



The Complexity of Trade Policy

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It is hard to keep track of all the trade issues in train at the moment—so please forgive me if I forget or omit some of them. The most important is whether the negotiators can salvage something from the Doha Round; this is uncertain, and if there is an agreement, it is unlikely to be very robust. The United States has now completed free-trade agreements (or preferential-trade agreements [PTAs] as they are called by those who object to the “free-trade” description) with Peru, Colombia, Panama, and most recently South Korea, and it is unclear which, if any, will be approved by Congress this year or even in 2008 before the November elections. There is an internal debate in the U.S. Congress about the need for alteration of the labor provisions in these PTAs to conform to labor safeguards agreed on in the International Labor Organization; Democrats will insist on these changes, and most Republicans do not favor this. Trade Promotion Authority (TPA; what used to be called “fast track”) expires at the end of June, and there is much congressional skirmishing on whether TPA should be renewed in order to deal with the pending agreements, including the Doha Round; and, if renewed, what conditions a renewed TPA should have on labor treatment, environmental protection, and even human rights or drug trade. The central point that trade agreements should focus on increasing trade is being lost.

China’s bilateral trade surplus with the United States may reach \$250 billion this year. In addition, China has not taken effective steps to strengthen its undervalued exchange rate and continues its accumulation of foreign reserves, already more than \$1.2 trillion. This is the backdrop to the more aggressive strategy recently adopted under which the United States brought a number of complaints to the World Trade Organization that China is not living up to commitments it made when it joined that body. These include charges of discrimination against imports of U.S. auto and truck parts, that rebates given by the Chinese government on exports are disallowable subsidies under WTO rules, that coated paper was being dumped in the U.S. market, that U.S. media are being excluded from the Chinese marketplace, and that China must curtail the extensive pirating of U.S. intellectual property that is taking place, such as copying DVDs without paying royalties. The Chinese reacted sharply to the U.S. actions but also complied in one instance by removing export rebates on most steel products. Revaluation of the Chinese renminbi will not solve U.S. trade problems with China, but would help. Chinese piracy of U.S. intellectual property leads to nonpayment of hundreds of millions of dollars. This is not a trivial issue that should be ignored.

Expert commentary on U.S. trade policy is extensive and often quite heated. Alan Blinder, a Princeton University economist and former vice chair of the Federal Reserve Board, made clear in an article on page 1 of the *Wall Street Journal* of March 28 that his support of open trade has diminished, because he fears that as many as 40 million U.S. workers, many skilled, may lose their jobs over the next decade by business outsourcing. There was no rush by economists to support his dire estimate, but he made an impression in the trade-economic community.

Martin Wolf’s column in the *Financial Times* of April 4 criticized the U.S.–South Korea agreement for its preferential nature; his key contention was that growth in “discriminatory trade will end up fragmenting the world economy rather than integrating it.” Some trade experts, such as Jagdish Bhagwati (see the *Financial Times* of April 9), agreed with Wolf; others, including Fred Bergsten and Carla Hills, disagreed, contending that the U.S.–Korea PTA will lead to other agreements opening the world economy further. It is undoubtedly true that every preferential agreement leads to pressures for other agreements to reduce the discrimination that nonmember countries face. However, when weaker countries negotiate PTAs with powerful entities such as the United States and the European Union, it is the powerful party that dictates most of the content. What is happening, therefore, is that a power-based system is replacing the rules-based system of the WTO, a point made in 2001 by Sylvia Ostry, a respected Canadian trade analyst.

U.S. producers are placed at a disadvantage when other countries discriminate against importing U.S. goods and services. The argument made when Western European countries started to integrate their economies was that this would lead to higher economic growth; and this, in turn, would lead to higher imports from outside, including from the United States. The U.S. government accepted this reasoning. Beyond the trade issues, the United States was a strong supporter of the political motivations behind the economic integration of Western Europe. Nevertheless, the European preferences led over time to a shift in U.S. trade policy to put in place its own preferential agreements, most notably the North American Free Trade Agreement, with two of the largest U.S. trading partners. The EU responded to that by concluding its own preferential agreement with Mexico. Since then, both the EU and the United States have expanded their preferential agreements, both within regions (in Europe and the Western Hemisphere) and outside their regions, as is the case of the U.S.–South Korea preferential agreement.

