

55. Trade

Congress should

- recognize that the relative openness of American markets is an important source of our economic vitality and that remaining trade barriers are a drag on growth and prosperity;
- move the focus of U.S. trade policy away from “reciprocity” and “level playing fields” toward commitment here and abroad to free-trade principles;
- take unilateral action to reform U.S. protectionist policies;
- renew fast track authority to facilitate new negotiations to eliminate trade barriers here and abroad;
- avoid using trade deficits as an excuse for trade restrictions;
- maintain support for the World Trade Organization as a body for settling disputes;
- revise section 301 to make it consistent with WTO rules;
- reform the antidumping law to eliminate unfair discrimination against U.S. businesses and consumers that buy foreign products; and
- adjust export control laws to the reality of today’s international marketplace.

Free Trade Means Free Markets

Its opponents like to portray free trade as an ivory-tower theory, but in fact the case for knocking down trade barriers rests on common sense. It is now widely recognized that free markets are indispensable to our prosperity: when people are free to buy, sell, and invest with each other as they choose, they are able to achieve far more than when governments attempt to control economic decisions. Given that fact, isn’t it obvious that free markets work even better when we widen the circle of people

with whom we can buy, sell, and invest? Free trade is nothing more than the extension of free markets across political boundaries. The benefits of free trade are the benefits of *larger* free markets: by multiplying our potential business partners, we multiply the opportunities for wealth creation.

From this perspective, it becomes clear that Americans gain from open U.S. markets even when other countries' markets are relatively closed. The fact that people in other countries are not as free as they should be is no reason to restrict the freedom of Americans. When goods, services, and capital can flow over U.S. borders without interference, Americans are able to take full advantage of the opportunities of the international marketplace. They can buy the best and cheapest goods and services the world has to offer; they can sell to the most promising markets; they can choose among the best investment opportunities; and they can tap into the worldwide pool of capital.

Unfortunately, supporters of open markets seldom put their case in those straightforward terms. Instead, trade liberalization in this country is identified almost exclusively with international negotiations in which the removal of U.S. trade barriers is contingent upon the removal of barriers abroad. Such negotiations convey the impression that exports are the primary benefit that accrues from international trade and that open markets at home are the price we pay for greater export opportunities. That impression is misleading—and ultimately harmful to prospects for continued liberalization.

The idea that exports are good and imports are harmful is the essence of the mercantilist fallacy that lies at the root of most protectionist thinking. That fallacy turns truth on its head: imports are in fact the primary benefit of trade. Imports give us goods that are cheaper or better than those we can produce ourselves; exports, which represent production that Americans do not get to consume, are actually the price we pay for the imports we enjoy. To the extent that free traders perpetuate the mercantilist fallacy by endorsing the dogmas of “reciprocity” and “level playing fields,” they are helping to foster a political culture that is hostile to open markets.

Opinion polls show that many Americans believe that U.S. openness to the rest of the world is destroying jobs and eroding living standards. That such “globaphobia” could be so widespread at a time of unrivalled prosperity demonstrates that free traders are doing something wrong. To combat the current intellectual confusion, supporters of trade liberalization should return to their free-market roots. They need to meet mercantilist

misconceptions head-on and to make the case that free trade is its own reward.

Alternatives to Reciprocity

Adopting a principled free-market approach to trade policy means more than a change in rhetoric—it means programmatic change as well. Free traders should expand beyond their traditionally exclusive reliance on negotiated liberalization and launch a campaign for the unilateral elimination of U.S. trade barriers—including the antidumping law, still-high tariffs on many products, import restrictions linked to agricultural price support programs, the Jones Act ban on foreign shipping between U.S. ports, the similar denial of cabotage rights to foreign airlines, and foreign ownership limits for air transport and broadcasting.

Advocating unilateral reform would enable free traders to frame the trade debate in terms that give them the natural advantage. Instead of always defending free trade, they could attack its alternative: protectionism in actual practice. The beneficiaries of protection would be forced to explain why they deserve their special privileges and why the welfare of other American businesses and their workers, not to mention consumers, should be sacrificed on their account.

