



Assessing the Impact of Egypt's Qualifying Industrial Zones

PREPARED BY
Thomas Hutcheson

SUBMITTED TO
USAID

SUBMITTED BY
Nathan Associates Inc

UNDER CONTRACT NO.
PCE-I-00-98-00016-00
Task Order 827

July 2006

Qualifying Industrial Zones in Egypt A Preliminary Assessment

Under the terms of a Protocol signed in late 2004, the United States grants duty and quota-free market access to imports originating from companies located within Qualifying Industrial Zones (QIZ) in Egypt, provided that their products comply with the rules of origin stipulated in the arrangement:

- First, the product must be a new and different article of commerce that has been grown, produced or manufactured in the QIZ. With respect to apparel products, this requirement can generally be met if fabric components are assembled together or the product is knit to shape in the QIZ.
- Second, the article must be imported directly from the QIZ, Israel, the West Bank or Gaza Strip (the U.S.IFTA region).
- Third, at least 35% of the appraised value of a product at the time it enters the U.S. must be attributable to materials produced, and direct costs of processing operations performed, in the U.S.IFTA region. Also, U.S. materials may account for up to 15% of the appraised value of the finished goods.
- Fourth, the agreement between Egypt and Israel provides that at least 11.7% of the value of the covered products must be Israeli.
- Alternatively, the Egyptian and Israeli manufacturers may each maintain at least 20% of the total production cost of the QIZ manufactured goods (excluding profits). Production costs may include raw materials, packing materials, wages and salaries, design and R&D¹

A similar arrangement between the U.S. and Jordan has generated over a billion dollars of new Jordanian exports and that success gave hopes for similar or better results in Egypt.

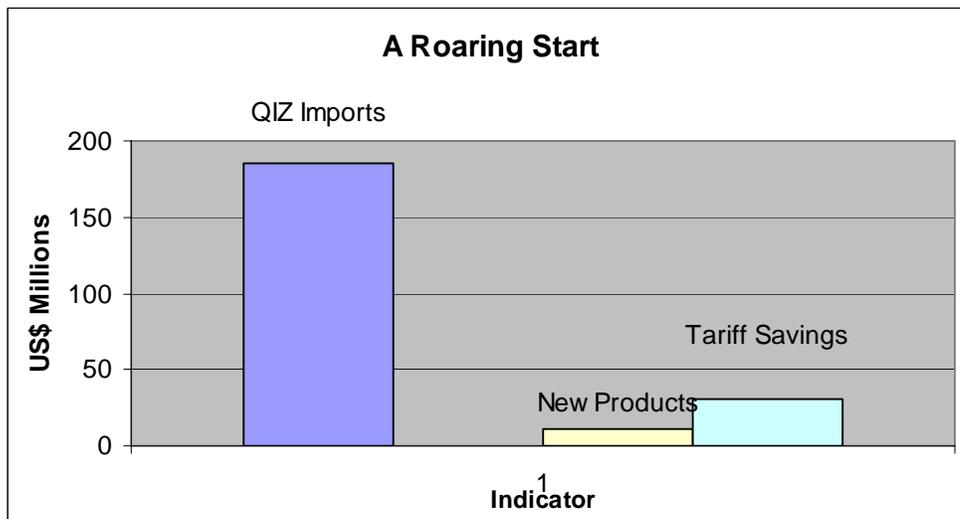
The first imports into the U.S. from the Egypt QIZ were recorded in February 2005.² Data are now available from the U.S. on imports through the first 10 months (9 months of actual imports) of 2005 and these permit a preliminary analysis of the performance of the QIZ.

¹ Taken from the description of the QIZ by the Ministry of Foreign Trade and Industry.

² All data on QIZ exports are taken from the website of the United States International Trade Commission: <http://reportweb.usitc.gov>. Data from CAPMAS are not as up to date, nor do they distinguish exports from the QIZ from other exports.

Imports from Egypt under the QIZ (excluding petroleum products)³ in the ten months through October reached almost \$ 185 million in 124 HS 6 digit categories.^{4 5} Of these, 21 had not been exported in 2004. Some 98% of QIZ imports by value are of textiles and apparel (HS chapters 60-63).

