Backgrounder

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America's Free Trade Agenda: The State of Bilateral and Multilateral Trade Negotiations

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Despite more than five decades of evidence demonstrating the gains from liberalizing trade, the impact of international trade and open markets on the U.S. economy remains a hotly debated issue. In 2005, Congress has already considered renewing the President's trade promotion authority, withdrawing from the World Trade Organization (WTO), and approving the Dominican Republic–Central American Free Trade Agreement (DR–CAFTA). Fortunately, free trade won the debate in each round, albeit sometimes by only a narrow margin. These successes are providing greater economic opportunity to Americans and allowing the United States to maintain its role as a leader in the international economic community.

However, the continued dominance of free trade in American policy is far from secure. There remain critical elements on the U.S. trade agenda that will further test the Congress's willingness to support the President's push to open markets bilaterally, regionally, and globally. In the coming months, Congress needs to guard against "free trade fatigue" and protectionist sentiment and objectively debate the merits of approving and implementing the U.S.–Bahrain Free Trade Agreement and of supporting U.S. leadership and negotiations in the WTO Doha Round.

For over 50 years, the United States and the rest of the world have reaped the economic benefits of gradual trade and investment liberalization. Congress should stay the course and allow Americans to enjoy the wealth and opportunities that will come from further freeing trade.

Talking Points

- Congress needs to guard against "free trade fatigue" and protectionist sentiment and objectively debate the merits of approving and implementing the U.S.–Bahrain Free Trade Agreement and of supporting U.S. leadership and negotiations in the World Trade Organization's Doha Round.
- Domestic priorities—such as fostering U.S. economic growth and jobs, opening foreign markets for American farmers and manufacturers, and increasing living standards—fully mesh with negotiators' efforts to promote trade liberalization.
- Successful conclusion of the current round of negotiations and implementation of beneficial free trade agreements will allow America a chance at a brighter future.
- For over 50 years, the U.S. and the world have reaped the economic benefits of gradual trade and investment liberalization. Congress should stay the course and allow Americans to enjoy the wealth and opportunities that will come from further freeing trade.

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Bilateral and Regional Free Trade Agreements

Congress has approved free trade agreements (FTAs) with Israel; Canada and Mexico (NAFTA); Jordan; Singapore; Chile; Australia; and Morocco. Most recently, it approved DR–CAFTA, which includes the Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. The gains to American families and business from these agreements have been significant.

- In the first year of the U.S.–Singapore FTA, America's trade surplus with Singapore more than tripled, growing to $4.3 billion.
- Just four months after the U.S.–Australia FTA was implemented, America's trade surplus with Australia grew by almost 32 percent to more than $2 billion.
- Exports to Chile and Singapore expanded by $4 billion in the first year after implementing FTAs with these countries.[1]

America's consumers now pay less for groceries and other consumer goods, allowing them to stretch their dollars into additional consumption or savings. U.S. firms have lower operating costs as a result of cheaper imported components for their products and face a brighter investment climate. Consequently, FTAs increase the potential for the creation of better, higher paying American jobs.

The U.S. signed an FTA with Bahrain on September 14, 2004, and recently concluded negotiations with Oman. It is currently negotiating FTAs with Thailand, Panama, and the United Arab Emirates. The U.S. is also pursuing regional agreements with the countries of the Southern African Customs Union, Andean countries, and 34 nations across the Western Hemisphere to create a greater Free Trade Area of the Americas. As with past U.S. trade agreements, the potential gains from these newest contenders are too good for America to pass up. The U.S. should continue to approve these important new free trade agreements and to expand its free trade relationships throughout the world.

Free Trade's Many Shapes and Sizes

Ideally, free trade should be achieved through multilateral trade negotiations across a large group of countries. However, the pace of such negotiations is slow, and consensus is hard to achieve.

