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Confronting Current Challenges to US Trade Policy

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Trade policy is usually not at the top of the "to do" list of a new administration, but in early 2005 US officials will have to make several important decisions regarding both trade legislation and trade negotiations. Failure to do so could foreclose negotiating options and limit prospects for advancing US trade initiatives throughout the administration's term in office. Some of these choices will require the investment of political capital to ensure support for trade bills before Congress; others will require commitment of negotiating resources to bolster ongoing trade talks so that US objectives can be achieved in agreements concluded later in the term.

How times have changed! The United States has long been the world's leading trading nation, but US trade policy never used to be a central concern of US economic policy. In part, this is a remnant of bygone times when trade played only a small role in the US economy. In the 1960s, US merchandise exports and imports of goods together averaged about 6.7 percent of US GDP; by 2003, however, the trade/GDP ratio had almost tripled to 18 percent. Add services to the equation and the US ratio now reaches 23 percent (figure 8.1). In short, the US economy is now much more open to international trade than a generation ago.

Greater openness to trade confers substantial advantages for the US economy as a whole, though the aggregate benefits mask difficult adjust-

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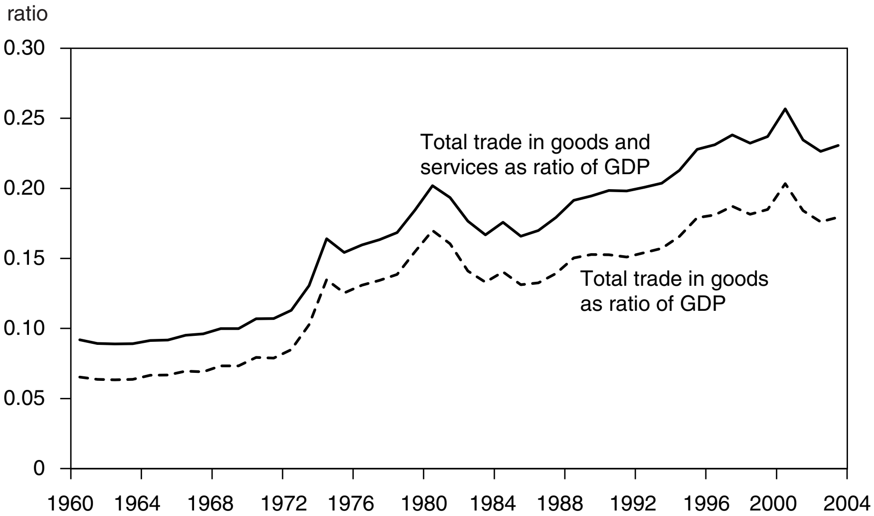
Figure 8.1 Ratio of US trade to GDP, 1960–2004



Sources: US Census Bureau (2004); Council of Economic Advisers, *Economic Report of the President* (2004).

ment burdens for some US firms and workers and their communities.[1] Consumers benefit from more choices and lower prices, as import competition dampens inflationary pressures. US companies that "consume" imports gain as well from access to better and/or cheaper inputs to their production of finished goods like autos or computers. Overall, openness has helped propel dramatic increases in US productivity by prompting companies to retool and restructure, and workers to retrain, to keep pace with global competition.

At the same time, however, greater openness means that US companies face stiffer competition at home and abroad, and US workers face greater uncertainty regarding job security and the maintenance of wages and benefits even though US unemployment levels remain relatively low. Record job creation in the 1990s occurred amid substantial churning in US labor markets in which millions of workers lost their jobs. Some workers found equal or better opportunities in the expanding US economy, while others suffered significant losses through prolonged unemployment or large wage cuts. Many more felt vulnerable to future job shocks (see the chapter by Lori Kletzer and Howard Rosen in this book).

1. Cumulatively, postwar trade reforms have raised US GDP by almost 6 percent, worth $600 billion in 2003 dollars. Eliminating all barriers to trade in goods and services—a task likely to progress incrementally and incompletely over the next decade—would increase US production by an additional $450 billion to $600 billion annually (see the chapter by Scott Bradford, Paul Grieco, and Gary C. Hufbauer in this book).

Table 8.1 US merchandise and services trade, 2002–04
(billions of dollars)

Year	Goods			Services			Goods and services balance
	Exports	Imports	Balance	Exports	Imports	Balance	
2002	681.8	1,165	–482.9	294.1	232.9	61.2	–421.7
2003	713.1	1,261	–547.6	307.4	256.3	51.1	–496.5
2004[a]	789.8	1,422	–632.4	335.1	284.1	51.0	–581.4

a. Data are for January-July 2004 at an annualized rate.

Source: US Department of Commerce, Bureau of Economic Analysis.

For the past two decades, succeeding US administrations have extolled the virtues of trade as an engine of job creation. At best, these promises have been misleading, since trade creates both winners and losers in the US economy.[2] By shifting resources from less productive to more productive sectors in the economy, trade affects the composition of jobs in the economy; in the aggregate, trade improves the "quality" of jobs, since exports generally support higher-paying and more secure jobs. But trade does not significantly influence the total level of employment, which is primarily determined by macroeconomic policies.

Nonetheless, the fear of job loss has been a powerful motivation for critics of trade and globalization more broadly. Concerns about globalization now color public attitudes and influence congressional deliberations on US trade policy and negotiations. As a result, the task of formulating and implementing US trade policy has become more complicated, just when US policymakers face two urgent tasks:

- to keep protectionist pressures at bay and to help reduce the massive US trade deficit; and
- to open new opportunities for US firms, workers, and farmers by reducing trade and investment barriers around the globe.

To date, calls for new protectionist measures have been limited (apart from the steel safeguards of 2002–03) despite the deterioration in the US trade accounts. The US merchandise trade deficit will exceed $600 billion in 2004 and has averaged more than 5 percent of GDP annually for the past three years. The traditional US surplus in services trade has been shrinking to less than $55 billion annually (table 8.1). As the US deficit in-

2. Consumers and investors generally benefit, while less-skilled laborers and factory workers often end up worse off. It is thus not surprising that support for freer trade among American workers broadly turns on their level of education; those with high school degrees or less are much more opposed to further increases in globalization than those with college and graduate degrees (Scheve and Slaughter 2001).

creases, however, pressures are mounting to do more—through both border controls (e.g., against Chinese goods) and new subsidies for US industries (which already have gotten a big financial fillip under the 2004 tax "reform"). To blunt these protectionist impulses, US policymakers will need to pursue domestic programs and international negotiations that promote US exports by competitive producers of goods and services while at the same time addressing the adjustment needs of import-competing industries and their workers.

This chapter details what the next administration needs to do to confront the challenges facing US trade policy in the coming years. Trade promotion authority (TPA) and other legislative initiatives require immediate attention to ensure that US officials have the requisite congressional mandate and guidance to conduct trade negotiations. At the same time, new efforts are needed to ensure that ongoing trade talks—particularly the Doha Round of multilateral trade negotiations—produce comprehensive results. In addition, US officials need to upgrade the United States' most important trade partnership, the North American Free Trade Agreement (NAFTA), to better meet the economic and security demands of the post-9/11 world. Finally, the next administration needs to reassess US policy regarding other free trade agreements (FTAs) and refocus efforts in areas with the biggest trade and foreign policy payoffs.

Domestic Trade Policy Agenda

By coincidence or design, the domestic trade policy agenda is congested right from the start of the next administration with contentious and politically sensitive issues. Several require legislative action *in the first half of 2005*; others involve crafting detailed negotiating proposals for ongoing multilateral, regional, and bilateral trade talks. In addition, trade officials are likely to be faced with petitions for import relief from the textile and apparel industries in the wake of the elimination of quotas under the Multi-Fiber Arrangement (MFA) at the end of 2004 and concerns about unfair foreign trade practices (especially by China).

Legislative Agenda

Trade issues will be prominent on the legislative agenda in 2005–06. By June 2005, Congress will likely hold two key trade votes. Both are mandated under existing statutory provisions. One involves the extension of TPA; the other concerns the continuation of US participation in the World Trade Organization (WTO). Congress may also be asked to consider several FTAs, which the president signed in 2004 but for which he had not previously submitted implementing legislation to Congress under the

TPA procedures. Trade officials undoubtedly will spend much of their time on Capitol Hill during the first half of 2005.