With the lapsing of the Multi-fiber Agreement starting in 2005, the principle economic benefit of the QIZ is access to duty-free status for QIZ goods. These tariffs are significantly higher on average, 15.6%, than on non-QIZ goods, 2.6%. Because of duty free imports under the QIZ program, Egyptian exporters and U.S. importers shared about \$30.7 million in duties not collected on QIZ imports. In its own terms, the QIZ appears off to a good start.



The larger question is, however, whether the QIZ will be successful in stimulating additional exports from Egypt, exports that would **not** have occurred without the QIZ. It is always difficult to say what would or would not have happened “if,” but one approach to that question is to look at exports of the same “QIZ goods” in 2004, when there was no QIZ. Imports of these same 124 items that did not use the QIZ added another \$ 256 million for a total of \$443 million imports of “QIZ goods.” This is shown in the table below.

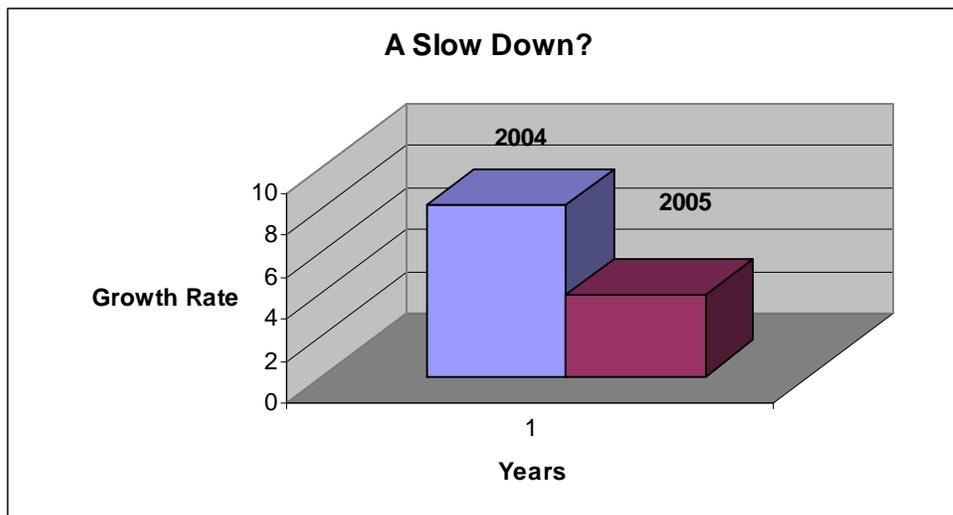
³ In the remainder of the analysis, petroleum products – one item – are excluded.

⁴ It is worth noting that in the first nine months of the Jordan QIZ, exports reached only \$17 million and comprised just 24 products.

⁵ By November, QIZ exports had grown to \$230.7 million and 133 products.

US Imports of QIZ Goods (Millions of US\$)			
	2004	2005	Increase
January – October	426,015,575	442,528,371	3.9%
	2003	2004	
January - December	465,731,309	503,992,836	8.2%

As seen, QIZ goods increased by 3.9% in 2005, but the year before, these same good had increased by 8.2%. Does this mean that the QIZ has been of only marginal benefit to Egypt's exporters?

