

A REPORT OF THE CSIS
SCHOLL CHAIR IN INTERNATIONAL
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THE ROLE OF FTA NEGOTIATIONS IN THE FUTURE OF U.S.-EGYPT RELATIONS

Meredith Broadbent

Executive Summary

Egypt, a long-time ally with profound influence on U.S. security, is facing the daunting prospect of making the transition from decades of authoritarianism to democracy. The outcome of the complicated deliberations on the new government's makeup, quality, and policy orientation can be expected to consume the next several years, posing high risks, challenges, and opportunities for both Americans and Egyptians.

Understandably, the natural tendency for the administration and Congress in the face of such uncertainty is to retreat to the safety of a circumspect, more hesitant policy toward Egypt, as the United States watches and waits for all elections to conclude and for the political stripes of the new leaders to become known.

A different path, discussed here, is to demonstrate support for Egyptians during this watershed transition. In the 1970s, when Egypt made a pivot away from the Soviet bloc and then another pivot toward peace with its neighbors, the United States showed its commitment with hundreds of millions of dollars in annual economic assistance to compliment more than a billion dollars in annual military aid. In this new era, the U.S. budget environment is dramatically more constrained. Yet the importance of influencing Egypt's transition to follow a positive course is no less important than it was four decades ago.

Putting more emphasis on reciprocal economic relations, decisionmakers in the United States should consider a bold policy that (1) expresses unambiguous support for the strategic, aspirational goal of reengaging in free trade agreement (FTA) negotiations with the newly elected government of Egypt, as it works to chart its economic future; and (2) seeks consultations with Egyptians on the interim step of updating the existing bilateral investment treaty between the United States and Egypt.

For the United States, there are also strong economic and trade policy reasons for pursuing a U.S.-Egypt FTA. American companies are increasingly being put at a disadvantage vis-à-vis competing companies in Europe, which is currently negotiating to expand the EU-Egypt Association Agreement. Europe's trade agreement with Egypt has endured despite changes in political leadership and is yielding concrete commercial benefits to both parties.

Egypt, for its part, will need to reciprocate with a message that bilateral trade and investment discussions are welcome and that its government is prepared to engage. Ideally, Egypt would see

consultations on an FTA as a useful public expression that the new government seeks to build a modern, more open economy.

Admittedly, some will view these options as unrealistic, given the overall lack of decisions being made by the Egyptian government during the political transition. However, the stakes could not be higher for achieving a successful democratic transition at this juncture in Middle Eastern history. The prospect of economic success through increased ties to the West may be the one thing that keeps Egypt aligned with U.S. policy, now that the basis for the security arrangement is eroding. The United States should choose to offer a sound pathway to economic modernization and transparency, embodied by the reform commitments that would be required under a future FTA, during a time when Egyptians will be engaged in a debate on many of those same issues.

Egypt in U.S. Strategy toward the Middle East

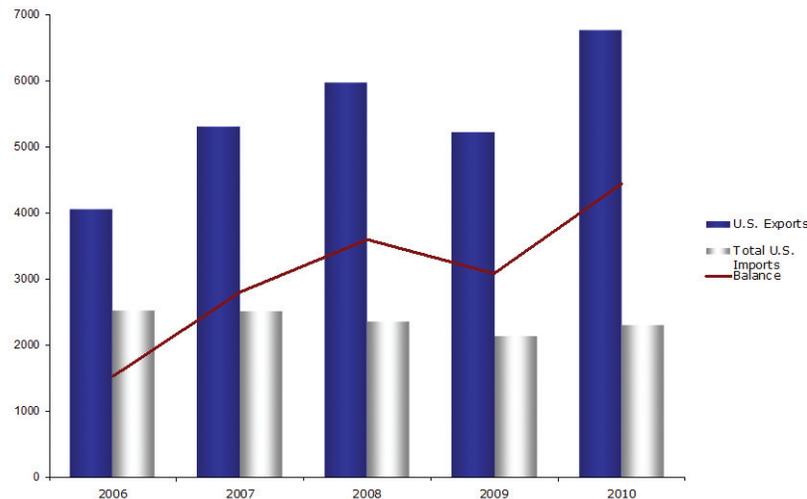
Egypt and the United States have cooperated on strategic matters since the early days of the Cold War. Spanning two continents, astride the Suez Canal, and possessing a long border with Israel, Egypt figures prominently in U.S. strategic thinking. In addition to its unique geographic position, with 80 million people, Egypt is by far the largest Arab state, more than twice as big as any other. Egyptians dominate the regional media environment as well as the arts, and in many Gulf Cooperation Council states, they dominate the professional ranks of teachers, doctors, lawyers, and accountants. By custom, Egyptian diplomats have headed the League of Arab States (except for an interregnum after Egypt's peace agreement with Israel), and Egyptian diplomats have led the effort to make the Middle East a region free from weapons of mass destruction. It is not an overstatement to say that Egypt is the center of gravity for the Arab world. For decades, Egypt's stolid politics provided certainty and stability to many smaller states afraid of being cast aside by the winds of regional politics. That Egypt experienced a sudden and profound political shift shook all of the regional governments to their core.

U.S. diplomacy toward Egypt has blended military and economic engagement. The Arab states have never fought a war with Israel that has not involved Egypt, evidence that the strong relationship between the United States and Egypt's military-led government, forged over many years, has been a triumph of U.S. diplomacy. U.S. military assistance plays a major role in Egyptian procurement, improving quality, relieving important budget pressure, and insuring interoperability with U.S. troops. The \$1.3 billion in annual military assistance that the United States has given Egypt since 1979 has also helped ensure that the U.S. military receives expedited passage through the Suez Canal and over flight rights for a range of Middle Eastern engagements. As Egypt began to battle religiously inspired terrorism in the 1990s, intelligence cooperation between the United States and Egypt grew, given their common goals and common enemies, and this further deepened the strategic alignment of the two states.

Economically, the United States has been a large donor to Egypt, sometimes straining the absorptive capacity of the Egyptian economy. For twenty years after the 1979 Camp David peace treaty between Egypt and Israel, the United States gave Egypt \$800 million per year, ranging across a variety of trade, economic, health, and education activities. Beginning in 1994, the two countries established the Gore-Mubarak Partnership (named after the U.S. vice president and Egyptian president at that time) to facilitate bilateral investment and Egyptian economic growth. While the

partnership lapsed into inactivity, it was by mutual agreement in 1999 that the United States began a ten-year reduction in economic assistance to Egypt. This support now stands at \$250 million a year, still among the largest of U.S. economic assistance programs.

