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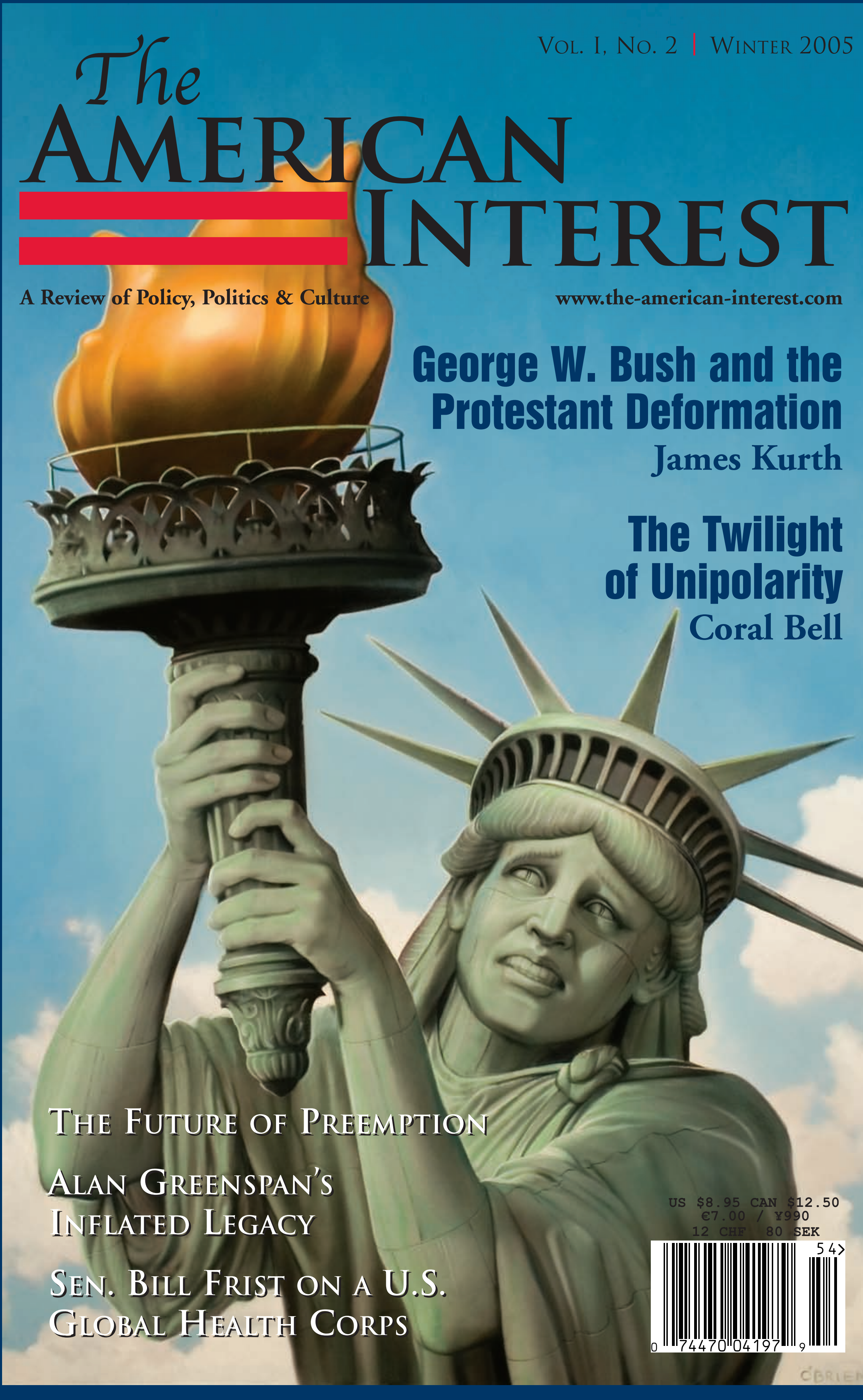

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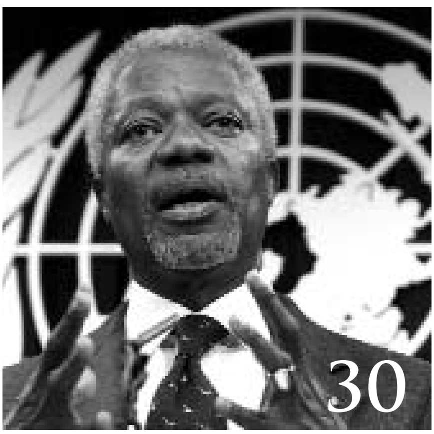

