International Trade:
America's Strategy for the Global Marketplace

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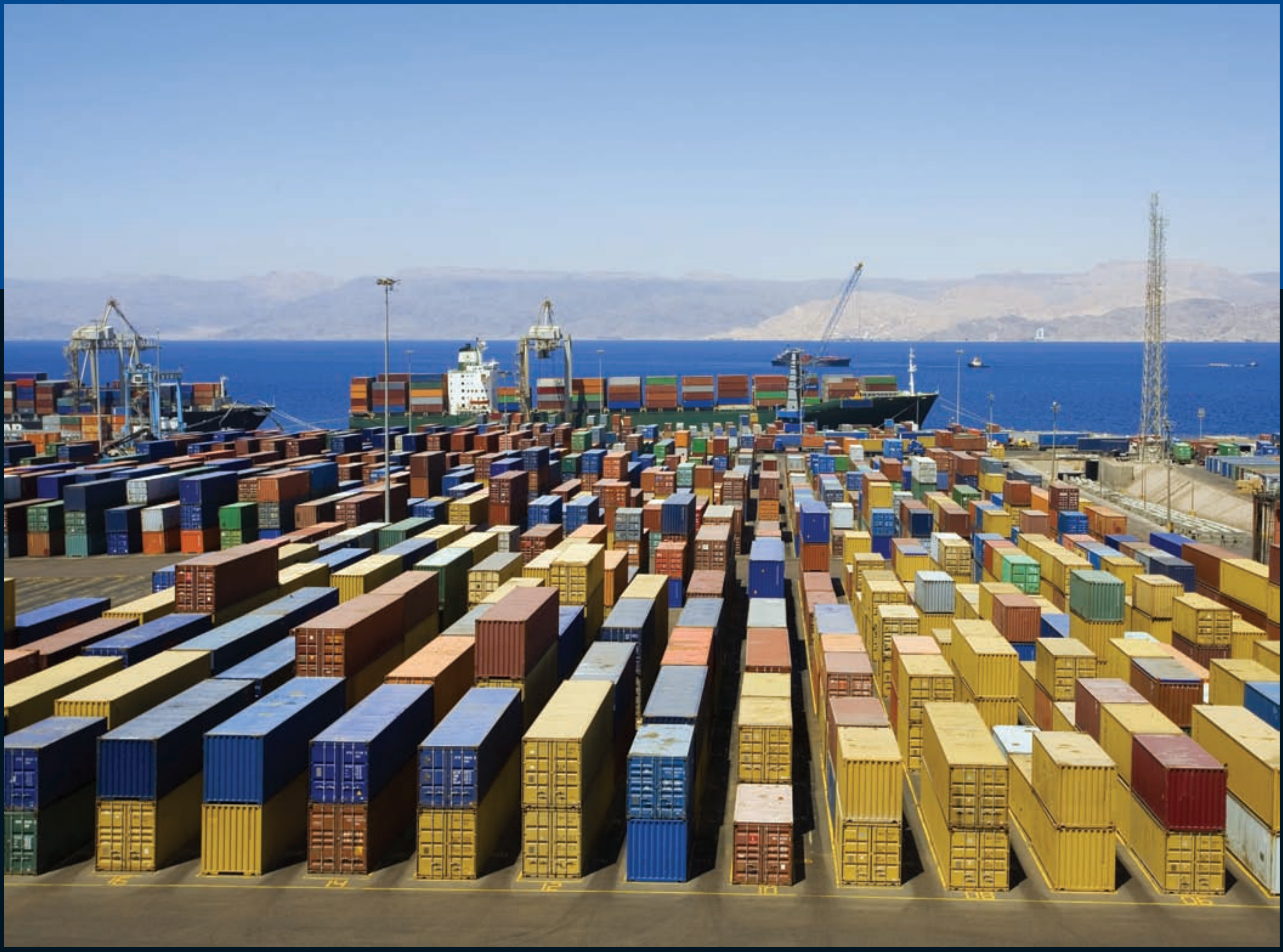


U.S. Representative Wally Herger

Trade Agenda in the 110th Congress

The 110th Congress has been challenging for Republicans in terms of pushing our GOP agenda forward. As Ranking Member of the Ways and Means Trade Subcommittee, however, I can report we have been productive in the arena of free trade!