Trade Promotion Authority

Securing the extension of TPA is the highest priority. The Trade Act of 2002, as amended, provided for a two-year extension of the negotiating authority beyond its expiry on June 30, 2005—if the president requests it by April 1, 2005, and neither house of Congress disapproves before July 1, 2005 (Section 2103). Any member can request a vote to deny the extension of TPA, which could lead to a floor vote if reported out by one of the designated committees.[3]

The last time Congress was confronted with a vote to extend "fast-track" authority was in 1991. That debate focused on the use of fast-track procedures for the prospective negotiation of the NAFTA. Before the vote, congressional leaders demanded and received assurances from the administration that labor and environmental interests would be safeguarded in the NAFTA negotiations. The disapproval resolution was then defeated by 231 to 192 in the House and by 59 to 36 in the Senate (Destler 1995, 98–103). A similar debate could evolve in 2005 with TPA critics demanding either changes in existing provisions of the Central American Free Trade Agreement (CAFTA) or supplementary obligations added to the body of the agreement on labor and the environment, as a condition for extending TPA.

While it would be extremely disruptive for Congress to revoke the administration's negotiating mandate in the midst of ongoing trade talks, it is entirely possible that Congress could add—through separate legislation—new conditions on the use of fast-track implementing procedures.[4] Calls for product-specific exceptions from trade reforms, earmarked spending programs, and stricter trade enforcement provisions will likely flood the congressional debate on TPA extension.

Could US trade policy operate effectively if TPA is not extended? Without TPA, trade initiatives would be implemented through regular legislative procedures. Several sectoral trade pacts plus China's protocol of accession to the WTO passed Congress in the second Clinton administration despite the fact that fast-track authority (renamed TPA in 2002) lapsed in 1994. The rub is that none of those deals required significant change in existing US laws, regulations, or levels of trade protection. Without TPA, other countries probably would be unwilling to commit to reforming their own politically sensitive trade restrictions. Why risk inflaming one's own

3. In the House of Representatives, such resolutions are referred to the Committees on Ways and Means and on Rules, which must report them out before the resolutions can be considered on the floor.

4. The Trade Act of 2002 includes the exact wording of the extension resolution, which does not allow consideration of amendments to TPA provisions.

political constituencies if there is a good chance that Congress will balk at reciprocal liberalization of US barriers, or demand that the negotiations be reopened? At best, US officials would be offered second-best deals; at worst, trade talks would collapse (or never engage), subjecting US negotiators to involuntary retirement.[5]

WTO Participation

About the same time that Congress considers TPA extension, it will likely be required to take another trade vote on a resolution to withdraw from the WTO. Section 125 of the Uruguay Round Agreements Act of 1994 requires the president to report to Congress every five years on the costs and benefits of US participation in the WTO. After receipt of the president's report, both houses of Congress have 90 days to vote on a joint resolution calling for the withdrawal of US membership in the world trade body.[6] If adopted, the withdrawal resolution is subject to presidential veto, in which case Congress has an additional 15 days to override the veto. The first WTO withdrawal vote took place in June 2000; the withdrawal resolution was rejected by a vote of 35 to 0 by the House Ways and Means Committee, and by 363 to 56 by the full House.

The WTO vote in 2005 could be more contested, in part due to a number of controversial WTO rulings against the United States in dispute settlement cases. Overall, the United States has a strong winning record in disputes that it has brought to the WTO but has lost many of the cases brought by others against US trade practices. In particular, WTO dispute panels have found that the US foreign sales corporation (FSC), US cotton subsidies, the Byrd amendment, and other specific provisions of antidumping law violate WTO obligations.[7] When US policies have not been brought into conformity with WTO norms, WTO members have received multilateral authorization to retaliate against US exports to their markets (as the European Union has done in the FSC case). The "scorecard" for WTO rulings involving the United States is summarized in table 8.2.

Recent WTO rulings against the United States have prompted criticism from members of Congress. Ironically, the new authorities vested in WTO panels derived from US demands at the start of the Uruguay Round in the

5. Arguments for and against fast-track procedures were actively debated in the late 1990s and reported in Schott (1998).

6. This period is actually longer than three months because it excludes most days when either the House or the Senate is not in session (see section 154 (b) of the Trade Act of 1974).

7. Unlike many other countries, the language of the agreements is not directly included into US statutes; rather, implementing legislation revises US law to conform to the new trade obligations. Some WTO violations have resulted from how Congress interpreted US obligations when crafting that legislation. In other cases, Congress passed and the president signed laws—like the Byrd amendment—that many experts thought would not pass WTO challenge.

Table 8.2 US record in WTO dispute resolution cases, 1995–2004
(number of cases and percent)

	Total	Won	Mixed result	Lost	Pending or inactive	Won and/or mixed (percent)
United States as complainant	71	22	22[a]	4	23	62
United States as respondent	72	10	14[b]	25	23	33

a. USTR defines as won on core issues.
b. USTR defines as resolved without completing litigation.

Source: US Trade Representative, WTO Dispute Settlement Proceedings, www.ustr.gov/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Section_ Index.html (accessed October 2004).

late 1980s. In the Trade Act of 1988, Congress made the establishment of a strong system of dispute resolution one of the highest US priorities in those talks to ensure that the new rule-making obligations under negotiation in areas like services and intellectual property would be enforceable. By the end of the Uruguay Round, however, Congress had second thoughts about giving up US power to block dispute rulings as in the past. Senator Robert Dole (R-KS) proposed a "three strikes and out" procedure in which the Congress could vote to quit the WTO if a panel of former federal judges found that three dispute rulings wrongly went against the United States. The Dole amendment failed. However, Congressman Newt Gingrich (R-GA) won approval of a simpler proposal requiring that the administration report every five years on US participation in the WTO, at which time Congress could vote by joint resolution to withdraw from the organization.

Because the effect of WTO withdrawal would be so disruptive to US production, trade, and employment, it is extremely unlikely that such a resolution would pass and override a certain presidential veto, but defeating the resolution also could be costly if it requires acceptance of new negotiating constraints or other types of political side payments. The timing of the vote will depend on when the president issues his report on US participation in the WTO. Since the second five-year period ends on December 31, 2004, the report presumably should be presented in early 2005 after the new Congress convenes, with the prospective vote on the withdrawal resolution in late spring.[8] Members of Congress thus could face two trade votes during May–June 2005.

8. President Clinton's report on the WTO was issued on March 2, 2000, as part of the annual report to Congress on the US trade policy agenda and on the operation of the US trade agreements program. The House of Representatives rejected the resolution on June 21, 2000.

Ratification of FTAs

In July 2004, the House and the Senate approved by wide margins legislation implementing FTAs concluded with Australia and Morocco.[9] However, several FTAs signed in 2004 still await congressional ratification. The most politically contentious of these pacts is the CAFTA, where some Democrats have demanded that the pact be renegotiated prior to congressional action. FTAs with Bahrain and the Dominican Republic (which has been integrated in the CAFTA) are also part of this legislative backlog. The longer the delay in implementing these pacts, the less US firms and workers (and US trading partners) will benefit from the trade reforms—and thus the harder it will be to maintain political support for the pacts. For the CAFTA countries in particular, a key benefit of the pact is the head start that they get over other Latin American and Asian countries in securing open access to the US market and in attracting foreign investment to their economies.

The TPA and CAFTA debates may become intertwined politically, thus perhaps forcing a delay in submission of CAFTA legislation until after Congress acts on the extension of TPA implementing procedures. Rejection of CAFTA, or even prolonged deferment of congressional action, would have negative consequences both for US relations with Central America and for the pursuit of other FTAs with developing countries.

Opposition to CAFTA comes primarily from US sugar producers, labor unions, and some textile firms. The unions criticize the pact's limited labor obligations and enforcement procedures (even though—unlike NAFTA—those provisions are included in the core agreement).[10] Textile and sugar producers oppose CAFTA because it subjects them to more competition in the US market.

Neither critique justifies scrapping the trade deal. The protectionist demands of the sugar and textile industries are straightforward; the problems with labor (and the environment) are more complex and require additional explanation.

In a nutshell, the labor critique about CAFTA is that the pact (1) only requires the Central American countries to enforce their own national laws, which are deemed too weak to ensure conformity with international core labor standards codified by the International Labor Organization (ILO);[11] (2) omits some CAFTA obligations on labor from the pact's dispute settlement regime; and (3) is inadequate to deter abuses (which have been com-

9. The Australia FTA passed the House by 314 to 109 and the Senate by 80 to 16. The Morocco FTA passed by 323 to 99 in the House and 85 to 13 in the Senate.

10. The same critique has been applied by environmental lobbies to CAFTA's environmental provisions.

11. The ILO standards cover freedom of association, abolition of forced and child labor, and nondiscrimination. See Elliott (2004).

monplace in much of the region) because the enforcement provisions provide minimal penalties for violations of CAFTA's labor obligations. These concerns are echoed by many members of Congress as the reason why implementing legislation for the CAFTA was put on hold in 2004.

