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## ***Examining the Deep Integration Aspects of the EU-South Mediterranean Countries: Comparing the Barcelona Process and Neighbourhood Policy, the Case of Egypt***

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**List of Abbreviations:**

AA	Association Agreement
ACAA	Agreement on Conformity Assessment and Acceptance of Industrial Products
BEC	Broad Economic Categories
CA	Conformity Assessment
CAPMAS	Central Agency for Public Mobilization and Statistics
COMESA	Common Market for Eastern and Southern Africa
COMTRADE	Commodity Trade Statistics Database
DS	Dispute Settlement
EAFMS	Egyptian Authority for Maritime Safety
EC	European Commission, European Community
ECA	Egyptian Competition Authority
ECL	Egyptian Competition Law
ECJ	European Court of Justice
EEA	European Economic Area
EFTA	European Free Trade Association
EGAC	Egyptian Accreditation Council
EIB	European Investment Bank
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood and Partnership Instrument
ENPO	The Egyptian National Postal Authority
ETA	The Egyptian Tourist Authority
EU	European Union
EU 5	European Union for 5 members
EU 25	European Union 25 Member States
FDI	Foreign Direct Investment
FK	Finger-Kreinin
FTA	Free Trade Area (Agreement)
GAFI	General Authority for Investment and Free Zones
GATS	General Agreement on Trade and Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GoE	Government of Egypt
G-L	Grubel-Lloyd
HS	Harmonised System
IDSC	Information and Decision Support Centre
IIT	Intra-Industry Trade
ILAC	International Laboratory Accreditation Cooperation
IMF	International Monetary Fund
IPX	Inward Processing Exports
ISO	International Standards Organisation
LOD	Level of Detection
MFA	Multi-Fibre Agreement
MFN	Most Favoured Nation
MR	Mutual Recognition
MRL	Maximum Residue Levels
NAFTA	North American Free Trade Association
NTRA	National Telecommunication Regulatory Authority

OPAT	Outward Processing Arrangement of Textiles
OPT	Outward Processing Trade
OPX	Outward Processing Exports
PAFTA	Pan-Arab Free Trade Area
RASFF	Rapid Alert System for Food and Feed
RCA	Revealed Comparative Advantage
ROW	Rest of the World
RTA	Regional Trade Agreement
R&D	Research and Development
SAAP	State Aid Action Plan
SITC	Standard International Trade Classification
SPS	Sanitary and Phytosanitary
TAIEX	Technical Assistance Information Exchange Instrument
TBT	Technical Barriers to Trade
TRAINS	Trade Analysis and Information System
T&C	Textile and Clothing
USA	United States of America
WITS	World Integrated Trade Solutions
WTO	World Trade Organisation



## Executive Summary

As is well known in the literature, the overall welfare impact of any process of regional integration will depend on the extent and nature of both shallow integration and deep integration. Shallow integration, sometimes also referred to as negative integration, typically involves the removal of border barriers to trade, such as tariffs and quotas with respect to one's regional partners. The net benefits from lowering such trade barriers preferentially are inherently ambiguous, because they involve both trade creation and trade diversion. Trade creation arises whenever more efficiently produced imported goods replace less efficient domestically produced goods. Trade is "created" and yields welfare gains. Trade diversion occurs when sources of supply switch away from more efficient non-partner countries to less efficient partner countries. Trade diversion reduces welfare, and the net welfare impact of a Regional Trade Agreement (RTA) will depend on the relative size of the two effects<sup>2</sup>.

Deep integration involves policies and institutions that facilitate trade by reducing or eliminating regulatory and behind-the-border impediments to trade, where those impediments may or may not be intentional. Welfare gains from a successful process of deeper integration may be considerably higher than losses from shallow integration. It is for this reason that this report is concerned with the process of deep integration in the context of the Association Agreement (AA) between the EU and Egypt, and the context of the Egyptian Action Plan, signed under the EU's European Neighbourhood Policy (ENP).

The report's main objective is to understand better what is deep integration, and how to achieve it, and to analyze the possibilities of deep integration in the between Egypt and the EU, whether in the context of the AA or in the context of the Action Plan of the ENP. As stressed by the European Commission in its last communication to the Council and European parliament in December 2006 "Deeper economic integration with our ENP partners will be central to the success and credibility of the policy". But what is meant by deep integration, and how to achieve it are issues that the Commission did not address in a direct manner. In this regard, we start in *Chapter One* of the report by providing a conceptual framework for what do we mean by deep integration in the context of regional trade agreements (RTAs) and apply it to the AA and the ENP. We identify the means of achieving deep integration, and differentiate between types of deep integration. In fact, as Chapter One discusses some kinds of deep integration do not result in discriminatory effects against non-partners, where they are more of Most Favoured Nation (MFN) type, whereas other measures are discriminatory. Chapter One points out as well that there are different means of achieving deep integration starting with MFN type of measures and reaching harmonization. The main features of the Association Agreement (AA) and the European Neighbourhood Policy (ENP) with its Action Plan are discussed in details, while

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<sup>2</sup> Where the partner countries already had preferential tariffs with third countries, than the process of integration could also lead to trade reorientation (switching sources of imports away from less efficient to more efficient suppliers) which would then be welfare increasing

providing a comparison between the AA and the Action Plan in enhancing deep integration and assessing the ENP Action Plan.

*Chapter Two* provides a thorough quantitative assessment of the Egyptian trade with the EU, while comparing it with the rest of the world (ROW). Several statistical indicators are applied including the Finger-Kreinin and the Intra-Industry Trade (IIT) indices. Moreover, the analysis focuses on both the geographical as well as the product dimensions.

Chapters Three, Four, and Five provide detailed analysis of deep integration aspects in three areas, namely; agricultural related standards, competition law and policy, and state aid. The choice of the three areas stems from the need to differentiate the main aim of the deep integration. Hence, the agricultural related standards represent the case of deep integration where the final aim is *enhancing market access*, whereas competition law and policy case represents the case where deep integration aims at *upgrading the domestic business environment*. Finally, state aid is highly related to competition law and policy, but we rather thought that this field is rather understudied and suffer from scarce resources and literature.

*Chapter Three* deals with the case of agriculture and standards. It analyses the performance of the Egyptian agricultural exports to the EU. It reviews the provisions related to standards in the context of the AA and the ENP Action Plan.

*Chapter Four* deals with the gap existing between Egypt's competition law and EU's legislations concerning competition. The chapter provides a brief review on the case of harmonizing competition laws in the context of RTAs while focusing on the EU's approach in its RTAs. The chapter then discusses in the details the differences in the two bodies of legislation dealing with dominant position, safe harbour rule, merger control, etc. Finally the chapter identifies the problems that could result from the existing gap and identifies whether deep integration is needed to overcome this problem or other form of cooperation might be appropriate in this case.

*Chapter Five* addresses the issue of State Aid. The Chapter compares the formally defined State Aid in the EU with what can be considered State Aid in Egypt. It points out the differences between the AA and the ENP Action Plan on issues dealing with State Aid. It suggests how the gap between Egypt and the EU in terms of dealing with State Aid can be narrowed down.

Different methodologies are adopted in the different chapters of the reports and within each chapter. While the institutional approach is the most common approach adopted in analyzing different issues, we complement it when necessary by quantitative assessment and anecdotal evidence.

The study pointed out that deep integration is not a panacea. The report identified that deep integration is much more complex than what is commonly thought. *Chapter One* showed that there are certain aspects that need to be carefully examined when applying deep integration if specific results are to be expected from it. For example, some kinds of deep integration could lead to MFN type of results whereas others could lead to discriminatory effects. When applying such deep integration concept in general to the Association Agreement (AA) and the European Neighbourhood Policy (ENP) Action Plan we observe that the Action Plan has not gone so far

beyond the AA. However, the ENP Action Plan includes new mechanisms which could foster deep integration if properly utilized (namely the committees and sub-committees overseeing the implementation of the Action Plan). *Chapter One* pinpointed that the aims of deep integration should be clear, whether *enhancement of market access or rather improving the domestic business environment*. Such distinction is of paramount importance as it could result in adoption of different means to achieve deep integration.

*Chapter Two* revealed that dismantling of tariff barriers still did not boost Egyptian exports to the EU, when compared to the rest of the world. This implies that shallow integration is not enough, and something extra needs to be undertaken to reap the benefits of duty free market access to the EU. Reaping such benefit could be some sort of deep integration that enhances the market access, especially that intra industry trade (IIT) is low, which could be a symptom of lack of deep integration.

*Chapter Three* showed that deep integration if adopted to enhance market access then it should opt for harmonization. The case of standards related to agriculture and how they act as a barrier to Egyptian exports to the EU showed that harmonization is the first best to overcome this impediment facing Egyptian exports. Even though several efforts have been undertaken to ensure mutual recognition of conformity assessment procedures, they remained short of securing the market access of the Egyptian exports in the EU. This could be a result of neglect of the infrastructure pillar of deep integration, while focusing only on the regulatory/policy pillar of deep integration in the context of the AA and the ENP Action Plan. The modest role played so far by mutual recognition can be a result of the relatively new system in Egypt which could be a concern for EU authorities and hence the trust is still weak and might be enhanced by time.

*Chapter Four* showed that deep integration is not always the first best given the developmental gap between Egypt and the EU. The analysis identified that there is a clear gap between Egypt and the EU in the area of competition, and that there is a de facto harmonization of EU competition rules and regulations in Egypt whenever trade between Egypt and the EU is concerned. The analysis pointed out that given the developmental gap, and the huge policy/regulatory and infrastructure gaps, coordination and cooperation might seem to be a better alternative than full harmonization.

*Chapter Five* showed that the gap between Egypt and the EU in terms of dealing with State Aid is wide. In fact, Egypt does not have a formal definition of what constitutes State Aid. Moreover, most of the Egyptian State Aid is eligible under the criteria set by the EU. The analysis point out that harmonization is not needed in this regard, and that the implementation so far on what has been mentioned in the AA and the Action Plan has been modest.

The general conclusions that can be reached from this report are that deep integration has several means and shapes, which is an issue that policy makers need to consider. The means of deep integration that should be adopted should be based on the aim of deep integration required. If the aim of deep integration is enhancing market access then harmonization, though costly for Egypt is a must and that it pays off in the future. However, if the aim of deep integration is upgrading the domestic business environment in Egypt then harmonization, given the developmental gap, might be very costly, and the pay off is not clearly identified in trade relations between Egypt

and the EU. Soft deep integration in the form of coordination and cooperation might be a better option within the context of Egypt-EU trade relations. Such conclusion is in line with what Islam and Reshef (2006) reached where they argue using empirical evidence that the quality of institutions (i.e. having efficient and well implemented laws and regulations) is more important than just harmonizing them if the main target is to enhance trade. Policy makers should be aware of the fact that some forms of deep integration can result in discrimination against non-EU members which could have detrimental effects on Egypt-non-EU members' trade relations. This is an important policy implication when negotiating deep integration means. Finally, the study pointed out that deep integration is hard to achieve if the focus is always on the regulatory/policy aspect while neglecting the infrastructure aspect of deep integration.

## Résumé

Comme détaillé dans la littérature, l'impact général d'un accord bilatéral sur le bien-être dépend tout autant de l'étendue que de la nature des différents procédés d'intégration. L'intégration faible (*shallow integration*), aussi connue comme intégration négative, implique la suppression des barrières douanières telles que les tarifs et les quotas entre partenaires régionaux. Les bénéfiques nets créés par la réduction préférentielle de telles barrières sont ambigus car ils entraînent dans le même temps la création et la déviation de commerce. La création de commerce se manifeste chaque fois que des biens importés produits plus efficacement remplacent les biens domestiques produits de manière moins efficace. Ainsi le commerce est « créé » et renforce le bien-être domestique. La déviation du commerce surgit quand les sources d'importation changent vers des partenaires régionaux en dépit de partenaires mondiaux qui sont plus efficaces. La déviation du commerce réduit le bien-être. L'interaction et la magnitude de ces forces détermineront l'impact net d'un accord bilatéral.

L'Intégration Profonde (*deep integration*) implique la coordination d'institutions et de politiques en vue de faciliter le commerce et de réduire, voire d'éliminer, les barrières régulatrices ou autres barrières douanières ou non-douanières causant des obstacles au commerce. Les gains en termes de bien-être d'un procédé d'intégration profonde peuvent considérablement surpasser les pertes associées à une intégration faible. C'est pour cette raison que ce rapport étudie le procédé d'intégration profonde mis en place dans le contexte de l'Accord d'Association (AA) entre l'UE et l'Égypte et dans le contexte du Plan d'Action Égyptien signé sous la Politique Européenne de Voisinage (PEV).

L'objectif principal du rapport est de mieux comprendre ce qu'est l'intégration profonde, comment l'atteindre, et d'analyser les possibilités permettant d'accroître l'intégration profonde entre l'Égypte et l'UE dans le cadre de l'AA ou sous le Plan d'Action de la PEV. Comme souligné par la Commission Européenne dans sa communication au Conseil et au Parlement Européen en Décembre 2006 « L'approfondissement de l'intégration économique avec nos partenaires de la PEV jouera un rôle essentiel dans la réussite et la crédibilité de cette politique ». Mais ce qui est sous-entendu par approfondissement de l'intégration, et comment l'atteindre sont des questions auxquelles la Commission n'a pas répondu de manière directe. De ce fait, le *Premier Chapitre* du rapport définit le cadre conceptuel de ce qu'on entend par intégration profonde dans le contexte des accords régionaux appliqués à l'AA et à la PEV. Nous identifions les moyens d'atteindre une intégration profonde et nous différencions les types d'intégration profonde. En effet, comme discuté dans le premier chapitre, il existe des types d'intégration profonde qui ne débouchent pas sur des effets discriminatoires vis-à-vis des pays non-partenaires, où les effets ressemblent plus à ceux d'une clause de nation plus favorisée (NPF), tandis que d'autres mesures peuvent être discriminatoires. Le premier chapitre souligne, entre autre, qu'il existe différents moyens d'atteindre une intégration profonde, commençant avec des mesures de type NPF et visant l'harmonisation. Les caractéristiques principales de l'AA et de la PEV avec son Plan d'Action sont discutées en détail, en fournissant une comparaison entre l'AA et le Plan d'Action visant l'accroissement de l'intégration profonde et l'évaluation du Plan d'Action de la PEV.

Le *deuxième chapitre* fournit une minutieuse évaluation quantitative du commerce égyptien avec l'UE, comparant celui-ci avec les flux avec le Reste du Monde (RdM). Plusieurs indicateurs statistiques sont appliqués, incluant les indicateurs Finger-Kreinin (F-K) et le commerce intra-branche (Intra-Industry Trade, IIT). De plus, l'analyse se focalise sur une perspective tant géographique que sectorielle.

Les chapitres Trois, Quatre et Cinq fournissent une analyse détaillée des aspects de l'intégration profonde dans trois secteurs, notamment; standardisation des normes dans le secteur agricole; législation et politique de concurrence; et Aides d'Etat. Le choix de ces trois secteurs résulte de la nécessité de différencier les propos de chacun dans le contexte de l'intégration profonde. Ainsi, la standardisation des normes dans le secteur agricole représente un important cas d'intégration profonde où le but final est d'accroître l'*accès au marché*, tandis que la législation et politique de concurrence représente un cas où l'intégration profonde vise à *améliorer l'environnement des entreprises*. Finalement, l'aide d'Etat est reliée à la législation et politique de concurrence, mais reste un domaine qui souffre de manque de commentaires à cause d'une insuffisance de ressources dans la littérature.

Le *Troisième chapitre* aborde le thème de la standardisation des procédures agricoles. Nous analysons la performance exportatrice égyptienne vis-à-vis l'UE en termes de produits agricoles et revenons sur les provisions des normes agricoles dans le contexte de l'AA et du Plan d'Action de la PEV.

Le *Quatrième chapitre* traite l'écart qui existe entre la législation de concurrence égyptienne et celle de l'UE. Le chapitre entreprend une revue des besoins d'harmonisation des normes de concurrence dans le contexte des accords régionaux en focalisant sur l'approche européenne de la régionalisation. Le chapitre discute en détail les différences entre les législations de concurrence face aux positions dominantes; *safe harbour rule*; contrôle des fusions etc. Finalement, le chapitre souligne les problèmes qui pourraient résulter de cet écart et montre si l'intégration profonde est nécessaire pour surmonter ce problème ou si une autre forme de coopération peut être plus adéquate.

Le *Cinquième chapitre* est consacré aux aides d'Etat. Le chapitre fait une comparaison entre ce qui peut être qualifié d'aide d'Etat en Égypte et ce que l'on entend par aide d'Etat dans l'UE. Le chapitre souligne les différences en termes d'aide d'Etat entre l'AA et le Plan d'Action de la PEV et suggère des mesures en vue de réduire l'écart entre les deux.

Différentes méthodologies sont adoptées à travers les différents chapitres de ce rapport. Bien que l'approche institutionnelle soit plus largement adoptée dans l'analyse, elle est complétée par des approches quantitatives et des exemples concrets.

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Le rapport montre que l'intégration profonde n'est pas une panacée. Nous introduisons l'idée que l'intégration profonde est beaucoup plus complexe par rapport à ce qui est communément présenté dans la littérature. Le *Premier Chapitre* montre qu'il y a certains aspects qui doivent être examinés avec attention quant à l'application de l'intégration profonde en vue d'obtenir des résultats spécifiques. Par exemple, certains types d'intégration profonde peuvent mener à des

résultats de type NPF tandis que d'autres peuvent être plus discriminatoires. En appliquant le concept d'intégration profonde en général à l'AA et au Plan d'Action de la PEV nous observons que ce dernier ne va pas très loin au delà de l'AA. Cependant, le Plan d'Action de la PEV inclut de nouveaux mécanismes qui pourraient encourager l'intégration profonde (à savoir les comités et sous-comités surveillant l'implémentation du Plan d'Action).

Le *Premier Chapitre* précise que les objectifs de l'intégration profonde doivent être clairs, choisir entre l'*accroissement de l'accès au marché* ou plutôt l'*amélioration de l'environnement pour les entreprises*. Une telle distinction est importante car elle peut mener à une adoption de différents moyens pour accomplir l'intégration profonde.

Le *Deuxième Chapitre* montre que les réductions tarifaires n'ont pas eu d'effets positifs sur les exportations égyptiennes envers l'UE en comparaison avec le reste du monde. Ceci implique que les bénéfices de l'intégration faible (*Shallow integration*) sont minimes, et que des mesures supplémentaires doivent être entreprises en vue de récolter les avantages de l'accès préférentiel au marché Européen. La captation de tels bénéfices pourrait se faire au travers d'une intégration profonde visant à accroître l'accès au marché, plus particulièrement le commerce intra-branche (IIT) qui est en ce moment réduit, ce qui pourrait être un symptôme du manque d'intégration profonde.

Le *Troisième Chapitre* montre que si l'intégration profonde est adoptée en vue d'améliorer l'accès au marché, il faudrait commencer par harmoniser les règles et normes. Le cas de la standardisation des normes agricoles et comment celles-ci peuvent être des barrières aux exportations égyptiennes envers l'UE démontrent que l'harmonisation est la meilleure solution aux obstacles auxquels font face les exportations égyptiennes. En dépit des efforts entrepris pour assurer la *reconnaissance mutuelle* (mutual recognition) des procédures d'évaluation et de conformité, ceux-ci restent moindres dans la sécurisation de l'accès au marché Européen aux exportations agricoles égyptiennes. Ceci peut être dû à une négligence du pilier 'infrastructure' de l'intégration profonde au profit du pilier 'régulation' de l'intégration profonde dans le contexte de l'AA et du Plan d'Action de la PEV. Le rôle modeste joué par la reconnaissance mutuelle (mutual recognition) peut surgir de la nouveauté du système en Egypte ce qui pourrait être problématique pour les autorités européennes. La faible confiance pourrait s'améliorer avec le temps.

Le *Quatrième Chapitre* montre que l'intégration profonde n'est pas toujours la meilleure solution à l'écart de développement entre l'Egypte et l'UE. L'analyse identifie un écart important entre l'Egypte et l'UE dans le secteur de la concurrence, et une harmonisation *de facto* des normes de concurrence européennes en Egypte en ce qui concerne le commerce entre les deux partenaires. Cette analyse démontre que, étant donné l'écart entre les politiques et réglementations, mais aussi les infrastructures, la coordination et la coopération pourraient être une meilleure alternative à l'harmonisation complète.

Le *Cinquième Chapitre* souligne aussi un important écart entre l'Egypte et l'UE vis-à-vis de la politique d'aide d'Etat, l'Egypte n'ayant pas une définition formelle du concept d'aide d'Etat. De plus, une grande partie de l'aide d'Etat égyptienne est éligible sous les critères européens.

L'analyse démontre que l'harmonisation n'est pas nécessaire, et que l'implémentation, d'après ce qui a été mentionné sous l'AA et le Plan d'Action de la PEV reste jusqu'à présent modeste.

Les conclusions générales de ce rapport voient l'intégration profonde comme un procès prenant diverses formes, et celles-ci doivent être considérées par les responsables des politiques. Les méthodes doivent être adoptées en fonction des résultats désirés de l'intégration profonde. Si ces résultats visent une intégration profonde prenant la forme d'un accroissement de l'accès au marché, alors l'harmonisation, bien que fortement onéreuse, donnera de meilleurs résultats à long-terme. Si au contraire, le but de l'intégration profonde devient l'amélioration du climat pour les entreprises, l'harmonisation, étant donné l'écart de développement, pourrait être trop coûteuse et n'aboutirait pas à des gains importants dans les relations entre l'Egypte et l'UE. Une sorte de douce intégration profonde prenant la forme de coordination et de coopération serait à recommander dans le contexte de relations commerciales entre l'Egypte et l'UE. Ces conclusions s'accordent avec celles d'Islam et Reshef (2006) qui soutiennent, avec des preuves empiriques, que la qualité des institutions (c'est-à-dire une implémentation de la législation et des régulations efficaces) est plus importante que l'harmonisation si le but est d'accroître le commerce. Les responsables des politiques doivent être conscients du fait que certaines mesures d'intégration profonde peuvent être discriminatrices contre des pays tiers, ce qui peut avoir des effets néfastes sur les flux de commerce avec des pays non-européens. Cet effet négatif a des implications importantes sur la politique de négociation des moyens visant l'intégration profonde. Finalement, le rapport montre que l'intégration profonde sera difficile à atteindre si on reste focaliser sur des aspects régulateurs/politiques au dépit de l'aspect infrastructurel.



## **General Introduction to the Report**

**By Ahmed Ghoneim**

As is well known in the literature, the overall welfare impact of any process of regional integration will depend on the extent and nature of both shallow integration and deep integration. Shallow integration, sometimes also referred to as negative integration, typically involves the removal of border barriers to trade, such as tariffs and quotas with respect to one's regional partners. The net benefits from lowering such trade barriers preferentially are inherently ambiguous, because they involve both trade creation and trade diversion. Trade creation arises whenever more efficiently produced imported goods replace less efficient domestically produced goods. Trade is "created" and yields welfare gains. Trade diversion occurs when sources of supply switch away from more efficient non-partner countries to less efficient partner countries. Trade diversion reduces welfare, and the net welfare impact of a Regional Trade Agreement (RTA) will depend on the relative size of the two effects<sup>3</sup>.

Deep integration involves policies and institutions that facilitate trade by reducing or eliminating regulatory and behind-the-border impediments to trade, where those impediments may or may not be intentional. Welfare gains from a successful process of deeper integration may be considerably higher than losses from shallow integration. It is for this reason that this report is concerned with the process of deep integration in the context of the Association Agreement (AA) between the EU and Egypt, and the context of the Egyptian Action Plan, signed under the EU's European Neighbourhood Policy (ENP).

The report's main objective is to understand better what is deep integration, and how to achieve it, and to analyze the possibilities of deep integration in the between Egypt and the EU, whether in the context of the AA or in the context of the Action Plan of the ENP. As stressed by the European Commission in its last communication to the Council and European parliament in December 2006 "Deeper economic integration with our ENP partners will be central to the success and credibility of the policy". But what is meant by deep integration, and how to achieve it are issues that the Commission did not address in a direct manner. In this regard, we start in *Chapter One* of the report by providing a conceptual framework for what do we mean by deep integration in the context of regional trade agreements (RTAs) and apply it to the AA and the ENP. We identify the means of achieving deep integration, and differentiate between types of deep integration. In fact, as Chapter One discusses some kinds of deep integration do not result in discriminatory effects against non-partners, where they are more of Most Favoured Nation (MFN) type, whereas other measures are discriminatory. Chapter One points out as well that there are different means of achieving deep integration starting with MFN type of measures and reaching harmonization. The main features of the Association Agreement (AA) and the European Neighbourhood Policy (ENP) with its Action Plan are discussed in details, while providing a comparison between the AA and the Action Plan in enhancing deep integration and assessing the ENP Action Plan.

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<sup>3</sup> Where the partner countries already had preferential tariffs with third countries, than the process of integration could also lead to trade reorientation (switching sources of imports away from less efficient to more efficient suppliers) which would then be welfare increasing

*Chapter Two* provides a thorough quantitative assessment of the Egyptian trade with the EU, while comparing it with the rest of the world (ROW). Several statistical indicators are applied including the Finger-Kreinin and the Intra-Industry Trade (IIT) indices. Moreover, the analysis focuses on both the geographical as well as the product dimensions.

Chapters Three, Four, and Five provide detailed analysis of deep integration aspects in three areas, namely; agricultural related standards, competition law and policy, and state aid. The choice of the three areas stems from the need to differentiate the main aim of the deep integration. Hence, the agricultural related standards represent the case of deep integration where the final aim is *enhancing market access*, whereas competition law and policy case represents the case where deep integration aims at *upgrading the domestic business environment*. Finally, state aid is highly related to competition law and policy, but we rather thought that this field is rather understudied and suffer from scarce resources and literature.

*Chapter Three* deals with the case of agriculture and standards. It analyses the performance of the Egyptian agricultural exports to the EU. It reviews the provisions related to standards in the context of the AA and the ENP Action Plan.

*Chapter Four* deals with the gap existing between Egypt's competition law and EU's legislations concerning competition. The chapter provides a brief review on the case of harmonizing competition laws in the context of RTAs while focusing on the EU's approach in its RTAs. The chapter then discusses in the details the differences in the two bodies of legislation dealing with dominant position, safe harbour rule, merger control, etc. Finally the chapter identifies the problems that could result from the existing gap and identifies whether deep integration is needed to overcome this problem or other form of cooperation might be appropriate in this case.

*Chapter Five* addresses the issue of State Aid. The Chapter compares the formally defined State Aid in the EU with what can be considered State Aid in Egypt. It points out the differences between the AA and the ENP Action Plan on issues dealing with State Aid. It suggests how the gap between Egypt and the EU in terms of dealing with State Aid can be narrowed down.

We adopt different methodologies in the different chapters of the reports and within each chapter. While the institutional approach is the most common approach adopted in analyzing different issues, we complement it when necessary by quantitative assessment and anecdotal evidence.

## **References**

European Commission (2006), "Communication from the Commission to the Council and the European Parliament on Strengthening the European Neighbourhood Policy", Brussels, 4 December 2006 COM (2006)726 final



## **Chapter One**

### **EU-Egypt ENP as a Form of Deep Integration**

**Peter Holmes  
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## Introduction

It is important to identify what is meant by deep integration, especially since scholars use this term to identify integration, which deals with “behind the border” issues, without clearly stating what are the behind the border issues, or how to achieve deep integration. The deep integration definition in itself is still wide and vague enough for any policy maker to derive policy implications from it.

In this part of the report, we first, focus in much more details on understanding what is meant by deep integration, and what type of measures of deep integration might constitute part of any process of regional integration. We discuss how deep integration can be included differently under Regional Trade Agreements (RTAs), and identify the gains from adopting deep integration. We then examine the content of both the Association Agreement and the Action Plan of the European Neighbourhood Policy in order to identify what areas of deep integration have been included.

### 1.1 What is “Deep” integration?

#### *1.1.1 Deep v Shallow Integration: A Conceptual Framework*

In principle a distinction can be made between measures applied at the border such as tariffs or quantitative restrictions which are enforced at the border by customs officials on the one hand and on the other domestic regulatory measures which affect goods (after they have passed the borders and are then circulated in the internal market) at the point of sale. Deep integration typically refers to a process in which it is the *domestic* economic (regulatory) policies/measures, which are modified in order to remove barriers to trade. These can include issues such as customs procedures, regulation of domestic services production that discriminate against foreigners, product standards that differ from international norms or where testing and certification of foreign goods is complex and perhaps exclusionary, regulation of inward investments, competition policy, intellectual policy protection and the rules surrounding access to government procurement. This is by contrast with shallow integration under which it is the “border measures” essentially tariffs and quotas, which are eliminated.

These concepts are also linked to the distinction between positive and negative integration. Negative integration means the prohibition of certain measures that will restrict trade. Positive integration is an obligation to adopt certain common policies. These distinctions become somewhat blurred in practice. The negative integration prohibitions may extend to domestic rules, e.g. on subsidies and a sufficiently broad set of restrictions on policy may end up prescribing what may be done! For example a trade agreement may state that signatories may not ban the sale of products produced to international standards. Cast in the form of a ban it nevertheless creates a positive obligation to allow the use of international standards.

In order to make more systematic the analysis of deep integration we need to first detail the types of both border and behind the border barriers to trade, which might exist; and then consider the ways in which these might be legitimately considered as barriers to deeper integration. A framework for this analysis is laid out in Table (1.1). The first column of the table details the

types of barrier, which might exist, and then the subsequent columns provide specify the nature of both border and behind the border impediments which may occur with respect to that barrier. The last column is the area where we think deep integration measures as identified earlier may be able to assist. When considering the border and behind the border barriers, it is also useful to distinguish between barriers which are directly related to physical infrastructure, and barriers which arise from institutional/regulatory policy measures undertaken.

Hence, if we take the first row of the table, here we identify tariffs and quotas. These are clearly in the first instance border barriers, which may limit trade directly because of the policy measure itself (the height of the tariff, or the amount of the quota), and as a result of customs clearance procedures at the point of entry. There could also be behind the border barriers arising from the procedures which may need to be undertaken in order to be able to supply the good. Here we seen that even for goods the distinction between deep and shallow integration is sometimes blurred, and this may be even more so once one goes beyond tariffs and quantitative restrictions that affect only imports.

In looking at technical barriers to trade (TBTs) and Sanitary and Phytosanitary (SPS) measures affecting food safety it is important to distinguish between: standards which are in principle voluntary, mandatory technical regulations, conformity assessment (CA) by which compliance with standards or regulations is checked, and accreditation in which the inspection system for CA is itself assessed. Here we see that there are both border barriers which may arise because of the e.g. warehousing infrastructure, or the policy that are in place for the inspection of goods; and behind the border barriers which are concerned with the presence of testing and certification laboratories, and the measures that are in place for conformity assessment and accreditation, as well as the presence or not of both private and public standards – which in turn may or may not require appropriate legislation. The absence of those standards, or the absence of a capacity to prove that given standards may have been met will clearly impede the capacity for firms to supply the market for which those standards are required. Hence, introducing standards, conformity assessment, and accreditation provides a clear example of deep integration which then serves to facilitate trade. For services obstacles to international transactions are generally internal regulations although some services do require services or their providers to cross frontiers.

In the following table we look at the different ways in which different kinds of obstacles to trade impinge on trade. In most cases there is a physical infrastructure for applying the restrictions and this may be at the border or domestic. Shallow integration proposals can reduce the impact of the barriers that come from rules applied at the border, whole deep integration requires one to address domestic processes. In both cases however modulating formal regulatory barriers will not facilitate tare unless the physical or human infrastructure is improved. For example liberalizing rules of public procurement will not help if the process for making bids still requires a heavy resource commitment. Anti-dumping duties are levied at borders but they have a domestic element in that there may be scope for appeals and rebates all of which are internal. Anti-competitive practices and their control are usually within the national economy but monopolised distribution channels might start to bite at the frontier itself.

**Table 1.1. Understanding Barriers to Deep Integration**

	Border barrier		Behind the border	
	Infrastructure	Institutional / regulatory / policy	Infrastructure	Institutional / regulatory / policy
<b>Tariffs / quotas</b>	Customs clearance	Actual measures		Domestic implementation of applications for clearances etc especially for quotas
<b>Standards: (SPS, TBT)</b>	Warehouse facilities	Inspection processes	Labs	Standards, regulations etc
<b>Investment</b>	n/a	n/a	Access to facilities	Investment rules
<b>IPR</b>		Checks to secure compliance	Patent office	IPR legislation and rules
<b>Trade defence (AD, CVDs Safeguards)</b>	Customs clearance	Actual measures	n/a	Bureaucratic procedures for imposing duties and appealing etc
<b>Services: e.g. financial, insurance, transport, telecoms)</b>	Internet	Possible blockages on internet	Core network for peripheral services	Regulations
<b>Govt procurement</b>		X	Purchasing system	Legislation and rules
<b>Comp. policy – private firms</b>	Any marketing obstacles by incumbents		Courts	Legislation and rules
<b>Comp policy-state aids</b>				Aids regime and ways to challenge

### ***1.1.2 The Gains from Deep Integration***

In an early pioneering empirical analysis, and in the context of the Euro-Mediterranean free trade area, Hoekman & Konan (1999) conclude that:

“Despite the weakness of the datasets that are available, the major points that emerge from the analysis are fully consistent with the economic theory and analytical models. PTAs that are limited to the elimination of tariffs for merchandise trade flows are of limited value at best, and may as easily be welfare reducing as welfare enhancing.”

Similarly to the preceding discussion, they define deep integration as “explicit actions by governments to reduce the market segmenting effect of domestic regulatory policies through coordination and cooperation”. They go on to conclude that the earlier pessimistic conclusion

may be overturned by appropriate forms of deep integration that eliminate regulatory barriers. But they are forced to make fairly arbitrary estimates of the impact on trade costs of integration.

This raises the question of what are the possible sources of the gains from deep integration? The answer is multifaceted and complex, partly because deep integration involves a number of diverse areas as detailed above, and partly because there are typically spillover/externalities associated with aspects of deep integration. However, there are a number of possible gains that can be identified. Examples of the benefits of deep integration include:

- more niche market specialisation and the creation of more stable value chains.
- technology transfer and diffusion both through trade and FDI,
- pro-competitive gains from increasing import competition in an environment of imperfect competition,
- greater exploitation of economies of scale in production
- the greater use of intermediate inputs;
- the increased geographical dispersion of production through trade that supports the exploitation of different factor proportions for different parts of the production process
- local economies of scale through finer specialization and division of labour in production;
- externalities arising from institutional changes that lead to a wide increases in productivity.

In addition to the potential, but once and for all, efficiency gains and losses, there may be welfare gains arising from growth effects induced by economic integration. There might be faster technical change and total factor productivity growth from the increased specialisation, and/or positive externalities between firms and/or sectors. These dynamic gains are typically more likely to arise in the presence of deep integration, and are often also associated with the presence of foreign direct investment

In this report we look at the areas where the AA agreements raise the possibility of genuine deep integration, bearing in mind that the impact of harmonisation will depend critically on the very nature of the deep integration process. Consider the barriers to deep integration identified in Table (1.1) above. Most of these are barriers to the contestability of domestic markets – hence introducing a competition policy, introducing measures encouraging investment, reducing public procurement etc are all concerned with increasing the responsiveness, capacity, and attractiveness of the domestic market – both for domestic and foreign firms (hence linking in to FDI). Introducing these elements of deep integration will therefore have a first order impact on the firms currently supplying the domestic market in the related and affected sectors. In the first instance this implies structural adjustment with winners and losers. In the second instance those processes of deeper integration are likely to increase the supply capacity and responsiveness within the domestic market (be it by domestic or foreign firms) – driven, for example, by increased availability of credit for investment purposes, market expansion, productivity growth, improved supply (in terms of both price and quality) of intermediate inputs (e.g. telecommunications), and improved infrastructure.



In contrast some of Table (1.1), is more directly related to improving the ability to access foreign markets. Here the impact is likely to be very different on those firms that are able to *benefit* from the enhanced market access as opposed to firms who must merely *respond* in the domestic market. Standards fall directly into this category. Consider, for example, the harmonization of standards:

1. Exporting firms that can meet higher standards gain (or do not lose) market access
2. Domestic firms may face higher costs
3. Consumers may pay higher prices (but may also get better quality)

Hence, to set an entire domestic “standards” regime to assist just those firms exporting to the EU might be a small tail wagging a large dog. It also needs to be born in mind that to the extent that standards generate public goods the costs will be lessened. It seems clear then that the importance of standards needs to be considered on a case by case basis. There is little point in worrying about the standards for some product which Egypt scarcely produces. There is not a lot of point in worrying about applying EU standards for which Egypt might produce but only for its domestic market such as ice-cream. Equally, there is a lot of point about worrying about standards for goods which Egypt produces and exports or is capable of exporting in significant quantities, such as potatoes.

It is also important to try and provide some prioritization of which measures of deep integration might be considered as particularly important and why, which in turn sheds light on where the attention of policy makers should be focused in order to extract the maximum benefit from this process of regional, deeper, integration. Here it may be useful to think of first order, second order, and third order measures, where first order measures can be seen as those policy areas where it is most important that policy makers focus their attention on.

As argued above, deep integration measures could either target the enhancement of market access (bilaterally) or focus on creating an efficient domestic business environment. For example, the harmonization of Egyptian products standards mainly, but not only, serves the aim of enhancing market access, whereas harmonization of competition laws for example certainly fall within the category of creating an efficient business environment. In other circumstances the policy measures are likely to address both of these concerns. Hence, liberalising rules for foreign direct investment is an issue of market access for the foreign firms, but typically also improves the quality of the business environment by providing further sources of investment – both financial and technical.

A key constraint in the Southern Mediterranean region are the relatively low (and erratic) levels of economic growth which are currently insufficient to deal with the rapidly expanding workforce. Estimates suggest that over the next 15 years 22 million new jobs need to be created simply to maintain unemployment at current (relatively high at 10%) levels – and this is without any change in participation rates (e.g. by females), or with any reduction in the size of the formal sector. The average rate of growth in the region over the period 2000-2004 was 3.6%, while for Egypt it was 3.4%<sup>1</sup> which is approximately half of what is required to deal with growth in the work force. Higher rates of growth require higher rates of investment, which in turn requires at a

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<sup>1</sup> This is for Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia and Turkey. See, Femise report on the Euro-Mediterranean Partnership, 2006, p.7.

minimum improved access to credit, improving the quality of the business environment in order to attract investment, and enhancing the export possibilities for Egyptian firms. Here too, standards may be important as they are a necessary precondition for the access to export markets. The importance of these then needs to be considered on a case by case basis. The EU as a major market for the region has to face up to the fact that the faster economic growth, and faster exports of goods and services will lessen the pressure for the export of people.

We would therefore argue that moves towards deeper integration in the first instance should be directed towards improving the investment climate in Egypt, improving the market access of Egyptian exports to the EU and enhancing the domestic business conditions in Egypt. All this is important both as a way of improving the living standards of the domestic Egyptian population, and hence also as way of lessening the pressure of migration to the EU. In the second instance, in order to increase efficiency than we need to have competitive or contestable markets, where competition policy and government procurement are likely to be very important. There are then areas of services liberalization which are clearly key inputs into the production process and which are likely to make the Mediterranean countries more competitive in world markets – especially transport, telecoms. Of course many aspects of deep integration go in parallel, and we are certainly not suggesting they are unimportant, but if one were force to prioritise, then these are probably third order measures.

### ***1.1.3 Deep Integration and (Free) Trade Agreements***

The preceding sections detailed the different types of barriers to deep integration which may exist and which in their different ways make it more difficult for foreign firms to access domestic markets, and considered the possible welfare consequences of deeper integration. In this section, we consider the extent to which the removal of such barriers could be formulated within the context of a regional trade agreement – such as the Association Agreement, and the European Neighbourhood Policy Action Plan between Egypt and the EU.

Barriers to foreign firms necessarily entail discrimination. The elimination of that discrimination can then be achieved in different ways and at different levels, and these are detailed in Table (1.2). In particular one can distinguish between:

**Most Favoured Nation (MFN) treatment:** The MFN rule is the weakest form of “deep integration” and is an obligation to treat all foreign suppliers in the same way. It is rarely considered to be relevant in the context of regulations for goods, since it does not require markets to be opened to foreign competition but merely that however closed or open they are the same treatment is extended to all foreign suppliers, even if collectively they are not treated the same as home firms., But it is more complex for services. The WTO agreement on services, the General Agreement on Trade in Services GATS (see Box 1.1) requires MFN even for unscheduled and un-liberalised sectors or modes, so all foreign suppliers must be treated alike unless an MFN exemption has been agreed. This has never been a diplomatic issue but it is a constraint on domestic rule making: one cannot decide to admit service suppliers from the EU but not the US without either an MFN exemption or the negotiation of a fully fledged Regional Trade agreement compatible with GATS article V. But this provision is more like to be relevant as a constraint on partial liberalisation than for highly regulated markets.

### **Box 1.1: The General Agreement on Trade in Services (GATS)**

#### **Part of the WTO agreement of 1994**

##### **What is covered?**

Each WTO member must list or “schedule” those sectors it is willing to open. These commitments are “bound”. Non scheduled sectors do not have to be opened up. But they subject to the MFN obligation unless the country files an exemption for them. There is a general but somewhat imprecise exemption for public services.

##### **What commitments apply to scheduled sectors?**

Countries listed how much and in what way they were willing to open each of 16 broad sectors with the possibility of excluding sub-sectors within them.

