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The Struggle for Free Trade

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SUMMARY The United States, leader of the free trade movement since World War II, has never faced higher stakes in the global arena. Asia's economic crisis is pummeling U.S. exports to the region. The 1998 overall U.S. trade deficit with the region was $250 billion, the highest ever recorded, and 1999 promises to be worse. As the deficit balloons, support for free trade dwindles among an already wary American public. In Asia, moves to restrict international commerce confirm fears that the financial crisis may generate a trade crisis. President Clinton, trying to head off global protectionism, is again asking for congressional authority to negotiate a new trade round. Advancing the free trade agenda will be a challenge, but Asian financial woes present the best opportunity in 50 years to push for real reform. A bias against imports has been a key component of Asia's successful growth strategy. The economic crisis called that approach into question. But the U.S. administration will have to take a new tack in persuading Congress, the American public, and its trading partners of the enormous benefits of unfettered international commerce.

Tough Times for Globalization

These have been trying times for Americans who believe in the merits of free trade. So-called "fast-track" authority, which would give President Clinton the right to negotiate binding trade agreements without risking line-by-line review and veto, has been rejected by Congress. In a July 1998 *Wall Street Journal*/ NBC News poll, 48 percent of respondents said globalization had been bad for the U.S. economy; only 42 percent said it was good. A 1999 survey found that only 25 percent of Congress favored open U.S. markets.[i]

Five years after the pro-NAFTA hyperbole, many Americans now feel they were deceived

This is remarkable considering the fact that the United States has been the leader of the free trade movement since World War II and the near consensus among economists, consumer groups, financiers, and business leaders that free trade is good for the U.S. economy. Why, then, are its proponents losing the debate? Why cannot the world's largest trading nation gain congressional approval for a free trade agenda?

Part of the answer lies in how U.S. administrations have approached the issue. The most recent example is the battle over ratification of the North American Free Trade Agreement. In the heated debate, overstatement became commonplace. NAFTA opponents hyperbolized about the "giant sucking sound" of divestment from the U.S. economy, while pro-NAFTA forces exaggerated its job-creating potential and the linkage between the U.S. and Mexican economies.

Five years after NAFTA's ratification, bilateral trade has increased, but the United States has enjoyed only modest job creation, and has a large and growing trade deficit with Mexico. These outcomes were predictable, but many Americans now feel they were deceived, and therefore distrust the administration on trade policy. The NAFTA case is but one egregious example of the long-standing practice of using bad arguments for short-term gain that result in long-term pain.

More Free Trade, More Red Ink?

In the U.S. political environment, protectionist sentiment tends to flourish during difficult economic times, and when there is a large and growing trade deficit. The first is easy to understand. Recessions provoke calls to keep scarce jobs at home by restricting imports. Regarding the second, growing trade deficits foster protectionism even in good economic times. They generate negative publicity as economic experts intone about long-term dangers of growing foreign claims on U.S. assets,[ii] and undermine public confidence. There have been many such warnings in recent decades. Political leaders since 1970 have espoused the benefits of free trade, but the cumulative U.S. trade deficit has grown to $1.89 trillion. Successive trade pacts, including the General Agreement on Tariffs and Trade (GATT) Tokyo Round, GATT Uruguay Round, NAFTA, and dozens of agreements with Japan, have been promoted as greatly benefiting the United States. Unfortunately, the trade deficit has stubbornly persisted, acting as a lightning rod for opponents of free trade and further pacts. The deficits result from many factors, but most important are 1) disparities in economic growth rates among trading partners; 2) disparities in savings/investment rates among trading economies; and 3) disparities in market openness among trading nations. The first two are beyond the scope of international trading rules (see box), and trade policy *per se* can only address the third, market openness. Thus, a trade negotiator's role is analogous to a doctor who is responsible for a patient's overall health, but can only treat one-third of his/her body. Even within this circumscribed field, recent travails of free trade supporters suggest that any initiatives promising to further open U.S. markets through international agreements will likely encounter public skepticism so long as the trade deficit persists, especially if its trajectory is toward record highs as it currently is (see figure 1).

Since late 1997, the trade account has steadily deteriorated. The deficit with Japan, the target of successive U.S. administrations, is approaching historic levels. By mid-1998 Japan had again surpassed China as the largest contributor to the U.S. deficit. Twenty years of export promotion by U.S. trade agencies is being negated.

