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What Type of Agreement?

The yardstick that matters is the degree to which trade reform contributes to the construction of a high-quality institutional environment at home.

Dani Rodrik (2002, 3)

A trade agreement is not simply about changing relative prices to achieve a more efficient outcome. Particularly for developing countries, it is also about achieving institutional reforms, therefore a key issue for a US-Egypt free trade agreement (FTA) is its likely impact on domestic institutional arrangements. To what degree will an agreement require Egypt to undertake changes that are in its own interest and to what extent will it impose constraints that could actually damage its welfare? A complete answer to these questions will depend on the precise terms of the agreement, but it is possible to give some idea of the major opportunities and risks.

The Egyptian economy is still in a state of transition, with a long list of areas in need of reform. The reforms most directly related to an FTA include additional trade and services liberalization, customs reform, measures to attract foreign direct investment (FDI), privatization and reform of public-sector enterprises, adoption of competition and regulatory policies, and labor- and capital-market reforms. There is also a general need to improve governance by increasing transparency, reducing red tape and transactions costs, and improving conflict resolution mechanisms.

The preferential arrangements Egypt has or is negotiating with its neighbors are fairly "shallow" in the sense that they focus mainly on border barriers to merchandise trade; they are unlikely to contribute

substantially to many of the reforms mentioned above. While they may include hortatory language covering services, investment, and cooperation, it is not clear to what extent they will achieve full national treatment or rights of establishment for FDI and liberalization of services.

What then should an FTA between Egypt and the United States look like? In principle, negotiators can opt for what Lawrence (1997) calls "shallow" or "deep" integration: They can choose to cover mainly trade in goods (i.e., shallow) or aim for a deeper, more comprehensive agreement that not only covers all goods, including agriculture, services, investment, and intellectual property, but also contains rules for constraining domestic regulatory practices and standards. The deeper type of agreement extends liberalization to many aspects of the domestic economic environment, including the production of goods, services, and investment, and may involve dictates for policies, such as environmental standards, labor laws, government procurement, regulations, antitrust legislation, and intellectual property rights. Agreements of this type represent the closest option to complete elimination of barriers to trade and capital flows and are typical of the recent FTAs signed by the United States, most notably the North American Free Trade Agreement (NAFTA).

The economic effect of traditional shallow FTAs, as Viner (1950) postulated, is to "create" trade between the partners of the agreement and improve their welfare. At the same time, however, they "divert" trade toward the countries involved in the agreement and away from the rest of the world. The net effect of such an agreement can therefore be positive or negative but is generally limited in magnitude. As noted in the previous chapter, the EU-Egypt agreement will divert purchases away from US exports and toward EU products. In principle, this inefficiency could more than offset the benefits from reducing tariffs, resulting in a reduction in Egyptian welfare. A US-Egypt FTA may correct this by reducing trade diversion toward the European Union. This will be discussed in greater detail below.

Along with liberalizing tariffs, however, negotiators could also draft a deep integration agreement obligating them to change additional policies. The merit of deep integration agreements is that, in principle, given their larger scope, they could lead to larger gains—both the static gains from the better allocation of resources in a more liberalized environment and the dynamic gains from greater investment and improved productivity. To the extent that they also enhance investor confidence in the stability of policy reforms, deeper agreements could reduce the perception of risk and encourage the flow of FDI. In turn, FDI can produce an immediate increase in labor productivity and more long-term accumulation of technology and human capital.

But deeper integration does not necessarily mean better integration, and the devil lies in the details. When agreements require harmonization of policies, it is possible that the adoption of (the wrong) common

standards could actually reduce efficiency.[1] It is also possible that forcing the regulatory policy of one country on another may create an indirect trade barrier (Noll 1997). Finally, because not all countries are at the same level of development, immediately enforcing an agreement that imposes costly standards may discriminate against the local industries of the poorer country and take away its producers' ability to compete on the basis of lower wages.

Faced with the limitations of shallow FTAs, and the tendency of deep FTAs to require harmonization, the negotiators have a third option, which is a combination of both shallow and deep integration agreements. This hybrid is what Galal and Tohamy (1998) call an "eclectic" FTA. Fundamentally, this type of FTA combines liberalization of trade barriers with agreement on certain rules about—but not necessarily harmonization of—some domestic policies and regulations. The parties must then determine on a case-by-case basis which domestic policies to negotiate and whether to harmonize them. In each case, agreement depends on the extent to which the regulatory policies and institutions of the two parties diverge and on the political feasibility and welfare implications of changing the policies. Having said that, a US-Egypt FTA that goes considerably deeper than Egypt's association agreement with the European Union is likely to benefit both parties more than one that simply replicates the EU agreement.