##### **For each open sector the country must schedule its willingness to open the sector for any or all of 4 “modes”:**

1. Cross border supply of services
2. Supply of services to buyers who travel
3. Establishment of foreign suppliers
4. Cross border supply of services by temporary movement of people

In each case the schedules distinguish between “liberalisation” (i.e. committing to allowing foreign firms to supply at all) and “National Treatment” i.e. letting them in on the same terms as locals

Many countries open their markets more than they are signed up for under GATS. These openings are reversible

In principle GATS affirms the right of countries to retain freedom for domestic regulation, though the border between this and “trade” is blurred.

##### **Services in RTAs:**

The rules on services in RTAs are separate from those on goods. The GATS agreement allows WTO members to sign preferential agreements on services with partners but only if substantially all services trade is covered. Some services RTAs however merely reaffirm GATS\_\_commitments.

**National Treatment:** It was sometimes thought that the General Agreement on Tariffs and Trade (GATT) of 1947 only dealt with shallow integration but in fact Art .III calls for “National Treatment” and thus requires all domestic regulations and taxes to treat home produced and imported goods alike. Also the ban on quantitative restrictions in Article XI has been interpreted as covering bans on the sale of all goods of a particular type that obstruct imports even if they also affect home goods.

The general obligation for National Treatment of GATT Article III and for those sectors so scheduled under GATS stipulates that taxes and regulations must be the same on imported as well as domestic goods, once the former have cleared customs. This obligation is weak if it is confined to saying that laws regulations and taxes cannot discriminate legally against foreign goods, but it is powerful if *de facto* discrimination is prohibited and there is binding dispute settlement (DS) system.

The European Court of Justice has ruled that any differences between national regimes even if they are not discriminatory can be obstacles to trade and the country imposing them must demonstrate that the country imposing them has a solid public policy objective in mind that cannot be achieved another way. Therefore, though the *term deep integration* was coined in the 1990s to refer to trade agreements that incorporated integration processes that went beyond the obligations of the GATT itself. Within the EEC, the ECJ went further than the GATT but was building on it.

It is rare that technical barriers to trade are written in such a way as to exclusively target imports, though it is possible for a technical regulation to fall more heavily on imports *de jure*. More common is the situation where regulations in one country are an implicit or *de facto* obstacle to imports because they are easier for local products to meet.

**Mutual Recognition and Harmonisation:** The EU has been the prime example of deep integration and its regulations and jurisprudence have gone well beyond the idea of national treatment. The Court of Justice has declared that differences in rules can be seen as obstacles and have to be shown to be necessary. As a result the EU has long found it necessary harmonise rules. However this is a difficult political project even though the EU has a legislative apparatus. Hence the ECJ developed the notion of *mutual recognition*: products made to meet one member state’s norms must be accepted by others, unless they can show why they not acceptable. Unfortunately it did leave some scope for Member States to reject partner country goods if they fell below a certain quality threshold and it became necessary to move towards the “new approach” in which basic elements of product specifications were harmonised leaving freedom on inessentials and how to achieve aims. Mutual recognition would seem to be the ideal mechanism to ease trade frictions without reducing regulatory freedom. Sadly it is not so simple. The EU has been forced to agree basic standards and it has in fact found it very difficult to agree mutual recognition of testing and certification with even the US. Mutual recognition in practice requires some degree of approximation and a high degree of trust between parties. Hence it has not been widely used at the WTO or in RTAs.

**Table 1.2. Ways of Eliminating Barriers to Deeper Integration**

Type of barrier removal	Meaning	WTO	Governance
<b>Most favoured nation</b>	Discrimination against foreigners allowed, but not between them	Key principle of GATT;  GATS if there are no exemptions	Minimal constraints on autonomy, but says any liberalization must be non-discriminatory
<b>National treatment</b>	Must treat foreign and home products equally once they are admitted	Key principle of GATT, Article III  GATS subject to commitments	Impact may be slight without binding dispute settlement (DS). Could be substantial with binding DS if <i>de facto</i> implicit discrimination addressed.  Sometimes impact underestimated for Technical Barriers to Trade

			(TBTs)
<b>Mutual recognition</b>	Equivalence assumed, but can be subject to challenge	SPS if equivalence can be shown	Depends on freedom to choose partners and if there is binding DS.
<b>Harmonisation/ Approximation</b>	Everyone has same/similar rules	TRIPs Telecoms reference paper  SPS & TBT some elements	Explicit agreement in detail needed – in the EU qualified majority voting; at the WTO consensus if multilateral. But ISO & Codex can be decided by majority  Approximation agreed in an RTA can reduce sovereignty

This brings us to the core issue of how far deep integration can be used to facilitate trade in RTAs, or put alternatively, to identify the mechanisms by which RTAs could attempt to address these barriers. Here there are actually two dimensions: (a) the extent to which the liberalization can and does discriminate between RTA and non RTA partners; and (b) which mechanism – national treatment, mutual recognition, or harmonisation is used. These issues are summarized in Table (1.3) below.

With regard to the issue of discrimination between RTA and non-RTA partner, in general an agreement to liberalise in a RTA can be preferential or MFN. The latter implies that any advantages given to the RTA partner country are then extended to others. This can be:

- by rules – e.g. the TRIPS agreement says that any increased protection of Intellectual property rights must be extended on an MFN basis to all partners; similarly in other areas some RTAs specify that liberalisation proposed in subsequent
- RTAs with other partners must be extended to signatories of earlier deals
- de facto – when it is very hard, if not impossible, to exclude others from benefits. For example with simplified bureaucratic procedures it is in many cases hard to apply these to some importers / exporters and not others. Similarly, agreeing to use EU standards (or ISO standards) would benefit all who sell into EU, and/or who sell into the domestic market. Introducing or changing a competition policy applies to all firms in the market. Investors can buy into a firm that is based in home that has benefited from a relaxation of investment rules.

In considering standards, we are faced with the somewhat unpalatable conclusion that if deep integration is to be effective it appears that it must be thorough-going and contain some form of harmonisation. A major practical problem is that the EU calls on its partners to approximate their legislation to that of the EU and with mutual recognition of conformity assessment very much as a final step. Even the recent generation of agreements contain largely aspiration and only the mildest of commitments. By contrast very few other RTAs such as NAFTA go beyond the National Treatment concept and hence are unlikely to be able to deliver much more than the

WTO. Other RTAs such as Mercosur have lofty ambitions for harmonisation but have de facto made little progress. This applies to most areas of regulatory harmonisation (Bourgeois et. al., 2007).

In fact a very considerable amount of deep integration can be done by the private sector. Standards are often private and conformity assessment is typically a private activity. Nevertheless it rests on a public infrastructure and there is little getting away from the fact that deep integration cannot confer real market access gains without loss of sovereignty. The EU's relations with its immediate EEA neighbours is a striking example of forced harmonisation with the bare minimum of consultation. These countries, like candidates, however have little option but to align their economies with their dominant market. For the ENP partners the degree of market integration is not so close so that real choices have to be made.

There is increasing pressure to create some form of "common market place" in which all forms of regulatory conditions are approximated. Standards and technical regulations are the most obvious elements in this process but as the EU itself has found, effort is needed to remove a range of other regulatory barriers such as restrictions on government procurement or competition laws that allow local firms to create entry barriers. We would argue that in these regulatory domains it is less likely that there will be adverse discrimination against 3<sup>rd</sup> parties. Putting it simply, adapting non-trade rules to make life easier for EU firms usually also makes it easier for any firm able to sell into the EU.

**Table 1.3. Ways in which Regulatory Barriers could be dealt with in an RTA**

	<b>PREFERENTIAL</b>	<b>MFN</b>	<b>NATIONAL TREATMENT*</b>	<b>MUTUAL RECOG.*</b>	<b>HARMONISATION</b>
Standards: (SPS, TBT)	MR with some partners	Agreement that both parties will adopt ISO etc norms	Generally required by GATT Art III anyway	For conformity assessment likely to be preferential	EU presses for this, but limited value without CA MR
Investment	Discrimination possible in industry so long as trade not affected. But de facto hard to apply if 3 <sup>rd</sup> country can buy into the industry	GATS requirement unless Art V satisfied.	Agree to apply same rules to foreign firms as home	Most likely to apply for services	
IPR		Must be MFN under TRIPS Rare case where you have to extend	Generally required under TRIPS	unlikely	EU & US call for this in some areas
Trade defence	EEA removes AD	Unusual	n/a		
Services	Must satisfy GATS	Quite likely;	Unlike goods	Home	Possible

	V. Preferences hard to apply if 3 <sup>rd</sup> country can buy into firms	GATS obliges MFN for all sectors even if not scheduled unless exemption taken out in 1994	only required for scheduled sectors; Preferences possible But subject to Art V	country regulation Possible, but GATS has rules.	
Government procurement	Can be done	PP not covered by GATT, only GPA	Possible	Would apply to approved lists	
Competition Policy	Unlikely but could apply to takeover rules	Most likely— would affect all partners	Possible to apply to some or all	Would imply MR of decisions	Possible
State aids rules	Hard to do except for CVDs.	State aid controls would affect all partners	?	?	EU seeks to secure: bonus – removal of CVD rules

**Note:** \* In principle each of these can be done preferentially or MFN in an RTA (open regionalism) What remains to be seen how far this framework can be used to characterize the AA and the ENP Action Plan developments *and potential* developments between the EU and Egypt, which is the focus of the next section.

## 1.2 Deep Integration in the Context of the EU and Egypt

### 1.2.1 EU-Egypt Trade Relations Background

The Egyptian – EU relations have been steadily evolving over the last three decades, starting by shallow integration and moving gradually towards more deep and comprehensive relationship. In this regard, we can distinguish among three stages of the Egyptian – EU relations: *firstly*, Egypt – EU preferential relationship under the General Cooperation Agreement signed in 1977 which extended till 1996; *secondly*, in the context of the Barcelona process, Egypt and the EU, on the bilateral track, signed the Association Agreement (AA), like all other South Mediterranean countries, which entered into force in January 2004; *thirdly and finally*, the Egyptian Action Plan in the framework of the European Neighbourhood Policy (ENP) which was adopted in March 2007 during the third Association Council meeting in Brussels.

The 1977 General Cooperation Agreement was concerned with non-reciprocal free market access of Egyptian industrial exports into the EU markets with the exception of textiles and clothing. Egypt did not have to offer in return any preferential treatment to EU industrial exports into Egypt, while both partners exchanged some forms of partial preferential treatment for some specific agricultural exports. Under the context of the Cooperation Agreement between 1977-1996, Egypt – EU financial cooperation was governed by a series of four bilateral protocols. A total of million 661 Euros was committed to different projects which focused mainly on supporting the modernization of the Egyptian economy, promoting market economy and, investing in socio-environmental infrastructure although actions in economic cooperation, energy, industry, scientific co-operation and health were also included (European Commission, 2002). The General Cooperation Agreement was a shallow non-reciprocal type of integration.

Following the Barcelona conference in November 1995, Egypt and the EU started negotiating the AA. The agreement stipulates that a free trade area between Egypt and the EU will be established over a transitional period of 12 years for all industrial goods except for a few related to the automotive industry that will be liberalized over 16 years. The agreement includes provisions for reciprocal preferential treatment of the agricultural and processed agricultural goods. In addition, Egypt – EU AA includes some other provisions in non-economic fields (social, political and cultural). The AA was shallow in its nature but contained the seeds for deep integration whether by vaguely referring to harmonization of laws and regulations sometimes or postponing the negotiations on deeper elements to the future.

In 2003 the EU announced its new European Neighbourhood Policy (ENP) which included a bilateral element of designing separate Action Plans for each country included in the Neighbourhood Policy of the EU.

**ENP plus:** After two years of operational experiences of the ENP in 2005 and 2006, the Commission and the Council agreed that ENP needs to be strengthened with the aim of achieving deeper integration, hence the current discussion around the idea of an ENP plus.

The Commission made a comprehensive proposal in 2006, which contained a rich agenda for strengthening the ENP (European Commission, 2006). In doing so, the EU will continue to tailor its support to the needs and aspirations of partners, and work on deepening the relations with ENP countries. The priority areas set by the Commission 2006 document included the following:

- **Enhancing the economic and trade component**, by increasing support for reforms and efforts to improve trade and economic regulatory environment and strengthened economic integration and cooperation in key sectors, besides pursuit of a deep and comprehensive FTA approach, which includes behind the borders elements.
- **Facilitating mobility, and managing migration**, through visa facilitation removing obstacles to legitimate travel, as well as ensuring well-managed mobility and migration.
- **Promoting people-to-people exchange** includes educational, cultural, youth and research exchanges and training the regulators of tomorrow.
- **Building a thematic dimension to the ENP**, through enhancing multilateral and bilateral dialogue with ENP partners in key sectors and work for the extension of the EU transport and energy networks. Nevertheless, there are a number of cross-cutting themes where the EU and its partners both south and east, share common interests and concerns and which could usefully be addressed in a multilateral context. In areas such as energy, transport, the environment, information society, research cooperation migration or maritime affairs, problems are often not merely bilateral in nature and could benefit from common debate, actions and cooperation between the EU and all or most ENP partners.
- **Strengthening political cooperation**, through more active EU role in regional or multilateral conflict-resolution efforts and intensify parliamentary cooperation.
- **Enhancing regional cooperation** by full implementation of the Euro-Mediterranean work program and deepening cooperation with neighbours' partners on energy, transport, provide simplification of the short-term visa issuing procedures for certain categories of persons, and the fight against illegal immigration.
- **Strengthening financial cooperation**, by maximizing the impact and leverage of scarce resources and improve coordination between member states and European Commission assistance (European Commission, 2006; CEPS, 2007).



It is worth noting that the main differences between ENP and the list pointed above in what has been coined as ENP-plus are a) focusing on specific issues; b) differentiating between goals and means to achieve them, though the programs or tactical pragmatic aspects of such means still remain not addressed. For example, ENP did not identify certain areas as those listed above as priority areas for cooperation. Moreover, ENP plus has explicitly stated that deep integration is the main objective which was not the case in the ENP.

### **“Action Plan for the Mediterranean and Northern Africa” An Economic Approach**

The European Commission President entrusted “*Council for Economic Cooperation (CEC)*” in July 2006 to set the design of an Action Plan for the Mediterranean and Northern Africa. Unlike the method of the Barcelona Process (meetings and conferences), the Action Plan will directly and heavily involve major decision makers in 9 countries<sup>2</sup> incorporated.

### **“Mediterranean Union” A Political Approach**

Newly Elected French President Sarkozy, announced in February 2007 the idea of a Mediterranean Union. There is no conclusive list of countries but it is said that; The Union would contain a mix of EU member states and South Mediterranean countries including Turkey and Israel. The initiative includes the formation of a regular council by Members under a rotating Presidency dealing with energy, security, counter-terrorism, immigration and trade.

The proposal was originally made as part of Sarkozy’s election campaign. President Sarkozy sees the initiative as a way of promoting peace between Israel and its Arab neighbours. Sarkozy’s proposal has been supported by some EU members as Spain and Italy and criticized by others as Germany which argued that such new initiative could compete with the Barcelona process. On the other side of the sea; Morocco, Tunisia and Israel supported the proposal, while Turkey rejected the proposal as an alternative to EU membership. The Libyan government was concerned about the proposal. Critics also say that, the creation of this union in the form which Sarkozy has proposed will not be different from the ongoing framework of the Barcelona Process:

- Both include a large variety of issue. (political , cultural , economic)
- It will be a long process and no immediate results will be felt.
- Too many parties are involved which will cause divergence of opinions and delay.
- The inclusion of Israel and the Palestinian Authority will integrate the problems of the Middle East Process into the Union. The major aspect is that it will exclude EU countries that have no interest in the Mediterranean region (Bremner, 2007).

## ***1.2.2 Comparing AA and the ENP Action Plans***

### **– The Association Agreement (AA)**

The Association Agreement (AA) included several “seeds” for deep integration; however it left issues of implementation not appropriately tackled. AA either postponed issues of deep

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<sup>2</sup> The 9 Countries are: In the North (Spain, France, Italy) and, In the South (Algeria, Egypt, Libya, Morocco & Tunisia)

integration to future negotiations (e.g. services and establishment), or referred to them in a very general manner (e.g. customs procedures and standards). In other words, AA set the framework for integration, both shallow and deep. It was precise on all details related to shallow integration, but very unclear on deep integration aspects.

Applying the concept of shallow versus deep integration to the AA should be tackled in the context of Barcelona framework, which includes two tracks of working, a bilateral and a regional track. On the regional level, several ministerial meetings were conducted since 1995 aiming at deepening trade relations between the South Mediterranean countries and the EU. Along the lines of deepening trade relationships, it is highly significant to shed light on the 5<sup>th</sup> ministerial meeting for trade ministers which took place in Marrakech 2006. During this meeting, the ministers agreed to start negotiations between the EU and the South-Mediterranean countries, which included Egypt, Morocco, Jordan, Palestine and Israel, to liberalize trade in services by going beyond these countries commitments' in the GATS (i.e. GATS plus) as well as guarantee the right of establishment for investment projects within their territories for EU partners. Negotiations, so far, have focused only on the design of general framework, and no actual sectoral commitments have been subject to negotiations. In addition, they agreed on initiating bilateral trade negotiations (between the EU and any of the Mediterranean countries) on agricultural and processed agricultural products in the framework of Rabat Road Map which was called for during the ministerial meeting in 2003 (which is a framework agreed upon between ministers of both EU and South Med countries on concrete steps to liberalize agriculture). Lastly, the ministers agreed on beginning the negotiations to draft a protocol regulating the strategy and tool of cooperation in dispute settlement between the EU and the Euro-Mediterranean countries.

In fact, the regional negotiations on services trade liberalization and the right of establishment have already started, in which 4 rounds of negotiations were conducted during the period of June 2006 – September 2007. The fourth round witnessed the start up of the bilateral negotiations, in order to realize an actual development in this area, likewise the ministerial meeting for Foreign Trade ministers which took place in October 2007. One of the main important points included in the current negotiations, is the existence of a whole separate chapter in the draft protocol dealing with the 'Regulatory Cooperation and Alignment' (this chapter is still a proposal to discuss. It includes the possibility of approximating and may be unifying some regulations and definitions for some services sectors as telecommunications, maritime, financial sector and E-commerce) for several services sectors between the Euro-Mediterranean countries, starting with financial services, telecommunications, international maritime transport, postal and courier services and the E-commerce.

These efforts / directions complement the seeds for deep integration in the AA. Moreover, this moves the AA from the shallow integration mode to a deeper integration mode, and at the same time these directions line up with the philosophy and policy of the ENP and its Action Plans as discussed below.

#### **– The European Neighbourhood Policy (ENP) and Action Plan**

The European Neighbourhood Policy (ENP)<sup>3</sup> stands for an extension of the EU governance regime – norms standards and values – beyond the political borders of the Union. The ENP as

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<sup>3</sup> The ENP covers 16 countries; the 10 Mediterranean countries Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, the Palestinian Authority, Syria and Tunisia in addition to Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. It does not cover neighbouring countries if they:

formulated in its early stages was vague regarding its objectives, which ranged from the promotion of human rights, democratizations and prosperity to support for good governance in the neighbourhood. Nevertheless, its implicit objective was always viewed as a vehicle for deepening trade and economic relations especially with countries of the South Mediterranean including Egypt (Hoekman, 2005). Within the ENP the EU offers the prospects of deeper economic integration, increased political dialogue and seeks to support the transformation of its neighbours in line with the EU norms, standards, and regulations, while not offering membership (European Commission, 2004).

It is worth noting that the deepening of trade objective is more realistic and acceptable than the former communications of the European Commission which have always stated that EU wanted to be surrounded by a “ring” of friends and that those friends incentive for deepening their trade relations with the EU is the “stake” in the EU internal market. Such “stake” in the internal market, whatever that means, was dropped in the latest European Commission communications on ENP which appeared in December 2006. The European Commission realized the vagueness of the stake incentive and adopted a more clear incentive and objective for ENP. European Commission (2006) identified that the aim of ENP is deepening trade integration “From the outset, a key premise of the ENP was that economic integration should go beyond free trade in goods and services to also include “behind the border” issues: addressing non-tariff barriers and progressively achieving comprehensive convergence in trade and regulatory areas (such as technical norms and standards, sanitary and phytosanitary rules, competition policy, enterprise competitiveness, innovation and industrial policy, research cooperation, intellectual property rights, trade facilitation customs measures and administrative capacity in the area of rules of origin, good governance in the tax area, company law, public procurement and financial services).”

Moreover, the European Commission (2006) added that Action Plans are a step in the direction of deepening such relations. It is worth mentioning that the Action Plans are not legally binding agreements, but political documents outlining a joint set of objectives and measures to undertake for the EU and its neighbours. They aim at providing a framework for the harmonization of norms and standards of the countries in the neighbourhood to the EU. The Action Plans’ stated aims are to enhance the strategic partnership with neighbouring countries “beyond cooperation and towards significant integration”. The Action Plans are not about foreign policy. Aside for the predictable parts on political partnership, cooperation in crisis management and common foreign and security policy issues, the Action Plans are overwhelmingly about domestic policies.

The Egyptian Action Plan, which has been signed and entered into force since March 2007, is a document developed jointly between Egypt and the European Union after several rounds of formal negotiations, within more than a year. Although the document is highly similar to other Action Plans (as those of Jordan, Tunisia, and Morocco) it still reflects the main future priorities of the Government of Egypt (GoE) in the fields of political, economic and social reforms during the period 2007-2010 as stated in presidency platform in 2005 and the government’s statement before the Parliament in 2006. This was clarified by the presence of more than 6 drafts for work

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- Are in the process of joining the EU.
  - Have customs unions with the EU (Andorra, San Marino and Turkey).
  - Are in the Stabilization and Association process (Albania, Bosnia and Herzegovina, Croatia, Montenegro, Republic of Macedonia, and Serbia).
  - Are the EFTA states (Iceland, Norway, Switzerland, and Liechtenstein).  
Russia or Kazakhstan.

plan, as each negotiation round created a new draft to measure the reform program as the GoE has observed and which accords with her capacities and her capabilities on development.

The Action Plan has three components which reflect Egypt’s economic, social and political priorities.

Egypt’s main economic priorities as stipulated in the Action Plan include enhancing the business and investment environment, improving macroeconomic governance; reforming the financial sector, strengthening the role of the private sector, reforming the tax system, boosting industrial development and enterprises capabilities and competitiveness, increasing economic integration, promoting south-south trade, deepening and enhancing the existing economic dialogue with the EU, as well as promoting co-operation in the transport and energy fields.

On the social front, both parties have committed themselves to cooperate on various issues including reducing poverty, combating illiteracy, reforming of the education and vocational training systems, modernizing social security system, developing health sector reform and upgrading the quality of health services. On the cultural front, priorities focused on strengthening links and cooperation in youth, sports, and other cultural related activities.

Finally, both parties are committed to enhance political dialogue and cooperation on issues of mutual interest most notably conflict in the Middle East; disarmament and non proliferation of weapons of mass destruction, fight against terrorism and organized crime. The Action Plan also emphasized that both parties will proceed with enhancing the effectiveness of political institutions; strengthening democracy and the rule of law, promoting the protection of human rights, eliminating discrimination, racism and xenophobia, all of which represent key political objectives for the government.

In return for undertaking the ENP initiative by the EU, the Commission stated the following “In return for the implementation of political, economic and institutional reforms, the neighbouring countries obtain the prospect of moving beyond the existing relationship to a significant degree of integration, including the conclusion of deeper free trade agreements and the possibility of participating progressively in key aspects of EU programmes; enhanced preferential trading relations and market opening;...”. (European Commission, 2007). The question that then follows, is what are the additions in terms of incentives for a country like Egypt to join ENP. The deep integration aspect could have been achieved without adoption of ENP whereas the market access issues were already part of the built-in agenda of the AA, however they were either vaguely mentioned or postponed to future negotiations. Table (1.4) shows that the aspects of deep integration that have been mentioned in the AA were repeated without substantive changes in the Action Plan. The substantive change has been in establishing special committees and sub-committees as stated below (not yet fully functional) that oversee the priorities and follow the implementation of programs agreed upon between Egypt and the EU, which is considered a change in the mechanism of implementation, and hence can lead to more effective integration between Egypt and the EU.

**Table 1.4. Aspects of Deep Integration in the AA and Action Plan\***

	AA		Action Plan	
	Infrastructure	Institutional / regulatory / policy	Infrastructure	Institutional / regulatory / policy
Tariffs / quotas		X		
Standards: (SPS, TBT)		X		X

Investment		X		XX
IPR		X		X
Trade facilitation (mainly transport)		X		X
Trade defence		X		X
Services		X		X
Network inds (mainly energy)		X		XX
Govt procurement		X		X
Comp. policy		X		X
Dispute settlement		X		X

If one X is included in the Action Plan then it replicates to a large extent what has been mentioned under the AA. If XX is included, then this implies that there have been some kind of extra deepening efforts.

### ***1.2.3 Implementation Policies of the ENP Action Plans***

#### **– Description of ENP and Action Plan**

EU is the largest regional block in the world, where in 2005 it accounted for 28% of the world's GDP, 39% of the global trade, 51% of foreign direct investments and was a major source of international tourism as well as it also accounted for 26% of the world's expenditure on R&D. In addition, the EU is considered Egypt's first trading partner where in 2006 it accounted for 37% of Egypt's total foreign trade, 61% of tourism and 32% of foreign investments (CBE, 2007). Furthermore, the EU is also the second source of foreign aid in Egypt.<sup>4</sup> All such reasons assert why Egypt has to support and develop the Egyptian-European bilateral relations.

Accordingly, Egypt's step to join the ENP, which was declared by the EU in 2004, and signing the Action Plan was due to several factors.

- First, this comes in coherence with the Egyptian foreign policy which focuses on creating an expanded network of relations with its neighbouring countries and with the most important trading partners, and the importance of its positive integration in the world economy.
- Second, guaranteeing that Egypt is not isolated or marginalized in its relationship with the EU, or losing its comparative advantages in its largest market for its foreign trade, as many Mediterranean countries had surpassed Egypt by integrating to the European Neighbourhood Policy and implementing the Action Plan (Jordan, Morocco, Palestine, Tunisia and Lebanon)<sup>5</sup>.
- Third, coinciding with the national reform agenda which was declared by the Government of Egypt (GoE). Hence, the Action Plan came to secure the commitment of

<sup>4</sup> US economic assistance was \$442 million and the EU was \$ 292 million by the year 2003

<sup>5</sup> In addition, the Country Paper of Algeria is currently being prepared and will be followed by the Action Plan negotiations. The Syrian European Association Agreement is also pending ratification, which is a necessary step before commencing negotiations on the ENP Action Plan, while no progress was made in the EU's relation with Libya. Finally, there are some other non Arab countries which have adopted the ENP and agreed upon specific Action Plans as Armenia, Azerbaijan, Georgia, Israel, Moldova and, Ukraine.

this program on international level as well as it can be used as an anchor for reform (Hoekman, 2005)

A careful reading of the Action Plan identifies two main observations; first, one of the main priorities jointly decided and stated in the Action Plan is approximation with EU technical legislation, standards and conformity assessment procedures, in addition to gradual convergence towards the principles of the EU internal electricity and gas markets; second, there are several direct commitments that were made across the three pillars of the Action Plan to strengthen and deepen the Egyptian European relations as follows:

- “Identify and adopt accompanying measures providing for the structural, institutional, legal and administrative support necessary in order to ease access of the Egyptian agricultural products to European export markets, inter alia, by approximation of technical legislation; and in particular increase cooperation in the field of international marketing standards for all agricultural and processed agricultural products”.
- Enhancing cooperation between Egypt and the EU in the field of sanitary and phytosanitary issues and explore possible areas of cooperation (e.g. legislation, implementing practices), while taking into account the different conditions prevailing on both sides.
- Continuation of work on the implementation of the Palermo Action Plan for the Free Movement of Industrial Products approved by the July 2003 Euro-Med. Conference of Ministers. Take the necessary steps with the support of continuing assistance, to complete and upgrade the quality infrastructure and to start negotiating an Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) (see Box. 1.2).
- Examine possibility of further convergence of customs related legislation.
- Harmonize the remaining national standards with European and international standards for industrial products
- Work towards the adoption of key principles of international accounting standards for listed companies and consolidated accounts
- Establish a qualified and independent audit professions and work towards the adopting of international standards on auditing for all statutory audits
- Enforce the competition law in line with that of the EU and establish an independent and adequately-resourced competition authority
- Work together to develop economic, environmental and social statistics in conformity with European and international standards.
- Initiate a process of gradual approximation with, and implementation of key international principles, transparency, competition and access to legal recourse. In order to help enhance access to each other’s public procurement markets.
- Cooperate in view of establishing and implementing a policy for upgrading the Public Internal Financial Control System on the basis of a gap analysis of the current internal control systems as compared to the relevant internationally agreed standards and best EU practice.
- Exchange expertise and cooperation in order to upgrade the institutional capacity of the public internal financial control systems to the internationally agreed standards and methodologies as well as EU best practices in the area of internal control and internal audit, covering all income, expenditure, assets and liabilities, of the general Government and budget entities and economic authorities.

- Strengthen maritime safety and develop the fleet; continue to implement the relevant international conventions; and when possible *approximate* standards
- Take steps to prepare (under the auspices of the Ministry of Petroleum and the Ministry of Electricity and Energy) an overall Egyptian energy strategy converging towards EU energy policy objectives (security of supply, competitiveness and environmental protection) and covering, inter alia, all sub sectors, the strengthening of institutions and financing.
- Explore possibilities for *gradual legal and regulatory convergence* towards the principles of the EU internal electricity and gas markets.
- Continue energy sector restructuring to explore possibilities for *gradual convergence* towards the principles of the EU internal electricity and gas markets and the Euro-Mashrek-Maghreb gas cooperation.
- Support and enhance cooperation in reforming and upgrading the education and training systems and work within the framework of the Egyptian plans towards *convergence* with EU and international standards and practice.

**Box 1.2: Negotiation of the Agreement on Conformity Assessment & Acceptance of Industrial Products (ACAA)**

**Egyptian Organization for standardization & Quality Control (EOS) has specified the sectors of high priority in the framework of this agreement as follows:**

- 1- Electrical
- 2- Pressure equipment
- 3- Construction products
- 4- Medical devices
- 5- Packaging, Egypt has asked for replacing the item for "Packaging" with the item for "Gas appliances", as Europe is in the process of completing the technical regulations related to packaging.

These priorities have been selected according to their importance in respect of:

- 1- Safety and health
- 2- Trade with European Union
- 3- Upgrading industry in this field

**EOS has carried out the following procedures for implementing the requirements of this agreement:**

- 1- Providing the European side with the Egyptian technical regulations currently implemented in these fields.

Applying the criteria set in Table (1.3) for the different forms of deep integration, we observe that most of the Action Plan objectives listed above are more in line with the extreme case of deep integration, namely harmonization and approximation. Though stated explicitly that the Action Plan will work on harmonization, convergence, approximation of Egypt rules, and regulations, the means for achieving such form of deep integration have not been mentioned.

#### – Institutional Setup of the ENP and Action Plan

In order to guarantee the implementation of the Action Plan commitments, the partners started a mechanism to follow up on the implementation of commitments from both parties. The Action Plan indicates that the mechanism established under the AA will be responsible for the implementation and monitoring of commitments under the Action Plan. These mechanisms are: First, the Egyptian European Association Council which was established as per article 74 of AA. It meets once a year at a ministerial level. Second, the Association Committee which was established as per article 77 of the agreement and is composed of senior government officials. Third, Sub-Committees<sup>6</sup> were established as stipulated in article 80. In this regard, both parties agreed to establish nine sub-committees on internal markets, industry, trade, services and investment, transport, environment and energy, information society and audiovisual, research and innovation, education and culture, agriculture and fisheries, justice and security, customs and co-operation and political matters: human rights and democracy-international and regional issues as well as one working group on migration, social and consular affairs.

Although this follow-up mechanism was stated under the AA, it was neither fully implemented nor enforced until 2007, when various sub-committees were formulated after the adoption of the Action Plan. The role of the nine subcommittees based on the ENP and following the Country Strategy Paper (2007-2013), is to “oversee implementation and monitoring of the different chapters and thematic undertakings in the Action Plan and will allow the two sides to set specific annual priorities.” The ENP: “The ENP offers a framework to support the modernisation process in Egypt. In this context, the EU will focus on a limited number of specific priorities, selected on the basis of the following principles: i) strategic interest to the EU; ii) consistency with the National Development Plan; iii) linkage with the conclusions of the subcommittees on implementation of the Action Plan; and iv) strategic approach to donor coordination, harmonisation and alignment, to focus on carefully selected key areas where the EU considers

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<sup>6</sup> Three sub committees meeting took place last month in Egypt, sub committee on industry trade, services and Investment (ITSI) on June 2007, followed by the subcommittee on Information society and audiovisual, Research and Innovation, Education and Culture, and lately the subcommittee on transport, environment and Energy in the same month, looking for the meetings of the other subcommittees at the end of this year, or at the beginning of the coming year.



that it has a comparative advantage and where there are distinct possibilities to complement the work of other donors, in particular of the EU Member States and the EIB.”

In order to reward progress in implementing reforms, EU members have developed a new financial instrument to support the Action Plan under the ENP, which is the European Neighbourhood and Partnership Instrument (ENPI). ENPI will replace the MEDA program<sup>7</sup>, previously applied to South Mediterranean countries including Egypt as well as the TACIS, which was used for Eastern European Countries. As of 2007, MEDA and TACIS are to be terminated and replaced by ENPI.

The EU has allocated about billion 12 Euros to the ENPI for the period 2007-2013. Additional support will be provided via the European Investment Bank with a total lending mandate of billion 12 Euros over the same period. To encourage countries achieving greater progress in the implementation of the Action Plan, the EU has established two new facilities where allocations will be based on progress; there is the Neighbourhood Investment Fund with a total budget of million 700 Euros for 2007-2013 and the Governance Facility with million 300 Euros (some million 43 Euros per year, on average). It is worth mentioning that country allocations are based on needs, absorption capacity and progress on implementing the Action Plan. Such new mechanism is recognized as a positive conditionality instead of the negative conditionality that used to prevail under MEDA program.

During the period 1995-1999, the EU allocations to Egypt under the MEDA (I) reached around million 686 Euros, which represents about 20% of the total funds allocated by the EU in the first phase of the program to the Mediterranean countries. While during 2000-2006 and under the second phase of the program (MEDA II), the allocated amount of funds to Egypt reached million 351 Euros, they only represented about 6.5% of the total funds under MEDA (II). Overall and under MEDA program (I & II) Egypt's share reached almost 12% from the total funds which the EU had allocated under the two phases. While under the ENPI funds, Egypt's share reached merely 4.65% of the total funds by the EU (European Commission 2007)<sup>8</sup>.

The EU has allocated million 558 Euros over the upcoming four years (2007-2010) to support the Government of Egypt (GoE) in implementing the reform program as agreed upon in the Action Plan, where 137 million Euros have been allocated for the first year 2007 (which is part of the ENP). Additional to this amount, the GoE can still benefit from other technical and financial support programs such as the Neighbourhood Investment Fund, Governance Facility and loans from the European Investment Bank. Finally, disbursements from previous periods financing ongoing project will continue.

Besides financial assistance, the EU provides technical assistance to support Egypt's implementation of the Action Plan. For instance, the Technical Assistance Information Exchange Instrument (TAIEX) which used to be limited to EU acceding countries has been opened up for ENP countries. TAIEX provides short term targeted technical assistance in the fields of

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<sup>7</sup> The main differences between the ENPI and previous instruments are: first - regarding the beneficiaries: ENPI covers Mediterranean countries as well as Eastern and Central European Countries. Previously, there were two separate instruments, the MEDA for Mediterranean countries and TACIS for Eastern and Central European Countries. Second - on the types of programs funded: the ENPI covers new programs such as Cross Border Cooperation, and Institutional Twinning. The new instrument is policy driven as it will be used mainly to support the implementation of the Action Plan.

<sup>8</sup> [http://ec.europa.eu/europeaid/index\\_en.htm](http://ec.europa.eu/europeaid/index_en.htm)

institutional building and approximation, which aims at enhancing the exchange of experts among different European and Egyptian organizations, hence enhancing deep integration through exchange of knowledge. The amount allocated for all South Mediterranean countries in the TAIEX reached million 1.6 Euros as a first step, subject to increase to million 25 Euros. Moreover, there is the Institutional Twinning Program which provides long term- technical support to reform and upgrade the administrative structure and public institutions in partner countries.

Twinning projects are inaugurated under the Support of the Association Agreement Program (SAAP). All twinning projects were financed through MEDA until 2006 and replaced by ENPI since the beginning of 2007 (see Box 1.3). Twinning projects are capacity building projects where million 27 Euros, subject to potential increase (Ministry of International Cooperation, 2007) have been earmarked for Egypt from the EU. They aim at introducing such type of partnership between public organizations in the EU member states and Egypt to enhance the implementation of the AA. Based on such partnership, Egyptian organizations should be able to transfer the best practice adopted in their European counterparts that meet their own environments. The fields of implementing the twinning projects are wide and range from maritime safety, to post services, tourism, irrigation, telecommunications, electricity, management systems in ministries, etc.

Twinning projects did not include projects related to standards organization, competition authority, and customs authority. Probably because there was no demand from the GoE for such issues, or the cooperation between the Egyptian and European counterparts would have been regarded as inappropriate due to the wide gap between the institutional setups (e.g. the case of Egyptian Competition Authority which only started functioning in 2006 compared to the old long lasting practice of the EU institutions). The only organization that was included was the Accreditation body.

Twinning projects are certainly, from a theoretical point of view, an excellent *device* for approximation of regulations and working methods, which is among the most suitable setups for achieving deep integration as it allows transfer of knowledge and institutional aspects between North and South organizations, while maintaining the flexibility of adopting only what is relevant for the South. Time is too early to assess the implementation of twinning arrangements in Egypt, since not enough time has elapsed to assess any of the projects that have started to be implemented. However, there is no institutional relationship between ENP and twinning programs where ENP has not included twinning initiatives. There is no one single document before the European Commission (2006) that is related to ENP and includes twinning as a device for achieving its aims. This implies that deep integration devices are being used without resorting to ENP. The same is true for the program of harmonizing Egyptian standards with the European and/or international equivalent.

### **Box 1.3: Twinning Projects in Egypt**

Egypt, within the framework of the Association Agreement, is engaged in three twinning projects starting 2005 as set out below:

- **The Egyptian Tourist Authority (ETA)**, launched of the call for proposal 2006, to support the ETA in improving the institutional capacity, modernizing its structure, system, management and human resource processes by applying or adapting the best practices of EU member states, in the Egyptian context, in order to enhance the contribution of the Egyptian Tourist Authority to economic development and employment creation.
- **The Egyptian National Postal Authority [ENPO]**, Start of project activities November 2006 to support ENPO in preparing for the future regulatory environment and liberalization of the postal sector by modernizing its financial management systems, quality measurement methodology and marketing organization through the application EU best practice in the Egyptian context. Furthermore, this project is in

– **Assessing ENP and the Action Plan:**

Assessing the role of the Action Plan, ENP and AA in deepening the Egyptian European relations requires in-depth analysis. Hoekman (2005) viewed the ENP and its Action Plans as a device for achieving deep integration between the EU and Egypt, an objective that the AA failed to achieve so far. Hoekman viewed the ENP and the AA as two complementary processes where the ENP provide a la carte approach for deep integration. Moreover, the ENP, when compared to the AA still enjoys a number of virtues including being a mutually agreed upon document between EU and Egypt, being more detailed in terms of the Action Plan, covering wider range of programs to be covered, and finally including a more comprehensive follow-up mechanism for monitoring the developments of the Egyptian EU relations under the context of the Action Plan. The ENP can be viewed as the executive plan of implementing the AA. The ENP, together with its Action Plans build on it and complement AA at least from a pragmatic point of view after the correction of direction of the EU as stipulated in the European Commission (2006). This does not imply that the AA or the ENP would not be able to stand alone, however from a practical point of view it seems that they are de facto complementing each other. At the outset, such framework seems to address Egypt developmental priorities in a flexible manner though lacking prioritization.

Other scholars had a different view who argued that ENP process is ineffective in achieving deep integration (Kheir-El-Din and Ghoneim, 2006). The process adopted an excessively broad step

of objectives which is considered to be a major obstacle, if few areas alone were targeted progress would have certainly been faster. The process mobilizes a great number of countries, which inevitably leads to divergence of the interest of the EU away from South Mediterranean countries towards other countries included in the ENP. In addition, the commitments which were mentioned in the Action Plan are not clear, general, and did not specify the needed steps to work with or the levels of harmonization needed to close the gap between Egyptian regulations and laws with their international or European equivalents. So far enhanced cooperation as predicted between EU and the Mediterranean countries has not materialized. The process is plagued with bureaucracy and complicated procedures.

Looking closely at the setup of Action Plan, the implementation arm of the ENP, we do not observe such “deepness” aspect promised in EU Commission communications and reports. It is true that the Action Plan included a time dimension, stating that it ranges from 3 to 5 years, however the actions considered had no time element. Moreover, actions considered used the same vague language that AA was criticized for being vague. Hence, we do not observe “deepness” in concrete terms as agreeing on certain measures to be implemented by a certain date. Based on the mechanism of ENP such Action Plans are just a step for identifying priorities of the EU partner and that it would be followed up by specific committees overseeing the projects required for achieving the priorities in the Action Plan. However, a better look on the Action Plans reveals that priorities identified are so many to the extent that there is no priority. Table (1.5) shows that almost all aspects that were raised before in the AA were repeated for all countries, more or less using the same language in their Action Plans.

