Testimony of
Under Secretary of Commerce for International Trade
Grant D. Aldonas
United States Economic and Trade Policy in the Middle East
Senate Finance Committee
March 10, 2004

Thank you, Mr. Chairman, Senator Baucus, and Members of the Committee, for inviting me to testify before the Senate Finance Committee and thank you for holding this important hearing. I welcome the opportunity to discuss the importance of economic reform and diversification in the Middle East, particularly the extent to which U.S. trade policy and the Commerce Department's efforts can contribute toward those worthy goals.

I applaud your leadership in this area and commend you for sending a Congressional staff delegation to Morocco, Egypt, Bahrain and Yemen last month. Both your interest in the Middle East and your commitment to exploring the ways in which we can foster a stronger trade and commercial relationship with our trading partners there reflects an understanding of the need for increased engagement with the region.

In the absence of increasing contact and interchange between the United States and the Middle Eastern people, we will not build a relationship of trust and friendship, which is the key to a more peaceful and secure world. Those contacts can begin, as they have for centuries in the Middle East and elsewhere, with the most basic of human relationships – the free exchange of goods and services that makes up the world of commerce.

What's more, despite the evident conflict in the region, the Middle East nonetheless represents fertile ground for the seeds of an initiative that would foster our commercial ties. I am certain that it is not lost on the Committee that the current round of World Trade Organization (WTO) talks were launched the Middle East. The Doha Development Agenda is not only a tribute to the members of the WTO and their commitment to using the world trading system as a primary tool of economic development, but also to the trading nations of the Middle East and the leadership of their officials, particularly the Emir of Qatar. That leadership proved instrumental in launching a trade round that could provide tangible benefits to the people of the Middle East, as well as every man, woman and child around the world.

There is one other and more fundamental reason that I refer to the launch of the new WTO round. Shortly after the events of September 11, I had the opportunity to be in Doha and see first-hand the thirst among the developing nations of the world for the benefits of free and fair trade. That thirst made real the need to extend the benefits of the world trading system to the developing world if we want to live in a world of peace and stability – a world in which there is hope for that half of the planet that currently lives on less than $2 per day.

The importance of the new round, and trade in general, to the developing country members of the WTO should surprise no one. Indeed, it is the developing countries that have the most to gain. A study by Joseph Francois of Erasmus University projects that global trade negotiations would generate between $90-190 billion a year in higher incomes for individuals living in developing nations. It=s no wonder that UN Secretary General Kofi Annan has said, "The poor are poor not because of too much globalization, but because of too little."

The Middle East/North Africa region, unfortunately, matches this description. While the region represents five percent of the world's population, it accounts for only two percent of world's income. According to the World Bank, the incomes and wages in the Middle East and North Africa are low (compared to those in other regions), and its population is growing; the annual growth in the labor force is projected at 3.4 percent a year from 2000-2010, which is twice the rate found in other developing countries.

As historian Bernard Lewis puts it in The Crisis of Islam, "The combination of low productivity and high birth rate in the Middle East makes for an unstable mix, with a large and rapidly growing population of unemployed, undereducated, and frustrated young men. . . . the Arab countries -- in matters such as job creation, education, technology, and productivity – lag ever further behind the West." In fact, according to the Arab Human Development Report 2002, the combined gross domestic product (GDP) of the 22 Arab states ranks lower than Spain's alone. The region's trade integration has changed little in the past 20 years, and, apart from the Gulf countries, the region falls behind other developing countries in attracting foreign investment.

With a few exceptions, tariffs and quotas are no longer significant barriers in industrial economies, but they remain high in most of the developing world. This is counterproductive. Reductions in market access barriers can promote trade, in particular trade between developing countries (south-south trade), and improve investment flows. In general, liberalized trade improves the quality of life of those in the world, which is why we must move forward with our global trade talks. We must encourage our Middle Eastern counterparts to join us at the negotiating table – for their benefit as well as ours.

The Importance of Diversification and Reform

Mr. Chairman, President Bush's proposal to create a U.S. – Middle East Free Trade Area (MEFTA) by 2013 and the Middle East Partnership Initiative (MEPI) remain two important policy tools for promoting diversification and reform. The MEFTA offers a vision of openness, trade integration, and economic development. The MEPI includes economic reform objectives to promote entrepreneurship and private sector development in these markets. These both advance what the President calls "a forward strategy of freedom in the Middle East." In his speech to the American Enterprise Institute in February 2003, the President noted that, "Leaders in the region speak of a new Arab charter that champions internal reform, greater political participation, economic openness and free trade."

