Carrots and Sticks: The Role of Economic Incentives in American Foreign Policy

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Abstract

If economic sanctions have, at best, a checkered history, might positive inducements be worth more consideration? Under what conditions might offers to expand trade or aid, or to extend other economic incentives be effective tools of American foreign policy? Are positive and negative incentives competing or complementary tools of foreign policy? In some cases, positive incentives are part of a carrot and stick bargaining process, such as the framework agreement that temporarily froze North Korea's nuclear weapons program in the late 1990s. More recently, the wars in Afghanistan and Pakistan have led to discussions about the role of development assistance and trade deals in state-building. In the latter case, the links between economic incentives and particular foreign policy objectives are more diffuse, but crucially important.

Another key difference between positive and negative economic incentives that will be explored in the paper is the role of Congress and its relationship with the executive branch. The executive branch has a great deal of authority under existing legislation to impose economic sanctions, but it must rely on Congress to appropriate funds for aid or to approve trade agreements. And, while Congress often seems to be in a position of pushing the executive branch to use sanctions more aggressively, it is often far more ambivalent toward aid and trade, even when national security is involved. In addition, international rules on trade emphasize nondiscrimination and impose constraints in that area as well.

Military action is costly and policymakers have long sought to supplement diplomacy with economic tools to pursue foreign policy goals without resorting to force. Economic sanctions became an increasingly common tool of American foreign policy over the latter half of the 20th century, but they contributed to achievement of U.S. goals only about a third of the time. Over this period, foreign aid and trade were also used to build and strengthen alliances and, in more recent years, as tools of state-building in countries whose fragility could threaten American interests. A paper for last year's Tobin Project national security conference focused on economic sanctions but concluded that the skillful use of carrots and sticks together would be more effective in some situations than either alone.[1] This paper focuses on positive economic incentives, beginning with the conditions under which they might be helpful and how they differ from economic sanctions. It then turns to a discussion of tools available to the U.S. government in this area and the potential constraints on their use. It concludes with a brief discussion of the use of aid and trade as incentives in Pakistan to highlight the difficulties and challenges in using positive incentives effectively as tools of persuasion.

How Do Positive and Negative Economic Incentives Differ?

The use of positive incentives, like economic sanctions, can be either conditional or unconditional. In the former case, incentives are offered as part of a more or less explicit bargaining process with the expectation of some reciprocal movement in the direction that the engager desires. Completely unconditional incentives are rare, but relatively untied aid, trade, or other positive incentives are often extended as part of longer-term strategies to build a country's capacity or generally influence its policy direction in ways that support cooperative outcomes. The primary focus here, as with much of the literature on sanctions, is on the uses of incentives in bargaining situations.

Before turning to the analysis, a brief definition of terms and how they will be used is needed. First, "incentive" is used generically to refer to both positive and negative measures, but "sanction" is used only in reference to negative incentives. To simplify the discussion of various actors, "sender" will be used to refer to the country offering or threatening the imposition of incentives and "target" will be used to refer to the country the sender is trying to persuade or coerce. The choice of these terms does not indicate use of a rational, unitary model for the analysis, however.

As a general matter, economic incentives in foreign policy are intended to change the behavior of targeted actors by manipulating the costs and benefits they face. As pointed out by David Baldwin (1971) 40 years ago, these tools are not simply opposite sides of the same coin and he lamented the fact that scholars to that point had neglected what he called positive sanctions in

[1] That chapter was based on analysis in Hufbauer, Schott, Elliott, and Oegg (2007).

their analysis of power. That lacuna has been filled to an important degree with contributions from Long (1996), Cortright (1997), Drezner (1999), and Haass and O'Sullivan (2000).[2] In addition, Etel Solingnen is organizing an edited volume on positive incentives with a focus on nonproliferation goals that should be available in 2011.