Egyptian Perspective

For Egypt, the key purpose of an agreement with the United States is not simply to stimulate trade but also to attract investment and bolster domestic reform. Like Mexico did with NAFTA, Egypt could use the FTA with the United States to boost its economic reform process and enhance the credibility of this reform. Without such an agreement, domestic and foreign investors, especially those interested in asset-specific sectors such as utilities, will either refrain from investing heavily in these sectors or will require a high risk premium to do so. An agreement with the United States that involves liberalization of services can reduce this risk and attract capital at favorable terms to Egypt.[2]

There are several arguments against the extensive commitments that Egypt would have to make to enter into an FTA with the United States. It can be argued that Egypt has already undertaken sufficient reforms to

1. A good example of an inefficient deep agreement is the Common Agricultural Policy in the European Union.

2. See François (1997) for elaboration of the favorable effect of NAFTA as a policy anchor for Mexico.

gain the confidence of investors, domestic and foreign. The fact that Egypt has already concluded an FTA with the European Union could be interpreted to mean that there is no need for further commitments to anchor policy reform. Egypt could also liberalize and make additional reforms unilaterally or through the World Trade Organization (WTO), without having to tie its own hands in the context of an FTA with the United States. By entering into an FTA with the United States, Egypt could lose control over some domestic policies and institutions when it agrees to harmonize them with those of the United States.

However, from the perspective of promoting exports, attracting FDI, and improving the business environment in Egypt, these arguments do not seem persuasive. The reform process in Egypt is incomplete, as indicated, for example, by Egypt's relatively low ranking on the World Competitiveness Index.[3] The low level of annual capital inflows, which did not exceed half a billion dollars during the last few years, also suggests that the economy can benefit from further reform and credibility-enhancing measures. An FTA with the United States could address both concerns, especially if the agreement is of the deeper variety.

The recent history of economic reforms in Egypt suggests that processes are more sustainable, and reform elements better integrated, when they are carried out in the context of external binding agreements. Conversely, unilateral reforms tend to be volatile and often not sufficiently integrated. Over the past 15 years or so, reforms were most intense from 1991 to 1997 and slower from 1998 to 2004. In the earlier period, Egypt was committed to a series of reform programs with the International Monetary Fund (IMF), the World Bank, or both. In the later period, there were no such commitments. It is true that the pace of reform picked up momentum with the appointment of a new government in July 2004, especially in the areas of trade liberalization and income taxation. However, there are no guarantees that this momentum will be sustained. The agreement with the European Union will not serve as a credible reform anchor because it involves no obligations regarding the right of establishment or liberalization of services (Hoekman and Djankov 1997). As a result, foreign investors may not view it as a serious commitment mechanism as they did NAFTA.

The more difficult argument to address relates to the tension between the gains in welfare resulting from an FTA and possible constraints on national sovereignty. But Egypt has made this trade-off in all of the international agreements that it opted to enter into. No country lives in isolation, and as long as the benefits outweigh the costs, countries can choose to tie their own hands. Furthermore, it is unlikely that the Egyptian negotiator will find most provisions of the agreement undesirable, as

3. Egypt ranked 62 among a sample of 104 countries in 2004 (World Economic Forum 2004).

many of them will support the reform effort that the government is already considering. In exceptional cases, the provisions and government reforms may diverge, but that is where the negotiator's work comes in: to make the agreement consistent with Egypt's reform strategy.

Some who agree with the idea of using international agreements to achieve liberalization and reforms but argue that the WTO rather than bilateral agreements should be employed for this purpose (Srinivasan and Tendulkar 2003). The problem is that for a country like Egypt, the opportunities to make such commitments through the WTO are limited, in part because the WTO gives developing countries special and differential treatment and in part because its scope is still limited. Egypt's bound rates—the tariff ceilings to which it is legally committed at the WTO—are so high that they do not constrain its policies. Even a very successful Doha Round is unlikely to require Egypt to liberalize much further.[4] A second issue is that in the aftermath of the failed Cancún ministerial, investment has been taken off the Doha agenda. By contrast, the FTAs signed by the United States are based on full reciprocity, the removal of (almost) all border barriers, and a far more extensive set of commitments covering goods, services, investment, and regulatory policies. Special and differential treatment comes into play only in the length of time required for the agreement to be phased in, not in the nature of the commitments assumed by each side.

