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Boosting World Trade in Tunisia and Egypt by Cutting Non-Tariff Barriers

Better Imports for Better Exports

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In a nutshell

- *Egypt and Tunisia have embraced trade liberalization which has helped them establish a successful export-focused strategy.*
- *However, the cost of non-tariff measures (NTMs) — policy measures other than ordinary customs tariffs that can potentially have an economic effect on international trade — has increased substantially.*
- *To achieve successful economic transition — which is a big challenge alongside their political transition — Tunisia and Egypt need to reform their NTMs.*
- *The reform process must be based on structured public-private dialogue with a common goal of improving firms' competitiveness.*
- *This process includes enhancing import settings, streamlining NTMs, simplification of procedures and transparency.*
- *It should also include establishing harmonization measures to facilitate access to foreign markets. The two strands are closely linked as better export means better import.*

About the author

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Tunisia and Egypt need to build on their success in expanding their export sectors through trade liberalization by streamlining non-tariff measures (NTMs) that can add costs for exporters and impose obstacles to imports. The two-fold strategy should involve: reviewing and harmonizing existing NTMs and implementing new rules to new NTMs; and ensuring the reform process is based on a participatory approach of structured public-private dialogue with a common goal of improving firms' competitiveness.

Compared with other countries in the MENA region, Tunisia and Egypt have been proactive in adopting a policy of trade liberalization and integration into the global economy. This strategy is based on their accession to the World Trade Organization (WTO), adherence to the rules and provisions of the multilateral trading system, signing free trade agreements with the European Union (in 1996 for Tunisia and in 2004 for Egypt), membership of the Greater Arab Free Trade Area (GAFTA) since 1998 and the Arab Mediterranean Free Trade Agreement (Agadir Agreement) since 2004. This general policy of trade liberalization resulted in the establishment of an export promotion policy that has gradually supplanted the strategy of replacing foreign imports with domestic production (import substitution).

Exports have risen but NTMs still impose costs

Like most countries in the MENA region, the main competitive advantage of Tunisia and Egypt is their geographical proximity to large markets. This led to the development of assembly activities where competition is based on time-saving due to a higher interdependence of supply chains. Thus, from the early 1990s, Tunisian exports increased by 5.1% per year, from 30.2% of GDP in 1986 to 55.6% in 2008 (although it is now less than 50% because of the recession in Europe and the 'Arab Spring' events in 2011). In Egypt, export growth has been more pronounced since 2004. On average, exports increased by 24% per year since 2004, against only 5% before. The share of trade in Egypt's GDP grew from 40% in 2000 to 60% in 2008 but had fallen to 40% by 2010 because of economic crisis.

Trade liberalization has also resulted in a significant drop in the share of total tax revenue from customs and other import duties, 20% and 39% respectively for Egypt and Tunisia between 1995 and 2010. However, this drop in prices has not meant a reduction in trading costs. Indeed, Non-Tariff Measures (NTMs) — policy measures other than ordinary customs tariffs that generate trade-related transaction costs — have increased substantially in Egypt and Tunisia. Over the period 1999-2010, NTMs were introduced gradually in Tunisia (14% in 1999, 20% in 2002 and 41% in 2010) while their implementation has been relatively concentrated in one year in Egypt (83% of NTMs were introduced in 2005). Despite the variety of NTM forms, they are concentrated around a few categories. In Tunisia, over 54% of NTMs are sanitary and phytosanitary measures (SPS), over 16% are technical barriers to trade (TBT), nearly 14% are pre-shipment inspection and other formalities, and over 8% are export-related measures (including export subsidies). In Egypt, the focus of NTMs is much narrower. Over 75% of measures are TBT, while 10.3% are charges, taxes and other para-tariff measures, and less than 9% are SPS and less than 4% are pre-shipment inspection and other formalities. NTMs are often considered the second facet of trade control measures and have similar effects to those of tariff measures. Increased NTMs in both countries are costly and often neutralize the expected benefits of economic openness. The NTMs have also hindered trade facilitation, which is a driver of competitiveness. Tunisia and Egypt are therefore losing potential for export and economic growth. It is because of all these that there is a need for a thorough review of NTMs and a program to streamline them.