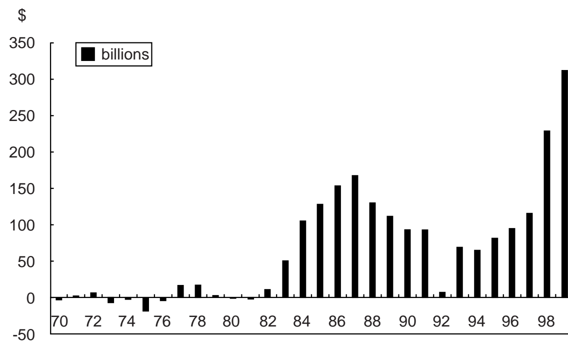

Fig. 1. America's trace deficit in 1970–99

The 1998 current account deficit was the biggest ever at $227 billion. It could reach $310 billion for 1999—a record 3.5 percent of GDP.[iii] With a few important exceptions, the feared surge of imports from Asian economies has not materialized; the chief culprit has instead been collapsing exports to them. In late 1998, U.S. Undersecretary of Commerce for International Trade David Aaron described exports to Asia as having "fallen off of a cliff."[iv] The severe recessions in most Asian domestic economies, coupled with sharp currency devaluations that have nearly doubled prices of U.S. goods, have created the worst market conditions for American exporters in over 20 years. While this has hurt many U.S. firms, booming demand in the U.S. economy has in most cases offset lost Asian business and prevented layoffs.

Progress on cutting the trade deficit is crucial to winning support for further market opening initiatives

In certain areas, notably steel and apparel, import surges have hurt domestic producers and provoked organized calls for market restrictions. So far, however, representatives of affected sectors have been unable to organize and rally broad-based support, or steer America's overall trade policy toward an overtly protectionist course. Nevertheless, they may be able to block further market opening tools, like the fast-track authority needed for a new trade round within the World Trade Organization (WTO). This underscores how crucial progress on the trade deficit is for winning public and congressional support for further market opening initiatives.

Do Deficits Matter?

Starting in the early 1980s, as the U.S. trade account went deep into the red, the question of trade deficits assumed center stage in policy debate. Since floating currencies had been instituted in the early 1970s, the emergence of large and persistent trade account imbalances was puzzling. Mainstream economics had argued that in a regime of floating currencies, such imbalances should more or less self-correct as currency values adjusted. As the steadily weakening dollar brought little or no relief, the Office of the U.S. Trade Representative began addressing what was diagnosed as the chief culprit: closed overseas markets, or "unfair trade." That effort continues today.

As the U.S. trade deficit again skyrockets, the question is again being asked: Do trade deficits matter? Some "neoliberal" economists argue that since the large deficit in the trade (current) account is balanced by an equally large surplus in the capital account, it poses no problem. A few even advocate eliminating trade-account tallying since it is meaningless and subject to misinterpretation. The U.S. Treasury and Federal Reserve perceives the deficit as manifestly undesirable and unsustainable, but sees it as an apparently long-term rather than immediate problem.[vi]

Neoliberal economists rightly highlight the axiom that the free exchange of goods and services expands overall economic output, without regard to either the terms of trade or whether the flow is balanced. But large, chronic trade imbalances also create financial distortions, the potential for higher interest rates, and political problems. The latter is particularly true if trade imbalances are concentrated in products that are well established domestically. For example, because the U.S. deficit with Japan centers on highly visible products like electronics and cars, that trade relationship has been particularly difficult.

In any case, it is indisputable that America's growing trade deficit with Asia is economically significant since, for the most part, it results not from growing imports but from a collapse of U.S. exports, the primary reason U.S. economic growth slowed in early 1999. The slogan, "exports mean jobs" adopted by successive U.S. administrations, emphasizes the political ramifications of this decline.

High Stakes

How important is foreign trade to the U.S. economy? The most common measure is its value as a percentage of the overall economy. In 1967, it totaled a mere 7 percent, whereas by 1997 it had grown to almost 20 percent. In other words, about one in five American jobs are now linked to foreign trade (see figure 2).

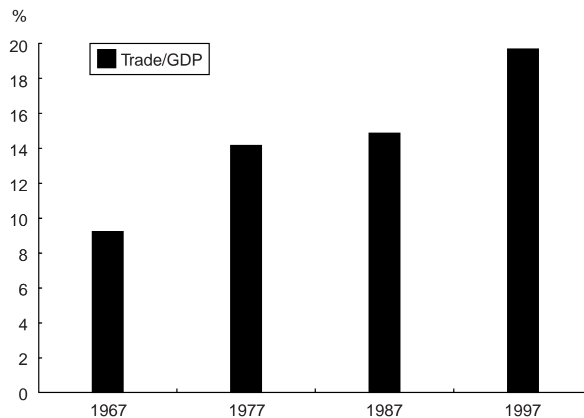

Fig. 2. The value of trade as a percent of the U.S. economy

The United States has spearheaded every major multilateral trade deal since World War II and helped overcome resistance from countries less committed to free trade. Without U.S. leadership, the international drive for free trade will likely stagnate or regress. The imposition of significant new protectionist measures by the United States or its trading partners would affect one-fifth of America's workers and threaten it's economic prosperity. If the fight to advance free trade is lost, the United States will pay dearly.