Admittedly, we have worked from a difficult position in the House to advance the free trade agenda. But fortunately, and with a great deal of work by dedicated free traders like Ways and Means Ranking Member Jim McCrery and U.S. Trade Representative Susan Schwab, we have achieved some success. Where we go from here will depend on our continuing partnership with like-minded free trade Democrats in the House and Senate, as well as the Bush Administration's drive to move ahead with competitive trade liberalization through bilateral and multilateral free trade agreements.

Benefits of Trade

Free trade is about leveling the playing field and getting Americans the same benefits we already provide the rest of the world.

The United States already has some of the lowest tariffs and other barriers to trade in the world. So when we pursue trade liberalization with other countries through the World Trade Organization or on a country-to-country basis, we're opening those countries up to export and investment opportunities for American citizens. This means that our products are having an easier time getting to international markets and are beginning to compete in previously high-tariff countries.

Increased trade benefits us both from an import and export perspective. Increased imports help American consumers save money on food, clothing, and household needs that are made less expensive by trade. In fact, low prices disproportionately help lower-income families because a larger percentage of their household budget goes toward these needs.

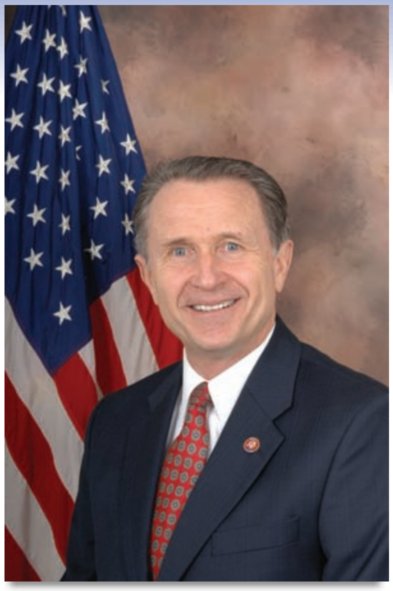
American businesses are also consumers in our economy, and improved trade allows firms to stay competitive by importing goods and services from overseas to make their products better and less expensive. Free trade also benefits companies that export goods, supporting an estimated 20 percent of growth in our economy. One of every ten jobs in the United States is linked to goods and services exports; these are good jobs that pay on average 13 to 18 percent more than non-exporting jobs.

Almost nowhere is free trade more important than in my own home state of California, where an estimated 3.7 million jobs are sustained by international commerce. In my agriculture-rich area of Northern California in particular, farmers, ranchers, and others depend on international markets to reach the 95 percent of consumers living outside the United States. Nationwide, an estimated one in three acres of cropland is destined to be consumed abroad. In California it may be closer to one in two. Our continuous drive to open new markets and reduce foreign trade barriers makes sale of our harvests possible abroad.

Not Losing Our Competitive Edge

Among the challenges we face in the new Congress is an uphill battle to reauthorize the President's Trade Promotion Authority (TPA), which will expire at the end of June. TPA has been integral to bringing down trade barriers and leveling the playing field for America's growers, manufacturers, and service providers. It is a powerful tool in our free trade arsenal that allows the agreements the President negotiates with our trading partners to receive an up-or-down vote in the House and Senate. Without TPA, trading partners would be less willing to come to the negotiating table.

Since we enacted TPA in 2002, we have negotiated free trade agreements (FTAs) with Chile, the nations of Central America, the Dominican Republic, Peru, Colombia, and Panama, as well as Australia, Morocco, Singapore, South Korea, Bahrain, and Oman. Through these FTAs, we have reduced our trade deficit by $5.5 billion. In fact, even though the economies of our FTA partners make up only 7.3 percent of the world GDP, our exports to these growing markets for U.S. goods comprised more than 42 percent of our total U.S. exports to the world. As TPA continues to help open markets around the world, our trading partners have shared the benefits of increased transparency and rule of law, a strengthened investment environment, and a strong alliance with the United States.