**Table 1.5. Economic Related Areas of Priorities as Identified in the Action Plans**

	<b>Jordan</b>	<b>Israel</b>	<b>Morocco</b>	<b>Palestine</b>	<b>Tunisia</b>	<b>Lebanon</b>	<b>Egypt</b>
Free Movement of Goods	Yes	Yes	Yes		Yes	Yes	Yes
Industrial goods	Yes	Yes	Yes	No	Yes	Yes	Yes
Agricultural, fisheries, & processed agricultural products	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Right of Establishment	Yes	Yes	Yes	No	Yes	Yes	Yes
Payments and capital movements	Yes		Yes	No	Yes	Yes	Yes
Economic cooperation	Yes (public finance)	Yes	Yes (public finance)	Yes (public finance)	Yes (public finance)	Yes (public finance)	Yes (named economic development)
Education	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Scientific & technological cooperation	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Environment	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industrial cooperation	Yes	Yes	Yes		Yes	Yes	Yes
Standards &	Yes	Yes	Yes	Yes	Yes	Yes	Yes

conformity assessment							
Approximation of laws	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Information & telecommunications	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Energy	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Investment	Yes	Yes	Yes		Yes	Yes	Yes
Customs	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Consumer protection	No	Yes	Yes	No	Yes	Yes	Yes
Social matters	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Migration	Yes	Yes	Yes	No	Yes	Yes	Yes
Export potential	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Services	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Poverty reduction	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Transport	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Business climate	No	Yes	Yes	Yes	Yes	Yes	Yes
Competition law and policy	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Source: Action Plans and Country Report of Lebanon

The EU Commission (2006), as identified above, pointed out the areas where deep integration should proceed. However, the question is that based on the AA several issues raised were a part of the “built-in” agenda of the AA. For example liberalization of services which is essential for deep integration cannot be viewed as an ENP initiative. It was part of the AA (Articles 29 and 30 of the Egyptian AA). Moreover, ENP has identified SPS as a priority based on the European Commission (2007) arguing that South Mediterranean countries should adopt EU standards for the market access of their agricultural exports in the EU market. However it is worth noting that it has been mentioned in the AA (related Articles 45 and 50) though not specifically as in European Commission (2007). Moreover, there have been several new cooperation mechanisms that have been announced by the EU including for example “twinning” projects. The basic idea here is that the Action Plan was supposed to be acting as a device for deeper integration by specifying dates and exact measures for enacting the provisions that came under the AA, which did not take place so far in light of the existing wording of the Action Plan and the related EU documents and plans. The new implementation mechanisms in the form of committees and sub-committees (as mentioned above) could overcome such deficiency if they appropriately tackled the issue of vagueness of measures and lack of time dimension. However, since such system of committees and sub-committees has not been fully working, it is difficult to assess its role.

Finally, among the virtues of deep integration as stated in the related literature is its ability to push and anchor reforms. However, the system of ENP has acted so far on the policy/regulatory aspect of deep integration (following the terminology used in 1.1.), whereas the infrastructure aspect has been left un tackled especially in light of absence or vagueness of concrete measures with exact dates to be implemented. Moreover, among the main challenges facing the Neighbourhood partners is that the EU programs to assist ENP Action Plan implementation are very slow to come due to internal procedures inside the EU institutions. The funding available to support the ENP reform agenda remains relatively modest, notwithstanding the ENP’s ambition to address a very comprehensive reform agenda. In addition the majority of the ministries and

different governmental or non-governmental entities that can benefit from these programs still have a worrying lack of knowledge about the EU, its norms, procedures and standards. Developing such knowledge requires time and effort.

## Conclusion

This chapter identified the conceptual framework for deep integration. It showed its different forms and that it comprises of an infrastructure aspect as well as a regulatory/policy aspect. An assessment for the ENP and its Action Plan of Egypt was undertaken vis-a-vis the AA. The assessment rather than reaching a conclusive answer to whether ENP and its Action Plan is good or bad for Egypt identified its pros and cons. The main conclusion reached in this chapter is that deep integration has many forms. What is important is to identify the means of reaching deep integration after identifying that it is needed and in which form, which seems not to have taken place in the context of the Egypt-EU relations.

Moreover, when evaluating the extent and type of deep integration between Egypt and the EU in line with Table (1.3) we find that both the AA and the ENP Action Plans have been mostly confined to MFN types of deep integration, either as explicitly stated in the AA or as applied in practice. We observe three ways in which MFN occurs. In the first case, MFN is an obligation in the AA and in practice. The second case, MFN is not necessarily available in AA as stipulated, but enjoys high probability of application in practice. The third case is absence of MFN in AA, but high probability of application in practice. The first case where MFN is included in AA and in practice includes the case of trade defence measures, and especially antidumping provisions have remained included in the AA. This implies that the AA has not resulted in any type of preferential treatment neither for exporters to the EU, nor for importers from the EU. The same applies for adoption of TRIPS and TRIPS plus requirements following the AA. In other words, MFN has remained applicable in both AA and practice.

In other cases, the approximation of Egyptian laws and regulations with the EU equivalents might *de facto* affect the MFN treatment of non-EU trading partners for Egypt. For example, adoption of EU standards might discriminate against Egyptian exporters when exporting to non-EU countries, if such countries do not recognize EU standards. It is not likely to be the case when dealing with non-EU imports in Egypt as the Egyptian law recognizes international standards including EU standards. In other words, the AA is preferential for exporters (out going products from Egypt) but not for importers (in going products in Egypt). In this case, the MFN might seem to be deviated from partially in AA, but not necessarily in practice. But if EU standards were mandatory there would be *de facto* discrimination against other producers.

Finally, the negotiations following the AA in the area of services and investment include an explicit discriminatory preferential approach, hence deviation from MFN, favouring EU firms. The negotiations are dealing with further liberalization of services based on GATS plus as well the right of establishment. However, given the fact that GATS commitments might be less than the status quo liberalization, a GATS plus approach might not result in practice in deviating from MFN if the GATS plus commitments remain less or equal to the status quo liberalization. Moreover, any GATS and/or right of establishment type of commitments involve a regulatory

change, which in practice might be considered difficult to apply on discriminatory basis. In this case, there is an explicit deviation from the MFN principle in AA, but is not necessarily the case in practice.

To reach the MFN status identified in Table (1.3), the AA and the ENP Action Plan have resorted to harmonization in some of the issues included in Table (1.3) including standards, competition, state aid (as long as it deals with trade affecting EU internal market), and intellectual property rights. It has not tackled investment and services through harmonization, but rather is leaning towards 'selective' national treatment in some areas as services and investments (following the extent of GATS plus commitments). Mutual recognition remains confined to standards with very limited steps for practical implementation. In other words, the Action Plan has confirmed what the AA has explicitly stated. In relation to the AA, it has neither reinforced existing measures, nor introduced new ones to deepen integration between Egypt and the EU.

The extent of deep integration in the AA is likely to yield MFN results in terms of applicability. The degree of preferential treatment included in the AA is modest in terms of deep integration either in the context of the AA or its application. The ENP Action Plan did not include further measures to deepen the integration between the EU and Egypt on preferential basis. It might have brought in additional support to anchor the MFN deep integration aspects but has not actually included measures to deviate from the MFN status. Such a result is of paramount importance as it supports the argument that the regulatory aspects of EU-Egypt integration processes (both AA and ENP Action Plan) are forms of *open regionalism*. Open regionalism is likely to lessen the negative effects of regional trade agreements arising from trade diversion and allows dynamic gains to be reaped due to economies of scale following the adoption of an EU standard or a regulation which is accepted and acknowledged on a universal level.

To conclude, this chapter has pointed out that there are certainly deep integration elements embedded in the AA and the ENP Action Plan. Most of the deep integration elements have been mentioned in the AA implying that the Action Plan, so far did not add much. It might be the case that the committees formed after the inauguration of the Action Plans will handle such implantation mechanisms for deep integration. The deep integration elements embedded in the AA and the Action Plan are of an MFN type whether on *de jure* or *de facto* basis. Such a conclusion is of paramount importance since it emphasizes that AA and Action Plan are leaning towards open regionalism, which is better for Egypt from a developmental perspective.

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## **Chapter Two**

### **Assessing the Trade and Welfare Effects of an EU-Egypt FTA Using the Sussex Framework**

**Michael Gasiorek  
Javier López González**

## Summary of Chapter Two

This study assesses the potential welfare consequences of a preferential trade agreement between the EU and Egypt. Our analysis focuses on the welfare consequences of an EU-Egypt PTA bearing in mind Egypt's current PTA situation.

In summary our analysis suggests the following:

- Egyptian tariffs have declined steadily during the last decade. However they remain high as compared to developed country averages. This entails that the magnitude of the trade creation and trade diversion effects could be high.
- Tariffs tend to be high against important (non-preferential) trading partners suggesting that trade diversion could be a problem. The large amount of preferences granted to important trading partners will dampen this trade diverting effect. However, the import overlap of preferential imports and non-preferential imports reveals important similarity and could re-enforce the scope for trade diversion.
- Egypt has shown progress in dismantling both tariff barriers to trade and ad-valorem rates as per the 2004 agreement leading to important liberalisation with respect to the EU. The EU seems to have maintained near-free market access to Egyptian goods but has shown an increase in non-ad-valorem duties in 2005.
- Disaggregated export analysis reveals important diversification of Egyptian economy during the last decade. Export similarity proxying for production similarity between the EU and Egypt shows scope for trade creation.
- Sectoral analysis of exports of textiles and clothing towards the EU and the Rest of World shows that composition of exports towards these regions vary significantly leading to the conclusion that there must be some barriers to exports towards the EU.
- Egypt shows very low levels of Intra-industry trade with the EU and its Agadir partners. This could be the result of reduced cooperation between these. We posit that given export similarity between Agadir countries, the EU can target deeper Agadir integration to enhance trade creation in the region. This should result in increased integration in the form of higher IIT.

## Introduction

The overall welfare impact of any process of regional integration will depend on the extent and nature of both shallow integration and deep integration. Shallow integration typically involves the removal of border barriers to trade, such as tariffs and quotas with respect to one's regional partners. As discussed earlier in this report (Chapter One), the net benefits from lowering such trade barriers preferentially are inherently ambiguous, because they involve both trade creation and trade diversion. Trade creation arises whenever more efficiently produced imported goods replace less efficient domestically produced goods. Trade is "created" and yields welfare gains. Trade diversion occurs when sources of supply switch away from more efficient non-partner countries to less efficient partner countries. Trade diversion reduces welfare, and the net welfare impact of an FTA will depend on the relative size of the two effects<sup>1</sup>.

Deep integration involves policies and institutions that facilitate trade by reducing or eliminating regulatory and behind-the-border impediments to trade, where those impediments may or may not be intentional. These can include issues such as customs procedures, regulation of domestic services production that discriminate against foreigners, product standards that differ from international norms or where testing and certification of foreign goods is complex and perhaps exclusionary, regulation of inward investments, competition policy, intellectual policy protection and the rules surrounding access to government procurement. Welfare gains from a successful process of deeper integration are likely to be considerably higher than losses from shallow integration. Deep integration, when focusing on enhancement of market access, permits both more niche market specialisation and the creation of stable value chains. The possible range of further gains associated with deeper integration include: technology transfer and diffusion both through trade and FDI, pro-competitive gains from increasing import competition in an environment of imperfect competition, which may also allow greater exploitation of economies of scale in production and the greater use of intermediate inputs; the increased geographical dispersion of production through trade that supports the exploitation of different factor proportions for different parts of the production process and/or local economies of scale through finer specialization and division of labour in production; externalities arising from institutional changes that lead to a wide increases in productivity.

In addition to the potential, but once and for all, efficiency gains and losses, there may be welfare gains arising from growth effects induced by economic integration. There might be faster technical change and total factor productivity growth and scale economies arising from increased specialisation, and/or positive externalities between firms and/or sectors. These dynamic gains are typically more likely to arise in the presence of deep integration, and are often also associated with the presence of foreign direct investment.

In this chapter we provide an analysis of the likely implications of an EU-Egypt FTA, where we apply a set of diagnostic indicators based on the Sussex Framework<sup>2</sup>, which shed light directly

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<sup>1</sup> Where the partner countries already had preferential tariffs with third countries, than the process of integration could also lead to trade reorientation (switching sources of imports away from less efficient to more efficient suppliers) which would then be welfare increasing.

<sup>2</sup> The Sussex Framework is an analytical template developed at the University of Sussex, together with DFID support, based on a set of diagnostic indicators, grounded in economic theory, and designed to support analysis of the impact and viability of proposed regional trade agreements.

and indirectly on the welfare consequences of a given FTA. The majority of these indicators are directly related to analysing the impact of shallow integration. Broadly speaking these are based on some key rules of thumb, grounded in economic theory, that help in evaluating the relative importance of trade diversion and trade creation. These rules of thumb suggest that:

- The higher are the initial tariffs, the greater is the likelihood of both trade creation and trade diversion.
- The more similar is the product mix in the member economies, the more likely it is that there will be trade creation because there is more scope for specialisation.
- The wider the differences in comparative advantage between partners and the higher the initial share of trade between them, the more likely the FTA will be welfare improving.
- Also the greater the number of FTA partners the more likely it is that there will be overlap with cost differences, and therefore the greater the likelihood of trade creation.

There are no easy rules of thumb for evaluating the implications of deep integration. The economics of the transmission mechanisms between deep integration and economic growth is an emerging field, and the relationships are more complex and less well understood than with shallow integration. Nevertheless, there are some indicators, such as measures of intra-industry trade, which are useful in this context.

## 2.1 Tariff Barriers to Trade

As indicated by the rules of thumb above, the first issue to consider when examining the welfare implications of an FTA between the EU and Egypt concerns the existing levels of protection. Hence, here it is important to consider the level and evolution of tariffs both with respect to the EU, and with respect to other partner countries. Generally, the higher are the initial tariffs, the greater is the implied distortion. In principle, this suggests more scope for both trade creation and trade diversion. Figure 2.1 investigates the evolution of Egyptian average MFN tariffs.

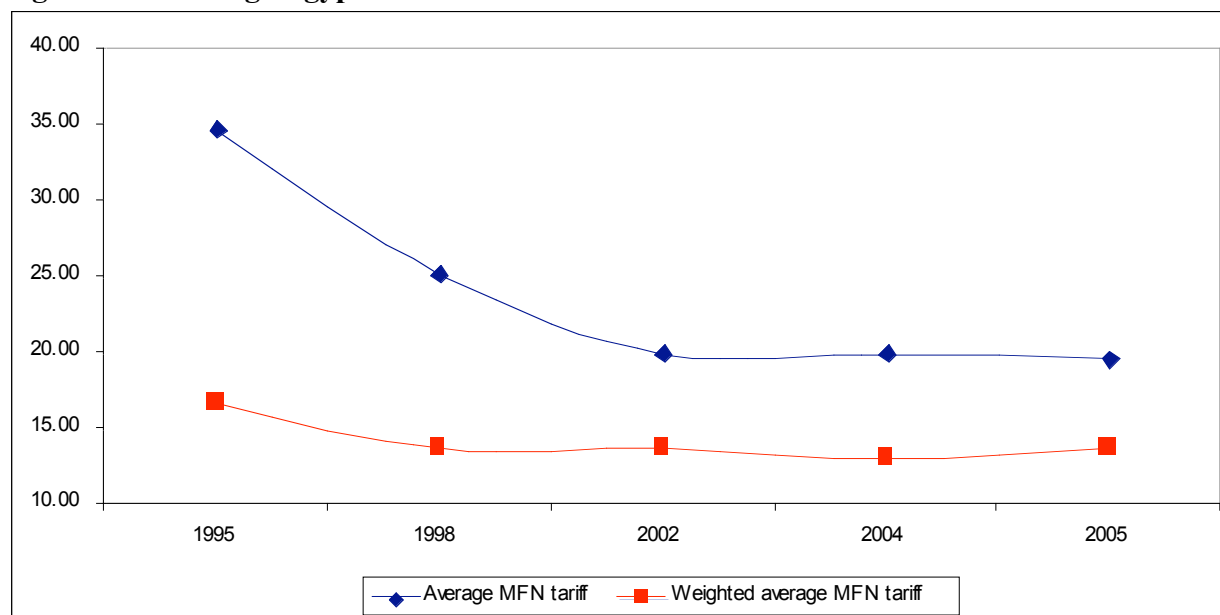
Egyptian unweighted tariffs fell by 15.06 percentage points (which is a reduction of over 40%) during the period 1995 to 2005. In 2005 they lie at just over 20%. Comparatively speaking these tariffs are still relatively high – by way of contrast EU average tariffs in 2005 were in the region of 4-5%. As stated earlier higher tariffs imply a higher level of distortion and thus more scope for both trade diversion and trade creation. It is interesting to note also that weighted tariffs remain relatively constant throughout the period under investigation and stand at 13.7% in 2005 (which is reduction of only 2.95 percentage points during the sample period). The reduction in the unweighted tariff, together with the relative constancy in the weighted tariff, suggests that the reductions occurred in largely in industries which did not comprise a significant share of Egypt's imports where protection has remained more constant. In interpreting these figures, it is also worth noting that Egypt has, in principle, undergone substantial bilateral/regional liberalisation in the form of the Pan-Arab Free Trade Area (PAFTA) which entered into force in 1997 and has been fully implemented since 2005; the Aghadir Agreement signed in Feb 2004 and entering into force in June 2006); the Common Market for Eastern and Southern Africa (COMESA) which

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<sup>3</sup> It is important to note that the tariffs reported here are compositional, which means that the tariffs are reported only on those products that are imported rather than on all products.

Egypt joined in 2001, and more recently the Egypt-EFTA agreement which entered into force in August 2007 as well as Egypt Turkey free trade area which was signed in 2006. These preferences will not be captured by the below figure.

**Figure 2.1: Average Egyptian Tariff over time 1995-2005**



Source: WITS, UNCTAD

We now turn to the analysis of Egyptian tariffs by Broad Economic Category, which enables us to consider the distribution of tariffs across consumer goods, and capital and investment goods. There is a considerable literature suggesting the liberalising tariffs on intermediates / capital goods initially is conducive to economic growth, hence it is interesting to see the extent to which this applies in the case of Egypt. From the table we can see a very high level of protection in the food and beverages sector with an average tariff of 76.75%. Liberalisation in this sector has been modest with a decline of 18.64% (17.58 percentage points) during the period under investigation. This sector is also characterised by the presence of domestic peaks which suggests that this is a sensitive sector for Egypt and benefits from substantial protection. However, more detailed investigation into the food and beverage sector reveals that the high average levels of tariffs are mainly due to very high tariffs being levied on alcoholic beverages (largely for cultural as opposed to economic reasons), which can be as high as 3000%, and these high tariffs are thus impacting on the average unweighted tariff<sup>4</sup>.

<sup>4</sup> Note also the decrease of average unweighted tariffs on food and beverages in 2002. This is driven by the lower level of imports of food and beverages for household consumption, which thus reduces the average weighted tariff for this sector in that year. There appears to be no known reason for this and we therefore conclude that it may well be driven by some error in the raw data supplied by COMTRADE.

**Table 2.1. Egypt average tariffs (unweighted) by BEC category**

	1995		1998		2002		2004		2005		% change in tariffs (1995-2005)
	Average	Domestic Peaks	Average	Domestic Peaks	Average	Domestic Peaks	Average	Domestic Peaks	Average	Domestic Peaks	
Food and beverages	94.33	14	58.05	28	24.54	15	77.07	16	76.75	16	-18.64%
Industrial supplies not elsewhere specified	23.43	0	20.45	0	19.92	0	9.95	1	9.46	1	-59.62%
Fuels and lubricants	8.75	0	8.25	0	8.25	0	4.95	0	4.70	0	-46.29%
Capital goods (except transport equipment)	12.62	0	9.54	0	9.87	0	4.73	0	4.61	0	-63.47%
Transport equipment and parts and accessories	28.64	10	24.20	18	22.17	26	12.00	6	11.60	6	-59.50%
Consumer goods not elsewhere specified	54.18	0	33.42	4	30.32	4	29.42	0	29.27	0	-45.98%
Goods not elsewhere specified	17.66	0	15.00	0	16.41	0	10.98	0	10.98	0	-37.83%
<i>Total Trade Average</i>	34.65	24	25.15	50	19.93	45	19.94	23	19.59	23	-43.46%
<i>Total Trade Standard Deviation</i>	128.62		130.59		17.82		147.74		148.33		15.32%

Source: WITS, Trains

\*The choice of years under analysis was constrained by the availability of data from the WITS database

The table also shows that tariffs are typically lowest for capital goods (which have also seen the largest percentage reduction), followed by fuels and lubricants. Tariffs on industrial supplies have also been substantially reduced from 23.43% to 9.46% over the period in question. Consumer goods, even though showing a strong reduction in tariffs, remain highly protected with average tariffs in 2005 at 29.27%.

Domestic tariff peaks (defined as the number of tariff lines where the tariff is more than 3 times the average tariff in the category) gives an insight into the extent of any variation of tariffs within a category. Hence tariffs may be on average 20%, but key product items could be highly protected with much higher tariffs. The table shows little evidence of widespread tariff peaks in Egypt. There are tariff peaks in the food and beverages sector (notably on alcohol) and also the transport equipment sectors, where for example there are high levels of protection for certain industries with a maximum peak of 135% on trailers and semi-trailers (HS6 871610). On the whole, and discounting food and beverages, the amount of tariff peaks remains modest suggesting that distortions are not excessive.

Table 2.1 then explores the pattern of tariffs by sector as opposed to by broad economic category, as well as by regional grouping. This is accomplished using the SITC rev 3. nomenclature as opposed to the BEC nomenclature.

Welfare consequences of an FTA not only depend on tariffs levied on the proposed FTA partner but also on tariff levied on other partners. Table 2 compares effectively applied tariff barriers faced by partners to those faced by the EU by product line<sup>5</sup>. This will give us an indication of prima facie evidence of differential treatment between Egypt's main trading partners and the EU. A negative (positive) value in Table 2 purports a partner country facing higher (lower) tariffs than those of the EU. It is important to note the Egypt is currently negotiating several bilateral

<sup>5</sup> Effectively applied tariff barriers are defined as min (MFN, preferential) and capture any preferences that may be granted to partner countries.



agreements as pointed out earlier. These are at significantly different stages. The Aghadir agreement was signed in 2004 and aims at the progressive reduction of tariff barriers until the complete removal of these in 2010. PAFTA has also made progress in reducing tariff barriers as has COMESA. Bearing these in mind we turn to the analysis of compositional tariff barriers as they stand in 2004 between Egypt and its main trading partners.

**Table 2.2: Average Egyptian tariffs (unweighted) on main trading partners as compared to EU by SITC rev 3 category 2004 .**

Product	WORLD	USA	PAFTA**	INDIA	China	Agadir
Food & live animals	-0.5831	2.6373	-4.7522	-8.7078	-6.8488	-10.5845
Beverages and tobacco	2.1125	7.1700	258.0875	0.0000	N/A	0.0000
Crude mater.ex food/fuel	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Mineral fuel/lubricants	-0.0164	-0.5833	0.0000	0.0000	-3.5000	0.0000
Animal/veg oil/fat/wax	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Chemicals/products n.e.s	-0.0062	0.0014	-0.0973	-0.0017	0.0015	-0.1908
Manufactured goods	-0.0111	-0.0322	0.0103	-0.0055	-0.0318	0.0186
Machinery/transp equip	-0.0094	0.0007	-0.0421	-0.0985	-0.0381	0.1044
Miscellaneous manuf	-0.0079	0.1419	-0.1329	0.0720	-0.1155	-0.2523
Commodities nes	0.0000	n/a	n/s/	n/a	n/a	n/a
<b>Total Trade</b>	<b>-0.0348</b>	<b>0.1589</b>	<b>1.5688</b>	<b>-0.2445</b>	<b>-0.2045</b>	<b>-0.9215</b>

Source: WITS, Trains

\*Aghadir : defined as Jordan, Tunisia, Egypt and Morocco

\*\* PAFTA: Egypt, United Arab Emirates, Bahrain, Jordan, Tunisia, Saudi Arabia, Sudan, Syria, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Morocco and Yemen.

As a rule of thumb, the higher the tariffs on other important trading partners, the more likely the amount of trade diversion. This happens predominantly as goods are switched from a more efficient source to one that becomes efficient as a consequence of the preferences granted.

Table 2.2 is of a compositional nature and shows the differential between EU and partner tariffs across partner traded lines. The intuition of the exercise is to capture compositional differential treatment so as to investigate the possible magnitude of the welfare effects. Positive values on Table 2.2 entail lower barriers to entry for a given partner. The removal of tariff barriers to trade between the EU and Egypt will have a more trade diverting effect the higher the tariffs are with other partners (negative value in Table 2.2). As an example we note that tariff barriers with respect to the world are on average higher than those faced by the EU. The likely implications of reducing tariff barriers between the EU and Egypt and maintaining barriers with the world would be the replacement of world imports by EU imports as a result of preferences. This could entail some form of trade diversion. This point will be investigated in subsequent sections.

To further analyse the scope for welfare gains from a FTA between Egypt and the EU we analyse the evolution of tariff structures between the EU and Egypt at a more detailed level. Table 2.3 reports.

**Table 2.3: Evolution of Egyptian Tariffs with respect to the EU-25**

	1998				2002				2005			
	MFN (Simple Average)	Duty free imports	Effectively Applied Tariff	Specific duty imports	MFN (Simple Average)	Duty free imports	Effectively Applied Tariff	Specific duty imports	MFN (Simple Average)	Duty free imports	Effectively Applied Tariff	Specific duty imports
Food & live animals	23.03	0.0%	22.74	0.0%	25.53	0.0%	25.22	0.0%	18.23	0.0%	31.06	0.0%
Beverages and tobacco	338.75	0.0%	354.8	98.6%	19.31	0.0%	16.76	46.5%	1859.22	0.0%	1890.33	77.6%
Crude mater.ex food/fuel	11.34	0.0%	11.13	0.0%	10.71	0.0%	11.49	0.0%	3.13	49.7%	3.12	0.0%
Mineral fuel/lubricants	12.96	0.0%	12.21	0.0%	10.95	0.0%	11.54	0.0%	7.02	0.2%	6.01	0.0%
Animal/veg oil/fat/wax	14.08	0.0%	14.11	0.0%	13.39	0.0%	13.41	0.0%	6.84	0.0%	7.59	0.0%
Chemicals/products n.e.s	13.1	0.0%	13.72	0.0%	13.06	0.0%	13.74	0.0%	7.26	3.6%	11.43	0.0%
Manufactured goods	26.63	0.0%	24.36	0.0%	27.2	0.2%	25.46	0.2%	14.7	1.0%	13.76	0.0%
Machinery/transp equipmt	12.66	0.0%	13.62	19.1%	14.23	0.0%	14.41	7.1%	7.97	19.4%	6.73	0.0%
Miscellaneous manuf arts	24.34	0.0%	21.66	3.4%	22.64	0.8%	20.5	5.2%	23.4	11.6%	18.55	0.0%
Commodities nes	10.5	0.0%	10.5	0.0%	20	0.0%	20	0.0%	7.25	0.0%	6.63	0.0%
<b>TOTAL</b>	<b>20.21</b>	<b>0.0%</b>	<b>18.78</b>	<b>8.0%</b>	<b>19.73</b>	<b>0.1%</b>	<b>18.58</b>	<b>3.7%</b>	<b>21.17</b>	<b>13.2%</b>	<b>24.36</b>	<b>0.8%</b>

Source: WITS

Duty Free imports: share of imports of category facing duty free access

Dutiable imports: share of imports of category facing dutiable access

Specific duty imports: share of imports of category facing non ad-valorem tariff

We first note an important reduction in tariffs on EU goods during the period under investigation. This reduction is masked in the simple average of total trade given the predominance of high tariffs on beverages and tobacco. We further observe the commencement of the Association Agreement (AA) with signs of increased duty free imports from the EU which go from 0.1% of total EU-25 imports in 2002 (pre-Aghadir) to 13.2% of imports from the EU-25 in 2005. This we attribute to the first year of tariff dismantling as agreed upon in the Aghadir agreement. Also noteworthy is the reduction in non ad-valorem duties from affecting 8% of imports from the EU-25 in 1998 to 0.8% of EU imports in 2005. This shows signs of more streamlined import procedures for goods from the EU and is probably again attributable to the Aghadir agreement.

We now carry out the same exercise to address EU-25 treatment of Egyptian imports. Table 4 mirrors Table 2.3 for EU tariffs on Egyptian imports. Here we see that the majority of Egyptian exports in principle enter the EU market duty free, and that there has been little change in this in aggregate over time. The biggest reported change is in the amount of imports in Beverages and Tobacco upon which a specific duty is payable. This applied to 91% of imports in this category in 1998, and 31.7% in 2005. Conversely we see an increase in the share of imports upon which specific duty was payable in the food and live animals sector – this could either be driven by a changing composition of Egyptian exports, or because of changes in EU policy / protectionism in particular sectors. On balance, this can be attributed more to the change in the overall composition of Egyptian exports, especially after the exports' subsidization policy for selected sectors adopted by the Government of Egypt in 2001 which helped to boost agricultural exports.

**Table 2.4: Evolution of EU effectively applied Tariffs with respect to Egypt**

	1998				2002				2005			
	Simple Average	Duty free imports	Dutiable imports	Specific duty imports	Simple Average	Duty free imports	Dutiable imports	Specific duty imports	Simple Average	Duty free imports	Dutiable imports	Specific duty imports
Food & live animals	6.35	5.19%	94.81%	32.54%	5.57	8.43%	91.57%	31.86%	5.92	6.05%	93.95%	43.70%
Beverages and tobacco	0	9.00%	91.00%	91.00%	0	18.46%	81.54%	81.54%	0	68.32%	31.68%	31.68%
Crude mater.ex food/fuel	0.47	98.81%	1.19%	0.00%	0.23	97.66%	2.34%	0.00%	0.27	95.86%	4.14%	0.00%
Mineral fuel/lubricants	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%
Animal/veg oil/fat/wax	2.88	23.75%	76.25%	0.00%	3.45	1.69%	98.31%	71.07%	2.81	1.55%	98.45%	81.73%
Chemicals/products n.e.s	0	99.83%	0.17%	0.00%	0	99.35%	0.65%	0.65%	0	99.97%	0.03%	0.03%
Manufactured goods	0	100.00%	0.00%	0.00%	0.19	90.81%	9.19%	0.00%	0	100.00%	0.00%	0.00%
Machinery/transp equipmt	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%
Miscellaneous manuf arts	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%
Commodities nes	n/a	n/a	n/a	n/a	0	100.00%	0.00%	0.00%	0	100.00%	0.00%	0.00%
<b>TOTAL</b>	0.55	94.32%	5.68%	1.95%	0.49	91.97%	8.03%	2.22%	0.5	93.63%	6.37%	2.93%

Source: WITS

Duty Free imports: share of imports of category facing duty free access

Dutiable imports: share of imports of category facing dutiable access

Specific duty imports: share of imports of category facing non ad-valorem tariff

## 2.2 Analysis of Trade Patterns

Investigating tariff barriers to trade gives us insight as to the magnitude of the underlying distortions. Here we have seen that tariffs are comparatively high in Egypt and that there is quite a wide dispersion across sectors. We now turn to analysing trade patterns both by geographical distribution and by sectoral decomposition. This is important again in identifying the relative likelihood of trade diversion and trade creation, and in identifying the role of key sectors in this.

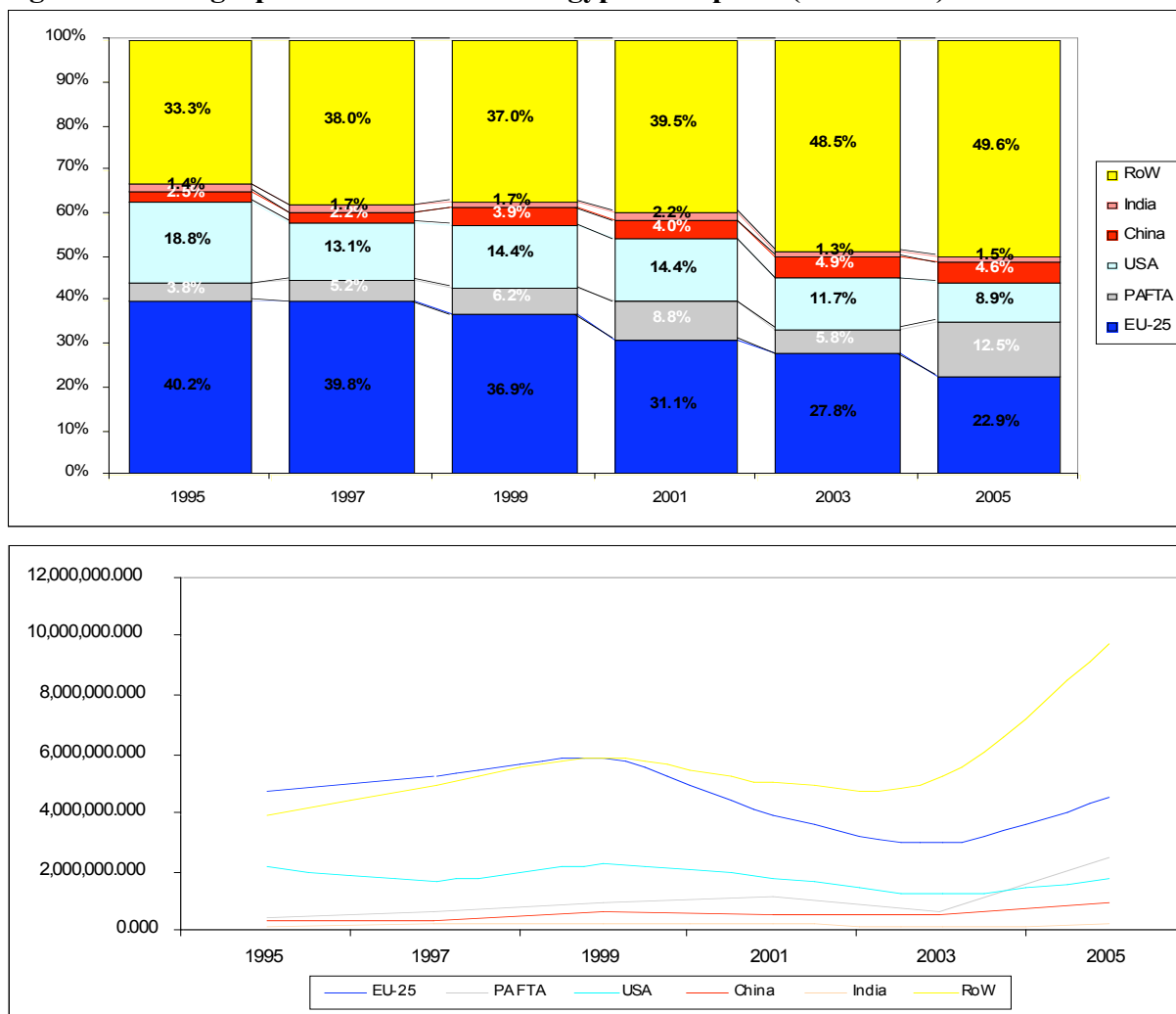
### 2.2.1 Geographical Distribution of Imports

First we turn to analysing the evolution of imports by trading partner. Figure 2.2 identifies Egypt's principal trading partners as being EU-25, USA, PAFTA<sup>6</sup>, China, India and the Rest of World (RoW). As can be seen, the EU remains Egypt's largest single source of imports. However the EU-25 predominance has diminished over time: going from a share of 40.2% in 1995 to 22.9% in 2005. What is interesting is that this decline in share is not simply occurring because of a decline in imports from the EU – and this can be seen in the bottom panel of the Figure. Here we see that from 1999-2003 there was a general decline in imports by Egypt, with a more dramatic decline for the EU. This is likely to be because of the exchange rate changes which resulted in an increasing price of imports from the EU, especially that the Egyptian currency has faced several devaluation attacks since 2001 and was announced to be floating January 2003. Moreover, given the fact that the Egyptian pound is pegged to the US dollar and

<sup>6</sup> PAFTA: Egypt, United Arab Emirates, Bahrain, Jordan, Tunisia, Saudi Arabia, Sudan, Syria, Iraq, Oman, Palestine, Qatar, Kuwait, Lebanon, Libya, Morocco and Yemen.

that the dollar has experienced devaluation vis a vis the euro, the effect of increased price imports from the EU have been evident, and hence could have resulted in decreased Egyptian imports share from the EU. Similarly, after 1993, EU exports are rising to Egypt, but at a slower rate than ROW exports to Egypt – hence the declining share. In contrast the US has also steadily lost its market in Egypt with a decline from 18.8% in 1995 to 8.9% in 2005, but this is being driven by an overall fall in imports over the entire time period. This could be indicative of trade diversion already occurring as a result of the different PTAs signed by Egypt (PAFTA, COMESA, Aghadir, AA). The biggest increase in the share of imports is experienced by PAFTA and the RoW countries, particularly after 2001. From the bottom panel we also see that the value of exports by these two groupings also increased sharply after 2003.

**Figure 2.2: Geographical distribution of Egyptian imports (1995-2005)**

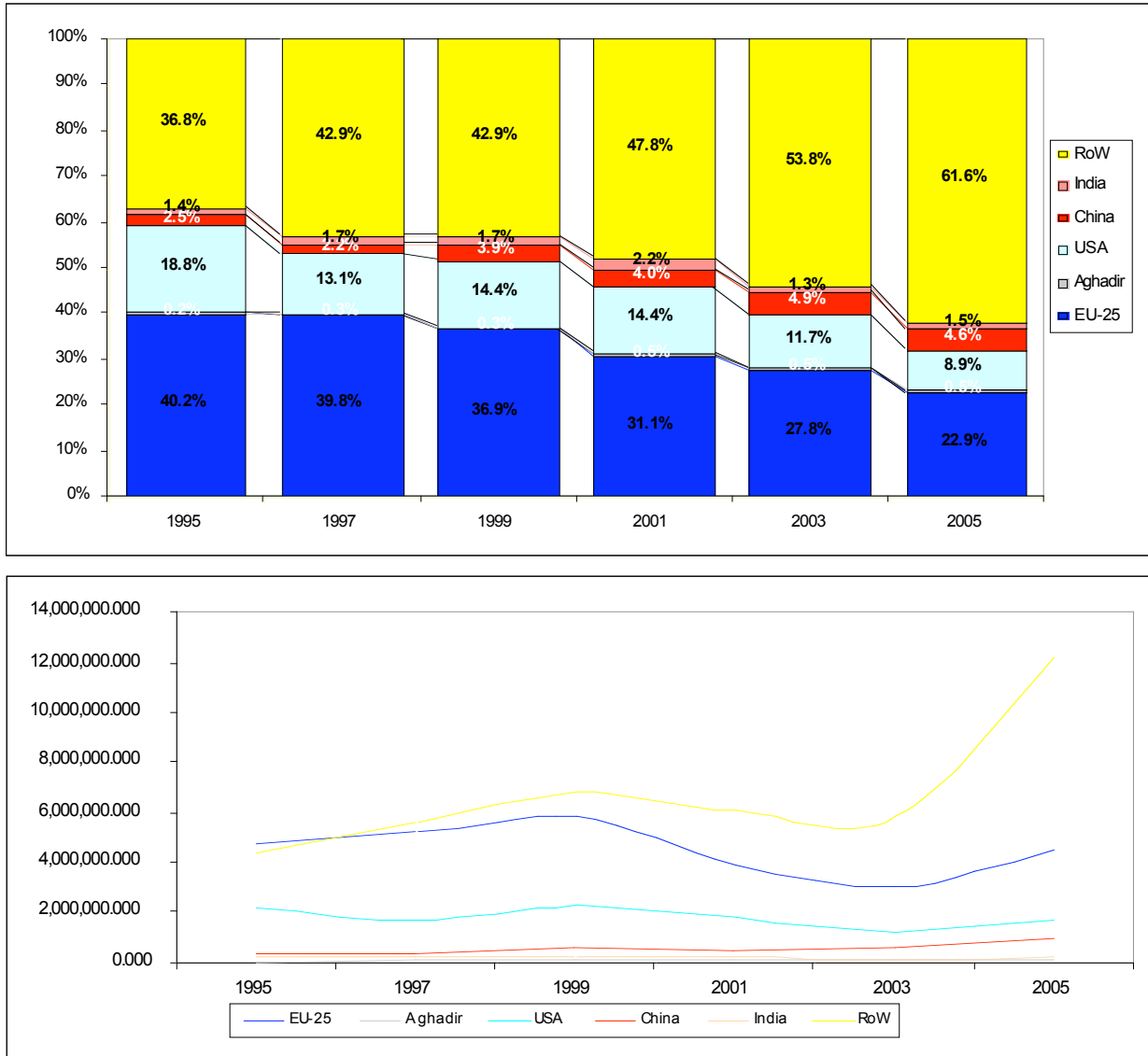


Source: WITS, Comtrade, Values are in \$ ,000s

In Figure 2.2 we separately identified the PAFTA grouping. However, Egypt has also separately signed the Aghadir Agreement with Morocco, Tunisia and Jordan, who also form part of PAFTA. Hence in Figure 2.3, and given the overlap between PAFTA and Aghadir countries, we examine the evolution of import shares where the Aghadir countries are now separately

identified and the remaining PAFTA countries are grouped together with ROW. From the figure we see that the Aghadir countries are a minor source of Egyptian imports, with a share moving from 0.2% to 0.5% during the period 1995 to 2005. The more substantial increase in the ROW share is now being driven by the rise of imports from the non-Aghadir PAFTA countries.

