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Introduction

The United States and Pakistan established diplomatic relations in 1947, shortly after Pakistan gained its independence. Since then, relations have alternated between episodes of close partnership and sharp friction, reflecting the ups and downs of global and regional geopolitics.[1] The tides of foreign policy have correspondingly affected trade and investment.

Post–September 11 diplomacy has now created a strong relationship between Pakistan and the United States. In this new setting, a free trade agreement (FTA) could promote economic reform in Pakistan and thereby strengthen bilateral political ties, which have otherwise been largely based on confronting enemies—first communism, then the Soviet invasion of Afghanistan, and now al Qaeda.

We begin with a short review of the diplomatic history between the two countries. Any proposal for an FTA will stir up, in Pakistan, memories of a checkered bilateral relationship dating back 50 years, and it is useful for American audiences to understand why Pakistani sentiments are strong. US leaders, for their part, will entertain a proposal only if it fits within the larger policy framework of US diplomacy toward the Middle East and South Asia.

In this chapter we offer an overview of the context for a US-Pakistan FTA, including factors such as geographical distance, political impacts, timing, and compliance with Article 24 of the General Agreement on Tariffs and Trade (GATT). We also consider the priority of a US-Pakistan FTA among concurrent multilateral and bilateral negotiations.

1. This introduction draws heavily on Kux (2001).

Diplomatic Ups and Downs

Against the backdrop of the Cold War, Pakistan's strategic geographic position made the country a valuable partner in the Western alliance to contain the spread of communism. Accordingly, during the first decade of the Cold War, Pakistan was considered one of Washington's closest allies in Asia, was a keystone of two security alliances, the Southeast Asia Treaty Organization (SEATO) and the Central Treaty Organization (CENTO),[2] and received nearly $2 billion in US assistance from 1953 to 1961, one-quarter of this in military aid.

However, when the 1965 Indo-Pakistan war erupted, the United States suspended military assistance to both countries. This decision affected Pakistan much more severely than it did India, and generated a widespread feeling in Pakistan that the United States was at best a fair-weather ally.

The next landmark event was the 1971 Indo-Pakistan war. Despite the widely publicized US "tilt" toward Pakistan, the United States did not lift its embargo on arms shipments to the country until 1975. US foreign policy of that era held that the intervention of outside powers should be avoided in the South Asian conflicts—both the civil war that led to the creation of Bangladesh and the ensuing Indo-Pakistan war.

In April 1979, based on concerns about Pakistan's nascent nuclear program, the United States suspended economic assistance (but not food assistance), as required under the Symington amendment to the Foreign Assistance Act of 1961. This amendment called for a halt to economic assistance to countries that were nonnuclear weapon states but nevertheless imported uranium enrichment technology.

The Soviet invasion of Afghanistan in December 1979 turned things around and revived the close relationship between Pakistan and the United States. The two countries shared a common interest in forcing the withdrawal of Soviet forces and fostering peace and stability in South Asia. Under President Ronald Reagan, the United States agreed in 1981 to provide $3.2 billion to Pakistan over a period of six years, divided equally between economic and military assistance. The president invoked a national security clause to waive the Symington amendment, but assistance was still subject to the annual congressional appropriation process.

A second economic and military assistance program was announced in 1986, this time for over $4 billion, with 57 percent for economic assistance (Library of Congress 1994). The ongoing war in Afghanistan ensured presidential waivers of legislative restrictions on aid to countries with possible nuclear weapons programs.

Following the Soviet withdrawal from Afghanistan in 1989 and the end of the Cold War, the United States took a harder line on the nuclear

2. Pakistan joined SEATO and CENTO, the successor of the Baghdad Pact, in 1955.

weapons issue. The Pressler amendment of 1985 required that US assistance to a country be suspended if the president could not certify to Congress, on an annual basis, that the country did not possess a nuclear weapon. For several years, the president, resting on Pakistan's assurances that its nuclear program was solely for peaceful uses, made this certification. But in 1990 President George H. W. Bush, after reviewing intelligence from several sources, was unable to make the required certification and all military assistance and new economic aid to Pakistan were terminated. However, in 1992, when Pakistan suffered devastating floods in the north, the United States relaxed its restrictions to allow food and economic assistance to nongovernmental organizations in Pakistan.

The decision by India to conduct nuclear tests in May 1998, followed by Pakistan's matching response, triggered the next big turning point. Under the mandatory terms of the Glenn amendment, the Clinton administration restricted the provision of credits, military sales, economic assistance, and loans to both governments, as well as credit guarantees to US agricultural exporters.

The overthrow in October 1999 of the democratically elected government of Prime Minister Nawaz Sharif led to an additional layer of US sanctions (under Section 508 of the Foreign Appropriations Act), including restrictions on military financing and economic assistance. Accordingly, US assistance to Pakistan was largely limited to refugee and counternarcotics programs. Although the United States urged General Pervez Musharraf to restore civilian rule, the administration opted to engage the new regime so that strategic concerns—nuclear and missile proliferation, regional instability, and Islamic terrorism—could be addressed.[3]

The terrorist attacks on September 11, 2001, again transformed relations between the two countries. Pakistan's important strategic position bordering Afghanistan, its vital role as a Muslim ally in the US-led "war on terror," and General Musharraf's willingness to support the US military effort in Afghanistan overrode all other US concerns, including the objective of spreading democracy throughout the Muslim world.[4] Remaining US sanctions were lifted in October and November 2001, allowing the United States to support multilateral lending to Pakistan. With US leadership, the Paris Club rescheduled $2.3 billion of Pakistan's debt on

3. While President Bush has called on President Musharraf to deliver free and fair elections in 2007, his efforts have not satisfied US prodemocracy advocates who are deeply suspicious of President Musharraf's intentions, and continue to lobby Congress for a more "muscular" promotion of democracy in Pakistan.

4. According to press reports, General Musharraf's forthcoming memoirs claim that his government was subject to crude pressure by the US State Department to join the post–September 11 alliance. Former Deputy Secretary Richard Armitage has denied the claim ("Musharraf memoirs launched in US," BBC News Online, September 25, 2006).

generous terms and provided up to $1 billion in soft loans and grants.[5] Meanwhile, the United States persuaded the International Monetary Fund (IMF) and the World Bank to extend more than $2 billion of assistance for poverty alleviation and growth over the following three years (Economist Intelligence Unit 2004).

During President Musharraf's visit to the United States in 2003, President George W. Bush announced that the United States would provide Pakistan with $3 billion in economic and military aid over five years, and the assistance package was implemented in 2005. In June 2004, in response to Pakistan's efforts to cement relations over the long term, the United States accorded Pakistan the status of a major non-NATO ally.[6]

In January 2004, the exposure of a nuclear technology proliferation network headed by the renowned Pakistani scientist A. Q. Khan renewed tensions between the United States and Pakistan. Khan admitted to overseeing the illegal transfer of nuclear technology and materials, beginning in 1998, to countries hostile to the United States, including North Korea, Libya, and Iran. Khan was placed under house arrest, but President Musharraf granted him immunity from prosecution because of his prior service in making Pakistan a nuclear power. The Pakistan government denied any involvement in the Khan network and launched its own investigation. In 2005 the government confirmed that Khan had supplied nuclear centrifuges—which can be used to enrich uranium for nuclear weapons—to Iran.[7] In April 2006 the government released the last Pakistani scientist detained for his role in the network, Mohammed Farooq, an action that likely signals the end of Pakistan's investigation. But given current alarms over Iran's nuclear program, Western diplomats and the International Atomic Energy Agency (IAEA) have stated that they do not consider the case closed. The Pakistan government has not allowed the IAEA or investigators from any foreign government access to Khan, nor has any action been taken against members of the network, about a dozen of whom were detained and released by the authorities.[8]

Further frictions erupted in early 2006 when, on January 13, a Central Intelligence Agency (CIA) Predator missile strike targeting al Qaeda sus-

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5. The Paris Club is an informal group of official creditors that find coordinated and sustainable solutions to the payment difficulties experienced by debtor nations. Permanent members are governments with large claims on various other governments throughout the world, including the United States.

6. NATO stands for the North Atlantic Treaty Organization. Non-NATO ally is a special designation by the US government for countries that enjoy close military relations without being NATO members.

