



COVER STORY

THE BIG THAW

BY PAUL SCHEMM

It was a cloudy overcast day with an uncharacteristic chill in the Egyptian air as a group of businessmen and industrialists from the Qalioubiya governorate gathered in Shobra Al-Kheima municipal building. Around a long table in a sparsely furnished room harshly lit with neon light, they sat down with

Qalioubiya governor Adly Hussein and Minister of Foreign Trade and Industry Rachid Mohamed Rachid to discuss their future.

PHOTOS: AFP, BUSINESS MONTHLY ARCHIVES





JUST DO IT: Many textile factory owners and workers want QIZs

The main topic on their minds was the historical agreement signed just days earlier on December 14 between Egypt, Israel and the US. The agreement created seven qualifying industrial zones (QIZs), whose products get duty- and quota-free access to the US market provided they include Israeli input. One of these zones was allocated in Shobra Al-Kheima, on the outskirts of Cairo. The others will be located in 10th of Ramadan City, 15th of May Industrial Zone, Badrashein, Borg Al-Arab, Amareya and Port Said.

The businessmen and industrialists quizzed Rachid about the nature of QIZs. Many feared the industrial zones implied a free trade agreement with Israel. Rachid assuaged their fears, stressing that QIZs were free trade areas with the US, not Israel, though the agreement requires that a minimum

of 11.7 percent of product input be Israeli. The minister put the agreement in the context of international trade agreements and ministry efforts to create opportunities for local companies. People need to lose their sensitivity to the word "Israel," he said.

It was a remarkable scene and an unprecedented one for Egypt as suddenly the long-taboo topic of Israel had come to the forefront. December witnessed a remarkable thaw in relations between Egypt and Israel that saw progress on both the economic front, with the signing of the QIZ agreement, as well as the political front, with prisoner releases and renewed efforts on the peace process.

On December 5, Egypt released convicted Israeli spy (and textile worker) Azzam Azzam after he had served about half of his 15-year sentence. At

the same time, Israel released six Egyptian youths caught crossing the border on August 25. Two weeks later, Israel released 170 Palestinians from prison, once again thanking President Hosni Mubarak for resolving the Azzam situation.

Egyptian authorities deny any connection between the events, saying only that the judicial procedures on Azzam's case had been completed. Meanwhile, though, negotiations over the future Egyptian security role in Gaza have picked up speed and there is speculation that the on-again-off-again natural gas deal with Israel will finally go ahead now that the QIZ agreement has been signed.

Analysts maintain that these events must be viewed as part of the same process. US trade representative Robert Zoellick described the QIZ signing as

the "most significant economic agreement between Egypt and Israel in 20 years." Hassan Nafaa, head of the political science department at Cairo University, said this could only have occurred in the context of broader political changes.

"I don't think Egypt could have taken such a decision [the QIZ] unless there had been some changes in the political situation," he said, citing the death of Palestinian leader Yasser Arafat, the re-election of the Bush administration and glimmerings of greater Israeli flexibility. "[These events] might create a new era where Egypt could play a role to resume the negotiations between the Palestinians and the Israelis."

IT'S THE ECONOMY, STUPID

On the day of the signing, however, the talk was less about the tortured negotiations in Palestine than about how the agreement would truly benefit Egypt. Journalists surged forward to witness

the three-way handshake and signing between Rachid, Zoellick and Israeli minister of industry and vice premier Ehud Olmert during the official ceremony in downtown Cairo.

In his opening comments, Rachid remarked on the significance of the agreement for the economy. "It is consistent with the government's efforts to open up the economy, increase growth rates, enhance job creation and promote exports," he said.

By Rachid's estimates – the most conservative of the numbers being thrown around in the state press – the QIZ agreement could create 150,000 jobs, mostly in the ailing textile industry. It could also triple Egypt's textile and garment exports to the US, currently valued at over \$550 million, in four years.

In his comments at the ceremony, Zoellick saw the agreement as not just helping peace in the region, but a way the US government could help the new team of reformers that entered the government in July. "We hope that by showing the benefits of a more open trading system and economic integration, it will help this new economic reform team on some of the other

issues that have hindered investment," he said.

The theme of the economic contribution to peace was also picked up by Olmert, who said it was vital to show the people themselves that peace has beneficial consequences. "I think it is very important for the Egyptian people to understand that when there is peace with Israel, and there are good relations with Israel, there can also be business benefits and trade benefits to the Egyptian economy."

Egyptian-Israeli trade in 2003 was a mere \$42 million. Taking Rachid's modest estimate, the QIZ agreement should increase Egypt-US trade in textiles and clothing to \$1.5 billion, from \$550 million. An 11.7 percent cut of the difference would suggest that trade with Israel could increase by some \$110 million, while Egypt's direct benefit would top \$840 million.

Yet for Olmert, the agreement is more than just about Egyptian-Israeli economic relations and normalization, it is a stepping stone to the rest of the region. "Let's face it, Egypt is the leader of the Arab world and is the most important country among the Arab countries.