Labor abuses persist in Central America; the question is how to reduce their frequency and improve working conditions in the region. Given severe budgetary constraints in Central America, and limited financial assistance from the United States, CAFTA critics favor strengthening both CAFTA's labor obligations and noncompliance penalties to pressure those countries to crack down on abusive labor practices. They argue that the CAFTA should have provided the same recourse to trade sanctions, as in the US-Jordan FTA. But the sanctions issue is a red herring. For such provisions to be acceptable to US trading partners, recourse to retaliation has to be so severely constrained as to make the use of those provisions extremely unlikely. That is true as well for the US-Jordan precedent. As a practical matter, there is no difference between the Jordan and CAFTA enforcement standards.

The labor provisions included in the FTAs attempt to balance concerns of: (1) US partner countries that easy-to-use trade sanctions would be abused; (2) US business lobbies that FTA obligations could force changes in US labor laws; and (3) labor unions that the threat of retaliation would deter labor abuses. The compromise reached in these FTAs has been to include new obligations on labor practices, cooperative projects to promote labor reforms, and dispute settlement via monetary fines or trade sanctions in cases where cooperation among the partner countries breaks down.

As a practical matter, CAFTA's shortcoming is inadequate commitment to labor and training programs as well as administration of existing laws and monitoring of compliance. The CAFTA contains annexes that establish cooperative programs to deal with labor and environmental problems in Central America. Putting these good intentions into action, however, has been constrained by inadequate funding. The next administration should provide greater support for these initiatives. With financial incentives from the United States, on top of funds provided by the Inter-American Development Bank, these countries also might be more willing to augment their national laws to expand protections of core labor standards.

Farm Bill

Last, but not least, the next Congress will need to begin work on legislation that will have a profound effect on US trade policy for the rest of the decade—the new farm bill. The US Farm Security and Rural Investment Act of 2002 runs for six years through the end of the 2007 crop year. Some US farm programs have been found to contravene WTO obligations; reforms of some others have been promised in the Doha Round of WTO ne-

gotiations in return for reciprocal cuts in subsidies provided to foreign farmers and market access reforms.[12] As the WTO negotiations advance, US trade officials will have to work closely with the agriculture committees to ensure that what is on offer in the Doha Round is compatible with what is under consideration in the legislative process.

US farm programs can be revised through a new farm bill or Doha Round implementing legislation, or both. Given the likely timetable for the WTO talks, the next farm bill will probably set the parameters, and provide more specific negotiating guidelines, for the final Doha Round deal.

All the major US farm lobbies supported the initial US farm proposals in the Doha Round, tabled just two months after President Bush signed the 2002 farm bill, which called for radical reductions in farm subsidies and border protection as part of a comprehensive package of agreements in the Doha Round. Their rationale was clear, since other countries support their farmers more generously than the United States. For example, on average OECD farmers received 31 percent of their gross farm receipts through transfers from consumers and taxpayers (measured by the producer support estimate, or PSE) during 2001–03, while the average PSE was 20 percent for the United States, 35 percent for the European Union, 58 percent for Japan, and 64 percent for Korea. For specific products, the differences among countries can be much greater (OECD 2004). A big WTO deal on agriculture is feasible, involving substantial cuts in farm subsidies and border protection, if it substantially narrows the gap between the permissible amount of farm support provided to European and other farmers compared with US farmers and includes reforms by middle-income developing countries.

In short, the success of the Doha Round depends importantly on reaching agreement on substantial agricultural reforms—and thus directly as well on what Congress includes in the next farm bill. The need to reduce the large US budget deficit adds urgency to the task of scaling back expensive farm programs. Making a virtue of necessity, Congress should reduce or eliminate some of the generous programs added to the 2002 farm bill to help both reduce the budget deficit and spur reciprocal reforms in other WTO member countries.

Fallout from MFA Reform

On January 1, 2005, the United States and other industrial countries will eliminate their quotas on imports of textiles and apparel from developing countries, which have been in effect for the past three decades under the

12. Deliberations on the farm bill may also have to address how to handle US cotton subsidies, which have been found by a dispute panel to contravene WTO obligations. If the US appeal of that ruling fails, then the WTO will likely require that US programs be brought into conformity with WTO rules within the normal compliance period of 15 months.

Multi-Fiber Arrangement (MFA). Other forms of protection for those industries will remain in force. Imported goods will still face US tariffs that average 6.6 percent for textile mill products (mainly yarns and fabrics) and 11.3 percent for clothing;[13] in addition, those goods will continue to be vulnerable to antidumping and countervailing duty actions as well as safeguard measures. Imports from China are subject to special and more stringent controls under those US statutes. Efforts to delay the elimination of the MFA quotas are designed in part to stiffen resistance to reducing these remaining protections in the Doha Round.

Even with quotas in place, and other trade barriers in effect or in reserve, US industries have faced increasingly sharp import competition, particularly from East Asian suppliers. Total US apparel imports have increased in value by more than 70 percent since the WTO entered into force in 1995 and in 2003 exceeded $70 billion. China accounted for 17 percent of the total, increasing its lead over Mexico substantially over the past three years as the main source of imports to the US market (Nordås 2004).[14]

In large measure, Chinese shipments have been growing at the expense of other foreign suppliers; for some products, the growth has been so rapid that it already provoked the imposition of special and discriminatory textile and clothing safeguards against China that are allowed under China's protocol of accession to the WTO.[15] Some econometric forecasts suggest that, after removal of the MFA quotas, China could capture in short order about half of the US import market. However, a survey of these forecasts conducted by WTO economists argues that the increase will be tempered, inter alia because (1) existing tariffs and preferential arrangements will continue to benefit suppliers in FTA partner countries, especially those closer to the importing country than the distant Asian suppliers;[16] and (2) Chinese competitiveness is greater in low-value-added products compared with the higher-end fashion segment of the market shipped by higher-wage countries.

Nonetheless, imports from China probably will grow substantially, and demands for import relief by US industry will become more strident. The specter of a broader surge of Chinese imports triggered new petitions for import relief in the fall of 2004 and is likely to be supplemented with additional demands in 2005 after the quotas are lifted. The next administration will be required to consider these petitions at the same time that it

13. The data are trade-weighted average tariffs in 2002 for these product sectors. See USITC (2004).

14. The Chinese total does not include clothing imports from Hong Kong, valued at $4 billion in 2003.

15. See Hufbauer and Wong (2004, appendix A) for a description of the safeguard and antidumping remedies available to blunt import surges from China.

16. Nordås (2004, 33) cites studies that argue "that distance matters because of its correlation with time to market, not primarily because of transport costs."

will be working with Congress to pass important trade legislation—and the issues will almost inevitably be joined in congressional deliberations and bargaining over the extension of TPA.

Rebuilding the Trade Coalition

Rebuilding the bipartisan support for US trade policies—which progressively weakened in the postwar period and substantially unraveled since the fractious NAFTA debates of a decade ago—is critical to the achievement of US objectives. It won't be an easy task.

Over the past decade, US trade politics has become more salient but more contentious. Congress (and particularly the House) often has been sharply divided on trade. Major trade bills have provoked fractious debates and close votes in the House: NAFTA passed in 1993 by a vote of 234 to 200, fast-track legislation was withdrawn before a negative vote in 1997 and then rejected in 1998, and the Trade Act of 2002 (including TPA and trade adjustment assistance [TAA]) cleared by 215 to 212. Only the Uruguay Round Agreements Act of 1994 passed with relative ease by a vote of 288 to 146.

In part, fractious congressional debates on trade reflect increasing partisanship on a broad range of issues dividing Democrats and Republicans. In addition, trade politics has become more complicated because of the success of past trade negotiations in reducing border trade barriers. Trade talks no longer are limited to the arcane world of tariffs and quotas. Instead, they target farm subsidies, regulatory policies on food safety, telecommunications and financial services, and protection of intellectual property rights as well as border barriers to trade. As a consequence, politicians now worry about how trade agreements will affect domestic programs of concern to their constituents.

The broader trade agenda also means that more members of Congress want to be involved in trade policymaking. The Senate Finance and House Ways and Means Committees no longer hold sole jurisdiction on trade matters, which are now also vetted by the Agriculture, Banking, and Judiciary Committees among others. Such diversity helps inform the congressional debate but complicates the process of building support for big trade initiatives.

Rebuilding the traditional majority in Congress in favor of more open US trade policies will likely require a mix of major domestic policy reforms and substantial liberalization of foreign trade barriers of interest to US farmers, workers, and companies. Strengthening US worker assistance programs to better meet the needs of those who suffer job dislocations is important; so, too, are trade initiatives that address labor and environmental problems of interest to Democratic members. However, such policies risk weakening support among business and other groups that have been the core supporters of US trade policy. Balancing these competing in-

terests will be a challenge for both parties and test executive branch–congressional relations in the new administration.

