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COMMERCE AND CONFLICT: U.S. EFFORT TO COUNTER TERRORISM WITH TRADE MAY BACKFIRE

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There is an old joke about the business acumen of the Arabs: A teacher asks a Lebanese boy, "What does two plus two equal?" And the boy responds, "Are you buying or selling?" The Bush administration is currently placing a good deal of faith in the commercial spirit of the Arab world. Secretary of State Colin Powell has committed more than $1 billion to the United States-Middle East Partnership Initiative, an ambitious aid program designed to unleash the private sector, empower civil society and foster democracy in the Near East and North Africa, and President Bush has recently announced a 10-year time frame for the negotiation of a U.S.-Middle East free-trade agreement.

The logic of Bush's strategy is certainly grand: A self-conscious and self-confident Arab private sector is expected to use free trade and market-oriented reform to foster sustainable growth, democratic transformation and an end to regional conflict, sub-state violence and religious radicalism. But the proposed policy mechanisms – preferential trade agreements (PTAs), free-trade zones (FTZs) and targeted assistance to the private sector – are actually well-worn instruments of a failed U.S. policy toward the developing world. Simply put, they assume that international trade alone not only can transform deeply entrenched social and political institutions but can do so in accordance with decidedly controversial American goals and interests. "Encourage international trade," the administration seems to be saying, "and peace, prosperity and good governance will necessarily follow."

Unfortunately, the lessons of world history suggest that investors, entrepreneurs and firms capitalize upon foreign trade by exploiting, rather than transforming, their preexisting social and political institutions. Consider, for example, the growth of the Baltic grain trade in early modern Europe. While the opening of the Northern European trade routes ushered in an era of modern industrial capitalism in England and the Low Countries, where private-property rights and unfettered labor markets had already been established, it encouraged the growth of feudal exploitation and repression in Poland, Russia and the East, where serfdom had not yet been overcome. Or consider the so-called triangular trade between England, Africa and the plantation societies of the New World. The industrial mother country prospered; her agricultural trading partners – including the southern United States – continue to bear the scars.

We need not reach back to the early modern era, however, to understand the explanatory primacy of social and political institutions. After all, the United States traded market access for political stability and support throughout the Cold War era. We built FTZs (Foreign Trade Zones) in Taiwan, the Dominican Republic and Guatemala. We encouraged the development of the private sector in Costa Rica, El Salvador and Indonesia. And we offered a number of trade incentives and preferences to a host of volatile countries throughout the developing world.

What were the long-term results? While the growth of trade would precipitate growth and improved living standards in places like 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, they would prove to be disappointing in places like Jordan, Haiti and Indonesia, where the preexisting conditions were less amenable to economic and political liberalism.

In fact, the lessons of history are clear. Trade alone will tend to underpin – rather than to undermine – preexisting social and political arrangements, and Washington's not-so-new effort to empower the Arab private sector is therefore likely to foster a Catch 22. If trade and aid are offered conditionally (i.e., as a quid pro quo for political, economic 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 entrench already powerful and self-serving elites and to thereby undermine the prospects for peace and prosperity in the Middle East.

JORDAN: A MODEL FOR THE MIDDLE EAST?

The U.S. trade representative, Robert Zoellick, has frequently portrayed international trade as a bulwark against terror, conflict and violence.[1] While the Hashemite Kingdom of Jordan is a frontline state in the Arab-Israeli conflict and a recent – and at times reluctant – convert to free trade and market-oriented reform, it arguably offers a best-case scenario for Zoellick's effort to "counter terror with trade" in the Middle East. After all, unlike Lebanon and Syria, Jordan has historically maintained close relations with the United States and – if covertly – Israel, and the kingdom's private sector and work force are well-educated, politically moderate and favorably disposed toward Western values. Furthermore, Jordan has already served as a model for Washington's effort to link trade and peace negotiations in the Middle East, for the late King Hussein signed a peace treaty with Israel in October 1994. His son and successor, King Abdullah II, signed a Free Trade Agreement (FTA) with the United States in October 2000. The two agreements have both engendered and been linked by a broader Jordanian effort to build and take advantage of qualified industrial zones (QIZs) as part of the Oslo peace process.

