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## Free Trade Agreements as Foreign Policy Tools: The US-Israel and US-Jordan FTAs

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The US-Israel and US-Jordan Free Trade Agreements are typically treated as footnotes in most discussions of US trade policy, owing to the small amount of trade they cover. The importance of these agreements to US trade policy goes far beyond their trade coverage, however. The agreements set several precedents for US trade policy and also provide some lessons for the broader debate over the value of bilateral free trade agreements.

First and foremost, the US-Israel and US-Jordan FTAs are clear examples of the use of trade policy—specifically bilateral free trade agreements—as a means of pursuing foreign policy objectives. The United States’ foreign policy interests in these countries and the region are much more significant than its economic interests. Although the agreements serve several objectives, the primary reason the United States entered into them was to pursue foreign policy goals.

The US-Israel agreement, signed into law in April 1985, was the first free trade agreement negotiated by the United States. The US-Jordan agreement, signed into law in October 2001, is the first US trade agreement that includes specific language concerning the protection of the environment and labor. Together, the two agreements illustrate the “elastic” nature of free trade agreements. Experience now suggests that the initial

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US-Israel agreement discriminated against US trade with the Palestinians and with the Jordanians, precisely at a time when US policy was seeking to strengthen their economies. The US-Israel FTA was first amended, and later complemented by the US-Jordan agreement, in order to eliminate this discrimination.

The US-Israel and US-Jordan agreements are also examples of bilateral trade agreements between very small economies and a very large economy. In 2000 the US economy was 86 times larger than the Israeli economy, and more than 1,000 times larger than the Jordanian economy. By contrast, the US economy is 7½ times larger than its North American Free Trade Agreement (NAFTA) partners—Canada and Mexico—combined.

## The US-Israel Free Trade Area Agreement

Although the US-Israel FTA is a by-product of the special relationship between the two countries, the agreement provides many important lessons for bilateral trade agreements between large and small countries. US goals in pursuing the agreement were:

- to demonstrate strong bilateral relations beyond military/security support;
- to counter discrimination against US exporters caused by the bilateral trade agreement between the European Community (EC) and Israel signed in 1975 (final tariff cuts were to be implemented in 1985);
- to strengthen the Israeli economy and reduce its dependence on US foreign assistance; and
- to put pressure on the major trading countries to move forward on the stalled multilateral negotiations.<sup>1</sup>

Israel's goals in pursuing the agreement were as follows:

- The Arab boycott made it necessary for Israel to secure access to markets outside the region.
- Given its chronic balance of payments deficits, Israel sought to expand access to markets in high-income countries, such as the United States and European nations.

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1. Although the US-Israel FTA alone clearly would not have been sufficient to break the stalemate in multilateral talks, it was a convenient way for the United States to demonstrate that it would not wait for the rest of the world before moving ahead on trade liberalization. The prospect of the larger US-Canada agreement was also on the horizon.

- Israeli policymakers saw international obligations as a means to support internal efforts to liberalize the domestic economy.
- Israel welcomed the opportunity to strengthen its ties with the United States.
- Israel was facing possible “graduation” from the US Generalized System of Preferences (GSP) program, which afforded preferential treatment to Israeli exports to the United States.

The fundamental objective of the agreement was to eliminate all tariffs and quotas on industrial products within 10 years. There was some flexibility in the coverage of agricultural products, and services and investment were excluded from the agreement. Tariffs were reduced according to three schedules: tariffs on some products were eliminated immediately (List A); tariffs on other products were phased out over a 10-year period (List B); and tariff reductions on sensitive products were negotiated after 10 years (List C). Currently, trade in industrial products between the United States and Israel is tariff and quota free.

A key element behind the establishment of the US-Israel FTA was strong congressional support for Israel, which made it possible for this unprecedented agreement to move through Congress seemingly unaffected by the growing opposition to trade liberalization in general. Given its unique backing by US politicians, Israel was probably the best candidate to be the first partner in a US free trade agreement.

## **The Bumpy Road Toward Liberalization**

The road to free trade between the United States and Israel was filled with obstacles thrown up by both countries. First of all, the Israeli economy is much more dependent on international trade than is the US economy. Between 1981 and 1985, total trade accounted for approximately two-thirds of Israeli GDP—Israeli imports accounted for 40 percent of GDP and exports about 23 percent. By contrast, imports and exports combined accounted for less than 20 percent of US GDP over the same period, although the United States had much lower barriers to imports than Israel. Thus, from the outset, the Israeli economy was much more sensitive to the dislocations that might result from increased import competition than the United States.

This imbalance was also present in the countries’ trade policies. Prior to the signing of the US-Israel FTA, most Israeli products were already afforded preferential treatment in the US market, primarily under the GSP (though, as noted above, Israel was facing probable graduation from the program in the mid-1980s). US goods were afforded no preferential treatment in Israel.

The opening of the market to imports from Europe placed further pressure on Israeli producers. In attempting to secure export markets—an effort made necessary because of the Arab boycott and Israel’s chronic balance of payments deficits—Israel entered into a free trade agreement with the European Community in 1975. Under the structure of that agreement, the European Community agreed to immediately lower its barriers to Israeli exports. In exchange, Israel agreed to lower its barriers to European exports by the end of a 10-year period. The design of this unequal schedule of tariff reductions was clearly to Israel’s advantage.

In direct contrast to the EC-Israel agreement, the US-Israel agreement called on both parties to follow a schedule of *simultaneous* tariff reductions. Given the differences in the structure of the two economies, these reductions placed more pressure on the Israeli economy than on the US economy.

The bottom line is that the Israeli economy faced considerable pressure from the increased competition that resulted when barriers to exports from Europe and the United States were reduced. These two markets accounted for more than two-thirds of Israel’s imports. It is therefore no surprise that the road to trade liberalization was much more bumpy in Israel than in the United States. Israeli trade negotiators had to deal with various forms of “administrative protection,” including the method used by Israel in calculating the value of its imports on which it placed tariffs, as well as other import fees and licensing requirements. There was considerable delay in negotiating the removal of tariffs from the most sensitive products.

