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Pathway to Prosperous Regional Integration in the Euro-Mediterranean and South-East African Regions: The case of Tunisia and Egypt [1]

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1. Executive Summary

Tunisia and Egypt have liberalized their foreign trade through various trade agreements with a number of partners around the world. In this framework, both countries signed Association Agreements (AAs) with the European Union (EU) respectively in years 1995 and 2001 for the implementation of bilateral Free Trade Areas (FTAs) that cover industrial products. Such AAs as part of the Barcelona Process, replace the former tariff advantages shared by both sides for decades.

Also in the Euro-Mediterranean region, the two countries have signed up to other integration agreements, such as the bilateral FTAs established with Türkiye respectively in 2004 and 2005. In a way to further reinforce their trade ties with Eastern and Southern African countries, the two countries entered the COMESA (Common Market for Eastern and Southern Africa) agreement respectively in 2018 and 1998, which consists of a Customs Union that brings together 21 African member countries.

The aim of this Policy Brief is to examine the integration of Tunisia and Egypt into the Euro-Mediterranean and South-East African regions. Emphasis is on the three mentioned trade agreements, i.e. the AAs with the EU, the COMESA and the FTAs with Türkiye. In order to determine the factors acting on the two countries' trade with their partners that are members of the aforementioned agreements, the usefulness was to use the gravity equation. The exogenous variables included in this equation could rise or reduce exports and imports of both countries with their selected partners according to the estimates conducted in this work. Still based on these estimates, the aim would also be to predict whether Tunisia and Egypt could assume intermediary roles easing triangular trade relations between the EU, Southern Mediterranean and South-East African regions.

The outcomes approve the expected influences of the traditional exogenous variables as included in the gravity equations (GDPs, distances, etc.). The effects of the considered trade agreements were also in conformity with expectations, particularly in view of the export and import data of both countries with their reported partners.

Recommendations take account of estimates, the state of existing trade and, in particular, the objectives to be achieved for a better integration of Tunisia and Egypt within the three trade agreements. In this respect, the suggestions also point in the direction of greater fluidity, diversification and fairness in trade between the EU, the southern Mediterranean and South-East African regions, notably through active gateway roles that both countries could assume.

2. Introduction

The liberalization of international trade has attracted a great deal of attention for decades. In this context, many preferential trade agreements have been concluded and sent to the World Trade Organization (WTO) for information and supervision. The outcomes of such agreements are mixed on a global scale: some have led to closer economic ties and trade creation, while others have not had the expected effects.

The Mediterranean region has not escaped this trend, and has been the focus of various preferential trade agreements. The accession of northern Mediterranean countries to the EU is a case in point. It is also important to note the tariff advantages shared between the southern Mediterranean countries and the EU, which were followed by the creation of the Barcelona Process, under which Association Agreements creating bilateral FTAs were drawn up. The process has continued with the establishment of the Agadir Agreement between Tunisia, Morocco, Egypt and Jordan, the accession of North African countries to the Pan-Arab Free Trade Area (PAFTA), the accession of Tunisia, Egypt and Libya to the COMESA, the creation of bilateral FTAs between some south Mediterranean countries (Tunisia, Egypt and Morocco) with Türkiye, etc.

Given the mixed record of preferential trade agreements at both global and Mediterranean level, a particular focus brings us back to the foundations of international trade. From the free-trade/protectionism debate, to the theory of customs union and theories of international exchange, there are many areas of reflection at this level. The idea is to understand the elements that influence exchanges, which would make it possible to recognize the factors behind the success or failure of the considered preferential trade agreements. This work focuses on the gravity model, widely discussed and applied in the field of international trade. Then, based on the results found, the aim would be to formulate feasible recommendations for achieving the desired objectives.

This work, focusing on the Euro-Mediterranean and South-East African regions, attempts to capture the contributions of the key determinants included in the gravity equation to the exports and imports of the two countries under consideration (Tunisia and Egypt) in their integration into three trade agreements mentioned, namely the AAs with the EU, COMESA and bilateral FTAs with Türkiye. The promotion of triangular trade and economic cooperation between the EU, the Southern Mediterranean and Eastern and Southern Africa is the second focus of this work. The recommendations are based on the results of the assessments carried out and the objectives set.

3. Mediterranean Context: Trade agreements with mixed outcomes

Trade links between most southern Mediterranean countries and the EU have remained strong for decades until now. In 2021 and even before, the EU is the leading trading partner of Tunisia, both in terms of exports (almost 75% of total Tunisian merchandise exports) and imports (almost 50% of total Tunisian merchandise imports). France, Italy and Germany are the countries with which Tunisia markets the most. The EU is also the Egypt's largest trading partner with a share of almost 30% of the Egyptian trade of goods. Italy and Spain are among the main destinations for Egyptian merchandise exports. Despite progress in signing AAs between several southern Mediterranean countries and the EU, achievements were below expectations since FTAs were limited to industrial products and did not have multilateral dimension that would involve all partners.