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TRADE TALK

– By Daniel Drezner

American perceptions about international trade have changed dramatically in the past two decades. Presidents can no longer craft positions on foreign economic policy in a vacuum. Trade now intersects with other highly politicized issues, ranging from the war on terror to environmental protection to bilateral relations with China. Old issues such as the trade deficit and new issues such as offshore outsourcing have made a liberal trade policy one of the most difficult political sells inside the Beltway.

Indeed, shifts in domestic attitudes have created the least hospitable environment for trade liberalization in recent memory. Unfortunately, this inhospitable environment has arisen at a time when trade is more vital to the U.S. economy than ever. The challenge for this President and for those who succeed him will be to reinvigorate U.S. trade policies despite the current public mood. In short, it is the challenge to lead.

The first thing any president must do to lead effectively on economic issues is to persuade the country that trade matters. This should not be that hard, for trade manifestly does matter. In 1970 the sum of imports and exports accounted for less than 12 percent of U.S. GDP; by 2004 that figure had doubled to 24 percent. Approximately one out of every five factory jobs in the United States depends directly on trade. U.S. exports accounted for approximately 25 percent of economic growth during the 1990s, supporting an estimated 12 million jobs. U.S. farmers export the yield of one out of every three acres of their crops. In 2003 the United States exported $180 billion in high-tech goods and more than $280 billion in commercial services. From agriculture to manufacturing to technology to services, the U.S. economy needs international trade to thrive.

Researchers at the Institute for International Economics recently attempted to measure the cumulative payoff from trade liberalization since the end of World War II. Scott Bradford, Paul Grieco and Gary Hufbauer conservatively estimated that free trade generates economic benefits ranging from $800 billion to $1.45 trillion dollars per year in added output. This translates into an added per capita benefit of between $2,800 and $5,000—or, more con-

Daniel Drezner *is assistant professor of political science at the University of Chicago and author of* U.S. Trade Strategy: Choices and Consequences*, to be published by the Council on Foreign Relations in December 2005. This article is adapted from a chapter of the book.*

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Indian employees at a call center in Bangalore.

cretely, an addition of between $7,100 and $12,900 per American household. The gains from future trade expansion have been estimated to range between $450 billion and $1.3 trillion per year in additional national income, which would increase per capita annual income between $1,500 and $2,000. There are few tools in the U.S. government's policy arsenal that consistently yield rewards of this magnitude.

Trade expansion brings several benefits to the U.S. economy. It allows the United States to specialize in making the goods and services in which it is most productive. The bigger the market created by trade liberalization, the greater the benefits from specialization. Trade also increases competition within economic sectors. Over the past decades economists have repeatedly shown that industries exposed to trade are more productive than sectors in which cross-border exchange is limited or impossible. As available markets expand, the rate of return for technological and organizational innovations increases. With freer trade, firms and entrepreneurs have a greater incentive to take risks and to invest in new inventions and innovations.

These benefits also make it easier for the Federal Reserve to run a bullish monetary policy. An open market is a significant reason why the United States has been able in recent years to sustain robust economic growth, dramatic increases in labor productivity, low unemployment, modest inflation and historically low interest rates. The combination of these effects boosts the trajectory of feasible economic growth without triggering inflation, which in turn has allowed the Fed to pursue more expansionary monetary policies than would otherwise have been possible.

Trade is equally vital to American foreign policy. The regions of the world that have embraced trade liberalization—North America, Europe and East Asia—contain politically stable regimes and, despite some problems with radical Islamist minorities, make our best partners in the war on terror. The regions of the world with the most tenuous connection to global markets—the Middle East and Africa—are plagued by unstable regimes and remain hotbeds of terrorist and criminal activity. Trade is not a silver bullet for U.S. foreign policy; many other factors affect the rise of terrorism and political instability. Nevertheless, trade is a handmaiden to hope. It provides significant opportunity to individuals in poor countries, offering a chance for a better life for them and their children. Creating hope among people is a powerful long-term weapon in the war on terror.