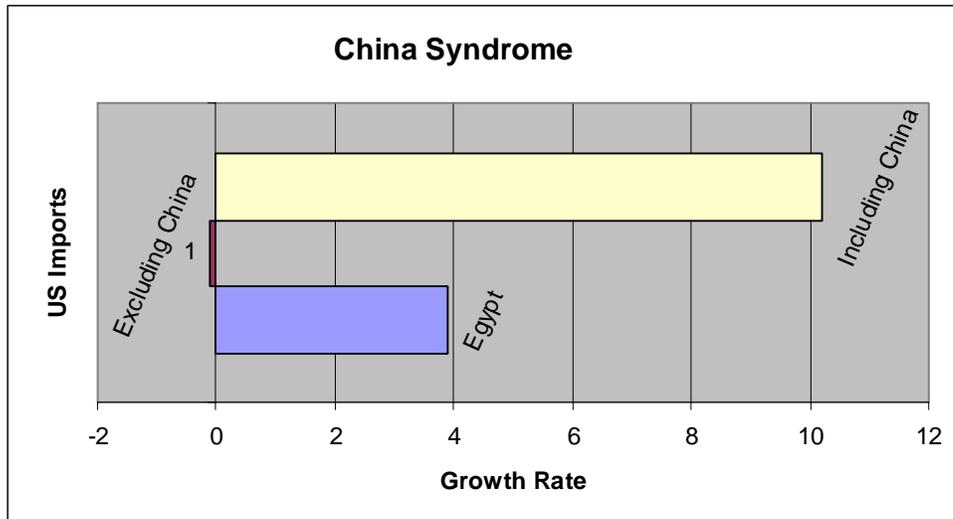


That conclusion would be erroneous because it ignores the other big event of 2005: the ending of Multifibre Agreement and hence, the end of quantitative restrictions on U.S. imports of apparel from China. Almost 98 % of QIZ goods imported by the U.S. from China, predominately textiles and apparel, were subject to quota until 2005. U.S. imports of QIZ goods from Egypt, therefore, were heavily impacted in 2005 by the lifting of quantitative restrictions on imports of these items from China.

US Imports of QIZ Goods (Millions of U.S.\$)			
Egypt	426.0	442.5	3.9%
China	13,094.6	19,603.8	49.7%
Other Countries	51,384.4	51,353.6	-0.1%
Total	64,905.0	71,399.9	10.2%

In the first ten months of 2005, total U.S. imports of "QIZ Goods," from all countries, rose by 10.2%, but imports of these goods from China rose by 49.7%. Imports from the rest of the world (excluding Egypt) actually fell slightly. China's share in those goods rose from 20% in the first ten

months of 2004 to 27% in the first ten months of 2005; whereas the share of the rest of the world fell from 79% to 72% over the same period. Thus, Egypt, with its QIZ, performed **significantly better** than the rest of the world excluding China.



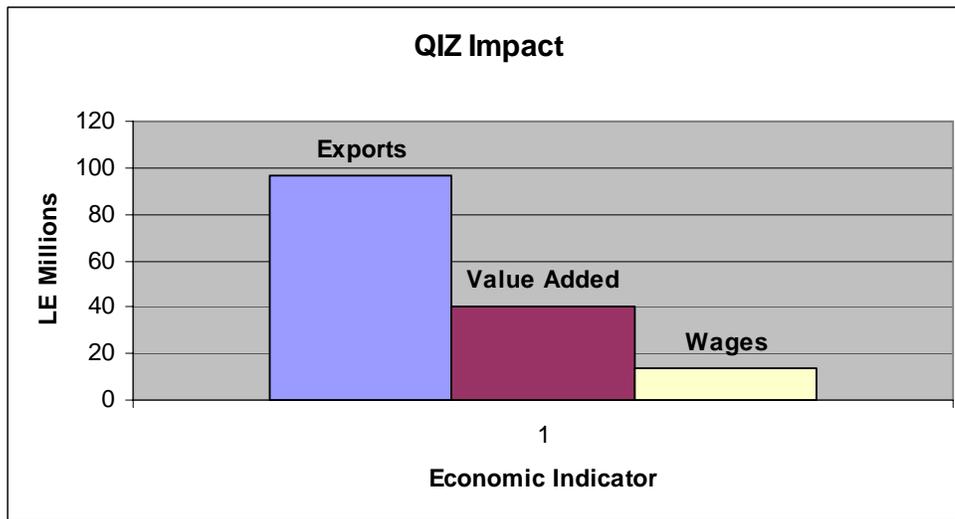
Another indicator of the QIZ’s positive impact on Egyptian exports is comparison of imports from Egypt by the European Union. Imports of QIZ goods by the EU in the January-September period, also facing stiff competition from China, were flat, increasing by just 0.2% compared to 3.9% growth in the U.S. market.⁶