In fact, the Oslo peace accords, like their counterparts in Ireland, South Africa and Central America, both encouraged and relied upon economic as well as political cooperation among their participants.[2] If Jordanian and Palestinian business persons would simply truck and barter with their Israeli counterparts, the negotiators reasoned, they would not only come to rely upon and encourage the normalization of political relations between the Arabs and the Israelis, but would also act to contain religious radicalism in the Eastern Mediterranean as a whole. Thus, the growth of trade among Jordan, the West Bank and Israel would simultaneously empower the forces of peace and stability and encourage growth and development in the broader Middle East.

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While Jordanian and American officials began to encourage meetings between Arab and Israeli business persons as early as 1994, their efforts would mature into business conferences and trade fairs with the establishment of the Regional Business Council (RBC) in 1995. The RBC arose out of the 1995 Amman Economic Summit, which brought Israel and the Arab states together to discuss regional economic development. It was managed by American officials under an organizational element of Oslo's multilateral track known as the Regional Economic Development Working Group (REDWG). The RBC was designed to serve as a kind of regional chamber of commerce that would facilitate meetings, multilateral exchanges and joint business ventures among leading Jordanian, Palestinian and Israeli business persons; it ultimately laid the foundation for the establishment of QIZs in Jordan in the late 1990s.

The QIZs offer to exporters who meet precise "rules of origin," tariffs and tax-free imports of capital and intermediate goods as well as duty-free access to the U.S. market. The rules of origin are designed to ensure cooperation between Jordan and Israel. Thus a minimum of 35 percent of the exported goods must be composed of local content; 11.7 percent of the local content must be Jordan's, 7-8 percent Israel's; and the remainder can come from any combination of the United States, Jordan, Israel or the West Bank/Gaza.[3]

While the QIZs are a byproduct of the all-but-moribund Oslo peace process, they have reportedly survived and prospered in the wake of the second intifada. According to Jordanian and U.S. government figures, for instance, the ten Jordanian zones are responsible for a significant increase in exports to the United States – an 84-percent jump between 2001 and 2002 alone – and currently employ roughly 20,000 workers. Furthermore, the QIZs ultimately served as a dry run of sorts for the October 2000 Jordan-U.S. Free-trade Agreement. Under the FTA, tariffs between the two countries will be phased out over a ten-year period. Jordanian products exported to the United States will be required to meet a 35-percent domestic value-added requirement, and the entire country will thereby be transformed into a large and – given the increasingly stringent domestic-content requirements – ever-more-domesticated QIZ.

In other words, the U.S. government has used economic incentives to encourage peace between Jordan and Israel, reward proponents of normalization and push the Jordanians toward an export-led development model and sustainable economic growth. If this silver bullet sounds too good to be true, perhaps it is.

After all, the effort to tame terror with trade actually backfired in the late 1990s. Shortly after the creation of the RBC, Prime Minister Yitzak Rabin was assassinated. While the late King Hussein immediately broke precedent by bringing leading Jordanian business persons with him to the Israeli state funeral, Benjamin Netanyahu's accession to power marked the beginning of the end of the Oslo peace process. Israeli delays in withdrawing from Hebron, collective punishment, a doubling of the settler population and the perpetuation of the occupation soured Jordanian public opinion on the peace process itself. And the RBC became a lightning rod for both the secular Jordanian opposition and the Islamic Action Front (IAF).

Jordan's major dailies, *Al-Dustur* and *Al-Rai*, began running articles critical of business dealings with Israel as early as 1996. Religious and, perhaps more important, secular associations allied with the IAF to boycott trade fairs at which Israeli delegations were present. Large public demonstrations followed. And Jordan's leading business persons, the majority of whom are of Palestinian origin, were torn between the government and a Jordanian public that was increasingly alienated from the peace process.

