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Free Trade Deals: Is the U.S. Losing Ground as Its Trading Partners Move Ahead: Hearing Before the H. Subcomm. on Trade of the H. Comm. on Ways and Means, 107th Cong., Mar. 29, 2001 (Statement of Daniel K. Tarullo, Prof. of Law, Geo. U. L. Center)

Daniel K. Tarullo
Georgetown University Law Center, tarullod@law.georgetown.edu

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FREE TRADE DEALS: IS THE UNITED STATES LOSING GROUND AS ITS TRADING PARTNERS MOVE AHEAD?

HEARING

BEFORE THE

SUBCOMMITTEE ON TRADE

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTH CONGRESS

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go to the plant. I'm constantly reminded when I look at the shipments on our dock and see their final destinations.

There is no substitute for U.S. leadership on trade. The right policies on trade, taxes and regulation are particularly vital at a time of slowing economic growth. For Purafil and other small-business exporters, we will continue to be successful only if we maintain our international customer base. In order to do that, we will depend on the reduction of tariffs and other trade barriers. Thank you.

Chairman CRANE. Thank you, Mr. Weiller. Mr. Tarullo?

STATEMENT OF DANIEL K. TARULLO, PROFESSOR, GEORGETOWN UNIVERSITY LAW CENTER

Mr. TARULLO. Thank you, Mr. Chairman. Let me say at the outset, Mr. Chairman, that I endorse fully the emphasis of the rest of the panel on the importance of U.S. leadership in trade policy. In general terms, I also agree with the proposition that a proliferation of bilateral and regional agreements to which the United States is not party can adversely affect U.S. commercial interests. But my point today is that the consensus on the desirability of U.S. leadership and justifiable concerns about trade agreements that exclude the United States do not take us very far in determining an appropriate policy response. I say this for three reasons.

First, the fact that we can assume some damage to U.S. interests from these agreements does not tell us how much damage is being caused. Without more careful, systematic study, we will not have the answer to this question. Aggregations of numbers of agreements and a compiling of anecdotes are a helpful starting point for analysis, but they can be misleading. When one talks about the number of bilateral investment treaties, for example, one has to recognize that there are 15 different countries in the European Union, each individually negotiating the Bilateral Investment Treaty (BIT). Moreover, it is very difficult to tell from the existence of these treaties how much advantage, in fact, is accruing to the countries negotiating them.

As to anecdotes, there are always anecdotes about lost sales because of trade agreements and I am sure that most, if not all, of them are accurate. But anecdotes alone do not tell us the overall effects of a free trade area upon non-member States. We cannot tell if the free trade area has promoted growth in the countries that are members to it, so that there are more exports from the United States and other non-member countries than would otherwise have taken place. We cannot tell if patterns of world exports have shifted in response to the preferential tariff agreements but have not resulted in much of a net change in world market share.

My second point is that even where preferential trade agreements are of concern and are clearly harming U.S. commercial interests, we cannot assume that a more activist U.S. trade policy will necessarily blunt their effects. Some of these agreements exclude the United States not because of inaction on the part of the United States, but because of an affirmative desire on the part of some of the negotiating countries to exclude the United States. These agreements are intended precisely to reduce U.S. influence, an outgrowth of fears in some other countries of having international systems dominated by the world's remaining superpower.

Now, these first two points do not, of course, mean that there is no sensible trade negotiating agenda which the United States can realistically pursue. Ultimately, the most important question before the Congress and the public is not whether the United States should undertake trade negotiations, but how and with what aim. The day has long passed when trade agreements could be approached as a simple balancing of the interests of import-sensitive industries with those of export-oriented industries and of consumers. The scope of trade agreements has so broadened in recent years that important domestic policies, as well as commercial interests, are regularly implicated in trade policy decisions. For example, recent events underscore the inadequacy of international arrangements to protect food safety and animal health, even as trade in food has been liberalized.