At the same time that Israel was struggling with meeting its international trade obligations, the United States began negotiating free trade agreements—first with Canada, and later with Mexico—under the North American Free Trade Agreement. Though US policymakers did draw on their experience in negotiating the US-Israel FTA, the magnitude of the issues covered by the new agreements meant that those lessons were of limited applicability. The US-Canada FTA and later NAFTA were much more far-reaching than the US-Israel agreement, going beyond trade in industrial goods to also cover agriculture, services, and investment. The US-Israel agreement quickly became obsolete—a circumstance that caused some frustration in Israel, as it wanted to ensure that its deal was as good as, if not better than, any other deal.

Although Israel and the United States met their respective obligations under the agreement, the existence of the US-Israel FTA has not removed all trade conflicts between the two countries. In addition to issues related to its implementation, a considerable amount of trade, as noted above, was not covered by the agreement. Article VI of the agreement allows both countries to maintain nontariff barriers on domestically produced agricultural products. Accordingly, in 1996 the United States and Israel signed the Agreement on Trade in Agricultural Products (ATAP), which provided for

gradual and steady liberalization of trade in food and agricultural products. The initial agreement was effective for five years, through the end of 2001, and was subsequently extended for another year. Negotiations are currently under way concerning the future of the agreement.

Protection of intellectual property has long been a source of tension between the United States and its trading partners. As a member of the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO), and as signatory to several international agreements, Israel has agreed to meet certain obligations regarding the protection of intellectual property. But in Israel, as in many countries, there are numerous instances of intellectual property and copyright abuses. Although Israeli law protects intellectual property rights, the US government has complained that enforcement of those laws has been inadequate. Accordingly, the Office of the US Trade Representative (USTR) placed Israel on the Special 301 Priority Watch List. After taking some steps to address these abuses, in 2003 Israel was removed from the Priority Watch List and placed back on the Watch List.

## Rules of Origin

The method used to determine a product's national identity is obviously central to any preferential trade agreement. By the terms of the US-Israel FTA, any product meeting any one of the following three criteria is considered of Israeli origin:<sup>2</sup>

- It is wholly grown, produced, or manufactured in Israel.
- It is "substantially transformed" in Israel into a new and different article from the article or material from which it was made.
- The sum of the cost or value of the materials produced in Israel plus the direct costs of processing operations performed in Israel is not less than 35 percent of its appraised value at the time it enters the United States. The use of US materials to produce goods in Israel has no effect on origin if their value is no more than 15 percent of the value of the article.

The rules of origin set out in the US-Israel FTA are considered to be the most liberal of those in all US trade agreements to date. The US-Israel FTA is also the only agreement that does not have special rules of origin for textiles and apparel.

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2. I am grateful to Erik Autor of the National Retail Federation for his coherent summary of the rules of origin included in various US trade agreements.

**Table 3.1 Average annual growth of Israeli exports, 1986–2000**  
(percent)

	1986–90	1991–95	1996–2000	1986–2000
Total	13.9	9.9	11.1	11.6
United States	10.2	10.6	15.8	12.2
European Community	15.9	7.0	7.6	10.2

*Sources:* US Census Bureau, Department of Commerce; and author's calculations.

**Table 3.2 Average annual growth of Israeli imports, 1986–2000**  
(percent)

	1986–90	1991–95	1996–2000	1986–2000
Total	9.6	13.0	5.9	9.5
United States	9.9	14.5	5.1	9.8
European Community	15.7	13.5	1.3	10.1

*Sources:* US Census Bureau, Department of Commerce; and author's calculations.

## Recent Developments in US-Israel Trade Flows

In 1985, when the US-Israel FTA was signed, the value of trade between the two countries was \$4.8 billion, or less than 1 percent of total US trade. Between 1986 and 2000, total Israeli exports grew on average by a little more than 11.5 percent per year. Over the same period, Israeli exports to the United States grew on average by a little more than 12 percent per year, and Israeli exports to the European Community grew on average by a little more than 10 percent per year (see table 3.1). Israeli imports have grown on average by 9.5 percent per year since 1985. During that time, US exports to Israel grew on average by a little less than 10 percent per year, and EC exports to Israel grew on average by a little more than 10 percent per year (see table 3.2).

In 1985, the year before the US-Israel FTA was signed, US exports to Israel accounted for approximately 18 percent of the Israeli market. European exports to Israel were twice as large—almost 40 percent of the Israeli market. The US government was concerned that while it was granting Israel \$3 billion in foreign assistance annually, US companies were being placed at a competitive disadvantage vis-à-vis European companies. The EC-Israel FTA intensified this concern. Under that agreement, Israel agreed to completely eliminate tariffs on EC goods by 1985, 10 years after its signing. This timetable helped to motivate the United States to negotiate the FTA, which was intended to level the playing field for US exporters.

But the existence of the US-Israel FTA does not seem to have significantly changed the market composition of Israeli imports. In 2001, US exports comprised 20 percent and EC exports almost 42 percent of Israeli imports. By contrast, Israeli exports are split almost evenly between the

**Table 3.3 Market concentration of Israeli imports, 1986–2000**  
(annual average, percent)

	1986–90	1991–95	1996–2000	1986–2000
United States	15.7	18.1	19.3	17.7
European Community	48.2	51.6	47.9	49.2
Other	36.2	30.4	32.7	33.1

*Sources:* US Census Bureau, Department of Commerce; and author's calculations.

**Table 3.4 Market concentration of Israeli exports, 1986–2000**  
(annual average, percent)

	1986–90	1991–95	1996–2000	1986–2000
United States	30.1	30.4	34.2	31.6
European Community	33.1	32.3	29.9	31.8
Other	36.9	37.3	35.9	36.7

*Sources:* US Census Bureau, Department of Commerce; and author's calculations.

United States and the EC market. In 1985, the United States and Europe each constituted one-third of Israel's export market; by 2001, those figures were 32 percent for the United States and a little more than 26 percent for the European Community. As tables 3.3 and 3.4 show, the agreement has made little difference in the relative dominance of EC and US trade. Israeli exports to other markets, primarily in the Far East, have increased over the past two decades.