The situations in which a policymaker might choose to use positive rather than negative incentives will clearly differ, as will the conditions for effectiveness. Still, a useful heuristic for starting to think about the conditions underlying an effective persuasion attempt is actually the flipside of the sanctions coin as described in last year's paper. For sanctions:

> *The costs of defiance imposed on the target by sanctions must be greater than the perceived costs to the target of complying with the sanctioner's demands.*

For positive incentives:

> *The benefit to the target from promised rewards for changing behavior must be greater than the perceived benefit to the target from staying the course.*

Similarly, a necessary condition for either a successful persuasion or coercion effort is that the sender have leverage, in terms of trade and financial relations, vis-à-vis the target. In this case, the sender must have something to offer that the target values and, the greater the scope of what the sender can promise (or threaten), the greater the scope of foreign policy challenges that *might* be within reach. But, just as the pain of sanctions will not be sufficient when the target's costs of compliance are simply too high, for example when they involve loss of power or threats to national security, the same will be true of economic promises.

With respect to five key explanatory variables—the difficulty of the goal sought, relations between sender and target, nature of the regime in the target, role of globalization and the need for international cooperation, and costs and domestic politics in the sender—there are interesting differences. First, with respect to goals, two of the recent analyses reach different but complementary conclusions. Haass and O'Sullivan (2000, p. 167) conclude that, "[e]ngagement should be considered mostly as a means for achieving modest goals, although on occasion it can be a vehicle for pursuing more ambitious ones," which is similar to the Hufbauer, Schott, Elliott, and Oegg (2007) conclusion on sanctions (henceforth HSEO). Drezner (1999, pp. 52-53), on the other hand, concludes that carrots will not be offered to adversaries very often, but they may be the only viable choice when the sender's demand is non-negotiable

[2] With widely varying degrees of detail, Long analyzes three case studies of trade and technology transfer in support of U.S. foreign policy; Cortright edits a volume that covers 10 case studies of incentives to prevent conflict and nuclear proliferation; the Haass and O'Sullivan edited volume includes seven case studies; and Drezner has the one case study of carrots offered to North Korea as a contrast to his analysis of economic coercion in the former Soviet Union.

and sanctions would be likely to result in deadlock. Both analyses point to North Korea as a case of successful engagement and one where sanctions alone were unlikely to achieve positive results. That case is discussed further below.

Second, and paradoxically, positive incentives may be relatively more effective with adversaries than sanctions, which tend to be more effective against. HSEO conclude that allies are more vulnerable to economic coercion primarily because they conduct more trade and investment with or receive more aid from the sender than do adversaries. Thus, carrots may be relatively more available than sticks when bargaining with an adversary, particularly when the target is already subject to extensive sanctions and the lifting of restrictions becomes a positive incentive. Drezner (op cit.) attributes adversaries' strong resistance to capitulation to concerns that it will make them more vulnerable in future conflicts; allies that are less concerned about the potential for future conflicts will be more willing to compromise. While a targeted country will obviously not want to become dependent on an adversary for trade, aid, or investment, it may be less concerned about reputational losses in future conflicts when considering an offer to engage. Drezner argues, however, that senders will be concerned about possibly looking weak by offering carrots and will be reluctant to do so in most cases. When reducing conflict is the goal, however, perhaps relative gains concerns matter less. Similarly, Baldwin (1971) and Long (2006) note that the target is likely to respond differently to a threat than to a promise—with "fear, anxiety, and resistance," instead of "hope, reassurance, attraction"—and that this will make subsequent communication and cooperation more difficult.

Third, HSEO conclude that authoritarian regimes are less susceptible to sanctions, while Haass and O'Sullivan (2000, p. 162) conclude that the "best potential candidates for conditional engagement are often countries in which decisionmaking is highly concentrated."[3] An authoritarian regime, which often also controls the economy with a heavier hand, may be in a better position to organize evasion strategies and manipulate sanctions to shield themselves and their key supporters. In the case of a conditional engagement strategy, the target must be able to deliver what it promises on its side of the bargain and narrower, more authoritarian regimes may be better able to do so than more open or divided governments.

Fourth, globalization may be more friendly to positive incentives than to sanctions. Increased international economic integration means that there are many alternative suppliers of or markets for most goods when sanctions are unilateral, yet international cooperation to bolster the impact can be difficult and costly to organize. Unless a really large carrot is needed,

[3] Haass and O'Sullivan later note (pp. 172-74), however, that long-term, unconditional engagement may be useful in trying to support civil society groups, or the military, that may move the country in a positive direction over time.

cooperation may not be as important with positive incentives. The flipside for adversaries is that globalization lowers the risk that accepting incentives will lead to excessive dependence on the sender for trade, aid or other finance. That should mitigate the target's concerns about negative relative gains.