EU Imports of QIZ Goods Egypt		
(US\$ Millions)		
Jan-Sept 2004	Jan-Sept 2005	Increase
437,796,062	438,790,710	0.2%

In this context, Egypt’s modest growth in value exported appears in a favorable light. Thus, it seems likely that the significant tariff preferences available under the QIZ prevented Egypt from suffering even more than it did from the surge in imports from China and permitted the modest growth in these exports observed. Conservatively, we can estimate that without the QIZ, Egypt’s exports of “QIZ goods” would have been at best stagnant. Therefore, we conclude that the establishment of the QIZ is responsible for approximately LE 97 millions of increased exports in the first ten months of 2005. Considering only the direct effects of these exports on the exporting firms, it is likely that the QIZ

⁶ Taken from the website of the European Union, Eurostat: <http://epp.eurostat.cec.eu>. Euro/Dollar exchange rate is from <http://www.amb-usa.fr/irs/irsrates.htm>

generated L.E. 40 millions in value added (GDP) and around L.E. 14 millions of wage payments.



Extensions

This analysis is preliminary and it should be extended in several ways:

- Repeated when data for all of 2005 is available from both the United States and the European Union and at quarterly intervals later. When the methodology is proven, the results could be published in the Ministry's quarterly economic bulletin
- Amplified with data from the Ministry's QIZ Monitoring Unit which will have data on domestic and imported inputs and value added, permitting a more accurate estimate of the employment effects.
- Confirmed by visits to the QIZ and interviews with the firms using (and not using) the Program to obtain real insights into the strengths, weaknesses and potential of the QIZ.
- Carried out, in time, using Egyptian data to permit examining intra-firm and intra-zone issues.

Trade Analysis Unit
Trade Agreements Section
Ministry of Trade and Industry

Qualifying Industrial Zones in Egypt: An Update

The study, “Qualifying Industrial Zones in Egypt: A Preliminary Assessment”¹ concluded that the significant tariff preferences available under the QIZ prevented Egypt’s export to the US from suffering even more than they did from the surge in imports from China in 2005 and that the QIZ permitted the modest growth in exports of QIZ goods observed. The study recommended, among other things, that the analysis be repeated when data for all of 2005 is available from both the United States and the European Union and at quarterly intervals later.

Data is now available from the US through May, 2006² that permits carrying out one recommendation of the first study by taking another look at the performance of the QIZ. This update will make the following points:

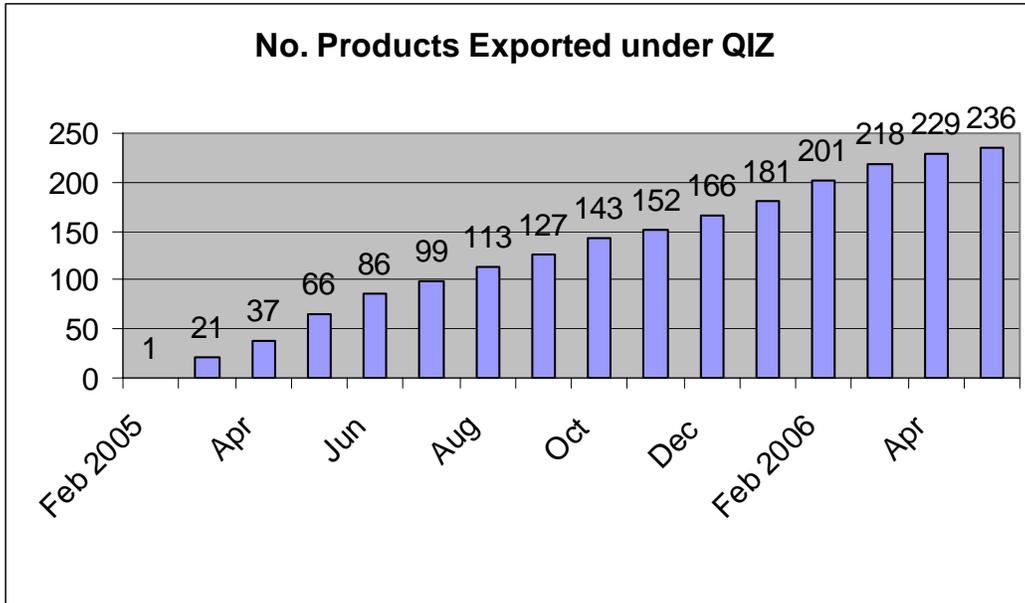
- QIZ results through May, 2006 remain strong.
- US imports of QIZ goods from Egypt have grown only a little faster than imports of non-QIZ goods, but
- US imports of QIZ goods from Egypt have grown considerable faster than from other countries, including from China.
- US imports of QIZ goods from Egypt have grown faster than EU imports of these goods
- The average US tariff rate on Egyptian imports has fallen sharply because of the QIZ resulting in large tariff savings
- Apparel remains the largest user of the QIZ, but the rang of sectors is increasing
- The Egyptian QIZ has gotten off to a much faster start than the Jordan QIZ