Finally, an FTA is a better vehicle than the WTO to mobilize the political support of export interests for liberalization and reform. For exporters, the carrot is permanent duty-free access to the US market. The connection between liberalization at home and foreign market access is more diffused at the WTO, as WTO liberalization for exports depends not only on what Egypt does but also on what the other 147 members of the organization do. In a bilateral FTA, domestic liberalization would be directly related to US market access.

US Perspective

The argument for a deeper agreement is also compelling for the United States. A traditional GATT agreement would eliminate the detrimental impact of trade diversion from the Euro-Mediterranean Agreement on US exports, moderately boosting them beyond their current market share. In addition, US consumers would derive some small benefits from reducing barriers to Egyptian exports. However, such an agreement would do little to deal with many of the frustrations US firms have experienced in Egypt due to nontariff barriers, administrative practices, and the regulatory environment. If the agreement were shallow, US investors in particular would

4. For a similar argument in the case of India, see Lawrence and Chadha (2004).

be struck by the lack of commitments to liberalize services, grant rights of establishment, improve access to government procurement, protect intellectual property rights, and improve regulations.

Thus, a traditional shallow agreement would not contribute significantly to either structural reform in Egypt or Egypt's prospects for economic growth. If the US-Egypt FTA is to really succeed in fostering Egypt's growth, it has to help change the general environment for entrepreneurship. It should help make Egypt a more attractive location for both foreign and domestic producers. A shallow agreement in these respects would have only a small effect, particularly for Egyptian producers of manufactured goods outside of textiles, who for the most part already have virtually duty-free access to the United States. Therefore, a shallow agreement would be unlikely to foster a boom in new investment in export industries; it would not result in Egyptian markets that were more contestable by other nations in the region.

Also, an agreement's contribution to regional economic integration and development depends crucially on the rules of origin for textiles and apparel, but in the case of a shallow agreement, it is unlikely to be very great. First, outside of textiles, since US tariffs are low, even if cumulation were allowed on value-added products in other Middle Eastern countries, the stimulus to regional trade would be small. In textiles, it could be more significant provided cumulation were allowed. On the other hand, if other regional economies were subject to Egypt's most favored nation (MFN) tariffs, there could be trade diversion toward US products and away from exporters in the region, which could hurt regional integration.

Finally, concluding a shallow agreement could also pose problems for US trade policy in general. It might suggest that other countries around the world could be given preferential access to the US market without committing to a WTO-plus arrangement like NAFTA, thus undermining the thrust of US trade policy in the 1990s and possibly establishing a precedent that weakens the ability of the United States to negotiate WTO-plus agreements with other trading partners.

In sum, it might be possible to pass a shallow agreement based on the argument that the United States and Egypt have a unique political and strategic relationship. It might also be easier for Egypt to sign such an agreement, since it would not require major adjustments. However, such an agreement could actually highlight Egypt's reluctance to make more binding commitments in other areas and thus actually erode the credibility of its policy pronouncements about liberalization. The idea that Egypt should be given special and less demanding conditions because of its strategic importance to the United States does little to enhance its economic attractiveness. Meanwhile, a shallow agreement might cause other countries to question the more involved agreements they have with the United States.

A deeper agreement would be different. As indicated above, dealing with nontariff barriers implies substantially larger quantitative effects. Improvements in access for US firms and products to the Egyptian market could be much greater if Egypt made a broader set of commitments involving national treatment and freedom of establishment for foreign investors, dramatic changes in customs and quality inspections, increased protection of intellectual property, and substantial liberalization of services and government procurement. In turn, US firms would find investment in Egypt more attractive, since greater access would enable them to employ both skilled and unskilled workers in producing goods and services for domestic, regional, and global markets.

Other benefits from a deeper agreement would come through strengthening Egypt's ability to engage in domestic reform. If such measures were made part of a binding FTA, they could be more credible than if they were undertaken unilaterally. In addition, if Egypt were open and experiencing rapid growth, other benefits would come from allowing the United States to reduce or redirect its aid grants to assist Egypt in dealing with other priorities and from the role that the Egyptian economy could play in generating growth and prosperity throughout the region.

Likely Content

Thus far, our discussion has focused on desirable attributes of an agreement for each side. But it is possible to provide a clearer idea of what an agreement is likely to include by looking at recent agreements negotiated by the United States. To be sure, there will be room for Egypt and the United States to introduce new features and terms in an FTA. Nonetheless, the United States is likely to seek to replicate agreements it has signed with other trading partners. Accordingly, it is helpful to describe the terms of such agreements and to reflect on their implications. To illustrate this, we will draw examples from the Central American Free Trade Agreement (CAFTA), as well as recent agreements between the United States and Morocco and the United States and Chile.