We need to work with those leaders, especially as long-term growth, employment and investment prospects in the Middle East and North Africa depend on economic reform and economic diversification. The countries in the region must remove impediments to foreign direct investment, strengthen labor markets, accelerate privatization, and further integrate into the global economy. Some of these reforms are already underway, but at varying speeds and degrees of commitment. The region needs to diversify away from oil-sector employment and public-sector growth toward more fully employing its fast-growing population. The region's non-oil producing countries over the past three decades have maintained real GDP per capita growth – unlike their neighbors who rely on petroleum. In many cases, the dependence on oil production has created parastatal structures that stifle private sector involvement in the economy and foster an enormous federal presence.

The region needs greater economic growth to create jobs – approximately 80 million new jobs are needed. According to the World Bank, the region's labor force will grow from 104 million in 2000 to 185 million by 2020. This will be difficult given the current 15 percent unemployment rate and a stagnant private sector. Diversification, especially through private sector growth, can produce many of those necessary jobs, provided that market forces are allowed to operate unhindered by government bureaucracy and corruption. Inadequate and restrictive insurance and monetary regimes also stifle growth. The World Bank projects that, if the region were to achieve non-oil export growth of about 15 percent a year, it could generate some 4 million jobs during the next five years. World Bank, 2003: Trade, Investment, and Development in the Middle East and North Africa.

While the MEFTA and the MEPI are not the only approaches that we might take to expand our trade and investment relationships with our friends in the Middle East, they have already proved to be catalysts for further thinking about the needs of the region and what would unleash the dynamism of the young people throughout the Middle East. I look forward to continuing our work together to foster our trade and engagement in the region.

Examples of Ongoing Reform and Diversification: Kuwait, UAE, Jordan

To reinforce the practical value of the President's proposals and initiatives focused on fostering trade in the Middle East, it is worth looking at the examples of ongoing reform and economic diversification that already exist. Certainly, at the Commerce Department, we continue to press for ongoing reform and economic diversification within the region, for the benefit of our trading partners and American firms engaged in the Middle East.

Kuwait, the United Arab Emirates (UAE), and Jordan seem to have heard and understood our message of open trade and economic reform, and they are beginning to reap the benefits. In the case of Kuwait, they have just begun to reform their economy and are looking forward to a closer relationship with the United States through the recently signed Trade and Investment Framework Agreement (TIFA). The UAE has begun to reform and diversify and has emerged as one of the most successful economies in the region. Finally, Jordan has begun to reap the benefits from its bilateral trade agreement with the United States

Kuwait is currently on the verge of implementing reforms and diversifying its economy away from oil. Bureaucratic inertia and the all-too-real threat from Saddam left the economic agenda behind. Currently, the private sector contributes to 22 percent of Kuwait's GDP, compared with 37 percent in 1982, according to the National Bank of Kuwait. The oil sector, which is part of the public sector in Kuwait, contributes a full 45 percent of GDP. In addition, the number of job seekers registering with the Kuwaiti Civil Service Commission has risen from

3,237 in 1997 to 21,213 at the beginning of 2004. Projections indicate that 25,100 Kuwaitis per year will have to find jobs outside the public sector.

Reform has been occurring, albeit slowly. Kuwait recently passed a new investment law allowing 100 percent ownership in nearly all sectors of the economy, excluding the press and publishing. Banking and financial services, healthcare, information technology, transport, tourism, and real estate are all now open. Significantly, the new law stipulates a 10-year tax exemption granted to foreign owned businesses. Before this provision went into effect in October 2003, foreign firms in Kuwait had to pay a sizeable 55 percent excise tax on profits from the start of operations. Kuwait also recently liberalized its commercial airline sector, allowing competition with the state-owned Kuwait Airways. Impressively, Kuwait plans to allow a larger foreign presence in the oil sector, with a public, international tender for the development of their northern oil fields.

The UAE has made great strides in terms of economic diversification and reform. Although the overall performance of the UAE's economy remains heavily dependent on oil exports, which account for nearly 30 percent of total GDP, the non-oil sectors of the UAE's economy are experiencing strong growth, particularly the petrochemicals and financial services sectors.

The UAE has created an inviting business environment and transformed itself into a truly international center for commerce and trade. It has the third busiest port in the world in terms of volume, with UAE's Dubai Jebel Ali port ranking behind Singapore and Hong Kong. More than 200 factories operate at the Jebel Ali complex in Dubai, which includes a free trade zone for manufacturing and distribution in which all goods for re-export enjoy a 100 percent duty exemption.

