US Middle East Economic Policy: The Use of Free Trade Areas in the War on Terrorism

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We will defeat [the terrorists] by expanding and encouraging world trade.

—President George W. Bush

This is a contest for the soul of Islam. Only Muslims will determine the outcome, but we can help.

—Robert Zoellick, former US Trade Representative

The events of 11 September made it painfully clear that the political, social, and economic problems of other countries have a direct impact on American national security. While the roots of terrorism are complex, it's safe to say that the United States was attacked by a criminal organization that in large part has had great success in recruiting new members in nations that offer young men little political voice and limited economic opportunity.[1]

Even before the smoke had settled from the 11 September attacks in New York and Washington, DC, US Trade Representative Robert Zoellick launched a series of speeches arguing that global trade liberalization was a central plank of the counteroffensive against terrorism. In a thoughtful essay, "Countering Terror with Trade," Zoellick's main premise was as follows:

> America's trade leadership can build a coalition of countries. . . . Open markets are vital for developing nations, many of them fragile democracies that rely on the international economy to overcome poverty and cre-

1. For a good overview of the issues, see Paul R. Ehrlich and Jianguo Liu, "Some Roots of Terrorism," *Population and Environment* 24, no. 2 (2002).

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> ate opportunity; we need answers for those who ask for economic hope to counter internal threats to our common values. To address the relationship between trade agreements and other international objectives, the president has proposed that we build on openness and growth in developing countries with a toolbox of cooperative policies.[2]

As Alan Tonelson also notes, "Trade policy as antiterror weapon is an understandably appealing idea. It doesn't put American soldiers in harm's way. It is nonviolent, market friendly, and holds the promise of 'draining the swamp' where terrorists are assumed to thrive. And it doesn't require a line in the federal budget."[3]

This logic was compelling enough to ensure that a large section of the current National Security Strategy of the United States be devoted to the means of expanding US trade with developing countries.

> A strong world economy enhances our national security by advancing prosperity and freedom in the rest of the world. Economic growth supported by free trade and free markets creates new jobs and higher incomes. It allows people to lift their lives out of poverty, spurs economic and legal reform and the fight against corruption, and reinforces the habits of liberty.[4]

The use of trade as a weapon against terrorism is not without its critics. In question is the basic assumption that trade with the United States automatically provides workers in developing countries with rising incomes and standards of living. Some critics of the administration's trade policies go as far as to note that "shortly after the September 11 terrorist attacks, the Bush administration speculated that trade policy could help fight terrorism. The theory is good—but in practice, current trade policy is at best irrelevant to the terror campaign, and at worst working against it."[5]

Trade is not the only economic approach to be used by the United States in the war on terrorism. Foreign assistance is seen by many as superior to trade in contributing to the war on terrorism through its ability to win new allies by

2. *Washington Post*, 20 September 2001.
3. Alan Tonelson, "There's Only So Much That Foreign Trade Can Do," *Washington Post*, 2 June 2002, B1.
4. National Security Strategy of the United States, Washington, DC, Office of the White House, 17 September 2002, at www.whitehouse.gov/nsc/nss6.html.
5. Ed Gresser, "Aiding Muslim Economies," *DLC Blueprint Magazine*, 15 April 2003.

focusing on humanitarian relief for refugees. It could be more tightly focused on eradicating poverty by facilitating higher rates of economic growth in key regional countries.

As with trade, however, aid has also had its share of critics. The testimony of Marc A. Miles before the Committee on International Relations, House of Representatives paints a telling picture:

> Experience has demonstrated that development assistance (i.e., government-to-government assistance intended to catalyze development in poor nations) is not a key factor in increasing economic growth in underdeveloped countries. On the contrary, development assistance has often proved to be counterproductive. Whether it is skimmed off by corruption, kept beyond the reach of poorer inhabitants due to regulations, or access is denied due to a lack of property rights or rigid credit markets, traditional aid usually fails to reach those below the top rungs. The lack of lasting impact is a demonstrable fact.[6]

In this essay I focus on the US economic strategy of using trade as a weapon in the war on terrorism.[7] From a theoretical perspective, expanded trade would appear to be capable of sufficiently improving the lives of potential terrorist recruits as to significantly lessen the attraction of al Qaeda and like-minded groups. At issue then is whether specific trade programs can be made sufficiently flexible, adaptable, and controllable so that they are capable of quickly bringing tangible benefits to targeted groups. If not, trade initiatives could actually undermine the war on terrorism. In a final section I outline several suggestions for making trade policy a more potent weapon in the war on terrorism.

