Is It Time for a US-Egypt Free Trade Agreement?
A US Perspective

Robert Z. Lawrence
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Abstract

This paper evaluates, from a US perspective, two distinct models for a US-Egypt free trade agreement (FTA). One model is the traditional GATT FTA exemplified by the US-Israel and Euro-Med agreements. The US-Israeli FTA was the first signed by the United States, and its provisions were relatively limited. The other model, as exemplified by NAFTA is a WTO-plus arrangement. If the United States signed a traditional FTA with Egypt, it would more than offset the effects of trade diversion on US exports due to the Euro-Med agreements. But it would not really deal adequately with the many barriers faced by US firms in operating in Egypt, nor would it make a major contribution to Egypt's internal reforms and its relationship with other trading partners. By contrast, a WTO-plus FTA with the United States, which did eliminate these measures would boost US employment related to trade by an additional 10 thousand, facilitate US access to the Egyptian market, promote Egyptian growth, provide a fulcrum for regional economic growth and trade and advance America's multi-track approach to freer trade and investment.

ملخص

تتناول هذه الورقة ـ من منظور الولايات المتحدة ـ نموذجين منصلين لاتفاق التجارة الحرة بين مصر والولايات المتحدة. والنموذج الأول هو الاتفاق التقليدى للتجارة الحرة فى إطار اتفاقية الجات، والذى تصوره الاتفاقية التى عقدت بين الولايات المتحدة واسرائيل، والاتفاقات بين الاتحاد الأوربى ودول البحر المتوسط. وقد كان الاتفاق الأمريكى الاسرائيلى هو أول اتفاق توقعه الولايات المتحدة، ونصوصـه محدودة نسبيا، أما النموذج الآخر والذى تصوره اتفاقية التجارة الحرة بين دول أمريكا الشمالية (NAFTA) فهو اتفاق منظمة التجارة العالمية (WTO) مضافا إلية بعض الترتيبات. وإذا ما قامت الولايات المتحدة بعقد اتفاق تقليدى للتجارة الحرة مع مصر فإنه سيؤدى إلى إلغاء آثار تحول التجارة على صادرات الولايات المتحدة التى تحدثها الاتفاقات بين الاتحاد الاوروبى ودول البحر المتوسط. ولكنه، فى الواقع، لن يتناول العوائق الكثيرة التى تواجهها المنشآت الأمريكية العاملة فى مصر بشكل كاف، ولن يسهم بقدر كبير فى الاصلاحات الداخلية فى مصر وعلاقاتها بالأطراف التجارية الأخرى. وعلى النقيض من ذلك، فإن اتفاق منظمة التجارة العالمية مضافا إليه اتفاق التجارة الحرة مع الولايات المتحدة الأمريكية، الذى يؤدى فعلا إلى استبعاد كافة الإجراءات، سوف يزيد حجم العمالة الأمريكية المرتبطة بالتجارة، مضيفاً عشرة آلاف عامل، كما سيؤدى إلى تسهيل درجة وصول الولايات المتحدة إلى السوق المصرية، وإلى تشجيع عملية النمو فى مصر، كما سيوفر مقطة ارتكاز للنمو الاقتصادى الاقليمى وللتجارة الاقليمية، ويساعد على تقديم النهج الأمريكى متعدد المسارات نحو تجارة واستثمار أكثر حرية وانطلاقاً.

I. Introduction

This paper evaluates a US-Egypt free trade agreement (FTA) from the perspective of the United States. For many Americans, the idea is quite surprising. Although fully aware that Egypt is strategically important and a partner in the search for peace and security in the Middle East, Americans generally view Egypt as a recipient of aid rather than an opportunity for trade. Since 1975, the US government has spent over $17.5 billion on economic assistance to Egypt in addition to $20 billion on military assistance.[1]

The reasons for this US view are quite understandable. In the first half of this decade, the Egyptian economy stagnated and although Egypt's earlier growth had been rapid, it occurred behind doors that were virtually closed to the outside world. In Egypt's state-controlled and protected economy there was only a limited role for Egyptian private entrepreneurs, not to mention foreign investors. As a result, selling and investing in Egypt has not been easy for American firms. Over the years, the reports of the US government have reflected complaints about many impediments, including official policies such as import licensing, high tariffs, time-consuming and expensive customs and quality control procedures, and unofficial practices such as corruption.

Another reason for Egypt's low economic profile has been developments elsewhere. While Egypt and other developing countries in the Middle East were slow to adopt reforms, in many other parts of the world emerging economies have been on the move. Global investors have had their attention riveted on those nations in Asia, Latin America and Eastern Europe that have dramatically reoriented their economies with outward looking strategies.

In 1991, however, economic reform in Egypt began in earnest with the signing of an IMF agreement and the Paris Club forgiveness of 50 percent of Egypt's official debt obligations. Egypt's macro-economic stabilization record in the 1990s has been impressive. The budget deficit was cut from 21 percent to 1.3 percent of GDP, inflation reduced from 25 to 7 percent, the current account brought into balance, and foreign exchange reserves built up to over $20 billion. With the appointment of a new government in January 1996, Egypt committed itself to accelerate economic reform, privatization, liberalization and a reduction of administrative bureaucracy. One

[1] Walker (1997).

indication of the seriousness of these intentions was the willingness to sign a FTA with the European Union under the Euro-Med program which would commit Egypt to remove all trade barriers to European industrial products by 2010. In addition, an agreement has been reached among members of the Arab League to establish at FTA over a ten-year period, starting in 1998.

American policy has also shifted in response to these changes. The USAID program, which once mainly supported large public sector projects, is now designed principally to enhance "private sector-led export-oriented economic growth." US Vice President Gore and Egyptian President Mubarak have established collaborative groups of officials from the public and private sectors in both countries (the "Gore-Mubarak" partnership) to promote economic growth and job creation in Egypt and to strengthen economic and commercial ties between the two countries. The partnership seeks to maintain Egypt's momentum in creating a business environment favorable to investment by implementing policies which spur privatization, liberalize trade, develop a unified commercial law, create a dispute settlement process, and protect intellectual property rights.

Are these US initiatives sufficient? Should the United States and Egypt deepen their economic relationship with a more comprehensive FTA? To answer this question from a US perspective several issues must be explored. What would be the impact of an agreement on the US economy? Would it be effective in advancing US economic interests in Egypt? How would it affect other US trade policy initiatives and goals? Would it help promote broader US interests in the Middle East? In addition, the terms of an agreement likely to be acceptable to the United States also need to be considered. In particular, should it mirror the relatively limited undertakings of the Euro-Med agreements or the US-Israel FTA or the more extensive undertaking of NAFTA or those planned for a FTA in the Americas (FTAA)?

To help answer these questions, this paper is divided into six sections. Section II provides an introduction to the US-Egypt economic relationship; Section III describes the major elements in current US trade strategy; Section IV examines in detail the possibilities of other agreements as precedents. It looks specifically at the US FTA with Israel, Egypt's Euro-Med agreement, NAFTA and FTAA. Section V considers the impact of eliminating US-Egyptian tariffs on trade and employment in the United

States; Section VI considers options from a US perspective and Section VII summarizes and concludes.

