

# INTERNATIONAL ECONOMIC POLICY

## 52. Trade

### *Congress should*

- avoid using trade deficits to justify trade restrictions;
- maintain the World Trade Organization as a body for settling international disputes;
- adjust export control laws to the reality of today's international marketplace;
- support fast-track authority for trade pacts and oppose "negotiating objectives" that mandate that other countries adopt U.S.-style environmental and labor standards;
- protect the intellectual property rights of American citizens and corporations; and
- take unilateral free-trade actions, such as repealing the anti-dumping laws and domestic content requirements, to improve our standard of living.

The less government restricts Americans' access to the goods, services, labor, and capital of their choosing, the better for the nation as a whole. That is the history of the past 200 years.

Despite overwhelming support for free trade among economists, American political leaders sometimes overlook the benefits of international trade. That is because those benefits accrue almost imperceptibly to the many, while the short-term costs are highly visible to the few. International trade pits lower prices, higher quality goods, and a better standard of living against short-term job dislocation, even though such dislocation is necessary if the economy is to use its resources most effectively. Few gain from a static economy.

No misconception about international trade is greater than the belief that it "costs" America jobs and lowers our standard of living. As international trade flows have increased, the number of U.S. jobs has nearly

doubled since 1960. Trade changes the mix of jobs and shifts people to different sectors, but overall it raises the economic well-being of individuals and families. The nation's businesses are able to specialize in the products and services they produce most efficiently.

Economics teaches that the best trade policy is one that allows U.S. companies and workers to make what we are best equipped to make at this stage in our development and to trade to obtain goods and services we *could* produce but are better off obtaining from other countries. To argue, as some do, that it is "unfair" that Mexicans work for lower wages and produce less expensive goods is no more valid than for Mexicans to complain that America possesses more highly educated workers who design and manufacture products in today's cutting-edge industries. Comparative advantage tells us that if Mexicans can produce some goods more cheaply than we can, we should buy those goods and make what our skills enable us to produce best.

## ***Trade Deficits***

Adam Smith wrote in 1776, "Nothing . . . can be more absurd than this whole doctrine of the balance of trade." Despite Smith's insight, the myth continues that "trade deficits" are inherently evil and reflect job losses. Trade deficits are only a problem if one believes that imports are bad and exports are good, even though in reality both exports *and* imports are good. The reason we engage in trade in the first place is to obtain imports, which raise our standard of living by furnishing a greater variety of goods and by providing needed competition to domestic producers. Goldman Sachs economist Ronald Krieger (see Table 52.1) succinctly presents the different views of economists, who view consumption as the end of economic activity, and noneconomists, particularly some politicians, who view production as the main goal. It is generally politicians, not economists, who support what is called a "mercantilist" trade policy that favors producers over consumers.

The irony is that even if achieving a trade balance were a worthwhile economic goal, making U.S. policy more protectionist would not accomplish it. The 1996 Economic Report of the President, which is produced by the Council of Economic Advisers, specifically states, "Trade policy . . . cannot significantly affect the overall trade balance. That is determined by domestic saving and investment and by government fiscal policy." Ten years earlier, the 1986 Economic Report of a Republican president

**Table 52.1**  
**Two Views of the World**

Concept	Economist	Noneconomist
The purpose of economic activity is	consumer welfare	jobs and growth
The basic element of economic activity is	exchange	production
Work is a	cost	benefit
Imports are a	benefit	cost
Exports are a	cost	benefit
Cheap foreign goods are a	benefit	cost
The objective of trade is to	get goods cheaply	create jobs
Trade barriers hurt	domestic residents and foreigners	foreigners only

SOURCE: Ronald A. Krieger, "Economics and Protectionist Premises," *Cato Journal* 3, no. 3 (Winter 1983-84): 668.

said essentially the same thing, noting that the "current account balance is determined primarily by macroeconomic relationships."

The 1996 Economic Report makes an even more important point—namely, that maintaining a trade deficit with a particular nation is inconsequential. "Even if our overall trade were balanced, there is simply no reason to expect (or desire) . . . that our sales to Japan or Zambia will cancel out our purchases from those countries, in any given year or even over an extended period." That is worth keeping in mind when the monthly trade balance between the United States and such countries as Japan and China is reported.

