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Free Trade by Any Means: How the Global Free Trade Alliance Enhances America's Overall Trading Strategy

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America's economy thrives on trade. The United States has seen its economy and per capita income grow strongly as trade has become an ever greater portion of the country's gross domestic product (GDP). It is in America's economic interest to continue to expand trade by lowering barriers to goods and services in the U.S. and in other countries. Traditionally, America has focused on multilateral efforts to liberalize trade, through the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO). More recently, the Bush Administration has increased U.S. emphasis on bilateral and regional free trade agreements to supplement multilateral negotiations. Although all of these options are valuable components in a strategy to pursue free trade, the Administration should consider a fourth option—a Global Free Trade Alliance (GFTA)—to supplement bilateral, regional, and multilateral free trade negotiations.

The GFTA would not be a treaty: It would be a legislative initiative offering free trade between the U.S. and other nations that have a demonstrable commitment to free trade and investment, minimal regulation, and property rights. Congress would authorize GFTA members access to the U.S. market—with no tariffs, quotas, or other trade barriers—on the single condition that they reciprocate this access to the U.S. and to other members of the GFTA. As proposed, the GFTA offers advantages that complement existing options for trade liberalization. Specifically:

- The GFTA would involve minimal negotiation. Membership in the GFTA would be based

Talking Points

- The United States has seen its economy and per capita income grow strongly as trade has become an ever greater portion of the economy.
- It is in America's economic interest to continue to expand trade by lowering barriers to goods and services.
- To its credit, the Bush Administration has increased U.S. emphasis on free trade by negotiating free trade agreements with 21 countries–of which four agreements have been approved by Congress.
- The Administration should consider a Global Free Trade Alliance as a complementary part of America's existing trade agenda of promoting free trade by any means.
- The GFTA would offer free trade among the U.S. and other nations that have a demonstrable commitment to free trade and investment, minimal regulation, and property rights–on the one condition that they reciprocate this access to the U.S. and the other GFTA members.

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on existing policies and a common commitment to free trade, not negotiated concessions.

- **It would be faster than existing trade options.** Without the need for specific congressional approval, new members would gain GFTA privileges immediately, subject to legislative requirements.
- **Sovereignty would be unaffected.** The GFTA would be voluntary, and nations would be free to adopt policies that violate the GFTA at any time—with the understanding that such actions would cost them privileged access to the U.S. and other GFTA members' markets.
- **The GFTA would be a carrot-based approach that, in itself, makes the alliance more attractive over time.** As membership grows, the organization would become increasingly attractive. States would have an incentive to maintain property rights and open their markets further to qualify for the GFTA, providing a virtuous cycle of freer trade.
- **The GFTA would offer a speedy means for global free trade.** Unlike bilateral or regional free trade agreements, the GFTA could include all nations in an alliance based on true free trade.

Rather than being seen as a substitute for other initiatives that further free trade, the GFTA should be viewed as a complementary part of America's existing trade agenda of promoting free trade by any means. It is a creative addition to current approaches in an era in which the advance of global free trade hangs precariously in the balance.

How the U.S. Benefits from Free Trade

Despite occasional protectionist tendencies, America has long been an advocate for free trade. Indeed, America's most significant departure from liberal trade in the past century was the enactment of the U.S. Tariff Act of 1930—commonly known as the Smoot–Hawley Tariff Act—widely seen as a key contributing factor to the Great Depression. America saw its trade halved between 1929 and 1933, while unemployment increased from 3.2 percent in 1929 to 24.9 percent in 1933.[1] Following this hard lesson, America has been a proponent of free trade, including being a founding member of the General Agreement on Tariffs and Trade after World War II and driving the major efforts to liberalize global trade.

During the 50-plus years under GATT (and later the WTO), trade barriers have been reduced substantially, with a commensurate increase in global economic growth both in developed countries and in developing countries that embraced trade liberalization. The United States and its citizens have overwhelmingly benefited from this policy, which has paved the way for six decades of economic expansion and increased living standards. (See Chart 1.) Some specifics are:

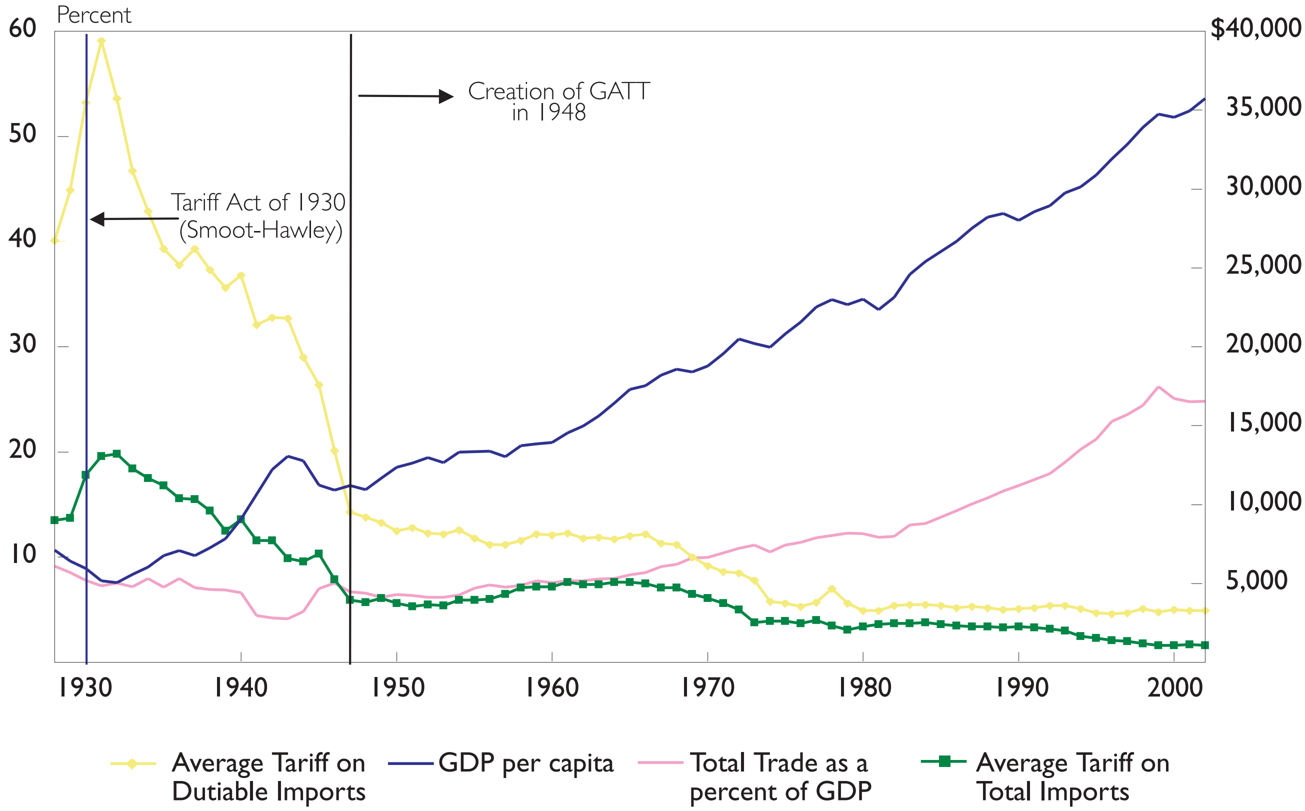
- The average U.S. tariff rate on all goods has fallen from over 19 percent in 1933 to 1.6 percent in 2003. The tariff rate on dutiable imports has fallen from nearly 60 percent to 4.9 percent today.
- Trade (as a percentage of the GDP) has climbed from single digits in the 1930s to nearly one-quarter of the U.S. GDP in 2003.
- During this period of increased trade liberalization and reliance on trade, real per capita GDP in the U.S. (in constant 2000 dollars) has climbed from a low of \$5,061 in 1933 to \$35,726 in 2003.

How does free trade increase standards of living? For one, free trade contributes to job growth by increasing efficiency in the U.S. economy.[2] Tariffs and other trade barriers are, in effect, hidden taxes on U.S. consumers and businesses. These

1. U.S. Bureau of the Census, "U 1-14 Value of Exports and Imports: 1790 to 1957," data series in *Historical Statistics of the United States: Colonial Times to 1957*, p. 537, and Federal Reserve Bank of Minneapolis, "Consumer Price Index 1913—," at *minneapolisfed.org/Research/data/us/calc/hist1913.cfm* (April 28, 2004).
2. Robert B. Zoellick, "The President's Trade Policy Agenda," in Office of the U.S. Trade Representative, *2004 Trade Policy Agenda and 2003 Annual Report of the President of the United States on the Trade Agreements Program*, March 1, 2004, at *www.ustr.gov/reports/2004Annual/overview.pdf* (August 2, 2004).

