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ECONOMIC REFORM IN EGYPT IN A CHANGING GLOBAL ECONOMY

by

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RÉSUMÉ

L'Égypte, pays le plus ancien et le plus peuplé du monde arabe — l'un des plus influents dans la région du Sud de la Méditerranée — entre aujourd'hui dans l'économie mondiale. Au cours des années 90, ce pays a adopté avec succès des politiques de stabilisation macro-économique et engagé les programmes de réforme structurelle nécessaires pour entrer sur le chemin d'une croissance forte, tirée par les exportations. La principale contrainte reste d'introduire les changements à un rythme qui ne mette pas en danger la stabilité politique.

Ce document examine les résultats des accords de l'Uruguay Round du point de vue de l'économie égyptienne ; il étudie également les relations économiques tissées avec l'Union européenne dans le cadre de l'Initiative de partenariat Europe-Méditerranée et identifie les principaux défis de politique intérieure. Il en ressort que l'Union européenne pourrait offrir à l'Égypte une aide technologique accrue et s'ouvrir à ses produits agricoles. L'Égypte pourrait de son côté libéraliser plus avant son régime commercial, y compris dans le secteur des services, et simplifier les formalités administratives qui freinent les échanges. L'Égypte pourrait également accroître l'ouverture de son économie à la concurrence étrangère et intérieure et envisager une baisse multilatérale des taxes douanières.

SUMMARY

Egypt, the oldest and most populous country in the Arab world, and one of its most influential in the Southern Mediterranean region, is now moving into the global economy. During the 1990s the country has pursued successful macroeconomic stabilisation policies and has also begun the structural reform programmes needed to put the country onto an export-led, high-growth path. The main constraint for this is the need to introduce change at a pace which will not undermine political stability.

This paper reviews the results of the Uruguay Round Trade Agreements from the perspective of the Egyptian economy, examines the country's economic relationships with the European Union in the context of the Europe-Mediterranean Partnership Initiative, and identifies main domestic policy challenges. It argues that the European Union could offer more technical assistance and better access for Egyptian agricultural products, while Egypt could further liberalise its trade regime, including services, and cut red tape which is hindering trade. Egypt should push ahead with opening up the economy to both domestic and foreign competition and consider lowering tariffs multilaterally.

PREFACE

During the 1990s many developing countries have embraced a regional approach to trade and investment liberalisation alongside their unilateral and multilateral efforts. This policy trend reflects the belief that regional policy initiatives can facilitate developing countries' domestic reforms. Whether these regional initiatives will indeed bring about such an outcome remains to be seen, however; the crucial factor is the scope and depth of such commitments. In this respect, the experience of several Southern Mediterranean countries, in the context of the European Union's New Mediterranean Policy, will provide useful lessons for policy makers in both OECD and non-OECD countries.

Following the Europe-Mediterranean Conference held in Barcelona in 1995, three Europe-Mediterranean Agreements have already been signed — with Tunisia, Israel and Morocco. Negotiations are underway with several other countries in the region. The establishment of new agreements helps the partnership countries to enhance policy credibility and business confidence, though they still need to clear many hurdles to meet the goals set by these agreements. This is why the Development Centre has undertaken in-depth research on this region — under the theme of "Regional Co-operation and Integration" — as part of its 1996-98 work programme.

This paper, which focuses on the Egyptian economy, is the third in a series with respect to the Southern Mediterranean region. Based on both empirical and recent analytical work, this series is expected to make a substantial contribution to policy making on relations between the European Union and the Southern Mediterranean.

Jean Bonvin
President
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December 1997

I. RECENT DEVELOPMENTS IN THE EGYPTIAN ECONOMY

Overview

Egyptian leadership in the Middle East and North Africa has so far been mainly in international politics and strategy. Its active part in the Uruguay Round trade negotiations[1] shows it could lead in international economic relations as well. A higher growth rate, a more open economy and stronger ties with other economies in the region would help the Egyptian economy and raise the country's profile in the Middle East and the world.

Table 1. **Basic Indicators for Egypt and Selected Middle East Countries (1995)**

	Population	GDP	GDP per capita	Exports of G & S	Imports of G & S	X+M / GDP of G & S
	million	$ billion	$	$ million	$ million	%
Egypt	58	47.4	818	10 083	15 275	53.5
Syria	14	16.8	1 200	5 824	5 438	67.0
Lebanon	4	11.1	2 775	1 065	6 880	71.6
Tunisia	9	18.0	2 000	7 979	8 811	93.3
Algeria	28	41.4	1 479	10 822	10 900	52.5
Morocco	27	32.4	1 200	8 867	11 331	62.3
Jordan	4	6.1	1 525	3 490	4 905	137.6
Israel	6	92.0	15 333	26 735	35 998	68.2

Source: World Bank.

Table 1 puts Egypt in a regional context. Among the eight Middle Eastern countries listed, it has easily the biggest population and the second-largest Gross Domestic Product after Israel. However, it has the lowest GDP per capita: about $818, with a purchasing power parity equal to 21 per cent of the OECD average. Egypt has the lowest share of merchandise trade in its GDP — 32 per cent, of which exports and imports account for 7 and 25 per cent respectively. The country's share of trade in goods and services is the second lowest after Algeria's.

These smaller shares reflect Egypt's larger size and lack of openness. They also indicate its potential. In Thailand, for example, with about the same population (58 million), the share of merchandise trade is 76 per cent of

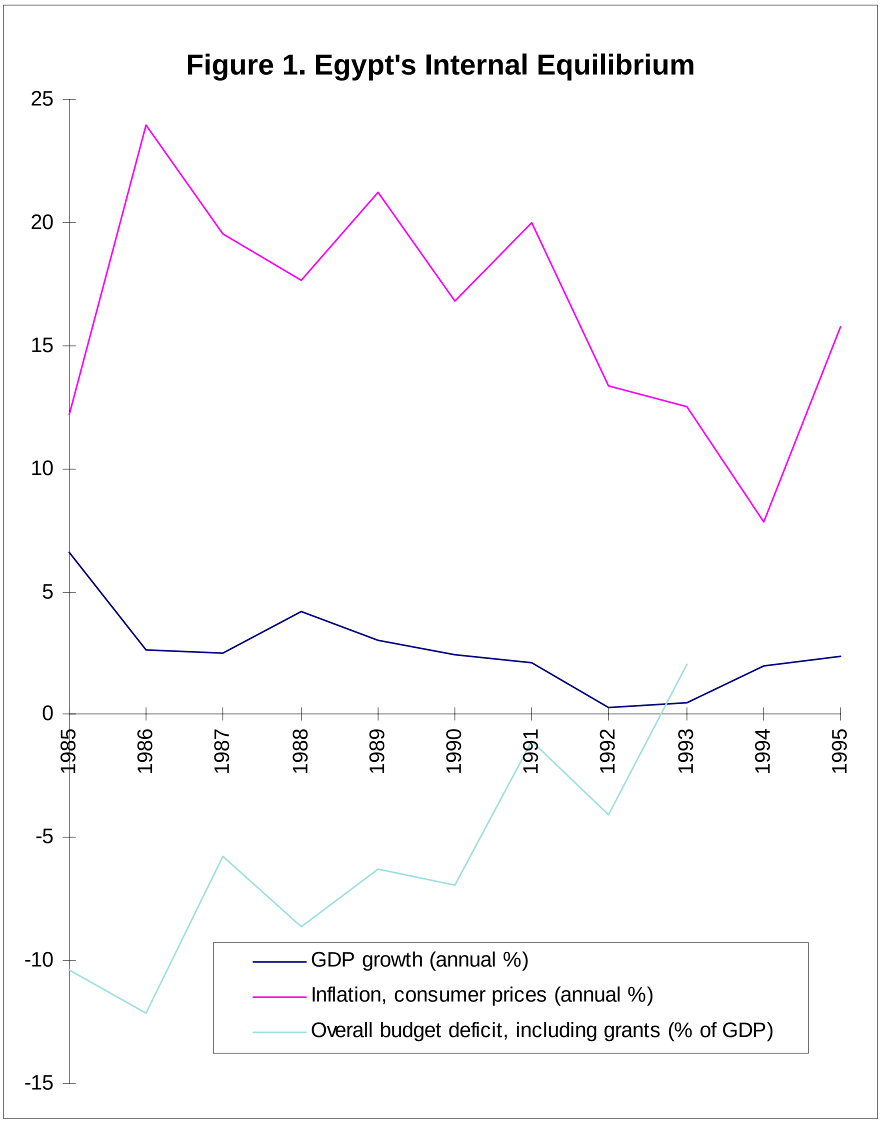
GDP and the share of trade in goods and services 90 per cent. A cross country model of sectoral trade in 1994[2], showed that only Egypt's fuel, metal and mineral exports were above the norm. Its exports of food, other primary commodities, machinery, textiles and other manufactures were well below it. Like other Middle Eastern countries, Egypt was under-represented in dynamic sectors prominent in the exports of its competitors.

Egypt's population[3] has doubled since the early 1960s, but the rate of increase recently slowed. In 1995, it was 1.75 per cent, compared to 2.6 per cent in 1985. Family planning has been partly successful, but lack of commitment to it in rural areas will probably raise the population to 100 million by 2030. As a result, more than half a million youths will come on the labour market each year for the next decade. So development of labour-intensive industries is vital to absorb this growing work force.

An annual GDP growth rate of 4 to 5.5 per cent in real terms is forecast for the next two years, or about 2 to 4 per cent per capita. This would continue the trend of the 1990s. After slowing down from 3.6 per cent in 1990/91 to 1.9 per cent in 1991/92, as a result of the stabilisation programme and closure of markets in the ex-USSR and Eastern Europe, Egypt's real annual GDP growth accelerated to 2.9 per cent, 3.9 per cent, 4.7 per cent and 5 per cent, respectively, until 1995/96[4]. The engines of growth were tourism and exports other than petroleum and gas. Between 1992/93 and 1996/97, tourism revenue rose from $1.6 to $3.5 billion, and non petroleum and gas export revenue from $1.6 to $2.8 billion.

Current growth rates are too low by the standards of fast-developing low-income countries. China, for example, has been recording growth of more than 10 per cent a year. They are also too low to raise living standards to acceptable levels. The World Bank estimates that a real GDP growth of between 4.4 and 4.6 per cent between mid-1996 and mid-2005 would see unemployment rising from 10.3 per cent to 17 per cent of the labour force. However, a growth rate which rose gradually from 5.7 per cent to 7.5 per cent during the same period would bring unemployment down to 6 per cent[5].