Trade and Aid in the US National Security Strategy

US foreign economic policy is formally outlined in the National Security Strategy of the United States.[8] Areas relating to trade and of particular rel-

6. See www.house.gov/international_relations/108/mile022604.htm.
7. For an earlier assessment of the Pakistani case, see Robert Looney "Problems in Using International Trade to Counter Terrorism: The Case of Pakistan," *Journal of South Asian and Middle Eastern Studies* 26, no. 4 (2003): 1–10.
8. National Security Strategy of the United States.

evance to the Middle East and the war on terrorism include the following directives:

1. *Seize the global initiative*: The United States will attempt to move the current World Trade Organization's (WTO) Doha global trade round to completion. Progress toward this goal is problematic in light of the failure of the WTO ministerial meeting (10–15 September 2003) in Cancun. That meeting was intended to focus on the needs of the developing countries but collapsed in the face of fundamental differences between rich and poor nations.[9]
2. *Press for regional initiatives*: Perhaps because of the difficulties in bringing the current WTO round to a conclusion, the United States has begun to place more emphasis on regional trade initiatives such as the Free Trade Area of the Americas and an additional free trade area with the Central American countries. The United States is also pursuing initiatives in Africa through the African Growth and Opportunity Act, essentially leading to free trade with the sub-Saharan countries. Most importantly for the issues at hand, the United States is also attempting to create a Middle East free trade area (MEFTA) enjoying free trade with the United States.
3. *Move ahead with bilateral free trade agreements*: As a step toward the creation of a MEFTA, the United States is signing a series of bilateral free trade deals with various Middle Eastern and North African countries, like the one it has with Israel. The first of these is the free-trade agreement signed with Jordan in 2001, followed by agreements with Morocco and Bahrain in 2004.[10] Negotiations are currently at one stage or another with the United Arab Emirates (UAE), Oman, and Egypt.[11] The US strategy in the Middle East is a graduated one: negotiating bilateral trade agreements country-by-country before moving toward a regional agreement to be completed in 2013.[12] In other parts of the world the United States has

9. Robert Looney, "The Cancun Conundrum: What Future for the World Trade Organization (WTO)?" *Journal of Third World Studies* 21, no. 2 (2004): 127–46.
10. Jeffrey Sparshott, "Bahrain, US Ink Accord on Trade," *Washington Times*, 15 September 2004.
11. "Bush Kicks Off New Round of Free-Trade Talks in the Middle East," Agence France-Presse, 11 March 2005.
12. Mike Allen and Karen DeYoung, "Bush Calls Trade Key to Mideast," *Washington Post*, 10 May 2003, A1.

completed free-trade agreements with Chile, Singapore, and Australia. In short, the administration's aim is to achieve free-trade agreements with a mix of developed and developing countries in all parts of the world.

4. *Promote the connection between trade and development*: Underlying US trade initiatives is the belief that trade policies can help developing countries strengthen property rights, competition, the rule of law, investment, the spread of knowledge, open societies, the efficient allocation of resources, and regional integration—all leading to growth, opportunity, and confidence in countries' abilities to grow and prosper.

Middle East Free-Trade Areas: Factors Impeding Success

The creation of individual free-trade areas (FTAs) that eventually merge into a grand MEFTA is an ambitious plan, one that takes the United States into largely uncharted waters. While the US National Security Strategy has identified the correct elements of a trade-based strategy toward assisting growth and development, designing a specific blueprint for the region is quite another matter. Several questions arise concerning the impact a group of FTAs (and eventually a MEFTA) might have on the region. The most fundamental among them is whether the region is ready to move to free trade with the United States. Would such a venture only create more dislocation and uncertainty—an improved breeding ground for terrorism?

