

Editorial

THE NEXUS BETWEEN PROSPERITY AND PEACE

Leigh O'Neil*

International trade issues, such as bilateral economic agreements, World Trade Organization accession and the formation of regional trading blocks, currently top the national agendas of both industrialized and developing countries. Implied in this global movement for increased economic cooperation among nations is the notion that consumers, industries and the public sector in participating states benefit from increased international trade. A broader assumption is also made, namely, that along with increased growth and affluence is a tendency away from civil strife, regional war and interstate conflict. In this edition of Conflict in Focus we explore the nexus between prosperity and peace by examining the correlation between economic development and conflict prevention.

When academics and policy makers evoke economic development as a solution for the ailments that plague the developing world, they often point to tools to promote investment and growth as ways to reduce poverty. This implies that poverty reduction through economic growth contributes to a condition that fosters both domestic peace and international stability between economic partners. Is that really the case, however? Do increased linkages between nations through international trade agreements and other economic partnerships really promote peace? The following articles will seek to answer those theoretical questions and look to the specific policies directed towards the Middle East and North Africa by the two largest economic players globally, the United States and Europe.

In *Does Trade Promote Civil Peace*, Costantino Pischedda examines the theoretical correlation between increased trade and civil peace. He argues that, while international trade, itself, may not directly affect the conditions around potential war or civil peace, it does promote economic growth. The case is made that increased levels of economic development do reduce the propensity towards conflict, and therefore there is a positive connection between increased trade and long-term peace.

Matthias Matthijs, in his article *US and EU Trade Policy towards the Middle East*, offers a comparative assessment of the economic strategies of the world's two largest economic actors towards the Middle East. He argues that the increased economic cooperation

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between countries in the Middle East and the United States and European Union signal not only an interest in promoting growth and development, but also in fostering closer political ties with an increasingly strategic region.

An important example of how the United States sought to boost economic and political cooperation between itself and regional actors in the Middle East is the Qualifying Industrial Zone program. Initiated in the mid-1990s, this was offered as an extension of free trade space between Israel and its two peace partners, Jordan and Egypt. Leigh O'Neill reviews the case of Jordan and assesses the economic impact of the QIZ program a decade after its inception in her article, "Trading Up?", she determines that despite the original good intentions of the program, it has fallen short of the original expectations for sustained economic growth in Jordan.

Kate Weber looks at the political and economic effects the QIZ program has had in both Jordan and Egypt in her article, The Nexus between Conflict Prevention and Economic Development. She assesses how the QIZ program contributed to the long term sustainability of economic development in both countries, given the promise of the so-called 'peace dividend'. ■

DOES TRADE PROMOTE CIVIL PEACE? AN ASSESSMENT OF THE EXISTING EVIDENCE*

Costantino Pischedda**

Introduction

Civil war causes high levels of material destruction and human suffering and disproportionately affects low income countries. These countries are simultaneously struggling to open their economies amid contrasting pressures from the international community and protectionist domestic forces. Whether progressive integration into the world economy tends to increase the probability of civil conflict or, on the contrary, helps to create conditions conducive to sustained peace, is a crucial policy question for developing countries.

Such a question is particularly relevant to the Middle East and North Africa (MENA). This region has been historically plagued by intrastate conflict, such as the Lebanese civil war from 1975-1990, the Algerian civil war of the 1990s, the ongoing Palestinian-Israeli conflict, and the current ethno-sectarian war in Iraq. At the same time, MENA has experienced a relatively low growth of its trade to GDP ratio, increasing by about half the world's pace since the 1980s and only in a few limited instances a dynamic expansion of non-oil exports (World Bank 2007). The last few years, however, have witnessed an acceleration of the rate of growth of the region's exports⁽¹⁾, and an increase of activism on the part of MENA governments in negotiating preferential trade agreements with the United States, the European Union, and China.⁽²⁾ A fuller understanding of the nexus between trade and civil conflict is necessary in order to evaluate these recent developments and guide future policy initiatives. This paper seeks to contribute to this goal, by examining the existing evidence on the relationship between trade and civil war.

The main finding is that there is no strong evidence of a robust direct relationship between commercial integration and civil conflict, which is to say that trade per se, does not appear to cause or prevent intrastate war. However, a substantial body of economic literature finds a positive relation between trade and growth, while many recent studies conclude that high levels of economic development strongly reduce the risk of civil war. Trade, therefore, seems to indirectly promote conditions favorable to civil peace, through its development-inducing role.

The second section briefly reviews the main arguments on the relationship between trade and international conflict, necessary to understand the central subject of this paper. The following section examines the theory and the existing empirical evidence on the trade-civil conflict nexus. The fourth section concludes and draws policy implications from our analysis.

The Trade-International War Nexus

The relationship between trade and interstate conflict

has long been debated in academic and policy-making circles.⁽³⁾ Thinkers belonging to the liberal tradition, dating back to Adam Smith and John Stuart Mills, tend to hold the view that trade promotes peace. According to one of the most influential formulations of the liberal argument, states are deterred from initiating conflict against trading partners because of the potential loss of the welfare gains associated with trade (Polachek 1980).⁽⁴⁾ Other liberal views emphasize the transformative effects of trade, which would have the power to make societies less warlike and, by increasing the number of contacts between them, lead to better mutual understanding, fewer misperceptions and even convergence of cultures, thus reducing the risk of conflict.

At the other end of the spectrum, Kenneth Waltz (1979), a prominent neo-realist, argued that more interdependence at the systemic level leads to more conflict, because increased contacts between states also generate more opportunities for discord and disputes.⁽⁵⁾ This, however, is not the prevalent position in the realist camp. Other authors, in fact, do not necessarily see trade as a source of conflict, but tend to underplay the importance of economic concerns vis-à-vis national security considerations, thus concluding that trade will often not represent a sufficient deterrent to war.

* The views here expressed are the authors own and do not reflect those of the World Bank.

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- (1) The annual average rate of growth of MENA countries' exports went from 3.4 percent in the period 1990-2000 to 4.5 percent between 2000 and 2004. World's exports grew at an annual average rate of 5 percent over the second period, while low and middle income countries as a whole experienced a growth of 10.1 percent (World Development Indicators 2006).
- (2) Israel, Jordan, Morocco, Bahrain, and Oman (in chronological order) have already concluded free trade agreements (FTAs) with the United States. Possible US bilateral FTA partners in the intermediate term include Egypt, Qatar and the United Arab Emirates. The European Union has concluded association agreements with Algeria, Egypt, Israel Lebanon, Morocco, the Palestinian Territories, and Tunisia as part of a project aimed at creating a Euro-Mediterranean FTA by 2010 (Syria participates to the Euro-Mediterranean initiative, but its association agreement with the European Union has not been signed yet). The European Union is also negotiating an FTA with the Gulf Cooperation Council (GCC), which includes Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates. In addition, the GCC has been negotiating an FTA with China since 2004.
- (3) See Barbieri (2002) for a review of the literature on the relationship between trade and international wars, and for quantitative tests of alternative theoretical propositions on the subject.
- (4) This argument does not require the assumption of the state as a unitary and welfare-maximizing actor. A similar conclusion can in fact be reached using a political economy framework, as business interests threatened by the disruption of trade would lobby against confrontation and war.
- (5) Lateral pressure theory (Choucri and North 1975) and neo-Marxist theories of imperialism also consider expansion of trade, and the related increased competition for markets and resources, as conducive to international conflict.