NTMs as disguised protectionist instruments

For Egypt and Tunisia, the NTMs have effects similar to those of conventional tariff barriers for three reasons:

- NTMs generate transaction costs and consequently create distortions between domestic and world prices, whatever their format and whatever the objectives of their implementation. It is often assumed NTMs are more restrictive of trade than tariffs.
- The NTMs are of particular concern to exporters and importers as they are a major inhibition to international trade, prevent market access and reduce competitiveness of domestic firms in global markets. On the import side, companies can improve their productivity levels by importing intermediate products at competitive prices and short lead times. On the export side, with quota ratios or technical barriers, firms find it difficult to benefit from the returns to scale. The effect of NTMs on market access and competitiveness is usually assessed through: the frequency of mea-

- sures notified by product; and their severity as measured by the rate of an ad-valorem tariff that would have the same effect on imports (called Ad-Valorem Equivalents).
- The establishment of NTMs favors the development of a rent-seeking economy. In particular, quota-setting generates rents for distributors or licensees. The development of rent systems in turn promotes the development of corrupt systems. This effect is comparable to custom tariffs protecting crony businesses from foreign competition.

NTMs as a brake on trade facilitation

In Tunisia as in Egypt, cost-related NTMs appear as one of the major causes hindering trade facilitation. This is for several reasons. First, NTMs require the establishment of complicated and sometimes duplicated procedures increasing bureaucracy and generating costs as a result of administrative barriers, red tape, lack of information and transparency. As NTMs refer to complex legal instruments, they are considered a major obstacle to international trade, impeding access to the market. Access to relevant information about standards, testing and inspection procedures, technical regulation and compliance rules, seem key factors. Under these conditions, trade is hampered by NTMs which are often seen as sources of deadlock or implicit barriers. For example, administrative procedure costs account for 2% to 15% of the value of traded goods. In addition, a one-day delay in the shipment of exports means a reduction in trade of at least 1%.

Second, NTMs increase time to trade, which is today a key competitive factor particularly for Tunisia and Egypt where international subcontracting activity for intermediates is central in the productive fabric. Better positioning of Tunisia and Egypt in global value chains requires reliability and efficiency in delivery times. For example, in Egypt, the preparation of documents is the procedure that consumes the most time, requiring nearly 60% of total time. In 2010, the red tape required for an import or export operation required 12 days and cost US$613 for export and US$698 for import.

Third, and due to the lack of transparency and clarity in the procedures imposed by NTMs, they can be one cause of corrupt practices in customs administration. Indeed, the complicated customs procedures coupled with the lack of transparency fosters corrupt practices at all levels.

Exploiting the trade potential

Although the market-oriented economy and trade liberalization have allowed Tunisia and Egypt to boost their economies' dynamics, progress in terms of economic growth and employment remain below the potential and expected effects. Indeed, other trade barriers still exist and trade facilitation is far from meeting international standards. The NTMs prevent trade liberalization from having the expected spillover benefits. Tunisia and Egypt aim at a structural transformation of their economies through diversification and sophistication of their exports. Yet these processes still seem to be hampered by administrative barriers illustrating one of the big pictures of NTMs. Better export means also better import.

In Egypt, administrative barriers negatively affect the ability of firms to expand the number of new customers or new countries (which economists call extensive margin). These barriers also affect the ability of exporting firms to increase the value of their exports (intensive margin), but in smaller proportions. Similarly, technical barriers to trade, pre-shipment clearance and other formalities and anti-competitive measures all have a significant negative effect on imports. In Tunisia, NTMs have a negative effect on intensive margins imports whereas this effect is positive for Egypt. In general, and for both countries, the impact of NTMs on trade is more important through the extensive than intensive margin.