In recent years, the UAE has undertaken several projects to diversify its economy and to reduce its dependence on oil and natural gas revenues. The Abu Dhabi Investment Authority works to bring foreign investment into the country, while Etisalat, the local telecommunications company, has succeeded regionally. The non-oil sectors of the UAE's economy presently contribute about 30 percent of the country's total exports.

Dubai has become a central Middle East hub for trade and finance, accounting for about 85 percent of the Emirates re-export trade. Additionally, the government has programs to educate the local business community and encourage understanding of the Internet and its capabilities. The Dubai Internet City is a successful example of government investment and growth incentives leading to a thriving local business sector. Several Commerce officials, including former Deputy Secretary Bodman and Assistant Secretary Lash, met with officials from the Dubai Ports Authority and the Jebel Ali Free Zone during missions to the region to encourage the free-enterprise initiative.

Jordan has been at the forefront of creating business opportunities and economic growth in the Middle East. Jordan supports an open investment climate, codified by the 1995 Investment Promotion Law, which offers incentives and national treatment to investors. In 1998, Amman embarked on an ongoing privatization program that includes the sale of the Jordan

Flight Catering Company to Alpha, a U.K. firm, the sale of the remaining 14.3 percent Government of Jordan (GOJ) stake in the Jordan Cement Factories Company to the Social Security Corporation, and the sale of the 10.5 percent GOJ share of Jordan Telecom via an initial public offering. In October 2003, the GOJ sold 50 percent of its stake in the Arab Potash Company to a Canadian company. The GOJ continues to seek a strategic foreign partner to buy up to 49 percent of Royal Jordanian (RJ) Airline's operating division.

Jordan acceded to the WTO in April 2000 and seeks to become a business gateway and trade hub for the region. It signed free trade agreements with numerous Arab countries and has had an Association Agreement with the EU since 1997. With the United States, Jordan has a Qualified Industrial Zones agreement, a bilateral investment treaty that entered into force in 2003, and a Free Trade Agreement signed in 2000, which came into force in December 2001.

Jordan's economy has grown since King Abdullah ascended to the throne in 1999. It grew by five percent in 2002, 4.1 percent in 2001, and over the last four years, economic growth rates in real terms averaged 3.5 percent. The strongest growth has been in the export sectors, particularly pharmaceuticals and textiles. Growth in 2003 slowed to about 3 percent due to the disruption of the country's traditional relationship with Iraq, which it had obtained oil at below market prices.

But, that recent downturn simply highlights the importance of the initiatives under way in Jordan under the King's aegis. Jordan's information technology (IT) sector, for example, is at the top of the national agenda, as Jordan has a higher proportion of university graduates in the technology field than any other Arab country. However, Jordan continues to face numerous economic challenges, especially given its limited natural resources and high population growth rates (2.8 percent annually). Up to 30 percent of Jordan's population lives below the poverty line, and 15 percent of the labor force is unemployed. Our trade with Jordan can ensure that more young Jordanians will see their future in a burgeoning information technology sector, rather than in poverty.

Commerce Activities to Foster Regional Reform and Diversification

Consultations, Negotiations

The President's strategy includes active U.S. support for WTO membership for countries in the region that are interested and eligible. WTO membership provides a platform on which we can build with other liberalizing measures, such as Trade and Investment Framework Agreements and comprehensive Free Trade Agreements (FTAs). My agency actively participates in TIFA council meetings.

We have established TIFA councils with: Algeria, Egypt, Saudi Arabia, Tunisia, Kuwait, and Yemen. We expect to hold meetings soon with the UAE, Qatar, and Oman. These formal consultations serve as the most direct method through which we influence and emphasize the importance of reform in the Middle East. We work closely with the United States Trade Representative on FTA negotiations and contribute sector, trade, and investment-issue expertise.

I am pleased that we concluded the FTA negotiations with Morocco earlier this month and have made excellent progress in the negotiations that we began with Bahrain at the beginning of the year.

In addition, we are exploring the possibility of allowing 'regional cumulation' under our FTAs in the Middle East and North Africa, so that a country could meet the FTA's rule of origin with inputs from other U.S. partners in the region.

Market Access, Compliance and Capacity Building

We carefully monitor our trade agreements. Obligations are useless unless they are monitored and enforced. Assistant Secretary for Market Access and Compliance (MAC) William H. Lash has visited the region five times already, and he plans to return. MAC staff has worked with all the countries in the Middle East to protect intellectual property rights. With better protection, indigenous and international companies in fields such as information technology, pharmaceuticals, and the arts can flourish and provide jobs.

