

## **The Jordan Free Trade Agreement: The Wrong Template**

**Testimony by**

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It is tempting to judge the US-Jordan FTA only in terms of whether it is an important component of our Middle East policy of promoting peace. But, even on that dimension, I find it hard to see how it can be seriously argued to be of any real importance relative to the numerous complexities that challenge us and which require political resolution. Nor can it, given the minuscule current and prospective trade between us and them, can it be regarded as of any importance relative to other more significant economic instruments such as aid. In fact, looking at FTAs being pursued worldwide, I find that often they are justified on "security" or "foreign policy" grounds: but this is little more than PR that sidetracks one from penetrating scrutiny of what the FTA in question is really about.

In truth, one may well ask why you and I should spend our valuable time on an FTA that appears so economically trifling. The answer is that this particular FTA raises two questions of extraordinary significance for our trade policy: one in regard to FTAs vis-à-vis multilateral Free Trade (FT) and the other in regard to its contents, specifically in relation to the issue of labor and environmental standards.

The first is a policy issue that a world leader in Trade Policy must concern itself with. We are not Chile, Singapore or Mexico; what we do matters much more than what each of them or all together do. We must address the questions raised by proliferating FTAs as they intrude into the world trading system in ever expanding numbers: do we join the stampede or do we seek to halt it using our power, such as it is, to persuade, bribe and punish other nations. But any FTA --- not just the US-Jordan FTA --- raises that question. I will therefore, in my oral testimony, not go beyond simply alerting you to this question which agitates a number of students of the trends in the world trading system, as was evident for instance at the Davos meeting this January and has

been discussed in the more informed media such as The Financial Times and The Economist in recent years.

The second is a matter that is truly specific to the US-Jordan FTA for the simple reason that its incorporation of labor and environment within the very text, as distinct from side agreements in the NAFTA treaty, is considered by our labor union lobbies, chiefly the AFL-CIO, and the Democratic politicians who accept and reflect these positions, to be a "template" of any future trade liberalizing agreement. In fact, it is a strategic elevation of labor (and certain environmental) concerns to an integral status within trade negotiations. It goes even further in its significance. For, it is also widely assumed, despite a few denials which seem less than credible to those of us who have followed the politics of this issue closely for over a decade, that it is also a legitimization of the demand for a Social Clause at the WTO. The US-Jordan "template" would establish so many legitimizing facts on the ground that the foot in the door would pave the way for putting the entire body, bloated belly and all, through the door when the "time was ripe".

This aspect of the US-Jordan FTA is therefore one that the Senate Finance Committee cannot ignore. Indeed, I need hardly remind distinguished members of the Senate who understand politics only too well, that the US-Jordan FTA was designed by the Democratic Clinton administration, as a priority item to be negotiated ahead of the change of administration, precisely with a view to creating this new "template" and to make it difficult, even for Republicans, to do anything but accept it.

But rejection of this template is precisely what needs to be done. And, if that is not done because it is too late to "disappoint" a friendly Kingdom which the earlier administration has brought more in its own labor lobbies' interest to the well, then there must be an explicit disclaimer that the US-Jordan FTA is not to be treated as a template in regard to future FTAs

(such as with Singapore and Chile).

Besides, the Senate Finance Committee must add the explicit proviso that "substantial" trade liberalization as in the proposed FTAA and certainly in a new Multilateral Round, dashed by mismanagement by the last administration at Seattle but to be launched hopefully at Qatar this November when the WTO Ministerial meets again, will not incorporate labor (and certain environmental) issues into the negotiations, exactly mirroring the objections of the major developing countries' governments, and also of many intellectuals, NGOs and even labor unions (e.g. all of them in India) to a Social Clause and indeed to even a discussion of these issues in the context of trade negotiations.

Let me explain and justify all this. I will first address the question of the risks posed by multiplying FTAs generally. Then, I will turn to the more specific and even more dangerous "template" issue.

#### **A: FTAs: The Systemic Issues: The "Spaghetti Bowl" Problem and the Question of "Stumbling" versus "Building" Blocks**

##### **I: PTAs, not FTAs: Trade Diversion**

Several points must be kept in view. At the outset:

- Free Trade Agreements are two-faced: they lower barriers for members, not for non-members. So, they increase the handicap faced by non-members vis-à-vis members in the markets of FTA members. So, FTAs constitute freer trade for members, greater protection for non-members. They are therefore NOT identical with free trade. Only those who deal in sound bites and who cannot read more than two words at one time-- - something one cannot accuse Senators of, since they necessarily transcend incompetence and petty politics --- will be in danger of beginning to read "Free Trade Agreements" and terminating their effort after the first two words!
- To underline this inherent and important difference between FTAs and FT (genuine Free Trade), the former constituting preferential or discriminatory trade liberalization and latter constituting non-preferential or non-discriminatory trade liberalization, economists now call FTAs (and customs unions such as Mercosur) PTAs. That way, the costly sloppiness that equates FTAs with FT is less likely: as Orwell reminded us, language matters.