It is doubtful that this proliferation of preferential-trade agreements has been optimal for world trade. One motivation of preferential agreements is to steal a march on other countries. Affected nonmember countries then respond with their own exclusive preferential agreements. It is not surprising that there was an inevitable ratcheting up of more and more agreements as countries tried to equalize treatment of their goods and services in countries where they faced discrimination. The clock cannot be turned back on this history.

There can be no disagreement that proliferation of PTAs does compromise the basic premise of the WTO, that global trade should be nondiscriminatory. The contention of those who favor PTAs has to be that that these agreements open markets more rapidly than do more traditional agreements based on the most-favored-nation principle (i.e., nondiscrimination). There is now as much trade under preferential terms as there is under the MFN principle. There is ample evidence that regional trade agreements, such as the European Union and NAFTA, increased trade *between the member countries* more rapidly than would have been the case had they not been created, but the evidence for increased trade is equivocal for cross-regional PTAs.

Had I been the decisionmaker, I reluctantly would have approved the *idea* of a U.S.–South Korea agreement (although I do not know if the actual content of the agreement is optimal), because the process of bilateral PTAs has gone quite far; and if the United States had not moved first, another country under what can be called the principle of “competitive preferences” would have moved first. Robert Zoellick, the former U.S. trade representative, argued in a letter to the editor of the *Financial Times* on April 12 that “competitive liberalization,” as he calls it, works; by that, he means that the United States should simultaneously negotiate bilateral, regional, and global agreements, and negotiate also for both discriminatory and nondiscriminatory outcomes. Zoellick had argued a few weeks earlier, in the *Wall Street Journal* of January 8, that it would be wise to unify the many bilateral PTAs in the Western Hemisphere into a single agreement, thereby solidifying regionalism and simplifying regional trade rules. This is an admission that the “spaghetti” of PTAs imposes, as he put it, much “regulatory red tape.”

The trade discussion taking place is part of a larger debate on who benefits from globalization. The evidence is clear that returns to capital under globalization have exceeded returns to labor. (By globalization, I have in mind increased trade and investment, changing production patterns and the location where labor inputs occur, and the near instantaneous techniques for funding these changes). Labor returns have not diminished absolutely, but income inequalities have widened in just about all major countries and in large emerging countries as well—in China, India, Russia, and Brazil, the BRIC countries. This creates problems, because lower- and middle-income groups compare their situations with others in their own nation.

The large U.S. merchandise trade deficit, \$818 billion in 2006, is disquieting. The congressional focus today on labor conditions in countries with which the United States is negotiating PTAs grows out of the large trade deficit. This combination—the trade deficit,

the reaction of skilled persons whose jobs are being outsourced, the sense that China is taking advantage of the U.S. market with a deliberately undervalued exchange rate vis-à-vis the U.S. dollar, and growing income inequality—is spawning considerable trade protectionism in the United States. Despite the low official unemployment rate in the United States and the satisfactory GDP growth rate in recent years, there is a sense of uncertainty about the state of the U.S. economy that shows up in legitimate opinion surveys. The well-off are doing well, the middle class is uneasy, and low-income groups face economic hardship.

Protectionism in the United States revolves largely around safeguarding jobs in industries that are not competitive. That comes out clearly when one looks at the kinds of products on which U.S. tariffs and nontariff barriers are high; these include textile products, cheap shoes, and agricultural products like sugar. The United States collects far more import duties on goods coming from poor rather than from rich countries. The Progressive Policy Institute compiles these numbers from time to time. This is hardly a rational economic policy, in that high U.S. wages do not come from these noncompetitive sectors, but rather from those that are on the cutting edge of technology and that require trained professionals. High U.S. incomes stem from having an educated population. The United States is rich enough to bear the cost of modest protectionism, but not forever; looking inward may be nationalistically satisfying, but this is not a viable path to maintaining the strength of the economy.

In the past, when the U.S. economy was growing satisfactorily, the cry for protectionism was muted, as it was in the long period of economic growth after World War II. There is a directional linkage from a growing GDP → trade liberalization. Is there a similar linkage from growing trade, especially from competitive exports → to higher growth? This depends on the nature of the export growth, whether U.S. industry and service providers are able to stay ahead of the competition. Japan built its economic growth on the back of the automobile and truck industry and other competitive leaders, and the United States in recent years has grown from leadership in such sophisticated areas as computer and communication technology. However, the simple relationship between economic growth and low protectionism is attenuated today because of globalization.

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