II. The US-Egypt Economic Relationship

Trade

The US-Egypt economic relationship is asymmetrical. For the United States, Egypt represents a relatively minor export market and an even less important source of imports. For Egypt, on the other hand, the United States is a major source of imports, investment and aid and an important export market. In 1996, Egypt was the 34th largest export market for the United States and accounted for only about half of one percent of US exports overall. US imports from Egypt represented less than one-tenth of a percent of all US imports, placing Egypt far down the ranks as a US supplier.[2] By contrast, imports from and exports to the United States accounted for about 20 and 10 percent of total Egyptian imports and exports respectively, making the US Egypt's second most important trading partner after the European Union.

A noteworthy feature of US-Egypt trade is that US exports to Egypt totaled $3.2 billion in 1996, which was far in excess of the $665 million the United States imported. This preponderance of merchandise imports over exports is typical of Egypt's trade patterns. In 1996, for example, Egypt's imports and exports were equal to 21.9 percent and 7.3 percent of GDP respectively. The low level of merchandise exports reflects Egypt's failure to develop as a manufacturing exporter. Currently, Egypt is able to pay for imports with revenue from other sources, most notably aid, services exports such as tourism, remittances from Egyptian workers abroad and earnings from the Suez Canal. In the long run, however, if it is to grow rapidly, Egypt will have to improve its export performance to meet its growing import demand.

As reported in Table 1, among the major US exports to Egypt were wheat ($775 million), maize ($312 million) and arms ($397 million) with other manufactured goods amounting to ($1.4 million) or about 44 percent of total US exports. As this composition of goods indicates, the relatively high value of US exports should not be thought of as generated in an open economy by private, market-based demand. They

[2] Egyptian imports from the United States are considerably less than those of countries with whom the United States has either signed or plans to sign free trade agreements. In 1996, they were equal to 2.4 percent of US exports to Canada, 5.7 percent of US exports to Mexico, about 52.4 percent of US exports to Israel and 76 percent of US exports to Chile.

reflect Egypt's inability to feed itself, its military reliance on the United States, and the necessity of importing high-technology equipment primarily for infrastructure and other public purposes. Around half of all US exports to Egypt are financed in part by US military or economic aid.

Table 2 shows that US imports from Egypt are concentrated in fuels ($229 million in 1996), apparel ($256 million) and textiles ($57 million) which together made up over 80 percent of all exports. However, even in these commodities, Egypt is a very small participant in the US market. Egypt's petroleum exports were too small to place it on the list of the top 20 suppliers. Egyptian exports of cotton apparel brought in under Multi-fiber Agreement quotas (valued at $74 million in 1996) were equal to just 1.5 percent of all US cotton apparel imports subject to MFA quotas. Overall, although Egyptian exports of apparel to the United States doubled in value between 1992 and 1996, at $256 million in 1996 they were just over half a percent of all US apparel imports of $41.6 billion in the same year.

Of course, one reason that Egypt is a small trading partner for the United States is that it is a relatively small and underdeveloped economy. Its GDP of $63.1 billion in 1996 was equal to less than one percent of that of the United States, while its per capita income of $738 barely places it within the ranks of middle-income developing countries. Nonetheless, Egypt's exports to the United States in particular and the world in general are considerably smaller than many other countries with GDPs that are similar.

US Barriers

With the possible exception of textiles and apparel, US tariff barriers are not the reason for this low level of Egyptian exports. Indeed, the combination of Egypt's preferences under the General System of Preferences (GSP) program and low US tariffs on industrial products generally reduces the average duties paid by Egypt on non-textile products to less than two percent. Non-tariff barriers are also not important in agricultural products exported by Egypt to the United States. Instead, outside of textiles, the reasons appear to lie with Egypt's lack of competitiveness, rather than US barriers.

Barriers *are* substantial in apparel and textiles. US tariffs in 1992 averaged 8.3 percent on Egyptian textiles and 17.4 percent on clothing, and as high as 33 to 35

percent on clothing products such as sweaters and cotton undershirts. In addition, most Egyptian exports of textiles and apparel to the United States are subject to quotas under the Multi-Fiber

Agreement (which covered 87 percent of Egyptian exports of clothing and 34.3 percent of exports of apparel). However, according to Kheir-el-Din and Sayed (1996, p. 8), for the most part Egypt does not fill its quota allotments and thus "its (textile) export performance is constrained by domestic factors rather than limiting conditions in export markets."

Egyptian Barriers

Tariffs

As reported in Table 2, US exports are concentrated in non-competing agriculture, machinery, transportation, arms and high-tech products on which tariffs are typically lower than average. Currently, for many types of capital goods, tariffs are 10 percent or less. Nonetheless, there are other US products which are prevented from competing in the Egyptian market by the generally high level of tariffs.[3] Weighted by export shares in 1994, data from Hoekman, Maskus et al (1997) indicate that the average tariff on US exports is 16.9 percent.[4]

Other Barriers

The US government publishes several reports which routinely describe the trade barriers faced by US firms and products in foreign markets. In particular, each year the United States Trade Representative (USTR) issues a publication on foreign trade barriers, the US Commerce Department publishes commercial guides, and the US State Department analyses current economic trends. The Appendix draws on these publications to provide a flavor for US concerns with regard to Egypt. As indicated, these include customs administration and procedures, standards, government

procurement, intellectual property, investment procedures and rules, competition policy, pharmaceutical price controls, workers rights and red tape.

Investment

In 1997 the value of US investments in Egypt was about $1.5 billion. This constituted about 18 percent of overall FDI in the country. The dominant share of US investment, amounting to $1.0 billion, was invested in petroleum. Aside from petroleum, US

[3] Egyptian tariffs in 1991 were as high as 120 percent. Subsequently there have been several phases of tariff reduction. In February 1995, the government reduced custom duties on 18 categories of machinery and other durable imported goods from a range of 20 to 70 percent to a flat rate of 10 percent. In January 1996, there was a similar reduction on 25 capital commodities. In October 1996, tariffs were set at between 5 to 55 percent. High rates still apply to automobiles with engines larger than 1300cc, alcoholic beverages, and certain luxury items. Furthermore, Egyptian Customs assesses a three or six percent service fee on imports, depending on the tariff applied (USTR, *National Trade Estimate Report on Foreign Trade Barriers*, 1996 p.81).

[4] According to Hoekman (1996), even after full implementation of Uruguay Round commitments in 2005, Egypt's final bound tariffs will remain high, averaging about 62 percent in agriculture, 32 percent in industry, and about 37 percent overall.

investment in Egypt is quite small. In 1995, it was valued at $109 million in manufacturing, $86 million in wholesale trade and $135 million in banking. Egypt clearly does not play a major role, either as a location for foreign investment designed to service the domestic market or to utilize Egyptian resources and labor to produce exports.

Aid

Egypt's significance to the United States is revealed by the aid it receives. Overall, US aid to Egypt in 1996 was $2.3 billion. More than half of this aid ($1.3 billion in 1994) took the form of military assistance, with about $900 million allocated to economic assistance. Egypt is the second largest recipient of US aid after Israel and, in 1993, Egypt accounted for almost 14 percent of all US aid -- reflecting shares of 10.6 percent of all US economic assistance and 31.4 percent of all US foreign military aid. Egypt's importance as an aid recipient far outweighs its economic importance. For example, the US economic aid to Egypt of $748 million in 1993 was similar in magnitude to all US aid to sub-Saharan Africa or to all of Latin America.

