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Memos to the Next PRESIDENT

To: The Next President

From: Edward Gresser, Director, PPI Trade and Global Markets Project

Re: Achieving Peace and Prosperity in the Greater Middle East—One Tariff-Free Towel at a Time

As you take office, you face a financial crisis more dangerous than any in decades. You inherit two wars, an angry Russia, a China claiming its place among the world's great economic powers, anti-American populism in South America, and a shaky nuclear status quo in North Korea. You are launching an ambitious domestic agenda—on everything from health reform to climate change—just as government finances collapse.

This is a lot. Some would say it's more than enough. But let me argue for one big addition: a major effort to support the Muslim-world economy, with trade policy as the central tool. We should waive tariffs on goods from the greater Middle East in order to encourage investment, job creation, and development in the world's most troubled region.

Our Gravest Problem

Why should this be a priority, when you have so much else to do? Because our nation's relationship with the Muslim Middle East is our gravest challenge. That's right—even with a financial crisis threatening our economy, it is our troubled interaction with the greater Middle East (defined, for these purposes, as the band of nations running from Morocco to Pakistan) that truly represents the most serious threat to our national security and well-being.

And so far, none of our efforts to stabilize or pacify this region have worked. We have tried aid programs, military action, sanctions, and diplomacy. Each of these approaches has failed to arrest the region's deterioration.

There is another alternative, one that offers greater promise than anything we have yet attempted. It is trade policy—supported by aid, diplomacy, intelligence, and military capability—that offers the best hope for truly constructive change in the greater Middle East.

Let me offer a bit more detail. First, consider three specific facets of our relationship with the majority-Muslim countries from North Africa to Central Asia:

- This relationship is vexed by a series of individual crises: fragile stability in Iraq; alarming slides in Afghanistan; a potential civil war in Lebanon; confident belligerence in Iran; deadlocked Arab-Israeli dialogues; and a nuclear-armed Pakistan that, in the aftermath of the Mumbai attacks, may be in for a period of renewed tensions with India and deepening uncertainty about its ability to control its own security services.

- The United States faces a stalemated "war on terror" in which military and intelligence tools are approaching their limits, while al Qaeda and its associates seem to be regaining strength; and

- We must contend with broadly hostile public attitudes throughout the Muslim world: polling finds that Muslim-world publics view America with suspicion at best and intense hostility at worst, complicating any American diplomatic initiative and making American support for political reform exceptionally difficult.

The global economic crisis is likely to intensify all of these problems. Pakistan, with all of the security challenges just mentioned, is close to sovereign default and financial collapse. Oil exporters in the Persian Gulf may see their incomes fall by 50 percent next year—which is bad for them, but even worse for countries like Lebanon, Afghanistan, Iraq, Turkey, Bangladesh, and (once again) Pakistan, which rely on remittances from workers in this region. Thus, social pressure in the Muslim countries will rise next year, swelling the pools of unemployed and angry young men that extremist movements recruit as their foot soldiers.

The Standard Policy Tools are Failing

Why should trade policy, controversial as it is among American progressives, be the mechanism for helping to bring about positive change in the greater Middle East? The modest answer would be that previous mechanisms simply have not worked.

The Bush administration made military and intelligence actions the center of policy. Soldiers and spies had some important successes after the Sept. 11 attacks, notably in driving al Qaeda out of its former havens in Afghanistan. But a military-centered U.S. policy has also deepened Muslim public anger, with the Iraq war in particular bringing American motives under grave suspicion.

Traditional progressive remedies, unfortunately, are not much more compelling.

One perennial idea is a big new aid program, often labeled a "Marshall Plan for the Middle East." But aid to Pakistan in the 1970s and 1980s did not help moderate Pakistani politicians. Nor have aid programs for Egypt brought development or eased anti-American sentiment. Finally, a new Marshall Plan for a region which earned a trillion dollars selling oil last year does not make sense.

What about sanctions as a way to push reform? No area of the world is more sanctioned than the Middle East. To put it mildly, its politics have not improved. How about democratic reform in the Arab lands? Unfortunately, the Iraq war cracked whatever base of Muslim-world support existed for it.

Would solving the Arab-Israeli dispute be the key to stability in the region? No doubt it would help. But this has proved quite difficult to achieve, and it probably is not enough on its own: After all, al Qaeda itself emerged as the Clinton administration tried to bridge the Israeli-Palestinian divide in the Oslo process.

