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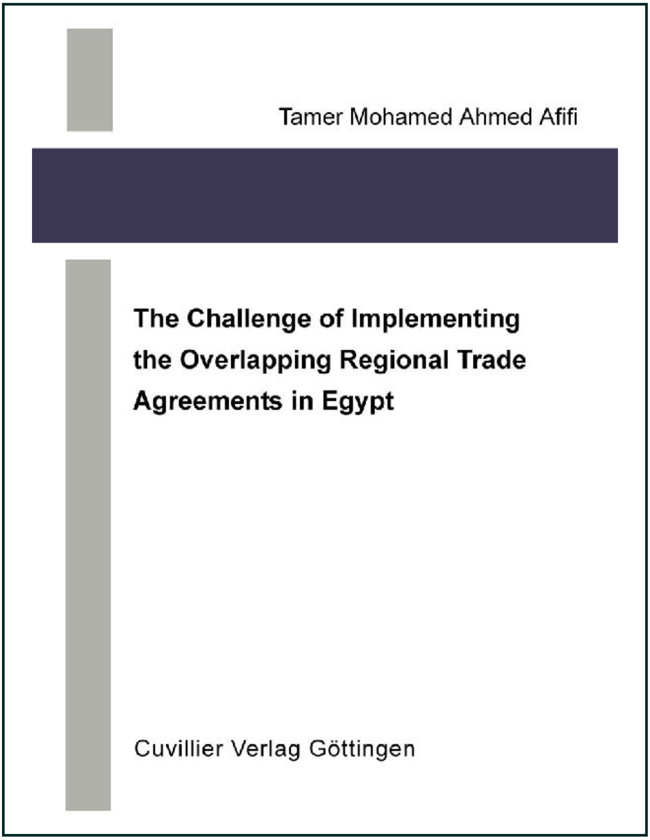
The Challenge of Implementing the Overlapping Regional Trade Agreements in Egypt



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Introduction

1. Egypt as a member of different RTAs

The Arab Republic of Egypt is a country located at the crossroads between Europe, the Middle East and Africa. It has always acted as a major link between these regional markets and their access to Asia, especially since the construction of the Suez Canal in 1869, which connects the Red Sea with the Mediterranean.

Egypt is therefore considered an Arab, Middle Eastern, African and Mediterranean country. As an Arab country, Egypt has played a leading political, economic and cultural role in the region. The Arab League (AL) that brings the 22 Arab countries together was established 1945 in Cairo. As a Middle Eastern country, Egypt has played a leading role in the peace process in the Israeli-Palestinian conflict and has signed 1978 the Camp David Peace Treaty with Israel. As an African country, it has also been influential, since over the years it has participated in dispute resolutions between different African countries. As a Mediterranean country, it has played an important role for European countries who were seeking market access to Africa and Asia. Egypt also makes a link between Mashrek (Eastern) and Maghreb (Western) countries of the Arab region (Egypt, Country Profile, 2005).

These different regional classifications were an important reason why Egypt has been involved in several Regional Trade Agreements (RTAs) besides its membership (1995) in the World Trade Organization (WTO). For example, Egypt joined the Common Market for Eastern and Southern Africa (COMESA) in 1998, being hereby the 19th member of the Agreement. An initiative that took place 1995 during the Barcelona Conference lead to the establishment of European-Mediterranean Partnership Agreements - also called Euro-Med - between European countries on one hand and Mediterranean countries on the other. This Agreement aims at a Free Trade Area[1] (FTA) between all the signatory countries of both sides in 2010. Egypt signed in 2001. In order to facilitate the Partnership Agreements between the European Union (EU) and four Arab countries including Egypt, the Aghadir Agreement was signed in 2004 and was supposed to lead to an FTA in 2005. Last but not least, 17 Arab countries including Egypt are part of the Greater Arab Free Trade Area (GAFTA) which aimed in the year 1997 at establishing an FTA by the year 2007 that

[1] The exact meaning of the Free Trade Area is to be elaborated in section 1.1.

was later accelerated to the year 2005. As will be elaborated in detail, RTAs have different degrees of economic integration, where the Monetary or Currency Union - like the case of COMESA - is the most sophisticated one, whereas in the case of FTAs - like the three other Agreements - , movement of goods within member countries is - under certain conditions - exempted from tariff barriers and every country keeps its right to impose its own tariffs on the rest of the world.