Tariff Reductions

Tariffs are removed on a large percentage of trade as soon as the agreement is implemented. The rest is mostly eliminated in the following 10 or 15 years. More than 95 percent of bilateral trade becomes duty free when the US-Morocco agreement enters into force, and almost all tariffs between the two countries will be eliminated within nine years (USTR 2004a). When the US-Chile agreement was implemented in January 2004,

tariffs on 90 percent of US exports to Chile and 95 percent of Chilean exports to the United States were eliminated (USTR 2004b).[5]

For Egypt, similar undertakings would add to the pressures for tax reform, especially of the value added system, to compensate for revenues lost on tariffs on US goods. They would also allow duty-free access to US capital equipment and other products, thereby reducing and possibly eliminating the need for the complex set of duty exemptions currently granted to firms producing for export markets.

Textiles and Apparel

Textiles and apparel are Egypt's most important export to the United States, amounting to $497 million, 44 percent of total exports, in 2003. Of this, cotton yarn and fabrics contributed $56 million. US quotas on imports of textiles and apparel from Egypt generally were not filled from 1997 to 2002. Products with the largest fill rates in 2002 included cotton knit shirts and blouses (74 percent) and carded and combed cotton yarns (67 percent). The European Union also maintains quotas on a variety of products, and from 1997 to 2001, the quota fill rates fell from 81 to 30 percent for yarn and 76 to 19 percent for woven fabrics (USITC 2004). With the expiration of the Multi-Fiber Arrangement (MFA) in 2005, Egypt will clearly be subject to considerable competition. The major Egyptian textile categories are generally those in which China has been constrained by the quota, with fill rates in the region of 80 percent. Similarly, Egypt is subject to strong competition from India in other categories, particularly cotton T-shirts. An FTA with the United States would favor Egypt in all textile products fulfilling the agreement's rules of origin. The current qualifying industrial zone agreement grants a select group of qualifying Egyptian products duty-free access to the US market and is therefore a useful transitional device, but it would be less attractive and ultimately obsolete once duty-free access for all Egyptian products was fully phased in.

The government of Egypt plays an important role in the textile industry by subsidizing farmers through price supports and maintaining ownership of plants. The sector has also been highly protected with tariffs and highly restrictive quotas. Although it has considerable potential due to the availability of high quality raw cotton, abundant labor, and its proximity to important European markets, the industry has been hindered by high input costs because of government price and tariff policies, excess employment, and outdated technology.

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5. No tariffs will be applied to 80 percent of US exports to Central America as soon as CAFTA is implemented, with the remaining tariffs to be eliminated over 10 years (USTR 2004c).

Egypt and the United States have had some friction over Egyptian textile policies, but a WTO dispute appears to have stimulated considerable liberalization and efforts to improve the sector's competitiveness. Just before Egypt ended its import ban on December 31, 2001, a presidential decree was issued amending the customs duties for some imports to specific duties. Rather than applying ad valorem duties to these products, Egypt applied specific duties denominated in Egyptian pounds, which, when converted to their ad valorem equivalent, amounted to duty rates ranging from 141 percent to 5,129 percent, according to the US formal consultation request. Also, according to the United States, because of the specific duties imposed by Egypt, it was able to export only $256,000 worth of these goods to Egypt in 2002 (USTR 2004d).

Egypt agreed in the Uruguay Round to lift an import ban on textiles and apparel by January 1, 2002, and to bind its duties at an ad valorem rate. For 2003, Egypt committed to a 46 percent ad valorem duty on knitted or crocheted apparel and clothing imports in Chapter 61 of the Harmonized System (HS), with two further reductions in subsequent years. This tariff commitment also extended to HS Chapter 62 products covering apparel and clothing imports not crocheted or knitted, according to the United States (USTR 2004d). Egypt committed to reducing duties in both chapters to 43 percent in 2004 and 40 percent thereafter. On January 22, 2004, tariffs on raw materials, inputs, and finished products were dramatically reduced or eliminated. Tariffs on yarns were cut from 30 to 12 percent, and tariffs on clothing were reduced to about 40 percent.