Fifth, Baldwin, Long, and Haass and O'Sullivan all note that the domestic consequences may make engagement strategies more sustainable than sanctions policies because they open new opportunities for trade or investment, rather than imposing, potentially steep, costs on domestic firms. That seems plausible, but it must also be noted that the business community has had surprisingly little impact on U.S. sanctions policy. Moreover, from the government's perspective, most economic sanctions are either off-budget (because private firms bear the costs) or save taxpayer dollars (if aid is suspended or cut off), while many positive incentives will have budget consequences for the government offering them. This will be discussed further below. Baldwin and Haass and O'Sullivan also point to other domestic political constraints on using positive incentives, which will also be discussed below.

Finally, what the contrasts discussed above miss are the often complementary interactions between diplomacy and carrots and sticks and how they can jointly influence costs and benefits of compliance and defiance. Maller (2010) analyzes how diplomatic sanctions can impede progress toward U.S. foreign policy goals, including undermining the effective implementation of economic sanctions by cutting off information sources and communication flows. One of the recommendations in Haass and O'Sullivan (2000, pp. 174-75) for effective implementation of engagement strategies is to always include the credible threat of penalties. Cortright (1997, chapter 11) observes that a combination of carrots and sticks are, in practice, present in most cases analyzed and that rewards for cooperation are needed to complement threats when the goal is anything other than unconditional surrender.

Two current examples may help to illustrate the potential interactions and how the various tools can be used in support of one another. In confronting North Korea in the mid-1990s, over its threat to leave the Non-Proliferation Treaty and begin reprocessing spent fuel from the Yongbyon reactor, the United States possessed little unilateral economic leverage because of long-standing sanctions from the Korean War. It also faced opposition from China and Russia, and some resistance from South Korea and Japan, to its efforts to secure multilateral sanctions at the United Nations to increase the costs of defiance for North Korea. Thus, American policymakers pushed forward on multiple tracks, seeking a UN resolution that would mandate mild but escalating sanctions, making clear that military options were not off the table (e.g., by suggesting Patriot missiles might be moved to South Korea), and by ultimately being willing to bargain with Pyongyang and offer energy and other incentives in exchange for cooperation on the nuclear program. The threat of sanctions appears to have been useful in constraining North Korean behavior at times, but the incentives in the framework agreement were ultimately required to reach a final deal. Haass and O'Sullivan (ibid.) conclude that it was the combination of carrots and sticks that was effective, disagreeing with the case study author in the volume, Leon Sigal, who concludes that the positive incentives alone were sufficient to get an agreement. Drezner (1999, pp. 302-03) also concludes that the carrots were decisive, but that sticks induced North Korean cooperation at times on lesser issues.[4]

In Iran, U.S. policymakers face similar challenges. While the recent tightening of UN economic sanctions, bolstered by aggressive implementation particularly in the United States and European Union, seems to be having more economic impact, China, in particular, remains reluctant to cooperate. Iran recently indicated a willingness to resume negotiations over its nuclear programs, but whether it will agree to meaningful concessions remains unclear. A willingness by U.S. policymakers to address Iran's security concerns and ultimately to normalize relations, which would reduce Iran's costs of compliance, might bring a resolution within reach.

While the empirical evidence on the utility of positive economic incentives for specific foreign policy goals continues to expand, there is already an extensive literature on foreign aid conditionality and the story there is not any happier than for economic sanctions. While approaches are changing somewhat, donors in the 1980s and 1990s, particularly the International Monetary Fund and World Bank, conditioned aid flows on policy reforms that they believed would make the aid more effective in promoting development. A few years ago, William Easterly (2002) examined the experience with "structural adjustment" loans (SALs), which coupled financing for balance of payment deficits with policy conditions aimed at promoting growth, which would then allow the countries to pay back the loans. Instead, what Easterly found was that growth did not follow and the international financial institutions had to make new loans to avoid defaults on the previous ones. Of the top 20 recipients of structural adjustment loans between 1980 and 1999, the average country received 19 SALs, the minimum was 14 loans, and Argentina received 30 loans, more than one a year. On average, annual per capita growth in these countries was basically zero (0.1 percent versus 0.3 percent for developing countries overall) (ibid., p. 25).