Ultimately, Jordan's official business representatives sided with the opposition and, in a decidedly atypical instance of open opposition to government policy, boycotted the trade fairs. As outbreaks of violence in the occupied territories increased in the late 1990s, civil-society associations and opposition figures circulated blacklists of individual businessmen who continued to work with Israelis. Eventually, a nationwide boycott of American and Israeli products took root. The RBC collapsed. And, partly in response, Jordanian officials arrested civil-association leaders and began intimidating the opponents of normalization.[4] The suspension of parliament in June 2001 (new elections are scheduled for summer 2003) allowed the government to pass a swath of "temporary laws" that curtail political dissent. In October 2002, the government turned the de-liberalization policy into a formal, well-funded public-relations campaign called "Jordan First" (*Al-Urdun Awalan*). Support for Palestinian nationalism, protest of trade with Israel and criticism of economic reform are not "putting Jordan first" and are therefore subject to punishment[5] [see Greenwood in this issue – Ed.].

What, then, of the QIZs? The anti-normalization campaign appears to have had an effect, for only 9 of the 47 firms found in the Jordanian zones are wholly owned by Jordanians. Most QIZ enterprises are owned by South Asian textile and luggage manufacturers. Nor is the labor force particularly indigenous. Late work hours and a minimum wage of $3.50 per day have dampened efforts to recruit domestic labor; hence, nearly half of the 20,000 workers are not Jordanian. While QIZ managers have allegedly promised the government that they will increase local employment, they have not made good on their commitments, and complaints about working conditions are apparently on the rise.[6]

Furthermore, given continual Israeli closures of the occupied territories, QIZ exports do not, as yet, include components made in the West Bank or Gaza. In fact, the actual involvement of Israeli business has been minimal. QIZ participants interviewed by one of the authors describe typical Israeli contributions as "zippers, labels and packaging at the port" and note that inputs from the broader Jordanian economy are – infrastructure notwithstanding – virtually non-existent. Most of the cloth is imported, wages are extraordinarily low, and QIZ business owners therefore have real difficulty meeting the 11.7-percent domestic-content requirement. In sum, while foreign investors offer potentially large returns to QIZ owners and managers, they make almost no contribution to growth, employment or long-term human development.

Given these trends, the maturation of Jordan's FTA poses an important question. If investors are currently having trouble meeting a domestic-content requirement of 11.7 percent, how will they meet a requirement of 35 percent under the FTA? By 2005, the Multifiber Agreement (MFA) will be abolished and U.S. textile quotas will be eliminated. Since many of the South Asian firms in the QIZs have leases that expire by 2005, their commitment to a post-MFA Jordan would appear to be questionable. Without rapid diversification, upgrading and integration into the local economy, Jordan's QIZs will likely survive the MFA as islands of re-export and assembly – if they survive at all. More ominously still, the current U.S. push for QIZs and FTAs in Turkey, Morocco, Bahrain and perhaps even post-war Iraq – not to mention Central America, the Caribbean, Vietnam and the rest of the developing world – threatens to put small, low-income Jordan into a debilitating competition in which it has few political or economic advantages.

In short, the U.S. effort to link trade and peace negotiations in Jordan – the best-case scenario for the strategy and the explicit regional model – has failed. Joint Arab-Israeli business ventures have been shallow, the returns from trade have been minimal and the Jordanian public continues to reject normalization in favor of a comprehensive political settlement.