It is unrealistic to put trade policy on autopilot (as with Section 301) and eliminate the discretion of trade negotiators

However, the United States faces a policy Catch-22. The only responsible solution for its deficit woes is to further open foreign markets to American goods and services. But Congress remains skeptical of granting the president authority to negotiate. To strengthen its appeal to Congress for authority to negotiate a new WTO trade round, the administration is courting select special interests by emphasizing labor rights and environmental aspects of trade.[v] But congressional support may prove a zero-sum game: every Democratic vote gained may be offset by a lost Republican vote since many Republicans oppose incorporation of labor and environmental issues in the trade agenda. Gaining congressional and public support may require a fresh look at other aspects of both the marketing and substance of U.S. trade policy. The goals should be to boost U.S. exports (thereby reducing the trade deficit) while increasing the U.S. public's understanding of long-term goals for the international trading system and America's role in it.

U.S. Trade Policy Abroad

The current U.S. approach to its trading partners is based not on dialogue, but on specific steps dictated by law. These supposedly ensure that "unfair" foreign trade practices are investigated and, if not resolved, retaliated against. The best known provision is the Section 301 process, established by members of Congress frustrated with persistent foreign trade barriers and what they considered inadequate U.S. responses. The provision allows retaliation against unfair trading practices by restricting access to selected U.S. markets.

The record, however, suggests a different approach is needed. First, many of the largest U.S. trading partners see the 301 process or other "unilateral actions" as illegal under the WTO. Thus, the United States and the European Union endlessly debate U.S. trade law rather than how to increase trade. Furthermore, that the 301 process is triggered by individual complaints virtually guarantees a piecemeal approach to a systemic problem. It is simply unrealistic to put trade policy on autopilot, eliminate the discretion of trade negotiators, and ignore political considerations.

Deal making, American style. The following scenario has been played out repeatedly. In response to a complaint, U.S. trade negotiators, operating under an impossibly tight deadline, engage in nonstop "consultations" with foreign counterparts to try to eliminate the alleged unfair practice. If the talks flounder, one would expect sanctions to be imposed,

If support for free trade collapses in the U.S. the biggest potential losers will include Japan, China, and Asia's developing economies

but that does not typically happen. The political costs of failure are too high for what is usually a minor product, or sector-specific dispute. And if sanctions are implemented, American consumers or industry will be deprived of the targeted item. So the deadline is extended, and the negotiators instructed to resume talks. Neither side, however, is given more flexibility or authority to make new concessions. At the last minute, an agreement is announced in convoluted language purporting to settle the dispute.

How is this possible? We find a clue in George Orwell's observation that the great enemy of clear language is insincerity. The language is "mutually acceptable" because it can be interpreted in two different ways, mirroring the original opposing positions. This becomes evident when trade patterns remain unchanged. Thus the redundant U.S. trade agenda, perpetually revisiting problems supposedly resolved long ago.

This approach blocks formulation of a trade policy based on strategies and tactics in favor of a de facto agenda composed of trade complaints filed by individual companies. The image of the U.S. Trade Representative diligently pursuing every complaint filed by U.S. citizens or corporations may have political appeal, but it precludes setting priorities or directing efforts toward areas more beneficial to U.S. industry and workers. Instead of a trade *policy*, we come away with a trade *result*, a list of companies that have filed complaints. This approach largely explains why the European Union's banana import regime sits at the top of the U.S.-EU trade agenda, even though no appreciable U.S. exports or jobs are at stake. Many features of the EU's trade regime do have significant negative impacts on the U.S., yet these take a back seat to bananas. Company-specific complaints should be pursued, but they should not be the primary determinant of the substance and direction of overall U.S. trade policy.

Prescription: An Open Dialogue with Trading Partners

A far more productive approach is to begin an open dialogue with U.S. trading partners, particularly those with large, chronic trade surpluses stemming from structural barriers to foreign imports. Many of these are Asian countries that maximize exports and minimize imports as a tenet of their economic development. For instance, Japan's adoption of this strategy largely explains why the United States exports less to Japan than to Mexico, a country whose economy is only one-twelfth as large. To address the current Asian crisis, the United States must focus on where the international trading system is headed and what it wants to accomplish within that system. The answer is not "tough talk," the watchwords of successive U.S. trade representatives. New conditions in the region have set the tone for change.