Failure to renew TPA would negatively impact America's future growth and trade liberalization efforts around the world, including the WTO's Doha Development Round. Our largest trading partners, for example, are moving ahead to cement trade agreements that will lock out American producers from lucrative markets. China has four bilateral and regional agreements in place already and is negotiating five more. The EU has twenty and another seven in negotiation. Likewise, Japan has five with eight more in progress. If the larger WTO negotiations falter, we would miss an opportunity to lower barriers to trade and enhance commercial relationships with other nations.

Since the beginning of the 110th Congress, we have worked to find consensus to move two outstanding FTAs with Peru and Colombia. More recently we have added Panama and South Korea to that list. Then, in early May, leaders in both parties in the House and Senate agreed to a framework that gives us a way to move the trade agenda ahead.

The breakthrough resulted in a reasonable and bipartisan compromise that reaffirms our commitment to free trade. Specifically, it will allow Congress to immediately move forward on the Peru and Panama FTAs, and with the Colombia agreement after we make progress on specific steps to address anti-labor violence in that country. The bipartisan framework will also apply to the South Korea agreement. Most importantly, it could serve as a template to extend Trade Promotion Authority, at least for the Doha Round in the short term and more broadly in the long term.

Our nation's trade policy is approaching a crossroads. By approving our outstanding FTAs, renewing TPA, and continuing to pursue free trade agreements with other nations, Congress would wisely move in a direction that benefits American producers, farmers, workers, and consumers alike.

— U.S. Representative Wally Herger is in his 11th term representing the 2nd district of California. He is on the House Ways and Means Committee and serves on the Trade Subcommittee.

Trade in the Twilight of the Bush Administration

Philip I. Levy

We may be at the most critical juncture in United States trade policy for a dozen years. The renewal of Trade Promotion Authority, the fate of the Doha round of WTO talks, and the U.S. free trade agreement agenda all hang in the balance. The Democratic assumption of control of Congress this year means that long-unresolved tensions with Republicans on trade must now be confronted. The confluence of all these events will require some difficult policy choices that will set the tone for U.S. economic interaction with the world for years to come.

From a strictly economic standpoint, the Doha round of trade talks are the most important. While this is the 9th round of global trade talks, it is the first to be held under the auspices of the World Trade Organization, created in the 8th (Uruguay) round of talks. In many ways, the Doha talks are meant to settle the unfinished business of the Uruguay Round. The earlier talks were the first in decades to deal with agricultural issues, but instead of seriously reducing existing barriers then, they opted to defer the pain and set the stage for future liberalization. The Uruguay Round talks were also the first in which developing countries were major participants. After the conclusion of the Uruguay Round in 1994, many developing countries were unhappy with the balance of the agreements. They felt their concessions on issues such as intellectual property protection outweighed the promises they received on agriculture, textiles, and apparel. This was a major motivation for the development focus of the current round's launch in Doha, Qatar in 2001.

The history helps explain the current impasse in the Doha talks. Since the modest agricultural liberalization of the Uruguay Round, the European Union has not found any new enthusiasm for scaling back the Common Agricultural Policy, while the United States has increased its intervention in agricultural matters (compare the Freedom to Farm Act of 1996 with the 2002 farm bill).

What's more, there's a fundamental difference of opinion about the meaning of a "development" round. Many developing nations interpreted this as a promise of liberalization by large countries without any required reciprocity. This would be in the world trading system's long and unfortunate tradition of "special and differential treatment" for poorer countries. In contrast, the U.S. interpretation has been that developing nations would now be full participants and their top issues would be prominent on the agenda. Reciprocity *would* be required, particularly from the large developing nations like Brazil, South Africa, India, and China.

Thus, the Doha talks face two major hurdles: agriculture and the level of developing country engagement. Beyond these, there is the daunting complexity of the issues themselves. Negotiators estimate that after agreement is reached on the broad outlines of a deal, at least a year will be required to handle the details. Difficult issues of great importance to the United States, such as service market access, have barely advanced at all, awaiting progress in the other negotiating areas.