### ***The World Trade Organization***

In the past five decades, the United States and other countries have negotiated successive rounds of the General Agreement on Tariffs and Trade. Those rounds have aided consumers by pushing down average tariffs worldwide from 40 percent to approximately 3 percent. But when Congress ratified the treaty from the Uruguay Round of GATT in 1994, critics raised concerns about the new World Trade Organization that it created.

The most prevalent misunderstanding is that the WTO threatens American sovereignty or that it may lead to world government. Though the organization would benefit from a less ominous-sounding name, its actual functions do not threaten American independence.

The WTO is not like the European Union, which does impinge on its members' sovereignty. In contrast to the EU, the main task of the WTO is to settle disputes between trading partners. When the United States or another nation alleges an unfair trading practice, the case is heard at the WTO by a three-judge panel, which is drawn from international trade experts from different nations. In addition, a type of court of appeals is made up of seven judges—three of whom are empaneled to hear an appeal—drawn from seven nations that currently include the United States and other friendly nations such as the Philippines, Egypt, and Germany.

The WTO dispute resolution mechanisms work as a type of binding arbitration, but the WTO does not possess a coercive power to enforce its rulings. If the United States decides not to abide by a WTO ruling, the other party to the dispute has the right to apply a trade sanction against U.S. products. And, of course, the United States might decide to retaliate for that sanction. All of that could happen, however, even if the WTO did not exist. The dispute resolution panels at least increase the likelihood that trade disagreements will be settled amicably.

In practice, domestic and international peace both benefit from mechanisms that resolve disputes on the basis of common rules rather than threats of aggression. If my neighbor and I disagree about who harmed whose property, is it better to escalate our argument into recriminations and violence or to submit our dispute to a civil court? In reality, the WTO does not threaten American sovereignty any more than the existence of arbitration or civil courts threatens individual liberty. The point is to take power away from politicians. Putting an end to midnight brinkmanship with Japan over trade disputes will benefit U.S. consumers by depoliticizing trade and moving it away from bilateral political fights and into multilateral forums based on the rule of law.

The second task of the WTO is simply to establish regular meetings to propose trade rule reforms, rather than waiting years to complete a round of GATT negotiations. Though each country has one vote on any reform, *no proposal from the WTO will become U.S. law if the U.S. Congress does not support it.* Cuba and Belize will not push around the United States, as some WTO critics allege, since our economy's might ensures us a virtual veto power over reforms that would damage important

American interests. In the face of a strong disagreement or WTO bias, the United States will always retain the right to leave the organization.

### ***Export Control Laws***

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, the Clinton administration's recent reforms of export control policy do not go far enough in permitting the export of strong cryptography and force unpopular "key recovery" procedures on users of the products. While the current policy on encryption is in flux, the U.S. government has restricted the export of strong encryption software despite the fact that competitors of American companies sell similar or even stronger encryption software abroad. That's just one example of the need to reform America's export control laws.

### ***Fast-Track Authority***

Congress should extend the president's "fast-track" authority, which will facilitate negotiations to include Chile in the North American Free Trade Agreement. In the Trade Act of 1974, Congress granted the president authority, with the support of implementing legislation, to negotiate and submit a trade pact to Congress, which then votes on it up or down without amendment. That procedure has helped prevent micromanaging from Capitol Hill and alleviated foreign concerns that an agreement made with a U.S. president could be reopened, picked apart, and returned in a different form.

Congress should not burden fast-track authority with such negotiating objectives as raising the labor and environmental standards of our trading partners. Forcing other countries to adopt U.S.-style labor and environmental laws is viewed internationally as an American attempt to rob other countries' workers of their comparative advantage.

### ***Intellectual Property Rights***

Unlike imposing new domestic laws on other nations, protecting the property rights of U.S. citizens is a legitimate function of government.

That is why defending the intellectual property rights of American producers whose materials are pirated abroad should be an important element of U.S. trade policy.

The U.S. government cannot abolish all piracy in this country, nor can a foreign government be responsible for every copyright or patent infringement in its territory. Nevertheless, where we see overwhelming evidence of government complicity or inaction in the face of substantial acts of piracy, it may be proper, as a last resort, for the U.S. government to apply targeted sanctions. In the long run, it is preferable to work with China and other nations on developing the proper institutions and policies to protect the intellectual property of U.S. nationals. China's eventual entry into the WTO would at a minimum allow such disputes to be settled in a less contentious forum.