Services make by far the biggest contribution to value added (59 per cent of GDP). Agriculture has declined in recent decades and now contributes only 20 per cent of value added. Industry accounts for the remainder — 21 per cent, of which 15 per cent is due to manufacturing[6]. In 1993, fuel was 50 per cent of merchandise exports and manufactures 33 per cent.



Source: World Bank.

The Background

The public sector in Egypt is still all-pervading as a result of nationalisation and centralised state control introduced between 1952 and 1974. The foundations of liberalisation were laid in 1974 with laws to open up the economy to foreign investment and protect investments against nationalisation and confiscation. Little was done however to weaken state control over the economy. The industries set up in the 1970s were highly protected, inward-looking and dependent on imported inputs.

By the early 1980s, the Egyptian economy already largely depended on oil export revenues, Suez Canal dues and remittances from Egyptians working abroad to pay for imports of food and capital goods (see Table 2). Substantial investments were meanwhile made in highly capital-intensive industries, which obviously did not ease unemployment. The fall in oil prices in the mid-1980s cut oil revenues and remittances and worked its way through the economy.

By 1989-90, the Egyptian economy had reached an untenable situation:

— the current account deficit was $1.3 billion in 1989;

— at the end of 1989, Egypt was among the world's most heavily-indebted countries. Its foreign debt was $43.7 billion and servicing it cost the equivalent of 22 per cent of Egypt's exports of goods and services (see Table 3);

— the general government deficit, at the root of foreign indebtedness, stood at 7 per cent of GDP in 1990;

— inflation, measured by the retail price index, averaged 18 per cent a year between 1989 and 1992;

— at the end of 1989, total reserves, apart from gold, stood at $1.5 billion.

The turnaround came in 1990-91. Egypt's participation on the Western side in the Gulf War in 1990-91 led to vast transfers of funds from Western and Arab donors and the promise of debt relief. The latter was conditional on the IMF's certification that Egypt had sound policies leading towards macro-economic stabilisation. In turn, the IMF required Egypt to adopt a comprehensive economic and structural adjustment programme which, irrespective of the government's enthusiasm, led to economic progress. Meanwhile Egypt's positive role in the Middle East peace process since 1993 has further encouraged Western governments' favourable disposition.

In the first half of 1991, Egypt benefited from several international measures:

— the Social Fund for Development was set up with about $600 million committed by the European Union, the United Nations and bilateral donors;

— the IMF agreed to a three-year standby accord for SDR 400 million;

— the World Bank extended a $300 million structural adjustment loan;

— the Paris Club agreed to debt relief covering half of Egypt's debts.

Table 2. **Balance of Payments, Current Account**
($ million)

	1980	1985	1990	1991	1992	1993	1994	1995
TRADE BALANCE	-2 960	-5 215	-6 379	-5 667	-5 231	-6 378	-5 953	-7 597
GOODS EXPORTS: F.O.B.	3 854	3 836	3 924	4 164	3 670	3 545	4 044	4 670
GOODS IMPORTS: F.O.B.	6 814	9 050	10 303	9 831	8 901	9 923	9 997	12 267
SERVICES BALANCE								
SERVICES: CREDIT	2 393	3 024	5 971	6 783	7 716	7 895	8 070	8 590
of which Tourism (travel)	455	410	1 100	1 373	2 165	1 927	2 006	n.a.
SERVICES: DEBIT	2 343	3 190	3 788	3 364	4 867	5 367	5 645	4 873
BALANCE ON GOODS AND SERVICES	-2 911	-5 381	-4 196	-2 248	-2 382	-3 850	-3 528	-3 880
INCOME BALANCE	-319	-792	-1 022	-1 283	-1 882	-857	-784	-405
INCOME: CREDIT	270	418	857	860	915	1 110	1 330	1 578
INCOME: DEBIT	-589	-1 211	-1 879	-2 143	-2 797	-1 967	-2 114	-1 983
BALANCE ON GOODS, SERV. & INC.	-3 230	-6 174	-5 218	-3 531	-4 264	-4 707	-4 312	-4 285
CURRENT ACCOUNT, N.I.E.	-438	-2 166	185	1 903	2 812	2 299	31	-254
CURRENT TRANSFERS, N.I.E.: CREDIT	2 791	4 007	5 417	5 434	7 076	7 006	4 622	4 284
of which workers' remittances	2 071	3 212	4 284	4 054	6 104	5 664	3 672	n.a.
CURRENT TRANSFERS: DEB.	0	0	-14	0	0	0	-279	-253

Source: IMF.

Table 3. **Foreign Reserves and External Debt**

	(1) Total reserves incl. gold	(2) Total External Debt	(3) Res / Debt (1) as % of (2)	(4) Debt / GNP	(5) Debt Service Ratio*
1971	142	2 049	6.9	25.0	21.8
1975	297	4 836	6.1	43.2	10.3
1980	1 149	19 131	6.0	89.2	13.4
1985	1 370	36 102	3.8	115.0	25.8
1990	3 325	32 551	10.2	94.8	22.5
1991	5 981	33 026	18.1	102.2	17.1
1992	11 426	31 573	36.2	89.4	15.3
1993	13 520	31 109	43.5	79.4	13.6
1994	14 175	33 358	42.5	78.9	14.6

* Total debt service paid as a percentage of exports of goods and services.

Sources: IMF, World Bank.

The Paris Club agreement has been part of Egypt's international economic relations since 1991. Under it, 15 per cent of the country's debts were written off in July 1991, another 15 per cent in March 1993 after completion of the programme agreed with the IMF in 1991, and a further 20 per cent in October 1996, when Egypt complied with the terms of the IMF's new three-year extended facility of September 1993. The latter expired in September 1996 and was replaced by a further stand-by agreement for about $400 million running until September 1998.

The Egyptian economy in the 1990s has been a mixture of progress and inertia. The government, worried about disturbing the status quo too abruptly, responded hesitantly to pressure from the IMF, the World Bank and other foreign sources to reform outdated and inefficient structures and practices. The living standards of most people, especially the poor, fell as subsidies on many items were reduced and wages failed to keep pace with inflation. The government feared the social repercussions.

The economic and structural adjustment programme led to macro-economic stabilisation, liberalisation of the banking and financial sector and freeing of prices on some goods. The legal basis for privatisation was laid down in 1991 by the transfer of 314 public sector enterprises from government ministries and their conversion into affiliates of 16 holding companies which were still not independent of the public sector. The IMF's September 1993 facility was conditional on structural reforms, including further reduction of the budget deficit and inflation, privatisation, further trade liberalisation and business deregulation. The October 1996 facility required privatisation of 60 per cent of public enterprises, preparations for introduction of value added tax, and further tariff reductions.

Fiscal adjustments have involved revenue increases and expenditure reduction. A new sales tax was introduced, subsidies were rationalised and prices of electricity and petroleum products were raised to international levels. The general government deficit fell to about 2 per cent of GDP by fiscal 1995/96 and will probably be lower than 1 per cent in fiscal 1996/97. As a result, inflation slowed to less than 6 per cent in 1997. The public debt is now about 53 per cent of GDP. There was also progress in Egypt's external situation.

The External Profile

Egypt's balance of payments on current account (Table 2) brings out its structural trade deficit, which averaged \$6.2 billion a year from 1990-95 and shows no sign of falling. This is partly made up for by income from invisible transactions, mainly workers' remittances, tourism receipts and Suez Canal dues. In 1990-94, workers' remittances averaged \$4.8 billion a year and receipts from tourism \$1.7 billion. Egypt had an average overall current account deficit of \$1.3 billion from 1980 to 1989 and an average surplus of \$1.2 billion from 1990 to 1995, but now has a small deficit.

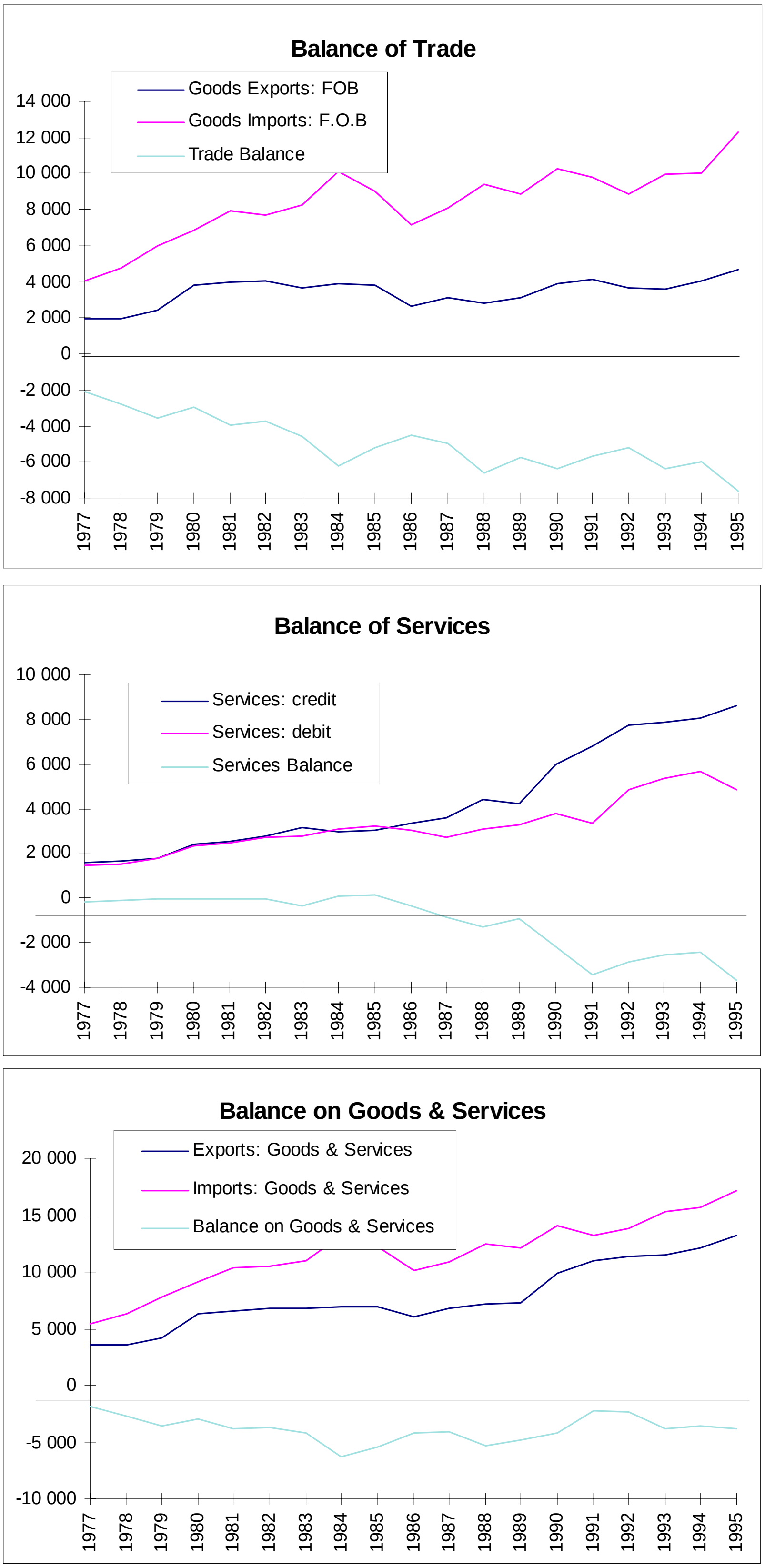
The country's external position greatly improved in the 1990s (Table 3). The average level of total reserves, including gold, as a percentage of total external debt, rose from about 5 per cent in 1980-89 to about 30 per cent in 1990-94. Similarly, external debt rose to about 143 per cent of GNP by 1988, and then fell to less than 80 per cent in 1994. As a result, the debt service ratio declined from a peak of 27 per cent in 1986 to an average 14.5 per cent in 1992-94.