The round is not near completion, therefore. Nor will the old trick for wrapping up a difficult negotiation work – i.e., to declare victory with the limited accomplishments at hand and promise to reconvene before long. The problem is that the United States has pushed hardest for an ambitious agreement and has been the most willing to table bold offers of concessions. These offers have been contingent on other countries' reciprocity. To stop now would be to let others pocket U.S. offers without offering anything in return. If the United States were to accept this, it would benefit from the unilateral liberalization, but such a lopsided deal would not likely be palatable for Congress.

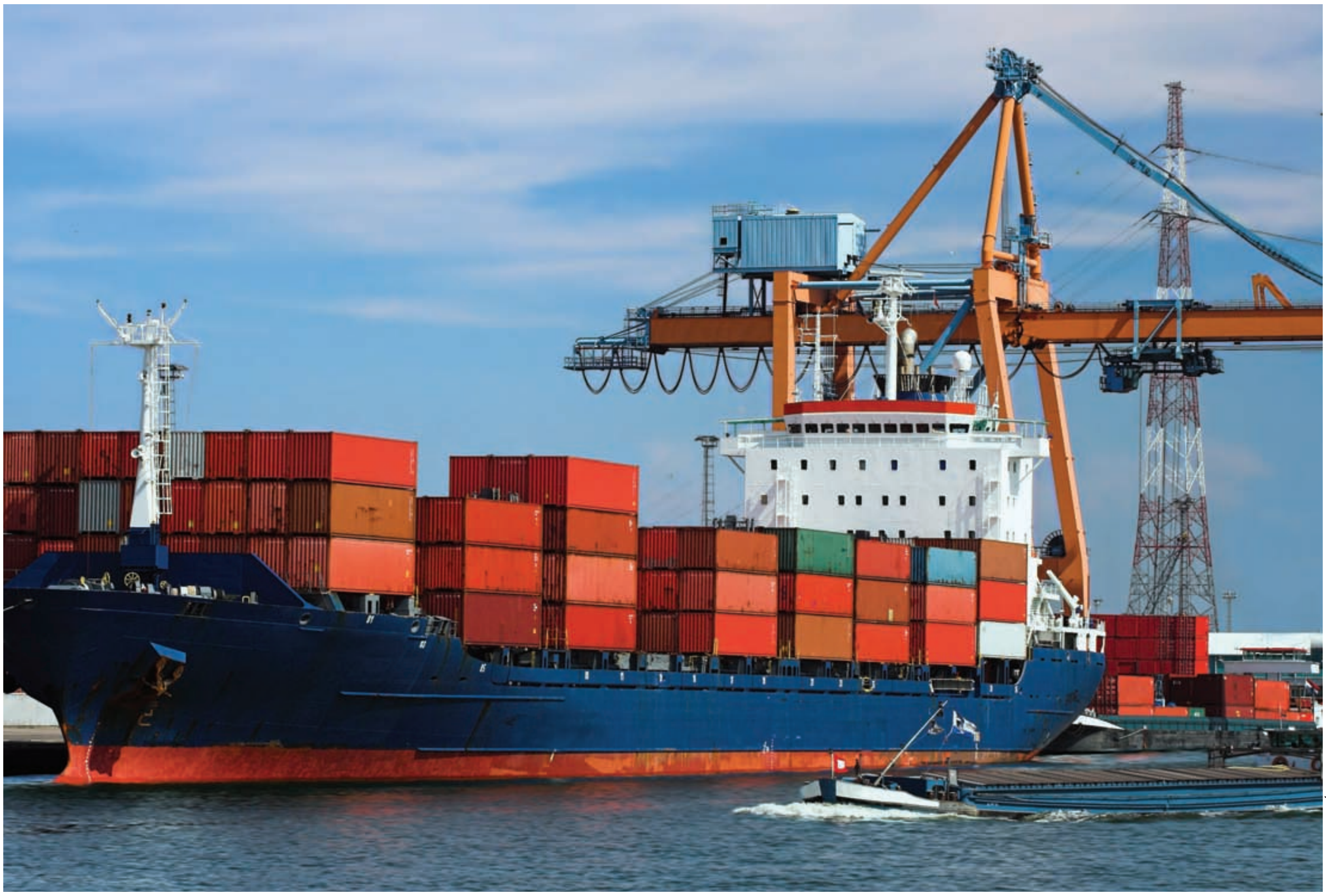
In the history of WTO rounds, the expiration of U.S. negotiating authority has played a critical role. It has generally set the endpoint that signaled the need for posturing to end and hard bargaining to commence. Although the expiration of Trade Promotion Authority (TPA) is fast-approaching, the effective deadline has long since passed (given the lags required to handle details). TPA expiration will still present some important choices. A straightforward renewal of TPA for WTO negotiations would permit discussions in the Doha talks to continue. If TPA were to lapse, the talks could still continue, though the *de facto* hiatus would be more apparent than without TPA. A lapse in negotiating authority would virtually guarantee that no real progress is made until 2009.