PHOTO: PAUL SCHEMM

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When Egypt signs an agreement with Israel it sends a green light for many other countries to follow suit.”

QUEASY ABOUT QIZs

It's precisely that sort of language that raises the hackles of those who oppose the agreement. During the signing ceremony, there was a small protest at the Journalists' Syndicate by a few dozen people. They saw the agreement as an example of the dreaded normalization that many sectors of Egypt's civil society have avoided for the past quarter century.

“The signing of this agreement is a surrender we don't accept,” said Yehia Fekry, a member of the Socialist Studies Center, attending the protest



USTR Robert Zoellick

rally. “It is a jump towards normalization with Israel,” as well as an attempt by Arab regimes to subvert the Palestinian intifida. He added that the QIZ agreement is not in the interests of Egyptian labor.

Egyptian labor, however, does not appear to agree. On the day of the signing, workers in the industrial towns of Ismailiya and Mahalla Al-Kobra were having their own protest rally. Their gripe? That they were *not* included in

the agreement.

In fact, there is widespread fear in the Egyptian textile and garment industry that the expiration of the Multi-Fiber Agreement on January 1 will severely threaten the economy. Factory owners, and apparently workers as well, view the QIZ agreement as a way of preserving the industry's US market, worth \$558.4 million in 2003. Losing this market would be a devastating blow to certain areas of manufacture. In the case of knitted apparel, for instance, US markets account for 72 percent of export production.

The most visible opposition to the agreement and the warming trend with Israel, however, seems to come from Egypt's intelligentsia. While opposition papers have predictably blasted the government's decision, there has also been



fierce criticism, somewhat paradoxically, in the opinion of the state press.

Respected Islamist writer Fahmi Howeidi attacked the agreement in his column in state-owned daily *Al-Ahram*, questioning how it could be signed amid the daily parade of atrocities car-

ried out by Israeli forces in the occupied territories.

In parliament, meanwhile, an angry debate over the QIZ agreement dominated activity on December 18, though it was not actually on the agenda. The government maintains that the agreement

does not need to be ratified by the parliament because it is merely a trade “protocol,” which benefits Egypt without any obligation from the Egyptian side.

Opposition members in particular denounced the idea that an agreement involving Israel would not be subject to

THE WIZARD OF QIZ

Minister of Foreign Trade and Industry Rachid Mohamed Rachid has once again taken the center stage. The reform-minded minister, a champion of free market policy, has landed Egypt a potentially lucrative, if not controversial, trade deal. Speaking to AmCham members during a special panel discussion on December 22, Rachid explained the importance of the new QIZ agreement.

Rachid noted that although Egypt has trade agreements with a number of countries and economic blocs, its relationship with the US – the biggest consumer market in the world – is of the highest importance. “We have always had a very special relationship with the United States,” he said, “The US has FDI up to \$3.5 billion in Egypt and when you look at the volume of our exports, 40 percent at the moment is tar-



Rachid Mohamed Rachid

geted toward the US market.”

The minister said the approaching deadline for full implementation of GATT on January 1, 2005 had given Egypt a sense of urgency to solidify its trade relationship with the US. Local exporters face fierce competition from cheaper world producers now that export quotas have been eliminated.

The government attempted to restart

stalled negotiations with the US for a free trade agreement (FTA), Rachid said, but even if successful, an FTA would take several years to implement. Instead, the government decided to focus on establishing QIZs, which extend the benefits of Israel's 19-year-old FTA with the US to approved industrial parks in Jordan, Egypt or the Palestinian territories.

“The QIZ agreement was something that was offered to Egypt in 1996 [as] part of President [Bill] Clinton's efforts to promote peace in the region,” Rachid said. Egypt found the offer too politically hot to handle at the time, while Jordan signed on in 1998. Since then, Jordan's exports to the US have grown from \$26 million in pre-QIZ 1998 to \$950 million in 2004 and are expected to surpass \$1 billion in the coming year.

Rachid said the new QIZ agreement, signed on December 14, 2004, will give Egyptian exports a competitive edge in the US market. “[Under a QIZ agreement], the US grants free market access to its market without any quotas or trade barriers,” he said. Accordingly, Egyptian exports to the US could grow to \$4 billion in four years, a three-fold increase.

In November, Rachid led a high-profile mission to Washington for talks with US trade representative (USTR) Robert Zoellick. The US side rejected Egypt's initial request for 16 zones, fearing a large number could negatively impact its own market. Zoellick reportedly pushed for just one or two, with more to follow if the model proved successful. Rachid, however, played hardball, returning

home with a US commitment for seven QIZs in three geographic areas.

The historic December 14 signing established seven QIZs in the areas of Greater Cairo, Greater Alexandria and the Canal zone. The minister said the QIZ locations were selected based on a number of criteria, but mostly their current and potential export volume to the US. Industrial areas excluded from the agreement would not be left out in the cold, Rachid insisted. “In the next few months, we can request more zones, and I am confident it will happen,” he said, adding that the government may also offer special support in the meantime.