[4] One of the case studies in the forthcoming project on positive incentives by Solingen is an excellent analysis of the use of incentives in bargaining with North Korea over the past decade by Stephan Haggard and Marcus Noland.

Development expert Owen Barder recently reviewed the literature and concluded that "there is *no* evidence that policy conditionality is effective at promoting reform" (emphasis in original).[5] He points to three possible explanations for the failure of policy conditionality:

- Threats to suspend or withdraw aid were not credible.
- Per the analysis of sanctions, the political costs to target governments of complying with donors' demands were greater than the potential benefits of aid.
- Again as with sanctions, if donors do not coordinate, then a cut-off by one may be offset by continued or increased aid from another.

In addition to quid pro quo bargaining situations, economic tools are often used to either constrain or to build the capacity of other countries in ways that are broadly supportive of foreign policy goals. Thus, while export controls during the Cold War were often manipulated to influence specific disputes over human rights or other issues, the overarching purpose was to reduce the military capability of the Soviet Union and thereby reduce its ability to threaten U.S. interests. Similarly economic and military aid, while frequently manipulated in specific influence attempts, were broadly justified during the Cold War as a means of supporting friends, cementing alliances, and, at least nominally, promoting economic development. After the Soviet collapse, economic development moved to the fore, both for humanitarian reasons and because it serves U.S. interests in promoting global peace and prosperity, if successful. Over this period, "state-building" in fragile states that could become havens for terrorism, disease, or criminal activities also became an important goal of U.S. foreign assistance, at least in rhetoric.

Even when the strategy is long-term and intended to move a country generally in a desired direction, a key question is whether the goal involves an element of persuasion, albeit of a gentler variety, or support for a government with weak capacity that is already moving in the right direction. Citing Killick (1998), Barder (ibid.) notes that there is a "considerable body of evidence over the years [that] concludes that aid conditions are only positively correlated with reform if there is a pre-existing intention on the part of the government to improve its policies." This supports the direction that many donors, including the United States with the Millennium Challenge Account, are moving, which is towards setting conditions a priori and then rewarding "good performers" that meet those conditions. However, there is still the problem noted by Barder, and supported by the Easterly analysis of structural adjustment loans, that incentives are not effective if donors are unwilling to cut off aid when countries regress. In general, problems are created when donors demand long lists of conditions that may be inconsistent or unclear, or where different agencies within the government disagree on which goals should

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[5] Owen Barder, "What sort of conditions should there be on aid?" from Owen Abroad, available at www.owen.org/musings/conditionality, accessed on August 17, 2010.

have priority. Uncertainty about the implementation of conditions can also discourage trade and investment, thereby undermining long run growth and development objectives.

Positive Incentives in the U.S. Toolbox: Opportunities and Challenges

Potential positive incentives that could be extended by the U.S. government include, on the one hand, the restoration of trade or financial flows that were previously restricted, or offers to provide additional incentives to promote those flows on the other. In cases where the target country is unfriendly, lifting or easing sanctions will often be an obvious carrot. In other cases, where new carrots are needed, the president will often confront a variety of budgetary, institutional, and political constraints.

But there also constraints on sanctions removal, occasionally legal but more often political. In general, the executive branch has broad authority from Congress to impose sanctions under the Trading With the Enemy Act, the International Emergency Economic Powers Act, and other statutes. When sanctions are imposed under executive authority, the president also generally has discretion in determining whether and how to lift them. In recent years, however, Congress has been pushing back against that discretion and trying to force the president’s hand, particularly with respect to Cuba and Iran (and Libya until recently). While legislation in both cases was aimed at increasing the impact of U.S. unilateral sanctions by penalizing other countries’ firms that did business in Cuba or Iran, Congress provided national interest waivers and presidents from both parties have used them extensively. In the Cuba case, Congress more tightly restricted presidential discretion by codifying the sanctions that were initially imposed under executive orders and specifying a long list of conditions that must be met before the president can lift the most significant sanctions on trade and finance.