In sum, therefore, the economic relationship between Egypt and the United States is dominated by political considerations, with private interaction restricted by trade barriers. For the most part, Egypt has failed to penetrate international markets for finished goods. The few textile products the United States actually imports from Egypt are subject to quotas and high tariffs. US exports to Egypt are almost five times as large as imports from Egypt. Some exports are driven by special factors, but the remainder is constrained by high tariffs. The United States has run a substantial trade surplus to Egypt, which has almost precisely been matched by military and economic assistance.

III. The US Trade Policy Context

> "An important aspect of our agenda is to build on the regional and multilateral agreements already reached, seeking higher levels of obligations. We also aim to expand the coverage of trade agreements to address practices that undermine benefits achieved through stronger trade rules and market access commitments: trade distortions created by low labor standards, excessive regulation, the lack of transparency, bribery and corruption, barriers to environmentally sustainable development and anti-competitive behavior affecting trade."[5]

Several features of US trade policy are crucial for evaluating the likelihood and character of a US-Egypt FTA. In particular, the US position in the world has changed over the postwar period and in response, US trade policy, which is highly responsive to domestic political concerns, has done likewise. The United States has shifted away from an approach which relied exclusively on multilateralism (to deal with broader barriers) towards a multi-track approach which confronts issues of deeper international economic integration. If a US-Egypt FTA is to prove attractive to the United States, it will have to mesh with these broader policy concerns.

For much of the postwar era, therefore, the United States concentrated on supporting a rules based, multilateral global system based on the General Agreement on Tariffs and Trade -- GATT. As border barriers have declined, however, the United States increasingly called for international measures which relate to policies formerly thought of as purely domestic in nature and for governance mechanisms which make such measures more credible and binding. Product standards, investment policies, competition policies, intellectual property, environmental policies, labor standards and human rights, all once thought of as matters of purely domestic concern are coming under international scrutiny.

What accounts for this shift? One reason is the changing nature of international competition -- in particular, the increasingly complementary role of trade and direct foreign investment. To compete effectively in sophisticated, high-technology manufactured products, a significant domestic presence is often required for

[5] USTR, *National Trade Estimate Report on Foreign Trade Barriers*, 1996 p. 10.

marketing, sales and service. The ability to follow market trends, respond to customer needs, and acquire innovative smaller firms in all major markets has become essential for competitive success. Foreign investment and trade have not only been in goods production. Direct foreign investment has grown even more rapidly in services. Indeed, this is quite natural since the essence of a service is that it is produced and consumed in the same location. Services investment is being driven, in part, by the globalization of sectors, once purely or heavily domestic in nature. The international diffusion of innovations has also become increasingly rapid.

These considerations all lead to a greater emphasis on market access for firms as well as products. The importance of access in turn leads to frictions resulting from differing systems of corporate governance and rules of operation. Even where border barriers are removed, the weak enforcement of anti-trust policies, for example, can lead to collusion which limits new entry. Multinational firms which plan to source in one country and sell in others naturally seek secure operating rules, intellectual property rights and technical standards and regulations that are internationally compatible.

Over the postwar period, trade has become more important to the US economy and US firms have come under increasing competitive pressures. These changed circumstances have also had a profound impact on the degree of importance accorded trade as a political issue. The Constitution of the United States actually gives the Congress, rather than the President, the final say in the conduct of US trade policy. And it is a power that the Congress jealously guards. As long as there was a strong domestic consensus to support free trade and trade was relatively unimportant to most Americans, US trade policy could remain relatively focused on global systemic goals and US trade policy making could be confined to a handful of specialists. However, as trade pressures increased, and trade became more salient in the domestic political debate, the conduct of US trade policy has become increasingly constrained by domestic political interests.

The growing importance of trade issues politically has had three powerful effects. First, it has increased the pressure on the US administration to do something about them. Accordingly, US policy has shifted from relying almost exclusively on time-consuming multilateral approaches through the GATT, towards a multi-track

approach which includes unilateral, bilateral, and regional measures. Second, US policy has become increasingly concerned with issues of fair trade. As national differences narrow and the intensity of competition increases, locational decisions become more sensitive to relatively small differences in domestic policies and practices. Paradoxically, the more similar countries are, the more significant their remaining differences become in determining trade and investment flows. This naturally creates pressures for harmonization of domestic rules and policies and increases calls for a level playing field.

The increased politicization of trade policy has turned attention to non-economic factors. When Congress is asked to vote to grant extensive trade benefits to trading partners they use the opportunity to raise questions about issues such as human and animal rights, racial discrimination and political practices. All these have become intertwined in trade policy discussions.

An additional factor in the US economic environment should also be noted. For two decades, labor market performance in the United States as been less than satisfactory. Real wages have stagnated. Between 1973 and 1994, real hourly compensation rose by only 9 percent.

A second ominous development in the American economy has accompanied this slump in real earnings growth: a dramatic increase in the inequality of earnings based on education and occupation. When arrayed by education or occupation, the changes over the decade have an uninterrupted pattern: the higher the level of education, the higher the increase in earnings. The premium commanded by both men and women with higher educational or occupational status has increased dramatically. In the United States, alarms have been sounded about the role of trade and international investment in shifting the demand for unskilled labor. The coincidence of America’s changed international economic relations with its slow real wage growth and widening wage inequality makes it scarcely surprising that the former has frequently been advanced as a primary cause of the latter.

The debate over NAFTA in 1993 crystallized concerns over wage performance that are best captured by Ross Perot's allusion to the “giant sucking sound” of jobs as they move southward. Another concern in the debate about NAFTA was the impetus it provided for what many in the United States see as a major phenomenon -- that of “runaway plants” -- the relocation by multinationals to low wage countries. Finally,

there were concerns that competition with countries who do not respect labor standards could damage US workers.[6]

While NAFTA was passed by the US Congress it left political wounds that remain deep. In addition, Mexico's financial crises contributed to the lack of popularity of NAFTA as a political issue. In this environment, it has been very difficult, politically, for the Clinton Administration to obtain fast-track authority from Congress to negotiate its proposed FTA with Chile and to participate in other regional and multilateral trade negotiations.

In sum, there are four important interactive features of US trade policy. First, the emphasis on deeper international integration; second, the use of multi-track rather than purely multilateral approaches to trade liberalization; third, the politicization of trade policy; and fourth, concerns about globalization and its impact on unskilled American workers. These concerns help determine both the feasibility and the character of a future US-Egypt agreement. First, if the agreement is to be negotiated, it is likely to have to be deep and involve more than simply the removal of border barriers. Second, it could meet with political obstacles, not simply those related specifically to US-Egypt trade questions or the likely economic impact of the agreement, but rather to the broader concerns of globalization and its interaction with domestic US economic problems.

IV. Benchmarks for an Agreement

This section describes two types of benchmarks that could serve as models for a US-Egypt FTA. The first benchmark is the traditional GATT FTA which is represented by agreements such as the US-Israel FTA and the Euro-Med agreements between the European Union and other MENA countries. The second benchmark will be termed a WTO-plus agreement which is represented by NAFTA and current plans for Western Hemisphere free trade. The following section evaluates which of these benchmarks appears better suited to a US-Egypt agreement from a US standpoint.