**Figure 2.3: Geographical distribution of Egyptian imports (1995-2005 with Aghadir)**



Source: WITS, Comtrade, Values are in \$ ,000s

From the above figures we see a constantly declining EU share. Prima facie this would appear to suggest little evidence of trade diversion away from other suppliers and towards the EU. To some extent this conclusion is complicated by the general decline in imports between 1999-2003. However, from 2003 we do observe an increase in EU exports, which is much more significant than that experienced by the US, which is most likely one of the EU's principal competitors in the Egyptian market. This is strongly suggestive of some trade diversion with respect to the US. In contrast there has clearly been little trade diversion with regard to the ROW and the PAFTA

countries. Here it is worth noting that the scope for trade diversion is reduced as Egypt enters into more preferential agreements with other main trading partners. The intuition behind this is that increasing preferences to incorporate more suppliers whilst reducing your own tariffs will dampen the scope for trade diversion. This will, however, depend on the similarity of composition between imports from preferential partners to non-preferential partners and this will be analysed in subsequent sections.

### ***2.2.2 Sectoral Composition of Imports***

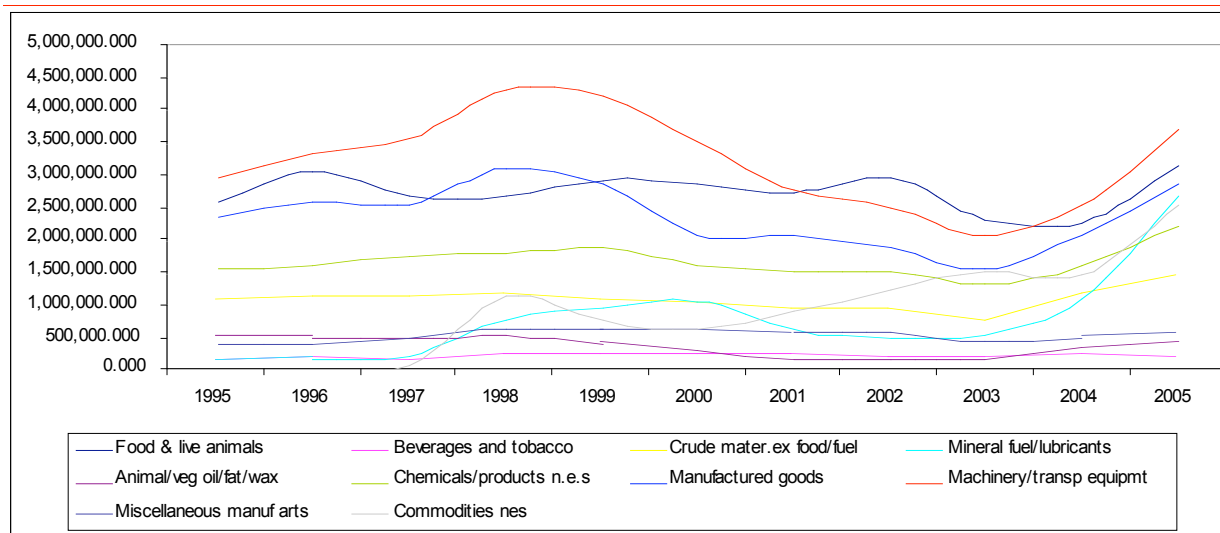
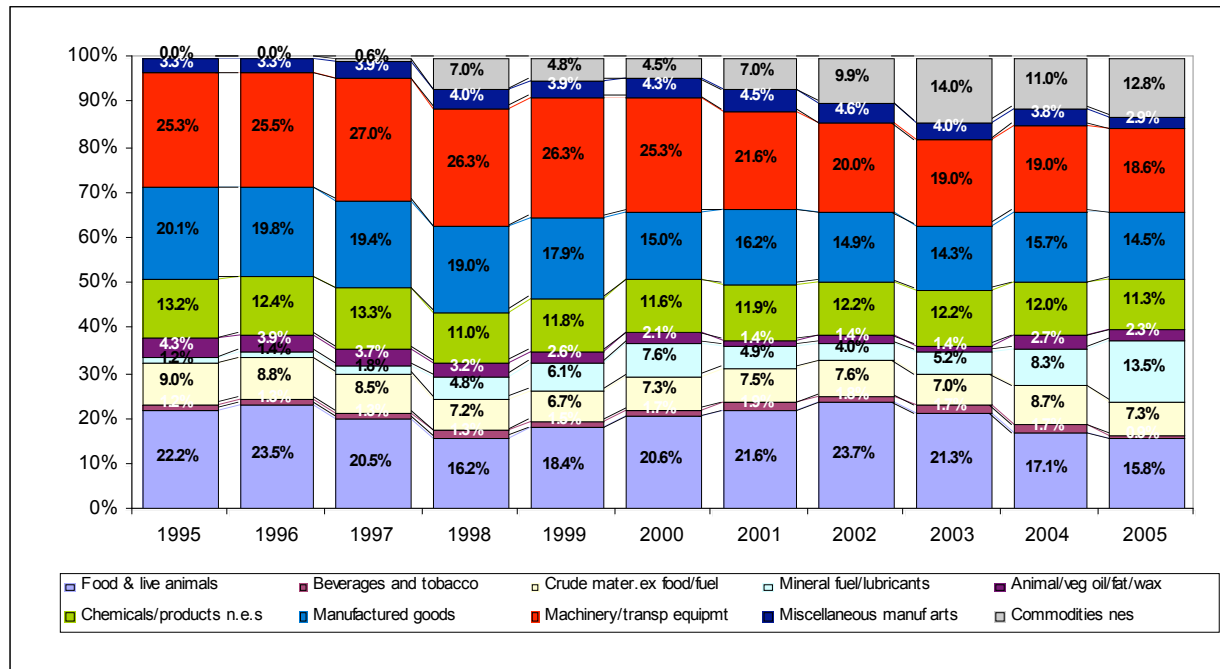
As well as considering the geographical distribution of trade, it is important to consider the sectoral pattern of trade. This is for three reasons. First it can help to identify the sectoral distribution of likely trade creation and trade diversion which is often masked by considering aggregate data. Secondly, it is by examining the degree of product overlap and the differences in competitiveness across countries, that a fuller picture of the possible scope for trade creation and trade diversion can be determined. Thirdly, it is important to identify those sectors, which are of particular importance to the economies concerned. This is clearly important from the perspective of economic significance, but may also be important from a political economy perspective.

Figure 2.4 investigates the sectoral distribution of Egyptian imports from all partners. We see that the biggest import sectors are machinery and transport equipment; food and live animals; and manufactured goods, with a cumulative weight of 48.9% of all imports. However the share of each of these import sectors has been declining steadily during the period under investigation, though with some flattening of in recent years. The sectors witnessing the strongest import growth are mineral fuel/lubricants, and commodities n.e.s.<sup>7</sup>. Of particular interest is the import share of mineral fuels and lubricants in 2004-2005, which is due to a three fold increase in imports of the ‘petroleum and products’ sector (SITC rev 3 sector 33). This is partially due to over consumption of petroleum products in Egypt due to the huge energy subsidies provided, and the declining production rates of petroleum. Once again from the bottom panel of the Figure we see a general decline in imports over the period 1999-2003 followed by a rise.

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<sup>7</sup> Commodities n.e.s. sector tends to be a catch-all for all other products not included in the rest of the classification. Also included in this chapter are: gold coins (non-legal tender); postal packages; other coins and; “Special transactions and commodities not classified according to kind”

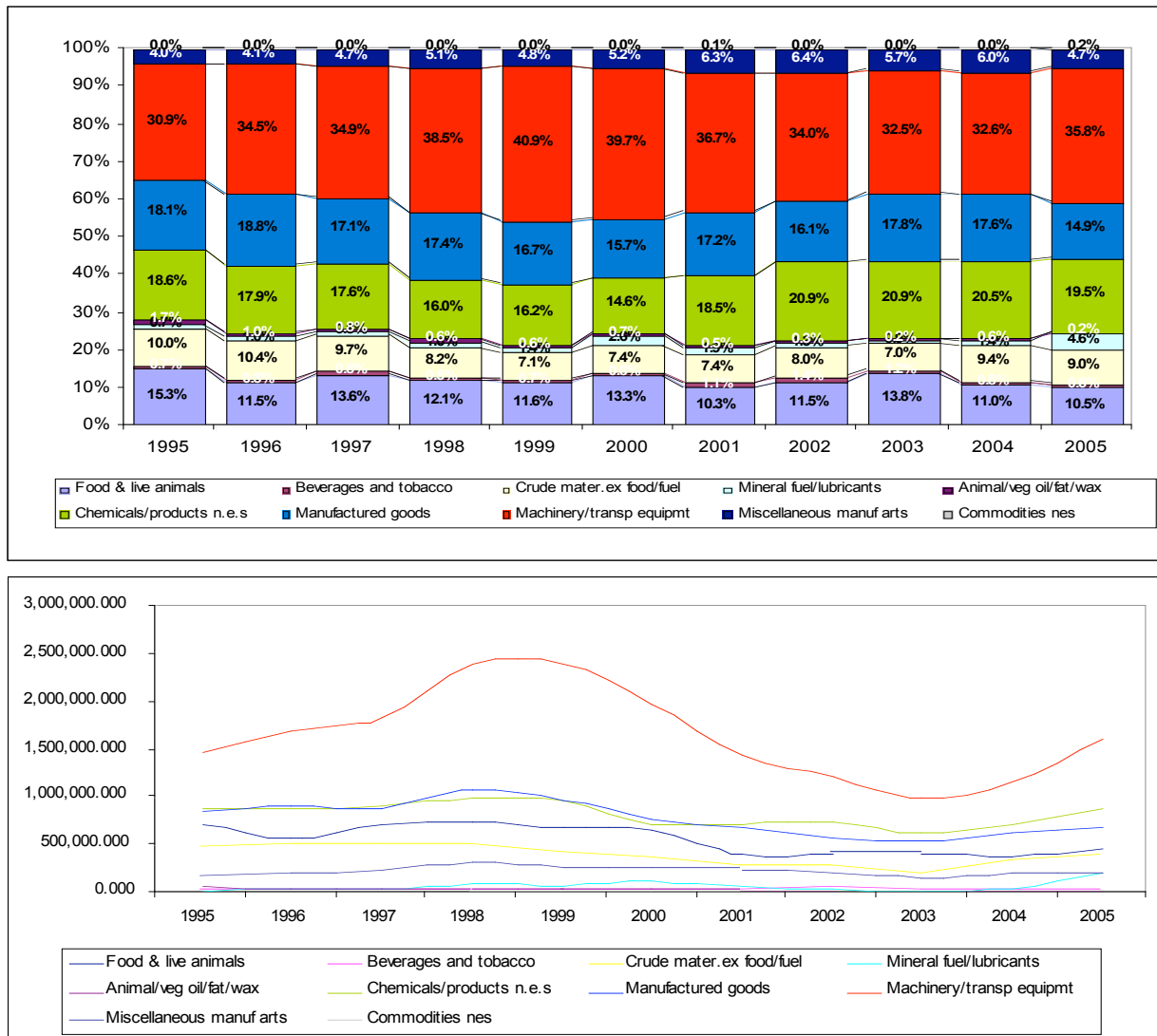
**Figure 2.4: Sectoral distribution of Egyptian imports (1995-2005)**



Source: WITS, Comtrade, Values are in \$ ,000s

Where Figure 2.4 examined the sectoral composition of imports from all sources, we now turn to examining the composition of imports first from the EU-25, and then from the ROW. Figure 2.5 shows that the ‘machinery and transport equipment’ import sector is the biggest with a share increasing from 30.5% in 1995 to 35.8% in 2005. Other key import sectors are the ‘manufactured goods’ sector and the ‘chemical products’ sector with a combined share of 34.4% in 2005. The ‘manufactured goods’ sector imports are composed mainly of imports of ‘iron and steel’ (SITC rev3. 67); paper/paperboard (SITC rev3. 64); and ‘Metal manufactures n.e.s.’ (SITC rev3. 69). What is also interesting is the relative stability of these shares over time, and of the value of exports (except for machinery/transport equipment). There is also a notably increase in imports of the ‘mineral fuel/lubricants’ sector in 2004-2005, and this is largely due to imports of lubricants with high petroleum content (SITC rev3. 3345) from EU countries, mainly from Italy.

**Figure 2.5: Sectoral distribution of Egyptian imports from the EU-25 (1995-2005)**

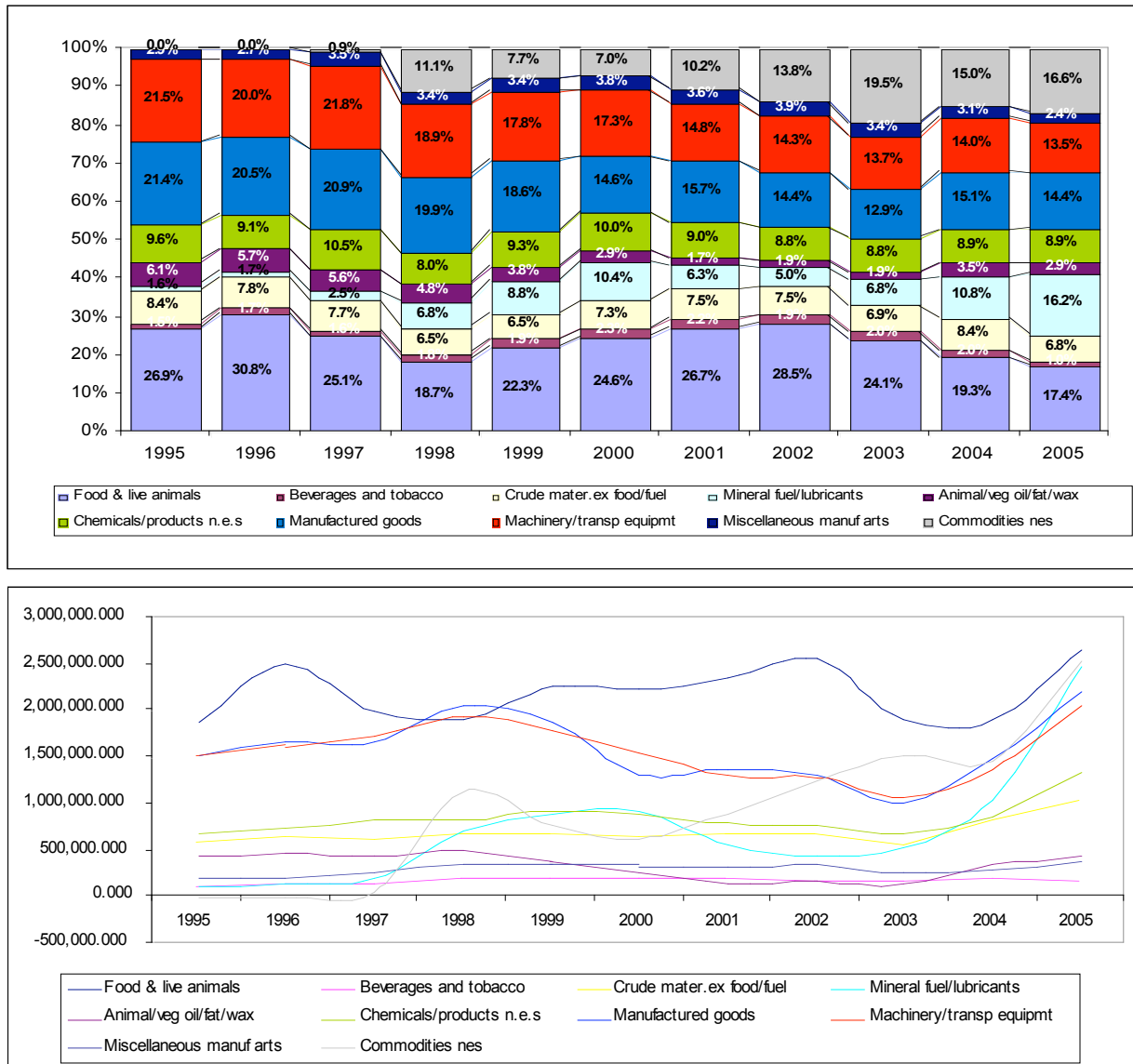


Source: WITS, Comtrade, Values are in \$ ,000s

In Figure 2.6 we investigate the composition of imports from the RoW (World minus EU25 imports). The purpose of this is to examine graphically the extent of any similarity between the EU imports seen earlier, and imports from the ROW. The greater is the degree of similarity the greater is the scope for trade diversion.



**Figure 2.6: Sectoral distribution of Egyptian imports from Rest of World (1995-2005)**



Source: WITS, Comtrade, Values are in \$ ,000s

From the Figure we can see that there are some important differences between the import patterns from the EU and from the ROW, most notably with respect to mineral fuels/lubricants, and commodities n.e.s.<sup>8</sup>, and to some extent also with respect to food and live animals., which together account for 50.2% of all imports from the ROW and only 15.4% of imports from the EU. However, there is also some overlap – hence the three most important sectors for the EU (machinery, manufacturing and chemicals) comprise 70.2% of all EU exports to Egypt, and they also account for 36.8% of the ROW exports to Egypt. This suggests a degree of overlap with some scope for trade diversion. We also note a very strong increase in the ‘mineral fuel

<sup>8</sup> This grouping includes :gold coins (non-legal tender); postal packages; other coins and; “Special transactions and commodities not classified according to kind”.

lubricant' sector from 2002-2005, and this is likely to be a key factor explaining the rise of the PAFTA share in imports discussed earlier.

In order to investigate this issue of the degree of similarity more formally, we compute the Finger-Kreinin index of import similarity<sup>9</sup>. The FK ranges from 0 to 1, taking value 1 when imports are identical across any pair of countries and 0 when imports are completely different. The F-K index gives insight into the scope for trade diversion resulting from a FTA insofar as it will identify the scope for imports currently being sourced from other partners switching to being sourced from the EU as a result of the preferences granted. Using data at the 6-digit level for the year 2005 we find an FK index for the exports of the EU and the ROW of 0.39. This reveals a considerable degree of import overlap, and indicates that preferences granted under a FTA could be welfare reducing as imports are switched from more efficient ROW partners to the EU. We also examined the degree of similarity between the exports of the EU and that of the US, where we get an F-K coefficient of 0.26. This suggests somewhat less overlap between the exports of the EU and the exports of the US, and therefore less scope for trade diversion between this pair of countries. Finally, we also investigated the degree of similarity between the imports of the EU and the PAFTA countries. Here the FK index was 0.115 which indicates comparatively little overlap. Given the importance of mineral fuel exports by the PAFTA countries this is not surprising, and suggests that liberalisation with the PAFTA grouping is more likely to lead to trade creation.

### 2.2.3 Geographical Distribution of Exports

We now turn to an examination of the pattern of Egyptian exports – again by country and by sector. From the point of view of a proposed FTA this is important because it helps to identify the sectors which are important to Egypt and where there might therefore be significant offensive interests. In the context of a symmetric FTA with significant liberalisation taking place on both sides, it can also help to identify possible sectors where trade diversion by Egypt might occur. In the context of the EU-Egypt AA this is not really an issue, as in principle, Egypt already has duty free access for most products into the EU (as seen earlier in Table 2.3).

Figure 2.7 shows the evolution of Egyptian exports by main trading partners. We have identified Egypt's main trading partners as being; EU-25, COMESA<sup>10</sup>, Aghadir, USA, China, India and ROW. We observe that the EU25 is Egypt's main destination for exports although the share declines from over 46% in 1995, to 33.7% in 2005. The level analysis shows that the declining share of EU25 as an export market is taking place while exports to the EU25 are increasing, but at a slower rate than the increase in exports to the ROW. Further notable increases in export shares are those of India and China with a strong decrease in the share of exports going to the US. Again we observe in the level analysis that while the value of trade with the US increases

<sup>9</sup> The mathematical formula for FK index is as follows:

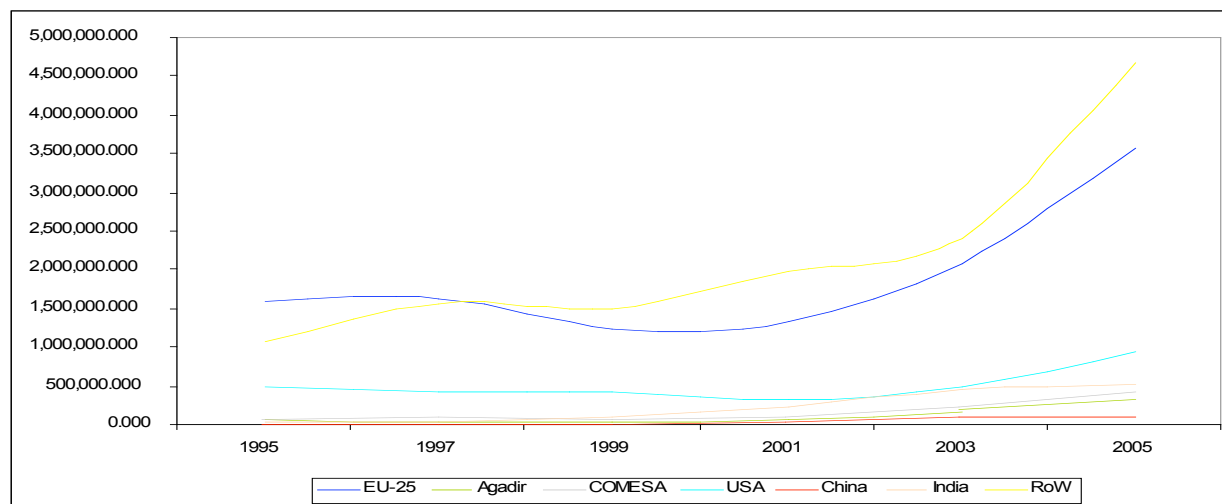
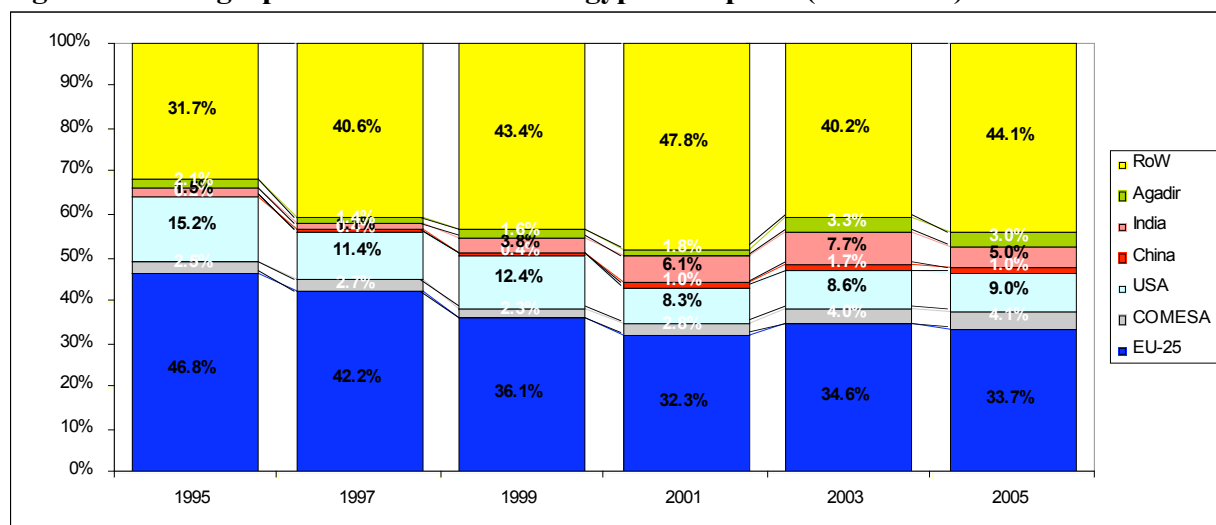
$$F - K = \sum_i \min \left( \left[ \frac{X_{i,a}}{\sum x_{i,a}} \right], \left[ \frac{X_{i,b}}{\sum x_{i,b}} \right] \right)$$

Where  $X_{i,a} / \sum X_{i,a}$  is the share of product i in country's a total exports,  $X_{i,b} / \sum X_{i,b}$  is the share of product i in country's b total exports.

<sup>10</sup> COMESA: Angola, Burundi, Comoros, Dem Rep Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

over the period, it does so at a much slower rate than the increases in exports to the ROW and to the EU-25. Again this is suggestive of some trade diversion away from the US, but in the direction of the EU as a result of the Barcelona process. We further included in our analysis the Aghadir Agreement countries. We note that the share of exports towards Aghadir countries is increasing but remains modest. COMESA is also increasingly becoming an export market but, again, at a moderate rate.

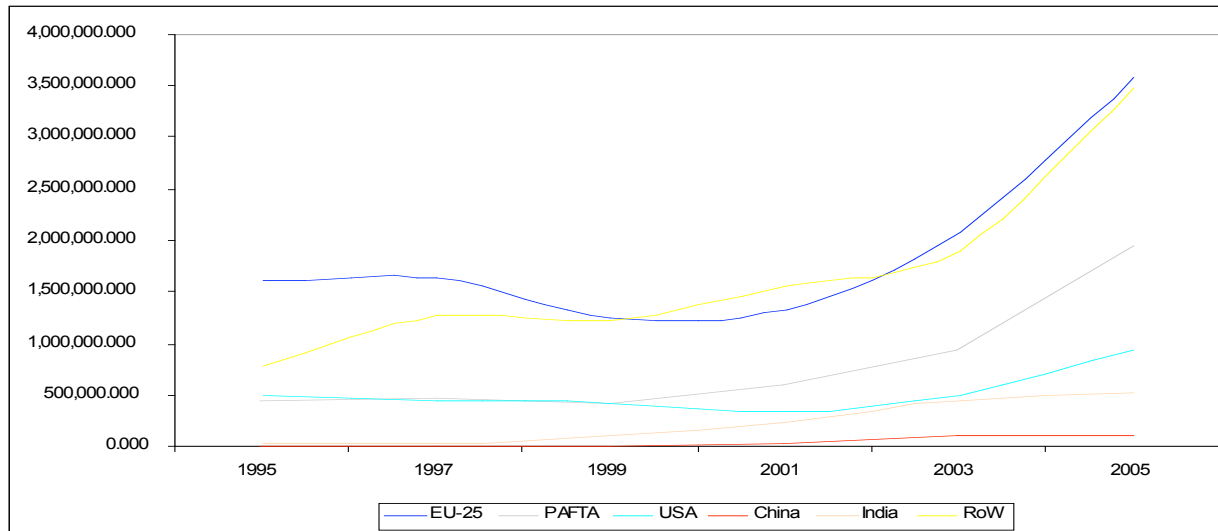
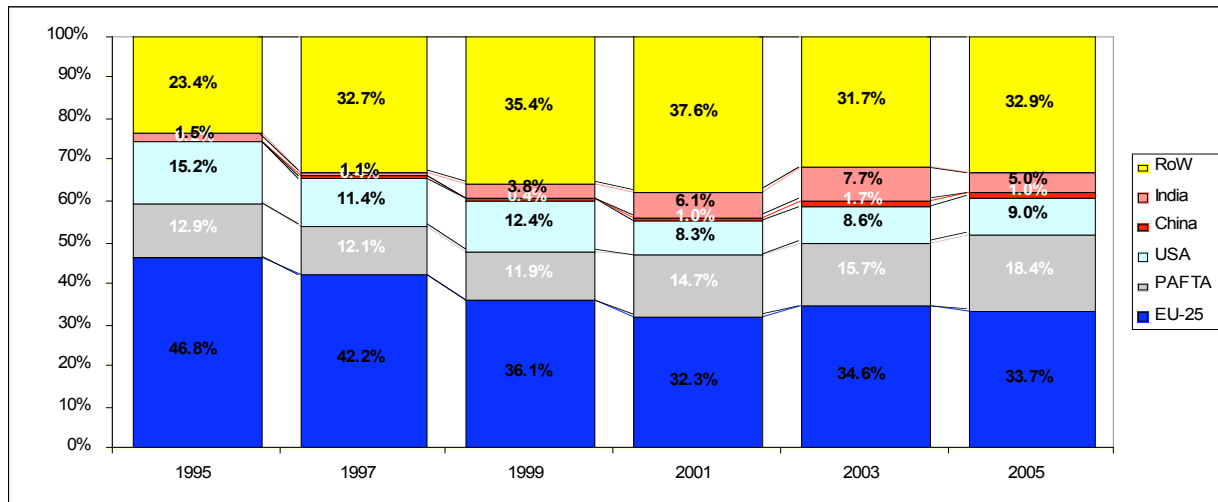
**Figure 2.7: Geographical Distribution of Egyptian exports (1995-2005)**



Source: WITS, Comtrade, Values are in \$ ,000s

Analogously to earlier, given the overlap between COMESA, Aghadir and PAFTA, we now turn to analysing export shares by including PAFTA countries and removing both Aghadir and COMESA. The interest in such exercise is to try to discern the extent to which the increase in the ROW share of exports is dictated by an increase in trade with PAFTA countries.

**Figure 2.8: Geographical Distribution of Egyptian exports (1995-2005)**



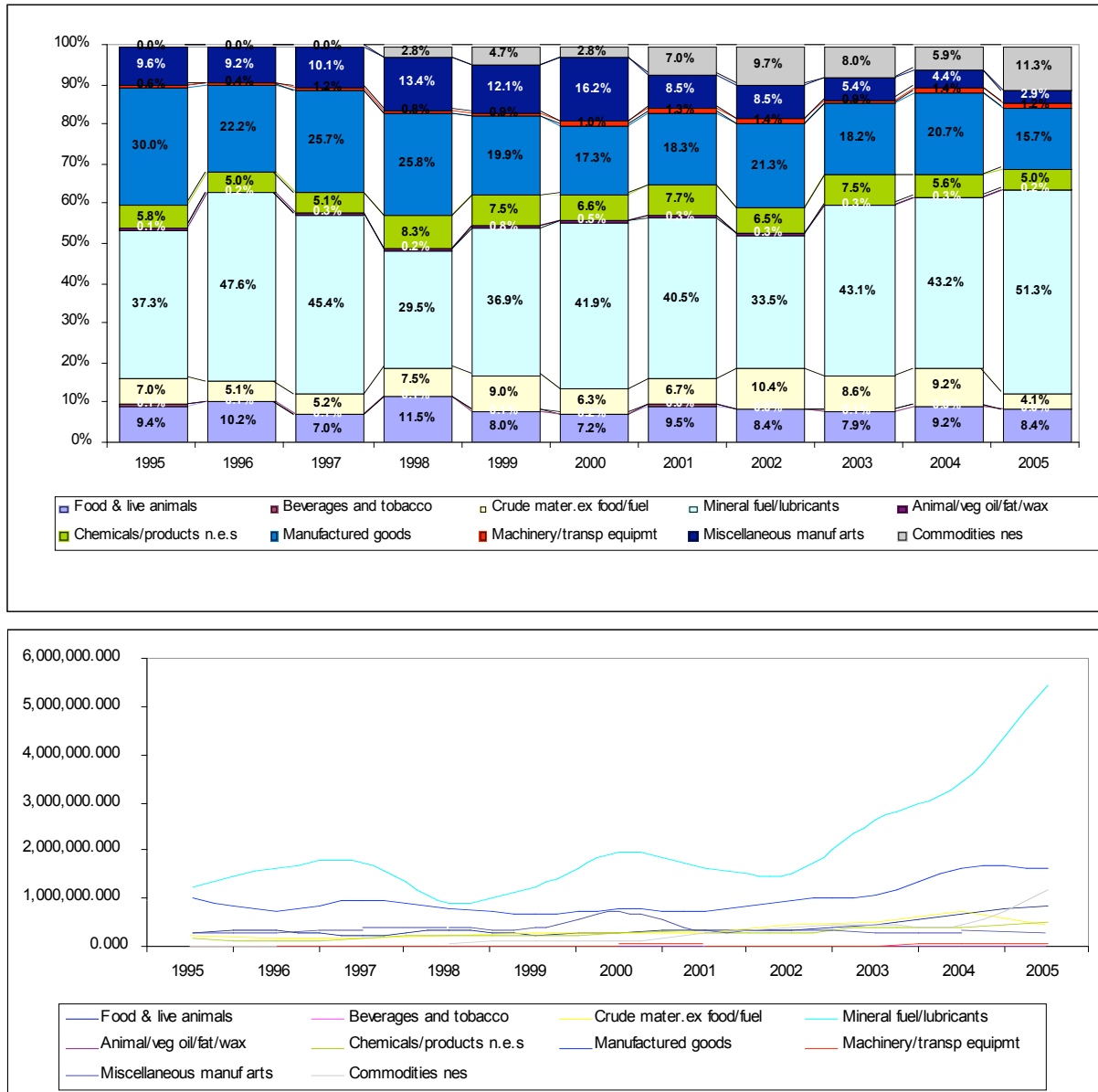
Source: WITS, Comtrade, Values are in \$ ,000s

From Figure 2.8 we can see that by including the PAFTA countries we note that the RoW increase reported in Figure 2.7 is in part due to the increasing role of PAFTA as an export market where the share increases from 12.9% to 18.4% over the period. The ROW share also rises significantly from 23.4% to 32.9%, hence indicating that greater integration between Egypt and PAFTA, as well as Egypt and the ROW.

### 2.2.4 Sectoral Composition of Exports

Turning now to the sectoral composition of exports, in Figure 2.9 we see that mineral fuels and lubricants are Egypt's main export sectors with over half the value of total exports in 2005. This sector also witnesses a very strong increase in the value of exports in the period under investigation – this is no doubt being driven in good part by the rise in the world price of fuels over this period. Other notable export sectors are 'manufactured goods'; 'commodities n.e.s.'; and 'food and live animals'.

**Figure 2.9: Sectoral composition of exports to world (1995-2005)**



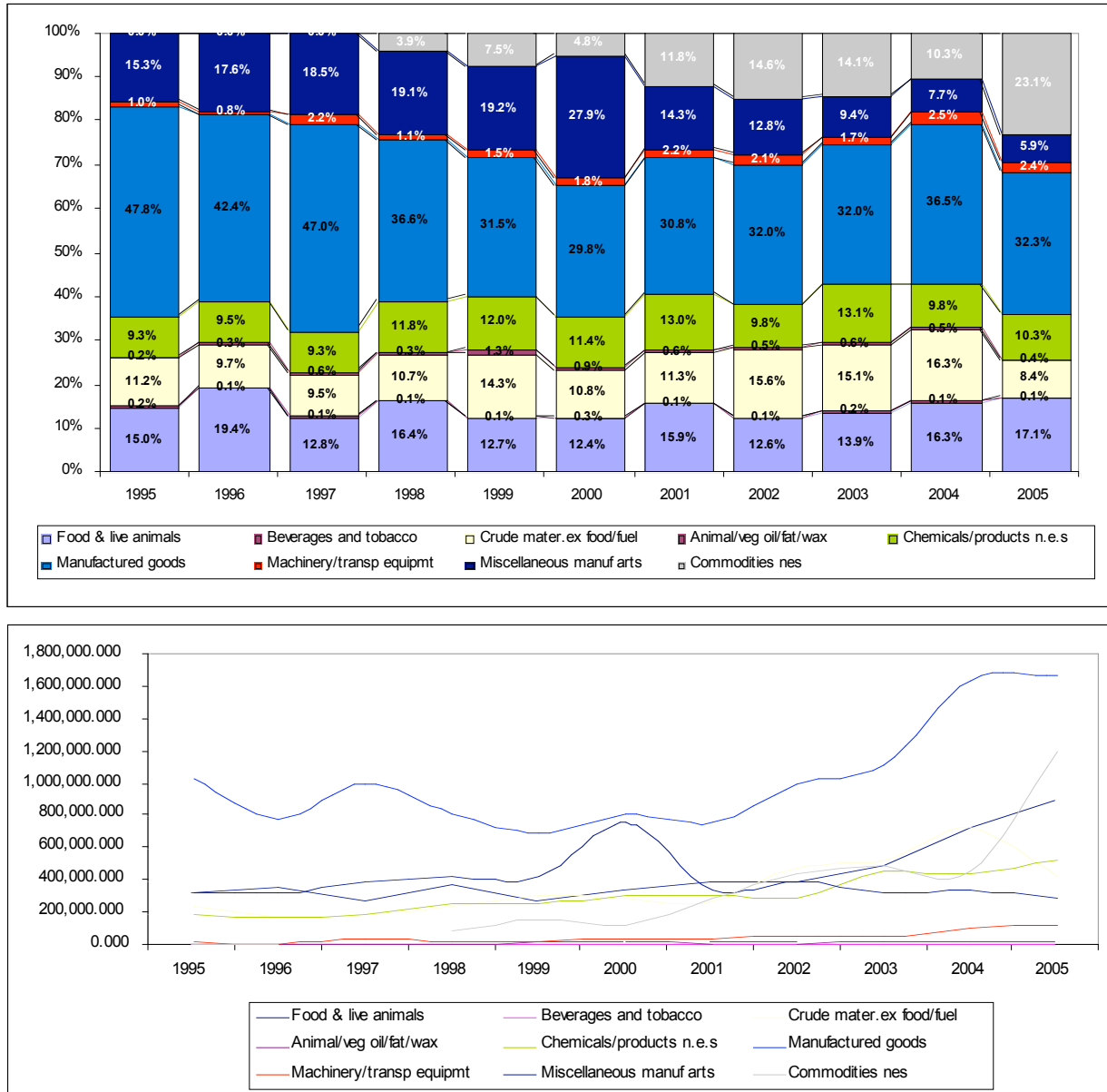
Source: WITS, Comtrade, Values are in \$ ,000s

Given the dominance of the mineral fuels/lubricants sector in Figure 2.9, and given the role of the rise in world fuel prices in impacting on the shares reported, we now exclude this sector and investigate the sectoral composition of Egyptian non-fuel exports (Figure 2.10). What is interesting here is first the dominance of the manufactured goods industry, and secondly the substantial decline in this sector’s share (from 47% in 1995 to 32% in 2005) which is by and large mirrored by the increase in the share of commodities n.e.s.<sup>11</sup>. The shares of most other

<sup>11</sup> This grouping tends to be a catch-all for all other products not included in the rest of the classification. Also included in this chapter are: gold coins (non-legal tender); postal packages; other coins and; “Special transactions and commodities not classified according to kind”.

sectors remain relatively stable over the period in question. When focusing on the value of trade we observe a steady rise in the exports of manufactured goods from the late 1990s up until 2004, followed by a tailing off between 2004-2005. We also observe the rise in the exports of commodities n.e.s especially again over 2004-2005.

**Figure 2.10: Sectoral composition of exports to world (no fuels) (1995-2005)**

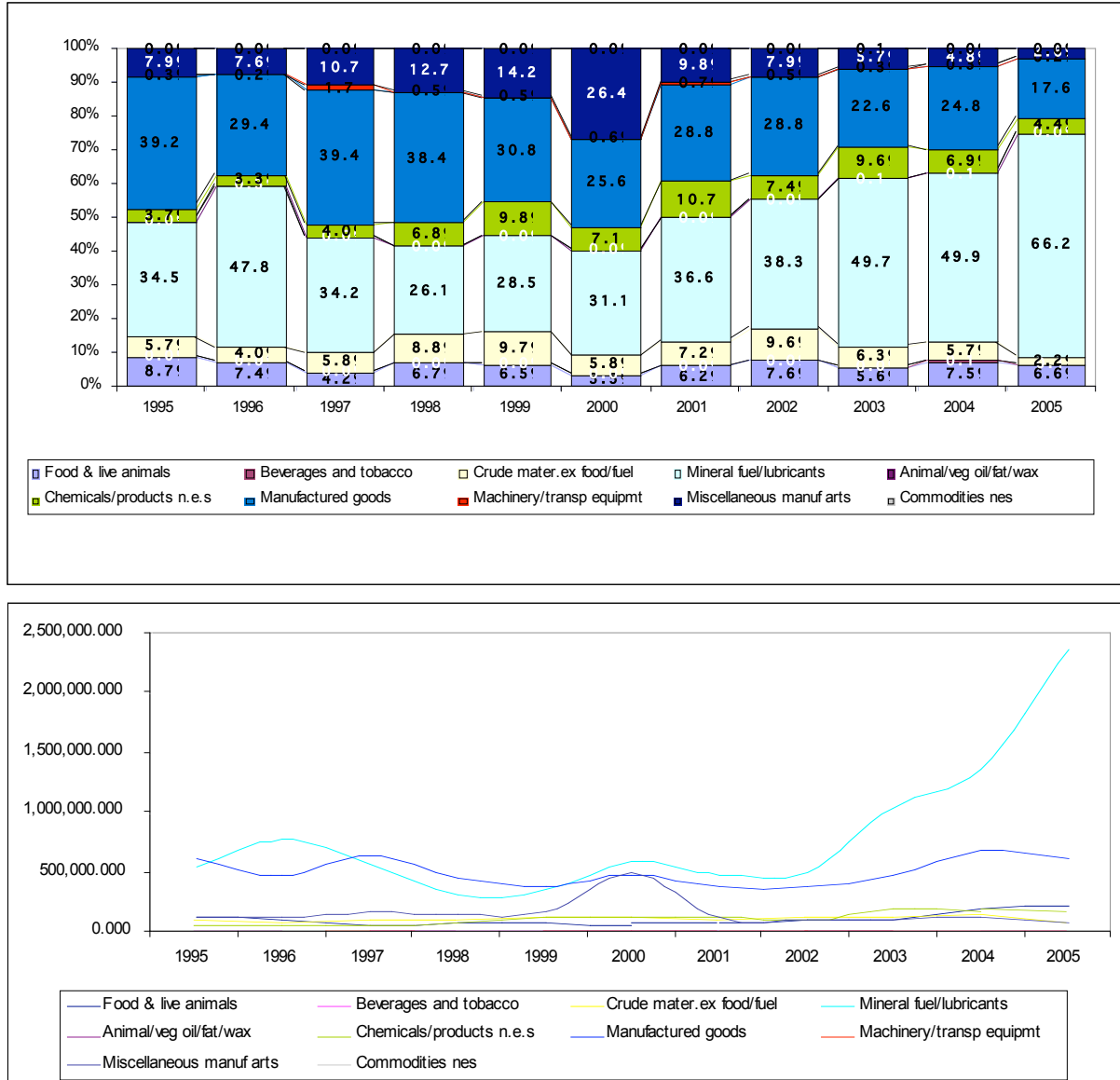


Source: WITS, Comtrade, Values are in \$ ,000s

We now turn to analysing the sectoral composition of exports towards the EU. Figure 2.11 shows that Egyptian exports to the EU are again largely composed of ‘mineral fuels and lubricants’ and where the share of these goods has increased considerably in the period under investigation. All other sectors, but especially manufactured goods and miscellaneous manufactures and chemical product see a decline in their share. From the bottom panel of Figure 2.11 we see that the dramatic rise in the share of mineral fuels/lubricants is being driven by the dramatic rise in the

value of these exports, which as before is in good part being driven by price as opposed to quantity changes. In Figure 2.12, therefore, we investigate the pattern of Egypt's non-fuel exports to the EU.