Chart 1 B 1786

Free Trade Fuels U.S. Economic Prosperity (1929–2003)



Source: U.S. Department of Commerce, Bureau of Economic Analysis, at *www.bea.gov/bea/dn/nipaweb/SelectTable.asp?Popular=Y* (July 13, 2004); Council of Economic Advisers, *Economic Report of The President 2004* "Table B34: Population by Age Group, 1929–2003," at *www.gpoaccess.gov/usbudget/fy05/sheets/b34.xls* (July 30, 2004); and U.S. International Trade Commission, "Value of U.S. Imports for Consumption, Duties Collected, and Ratio of Duties to Values, 1891–2003," February 2004, at *www.usitc.gov/ave.pdf* (July 30, 2004).

trade barriers harm the American economy by allocating resources inefficiently, thereby reducing growth and costing jobs in the long run. Moreover, barriers raise prices for every consumer, reducing the purchasing power of each paycheck. As noted by the U.S. Trade Representative (USTR), the costs of trade barriers are staggering:

> Last year alone, hidden import taxes cost American consumers $18 billion. Duty-free trade would eliminate these hidden costs and lower prices for consumers.

While this proposal would offer substantial benefits to all Americans, it would particularly help low-income families. A recent study by the Progressive Policy Institute found that cutting U.S. import taxes especially benefits single-parent, low-income families, who typically pay a higher proportion of their income on import taxes than other households. A University of Michigan study found that the U.S. economy would expand by $95 billion as a result of tariff-free trade—contributing to job-creation and higher wages.[3]

America's experience is not unique. Countries that embrace economic freedom—including freedom of trade—experience stronger economic growth than those that seek to thwart the market through regulatory hurdles and policy restrictions.[4] Numerous economic studies confirm the benefits of free trade, including a 2003 study by Michael W. Klein, Scott Schuh, and Robert K. Triest, which found that the benefits of trade outweigh its costs by 100 percent, or two to one.[5] The bottom line is that free trade is a net boon for economic growth because it increases productivity, lowers costs, and bolsters living standards.

Routes to Free Trade

There are three traditional routes for pursuing trade liberalization: bilaterally, regionally, and multilaterally. Each option has strengths and weaknesses.

Bilateral Trade Agreements. Bilateral trade negotiations have the virtue of flexibility. They allow the U.S. to pick and choose among prospective trade partners and customize individual agreements based on the needs and concerns of individual countries. Moreover, negotiating bilaterally allows each agreement to move at its own speed, rather than being held hostage to the slowest moving party (as in a multilateral or regional agreement).

Unfortunately, the flexible nature of bilateral negotiations is also a weakness in that it permits countries to exclude entire economic sectors, such as agriculture, from the scope of the agreements. These negotiations are also limited in that they extend free trade incrementally, one nation at a time, rather than broadly (as is the case through regional and multilateral agreements). Another weakness is that the individual nature of bilateral agreements means that each must run the gauntlet of congressional approval. Even with trade promotion authority—which restricts Congress to either an up or down vote without amendment—this process can be tedious and fraught with delays. For instance, Congress is unlikely to vote on a free trade agreement with Bahrain prior to the U.S. election this November.

Regional Trade Agreements. Regional free trade agreements counter some of the weaknesses of bilateral negotiations, but sacrifice some of the strengths. On the positive side, negotiating with multiple countries broadens the impact of the agreement to more economies, sets common rules for trade among the agreement partners, and streamlines congressional consideration to one agreement instead of several.

However, these negotiations can proceed only as quickly as the slowest member. This can substantially delay the process, as evidenced by negotiations on the Free Trade Agreement of the Americas, which has made little tangible progress despite years of effort. Additionally, a greater number of negotiating partners means that more diplomatic problems could constrain portions of the agreement, thereby undermining its effectiveness.