The Business Roundtable's report, which I assume was in part the prompt for this hearing, quite rightly identifies the need to build the national consensus that can form the basis of an agreed mandate from the Congress. Whether one agrees or disagrees with the Roundtable's specific ideas, one should applaud the desire to engage on these issues. Indeed, those who most fear the costs of trade agreements that exclude the United States should have the greatest incentive to address the concerns of citizens who do not stand to benefit directly from new trade agreements involving the United States.

Let me close by trying to place trade negotiations in perspective. As important as they are, they cannot on their own sustain U.S. economic leadership or protect U.S. interests. I would like to suggest just two, rather different additional policies for the consideration of Congress and the administration to complement trade negotiations.

First, we do not need to be passive. I would like to echo Mr. Levin in suggesting that the United States reconsider its position of acquiescing in trade agreements concluded by the European Union that may well violate WTO rules. Historically, there were good foreign policy reasons for acquiescing in those agreements on the European continent. But as Europe seeks preferential trade agreements in other parts of the world, there seems to me no geopolitical or foreign policy reason to give the EU a free ride.

Second, and in conclusion, successful international leadership by the United States requires more sustained attention at home and abroad to those who have difficulty benefitting from increased international trade. I think the members of the Committee are well aware of the range of possibilities and I hope that you and the administration will continue to pay attention to them as you move forward. Thank you, Mr. Chairman.

Chairman CRANE. Thank you, Mr. Tarullo.

[The prepared statement of Mr. Tarullo follows:]

Statement of Daniel K. Tarullo, Professor, Georgetown University Law Center

Mr. Chairman, Congressman Levin, I appreciate this opportunity to appear before you today. I am currently a professor at Georgetown University Law Center. Formerly, as you know, I was Assistant to the President for International Economic Policy. I testify before you purely in my individual capacity as an academic, with no client interests or representation.

This hearing was presumably prompted in part by a recent report of the Business Roundtable entitled *The Case for U.S. Trade Leadership: The United States is Falling Behind*. Let me say at the outset that I endorse fully the Business Roundtable's emphasis on the importance of U.S. leadership in trade policy, as in other international economic matters. Constructive U.S. leadership maximizes the chances that the prevailing forms of trade arrangements—regional and multilateral—will reflect American values and promote American interests.

My testimony today is intended to show that consensus on the desirability of U.S. leadership and observation of trade agreements that exclude the United States do not take us very far in deciding upon the best set of policy responses. First, we do not have the kind of data that permit even a rough calculation of the potential harm to the United States from these agreements. Second, we need to recognize that some of the actual or proposed agreements may be motivated precisely by the desire to exclude the United States. Accordingly, even a highly active U.S. trade policy may fail to derail them. Third, even if we all agree that it is important to move forward with trade agreements, the difficult question of our negotiating aims remains.

Thus the Roundtable's report is more a useful starting point for discussion than the basis for action. Following an identification of the potential adverse effects on the United States from other countries' trade agreements, I will elaborate on each of the three points just noted. At the end of my testimony I will suggest two policies beyond launching trade negotiations—one reactive and one proactive—that could strengthen our international position.

Potential Adverse Effects of Agreements that Exclude the United States

In general terms I agree with the proposition that a proliferation of bilateral and regional agreements to which the United States is not party can adversely affect U.S. commercial interests. These adverse effects come in three forms. First is the well-known effect of *trade diversion*. Products from Country A that were not competitive against those of Country Y when each faced a common tariff in Country B may become competitive when Country A's products receive zero tariff treatment in Country B as a result of a free trade area, but Country Y's products continue to be subject to the tariff. Similarly, the harmonization of certain product standards by members of a free trade area could operate to the detriment of producers from non-member countries. Our concern here, of course, is that competitive U.S. exports may lose market shares in other countries solely because they do not benefit from tariff preferences or other benefits.