Free traders would be able to reclaim their populist roots. Today trade liberalization is often characterized as elitist—padding the bottom lines of Fortune 500 multinationals and confirming the cosmopolitan prejudices of highly educated professionals. The stereotype is only confirmed by free trade's reliance on secretive negotiations and international bureaucracies. Unilateralism would combat that stereotype by stressing those aspects of the free-trade cause with the greatest populist appeal: cutting taxes and eliminating corporate welfare.

Furthermore, unilateral U.S. reforms would do more to encourage liberalization abroad than any trade negotiations ever could. The most sweeping and dramatic moves toward freer trade in recent years—in countries as diverse as Australia, New Zealand, Chile, Argentina, Mexico, and India—have occurred not at the bargaining table but unilaterally. The leaders of those countries finally realized that isolation from the world economy was a recipe for economic stagnation, and therefore they sought to emulate the relatively open-market policies of more prosperous countries. History shows, therefore, that the most effective form of international economic leadership is leadership by example.

Still, pursuing unilateral reform would not mean an end to trade negotiations. International agreements can facilitate the liberalization process by recruiting export interests to support free trade at home; also, such agreements provide a useful institutional constraint against protectionist backsliding. But a new U.S. negotiating posture is needed, one that replaces demands for reciprocity with commitment to free-trade principles.

Instead of seeking to “win” at the negotiating table by “getting” more than it “gives,” the United States could define some liberalization objectives—for example, tariff reductions, reforms of antidumping laws, rules on treatment of foreign investment, rules against protectionist misuse of health and safety standards, and so on—and offer to elevate its own unilaterally adopted free-trade policies into binding international commitments, provided that some “critical mass” of other countries agreed to exceed a defined minimum threshold of liberalization.

The United States does not need protectionist policies as “bargaining chips” to exert significant leverage. The recent multilateral agreements on telecommunications and financial services demonstrate that point: other countries signed on even though the major U.S. “concession” was to lock in current levels of openness. Also, U.S. involvement in international agreements is desirable apart from any consideration of “concessions,” since U.S. participation lends legitimacy to an agreement, thereby increasing other countries’ confidence in the integrity of each others’ commitments.

Thus, by taking a principled free-market approach, free traders can revitalize their cause both here and abroad. In particular, they can enjoy the best of both the unilateral and the multilateral worlds.

Fast Track Authority

Ideally, “fast track” trade negotiating authority would not be necessary. Instead, the United States would eliminate its trade barriers unilaterally—as a matter of sound economic policy and regardless of what other countries do. If it then entered into international agreements, changes in legislation would not be necessary. Such a scenario is more than a theoretical possibility: the United States negotiated the 1997 WTO agreements on telecommunications and financial services without fast track authority precisely because those agreements entailed no changes in U.S. law.

Until the United States embraces unilateral liberalization, however, traditional trade negotiations represent the best available vehicle for reforming protectionist policies here and abroad. Fast track—by requiring that

Congress vote up or down on implementing legislation without amending it—greatly facilitates the negotiating process by assuring our trading partners that the deals they sign will not be rewritten on Capitol Hill.

Accordingly, in the absence of unilateral trade policy reforms, Congress should enact fast track legislation. To be acceptable, though, such legislation must be “clean”; in other words, it should exclude agreements on non-trade-related matters like labor or environmental policy from the scope of the fast track procedures. The only valid purpose of trade negotiations is to reduce governmental interference in trade and investment flows; any fast track bill that threatens to increase governmental interference in those flows should be rejected.

