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Building Strategic Alliances Through Trade Agreements

Remarks by

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Today, I'd like to talk about trade, how it can help our economy recover and become more resilient, and how we can use trade agreements to strengthen strategic partnerships with key nations. At the outset I should point out that these are personal views and do not derive from RAND research.

In his State of the Union message last month, President Obama announced a "National Export Initiative," drawing particular attention to the important role exports can play in economic recovery. He re-dedicated the Federal Government to commercial advocacy abroad, supporting exporters with increased resources for EX-IM Bank, "strengthening" our trade relations with countries such as Korea, Panama and Colombia, and redoubling efforts to

get a good outcome from the Doha multilateral trade negotiations under the World Trade Organization, or WTO.

Los Angeles knows the value of trade. The Port of Long Beach is the second busiest port in the country, supporting 316,000 jobs in the five county Los Angeles area, and many more throughout the nation. Better than other parts of the country, Angelenos know that the U.S. economy benefits from imports as well as exports. Trade is a two-way street. As in any local community, the more that we buy from abroad, the more that we can sell. We benefit from imports as well as exports. Our customers are our suppliers.

As noted in the introduction, I was a member of the NAFTA negotiating team. In fact, I led the U.S. side of the negotiating group that was responsible for Chapter 9 of the agreement, which set rules for application of product standards and regulatory issues. I also led the environmental review of the agreement, the first ever conducted on a trade agreement. Some have criticized NAFTA on various grounds, arguing for example that it failed to deliver all the expected benefits to the United States, or to Mexico. (I'll leave the Canadians out for the moment.) But a good argument can be made that NAFTA was good for Mexico and good for the U.S.

Two way trade with Mexico grew dramatically after NAFTA. When we negotiated the agreement, roughly 70 percent of Mexico's exports went to the United States. Now it is over 80 percent. Many of those exports contain high percentages of U.S. components. That is sometimes questioned in Mexico, but it is exactly the type of mutual benefit we had hoped to achieve with the agreement. Mexican manufactures incorporating U.S. parts and components, especially automobiles, compete with imports to the United States from elsewhere that don't have as much U.S. content. That helps the U.S. auto parts industry. American engineers and designers also benefit from the extra competitiveness that comes from teaming with the Mexican workforce.

Negotiation of the landmark NAFTA did not hamper our efforts to simultaneously liberalize and bring a reliable, rules-based framework to global trade. It is sometimes forgotten that we negotiated NAFTA at almost the same time as we finished the ground breaking "Uruguay Round" of trade negotiations. The Uruguay Round established the World Trade Organization – the "WTO" -- out of the less-effective General Agreement on Tariffs and Trade (or GATT) that preceded it. The Uruguay Round also cut industrial tariffs to an average of about 3 percent in developed

countries, covered some service sectors and intellectual property rights, and put overall constraints on agricultural subsidies.

The most significant aspect of the WTO, of course, was its dispute settlement mechanism, which is less able to be blocked than the GATT was by the country accused of failing to live up to its obligations. A more certain path to relief or retaliation has led to a raft of trade complaints, which might lead you to conclude trade obligations are being breached more often.¹ It is rather evidence of a more certain – though still long – path to relief.

During my tour in London, the United States joined Latin American countries in challenging the EU banana regime of 1994, which had reduced access to European markets that so-called dollar bananas produced by U.S. companies in Latin America had had for generations. After more than 13 years of brief and counter-brief, retaliation and adjustment, we have finally achieved a fairer European banana regime. This is perhaps an extreme case, but many countries, rich and poor, are using the WTO dispute settlement system the way we use civil courts in domestic law, as a deterrent, a lever, and occasionally a route to relief.

¹ In its first 16 years of operation 1995-2010, 405 cases were brought before the WTO Dispute Settlement Body, including many still underway. In contrast, in 47 years of the GATT, only 101 cases were brought in total (http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm).

As we began the last decade, however, the global trade world was upended by several trends. As a result of reductions in trade barriers in the past, globalization took off. Companies developed integrated product chains dependent on design, manufacturing and services from many parts of the world. Middle income countries, such as Brazil, India, South Africa, and Malaysia demanded a seat at the trade decision making table. With different interests and different economic structures than the traditional trade negotiation heavyweights – the United States, the European Union and Japan - - these countries made it much harder to reach agreement on a new multilateral round, the so-called “Doha Development Round” begun in 2001 and still underway. Why? While the issues are very complex, the new players like India and Brazil want the developed countries to liberalize their agricultural sectors, but resist opening their own industrial markets, which have high, and commercially significant, barriers.

While proceeding at a global level in the WTO, the United States, the European Union and various Asian countries nonetheless also negotiated regional or bilateral trade pacts, some on the model of the NAFTA, others less comprehensive.

There is a long debate in trade policy and academic circles as to whether such regional trade agreements are economically sound and whether they harm multilateral market opening efforts.