A second potential negative effect is that a pattern of bilateral and regional agreements with features disadvantageous to the United States might continue to have disadvantageous effects once multilateral negotiations get underway. The Business Roundtable report contains several examples of possible patterns in bilateral and regional agreements that could set precedents the Roundtable believes to be undesirable. For example, the Roundtable fears that the limited coverage of agriculture in free trade agreements concluded by the European Union with other countries may create the view that agriculture is too sensitive to be subject to the normal international rules that govern trade.

While a fairly broad U.S. consensus likely exists around the desirability of fully including agriculture in trade negotiations, other concerns of the Roundtable about precedent are more controversial. For example, the Roundtable cites as another bad precedent certain provisions in the EU-Mexico agreement that protect the privacy of individuals in the dissemination of electronic data. Judging by public and Congressional discussion since passage of the Gramm-Leach-Bliley Act of 1999, I suspect that many members of Congress would be more sympathetic to efforts to protect individual privacy.

A third possible negative effect of a proliferation of bilateral and regional trade agreements is that they may strengthen geopolitical ties among the members of those arrangements so as to diminish U.S. influence with the member countries. This possible negative effect is really the converse of the foreign policy gains that some believe accrue to countries that conclude free trade agreements. It is, however, very difficult to measure gains and losses in geopolitical influence, much less to separate out the effect of trade agreements from the many other factors that determine the state of relations among nations.

Some Questions About the Costs of Agreements that Exclude the United States

The existence of grounds for concern about the spread of agreements among U.S. trading partners does not in itself yield prescriptions for policy. For one thing, the fact that we can assume *some* damage to U.S. commercial and other interests does

not tell us *how much* damage is being caused by these agreements, and thus how urgently a policy response is needed.

There have not—at least to my knowledge—been any careful, systematic studies in recent years of the economic costs to the United States of being excluded from new trade agreements, though some may be underway. It is, of course, quite difficult to quantify accurately the net effects of a free trade agreement, including effects on producers in non-member states. Anecdotes about specific lost sales following a trade agreement may be quite valid, but alone they do not tell us very much. We do not, for example, know from such anecdotes whether there may simply have been a reshuffling of supplier-consumer relations, so that U.S. suppliers are selling more to countries which formerly were supplied by producers from the new free trade area.

Furthermore, if the free trade area is a success and helps promote economic growth in the participating countries, consumers in those countries may make purchases from U.S. firms that they would not otherwise have been able to make. These purchases may be of altogether different goods or services from those which suffered initially as a result of the free trade agreement. Of course, no specific new sales can be traced to the agreement the way lost sales can be linked to a tariff disadvantage, so there are rarely countervailing anecdotes.

Because of the complexity of calculations that are necessary to determine the net economic effects of free trade areas and customs unions, empirical assessments have yielded varying results. While some economic studies have produced findings of statistically significant relative increases in trade within various regional trade groupings (as compared to their trade with the rest of the world), it is very hard to project accurately the impact of any single agreement. Moreover, the difficulties in disentangling the specific effects a free trade agreement from other factors, such as accelerating economic growth in geographically proximate countries, remain substantial. For example, one might expect accelerating growth in both Brazil and Argentina to produce increased bilateral trade at a more rapid rate than that at which their global trade increases, quite apart from the effects of a preferential trade arrangement between them.

The Business Roundtable report does not claim to be an economic study. It is an expression of concern by the organization's membership, which includes the nation's largest exporters. The concern is understandable, and the report has provoked a useful discussion, including this hearing. But it would be misleading to conclude too much from the raw numbers contained in the study. A couple of examples demonstrate this point:

- The report indicates that 33 percent of world exports is covered by preferential trade arrangements concluded by the European Union, whereas only 11 percent of world exports is covered by preferential trade arrangements to which the United States is party. A look at the list of agreements concluded by the EU suggests that the only way to reach the 33 percent figure is to include the Treaty of Rome itself. That is, this number must include exports from Germany to Italy, as well as from Germany to Latvia or Tunisia. Given that we now think of the EU as a single economic unit for trade purposes, the inclusion of such exports is accurate but not particularly meaningful.
- The report notes that as of January 2000 there are 1,857 bilateral investment treaties (BITs) in the world, of which only 43 involve the United States. In the 1990s numerous emerging market and formerly communist countries went on a kind of BIT binge, signing such agreements with just about any other country that wished to do so. Thus, Argentina signed 53, including one with the United States. The other 52 agreements do not "exclude" the United States—they simply provide comparable protections for other countries. The report further notes that Western European nations have negotiated 909 BITs. Again, these numbers are accurate, but standing alone they do not tell the whole story. Because European nations negotiate BITs individually, rather than through the European Union, there would need to be 15 separate BITs to achieve the protection for all EU investors that a single BIT provides U.S. investors. Furthermore, as the report itself indicates, Germany alone has concluded 124 BITs, including with a number of very small countries that are unlikely to host significant foreign investment.

The point of these examples is not to quibble with the report, but simply to caution that an inquiry into the potential negative impact on the United States requires considerably more analysis than the aggregation of numbers of agreements and anecdotes, useful as that may be as a starting point for a more extensive investigation. Again, I do not disagree with the proposition that some harm is likely to result from proliferating trade and investment agreements to which the United States is not party. I do believe that we are some ways from being able to identify the order of magnitude of that harm.

The Possibility of Competing Economic Blocs

One frequently-cited concern in recent years is that Europe and Asia are self-consciously attempting to create economic "blocs" that exclude the United States. Based on the existence of Mercosur, some would add Latin America to the list of potential regional blocs. Concerns along these lines are frequently exaggerated, though not unfounded. More importantly, those who raise concerns about blocs sometimes erroneously conclude that these tendencies are due primarily to the failure of the United States to pursue an aggressive negotiating agenda in recent years, and that they can be reversed if the United States pursues just such an agenda.

The European Union is itself a trading bloc, of course. In its external policies, however, the EU is not so much attempting to extend an exclusive, regional bloc as to extend its influence globally. Its free trade agreement with Mexico and its overtures to Asian nations are two good examples. To be fair to the EU, these initiatives are in part responses to American policy in NAFTA and APEC, respectively. They are also, however, part of an emerging European challenge to U.S. leadership in numerous areas, including trade. Europe's coherence as an international actor is still more latent than realized. But many European officials aspire to co-equal status with the United States. As a byproduct of those aspirations, they resist following U.S. leadership and resent occasions when—as in the Balkans—they are nonetheless forced to do so. In these circumstances, it seems misguided to believe that U.S. trade initiatives will substantially deflect European efforts.

The dynamic between America and Europe that produced the Kennedy, Tokyo, and Uruguay rounds of trade negotiation was itself contentious at times. Even this brand of cooperation is probably gone forever. Rather than believe we can turn back the clock, it is more realistic to prepare ourselves for an extended period of friction with Europe as we redefine our relationship in the post-Cold War era. With skill and luck, our shared values will more than outweigh our sometimes diverging interests. But we should be under no illusion that Europe is simply waiting for us to take up the mantle of economic leadership and will then politely step aside.

Proposals for exclusively Asian economic arrangements have issued for decades. Usually these proposals are not pursued. Even when they have been implemented, as in the case of ASEAN, the member countries have remained quite outward looking. Recent proposals for an approach based on exclusivity should be taken seriously, even though they are far from being realized. However, the very impulse to exclusivity contradicts the notion that a parallel U.S. or multilateral initiative will deflect these efforts. Some countries in the region favor exclusivity because they wish to confine the broad U.S. influence that comes from being the world's remaining superpower. Other countries are not antagonistic to the United States as such, but believe they need to reach a rapprochement on Asian terms with other Asian countries in order to achieve regional stability. To be effective, U.S. policies toward Asia will have to be both patient and nuanced.