FTAs negotiated by smaller groups of countries are the next best thing to promote global trade liberalization.[2] FTAs can provide institutional competition to help keep multilateral talks on track and to give the U.S. an option of pursuing agreements with countries willing to engage seriously in liberalizing foreign trade. In the process, FTAs formed with smaller groups of countries can serve as building blocks for broader agreements.

Free trade arrangements do have some potential shortcomings. First, some argue that preferential arrangements are not truly legitimate trade policy options under WTO rules. Second, bilateral and regional free trade areas may inefficiently divert international trade from lowest-cost sources to trade partners receiving preferential treatment.[3] Finally, Congress has further criticized the Bush Administration for extending free trade proposals to countries with small economies or only marginal trade relationships with the United States. While these concerns are valid, FTAs have benefits that may outweigh the costs, maintaining the viability of such agreements as an alternative way to reduce trade barriers around the world.

1. Office of the U.S. Trade Representative, "Free Trade Agreements Are Working for America," *CAFTA Policy Brief*, May 26, 2005, at *www.ustr.gov/assets/Document_Library/Fact_Sheets/2005/asset_upload_file204_7872.pdf* (October 13, 2005).
2. Edward Hudgins, "Regional and Multilateral Trade Agreements: Complementary Means to Open Markets," *Cato Journal*, Vol. 15, No. 23 (Fall 1995/Winter 1996), and Fred Bergsten, "Open Regionalism," Institute for International Economics *Working Paper* No. 97, 1997.
3. Jagdish Bhagwati and Arvind Panagariya, *The Economics of Preferential Trade Agreements* (Washington, D.C.: AEI Press, 1996), and Anne O. Krueger, "Free Trade Agreements as Protectionist Devices: Rules of Origin," in James R. Melvin, James C. Moore, and Raymond Riezman, eds., *Trade, Theory and Econometrics: Essays in Honor of John C. Chipman* (New York: Routledge Press, 1999), pp. 91–101.

FTAs and the WTO. Free trade agreements between countries can exist in harmony with the WTO. Legally, preferential trade agreements are permitted under the multilateral auspices of the WTO provided that:

1. They do not result in higher overall trade barriers for WTO members outside the agreement,[4]
2. They eliminate duties and other trade barriers on a substantial amount of products originating in participating countries,[5] and
3. The trade barriers are eliminated within a reasonable amount of time.[6]

Along with the European Union and NAFTA, some 215 FTAs and customs unions are in force. Over 145 regional trade areas have been reported to the WTO since 1995 alone.[7]

Counterproductive FTAs? The second criticism of FTAs centers on their potential to restrict rather than bolster free trade. The fundamental purpose of international trade is increased competition in domestic markets and wider opportunities for a country's exporters. Increased competition results in lower prices for households and businesses and a greater selection of goods available for consumption. Competition also promotes an efficient allocation of labor and capital to the most competitive firms, driving innovation, increases in labor productivity and real wages, investment, and long-term growth. This goal can be thwarted by free trade agreements that divert trade from low-cost suppliers to those with higher-cost structures.

While trade diversion can certainly result from preferential trade agreements, recent research indicates that the loss associated with diversion from low-cost suppliers may be offset by gains from services trade, investment, and economic reform that are not captured in the usual static trade analysis.[8] If the dynamic effects of trade and the long-term effects of trade-induced investment are added to the analysis, the short-term loss associated with preferential trade in goods may be offset by gains in economic growth and trade in services.

The United States is party to only eight of the current 215 preferential trade areas. As a consequence, even though the U.S. may be the world's most efficient producer of a particular good, American firms may be unable to compete with foreign producers that can export their products duty-free to countries with which their governments have signed an FTA but with which the U.S. has yet to conclude an agreement. As a result, additional U.S. FTAs provide opportunities for American exporters that have been hurt by free trade agreements that do not include the United States.

FTAs with Small Economies. Finally, free trade agreements can assist developing countries to lock in and implement economic and political reforms effectively, to spur regional integration, and to enhance prospects for investment and economic growth. While some U.S. trade partners may be small now, over time they will mature into larger, more sophisticated markets more closely integrated with the U.S. economy. As these economies develop, they will demand more and more U.S. products. As the data demonstrate, America has experienced growth in exports to all of the countries with which it has formalized free trade agreements.

