FOREIGN AFFAIRS

A High-Risk Trade Policy

Bernard K. Gordon. **Foreign Affairs**. New York: July/August 2003. Vol. 82, Iss. 4; pg. 105

Subjects:	Free trade, Trade policy, Foreign policy, Trade relations
Classification Codes	9190, 1300, 1210
Locations:	United States, US
Companies:	World Trade Organization (NAICS: 928120)
Author(s):	Bernard K. Gordon
Article types:	Feature
Publication title:	Foreign Affairs. New York: July/August 2003. Vol. 82, Iss. 4; pg. 105
Source Type:	Periodical
ISSN/ISBN:	00157120
ProQuest document ID:	411186201
Text Word Count	4816
Article URL:	http://gateway.proquest.com/openurl?ctx_ver=z39.88-2003&res_id=xri:pqd&rft_val_fmt=ori:fmt:kev:mtx:journal&genre=article&rft_id=xri:pqd:did=000000411186201&svc_dat=xri:pqil:fmt=text&req_dat=xri:pqil:pq_clntid=11969

Abstract (Article Summary)

Washington's unwise return to economic "regionalism," evidenced by the many US efforts to build new bilateral or regional free trade agreements, threatens to damage both US foreign and US trade policy. The US should work instead to strengthen the World Trade Organization and the single world trade system it represents.

Full Text (4816 words)

Bernard K. Gordon

A STEP IN THE WRONG DIRECTION

Robert Zoellick, the U.S. trade representative and the main force shaping U.S. foreign trade policy today, combines prodigious negotiating skills with an equally solid background in realpolitik. Nevertheless, the current American approach to trade, over which he has presided, promises to severely damage U.S. foreign policy and trade. At the heart of the problem is Washington's unwise return to economic "regionalism" -- an approach evident in the many U.S. efforts now underway to build new bilateral or regional trade agreements with a number of small trading partners.

Washington's regionalism aims, in principle, to induce the world's major trade actors, especially Europe and Japan, to complete the broader, multilateral agenda of the World Trade Organization (WTO). This strategy is no secret; in fact, it has been publicly discussed several times. In a letter to the author in late 2001, for example, Zoellick wrote, I believe a strategy of trade liberalization on multiple fronts -- globally, regionally, and bilaterally -- enhances our leverage and best promotes open markets. As Europeans have pointed out to me, it took the completion of NAFTA [North American Free Trade Agreement] and the first APEC [Asia-Pacific Economic Cooperation] Summit in 1993-94 to persuade the EU to close out the Uruguay Round. I favor a "competition in liberalization" with the U.S. at the

center of the network.

Zoellick's description of events in the early 1990s is dead on. That was a time when the former main framework for world trade, the General Agreement on Tariffs and Trade (GATT), was notoriously in trouble -- "GATT is dead," economist Lester Thurow declared at the time -- and its weaknesses led to the establishment of the considerably more institutionalized WTO. American efforts were key to that change, and the WTO's present Doha Round of negotiations likewise owes much to Washington. Two recent and very bold American proposals -- dealing with trade in agricultural goods and industrial products -- could make the Doha Round the most successful round thus far.

Yet at the same time the United States has also accelerated its "free trade areas" policy, and these ftas -- precisely because they are not broadly multilateral -- are bound to cause serious problems. Aside from the conceptual and practical challenge they pose to the WTO (a point its leaders recognize and often condemn), regional ftas are also fundamentally incompatible with America's national interests. Nowhere is that incompatibility clearer than in East Asia, where local ftas are proliferating, and where all are justified as a necessary response to American initiatives.

China, for example, since 2001 has embarked on a mission to achieve a free trade area with all of Southeast Asia and has begun work on a similar arrangement in Northeast Asia. In direct response to that Chinese initiative, Japan has announced that it is ending its 50-year commitment to multilateral trade. Recognizing how large is its policy shift, Japan frankly calls it a "departure." Yet both countries, to explain and justify their new emphasis on regionalism, regularly blame the United States for starting the trend.