Figure 1. U.S.-Egypt Trade (in millions of U.S. dollars)



Source: Data from the U.S. International Trade Commission; graphs provided by Advocacy by Design.

Egypt as a Promising Emerging Market

Between 2005 and early 2011, macroeconomic indicators in Egypt were strong and continually improving. Prior to the revolution, the public debt to GDP ratio was declining steadily from 104.7 percent to 80.5 percent.¹ Between 2005 and 2008, Egypt implemented a full array of difficult market-oriented reforms, including reductions in corporate and personal taxes to globally competitive rates, modernized insurance regulations, and the privatization of several large government enterprises. According to the International Monetary Fund, “A wide range of productive assets, including joint venture banks and the fourth largest state bank, were privatized, resulting in more than half of the banking system being placed in private hands.”²

In recent years, Egypt opened its economy extensively to trade and global competition. Although many non-tariff barriers remain, Egyptian tariffs have dropped steadily since 2005 from a 14.6 percent weighted average tariff rate to 5.5 percent in 2009. Improvements were made in

1. Michele Dunne, Jeffrey Gedmin, Marek Dabrowski, Uri Dadush, Hafez Ghanem, Mara Revkin, Dalibor Rohac, Dessy Roussanova, Michal Safianik, and Tarik Youse, “Egypt’s Democratic Transition: Five Important Myths about the Economy and International Assistance,” Legatum Institute and Carnegie Endowment for International Peace, July 2011, http://carnegieendowment.org/files/Egypt's_Democratic_Trans_UK16ppWEB.pdf.

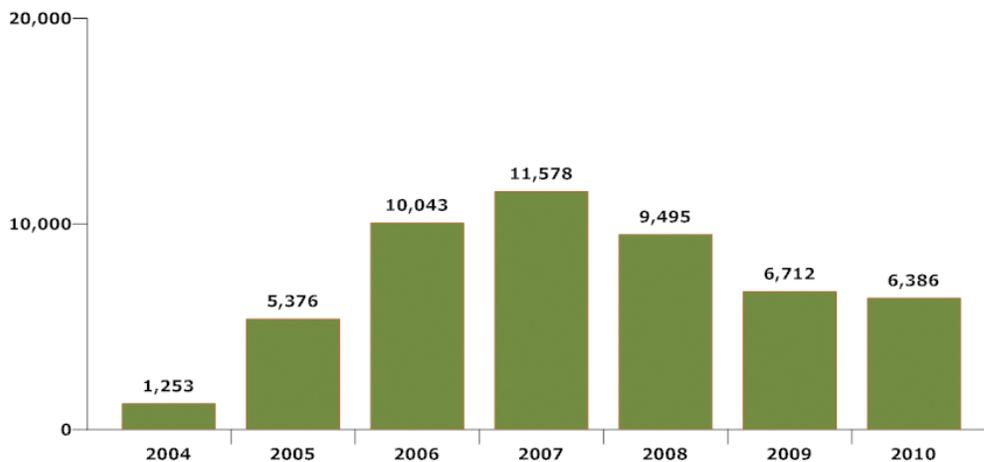
2. Klaus Enders, “Egypt: Reforms Trigger Economic Growth,” International Monetary Fund, February 13, 2008, <http://www.imf.org/external/pubs/ft/survey/so/2008/car021308a.htm>.

the areas of burdensome government bureaucracy, nontransparent sanitary and phytosanitary measures, import licensing requirements, and the enforcement of intellectual property protections. The government established a “one-stop shop” for business investment and reduced the time required to launch a business to seven days from the nearly six weeks it took in 1995.

According to the *Index of Economic Freedom*, just prior to the revolution Egypt had succeeded in creating a “vibrant entrepreneurial environment.”³ Overall, the country was named a top economic reformer for four out the last seven years by the World Bank’s *Doing Business*, making it one of the most consistent reformers in the Middle East and North Africa.⁴

While significant elements of a heavy-handed statist bureaucracy remain, international investors rewarded Egypt’s progress in liberalizing and modernizing its economy. Investors contributed to a 7 percent annual growth rate between 2005 and 2008. Growth even held steady at 5 percent during the downturn of the global economy in 2008.

Figure 2. Foreign Investment into Egypt (net inflows, in millions of U.S. dollars)



Source: Data from the World Bank; graphs provided by Advocacy by Design.

Economic Implications of January 25

In the early months following January 25, Egyptians were seized by optimism about the opportunities for political reform, transparency, and democracy. U.S. companies report, however, that the optimism has been replaced by a creeping sense of frustration and concern. An improving macroeconomic picture prior to the revolution has given way to burgeoning macroeconomic imbalances and capital flight. There is danger that a budget crisis could lead to a collapse of

3. Heritage Foundation, “2011 Index of Economic Freedom: Egypt,” <http://www.heritage.org/Index/Country/Egypt>.

4. World Bank, “Doing Business, Egypt, Arab Rep.,” 2011, <http://www.doingbusiness.org/data/exploreconomies/Egypt>.

confidence in the Egyptian pound, resumption of capital flight, a resort to printing of money, and hyperinflation.⁵ Economic growth was less than 2 percent for the year ending in July. According to press reports, the interim government has spent about a third of the government's reserves and driven up interest rates by borrowing.

Conversations with business leaders on the ground in Egypt applaud the country's economic reforms of the last decade, but point out that the economic benefits of strong growth rates were captured by a closed section of the society, never reaching large swaths of the population that remain trapped in poverty.

Given the growing weakness of the government, a lack of economic growth in Egypt is a major concern. As the domestic security situation continues to deteriorate, strikes are rampant in many sectors. A regional manager from a consumer products company observed, "Without economic growth, there is practically no way to address grievances that have accumulated for years."⁶

If political transformation is to succeed, Egyptians must work to safeguard the positive economic reforms that, in the years before the revolution, brought economic growth and stronger, more globally competitive industries to Egypt.

Why Egypt as a Potential U.S. Free Trade Agreement Partner?