US-Israel Free Trade

The US-Israel FTA was signed for several reasons. An immediate concern for Israel was that in 1985 the GSP program which gave Israel preferential access to the US

[6] My research calls these views into question. It suggests the major sour ce of the problems facing workers in the developed countries is changes in technology, in particular labor -substituting technical change rather than trade. See Robert Z. Lawrence, *Single World, Divided Nations: The Impact of International Trade on OECD Labor Markets*. Brookings Institution and OECD Development Center, Washington D.C., 1996.

market was scheduled to expire. There was also a strong drive in the United States to confine the program to least developed countries and to force more advanced developing countries to "graduate." Israel could have been among this group.[7]

The willingness on the part of the United States to sign the agreement with Israel was also interesting. The United States had historically refused to negotiate preferential arrangements because it had been the victim of such arrangements -- particularly imperial preferences -- in the 1930s. In addition, the United States had played a pivotal role as the leader of the multilateral trading system. However, in the early 1980s, difficulties in launching the Uruguay Round had led the United States to look more favorably on a multi-track approach to liberalization. Paradoxically, the fact that unique strategic arguments could be used to achieve an agreement with a partner that was not particularly significant economically made the agreement easier from a political standpoint. Once concluded, it created a precedent which helped the passage of the US-Canada agreement.

Another motive for the agreement has interesting similarities with the topic of this paper. Just as Egypt has concluded a FTA with the European Union so, in 1975, Israel had concluded a FTA with the European Community. This agreement was scheduled to be fully implemented by 1985 by which time Israeli tariffs on European exports were to be eliminated. Without a similar agreement with the United States, Israel would have been discriminating against its most important ally. This would have been politically problematic and economically damaging both to the United States, as it would cause export losses, and to Israel, as it would lead to purchases of European products when American products would have been preferred, had they been available without import duties.

For the United States, the agreement created almost no need for adjustment, since over 90 percent of Israeli exports actually entered the US duty free before the agreement was signed because Israel was already the recipient of preferences under the GSP program. Moreover, Israeli trade is relatively unimportant for the United States. US exports to Israel, on the other hand, were subject to tariff and non-tariff barriers which were more significant. In 1984, the explicit duties averaged about 3.8 percent, although additional fees, (hidden tariffs) valued at 6.8 percent, were also

[7] For a more complete discussion see Rosen in Schott (1989), Pelzman (1989) and Goldberg (1988).

levied in the course of applying the purchase tax. From an American standpoint, viewed through the mercantilist perspective by which exports are good and imports are bad, the agreement was likely to increase net exports, while Israel had already agreed to give EU products duty-free access, so that Israeli producers were already bound to make adjustments.

Tariffs were reduced in four stages over a ten-year period. In the first stage tariffs were eliminated on 8 percent of US exports to Israel and 53 percent of Israeli exports to the United States. Israel, as the relatively less developed partner, was given more time to phase in its concessions.

The agreement appears to have met the basic requirements under GATT Article 24 which governs preferential trading agreements. It covered substantially all trade, it did not raise external barriers and it was implemented within ten years. However, it did not go beyond the GATT by implementing measures which would achieve deeper economic integration. First, the agreement did not eliminate trade remedies, such as countervailing duties and anti-dumping,[8] and it did not implement a binding binational dispute resolution mechanism, although Israel was required to sign the GATT subsidies code. Second, it did not really cover services with any provisions that were binding. Third, it did not fully liberalize Israeli agriculture. Although in principle tariffs were eliminated, in agriculture non-tariff measures (such as quotas and even outright bans) were permitted.[9] Fourth, it did not establish full freedom for investment although it did deal with trade-related investment measures by ensuring that requirements to export or purchase domestic goods and services not be a condition for investment or receiving investment subsidies.

What lessons does the US-Israel agreement provide? In several respects there are interesting analogies which could make the US-Israel agreement a noteworthy precedent for a US-Egypt agreement. First, there were strong political motivations for concluding a FTA. Israel like Egypt was a key US ally in the Middle East. The agreement helped cement that relationship. Second, Israel had signed a FTA with

[8] Israel was allowed, until 1995, under Article 10 of the agreement for infant industry reasons to increase or reintroduce ad valorem duties not exceeding 20 percent above the agreed level. However, the percentage of products to which this could apply was not to exceed 10 percent of the total value of Israeli imports from the United States.

[9] In October 1995, the United States consulted with Israel on bringing the FTAA into compliance with the WTO standard for agriculture liberalization. Israel has since agreed to steady improvements in US access for agricultural goods.

Europe. The agreement helped rebalance Israel's economic links with the United States and mitigate the trade diversion it entailed. Third, Israel was a relatively minor trading partner for the United States and already receiving substantial preferential access so the agreement did not require major economic adjustments. Egypt has a similar relationship. Fourth, Israel faced the potential loss of its preferential access to the US market under the GSP program and was able to avoid that loss through the agreement. Egypt similarly faces the erosion of its preferential access to the US market as America signs more FTAs. Finally, the FTA contributed importantly to the broader US trade liberalization strategy by initiating a bilateral free trade track. In this respect, however, the US-Israel agreement is likely to be seen as less interesting today. In several respects, its provisions are likely to be viewed as too limited, because over the past decade, both regional and multilateral liberalization have moved further.

The Euro-Med Agreements

The European Union has changed its trade policy towards the Middle East. In the 1970s, cooperation agreements were signed between the European Union and Mediterranean countries that provided for duty-free access to EU markets for industrial products and preferential access for agricultural commodities. The agreements were not reciprocal however, and countries could apply most favored nation (MFN) tariffs to European products.

The Euro-Med agreements, launched at the Barcelona Conference in November 1985, by contrast aim at achieving reciprocal free trade between the European Union and Mediterranean countries through the removal of all tariff and non-tariff barriers. Its other objectives include: gradually liberalizing agriculture through reciprocal preferential access; establishing conditions for liberalization in services and capital; encouraging the economic integration of Mediterranean countries through the gradual progress towards cumulative rules of origin and gradual progress towards harmonization of regulations and norms on standards, conformity certification, metrology and quality control, intellectual property, competition rules and customs procedures. The agreements also provide financial aid and technical assistance (Hoekman 1995).

While the agreement with Egypt has not yet been concluded, it will presumably resemble the agreement signed with Tunisia. If this is the case, the agreement will require liberalization of Egyptian manufactured imports from the European Union

over a twelve-year period (although almost no liberalization in the first five years). Since Egyptian manufactured products have duty-free access (already for the most part) to the European Union, the major change will involve the removal of Egyptian tariffs on EU exports. Moreover, in cases where Egyptian exports are covered by quotas these will be liberalized no more rapidly than agreed under the GATT.