In a typical year, Egypt's exports of petroleum and gas, tourism, official transfers, Suez Canal dues and workers' remittances add up to between a fifth and a quarter of GNP. These receipts are a sort of economic rent, deriving from Egypt's geological, historical and strategic situation. They are only partly influenced by domestic economic policies and tend to be volatile. Tourism was hit in the early 1990s by the Gulf War and a campaign of incidents to deter foreign visitors. Oil revenue depends on the fluctuating price of oil. Remittances also depend on oil prices since most workers are in oil-producing states. They also depend on political relations with the host countries. Canal dues have stagnated and foreign aid may well decline.

In the 1990s, the government went a long way towards liberalising international trade and payments policies. In 1990, import bans protected 23 per cent of all traded goods and services. Tariffs on imports ranged from 5 to 100 per cent. Most domestic production was protected by non-tariff import barriers. The export of some products was banned, while others were subject to quotas and other non-tariff barriers.

Figure 2. Egypt's External Equilibrium

(US$ million)



Source: IMF.

As a result of liberalisation, the number of tariff preferences has since been reduced and export bans and quotas abolished, as has the requirement of prior deposits for imports. By 1993, most non-tariff barriers had been eliminated, except those on textile imports, which will be phased out in line with the results of the Uruguay Round. Import tariffs have been greatly reduced and some abolished. The latest round of liberalisation in 1996 involved across-the-board import tariff cuts of between 10 and 25 per cent. The maximum rate for goods other than luxuries has been cut to 55 per cent, while tariffs for some items have been set much lower. Egypt is committed to reducing the current maximum tariff of 55 per cent to 40 per cent by July 1998.

The Egyptian pound's nominal exchange rate depreciated by a quarter between June 1990 and March 1991. The rate was unified in 1991 and has since been notably stable at about 3.39 to the US dollar. In 1995, exchange control was abolished, along with the obligation for exporters to repatriate foreign exchange receipts.

"The stabilisation policies have been highly successful", the World Bank said in 1997[7]. However, there have been two dark spots. (See Section III.) First, privatisation, vital if loss-making industries are to attain international competitiveness and profitability, has been slow. Some of the progress announced has been more window-dressing than a real shift in ownership. Also, despite the improved business environment, private investment — indispensable if the economy is to grow fast enough to reduce unemployment and raise living standards — has not grown much.

The Implications of the Uruguay Round

Egypt's growing participation in the changing global economy should stimulate private investment and privatisation. The impending association agreement in the context of the Europe-Mediterranean Partnership is regarded as "*GATT plus"* because it takes the Uruguay Round agreements as its base. The present section draws heavily on Hoekman and Subramanian's *Egypt and the Uruguay Round*[8]. In their simulation, they conclude that "*the Uruguay Round will generally have a limited impact on Egyptian policies affecting goods, investments and services*", and that the overall balance of payments implications of the Round for Egypt, while negative, may not be very significant.

Implications for Egyptian exports. For Egypt and other developing countries, the Uruguay Round was mainly a way of getting better access to industrial countries' markets. Under the co-operation agreement with the EU in 1977, Egypt gets duty-free access to the EU for exports of industrial goods (except textiles and clothing), which accounted for 58 per cent of its total exports to that market. Similarly, 41 per cent of its exports to Japan already entered at zero MFN rates.

The Uruguay Round has reduced the average MFN tariff on other Egyptian exports from 6.8 to 4.5 per cent[9]. This reduction is being phased in five equal steps which began in 1995. However, tariffs on two product groups of special interest to Egypt were cut by a lower than average rate and stand at a higher than average level: tariffs on textiles and clothing are being reduced from 14.6 to 11.5 per cent and those on leather, rubber, footwear and travel goods from 8.1 to 6.6 per cent. According to Hoekman and Subramanian, this reduction of the MFN rate will boost exports by about $4 million by 2005.

The phasing out of the *Multi-Fibre Arrangement* will help Egypt's textile and clothing exports. Over 10 years, quota growth rates will be expanded: products will be integrated into the GATT and so no longer be subject to quotas. By 1997, about a third of the 1990 total volume of imports was due to be integrated in this way. All this will help Egypt's exports and further its comparative advantage in the sector. The simulation exercise concludes that by 2005, exports of textiles and clothing to the EU and the US will be $218 million more than in the absence of the Uruguay Round. However, "to avail itself of the opportunity opened up by expanded exports, Egypt's supply capacity will have to be improved"[10].

As the MFN rate on industrial imports to developed countries falls, Egypt's preferential margins on its zero-rated industrial exports will be eroded. By 2002, this will have caused an estimated loss of about $2 million worth of exports.

Implications for Egyptian imports. Egypt's commitments under the Uruguay Round will help integrate it further into the global economy. It has increased its tariff bindings from 3 per cent of tariff lines before the Round to 100 per cent in agriculture and 97 per cent in the industrial sector. These commitments are comparable to those of many OECD countries. As a result, Egypt's unweighted bound tariff in 2005 will average 62 per cent in agriculture and 32 per cent in industry — or 37 per cent overall.

The level of applied tariffs is 32 per cent overall, or 56 per cent for agricultural goods and 27 per cent for industrial goods. This is high by international standards. The average tariff in many developing countries is no more than 15 per cent. While the overall bound tariff is 5 percentage points higher than the applied tariff (37 per cent as against 32 per cent), Egypt's reform programme under its arrangement with the IMF calls for further tariff cuts. Once the programme is implemented, the overall applied tariff will fall to 26 per cent — 11 percentage points lower than the bound tariff.

Under the Uruguay Round, all countries made a further commitment to eliminate all quantitative restrictions on agriculture. For Egypt, this will mean abolishing restrictions on some poultry products. It also pledged to eliminate by 2005 quantitative restrictions on textiles and clothing which account for about 8 per cent of all tariff lines. According to Hoekman and Subramanian, this will increase imports by about $220 million by 2005.

The Uruguay Round's agreement on agriculture will also lead to gradual liberalisation of trade in this sector. Over six years, non-tariff barriers will be converted into tariffs or eliminated and the new tariffs bound by all countries. The level of domestic support and export subsidies will be cut. This may increase Egypt's import bill for such items as wheat and maize and reduce it for others, such as tea and edible oil. The simulation exercise concludes that the import bill may be as much as $26 million higher in constant dollars.

New areas. Egypt's commitments under the *General Agreement on Trade in Services* (*GATS*) amount to locking in the status quo: while they do not represent any liberalisation, they do promise no increase in restrictions.

The Uruguay Round's *Agreement on Trade-Related Intellectual Property Rights (TRIPs*) will most affect the Egyptian pharmaceutical sector, but its full impact will not be felt until 2015. By then, the requirement of patent protection for pharmaceuticals may increase drug prices. Pharmaceutical sales in Egypt topped $600 million in 1993.

The Uruguay Round's *Agreement on Trade-Related Investment Measures (TRIMs*) acknowledges that some investment practices restrict or distort trade. Measures requiring particular levels of local sourcing by a firm are one kind of TRIM which, according to the agreement, should be eliminated over a five-year period. Egypt already eliminated some local content requirements in 1994, under the adjustment programme agreed with the IMF, but certain industries still require local content of up to 60 per cent to qualify for customs duty reductions.

Overall, Egypt made few commitments under the Uruguay Round agreements to liberalise its trade and mainly limited itself to locking in its past liberalisation measures and making its regime more transparent and rules-bound. The only real new element was its pledge to eliminate quantitative restrictions on textiles and clothing and on poultry.

At the same time, Egypt did not get much better access to markets in industrial countries. The only major opening will be the phasing out of the *Multi-Fibre Arrangement,* which limits Egypt's textile and clothing exports. In this key sector for Egypt, a traditional producer and exporter of cotton, the quotas should be eliminated by 2005, though tariffs will remain relatively high in the European Union and the United States. Overall, the Uruguay Round will probably have virtually no net balance of payments effect on Egypt (Hoekman and Subramanian, 1996).

Most disappointing in the present situation are Egypt's persistently high import tariffs. The binding of past tariff reductions is significant insofar as Egypt has reduced its margin for reversing past liberalisation. This is important for domestic producers, who understand that in future protection can only decrease, together with the economic rent it gives rise to. Nevertheless, the present level of protection is damaging enough for Egypt. Consumers have less choice, pay more and have to buy lower quality goods than those available on the world market. Some producers must be pocketing an economic rent, which they partly use to bolster their position, and others must be paying higher prices than they need to for intermediate inputs. The inherent anti-export bias of Egypt's high tariffs slows the country's efforts to emulate the export-led growth of the dynamic economies of South-East Asia. Non-tariff barriers to trade in many services, which are an intermediate input for industry, reinforce the anti-export bias.

II. EGYPT AND THE EUROPEAN UNION

An association between Egypt and the European Union is being negotiated in the context of the Europe-Mediterranean Partnership. Meanwhile, relations between the two sides are governed by the co-operation agreement of 1977. This section looks at current economic relations and then at the Europe-Mediterranean agreements with Tunisia and Morocco to analyse the implications of a similar agreement for Egypt.

The 1977 Co-operation Agreement

The policy of the European Community (later the European Union) towards Egypt has been typical of its policy towards non-member Mediterranean states[11]. A trade agreement has given preferential treatment to Egypt's exports, while financial protocols have helped finance improvement in the country's supply capacity. The co-operation agreement of January 1977, which was updated as the European Community grew bigger, provides for broad co-operation and, being of indefinite duration, established a stable contractual framework for long-term programming decisions. Four successive financial protocols to the agreement covered the period 1977-96.

