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The Distorted Nature of Trade Debates

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It is distressing to examine the partisan arguments both for and against proposed trade agreements because there appears to be a prodigious effort on both sides to obscure the real issues.

The central purpose of trade agreements is to expand trade, both imports and exports. As globalization has advanced and different parts of final products are made in more than one country, the freedom to move capital for production in these various locations increasingly is part of the trade process. Specialization is sharper than it was when most trade was in finished products—such as an auto or a computer, rather than their components—and this requires easy and inexpensive movement of parts among the various producing countries. Much trade, therefore, takes place within industries. Finally, for a postindustrial society like the United States, open trade in sophisticated services—financial services, communications, software, and the like—is a crucial element of any modern trade agreement. U.S. trade agreements cover other themes as well, and I will discuss some of these later.

U.S. political and partisan actors raise a different set of issues. How many U.S. jobs will be created by increased exports under a trade agreement? How many jobs will be lost by imports replacing domestic production? Will foreign direct investment destroy U.S. jobs? Will outsourcing of intermediate activities in the production of goods and the provision of services (such as physical inputs for final products, call centers, etc.) take jobs from U.S. workers? Does the ability of low-wage countries to export goods and services to the United States curtail the emigration of their nationals?

The following are some brief answers to these questions: Significant job creation and loss in the U.S. economy are not essentially the result of trade, but rather of the vigor of the U.S. economy. Trade policy, therefore, is not well suited to deal with employment issues. Rather, the relevant instruments to affect the dynamism of the U.S. economy are macroeconomic in the short to medium term, dealing with fiscal, monetary, and exchange-rate policy; and structural in the medium to longer term, particularly by promoting education. Exports, however, can affect the quality of jobs and tend to raise the wages of persons working in export activities. There is no observable correlation between trade deficits and unemployment. Put differently, increasing imports may hurt competing workers, but not total U.S. job creation. Outsourcing may be necessary to remain competitive; preventing outsourcing, consequently, is likely to reduce employment. Carlos Salinas de Gortari, the Mexican president when the North American Free Trade Agreement (NAFTA) was negotiated, argued when he pushed the agreement that Mexico wanted to export goods, not people. This was a politician's way of phrasing the issue. Mexico is now exporting more of both.

U.S. trade negotiators or the administration may provide a number when asked, "How many U.S. jobs will the Central American Free Trade Agreement create?"—but economists should not. Labor union leaders will give an answer (indeed, many answers) to the question, "How many U.S. jobs were lost as a result of U.S. trade deficits with Mexico and Canada since NAFTA?"—but reputable economists should not. The answer, stupid, depends on the health of the U.S. economy. The U.S. economy gained millions of jobs in the years following NAFTA's entry into force in 1994, despite growing trade deficits.

The statements above refer to the United States as a whole and should not be taken to mean that no people are hurt from imports and outsourcing. There are losers from increased trade, just as there are from domestic innovations unrelated to trade, and a just society should seek to compensate the losers using resources contributed by winners through the tax structure. The United States has not been good at this and must do better if continued support for freer trade is to be maintained.

Over the years, trade agreements acquired many other provisions. Protection of intellectual property, to cite one, is important to a country like the United States that thrives on innovation. Agreements promoting trade also require safeguards to give time to adjust to unexpected surges in imports. This has largely taken the form of antidumping duties, or requests for these duties, in the United States; unfortunately, other countries are replicating this. (Dumping refers to sales at less than fair value, but the techniques for determining this are far from straightforward.) Two non-trade issues took a prominent role in securing congressional approval of NAFTA, namely, labor conditions and environmental protection in the signatory countries.

The next trade agreement scheduled to come before the U.S. Congress for approval is with five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua), plus the Dominican Republic (CAFTA-DR), and treatment of labor in the countries has become a subject of substantial contention. The House vote, which is still a cliffhanger, must come before the end of July under "fast-track" (or trade-promotion authority, as it is now called) procedures. The Senate has already given its approval (54 for, 45 against). The division is not completely party line, but most Republicans favor the agreement and almost all Democrats oppose it.

The economic arguments being used for and against the agreement generally follow a familiar line. Proponents: It will increase U.S. exports to countries whose collective market is second only to Mexico's in Latin America and the Caribbean; it will thereby increase U.S. jobs. Opponents: it will further decimate the U.S. apparel industry because of low wages in Central America and the DR; these low wages will lead to a race to the bottom in order for U.S. producers to compete; and the increase in sugar imports will seriously damage U.S. sugar production. (Note: The sugar imports inherent in the CAFTA-DR agreement, if all were sent, would amount to between 1 and 2 percent of U.S. consumption.)

In general, Republican opponents of the agreement use standard job-loss arguments, particularly if they come from districts where the ability to compete requires protection against imports. The Democrats, in addition to this, have been zeroing in on labor provisions in the agreement. For example, Representative Sander Levin (D-Mich.), in an op-ed column in the *Washington Post* on July 11, asserted that the "agreement would provide cover for maintaining an oppressive status quo in the workplace and in society at large" in the Central American countries and the DR. The countries involved are developing and working conditions and wages, as one would expect, are considerably lower than in the United States.

The labor provisions of CAFTA-DR are essentially that the countries enforce the labor laws and regulations on the books. The problem thus seems to be with enforcement, not the laws themselves, and it is far from clear precisely what rewriting of the agreement is being demanded. Levin argues, "CAFTA can be quickly renegotiated to achieve the bipartisan support it deserves…." Maybe, but probably not. Rather, rejection of an agreement that has taken years to put together will likely lead to skepticism that the United States is prepared for free trade with Central America unless all the promising regional export opportunities are first removed—such as sugar. That, in my view, is a likely outcome; in the free trade agreement with Australia, the United States removed all concessions on sugar.

As one scans the agreement, most of the import liberalization is to be undertaken by the Central American countries and the DR. The United States already provides much free trade unilaterally, done in part to equalize treatment on key products with concessions to Mexico in NAFTA, and in part because of security considerations in a region so close to the United States. The Central Americans and the DR prefer a legally binding agreement that obligates the United States to policy continuity. That would provide more assurance to potential investors in the region.

U.S. trade policy has become highly divisive. There is a big divide between business and labor and between Democrats and Republicans stemming from this. The large U.S. trade deficit complicates the continuation of an open U.S. trade policy, particularly when it comes to trade with low-wage countries. Reasons for the policy positions of the contending groups in the United States are largely stated in code words like "jobs" and "working conditions" and "fair" trade. The Central Americas and the DR are also concerned about jobs there, and upgrading the working conditions of their workforce, and getting a fair crack at the U.S. market. My position is to support CAFTA-DR because I think the agreement has little to do with creating good jobs in the United States and much to do with helping to transform the Central American countries and the DR into more solid and more secure countries.