As the center of gravity of the world economy shifts east and south from the developed markets that have dominated trade flows since the 1950s, U.S. companies and investors are assessing which countries to prioritize for expanded trade and investment links. The wild-growth BRIC markets (Brazil, Russia, India, and China) have been standard priorities for companies and investors seeking better future returns. But in the past few years, key companies, banks, and investment houses, taking a longer-term view, began identifying a "new group of emerging market dynamos," which includes Egypt.⁷

This new group, CIVETS—an acronym coined by Robert Ward, director of global forecasting for the Economist Intelligence Unit—includes Colombia, Indonesia, Vietnam, Egypt, Turkey, and South Africa. These are "the new BRICs" described by Michael Geoghegan, HSBC Holdings's group chief executive, during a speech in Hong Kong in 2010. "Each has a diverse and dynamic economy. Each has a bright future. Any company with global ambition needs to act now in regards to these markets," he said. His analysis delineates how each of the CIVETS sits in a geostrategic location and "has instilled confidence to attract drastically increasing levels of investment."⁸ According to the Economist Intelligence Unit, CIVETS are expected to have average annual growth rates of nearly 4.9 percent, while developed countries will be lucky to achieve 1.8 percent yearly growth rates going forward.⁹

5. Uri Dadush and Michele Dunne, "American Response to the Arab Spring: What's the Big Idea?" *Washington Quarterly* 34 (2011): 4, 135.

6. Interview with the author, October 10, 2011.

7. Michael Geoghegan, "From West to East," speech to the American Chamber of Commerce, Hong Kong, April 27, 2010.

8. *Ibid.*

9. Economist Intelligence Unit, "World Economy: Beyond BRICS," July 23, 2010, http://viewswire.eiu.com/index.asp?layout=VWArticleVW3&article_id=1027296087®ion_id=1510000351&country_id=&channel_id=190004019&category_id=&refm=vwCh&page_title=Article&rf=0.

Table 1. CIVETS: 2010 Performance Indicators

	Population (m)	GDP per Head (US\$, PPP)	Consumer Price Inflation (% , av)	Budget Balance (% of GDP)
Colombia	46.9	8920	2.6	-3.9
Indonesia	243	4230	5.1	-2.2
Vietnam	87.8	3150	9.3	-7.7
Egypt	84.7	5910	11.8	-8.7
Turkey	73.3	12740	8.7	-4.5
South Africa	49.1	10730	5.8	-6.3

Source: Economist Intelligence Unit.

Goldman Sachs identified Egypt as a part of its Next-11 grouping, made up of countries that have large, growing populations and the potential to greatly impact the global economy.¹⁰ Although countries like Egypt are not as large in population as the BRICs, emerging market investment analysts were predicting earlier this year that they could be expected to follow in the suit of the BRIC powerhouses, becoming key contributors to the next period of sustained global economic growth. Indeed, these analysts believe that the new CIVETS have the potential to outperform the now well-established BRICs.

That Egypt appeared as a chosen market out of the 95 or so developing countries struggling to climb out of poverty, and was placed within the ranks of developing country success stories like Turkey and Colombia—not to mention South Korea—is a testament to the value of the difficult reforms adopted by the Egyptians during the five years preceding the January revolution.

Egypt's moniker as a premier market of the future continues to grow despite political disruptions resulting from the January 25 revolution. Writing in October 2011, the HSBC Trade Forecast anticipates that "Egypt, India, Vietnam, Indonesia, China and Brazil will be the international powerhouses that drive world trade growth between 2011 and 2025."¹¹ According to this analysis, Egypt's anticipated success is "driven partly by the country's redevelopment following the Arab Spring of 2011 but also because other countries around the world are seeing Egypt as a platform into the Middle East." Among all emerging markets, Egypt is predicted to be the country with the fastest growth in international trade volumes—albeit from a low base of 185 percent—by 2025.¹²

All this is to say that if the United States is looking for promising developing countries that will be integrating into the global economy, Egypt should continue to be on a short list of countries to consider. Policymakers in Egypt should take into account that the positive economic reforms that attracted capital, resources, and know-how to Egypt have enhanced its reputation as a market with exceptionally strong growth prospects.

10. The N-11 countries are Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey, and Vietnam (http://www2.goldmansachs.com/gsam/individuals/products/growth_markets/n11/index.html).

11. "HSBC Trade Connections: Trade Forecast Quarterly Update," HSBC Commercial Banking, October 2011, <http://www.deltaeconomics.com/Uploads/Misc/Global%20Trade%20Forecast%20-%20FINAL%20-%202006.10.11.pdf>.

12. Ibid.

Table 2. Egyptian and U.S. Imports, 2010 (in millions of U.S. dollars)

	Egyptian Imports 2010				U.S. Imports 2010		
	What Egypt Imports from the World	What the United States Sends to Egypt	U.S. Market Share		What the United States Imports from the World	What the United States Imports from Egypt	Share of Total U.S. Imports from Egypt
AGRICULTURAL & LIVESTOCK	6144.1	1502.2	24%	AGRICULTURAL & LIVESTOCK	28001.2	22.8	0.08%
BOOKS/PAPER	1280.7	93.3	7%	BOOKS/PAPER	19866.9	22.2	0.11%
CERAMIC	123.3	2.2	2%	CERAMIC	4490.9	0.6	0.01%
CHEMICALS	6695.4	651.6	10%	CHEMICALS	200115.5	277.5	0.14%
COTTON/TEXTILES	2907.4	67.2	2%	COTTON/TEXTILES	95161.7	1064.9	1.12%
ELECTRONICS/MACHINERY	13577.7	959.6	7%	ELECTRONICS/MACHINERY	772908.2	8.2	0.00%
FOOD	4119.6	390.7	9%	FOOD	68228.9	46.9	0.07%
FUEL	7130.7	227.2	3%	FUEL	336246.5	785.1	0.23%
GLASS	156.6	2.7	2%	GLASS	5277.9	2.5	0.05%
METALS	7197.4	904.4	12.6%	METALS	147985.7	22.1	0.01%
OTHER	3670.5	160.8	4.4%	OTHER	164726.5	59.2	0.04%
TOTAL	53003.4	4961.9	9.4%	TOTAL	1843009.8	2312.0	0.13%

Source: Data from UN Comtrade Imports as reported by Egypt and from U.S. International Trade Commission; tables provided by Advocacy by Design.

U.S. Trade Agenda under Review

If the new leadership in Egypt showed interest in negotiating an FTA with the United States, it is legitimate to ask whether the United States would be in a position to seize the opening. Negotiating an FTA with Egypt is a budget-neutral, economic approach to a serious strategic challenge. However, the question remains, is there enough domestic political support for new trade agreements in the United States?