QIZ Results

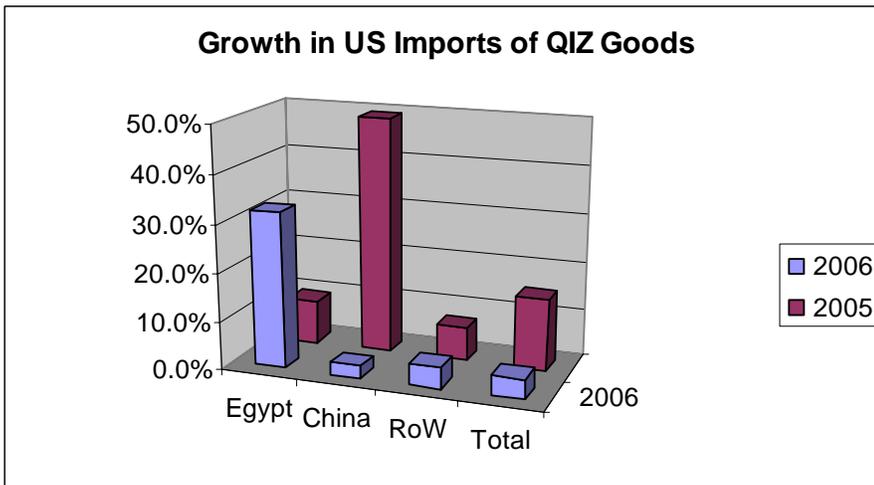
Exports under the QIZ in the first 5 months of 2006 totaled \$222.6 million compared to just \$21.3 last year when the QIZ was just getting off the ground. The number of goods exported under QIZ has continued to grow, reaching 236 in May 2006.

¹ Trade Analysis Unit, Trade Agreements Section, Ministry of Trade and Industry, November, 2005

² US trade data is updated around mid month each month at
http://dataweb.usitc.gov/scripts/user_set.asp