The failure of a global trade round (as opposed to a postponement) is uncharted territory. At best, it would leave key issues in trade unaddressed and shake countries' confidence in the WTO's usefulness as a negotiating forum. At worst, it could cause countries to lose interest in the WTO. That could lead to uncomfortable questions about why anyone should obey WTO dispute rulings on existing agreements. The penalties for disobedience in the WTO are often rather small; the main incentive for obedience has been a desire to respect and uphold the institution. If the institution is no longer seen as useful or viable, that incentive could disappear. The alternative to progress on Doha may not be the *status quo ante*; it could be a major step backwards.

With WTO negotiations stymied, U.S. trade strategy has turned to the pursuit of free trade agreements (FTAs) on a bilateral or regional basis. From an economic standpoint, FTAs are distinctly inferior to global liberalization. There is the risk that orders will go not to the cheapest producer, but rather to the producer with the greatest tariff preference. Further, in a world of globally integrated production, the proliferation of different rules across different agreements makes life inordinately difficult for businesses. For these reasons, prominent economists have decried the turn toward FTAs.

There are two principal counterarguments in FTAs' favor. First, if they help lead toward multilateral liberalization, other sins would be forgiven. Second, they are often undertaken for primarily political rather than economic reasons.

The U.S. approach to 'competitive liberalization' has been explicit in enlisting FTA partners to play a constructive role in



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WTO talks. At one level, that works the way any alliance would work, with increased contact and understanding leading to better cooperation. At another level, FTAs can address key obstacles that also plague WTO talks. For a developed country like South Korea, this can involve a willingness to address agricultural liberalization, a long-standing sensitive area. For developing nations like those in Latin America, it can mean an acceptance of the idea of deep and reciprocal trade liberalization. Deepening here refers to a move beyond border barriers such as tariffs and quotas into questions such as investment and service regulation. The United States has demonstrated a comparative advantage in services trade (financial services, express delivery, etc.) and a large fraction of world trade in goods takes place within multinational corporations (hence the importance of investment to trade). Whereas developing countries have opposed efforts at dealing with these issues at the WTO, investments and services are central to U.S. FTAs. Not only do developing nations concede the principle of negotiating in these areas when they sign an FTA with the United States, their negotiators gain valuable experience in their discussions with U.S. counterparts.

The geopolitical aspect of FTAs is no less important. They are an important tool of U.S. foreign policy. An FTA signals allegiance, U.S. interest, and U.S. support in a way that WTO membership cannot. The two biggest FTAs-in-waiting illustrate the point. Adoption of the South Korean FTA would not only constitute a significant market opening but would also provide a major boost to U.S. standing in Asia. At a time when China has been proposing regional configurations such as "ASEAN plus three" which just happen to exclude the United States, the South Korean FTA would restore the United States to the center of commercial discussions in the region. Japan has already expressed interest in an accord with the United States if South Korea successfully concludes one. On the other hand, if the United States were to fail to adopt the agreement, it would have serious negative foreign policy implications and diminish American influence in the region.