International Trade Agenda

While priority attention must be focused on the "domestic" negotiations just discussed, the next administration also will have to confront a large, unfinished agenda of trade negotiations. The Doha Round has been revived but is far from complete. The negotiation of the Free Trade Area of the Americas (FTAA), involving the 34 democratic countries of the Western Hemisphere, has lagged as well. The NAFTA has entered its second decade with notable achievements; however, important new challenges to regional trade and investment have arisen since 9/11, which need to be addressed by the three partners in the context of their North American compact. In addition, FTA talks with the Southern African Customs Union (SACU), plus those started in 2004 with Colombia, Ecuador, Panama, Peru, and Thailand, will likely spill over into 2005 with the hardest issues left for last, and negotiations will begin with Oman and the United Arab Emirates in early 2005. The new administration will also need to decide to accept or defer requests from other countries to join in new FTA negotiations.[17]

Before turning to these trade initiatives, it is worth examining who the United States actually trades with and why it negotiates with them in bilateral, regional, and multilateral fora.

US Trading Partners and Trade Negotiating Objectives

The United States has global trading interests, but about $1.4 trillion or 70 percent of US merchandise trade takes place in a few key markets. In 2003, NAFTA partners Canada and Mexico accounted for 32 percent of total US exports and imports, the European Union (EU-15) took another 20 percent, and China and Japan each about 9 percent. These countries also host two-thirds of US foreign direct investment (FDI) abroad and account for 82 percent of FDI in the United States (table 8.3). Adding the other countries that have concluded or are negotiating FTAs with the United States brings the cumulative total to $1.6 trillion or more than 80 percent of total US merchandise trade (see tables 8.3 and 8.4).

This pattern of trade explains a lot about US trade negotiating objectives and priorities. For the major US trading partners, trade barriers are generally low due to GATT reforms and/or bilateral FTAs that give US exporters preferential access to that market. However, some intractable prob-

17. For example, Pakistan, Sri Lanka, and Taiwan have actively lobbied for FTAs with the United States, and others seek to negotiate FTAs in the context of the Middle East and East Asian trade initiatives (Schott 2004).

Table 8.3 Main US trading partners, 2003 (billions of dollars)

Partner	Exports[a]	Imports[b]	Trade balance	FDI in United States[c]	US FDI abroad[c]
NAFTA	267	362	–95	112	254
EU-15	151	245	–94	856	845
China	28	152	–124	n.a.	12
Japan	52	118	–66	159	73
World total	724	1,259	–536	1,378	1,789

n.a. = not available
FDI = foreign direct investment
NAFTA = North American Free Trade Agreement

a. "Free alongside ship" value of total exports.
b. Customs value of general imports.
c. Historical-cost basis, year-end 2003.

Sources: USITC Dataweb (2004); US Department of Commerce, Bureau of Economic Analysis (2004).

lems remain, particularly in agriculture (e.g., European farm subsidies and Japanese rice and Canadian dairy restrictions) and services, but also involving compliance with WTO norms (e.g., Chinese protection of intellectual property, restrictions on genetically modified crops, and operations of state-trading enterprises). In these areas, bilateral initiatives by the United States have not been sufficient to overcome strong political resistance to reform of those foreign practices. Progress on these matters will require a bigger deal that can only be crafted in multilateral negotiations. Most of them are under discussion in the Doha Round.

While the major industrial countries will continue to be the most important US trading partners, US trade officials also need to work more closely with partners in the developing world, for two reasons. First, agreement among the industrial countries is still necessary but no longer sufficient to conclude global trade talks. As the WTO ministerial in Cancún in September 2003 plainly demonstrated, the interests of developing countries have to be addressed if talks are to succeed in a forum where decisions are taken by consensus of the large membership. Second, the best prospects for US export growth probably lie in expanding trade with developing countries like Brazil, China, India, Indonesia, and Malaysia, among others. Liberalization of the generally much higher barriers to those markets could open substantial new opportunities for US trading interests.

Compared with its trading partners, average US tariffs on farm and industrial products are low, and nontariff barriers are scattered and relatively benign. Table 8.5 compares the US most favored nation (MFN) tariffs with those applied by the major US trading partners. Simple tariff averages can mask substantial variations in protection among products, but the differences are noteworthy. In agriculture, only Hong Kong and Malaysia maintain lower average tariffs, while tariff barriers in Nigeria,

Table 8.4 Current and prospective US FTA partners

			US merchandise trade, 2003			
Partner	2003 GDP[a] (billions of dollars)	2003 GDP per capita (dollars)	Exports to[b] (billions of dollars)	Imports from[c] (billions of dollars)	Trade balance (billions of dollars)	Total two-way trade (billions of dollars)
Current FTA partners						
Canada	867	27,408	169.5	224.2	–54.7	393.6
Mexico	626	6,121	97.5	138.1	–40.6	235.5
Chile	72	4,568	2.7	3.7	–1.0	6.4
Singapore	91	21,492	16.6	15.2	1.4	31.7
Jordan	10	1,858	0.5	0.7	–0.2	1.2
Israel	109	16,228	13.1	12.8	0.3	25.9
Australia	508	25,553	6.9	6.4	0.5	13.3
Morocco	45	1,481	0.5	0.4	0.1	0.9
Subtotal			**307.3**	**401.5**	**–94.2**	**708.5**
FTAs subject to ratification						
Bahrain	9	13,028	0.5	0.4	0.1	0.9
CAFTA-5	60	1,690	10.9	12.4	–1.5	23.3
Dominican Republic	16	1,827	4.2	4.5	–0.2	8.7
Subtotal			**15.6**	**17.2**	**–1.7**	**32.8**
FTAs under negotiation						
Colombia	81	1,835	3.8	6.4	–2.6	10.1
Ecuador	27	2,082	1.4	2.7	–1.3	4.2
Peru	61	2,233	1.7	2.4	–0.7	4.1
Panama	13	4,339	1.8	0.3	1.5	2.1
Thailand	143	2,309	5.8	15.2	–9.3	21.0
SACU-5	177	3,412	2.9	5.3	–2.4	8.2
Subtotal			**17.4**	**32.3**	**–14.8**	**49.7**
Other FTAA[d]	776	2,835	23.0	44.8	–21.8	67.8
United States	10,985	37,745	723.7	1,259.4	–535.7	1,983.1

CAFTA-5 = Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua
SACU-5 = Botswana, Lesotho, Namibia, South Africa, and Swaziland

a. GDP is in current US dollars.
b. “Free alongside ship” value of total exports.
c. Customs value of general imports.
d. Includes the following countries: Belize, Bolivia, Caribbean islands (Bahamas, Antigua and Barbuda, Barbados, Jamaica, Netherlands Antilles, St. Kitts and Nevis, St. Lucia, St. Vincent and Grenadines, Dominica, Grenada, Haiti, and Trinidad and Tobago) Suriname, Guyana, Mercosur-4, and Venezuela.

Sources: For GDP: IMF *World Economic Outlook* (2004); for trade: USITC Dataweb, http://dataweb.usitc.gov.

Table 8.5 Tariffs of US trading partners

Country	Total trade with United States, 2003 (billions of dollars)	MFN applied tariffs, 2002 (simple average, percent)				
				All products		
		Agriculture	Nonagriculture	Applied	Bound	Tariff gap[a]
United States[b]		4.7	3.8	3.9	3.6	–0.3
EU-15	396	5.9	4.2	4.4	4.1	–0.3
Canada	394	3.0	4.3	4.1	5.1	1.0
Mexico	236	23.4	17.1	17.9	34.9	17.0
China	181	19.2	11.3	12.4	10.0	–2.4
Japan[b]	170	7.1	2.7	3.3	2.9	–0.4
Korea[b]	61	45.5	7.5	12.4	16.1	3.7
Taiwan[b]	49	17.3	6.3	7.8	6.1	–1.7
Malaysia[b]	36	2.1	8.1	7.3	14.5	7.2
Brazil[b]	29	12.5	14.9	14.6	31.4	16.8
Hong Kong	22	0.0	0.0	0.0	0.0	0.0
India[b]	18	37.0	30.5	31.4	49.8	18.4
Philippines	18	9.2	5.2	5.7	25.6	19.9
Indonesia	12	8.2	6.7	6.9	37.1	30.2
Nigeria	11	53.9	26.3	30.0	118.4	88.4
Turkey[b]	7	42.2	5.5	10.2	29.4	19.2
Egypt	4	22.8	19.4	19.9	37.2	17.3
Pakistan[b]	3	22.0	19.9	20.1	52.4	32.3

MFN = most favored nation

a. Tariff gap = bound minus applied rates
b. Refers to countries with 2001 tariff data.

Sources: WTO *World Trade Report* 2003; USITC Dataweb, US Trade by Geographic Regions.

