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Qualifying Industrial Zones in Jordan and Egypt

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Summary

In 1996, Congress authorized the creation of *Qualifying Industrial Zones* (QIZs), thereby entitling goods jointly produced by Israel and either Jordan or Egypt to enter the United States duty free. The QIZ creation vehicle was an amendment to the *United States-Israel Free Trade Area Implementation Act of 1985* (P.L. 99-47), and its purpose was to promote peace and development between Israel and her Arab neighbors. Although Israeli-Palestinian violence has continued, some observers have praised QIZs for helping to spark Jordan's economic growth. Others note that QIZs, while promoting U.S.-Jordanian trade, have had modest impact on promoting job growth in Jordan. In 2005, Egypt began participating in the QIZ program. This report provides an overview of QIZs in the context of promoting regional development and peace. It will be updated periodically to reflect recent developments. For more information on Jordan, see CRS Issue Brief IB93085, J*ordan: U.S. Relations and Bilateral Issues,* by Alfred Prados. For more information on Egypt, see CRS Report RL33003, *Egypt: Background and U.S. Relations*, by Jeremy M. Sharp.

QIZ Authorizing Legislation

The 1996 *West Bank and Gaza Strip Free Trade Benefits Act* (P.L.104-234) amended and extended the *U.S.-Israel Free Trade Area Implementation Act* to permit certain products from *qualifying industrial zones* (QIZs) to enter the United States duty free. QIZs were designed to: (1) help broaden support for the Middle East peace process, since Jordan and Egypt were the two Arab countries in the Middle East-North Africa (MENA) region[1] that had signed peace treaties with Israel; and (2) produce tangible economic benefits for Jordan, Egypt, the West Bank, and the Gaza Strip by stimulating their economies and increasing employment. (S.Rept. 104-270, p.3.)

[1] Middle East entities are: Bahrain, Cyprus, Egypt, Gaza Strip/West Bank, Iran, Iraq, Israel, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen. North African Countries are: Algeria, Libya, Morocco, and Tunisia.

During the first eight years after the QIZ amendment was adopted, Jordan, but not Egypt, entered an agreement with Israel to take advantage of QIZ benefits offered. Subsequently, the United States Trade Representative (USTR), on behalf of the President, designated 13 QIZs (one was later expanded) in Jordan. Finally, in December of 2004, following an agreement between Israel and Egypt, the USTR designated the first three QIZs in Egypt, and in 2005 expanded two of these and added a fourth.[2]

QIZs in a Nutshell

QIZs can be compared to free trade zones. QIZs are typically industrial parks housing manufacturing operations. They simplify cooperative production between countries because they: 1) are enclaves of infrastructure in developing countries where infrastructure may be sparse; and 2) are fiscally outside the customs territory of a country. Thus, on raw materials flowing into and goods moving out of zones, customs procedures are streamlined and tariffs do not apply until the item formally enters a country as an import for consumption. QIZs are distinguished from other trade zones as follows: Trade zones in general: (a) are stand-alone entities within *one* country (not directly connected to *other* countries); (b) produce for export to or domestic consumption in *any* country; and (c) operate solely under the authority of and conditions determined by the host government. QIZs, however: (a) have operations in two countries (Israel and either Jordan or Egypt); (b) produce goods solely for export to the United States; and (c) operate under both the authority of the host countries and the oversight authority of the United States, which determines conditions for and authorizes tariff relief for QIZ imports.

P.L. 104-234 requires that articles eligible for QIZ status must: (1) be wholly the growth, product, or manufacture of, and must be imported directly from, the West Bank/Gaza Strip (administered by the Palestinian Authority), or a QIZ; and (2) meet the following rules-of-origin requirements: At the time the product enters the United States, material and processing costs incurred in a QIZ[3] must total not less than 35% of the appraised value of the product. Of this 35%, 20% must come from Israel and Jordan or Egypt, and 15% may be either U.S. materials or materials from Israel, the West Bank/Gaza Strip, and/or Jordan or Egypt, depending on the participating QIZ program. The remaining 65% can come from anywhere in the world. In addition, the article must have been "substantially transformed in the manufacturing process."[4] The importer must certify that the article meets the conditions for the duty exemption. Details of the Jordanian-Israeli and Egyptian-Israeli QIZ programs (including exact shares comprising the minimum 20% from Israel and either Jordan or Egypt) differ slightly, based on the QIZ agreements between Israel and Jordan and Israel and Egypt, respectively, and on U.S. approval.[5]

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[2] Proclamation 6955, Nov. 13, 1996 (61CFR 58761) gave the USTR power to designate.