- All trade economists know that PTAs can lead to trade diversion: diverting trade from cheaper non-member suppliers to more expensive member suppliers, because the members face lower, eventually zero, tariffs and even differential exemptions from non-trade barriers like anti-dumping actions. This is clearly costly: the country imports at higher cost. Offsetting it may be increased trade from the members which displaces our own higher-cost production and also because cheaper tariff-inclusive consumer prices lead to increased consumption.
- In evaluating PTAs, it is remarkable that rarely is this key problem mentioned, and all trade increase is treated as if it was good, which would be the case if we were dealing with FT, not PTAs. Thus, look back on the DRI evaluation of NAFTA for the Clinton administration: it never mentioned trade diversion. That document would have been graded an F in an elementary class on International Economics 101. Several of the other studies cited are almost as bad, almost worthless, at a conceptual level. The Senators may recall for instance the pro-NAFTA study done at the Institute for International Economics, during the NAFTA debate. I hesitate to say it, particularly since that think-tank is usually on the side of freer trade which I embrace and espouse, but say I must: this study was flawed, characteristically for many reports from that Institute, because it calculated employment effects from NAFTA in a model that did not analytically permit aggregate employment effects to follow from changes in trade policy!

## II. "Spaghetti Bowl": A Systemic Problem

But the problem that faces us today is a “systemic” one. These PTAs, most of them bilaterals and some plurilaterals (i.e. more than two members), have proliferated and are multiplying at an epidemic rate. The result is a maze of criss-crossing preferences With different rules of origin applied to different sectors in different countries in different bilaterals, with the same commodity often on different schedules of tariff abolition, so that the name of the game becomes defining which product comes from where --- a matter that can make being a customs official a lucrative business aside from creating huge headaches for planning production location and product content decisions. I have called this the “spaghetti bowl” problem: an apt phrasing that has caught on among economists and was used by prominent Trade Ministers at the Davos meeting this year as well. The maze and the mess are, as the remarkable South African Trade Minister Alec Erwin noted, particularly acute for the developing countries: small nations and small businesses find it ever more difficult to operate within this (I should say, lack of a) system.

When I originally drew attention to this spaghetti bowl problem some years ago, the number of PTAs notified to the GATT were still around a hundred: a bad enough figure for me to ring the alarm bells. Today, there are well over 200 such notified PTAs, mostly bilaterals, and by some counts, the new ones being plotted, including the US-Jordan FTA, turn the aggregate number to over 400. Besides, the disease has spread to Asia which, until recently, was bravely

holding on to non-discriminatory trade liberalization, including at APEC (which is not an FTA and had embraced nondiscriminatory trade liberalization for its members as its operating principle despite pressures from some of our people to the contrary). So, we have now Japan and Singapore breaking ranks with active exploration, even negotiation, of bilaterals of their own. Other nations of Asia will not be far behind.

And so we may soon expect the world trading system to be awash in preferences that will have reproduced the chaos and the mutually harmful ravaging of the world trading system, again with individual countries acting rationally in an uncoordinated fashion but arriving at collectively irrational outcomes, that we had in the 1930s after the Smoot-Hawley tariff. [The competitive nature of this proliferation is evident from the fact that nations that were wedded to the multilateral system have recently confessed to their “need” to have their own PTAs to offset the preferences that rule them out of other nations’ PTAs. The Business Roundtable makes a similar argument, saying that the US also faces such dangers of “exclusion” because of others’ PTAs and must pursue them herself.] This time, however, the world trading system, which would be far better served by a discrimination-free set of rules, will have been damaged by the world’s politicians and their advisers in the name of Free Trade rather than in the name of Protection.

I invite the distinguished Senators to look at the two charts (1 and 2) that I have prepared, that illustrate the spaghetti bowl as of some time ago, for the EU and for Africa; things have gotten worse since. If that does not impress you enough, let me tell you that, in the EU today, I am told that there are only five countries that enjoy access at the EU’s MFN tariffs: all the rest are on some preferences or others, among them those embodied in the bilaterals!