Like most countries in the MENA region, productive activities in Egypt and Tunisia are characterized by the predominance of small and medium enterprises (SMEs). But these small exporters are more affected by these barriers than large firms. Time for export and import is crucial for smaller businesses, while their impact is negligible for larger firms. So, the negative effect of NTMs is more important for SMEs than for large multinational firms. Taking into account the weight of SMEs in the Tunisian and Egyptian economies and their ability to create jobs, one can see the economic costs that NTMs can impose whether in terms of diversification versus sophistication of exports or in terms of job creation and sustainability.

Policy recommendations

Taking into account the effects of NTMs as an impediment to trade development, policymakers in Tunisia and Egypt should look at two main areas of recommendations in order to transform their economies and achieve greater dynamism.

What to do: streamlining NTMs

Although it is clearly recognized that some NTMs can be reduced or eliminated altogether, it should be noted that several measures are implemented for entirely lawful purposes. Streamlining NTMs involves reviewing and harmonizing NTMs in all their forms so as to maintain the objective assigned to these measures while keeping trade-related costs at the lowest possible level. It should involve reforms whose guiding principle is to have efficient regulations that improve competitiveness of both countries. These principles relate to transparency, non-discrimination, simplification and computerization, reducing compliance costs and the systematic assessment of the new regulation-related costs.

This strategy of NTMs streamlining should be aimed at both improving existing NTMs and implementing new rules process. Such an approach will enhance the import conditions for companies — while seeking to improve their productivity and competitiveness — by helping them to meet a wide range of needs, including technical regulations, standards, customs procedures and products.

Meanwhile, Tunisian and Egyptian exporters are facing technical regulations, conformity assessment, and SPS measures, which are perceived as the biggest hurdles. As the EU is the main trading partner for both countries, it is quite reasonable to negotiate technical and financial assistance to help Tunisian and Egyptian producers, particularly the smallest and in the most strategic sectors, to adapt their products to required standards. Egypt and Tunisia have already benefited from an industrial upgrading program, called Mise à Niveau in Tunisia, aiming at improving export market competitiveness. But the impact of these initiatives and programs remains controversial. New technical and financial assistance programs could be re-negotiated based on clearly defined objectives. This is especially useful for Tunisia, which in October launched negotiations with the EU for a Deep and Comprehensive Free Trade Agreement (DCFTA). While harmonization and mutual recognition agreements certainly help improve the access of exporters of both countries to the European market, they might also increase their production costs and consequently reduce their potential market share of other markets.

How to do it: A participatory approach

A participatory approach seeks to complete a top-down initiative through structured bottom-up dynamics. The private sector is the key player in terms of the perception of the NTMs' effects on competitiveness. From its side, the administration is a central player since it is in charge of implementation of any reform on existing measures or design of new regulations. Thus, the reforms to be considered should be discussed through a public-private dialogue structured around common objectives of improving competitiveness and rationalizing of NTMs. This probably requires the creation of a strong governance and regulatory structure to conduct this type of dialogue for NTMs in particular and more generally for a broader reform agenda. In a context of newly established democracies in Tunisia and Egypt, ensuring that institutions practice dialogue for structural reform projects will strengthen the democratic process. Tunisia's Ministry of Finance has worked with professionals and companies to reform tax and customs formalities through a participatory and structured approach. After an evaluation, the scope could be broadened to cover issues directly related to NTMs.

The implementation of a transparent rulemaking process increases the chances of success and sustainability of reforms. On the one hand, this gives the private sector the opportunity to state its objections to proposed reforms of NTMs (existing and future) prior to their implementation. As private firms are most concerned and affected by these measures, they will be better able to propose practical reviews. On the other hand, the various stakeholders in public administration can display their constraints as well as institutional practices in terms of different reform scenarios. To be a truly constructive process, it is essential that the governance structure is endowed with qualified staff in fields as diverse as economics, social, law, and the environment. By launching a large and structured consultation process, governments should involve all stakeholders regardless of their size and their degree of influence to prioritize collectively the most binding constraints on trade liberalization and competitiveness improvement and to identify appropriate means to overcome them. In addition, the governance structure responsible for public-private dialogues should ensure that this momentum is maintained. Public-private dialogues should concern not only the stage of proposal, discussion and design of reforms, but also their implementation, impact and sustainability.

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