

# **David and Goliath: The U.S.-Jordan Free Trade Agreement and the Economic Development of Jordan**

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## **1. Introduction**

Developing countries are participating in bilateral and multilateral trade agreements in record numbers. This is true for countries of the Middle East and North African region. For example, Jordan recently negotiated bilateral trade agreements with the United States and the European Union, joined the multilateral World Trade Organization, and initiated negotiations with Egypt, Morocco, and Tunisia for a regional free trade area. Despite the eagerness of small developing countries to improve market access, fears remain that trade liberalization with large industrialized nations will erode infant industrial sectors, hindering the process of economic development. Empirical evidence from the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico has not supported fears that trade liberalization with industrialized nations slows economic development in less-developed countries. NAFTA trade flows and foreign direct investment into Mexico expanded at a greater rate following NAFTA implementation, taking into account real exchange rate changes and capital flight during the 1995 peso crisis. Like Mexico, Jordan's improved access to the large U.S. market is expected to increase opportunities for Jordanian exports, attract foreign investment, and stimulate economic development with trade as the engine of growth. This study compares and contrasts Mexico's experience under NAFTA with Jordan's potential under the U.S.-Jordan Free Trade Agreement (FTA).

## **2. Comparing the Jordanian and Mexican Experiences**

### The Mexican and Jordanian economies

The net benefits accruing to the developing Mexican economy from liberalizing trade with its industrialized North American neighbors stimulated the Mexican government to expand its free trade policy. Mexico signed bilateral trade agreements with 10 countries over the last 7 years. These countries included developing countries in Latin America as well as industrialized economies such as the EFTA members and the European Union. The new Mexican FTAs are all modeled after the NAFTA, a rules-based agreement with a clearly defined dispute settlement mechanism (Diaz, 2001). The Mexican experience under NAFTA has shown a country rapidly expanding exports, not only to North America but to the world. Mexico received increased infusions of FDI from investors around the world during NAFTA negotiations and following NAFTA implementation. Mexico has been able to maintain economic reforms, even under the severe financial crisis of 1994-95. Empirical studies of NAFTA trade liberalization have indicated significant positive impacts for the Mexican economy from trade liberalization with Canada and the United States (Kehoe and Kehoe, 1994).

The Mexican economy was expected to experience the greatest adjustments under the NAFTA, due to the small relative size of its economy and higher levels of protectionism. Lopez-Cordova (2001) reports Mexican real per capita GDP only 34 percent of U.S. GDP in 1994, suggesting large factor endowment differences between Mexico and its northern neighbors. Large differences in factor endowments prior to trade liberalization suggest large trade and production effects from liberalization. Jordanian per capita GDP in 2000 was 5 percent of U.S. per capita GDP. Like Mexico, Jordan is expected to experience efficiency and welfare gains from resource adjustments under the trade liberalization measures of the FTA.

How do Mexico and Jordan compare as developing countries? Mexico's population is significantly greater than Jordan (Table 1). The Mexican population

Table 1

Development Indicators for the United States, Mexico, and Jordan, 2000

|               | GDP per capita         | Population      | Life expectancy | Infant mortality | Adult literacy |
|---------------|------------------------|-----------------|-----------------|------------------|----------------|
|               | <i>million dollars</i> | <i>millions</i> | <i>Years</i>    | <i>per 1,000</i> | <i>percent</i> |
| United States | 34,266                 | 281.6           | 77              | 7                | 100            |
| Mexico        | 5,862                  | 98.0            | 72              | 29               | 91             |
| Jordan        | 1,694                  | 4.9             | 71              | 26               | 90             |
| World         | 5,150                  | 6,054           | 66              | 54               | 76             |

Source: World Bank, found at Internet address <http://www.worldbank.org>.

is 35 percent of the U.S. population (281.6 million). By comparison, Jordan's population is less than 2 percent of the U.S. population. Mexico's economy is more developed than Jordan's economy, even pre-NAFTA. Mexico instituted significant economic reforms much earlier than Jordan, starting in the 1980s. In addition, Mexico's companies benefitted from over 30 years of production-sharing with U.S. companies. Mexico's share of GDP from industry was 28.4 percent in 2000, with the manufacturing sector accounting for 20.7 percent. By comparison, industry's share of Jordanian GDP was 24.8 percent, with manufacturing contributing only 15.6 percent. This share has been steadily increasing, from 12.7 percent in 1980. Services, primarily tourism, are the largest share of Jordanian GDP, 73 percent in 2000. This has increased from 64.1 percent in 1980. Services also account for the largest share of Mexican GDP, 67.3 percent. Agriculture's share of Jordanian GDP fell from 7.9 percent in 1980 to 2.2 percent in 2000. Although the Jordanian government's share of consumption of GDP has fallen from 28.8 percent in 1980 to 23.8 percent in 2000, it continues to burden the economy. By comparison, the Mexican government's share of GDP was 10 percent in 1980 and 11 percent in 2000.