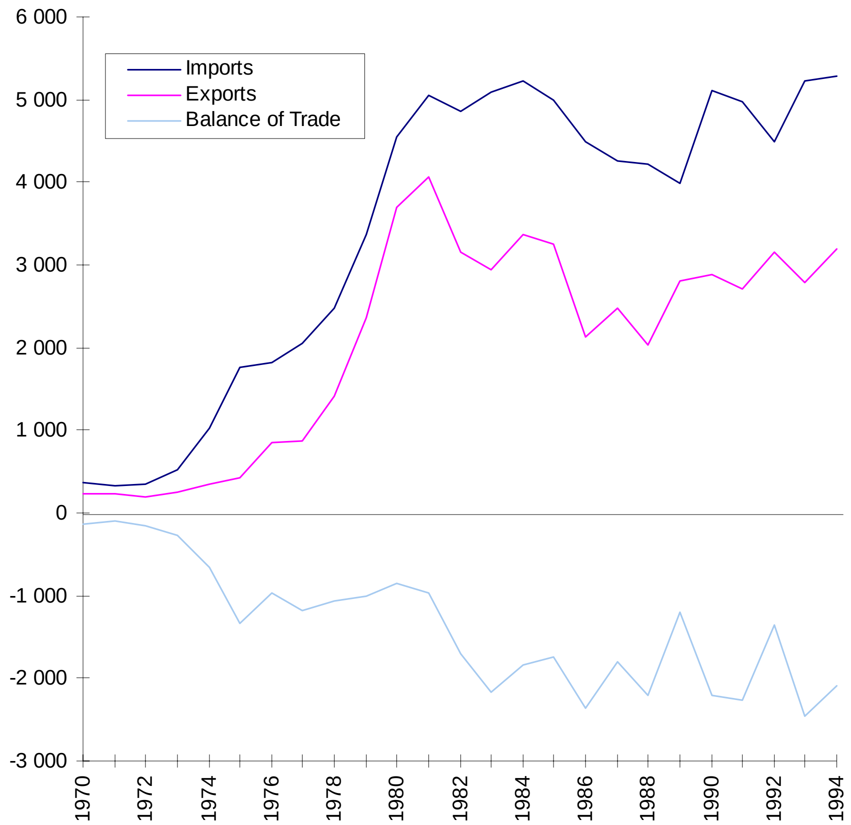
The agreement gives Egypt's raw material and industrial exports free access to the EU market, except for sensitive products such as textiles and clothing. Annual ceilings are sometimes imposed on certain cotton fabrics and cotton yarn, but Egypt has not usually attained these ceilings. The agreement is not reciprocal and the EU's exports to Egypt receive only most-favoured-nation treatment.

Egypt's agricultural exports enjoy significant and well-defined concessions. Most are complementary to EU production, either not being produced in the EU, like dates and mangoes, or produced earlier, like onions and potatoes. About 70 per cent of agricultural exports benefit from tariff concessions of 40 to 80 per cent of the common external tariff, but quotas and calendars are imposed. Tariff reductions apply only part of the year, usually before competing European products come on the market. Also, protection of the EU's common agricultural policy involves reference prices for fruit and vegetables.

Egypt's imports from the EU were boosted by opening up the economy to the outside world from 1974 on. Exports increased later and more slowly (Appendix A). From 1990 to 1994, Egypt's exports to the EU Twelve (the EU countries between 1986 and 1994) were 55 per cent of its total exports.

Imports from the EU were 43 per cent of its total imports. Over the five-year period, Egypt's exports to the EU paid for about 56 per cent of its imports from the same source, and its average annual trade deficit of $2.4 billion with the EU was about a third of its total deficit.

Figure 3. Trade between Egypt and Europe
(US$ million)



Source: OECD.

Petroleum, petroleum products and related materials have invariably been the bulk of Egypt's exports to the Twelve, though their share fell from 87 to 57 per cent between 1980 and 1994 (see Appendix B). Egyptian manufactured exports to the Twelve more than trebled in value between 1980 and 1994 and their share rose from 4.7 to 18.3 per cent of total exports. The major item was textile yarn, fabrics, made-up articles and related products (12.4 per cent in 1994) and non-ferrous metals (4 per cent). Other major exports have been machinery and transport equipment (8.2 per cent) and miscellaneous manufactures (6 per cent), most of which (4.8 per cent) were articles of apparel and clothing accessories. Food and live animals have a small share of exports — 3.5 per cent in 1994, of which 2.5 per cent were fruit and vegetables.

Among EU exports to Egypt, machinery and transport equipment is about half the total — 48.7 per cent in 1994 (see Appendix C). This includes general and specialised industrial machinery, power-generating machinery and other capital goods, as well as electrical appliances, vehicles and other transport equipment. The other three main exports are chemicals and related products, manufactured goods, and food and live animals, each 12-13 per cent of exports from the EU to Egypt.

EU aid to Egypt under the four financial protocols covering 1978-96 is summarised in Table 4. The country also received 450 million ECUs in food aid and 175 million ECUs as special assistance during the Gulf War. The total of 2.1 billion ECUs is about a third of EU aid for the whole Mediterranean and makes Egypt by far the region's biggest recipient of EU financial support.

Table 4. **Egypt-EU Co-operation Agreement Financial Protocols**
(in millions of ECUs)

	I (1977)	II (1981)	III (1986)	IV (1991)	Total
EIB loans	93	150	249	310	802
Soft loans	14	50			64
Non-refundable aid	63	76	189	242	570
Venture capital			11	16	27
Total	170	276	449	568	1 463

Source: EEC.

The loans by the European Investment Bank on its own resources were at market-related interest rates, but a rate subsidy could be paid by using part of the grant component of the protocols. The subsidy was 3 per cent under the first and second protocols, and 2 per cent under the third and fourth. As from the second protocol, it was not available for loans to the oil sector. The first and second protocols included loans on special conditions — for 40 years at 1 per cent with a 10-year grace period for repayment of the principal. These were discontinued under the third and fourth protocols and replaced by a contribution to formation of risk capital.

The first and second protocols (1978-81 and 1981-86) said aid could be used to invest in direct production or economic infrastructure. Industrialisation and modernisation of agriculture were special targets. It could also be used for training and technical assistance. The protocol said Egypt and the European Community had to agree on specific aims of financial co-operation and that participation in the financed projects was limited to individuals and legal entities with Egyptian or Community nationality.

The third protocol (1986-91) was different. Venture capital was to be a priority in helping Egyptian private and public firms, especially those having links to a Community member-state. Three new priorities were set for projects to be financed: *a)* development and diversification of farm production to help reduce Egypt's food dependence and diversify agricultural exports "with a view to greater complementarity between the different regions of the Mediterranean"; *b)* strengthening economic links between Egypt and the Community through co-operation in industry, training and research; and *c)* helping regional and multilateral co-operation.

The fourth protocol (1991-96) reiterated the first two priorities, but replaced the third by a new one — environmental protection. It highlighted agricultural projects included in a pluri-annual national strategy to make up for product deficits. On industry and services, it called for joint action between Egyptian and Community operators, such as direct contacts, information exchange, investment promotion and help for small and medium-sized firms. The protocol favoured projects for diversifying and promoting exports and encouraging contacts between Egyptian and Community operators. It also said help was available for Egypt's population policy and family planning programme.

The grant element of the fourth protocol comprised support for agricultural and related sectors (40 per cent), improvement of the economic reform programme (30 per cent) and environmental and demographic policy (10 per cent). The rest (20 per cent) was kept as a reserve for structural adjustment operations. Priority areas for EIB loans were energy, economic infrastructure and investment in small and medium-sized enterprises. Under this protocol, Community grants of 300 million ECUs were provided for Mediterranean countries for the five years to 31 October 1996 to promote economic reform and structural adjustment programmes approved by the IMF and the World Bank.

Together, grants under the four protocols have concentrated on agriculture (48 per cent) and environmental and social infrastructure (33 per cent). The remaining 19 per cent went to programmes related to economic co-operation, energy, scientific co-operation and health. Energy, infrastructure and industrial development attracted most of the EIB loans of the first three protocols.

The co-operation agreements were judged to have helped the economic and social development of the European Union's partner states in the Mediterranean. The EU contributed[12] an estimated $4.5 billion to Algeria, Morocco and Tunisia together during the life of the agreements. The bulk of it ($4.3 billion) was through imputed gains from trade and the rest in financial flows. However, the accords were deemed insufficient in the political and economic context of the 1990s and it was agreed Mediterranean countries should have a bigger place in the European Union’s political and economic relations. This led the EU to develop a more integrated approach, which gave rise to the Europe-Mediterranean Partnership.

The Europe-Mediterranean Partnership

In November 1995, a Europe-Mediterranean Partnership was launched by the European Union and 12 non-member Mediterranean partners (11 states and the Palestinian Authority). The Partnership was outlined in the Barcelona Declaration and Work Programme and has three parts: political and security matters, economic and financial matters, and social, cultural and human affairs.

The economic and financial partnership involves creation of a free-trade area among the 27 partners; economic co-operation and concerted action; and financial co-operation. The free-trade area will be set up through new association agreements between the EU and individual countries, called Europe-Mediterranean agreements, and free-trade accords between the partners themselves. The year 2010 was set as target date for gradual establishment of this area which “will cover most trade with due observance of the obligations resulting from the WTO”.

Four agreements have so far been made, though not yet ratified — with Tunisia, Morocco, Israel and the Palestine Liberation Organisation. Others are being negotiated with Egypt, Algeria, Jordan, Lebanon and Syria. The agreements are similar. Industrial exports from the partner country will still have duty-free access to the EU, while duties on industrial exports from the EU to the partner country will be phased out over 12 years. The EU is expanding somewhat the facilities it gives agricultural exports from partner countries. It is also allocating 4.7 billion ECUs in non-refundable aid to the whole region for the five years up to 1999 and an equivalent amount in loans from the European Investment Bank.

The bilateral agreements are set to establish the framework for free trade by about 2010 between the EU and the Mediterranean countries. However, there is still no prospect of free trade agreements between the non-member Mediterranean countries. Peace is obviously needed for free trade between Israel and the Arab countries. But even among the Arabs, there are few frontiers presently open to free trade despite attempts at closer economic integration over the last 50 years. So by 2010 a hub-and-spokes system will probably have developed, with the EU as the “hub” and the partner countries as its “spokes”. As the EU is likely to expand before 2010 to take in several Central and Eastern European countries, the “hub” will become bigger and stronger in the meantime.