**Figure 2.11: Sectoral composition of exports to EU-25 (1995-2005)**

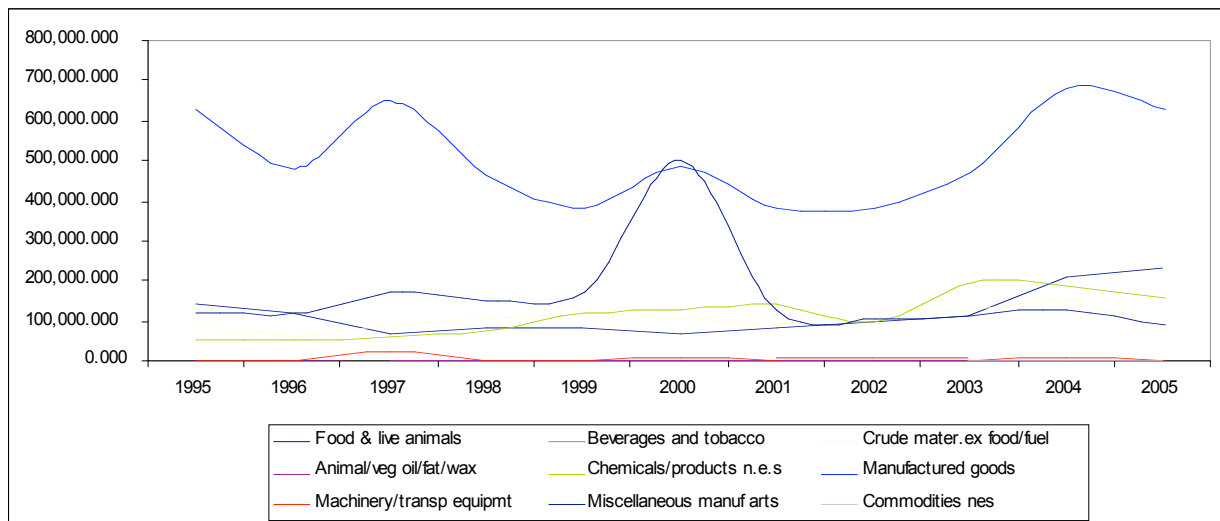
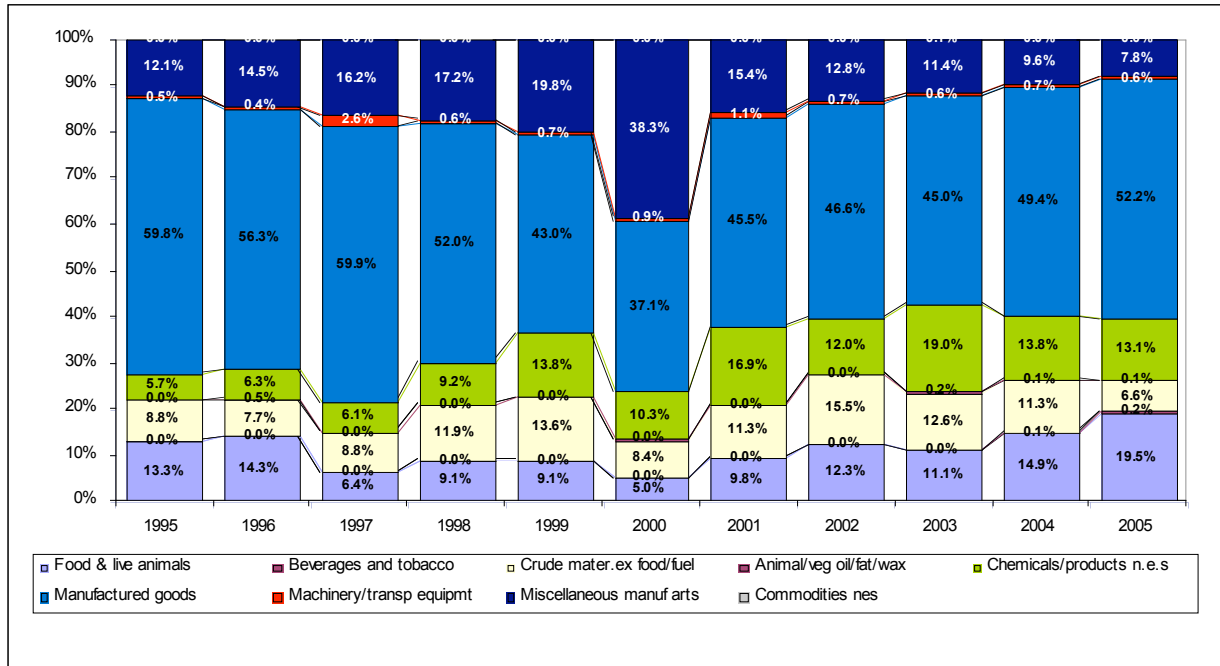


Source: WITS, Comtrade, Values are in \$ ,000s

Figure 2.12 shows that Egypt's non-oil exports to the EU are largely composed of 'manufactured goods' which accounts for approximately half the share of total non-oil exports in 2005. The relative importance of manufacturing with regard to Egypt's exports, together with the importance of EU exports of machinery to Egypt is indicative of some possible complementarities between EU and Egyptian trade which promote trade creation in both a static and dynamic sense. The other important export sectors are the 'chemical/products n.e.s.' and 'food and live animals' which cumulatively occupy 32.6% of non oil exports in 2005. These

sectors are also the ones, which have exhibited the most important growth during the period under investigation.

**Figure 2.12: Sectoral composition of exports to EU-25 (No fuels) (1995-2005)**



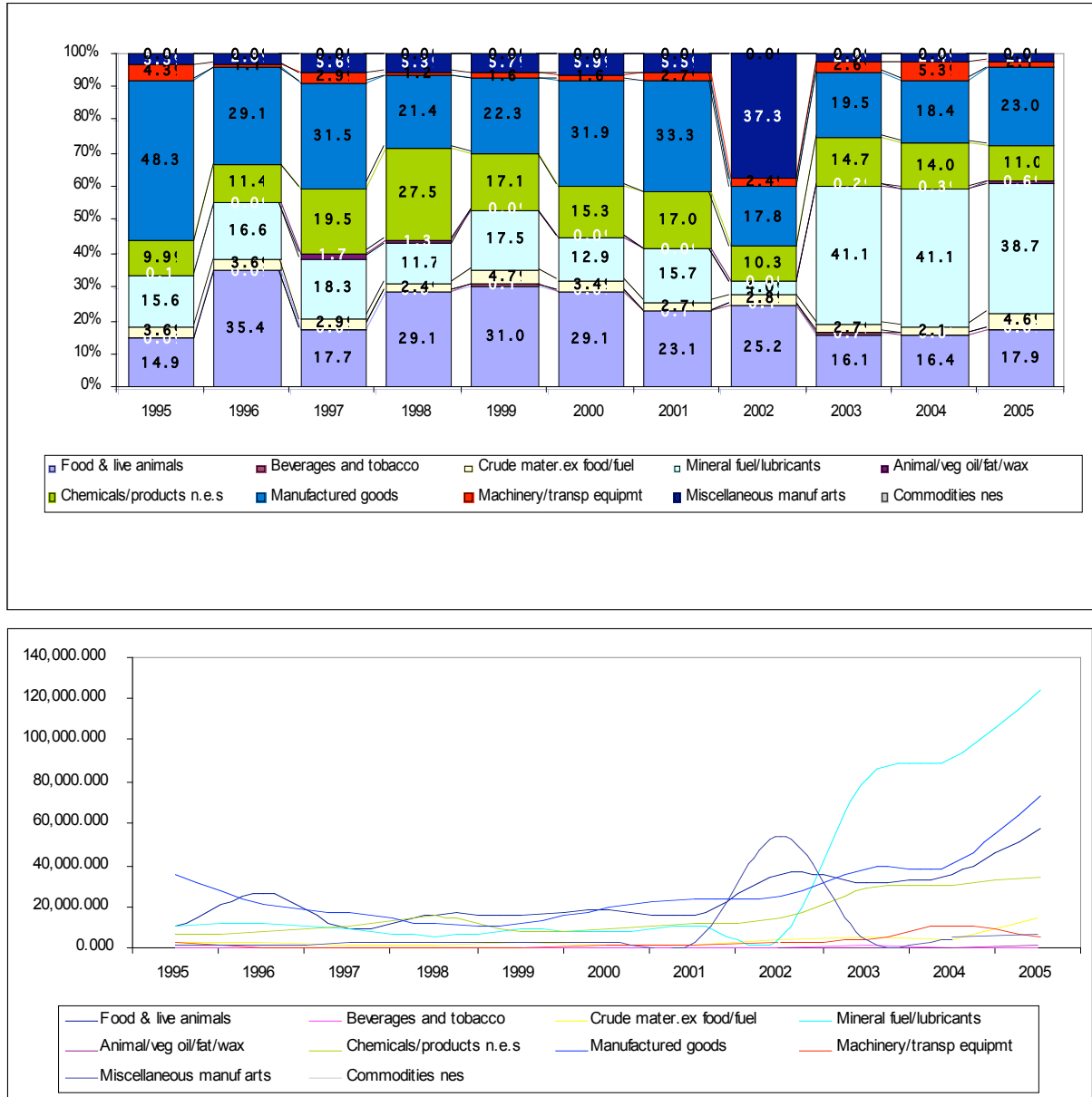
Source: WITS, Comtrade, Values are in \$ ,000s

Finally, we also consider the pattern of trade between Egypt and its Aghadir partners. Figure 2.13 shows that the sectoral composition of Egyptian exports towards Aghadir countries is also dominated by fuels especially in recent years. However, there is also substantial trade in manufactured goods, chemicals and food products which has been rising substantially in recent years. This would appear to suggest that the pattern of exports with the Aghadir countries is somewhat different to the pattern of exports with the EU and the ROW. This can be examined more formally by computing bilateral Finger-Kreinin indices of Egypt's exports to different destination markets. The biggest overlap is between exports to PAFTA and Aghadir (no doubt in



good part driven by the overlap in country groupings), where we see an overlap of 47.5%. In contrast the degree of overlap between Egypt's exports to the EU, and Aghadir, PAFTA, COMESA and China is 13.8%, 14.7%, 8.5% and 13.5% respectively.

**Figure 2.13: Sectoral Composition of exports to Aghadir (1995-2005)**



Source: WITS, Comtrade, Values are in \$ ,000s

Figure 2.13 also reveals important fluctuations in export patterns to Aghadir with periods of important increases in the 'food and live animals' in 1996; 'chemicals/products n.e.s.' in 1998; or 'miscellaneous manufactures' in 2002.

We also look at indices of export similarity between Egypt and other countries so as to discern the scope for trade creation. The idea being that countries bearing similar production structures will be increasingly complementary therefore signing RTAs with countries with similar production structures will lead to greater increases in welfare. Ideally this exercise should be carried out on the basis of data on production at high levels of disaggregation, however lack of data force us to substitute export structures for production structures.

Table 2.5 investigates the Finger-Kreinen indices of export similarity between Egypt and its main trading partners at the 6-digit level.

**Table 2.5: Finger Kreinin index of export similarity 2005**

	Egypt	EU-25	USA	Morocco	Tunisia
Egypt	1				
EU-25	0.3171	1			
USA	0.2937	0.6109	1		
Morocco	0.6435	0.3545	0.4568	1	
Tunisia	0.4293	0.3869	0.415	0.6545	1

Source: WITS, Comtrade - Author's calculations

We note that the degree of export similarity between Egypt and the EU is modest at 0.3171 leading us to assert that there is reduced scope for trade creation between these two partners as the production structures differ significantly. Having said this, the degree of export similarity between Egypt and its Aghadir partners seems high, 0.6435 with Morocco and 0.4293 with Tunisia indicating that there could be important complementarity between these countries that could be enhanced by the Aghadir agreement. There could be a form of cumulative complementarity as these countries enter a FTA with the EU which could increase the welfare of the agreement. We also perceive that the lowest FK in the table is that between Egypt and the US, showing that a FTA between these partners would be less trade creating than one with the EU. It is also worth noting the high degree of similarity between the EU and the US (0.61) which would again indicate the greater possibility of trade diversion away from the US and towards the EU.

Table 2.6 investigates the FK indices without oil products (we remove chapter 27 from all calculations). We note that the removal of oil products from the calculations reduces the FK indices considerably (from those reported in table 2.6), however, the US remains the one with the lowest FK with respect to Egypt, but we also note an important deterioration in FKs between Egypt and the EU.

**Table 2.6: Finger Kreinin index of export similarity 2005 (no oils)**

	Egypt	EU-25	USA	Morocco	Tunisia
Egypt	1				
EU-25	0.2668	1			
USA	0.2682	0.5863	1		
Morocco	0.3841	0.3095	0.4277	1	
Tunisia	0.3023	0.3464	0.3888	0.4998	1

Source: WITS, Comtrade - Author's calculations

Table 2.6 further sees an important reduction in the FKs between Egypt and its Agadir partners, leading us to conclude that a lot of export similarity between these countries is due to important exports of oil products.

### 2.2.5 Disaggregated analysis of exports

In this section we dig a little deeper in order to provide a better understanding of the pattern of Egypt's exports and its evolution over time, and we do so by considering trade at a more disaggregated level. Consider Table 2.7 which lists the top 15 Egyptian export sectors in 1996, and their share in exports is given in the third column. The fourth column gives the index of revealed comparative advantage for each product<sup>12</sup>. Where the index is greater than 1 than the country is said to have a revealed comparative advantage in the product, and where the index is less than one the converse applies. For each product identified, the last two columns of the table then give the share of that product in 2005, and the corresponding RCA. Hence if you take the first row of the table, we see that in 1996 the most important export sector was HS 270900, with an export share of 50.32%, and an RCA of 24.1. The same product in 2005 had an export share of only 8.31%, and a much lower revealed comparative advantage (1.45).

**Table 2.7: Top 15 export sectors to world**

Product	product description	1996		2005	
		Share	RCA	Share	RCA
270900	Petroleum oils and oils obtained..	50.32%	24.1	8.31%	1.45
271000	Petroleum oils and oils obtained..	5.12%	14.6	14.65%	4.25
520100	Cotton, not carded or combed.	2.11%	16.4	1.89%	23.09
070190	Other (potatoes)	2.08%	83.9	0.80%	53.67
610910	Of cotton (t-shirts)	1.72%	10.4	1.17%	6.36
760110	Aluminium, not alloyed	1.72%	10.9	0.20%	1.12
620342	Trousers, bib and brace overalls..	1.15%	5.9	1.13%	7.20
620520	Of cotton (articles of apparel)	1.12%	9.7	0.19%	2.51
520812	Unbleached :-- Plain weave (cotton)	1.03%	39.2	0.06%	5.02
760120	Aluminium alloys	0.98%	6.7	1.10%	6.71
611020	Of cotton (jerseys, pullovers)	0.85%	6.6	0.44%	3.84
270400	Coke and semi-coke of coal...	0.78%	17.9	0.78%	12.23
841112	Turbo-jets :-- Of a thrust exceeding..	0.74%	4.9	0.06%	0.31

<sup>12</sup> Commonly the index of revealed comparative advantage (RCA) bears the name of its inventor and is known as the Balassa index. This is calculated using the following equation:

$$RCA = \left( \frac{X_{i,j}}{\sum_i X_{i,j}} \right) \div \left( \frac{\sum_j X_{i,j}}{\sum_i \sum_j X_{i,j}} \right)$$

with  $X_{i,j}$  = exports of sector  $i$  from country  $j$ . Hence the index compares the share of exports of a given country of a given product, with the share of exports of that product in world (or sometimes other country groupings) exports. If a country exports proportionately more than the level of exports in the world, then the country is said to have a "revealed" comparative advantage in that product. It is of course important to note that as the index is based on observed trade flows, to the extent that those flows are distorted due to trade policy measures then so will the index.

610510	Of cotton (men/boys shirts)	0.67%	14.9	0.29%	8.05
570242	Other, of pile construction.. (carpets)	0.62%	31.2	0.66%	82.11
<b>Total</b>		71.03%		31.73%	
<b>Average</b>		19.8		14.53	

Source: WITS, Comtrade - Author's calculations

\*Egyptian exports at the HS-6 digit level have been computed using mirror flows given that data was unavailable. This is why there are discrepancies between this table and figure 2.5.

\*\*Fuels are excluded by removing chapter 27 at the Hs 6 digit level.

Table 2.7 shows that in 1996 fuel exports were clearly predominant, with the other important sectors encompassing textiles and clothing. In 1996 overall the share of the 15 most exported sectors amounts to over 71%. By 2005 we see that the share of the same 15 sectors has decreased significantly to 31.73%; only 3 of the sectors see an increase in their export share, and 11 of the 15 sectors see a decline in their measured revealed comparative advantage. All this would appear to indicate that the pattern of Egyptian exports has changed considerably over the period in question. To investigate this more fully, we calculate the correlation coefficients of the 1996 shares on 2005 shares across all the HS 6-digit industries and find a coefficient of 0.498. Carrying out the same exercise for RCAs, across all HS 6-digit industries, we note that the coefficient becomes 0.609. Once again suggests significant changes over the 9 year period in the pattern of Egyptian trade.

Table 2.8 shows the results of a similar exercise, except where this time, we take the top 15 export sectors in 2005 and then compare these to 1996. Once again we see the importance of fuel products, and the emergence of liquefied natural gas. Interestingly the top 15 sectors in 2005 accounted for 53.2% of exports, while the same products accounted for over 62% of exports in 1996 – this is due to the importance HS 270900 in the earlier period. Without this industry cumulative 1996 share would stand at 12.25%, while the 2005 share would be around 45%. Once again this is indicative of a major transformation and diversification of export structures during the period under investigation. What is also interesting is that six of the 15 principal exports sectors in 2005, were not exported at all in 1996. These sectors account for 20.64% of total Egyptian exports in 2005. Of the remaining nine sectors, six of them have a higher revealed comparative advantage in 2005 than in 1996. As before we calculate the correlation coefficients between 2005 and 1996 values and find a share correlation of 0.355 and an RCA correlation of -0.311. which confirms the hypothesis of significantly changing export structure, and export competitiveness in Egypt.

**Table 2.8: Top 15 export sectors to world (2005)**

Product	product description	2005		1996	
		Share	RCA	Share	RCA
271000	Petroleum oils and oils obtained...	14.65%	4.3	5.12%	14.61
271111	Liquefied :-- Natural gas	12.18%	36.6	0.00%	
270900	Petroleum oils and oils obtained...	8.31%	1.5	50.32%	24.10
720839	Other, in coils, not further worked (iron/steel)	2.14%	19.2	0.00%	
080510	Oranges	2.00%	76.8	0.23%	5.66
252310	Cement clinkers	1.95%	128.99	0.00%	
520100	Cotton, not carded or combed.	1.89%	23.1	2.11%	16.39
252329	Portland cement :-- Other	1.85%	39.5	0.00%	
271112	Liquefied :-- Propane	1.28%	9.3	0.00%	

100630	Semi-milled or wholly milled rice,	1.27%	18.6	0.37%	5.45
310210	Urea, whether or not in aqueous solution	1.24%	21.2	0.00%	
610910	Of cotton (t-shirts)	1.17%	6.4	1.72%	10.37
620342	Trousers, bib and brace overalls... (men)	1.13%	7.2	1.15%	5.88
620462	Trousers, bib and brace overalls... (women)	1.12%	6.9	0.57%	5.34
760120	Aluminium alloys	1.10%	6.7	0.98%	6.69
<b>Total</b>		53.28%		62.57%	
<b>Average</b>			27.1		10.50

Source: WITS, Comtrade - Author's calculations

The preceding two tables were based on the total Egyptian trade. However, as we have already seen the fuel sector tends to dominate aggregate trade, and the changing apparent composition of trade may be in part driven by changing fuel prices. Hence, we now repeat the previous analysis but this time exclude the fuel sector, and hence we investigate how the non-fuel sectors shares have evolved by comparing the 1996 data with the 2005 data. Table 2.9 is analogous to Table 2.7 and takes as the base the 1996 shares. Tables 2.9 shows us how the top sectors in 1996 are behaving in 2005. Once again we see evidence of considerable change. We also note an important decline in the RCAs of the investigated sectors. The corresponding correlation coefficients stand at 0.48 for shares and 0.65 for the RCAs.

**Table 2.9: Evolution of Top 15 1996 export sectors (no fuels)**

					<b>Difference 1996-2005</b>		
	<b>share 1996</b>	<b>RCA 1996</b>	<b>share 2005</b>	<b>RCA 2005</b>	<b>Share</b>	<b>RCA</b>	
520100	Cotton, not carded or combed.	4.85%	36.16	3.11%	33.6	-35.88%	-7.08%
070190	Other (potatoes)	4.78%	185.14	1.31%	78.11	-72.59%	-57.81%
610910	Of cotton (t-shirts)	3.96%	22.87	1.92%	9.26	-51.52%	-59.51%
760110	Aluminium, not alloyed	3.95%	24.19	0.33%	1.63	-91.65%	-93.26%
620342	Trousers, bib and brace overalls,	2.63%	12.97	1.86%	10.51	-29.28%	-18.97%
620520	Of cotton (articles of apparel)	2.58%	21.31	0.32%	3.66	-87.60%	-82.82%
520812	Unbleached :-- Plain weave (cotton)	2.35%	86.49	0.09%	25.42	-96.17%	-70.61%
760120	Aluminium alloys	2.24%	14.75	1.81%	9.75	-19.20%	-33.90%
611020	Of cotton (jerseys, pullovers)	1.95%	14.63	0.73%	5.61	-62.56%	-61.65%
841112	Turbo-jets :-- Of a thrust exceeding	1.71%	10.75	0.10%	0.45	-94.15%	-95.81%
610510	Of cotton (men/boys shirts)	1.54%	33.02	0.47%	11.71	-69.48%	-64.54%
570242	Other, of pile construction.. (carpets)	1.43%	68.92	1.09%	119.51	-23.78%	73.40%
620462	Trousers, bib and brace overalls,	1.31%	11.77	1.84%	10.11	40.71%	-14.10%
970600	Antiques of an age exceeding 100 years	1.30%	40.57	0.23%	7.54	-82.67%	-81.41%
630231	Other bed linen :-- Of cotton	1.27%	76.2	0.65%	19.27	-48.61%	-74.71%
<b>Total</b>		37.85%		15.86%			
<b>Average</b>			43.983		23.076	-54.96%	-49.52%

Source: WITS, Comtrade - Author's calculations

**Table 2.10: Evolution of Top 15 2005 export sectors (no fuels)**

					Difference 1996-2005	
	share 1996	RCA 1996	share 2005	RCA 2005	Share	RCA
720839 Other, in coils, not further worked	0.00%	0.00	3.53%	27.92		
080510 Oranges	0.53%	12.49	3.28%	111.79	513.96%	795.02%
252310 Cement clinkers	0.00%	0.00	3.21%	187.73		
520100 Cotton, not carded or combed.	4.85%	36.16	3.11%	33.60	-35.77%	-7.07%
252329 Portland cement :-- Other	0.00%	0.00	3.04%	57.47		
100630 Semi-milled or wholly milled rice, Urea, whether or not in aqueous solution	0.85%	12.03	2.09%	27.03	147.06%	124.78%
310210 Of cotton	0.01%	0.15	2.03%	30.89	40193.10%	20438.49%
610910 Of cotton	3.96%	22.87	1.92%	9.26	-51.42%	-59.53%
620342 Trousers, bib and brace overalls, b	2.63%	12.97	1.86%	10.51	-29.34%	-18.99%
620462 Trousers, bib and brace overalls, b	1.31%	11.77	1.84%	10.11	40.71%	-14.05%
760120 Aluminium alloys	2.24%	14.75	1.81%	9.75	-19.32%	-33.88%
701810 Glass beads, imitation pearls, imit	0.12%	11.31	1.56%	86.02	1182.83%	660.38%
390120 Polyethylene having a specific grav	0.00%	0.03	1.36%	8.44	47261.84%	31633.70%
070190 Other	4.78%	185.14	1.31%	78.11	-72.49%	-57.81%
570242 Other, of pile construction, made u	1.43%	68.92	1.09%	119.51	-23.66%	73.40%
<b>Total</b>	22.70%		33.06%			
<b>Average</b>		25.91		53.88		

Source: WITS, Comtrade - Author's calculations

\*we note that Urea has been subjected to antidumping investigations during the period under investigation which could explain the dramatic change in share.

Table 2.10 investigated how non-oil products that now show important export shares have evolved since 1996. Here we note the important diversification of the Egyptian economy, with new sectors (notably textile and cement) inexistent in 1996 taking a very important role in 2005. We find correlation coefficients between 1996 and 2005 shares at -0.22 and for RCAs at 0.18.

Finally Table 2.11 examines the correlation coefficients between the 1996 and 2005 shares bases on the top 20, 50, 100 and all products. Across all products we see that the share correlation coefficient is just below 50%, and the RCA correlation coefficient is nearly 70%. Hence there is more stability with regard to revealed comparative advantage than with respect to trade shares, which have clearly changed significantly over the period in question. This is particularly true if we take the 2005 shares as the base, and for example consider the top 20 export industries. We then see that the correlation coefficient is less than 0.1. All of this indicates a dramatically changing pattern of Egyptian exports and as seen earlier this applies both to aggregate trade and to manufacturing trade. This change in the pattern of trade is perhaps not surprising given the reductions in tariffs outlined earlier and the increasing integration of Egypt into the world economy. This would suggest that Egypt's pattern of trade is moving more in line with its comparative advantage, which in turn should yield domestic welfare gains. It also suggests considerable change in production structures in the Egyptian economy, which in turn implies a significant amount of restructuring and adjustment – which in turn can increase social pressures within the economy. In order for Egypt to maximise the welfare gains from this process of

change and adjustment it is important to minimise the distortionary application of trade policy – alternatively put to try and maximise trade creation and minimise trade diversion.

**Table 2.11: Correlation Coefficients between 1996 and 2005 at varying ranks**

	1996 values		2005 values	
	Share	RCA	Share	RCA
corr coeff top 20	0.564	0.742	0.095	0.194
corr coeff top 50	0.494	0.698	0.294	0.463
corr coeff top 100	0.581	0.749	0.318	0.589
All	0.500	0.676	0.500	0.676

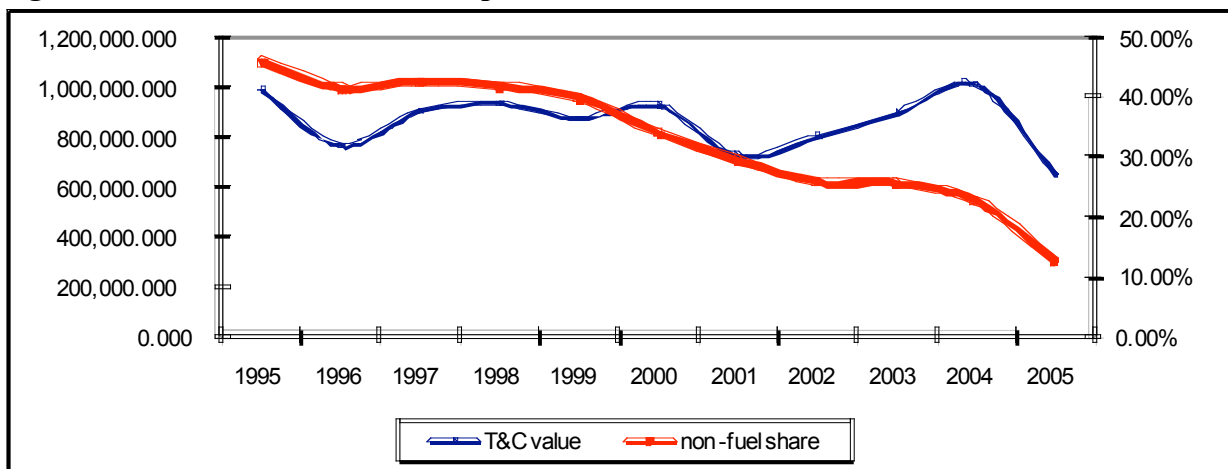
Source: WITS, Comtrade - Author's calculations

### 2.2.6 Textile and clothing

It is worth noting that the preceding discussion did not separately identify the textile and clothing sector – which is often said to be an important sector in Egypt. Exports of textiles fall within the category of ‘manufactured goods’; ‘crude material excluding food/fuel’; and ‘miscellaneous manufactured articles’. In this section we therefore examine the textile and clothing sector in a little more detail.

Figure 2.14 identifies the textile sector using the SITC rev 3 nomenclature (sectors 26, 65 and 84) and maps the evolution of the textile and clothing sector share in total non-oil exports from 1995 to 2005.

**Figure 2.14: Evolution of Textile exports 1995-2005**



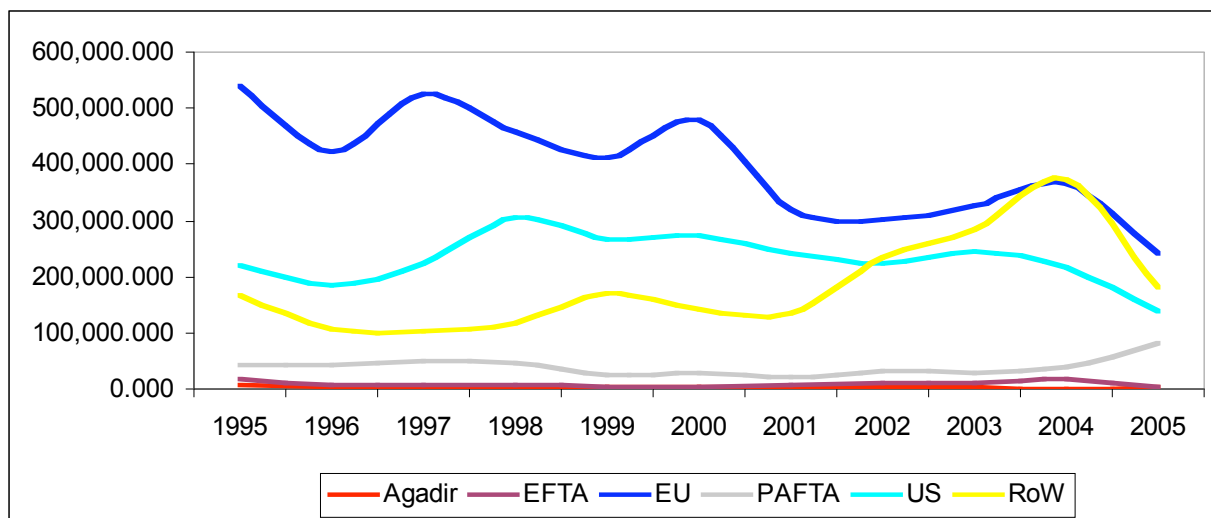
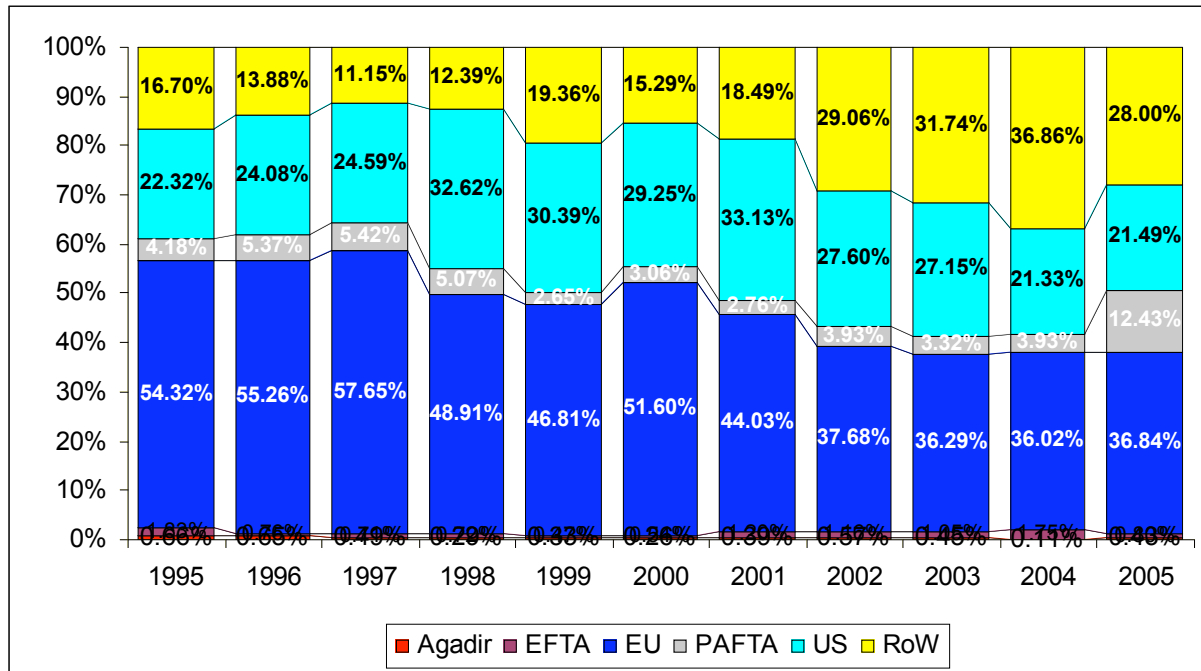
Source: COMTRADE, WITS

During the period under investigation the textile and clothing sector shows an important decline in share of non-oil exports from 45.91% in 1995 to 12.57% in 2005 (see red line against right axis). Figure 2.14 also reveals that the declining share is not matched by a declining value of T&C exports, the evolution of which appears quite uneven but stable (see blue line, to be read against the left axis). This leads us to conclude that textiles and clothing exports have remained relatively constant during the last decade, however the importance of these with respect to total

non-oil exports has declined as Egypt has undergone important diversification of exports. 2004 shows a maximum point in T&C export values after which we note a pronounced decline.

Figure 2.15 investigates the share of textiles by destination. Here we note the important decrease in EU imports of textiles during the period under investigation going from a share of 54.32% in 1995 to 36.84% in 2005. Other important destinations of Egyptian textile exports are the US and PAFTA countries.

**Figure 2.15: Evolution of textile exports by destination 1995-2005**

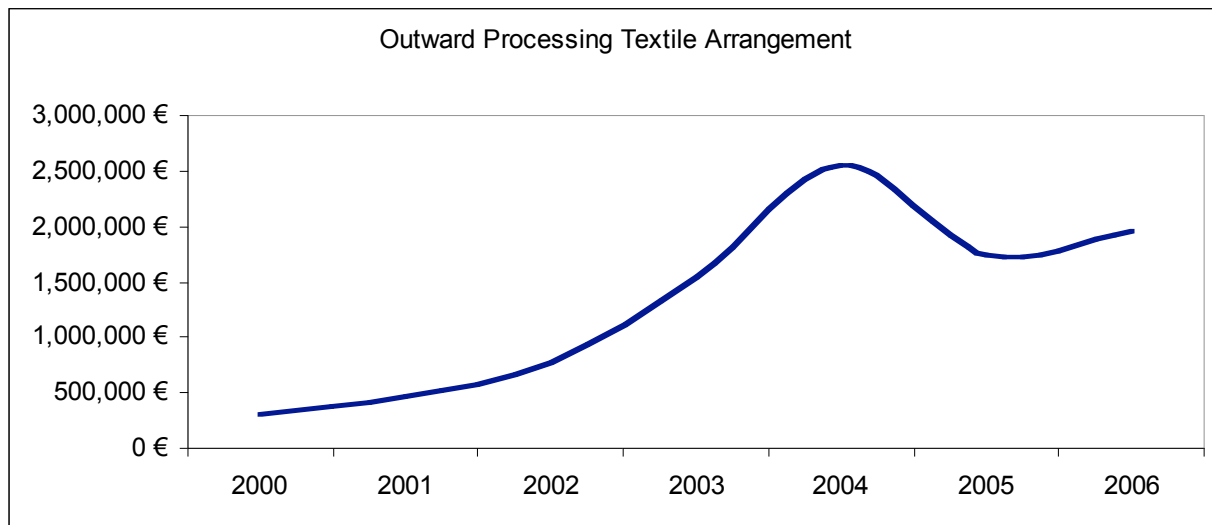


Source: WITS, Comtrade, Values are in \$ ,000s  
 \*Textiles identified under SITC rev 3 26, 65 and 84



Trade relations between the EU and other trading partners with respect to textiles have been contentious, however, under the EU-Egypt AA there are provisions to remove all existing tariffs and quotas on textiles. This may give Egyptian textile exports an advantage with respect to other partners under the post Multi-Fiber Agreement (MFA). Also noteworthy is the specific arrangements governing outward processing of textiles<sup>13</sup>. This enables European companies to export textile products to certain countries for processing in view of re-importing them, thus avoiding any tariff or quota. Effectively, outward processing attributes national status to a product given it satisfies some pre-set conditions. Figure 2.16 investigates the evolution of use of Outward Processing Arrangements of Textiles (OPAT) between the EU and Egypt.

**Figure 2.16: Evolution of Outward Processing Textile Arrangement between EU and Egypt**



Source: EUROSTAT, Comext

We perceive an important increase in the use of the OPAT peaking in 2004 (removal of MFA and beginning of AA). This can be explained by the fact that the textiles and ready made garments exports were constrained by quota system in the EU. Hence their removal when accompanied by preserving the preference of margin (being shielded from other competitors, such as Bangladesh, Pakistan, and India due to the presence of tariffs) implies a significant increase in exports, especially when accompanied by generous export subsidies from the Government of Egypt to this sector.

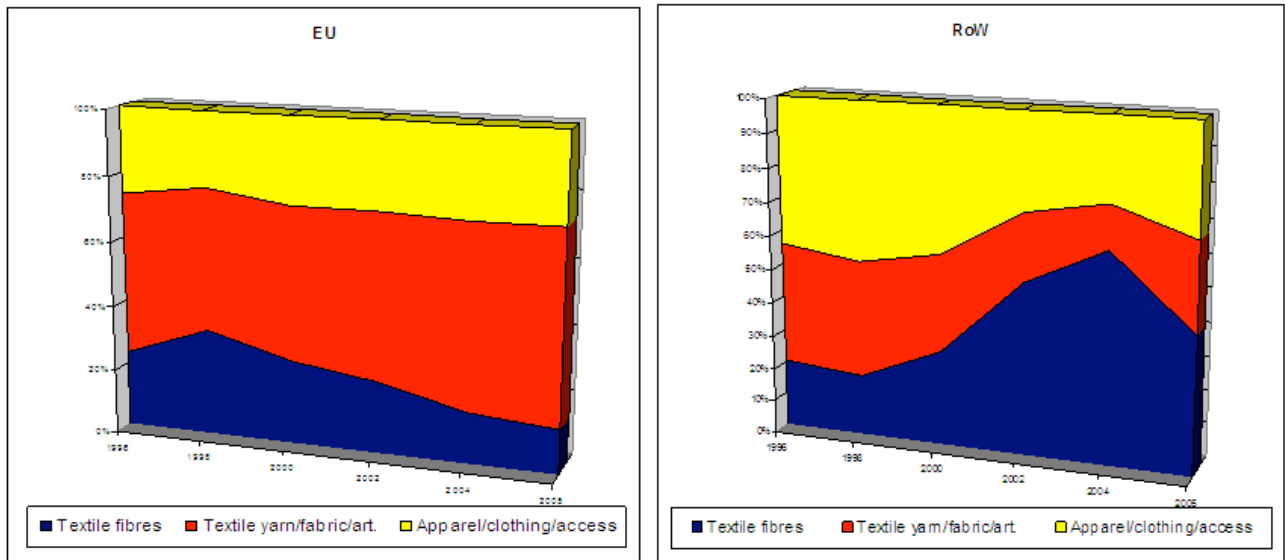
Figure 2.17 disaggregates the textile and clothing sector into three broad categories and investigates the evolution of exports to both the EU and the ROW. This exercise is carried out given the sensitivity of said sector. The three categories are SITC rev 3 sectors<sup>14</sup> are Textile fibres; Textile yarn, fabrics; and Articles of apparel and clothing accessories.

<sup>13</sup> COUNCIL REGULATION (EC) No 3036/94: “establishing economic outward processing arrangements applicable to certain textiles and clothing products re-imported into the Community after working or processing in certain third countries”

<sup>14</sup>

- Sector 26 **Textile fibres** (other than wool tops and other combed wool) and their wastes (not manufactured into yarn or fabric): Including, silk; cotton; Jute and other textile bast fibres; Vegetable textile fibres; Synthetic fibres suitable for

**Figure 2.17: Exports of textile and clothing to EU and RoW 1995-2005**



Source: COMTRADE, WITS

Figure 2.17 shows that exports to the EU are largely dominated by textile yarn/fabric articles showing an increasing share in total exports of textile and clothing products throughout the sample period. This increase seems to be to the detriment of textile fibres. Exports to the ROW grouping appear to be less stable throughout the period investigated, with the 2005 share being largely concentrated in textile fibres. This exercise shows us the difference in types of exports between the EU and the ROW. We note that exports of textile and clothing towards the EU greatly differ from those towards the ROW. This leads us to conclude that there maybe differing behind-the-border measures that impede Egyptian exports to the EU being similar to those to the ROW.