Jordan has undertaken significant economic reforms during the 1990s and continues to pass economic reform legislation [1]. In 1995, a new Sales Tax Law was passed. This law expands the tax base and increases tax rates to provide government revenues which will be lost under recent trade liberalization policies. An Investment Promotion Law was passed in 1995 that provides incentives to domestic and foreign investors. This is necessary to encourage capital inflows into the capital-scarce economy for further industrialization. Non-Jordanians are allowed to own 100 percent of businesses, with the exclusion of mining, trade services, and construction. Investment in certain regions of the country will receive "tax holidays" over a specified period of time. In 1997, the government passed the Securities Law, creating a regulatory body called the Jordan Securities and Exchange Commission. The Commission's goal is to increase transparency and to safeguard investor's rights. The government is currently preparing a number of reforms to improve transparency, market efficiency, and the overall business climate in Jordan; The Insurance Law, the Mutual Funds and Trust Law, the Secured Financing and Leasing Law, The Safeguard Law, the Competition (Antitrust) Law, the Companies Law, the Customs Law, and Intellectual Property Rights Legislation. Effective implementation of new and pending legislation will enable Jordan's economy to capture potential welfare gains from multilateral and bilateral trade liberalization.

The socio-economic development indicators for Jordan are not significantly different from Mexico (Table 1). For example, life expectancy in 2000 was 72 years in Mexico and 71 years in Jordan [2]. The world average was 66 years and in the United States life expectancy was 77 years. Infant mortality rates in Jordan and Mexico are significantly below the world average of 54 deaths per 1,000 live births. Mexico had an infant mortality rate of 29 and Jordan had a lower rate of 26 in 2000. The adult literacy rate for Mexico was 91 percent and 90 percent for Jordan in 2000. The United Nations Human Development Index (HDI), constructed from life expectancy at birth, adult literacy, school enrollment, and GDP per capita, ranks both Jordan and Mexico as countries with "medium human development" in 1999. Mexico ranked 51 and Jordan 88 out of 150 countries in the 2000 report. The HDI for Jordan is 0.714, compared to Mexico's HDI of 0.790. The largest component contributing to the difference between these two countries HDI indices is the GDP index. Jordan's 1999 GDP per capita is less than half that of Mexico. Even Mexico's HDI for 1990 (pre-NAFTA) is higher than Jordan's HDI in 1999. We have to look prior to 1980 to find a Mexican HDI value equivalent to Jordan's value in 1999. Jordan's income constraint, relative to Mexico, is a leading factor contributing to limited domestic investment and slow economic growth.

#### Tariff liberalization

The U.S. effective tariff rate [3] on imports from Mexico was relatively low prior to implementation of NAFTA (Appendix, Table 1). The average tariff rate fell from 3.1 percent in 1989 to 2.1 percent in 1993. Following implementation of NAFTA, the effective tariff rate fell to 0.2 percent in 2000. Israel, which implemented a free trade agreement with the United States in 1985, has experienced an effective tariff rate of 0.1 percent since 1993, which is lower than Mexico. Canada, which implemented a free trade agreement with the United States in 1989, faced a higher effective tariff rate than Israel. The effective tariff rate on Canadian merchandise was 0.4 the year prior to NAFTA implementation, falling to zero in 2000. The effective tariff rate on U.S. imports from Jordan in 2000 was higher than the effective tariff rate on U.S. imports from Mexico in 1993, prior to NAFTA implementation. This is partly due to the mix of products imported from Jordan, mostly textiles and apparel which face significantly higher tariff and non-tariff barriers entering the United States. Production-sharing between Mexican and U.S. companies through the maquiladora program also contributed to lower average effective tariff rates on U.S. imports from Mexico. Obviously, production-sharing is more feasible when two countries share a border, a situation which does not exist for Jordan and the United States. Prior to NAFTA, Mexican products could enter the U.S. with special duty provisions under U.S. Harmonized Tariff System (HTS) 9802.00.60 and 9802.00.80 if they were assembled or processed using U.S. inputs. The final products entering the U.S. market under special rules-of-origins pay tariffs only on the value-added in Mexico. Mexican imports of U.S. inputs entered maquiladoras duty-free, if the final products were re-exported. The maquiladora program was implemented by Mexico in 1965.

Effective tariff rates on U.S. imports from Jordan have come down in the late 1990s, partly in response to initiation of a U.S. program to allow qualifying goods from Jordan, Israel, West Bank, Gaza Strip, and Egypt to enter the United States duty free [4]. Jordanian qualifying products enter the United States duty-free as products of Israel through a production-sharing scheme called Qualified Industrial Zones (QIZ), under provisions of the U.S.-Israel Free Trade Area Agreement of 1985. Legislation was passed in October 1996 authorizing the U.S. President to eliminate duties on articles produced in these qualifying regions. The President authorized the U.S. Trade Representative to designate QIZs in the participating countries. The first zone was designated in March 1998. Four additional zones have been authorized.