The effects of rejecting the Colombia FTA would be similar. To snub a major regional ally, one that sits next door to a consistently and increasingly hostile Venezuela, could greatly diminish support for the United States within Latin America.

For decades trade policy was seen as an important part of foreign policy and received bipartisan support on that basis. That bipartisan support ended in the early 1990s with the introduction of labor and the environment as wedge issues. Disputes over these issues led to the lapsing of trade negotiating authority in the mid-1990s after the Uruguay Round. Labor and environment were also the leading subjects of the May 10 agreement this year between the Administration and Congress. Before considering that agreement, it's worth exploring the issues themselves.

There are at least two explanations for the push to include binding labor and environmental measures in trade agreements. One possibility is that this could be motivated by an altruistic concern for the citizens of FTA partner countries. The argument could be that the countries fail to realize their own self-interest or have democratic deficiencies such that the United States is better positioned to determine appropriate labor and environmental legislation for them. Aside from the objectionable paternalism, this neglects the evidence that progress on labor rights and environmental quality have historically advanced with economic development. It is trade and growth that will bring progress on these fronts, not additional regulation.

An alternative possibility is that trade agreements are just serving as a lever to get partners to adopt measures that will do them no good but will help us. The notion that the United States will benefit by compelling trading partners to raise their costs is highly dubious. There is also the very real danger that overloading the trade agreement lever will break it. In most cases, the United States market is already open to FTA negotiating partners. The United States typically requests a series of politically difficult liberalization measures from partners that will enhance U.S. market access. If one then adds on undesirable regulatory measures, there comes a point at which partners will balk. That point will differ depending on the partner country. The fact that some small, particularly eager country is willing to accede to U.S. demands does not mean that the approach will work worldwide.

To date, labor and environmental measures in U.S. FTAs have required partners to enforce their own laws. This maintains a degree of respect for their autonomy to set their own domestic policy. The May 10 agreement purports to push beyond this into enforceable commitments based on international understandings. The crossing of this threshold was justified by the promise that the Peru and Panama FTAs, completed and before Congress, would be passed. It was also heralded as a return to the bipartisan era of trade policy.

The Panama FTA is minor, but the Peru FTA is an important signal of support for President Alan Garcia, who has been engaged in ideological battles against anti-democratic allies of Venezuela's Hugo Chavez. It is not as significant as the Colombia or South

Korea FTAs, however, nor as vital as the extension of trade promotion authority – all items left unsettled by the May 10 agreement. Nor does the return of bipartisan trade support seem imminent. It is too late for this Administration to launch serious new liberalization efforts and the next Administration, whether Democratic or Republican, will need to reach its own understanding with the next Congress. Those 2009 discussions will undoubtedly take the ill-advised labor and environmental requirements of the May 10 accord as the starting point for discussion. Rather than laying the groundwork for future liberalization – the great promise of FTAs – this moves the United States away from international sentiment about the appropriate scope of trade agreements. The passage of the Peru FTA seems scant recompense for such a lasting move in the wrong direction.

It may seem odd to assess the pros and cons of FTAs without bringing up U.S. jobs gained or lost, wages driven up or down, or new waves of trade flows. These factors are the standard fare of contentious debates over FTA passage. Those debates have been remarkably disconnected from economic reality. The acrimonious debate over adopting the Central American–Dominican Republic Free Trade Agreement (CAFTA-DR) in 2005 serves as a prime example. The countries involved had largely free access to the U.S. market before CAFTA was adopted through the Caribbean Basin Initiative; 80 percent of goods entered the United States free of any tariff. The countries involved – Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua – are also small. The detailed 2004 study by the U.S. International Trade Commission of CAFTA-DR's likely effects reached the following conclusion:

"…given the small economy and market size of the CA/DR region relative to the United States, …(increases in trade) would be from a small initial level and, thus, are likely to have a minimal impact on production, employment, or prices in corresponding U.S. sectors."