The Japanese shift dates to 1999, when the director of the Japan External Trade Organization (JETRO), Japan's foreign trade body, wrote that in a world of regional trading blocs, "we cannot prevail alone. We have to face reality. ... 26 of the world's 30 main economies were or would be partners in such [regional] accords -- the European Union, the North American Free Trade Agreement and the Association of Southeast Asian Nations' planned Free Trade Agreement (AFTA)."

Since then, and especially in light of China's economic successes and its announced FTA with the Association of Southeast Asian Nations (ASEAN), Tokyo has hardened its rhetoric still further. Old rivalries between Japan and China, among Asia's longest-standing, have resurfaced. Today, however, the antagonism is marked by an ascendant China and a possibly declining Japan. A Tokyo official put the issue simply: "If Japan does nothing, its economic leadership in East Asia would be taken over by the Chinese."

This new and developing competition between Beijing and Tokyo is not something Washington could possibly want. Nor would American interests be served by the most likely alternative: formal collaboration between China and Japan on East Asia's trade. Yet that is precisely the pattern now forming. Since early last year, and culminating in November 2002 -- when the foreign ministers of China, Japan, and South Korea met on the fringes of the annual ASEAN meetings -- evidence of such cooperation has proliferated, coming under the rubric of "ASEAN + 3" (or the reverse), which combines the ten ASEAN countries with Japan, China, and South Korea.

As many will remember, "ASEAN + 3" is exactly the model first proposed in the mid-1980s by Malaysian Prime Minister Mahathir bin Mohamad. He called at the time for an "East Asian Economic Caucus," a proposal that was quickly resisted and successfully put down by U.S. Secretary of State James Baker, who believed the Mahathir plan would in effect draw a line down the Pacific separating the United States from East Asia. Because the grouping would also have excluded Australia, New Zealand, and Canada, it was quickly labeled a "caucus without Caucasians," and those racist overtones have been perpetuated by the fact that ASEAN continues to rebuff Australia's membership.

LESS IS LESS

The growth in regionalism was thrown into new and urgent focus earlier this year, when preliminary 2002 trade data were released. Most attention centered on Japan because, for the first time since 1961, Japan imported more from China than from the United States. Similar dramatic changes were reported by the other East Asian economies. Taiwan and South Korea, along with the principal ASEAN nations, all recorded 50 percent increases in their exports to China in 2002, while their exports to the United States remained flat.

This was sobering news, but it should not have been surprising. Signs of change, particularly of a relatively reduced U.S. trade presence in East Asia, have been evident since at least the mid-1990s. Those signs were discounted or

ignored by many observers because they ran counter to the widespread belief that large and growing exports from Asia to the United States were a reliable fixture of the environment. Indeed, the "Asian miracle" analysis identified exports to the United States as a key element in East Asia's growth, so much so that they were taken for granted.

Many American observers were so blinded that they ignored the evidence and dismissed as naive any suggestion that Asia's economies were intensifying their regional interactions and becoming less reliant on the U.S. market. Whenever that suggestion was made, the common rejoinder was that "the Japanese [or the Koreans, or the Chinese] would never do anything so foolish and so much opposed to their own interests." The response recalls a comment made by John Foster Dulles when he was supervising the end of America's occupation of Japan in the early 1950s. In a memorable remark on Japan's economic future, he urged that Tokyo concentrate on nearby Asian markets because Japanese products would never be attractive to Americans. Needless to say, the seeds had already been planted that would soon become known to Americans as Honda and Sony.

Incipient trends are once again present in U.S.-East Asian trade, but this time in the reverse direction. As the accompanying charts illustrate, the rise of China and the relative decline of the United States -- the two events that raised eyebrows in 2002 -- have already been evident for a number of years. The chart on the facing page shows that Japan's imports from China rose from $36 billion to almost $60 billion between 1995 and 2001, while its imports from the United States fell, from $76 billion to $63 billion. It is hardly surprising, then, that in the year following, Japan's imports from China exceeded those from the United States.