All of this is not to say that aid is pointless, or that sanctions are never an option, or that there is no reason to revive the Middle East peace process, or that we should not support democratization. It is simply to suggest that these classic progressive policy prescriptions are not enough—and never will be. Something else is needed.

Why Trade? A Look at the Muslim World's Depression

The missing element in U.S. policy has been economics. The Muslim world has endured a prolonged and little-recognized economic depression. Failure in trade is among its main causes, and trade policy is therefore a practical strategy for fighting unemployment and generating an economic recovery in the region.

Let's begin with the obvious question: Why does the greater Middle East produce extremists when other regions do not? Paul Collier, in *The Bottom Billion*, suggests an answer. His statistical analysis of civil wars found that neither democracy nor autocracy nor historic grievances have close association with outbreaks of civil war. Only two things do: low income and economic contraction. According to Collier:

> "[A] low-income country faces a risk of civil war of about 14 percent in any five-year period. Each percentage point of growth knocks off a percentage point from this risk. So if a country grows at 3 percent, the risk is cut from 14 to 11 percent; if its economy declines at 3 percent, the risk increases."[1]

History elsewhere suggests a strong link between economic suffering and radicalism. In the 1930s, European fascism and communism drew strength from the Depression. The revolutionary communist movements of Southeast Asia and Latin America during the 1960s and 1970s likewise emerged during periods of deep economic stress and withered as economies recovered. The greater Middle East may not be so different, even though its characteristic extremism is derived from perverse interpretations of religious doctrine rather than from nationalism or egalitarianism.

This region was the unrecognized loser of the "globalization" era. Between 1982 (the year the first oil boom ended) and 2000, its people endured simultaneous demographic growth and economic contraction. As Table 1 shows, its combined populations grew by nearly half a billion people. Meanwhile, its share of world trade and investment collapsed.

TABLE 1: DEMOGRAPHIC BOOM, ECONOMIC BUST

	Greater Middle East Population	Share of World Exports
1980	400 million	13.5 percent
2000	710 million	4.5 percent

Taken together, a rising population and a shrinking economy mean poverty. According to the UN Development Program's widely praised studies of the Arab economies, Arab per-capita GDP fell by nearly 25 percent between 1980 and 2000, from $2,300 to $1,650.[2] The region's unemployment rate became the world's worst—the International Labor Organization places it at 12 percent, double the world's 6.3 percent rate. Among young people, it is 25 percent.[3]

In such times, ordinary people feel—correctly—that their future is bleak and their children's is likely to be worse. Governments fall into discredit, and radicals find an audience.

The oil-fueled surge of growth since 2005 is no solution. While it has brought a gush of cash into the region, commodity-export booms, even in good times, do little to create jobs. Rather, they tend to centralize power and increase inequality. The evanescent gains of such periods are always prone to sudden collapse when prices turn down. Even today, petro-optimism is fading, as the high oil prices of 2006 and 2007 fall.

The reality is that the greater Middle East remains isolated from the global economy: The region's share of manufacturing and farm trade remains minuscule, accounting for only 1 percent of the world total even though the region comprises a full 10 percent of the globe's population.

Anyone who thinks foreign aid can make a decisive difference here should think again. Consider first its modest scale—all world aid programs combined total approximately $120 billion annually, one-half of the money Saudi Arabia alone earns from oil. And like oil cash, aid does little to help with unemployment. Effective programs that can help willing governments create better schools, strengthen women's rights, improve business climates' and provide more effective public services are important. But the region needs jobs most of all, and here trade is more effective: One shipping container filled with Pakistani towels, for example, puts 485 men and women to work.

The Perversity of the Current American Trade Regime

Supporting growth and job creation through trade is our best chance to bring down the political temperature in the Middle East. But today we are doing just the opposite—America's trade regime tilts sharply (albeit unintentionally) *against* the Muslim world.