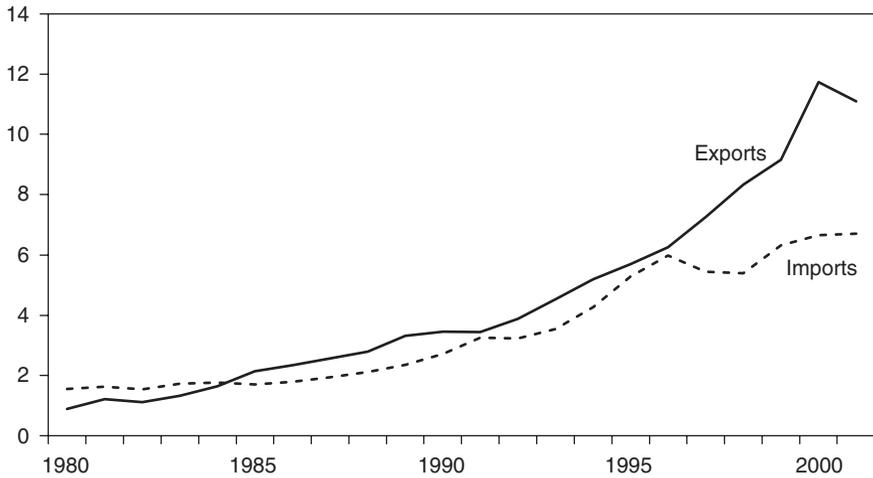
It appears that Israeli exports to the United States have surpassed US exports to Israel since the US-Israel FTA was signed in 1985. Indeed, the United States has consistently recorded a trade deficit with Israel over the past 15 years (see figure 3.1). Various explanations have been given for this disparity:

- Israel is geographically closer to Europe.
- Consumer tastes differ (though this factor is less important today than it was 20 years ago).
- It is not profitable for US exporters to serve the Israeli market, given its small size and limited capacity to serve as a regional supplier.
- Many US firms serve the Israeli market from their European subsidiaries.

The combination of the US-Israel and EC-Israel FTAs appears to have contributed to the increase in Israeli trade. Between 1981 and 1985 Israeli exports grew on average by less than 3 percent a year. Between 1986 and 2000, Israeli exports have grown by more than 11 percent a year. And

**Figure 3.1 Israel's trade with the United States, 1980–2001**

billions of dollars



while Israeli imports grew by less than 1 percent a year between 1981 and 1985, they grew by 9.5 percent a year between 1986 and 2000.

The US-Israel FTA does not seem to have lessened Europe's dominance of Israel's import market: the modest increase in market share by US producers has not affected the ability of European producers to increase their market share. Between 1986 and 2000, the average EC share of the Israeli market remained between two and a half to three times as large as the US share of that market. However, throughout the 1990s, US exports to Israel grew faster, on average, than did EC exports.

On the export side, it appears that Israeli producers have benefited from preferential treatment in the US market. Israeli exports to the United States were a little slow to take off, but since 1990 they have been growing faster than Israeli exports to the European Community. In the late 1980s and early 1990s, most of the increase in Israeli exports went to the European Community. In the late 1990s, exports to the United States made up much of the increase in total Israeli exports. Between 1996 and 2000, Israeli exports grew twice as fast, on average, to the United States as to the European Community. As a result, by the end of the 1990s, Israel was exporting more to the United States than to the European Community.

### **What Do the United States and Israel Trade?**

The growth in US exports to Israel seems to be concentrated in high-technology products. Table 3.5 lists the 10 products that constituted the largest

**Table 3.5 Products contributing most to total growth in US exports to Israel, 1989–2000 (percent)**

Standard International Trade Classification	Share of total change	Own change
79 Transport equipment	17.1	135.7
77 Electrical machinery, apparatus, and appliances	16.1	197.1
72 Specialized machinery	10.2	421.3
87 Professional scientific instruments	7.7	169.8
89 Miscellaneous manufactured articles	5.5	75.8
78 Motor vehicles	3.6	202.4
74 General industrial machinery	3.6	101.6
75 Office machines and automatic data processing equipment	3.6	49.1
33 Petroleum and chemical products	3.3	285.7
54 Medicinal and pharmaceutical products	3.0	491.9

Sources: US Census Bureau, Department of Commerce; and author's calculations.

**Table 3.6 Products contributing most to total growth in US imports from Israel, 1989–2000 (percent)**

Standard International Trade Classification	Share of total change	Own change
77 Electrical machinery, apparatus, and appliances	15.4	297.4
54 Medicinal and pharmaceutical products	11.8	9,340.3
76 Telecommunications equipment	9.4	254.0
93 Special transactions	9.2	686.2
87 Professional scientific instruments	7.4	258.5
89 Miscellaneous manufactured articles	6.6	121.7
84 Articles of apparel and clothing	6.4	258.9
79 Transport equipment	5.3	182.9
65 Textile yarn, fabrics	5.0	634.7
75 Office machines and automatic data processing equipment	3.3	187.1

Sources: US Census Bureau, Department of Commerce; and author's calculations.

share—taken together, three-fourths—of the *increase* in overall US exports to Israel between 1989 and 2000.

The largest gainers in Israeli exports to the United States between 1989 and 2000 were also largely concentrated in high-technology products. Most of the products are similar to those exported to Israel; the exception is textiles and apparel, which the United States does not export to Israel. The 10 products listed in table 3.6 constituted almost 80 percent of the increase in US imports from Israel between 1989 and 2000.

### The “Elastic” Free Trade Agreement

One of the negative consequences of the US-Israel FTA was that it discriminated against economies that the United States was interested in assisting.

Though not much of a problem in the agreement's early years, more recently this discrimination has come into direct conflict with other US foreign policy objectives in the region.

At the time the agreement was signed in 1985, Israel exercised absolute control over territories occupied by Palestinians. A large share of Palestinians worked within Israel's pre-1967 borders, and others were employed in Palestinian-owned enterprises within the West Bank and the Gaza Strip. All Palestinian products were exported through Israel, regardless of their final destination. Under this arrangement, the US-Israel FTA technically covered Palestinian products manufactured within the existing borders of Israel.

The first intifada—the violent uprising against Israeli control of Palestinian territories—began in December 1987, two and a half years after the agreement was signed. Security concerns made it increasingly difficult for Palestinians to export their products through Israeli markets. The European Union assisted the Palestinians in setting up “direct exports”—that is, separating Palestinian from Israeli exports. The US-Israel FTA did not allow for similar treatment.