The tariff phase-ins under NAFTA were scheduled over 15 years, through 2008. For the U.S.-Jordan FTA, tariff liberalization will be phased-in over 10 years, with 2001 designated as the first year of tariff reductions [5]. Tariffs less than 5 percent will be eliminated over two years, tariffs between 5 and 10 percent will be eliminated over four years, tariffs between 10 and 20 percent will be eliminated over five years, and tariffs greater than 20 percent will be eliminated over 10 years [6]. Some non-reciprocal concessions were given to Jordan under the U.S.-Jordan FTA due to its developing country status. For example, Jordan can maintain high tariffs to restrict imports of socially-unacceptable products, such as tobacco and alcohol. Jordan can apply temporary safeguard measures to protect domestic industries during a 15 year grace period. The multilateral Agreement on Textile and Clothing (ATC) will be implemented by 2005, thus removing any trade-diverting welfare gains to Jordanian apparel exporters from special access to the U.S. market. Given the long tariff phase-ins negotiated under the U.S.-Jordan FTA, the welfare gains will be spread out over time and difficult to measure, as was the case with NAFTA. For sectors with the highest tariff rates, liberalization will come near the end of the 10 year phase-in period. Given the higher effective tariff rate facing top U.S. imports from Jordan, relative to Mexico, the potential welfare gains to Jordan are higher than for Mexico under the NAFTA.

### Trade flows

Mexican exports to the United States rose steadily since NAFTA implementation, however, Mexican exports to the world also increased significantly (Appendix, Table 2). This export growth cannot be attributed solely to tariff liberalization. As we have seen, NAFTA tariffs that were not already low or zero in 1993 were scheduled to be phased-in over 15 years, to be completed in 2008. Part of the post-NAFTA growth in Mexican exports can be attributed to the effect of the 1995 peso devaluation on Mexico's real exchange rate (Krueger, 2000). The fall in the relative price of Mexican exports increased North American and world import demand, compounding the price effect of North American tariff liberalization. The growth in Mexican exports to North America would have been smaller if NAFTA tariff liberalization did not begin in 1994. Lustig refers to this rise in Mexican exports as the "engine of Mexico's recovery". But tariff liberalization alone cannot explain the phenomenal growth in intra-NAFTA trade.

Mexico was the number three trading partner of the United States in terms of volume of trade prior to NAFTA. Mexico replaced Japan as the number two U.S. trading partner in 1999, when growth in U.S.-Mexico trade outpaced the growth in U.S.-Japanese trade. U.S. imports from Mexico grew 31 percent in the five years prior to NAFTA (1989-93) and 48 percent in the five years following implementation (1994-1998). By comparison, growth in the value of imports from Japan fell from 14 percent in the period 1989-93 to only 3 percent in 1994-98. Peso devaluation and the economic downturn adversely affected Mexican import demand, with U.S. exports to Mexico growing only 35 percent in the five years following NAFTA implementation, compared with 40 percent growth over the five years preceding NAFTA. By comparison, U.S. exports to Japan grew only 7 percent during 1989-1993 and 1994-1999 periods. Jordan trade flows with the United States are extremely small compared with total U.S. trade flows, and Jordanian exports to the United States are an insignificant share of total Jordanian exports. Primary destinations for Jordanian exports in 1999 were India (20 percent), Saudi Arabia (14 percent), Iraq (12 percent), other Arab countries (35 percent), the European Union (9 percent), China (4 percent), and all other destinations combined (35 percent). On the other hand, the United States is a significant supplier of Jordanian imports. Jordanian imports in 1999 were supplied by the European Union (32 percent), Iraq (11 percent), the United States (10 percent), Arab countries (10 percent), other European countries (7 percent), Japan (6

percent), South Korea (4 percent), and all other sources combined (20 percent). The Jordan economy will experience welfare gains from removing import trade restrictions on U.S. goods.

Seven of the top 15 U.S. import categories from Mexico in 2000 at the HTS two-digit chapters ranked by value are also in the top 15 U.S. import categories from Jordan (Appendix, Tables 3 and 4). Two of these chapters (HTS 98 and 99) are special provisions. As would be expected, Mexico and Jordan are both net exporters of apparel products to the United States. In 1993, Mexican apparel entering the United States under HTS chapters 61 and 62 accounted for 3 and 5 percent, respectively, of U.S. apparel imports from all sources. They were the 5th and 9th highest value Mexican export categories to the United States. These products faced U.S. effective tariff rates of 5.5 and 6.6 percent, respectively in 1993, the year prior to NAFTA implementation. The effective tariff rate on U.S. apparel imports from all sources in 1993 was 17.6 and 13.9 percent, giving Mexican apparel producers an obvious competitive advantage. Mexico had a price advantage over foreign competitors primarily due to special duty rates granted under production-sharing with U.S. firms. Under NAFTA, the effective tariff rate for Mexican apparel in the United States fell to 0.4 percent by 2000 in both HTS chapters. Mexican exports of apparel significantly increased their share in the U.S. market, to 13.3 and 15.6 percent, respectively for HTS chapters 61 and 62. By comparison, Jordanian apparel entering under HTS chapters 61 and 62 accounted for only 0.1 percent of U.S. apparel imports in 2000 and paid effective tariff rates of 8.2 and 9.7 percent. This was slightly lower than the effective tariff rates from all sources, which were 13.1 and 12 percent in 2000 [7]. Only Jordanian apparel exports produced outside of the QIZ program face the high U.S. effective tariff rates. Under the Multi-fiber Arrangement (MFA), developing country textile and apparel exports faced substantial tariff and non-tariff barriers in the industrialized nations, including the United States. The 1995 ATC phases-out the MFA over ten years, by 2005. At that time, Jordanian apparel exports will lose their competitive advantage under the QIZ programs. However, Kheir-El-Din and Abdel-Fattah (2001) point out that textiles and apparel exports represent a higher share of Mediterranean merchandise exports than world exports in this sector, implying that the Mediterranean producers have a comparative advantage. If this is true, Jordanian apparel and textile exporters should remain competitive in the U.S. market.

