Free Trade from the Bottom Up

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In determining the proper course of future WTO negotiations, it is useful to ask a very basic question at the outset. Namely, why have international trade negotiations in the first place?

The question posed here is addressed to free traders, not protectionists. Of course protectionists oppose trade talks; they do so because they oppose open markets. But just because protectionists are against trade negotiations does not mean that free traders should automatically embrace them.

That suggestion might seem baffling at first, since the cause of free trade and the vehicle of trade negotiations are so inextricably connected in the prevailing conventional wisdom. But if we step back from current preconceptions and examine the underlying economic and political realities, the need to pursue trade liberalization through international negotiations begins to look much less obvious.

In trade negotiations, countries offer to reduce import barriers in exchange for other countries' offers of equivalent reductions. In other words, liberalization at home is made contingent upon liberalization abroad. Indeed, according to the rhetoric of negotiations, removal of domestic protectionist policies is treated as the price to be paid for freer markets elsewhere. Countries "gain" access to other nations' markets in exchange for which they "give up" greater access to their own. Thus, in official GATT parlance, commitments to open one's own market are labeled "concessions" while other countries' commitments to open their markets are labeled "benefits."

The rhetoric of negotiations, however, turns out to be economic nonsense. The overwhelming weight of economic analysis and evidence supports the conclusion that a country benefits from opening

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its own markets *regardless of what policies other countries choose to pursue*.

Free Trade Is Its Own Reward

The case for free trade at home can be embellished with all kinds of technical complexities, but in the end it boils down to common sense. It is now widely recognized that free markets are indispensable to our prosperity: when people are free to buy from, sell to, and invest in each other's markets 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 that circle in which 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 creating wealth.

From this perspective, it becomes clear that Americans gain from open U.S. markets even when other countries are relatively closed.[1] 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 flow over U.S. borders without interference, Americans are able to take full advantage of the opportunities of the international marketplace. We can buy the best and cheapest goods and services the world has to offer; we can sell to the most promising markets; we can choose from the best investment opportunities; and we can tap into the worldwide pool of capital.

In particular, openness to foreign competition boosts American productivity and living standards in two basic ways. First, import penetration causes us to shift resources out of import-competing sectors in which we are relatively less productive and into exporting sectors in which we are relatively more productive. Thus, the workings of comparative advantage raise our nation's overall productivity by allowing us to concentrate on the things we do best.

Second, resistance to import penetration on the part of domestic suppliers causes them to reduce costs, improve quality, and otherwise increase productivity. Thus, even when foreign competitors do not succeed in expanding their market share, the spur of added competition that they provide sharpens the incentives to innovate here at home. For example, Americans today drive much better cars than we did 20 years ago, and not just because many drive imports; American

[1]For a comprehensive argument for unilateral free trade, see Powell (1990).

cars are much better today, in large part because the U.S. auto industry was forced to compete at a higher level to stave off an onslaught of Japanese and European competition.

Thus, contrary to the logic of trade negotiations, countries should open their markets as a simple matter of national economic interest. The benefits that come from openness to foreign competition should not be rejected just because other countries insist on sticking with benighted and dysfunctional policies.

Many free traders are familiar with the theoretical case for unilateral liberalization. Nevertheless, they dismiss any alternative to international negotiations as politically impractical. It is widely assumed that countries will undergo the political pain of liberalization only if they get something in return—namely, improved market access abroad, and with it improved business opportunities for exporting firms. According to this view, which enjoys overwhelming acceptance in contemporary U.S. trade policy circles, trade negotiations may be based on economically questionable premises, but for free traders they are the only game in town. Furthermore, in this conventional conception, trade negotiations are dominated by considerations of reciprocity—that is, countries are motivated to liberalize not by the good it will do them, but by the quid pro quo they can win in return.

But this belief, however firmly entrenched, is demonstrably incorrect as a matter of historical fact. Not only *should* countries liberalize because it serves their national economic interest, but in the big picture that is precisely what they *do*.

