

# **CATO HANDBOOK FOR CONGRESS**

**POLICY RECOMMENDATIONS FOR THE 108TH CONGRESS**

**CATO**  
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Washington, D.C.

## **61. 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;
- refrain from exerting protectionist pressure on U.S. negotiators in trade negotiations, especially with respect to (1) labor and environmental standards and (2) antidumping and other trade remedy laws;
- enact implementing legislation for market-opening trade agreements;
- maintain support for the World Trade Organization as a body for settling disputes;
- avoid using trade deficits as an excuse for trade restrictions; 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 “globalphobia” could be so widespread 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 reduction or outright 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.

#### **Top 10 Most Costly U.S. Trade Barriers**

Quota, tariff, and licensing barriers to imported

- Textiles and apparel
- Domestic maritime transport (Jones Act)
- Sugar
- Dairy products
- Footwear
- Frozen fruits, fruit juices, and vegetables
- Ball and roller bearings
- Watches, clocks, watch cases and parts
- Table and kitchenware
- Costume jewelry

SOURCE: U.S. International Trade Commission.

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. The U.S. sugar protection program, for example, forces domestic consumers to pay double the world price for

sugar and costs American sugar-using industries and consumers an estimated \$1.9 billion a year. Meanwhile, removal of quotas and tariffs on imported textiles and apparel would result in a welfare gain to the U.S. economy of \$13 billion, according to the U.S. International Trade Commission.

Free traders need 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, 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. For example, other countries signed

on to the 1997 multilateral agreements on telecommunications and financial services even though the only 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.

### ***Oversight during Trade Negotiations***

If Congress were to adopt a policy of unilateral trade liberalization, the need for the highly contentious “trade promotion authority” (TPA) legislation would disappear. Trade barriers would be eliminated by domestic legislation; afterwards, if the United States were to enter into international agreements, no changes in U.S. laws would be necessary.

Until the United States embraces unilateral liberalization, however, traditional trade negotiations represent the best available vehicle for reforming protectionist policies here and abroad. In such negotiations, the White House, not Congress, controls the agenda. Under the TPA legislation signed into law in August 2002, Congress retains the power to vote up or down on trade agreements presented to it, but the negotiations themselves are the responsibility of the executive branch.

Nevertheless, Congress still can exert considerable influence on the course of trade negotiations. Formally and informally, it consults with the administration while negotiations are pending and can pressure the administration to take this or that negotiating position. That pressure can have either a positive or a negative impact on the prospects for open trade.

Unfortunately, congressional input far too often undermines trade negotiations by pushing the United States to adopt anti-trade negotiating positions. Congressional pressure has been particularly misdirected in two areas: (1) labor and environmental standards and (2) U.S. trade remedy laws.

Many members of Congress have strongly urged the inclusion of agreements on international labor and environmental standards in any new trade agreements. The whole purpose of trade negotiations, however, is to reduce governmental interference in cross-border flows of goods and services; international regulatory mandates on labor and environmental matters

would threaten to increase government interference in those flows and thus subvert the basic mission of negotiations. Meanwhile, labor and environmental standards are implacably opposed by developing countries, and a U.S. negotiating position that insisted upon such standards could end up dooming negotiations to fail.

The U.S. trade remedy laws—the antidumping, countervailing duty, and Section 201 “safeguard” laws—and their counterparts in other countries are badly in need of reform. In particular, the antidumping law, which purports to focus on “unfair trade,” frequently penalizes healthy foreign competition for business practices routinely engaged in by American companies. While the U.S. antidumping law victimizes American import-using industries and consumers, foreign copycat laws now target U.S. exporters with depressing frequency. Indeed, the United States was the third leading victim of worldwide antidumping actions during the second half of the 1990s.

The prospects for reform here and abroad, however, are dimmed by vehement congressional opposition to any trade negotiations that might “weaken” U.S. trade laws. That opposition threatens, not just to block improvements in trade laws, but to prevent market-opening agreements more generally. Many of our trade partners are demanding changes to antidumping rules as a condition of any new agreements. If congressional pressure forces the administration into adopting an obstructionist position on antidumping, the United States could ultimately pay a grievously heavy price in lost opportunities to open markets around the world.

### ***Implement Market-Opening Agreements***

The 108th Congress should have the opportunity to reduce trade barriers here and abroad by passing the legislation needed to implement bilateral free-trade agreements. In particular, agreements with Chile and Singapore are nearing completion. Those countries are minor trading partners of the United States, and thus free-trade agreements with them would mark only modest steps toward more open trade. But they are steps in the right direction, and Congress should take them as soon as it has the opportunity. Meanwhile, Congress should encourage the negotiation of free-trade agreements with other, more important trade partners—including, for example, Australia, New Zealand, and South Korea. In addition, Congress should support the Bush administration’s efforts to negotiate a Free Trade Area of the Americas.

## **Trade Deficits**

America's trade deficit is not an economic problem. It is the benign consequence of a persistent surplus of foreign capital flowing into the United States. That additional capital has helped to make U.S. workers more productive, raising living standards above what they would be without it and building the foundation for future growth.