2. A brief historical background of RTAs

In an opening sentence of a Working Paper by *Crawford and Fiorentino* (2005) they state that "RTAs are a major and perhaps irreversible feature of the multilateral trading system"[2]. Till June 2005, 312 RTAs had been notified to the General Agreement on Tariffs and Trade (GATT)/WTO, and 196 of these were in the decade after the establishment of the WTO in January 1995. Between January 2004 and February 2005 alone, 43 RTAs have been notified to the WTO, which made this period the most abundant one in the history of RTAs (Pomfret, 2006). These numbers are even underestimated, since some RTAs under negotiation have not yet been notified to the WTO and others are among non-WTO members[3]. Therefore, it has become a stylized fact of the world trading system that regionalism is growing at an accelerating rate.

Except for Mongolia, all the WTO member countries are part of RTAs. According to *Crawford and Fiorentino* (2005), for some of these members preferential trade represents over 90 percent of their total trade. *Schiff and Winters* (1998) state that "some 55 to 60 percent of world trade now occurs within such trading blocs"[4]. These percentages hint to the fact that the Most Favored Nations[5] (MFN) treatment required by the WTO's is in reality applied only on 10-50 percent of the world trade (Pomfret, 2006).

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[2] Crawford, Jo-Ann, and R. Fiorentino (2005) 'The Changing Landscape of Regional Trade Agreements', WTO Discussion Paper No.8, World Trade Organization, Geneva, p. 1

[3] At the same time, the cumulative WTO counts overestimate the number of RTAs, since they do not consider the RTAs that have been ceased.

[4] Schiff, Maurice and L.A. Winters (1998) 'Dynamics and Politics in Regional Integration Arrangements: An Introduction', *World Bank Economic Review 12(2)*, p. 178.

[5] An agreement according to which the signatories agree to accord each other the same favourable terms that are offered in agreements with any other nation.

3. Research problem

When studying the membership of one country in different RTAs, one should consider the political motivations and pressures that the country is subject to. In many cases, there is no other choice for the country than getting integrated in such RTAs. This has been the general trend for the past decades. In such case, the country should attempt to make the best out of these RTAs in accordance with its own interests. For example, Egypt needs the financial and technical assistance of the developed countries, such as the EU. Being part of a Partnership with these countries is supposed to facilitate the access to their markets as well as their technology and know-how.

In general, the economic benefits of Bilateral Trade Agreements can be well determined and the implementation is a simple task compared to RTAs that include several countries. It is argued that the RTAs that Egypt is part of were signed due to political rather than economic reasons. Hence, no real assessment of expected trade creation/diversion was run before signing the Agreements. Moreover, many of the RTAs have only been weakly implemented, if at all.

In addition to the difference between the announced tariff reductions and the implemented ones, there are still significant Non-Tariff Barriers (NTBs) across member countries in all the RTAs.

Each of the RTAs includes a different set of Rules of Origin (RoO). The co-existence of multiple RoO is inconvenient for both exporters and producers who may be unable to achieve any benefits from the preferential treatment granted by all these RTAs.

The reasons behind not implementing the Agreements properly might be lobbies/interest groups protecting local producers and hindering proper implementation; resistance of the government, due to a loss of revenue (tariff collection); the lack of common policies and standards among countries that have signed these RTAs; conflicting interests between different ministries, stakeholders, etc. within one member country (in this case, Egypt); the RoO overlap and/or the high transaction and administrative costs incorporated with the RTAs; and/or the economic worthlessness of the RTAs, leading in turn to the lack of incentive for implementing them.