Judging by the Europe-Mediterranean agreements already made, the one with Egypt will divide the country's industrial imports into several groups. One is a group of goods which will *not* be allowed in duty-free even after the transition period — probably consumer goods produced by firms needing protection from foreign competition. The other groups will include goods on which duties will be phased out over different parts of the 12-year period, for example, the first five years, uniformly or not over the 12 years, or during the later part of the period.

As Egypt will still charge MFN rates on imports from non-EU countries, the preferential Europe-Mediterranean agreement will divert trade from non-EU to EU suppliers. This could be substantial since the EU supplies less than half Egypt's imports — 43 per cent in 1990-94 (Appendix A) — and Egypt's MFN tariff remains high.

Liberalisation will create trade because more efficient EU suppliers will replace domestic production. However, this will be moderated by two things. The first is the timing of tariff dismantling. Tunisia, for example, front-loaded reductions in duties on imports of intermediate and capital goods and backloaded reductions in duties on final and consumer goods. So during the 12-year transition, the latter will have higher effective protection. This may also happen with the Egyptian agreement. Import flows will be kept under observation too and measures may be taken to protect the Egyptian or EU markets from disruption or special circumstances.

The agreements with Tunisia and Morocco[13] allow them to take exceptional short-term measures increasing or reintroducing customs duties, provided they concern infant industries or sectors being restructured or facing serious difficulties "particularly where these produce major social problems". Such duties may not exceed 25 per cent and shall retain an element of preference for EU products. Imports subject to these measures may not exceed 15 per cent of total imports of industrial products from the EU during the last year for which statistics are available. These measures may not, in principle, be applied for more than five years and "shall cease to apply at the latest on expiry of the maximum transitional period of 12 years".

Safeguard measures may also be taken[14] where a product is imported in such increased quantities as to cause, or threaten to cause serious injury to domestic producers of similar or directly competitive products, or serious disturbances in any sector of the economy or difficulties which could bring about serious deterioration in a region's economy. So the EU keeps the right to take anti-dumping and countervailing measures which have proved strongly dissuasive.

Under the co-operation agreement, at least 60 per cent of the value of an Egyptian industrial export must originate in Egypt or the EU to qualify for duty-free access to the EU. The Europe-Mediterranean agreement is likely to follow the agreements with Tunisia and Morocco[15] which define originating products as “having undergone sufficient working or processing” in the contracting countries. This will exclude mixing of products, packaging or placing in containers, “simple assembly of parts to constitute a complete product” and other simple operations.

The relatively high local content requirement discourages investment by non-EU firms in the partner Mediterranean country. Since many manufacturers have to import a lot of their inputs from parent companies in their first years of operation, a parent company in a non-EU country may not be able to take advantage of the free trade provisions[16].

The agreement with Tunisia allows cumulation of origin with Algeria and Morocco and that with Morocco allows cumulation with Algeria and Tunisia. Both include a European Community declaration that “if Tunisia (or Morocco) concludes agreements with other Mediterranean countries with a view to establishing free trade, the European Community is willing to consider cumulation of origin in its trade with those countries”. This encourages economic ties. Egypt’s trade with non-EU countries in the Europe-Mediterranean Partnership is a small share of its foreign trade, but cumulating local content requirements among all 27 partners would help create area-wide linkages and partly offset the Eurocentric effect of the bilateral agreements.

Egypt’s insistence on better access to the EU for its farm exports has been one of the trickiest points of the current negotiations. In its Barcelona Declaration, the commitment on agriculture was limited: *“Taking as a starting point traditional trade flows, and as far as the various agricultural policies allow and with due respect to the results achieved within the GATT negotiations, trade in agricultural products will be progressively liberalised through reciprocal preferential access among the parties*”. However, Egypt feels the agreement being negotiated favours the EU. Egypt will give the EU free access to its market for industrial exports, while continuing to impose MFN rates on imports from EU competitors. Egyptian industrial exports already enjoy free access to the EU, but the two sides are not at the same level of economic development and their products do not compete equally. So Egypt could reasonably expect compensation through easier access to the EU for its farm products.

The EU’s agricultural exports to Egypt are five or six times more than its imports. However, the EU claims that easier access for typically Mediterranean products exported by Egypt (oranges and potatoes) could disrupt markets for these items. The idea of “traditional flows” also limits Egypt’s requests for better access. These are mentioned in the co-operation agreement of 1977, as periodically updated, when Egypt’s foreign trade was overwhelmingly with Central and Eastern Europe, including the USSR. The EU considers as unrealistic Egyptian requests based on comparisons with agreements with other countries with traditionally greater trade with the EU, such as Tunisia and Morocco. As it did with these two countries[17], the EU may agree to review its agricultural concessions as from January 2000. However, in view of past and present negotiating positions, such commitments seem unlikely.

On liberalisation of trade in services and right of establishment, the agreements so far with the Mediterranean countries are only evolutionary. In the case of Tunisia and Morocco[18] the parties reaffirm their GATS obligations, particularly of granting reciprocal most-favoured-nation treatment in service sectors. They also agree to widen the accord to cover right of establishment of one party's firms on the territory of the other and easier provision of services by one party's firms to consumers of services in the other. The institutions set up by the agreement will make recommendations about this and an assessment will be done within the agreement's first five years. The agreement with Morocco provides for immediate assessment of international maritime transport. These provisions do not go beyond the WTO's General Agreement on Trade in Services. However, by creating an institutional mechanism to anchor some of the partner economy to the EU, they ensure that change will be towards liberalisation.

The same cautious assessment can be made of other potentially-important provisions:

a) the parties will "take appropriate steps" to promote use by Tunisia and Morocco of European technical rules and standards for industrial and agri-food products and certification procedures, and "when the circumstances are right," will sign agreements for mutual recognition of certification[19];

b) the parties shall provide suitable and effective protection of intellectual, industrial and commercial property in line with the highest international standards[20];

c) the parties shall "take as their aim" reciprocal and gradual liberalisation of public procurement contracts[21];

d) within five years after the agreement, rules will be adopted banning practices restricting competition such as abuse of dominant position and state aid which distorts competition[22].

These provisions justify the comment that "on other important issues, there is more promise than progress"[23].

Financial aid is a major feature of the Mediterranean agreements. Ninety per cent of the 4.7 billion ECUs will be allocated to national projects and 10 per cent to regional ones. Each country will be unofficially assigned its share of funds earmarked for national projects. Informal assessments show Egypt's share could exceed 700 million ECUs for the five-year period. Non-refundable aid under the last financial protocol was 242 million ECUs, so the current situation is a great improvement.

The distribution of funds is also significant. At least a third will be assigned to making Egyptian industry more competitive by investing in modernisation, upgrading human resources and by contributions to the Social Fund. Technical aid to improve the quality of Egyptian exports will be emphasised.

Egypt was one of the countries most insistent that the EU partnership with the Maghreb countries be expanded into a fully-fledged Europe-Mediterranean Partnership. Egypt gains by being at least as favoured in EU markets as its Mediterranean competitors and it is clear the current negotiations will succeed. Various things are delaying them. On one hand, Egypt's industrial products already have duty-free access to the EU under the 1977 agreement and the EU has continued to give Egypt financial aid under the MEDA funds, which have replaced the financial protocols. On the other hand, the EU is not offering much greater access for Egyptian farm exports and under the Europe-Mediterranean agreement, Egypt will have to start opening its markets to EU industrial items. Despite the Egyptian government's good will, some caution is understandable, especially since domestic lobbies are resisting.

III. POLICY REFORM AND POLITICAL CONSTRAINT

By introducing free trade between two entities of very different economic levels, the Europe-Mediterranean agreement between Egypt and the EU will impose very ambitious targets on Egypt and its policy-makers. The right scene has been set by the highly successful stabilisation policies of the 1990s (see Section I). But more basic structural reforms would be needed during the 12-year transition period. The Egyptian economy would then be expected to compete with industrial products from the EU without sheltering behind protective barriers and without economic and social traumas.

The government's ability to implement many of the reforms is not in doubt. But in the light of past experience[24], can it do so in such a short time, especially as the reforms would cut into the very fabric of Egyptian society and way of life? At the start of the current negotiations, Egypt asked for a 15-year transition period but the WTO expects a free trade area to be formed "within a reasonable length of time" which "should exceed 10 years only in exceptional cases"[24a]. The EU held it could not stretch this requirement beyond 12 years.

In Egypt, as in the rest of the region, the main aim of trade and domestic economic management should be to stimulate competitiveness[25]. This can be done by improving the investment climate and technical efficiency and by reducing transaction costs. The necessary policies come under these headings:

A. Investment

B. Privatisation

C. Greater openness and deregulation

D. Improvement of the business environment

E. Agricultural expansion

F. Adjustment, financial assistance and the new entrepreneurs.

A. Investment

Investment in Egypt is low compared with dynamic developing economies and too low to put the country on a high growth path. As well as strengthening existing policies, more emphasis should be put on industries with comparative advantage and on agreements for freer trade and greater economic integration in the region.

The World Bank estimates[26] that for real GDP growth to reach 7.5 per cent in 2005 (or 5.4 per cent per capita), gross domestic saving has to rise from the current 17 per cent of GNP to 28 per cent in 2005 and gross investment from 20.7 to 26 per cent of GNP. The problem is not lack of funds. Egypt has high official foreign reserves (see Section I above) and higher private reserves. Flight capital accumulated abroad is unofficially put at $60 billion and was probably the source of some of the foreign portfolio investment in recent years. Higher growth would also bring higher income and its own higher savings. In addition, capital is mobile world-wide and all investors are drawn by the chance of profit.

Egypt has gone as far as its competitors to attract foreign direct investment. It recently modernised its banking and stock exchange laws and in May 1997, parliament passed a unified investment law to rationalise the multiple enactments that regulated investment. Incentives include a guarantee of foreign ownership of firms, recruitment of necessary expatriate staff and repatriation of profits. It also provides for tax holidays, low interest finance, cheap land and infrastructure and other incentives. So the reason for the low level of investment must lie elsewhere.

A main aim of the Europe-Mediterranean agreement is deeper integration with the EU so as to make Egypt more attractive to foreign direct investment. However, the agreement will do this only when some of the provisions are in place (see Section II above). Initially, it will be more of a traditional trade agreement[27] and could even encourage diversion of investment towards the EU.

The free-trade agreements among the EU's Mediterranean partners, envisaged by the Barcelona Declaration to counterbalance their bilateral agreements with the EU, are unlikely to be in operation by 2010. This will tend towards a "hub-and-spokes" system[28]. A prospective EU investor will have free access for his products to the EU plus 12 countries, while an investor in Egypt or another Mediterranean partner will have free access to the EU plus one country. This will be less harmful in Egypt's case because of the country's size, but the trend will sharpen during the transition period. Several Central and Eastern European countries already have deeper association accords, called Europe agreements, with the EU and are expected to join the Union well before 2010. So the "hub" will become larger and stronger while the Europe-Mediterranean agreements are still being implemented. It is thus in Egypt's interest to make more free-trade agreements with other Mediterranean states and further afield, using its leadership position in the region and world-wide.