When it comes to providing more aid, or encouraging trade or investment with other countries, the president’s standing authority is more limited and he will often find himself needing congressional cooperation. In addition, Baldwin (1971) and Haass and O’Sullivan also note that offering carrots is often less politically popular than wielding the stick and can lead to criticisms that the president is too soft, or is rewarding dictators. In some cases, presidents may only pay a political price, and likely a relatively small one since Americans seldom base their votes on foreign policy issues. But in others, he could find his policy undermined by domestic political opposition, such as when Congress in the 1990s refused to fund President Clinton’s commitment under the framework agreement to provide fuel oil to North Korea. While presidents can offer incentives through programs to promote foreign investment, license technology, provide visas and encourage scientific and other people exchanges, the following sections focus on the two major tools, aid and trade, and key constraints on using them.[6]

Foreign Aid

In Fiscal Year 2009, foreign operations spending (excluding supplemental appropriations) was $34 billion. Of that, nearly $7.3 billion was spent on global health (mainly for HIV/AIDS), $6.2 billion on foreign military financing, of which $4 billion went to Egypt and Israel, $3 billion for Afghanistan and Pakistan, and $2.5 billion for multilateral economic assistance and the international financial institutions, almost $20 billion in all. That leaves less than $15 billion for all other sectors and parts of the globe, much of that earmarked for particular countries or projects. The U.S. Foreign Assistance Act has been amended repeatedly and not rewritten since the Kennedy administration. The accretion of congressional mandates and earmarks limits executive branch flexibility significantly.

For the next several years, budget pressures will be a major constraint on U.S. foreign aid. In addition, despite top level attention from the White House, with the Presidential Policy Directive on Development, and the State Department, with the new Quadrennial Diplomacy and Development Review, is it not clear that the administration is going to succeed in solving the coordination problems involved in having aid strategy and delivery spread across the government. Moreover, there is a major battle going on within the administration over the relationship between the development and diplomacy legs of the national security policy stool (with defense as the third leg). It is positive for development that Secretary of State Hillary Clinton is personally interested and places a high priority on making development assistance a stronger tool of American policy. The concern in the development community is that if the State Department, rather than USAID, is in control of policy and budget decisions, development policy will be subordinate to diplomacy. That might be good for using aid as a tool of short-run influence (though with no guarantee of effectiveness) and bad for long-run economic development. An even bigger problem is that no one really knows how to "do development" in fragile states with little security, weak states, and few viable institutions.

Trade

[6] The U.S. government has a limited role in encouraging foreign investment in developing countries, by providing risk insurance from the Overseas Private Insurance Corporation and by signing bilateral investment and tax treaties, which also contribute to lower risks or costs for U.S. corporations. But those flows still depend on whether private firms see a profitable opportunity or not and the government can generally only affect the decision at the margin. The president has somewhat more control over technology licensing and immigration, but within statutory limits in the former case, and very tight political constraints in the latter case.

In general, trade is conducted by private actors with relatively limited interference from governments, at least in the more developed economies. Government influence over these private actors is also asymmetric, at least in theory, since firms are legally bound to respect sanctions orders, but have no obligation to create or expand trade with a target country in the service of foreign policy goals. In other words, providing positive incentives to a target country requires the executive branch to, first, offer incentives to the private firms whose cooperation is needed. In addition, there is a well-developed set of international trade rules, overseen by the World Trade Organization (WTO), that limits member governments' freedom of action with respect to trade. In particular, the "most-favored nation" principle is the foundation for the rules-based trade system and it requires members to extend the same treatment to all other members as it extends to its "most-favored" trade partner.