Korea, Turkey, and India are about 10 times higher than the US average. In nonagricultural sectors, the tariffs protecting the developed-country markets average about 3 to 4 percent; in comparison, some developing countries have lowered their average tariffs to less than 10 percent (Philippines, Taiwan, Indonesia, Korea, and Malaysia), while others maintain tariff walls of 15 percent (Brazil) to 30 percent (India). While many developing countries have reduced their tariffs over the past decade, they have not necessarily "bound" that liberalization in their WTO schedules and can thus raise them at any time without violating WTO obligations. The "tariff gap" between the bound and applied tariffs (averaged across all products) is most pronounced for Nigeria (88 percentage points), Pakistan, and Indonesia (more than 30), but also is substantial for the Philippines, Turkey, India, Brazil, and Egypt (17 to 20).

To be sure, there are a few notable exceptions in agriculture and apparel where US restrictions remain high. The US International Trade Commission (2004) reported that the combined effect of tariffs and quotas in 2002 conferred effective protection of 109 percent for sugar, 38 percent for dairy, and 20 percent for tobacco and apparel. Clearly, protection that has survived the past eight rounds of multilateral trade reforms benefits politically powerful interests.

Therein lies the challenge for US trade officials: The remaining US trade negotiating chips are politically sensitive items and will require large concessions from US trading partners to convince Congress to change existing practices. To get congressional support for changes in long-standing US trade barriers, US negotiators need to bring home agreements that offer substantial new trading opportunities for US farmers, manufacturers, and services industries.

What does Congress want US trade officials to bring home from the negotiating table? US negotiating objectives are as broad ranging as the countries with which the United States trades. The Trade Act of 2002 lists 16 key US objectives in bilateral, regional, and multilateral trade negotiations, encompassing "traditional" issues like tariffs and quotas as well as trade-related policies on intellectual property, labor, and the environment. Not all of the objectives need be achieved in each trade pact. In some areas, progress is more feasible in FTAs than in the WTO (e.g., intellectual property rights); in others, results are possible only through agreement on multilateral disciplines (e.g., domestic farm subsidies). Some issues have been excluded from the WTO agenda (e.g., labor practices, investment, and competition policy) and currently can be vetted only in bilateral or regional talks. In those cases, FTA provisions could establish precedents for possible future WTO accords. Note, however, that adding those issues to WTO talks would likely require a "rebalancing" of the negotiating agenda to include issues of priority to developing countries—such as fundamental antidumping reform and new exceptions to obligations on intellectual property rights.

Each type of negotiation presents different opportunities to advance US trade objectives. The bilateral initiatives can help catalyze broader regional reforms and build alliances in support of multilateral initiatives in the WTO. Success in the WTO in turn can help minimize the adverse effects of trade diversion generated by FTA trade preferences and help ensure that the bilateral and regional initiatives complement the objectives of the multilateral trading system. US officials should take advantage of them all, and thus follow the precedents of the past two decades, in both Republican and Democratic administrations, by pursuing a multitrack trade negotiating strategy that links bilateral, regional, and multilateral trade initiatives.

Completing the Doha Round

As the world's leading trading nation, the United States has substantial interests in the successful conclusion of the Doha Round of multilateral trade negotiations. Global trade reforms provide the biggest bang for the US negotiating buck, even though the outcomes may not eliminate border barriers to trade as FTAs seek to do.[18] Even partial liberalization of existing trade barriers could yield global welfare gains of almost $700 billion, of which about one-quarter would accrue to the United States (Brown, Deardorff, and Stern 2003). A new round is also needed to fix the problems that have arisen in the WTO's first decade of operation (e.g., dispute settlement reforms) and to augment the trading rules to keep pace with the rapidly changing developments in world commerce in goods and services (e.g., electronic commerce).

As in previous GATT rounds, the United States was the key *demandeur* of the Doha Round for both economic and foreign policy reasons. From the US perspective, the launch of new WTO negotiations in November 2001 served three critical purposes: first, it sent a signal that the United States and others would resist growing protectionist demands despite deepening economic slumps in the United States, Europe, and Japan; second, it promoted development and growth in member countries; and third, the new WTO initiative helped solidify the international alliance of nations working together to confront global terrorism just two months after the tragic events of September 11, 2001. Indeed, some of the countries that previously had been reluctant to engage in new WTO talks became key allies in the war on terrorism and supported the launch of new negotiations.

After an early flush of activity, spurred by the passage of TPA and marked by radical US proposals to slash agricultural protection and to eliminate industrial tariffs by 2015, the negotiating momentum soon

18. WTO negotiations elicit incremental reforms from the now 148 member countries, although the least developed countries generally are required to make only token contributions.

ebbed. Many WTO members were skeptical that the United States would abandon the generous new subsidies promised in its 2002 farm bill, or that the European Union would recast its Common Agricultural Policy. In addition, the Doha Round was burdened by sharp differences on access to medicines and WTO obligations on patents and strident demands from developing countries for special and differential treatment.

Talks languished until the summer of 2003, when EU negotiators finally received a new negotiating mandate on agriculture. By that point, Geneva negotiators had failed to meet their assigned deadline to agree on "modalities" for farm trade talks. Indeed, Geneva officials missed *every* negotiating deadline set in the Doha Declaration, leading ministers to inaugurate a series of ad hoc meetings, called "mini-ministerials," to try to circumvent the roadblocks erected in the WTO talks in Geneva. While these meetings achieved at least an interim solution to the dispute on patent rights and access to medicines, they failed to narrow differences on agriculture—especially regarding cutbacks in subsidies disbursed by the United States and the European Union—which was a high priority for many developing countries.

Fearing failure at the upcoming WTO ministerial in Cancún, Mexico, in September 2003, participants at the July 2003 mini-ministerial held in Montreal asked US and EU trade officials to put forward a new proposal on farm trade reform before the Cancún meeting. The subsequent US-EU proposal closely followed the recently minted EU negotiating mandate and called for few changes in existing US and EU farm policies. The reaction was immediate and harsh; Brazil, China, India, and South Africa organized a new coalition of prominent developing countries (the G-20) to oppose the transatlantic proposal.[19] The backlash against the US-EU compromise contributed importantly to the breakdown in negotiations at Cancún.

The G-20 was founded—and still exists in large measure—to push the United States, Europe, and Japan to liberalize their barriers to agricultural trade. That position is not antithetical to US interests and objectives in the Doha Round, provided that the large and middle-income developing countries in the group also reduce barriers to trade in their markets. Indeed, the United States and Brazil share key objectives regarding agriculture in the WTO and should be working together to advance their common interests.

WTO members finally did agree in July 2004 on new guidelines for the negotiation of global trade reforms in agriculture, industrial products, and services. Members also agreed to launch new negotiations on customs reform and other so-called trade facilitation measures and to delete

19. While united on their demands for reform by industrial countries, the G-20 members could not agree on a common position for their own contributions, provoking the ire of US and other officials.

the other "Singapore issues" (investment, competition policy, and transparency in government procurement) from the negotiating agenda.

However, the progress achieved at that meeting simply revived talks that had been stalled since the failed Cancún ministerial in September 2003. Priority was given to clarifying negotiating options on agriculture. In the area of nonagricultural market access (NAMA), officials merely accepted as a basis for further negotiation the disputed text that had been tabled in Cancún. On services, the WTO Council offered only a charge to try harder to table requests and offers. In all areas, decisions on the most contentious issues were deferred.

Clearly, extensive work remains on all issues on the Doha Round agenda before hard decisions can be taken to reduce trade barriers and trade-distorting subsidies protecting agriculture, manufacturing, and services industries. Substantial results will be needed in all three areas. To get the United States, Europe, and Japan to commit to significant reforms in long-standing protection in agriculture and some manufacturing sectors, other WTO members—including middle-income developing countries—need to offer concrete reductions in their protection as well. To date, developing countries have objected to lowering their own generally much higher trade barriers without increased and more secure access to industrial markets. Now that the United States, European Union, and Japan have signed onto the new WTO framework for farm negotiations, signaling their willingness to change their current policies *in the context of an overall WTO deal*, substantive talks can be reengaged in all areas of the Doha Round agenda.

The next big test of the Doha Round takes place in December 2005 at the WTO ministerial in Hong Kong. That meeting will surely not conclude the negotiations but needs to produce an agreement on specific numbers or ranges for the depth of cuts in agriculture and NAMA and on specific areas in which countries will commit to augment existing GATS obligations.[20] Only then can negotiators develop a final package of agreements—hopefully limiting exceptions and special treatment for sensitive products—a task that will take at least another year. Thus, a more realistic deadline for the Doha Round may now be the expiration of TPA in June 2007 (if extended by Congress in 2005).