Multiple economic analyses demonstrate that trade promotes economic freedom and economic development. Trade will be essential to advancing the Millennium Development Goals of halving global poverty by 2015. Exposure to the global economy correlates strongly with the spread of democracy, the rule of law and the reduction of violence.

Over the long term, trade liberalization is a win-win proposition among countries and therefore serves a useful purpose in promoting American interests and values. Most of the time, trade helps to reduce frictions between countries and serves as one of the most powerful tools of soft power at America's disposal. Bilateral relations have improved with every country that has signed a free-trade agreement (FTA) with the United States. If countries perceive that the rules of the global economic game benefit all participants—and not merely the United States—these countries will be more favorably disposed toward the United States on other foreign policy dimensions.

Over the very long term, U.S.-led trade expansion can cement favorable perceptions of the United States among rising powers. Both the CIA and private sector analysts project that China and India will have larger economies than most G-7 members by 2050. Decades from now, it would serve American interests if these countries looked upon the United States as a country that aided rather than impeded their economic ascent. Trade liberalization undertaken now serves as a down payment for good relations with rising great powers in the future.

OUR AMBIVALENT PUBLIC

Despite these significant economic and diplomatic benefits, the American public is increasingly hostile to freer trade. Between 1999 and 2004, public support for free trade dropped off a precipice. The most dramatic shift in opinion came from Americans making more than $100,000 a year: Support for promoting trade dropped from 57 percent to 28 percent in this group. According to a July 2004 poll jointly conducted by the Pew Research Center and the Council on Foreign Relations, 84 percent of Americans thought that protecting the jobs of American workers should be a top priority of American foreign policy. The same month, a poll conducted by the German Marshall Fund of the United States concluded that only 4 percent of Americans still supported NAFTA. Americans are also less enthusiastic about further international trade deals than are Europeans: 82 percent of the French and 83 percent of the British want more international trade agreements, compared to just 54 percent of Americans.

Hostile attitudes toward trade liberalization are even more concentrated when the focus turns to newer forms of trade, such as outsourcing. In 2004 at least ten different surveys asked Americans how they felt about the growing number of jobs being outsourced overseas. The results were consistently and strongly negative. Depending on the poll, between 61 and 85 percent of respondents agreed with the statement that outsourcing is bad for the American economy. Between 51 and 72 percent of Americans were even in favor of the government penalizing U.S. firms that engage in outsourcing. In a Harris poll taken in May and June of 2004, 53 percent of Americans said U.S. companies engaging in outsourcing were "unpatriotic." This hostility remains consistent regardless of how respondents are categorized. A 2004 *CFO Magazine* survey of chief financial officers revealed that 61 percent of them believed outsourcing was bad for the economy, while an April 2004 Gallup poll showed 66 percent of investors believed outsourcing was hurting the investment climate in the United States.

Free traders assert that greater liberalization will always benefit the economy. The polling data reveal that most Americans do not buy the "always", and instead believe in "fair trade." They believe that the expansion of trade leads to an increase in economic insecurity that outweighs any increase in national income. A fair-trade doctrine recommends the use of safeguards, escape clauses and other legal protections to slow down the economic and social effects of import competition. Such views have become dominant in the United States over the past two decades. But why?

THE IRON LAWS OF TRADE POLITICS

Three political facts of life have caused many Americans to shift their support from free trade to fair trade. First, during economic downturns or periods of slack job growth, public suspicion of free-trade policies explodes into hostility. Inevitably, foreign countries become the scapegoat for business cycle fluctuations that have little to do with trade. When presented with economic theories and statistical data on the one hand showing that trade is good for the economy, and anecdotes of job losses due to import competition on the other, most Americans are swayed by the anecdotes. There may be no discernible economic correlation between trade and overall employment, but many Americans believe there is one—a belief that policymakers ignore at their peril.

Combine this with a massive trade deficit and the perception problem becomes even more acute. Most Americans think a large trade deficit is bad for the economy, even though such deficits correlate *positively* with strong economic growth. Indeed, the growth in the trade deficit since 1998 has been accompanied by strong GDP growth and excellent productivity gains. Nevertheless, the U.S. trade deficit is projected to top $670 billion this year—in absolute dollar terms, the largest trade deficit in world economic history. In an uncertain economy, that number will lead to greater public skepticism about the merits of freer trade. To be sure, there are valid reasons to be concerned about the size of the current account deficit, but even those economists who voice such concerns do not recommend higher tariffs as the answer.