From an economic theory point of view, that debate often comes down to the question of whether trade expected to be “created” by the agreement is greater than the trade likely to be “diverted” to countries making the agreement at the expense of other trading partners.

In the United States, we have insisted that our partners in regional or bilateral trade agreements also make commitments to apply high labor and environmental standards, and protect intellectual property, among other things.

In general, trade creation is likely to be bigger than trade diversion in trading relationships that are already deep and significant in terms of commodities and market share and in agreements that have few, if any exclusions. The environmental and labor standards conditions are also important. Regional trade agreements are also significant politically, as they bind partners in long-term economic relationships that often complement strategic partnerships.

We have now free trade agreements in force with 17 countries ranging from Morocco to Australia. Three additional agreements - - with South Korea, Panama and Colombia -- were completed by the last Administration, and are pending ratification. In addition, the President notified Congress in December 2009 of his intention to begin negotiations on a Trans Pacific Partnership, which it describes as a regional, Asia-Pacific “high-standard, broad based” trade agreement. This makes good sense, as the countries of the Pacific basin are some of the fastest growing in the world. Obtaining duty-free market access to these countries would be in the United States’ economic interest. Such a “Partnership” can reinforce our strategic position in the important Asian-Pacific region.

But here’s a question for you: if it makes sense to negotiate 20 free trade agreements with a wide variety of partners, and start a negotiating process in the Pacific Basin, why not do something similar with Europe, where our two-way trade in goods was worth over \$639 billion in 2008? Tariffs of three percent or so may be at nuisance levels in trans-Atlantic trade, but in the aggregate three percent of \$639 billion is worth \$19 billion in cost savings. Businesses like yours are struggling to cut costs from their

operations in any way they can, and \$19 billion is pretty big number all by itself, even before trade creation in new markets cuts in.

The United States and Europe also have more direct investment in each other's economies – more than a trillion dollars in each direction -- than any other pair of trading partners in the world.

The United States and Europe are allies in NATO and we are fighting together in Afghanistan. We are partners in addressing political and economic problem around the world. Certainly our labor and environmental standards are comparable. Wouldn't a free trade relationship give a new sense of purpose to that strategic relationship and open some new markets to boot?

This idea, of course, has been considered before. In 1995, there was serious consideration, even advocacy, from many prominent figures on both sides of the Atlantic for a Transatlantic Free Trade Agreement or "TAFTA." German and British Foreign Ministers, the AFL-CIO's Lane Kirkland, various business groups, and many others recommended that the United States and the EU complement the then just-completed NAFTA and Uruguay Round with a TAFTA.

Some reasoned that the United States and the EU needed a new common project to cement the transatlantic relationship with the end of the Cold War; others considered TAFTA the next logical step in trade liberalization and an example of how bilateral and multilateral liberalization could work together in a virtuous circle.

However, neither Washington nor European trade establishments were very interested in a TAFTA for a variety of reasons I'll come back to in a minute. Instead, a "New Transatlantic Agenda" was proclaimed at the Madrid Summit in December 1995. It made significant substantive and procedural improvements to U.S.-EU relations, but relegated the TAFTA boomlet to a "joint study" of the trade liberalization possibilities. The joint study, and another one commissioned at the U.S.-EU Summit in 1998, never really subjected transatlantic tariff elimination, in the context of a comprehensive WTO Article 24-consistent FTA, to careful analysis.

So, for a number of reasons, in the 1990's a TAFTA was a non-starter politically. Most important was probably the inability of proponents to have good answers to the following five questions:

1. What would it mean for the WTO? The trade policy community feared a TAFTA would indicate that the United States and the EU had given up on the multilateral system at the very birth of the WTO, and that the U.S. and the EU were not committed to bringing the developing countries into the management of the trade system, as we had promised.

2. Could a TAFTA overcome agricultural interests? Many politicians thought that subsidies and trade restrictions on agriculture were so pervasive and systemic that a free trade agreement either could not be negotiated, or would be so vigorously opposed by agricultural interests on both sides of the Atlantic it would never be finished. Some believed that agricultural subsidies and market access were better dealt with in a multilateral setting.

3. Would it be worth it? Economists argued that tariff barriers between the United States and the EU were so trivial that the trade creation that would follow an agreement would not be worth the political effort, or, alternatively, that elimination of tariff peaks on sensitive products like apparel would be too disruptive.

4. Were we looking in the wrong direction? As now, the focus of U.S. trade policy in the nineties was on the Pacific, where we hoped to achieve a consequential basin-wide free trade arrangement of some sort just as we do now. There was concern in Washington that a transatlantic approach would annoy our Asian partners, who provided most of the more significant “emerging markets.”

5. And finally, would it really remove key obstacles? Many experts thought the more important trade barriers between the United States and EU are regulatory differences that either prevent trade from taking place altogether, or burden exporters with standards and testing requirements that increase costs beyond those of nominal (and explicit) tariff barriers.