7. See "A.Q. Khan Relative Held over Attack," *BBC News,* August 12, 2005, http://news.bbc.co.uk.

8. See Farhan Bokhari and Stephen Fidler, "Pakistan Release Seen as Closing Khan Inquiry," *The Financial Times,* May 3, 2006.

pects in the Bajaur region of Pakistan killed at least 18 civilians. The action took place amid continuing allegations in the American press that terrorists lurking in northwest Pakistan. Pakistani officials said that the intended target of the attack, al Qaeda second-in-command Ayman al-Zawahri, was not at the site, contrary to US intelligence. Although Pakistani intelligence sources claimed that four other al Qaeda leaders may have been killed, their deaths remain unconfirmed. US and Pakistani intelligence circles believe that the Pakistani leadership were forewarned of the attack and that the military's Inter-Services Intelligence (ISI) agency provided information that prompted the CIA to launch the airstrike.[9]

To repair relations following this incident in March 2006 the two countries, following a visit by President Bush to Islamabad, issued a joint statement affirming their long-term, strategic partnership. In addition, President Bush indicated that the United States had dropped its opposition to the proposed gas pipeline from Iran to India via Pakistan. The $6 billion project for the 1,625-mile pipeline will bring gas revenues to Iran, transit fees to Pakistan, and energy to India. The three nations plan to start construction in 2007.

Context for a US-Pakistan FTA

Great distances and sharp differences might seem to argue against a US-Pakistan FTA. Pakistan and the United States do not share a common border or even the same continent. While the United States is one of the foremost advocates of market capitalism, Pakistan began only in 1985 to liberalize its trade and investment regimes (see tables 1.1, 1.2, and 1.3 to compare economic, cultural, trade, and development data). Political institutions have very different origins in the two countries.[10] (See box 1.1 for a brief timeline of political events in Pakistan.) Moreover, in the closing months of the World Trade Organization's (WTO) Doha Development Round,[11] it might not seem sensible to drain diplomatic and legislative energy from the overarching goal of global trade liberalization.

Some observers, in both Pakistan and the United States, will conclude from such observations that a bilateral FTA makes no sense. Others will

9. For details, see David Morgan, "U.S. Targeted-Killings of al Qaeda Suspects Rising," Reuters, January 18, 2006. See also David Morgan and Simon Cameron-Moore, "CIA Unlikely to Back Off al Qaeda Attacks in Pakistan," Reuters, January 29, 2006, available at www.alertnet.org.

10. Since Pakistan's creation in 1947, the army has been the country's most influential institution and the ultimate guarantor of national stability and presidential power. Many Pakistani leaders, like General Musharraf, have come to office with military backgrounds.

11. US trade promotion authority (TPA), as written, expires on June 30, 2007. Therefore, the Doha Development Round should conclude by spring 2007, to be ratified by the US Congress under the existing TPA legislation.

Table 1.1 Comparative indicators, Pakistan and the United States, 2004

Indicator	Pakistan	United States
GDP (billions of dollars)	95.0	11,734.0
GDP per capita (dollars)[a]	455.0	39,959.0
Exports (billions of dollars)	13.4	807.5
Imports (billions of dollars)	16.7	1,472.9
Inward FDI stocks (billions of dollars)	7.6	39,473.9
Outward FDI stocks (billions of dollars)	0.7	2,018.2
Population (millions)[b]	162.4	295.7
Labor force (percent by sector)		
Agriculture	42	1
Manufacturing	20	22
Services	38	77
Literacy (percent)[c]	49	97
Male	62	97
Female	35	97
Life expectancy at birth (years)	63	78
Religious groups (percent of population)		
Muslim	97	1
Sunni	77	n.a.
Shi'a	20	n.a.
Other	3	20
Protestant	n.a.	52
Roman Catholic	n.a.	24
Mormon	n.a.	2
Jewish	n.a.	1

n.a. = not applicable

a. Pakistan data are for 2003, at the market exchange rate.
b. July 2005 estimates.
c. Literacy is defined as age 15 or older and able to read and write.

Sources: OECD Economic Survey: United States, October 2005; Economist Intelligence Unit Country Report: Pakistan, October 2005; UNCTAD, *World Investment Report 2005,* www.unctad.org/wir; CIA World Factbook, Pakistan and the United States, www.cia.gov.

be less critical but question the timing: Why not wait until after the Doha Round is sealed and South Asia gets a better sense of its economic and political direction? Still others will argue that each skeptical question can be turned into an argument for a bilateral FTA. This study will be of most interest to those in the second and third camps—that is to say, observers who do not foreclose the possibility or desirability of a US-Pakistan FTA.

Table 1.2 Pakistan: Trade in goods, 2003
(billions of US dollars and percent)

Country/region	Value	Share
Major export market		
European Union	3.7	30
United States	2.9	24
United Arab Emirates	0.9	8
Hong Kong	0.6	5
Afghanistan	0.5	4
Saudi Arabia	0.3	3
China	0.3	2
Turkey	0.2	2
Bangladesh	0.2	2
Others	2.6	21
Total	12.3	100
Major import source		
European Union	2.4	15
Saudi Arabia	1.8	11
United Arab Emirates	1.7	11
United States	1.3	9
China	1.2	7
Kuwait	1.0	6
Japan	0.9	6
Malaysia	0.6	4
Singapore	0.5	3
Others	4.2	27
Total	15.6	100

Source: Government of Pakistan, Federal Bureau of Statistics, www.statpak.gov.pk (accessed November 9, 2005).

Before launching into the chapters, issue by issue, it's worth seeing how the broader skeptical questions can be addressed.

Is the Geographic and Political Distance Too Great?

To start, can support for an FTA gain traction—given the certainty of economic hurdles between the two countries in agriculture and textiles—if the partners are not steadfast political or military allies and are separated by thousands of miles? Prior to the mid-1990s, FTAs and customs unions were dominated by pacts between countries that were already, or in the process of becoming, political allies—the European Common Market and

Table 1.3 US trade in goods, 2004
(billions of US dollars and percent)

Country/region	Value	Share
Major export market		
Canada	189.9	24
European Union	172.6	21
Mexico	110.8	14
Japan	54.2	7
China	34.7	4
South Korea	26.4	3
Taiwan	21.7	3
Singapore	19.6	2
Hong Kong	15.8	2
Others	161.8	20
Total	807.5	100
Major import source		
European Union	282.0	19
Canada	256.4	17
China	196.7	13
Mexico	155.9	11
Japan	129.8	9
South Korea	46.2	3
Taiwan	34.6	2
Malaysia	28.2	2
Venezuela	24.9	2
Others	318.2	20
Total	1,472.9	100

Source: US Census Bureau, Foreign Trade Statistics, www.census.gov.

then the European Union, the Association of Southeast Asian Nations, the Australia–New Zealand Closer Economic Relations Trade Agreement, the North American Free Trade Agreement, and Mercosur.[12]

In short, experience up to the mid-1990s led many commentators to forecast a three-bloc world: contiguous customs unions and FTAs organized around the European Union, the United States, and Asian powers

12. Unlike its counterparts listed here, the European Free Trade Area (EFTA) was, from its inception, a purely economic venture without the overlay of a political alliance. In a way, it seems to be the exception that proves the rule: In the 1970s, 1980s, and 1990s, several EFTA members peeled off to join the European Union. In 1960, the original members of EFTA were Austria, Denmark, Norway, Portugal, Sweden, Switzerland, and the United Kingdom. Finland joined in 1961, Iceland in 1970, and Liechtenstein in 1991. In 1973, the United Kingdom and Denmark left EFTA to join the European Communities. They were followed by Portugal in 1986, and by Austria, Finland, and Sweden in 1995, leaving only Iceland, Liechtenstein, Norway, and Switzerland as members in 2005.

