

FINAL REPORT

Enhancing Egypt's Exports

Prepared for

**The Government of Egypt
Ministry of Trade and Supply**

Submitted to

**U.S. Agency for International
Development Cairo, Egypt**

Submitted by

Nathan Associates Inc.

Under

Contract # 263-C-00-96-00001-00



June 1998

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PREFACE

This report is based on a study conducted by the Development Economic Policy Reform Analysis (DEPRA) Project, under contract to the United States Agency for International Development, Cairo, Egypt (USAID/Egypt) (Contract No. 263-C-00-96-00001-00).

The DEPRA project is intended to encourage and support macroeconomic reform in Egypt through the provision of technical assistance and services to the Ministry of Trade and Supply with particular focus on international trade and investment liberalization, deregulation and financial sector strengthening.

The study was compiled and authored by a team from Nathan Associates Inc., Dr. James H. Cassing, Team Leader, and Mr. Denis Gallagher, and from Allied Corp. - Egypt, Dr. Ahmed M. Moharram, working under contract, and a team from Cairo University, Dr. Hanaa Kheir El Din, Dr. Samiha Fawzy, Dr. Omnia Helmy, and Dr. Mona El Garf, working under a purchase order agreement.

The team would like to thank the DEPRA coordinator, Dr. Rollo Ehrich, and the staff at DEPRA for their support. The team would also like to thank all entities, both private and public, who gave of their time to help this study achieve its purposes and to Dr. Omar Salman, and Mr. Araby Madbonly of the Center for Foreign Trade of Helwan University, and Nihal El-Megharbel and Hala Sakar at Cairo University for research assistance. The study has benefited from presentations at the Ministry of Trade and Supply, the Ministry of Economy, USAID, the Alexandria Businessmen's Association, and the Egyptian Exporters Association.

The authors are solely responsible for all opinions expressed in this report, and the conclusions and recommendation do not necessarily reflect opinions or policies of either the Government of Egypt or the U.S. Agency for International Development.

ENHANCING EGYPT'S EXPORTS

EXECUTIVE SUMMARY

The Government of Egypt (GOE) has set a target for gross domestic product growth at an annual rate of 7 to 8 percent by the year 2000. An important part of the strategy for achieving this goal is policy reform aimed at enhancing export performance and attracting increased investment.

Egypt currently has a unique opportunity to achieve its growth target by relying increasingly on the rapidly growing world economy, large amounts of international capital seeking productive investments, and, in particular, through closer cooperation with the European Union.

However, there are currently some serious obstacles to the globalization strategy, which threaten not only to undermine export growth and investment, but also to entice new job entrants into less productive jobs and new investment into artificially protected, less productive industries. If the price and other incentives are not changed rationally and promptly, Egypt will experience uneven and socially less desirable growth and will continue to fall far behind expectations.

While it is the GOE's intention to create an exporter friendly business climate and to help exporters re-connect with the global trading network with which Egypt has essentially disengaged, there are serious challenges to avoiding what the World Bank [1998a] has referred to as "the base case scenario" wherein structural reform moves slowly, resulting in low per capita income growth and rising unemployment.

The world trading system is evolving rapidly into a global market with low trade barriers and harmonized systems of standards and quality control. Overly gradual engagement of the global economy amounts to losing ground in light of the rapid pace of change in the marketplace. While there is indeed a window of opportunity just now, windows do close and a sense of some urgency would not be misplaced.

This report addresses some of these challenges to fostering prosperity through export enhancement and aims to identify and assess the impact of several of the impediments to the globalization strategy. It is also pro-active in the sense that it offers prescriptions for achieving the GOE's strategic objective. In particular, we focus upon the structure of tariffs, non-tariff barriers, and missed opportunities.

Tariffs

Current tariffs are high and uneven. The average nominal rate of protection in manufacturing, excluding beverages and petroleum refining, is **24.6%**. The average effective rate of protection (ERP) in manufacturing is **34.22%** and highly non-uniform, with some rates well over 80%.

Current import tariffs are inconsistent with the GOE's export promotion strategy. By raising the price of domestically produced and sold goods relative to export prices, the tariffs create an anti-export bias and work as a serious deterrent to export performance.

We estimate that the tariffs amount to a **19.4% export tax economy-wide**. Such a tax falls especially hard on non-traditional exports, which cannot absorb much of a tax on profits and still be price competitive on world markets. The effective rate of protection for exporters in every sector of the economy is negative and often large. Even with duty drawback, the tariffs burden exporters. On average, potential exporters of manufactured goods receive a **21.7% premium** for not exporting but selling on the domestic market.

The dispersion in the tariff structure gives uneven protection to industries, favoring some over others. This threatens to divert new investment resources away from the potentially most promising sectors of the economy.

Non-Tariff Barriers

GOE regulations in quality control, port management and price setting of basic services act as non-tariff barriers (NTB's) to trade and investment throughout the economy. These NTB's significantly magnify the tax on exports levied through the current tariff and tax system.

The "red tape" costs of quality control related clearance delays alone are equivalent to a **10% export tax**, (estimated by the World Bank in 1997 Country Economic Memorandum) while inefficiencies in port operations add an **additional 10%** to the costs of imported inputs.

The adoption by Egypt of international standards would greatly reduce these implicit export taxes and send a clear signal to trading partners and investors that Egypt is a credible participant in the global economy. Alternatively the lack of such a strategic signal creates another barrier to the development of non-traditional exports as both buyers and investors seek more predictable business partners in the competitive market.

Fundamentally, harmonization of Egyptian product standards linked to a mutual recognition agreement within the free trade agreement with Europe [EMA] is the fastest way that Egypt could stimulate exports and integrate into the global economy. The dynamic gains for Egypt could be in excess of **2.5-3.0% of GDP** by this initial step toward deep integration and accelerated harmonization of its regulatory regimes.

However, greater gains could be expected from a deep integration approach when extended under a set time horizon to include all of Egypt's current and potential trading partners. This could emerge by allowing the international business community unfettered right to establish business operations linked to a program of rigorous deregulation of the Egyptian economy. This deep integration will result in:

- harmonization of regulatory regimes including product and service standards and competition policy.
- elimination of “hub & spoke” patterns of investment as national treatment is provided.
- new investment opportunities in all markets and sectors.
- providing an anchor for the economic reform program in a timetable toward global integration.

Evidence from Industry

Evidence from sector studies and company interviews undertaken during the course of this review support the findings identified above and point toward several important results. The industries were textiles and clothing, foodstuffs, electronics, leather footwear, and wooden furniture.

Largely, the industries studied revealed potential for exporting. They enjoy a favorable Revealed Comparative Advantage, high export growth rates, and they are highly labor intensive in a “labor cheap” country.

However, both export and efficiency indicators show the industries to be under performing expectations. While there may also be a number of other problems related to Egyptian business practices, two sources of current under performance are clear: a distorted incentive structure and high export transactions costs. The first results in a weak incentive to export and the second in a lack of export competitiveness.

According to the survey results, high export transactions costs stem from both institutional constraints, which increase the cost generally of doing business in Egypt for everyone, and from direct constraints on export performance such as cumbersome export procedures. The survey identified the tariff level as the most critical element that should be considered in promoting exports.

Strategically, trade policy reform interventions should be shaped by industrial structure and current policies. Three different categories of industrial structure seem relevant and would dictate different approaches to policy reform and export promotion: (1) inefficient and highly protected, (2) efficient and highly protected, and (3) efficient and not protected.

Recommendations

- continue current policy of cutting the highest tariffs even more aggressively
- target a goal of a low, uniform tariff in the range of 10% - 15%
- improve duty drawback and temporary admission
- aggressively pursue a deeper integration with the global economy through an EMA
- aggressively pursue direct export promotion activities and programs to improve production efficiency in those industries benefiting from a more favorable, reformed tariff structure.

ENHANCING EGYPT'S EXPORTS

1.0. Introduction

The Government of Egypt (GOE) has set a target for gross domestic product growth at an annual rate of 7 - 8 percent by the year 2000. An important part of the strategy for achieving this goal is policy reform aimed at enhancing export performance and attracting increased investment. While exports and investment are not in themselves measures of prosperity, the GOE's instincts are undoubtedly correct in that policies which are more amenable to increased levels of exports and investment may well lead to higher levels of real income in Egypt. And the "globalization" strategy is well timed. Egypt currently has a unique opportunity to achieve its growth target by relying increasingly on the rapidly growing world economy, large amounts of international capital seeking productive investments, and, in particular, through closer cooperation with the European Union.

However, there are currently some serious obstacles to the globalization strategy which threaten not only to undermine export growth and investment, but also to entice new job entrants into less productive jobs and new investment into artificially protected, less productive industries. If the price and other incentives are not changed rationally and promptly, Egypt will experience bad growth and will continue to fall far behind expectations. As it stands, Egypt has been marginalized in international trade with a mere US\$ 3.5 billion of merchandise exports concentrated in a handful of traditional exports and petroleum. (Non-factor service receipts such as from tourism and the Suez Canal are US\$ 10.6 billion.) Manufactured exports amount to only US\$ 1.3 billion, of which half are textiles [World Bank, 1998a]. Had Egyptian exports simply grown at the world average since 1983, exports would be about twice what they are now. However, despite low labor costs, rich natural resources, and an advantageous location, Egypt's share of world exports and imports has declined, as has the openness of the economy [Subramanian, 1997]. As for non-traditional exports, even a robust growth rate in merchandise exports of say 35% for five years would not return Egypt's merchandise export share of world trade to the level of 1970 -- 0.27% [World Bank, 1998b]. Furthermore, while the flow of real investment is respectable, although not high, the performance of the investment has not been satisfactory. If this pattern of investment were to continue, even modest rates of GDP growth -- 3% to 4% -- would probably be unachievable and per capita real incomes would stagnate with population growth.

So, while there is much talk of reasons for optimism, there is also reason for concern regarding the fragility of the necessary preconditions for an export boom and the direction and pace of Egypt's current economic reforms. There is ample evidence that export booms and the accompanying high real income growth can and do happen if the economic structure is a friendly one [Roberts and Tybout, 1997]. And the evidence also indicates that exporting is self-reinforcing in that once the boom starts, it tends to spread to new firms and industries. It is clearly the GOE's intention to create an exporter friendly business climate and to help exporters re-connect with the global trading network with which Egypt has essentially disengaged. But good intentions are insufficient to deal with the taxes and stifling bureaucracy that block initiatives

and lower efficiency and productivity. There are serious challenges to avoiding what the World Bank [1998b] has referred to as “the base case scenario” wherein structural reform moves slowly, resulting in low per capita income growth and rising unemployment. The world trading system is evolving rapidly into a global market with low trade barriers and harmonized systems of standards and quality control. Overly gradual engagement of the global economy is essentially losing ground in light of the rapid pace of change in the marketplace. While there is indeed a window of opportunity just now, windows do close and a sense of some urgency would not be misplaced.

This report concerns some of these challenges to fostering prosperity through export enhancement and aims to identify and assess the impact of several of the impediments to the globalization strategy. In particular, we focus on the structure of economic incentives embedded in the tariff/tax system as it now exists and as it is proposed to be modified. We comment on the implications of this tariff structure on both trade and growth, arguing that it has an anti-trade bias and discourages investment in the most productive sectors. We next recount some remaining non-tariff barriers (NTBs) to trade and investment, focusing especially on problems with moving product through the ports. In particular, we revisit the delays and confusion inherent in the Egyptian system of standards and quality control, arguing that the current system burdens traders and serves as a significant non-tariff barrier. Also, we highlight the increasing importance of standards and quality control in accessing world markets and worry that Egypt is falling behind in this rapidly evolving area to the detriment of its international trade and investment opportunities. Finally, we look specifically at five industries which have become the focus of some attention in Egypt and assess at several levels the problems and prospects in these sectors with an eye toward growth and export potential. While we recognize that other considerations such as the appropriate level of the exchange rate, human resource development, and so on, also impinge upon export prospects, such issues are beyond the scope of this Report.

2.0. The Current Tariff Regime and Proposals for Reform

2.1. The structure of tariffs and taxes

Egypt taxes corporations, individuals, commodities, and a number of other activities. (See Appendix 1 for details.) Regarding the effects on international trade flows and investment, the proximate taxes are the import duties and surcharges, the general sales tax (GST) because it is levied on a duty-inclusive basis, and certain corporate taxes because of the GOE propensity to grant substantial tax holidays for investment since 1974. In this section we focus exclusively on the structure of import duties and the GST. We address partial exceptions like duty drawback, free trade areas, and tax holidays, in a later section. (There are no export taxes or quotas.) In particular, we review the pattern of nominal protection and provide new estimates of the effective rates of protection at a sectoral level. We also offer some comparisons of these rates with other countries of relevance.

2.1.1. Levels of Nominal and Effective Rates of Protection

Egypt is emerging from a long period of import substitution and, despite substantial tariff cutting, it is still left with a legacy of high and dispersed import duties. The trade weighted average is reported to be 30% by the World Bank [1998] with rate bands of 0%, 5%, 10%, 20%, 30%, 35%, 40%, 45%, and 50%. Also, there are several important exceptions including poultry, large cars, tobacco, and certain beverages, especially alcoholic ones, with very high duties. Customs classifies product according to the harmonized system (HS) and has responsibility for collecting duties. Details of the current structure are available in World Bank [1998b] and, for finer details, through Customs and the GOE statistical agency CAPMAS. There is a tariff reform due on July 1, 1998, which will again compress the tariff structure a bit more and tariffy currently banned fabric imports at 54%. (Final wear imports, now banned, remain the only quantitative restriction beyond firearms, illegal drugs, and such. Other significant non-tariff barriers are discussed in Section 3 of this Report.)

In this section, we offer an overview of the structure of tariffs in Egypt for manufacturing and agriculture using the 3-digit level aggregation consistent with the latest available input-output table. This allows us to compute some summary measures of protection at a comprehensible and meaning, as well as to calculate effective rates of protection, implicit rates of protection on material inputs, and some other helpful summary statistics. In following sections, we offer some economic analysis of this tariff structure with a focus on the implications for trade and investment. The current rates of nominal and effective protection are those set in 1997. The effects of the 1997 tariff revisions on the structure of effective protection in the economy are examined below. This evaluation is based on the analysis of the 1991/92 input-output table. Twenty-four activities have been considered, namely three in agriculture and twenty-one in manufacturing.

However, when calculating averages for agriculture, manufacturing, and all tradables, two manufacturing activities have been disregarded, namely: beverages and petroleum refining, as their inclusion distorts the results. Beverages have received enormous protection due to a prohibitive nominal tariff imposed on alcoholic beverages to restrict their access to the domestic market.

Petroleum refining is a highly regulated activity which depends on political decisions concerning the rate of crude petroleum extraction, on the expected domestic consumption as well as on the foreign exchange needs and thus the required petroleum export proceeds. Thus, investigation of the degree of protection extended to this activity is somewhat irrelevant.

By subtracting inputs from outputs estimated at world prices, one obtains a figure for value added at world prices. Using this information together with value added at domestic prices taken from the 1991/92 input-output table, the effective rate of protection (ERP) granted to each activity has been calculated. World prices have been compiled by deflating domestic prices by the nominal 1997 tariff on the respective outputs and inputs. The results are reported in the following table along with the nominal rate of protection (NRP) to various activities (1).

Table (2.1.)
Nominal and Effective Protection Rates in 1997

Activity	NRP _j	INRP _i	ERP _j
	%		
Agriculture	7.14	4.81	8.20
1. Agricultural Food Products	6.82	5.04	6.62
2. Agricultural Non-Food Products	9.49	6.08	9.63
3. Livestock Products	5.11	3.31	4.17
Manufacturing	27.37	7.62	34.22
4. Food Processing	6.87	2.23	6.39
5. Beverages	271.64	11.34	-1781.7
6. Tobacco Processing	85.00	-1.92	88.47
7. Cotton Ginning	5.01	7.96	-10.89
8. Spinning and Weaving	27.95	7.67	47.55
9. Final Wear	46.64	14.56	55.86
10. Leather & Leather Products (excl. Footwear)	31.13	17.43	47.57
11. Footwear	39.10	15.54	50.81
12. Wood & Wood Products (excl. Furniture)	8.64	10.41	6.10
13. Furniture	49.90	8.19	83.80
14. Paper and Printing	17.05	5.47	17.84
15. Chemicals (excl. Petroleum Refining)	10.01	2.65	9.20
16. Petroleum Refining	11.81	-1.56	14.76
17. Rubber and Plastic Products	28.47	6.21	43.07
18. Porcelain, China and Ceramics	35.04	6.19	55.95
19. Glass Products	20.65	9.91	23.20
20. Non-Metallic Products	15.18	6.23	18.52
21. Steel, Iron and Metallic Products	16.06	7.68	18.06
22. Machinery and Equipment	15.30	6.57	14.49
23. Means of Transport	43.97	2.83	55.62
24. Other Manufacturing	18.14	8.92	18.52
Average (excl. Beverages and Petrol. Ref.)	24.62	7.23	30.48
Standard Deviation	19.51	4.50	26.93

Source: NRP_j = nominal rate of protection on output of activity j, calculated by Maurice Thorne.

INRP_i = implicit nominal rate of protection on material inputs i in activity j, calculated by the Hanaa Kheir-El-Din.

ERP_j = effective rate of protection for activity j, calculated by the Hanaa Kheir-El-Din. [See] the "Note" for the DEPRA project, MOE, on "Effective Protection in Egypt due to the Tariff Structures in 1996 and 1997 compared to 1994.")

It appears from Table (1) that the effective rates of protection are highly correlated with the nominal rates of protection as reflected by the estimated rank correlation coefficient of 0.98, in the sense that a relatively high NRP is usually associated with a relatively high ERP. For agriculture, on average, ERP is somewhat higher than NRP, but both measures of protection are lower than 10%. As to manufacturing, it is also enjoying ERP higher than NRP, and both are significantly higher than for agriculture, as they exceed respectively 34% and 27%. Overall, agricultural and manufacturing activities enjoy on average, according to the 1997 tariff structure, nominal protection of 24.6% while effective protection reaches 30.5% (2).

It also appears that in most manufacturing activities ERP granted to various activities is higher than NRP, with few exceptions where both measures of protection are very close to each other with ERP somewhat lower than NRP -- namely for food processing, wood and wood products other than furniture, chemicals other than petroleum refining and machinery and equipment. One striking exception, however, is that of cotton ginning which nominally receives a low protection of around 5%, but is effectively discriminated against as shown by a negative ERP of 10.9%, suggesting that competitive firms in this activity would be discouraged from production.

The table also shows that the implicit nominal rates of protection on intermediate inputs in various activities are low, averaging 4.8% in agriculture and 7.6% in manufacturing, disregarding again inputs in beverages and in petroleum refining. However, inputs in tobacco processing and petroleum refining appear to be slightly subsidized. These low rates contribute to high ERPs. Furthermore, it would appear that the GOE's stated policy of reducing tariffs on intermediate goods without appropriate reduction in product tariffs, should be viewed with caution as it could actually increase the effective rates of protection.

The figures in Table (2.1) further indicate that effective protection extended by the 1997 tariff structure tends to favor consumer goods activities, whether durable or non-durable (3), in addition to means of transport which all enjoy ERPs exceeding 50%, with the exception of food processing which receives very little protection both nominally and effectively. The 1997 tariff structure moderately protects intermediate goods industries, while it discriminates against the main traditional manufacturing activity, namely, cotton ginning.

2.1.2. Dispersion of the Nominal and Effective Rates of Protection

A less than uniform tariff structure -- i.e., tariffs at differing rates across products -- creates some undesirable effects (discussed later) and so measures of tariff dispersion are frequently reported. We report here the standard deviation of tariffs as a summary statistic of tariff dispersion about the mean tariff.

- *Nominal Tariffs Are Highly Dispersed*

A first pass summary measure of non-uniformity of protection is the **standard deviation of the nominal tariffs**. For Egypt, from Table (2.1), this is 19.51 overall and 24.62 for manufacturing alone, with a range of 5% to 50%, except for beverages and tobacco which exceed the maximum tariff. This is high in comparison with most countries, as reported below.

- *ERPs Are Highly Dispersed*

A more accurate measure of non-uniformity in production or investment incentives compares the dispersion in the **effective rates of protection**, since these rates measure protection by sector. These rates are shown in Table (2.1) above. Compared with nominal rates, the ERPs are significantly more dispersed with a standard deviation of 34.22 in manufacturing and 26.93 overall. This indicates that some sectors are much more favored by the tariff structure than others and so are likely to attract resources away from sectors which are in fact more productive. And, while unskilled labor is abundant, capital and certain skills are not, and so the more protected sectors are likely to have expanded at the expense of other less protected sectors including non-traditional exports. Ironically, to the extent that capital and skilled labor are diverted to uses in less labor intensive sectors, employment opportunities are suppressed and real wages, already lower due to high tariffs on consumer goods, are further reduced.

Sectors which are particularly favored by the tariff structure at the expense of other sectors, and of exports generally, include final wear, footwear, furniture, rubber and plastic products, porcelain, china and ceramics, and means of transport. As an extreme example of the perversity of this tariff structure, note that furniture receives an 83.8% “subsidy” to its value added due to tariffs alone (It is also protected by international transport costs and port clearance costs.), while cotton ginning exports has its value added essentially “taxed” at 10.89% by this tariff structure even if duty drawback works more than perfectly.

2.1.3. Comparisons with Other Countries

While Egypt’s tariffs have clearly been trending downward, they are still quite high. One problem with trying to assess the height of a tariff structure is that summary measures are necessarily misleading. For example, a simple arithmetic average may give too much weight to high tariffs on goods which are not imported anyway or which have become redundant because trade was already precluded at much lower tariff levels, as with alcoholic beverages in Egypt. On the other hand, attempts to weight tariffs by the level of imports may significantly understate the tariff level because high tariffs themselves choke off imports and thereby receive less weight in the average. Also, in Egypt and in other countries there are invariably exceptions to duties such as duty drawback, free trade agreements, and so forth.

One way to put things in perspective is to compare Egypt’s tariffs with those of other countries. Table (2.2) shows some comparisons of nominal rates of protection with other countries and regions. In particular, the 1996 trade-weighted average tariff for Egypt was 28% which significantly exceeds the world average (8.2%) and even the developing country average (21.4%). We might note, though, that other countries in the region also have high tariffs, except for Israel, and that while Egypt’s is among the highest tariff structures in the world, it is not the highest. Also, using our own calculations for the arithmetic mean of tariffs in Egypt, omitting the beverages and petroleum refining sectors, the average tariff is 27.37% for manufacturing, but only 7.14% for agriculture, and 24.62% overall.

Table (2.2)

Weighted Average Tariffs: Egypt, Southern Mediterranean Countries, Other Regions (In percent; March 1996)

Algeria (1992)	21.6
Egypt	28
Israel	7.2
Jordan	19.8
Lebanon	24.2
Morocco	20.3
Syria	17.2
Tunisia	31.7
East Asia	21.3
Central Europe	9.1
High Income Countries	5.8
Latin America	14.1
South Asia	47.1
Sub-Saharan Africa	14.8
Developing Countries	21.4
World	8.2

[Havrylyshyn, 1996]

Egypt's mean effective rate of protection is 34.22% in manufacturing, 6.81% in agriculture, and 30.48% overall for these two groups. World Bank [1997] calculates a much higher overall ERP of 70%, including beverages, which is high when compared with other countries like Jordan [Hoekman and Djankov, 1997].

Another difficulty in assessing the height of tariffs is that the duties may differ across sectors of the economy. This is certainly the case in Egypt with tariffs ranging from zero to 50% as a norm, and with exceptionally high tariffs on some items -- tobacco, poultry, certain beverages, and automobiles. An indication of this dispersion in rates for Egypt is given by the standard deviation in Table (2.1) of 19.51, indicating a non-uniform structure of protection. Exceptions such as duty drawback would, of course, increase this non-uniformity.

In comparison, for manufacturing, the standard deviation for Egyptian tariffs is substantially higher than that for all the 57 countries represented in World Bank [1998a] except Bangladesh, India, Mauritius, Nigeria, Sri Lanka, Tanzania, and Zimbabwe. Egypt's tariff dispersion is about twice the average for all countries in the sample.

In light of the raw averages and the comparisons with other countries, it is probably fair to say that **tariffs in Egypt are still high and quite dispersed**. Below we will address some of the concerns with such a structure.

2.1.4. The General Sales Tax (GST)

The GST is a sales tax applied at the manufacturing level on imported and domestically produced goods, with some exceptions, and on certain services. The rates range from 5% to 25%, with a standard tax on goods of 10%. There are also some exceptionally high GST rates on some goods -- e.g., mineral water, soft drinks, and juices (32.5% - 60%), cigars and cigarettes (50% - 200%), and alcoholic beverages (100%). Thus, the GST is a fairly high, non-uniform tax on commodities (see Appendix I for details).

Although our focus is on international trade, the GST is relevant for two reasons. First, while it is applied to both imported goods and domestically produced goods, the GST is applied to imports on a duty-inclusive basis. Thus, it has the effect of magnifying existing tariff rates. For example, suppose that there is a commodity that is produced locally as well as imported. And, suppose that the duty on imports is 40% and that the GST is 10%. Then, the domestically produced good will be taxed at 10%. But the imported good will be taxed at 40% by the duty, and an additional 14% by the GST since the duty is in the tax base. For some goods, this magnification of the tariff rate is substantial.

Second, the GST is relevant because the welfare effect of any commodity tax depends on the addition to the tax wedge of each tax at the margin. For example, a 20% tariff on an otherwise untaxed good will have a certain negative welfare impact. However, that same 20% tariff on a good which will then be taxed by the GST at, say 20%, will have a greater negative welfare impact because the tax is laid on an already distorted base. As a rule of thumb, a 20% tariff when there is a 20% GST will have four times the negative welfare effect as a 20% tariff when there is no GST [Vousden, 1990].

2.2. Implications of the Tariff Structure for Exports

The current structure of Egypt's trade taxes gives rise to several concerns because the import duties are both very high and very dispersed, giving more protection to finished goods than to raw materials, capital goods, and other inputs. While this "cascading" tariff structure aims to foster manufacturing through import-substitution, in fact it creates an anti-export bias which is inconsistent with the GOE's current globalization strategy. This section reviews this phenomenon more closely.

2.2.1. The Anti-Export Bias Due to High Tariffs

An import tariff is effectively an export tax. Taxes and subsidies on commodities serve to change prices since they are seen to be part of the true price by buyers and sellers. Tariffs or import duties are commodity taxes which raise the price of imports by the full amount of the duty for a small country like Egypt and so provide a margin of protection for the Egyptian producers of similar goods who sell in the domestic market. The exporters, on the other hand, see the price of their exports fall relative to both the tariff protected import-competing goods and, to some extent, non-traded goods. Thus, the tax on imports affects prices in essentially the same way as a tax on exports.