With respect to several of the other objectives, however, the agreement actually undertakes few concrete and binding measures. Negotiations to improve agricultural access are to be initiated only after 1 January 2000. No specific language is devoted to the right of establishment, such as foreign direct investment (FDI). The agreement requires only that "capital flows moving in accordance with current law can move freely" and income can be liquidated and repatriated. The agreement does not ensure foreign investors rights of establishment or national treatment. No time frame is established for the liberalization of services, and indeed, as Hoekman and Djankov emphasize there is not even mention of free trade in services as an objective. Antidumping laws continue to apply although there are commitments to apply EU competition disciplines in trade-related activities. A key feature of the agreement is economic cooperation and aid. In particular, efforts are to be made to upgrade Egyptian technical and regulatory capacities in addition to providing financial aid.

In their appraisal, Hoekman and Djankov conclude that the agreement does not go beyond existing multilateral disciplines. It provides little in improved access for agricultural products, requires no liberalization of government procurement, does not ensure free movement of capital, makes no commitments to liberalize services and retains the antidumping rules.

NAFTA

NAFTA was a unique achievement because it contemplates virtually complete free trade between two highly developed economies and a developing country within 15 years.[10] Remarkably for trade between countries at very different development levels, NAFTA will remove all border barriers to trade, including those in hitherto highly protected trade in agriculture and in textiles and automobiles which meet North American content requirements. The agreement is also remarkable in providing no permanent special and differential treatment for Mexico as a developing country.

[10] Mexico and the United States, as well as Canada and Mexico, will have complete free trade within 15 years, with the exception of poultry, dairy and eggs.

NAFTA also aims at liberalizing investment and trade in services. NAFTA covers all services with obligations for national treatment and rights of establishment unless the service is explicitly excluded. It is significant that the services chapter of NAFTA follows a negative list approach -- explicitly listing the sectors which are not covered by the agreement. This approach implies that there will be free trade in all new services areas. By forcing countries to list the sectors in which restrictions remain, it makes these transparent and indicates where further negotiations should focus. By contrast, with a positive list approach, such as that applied in the General Agreement on Trade in Services (GATS), sectors with barriers remain hidden and new sectors are protected unless they are explicitly recognized.

NAFTA institutes a trinational appeals mechanism which can replace existing judicial review by national administrative agencies. It provides a review mechanism to monitor changes in antidumping and countervailing duty laws as applied to partner countries. NAFTA also includes a fairly substantial package on government procurement that goes further than the US-Canada FTA.

Both NAFTA itself and the debate over its ratification demonstrate the problems and benefits from mini-lateral agreements that go beyond the GATT and, in particular, the problems these agreements pose for countries with different development levels. It is noteworthy that while it sparked a heated debate in Canada, the US-Canada FTA was barely noticed in the United States. The US-Israel agreement was also not controversial. The NAFTA discussion in the United States has by contrast been highly charged. Its opponents argue that NAFTA represented a fundamental threat to US domestic institutions, particularly in the areas of environmental and labor standards. Some concerns related to the direct impact of economic development in Mexico on the Mexican environment in general and its Northern border area in particular. But others reflected the view that Mexico will be able to offer a safe-haven for US firms who seek to evade US regulations on worker safety and environment, leading to a “leveling down” pressure in the United States.

The idea that trade should not occur between countries whose institutions and internal regulatory regimes are “too different” does not fit with the theory of comparative advantage. Nonetheless, it would have probably been impossible to obtain a NAFTA agreement between Canada, the United States and Mexico, without addressing the concerns about the differences in regulatory arrangements.

Side Agreements

On the initiative of the Clinton Administration, three accords were signed to go along with NAFTA. They cover the environment, labor issues and import surges respectively. These accords establish new institutions to monitor conditions, to promote compliance and to administer new dispute settlement procedures. These side agreements allowed both for fines to be levied and trade sanctions (suspension of NAFTA benefits) to be applied.

WTO-plus?

In most respects, NAFTA nations have freedom to follow domestic policies, but in several areas, such as the administration of trade rules, labor and environmental policies, the enforcement of their own laws is subject to international scrutiny and sometimes the threat of trade sanctions. While a common set of rules and institutional harmonization has not been attempted, efforts have been made, both within the treaty and in parallel to it, to ensure the protection of intellectual property and to mitigate environmental problems linked with trade and to do so by not relying entirely on voluntary national compliance.

The agreement covering disputes between investors and governments allows complainants to initiate proceedings through either the International Convention for Settlement of Investment Disputes or the United Nations Commission on International Law (UNCITRAL) once all other measures are exhausted. This represents a repudiation by Mexico of the Calvo doctrine under which countries do not allow foreigners to intervene in disputes over foreign investment.

NAFTA moved considerably beyond the Uruguay Round agreement in liberalizing trade in the areas of foreign investment, services and intellectual property rights. In NAFTA investment rules, the restrictions on performance requirements are more extensive than those in the Uruguay Round. *The agreement on intellectual property includes products that were under development at the time the agreement was signed*. By contrast, these were excluded from the Uruguay Round coverage. The agreement on services follows a negative list approach and extends national treatment coverage to all other sectors, whereas GATS applies only to sectors that are listed. The definition of investment under NAFTA is broader than under the Trade Related Investment Measures agreement (TRIMs), which relates only to goods, or under

GATS, which covers only operating services establishments, because it includes portfolio investors and commercial real estate.

Two other aspects of NAFTA are particularly noteworthy. First, Mexico took the NAFTA opportunity to extend the rights granted to US investors to other investors in Mexico. In other words, it took the NAFTA opportunity to liberalize its investment regime multilaterally.

Second, NAFTA included textiles and apparel but it applied a special, highly restrictive definition of rules of origin. In particular, NAFTA requires that a triple transformation rule be met: that fiber, fabric and sewing all be performed in North America. Even though NAFTA countries have not raised their external barriers, this could entail a substantial amount of trade diversion.

Unresolved

NAFTA can be classified as a genuine GATT-plus agreement although there are numerous areas in which it goes no further than GATT. NAFTA does not harmonize competition policies and/or eliminate administered protection in the areas of antidumping and subsidies.[11] No specific agreements were signed on the issue of subsidies. In these respects, NAFTA remains a much “shallower” arrangement than the European Union or the Closer Economic Relations Agreement between Australia and New Zealand in which competition policies replace administered protection

Free Trade Area of the Americas

At the 1994 Summit of the Americas in Miami, 34 Western Hemisphere leaders adopted a US proposal to construct the “free trade area” of the Americas (FTAA) by 2005. On 30 June 1995 in Denver, the ministers from these countries agreed to key principles on which to base the FTAA. The trade agreements negotiated through the FTAA will be comprehensive, at a minimum covering the areas explicitly listed in the Summit of the America’s plan of action. Eleven working groups have been established to cover market access, customs procedures and rules of origin, and investment; standards and technical barriers to trade; sanitary and environmental measures; subsidies, antidumping and countervailing duties; smaller economies; and government procurement, intellectual property rights, services and competition policy. Of course, it remains unclear what the specific nature of these agreements will be but according

[11] The obligations on domestic support and export subsidies are merely hortatory. NAFTA actually gives up on the effort to abandon subsidy and countervailing duty rules, which was mandated in the US-Canada FTA.

to the USTR, “the US plans to use NAFTA and WTO as starting points for its objectives in the FTAA negotiations” (USTR p. 75). In other words, this is likely to be a WTO-plus.