This minimal impact was found even in sectors with more significant liberalization, such as textiles and apparel. This is not to say that CAFTA-DR was unimportant. It bolstered an important region of major interest to the United States. It helped lay the groundwork for future hemispheric negotiation. But the direct economic impact on the United States will likely be negligible. Yet the agreement passed in the House of Representatives by a vote of 217 to 215.

For an FTA to have a significant economic impact on the United States, the partner country has to be large and the agreement has to remove major barriers to trade. For the kind of labor impact that is commonly feared, a large trading partner would have to have not only lower wages, but also comparable productivity. If another country's workers are half as expensive but half as productive at producing a particular type of good, there is no cost advantage.

The United States has prospered by pursuing a relatively open trading regime in recent decades, which means that major barriers are relatively scarce. In those instances in which there are still significant barriers to free trade (e.g. sugar), those areas have been largely exempt from major liberalization in FTAs (sugar was excluded entirely from the FTA with Australia).

A clearer understanding of the true costs and benefits of trade liberalization agreements may help foster a more constructive dialogue toward a new trade policy. With a durable bipartisan consensus on the importance of trade, there are feasible policies that could promote international economic integration and prosperity and strengthen U.S. standing in the world. Without such a consensus, the challenges of both internal and external divisions are daunting.

It is not within the United States' power to single-handedly bring the Doha round to a successful conclusion. Should the United States seize the opportunity to send positive signals by removing trade-distorting agricultural subsidies in the next farm bill, there is hope that other countries would respond. Key countries such as Brazil seem poised to play a leadership role in breaking the deadlock that exists. A necessary but not sufficient condition for this progress to take place would be Congressional passage of new Trade Promotion Authority. For this to be meaningful for the WTO, such a bill would have to be free of poison pills. In this instance, that means labor and environmental

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requirements that have already been roundly rejected in the WTO context.

Ideally, rather than adding new burdens to the trade agenda, the next TPA would lay out a path of open and inclusive trade liberalization. It would authorize work on stitching together existing trade agreements and leave an open door for any country that wished to adopt the high standards of liberalization and join. The United States has been explicitly pushing toward this goal in the Middle East, with the President's goal of a Middle East Free Trade Area by 2013. In other regions the possibilities are tantalizing. While negotiations for a Western Hemisphere Free Trade Agreement of the Americas have stalled, agreements have been negotiated with hemispheric partners from Canada to Chile. The open door policy, laying out explicit and objective requirements for joining, would not only offer an immediate opportunity for countries such as Uruguay but would also make clear to important allies such as Brazil that they are not being excluded. Further, it would make clear the commitment to high standards in trade agreements that the Congress has consistently demanded. In Asia, agreements have been negotiated with Australia, Singapore, and Korea. Negotiations have been launched with Thailand and Malaysia, while Japan seems interested and New Zealand would be a natural addition (albeit one with agricultural prowess – traditionally a sticking point).

Thus, much of the scaffolding is already in place to build a modern open trading system from the ground up that would enhance trade and growth and could be expanded. The principal obstacle to this vision is U.S. willingness.

Unfortunately, U.S. trade policy discussions have devolved into domestic policy discussions with trade serving as a proxy for forces that cannot be opposed (technological change and domestic competition). There is ample room for good policy here. There must be policies within the United States to address insecurities about the rapid pace of economic change. There should be a well-thought out safety net that limits the risks faced by individual workers. However, trade agreements should be seen as major instruments of foreign policy, not primarily domestic concerns. Until domestic concerns are addressed, though, trade policy may suffer as the surrogate for all the modern economic challenges that face the U.S. populace.

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If domestic fears can be overcome, this could open the way for a return to the bipartisan backing of trade and foreign policy that prevailed through the Cold War. TPA extension would be a major step in the right direction, but only if done properly. It will not immediately cure the ills of the Doha talks, and if it is done with terms that are anathema to the rest of the world, the victory will be Pyrrhic. If such terms are inescapable, it would be better to wait and let the world wonder whether the United States has lost its commitment to global economic leadership than to act and remove all doubt.