[3] Examples of such costs are originating materials, wages and salaries, design research and development, depreciation of capital investment, and overhead.

[4] Section 1 of P.L. 104-234, amending Section 9 of P.L. 99-47.

[5] For example, the manufacturer from the Jordanian side must contribute at least 11.7% of the final produce and the manufacturer on the Israeli side must contribute 8% (7% on high tech products); and under the Israeli-Egyptian agreement, 11.7% of the inputs must be made in Israel.

QIZs in Jordan

For Jordanian-Israeli QIZs, a Jordanian-Israeli joint committee with two co-chairmen, each appointed by the respective government, and an American Observer must approve all eligible products. Product approval is renewed every 12 months.[6]

Both the public and private sectors in Jordan have a role in the industrial activity taking place in Jordan's QIZs. Of Jordan's 13 QIZs, three are publicly operated industrial estates and function under the supervision of the Jordan Industrial Estates Corporation (JIEC). A semi-governmental corporation with financial and administrative autonomy, the JIEC was created by law in 1985 to promote the establishment of industrial estates in Jordan. Subsequently, JIEC spearheaded the development of QIZs after President Clinton inaugurated the program in 1996.

Impact of the QIZs on Trade and the Jordanian Economy

U.S. trade with Jordan has grown substantially in recent years — from both the QIZ program and, to a substantially lesser extent, from the U.S.-Jordan free trade agreement which went into effect in 2001. Between 1998 and 2005 Jordan moved up from the United States' 13th to 8th largest trading partner among the 20 Middle-East-North African (MENA) entities. In 2005, U.S. exports to and imports from Jordan totaled an estimated $1.9 billion: U.S. exports, at an estimated $646 million, were 1.8 times their 1998 level; U.S. imports, at $1.3 billion, were 80 times their 1998 level (USITC Dataweb). (See **Figure 1**.) Despite the 2001 FTA between the United States and Jordan, most Jordanian articles still enter the United States through the QIZ program (75%). The apparel industry dominates both Jordan's QIZs and total exports to the United States, accounting for 99.9% of all QIZ exports and 86% of all Jordanian exports to the United States. The reason for continuing QIZ dominance is that QIZ products enter the United States free of duty, whereas, under the U.S.-Jordan FTA, tariffs will not be fully eliminated until the end of the ten-year phase-in period, in 2011. Nevertheless, in 2005, the growth in QIZ exports from Jordan leveled off to only a 2% growth over 2004 exports. This growth slowdown could have been affected by the removal of textile and clothing quotas (but not tariffs) that occurred with the January 2005 expiration of the 1995 *WTO Agreement on Textiles and Clothing*.

Trade in general and QIZ trade in particular has been a major engine of growth for Jordan's economy in the past few years. The Economist Intelligence Unit (EIU) projects that from an average annual rate of around 20% in 2000-2004, export earnings growth is expected to slow to a more modest 9% for 2005-2007 as the initial impact of the special trade agreement with the United States wanes, and competition from Asian textile producers toughens. The gains in export earnings have been overwhelmed by a surge in import spending, which was driven sharply upward in 2005 by rapid growth in international oil prices.[7]

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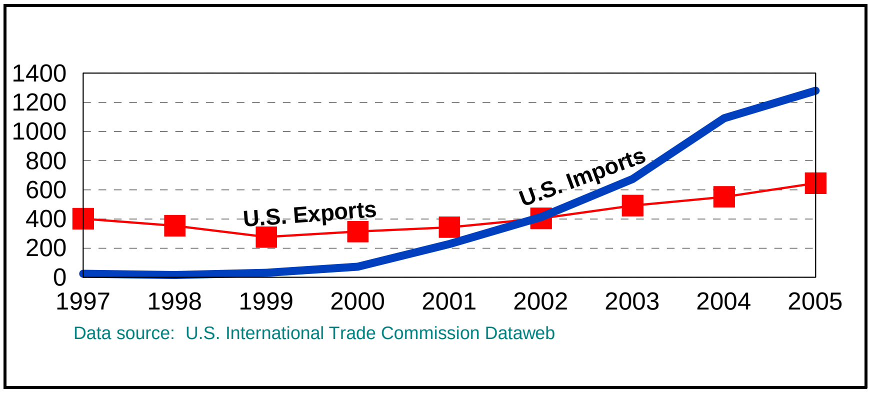
[6] Export and Finance Bank, Jordan. *Qualifying Industrial Zones*. Sector Report, June 10, 2003.