Agriculture, of course, holds the key—though not because of its importance in international trade (less than 10 percent of global merchandise trade). Farm trade barriers remain high in both developed and developing countries, and many developing countries could reap large dividends from policy reform. Without agricultural reforms, developing countries probably will balk at liberalizing their own trade barriers in services and

20. Including in the area of labor services, where reforms could yield new export opportunities for developing countries. But commitments will need to be carefully tailored to safeguard security interests and to avoid conflict with immigration policies.

industrial products—which are generally much higher than those in the OECD area. Without contributions in those areas by at least the middle-income developing countries—including market access reforms—it is hard to see how the OECD countries could agree on a deal to sharply reduce farm subsidies and border protection. In short, a big package of farm reforms may be the sine qua non of the overall Doha Round accords.

Based on the WTO Council decision in July 2004, WTO negotiators agreed to eliminate export subsidies, substantially reduce domestic farm support that distorts prices and production decisions, and implement tariff cuts/quota increases that expand trade opportunities for foreign suppliers. Concrete results are needed in all three areas of the agricultural negotiations for the Doha Round to succeed.

Eliminating export subsidies is the easiest of the three tasks. European farm reforms and higher world prices have reduced the size of total European export subsidies from about $10 billion a decade ago to $3 billion in 2003, slightly more than US payments. The Europeans agreed to eliminate these subsidies by a fixed date, provided that the export subsidy component of US export credits and food aid programs is also removed. Such "parallelism" will require revisions in both programs to prohibit credit maturities of more than six months and to avoid food aid shipments that displace commercial sales. The most difficult issue in this area is whether the operation of state trading enterprises (such as the Australian and Canadian Wheat Boards) confers benefits akin to export subsidies.

Domestic subsidies account for the bulk of the payments provided by governments to their farmers for production and income support, research and development, and conservation and other environmental purposes. WTO members agreed in the Uruguay Round to cut these subsidies by 20 percent from a level calculated as their Aggregate Measure of Support (AMS). But WTO negotiators adopted an intricate set of "accounting principles" to determine which farm programs should be included in the cuts and which should be exempted. Simply put, the AMS is adjusted to exclude certain de minimis payments, plus specific programs sheltered from cuts by placement in the blue box (minimally trade distorting) or green box (nondistorting). As a result, actual subsidy disbursements have been generally well below the maximum permissible amounts under the Uruguay Round Agreement on Agriculture.[21]

In the Doha Round, the conventional wisdom is that cuts in the AMS will average about 60 percent, but whether this will require a change in existing policies will depend on how much the de minimis thresholds are reduced, whether and how the blue and green boxes are redefined, and

21. For a detailed analysis of the WTO negotiations on agriculture, see Josling and Hathaway (2004).

whether value caps are placed on either of those types of exceptions. The WTO Council decision of July 2004 is vague on all of these issues—leaving to further negotiation, for example, whether US countercyclical payments (reconstituted under the 2002 farm bill) qualify for the blue box.

Market access reforms are the most contentious area of the farm trade talks. For many products, cuts in subsidies may not improve trading opportunities unless those reforms are implemented in conjunction with the liberalization of tariffs, the expansion and more flexible administration of tariff-rate quotas (TRQs), and reductions in other nontariff barriers (including sanitary and phytosanitary restrictions that are inconsistent with the letter or spirit of WTO obligations). The WTO Council decision left unresolved decisions on the type of formula to cut tariffs, how to impose lesser requirements on developing countries (plus whether to give the least developed countries a "free pass"), how to structure safeguard measures that could "temporarily" reverse agreed reforms, and—most importantly—exceptions for "sensitive" products.

What is a "sensitive" product? As a practical matter, a product is "sensitive" if it is subject to high trade barriers—usually a sure sign that the protection benefits influential political constituencies. "Sensitive products" will be spared the full thrust of reforms but will not be excluded from liberalization initiatives as they effectively were in the Uruguay Round. For the United States and European Union, this means that protection of livestock, dairy, and sugar must be scaled back from current levels. Japan and Korea will also need to open new trading opportunities for foreign suppliers of rice and beef. Much of the time spent on negotiations in these sensitive areas will involve how to minimize reforms without so diluting the farm package as to render the entire negotiation unacceptable. Without concessions in these sensitive areas, however, it will be difficult to obtain concrete results in other areas of the Doha Round of interest to manufacturing and services industries.

In sum, for the agricultural negotiations to succeed, developed countries will need to demonstrate their willingness to reduce both the absolute value of subsidies provided to their farmers and the tariffs, quotas, and other nontariff barriers that protect agriculture. Middle-income developing countries also will have to liberalize their restrictions (though to a somewhat lesser extent) to provide benefits for other poorer countries and OECD exporters. Concrete commitments can't be expected soon but could be forthcoming once the United States, European Union, and Japan proceed with their own domestic reviews of farm policy in 2006.

In industrial products, the best result would be to accept the US proposal to eliminate tariffs by 2015 (with some exceptions or longer implementation periods for developing countries). This is extremely unlikely: US apparel firms strongly oppose further trade reforms on top of the removal of MFA quotas; and many developing countries fear the impact of deep tariff cuts both on their trade preferences in industrial markets and

on their fiscal balances.[22] In any event, developing countries will not be asked to cut as deeply or quickly as developed countries. WTO members seem to agree, however, that the tariff-cutting formula should require deeper reductions for higher tariffs (i.e., "nonlinear" cuts). Such an approach would have the added advantage of mitigating problems with tariff escalation. In addition, WTO members may agree to remove tariffs and liberalize key nontariff barriers on a sector-by-sector basis (following the precedent of the Information Technology Agreement).

In services, the Doha Round negotiations provide a great opportunity to put flesh on the skeletal commitments to trade reform that WTO members undertook a decade ago in the Uruguay Round. Negotiations on services offer substantial promise on a sector-by-sector basis. Industrial countries seek reforms in infrastructure services where their industries are competitive (e.g., banking, insurance, telecom, energy, and air transport), while developing countries want new opportunities to provide labor-oriented services (e.g., health care, construction, and low-value-added information technology services). These talks are particularly important for the United States, which runs a substantial surplus in services trade. More than half the surplus is in business, financial, and other private services that are the focus of most reciprocal bargaining in the GATS negotiations. Catherine L. Mann (in her chapter in this book) calculates that a large portion of the prospective US gains from the Doha Round derive from liberalization of traded services.

The original framework of WTO rules on services, embodied in the General Agreement on Trade in Services (GATS), did not require significant liberalization of services trade barriers. Instead, WTO members committed to continue negotiations on basic telecommunications and financial services (concluded in 1995 and 1996, respectively) and movement of natural persons (i.e., "mode 4" labor services), and to restart broader negotiations by 2000 "with a view to achieving a progressively higher level of liberalization" (GATS Article XIX:1). The new accords required almost no changes in US and European laws and regulations and mostly codified existing policies of developing-country signatories that had been revamped in response to financial crises of the 1990s. Sectoral talks on labor services were abandoned until the new services talks began in 2000.

Despite starting before the launch of the Doha Round, services trade negotiations have lagged; most countries have not even tabled offers. The WTO Council decision of July 31, 2004, simply asks members to submit new offers by May 2005.

The challenge in the Doha Round is twofold: broaden the scope of services reforms under existing GATS obligations and augment the GATS rules to take account of important technological changes (e.g., electronic

22. Some Caribbean countries, for example, derive 25 to 40 percent of total government revenues from trade taxes. See Schott (2001, table 2.10).

commerce) that increasingly affect international transactions of goods and services. The task will not be easy. Most GATS disciplines apply only to services that are listed in national schedules, and getting countries to top up their offers requires sector-by-sector and country-by-country efforts. Moreover, creating new trading opportunities often requires reform of domestic regulatory policies—a contentious process when the regulations also reflect national security and other noncommercial objectives.

For US providers of financial, telecom, air transport, and other services, this is an area where developing countries in particular can make valuable contributions to global trade reform. Some of those countries are now working constructively on a big package of services reforms—but they want in turn access to US and other industrial markets for their labor-intensive services. A big deal on services is possible, but only if the United States and others negotiate seriously on all areas of the GATS agenda, including labor services. To date, however, Congress has tied the hands of US negotiators by forbidding coverage of visa and immigration issues in trade pacts—thus complicating efforts to negotiate the cross-border provision of temporary labor services (known as "mode 4" in GATS parlance).

In sum, the Doha Round will succeed only if WTO members agree to a big package of reforms in all the major areas under negotiation. Major trading nations, both developed and developing, will have to undertake reforms in long-standing trade barriers. Poorer countries should be given more flexibility in liberalizing their border restrictions but should be encouraged to do so over time through a combination of trade concessions and development assistance from the industrial countries.

Reviving the Free Trade Area of the Americas

A decade ago, leaders of the 34 democratic nations in the Western Hemisphere agreed at the Summit of the Americas in Miami to negotiate a Free Trade Area of the Americas (FTAA) by January 2005. Trade ministers formally launched negotiations in 1998. The United States and Brazil assumed the cochairmanship of the FTAA negotiations in November 2002 and are supposed to remain in that leadership position for the duration of the talks. The decision to share this task between the dominant economies of North and South America makes sense, since the ultimate success of the hemispheric accord depends importantly on bridging the gap between the positions of the two countries.

