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THREE CHEERS FOR A NEW BAKER INITIATIVE

(Updating *Backgrounder* No. 587, "Free Trade Areas: Removing Trade Obstacles and Bucking Protectionism," June 17, 1987.)

The Baker Plan, U.S. Treasury Secretary James Baker's 1985 strategy to deal with the Third World debt crisis, has had questionable results. More promising is a new Baker initiative, outlined in an article in the January/February 1988 issue of *The International Economy*. Here Baker focusses his attention on how to liberalize world trade. He draws on the recently concluded United States Free Trade Area agreement with Canada that will phase out all tariffs and many non-tariff barriers over the next ten years. In his article, Baker maintains that the expanded use of such bilateral agreements can push the current round of multilateral General Agreement on Tariffs and Trade (GATT) talks toward measures opening markets.

Spurring Trade Liberalization. Baker's enthusiasm for the potential of FTAs is welcome. It may prove crucial in outflanking those countries that place roadblocks in the path of multilateral trade agreements. To improve the chances of this, the Reagan Administration should begin discussions with other countries that desire FTAs with the U.S. Congress can spur the trade liberalization process by renewing the President's authority, which expired this month, to participate in GATT negotiations. This renewal is part of the otherwise protectionist Omnibus Trade Bill, currently in a House-Senate conference committee. Congress also can approve the U.S.-Canada FTA when it is submitted by Ronald Reagan.

Trade protectionism was a major cause of the Great Depression of the 1930s. After World War II, the GATT sought to promote economic prosperity through multilateral trade liberalization. The central principle of the GATT is most favored nation (MFN) status. By this, each signator country accords the same access to its market and applies its own trade laws without discrimination to all other GATT members. Thus if a country levies a 5 percent duty on imported steel, it must apply this tariff to all countries, no matter whether the tariffs of other countries are higher or lower. Subsequent GATT rounds have reduced substantially worldwide tariff rates. The current round, launched in Uruguay in 1986, seeks to deal with such issues not adequately covered in the past as trade in services, subsidies, agriculture, and other non-tariff barriers.

"Crucial Precedent." The GATT permits FTAs. Some observers fear, however, that FTAs could undermine the most favored nation principle and disrupt multilateral trade liberalization negotiations. Yet Baker points out correctly that FTAs and the GATT are complementary means to the general goal of freer trade. Baker observes that, to reverse the destructive effects of the Smoot-Hawley Tariff of 1930, the 1934 Reciprocal Trade Act gave the President authority to negotiate bilateral reductions in tariffs. This gave the Roosevelt Administration bargaining power to initiate tariff reductions with 27 countries. Baker notes that "These bilateral achievements of the United States set a crucial precedent for the multilateral negotiations that followed World War II. Indeed, even the architects of GATT began with a bilateral model--they expected that the new trade structure would be built upon a U.S.-U.K. foundation, or later, a U.S.-European base."

The GATT came to include most non-communist countries. In the current round, worldwide agreement in new areas might be difficult because many less developed countries erroneously fear that trade liberalization would harm their economies. Protectionist pressures in the developed countries also threaten the Uruguay Round. Baker points out that FTAs, like the bilateral agreements of the 1930s, can help the multilateral process by providing a model for solutions to trade problems in new areas. Baker suggests that if GATT progress is inadequate, "we might be willing to explore a 'market liberalization club' approach, through minilateral arrangements or a series of bilateral agreements." This imaginative approach would open more markets for U.S. goods and provide incentives for other countries to liberalize trade.

Shifting the Political Dynamics. Baker's suggestion might be accomplished through a GATT-Plus group of countries in which free trade oriented members agreed to liberalization with one another beyond the basic GATT principles. In the 1974-1979 GATT Tokyo Round, certain members adopted this approach concerning rules governing anti-dumping and countervailing duty standards. In addition to the GATT-Plus approach, FTAs could be extended by the U.S. to all interested countries. Both of these approaches would give protectionist countries the incentive to liberalize their markets, since those not joining a freer trade arrangement would be cut out of the benefits of more open markets. The basic MFN principle of the GATT would be preserved within the GATT and the GATT-Plus group. Yet there would also be strong incentives for greater liberalization.

The FTA strategy would open markets bilaterally for the U.S. and to put pressure on the GATT talks to come up with substantive free trade reforms. Baker's statements on this general issue reveal that he is determined to fight for freer trade in a way that will help American consumers and workers. Rather than threatening protectionism, which results in higher prices and less freedom of choice for Americans, while also risking job-destroying retaliation, the new Baker initiative would apply pressure by opening up U.S. markets with other countries willing to reduce their barriers, thereby benefitting Americans. By using FTAs in this creative way, the Baker proposal could shift the political dynamics decisively in favor of freer world trade. For this, Baker deserves three cheers.

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