Multilateral Trade Agreements. The ideal means for pursuing free trade is multilaterally. The original forum for such negotiations was the General Agreement on Tariffs and Trade, agreed to in 1948, which eventually formed the core of the World Trade Organization, founded in 1994. With 147 members accounting for 97 percent of the

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3. Office of the U.S. Trade Representative, "U.S. Proposes Tariff-Free World, WTO Proposal Would Eliminate Tariffs on Industrial and Consumer Goods by 2015," November 26, 2002, at *www.ustr.gov/releases/2002/11/02-112.htm* (August 3, 2004), and Edward Gresser, "Toughest on the Poor: Tariffs, Taxes, and the Single Mom," Progressive Policy Institute *Policy Report*, September 10, 2002, at *www.ppionline.org/documents/Tariffs_Poor_0902.pdf* (July 30, 2004).

4. Marc A. Miles, "Introduction," Chap. 1 in Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at *www.heritage.org/index*.

5. Jeff Madrick, "Economic Scene; As Job Exports Rise, Some Economists Rethink the Mathematics of Free Trade," *The New York Times*, March 18, 2004, at *www.nytimes.com/2004/03/18/business/18scene.html* (July 30, 2004), and Michael W. Klein, Scott Schuh, and Robert K. Triest, *Job Creation, Job Destruction, and International Competition* (Kalamazoo, Mich.: W. E. Upjohn Institute for Employment Research, 2003).

world's trade, successful negotiations in the WTO would apply liberalization across most of the world in one stroke. During the past five decades, the GATT/WTO framework has dramatically reduced global barriers to trade.

Regrettably, while GATT/WTO has effectively lowered trade barriers, its members are not required to engage in actual free trade. Members merely agree to lower existing barriers on specified products, not eliminate them.[6] Moreover, the large membership and rules that require adopting changes through consensus mean that negotiations in the WTO are difficult, slow, and often avoid controversial aspects of trade liberalization. Each of the successive (and completed) GATT negotiation rounds has taken longer to complete than the preceding round.[7] The Uruguay Round—the most recent completed round, which led to the creation of the WTO—lasted nearly a decade, from 1986 to 1994. The current Doha Round began in 2001, and the prospects for reaching a final agreement by the 2005 deadline are dubious.

Since World War II, America's main focus on trade liberalization has been through multilateral negotiations using GATT and its successor, the WTO. Only in the past two decades has the United States focused on other options for pursuing free trade. Unsurprisingly, the United States had free trade agreements with only three countries through two agreements before the current Bush Administration.[8]

The Bush Administration has recognized the unrealized potential of free trade outside the WTO and sought to forge numerous bilateral and regional agreements. This commonsense approach to trade has enabled the Administration to pursue trade liberalization through the most effective means. When one means of pursuing free trade is slowed, such as the current WTO negotiations, the U.S. can pursue free trade bilaterally or regionally.

This agile approach to trade has resulted in a flurry of agreements and negotiations. Congress has already approved free trade agreements with Australia, Chile, Morocco, and Singapore. Seven other free trade agreements, encompassing 17 countries, are either currently being negotiated or waiting for congressional approval.[9] Moreover, the Bush Administration has continued to pursue the Free Trade Agreement of the Americas (started under the Clinton Administration), the U.S.–Middle East Free Trade Agreement, and the Doha Round of the WTO.

The Bush Administration deserves praise for revitalizing America's trade agenda by pursuing bilateral and regional trade alternatives. However, the Administration still seems bound by traditional notions of trade agreements. Yet there is no reason to restrict trade liberalization to existing models, particularly when a complementary alternative—a voluntary Global Free Trade Alliance—offers advantages unavailable through traditional strategies.

A Global Free Trade Alliance

A Global Free Trade Alliance offers an alternative option for pursuing free trade that avoids the weaknesses of bilateral, regional, and multilateral free trade agreements. First, the GFTA would not be a treaty; it would be a legislative initiative simi-

6. World Trade Organization, "The Agreements," Chap. 2 in *Understanding the WTO*, 3rd ed., September 2003, at *www.wto.org/english/thewto_e/whatis_e/whatis_e.htm* (July 30, 2004).
7. World Trade Organization, *Understanding the WTO*, p. 16.
8. These agreements are the U.S.–Israel Free Trade Agreement (effective in 1985) and the North American Free Trade Agreements (effective 1994 and incorporating the pre-existing Canada–U.S. Free Trade Agreement). Although the U.S.–Jordan Free Trade Agreement was negotiated during the Clinton Administration, it was enacted due to strong support from the Bush Administration and became effective in 2001.
9. Negotiations are concluded or ongoing with the Andean region (Colombia, Ecuador, and Peru), Bahrain, the Central American Free Trade Agreement (CAFTA, which includes Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua), the Dominican Republic, Panama, the Southern African Customs Union (SACU, which includes Botswana, Lesotho, Namibia, South Africa, and Swaziland), and Thailand.