Nor has linkage worked at the micro-level. "Jordanians who know Israelis," according to Jordanian political analyst Rami Khouri, "are just as critical of Israeli actions as are Jordanians who refuse to meet with Israelis or travel to Israel." And Jordanians as a whole have abandoned whatever faith they may have had in the long-promised "peace dividend."[7] After all, the Jordanian economy is a disaster area. Unemployment is high (i.e., 15 to 20 percent of the labor force), population growth is rapid and per capita income peaked in the mid-1980s – a decade before King Hussein signed the peace treaty with Israel.[8] While the normalization process is not necessarily responsible for the crisis, it has done precious little to relieve the pressure and the new economic model of trade and foreign direct investment has therefore been treated as a handy scapegoat by the already powerful opposition forces.

The too-predictable result is a perverse cycle of opposition and oppression that is merely aggravated by the new model's need for political stability. Thus, King Abdullah draws closer to the United States and Israel, while Israeli tanks ring Palestinian cities and American soldiers patrol Baghdad. The Jordanian masses respond with blacklists, boycotts and demonstrations. Since such opposition is deemed bad for business and not in tune with Washington's regional aims, the king authorizes a political crackdown and thereby undermines the admittedly tentative process of political liberalization inaugurated in 1989. The king's legitimacy is called into question, and he looks toward the United States, Israel and the domestic business elite for compensatory support. The cycle is thereby perpetuated.

Whatever Washington's original goals and intentions, the QIZs and the FTA have clearly been incorporated into a homegrown Jordanian effort to ensure regime stability by expanding business access to exogenously funded, yet state-mediated, profits. In Washington, the Jordanian private sector is viewed as pro-Western and pro-peace, but at home it is increasingly recognized as a hornet's nest of crony capitalists who are concerned with little more than their own rents and profits.[9] Freer trade has not led to greater economic and political decentralization, therefore, but has served to institutionalize status-quo political interests.

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Washington recently gave Amman $700 million in return for its help in the war against Iraq. This follows a significant increase in economic aid, debt relief and military assistance over the course of the past decade. In fact, U.S. economic and military aid – including the most recent payment – have grown to nearly $3 billion since 1993. It is increasingly hard to escape the conclusion that, in the absence of a comprehensive Israeli-Palestinian peace agreement, Jordan's near-term future will depend upon additional infusions of aid. This, unfortunately, will only serve to prop up a corrupt system in which both economic resources and political power are narrowly distributed. Meanwhile, Jordan's young people face a precarious world of limited opportunity and wonder what peace with Israel, a close relationship with the United States and a handful of foreign-owned garment factories have wrought.

CONDITIONS FOR PEACE?

It is easy to see why American diplomats are increasingly enamored of bilateral trade agreements. The law of comparative advantage holds that both parties gain from opening their markets to each other's goods and services, and Washington insiders therefore believe that trade agreements will engender large political payoffs at no economic cost. Thus, diplomats and the chattering classes were advocating the Jordanian model – QIZs, FTAs and all – for a hypothetically "liberated" Iraq before the bombs had even begun to fall.[10] Nevertheless, the diplomatic community's faith in the political power of free trade rests upon two faulty assumptions: first, that "both parties gain" is synonymous with "nobody loses"; and second, that traders will transform, rather than exploit, their surrounding social and economic resources. Unfortunately, neither assumption is correct.

The gains from trade derive from the reallocation of human, physical and financial resources from inefficient or comparatively disadvantaged sectors to their more competitive counterparts. As governments tear down tariff and non-tariff trade barriers, investors, firms and entrepreneurs abandon traditionally protected activities and move their capital into comparatively advantaged sectors – many of which do not yet exist. While the process of reallocation will engender positive-sum returns over the long term, in the short term it will force into bankruptcy and unemployment owners and workers who are unable to make the transition. And owners and workers in the most protected markets and sectors tend to be the least prepared for liberalization.

Thus, the Middle East offers a decidedly inauspicious setting for a new round of trade agreements. It is, after all, the most heavily protected region in the world. Average tariffs are in excess of 20 percent. Non-tariff barriers are commonplace. Investment codes are outdated. And only eight of the region's eleven largest economies are even members of the World Trade Organization.[11] Observers who are aware of the risks therefore advocate not bilateral trade agreements, but the unilateral opening of the U.S. market for imports of light manufactured goods like textiles, clothing and footwear from the Middle East. They hold that "these are industries in which investment can move fast, putting plants on line and creating jobs rapidly."[12] They are in large measure correct.