Why Countries Liberalize

The past couple of decades have witnessed dramatic reductions in trade barriers around the world, and by and large these bold moves toward freer trade have occurred outside the context of trade negotiations. Countries as diverse as Australia, New Zealand, Argentina, Bolivia, Peru, Chile, the Philippines, Thailand, Indonesia, and India have decided unilaterally to forsake the old autarkic model of import substitution in favor of greater integration with the global economy. The driving force for sweeping change in those countries was not tough bargaining or the prospect of a quid pro quo, but rather the realization that protectionism was causing economic stagnation. In other words, protectionist countries have changed their policies to catch up economically with more open countries. When liberalization is unilateral, it goes without saying that considerations of reciprocity play no role; rather, the impetus for reform comes entirely from changing perceptions of national economic interest.

Even when liberalization occurs in the context of negotiations, it often fails to follow the reciprocity model. Consider the case of Mexico, our partner in the North American Free Trade Agreement: Mexico began dismantling protectionist policies on its own in the mid-1980s, and those initial unilateral reforms were actually far more sweeping than the additional reforms it promised under NAFTA. The NAFTA negotiations were then undertaken at Mexico's initiative, despite the fact that it still had more trade barriers than either the United States or Canada and thus relatively more to "give up" than to "gain" through negotiations. Mexico pushed for NAFTA primarily as a means to lock in prior unilateral reforms; the Salinas administration believed that it would be more difficult for future administrations to undo those reforms if they had been made a matter of international obligation. Here again, then, considerations of the national economic interest in liberalization were paramount.

A similar dynamic explains China's bold offer in 1999 of sweeping market-opening commitments in its World Trade Organization accession agreement with the United States. China has been officially seeking membership in the General Agreement on Tariffs and Trade and then WTO for 13 years, over which time negotiations dragged on and on with little progress. Then, suddenly, over the course of a few weeks, China agreed to almost everything the United States had been asking for. Why the change of heart? It seems clear that China's leadership came to the conclusion that a new round of market reforms was necessary to reverse the country's recently flagging economic performance; like Mexico in the NAFTA talks, China endeavored to use international negotiations to ram through needed domestic policy changes and then to insulate those changes from later reversal.

Of course, liberalization does occur as well through conventional reciprocity-driven swapping of "concessions." The point here, though, is this conventional model is not the only, or even the most important, path to liberalization. The real energy propelling liberalization around the world over the past couple of decades has been at the national level. When countries perceive that it is in their economic interest to open their markets, they do so—without especially worrying about what reciprocal offers of market-opening they will get in return. On the other hand, when countries do not believe that liberalization is needed, negotiations are doomed to achieve only marginal gains.

The conventional understanding of trade liberalization can be thought of as a "top-down" vision of international order. In this vision, the relatively open world trading system is imposed from above by international institutions and agreements. This interpretation, however, distorts why countries should liberalize their trade and why they usually do. However at odds with received wisdom, a "bottom-up" vision of international order is actually much more consistent with both economics and political reality. According to the bottom-up view, the bedrock of the relatively liberal international trading system consists of national-level decisions that openness at home is in the national interest. Freedom of international exchange thus flows up from below as a necessary consequence of predominantly unilateral decisions at the national level.[2]

How Trade Talks Can Help

What then is the role for international negotiations and institutions in the bottom-up vision of trade liberalization? When appropriately structured and limited, trade agreements can play an important role in facilitating liberalization and especially in consolidating prior gains.

In the first place, linking liberalization at home with liberalization abroad can greatly strengthen the political prospects of dismantling domestic trade barriers. For one thing, the economic benefits of mutual liberalization are greater than those of unilateral liberalization. Although liberalization pays even if other countries remain protectionist, the payoff is richer still if other countries follow suit. Thus champions of international liberalization have a more appealing product to sell. Furthermore, although reforming protectionist policies brings economic benefits, it usually faces concerted political opposition from affected import-competing interests. If that lobbying pressure can be counteracted by the pro-trade lobbying, not just of import-using interests but also of exporting interests eager for improved access to foreign markets, then the chances of overcoming the opposition are enhanced considerably.