The Relationship between Trade and Civil War

A direct link?

A smaller and more recent body of literature focuses on the relationship between trade and civil conflict. Some of its theoretical propositions represent an application of international theory to the intra-state case. On the one hand, trade could reduce the risk of civil war because government and potential rebel groups are aware of the costs of the trade disruption that large-scale violence would instigate (Barbieri and Reuveny 2005).⁽⁶⁾ On the other hand, however, an organization may not be deterred from initiating war if the benefits that arise from trade primarily flow to its opponents. In addition, trade openness is likely to be associated with an increase of information flows abroad, which in turn could enable the international community to prevent and manage more effectively civil conflict in developing countries. The counter-argument would say that communication expansion could work as a double-edged sword, potentially facilitating rebel activities, especially fund-raising, propaganda, and recruitment, and helping to spread civil war across international borders through demonstrative behavior.

Given these conflicting theoretical expectations, clarifying the trade-civil war nexus requires an assessment of the empirical evidence. Using several econometric techniques, Esty et al. (1998) found that the greater a country's trade openness, which is measured as the total value of exports plus imports as a share of GDP, the less likely it is for that country to experience an episode of state failure. State failure in this case includes 'disruptive regime transitions', civil wars and genocides. Fearon and Laitin (2003), however, did not find significant evidence of a direct relationship between trade openness and the onset of civil war, after controlling for the size of the country. It is important to note that smaller countries not only trade more because of the limited size of their internal markets, but also tend to experience less civil war.⁽⁷⁾ Hegre and Sambanis (2006) convincingly affirm this result. In their systematic testing of other studies about the onset of civil war, the authors observed a generally insignificant nexus between civil conflict, on the one hand, and trade openness and the export share of GDP on the other.⁽⁸⁾

Does trade cause conflict by increasing vulnerability to economic shocks?

Even if there is no strong evidence of a direct trade-civil conflict nexus, trade could influence the probability of civil war in more indirect ways.⁽⁹⁾ Economies with a high trade share of GDP are especially sensitive to economic shocks, such as fluctuations in international prices, which are often measured as changes in the terms of trade (i.e., the ratio of the export price index and the import price index).

Elbadawi and Hegre (2004) highlight different possible causal mechanisms through which terms-of-trade shocks could increase the risk of civil war in countries highly

exposed to international trade. A sharp decline in terms of trade can lead to a reduction of growth rates and an increase in unemployment, thus exacerbating social tensions that could eventually lead to organized armed rebellion. In addition, exogenous shocks can change the domestic balance of power between government and potentially violent opposition, which in turn may lead to war.

However, Elbadawi and Hegre discover only very weak evidence of a link between terms-of-trade shocks and civil conflict. The relationship failed to reach statistical significance in all but one of their alternative models. The authors also test the hypothesis that the relationship between economic shocks and war is conditional upon underlying levels of social conflict. It is, in fact, possible that economic shocks have a particularly negative impact on countries characterized by high levels of ethnic fractionalization and a lack of democratic institutions, which could assist in defusing social tensions. Nevertheless, Elbadawi and Hegre reject this hypothesis. Trade shocks, they argue, do not appear to affect the risk of civil war even after controlling for a series of possible proxies of preexisting levels of social conflict.

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- (6) Solingen's (2001) theory of internationalization emphasizes a somewhat similar mechanism. According to this theory, internationalizing domestic political coalitions, eager to promote their country's integration with global markets, tend to adopt cooperative policies at the domestic and regional level, while resisting mobilization of resources for potential military conflict. In this way, they create stable and non-violent environments, which in turn foster the goals of internationalization. Examining ninety-eight coalitions in nineteen states over the period 1948-1993, Solingen found some empirical support for her thesis.
 - (7) Elbadawi and Hegre (2004) also found no direct effect of trade openness on the risk of conflict. Consistently with Fearon and Laitin (2003), they explain the discrepancy with Esty et al. (1998) as a consequence of the fact that Esty et al. did not control for country size.
 - (8) Consistently, Barbieri and Reuveny (2005) found that international trade (as well as other measures of globalization, such as foreign direct investments and foreign portfolio investments) does not affect the risk of civil war onset. However, the authors did find that trade reduces the probability of civil war presence (i.e., a new war onset or the continuation of an ongoing conflict).
 - (9) An indirect conflict-trade mechanism often debated in the literature and the media is associated with a country's abundance of natural resources. There are several theoretical arguments in support of the natural resources-war nexus: rebellion may be made feasible and/or motivated by the opportunities for predation of natural resources, or it is possible that the governments of resource-abundant countries tend to be less accountable towards their population, because they do not need to tax it to raise revenues, thus generating strong grievances. Some authors (for example, Collier and Hoeffler 2004a) found a positive association between risk of civil war and the GDP share of primary commodity exports (intended as a proxy for natural resources endowment), while others did not detect such a relationship or argued that it is driven by oil rather than natural resources in general (Fearon 2005). This evidence may warrant the adoption and support of programs such as the Kimberly Process and the Extractive Industries Transparency Initiative. In any case, increased openness to international trade flows has the potential of diversifying the economy, thus reducing dependence on exports of primary goods (World Bank 2003).

The effects of trade on civil peace through economic development

Another way in which trade can indirectly influence the probability of civil peace is through its impact on economic development. Substantial evidence indicates that trade openness contributes importantly to economic growth (see, for example, Berg and Krueger 2003). In addition, due to its growth-catalyzing function, trade liberalization has a strong potential for reducing global poverty. Cline (2004) estimated that global free trade could lift 440 million people out of poverty, over a period of about 15 years (from a global poverty baseline that would otherwise be reached without trade liberalization⁽¹⁰⁾).

At the same time, a very solid finding emerging from the civil war literature is that violent conflict is most likely in low-income and slow-growing countries. This holds true whether one considers the onset of civil war (Collier and Hoeffler 2004a; Hegre and Sambanis 2006) or war recurrence (Doyle and Sambanis 2006; Collier, Hoeffler and Söderbom 2006).⁽¹¹⁾ The causal mechanism through which development would reduce the risk of civil conflict is still debated. Fearon and Laitin (2003) argue that economic development indicators should be interpreted as proxies for state financial, administrative, military, and police capabilities. In other words, a strong state is likely to be able to deter or prevent the organization of armed rebellion, while the presence of a highly developed transport infrastructure should reduce the availability of rebel sanctuaries beyond the reach of government forces. Collier and Hoeffler (2004a), on the other hand, contend that high levels of development reduce the risk of war by increasing the opportunity costs of rebellion. Namely that insurgent recruitment is easier when there are limited economic opportunities and widespread poverty. These different interpretations of the conflict-development nexus should not be seen as theoretically contradictory, since they both emphasize the feasibility of rebellion as crucial in explaining civil war and point out causal mechanisms that could be operating simultaneously. In sum, trade emerges from this literature as an important, albeit indirect, determinant of civil peace.

