



USEF EXPERT PANEL DISCUSSION NOTES

January 19, 2005

QIZ in Egypt: What will they mean for Egypt, the U.S., and trade?

Speakers

- Mr. Steven Lamar, Senior Vice President, American Apparel and Footwear Association
- Mr. Yuval Rabin, Managing Partner, Rabin, Sheves, Lipkin-Shahak & Birger (RSLB) Inc.
- Edward Saums, Director, Middle Eastern Affairs, USTR
- Ayman Zaineldine, Counselor, Embassy of Egypt

Moderator

- Ambassador Nicholas Veliotes, Chairman, USEF

Economic linkages to Egypt are set to receive a big boost through the implementation of the Qualified Industrial Zones (QIZ) program in Egypt. On December 14, 2004, Egypt, Israel, and the United States signed an agreement to implement QIZ, under which companies manufacturing in Egypt will be able to export to the U.S. market under the same terms governing trade as under the U.S.-Israel Free Trade Area Agreement, provided that certain requirements for Egyptian and Israeli content are met. This new arrangement creates opportunities for expanded trade in several areas, notably consumer goods, and constitutes a step forward in U.S.-Egypt relations.

Ambassador Nicholas Veliotes opened the panel by emphasizing the economic benefits of the QIZ program, as well as its importance in the larger context of the ongoing efforts to achieve lasting peace in the Middle East. QIZ are a significant first step toward the completion of a free trade agreement between the United States and Egypt. While opponents have rejected such economic agreements between Egypt and Israel as inappropriate before peace has been achieved, closer economic ties between Egypt and Israel will bring the two countries closer together politically and socially, laying a foundation for political rapprochement.

Mr. Ned Saums began by thanking USEF for hosting the event and by expressing his personal satisfaction in seeing the completion of the QIZ agreement after seven years of work. Signed in Egypt, the agreement is the culmination of a collaborative effort between the three nations and their business communities, and is the most important economic accord between Egypt and Israel in the last 20 years.

The principles behind the QIZ legislation, enacted in 1996, are the following:

- To foster the development of deeper relationships in the region through economic cooperation;
- To demonstrate to the region the benefits of economic integration, through job creation and greater trade flows; and
- To increase trade between the region and the United States.

With this agreement, the United States hopes to replicate the success of the QIZ agreement with Israel and Jordan signed in 1998. Since then, investment in the region has risen and trade between the United States and Jordan has increased from \$40 million to \$300 million per year. The U.S. also hopes that this agreement will assist Egypt in keeping its broader commitment to economic reform, liberalization, and increased growth. Finally, completing the QIZ agreement with Egypt is a significant step toward the United States' goal of establishing a Middle East Free Trade Area by 2013.

USEF EXPERT PANEL DISCUSSION NOTES

January 19, 2005

Mr. Ayman Zaineldine began by noting that the strategy of linking economic and political goals is not a new one. Most notably since World War II, GATT has used economic incentives to foster political integration. The economic argument in favor of establishing QIZ in Egypt was strong: there were significant trade benefits to be gained at little cost. Jordan's earlier success in creating QIZ provided another incentive. Since its establishment in 1998, the QIZ in Jordan has led to the creation of 30,000 jobs, increased investment, and a thirty-fold increase in trade.

Despite the expected benefits and Jordan's example, a QIZ agreement with Egypt took several years to complete. Through the 1990's, the Egyptian government and business community were at first focused primarily on reaching a Free Trade Agreement. In addition, there was a elusive search for the right political moment. However, uncertainty over the effect of this year's expiration of the Multifibre Agreement prompted the Egyptian business community to press for a QIZ agreement in the last few years. The Egyptian government supported their request, and thought it could provide a positive signal for advancing peace in the Middle East, as did the release of a convicted Israeli spy.

There has been significant opposition to the establishment of QIZ in Egypt. In areas where QIZ were not established there have been some demonstrations by those who feel left out or disadvantaged by the agreement. Opposition to the QIZ based on political consideration, on the other hand, was intense, as it was seen to be out step with the political atmosphere in the region, and many believed that looking only after Egypt's economic interests, without regard to the plight of the Palestinians might be unprincipled. While opposition is dying down, it is not disappearing.

Nevertheless, the Government of Egypt is convinced of the economic and political merits of the agreement, and there are numerous projected benefits for Egypt. While the textile industry might be the first to profit from the QIZ, Egypt hopes that other industries will take advantage of the arrangement. The government sees this agreement in the context of the major economic reforms it is undertaking including: reducing tariff barriers, cutting income and corporate taxes by half, reforming the banking sector, and increasing foreign direct investment. There are numerous signs of the positive response to those reforms, including a significant rise in the value of the Egyptian pound against foreign currencies, record numbers of tourists, a 100% rise in stock market indexes and an intensification of interest by foreign investors.