Like the Doha Round, the FTAA negotiations stalled due to differences over agriculture and the inclusion of issues like investment and intellectual property in the overall package of agreements. As a result, the trade talks will extend well past the original deadline and probably will proceed in parallel with the Doha Round for another two years or so—here again, the timetable probably is linked to TPA.

The recent progress in the Doha Round has reopened prospects for reviving the FTAA talks, which have not advanced since the last FTAA ministerial meeting in Miami in November 2003. Under pressure "not to fail" so soon after the WTO fiasco in Cancún, trade ministers issued a declaration at the Miami meeting that simply papered over major substantive disputes. The FTAA process did not break down, but Miami's muddled mandate raised additional stumbling blocks.

At the Miami meeting, ministers "affirmed their commitment to a comprehensive and balanced FTAA" (paragraph 5), which includes "provisions in each of the [FTAA] negotiating areas" (paragraph 10). However, countries were permitted to take specific issues or products off the table, and some "countries may assume different levels of commitments" (paragraph 7). If other countries want to do more, say on investment, they could enter into so-called plurilateral agreements that obligate only those countries that sign the specific pact.

In essence, the Miami Declaration presaged a "hollow core" agreement in which individual countries could avoid committing to reforms in politically sensitive areas (hence "FTAA-lite"). Thus, if Brazil and others did not want to negotiate on investment and intellectual property issues, they could opt out of a hemispheric accord in those areas while the United States and others could adopt a more comprehensive accord among a subset of FTAA participants (probably the same countries that already have signed FTAs with the United States). The value of this plurilateral approach is unclear, since there is little "additionality" if the plurilateral pacts only involve existing US FTA partners. At best, plurilateral pacts would harmonize the terms of existing FTAs by, inter alia, augmenting Canadian obligations in NAFTA and unraveling politically sensitive compromises on FTA origin rules for textiles, clothing, and agricultural products. Such a result is highly unlikely. A more limited outcome would not seem sufficient to justify the political cost/risk of going back to Congress for another vote on these pacts.

By suggesting the possibility of an "FTAA-lite"—i.e., allowing countries to exclude trade reforms in sensitive areas like agriculture, intellectual property, and services—the Miami Declaration opened loopholes that substantially reduce the prospect of achieving a "balanced" package of agreements.[23] Not surprisingly, the talks have drifted since then while US and Brazilian negotiators switched their focus to both the WTO and other FTA initiatives. For Congress to approve changes in existing US trade barriers of interest to Brazil and other Latin American countries, US negotiators need to receive concrete commitments that open access to those markets for US exporters and investors. In short, the FTAA has to be a big deal, or the deal won't fly.

23. Furthermore, a so-called FTAA-lite agreement probably would run afoul of the requirements of US TPA and also could trigger a WTO challenge based on GATT Article XXIV provisions due to extensive exceptions from the free trade obligations.

Crafting a free trade pact among 34 countries that span the world's richest and poorest, and largest and smallest, was never going to be easy. The task has been further complicated by the financial crises and political turmoil that beset many Latin American participants since the FTAA talks began, the US economic downturn in 2001–02, and the new security imperatives of the post-9/11 world.

However, the United States has important economic and foreign policy interests in the region that can be advanced by a successful FTAA (Schott 2001). The trade pact is the economic engine that drives hemispheric cooperation on a number of political, socioeconomic, and cultural issues (e.g., promoting education, strengthening the rule of law, and protecting the rights of indigenous peoples) that have been put forward in the Summit of the Americas process. Progress on the FTAA is critical to sustain efforts in these other areas.

To get the FTAA process back on track, ministers must recognize that the negotiations need to aim higher than the Miami 2003 mandate and thus will take longer to produce results. The next ministerial is slated for Brazil—now probably in 2005. At that meeting, ministers should reassess the state of play and redirect negotiators to fulfill the original Summit of the Americas mandate for a growth-enhancing FTAA.

What could be achieved? Eliminating all industrial tariffs is likely to be the basis of the deal, with some balance struck between US farm trade reforms and enhanced access to Latin American procurement and services markets. Smaller and poorer economies should be afforded longer transition periods to implement the free trade obligations, but not exemptions from the FTAA disciplines (see IGE 1997).

On agriculture, tariffs should be phased out over a 10-year period with only limited exceptions, and reforms of nontariff barriers should yield concrete market access benefits for other sensitive products (even if some protection is left intact). Trade problems related to domestic subsidies cannot be resolved in the context of a regional agreement but could be substantially reduced in reforms likely to be accepted in the Doha Round. Regarding procurement, FTAA negotiators should be able to agree on principles that provide transparency for public tenders and guidelines for open tendering. In addition, such rules should be complemented by a commitment to negotiate within five years or so a list of entities whose purchases would be covered by these new obligations. Regarding services, the preferred outcome would be agreement on a "negative list" that covers all services subject to FTAA obligations except those explicitly listed, but the more likely outcome will simply augment WTO commitments on a sector-by-sector basis, with particular emphasis on infrastructure services and e-commerce.

In sum, the key to success in the FTAA is agreement on a big package of market access reforms, including agriculture and other goods and services. That means both liberalization of existing tariffs and quotas plus re-

form of regulatory and administrative practices that effectively impede the ability to sell in foreign markets (including discriminatory standards and customs procedures, sector-specific investment reforms, and import relief policies—particularly safeguards). Opening new opportunities for trade and investment in the hemisphere is a prerequisite to closing the FTAA deal and ensuring its ratification by national legislatures.

Upgrading NAFTA

By most standards, NAFTA has been a great success for all three countries, contributing to unprecedented growth in regional trade and investment. During its first decade, trade among the NAFTA partners doubled to more than $600 billion. Integration of the three economies has advanced—though the gains have been distributed unevenly within each country and mask adjustment problems besetting some workers and firms.

Since 9/11, however, the NAFTA partners have had to face a new and overriding challenge: addressing the added security measures needed to deal with recurring terrorist threats. Heightened security measures have made it more costly and cumbersome to move goods and people across borders and pose a particular challenge to businesses that have integrated their operations on a regional basis—one of NAFTA's great virtues. The "Smart Border" initiative concluded with Canada and the "Border Partnership Action Plan" with Mexico have been a good start. These initiatives are designed to both improve security and minimize delays. However, the basic structure of border inspections remains in place—and it was designed to collect tariffs and detect smuggling, not combat terrorism.

After a decade of progress, the three NAFTA partners still have important unfinished business. Trade and investment continue to be clouded by security concerns and residual restrictions; the region remains vulnerable to volatile energy prices and supply shortfalls; illegal immigration still confronts political leaders on both sides of the Rio Grande; and longstanding labor and environmental problems need to be redressed, particularly in the US-Mexico border region. For better or worse, many of these issues are linked politically.

For the United States, improving prospects for sustained economic growth in Mexico is critical to strengthening security on its southern border, while deeper cooperation with Canada on border-security initiatives is essential to ensure the efficient flow of goods and people across our long northern border. Mexico's economic prospects depend importantly on reforms of Mexican tax and energy policies and extensive new foreign investment in the energy sector, which has been barred for the past seven decades. This should be a stand-alone priority for Mexico, though political realities may require attention to the plight of Mexican migrants in the United States as an unstated quid pro quo. Plans for needed energy

infrastructure investments will have to balance economic considerations, sovereignty concerns, and environmental effects.

Updating and deepening North American economic integration merits priority attention for both economic and security reasons. New initiatives in the areas of trade, energy, and migration could help deal with pressing problems in each country, while promoting closer security ties to better handle aftershocks of future terrorist attacks. The key is to find the right combination of economic and security initiatives that will spur political leaders of all three countries into action.

First, the NAFTA countries should deepen the trade bargain. While creating a customs union may not be feasible, the three partners could move toward a common external tariff (CET) by lowering and gradually harmonizing MFN tariffs on industrial goods. Though desirable, extending a CET to agriculture probably would overload the political circuits. Even so, a CET would have several advantages: it would reduce the cost of imported goods, mitigate concerns about the protectionist impact of NAFTA rules of origin (since cutting MFN tariffs dilutes the value of the regional tariff preferences that are conditioned on meeting the origin rules), and promote liberalization that would also contribute to the success of the Doha Round. However, a CET would not resolve vexing problems long immune to negotiated fixes, most notably regarding softwood lumber, wheat, and sugar, and countervailing and antidumping duties.