The one thing most observers agree on is the magnitude of the problem—by most of the standard metrics, the countries in the region are currently ill prepared to thrive in the global economic system. A litany of indicators documents the weakness of the region's linkages to the world economy, among them the fact that import tariffs average over 20 percent.[13] Most of the larger countries in the region are not members of the WTO, the international agency largely responsible for reducing trade barriers and reconciling disputes over trade practices. Perhaps even more telling, the region's share of world exports has fallen steadily even as the region as a whole attracts roughly as much foreign direct investment as Sweden.[14]

13. The average for those countries can be found in the United Nation's Economic and Social Commission for Western Asia countries (ESCWA).

14. Marcus Noland and Howard Pack, "Islam, Globalization, and Economic Performance in the Middle East," Institute for International Economics Policy Brief PB04-4, June 2004.

Structural Problems within the Region

These patterns reflect a number of underlying structural factors that have constrained the region's competitiveness in international markets over the past several decades.[15]

1. *Massive population increases*: The Middle East and North Africa had a population of 112 million in 1950. The population is well over 415 million today. Most likely it will more than double again, reaching at least 833 million by 2050.
2. *A youth explosion, especially in the twenty-to-twenty-four age bracket*: This is the key age group for new job entrants and has grown steadily from 10 million in 1950 to 36 million today. Growth is expected to remain steady, reaching at least 56 million by 2050.
3. *A failure to achieve global competitiveness, diversify economies, and create productive jobs*: Direct and disguised unemployment ranges from 12 to 20 percent in many countries. The high percentage of the population entering the labor force only compounds this problem.
4. *A steady decline in nonpetroleum exports*: These exports have declined as a percentage of world trade over the past half century, and an equal pattern of decline is evident in regional gross domestic product as a share of global GDP.
5. *Overurbanization*: A half century decline in agricultural and traditional trades have imposed high levels of stress on traditional social safety nets and extended families. The urban population was under 15 million in 1950. It has since more than doubled, from 84 million in 1980 to 173 million today, and some 25 percent of the population will soon live in cities of 1 million or more.
6. *Broad problems in integrating women effectively and productively into the work force*: While female employment in the Middle East–North African (MENA) region has grown in recent years, it still averages 15 percent lower than in high growth areas, such as East Asia.

15. Anthony H. Cordesman, *Beyond Anger and Counterterrorism: A New Grand Strategy for US and Arab Relations* (Washington, DC: Center for Strategic and International Studies, 13 September 2004).

7. *Growing pressures on young men and women*: Young people of the Middle East and North Africa emigrate to Europe and the United States to find jobs and economic opportunities—a process that inevitably creates new tensions and adjustment problems.
8. *Little regional trade*: Almost all nations in the region have as their major trading partners economies outside the region. Increased intraregional trade offers little or no comparative advantage.
9. *Increasing water scarcity*: Much of the region cannot afford to provide more water for agriculture at market prices—many countries have become permanent importers of food.
10. *Failed or inadequate growth in infrastructure*: Growth has been stymied in key areas like housing and education.

Limited Progress in Governance and Economic Reform

The Middle East region lags considerably behind other parts of the world in various aspects of economic liberalization and governance. In particular a significant gap exists across all measures of governance between MENA and non-MENA countries. While the MENA countries have closed this gap a bit in recent years, it is still striking in the area of voice (the participatory process of decision making) and accountability.

On the other hand, the MENA countries compare fairly favorably to non-MENA countries in several areas of economic freedom[16]—monetary policy, regulation, and the size of the informal (black) market. Still, the region's trade policies, government intervention, foreign investment, and flexibility in wages and prices lag behind other parts of the world. Even worse, there is little evidence that for the region as a whole this gap has narrowed in recent years.[17]

16. Data are from the *Index of Economic Freedom Rankings* (Washington, DC: Heritage Foundation, various issues).
17. Documented in Robert Looney, "Reform Initiatives for Iraq and the Middle East: The Search for What Works," *Journal of South Asian and Middle Eastern Studies* 28, no. 1 (2004): 1–33.

Distance from the United States

Another problem confronting the creation of a MEFTA is simply that of distance. For some time, economists have discounted the distance factor, often citing declines in transport costs, improved communications, and the like. Recent research, however, suggests that distance may still be a key factor in affecting trade patterns. First, transport costs are higher for longer distances. Second, the costs of accessing information about foreign markets and establishing a trade relationship in those markets are higher for longer distances. In fact, despite the "death of distance" associated with the communications revolution, proximity appears to be increasingly important for trade flows.