An FTA with the United States could help Egypt compete in the textile market, especially with the elimination of quotas in 2005 per the WTO Agreement on Textiles and Clothing (see USITC 2004, 42–43). The US-Morocco agreement eliminates over five years US duties on most textile and apparel products that meet the FTA's rules of origin. These rules require that imports use either US or Moroccan inputs, usually from the yarn stage forward (i.e., only fibers can come from third countries). However, the agreement also contains tariff preference levels (TPLs) for certain quantities of "nonoriginating goods" that do not meet the rules of origin requirements. These include duty preferences for 10 years for "nonoriginating" textiles and apparel in the first four years and then a phaseout in equal increments over the next six years. There is also a special TPL for textile and apparel articles of cotton grown in a least-developed sub-Saharan African country, provided the cotton fibers are carded or combed there.

Such an arrangement could be used to stimulate further reforms of the policies that have hindered Egyptian competitiveness in this sector. To be sure, the need to administer similar rules of origin for US clothing sold in Egypt would further complicate Egyptian customs procedures, but Egypt could, of course, choose simply not to require or enforce them.

Agriculture

The US-Morocco FTA requires all agricultural tariffs to be phased out under the agreement, most within 15 years. CAFTA adopts a similar general approach. An agreement between Egypt and the United States modeled on these would create additional export opportunities for Egyptian farmers.

However, the agreements also contain special agricultural safeguards, excluding particularly sensitive sectors or allowing long periods of transition. In CAFTA, liberalization for a few sectors begins only after the agreement has been in place for 10 years. The agreement with Morocco keeps restrictions on some especially sensitive sectors for as long as 25 years.[6] In NAFTA, Canada insisted on maintaining some of its agricultural protection, and in the recently signed US-Australia FTA, at US insistence, sugar was actually exempted.

The United States continues to subsidize farmers in ways that distort trade and production, and some argue that until these subsidies are removed, it is impossible to include agriculture in an FTA. But it is important to understand that for the most part, exported American farm products are sold basically at world prices. While farmers sometimes receive additional payments, these affect the prices at which they sell only to the extent that US subsidies lower the world price. Studies suggest that US payments do reduce world prices, but the effects are smaller than many discussions imply. Bruce Gardener of the University of Maryland has estimated that the 2002 US farm bill reduced world prices by 6 percent; the US Economic Research Service has estimated price effects of 1.5 to 4 percent for grain and soybean and up to 10 percent for cotton (Hathaway 2002). For Egyptian farmers, who are protected by tariffs that are larger than these effects, the challenge of adjusting to world agricultural prices is far greater than that of dealing with the marginal impact of US subsidies. Nonetheless, both sides could make it clear that they would continue to apply the basic principles of the WTO Agreement on Subsidies and Countervailing Measures (SCM) to all trade.[7] Aside from export subsidies, the code allows for subsidized goods to be traded unless they cause injury. In the event of injurious subsidies, each side would apply countervailing duties commensurate with the subsidies, thereby leveling the playing field.

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6. For two poultry products, the agreement sets up two Moroccan tariff rate quotas (TRQs), under which out-of-quota tariffs would be eliminated over 19 and 25 years respectively. A 19-year TRQ has been created for US exports of whole birds, and a 25-year TRQ for exports of US leg quarters. These are the two most sensitive poultry products for Morocco. See http://subscript.bna.com/samples/itr.nsf/searchallview/652F995F8DCOFB5785256E4C00788398?open&highlight.

7. Under the FTAs signed by the United States, countries continue to apply their anti-dumping and countervailing duty laws.

Services

Existing FTAs include broad commitments to open services markets. They use a "negative list" approach, meaning that all sectors are covered unless specifically excluded. Key services covered include audiovisual, telecommunications, computer and related services, distribution, construction, and engineering. Significant measures are also included for opening up financial services, such as banks, insurance, and securities, and for an open and competitive telecommunications market. These reforms would introduce new competitors, ideas, and technologies.

The agreements also provide benefits for businesses wishing to supply cross-border services (for example, by electronic means) as well as businesses wishing to establish a local presence. The secure market access given to these dynamic Egyptian sectors would help stimulate investments by both Egyptian and foreign firms. Egypt would also be able to secure greater access to visas for supply of services in the United States.

Many Egyptian services sectors remain closed, and an agreement would help open them to foreign competition and investment. In these cases, opening up to the United States would not lead to trade diversion. Moreover, in sectors where there is a foreign presence, if regulations that curtail competition were lifted, all who compete would benefit.

Regulatory Transparency

The US-Morocco agreement contains "strong and detailed disciplines" for regulatory transparency. Improving transparency in the Egyptian regulatory system would benefit not only US exporters and firms but also all domestic and international firms subject to these regulations.