The potential of such regional agreements seems even higher than the Europe-Mediterranean agreement. Egypt's intra-industry trade index has been calculated[29] to show its degree of industrial specialisation and hence ability to compete in a more open trade environment. Three conclusions emerged:

i) The index is low: 0.17 in 1992-94, compared to 0.89 for the EU, 0.58 for Israel, 0.30 for Tunisia, and an average of 0.25 for 13 Arab countries;

ii) It is rising rapidly: it was 0.10 in 1984-86, compared to 0.88 for the EU, 0.47 for Israel, 0.24 for Tunisia, and an average of 0.16 for the 13 Arab countries;

iii) Egypt's index in trade in manufactures in 1992-94 was lowest in its trade with the EU: 0.11 compared to 0.17 for its total world trade, 0.25 for its trade with developing countries and 0.28 for its trade with other Arab states.

The index's very low level, compared to the EU's, means Egypt's "flexibility to adjust to a more competitive environment will take time". Its rapid rise shows the country's potential. Its higher level for regional trade with other Arab countries and developing countries suggests such trade is more promising than trade with the EU and "could be viewed as reinforcing the position that bilateral trade agreements between the signatory Arab states and the EU should be accompanied by regional or even multilateral liberalisation".

Direct investment, both foreign and domestic, will probably be attracted by sectors where Egypt has a comparative advantage. In the early 1990s, the comparative advantages of the manufacturing sector — abundant skilled but relatively low-wage labour, a wide range of domestically-produced intermediate goods and a relatively developed infrastructure — were considered largely untapped[30]. Trade flows for 1985-87 showed Egypt's strong revealed comparative advantage in fruit and vegetables, cotton, animal and vegetable materials, beverages, essential oils, leather goods, yarns and fabrics, aluminium, handbags, travel goods, apparel, clothing and footwear[31].

More recent overall studies on the Middle East and North Africa tend to agree. The region has comparative advantage and greatest export opportunities in refined fuels, chemicals, food and animal feeds, and manufactures, especially textiles[32]. Intra-industry trade indices for 1992-94 show chemicals are the most specialised item and thus most likely to compete effectively in Arab countries. Other manufactured products are well placed. The indices were: organic chemicals 0.96; aluminium 0.85; clothing 0.84; leather manufactures 0.80; soaps 0.70; leather 0.64; inorganic elements 0.64; plastic materials 0.64; footwear 0.53; and textile products 0.44[33].

B. Privatisation

By mid-1997, the government had proved its determination to reduce the role of the public sector in the economy, but privatisation was likely to be slower than officially expected.

Between 1952 and the early 1990s, the Egyptian government over-extended itself in areas unsuited for public ownership. Managers of public enterprises had little incentive to be efficient and respond to consumer tastes and market conditions[34] and so they did not. In the pharmaceutical industry, value added per worker in the private and foreign sectors is four times higher than in the public sector, while wages are only 26 per cent higher[35]. During the world textile recession of the late 1980s and early 1990s, exports of cotton lint, yarns and other products for which the public sector was the only or main supplier lost ground, while exports of clothing and other manufactures — parts of the industry with higher value added and higher private sector participation — expanded. This clearly shows the private sector's greater ability to adapt and to penetrate foreign markets[36].

In sectors where public companies have a monopoly, particularly services, international comparisons are similar. Transport accounts for 10-11 per cent of the CIF cost of imports into Egypt, which makes Egyptian products less competitive. In 1994, the cost of shipment and loading was higher than in Jordan, Syria and Turkey by 27, 22 and 19 per cent, respectively[37]. The revenue of the telecommunications sector as a percentage of GDP is marginally higher in Egypt than in Korea, which has nine times as many telephones per capita. In Korea, demand for telephones is fully satisfied and there is no waiting list. In Egypt, the waiting time is 5.8 years. Egyptian public banks are protected by an array of regulations and preferential treatment. Branching is more restricted for private banks than public sector banks. But the latter are more prone to interference in credit and planning decisions than private banks and have had relatively high levels of non-performing loans, most of them theoretically guaranteed by the government.

The government accepted privatisation as part of the programmes agreed with the World Bank and the IMF in the early 1990s. It earmarked 314 companies for privatisation. The process, slow at first, has been more vigorous since 1996. Early that year, a list of 120 firms ripe for privatisation was published and two lists of 120 others were released in 1997. They cover a wide range of activities — cement, metallurgy, textiles, pharmaceuticals, food processing, maritime transport and tourism. By mid-1997, the government had sold stakes in 40 companies and, in the case of 11 others, sold a majority of shares to employees. In fiscal 1996/97, privatisation drew portfolio investment of $1.3 billion and foreign direct investment of $800 million. Much progress has also been made towards commercialisation. Public enterprises are now incorporated under a law distinguishing between ownership and management responsibilities. Budget transfers to public enterprises have been reduced and banks are being encouraged to lend to them on commercial grounds[38].

However, these trends cannot be extrapolated into the future. The government first privatised the easiest companies to sell, but few others are attractive enough to be put on the market. So the authorities are looking for direct investors who can bring in technology and skills to make them profitable. This will take longer than offering them through the market. The sale of second tranches in partly privatised companies could also be a problem unless their prices are lowered[39]. The right policies are being followed, but again the process will be longer than officially anticipated.

C. Greater Openness and Deregulation

The Europe-Mediterranean agreement will not provide for immediate liberalisation of services or right of establishment, but will create an institutional framework for it and so give greater credibility to domestic policies in the right direction.

Competitiveness should be sought world-wide as well as domestically, and privatisation and commercialisation should be accompanied by greater openness to the world. The World Bank has noted[40] that Egyptian products lack price competitiveness and quality ("Domestic prices can be even higher than world market prices"). High prices are clearly not generated by labour costs, which are among the region's lowest, but by the other factors in price formation: "Import substitution prevents foreign competition from accessing Egypt's market, domestic monopolisation stifles internal competition". This leads to high prices, low quality, mediocre export performance and a structural trade deficit. It also stops Egypt reaping the benefits of its resources: petroleum and gas reserves, fertile farmland and a convenient geographical location served by the Suez Canal and ports on the Mediterranean Sea.

Protectionism has perpetuated the cosy rentier mentality. Only a determined reversal of such attitudes and policies can launch Egypt on the high 6-7 per cent annual growth path needed to cut unemployment (see Section I above). This change seems to be taking place slowly, judging by Egypt's minimalist approach in the Uruguay Round and the Europe-Mediterranean agreement negotiations. The agreement's expected early reduction of import duties on capital and intermediate products will cut costs for Egyptian industry, which will get increased effective protection. The government can at least reduce at the same time barriers to internal competition, including subsidies, regulations impeding new entrants into particular production lines, certain public utility monopolies, and rules and practices favouring public over private companies. This would help soften the resistance of the economic establishment to reducing import duties on final goods during the last part of the transition period.

The evidence shows[41] that protectionism in the services sector, and hence high prices and low quality, are a serious handicap for Egyptian industry at all levels. So it is a great pity that for the first five years, the Europe-Mediterranean agreement will not require liberalisation of services or right of establishment and that even after that it will only make recommendations.

The Egyptian government's view that the country will not get enough from the association agreement is somewhat justified. However, the agreement is only to eventually establish a free-trade area between Egypt and the EU, that is, unimpeded reciprocal trade. Unlike the long-standing association agreements with Turkey (1963), Malta (1970) and Cyprus (1972), the new Europe-Mediterranean agreements do *not* provide for a customs union with the EU. So Egypt will not be bound to adopt the EU's common external tariff. As most Egyptian imports come from non-EU countries, preferential liberalisation only favouring the EU is bound to lead to trade diversion from Egypt's other trading partners at a cost. Egypt could avoid this cost by reducing its tariffs to all countries simultaneously.

At present, MFN rates are high and are being negotiated downwards with the World Bank and the IMF; but their reduction seems to be a manageable medium-term revenue problem for the government because import duties are 15 per cent of tax revenue and 10 per cent of current central government revenue. However, it would obviously help Egypt towards extending the access it gives EU exports to *all* OECD countries if they all, in turn, gave the same access as the EU to Egyptian exports.

The Europe-Mediterranean agreement will provide an institutional anchor. The current state of liberalisation will be locked in and there will be an implicit guarantee that protectionism will not be strengthened. Indeed, there will be the prospect of further liberalisation. This anchor to the EU makes credible Egypt's promise to move towards its more developed partner. Mutual recognition of standards and certification procedures and liberalisation of services and right of establishment will come slowly, but surely.

D. Improvement of the Business Environment

Egypt would get a sizeable gain in efficiency and welfare by just reducing its administrative non-tariff import and export barriers[42].

Commentators often say "red tape" is a big handicap for Egyptian industry and exports and blame administrative controls for undermining the credibility of trade policy reform[43]. Other observers talk more frankly of corruption[44]. As the state is omnipresent and often represented by badly paid employees, corruption can become endemic. In Egypt, it is a deeply-rooted cultural phenomenon impossible to eradicate within the 12-year transition period laid down by the Europe-Mediterranean agreement.

The country's ports and airports are some of the most frustrating and expensive obstacles to foreign trade in both directions. Lengthy customs procedures are euphemistically said to be lacking in transparency, as are inspection procedures of standards, quality, health and safety. The legal and regulatory system is seen by all as a block to efficient conduct of business.

Enforcement of rules and regulations are not always preceded by adequate discussion or notice. Contract enforcement is more uncertain and takes longer than in modern and fast-growing economies.

The World Bank[45] has recommended steps to improve the business environment, including:

— legislation to end legal and regulatory state monopolies in port services;

— elimination of interlocking directorships and share-holdings among port authorities and operating companies;

— the end of air transport monopolies;

— adoption of pre-shipment inspection;

— customs reform to minimise face-to-face contact between importers and officials;

— establishment of a single inspection and testing authority;

— recognition of international standards certification;

— greater transparency and due process in regulatory, legal and judicial matters.

These are the roadblocks manufacturers and exporters can encounter in Egypt. Dismantling well-entrenched institutions and practices, often at grassroots level, involves facing political resistance. Despite official good will, substantial progress can only be expected in the long term. The government took six years to privatise 40 out of 314 companies and in the coming 12 can only be expected to carry out some of the World Bank recommendations. The Europe-Mediterranean agreement will be an anchor and a credible assurance that reform will be in the right direction, but until the reforms are fully implemented, exports will remain hampered, in terms of cost and delivery dates, and the 12-year target will become even more elusive.