Trade Deficits

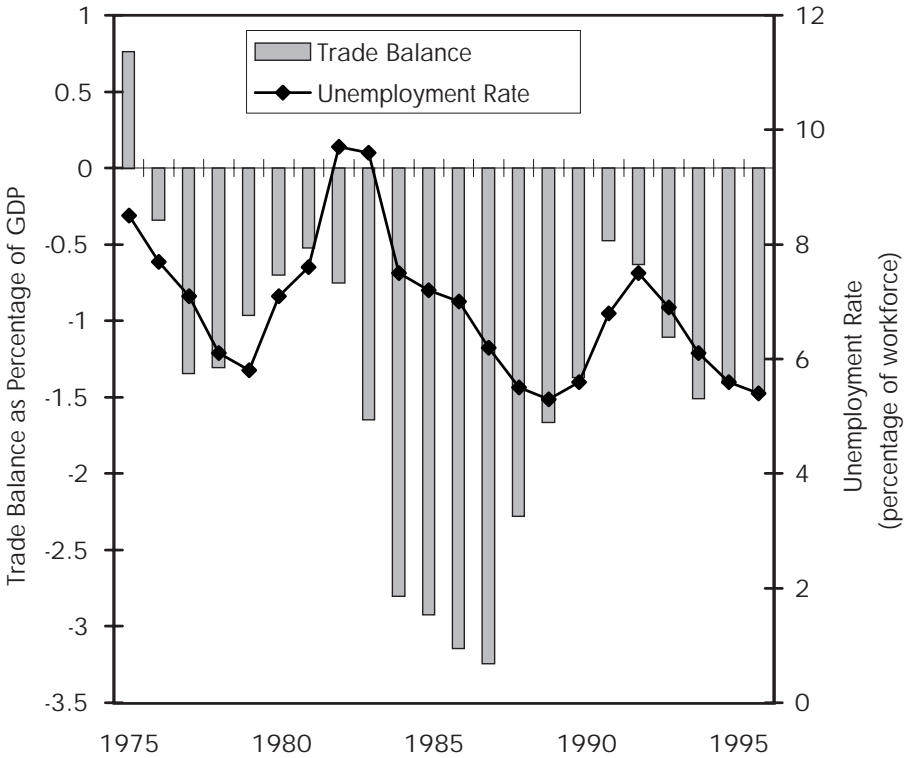
America’s persistent trade deficit has been climbing again, largely as a result of the Asian economic crisis. Although events in Asia are cause for concern, focus on the rising trade deficit is misplaced. In the present circumstances, the deficit merely reflects the relative health and strength of the U.S. economy.

Contrary to popular conception, the trade deficit is not caused by unfair trade practices abroad or declining industrial competitiveness at home. Trade deficits are determined by flows of capital across international borders, flows that are a function of national rates of savings and investment. That renders trade policy an ineffective tool for reducing a nation’s trade deficit.

A survey of America’s major trading partners reveals no relationship between bilateral trade balances and openness to U.S. exports. For example, the United States runs a bilateral surplus with Brazil, which is relatively protectionist, while we run deficits with Canada and Mexico, which are almost totally open to U.S. exports thanks to the North American Free Trade Agreement.

There is no connection between trade deficits and industrial decline. From 1992 to 1997, the U.S. trade deficit almost tripled, while U.S. industrial production increased by 24 percent and manufacturing output by 27 percent. Trade deficits do not cost jobs. In fact, rising trade deficits correlate with falling unemployment rates (Figure 55.1). Trade deficits are not a drag on economic growth; the U.S. economy has actually grown faster in years in which the trade deficit has been

Figure 55.1
The Trade Deficit Doesn't Cost Jobs



SOURCE: Council of Economic Advisers, *Economic Report of the President 1997* (Washington: Government Printing Office, 1997), Table B-40, p. 346, Table B-101, p. 414.

rising than in years in which the deficit has shrunk. Trade deficits may even be good news for the economy because they signal global investor confidence in the United States and rising purchasing power of domestic consumers.

The recent increases in the trade deficit reflect a slump in exports combined with moderate growth in imports. Exports are off because of turmoil in Asia, while the healthy U.S. economy continues to pull in imports and investment capital. Although weakening export markets are bad news for U.S. producers, the trade deficit simply indicates that economic conditions here are relatively rosy. Congress should ignore the much-hyped but ultimately meaningless trade balance figures when formulating trade policy.

World Trade Organization

The World Trade Organization is the primary institutional support for an open world trading order. In addition to serving as a forum for ongoing trade negotiations, the WTO and its dispute settlement procedures uphold a limited but real rule of law in international commerce. The WTO strongly advances the U.S. national interest in free markets here and abroad and therefore deserves strong U.S. support.

Complaints that the WTO impinges on U.S. sovereignty are groundless. The WTO cannot overturn U.S. laws; at most, it can declare that U.S. laws are inconsistent with international obligations. Whether we honor those obligations is up to us.