Modernization theory poses a challenge to this interpretation of the trade-development-civil peace relationship.⁽¹²⁾ This theory holds that the risk of civil war is higher in the initial phases of industrialization, characterized by rapid growth and structural changes to the economy, which intensifies group competition for scarce resources.⁽¹³⁾ This hypothesis can be applied to better understand specific conflicts, but its general validity is unclear, as a systematic empirical test has yet to be conducted (Sambanis 2002).⁽¹⁴⁾ Even if there were strong evidence in support of modernization theory, however, it would be unwise to advocate for developing countries to reject open trade policies in order to prevent conflict. In fact, the theory shows that reaching certain thresholds of development may be associated with temporary intensification of social conflict, but rejects that the risk

of civil war increases throughout the entire process of development. Indeed, the studies discussed above strongly support the view that economic development, in addition to being desirable for other obvious reasons, reduces the probability of civil war in the long run.

Policy Implications

The general policy implications for conflict prevention emerging from this analysis are relatively straightforward. An economic strategy that aims to increase the traded openness of a developing country is likely to bring about faster economic growth and poverty reduction in the long term, thus creating conditions that favor sustained civil peace. Of course, this is not to say that trade is the only tool of economic policy that the national policy makers and the international community should employ to prevent or manage civil conflict, nor that the political and military dimensions are necessarily of secondary importance.⁽¹⁵⁾

The integration of developing countries into the global economy should be implemented cautiously, with all actors paying particular attention to specific local realities and avoiding any one-size-fits-all approach. In fact, some of the mechanisms through which trade could increase the risk of civil conflict, as discussed above, may be extremely important in individual cases, despite any observed general trend in the opposite direction. Finally, trade liberalization should be accompanied by policies that both compensate those who might stand to lose from increased openness and alleviate tensions inevitably associated with rapid social change. When employed together, these policies would greatly reduce risks conventionally associated with modernization theory. ■

(10) The corresponding poverty reduction for the Middle East and North Africa is 15 million people, or about 18 percent of the poor in the region in 2004 (Cline 2004).

(11) Low levels of economic development are also associated with longer civil wars (Collier, Hoeffler and Söderbom 2004).

(12) See, for example, Huntington (1968).

(13) The argument does not specifically focus on trade, and indeed industrialization can take place in a context of limited openness to world markets. However, given that international trade is often seen as a path toward growth and industrialization, modernization theory implicitly questions the desirability of an open trade policy from a conflict prevention point of view.

(14) Assessing the empirical plausibility of the theory is made difficult by the lack of a clear definition of modernity. Depending on how the concept is employed, one may contend that conflict occurs frequently in countries with very low levels of modernization (e.g., Chad and Sudan in the 1960s) or that the theory's applicability to today's development world is limited, given that arguably industrialization has by now passed its initial stages in virtually any country.

(15) See Collier and Hoeffler (2004b) for a discussion of the role of aid in post conflict settings.

THE NEXUS BETWEEN CONFLICT PREVENTION AND DEVELOPMENT: A COMPARISON OF THE QUALIFYING INDUSTRIAL ZONES (QIZS) IN JORDAN AND EGYPT

Kate Weber

Introduction

The creation of Qualifying Industrial Zones (QIZs) in 1996 represented a strategic new direction in U.S. efforts to warm a 'cold' Arab peace with Israel and integrate the latter in to the regional economy. The QIZ program, authorized by the U.S. Congress as an amendment to the U.S.-Israel Free Trade Agreement, was tasked with an ambitious mandate: first, to help broaden support for the Middle East peace process in Egypt and Jordan, the only two Arab countries already to have signed peace treaties with Israel, and second, to produce tangible economic benefits for Jordan, Egypt, the West Bank and the Gaza Strip by stimulating their economies and increasing employment.⁽¹⁾ Jordan, the first on board, inaugurated its first QIZ in 1998 and today boasts 13 zones. Egypt, a much later signatory, opened three QIZs in 2004, expanding them and adding a fourth in 2005.

Eleven years since its inception, how successful has this essentially political agreement been in both economic and political terms? Has the economic success or failure of the QIZs in Jordan and Egypt had an effect on the normalization of relations with Israel? The cases of Jordan and Egypt, with each country's differing demographics, political concerns, and labor markets, present different pictures of QIZs in practice and make an interesting comparative study of the highly contentious 'trade for peace' concept.

Jordan: Failed Expectations of a "Peace Dividend"

The 1994 Jordanian-Israeli peace treaty was met with much unease by the Jordanian public, more than half of whom are Palestinian in origin. To appease public discomfort, US, Jordanian and Israeli officials promoted a "peace dividend", wherein increased economic opportunity and development would follow peace.⁽²⁾ Needless to say, such a 'peace dividend' was an attractive concept to a country with an unemployment rate in excess of 20 percent and rapidly rising consumer prices.

Immediately following the 1994 treaty, the U.S. and Jordanian governments began encouraging Jordanian, Israeli and Palestinian businesspeople to meet and form relationships. These relationships were formalized in 1995 at the Amman Economic Summit with the creation of a Regional Business Council (RBC). Managed by American officials, the purpose of the RBC was to facilitate joint business ventures and multilateral exchanges between prominent Jordanian, Israeli and Palestinian businesspeople.⁽³⁾

The U.S. government offered both Jordan and Egypt participation in the QIZ program in 1996. Egypt refused, deeming the offer unattractive at the time. Keeping in line with the 'peace dividend' promised to Jordanians following the peace treaty, Jordan accepted and opened its first QIZ, the Irbid-based Al Hassan Industrial Estate, in 1998.

QIZs, in a nutshell, can be compared to free trade zones. The premise of the QIZ is to allow certain products originating from the zones duty-free entry into the United States as an extension of the U.S.-Israel Free Trade Agreement. These items must meet strict rule-of-origin requirements, however, in Jordan's case; no less than 35 percent of the appraised value of a good must come from a combination of Jordan (11.7 percent) and Israel (8 percent), with the remainder from Jordan, the U.S., the West Bank or Gaza.⁽⁴⁾ The textile and apparel industry has dominated Jordan's QIZs since the beginning, with ready-to-wear garments making up nearly 99.9% of QIZ exports.