### III. “Building” versus “Stumbling” Blocks

One may fondly hope that this proliferation is only an “en route” chaos and that, to use another phrasing that I have introduced in the policy debate, they only represent a “building”, not a “stumbling” block in **getting to** the goal or architecture of multilateral, non-preferential Free Trade.

But just consider that nearly every bilateral consists of numerous features that vary across the bilaterals. Even when “hegemonic” powers like the EU or US, and now Japan, are involved in a bilateral (and remember that there are numerous bilateral PTAs that do not involve these hegemonies but are among the lesser powers only as with Mercosur), their own “core” templates on issues like labor standards and a whole host of “trade-unrelated” issues are not identical or even similar. How are these different blocks, with many different sizes and shapes, going to be

used as building blocks for the multilateral project? That is a question that is now being raised, as it was at Davos too.

I raise these important systemic questions regarding FTAs, even as the Senate contemplates what superficially seems like a wholly inconsequential FTA with Jordan as whose passage should be a matter best relegated to the back pages of lesser newspapers, it is simply “received wisdom”, or perhaps it is better to call it “received folly”, in Washington that we can walk on “both legs” by going in for more PTAs and going as well for MTN (multilateral trade negotiations) under WTO auspices. Walking on two legs, I suggest, is likely to get us, a superpower that must lead with a vision, walking on all fours instead.

**B: Jordan Free Trade Agreement as a Template on Labor and Environmental Standards**

But if the systemic questions I have raised above are those that must concern the Senate and the House, the USTR and the President more fully at a different time, but certainly before the FTAA meeting in Quebec in late April where these questions must be addressed and the matter addressed frontally, the main and currently pressing problem with the Jordan Agreement lies elsewhere.

This has to do with the fact that its real rationale is not as something its political proponents want to do for Jordan but as something that they wish to do for themselves in a broader and more ambitious agenda. They wish to use it as a **template**, as Ambassador Barshefsky said quite explicitly several weeks ago, for all future trade agreements when it comes to **incorporating labor and environmental provisions into trade agreements**. In this regard, the most important change from NAFTA, which is considered properly to be significant, is that the NAFTA treaty put such provisions into side agreements; in the Jordan Agreement, they are right within the text.

Again, it is important to remind ourselves: what exactly is the game plan? There are three possibilities.

- **Plan 1:** A modest game plan would be to consider this shift from side agreements to within-the-text provisions as an end in itself. It would represent, from the viewpoint of the lobbies and the Democrats, an upscaling that could then make it easier to demand such provisions in any bilateral PTAs we may sign in the future, say with Singapore or Chile.
- **Plan 2:** An ambitious game plan would be to treat this concession as one that undercuts objections to having a Social Clause in the WTO. Since such a Clause inherently implies the use of trade sanctions, this would imply providing political legitimacy to the use of sanctions to advance specified labor and environmental standards or objectives abroad.
- **Plan 3:** An equally ambitious objective would be to pave the way for the inclusion of such provisions in the grant of any new fast-track or “trade promoting” authority to the new President.

But all three plans are fraught with adverse consequences for the United States. Let me explain why.

Plan 1:

Even if the template is only for all future FTAs, with the Jordan Agreement acting as a precedent we cannot walk away from, this will bring us harm because, in a world of proliferating FTAs (about which, I suspect, we plan to do little by way of leadership to halt such a development, despite the dangers that I have noted above), we will find ourselves in adverse competition with other nations who will not impose such provisions on prospective trade partners.

This is evident, to give just one example, of the FTA being proposed by some between India (a lucrative market that is rapidly opening up) and the US. India opposes the incorporation of labor and environmental standards in trade treaties. The EU and Japan do not require them currently. The danger is that India, faced with the need to create her own FTAs, will join with the EU and Japan instead: a proposal that has already surfaced as an alternative. That would freeze the US out of the Indian market, with preferences going to the EU and Japan instead. Trade diversion would strike, but at us as a non-member country.

Again, as of now, Brazil is a strong opponent of such incorporation of labor and environmental standards into trade treaties. What does that do to the prospect of FTAA?

The Jordan Agreement template would have driven a stake through that project as well since Brazil remains the dominant economy in South America and also actively opposes US hegemony (one consequence of which has been a longstanding tension between Mercosur and NAFTA).

Plan 2: Of far greater consequence would be the game plan to use the Jordan Agreement precedent to actively pursue the insertion of a Social Clause into the WTO.

First, any likelihood that one might be able to sideline the issue by creating a Study Group on the question at the WTO or with WTO participation, proposals which were advanced as innocuous by the US and the EU but summarily rejected by major developing countries as foot-in-the-door measures craftily devised by our labor unions and NGOs, would become yet more remote.