This issue took on more urgency during the Oslo peace process in the 1990s. Establishing Palestinian authority over certain territories was one of the Oslo objectives. But US law restricts the provision of trade preferences only to sovereign nations. This conundrum was particularly troublesome, since promoting Palestinian economic development became a US priority. In a great irony of economic policy, the US-Israel FTA was discriminating against the Palestinians exactly at the time US policy was aimed at promoting Palestinian economic development.

The conundrum was partially addressed in October 1996, with the establishment of the Egyptian and Jordanian-Israeli Qualifying Industrial Zones (QIZs). Like the maquiladoras that operate along the Mexican side of the US border, plants along the Egyptian and Jordanian sides of the Israeli border make products that are afforded preferential trade treatment in order to stimulate economic development. Ideally, plants operating in QIZs might cooperate to some extent with Israeli companies.

To date, fewer than a dozen industrial zones have been established, accounting for approximately \$30 million in exports. Almost three-fourths of those exports have been in apparel and clothing (approximately \$22.4 million). An additional \$7.7 million in exports have been in leather, travel goods, and handbags. The extension of trade preferences to QIZs was a precursor to the establishment of the US-Jordan FTA.

The QIZ initiative also provided an opportunity to amend the US-Israel FTA to include articles grown, produced, or manufactured in the West Bank and the Gaza Strip. The limited availability of data makes the extent to which Palestinian trade has benefited from this arrangement difficult to judge.

## Evaluation of the US-Israel FTA

The US-Israel FTA has met many of the initial goals set out by the two countries:

- It provided the United States a means to display its strong support for Israel without providing additional financial assistance. In fact, the agreement supported Israeli efforts at economic reform and liberalization, thereby strengthening the Israeli economy and reducing its long-term dependence on foreign assistance. The US-Israel FTA became an important part of Israel's efforts to liberalize its economy in the 1990s.
- Although US producers have increased their exports to Israel, the Israeli market continues to be dominated by Europe. In that regard, US efforts to level the playing field, with an eye to the EC-Israel FTA, have had little effect.
- At the same time, Israeli exporters have made significant inroads into the US market. Israeli products still constitute less than 1 percent of US imports, but Israel's share of the US market has increased by 140 percent since the agreement was signed.
- The US-Israel FTA gave the US Trade Representative an opportunity to learn about negotiating free trade agreements. However, this experience proved to be of limited value during the US-Canada FTA and NAFTA negotiations, which covered a vastly larger amount of trade and far more complicated issues.
- The signing of subsequent free trade agreements raises the question if there should be some kind of "most favored" FTA. All countries want to have the best deal (an impossible goal, unless all agreements are identical). For example, Israel continues to believe that Canada and Mexico got "better deals," and it has been asking the United States to update their agreement accordingly.
- A side benefit of the US-Israel FTA has been its use by US negotiators as a convenient tool with which to threaten other nations when multilateral negotiations seem about to stall. The United States' threat of possibly pursuing bilateral agreements, as it had done with Israel (and, more important, with Canada and Mexico), may have had some effect in pressuring others to move forward on multilateral trade negotiations. Conversely, Israeli trade negotiators firmly believe that the US-Israel FTA has strengthened their ties to the multilateral system.
- The experience of the US-Israel FTA suggests that free trade agreements may require more effort than originally anticipated. Even though Israel's economy is small and the agreement did not cover all aspects

of bilateral trade, the agreement shifted a great deal of attention on trade policy issues. The US-Israel FTA therefore brought to light certain practices in the United States and Israel that might otherwise have been little heeded.

- One of the most important lessons of the US-Israel FTA is that an agreement designed to strengthen ties between two countries may unintentionally conflict with other foreign policy objectives. In this case, the US-Israel FTA discriminated against Palestinian products at just the time when the United States desired to promote Palestinian economic development. As a result, the US-Israel FTA was amended to extend coverage to the West Bank and the Gaza Strip, and later another agreement was negotiated between the United States and Jordan.

## The US-Jordan FTA

The US-Jordan FTA is a direct outgrowth of the US-Israel FTA. By the end of the 1990s, the United States found itself wishing to provide assistance to Jordan for reasons somewhat similar to those that existed almost two decades earlier regarding Israel. President Clinton was looking for a way to reward King Hussein for his cooperation in the Oslo peace process—in particular, for his mediating role between Israel and the Palestinians during negotiations at Camp David. In addition, the United States wanted to keep Jordan in the peace process.

King Hussein died soon after the Camp David meeting and his eldest son, Abdullah, succeeded him. During his first official visit to Washington, on June 6, 2000, King Abdullah II and President Clinton announced the beginning of negotiations for a free trade agreement. Once again, a free trade agreement was being used primarily as a tool of foreign policy. Moreover, a full-fledged free trade agreement would remove any remaining discrimination against Jordan that had resulted from the US-Israel FTA.

Despite the clear emphasis on the foreign policy objective, economic objectives did come into play once the agreement was being negotiated. Then-US Trade Representative Charlene Barshefsky outlined the following US goals in pursuing the US-Jordan FTA:

- to encourage regional economic integration,
- to support Jordan's economic reform, and
- to develop a model for free trade agreements.<sup>3</sup>

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3. Testimony by Ambassador Charlene Barshefsky before the Senate Finance Committee, March 20, 2001 (US Congress 2001, 6).

In contrast to the motivation for the US-Israel FTA, the proposed US-Jordan FTA was not seen as a wedge in the bilateral versus multilateral debate. For one thing, this time the holdup to starting multilateral negotiations was here at home—President Clinton had been unsuccessful for seven years in winning congressional authorization for entering into international trade negotiations. By contrast, in the mid-1980s, when the prospect of bilateral agreements, starting with the US-Israel agreement, was used by the United States to pressure the multilateral system, the other major trading partners were the source of the problem. In the 1990s, the holdup to starting multilateral negotiations was at home. For seven years, President Clinton was unable to win fast-track negotiating authority from Congress, which significantly contributed to the delay in starting multilateral negotiations.

To attract Democratic congressional support for further trade liberalization, President Clinton included provisions to protect the environment and labor standards in the US-Jordan FTA. His bold stroke made the US-Jordan FTA probably one of the most important trade policy precedents of his administration—and it occurred less than three weeks before the Bush administration began.