V. Estimates of the Impact of a US-Egyptian FTA

The US-Israel and Euro-Med agreements are examples of FTAs which appear to meet the criteria for preferential arrangements contained in Article 24 of GATT, but they do not extend its disciplines. They entail few obligations aside from removing border barriers on industrial products. While they are inevitably embellished with language indicating intentions to prepare the way for services liberalization, freer investment and regulatory reform, in substance they have few binding provisions on these matters. By contrast, an agreement such as NAFTA is “WTO-plus.” It includes commitments which go further than GATT in agriculture, investment, and services, and has measures to provide oversight of regimes for administered protection, and side agreements which cover labor and environmental standards.

Before considering which of these options would be a more attractive model for a US-Egypt FTA from an American standpoint, it is helpful first to clarify the likely effects of such an agreement and second the nature of US interests in such an agreement. This section will undertake such estimates, drawing heavily on the work of Hoekman, Konan and Maskus. It will consider both a traditional agreement in which only border barriers are removed and a GATT-plus agreement which includes the removal of non-tariff barriers and other elements of reform.

In evaluating the effects of a (traditional) US-Egypt FTA it is necessary to make adjustments to the current trade data to reflect anticipated changes in trade policy. First, a sizeable share of US imports of textiles and apparel from Egypt are subject to the Multi-fiber Arrangement which is scheduled to be fully eliminated by 2005. Second, US and European exports to Egypt are currently subject to similar tariffs but by 2010 European products will enter Egypt duty free. It is therefore reasonable to benchmark the economic impact of the FTA against a counter factual in which US imports from Egypt are somewhat higher and US exports to Egypt lower than they are currently. *Nonetheless, even making these adjustments suggests that on balance the static economic effects on the United States are likely to be positive but very small. Recall that US exports to and imports from Egypt are less than one-half and one-tenth of one percent of total US exports and imports respectively. Moreover, since they are*

likely to come into effect over a decade or more, the impact on the US economy will be barely perceptible.

Trade Impact

Outside of textiles and apparel, US barriers to Egyptian products are low. The elimination of a low level of tariffs is likely to generate very small increases in imports. On the other hand, the elimination of Egyptian duties averaging 17 percent on a higher level of US exports will generate absolutely larger increases in US exports. This suggests that compared with what it might have been otherwise, in the face of bilateral free trade, overall the US bilateral trade balance with Egypt is likely to rise. Some of this increase will occur because of reductions of Egyptian imports from other trading partners, both from Europe, as the United States restores parity, and from other trading partners, such as Japan, over whom the United States will enjoy preferential access. These considerations will be explored in greater detail below.

Imports of Textiles and Clothing

Under the Uruguay Round agreement, the quotas on products subject to the Multi-fiber Arrangement are all to be removed in 2005 -- fully half of the changes at the end of the period. This will subject Egyptian exports to two offsetting effects. (A) Exports will no longer be constrained by the MFA but (B) the constraints on other exporters of MFA products to the United States will also be lifted. In addition, if the United States signs other FTAs with nations from the Western Hemisphere and elsewhere, Egypt could experience some trade diversion. It is not clear which of these effects will dominate. According to estimates in Hoekman and Subramanian, the effect would be a rise in Egypt's exports of MFA-constrained products by 54 percent. If, however, as suggested by Kheir-El-Din and El-Sayed, the MFA quotas have not been binding on Egypt, but have been binding on other suppliers, Egyptian exports could actually be reduced.

To obtain an illustrative upper bound impact, Hoekman and Subramanian are followed, assuming that removing the quota constraint would raise the value of clothing exports valued at $256 million in 1996 to $394 million. Furthermore, it is assumed that removing the 17.4 percent tariff currently assessed on these products would lower their prices in the United States by 14.8 percent. With an elasticity of 3, this would increase clothing exports by $174 million. A similar calculation for textiles

which are subject to lower tariffs suggests an increase of $20 million. Therefore, scaled by trade in 1996, the rise in US imports would be $194 million.[12]

Other Imports

Besides fuel, textiles and apparel, US imports from Egypt were valued at $123 million in 1996. Assuming an average reduction in the United States of 2 percent and an elasticity of 2, this would lead to an additional increase in imports of $5 million.

US Exports to Egypt

US exports are likely to be depressed as a result of Egypt's Euro-Med and Arab League agreements. According to Hoekman, Maskus and Konan (1998, Table 8), the impact of Egypt's FTAs with Europe and other Arab countries would reduce US exports from $2.92 billion to $2.41 billion when scaled by 1996 values. In their simulations, a traditional FTA with Egypt allows the United States to more than offset this and raise exports to $3.39 billion. This implies that the overall impact of a traditional agreement would be to increase the US trade balance with Egypt by $800 million.

WTO-plus

Hoekman et al also estimate a NAFTA-plus agreement which eliminates non-tariff barriers. In this simulation, US exports rise to $4 billion while Egyptian exports to the United States increase by an additional $75 million. Overall, this increases the US trade balance by $1.3 billion.

Employment Impact

It has become common in US discussions of this type to estimate the employment impact of such changes. These estimates are sometimes used to suggest (or imply) that aggregate US employment in the United States will increase or decrease by this amount. However, this is not appropriate since it ignores macroeconomic adjustments that will occur in the rest of the economy. The estimates could be used with caution to provide a feel for the adjustment required by shifts in trade flows. But, again, not all these adjustments would occur in the United States since a sizeable share of US imports from Egypt are likely to replace other US imports, rather than domestic production. Nonetheless, in 1994 value added per worker in the United States was $40.6 thousand and $52.7 thousand in apparel and textiles, respectively. Assuming 6

[12] Hoekman, Konan and Maskus (1997) derive smaller estimates, with imports rising by just $56 million in response to a traditional FTA.

percent inflation and 4 percent productivity growth between 1994 and 1996, this works out to 23.2 and 17.9 jobs per $1 million, respectively. This implies that the rise in imports from Egypt due to the FTA would have a US employment equivalence of 4,037 jobs in apparel and 357 jobs in textiles for a total of 4,394 jobs compared with the total US employment in these industries in 1994 of 1.577 million, or 3/10 of one percent. Using 25 jobs per million as typical of labor intensive industries in the United States (such as apparel), this would add an additional 125 jobs related to the $5 million worth of other imports. All in all, the employment impact on the import side of a traditional FTA would be 4,162 jobs.

US exports to Egypt are relatively less labor intensive than US imports. Accordingly, to estimate the employment content of US exports, the 17 jobs per $1 million of value-added which was the average in US manufacturing overall has been used. This suggests that an increase in exports of $1.47 million that is associated with a traditional agreement would raise employment related to Egyptian exports by 16,660 jobs. Overall, the net employment effects would be positive 12,498. Again, it should not be assumed that these are jobs that would be available to unemployed US workers. Many would reflect a shift in the destination of products which might otherwise have been sold in the United States or in other foreign markets. These results are by no means surprising given the starting point from which US imports from Egypt are less than one-fifth of US exports to Egypt. US exports would be even stronger if the agreement was WTO-plus and covered non-tariff barriers (NTBs). This would add an additional 10,030 jobs for a total of about 22,500.