E. Agricultural expansion

Agricultural reform has already given good results because natural conditions were right from the start and production had been depressed only because of state intervention and control. Continued reform, with more investment in food-processing and easier access to export markets, will further improve the sector's performance.

Egypt is blessed with fertile farmland. Agriculture accounts for about 20 per cent of GDP, 20 per cent of total exports and 34 per cent of total employment. The GATT noted[46] that Egypt had been a net exporter of agricultural items until 1973. Production was then depressed by state intervention and controls which turned the country into a major food importer. The GATT said: "Fully implemented agricultural reforms should lead to a major reallocation of resources and a radical improvement in the agricultural trade balance".

The GATT recommended world market pricing of agricultural crops which would lead to reallocation of production and encouragement of rural industrialisation. Piecemeal agricultural reform began in the 1980s and has included fewer controls on crop area and farm output prices, reduced subsidies for farm inputs and fewer constraints on private sector agricultural imports and exports. In late 1997, the government plans to repeal laws freezing land rents and allow smallholding tenants to pass land on to their children at fixed rents.

Substantial investment, in part internationally financed, has targeted irrigation improvement, water management and marketing and export promotion. This and the reforms have had good results. Between 1992 and 1995, wheat production rose 24 per cent, rice 22 per cent, sugar cane 19 per cent, vegetables 18 per cent and fruit 17 per cent[47]. Government sources[48] also note that between 1982 and 1995 the area under cultivation increased by 26 per cent and the area under crops by 28 per cent. Between 1982 and 1994, total agricultural production and income increased sevenfold, production of livestock six-fold and agricultural exports four-fold.

Egypt has a production surplus over consumption in rice, potatoes, oranges, dairy products, poultry, eggs and fish. The self-sufficiency ratio of wheat rose from 25 per cent in 1982 to 55 per cent in 1995. New products like strawberries and flowers also seem to have good prospects, partly through co-operative ventures with EU interests.

Mainly because natural conditions were right from the start, agricultural reforms have shown quick results and some farmers are becoming more business-minded. Proper market access could restore higher production and lead to increased downstream investment in agro-industrial processing. Egypt is thus justified in seeking better terms for its farm exports to the EU in the Europe-Mediterranean agreement negotiations.

F. Adjustment, financial assistance and the new entrepreneurs

An exchange rate adjustment seems desirable but will not be enough to get Egypt through its transition. The EU could give more technical help to encourage partnership accords, including subcontracting and outward processing, between Egyptian and European firms, especially in industries identified as ripe for expansion.

The Europe-Mediterranean agreement is likely to need serious reappraisal by its half-way mark. By then, Egypt will probably have adopted only a few of the EU technical rules and standards and have made little progress towards mutual recognition of certification. Two-way trade will probably increase but it is unlikely Egypt's trade deficit with the EU will be very much lower. Egypt will then have to make sharp tariff reductions on EU imports which are in direct competition with domestic production and handle the related adjustment problems. It will either have to dismantle tariffs as planned or make greater use of the special safety measures in the agreement — except that it might not use them within the set limits. It might also need to revise its exchange rate policy.

The Egyptian pound's nominal exchange rate has been remarkably stable at about 3.39 to the US dollar since 1991[49]. The real exchange rate has appreciated over the last five years, partly because of capital inflows, and the government has been resisting. The IMF has reportedly recommended a devaluation. The World Bank comments that "introducing an element of flexibility in the exchange rate, for example through the adoption of a crawling band, should be considered seriously"[50]. The government has adamantly refused, saying a devaluation would make imported goods even more expensive, cut living standards further and discourage repatriation of workers' remittances, without necessarily expanding exports constrained by inadequate supply.

These objections are debatable. Remittances of Egyptians working abroad are usually regular contributions to the income of family members and would be worth more in Egyptian pounds after a devaluation. In any case, a change in the parity would probably not stop their inflow.

Capital repatriation by Egyptians working abroad and repatriation of flight capital are subject to similar considerations. Since any parity change would be downward, such capital stays abroad unless attracted by an immediate need, such as buying a house, a vehicle or a small business in the case of a worker returning home, or direct or portfolio investment in the case of someone with more assets. In both cases, greater certainty, whether through a credible once-and-for-all devaluation or a predetermined crawl, would help repatriation of funds.

The effects of devaluation on merchandise trade are less certain. The price of Egyptian exports abroad would fall, but quality is as much a block to their expansion as price. Supply constraints also make it doubtful that exports would respond in the short term to increased demand. But a downward crawling peg, along with a good effort at implementing the other reforms, could boost private investment. This applies also to tourism, a major foreign exchange earner. Devaluation would attract more tourists, but infrastructure (hotels and other facilities) would have to be expanded in the medium term and steps taken to improve the quality of services rendered.

The major problem would be the dearer imports after a devaluation. With capital goods and intermediate inputs, slow depreciation of the Egyptian pound would be partly compensated for by lower import duties as the Europe-Mediterranean agreement came into effect. Costlier indispensable consumer goods would mean harsher living conditions for large sections of the population, with the risk of civil unrest. Price increases could be moderated by further rationalisation of subsidies which could be channelled to the lowest income groups.

Egyptian policy-makers have resisted lowering the Egyptian pound's parity which, with other measures, would make the economy more competitive and open. At the same time, they have shown strong preference for gradual economic policy reform. So economic and political factors seem to indicate that gradual depreciation of the Egyptian pound — a crawling peg or band, rather than a big once-and-for-all devaluation — is the best option.

Meanwhile the EU might consider stepping up technical assistance as soon as the association agreement comes into force. The consequent upgrading of supply capacities would soften the adjustment shock, with its related intersectoral movement of labour, and minimise later implementation snags. The EU's present approach seems right. Funds are needed for greater investment in human and physical capital and to strengthen partnership between Egyptian firms and European ones providing Egypt with technical know-how and market outlets. The EU contribution to Egypt's Social Fund for Development between 1993 and 1996 was about $700 million[51]. In view of the massive adjustment problems full implementation of the tariff reductions may cause in Egypt in the second half of the transition, the EU may wish to remember that it could be called on to intervene more substantially in operations like those by the Social Fund, including retraining and relocation schemes.

More help could meanwhile be given to business people better prepared to benefit from the reforms. They are active in traditional and non-traditional areas. The government has already targeted some sectors with a comparative advantage, like chemicals, chemical fertilisers, cement, iron, steel, manufactured goods including consumer durables, agricultural and food products, and tourism[52].

EU aid has rightly focused on agriculture. Egypt's natural endowments once made it a net exporter of farm products and only misguided policies turned it into a large-scale net importer. As the reversal of interventionism produces results, there is every reason to pursue the reforms, increase investment to help small and medium-sized producers and entrepreneurs, and improve access of Egyptian exports to OECD-country and Middle Eastern markets. There are also good prospects for non-traditional exports (flowers and strawberries) if access to the right markets is available[53].

The same goes for the clothing and textile industry which has deep roots in Egypt, traditionally a major cotton producer and exporter. The Uruguay Round agreements will affect most of all the textile industry, by greatly boosting exports and imports. The Europe-Mediterranean agreement will probably provide for complete elimination of tariffs, charges having equivalent effect, and quotas over a 12-year period. So outward processing activities have great potential and European investors could subcontract in Egypt and provide know-how for producing high value-added exports for European markets.

The Egyptian authorities have identified other very promising sectors, such as petrochemicals, synthetic fibres and automobile parts. Several international firms have set up automobile assembly plants in Egypt, including Peugeot, JAC Carmakers, Nissan Misr, Mercedes Benz, Suzuki Egypt and BMW. Since 1992, most of these plants have been set up by private Egyptian investors, with the foreign manufacturer granting the licence and selling the components[54]. But the Europe-Mediterranean agreement will exclude free access to the EU for automobiles simply assembled in Egypt, unless the components originate in the EU. However, it will encourage out-processing and subcontracting by EU firms wishing to benefit from Egypt's other investment attractions, once the investment climate becomes friendlier after implementation of necessary reforms.

Egypt also makes consumer durables such as furniture, refrigerators, washing machines and kitchen equipment, along with other non-traditional products, for its protected domestic market and sometimes for export to the Middle East and Africa. These products have the double handicap of high prices and low quality. Egyptian industry will need technical help to improve their quality, but also a stepping-up of the reforms listed earlier — less red tape, more competitive and lower-priced inputs, and preferably a lower-valued currency.

Loosening the organisational set-up would also help. Egypt's Federation of Industries is under close government control. It has usually been protective of the status quo and wary of measures which could expose its members to greater national or international competition. However, it declared for greater liberalisation after President Mubarak's vigorous espousal of the policy in January 1996. Other powerful businessmen's associations are more independent of the government. Their interest is to counter defenders of red tape, government intervention and an overvalued currency.

IV. CONCLUSIONS

During the 1990s Egypt has pursued successful macroeconomic stabilisation policies. It has also begun the structural reforms needed to put the country on an export-led high-growth path. The main forces for change have been foreign: the IMF, the World Bank, the Uruguay Round, the European Union and Western governments. However, since 1996 the Egyptian government has espoused reform more enthusiastically. Its aim is to raise the living standards of some 60 million people who each earn on average less than US$1 000 a year. Its main constraint is the need to introduce change at a pace which will not undermine political stability.

The Europe-Mediterranean agreement would be the main platform for sustained growth over the next 12 years. However, the time-frame may not be ideal in Egypt's circumstances. Liberalisation of trade in services, the right of establishment and other measures could be introduced earlier than the agreement would provide, whereas the timing of the liberalisation of merchandise trade seems too optimistic. A longer-term approach would be smoother and probably more successful.

The rise of a strong business class in Egypt has been slowed by the extensive state ownership of public utilities and commercial firms and by government control over the limited private sector. The state also gave protection against foreign competition with an array of tariff and non-tariff barriers. So the impetus for market-oriented reform could not come from within the country itself. However, the business sector has responded positively to the changes. Three sectors/groups have benefited and will benefit from reform and have an interest in continuing to give it support and impetus.

The first is agriculture. Reform and investment here have already had good results. Apart from traditional crops, non-traditional products have great potential if markets are available. More importantly, food-processing is a major and growing industry, as shown by industrialised countries' emphasis on exporting capital equipment for it. The second group is those importers that are making the transition from seeking monopolistic or oligopolistic rents to a situation where their interest is in lower trade barriers. The third group is exporters of manufactured goods with interest in cheaper imports of intermediate and capital goods needed to produce more competitive products in the international market place.

