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Trade Policy at the Institute: 25 Years and Counting

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The Institute for International Economics opened its doors in 1981, a pivotal time for the world trading system. Only two years after the conclusion of the Tokyo Round of multilateral trade negotiations (1973–79),[1] world trade was buffeted by a second oil shock that precipitated the deepest global recession since the 1930s. Growing protectionist pressures threatened to stall or reverse the freshly minted commitments to trade liberalization. Debt crises in developing countries and currency misalignments further complicated the political economy of trade. Calls for fresh trade negotiations to address these manifold challenges fell victim to increasingly fractious transatlantic trade disputes over steel and agriculture, the proliferation of orderly marketing agreements and voluntary export restraints, and US extraterritorial sanctions seeking to block construction of Soviet gas pipelines. The "twilight of the GATT"—the General Agreement on Tariffs and Trade—seemed a real possibility.

The travails of world trade, linked integrally to problems with international debt, finance, and exchange rates, became prime targets of Institute analysis and the focus of one of its first major conferences, in June 1982, leading to the publication of *Trade Policy in the 1980s*, edited by William

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1. The Tokyo Round, like its six predecessors and its immediate successor (the Uruguay Round), was conducted under the auspices of the General Agreement on Tariffs and Trade (GATT).

Cline (1983). Globalization was then a fresh term, if not a new phenomenon. Trade negotiations were no longer narrowly focused on border restrictions. Policy analysis required an understanding of the interactions between domestic and international economic policies and of how these interactions obstructed or encouraged international flows of trade and investment. Such multifaceted issues were made to order for the experienced team that founded the Institute.

Trade Mavens on Board. The Institute's initial complement of fellows, advisers, and board members brought an array of trade experience from executive departments and congressional halls. Prior to launching the Institute, the director, C. Fred Bergsten, and the chairman of the advisory board, Richard Cooper, had both engineered key accords in the Tokyo Round from their perches at Treasury and State. The chairman of the board of directors, Peter G. Peterson, served as secretary of commerce during the Nixon administration, and his fellow board member Anthony Solomon dealt with trade issues and other economic matters as a senior official in both the Johnson and Carter administrations. At the Institute's founding, Bergsten lured three Treasury colleagues with trade backgrounds: William Cline, Gary Hufbauer, and Jeffrey Schott. I. M. Destler came to the Institute with trade experience from Capitol Hill. Among the other research staff from that era, Kimberly Elliott, Joanna Shelton Erb, and Howard Rosen brought a wealth of trade expertise. As the Institute grew and thrived, other talented scholars with an interest in trade and investment policy joined the staff permanently or as visitors: Edward M. Graham, Jeffrey Frankel, Robert Z. Lawrence, Catherine Mann, Marcus Noland, J. David Richardson, and Matthew Slaughter.

Armed with this array of talent, the Institute was well positioned to grapple with the big trade debates that emerged in the 1980s, 1990s, and 2000s. In this chapter, we highlight three megathemes: rampant globalization, multitrack trade strategy, and the splintering US trade coalition.[2] Following a short preview in this introduction, we turn to the meat of the Institute's work in these areas.

Globalization Steals the Show. Economists are fond of pointing out that globalization finds ample precedent in the golden decades between 1871 and 1914. What is undeniably new, however, is public fascination and debate, which enables a handful of authors to make an excellent living (exemplified by Thomas Friedman), boosts a few neo-isolationist politicians (Ross Perot and Patrick Buchanan), and provides a theme for certain TV personalities (notably Lou Dobbs). It also presents a special challenge to

2. As a result, we skip lightly over several trade policy debates that engaged the Institute in its first quarter century. Our tread is light both because "trade policy" has expanded well beyond tariffs and because each issue has its own complex dimensions.

the Institute, since much of the public debate questions the value of traveling the globalization road.