In sum, measured in 1996 dollars and scaled by the size of the US and Egyptian economies in that year, a US-Egypt FTA would increase the US bilateral balance with Egypt by about $800 million with a traditional agreement and $1.3 billion with a GATT-plus agreement covering NTBs. On balance, net employment related to Egyptian trade would rise by about 12.5 thousand with a traditional agreement and 22.5 thousand with a GATT-plus agreement which covered NTBs. The readily quantified impacts on the United States are thus small and unlikely to be the source of much controversy. The major domestic opposition to such an agreement could be expected to come from US textiles and apparel producers.

VI. The Terms of the Agreement: Traditional or GATT-plus?

US interests are usefully considered under four headings.

US-Egypt Economic Relations

One set of concerns is US-Egyptian economic relations. Would an agreement provide economic benefits to the United States by improving resource allocation in a way that will raise US living standards? There is the immediate question of avoiding the loss of exports represented by the Euro-Med agreement. There is the desire to improve access to the Egyptian market for US exports and US firms and there are the benefits to US consumers from removing import barriers to US markets, particularly in textiles and clothing.

Egyptian Economic Development

Egypt is an important US ally. Not simply on questions relating to the peace process between Israel and its neighbors but also in US relations with other countries in the Middle East. The United States has an interest in having Egypt develop. Egypt is strategically important for the United States as is evident from the considerable US expenditures on military and economic assistance. The United States would gain, therefore, if Egypt were economically prosperous. This would contribute to its political stability and alleviate the need for US aid based on humanitarian concerns.

Regional Economic Development

A third set of interests relates to the economic role that an open, dynamic Egyptian economy could play in the Middle East region. The United States would also like to see the region’s economic relations promote economic development and peace. A rapidly growing, open Egyptian economy would provide important markets for other economies in the region and leadership in bringing freer trade and investment to the region.

US Trade Policy

Finally, the United States has a broader interest in pursuing a trade policy that will lead to a more open global system for trade and investment. The United States has adopted a multi-track strategy in which comprehensive free trade and investment agreements play an important role. An agreement with Egypt could potentially contribute to this strategy. In light of these concerns, it is possible to evaluate the traditional and WTO-plus options.

A Traditional FTA Agreement

According to estimates made by Hoekman et al, a traditional GATT agreement would eliminate the detrimental impact of trade diversion from the Euro-Med agreement on

US exports and provide a moderate boost to US exports beyond its current market share. In addition, US consumers would derive some small benefits from reducing barriers to Egyptian exports. Overall, as estimated in Section IV the US trade surplus with Egypt would increase by about $600 million and net employment related to Egyptian trade would rise by about 9,438 jobs. However, from a US perspective, such an agreement would do little to deal with many of the frustrations US firms have experienced in Egypt with non-tariff barriers, administrative practices and the regulatory environment as listed in the Appendix 1. Its impact on US investment in Egypt would be minimal. US investors, in particular, would be struck by the lack of commitment to liberalize services, grant rights of establishment, improve access to government procurement, protect intellectual property rights and improve the regulatory environment.

A traditional agreement would therefore not make a major contribution towards structural reform in Egypt or therefore Egypt's economic growth prospects. Indeed, as suggested by Hoekman et al estimates, the net welfare benefits to Egypt's GNP of a traditional agreement are extremely modest. If the US-Egypt FTA is to really succeed in fostering Egyptian growth, it would have to help change the general environment for entrepreneurship. It should help make Egypt a more attractive location for both foreign and domestic producers. At the margin, however, the contribution made by a standard GATT agreement in these respects would not be large, particularly for Egyptian producers of manufactured goods outside of textiles, who for the most part already have virtually duty-free access to US markets. Therefore, the agreement would be unlikely to directly provide a boon to new investment in export industries. The agreement would not result in Egyptian markets being more contestable by other nations in the region.

A traditional agreement's contribution to regional economic integration and development would depend crucially on the rules of origin for textiles and apparel, but it is unlikely to be very great. First, outside of textiles, since US tariffs are low, even if cumulation was allowed on value-added in other Middle Eastern countries, the stimulus to regional trade would be small. In textiles, it could be more significant, provided cumulation is allowed. On the other hand, if other regional economies were subject to Egypt's MFN tariffs, there could be trade diversion towards US products and away from exporters in the region. This could hurt regional integration.

Finally, concluding such an agreement could also provide 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 making the kind of commitments to a WTO-plus arrangement represented by NAFTA. In this regard, it would be a retrogression from the thrust of US trade policy in the 1990s. Such an agreement might be seen as establishing a precedent that weakens America's ability to negotiate GATT-plus agreements with other trading partners.

In sum, it might be possible to pass a traditional GATT FTA 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 underscore Egypt's reluctance to make more binding commitments in other areas and thus actually undermine the credibility of its policy pronouncements about liberalization. The image of Egypt being given special and less demanding conditions because of its strategic importance to the United States does little to enhance its economic attractiveness.

WTO-Plus

A WTO-plus agreement would be different. As indicated above, dealing with non-tariff barriers would imply substantially larger quantitative effects. Moreover, the adoption of a more extensive set of commitments patterned after NAFTA, for example, would send a dramatic signal to US and other foreign investors about the changes that have already taken place and are likely to take place in Egyptian policies.

The improvements in access for US firms and products could be much greater than estimated above, if Egypt were to make 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. With a suitable change in the regime, US firms would find investment in Egypt more attractive. It would enable them to employ skilled and unskilled workers in producing goods and services for domestic regional and global markets.

Other benefits from a WTO-plus FTA with Egypt would come through strengthening Egypt's ability to engage in domestic reform. If such measures are made part of a binding free trade agreement, they could be more credible than if they were

undertaken unilaterally. In addition, if Egypt were open and experiencing rapid growth, other benefits would follow: 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.

A key virtue of many institutional changes entailed by a WTO-plus agreement is that, by changing administrative practices in Egypt, they would automatically or fairly easily facilitate trade and investment with other trading partners both in the region and outside it. If Egypt's customs or standards practices, for example, were streamlined, all who used them would automatically benefit. Similarly, if its intellectual property rules change, all outsiders would gain. Likewise, if its markets were made more readily contestable because of regulatory reform, firms from all nations will 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 these in NAFTA.

In concluding a preferential agreement, the problems for the United States would be mitigated. The more comprehensive the agreement, the easier it will be for the United States to accept it. A WTO-plus agreement with Egypt would represent an extension of US trade policy even further along the multi-track approach by which freer trade and investment are achieved through both bilateral and multilateral means. The specific agreement with Egypt could be a model which could readily be extended to other countries in the Middle East -- indeed, a group of countries in the region which could enter into an agreement with the United States plurilaterally, rather than sequentially.

Finally, these WTO-plus provisions introduced into NAFTA and FTAA are not simply a matter of principle. They reflect the coalition of interests which supports free trade agreements in the United States and the minimum measures required to placate those who are opposed. In particular, US multinationals with an interest in using Egypt as an export platform to serve both regional and the US market seek assurance of a hospitable regime. They require protection for intellectual property, national treatment, and rights to operate under non-discriminatory conditions. It may also be necessary for the agreement to include provisions on worker and environmental policies, although these are bound to be more controversial.