Egypt may well be taxing its non-traditional export sector out of existence. High import tariffs divert production and investment away from exporting and into the other sectors of the economy. Now, as with any tax, the implied export tax falls hardest on those industries which are least positioned to see their profit margins squeezed. In Egypt, this is the non-traditional export sector. Traditional exports like petroleum, mineral resources, the Suez canal, tourism, and some agriculture, rely extensively on fairly industry specific inputs whose values can simply absorb the tax but will still be viable economic activities, albeit somewhat less profitable. However, non-traditional industries such as manufactured exports have no such luxury. Such goods must compete in the world marketplace with other high quality, highly competitively priced commodities. Profit margins of such exports are already squeezed by transport costs and, in the case of Egypt, substantial other non-tax costs and delays. So even a small export tax may be enough incentive to discourage exports and so the non-traditional export industries simply never appear. Since evidence suggests that the existence of some exporters contributes significantly to enhancing the prospects for new exporters (Roberts and Tybout[1997]), the pre-conditions for a non-traditional goods export boom are compromised by the import tariffs.

The negative effects on exporters are further magnified by non-tariff barriers. Beyond this implied export tax owing to the import tariffs, there is an additional tariff equivalent effect raising import-competing goods prices owing to non-tariff barriers working through high “red tape” costs at the ports (See Section 3.1 for details.) and the fact that the GST is applied on a duty-inclusive basis. Because of the potential importance of non-tariff barriers at the ports, it is difficult to know the precise level of tariffs and tariff equivalent import barriers. However, various tariffs-only weighted and unweighted averages vary from 25% to 30%. Non-tariff barriers to trade may add from 5% to 15% to this average. Nathan Associates [1996] used the number 5% for the NTBs associated only with the system of standards and quality control, based on survey data and product coverage ratios reported by the World Bank. Maskus and Konan [1997] used 10% for exports and 15% for imports.

2.2.2. Measures of the Anti-Export Bias in Egypt

- *Tariffs in Egypt Are Equivalent to a High Tax on Exports*

Economic analysis provides a way to estimate the export tax equivalent of import tariffs. (See Greenaway [1989], Wells and Evans [1989], Clements and Sjaastad [1984], and Appendix 3 of this Report for details.) If the average tariff in Egypt is taken to be 30%, the World Bank [1998b] weighted tariff-only rate, the equivalent **export tax would be 19.4%**. In other words, current Egyptian import duties are having the same effect as a very large export tax.

Theory suggests that such a tax would fall especially hard on the non-traditional exports, precluding the development of a non-traditional export sector, and **resulting in low levels of exports skewed toward traditional export industries.** This is indeed what we see in Egypt. Modifying the assumptions would change the estimates somewhat in either direction, but it would not change the qualitative result that tariffs work essentially as a tax on exporters. For example, even a modest average import duty of 16% -- about the percent of import value actually collected

as tariff revenue in Egypt -- would imply a tax on exporters in excess of 10%. And remember, this tax falls on the gross value of exports, not just on profits, and so can have a **chilling effect on the incentive to export**.

- *Tariffs Represent Taxes on Inputs for Exporters and Other Producers*

Another way to quantify the burden of the import tax structure on producers, including exporters, is to look at the **implicit nominal rates of protection on material inputs (INRP)**. This is essentially a measure of the tax paid explicitly for imports or implicitly for import substitutes on inputs for various activities. While this conceals the more subtle “general equilibrium” effects of import tariffs discussed immediately above, and so understates the burden placed on exporters, it does explicitly reveal what direct additional costs tariffs impose on imported inputs and their locally produced counterparts. This is shown in Table (2.1) in the column labeled INRPi.

While the average tariff rate on imported inputs, omitting the beverages and petroleum refining, is not exorbitant at 7.23% (7.62% for manufacturing, 4.81% for agriculture), and can be partially recovered through duty drawback, it is nonetheless one more cost of doing business and, for some sectors like leather products or footwear, is quite high.

- *Tariffs Burden Exporters in Egypt with Substantial Negative Effective Protection Even If Duty Drawback Works Perfectly*

A measure aimed to expose the direct burden of the import taxes on exporters is to calculate the **effective rate of protection for firms that decide to export** some of their product. Such firms must pay the tariff protected prices for inputs, whether imported or domestically produced under protection, but receive no such protection for their output prices since they are selling into the world market. These calculations are shown in Table (2.3). The first column (Experiment 1) ignores the possibility of duty drawback, while the second column (Experiment 2) assumes that duty drawback works perfectly and costlessly for all exporters. Also, it is assumed, unrealistically, that duty is rebated even if the imported materials are not imported directly but purchased from another importer, which is not allowed in Egypt. Thus, the Experiment 2 calculations are biased and make drawback look more effective than it in fact is.

Table (2.3)
Effective Rates of Protection to Exports in 1997

Activity	%	
	ERPj Experiment 1 ⁽¹⁾	ERPj Experiment 2 ⁽²⁾
Agriculture	-2.00	-1.52
1. Agricultural Food Products	-1.22	-0.87
2. Agricultural Non-Food Products	-1.42	-1.17
3. Livestock Products	-3.35	-2.52
Manufacturing	-16.60	-7.77
4. Food Processing	-7.78	-3.01
5. Beverages	94.99	60.20
6. Tobacco Processing	-30.54	-5.52
7. Cotton Ginning	-32.82	-32.79
8. Spinning and Weaving	-17.34	-10.58
9. Final Wear	13.69	-10.33
10. Leather & Leather Products (excl. Footwear)	-17.61	-11.82
11. Footwear	-28.04	-24.68
12. Wood & Wood Products (excl. Furniture)	-12.66	-3.38
13. Furniture	-10.80	-4.28
14. Paper and Printing	-21.12	-0.99
15. Chemicals (excl. Petroleum Refining)	-13.94	-2.35
16. Petroleum Refining	-2.61	-0.59
17. Rubber and Plastic Products	-18.27	-9.37
18. Porcelain, China and Ceramics	-5.92	-4.87
19. Glass Products	-6.29	-1.57
20. Non-Metallic Products	-5.20	-4.82
21. Steel, Iron and Metallic Products	-9.48	-7.58
22. Machinery and Equipment	17.92	-2.29
23. Means of Transport	-31.29	-3.25
24. Other Manufacturing	-14.66	-4.06
Average	-14.61	-6.91
Standard Deviation	9.59	7.87

(1) Experiment 1 represents the effect on ERP of selling exports at the international price while producers of export goods pay the domestic price for their domestic and imported inputs.

(2) Experiment 2 represents the effect on ERP of selling exports at world price, and receiving duty drawback on imported inputs.

Several points are apparent. First, tariffs provide negative effective protection for exporters. Value added per unit for firms that decide to export is on average between 6.91% and 14.61% lower than it would be in the absence of tariffs on inputs, depending on how well duty drawback works. For non-traditional exports trying to compete with high quality products on world markets, even the lower of these two numbers can erode any profit margin and be a substantial disincentive to export. Second, drawback clearly makes a large difference for most sectors, but not all. For example, footwear and cotton ginning suffer substantial disincentives to export with or without duty drawback. Finally, in light of the large difference that drawback appears to make, and because studies show that export booms are likely to be fueled especially by new exporters (Roberts and Tybout (1997)), it is particularly important that this facility -- or an improvement like duty/VAT remission -- be easily accessible to all exporters.

- *Tariffs Discourage Exporting in Favor of Domestic Sales*

Another measure of the anti-export bias inherent in the customs tariffs is the **anti-export bias calculation**. For a domestic producer, there is a choice of selling the output in the domestic market or exporting it. This decision depends, to a large extent, on the relative profitability of the domestic versus the export market which, in turn, depends upon the prices. If the domestic price exceeds the potential price from foreign markets, production for the domestic market will be preferable. Conversely if the price obtained from exporting exceeds that to be obtained from selling in domestic markets, exports will be more profitable.

Domestic prices are affected by economic policies. If the policies pursued render production for the domestic market more profitable than production for export markets, then they are said to discriminate against exports and entail an anti-export bias.

Egypt, like most industrial and developing countries, has protected its manufacturing industries producing for the domestic market. It has traditionally protected import substituting industries over exports and industry over agriculture, principally through imposing high protective tariffs on imported commodities. Some essential foods and raw materials are exempted from tariff, but most imported inputs and final products are subject to import taxes which have gradually been reduced but are still high. These taxes increase costs of production and hinder export expansion. They further raise domestic prices, thus raising the financial profitability of domestic sales compared to that of exports.

Since 1986, Egypt has undertaken major tariff revisions aimed at reducing the level of protection to various economic activities. However, with the exception of the drawback scheme, very few incentives are directly provided to exports to increase their competitiveness abroad. This section will examine the extent of tariff induced bias against exports implied by the 1997 tariff structure. The corresponding figures for 1994 are also presented for comparison. Table (2.4) shows the extent of tariff induced bias against exports for the two years. Calculations are based on input structures in various activities as given in the 1991/92 input-output table. The extent of tariff induced bias against exports (B_{xj}) has been estimated as:

$$B_{xj} = \left[\frac{1+t_j}{1+s_j} - 1 \right] \times 100^{(4)}$$

Where:

t_j = tariff rate on product j - NRP_j

s_j = export subsidy rate; this rate represents the **potential** duty drawback per L.E of export and has been calculated as $NRP_i \times m_{ij}$, m_{ij} is the technical coefficient of imported commodity i per L.E. worth of product j- these coefficients have been obtained from the import technical coefficient matrix annexed to the 1991/92 input-output table.

Table (2.4)
The Extent of Tariff Induced Bias against Exports
(1997 compared to 1994)

<u>Activity</u>	<u>1994</u>			<u>1997</u>		
	<u>1+tj</u>	<u>1+sj</u>	<u>B_{xi}%</u>	<u>1+tj</u>	<u>1+sj</u>	<u>B_{xi}%</u>
Agriculture			9.385			6.745
1. Agricultural Food Products	1.089	1.004	8.495	1.068	1.003	6.480
2. Agricultural Non-Food Products	1.157	1.003	15.397	1.095	1.002	9.250
3. Livestock Products	1.050	1.007	4.263	1.051	1.006	4.505
Manufacturing			29.354			21.711
4. Food Processing	1.084	1.030	5.259	1.069	1.023	4.451
5. Beverages	13.705	1.038	1220.434	3.716	1.018	265.061
6. Tobacco Processing	1.850	1.177	57.126	1.850	1.177	57.156
7. Cotton Ginning	1.050	1.000	4.990	1.050	1.000	5.001
8. Spinning and Weaving	1.376	1.037	32.692	1.280	1.028	24.439
9. Final Wear	1.696	1.026	65.246	1.466	1.020	43.824
10. Leather & Leather Products (excl. Footwear)	1.466	1.027	42.718	1.311	1.024	28.118
11. Footwear	1.639	1.018	60.951	1.391	1.015	36.983
12. Wood & Wood Products (excl. Furniture)	1.120	1.056	5.064	1.086	1.043	4.146
13. Furniture	1.698	1.032	64.52	1.499	1.025	46.240
14. Paper and Printing	1.171	1.089	7.539	1.171	1.088	7.592
15. Chemicals (excl. Petroleum Refining)	1.111	1.060	4.850	1.100	1.051	4.684
16. Petroleum Refining	1.096	1.015	7.981	1.118	1.013	10.378
17. Rubber and Plastic Products	1.330	1.048	26.838	1.285	1.041	23.452
18. Porcelain, China and Ceramics	1.525	1.005	51.674	1.350	1.005	34.384
19. Glass Products	1.332	1.047	27.285	1.207	1.032	16.906
20. Non-Metallic Products	1.231	1.003	22.660	1.152	1.002	14.906
21. Steel, Iron and Metallic Products	1.230	1.016	21.119	1.161	1.011	14.818
22. Machinery and Equipment	1.225	1.106	10.712	1.153	1.075	7.249
23. Means of Transport	1.527	1.170	30.569	1.440	1.137	26.616
24. Other Manufacturing	1.253	1.081	15.919	1.181	1.059	11.548
Average			26.631			19.670
Standard Deviation			21.350			15.755

Source: Hanaa Kheir-El-Din

The extent of the economy-wide average bias against exports decreased from 26.6% in 1994 to 19.7% in 1997. However, it did not decrease uniformly across all activities. Anti-export bias in agricultural activities decreased on average from 9.4% in 1994 to 6.7% in 1997, with the highest decrease being observed in agricultural non-food products, followed by food products. As to livestock, they experienced a slight increase in anti-export bias, although this bias remained low (less than 5%). As for manufacturing, the average anti-export bias declined from 29.4% in 1994 to 21.7% in 1997. This average, however, conceals large variations among various manufacturing activities. In particular, the incentives against exporting remain especially high in tobacco, final wear, leather and leather products, footwear, furniture, and porcelain, china, and ceramics.

2.3. Implications of the Tariff Structure for Investment

The high tariffs are also quite dispersed in comparison with other countries. This “non-uniformity” of tariffs, along with the average height, may contribute to the low productivity growth that Egypt has been experiencing recently and certainly threatens to divert new investment and employment away from the most promising sectors of the economy, including the export sector generally.

2.3.1. Non-Uniform Tariffs Lower Productivity

Non-uniform tariffs (different tariffs for different products) are especially inefficient. If all import-competing industries were provided the same proportional rate of protection, say 30%, then while production and investment would be increased inefficiently in the protected industries at the expense of other non-protected industries, within the group of protected industries all are equally favored. Consequently, the resource distortion cost is somewhat minimized. However, since higher tariffs do more harm to economic efficiency than do lower tariffs, if tariffs are non-uniform, then the average tariff rate understates the harm.

At the margin -- that is, looking at the efficiency of the firms or projects that are just barely profitable -- the more protected industries are the least efficient in the economy. This happens because the tariffs distort the price signals to give the impression that highly protected industries are the most lucrative, which they are in money terms, but only because of the protection. Protection cannot add real value to an endeavor and only draws resources to less productive activities.

There is ample evidence that protection lowers productivity. Empirically, there is considerable documentation of the resource inefficiency costs of protection. (See, for example, Vousden [1990] and the many references therein.) Also, numerous studies have linked import restrictions to low levels productivity [Thomas and Nash, 1990]; [Nishimizu and Page, 1991]. The link between import-substitution policies and low levels of total factor productivity have been established at the country level for Turkey [Krueger and Tuncer, 1982] and India [Golder, 1986]. Handoussa, Nishimizu, and Page [1986] imply this link for Egypt and find that trade opening in Egypt is associated with an increase in total factor productivity.

2.3.2. Domestic Resource Cost

A widely used indicator of comparative advantage, or of efficiency of primary factors of production, is **the domestic resource cost per unit of foreign exchange (DRC)**. The DRC measures the amount of domestic resources required to earn (or save) one unit of foreign exchange through export (or import substitution). Domestic resources that enter this measure are essentially the costs of labor, capital and land required -- directly or indirectly -- in the production process. As domestic prices and incentives may be distorted due to government intervention and market imperfections, costs must be measured in appropriate prices reflecting their opportunity costs. Foreign exchange earned (or saved) is measured by the value added at world prices, i.e. the difference between the foreign exchange earned (or saved) from exporting (import substituting) a

commodity and the foreign exchange spent on all intermediate inputs used to produce the commodity.

Value added at world prices -- used in the denominator of the DRC ratio -- is the same as that used for ERP calculation in 1997, whereas the value of domestic resources used by each activity is the sum of wages, operating surplus and depreciation charges shown in the 1991/92 input-output table. The assumption here is that the domestic value of these elements of value added at factor cost reflects their true opportunity cost, which may be approximately correct since the government has stopped, from the beginning of the 1990s, interfering in price setting. However, due to the sterilization policy with respect to short-term capital inflows, geared to stabilizing the exchange rate, it is believed that the domestic cost of capital is somewhat higher than its opportunity cost. Hence, DRCs have been also calculated assuming that the opportunity cost of capital -- as represented by operating surplus and depreciation -- is successively 0.9 and 0.8 of the prevailing corresponding domestic equivalent. The results of these calculations for various manufacturing activities are shown in Tables (2.5) and (2.6).

DRC estimates indicate that production of beverages is highly inefficient, as it results in negative value added at world prices. Furniture and means of transport -- two of the highly protected manufacturing activities, as reflected by nominal and effective protection -- appear to be inefficient according to the three estimates of DRCs. Paper and printing, and porcelain, china and ceramics are on the margin, as they appear to be efficient according to some estimates and inefficient in others. The remaining sixteen manufacturing activities are efficient according to the three sets of estimates of DRCs, although in varying degrees.

In order to assess the relationship between the structure of protection and the efficiency of manufacturing activities, the rank correlation coefficients between nominal and effective rates of protection of 1997 and the average rank of DRCs derived from the three sets of estimates have been calculated, and they were successively 0.440 and 0.452. These coefficients, although low, were found to be significantly different from zero.

This result points to some evidence of correlation between the rates of nominal and effective protection and the degree of efficiency of manufacturing activities as measured by the DRC criterion. As the ranks for protection increase with the rate of protection while those of DRCs increase with the degree of inefficiency (i.e. one is the most efficient activity while 21 is the most inefficient), one may conclude that the tariff structure tends to favor the less efficient activities thus drawing resources into them, while they relatively disfavor (or even discourage, in the case of ginning) the more efficient ones, leading to the conclusion that the non-uniformity of the tariff structure does not favor activities with comparative advantage and tends to draw investments in less advantageous activities.

Table (2.5)
Domestic Resource Cost (DRC) per L.E. Worth of Foreign Exchange
in Manufacturing under Three Alternative Assumptions
(1997)

<u>Manufacturing Activities</u>	<u>DRC (1)</u>	<u>DRC (2)</u>	<u>DRC (3)</u>
Food Processing	0.756	0.693	0.629
Beverages	-7.401	-6.910	-6.419
Tobacco Processing	0.586	0.535	0.483
Cotton Ginning	0.151	0.145	0.139
Spinning and Weaving	0.818	0.771	0.723
Final Wear	0.784	0.742	0.701
Leather & Leather Products (excl. Footwear)	0.852	0.804	0.756
Footwear	0.943	0.892	0.842
Wood & Wood Products (excl. Furniture)	0.836	0.764	0.693
Furniture	1.673	1.528	1.383
Paper and Printing	1.021	0.944	0.866
Chemicals (excl. Petroleum Refining)	0.807	0.753	0.698
Petroleum Refining	0.913	0.827	0.741
Rubber and Plastic Products	0.700	0.651	0.601
Porcelain, China and Ceramics	1.099	1.019	0.938
Glass Products	0.960	0.888	0.816
Non-Metallic Products	0.830	0.767	0.704
Steel, Iron and Metallic Products	0.823	0.758	0.694
Machinery and Equipment	0.829	0.780	0.730
Means of Transport	1.263	1.176	1.088
Other Manufacturing	0.448	0.425	0.403

Source: calculations by Hanaa Kheir-El-Din

Note 1: DRC ratio may fall into one of three ranges:

DRC > 1, thus indicating that the activity is not advantageous to the economy, as it is inefficient,

1 > DRC > 0, the activity is advantageous,

0 > DRC, the activity is again disadvantageous, as it involves foreign exchange loss as value added at world prices would be negative.

Note 2: DRC (1) is calculated on the assumption that the value of domestic resources valued at opportunity cost is the sum of wages, operating surplus and depreciation charges.

DRC (2) reflects the value of domestic resources as the sum of wages and 0.9 of operating surplus plus depreciation.

DRC (3) measures the value of domestic resources as the sum of wages and 0.8 of operating surplus plus depreciation.

Table (2.6)
Ranking of Manufacturing Activities according to Various Estimates of DRC and according to Nominal and Effective Protection (1997)

<u>Manufacturing Activities</u>	<u>Ranking According to</u>					
	<u>DRC</u> <u>(1)</u>	<u>DRC</u> <u>(2)</u>	<u>DRC</u> <u>(3)</u>	<u>Average</u> <u>ranking</u> <u>of DRC</u>	<u>NRP</u>	<u>ERP</u>
Food Processing	5	5	5	5	2	3
Beverages	21	21	21	21	21	21
Tobacco Processing	3	3	3	3	20	20
Cotton Ginning	1	1	1	1	1	1
Spinning and Weaving	8	11	11	10	12	13
Final Wear	6	6	9	6	18	17
Leather & Leather Products (excl. Footwear)	13	13	14	13	14	14
Footwear	15	16	16	16	16	15
Wood & Wood Products (excl. Furniture)	12	9	6	9	3	2
Furniture	20	20	20	20	19	19
Paper and Printing	17	17	17	17	9	7
Chemicals (excl. Petroleum Refining)	7	7	8	7	4	4
Petroleum Refining	14	14	13	14	5	6
Rubber and Plastic Products	4	4	4	4	13	12
Porcelain, China and Ceramics	18	18	18	18	15	18
Glass Products	16	15	15	15	11	11
Non-Metallic Products	11	10	10	11	6	9.5
Steel, Iron and Metallic Products	9	8	7	8	8	8
Machinery and Equipment	10	12	12	12	7	5
Means of Transport	19	19	19	19	17	16
Other Manufacturing	2	2	2	2	10	9.5

Note: The ranks 1 to 21 according to DRCs indicate the most efficient to the least efficient activity, while the ranks 1 to 21 according to the rates of protection indicate the least protected to the most protected activity.

2.4. Approaches to Reform: Assessment

2.4.1. The Current Trade and Investment Reform Strategy

Within the context of a broader program of privatization, deregulation, and reform, the GOE has articulated a foreign trade and investment strategy which emphasizes substantially deeper engagement in the global economy. Two themes of this more outward-looking orientation have been export enhancement and investment encouragement.

Operationally, the foreign trade and investment strategy is comprised of several key components. First, the LE/\$US exchange rate serves as a nominal anchor for the economy and will probably remain fixed in the foreseeable future. Second, tariffs are now essentially bound by WTO commitment, with most well below these bindings, and the tariff schedule continues to be revised downward gradually, although plans after July 1, 1998, have not been revealed beyond the WTO

commitment. Third, import bans continue to be phased out and now only the ban on imports of ready-made garments remains, aside from restrictions on illegal drugs, weapons, and so on. Finally, the gradual tariff reductions and other reforms are being augmented by a number of exceptions in the form of evolving regional free trade areas, duty drawback, export processing zones, and various investment incentives including “tax holidays” for new investment.

In this section, we assess the likely impact of this package in light of a number of recent studies as well as some of our own calculations. Additionally, there is an awareness that formidable non-tariff barriers to trade reside in the current treatment of product at the ports, and there is a continuing discussion of how these impediments can be alleviated and, in particular, how the current system concerning standards and quality control can be used more positively to enhance trade instead of to discourage it. These issues are the subject of section 3.0 of this Report and are not explicitly addressed in this section.

Tariff Reform

Tariffs and ERPs have trended downward in Egypt. Various sources -- e.g., [World Bank, 1998b] -- recount the progress to date of tariff reform with respect to the overall change in the structure of nominal and effective rates of protection. Clearly both nominal and effective rates have fallen substantially economy-wide as well as by sector. In particular, as noted above, the average nominal and effective rates of protection have fallen in almost every sector.

The new tariff reform will lower tariffs but raise some ERPs. On July 1, 1998, another downward revision in the tariff schedule is to be announced. Consistent with the IMF stand-by arrangement and various WTO commitments, this package will set the maximum nominal duty at 40%, and revise downward tariffs on items now at 40% to 35% and those at 35% to 30%. Rates on items now at 30% will remain so, as will rates on items currently tariffed at 20%, 10%, and 5%. The import surcharges will be lowered to 1%. Exceptions to these rates will consist of heavy cars (135%), poultry (80%, to be reduced by 24% over the next five years), alcoholic beverages (180% to 3000%), and textile fabric (54% in addition to the 4% service fee, raised from 40% following the removal of an import ban). Table (2.7) reports the consequences of these revisions for nominal and effective rates of protection.

Table (2.7)
Nominal and Effective Protection Rates in 1997 compared
to Expected Rates in 1998
 (percentages)

Activity	NRP _j		ERP _j	
	1997	1998	1997	1998
Agriculture	7.14	7.01	6.81	6.67
1. Agricultural Food Products	6.82	6.44	6.62	6.20
2. Agricultural Non-Food Products	9.49	9.49	9.63	9.63
3. Livestock Products	5.11	5.11	4.17	4.17
Manufacturing	27.37	25.42	34.22	31.53
4. Food Processing	6.87	6.82	6.39	6.54
5. Beverages	271.64	263.03	-1781.70	-888.65
6. Tobacco Processing	85.00	85.00	88.47	88.90
7. Cotton Ginning	5.01	5.01	-10.89	-10.86
8. Spinning and Weaving	27.95	28.95	47.55	53.09
9. Final Wear	46.64	38.29	55.86	45.06
10. Leather & Leather Products (excl. Footwear)	31.13	28.49	47.57	43.44
11. Footwear	39.10	34.55	50.81	43.79
12. Wood & Wood Products (excl. Furniture)	8.64	8.61	6.10	6.26
13. Furniture	49.90	39.95	83.80	63.30
14. Paper and Printing	17.05	16.37	17.84	17.11
15. Chemicals (excl. Petroleum Refining)	10.01	9.98	9.20	9.25
16. Petroleum Refining	11.81	11.81	14.76	14.80
17. Rubber and Plastic Products	28.47	27.64	43.07	45.31
18. Porcelain, China and Ceramics	35.04	29.55	55.95	45.33
19. Glass Products	20.65	19.74	23.20	22.27
20. Non-Metallic Products	15.18	15.01	18.52	19.11
21. Steel, Iron and Metallic Products	16.06	15.78	18.06	17.97
22. Machinery and Equipment	15.30	14.29	14.49	13.14
23. Means of Transport	43.97	41.49	55.62	52.64
24. Other Manufacturing	18.14	17.47	18.52	17.49
Average	24.62	22.91	30.48	28.14
Standard Deviation	19.51	18.24	26.93	24.31

Source: NRP_js have been calculated by Maurice Thorne (DEPRA/MOE) as average nominal tariffs weighted by 1996 imports. ERP_js have been calculated by Hanaa Kheir-El-Din.

The average unweighted nominal rate falls to 22.91% (omitting beverages and petroleum processing) from 24.62%. The average ERP falls to 28.14% from 30.48% overall and to 31.53% from 34.22% in manufacturing. The standard deviation overall falls to 24.31 from 26.93. While there are some significant drops in some sectoral ERPs, there is not much movement in many and **increases in the ERPs for a few sectors** -- food processing, tobacco processing, spinning and weaving, wood and wood products, chemicals, petroleum refining, rubber and plastic products, and non-metallic products. Except for tobacco, spinning and weaving, and rubber and plastic products, though, the sectors with increasing ERPs are initially at the lower end of the protection spectrum and so these increases may not be so serious. Also, the increase for spinning and weaving is at least somewhat related to the tariffication at 54% of previously banned fabric imports. **Probably of more concern is the height of the ERPs in the most protected sectors, even after the reform** --e.g., final wear, footwear, furniture, and means of transport.