Concerns about Latin America have centered on Mercosur, an arrangement among Argentina, Brazil, Paraguay, and Uruguay (with Chile as an associate member). Mercosur began as a trade agreement, with aims for broader economic integration among the existing members and within Latin America as a whole. Yet even those who support a stronger Mercosur as a counterweight to the United States appear to contemplate an eventual negotiation with the United States (or, perhaps, NAFTA). Moreover, Mercosur has been weakened in the aftermath of Brazil's financial problems in 1998–1999. Most countries in the region prefer closer economic ties with the United States.

Trade Policy Decisions Remain

Notwithstanding my first two points, there is surely a sensible trade negotiating agenda which the United States can realistically pursue. Ultimately, the most important question before the Congress and the public is not whether the United States should undertake trade negotiations, but *how* and with *what aims*. The day has long passed when trade agreements could be approached as a simple balancing of the interests of import-sensitive industries with those of export-oriented industries and consumers. The scope of trade agreements has so broadened in recent years that important domestic policies, as well as commercial interests, are regularly implicated in trade policy decisions. For example, recent events underscore the inadequacy of international arrangements to protect food safety and animal health, even as trade in food has been liberalized. Current proposals for trade provisions that would permit foreign investors to challenge non-discriminatory state and local regulations, or that could subordinate consumer protection aims in antitrust policy, raise key issues of national policy.

The Business Roundtable's report quite rightly identifies the need to "build a national consensus that can form the basis of an agreed mandate from the Congress."

In this spirit, the Roundtable goes on address labor and environmental issues and to suggest some possible approaches to those issues. Whether one agrees or disagrees with the Roundtable's specific ideas, one should embrace the Roundtable's desire to seek a serious discussion on how to move forward. Indeed, those who most fear the costs of other trade agreements should have the greatest incentive to address the concerns of citizens who do not stand to benefit directly from new trade agreements involving the United States. Only if we confront the risks and costs attendant to trade and economic integration will we build the consensus that permits full realization of the benefits that come from trade.

Some may respond that a trade policy agenda that pursues such aims, or that excludes ill-advised ideas like placing competition policy in the WTO, will meet with resistance among our trading partners. Of course, some countries will resist some U.S. negotiating aims and preferences. But this is true for commercial negotiating aims as well. The task for Congress will be to devise an approach that can command broad support from the public. Moreover, there is no reason to think that—for example—labor and environment are qualitatively different from intellectual property, product standards, or government procurement in the reception U.S. proposals will elicit from other countries. Indeed, the U.S.-Jordan FTA has evidenced the willingness of a developing country to include labor and environment provisions in a trade agreement. And the importance which the EU attaches to the "precautionary principle" assures that similar topics will be raised by other countries.

Policies to Complement Trade Negotiations

My final point is that it is important to place trade negotiations in perspective. As important as they are, they cannot on their own sustain U.S. economic leadership and protect U.S. interests. Moreover, the difficulties in reaching domestic consensus and international agreement are such as to assure delay in achieving the desirable outcomes that trade negotiations *can* deliver. Let me close by commending to the Congress and the Administration just two examples of policies to complement trade negotiations.

First, I suggest that the United States reconsider its position of acquiescing in trade agreements concluded by the European Union that may well violate WTO rules. Historically, the United States raised questions about the compatibility of free trade agreements concluded by what was then the European Economic Community with Article XXIV of the GATT. The most important, but not the only, issue has been whether certain of those agreements met the Article XXIV requirement that "substantially all trade" be covered in a free trade area. While U.S. officials raised these issues, they did not attempt to block working party reports on the free trade areas in question. Nor has the United States invoked the dispute settlement provisions of the GATT or WTO to challenge any of these agreements. Within the U.S. Government, this posture was justified by the geopolitical imperative of strengthening Western Europe during the Cold War. In the 1990s, geopolitics again counseled restraint as the EU concluded agreements with Central and Eastern European countries, based on the reasoning that it was important to bring these new democracies closer to the established democracies of Western and Southern Europe.

