
Introduction

One of President Barack Obama's key foreign policy challenges is to craft a constructive new US strategy toward the Middle East and North Africa (MENA). Given the political fissures in the region caused by the Iraq war, US policy will likely shift focus from military intervention to economic engagement. In turn, this policy reorientation will require more attention to US-Egypt relations, for two broad reasons.

First, Egypt holds a strategic position both economically and politically in the MENA region. It controls the Suez Canal, borders on both the Red and Mediterranean Seas, and is a land bridge between Africa and Asia. It has close ties to the economies of the Middle East and Europe. Egypt contributes substantially to UN peacekeeping missions, hosts climate change talks, serves as the location for the Arab League headquarters, and often provides the site for diplomatic talks on Middle Eastern issues, particularly Arab-Israeli peace talks.

Second, the United States and Egypt already have a significant economic partnership dating back three decades. Enhancing that relationship could yield substantial dividends in terms of increased trade and investment and closer cooperation on strategic initiatives in the MENA region.

Since the Camp David accords in the late 1970s, the United States has provided large sums of development assistance to Egypt as well as Israel. US economic and military aid was designed to foster economic opportunities in the region, promote economic cooperation among former regional adversaries, and offset the economic backlash against Egypt by its Arab partners in the wake of its peace agreement with Israel.¹ Cumulatively, US financial and military assistance to Egypt has exceeded \$50 bil-

1. Egypt was expelled from the Arab League, which it had helped found, in 1979. It was readmitted in 1989.

lion. US support for Egypt has been considered a long-term investment toward peace in the region reflecting the view that economic development breeds stability. On balance, the strategy has worked to the benefit of all.

Yet US-Egypt commercial relations remain underdeveloped. Bilateral merchandise trade in 2008 totaled \$8.4 billion and represented only 5 percent of US trade with the entire MENA region. US foreign direct investment (FDI) in Egypt, valued at almost \$8.8 billion at end 2008, is concentrated in the mining/petroleum sector; Egypt hosts less than 20 percent of all US placements in the MENA region. Long-anticipated free trade negotiations were stillborn in late 2005 due to US objections to political developments related to Egypt's presidential election. Since then, US trade promotion authority (TPA) has expired, complicating the politics of launching new negotiations on a comprehensive bilateral free trade pact.² More recently, US officials have been distracted by the global economic crisis, the continuing military action in Iraq and Afghanistan, tensions over Iran's nuclear program, and domestic reforms on health care and climate change, which have pushed new trade initiatives to the backburner.

In this Policy Analysis we argue that the success of a new Middle East strategy depends importantly on the future course of US-Egypt economic relations and that deepening bilateral ties could pay both commercial and political dividends. Such a conclusion may sound odd to those conditioned to think of the MENA region largely as a petroleum platform. But US interests in the region go well beyond oil and gas.

Table 1.1 provides summary indicators of Egypt's profile in the MENA region and highlights both its strengths and vulnerabilities. On the political front, Egypt maintains the largest armed forces in the MENA region, with more than 800,000 military personnel in 2007 (50 percent more than Iran). Like many Middle Eastern regimes, it scores relatively poorly on the Freedom House index of civil liberties and political rights, reflecting decades of autocratic rule. On the economic front, Egypt is the most populous country in the region with 75 million people and has the third largest economy (after Iran and Saudi Arabia). But it falls into the middle of the pack in several other categories: merchandise trade, economic freedom, and surplus energy (Egypt produces oil but not much more than it consumes). More worrisome, Egypt receives low scores for economic and social development (as rated by the UN Human Development Index) and

2. In the president's trade policy agenda, issued in March 2009, reauthorization of TPA is mentioned as a priority but one that will be pursued only "after engaging in extensive consultation with Congress to establish the proper constraints on that authority and after we have assessed our priorities" (Office of the US Trade Representative, *2009 Trade Policy Agenda and 2008 Annual Report of the President of the United States on the Trade Agreements Program*, Washington, available at www.ustr.gov). It is unclear whether TPA will be revived but if it is, the new authority likely would be subject to additional conditions regarding a partner's policies toward labor, environment, and human rights.

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for mitigating poverty—reflecting continuing strains in Egyptian society that are also illustrated by several political indicators.

In a nutshell, table 1.1 shows Egypt as a regional power with untapped economic potential that if nurtured could yield new prosperity and if ignored could exacerbate tensions in Egyptian society with adverse implications for the region as a whole. Since 2004, economic reforms in Egypt have created new opportunities for trade and investment. However, these reforms have not been able to alleviate the entrenched poverty and unemployment in Egyptian society. The challenge for US policy is to pursue a commercial diplomacy that supports economic progress in Egypt by deepening trade and investment ties. The United States can enhance these ties and make them sustainable by supporting investments in physical infrastructure and by helping Egypt to improve its quality and supply of human capital. Such a policy would ensure that the United States has a strong and stable partner in the region and would enhance US-Egyptian economic relations to the benefit of both societies.