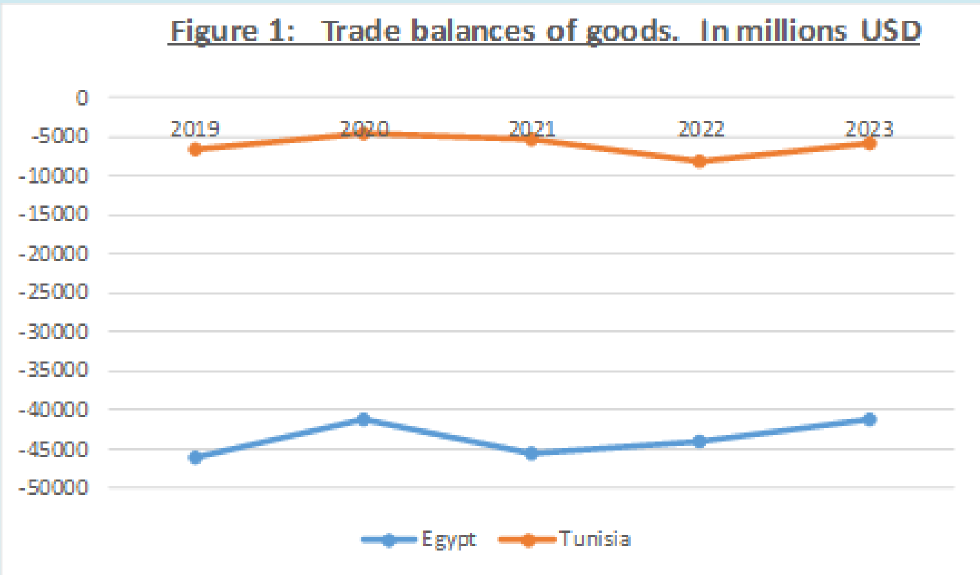
Bilateral FTAs signed by Tunisia, Egypt and Morocco with Türkiye respectively in 2004, 2005 and 2004 cover both industrial and agricultural goods. These agreements have led to an intensification of trade, particularly in terms of imports of the three North African countries from Türkiye. Such FTAs have played a role in trade diversion, with Türkiye becoming a major supplier of capital goods to all three countries. In 2021, Türkiye's shares in the three countries' merchandise imports were respectively about 5.5%, 4%, and 5%.

In contrast to the two integrations mentioned above, where an intensification of trade followed, the Pan-Arab Free Trade Area (PAFTA) signed in 1997 by sixteen Arab countries "is one of the shallowest free trade agreements ever signed" as highlighted by El-Sahli Z. (2023). Intra-Arab trade of goods remains very low despite the removal of customs duties. Non-tariff barriers are still greatly prevailing in many MENA (Middle East and North Africa) countries.

Regarding the Agadir Agreement signed in 2004 by Tunisia, Egypt, Morocco and Jordan for the cumulation of rules of origin between member states and Euro-Mediterranean countries, outcomes are also very modest. According to the "Euromed Trade Helpdesk", which is a trade intelligence tool implemented by the International Trade Center and funded by the EU, the potential for unrealized intra-regional trade in the Mediterranean was estimated in 2023 at 782.5 million USD for Tunisia, 3290 million USD for Egypt, 911.5 million USD for Morocco and 548.9 million USD for Jordan.

The COMESA, created in 1994, brings together currently 21 African countries. This integration created a Free Trade Agreement covering agricultural and manufactured products since 2000. Although the aim was to establish a Customs Union between the member states, this has not yet been achieved. Tunisia and Egypt joined COMESA in 2018 and 1998 respectively, but trade of the two countries within the integration is still below expectations.

As regards trade balances of goods (excluding services) with all partners, Tunisia and Egypt have structural trade deficits. Over the period 2019-2023, the trade deficit approached 15% of GDP in Tunisia, and fell from around 15% to 8% of GDP in Egypt. The evolutions of the trade balances of the two countries in millions of current USD are shown in Figure 1 below.



Source: Trademap database

Tunisia's main exports are mechanical and electrical engineering products, phosphates, textiles and clothing, energy, agricultural products and agri-foodstuffs. Its imports consist mainly of energy products, capital goods, raw materials, semi-finished products and foodstuffs. Egypt imports mainly wheat (the world's largest importer) and inputs for manufacturing and industrial production. Its' exports generally include hydrocarbons, textiles, household appliances, mineral fertilizers and phosphates. Egypt's global partners are more diversified compared to Tunisia: in addition to the EU, China and Turkey, Egypt also trades with Saudi Arabia, the United States, etc.

