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## THE ECONOMICS AND POLITICS OF THE EGYPT-ISRAEL TRADE AGREEMENT

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On 14 December 2004, the Egyptian and Israeli Ministers of Industry and the US Trade Representative signed an agreement to create eight "Qualified Industrial Zones" (QIZs) in Egypt. The agreement, which must be ratified by the Egyptian parliament and the US Congress, will permit goods made in Egypt but with a specified minimum Israeli content to enter the US duty free. Because there is no free trade agreement between Egypt and the US, Egyptian exports to the US are currently subject to duties and other restrictions. The QIZ agreement will make it possible to expand industrial exports and create thousands of jobs -- two vital needs of the Egyptian economy.

The QIZs will be located in the Greater Cairo area, in Alexandria and in Port Said on the Suez Canal. In order for goods to have duty-free access to US markets, they will have to contain a minimum 11.7% Israeli share in the value added for the factory concerned, measured on a quarterly basis. The method of calculation is designed to encourage a wide range of activities. Two existing Israeli clothing factories in Egypt will be in these zones. An investment fund is being set up in London by groups interested in investing in the new zones.

The Egyptian-Israeli agreement has been under discussion between the two sides for many months, but its completion and the timing of the signing ceremony are highly political. For Israel, the issues are clear: it wants better relations with Egypt and believes that trade is a way to achieve this. The economic gains will go to those Israeli companies selling to companies in the QIZs. For Egypt, the considerations are more complex. Much of Egyptian public opinion is extremely hostile to Israel, and at least part of this can be attributed to the media, which are under the direct or indirect control of the government. As a result, the agreement will face opposition in parliament. The Egyptian public -- including even those who will benefit from the creation of new jobs -- continue to believe that Israel is the enemy, and many Egyptians are convinced that economic cooperation with Israel is a zero-sum game: whatever Israel gains, Egypt (and the Palestinians and the Arabs, in general) lose. Accordingly, cooperation with Israel should be avoided. Trade between the two countries has reflected this disposition.

But there is a different view, apparently now being adopted by the Egyptian government, which is more economic and less political.



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Egypt desperately needs jobs, investment and income, and the agreement with Israel offers all these. Moreover, the agreement will strengthen Egypt's position in the US, where there have been calls to reduce the military and economic aid given to Cairo. An additional consideration has been Egypt's decision to intensify its involvement in efforts to bring about a cease-fire in Gaza. As part of its desire to play a constructive role, Egypt has offered to bring 750 troops to man the Egyptian border with Gaza. Under the terms of the 1979 peace treaty with Israel, the forward deployment of those troops requires Jerusalem's agreement. The death of Yasir Arafat, the reelection of George W. Bush, and Ariel Sharon's commitment to remove Israeli settlements in Gaza have presented President Husni Mubarak with an opportunity to tie all the ends together. Improving relations with Israel will yield political and economic gains and reinforce Egypt's centrality in the region.

In July 2004, Mubarak installed a new technocratic government to deal with Egypt's deteriorating economy. The new Minister of Industry and Foreign Trade, Rashid Mohamed Rashid, is one of the few senior Egyptians with international business experience. He is also one of those who would like to "put the economy first" and not make Egypt's economic fate hostage to an Israeli-Palestinian agreement. The new Prime Minister, Ahmed Nazif, is also a technocrat, much younger and more business-minded than his predecessor.

Mubarak and his ministers have seen how QIZs have benefited Jordan. Since they were inaugurated in December 2001, QIZs have led to a dramatic increase in Jordanian exports to the US: from \$16 million in 1998 to \$674 million in 2003. Estimates for 2004 are about \$900 million. This has made possible the creation of some 40,000 new jobs in Jordan.

The key to Jordan's success and to Egypt's new policy direction is the fact that US "rules of origin" regulations are liberal. Products entering the US from a country with which it has an FTA (like Israel) are not subject to import duties if they have a specified minimum local content. Goods exported from Jordan count as Israeli and are exempt from duties if they have at least 8% of value added originating in Israel. In other words, the US is encouraging other Middle Eastern countries to produce goods jointly with Israel, something that benefits Jordan and could now benefit Egypt.

Egypt's decision about QIZs is also part of a broader trade picture. Negotiations with the US on a free trade agreement have been stalled because of Egyptian fears about the inability of its weak industrial sector to compete with American imports and about the loss of revenues from import duties. The advantage of the QIZ agreement is that it is about exports, which do not threaten local industry but rather encourage it. The disputes in Egypt are therefore about which areas will benefit from QIZ status and whether companies will move out of other areas to relocate there.

There are reports that Egypt signed the agreement as a result of US pressure and that Mubarak has warned Egyptians not to conclude deals with Israel before an agreement between the latter and the Palestinians is signed. If these reports are true, then Egypt will continue to pay the cost in economic terms for its altruism on behalf of the Palestinian cause; its losses will be far greater than Israel's. Whether that cost outweighs the domestic political cost of implementing the agreement is a decision that Mubarak, alone, will make.

**KEYWORDS:** Egypt; Israel