The collapse of support for free trade within the United States is not solely—or even mainly—a U.S. problem. The biggest potential losers are those countries that benefit most from international trade, including Japan and China and other Asian developing economies. They must be made to understand that the chronic trade deficits of the past 20 years have seriously undermined political support for open markets, and that continued access to U.S. markets will require export-oriented economies to undergo major structural changes to become more open to imported goods and services.

Political leaders in these countries should respond positively to this, and certainly will understand that such deficits are unsustainable. The U.S. should also direct its message at nongovernmental bodies (such as consumer groups) and the general public. U.S. trading partners would be more receptive to this approach than the old one of retaliation and threat, and the timing is perfect.

The Asian Crisis: The Best Chance for Reform in 50 Years

Although Asia's economic crisis has increased the U.S. trade deficit and has undermined the free trade agenda, it has a silver lining. The United States now has its best chance since World War II to argue forcefully for meaningful reform in the trade regimes of affected Asian economies. Throughout the 1970s and 1980s, Asian nations sustained high growth

rates that were the envy of the world. Their economies relied on a collusive system among industry, finance, and government that disadvantaged outsiders and discouraged imports. The success of this approach made it resistant to calls for change. Why fix something that is not broken?

Today, the atmosphere is much more conducive to accepting the economic advantages of unfettered access to imports. Many factors generated the current Asian crisis, but closed domestic markets and the economic distortions they fostered were key. In Korea, for example, retail and major product sectors such as motor vehicles were protected. This resulted in high profits for Korean producers, but also in lack of innovation, low quality, and weak management practices and structures.

Market openness would help combat the higher interest rates that have accompanied IMF programs in many Asian countries

When domestic market growth slowed in the 1990s, and higher living standards made Korea less competitive as an exporter of labor-intensive products, Korean conglomerates launched a massive overseas investment drive, largely financed with foreign capital. This proved unprofitable and in many cases resulted in massive losses. Decades of protection had left these firms ill-equipped for international competition. When international lenders fled to quality in 1997 these companies were hard hit, and the International Monetary Fund had to bail Korea out.

A more open Korean domestic economy would have produced industries able to compete abroad, and internal market liberalization will be an essential element to recovery for Korea and other Asian economies. Market openness would help combat the higher interest rates that have accompanied IMF programs in Korea and many other Asian economies. The United States has made this point principally through the IMF. That the United States cannot be the "importer of last resort" for the rest of the world has been argued repeatedly by U.S. officials, including Vice President Gore, USTR Charlene Barshevsky, and Deputy Treasury Secretary Lawrence Summers. But the point must be made more forcefully and incorporated as a central component of *trade policy*, not just an ancillary point to the Asian crisis. U.S. financial and trade problems with Asia are two sides of the same coin and deserve equal treatment. A world trading regime that encourages all countries to export and import based on competitive market factors is the best model for sustained growth.

Promoting Open Trade at Home

The growing importance of external trade to the U.S. economy merits a higher profile, and a program of public advocacy to engage the American people. Traditionally, U.S. trade agencies have worked with industry and sectoral advisory committees, staffed by lobbyists who do not necessarily represent the rest of the country. The modus operandi has been to first make the deal, then sell it to Congress and the public. This strategy's limitations are evident in the current impasse in fast-track and other trade-related legislation.

Priority one: Public outreach. U.S. officials with responsibilities in trade policy should interact with local governments, labor, business groups and ordinary citizens at least as much as with foreign trade officials. In 1993, I worked with the Office of the U.S. Trade Representative to persuade the American states to join the GATT Government Procurement Code. In a misguided attempt to boost local economies, over the past 40 years many states had incorporated "buy local" laws governing state procurements. These had to be repealed before these states could join the GATT Code and allow local suppliers to bid on overseas procurements. We started by contacting the National Association of State Purchasing Officers, the National Governors Association, and two state legislator associations. An institutional bias against this domestic orientation was obvious: we obtained permission to attend a meeting of state officials in Lexington, Kentucky only through lengthy explanations, although twice-monthly trips to international meetings in Geneva, Switzerland were routinely approved.

Such domestic trips historically just were not done by our office, or anyone else in the U.S. trade policy apparatus. Few, if any, of the dozens of state and local officials I encountered had ever met with a U.S.

trade official, let alone been consulted. A typical comment was, "we are pleasantly surprised that you are consulting with us, and not handing us a fait accompli." The good will engendered was enormous. In the end, we persuaded most states to join the GATT Code, and billions of dollars in procurements are now conducted more economically.