The political backdrop to the first years of the so-called 'peace dividend' and Jordan's participation in the QIZ program was unsettling. The year 1996 marked a decline in the peace process with troubling political developments in Israel and increasing violence in the occupied Palestinian territories. In response to these developments, Jordanian opposition to normalization of ties with Israel increased. The most visible evidence of Israeli-Jordanian ties - business relationships - was an obvious target. Under a boycott of cooperation with Israeli businesses organized by Jordan's professional associations, the RBC eventually ceased to exist and Jordanians doing business with Israeli firms kept a lower profile. Although the boycott officially ended in the late 1990s, the damage had been done; Jordanian public opinion had turned against the

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- (1) Bolle, Prados and Sharp. 2006. CRS Report for Congress: 'Qualifying Industrial Zones in Jordan and Egypt', pp. 1 (July 5)
- (2) Moore, Pete M. 2006. 'Contested Trade in the Middle East: How Free Trade Helped End the Oslo Peace Process and De-Liberalize the Hashemite Kingdom of Jordan', Presented at Princeton University, pp. 1. (March 10)
- (3) Moore, Pete M. 2003. 'The Newest Jordan: Free Trade, Peace and an Ace in the Hole', Middle East Report Online, pp. 2. (June 26)
- (4) Moore, Pete M. 2006. 'Contested Trade in the Middle East', pp. 2 (March 10)
- (5) Moore, Pete M. 2006. 'Contested Trade in the Middle East', pp. 4. (March 10)

QIZ program⁽⁵⁾. The second Palestinian Intifada, from 2001 to 2003 only served to harden opposition to the QIZs. This political unease with the program continues to today, although it does not always take overt forms such as official boycotts.

Perhaps initial political opposition to the QIZ program in Jordan could have been mitigated had the program had a substantial effect on the economic circumstances of average Jordanians. Although Jordan's dramatic growth in exports and rapidly increasing foreign direct investment following the inception of the QIZ program in 1998 is often heralded as a shining example of the program's economic success, several factors limited the QIZs economic reach in the country. First, although the QIZs have created approximately 56,000 jobs to date, nearly 37,000 of these are filled by foreign guest workers, primarily from East and South Asia. A mere 19,000 jobs are filled by Jordanian workers. Second, the majority of the investors, which are concentrated in the apparel sector, are not Jordanian, and the profits of their operations do not stay in Jordan. Finally, virtually all of the raw materials for production in the apparel sector for the QIZs are imported into Jordan, since the country does not have the resource base to vertically integrate. The best estimate of the industry's value added in Jordan is approximately 35% of the total export value. According to Pete Moore, "at best, these are modest gains in the context of a low-growth, high unemployment, demographically young developing country."⁽⁶⁾

Adding to these obstacles for QIZ success in Jordan, the inking of the Jordan-U.S. Free Trade Agreement in 2000 provides quota-free, duty-free access to the U.S. market without requiring Jordan-based manufacturers to buy the expensive components from Israel mandated under the QIZ agreement. The JUSTFA included a 10-year scheduled phase-out of tariffs, so it is likely that as 2011, when the final tariffs will be phased out, draws closer, nearly all Jordan-based manufacturers will switch to exporting under this agreement.

A final obstacle to the success of Jordan's QIZs, the future of the dominant QIZ industry, textiles and apparel, in Jordan is by no means certain. A report alleging labor and human rights violations published last year by the Washington D.C.-based National Labor Committee (NLC), subsequently followed by three other reports, has cast a bright spotlight on working conditions in the industry. This has not only caused serious concern on behalf of the American apparel companies who source their garments in Jordan, but also created confusion regarding legal procedures for foreign guest workers in the Jordanian government. These serious labor issues, coupled with a high minimum wage (by apparel industry standards) and rising water and fuel costs, do not bode well for the highly mobile apparel industry. It is reported that many

Jordan-based apparel manufacturers - most of whom, as mentioned above, are not Jordanian - are currently scouting in Egypt and making plans to move at least some production there due to cheaper costs.

The academic consensus of the QIZ program in Jordan, now in its ninth year, is that it has been at best a moderate short-term economic success, and a political failure. True, the QIZs have facilitated Israeli-Jordanian business and government cooperation, but their original goal of 'regional economic integration', according to Desiree Baron, a former U.S. Foreign Service officer involved in negotiating the QIZ agreement, has sadly fallen short. Two contributing factors to this failure are a) the continuing Israeli-Palestinian conflict, which makes it hard for governments to promote the QIZ program, and b) the 'profit motive' factor: Jordan's initial interest in the QIZ program had to do with making money, not promoting peace. Considering the cheaper, easier terms of the Jordan-U.S. Free Trade Agreement, manufacturers are switching to production under the FTA and will only continue to do so in greater numbers as duties are phased out under the Free Trade Agreement.⁽⁷⁾

Egypt: Great Expectations, Uncertain Successes

Egypt is the newcomer to the QIZ program. Although originally offered participation in 1996, Egypt declined only to accept eight years later in late 2004. In mid-December 2004, the United States Trade Representative designated three QIZs in Egypt, later to add a fourth in 2005. As in Jordan, textile and apparel goods make up the lion's share of Egypt's QIZ exports; nearly 94%.⁽⁸⁾

The Egyptian government's reasons for signing the QIZ agreement were several: first and most importantly, the January 1, 2005 removal of quotas on textile and apparel goods under a WTO agreement meant the possibility of a massive loss of Egyptian market share in this industry, coupled with widespread downsizing. Fearing a loss of up to 150,000 jobs (out of a total of 1 million in the industry) and \$558.3 million in exports⁽⁹⁾, the Egyptian government had "little alternative but to sign."⁽¹⁰⁾ In essence, the Egyptian government viewed the QIZ agreement as a way to maintain existing jobs in the textile and apparel industry and gain a competitive edge through preferential trade status.

Another important motivating factor for the Egyptians in signing the agreement was the example of Jordan's

(6) Moore, Pete M. 2006. "Contested Trade in the Middle East", pp. 2

(7) Wells, Madeleine. 2006. "Trade for Peace with Israel Falls Short", Century Foundation Taking Note, pp 1-2 (March 28).

(8) Bolle, Prados and Sharp. pp. 5.

(9) Yadav, Vikash. 2007. "The Political Economy of the Egyptian-Israeli QIZ Agreement", *The Middle East Review of International Affairs*, Vol. 11 No. 1, pp. 74 (March)

(10) Yadav, Vikash. 2007., pp. 74.

experience with the QIZs; not only did Jordan's overall exports grow exponentially following the country's entry into the agreement (a fairly misleading statistic in economic development terms, as discussed above), but Jordan signed a free trade agreement with the United States only several years later. Motivated by the potential for economic development, the Egyptians hoped that by signing the QIZ agreement, they too could expect to enter into an FTA with the United States within a few years (a hope which now looks unlikely). Containing fiscal deficit, arresting the growth of public debt, assessing the trade deficit with the United States and finding further sources of economic growth for its rapidly expanding labor force were also factors in signing the agreement.

Politically, Egypt's entry into the QIZ program was controversial amongst the Egyptian population, but not nearly as contentious as in Jordan. Initially, the QIZ agreement caused a heated debate in the Egyptian parliament, and there were limited protests against it. However, there were also street protests by unionized workers for an expansion in the number of QIZs in Egypt. According to Vikash Yadav, "while politicians, students and intellectuals remain hostile to the agreement and 'normalization' of relations with Israel, Egyptian labor leaders clearly viewed the agreement as a mechanism to save jobs in an endangered industry."⁽¹¹⁾ In contrast to Jordan, with its large Palestinian population, there were no widespread opposition movements or organized boycotts against the QIZs in Egypt.