Under the WTO system, there are two important exceptions to the MFN principle that leave some scope for using trade as an incentive: unilateral trade preferences, under which countries reduce or eliminate tariffs on eligible exports from poorer countries; and free trade agreements (FTAs), under which parties reciprocally reduce barriers to one another's exports.[7] The basis under international trade rules for the former is the Generalized System of Preferences (GSP), which permits developed countries to discriminate in favor of developing countries, but then requires that all developing countries are treated similarly.[8] With respect to FTAs, the international rules say only that they should cover "substantially all trade." But there is no explicit definition of that phrase and, in practice, it has done little to stem the explosion of FTAs around the world over the past two decades. When the WTO was created in 1995, there were 40 regional trade agreements notified and today it is over 200.[9] Of those, the European Union is party to 30 and the United States to 11.

Under unilateral trade preference programs, preference-giving countries are free to choose which products they will cover, but the incentive is supposed to be provided unconditionally to all developing countries with the long-run goal of promoting growth and economic development. The European Union's GSP program has few conditions and is available to most

[7] Until 2005, another exception under international trade rules was the Multi-Fiber Arrangement, which allowed importing countries to negotiate bilateral quotas to manage international trade in textiles and apparel. In the 1990s, the United States used the incentive of a larger quota allocation to persuade Cambodia to better enforce worker rights and to allow the International Labor Organization to monitor factory conditions in the garment sector. This case is widely regarded as a success, but that particular incentive disappeared when the Multi-Fiber Arrangement was phased out at the beginning of 2005 as part of the Uruguay Round trade agreement. See Elliott (2003) and Polaski (2006).

[8] At some point, an additional carve-out was created allowing even more preferential treatment for UN-designated "least developed countries," but it is not important for this story.

[9] The WTO keeps a database on regional trade agreements at: http://rtais.wto.org/UI/PublicMaintainRTAHome.aspx.

developing countries (all but Burma at last check). Import tariffs above a certain level are reduced, but not eliminated, which leaves scope for the EU to offer positive incentives in the form of additional duty reductions. Thus, under their GSP-Plus program, eligible developing countries can receive additional trade benefits for meeting specified goals with respect to human rights and environmental protection.

Unlike the EU and most other developed countries, the U.S. GSP program eliminates duties for eligible countries, removing the possibility of offering positive incentives through further tariff cuts, and it also includes a laundry list of eligibility conditions that introduce the possibility of sanctions for violators. Congressionally-mandated conditions resulted in Soviet bloc countries and OPEC members being excluded from the start. Most other developing countries were declared eligible at the start, but preferences have been suspended or revoked for a small number over the years, usually because of inadequate protection of U.S. intellectual property rights or violations of worker rights, the two conditions that have been the most frequently invoked.[10] In subsequent years, Congress created regional preference programs for sub-Saharan Africa, the Caribbean and Central America, and the Andean region that offered more favorable market access, but also came with more conditions attached, such as cooperation with U.S. anti-narcotics policy in the case of the Andean program.

Like most other preference-giving countries, the U.S. GSP program excludes a number of import-sensitive products, such as footwear, textiles, and apparel, that are important exports for many developing countries. Adding those products to the eligible list could be used as a positive incentive, but there are two important constraints. First, the most important product exclusions are specified in the authorizing statute and changing them would require new legislation from a reluctant Congress. Second, the incentives could not be selectively provided to target countries, unless American policymakers seek a WTO waiver, as they have done for the existing regional programs. In sum, U.S. unilateral trade preferences as currently constituted offer more scope as a stick than a carrot.

With respect to reciprocal free trade agreements, where each party must open their market to the others, there are no international disciplines on the conditions that one or the other party may set before entering negotiations, beyond the largely unenforceable requirement to liberalize "substantially all trade." But there are a number of legal and political constraints in the U.S. context. First and most important, the Constitution grants authority to regulate trade to the Congress. As noted above Congress has delegated substantial authority to the president over the years to *restrict* trade for foreign policy purposes, but there is no such standing

[10] The Generalized System of Preferences Guidebook is available on the U.S. Trade Representative website at www.ustr.gov.

authority allowing him to *expand* trade. The president can promote trade at the margin through Export-Import Bank financing (as long as the program is authorized and funded by Congress) or by providing technical or financial assistance for trade capacity-building (ditto).