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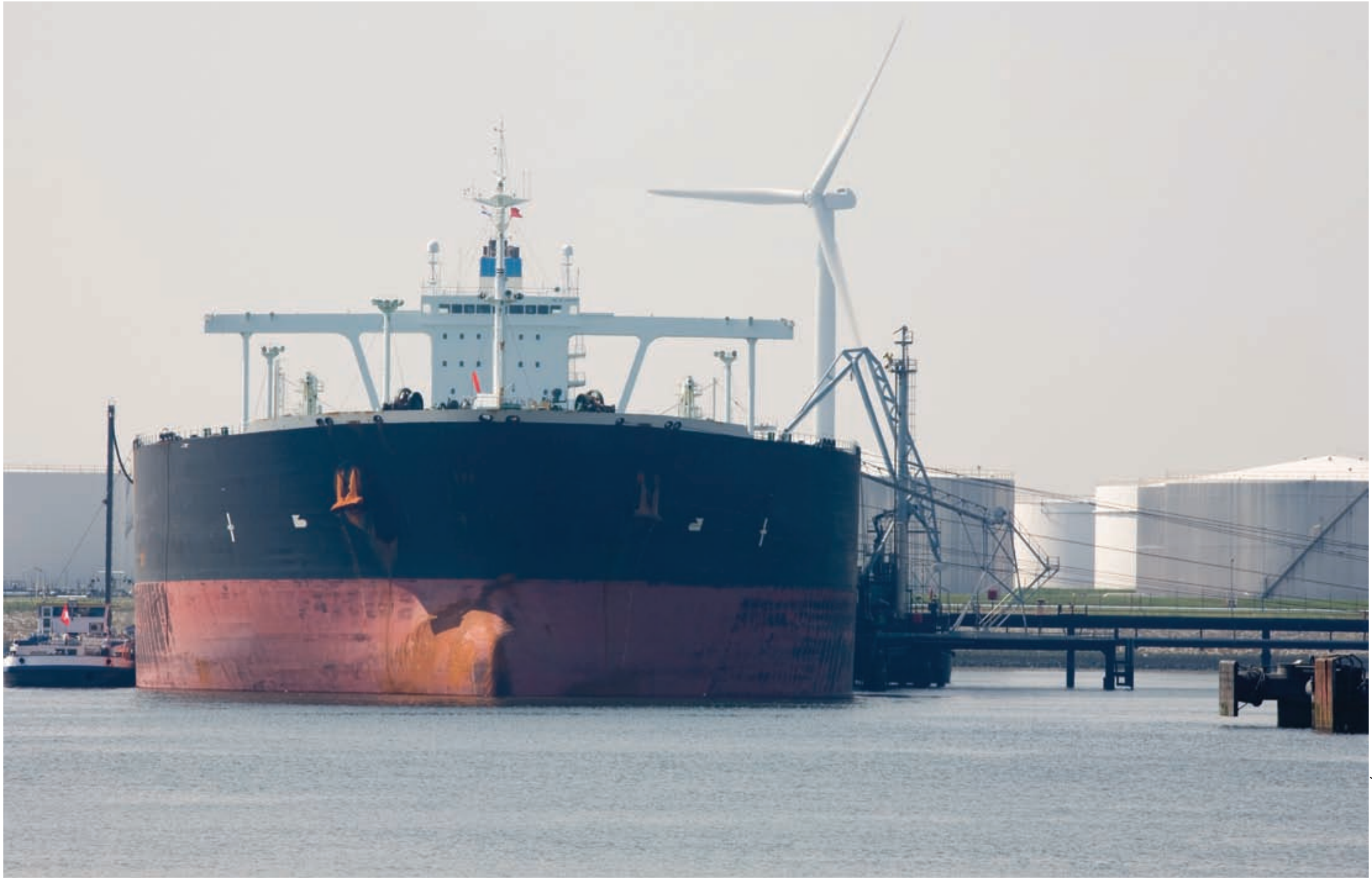

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