The second reason American support for

free trade has dropped is that it is particularly difficult to make the case for trade expansion during election cycles. Trade generates large, diffuse benefits but concentrated—if smaller—costs. Those who bear the costs are more likely to vote on the issue—and make campaign contributions based on it—than those who reap the benefits. In this situation, politicians will always be tempted to engage in protectionist rhetoric. The latest example of this came when politicians on both sides of the aisle demanded government action to halt outsourcing. As election cycles continue to lengthen, this political temptation will only get stronger.

The third iron law of trade politics is that both advocates and opponents talk about trade in ways that simultaneously inflate its importance and frame the issue as a zero-sum proposition. Trade is both blamed and praised for America's various economic strengths and ills, even though domestic factors such as macroeconomic policy, stock market fluctuations and the pace of innovation are far more significant determinants of America's overall economic performance. Politicians routinely address trade issues by discussing how changes in policy will affect the trade deficit. The implicit understanding in their arguments is that it is better to run a trade surplus than a deficit, even though there is no economic data to support that view. Debates about trade inevitably revolve around the question of jobs, even though trade has a minimal effect on aggregate employment levels.

We should be used to this by now. A decade ago, the political debate over NAFTA was framed in terms of job creation and job destruction, despite the fact that every sober policy analysis concluded that NAFTA would not significantly affect the employment picture in the United States one way or the other. As a result, even politicians who advocate trade liberalization do so by focusing on increasing American exports and downplaying imports. If politicians talk about trade in a mercantilist, zero-sum way, Americans will be led to think about the issue this way as well.

NEW CONSTRAINTS ON TRADE POLITICS

The next presidential election is three years away. The economy has created a net gain of nearly 2 million new jobs in the past year, so the public should be more receptive to a discussion of free trade now than it was a year ago. Public opinion polls, however, say otherwise. Part of the reason is that, in a world of high oil prices and frequent natural disasters, many Americans remain nervous about the state of the American economy. A bigger part of the problem, however, is that new trade-related issues have made talking about trade policy more difficult than before. Even as the economy continues to add jobs, there are sound reasons to believe that public antipathy toward trade liberalization will not abate. If anything, it will increase.

One new problem is that the percentage of the American economy exposed to international competition is on the rise. Over the next decade, technological innovation will convert what have been thought to be non-tradable sectors into tradable ones. Trade will start to affect professions that have not changed their practices all that much for decades—fields such as accounting, medicine, education and law. This will increase the number of Americans who perceive themselves to be vulnerable to international competition and economic insecurity. This insecurity is the driving force behind the growing hostility to free trade among the upper income brackets.

Another relatively new issue is the rise of China. Twenty years ago, there was a great deal of American hand-wringing at the prospect of Japan "overtaking" the U.S. economy. For *realpolitik* reasons, the current fear of China's economic rise will be worse. At least Japan was a stable democratic ally of the United States. China is neither democratic nor an ally, and the jury is still out with respect to its long-term stability.

Beijing has brought some of this enmity on itself. China's central bank has increasingly intervened in foreign exchange markets to maintain the dollar's strength against the yuan, even though China's currency has risen in value compared to other major currencies. In July 2005, China's central bank announced a slight devaluation against the dollar, with an intention to move to a managed float. However, Beijing has continued to purchase dollars at an extraordinary rate, ensuring that the yuan will not appreciate significantly anytime soon. China's interventions have exacerbated the U.S.-China trade deficit: In 2004 the bilateral deficit was a record $162 billion.

These practices—combined with China's high growth rate, the media firestorm over outsourcing and a recent flurry of Chinese corporate takeover efforts directed at U.S. firms—have created intense domestic pressures for some kind of retaliatory policy. In April 2005, a bill was introduced in the U.S. Senate that threatens a 27.5 percent tariff on Chinese goods unless Beijing revalues its currency; the bill garnered a veto-proof majority. In May, the House of Representatives proposed a different piece of legislation to widen the definition of exchange-rate manipulation to include China as an offender. Many congressmen reacted negatively to the proposed takeover of Unocal by the China National Offshore Oil Corporation, with the House passing a measure urging the President to block the purchase on national security grounds. This congressional hostility helped to scotch the proposed takeover.