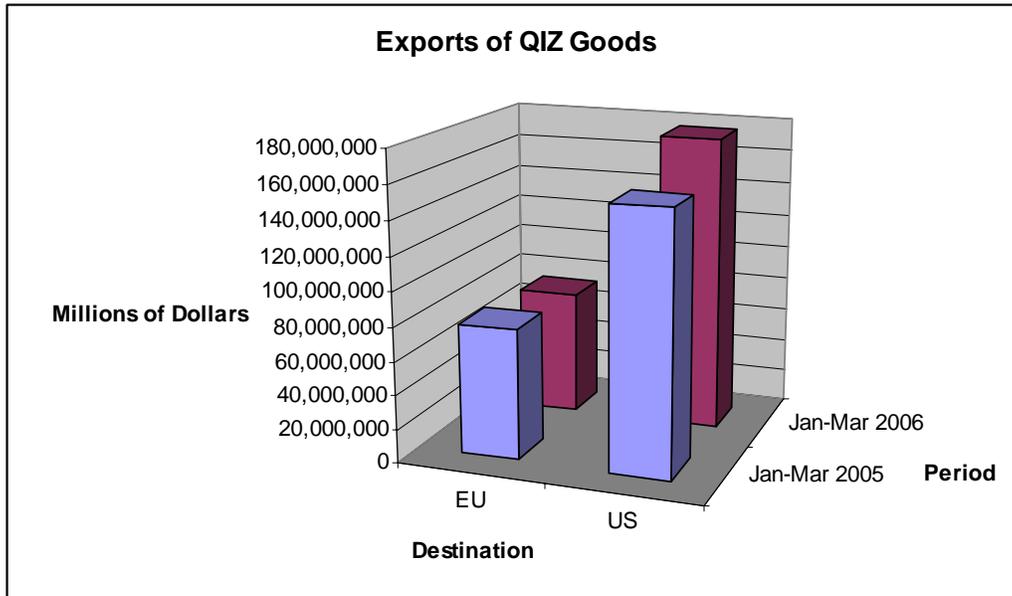


More significantly, “QIZ goods,” defined as in the earlier study as all exports of items at least some of which were exported under the QIZ, increased from \$232.9 millions to \$308.3 millions between the same periods, a 32% increase. This was a larger increase than in Egypt total non-fuel exports, which was 29%. The performance of QIZ goods is even more impressive considering that total US imports including from China of those “QIZ goods” rose only 4.1%.

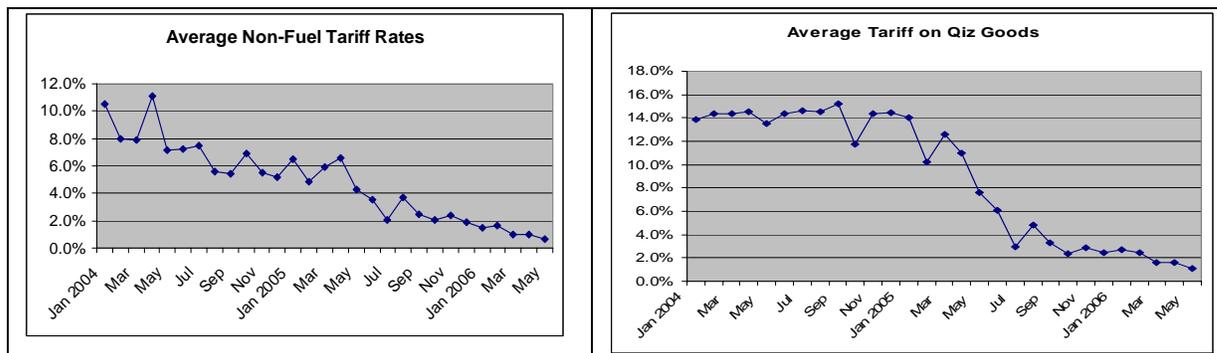


Exports of QIZ goods to the US also compares favorably with exports of these same goods to the EU. Comparing the first THREE months of 2006 to 2005 (data on EU trade is typically several months behind US data)

shows growth in exports to the EU of just 3.9% compared to 14.5% to the US.³⁴



With the end of the Multi-fiber Agreement at the end of 2004, the most important benefit Egypt enjoys under the QIZ is duty-free access to the US market. The average tariff paid on US imports from Egypt has fallen steadily, driven by the rise in exports under QIZ.