Criteria for a GFTA

GFTA membership should be based on objective analysis of the country's commitment to free trade in goods, services, and investment, such as that used in *The Index of Economic Freedom*, published annually by the The Heritage Foundation and *The Wall Street Journal*.[1] While the *Index* annually evaluates over 160 countries on 10 specific factors, not all of these would directly relate to GFTA eligibility. Of these 10 factors, four constitute a sound measure of the openness[2] of a country's markets:

- Trade Policy. Obviously, a prospective GFTA member would have to have minimal barriers to trade, including low tariffs and minimal import licenses, controls, quotas, and other non-tariff barriers.
- Capital Flows and Foreign Investment. Another key requirement would be an open investment regime, including a transparent and open investment code, impartial domestic treatment of foreign investment, and an efficient and speedy approval process.
- Property Rights. A central tenet for the exchange of goods and services is an established rule of law—enforced by an independent, fair, and efficient judicial system—that protects private property and provides an environment in which business transactions take place with a high degree of certainty.
- Regulation. A GFTA member must not impose an undue regulatory burden on entrepreneurs or business. Key elements include an efficient, transparent licensing system that allows a business to be established quickly, equal application of regulations, and transparency.

To qualify for the GFTA, a country would need to be open to trade and investment and maintain a secure rule of law with low levels of regulation. The *Index* ranks countries on a scale of 1 to 5, with 1 being the most free score and 5 being the least free. Using the *Index*, countries receiving a score of either 1 or 2 on trade policy, capital flows and foreign investment, property rights, and regulation would qualify. Although only 12 countries currently qualify for the GFTA, another 19 countries representing every region of the world qualify in three of the four factors and thus would only need to improve their scores on the remaining factor. (See Table 1 and Map 1.)

1. Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at *www.heritage.org/index*.
2. John C. Hulsman, Ph.D., and Aaron Schavey, "The Global Free Trade Association: A New Trade Agenda," Heritage Foundation *Backgrounder* No. 1441, May 16, 2001, at *www.heritage.org/research/tradeandforeignaid/bg1441.cfm*.

lar to Normal Trade Relations (formerly Most Favored Nation) status.[10] The legislation would offer free trade between the U.S. and other nations that have demonstrated a commitment to free trade and investment, minimal regulation, and property rights. As former British Prime Minister Margaret Thatcher has noted, "Not only would this [GFTA] arrangement work to stimulate the members' prosperity: it would also act as a beacon and an example to others."[11]

To create a GFTA, Congress would simply need to pass legislation giving GFTA members access to

10. Due to the inclusive nature of the GFTA and given that members, regardless of other factors, are able to join when they meet the same objective standards, the authors feel that the GFTA does not violate Most Favored Nation standards of treating all relevant nations the same. In addition, GFTA is in line with the spirit of Article 24 of the GATT: "A regional arrangement must facilitate trade among its members, and not raise trade barriers between its members and other nations."
11. Margaret Thatcher, *Statecraft* (London: HarperCollins, 2002), p. 405.

the U.S. market with no trade restrictions—on the one condition that they reciprocate this access to the U.S. and the other members of the GFTA. As standing legislation, admitting new members would not require additional votes. The USTR would simply need to certify that a qualifying country has granted U.S. goods and services free access to its markets.

Table 1 B 1786

Membership in a Global Free Trade Alliance

	Qualifying Countries		Countries Next in Line	Policy Blocking Membership
1	Australia	1	Austria	Regulation
2	Denmark	2	Bahrain	Trade
3	Estonia	3	Belgium	Regulation
4	Finland	4	Canada	Foreign Investment
5	Hong Kong	5	Chile	Regulation
6	Iceland	6	Cyprus	Foreign Investment
7	Ireland	7	Germany	Regulation
8	Luxembourg	8	Netherlands	Regulation
9	New Zealand	9	Sweden	Regulation
10	Singapore	10	Switzerland	Regulation
11	United Kingdom	11	Botswana	Trade Policy
12	United States	12	El Salvador	Property Rights
		13	France	Regulation
		14	Israel	Regulation
		15	Italy	Regulation
		16	Portugal	Regulation
		17	Spain	Regulation
		18	Trinidad and Tobago	Regulation
		19	Uruguay	Regulation