If the president wants to negotiate a trade agreement to provide preferential market access for foreign policy or other reasons, he will have to submit it to Congress for approval and that has become increasingly politically difficult over the past two decades. In the most recent and most glaring example, Presidents Obama and Lee were unable to agree in Seoul during the G20 meeting on adjustments to the US-Korea FTA, which had been negotiated and signed under President Bush in 2007, that would allow it to be submitted to the U.S. Congress. The failure occurred despite the fact that the two parties both want to strengthen their security alliance in the face of North Korean intransigence on nuclear issues and the sinking of the Cheonan last year, and despite the fact that President Obama put his personal credibility on the line at the June Toronto G20 summit by pledging to get the deal done by Seoul. Bush-era FTAs with Colombia and Panama have also been languishing for more than three years after they were signed because of congressional opposition, in the former case over union concerns about worker rights and in the latter case because of Panama's status as a tax haven.

Beyond the political constraints deriving from partisan divisions over trade in Congress, the executive branch approach to negotiating FTAs has been reactive rather than strategic in choosing partners. While foreign policy concerns are often used in trying to sell unpopular FTAs in Congress, most of the agreements to date were negotiated at the behest of U.S. trading partners and not at the initiative of U.S. policymakers. Where presidents attempted to embed FTA negotiations in a broader strategic vision, they often faltered over U.S. demands rooted in narrow economic or political interests rather than foreign policy concerns. The problem is that U.S. negotiators are reluctant to deviate from a template for free trade agreements that they view as the "gold standard" in terms of ambition. The template also includes provisions carefully designed to placate important constituencies that will be needed when agreements are submitted to Congress. For a variety of reasons, then, trade partners are usually presented with a text on a take-it-or-leave-it basis and even foreign policy concerns are rarely allowed to interfere with the negotiating process.

Thus, President Clinton's desire to expand the agreement with Canada and Mexico into a Free Trade of the Americas, encompassing the entire hemisphere (except for Cuba, of course), foundered when Brazil resisted U.S. demands to include enforceable protections for workers and intellectual property owners that went well beyond what the United States had been able to achieve in multilateral negotiations at the World Trade Organization. At the same time American negotiators resisted Brazilian demands to cut U.S. farm subsidies. The second

President Bush announced his intention after 9/11 to create a Middle Eastern Free Trade Area and ended up with agreements only with Bahrain, Oman, Jordan, and Morocco. A negotiation with the UAE faltered over U.S. demands for worker rights protections and then failed in the wake of the Dubai ports investment brouhaha.

Aid, Trade, and the U.S. National Interest in Pakistan

Recent U.S. policy in Pakistan underscores both the desire on the part of American policymakers to use positive economic incentives in support of national interests, and the limitations and constraints. U.S. foreign assistance to Pakistan over a number of years clearly demonstrates the limitations of economic incentives, positive or negative, in changing behavior, while efforts to expand Pakistan's access to the American market is a sad example of the political constraints on using incentives, even when U.S. national security is at stake. The key issue for planning and assessing the use of incentives in this case is to specify U.S. objectives clearly. Are they to elicit Pakistan's cooperation in relatively short-run goals related to combatting terrorism and stabilizing Afghanistan? Or is the goal a stable, democratic, and more prosperous Pakistan?

Foreign Aid to Pakistan

For fiscal years 2002 through 2008, the United States provided $12 billion in aid, three-quarters of it military assistance, with little to show for it. From a development perspective, as summarized in a recent Center for Global Development paper, Pakistan's "democracy is fragile, corruption and patronage are rampant in government, most of its children never complete primary school, and its health indicators lag behind those of Bangladesh, despite having higher average income." The authors also note that "poverty in Pakistan was higher in 2004 than it was a decade earlier, despite millions of dollars spent by the World Bank on a large antipoverty program in Pakistan in the 1990s."[11] Nor have the billions bought as much as one might expect in terms of more immediate U.S. foreign policy priorities. A recent Council on Foreign Relations report (Markey 2010) noted that the Pakistani military took on militant groups in the tribal areas that it viewed as a threat to the state, but continues to ignore or even support others that threaten U.S. interests. Aid money has also failed to buy the United States popularity among the Pakistani people.