Foreign Investment

Foreign investors bring much-needed capital, so a key priority must be to stimulate domestic and foreign investment. Egypt and the United States have a bilateral investment treaty (BIT) in effect since 1992, the first of a large number of such agreements that the United States signed. However, the US-Egypt BIT is less comprehensive than more recent BITs. Investment was excluded from the US-Jordan agreement on the grounds that the countries had negotiated a BIT only a few years earlier, but in the US-Egypt case it would be preferable to have investment rules incorporated in an FTA. This would allow for an updating of the BIT and the inclusion of investment provisions in the general dispute settlement provisions of the agreement.

The United States has signed agreements that included investment provisions; these give investors from the United States and the participating country, in almost all circumstances, the right to establish, acquire, and

operate investments on an equal footing with local investors and investors from other countries. The agreements contain quite extensive provisions relating to expropriation. All of these rights are reinforced by a transparent, impartial procedure for dispute settlement.[8] Similar regulatory changes in a US-Egypt FTA could help attract FDI. In response to the liberalization that has already taken place, foreign investment has increased in recent years, but its aggregate level is remarkably small.[9] Foreign investors have faced numerous discriminatory obstacles in addition to those that confront Egyptian firms. A binding agreement and a permanent commitment to provide national treatment in most sectors could go a long way toward eliminating these disadvantages. With Egypt's secure access to the US market and an improved operating environment, US firms would start to view Egypt as a far more attractive base for serving the world market. Meanwhile, having implemented such changes for US investors, Egypt could provide similar benefits to other foreign firms.

Governance

The US-Morocco agreement requires the publication of laws and regulations governing trade and investment, as well as publishing proposed regulations in advance to provide an opportunity for public comment. Governments agreed to establish criminal penalties for bribery. Similar agreements in a US-Egypt FTA would benefit both domestic and foreign participants in the Egyptian economy.

Government Procurement

Existing FTAs include disciplines on the securing of most government purchases. These require national treatment of firms for purchases in

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8. In its WTO accession agreement with the United States, with respect to foreign investment, "China agreed to eliminate export performance, local content and foreign exchange balancing requirements from its laws, regulations and other measures, and not to enforce the terms of any contracts imposing these requirements. China has also agreed that it will no longer condition importation or investment approvals on these requirements or on requirements such as technology transfer and offsets. China has further agreed that it will only impose, apply or enforce laws, regulations or other measures relating to the transfer of technology that are not inconsistent with the TRIMs Agreement (or the TRIPs Agreement)." www.usutc.org/trade/wto/China_WTO_compliance_report.pdf.

9. The gross product of US majority-owned foreign affiliates amounted to 0.1 percent of GDP in 1994 and 0.4 in 2001. According to its most recent survey, the US Bureau of Economic Analysis reports that in 2001, US firms had majority-owned foreign affiliates with assets of $33.4 billion in China and $13.53 billion in Egypt; their sales were $32.5 billion and $7.6 billion and net incomes were $1.8 million and $0.265 million, respectively. Chinese firms shipped goods valued at $2.9 billion to the United States compared with just $140 million from Egypt. They employed 273,000 in China and 77,000 in Egypt (BEA 2003).

excess of certain monetary thresholds. In addition, there are strong and transparent disciplines on procurement procedures, such as timely and effective bid review processes and requirements for advance public notice of purchases. By signing such an agreement, Egypt would be able to rationalize its own public procurement system.

State-Owned Enterprises

One of Egypt's most crucial economic reforms is in the area of state-owned enterprises. The key challenge is to free firms from political intervention and allow them to operate on a commercial basis. Privatization is one way to do this, but even without a change in ownership, these enterprises need to be transformed. A commitment to do this could readily be introduced into an FTA. When the United States negotiated the agreement for China's accession to the WTO, it was forced to deal with the extensive role played by state-owned enterprises in that economy. Accordingly, in its accession agreement, China agreed that laws, regulations, and other measures relating either to the purchase, commercial sale, and production of goods or to the supply of services, whether for commercial sale by state-owned (and state-invested) enterprises or for nongovernmental purposes, would be subject to WTO rules. China also agreed that "state-owned enterprises must make purchases and sales based solely on commercial considerations, such as price, quality, marketability and availability, and that the government will not influence the commercial decisions of state-owned enterprises."[10] A US-Egypt FTA could include similar conditions.

