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Conclusion

We began this volume by postulating that a US-Egypt free trade agreement (FTA) could be advantageous to both parties, economically and politically. We also argued that the timing for concluding such an agreement seems appropriate in light of recent changes in US trade policy, the state of reform in Egypt, and the increasing world attention given to the Middle East. Our analysis supports these broad conclusions. In this concluding chapter, we reiterate and elaborate three points. First, the benefits from the agreement are sensitive to the terms agreed upon, which has implications for the negotiating position of both parties if and when the negotiations begin. Second, the benefits are contingent on complementary measures by the United States and Egypt. Third, the agreement is likely to be met with some opposition on both sides. However, the gains to both parties warrant finding mechanisms to compensate the losers.

With respect to the first point, our analysis indicates that for the United States, minor economic adjustment costs would yield direct economic benefits, although they are unlikely to be perceptible in an economy of its size. The real US payoff stems from the political benefit of promoting Egyptian development. By contrast, Egypt could derive significant positive economic benefits through improved access, greater levels of foreign direct investment (FDI), and increased efficiency, though realizing those benefits may be politically difficult. Both of these conclusions are sensitive to the scope of the agreement. The simulations carried out in chapter 4 indicate that Egypt would benefit much more from a deep agreement that includes services and investment reform than from one confined to merchandise trade.

Negotiating Postures

These findings have important implications for Egyptian and US negotiators. The traditional perspective on negotiations is that they are zero-sum. A win for one side implies making the least number of concessions to

secure the most from the other side. However, a negotiating posture that concentrates on minimizing commitments is not necessarily in Egypt's best interest. The agreement provides Egypt with important opportunities: the chance to improve market access, increase FDI, enhance consumer choice, stimulate regional integration, and encourage institutional reforms. Taking advantage of these opportunities may mean making more rather than few commitments. This does not mean that everything sought by the United States will necessarily be desirable and consistent with Egypt's level of economic development and reform strategy. But the Egyptian negotiator might seek more appropriate terms only in instances when US demands diverge from Egypt's development needs.

For the US negotiator, recent vintages of US FTAs are likely to serve as the starting negotiating position. However, two such positions may prove counterproductive. The first is the insistence by the United States that Egypt undertake "enough" reforms before FTA negotiations begin, a position held by some US officials in the past. It is problematic because it leaves open the question of how much reform is "enough" for the process to move forward. Indeed, while Egypt has much to reform, the same can be said of other countries that are already US FTA partners. More important, this posture diminishes one of the key benefits from the agreement, namely its value as a reform anchor.[1] To avoid vagueness about what is required of Egypt, and for the FTA to really boost reform, the agreement can be constructed in such a way as to involve conditionality and monitoring mechanisms to ensure compliance. Implementation could also be phased over time to enhance the feasibility of reform, taking into account Egyptian social considerations.

US negotiators face another potential pitfall in focusing on the narrow interests of particular US companies who have large stakes in the Egyptian market when these actually conflict with the general interest in promoting economic development. One particular example, in our view, would be US demands for rules about using test data that delay introducing generic pharmaceuticals once their patents have expired. Paying exclusive attention to these interests is not problematic to the extent that the demands are also consistent with the objective of supporting economic development in Egypt. But there will be instances where the two objectives conflict with each other. In such cases, it is important that US negotiators be mindful of the broader interests of the two countries.

Complementary Actions

Turning to the second point, full exploitation of the benefits of the agreement clearly requires a number of complementary measures on both sides.

1. On the merit of FTAs as a reform anchor, see, for example, François (1997).

On the Egyptian side, complementary measures will be needed to enhance the competitiveness of its exports. Currently, Egyptian exports of manufactured goods to the United States (besides textiles) already enjoy virtually duty-free entry. Despite this advantage, with the exception of clothing, manufactured goods exports to the United States are miniscule. While nontariff barriers undoubtedly play some role, the most important source of Egypt's relatively weak export performance is its inability to produce goods and services that Americans will buy. The United States is a highly competitive market, requiring considerable know-how to produce and market products successfully. While there are undoubtedly many Egyptian goods and services that could be successfully exported to the United States, Egypt has yet to identify what they are and how to export them effectively.

One way to address Egypt's supply-side weaknesses is through additional reforms that make it more attractive for FDI to locate in Egypt, taking advantage of the prospects of producing in Egypt and selling in the United States once the US-Egypt FTA improves and secures market access. This reform is particularly important for Egypt because it needs to offset the disadvantages of its small domestic market for foreign investors. The current low ratio of FDI to GNP in Egypt, and the low ranking of the Egyptian economy on the competitiveness index of the World Economic Forum, indicate that further reforms in the business environment are necessary. The list of needed reforms has been elaborated elsewhere, but the most important elements include administrative reforms to reduce transactions costs, judicial reforms to improve the efficiency of conflict resolution, and financial-sector reform to better the process of resource mobilization and allocation (see, for example, Benham 1997; Radwan 1997; and Sachs 1996). Egyptian political reforms will also help the agreement pass in the US Congress.

Since US interest in the FTA is heavily political, it is no surprise that the most important complementary actions for the United States relate to the politics of the region. An acceptable resolution of the conflict between Israel and Palestine is long overdue. This should be America's highest priority. The issue has long distracted governments in the region from concentrating on domestic economic, social, and political reforms. Resolving it would not only pay off handsomely in geopolitical terms but could also help stimulate domestic reforms in the region.

Dealing with Opposition

The third point relates to potential opposition to the agreement in the United States and Egypt from import-competing interests. The grounds for opposition in both cases are not very strong, and furthermore, it is possible to devise mechanisms to mobilize support for the agreement.

The impact of the agreement on labor in the United States is negligible and should not provoke intense opposition. The simulations indicated an increase in Egyptian exports of $2 billion, with clothing exports—Egypt's major manufactured export to the United States—rising by $155 million, most of which would reduce US imports from other countries rather than hurt domestic production.

As for Egypt, the main benefits of the agreement lie in the process of reallocating resources from import-competing to export industries. The United States is unlikely to be a strong competitor in labor-intensive manufactured goods, where Egypt enjoys a comparative advantage. Instead, the major adjustment pressures in Egypt could be in agriculture. The import-competing industrial sector in Egypt has already begun the adjustment process through multilateral trade liberalization and the association agreement with the European Union. And the history of the last 15 years supports the view that Egypt's economy can adjust. Despite dramatic reductions in tariffs, the trade deficit remained within a fairly constant range, indicating that exports kept pace with imports.

To be sure, some adjustments will need to be made, and certain groups will be affected adversely. To reduce the opposition of such groups and the pain of adjustment, again, the FTA can be phased in over time—and special safeguards for agriculture are warranted. In addition, the United States could provide some financial assistance to ease the process, as the European Union did in its FTAs with most countries in the Middle East.

A US-Egypt FTA is a chance for both sides to enter into a mutually beneficial agreement. For Egypt, it is a unique opportunity to use a trade agreement to promote domestic reforms; for the United States, it is a vehicle for supporting economic development in a key country in the region. The gains from this endeavor for both parties are not automatic, however. It will take mutual understanding by negotiators on both sides to realize the potentially significant economic and political gains. The process also depends on the complementary measures adopted by both sides, while its political acceptability will be enhanced by measures to assist those who are adversely affected. Success thus hinges on a high level of collaboration and compromise and on a keen eye on the long-term dynamic gains rather than the short-term static ones. But the potential political and economic benefits for both sides are great enough to make it worthwhile.