Although Japan's shift is the most dramatic in absolute dollar terms among the several East Asian economies, there were similar striking trends across the board. South Korea's exports to China rose by 100 percent (from $9 billion to $18 billion), while its exports to the United States grew by just 30 percent. Likewise for its imports: from China they nearly doubled, to $13 billion, while from the United States they fell by a quarter. Again, in absolute dollar terms, South Korea's trade with the United States still remains larger than its trade with China, but the very different growth rates are not promising -- and the same applies to Thailand, Singapore, and Malaysia. For each of these four countries, trade with China has been rising much faster than trade with the United States. In three out of four, imports from China rose by more than 70 percent, while imports from the United States fell. Singapore's experience is particularly dramatic: its imports from China rose by 120 percent, while those from the United States fell by 6 percent.

These trends, to borrow a Wall Street reminder, do not necessarily predict the future, but they do highlight several important realities. One is the mammoth size of U.S. exports to East Asia. In 2001, precisely a quarter of the United States' total exports of goods went to the Pacific Rim. Their value, at $182 billion, was identical to the value of the United States' exports to Europe. In 2002, U.S. exports to the Pacific Rim rose still further, to 26 percent of the U.S. total, while Europe's share dropped slightly, to 24 percent.

The sharply different trade growth rates underline a second reality: East Asia's tightening economic ties. That process was accelerated by the region's financial crisis in 1997-98 and reinforced by Washington's initially cool response. Tokyo, in contrast, stepped up to the plate with several imaginative offers of help, including its sponsorship of the "Asian Monetary Fund," an idea quickly -- and, some would say, brutally -- crushed by then Treasury Secretary Lawrence Summers. The contrast in behavior strengthened the view, especially in Southeast Asia, that the United States was prepared to write off several of the Asian economies; some even believed that Americans were anxious to benefit from Asia's plight.

A good reflection of this sentiment were the statements of a senior official in Thailand's Foreign Ministry. In 1997, at the onset of the crisis, he complained that while the United States benefited from globalization, Thailand suffered. Three years later, when Bangkok was planning to host an economic conference, his bitterness had ripened to a conviction that the United States was simply unconcerned with Southeast Asia: "The leaders of eight ASEAN countries have confirmed participation. The Japanese prime minister will attend. ... EU leaders will ... attend [but] I am a bit disappointed with the U.S. participation. ... The U.S. domestic economy is large and sound, which is probably why it does not attach much importance to participation in international forums."

Much the same disappointment with the United States was reflected this past March, in a Washington speech given by Emil Salim, one of Indonesia's most prominent economists. Salim co-chairs the United States-Indonesia Society, and in remarks there, he spoke of a fundamental change in Indonesia's future economic orientation. Gone was the familiar talk of first-rung manufacturing progress, of the sort typified by Nike footwear and garments destined for the United States. Instead Salim spoke of how Indonesia must now fit in with "China's role in Asia's economies," of "ASEAN + 3," and of how Indonesia's future must depend not on manufactured exports but on exports of its traditional "tropical products." His statements, like those of many others in Southeast Asia today, reflect a shift

away from the region's 30-year effort to integrate with America and the West. They signal instead a turn toward planning for prosperity as part of a resurgent and postcrisis Asia.

The third reality these illustrations point to is the global distribution of U.S. exports. As the chart on the facing page demonstrates, half of American exports are divided almost equally between Europe and Asia, and more than a third go to immediate neighbors, Canada and Mexico. Putting this another way, almost 90 percent of U.S. exports are directed, in roughly equal proportions, to the globe's three main economic regions: North America, East Asia, and the EU. None of the world's other major economic players, whose exports go mainly to nearby markets, has a distribution even approaching this U.S. record. The EU export pattern is the least diversified, with two-thirds of the exports staying within the EU, and Japan's exports are almost as concentrated.

ONE AFTA THE OTHER

These contrasts are a reminder of the enormity of the United States' stake in all of the world's regions, and of the corollary U.S. need to strengthen and maintain its commitment to the global trade system symbolized by the WTO. Yet both recent presidents have undermined that goal by their insistence on new regional or bilateral free trade agreements. None of those agreements is remotely analogous to NAFTA, the creation of which was justified by the political and strategic advantages it brought to the United States. The items on today's FTA agenda represent no such political or economic gain to Washington.