The Bush Administration's trade policy agenda has captured the reasons favoring preferential trade agreements. The President's goal of negotiating free trade agreements in multilateral, regional, and bilateral settings is an integral part of the Administration's "competitive liberalization strat-

4. General Agreement on Tariffs and Trade 1947, Part III, Article XXIV, Section 4.
5. *Ibid*, Part III, Article XXIV, Section 5.
6. *Ibid*, Part III, Article XXIV, Section 8.
7. World Trade Organization, "Regional Trade Agreements: Facts and Figures," at *www.wto.org/english/tratop_e/region_e/regfac_e.htm* (October 13, 2005).
8. Robert Z. Lawrence, "Regionalism, Multilateralism, and Deeper Integration: Changing Paradigms for Developing Countries," in Miguel Mendoza, Patrick Low, and Barbara Kotschwar, eds., *Trade Rules in the Making* (Washington, D.C.: Brookings Institution Press, 1999), pp. 41–45.

egy" to enhance prosperity and freedom for the rest of the world.

Thus, a country's economic might is not the sole reason for attracting America's interest in forming a closer trade relationship through an FTA. A 2004 General Accounting Office study reported that the process of assessing potential FTA partners is based on six criteria:

- A country's readiness in terms of trade capabilities, the maturity of its political and legal systems, and the will to implement economic reforms;
- The economic benefit to the U.S.;
- The country's support of U.S. goals in liberalizing trade;
- The country's support of U.S. foreign and economic policy interests;
- Congressional or private-sector support; and
- Constraints on U.S. government resources.[9]

The U.S.–Bahrain FTA is next in the queue for congressional evaluation. As with other recent agreements, the U.S.–Bahrain FTA contains provisions to safeguard labor and property rights, protect the environment, and guarantee U.S. sovereignty concerns. The agreement will eliminate tariffs on all U.S. merchandise exports and on 98 percent of all U.S. agricultural exports to Bahrain. An important feature of the agreement is that firms in the U.S. services sector will have a higher degree of access to such industries as telecommunications, delivery services, health care, engineering, and computers in Bahrain than in any other U.S. FTA to date.[10]

Bahrain was a founding member of the WTO in 1995 and signed a bilateral investment treaty with the United States in 2001 and a trade and investment framework agreement in 2002. The FTA with Bahrain is an important step toward the President's goal of creating a larger Middle East FTA by 2013. The Administration should submit implementing legislation for congressional approval soon. By forging stronger economic ties with U.S. allies in the Middle East, America strengthens its strategic position vis-à-vis countries in this important but turbulent region while promoting economic prosperity and opportunity.

Multilateral Negotiations

In November 2001, the WTO embarked on a new round of trade negotiations in Doha, Qatar, the so-called Doha Development Agenda (DDA). The agenda for this round of trade negotiations included some of the most politically sensitive and difficult trade issues. Among the most important issues were reform in agriculture, further reductions in non-agriculture tariffs, expansion of market access in trade in services, WTO institutional rules and procedures, and developing country issues, including the need to reconcile the protection of intellectual property rights while ensuring access to necessary medicines.

After WTO member countries failed to reach agreement on these key issues, especially agriculture trade liberalization, at the Fifth Ministerial meeting in Cancun, Mexico, in September 2003, a Sixth Ministerial Conference was scheduled for December 2005 in Hong Kong. Because negotiators failed to reach agreements in past meetings, significant uncertainty surrounds the potential for concluding the DDA at the upcoming meeting in Hong Kong, and the very viability of the WTO as a global forum for negotiating trade liberalization is in question.

Failure to conclude the DDA successfully means significant lost opportunities for economic gains for countries around the world. Numerous studies have attempted to measure these gains under various trade liberalization scenarios. While the results and methodologies differ, the studies consistently show that real economic gains are associated with further trade liberalization.