In economic terms, the QIZs in Egypt have been so far regarded as a success by many. Apparel exports to the U.S. under the QIZ agreement are 'soaring.'⁽¹²⁾ Egyptian QIZ exports in the first nine months of 2006 were \$464 million, up 59% from the same period in 2005. Many Egyptian apparel exporters are expanding their QIZ production, and major U.S. retailers are reported to be increasing their sourcing from Egypt in 2007 and 2008⁽¹³⁾. The majority of the workers in the Egyptian QIZs, as opposed to the Jordanian, are actually Egyptian. And Egypt has a natural resource base that allows factories to vertically integrate, not to mention a textile industry with historical roots in antiquity.

So is it realistic to expect that the Egyptian QIZs will enjoy great economic, and therefore potentially political, success than the Jordanian QIZs? There are several compelling arguments as to why the Egyptian QIZs, though booming, will not have the economic impact expected by the U.S. and Egyptian governments. First, although the Egyptian QIZs prevented massive job loss following the textile and apparel quota phase-out, the number of jobs created under the QIZs will not close Egypt's overall unemployment and underemployment gap.⁽¹⁴⁾ Furthermore, the QIZ agreement infuses the Egyptian textile industry with capital, temporarily

allowing it to avoid making necessary 'painful structural changes' in order to remain competitive in the long-term. Third, Egypt's extraordinary levels of red tape and high corruption make it an unattractive place for foreign direct investment, a sentiment the author has heard frequently in complaints from Jordanian QIZ investors scouting in Egypt. Finally, as other countries ink FTA deals with the United States, Egypt's QIZ advantage will erode.

Therefore, although the Egyptian QIZs have been in existence for a shorter period than the Jordanian QIZs, making it harder to make concrete assessments, there is evidence that the Egyptian QIZs will also have a limited economic and political impact. Most of the 'business linkages' between Egyptian and Israeli businesspeople are within the limited scope of the textile and apparel industry. Broader economic engagement does not appear to be taking place. The Egyptian government has not taken any steps to encourage a strengthening of social or cultural ties with Israel outside of the limited economic ties established by the QIZ out of necessity. Additionally, there is substantial evidence that the economic gains from the QIZs will not be enough to substantially change Egyptian public opinion toward Israel.

Conclusion

Despite initial promise, the QIZ 'experiment' in Jordan has not caused either widespread economic gains among Jordanians or broad-based economic engagement with Israel. Although Egypt is much newer to the game and has some key predictors for QIZ success not held by Jordan, it is relatively unlikely that the QIZs in Egypt will achieve economic success of the kind necessary to change Egyptian public opinion toward Israel. The idea of 'Trade for Peace' adopted by the QIZ architects assumes that economic engagement will be enough to integrate Israel into the regional economy; unfortunately, the kind of limited economic engagement prompted by Jordan and Egypt's QIZ experiment has not had this effect and is unlikely to have it in the future. ■

(11) Yadav, Vikash. 2007. pp. 74-75.

(12) De Coster, Jozef. 2006. 'Egyptian QIZs Boost Apparel Exports to the U.S.'; www.just-style.com, pp. 1. (December 13).

(13) De Coster, Jozef. 'Egyptian QIZs Boost Apparel Exports to the U.S.'; pp. 1

(14) Yadav, Vikash. 2007. pp. 81

US AND EU TRADE POLICY TOWARDS THE MIDDLE EAST: A COMPARATIVE ASSESSMENT

Matthias Matthijs*

Trade is fundamental to rebuilding peace and confidence, as trade is usually one of the earliest green shoots to emerge from the dust and the rubble. Trade reconnects people, and by bringing them into contact with markets, gives them an economic stake in a stable society. Pascal Lamy (2003)⁽¹⁾

Floating on the bulk of the world's oil reserves and rife with violent ethnic and religious conflict, the Middle East is one of today's most important geo-strategic areas in international politics. The region has a long and turbulent history of both close involvement and tense relations with both Europe and the United States. Despite the undeniable and perhaps pivotal role the Middle East holds in current world affairs, its unfulfilled potential as a strong partner in the international trade arena has often been understudied, especially in the economic literature⁽²⁾. In recent years, however, both the United States and the European Union have pursued a much more active trade agenda in the region, promoting stronger bilateral and regional trade integration not just for its inherent economic virtues, but also for its potential political merits. In principle, both the EU and the US share the view that fostering economic growth through trade will not only increase economic welfare in the region, but also promote much needed liberal domestic reforms and gradually tame extremist sentiments threatening the relative security of both Europe and America.⁽³⁾

Whether initiated by an external hegemon or championed by charismatic regional leaders, the integration of the countries of the Middle East has proved to be a tremendously difficult task. Currently intra-regional trade in the Middle East is among the lowest in the world (even lower than in Africa). In 2004, for example, intraregional merchandise exports totaled just over 5% of the region's total exports. Some observers have suggested that this is due to a clear lack of 'complementarity' of trade in the region, arising from similar production structures. Others point to the fact that most countries are falling short in establishing a functioning and transparent regulatory environment needed for doing business.⁽⁴⁾ Furthermore, there are numerous political obstacles on the road towards deeper integration: there is mutual distrust among Arab leaders and the power of vested interests usually works in favor of more statist and inward-looking policies⁽⁵⁾. Given the dismal record of past attempts to move towards deeper political and economic integration, it should therefore be no surprise that there is widespread skepticism among Arabs about the potential success of any new 'pan-Arab' unions.

This article assesses the respective trade policies of the United States and the European Union in their efforts to bring peace and prosperity to the Middle East. It will identify the synergies between their respective policies, as well as the contradictions and areas of potential friction. This is followed by a brief review of the latest trade developments in three specific country cases in the region - namely Jordan, Israel and Egypt - in order to find evidence of the potential merits of both US and European approaches. The conclusion will also outline some of the potential drawbacks of regarding free trade as a solve-all solution.