Our work to press for market access reforms coincides with diversification goals and can serve as a catalyst for structural adjustment. Working with the governments in the region to open markets creates new opportunities for foreign investment and knowledge transfer. These new opportunities in turn help to build a more stable and varied economy, which can better absorb the growing population and is less prone to volatile shocks caused by fluctuations in world oil prices.

Assistant Secretary Lash also wears another hat. He heads our task forces on Iraq and Afghanistan – looking at reconstruction and the continuing reform in both countries. Under his leadership, the Department's Iraq Investment and Reconstruction Task Force counsels U.S. business on opportunities in Iraq and advises U.S. companies about going into Iraq (www.export.gov/iraq). We work directly with the Coalition Provisional Authority to develop the commercial, legal, and regulatory environment in Iraq necessary for economic growth and private sector activity. Recently, with our support, the World Trade Organization accepted Iraq as an observer.

Most importantly for the region as a whole, Secretary Evans has created the Iraq Reconstruction Regional Initiative, through which Commercial Service officers in countries neighboring Iraq have formed a Regional Field Team to coordinate activities to support the efforts of those in Iraq and to maximize the positive impact on Iraq reconstruction. This team focuses on reaching out and helping U.S. firms and facilitating participation by host country national firms in the reconstruction of Iraq and the development of the Iraqi market through the sale of goods and services and the establishment of operations in Iraq.

Similarly, the Afghanistan Investment and Reconstruction Task Force assists companies by gathering and disseminating information on commercial opportunities associated with reconstruction activities in Afghanistan. The Task Force provides business counseling and assesses the feasibility of individual projects and proposals. Information can be found at www.export.gov/afghanistan. The Task Force coordinates with the National Institute of

Standards and Technology (NIST) to bring international standards to Afghanistan. My Department and the Afghan Ministry of Commerce co-lead the U.S.-Afghanistan Commercial Working Group, an ongoing dialogue of all aspects of bilateral economic and commercial relations. Assistant Secretary Lash and the Task Force participate in outreach events to Afghan-American communities nationwide. Finally, the Commerce Department and the U.S. Trade and Development Agency co-sponsored "Afghanistan: Rebuilding a Nation," conference in June 2003 with presentations on 35 projects to over 430 conference participants, including 300 company representatives.

The Commerce Department also assists Middle Eastern economies in their reform efforts through our Commercial Law Development Program (CLDP). Most of this effort is currently focused in North Africa and Egypt. CLDP will supply a large portion of the technical assistance required under the U.S.-Morocco Free Trade Agreement. In 2004, CLDP will spend $800,000 in four categories: IPR enforcement, transparency in government procurement, customs modernization, and compliance with U.S. standards. In providing this assistance, CLDP will help Morocco meet its FTA commitments and create a better environment for U.S. business investment.

CLDP leads the U.S. government's technical assistance efforts to help Algeria become a WTO member. The Department of Commerce, through CLDP, is easing Algeria's transition into the global marketplace by providing standards training, reviewing Algeria's draft IPR legislation, and showing Algerian judges how to adjudicate commercial disputes. CLDP has also targeted areas where U.S. expertise can best support Tunisia's efforts to liberalize its economy and open its markets. Projects have included training in trade remedies, competition law and policy, intellectual property rights protection, and e-commerce. Currently, CLDP programs in North Africa are being funded through the State Department's Middle East Partnership Initiative (MEPI) program.

In Egypt, the CLDP works in the general areas of trade-related institution building, intellectual property rights, regulatory and quality controls, as well as providing technical assistance for specific legislation drafting. CLDP continues to advise Egypt on e-commerce matters and sponsors Egyptian real estate officials to attend symposiums and workshops in the United States. CLDP provided Intellectual Property Rights (IPR) training to judges and attorneys after Egypt passed a comprehensive IPR law in 2002. The IPR law was a direct result of continuous consultation between our two governments, with the USPTO and CLDP providing technical support and review for the legislation.

Through MEPI funding, the Department of Commerce has created the Middle East Executive Training in the United States (MEET U.S.) program. The MEET U.S. program exposes Middle Eastern business executives to U.S. products and business practices, creating a cadre of executives who are predisposed to doing business with the United States. The program also facilitates trade between Middle Eastern companies and U.S. small and medium-sized businesses that otherwise might not have the resources to directly enter these markets. So far, the MEET U.S. program has conducted visits to the United States by Middle Eastern women entrepreneurs, as well as health administration executives.