More generally, while the tariff reforms have been generally moving the tax structure toward lower rates of protection, several concerns remain, especially if the pace of reform is not substantially increased. First, while tariffs have been lowered meaningfully, nominal rates at 22.91% overall and 25.42% in manufacturing are still quite high relative to world tariffs generally, developing countries' tariffs, and certainly to the most successful recent liberalization experiences such as Taiwan, Singapore, New Zealand, and Chile. As explained above, these high levels of import protection will continue to serve fundamentally as a very high tax on exports. Using our methodology, **that export tax equivalent would stand at 14.8% even after the new reforms.** Such a high rate of tax on the gross value of exports, particularly in light of ever-increasing price competition from Asian economies, will continue to squeeze the already thin profit margins of non-traditional exporters and so work at cross-purposes with the export enhancement strategy.

Similarly, while the dispersion in the tariff structure has been reduced somewhat since lower rates remained unchanged, the tariffs are still highly non-uniform. Specifically, the standard deviation for Egyptian effective tariff rates after the reforms calculated at the 3-digit level of 24.31 is high. Consequently, **the structure of protection in Egypt will continue to favor some economic activities over others irrespective of industry prospects or productivity.** Thus, some valuable managerial and other skills, along with precious new investment capital and new labor entrants, will continue to be drawn into less productive industries when outputs are valued at true world prices.

Other Components of Reform

In recognition that tariffs and other barriers to trade and investment in Egypt remain daunting, the GOE has been pro-active in promoting a number of ways around these barriers. Important reforms include the Arab Free Trade Agreement (AFTA) and the nearly completed European-Mediterranean Agreement (EMA), duty draw-back schemes and their variant export processing zones, and "tax holidays" for new investment. While all of these policies represent movements toward freer trade and investment, because they reside as exceptions in an otherwise highly distorted economy, we cannot be sure that they in fact constitute an improvement in the welfare of Egyptians. This is an empirical issue which we will comment on, but that really deserves some serious attention by policy-makers.

Free Trade Areas

Whenever a nation reciprocally reduces its tariffs with some, but not all, of its potential trading partners, there arises the positive effect of trade creation -- more free trade -- and the negative effect of trade diversion -- the diversion of trade to higher cost but duty free partners with the attendant loss of tariff revenue. For a country like Egypt with its high tariff rates, the prospects of substantial trade diversion are real and deserve recognition. This is particularly true in the instance of the EMA, as Egypt can already export industrial products into the EU duty-free, may confront barriers to its agricultural exports to the EU even with an agreement, and will undoubtedly displace a large amount of potential lower-cost imports from non-member countries with product from the EU.

In light of such concerns, a number of studies have addressed the consequences of the EMA for Egypt. Most studies find small, but positive, static welfare gains from a Euro-Med Agreement and other agreements (Maskus and Konan [1997], Hoekman, Konan, and Maskus [1998], Konan and Maskus [1997], Kheir-El-Din, Morsy, and El-Megharbel [1996]). The latter study incorporates dynamic adjustment considerations and finds that prospects are enhanced with some exchange rate adjustment and revision of indirect taxes.

Several of these studies find that while unilateral free trade is more welfare enhancing, the EMA brings positive gains but only if “red tape” barriers are reduced. Havrylyshyn [1997], in particular, argues that the more significant gains of the EMA for Egypt are likely to come from a deeper integration which entails a harmonization of standards, common trade protocols, and a more integrated business environment generally. Because the EMA appears to be a particularly accessible avenue to global integration for Egypt, Section 3.0 below explores at some length what the source of gains might be and what a deeper integration would entail for Egypt.

Duty Drawback

Duty drawback aims to alleviate the burden on Egyptian exporters of high import taxes on their imported inputs by simply rebating the duty paid when the item is exported. Theoretically, while such a policy will certainly enhance exports, it also leads to higher domestic prices for goods similar to those exported since no one would sell comparable goods on the domestic market unless there is a premium in the price to compensate for losing the duty rebate. So, the duty drawback scheme does some good by encouraging otherwise taxed exports, and it does some harm by inducing higher prices for comparable goods on the domestic market and so discouraging their consumption or use in Egypt. Also, note that duty drawback does not prevent an increase in the price of comparable domestically produced inputs or of inputs purchased from an Egyptian importer.

As a practical matter, the positive effects probably outweigh the negative for Egypt. This is because the drawback typically applies to inputs which are not taxed very heavily in the first place. (Exceptions might be furniture and ready-made garments.) Certainly, as was reported in Table (2) above, access to duty drawback does considerably reduce the anti-export bias. And, the experience with duty drawback as an export enhancement in other country has generally, although not always, been a positive one (Dean, Desai, and Riedel [1985]; Harold, Jayawickrama, and Bhattasali [1997]). However, there is some evidence that drawback has not worked well to date in Egypt (World Bank [1998a]; This Report, Section 4.0).

Tax Holidays

Tax holidays consist of the forgiveness of some or all taxes on new investment projects for a certain number of years. Originally intended as an exemption from import duties for specified sectors -- e.g., tourism -- and foreign investment under Law 43 of 1976, the exemptions grew to include local sales as well. In Egypt now, these and other exemptions from tax liabilities can be quite substantial and have certainly attracted a lot of attention, if not investment. There are two concerns, one general and one relating to the high non-uniform structure of protection in Egypt.

In general, a tax advantage that is available to all is a tax reduction and so probably enhances economic efficiency at the expense of tax revenue. However, if the advantage targets certain groups or sectors, then it works like a subsidy economically and will encourage investment in favored sectors irrespective of real value added. Thus, it is important that the investments encouraged not come at the expense of the most productive industries or the labor intensive industries with comparative advantage. While we have not specifically studied this consideration, we do note that foreign participation is especially high in some fairly capital intensive, low exporting industries.

For Egypt, there is the additional consideration of existing high, dispersed tariffs. Existing and new investment is already being directed by a highly distorted set of price signals. Thus, it is quite likely that some sectors are already over-developed at the expense of other sectors. For example, the import-competing sector has been over-developed at the expense of the export sector, manufacturing at the expense of agriculture, and some industries like leather, furniture, porcelain, china and ceramics, and means of transport have probably, based on ERPs, been over-developed at the expense of other sectors like cotton ginning and some agriculture. Selective tax holidays in such an environment thus holds the potential to encourage investment in already over-developed sectors.

2.4.2. Some Alternative Scenarios

In order to inform the current policy discussion concerning the direction and pace of policy reform, we have experimented with some alternative policy packages. Regarding tariff reform, we have calculated the implications for the nominal and real rates of protection from a 30% across the board tariff cut, which would put Egypt's average tariff at about that of its regional neighbors (Morocco, Algeria, Jordan, Lebanon, and Syria), and a 70% cut, which would approximate for Egypt the average tariff of Israel and the Tigers of Asia. Table (2.8) reports the results.

Table (2.8)
Effective Rates of Protection 1997 Assuming a Uniform Reduction
of NRP by 30% and 70%

%

Activity	ERP		
	1997	1997(-30%)	1997(-70%)
Agriculture	6.81	4.76	2.03
1. Agricultural Food Products	6.62	4.63	1.98
2. Agricultural Non-Food Products	9.63	6.74	2.88
3. Livestock Products	4.17	2.91	1.24
Manufacturing	34.22	23.41	9.73
4. Food Processing	6.39	4.46	1.90
5. Beverages	-1781.70	2267.25	197.58
6. Tobacco Processing	88.47	61.68	26.28
7. Cotton Ginning	-10.89	-8.28	-4.00
8. Spinning and Weaving	47.55	32.07	13.09
9. Final Wear	55.86	38.75	16.38
10. Leather & Leather Products (excl. Footwear)	47.57	32.38	13.36
11. Footwear	50.81	35.12	14.78
12. Wood & Wood Products (excl. Furniture)	6.10	4.21	1.76
13. Furniture	83.80	55.52	22.14
14. Paper and Printing	17.84	12.47	5.34
15. Chemicals (excl. Petroleum Refining)	9.20	6.40	2.72
16. Petroleum Refining	14.76	10.28	4.37
17. Rubber and Plastic Products	43.07	29.42	12.20
18. Porcelain, China and Ceramics	55.95	37.69	15.35
19. Glass Products	23.20	16.18	6.90
20. Non-Metallic Products	18.52	12.87	5.46
21. Steel, Iron and Metallic Products	18.06	12.59	5.36
22. Machinery and Equipment	14.49	10.10	4.30
23. Means of Transport	55.62	38.32	16.06
24. Other Manufacturing	18.52	12.87	5.46
Average	30.48	20.87	8.68
Standard Deviation	26.93	18.39	7.65

The three columns of Table (2.8) show respectively the current sectoral 1997 ERPs and the impact on the sectoral ERPs of a 30% and 70% across the board cut. Of some note, even a relatively large 30% cut still leaves the ERP in some sectors quite high, even ignoring the unusually high rates in beverages and tobacco -- spinning and weaving, ready-made garments, leather, shoes, furniture, rubber and plastic, porcelain and china, and transportation means all still have ERPs at 30% or above.

A bolder cut of 70% somewhat redresses these high rates of protection for the most favored sectors. But even then, furniture and final wear are strikingly favored over other industries. On the other hand, by lowering the mean by so much, the standard deviation in the tariff structure is substantially reduced.

Another approach to tariff cutting is cutting the highest tariffs most and moving toward a more uniform tariff schedule, possibly even raising some of the lowest tariffs. In Section 6 we advance the case for such a reform and discuss other aspects of rationalizing tariffs. One strategy offered is:

- Cut tariffs above 15% aggressively
- Aim for an overall uniform tariff of around 10 - 15%
- Speed the pace of tariff reform

3.0. Non-Tariff Barriers to Trade and Investment

3.0. Non-Tariff Barriers

This section of the report speaks to three points: [a] non-tariff barriers in Egypt, [b] prices of non-traded inputs may be distorted [eg. not market determined], and [c] the global system is moving rapidly toward harmonization of product and service standards as a pre-condition for integration.

3.1. Review of important non-tariff barriers to Trade and Investment in Egypt.

The main NTBs remaining in Egypt are largely associated with delays in port clearances emanating from customs and certification of compliance with Egyptian standards. Additional NTBs arise from current management and ownership of port operations. There also exist implicit investment barriers due to the distorted pricing arrangements within the energy industry.

3.1.1. Egypt's Unique Approach to Product Standards

The current system in Egypt of standards setting, quality control and inspection has been the subject of exhaustive review by joint GOE/USAID teams, and consultants from the European Union and its member states over the last five years. A synopsis of findings and recommendations from each of the four major USAID funded studies since 1993 is shown below in charts 3.1 – 3.4 to provide a perspective on the unique approach of the Egyptian regulatory system in this area.

**Chart [3.1] Quality Control to Quality Assurance
January 1994**

<u>FINDINGS</u>	<u>RECOMMENDATIONS</u>
<ul style="list-style-type: none">• health, safety and QC regulations have been used as NTB's• QC regulations based on questionable scientific premises• the major problem with Egypt's QC system stems from conflicting institutional missions, diffused and overlapping authority, and lack of transparency.	<ul style="list-style-type: none">• establish a review commission of QC regulations with ISO and private sector participation.• GOEIC should cease multiple mandatory inspections of products.• an open and free process for the development of QC standards and regulations must be established.

Chart [3.2] Research Study of the Quality Control System in Egypt: July 1996

<u>FINDINGS</u>	<u>RECOMMENDATIONS</u>
<ul style="list-style-type: none"> • quality standards are confused with safety standards; • multiple centers of overlapping authority exist; • there is a lack of transparency and due process. • compliance costs are high. • direct and indirect additional costs to affected producers and traders of 5% to 90% • exports decreased by at least an estimated 9% to 12% • consumer and producer welfare losses 1% of GDP • reduced access to the important Euro-Med market • decreased foreign and domestic investment • Reduced product variety and availability • Reduced access to best available technology • Government resources expended on duplicative and unnecessary activities 	<ul style="list-style-type: none"> • establish a single authority for the inspection and testing of an imported product. • recognize international standards certification for non-food imports and reduce inspection levels to minimum. • establish due process and transparency in the quality control regulations • establish the Egyptian Organization for standardization and quality control (EOS) as a voluntary standards institute • restructure the General Organization for Import and Export Control <p>This report provided [19] recommendations to improve the Egyptian regulatory and quality control system; the most relevant are included above.</p>

Chart [3.3] Review of selected Egyptian Food standards with respect to International Norms: March 1998

<u>FINDINGS</u>	<u>RECOMMENDATIONS</u>
<p>EOS Standards appear to be used:</p> <ul style="list-style-type: none"> • to carry out national health policy. • to help ensure consumer protection rather than relying on consumer education comprehensive fraud and product labeling laws. • to assist in ensuring product safety rather than addressing certain infrastructure issues that should be in place to prevent unsafe or spoiled product. • there appears to be a strong need within the Egyptian regulatory system to have and maintain a standard for each and every product. • maintenance by Egypt of multiple regulatory inspection and control systems. 	<ul style="list-style-type: none"> • until policy issues are clarified at top ministerial level it would not be productive to carry out further review of EOS standards. • consider the development of guiding principles for the operation of EOS technical committees • reduce the level of prescriptiveness of standards. • develop standards which are easier to understand and make amendment more straightforward. • replace standards which regulate individual foods with standards that apply across all foods or a range of foods.

- | | |
|--|--|
| <ul style="list-style-type: none"> • differential application of standards to import vs. domestic product. • tendency to establish provisions within standards based on weak or incomplete scientific information. | <ul style="list-style-type: none"> • consider the possibility of industry codes of practice as an alternative to regulation • for controversial standards obtain outside peer review from governments and other organizations on re-drafted standards • consider requesting the Codex Alimentarius secretariat to develop new standards where such standards would be helpful to assist Egypt in arriving at standards where consensus domestically has been difficult. |
|--|--|

Chart [3.4] Pilot Study for Pre-Certification of Imported Products, March 1998

<u>FINDINGS</u>	<u>RECOMMENDATIONS</u>
<ul style="list-style-type: none"> • For non-food products, pre-inspection and pre-certification are viable alternatives to the presently existing system. • Many Egyptian standards and their application are incompatible with internationally accepted norms and many do not comply with the WTO “Technical Barriers to Trade” Agreement. • It is imperative that the Government of Egypt agrees on a clear definition of standards and technical regulations and insures that they are used properly and consistently by all Ministries and organizations. • It should be noted that the official list of inspected and tested items provided to DEPRA by GOEIC contains 130 line items, 26 of which are food and agriculture products. The list contains categories or groups of products that do not appear to have any safety, public health or environmental implications. 	<ul style="list-style-type: none"> • Reduce the number of imported products requiring inspection at the point of entry. • Establish a register of repeatedly imported products. • Adopt a system of Pre-shipment inspection and establish a system and procedures for the choice, recognition, registration, and continual assessment of competent inspection companies. • Speed up the harmonization process of Egyptian standards with ISO, IEC, and ITU standards, where they exist. Follow the EU approach which is to directly adopt these standards. • Establish a National Product Conformity and Consumer Protection Board. • Establish a quality assurance department in GOEIC to insure continual compliance to the requirements of ISO 9000, laboratory accreditation and other international standards and technical regulations.

Quality Control to Quality Assurance

During the course of this current study a sample list of 25 non-traditional export companies were interviewed to gauge the impact Egyptian standards have on their export performance.

The firms were evenly divided between large exporters and small and medium size companies and were a cross section of companies working in the key non-traditional textiles/ready to wear, leather, furniture, and agro-foods industries. The majority (**70%**) of the firms, exported to Europe and the regional markets while a significant minority (**40%**), especially in textiles and the ready-to-wear sectors, sent product to the US market.

The purpose of these interviews was to scan a cross section of active exporters to assess what impact the current Egyptian standards system has on these firms' export drive and how management achieves quality standards to match market demand.

The findings of this limited research tend to confirm the observation that Egyptian exporters are shifting their focus on standards and quality assurance toward what their markets demand, which is at variance to the unique system of quality control operating in Egypt. Let us look at the responses to the following questions.

How are product specifications defined?

The overwhelming response (**80%**) was that it is the customer who defines the export product specifications, which is not particularly surprising. However when asked how the customer's buyer actually defines product specifications, **62%** believe it was company specifications while nearly **40%** stated that either voluntary or mandatory industry standards applied.

Awareness level of current Egyptian Standards?

Some **71%** Egyptian exporters are aware of the existence of Egyptian national standards but only **19%** believe them mandatory on their products. This finding tends to confirm the anomalies identified in the studies above, which cited unequal treatment by GOEIC and other agencies of the GOE, which carry out various inspections on imports beyond the official GOEIC list of over 180 categories for inspection is required.

Do Egyptian Standards support the firm's export activities?

Most companies replied that they did not manufacture to Egyptian standards with **71%** using foreign standards based on either customer or market expectations for their export products. There appears however to be potentially negative consequences linked to this, as a small number of the companies may be producing separate product lines for the domestic and export markets, which can contribute to inefficiencies.

Prevalence of a documented Quality Assurance system?

While most firms (**71%**) stated they were aware of the ISO 9000 quality assurance standards process, only a small group (**19%**) of mostly the large exporters have been certified; all by private foreign certifications bodies.

Degree and method to certify Quality Assurance?

Most firms (**67%**) were anxious to confirm that the company had documented quality assurance procedures and work instructions but a little over **20%** had outside laboratories or inspection firms test their products. Most firms interviewed relied either on in-factory testing and/or tests carried out on instruction by buyers in their home markets.

These findings are only illustrative and cannot be a substitute for a rigorous survey of the awareness and methods by which quality assurance standards can be promoted to stimulate non-traditional export growth in Egypt. Nevertheless, they do confirm that the current Egyptian quality control system has little or no positive impact on the export growth strategy.

Furthermore it appears that no substantive improvement in the quality control and inspection system of Egypt has taken place over the last five years. 1998 may be a turning point in that several actions are being taken to streamline the inspection system, including the adoption of a product register to reduce inspections required of repeated imports and action to introduce pre-shipment inspection. Egypt's quality control system continues, however, to be its most notable non-tariff barrier to trade and investment and is recognized as such by international institutions such as the World Bank [1998c]. The following observations about Egypt's non-tariff barriers from the European Commission support this view:

Standards and Other Technical Requirements.

Standards are designed and implemented by two bodies, the Egyptian Standards Organization and the General Organization for Export and Import Control (GOEIC), which also participate in the framing of international standards. The former has to enforce requirements for domestic products, the latter inspects imported and exported goods.

The competent authority issues certificates of conformity for shipments, which fulfill the relevant conditions and specifications. Egyptian authorities recognize foreign standards only when there is no Egyptian standard for the goods or products concerned.

Problems arise when the required norms imposed by Egyptian authorities are at variance with internationally recognized standards, and the products in question are therefore subject to import quality inspection by the GOEIC. This currently applies to some 102 products, and there have been instances where the GOEIC subsequently refuses to allow import of these goods. Recent cases have included ceramic tiles and sanitary ware, and phyto-sanitary products. A lack of transparency and arbitrary decisions also cause problems in the processed food sector. Imported beef, for example, should have less than 7% fat (regulation from the Ministry of Health), a level usually not obtained. It is highly unusual for such a requirement to be imposed on meat which is to be transformed, and the Egyptian authorities do not make this distinction (although it is foreseen in the relevant decree).

Indeed, problems related to standards and other technical requirements are becoming one of the major trade irritants with Egypt. They affect several sectors, and often occur in parallel with trade liberalization. On the Egyptian side, the requirements are intended to fulfill two purposes: to protect the consumer and to fight against fraud.

Another particular case is that of cosmetics, which are treated as pharmaceuticals by the Egyptian authorities, and are therefore subject to extensive testing procedures. In addition, all substances and recipes must be registered with the Ministry of Health. Products must also satisfy labeling regulations concerning product number, lot number and validity dates. These requirements are extremely costly and time consuming.

The Egyptian authorities are also introducing increasingly strict labeling requirements (particularly on textiles products and on meat.) These represent a barrier to trade for EU exporters.

Source: European Commission - Market Access Sectoral & Trade Barrier Database May 31,1998

This database [<http://mkaccdb.eu.int>] is available worldwide and is provided as a service to European citizens and businesses as a guide to trade and investment opportunities for 40 countries and a large number of market segments. The complete and unabridged excerpt regarding standards and technical regulations in Egypt is not positive for increasing trade and investment between European and Egyptian firms.

3.1.2. Egyptian Maritime Port Services

The costs of Egyptian port services act as a significant non-tariff barrier to trade and a potential serious impediment to investment. An extensive and detailed analysis of the structure, competitiveness, and projected investment demands of Egypt's maritime port services was undertaken in mid-1996 by DEPRA.

The key issues identified in the 1996 report included:

- all port services including but not limited to pilotage, tugs boat services, stevedoring, shipping/clearance, safety/inspection, warehousing, terminal operations/maintenance etc...are essentially reserved for state entities and state owned operating companies.
- all tariffs, fees, and commissions charged by these state entities are either set by the responsible Ministries or approved by them.
- interlocking directorships and share ownership between the state operating companies and the Port Authorities who are responsible to the Ministry of Transport and Communications inhibit competition and reduce incentives to maintain and improve port facilities.

The World Bank [1998] has reported that “freight plus port costs are as much as 40 percent for some perishable goods requiring refrigerated containers and that port costs for containerized cargo represents 9-14% of the CIF price.”

Effects of expensive Egyptian port services

<u>Barrier/impediment</u>	<u>Net effect</u>
Seaport services	Overall charges triple that of competitors
Container freight rate	15-20% higher than other Mediterranean ports
Container handling cost	2-3 times that of nearby ports
Terminal handling charges	Double that of nearby ports
Maintenance and housekeeping	Poor
Vessel time lost	Nearly 10% of total chargeable time due to delay in testing for radiation and in time between unloading cargo and departure.
 Airport services	 Air-freight rate is twice as much [\$1.0-1.4/kg] as other Middles East countries

General remarks: It was estimated that the seaport charges raise CIF cost for imports to Egypt by over 10 percent - a relatively high cost

Source SRI International in World Bank 1998

Notwithstanding the costs to industry of current ports services, the DEPRA [1996] study revealed that Egyptian ports are approaching maximum capacity which can present an additional risk to potential investors since:

- lack of private sector investment in port related services chokes business opportunities and defers costs reductions.
- domestic and FDI decisions may become deferred as actual port capacity exceeds global operating norms.
- absence of an accelerated privatization program and an industry determined BOT scheme to increase port capacity could jeopardize Egypt's overall growth potential.

The estimation of the port capacity limits shown behave aroused legislative change by the GOE to allow private sector participation in port development and management. It remains unclear whether an accelerated program will reach the pace of development required to remove this non-tariff barrier to trade and investment. The GOE has adopted a policy of privatization of port services and legislation to their effects in pending review in the People's Assembly.

<u>Ports</u>	<u>Impact</u>
Capacity [100% theoretical]	51.0 million dry tons [MDT]
Capacity [75% actual]	37.0 MDT
Capacity [FY95]	35.8 MDT
Capacity Improvement [operations]	5.0 MDT
Capacity Investment [US\$700 million]	8.0 MDT
Capacity Requirement 1996-2000 [@6.5% GNP growth]	13.0 MDT

Source: DEPRA 1996

3.1.3. Price Distortions in Non-Traded Inputs

The distortion of input prices of Egyptian state provided infrastructure services especially in the energy sector sends mixed signals to investors and raises the risk factor for high-energy consuming industries.

While there have been some legislative changes to allow private sector participation through the introduction of BOT operations for the building and management of power plants, these nascent changes reflect the gradualism inherent in the current policy reform process. It is also likely that further BOT contracts which are negotiated under a distorted price regime could “lock in” distortion and raise the risk factor to private industrial consumers.

In the following section we will examine the pricing and operational modalities of the electricity and natural gas industries, which will reveal additional underlying cost threats to investment in non-traditional export manufacturing.

Electricity Service

The electrical power service including generation, transmission and dispatch is dominated by public sector companies centered around the Egyptian Electricity Authority [EEA]. Recent decentralization of distribution has created eight [8] regional Electric Power Distribution Companies [EPDC's] all of which remain within public sector ownership.

Of the 52.8 billion kilowatt hours consumed in FY96 in Egypt, the EEA sold directly to customers with high voltage requirements 11.71 billion. The eight EPDC's sold the remaining 78%. Currently there is no export of electrical power, though a USD\$350 million project is nearing completion to establish a power grid link to Jordan, Syria and Turkey.

Close examination of the pricing structure below shows severe distortion, biased against the price of electricity charge to private industry at 17% above long run marginal cost (LRMC). However given that fact that public sector companies and GOE institutions are in acute payment arrears, the financial sustainability of the system, especially as it prepares for privatization, may be questionable; the more so as the EEA in aggregate is pricing electricity at 72% of LRMC, which is not sustainable.

**Power Distribution and Pricing
FY95**

<u>Customers</u>	<u>Sales</u> [%]	<u>Price</u> [LE/Kwh]	<u>LRMC*</u> [LE/Kwh]	<u>Price Ratio to</u> <u>LRMC*</u>
<u>Direct EEA</u>	<u>24.35</u>			
VHV very high voltage	17.18	0.0764	0.099	0.77
HV high voltage	6.61	0.1134	0.119	0.95
MV medium voltage	0.57	0.1734	0.148	1.17
<u>Dist. Companies</u>	<u>75.65</u>			
Priv. Industry	21.97	0.1734	0.148	1.17 [MV]
Pub. Sector Co.s**	10.86	0.1800	0.161	1.12 [LV]
Agriculture	1.78	0.1000	0.161	0.62
Residential	32.89	0.0837	0.262	0.32
Commercial	3.70	0.2852	0.189	1.51
Street lighting	4.40	0.3000	0.221	1.36

Source: USAID - Division of Power & Telecommunications

* LRMC = long run marginal cost

**28 months average arrears in revenue collection and includes all GOE institutions of civil and public services

The current installed capacity in 38 power plants is 13,500 megawatts which generated 54.4 billion kilowatt hours in 1996. Transmission is via 8,500km of 220/500 kilowatt lines.

Growth in power generation averaged 6.5% in the 1985/96 period. This rate of growth is expected to continue until 2002, with a tapering off to 5.7% in the next ten years to 2012. These projections will result in an additional installed capacity of 10,000 megawatts by the year 2012.

Achieving this generating capacity by the year 2012 implies commissioning a 650 megawatt plant costing US\$750 million - US\$1.0 billion every 12 months. To supplement the EEA's direct build capability the private sector has been invited to participate through a build-operate-transfer [BOT] scheme for power generation.