Until recently, the U.S. trade agenda was lagging. Congress just completed the controversial process of approving FTAs with Korea, Panama, and Colombia, which were negotiated in 2006 and 2007. Multilateral negotiations in the World Trade Organization (WTO) on the Doha Round are in a state of virtual suspension in Geneva. President Barack Obama's administration is pursuing negotiation of a so-called 21st-century trade agreement with eight other countries in the Trans-Pacific Partnership Initiative (TPP), but there is no scheduled conclusion. Even so, Congress has not authorized new trade negotiations since 2002.¹³

During the same decade, the relative share of the U.S. economy and its consumers in the global economy has fallen as emerging markets continue to expand. Demographers expect that the middle class in developing countries will triple from its 2005 level, reaching 1.2 billion in 2030.¹⁴ This group, comprising 15 percent of the global population, will enjoy increasing purchasing power, demand high quality products, have the ability to travel abroad, and seek higher education. Yet, with the delay in passing the FTAs, a comprehensive global trade strategy for the United States that takes these dramatic changes in the world economy into account has yet to be formulated.

13. *U.S. Trade Act of 2002*, Public Law 107-210, 107th Cong., 2nd sess. (2001).

14. International Bank for Reconstruction, *Global Economic Prospects: Managing the Next Wave of Globalization* (Washington, DC: World Bank, 2007), xvi, http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/12/06/000112742_20061206155022/Rendered/PDF/381400GEP2007.pdf.

Congressional trade committees and private sector advisory groups are just now able to turn in earnest to an examination that will weigh the next targets of opportunity for possible FTA negotiations. This shift in Washington's attention, at a time when Egyptians will be moving in a new direction, presents an opportunity for both countries to choose to chart an ambitious course for bilateral trade relations.

Fortuitously for Egypt, the obvious list of target priority countries for the next generation of U.S. trade agreements is relatively short at the moment. Countries with the biggest growth markets and populations, the so-called BRICs (Brazil, Russia, India, and China) are not likely to seek FTA negotiations with the United States in the foreseeable future. The TPP contains two significant markets that are currently not U.S. free trade agreement partners—Vietnam and Malaysia—and prying open these growing and valuable markets to U.S. exports will be addressed in that negotiation.

In a speech on May 19, 2011, President Obama announced his intention to craft a comprehensive and forward-leaning trade and investment policy toward Egypt, and the Middle East and North Africa (MENA) region focusing on “trade, not just aid; on investment, not just assistance.”¹⁵ The Office of the U.S. Trade Representative (USTR) has requested comments from the public on policy suggestions for expanding trade generally with the Middle East, but has made no mention of the future possibility of reengaging the Egyptian government on FTA negotiations if there were support on the Egyptian side to do so.

Setting aside for the moment the geopolitical reasons to consider Egypt as a potential free trade agreement partner, there are clear-cut economic and trade policy arguments for working to expand the U.S. economic presence in the Egyptian market. Strong competitors such as the European Union are benefiting from active commercial engagement in Egypt.

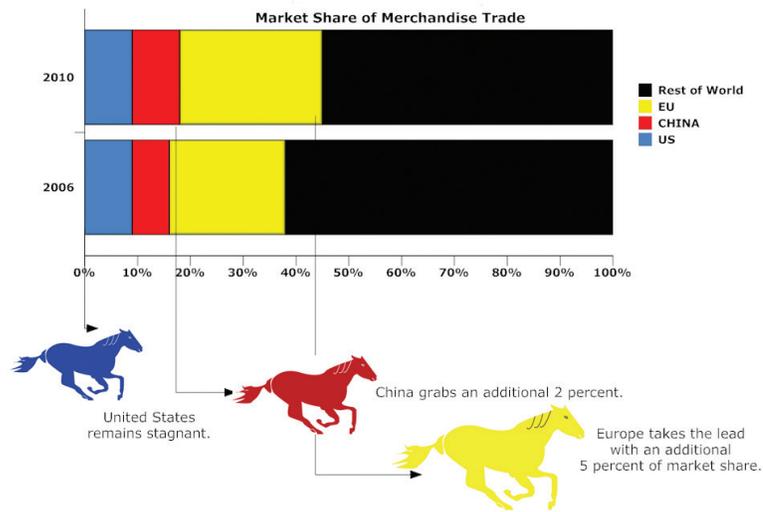
Competitive Impact of EU-Egypt Association Agreement

A substantial number of U.S. companies report that they see this regional power, located at the intersection of trade routes spanning the Middle East, Europe, and Africa, as strategically important to their global strategy. Capitalizing on its location, Egypt has built its market into a dynamic trade hub, managing commerce through the Suez Canal and stepping up to participate in an impressive network of international trade agreements with many regional trading partners. Egypt boasts membership in the Greater Arab Free Trade Area (GAFTA), Common Market for Eastern and Southern Africa (COMESA), Agadir Agreement (with Jordan, Morocco, and Tunisia), Egypt-Turkey FTA, and others.

With more than four hundred million consumers, the MENA region, which can be more easily accessed via the Egyptian market, presents large, untapped opportunities for U.S. companies. The MENA region comprises twenty countries across North Africa, the Levant, and the Gulf Cooperation Council countries. The United States already has FTAs in place with five (Israel, Jordan, Morocco, Bahrain, and Oman) and has expanded trade ties with Saudi Arabia as a result of its

15. Barack Obama, “Remarks by the President on the Middle East and North Africa,” speech, Washington, D.C., May 19, 2011, <http://www.whitehouse.gov/the-press-office/2011/05/19/remarks-president-middle-east-and-north-africa>.

Figure 3. In the Effort to Grab Egyptian Market Share, the Europeans Are Making Strong Gains



Source: Data from UN Comtrade Imports as reported by Egypt; EU (excludes Czech Republic and Estonia); graphs provided by Advocacy by Design.

negotiation to accede to the WTO. While the five existing FTAs with MENA countries have shown positive results, improving the competitive position of the United States in the region and demonstrably expanding exports, the much more diverse Egyptian economy promises to be an even more lucrative FTA partner. The region’s GDP as a whole reached \$2.4 trillion at the start of 2011, making MENA a global powerhouse, surpassing Canada as the world’s ninth largest economy.

The European Union is Egypt’s main trading partner, and the EU-Egypt Association Agreement, in force since 2004, is having a significant impact on U.S. global competitiveness that U.S. policymakers should consider. Although trade flows are just beginning to be affected by Egypt’s reciprocal tariff concessions, Europe appears to be expanding its market share in Egypt at the expense of U.S. exporters that have historically also accounted for a large share of Egypt’s imports. As in many markets, U.S. and European exporters are often direct competitors in Egypt.