China's economic growth and aggressive trade diplomacy also pose significant challenges to the United States from a security perspective. In 2004 China accounted for 31 percent of global growth in the demand for oil. China's energy diplomacy has led to ambitious deals with authoritarian regimes

CHINA'S ENERGY DIPLOMACY HAS LED TO AMBITIOUS DEALS WITH AUTHORITARIAN REGIMES.

in Myanmar, Iran and Sudan, and has placed China's diplomacy in all three cases at loggerheads with that of the United States. China's growing interest in commercial relations with other Pacific Rim countries contrasts with U.S. regional policy, which prioritizes the war on terror. At a fundamental level, even if the United States benefits from the bilateral trading relationship, China appears to benefit more—and that could clash with the stated *National Security Strategy* objective of "dissuad[ing] potential adversaries from pursuing a military buildup in hopes of surpassing, or equaling, the power of the United States."

The content of current trade negotiations has also made trade a tougher sell. World Trade Organization negotiations have shifted much of their focus away from tariff reduction to ensuring that disparities in national regulations do not interfere with international trade. In large part this is due to the WTO's success at reducing border-level trade restrictions. For most areas of merchandise trade (agricultural, textile and clothing products excepted), tariffs and quotas have been at nominal levels since completion of the Uruguay Round in 1994. As for agriculture and textiles, liberalization of either sector will not be an easy sell. The end of the Multi-Fibre Agreement in January 2005 has led to "bra wars" between the developed world and China, with the Bush Administration using every tool at its disposal to staunch the flow of textile imports. As for agriculture, the lack of progress in those negotiations now threatens to derail the upcoming WTO's Ministerial Conference in Hong Kong.

Increasingly, trade negotiations inside and outside the WTO have revolved around the residual non-tariff barriers to trade—social and business regulations. The most obvious examples include labor standards, environmental protection, consumer health and safety, antitrust, intellectual property rights and immigration controls. Because most regulatory policies were originally devised as domestic policies, they are more politically difficult to change than tariffs or quotas.

Some of these new trade negotiations will touch third rails of American politics. For example, developing countries are pushing in the WTO for greater liberalization in the trade of "Mode 4" services, in which the person performing the service crosses a border to do his or her job. The benefits of such liberalization for the United States economy would be significant; Microsoft chairman Bill Gates warned early this year that visa restrictions were limiting U.S. access to highly trained computer engineers from other countries, undercutting America's ability to innovate. Despite the economic advantages, however, such a move raises politically sensitive questions. One obvious concern would be the effect this kind of liberalization would have on homeland security. Another prominent concern would be the effect on U.S. immigration policies: Opponents would claim that the liberalization of trade in services was back-door immigration.

The American public's growing hostility to freer trade has made congressional passage of trade agreements more difficult, and this in turn has worsened the public image of trade. The victory margins in congressional votes for trade legislation have narrowed over the years. In December 2001, the Bush Administration secured Trade Promotion Authority by a single vote in the House of Representatives. (Trade Promotion Authority—which used to be called "fast track"—allows the president to submit trade deals for congressional approval via a simple up-or-down vote, preventing any poison-pill amendments.) In July 2005, the Central American Free Trade Agreement passed by only two votes, and that was after significant White House lobbying of wavering representatives. The smaller the margin of victory, the more leverage wavering representatives have to extract district-specific spending or trade-distorting measures that undercut the original purpose of the trade deal. As a result, congressional negotiations over trade agreements have begun to give off the same whiff of pork that comes with transportation and agricultural bills.

WHAT CAN BE DONE?

Can the public's turn against free trade perhaps be ignored? Political analysts and trade experts alike argue that the political significance of this attitudinal shift remains an open question. Americans are skeptical about the benefits of trade, but they are not particularly passionate about it. Polling data, purchasing behavior and experimental evidence all suggest that American consumers talk like mercantilists but purchase goods like free traders. It is difficult to point to specific members of Congress who have lost their seats because they adopted an unpopular position on trade policy.