4. Methodology

The methodology used in this work is the estimation of a gravity model on panel data. The purpose is to assess the concomitant involvement of two southern Mediterranean countries, i.e. Tunisia and Egypt, in their trade integrations with the European Union (EU), COMESA and Turkiye.

Firstly, the dependent variable consists of Tunisian and Egyptian exports as directed to the EU and COMESA countries. Then, for comparison purposes and given the importance of FTAs with Türkiye in the Euro-Mediterranean region, the sample of partner countries is extended to include Türkiye. In addition, in order to take into account both sides of Tunisia's and Egypt's trade with their partner countries, the estimates also apply to imports, so that the other dependent variable becomes imports.

The started gravity equation (1) in this work initially takes the following log-linear form. As stated, it applies to exports. It subsequently applies to imports. [2]

LExportsijt = φ0 + ß1 LGDPit + ß2 LGDP_Partnerjt + ß3 LDistij + ß4 Langij + ß5 Colonyij + ß6 COMESAijt + ß7 EUM_AAijt + ß8 FTA_Türkiyeijt + ß9 MRTit + ß10 MRTjt + Ɛijt (1)

The dependent variables are LExportsijt and LImportsijt: Natural Logarithm of exports and imports from country (i) to partner country (j) in year t. The exogenous variables are the Natural Logarithm of the GDPs (LGDPs), the Natural Logarithm of the distance between countries (i) and (j) (LDist), the Multilateral Resistance Terms and the Dummy variables for common language (Lang), for colonial links (Colony), for the common membership to COMESA (COMESA), for the common membership to Euro-med AAs (EUM_AA) and for the common membership to bilateral FTAs with Türkiye (FTA_ Türkiye).

[2] Further information on decomposing equations to take account of theoretically proven criticisms and appropriate estimation methods, is included in the FEMISE Conference Paper N°4 (Chaabouni K. 2024) published and available on the FEMISE website.

All exports, imports and GDPs are in current US dollars (USD). Multilateral Resistance Terms (MRT) refer to the resistances imposed on the exporter and the importer with third countries, i.e. they comprise trade barriers of countries i and j with all their trading partners, except for j and i.

All estimations regarding the mentioned Gravity equations are carried out separately for the two exporter countries (i): Tunisia and Egypt. The data is annual and covers the period from 2001 to 2021. Forty-one partner countries (j) are selected in the sample: 22 EU countries, 18 COMESA countries and Türkiye. Data come from various databases: the Gravity Dataset of CEPII (Centre d'Etudes Prospectives et d'Informations Internationales), the Trade-Map Database of the International Trade Center (ITC), the World Bank Development Indicators Dataset (WDI), the COMESA and WTO websites.

5. Main results and conclusion

Results are mostly in line with expectations and previous empirical works. GDPs are proxies for production in the exporting country and demand in the importing country. With respect to exports from Tunisia and Egypt, estimates are positive and significant: for every 1% growth in the GDP of the country of origin, Tunisian and Egyptian exports increase by 0.644% and 0.596% respectively. Similarly, every 1% increase in the GDP of the importing partner country generates increases in Tunisian and Egyptian exports of 0.617% and 1.035% respectively.

On the import side, the estimated GDP elasticities also have multiplier effects overall: each 1% growth in the importer's GDP generates a 0.972% increase in Egyptian imports. Likewise, for each 1% growth in the partner country's GDP, Tunisian and Egyptian imports increase by 0.853% and 0.358% respectively.

Impact of EU-Med Bilateral Association Agreements

As regards to the EU-Med bilateral Association Agreements, COMESA, and the free-trade areas with Türkiye, results are generally in line with expectations. Positive and significant estimates apply to the EU-Med Association Agreement (EUM_AA) dummy exogenous variable relating to both exports and imports of Tunisia and Egypt. Accordingly, Tunisian and Egyptian exports increase respectively by almost 156% and 37.4% when the destination is the EU compared with their exports to other markets, while Tunisian and Egyptian imports increase respectively by almost 52% and 38.3% when originating from the EU compared with their imports from other source markets.

Trade Effects of COMESA Agreements

Relating to the COMESA dummy exogenous variable, results show negative effects in accordance with the low values of trade that both countries have with COMESA. According to estimates, Tunisian exports decrease by nearly 21.3% when the destination is a COMESA country compared to targeted exports to other markets. Similarly, as to imports, Tunisian and Egyptian imports decline respectively by almost 48.3% and 41.4% when the origins are COMESA countries in comparison with other source markets.