As a former military officer that spent four years on Egyptian soil, **Mr. Yuval Rabin** observed that this agreement is a remarkable achievement in Egyptian-Israeli relations. Neither side, however, should be deceived in thinking that further progress will be easy. Although not a representative of the state of Israel, Mr. Rabin congratulated the Israeli government on the QIZ agreement.

Through regular economic and social interactions, this accord will do more to create a reality of peaceful relations between Egypt and Israel than any peace document. Peace accords often fail in the short term because they do not institute mechanisms for putting peaceful relations into practice. Economic agreements, on the other hand, have the potential to reap immediate economic benefits by opening markets and stabilizing relations, and long term political benefits by establishing personal trust through commercial cooperation. Nevertheless, the success of the QIZ should be measured economically, not in terms of its political impact.

Mr. Steven Lamar started his presentation with a brief overview of the textile industry. The Multifibre Agreement, he explained, was a system of quotas established during the Uruguay

USEF EXPERT PANEL DISCUSSION NOTES

January 19, 2005

Round of trade negotiations by the United States and Europe to restrict lower priced imports from developing nations. The agreement arranged for a gradual reduction of the quotas until its expiration on January 1st, 2005.

There has been considerable debate over the impact that the expiration of the Multifibre Agreement will have on the textile industry, but Mr. Lamar's view was that the elimination of quotas will be beneficial for the textile industry. Quotas increase transaction costs and introduce inefficiencies into the market. Exporters in developing countries are forced to buy permission to export. Consequently, the best producers may not be selected to fill quotas, but producers that can meet government requirements or that have ties to government officials. Quotas also create compliance costs for importers that must provide proof of origin and customs officials that must verify these claims. Ultimately, the quotas were also ineffective. Textile import penetration reached 96% while the Multifibre Agreement was still in effect.

It is generally expected that the expiration of the Multifibre Agreement will result in a more competitive textile market and production will be consolidated among fewer producers, especially Chinese, with larger market shares. In this environment, other factors will become more important, including corporate social responsibility, environmental impact, and attention to human rights. Yet uncertainty remains.

In this context, the QIZ agreement is a welcome development because it establishes predictability in the textile industry. While other trade preference programs often expire and must be renewed, QIZ has no time limit. It also significantly reduces compliance costs because the rules of origin are easy to understand, follow, and document. In contrast, importers from other countries need as many as 80 to 100 documents to satisfy US customs requirements. The agreement makes Egypt, already an attractive trading partner because of the diversity and viability of its textile industry, even more so.

Mr. Lamar concluded his presentation by outlining the AAFA's hopes for Egypt. The first is that QIZ will be established for other textile-producing areas in Egypt. The second is that the Egyptian government will continue its program of reform to improve the trade environment. The AAFA also looks forward to the establishment of a free trade agreement for Egypt and for the region.

Q&A Highlights

Q: What are the economic projections? What kind of manufacturing industries will take advantage of QIZ?

Mr. Zaineldine: The higher the US tariffs for the industry, the more interest there will be in taking advantage of QIZ. Information Technology has few restrictions, so there is no incentive for market access. The projections for the increase in exports range very widely, from 20 to 50%.

Mr. Saums: While there is interest in diversifying light to medium manufacturing in Egypt, the current focus is in maintaining market share in the apparel industry with the expiration of the MFA.

Q: How was the balance of Israeli and Egyptian input determined?

Mr. Saums: The three criteria for establishing QIZ are: that the region be designated by the President (through the USTR), that the participating nations come to agree on the terms of the agreement, and that the agreement be beneficial for both. The requirement for duty-free status

USEF EXPERT PANEL DISCUSSION NOTES

January 19, 2005

under the agreement is that QIZ production accounts for at least 35% of the value added to a product. The 11.7% figure for Israeli input was based on negotiations between Egyptian and Israeli parties. The Federal Register for December 29th, 2004 provides more details on the terms of the QIZ agreement.

Q: Regarding the theme that was emphasized by the speakers of de-linking of economic and political objectives, how idealistic are the motives? What are the reasons for the grassroots resistance in Egypt?

Mr. Saums: By de-linking economic and political objectives, the panelists mean that the political peace process should not be penalized for unrealized economic objectives.

Mr. Mohamed Allam, Third Commercial Secretary, Embassy of Egypt: A booklet on the QIZ is available from the Economic and Commercial Bureau of the Egyptian Embassy.