Probably the greatest assistance that international negotiations lend to trade liberalization, though, is in consolidating and institutionalizing prior gains. Once countries have decided to open their markets in the furtherance of their own national self-interest, those decisions can be harder to undo by subsequent protectionist-minded governments if liberalization has been enshrined as an international obligation. Thus, trade agreements can serve to "lock in" reforms by imposing additional political constraints on their reversal. Mexico's pursuit of NAFTA, discussed earlier, was motivated primarily by precisely such considerations. Similarly, the recent defeat of legislation to impose quotas on U.S. steel imports was achieved largely on the ground that

[2]The distinction between liberalization "from above" and liberalization "from below" is made in Sally (1998).

such legislation amounted to a blatant violation of U.S. obligations under the WTO agreements.

Avoiding the Pitfalls of Reciprocity

Although trade negotiations can assist the process of liberalization, there are potential drawbacks as well. First, trade negotiations can actually undermine political support for open markets by fostering protectionist misconceptions and thus breeding a hostile political culture. As discussed previously, the conventional "reciprocity" model of trade talks is premised on the protectionist notion that imports are harmful and trade barriers are prized strategic assets. By following this model, trade negotiators and their supporters end up validating the very ideas that give rise to protectionist pressure in the first place.

Because of the reciprocity model, protectionist assumptions and attitudes color every aspect of how trade agreements are currently negotiated and evaluated. Trade negotiators, in the process of championing freer trade, insist that a "bad deal" (i.e., one in which we liberalize more than other countries do) is worse than no deal at all. They oppose domestic reforms outside the context of negotiations on the ground that our own bad policies are "bargaining chips" that should be retained for their exchange value. More ominously, they refer to liberalization without reciprocity as "unilateral disarmament." And when an agreement has been reached, supporters focus on the benefits to exporters, not importers. They tout the benefits of reducing foreign trade barriers, but say little or nothing about the benefits of reducing our own.

By adopting the reciprocity model, free traders forfeit the opportunity to educate the public on the true benefits of open markets. That default was not especially important in the past when trade policy was hammered out in back rooms by experts and insiders. Now, however, trade issues engage the attention and passions of the broader public. And what the public sees in the often heated debates over trade policy is not a contest between true free traders and protectionists, but rather a disagreement between optimistic mercantilists and pessimistic mercantilists. The optimists, the supporters of trade liberalization, highlight the new export opportunities created by opening markets abroad; the pessimists dwell on the supposed threat of increased imports caused by opening markets here. Neither side, though, challenges the fallacious "exports good, imports bad" worldview.

Meanwhile, although free traders push optimism when they are trying to sell trade agreements, they unwittingly corroborate the pessimists' fears when they are actually negotiating those deals. Thus, our trade negotiators never tire of claiming that the U.S. market is the most open in the world. Of course, within the logic of trade negotiations, this is a sensible bargaining position, since it supports the conclusion that the United States should not have to "give in" on this or that issue. The American public, though, hears these claims and many conclude that the United States has been short-changed by past negotiations. Skepticism about future negotiations is therefore understandable. Similarly, U.S. trade negotiators complain incessantly about other countries' trade barriers and their failure to live up to past agreements. Again, this line makes sense at the negotiating table, since it pressures our trade partners to make additional "concessions." The American public hears these repeated complaints, though, and for many they confirm suspicions that the United States is always being out-negotiated or even cheated. Trade liberalization therefore looks like a losing proposition.

Trade policymakers can avoid these pitfalls by abandoning the old "reciprocity" model in favor of a new approach toward international negotiations. Under this new approach, policymakers would explicitly recognize what is in fact the case—namely, that open markets at home are the primary benefit of participating in trade agreements. Such a recognition would create an entirely different negotiating dynamic—it would replace haggling over reciprocity with "coordinated unilateralism."