Trade Trends with Türkiye

The estimated effects on trade of the exogenous dummy variable FTA_Türkiye are in line with expectations and both countries' trade trends with Türkiye. Results confirm that Egypt would raise its exports to Türkiye by almost 67.2% in comparison with its exports to other markets. Relating to imports, estimates confirm that Tunisian and Egyptian imports rise respectively by 57.6% and 112.1% when the origin is Türkiye in comparison with other source markets.

Effects of Distance and Linguistic Proximity on Trade

Findings in relation to other traditional exogenous variables as included in the log-linear equations 1 and 2 and estimated using the Random Effect (RE) method meet expectations and previous works mainly with reference to the special effects of distance on trade. Each additional 1% in the distance separating Tunisia or Egypt with the partner countries generates reductions in both their exports (of respectively 1.273% and 1.665%), and imports (of respectively 2.266% and 1.534%). Linguistic proximity has a positive impact on Tunisian and Egyptian exports according to results. Sharing common languages makes that Tunisian and Egyptian exports are respectively 555.4% and 165.6% higher than their exports to any other destination country that does not enjoy the same linguistic proximity. As to imports, estimates are not significant in this context.

6. Policy Implications and Recommendations:

Given the estimation results found in this work and the gravity model data, the idea would be first to grasp how Tunisia and Egypt could optimize their integrations within the three FTAs under consideration. Then, as a corollary, the awareness would be to recognize whether both countries could assume pivotal roles to ensure further triangular trade within the three zones: the European Union, the Southern Mediterranean and South-East Africa.

Diversification of trade partners remains a requirement for any country with an open economy. This would make it possible to control the threats related to reliance on a small number of target markets. In this context, although recommendations are aimed at both countries, Tunisia in particular should strive to ensure a broader and more balanced commercial presence on all markets of the 27 EU countries, Türkiye and the COMESA countries. The recommendations are addressed separately or jointly to public and private authorities in Tunisia and Egypt, to EU institutions and experts, to Turkish and COMESA institutions. These recommendations include the following measures:

Enhancing Regional Integration Through Value Chains and Logistics Modernization

- Involving companies from both countries (Tunisia and Egypt) to a greater extent in the production of imported products from various source countries such as the EU and Türkiye. This participation in part of the added value would enable better integration into global value chains. Re-exporting such goods to the COMESA countries would be a second objective for both countries. Public authorities in both countries could support the private sector's efforts in this area, notably by referring to the trade agreements already signed with the partners in question. The EU countries and Türkiye would also benefit from a better access to the COMESA market following the relocation of part of their productions.

- With the aim of bridging distances closer, it is recommended to streamline the logistic chains between the countries of the three regions through various actions such as the removal of bureaucratic constraints in ports and airports and the investment in fast and modern transport infrastructure. Tunisian and Egyptian institutions could act in this context through the digitization of procedures as well as through the adoption of concessions that would allow a more rapid implementation of modern infrastructure.

Expanding Market Reach, Fostering Fair Competition, and Strengthening Trade Policy Advocacy

- Strengthening marketing initiatives in under-exploited markets, particularly the COMESA countries, through a variety of engagements and more present and influential commercial representations. In this context, it would also be desirable to take advantage of existing cultural links, as well as to consolidate the sharing of common languages with partners, notably through post-graduate university relations that could for instance consist of involving students from COMESA countries who have completed their university studies in Tunisia or Egypt in joint professional networks. Although these recommendations apply to all countries of the three regions, they are strongly suggested to Tunisia so that it could further diversify its trading partners by targeting more markets within the mentioned regions, i.e. distant EU countries, Türkiye and the COMESA countries.

- Enhancing competition to encourage initiatives and promote better integration of the private sector with foreign companies in trade. This could be achieved through setting up more equitable business environments and strengthening antitrust measures and competition policies. Tunisian and Egyptian competition authorities could collaborate more closely with EU competition authorities.

- Consolidating the involvement of both countries (Tunisia and Egypt) in WTO negotiations. The main things would be to follow and defend their interests by adopting the suitable instruments of trade policy. At the same time, it would be wise for the public authorities of both countries to monitor existing preferential trade agreements already signed with partners, and to restrict adaptations to ad hoc requirements.

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The European Institute of the Mediterranean (IEMed), founded in 1989, is a think-and-do tank focused on Euro-Mediterranean relations. Guided by the Euro-Mediterranean Partnership (EMP), European Neighbourhood Policy (ENP), and Union for the Mediterranean (UfM), it promotes cooperation, mutual understanding, and intercultural dialogue to build a shared space of peace, stability, and prosperity. IEMed is a consortium of the Catalan Government, the Spanish Ministry of Foreign Affairs, the EU, and the Barcelona City Council, with contributions from civil society through its Board of Trustees and Advisory Council.

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