As Table 2 shows, our permanent tariff system imposes higher penalties on the goods big Muslim countries export than on those we buy from wealthy countries. On average, American tariffs are approximately 2.4 percent. But for the exports most important to Pakistan, Egypt, Turkey, Bangladesh, Lebanon and other countries in the region—clothes, bedsheets, towels, shoes, glass, luggage, ceramics—the average tariff rises to 15 percent. Pakistan, infuriatingly, gets the same tariff pen-

TABLE 2: THE AMERICAN TARIFF SYSTEM'S TILT AGAINST PREDOMINANTLY MUSLIM NATIONS

Country	Imports	Tariff Penalty	Tariff Rate
Bangladesh	$3.4 billion	$523 million	15.4%
Pakistan	$3.6 billion	$365 million	10.1%
Turkey	$4.6 billion	$169 million	3.7%
Tunisia	$0.45 billion	$12 million	2.7%
Indonesia	$14.4 billion	$840 million	5.8%
Brazil	$25.0 billion	$452 million	1.8%
WORLD	**$1.94 trillion**	**$26.1 billion**	**1.4%**
Lebanon	$0.1 billion	$1 million	1.0%
France	$41.2 billion	$378 million	0.9%
UK	$57 billion	$412 million	0.7%
Norway	$7.2 billion	$28 million	0.5%
Egypt	$2.4 billion	$10 million	0.4%
Russia	$19.6 billion	$61 million	0.3%
Saudi Arabia	$35.2 billion	$45 million	0.1%
Venezuela	$37.4 billion	$38 million	0.1%
South Africa	$9.1 billion	$7 million	0.01%

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alty on $3.6 billion in towels and clothes that France receives on more than $40 billion in medicines, wines, paintings, and airplane parts.

Second, our collection of free-trade agreements and trade preference programs places many Muslim countries at a disadvantage vis-à-vis direct competitors elsewhere in the world. For example, each Pakistani towel gets a standard tariff penalty of 9.1 percent. The same towel, imported from any of 73 competing countries enrolled in trade preference programs or a Free Trade Agreement, gets no tariff at all.

Toward a Better Trade Program

Peacemaking and political reform are failing in the greater Middle East. You will need to show

TABLE 3: AMERICAN TARIFFS ON LEADING EXPORT GOODS FROM SELECTED PREDOMINANTLY MUSLIM NATIONS

Country	Top Export	Tariff Penalty (Muslim state)	Tariff Penalty (FTA/preference country)
Pakistan	Cotton terry towel	9.1%	0%
Bangladesh	Men's cotton pants	16.6%	0%
Indonesia	Cotton pullover shirts	16.5%	0%
Turkey	Travertine building stone	3.7%	0%

the region's young people that they can find a job, support a family, and offer their children something better. Neither military policy nor sanctions nor aid can do this. Trade has the best chance—and it is sad to see America's present trade policy doing the opposite.

You have a chance to put it right. I suggest a simple waiver of tariffs on goods from moderate Middle Eastern nations that denounce terrorism and cooperate in regional peace efforts. This step alone would spur investment and job creation.

The best goods to target with such a waiver would be clothes, home textiles, and light manufactures in ceramics and glass—these industries create urban jobs—along with some selected farm products like olives and olive oil to bring some money to rural areas.

To be truly effective, such a waiver should be instituted not only by the United States, but also by Europe, Japan, and China. All of these economic powers have obvious stakes in a Middle East that is more stable, less violent, and better able to balance oil revenue with normal and healthy farming and manufacturing sectors.

The cost to American taxpayers would be nil—in fact, they would get modest benefits from the program through lower store prices. Nor would the remaining American workers in these light industries lose. Tariff waivers would simply divert some imports from more diversified, faster-growing China, India and Vietnam.

The Need to Act Fast

The important thing is that this program start soon, because the status quo will deteriorate quickly. As the financial crisis spreads from rich world to poor, a few billion dollars more in purchases of towels, raisins, and T-shirts from places like Karachi, Istanbul, Tunis, and Beirut will pull hundreds of thousands of young people off the streets and into factories and offices where they can earn salaries. The pools of support for fundamentalist groups will shrink. And as this proceeds, radicals will find their pools of support shrinking, while your diplomats will find the region's problems somewhat more amenable to compromise solutions.

Of course, you already have a big agenda, and trade is controversial among progressives. But our gravest single problem is worth an exceptional response. Your opportunity to reshape our relationship with the Muslim world is now—building on the good feelings aroused by your election, before the worst of the financial crisis hits. Take the opportunity. A year from now, it may be gone.

Endnotes

1. Collier, Paul, *The Bottom Billion: Why the Poorest Countries are Failing and What Can be Done About It*, Oxford University Press, 2007, pg. 20.
2. UN Development Program, *Arab Human Development Report 2002*, page 88, available at *http://www.undp.org/rbas/ahdr/bychapter.html.*
3. International Labor Organization, Key Indicators of the Labor Market, 2007, Chapter 9, pg. 7: *http://www.ilo.org/public/english/employment/strat/kilm/download/kilm09.pdf.*

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