A major study focused on international trade by individual states has found that trade has become relatively more intense with nearby partners as opposed to distant countries.[18] US state trade shares with Mexico, Canada, and Latin America have increased while shares with Europe, Asia, Africa, and Oceania have decreased. Reflecting the change in trade shares, the distance of trade for the aggregate of states has declined. The North American Free Trade Area in particular has had a fairly significant effect on the geographic distribution of state exports. In fact, distance alone may neutralize many of the perceived benefits of FTAs. It is estimated that depending on the type of good, a distance of one thousand miles is equivalent to having to pay import tariffs of between 7 percent and 17 percent. The example of Chile is instructive. Even with an FTA with the United States, it is estimated that at best Chile will move in the Remoteness Scale[19] from a ranking of sixty-two out of sixty-eight countries to fifty-nine.

The notion of *economic proximity* is mostly, as Nobel laureate economist Douglas North has emphasized, about "transactions costs." Countries with less regulation, stronger private sectors, leaner bureaucracies, less red tape, more transparent political systems, and greater protection of property rights have lower transaction costs and thus greater "proximity" to global markets

18. Cletus C. Coughlin, "The Increasing Importance of Proximity for Exports from the United States," *Federal Reserve Bank of St. Louis Review* 86, no. 6 (2004): 1–18.
19. Bernardo Blum and Ed Leamer, "Can an FTA Suspend the Law of Gravity and Give the Americas Higher Growth and Better Income Distribution?" at emlab.berkeley.edu/users/obstfeld/e281_sp03/leamer.pdf.

than countries with distorted economies and glutted bureaucracies.[20] Countries that share institutional frameworks—such as similar judiciary systems—or have a common language are "closer" to each other than countries that do not. Finally, an educated work force, one that can communicate easily in the modern languages of technology, helps.[21]

To take maximum advantage of a MEFTA with the United States, the Middle East countries will have to work on implementing the type of policies that will remove remoteness. So far this idea has not been well recognized in the region—as noted above, the region as a whole lags considerably behind most other parts of the world in making progress in key reform areas. Even more telling, recent years have seen little or no progress in improved market reforms, economic freedom, or supporting governance institutions in many of the region's key countries.[22]

Limited Ability of Trade to Initiate Reform

Despite the lack of significant progress in reform in the region, might we expect freer trade to exert the right pressures to initiate a series of follow-on reforms? The use of trade incentives is a long-standing US policy. Especially during the Cold War, trade and access to the US market was used to strengthen allies such as Taiwan, South Korea, Israel, and on a smaller scale, a host of other friendly governments. Implicit in this strategy was the belief that improved trade and incomes would set in motion a virtuous circle of further economic and governance reforms as countries sought to improve efficiency and competitiveness. In turn, improved economic efficiency and governance further expanded the economy's gains from trade.

What happened in practice? Virtuous circles or something closely resembling them were attained in countries such as South Korea, Taiwan, and Costa Rica, where the preexisting social and political conditions were more or less conducive to development and—at least eventually—democracy. On the other hand, only very limited successes were achieved in countries such

20. Sebastian Edwards, "How Chile Can Make the Most of Its US Trade Deal," *Wall Street Journal*, 3 January 2003, A11.
21. Ibid.
22. Looney, "Reform Initiatives for Iraq and the Middle East," 1–33.

as Haiti, Honduras, Indonesia, and the Philippines, where the preexisting conditions were less amenable to economic and political liberalism.[23] Pete Moore and Andrew Schrank go as far as to conclude the following:

> In fact, the lessons of history are clear. Trade alone will tend to underpin—rather than to undermine—preexisting social and political arrangements. . . . If trade and aid are offered conditionally (i.e., as a quid pro quo for political or foreign policy reform), they risk igniting a nationalist, anti-American, and quite possibly Islamist backlash—particularly if the conditions are perceived to benefit the United States or Israel rather than Arab firms, investors, and citizens. If they are offered unconditionally, however, they threaten to do little more than enrich already powerful and self-serving elites and to thereby undermine the prospects for peace and prosperity in the Middle East.[24]

The less successful countries' difficulties stem from the fact that there seem to be only limited linkages between freer trade and the major dimensions of governance.[25] This finding was confirmed through a statistical analysis of a large sample of developing countries.[26] Specifically, using a classification analysis of 162 countries,[27] trade linkages were found to occur only in the areas of (a) overall governance,[28] (b) regulatory quality, and (c) voice and accountability.