Box 1.1 Timeline of political events in Pakistan

Year	Event
1947	Formation of East and West Pakistan.
1948	War with India over disputed territory of Kashmir. Muhammed Ali Jinnah, the first governor general of Pakistan, dies.
1951	Jinnah's successor, Liaquat Ali Khan, is assassinated and military rule is established.
1954	Amid concerns about Soviet expansion, the United States and Pakistan sign a mutual defense agreement.
1955	Pakistan joins the Southeast Asia Treaty Organization (SEATO) and the Central Treaty Organization (CENTO).
1958	Martial law declared; General Ayub Khan becomes de facto president. The United States and Pakistan sign a cooperation agreement.
1960	General Ayub Khan is elected president.
1965	Second war with India over Kashmir. President Ayub Khan wins reelection.
1969	President Ayub Khan resigns and General Yahya Khan (no relation) becomes president.
1971	East Pakistan attempts to secede, leading to civil war and the creation of Bangladesh. The third Indo-Pakistani conflict ensues.
1973	Zulfiqar Ali Bhutto becomes prime minister.
1977	Allegations of vote rigging by Bhutto's Pakistan People's Party (PPP) lead to widespread rioting. General Zia ul-Haq stages military coup.
1978	General Zia becomes president.
1985	Martial law and ban on political parties is lifted.
1988	General Zia, the US ambassador and top Pakistani army officials die in an airplane crash of mysterious origin.
1988	Benazir Bhutto, Zulfiqar Ali Bhutto's daughter, and the PPP win general election. Benazir Bhutto becomes prime minister.
1990	Benazir Bhutto is dismissed as prime minister on charges of incompetence and corruption. Nawaz Sharif becomes prime minister.
1993	President Ghulam Ishaq Khan and Prime Minister Sharif both resign under pressure from the military. A general election brings Benazir Bhutto back to power.
1996	The Benazir Bhutto government falls again in the wake of corruption allegations. Nawaz Sharif assumes power.
1997	A general election brings Nawaz Sharif back to power.
1999	Prime Minister Sharif is overthrown in a bloodless military takeover led by General Pervez Musharraf.

(box continues next page)

Box 1.1 Timeline of political events in Pakistan *(continued)*

Year	Event
2001	General Musharraf names himself president while remaining head of the army. Parliament is dissolved.
2002	General elections are held. President Musharraf wins another five years in office in a referendum.
2003	The centrist Pakistan Muslim League (Q) assumes power under Prime Minister Mir Zafarullah Khan Jamali.
2004	General Musharraf announces that he will retain his military role. In August, former Citibank executive Shaukat Aziz is sworn in as prime minister.
2005	General Musharraf declares that he will seek reelection as president when his term expires in 2007.

(China and/or Japan). FTAs came to be seen as building blocks for the sort of economic and political integration that characterizes modern geographically contiguous nations. These economic blocs might, in turn, fortify political alliances while erecting walls that divide the global economy.

Simply put, this vision proved wrong, even though FTAs have flourished. By one count, some 176 new trade agreements have been notified since the birth of the WTO in January 1995, and the total number may soon exceed 300 (WTO 2005a). Yet many of the post-1995 FTAs are "out of area" and not motivated by existing or anticipated political alliances; indeed, partners are often separated by thousands of miles, distinct cultures, and the lack of a common language. Examples of recent agreements include US FTAs with Chile, Australia, and Singapore; EU FTAs with Mexico and Chile; and Japanese FTAs with Mexico and Singapore. Even China's menu of prospective FTA partners—the Association of Southeast Asian Nations (ASEAN), India, Pakistan, Australia, New Zealand, the Gulf Cooperation Council (GCC), and the Southern African Customs Union (SACU)—seems devoid of political alliances (Hufbauer and Wong 2005).

In fact, the United States has adopted a strategy of "competitive liberalization" based in part on concluding bilateral and regional FTAs with a large number of partners, many of them outside the Western Hemisphere. Rather than forming tightly knit geographic units, centered on a major power, FTAs are creating criss-cross networks spanning the globe, where there is no clear separation between "hubs" and "spokes." Thus, a US-Pakistan FTA is perfectly compatible with current FTA trends.

As mentioned, post–September 11 diplomacy also plays a major role. The Bush administration and many members of Congress place a very high priority on measures that buttress US national interests in Muslim countries generally and the Middle and Near East specifically. The administration believes that prosperous market-oriented economies, run on democratic principles, are far less likely to breed terrorists or threaten world peace. That view is at the apex of policy and explains why the administration favors new FTAs with countries in the Middle and Near East. Morocco was first on the list, followed by Bahrain, Oman, and the United Arab Emirates. Egypt, Pakistan, Malaysia, and Indonesia are all prospects. FTAs with these countries are valued by the United States for the role they can play both in promoting broad economic reform and in averting the "clash of civilizations" that Samuel Huntington has predicted will dominate global politics in the 21st century.[13]

Are There Real Benefits to an FTA?

An FTA between Pakistan and the United States is fundamentally about large political gains for the United States and potentially large economic gains for Pakistan.

While the political payoff is crucial, it would be wrong to focus the FTA analysis on politics alone. Even if FTA signatories are mainly interested in political benefits, they must appraise the pact's economic merits. The costs of trade diversion and trade adjustment need to be weighed against the gains from trade creation, investment promotion, and productivity growth, as well as—most importantly—the role an FTA might play in fostering reform.

For Pakistan, an agreement could spur measures to liberalize the domestic economy and integrate the country into world markets.[14] For the United States, which has historically based its relationship with Pakistan on political and military considerations, an FTA would nourish the economic dimension.

As described in the chapters that follow, both countries retain significant trade barriers. Many of their important barriers operate behind the border as nontariff barriers. Commerce in agriculture, manufactures, some services, and government procurement is often conducted on terms far from the ideals of free trade and investment. Econometric research—using both a gravity model and a computable general equilibrium (CGE)

13. In his 1993 *Foreign Affairs* article, Samuel P. Huntington argued that the primary axis of conflict in the 21st century will be along cultural and religious lines. The fault lines between civilizations, he wrote, will be the battle lines for the future. He further developed the case in Huntington (1996).

14. See Ferrantino (2006) for the argument that FTAs between large countries and developing countries can serve as "policy anchors" by acting as a mechanism for the smaller country to make credible commitments to policy reform that it might not otherwise make.

model—suggests that reducing these barriers will substantially augment commerce between the United States and Pakistan.[15]

To preview the econometric research presented in chapter 8, elimination of *all* bilateral barriers between Pakistan and the United States might double two-way merchandise trade.[16] Companion estimates, using CGE analysis, suggest that a US-Pakistan FTA could significantly improve economic performance in Pakistan, resulting in annual gains of around 1.5 percent of GDP. Deeper trade and investment links would erode the power of oligopolies in both economies, especially in Pakistan, and thereby reduce markup margins and spur productivity. Deeper links would also spur the exchange of technology and skilled personnel, and thus enhance economic efficiency.

Is the Timing Wrong?

Perhaps the strongest argument against a US-Pakistan FTA is the matter of timing. Why distract attention from the final push to complete the Doha Development Round? For both countries, the political and economic payoff from a successful WTO negotiation far exceeds whatever achievements can be realized on a bilateral basis.[17] As a related point, it must be mentioned that the US congressional battle over the Central American Free Trade Agreement–Dominican Republic (CAFTA-DR) was prolonged and bruising, and the agreement only narrowly won approval from the US House of Representatives on June 28, 2005, by a tight 217 to 215 vote. In the aftermath of the prolonged CAFTA-DR polemic, there is a certain amount of "trade fatigue" among US business and legislative proponents of greater liberalization. These stalwarts doubtless need time to "rest up" before they take on the "big battle"—congressional ratification of the WTO Doha Development Round package.[18]

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15. The first section of chapter 8, authored by Dean DeRosa, applies the gravity model technique to a prospective US-Pakistan FTA. While the technique has been well known since the 1960s, it has been applied to assess the effect of FTAs only since the late 1990s. The second section of chapter 8, authored by John Gilbert, applies a static CGE framework using the GTAP6 database.

16. One reason for such large gains may be an "announcement" effect—the wake-up call that an FTA conveys to potential investors, exporters, and importers. Another reason could be the "lock-in" effect that results when firms place greater certainty on a country's trade and investment policies once commitments are made in an FTA.

17. This seems obvious for the United States. Even for Pakistan, better terms of access to world markets for its large textile industry, and its growing agricultural production, are the foremost commercial priorities.

18. The scarcest resource in US trade negotiations is not bureaucratic talent but congressional time and energy. The next scarcest resource is top-level support from leading CEOs in the private sector.

Like CAFTA-DR, a US-Pakistan FTA may in the end be voted up or down in a hot and highly partisan congressional battle. For these reasons, this debate should be put off until the WTO Doha Round has been ratified.

The timing arguments would be persuasive if the US-Pakistan FTA and the WTO Doha Round were alternatives. But the two agreements can be complements, not substitutes. If a political decision is made to go forward during 2006, the central focus of the US-Pakistan FTA should be negotiation, not ratification, either by the US Congress or the Pakistani legislature. Ratification might well occur after approval of the Doha package.