Today we are in substantially different circumstances. As the Business Roundtable report points out, the EU-Mexico agreement does not contain anything approaching complete coverage of agriculture. Presumably, the EU's intended agreements with South American countries will have similarly limited coverage. Insofar as European Commission officials have explicitly stated their intention to "consolidate" their leading commercial position in South America through such agreements, it seems to me that there is no strong geopolitical reason to acquiesce in possible WTO violations.

This is not to say that the United States should immediately begin challenges to one or more EU agreements. Nor is it to say that any of these is a clear violation. In fact, the requirements of Article XXIV have barely been developed in the GATT and WTO. But the European Union should not have a free ride if it is evading multilateral rules governing the free trade areas it is concluding outside Europe. We should make this policy position clear. Then, if and as appropriate, the United States should challenge non-conforming agreements in the WTO Committee on Regional Trade Agreements, in dispute settlement proceedings, or both.

My second recommendation is hardly novel but, I believe crucial nonetheless. Successful international economic leadership by the United States requires more sustained attention, both at home and abroad, to those who will have difficulty benefiting from increased international trade. At home we must take more seriously the plight of workers, particularly unskilled and semi-skilled workers, who will be dislocated because of agreements that are beneficial to Americans as a whole. Modest

programs for dislocated workers, usually passed in an effort to move a particular fast-track authorization or trade agreement, will not do the job.

Internationally, we must recognize how much our leadership suffers when we fail to meet financial obligations to which we have already committed ourselves, or when we only grudgingly contribute to development efforts for the poorest countries, such as replenishing funds the International Development Association. I can testify from experience as the President's "sherpa" in preparation for G–7 Summit meetings how much of my time was spent fending off criticism, even from our friends, to the detriment of our efforts to advance our affirmative agenda.

Beyond the simple but important responsibility of the United States as the world's richest nation to do its part in meeting global problems, a more generous and well-conceived development policy can yield benefits for our capacity and credibility as a world leader. In some instances, there may also be ways to accomplish commercial aims through technical and financial assistance and to do so with less rancor than is often produced in trade negotiations. For instance, the Roundtable report mentions European and Japanese technical assistance programs for developing countries. One byproduct of such programs can be a leg up for companies from the assisting country, since the assistance is presumably compatible with standards developed at home. While such advantages should not themselves drive decisions on technical assistance, there is an obvious opportunity to serve commercial and genuine development needs simultaneously.

There are obviously many other possible complementary policies. While the merits of any one such policy can be the subject of good faith differences of view, it is disconcerting that, at a time when we are preparing to spend a good part of the budget surplus anticipated in coming years, so little attention has been paid to the needs of globalization's losers.

I thank you for your attention, and would be happy to answer any questions.

Chairman CRANE. We are going to be interrupted here shortly by a couple of votes on the floor and we will recess, but we will wait until the second bells go off. In the interim, I have a question for the entire panel.

Some have said that the U.S.-Jordan Free Trade Agreement is a political document closely related to the Middle East peace process. What do you see as the benefits and pitfalls of this agreement from a trade perspective? Yes, Mr. Donohue?

Mr. DONOHUE. Mr. Chairman, the total trade between the U.S. and Jordan is less than $300 million. A great portion of that is money that we give them to buy weapons from us. They are a very important strategic country to us. We have hosted the King at the Chamber on a number of occasions. But this agreement, which he sought for strategic reasons, was then loaded up with the labor and environmental provisions as a cost of getting the agreement and was then sold to the labor unions and others as the template that they would use for future trade agreements. And to retract—there is very little trade going on here.

If we decide that this is something strategically we should do, then Congress is very able to take care of it. It was not done under a fast track provision, so Congress can remove the defined template of labor and environmental issues, which can and should be dealt with in other ways, and pass the strategic agreement without any delusion that it is a free trade agreement. There is no trade going on.

And the Chamber and other members of the business community will oppose this agreement if it contains those provisions, not because we have any problem with Jordan or with a free trade agree-