Standards

The agreements include provisions for technical standards and sanitary and phyto-sanitary standards (SPS). Developing countries often view these as creating barriers to their exports. But for the most part, meeting such standards is a prerequisite for international competitiveness, since developed countries will not relax them for imports. International experience also suggests that deep integration agreements can trigger major improvements in standards and product quality. Mexico has successfully used NAFTA to raise standards and improve regulation. Sen (2003) emphasizes the extent to which the Free Trade Commission formed as a result of NAFTA and various other trilateral committees adopted a problem-solving approach to regulatory issues, obviating the need for dispute settlement mechanisms. NAFTA established an SPS committee, nine technical working groups, and a committee on standards-related measures

10. See www.usutc.org/trade/wto/China_WTO_compliance_report.pdf.

with associated subcommittees that meet regularly to discuss implementation issues: "The mechanism, which has a strong problem solving ethos, works to support improving the application of SPS provisions and in reducing regulatory discretion" (Sen 2003). Similarly, as noted by Salazar-Xirinachs and Granados (2004), "The experience of NAFTA in the environmental area shows that NAFTA's environmental institutions have been partly responsible for deepening the level of technical cooperation on environmental protection between the US and Mexico."

Intellectual Property

One controversial area of the existing FTAs deals with the inclusion of rules for intellectual property protection. Egypt's present law protects intellectual property rights and provides national treatment for products of other countries (Subramanian and Abd-El-Latif 1997). Egypt reiterated these commitments when it signed the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). The catch, however, was that TRIPS provided for a transition period, starting in 1995, during which pharmaceutical patents could be put in a "black box" for 10 years by countries that did not previously grant patent protection (including Egypt). A similar time frame was required for getting approval for commercial marketing of patented products in developed countries. Debate over this issue was intense in Egypt due to concern about the negative impact it would have on the pharmaceutical industry and consumers as prices of pharmaceutical products increased. Egypt today is much better prepared for an agreement than it might have been a decade ago. Nonetheless, the agreements recently signed by the United States not only require protection for trademarks, copyrights, and patents but also demand strict enforcement of these provisions, including criminalizing end-user piracy and allowing for both statutory and actual damages under law. Some of these provisions in a US-Egypt FTA would go further than TRIPS and could increase Egyptian obligations in what is still a controversial area. It would behoove Egyptian negotiators to be particularly wary.

Labor and Environment

There are many misconceptions about what the labor and environmental provisions of an FTA would include. It is important to emphasize first that none of the agreements signed by the United States require adherence to specific environmental and labor standards.[11] Instead, the agreements

11. The US-Singapore FTA states, for example, that the parties "shall strive to ensure" that their labor laws are enforced and consistent with the right of association, the right to organize and bargain collectively, the prohibition on forced labor, a minimum age of employment, and acceptable work conditions.

commit countries to promote workers' rights and protect the environment generally, saying only that each government should enforce its own domestic environmental and labor laws and not weaken laws or reduce domestic labor protection to encourage trade or investment.[12]

Moreover, when it comes to enforcement, the agreements stress that "the parties retain the right to make decisions regarding the allocation of resources to enforcement with respect to labor (or environmental) matters determined to have higher priorities" (CAFTA Chapter 16, Article 16.2 1 (b)). To be sure, these obligations are backed by the agreements' dispute settlement procedures, and cases can be brought where enforcement failures affect trade.[13] However, if one party is found guilty of such infractions and fails to come into compliance, the other party may not be entitled to retaliate with trade protection. In CAFTA, if a country is found by a panel to be in violation of its enforcement obligations, it is subject to a monetary assessment of no more than $15 million, and the funds are not necessarily paid to the other party but may instead be used to help improve compliance.

Introducing labor and environmental standards into trade agreements is extremely controversial. Basic principles of fiscal federalism indicate that the scope of governance should match the scope of the problem and that national rather than international rules are best suited to deal with environmental problems confined to one nation. This is particularly important when countries at very different levels of economic development wish to make very different choices regarding standards and rules. Efforts to harmonize or raise standards could unfairly penalize poor countries with limited means. Even when environmental problems have an international or global scope, it is better to deal with them through explicit environmental agreements such as the Kyoto Protocol than through trade agreements. Similarly, it is better to have labor standards determined nationally, particularly when they only affect domestic workers. To be sure, some standards are best viewed as so fundamental that they should be matters of international concern, but it may be better to deal with such core labor standards through the International Labor Organization than the WTO.

Nonetheless, there is political support in the United States for introducing labor and environmental rules into bilateral trade agreements. Given these pressures, the particular formulation described above has some virtues. First, it encourages but does not require adherence to specific

12. CAFTA states, for example, "A Party shall not fail to effectively enforce its labor laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the parties" (Article 16.2. Part 1 (a)).