Unlike in reciprocity-based negotiations, the goal wouldn't be to "win" at the bargaining table by "getting" more than you "give." Rather, the express purpose of negotiations would be for each country to gain by reforming its own policies, but also to maximize that gain by linking reforms to liberalization abroad. Reforming one's own policies would be a central negotiating objective rather than the downside of the transaction, while coordination would strengthen the political case for free trade by adding the benefits of liberalization abroad to those of market-opening at home.

Such an approach still leaves plenty of room for tough bargaining. Under coordinated unilateralism, however, the focus would be on the integrity of the overall agreement, not on any country-by-country tallying of "concessions" given and received. Specifically, the measure of success would be an agreement that reflects a serious international commitment to free-trade principles—as evidenced by the fact that a "critical mass" of countries has agreed to commit to some minimum threshold of liberalization. And in measuring the level of commitment of various countries, what matters is the extent of liberalization agreed to in the end; whether that end result is achieved through new reforms, or simply through an agreement to "lock in" previously made unilateral reforms, should be irrelevant.

Under this approach, if there is not sufficient international interest in meaningful and significant commitments, then no agreement is reached. Countries are then free to continue to liberalize unilaterally. Going it alone will not mean a loss of "bargaining chips" or leverage in subsequent negotiations; if such negotiations do occur in the future, countries will receive full "credit" for any liberalization achieved in the interim.

Although coordinated unilateralism would represent a sharp break from the current rhetoric of trade talks, diverging from current practice would be much less dramatic. In a study of the Uruguay Round negotiations, J. Michael Finger of the World Bank found that the reciprocity model does a very poor job of explaining what actually happened.[3] That model would predict that countries' "net concessions" should be close to zero; in fact, however, an analysis of the tariff commitments of 33 countries shows that net concessions varied dramatically from country to country. Meanwhile, interviews with 10 different negotiating delegations found none that had actually tallied concessions given versus received (either within the tariff negotiations specifically or across the range of all Uruguay Round agreements). There was broad agreement, however, about the importance of ensuring that each county made an "appropriate contribution" to tariff cutting. In this regard, Finger found that countries did receive "credit" for prior unilateral cuts when they agreed to bind their rates at the currently applied levels.

In addition, the coordinated unilateralism model fits very well with the record of the post-Uruguay Round sectoral negotiations—the Information Technology Agreement and the agreements on telecommunications and financial services. For all three agreements the challenge was to enlist a critical mass of countries to agree to particular liberalization thresholds. In all of these talks, the United States exercised significant leverage despite the fact that it already had a zero tariff rate for semiconductors and offered only to lock in current levels of openness in telecommunications and financial services. The lock-in by itself was considered a valuable U.S. contribution by other countries; furthermore, U.S. participation in the agreements gave them legitimacy and thus bolstered other countries' confidence in each other's commitments. Using its leverage, the United States walked away from the financial services talks when it was dissatisfied

[3]"Market Access Bargaining in the Uruguay Round: Rigid or Relaxed Reciprocity?" is discussed in Bhagwati (forthcoming).

with some of the offers from key participants; in the end negotiations resumed and a stronger package of commitments was achieved.

So how would coordinated unilateralism differ from the status quo? The difference would be primarily rhetorical, not substantive. But in politics rhetorical changes can be extremely important. In the present case, a shift to coordinated unilateralism would allow trade policymakers to continue to reap the political advantages of international liberalization without at the same time salting the earth with protectionist nonsense.

Keeping Negotiations on Track

The other major problem with trade negotiations, besides their mercantilist assumptions, is that they can veer off in the wrong direction. Instead of reducing government interference in trade and investment flows, misguided international agreements can actually increase such interference. This risk has grown in line with the increasingly ambitious scope of trade negotiations.