But these are also industries that pay extraordinarily low wages, generate few positive externalities or spillover effects and are prone to engage in the worst varieties of labor-rights abuses. Jordan's QIZs are subject to the most stringent labor standards ever incorporated into a bilateral U.S. trade agreement but have nonetheless become a lightning rod for human-rights activists. So imagine the likely consequences of unconditional trade preferences in Egypt, Morocco, Pakistan or Yemen – where child labor is common, poverty widespread, underemployment rampant and workers' rights at best precarious.

The point is not simply that sweatshops are unlikely to win the United States allies in the campaign against al-Qaeda but that investors and entrepreneurs will tend to compete with the tools at hand. In the non-industrialized, non-democratic Middle East, the tools at hand are unskilled workers – an abundance of them – and lax labor laws. Unconditional trade preferences will therefore do little to encourage Middle Eastern governments to invest in their workers by providing job training, building schools, or otherwise upgrading their human capital. On the contrary, they will open the door to a debilitating downward leveling of wages and working conditions throughout the region and quite possibly beyond.

But unconditional trade preferences are not on the table. If anything, President Bush is offering the contemporary Middle East less market access than President Clinton offered Jordan.[13] And it is generally expected that market access will require a host of concessions including not only the eventual normalization of relations with Israel, as in Jordan, but also cooperation in the so-called war on terror more broadly. In fact, the recent U.S. decision to take Turkey off the fast track to a trade agreement reflects Washington's growing willingness to politicize international commerce, even to the detriment of democracy.[14]

The problem with the U.S. approach, as the "best case" Jordanian experience so aptly illustrates, is that the conditions themselves may well arouse anti-American animosity and thereby simultaneously undermine both the struggle against terrorism and the struggle for democracy in the Middle East. After all, Jordan's FTA has engendered a blacklist, mass protest, and a government crackdown on dissidents and the press. How will similar trade agreements fare in authoritarian countries like Saudi Arabia and the Gulf states, where oil wealth offers a degree of latitude unavailable in the Eastern Mediterranean, and boycotts of American goods and services are already underway?

TRADE FOR PEACE?

The Bush administration is hoping that a new series of bilateral trade agreements will offer a low-cost solution to a number of American security concerns in the Middle East including anti-Americanism, terrorism and the Israeli-Palestinian conflict. By empowering a new class of forward-looking Arab business persons, in the words of Ambassador Robert Zoellick, the United States hopes to counter terror with trade. Nevertheless, the administration's plans are overly optimistic, for economic history – including the economic history of the Middle East – suggests that trade alone will tend to entrench, rather than enervate, existing social and political institutions. While Washington plans to condition market access on thoroughgoing economic and political reform and to thereby lay the groundwork for a broader social and political transformation, it does so at great potential cost, for externally imposed conditions are likely to antagonize the Arab masses and thereby force their leaders to choose between détente with the United States and Israel and democratization at home. Jordan, an allegedly best-case scenario and the acknowledged model for the rest of the region, has chosen détente. Jordanian democracy has suffered accordingly.

Thus, in terms of the political stakes, what counts is not so much whether one is buying or selling but what is being bought and sold, and at what price. Washington is currently trying to buy peace on the cheap with a niggardly offer of trade and aid. "Put down your arms, forget your grievances and dedicate yourselves to the realm of commerce and industry," say the diplomats and trade negotiators, "and we will open our markets to your goods and services." Unfortunately, the strategy is not only bound to fail but is likely to exact an enormous price in doing so, for it promises to magnify the already enormous political and economic gap between the rulers and the ruled in the Middle East and thereby to exacerbate an already combustible geopolitical situation. A more realistic U.S. strategy would begin by recognizing the obvious: Peace will not come cheap. It will not only demand but will begin with a political settlement that will be costly to both sides of the conflict. No more costly, however, than a half century of war.

