two largest economies can enhance the agenda of the TFTA and help it to overcome obstacles, especially given that together Egypt and South Africa represent more than 55% of the total TFTA GDP. On the other hand, political competition between the two could divide the markets through the application of hidden NTMs, and create political friction that could jeopardise the functioning of the envisaged FTA.

A fifth reason that could affect Egypt's decision to join the TFTA is the potential problems expected to arise if Egypt continues with the process of completing the COMESA Customs Union. If Egypt joins the union, difficulties are likely to arise regarding Egypt's trade policy with its PTA partners. In fact, joining the TFTA, rather than a customs union, would be more in line and consistent with Egypt's trade policy.

Finally, the design of RoO is of paramount importance for ensuring trade gains for Egypt from joining the TFTA. The design proposed so far under the current negotiations has leant towards adoption of the general rule applied in COMESA and the EAC, in contrast with the product-specific approach applied under the SADC.[50] The design of RoO is of crucial importance to Egypt for three main reasons. The first is associated with Egypt's relatively advanced position in terms of its manufacturing base, which even caused Egypt to renegotiate RoO under COMESA, requesting an increase in the value-added criterion to 45%[51] on a reciprocal basis to protect its industrial base. This is likely to be repeated under the TFTA despite Egypt's agreement to relax the criterion to 35%. The second reason is associated with the friction expected to arise between the developing and least-developed countries in the TFTA. In this regard it is highly expected that South Africa and Egypt will be on the same side. The third reason is associated with aligning the RoO adopted under the TFTA with other PTAs that Egypt has signed, whereas in practice the adoption of multiple RoO does not constitute a problem for Egyptian exporters.[52]

CONCLUSION AND POLICY IMPLICATIONS

It would be both politically and economically beneficial for Egypt to join the TFTA. The importance of Egypt joining the TFTA extends to geopolitical gains that cannot be easily measured. The static economic gains expected a priori might be meager in light of the previous experience of Egypt in COMESA and the existence of several obstacles that can hinder the exploitation of gains from such a PTA. However, there are no significant potential threats. The displacement of South African exports for Egyptian exports in traditional COMESA members' markets and in Egypt itself, is likely to be minimised given the relatively limited trade already existing between Egypt and South Africa on the one hand, and Egypt and the African continent on the other, and given the segmentation of TFTA markets for both Egypt and South Africa where geographical proximity and historical ties confirm such segmentation.

The political economy reasons for Egypt joining the TFTA should not be overlooked, especially the issue of political friction over the Nile River water. Egypt's engagement in the largest African PTA will ensure its attachment to the African continent, and help to cement its status as a core and influential country. The political economy aspects concerning the relationship between South Africa and Egypt cannot be easily determined, as these can go both ways – co-ordination or competition.

Joining the TFTA fits the approach of liberalisation of trade policy that Egypt has adopted since the mid-1990s. Such a move could help Egypt to overcome the potential complexity of being a member in the COMESA and PAFTA Customs Unions. However, this depends on how the TFTA will be negotiated. So far the specifics of the negotiations have not been tackled in any of the official documents associated with the TFTA, these have only referred to the formation of a customs union as a later stage to be undertaken in the future. To date the only study to have tackled this issue is that which was conducted by Bienen,[53] who proposed the possibility of two tracks: either SADC and COMESA continuing with their customs union and then forming the TFTA; or both SADC and COMESA forming the TFTA and then considering a regional customs union later. If the negotiations proceed following the second track, then Egypt's joining of the TFTA will be in line with its overall trade policy without creating any kind of potential inconsistency. Hence, and building on the approach of Egypt in terms of its design and liberalisation of trade policy, joining the TFTA seems to be the plausible choice.

In sum, geopolitical, political and economic aspects all emphasise that Egypt joining the TFTA is indispensable. A narrow economic vision, estimating the gains in a static manner, will not reveal the full extent of benefits Egypt is likely to derive from joining the TFTA. However, a dynamic vision, which includes political aspects, suggests that such a move will surely result in positive gains for Egypt. These include economic gains, (although they will be dependent on how the RoO will be negotiated), movement to a customs union, the extent of depth applied, and the ability to utilise a value-chains approach with other countries in the TFTA, especially South Africa and Kenya.

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SAIIA'S FUNDING PROFILE

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