The first BOT project in this sector is the 650 megawatt Sidi Krir Power Project units 3 and 4, which is a dual gas/oil fuel conventional plant. The World Bank is offering a partial risk guarantee to help reduce the financial exposure to the BOT operators on non-performance of contracts regarding prices of inputs and outputs.

The distortion of electricity prices in Egypt not only currently penalizes private industry and represents an implicit tax to finance the cross-subsidies to residential and public sector users, it may present longer term obstacles to investment in energy dependent manufacturing as:

⇒ Poor pricing and revenue collection performance of the publicly-owned EEA/EPDC's could jeopardize expansion of the BOT scheme due to the reluctance of World Bank and other project financing institutions to provide credit guarantees which have ultimate recourse to the GOE's budget.

⇒ In a worse case scenario the possible development of a private monopoly, emerging from the restructured EPDC's into one entity prior to privatization, could result in price volatility for industrial investors, who can be identified and targeted for price and revenue enhancement activities should a crisis management scenario emerge.

Natural Gas Service

The Egyptian General Petroleum Company [EGPC], a wholly Government-owned company, is the only supplier of natural gas in Egypt. As the effective "trustee" of the Egyptian State in the development of oil and gas reserves, the EGPC is dominant in both *upstream* exploration and production as the licensor with major oil internationals and *downstream* as the majority stakeholder in all transmission and distribution activities.

EGPC dominance of the domestic pipeline transmission, distribution, and installation is confirmed by a majority cross-shareholding in a number of related companies:

- Transmission - has been consolidated under the Gas Company of Egypt [Gasco] which is 70% directly held by EGPC, with 25% controlled by wholly owned subsidiaries, and with less than 5% held by either non-related Government institutions or the banking sector. Gasco operates a network of 3,000km of high pressure pipeline throughout Egypt.
- Distribution - has until recently been a monopoly activity of Petroleum Gas Company [Petrogas], a 100% owned subsidiary of EGPC. Private companies are now allowed to enter gas distribution; but the development of a competitive market is not yet a reality.
- Installation - until the first quarter of 1997 Egypt Gas, a 70% held subsidiary of Petrogas, had been the sole installer of natural gas to non-industrial consumers. As in the case for distribution, private companies are now legally allowed to develop this market segment.

The demand for natural gas reached 12 billion cubic meters in 1996, with 66% consumed by the EEA power plants, 14% by the largely state-owned fertilizer industry, 10% by the cement industry, with the remaining 10% by large private industrial users.

The pricing structure of natural gas below could have a severe negative impact on private sector domestic and foreign investment since:

- ⇒ rapid adjustment of the uneconomic pricing of gas as a feed-stuff to electrical power generation may lead to price rise shocks for electricity consumers;
- ⇒ the overall range of implicit subsidies to the public sector and residential customers sends negative signals to investors;
- ⇒ the current price explicitly discriminates against large private industry.

Comparison of Gas Prices with Economic Values

Customer	Alternative Fuel	Economic Value of Gas - Pt/cu.m.	Current Gas Price Pt/cu m	% of Economic Value
Power Stations	Heavy fuel oil	21.9-37.5	12.6	33.6-57.5
Public Industry	Heavy fuel oil	21.9-37.5	12.6	33.6-57.5
Private Industry	Heavy fuel oil	21.9-37.5	28.5	76.0-131.5
Residential	LPG*	93.2-139.1	24.0	17.2-25.8
Commercial	LPG*	39.3-93.2	24.0	25.8-6.1
SME's**	Gas oil	62.2	34.0	54.7

Source: World Bank unpublished/draft;

Updated from ESMAP Report "Arab Republic of Egypt" - 189/96

* LPG: Liquefied Petroleum Gas. ** SME's: Small and Medium Enterprises

Though there is currently an excess demand over capacity which makes the above pricing inexplicable, the rapid rate of discovery and the current proven reserves of 680 billion cubic meters makes the export of natural gas likely. This will establish a border/world price which could radically alter the pricing structure, with the consequent effects throughout the power industry to industrial investors.

The above analysis of the distorted pricing structure within the energy industry reveals additional barriers to investment. The financial risks that adjustment to market determined pricing will generate could impact negatively on prospective investors.

In the next section we will illustrate the consequences that non-tariff barriers and distortions of inputs prices have on export performance and, importantly, how the private sector views the public institutions that generate distortions and NTBs.

3.1.4. Consequences and Impact

The consequences and impact of the NTBs reviewed above are reflected in the sluggish and uneven growth of exports. This high degree of institutional constraints is also clearly cited by the private sector as hampering business growth.

As the data below indicates, growth in exports of manufactured goods from Egypt has been unremarkable over the last 15 years, while exports of services increased fourfold. The growth of tourism contributed significantly to services exports; and remittances from the estimated 2 million Egyptian workers abroad consistently equaled or exceeded the total of merchandise exports, including oil and other traditional.

<u>GDP Growth</u>		<u>Manufacturing Growth</u>		<u>Services Growth</u>		
%		%		%		
1980-90	1990-96	1980-90	1990-96	1980-90	1990-96	
5.3	3.7	-	4.3	6.6	3.4	
			<u>Merchandise Exports*</u>		<u>Services Export</u>	
			1980	1996	1980	1996
			\$1.1 bn	\$1.8 bn	\$2.4 bn	\$10.6bn

Source: World Development Indicators 1998 *non-oil

Recent export data available from the Ministry of Economy would also suggest that non-traditional export growth was uneven over the 1992 – 1997 period.

Non-traditional Exports						
LE '000	1992	1993	1994	1995	1996	1997
[current]						
value	4,778	4,435	5,899	6,044	5,263	6,425
change		[-7%]	+33%	+2%	[-13%]	+22%

Source: MOE [1998]

Regarding institutional constraints, the private sector in particular has consistently voiced its frustrations with the institutional impediments to growth, as reflected in the work of Galal [1996].

More recent work of Fawzy [1998] has attempted to measure how these institutional constraints have been translated into increased transaction costs at the firm level which could undermine the GOE stated goal of 10% growth in exports. Dr. Fawzy, who is a major contributor to this report, has updated and expanded the findings of this work; and the reader is referred to section 4 for further details.

The response of the industry summarized in the data above and in section 4 appears consistent with the premise of this report that tariffs and non-tariff barriers act as a tax on exports and undermines the GOE's overall economic reform program.

Nevertheless, the GOE with the support of [USAID has begun to analyze the various constraints and opportunities for accelerating non-traditional export growth. From 1992-1996, USAID in conjunction with the GOE conducted twelve separate studies on issues, obstacles and growth prospects for export development in Egypt and made 191 specific recommendations. [Korponai, 1996]

In the remaining parts of this section of the report we will review global developments regarding deregulation and the emergence of harmonized product and service standards as well as what opportunities exist in this area for Egypt to integrate more fully into the global economy

3.2. Pre-Conditions for Deeper Global Integration

Previous sections of this report provided an analysis of the “anti-export” bias of taxes, tariffs, and the current quality control and inspection system in Egypt, which also act as a tax on Egyptian exporters. We also reviewed how distorted prices on non-traded inputs have sent mixed signals to the private sector and raised the risk profile of Egypt for investors in non-traditional export sectors.

In this sub-section we will focus on the pre-conditions required by the international business community for Egypt to integrate more deeply into the global economy. These pre-conditions are largely centered on:

- ⇒ the role of international product and service standards in investment and purchasing decisions.
- ⇒ the right to unfettered establishment of business operations to service clients and grow markets.
- ⇒ the role of national treatment, deregulation of the economy and access to modern commercial law in growth of exports.

This analysis is conditioned by Egypt's eminent conclusion of a free trade agreement [EMA] with the European Union. In the concluding sub-section we will illustrate recent moves toward faster global integration among the developed economies of Europe, North America and Asia.

3.2.1. Harmonized Standards in International Trade and Investment

The adoption by Egypt of international standards would send a clear signal to trading partners and investors that Egypt is a credible participant in the global economy. The lack of such a strategic signal creates another barrier to the development of non-traditional exports as both buyers and investors seek predictable business partners in the competitive international market.

To underwrite this need for predictability through the emergence of international standards a clear definition of terms is needed by all parties if credibility is to be sustained:

Regulation - is a mandatory policy regarding product or service performance.

Standardization - is the definition and mandatory use of common units of measurement.

Harmonization - is the homogeneity of rules.

Convergence - is the homogeneity of outcomes.

These terms are very precise and from a business investment perspective have scientific, legal, engineering and marketing implications which drive decision making. From the Egyptian policy making viewpoint these terms pose a challenge to the realization of trade policy reform and the supply side response by Egyptian industry in order to develop growth in non-traditional exports.

It is also important that strong consensus is reached on the pace of strategic reform in the area of standards and quality control so Egypt can more deeply integrate into the global economy. Areas of required consensus include:

- implementing international standardization processes in Egypt as a pre-requisite for mutual recognition and harmonization.
- essential requirements which govern health and safety issues within product regulations can only be determined between countries if standardization is complete.
- mutual recognition agreements [MRA] need standardization to international norms and the recognition of a supra-national certification body to independently accredit conformity assessment practices and procedures in Egypt.

- harmonization of Egyptian product standards linked to a mutual recognition agreement within the EMA is the fastest way Egypt could stimulate exports and integrate into the global economy.

If Egypt were to adopt this strategic framework, it would join a dynamic process as new trade relations, market developments and technology change are constantly reshaping international product and service standards. If Egypt remains in a static and legalistic posture, defending national standards, it would deny consumers and exporters the opportunity to fully engage in the global economy.

3.2.2. EMA: Challenge of Integration

Egypt stands at the threshold of deepening its integration into the global economy with the impending free trade agreement with the European Union. The depth by which Egypt embraces this opportunity will mark the degree of integration it is willing to undertake at this juncture. The proposed EMA for Egypt follows that of Tunisia and Morocco signed in 1995 and is likely to reflect the pattern established by those agreements. The basic objectives of the EMA mechanism are:

- to support economic growth and integration throughout the Mediterranean region.
- achieve free trade in manufactured goods between the EU and a signatory country.
- grant preferential access in agricultural products
- liberalize trade in services and capital.

A key difference between the current series of EMA's and previous ones is that the protocols that support financial and technical assistance transfers from the EU are no longer tied to individual countries. Resources, under the current EMA protocol [1995-99], amounting to 4.7 billion ECU's [U.S. \$5.0 billion], with a near equal amount from the European Investment Bank, are allocated and disbursed to country or regional activities that promote the objectives of the EMA and general market orientated reform of the economy, as well as private sector development.

The EMA negotiations are expected to be completed during 1998 and the key elements believed likely to be incorporated include:

- ⇒ political dialogue
- ⇒ free movement of goods and a gradual reduction of tariffs [12 years]
- ⇒ progress in clarifying the right to invest in manufacturing and in the supply of services on a equal basis.
- ⇒ defining the rules of competition, public procurement, and rules of origin.
- ⇒ spheres of economic, social, and financial cooperation.

The EMA will not address the specifics of harmonization of standards and the methods to reach mutual recognition of conformity assessment procedures. However, the effective functioning of

the EMA will eventually require harmonization to international standards and a conformity assessment regime that is seamless with the European Union.

In tandem with Egypt's adoption of harmonized standards, which will place current producers on an equal footing with international competitors, the greatest dynamic impact expected of the free trade agreement with Europe will come from accelerated investment, as international business seeks to capitalize on the advantages of locating in Egypt.

Of the policy issues that can affect the attractiveness of Egypt as a location to invest, the right to establish and the deregulation of the economy are of fundamental concern. For the dynamic effect of the EMA to stimulate growth in investment in non-traditional exports, a facilitating environment for foreign direct investment [FDI] is required. Such an environment would require an explicit recognition of the right to establish and an expectation of national treatment under a program of deregulation.

Right to Establish

The right of the international business community to establish investment in manufacturing and business services under the EMA is a critical issue to support Egypt's integration into the global economy. As the following tables illustrate, Egypt on a *per capita basis* is a regional laggard in both export propensity and foreign direct investment. Unfettered right to establish business operations under the EMA could help redress this bias against investment in non-traditional export sectors.

Manufactured Exports per capita US\$

	To European Union	To Rest of the World	Total
Tunisia	310	60	370
Morocco	145	10	155
<i>Egypt</i>	<i>20</i>	<i>15</i>	<i>35</i>

Source: I. Diwan, World Bank [CEPR/ECES 1997]

The extent of Egypt's lack of integration in global trade, as indicated by the low per capita level of exports, is stark insofar as Europe, including the EU, accounts for over 50% of Egypt's total manufactured exports. Furthermore, Egypt's per capita foreign direct investment, which has a direct impact on exports and wealth creating opportunities, has declined, and Egypt has gone in the opposite direction compared to its MENA neighbors.

Foreign Direct Investment per capita US\$

	1990	1996	GNP per capita [1996] at PPP
Tunisia	10.15	35.60	6,060
Morocco	6.90	11.50	3,320
<i>Egypt</i>	<i>14.70</i>	<i>10.80</i>	<i>2,860</i>

Source: World Development Indicators 1998

Though it is difficult to obtain accurate disaggregated figures on the sector allocation of FDI in Egypt, most is believed to flow heavily towards the oil, gas and related energy sectors, with minimal investment in manufacturing for export. Some 76% of US foreign direct investment went into the energy sector with less than 8.0% to manufacturing [Coopers & Lybrand, 1998].

It would appear therefore that unless an unfettered right to establish is obtained under the EMA, which reflects a deep integration approach, investment by the international business community in non-traditional export sectors will remain at current levels as more open and harmonized business environments both regionally and in Central Europe appear increasingly attractive.

National Treatment and Regulatory Reform

Under the WTO Agreement Egypt has committed not to discriminate between domestic and international business investors. This concept of “national treatment” however needs to be placed into the context of sustained regulatory reform if the benefits of deeper integration into the global economy are to be realized.

As we have seen in earlier sections of this report, the heavy influence of state regulations in quality control, transport management and price setting of basic services act as non-tariff barriers to trade and investment throughout the economy. It is therefore disingenuous to believe that providing “national treatment” under such distortions could stimulate growth in export-orientated investment.

The debate surrounding regulatory reform needs to be strengthened in Egypt. Such a debate has been the focus of advanced industrial countries for over twenty years. While it is beyond the scope of this study to review the culmination of this debate as represented by the establishment of the WTO in the early 1990’s, the most salient issue confronting Egyptian policy makers as they assess the opportunities of the EMA is the pace of change and resistance to regulatory reform.

Though the concept of regulatory reform can be very broad, the core idea is:

“to improve the efficiency of policies that intervene in decisions about market entry, production methods, product attributes, and transaction arrangements between supplier and customers”.
[R. Noll in OECD, 1996]

While we have touched on such issues as market entry and product attributes, the most fundamental aspect of the need for regulatory reform affecting the national treatment of business relationships in Egypt is the current level of contract enforcement. Enforcement of contracts in Egypt is a difficult undertaking, with estimates of completion of commercial courts cases ranging from 6 years [World Bank, 1997b] to over 9 years in recent press reports. This economically perilous state of affairs has been recognized by the GOE, which has recently introduced comprehensive legislation to update the commercial code of Egypt.

The transformation of this legislation into commercial practice will, however, take some time; and the pace and degree of harmonization with international “best practices” can seriously affect the

expected welfare gains from free trade agreements such as the EMA. Indeed, some commentators [D. North in Galal/Hoekmann, 1996] have stated that “ the inability of societies to develop effective, low-cost enforcement of contracts is the most important source of both historical stagnation and contemporary underdevelopment.” This is the first priority for regulatory reform in Egypt as a pre-condition to deeper integration in the global economy.

In tandem with the fundamental review of the commercial code, the GOE authorities have initiated fairly strong legislation and an enforcement mechanism for intellectual property protection. This is a positive step for integration, though leaders in the information technology industry continue to raise concerns regarding software “piracy” from both individuals and companies.

Recent reports [Financial Times 08/28/97] of an impending agreement between the GOE and Microsoft (MS) regarding the production in Egypt under license of Arabic versions of the MS application range, in return for heightened enforcement and policing of IPR, is clearly indicative of the serious manner in which both industry and the GOE have addressed this issue. However, for the Egyptian software industry to mature from the fairly low-level operations of Arabic translation of existing packages towards investment by the international informational technology industry in value-added software development and consultancy services, the timely passage of the new commercial code and much speedier of enforcement of contracts will be necessary.

Within the context of the pending EMA the issue of contract enforcement and IPR should not be separated. The ability to obtain swift and certain legal redress is the fundamental regulation intervening between buyer and seller. Enforcement of performance of contracts lies at the basis of product and services harmonization, as it does for the right to establish and national treatment of investors. Therefore the positive reform initiatives by the GOE in this area are critical to the economic integration process represented by the EMA.

3.3. Dynamic Effects of Deep Integration

In the previous sub-section we reviewed a number of pre-conditions for deeper integration of Egypt into the global economy. These included the:

- ⇒ need to adopt harmonized international product and service standards.
- ⇒ need to allow unfettered right to establish business operations.
- ⇒ need to begin a program of rigorous deregulation of the economy.

In the following sections we will explore the expected gains from deeper global integration and what realistic alternatives Egypt has.

A number of economic commentators [Page & Underwood, 1996; Galal & Hoekman, 1996; Galal & Tohamy, 1997] have described the political and economic parameters open to Egypt by “free trade agreements” (such as the EMA) as follows:

Classic Free Trade Agreements such as those already concluded between the EU, Tunisia and Morocco, as well as those between Israel and the US and the EU have the following characteristics:

- eliminate tariffs and quotas.
- can divert trade between partners and the rest of the world.
- often narrowly focused on market access for manufactured and commodity products.
- largely ignore deregulation and trade policy reform process.
- can result in limited benefits to both parties.

Under a classic FTA arrangement, the right to establish and national treatment of international investment remains restricted. Such an approach by Egypt to the EMA will likely be of little benefit, as Egyptian manufactured exports already have in essence duty free access to the markets of Europe. Limitations on agricultural exports may, if removed, have a significant impact on Egypt's trade volume. Both processed and fresh agricultural products seem to have a real comparative advantage, but growth in trade to the EU has been slow.

Deep Integration Agreements such as the NAFTA and the Association Agreements between the EU and the countries of Central Europe provide the most potential dynamic gains through:

- harmonization of regulatory regimes, including product and service standards and competition policy.
- elimination of “hub and spoke” patterns of investment as national treatment is provided.
- new investment opportunities in all markets and sectors.
- providing an anchor for the economic reform program in a timetable toward global integration.

It appears clear that the greatest dynamic gains for Egypt in the EMA would be to opt for deep integration and accelerate harmonization of its regulatory regimes with that of Europe. However, given the cultural and political/economic imbalances between Europe and Egypt, such a “fast-track” approach may be problematic. On the other hand, the alternative “*eclectic*” FTA approach in which Egypt would pick and choose [e.g. negotiate] the areas and pace of harmonization is unlikely to send strong enough signals to the international business community to counteract the competitive attraction of emerging Central and East European markets.

Neither a “classic” nor “eclectic” approach to the possible US/Egypt FTA would produce tangible benefits to either party, because in reality large US firms are likely to source their exports to Egypt from their existing European operations, or they would be indifferent if the tariff reductions are equivalent. In turn, current Egyptian manufacturing exporters to the US, mostly in carpets, textiles and garments, would gain little or no incremental access to the US market under a classic FTA.

A combination of deep integration FTA's with both the EU and the USA could provide a clear path for Egypt's integration in the global economy, if harmonization of products and services standards are coupled to rigorous deregulation of the economy. Though estimates of the impact

of such a combination scenario are not available, the informed analysts of the Egyptian economy referred to previously [Galal & Hoekman, 1996 and Page & Underwood, 1995; Konan & Maskus, 1996] have developed econometric forecasts of the potential dynamic effects of the EMA on productivity and how this could be enhanced by de-regulation and harmonization of product and services standards.

**Welfare Effects of the Euro-Mediterranean Agreement
(% GDP Growth)**

	w/o agriculture. liberalization	with agriculture liberalization	with worldwide liberalization	EMA Dynamic Gains
Egypt	0.2-1.8	n/a	2.6	n/a
Morocco	1.3	1.6	2.5	n/a
Tunisia	-0.9-1.6	1.7	5.3	4.6
Turkey	0.6	0.7	1.1	n/a

Source: O. Havrylyshyn - IMF 1997

It must be stressed that the range of the “dynamic gains” from de-regulation and product and service harmonization [1.8 - 2.6% GDP] must be labeled as *conservative* and are based on price adjustments on input costs and exports. These estimates *do not* at this stage incorporate the gains expected to flow from increases in foreign and domestic investment in export industries and related business services under an unfettered right to establish and national treatment framework.

Harmonize or Negotiate?

The European Union will transform the unified market into an economic and monetary union [EMU] with a common currency on January 1, 1999. A number of Central European countries such as Poland, Hungary, the Czech Republic, and Estonia have already begun negotiations to become full members. As well, there are continuing discussions on accession paths for Turkey and Cyprus.

Among the many actions and dynamics which are driving integration, the core issue of standardization of measurement and the *harmonization* of the national product and services standards in Europe is one of the key underpinning mechanisms of the unified market. The dynamics for harmonization emanates from the business community, which is requiring:

- ⇒ reduced uncertainty and levels of risk in the unified market.
- ⇒ voluntary methods to facilitate compliance with the health and safety “directives” of the European Commission.
- ⇒ promotion of business networks of consumers and producers through a common understanding of essential product requirements and quality assurance.

In essence it is participation in the regional European integration process and the provision of this market-driven standardization and harmonization predictability which is “on offer” to Egyptian firms if the GOE decides to develop the EMA into a “*Deep FTA Agreement.*”

The following data helps measure the economic dynamics that EMU may offer to Egyptian firms in terms of market size, EU export propensity, and recent trends in the Egyptian and other MENA countries' share of the EU market.

	<u>POPULATION</u> millions	<u>GNP per capita</u> US\$	<u>GNP</u> US\$ billion
Europe Union	372.1	\$22,760	8,468
<i>Egypt</i>	59.1	\$1,080	64
NAFTA	388.0	\$25,550	9,912

Source: World Development Indicators 1998

Share in EU Markets

[Imports percentage from country/total EU imports, excluding intra-EU trade]

	<u>1980</u>	<u>1990</u>	<u>1994</u>
<i>Egypt</i>	0.971	0.543	0.506
Morocco	0.507	0.691	0.686
Tunisia	0.503	0.516	0.600
Turkey	0.409	1.443	1.499
Hungary	0.637	0.887	1.132
Poland	1.216	1.419	1.916

Source: IMF

Regional Trade Blocs

	<u>1980</u>	<u>1990</u>	<u>1996</u>
<u>Exports within Bloc</u> [% of total exports]			
APEC	57.6	68.5	73.1
EU	61.0	66.0	61.5
NAFTA	33.6	41.4	47.5
<u>Exports by Bloc</u> [% of World Exports]			
APEC	33.5	38.7	44.1
EU	41.1	44.1	39.1
NAFTA	16.6	16.1	17.4

Source: World Development Indicators 1998

The data contain the tables above is sobering but could help stimulate a number of key concerns and questions for GOE policy makers such as:

If the countries of the EU, NAFTA and APEC, which account for nearly 85% of world trade, are rapidly engaged in the process of standardization and harmonization of their products and services, is it not in the best interests of Egypt to join this process?

If not, is there an alternative path by which the average Egyptian can close the gap in their incomes with the citizens of these trading blocs?

In the next section of this report the most recent developments regarding standardization, harmonization and convergence of product and service standards in Europe and the parallel developments in the negotiating mutual recognition agreements [MRA's] between the US - EU and within the APEC trade bloc are reviewed.

3.4. The Evolving Global System of Trade

The 1996 DEPRA study "Research Study on the Quality Control System in Egypt" gave a detailed description of the structure and responsibilities of the main European organizations designated to drive the harmonization and convergence process in Europe. These included:

- 1. CENELEC** *European Committee for Electrical Standardization*
- 2. ESTI** *European Telecommunications Standards Institute*
- 3. EOTC** *European Organization for Testing and Certification*
- 4. CEN** *Committee for European Standardization*

There is no need to reproduce the organizational structures, work programs or responsibilities and membership of these organizations or their technical committees, which are easily available via the Internet. However, the following data illustrates the pace of harmonization and convergence within Europe:

	<u>1996</u>	<u>1998</u>
CEN Member Countries	18	20
CEN Affiliate Countries	13	13
Standards Produced	1736	4300
Technical Committees	267	331

Source: CEN 1998

It should be recalled that the 33 countries who have joined in the European harmonization and convergence process have a combined population of over 500 million people with a GDP approaching \$10 trillion. This emerging unified market has stimulated the acceleration of standards harmonization driven by private industry's need for predictability and competitiveness, supported by leading standardization bodies which themselves are increasingly seeking a global presence.

For instance the British Standards Institute [BSI], which is the largest standards body in the world with annual sales of over \$250 million in testing, inspecting and consulting services, has recently made a \$50 million purchase of Inspectorate Plc., which will give it a world-wide network of testing laboratories and allow it to service its international clients in key competitive markets. Likewise, companies such as Societe Generale de Surveillance [SGS] are also expanding their global presence, as the market for conformance assessment grows and competition intensifies with US and Asian entrants.

The momentum toward standardization and harmonization is not solely a European affair, as the recent initialing of two major mutual recognition agreements [MRA's] attests. The long awaited US/EU MRA covering the testing, inspection and certification requirements of regulated products in telecommunication equipment, medical devices, recreational craft, pharmaceutical good manufacturing practices, and electrical safety and electromagnetic compatibility will substantially reduce the duplication and cost of testing on approximately \$40 billion of the \$70 billion of those US exports to Europe that currently require some form of EU certification [OECD, 1996].

A second but no less important MRA is the recognition of technical equivalence test reporting among the members of the Asia-Pacific Laboratory Accreditation Cooperation [APLAC] organization, which is comprised of Australia, Hong Kong, New Zealand, Singapore, Taiwan and the United States. This agreement will also help reduce the duplication and cost of testing on \$300 billion of US exports to the APEC region [ibid].

These MRAs are agreements on the mutual recognition of *conformity assessment* of regulated products based on good science of accepted standards. A MRA is not necessarily an intermediate step toward harmonization, though it should provide [i] cost savings in conformity assessment, [ii] certainty of market access, [iii] increased regulatory efficiency.

For many policy makers, including those in Egypt, the MRA path to trade policy reform looks attractive and has clearly been signaled within the EMA negotiations. This is to be applauded – but only if negotiations to reach a mutual recognition agreement are:

- ◆ engaged in tandem with a process of standardization to international norms with early dates set for completed harmonization.
- ◆ linked to the right to establish and national treatment in a deregulated economy to reflect a deep integration agreement along the line of the EU's Association Agreements with the countries of Central Europe.
- ◆ allied to a rigorous program of de-regulation of the economy, exit by the GOE and other state-related bodies from direct participation in manufacturing, and the provision of improved business and financial services.