Our failure to answer these questions meant the TAFTA moment of the 1990's passed. Soon the focus was on the disastrous Seattle WTO Ministerial and then the launch of the WTO's “Doha Development Round.” Seattle made clear that in the post-NAFTA, post-Uruguay Round environment there were many other global groups that asserted an interest in trade policy and negotiations, to the detriment of the old traditional, reasoned, reciprocal and economic approach to trade negotiations.

The Doha Round has been underway for eight years. In many ways the agenda of the Round has been overtaken by events in the broader economy. No longer are major developing countries on the sidelines of the global economic system. The G-20 Summit in Pittsburgh last fall cemented what has been evident for some years, that China, India, and other emerging economies are major players in the global economic system.

Yet asymmetries continue to exist, to the detriment of trade and economic policy. In trade policy, the asymmetry is in barriers: by and large, the developed wealthy economies have low tariff barriers, deficits in goods trade and modest surpluses in trade in services. The emerging markets have significant trade barriers in goods and services that allow them to accumulate large surpluses overall. The fundamental problem holding up resolution of the Doha Round is that the emerging markets don't have much to gain in terms of market access in rich countries, and believe they have much to lose in terms of protection of their own goods and services markets. So we see inadequate offers in market access and difficult demands in terms of agriculture. At Pittsburgh promises were once again made to conclude the Doha Round next year.

Will it happen this time? Maybe, but the balance of bargaining power is not propitious without some new leverage.

With formal transatlantic trade liberalization delegated to the Doha Round, in the U.S.-EU dialogue we experimented with a variety of means to tackle behind-the-borders regulatory barriers.

We completed a first Mutual Recognition Agreement covering six sectors, but affecting few commercially significant trade restrictions.

We announced an agreement on “Principles” for regulatory cooperation.

The United States brought and sometimes won cases in the WTO against the EU’s practices we thought were not justified and they did the same.

And in 2007, we established a cabinet-level council to bring a peer group approach to tackling stubborn regulatory barriers.

With the benefit of hindsight, it seems all of these efforts have largely failed to create significant new trade opportunities, despite occasional successes.

In the meantime, both the United States and the EU negotiated free trade agreements of various sorts with a wide variety of other partners. I already mentioned our 17 agreements in force. Europe has many as well, including an FTA with Mexico, and it is negotiating now with Canada.

The question becomes whether in this context and at this juncture, a new look at the pros and cons of a transatlantic free trade agreement is merited. And if so, what kind of a FTA should be examined?

In my view, TAFTA is a good idea and its time may have come. I am heartened by similar views beginning to be heard in Europe.

What the transatlantic community needs is an exciting project that holds the prospect of economic stimulus, but not an initiative so big that it would take years of disputatious talks to complete. A WTO-consistent, “substantially all trade,” tariff-only TAFTA would meet that criteria. It could perhaps include balanced add-

ons such as government procurement or geographical indicators, but only if feasible.

More controversial topics – such as some service sectors or standards harmonization – should be deferred to a follow-on agreement. It's an approach that our European partners will recognize – as it would have us proceeding step by step, like the Europeans did from the 1956 Treaty of Rome to Lisbon Treaty just adopted. This could be a big project that could reinvigorate the transatlantic process with benefits beyond trade and economics.

The obstacles? Obviously agriculture above all. But it may be that agriculture is not so impossible to deal with any more. There is now, for example, substantial transatlantic trade in agriculture products, not just long-traded commodities like soybeans and feed grains, but fresh fruits and vegetables, wine and other processed food products. American cranberries are as common in European markets as they are here (except at Thanksgiving of course).

If each side were allowed to set aside a handful of agricultural products as “sensitive,” tariff elimination for most of the tariff lines should be manageable with long phase-outs and limits on subsidies. The real problem will be those public opinion-based

European restrictions (beef grown with hormones, and GMOs). A way must be found around these obstacles but I think with creativity it would be possible. Certainly it is worth considering, and consulting with industry and agricultural groups to see what may be possible.

In the nineties, we worried about the possible adverse impact of a TAFTA negotiation on the multilateral trade system and on the prospects for a new multilateral round. For eight years of Doha, and for several years before that, we tested that proposition. We didn't have a TAFTA, but we didn't succeed in the multilateral arena either.

In the nineties, one could have also made the argument that a TAFTA might have helped to incentivize emerging market countries to make their own market opening concessions to advance things. In fact, that may have been the effect of NAFTA on the Uruguay Round. Maybe we should test *that* proposition.

So at this juncture a TAFTA may be an idea worth re-considering and a perfect complement to the Trans Pacific Partnership process. It would be an ambitious big project for the United States and the EU to tackle, suitable for a revived post-Lisbon Treaty

relationship. It could help the Europeans anxious about the stability of the euro-zone. It would open new markets for businesses like yours. It could reduce costs and stimulate economies on both sides of the Atlantic, and set the stage for a second more ambitious behind- the- barriers harmonization process in the years ahead. It would not threaten labor or environment equities. And it just might help the multilateral process also.

It is, in short, a good idea whose time has come.