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Summing Up

The success of any US strategy in the Middle East and North Africa (MENA) region depends importantly on the future course of US-Egypt economic relations. Deepening bilateral ties now can pay both commercial and political dividends in the future. This is particularly important given the lingering effects of the global financial crisis and the ongoing unrest in the Middle East and Egypt's pivotal role in promoting negotiations to resolve problems in Gaza and elsewhere in the region.[1]

President Obama has given high priority to launching a new Middle East initiative and reviving peace talks. Special envoy George Mitchell, former Senate majority leader, has been tasked with forging a new US policy that contributes to regional stability and economic development. The Obama administration is working with Egypt to define the shape of a new economic partnership between the two countries.

The time is ripe for the United States to supplement its diplomatic strategy with a Middle East economic development strategy. As we have argued in this Policy Analysis, enhancing economic relations with Egypt is an essential component of such a strategy. US economic relations with Egypt need to be refocused and reenergized. US-Egypt economic ties are no longer defined by the large-scale US economic and military aid that was instituted to smooth the implementation of the peace accords and to counter the sanctions of countries opposed to that reconciliation. Nor is a bilateral trade pact adequate to address the myriad economic, political,

1. At a press conference at the end of her second trip as secretary of state, Hillary Clinton thanked the Egyptian government for its help in brokering the Israel-Palestinian ceasefire and more broadly for its "commitment to bridging the divides and ending the conflict"; see Hillary Clinton, press conference at the end of Gaza Reconstruction Conference, Sharm El Sheik, Egypt, March 2, 2009, available at www.state.gov (accessed on November 9, 2009).

and social challenges facing Egyptian society. The approach needs to be more comprehensive.

Three decades after the Camp David accords, the peace dividend from that visionary compact has yet to be fully realized. As economic reforms were picking up steam in the mid-2000s, US aid to Egypt continued to fall. Despite notable economic progress since 2004, poverty remains too high and investment too low. In the absence of a more comprehensive cooperation package to replace US aid, US support was greatly reduced. It is fair to ask whether greater US support in certain areas could have helped strengthen the reform process and allowed the reforms to deepen.

The United States has a vested interest in helping Egypt through enhanced commercial ties to develop its economic potential and improve the living standard of its people. In so doing, the expanded US-Egypt partnership would 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.

Currently, 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), though larger than other US free trade agreement (FTA) partners in the MENA region (Bahrain, Jordan, Morocco, and Oman). In recent years US exports have benefited from strong commodity prices and grown modestly; by contrast, the value of Egyptian shipments to the United States has been flat—even though exports from qualifying industrial zones (QIZs) are up markedly since 2005. Amid the current global economic crisis, bilateral trade is down about 5 percent so far in 2009 compared with 2008.
- US direct investment in Egypt, valued at $8.8 billion at end 2008, is exceeded in the MENA region only by US investments in Israel and Qatar. However, US investment is highly concentrated with little activity outside of the petroleum sector. Prospective regulatory reforms could yield lucrative new opportunities for US investors in Egypt's manufacturing and services industries.
- The United States has provided around $50 billion in economic and military assistance to Egypt over the past three decades. However, the annual disbursements have been reduced sharply over the past five years and totaled $415 million in FY2008. This trend could be more than offset by financial and technical assistance from US firms supported by the enhanced US-Egypt economic partnership.

In short, bilateral trade and investment, and US aid to Egypt, are significant but less than one would expect with such a populous and strategically located country. The United States and Egypt already have in place numerous trade and investment accords that cover bilateral commerce. These pacts have value but need to be updated and augmented. Simply put, there is substantial room to grow or deepen the bilateral relationship for mutual benefit.

What needs to be done? As we have argued in this Policy Analysis, reengaging Egypt will require an economic strategy that builds upon but goes beyond past initiatives. The "traditional" approach of negotiating an FTA—on the backburner since late 2005—is not a practical option, given the current economic crisis and the continuing divisions in US trade politics, even though it should remain on the medium-term bilateral agenda. In the interim, we suggest other actions—discussed more fully in the previous chapter—organized into three tranches that could be implemented sequentially or concurrently.

The first tranche covers measures to liberalize trade. These include further expanding the QIZ program; modernizing the bilateral investment treaty; and negotiating a bilateral services trade agreement with an emphasis on key sectors such as transportation, construction, electricity, and communications.

The second tranche includes measures to facilitate trade that can be implemented without legislative approval. Such measures can improve efficiency in key areas such as customs reform and modernization. Technical and administrative support is also needed to help Egypt implement and enforce intellectual property rights.

The third tranche includes activities designed to improve Egypt's business climate. The activities we have identified in this analysis include cooperation in investing in infrastructure and human capital, with a view to alleviating Egypt's unemployment and poverty.

What will the United States need to do to advance this agenda and deepen the partnership with Egypt? Several specific actions should be pursued to expand bilateral trade and investment and to broaden the scope of development assistance.

First, the United States should approve additional QIZ sites with a view to expanding trade and investment opportunities beyond the traditional focus on textiles to sectors where Egypt has a revealed comparative advantage such as prepared foods and stoneware.

Second, 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 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.

Third, US officials should strongly consider the participation of Egypt for programs funded by the Millennium Challenge Corporation (MCC).

Egypt exceeds most of the requirements for MCC participation and has made great strides in the main criterion, market reform. MCC funds target the types of development activities needed for Egypt to encourage new investment in infrastructure and human capital/education. Overseas Private Investment Corporation (OPIC) programs to support residential investment could complement these initiatives.

Egypt, for its part, will need to do some homework to take better advantage of expanded access to the US market and to consolidate its economic reforms. In particular, Egyptian officials should mount a large-scale effort to disseminate information on the QIZ program and assist companies, including non–textile and apparel companies, to establish in these zones. Companies in industries in which Eygpt has a high revealed comparative advantage should be particularly targeted. Expanded market access is meaningful only if companies are ready, able, and willing to exploit this program.

Egypt can also help its firms become more competitive—in the US market as well as in other markets—by reducing or eliminating some of the obstacles to trading. Chapter 3 examines 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. Finally, Egypt must 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.

Egypt and the United States should work together to amplify two areas of commercial relations: trade in services and investment. First, the United States and Egypt should negotiate an FTA in services, supplemented by technical cooperation that could help enhance Egypt's competitiveness and ability to serve as a regional services hub. For example, US assistance could help Egypt upgrade its maritime and land transportation infrastructure (which would have additional benefits for the tourism sector). Second, efforts should be made, as detailed in the previous chapter, to modernize the bilateral investment treaty. Particular attention should be given to expanding sectoral coverage, improving transparency of investment laws and regulations, and upgrading procedures to resolve disputes. While such improvements do not guarantee the attraction of new US investment in Egypt, they would send a positive signal to investors and complement the policy reforms under way or under consideration in Egypt.

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. Reinforcing the important economic reforms being pursued by the Egyptian government helps Egypt and is good for the United States as well; the United States benefits when its trading partners and close allies prosper. As Ahmed Galal and Robert Z. Lawrence (2005) argued a few years ago, deeper bilateral economic ties can help anchor Egyptian reforms. Similarly, a more stable and prosperous Egypt can provide a solid foundation for building a broader US economic partnership in the MENA region.