These are the benchmarks of the evolving global economy and should be the basis for Egyptian participation in the global economy.

4.0. Export Enhancement at the Industry Level: Prospects and Problems in Five Industries

While Egypt enjoys a long history of industrialization, a diversified industrial base, relatively low labor costs, rich natural resources (high-valued agricultural products, sufficient oil and gas reserves), and an advantageous geographical location, it has failed to turn these comparative advantages into competitive ones (5). Consequently, Egypt's share in world exports and imports declined from 0.2 and 0.5 in the 1980s to 0.07 and 0.2 respectively, in 1995. The openness index, which measures the share of exports and imports of goods and non-factor services to GDP, also dropped from 88 percent in 1985 to 47 percent in 1996/97 [Subramanian, 1997].

Egypt needs to improve its competitive position in the world market. The current focus on exports is critical in this regard, as it provides the mechanism for modernizing the economy and enhancing productivity in both the export sector and the domestic sector and for generating a higher level of productive employment.

This section examines five industries (food, textiles and clothing, leather footwear, wooden furniture, and software) which have become the focus of some attention in Egypt and which are believed to have potential for export growth. Our main concern is to explore this potential and to investigate whether it is fully exploited, and if not, why not? The section is divided into three subsections. The first analyses whether or not the industries under study have substantial potential for export promotion. The second, relying on different efficiency measures, investigates if this potential is well exploited. The final section assesses the major constraints – the incentive structure and export transactions costs – to efficiency improvement and export development.

4.1. Do these industries have significant potential for export promotion?

Three important features of the industries selected can be considered to see if they should be leading candidates for export promotion and rapid economic growth in Egypt. First, do they enjoy a greater than unity Revealed Comparative Advantage (RCA) (6)? Second, do they manifest a high rate of export growth? Third, do they use highly labor intensive techniques of production which are more suitable to Egypt's factor endowments?

4.1.1. Revealed Comparative Advantage

The Revealed Comparative Advantage (RCA) index provides a rough indication of export prospects (6). It has a simple interpretation, as it compares Egypt's share of world exports of a certain product with Egypt's overall share of world exports. If it takes a value of less than unity, this implies that the country has a revealed comparative disadvantage in the product. Similarly, if the index exceeds unity, the country has a revealed comparative advantage. Table (4.1) provides evidence that opportunities for promoting exports in the food and textiles and clothing industries are good, based primarily on the (RCA) index values. It indicates that Egypt has a strong comparative advantage in producing and exporting specific products in these two sectors. They include: new types of processed food such as confectionery, prepared foods, preserved vegetables and fruits, pastas, cheeses; and nontraditional textile products such as bed linens, bathroom linens,

table linens, floor coverings and handmade and machine carpets. As for furniture and footwear, their RCA index is far below unity, although the table indicates an increase in the index value which suggests some improvement in their competitiveness. For software, we could not get the necessary data to calculate the RCA index, but interviews with business people indicate that Egypt has a comparative advantage in this field (see Section 4.3 below for details).

Confidence that these indications of comparative advantage reflect true conditions in the Egyptian Economy is enhanced by the DRC calculations in Section 2 above. For example, footwear and furniture do not have a comparative advantage according to either measure, while food processing has an advantage according to both.

Table (4.1)
Manufactured Products with Revealed Comparative Advantage

Industry	1985	1995
<u>Food Products</u>		
Copra	0.0	15.6
Vegetables used in pharmacy	5.0	5.9
Molasses	6.9	3.4
Dried fruit	0.2	3.2
Salt	0.1	3.1
Sugar	0.2	3.0
Vegetables Preserved	1.0	2.7
Sugars and syrups	...	2.5
Fixed vegetable oil	0.2	2.4
Macaroni and Spaghetti	0.2	1.7
Food waste and prepared feed	0.2	1.6
Cheese and curd	0.3	1.5
Hydrogenated oil and fat	...	1.2
Food preparations	0.3	1.1
<u>Textiles</u>		
Gray cotton yarn in bulk	32.4	43.8
Gray woven cotton fabric	10.0	16.8
Unknotted carpets	1.8	14.4
Cotton waste	7.7	9.7
Flax, ramie and yarn	0.2	6.5
Other textile products	1.1	6.0
Waste of synthetic fiber	0.7	2.9
Knotted carpets	0.3	2.6
Waste of textile fabrics	3.1	2.6
Felt and articles	...	2.0
Waste of wool and hair	4.4	1.7
Textile clothes not knit	0.1	1.4
Clothing accessories knit	0.3	1.3
Textiles for machinery	...	1.2
Blankets and coverlets	...	1.2
<u>Leather</u>		
Calf leather	...	1.5
Artificial leather	...	1.4
Footwear	0.11	0.25
Furniture*	0.20	0.41

Source: Ministry of Economy and International Cooperation, 1996, Egypt Economic Profile, Cairo.

**RCA for furniture and footwear from Yeats.*

4.1.2. Rate of Growth

Two of the five industries, spinning and weaving and foodstuffs, are likely to increase their exports in the future because of their current high rate of growth. Therefore, while presently some of the industries under study do not account for a large share of Egypt's exports (7), such as processed food which accounts for 3.0% or less, as shown in Table (4.2), still they may have export potential in the future and may be identified as dynamic products for future fast growth. Some of them have experienced growth rates which have been above the annual average growth of total manufactured exports over the 1990/91 to 1996/97 period; and therefore they may be an important part of the country's export earnings in the future. (Table 4.3) Favorable treatment in the EU following completion of the EMA negotiations would certainly boost exports of processed food, for example.

Table (4.2)
Export Commodity Composition, Million US\$

Exports	90/91	91/92	92/93	93/94	94/95	95/96	96-97	%
Total Exports	4,250	3880	3417	3337	4766	4608	4925	100
I. Agricultural Commodities	226	257	199	238	616	339	271	7
II. Industrial Commodities of which:	3457	3359	3217	2900	4150	3540	3832	84
Petroleum Exports	2334	1898	1803	1772	1948.8	2226	2578	50
Manufacturing Exports of which:	1123	1461	1414	1128	2201.2	1314	1254	34
a. Spinning & weaving Industry	529	575	451	496	1077	574	607	15
b. Engineering Ind. of which:	80	119	91	93	51	126	151	2
Wood Furniture	26	38	23	14	16	4	9	0.5
c. Foodstuffs	86	145	101	88	125	129	152	3
d. Chemical Industries	180	237	111	110	293.2	139	117	4
e. Metal Industries	198	262	288	235	498	247	163	6
f. Mining Industry	18	28	33	37	68	44	29	1
g. Building materials	5	11	26	26	32	26	32	1
h. Other misc. commodities	67	84	67	42	57	29	53	1
of which: Leather products	23	35	21	15	23	10	20	1
III. Other	527	264	247	200	0	729	772	9

Source: Central Bank of Egypt, Economic Journal, various issues, calculated by the author.

Table (4.3) shows that textiles and clothing and foodstuffs have higher average annual growth rates compared with the average growth rate of manufacturing exports during 1990/91 - 1996/97. Interviews with business people also suggest that software exports have grown at an average rate of more than 9%, which is far above the average for total manufacturing exports. Leather products and wooden furniture had a negative growth rate in exports, a fact consistent with estimates of inefficiency and lack of comparative advantage presented above.

Table (4.3)
Dynamic Products in Egypt's Exports

Exports	Annual Average Growth Rate (%)*
Spinning and weaving industry	4.6
Wood Furniture	-28.7
Foodstuffs	6.0
Leather products	-10.1
Total Manufacturing	2.2

Source: Central Bank of Egypt, Economic Journal, various issues.

*Computed as $\log(\text{exports}) = a + b(\text{time})$, where b is the compound annual rate of growth

4.1.3. Labor Intensity

Each of the five industries is highly labor intensive, as shown in Table (4.4). They are more labor intensive than manufacturing as a whole. As shown in Table (4.4), the five industries have lower – almost half or less – capital/labor ratios compared with averages for the total manufacturing sector. Moreover, the table indicates that the electronics and leather industries have the highest labor intensity within the manufacturing sectors. Other things being equal, expanding exports in these industries would help achieve the GOE's primary goal of increasing employment. Three of the industries show a healthy rate of growth in exports, but furniture and leather products exports declined significantly. This is probably caused by high protection levels that contribute to production inefficiency and high unit costs.

High labor intensity combined with low wage levels increases the likelihood of expanding manufacturing exports. Tables 4.5a and 4.5b illustrate that labor cost in all five industries -- except for the professional and scientific equipment industry -- is lower than in the other industrial sectors and is below the average for the total manufacturing sector. In addition, they also show that wage levels in Egypt are by far the lowest in the region, which increases the chances for regional exports. Thus, removing market distortions, especially in the leather and furniture industries, could greatly expand exports and contribute significantly to expanded employment.

Table (4.4)
Labor Intensity Indicators, 1994/95

Industry	Capital/labor ratio (Thousand LE)
Food, beverages and tobacco	17.80
Textile, clothing, footwear except leather wear	16.44
Leather footwear	7.98
Wood products except furniture	13.46
Wood furniture	18.79
Paper products and printing	25.73
Chemicals	62.25
Non metallic products	90.44
Basic metallic	38.31
Machinery electric equipment and transport means	17.29
Electronics	5.23
Total Manufacturing	30.24

Source: Calculated from CAPMAS, 1997: Annual Industrial Production Statistics (private and public enterprises)

Another reason to focus export promotional efforts on these sectors is that most of them require locally available production inputs. This applies especially for the textiles and clothing, food, and software industries, and to a lesser extent to leather footwear, but not to furniture.

According to the previous analysis, these industries have promising potential, but what about present performance and how do they compare to other countries in the region? Section 4.2 examines data relevant to these questions.

Table (4.5a)
Wages in Manufacturing, Selected MENA Countries US\$, 1992

Industry	Egypt	Jordan	M	Tunisia	Turkey
Total manufacturing	1,479	3,092	3,616	n a.	8,724
Food products	1,012	2,384	4,374	3,062	6,945
Beverages	1,267	3,776	5,481	5,518	9,726
Tobacco	1,915	5,499	-----	7,003	7,044
Textiles	1,312	2,767	2,802	3,730	6,713
Wearing apparel, except footwear	692	1,767	2,107	2,596	3,589
Leather products	1,624	5,127	2,947	n.a.	3,455
Leather Footwear	444	2,053	-----	n.a.	6,120
Wood products, except furniture	1,154	1,917	3,702	n.a.	6,415
Furniture, except metal	837	2,059	-----	n.a.	4,938
Machinery electrical	1,515	2,843	6,165	3,633	9,389
Transport equipment	950	2,355	5,714	n.a.	12,809
Professional and scientific equipment	2,129	3,136	3,418	n.a.	6,571

Note: Wages are per worker and per annum.

Source: The Economic Research Forum (ERF), 1996: ERF Indicators Economic Trends in the Region.

Table (4.5b)
Unit Labor Cost of Production in Manufacturing, Selected MENA Countries US\$, 1992

Industry	Egypt	Jordan	Morocco	Tunisia	Turkey
Total manufacturing	9	11	12	n.a.	11
Food products	6	11	7	6	9
Beverages	11	18	8	13	8
Tobacco	8	36	----	4	10
Textiles	12	13	----	12	15
Wearing apparel, except footwear	11	38	24	23	8
Leather products	15	12	21	n.a.	8
Leather Footwear,	9	30	----	n.a.	16
Wood products, except furniture	16	23	14	n.a.	14
Furniture, except metal	13	31	----	n.a.	11
Machinery electrical	8	13	14	11	10
Transport equipment	18	18	10	n.a.	12
Professional and scientific equipment	23	35	12	n.a.	17

Note: Unit Labor cost of Production = wages per worker / gross output per worker.

Source: The Economic Research Forum (ERF), 1996: ERF Indicators Economic Trends in the Region.

4.2. Current Export Performance

Despite these advantages, or potentials, the export and efficiency indicators show that these industries are -- by various measures -- underperforming. The manufacturing export performance, in general, is not by any standard satisfactory or acceptable. According to Table (4.6), the manufacturing export growth rate between 1985 and 1994 was only 1%, a level well below the average of 25% shown for many developing countries.

Table (4.6)
Growth in Manufacturing Exports for Selected Fast-growing Economies and Egypt (%)

Country	Average annual growth rate 1985-94 (%)
Chile	26.3
Hong Kong	21.4
Indonesia	33.2
Republic of Korea	14.1
Malaysia	29.2
Singapore	20.2
Thailand	33.7
Egypt (for the period 1986-94)	1.0

Source: Sachs J., 1996: Achieving Rapid Growth: The Road Ahead For Egypt. Egyptian Center for Economic Studies, ECES, Cairo.

The share of manufacturing exports (excluding petroleum) is only 34% of total merchandise exports on average during the period from 1990/91 to 1996/97 (see Table (4.2)). Such an export performance does not contribute to achieving a sustainable growth in GDP.

As for the specific industries under study, Table (4.2) indicates that the five industries' share in Egypt's merchandise exports is negligible with the exception of textiles and clothing. Moreover, Table (4.7) shows that the percentage of exports to total output in most industrial sectors is very limited. It is only 1.2% in furniture, 1.6 % in spinning and weaving, 1.97 % in food, 4.28% in footwear, and 4.65% in cotton ginning. The exception is ready made garments, which reached 40%. Thus, manufacturing exports do not constitute a large share of total exports, the five industries under study have a negligible share in merchandise exports, and exports within the five industries are a small percentage of total production. Under performance in exports is certainly associated with a combination trade policy (implicit taxes on exports), the associated production inefficiencies, and perhaps a lack of skill in marketing the products in the global market place.

Table (4.7)
Percentage of Exports to Total Output (L. E. million)

Item	Exports	Total Output	%
Food products	302.7	15293.4	1.97
Beverages	6.4	1078.9	0.59
Tobacco	0.6	3520.9	0.01
Cotton ginning	105.7	2273.0	4.65
Spinning and weaving	175.7	11143.0	1.57
Garments	1199.8	3004.1	39.93
Leather products except footwear	23.2	326.7	7.10
Footwear	31.8	742.5	4.28
Wood products except furniture	6.1	1784.5	0.34
Furniture	37.6	3082.7	1.21
Paper and Printing	67.8	2765.8	2.45
Chemicals except oil refining	287.5	6292.1	4.56
Oil refining products	2968.5	8139.9	36.46
Plastic	30.2	1675.7	1.80
Pottery and chinaware	18.3	679.9	2.69
Glass products	17.3	643.5	2.68
	14.7	3385.2	0.43
Iron and steel	204.1	5153.2	3.96
Machines and equipment	578.4	5979.6	9.67
Means of transport	35.0	2050.6	1.70
Total Manufacturing	6111.4	79015.2	7.73

Source: CAPMAS, 1997: National Accounts, Egypt: Input/Output tables 1991/92

This unsatisfactory export performance may be attributed to the above factors, but production inefficiency is certainly one of the more important ones. Data in Table (4.8) confirms that most industries under study manifest lower levels of capital and labor productivity compared with the average of the manufacturing sector. It also indicates that the relatively best performing sectors are electronics and food, respectively, while the worst performing sectors are footwear and furniture. Textiles are somewhere in-between. Moreover, labor productivity is below its corresponding figures in many countries in the region, as shown in Table (4.9).

Table (4.8)
Efficiency Indicators, 1994/95

Industry	Labor productivity (Thousand LE)	Capital productivity (LE)
Food, beverages and tobacco	16.57	0.93
Textile, clothing, footwear except leather wear	7.69	0.46
leather footwear	2.17	0.27
Wood products except furniture	17.88	1.32
Wood furniture	7.26	0.38
Paper products and printing	21.05	0.81
Chemicals	39.49	0.63
Non metallic products	30.20	0.33
Basic metallic	11.79	0.30
Machinery electric equipment and transport means	19.81	1.14
Electronics	8.19	1.56
Man. total	18.34	0.60

Source: Calculated from CAPMAS, 1997: Annual Industrial Production Statistics (private and public enterprises)

Low levels of efficiency are due to many reasons, of which the most important arguably is the height of the current structure of tariffs. With the exception of the food industry (6%), the five industries under study have high and above average effective rates of protection, exceeding 50% for furniture (83.80%), footwear (50.81%), final wear (55.86%), while spinning and weaving is nearly there (47.55%). This compares with the average ERP in manufacturing of 30.48%.

In addition, low rates of capacity utilization coupled with high rates of inventories in most manufacturing are also responsible for poor levels of efficiency [Fawzy, 1993]. High protection is usually associated with the latter, as high domestic prices reduce demand and make it very difficult to compete in world markets. Two more measures indicate a deterioration of Egypt's productivity and help explain why exports performed badly. The first is an index based on unit labor cost developments in the public sector which shows a deterioration of competitiveness of 57% for the period 1991/92 - 1994/95. The second is a dollar wage index which suggests a deterioration of 25% between 1990/91 and 1995/96 [Subramanian, 1997].

Table (4.9)
Labor Productivity in Manufacturing, Selected MENA Countries US\$, 1992

ISIC Code	Egypt	Jordan	Morocco	Tunisia	Turkey
Total manufacturing	15,973	29,055	30,664	n.a	82,025
Food products	16,119	20,979	60,786	48,271	75,916
Beverages	11,696	20,996	66,921	42,111	124,021
Tobacco	23,563	15,437	-----	184,384	68,594
Textiles	10,593	21,121	-----	30,969	44,808
Wearing apparel, except footwear	6,320	4,666	8,890	11,183	45,485
Leather products	10,806	43,638	14,234	-----	45,775
Leather Footwear,	4,743	6,757	-----	-----	37,838
Wood products, except furniture	7,206	8,333	26,677	-----	46,333
Furniture, except metal	6,371	6,722	-----	-----	43,424
Machinery electrical	18,540	21,319	43,700	31,803	90,222
transport equipment	5,373	12,897	56,933	-----	103,210
Professional and scientific equip	9,385	8,896	28,131	-----	39,040

Note: Productivity is annual output per worker.

Source: The Economic Research Forum (ERF, 1996) ERF Indicators Economic Trends in the Region.

Thus, one might say that low levels of efficiency and productivity explain, albeit partially, the disappointing export performance. A key issue is to determine what policies and institutions can help to improve efficiency and expand exports. We attempt to do this in the following section.

4.3. Sources of Export Underperformance

Since the 1990s, the government has done a great deal to deregulate the economy and liberalize its trade regime, yet exporters continue to face two major problems: a distorted incentive structure, and high export transaction costs. The former results in a weak incentive to export and the latter in a lack of export competitiveness. Although identifying both is important for export promotion, special focus will be devoted to export transaction costs, which are more regulatory in nature and could be immediately and easily eliminated by the government. Eliminating the

distortion in the incentive structure may be a longer term process and is the focus of Section 2.0., above.

4.3.1. The Incentive Structure

The fact that domestic prices in Egypt are higher than world market prices for many goods explains why many producers find it more profitable and less risky to sell in the domestic market rather than in the world market. This trend can be explained by several factors. Primarily, it is attributable to the high average nominal tariff rate of 24.62%, with an effective protection rate of 30.48%, as reported in Section 2.0. Also, there has been a change in the relative prices of tradables and non-tradables. Table (4.10) shows that the relative prices have shifted in favor of non-tradables since 1991, with prices of non-tradables rising 20% more than those of tradables between 1991 and 1995, reflecting a large exchange rate appreciation in real terms, following the large devaluations of 1990 and 1991.

Moreover, the cascading nature of the tariff structure creates an anti-export bias, as was documented in Section 2.0., above. This bias is evident in wooden furniture, final wear and clothes, and footwear.

Table (4.10)
Real Effective Exchange Rate Index and Domestic Price Indices of Tradables and Nontradables
(1991=100)

Year	REER*	Tradables CPI (TCPI)	Non-Tradables CPI (NTCPI)
1985	61	34	52
1986	60	40	55
1987	57	50	61
1988	51	60	67
1989	57	72	73
1990	83	88	85
1991	100	100	100
1992	93	119	127
1993	81	126	158
1994	79	137	174
1995	78	152	183

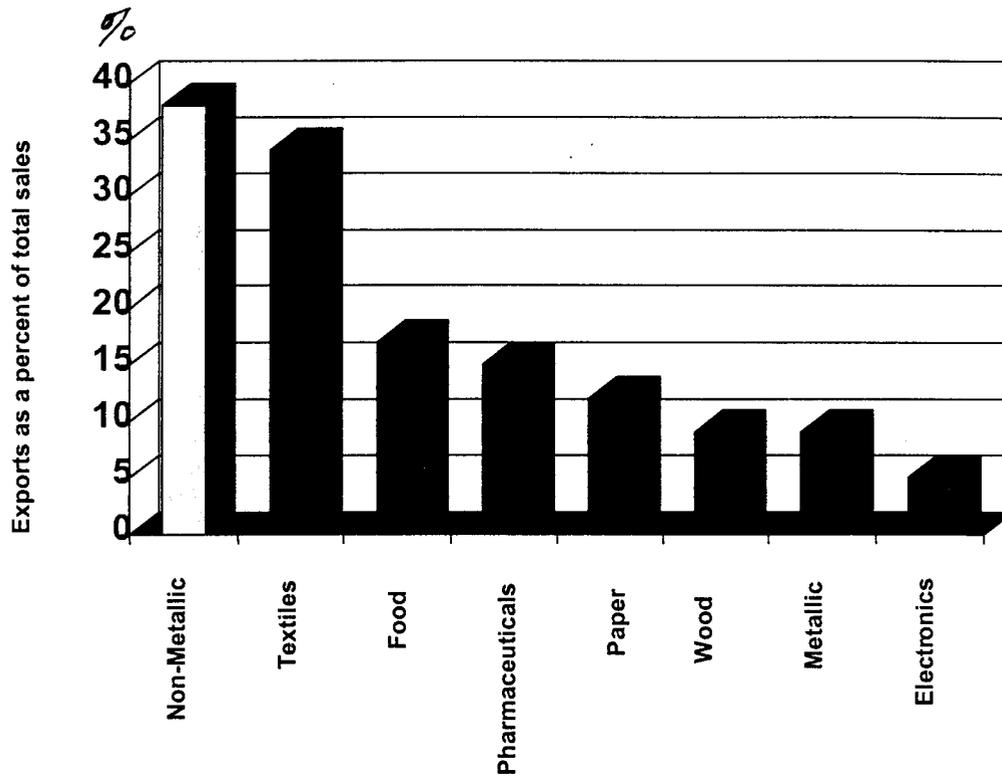
*Real effective exchange rate; decrease is real appreciation.

Sources: World Bank. 1997. *Arab Republic of Egypt Country Economic Memorandum Egypt: Issues in Sustaining Economic Growth. Main Report*, Volume II, Washington, D.C.: The World Bank

The negative impact of the incentive structure on manufacturing exports was confirmed by recent survey results, which show that the average share of exports to total sales for all surveyed firms in all industries was 23%. Only textiles and clothing have a share (34%) above the average, while the other three industries have lower than average shares: food (16%), furniture (9%), and electronics (5%).

Figure 4.1. Share of exports to total sales

Average = 23%



4.3.2. Export Transaction Costs

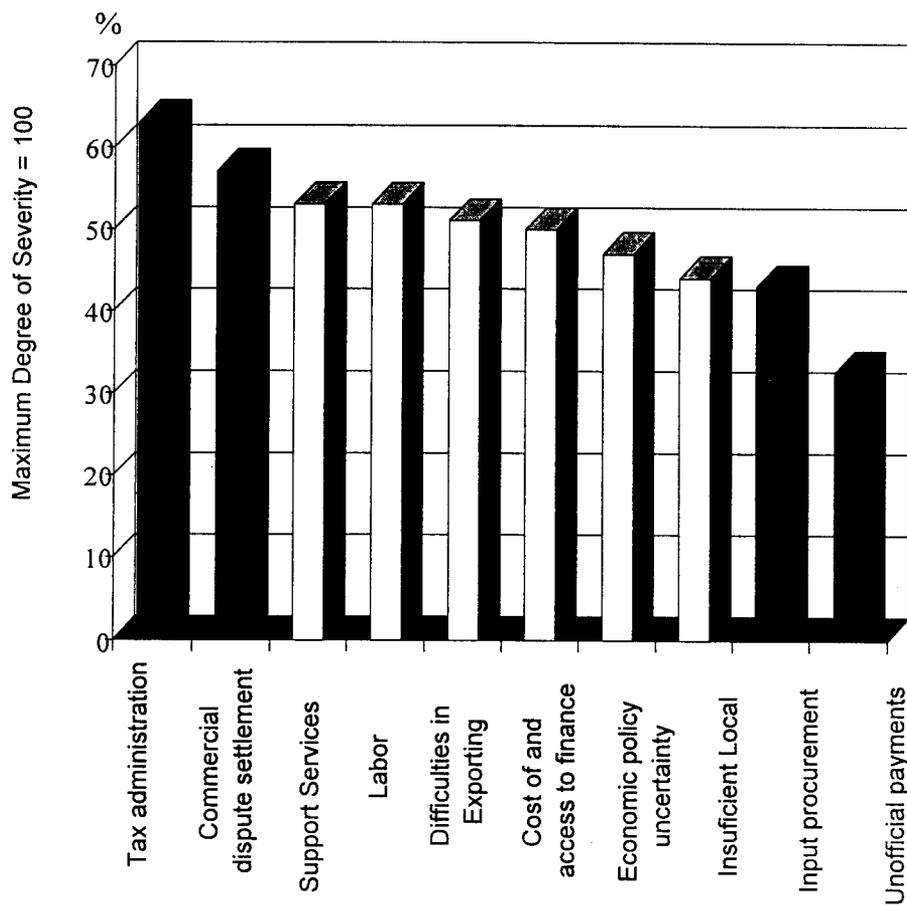
Identifying the sources of high transaction costs is an important step toward designing government policies to promote exports. To identify which institutions constrain exports the most in Egypt, from the business people's perspective, the analysis below relies on a survey of a sample of one hundred private firms in manufacturing. The sample was selected randomly from different industries and according to size group. The profile of the sample is given in Appendix 4.

According to the questionnaire results one might differentiate between institutional constraints that impede export growth indirectly and those that affect export prospects directly. The first set of obstacles – as revealed in Figure 4.2 – increases generally the cost of doing business in Egypt for everyone, and hence negatively affects Egypt's export competitiveness. Figure 4.2 indicates that investors complain the most about tax administration, commercial dispute settlement and labor, while lesser problems – as perceived by business people – are unofficial payments, input procurement and insufficiency of local demand. The second group of obstacles concerns the specific export problems that investors confront directly while exporting, and which are responsible for high export transaction costs. Below is a detailed analysis of export institutional constraints, their degree of severity, types, and variation across industries.