Trade patterns between the United States and Mexico did not change significantly following NAFTA implementation. The top four U.S. import categories from Mexico in 2000 were also the top four U.S. import categories in 1993. The mix of products within the broad 2-digit HTS chapters have changed somewhat. For example, under the electrical machinery chapter, insulated ignition wiring sets (HTS 854430) was the top U.S. import category from Mexico in 1993. This product category was bumped to second place in 2000 by reception apparatus for color television (HTS 852812), which wasn't even in the top 15 U.S. imports of electrical machinery from Mexico in 1993. Despite some changes in the mix of products within the 2-digit HTS chapters, it is generally apparent that NAFTA did not significantly change Mexico's comparative advantage vis-a-vis the United States. What is noticeable is the substantial increase in volume of trade in these categories. Insulated ignition wires contributed \$1,621 million of U.S. imports from Mexico in 1993. This rose to \$4,171 million in 2000. Passenger motor vehicles from Mexico (HTS 870323) accounted for \$3,416 million in U.S. import value in 1993. This rose to \$9,291 million in 2000. Inferring from the Mexican experience, it is unlikely that tariff liberalization under the U.S.-Jordan FTA will stimulate significant changes in the mix of U.S. imports from Jordan. Jordan's top export categories to the United States in 2000 were apparel, jewelry, leather goods, and art. Apparel accounted for the top two value HTS chapters of U.S. imports from Jordan in 2000. These Jordanian exports face high U.S. effective tariff rates. The volume of these exports should expand as U.S. tariff and quota barriers are reduced. However, nine of the 15 top U.S. import categories from Jordan paid zero or less than 1.1 percent *ad valorem* in 2000, therefore we wouldn't expect to see great increases in trade flows in these categories.

Except for apparel, none of the top Jordanian exports to the United States were in the top 15 U.S. imports from Mexico, such as electrical machinery and vehicles. At first glance it appears unlikely that Jordan's economy will expand into the top areas of Mexico's comparative advantage with the United States. Machinery and vehicles would require substantially more capital investment per worker and would have significantly higher transport costs to the U.S. market due to the great distances between Jordan and the United States, relative to Mexico and the United States. Top Jordanian exports to the world also differ significantly from Mexico's top exports to the United States, suggesting a significantly different resource mix for Jordan relative to Mexico. Jordan's comparative advantage may change over time as more capital enters the Jordanian economy and labor becomes more highly specialized. However, light manufactures appear to have the most potential for growth under the FTA, given the great distance between Jordan and the U.S. market. It may be more enlightening to examine Israeli trade with the United States. Israel was the first country to sign a free trade agreement with the United States in 1985 and has a more advanced economy than Jordan. However, if we look at the mix of products imported from Israel, we can see many similarities with Jordan (Appendix, Table 6). The top U.S. import from Israel in 2000 was jewelry. This was the third highest value U.S. import from Jordan in 2000. The second highest value import from Israel in 2000 was electrical machinery. Unlike Mexico, which exports high weight per value electrical machinery (televisions) to the U.S. market, the Israeli electrical machinery exports (semiconductors) are light manufactures. For light manufactures, transportation costs are low relative to product value. It is possible for Jordan to diversify its exports to the United States within the category of light manufactures (electrical machinery, pharmaceuticals) under the improved market access offered by the FTA. Lack of investment capital will be the most likely factor limiting diversification of Jordanian exports to the United States.

Domestic economic and regulatory reforms are essential to move Jordan away from previous import-substitution policies towards trade liberalization and export promotion. Amerah lists necessary reforms in fiscal, monetary, and commercial policies to enhance

Jordanian "domestic producers' competitiveness through market forces." Many of these reforms have been implemented, such as trade liberalization through the WTO and the U.S.-Jordan FTA, the Euro-Mediterranean Association Agreement, and other Jordanian bilateral trade agreements. The QIZ program and Economic Free Zones have been launched to stimulate growth in the export sectors. Other significant reforms were discussed earlier.