## 2.3 Deep Integration

spinning; Other man-made fibres suitable for spinning; waste of man-made fibres; Wool and other animal hair (including wool tops); and Worn clothing and other worn textile articles.

- Sector 65 **Textile yarn, fabrics, made-up articles, n.e.s., and related products:** Including Textile yarn; Cotton fabrics, woven; Fabrics, woven, of man-made textile materials; Other textile fabrics, woven; Knitted or crocheted fabrics; Tullies, lace, embroidery, ribbons, trimmings and other smallwares; Special yarns, special textile fabrics and related products; Made-up articles, wholly or chiefly of textile materials, n.e.s.; Floor coverings, etc
- Sector 84 **Articles of apparel and clothing accessories:** Including; Men's or boys' coats, capes, jackets, suits, blazers, trousers, shorts, shirts, underwear, nightwear and similar articles of textile fabrics, not knitted or crocheted; Women's or girls' coats, capes, jackets, suits, trousers, shorts, shirts, dresses and skirts, underwear, nightwear and similar articles of textile fabrics, not knitted or crocheted; Men's or boys' coats, capes, jackets, suits, blazers, trousers, shorts, shirts, underwear, nightwear and similar articles of textile fabrics, knitted or crocheted; Women's or girls' coats, capes, jackets, suits, trousers, shorts, shirts, dresses and skirts, underwear, nightwear and similar articles of textile fabrics, knitted or crocheted; Articles of apparel, of textile fabrics, whether or not knitted or crocheted, n.e.s.; Clothing accessories, of textile fabrics, whether or not knitted or crocheted (other than those for babies); Articles of apparel and clothing accessories of other than textile fabrics; headgear of all materials.

Gains from an RTA can be divided into gains from shallow integration and gains from deep integration. The previous section was largely concerned with approximating the gains arising from the removal of tariff barriers to trade (shallow integration). This section investigates the scope for dynamic gains through increased deep integration.

As previously discussed the gains from deep integration can far outweigh any gains derived from shallow integration. Deep integration positive effect arise mainly from productivity gains arising from increased cooperation between countries and can also generate positive externalities that allow for further reduction of production costs, and higher rates of growth. Deep integration can be achieved through closer institutional cooperation or through increased private sector interaction. It can foster Smithian specialisation gains that serve to increase welfare<sup>15</sup>.

### 2.3.1 Intra Industry Trade

A measure of the scope for deep integration can be estimated by investigating the evolution of intra-industry trade (IIT<sup>16</sup>). This is because a key feature of trade as economies become more deeply integrated is the rise in vertically fragmented trade – frequently within the same product category. In addition where common standards are introduced this is also likely to encourage more trade in similar products – either vertically or horizontally differentiated. IIT motivated by deeper economic integration can encourage niche specialisation, and can generate productivity gains driven by deeper integration. Table 2.12 shows the evolution of IIT between Egypt and its main trading partners. Table 2.12 reveals very low levels of IIT between Egypt and any of its trading partners. The highest levels of IIT are between the EU and Egypt standing at 0.043 in 2000 and 0.058 in 2005. These are very low though slightly rising. We also note an increase in the number of tariff lines in which there is IIT from 442 in 2000 to 593 in 2005. This small rise might indicate some moves towards deeper integration but which clearly remain extremely modest. Table 2.12 also reveals that IIT between Egypt and its Aghadir partners is very low. The amount of overlapping tariff lines goes from 2.9 in 2000 to 24 in 2005. Comparing the IIT values with FK indices calculated in Table 2.10 and 2.11 allows us to conjecture that there is little evidence of deep integration between these countries, though perhaps some scope. Tables 2.10 and 2.11 revealed high export similarity between partners (and thus high similarity in production structures), but Table 2.12 shows little degree of cooperation between Aghadir countries. Deep integration policies should seek to enhance cooperation between Aghadir countries so as to take advantage of this complementarity.

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<sup>15</sup> Smithian gains are derived from finer specialisation in different parts of the production process

<sup>16</sup> The classical measure of IIT was introduced by Grubel-Lloyd (1975) and bears the authors names; G-L index. The latter measures the overlap of imports and exports at a given aggregation level. The G-L index follows a very simple equation:

$$G - L_{ijk} = 1 - \frac{|X_{ijk} - M_{ijk}|}{(X_{ijk} + M_{ijk})}$$

Where  $X_{ijk}$  is exports from country i to country j of commodity k, M is imports with the same subscript. k is defined at the level of aggregation. The index range sin value form 0 (no IIT) to 1 (all trade IIT).

**Table 2.12: Evolution of IIT between Egypt and its main trading partners 2000-2005**

	2000		2001		2002		2003		2004		2005	
	IIT	IIT lines	IIT	IIT lines	IIT	IIT lines	IIT	IIT lines	IIT	IIT lines	IIT	IIT lines
EU-25	0.043	442	0.045	439	0.047	461	0.055	493	0.054	503	0.05819	593
EFTA	0.008	27	0.009	28	0.007	18	0.01	20	0.006	19	0.00899	34
Morocco	0.012	3	0.018	8	0.011	8	0.008	3	0.041	18	0.01196	11
Tunisia	0.022	6	0.032	11	0.014	10	0.027	11	0.023	12	0.03081	13
USA	0.02	137	0.024	135	0.027	131	0.027	129	0.021	96	0.02361	135

Source: COMTRADE, WITS

\*IIT values are calculated at 5-digit SITC rev 3 level and aggregated up.

### 2.3.2 Outward Processing Trade

Outward processing trade is also likely to be related to measures of deep integration, as it can serve as an important proxy for production sharing incentives. Existence of outward processing is evidence of inter-regional (or cross country) value chain formation. These value chains can be re-enforced considerably through deep integration, where there may be increased specialisation in tasks.

The EU allows tariff exemption under a provision known as Outward Processing Trade (an equivalent provision for the US is the Offshore Assembly Provision). Under these provisions, tariff exemption is applied for certain goods allowing temporary export of intermediate goods for processing in a foreign country followed by re-importation under partial or complete tariff exemptions.

In the EU, outward processing activities are mediated under the Community Customs Code<sup>17</sup>. Provisions exist for both outward processing and inward processing respectively known as OPX(or M) and IPX(or M). Inward processing imports, as opposed to outward processing exports as explained above, captures intermediate imports from a foreign country for home-processing with a subsequent re-export to the country of origin with tariff exemption. Processing authorisation is granted under special conditions. A particular line is created for repair of goods; otherwise goods have to undergo an economic examination before authorisation is granted. The latter evaluates possible disadvantages of foreign processing on domestic processing firms. The conditions under which outward processing may be granted are also limited by type of processing. Detailed annexes provide a list of possible processing activities covered. Outward processing takes place in 3 distinct phases.

- Community goods are exported temporarily to a territory outside the EC customs territory.
- Goods exported undergo processing
- The permit holder re-imports processed products

<sup>17</sup> COUNCIL REGULATION (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code (OJ L 302, 19.10.1992, p. 1)

Under community legislation there exists scope for full or partial relief of duties depending on the type of processing. Outward processing thus allows own nation tariff jumping and allows EU countries to take locational advantages in production. However, OPT in Egypt is of very small magnitude and represents only 0.11% of all imports. For some product lines it represents a large majority of imports. Table 2.13 shows that 74.27% of imports of product 870600 (Chassis with fitted engines) falls under OPT. We further calculate regional RCAs so as to investigate if the EU is importing goods from Egypt at a higher proportion than from the rest of the world. As can be seen some of these sectors benefit from a revealed comparative advantage.

**Table 2.13: OPT with Egypt 2005**

Product	OPT 000€	OPT share in imports from Egypt	Regional RCA	share of Egypt imports in total EU imports
870600:CHASSIS FITTED WITH ENGINES	4369.24	74.27%	2.0051	1.51%
870210:MOTOR VEHICLES FOR THE TRANSPORT OF >= 10 PERSONS	430.52	4.91%	1.3572	1.02%
846299:PRESSES, NOT HYDRAULIC, FOR WORKING METAL	368.95	28.05%	0.5356	0.40%
853932:MERCURY OR SODIUM VAPOUR LAMPS; 845229:SEWING MACHINES, INDUSTRIAL TYPE	296.65	27.55%	0.8106	0.61%
870899:PARTS AND ACCESSORIES, FOR TRACTORS	157.85	3.08%	4.0044	3.02%
844712:CIRCULAR KNITTING MACHINES	152.86	0.31%	0.6183	0.47%
853931:DISCHARGE LAMPS, FLUORESCENT, HOT CATHODE	150.09	2.20%	4.5764	3.45%
853650:SWITCHES FOR A VOLTAGE <= 1.000 V	139.21	7.67%	1.3911	1.05%
853922:FILAMENT LAMPS OF A POWER <= 200 W	121.9	2.37%	0.5394	0.41%
	119.71	9.96%	1.3416	1.01%

Source: Eurostat, COMEXT

Table 2.13 reveals negligible OPT, this could be the result of either very low tariff barriers in the given sectors which reduce the need to apply for OPT concessions or a very low integration of production structures between Egypt and the EU. Given the low levels of both F-K indices (tables 2.10 and 2.11) and IIT (table 2.12) between the EU and Egypt we can conclude that there appears to be very little in the way of production sharing.



## **Chapter Three**

### **Agriculture and Deep Integration**

**Dagmar Hertova,  
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## Introduction

The EU calls upon its partners in trade agreements to adopt EU standards in the hope that goods can flow more freely between the markets and it is hoped that an upgrading of output quality can be achieved in partners such as Euromed.

The Association Agreement (AA) between EU and Egypt was signed in 2001 and entered into force on 1.6.2004. The core of the AA is the establishment of a Free Trade Area (FTA) between Egypt and EU which ensures reciprocal tariff liberalization for industrial goods, with limited liberalization in the area of agriculture (where further liberalization is to be negotiated five years after entry into force of the agreement). The AA also called for the abolition of quantitative restrictions and comparable measures. However laws relating to technical standards became very loosely worded in the Association Agreements between EU and South Mediterranean countries and in the case of Egypt call only for cooperation (EU-Egypt Association Agreement Art. 47). This situation where EU is continuously introducing new technical requirements and Egypt is lacking the capabilities to adopt these measures is ultimately likely to result in negative effect on Egypt's export market to the EU (Kheir-El-Din and Ghoneim, 2005). As we shall see, the 2007 Action Plan reflects caution with respect to Egypt's ability to adapt, more than the urgency of the need to adjust.

We investigate in this chapter whether deep integration is needed to enhance market access of Egyptian exports in the EU or not, and if needed what kind of deep integration is needed following the conceptual framework identified in *Chapter One* of the report. We analyse the trade flows to see how far the FTA has itself been a help.

### 3.1 Standards related to Agriculture in the context of EU-Egypt Association Agreement

The Egypt-EU AA has very soft commitment on mutual recognition of conformity assessment. Harmonisation of standards and regulations alone is not enough to open markets and mutual recognition of another state's conformity assessment is much more difficult. For a country to establish conformity assessment procedures it must first have the capacity to *accredit* its testing laboratories. Many countries in the developing world do not have labs offering this higher level of capability. Egypt has made some progress in this area, but still has a way to go.

In the area of agricultural trade these issues are becoming progressively more significant. Quite apart from the temptation to use technical barriers as a substitute for classic protectionism, both market forces and technology are driving standards higher. Consumers want safer food and technology is constantly making it easier to detect traces of contaminants, hence making it harder to get food products accepted.

Norms are constantly tighter: for example Maximum Residue Levels (MRLs) of pesticides have become more demanding as hazard awareness and detection of traces of pesticide becomes easier. Conformity is all the harder especially when regulations require no detectable quantity,



fixed at Level of Detection (LOD). Moreover new norms are process and traceability related and depend not on being able to get your goods past inspectors at the docks but on being able to prove that every step in the production process satisfies certain Quality Assurance norms.

For Egypt to export agricultural goods to the EU, it must comply with EU rules and requirements of the European Food and Safety policy. Potato growers in Egypt are faced with the Brown Rot disease for many years now and policies were put in place to only allow potatoes coming from 'pest free areas' to be exported to the EU and only five interceptions are allowed per season. In the last two seasons (2004/2005 and 2005/2006) there were 14 and 11 interceptions respectively recorded in the EU (European Commission's Delegation to Egypt, 2007). The monitoring system in place is not working properly, since infected potatoes should be stopped in Egypt, but in fact they are being intercepted at the ports of entry into the EU. All over Middle East and Africa accreditation and testing and certification capacity is very limited. The challenge is to create economic cooperation agreements that actually allow partners to produce goods that can be sold in the EU.

### **3.2 Progress undertaken by Egypt in the area of Standards related to Agriculture**

Egypt has local offices of international testing certification and accreditation organisations but we (University of Sussex, unpublished) found that as of summer 2004 there has been very little progress in getting internationally recognised accreditation by local organisations. Also, mutual recognition of local conformity assessment procedures in Egypt has not made any progress. A crucial bottleneck is the lack of accreditation procedures. Exporters have to rely either on international standards consultancies or on inspection at the point of import which runs the risk of entire consignments being rejected.

Since then, the Egyptian Organization for Standardization & Quality has implemented a project to harmonise all existing Egyptian standards with international and European standards. Currently, more than 4600 standards were harmonised, with the target of harmonising the remaining standards by the end of 2007 (Eisa, 2007). The Egyptian harmonised standards cover areas of food, engineering, chemical, and textile industries.

The Egyptian Accreditation Council (EGAC) has become a member of the International Accreditation Forum (IAF) and has successfully passed International Laboratory Accreditation Cooperation (ILAC) evaluation for full membership. EGAC is now recognised as an independent body and the single accreditation body in Egypt. Egypt has now accredited more than 150 testing and calibration laboratories to international standards ISO 17025 through EGAC and about 300 are in different stages of qualification and accreditation. 2 certification and inspection bodies are accredited according to ISO 17021 and ISO 17020 respectively, with further 5 and 4 bodies currently in the accreditation process (Eisa, 2007).

Databases of accredited conformity assessment bodies and certification bodies have been developed and are made available to Egyptian industrial community and companies. Efforts are currently being made to reform Egyptian conformity assessment scheme to comply with the

world's best. Also restructuring of the regulatory and conformity assessment bodies in order of separating regulatory, standardisation, accreditation and certification functions to avoid conflict of interest and overlapping and duplication of services is under review.

Even despite all the progress made by Egypt in these areas, technical assistance is still much needed in order to create market surveillance system based on the European experience, establish notification system, set up and/or approximate Egyptian technical regulations in the context of European New Approach directives, and to support awareness and capacity building.

### **3.2.1 SPS barriers still facing Egyptian exports**

Egypt has also requested technical assistance to meet many of the strict sanitary and phytosanitary (SPS) requirements that are enforced by the EU as necessary when accessing the EU markets and that sometimes even go beyond the standards of both IPP and CODEX (Ministry of Trade and Industry, unpublished).

The recent Action Plan identifies these issues but proposes few concrete steps beyond EU-Egypt cooperation in this field. As we noted above there has been very limited progress on conformity assessment, despite some advance in securing accreditation for Egyptian laboratories. The hurdles are set to remain high.

In this section we first enumerate the key problem areas as seen from the Egyptian perspective and then we look at the apparent trade consequences of some of these measures. The purpose of this section is not to debate whether the EU measures are really necessary or whether they are being applied unduly strictly, but to highlight the areas where action of some sort is needed, action that in our reading of the Action Plan is foreseen but not forthcoming.

### **3.2.2 Barriers facing Egyptian exports as identified by the Government of Egypt<sup>1</sup>:**

#### **A) Pesticides Residues:**

- The EU applies strict rules that control agricultural and processed agricultural products' pesticides residues (Minimum residues level "MRL") as a pre-requisite for accessing the EU markets.
  - In order to export exporting dairy products and **white honey**, the EU requires third countries to prepare a national plan on pesticides' residues and heavy elements (by distributing questionnaires). Egypt has requested technical assistance in this regard.

#### **B) Animal products:**

- Specific EU requirements, regarding white and natural honey, are specially applied on the assortment of honey and apiaries.
- In addition, the EU does not file Egypt on the list of countries permitted to export some animal products such as *thermally treated poultry, dairy products, fishery products, honey and table-eggs*, so Egypt should request from the EU side to be listed as one of the countries to be permitted to export some of these products and to be provided technical assistance, as well, in this regard.

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<sup>1</sup> Source: Ministry of Trade and Industry, unpublished data

### **C) Fisheries:**

- A ban has been already enforced on Egypt's fishery exports since 1999. The commission's decision of 23 December 2003 laying down the special conditions that should govern imports of fishery products from Egypt was then issued lifting the previously mentioned ban by January 2004, where 1 company has been permitted to export fishery products to the EU. Now, they reached 6 companies exporting fishery products to the EU.

### **D) Agricultural products:**

#### **Potatoes:**

A specific system for exporting Egyptian potatoes is laid down by the EU where imports are banned if more than 5 cases of brown rot potatoes are discovered in the shipments or consignments. The Egyptian side is requesting to re-consider the current system.

#### **Peanuts:**

The European Commission suspended the peanuts imports from Egypt due to the presence of aflatoxin in concentrations in excess of maximum levels specified in EU regulations. At the same time, this level of concentrations is less than the permitted level according to CODEX. Egypt requested technical assistance from the EU in this regard.

#### **Other agricultural products**

Sanitary authorities in the EU member states rejected a number of Egyptian agricultural consignments such as oranges, coriander seeds, red pepper, onions, jams, honeybee, dried kernel, rice contaminated with aflatoxins, fungus, salmonella, microbiological contamination, food additives, heavy metals, veterinary medicinal products or pesticide residues. Egypt has requested technical assistance on this regard.

### **E) Rapid alert system:**

The EU sends notifications to all EU member states to stop shipments from violating countries before even assessing real violations for consignments exported from Egypt.

### **F) The Eurepgap:**

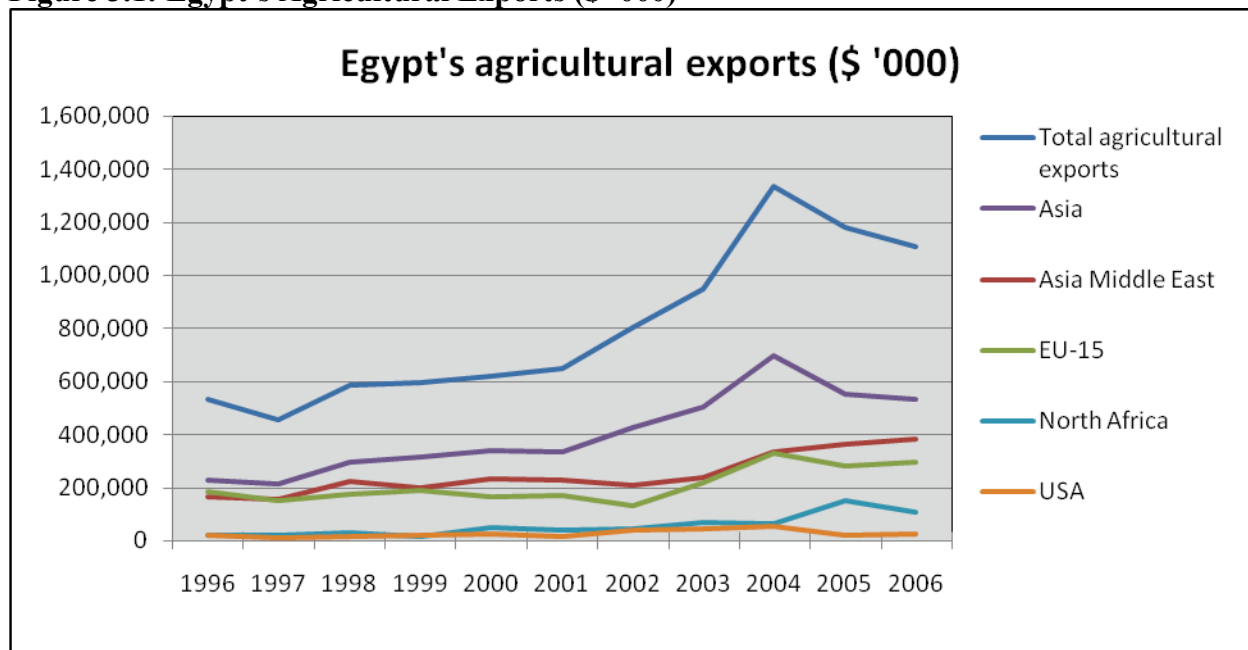
The Eurepgap certificate is considered as one of the most important certificates required by the EU for agricultural products to access its market, although it's quite expensive. In addition, this certificate is requested annually by the EU and almost for each crop.

## **3.3 Quantitative Assessment of the Performance of Egypt's Agricultural Exports to the EU and Rest of the World**

The first striking fact seen from figure (3.1) is the decline in the share of the EU in Egyptian exports in the late 1990s and early 2000s. The 1990s onwards have seen a rise in Egyptian agricultural exports, but a decline in the share of agricultural exports to the EU. The share of the EU in Egypt's agricultural exports has fallen from 34.3% in 1996 to just 16.2% in 2002

(Authors' calculations on UN COMTRADE data). This fall seems to be compensated for by the rise in exports to Asia and to some extent North Africa and the USA. The overall 2005 decrease in Egypt's agricultural exports was also reflected in a fall in exports to the EU. An opposite effect was however observed in the case of Asia Middle East and North Africa as Egypt's agricultural exports to these regions kept rising in 2005. The question here is why despite successful Free Trade Agreements is Egypt not selling more to the EU?

**Figure 3.1: Egypt's Agricultural Exports (\$ '000)**



Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)

We provide a comparative analysis of potatoes, onions, rice and cotton, as these are the most important crops that Egypt exports to the EU. During the period 1991-2003 these constituted 53.1% of total Egyptian agricultural exports (Shafik and Soliman, 2006).

**Table 3.1. Revealed Comparative Advantage of Selected Agricultural Products**

Code	Product	RCA 1996	RCA 2005
070190	Potatoes, not seed	185.14	78.11
070310	Onions and shallots	4.46	34.16
100610	Rice in the husk (paddy or rough)	17.64	7.64
100620	Husked (brown) rice	26.67	146.90
100630	Semi-milled or wholly milled rice,	12.03	27.03
100640	Broken rice	2.96	63.52
520100	Cotton, not carded or combed.	36.16	33.60
520210	Yarn waste (including thread waste)	112.08	2.25
520300	Cotton, carded or combed	23.73	3.07

Source: Authors' calculations of revealed comparative advantage on United Nations Commodity Trade Statistics Database (UN COMTRADE) data

$RCA = ([x_{ie}/\sum x_{ie}]/[x_{iw}/\sum x_{iw}])$ , where the first term is the export share of product i in total exports of Egypt and the second term is the export share of product i in total world exports.

Revealed Comparative Advantage (RCA) here is calculated as the share of Egypt's exports of a product over the share of total world's exports of this product. Potatoes had the highest RCA in 1996, which has decreased substantially since then, while the exports of potatoes to the EU have been fluctuating. The RCA for onions was higher in 2005 than in 1996 and its exports, as well as rice exports, have increased as compared to 2005. The fall in RCA of paddy rice has been compensated for by the increased in RCA of other types of rice. All types of cotton have experienced a fall in its RCA since 1996, but its exports have been largely fluctuating over the period. Thus we can conclude that analysing RCAs of these products is not a good indicator of predicting the performance of exports in the future.

**Table 3.2. Egypt's Exports of Selected Agricultural Products to EU-15 (\$ '000)**

Year	Potatoes (HS 070190)	Onions (HS 070310)	Rice (HS 1006)	Cotton (HS 5201-5203)
1996	69,080	1,886	3,364	27,200
1997	33,465	2,553	409	49,517
1998	35,881	5,037	3,516	68,256
1999	38,369	1,836	2,195	88,254
2000	20,844	1,987	1,110	68,565
2001	23,550	2,792	6,204	59,836
2002	35,133	3,808	5,818	80,082
2003	30,623	5,194	6,877	71,021
2004	49,614	5,927	13,072	79,065
2005	60,997	4,287	13,007	19,474
2006	48,266	6,205	23,459	20,879

Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)

The Rapid Alert System for Food and Feed (RASFF) provides information on measures taken to ensure food safety. Two classifications of notifications appear in the RASFF. Alert notifications include foods that are already in the market and where immediate action is required. Egyptian products were mostly in the second category, information notifications, which include food for which risk has already been identified and which have not reached the market. For all notifications, consumers can be assured that products have already been or are in the process of being withdrawn from the market or that all necessary measures have already been taken (EU RASFF).

In the last four years there was one notification reported by the RASFF for each, onions and rice originating in Egypt. Both occurred in early 2006 and did not seem to halt the steady increase of Egyptian exports of these goods into the EU-15 as seen Table (3.3)

**Table 3.3. RASFF Notifications for Onions and Rice**

Date	Reporter	Product	Country of origin
28/03/2006	Finland	prophenophos in fresh spring onions	EGYPT VIA THE NETHERLANDS
21/02/2006	Poland	foreign body in white broken rice	EGYPT

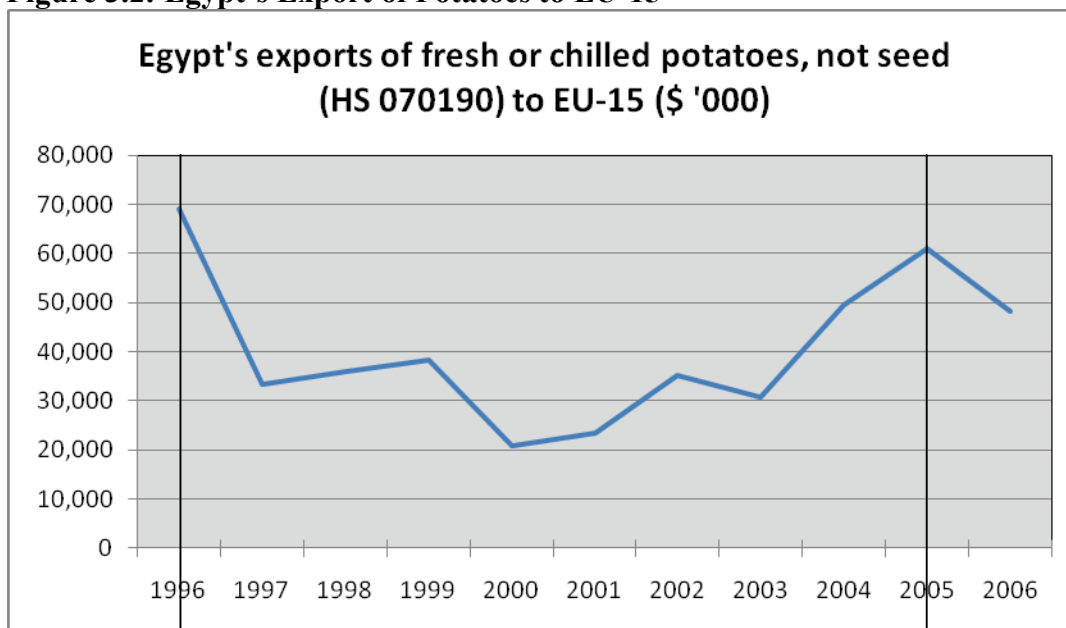
Source: EU Rapid Alert System for Food and Feed, RASFF (weekly overviews)

## **Potatoes**

In 1996 Brown Rot disease was found in Egypt and a 1996 EU directive was introduced on the import of potatoes from Egypt and further tightened in 1998. Measures were further tightened in 2000. In 2005, further measure was introduced. In the last two seasons (2004/2005 and 2005/2006) there were 14 and 11 interceptions respectively recorded in the EU (European Commission's Delegation to Egypt). As the figure and table below show, the introduction of these measures, especially those in 1996 and 2005 and the large number of interceptions due to Brown Rot coincides with a notable drop in Egyptian agricultural exports.

Egyptian top 5 export markets for new potatoes in the period of 1996-2006 were Germany, Greece, United Kingdom, Italy and Lebanon. United Kingdom for example has however become substantially less important for Egypt over the years; in 1996 the trade value of new potatoes exported to the UK was \$18,644,000, while in 2006 it was only \$3,556,000 (UN COMTRADE). As seen in table (3.4), while the EU is still main buyer of Egyptian potatoes, new markets have been opening up in recent years, most importantly Russia and Ukraine, but also countries like Romania and Tunisia.

**Figure 3.2: Egypt's Export of Potatoes to EU-15**



Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)

By Decision 96/301/EC of May 3, 1996 the European Commission (EC) imposed a series of restrictions on imports of potatoes from Egypt.

Decree 757/2005 allows export of potatoes only to companies that exported to the EU an amount not less than 4000 tons during last season and limited to a quantity not exceeding those that were exported last season.

**Table 3.4. Egypt's Export of Potatoes (HS070190)**

Year	EU-15	Lebanon	Russian Federation	Ukraine	Romania	Oman	Tunisia	World
1996	69,080	5,704	179	0	975	0	0	79,828
1997	33,465	5,142	26	0	380	0	0	41,229
1998	35,881	5,079	0	0	365	0	163	43,149
1999	38,369	3,383	0	0	3	30	0	46,033
2000	20,844	4,690	0	0	0	172	52	26,643
2001	23,550	5,069	0	15	0	122	0	29,632
2002	35,133	4,885	284	6	406	367	0	42,614
2003	30,623	5,057	3,440	18	1,336	267	0	43,937
2004	49,614	5,867	4,155	0	1,312	257	3,025	67,043
2005	60,997	7,156	5,073	276	793	309	653	77,122
2006	48,266	2,427	9,429	1,174	395	189	515	65,084
<b>Total</b>	<b>445,822</b>	<b>54,459</b>	<b>22,586</b>	<b>1,489</b>	<b>5,965</b>	<b>1,713</b>	<b>4,408</b>	<b>562,314</b>

Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)

### **Peanuts**

The European Commission suspended peanuts imports from Egypt due to the presence of aflatoxin in concentrations in excess of maximum levels specified in EU regulations (Ministry of Trade and Industry, unpublished). At the same time, this level of concentrations is less than the permitted level according to CODEX. Egypt has requested technical assistance from the EU in this regard.

Sanitary authorities in the EU member states rejected a number of other Egyptian agricultural consignments such as *oranges, coriander seeds, red pepper, onions, jams, honeybee, dried kernel, rice* contaminated with aflatoxins, fungus, salmonella, microbiological contamination, food additives, heavy metals, veterinary medicinal products or pesticide residues (Ministry of Trade and Industry, unpublished).

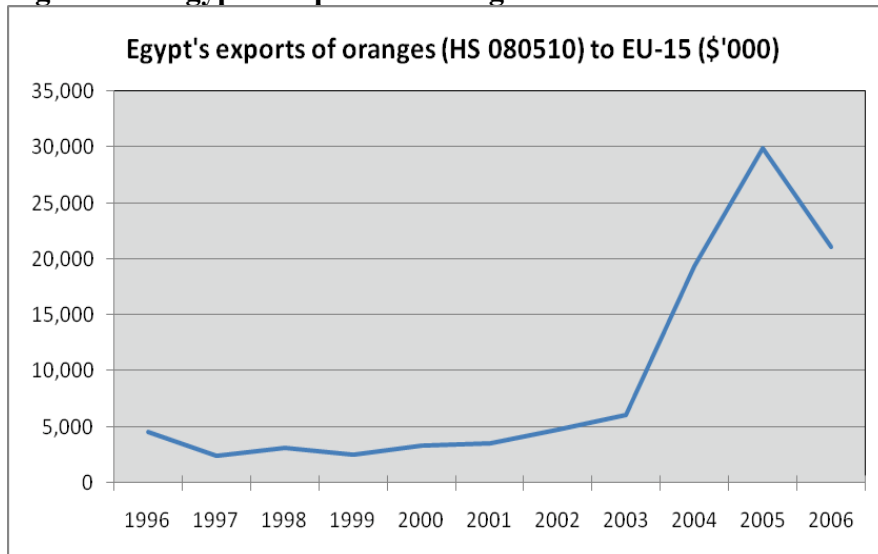
In mid-2005 and early 2006, there have been altogether 3 notifications by the RASFF informing of chemicals in oranges from Egypt, compared to just one notifications before 2005. These interceptions coincide with the fall in exports of oranges from Egypt in 2006.

**Table 3.5. RASFF Notifications for Oranges from Egypt**

16/05/2007	2007.BEN	fenitrothion in oranges	EGYPT
27/03/2006	2006.AUF	Phenthoate on oranges	EGYPT
15/02/2006	2006.ALD	prophenophos in oranges	EGYPT
15/06/2005	2005.BPY	Dimethoate in oranges	EGYPT
01/07/2004	2004.BML	Dimethoate in fresh oranges	EGYPT

Source: EU Rapid Alert System for Food and Feed, RASFF (weekly overviews)

**Figure 3.3: Egypt's Export of Oranges**



Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)

We have also looked at a number of other products affected by RASFF notifications (see appendix). Without further information it is difficult to identify underlying trends. We do note that there has been spectacular and fairly uninterrupted rise in some new products despite SPS problems, notably grapes and strawberries.

We were unable to make comparisons with the US market. Egyptian agricultural exports to the USA are very small in comparison to exports to the EU; when comparing EU and USA interceptions, different products are being stopped in the EU and in the USA. One product that has been stopped in both is basil for the reason of contamination by salmonella. It was intercepted in the USA in February 2007 and in the EU in June 2007 (EU RASFF, U.S. Food and Drug Administration).

The 2007 Action Plan recognises the need to move further in the direction of approximating standards but in fact in section 2.1.2d, the commitment is merely to "identify and adopt" measures necessary for this purpose as no concrete actions or priorities are highlighted. It is therefore clear that what came in the Action Plan does not really go beyond the AA. It seems that Egypt was very concerned about the costs of speeding up the harmonisation or approximation process of standards for domestic as well as exporting farmers, and it seems that this is why Egypt mainly focused on enhancing the cooperation with the EU and receive some technical assistance in that regard.

Egypt has made considerable progress in aligning its mandatory standards in the field of agriculture with international standards (ISO etc). But Egypt has not started the approximation process with the EU in the fields of agricultural or processed agricultural products, since it was previously agreed during the negotiations process that Egypt would only start the approximation process when the EU itself is totally finished with the simplification process for its own Agricultural and Processed agricultural products standards system within the context of the EU new approach system. This would require substantial technical assistance. Moreover, Egypt has some reservations about making EU standards mandatory in cases where they are more



demanding than ISO or Codex rules, which is not only cost increasing but potentially discriminatory where imports are involved.

In the meantime Egyptian farmers who do wish to export to the EU are faced with the need to demonstrate compliance with EU public and private requirements which go beyond international requirements including HACCP and Eurepgap norms. Certification of conformity is costly and requires inspection from abroad as there are no Egyptian laboratories accredited to do this. Egypt has not been able to secure technical assistance for this.

## **Conclusion**

Egypt is committed to eventually aligning its SPS norms to EU standards, but despite the FTA there is limited progress in securing EU recognition and exports have stagnated. The largest single agricultural export potatoes is still subject to SPS barriers that clearly affect trade and the same is true of oranges (also facing a barrier related to the EU entry price system). We should be aware however that Egyptian trade is diversifying both in terms of new products and new markets. The products with the highest RCA in the 1990s were not necessarily the ones where growth was fastest. And the EU market has not been the fastest growing. The potato example shows that Egypt's ability to comply with EU regulations can have major effects on major trade flows. And failure of agricultural exports to the EU to rise much since the mid 1990s suggests that the integration process has delivered modest benefit. However the striking rise in exports to Asia and Russia, as well as the drop there in 2005 shows that Egyptian agricultural trade is not solely affected by what happens in the EU.

Earlier work (Mandour, 2006) has shown that learning how to comply with EU norms does not make it harder for agricultural producers to satisfy demands of other markets. It is likely that enhanced compliance with EU norms will increase global competitiveness.

The overall policy implication is not entirely evident. There has been some progress in moving towards mutual recognition of testing and certification and it remains the ultimate aim. However it is likely to be fraught with difficulty and key issue seems to be the necessity of individual farmers and perhaps regional entities to ensure the upgrading of quality to meet the demanding standards of the EU which capacity is likely to promote access to other important markets too. Ultimately the solution for market access will remain problematic until Egyptian agriculture is ready to harmonise its standards with those prevailing in the EU, initially for those producers involved in exports but eventually for the entire sector.

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EU Egypt Action Plan

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EUROPA - Food Safety - Rapid Alert System for Food and Feed

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## Appendix 1: Commodities Reported by the RASFF

**Table 3.6. Alerts and Notifications Including Egypt for the Year 2007**

Date	Type	Country	Ref	Description	Country of Origin
11/07/2007	Info	The Netherlands	BRW	methomyl (0.83 mg/kg - ppm) in fresh seedless grapes product already consumed / no stock left	EGYPT
20/06/2007	Alert	Belgium	2007.0407	Salmonella in basil distribution on the market (possible) / withdrawal from recipient(s)	EGYPT
05/06/2007	Info	United Kingdom	BJL	aflatoxins (B1 = 9.2; Tot. = 10.7 µg/kg - ppb) in sunflower seeds distribution restricted to notifying country / product (to be) destroyed	EGYPT
04/06/2007	Info	Italy	BIT	aflatoxins (B1 = 44.59 µg/kg - ppb) in white sunflower seeds	EGYPT
25/05/2007	Info	Belgium	BGX	aflatoxins (B1 = 0.07 µg/kg - ppb) in white sunflower seeds no distribution / product (to be) re-dispatched	EGYPT
16/05/2007	Info	Italy	BES	unauthorised colours Sudan 1 (605 mg/kg - ppm) and Sudan 4 (498 mg/kg - ppm) in ground red hot chilli no distribution / product (to be) re-dispatched	EGYPT
16/05/2007	Info	Lithuania	BEN	fenitrothion (0.12 mg/kg - ppm) in oranges no distribution / product (to be) re-dispatched	EGYPT
14/05/2007	Info	Poland	BDH	bovine protein in salted hog casings no distribution / product (to be) re-dispatched	EGYPT
08/05/2007	Alert	The Netherlands	2007.0318	oxamyl (0.57 mg/kg - ppm) in organic cucumber distribution on the market (possible)	EGYPT
17/04/2007	Alert	Slovenia	2007.0275	abnormal smell of mashed dates without stones distribution on the market (possible) / destination of the product identified	EGYPT
03/04/2007	Info	Greece	AVS	chlorpyrifos and prophenophos in dried basil	EGYPT
03/04/2007	Info	Italy	AVR	aflatoxins in peanuts in shell	EGYPT
05/04/2007	Info	Hungary	AWI	methomyl in peppers	EGYPT
30/03/2007	Info	Hungary	AWG	methomyl in peppers	EGYPT
20/03/2007	Info	Italy	ARZ	bad state of preservation of artichoke	EGYPT
15/03/2007	Info	Spain	ARA	unauthorised colour Sudan 1 in chilli powder	EGYPT
09/03/2007	Info	Belgium	APS	aflatoxins in white sunflower seeds	EGYPT
27/02/2007	Info	Greece	AMS	aflatoxins in groundnut kernels	EGYPT
22/01/2007	Info	Cyprus	AEK	methomyl in fresh strawberries	EGYPT
17/01/2007	Info	Italy	ADL	aflatoxins in peanuts with shell	EGYPT
19/01/2007	Info	Greece	AED	aflatoxins in groundnuts in shell	EGYPT
12/01/2007	Info	Italy	ACQ	aflatoxins in peanuts in shell	EGYPT
12/01/2007	Info	Italy	ACF	aflatoxins in peanuts with shell	EGYPT
12/01/2007	Info	Italy	ACE	aflatoxins in peanuts with shell	EGYPT
03/01/2007	Info	Cyprus	AAQ	aflatoxins in groundnuts in shell	EGYPT

**Table 3.7. Other Agricultural Goods Reported by the RASFF Due to SPS Problems Since 2003**

Commodity	Groundnuts	Fresh	Strawberries	Grapes	Sunflower	Cucumber	Artichoke	Fennel

HS Code	120210	070960	081010	080610	120600	070700	070910	090950
RASFF notifications	Multiple times each year since 2003	02/2004	02/2007 01/2007	07/2007 07/2004	06/2007	05/2007	03/2007	12/2004
Export (\$'000)								
1996	1,200	0	28	755	1,251	38	260	1,769
1997	1,413	0	13	385	1,282	34	791	953
1998	758	0	20	337	1,371	81	307	647
1999	281	0	124	349	1,248	65	241	592
2000	830	0	38	1,033	1,493	26	1,037	746
2001	723	0	143	1,144	1,366	12	234	525
2002	1,366	0.7	267	1,621	1,874	22	769	558
2003	1,830	0	591	2,239	1,891	19	1,554	605
2004	4,745	56	792	10,014	2,620	62	4,206	997
2005	2,715	2	417	15,327	1,799	92	7,684	768
2006	1,622	7	1,967	19,127	2,074	144	8,144	1,049

Source: EU Rapid Alert System for Food and Feed, RASFF (weekly overviews)  
United Nations Commodity Trade Statistics Database (UN COMTRADE)

**Table 3.8. All Products Reported in RASFF Since 2003**

Artichoke	Fresh spring onions	Organic basil and calendula
Basil	Frozen octopus vulgaris	Organic cucumber
Bitter almonds	Frozen strawberries	Organic herbs
Black olives	Green tea	Organic paprika powder
Broken white rice	Ground chilli	Oriental spice mixture
Chilli powder	Ground paprika	Peanut kernels
Corriander seeds	Ground red hot chilli	Peanuts
Crushed hot chilli peppers	Groundnut kernels	Peanuts in shell
Crushed senna	Groundnuts in shell	Peppers
Crushed spearmint	Groundnuts without shell	Roasted peanuts in shell
Curry and hot pepper (powder)	Halawa and tahyma (sweets)	Rosemary
Date jam	Hot pepper powder	Salted hog casings
Dried basil	Mango nectar	Sesame seeds
Dried hibiscus flower	Marjoram	Soft drink
Dried maligold flower	Mashed dates without stones	Spearmint leaves
Fennel seed	Minced chilli	Spicy pepper
Fig Jam	Natural Bottled water	Strawberries
Fresh peppers	Natural honey	Sunflower seeds
Fresh seedless grapes	Oranges	Sweet pepper

Source: EU Rapid Alert System for Food and Feed, RASFF (weekly overviews)

## Appendix 2: Commodities Not Reported by the RASFF

We have selected commodities that are among the top 20 exports but have not been reported by the RASFF. Fresh beans and peas belong to the top 20 exports of raw commodities and olives and cane molasses belong to the top 20 exports of processed commodities as in 2006.