Second, it would give dangerous credibility to the false doctrine that trade treaties must address labor issues because trade liberalization is a significant cause of fall in our workers' wages due to competition with the developing countries and, through a race to the bottom, also of decline in our labor standards. There is little, if any, evidence for these fears and assertions.

Indeed, it is the common surrender to these unsubstantiated fears that has led many unions and Democrats to support the demands to raise foreign labor standards with a view to raising the cost of production abroad in many labor-intensive industries such as textile where our competitive advantage has disappeared by and large and where we face intense competitive pressures from the low-wage developing countries. Since asking for outright protection is not kosher any more, why not try to raise production costs abroad by citing lower standards, lower "living wage" and the like, and saying that otherwise the competition and the trade are "unfair"? That is real smart, you must admit. It is what I call a form of "export protectionism" (i.e. getting

the exporter to become uncompetitive) as against conventional “import protectionism” (i.e. raising import barriers). Alternatively, if import barriers are a form of “isolationism”, the raising of foreigner’s costs of production are a form of “intrusionism”. Neither makes sense as good policy.

Third, those proponents of a Social Clause who are looking for trade sanctions as a way of spreading better labor and environmental standards abroad on altruistic grounds often assert that the issue belongs to the WTO because its trade sanctions imply that the “WTO has teeth” whereas the alternatives proposed by many developing countries, their intellectuals, NGOs and some labor unions as well, such as going to the ILO make no sense because the ILO has no teeth.

But this is one argument which, while it looks compelling to most people in the US who desire to have a better world, is totally wrong in my view. It presumes that trade sanctions are productive and efficient relative to non-trade-sanctions in promoting such social agendas. But that is not so. Let me give some of the reasons:

- When trade sanctions were threatened under the proposed Harkin Child Deterrence legislation, several children were fired and wound up in prostitution instead, according to a widely cited Oxfam study.
- Complex issues such as child labor, where over 100 million children work in the poor countries principally owing to poverty, cannot be solved meaningfully via trade policy. Only 5% of the output where children work is exported, for instance. If you bump children out of the exporting industries or firms, they will likely end up elsewhere, even if not in prostitution.
- The effective removal of child labour requires “heavy lifting”: working with local NGOs, ensuring that children taken from work are put to schools which may require to be built, helping with moneys (which foreign aid can provide) poor parents who might starve if children’s income is removed, and so on. This is, in fact, what the ILO’s International Program for the Eradication of Child Labour (IPEC) is doing; and that is the correct answer, surely. Trade sanctions have no role in this program.
- It is wrong to believe, in any case, that the use of techniques other than trade sanctions is ineffective for most of the social agendas one may wish to advance. In a debate with former Labor Secretary Robert Reich, I said: God gave us not just teeth but also a tongue. And, when it comes to morally compelling causes, a good tongue-lashing can be more effective today than biting with one’s teeth. Today, with civil society actions and CNN, the power of moral suasion is far greater than when teeth were considered necessary: one can proceed from credible documentation by impartial and competent bodies such as a restructured ILO to unleash shame, guilt, and embarrassment to push societies towards greater progress on social and moral agendas. I call this the Dracula Effect: expose evil to sunlight and it will shrivel up and die. True, Dracula returns from time to time; but I believe nonetheless that the Dracula Effect captures reality pretty well.

And I would remind the Senators, especially when this administration is turning to the Christian faith, that the Pope has no troops, only the power that proceeds from his

moral stature; that we no longer use the rack to convert the non-believers to true faith; and that the Inquisition showed that such use of teeth was simply ineffective: the Jews who could not take the torture pretended to convert but continued to embrace Judaism, declaring themselves when the Inquisition had passed.