Statistically, property rights not freer trade were found to be the controlling economic reform variable in effecting progress toward improved governance. The progression is steady, with higher mean values of property rights associated with a higher attainment of overall governance. Within this progression

23. Pete W. Moore and Andrew Schrank, "Commerce and Conflict: US Effort to Counter Terrorism with Trade May Backfire," *Middle East Policy* 10, no. 3 (2003).
24. Ibid.
25. Governance data is from Daniel Kaufmann, Aart Kraay, and Massimo Mastruzazi, *Governance Matters III: Governance Indicators for 1996–2002* (Washington, DC: World Bank, 2003). Governance measures include voice, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption.
26. A complete set of results are available from the author upon request.
27. For this purpose a classification tree was developed. See AnswerTree 3.0 User's Guide (Chicago: SPSS, 2001) for a description of the program and logic underlying classification trees.
28. An unweighted index of voice and accountability, regulatory quality, control of corruption, political stability, regulatory quality, and government effectiveness for the years 2000 and 2002.

of governance groups, (a) progress incorporating informal markets into the formal economy, (b) proper monetary policies (low inflation), and (c) improvements in banking and finance systems helped differentiate countries as to high or low overall governance. Improved trade policies played a lesser role.

Based on the overall attainment of good governance, several distinct groups of countries occur in the Middle East.[29] The first comprises mainly the smaller oil-rich Gulf countries—Bahrain, Kuwait, UAE, Oman, and Qatar, together with Israel. All have made good progress in overall good governance. Another group consists of Jordan, Turkey, Egypt, Saudi Arabia, and Tunisia (and possibly Morocco and Lebanon), which are somewhat further behind in governance reform. A final group consists of Algeria, Pakistan, Syria, Sudan, Yemen, Iran, Iraq, Libya, and Somalia, all well below the norm for good governance.

Trade policies are useful in effecting the quality of regulation, but again not the dominant factor in this regard. As with overall good governance, property rights are again the most important aspect of economic reform associated with improved regulatory quality.

Finally, a similar pattern is associated with voice and accountability, with trade policy as a secondary factor (separating Iran from countries with poorer trade policies, Iraq, Libya, and Somalia). One interesting aspect of voice and accountability was the particularly low scores attained by the Middle East countries.

Middle East FTAs: Some Practical Concerns

This discussion raises a number of concerns over the effectiveness of FTAs in the Middle East region. Structural impediments, lack of progress in economic and governance reform, distance from the US market, and the unlikelihood of trade initiating follow-on policies to improve the overall economic environment cast doubts on the effectiveness of trade-based strategies in assisting in the war on terrorism.

29. A result produced using the classification program cited in note 27.

Trade Diverted from Terrorist-Prone Countries

Unfortunately, one cannot even say with complete certainty whether the agreements are in the best economic interest of the individual Middle Eastern countries. The classic argument against FTAs focuses on their trade-creation versus trade-diversion effects. Trade creation occurs when production is shifted from higher-cost producers to lower-cost producers within the trading bloc. When trade barriers are eliminated among the FTA countries, differences in comparative costs will lead to shifts in trade, production, and investment patterns that favor the lower-cost producers and improve economic efficiency within the FTA.

On the other hand, trade diversion occurs when production is shifted to higher-cost internal producers from lower cost external producers. If trade diversion outweighs trade creation, an individual country within the FTA may find itself worse off as a result of the agreement. This is unlikely to happen for the United States in the strict economic sense, since the actual volumes of trade are so small (the Moroccan economy is about the size of that of greater Albany, New York).[30]

Only a detailed statistical study can determine if trade diversion is a significant problem for individual countries in the Middle East. On the other hand, it is fairly easy to speculate about the short-run impact on terrorism stemming from the trade creation/diversion process. If, as a result of the new FTAs, trade is shifted from high-terrorist-risk countries such as Pakistan or Turkey to relatively low-terrorist-threat ones such as Morocco or Jordan, then the FTA results in lost ground in the war on terrorism. Given the sequence of FTAs in the Middle East, there is a good chance of this happening, since only those countries already relatively stable after undertaking significant reforms can qualify for FTA status: "Basically the administration is picking low-hanging fruit, where significant reform already has been undertaken and the volume and nature of trade very simple."[31]

30. Alan Tonelson, "Small Is Dumb, Not Beautiful, in Trade Policy," 30 April 2002, at American-EconomicAlert.org.
31. Quoted in Sparshott.

