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PROSPECTIVE US-EGYPT FREE TRADE AGREEMENT COULD SUBSTANTIALLY BENEFIT BOTH COUNTRIES

Washington—The United States and Egypt could achieve major political and economic gains by committing to comprehensive trade liberalization under a bilateral free trade agreement (FTA) between the two countries. Egypt could increase its GDP by almost 3 percent. The FTA could stimulate regional integration throughout the Middle East and lock in recent reforms by the Egyptian government. For the United States, the economic effects of the agreement would be small, but the payoff would come from promoting Egyptian development and accelerating the prospects for an FTA with the Middle East as a whole, on which the Institute has just launched a major new project as well.

In *Anchoring Reform with a US-Egypt Free Trade Agreement*, a new book released today by the Institute for International Economics, authors Ahmed Galal and Robert Z. Lawrence assess the impact on both parties of negotiating an FTA. They outline the provisions such an agreement ought to include to maximize its benefits and cite four key effects that the FTA could produce:

- **Boosting domestic reform in Egypt.** Starting in 1991, Egypt began to make significant progress in stabilizing and liberalizing its economy. Trade liberalization gained momentum when a new government took office in 2004. However, further privatization and institutional reforms are needed, and an FTA could importantly support these initiatives.

- **Stimulating regional reform.** Because of Egypt's size, location, history, and regional role, a US-Egypt FTA could produce an important demonstration effect. Such a result would promote the Bush administration's goal of launching bilateral FTAs with individual Middle Eastern countries in order to eventually build a comprehensive US–Middle East FTA.

- **Avoiding trade diversion.** Egypt already has FTAs with the European Union and other Arab countries, which places US exporters and investors at a disadvantage. An FTA with the United States will complement Egypt's existing web of agreements because the United States is Egypt's second most important trading partner (after the European Union).

- **Improving bilateral economic relations.** The small amount of US direct investment in Egypt is concentrated in the oil industry. Bilateral trade also is concentrated in a few sectors. Aid to Egypt from the United States has been dwindling. An FTA could strengthen these modest economic ties between the two countries.

The authors recommend that Egypt and the United States negotiate a deep and comprehensive agreement—including measures to attract investment to Egypt and to remove nontariff barriers and administrative barriers to trade—rather than a shallow pact focused solely on reducing tariffs in manufacturing. They do so on the basis of calculations of the impact of alternative types of agreements, taking into account the fact that Egypt is already committed to bilateral free trade with the European Union and to a Greater Arab Free Trade Area (GAFTA).

Under the scenario of a comprehensive FTA that eliminates nontariff barriers on trade in goods and services, and reciprocally removes Egyptian and US tariffs, there are important, positive effects on the Egyptian economy. Output increases by 2.82 percent. Household incomes increase by 1.63 percent. Returns for labor go up by 3 percent. The consumer price index falls by 1.6 percent as the cost of imports and regulatory costs decline. The real exchange rate increases by 3.21 percent. Returns to capital owners rise 0.84 percent. Egypt would clearly gain from such an agreement, and the United States thus also has a considerable interest in concluding such an agreement.

About the Authors

Ahmed Galal is executive director and director of research at the Egyptian Center for Economic Studies (ECES) in Cairo. He has also been a staff member of the World Bank since 1984, where he served as industrial economist in Europe, the Middle East, and North Africa; senior then principal economist in the bank's research arm; and economic adviser to the private-sector development department. His works include, among others, *Building Bridges: An Egypt-U.S. Free Trade Agreement* (Brookings Institution Press, 1998) and *Monetary Policy and Exchange Rate Regimes: Options for the Middle East* (ECES, 2002).

Robert Z. Lawrence, senior fellow, is also the Albert L. Williams Professor of Trade and Investment at the John F. Kennedy School of Government at Harvard University. He served as a member of the Council of Economic Advisers from 1999 to 2000. He held the New Century Chair as a nonresident senior fellow at the Brookings Institution between 1997 and 1998 and founded and edited the Brookings Trade Forum in 1998. He was a senior fellow in the Economic Studies Program at Brookings (1983–91), a professorial lecturer at the Johns Hopkins School of Advanced International Studies (1978–81), and an instructor at Yale University (1975). He is the author or coauthor of more than 100 papers and articles on international economics and of several books, including *Crimes and Punishments: Retaliation under the WTO* (2003), *Globaphobia: Confronting Fears about Open Trade* (Brookings Institution Press, 1998), and *Building Bridges: An Egypt-U.S. Free Trade Agreement* (Brookings Institution Press, 1998).

About the Institute

The Institute for International Economics, whose director is C. Fred Bergsten, is the only major research center in the United States that is devoted to global economic policy issues. The Institute's staff of about 50 focuses on macroeconomic topics, international money and finance, trade and related social issues, and international investment, and covers all key regions—especially Europe, Asia, Latin America, and the Middle East. The Institute averages one or more publications per month; holds one or more meetings, seminars, or conferences almost every week; and is widely tapped over its popular Web site.

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