VII. Summary and Conclusions

The United States runs a substantial trade surplus with Egypt that is offset by US expenditures on economic and military assistance. The Egyptian presence in the US market is limited and, aside from petroleum, is concentrated in exports of textiles and apparel which are subject to both tariff and quota restrictions. Although US exporters are constrained by many aspects of Egypt's trade and regulatory environment, the United States has been able to export grains, arms and specialized equipment fairly successfully. Outside of petroleum, US investment in Egypt is very small.

The US share of the Egyptian market could fall as a result of the Euro-Med agreement and liberalization to EU products and, although by considerably less, as a result of a FTA for the Arab League. Scaled by 1996 exports, together this would represent a loss of over $500 million in US exports to Egypt. Removing US-Egypt tariffs could more than restore this share, boosting exports by $1.5 million and net employment, thanks to Egyptian trade, by about 12,500 jobs.

Two distinct models could serve as precedents for a US-Egypt agreement. One model is the traditional GATT FTA exemplified by the US-Israel and Euro-Med agreements. The US-Israel FTA was the first signed by the United States. Its provisions were relatively limited. It did not fully liberalize agriculture, contained no binding international dispute settlement mechanism, and did not cover services or foreign investment. It also proved disappointing because of several Israeli non-tariff protectionist measures which continue to prove problematic. The binding provisions of the Euro-Med agreements similarly achieve free trade by concentrating on reciprocal, tariff-free access in industrial products. They achieve only partial liberalization in agriculture, and do not cover services or foreign investment.

The other model, as exemplified by NAFTA, is a WTO-plus arrangement. This model accords more closely with the recent thrust of US trade policies which have shifted, over the postwar period, from an almost exclusive reliance on multilateral negotiations to reduce border barriers towards a multi-track approach which emphasizes domestic policies and barriers to goods, services and investment. NAFTA includes agriculture on both sides in a meaningful way; it includes services with a negative list; it includes guarantees for direct foreign investors; and it provides for a trinational binding dispute resolution. It also contains side agreements relating to labor standards enforcement and the environment. Tougher intellectual property rules

accompanied the negotiations. The agreements to be negotiated with Chile and other Western Hemisphere countries are likely to have a similar character.

If the United States signed a traditional FTA with Egypt, it would more than offset the effects of trade diversion on US exports due to the Euro-Med agreements. But it would not really deal adequately with the many barriers faced by US firms in operating in Egypt, nor would it make a major contribution to Egypt's internal reforms and its relationship with other trading partners. By contrast, a WTO-plus FTA with the United States -- which did eliminate these measures -- would boost US employment related to trade by an additional 10 thousand jobs, facilitate US access, promote Egyptian growth, provide a fulcrum for regional economic growth and trade, and advance the US multi-track approach to freer trade and investment.

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Appendix 1

US Concerns about Egyptian Practices

Customs Valuation and Procedures. Exporters and importers claim that Egypt's customs duty assessment is often arbitrary, and rates charged are often higher than prescribed in the tariff code. Tariff valuation is based on the so-called Egyptian selling price based on the commercial invoice that accompanies a product the first time it is imported. Subsequent imports of the same product must have a value not lower than that noted on the invoice of the first shipment. Customs officials routinely increase invoice values from 10 to 30 percent for customs valuation purposes.

Banned Imports. Egypt is phasing out an import ban applied to textiles, apparel and poultry as a result of its commitments in the Uruguay Round. The ban list has an important impact on American exports of poultry. However, Egypt has imposed new obstacles to importing previously banned products. Substantial increases in the duty rates of several products such as tractors, cement, and frozen vegetables were imposed immediately after their removal from the ban list in August 1992. The tariff on poultry was increased from 5 to 70 percent. Many items removed from the banned items list, including meat, fruits, vegetables, household appliances, construction products, electronic devices, appliances, transformers, and many consumer goods, were added to the list of commodities requiring inspection for quality control before importation.

Standards. Some 1,500 tariff lines (25 percent of the tariff schedule) are subject to quality control. Internationally recommended methods for testing and certification are allegedly ignored, and internationally recognized quality and certification marks may not be accepted. Importers report that testing procedures for import differ, and that tests are carried out with faulty equipment by testers who often make arbitrary judgments. Other product specifications act as barriers to trade. For example, the Ministry of Health requires that beef imported for direct human consumption have less than seven percent fat, a level virtually never reached in premium beef exports. Sales of $1-2 million of high quality US beef have allegedly been jeopardized.

Government Procurement. Egypt by law gives national bidders a 15 percent price advantage. The tender process is subject to complaints about lack of transparency, poor enforcement of rules and rigged outcomes. Egypt is not a member of the WTO government procurement agreement.

Intellectual Property. Egypt has increased intellectual property protection over the past few years. The United States has progressively improved its ratings of Egypt's laws and enforcement. Since 1994 Egypt has moved from the priority watch list to the list of countries "to be monitored for progress achieved." Nonetheless, efforts to draft a modern patent law have met with stiff resistance from Egypt's pharmaceutical and chemical industries.

Services. Egypt maintains limitations on the share of foreign personnel in foreign controlled enterprises and a maximum of 49 percent of foreign capital in several industries (construction and related engineering services, tourism projects in the Sinai region, insurance). Economic need tests are required in the case of tourism, the opening of branches by foreign banks and insurance companies (for example, new companies should be able to work without harmful competition to existing companies), and the operation of representative offices, among others. Egypt's state-owned telecommunication industry remains heavily regulated.

Investment. In 1991, Egypt removed virtually all categories of direct investment from the negative list requiring prior government approval, with the exception of tobacco, military industries and Sinai investments. On 11 May 1997 a new investment law reaffirmed basic guarantees for investors, clarifying the framework for investment incentives. Under the 1992 US-Egypt Bilateral Investment Treaty (BIT), Egypt is obliged to maintain certain critical elements of an open investment regime. Despite the BIT and further liberalization, approval of foreign investment is subject to long procedures and is not yet automatic. The United States has addressed the liberalization of Egyptian investment screening requirements in the context of the Uruguay Round negotiations on TRIMS and the Gore-Mubarak partnership for economic growth.

Privatization. It is difficult for private firms to compete in sectors dominated by state-owned enterprises. While Egypt has privatized 46 firms valued at $3.1 billion by 1997, this is a small share of the approximately 300 companies with book values of $27 billion.[13] In 1997, the government was unable to meet its plans for privatizing 33 companies.

Competition Policy. Egypt does not have laws prohibiting monopolies, cartels, or conflicts of interest.

***Pharmaceuticals*.** The price control of the pharmaceutical sector results in the inability of US companies to adjust prices to reflect general inflation. US companies occasionally allege discrimination in granting price increases. Another area of difficulty for foreign pharmaceutical companies is that no more than four similar drugs are allowed in the market, reducing companies ability to expand their product lines.

Workers' Rights. Another problem relates to workers' rights. All industrial unions in Egypt are required to belong to the Egyptian Trade Union Federation, the sole legally recognized labor federation. This according to the US government is in violation of the ILO principle of freedom of association.

Red Tape. Major bureaucratic requirements hinder private initiative. Although the government has simplified company registration and streamlined approval processes, "pervasive red tape remains the number one complaint of both foreign and domestic investors."[14]

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[13] *Economic Trends Report for Egypt*, US Department of State, July 1997, p. 3.
[14] *Economic Trends Report for Egypt*, US Department of State, July 1997, p. 3.