### ***Unilateral Free Trade***

Removing all tariffs and nontariff import restrictions would improve consumer welfare far more than would any new initiative that emerges from a federal agency. In other words, U.S. policymakers need not wait for more trade agreements to sign. The net welfare gains to U.S. consumers if the United States simply eliminated all tariffs and quantitative restrictions on imports would be \$15.62 billion a year, according to a U.S. International Trade Commission estimate for 1993. An additional \$1.59 billion in net benefits would accrue from eliminating America's anti-dumping and countervailing duties. Permitting foreign airlines to operate without trade restraints in the U.S. domestic transportation market would yield additional standard-of-living improvements.

The phaseout of U.S. textile and apparel import quota rules—and the accompanying lower tariff rates under GATT—is a welcome step, though that measure will not be complete for a number of years. Other issues, though, need to be addressed. Today, many import restrictions are not tariffs per se but tariffs tied to numerical restrictions. For example, under the Uruguay Round Agreements of GATT, after a six-year period, no duties will be assessed on the country's first 20,000 metric tons of imported peanut butter and peanut paste. Yet imports over 20,000 metric tons will be dutiable at 131.8 percent ad valorem. Such restrictions increase prices below the quota as well as above by reducing the available quantity to be imported. The Uruguay Round Agreements also failed to eliminate America's restrictive import quotas on sugar. For dairy imports that come in "over" the established quotas, tariffs will merely replace blanket **prohi-**

bitions. Higher tariffs also will be paid on cotton and meat imports that exceed a predetermined quota.

No economic rationale justifies numerical restrictions on imports. Only political influence can explain them. The same is true for provisions, often slipped into larger bills, that require certain products bought by the public or the U.S. government to contain a specific percentage of "domestic content." Such measures increase costs to taxpayers and consumers and distort the marketplace by mandating adherence to noneconomic factors of production. Another policy that serves no economic rationale is the Jones Act, under which U.S. domestic maritime shippers are protected from foreign competition at a cost of over \$3 billion a year to the U.S. economy, according to the U.S. International Trade Commission. The Jones Act needlessly raises costs for agriculture, petroleum, and other industries that ship goods within the United States.

Anti-dumping and countervailing duty laws are another way government trade policy hurts consumers—and consumers include companies that import for manufacturing purposes. Anti-dumping laws are badly misused against foreign-made products, in part because the formulas employed are often biased in favor of the U.S. company filing the grievance. One major reform would be to make any case for anti-dumping duties pass a simple test: will assessing the duties benefit American consumers? The answer is likely to be no. Moreover, foreign companies should not be treated differently from domestic companies when evaluating claims of predatory pricing.

Anti-dumping orders can often be broad in scope and therefore frequently even include products that are not currently manufactured in the United States. For example, some anti-dumping orders have hurt high-tech companies seeking to import certain types of semiconductors. A bill introduced by Rep. Phil Crane (R-Ill.) would have temporarily suspended anti-dumping duties in situations in which the U.S. domestic user cannot obtain the product from a U.S. source.

## **Conclusion**

International trade is not a war or even a contest between nations, which is why the "level playing field" argument for maintaining U.S. trade restrictions is inappropriate. Trade is a series of mutually beneficial exchanges between companies and individuals. Every distortion of those voluntary exchanges will probably lower the standard of living of Americans. While U.S. companies compete with their foreign competitors in



the same industry, there is no case for government action to ensure that a particular company prevails or increases its sales.

Do other governments engage in protectionism? Yes, and such actions hurt their own citizens the most. We should address legitimate complaints of U.S. producers about lack of access to a foreign market through the dispute resolution panels established by the WTO. We must continue to move international trade away from highly politicized, bilateral confrontations and into a more **depoliticized**, multilateral arena where disputes can be settled judiciously. That course holds the most promise for expanding freedom and opportunity throughout the world.

### **Suggested Readings**

- Bhagwati, Jagdish, and Robert E. Hudec, eds. *Fair Trade and Harmonization: Prerequisites for Free Trade*. Cambridge, Mass: MIT Press, 1996.
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- Smith, Adam. *The Wealth of Nations*. 1776. Reprint, New York: Modern Library, 1937.
- U.S. International Trade Commission. *The Economic Effects of Significant U.S. Import Restraints: First Biannual Update*. Publication 2935. Washington: U.S. International Trade Commission, December 1995.

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