The most recent, a proposed "Central American Free Trade Area," can hardly be taken seriously from a U.S. perspective, in part because Central America is a tiny market, but more important because U.S. exports there already account for at least 40 percent of Central America's imports. In contrast, the United States' supposed "competitors," the EU and Japan, have less than 10 and 5 percent of the Central American market, respectively. Yet so strong is today's FTA fetish that when President George W. Bush called for a Central American FTA, all perspective (and humor) went out the window. The White House solemnly announced that U.S. exports to Central America were "more than to Russia, Indonesia, and India combined" -- conveniently forgetting that those three have long ranked at the bottom of America's markets.

How to explain this belief in the future of ftas? Zoellick hopes that they will act as "building blocks" of global free trade, but that has always been a debatable proposition, and now there is clear evidence that trade blocs in one region simply beget trade blocs in other regions. This is the real lesson of the Asian experience and Asia's new FTA proposals. Whether under Chinese or Japanese sponsorship, these proposals are responses to burgeoning ftas elsewhere -- especially those in the western hemisphere, which are U.S.-sponsored -- and they will likewise have two consequences for the United States. The first, as the above data demonstrate, will be to threaten the United States' major economic stake in East Asia. The second will be to help build a political and strategic counterweight to Washington's long-term security interests in the Pacific.

Critics will object that there is no tradeoff between the two: that East Asia and the western hemisphere are quite separate, and that U.S. policy can readily handle that separation. But events in the two regions are far from separate, as Henry Kissinger was forcefully reminded when he visited Tokyo in the early 1990s. Kissinger spoke with Ryutaro Hashimoto, who was then Japan's finance minister and would soon become its prime minister. In his book Vision of Japan, Hashimoto reported on their conversation and recalled that its background was two policy questions that directly connected the western hemisphere and East Asia.

The first issue was Malaysia's proposal for an "East Asia Economic Caucus" (EAEC). The second was the debate then current in the United States about NAFTA, specifically its possible expansion to Central and South America. Those developments, which of course later led to President Bill Clinton's call for a hemisphere-wide Free Trade Area of the Americas (FTAA), were closely monitored by Asian leaders, who worried that an enlarged NAFTA would give South Americans preferential treatment in the enormous U.S. market and that those preferences would come at Asia's expense. Some also feared that this FTAA talk in the western hemisphere would give added support and justification to those Asians who had long contemplated establishing their own regional trade bloc in the Pacific.

It was in that context that Hashimoto spoke with Kissinger about the link between the EAEC proposal, which Japan was being pressed to support, and the possibility of NAFTA expansion, which the United States was considering. When Kissinger asked whether Tokyo's posture would be influenced by American plans to extend NAFTA southward, Hashimoto answered, "Yes, that is what would happen":

As a member of the cabinet I do not highly regard the Mahathir plan. But if the United States strengthens its posture towards forming a protectionist bloc by extending NAFTA and closing off South America and North America, then Japan will have to emphasize its position as an Asia-Pacific country. This will inevitably alter the Japan-U.S. relationship. ... So please do not force us into such a corner.

In the years since that blunt advice, Japan's posture has moved substantially along the lines of Hashimoto's warning, as two recent developments suggest. The first is the reemergence of what Hashimoto called Japan's "position as an Asia-Pacific country." In part this revival stems from Japan's perennial debate about whether it is truly "Western," and in part it derives from the passing of the generation that directly (and usually favorably) experienced the American occupation. Equally important, however, are the views of Japan's most senior and sophisticated observers, in which a central strand holds that U.S. primacy has become somewhat suffocating and must be loosened. A good example is Ogura Kazuo, one of Japan's most senior Foreign Ministry officials, and hardly an elderly right-wing "nationalist." Now ambassador to France, he has a graduate degree in economics from Cambridge, was ambassador to both South Korea and Vietnam, and has been his ministry's director-general for economic affairs. He writes often on Asian affairs in influential Japanese journals, and in a 1999 essay titled "Creating a New Asia," Ogura argued that it is "necessary for a united Asia, along with Western Europe, to be prepared to check America. Asia must act in a unified way and ... Japan must shoulder a large part of the leadership needed to achieve that. One reason has to do with America's world dominance, the concentration of power in the hands of the United States."