- Overall severity and ranking of export constraints

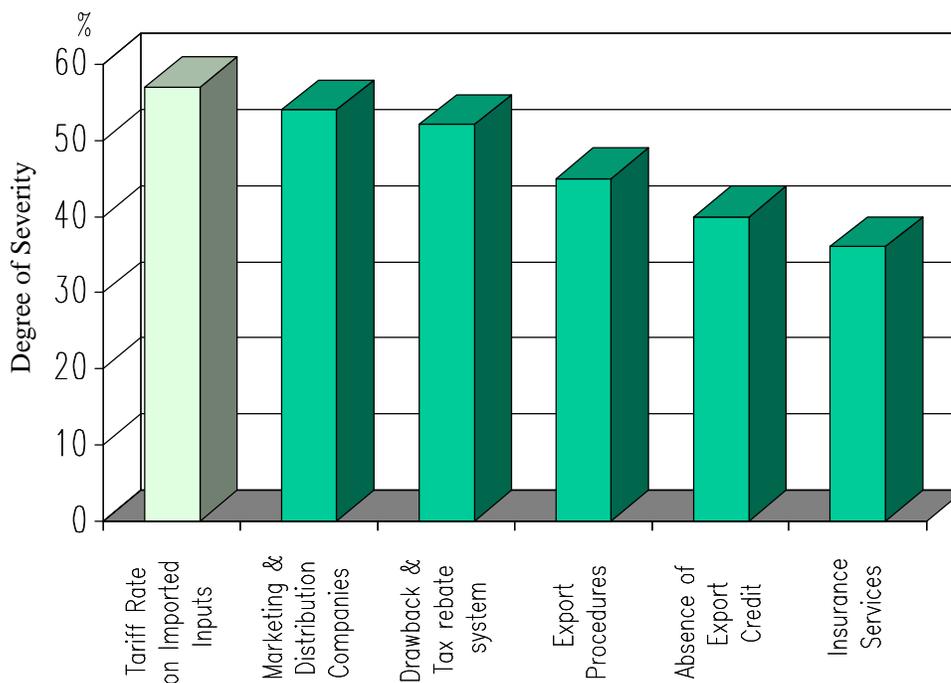
Questionnaire returns indicate two broad findings. First, the severity of direct constraints to export (Figure 4.3) are not considered very high, compared with other institutional constraints to doing business in Egypt (Figure 4.2). This may be explained by the fact that most firms in Egypt produce for the domestic market rather than for export, and therefore are not seriously affected by export problems.

Figure 4.2. Survey Results
Overall Ranking of Institutional Constraints



Second, with regard to the ranking of specific direct export constraints, firms rank the most binding constraints related to exporting to be high tariff rates on imported inputs, lack of marketing and distributing companies, inefficiency of drawback temporary admission, cumbersome export procedures, and, finally, the absence of export credit and insurance services, in that order (Figure 4.3).

Figure 4.3. Survey Results
Export Constraints: Industrial Sector



The fact that tariffs on imported inputs (intermediate inputs and capital goods) are perceived to be the most binding constraint is not consistent with the previous analysis in Section 2.0. Input tariffs are actually quite low and ERP's are consequently higher than NRP's overall. It is the domestic price of products which is inflated relative to export prices, thus inhibiting the growth of exports. High final product tariffs, plus other taxes and surcharges, increase the cost of both imports and exports, thereby impeding export expansion. Significant complaints about tariffs on imported inputs can also be attributed to the high percentage that imported intermediate inputs –nearly 45% – are of total intermediate inputs used in the manufacturing sector (1991/92) (Table 4.11). The lack of distribution and marketing companies ranks second, particularly for small and medium enterprises. As for drawback and temporary admission, investors complain that they are still cumbersome, involving many steps which prove to be costly in terms of time and money.

Table (4.11)
Imported Intermediate Inputs as a Percentage of Total Intermediate Inputs
 (%)

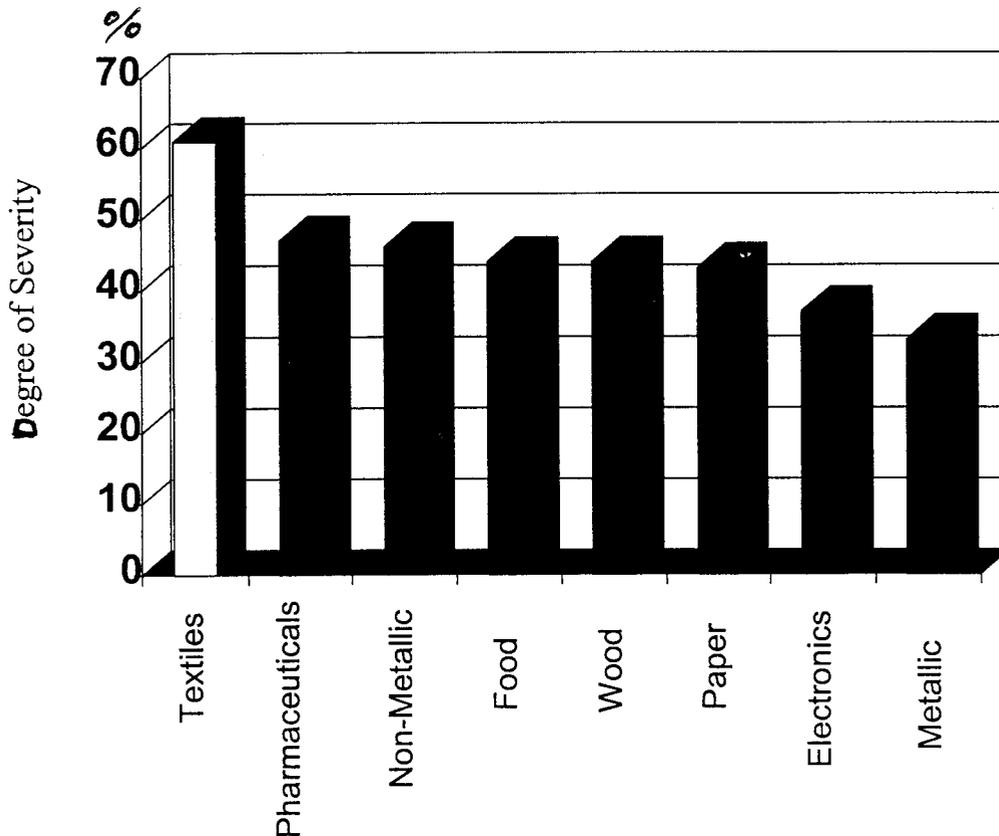
Industry	Percentage of imported inputs to total inputs
Food	51.78
Beverages	32.76
Tobacco	67.74
Cotton ginning	0.03
Spinning and weaving	20.94
Garments	13.01
Leather products except footwear	38.09
Leather footwear	8.73
Wooden products except furniture	75.20
Wooden furniture	69.14
Paper and printing	86.78
Chemicals except oil refining	72.38
Oil refining products	74.09
Rubber and plastic products	23.41
Pottery and chinaware	9.53
Glass and its products	48.51
Non metallic minerals	3.84
Basic metallic	17.92
machinery and equipment	76.41
means of transportation	77.24
Others	55.39
Total	45.36

Source: CAPMAS 1996(National accounts Egypt, input output tables 1991-1992)

- Severity of constraints across industries

The severity of institutional constraints varies by industry. It is highest in the textile industry (60%), followed by the food and furniture industries (41% each), and lowest in the electronics sector (37%) (Figure 4.4). Businessmen's perception of the degree of severity reflect, to a certain extent, the propensity to export in each industry, as measured by the percentage that exports are of total production (Table 4.7).

Figure 4.4. Survey Results
Export Constraints:
Cross-Industries



- Ranking of constraints among industries

The ranking of specific export constraints also varies among industries. For example, tariffs on imported inputs are reported as a more binding constraint in the textile and food sectors than in the wood and electronics sectors, while the most binding constraint in the wood and electronics industries is the unavailability and inefficiency of the marketing and distribution companies. The survey also shows that while problems related to the drawback and tax rebate systems rank first in the food industry, they rank second in the other three industries. Absence of export credit and insurance services are less problematic in all industries (Figures 4.5, 4.6, 4.7 and 4.8).

Figure 4.5. Survey Results
Exports Constraints: Food Sector

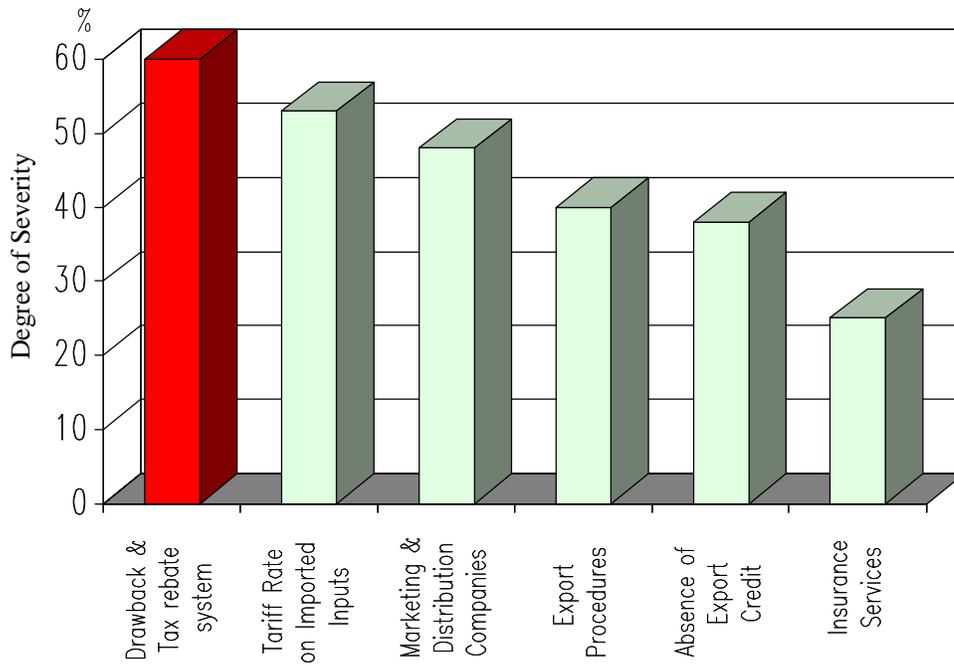


Figure 4.6. Survey Results
Exports Constraints: Textile Sector

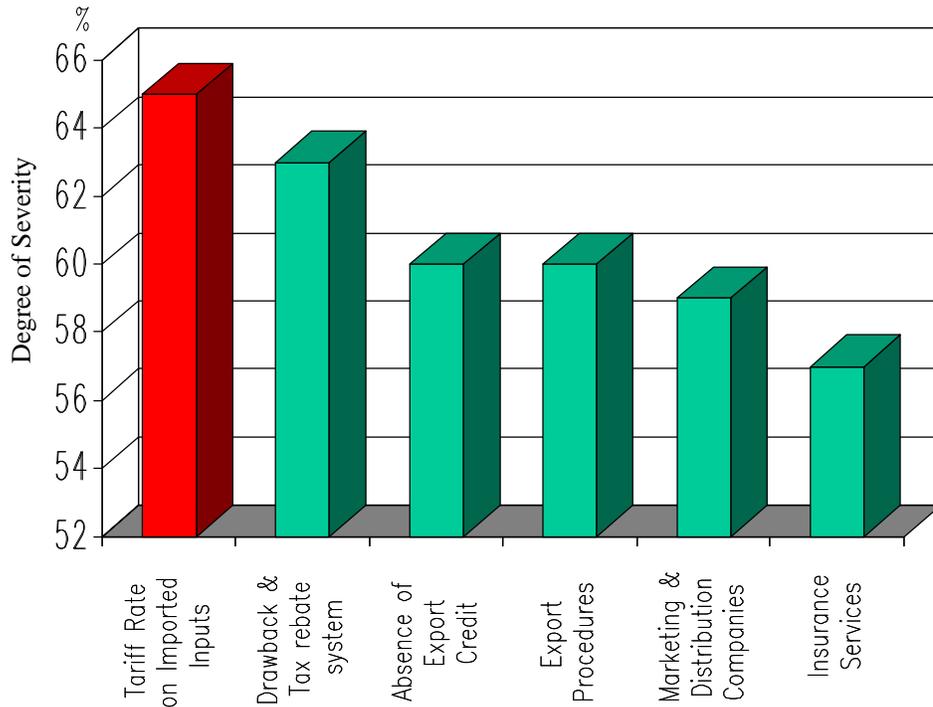


Figure 4.7. Survey Results
Exports Constraints: Wood Sector

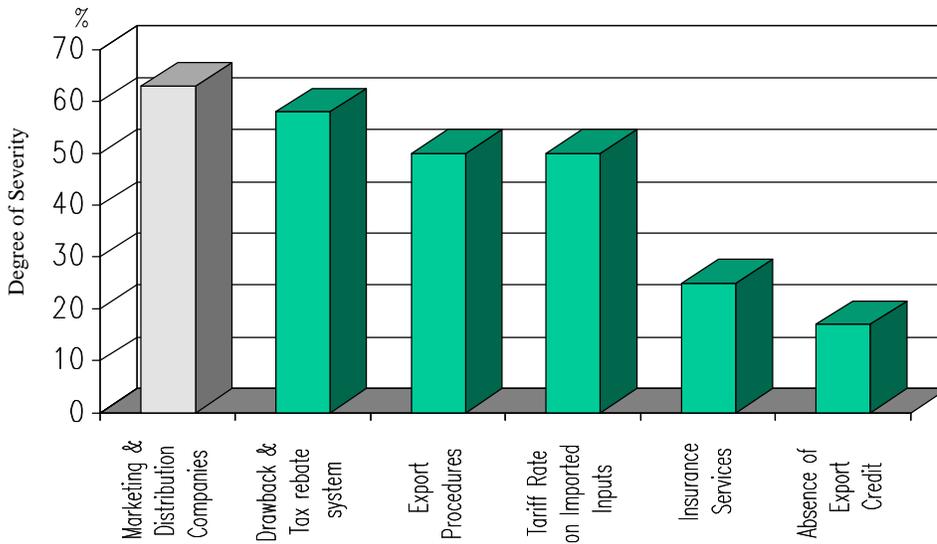
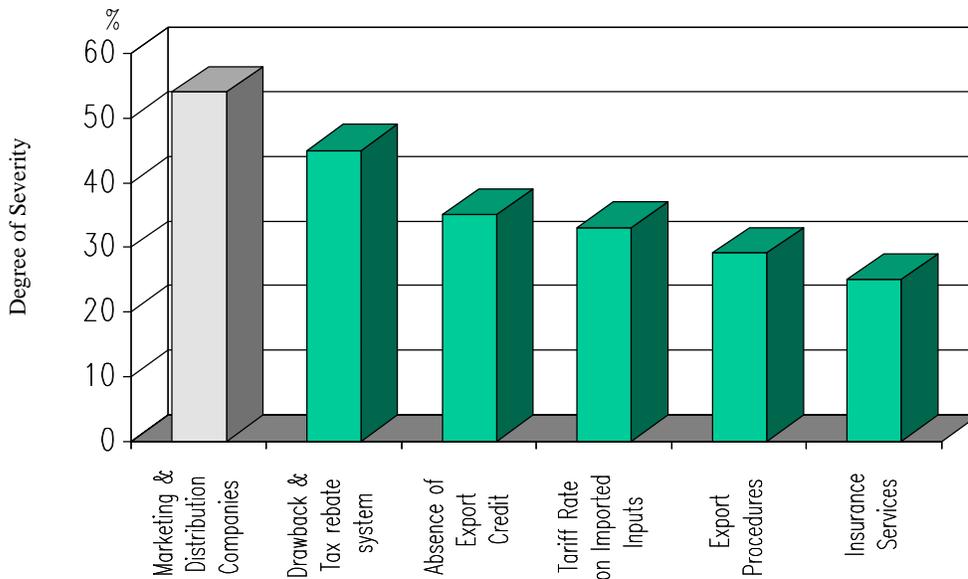


Figure 4.8. Survey Results
Exports Constraints: Electronics Sector



The survey results generally that tariff levels on inputs and malfunctioning of the duty drawback system are the most critical elements that should be considered in promoting exports. While the results suggest that the drawback and tax rebate systems are key priorities for reform and that input tariffs are a problem, they do not indicate that tariffs on final products are a problem. This may simply mean that businessmen in general are not aware of the direct link between import tariffs on final products and the “implicit” tax on exports.

5.0. Net Impacts of Tariffs, NTB's and Inefficiency Factors:

5.1. Macro-Economic Comparisons:

High levels of protection can of course cause industries to decline in efficiency over time. Innovation, i.e., adoption of modern technology, is in part a function of competitive pressure. If a firm is protected it is less likely to adopt cost-saving technology. Similarly, development of management skills and the ability to identify new markets for their products is bound to be inhibited by confinement to domestic markets behind a wall of protective tariffs. Therefore, one would expect Egypt's most protected industries to be the least efficient. Not only would they be the least efficient, they would face high implicit export taxes, further inhibiting their ability to export into global markets.

It may be instructive to do a comparative analysis of the most protected industry, wood furniture, and the least protected industry, processed food products. The tabulation compares capital/output ratios, labor cost per unit of output, effective rates of protection, domestic resource costs, and exports as a percentage of total output.

Industry	L/O¹⁾	K/O²⁾	ERP³⁾	DRC⁴⁾	Exports as % of Production
Wood Furniture	7	0.38	83.80	1.67	1.21
Processed Food	16	0.93	6.39	0.75	1.97
Total Manufacturing	18.3	0.60	30.48	0.45	7.73

- 1) Labor cost per unit of output
- 2) Capital per unit of output
- 3) Effective rate of protection
- 4) Domestic resource cost

Exports are almost twice as important in the processed food industry as in the wood furniture industry, but the average for all industries is much higher than for either. Wood furniture does not appear to have a comparative advantage as shown by the very high DRC estimate. In terms of efficiency of use of labor and capital, the furniture industry is very efficient in use of capital but very inefficient in use of labor. The processed food industry is marginally efficient in use of both labor and capital.

Overall, this rough and ready comparison is inconclusive in terms of detecting cause and effect relationships between exports, protection, and industry efficiency. Further research is recommended in order to classify industrial structure and its propensity for exports more precisely and to identify the best strategies for promoting exports according to industrial situation.

5.2. Industry Survey Results:

Egyptian entrepreneurs' own perception of barriers to their ability profitably to export their products sheds some light on this issue, and helps put the macro-economic indicators in perspective. Representatives of each of the five industries universally remarked that domestic markets were much more profitable than export markets. This is consistent with the conclusion of this study that there is an implicit tax on exports of almost 40 percent.

Several other comments indicated a high degree of inefficiency in the five industries *vis a vis* competition in global markets. Companies tend not to be managed with a view to exporting, with the exception of ready made garments, as witnessed by a lack of marketing staff with international experience. Moreover, unit costs tend to be high because plants almost universally operate at less than 60-70% of rated capacity. Thus, Egyptian firms apparently lack international market promotion as part of their business strategy, face high domestic prices but low domestic demand, and must overcome a high implicit export tax to enter world markets. This appears to be a vicious circle of high domestic prices, low domestic demand, low utilization of plant capacity, and lack of incentives to expand output for world markets.

Redundant labor was also mentioned as a negative factor affecting competitiveness, primarily by public-sector firms.

5.3. Comparative Advantage:

A "pure" measure of comparative advantage is the DRC (domestic resource cost) which is the cost in domestic resources of gaining or saving one dollar of foreign exchange (at world prices). If reliable data are available, the DRC should measure or rank products according to their advantage in world markets. The table ranks four of the five industries for which data are available according to the DRC and compares this to effective protection rate protection rates, the importance of exports and a measure of revealed comparative advantage (RCA).

Industry	DRC	ERP	Exports as a % of Production	RCA
1. Food Processing	0.8	6.4	2.0	3.0
2. Textiles (Garments)	0.8	55.9	40.0	1.4
3. Shoes	0.9	50.8	4.3	0.25
4. Wood Furniture	1.7	83.8	1.2	0.41

The wood furniture industry stands out as the most protected, costs more in domestic resources than the value of its product on the world market, has next to the least revealed comparative advantage and is the poorest performing with respect to exports. Most efficiency measures were also low for this industry. Thus, it is a highly protected industry which apparently needs protection to survive, and is primarily a domestically-oriented industry. Clearly, lowering tariff protection precipitously could cause severe damage to this industry, although it would be beneficial to the economy as a whole in the medium term, since the wood furniture industry is currently wasting domestic resources per dollar of foreign exchange saved or earned. The

industry overall could not compete effectively in the global markets because it is inefficient, so some gradual strategy might be indicated to avoid an unemployment shock.

The solution for the furniture industry would likely differ qualitatively from, say, the food processing industry. The latter is fairly efficient, is not highly protected and is moderately successful in exports. Its exports are a significant percentage of total exports; and it has a moderate revealed comparative advantage. Stimulating growth in exports for the food processing industry should have a high payoff and no major policy impediments are evident. Perhaps three interventions, by the industry itself with some help from the GOE, would serve to promote growth in exports:

- (1) attention to export market demand and quality requirements,
- (2) modernization to reduce costs, and
- (3) technical assistance targeted on management of marketing, processing technology, and quality control.

In addition, vigorous negotiation with the EU to reduce tariff barriers would stimulate increased exports of processed food. Textiles are yet another special case and the solution to its growth and export problems will have to be tailor-made. Current high export performance is owing largely to extensive use of a duty-draw-back mechanism and specialized production for export only. The bulk of the textile industry shows a much different set of measurements. Duty drawback is an artificial policy, made necessary by the high tariff structure. Those who gain the right to waiver duties will tend to earn part of the high economic rents couched in the privilege itself.

Those industries having a comparative advantage (DRC less than 1) theoretically need no tariff protection. On the contrary, they should be able to compete successfully in global markets as well as in the domestic market. Thus, the shoe industry, which has a very high ERP but a solid comparative advantage (DRC less than 1), theoretically needs no tariff protection. On the contrary, it should be able to compete successfully in global markets as well as in the domestic market without protection. Thus, in the case of shoes, the policy should clearly be to greatly reduce tariffs and thus reduce the implicit tax on exports. Exports of shoes should then grow rapidly, there should be an increase in utilization of plant capacity, and employment would grow because the industry is highly labor intensive.

5.4. Strategic Implementation of Policy Change:

It will come as no surprise to Egypt's policy makers that different policy solutions should be fashioned to fit the various industry situations. If an industry is currently inefficient, removing protective tariffs suddenly could serve to create an employment crisis, or unnecessarily penalize investors who have grown up under the protective umbrella. Those industries that are efficient and have a comparative advantage would benefit from rapid removal of tariffs. Domestic demand would increase, export prices would become relatively more attractive and both domestic and export markets will increase, allowing more efficient use of plant equipment and labor. The furniture industry seems to fit the former scenario while the shoe industry appears to fit the latter.

In fact, for policy planning purposes, one can identify three categories of industrial situations that call for different policy interventions:

- (1) inefficient and highly protected
- (2) efficient and highly protected
- (3) efficient and not protected

For category (1) a gradual reduction in tariffs accompanied by government assistance during the transitional phase may be the most socially desirable policy. For category (2), rapid reduction of tariffs is advisable, with a small amount of targeted assistance to assist firms enter global markets, and category (3) may require promotional assistance from the government to get them into the global markets. A follow-up study could classify the various industries according to protection/efficiency/export-potential criteria, followed by a more detailed phased plan for implementation by the GOE.

6.0. A Bolder Plan to Enhance Exports and Improve Productivity: Recommendations Based on Conditions in Egypt and Reform Experiences of Other Countries

While Egypt has delayed economic reform relative to much of the world, this has a certain advantage in that there is by now considerable documentation of liberalization experiences from around the world. Also, while structural reform has moved forward gradually, the macro adjustment program has moved more expeditiously and the GOE now finds itself in a favorable macroeconomic environment conducive to more rapid structural reform. The purpose of this section is to comment on the current Egyptian reform program with its target of export and investment enhancement in light of the lessons we have learned from here and elsewhere.

6.1. Tariff and Tax Reform

The current structure of trade taxes in Egypt, even after the July 1998 reforms, is characterized by high, non-uniform tariffs which are rendered even more dispersed by the GST being applied to imports on a duty-inclusive basis. The strategy has been one of gradually reducing the highest tariffs and unifying the tariff structure into fewer, broader based rate bands. (There will be six bands, with some exceptions, after July 1 with a top rate of 40%.) There is some theoretical and empirical support that this is indeed a welfare improving strategy, and that it is also consistent with export enhancement by reducing the current anti-export bias of the tax structure. The issues now are where to end up, how to proceed, and at what pace to proceed. Economic theory and previous experience can inform this debate, although we are well aware of deeper societal issues which necessarily entail other, more political, calculations.

6.1.1. Where To End Up: The Case for A Lower, More Uniform Tariff Schedule

There is a vast literature on the optimal structure of taxes, including commodity taxes. Roughly, in light of the justified revenue needs of government, the best tax structure is one that collects a given amount of revenue while minimizing explicit collection costs and the implicit costs of economic distortions among products caused by variable tax rates. Tariffs are usually not a particularly efficient way to collect taxes and would easily be dominated, for example, by a broadly based consumption tax which avoids the production distortions of tariffs [Vousden, 1990]. Nonetheless, we will take it that tariffs are an inevitable part of the medium run strategy of the GOE. (They need not be. New Zealand found that they could be removed quickly and the revenue replaced efficiently.)

Now, in theory, the least distorting tariffs would not be uniform but would take into account the elasticity of import demand for each commodity group in question, roughly applying higher duties to the more inelastically demanded goods. However, recent thinking and experience have questioned the practical advisability of this application of the so-called “Ramsey rule” and made a convincing case for a more uniform tariff structure (See, for example Harberger [1990] and Subramanian [1994], and the references therein.)

In the extreme, suppose that there was only one tariff rate applied to all imports. In Egypt, according to data from the Ministry of Finance, that rate would be revenue neutral at somewhere between 10% and 15%. The advantages are many:

- There would be no dispersion in the tariff schedule and so, while domestic production and sales are still protected to the detriment of exporting, within the group of protected activities the ERPs are a uniform 15%, thus giving no artificial advantage to one sector over another and so increasing the productivity of investment. This real income gain may itself lead to higher rates of investment and growth.
- Customs classification becomes a non-issue and so product can move through the ports faster.
- The system is easy to administer.
- The flat rate eliminates the adverse interaction with the GST caused by its duty-inclusive application.
- The lower, uniform tariff is less likely to cause trade diversion which erodes the gains from the EMA and other free trade agreements.
- Smuggling and so disrespect for the law would be less encouraged.
- Since the tariffs show no favoritism, lobbying for tariff protection would be reduced.