9. U.S. General Accounting Office, *International Trade: Intensifying Free Trade Negotiating Agenda Calls for Better Allocation of Staff and Resources*, GAO–04–233, January 2004, at *www.gao.gov/new.items/d04233.pdf* (October 25, 2005). The General Accounting Office was renamed the Government Accountability Office on July 7, 2004.

10. Office of the U.S. Trade Representative, *U.S.–Bahrain FTA Briefing Book*, at *www.ustr.gov/Trade_Agreements/Bilateral/Bahrain_FTA/Briefing_Book/Section_Index.html* (October 13, 2005).

- Gary Clyde Hufbauer, at the Institute for International Economics, has calculated that moving from today's trade environment to one characterized by perfectly free trade and investment would generate an additional $500 billion in annual U.S. income, or about $5,000 per household each year.[11]
- Drusilla Brown, Alan Deardorff, and Robert Stern conclude that reducing agriculture, manufacturing, and services trade barriers by just one-third would add $164 billion (about $1,477 per American household) annually to U.S. economic activity. Completely eliminating trade barriers would boost U.S. annual income by $497 billion.[12]

Overall, freeing trade stimulates economic growth, creates better jobs, encourages innovation, and improves living standards for millions of Americans.

The *Index of Economic Freedom*,[13] published annually by The Heritage Foundation and *The Wall Street Journal*, reinforces these calculations of the gains from free international trade by clearly showing that countries implementing freer trade policies experience higher per capita GDP growth than is experienced by countries that maintain trade barriers.

The stumbling block for the WTO Doha Round is the agricultural trade issue. While tariffs, quotas, subsidies, and other trade distortions in manufactured goods have been reduced or eliminated since the end of World War II, protectionist agricultural policies were allowed to remain until the Uruguay Round (1986–1994).

The process of eliminating agricultural trade barriers was initially defined in the Agreement on Agriculture, which called for trade liberalization on three fronts: market access, domestic support, and export subsidies. Market access refers to the regulation of imports through various policies such as tariffs and quotas. Domestic support is aimed at protecting domestic agriculture producers through production subsidies and price support programs. Export subsidies refer to the various policies that directly promote agricultural exports.

While the Uruguay Round did reduce agricultural tariffs, market access for agricultural products remains much more restricted than market access for manufactured goods. Globally, the trade-weighted average agricultural tariff in 2001 was more than three times the average for merchandise trade. In the United States, agricultural products face a level of protection that is 1.3 times the rate for manufactured items.[14] On the basis of trade-weighted averages, the U.S., with an average ad valorem rate of 9.5 percent, has low restrictions on foreign agriculture. However, when extreme tariffs and tariff rate quotas (such as those on sugar and milk) are included, U.S. tariff rates can go as high as 350 percent. Both tariffs and tariff rate quotas are targeted for reduction under the ongoing Doha Development Round.

Subsidies supporting agriculture producers are significant and widespread around the world. WTO members report average subsidies totaling more than $221 billion per year,[15] a little more than 18 percent of global agricultural output.[16] Based on World Bank and WTO data, the European

11. Gary Clyde Hufbauer and Paul L. E. Grieco, "The Payoff from Globalization," *The Washington Post*, June 7, 2005, p. A23.
12. Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Multilateral, Regional, and Bilateral Trade-Policy Options for the United States and Japan," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 490, December 2002, and Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "Computational Analysis of Multilateral Trade Liberalization in the Uruguay Round and Doha Development Round," University of Michigan, Research Seminar in International Economics, *Discussion Paper* No. 489, December 2002.
13. For the most recent edition of the *Index*, see Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2005 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2005), at *www.heritage.org/index.*
14. Congressional Budget Office, "Policies That Distort World Agricultural Trade: Prevalence and Magnitude," August 2005, at *www.cbo.gov/ftpdocs/66xx/doc6614/08-22-Doha.pdf* (October 25, 2005).
15. *Ibid*, p. 22, Table 12.

