Testimony by Under Secretary of State

for Economic, Business, and Agricultural Affairs

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before the Senate Finance Committee

March 10, 2003 (draft 3/9/04 1200)

Mr. Chairman, distinguished Members of the Committee, I appreciate the opportunity to testify on U.S. economic and trade policy with respect to the Middle East.

THE MIDDLE EAST: CHALLENGES AND OPPORTUNITIES

I can think of no other region in the world today that is as vital to U.S. interests, yet poses as many challenges for us, as the Middle East. As President Bush declared in his speech last May, "What happens in the Middle East greatly matters to America."

Among those challenges, and the focus of my remarks today, is the growing thirst for opportunity that characterizes the Middle East, and the substantial efforts the United States is undertaking to respond to that demand. U.S. policies to stimulate economic reform and trade liberalization have much to offer, both in terms of generating growth and employment, and in solidifying our broad ties with this diverse and culturally rich region. At the same time, they promote U.S. economic and commercial interests.

During the last week of February, I had the opportunity to visit several Middle Eastern cities, including Ramallah, Jerusalem, Amman, Riyadh, and Cairo. Last week, my colleague Under Secretary Marc Grossman visited Rabat, Cairo, Manama, and Amman. In our meetings with a broad spectrum of individuals - from students to business and civic leaders to government officials - several consistent themes emerged:

-- the people of the Middle East, and especially the young people, are yearning for greater economic opportunities;

-- governments in the region increasingly understand the imperative for economic reform; but

-- the many regional leaders - and we ourselves - believe that change and economic reform come from within, and that the region's cultural and historical legacy will be an important factor in shaping those reforms.

The widely quoted UNDP Arab Human Development Reports for 2002 and 2003 examine in considerable detail the challenges and opportunities for building a better Middle East. As the 2003 report concludes, a strategic vision for establishing a "knowledge society" in the Arab world requires diversifying economic structures and markets. This also requires upgrading the Arab presence in the "new economy," and in opening up to other cultures.

Grounded in home-grown ideas and a realization that change is necessary to generate jobs, there is growing support in the Middle East for the catalytic role of economic opportunity, a light that shines brightly, dispelling negativism and despair. I am encouraged by concrete demonstrations that the Middle East is taking ownership of this process; last September's U.S.-Arab Economic Forum in Detroit - the first ever - provided ample evidence of this energy and enthusiasm.

Of course, I do not want to downplay the formidable challenges and obstacles that lie ahead before a new, more open, and economically vibrant Middle East can be realized. The Middle East remains woefully un-integrated in the global trading system. The region's share of total world exports accounted for only 5 percent in 2001, and less than 1 percent of global foreign direct investment. Middle Eastern economies are characterized by structural rigidities, red tape, high unemployment, and a lack of export diversity, which have led to sub-optimal economic performance over many decades. Despite its abundant energy resources and oil wealth, the Middle East has not been successful in creating opportunities that engender a sense of a better tomorrow. This is turn has fostered a loss of hope, particularly among young people, which has increased their susceptibility to those who use terrorism as a means to channel their desperation.

Nonetheless, there is a growing awareness in the Middle East of the nature of the problem, and of the need to change. U.S. economic and trade policy is calibrated to support these nascent developments by promoting economic reforms, and by fostering economic ties and trade linkages. This in turn can help build the prosperity and stability needed to anchor lasting peace in the region.

Recent examples of developments that reflect positive movement in this direction include:

-- Our **trading relationship with Jordan** has already borne considerable fruit; the **U.S.-Jordan Free Trade Agreement** has contributed to regulatory reforms, a dramatically improved investment climate, and increased investment in human capital. Indeed, Jordan and the United States have experienced an increase in bilateral trade of 205 percent from 2001 to 2003 alone. Jordan's economic reforms have also resulted in the establishment of eleven Qualifying Industrial Zones, wherein products manufactured in cooperation between Jordanian, Palestinian, and Israeli entities can be exported to the United States tariff free;

-- The **U.S.-Morocco Free Trade Agreement**, which was just concluded on March 2 of this year;

-- Substantial progress is being made in negotiating the **U.S.-Bahrain Free Trade Agreement**;

-- **Trade and Investment Framework Agreements** were signed on February 6 with Kuwait and Yemen; agreements are also pending with Oman, Qatar, and the United Arab Emirates; and

-- We are partnering with **Saudi Arabia** to facilitate its **accession** to the **World Trade Organization**, a process that is gaining momentum through technical cooperation.