[1] See Zoellick, "Countering Terror with Trade," *The Washington Post*, September 20, 2001; and "Five U.S. reasons for liberalizing trade," *International Herald Tribune* (Special Supplement on the WTO Ministerial meeting), November 8, 2001. See also Natasha Walter, "Rumours of Anti-capitalism's Death Have Been Much Exaggerated," *Independent*, November 9, 2001.
[2] See John Darby and Roger MacGinty, *The Management of Peace Processes* (New York: St. Martin's Press, 2000); and Allan Gerson, "Peace Building: The Private Sector's Role," *American Journal of International Law*, Vol. 95, January 2001.
[3] *Your Guide to QIZ* (The Hashemite Kingdom of Jordan: Ministry of Industry and Trade, 2002).
[4] The crackdown resulted in the arrest, jailing and eventual release of Toujan Faisal, Jordan's only elected female parliamentarian (1993-1997), for "spreading information deemed harmful to the reputation of the state."
[5] See Jillian Schwedler, "Occupied Maan: Jordan's Closed Military Zone," December 3, 2003, and "Don't blink: Jordan's Democratic Opening and Closing," July 3, 2002, *Middle East Report Online*.
[6] Ghassan Joha, "QIZs Create Economic Base, Better 'Work Ethic' Needed," *The Daily Star*, March 9, 2003.
[7] Rami Khouri, "Some Jordanians Gain, Many Do Not," *Jerusalem Post*, October 22, 1999.
[8] Marwan A. Kardoosh, "Jordan's Economy from a Western Perspective," *The Daily Star*, November 26, 2002.
[9] For a more complete analysis of these dynamics, see Oliver Schlumberger and Andre Bank, "Succession, Legitimacy and Regime Stability in Jordan," *Arab Studies Journal*, Fall 2001/Spring 2002.
[10] See, for example, David Makovsky, "Peace Pays Off for Jordan; Benefits of Pact with Israel Suggest a Regional Model," *The Los Angeles Times*, January 31, 2003; Charlene Barshefsky, "The Middle East Belongs in the World Economy," *The New York Times*, February 22, 2003; and Stef Wertheimer, "Levitate the Levant," *Jerusalem Post*, May 16, 2003.
[11] See Edward Alden and Guy De Jonquieres, "U.S. to Open Talks on Trade Reforms in the Middle East," *Financial Times*, May 10, 2003; Edward Alden, "U.S. Free Trade Zone on Offer – No Liberalization Required," *Financial Times*, May 9, 2003; as well as Barshefsky 2003.
[12] Edward Gresser, "A New U.S. Trade Relationship With Turkey: Good Idea, Plan Needs Work," *Progressive Policy Institute Policy Report* (September 2002); and Gresser, "Blank Spot on the Map: How Trade Policy Is Working Against the War on Terror," *Progressive Policy Institute Policy Report* (February 2003). See also Elisabeth Bumiller, "Bush Seeks a Free Trade Zone with the Mideast by 2013," *The New York Times,* May 9, 2003; and Alden, "U.S. Free Trade Zone on Offer – No Liberalization Required."
[13] For example, in an effort to placate voters in the southern textile states, the Bush administration has left textiles, clothing and footwear out of negotiations with Turkey. See *The New Republic*, "Notebook," September 30, 2002.
[14] See Thomas Carothers, "Punishing Democracy," *The Washington Post*, May 19, 2003. According to Carothers, the Bush administration is punishing the Turkish government for adhering to the principles of democracy and refusing to allow the United States to use the country as a staging area during the war on Iraq. According to Carothers, Assistant Secretary of Defense Paul Wolfowitz recently rebuked the Turkish military for its failure to take a "strong leadership role" on the issue.