The need to do so is evident. US economic policy in the Middle East is currently adrift. In 2003, President George W. Bush announced a new initiative to create a US-Middle East Free Trade Area (MEFTA) by 2013 that would promote freedom and economic prosperity in the region. The MEFTA was put forward in the flush of successful military operations in Iraq, in the expectation that “freedom and peace in the Middle East would . . . increase our own security” and that the MEFTA would be part of a broader US effort to promote “economic and political and social progress” in the region.³ The MEFTA would be constructed through an iterative process: The United States would first provide technical and financial assistance to spur economic reform in the Middle Eastern countries, while deepening trade and investment relations through bilateral investment treaties (BITs) and trade and investment framework agreements (TIFAs). Such efforts would encourage greater integration into the world trading system and help prepare countries to undertake the more comprehensive obligations contained in free trade agreements (FTAs).

To date, the MEFTA initiative has fallen far short of its projected mark, even though the goals of such an initiative remain compelling. The United States has made only limited progress in its efforts to strengthen economic ties with Egypt and the broader MENA region. The United States has concluded FTAs with Jordan, Morocco, Bahrain, and Oman and BITs with Egypt, Bahrain, Jordan, and Morocco, but none of these pacts has promoted the type of broader intraregional associations that the MEFTA architects envisaged as critical to integrating a region that still ranks among the least globalized in the world (Noland and Pack 2007). None of

3. President Bush announced the trade initiative at a commencement address to the University of South Carolina, Columbia, May 9, 2003, available on the American Presidency Project website, www.presidency.ucsb.edu (accessed on November 11, 2009).

Table 1.1 Selected indicators for countries in the Middle East and North Africa

Country	Population, 2008 ^a		GDP (PPP), 2008 ^a		Merchandise trade, 2008 ^b			
	Millions	Rank	Billions of current international dollars	Rank	Exports (millions of US dollars)	Rank	Imports (millions of US dollars)	Rank
Algeria	35	4	241.1	4	78,233	5	39,156	7
Bahrain	1	20	26.5	18	18,865	13	12,530	15
Djibouti	1	19	1.9	20	69	20	580	20
Egypt	75	1	443.1	3	25,483	10	48,382	5
Iran	73	2	816.8	1	116,350	3	57,230	4
Israel	7	10	200.9	5	60,825	8	67,410	3
Jordan	6	12	30.3	17	7,790	17	16,888	13
Kuwait	3	15	141.0	7	93,180	4	25,125	9
Lebanon	4	14	45.8	16	4,454	18	16,754	14
Libya	6	11	90.6	11	63,050	7	11,500	16
Mauritania	3	16	6.4	19	1,750	19	1,750	19
Morocco	31	5	138.2	8	20,065	11	41,699	6
Oman	3	17	67.7	14	37,670	9	23,095	11
Qatar	1	18	95.1	9	63,830	6	26,850	8
Saudi Arabia	25	6	600.5	2	328,930	1	111,870	2
Sudan	38	3	89.0	12	12,450	15	9,200	18
Syria	20	8	92.8	10	14,300	14	18,320	12
Tunisia	10	9	83.1	13	19,319	12	24,612	10
United Arab Emirates	5	13	186.2	6	231,550	2	158,900	1
Yemen	23	7	55.2	15	9,270	16	9,300	17

n.a. = not available

Sources: a = International Monetary Fund, *World Economic Outlook* Database; b = World Trade Organization, International Trade Statistics Database; c = United Nations *Human Development Report 2008* Statistical Update; d = Heritage Foundation/Wall Street Journal 2009 Index of Economic Freedom; e = World Bank, *World Development Indicators* Database; f = Freedom House, 2008 Freedom in the World Index.

the FTA partners has significantly expanded economic ties with Egypt, despite hortatory pronouncements emanating from negotiations to establish a pan-Arab free trade area. The prospect for achieving a MEFTA by knitting together bilateral FTAs with MENA countries appears to be off the table.

If the Obama administration wants to deepen economic ties with Egypt and other MENA countries, it will need to consider other options for economic engagement than the conventional FTAs pursued during the Bush