Frictions with Allies

Even worse, a whole spectrum of US foreign policy interests (as well as those of major allies in the war on terrorism) can be undermined by the proliferation of FTAs in the Middle East and elsewhere. A good example of this is provided by the European Union's strategic partnership with the Mediterranean and Middle East, the Barcelona Process, initiated in 1995. In some regards this is a program similar to the US FTA initiatives. Specifically, the EU wants to achieve the "construction of a zone of shared prosperity through an economic and financial partnership and the gradual establishment of a free trade zone."[32] The problem here is that the United States has announced that countries seeking free-trade agreements with the United States must cooperate with Washington on foreign policy and security issues.[33] This puts many of the Middle East countries in the middle of US and EU disagreements, distracting all parties from the war on terrorism. For example, until recently the United States was not considering moving ahead with an FTA with Egypt because that country refused to support the US WTO challenge to the EU's de facto moratorium on genetically modified food.[34]

Finally, the United States has said that FTAs would not affect existing regional trade agreements such as the Gulf Cooperation Council (GCC). However, Saudi Arabia, a key US ally in the region, has taken a strong counterposition, arguing that the recent FTA signed with Bahrain and the prospects for one with the UAE would undermine the foundation of the GCC. In this regard, Prince Saud Al-Faisal, the Saudi foreign minister, noted that "it is alarming to see some members of the GCC enter into separate bilateral agreements with international powers. . . . They diminish the collective bargaining power and weaken not only the solidarity of the GCC as a whole but also each of its members."[35]

32. Palestine Media Center, "The EU, the Mediterranean and the Middle East: A Long-Standing Partnership," 12 October 2004, at www.palestine-pmc.com/details.asp?cat=2&id=772.
33. "WTO Suffers from New Security Agenda," *Oxford Analytica*, 15 July 2003, 1.
34. Ibid.
35. Quoted in Linda Heard, "US Free Trade Agreements Split Arab Opinion," *Arab News*, 8 March 2005.

Congressional Approval

A final consideration entails the implementation of FTAs. While they may be relatively easy to negotiate, it may be difficult to obtain congressional approval. To overcome expected fierce resistance from domestic agricultural, labor, and textile interests, the rest of the business community would have to organize a very large effort to support passage. With relatively small commercial opportunities at stake, big business may not have the requisite incentives to push hard.[36] The embarrassment surrounding a failed attempt at FTA approval may only fuel further anti-Americanism in the affected country.

Phasing Out of Textile Quotas

To counter these arguments, proponents of FTAs in the Middle East often cite the success of Jordan. That country's exports have increased from $31 million in 1999 to $673 million in 2003.[37] This figure is expected to top $800 million in 2004.[38] However, these figures are a bit misleading in that they do not accurately reflect the effects of the free-trade agreement with the United States. The lion's share of Jordan's increased exports came from the recent creation of Qualifying Industrial Zones (QIZs), specific areas whose outputs get duty-free and quota-free access to the US market if they are produced with at least 8 percent of Israeli inputs. These zones have attracted investment from Asian apparel manufacturers seeking to circumvent US quota restrictions. Because these manufacturers import most of their fabrics from Asia, job creation in Jordan has been minimal.[39]

In any case, with the end of the Multi-fiber Agreement at the end of 2004 and as worldwide quotas on garments are removed, the importance of Jordan's QIZs will fade. With the global removal of quotas, many companies will move their operations to low-cost countries such as China and India. Further complicating things for Jordan, on 14 December 2004 Egypt, Israel, and the

36. "United States: Trade Strategy Meets Numerous Setbacks," *Oxford Analytica*, 19 November 2003, 1.
37. "Cash-Strapped Jordan Aims High," *AME Info*, 11 December 2004, at www.ameinfo.com.
38. Oxford Business Group, "Jordan: Standing by Uncle Sam," *Online Briefing* 77, no. 9 (2004), at www.oxfordbusinessgroup.com/weekly01/asp?id=1441.
39. Debra Glassman, "Bush Tries to Recycle Cold War–Era Policy," *Seattle Post-Intelligencer*, 1 July 2003.

