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Trade Policy Confusion

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There are deep disagreements between different groups over the future of U.S. trade policy. Most economists favor open markets in the United States and elsewhere based on their belief that this stimulates economic welfare. Opinion polls indicate that a plurality of the general public now believes free trade agreements (FTAs) hurt the United States, a reversal from as few as 10 years ago when a modest plurality said they thought these agreements helped the country. The majority of Republicans in Congress support approval of pending FTAs, whereas a majority of congressional Democrats oppose them, including that with Colombia on which the Bush administration still seeks to force a vote despite the action by the Democrats in the House of Representatives to change the rules on fast-track voting timetables. The two Democratic presidential candidates, Senators Hillary Clinton and Barack Obama, oppose the Colombia agreement and also want to renegotiate the 14-year old North American Free Trade Agreement (NAFTA), whereas the presumptive Republican presidential candidate, Senator John McCain, goes all out in his statements favoring open markets.

Two questions should be asked: 1) What brought about the shift in public sentiment from pro-trade to anti-trade? 2) What do the various proponents/opponents want? And, for a concluding comment, what does this all mean?

Majority sentiment in the United States favored bilateral reciprocal negotiations to reduce trade barriers starting in the 1930s following the disastrous economic consequences of the protectionist Smoot-Hawley tariffs, and this pro-trade majority endured until about the end of the 20th century. After the General Agreement on Tariffs and Trade (GATT) came into effect following World War II, the successive rounds of negotiations to reduce trade impediments (to have *freer* trade, not free trade) became multilateral. The onset of a change in the public attitude became evident when low-wage Mexico was granted free trade on a preferential basis in NAFTA. The U.S. labor movement, led by the AFL-CIO, argued forcefully for "fair" trade, not free trade. In order to obtain congressional approval in 1993, President Bill Clinton found it necessary to add side agreements on labor and the environment to the NAFTA agreement, which had already been largely negotiated during the administration of George H.W. Bush.

Today, some 15 years later, the United States has many additional FTAs with developing countries. Despite the fact that labor conditions are incorporated in the body of these agreements and are stronger than in the NAFTA side agreement, the U.S. labor movement still believes that most FTAs result in unfair competition with U.S. labor. U.S. labor is likely to oppose two pending agreements, those with South Korea and Colombia, despite the inclusion of strong labor conditions. The U.S. labor movement would almost certainly continue its opposition to NAFTA even if the agreement were renegotiated to include stringent labor conditions in the body of the agreement.

The constant repetition of labor's anti-NAFTA view, coupled with the electoral reliance of the Democratic Party on labor, contributes to the anti-trade posture of the general public. Alongside this, there is public concern that globalization involving job outsourcing is weakening U.S. economic vitality.

It is not clear what trade antagonists have in mind. Do they wish to curtail only imports on the assumption that this will not lead to retaliation affecting U.S. exports? If we learned anything from the 1930s it is that other countries do retaliate against U.S. protectionism. Since most Colombian exports already enter the United States duty free under trade preferences granted to Andean countries (Ecuador and Bolivia in addition to Colombia), is the issue about the permanence of preferences inherent in an FTA with Colombia? Do the anti-trade advocates wish to prevent outsourcing of production facilities even if outsourcing makes the producers involved more competitive in global markets?

Similarly, it is by no means evident what actions trade advocates want. International agreement was reached in November 2001 to begin the Doha Round of global trade negotiations. There is much hand wringing about the fact that these negotiations are still going on without assurance of success. There are many reasons for the protracted discussions: the uncertainty about the extent to which the United States and the European Union are prepared to reduce their agriculture support programs; the unwillingness of key emerging countries like India and Brazil to specify how much they will open their markets for nonagricultural imports; and the focus of many developing countries on the special and differential treatment they would obtain. Because of the negotiating hang-ups, some U.S. trade experts have suggested a two-tier World Trade Organization (WTO): free trade among countries willing to go this far, and an option for the remaining countries to enter into the first tier when they feel ready to do so. The first tier, if it could be negotiated (which I doubt), would be dominated by the developed countries on both sides of the Atlantic. Those in the second tier would probably include China and India, even as the center of gravity for the U.S. economy moves toward Asia rather than Europe.

The aficionados of dividing the WTO into different tiers of countries, each with its own set of rights and obligations, do not point out that international trade is increasing nicely. Setting the volume of trade at 100 in 2000, the year before the Doha negotiations were approved, the trade volume stood at 176 in 2006. The trading structure could be improved (for example, to reduce agricultural subsidies in the European Union, the United States, and Japan; to further open trade in services; and to bring uniformity in rules of origin, which define when a product is eligible for free trade)—but it is not broken.

The interplay between exchange rates and international trade is one of the principal reasons why the International Monetary Fund was established after World War II, but neither the IMF nor the WTO gives heed to this monetary-trade connection. Many countries intervene, directly and indirectly, to keep their exchange rates undervalued to augment exports—Japan, China, and South Korea are examples—and this can hardly be considered a level playing field. Asian countries have long practiced export promotion as a development tool, and the tendency there was to keep exchange rates undervalued with respect to the currencies of their export markets. Latin American countries, until about 20 years ago, did not emphasize export-led growth and, concurrently, many of their currencies were overvalued. During the past few years, Argentina has adopted the long-standing Asian practice and consciously keeps its exchange rate undervalued.

The presidential campaign in the United States deserves the grand prize for generating trade confusion throughout the world. Latin Americans, before most regional economies crashed during the 1980s, tended to blame others for their problems. The main complaint was that the center (the developed countries, especially the United States) consciously kept the periphery (the developing countries) dependent on them; this, in fact, was the intellectual basis for the import substituting industrialization model. As Latin America complained about the center-periphery divide, Asia moved ahead with its exports to the center, and Asian economies now far surpass those of Latin America. The two Democratic presidential candidates are intent on taking the mantle of complaint away from the rest of the Americas. Other countries don't live up to their obligations, but the United States does! The United States has lost hundreds of thousands, even millions, of jobs as a result of trade agreements—even though job creation is a function of macroeconomic and structural policies and, until the current economic slowdown, the U.S. economy has been at or near full employment. NAFTA should be renegotiated because the trade and environmental provisions are not strong enough and are in side agreements—but, of course, U.S. trade and environmental policies set a model for the world!

Latin Americans are confused. If the U.S. Congress insists on treating Colombia with disdain, what can less friendly countries expect? If the U.S. House of Representatives changes the fast-track voting timetable at will, what confidence can other countries have in these procedures that were adopted expressly to give them assurance that they will not have to negotiate trade agreements twice, once with the executive branch and a second time with the 535 members of Congress? What will either Senator Clinton or Senator Obama do if elected president? I am regularly asked this question. My defensive answer is that they will change their trade tune when the political season is over, but I can't provide assurance about this because the two candidates are digging themselves so deeply into the protectionist pit.

The United States is going through one of its recurrent anti-trade bouts stimulated by concerns about the domestic economy. These anti-trade sentiments blame foreigners for economic conditions that we created for ourselves. There is no evidence that the United States has lost more jobs than have been gained from NAFTA. There are unlikely to be direct job losses from free trade with Colombia whose traders already enjoy preferences in the U.S. market, whereas U.S. traders do not enjoy reciprocal preferences in the Colombia market; the Colombians hope that free trade will encourage foreign direct investment. Many of our policy wonks seem prepared to damage, perhaps even destroy, the WTO in order to entrench the dominance of the current powers in the organization rather than look ahead to economic power shifts already in train. This is not a good moment for U.S. trade policy, and this trashing of a structure we created carries the danger of infecting the global trading system.

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