The lesson here is that support for free trade can be obtained, even where open trade may threaten local economic interests. But concepts and policies must be explained in specific terms that are relevant to local concerns. Chances of success are far better if the case is made early, before unaddressed anxieties have hardened into negative positions.

Keep it Simple

Trade policy is intrinsically complex. Besides import tariffs, a wide range of other issues, such as health and safety standards, affect trade and must be dealt with internationally. Over the past two decades, a dizzying array of bilateral, multilateral, and sectoral initiatives have been pursued. Multilateral fora have focused on crafting "balanced" agreements. But there remain glaring, politically destructive disparities in important product categories. For example, under the Uruguay Round, an American-made Buick draws roughly a 10 percent import tariff if shipped to Europe, while a European-made Mercedes draws only a 2 percent tariff in the United States. It is difficult to argue to the United Auto Workers that the agreement is "balanced."

Reciprocity is a powerful concept that is readily understood and accepted as fair

A more sellable approach is to pursue the simple principle of reciprocity whenever possible, particularly in sensitive product categories. Reciprocity—"I'll treat you the same way you treat me"—is a powerful concept readily understood and accepted as fair. There are difficulties with this approach. For example, intersectoral trade-offs become more difficult. But the payoffs in domestic support for free trade would be enormous. Occasional exceptions will be necessary, but by adhering as closely as possible to the reciprocity principle, the U.S. government is much more likely to win public support. The U.S. task of selling its free trade agenda will be greatly eased if it can honestly say that future trade agreements will provide U.S. exporters with the same access as that enjoyed by those wishing to import into the United States.

Do Not Get Caught in the Numbers Game

In recent trade agreements such as NAFTA and the Uruguay Round, the principal strategy used to win over Congress and public opinion has been to emphasize the precise number of jobs likely to be created by the agreement through increased exports. While everyone supports jobs, projecting job creation is difficult. In the heat of political debate people are tempted to cite the most optimistic estimates. This may help carry the day, but it will create credibility problems later if actual job creation falls short of predictions. Microeconomics simply cannot precisely predict how employment will respond to changes in access to a trading partner's market, and the urge to claim otherwise should be resisted.

Emphasize Political and Social Benefits

A better approach is to integrate trade policy more closely with overall U.S. foreign policy goals. In the postwar period, the United States has sought to foster democratic institutions as the best chance for peace, prosperity and basic human rights. Promoting the free flow of people, goods, services, capital, and ideas is key to this process. Countries that share extensive two-way commercial relations rarely go to war. The dramatic improvement in European relations since World War II, for example, is largely attributable to the binding web of commercial relationships created under the European Union.

During the Cold War, U.S. presidents never underestimated to the American people the difficulties of that struggle, or the likelihood of occasional setbacks. Nevertheless, on the whole the public supported their foreign policy goals. Presidents will likely receive similar support for trade policy if they place it in this larger context. The Soviet collapse was an important step toward a world system consistent with American ideals, but much work re-

Advancing the free trade agenda is the surest road to a safer and more prosperous world for everyone

mains. In its dialogue with the American public, the government should not disguise the difficulties it may encounter. Not everyone shares U.S. views on free trade, and competing ideologies exist. Still, U.S. leaders should make clear that advancing the free trade agenda is the surest road to a safer and more prosperous world for everyone.

Conclusion

Turning around the U.S. trade account and regaining America's support for free trade will not be easy. Many factors behind the trade deficit, such as disparities in economic growth and savings/investment rates among trading partners, are not attributable to trade policy per se. In addressing the trade policy factors most responsible for the deficit, namely market barriers, the United States will encounter many domestic and foreign opponents. Among them are cynicism, a poor track record, parochial interests, competing philosophies, and closed minds. But the potential rewards are enormous, as will be the negative consequences of failure. Success will require more open communication with the American people and their elected representatives, and a new approach with U.S. trading partners. The current Asian economic crisis has caused the U.S. trade deficit to soar and damaged the free trade effort, but it also offers a rare opportunity to address underlying causes of the imbalance. Such an opportunity, if missed, is unlikely to reappear soon.

Notes

[i] CATO Institute, January 18, 1999 (as reprinted in *Journal of Commerce*, February 9, 1999)

[ii] Remarks by Federal Reserve Chairman Alan Greenspan before the U.S. House of Representatives Banking and Finance Committee, March 3, 1999, *Congressional Record*.

[iii] DRI/Standard & Poor's economic forecast, January 1999

[iv] *Journal of Commerce*, November 3, 1998

[v] President Clinton, January 1999, *State of the Union* address

[vi] U.S. Secretary of the Treasury Robert E. Rubin, February 17, 1999, press conference

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