

Egyptian Officials Visit Israel to Discuss QIZs

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Articles & Testimony

Egyptian officials and businessmen are visiting Israel this week to discuss the creation of Egyptian-Israeli qualified industrial zones (QIZs), which would give them free trade access to US markets. They seek to emulate Jordan's QIZ, the most successful example to date of US-Arab free trade.

Indeed, these zones have given Jordan - a relatively poor and resource-scarce country - its most substantial peace dividend from its 1994 treaty with Israel. Yet, the Jordan QIZ experiment is in danger of failure, a situation that has important implications for US efforts to promote regional free trade.

Established in 1997, Jordan's QIZs were designed to promote normalized relations between Israel and Jordan through joint economic gains. QIZ goods qualify for free trade access to US markets if 35 percent of their content is QIZ-produced (including a minimum of 7 to 8 percent Israeli inputs).

Although the breakdown of the Israeli-Palestinian peace process has inhibited widespread normalization, the QIZs have been credited as a policy victory in light of economic benefits Jordan has gained. Washington envisions replicating Jordan's QIZ gains on a regional scale by establishing a Middle East Free Trade Area (MEFTA). The QIZs have helped Jordan increase trade with the United States, create jobs, and improve foreign investment and growth.

The US was Jordan's primary trade partner in 2003, importing \$673 million worth of Jordanian goods (up from \$16 million in 1998), or 28 percent of the country's total exports. QIZ exports accounted for \$587 million of US-Jordanian trade.

The QIZs have created more than 26,000 jobs for Jordanians, not including their impact on peripheral industries such as shipping, packaging and support facilities. More than 70 percent of the Jordanian workers in the QIZs are women, many of whom are their family's only source of cash income.

Jordan's QIZs have attracted \$678 million in investment. From January to October 2003, foreign investment in Jordan increased by 46.8 percent compared with January-October 2002. Moreover, Jordan's gross domestic product grew by 4.2 and 5.0 percent in 2001 and 2002, respectively - a remarkable gain considering the regional political environment.

Despite these impressive statistics, Jordan's QIZs have had certain unintended consequences that could undermine the entire project. A large part of the zones' success is attributable to the fact that Asian companies have exploited them as a temporary, backdoor opportunity to gain quota and tariff-free access to the US garment and textile market.

Given the eagerness of foreign investors to maximize profits prior to imminent changes in the international garment and textile market, many of the Asian-owned companies operating in Jordan's QIZ are not concerned with further developing local industries or a labor force that will remain competitive beyond the short term. Consequently, many foreign-owned QIZ factories produce mostly cheap garments and rely heavily on Asian labor.

In 2002, 93 percent of Jordan's exports to the United States consisted of clothing: various types of coats (50 percent) and other apparel made of textile fabrics (43 percent). Jordan's next greatest export to the US was jewelry, at only 2.6

percent. Effectively, then, the success of the QIZ depends on America's demand for cheap garments. In fact, garments accounted for 33.6 percent of all Jordanian exports worldwide in 2003.

Moreover, according to the Jordanian Labor Ministry, 44 percent of the QIZ workers who make these garments are foreigners. Jordan had to import experienced foreign labor because it lacked a pre-existing force of skilled garment workers when the QIZs were created. Jordan's continued employment of so many foreigners is a missed opportunity to reduce its own unemployment (currently at 15 percent) and develop a more skilled Jordanian workforce.

New sources of competition will soon challenge the market share held by Jordan's QIZs. Bahrain is negotiating a free trade agreement (FTA) with the US and could emerge as another garment hub for Asian investors. Egypt, a resource-rich and labor-abundant country, is also eager to negotiate an FTA with Washington, in addition to its previously mentioned efforts to establish QIZs with Israel.

Jordan's QIZ garment industry could soon be competing with manufacturing giants such as China if quotas on textiles and garments are lifted under the Multi-Fiber Agreement in January 2005, as mandated by the World Trade Organization.

Amman's current preferential trade status gives it an opportunity to carve out a more enduring niche, provided it moves quickly. In order to take advantage of the existing US-Jordanian FTA and maintain long-term competitiveness, Amman will have to both diversify its exports and further develop its labor force.

Jordanian industries need to move from producing cheaper goods (e.g., underwear) to more expensive goods (e.g., designer shirts) so as not to wind up competing with "sweat shop" industries in other countries. The key to such diversification is more productive and skilled labor. Toward that end, the Jordanian Labor Ministry has established a training program and rural recruiting campaign aimed at increasing the number of skilled Jordanian workers. Both programs target Jordanian women, whose unemployment rate is 60 percent higher than the national average.

The future of Jordanian trade with the United States depends on the success of these programs. Jordanians cannot expect US protection to continue indefinitely. Unless Jordan takes aggressive action now, before it is forced to face new international competition, it could lose thousands of jobs.

However, Amman is Washington's most consistent Arab ally, cooperating on the "war on terror," playing a positive role in the peace process and supporting US action in Iraq. Washington therefore has a strong interest in ensuring that the QIZs do not collapse.

Policymakers should draw two key lessons from the Jordanian QIZ experience. First, economic reforms must yield tangible benefits if they are to succeed. Taken together, the income and training that Jordanian women have gained by working in QIZs constitute the most tangible benefits of the initiative, and one that has had a significant multiplier effect. As such, future FTA negotiations with Arab countries should be structured as win-win opportunities; US officials must consider the interests of foreign populations alongside the potential benefits for Americans. Free trade must be viewed as a part of overall Middle Eastern reform efforts, not strictly through the lens of US commercial interests.

Also, an environment of complementary relationships must be established to account for the competing needs of different countries. Fortunately, policymakers have correctly chosen to take a country-by-country approach in laying the groundwork for the MEFTA. In the case of Jordan, Washington's challenge is to help Amman create competitive industries while not shutting out Egypt, a future player that is not yet structurally ready to enter FTA negotiations. Allowing one country's trade relationships and industries to stagnate while concentrating on the short-term interests of another will only create new economic distortion, not the widespread benefits that are MEFTA's goal.

Benjamin Orbach is a Research Fellow at The Washington Institute for Near East Policy. This article is reprinted with permission from The Washington Institute. ❖

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