There were risks in adding provisions on the environment and labor. By doing so, the Clinton administration hoped to win back the support of Democrats who, following the president's unsuccessful attempt to win approval of fast-track trade negotiating authority in 1997, claimed to be holding trade policy "hostage" until such stipulations were made. Yet their inclusion in the agreement might have cost Republican support for this and future congressional battles. More important, a Republican move to torpedo the deal would be a great foreign policy embarrassment for the United States.

In the end, once again, foreign policy interests overshadowed the trade policy debate. By early fall of 2001, the US-Jordan FTA—with its environmental and labor provisions intact—passed both the House of Representatives and the Senate by voice vote.

The US-Jordan FTA is more comprehensive than the US-Israel FTA, covering the following areas:

- ***Trade in goods:*** The agreement calls for the elimination of almost all tariffs within 10 years, phased out in four stages: (1) tariffs of less than 5 percent, within 2 years; (2) tariffs between 5 and 10 percent, within 4 years; (3) tariffs between 10 and 20 percent, within 5 years; and (4) tariffs above 20 percent, within 10 years.
- ***Trade in service:*** The agreement aims to open the Jordanian market to US service providers.
- ***Intellectual property rights:*** Jordan agrees to ratify and implement the WIPO Copyright Treaty and the Performances and Phonograms Treaty within two years.

**Table 3.7 US trade with Jordan, 1996–2002**  
(millions of dollars)

Year	Exports	Imports	Balance
1996	345.2	25.2	320.0
1997	402.5	25.3	377.2
1998	352.9	16.4	336.5
1999	275.6	30.9	244.7
2000	316.7	73.3	243.4
2001	339.0	229.1	109.9
2002	404.4	412.2	-7.8

*Sources:* US Census Bureau, Department of Commerce; and author's calculations.

- ***The environment:*** The agreement includes a specific provision linking trade liberalization to environmental protection (see below).
- ***Labor:*** The agreement includes a specific provision, similar to that dealing with the environment, linking trade liberalization to protection of labor standards (see below).
- ***Electronic commerce:*** The agreement is the first to include specific language committing both parties to promoting a liberal environment for electronic commerce.
- ***Safeguard measures and dispute settlement:*** Although most disputes are to be handled through direct consultations between the two parties, the agreement establishes a dispute settlement process. If consultations are unsuccessful, a dispute settlement panel can be asked to prepare a nonbinding report. The affected country can take appropriate measures if the parties are still unable to resolve a dispute after the panel has issued its report.
- ***Joint committee:*** The agreement establishes an organization, composed of representatives from the United States and Jordan, that is designed to supervise the implementation of the agreement.

## US-Jordanian Trade Flows

In 2000, when the US-Jordan FTA was signed, total trade between the two countries amounted to \$390 million. US exports to Jordan accounted for less than half of 1 percent of total US exports and a little less than 10 percent of total Jordanian imports. US imports from Jordan accounted for approximately one-tenth of total US imports and 5 percent of total Jordanian exports. The value of US-Jordanian trade was clearly very small.

Table 3.7 presents data on US-Jordan exports and imports from 1996 to 2002. The level of trade was fairly constant throughout the period, until US imports from Jordan began to sharply increase in 2001. US imports

**Table 3.8 Top US exports to Jordan, 2002** (millions of dollars)

Standard International Trade Classification	Value	Share (percent)
04 Cereals	53.5	13.2
79 Transport equipment	46.4	11.5
89 Miscellaneous manufactured articles	43.1	10.7
77 Electrical machinery	27.5	6.8
76 Telecommunications	22.1	5.4
74 General industrial machinery	18.1	4.5
78 Road vehicles	16.9	4.2
87 Professional and scientific equipment	16.0	4.0
42 Fixed vegetable fats and oils	15.8	3.9
75 Office machines and automatic data processing equipment	13.9	3.4

Sources: US Census Bureau, Department of Commerce; and author's calculations.

**Table 3.9 Top US imports from Jordan, 2002** (millions of dollars)

Standard International Trade Classification	Value	Share (percent)
84 Apparel	384.2	93.2
89 Miscellaneous manufactured articles	13.9	3.4
54 Medicinal and pharmaceutical products	1.9	0.5
27 Crude fertilizers	1.7	0.4
74 General industrial machinery	0.9	0.2
65 Textile yarn and fabrics	0.8	0.2
83 Travel goods and handbags	0.7	0.2
55 Essential oils	0.6	0.1
72 Special machinery	0.5	0.1
66 Nonmetallic mineral manufactures	0.5	0.1

Sources: US Census Bureau, Department of Commerce; and author's calculations.

from Jordan grew threefold between 2000 and 2001, and nearly doubled again between 2001 and 2002. Although it is impossible to draw any definite conclusions from two years of data, the US-Jordan FTA may have already begun to benefit Jordanian exports to the United States, much as the US-Israel FTA has benefited Israeli exports.

### What Do the United States and Jordan Trade?

Trade between the United States and Jordan seems to be more diverse than that between the United States and Israel. Table 3.8 presents the top 10 US exports to Jordan in 2000, which account for more than two-thirds of all US exports to Jordan. The products include some food and some basic manufactured goods.

Apparel accounts for almost all of Jordan's exports to the United States (see table 3.9). This raises some concern in trade policy circles, since the US apparel industry has experienced severe dislocations—both plant closings

### **Box 3.1 Textile and apparel rules of origin included in the US-Jordan FTA**

#### **Basic rules**

The country of origin is that country in which the textile or apparel product is wholly obtained or produced.

- For fabric, it is the country where the yarns, etc., are woven, knitted, or otherwise made into fabric.
- For any other textile/apparel product, it is the country where the product is wholly assembled from its component pieces.

#### **Special rules**

The country of origin is determined

- *For knit products:* by where the product is knit-to-shape.
- *For certain flat goods made from cotton, wool, or fiber blends containing 16 percent or more of cotton:* by where the fabric is made.
- *For certain flat goods made from silk, cotton, man-made fibers, and vegetable fibers:* by where dyeing, printing, and two or more finishing operations take place.

*Source:* Provided to author by Erik Autor, National Retail Federation.

and mass layoffs—over recent years. Although the volume of imports coming from Jordan remains quite small, US trade negotiators were sensitive about this issue when the US-Jordan FTA was drafted, and special rules of origin for textiles and apparel were included in the agreement.