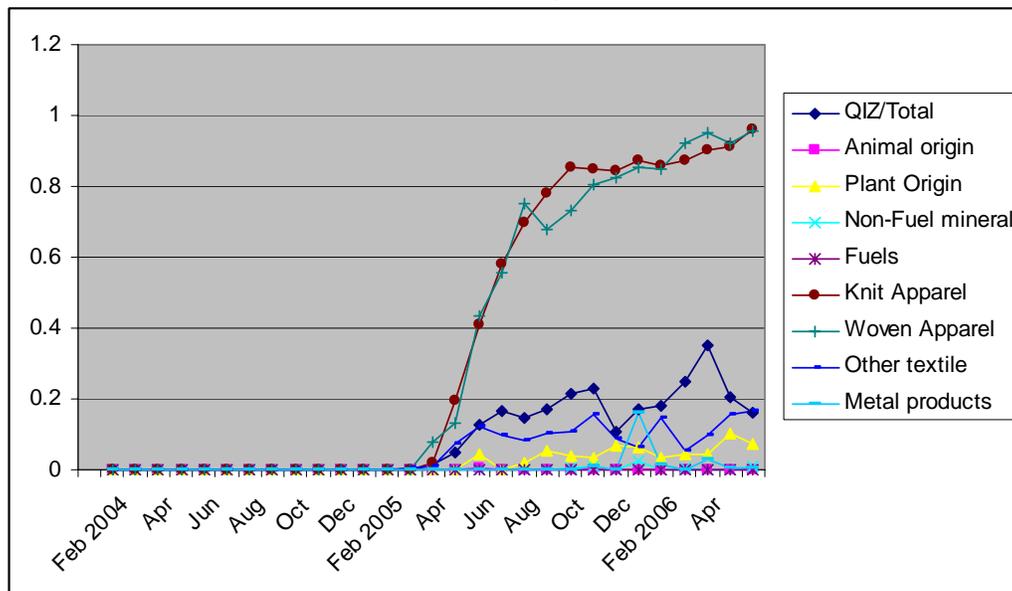
At the duty rates prevailing on QIZ goods in 2005, duty-free access for Egypt has been worth approximately \$62.million to traders in these goods.

³ EU trade data is taken from <http://fd.comext.eurostat.cec.eu.int/xtweb/setupdimselection.do>

⁴ Euro-Dollar conversion used data from : http://www.federalreserve.gov/RELEASES/h10/Hist/dat00_eu.txt

Although the range of products exported under QIZ continues to expand, to date the biggest impact of QIZ has been in the garments and apparel sectors. Over 90% of exports in these categories benefit from QIZ compared to an overall rate of around one half. The concentration of QIZ exports in the garment and apparel areas is probably driven by those being the items for which duty –free access is most important.

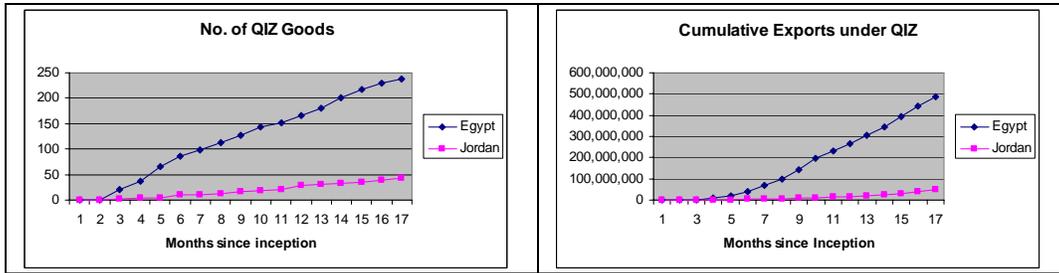
Use of QIZ by Sector



Comparison QIZ in Egypt and Jordan

In 2005, \$945 million was exported under the Jordan QIZ, considerably more than the \$266 million from Egypt that year, notwithstanding Egypt's much larger and more diverse economy. That difference, in large part however, is surely due to the much earlier start of the Jordan QIZ, in 1999. One should also take into account that The Jordan QIZ started when it still gave exporters quota free access to the US apparel market when other countries (including Egypt) still faced quotas.

It is more instructive, therefore, to compare the 17 months of the Egypt QIZ with the first 17 months of the Jordan QIZ. As the two charts below show, Egypt started benefiting from its QIZ much more quickly than did Jordan both in number of products exported, 236 compared to 34, and in the cumulative value of exports in the same period, \$489 million compared to \$44 million.



Conclusions

Careful periodic examination of data from partner countries is invaluable for the analysis of performance of Egypt's export performance under the QIZ. This should be continued, but it needs to be complemented with detailed data from the individual exporting firms. This would permit investigating issues such as:

- Employment creation
- Net exports generated
- Comparative performance of different QIZ's in Egypt, and
- Ways in which government can facilitate the continued growth in QIZ exports (facilitating foreign investment, improving port infrastructure, promoting productivity and innovation, speeding up customs clearance times, etc.).

Dr. Thomas L. Hutcheson
Assisting Trade Reform Project