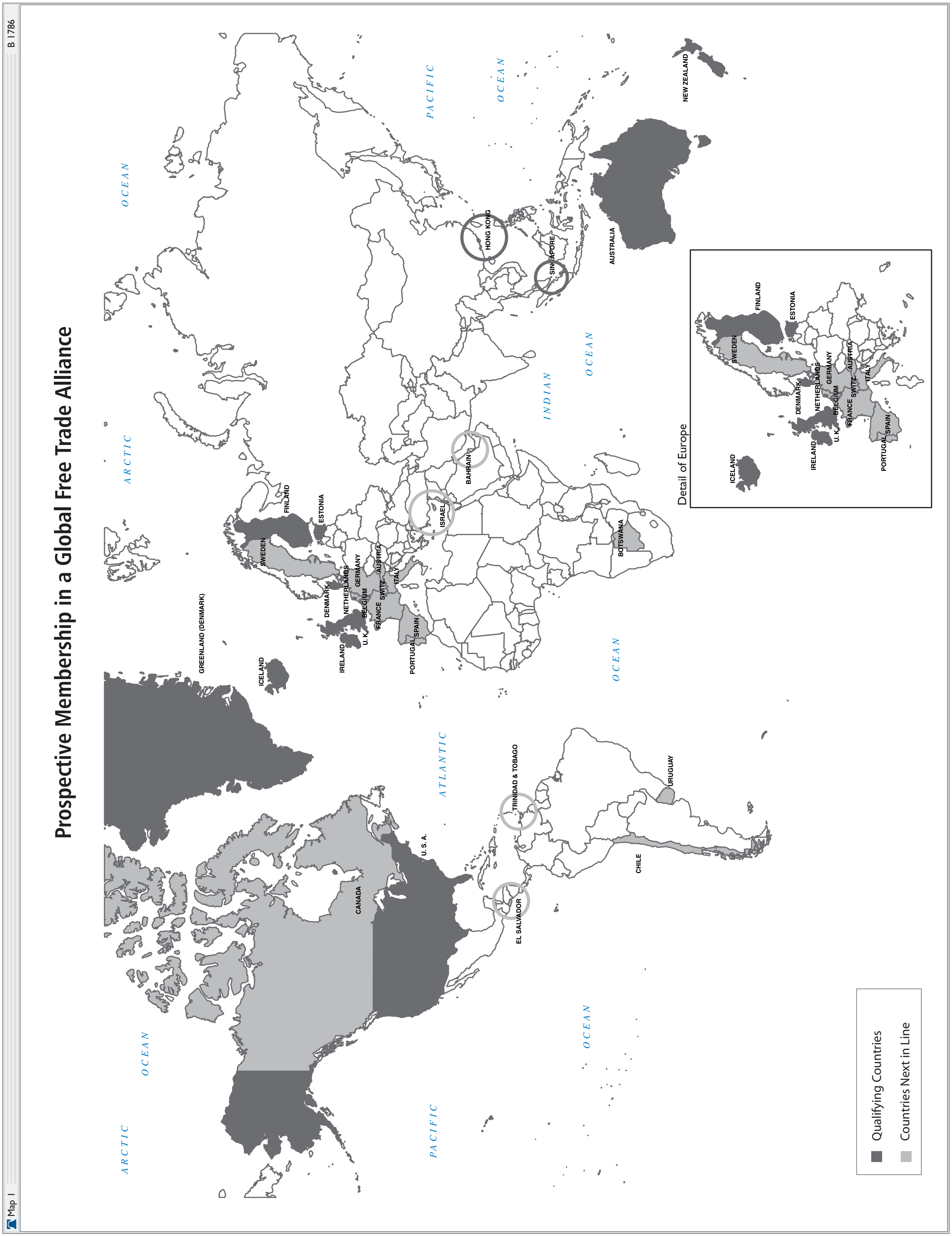
Source: Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), at *www.heritage.org/index*.

The legislation should include an enforcement mechanism rescinding special access to U.S. markets if a country ever imposes trade barriers against U.S. goods or services in violation of the GFTA legislation or if the country enacts policies that would cause it to fall short of the qualifying criteria. When members join the alliance, they would stipulate that if they fail to meet the numerical targets in the future, they would agree to leave the alliance unless they corrected the lapse within one year. This action could be triggered by congressional act or USTR notification.