Capitalizing on their proximity, the position of European exporters is strengthened further by the EU-Egypt Association Agreement (AA), which phases in a “free trade area” between the two partners with the eventual elimination of tariffs on industrial products and significant reductions in barriers to agricultural products. Under the AA, EU-Egypt bilateral trade has nearly doubled. This trade agreement, part of the larger Euro-Mediterranean Partnership (EUROMED) trade area is noteworthy in that it replaced a unilateral, developing country trade preference program under which most Egyptian exports received duty-free treatment in the EU market. Now, however, Egypt offers reciprocal tariff concessions to exports from Europe. For example, in 2007 Egyptian customs duties on imports of raw materials and many categories of industrial equipment from Europe were eliminated. Egyptian customs duties on automobile tariffs are being phased out by 10 percent a year between 2010 and 2019. Since June 2010, almost 90 percent of Europe’s agricultural exports to Egypt have been liberalized with European exports to Egypt in this sector growing more than

30 percent annually during the last three years. EU products now receiving duty benefits in Egypt include sugar, corn, potatoes, baby food, powdered milk, soybeans, peanuts, and butter.

It is noteworthy that, despite political uncertainty, Egypt has continued to fulfill its obligations under the EU-Egypt AA and has not resorted to protectionist tariff hikes or other import restrictions. European officials report that Egypt remains one of the countries most open to international trade and investment in the MENA region and that there have been good opportunities under the AA to work out constructive solutions on day-to-day issues.¹⁶

The new reciprocal concessions, which Egypt began to implement in 2007, give a competitive advantage to Egyptian exports competing with similar products from the United States. In November 2010, the EU and Egypt also signed an agreement establishing a dispute settlement mechanism applicable to bilateral trade disputes. Negotiations to open services sectors to European providers, including the important right of establishment, are ongoing.¹⁷ U.S. firms could suffer in many services sectors if Europe is able to secure better commitments than the WTO rules that will continue to apply to the United States.

The AA also establishes a system of cooperative councils and committees such as the AA Economic Dialogue and the AA Subcommittee on Industry, Trade and Investment—a committee of trade officials from Europe and Egypt that meets regularly to consider implementation matters and address barriers to trade and investment that may arise. Indeed, by virtue of the joint institutional mechanisms and the dynamic trade relationship supported by the AA, the president of the European Commission was able to travel to Cairo on July 14, 2011, in the heat of the turbulent political transition in Egypt. He offered his Egyptian trade agreement partners the opportunity to “intensify on-going negotiations on the liberalization of trade and investment and not to lose sight of our long-term vision of a full free trade zone” between the European Union and Egypt.¹⁸ This outreach exemplifies the practical lines of communication into the complex political and economic debates taking place in Egypt that are available to the EU. Similar lines of communication are not open to the United States, as we lack an FTA relationship with Egypt and so are missing the accompanying institutional networks of cooperation to work through routine issues of trade and commercial regulation.

As a result of the AA, several U.S. companies are beginning to see an erosion of their position in Egypt in the complex and commercially important area of standards. A concern of several U.S. companies is that Egypt’s previous practice of accepting both U.S. and Egyptian standards may be eroding under pressure reinforced by Article 47 of the EU-Egypt Association Agreement. It obligates the parties to “aim to reduce differences in standardization and conformity assessment.”¹⁹ In this respect, the AA agreement can be seen as part of a larger strategy by Europe to “promote global regulatory convergence including—where appropriate—the adoption of European standards internationally.”²⁰ The EU’s approach, and the leverage the AA gives it to encourage Egypt to

16. Conversation with the author, November 4, 2011.

17. Delegation of the European Union to Egypt, “Association Agreement,” http://www.eeas.europa.eu/delegations/egypt/eu_egypt/political_relations/agreements/index_en.htm.

18. Jose Manuel Barroso, “Partners in Freedom: The EU Response to the Arab Spring,” speech, Cairo, July 14, 2011, <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/11/523>.

19. Euro-Mediterranean Agreement between the European Communities and their Member States, of the One Part, and the Arab Republic of Egypt, of the Other Part, EU-Egypt, 2004/635/EC, June 1, 2004, 36.

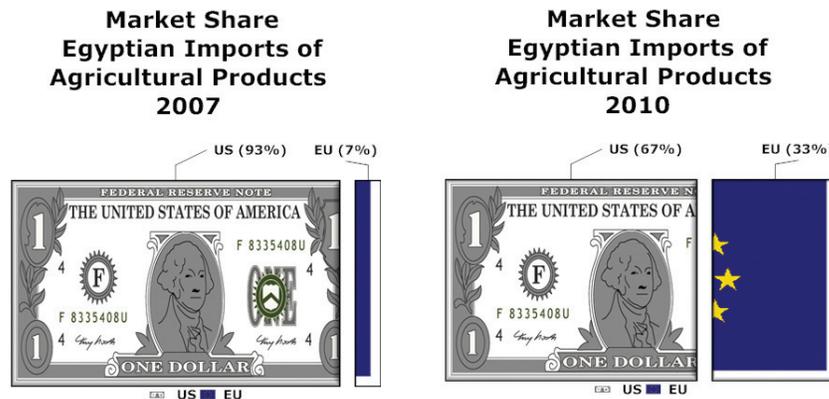
20. Commission of the European Communities, “Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee

adopt EU standards, while diminishing the acceptance of U.S. or internationally based standards, represents a strategic challenge to the United States, not just in Egypt, but also more broadly in many other markets.²¹ Using the AA as the basis for consultations, training, and capacity building, EU trade officials are more effectively positioned than U.S. officials to promote their own standards and methods of conformity assessment.

An example of an emerging discriminatory non-tariff barrier is in the area of homologation (certification) standards for automobiles that are applied in Egypt. These standards are based on European “CE” standards, and competing exports from the United States are deemed incompatible by Egyptian regulators, although in many cases U.S. standards are more rigorous and comprehensive. U.S. companies report that while automobile standards based on the European model are not fully implemented in Egypt, partial implementation (particularly with respect to car parts and accessories) is causing difficulty and uncertainty for U.S. automobile exports to Egypt.