[7] *The Economist*. Economist Intelligence Unit (EIU) Country Outlook: Jordan, Dec. 2005.

Figure 1. U.S. Trade with Jordan, 1997-2005, in $Millions



Jobs. An important ancillary effect of the QIZ program in Jordan has been the creation of jobs to ease generally high rates of unemployment. In late 2003, the State Department estimated that QIZs had created more than 40,000 new jobs in Jordan, mainly for women.[8] According to local Jordanian press reports and international economists, however, close to half of these jobs have been filled by expatriates, mainly from southern Asia.[9] A breakdown of the number of workers employed at each of the 13 QIZs is not available.

QIZs in Egypt

On December 14, 2004, after an agreement between Israel and Egypt (which has the largest economy of the Middle East countries), the USTR designated three QIZs in Egypt: the Greater Cairo Zone, the Alexandria Zone, and the Suez Canal Zone (69 CFR 78094). On November 4, 2005, the USTR designated a fourth zone in the Central Delta region and expanded the Greater Cairo and Suez Canal zones. Several factors contributed to Egypt's desire for QIZ participation at this time. First was the January 1, 2005 end of quotas on textiles and apparel (which dominate Egypt's as well as Jordan's exports to the United States) under a WTO agreement. This meant that the flood of similar articles from China and India to the United States could crowd out Egyptian exports, and could result in the loss of 150,000 job opportunities in the industry,[10] and some of the $3.2 billion U.S. foreign direct investment in Egypt. In addition, Egypt was in search of sources for increased economic growth and trade to provide jobs for its rapidly growing labor force, to contain the fiscal deficit, to arrest the growth of public debt, and to address the trade deficit with the United States, and bolster ties with Israel in order to improve regional relations. The United States, on the other hand, views Egypt's interest in QIZ

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[8] U.S. Department of State, International Information Programs, "U.S.-Jordan Free Trade Agreement Spurs Jordan's Economic Growth," Oct. 16, 2003.

[9] According to the Jordanian press in late 2003, QIZs were employing 21,486 local workers and 15,078 expatriates. Sahar Aloul, "QIZ investors voice concerns at workshop," *The Jordan Times*, Sept. 23, 2003.

[10] Embassy of Egypt. *Qualifying Industrial Zones (QIZ) Protocol and the Potential Impact on the Egyptian Economy*, 2004, p. 16.

participation as an opportunity to press for desired economic reforms in Egypt.[11] Negotiations toward a U.S.-Egyptian free trade agreement have recently been suspended over human rights issues.[12]

Among the 20 MENA entities, Egypt is the United States' 7th largest trading partner, with U.S. imports for 2005 at an estimated $2.1 billion and exports at an estimated $3.1 billion for the first 11 months of 2005. For 2005, Egypt's first full year of QIZ participation, Egypt exported $230 million dollars worth of goods to the United States through the QIZ program. This represents 12% of Egypt's total exports to the United States. As with the Israel-Jordan QIZ program, textiles and apparel exports dominated Egypt's QIZ exports to the United States: 89% of those exports were apparel and 5% were textiles.

QIZs: Broader Implications

Although the creation of QIZs has been a positive step toward Jordan's and Egypt's economic growth, Jordan, like other non oil-producing Middle East countries, faces enormous challenges to its long term economic well being. For some countries in the region, lack of adequate water resources impedes growth (Jordan is one of the ten most water-deprived countries in the world). Beyond natural resources, the region's human resources also need to be further developed in order to spur economic development. For example, most experts note that Jordan's workforce is still largely unskilled, which hinders the economy's transformation from one based on small-scale agriculture and pastoral grazing to a labor-intensive, industrialized economy. Despite recent government investment in higher education and vocational training, Jordanian workers, according to one Jordanian businessman, "lack vocational experience and a strong work ethic."[13] Some factories located in QIZs have high numbers of more productive foreign workers from China and Southeast Asia.[14] In order to increase the competitiveness of Jordanian labor, the Ministry of Labor has launched several programs aimed at recruiting skilled rural workers, particularly women.