Hashimoto's prediction has also come to pass in Japan's decision to end its exclusive reliance on the GATT-WTO system. The Japanese government's 2000 white paper on trade signaled the change, and China's announcement of its ASEAN free trade plan prompted an immediate Japanese response. Within weeks of Beijing's initiative, Prime Minister Junichiro Koizumi went to Southeast Asia to stake out Japan's claim. In Singapore, he conceded that "China is an attractive market" but insisted nevertheless that Japan's trade approach is better: "Cooperation among Japan, China, and South Korea is essential; and in the future, it would only be natural to add Australia and New Zealand." The prime minister's rhetoric led quickly to action: Tokyo signed its first-ever free trade agreement, with Singapore, and in early 2002, Japan and South Korea announced they too were talking about an FTA.

In practice, and because of the power of Japan's agricultural interests, both steps will result in less than meets the eye. The agreement with Singapore, for example, excludes agriculture, even though Singapore has no pastureland and its "agricultural" exports are mainly its tropical fish. An agreement with South Korea will face similar hurdles. Even so, Japan is engaged in ongoing talks with both New Zealand and Mexico, and elsewhere in the region other FTA negotiations are in progress. They include talks between Thailand and China, between New Zealand and Singapore, and reportedly even between the United States and Thailand and Japan.

It is certainly true that this flurry of activity does not mean imminent change, as Beijing acknowledged with its ten-year ASEAN time frame. But more important is the question of whether Asia should be moving in this direction at all. Today's competing Chinese and Japanese models remind us why, thanks largely to Cordell Hull, U.S. secretary of state from 1933 to 1944, the early postwar vision of regions and economic blocs promoted by Winston Churchill was rejected, and why multilateralism was adopted instead. Political rivalries inevitably develop within and among the blocs, and protectionist walls, by whatever name, necessarily rise between them.

A good example is Northeast Asia today, where an FTA is being actively discussed by specialists and governments, and where its advocates expect it to result in a "huge trading bloc." That outcome, which implies a dividing line in the Pacific, would hardly be in the interests either of the global economy or of the United States. It is tempting to believe that, given the history and consequences of regional blocs between the two world wars, no policymaker today would deliberately repeat such folly, but the historical record provides no such assurance or comfort.

A WINNING RECORD

Much of the current trade dilemma and its U.S. foreign policy consequences stem from a widespread American belief that the United States has not been a successful player in world trade. This perception is found both at the local level and in Washington, and it is rooted in a long-standing mercantile tradition, which teaches that exports are better than imports. That lesson is regularly reinforced when monthly trade figures are released because they are always accompanied by reports of the nation's "growing trade deficit." The genuine importance of that deficit is debated among economists, but what is not in doubt is that Americans commonly believe that they are a "soft touch" on trade and that the United States has not done too well as an exporter.

Nothing could be further from the truth. A long look back at the record of the last 100 years, illustrated on page 116, shows that the United States has largely held a steady 12-13 percent share of world exports. That was the case at the beginning of the twentieth century, when farm products and commodities dominated U.S. exports (and Europe dominated global exports), and at the century's very end, when U.S. exports of aircraft, jet engines, medical equipment, and other high-technology and industrial products had replaced those earlier commodities.

Only in the periods that followed the two world wars did America's exports account for more than their rock-steady 12-13 percent. In those years, as a result of wartime devastation, few other nations were left on the trade scene, and American suppliers briefly and very temporarily had the export field to themselves. In all other periods, 12-13 percent was the norm; indeed it is remarkable that both in 1913 and 1998, two years that are worlds apart in almost every other respect, the U.S. share of world exports was the same: 12.6 percent.