4. Research objectives

1. To recognize the gap between the implementation plans and the real implementation of the Egyptian RTAs.
2. To identify the economic potential of the Egyptian RTAs.
3. To find out the impact of institutional factors on the potential implementation of the RTAs and the institutional factors behind the weakness/delay of implementation.
4. To assess the applicability of the complex RoO of the overlapping RTAs.

5. Research questions

1. What is the status/degree of implementation of the four RTAs that Egypt is member of?
2. What is the impact of the RTAs on trade creation/ trade diversion and what are their expected static, dynamic and institutional effects on Egypt?
3. To what extent do the institutional factors affect the implementation of the RTAs?
4. Do the RoO of the signed RTAs conflict and how would this affect/constrain the implementation process?

6. Research hypotheses

1. There is a gap between what the signed RTAs entail and what is implemented in reality.
2. COMESA, GAFTA and Aghadir are not less trade creating than Euro-Med, thus, there must be other problems making Euro-Med apparently more advantageous so far.
3. Institutional factors have a significant effect on implementing the RTAs, and therefore, GAFTA, COMESA and Aghadir which lack the good institutions seem to be less advantageous than Euro-Med.
4. The complex RoO are an obstacle on the way of implementing the overlapping RTAs that Egypt has signed, due to:
   -Contradicting and hence, inapplicable rules.
   -Institutional problems associated with RoO.

7. Research methodology

1. In order to recognize the gap between the implementation plans and the real implementation of the Egyptian RTAs, a comprehensive analysis of the available documents of the RTAs and a comparison between them is run.
2. In order to identify the economic potential of the Egyptian RTAs the study relies on the trade creation/diversion criteria and uses hereby a Revealed Comparative Advantage analysis.
3. In order to find out the impact of institutional factors on the eventual implementation of the RTAs a gravity regression model is used, where the key variables are the institutional factors existing in the different countries of the RTAs of study. In addition, a descriptive analysis, based on interviews with Egyptian government officials, producers, importers and exporters is run, in order to find out the institutional factors behind the weakness/delay of implementation.
4. In order to assess the applicability of the complex RoO of the overlapping RTAs the detailed production processes of the important Egyptian products that are exported to the countries of the different RTAs are traced, taking into account the necessary inputs and raw materials used in the production.

8. Time, geographic and product coverage of the research

Although the RTAs that Egypt has signed include other countries, in general, the main focus of the study is on Egypt and its implementation of these RTAs as a case study. The starting year for the study period is 1994, where the first RTA that Egypt joined (COMESA) was signed.

In order to have a sufficient number of observations, the gravity regressions include all the countries of the RTAs that Egypt is part of in addition to the member countries of the WTO. The year of estimation is the year 2002, where there is a database available for the most important institutional factors existing in the countries of the RTAs and that might have an influence on the trade among them.

The Revealed Comparative Advantage analysis comprehends 240 commodities produced and traded in the countries of the RTAs, based on the Standard International Trade Classification.

The RoO analysis concentrates on the twenty most important products that Egypt exports to the members of each RTA.

9. Research limitations

Due to time and financial constraints, it was not possible to run the interviews with government officials, local producers, importers and exporters in countries of the RTAs other than Egypt.

Originally, it was planned for the dependent variable of the gravity regressions to be the exact degree of implementation of the RTAs, in order to find out to which extent this variable would be influenced by the institutional factors. However, running the regressions with a discrete dependent variable based on the subjective and diverse opinions of the government officials could end up with misleading results, especially that the problem of lack of information and transparency is widespread in Egypt and within many of the member countries of the RTAs. Therefore, the trade flows between the member countries is taken as a proxy for the potential implementation of the RTAs. Nevertheless, the evaluation of the government officials is still considered as a supporting outcome of the study.

The institutions included in the gravity model are based on a certain index. However, there are other institutions that are hard to measure but which might play a more significant role. In an attempt to lessen this limitation, these institutions are dealt with in a descriptive approach in a chapter of the study specified for this aim.