The original focus of trade agreements was on border measures that discriminate overtly against foreign goods—namely, tariffs and quantitative restrictions. Over time, though, as tariff levels have fallen and import quotas have been relaxed and eliminated, the scope of trade negotiations has expanded to address nontariff barriers—that is, domestic policies that discriminate against or simply inhibit international commerce. Thus, such areas as product standards, food safety regulation, subsidies, and intellectual property protection have been swept within the purview of trade policy.

As the reach of trade agreements into domestic policy has extended, it has become increasingly plausible to argue that any policy area that "affects" trade—and practically every public policy has some effect on trade—deserves to be included on the trade agenda. In particular, those who call for negotiating international labor and environmental agreements through the WTO are able to make a seductive argument: If the WTO requires national governments to protect the intellectual property rights of software companies and pharmaceutical manufacturers, why shouldn't it require, or at least allow, national governments to protect the environment or the rights of workers? Are these objectives somehow less valuable than the profits of multinational companies?

If such thinking carries the day, there is a serious risk that future trade negotiations will end up doing more harm than good. First, they could create broad new exceptions that allow national governments to close their markets out of social policy considerations—for example, restricting imports from countries that do not guarantee a particular minimum wage or that do require certain air quality standards. Alternatively, trade agreements could impose ill-considered new international regulatory requirements on national governments, compliance with which would then be enforceable through the WTO dispute settlement process.

Such unfortunate developments can be resisted effectively only if free traders remember what makes trade negotiations worth pursuing in the first place. Trade agreements are beneficial insofar as they facilitate the opening up of national markets to foreign competition. If they subvert that objective—whether by conferring international legitimacy on new forms of protectionism or by saddling the world with a new layer of international regulatory bureaucracy—they deserve the opposition, not the support, of believers in free trade.

The risk that trade agreements will wind up increasing rather than decreasing government interference in international markets is heightened considerably by the currently dominant top-down vision of international order. People who believe that a global economy requires a global rule-making body will naturally sympathize with extending the WTO's mandate into any area of plausibly international concern—even when such extension conflicts with the original market-opening purpose of the organization. Even more committed free traders who do not welcome WTO "mission creep" will be influenced to compromise by the top-down viewpoint. To the extent that they believe the world trading system is completely dependent on international negotiations and institutions, they are correspondingly more likely to give in to demands to expand the trade agenda in illiberal directions if that is the only apparent way to keep the "process" moving forward. Just in the past year or so, in the wake of the multiple failures of fast track legislation and then the debacle in Seattle, there has been increasing pressure within elements of the U.S. free-trade camp to make concessions on environmental and labor issues.

From the bottom-up perspective, on the other hand, it is clear that liberalization can proceed if need be without international negotiations—and indeed would be much better off without them if they become infected by anti-market initiatives. Those free-traders who counsel appeasement of environmental and labor activists cite the "bicycle theory" of trade negotiations, according to which the process must either keep moving forward or else collapse into protectionism and conflict.[4] But as trade economist Jagdish Bhagwati has responded, it may be better to fall off the bicycle than to keep pedaling in the

[4]The "bicycle theory" is discussed in Destler (1995: 17–18).

wrong direction. And in the end, a credible willingness to accept no agreement rather than a bad agreement may be the best guarantor of avoiding a wrong turn.

Conclusion

The case for trade negotiations from the free-trade perspective is more nuanced than is commonly understood. Negotiations are not required for trade liberalization to occur; after all, the most dramatic progress in market-opening over the past couple of decades has occurred through unilateral reforms at the national level. Furthermore, negotiations, if conducted incorrectly, can actually undermine the free-trade cause.

When structured properly, though, international trade agreements can provide a useful supplement to purely unilateral liberalization. Such agreements can help overcome political obstacles that hinder the opening of markets; also, they can consolidate market-opening gains and make them harder to reverse. The key to maximizing negotiated liberalization's advantages, and avoiding its pitfalls, is found in the bottom-up vision of international economic order. That vision recognizes that countries should and do open their markets largely on the basis of perceived national economic interest. Accordingly, the proper model for trade negotiations is not mercantilist-minded "reciprocity" but rather "coordinated unilateralism."

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