RESPONDING AND SUPPORTING REGIONAL REFORMS

The **Greater Middle East (GME)** proposal reflects President Bush's "Forward Strategy for Freedom." This strategy seeks to support peace and security in the Middle East through the pursuit of freedom and promotion of democracy and human rights, through both words and deeds. In consultation with various European, G-8, and Middle Eastern partners, we are seeking ways to encourage and support those individuals, organizations, and governments in the region willing to embark on the path of reform and positive change. Our efforts should leverage U.S. resources and those of our partners for the maximum benefit of the region.

This approach has provoked a constructive discussion, launching open debate on the directions reforms should take, and on the means to achieve those ends. Countries of the Middle East are contemplating how better to define and organize their approaches to the reform process, and are engaging a broad cast of interlocutors. In short, the interest and energy of Middle Eastern countries provide impetus for change and the development of a social climate that increasingly accepts change.

As recently as last week's troika meeting with Irish Foreign Minister Brian Cowen, EU High representative Javier Solana, and EU External Affairs Commissioner Christopher Patten, Secretary of State Powell held productive discussions on how the EU and the United States can best work together to support indigenous voices for reform in the Greater Middle East. After the meeting between Secretary Powell and his European Union counterparts, the Secretary declared that the United States and the EU "see great opportunity and scope for cooperation on a Greater Middle East

Initiative in the run-up to the G-8, U.S.-EU, and NATO summits" to be held this coming June.

The Greater Middle East proposal signals a readiness to undertake projects to address indigenous calls for change in areas defined by Arab reformers themselves. This self-diagnosis, outlined in the UNDP Arab Human Development reports, has produced the following priorities for the region:

-- promoting good governance;

-- building a knowledge-based society; and

-- expanding economic opportunities.

The last of these, expanding economic opportunities, is essential for a variety of reasons. The UNDP Arab Human Development Report for 2002 notes that all Arab countries had a combined 1999 GDP of $531 billion, less than that of Spain alone. GDP growth, investment, and productivity have all declined in Arab countries over the past two to three decades. The World

Bank also estimates that the Middle East will need to create 100 million new jobs by 2020 to keep pace with the growth in the labor force-age population. The region's persistent economic problems demand action in terms of increased economic growth and development, regional economic integration, and foreign direct investment.

As we prepare for the G-8 Sea Island Summit on June 8-10, we are considering a number of ideas that could expand economic opportunities in the Greater Middle East. Among them are:

-- **information technology for business development**. With the world's lowest per capita Internet access, the Middle East suffers from critical information deficits. Training and technical assistance can address this vital need;

-- **financial reform and the development of capital markets and increased capital access to small and medium-sized enterprises (SMEs)**. Increasing economic growth and job creation in the Middle East requires more efficient allocation of capital and a more vibrant private sector. Partners should cooperate to improve financial institutions and capital markets to improve the business environment for small and medium-sized enterprises, which comprise the vast majority of private businesses in the region;

-- **promotion of good business practices and improving the investment climate**. Efforts in this area should include expanding modern business education, promoting best practices for businesses, and encouraging a level playing field to stimulate investment;

-- **promoting regional dialogue on economic and social reform.** Partners should address the need for serious dialogue on economic and social reform by supporting regional fora, fostering discussion by government officials, regional and international financial and development institutions, private business leaders, and academics; and

-- **improving trade opportunities**. Intra-regional trade in the Middle East is among the lowest in the world; furthermore, the area also suffers from low levels of integration with the global trading system. Partners should provide training and technical assistance to address this situation, and support regional trade initiatives to facilitate intra-regional trade.

TRADE POLICY: EXPORT OPPORTUNITIES AND PROMOTING REFORM

The United States has several objectives in its economic and trade engagement with the Middle East, including:

-- Ensuring a **level playing field for exports**, so that our goods and services are not disadvantaged in comparison to those of others, such as the European Union, in terms of their ease of market entry;

-- Encouraging **greater market access** generally, so that the Middle East becomes more fully integrated into the world trade system, with minimal barriers to entry, and commercial transactions with a broader range of partners involving a greater scope of goods and services;

-- Accelerating **economic reforms and trade liberalization** essential to the development of sound fiscal and monetary policies that provide the foundation for long-term, sustainable growth and employment creation; and

-- Engendering **alternatives** to the often **stagnant economic situation** many countries face, which is all too often accompanied by rising unemployment, minimal technology transfer and skills development, and a lack of export diversification. Supporting innovative efforts to transform economies from sluggish to dynamic will pay social dividends, as countries become increasingly able to provide opportunities commensurate with rising expectations. This will offer alternatives to despair and acts of desperation, as societies afford a broader range of prospects for prosperity. Economic reforms will also provide opportunities for those, particularly the young, who might otherwise become disillusioned and hence vulnerable to exploitation by those who advance terrorism as a means to express their grievances.

