Assessment of the impact of trade liberalization between Ukraine and Egypt

The summary of the research conducted
by the Institute of Economic Research and Policy Consulting
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Ukraine is a small open economy, which pace of economic development depends on how successfully the country is embedded in global economic relations.

Ukraine has established free trade zones (FTAs) with several important partners, including the European Union, the United Kingdom, and most CIS countries. Negotiations with Turkey are ongoing. In addition, the conclusion of new free trade agreements with several countries of the Barcelona Process, particularly with Egypt, has been under consideration. The **FTA with Egypt is the focus of** this study.

Although Egypt is significantly larger than Ukraine in physical terms (area, population), **the countries are comparable in economic terms**. The countries have almost the same GDP per capita in purchasing power parity terms.

Ukraine has a **positive trade balance in goods and services with Egypt.** Trade in goods takes a lion share of total trade between partners, and goods exports are well above imports. That allows offsetting the negative balance in trade in services, driven primarily by the demand for travels to Egypt. The main components of Ukraine's exports are agro-food products and metals, while travel services dominate imports.

At the same time, **trade is very concentrated**. The main components of Ukraine's exports are agro-food products and metals, while travel services dominate imports.

One of the reasons for the low level of trade diversification may be **the relatively high tariff and non-tariff barriers faced by Ukrainian exporters in the Egyptian market**. These barriers exceed the level of protection faced by the Egyptian exporters in the Ukrainian market. For example, the level of Egypt tariff protection is about 4.8 times above Ukraine's tariffs. The average MFN import duty rate in Egypt is 19.0% compared to 4.5% in Ukraine. Traditionally, import rates for food products are much higher than non-food.

Egypt does not apply tariff quotas. Some goods are subject to paid inspections at customs or to excises creating additional trade barriers. In addition, although the product safety system in Egypt is based on WTO principles, exporters face difficulties in obtaining certificates of compliance with sanitary and phytosanitary requirements.

Egypt has a **network of free trade agreements** covering its key partners, both by trade and geography. **All FTAs, without exception, cover exclusively trade in goods**. The signed FTAs belong to the classic agreements related to trade liberalization through reduction/abolition of import duties and are mainly based on the WTO provisions concerning SPS and dispute settlement procedures.

Ukraine and Egypt have **different "competitiveness profiles",** which allow them to **complement trade flows**, thus providing benefits for both partners, given that a free trade area is created. For example, Ukraine has high competitiveness in the Egyptian market in plant products (grains) and metal products. Instead, Egypt has a competitive advantage in exports to Ukraine of fruits and vegetables, textiles and clothing, and chemical products.

The analysis of the short-term consequences of the FTA between Egypt and Ukraine, based on the SMART model, shows a **positive but low direct impact of the liberalization of import duties** on mutual trade.

According to the model results, in Ukraine's trade in goods with Egypt, the nominal increase in exports will be much higher than the increase in imports, which in the short term will mean maintaining **a positive balance of trade in goods**. Among Ukrainian exporters, the producers of industrial tobacco and its substitutes, metal products and cleaning products gain the most.

Analysis based on the general equilibrium model gives similar results. The simulation shows that the **FTA with Egypt will have a positive**, albeit not very significant, impact on the **population's well-being and GDP.** In particular, there will be a shift in the trajectory of real GDP by +0.27% and welfare - by +0.36%.

The critical scenario for these gains is the liberalized access to the Egyptian market by reducing non-tariff barriers to trade in goods. Egypt's abolition of import duties on Ukrainian products is the second crucial factor allowing gaining the highest welfare and GDP increase thanks to the FTA establishment. At the same time, even the full liberalization of Ukraine's import duties on trade with Egypt will have a minimal impact on real GDP and welfare and other macroeconomic indicators.

According to the model, the **most significant increase in income will occur for capital and unskilled labor**. Still, these two factors of production are also most affected by changes in the economy. However, the scale of redistribution of factors of production between sectors will be insignificant.

The increase in exports will exceed the increase in imports due to Egypt's higher level of protection than Ukraine and the trade structure. Therefore, under the proposed scenarios, **we can expect an expansion of the trade surplus.**

In imports from Egypt, services imports exceed imports of goods, making **trade in services a potentially important area of FTAs** with that country. In particular, the growth of imports from Egypt is primarily due to lower barriers to trade in services with this country. Among the sectors, the highest output growth rates were recorded in water and air transport and the production of other food products. At the same time, in terms of contribution to overall growth, the role in grains and metallurgical output, the main export items to this market, is more significant.

Noteworthy, **the growth of exports of metals and grains** is the expected result of the FTA with Egypt according to all three used tools to assess export potential (analysis of the identified competitive advantage, partial equilibrium model and general equilibrium model).

In sum, the **analysis shows the positive impact of the FTA with Egypt on the economy of Ukraine.**

The full version of the analytical report will be available on the websites of the Ministry of Economy of Ukraine and the Institute for Economic Research and Policy Consulting on 19 November 2021.