In late 2009, with the leadership of Senators John Kerry (D-MA) and Richard Lugar (R-IN), and Howard Berman (D-CA) in the House, Congress approved legislation to double economic aid to

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[11] The Birdsall, Elhai, and Kinder (2010, p. 7) analysis and recommendations draw on the expertise of the CGD Study Group on U.S. Development Strategy in Pakistan; a list of members may be found at: www.cgdev.org/section/initiatives/_active/pakistan.

Pakistan (to $15 billion over 5 years) and to focus more on development as the sustainable path for achieving US goals. The problems is that it is not at all clear that anyone really knows how to "do development" in situations involving violent conflict and states as weak and corrupt as in Pakistan. Birdsall et al. (op cit.) also emphasize that, if not done well, aid can make things worse, by fostering corruption, creating a moral hazard, and undermining the capacity and accountability of the government it is nominally supporting. The authors also note that, despite the large amount of assistance, American policymakers have limited leverage in Pakistan because there is no credible threat of exit; they must balance competing goals and are likely to soften demands for politically-sensitive policy reforms if they might threaten political stability; and because U.S. flows will still be small relative to funding from the International Monetary Fund and World Bank. Birdsall offer several recommendations for maximizing the chances of that aid will contribute to development, but they also counsel patience and caution against inflated expectations.

Trade: Politics Trumps National Security

Paradoxically, at the same time that the U.S. Congress is willing to bet billions of taxpayer dollars on this long-shot effort, they are unwilling to do something that would not require an appropriation, would cost less than a fifth as much (in revenues foregone), and would be likely to create Pakistani jobs almost immediately. In 2008, textiles and apparel constituted 85 percent of total Pakistani exports to the United States and importers of those goods paid an average tariff of 11 percent, nearly ten times the average on all U.S. imports of 1.2 percent. Removing these tariffs would boost Pakistani exports, create jobs, and assist in the recovery from the floods. Increased access to the American market is also something that Pakistanis officials often say they want more than (more) aid.

Legislation to move in this direction passed the House in 2009 but stalled in the Senate over how stringently to monitor and enforce worker rights. But that debate was basically a diversion because the restrictions and other conditions placed on market access were such as to make the entire exercise meaningless. Similar bill were introduced in 2009 by Chris Van Hollen (D-MD) in the House and Maria Cantwell in the Senate that would eliminate the tariffs on about half of Pakistani exports, mostly textiles that tend to be more capital-intensive and create fewer jobs per dollar of output than clothing, and *only* if produced in designated zones along the Afghan border (the key difference was on the worker rights issue). While the idea of trying to create jobs in these regions is a good one, they are areas that currently have little or no existing industry to build on, little or no transportation or energy infrastructure, few skilled workers, and, in some cases, no security (Bolle 2009). Moreover, the average tariff on the designated eligible items is eight percent (about half the average for the clothing items that are excluded), which hardly seems lucrative enough to induce investors to take on all those challenges.

Pakistan has only a two percent market share for textiles and apparel in the U.S. market and general equilibrium modeling suggests that providing completely duty-free access for its exports would have a vanishingly small impact on U.S. production. Moreover, the overall import market share in the U.S. apparel sector is already 88 percent and most of what is excluded from the market access bills is apparel. And, yet, conversations with congressional staff, industry representatives, and in the White House suggest that the chances of seeing meaningful legislation that would expand access for all Pakistani exports, including from the regions where textiles and clothing production that might be scaled up exists, is approximately zero.

Although the data suggest that direct competition between Pakistani exports and U.S. production is minimal, the real problem is that the U.S. industry is trying to protect its captive market in the Western Hemisphere. A key condition for expanding access for clothing exports from our partners in Central and South America and the Caribbean under free trade agreements and preference programs is that they contain *American* fabric, yarn, and other inputs. Even in the wake of the massive earthquake that killed hundreds of thousands in Haiti, the U.S. textile industry fought vociferously against allowing Haitian clothing producers to source more inputs globally, which would make them more competitive, and still export duty-free to the United States. As long as the textile and some agricultural sectors (for example, sugar and cotton) retain their stranglehold on U.S. trade policy, positive trade incentives will be constrained.

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