Union and the United States each accounted for more than a third of total subsidies in 2001. A 2004 Cato Institute study indicates that farmers in Organisation for Economic Co-operation and Development (OECD) countries received $279 billion in some form of production support, or 30 percent of total farm income. U.S. farmers received $46.5 billion from the American government, or 18 percent of total U.S. farm income.[17] Only a limited number of these support programs are on the negotiation table in the current round.

Export subsidies are the most distorting type of trade barrier, but they are also the least widespread of protectionist policies implemented by countries around the world. Nonetheless, because of market disruptions induced by such policies, countries—with the temporary exception of some developing nations—are required under the Agreement on Agriculture to commit to fully reducing and eliminating export subsidies. The European Union dominates the world in the use of export subsidies, providing almost 90 percent of all export subsidies among WTO countries with reduction commitments.[18] The U.S. ranks a distant fourth place with less than 2 percent of all export subsidies. Export subsidies are to be reduced under the ongoing Doha Development Round.

Global barriers to trade in agricultural products artificially prop up domestic prices for food and food products, raising the cost of living for families in distorted markets. According to a 2004 OECD study, U.S. farm programs resulted in higher food prices, effectively transferring more than $16 billion from American households to domestic farmers in addition to what they received in direct government assistance.[19] The Office of Management and Budget forecasts that American taxpayers will pay for $26 billion in direct agricultural subsidies in 2005.[20]

Not only are agricultural trade barriers a burden on American households, but they also depress world agricultural prices, negatively affecting farmers in developing countries by impeding their attempts to improve their living standards. The U.S. argues for free trade and economic liberalization, yet it refuses to eliminate the very policies that would truly allow developing countries to pursue and achieve economic prosperity. William Cline, at the Institute for International Economics, has estimated that by removing trade barriers, developed countries could convey economic benefits to developing countries that are worth about double the amount of their annual aid transfers.[21]

Conclusion

Historically, the U.S. has led the fight to reduce trade barriers in the WTO. This effort needs to continue if the world is to keep reaping the profits of free trade. Study after study reveals that the price of protectionism is steep for both the U.S. and the rest of the world.

American leadership depends not only on U.S. trade negotiators doing a good job, but also on congressional support for free trade. Recent statements from Members of Congress that "domestic priorities, not the world's trade negotiators" will write the next U.S. farm bill completely miss the point. Domestic

16. Based on calculations using data from World Bank, World Development Indicators Database, at *devdata.worldbank.org/data-query* (October 3, 2005).

17. Daniel Griswold, Stephen Slivinski, and Christopher Preble, "Ripe for Reform: Six Good Reasons to Reduce U.S. Farm Subsidies and Trade Barriers," Cato Institute, Center for Trade Policy Studies *Trade Policy Analysis* No. 30, September 14, 2005, at *www.freetrade.org/pubs/pas/tpa-030es.html* (October 25, 2005).

18. Congressional Budget Office, "Policies That Distort World Agricultural Trade."

19. Organisation for Economic Co-operation and Development, *Agricultural Policies in OECD Countries: Monitoring and Evaluation 2005*, June 2005.

20. Office of Management and Budget, *Budget of the United States Government: Fiscal Year 2006* (Washington, D.C.: U.S. Government Printing Office, 2005), p. 58, at *www.whitehouse.gov/omb/budget/fy2006/budget.html* (October 25, 2005).

21. William R. Cline, "Effective Economic Growth for People: The Role of the United States," Center for Global Development, December 2004, at *www.cgdev.org/doc/commentary/cline_12_04.pdf* (October 25, 2005).

priorities—such as fostering U.S. economic growth and jobs, opening foreign markets for American farmers and manufacturers, and increasing living standards—fully mesh with negotiators' efforts to promote trade liberalization.

The American economy depends on international trade. The successful conclusion of the current WTO round of negotiations and implementation of beneficial free trade agreements will allow America a chance at a brighter future.

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