The U.S. experienced a $17.9 billion dollar merchandise trade deficit with the Middle East in 2003. U.S. imports of crude oil and petroleum products represent over 55% of Middle Eastern exports to the United States. Without trade in crude oil and petroleum products, the U.S. would have run a $3 billion/year trade surplus with the Middle East.

In 2002, U.S. exports to the region reached a level of $23.6 billion, principally from sales of machinery, equipment, vehicles, manufactured goods, and foodstuffs. This, however, is dwarfed by the volume of exports from the European Union to the Middle East, which attained a value of $97.7 billion in 2002. In terms of total bilateral business activity, the U.S. traded $62.1 billion with the region in 2002, in comparison to $176.2 billion for the European Union.

Market access is therefore an area that needs to be addressed. Tariffs and quotas in the region remain too high and limit the opportunities for U.S. products in Middle Eastern markets. Moreover, U.S. goods and services have also been handicapped by the advantages European traders have enjoyed in the region. Building on its favored position, the European Union has an ambitious trade agenda for the Middle East. It has already entered into an Association Agreement with Egypt. It is essential that the United States strive to counter these trends in the Middle East to ensure that we gain equal market access and enjoy a level playing field. While that market is currently small, the potential for growth is large.

The United States is addressing this situation with abroad strategy of economic engagement activities. On May 9, 2003, President Bush reaffirmed the U.S. Government's commitment to promoting and supporting economic reform in the region. This broad policy initiative includes the proposed **Middle East Free Trade Area**, known as **MEFTA**.

The President's vision for **MEFTA** is to build, over a decade, on current free trade agreements with Israel and Jordan. MEFTA offers a framework for openness, trade integration, and economic development for the Middle East. Applying technical assistance, it seeks to promote trade expansion and policy reforms, re-igniting economic growth and expanding opportunities throughout the region. The U.S. Government is working with countries of the Middle East through a series of graduated steps tailored to their individual level of development.

Trade and Investment Framework Agreements - TIFAs - are typically the initial fora for ongoing dialogue with the U.S Government on economic reform and trade liberalization. TIFAs promote the establishment of legal protections for investors, improvements in intellectual property protection, more transparent and efficient customs procedures, and greater transparency in government and commercial regulations.

As of mid-2003, the United States had signed TIFA agreements with Algeria, Bahrain, Egypt, Tunisia, and Saudi Arabia. In February 2004, we signed with both Kuwait and Yemen. Furthermore, TIFAs are currently under negotiation with Oman, Qatar, and the United Arab Emirates. Through this process, and the joint development of robust action plans, the U.S. Government can identify potential partners for further trade cooperation, such as free trade agreements.

In consultation with Congress, the U.S. Government is pursuing a series of **Free Trade Agreements** with Middle Eastern countries to build on those already concluded with Israel and Jordan. These agreements are designed to expand bilateral trade through commitments to high standards and comprehensive trade liberalization.

On March 2, following a year of intense negotiations, we concluded FTA negotiations with Morocco; which will immediately provide duty-free market access to 95 percent of traded goods, providing significant incentives for both countries to identify and target opportunities in each other's markets. This agreement covers all agricultural products, and provides substantial market access to the services sector, such as banks and insurance companies. Furthermore, the FTA affords legal protections for U.S. investors, as well as covering trademarks, copyrights, and patents. The Morocco FTA is a high-quality agreement that will set the standard for FTAs with other Middle East partners.

Building on the Morocco agreement, the U.S. Government hosted Round II of the U.S.-Bahrain Free Trade Agreement negotiations here in Washington last week. The round went well; based on progress attained so far, we look forward to concluding the agreement by mid-year.

Many Middle Eastern trading partners are in close and active consultations with us through the TIFA process, and have a strong interest in concluding an FTA with us, including the United Arab Emirates, Tunisia, and Egypt. More open markets in these and other countries will offer not only significant opportunities for U.S. exporters, it will also reinforce their economic reform efforts. We are actively engaged with these countries on a range of pending bilateral trade and economic reform issues through the

TIFA Council process and other bilateral discussions. Continued progress in these areas will help pave the way toward eventual FTAs.