But honor them we should. The principles of market access and nondiscrimination incorporated in WTO agreements are ones that ought to be reflected in U.S. policy. When U.S. laws violate those principles, they ought to be changed. It is a mistake to complain simply because the United States “loses” a case in the WTO; when the dispute settlement process leads the U.S. government to reform protectionist policies, that is a victory, not a defeat, for the American people. Furthermore, by heeding “adverse” WTO decisions, the United States sets an example for the rest of the world. We stand to gain when other countries follow the WTO’s free-trade rules. Consequently, we have a large stake in the legitimacy and credibility of the dispute settlement process, which cannot be sustained if we selectively disregard WTO rulings.

The United States should show its support for the WTO process by reforming section 301 of the U.S. trade law. Section 301 authorizes the U.S. Trade Representative to impose retaliatory trade penalties against countries that it determines are blocking U.S. exports. Such penalties, however, are flatly inconsistent with our WTO obligations. Moreover, the section 301 process—in which the United States presumes to act as judge, jury, and executioner for the rest of the world’s trade-affecting policies—lacks any kind of international legitimacy and serves only to alienate our trade partners. We do not encourage free trade abroad by a hypocritical policy of badgering others to do what we say, not what we do. Section 301 should be eliminated, or at least changed so that its procedures and remedies are consistent with the WTO dispute settlement mechanism.

Antidumping Law

The U.S. antidumping law is today the single most effective tool for erecting new protectionist barriers against foreign goods. Although justified

as a remedy against “unfair trade,” in fact the law itself is blatantly unfair. Its supporters argue alternately that the law is a defense against predatory pricing or against market distortions caused by closed markets abroad, but the fact is that neither predatory pricing nor closed foreign markets are a criterion for imposing punitive duties under the law. Through its horribly complex and convoluted provisions, the antidumping law subjects the pricing of imports to restrictions that are far more onerous than those that apply to domestic merchandise. Such discrimination stifles honest competition and gouges U.S. businesses and consumers.

Beyond the specific economic damage that it causes, the antidumping law undermines support for open markets more generally. The law confirms the mercantilist fallacy that cheap imports are destructive and “unfair” and thereby helps to foster a political culture in which trade is viewed as a zero-sum game. Furthermore, aggressive U.S. use of this protectionist weapon compromises our ability to encourage freer markets abroad. Hypocrisy is not a solid foundation for leadership.

The U.S. antidumping law ought to be repealed. At the very least, it should be revised so that it does not apply to pricing practices that U.S. producers freely engage in. The United States should then lead multilateral talks to revise the Antidumping Code so that protectionist abuses abroad are eliminated as well.

Export Barriers

Although we complain about other countries’ barriers to our exports, the fact is that many barriers are homegrown. In particular, America’s export control policies remain detached from the realities of the global marketplace. U.S. companies should be allowed to sell technologies that are being sold freely elsewhere in the world by their foreign competitors and the sale of which fails to present a clear danger to U.S. citizens or world peace. That is not the case today for many products, and much bureaucratic wrangling is needed before others can be exported.

For example, U.S. restrictions on the export of strong encryption and attempts to force unpopular “key recovery” procedures hamstring U.S. companies and stifle the development of electronic commerce. National security concerns cannot justify the current policies; indeed, the real threat is that excessive controls here may cause technological leadership in this field to move elsewhere.

Sales and investments abroad by U.S. companies are also hindered by a growing web of foreign policy trade sanctions. Those sanctions are

addressed in a separate chapter. It should be noted here, though, that export and import barriers are two sides of the same coin. Governmental restrictions on the outward as well as the inward flow of goods, services, and capital across political boundaries undermine the creative power of free markets and are therefore inherently suspect.

Suggested Readings

- Burtless, Gary, et al. *Globaphobia: Confronting Fears about Open Trade*. Washington: Brookings Institution, Progressive Policy Institute, and Twentieth Century Fund, 1998.
- Glassman, James K. "The Blessings of Free Trade." Cato Institute Trade Briefing Paper no. 1, May 1, 1998.
- Griswold, Daniel T. "America's Maligned and Misunderstood Trade Deficit." Cato Institute Trade Policy Analysis no. 2, April 24, 1998.
- Hudgins, Edward L., ed. *Freedom to Trade: Refuting the New Protectionism*. Washington: Cato Institute, 1997.
- Lindsey, Brink. "A New Track for U.S. Trade Policy." Cato Institute Trade Policy Analysis no. 4, September 11, 1998.

—*Prepared by Brink Lindsey*