A US-Pakistan FTA can liberalize trade in goods and services to a far greater extent than the Doha Round can. In the WTO, modest progress at best seems possible on agricultural market access barriers.[19] WTO services negotiations have made so little headway that private firms have declared a crisis.[20] WTO members are dickering over tariff-cutting formulas to improve nonagricultural market access (the NAMA group), but the foreseeable outcome will not lead to zero tariffs on a wide range of manufactured goods.[21] By contrast, in all these areas and others (e.g., government procurement, investment, sanitary and phytosanitary barriers), the US-Pakistan FTA should go far beyond what can be achieved in the WTO. In fact, US-Pakistan FTA liberalization should start where the Doha Round foreseeably ends.

Will the Agreement Comport with GATT Article 24?

As indicated above, the United States has entered into numerous FTAs. Apart from NAFTA, these include FTAs with (in chronological order) Israel, Jordan, Chile, Singapore, Australia, Morocco, CAFTA-DR, and

19. Former US Trade Representative Robert Portman has described proposed tariff-reduction formulas as too modest in their ambitions, although cuts may be agreed in farm subsidies (progress that cannot be made in FTA talks). See "Key Ministers Make No Progress in WTO Talks as U.S. Criticizes EU," *Inside U.S. Trade* 23, no. 42, October 21, 2005. Most recently, US Agriculture Secretary Mike Johanns and Ambassador Portman acknowledged that countries will miss their goal, articulated at the Hong Kong ministerial in December 2005, of agreeing to a specific blueprint for the Doha Round. At the same time, EU Trade Commissioner Peter Mandelson announced that the Hong Kong goals would have to be lowered given the large substantive differences among members. See "US, EU Officials Acknowledge They Will Miss Goals at Hong Kong," *Inside U.S. Trade* 23, no. 45, November 11, 2005.

20. The Global Services Coalition, a group of Australian, Chilean, European, Indian, Japanese, and US providers, met with WTO officials in Geneva on June 24, 2005, and circulated an alert titled "WTO Services Negotiations in Crisis; Political Will Must Be Mobilized Urgently."

21. See "NAMA Group Struggling to Readjust Goal for Hong Kong," *Inside U.S. Trade* 23, no. 45, November 11, 2005.

Bahrain. Several more are in various stages of discussion and negotiation. For its part, Pakistan has signed an FTA with Sri Lanka and is completing negotiations with Singapore and the Gulf Cooperation Council (made up of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates).[22] Pakistan has also entered into a preferential trade agreement with China as a step toward signing an FTA. In addition, Pakistan belongs to the South Asian Association for Regional Cooperation (SAARC). This group of countries—Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka—established the SAARC Preferential Trading Arrangement (SAPTA) in 1993 and the South Asian Free Trade Area (SAFTA) in 2004.[23]

So far, none of the US or Pakistan free trade pacts have been found in violation of GATT Article 24, even though some of them cover much less than "substantially all trade." The simple reason that they have not been found wanting is that GATT/WTO reviews of Article 24 compatibility either say nothing or convey only bland misgivings (Schott 2004). Indeed, only one review group (for the Czech-Slovak pact) reached an affirmative consensus (Sutherland et al. 2004).[24] Nevertheless, it is reasonable to state that US FTAs come fairly close to the Article 24 ideal of eliminating barriers on substantially all the merchandise trade of the partners. The major shortcomings of the US FTAs are the inadequate coverage of agricultural barriers (as in the US-Canada FTA signed in 1989) or very long phaseouts and even exclusions for sensitive agricultural products (a conspicuous fault of the US-Australia FTA, at US insistence). In contrast to their agricultural shortcomings, the FTAs agreed by the United States liberalize services and investment, areas that the GATT/WTO system barely touches.

Under the Enabling Clause of the GATT,[25] exceptions from most favored nation (MFN) treatment are allowed either in the form of differential and more favorable treatment of a developing country by a developed country, or in regional or global arrangements among developing countries (such as SAFTA). This clause could permit the United States to stop far short of liberalizing substantially all imports from Pakistan and yet not run afoul of Article 24. However, the United States is not disposed to rely on the Enabling Clause in its FTA pacts with developing countries.

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22. See "Pakistan to Sign FTA with GCC Soon," *Daily Times*, Islamabad, October 25, 2005.

23. Afghanistan was admitted as the eighth full member of SAARC in the Dhaka Declaration of the 13th SAARC Summit, adopted on November 13, 2005.

24. Even when an FTA is fully consistent with Article 24, one or both parties may still owe "compensation" to other WTO members for trade diversion. Usually such claims are settled in the context of larger trade negotiations, such as the Tokyo Round, the Uruguay Round, and now the Doha Round.

25. GATT Decision of November 28, 1979, on Differential and More Favorable Treatment; see GATT, 26th Supplement, Basic Instruments and Selected Documents (BISD) 203 (1980).

If Pakistan and the United States reach an FTA, it should come close to the Article 24 ideal. While long phaseouts and special safeguards may be necessary on both sides for sensitive agricultural products, the coverage should otherwise be comprehensive and the elimination of barriers rapid.

Pakistan's Place in the Queue

As mentioned, the United States is currently engaged in free trade talks with many potential partners, most of them developing countries, although three belong to the Organization for Economic Cooperation and Development (OECD)—Switzerland, New Zealand, and South Korea. Given the relatively long list of potential FTA partners, the new US Trade Representative, Ambassador Susan Schwab, will inevitably establish priorities. These will depend of a variety of considerations, such as political alliances, prospective economic payoff, likely speed and ease of negotiation, and quality of results. Most of these considerations cannot be quantified, but available data do shed light on the strength of trade and investment ties between the United States and its prospective partners, the extent of protective barriers, and the degree of social similarity, measured by corruption, economic freedom, and labor and environmental standards.

In 2003 the United States and Pakistan signed a trade and investment framework agreement (TIFA) that established a Joint Council designed to facilitate the discussion of bilateral issues. In 2004, following the recommendations of the council, the United States and Pakistan began to negotiate a bilateral investment treaty (BIT). Recent negotiations have stalled due to disagreement over appropriate dispute resolution clauses.[26] Nevertheless, developments in US trade policy, global politics, the US-Pakistan relationship, and Pakistani domestic policies all enhance the prospects both for concluding the BIT and opening talks on an FTA.

We now turn to an array of quantitative and qualitative indicators that enable a comparison of Pakistan and other current and prospective US FTA partners. The quantitative indicators consist of inward and outward foreign direct investment (FDI) stocks, two-way US merchandise trade, two-way US services trade, and the average MFN tariff rates for

26. The United States wants to include a clause that stipulates, in the event of arbitration, that only the Washington-based International Center for Settlement of Investment Disputes (ICSID) should be used as a forum. Pakistan agrees to an arbitration clause, but calls for dispute resolution by the United Nations Commission on International Trade Law (Uncitral), based in Vienna, Austria. Pakistan has also declined to accept a clause that would provide retroactive coverage for investments made by US firms prior to the date when the BIT enters into force. See Ihtashamul Haque, "US-Pakistan Differences over BIT Persist," *Dawn*, August 19, 2005, available at www.dawn.com (accessed October 25, 2005).

agricultural and nonagricultural products. The qualitative indicators include a corruption index, two economic freedom indexes, and indexes for labor and environmental standards.

Based on these indicators, appendix tables 1A.1 through 1A.7 compare Pakistan with current and potential US FTA partners. The current partners include Israel (1986), Canada (1989), Mexico (1993), Jordan (2001), Chile (2003), Singapore (2004), Australia (2004), Morocco (2004), CAFTA-DR (2005), and Bahrain (2006). Prospective US FTA partners are divided into three groups:

- partners for which an FTA has been negotiated but not yet ratified: Oman, Peru, and Colombia (in the final drafting stage)
- partners in the process of negotiation: Ecuador, Panama, SACU countries, South Korea, Thailand, and the United Arab Emirates
- partners under consideration: Bangladesh, Bolivia, the Caribbean Community (Caricom), Egypt, Indonesia, Malaysia, New Zealand, Pakistan, Philippines, Qatar, and Taiwan.

