



## Reengaging Egypt: Options for US-Egypt Economic Relations

Barbara Kotschwar and Jeffrey J. Schott • January 2010 • 207pp • ISBN 978-0-88132-439-6 • \$20.95

President Barack Obama has given high priority to launching a new Middle East initiative and reviving peace talks. Special envoy George Mitchell has been tasked with forging a new US policy that contributes to regional stability and economic development. The time is thus ripe for the United States to supplement its Middle East diplomacy with an economic development strategy.

Strengthening economic relations with Egypt is an essential component of such a strategy. Egypt is an important Middle Eastern market. It has seen relatively robust growth over the past decade, despite declining US aid, and has weathered the global economic crisis well, with GDP growth predictions for next few years at over 4.5 percent per year. The United States has a strong interest in enhancing its commercial ties with Egypt. An expanded US-Egypt partnership would help develop Egypt's economic potential and improve the living standard of its people. It would also encourage Egypt to continue to play a constructive role in the Middle East, strengthen its economic ties with regional partners, and help the United States pursue a more cohesive and sustainable policy in the Middle East.

Kotschwar and Schott argue that the path to reengaging Egypt should build upon but go beyond past bilateral initiatives, focusing on bolstering Egypt's economic development as well as enhancing bilateral commercial ties. The "traditional" approach of negotiating a free trade agreement (FTA)—on the back burner since late 2005—is not a practical option in the near term, given the lingering effects of the global economic crisis and the continuing divisions in US trade politics. However, an FTA should remain on the medium-term bilateral agenda. In the interim, the authors suggest other actions—organized into three tranches—that could be implemented sequentially or concurrently:

- measures to liberalize bilateral trade, including expanding the qualifying industrial zones (QIZ) program, modernizing the bilateral investment treaty, and negotiating a bilateral services trade agreement
- measures to facilitate trade, such as customs reform and modernization and helping support the implementation of intellectual property rights commitments; and
- reforms designed to improve Egypt's business environment and strengthen its physical infrastructure and, most importantly, its human capital.

### LIBERALIZING BILATERAL TRADE AND INVESTMENT

The United States and Egypt are not using their bilateral economic relationship to its full potential. Bilateral trade is relatively small (\$8.4 billion in 2008), and US direct investment in Egypt, valued at \$8.8 billion at end 2008, is exceeded in the Middle East and North Africa (MENA) region only by US investment in Israel and Qatar.

**Expanding the QIZ:** The QIZ agreement allows Egypt to export goods to the United States duty free provided that at least 35 percent of the value is added through processing in a designated QIZ. Of that 35 percent, a specified percentage must be Israeli content. The agreement significantly improves upon the duty-free access Egypt already enjoyed through the Generalized System of Preferences (GSP), allowing Egyptian exports of textiles and apparel and other products to be imported duty free. The United States can improve the reach of the QIZ program by approving additional zones to expand trade and investment opportunities for more textile and apparel firms and to encourage other sectors where Egypt has a revealed comparative advantage, such as prepared foods and stoneware.

**Modernizing the Bilateral Investment Treaty:** Since 1992, when the US-Egypt BIT came into effect, significant changes have taken place in international provisions on investment, both through changes in the texts of BITs and through innovations within the investment provisions of FTAs. The United States has recently reformulated the model text it has used in BIT negotiations over the past two decades. If the current US-Egypt BIT were to be updated, a number of issues would be subject to review, including coverage, trade-related intellectual property rights, and dispute settlement. Modernizing the BIT could address a number of concerns raised by US companies, including intellectual property protection and labor and environmental standards, and would “give credit” to Egypt for the vast changes it has made to its investment regime, particularly since 2004. An updated BIT could serve as a model for an investment chapter in an eventual US-Egypt FTA.

**Bilateral Services Trade Agreement:** Services constitute about 45 percent of Egypt’s GDP and account for more than half of the country’s formal-sector jobs. A US-Egypt services trade agreement should place priority on sectors where modernization is necessary and in which the presence of US firms could either introduce necessary competition or bring new technology and management practices. The authors identify transportation, construction, electricity, and information and communications as priority areas. Progress in these areas could help Egypt better profit from its strategic geographic position and become a more dominant player in regional transportation, communications, and outsourcing.

## TRADE FACILITATION

The United States should pursue specific trade facilitation measures in two areas: customs/ports and intellectual property rights. Technical assistance should be oriented toward helping Egypt implement the World Trade Organization (WTO) Customs Agreement and meeting the new port safety standards mandated under US container security legislation. In the area of intellectual property rights, the United States should help Egypt implement its new intellectual property legislation and develop new disciplines to cover emerging technologies.

## ENHANCING EGYPT’S TRADE CAPACITY

Kotschwar and Schott examine several competitiveness indicators in which Egypt scores well below other MENA countries and below its competitors in the US apparel market. These factors can undermine the advantage offered by Egypt’s low labor costs and preferential access to its major markets. Increasing reliability and efficiency in sectors such as transportation, electricity (where the delay in obtaining an electrical connection is by far the longest of any of the MENA countries), and communications will require a combination of regulatory reform and attention to upgrading infrastructure. Egypt must also focus on upgrading its human capital—including taking advantage of resources that have been underutilized as a result of gender inequity—by enhancing educational services and training and addressing the educational and employment needs of women. A better trained workforce will help Egypt in its quest to serve as a regional outsourcing hub and help enhance its economic development in the longer run.

Infrastructure and human capital improvements require substantial resource commitments and a robust funding source. One potential source is the Millennium Challenge Corporation (MCC). US officials should strongly consider the participation of Egypt for programs funded by the MCC. Egypt exceeds most of the requirements for MCC participation and has made great strides toward meeting one of the main criteria, market reform. MCC funds target the types of development activities needed for Egypt to encourage new investment in infrastructure and human capital/education. An additional reason to include Egypt in the MCC is its strong performance in the natural resource management indicator—and its pressing needs in the area of environment and climate change. As part of their economic partnership, Egypt and the United States could set up an investment fund related to climate change to assist Egyptians in meeting the costs of mitigation and adaptation.

Revitalizing US-Egypt economic relations would open new development opportunities in Egypt through expanded trade and investment, spur innovation and productivity gains, and create important precedents for future regional initiatives.

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