

# Preventing a Boom-to-Bust in Jordan's QIZs: Implications for Middle East Free Trade

Mar 19, 2004



## Brief Analysis

**E**gyptian 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 U.S. markets. They seek to emulate Jordan's QIZs, the most successful example to date of U.S.-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 U.S. efforts to promote regional free trade.

### Background

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 U.S. 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 the economic benefits that Jordan has reaped. Indeed, Washington envisions replicating Jordan's QIZ gains on a regional scale by establishing a Middle East Free Trade Area (MEFTA). Specifically, the QIZs have helped Jordan increase trade with the United States, create jobs, and improve foreign investment and growth:

**Trade.** The United States 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 U.S.-Jordanian trade.

**Employment.** QIZs have created more than 26,000 new jobs for Jordanians, not including their impact on peripheral industries such as shipping, packaging, and support facilities. Significantly, 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.

**Investment and growth.** Jordan's QIZs have attracted \$678 million in investments. From January to October 2003, foreign investment in Jordan increased by 46.8 percent compared to 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.

### Unintended Consequences

Despite these impressive statistics, Jordan's QIZs have had certain unintended consequences that could undermine the entire project. For example, 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 U.S. 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 currently operating in Jordan's QIZs are not concerned with further developing local industries or a labor force that will remain competitive beyond the near term. Consequently, many foreign-owned QIZ factories produce mostly cheap garments and rely heavily on

Asian labor.

In 2002, for example, 93 percent of Jordan's exports to the United States consisted of various types of coats (50 percent) and other apparel made of textile fabrics (43 percent). (Jordan's next greatest export to the United States was jewelry, at only 2.6 percent.) Effectively, then, the success of the QIZs 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 Ministry of Labor, 44 percent of the QIZ workers who make these garments are foreigners. As a newcomer to the garment industry, Jordan had to import experienced foreign labor because it lacked a preexisting force of skilled garment workers when the QIZs were created. Although some of these foreign workers remain necessary as trainers, 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. Despite the fact that more than 26,000 Jordanians currently work in the QIZs, thousands more could be employed there in place of foreigners.

#### Necessary Action

New sources of competition will soon challenge the market share currently held by Jordan's QIZs. Bahrain is negotiating a free trade agreement (FTA) with the United States 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. Most important, Jordan's QIZ garment industry could soon be competing with manufacturing giants such as China if quotas on textiles and garments are in fact 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 U.S.-Jordanian FTA and maintain long-term competitiveness, Amman must both diversify its exports and further develop its labor force. Specifically, Jordanian industries must 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 Ministry of Labor 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. Amman cannot assume that U.S. electoral pressures will prevent Washington from lifting preferential quotas in 2005. Nor can Jordanians expect U.S. protection to continue indefinitely, especially in light of the proposed MEFTA, slated to be established by 2013. Unless Jordan takes aggressive action now, before it is forced to face new international competition, it stands to lose thousands of jobs and suffer a grievous economic blow.

Washington has a strong interest in ensuring that the QIZs do not collapse and that Jordan develops its industries and labor force. Amman is Washington's most consistent Arab ally, cooperating on the war on terror, playing a positive role in the peace process, and quietly supporting U.S. action in Iraq. Hence, Jordan's economic prospects will have a significant impact on U.S. foreign policy goals. To be sure, the phasing in of new bilateral trade agreements should be conducted in a manner that gives Jordan's new programs time to succeed. Nevertheless, U.S. policymakers should press Amman to address diversification and labor issues immediately.

#### Policy Lessons

Regarding future Middle Eastern reforms, 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 salient benefit of the

initiative, one that has had a significant multiplier effect. As such, future FTA negotiations with Arab countries should be structured as win-win opportunities; U.S. 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 U.S. commercial interests. Arabs should not lose, even in the short term, by deepening relations with the United States. Such an approach requires working with local actors to ensure that the benefits of free trade accrue throughout all stages of implementation.

Second, 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 current 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 due to the short-term interests of another will only create new economic distortions, not the widespread benefits that are MEFTA's goal.

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