The underlying cause of the U.S. trade deficit is the fact that domestic savings in the United States are insufficient to fund all the available domestic investment opportunities. Any savings gap is filled by a net inflow of foreign investment. Those foreign funds allow Americans to buy more than we sell in the international market for goods and services, resulting in a trade deficit. As long as the pool of domestic savings available for investment is smaller than the actual level of investment, the United States will run a trade deficit.

The trade deficit is not the cause of alleged and real problems in the U.S. economy; rather, it is but a reflection of America's relative attractiveness as a home for global investment. As a result, the trade deficit tends to expand and contract along with the overall economy. By virtually every measure, U.S. economic performance is superior during years in which the trade deficit rises compared to years in which it shrinks. In contrast to conventional wisdom, rising trade deficits are associated with faster growth, falling unemployment, and accelerating manufacturing output. That explains why the U.S. trade deficit rose during the decade-long economic expansion of the 1990s but then actually shrank somewhat during the recession year of 2001.

Specifically, there is no credible evidence that expanded trade and bilateral deficits with such trading partners as Mexico and China cause a net loss of jobs. In fact, manufacturing output and the volume of imported goods tend to rise and fall together because both are stimulated by overall economic growth. During the late 1990s manufacturing output and import volume rose strongly, while in 2001 a slumping economy caused manufacturing output and the volume of imported goods to both plunge. The U.S. economy actually added a net 707,000 manufacturing jobs during the first four years of the North American Free Trade Agreement, from 1994 through 1997. Recent job losses, meanwhile, have been caused by slumping demand, first abroad and more recently at home, not by rising imports or trade agreements.

The only real sense in which the trade deficit is a threat to the U.S. economy is its potential effect on public policy. Persistent worries about



the trade deficit could prompt policymakers to implement a “cure” for the trade deficit, such as higher tariff barriers, that itself could impose serious damage on the economy. Members of the 108th Congress should reject the idea of “balanced trade” as a policy goal. The best policy response would be to ignore the U.S. trade deficit and concentrate on maintaining a strong and open domestic economy that welcomes trade and foreign investment.

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

The World Trade Organization is at present 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.

Congress should support the new Doha Round of WTO negotiations. If successfully concluded, those talks could open vast new markets for American exports, raise global welfare by hundreds of billions of dollars, and help protect American consumers from trade-distorting barriers here at home.

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.

Congress should show its support for the WTO process by passing legislation to implement all outstanding adverse WTO rulings as soon as possible. In particular, Congress should reform U.S. tax laws to eliminate

the WTO-inconsistent preference for exports under what was formerly known as the “foreign sales corporation” provision. Meanwhile, there are a large and growing number of outstanding rulings against various aspects of the U.S. trade laws. To the extent that legislation is needed to implement those rulings, Congress should move immediately to make the necessary changes to U.S. law.

In addition, Congress should urge the administration to negotiate improvements in the WTO dispute settlement process—specifically, by deemphasizing trade sanctions, or “retaliation,” as a tool for enforcing WTO rulings. Sanctions are a perverse and ineffective method of encouraging other nations to open their markets. By withdrawing “concessions,” sanctions reinforce the faulty notion that our market-opening commitments are a favor we do other countries contingent on good behavior. In reality, sanctions punish our own consumers and producers by making the target list of import goods more expensive or even inaccessible. Meanwhile, sanctions make the global economy less free and tend to arouse resentment in our trading partners.

Instead, alternatives to sanctions should be explored. WTO members found to be out of conformity with agreed-upon rules could instead offer market-opening “compensation” by lowering barriers on other goods, or they could face suspension of the privilege of using the dispute settlement mechanism. Such alternative enforcement mechanisms would encourage compliance with WTO rulings without the perverse side effects of sanctions.

## ***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.

Sales and investments abroad by U.S. companies are also hindered by ill-considered foreign policy trade sanctions against Cuba, Burma, and other countries. The Cuban embargo is discussed in Chapter 60. It should be noted here, though, that trade sanctions rarely accomplish their foreign policy objectives. Instead, they end up hurting the very people they are

designed to help—the unfortunate subjects of despotic regimes. Absent compelling national security considerations, trade sanctions are almost always a bad idea. Trade and investment, on the other hand, can improve the lot of despotism’s victims while sowing the seeds of political change.

***Suggested Readings***

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Groombridge, Mark. “America’s Bittersweet Sugar Policy.” Cato Institute Trade Policy Briefing Paper no. 13, December 4, 2001.

Irwin, Douglas. A. *Free Trade under Fire*. Princeton, N.J.: Princeton University Press, 2002.

Lash, William H. III, and Daniel T. Griswold. “WTO Report Card II: An Exercise or Surrender of U.S. Sovereignty?” Cato Institute Trade Policy Briefing Paper no. 9, May 4, 2000.

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U.S. International Trade Commission. “The Economic Effects of Significant U.S. Import Restraints.” June 2002.

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