The Social Impact of QIZs. Although most experts note that companies based in QIZs continue to hire foreign laborers, thousands of Jordanians, particularly women from the rural countryside, have found jobs at garment factories in QIZs. In a traditional society such as Jordan, many of these women had little previous work experience and were largely caretakers of their home. Despite the low wages paid by apparel factories in the QIZs, some women have been able to support their families where the father or husband had fallen sick or died, and others have been able to supplement the income of the male breadwinner. However, traditional attitudes toward a woman's place in the home persist, and many families continue to prohibit female members from working in

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[11] "U.S. to Consider Egypt FTA after next TIFA, wants Further Reforms." *Inside U.S. Trade.* Jan. 14, 2005.

[12] The Realities of Exporting Democracy. *The Washington Post*, Jan. 25, 2006, p. A-1.

[13] "Jordan's Peace Dividend," *Jerusalem Post*, Oct. 26, 2004.

[14] Some estimate that approximately 20% of companies based in QIZs are wholly owned by Jordanians. See "Trade Without Consent — Choosing Between Free Trade and Democracy in Jordan," Daily Star, July 14, 2003.

QIZs. In response, the Jordanian Ministry of Labor has worked to ease the adjustment of women moving from the home to a new job by providing free transportation to work, subsidizing the cost of food in QIZs, and paying for dormitories near factories to cut commuting times. According to the Jordanian Trade Minister, "a new sort of culture is being established where girls are going to work, they are supporting their families and they are raising the standard of living in their villages."[15] The long term effect of female employment in QIZs has yet to be measured, and there is some concern that over time, Jordanian women may have difficulty in achieving higher wages in a global economy where apparel manufacturers can easily relocate to cheaper labor markets.

Impact on the Arab-Israeli Peace Process. When the QIZ program came into being in 1996, many observers regarded it as a vehicle to support the development of peaceful relations and normalization of commercial ties between Israel and the two Arab states (Jordan and Egypt) with which it had signed peace treaties. In both cases, however, a "cold peace" continues to prevail between Israel and the two Arab states. Since the conclusion of the Jordan-Israel peace treaty in October 1994, large numbers of Jordanians, particularly Islamic fundamentalists, those of Palestinian origin, and members of the professional unions continue to oppose normalization with Israel and resist the expansion of commercial relations. With the establishment of 13 QIZs in Jordan, there has been an increase in the volume of bilateral trade, though the overall totals remain modest. Trade between Israel and Jordan in 2004 were nearly six times what they were in 1997. Israel's exports to Jordan in 2004 were roughly $133 million (up from about $21 million in 1997). Israel's imports from Jordan were roughly $51 million (up from about $12.5 million in 1997.)[16] It is possible that some incremental improvement in bilateral relations could occur over time as a result of increased commercial contacts and joint participation in mechanisms related to the QIZ program.

Recent Issues

In May of 2006, the National Labor Committee (NLC), a human rights advocacy group, issued a 161-page report alleging sweatshop-like conditions in 28 out of 100 QIZ plants in Jordan. The report, *U.S.-Jordan Free Trade Agreement Descends into Human Trafficking and Involuntary Servitude*, was compiled from interviews with over 100 foreign guest workers in Jordan and workers forcibly returned to Bangladesh. In response to the allegations, the USTR raised the matter with the Jordanian Government. Jordan's trade minister Sharif Zu'bi subsequently indicated that the report incorrectly identified three sweatshops that are not even in Jordan, and that three others had been closed before the report was released in May. In addition, he noted that the Jordanian government had formed nine inspections teams to investigate the entire garment trade in the country, and is working with the International Labor Organization, U.S. labor committees, the USTR, the State Department, and U.S. and Jordanian apparel companies to address the challenges and improve their monitoring system.

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[15] "Jordan's Peace Dividend," op. cit.

[16] Source of data: U.S. Department of Commerce. Trade Policy Information System (TPIS).