U.S. farmers, ranchers, and manufacturers regularly encounter non-tariff barriers in Egypt in the form of product standards, technical regulations and testing, and certification requirements. Achieving improved implementation of Egypt’s obligations under the two WTO standards agreements—the Agreement on Technical Barriers to Trade and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)—will help the United States counteract pressure in Egypt to conform to European standards. Under the WTO, Egypt has committed to adopting international standards through transparent processes and strict notification procedures.

Figure 4. Egyptian Imports of Agricultural Products by Market Share, 2007 and 2010



Source: Data from UN Comtrade Imports as reported by Egypt; EU (excludes Czech Republic and Estonia); graphs provided by Advocacy by Design.

of the Regions—A single market for citizens,” February 21, 2007, 7, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007DC0060:EN:NOT>.

21. Ron Kirk, *2011 Report on Technical Barriers to Trade* (Washington, DC: Office of U.S. Trade Representative, March 2011), <http://www.ustr.gov/sites/default/files/TBT%20Report%20Mar%2025%20Master%20Draft%20Final%20pdf%20-%20Adobe%20Acrobat%20Pro.pdf>.

It is important that Egyptian producers aim to integrate into global supply chains so that components manufactured in Egypt can be sold in markets around the world. A sound standards regime based on international standards is vital to promoting sales in global markets and avoiding exclusive dependence on the European Union market, where economic growth is lagging.

In addition to addressing Europe's heavy influence over standards regimes in Egypt, the United States can be expected to use the opportunity of FTA negotiations to seek improved regulatory transparency, fair and balanced regulatory processes, and provisions for the Egyptian government to accept the results of conformity assessment procedures carried out in the United States. Weak laboratory accreditation systems should be improved through technical assistance and training.

An Interim Step: Updating the Bilateral Investment Treaty

While it is critical to U.S. job creation for the United States to get its free trade agenda back on track, as a practical matter, FTAs historically take many years to conclude. Egypt needs a boost now. Reclaiming the enviable economic growth rates that existed in Egypt prior to January 25 will require substantial capital far beyond what might be available through U.S. foreign aid, other donors, and international financial institutions.

President Obama has expressed the goal of promoting development in the MENA region by putting special focus on increased foreign direct investment.²² A key chapter of all U.S. FTAs addresses commitments to provide robust protections for investment. As an interim step to launching FTA negotiations, the United States and Egypt should initiate talks focused on modernizing the current Bilateral Investment Treaty (BIT) in force with Egypt. It is in need of updating as it was signed in 1992 and provides more limited coverage with respect to market access and certain investment protections than current U.S. BITs.²³

In general, modern U.S. BITs provide seven basic benefits that promote investment:

1. National treatment and MFN treatment (nondiscrimination) for the full life cycle of the investment;
2. A minimum standard of treatment in accordance with customary international law, including fair and equitable treatment and full protection and security;
3. Limits on expropriation, including an obligation to provide prompt, adequate, and effective compensation;
4. Rights to freely transfer funds into and out of country using a market rate of exchange;
5. Restrictions on performance requirements such as local content and technology transfer requirements;
6. Allow for choice of top management, regardless of nationality; and
7. Establish binding international investor-state dispute settlement.

22. Barack Obama, "Remarks by the President on the Middle East and North Africa," May 19, 2011,

23. Barbara Kotschwar and Jeffrey J. Schott, *Reengaging Egypt: Options for US-Egypt Relations* (Washington, DC: Peterson Institute for International Economics, 2010).

Inside the U.S. executive branch, there have been long deliberations over revisions to the U.S. Model Bilateral Investment Treaty (BIT), the latest version of which was completed in 2004. In the several years up to and including 2004, President George W. Bush's administration made extensive revisions to the Model BIT to address various concerns raised in Congress and elsewhere to ensure that the protections provided in the BIT were consistent with U.S. legal principles and practice. New provisions were added, as well as several procedural improvements to the investor-state dispute settlement process. The Obama administration has been reviewing the Model BIT since 2009, but has yet to conclude the review and issue a revised model text, which is what the United States would ask of new countries with which we seek BITs.

Notably, however, on September 28, 2011, the U.S. Senate approved, by voice vote, the U.S.-Rwanda Bilateral Investment Treaty that was negotiated during the Bush administration based on the 2004 Model BIT. Given that the text of the Rwanda BIT received unanimous support in the Senate, the best course for the United States to follow with Egypt, absent timely completion of the new model text, is to use the Rwanda text as the basis for a negotiation of an updated U.S.-Egypt BIT.

The existing U.S.-Egypt BIT has several major deficiencies. It currently excludes many entire services sectors that should be encompassed in the scope of covered investments.²⁴ Several of these sectors were opened up as a result of Egyptian reforms in 2004; that liberalization should be locked in, and more liberalization may be possible under a new regime. In addition, certain of the core protections in the existing U.S.-Egypt BIT are weaker and less well-defined than in the current U.S. Model BIT. Intellectual property rights protection is also weaker than appropriate in the U.S.-Egypt BIT, and it should include limits on the issuance of compulsory licenses by the government.²⁵ Other new provisions of the 2004 Model BIT update dispute settlement and provide for the enforcement of labor and environment laws. For example, the Rwanda BIT provides that countries should strive to ensure that they do not weaken their labor or environmental laws in order to attract investment.

Since 1992 Egypt has worked to modernize its administrative processes for obtaining investment registrations and licenses. A modern BIT with Egypt would take into account the establishment of the General Authority for Investment in Egypt but also encourage improvements in the speed of processing, transparency, and due process. In this regard, the USTR rightly makes the point that both the United States and Egypt would benefit from "exploring practical solutions through changes in domestic law, policies, or practices that could help boost confidence in the rule of law and local institutions in the region and stimulate further inward investment across a wide range of sectors."²⁶ Modernizing the BIT would promote many of these goals and could help the Egyptian economy turn the corner toward stability.

In short, updating the BIT is a practical interim step to embarking on FTA negotiations. Not only would a modernized BIT provide a highly visible, symbolic, and reassuring commitment to

24. Excluded sectors are transportation, banking, insurance, telecommunications, commercial distribution including wholesaling/retailing and import/export, ownership of real estate, and issuance of newspapers and magazines.

25. Bilateral Investment Treaty, U.S.-Rwanda, 110-23, sec. A, articles 1 and 6, para. 5, <http://www.state.gov/e/eeb/rls/othr/2008/101641.htm>.