13. The US-Singapore FTA requires each party to "not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the parties. . . ."

environmental or labor standards and therefore accommodates diverse national circumstances. Second, it allows action with respect to nonenforcement but only where it affects trade; it also gives countries room to argue that they have limited resources and that their enforcement efforts may have different priorities. Third, breaches do not lead to trade sanctions and should therefore not become a disguised form of protectionism. Monetary assessments are capped and not necessarily paid to the complaining country. Finally, there are usually provisions for cooperation and aid to improve domestic enforcement capacity. On balance, the costs of signing such an agreement are unlikely to be large, and it could help win political support from (and provide cover for) members of Congress with strong labor and green constituents.

Conclusion

It is clear from even this partial list of the essential elements of an FTA with the United States that Egypt could use an agreement to bolster and accelerate many dimensions of economic reform: tariffs, taxes, agriculture, foreign investment, government procurement, regulatory policy, competition policy, and public-sector enterprises. Egypt would probably have to accept obligations in the areas of intellectual property, labor, and environment that it might not welcome. However, the obligations would relate primarily to enforcement and not to specific rules and in the event of breach, would not give rise to trade sanctions.

We close here with three final observations. The first relates to the importance of complementary action. Signing trade agreements is not a panacea; it cannot ensure that the institutions necessary to capitalize on reform will be in place. It can provide opportunity and stimulus, but domestic policy must follow through, and a failure to do so could worsen conditions. Thus, an agreement to place public-sector undertakings on a commercial basis must be accompanied by the creation of appropriate institutions and policies to regulate and police competition; an agreement to open domestic markets should be accompanied by programs to help small producers become more competitive; and an agreement to eliminate or reduce tariffs must be accompanied by the implementation of offsetting taxes. All these measures will take time and require financial, political, and intellectual resources. Without them, the agreement is unlikely to be implemented effectively. Accordingly, the use of trade agreements as an instrument for reform requires particular preconditions and may not be appropriate for all countries. Even if most of the changes called for in an FTA with the United States are desirable, it is crucial that the agreement require changes at an appropriate time—and that sufficient time be given to adequately prepare for the changes. Sometimes, as they say, a kick in the pants gets you going; other times, it just hurts.

The second type of crucial complementary action relates to extending the benefits accorded to the United States to other foreigners. In an FTA, nothing prevents Egypt from avoiding excessive dependence on the United States by additional liberalization. An FTA with the United States should be but one component of a broader strategy to immerse Egypt in the global economy. Opening to the United States should be accompanied by similar measures, both unilateral and through negotiations with other countries.

A key virtue of many of the institutional changes implied by a deeper agreement is that by changing administrative practices in Egypt, they would automatically or fairly easily facilitate trade and investment with other trading partners both inside and outside the region. If Egypt's customs or standards practices were streamlined, all who used them would benefit. If its intellectual property rules were changed, all outsiders would gain. If regulatory reform made its markets more accessible, firms from all nations would find it easier to enter and compete. Other components of an agreement, such as rights granted to foreign investors, could readily be extended by Egypt on a MFN basis to all investors—a move Mexico made when agreeing to NAFTA.

For the United States, the more comprehensive the agreement, the easier it will be to accept. A deeper agreement with Egypt would extend US trade policy even further along the multitrack approach by which freer trade and investment are achieved through both bilateral and multilateral means. The specific agreement with Egypt could also be a model for FTAs with other countries in the Middle East.

Finally, the provisions introduced into other US FTAs such as NAFTA are not simply a matter of principle. They reflect the coalition of interests that support FTAs in the United States, and the minimum measures required to placate those who are opposed. US multinationals interested in using Egypt as an export platform to serve both regional and US markets need assurance of a hospitable regime. They require protection for intellectual property, national treatment, and rights to operate under nondiscriminatory conditions. The agreement may also need to include provisions on labor and environmental policies, although these are bound to be more controversial.

The US-Egypt FTA should therefore be an example of deeper international integration, involving legally binding commitments enforced by dispute settlement procedures and possibly trade retaliation. Reflecting its status as a developing country, Egypt should be given longer adjustment periods. Nonetheless, once the FTA has been fully phased in, both sides should generally assume symmetrical commitments to realize the FTA's full economic benefits. But what might those benefits be? And how will they be affected by the array of free trade and association agreements that both partners currently have? Chapter 4 seeks to answer these questions.