### Foreign direct investment

Kehoe and Kehoe (1994) report that the potential Mexican welfare gains from NAFTA trade liberalization are substantially increased if NAFTA results in large capital flows into Mexico. Lustig notes that NAFTA was significant in stimulating inflows of FDI into Mexico. Firms with FDI employ 20 percent of the formal sector workforce in Mexico, enjoying wages 48 percent higher than the national average (Lustig). Improved market access to the United States is one component that stimulated post-NAFTA investment into Mexico (Lopez-Cordova, 2001). Another important factor is investor confidence in Mexican reforms and trade liberalization. Although the 1995 peso crisis caused a temporary flight of capital from Mexico, Standard and Poor's suggests the capital flight would have been greater without NAFTA. Under the framework of NAFTA, the Mexican government was more likely to maintain its package of economic reforms and not use trade barriers to remedy temporary balance of payments problems. Raising trade barriers to solve balance of payments problems has been a regular device used by developing countries. India extended implementation of tariff reductions under its WTO accession package by claiming balance of payments problems. Argentina violated its tariff obligations to its Mercosur regional trade bloc by adjusting tariffs to protect its domestic economy. The Mexican peso crisis was the first real test of the will of a small, developing country to adhere to its bilateral trade liberalization obligations with a large, industrialized economy.

The Mexican economy was successfully attracting foreign direct investment (FDI) long before implementation of NAFTA (Appendix, Table 6). Between 1980 to 1993, FDI in the Mexican industrial sector rose 255 percent, while FDI in the services sector rose 2,000 percent, equivalent to simple annual average growth rates of 20 and 145 percent, respectively (Mutti, 2001). Mutti jointly attributes the higher growth in services investment to Mexican privatization of state-owned enterprises and NAFTA negotiations which were launched in June 1991. Standard & Poor's reports FDI in Mexico increased substantially during the NAFTA implementation period. NAFTA improvements in investment security, transparency for foreign investors, and protection of intellectual property rights (IPR) are all factors contributing to the increased investment flows into Mexico. A NAFTA dispute settlement mechanism that provides for investor-state disputes is another investor-friendly feature that encouraged intra-NAFTA investment. Canadian direct investment in Mexico rose from 530 million Canadian dollars in 1993 to 2,246 million Canadian dollars in 1998, a 300 percent increase over the first five years of NAFTA, with only a slight dip in 1995 representing the capital flight under the peso crisis [8]. U.S. direct investment in Mexico rose from \$16,968 billion in 1994 to \$26,657 billion in 1998, with only a slight dip in 1995 [9].

FDI is encouraged by the Jordanian government through economic and regulatory reforms and investment agreements with the United States and other trade partners. Jordan has undertaken commitments to protect intellectual property rights in accordance with its obligations under the U.S.-Jordan FTA. Proposed legislative IPR reforms in Jordan are likely to stimulate Arab and non-Arab investment inflows. Domestic reforms, including reducing the lions share of GDP consumed by government, must continue if Jordan is to achieve potential welfare gains from specialization and trade under the U.S.-Jordan FTA and the WTO.

The countries of the Middle East region have chronically suffered from lower than world average foreign direct investment. U.S. FDI in the Middle East has been very small (Appendix, Table 6). The primary recipients of U.S. FDI in the region have been Israel and Saudi Arabia. The sectors receiving U.S. FDI also differ significantly between North America and the Middle East. The petroleum sector received 24 percent of U.S. FDI in the Middle East in 2000. Financial and banking services received 26 percent with 9 percent going into other services, such as tourism. The manufacturing sector received only 21 percent of U.S. FDI in the Middle East. By comparison, 58 percent of U.S. FDI in Mexico went into the manufacturing sector in 2000. Capital accumulation is essential for Jordan's economic development. Foreign capital investment in Jordan has been minimal for a number of reasons. Prior to recent reforms, the Jordanian economy lacked necessary safeguards and regulatory infrastructure to attract foreign capital. The recent reforms were made in preparation for Jordan's accession to the WTO. For Mexico, FDI inflows increased significantly while the NAFTA agreement was still being negotiated as investors anticipated improved market access. The U.S.-Jordan FTA and Jordanian accession to the WTO should signal international investors that Jordan is serious about recent economic reforms and will have greater market access.

Mexico is geographically linked to the United States. Lopez-Cordova (2001) suggests that the geographic location of Mexico is one of the key factors leading to the FDI flows and employment growth that developed following NAFTA implementation. He suggests this unique proximity of a developing country to the U.S. market would not be available for other hemispheric countries joining FTAs with the United States. The amount of investment in maquiladora firms in many Mexican states increased substantially following implementation of NAFTA [10]. GAO reports "...growth in shared production activity and two-way trade suggests that increases in sector specialization, a mechanism through which productivity may be improved, have occurred." Lopez-Cordova reports maquiladora employment doubled from 1994 to 1999. Large firms and foreign-owned firms contributed the bulk of manufacturing employment growth in Mexico. Jordan is not geographically located near the United States, or even in the Western Hemisphere. Thus production-sharing with U.S. firms is less likely to be stimulated by the FTA than the maquiladora

industry of Mexico. The U.S.-Jordan FTA does encourage production-sharing through rules-of-origin. The FTA allows Jordanian exports with 35 percent Jordanian value-added to qualify for the preferred U.S. duty-treatment. Up to 15 percent value can come from U.S. inputs. For example, if the maximum 15 percent value-added is from U.S. inputs, then Jordanian value-added needs to be only 20 percent to qualify under the FTA. However, it is unlikely that the FTA will stimulate large amounts of U.S. production-sharing with Jordan due to transportation costs. It is more likely that the U.S.-Jordan FTA will stimulate regional production-sharing, as neighboring countries use Jordan's special trade status to access the U.S. market. Production-sharing opportunities between Jordanian and Israeli firms which exist through the Qualified Industrial Zone (QIZ) program should increase, as QIZ products will continue to receive special tariff treatment under the U.S.-Jordan FTA.