United States signed a partial free-trade agreement creating QIZs in Egypt that will allow Egyptian-Israeli goods access to the US market. As a result, Egypt may capture much of Jordan's apparel business, as Egyptian labor costs are lower and raw materials are more readily available.[40] For Jordan to remain competitive in the clothing/apparel markets, the country will have to undertake major investments in its infrastructure at a time the government is severely short of funds.

Assessment

On the surface, the US economic policies toward the region appear to be based on sound economic theory and empirical fact—increased trade leads to rates of growth and incomes, together with lower unemployment rates, reduced poverty, and most likely reduced attractiveness of terrorism among the youth. However, sequence and end result implicitly assumes that a certain critical mass of institutions facilitating economic expansion is in place. In the Middle East this is likely to be the case for only a handful of countries—a number of the Persian Gulf oil economies together with Israel, Jordan, and Turkey. Morocco, Egypt, and Saudi Arabia may not be at the point where expanded trade is capable of inducing improved governance structures capable of sustaining and expanding growth and trade. The rest of the countries are definitely not at this point and might even experience a vicious circle of expanded trade causing increased inequality, poverty, corruption, and anti-Americanism, leading to lower rates of investment and growth.

US economic policy also suffers from a fundamental inconsistency. In its rush to create FTAs around the world, it has become literally impossible to assess the impact on any one particular region. In fact, current US FTAs with other parts of the world may be shifting trade away from critical Middle Eastern countries. Countries in the Andean region, sub-Saharan Africa, and elsewhere, granted preferential, duty-free access to the US market, have enjoyed a comparative boom, with exports to the United States rising nearly 40 percent in some cases.[41] Again, these FTAs have the potential

40. "Joint Industrial Zones Seen as Boon for Egypt," *Jerusalem Report*, 27 December 2004.
41. Paul Blustein, "US Free-Trade Deals Include Few Muslim Countries," *Washington Post*, 4 December 2004.

to significantly shift trade away from the terrorist-prone countries to relatively peaceful areas of the world.

Still, the issue is not crystal clear. A recent report on a potential US-Egyptian free-trade agreement notes that such an arrangement would produce strong benefits for both countries as well as speed up economic reforms in Egypt.[42] Given its size, however, Egypt may be the exception to the rule in the region.

Given the limitations of an FTA-based strategy, the most constructive US trade policy is no doubt one of unilaterally opening up its economy to exports from the region.[43] This is simply good economics. More importantly, with time as, one-by-one, the Middle Eastern countries experience the practical benefits of increased trade, domestic pressures are likely to push for further reforms, setting these countries on the path to increased growth and prosperity at their own pace and on their own terms. Over time, the United States should reinforce these positive market-based trends through the appropriate use of grants targeting institutional development and market-strengthening initiatives to support expanded trade. The main disadvantage to this option is that it might shift some trade away from other countries such as Indonesia or the Philippines, where significant terrorist concerns also exist.

Another option is to drop the movement toward individual FTAs or a MEFTA and focus on bringing the current WTO round to a successful conclusion. In many ways, this would be a far more difficult task for the United States, but one with greater economic rewards for both the United States and the Middle East as a whole.

The financial implications of completing this trade round are staggering. A recent World Bank study projected that a new trade agreement would have a giant impact on the global economy.[44] The bank's estimate is that an accord promoting free trade would produce annual income growth of between $290 billion and $520 billion. It would lift approximately 144 million people out of poverty by 2015.

42. Robert Z. Lawrence and Ahmed Galal, "US-Egypt Free Trade Agreement," Institute for International Economics, Washington, DC, 2005.
43. Clyde Prestowitz, "Bold Action Can Still Save Doha Round: An American Initiative to Eliminate Subsidies Would Break the Trade Logjam," *YaleGlobal*, 19 September 2003.
44. *Global Economic Prospects (2004): Realizing the Development Promise of the Doha Agenda* (Washington, DC: World Bank, 2003).