Addressing the sticky topic of Egyptian-Israeli relations and the possibility that Israel could exploit the fixed portion of inputs to exact higher prices, Rachid insisted that free market rules would prevail.

“At the end of the day, this is something that business people will have to negotiate,” he said. “We are not worried because it will be an open market.”

The minister pointed to one of the strengths of the agreement, in that – unlike an FTA – the agreement does not require Egypt to reciprocate the privileges it receives from the US. “There is nothing in the protocol that [implies] any specific requirements or liabilities for Egypt,” he said. The agreement is also not limited to textiles, and could be expanded to other sectors as well.

Egypt may have landed a prized QIZ deal, but an FTA with the US is still on everyone's mind. Officials from both sides are scheduled to meet in mid-January to discuss the future of trade relations.

CAM McGRATH

parliamentary approval, maintaining that it was their constitutional right.

Meanwhile, economist Ahmed Al-Naggar in an article published in *Al-Ahram* newspaper dubbed QIZs “Trojan horses” that would bring a flood of Israeli products into the country. His assertion is based on the notion that QIZs create a free trade zone between Israel and Egypt, which the agreement’s authors maintain is not the case. Jordan has had QIZs in operation since 1998 but has yet to exhibit a major influx of Israeli products.

In a conversation with journalists the day of the signing, industry minister Rachid acknowledged that there were still a lot of emotions about the whole issue, but he said it was largely a matter of educating people about the agreement. “We need to tell them what it is,” he said. “The reason why is because people who are negative about this, emotionally, they keep putting in things that are not true about it.”

INVESTMENT MAGNET

One of the key points of the government is that demand for the QIZ came out of the private sector, and that the agreement is a purely economic one and not part of some political process. The government flatly refused the QIZ model when it was first offered in 1996, but in recent years the business community has urged it to put the country’s economic interests ahead of political and moral concerns. “The reality of course is that it has been influenced by the business community feeling pressure with the Multi-Fiber Agreement coming to an end at the beginning of 2005,” said Rachid.

Industry analysts say that without the competitive edge offered by the QIZ agreement, Egyptian textile and garment exports would stand no chance against significantly cheaper Asian products. China alone is expected to increase its market share of clothing products to 50



percent in 2005, from 20 percent.

Negotiations with the Israelis over the QIZs only began in July 2003, shortly after Zoellick said the Egyptians had a long way to go before they would be granted a free trade agreement (FTA) with the US. The timing, however, is proof to some critics that the issue is one of pressure from the US. After all, if Egypt had received an FTA like Morocco and Bahrain then it never would have needed a QIZ, Al-Naggar pointed out in his article. “America’s obstruction of an FTA was a devastatingly effective way to force Egypt to sign the QIZ deal,” he wrote.

Initially it will be just garment manufacturers that take advantage of the deal, though there is nothing to stop other industries from utilizing it. US tariffs on textiles and garments are among the highest, reaching 35 percent on some goods. The duty-free status of QIZ outputs will make otherwise uncompetitive products much more competitive in the US market. Even with the removal of export quotas as of January 1, foreign companies will invest in Egypt’s QIZs to gain this extra advantage in the highly competitive global garment market.

“We expect the QIZ to bring a lot of new investment to Egypt,” said Magdy Tolba, chairman of Cairo Cotton Center in Qalioubiya, which exports over two-thirds of its clothing production to the US. He added that there has already been interest in the QIZ from his clients. “All of them, for the last couple of months, have been

contacting us to reserve capacity.”

Left out for now, however, are the textile companies themselves, especially those that concentrate on spinning and weaving and creating fabric. Egypt’s textile and garment industries remain unintegrated, so that high-end garment exporters such as Cairo Cotton Center import their cotton yarn or woven fabric from abroad.

“There is a need to integrate and reform the industry,” confirmed Hani Al-Habibi, head of Sahara Group, a textile consulting firm. The way things stand now, he said, only apparel manufacturers will benefit. “It depends if apparel manufacturers coordinate with the others in the supply chain, but until now this has not happened.”

For his part, Rachid acknowledged that industry, particularly the public sector-dominated spinning and weaving sector, faces serious challenges. He said the government was forming a clear and transparent strategy for the whole textile and apparel sector that would take advantage of its skilled labor pool and the high quality of Egyptian cotton.

The future success of the QIZ and Israeli-Egyptian relations may yet be hostage to the future of the peace process. Renewed violence in the territories, many analysts worry, could still hurt economic relations – though that has yet to happen with Jordan.

Israeli officials say that as far as they are concerned, the agreement has little economic value for their country; rather it is more important for building personal ties between the two countries.

Oded Beit-Halachmi, head of Delta Textile Egypt, an Israeli firm operating a factory in Cairo since 1995 with 4,500 local workers, sees this as the agreement’s strongest point. “I feel it will encourage relations just for the fact that people will have to travel to meet each other,” he said. “It will force people to talk to each other.”