Quantitative Indicators

Table 1A.1 shows that Pakistan's two-way FDI stocks with the United States rank 24th out of the 32 current and prospective US partners. If a BIT and an FTA are both concluded, US multinational enterprises (MNEs) as well as European and Asian MNEs may take a more favorable view toward expanding stakes in Pakistan.

Table 1A.2 depicts US merchandise trade with current and potential FTA partners. When two countries have an important base of merchandise trade, not only do business firms have a tangible reason to support an FTA but also the prospects are much better for a substantial dollar increase in bilateral commerce. Pakistan ranks 23rd among 32 current and prospective US partners, with a dollar figure in 2003 of about $5 billion in two-way merchandise trade. This figure is obviously far behind NAFTA partners Mexico and Canada (whose two-way trade with the United States totals $356 billion), but it easily exceeds the two-way trade of three current Muslim partners: Jordan, Morocco, and Bahrain. Compared with other prospective partners, Pakistan's two-way merchandise trade with the United States is similar in magnitude to that of Egypt and New Zealand.

Table 1A.3 presents two-way trade in services between current and potential US FTA partners. The logic of this indicator parallels that for merchandise trade. While data on services trade do not exist for many countries, and are thus missing for several of the current and prospective FTA partners, tentative conclusions can be drawn from the available figures. Based on these data, Pakistan ranks ninth in two-way trade in services, around $2.3 billion annually. These flows exceed US services trade with Chile and are comparable to bilateral trade in this area with prospective partners in Southeast Asia and New Zealand.

Table 1A.4 presents recent MFN tariff rates for current and prospective FTA partners. The MFN figures are averages of applied tariff rates for agricultural and nonagricultural products. The rationale for this indicator is that it suggests whether commercial negotiations will be more or less difficult, in the sense of whether larger or smaller tariff cuts will be needed to reach the goal of free trade. An FTA, by definition, aims at eliminating tariffs and quotas, and achieving this goal is easier if the partner country already has low applied MFN tariff rates.

Pakistan has a high MFN average applied rate for nonagricultural products. At an applied average rate of 16.6 percent, Pakistan ranks 27th, just behind Thailand. Pakistan also has a high applied average MFN rate for agricultural products, ranking 24th on this indicator. It must be noted that Pakistan's bound tariff rates substantially exceed its applied rates. Pakistan's wall of actual (applied) and theoretical (bound) tariff protection implies difficult FTA negotiations. But looking on the bright side, the current high tariffs mean that the potential benefits to both countries of an FTA are substantial.

The United States has concluded FTAs with countries that had both high and low applied MFN tariffs. Canada, Singapore, Australia, and Chile had relatively low applied MFN tariff rates on both agricultural and nonagricultural products.[27] By contrast, Mexico, Jordan, Morocco, and Israel have much higher applied MFN rates. From this spectrum, one might conclude that the United States can negotiate with partners that have a wide range of MFN barriers, provided that high-barrier countries are prepared to make asymmetric cuts.

Qualitative Indicators

Table 1A.5 presents a comparative perspective of the degree of corruption among current and prospective FTA partners. The logic of this indicator is twofold. First, less corruption probably means less political influence by vested interests that seek to preserve the economic rents generated by trade and investment barriers. Second, less corruption definitely means a more desirable environment for foreign firms to expand their trade and investment contacts with the partner country.

Corruption can be a stumbling block to a successful agreement and subsequent implementation. Apart from Jordan, Mexico, and Morocco,

27. While the figures in table 1A.4 refer to the situation in 2004, at the time the FTAs were negotiated all these partners had comparatively low average MFN tariffs.

current US FTA partners have low levels of corruption. By contrast, several prospective partners have somewhat higher levels. With levels of corruption exceeded only by Bangladesh and Indonesia, Pakistan ranks 30th out of 32 current and prospective partners.

Table 1A.5 also presents two different indexes of economic freedom (Heritage Foundation and the World Economic Forum), covering trade policy, fiscal burdens, government intervention in the economy, monetary policies, capital flows and foreign direct investment, wages and prices, banking and finance, property rights, and overt and informal market regulation. The indexes suggest that Pakistan offers a less attractive business environment compared with all but two other prospective partners, ranking 27th out of 28 countries (data are not available to rank CAFTA, Caricom, Oman, and Qatar). While Pakistan's current score places it in the "mostly unfree" category from an economic standpoint, the Heritage Foundation does note improvements in the business environment due to reduced regulation and increased privatization.

Table 1A.6 presents the Environmental Sustainability Index (ESI) for current and prospective US FTA partners. The ESI assesses water and air pollution, protected areas, and environmental regulations and enforcement. Pakistan is on the lower end of the scale, at a disadvantageous position compared with other prospective partners. An FTA between the United States and Pakistan could raise environmental concerns in the US Congress. Because Pakistan may face criticism akin to what Central American countries faced over CAFTA-DR, a strong commitment from Pakistan to increase efforts to enforce its environmental laws will be necessary.

Table 1A.7 compares labor standards for current and prospective US FTA partners. The labor standard index is based on five indicators: the right of association (i.e., the right to form unions) and the related rights to bargain and strike; forced labor; child labor; working conditions; and the number of international labor treaties that have been ratified. The index rates each country as high, medium/high, medium, medium/low, or low in these five categories. The results show that this is another troublesome area for Pakistan and could mean that an agreement with Pakistan would face opposition in the US Congress. A credible assurance from Pakistan to adhere to the core labor standards will help to answer critics.

While Pakistan's relatively weak performance on some indicators gives the country a less favorable position in the US FTA queue, it is worth noting that Pakistan has made significant headway in the last decade. Moreover, President Musharraf has committed his government to dramatic political and economic reform, the effects of which should be reflected in future rankings.

A US-Pakistan FTA could help anchor existing commitments, enhance credibility, and hasten the reform process. It could also put economic relations between the two countries on a better footing, moving away from aid to trade. The US FTA with Jordan provides evidence that such agreements can work. In 1999 total US imports from Jordan amounted to a paltry $31 million dollars, US apparel imports from Jordan were negligible ($2 million), and the United States had a trade surplus with the country of $239 million. Just five years later, in 2004, US imports were almost $1.1 billion, of which $956 million was apparel, and US exports had almost doubled, from $270 million to $531 million. Jordan's bilateral merchandise trade balance with the United States shifted from a deficit of $239 million to a surplus of $562 million. The remarkable increase in Jordanian exports, which come mainly from a set of qualifying industrial zones (QIZs), demonstrates how rapidly a country can take advantage of trade preferences (Galal and Lawrence 2005).

While some US officials have taken the position that countries with weaker initial conditions, such as Jordan, Egypt, or Morocco, should undertake further reforms before FTA negotiations begin, this leaves open the question of how much reform is enough for the process to move forward. Indeed, while Pakistan has much to reform, the same can be said of other countries that are already US FTA partners. More importantly, such a hurdle would diminish one of the key benefits of the agreement, namely its value as a reform anchor. To avoid vagueness about what is required of Pakistan, and for the FTA to sustain and boost reform, the agreement can be constructed in such a way as to create monitoring mechanisms to ensure compliance.

Plan of the Report

Agriculture and foodstuffs are highly protected in both Pakistan and the United States, and so two-way trade in agricultural goods and foodstuffs represents only 7 percent of bilateral merchandise trade between the two countries. Chapter 2 addresses the agricultural barriers and sanitary and phytosanitary standards that reflect the sensitivity of the sector for both countries. The chapter concludes with recommendations for their gradual phaseout in the context of a bilateral FTA.

Chapter 3 addresses textiles and clothing, an area that is by far the dominant component of bilateral merchandise trade between the United States and Pakistan, amounting to about $2.7 billion annually. Historically, the US textile and clothing industry has been highly allergic to trade liberalization that does not take place on its own terms. Moreover, the industry faces intense pressure in the aftermath of the recent elimination of quotas that long restricted trade under the Multi-Fiber Arrangement. Indeed, the US textile and clothing industry has sought and obtained renewed protection in the form of safeguards on imports of Chinese goods. A US-Pakistan FTA, if negotiated and ratified, will be the first agreement between the United States and a country with a highly competitive textile and clothing industry. Chapter 3 presents a brief profile of the industries in each country and discusses the possible impact of a US-Pakistan FTA on trade flows. The chapter also addresses remaining barriers and past negotiating experiences of the United States and Pakistan in this area.