The American Approach: Two-Speed Bilateralism

America's enthusiasm for enhancing trade ties with the Middle East was reinvigorated after the 9/11 terrorist attacks on US soil. Nine days later, Robert Zoellick - then US Trade Representative - wrote in the Washington Post that 'America's trade leadership [could] build a coalition of countries [in the fight against terrorism],' emphasizing that 'open markets [were] vital for developing nations, many of them fragile democracies that rely on the international economy to overcome poverty and create opportunity.'⁽⁶⁾ In 2003, in a speech at the University of South Carolina, President Bush proposed the creation of a comprehensive free trade area between the United States and the Middle East (MEFTA). In order to achieve that objective, the Bush Administration would move first to negotiate comprehensive bilateral trade agreements with the region's countries, with the aim of ultimately "combining these into a single overarching arrangement between the US and the Middle East region as a whole."⁽⁷⁾ With MEFTA, the US sought to liberalize bilateral trade and investment with the region, facilitate domestic reforms in many Arab countries and build mutual trust by encouraging regional economic cooperation.⁽⁸⁾

The Bush administration thus favored a "bottom up" approach to regional economic integration in the Middle East.⁽⁹⁾ By first negotiating bilateral trade deals, the US could negotiate wide-ranging trade agreements with

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(1) Lamy (2003)

(2) Momani (2007)

(3) Looney (2005) and Mandelson (2005)

(4) Fawzy (2003)

(5) Momani (2007)

(6) Zoellick (2001)

(7) Lawrence (2006b)

(8) Yousef (2004)

(9) Schott (2004)

those countries that were most able and willing to engage, using the economic carrots to reward those countries in the region who were staunch allies in the "war against terror."⁽¹⁰⁾ Given US frustration with the slow progress of multilateral "top down" trade agreements that come through collective negotiation with many participants where foot-draggers can potentially stall the process, such as with APEC or the FTAA, the bilateral approach allowed the US to tailor the details of the agreements to particular bilateral circumstances. The clear advantage of the MEFTA is that it thus allowed for the conclusion of deep and far-reaching agreements - such as those with Jordan, Egypt, Bahrain, Morocco and Oman - that almost certainly could not have been negotiated with universal Arab participation. On the other hand, the cost of the approach is that it creates a labyrinth of overlapping trade regimes that often build walls which could significantly complicate full integration.⁽¹¹⁾

The European Approach: Reluctant Regionalism

From its inception in the 1950s, the European Union has placed a high priority on establishing and maintaining close links with its neighbors in the Mediterranean and the Middle East. Europe's ancient links with its immediate neighborhood found new expression in the 'Euro-Mediterranean Partnership' created in 1995.⁽¹²⁾ Better known as the 'Barcelona Process,' the agreement identified three areas of enhanced cooperation between both regions: security and stability, cultural exchange, and economic and financial issues. It was envisioned that the EU would sign free trade agreements with ten countries by 2010 - Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, the Palestinian Authority, Syria, Tunisia, and Turkey - eventually leading to a Euro-Mediterranean Free Trade Area (EMFTA). Brussels' approach would be both bilateral (with association agreements) and multilateral (with future working groups).⁽¹³⁾ However, the Barcelona Process was fundamentally flawed from its inception, given that it could not offer the countries from the Middle East and North Africa the same sticks and carrots as it could to the post-communist countries of Eastern Europe, because of the absence of potential EU membership for most of those countries, with the exception of Turkey. As a result, the EU's 'à la carte' approach failed to trigger those economic reforms that were most sensitive politically, and the overall pace of reform has been very slow.⁽¹⁴⁾

Again, it was September 11th that renewed EU interest in the region and reinvigorated the Barcelona Process. Given its geographical proximity to the region, the European Union realized that the spread of Islamist militancy and the growing unrest of its own Muslim minorities was a potentially explosive situation which needed to be addressed in the short term. In its 2003 Security Strategy Report, the EU underscored the link between domestic economic reform, international trade and security, stating

that "trade and development policies can be powerful tools for promoting economic reform."⁽¹⁵⁾ To foster intraregional trade and economic policy harmonization, the EU supported the Agadir Agreement in 2004, which established a free trade agreement between Jordan, Tunisia, Egypt and Morocco. The Agadir Agreement was meant to be the beginning of a greater Middle East free trade area which goes well beyond the removal of tariffs and quotas.⁽¹⁶⁾ The rationale behind Agadir was that integration would be easier to achieve with a core of countries, while others could join later when they were ready. The EU also developed a system of pan-European 'rules of origin' permitting diagonal accession among regional members with a FTA that uses European rules of origin.⁽¹⁷⁾

EU and US Policies: Synergies and Conflicts

The US and the EU share the same broad goal of trying to promote economic development in the Middle East and promote political and social reform. In many respects, both approaches to trade are complementary and will tend to strengthen each other. While the bilateral US trade agreements tend to be much more comprehensive, and cover a broad range of economic issues, the EU agreements deal with numerous non-economic issues and exclude services, investment, and have serious limitation when it comes to agriculture. The US and the EU have encouraged Middle Eastern countries to create a business enabling environment and adopt international standards and norms.⁽¹⁸⁾

The European Union's two-way trade with the Middle East was worth \$155 billion in 2004, which is nearly three times the trade of the United States with the region. Geographic proximity clearly matters, and there is growing evidence that international trade has become much more regional than global. For most countries in the region, the economic relationship with Europe will therefore always be more important than the one with America. Forced to choose, Arab countries will probably follow EU rules, limiting the potential regional impact of a US agreement.

There is also the risk that many Middle Eastern countries will find themselves in the middle of transatlantic trade disputes. The problem stems from the Bush administration's announcement that "countries seeking free trade agreements with the United States must cooperate with

(10) See Looney (2005)

(11) Lawrence (2006a)

(12) European Commission Delegation to the USA (2004)

(13) Momani (2007)

(14) Lawrence (2006b)

(15) European Union (2003)

(16) Momani (2007)

(17) Lawrence (2006b)

(18) Ibid.

Washington on foreign policy and security issues.⁽¹⁹⁾ One example of this is the reluctance of the US to move forward with the US-Egypt FTA because Cairo refused to support the US WTO challenge to the EU's moratorium on genetically modified food.⁽²⁰⁾

Evidence from Jordan, Israel and Egypt

Jordan is the poster child of Washington's free trade strategy. Jordanian exports to the US increased from a mere \$72 million in 2000 to an amazing \$1.27 billion in 2005, with exports so large that the bilateral trade balance shifted from a Jordanian deficit of \$239 million in 2000 to a surplus of \$624 million in 2005⁽²¹⁾. However, these numbers do not accurately reflect the US free trade agreement. The lion's share of Jordan's increased exports came from the Qualifying Industrial Zones (QIZs) - specific areas whose outputs enjoy duty-free and quota-free access to the US market if they are produced with a minimum of 8 percent of Israeli inputs⁽²²⁾. These QIZs have attracted huge amounts of investment from Asian manufacturers seeking to circumvent US quota restrictions. Since these manufacturers import most of their inputs from Asia, job creation in Jordan has been disappointing. Also, with the end of the Multi-Fiber Agreement, most of those companies will gradually relocate back to China and India.⁽²³⁾

Israel has distanced itself more and more from its Arab neighbors. It has managed to turn itself into a high-tech country which is not very different from your average Western EU economy. Israel's political governance and technical rules and regulations have become very similar to those applied by the EU. Also, Israel is more deeply integrated with Europe through scientific and cultural exchanges, as well as similarities of work-consumption patterns, than any other country in the Middle East⁽²⁴⁾. In many ways, if peace could be achieved between Israel and the Palestinian Territories, Israel could become an ideal trade partner for its Arab neighbors. But real prosperity can only be achieved if there is a lasting peace. Unfortunately, ever since the second Intifada, EU exports to the Palestinian territories have dropped on average by a catastrophic 26% per year. Between 2000 and 2003, Israeli trade with the European Union fell on average by 10%.⁽²⁵⁾ More recently, Israeli exports have rebounded, with the US buying a larger share of Israeli exports, even though the EU as a whole remains Israel's main export market.⁽²⁶⁾