As a practical matter, the uniform tariff could be approximated to address political reality. As a general rule of thumb, the system should try to tax similar goods at similar rates – “grouping” – in order to minimize tax distortions among products. Suppose that we divide the groups into final goods and essential food and inputs. Then, for example, there might be two rates: 10% for essential foods and (already low tariffed) inputs and 20% for final goods. This would be approximately revenue neutral but considerably more efficient and easier to collect.

6.1.2. How to Proceed: The Case for “Topping” Tariffs and Eliminating Exceptions

The current GOE strategy concerning tariff reform is a thoughtful one entailing cutting the highest tariffs and bringing these product groups into the next lowest rate band for tariffs over 30%. This approach makes sense economically and seems to be moving the tariff structure rationally. But tariffs are still quite high and dispersed. The annual reviews and cuts mandated by the now elapsed IMF stand-by arrangement appear to have worked well. Assuming that the political will for reform can be maintained, a natural next step would be to set the next maximum tariff at 30%, leave the 20% rate intact, and consider unifying the other two rates at 10%. (Tobacco and alcoholic beverages might be exempted for revenue, cultural, and religious reasons.) As the GST base is broadened, the unified 15% tariff rate could become reality, followed by uniform cuts. Duty drawback should be augmented by total rebate of the GST on exported items.

Naturally, there needs to be consideration given to tariff revenue. Given the current rates, the above approach would probably be nearly revenue neutral, as some lower rates might be raised and reducing the top rates affects a small base and might even raise revenue, to the extent that at such high rates import demand is elastic.

With the possible exception of tobacco and alcoholic beverages, exceptions to the maximum tariffs should probably be eliminated on efficiency grounds. Also, as tariffs come down, some exceptions to the tariffs might be phased out. One problem with exceptions to the tariff structure is that they are just ways of trying to avoid the negative consequences of tariffs and to distract attention from the actual source of the problems, namely, the tariffs themselves.

6.1.3. The Pace of Reform: The Case For and Against Gradualism

One of the most serious problems confronting progressive policy-makers is the timing of the reforms. This undoubtedly owes both to the political obstacles engendered by a long history of import substitution and to an “attitudinal” problem of export pessimism in light of the keenness of world competition. While the fears about and opposition to reform are real, the experience of successful economic liberalization argues for reasonably speedy implementation [Krueger, 1997; Dean, Desai, and Riedel, 1994]. However, Agosin and French-Davis [1995] find that in Latin America, gradual reform was successful in giving industry some time to adjust to reality and, in their opinion, is to be recommended so long as reform is not overly gradual. Nonetheless, several studies show that the stronger and faster the liberalization, the greater the manufacturing output and export growth [Jayanthakumaran, 1997].

There appear to be at least two arguments advanced by the proponents of a quicker pace of reform. First, the benefits of reform are real and these benefits can be brought forward in time through faster liberalization. Export pessimism may be largely unjustified if the reform is broad based, including non-tariff and institutional reform. For Egypt, in particular, the current regional environment is a favorable one with growing markets and optimism over a more integrated Europe. Delaying reform risks moving crucial structural adjustments to a future time when economic trends may not be so favorable. Also, the current favorable macroeconomic climate in Egypt bodes well for relatively smooth structural adjustment.

Second, it has been the experience of a number of failed liberalization episodes that gradualism gave way to stagnation. As the pace of reform slowed, government credibility was lost and opponents of reform were able to seize the day. And, once a reform fails, credibility is hard to re-attain by government authorities committed to liberalization. (See Krueger (1997) and some of the references therein.)

It is important to remember that, while gradual economic reform in Egypt has succeeded by many measures, more rapid reform may have been much more successful.

6.2. Addressing Remaining Non-Tariff Barriers

As we have seen in earlier sections of this report, GOE regulations in quality control, port management and price setting of basic services act as non-tariff barriers to trade and investment throughout the economy. These NTB's significantly magnify the tax on exports levied through the current tariff and tax system. The pace and means by which these barriers are removed through deregulation is undoubtedly the key to economic success in Egypt.

6.2.1. Removal of NTB's

The leadership of the GOE has clearly signaled a direction of change that will result in reform and removal of these NTB's. The main challenge appears to be the resistance from within the public service to the pace and methods of this reform.

World-wide this type of structural reform is administratively and politically difficult to achieve as it *may* eliminate jobs but will *certainly* eliminate positions of discretion, influence and therefore power within a public service.

Nevertheless, the pace of deregulation and the divestiture of state functions from direct intervention in the relationship between buyers and sellers are benchmarks to grow trade and investment in the global economy. Achieving real sustainable economic growth in Egypt for the benefit of the mass of Egyptians will require sacrifice of position and power from both individuals and organizations in the public and private sectors.

Openness and transparency is a requirement of modern global economic relations as investors place a premium on reducing risk. The necessity for Egypt to develop commercial, legal, and financial transparency lies in the competitive fight for investment capital with other emerging economies of Central Europe and the MENA region.

6.2.2. Road to Convergence

Egypt's immediate adoption of harmonized international standards will place current producers on an equal footing with international competitors in the global market. The unfettered right of the international business community to establish investment in manufacturing and business services under free trade agreements with Europe and North America as well as with neighbors in the MENA region is critical to support Egypt's integration into the global economy.

This is fundamentally an issue of convergence by Egypt to the evolving international norms and practices that improve the efficiency of firms and individuals to create and distribute wealth both globally and within individual countries.

This process of convergence is often aided, and at times seemingly driven, by technological change that is readily understood and accepted. As the focus turns to convergence of property rights and the rule of law among independent countries, major players in the global market seek

certainty and predictability. It is the credibility of the latter convergence which will determine Egypt's place at the core or the margins of global integration.

6.2.3. Road Signs of Integration

The Egyptian policy makers have the power and ability to remove the remaining non-tariff barriers at any pace they chose within the parameters of WTO commitments and EMA undertakings. This means that the first decade of the new millennium will witness a period of rapid change within Egypt's business environment and administrative system.

However, for Egypt to achieve the sustained "high growth scenario" of 7.5% GDP as envisioned by the World Bank [1998] and the GOE in the middle of the next decade, *deep integration* with the global economy is required.

The road signs on this path begin with joining the integration process of Europe within the EMA, supplemented by free trade arrangements with Egypt's MENA neighbors. Other countries on the geographical or historical periphery of Europe such as Ireland and Poland have vigorously embraced harmonization and convergence of their business environments, resulting in growth rates which are treble comparator economies.

GOE policy makers are well placed to direct the pace of Egypt's integration with the global economy which can best build domestic consensus for economic reform. However they are ill placed to slow down or otherwise affect the pace of global economic integration beyond Egypt's borders.

4.4. Endnotes

- (1) B. Balassa: **The Structure of Protection in Developing Countries**, Baltimore, IBRD, 1971, pp. 331-332.
- (2) See the paper by H. Kheir-El-Din “Effective Protection in Egypt due to the Tariff Structures in 1996 and 1997 compared to 1994,” DEPRA/MOE.
- (3) Average ERPs and NRPs does not include beverages and petroleum refining.
- (4) These highly protected consumers’ goods activities include beverage, tobacco processing, final wear, footwear, furniture, porcelain, china and ceramics.
- (5) Egypt started its modern industrialization experience in the 1960s, at the same time as Korea and before many other Asian (Indonesia, Malaysia) and Middle Eastern (Turkey) countries.
- (6) The RCA of country i for product j is measured by the item’s share in the country’s total exports relative to its share in total world trade: $RCA = (X_{ji}/X_{ti})/(X_{jw}/X_{tw})$ where X denotes exports, t denotes total country trade, and w denotes world variables. (See Yeats [1995] for a discussion.)

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Appendix 1

Tax Summary as of 1 July 1997

A. Central Government

1. Taxes on income and profits

1.1 Taxes on corporations

Law No. 157/1981 amended by Law No. 187/1993.

An annual tax on accrued net taxable profits earned in Egypt by both foreign and domestic corporations (including limited partnerships, joint stock companies and public sector enterprises) engaged in manufacturing, commerce, banking, mining, real estate brokerage, commercial leasing activities etc. Tax year is calendar year unless stated otherwise in company's articles.

Taxable profits include:

- realized non-reinvested capital gains; and
- 10 percent of income from moveable capital (for joint stock companies, dividends received from Egyptian investment joint stock companies are exempt).

Forms of corporate business include:

- joint stock company
- limited liability company
- partnerships limited by shares

They are governed by Companies' Law No. 159/1981.

Deductions allowed cover all business expenses including actual rent or estimated rental value of premises, wage and bonuses to be statutorily granted to workers, social security contributions on their behalf, savings fund and pension fund contributions (up to 20 percent of the wage bill), inventory costs (mainly FIFO), interest, royalties, remunerations to Board of Directors and allowances to major shareholders to attend general meetings, subscriptions to governments, contributions to charitable and social institutions (up to 7 percent of net profits), bad debt and loss reserves (up to 5 percent of net profits), and all other taxes paid.

Joint stock companies can deduct a portion of paid up equity equal to the interest rate declared by the Central Bank of Egypt.

Depreciation allowances are granted on depreciable assets mainly using the straight line method at varying rates (the following act only as guidelines): buildings—2 percent, furniture—6 percent, hotel furniture—12.5 percent, machinery—10 percent. In addition, there is a depreciation allowance of 25 percent of the cost of new machinery and equipment in the first year.

In addition to the above deductions and allowances, executive regulations allow gifts and donations (up to 7 percent of chargeable profits) in lieu of entertainment expenses and other public relations expenses.

Losses are allowed to be carried forward for five years; however, losses from one source are not allowed to be offset against profits from another source.

There is no adjustment for inflation.

Profits above LE 18,000 per annum (subject to the above deductions, exemptions etc) are taxed as follows:

Industrial and export profits	32 percent
Profits from oil exploration production	40.55 percent
Other profits	40 percent

In addition, a development duty of 2 percent is applied to all profits above LE 18,000 annually.

There are no withholding taxes on dividend distributions.

Corporations are required to withhold:

(a) interest: 32 percent on the amount paid plus 2 percent development tax on interest in excess of LE 18,000 per annum;

(b) royalty payments:

- 32 percent on the amount paid if a company carries on activity in Egypt.
- If the company does not practice any activity in Egypt, the gross amount of the royalty payments are subject to 32 percent withholding tax plus 2 percent development duty when the payments exceeds LE18,000 annually.

(c) dividend:

- If a company does not carry on an activity in Egypt, dividend distribution shall be subject to 32 percent withholding tax plus 2 percent development duty when the amount exceed LE18,000 annually.
- There are no withholding taxes on dividend distributions if a company paid the dividends carries on the activity in Egypt and subject to corporate income tax.

Exemptions

(i) Law No. 59/1979 provides a ten year tax holiday in New Urban Communities (NUCs).

(ii) Law No. 230/1989 provides an indefinite tax holiday for direct taxes (on corporate profits and dividends at the individual level) for investment in free zones (seven are currently operating, two more will be coming on stream shortly). For investments outside free zones, projects must fall under specific though broad, categories such as industry and tourism sectors. All qualified investments receive 5 to 15 years holiday for corporate tax and individual income tax on dividends. All imported machinery and equipment is then subject to a 5 percent customs duty.

(iii) Law No. 187/1993 provides a 5 year corporate income tax holiday for industrial corporations employing 50 or more workers (dividends at the individual level are exempt from the tax on moveable capital).

1.2 Taxes on individuals

Individual taxes are based on the "Global Income Tax Law", No. 187/1993. However, the law distinguishes 5 categories of income: immovable property income, commercial and industrial activities income, Noncommercial/liberal professional income, moveable capital income, salaries and wage income. The first three sources are calculated according to a graduated rate schedule. Salaries and wages are taxed according to a separate graduated rate schedule. Income from moveable (financial) capital is taxed separately as described below. The tax on Egyptians is Law No. 208/1994. Declarations must be sent to the tax directorate before 1 April, wages and salaries tax is deducted at source.

[Law No. 208/1994 imposing a tax on income derived by Egyptians performed employee services abroad.]

Law No. 208/1994 imposing a tax on wages and salaries obtained by Egyptians working abroad.

Unified tax is levied on 5 categories of income:

(i) Tax on wages and salaries
The base is labor compensation in the form of salaries, wages, allowances, gratuities and benefits in-kind.

(i) Tax on wages and salaries
Employment-related pensions are exempt. Wages of a daily worker are also exempt provided the employment is not permanent and the worker has no other source of income. Annuities paid by insurance companies for policies with a period of less than ten years are also exempt.

Allowances, that do not in total exceed LE 4,000 per year are deductible from income. These include life insurance premiums, contributions to the Egyptian state social insurance and certain private insurance funds schemes, an occupational allowance, representation allowance, production incentive bonuses. Personal allowances are LE 1,440 for single persons, LE 1,680 for married couples without children or unmarried with children, LE 1,920 for a married person supporting one or more children.

In addition to some other allowable deductions from tax base:

- contributions to the Egyptian state social insurance
- life insurance premiums and cert-private insurance Funds scheme provided the total amount 15 percent of total income or EL 1,000, whichever is less.

(i) Tax on wages and salaries

The tax rates on taxable incomes are:

Up to LE 50,000	20 percent
Over LE 50,000	32 percent

This tax is withheld at source and incomes in excess of LE 18,000 are subject to an additional 2 percent development duty.

(ii) "Unified" tax

This tax applies to income from commercial and industrial activities, professions and real estate activities. The Egyptian firm subject to this tax includes sole partnerships, general partnerships and simple limited partnerships.

- The tax on commercial and industrial activities income, the base is net profits, including capital gains, letting of commercial and furnished premises or plants, selling assets, building or dealing in real estate, exploitation of natural resources, poultry farms, animal husbandry and land reclamations. Net profits also include 10 percent of moveable capital and real estate revenues.
- The tax on non-commercial professions applies to income earned in Egypt or abroad.
- The real estate wealth tax is applied to agricultural land revenues and building revenues. The revenues are based on the assessment used for property taxes under Law No. 56.

(iii) The tax on moveable capital is applied (at source) on payments to both residents and non-residents and includes interest payments (except for interest on savings accounts of banks supervised by the Central Bank of Egypt and debentures of public banks) and foreign dividends (net of foreign taxes).

(iv) Law 208/1994 established a tax on the earned income of nonresident Egyptians, except those who have emigrated permanently and who meet the requirements of Article (8) of Immigration Law No. 111/1983.

Law No. 208/1994 establishes a tax on the earned income of Egyptians performed employee services abroad.

(ii) "Unified" tax

Under the tax on commercial and industrial activities, the following deductions apply: rents of either owner occupied or owned by the business; annual depreciation based on historical cost, net of initial allowances; direct taxes except those paid under this law; donations; actual and doubtful financial losses; social insurance payments; contributions for employees to special savings and pension funds (up to 20 percent of payroll); mobile capital revenue and taxes on agricultural land and real estate, with 10 percent of these revenues included in the base of the unified tax. Losses may be carried forward for 5 years. There are various exemptions, including profits from stock breeding and fishing and private insurance funds.

Under the real estate tax, a deduction of 20 percent is applied against "costs" (these are not defined by law but seem to imply rental payments). Losses may be carried forward for 5 years.

(iii) Besides interest on bank savings accounts, other exempt forms of income include: proceeds of loans and credit facilities granted to the government and public agencies; proceeds due on balances of free foreign currency; proceeds of public issued debentures issued by joint stock companies that does not exceed the prescribed interest rate of the Central Bank of Egypt; and cash or in-kind benefits related to lotteries done by insurance or savings companies.

(iv) Exemptions are: social security payments; other savings payments deducted or in accordance with social security regulations of Egypt of the state where employed; family support; foreign taxes.

(ii) "Unified" tax

The amount of tax owing on profits is calculated as follows:

Up to LE 2,500	20 percent
LE 2,501 - 7,000	27 percent
LE 7,001 - 16,000	35 percent
LE 16,001 - 27,000	40 percent
LE 27,001 - 68,000	45 percent
Over LE 68,000	48 percent

In addition, the development duty of 2 percent is applied to the unified income tax base above LE 18,000. Personal allowances are the same as those under the wage and salary tax.

(iii) Income subject to the moveable capital tax is taxed at 32 percent. For income above LE 18,000 annually, an additional 2 percent development duty is levied.

(iv) The nonresident tax on annual earned income is:

Up to LE 20,000	1 percent
LE 20,001-40,000	2 percent
Over LE 40,000	3 percent

1.3 Other taxes on individuals

(i) Capital gains

Individuals are not subject to a tax on capital gains except in the case of sales of real estate or building sites within the boundaries of Egyptian cities. Such gains are taxed at a rate of 5 percent of the value of the property. Such gains are not subject to income tax.

Social security contributions are levied on both government employees and employees of publicly owned enterprises. Employee contributions are withheld at source. None of the revenues revert to the government but are retained by off-budget pension fund. Revenue in excess of pension fund payments and operating costs are earmarked for public sector investment financing. Most private sector employees are covered by another fund.

None.

Contribution by Percent of payroll

• On annual salary up to LE 3,600

Employer	26.0
Employee	14.0

• LE 3,600-9,600

Employer	24.0
Employee	11.0

On tradesmen and other workers employed by a contractor for the duration of a contract or part thereof.

Employer	18.0
Employee	10.0

(ii) Estate duty

Estate duty is payable at rates ranging from 5 to 15 percent. A number of exemptions apply.

(iii) Inheritance tax

Inheritance tax was abolished in 1989.

Besides the provisions of the income tax that apply to agricultural land and buildings, real estate taxes are levied on the assessed annual rental value of agricultural land and property.

2. Social security contributions

Law No. 79/1975, as amended by Law No. 25/1977 and No. 47/1984.

3. Payroll taxes

See Stamp duties.

4. Real estate taxes

(i) Agricultural land tax: Decree Law No. 53/1935 and Law No. 113/1939.

(ii) Buildings tax: Decree 56/1954 as amended by Laws No. 129/1961 and No. 136/1981.

(i) For the agricultural tax, 20 percent of estimated rental value is deducted, and properties of less than 3 feddans are exempt.

(ii) For the buildings tax, a deduction of 20 percent of the annual rental value is allowed for maintenance and other expenditures. Exemptions include: residential buildings built after 1981 which are not "luxury"; most rural buildings; buildings with a rental value less than LE 10 per year; buildings used by schools, hospitals, and religious institutions; buildings specifically exempt under various laws.

(i) The basic rate for agricultural land is 14 percent.

(ii) The rates for the buildings tax range from 10 to 40 percent depending on the number of rooms. Cairo and Alexandria are taxed 2 percentage points higher.

5. Taxes on goods and services

5.1 General Sales Tax

Law No. 11/1991, Decree No. 180/91, No. 295/93, No. 304/93, No. 39/94.

A sales tax applied at the manufacturing level on imported and domestically produced goods (with exceptions) and specified services. Services included are tourism, telecommunications, electricity and professional brokers.

Firms with turnover less than LE 54,000 are exempt. Input credit can be obtained by registered firms for goods only, except for "Table I" goods. Exports are zero-rated. Untaxed goods are exempt. Free zones are exempt if the items are sold abroad or to other free zones.

Exempt items (schedule A): Milk products; edible oils made from seeds, fixed, liquid, hard or refined; products of mills with the exception of excellent flours or imported yeasted flours; products and manufactures, canned or prepared from meat; products and canned, manufactured or prepared fish except caviar and smoked fish; vegetables, fruits, beans, seeds, spices, prepared or packed, fresh or frozen or preserved except imported; halawa tahinia; food prepared and sold by restaurant other than tourist; all kinds of controlled bread; natural gas and butane gas for retail; waste of food manufactures, food for animals, birds or fish except dogs, cats and ornament fish; popular clothes distributed by the ministry of supply and trade; paper pastry, paper scrap and paperboard ancient products made of paper or paperboard used only in the manufacture of paper; paper for journals, printing and writing; books, circulars, and the printing of similar nature from some papers; newspaper, magazines and printed circulars; paper money and coins except memorial coins; and macaroni from flour.

The rates range from 5 to 25 percent with most goods subject to the standard 10 percent tax on gross sales.

(a) 5 percent

• Services

Hotels, tourist services and restaurants
Air conditioned transport between governorates
Local telephone and telegraph services

• Goods

Coffee

All flour products except controlled bread
Soap and manufactured household cleaners
Fertilizers

Purification materials and insecticides

Gypsum

Wood sawn lengthwise

(b) 10 percent

• Services

Telex and facsimile services

Sound and light shows

International communications

Telephone installation and connection services

Private car rental

Express delivery services

Cleaning and security services

Real estate brokering

Car dealerships

• Goods

All other goods not taxed at other rates or exempt.

(c) 25 percent

Color TVs

Refrigerators

Deep freezers of 10 feet or more

Sound recorders or reproducers

Air conditioners

Cameras and their parts

Perfumes, cosmetics, preparations for the care of skin and hair

Chandeliers and their parts

Video tapes

Motor vehicles for persons of capacity of between 1600 and 2000 cc, passenger cargo cars and jeeps

"Table 1" goods

Item	GST rate (percent)
Tea (basic)	6.7 1/
Sugar	4.3 1/
Mineral water, soft drinks and juices	
Imported	32.5
Domestic	
less than 250 cm	50.0
above 250 cm	60.0
Beer	
Alcoholic	100.0
Non-alcoholic	60.0
Tobacco	
Unprocessed	
For water pipes	100.0
Others	75.0
Processed	
Cigar and pipe	200.0
Cigarettes (domestic)	
Less than pt. 65	141.4 1/
More than pt. 65	60.5 1/
Others	50.0
Petroleum products	
Gas	25.4 1/
White spirits	
Kerosene	3.4 1/
Solar	
Diesel oil	
Fuel oil	0.5 1/
Lubricating oil	0.5 1/
Lubricating preparations	0.3 1/
Pure ethyl alcohol	375.0 1/
Processed alcohol for fuel	17.7 1/
Alcoholic beverages	100.0
Medicines (except exempt by decree)	
Imported	1.6
Domestic	5.0
Equipment for handicapped	exempt
Vegetable oil (non-rationed)	
Imported	0.8 1/
Domestic	1.4 1/
Hydrogenated animal or vegetable fat/oil	1.7 1/
Hydraulic cement	2.1 1/

1/Ad valorem equivalent of specific rates.

5.2 Excises

• Development duty

Law No. 147/1984 amended by Law No. 5/1986 and by Law No. 520/1994. See Development duty under income taxation.

Levy of taxes on selected goods and services.

Selected items

- 25 percent on price of tickets issued in local currency for foreign travel.
- 20-40 percent on cost of parties and receptions held in hotels and public halls.
- 5 percent of auction price for auction sales.
- LE 1 per item if price exceeds LE 15 bought at duty-free shops.
- Passport fees at specific rates.

5.3 Selective issues on services

See Stamp duties.

B. Local government

1. Taxes on income and profits

None

2. Social security contributions

None

3. Payroll taxes

None

4. Taxes on property

Local authority duty. Legal reference not available.

A local tax is levied on the same basis as the agricultural land tax and the buildings tax. The proceeds from this tax are earmarked for the individual governorate.

See agricultural land and buildings tax in central government.

See agricultural land and buildings tax in central government.

5. Taxes on goods and services

5.1 Selective tax on services

(i) Hotel tax

Legal reference not available.

A tax is charged on the total value of amounts charged to a hotel account.

None.

Tax is levied at 2 percent of the total hotel bill in Cairo. Rates vary from one governorate to another.

(ii) Motor vehicle tax
No details available.

6. Taxes on international trade

6.1 Import duties

Customs Law No. 66/1963, as amended, Decree No. 351/1986; Law No. 186/1986; Law No. 187/1986; No. 304/1989; No. 305/1989; No. 178/1991; No. 294/1993; No. 38/1994.

Customs tariff consists of a single column based on the Brussels Tariff Nomenclature. Ad valorem duties are applied to a fair market c.i.f. import price. The valuation of imports for the purpose of assessing customs duties is based on the free market foreign exchange rate as stated by the Central Bank of Egypt.

Exemptions from customs duties include:

(a) imports by the Ministry of Defense, the companies, units and organizations subject to the Ministry of Military Production; by the National Security Authority of special devices, necessary for its activity; by the Republic Presidency of articles for formal use; and by the Ministry of Interior;

(b) gifts and donations to the Government;

(c) personal effects belonging to passengers;

(d) imports by the establishments authorized to be in free zones (except motor cars and furniture);

(e) articles, and small riding motor cars equipped with special medical equipment;

(f) personal effects for members of the Diplomatic Corps, and imports by embassies;

All duties, with the exception of those levied on tobacco, are ad valorem.

Rates mainly vary between 5-70 percent. The rate of 1 percent is levied on 33 items of foodstuffs. Rates of 5 and 10 percent are levied on most other foodstuffs. Duties for many industrial supplies are in the range of 5-20 percent. 18 categories of machinery and durable goods are subject to 10 percent tariff, the rest between 30-70. Duties on consumer goods are generally higher 40-70 percent, for example, color TV sets 70 percent, refrigerators 50-70 percent.

Exceptions include alcoholic beverages, taxed at 600-3,000 percent (300 percent at tourist facilities) and passenger vehicles taxed at 135-160 percent. Specific duties in the range of LE 6.1-9.0 per kilogram are levied on tobacco products.

(g) articles which are exempt by a decree of the President of the Republic.

Goods in transit and goods which enter specified free zones are exempt from import duties and excises. Duties may be refunded on imports which are embodied in exports if the re-exportation takes place within one year after the duties were paid.

Under the program of investment incentives for approved undertakings, customs duties may be excused for specific periods, but a minimum unified rate of 5 percent is collected on all exempt imports.

The assembly industries may request permission that their assembled products are to be treated according to the following provisions:

(a) The completely knocked-down parts, imported by the factories to be assembled, under supervision of the customs administration, subject to the import duty rate imposed on the final product, less 20 percent.

(b) In case locally manufactured parts are used, the imported parts are subject to the duty rates applicable to the finished product, after being reduced according to the following proportions (with a maximum limit of 75 percent) or the established import duty on the imported parts, whichever is lower:

Proportion of the locally duty manufactured parts to the parts entering in the finished product	Reduction in import duty In percent
20	25
30	30
40	40
50	50
60	60
over 65	75

6.2 Export duties

Customs Law No. 66/ 1963, as amended,
and Decree No. 351/1986.

Specific or ad valorem duties are levied on the export of a small number of commodities; raw hides and skins, molasses, metal waste and scrap, and antiques over 100 years old.

None.

Illustrative export duties are LE 11 per metric ton of metal waste and scrap, LE 0.6 per 100 kilograms of molasses, and LE 1.2 per metric ton of raw hide. Antiques-5 percent of their value.

7. Other taxes

7.1 Poll taxes

None

7.2 Stamp duty

Law No. 111/1980; Law No. 95/1986; Law No. 104 /1987; Law 224/1989.