Second, the NAFTA countries need to jointly develop a North American energy security policy that promotes regional production and trade, as well as the buildup of strategic reserves and production capacity in the event of overseas supply disruptions. Since 9/11 and especially since the Iraq war, concerns have resurfaced about the adequacy of North American production of oil and gas in light of problems in the Persian Gulf region and soaring oil prices. Development of oil and gas fields, as well as construction of new energy distribution channels,[24] is a high priority—though for somewhat different reasons—in both Canada and Mexico as well.

The United States, Canada, and Mexico share a common interest in expanding regional energy production, especially oil and natural gas. The US-Canada energy infrastructure is already fairly well integrated, but distribution of energy supplies continues to face obstacles arising from different regulatory policies both within and between countries. In contrast, US-Mexico energy relations continue to be sharply constrained by Mexico's constitutional prohibition against foreign participation in the exploitation of oil and gas. Amending the Mexican constitution will be a difficult task; even incremental energy reforms are problematic. Recognizing the political roadblocks, Mexico will nonetheless have to rethink its oil policies in

24. The blackout that deprived 50 million Americans and Canadians of electricity in August 2003 underscored the problems of aging electrical transmission lines.

the near future to avoid major power shortages and to ensure the success of its development strategies. Necessity may be the mother of intervention. If so, reforms in US immigration policies could provide added incentives for binational cooperation in both areas.

Third, the three countries should coordinate more closely regarding their immigration regulations, starting with common visa standards for most non-NAFTA visitors and immigrants. This goal is highly significant from a security standpoint. For people arriving from outside the NAFTA region, the North American countries need a shared system for excluding non-NAFTA nationals who pose a security threat. In addition, NAFTA partners should develop common document and biometric identification standards for all non-NAFTA visitors. In short, homeland security requires a regional perspective as well.

Refocusing US Strategy on Free Trade Agreements

In the United States, FTAs surfaced as a policy option in the early 1980s and have become a staple of US trade policy in recent years. The FTA with Israel served as the pilot project for this new policy; the Canada-US FTA followed soon after, reinforcing the extensive economic integration already occurring in the North American market and offering negotiating options if new multilateral trade talks stalled (Schott and Smith 1988). This message was echoed at the start of the NAFTA negotiations, which began in 1991, a few months after the GATT ministerial in Brussels in December 1990 failed to conclude the Uruguay Round (Hufbauer and Schott 1992, 42–43). In the aftermath of the failed Seattle WTO ministerial in December 1999, the Clinton administration pursued bilateral FTAs with Jordan, Chile, and Singapore.

As of November 2004, the United States has ratified FTAs with Israel, Canada, Mexico, Jordan, Singapore, Chile, Australia, and Morocco. In addition, FTAs have been signed with the five Central American countries, the Dominican Republic, and Bahrain, and await congressional approval. FTA talks are currently in progress with the five members of SACU, Thailand, Colombia, Ecuador, Peru, and Panama, as well as the other countries in the Western Hemisphere negotiating the FTAA.

Current FTA partners account for more than one-third of total US merchandise trade. Upon completion and ratification of the other bilateral FTA negotiations and the FTAA, more than 43 percent of total US trade, and half of US exports, will be covered by free trade pacts (table 8.4).

To date, most US free trade initiatives have involved Western Hemisphere countries with which the United States is also negotiating the FTAA. Those current and prospective FTAs can be seen as way stations to the larger hemispheric agreement. However, this incremental approach to building the FTAA does not cover Brazil and other countries that account for almost 50 percent of Latin America's GDP.

Other US FTA initiatives involve countries that also are engaged in regional integration arrangements in their own neighborhood. In both southern Africa and southeast Asia, and to a lesser extent in North Africa and the Middle East, US initiatives seek to create new bilateral trade and investment opportunities with and to deepen the integration among the partner countries. Except for southeast Asia, where US merchandise trade and investment with the Association of Southeast Asian Nations (ASEAN) is substantial (about $127 billion in 2003), US economic ties with these other FTA partners are small.

Assuming TPA is extended, the next administration will need to decide whether to continue the ambitious program of bilateral FTAs, and if so, which negotiations to give priority. At the same time, US officials will need to finish ongoing bilateral FTA negotiations. In addition, there is a possibility that the CAFTA will need to be embellished to mitigate opposition from labor and environmental groups that threaten to block congressional approval of the pact.

Based on extensive analysis of and recommendations for US FTA policy reported in Schott (2004), and cognizant of the significant negotiating resources that will have to be devoted to completing the Doha Round, US trade officials should focus on fewer but bigger FTAs, with three distinct objectives:

- complete the FTAA;
- preempt/offset discrimination against US exporters/investors generated by current and prospective FTAs among other countries; and
- consolidate regional negotiations in southeast Asia and the Middle East and North Africa when the largest countries in those regions (i.e., Indonesia and Egypt, respectively) are ready to engage in FTA talks.

The FTAA is the biggest US free trade initiative and merits priority attention. Election year politics have constrained US and Brazilian offers to reduce their main trade barriers, but new efforts should be made at the next FTAA ministerial in Brazil—as noted above—to reengage negotiations on liberalization of goods and services in the hemisphere. A deal will not get done unless the leading economies of North and South America bridge their differences and offer concrete new opportunities for their exporters and investors in each other's markets.

Second, US officials should prepare for new talks with Korea and Japan in the next few years. The current line-up of FTA initiatives is notable for its length as well as for its exclusion of countries in one important region, northeast Asia. That omission is explained by the fact that Japan and Korea have been unwilling to talk about key US demands in areas like agriculture. But trade policies are changing rapidly in East Asia, and events there may lead to new initiatives in the near future.

Why? Part of the impetus for US officials to pursue FTAs is to redress discrimination generated by pacts to which a country is not a party. This factor will gain prominence if Japan and Korea conclude a bilateral trade pact as well as FTAs with other countries in East Asia. Japanese-Korean trade covers many of the same products that US firms export to both countries; US firms could suffer trade diversion of key US exports such as semiconductors and telecommunications equipment (Schott and Goodrich 2004). US industries and farmers will demand that trade officials "level the playing field" by negotiating similar trade preferences with Japan and Korea.[25] So by later this decade, one may well see a new burst of US FTAs with Asia-Pacific countries or a rash of new trade friction between the United States and its northeast Asian trading partners.

Third, new initiatives should target big countries that drive regional integration efforts in southeast Asia and the Middle East and North Africa region. The prospect of concluding FTAs with the United States could energize domestic economic and political reforms in countries like Indonesia and Egypt that are needed to meet the requirements of a comprehensive free trade pact. At the same time, such reforms could spur integration initiatives among countries in those regions and thus help advance the broader goals of the US Enterprise for ASEAN Initiative and the Greater Middle East FTA.

Conclusions

The United States can achieve important economic and foreign policy objectives if it continues to pursue a broad set of trade pacts and if it underpins those efforts with domestic programs that bolster competitiveness and facilitate adjustment of US firms. To do so, the new administration needs to set its trade policy priorities right from the start.

First, US officials need to ask Congress to extend TPA so they can complete ongoing WTO and FTA negotiations. Without TPA, US trade policy will be severely constrained for the duration of the administration's term in office. Note, however, that TPA is necessary, but not sufficient, to ensure that the United States maximizes its benefits from trade agreements. New farm legislation also is needed to induce trade reforms abroad and to reduce the domestic budget deficit. In addition, TPA needs to be complemented by domestic policies that enhance the competitiveness of US firms and workers so that they can better take advantage of the new opportunities created by foreign trade liberalization, plus new or expanded programs that help manage the adjustment burdens of those adversely affected by the resulting restructuring in the US market.

25. New US FTA initiatives could prompt agricultural and services-sector reforms in those countries that will have to be pursued in any event to fulfill the likely demands of the WTO talks.

Second, the administration should give priority to concluding the Doha Round of WTO negotiations. The WTO talks provide the biggest bang for the US negotiating buck, the only practical venue for confronting farm subsidy problems and the only channel for improving rules and fixing flaws (particularly in the dispute settlement system) in the multilateral trading system. Concerns about FTA trade preferences and discrimination would be more pronounced in the absence of such efforts.

Third, the administration should give priority to upgrading NAFTA and to "big stakes" FTAs—particularly the FTAA—that also yield substantial payoffs for US firms, workers, and farmers. It is important to emphasize, however, that the substantial US gains from these efforts result from both the liberalization of trade and investment by US trading partners and the *reductions in US trade barriers and subsidies*. Big FTAs can yield larger benefits than those generated by many recent US FTAs but will also require significant US adjustment.

In sum, the United States should continue to pursue a multitrack approach to trade negotiations but devote more resources and effort to address the significant challenges facing US workers, farmers, and firms as they compete in markets at home and abroad.

Lowering foreign trade barriers and reducing home-grown impediments to the competitiveness of US firms and workers can open up substantial new trading and investment opportunities and promote better relations with more prosperous and stable trading partners.

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