Egypt signed a QIZ Agreement with the United States in 2004 which allows the country to gain non-reciprocal, duty-free access to US markets for products containing at least 11.7 percent Egyptian and 11.7 percent Israeli components.⁽²⁷⁾ The Egyptian government views the QIZ as a 'quick fix' to prevent job-shedding in the textile sector and as a stepping stone to a direct bilateral trade agreement with the United States. However, US mistrust

about Egypt's law enforcement regime has delayed the start of negotiations for a US-Egypt agreement. Moreover, the Bush Administration's plan for a broader Middle East free trade area will gradually undermine the QIZ framework and divert investment toward countries that achieve bilateral preferential agreements with the United States. Although the QIZ provides a modest boost in exports and a chance to salvage market share in a labor-intensive industry, it mainly functions to remove the Arab taboo against conducting business openly with Israeli firms. In this sense, it has been argued that the political achievements and economic gains from the QIZ Agreement will be rather limited.⁽²⁸⁾

Where do we go from here?

It should be emphasized that free trade can be no panacea. It is doubtful that US or EU trade policies can quickly deliver the desired political results. In the short run, opening markets tend to go hand in hand with serious economic dislocations - what economists call 'adjustment costs' - such as job losses in certain industries, bankruptcies and social hardship. These costs are politically crucial and could increase the number of disaffected populations, raising the threat for Islamist terrorism. Also, if the FTAs are seen as disproportionately benefiting the US or Europe, they will have the opposite effects by strengthening the overwhelmingly negative perception of Western-led globalization.

In sum, while trade agreements provide opportunities, they never guarantee results. The current US and EU initiatives are a step in the right direction, but need to be accompanied with domestic reform and the establishment of trade enabling regulatory and business environments. Currently, however, it seems that the negative fallout from the Iraq war and the ongoing tensions between Israel and its neighbors far outweighs any political benefits that could come from Europe's or the US' free trade agreements. ■

(19) Looney (2005)

(20) Oxford Analytica (2003)

(21) Lawrence (2006b)

(22) EIU (2007), Jordan Country Report

(23) Looney (2005)

(24) Cameron (2005)

(25) Mandelson (2005)

(26) EIU (2007), Israel Country Report

(27) EIU (2007), Egypt Country Report

(28) Yadav (2007)

TRADING UP? THE ECONOMIC IMPACT AND LONG TERM SUSTAINABILITY OF THE QUALIFIED INDUSTRIAL ZONES IN JORDAN

Leigh O'Neill*

Introduction

It was in 1996, two years after Jordan's peace with Israel, that the United States Congress designated the first Qualifying Industrial Zones in Jordan. The purpose of these QIZs was to nurture closer trading ties between the business communities in Jordan and Israel in order to build a foundation for lasting peace between the two countries and boost economic development in Jordan. This article will address the latter goal, namely the impact of the QIZ program on the Jordanian economy a decade after its inception and its long term economic sustainability. The first two sections provide an overview of the Jordanian economy and explain the origin of the QIZ program. The third section presents the arguments used to promote the zones, while the final section lays out a more detailed, and, unfortunately, less positive, assessment of the impact of the current program on the Jordanian economy.

Political Economy of Jordan, 1974-1994

The Hashemite Kingdom of Jordan is a small, middle-income country, with few natural resources, limited industry, and concentrated population centers. It follows the classic semi-rentier model, generating most state revenue from foreign aid and salary remittances from Jordanians working abroad in nearby oil industries, making Jordan heavily dependent on the petroleum-rich economies of its neighbors. Considering this dynamic, Jordan benefited initially from the high energy prices of the 1970s, but fell into recession when energy prices leveled out and aid from neighboring oil-producers slowed. By the late 1980s, Jordan was facing a financial crisis, after failing to adjust fiscal spending in response to its economic downturn. In 1989 Jordan accepted a stabilization plan put forward by the International Monetary Fund⁽¹⁾.

The IMF plan halted, however, during the subsequent war in the Gulf, a conflict that left Jordan politically isolated and further economically insecure. Jordan judged that the potential economic benefits of peace with Israel would outweigh any domestic political opposition. The hope was for this so-called 'peace-dividend' to restore the country's political standing and provide a substantial economic windfall.

Inception of the Qualifying Industrial Zones

Jordan did reap immediate economic benefits from the

peace deal. The United States wrote off \$833 million of Jordan's debt, committed an annual \$150 million in military and economic aid and pressured France and the United Kingdom for additional assistance⁽²⁾. It looked as though the peace dividend would fail to materialize in the long run, however, and Jordan found itself still at the mercy of semi-rentier economic dependence. In 1996, to encourage the development of Jordanian, Palestinian and Israeli business partnerships, the United States extended the existing United States-Israel Free Trade Area Implementation Act of 1985 to include designated free trade space in Jordan that would 'cover articles grown, produced or manufactured in the West Bank, the Gaza Strip, or a QIZ between Israel and Jordan or Israel and Egypt.' It defines a QIZ as a 'territory of Israel and Jordan or Israel and Egypt...designated locally and by the US Trade Representative as an enclave where merchandise may enter without payment of duty or excise taxes' and stipulates that 'articles shipped to the US from the West Bank, the Gaza Strip or a QIZ be treated as though they were articles directly shipped from Israel for the purposes of the US-Israel Free Trade Agreement.'⁽³⁾

This designation of QIZs in Jordan allows for the business community, and especially the manufacturing sector, to profit by exporting goods to the United States without duties, tariffs or other trade restrictions. In order to qualify to export goods to the United States under this agreement, 35% of a good's value must be produced with local content. This must include 11.7% Jordanian input, 8% Israeli input (7% for high-tech production), with the remaining 15.3% from Jordan, Israel, the West Bank, the Gaza Strip or the United States. The remaining 65% content can originate or be produced anywhere else in the world and Jordan is not subject to quota restrictions on its exports entering the United States.

The Case for the Qualifying Industrial Zones in Jordan

Given the lack of any notable manufacturing industry in

* Brynen, Rex. 'Economic Crisis and Post-Rentier Democratization in the Arab World: The Case of Jordan,' *The Canadian Journal of Political Science*, Volume 25, Number 1 (March 1992), pages 71-72.

(1) El-Said, Hamid. 'The Political Economy of Reform: Breaking Resistance to Reform?' found in *Jordan in Transition* pp. 254-277.

(2) United States House Resolution 3074, To Amend the United States-Israel Free Trade Implementation Act of 1985 to provide the President with additional proclamation authority with respect to articles of the West Bank or Gaza Strip or qualifying industrial zone. Public Law 104-234. Found on the Library of Congress website: <http://thomas.loc.gov/cgi-bin/bdquery/z?d104:h.r.03074>:

(3) Kardoosh, Marwan and Riad al-Khoury. 'Qualifying Industrial Zones and Sustainable Development in Jordan', *Jordan Centre for Public Policy Research and Dialogue*; February 2005, page 13.