### **3. Conclusions**

U.S.-Jordan trade liberalization will improve economic development of Jordan by eliminating tariff distortions that led to resource allocations in inefficient sectors, and opening access to U.S. markets. However, like Mexico under NAFTA, maximum gains to Jordan will come if FDI inflows are stimulated to invest in export sectors given the new access to U.S. markets. Jordan stands to gain improved productivity from multinationals and regional production-sharing. Improved competitiveness will benefit Jordan's exports in the U.S. market as well as other world markets, multiplying the positive economic effects of the U.S.-Jordan FTA. The key for Jordan is to attract investment funds. The Middle East chronically suffers from lower than world-average foreign direct investment and Jordan has not been a big recipient of the limited U.S. FDI in the region. However, Jordan has made great strides in improving its investment climate, including a Bilateral Investment Treaty (1997) and a Trade and Investment Framework Agreement (1999) with the United States. These steps, over time, should increase Jordan's attractiveness for FDI.

Internal factors slowing Jordanian economic development include a small domestic market and the lack of investment capital. Jordan's small domestic market hinders the process of industrialization and economic growth, especially when the government sector consumes such a large share of GDP. External economies of scale have been stimulated by government policies to promote industrial agglomeration through establishment of industrial estates. Locating these estates near Aqaba harbor and the international airport have been especially beneficial in cutting transportation costs to export destinations. Companies locating in these industrial estates benefit from pooled labor, shared information, improved transportation and public services, and lower costs to their input suppliers. Further efforts should be taken to identify and support development of cost-effective input supply industries to improve efficiency of the domestic input and service sectors.

The pre-NAFTA effective tariff rate for U.S. imports from Mexico was less than half the effective tariff rate facing Jordanian exports. Thus, the potential welfare gains to Jordan from U.S. tariff liberalization under the U.S.-Jordan FTA are relatively greater than for Mexico under the NAFTA. The Mexican maquiladora program has been an integral part of U.S.-Mexico production-sharing since 1965. The number of maquiladoras grew substantially under NAFTA, contributing to the rapidly increasing volume of intra-NAFTA trade. U.S.-Jordan production-sharing is less viable due to transportation costs. However, the 35 percent rules-of-origin under the U.S.-Jordan FTA should encourage Jordanian production-sharing with other countries in the region. For example, the U.S. Qualified Industrial Zones program authorized in 1996 stimulated production-sharing between Jordan, Israel, Egypt, and the Palestinian territories. Regional production-sharing is a key to improving the Middle East's share of world trade and investment.

Integration with regional and international markets is the most likely engine of growth for small, developing countries like Jordan. Jordan's trade policy objectives have changed significantly, from protectionism to export promotion. Jordan acceded to the World Trade Organization in April 2000, signing a Euro-Mediterranean Association Agreement with the industrialized countries of the European Union, and supporting regional integration through a Mediterranean Arab Free Trade Area with Morocco, Tunisia, and Egypt. The Jordanian economy has a lot of potential gains from trade liberalization with the industrialized countries and its regional neighbors. Given Jordan's top export products to the United States (jewelry, apparel), it is unlikely to stimulate industrialization by focusing resources on expanding exports in these sectors alone. Jordan will gain most from the FTA by diversifying exports to the United States into other light manufactures such as electrical machinery and pharmaceuticals.

Domestic economic reforms are essential for developing countries who sign multilateral and bilateral trade agreements with industrialized countries. Trading agreements with industrialized countries can give incentives to maintain economic reforms in times of macroeconomic crisis. NAFTA membership helped Mexico maintain its economic reforms during the financial crisis of 1994-95. Jordan's recent bilateral and multilateral trade agreements give incentives for the government to implement reforms. Economic and regulatory reforms, along with laws on intellectual property rights, should encourage necessary FDI, bringing capital, modern technology, and improved skills for domestically hired labor.

Non-economic external factors continue to hinder Jordan's economic development. The Gulf War, the Israeli-Palestinian conflict, Palestinian refugees, and U.N. sanctions on Iraq are regional events stifling Jordan's economic growth. Iraq is Jordan's neighbor and historical trading partner. Economic sanctions that hinder the Iraqi economy indirectly damage the Jordanian economy. The lack of solutions to the Palestinian refugees has stretched Jordan's limited resources, reducing capital funds available for economic development projects. Regional instability adversely affects the Jordanian investment climate. Tariff liberalization under a free trade agreement with the United States will have a minimal impact on FDI in Jordan if regional instability continues. Although

theoretical models discussed in this paper illustrate welfare gains to Jordan from a U.S.-Jordan free trade agreement, these models do not include parameters for non-economic factors. Anticipated dynamic gains to the Jordanian economy from tariff liberalization with the United States will continue to be overshadowed by the negative impact of external regional factors.