- In addition, there are reasons to think that Appropriate Governance requires that issues be addressed at international agencies which have been designed to address these issues. For labor standards, or workers' rights as they are now characterized, are surely better addressed at the ILO; environmental standards at UNEP; children's rights at UNICEF; migrants' rights at an institution which must be created for that purpose: I have long written that we need a WMO, the World Migration Organization; and so on.
- Ruling out the rationale that the WTO provides trade sanctions and hence must deal with these standards, and rejecting also the reasoning that WTO must address these issues because trade creates a downside for our wages and our standards, as I have already argued, we are left with no reason to have the WTO involved in any way whatsoever in these matters.
- Besides, it is important to remember that the WTO's annual budget is \$100 million, of which the US pays 15%. The WTO is leaner than it should be: it suffers from phenomenally inadequate resources compared to the huge amounts of funds that are available to the World Bank, for instance, and which are used by the Bank with an extravagance, relative to WTO's frugality, that would be scandalous only if known. Is it coherent to deny the WTO more funds for staff (which has less than ten economists in its Research division!) while adding to its burden the management of a Social Clause which, given its current funding, would allow perhaps half a person to manage these complex questions?
- Then again, the Senators must face up to the fact that we will surely destroy the WTO if we go the Social Clause route. Most of the proponents of the Clause assume that the defendants will be the developing countries, whose standards we fear and deplore whereas we will be the plaintiffs. It is difficult for them to see that we could well be the defendants. Even the so-called "core" workers' rights which are to be proposed to be included in the Social Clause include broad declarations that can imperil our own exports. Thus, for instance, they include the right to associate freely, which refers to unions of course. But this is a very broad right. And Human Rights Watch has just issued a Report on this right in the US, concluding that "millions of workers" are denied that right, largely (but by no means exclusively) because the right to strike effectively is crippled by legislation that allows replacement workers and discourages sympathetic strikes. Thus, the fact that our union membership has steadily been falling and is around 12% of the labor force by now is a surefire symptom, though evidently not in itself proof, of this documented denial of the core workers' right to unionize. If then we had this right in the Social Clause, as we must if there ever were to be such a Clause at the WTO, we could well face the prospect of being taken to the Dispute Settlement Mechanism at the WTO for violation of this right in virtually all export industries. In that case, which way does the WTO rule? If against us, several Congressmen can be expected to march down the steps of Capitol Hill in

- condemnation; if for us, the unions, NGOs and intellectuals can be expected to take to the streets and to mount yet more effective attacks on the WTO. Do we want this?
- By contrast, if the ILO finds against our practices on these core rights, no trade sanctions follow and therefore none of this would happen. Instead, impartial findings like this would enable our unions, NGOs and politicians to argue more convincingly for reforms that advance better conformity to these rights nationally. And that could produce good results, not senseless wrecking of a necessary international institution like the WTO.
  - Finally, the problem is that we could not even get to the Social Clause in the WTO, and indeed would have great difficulty in even getting an MTN Round going, if we were to insist on a Social Clause negotiation as part of such a Round. For, it is not just many of our economists, many Democrats, and several Republicans in the House and Senate who reject such a Clause; the developing countries do so equally passionately as witting or unwitting protectionism. By going this route, at the insistence of our union lobbies, we create a North-South divide that accentuates the difficulties we face in launching an MTN Round, a matter of some importance today.

And so, I think that Plan 2 of using the Jordan Agreement as a stepping stone towards the Social Clause is to go down a path that is fraught with far too many problems and dangers.

Plan 3: For many of the same reasons, the plan to use the Jordan Agreement as a signal that the grant of fast-track authority will be made contingent on accepting an integral link between trade liberalization and labor and environmental standards provisions, is to be deplored as well.

### **III: My Recommendations**

I would therefore urge the Finance Committee to vote for the following in regard to the Jordan Agreement:

- Approve it but subject to deletion of the labor and environmental provisions, instead adding a commitment to pursue these questions proactively at appropriate agencies such as the ILO and UNEP while taking meaningful steps to enhance their capabilities and improving their functioning;
- If labor and environmental provisions are retained as a compromise, they must be taken out of the text and put in NAFTA-style as side agreements, so that no signals are sent out that make concessions to the untenable view that there is an integral and adverse relationship between trade liberalization and our wages, labor standards and the environment, nor is a signal sent that we are taking a further step towards a Social Clause at the WTO.
- In fact, under the latter alternative, it would be a matter of urgency for the Senate Finance Committee to add unambiguously also that “the Jordan Agreement’s side agreements have no implication whatsoever for the disputed question of the negotiation of such provisions in the next MTN Round or of a Social Clause at the WTO”.

Ambassador Robert Zoellick has said in recent interviews that he would like to put FTAs, including FTAA, and a new MTN Round into a package that would be presented in a package to the Congress for grant of fast-track authority. With the Jordan Agreement suitably altered in the way I recommend above, and with labor and environmental requirements taken out of the proposed MTN to be launched hopefully in Qatar, the Zoellick proposal would seem to be just right.

But to get broad support, and indeed to do the right thing regardless of politics, it is important, I should like to reiterate, that the seeking of such fast-track be also accompanied by a declaration of a firm commitment to take proactive steps to advance workers' rights and environmental objectives in suitable fora and indeed by some actual steps to make such a declaration credible.