The years since 1980 are worth a second look because that period witnessed an explosion in world trade and the arrival of major new economic actors. Both factors are essential for understanding America's role in world trade because most of those new actors either simply did not exist as independent players when the century began or -- as in Japan's case -- had just entered global export markets. In 1913, Japan's share of world exports was just 2 percent; since then it has more than tripled. The other new actors -- Singapore, South Korea, Taiwan, and Hong Kong -- played no separate role at all as export economies before World War II, but today their combined global share is more than 10 percent. Add to that China, the newest major Asian exporter, and the global share of these newcomers becomes more than 13 percent. Japan's inclusion brings the figure to more than 20 percent.

The meaning of this arithmetic is that more than a fifth of today's global export market is now held by economies that had little or no international significance when the century began. Yet despite those new arrivals, and in the face of the overall explosion in world trade, America has continued to hold a steady global share. That has been the one constant factor in a world of otherwise enormous change; it should help demonstrate that the United States, far from having been "disadvantaged" in world trade, instead has a clear winning record.

Believing the opposite, that the field is not level but is tilted against the United States, has led to two troublesome consequences. One is the kind of protectionist "safeguards" the United States is often led to adopt: antidumping measures and countervailing duties, spurred by the self-serving demands for Washington's protection that regularly come from America's steel, textile, and farming sectors. The second and now more dangerous consequence is the belief that the United States needs to build special bilateral or regional ftas. The reality is that the United States not only does not need any such special ftas, but is precisely in the opposite situation: because it has the world's most evenly distributed pattern of exports, U.S. interests would be harmed were regional ftas to flourish.

To avoid that outcome, Washington should take two main steps. One is to end the promotion of regional blocs. For the United States that will mean recognizing that its own trade policies, especially its quixotic insistence on a western hemisphere FTA, have helped bring about what it cannot want: the emergence of an East Asian economic bloc. The FTAA has long been in trouble in any case, especially and increasingly with Brazil, and its aims would best be met at the WTO. Second, the United States must resume in practice as well as in rhetoric its postwar role as world trade leader. It must reject, and be seen to reject, whatever short-term advantages regionalism or bilateralism might seem to offer. That will be no easy task for an administration now in serial FTA mode: witness Australia, which was moved to the top of the list of FTA candidates following its support for the United States in Iraq, and the president's recent call for a "Free Trade Area for the Middle East." Instead, the United States must act intensively and single-mindedly to champion the multilateral system of trade, which means principally to ensure that the U.S.-inspired WTO and its Doha Round offshoot are vigorously maintained and strengthened.

Many will argue that because of its recent actions on steel, textiles, and timber, the United States cannot now enter that fray with clean hands. Paradoxically, however, since the United States clearly is not about to reverse those actions, and has already been subjected to worldwide criticisms for them, its situation contains an important tactical and strategic advantage, namely that any positive trade steps it now takes will be welcomed as acts aimed at redemption. The United States has already begun to seize that advantage with its call for the elimination of all tariffs on industrial goods traded among the nations of the Organization for Economic Cooperation and Development. More broadly, however, what is called for is a trade-policy initiative that will restore to center stage the multilateral trading system represented by the WTO.

Such an initiative will mean sparing no effort to complete, by its scheduled 2005 date, the WTO's Doha Development Round, and to meet its important milestones before then. One opportunity has already slipped by, when negotiators failed in March to agree on agricultural "modalities." The next test will be the September ministerial meeting in Cancun, Mexico, and if that chance too is missed, the prospects for 2005 will be bleak

indeed. The administration should therefore now concentrate its energies on Cancun and on the core agricultural and market-access issues. In the overlapping trading format represented by the WTO's 146 members, the onus will be on several key actors: the EU, Japan, South Korea, Brazil, India, and of course the United States. All stand to gain, as the GATT's 50-year trade explosion has shown, but all will have to give in order to get.

For that reason, Zoellick -- acutely sensitive to Congress' constitutional power in trade matters and already an avid counter of congressional votes -- will need to hear from business, agriculture, and industry, along with consumers, that their interests require success in the Doha Round. The WTO is not as strong as it needs to be, but from the perspective of American national interests it is better than any realistic alternative. It is time, in other words, to recall that in the 1930s and 1940s, the massive contribution of U.S. policymakers was to aim for a world not of regional economic blocs, but a single world trade system. That is what we now have, and that is what could now be lost.?

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