Chapter 4 turns to commerce in manufactures besides textiles and clothing, a category we call "other manufactures." Trade in this area is an integral part of US-Pakistan commercial relations, as more than 80 percent of US exports to Pakistan fall in the "other manufactures" product category (although Pakistan does not export large amounts of "other manufactures" to the United States). Despite serious efforts at liberalization, Pakistan still applies high tariffs and nontariff barriers on manufactured imports. The Pakistani MFN rate on manufactured imports—excluding textiles and clothing—is about 14 percent, while the corresponding US tariffs (with a few exceptions) are mostly low (the US MFN rate is just below 4 percent). In addition, some Pakistani firms already enjoy duty-free access to the US market through GSP or MFN rates. Hence, our discussion in chapter 4 focuses largely on Pakistan's manufacturing sector, though we also examine barriers that affect Pakistan's access to the US market.

Chapter 5 discusses how labor and environmental issues might be addressed in a US-Pakistan FTA. We review how these areas have been treated in other agreements and recap the arguments raised during the congressional ratification of CAFTA-DR.

Chapter 6 reviews government procurement, an area that has proven highly resistant to liberalization in the WTO and that evokes political sensitivities in both countries. The United States has selectively opened up its market on a reciprocal basis. We recommend that Pakistan join the WTO's Government Procurement Agreement (GPA) and that Pakistan and the United States extend to each other the best government procurement terms offered to any other country, either through the GPA or in bilateral FTAs (an unconditional MFN approach).

Direct and portfolio investment links between Pakistan and the United States, as well as the services sector, are taken up in chapter 7. The chapter identifies areas of FDI friction and provides an overview of current international investment agreements between the two countries. Turning to services, the chapter analyzes selected sectors in each country and concludes with recommendations for investment and priorities.

Chapter 8 provides estimates of potential US-Pakistan trade expansion, based on gravity and computable general equilibrium (CGE) models. The two models attempt to forecast the effect of a bilateral FTA on the volume of trade created between the two countries, the volume of trade diverted from third countries, and economic gains in the two partners.

Chapter 9 concludes with a review of the main points and recommendations of the previous chapters. While our book is essentially an economic analysis, we recognize that geopolitical forces will determine the course and outcome of FTA talks between Pakistan and the United States.

Appendix A takes a historical look at trade in the South Asian region and explores the most significant attempt at intraregional integration, the South Asian Free Trade Area (SAFTA). The appendix concludes that for Pakistan, a US-Pakistan FTA could complement SAFTA by increasing Pakistan's trade both within South Asia and with the rest of the world. Also, as countries reduce tariffs across the board, trade facilitation—customs procedures, transport, and standards—becomes increasingly important. A US-Pakistan FTA could spur the reform process in SAFTA in this key area.

Appendix 1A

Table 1A.1 Foreign direct investment stocks, 2003
(billions of US dollars)

Partner	Rank[a]	From United States	To United States	Two-way FDI
NAFTA				
Mexico	3	61.5	6.7	68.2
Canada	1	192.4	105.3	297.7
Other current				
Australia	4	41.0	24.7	65.6
CAFTA	18	3.4	0	3.4
Dominican Republic	25	0.9	0	0.9
Chile	12	10.0	0.1	10.0
Israel	13	6.2	3.8	10.0
Jordan	32	0.1	0	0
Morocco	30	0.3	0	0.3
Singapore	5	57.6	–0.2	57.4
To be ratified				
Bahrain	26	0.2	0.3	0.5
Colombia	20	2.8	–0.2	2.6
Oman	29	0.4	0	0.4
Peru[b]	21	2.7	–0.1	2.5
Under negotiation				
Ecuador	22	1.4	0	1.5
Panama	9	6.5	8.4	14.9
SACU-5	26	0.8	0.1	0.9
Thailand	15	7.4	0.2	7.6
United Arab Emirates	23	1.4	0	1.5
Under consideration				
Europe				
Switzerland	2	86.4	112.9	199.3
Middle East				
Egypt	7	19.0	0	18.9
Qatar	19	3.1	0	3.1
East Asia and Pacific				
Indonesia	11	10.4	0	10.4
Malaysia	14	7.6	0.2	7.8
New Zealand	17	3.8	0.6	4.5
Philippines	16	4.7	0	4.7
South Korea	8	13.3	2.3	15.7
Taiwan	10	11.0	2.7	13.7

(table continues next page)

Table 1A.1 *(continued)*

Partner	Rank[a]	From United States	To United States	Two-way FDI
Latin America				
Bolivia	28	0.4	0	0.4
Caricom	6	17.0	10.0	26.9
South Asia				
Bangladesh	31	0.2	0	0.2
Pakistan	24	1.1	0	1.1

CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

Note: FDI stock is computed as direct investment position on a historical-cost basis.

a. Based on two-way FDI.
b. Data for 2001.

Source: BEA (2004a).

Table 1A.2 US merchandise trade, 2004 (billions of US dollars)

Partner	Rank[a]	US exports	US imports	Two-way trade
NAFTA				
Mexico	2	110.8	155.8	266.6
Canada	1	189.1	255.9	445.0
Other current partners				
Australia	10	14.3	7.5	21.8
CAFTA	7	15.7	17.7	33.4
Dominican Republic	17	4.3	4.5	8.9
Chile	18	3.6	4.7	8.4
Israel	9	9.2	14.5	23.7
Jordan	27	0.6	1.1	1.6
Morocco	28	0.5	0.5	1.0
Singapore	6	19.6	15.3	34.9
To be ratified				
Bahrain	31	0.3	0.4	0.7
Colombia	15	4.5	7.3	11.8
Oman	30	0.3	0.4	0.7
Peru	20	2.1	3.7	5.8
Under negotiation				
Ecuador	19	1.7	4.3	6.0
Panama	26	1.8	0.3	2.1
SACU-5	16	3.3	6.9	10.2
Thailand	8	6.4	17.6	23.9
United Arab Emirates	21	4.1	1.1	5.2
Under consideration				
Europe				
Switzerland	11	9.3	11.6	20.9
Middle East				
Egypt	24	3.1	1.3	4.4
Qatar	29	0.5	0.4	0.8
East Asia and Pacific				
Indonesia	13	2.7	10.8	13.5
Malaysia	5	10.9	28.2	39.1
New Zealand	22	2.1	3.0	5.0
Philippines	12	7.1	9.1	16.2
South Korea	3	26.3	46.2	72.5
Taiwan	4	21.7	34.6	56.3
Latin America				
Bolivia	32	0.2	0.3	0.5
Caricom	14	5.7	7.7	13.4

(table continues next page)

Table 1A.2 *(continued)*

Partner	Rank[a]	US exports	US imports	Two-way trade
South Asia				
Bangladesh	25	0.3	2.3	2.6
Pakistan	23	1.8	2.9	4.7

CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

a. Ranking based on two-way trade.

Source: US Department of Commerce, TradeStats Express, http://tse.export.gov.

Table 1A.3 US trade in services, 2003 (billions of US dollars)

Partner	Rank[b]	US exports	US imports	Two-way trade
NAFTA				
Mexico	2	16.6	11.7	28.3
Canada	1	26.7	19.1	45.9
Other current partners				
Australia	6	5.8	3.2	9.0
CAFTA	n.a.	n.a.	n.a.	n.a.
Dominican Republic	n.a.	n.a.	n.a.	n.a.
Chile	14	1.0	0.7	1.7
Israel	7	2.3	1.8	4.1
Jordan	n.a.	n.a.	n.a.	n.a.
Morocco	n.a.	n.a.	n.a.	n.a.
Singapore	5	6.9	4.9	11.8
To be ratified				
Bahrain	n.a.	n.a.	n.a.	n.a.
Colombia	n.a.	n.a.	n.a.	n.a.
Oman	n.a.	n.a.	n.a.	n.a.
Peru	n.a.	n.a.	n.a.	n.a.
Under negotiation				
Ecuador	n.a.	n.a.	n.a.	n.a.
Panama	n.a.	n.a.	n.a.	n.a.
SACU-5[a]	10	1.2	1.0	2.2
Thailand	12	1.1	0.7	1.8
United Arab Emirates	n.a.	n.a.	n.a.	n.a.
Under consideration				
Europe				
Switzerland	3	8.0	8.3	16.4
Middle East				
Egypt	n.a.	n.a.	n.a.	n.a.
Qatar	n.a.	n.a.	n.a.	n.a.
East Asia and Pacific				
Indonesia	15	1.1	0.3	1.4
Malaysia	13	1.2	0.5	1.7
New Zealand	11	1.0	1.1	2.1
Philippines	8	1.4	1.4	2.8
South Korea	4	8.4	4.4	12.8
Taiwan	n.a.	n.a.	n.a.	n.a.
Latin America				
Bolivia	n.a.	n.a.	n.a.	n.a.
Caricom	n.a.	n.a.		n.a.