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2008 Human Development Index (2006 data) ^c		2008 Human Poverty Index (2006 data) ^c		2009 Economic Freedom Index ^d		Surplus energy, 2006 ^e		Military personnel, 2007 ^e		2008 Freedom in the World Index ^f	
Value	Rank	Value	Rank	Value	Rank	Value	Rank	Thousands	Rank	Score	Rank
0.748	13	18.1	12	56.6	14	136.5	3	334	4	5.5	10
0.902	4	8.3	4	74.8	1	7.6	12	19	18	5.0	7
0.513	20	26.5	14	51.3	16	n.a.	n.a.	12	19	5.0	7
0.716	15	20.0	13	58.0	10	15.3	9	866	1	5.5	10
0.777	10	12.0	6	44.6	18	138.4	2	563	2	6.0	15
0.930	1	n.a.	n.a.	67.6	2	(18.6)	18	185	7	1.5	1
0.769	11	6.1	1	65.4	6	(6.8)	16	111	10	4.5	4
0.912	2	n.a.	n.a.	65.6	5	125.3	5	23	16	4.0	2
0.796	9	8.5	5	58.1	9	(4.5)	15	76	11	4.5	4
0.840	6	13.6	9	43.5	19	84.2	6	76	12	7.0	19
0.557	18	35.9	17	53.9	15	n.a.	n.a.	21	17	4.0	2
0.646	16	31.8	15	57.7	12	(13.3)	17	246	5	4.5	4
0.839	7	15.0	10	67.0	3	45.1	8	47	15	5.5	10
0.899	5	7.2	2	65.8	4	76.8	7	12	20	5.5	10
0.835	8	12.5	7	64.3	8	424.6	1	238	6	6.5	17
0.526	19	34.3	16	n.a.	n.a.	13.0	10	127	9	7.0	19
0.736	14	13.0	8	51.3	17	7.6	13	401	3	6.5	17
0.762	12	16.1	11	58.0	11	(2.1)	14	48	14	6.0	15
0.903	3	7.8	3	64.7	7	130.4	4	51	13	5.5	10
0.567	17	36.6	18	56.9	13	11.6	11	138	8	5.0	7

era. In the case of the US-Egypt economic relationship, existing bilateral mechanisms—the long-standing BIT and TIFA as well as links through chambers of commerce and other business networks—could be enhanced so that US programs more directly support efforts to expand production and employment opportunities in Egypt. New initiatives that promote broader bilateral cooperation and enhanced commercial and investment ties could reinforce Egypt’s efforts to improve its international competitiveness. Sustaining and augmenting those policies, in turn, could help create a better environment for expanding economic opportunities and promoting democratic processes in Egypt.

President Obama already has taken several important steps with respect to the MENA region: appointing George Mitchell, former Senate majority leader, to coordinate US Middle East policy; making a major pol-

icy address on US relations with the Muslim world from Cairo University in June 2009; and pushing for the resumption of peace talks between Israel and the Palestinian Authority. In May 2009 US Trade Representative Ron Kirk and Egyptian Minister of Trade and Industry Rachid Mohamed Rachid agreed to develop a US-Egypt Plan for a Strategic Economic Partnership on Trade-Related and Investment Issues, which would seek to “remove impediments to trade and investment between the two countries.” In announcing the plan, USTR Kirk noted that “priority areas for discussion and cooperation” should include intellectual property rights, agriculture, environment, labor, and investment issues.⁴ Minister Rachid noted, in a subsequent speech in Cairo, that he hoped that US-Egypt trade would double in the next four years as a result of the strategic partnership.⁵

The strategic economic partnership provides an opportunity to reinvigorate US-Egypt relations and bolster two-way trade. As Ahmed Galal and Robert Z. Lawrence (2005) argued several years ago, by helping anchor Egyptian reforms, deeper bilateral economic ties can create a strong foundation for Egyptian economic growth and broader opportunities for bilateral trade and investment. Similarly, a more stable and prosperous Egypt can provide a solid foundation for building a broader US economic partnership in the region.

To that end, this Policy Analysis examines the current state of bilateral economic relations and channels for deepening bilateral engagement. In chapter 2 we assess steps taken to date to enhance the economic relationship and to replace aid with trade and investment through inter alia establishment of a BIT and new trade preferences under the qualifying industrial zones (QIZ) program. We also assess the progress to date of Egyptian economic reforms that are critically important both to enhance Egyptian competitiveness and to expand trade and investment opportunities in Egypt.

In chapter 3 we set out specific policy initiatives that each country could pursue to propel Egyptian economic development and broaden bilateral trade and investment. The first tranche of measures aims to expand market access in goods and services. The second tranche of measures focuses on trade facilitation measures that could remove the obstacles in the trade logistics chain undercutting Egypt’s competitiveness. The third tranche addresses fundamental competitiveness issues that could yield substantial long-term benefits for the Egyptian economy such as improving phys-

4. Office of the US Trade Representative, *United States–Egypt Plan for a Strategic Economic Partnership on Trade-Related and Investment Issues*, May 27, 2009, Washington, available at www.ustr.gov.

5. Rachid Mohamed Rachid, *A More Engaging US-Egypt Economic Relationship*, speech at the American Chamber of Commerce, Cairo, May 31, 2009, available at www.amcham.org.eg (accessed on August 9, 2009).

ical infrastructure and human capital—including addressing the issue of gender inequity.

Chapter 4 summarizes our policy recommendations and what each country needs to do—both unilaterally and jointly—to promote economic growth in Egypt and create new opportunities for bilateral trade and investment. Taken together, these initiatives could contribute importantly to the strategic economic partnership that both countries have committed to pursue.