## **Rules of Origin**

The general rules of origin under the US-Jordan FTA are identical to those included in the US-Israel FTA, with the major exception of textiles and apparel, which follow the Breaux-Cardin rules. These also serve as the general rules of origin for all trade in textiles and apparel not covered by special agreements (see box 3.1).

## **Environmental and Labor Provisions**

The great precedent in the US-Jordan FTA was the inclusion, in the text of the agreement itself, of specific (and parallel) provisions concerning environmental and labor issues.

At the core of the environmental provision is the recognition that “it is inappropriate to encourage trade by relaxing domestic environmental laws.” At the same time, the US-Jordan FTA acknowledges the right of each country to establish its own environmental laws and policies. It goes

on to state that “a Party shall not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties” (USTR 2000, 9).

The substance of the environmental provision in the US-Jordan FTA is almost identical to that included in NAFTA. The primary difference is that the US-Jordan FTA places it in the actual body of the agreement, thereby making it subject to the general dispute settlement mechanism set out in the agreement. By contrast, under NAFTA, the environment provision is relegated to a side agreement, where it must rely on its own dispute settlement mechanism.

The dispute settlement procedure in the US-Jordan FTA sets out several steps:

1. First, both parties must attempt to resolve disputes through direct consultations.
2. If the dispute remains unresolved after 60 days, either party can refer the issue to the joint committee.
3. If the dispute is not resolved by the joint committee within 90 days, the parties can appoint a three-member panel, which can make a non-binding recommendation.
4. Within 90 days after the panel makes its nonbinding recommendation, the joint committee “shall endeavor to resolve the dispute, taking the panel report into account, as appropriate.”
5. If the joint committee’s efforts do not resolve the dispute within 30 days, “the affected Party shall be entitled to take any appropriate and commensurate measure” (USTR 2000, 17–18).

Table 3.10 compares the provisions concerning the environment in the US-Jordan FTA, NAFTA, and the North American Agreement on Environmental Cooperation (NAAEC)—the NAFTA side agreement.

The provision relating to labor issues is very similar to that dealing with the environment. It, too, is included in the text of the US-Jordan FTA and is subject to the dispute settlement procedures set forth in the agreement. The labor provision sets out three requirements:

- Each country must enforce its own labor laws in manners that affect trade, and those labor laws must reflect both “internationally recognized labor rights” as defined by the Trade Act of 1974, as amended, and core labor standards as defined by the International Labor Organization.
- The parties agree not to relax their own labor laws in order to encourage trade with the other party.

**Table 3.10 Comparison of US-Jordan FTA, NAFTA, and NAAEC: Key environmental provisions**

Provision	US-Jordan FTA		NAFTA	NAAEC
	Relaxation of laws to attract investment	<p>Article 5.1. The Parties recognize that it is inappropriate to encourage trade by relaxing domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws as an encouragement for trade with the other Party.</p>	<p>Article 1114.2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, each Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that another Party has offered such an encouragement, it may request consultations with the other Party and the two Parties shall consult with a view to avoiding any such encouragement.</p>	<p>Article 1114.1. Nothing in this Chapter (on investment) shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with the Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.</p>
Adoption of environmental measures: Levels of protection	<p>Article 5.2. Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws, each Party shall strive to ensure that its laws provide for high levels of environmental protection and shall strive to continue to improve those laws.</p>	<p>Article 3. Recognizing the right of each Party to establish its own levels of domestic environmental protection and environmental development policies and priorities, and to adopt or modify accordingly its environmental laws and regulations, each Party shall ensure that its laws and regulations provide for high levels of environmental protection and shall strive to continue to improve those laws and regulations.</p>		

<p>Effective enforcement of environmental laws: Obligation</p>	<p>Article 5.3(a). A Party shall not fail to effectively enforce its environmental laws, through a sustained or recurring course of action or inaction, in a manner affecting trade between the Parties, after the date of entry into force of this Agreement.</p>	<p>No comparable provision.</p>	<p>Article 5.1. With the aim of achieving high levels of environmental protection and compliance with its environmental laws and regulations, each Party shall effectively enforce its environmental laws and regulations through appropriate governmental action, subject to Article 37... Article 37: Nothing in the Agreement shall be construed to empower a Party's authorities to undertake environmental law enforcement activities in the territory of another Party.</p>
<p>Effective enforcement of environmental laws: Exercise of discretion</p>	<p>Article 5.3(b). The Parties recognize that each Party retains the right to exercise discretion with respect to investigatory, prosecutorial, regulatory, and compliance matters and to make decisions regarding the allocation of resources to enforcement with respect to other environmental matters determined to have higher priorities. Accordingly, the Parties understand that a Party is in compliance with subparagraph (a) where a course of action or inaction reflects a reasonable exercise of such discretion, or results from a <i>bona fide</i> decision regarding the allocation of resources.</p>	<p>No comparable provision.</p>	<p>Article 45.1. For the purposes for this Agreement: A Party has not failed to "effectively enforce its environmental law" or to comply with Article 5(1) in a particular case where the action or inaction in question by agencies or officials of that Party: (a) reflects a reasonable exercise of their discretion in respect of investigatory, prosecutorial, regulatory or compliance matters; or (b) results from a <i>bona fide</i> decision to allocate resources to enforcement in respect of other environmental matters determined to have higher priorities.</p>

NAFTA = North American Free Trade Agreement  
 NAAEC = North American Agreement on Environmental Cooperation  
 Source: Tiemann (2001).

- What counts as effective enforcement of labor laws allows for a “reasonable exercise of . . . discretion” and “bona fide decision[s] regarding the allocation of resources” (USTR 2000, 10).

The labor provisions are covered by the same dispute settlement procedure discussed above. Table 3.11 presents a comparison of the labor provisions in the US-Jordan FTA and in NAFTA.

## The Congressional Debate

By including the articles on labor and the environment in the body of the agreement, and thereby making these provisions subject to the agreement’s dispute settlement procedures, the US-Jordan FTA set two precedents. Both set off considerable controversy within Congress. Liberal Democrats, while continuing to oppose efforts to provide broader trade promotion authority (TPA) to the president, applauded the inclusion of these provisions, under the umbrella of the normal dispute settlement process, as an integral part of the US-Jordan FTA. Many Republicans, on the other hand, threatened to defeat any legislation that linked international trade to environmental and labor standards.