26. Office of the U.S. Trade Representative, "The Trade and Investment Partnership for the Middle East and North Africa," 76 Fed. Reg. 173 (September 7, 2011), <http://www.gpo.gov/fdsys/pkg/FR-2011-09-07/html/2011-22804.htm>.

the preservation of an inviting investment climate by Egypt’s new government, but it also would open doors to some additional private capital that will be encouraged by the reaffirmation and associated improvements in the agreement. A new BIT would stand out as a visible commitment of support from the United States during this uncertain time, while sidestepping, for the moment, the more politically sensitive tariff cuts that are contained in FTAs.

A 21st-Century Free Trade Agreement for Egypt

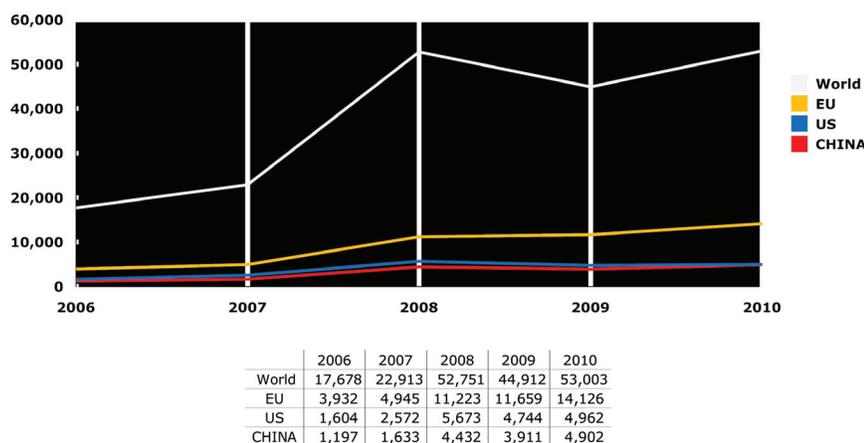
We have said that if political transformation following the Arab Spring is to succeed, Egyptians will need to consider ways to safeguard the positive economic reforms that, in the years leading up to the January revolution, brought economic growth and stronger, more globally competitive industries to Egypt.

Egypt’s new leaders can help solidify past gains by stemming corruption and continuing the effort to bring more fairness, accountability, and due process to government decisionmaking. As a practical matter, the obligations of a free trade agreement would reinforce these goals.

In 2005, as reforms in these areas were taking place, discussions between the United States and Egypt aimed at beginning free trade agreement negotiations were abruptly suspended. Now that the political situation has changed in Egypt, consideration should be given to reigniting these talks.

High standard trade agreements reduce uncertainty, encourage open government decision-making in procurement and economic regulation, and guard against the inconsistent application of law. The overriding principles of nondiscrimination, due process, and transparency that are attached to the international obligations of U.S. FTAs can serve as systemic tools to help pry open closed government regulatory processes.

Figure 5. Egyptian Imports (total imports of merchandise in millions of U.S. dollars)



Source: Data from UN Comtrade Imports as reported by Egypt; EU (excludes Czech Republic and Estonia); graphs provided by Advocacy by Design.

Under these agreements, countries commit to pro-growth policies such as simplifying customs procedures, ramping up the enforcement of intellectual property rights, and promoting open competition in the provision of services. FTAs foster a business-enabling environment by promoting certainty for investors.

Currently, the Obama administration and Congress are in the midst of developing U.S. negotiating positions for the Trans-Pacific Partnership (TPP), which they have tagged as a 21st-century trade agreement. Changes in the global economy and in the domestic political landscape since U.S. trade negotiating authority expired in 2007 have prompted new and evolving negotiating objectives on the part of the United States, which are being revealed gradually as the TPP talks progress. It can be expected that TPP disciplines, when they are decided, will be the future template for the United States with many of the same U.S. negotiating objectives certainly applying to a future negotiation of an FTA with Egypt. The U.S.-Korea FTA, the most ambitious FTA yet to be approved by Congress, offers further guidance regarding what might be involved in a negotiation with Egypt.

Open access to the large U.S. market and the advantage it would offer Egyptian exporters vis-à-vis their competition in other developing countries should be attractive for Egyptians. But they will need to be comfortable discussing new issues such as enforceable labor rights, free data flows, and customs facilitation.

On the issue of trade and labor rights, part of the domestic political compromise that preceded congressional consideration of the FTAs with Korea, Panama, and Colombia was an understanding laid out in the so-called May 10 Agreement, which stipulates that FTA signatories must adopt and enforce the five basic international labor standards set forth in the 1998 International Labour Organization (ILO) Declaration on the Fundamental Principles and Rights at Work:

- freedom of association;
- effective recognition of the right to collective bargaining;
- elimination of all forms of forced or compulsory labor;
- effective abolition of child labor and a prohibition on the worst forms of child labor; and the
- elimination of discrimination in employment and occupation.²⁷

While enforcing labor rights through trade agreements continues to be a sensitive political issue in United States, the changing environment for unions in Egypt should make it more open to discussions on workers' rights. During Hosni Mubarak's regime, all unions were obligated to belong to a state-run union federation called the Egyptian Trade Union Federation (ETUF). Established in 1957, the ETUF controlled union activity in Egypt with a heavy hand that served government control. The ILO long criticized the Mubarak government for restricting or denying workers' rights to join unions, and Egypt was included in the ILO's blacklist of twenty-five countries for thwarting unionist freedoms.²⁸ The 2003 Egyptian Unified Labor Law mandated that strikes could only take place "after an extended negotiation process and only if the strike is announced in

27. Office of the U.S. Trade Representative, "Bipartisan Trade Deal," May 2007, http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf.

28. "ILO lifts Egypt's name from unionist freedoms black-list," *Egypt State Information Service*, June 2, 2011, <http://www.sis.gov.eg/en/Story.aspx?sid=55976>.

advance and approved by a general trade union affiliated with ETUF.”²⁹ According to the *2010 Human Rights Report: Egypt*, released by the U.S. State Department, strikes were rarely approved.