## ENDNOTES

1. Economy - Legislative and Regulatory Reforms, found at Internet address <http://www.kinghussein.gov.jo>.
2. World Bank, found at Internet address <http://www.worldbank.org>.
3. Import duties as a percentage of total imports at customs value. Calculated from official statistics of the U.S. Department of Commerce.
4. USTR, "U.S. Trade Representative Designates Three New Duty-Free Zones in Jordan and Israel," Press Release 99-86, October 13, 1999, found at Internet address <http://www.ustr.gov>.
5. U.S. Trade Representative, "The U.S.-Jordan Free Trade Agreement Fact Sheet," found at Internet address <http://www.ustr.gov>.
6. Jordanian Ministry of Industry and Trade, "Jordan and the United States of America," found at Internet address <http://www.mit.gov.jo>.
7. Note that these are averages for the whole 2-digit chapters. There may be tariff peaks within these chapters, with some tariff lines entering duty-free. It would be necessary to look at 8-digit classifications to determine when Jordanian apparel tariffs will be liberalized under the U.S.-Jordan FTA phase-in schedule.
8. Department of Foreign Affairs and International Trade, found at Internet address <http://www.dfait-maeci.gc.ca>.
9. Bureau of Economic Analysis, found at Internet address <http://www.bea.doc.gov>.
10. NAFTA Works, Embassy of Mexico, various issues, found at Internet address <http://www.secofi.org>.

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## APPENDIX

Appendix Table 1

Average tariff rates [1] for U.S. imports from FTA partners, 1993-2000.

| Exporter | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|----------|------|------|------|------|------|------|------|------|
| Mexico   | 2.1  | 1.4  | 0.8  | 0.6  | 0.6  | 0.5  | 0.5  | 0.2  |

|        |      |      |      |     |     |     |     |     |
|--------|------|------|------|-----|-----|-----|-----|-----|
| Canada | 0.4  | 0.3  | 0.2  | 0.2 | 0.1 | 0.1 | 0.1 | 0.0 |
| Jordan | 13.1 | 13.2 | 10.7 | 9.1 | 2.4 | 3.7 | 1.6 | 5.7 |
| Israel | 0.1  | 0.1  | 0.1  | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |

1. Import duties as a percent of U.S. imports by customs value, annual data.

Source: Compiled from official statistics of the U.S. Department of Commerce

Appendix Table 2

U.S. trade flows with FTA partners, million U.S. dollars, 1993-2000.

|                           | 1993    | 1994    | 1995    | 1996    | 1997    | 1998    | 1999      | 2000      |
|---------------------------|---------|---------|---------|---------|---------|---------|-----------|-----------|
| <i>Total U.S. exports</i> | 439,295 | 481,887 | 546,464 | 582,137 | 643,222 | 634,705 | 642,189   | 712,287   |
| Mexico                    | 40,265  | 49,136  | 44,881  | 54,686  | 68,393  | 75,369  | 81,381    | 100,442   |
| Canada                    | 91,866  | 103,643 | 113,261 | 119,123 | 134,794 | 137,768 | 145,731   | 155,601   |
| Jordan                    | 361     | 287     | 332     | 342     | 398     | 351     | 270       | 306       |
| Israel                    | 3,952   | 4,368   | 4,813   | 5,069   | 4,835   | 5,680   | 6,338     | 6,191     |
| <i>Total U.S. imports</i> | 574,863 | 657,885 | 739,660 | 790,470 | 862,426 | 907,647 | 1,017,435 | 1,205,339 |
| Mexico                    | 38,668  | 48,605  | 61,721  | 74,179  | 85,005  | 93,017  | 109,018   | 134,734   |
| Canada                    | 119,482 | 128,753 | 144,882 | 156,299 | 167,881 | 174,685 | 198,242   | 229,059   |
| Jordan                    | 19      | 29      | 29      | 26      | 26      | 16      | 31        | 73        |
| Israel                    | 4,424   | 5,218   | 5,722   | 6,421   | 7,320   | 8,619   | 9,863     | 12,949    |

Source: Compiled from official statistics of the U.S. Department of Commerce

Appendix Table 3

Top 15 U.S. imports from Mexico in 2000, by 2-digit HTS chapters

| HTS | Description | Import value |
|-----|-------------|--------------|
|-----|-------------|--------------|

|    |  | (million dollars) |
|----|--|-------------------|
| 85 | Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television recorders and reproducers, parts and accessories   | 35,640            |
| 87 | Vehicles, other than railway or tramway rolling stock, and parts and accessories thereof   | 26,011            |
| 84 | Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof  | 17,037            |
| 27 | Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes   | 11,338            |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted   | 5,118             |
| 90 | Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof | 4,452             |
| 98 | Special classification provisions, nesoi   | 4,369             |
| 94 | Furniture; bedding, cushions etc.; lamps and lighting fittings nesoi; illuminated signs, nameplates and the like; prefabricated buildings            | 3,821             |
| 61 | Articles of apparel and clothing accessories, knitted or crocheted   | 3,499             |
| 73 | Articles of iron and steel   | 1,584             |
| 07 | Edible vegetables and certain roots and tubers   | 1,582             |
| 99 | Special import reporting provisions, nesoi   | 1,524             |
| 22 | Beverages, spirits and vinegar   | 1,264             |
| 39 | Plastics and articles thereof  | 1,184             |
| 72 | Iron and steel   | 1,068             |

Source: Compiled from official statistics of the U.S. Department of Commerce.