Because President Clinton submitted the agreement to Congress three weeks before leaving office, the Bush administration found itself in the odd position of advocating in favor of the US-Jordan FTA, despite its opposition to the agreement’s inclusion of provisions on the environment and labor. In addition to threatening the administration’s efforts to win congressional approval of TPA, the controversy over these provisions threatened to create an embarrassing foreign policy debacle for the United States: at one point it seemed possible that Congress might not approve the agreement already signed by President Clinton and by the Jordanian government.

A compromise was reached and on July 23, 2001, the Jordanian Ambassador to the United States and US Trade Representative Robert Zoellick exchanged identical letters. These made clear that the phrase “appropriate and commensurate measures” in the description of the dispute settlement procedures did not mean sanctions. Furthermore, the two countries agreed to settle any differences they might have through consultations, rather than through the formal dispute settlement process. The letters also stated that each government “would not expect or intend to apply the Agreement’s dispute settlement enforcement procedures . . . in a manner that results in blocking trade.”

Within days after the exchange of letters, the House of Representatives approved the US-Jordan FTA by voice vote. The Senate followed suit several weeks later, after debating whether the US-Jordan FTA should serve as a model for future free trade agreements.

**Table 3.11 Comparison of labor provisions in the US-Jordan FTA and NAFTA**

Provision	US-Jordan FTA, Article 6	NAFTA (PL 103-182) (in side agreement)
<b>Rights of workers</b>	<p>"Internationally recognized labor rights" from Trade Act of 1974 (PL 93-618 as amended by sec. 503 of PL 98-573):</p> <ul style="list-style-type: none"> <li>a) right of association</li> <li>b) right to organize and bargain collectively</li> <li>c) prohibition of forced or compulsory labor</li> <li>d) minimum age for employment of children</li> <li>e) acceptable conditions re minimum wages, hours, and occupational safety and health</li> </ul> <p>Core labor standards from the International Labor Office (ILO):</p> <ul style="list-style-type: none"> <li>a) freedom of association</li> <li>b) right to organize and bargain collectively</li> <li>c) prohibition on the use of forced labor</li> <li>d) prohibition of exploitative child labor</li> <li>e) prohibition of employment discrimination</li> </ul>	<p>"Internationally recognized labor rights" from Trade Act of 1974 plus the following additions:</p> <ul style="list-style-type: none"> <li>f) the right to strike</li> <li>g) minimum employment standards relating to overtime pay</li> <li>h) elimination of employment discrimination</li> <li>i) equal pay for men and women</li> <li>j) compensation in case of occupational injuries and illnesses</li> <li>k) protection of migrant workers</li> </ul>
<b>Basic labor requirements</b>	<p>All countries must enforce their own labor laws and standards in trade-related situations. Each party shall strive to "not waive or otherwise derogate from" its laws as an encouragement for trade.</p>	<p>All countries must enforce their own labor laws and standards in trade-related situations and shall strive toward the entire list of worker rights. No comparable provision.</p>

*(table continues next page)*

**Table 3.11 Comparison of labor provisions in the US-Jordan FTA and NAFTA (continued)**

Provision	US-Jordan FTA, Article 6	NAFTA (PL 103-182) (in side agreement)
<b>Which worker rights are subject to dispute resolution?</b>	<p>All of them</p> <p>No comparable provision</p>	<p>Only 3 standards out of 11 (for child labor, minimum wages, and occupational safety and health) are enforceable through dispute settlement and ultimately sanctions.</p> <p>Dispute resolutions may be undertaken only for failure to enforce one's own labor rights laws and regulations, and if alleged failure to enforce is trade-related and covered by mutually recognized labor laws.</p>
<b>Enforcement body and dispute resolution procedure</b>	<p>Each country shall designate an office to serve as a contact point on the agreement.</p> <p>Any issue not resolved through consultation within 60 days may be referred to a <b>joint committee</b>, and, if still not resolved within 90 days, to a <b>dispute settlement panel</b> chosen by the parties.</p>	<p>Trade ministers (Ministerial Council) meet occasionally, supported by a 15-member Secretariat to resolve issues with consultation and persuasion.</p> <p>In each country a <b>national administrative officer (NAO)</b> oversees the law. An <b>evaluation committee of experts (ECE)</b> and subsequently an <b>arbitral panel (AP)</b> are appointed as needed to debate cases.</p>
<b>Ultimate penalties</b>	<p>If the issue is still not resolved in 30 days, after the panel issues a report, the affected party may take "any appropriate and commensurate measure."</p>	<p>The AP may issue a monetary assessment; and if this is not paid, issue sanctions. <b>Maximum penalties:</b> suspension of NAFTA benefits to the amount of the monetary penalty (which may be no greater than NAFTA benefits from tariff reductions)</p>

Source: Bolle (2002).

## Lessons from the US-Jordan FTA

There has barely been enough time since the US-Jordan FTA was signed in October 2000 for the ink to dry, let alone for the agreement to have had any serious impact on bilateral trade flows.<sup>4</sup> It is therefore premature to make any comments on the agreement's effectiveness in that regard.

Yet the US-Jordan FTA may have had a more immediate impact on US trade policy. Some argue that the passage of this agreement, with its environmental and labor provisions subject to rigorous dispute settlement, may have helped facilitate congressional passage of the Trade Act of 2002, which granted the president TPA.

The long-term impact of the US-Jordan FTA on US trade policy has yet to be seen. The US-Chile and US-Singapore FTAs, the only other bilateral agreements signed since its enactment, include similar language on the environment and labor, though their dispute settlement procedures are less stringent. Both agreements also borrow from the US-Jordan FTA and from the subsequent exchange of clarifying letters.

## Conclusions and Questions for the Future

A number of conclusions and lessons can be drawn from the US-Israel and US-Jordan FTAs:

- Both the US-Israel and US-Jordan agreements unambiguously exemplify the use of free trade agreements as tools of foreign policy. In each case, the foreign policy objectives far outweighed the economic objectives as the United States entered into the agreement.
- Both agreements were used to pursue broader trade policy objectives:
  - The US-Israel agreement was the first US bilateral free trade agreement, passed largely because of the special relationship between the two countries. Yet the United States was able to use the FTA's passage—the suggestion that it could pursue other bilateral trade agreements—as leverage in stalled multilateral negotiations.
  - The US-Jordan agreement was the first to include specific provisions on labor and the environment. The US-Jordan FTA may thus have helped to win congressional passage of trade promotion authority in 2002.