That said, international trade is viewed as increasingly salient by many Americans. Now is not the time for a policy of trade expansion to lose political legitimacy. This is particularly true given the Bush Administration's full plate of trade issues for the next several years. At the top of the list is the Doha Round of WTO talks. Thorny negotiations remain on the liberalization of trade in services and the reduction of internal price supports and market restrictions for agricultural producers. The nominal deadline for these negotiations is the Hong Kong Ministerial Conference scheduled for December 2005. That deadline will not be met, but it cannot be extended indefinitely, since other countries will want to see the Doha Round completed well before the expiration of U.S. Trade Promotion Authority in 2007.

At the regional level, efforts to advance the Free Trade Area of the Americas and the Middle Eastern Free Trade Area Initiative are continuing, albeit at less than breakneck speed. At the bilateral level, the Administration has stepped up its use of free-trade agreements with favored allies. In the first term, FTAs were ratified with Singapore, Australia, Morocco and Chile. FTAs have been negotiated and signed with Bahrain and Oman. Negotiations with Panama, Peru, Ecuador, Colombia, Thailand and the United Arab Emirates are ongoing.

Can public attitudes be changed? The primary impediment to boosting public support for trade liberalization is not one of economics but of psychology. People *feel* that their jobs and wages are threatened. Even if the probability of losing one's job from import competition or outsourcing is small, the percentage of workers who know someone who has lost his or her job because of trade is much larger. In this sense, public perceptions about trade are akin to perceptions about crime: Knowing a victim of crime often makes the problem appear to be greater than it actually is. While these fears may be exaggerated, they are nonetheless real.

PSYCHOLOGY, NOT ECONOMICS, HOLDS DOWN PUBLIC SUPPORT FOR FREER TRADE.

If the Bush Administration decides to follow through on its ambitious trade agenda, it will need new strategies to counteract shifts in public opinion. The good news is that while the current political environment is challenging, it is not hopeless. Polling strongly suggests that a healthy majority of Americans—including skeptics of freer trade—supports policies that pair liberalization with policies that reduce the disruptions to groups that are negatively affected. These policies can take the form of expanded insurance opportunities, greater public investment in research and development, and retraining programs. The 2002 expansion of the Trade Adjustment Assistance program is a good first step, but more steps are needed: a wider use of wage insurance schemes, increased portability of health care coverage and including service-sector workers in assistance programs.

Another useful tactic would be to link trade to larger foreign policy priorities. One reason the United States was able to advance trade liberalization during the Cold War was the bipartisan consensus that a liberal trading system aided the cause of containment. Trade expansion can and should be presented as a critical element of the long-term grand strategy of the United States to spread democracy and defeat terrorism. Security arguments resonate with a broad majority of the American public. According to new polls, a large majority of Americans support promoting international trade with poor, democratic governments—a message consistent with President Bush's second Inaugural Address. As with the Cold War, a communications strategy that markets economic diplomacy as "America's first line of offense" would blunt the arguments of protectionists while promoting the virtues of trade liberalization. Greater presidential involvement in shifting public attitudes—including aggressive use of the bully pulpit—will be needed.

The alternative to blunting the shift in public opinion is to go with the flow. While politically expedient, adopting a more protectionist foreign economic policy will hurt the U.S. economy and ultimately undermine global stability. If barriers are placed on trade, the effect would be to preserve jobs in less competitive sectors of the economy and destroy current and future jobs in more competitive sectors. Trade protectionism would therefore lead to higher consumer prices, lower rates of return for investors and reduced incentives for innovation in the United States. The International Monetary Fund recently warned that trade protectionism in the United States would also magnify the negative effects of any global economic shock.

Ignoring public attitudes about trade is dangerous in the long run, and following the public mood on trade would be an unfortunate abdication of leadership by the Bush Administration in the short run. If the first step to recovery is recognizing that there is a problem, then responsible policymakers in Washington need to appreciate the extent to which the political terrain has shifted. The next step will be changing the American public's mind—a difficult but achievable task, if there is true leadership in the White House.

ON THE OTHER HAND...

Commerce produces money, money Luxury, and all three are incompatible with Republicans.

—John Adams

Commerce diminishes the spirit, both of patriotism and military defense, and would eventually destroy America's soul.

–Thomas Paine