Rather than having a standing secretariat, the GFTA would merely be a formalized meeting of the member countries' trade ministers, staffs, and technical experts. Any specific technical working group would exist only so long as its specific task was being addressed (e.g., agreeing on common accounting standards). Further decisions on trading initiatives would be made on a consensual basis, in areas such as codifying uniform standards on issues such as capital flows, subsidies, or regulations to further minimize barriers within the alliance.

As proposed, the GFTA offers advantages that complement existing options for trade liberalization. Specifically:

- As a coalition of the willing, the GFTA would involve minimal negotiation. Membership in the GFTA would be based upon existing policies, not negotiated concessions. It would secure the benefits of increased trade and investment among members without necessitating any new major policy reforms. It would reward nations for their commitment to economic freedom by securing a coalition of the willing determined to maximize trade liberalization.
- It would be faster than existing options. Because new members would become eligible based on their own existing policies and willingness to open their markets to the U.S., the only delay to admission would be a short period of consideration prior to USTR notification to Congress. Without the need for specific congressional approval, new members would gain GFTA privileges immediately, subject to legislative requirements.
- Sovereignty would be unaffected. GFTA membership would be voluntary, and nations would be free to adopt policies in violation of the GFTA at any time—with the understanding that such actions would cost them privileged


Map 1
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Prospective Membership in a Global Free Trade Alliance
ARCTIC OCEAN
PACIFIC OCEAN
ATLANTIC OCEAN
INDIAN OCEAN
CANADA
U.S.A.
GREENLAND (DENMARK)
ICELAND
IRELAND
U.K.
PORTUGAL
SPAIN
FRANCE
BELGIUM
NETHERLANDS
DENMARK
SWITZ.
GERMANY
AUSTRIA
ITALY
SWEDEN
FINLAND
ESTONIA
ISRAEL
BAHRAIN
BOTSWANA
HONG KONG
SINGAPORE
AUSTRALIA
NEW ZEALAND
EL SALVADOR
TRINIDAD & TOBAGO
CHILE
URUGUAY
Detail of Europe
Qualifying Countries
Countries Next in Line

access to U.S. and other GFTA markets. Its numerical target methodology would allow for self-selection and would give the whole policy initiative a self-governing aspect. The GFTA is not an example of an American fiat.

- **The GFTA would be a carrot-based approach that, in itself, makes the alliance more attractive over time.** There is a tipping point here: As membership grows, the organization would become increasingly attractive. Such an opportunity for momentum has long been missing in trading regimes. Without American finger-pointing about the merits of liberalization, states would have an incentive to open their markets further to qualify for the GFTA. It would thus give non-member countries an incentive to make market-friendly reforms in order to qualify for membership.
- **The GFTA would offer a speedy means for global free trade.** Unlike bilateral or regional free trade agreements, the GFTA would not be bound to a finite number of partners or a specific region. In theory, it could include all nations. However, unlike the WTO, it would be based on true free trade rather than an incremental reduction in trade barriers.

The GFTA would have the potential to encompass every nation, if it meets the criteria and wishes to open its markets to goods and services from other GFTA members. However, this is unlikely to occur, at least in the near future, because only three dozen countries are currently within sight of GFTA membership. This means that the U.S. should not abandon bilateral, regional, or multilateral options for pursuing free trade with countries that are not eligible or willing to take advantage of the GFTA. Instead, the U.S. should treat the GFTA as an attractive supplement to these efforts.

Conclusion

The Bush Administration is committed to pursuing free trade by any means. As stated by U.S. Trade Representative Robert Zoellick, the Bush Administration has "a strategy of trying to move liberalization ahead globally, regionally, bilaterally, and to create a competition on liberalization."[12] The Global Free Trade Alliance offers a new, innovative means for pursuing this strategy.

The GFTA can change the very way that people and countries think about free trade. Further global trade liberalization will no longer require wrangling over "concessions." Instead, free trade will be seen for what it is—a policy that gives countries that embrace it a massive economic advantage. As the advantages of an alliance become apparent, the GFTA would serve as a practical advertisement for the enduring global benefits of free trade.

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12. Ann M. Veneman and Robert T. Zoellick, press briefing, U.S. Department of Agriculture, August 13, 2002, at *www.usda.gov/news/releases/2002/08/0341.htm* (July 30, 2004).