Appendix Table 4

Top 15 U.S. imports from Jordan in 2000, by 2-digit HTS chapters

| HTS | Description   | Import Value<br>(million dollars) |
|-----|---|-----------------------------------|
| 62  | Articles of apparel and clothing accessories, not knitted or crocheted  | 26.1                              |
| 61  | Articles of apparel and clothing accessories, knitted or crocheted  | 16.3                              |
| 71  | Natural or cultured pearls, precious or semiprecious stones, precious metals; precious metal clad metals, articles thereof; imitation jewelry; coin | 9.4                               |
| 42  | Articles of leather; saddlery and harness; travel goods, handbags and similar containers; articles of gut (other than silkworm gut)                 | 8.7                               |
| 98  | Special classification provisions, nesoi  | 4.0                               |
| 97  | Works of art, collectors' pieces and antiques   | 1.8                               |
| 76  | Aluminum and articles thereof   | 0.7                               |
| 49  | Printed books, newspapers, pictures and other printed products; manuscripts, typescripts and plans  | 0.6                               |
| 57  | Carpets and other textile floor coverings   | 0.5                               |
| 84  | Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof   | 0.5                               |
| 33  | Essential oils and resinoids; perfumery, cosmetic or toilet   | 0.5                               |

|    |  |     |
|----|--|-----|
|    | preparations   |     |
| 39 | Plastics and articles thereof  | 0.4 |
| 99 | Special import reporting provisions, nesoi   | 0.3 |
| 90 | Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof | 0.3 |
| 63 | Made-up textile articles nesoi; needlecraft sets; worn clothing and worn textile articles; rags  | 0.3 |

Source: Compiled from official statistics of the U.S. Department of Commerce.

Appendix Table 5

Top 15 U.S. imports from Israel in 2000, by 2-digit HTS chapters

| HTS | Description  | Import value<br>(million dollars) |
|-----|--|-----------------------------------|
| 71  | Natural or cultured pearls, precious or semiprecious stones, precious metals; precious metal clad metals, articles thereof; imitation jewelry; coin  | 5,649                             |
| 85  | Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television recorders and reproducers, parts and accessories   | 2,401                             |
| 84  | Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof  | 909                               |
| 90  | Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical instruments and apparatus; parts and accessories thereof | 771                               |
| 98  | Special classification provisions, nesoi   | 525                               |
| 61  | Articles of apparel and clothing accessories,  | 373                               |

|    |   |     |
|----|---|-----|
|    | knitted or crocheted  |     |
| 88 | Aircraft, spacecraft, and parts thereof   | 332 |
| 30 | Pharmaceutical products   | 279 |
| 29 | Organic chemicals   | 253 |
| 39 | Plastics and articles thereof   | 211 |
| 62 | Articles of apparel and clothing accessories, not knitted or crocheted  | 103 |
| 82 | Tools, implements, cutlery, spoons and forks, of base metal; parts thereof of base metal  | 103 |
| 94 | Furniture; bedding, cushions etc.; lamps and lighting fittings nesoi; illuminated signs, nameplates and the like; prefabricated buildings | 78  |
| 28 | Inorganic chemicals; organic or inorganic compounds of precious metals, of rare-earth metals, of radioactive elements or of isotopes      | 71  |
| 54 | Manmade filaments, including yarns and woven fabrics thereof  | 67  |

Source: Compiled from official statistics of the U.S. Department of Commerce.

Appendix Table 6

U.S. Direct Investment Abroad in FTA partner countries, 1994-2000

|                      | 1994    | 1995    | 1996    | 1997    | 1998      | 1999      | 2000      |
|----------------------|---------|---------|---------|---------|-----------|-----------|-----------|
|                      |         |         | million | dollars |           |           |           |
| <i>All countries</i> | 612,893 | 699,015 | 795,195 | 871,316 | 1,000,703 | 1,130,789 | 1,244,654 |
| <i>N. America</i>    | 91,189  | 100,371 | 108,943 | 120,676 | 124,857   | 143,313   | 161,835   |
| Canada               | 74,221  | 83,498  | 89,592  | 96,626  | 98,200    | 111,051   | 126,421   |
| Mexico               | 16,968  | 16,873  | 19,351  | 24,050  | 26,657    | 32,262    | 35,414    |

|             |       |       |       |       |        |        |        |
|-------------|-------|-------|-------|-------|--------|--------|--------|
| Middle East | 6,367 | 7,198 | 8,294 | 8,836 | 10,739 | 10,519 | 11,851 |
| Jordan      | 1)    | 1)    | 1)    | 1)    | 1)     | 1)     | 1)     |
| Israel      | 1,483 | 1,831 | 2,045 | 2,071 | 2,837  | 3,051  | 3,426  |

1) Suppressed by BEA-DOC to avoid disclosure of individual company data.

Source: Bureau of Economic Analysis, U.S. Department of Commerce, found at Internet address <http://www.bea.doc.gov/be/di>.