(table continues next page)

Table 1A.3 *(continued)*

Partner	Rank[b]	US exports	US imports	Two-way trade
South Asia				
Bangladesh	n.a.	n.a.	n.a.	n.a.
Pakistan	9	0.7	1.7	2.3

n.a. = not available
CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

a. Using data for South Africa.
b. Based on two-way trade; rank positions exclude countries for which information is not available.

Sources: US Department of Commerce, Bureau of Economic Analysis, www.bea.gov (accessed October 20, 2005); State Bank of Pakistan.

Table 1A.4 Average MFN tariff rates, 2003–04
(simple average ad valorem rates)

	Agricultural			Nonagricultural		
Partner	**Bound**	**Applied**	**Rank[e]**	**Bound**	**Applied**	**Rank**
NAFTA						
Mexico	35.1	24.5	27	34.9	17.1	28
Canada	3.5	3.1	5	5.3	4.2	6
Other current partners						
Australia	3.2	1.1	2	11.0	4.6	8
CAFTA[a]	42.3	10.5	14	38.2	5.7	11
Dominican Republic	39.6	13.0	16	34.2	7.8	18
Chile	26.0	6.0	7	25.0	5.9	13
Israel	73.0	15.9	19	9.2	4.0	4
Jordan	23.7	19.8	23	19.8	12.1	24
Morocco	54.5	48.6	30	39.2	27.5	31
Singapore	9.5	0	1	6.3	0	1
To be ratified						
Bahrain	37.5	9.0	10	35.1	7.6	17
Colombia	91.9	14.9	15	35.4	11.9	23
Oman	28.0	10.2	13	11.6	5.0	9
Peru	30.8	17.2	21	30.0	13.1	25
Under negotiation						
Ecuador	25.5	14.7	17	21.1	11.5	22
Panama	27.7	14.8	18	22.9	7.4	16
SACU-5[b]	39.2	9.1	11	15.8	5.3	10
Thailand	35.5	29.0	28	24.2	14.2	26
United Arab Emirates	25.4	n.a.	n.a.	13.1	n.a.	n.a.
Under consideration						
Europe						
Switzerland[c]	n.a.	36.2	29	n.a.	2.3	2
Middle East						
Egypt	95.3	22.8	26	28.3	19.4	30
Qatar	25.7	4.9	6	14.5	4.1	5
East Asia and Pacific						
Indonesia	47.0	8.2	9	35.6	6.7	14
Malaysia	12.2	2.1	4	14.9	8.1	19
New Zealand	5.7	1.7	3	11.0	3.5	3
Philippines	34.7	8.0	8	61.8	4.3	7
South Korea	52.9	52.1	31	10.2	7.0	15
Taiwan	15.3	16.3	20	4.8	5.5	12
Latin America						
Bolivia	40.0	10.0	12	40.0	9.3	20
Caricom[d]	98.0	18.4	22	51.2	11.1	21

(table continues next page)

Table 1A.4 *(continued)*

	Agricultural			Nonagricultural		
Partner	Bound	Applied	Rank[e]	Bound	Applied	Rank
South Asia						
Bangladesh	188.5	21.7	25	35.7	19.2	29
Pakistan	97.1	20.4	24	35.3	16.6	27
US comparison	6.9	5.1	7	3.2	3.7	4

CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
n.a. = not available
MFN = most favored nation
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

a. Simple average of observations for Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.
b. Using South Africa's average bound tariff. Tariff binding figures are based on simple averages of national averages reported by the World Trade Organization (WTO) and exclude Lesotho.
c. Using ad valorem equivalent (AVE). Switzerland has a 99.8 percent binding coverage, but bindings are in the form of specific tariffs.
d. Simple averages of observations reported by the WTO for each Caricom member.
e. Ranks based on applied rates and run from high to low.

Sources: World Trade Organization, *2004 World Report* and *Trade Profiles*.

Table 1A.5 Corruption and economic freedom
(index values)

Partner	Corruption, 2004[a]	Corruption rank	Economic freedom: Heritage, 2005[b]	Economic freedom: WEF, 2005[c]	Economic freedom: Average rank
NAFTA					
Mexico	3.6	20	3.1	3.9	17
Canada	8.5	5	4.1	5.1	6
Other current partners					
Australia	8.8	4	4.2	5.2	5
CAFTA	3.2	23	n.a.	n.a.	n.a.
Dominican Republic	2.9	26	2.5	3.1	26
Chile	7.4	6	4.2	4.9	7
Israel	6.4	7	3.6	4.8	11
Jordan	5.3	12	3.2	4.3	14
Morocco	3.2	23	2.8	3.5	23
Singapore	9.3	2	4.4	5.5	1
To be ratified					
Bahrain	5.8	10	3.9	4.5	9
Colombia	3.8	19	2.8	3.8	20
Oman	6.1	8	3.2	n.a.	n.a.
Peru	3.5	22	3.2	3.7	19
Under negotiation					
Ecuador	2.4	28	2.5	3.0	28
Panama	3.7	18	3.3	3.6	18
SACU-5[d]	4.9	15	3.2	4.3	15
Thailand	3.6	20	3.0	4.5	16
United Arab Emirates	6.1	8	3.3	5.0	12
Under consideration					
Europe					
Switzerland	9.1	3	4.1	5.5	3
East Asia and Pacific					
Indonesia	2.0	31	2.5	3.5	25
Malaysia	5.0	14	3.0	4.9	13
New Zealand	9.6	1	4.3	5.1	4
Philippines	2.6	27	2.7	3.5	24
South Korea	4.5	16	3.4	5.1	10
Taiwan	5.6	11	3.7	5.6	8
Middle East					
Egypt	3.2	23	2.6	4.0	22
Qatar	5.2	13	2.9	n.a.	n.a.
Latin America					
Bolivia	2.2	29	3.3	3.1	21
Caricom	4.0	17	n.a.	n.a.	n.a.

(table continues next page)

Table 1A.5 *(continued)*

Partner	Corruption, 2004[a]	Corruption rank	Economic freedom: Heritage, 2005[b]	Economic freedom: WEF, 2005[c]	Economic freedom: Average rank
South Asia					
Bangladesh	1.5	32	2.0	2.9	29
Pakistan	2.1	30	2.3	3.3	27
US comparison	7.5	6	4.1	5.8	2

n.a. = not available
CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)
WEF = World Economic Forum

a. Countries with a high score are the most transparent (i.e., a high score is better).
b. High score = economically more free. Heritage Index scores have been rescaled so that 5 = "economically free" and 1 = "economically unfree."
c. High score = economically more free.
d. Using data for South Africa.

Sources: Transparency International (2005); Heritage Foundation (2005); WEF (2005).

Table 1A.6 Environmental standards

Partner	ESI rank 2005[a]	ESI[b]	CO_2 emissions damage[c]	Protected areas[d]	Compliance[e]	Treaty[f]
NAFTA						
Mexico	19	46.2	High	Low	Medium	Medium/High
Canada	1	64.4	High	Low	High	High
Other current partners						
Australia	3	61.0	Medium	Medium	Medium	High
CAFTA	15	49.0	High	Medium	Low	Medium
Dominican Republic	25	43.7	Medium	High	Medium/Low	Medium
Chile	10	53.6	Medium	Medium	Medium/High	High
Israel	12	50.9	High	Medium	Medium	Medium
Jordan	18	47.8	Low	Medium	Medium/High	Medium
Morocco	20	44.8	Medium	Low	Medium/Low	High
Singapore	13	50.0	Medium	Low	High	Low
To be ratified						
Bahrain	n.a.	n.a.	Low	Low	n.a.	Low
Colombia	7	58.9	High	High	Medium	Medium/High
Oman	17	47.9	Medium	Medium	Medium/Low	Medium/Low
Peru	5	60.4	High	Medium	Low	Medium/High