However, even with the best political will, the reforms will take time. Substantial investment is needed in infrastructure and direct production. The powerful lobbies of the beneficiaries of the status quo, including state subsidies and red tape, must be overcome. The Europe-Mediterranean agreement will provide a favourable context for change, but its time-frame would have to be constantly reviewed.

NOTES

1. See, for example, Shiells, Subramanian and Uimonen (1996).
2. See Petri (1997*a*).
3. See Cochrane and Massiah.
4. See World Bank (1997), Vol. II, p. 1, Table 1.1.
5. See World Bank (1997), Vol. II, p. 27, Table 3.1.
6. World Bank C.D. Rom 1997.
7. See World Bank (1997), Vol. I, p. 1.
8. Hoekman and Subramanian (1996).
9. Safadi and Laird.
10. See Shiells, Subramanian and Uimonen (1996).
11. See Pomfret (1986) and Fontagné and Péridy (1997).
12. See Fontagné and Péridy (1997).
13. See Article 14 in the case of both agreements.
14. See Article 25 of both agreements.
15. See Article 29 and Protocol 4 of both agreements.
16. See Winters (1996).
17. See Article 18 of both agreements.
18. See Articles 31 and 32 of both agreements.
19. See Article 40 of both agreements.
20. See Article 39 of both agreements.
21. See Article 41 of both agreements.
22. See Article 36 of both agreements.
23. See Winters (1996) and Dadush and Riordan (1996).
24. See Weiss and Wunzel (forthcoming).

24a. See "Understanding on Interpretation of Article XXIV of the General Agreement on Tariffs and Trade 1994 — Article XXIV:5, para. 3", in WTO (1994), *The Results of the Uruguay Round of Multilateral Trade Negotiations*, (p. 32).

25. See Petri (1997*a*).
26. See World Bank (1997), Vol. II, p. 27.
27. See Lawrence, R.Z., "Preferential Trading Arrangements: the Traditional and the New", in A. Galal and B. Hoekman (eds.).
28. See Hoekman, B. and S. Djankov, "Towards a Free Trade Agreement with the European Union: Issues and Policy Options", in A. Galal and B. Hoekman (eds.).

29. See Havrylyshyn and Kunzel (1997).

30. See GATT, Vol. I, p. 107.

31. Kheir-el-Din, H. and A. El-Dersch (1991), *Egypt's Foreign Trade Policy, 1986-91*, Cairo, quoted in GATT, Vol. I, p. 113.

32. See Alonso-Gamo, Fennell and Sakr (1997).

33. See Havrylyshyn and Kunzel (1997).

34. See World Bank (1997), Vol. II, p. 38.

35. See Subramanian, A. and M. Abd-El-Latif, "The Egypt-EU Partnership Agreement and the Egyptian Pharmaceutical Sector", in A. Galal and B. Hoekman (eds.).

36. See Kheir-el-Din, H. and H. El-Sayed, "Potential Impact of a Free Trade Agreement with the EU on Egypt's Textile Industry", in A. Galal and B. Hoekman (eds.).

37. The examples quoted in this paragraph are cited in Mohieldin, M., "The Egypt-EU Partnership Agreement and Liberalisation of Services", in A. Galal and B. Hoekman (eds.).

38. See World Bank (1997), Vol. II, p. 38.

39. See Gardner, D., "On the scent of an emerging market", *Survey: Egypt*, in *Financial Times*, 13 May 1997.

40. See World Bank (1997), Vol. II, pp. 62-63.

41. See Mohieldin, M., "The Egypt-EU Partnership Agreement and Liberalisation of Services", in A. Galal and B. Hoekman (eds.).

42. See Konan, D.E. and K.E. Maskus, "A Computable General Equilibrium Analysis of Egyptian Trade Liberalisation Scenarios", in A. Galal and B. Hoekman (eds.).

43. See Majd (1996).

44. See Allen, R., "Expensive Problem at the Quayside", *Survey: Egypt,* in *Financial Times*, 13 May 1997.

45. See World Bank (1997), Vol. I, pp. 13-14 and Vol. II, pp. 63-78.

46. See GATT (1993).

47. See CFCE (1997).

48. Interview with the commercial counsellor, Egyptian Embassy, Paris.

49. See Majd (1996).

50. See World Bank, Vol. II, pp. 10-11.

51. See Social Fund for Development (1997).

52. Egypt's minister for economic reforms, Youssef Bhoutros Ghali, at a seminar at the Centre français pour le commerce extérieur, Paris, 29 May 1997.

53. See Majd (1996).

54. See CFCE (1997).

Appendix A. **Egypt's Foreign Trade, 1970-94**
($ million)

	(1) Egypt Exports to World	(2) Egypt Exports to EU 12	(3) (2) as % of (1)	(4) Egypt Imports from World	(5) Egypt Imports from EU 12	(6) (5) as % of (4)	(7) Bal. of Trade with World	(8) Bal. of Trade with EU 12
1970	935	228	24.4	979	371	37.9	-44	-143
1975	1 661	402	24.2	4 349	1 781	41.0	-2 688	-1 379
1980	5 334	3 476	65.2	9 500	4 629	48.7	-4 166	-1 154
1985	4 823	3 033	62.9	10 829	5 069	46.8	-6 006	-2 035
1990	4 837	2 748	56.8	11 687	5 145	44.0	-6 850	-2 397
1991	4 543	2 553	56.2	11 501	4 945	43.0	-6 958	-2 392
1992	5 173	2 984	57.7	11 591	4 493	38.8	-6 419	-1 510
1993	4 971	2 633	53.0	12 269	5 210	42.5	-7 298	-2 578
1994	5 514	3 072	55.7	13 080	5 325	40.7	-7 565	-2 253

Source: Chelem.

Appendix B. **Composition of Egypt's Exports to the European Union**

		1980	1985	1990	1994	1980	1985	1990	1994
		($ million)				(as a percentage of total exports)			
Total		3 694 612	3 249 752	2 889 427	3 200 503				
0	FOOD AND LIVE ANIMALS CHIEFLY FOR FOOD	92 222	44 452	99 107	110 541	2.5	1.4	3.4	3.5
05	Vegetables and fruit	77 165	34 324	71 941	81 549	2.1	1.1	2.5	2.5
1	BEVERAGES AND TOBACCO	61	11	441	645	0.0	0.0	0.0	0.0
2	CRUDE MATERIALS. INEDIBLE, EXCEPT FUELS	161 010	153 006	71 098	106 028	4.4	4.7	2.5	3.3
26	Textiles fibres (other than wool tops) and their waste (not manufactured into yarn or fabric)	140 477	140 017	30 734	60 828	3.8	4.3	1.1	1.9
3	MINERALS FUELS, LUBRICANTS AND RELATED MATERIALS	3 204 031	2 738 275	1 928 823	1 854 335	86.7	84.3	66.8	57.9
33	Petroleum, petroleum products and related materials	3 203 915	2 736 569	1 926 454	1 834 465	86.7	84.2	66.7	57.3
4	ANIMAL AND VEGETABLE OILS, FATS AND WAXES	134	70	72	2	0.0	0.0	0.0	0.0
5	CHEMICALS AND RELATED PRODUCTS, N.E.S.	7 717	13 711	31 207	82 112	0.2	0.4	1.1	2.6
6	MANUFACTURED GOODS CLASSIFIED CHIEFLY BY MATERIAL	175 384	213 241	457 514	584 334	4.7	6.6	15.8	18.3
65	Textile yarn, fabrics, made-up articles, n.e.s., and related products	95 662	106 565	217 918	396 983	2.6	3.3	7.5	12.4
68	Non-ferrous metals	60 449	105 299	173 551	129 351	1.6	3.2	6.0	4.0
7	MACHINERY AND TRANSPORT EQUIPMENT	24 131	45 102	180 092	260 857	0.7	1.4	6.2	8.2
79	Other transport equipment	2 803	4 753	136 952	179 962	0.1	0.1	4.7	5.6
8	MISCELLANEOUS MANUFACTURED ARTICLES	23 237	24 877	98 651	192 499	0.6	0.8	3.4	6.0
84	Articles of apparel and clothing accessories	14 427	10 773	78 516	152 332	0.4	0.3	2.7	4.8

Source: OECD.

Appendix C. **Composition of Egypt's Imports from the European Union**

		1980	1985	1990	1994	1980	1985	1990	1994
		($ million)				(as a percentage of total imports)			
Total		4 542 602	4 988 291	5 101 794	5 285 699				
0	FOOD AND LIVE ANIMALS CHIEFLY FOR FOOD	849 751	828 541	705 504	642 349	18.7	16.6	13.8	12.2
1	BEVERAGES AND TOBACCO	29 050	23 157	29 658	75 160	0.6	0.5	0.6	1.4
2	CRUDE MATERIALS, INEDIBLE, EXCEPT FUELS	36 970	35 766	83 292	88 770	0.8	0.7	1.6	1.7
3	MINERALS FUELS, LUBRICANTS AND RELATED MATERIALS	143 920	103 639	95 635	41 577	3.2	2.1	1.9	0.8
4	ANIMAL AND VEGETABLE OILS, FATS AND WAXES	16 137	56 174	25 958	29 044	0.4	1.1	0.5	0.5
5	CHEMICALS AND RELATED PRODUCTS, N.E.S.	481 596	594 464	633 876	706 787	10.6	11.9	12.4	13.4
6	MANUFACTURED GOODS CLASSIFIED CHIEFLY BY MATERIAL	779 648	953 605	679 296	652 360	17.2	19.1	13.3	12.3
7	MACHINERY AND TRANSPORT EQUIPMENT OF WHICH	1 936 387	2 048 511	2 372 538	2 573 772	42.6	41.1	46.5	48.7
72	Machinery specialised for particular industries	433 220	399 829	304 091	439 702	9.5	8.0	6.0	8.3
74	General industrial machinery and equipment, n.e.s. and machine parts, n.e.s.	350 885	476 568	404 003	540 485	7.7	9.6	7.9	10.2
77	Electrical machinery, apparatus and appliances, n.e.s., and electrical parts thereof (including non-electrical counter-parts, n.e.s., of electrical household type equipment)	217 826	260 578	278 600	389 297	4.8	5.2	5.5	7.4
78	Road vehicles (including air cushion vehicles)	345 522	318 049	234 642	316 519	7.6	6.4	4.6	6.0
79	Other transport equipment	179 107	109 721	566 346	414 292	3.9	2.2	11.1	7.8
8	MISCELLANEOUS MANUFACTURED ARTICLES	213 227	238 059	248 831	331 404	4.7	4.8	4.9	6.3

Source: OECD.

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