Commercial Diplomacy, Private Sector Development and Trade Promotion

We currently have an office in Tel Aviv, Israel that has initiated Access Eastern Mediterranean (AEM). AEM brings together our CS colleagues in Israel, Egypt, Jordan, Lebanon, Turkey and West Bank/Gaza, to target opportunities for U.S. exporters of equipment and services in the Building Materials and Construction, Energy/Electrical, Environmental and Water, Medical and Healthcare, and ICT/Telecoms sectors. We currently have 17 Commercial Service officers and 78 local staff who work in 17 offices in the region: Abu Dhabi, Alexandria, Algiers, Amman, Beirut, Cairo, Casablanca, Dhahran, Dubai, Islamabad, Jeddah, Jerusalem, Karachi, Kuwait, Lahore, Riyadh, Tel Aviv. We plan to have an office with two to three officers in Baghdad by July 1.

This year, our Commercial Service will establish a Middle East Business Information Center (MEBIC), which will act as a focal point providing information to U.S. businesses about market conditions and opportunities in the Middle East, ITA functions and other US Government services to help U.S. companies access these markets. The Center will support the Administration's goal of fostering closer economic ties with the region and will be linked to the MEPI economic reform objectives to promote entrepreneurship and private sector development in these markets.

I want to assure you that we are regularly exploring new venues for fostering our trade and commercial relations in the Middle East as well. One salient example is the U.S.-Jordanian Entrepreneurship Forum, which will be held in Jordan on June 6-7, 2004, under the auspices of the U.S. Department of Commerce and the Jordanian Ministry of Industry and Trade. The goal of the forum is to foster the exchange of ideas between U.S., Jordanian, and Palestinian entrepreneurs, government officials, venture capitalists and academics, and to accelerate economic growth in Jordan and Palestine through entrepreneurship. The forum recognizes four key components important to the development of entrepreneurs and their companies – entrepreneurial training, capital formation, the legal and regulatory environment, and the role of innovation/use of technology.

Beyond that, we are exploring the formation of a U.S.-Palestinian private sector dialogue to promote Palestinian private sector development, as well as broader commercial cooperation between Palestinian and American businesses. This forum is expected to identify pressing commercial issues and highlight local and regional requirements, needs, and concerns regarding business development in the West Bank and Gaza. I expressly hope to include members of the Israeli business community in our approach given their stake in the economic future of the region and the benefits they saw from the implementation of the Qualified Industrial Zones in Palestine in the 1990s.

I was also heartened by a recent article in *The Wall Street Journal* reflecting the renewed interest of the Israeli business community in investment in Palestine. Their interest reflected an understanding that, unless there is an alternative to the forces opposed to peace in providing for the basic needs of life – a job, a roof over one's family, schools, access to healthcare, etc. – there can be little doubt that continuing strife will prevail. In my view, the interest of the business community, if combined with the energy and initiative of governments in creating a business-friendly environment, would attract investment and create jobs. In that sense, a commitment to expanding trade with the region represents one important part of a multi-faceted approach to fostering peace and stability in the Middle East.

Conclusion

Mr. Chairman, the region will see dramatic changes in the years ahead. Middle Eastern countries must develop their private sectors and open their economies, if they are to grow and meet the demand for jobs spurred by population growth. Without economic stability, we can have little hope of political stability. Our bilateral trade with the Middle East (minus Israel) amounted to just under $52 billion in 2003. This is less, individually, than out bilateral trade with Canada, Mexico, China, Japan, Germany, the United Kingdom, or South Korea.

Clearly, we need to do more. The Doha Development Agenda offers the best opportunity for deeper economic engagement on a global scale. MEFTA and MEPI also are strengthening bilateral ties. The MEFTA promotes cumulation among a framework of trade agreements and the use of the Generalized System of Preferences (GSP), which provides duty-free entry for many products from eligible developing countries. I hope we can count on your support for these initiatives.

Chairman Grassley, Senator Baucus – working on the African Growth and Opportunity Act with you and Senators Roth and Moynihan remains one of my proudest achievements. You were able to garner strong bipartisan support for the most generous trade preferences that we extend. You did this in the spirit of fostering regional integration and building democracy. These are worthy goals, and the process has benefited the people of Sub-Saharan Africa.

I know that same spirit animates your interest in the Middle East, and I applaud your interest and commitment. As Secretary Don Evans has said, " We believe it is through economic development and economic growth that we will lead the world to greater peace and prosperity." I cannot think of a more valuable goal.

Thank you.