Stamp duties are levied on a wide range of documents including deeds, applications, contracts, permits, registration, insurance premia, checks, invoices, lotteries, education degrees, stocks, promissory notes, bearer notes of guarantee, publicity and advertisements, judicial papers, postal, passenger tickets, water, electricity, gas, telephone, and salaries of government and public sector companies. Bank credits are also subject to annual stamp tax equal to 1 percent. Stamp duties may be dimensional, specific, proportional, or graduated. The tax is collected by means of stamped paper, stamps, a control plate or in cash.

Under the program of investment incentives for approved undertakings, the tax may be excused or reduced. Stamp duties are not changed on interactions between government departments.

There are many varied rates.

Selected rates

- LE 50 for registration of a company in the commercial register.
- LE 0.1 on bank checks and vouchers carrying a signature as a development duty plus 0.3 stamp duty.
- 0.3 percent on bills of exchange, promissory note and bearer notes as stamp duty plus 0.1 development duty.
- LE 900 to 1,800 on the Formation of a Company. (Corporations: joint stock company, limited liability company of partnerships limited by shares governed by Law No. 159 of 1981)
- LE 90 on the Formation of Partnerships.

Appendix 2

Evaluating ERPs from the 1991/92 Input-Output Data

The **effective rate of protection** (ERP) of an economic activity sums up the overall impact of the tariff structure on the incentive structure. It may be defined as the percentage excess of domestic value added (V) over the international market value added (W), i.e. that which would have been realized in the absence of the existing tariff structure.

$$ERP_j = \frac{V_j - W_j}{W_j} \times 100$$

The major advantage of ERP over the nominal protection rate (NPR) is that the former includes the effects of tariffs on both the inputs and output prices, and hence on the profitability of the domestic activity. The ERP expresses the joint effects of the nominal rates of protection of both the final product and the intermediate goods on the production profitability.

ERP also expresses the change in the returns of primary factors induced by the structure of protection and indicates the likely direction of their movement. It is generally true that competitive industries with higher positive ERP would probably draw resources into them. Those with ERP between (-100%) and 0 have resources squeezed out. Those with ERP below (-100%) again receive very high net protection since they have negative value added in international prices; yet, due to the domestic price structure, value added at domestic prices is positive, thus permitting these activities to operate at profit domestically.

The main determinant of the ERP level is the relation between the nominal rates of protection of outputs and inputs. Practically the ERP could be calculated either through detailed information concerning the activities at the firm level, or through the data supplied by input - output tables. In this report, the latter method has been used and ERPs have been calculated as follows:

$$\begin{aligned} ERP_j &= \frac{V_j - W_j}{W_j} \times 100 \\ &= \left\{ \left[\left(1 - \sum_i a_{ij} - \sum_i m_{ij} \right) \div \left(\frac{1}{1+t_j} - \sum_i \frac{a_{ij}}{1+t_i} - \sum_i \frac{m_{ij}}{1+t_i} \right) \right] - 1 \right\} \times 100 \end{aligned}$$

Where:

- a_{ij} = the technical coefficient of input i in activity j , i.e. the value of input i per unit value of output in activity j ,
- m_{ij} = the value of non-competing imported input i per unit value of output in activity j ,
- t_j = the nominal rate of protection of production of j ,
- t_i = the nominal rate of protection of input i .

Compiling ERPs from an input-output table has both advantages and disadvantages.

A major advantage is that non-tradable inputs, such as transport or services, may be decomposed into their tradable inputs and primary factor inputs, thus permitting estimates of indirect use of foreign exchange and primary factors by commodity-producing sectors (agriculture and industry) through purchases of non-tradables.

The main disadvantage is that the input-output table comprises a relatively high degree of aggregation.

1. Main Features of the 1991/92 Input-Output Table:

The latest input-output table for Egypt has been prepared by CAPMAS. It includes 38 activities in total which, in turn, are the aggregates of around 500 secondary activities. Of the 38 main activities, 3 are in agriculture, 2 in mineral extraction (crude petroleum and natural gas and other extraction), 21 are in manufacturing and 12 are non-tradables, such as electricity, construction, transport, communication, storage, ... or services, such as insurance, financial institutions, housing and other services.

The activity breakdown in the table follows closely the International Standard Industrial Classification (ISIC), at the 3-digit level of aggregation, with a few exceptions, however.

2. The Activities Considered:

ERPs have been calculated for 24 activities: 3 in agriculture and 21 in industry, namely, all manufacturing industries.

3. Main Assumptions for ERP Calculation:

The ERP calculation, as previously mentioned, requires an evaluation of value added by each activity in terms of border prices as well as in domestic prices which, in turn, requires evaluation of tradable material inputs, non-tradable inputs and outputs.

3.1. Tradable Material Inputs :

As a first step, material inputs must be estimated in terms of domestic and world prices. The input-output table contains two sets of material inputs: those domestically produced and those imported.

Imported inputs appear in the import matrix showing intermediate sectoral imports expressed in world 1991/92 prices – i.e., at the c.i.f. price prevailing then. Any column in this matrix shows the breakdown of imported inputs at c.i.f. prices and, by commodity group, used by the corresponding activity.

To assess the effect of the **1994, 1996, 1997 Customs Rates** on the structure of protection, imported inputs had to be valued at the domestic prices which would have prevailed had these rates been applied to imported inputs used in 1991/92, valued at their estimated world price. For

this purpose, the 1994, 1996 and 1997 tariff structures have been used successively to calculate the corresponding imported inputs at domestic prices.

Domestically produced tradable material inputs, whether competing with currently imported inputs or with sufficient domestic production so that no competing similar inputs have actually been imported, as given in the input-output table, are expressed in domestic prices. To convert each column to world prices, the 1991/92 tariff rates corresponding to each ISIC group have been used to deflate domestic intermediate materials to a world price estimate in Egyptian pounds. The more disaggregated figures of around 500 commodity groups have been used for these compilations. To convert these domestic intermediate inputs to domestic prices for 1994, 1996 and 1997, they have been augmented by the tariffs of the respective years.

Obviously these procedures involve potential sources of error to the extent that the gap between the value in actual world price and that recorded in the input-output matrix – or in the import matrix – differs from the 1991/92 import duties on such items. There are reasons to believe that this gap may not be negligible due to the pervasive use of domestic sales tax. In addition, the 1994, 1996 and 1997 customs tariffs are applied to data related to a previous year, with a different input structure as well as a different import structure, to mention a few of these sources of error. However, in the absence of more recent information on sectoral input structure, these procedures are believed to give a good approximation to the impact of tariffs on effective protection extended to various productive activities.

3.2. Non-Tradable Inputs:

Electricity, transport and communication, construction and other services each sell part of their product to agricultural and industrial activities. Being essentially non-tradable, their output cannot be valued directly at world prices. Instead, their tradable material inputs were calculated as explained above. The value of these materials at world prices per unit value of total output by the particular service sector is then multiplied by expenditure on the service by each agricultural or manufacturing sector considered.

This calculation may be carried a step further to include the main materials used by one service in producing output for sale to another service and hence to agriculture or to manufacturing. Thus, oil used in the production of electricity may be charged to spinning and weaving production to the extent that textiles purchase electricity and to the extent textiles use transportation and transportation uses electricity. However, this step was not implemented.

3.3 Valuation of Outputs

The products of the 24 sectors were estimated at world prices using average import duties for 1991/92. The tariff rates for 1994, 1996 and 1997 were further used to evaluate sectoral outputs at the domestic prices corresponding to these tariff structures.

Appendix 3

An Evaluation of the Incidence of Protection in the Egyptian Economy

The incidence analysis provides a general equilibrium framework which focuses on the relative price effects of protection at the sectoral level.*

To deal with these relative price effects, all of the goods produced and consumed in the small open economy are classified into tradables and home goods, with tradables disaggregated further into importables and exportables.

An import tariff raises the prices of importables relative to exportables and home goods. This rise in domestic prices of importables induces shifts in demand away from those goods and towards both exportables and home goods. At the same time, producers will increase the supply of import-competing goods, by pulling resources towards them and away from the sectors producing home goods and exportables. Reduced supply and increased demand drives up the prices of home goods until the excess demand has been eliminated.

Thus, as the import tariff increases not only internal prices of importables relative to exportables and home goods but also those of home goods relative to exports, it will reduce the real income of exporters much as does an explicit export tax.

The incidence of a tariff can be decomposed into an implicit subsidy for import-competing firms and a tax on the producers of exportables. Similarly, an export subsidy, by increasing domestic prices of both exportables and home goods relative to importables, is only in part a subsidy to exporters, and is also an implicit tax on producers of importables.

The degree of substitutability between home goods and importables is crucial to the degree of shifting of protection.

The higher the degree of substitutability between home goods and importables, the more stable will be their relative price, and the greater the rise in the price of home goods as protection increases. In this case, a uniform import duty would increase prices of both importables and home goods relative to exportables by nearly the full amount of the duty, causing nearly all of that duty to fall on exporters in the form of reduced purchasing power over home goods and importables.

Thus, import protection is impossible when the price of home goods increases in full measure with the protection, **and the import duty becomes wholly an export tax.**

-
- Protection refers to any government policies which promote domestic industry by discriminating against goods produced abroad, that is, policies which raise the prices of imports relative to those of domestically-produced goods which compete with them.

If **home goods and exportables were close substitutes**, the internal price of importables would rise relative to both home goods and exportables by the amount of the import duty and, hence, that duty is equivalent, in terms of incidence, to a **pure subsidy for import-competing firms**. In this case, export promotion via subsidies will only drive up the prices of home goods, thereby damaging the interests of import-competing firms.

The procedure used in analyzing the incidence of protection in Egypt was:¹

1) Estimating an index of the degree of substitutability between home goods and importables, in production and demand, through:

a) Expressing the relationship between changes in the price of importables, exportables and non-tradables by the following equation:

$$P_H = w P_M + (1-w)P_X \quad (1)$$

Where w denotes a proportionate change.

b) Expanding and rearranging equation (1), such that:

c)

$$(P_H - P_X) = w (P_M - P_X) \quad (2)$$

c) Transforming equation (2) to a double logarithmic specification, in order to analyze proportional changes in the prices of importables, exportables and home goods, such that:

$$\text{Log} (P_H / P_X) = B_0 + B_1 \log (P_M / P_X) + u_i \quad (3)$$

B₁ provides an estimate of the ‘w’ (shift coefficient), which is an index of the degree of substitutability between home goods and importables, in production and demand and will lie between zero and unity (**0 < w < 1**).

When the shift coefficient is unity (its upper limit), home goods and importables are perfect substitutes, so the price of both increases by the same extent, relative to the price of exportables, and the incidence of an import tax falls totally on exporters.

If, however, the shift coefficient is zero (its lower limit), home goods and exportables are close substitutes and the price of importables rises relative to both exportables and home goods and the incidence of the import tariff is shared equally by those two sectors.

2) Calculating the proportionate increase in the price of home goods (P_H= d) following the imposition of an import tariff and export subsidy:

P_H = d, is composed of two elements: that part of the increase shifted on from the rise in the price of importables due to the tariff (wt) and that part of the increase shifted on from the domestic price of exportables due to the subsidy ((1-w)s). That is:

¹ D. Greenaway,(1989), “ Commercial Policy and Policy Conflict: An Evaluation of the Incidence of Protection in a Non-Industrialized Economy”, *The Manchester School*, vol. LVII, no.2, June.

$$P_H = d = wt + (1-w)s \qquad 0 < d < t$$

Where:

t= nominal tariff rate

s= nominal rate of subsidy

w= shift or incidence parameter.

[B₁ (estimate of w), was used to calculate P_H = d.]

3) Measuring both true tariffs and true subsidies:

True tariffs and true subsidies, were defined as the proportionate change in the prices of importables and exportables, respectively, relative to the price of home goods:

$$T^* = \Delta (P_M/P_H) = (t-d)/(1+d)$$

$$S^* = \Delta (P_H/P_X) = (s-d)/(1+d)$$

If importables and home goods are perfect substitutes ($d = t$), and the incidence of an import tariff is shifted fully to the export sector the true tariff is zero ($t^*=0$). If home goods and exportables are perfect substitutes ($d = 0$), and the import tariff is a pure subsidy to the import-competing industries ($t^* = t$).

*** Equation (3) was estimated by applying ordinary least squares (OLS), to the following price indices:**

- 1- Merchandise Import and Export Price Indices (1974-1996)
- 2- WPI of transportation means: (1974-1996, 1974=100)
- 3- WPI of construction materials: (1977-1993, 1977=100)
- 4- CPI (1980 - 1996, 1980=100)
- 5- CPI of nontradables: (1985- 1995, 1985 =100)
- 6- CPI of housing and fuel: (1980-1996, 1980=100)*
- 7- CPI of furniture and home services: (1980-1996, 1980=100)*
- 8- CPI of Medical Care: (1980-1996, 1980=100)
- 9- CPI of transportation means: (1980-1996, 1980=100)*
- 10- CPI of Sports, Cultural and educational services:(1980-1996, 1980=100)

*** Data Sources were:**

- 1- The World Bank, World Tables, various issues.
- 2- Egypt CAPMAS, various annual reports.

*For nearly all equations estimated there was evidence of positive autocorrelation. In each case the model was re-estimated using the first order autoregressive scheme AR(1).

The most significant results were obtained when the CPI of transportation means (1980-1996, 1980=100) was used.

Summary of the results of estimating the shift parameter are presented below:

B₀	B₁	R²	F	DW	N
3.18 [@]	0.80 [#]	0.97	238.2	1.79	17
(2.29)	(0.29)				

[@] significant at the 10% level.

[#] significant at the 1 % level.

Results:

1- B₁ (the estimate of w) suggests that 80% of the incidence of protection may be shifted to the export sector in the form of an implicit export tax.

2- If the average nominal tariff on manufactures in 1996 calculated on the basis of the 1996 import structure is 25.9% *, and if export subsidies are assumed to be zero, then:

$$P_H = d = wt + (1-w)s = (0.8 * 0.259) = 0.2072 = 0.21 \quad \mathbf{0 < d < t}$$

3- The true tariffs and subsidies, i.e., the extent to which the prices of importables and exportables rise or fall relative to home goods :

$$T^* = \Delta (P_M/P_H) = (t-d)/(1+d) = (0.259-0.21)/(1.21) = 0.04 = 4\%$$

$$S^* = \Delta (P_H/P_X) = (s-d)/(1+d) = -0.21/1.21 = -0.17 = -17\%$$

Thus, true protection is only 4%, that is importables' prices rise by only 4% more than the prices of home goods.

The export sector is heavily punished; the true 'subsidy' in that sector is -17%.

This means that a 25.9% tariff resulted in a mere 4% of true protection coupled with a 17% export tax.

* Own calculations from: Dr. Hanaa Kheir-El-Din, (1998), " Effective Protection in Egypt due to the Tariff Structures in 1996 and 1997 compared to 1994".

Appendix 4

The Sample of Industries

Industry: 100 Firms

Small:	52%
Medium:	31%
Large:	17%

Sample Industry by structure:

Electronics:	15%
Food:	18%
Textiles:	15%
Wood:	6%
Paper:	9%
Pharma:	—
Chem:	24%
Metallic:	6%
Non-Metallic:	7%

التقرير النهائي
تنمية صادرات مصر

أعدت
لحكومة جمهورية مصر العربية
وزارة التجارة والتمويل

مقدمة الى
الوكالة الامريكية للتنمية الدولية

مقدمة من
شركة ناثان اسوشيتيس انكوربوريشن

عقد رقم
٢٦٣-٢٠٠-٩٦-١-٠٠٠-٠٠٠

يونية ١٩٩٨



ملخص تنفيذي

وضعت الحكومة المصرية هدفا محددًا لتحقيق معدل نمو في الناتج المحلي الإجمالي يتراوح بين ٧-٨ % سنويا حتى عام ٢٠٠٠، وكان من أهم الاستراتيجيات التي تحقق هذا الهدف تبنى سياسة إصلاحية تستهدف تحسين الأداء التصديري وجذب مزيد من الاستثمارات.

وتتمتع مصر في الوقت الحالي بفرصة فريدة لتحقيق هدف النمو عن طريق الاعتماد على الاندماج مع الاقتصاد العالمي السريع النمو، ورؤوس الأموال العالمية الضخمة الباحثة عن فرص الاستثمار المنتج، وبصفة خاصة من خلال التعاون الوثيق مع الاتحاد الأوروبي.

و مع ذلك ما زالت هناك بعض المعوقات في مواجهة استراتيجية العولمة. وهذه المعوقات لا تهدد فقط النمو التصديري والاستثمار، بل تعمل أيضا على تحويل فرص العمل الجديدة نحو المجالات الأدنى إنتاجية، وكذلك توجيه الاستثمارات الجديدة نحو الصناعات المشمولة بالحماية المصطنعة. وإذا لم يتم إحداث التغيير الملائم في الأسعار وغيرها من الحوافز، فإن مصر سوف تشهد نموا غير مرغوب فيه من الناحية الاجتماعية، ولن يصل إلى المستهدف.

وبينما تعمل الحكومة المصرية على خلق بيئة أعمال ملائمة للمصدرين وتساعدهم على إعادة ربطهم بشبكة التجارة العالمية فإن هناك تحديات كبيرة تواجه تجنب ما أسماه البنك الدولي "بسيناريو حالة الأساس" الذي تشهد تحركا بطيئا للإصلاح الهيكلي، الأمر الذي يترتب عليه انخفاض نمو الدخل الفردي وزيادة البطالة.

ولما كان النظام التجاري العالمي يتطور بسرعة في اتجاه سوق كوني، بما ينطوي عليه من تخفيض القيود التجارية وإتباع النظم المنسقة للمواصفات ورقابة الجودة، فإن الاندماج في الاقتصاد العالمي بصورة بطيئة، يؤدي إلي فقدان مكانة الدولة في الأسواق. وفي الواقع، ورغم أنه ما زالت هناك حتى الآن نافذة مفتوحة على الفرص المتاحة، فإن هذه النوافذ لن تظل مفتوحة لوقت طويل. الأمر الذي يقتضي الإسراع بالخطى.

و تتناول هذه الدراسة بعض هذه التحديات التي تواجه الرخاء من خلال تحسين الصادرات، كما تستهدف التعرف على وتقييم أثر المعوقات العديدة التي تواجه استراتيجية العولمة. كما تقدم أيضا، بعض الوصفات العلاجية لتحقيق الهدف الإستراتيجي للحكومة المصرية. وعلى وجه الخصوص، تركز الدراسة على هيكل التعريفات الجمركية والقيود غير الجمركية، والفرص الضائعة.

التعريفات الجمركية Tariffs:

تتسم التعريفات الجمركية بأنها مرتفعة فضلا عن اتساع مداها. و يبلغ متوسط معدل الحماية الاسمي على السلع المصنوعة - باستبعاد المشروبات وتكرير البترول - ٢٤,٦%، بينما يبلغ متوسط معدل الحماية الفعال (ERP) في السلع المصنوعة ٣٤,٢٢% وبشكل غير موحد بدرجة كبيرة، بحيث ترتفع معدلات التعريفات الجمركية على بعض البنود لتصل إلى أعلى من ٨٠%.

كما تتسم تعريفات الواردات الحالية بعدم الاتساق مع استراتيجية تنمية الصادرات، حيث تؤدي رفع أسعار السلع المنتجة والمباعة محليا، بالنسبة لأسعار التصدير، ومن ثم تخلق التعريفات تحيزاً ضد التصدير، وتعمل كمعوق خطير للأداء التصديري.

وقد قدرت الدراسة ما تتحمله الصادرات من تعريفات الواردات بنحو ١٩,٤% وهي بمثابة ضريبة على الصادرات. وتمثل هذه الضريبة عبئا كبيرا على الصادرات غير التقليدية بصفة خاصة، التي لا تستطيع امتصاص أغلب هذه الضريبة في الأرباح بغير تأثير على السعر التنافسي في الأسواق العالمية. وتبين الدراسة كذلك إن معدل الحماية الفعال ERP للمصدرين في كل قطاعات الاقتصاد سالب ومرتفع في اغلب الاحوال.

وحتى في وجود نظام (الدروباك) فان التعريفات تمثل عبئا على المصدرين، وفي المتوسط فان المصدرين المرتقبين للسلع الصناعية (وليس المصدرين بالفعل) يتلقون علاوة تصل إلى ٢١,٧% في حالة عدم قيامهم بالتصدير والبيع في السوق المحلي. وهذا التشتت في هيكل التعريفات يقدم حماية غير عادلة للصناعات، بحيث يؤدي إلى محاباة بعضها ضد البعض الآخر. ويهدد هذا الأمر بتحويل الموارد الاستثمارية بعيدا عن القطاعات الواعدة في الاقتصاد المصري.

العوائق غير الجمركية Non-Tariff Barriers:

تعمل بعض تنظيمات الحكومة فيما يتعلق بالرقابة على الجودة ، وإدارة الموانئ ، وتحديد أسعار خدمات الموانئ كعوائق غير جمركية أمام التجارة والاستثمار . ومن شأن هذه العوائق أن تضخم الضريبة على الصادرات من خلال الهيكل الحالي للتعريفات والنظام الضريبي .

وبتقدير أثر الروتين الحكومي فيما يتعلق بالرقابة على الجودة - في شكل تأخير في عمليات الإفراج عن السلع - تبين انه يعادل بمفرده ١٠% على الأقل كضريبة على الصادرات (حسب تقرير البنك الدولي عام ١٩٩٧)، بينما قدرت عدم كفاءة عمليات الموانئ بأنها تعادل ١٠% أخرى تضاف إلى تكاليف السلع المستوردة .

ويؤدي تبني مصر للمواصفات الدولية إلى تخفيض الضرائب الضمنية على الصادرات ، كما ينطوي على إشارة واضحة إلى الشركاء التجاريين والمستثمرين مغزاهل إن مصر شريك موثوق به في الاقتصاد العالمي . وعلى العكس من ذلك فان غياب هذه الإشارة الاستراتيجية يخلق عائقا لتنمية الصادرات غير التقليدية ، حيث يبحث كل من المشترين والمستثمرين عن شركاء يمكن الوثوق بهم في السوق التنافسي .

ومن حيث المبدأ، فإن إيجاد مواصفات منسقة للمنتجات المصرية وربطها باتفاق للاعتراف المتبادل في إطار اتفاق تجارة حرة مع أوروبا (EMA) هو أسرع الطرق لتنشيط الصادرات المصرية والتكامل مع الاقتصاد العالمي . ويمكن أن تحقق مصر مكاسب ديناميكية تتمثل في زيادة الناتج المحلي الإجمالي بنسبة تصل إلى ما بين ٢,٥-٣,٠% كنتيجة لهذه الخطوة المبدئية في اتجاه تعميق التكامل والتنسيق المتسارع لنظمها الإجرائية . ومن الممكن توقع مكاسب أكبر من خلال التكامل العميق ، إذا جرى تطبيقه في إطار مدى زمني معين ليضم كل شركاء مصر الحاليين والمرتبين . ويمكن أن يتحقق ذلك بإعطاء مجتمع الأعمال الدولي الحق في القيام بعمليات تجارية ترتبط ببرنامج لتحرير الاقتصاد المصري من القيود الإجرائية . وسوف ينتج عن هذا التكامل العميق ما يلي :

- ❖ تنسيق النظم الإجرائية بما فيها مواصفات السلع والخدمات، وسياسة المنافسة .
- ❖ إلغاء أنماط الاستثمار التي تأخذ شكل المحور والأطراف، حيث يتم تطبيق مبدأ المعاملة الوطنية .

- ❖ فرص استثمارية جديدة في جميع الأسواق والقطاعات .
- ❖ جدول زمني لبرنامج الإصلاح الاقتصادي من أجل التكامل العالمي .

الدلائل من الصناعة:

أيدت الدلائل والبراهين من الدراسات القطاعية والمقابلات الشخصية مع مسئولى الشركات خلال إعداد الدراسة، النتائج التي تم التوصل إليها عالية، وأشارت إلى العديد من النتائج الهامة. وقد تضمنت قائمة الصناعات، صناعات مثل المنسوجات والملابس، والأغذية، والإلكترونيات، والأحذية الجلدية، والأثاث الخشبي .

وقد أظهرت الصناعات التي تناولتها الدراسة أفاقا جيدة للتصدير . فهذه الصناعات تتمتع بميزة نسبية مستبانة، ومعدلات نمو تصدير مرتفعة، وهي ذات كثافة عمالية عالية، في بلد يتمتع بميزة العمل الرخيص.

ومن ناحية أخرى، أظهرت مؤشرات التصدير والكفاءة أن هذه الصناعات تؤدي بأقل مما هو متوقع منها. وبالرغم من إمكانية وجود عدد آخر من المشاكل المرتبطة بقطاع الأعمال في مصر، فهناك مصدران واضحان للأداء المنخفض: وجود هيكل حوافز مشوه، وارتفاع تكلفة المعاملات في عمليات التصدير. والنقطة الأولى تمثل حافزا ضعيفا على التصدير، على حين تمثل النقطة الثانية النقص في درجة تنافسية الصادرات.

وطبقا لنتائج الدراسة المسحية ، تتبع نفقة المعاملات المرتفعة للصادرات من كل من القيود المؤسسية ، والتي تؤدي - بشكل عام - إلى ارتفاع تكلفة القيام بالنشاط الاقتصادي في مصر لأي شخص. زمن القيود المباشرة على أداء الصادرات، إجراءات التصدير المعوقة. ولقد أشار المسح إلى أن مستوى التعريف، باعتباره أكثر العناصر الحرجة أهمية، وينبغي أخذه في الاعتبار من أجل تشجيع الصادرات.

ومن الناحية الإستراتيجية ، فإن التدخل بإجراء إصلاحات في السياسة التجارية يجب أن يتمشى مع الهيكل الصناعي والسياسات الراهنة. وهناك ثلاثة مستويات مختلفة من الهيكل الصناعي ، والتي تتطلب وجود مناهج مختلفة من إصلاح السياسات وتشجيع الصادرات:

1. صناعات غير كفاء ذات حماية مرتفعة .

٢. صناعات ذات كفاءة وذات حماية مرتفعة .
٣. صناعات ذات كفاءة ولا تتمتع بالحماية .

التوصيات:

- ❖ الاستمرار في السياسة الراهنة القائمة على تخفيض التعريفات الجمركية المرتفعة بشكل متوالي.
- ❖ استهداف معدل تعريفية جمركية موحد يتراوح بين ١٠-١٥ %.
- ❖ تحسين نظام رد التعريفية الجمركية (الدروباك) ونظام السماح المؤقت.
- ❖ الاتجاه نحو المزيد من تعميق التكامل مع الاقتصاد العالمي من خلال اتفاقات التجارة الحرة مع أوروبا.
- ❖ الاتجاه نحو المزيد من الأنشطة المباشرة لتشجيع الصادرات، وبرامج تحسين كفاءة الإنتاج في تلك الصناعات من أجل الاستفادة من هيكل التعريفية المعدل والمشجع.