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4. Jordanian exports to the United States—which had already received preferential treatment prior to the agreement—grew threefold between 2000 and 2001. Though US exports to Jordan grew by 19 percent between 2001 and 2002, the level reached was similar to that of 1997 (well before the agreement was contemplated).

- Both Israel and Jordan, in the Middle East, rank high on the US foreign policy agenda. As the United States fashioned agreements with both, foreign policy interests far exceeded domestic economic sensitivities.
- The fact that both Israel and Jordan are small countries, accounting for a small share of US trade, raised particular issues in negotiating and implementing the agreements.
- Strong congressional support, enjoyed by both Israel and Jordan, lowered political resistance to these trade-liberalizing agreements and made them good candidates to set trade policy precedents.
- Both Israel and Jordan were undergoing internal economic reforms and trying to liberalize their economies at the time each FTA was negotiated. The US-Israel FTA provided some assistance to Israeli policymakers in overcoming domestic opposition to market liberalization, but it is too early to tell whether the US-Jordan FTA will do likewise.
- Both agreements were of more economic benefit to their partner than to the United States.
- Both agreements helped the United States to move along the FTA learning curve, although the experience it gained was of limited and short-lived value.
- Both agreements focused more attention on bilateral trade policy issues than the actual amount of trade warranted (and thus focused more attention than would have been given in the absence of the negotiations).
- Because there is very little boilerplate in free trade agreements—each FTA must take into account the nuances of the other country—they enjoy few economies of scale. In this respect, the US-Israel and US-Jordan agreements have provided little assistance in subsequent negotiations. There is one possible exception: the provisions on labor and the environment included in the US-Jordan agreement may serve as a model for future FTAs.
- FTAs are highly “USTR-intensive.” Because each agreement has to take into account the nuances of the other country’s situation, the USTR must start from scratch in beginning each negotiation. Because its staffing has not increased significantly over the past several years, the USTR has been forced by the increase in the number of FTAs to divert resources away from other functions. This strain is especially troubling in the functional areas, such as intellectual property rights.
- FTAs discriminate against other countries, potentially working against US efforts to assist those countries. For example, the US-Israel FTA initially discriminated against Palestinians. The later expansion of

agreement to cover Palestinian trade resulted in discrimination against Jordan. The US-Jordan FTA, in turn, discriminates against Egypt and all other countries in the region and elsewhere that do not have FTAs with the United States.

- To use a biblical metaphor, FTAs may beget more FTAs. Negotiating FTAs is an endless process. To address their inherent discrimination, the number of countries with which we have an FTA must constantly expand. For example, the US-Israel FTA contributed to the need for the US-Jordan FTA, and has set the stage for some sort of agreement with other Arab countries. This expansion further strains USTR resources.
- One way to address the proliferation of FTAs is to use them as a first step toward regional agreements.<sup>5</sup> The US-Canada FTA is a case in point, paving the way for NAFTA (though NAFTA covers only three countries). Regional agreements have economies of scale and reduce discrimination—but they also run the risk of establishing regional trading blocs. In addition, a country that has signed an FTA with the United States might be reluctant to enter into a regional agreement and share its preferential treatment with its neighbors.
- FTAs become obsolete as soon as they are signed. Most agreements look to the past and do not anticipate the future. In this regard, a ratified FTA signals not the end but rather the beginning of negotiations. Once the agreement is in place, the two countries are obligated to deal with its implementation and new issues that may arise. In addition, FTAs may need to be updated to take into account subsequent FTAs between other countries.

The lessons of the US-Israel and US-Jordan FTAs raise some very important questions:

- What criteria should be used for choosing and negotiating FTAs?
- Should these criteria be transparent?
- Are FTAs deflecting scarce USTR resources away from other (and more important) functions?
- Should all FTAs represent the same deal? Should FTAs include a clause that automatically updates the agreement when subsequent FTAs are signed?
- Do we need an “MFFTA”—a “most favored” FTA?

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5. In fact, a day after I presented the paper on which this chapter is based, President Bush called for the establishment of a Middle East FTA.

The limited experience of the US-Israel and US-Jordan FTAs provides only partial answers to these questions. In both cases, the agreements were primarily motivated by political, not economic, factors. Pending agreements with Bahrain and Morocco seem to follow this pattern. If it continues to hold, then we should expect these agreements to be of limited economic benefit to the United States.

Except for NAFTA, it appears that the volume of bilateral trade has not influenced the US choice of partners in negotiating an FTA. As a result, we are diverting scarce USTR resources away from issues that affect large amounts of trade and devoting them to the negotiations of FTAs, which have little potential economic payoff. From a purely economic standpoint, this strategy seems irrational.

As noted above, signing an FTA marks the beginning of continued monitoring and negotiations. And because each country entering into an FTA will want a better deal than was offered in earlier FTAs, and each signatory of an earlier FTA will want a deal as good as the latest agreement, there will be constant pressure for renegotiation. The cycle will never end unless “all FTAs are created equal”—perhaps through a standard FTA for all countries (i.e., some kind of “most favored” FTA).

Such uniformity in the agreements is unlikely; a second-best solution would be to include a clause in each FTA that calls for updating the agreement once others are signed. Some countries may be unwilling to agree to such a clause, since it would mean that other countries are in effect negotiating on their behalf.

Obviously, one way to deal with all these problems is to stop the proliferation of FTAs and concentrate solely on strengthening the multilateral trade system, affording preferential treatment to all countries on a nondiscriminatory basis and encouraging all countries to abide by internationally agreed upon standards of labor rights, environmental protection, and the like.

Are FTAs worth the effort? Is the prospect of small increases in trade worth all the time and energy spent negotiating the agreement, plus the risk FTAs pose to the multilateral trading system? Based on the limited experience to date, it appears that FTAs benefit the partner countries more than they benefit the United States. Furthermore, the risk to the multilateral system may be greater than any modest returns from FTAs.

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