**Table 3.9. Commodities Not Reported by the RASFF**

<b>Commodity</b>	<b>Fresh beans</b>	<b>Peas</b>	<b>Prepared Olives</b>	<b>Cane molasses</b>
HS Code	070810	070810	200570	170310
Export (\$'000)				
1996	1,649	146	76	2,226
1997	802	45	64	1,232
1998	1,290	63	21	2,777
1999	756	77	220	3,554
2000	1,129	47	535	4,678
2001	1,233	35	554	13,402
2002	1,500	45	936	17,927
2003	1,640	60	1,171	18,731
2004	3,940	159	585	26,723
2005	4,685	109	437	28,527
2006	9,636	398	76	19,442

Source: United Nations Commodity Trade Statistics Database (UN COMTRADE)



## **Chapter Four**

### **Competition**

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<sup>1</sup> The author would like to acknowledge Malcolm Ross, Professor of European Law, University of Sussex, for providing comments on an earlier draft of this chapter.

## Introduction

There has been debate in Egypt, as well as other developing countries, on the need for a competition policy as opposed to merely a competition law. It has been argued that competition law would not be functional in the absence of other important pillars of competition policy (e.g. liberal trade policy, efficient tax and investment policies, etc.); hence a competition law alone would not function properly (Ghoneim, 2002). Another point of view argues that a competition law is needed regardless of the availability of other pillars of competition policy, and that through learning by doing, the law would be able to function better. Egypt opted for introducing the competition law in 2005 by which time not all the pillars of competition policy had been set in place. There were several reasons that could have accelerated the adoption of the law including external pressures (such as the fear of EU applying its competition law towards the Egyptian economy in relation to the trade between Egypt and the EU if Egypt does not have a law). In fact such provision was included in the Association Agreements between EU and Morocco and EU and Tunisia as well as in the Egypt-EU Association Agreement (AA)<sup>2</sup>. It has been argued that among the pressures that accelerated the introduction of competition law in Egypt, among other factors was the entry into force of the AA in 2004 (Ghoneim, 2002).

This chapter deals with the gap existing between Egypt's competition law and EU's legislations concerning competition. The chapter starts first by providing a brief review on the case of harmonizing competition laws in the context of RTAs while focusing on the EU's approach in its RTAs. The chapter then discusses in the details the differences in the two bodies of legislation dealing with dominant position, safe harbour rule, merger control, etc. Finally the chapter identifies the problems that could result from the existing gap and identifies whether deep integration is needed to overcome this problem or other form of cooperation might be appropriate in this case.

### 4.1 Is there a need for harmonizing competition laws? A Brief Review

RTA competition provisions may take several forms depending on the degree of deepness. They range from best endeavours measures to adopt, maintain and apply competition law, to establishment of a supra national authority. There is a need to differentiate between the degree of similarity or extent of harmonization between formal texts as stipulated in RTAs and the provisions for cooperation (formal or informal) between competition authorities related to the countries which are members of the RTA. It is worth noting that some experts feel that informal cooperation between competition authorities may be more effective than competition rules embedded in a RTA (Puri, 2005). The differences in competition regimes do not impede trade flows between trading partners (Rosenthal and Nicholaides, 2006). There has been no argument in the literature that promulgates that a country should introduce a similar law to the one adopted among its major trading partners.

Mohieldin (2002) argues that there should be a low common dominator that ensures that competition laws in both countries are in line with each other, but there is no need for

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<sup>2</sup> The Association Agreement between Tunisia and the EU was signed in 1995 and entered into force in March 1998 whereas the Association Agreement with Morocco was signed in 1997 and entered into force in March 2000.



harmonization. In fact, the harmonization of competition related provisions in RTAs and its positive effect on better and effective implementation of competition laws and polices and/or better cooperation schemes among competition authorities is subject to debate. The practicability of actually applying such competition related provisions faces several problems in implementation. A number of studies remain sceptical regarding this issue (e.g. Cernat, 2005; Holmes et. al, 2005; and Alvarez et. al., 2005). Other studies recommend harmonization, but argue that the approach to harmonization should be progressive to take into consideration the gap in the level of economic development between different partners and the specific economic characteristics of the partners (UNCTAD, 2007).

#### ***4.1.1 The EU Approach regarding Competition Provisions in its RTAs:***

The EU has prioritized the inclusion of competition provisions in its RTAs and focusing more on their harmonization with little effective use of such provisions in addressing anti-competitive practice abroad or cooperating efficiently to make the provisions operational (Cernat, 2005). In fact, the EU Association Agreements signed with Eastern European and South Mediterranean countries did not include explicit provisions for formal cooperation or information exchange (Holmes et. al., 2005). Some studies observed that harmonization of competition related provisions were a difficult process for countries of accession during the EU 25 enlargement. The legal and institutional setups were heralded by major difficulties during the process of harmonization (Lorentzen and Møllgaard, 2002). Yet, the EU is continuing with its policy of harmonization when entering into new RTAs. On the other hand, the EU has sought of cooperation with major trading partners that there exist no RTAs with them, notably with the United States of America (USA). Several cooperation agreements have been signed between the EU and USA to address the cross-border competition related differences, and have proved to be relatively successful so far with no further harmonization (Bertrand and Ivaldi, 2006).

From the EU perspective harmonization of competition laws with its trading partners can be viewed in the context of its general policy of harmonization of different related aspects including its adoption of Pan European rules of origin, its efforts of harmonizing standards, and maritime laws and regulations, etc. It is part of its overall general approach towards deepening RTAs, but it is specifically motivated by the EU's perception and experience that the removal of private barriers to entry was essential to complete the process of removing governmental barriers. This philosophy has driven the EU's bilateral and multilateral agenda.

#### **4.2 The Egypt-EU Association Agreement Case:**

There are two questions that should be raised in this context, what are the gaps between EU competition law and the Egyptian competition law? And where there is a gap, is there benefit from trying through legislation to narrow it down or not, if our aim is enhancing the developmental process in Egypt?

The three articles that are concerned with competition in the AA are 34, 35, and 36. Article 34 provides for the prohibition of agreements and concreted practices between undertakings that restrict or distort or threaten to distort competition, only in so far as they affect trade between the EU and Egypt. It also provides for transparency in the area of public aid. Article 35 provides that the parties to the agreement shall progressively adjust any state monopolies of a commercial

character to ensure that there is no discrimination regarding the conditions under which the goods are procured or marketed. Article 36 provides that no new measures are enacted or old ones maintained with regard to public enterprises and enterprises to which special or exclusive rights have been granted.

At the outset, such provisions give the impression that they are shallow, very general and might have a limited impact on the application of competition law in Egypt. However, a thorough analysis reveals other insights. Such provisions have created some type of *de facto imposed harmonization* of competition rules and regulations in Egypt with the European ones. A grace period of five years is given within the AA starting from the entry into force of it for application of Articles 34-36. Moreover, the rules of implementation of Article 34(1) should be adopted by a decision of the Association Council<sup>3</sup>, within five years from entry into force of the AA, which still did not take place. The implementation rules are of paramount importance since they represent the flexibility in the extent of harmonization. With their lack of adoption, any practice related to anti-competitive behaviour taking place in Egypt will be interpreted following the provisions of the EC Treaty. This implies that AA provisions have to be interpreted in conformity with the European Community's secondary legislation, the decisions of the European Commission, and the case law of the European Court of Justice ('ECJ') as well as the Court of First Instance (Geradin, 2004).

The importance of implementation rules arise from the different interpretations of the concepts contained in Article 34. The concepts and definitions have different meanings under the EU and Egyptian jurisdictions (see below). Early agreement in the Association Council on implementation rules would have clarified such differences and reached an agreed-upon interpretation for the different concepts embedded in Articles 34-36. The lack of implementation rules imply that Egypt *de facto* applies the EU competition provisions following the EC treaty.

The question that should be asked from a legal perspective is after the five years transitional period ends, what would apply? It seems that the provisions of the competition law in the AA as reviewed are modest, and that if problems related to competition happen in trade issues between EU and Egypt, then it is the EU competition law that will apply, which means a *de facto* compulsory harmonization for EU competition provisions in the Egyptian jurisdiction for whatever affects trade with the EU.

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<sup>3</sup> The Association Council is the body that oversees the implementation of the Association Agreement. It includes EU and Egyptian senior government officials.

In some occasions, on the one hand, the Association Council's decisions have had a direct effect in the EU. For instance, see Case 192/89 *Sevince* [1990] ECR 3461, as an ECJ judgment based on a decision of the Association Council of EC-Turkey Association Agreement. For more detail, see Hillion, Christophe, (2007), "Mapping-out the new Contractual Relations between the European Union and its Neighbours: Learning from the EU-Ukraine 'Enhanced Agreement'", (12), *European Foreign Affairs Review*, Kluwer Law International BV, pp,179-181. On the other hand, we have not found any legal source to suggest that the situation is the same with respect to the EU's trading partners. In other words, these decisions do not have a corresponding direct effect in the EU's trading partners and thus, could not be invoked before their competent national authorities without national implementing legislation. The Agreement with Egypt does not provide for even future discussions regarding such matter as is the case with respect to the Europe Agreement with Poland. Hence, the Association Council's decisions could not be invoked before Egyptian authorities, yet the Association Agreement itself is considered as a binding legal obligation by the Egyptian authorities.

The Action Plan has only repeated what has been mentioned in the AA:

“– Adoption of implementing rules on competition (Association Agreement, article 34.2), for which the deadline is five years after the entry into force of the Association Agreement (1/6/2009).

*Antitrust*

– Enforce the competition law in line with that of the EU and establish an independent and adequately-resourced competition authority.”

In other words, the Action Plan did not go further than what the AA reached whether in terms of cooperation or harmonization.

### 4.3 Examples of the gap between EU and Egypt Competition Laws:

#### 4.3.1 Abuse of Dominance

The EU’s treatment to abuse of dominance differs from that under the Egyptian Competition Law (‘ECL’) and its executive regulations. The EU’s approach to dominance may be reflected from its case law and subsequently, the Commission’s *Discussion Paper on the Application of Article 82 to Exclusionary Abuses* (‘Discussion Paper’). This is due to the fact that Article 82 of the EC Treaty does not explicitly provide a definition for dominance. The European Commission, in its Discussion Paper, has defined dominance in the strict *neoclassical* sense while concurrently, upholding the ECJ’s definition in *United Brands*<sup>4</sup>. Dominance under the Discussion Paper is “the power to influence market prices, output, innovation, the variety or quality of goods and services, or other parameters of competition on the market for a significant period of time”<sup>5</sup>.

On the other hand, Article 4 of the ECL defines dominance as “the ability of a person, holding a market share exceeding 25% .... to have an effective impact on the prices or the quantities supplied, without his competitors having the ability to limit it ....”<sup>6</sup> Hence, there are three pre-requisites for a contemplation of dominance, as clarified by Article 7 of the executive regulations. Firstly, the person must have a market share of more than 25% of the relevant market for a certain period of time. Secondly, the person should have ability to influence price or volume of products supplied and thirdly, the inability of competitors to restrict his or her influence on price or volume of these products<sup>7</sup>.

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<sup>4</sup> The ECJ in *United Brands v. Commission* has adopted a basic definition for dominance which has been subsequently used in *Hoffmann-La Roche and Kali-Salz/MdK/Treuhand*. The definition has further been continuously used in many of the Community’s disputes thereafter. For the definition, see judgement of the European Court of Justice, Case 27/76, *United Brands v. Commission* [1978] E.C.R. 207 at para.65. Dominance in its *neoclassical* sense is substantial market power that signifies a firm’s capability of setting its prices above the competitive level in a profitable manner by virtue of reducing this market’s output for a substantial period of time. For discussion on the different approaches to dominance, see Monti, Giorgio (2006) “The Concept of Dominance in Article 82” *European Competition Journal*. (Special Issue) 31.

<sup>5</sup> Para.21, 24, DG Competition Discussion Paper on the Application of Article 82 of the Treaty to Exclusionary Abuses, 2005.

<sup>6</sup> Article 4, Law No.3 of 2005 Promulgating the Law on the Protection of Competition and the Prohibition of Monopolistic Practices

<sup>7</sup> Article 7, Prime Ministerial Decree No.1316 of 2005 issuing the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law No.3 of 2005

Patently, Articles 4 and 7(2) of the ECL and its executive regulations respectively are intended to require either the ability to raise prices or to reduce output for a market power qualification as a criterion market power. This is indeed apparent from the wording ‘or’ in both Articles (as previously underlined). The difference may seem slight at first sight. However, when applied in practice, its implications clearly need to be explored. Assume that a producer has the ability to relatively raise prices above the competitive level and has market power, but not to the extent of a monopolist. He might not simultaneously have the ability to reduce output supplied to the market. This is due to other competitors of the product itself who would have a role in retaining the output quantity’s balance in the market. A *neoclassical* approach may not contemplate this producer as dominant, as opposed to Articles 4 and 7(2), as long as other criteria of dominance thereof were satisfied. The ECL and its executive regulations are thus, wider in terms of scope of application when compared to EU provisions (‘broad Egyptian approach to dominance argument’).

Moreover, Articles 4 of the ECL and 7 and 8 of its executive regulations do not require a certain period of time to which a firm’s ability to increase prices and/or reduce output is to take place, as opposed to the Discussion Paper which has provided for a substantial period thereof. The period stipulated under the ECL and its executive regulations in this respect rather addresses market shares which may not necessarily signify the ability to control prices and output in any given market.

In line with this analysis, the dominant firm of a competitive fringe, though for a short term, might be considered as dominant under the Egyptian system as long as the remaining criteria to dominance have been satisfied<sup>8</sup>. Under the EU competition regime, the said firm may not have been found dominant by virtue of the Discussion Paper’s definition i.e. the *neoclassical* concept of dominance due to no fulfilment of the ‘significant period of time’ criterion. One may therefore, observe that the Egyptian system adopts a broader approach to dominance than that of the EC, possibly leading to more dominance findings.

This broad approach to dominance may have a negative impact on Egyptian firms. Efficient firms may be easily caught dominant and would thus, incur losses, in the event of lost disputes and thereby, substantial fines. Newly established firms, on the other hand, would be keen to not reaching dominant positions. This in turn may have a spill over effect on the EU-Egypt trade. More specifically, this may reduce Egyptian exports to the EU due to possible inefficiency of both dominant and non-dominant Egyptian firms, on the one hand, and may play a role in diminishing the number of EU investors in Egypt (where trade between both parties is applicable), on the other hand.

Another difference in the definition of dominant position in the EU and Egypt jurisdictions is the threshold criteria. Article 82 of the EC Treaty, as opposed to the Egyptian system, did not

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<sup>8</sup> Competitive fringe is a market where its dominant is the price maker and his competitors are the price takers. The competitors are obliged to accept this price otherwise they will find their way out of the market. Market power of the fringe’s dominant is only derived from the inability of his competitors to satisfy the market’s needs due to a significant shortage in quantity of output supplied at this stage. Therefore, the degree of his ability to adjust prices substantially and remain dominant relies solely on the demand side of the market i.e. quantities in demand by the market and which the fringe is in shortage of. For more discussion, see O’Donoghue, Robert & Padilla, and Jorge (2006) at p.108.

provide for a minimum threshold as a base for the determination of dominance. The minimum threshold is rather derived from the EC's case law on Article 82 EC which seems to have categorised market share thresholds relative to their further evidentiary necessitation. Thresholds of lower than 40% usually entail that the firm is not dominant, except for particular circumstances<sup>9</sup> (O'Donoghue & Padilla 2006).

Generally speaking, the EU's investigating authorities contemplate market shares of below 25% as a conclusive evidence of inexistence of dominance. Reviewing a number of cases show the following. The Commission, in *Grundig*, did not reach a dominance finding, where it had at hand market shares of 23 and 33% of two of the leading German TV Market. In contrast, in *Virgin/British Airways*, the Commission found BA, with a market share of 39.7% in a dominant position<sup>10</sup>.

Market shares which lie within 40-50% do not usually provide a presumption of existence of dominance; further evidence would be required. The ECJ, in *Hoffmann-La Roche*, did not uphold the Commission's finding of dominance when Hoffmann had a threshold of 43% in the Vitamin B3 market unaccompanied by additional evidence of dominance<sup>11</sup>.

Market shares which lie between 50-70% are considered, under the EU practice as substantial thresholds which do normally create presumptions of a dominant position. In *Michelin I*, it was held that market shares of 57 and 65 % were adequate for the finding of dominance, notwithstanding the inexistence of any supplementary evidences. The ECJ, in *AKZO*, has even taken it to the extreme when it stated that market shares which exceed the 50% create a rebuttable presumption of dominance i.e. in the absence of countervailing evidence<sup>12</sup>.

The EU competition investigating authorities consider market shares which are above 70% as a *prima facie* case of dominance. In *Hilti*, the ECJ adopted the Commission's view that a market share of 70-80% would not require any further investigation and this was the case in *Tetra Pak* where it had a 90% market share<sup>13</sup>.

On the other hand, Articles 4 and 7(1) of the ECL and its executive regulations respectively provide for a threshold of a minimum of 25% of the market under scrutiny for a firm to be contemplated as dominant. It is noteworthy that drafts of the ECL and its executive regulations in 2000 had previously proposed a threshold of 35%. In addition, under the drafts market shares of over 65% would have constituted a *prima facie* presumption of dominance, except in the case

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<sup>9</sup> Exceptional circumstances in this respect may be where, for instance, thresholds of other market players are comparably low or where other evidence of dominance is substantial such as the case of very high entry and/or expansion barriers.

<sup>10</sup> *EEC Distribution System, Grundig*, Commission Decision 85/404, OJ L233, [1988] 4 CMLR 865; *British Airways v. Commission*, Case T-219/99, [2003] ECR II-591; [2004] 4 CMLR 19

<sup>11</sup> Para.58, Case 85/76, *Hoffmann-La Roche & Co AG v. Commission* [1979] E.C.R. 461

<sup>12</sup> *NV Netherlandsche Baden-Industrie Michelin v. Commission*, Case 322/81, [1983] E.C.R. 3461; *ECS/AKZO*, OJ 1985 L 374/1

<sup>13</sup> T-30/89, *Hilti v. Commission* [1992] E.C.R. 1439 and C-53/92; T-83/91, *Tetra Pak International v. Commission* [1994] E.C.R. II-755

of a proven inability to affect prices. However, these proposals did not reach a consensus in the Egyptian Parliament<sup>14</sup>.

The Egyptian Competition Authority (ECA) has however, shown some reluctance to rely on market share thresholds. On July 25<sup>th</sup>, 2006, the ECA has adopted an Advisory Opinion by virtue of an inquiry by an unnamed holding company affiliated to the Ministry of Investment. More precisely, the said company asked the ECA to determine as to whether or not a subordinate company is in a dominant position, in accordance with the terms of Article 4 of the ECL<sup>15</sup>.

Following its definition of the market, the ECA went on to verify the company's position in the market while taking into consideration that it is the sole producer of this particular type of product in Egypt. Notwithstanding the ECA's finding that the company's market share was 68.3% in 2005, it concluded that it was not in a dominant position. The reasoning behind this was that it neither had control over prices nor had an impact on the quantity of output supplied in Egypt due to competitively priced imports of the product itself. This conclusion, along with its reasoning provides some future implications.

The ECA's reliance on market share thresholds was minimal even with very high levels. The ECA rather concentrates on a firm's impact on market prices or perhaps on quantity of output supplied to the market. Indeed, this serves as a positive implication due to the fact that market share thresholds do not always provide the investigator with the entire picture, as commonly established.

The ECA's analysis and finding strengthens the authors' *broad Egyptian approach to dominance argument*. As the subordinate company at glance may have been found dominant, had it either the ability to raise prices or reduce output in accordance with the terms of Articles 4 and 7(2) of the ECL and its ERs respectively.

The ECA's Opinion further, implies that a thorough analysis has been carried out and more specifically, regarding the number of market players, the degree of competition in the market (domestic and foreign), the impact on prices and output quantity and finally, entry barriers. What followed is that the ECA has neither relied on the 'sole producer' fact nor has it on the 68.3% market share threshold, otherwise it would have certainly considered the firm in question as dominant.

Therefore, one may validly submit, based on the aforementioned assumption of the 65% *prima facie* presumption, that the ECA would not have considered the respondent as dominant. Indeed, this would have been an exception to the said general rule of the law and its former drafts. The reason behind this is that the ECA would have detected the alleged dominant's inability to affect

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<sup>14</sup> See Article 4, Law No.3 of 2005 promulgating the Law on the Protection of Competition and the Prohibition of Monopolistic Practices; Article 7(1), Prime Ministerial Decree No.1316 of 2005 issuing the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law No.3 of 2005.

<sup>15</sup> The Egyptian Competition Authority Website, (2007):  
<http://www.eca.org.eg/EgyptianCompetitionAuthority/Publication/List.aspx?MainNav=Press&SubNav=Releases>.  
Accessed 22-09-2007.

the market's price and quantity due to competitively priced foreign exports and thereby, no finding to dominance would have been reached.

In addition, the ECL and its executive regulations do not explicitly prohibit excessive pricing, as opposed to Article 82(a) EC. If not apparent from the ECL and its executive regulations, it may well be reflected from the jurisprudence. A complaint has officially been filed before the ECA by an association specialized in barcodes against a company on the premises of "overpricing the barcode fees, and for misrepresenting the European Barcode Association in Egypt". The ECA's Board of Directors, following an examination of the claims in light of the ECL, and despite the fact that the defendant was in a dominant position in the relevant market of barcodes, have concluded that the claims do not involve any violation to the ECL, as, overpricing i.e. excessive pricing is not a prohibited conduct under Article 8 of the ECL<sup>16</sup>.

One obstacle which the ECA may encounter in excessive pricing investigations is that they necessitate substantive and sophisticated analysis which may be misleading (Evans and Padilla 2005). However, the enforcement of excessive pricing has been successful in some emerging economies<sup>17</sup>. Moreover, the ECA may cooperate with EU competition investigating authorities, should it encounter any difficulties while investigating these disputes. This in turn makes the introduction of excessive pricing in Egypt feasible.

Furthermore, the importance of prohibiting excessive pricing under the Egyptian regime, apart from its manifest detrimental impacts on Egyptian consumers, is that it may well open the door to EU firms to practice such conducts in Egypt (in the event of trade between both parties) so as to evade the application of Article 82(a) EC towards them. This would, inevitably, comprise a clear contravention to one of the core aims of the AA as set out in Article 1(2); the encouragement of Egypt's social and economic development. It is hence, proposed that the Egyptian system would consider prohibiting excessive pricing in the future.

#### **4.3.2 Safe Harbour Rule**

The *EC Commission Notice on Agreements of Minor Importance* (The Notice) has recognised the case of market power under Article 81 EC. *The Notice* has formulated the safe harbour rule under which it indicated that agreements concluded between undertakings with thresholds below that stipulated would not be considered as restrictive of competition.

According to paragraph 7(a) of *The Notice*, in the event of agreements between competitors (such as joint ventures), the aggregate market share threshold is 10%. As for agreements between non-competitors i.e. vertical agreements, market share threshold of each undertaking should not exceed 15%, as pursuant to paragraph 7(b) of *The Notice*. Paragraph 11(1) has however, provided for exceptions to paragraph 7(a). Price fixing agreements, resulting in the limitation of a market's output and those which allocate markets or customers between competitors, even if

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<sup>16</sup> The Egyptian Competition Authority Website, (2007): <http://www.eca.org.eg/EgyptianCompetitionAuthority/Publication/List.aspx?MainNav=Press&SubNav=Releases>. Accessed 05-10-2007; Article 82(a), the Treaty establishing the European Community as amended by subsequent Treaties, Rome, 1957.

<sup>17</sup> See the South African Competition Tribunal's decision dated 23<sup>rd</sup> March, 2007, *Mittal Steel South Africa Ltd and Macsteel International B.V.* Complaint (Case 13/CR/FEB04). It is the first excessive pricing dispute in South Africa.

below the 10% threshold, are prohibited. It is worthwhile mentioning that the Commission, by virtue of *The Notice*, seems to have contravened the ECJ in *Volk v. Vervaecke* when it stated that competition law should not block agreements between underdeveloped undertakings<sup>18</sup>.

The Egyptian regime, on the other hand, lacks a corresponding mechanism to the safe harbour rule. In fact, neither does the ECL nor its executive regulations consider the case of market power by virtue of horizontal and vertical agreements. They rather prohibit horizontal agreements which involve, for example, price fixing and vertical agreements which are restrictive of competition<sup>19</sup>.

#### **4.3.3 A rigid approach to horizontal and vertical agreements**

The Egyptian regime has not provided for an exemption mechanism for agreements restrictive of competition similar to that under Article 81(3) EC whether by virtue of an individual exemption or by block exemptions<sup>20</sup>. Instead, it has strictly prohibited all agreements which are competition restrictive regardless of the efficiency benefits that may thereby, accrue. This in turn may generate two potential negative implications to the Egyptian system.

Firstly, agreements that may have efficiency gains which outweigh the related negative effects of competition restriction would be prohibited. Secondly, the Egyptian system will not commit its competition law to the attainment of the broader public policy objectives as is the case under the EU regime. In some instances, it exempts agreements which fall within the ambit of Article 81(1) EC i.e. restrictive of competition for the accomplishment of non-competition objectives such environmental, social, industrial, employment policy objectives etc. as long as they satisfy the exemption criteria of Article 81(3) EC<sup>21</sup>. The European Commission has clearly reflected this linkage in its *Twenty-first Report on Competition Policy* by stating: “this link between Community objectives and competition policy is a two-way process. It is inconceivable that

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<sup>18</sup> Case 5/69, *Volk v. Vervaecke* [1969] ECR 295; EC Commission Notice on Agreements of Minor Importance which do not appreciably restrict competition under Article 81(1) of the Treaty Establishing the European Community, 2001.

<sup>19</sup> Articles 6, 7, Law No.3 of 2005 promulgating the Law on the Protection of Competition and the Prohibition of Monopolistic Practices; Articles 11, 12, Prime Ministerial Decree No.1316 of 2005 issuing the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law No.3 of 2005

<sup>20</sup> Exemptions under Article 81(3) EC may take the form of individual exemptions or block exemptions. Individual exemptions are those which are reached following a case-by-case analysis. Block exemptions are those regulations which cover certain types of agreements. Agreements which fall within the ambit of block exemption regulations are presumed satisfactory of conditions laid out under Article 81(3) EC. In order to limit the scope of exemptions granted under this category, block exemption regulations have stipulated for market share thresholds which if surpassed exemption would not be granted.

See Council Regulation 19/65 on the application of Article 81(3) to certain categories of agreements and concerted practices OJ [1965] 36 as amended by Council Regulation 1215/1999 OJ [1999] L148/1, Council Regulation 2821/71 on the application of Article 81(3) to categories of agreements and concerted practices [1971] OJ L 285/46, Council Regulation 1534/91 on the application of Article 81(3) to certain categories of agreements, decisions and concerted practices in the insurance sector [1991] OJ L143/1, Council Regulation 479/92 on the application of Article 81(3) to certain categories of agreements, decisions and concerted practices between liner shipping companies (consortia) [1992] L55/3, and Council Regulation 3976/87 on the application of Article 81(3) to certain categories of agreements and concerted practices in the air transport sector [1987] OJ L374/9.

<sup>21</sup> For illustration, see *Ford/Volkswagen*, Commission Decision 93/49 - [1993] 5 CMLR 617, OJ L20/14 and *Wouters v Algemene Raad Van De Nederlandse Orde Van Advocaten* C-309/99 [2002] ECR I-1577, ALL ER (EC) 193, [2002] 4 CMLR 913, ECJ.



competition policy could be applied without reference to the priorities fixed by the Community. But it is also important to realise how an effective competition policy will help attain these goals” (EC Commission, 1991; Monti, 2007).

#### **4.3.4 Rule of reason versus per se approach**

It is questionable as to whether or not the ECA should employ a rule of reason approach. The debate elevates due to the lack of ECA’s experience. A *per se* approach supporter would assert that, while knowledge and information problems may lead to invalid judgments which may hinder efficient economic policies, a given set of rules would disguise these problems (Christiansen & Kerber, 2005).

Assuming the inefficiency and imperfectness of decision makers, Christiansen & Kerber (2005) argue against an employment of rule of reason. While this view may seem valid, to some extent, with respect to an emerging economy like Egypt, the EU’s decision makers are a lot more experienced to analyze disputes from an economic perspective.

However, this is not to deny the possible beneficial outcome of rule of reason employment with its ability to capture conducts which a *per se* approach may not be capable of capturing. Indeed, this sole advantage may be sufficient to outweigh those of the *per se* approach such as legal certainty, predictability and the lesser consumption of time and resources. The EC seems to employ a rule of reason test while exempting agreements which are prohibited under Article 81(1) and which, concurrently, fall within the scope of Article 81(3) EC i.e. balancing pro and anti-competitive effects. Moreover, Article 82 EC is moving towards the approach itself, as suggested by the Economic Advisory Group for Competition Policy’s Report on an ‘*economic approach to Article 82 EC*’ and as was applied in *AKZO* by virtue of its predation test (Ali-El Dean & Mohieldin, 2001; Economic Advisory Group for Competition Policy, 2005; Nikpay, Kjolbye & Faull, 2007).

Article 12 of the ECL executive regulations seems to adopt a rule of reason approach by providing the ECA with the right to inquire about the impact of the vertical agreement at stake on the competition process and the existence of consumer benefits accruing from it. Clearly, this is not a full rule of reason test, as an inquiry of a beneficial alternative which is less restrictive is missing from the test stipulated under Article 12. However, we argue that a rule of reason test would not be useful within the Egyptian context of these agreements due to the lack of an exemption mechanism. It would rather be useful within the context of abuse of dominance disputes<sup>22</sup>.

#### **4.3.5 Lack of Merger Control**

The Egyptian system further, lacks a merger control mechanism, in contrast with the EC. Article 11(2) and 44 of the ECL and its executive regulations respectively provide only for a notification of mergers within 30 days of the transaction. Drafters of the ECL and its executive regulations seem to have adopted the view that newly established competition authorities should not apply

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<sup>22</sup> Article 7(1), Prime Ministerial Decree No.1316 of 2005 issuing the Executive Regulations of Protection of Competition and Prohibition of Monopolistic Practices Law No.3 of 2005

merger control rules due to the shortage of staff and time<sup>23</sup>. In some authors' view, however, it could be worth investing these resources for the sake of preventing the negative impacts on competition by virtue of hardcore mergers<sup>24</sup>. It can be argued that the benefits of adopting a merger control mechanism would outweigh the resources spent on it on the long-run (Afifi, 2007).

The aforementioned examples of differences between the Egyptian and EU competition laws and bylaws emphasize that there is a need for cooperation and coordination among competition authorities. Harmonization, in light of the different developmental stages, and different institutional setups could have negative effects on Egypt. For example, difficulties in applying a rule of reason approach may create a burden on the newly born ECA, whereas different size of markets can create frictions on determining the most suitable dominant position threshold.

## Conclusion

The competition related Articles in the AA are confined to practices that have or may have an effect on trade. In theory it might seem easy to differentiate between the impact of such provisions which is confined to impact on trade between Egypt and the EU, but in reality it would just lead to legislative problems and difficulties in applying the law (as shown above). In fact we argue that this type of dual system may cause diversion of Egyptian exports away from the EU to other markets if the EU law is more restrictive than the Egyptian law. Moreover, it could lead to some type of chilling effect on potential exporters to the EU. If one precedent took place and an Egyptian producer or exporter to the EU was subject to EC competition provisions, it is very likely that a large number of Egyptian exporters and producers will divert away from the EU market, fearing from application of EC competition law on them.

There are several gaps in the Egyptian law that could be filled by EU Competition Law such as merger control and safe harbour provisions, provided clear guidelines for cooperation are set. The review above has shown that the Egyptian law in some cases is more restrictive whereas the EU law in other cases is more restrictive. In fact, it is very unlikely that in such a dichotomous system positive results are expected for the competition law implementation in Egypt. It is very difficult to predict the impact of such type of incomplete harmonization competition law system on Egypt. However, we suggest that it might create a lot of vagueness in implementation and is likely to create uncertainty among the community of exporters and producers.

The misrecognition of market power under horizontal and vertical agreements may cause conflicts in the Egyptian market. It may more precisely, motivate EU firms towards concluding their related agreements in Egypt rather than the EU, so as to escape the application of the *safe*

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<sup>23</sup> Many emerging economies such as South Africa have not adopted this view. The South African Competition Act has dedicated a whole chapter on Merger Control. See chapter (3) of the South African Competition Act No.89 of 1998.

<sup>24</sup> The South African Competition Tribunal, as a newly born one, has prohibited seven anti-competitive mergers which relate to primary products and services such as petroleum refining, health care management, sugar and retail furniture which might have had severe consequences on the South African market, should they have been neglected. For more discussion on the South African merger control experience, see Lewis, David, (2007) "South African Competition Law – Origins, Content, and Impact" *Competition Law Today – Concepts, Issues, and the Law in Practice*. Dhall, Vinod (Edt.). Oxford University Press pp.352-358

*harbour rule* and gain market power in the Egyptian market. It is therefore, suggested that the Egyptian legislator would contemplate treating this case in the future.

The lack of an appropriate exemption instrument of agreements restrictive of competition under the ECL and its executive regulations may imply two negative policy effects on the long-term. Firstly, the ECA would prohibit agreements which, even though restrictive of competition, provide substantial efficiency gains which would have been in the Egyptian consumer's interest if these agreements were to be exempted. Secondly, in event of an agreement which relates to the attainment of non-competition objectives such as social, industrial, employment policies etc. but is restrictive of competition, these objectives would be undermined, nonetheless their attainment might outweigh the restriction of competition. The adoption of an exemption tool under the Egyptian system remains hence, crucial.

Following the AA, whether Egypt has enacted a law or not, the EU competition provisions will apply where an anti-competitive act has affected trade between Egypt and the EU and no implementation rules have been reached by the Association Council. This implies that Egypt is experiencing already a *de facto* application of the EU competition laws and regulations in its jurisdiction as long as it affects trade between EU and Egypt. Such *de facto* application implies compulsory harmonization as argued above, or at least the creation of a dual legislative system. Such a harmonized system in light of the review of the studies aforementioned is neither needed to ensure an effective implementation of competition law in Egypt, nor to enhance trade between Egypt and the EU. This creates a legislative burden for the ECA and Egyptian courts on how to treat competition cases that has a relationship with EU trade.

The above analysis identified that there is a clear gap between Egypt and the EU regarding competition provisions. The full application of EU competition related provisions in the Egyptian jurisdiction may seem to be the first best if Egypt and the EU were sharing the same level of development, and institutional infrastructure, which is not the case. This implies that there is a need for cooperation and coordination which should be fostered by the existing mechanisms for integration including the ENP Action Plan.

In light of the above, we would expect that the European Neighbourhood Policy (ENP) Action Plan would bring in some mechanisms that aim at enhancing cooperation between Egypt and the EU regarding competition issues. Issues as positive and negative comity should have been put on the agenda, as well as other means that promote cooperation between competition authorities. Reading the Action Plan of EU-Egypt we realize that it is modest both in terms of further harmonization as well as cooperation.

To conclude, the above analysis implied that there is gap between the Egyptian competition law and the EU competition rules and regulations. The AA has included a *de facto* adoption of EU competition rules and regulation in Egypt, which we consider a case of compulsory harmonization. Empirical studies reviewed asserted that there is no evidence for reaping benefits out of the harmonization in the competition field. The studies that have opted for harmonization emphasized the need for adopting a progressive approach that ensures overcoming the different economic circumstances and developmental stages of the different countries. The reviewed studies emphasized the need for cooperation, which has been deemed to be important than

harmonization, and the EU-Egypt cases have shown that effective cooperation still does not exist. The ENP and its Action Plan have neither added the element of cooperation, nor have worked on providing mechanisms for deepening harmonization.

The Egyptian system's gaps along with their possible future consequences with respect to EU-Egypt trade indicate that harmonization of competition provisions may be conditionally necessary. The condition, which if not satisfied, harmonization would be pointless and thus, would not be preferable by any means, is clearly the valid and appropriate enforcement of the EU's transplanted rules by Egyptian authorities (the ECA and national courts). Obviously, this is not attainable at this stage. The gaps should, thus, be approached from a different viewpoint. Moreover, any harmonization in this area would result in MFN type of treatment for investors and producers in Egypt, however following the EU lines.

The Egyptian system may rather fill in the gaps by introducing a new set of rules which are similar to that of the EU in general but simpler in terms of substance to match its current level of development and enable the enforcement process. For instance, Egypt should not transplant the exact EU Merger Control Regulation. Instead, it should consider finding an alternative mechanism which would serve the same purpose but in a rather simpler and more flexible manner.

Given the existing developmental, and infrastructural gap between Egypt and the EU harmonization might not be the first best or in a broader context deep integration might not always be better. The optimal case in this regard would have been shallow integration complemented by cooperation, which neither the AA, nor the ENP have provided. In other words, since competition law is needed to have an efficient domestic business environment, and does not serve a market access purpose, then deep integration might not be suitable given the developmental gap between the trading partners, and the costly (without pay-off) process of narrowing the gap. In this case, cooperation would serve the ultimate purposes of having an efficient domestic business environment, and preserving trade interests between partners.

Whether or not harmonization is necessary, cooperation between European Competition Authorities and the ECA is a must especially for the first ten years of enforcement of the ECL and its executive regulations. Not only is this cooperation beneficial to the Egyptian market but also to European investors in Egypt. As the costs of errors in judgments may inevitably, have severe consequences on the Egyptian market, credibility of the ECA and EU-Egypt trade. It should be noted that cooperation should be on the two aspects of infrastructure as well as regulations and policies.

To sum up, harmonization is not the best way to approach these gaps and is thus, not preferable. Simpler rules than those of the EU should be introduced to successfully fill in these gaps accompanied by intensive cooperation by EU Competition Authorities.

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## **Chapter Five**

### **State Aid**

**Mona El Garf and Sherine Bayoumi**

## Introduction

The purpose of this section is two fold, namely: to diagnose and analyze the State aid policy in both the European Union and Egypt, starting by the scope, as well as the definition of the State aid under these polices, what are the criteria for eligible and ineligible State aid, the control and notification system of the State aid and finally to highlight State aid's statistics and figures. Secondly, explore the main features and concerns of the State aid within the Egyptian- European relationships (From the Association Agreement (*AA*) to The European Neighbourhood Policy (*ENP*) Action Plan) and finally, investigate the possibility and the potential to approximate Egyptian policy with its comparable in the EU.

This section is divided to three sub sections, as follows: 1) State aid policy in the European Union, 2) State aid policy in Egypt, 3) State aid file in the Egyptian –European relationships.

### 5.1 State Aid Policy in the European Union, *State Aid under the EC Treaty*

#### 5.1.1 Definition

State aid policy is an important part of EU competition policy, so one of the goals of the EC treaty is the establishment of a “system ensuring that competition in the internal market is not distorted.” The main rules of the EC treaty dealing with State aid are part of the chapter entitled “rules on competition”. But while the traditional anti-trust rules aim at protecting competition against undue private action, the State aid rules aim at protecting competition against one of the most important threats resulting from government action.

The basic rules of the State aid policy are outlined in Articles 87-88 of the Treaty. These rules have been amplified over the years by secondary legislation and court rulings. Though the EC Treaty recognized the risk of State aid, nevertheless it accepts that the granting of such aid can be justified in exceptional circumstances.

The point of departure of EU State aid policy is laid down in Article 87(1) of the Treaty. This article provides that State aid is, in principle, incompatible with the common market and it is forbidden if all following accumulated criteria are met;

Article 87, EC establishes the general rule that State aid is forbidden if (a) it **transfers part of the State resources**, as the State aid has been an intervention by the State or through State resources which can take a variety of forms (e.g. grants, interest and tax relief's, guarantees, government holdings of all or part of a company, or the provision of goods and services on preferential terms, etc)<sup>1</sup>, (b) **it should grant a selectively economic advantage** to "certain undertakings or the production of certain goods", (c) it distorts competition or threatens to do so and (d) it affects trade between Member States.

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<sup>1</sup> State aid can be given indirectly, for example the government might provide a grant to a commercial company which then passes a proportion of the aid to a subsidiary company. There is likely to be State aid at both levels.

This brief description of the criteria defining State aid shows that the scope of Community State aid rules is wide but not open-ended (European Commission, 2007).