Jordan pre-1996, private sector interests and international garment manufacturers sought to take advantage of the free trade space designated in the QIZs. There are currently thirteen existing zones in Jordan, three of which are government owned and operated. Presently, seven are fully operational, housing sixty-two companies, ten of which are partially or fully owned by Jordanians. The majority of investments in garment manufacturing factories originally came from larger multinational firms, based in Hong Kong, Taiwan, Pakistan, India, Sri Lanka, and the United Arab Emirates. Currently, total labor employed in the factories amounts to 56,000 workers; 19,000 of which are Jordanian, 37,000 of which are foreign. In order to encourage the companies to invest in the QIZs, the Jordanian government offered various subsidies and other incentives, including tax-free profit and wage repatriation.

The result has been an exponential increase of exports from the QIZs, up by nearly 1000% in the past decade. Currently, 45% of Jordan's country exports are derived from the garment industry in the QIZs. In addition to these impressive statistics, the economic argument often made in favor of the QIZs, and in particular the garment industry, points to export diversification, worker training, increased participation of Jordanian women in the workforce, and the continued potential benefits of manufacturing apparel in Jordan after the Agreement on Clothing and Textiles came into effect in January 2005.

Looking Beyond the Figures: Why QIZ Benefits are Marginal

While all of the above-mentioned is true, the impact of the QIZ program on genuine, sustainable development in Jordan has been meager. Most investments are confined within the QIZs and nearly all of the required inputs for manufacturing are imported. The failure of foreign companies to integrate into the local economy has denied the garment industry in Jordan a chance to vertically integrate, or adopt a value chain, which could potentially include, for example, design and sample production, and could eventually yield a local fashion industry. Instead, the garment industry in Jordan mainly involves cutting, sewing and finishing operations, which contribute the lowest value in the production chain.

Garment manufacturers in Jordan have been able to meet the qualifying content requirement of 35% of local materials, also known as value-added, because the QIZ agreement allows for the value of the imported material to count as locally produced if it is altered twice in Israel, Jordan, the West Bank or Gaza Strip. This requirement is easily met in the production of garments with cutting and sewing, a process that meets the necessary dual alteration of inputs in order to qualify for exportation to the United States under the QIZ agreement⁽⁴⁾. This allowance, although a structural loophole, encourages

that only the minimum contribution of added value to the overall economy, while allowing foreign companies to take advantage of Jordan's privileged trading status with the United States.

Because of the deficit of existing industry in Jordan pre-1996, there was a shortage of a trained and skilled workforce familiar with modern manufacturing technology. The lack of a trained labor force created incentives for factory owners to import foreign workers, depriving Jordanians of much needed employment opportunities. The large number of foreign workers in the QIZs has also hindered a broader domestic workforce from acquiring the skill set and technical training a country expects when new industry is introduced locally. The training programs for Jordanian workers have been geared towards specific production-line tasks applicable to nothing more than manufacturing garments.

Over time, low wages, social prejudices against factory work and other barriers, made foreign workers preferable to Jordanians. Contributing to this is the inherent motivation of foreign workers, who come to Jordan for relatively high wages and potential overtime pay to remit back to their home countries. This directly conflicted with those Jordanians, primarily young, unmarried women who work in the QIZ factories, who had domestic obligations during the latter part of the day and whose presence after normal working hours would be considered inappropriate.

Given Jordan's high rate of unemployment, which is officially stated around 15%, job creation was a major goal in the QIZ program. The official numbers of Jordanians working in the QIZs has grown steadily since the inception of the program, from 13,300 in 2001 to 19,000 in 2007, but has been outpaced by an increase in number of foreign workers employed in the zones, from 5,700 in 2001 to 39,000 in 2007. Given, however, that nearly 50,000 Jordanians enter the local workforce annually, the large presence of foreign labor in the QIZs further hinders the positive impact of the QIZs on unemployment.

It should also be noted that part of the early investment promotion strategy to attract firms to the QIZs included tax-free repatriation of profits for factory owners and wages for foreign management and workers. This means that the Jordanian state earns no revenue on foreign income earned in the QIZs.

In addition to these ongoing issues, there are several factors that threaten the long-term viability of the QIZs in Jordan. The Multi-Fiber Agreement (MFA), a forty year-

(4) Kardoosh, Marwan and Riad al-Khouri. "Qualifying Industrial Zones and Sustainable Development in Jordan", Jordan Centre for Public Policy Research and Dialogue; February 2005, page 13.

old quota regime imposed by industrialized countries to limit imports from the developing world, expired on January 1, 2005. It was replaced by the Agreement on Textiles and Clothing, which phases out existing MFA quotas over a ten-year period. The expiration of the ATC actually presents an opportunity for Jordan to compete in production of middle-market goods, but measures to attract new investments from countries that will lose their own competitive quota status by the end of next year, such as UAE and Turkey, have thus far been lacking or ineffective.

The QIZ program currently being implemented in Egypt poses an additional threat to the existing program in Jordan. Egypt is better suited to reap the benefits of foreign garment manufacturers since the existent Egyptian textile industry would provide extensive opportunities for incoming producers to vertically integrate, and therefore enhance, the local economy. Egypt also has a much larger potential workforce and lower wages than Jordan, both incentives for firms in Jordan to relocate. Finally, companies exporting from Egypt enjoy reduced shipping costs through that country's access to the Mediterranean, instead of Aqaba or Haifa.

In addition to these changing dynamics in international trade, the National Labor Committee, in conjunction with the International Labor Organization, last year issued a scathing report about labor conditions in Jordanian QIZ factories. This report, though likely intended to inform American consumers, has been countered by the Jordanian government with new regulations that will likely make continued production in Jordan cost ineffective.

Finally, the US-Jordanian Free Trade Agreement, authorized in 2001, is expected to render the QIZs obsolete in the coming years. The FTA will not affect the QIZs in the short term, since textiles and garments produced in Jordan outside of the zones carry heavy tariffs until the FTA is fully implemented in 2011. In the long-run, however, the QIZs will not provide the unique benefits of free trade space, since the entire kingdom will have that status under the FTA.

Conclusion

The expiration of the MFA, the US-Jordanian FTA and the Egyptian QIZs represent immediate, short and long term threats to the viability of the QIZs in Jordan. Whether the kingdom can expedite growth and integration of the country's newly established industrial base and realize the potential benefits of the free trade agreement with the US remains to be seen. In the interim, it is not clear that the QIZ program has benefited the domestic economy as much as originally hoped. The presence of foreign labor and the lack of interaction between the foreign companies and local firms have prevented Jordan from integrating the operating industries in the zones

into the overall economy, which is necessary for long-term success. Although there has been an extraordinary boost in exports, especially over the past six years, these numbers do not present an adequate picture of whether the QIZ program has been a valuable tool for economic development. The program has not realized its political goals, failing to create lasting, broad-based ties between the Jordanian and Israeli business communities. Overall, the QIZ program in Jordan will likely be remembered as a short-term boost for a persistently dependent economy. ■