The U.S. Government has been working with countries of the region so that they can take advantage of the **Generalized System of Preferences** program. On March 1, President Bush announced that Algeria had qualified for GSP; on the same day, he also announced that Bahrain would graduate from GSP eligibility on January 1, 2006, as its per capita income had moved it above the World Bank's developing country threshold - a Middle East success story.

The U.S. Government is also actively engaged with several Middle Eastern countries - **Saudi Arabia, Algeria, Yemen, and Lebanon** - to expedite their **accession to the World Trade Organization**. The accession process involves countries voluntarily opting for economic reform and trade liberalization in order to join the rules-based world trade system. We see WTO accession as a key step forward, as it involves making commercially meaningful market access commitments for goods, services, and agricultural products.

So powerful is the interest to participate in the global marketplace that **Iraq** has already sought and gained WTO status as an **observer**. This will help accelerate its reintegration into the global trading system.

The United States would like to see countries of the region play a stronger role in advancing the World Trade Organization's **Doha Development Round**. Leadership, particularly by key countries such as Egypt, Morocco, Tunisia, and Jordan, as well as Pakistan and Turkey, would go far to reinvigorate this essential global dialogue about the future of the world's commercial transactions. Their concerted efforts could result in the preparation of a framework agreement by mid-2004 by leveraging participation by a broader spectrum of countries.

A major weakness the Middle East shares with other regions of the world is a lack of expertise and skills needed to promote greater trade. In recognition of this, the United States has committed, as a part of the Doha Development Round agenda, to a major effort to help these countries to develop these skills.

There are a variety of means that the U.S. Government is undertaking to **build trade capacity**, so that countries of the Middle East can take full advantage of increased trade opportunities with the United States. In addition to promoting trade-related policies that enhance the business environment, the **Middle East Partnership Initiative (MEPI)** plans to establish regional offices in Tunis and Abu Dhabi to coordinate trade capacity building efforts.

In 2003, the U.S. Government expended over $174 million in the Middle East in trade capacity building. Most of this assistance involved trade facilitation, financial sector development, support for governmental transparency, export promotion, and business services and training.

A key funding mechanism for trade capacity building and trade-related technical assistance derives from the MEPI. MEPI-provided assistance, carried out in cooperation with the USTR and USAID, includes a broad spectrum of economic reform and trade liberalization elements. It involves facilitating WTO accession, assisting in TIFA-driven policy restructuring, and supporting regulatory measures for ensuring compliance with FTA provisions.

Broadening the base of trade between the United States and the countries of the Middle East is necessary but not sufficient. It is essential that the U.S. Government also work to promote trade between Middle Eastern countries. Economic interdependence is key to forging strong linkages between countries of the region, which will promote mutual prosperity and increase the collective stake in regional peace and stability. This presents a complex issue, as many Middle Eastern countries have relied for too long on petroleum-based exports to drive their economies, versus building a more diverse export base.

Trade within the Middle East accounted for only 8 percent of the region's total trade in 2001. This is far below the intra-regional level of nearly 75 percent for Europe and 50 percent for Asia. Increased intra-regional trade not only promotes economic growth and development, it also enhances the political stability of the region through fostering interdependence.

The United States can foster greater intra-regional trade through several means, including supporting the efforts of the **Gulf Cooperation**

Council (GCC) to generate a greater volume of trade between its six member states through the **customs union** it launched in January 2003; the **Agadir Initiative**, wherein Morocco, Tunisia, Jordan, and Egypt are forming a free trade area; and the promotion of an economic policy dialogue within the region.

CONCLUSION

To summarize, Mr. Chairman, distinguished Members of the Committee, the countries of the Middle East have taken stock of their economic situation, and have decided to participate more fully in the world trade system. Recognizing that the future of their youthful societies lies in the creation of meaningful economic opportunities, the countries of the Middle East are increasingly open to making the sometimes-difficult choices required to effect economic reform and trade liberalization.

The United States is responding to this thirst for economic opportunity. Through MEFTA, MEPI, and other components of our economic and trade policy, we are supporting efforts of Middle Eastern countries to reform and liberalize, while simultaneously increasing market access opportunities for U.S. goods and services - a "win-win" situation.

We look forward to continued close consultation with Congress.