### 5.1.2 Exemptions

According to Article 87(1) of the Treaty, aid measures that satisfy all the criteria outlined above are, in principle, incompatible with the common market. However, the principle of incompatibility does not amount to a full-scale prohibition, as articles 87(2) and 87(3) of the Treaty specify a number of cases in which State aid could be considered acceptable (the so called “*exemptions*”).

A number of exemptions are derived from the Treaty, as some aids of a social character, aid to make good damage caused by natural disasters and aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany are exempted from this prohibition. In addition, the Commission has the power to grant derogations in respect of aid for the following purposes:

- a) To promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- b) To promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- c) To facilitate the development of certain economic activities or of certain economic areas, "where such aid does not adversely affect trading conditions to an extent contrary to the common interest";
- d) To promote culture and heritage conservation "where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest."
- e) Such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

To summarize, We can distinguish three main exemption aid categories under Articles 87(3)(a) and 87(3)(c) of the Treaty and from a large body of secondary legislation and guidelines which has grown up over the past half-century , as stated below:

- a) **Regional aid:** gives Member States the possibility to assist regions and areas which are disadvantaged *compared to the national average*. The list of regions qualifying for this exemption is also decided by the Commission, but on a proposal by Member States. Member States can use *national* criteria to justify their proposal.
- b) **Other Horizontal rules:**  
Cross-industry or “horizontal” rules set out the Commission’s position on particular categories of aid which is aimed at tackling problems which may arise in any industry and region. To date, the Commission has adopted “frameworks”, “guidelines” or “block exemption regulations” setting out the criteria that are to be applied to the following categories of Main horizontal aid categories allowed under EU guidelines, frameworks or regulations:

- Aid for small and medium-sized enterprises;
- Aid for research and development and innovation;
- Aid for environmental protection;
- Aid for risk capital;
- Aid for services of general economic interest;
- Aid for the rescue and restructuring of firms in difficulty;
- Aid to employment; and
- Training aid.

c) **Sectoral rules: Industry-specific or “sectoral” rules**

The Commission has also adopted industry-specific or “sectoral” rules defining its approach to State aid in particular industries.

1. General sectors these currently include the sectors of: (audiovisual production, broadcasting, coal, electricity (stranded costs), postal services, and shipbuilding).
2. Agriculture, forestry, fisheries and aquaculture
3. Transport (road, rail, air, inland waterways and maritime transport).

The Treaty explicitly allows exceptions to the ban on State aid where the proposed aid schemes may have a beneficial impact in overall Union terms. State aid may be declared compatible with the Treaty provided it fulfils clearly defined objectives of common interest and does not distort intra-community competition and trade to an extent contrary to the common interest. State aid measures can sometimes be effective tools for achieving objectives of common interest. They can correct market failures, thereby improving the functioning of markets and enhancing European competitiveness. They can also help promote e.g. social and regional cohesion, sustainable development and cultural diversity, irrespective of the correction of market failures.

**5.1.3 Ex-ante (Control of State Aid and Notifications to the Commission)**

The control of State aids is an almost unique feature of competition policy in the European Union. Only in the EFTA is there a similar system of supranational control over the subsidies granted by States to enterprises, a system which owes its existence to the need to harmonize competition policies in the European Economic Area. Other regional economic groupings and even federal States lack mechanisms for controlling the subsidies granted by their constituent parts (Buelens, Garnier, Johnson and Meiklejoh, 2007).

European Union insists on the importance and the necessity of the State aid control, which comes from the need to maintain a level playing field for all undertakings active in the Single European Market, no matter in which Member State they are established.

Further, it is important to realize that State aid does not come for free, Giving aid to undertakings means taking funding away from other policy areas. State resources are limited and they are needed for many essential purposes.

The benefits of State aid control are clear. In many circumstances, subsidies can reduce economic welfare by weakening the incentives for firms to improve their efficiency and by

enabling the less efficient to survive or even expand at the expense of the more efficient. The resulting distortions of trade can lead to friction between national governments and to retaliatory measures which may be a source of further inefficiency. Furthermore, unless some supranational discipline is imposed, competition between governments to attract investment can lead to costly subsidies races

Community supervision of State aid is based on a system of ex-ante authorization. Under this system, Member States are required to inform (“*ex-ante notification*”) the Commission of any plan to grant or alter State aid and they are not allowed to put such aid into effect before it has been authorized by the Commission (“*Standstill-principle*”). Under the Treaty, the Commission is given the competence to determine whether or not the notified aid measure constitutes State aid in the sense of Article 87(1) of the Treaty, and if it does, whether or not it qualifies for exemption under Article 87(2) or (3) of the Treaty. Member States can not grant any State aid unless it has been notified *and* authorized by the Commission. Any aid, which is granted in absence of Commission approval, is automatically classified as “*unlawful aid*”. Under the present procedural rules, the Commission is under the obligation to order the recovery from the beneficiaries of any unlawful aid that is found to be incompatible with the common market. Moreover, the European Courts have recognized that national judges are competent to decide whether the notification procedures have been complied with and if not, to order recovery of the aid.

In exercising its powers, the Commission has developed specific approaches depending on the size of the firm, its location, the industry concerned, the purpose of the aid, etc. In order to ensure transparency, predictability and legal certainty, the Commission has made public the criteria it uses when deciding whether aid measures notified to it qualify for exemption. These publications have taken the form of regulations, “communications”, “notices”, “frameworks”, “guidelines”, and letters to Member States<sup>2</sup>. In spite of what we previously mentioned, the Commission, during practice, enjoys a wide margin of discretion when authorizing State aid on the basis of the various Treaty provisions outlined above. The broad scope of this discretion made it difficult to predict how the Commission would deal with certain recurring fact patterns.

In recent years, the Commission has started a process of modernization and simplification of State aid procedures. To this end, the Council adopted Regulation (EC) No 994/98 of 7 May 1998, which enables the Commission to adopt so-called “*block exemption regulations*” for State aid. With these Regulations, the Commission can declare certain categories of State aid compatible with the Treaty if they fulfil certain conditions, thus exempting them from the requirement of prior notification and Commission approval. At present, the Commission has adopted five block exemption regulations. Three of these regulations create exemptions for aid to small and medium-sized enterprises, employment aid and training aid (all of which have been prolonged until 30 June 2008). As a result, Member States are able to grant aid that meets the conditions laid down in these three regulations without the need for giving prior notification to and securing the agreement of the Commission. A fourth regulation exempts transparent regional investment aid schemes, and some ad hoc aid. This regulation applies from 2007 until the end of

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<sup>2</sup> All relevant regulations, communications, notices, frameworks and guidelines are available on the DG Competition web site: [http://ec.europa.eu/comm/competition/state\\_aid/legislation/](http://ec.europa.eu/comm/competition/state_aid/legislation/).

2013. A fifth regulation codifies the application of the *de minimis* rule. That regulation clearly establishes that aid to an enterprise that is below the threshold of € 200,000 over a period of three fiscal years and that respects certain conditions, does not constitute State aid in the sense of Article 87(1) of the Treaty, since it is deemed not to affect trade or distort competition. Such aid does therefore not need to be notified.

Approval of aid under the State aid rules provides legal certainty for Member States and the recipients of State aid. This provides a safe legal environment for aid that can benefit the economy.

Finally, it is worth mentioning that the Commission may act on its own initiative to investigate any public sector support which it has not formally approved. It must also investigate any complaint from an aggrieved third party without delay and this could lead to a formal investigation. The Commission can adopt a decision that requires a Member State to suspend or provisionally recover aid. Third parties can also pursue the matter through national courts. National courts have a duty to apply and enforce the State aid rules in cases brought before them. ([www.erd.comunities.gov.uk](http://www.erd.comunities.gov.uk))

#### **5.1.4 The State Aid Reform**

There are new challenges facing the EU State aid policy, which call for action. As was clearly expressed by the European Council in November 2004, there is a need for renewed impetus to the so-called Lisbon Strategy<sup>3</sup>. The Commission Communication to the 2005 Spring European Council ‘*Working together for growth and jobs, a new start for the Lisbon Strategy*’, has already set out a new Lisbon Action Program where State aid control plays an important role.

In June 2005, The European Commission has launched a comprehensive reform of State aid rules and procedures under the title of State Aid Action Plan (SAAP) (European Commission, 2006). The Commission announced that it would aim in particular to ensure that EC Treaty’s State aid rules are better suited to encourage Member States to contribute to the Lisbon Strategy by focusing aid on improving the competitiveness of EU industry and creating sustainable jobs (for example aid for R & D, innovation and risk capital for small firms), on ensuring social and regional cohesion and improving public services. Since the adoption of the Plan, a number of new regulatory texts have been adopted (such as the new regional aid guidelines) and others are currently under revision. The process should largely be completed by 2009. The document presented two elements: i) the underlying reasons and guiding principles for State aid reform and ii) a roadmap for the revision of the State aid rules, the aim being to improve administration and procedures. Consequently, Community State aid policy has undergone a number of important changes in recent years and further reforms are envisaged.

The Commission in its SAAP document foresees a thorough modernization of the EU State aid rules on the basis of four groups of objectives:

1. Less and better targeted State aid,
2. A refined economic approach, "Making more use of a refined economic approach is a means to ensure a proper and more transparent evaluation of the distortions to competition and trade associated with State aid measures. The Action Plan outlines

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<sup>3</sup> In March 2000, the Lisbon Strategy was launched aiming at making the EU the most competitive economy in the world and achieving full employment by 2010.

an assessment procedure based on balancing the positive impact of a State aid against its potential negative side-effects.

3. More effective procedures and enforcement, greater predictability and transparency,
4. Sharing of responsibility between the Commission and the Member States (Buelens, Garnier, Johnson and Meiklejoh, 2007).

The European Council in March 2005 has called on "Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimization of human capital. The reform of regional aid should also foster a high level of investment and ensure a reduction in disparities in accordance with the Lisbon objectives".

State aid policy safeguards competition in the Single Market and it is closely linked to many objectives of common interest, like services of general economic interest, regional and social cohesion, employment, research and development, environmental protection and the protection and promotion of cultural diversity. It must contribute by itself and by reinforcing other policies to making Europe a more attractive place to invest and work, building up knowledge and innovation for growth and creating more and better jobs.

Besides, the increasing complexity and number of documents progressively adopted by the Commission over time have created a need to streamline State aid policy (European Commission, 2005).

**Table 5.1. Roadmap of the State Aid Reform, 2005 -2009 (indicative)**

<b>Modifications</b>	<b>2005/2006</b>	<b>2007/2008</b>	<b>2009</b>
<b>Substance</b>	Road map for State aid reform 2005-2009 Regional aid guidelines General Block Exemption (SME, employment, training, R&D, <i>de minimis</i> , regional, environment)  Communication interest rates Guidelines R&D and Innovation Communication short term credit insurance Communication risk capital Decision and guidelines on the Services of General Economic Interest and transparency directive Guidelines environment Framework on State aid to Shipbuilding	Assessment/modification of the rescue and restructuring aid guidelines. Notice on State aid in form of guarantees Communication on direct business taxation Communication on State aid to public broadcasting. Possible additional block exemptions	Assessment of the reform and review of existing State aid rules
<b>Consultation documents</b>	Communication on innovation	Consultation document on possible modification of Council Regulation (EC) No 659/99. Consultation document on the different forms of aid	

<b>Procedure</b>	Internal best practices guidelines Promotion of State aid advocacy. Increase monitoring of decisions and recovery Possible proposal for amendment of the Council Regulation (EC) No 994/98 (enabling regulation)	Possible proposal for amendment of Council Regulation (EC) No 659/99 (procedural Regulation) Notice on cooperation between national courts and the Commission in the State aid field	
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Source: European Commission, (2005) "Less and better targeted State aid: a roadmap for State aid reform 2005–2009, Brussels, 7.6.2005 COM. 107 final STATE AID ACTION PLAN

### 5.1.5 State Aid Statistics

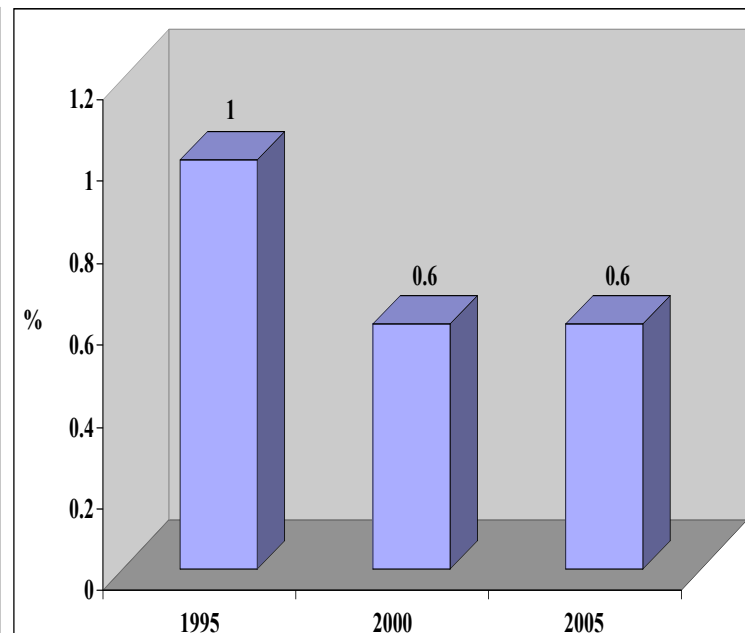
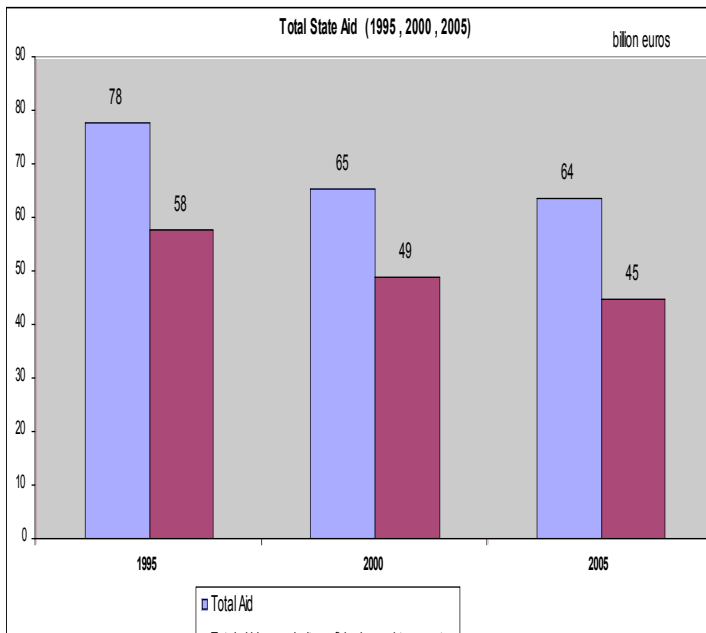
#### A) Total State Aid and As a Percentage of GDP

As shown in figure (5.1) the total value of the State aid in the EU-25 has decreased significantly over the period 1995-2005. In addition, the State aid as a percentage of GDP decreased from 1% to 0.6% over the same period at both the EU-25 level and Member State level; while the State aid as percentage of GDP varies from one country to another.

**Figure 5.1:**

**a) Total State Aid during (1995, 2000, 2005)**

**b) State Aid as % of GDP during (1995, 2000, 2005)**



\*Data are provided in Million Euro at constant 1995 prices but have been re-referenced on the year 2005.

Source: [http://ec.europa.eu/comm/competition/state\\_aid/studies\\_reports/stat\\_tables.html](http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.html)



## B) State Aid by the Member State 2005

It is obvious that the EU-25 State aid concentrates in a few numbers of the Member States, as 25% of the total Member States delivered 70% of the total aid during 2005.

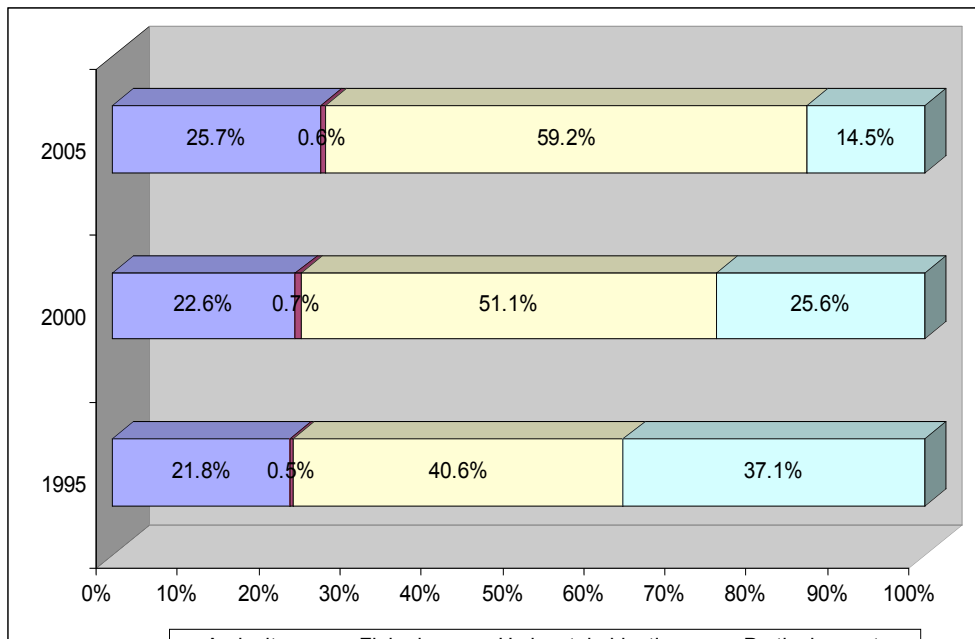
**Table 5.2. State Aid by the Member States**

EU Member State	Total State Aid (Million €)	Share in Total EU-25 State Aid (%)
Germany	20,332	32%
France	9,650	15%
Italy	6,391	10%
United Kingdom	4,518	7%
Spain	3,753	6%
<b>Total EU-5</b>	<b>44,644</b>	<b>70%</b>
<b>Total EU-25</b>	<b>63,750</b>	<b>100%</b>

Source : [http://ec.europa.eu/comm/competition/state\\_aid/studies\\_reports/stat\\_tables.htm](http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.htm)

## C) State Aid by Main Sectors/ Objectives

**Figure 5.2: State Aid by Main Sectors/Objectives**



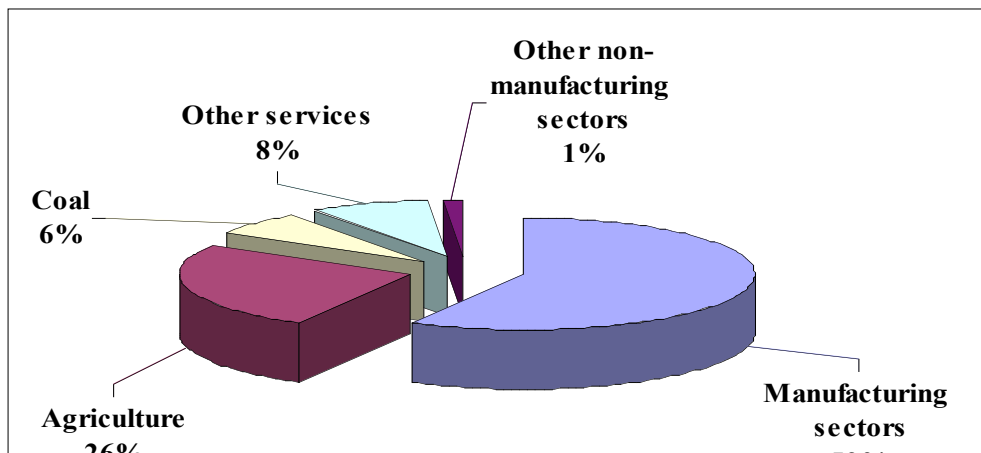
Source : [http://ec.europa.eu/comm/competition/state\\_aid/studies\\_reports/stat\\_tables.htm](http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.htm)

The investigated State aid figures by main sectors and objectives explore a noteworthy trend of an increasing share of the horizontal objectives from around 40% in 1995 to 60% in 2005, where as the share of the State aid directed to particular sectors declined during the same period from 37% to less than 15%.

#### D) State Aid by Main Sectors:

On the sectoral level it is very obvious that both manufacturing sector and agricultural represent around 75% of the total State aid in 2005.

**Figure 5.3: Sectoral Share of State Aid in 2005**



Source : [http://ec.europa.eu/comm/competition/state\\_aid/studies\\_reports/stat\\_tables.htm](http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.htm)

To **conclude**, the State aid figures in the EU show a downward trend in the absolute value of the aid and even in its percentage to GDP, this in fact coincides with the EU goals of State aid policy reform. The structure of the State aid further records a trend towards targeting horizontal areas, which is provided without any exception to all sectors. This in turn will definitely limit the State aid negative effects on competition and trade in the EU countries.

## 5.2 State Aid Policy in Egypt

Unlike the EU, there is no legislation in Egypt that organizes State aid, specifies a definition for it, or regulates the pattern of authorized and unauthorized State aid. Furthermore, most of the local and even the international studies and writings that tackled this issue, did not use the term "State aid" but used the term "Subsidy" instead.

Besides of the absence of legislation in Egypt that should govern State aid, there is no one entity that releases State aid data<sup>4</sup>, which in turn requires requesting from more than one ministry or body to provide State aid data. Hence, the following section of the report will deal with the State

<sup>4</sup> The term State aid is used in this section as referenced in the local sources.

aid in Egypt; however, it is not asserted that the following structure that would be tackled later represents the whole picture of State aid.

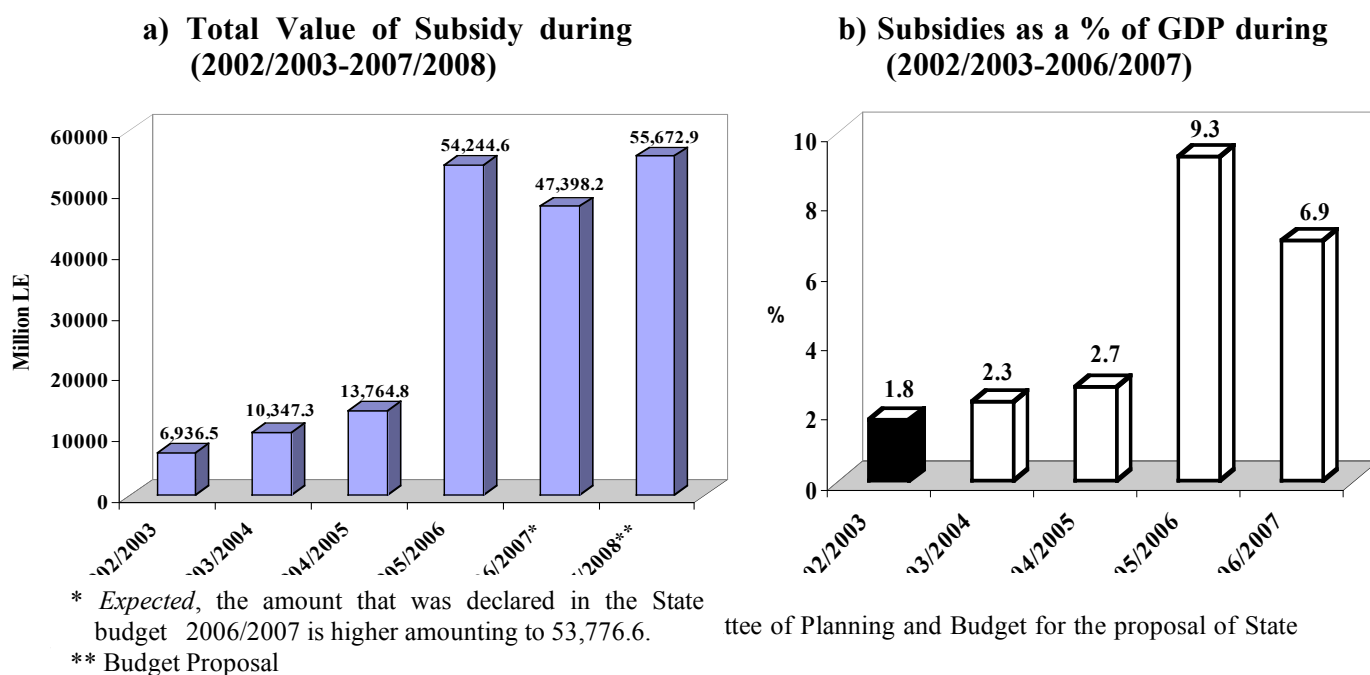
State aid can be classified into various forms; there is the ***explicit subsidy*** which appears in the State budget and takes in the form of direct and indirect subsidy through financing the Public Economic Authorities deficit. In addition, there is the ***implicit subsidy*** which represents the forgone revenues not explicitly shown in the State budget, while in fact it is a usage of government's revenues. This includes subsidizing prices of some services like education, health and subsidizing the prices of petroleum products and electricity.

Since 2005/2006, the Egyptian government included a large part of this subsidy in the State budget and transferred it into explicit subsidy. The State budget incorporated, since this fiscal year, petroleum products' subsidy in which the Egyptian General Petroleum Corporation buys, in international prices, part of foreign petroleum companies' shares working in Egypt to provide petroleum products in the local market, and sells these products with subsidized prices that do not exceed 24% of the average international prices in 2004/2005 (Al-Shawarby, 2005; IMF, 2005).

The proposal of the State budget 2007/2008 also allocated 2 billion LE to subsidize electricity (Egyptian Parliament, 2007). The electricity sector is considered one of the most essential sectors subsidized by the government for economic and social purposes. There exists in this sector various forms of subsidies, of which is the cross subsidy that uses some subsidized petroleum products like natural gas, mazot and petroleum in generating electricity and which represents about 27% of the total cost (IDSC, 2005; Al-Shawarby, 2005). In addition to the cross subsidy between the petroleum and electricity sectors, there is also a cross subsidy among electricity users/consumers due to the differences in price of kilowatt/hour according to the nature of the consumed sector. Truthfully, the households and agriculture sectors pay less than the average cost of electricity production, compared to other sectors, like the industry, which endures prices above the average of this cost.

Accordingly, by reviewing the evolution of subsidy data in the State budget, as shown in figure (5.4), major increase in subsidies has existed since 2005/2006 due to the explicit appearance of petroleum products subsidies along with other forms of subsidies, which would be discussed later.

**Figure 5.4: Evolution of Subsidy in the State Budget**



As shown from figure (5.4: b), the share of subsidies as a percentage of GDP increased during the studied period.

### 5.2.1 Structure

**Table 5.3. Different Forms of State Budget Subsidies during 2004/2005 – 2007/2008**

(Million LE)

Subsidy	Form of Subsidy	Year			
		2004/2005	2005/2006	2006/2007	2007/2008
Food Products	In-kind	11,203	9,406.6	9,818	9,482
Petroleum Products	In-kind	0	41,778.1	31,257	36,579
Electricity	In-kind	0	0	0	2000
Export Promotion	Cash	834.4	1,084.9	1,500	2000
Farmers	Cash	285.9	267.3	342.6	342.6
Upper Egypt Development	Cash	0	0	0	200
Other <sup>5</sup>	In-kind / Cash	690.6	1,348	2,635.2	2,911.4
Easy Loans Interest Rate	Cash	750.9	359.7	569.4	747.6
Other	--	0	0	276	410.3
Low Income People Housing	Cash	0	0	1000	1000
<b>Total Subsidies</b>		<b>13,764.8</b>	<b>54,244.6</b>	<b>47,398.2</b>	<b>55,672.9</b>

Source: Ministry of Finance.

<sup>5</sup> Includes the subsidies directed to services like public transportation for passengers, health insurance for students, medicine, and infants milk and cotton prices differences.

From table (5.3), clearly the food products subsidies<sup>6</sup> comprised a major bulk of the direct subsidies in the State budget reaching 81.4% during 2004/2005. However, the whole issue has changed obviously after explicitly showing the petroleum product subsidies in the State budget, which constituted 77% of total subsidies in the State budget during 2005/2006 compared to 17%, which is the share of food products subsidies.

The above figures also show the massive increase in subsidies directed to export promotion; according to law no.155/2002 regarding export development, the export development fund was established to increase the export volumes, widen its ranges and enhance the competitiveness of Egyptian exports of goods and services. Therefore, the Egyptian government directed 500 million LE in 2003 which increased to 1.5 billion LE in 2006/2007 and to 2 billion LE in the budget proposal of 2007/2008.

Moreover, the budget proposal of 2007/2008 shows an amount of 200 million LE being allocated to developing Upper Egypt, through which the government has announced a program of incentives for industrial development in Upper Egypt governorate to realize a balanced regional development.

**Box 5.1: Incentives Program for Industrial Development in Upper Egypt Governorate**

- ❑ Granting free land for investors in all Upper Egypt governorates except Al-Fayoum.
- ❑ Providing the investment and employment grant for industrial investments
  - This grant is linked to the employment volume that the factories provide and in which their investments are not below 15 million LE.
  - Not less than 15 thousands LE/work opportunity with ceiling of 25% of the company's total investments.
  - These incentives are fully applied (100%) on El-Menya, Assiut, Sohag, Qena, Aswan, Luxor governorates and 50% on Beny Suef governorate.
  - These incentives are used to pay for the operating expenses.
  - In order to link the industrial development with operation and enhancing the employment quality, these incentives are conditional upon receiving a credited certificate from the Industrial Training Council, and the employed labors are conditioned to be from the same area.
  - The most targeted sectors are: Textile and Clothing, Furniture and wooden industry, food, Minerals, chemicals, electrical and electronic, leather, medicine and construction materials.
  - The number of firms, which was granted the investment incentives for the new industrial projects in Upper Egypt governorates, reached 17 companies in Assuit, Qena, El Menya and Beny-Suef governorate.

Finally, as mentioned before, the budget proposal of 2007/2008 allocated 2 billion LE for subsidizing electricity.

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<sup>6</sup> Incorporates bread subsidy (imported and local wheat, local maize), in addition to sugar, edible/food oil, directed subsidies to rice and tea.

The subsidy allocation in the State budget is not only confined to direct subsidies, with its two forms (In-kind and Cash), but also includes indirect subsidies allocated to finance the Public Economic Authorities. Many of the Public Economic Authorities, like the Public Organization for Railways, Cairo and Alexandria public transportation, water and sanitary utilities, deliver their services with social prices which do not truly reflect the real cost of these services (Abdellatif and Shehata, 2005). In return, the State budget is increasingly burdened, as a result of covering this deficit and compensating the price differences for such services, and the share of these authorities reached 2.5 billion LE in 2004/2005. The Public Railways Organization constitutes about 72% of the total Public Economic Authorities' deficit.

Finally, the ***Implicit Subsidies***

Despite the fact that the government has incorporated some forms of the implicit subsidies into the State budget such as the petroleum products and electricity subsidies, there still exist some other forms of implicit subsidies not mentioned in the government State budget. For an example, the education subsidy - Pre and Post University - had reached about 11 billion LE during 1999/2000<sup>7</sup> (Helmy, 2005).

Furthermore, if we take into consideration the fact that the implicit subsidies are not only limited to education, but also include many of the subsidized goods and services in other sectors such as the health services, for instance, we would be confident that there is a rise in the government State aid beyond what appears in the State budget. Nevertheless, we can not guarantee in conclusion that these figures depict the total value of State aid or its full forms.

One of the subsidy forms that the government used to provide until 2005, and which did not appear in the State budget, is the tax exemptions that the government used to offer to various companies and plants, in accordance with the investment law no. 8/1997. According to article 16 and 17 of that law, the companies' and plants' commercial and industrial activity revenues or corporate income are tax exempted for 5 years and up to 10 years provided that they are located in the new industrial zones, new Communities and remote areas or projects referred to by the social development fund. This tax exemption could reach up to 20 years for companies which operate their activities outside the old valley; however, those exemptions were abolished and their pertaining articles by the Income Tax law no. 191/2005.

Hence, this does not represent one of the subsidy forms that the government provides since 2005/2006. Nonetheless, this certifies that we can not rely on one source or one entity, here the State budget, to collect all forms and structures of State aid in Egypt.

To ***conclude***, the aim of this part was not to demonstrate the State aid in Egypt and how it is aligned with the European legislations, or whether it falls under the permitted or prohibited subsidies to contribute to trade and competitiveness distortions. There are no regulations/legislations in Egypt that governs the State aid or State subsidies and which define its various forms and structures. Besides, there is no one entity that is responsible to gather State

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<sup>7</sup> This was calculated as the difference between the government and students' expenditures on both types of education – pre and post university education during the same year.

aid/subsidy data in Egypt. However, the aim of this report is to shed some lights on the various facets of State subsidies and depicts the evolution of its pattern, goals and figures across time. Obviously, all forms of State subsidies reflected economical, social and developmental objectives, in which the largest part of this State aid could be categorized in the permitted State aid list according to the European legislations.

### 5.3 State Aid in Egyptian-European Relationship: From the Association Agreement (AA) to the Action Plan of the European Neighbourhood Policy (ENP)

Article 34 in Egypt-EU AA came to ensure 3 types of commitments upon the Egyptian side in the area of State Aid, which are as follows; ***First***, any type of State aid that could distort or attempt to distort competition is not fully compatible with the AA. ***Secondly***, transparency should be guaranteed in the field of State aid through exchanging with the EU an annual report on the total amount and distribution of State aid, which could be also achieved through publishing the State aid data on the electronic web. In addition, Egypt should provide further detailed information on State aid plan upon the request of the other partner and present all data and information on specific cases when needed. ***Finally***, the agriculture sector is excluded from the application of this article as the rules of this sector fall with the State aid rules of the WTO.

**Table 5.4. Comparison between AA and Action Plan Regarding State Aid**

AA	Action Plan of the ENP
<p>ARTICLE 34</p> <ul style="list-style-type: none"> <li>- The following are incompatible with the proper functioning of the Agreement, insofar as they may affect trade between the Community and Egypt:</li> </ul> <p>(iii) Any public aid which distorts, or threatens to distort, competition by favouring certain undertakings or the production of certain goods.</p> <ul style="list-style-type: none"> <li>- Each Party shall ensure transparency in the area of public aid, inter alia by reporting annually to the other Party on the total amount and the distribution of the aid given and by providing, upon request, information on aid schemes. Upon request by one Party, the other Party shall provide information on particular individual cases of public aid.</li> <li>- With regard to agricultural products referred to in Title II, Chapter 2, paragraph 1(iii) does not</li> </ul>	<p><i>State aids</i></p> <ul style="list-style-type: none"> <li>- Agree on a definition of State aid and develop a national mechanism for collecting information on State aid in order to ensure implementation of article 34.3 of the AA by exchanging with the EU an annual report on the total amount and distribution of State aid<sup>8</sup>.</li> <li>- Exchange experience and know how at the appropriate time on the conditions to be met with reference to State aid control regimes in order to prepare Egypt's participation in the internal market.</li> </ul>

<sup>8</sup>For any sectors which should participate in the internal market, there would have to be in force a State aids control regime and legislation meeting the requirements of the EU acquis, including a system of prohibition and ex-ante control of State aids which distort trade between the EU and Egypt

AA	Action Plan of the ENP
apply. The WTO Agreement on Agriculture and the relevant provisions on WTO Agreement on Subsidies and Countervailing Duties shall apply with regard to these products.	

As seen from table (5.4), there is no major difference between what came in the AA and the Action Plan of the ENP regarding State aid.

In fact, the exchange of annual reports, data or any information between the two parties will begin after the 5<sup>th</sup> year of implementing the AA; however Egypt has progressed in explicitly showing some items of the implicit subsidies in the State budget since 2005/2006, which was not necessarily to implement the AA in the first place.

Given the Action Plan that Egypt signed in March 2007, we can say the point pertaining to State aid came to ensure the implementation of what was agreed upon in the AA; without however laying down the necessary rules that guarantee abiding by the implementation this time. On the other hand, the Action Plan came to further put more commitments on both the Egyptian and European sides which would help in implementing the article 34.3 of the AA.

The Action Plan affirmed,

1. The importance of having a common definition of State aid, which Egypt lacks now and thus, can make use by adopting the EU definition,
2. Developing a national mechanism for collecting information on State aid,
3. Technical support offered by the EU in the area of State aid control in order to prepare for Egypt's participation in the internal market.

While comparing Egypt's commitments under the Action Plan with the other Mediterranean countries, it shows that Egypt is the sole country in which its Action Plan has covered the whole set of State aid criteria. Although participating in the EU internal market, all countries' Action Plans ensured the presence of a control system and legislation compatible with that of the EU.

**Table 5.5. State Aid Comparison in Egypt's, Morocco, Tunisia, Jordan and Israel Action Plans**

Criteria	Egypt	Morocco	Tunisia	Jordan	Israel
Agree on a definition of State aid	✓	✓	✓	✓	✓
National Mechanism for collecting information on State aid	✓		✓	✓	
Exchange annual report	✓			✓	
Technical support to prepare the other's partner's participation in the EU internal market	✓	✓			



Hence, we can humbly say that the Action Plan came to put forward some rules which would allow for the implementation of article 34.3 of the AA and that Egypt could benefit from.

## **The Step Forward**

The previous discussion clearly shows that there is a wide possibility of realizing deep integration between Egypt and the EU in the area of State aid; in which the two parties can decide on a definition of permitted and non-permitted State aid, taking into consideration the EC Treaty, without necessarily reaching a full compatibility with the State aid definition in the EC Treaty.

This possibility of realizing this kind of integration between the Egyptian and European parties comes within the narrow scope of the State aid definition in the EU in comparison to the State aid definition under the auspices of the WTO, in which the Member States including Egypt abide by within the framework of the Subsidies and Countervailing Measures Agreement.

Nevertheless, the system of Ex-ante control that the EU administers, in order to prove that the State aid corresponds with the permitted criteria in article 87 in the EC Treaty, will burden the governmental institutions with the necessity of prior approval before granting such aid. This in fact differs than the system administered by the WTO, namely Ex-post control, in which there has to be a proof of inflicted damage on an industry or activity upon granting such aid.

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## **General Conclusions and Policy Implications**

### **By Ahmed F. Ghoneim**

Deep integration is not a panacea. This report identified that deep integration is much more complex than what is commonly thought. *Chapter One* showed that there are certain aspects that need to be carefully examined when applying deep integration if specific results are to be expected from it. For example, some kinds of deep integration could lead to MFN type of results whereas others could lead to discriminatory effects. When applying such deep integration concept in general to the Association Agreement (AA) and the European Neighbourhood Policy (ENP) Action Plan we observe that the Action Plan has not gone so far beyond the AA. However, the ENP Action Plan includes new mechanisms which could foster deep integration if properly utilized (namely the committees and sub-committees overseeing the implementation of the Action Plan). *Chapter One* pinpointed that the aims of deep integration should be clear, whether *enhancement of market access or rather improving the domestic business environment*. Such distinction is of paramount importance as it could result in adoption of different means to achieve deep integration.

*Chapter Two* revealed that dismantling of tariff barriers still did not boost Egyptian exports to the EU, when compared to the rest of the world. This implies that shallow integration is not enough, and something extra needs to be undertaken to reap the benefits of duty free market access to the EU. Reaping such benefit could be some sort of deep integration that enhances the market access, especially that intra industry trade (IIT) is low, which could be a symptom of lack of deep integration.

*Chapter Three* showed that deep integration if adopted to enhance market access then it should opt for harmonization. The case of standards related to agriculture and how they act as a barrier to Egyptian exports to the EU showed that harmonization is the first best to overcome this impediment facing Egyptian exports. Even though several efforts have been undertaken to ensure mutual recognition of conformity assessment procedures, they remained short of securing the market access of the Egyptian exports in the EU. This could be a result of neglect of the infrastructure pillar of deep integration, while focusing only on the regulatory/policy pillar of deep integration in the context of the AA and the ENP Action Plan. The modest role played so far by mutual recognition can be a result of the relatively new system in Egypt which could be a concern for EU authorities and hence the trust is still weak and might be enhanced by time.

*Chapter Four* showed that deep integration is not always the first best given the developmental gap between Egypt and the EU. The analysis identified that there is a clear gap between Egypt and the EU in the area of competition, and that there is a de facto harmonization of EU competition rules and regulations in Egypt whenever trade between Egypt and the EU is concerned. The analysis pointed out that given the developmental gap, and the huge policy/regulatory and infrastructure gaps, coordination and cooperation might seem to be a better alternative than full harmonization.

*Chapter Five* showed that the gap between Egypt and the EU in terms of dealing with State Aid is wide. In fact, Egypt does not have a formal definition of what constitutes State Aid. Moreover,

most of the Egyptian State Aid is eligible under the criteria set by the EU. The analysis points out that harmonization is not needed in this regard, and that the implementation so far on what has been mentioned in the AA and the Action Plan has been modest.

The general conclusions that can be reached from this report are that deep integration has several means and shapes, which is an issue that policy makers need to consider. The means of deep integration that should be adopted should be based on the aim of deep integration required. If the aim of deep integration is enhancing market access then harmonization, though costly for Egypt is a must and that it pays off in the future. However, if the aim of deep integration is upgrading the domestic business environment in Egypt then harmonization, given the developmental gap, might be very costly, and the pay off is not clearly identified in trade relations between Egypt and the EU. Soft deep integration in the form of coordination and cooperation might be a better option within the context of Egypt-EU trade relations. Such conclusion is in line with what Islam and Reshef (2006) reached where they argue using empirical evidence that the quality of institutions (i.e. having efficient and well implemented laws and regulations) is more important than just harmonizing them if the main target is to enhance trade. Policy makers should be aware of the fact that some forms of deep integration can result in discrimination against non-EU members which could have detrimental effects on Egypt-non-EU members' trade relations. This is an important policy implication when negotiating deep integration means. Finally, the study pointed out that deep integration is hard to achieve if the focus is always on the regulatory/policy aspect while neglecting the infrastructure aspect of deep integration.

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