In the years before the revolution, Egypt witnessed “unprecedented wave of strikes, labor actions and economic protests.”³⁰ And workers played a visible role in the revolution. Since January 25, Egyptian workers have secured several key gains, allowing the country to be removed from the ILO blacklist and supporting establishment of many new independent unions. Upon Ahmed al-Borei’s appointment as minister of Manpower and Immigration, he announced the right of Egyptian workers to establish their own independent labor unions and federations. ETUF, its board having been dissolved, now operates under a caretaker council.³¹ Whether conforming changes to Egypt’s labor laws will be forthcoming remains uncertain, but encouragement by the international community would likely advance progress for Egyptian unions. The Canadian Labour Congress and the AFL-CIO recently called on the prime minister of Egypt to ensure that the nation’s proposed Freedom of Association Law will comply with ILO conventions.³²

It can be anticipated that many of the new trade issues now emerging in the TPP negotiations would be brought into a negotiation with Egypt. For example, as one of the few developing country members of the WTO Information Technology Agreement, Egypt has been forward-leaning in removing barriers to trade in this sector. Indeed, Internet freedom and moves by the Mubarak government to shut down the Internet energized demonstrators in Tahrir Square. Revolutionary changes to the information and communication technology sector have prompted the consideration of new trade disciplines in TPP, such as binding provisions to support the cross-border flow of data and prohibitions against local content requirements in the delivery of services that rely on data flows. Strong disciplines for intellectual property are seen as critical to U.S. innovative pharmaceutical and biotechnology industries including regulatory data protection rules and patent enforcement rules. By the same token, pricing and reimbursement for pharmaceuticals in Egypt is a big concern for American companies.

In short, the landscape is evolving in terms of anticipating U.S. objectives in a future negotiation. Egyptians, with the perspective of having addressed many similar issues in the EU-Egypt Association Agreement and other agreements would, no doubt, come to the negotiating table with very defined views on the wide variety of matters addressed by a U.S. FTA. For example, U.S. barriers to Egyptian exports of textile and apparel will be on the table, as will problems faced by exporters of fresh agricultural products. Securing benefits for small and medium-sized industries will be of interest to both sides in this negotiation. Egypt is in the process of establishing modern customs centers with new information technology systems designed to improve communications among ports and airports. New customs legislation to streamline inspection procedures, under

29. U.S. Department of State, *2010 Human Rights Report: Egypt*, (Washington, DC: U.S. Department of State, April 8, 2011), <http://www.state.gov/g/drl/rls/hrrpt/2010/nea/154460.htm>.

30. Samer S. Shehata, *Shop Floor Culture and Politics in Egypt* (Albany: State University of New York Press, 2009), 254.

31. Safaa Abdoun, “June ILO conference was Egypt’s most successful, says independent union,” *Daily News Egypt*, June 22, 2011, <http://www.thedailynewsegypt.com/human-a-civil-rights/june-ilo-conference-was-egypts-most-successful-says-independent-union-dp2.html>.

32. The Canadian Labour Congress is calling for Trade Unions Act No. 35/1976 and Decree No. 34/2011, which criminalizes strikes, to be removed, while welcoming the new minimum wage requirements and allowance of independent trade unions. See <http://www.canadianlabour.ca/national/news/egypt-trade-union-rights>.

consideration before the revolution, will be an important improvement for both importers and exporters in Egypt.

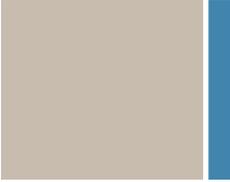
The United States can help Egypt build support for necessary reforms and stave off backsliding into protectionist or antiunion measures by engaging in FTA negotiations and revising the BIT. EU officials report that the existing EU-Egypt Association Agreement is having a positive effect, increasing Egypt's reluctance to impose new trade restrictions in the face of populist pressures after January 25. Reigniting exploratory discussions about a possible FTA with the United States would have the beneficial effect of familiarizing Egyptian officials with reforms to business and labor regulations that are typically involved in FTAs with the United States. New Egyptian officials, faced with decisions about the future direction of governance in Egypt, could find these consultations useful and relevant to their responsibilities, whether or not negotiations are ever officially launched. By the same token, the United States would benefit from gaining a better appreciation of the enormous development challenges Egyptians face.

Conclusion

Egypt has been a key partner for the United States in the Middle East, leading the region in war and in peace, and creating a crucial alliance in counterterrorism. As Middle East politics grew more strained, it was Egypt's transition that persuaded everyone that the region's political changes were real and fundamental, and that caused both governments and citizens around the region to react. In the same way, the course of Egypt's transition will cast a large shadow over the future of the Middle East.

The Egyptian economy will drive much of the way Egyptians think about their government and that government's relationship with the outside world. Knowing that U.S. relations with Egypt will be far more complicated than in the past, there is room to build new avenues of interchange and cooperation that can supplement historical ties between the military and foreign ministries. Europe's trade agreements with Egypt have endured despite the changes in political leadership and are yielding concrete benefits to both parties. Without an FTA, the United States has been less well positioned to pursue its trade objectives with Egypt during this turbulent time.

If our wish for Egyptians is that they choose a pathway that lessens the state-centered nature of their economy, negotiating a free trade agreement by its nature will have this effect. A forwardly deployed economic strategy, involving the aspirational goal of a future free trade agreement, would be a clearly understood gesture of good will and encouragement to Egyptians at an uncertain time when it could make a difference.



ABOUT THE AUTHOR

Meredith Broadbent is a senior adviser and holds the William M. Scholl Chair in International Business at CSIS. From 2003 to 2008, she served as assistant U.S. trade representative for industry, market access, and telecommunications. In that position, she was responsible for developing U.S. policy affecting trade in industrial goods, telecommunications, and e-commerce. She led the U.S. negotiating team for the Doha Round negotiations to reduce tariff and nontariff barriers on industrial goods and successfully concluded an innovative plurilateral trade agreement with the European Union, Japan, Korea, and Taiwan. An expert in trade and development issues, she led an administration initiative to reform a \$32-billion trade benefits program for developing countries. Much of her knowledge of U.S. trade relations was gained while serving as a senior professional staff member for the House Ways and Means Committee. In that position, she drafted and managed major portions of the Trade and Development Act of 2000, legislation to authorize normal trade relations with China, and the Trade Act of 2002, which includes trade promotion authority and the Andean Trade Promotion and Drug Eradication Act. Earlier in her career, Ms. Broadbent served as professional staff for the House Ways and Means Trade Subcommittee, where she was instrumental in the development and House passage of the implementing bills for the NAFTA and Uruguay Round Agreements.

Appointed to the Scholl Chair in October 2010, Ms. Broadbent came to CSIS from the Global Business Dialogue, a multinational business association focusing on international trade and investment issues. She holds a B.A. in history from Middlebury College and an M.B.A. from the George Washington University School of Business and Public Management.

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