Under negotiation						
Ecuador	12	52.4	Low	High	Low	Medium/High
Panama	8	57.7	Medium	High	Med/Low	Medium/High
SACU-5	11	52.9	Medium	Medium	Medium	Medium/Low
Thailand	14	49.7	Low	Medium	Medium	Medium
United Arab Emirates	21	44.6	Low	Low	n.a.	Medium/Low
Under consideration						
Europe						
Switzerland	2	63.7	High	High	High	High
Middle East						
Egypt	24	44.0	Low	Medium	Medium	High
Qatar	n.a.	n.a.	Low	Low	n.a.	Low
East Asia and Pacific						
Indonesia	16	48.8	Medium	Low	Medium/Low	Medium
Malaysia	9	54.0	Low	High	Medium/High	Medium
New Zealand	4	60.9	High	Medium	High	Medium/High
Philippines	22	44.3	Medium	Low	Low	Medium/High
South Korea	26	43.0	Medium	Low	Medium/High	Medium/High
Taiwan	29	32.7	Medium	Low	Medium/High	Low
Latin America						
Bolivia	6	59.5	Low	Medium	Low	Medium
Caricom	27	41.0	Medium	Low	Medium	Medium

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Table 1A.6 Environmental standards *(continued)*

Partner	ESI rank 2005[a]	ESI[b]	CO_2 emissions damage[c]	Protected areas[d]	Compliance[e]	Treaty[f]
South Asia						
Bangladesh	23	44.1	High	Low	Low	Medium/Low
Pakistan	28	39.9	Low	Low	Low	Medium
US comparison	11	52.9	High	High	Medium	High

n.a. = not available
CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
ESI = Environmental Sustainability Index
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

a. Low rank = poor environmental standards. Rank is inverse to score because high score indicates high environmental standards.
b. Countries with high ESI have high environmental standards.
c. High = CO_2 damage $<$ 0.5 percent, medium = CO_2 damage $>$ 0.5 and $<$ 1 percent, low = CO_2 damage $>$ 1 percent.
d. Ratio of protected area to total area: high = ratio $>$ 0.2, medium = ratio $>$ 0.1 and $<$ 0.2, low = ratio.
e. High = compliance score $>$ 5.8, medium/high = compliance $<$ 5.8 and $>$ 4.6, medium = compliance $<$ 4.6 and $>$ 4.0, medium/low = compliance $>$ 3.6 and $<$ 4.0, low = compliance $<$ 3.6.
f. High = more than 120 treaties, medium/high = between 80 and 120, medium = 60 to 80, medium/low = between 50 and 60, low = less than 50.

Sources: 2004 Environmental Sustainability Index of the Environmental Performance Measurement Project (Yale University, Columbia University, and World Economic Forum); World Bank (2004b); UN Environmental Statistics for Protected Areas; Globalis Human Impact 2002; Environmental Treaties and Resource Indicators (ENTRI) for Treaties Participation.

Table 1A.7 Labor standards

Partner	Rank (ca. 2004)	Index[a]	Right of association	Forced labor	Child labor	Working conditions	Conventions ratified[b]
NAFTA							
Mexico	8	3.6	High	Medium	Medium	Medium	High
Canada	4	4.4	High	Medium/High	High	High	Medium
Other current partners							
Australia	2	4.8	High	High	High	Medium/High	High
CAFTA	8	3.6	Medium	Medium/High	Medium/High	Medium	Medium/High
Dominican Republic	24	2.0	Medium/Low	Medium	Low	Low	Medium
Chile	4	4.4	Medium/High	High	Medium/High	Medium/High	High
Israel	6	4.0	Medium	High	High	Medium	Medium/High
Jordan	13	3.0	Medium	Medium	Medium/High	Medium/Low	Medium
Morocco	19	2.6	Medium/Low	Medium	Medium	Low	Medium/High
Singapore	7	3.8	Medium	High	Medium/High	Medium/High	Medium
To be ratified							
Bahrain	19	2.6	Medium	Medium	Medium	Medium	Low
Colombia	13	3.0	Medium/Low	Medium/High	Medium/Low	Medium/Low	High
Oman	22	2.2	Medium	Medium	High	Medium	Low
Peru	13	3.0	Medium	Medium	Medium/Low	Medium/Low	High
Under negotiation							
Ecuador	16	2.8	Medium/Low	Medium	Medium/Low	Medium/Low	High
Panama	12	3.2	Medium	Medium	Medium/Low	Medium	High
SACU-5	27	1.8	Low	Medium	Low	Low	Medium
Thailand	30	1.4	Medium/Low	Low	Low	Medium/Low	Low
United Arab Emirates	22	2.2	Medium	Medium	Medium/High	Medium	Low

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Table 1A.7 Labor standards *(continued)*

Partner	Rank (ca. 2004)	Index[a]	Right of association	Forced labor	Child labor	Working conditions	Conventions ratified[b]
Under consideration							
Europe							
Switzerland	1	5.0	High	High	High	High	High
Middle East							
Egypt	16	2.8	Medium/Low	Medium	Low	Medium	High
Qatar	27	1.8	Low	Medium/Low	Medium/High	Low	Low
East Asia and Pacific							
Indonesia	24	2.0	Medium	Medium/Low	Low	Medium	Low
Malaysia	19	2.6	Medium/Low	Medium/Low	Medium	Medium	Medium
New Zealand	2	4.8	Medium/High	High	High	High	High
Philippines	29	1.6	Medium	Low	Low	Medium/Low	Medium
South Korea	11	3.4	Medium	Medium/High	Medium/High	Medium	Medium
Taiwan	16	2.8	Medium/Low	Medium	Medium/High	Medium/Low	Medium
Latin America							
Bolivia	24	2.0	Medium/Low	Low	Low	Medium/Low	Medium/High
Caricom	8	3.6	Medium/High	High	Medium/High	Medium/High	Medium
South Asia							
Bangladesh	30	1.4	Medium/Low	Low	Low	Low	Medium
Pakistan	30	1.4	Medium/Low	Low	Low	Low	Medium
US comparison	5	4.2	High	High	High	High	Low

n.a. = not available
CAFTA = Central American Free Trade Agreement
Caricom = Caribbean Community
NAFTA = North American Free Trade Agreement
SACU-5 = Southern African Customs Union (South Africa, Botswana, Lesotho, Namibia, and Swaziland)

Note: Methodology for labor indicators

1. *Collective bargaining, right of association, and labor strikes*
   Low: Collective bargaining, strikes, and right of association all prohibited.
   Medium/Low: Some prohibited or government approval needed.
   Medium: Not prohibited and no requirement to seek authorization prior to forming unions, but labor rights are not really enforced or widespread antiunion discrimination exists.
   Medium/High: Not prohibited and labor rights are enforced most of the time.
   High: All allowed and labor rights enforced.
2. *Forced labor*
   Low: Pervasive forced labor.
   Medium/Low: Law prohibits forced labor but certain foreigners and local groups are consistently subject to forced labor.
   Medium: Forced labor is prohibited but some cases are reported.
   Medium/High: Rare cases of forced labor reported
   High: No cases of forced labor reported.
3. *Child labor*
   Low: Pervasive (child labor exceeds 8 percent of the age group).
   Medium/Low: Prohibited but many cases reported in different sectors of the economy (child labor represents 2 to 8 percent of the age group).
   Medium: Prohibited but some cases are reported in the informal sector (child labor 0 to 2 percent of the age group).
   Medium/High: Prohibited but rare cases of child labor are reported.
   High: No child labor reported.

4 *Working conditions*
   Low: Low or no negotiations possible with employer, low or no protection, working standards not "enforced, substandard living conditions, lack of protections, abuse, and labor law violations."
   Medium/Low: Labor laws exist but not well enforced regarding protection, safety and health standards, and working hours.
   Medium: Working conditions acceptable, usually with acceptable safety and health standards, and premium for working longer hours.
   Medium/High: Most working conditions are satisfied.
   High: All working conditions are satisfied.

a. Low rank = low labor standards. Rank is inverse to score because higher score indicates better labor standards. Index based on average of the 5 indicators: high = 5, medium/high = 4, medium = 3, medium/low = 2, low = 1.
b. ILO conventions ratified: high = ratified conventions > 50, medium/high = ratified conventions > 40 and < 50, medium = ratified conventions > 20 and < 40, low = ratified conventions < 20.

Sources: World Trade Organization; US Department of State (2002, 2004, 2005); World Bank (2004b); ILO database.