Chapter 1 gives a theoretical background about some important concepts related to RTAs, such as trade diversion, trade creation, RoO, and institutional aspects associated with international trade. *Chapter 2* attempts to identify the differences between the four RTAs that Egypt is member of and the status of their implementation. *Chapter 3* deals with the static, dynamic and institutional effects that might have an influence on Egypt as a consequence of its membership in the different RTAs. *Chapter 4* demonstrates the important institutional obstacles hindering the full implementation of the signed RTAs. *Chapter 5* measures the impact of the institutional quality on the trade flows between the different countries of the RTAs. *Chapter 6* assesses the applicability of the complex RoO of the RTAs and the extent to which their overlapping could constrain the implementation. Finally, *Chapter 7* presents the concluding remarks of the study.

CHAPTER 1

Theoretical Background

It would be necessary to shed some light on a number of concepts and definitions that will be used in this study, such as the different degrees of economic integration, especially that the four RTAs that this study is concerned with do not have the same degree of integration as a target. The problems associated with signing a network of different RTAs is also an important point that should be raised, since the study is concerned with the overlapping RTAs and their institutional problems. And since the study focuses on the RoO as an important non-tariff barrier of trade, a section is devoted to this concept. Another important concept that is introduced and which is highly associated with RTAs and RoO is trade creation/ trade diversion. In addition, this chapter gives a theoretical background about the potential institutional problems associated with signing and implementing RTAs.

1.1. Degrees of Economic Integration

The theory of economic integration refers to the commercial policy of discriminatively reducing or eliminating trade barriers only among the nations joining together (Salvatore, 1998). The degree of economic integration takes different forms that could range from Preferential Trade Arrangements to Free Trade Areas, Customs Unions, Common Markets, and Economic Unions.

In the *Preferential Trade Arrangements (PTAs)* there are usually lower tariff barriers on trade among participating nations than on trade with non-member nations. This arrangement, which usually refers to only one or a few products, could be considered as the most flexible form of economic integration. The British Common Wealth Preference Scheme, established in 1932, is the best example of a PTA.

In a *Free Trade Area (FTA)* all tariff barriers among members are removed from all goods. However, each nation keeps its own tariff barriers to trade with non-members. A good example is the European Free Trade Association (EFTA), formed in 1960 by the United Kingdom, Austria, Denmark, Norway, Portugal, Sweden, and Switzerland (Finland joined later in 1961). One other good example is the North American Free Trade Agreement (NAFTA) formed by the United States of America (USA), Canada, and Mexico in 1993.

A *Customs Union (CU)* is an association of nations to promote free trade within the union and set common tariffs for nations that are not members. The most famous example is the European Community (EC), formed in 1957 by West Germany, France, Italy, Belgium, the Netherlands, and Luxembourg.

A *Common Market (CM)* further allows free movement of labor and capital among member nations. At the beginning of 1993, the EU achieved the status of a CM.

The most advanced type of economic integration is the *Economic Union*, where the monetary and fiscal policies of member states are harmonized and sometimes even completely unified. An example is Benelux, which was the Economic Union of Belgium, the Netherlands, and Luxembourg, formed after the Second World War. The extreme case of an Economic Union could be a *Monetary Union (MU)*. A good example for the former is the countries of the EU who use a single currency, the Euro.

An important factor is the extent to which the RTA enhances the credibility of the government's commitment to liberalize the economy and maintain an outward-oriented and investment-friendly policy stance.

1.2. The static effects of implementing the RTAs

The *static effects* of forming an FTA are measured in terms of trade creation and trade diversion. *Trade creation* takes place when part of the domestic production in a country which is a member of the FTA is replaced by lower-cost imports from a member country in the same FTA. This is supposed to increase the welfare of member countries, since it leads to greater specialization in production based on comparative advantage. A trade-creating FTA can also increase the welfare of non-member countries, as some of the increase in the real income of the FTA (as a result of greater specialization in production) can spill over into an increased volume of overall imports from the rest of the world.