One of the reasons the globalization debate is so strident—whether in the United States, Europe, or in developing countries—is that advocates and critics often focus on gross gains or losses. It is easier to cast blame (especially against foreigners) than to address the nuanced distributional consequences resulting from global competition. Harder still is to prescribe responsible domestic policy reforms that redistribute gains or losses via taxes or subsidies from one group to another.

Yet globalization inevitably creates winners and losers in each society. While many Institute volumes published in the 1980s and early 1990s addressed the costs of protection and the benefits of liberalization, the first Institute book featuring globalization in its title, *Has Globalization Gone Too Far?* by Dani Rodrik (1997), struck a skeptical note. So, too, did Laura Tyson (1992) in *Who's Bashing Whom? Trade Conflict in High-Technology Industries*, which was published shortly before she was named to lead President Clinton's Council of Economic Advisers. Later that decade, the Institute launched the Globalization Balance Sheet (GBS) project, directed by J. David Richardson. Since its inception, the GBS project has provided an umbrella for more than a dozen books and monographs, covering the pluses and minuses of trade, investment, labor, environment, and other dimensions. Institute studies have offered pioneering analyses of electronic commerce (Mann, Eckert, and Knight 2000), worker adjustment (Kletzer 2001), worker perceptions (Scheve and Slaughter 2001), labor standards (Elliott and Freeman 2003), the gains from globalization (Bradford and Lawrence 2004; Bradford, Grieco, and Hufbauer 2005), and other themes. As this chapter is written, Richardson is tying the whole GBS project together in his capstone volume, *Global Forces, American Faces.*

Multitrack Strategy: Flavor du Jour. Soon after the Institute opened its doors, US Trade Representative William Brock radically shifted US trade strategy from its historic "single-track" approach, centered on multilateral GATT negotiations, to a "multitrack" approach, which eventually featured bilateral and regional agreements alongside GATT talks. The provocation was foot-dragging by the European Community, Japan, and others over the launch of a new GATT round; Brock turned to the multitrack strategy after the failed GATT ministerial meeting in November 1982. The United States tested the waters with a free trade agreement (FTA) with Israel in 1985; shortly after, the US-Canada FTA was signed in 1988, covering a hundred times more commerce.

President George H. W. Bush then started the United States down the regional track, not only opening NAFTA negotiations with Mexico in 1991 and signing the pact in 1992 but also proposing at the same time the Enterprise for the Americas Initiative to deepen US trade and investment ties with, and help address the debt problems of countries in Latin America and the Caribbean. President Bill Clinton proved equally enthusiastic, augmenting the NAFTA with side agreements on labor and environment before securing congressional ratification in 1993. The following year, Clinton pushed summit initiatives in the Western Hemisphere and the Asia-Pacific regions that called for the Free Trade Area of the Americas (FTAA) and free trade and investment across the Asia-Pacific, under the auspices of the Asia-Pacific Economic Cooperation forum (APEC). All the while, the Uruguay Round of GATT negotiations, launched at Punta del Este in 1986, was grinding to a finale at Marrakesh in April 1994. In retrospect, these multiple trade initiatives, playing off one another, created the golden age of "competitive liberalization," to use the phrase later coined by Bergsten (1996).

Each of these trade initiatives was both anticipated and then analyzed in Institute books, articles, and policy briefs. Wonnacott (1987) examined the US-Canada quest for free trade, and Schott and Smith (1988) assessed the subsequent US-Canada FTA; in Hufbauer and Schott (1992, 1993, 1994) we anticipated and then analyzed the North American Free Trade Agreement (NAFTA) as well as the prospective Western Hemisphere accord; and Schott (1990, 1994) evaluated the Uruguay Round both in prospect and in retrospect. Last but certainly not least, Bergsten developed the "vision" of free trade and investment in the Asia-Pacific region in the three annual reports issued during his tenure as chairman of APEC's Eminent Persons Group. Bergsten (1995) then prescribed options for implementation of the ambitious goals set out by APEC leaders in their 1994 Bogor Declaration.

After Marrakesh, US trade officials were constrained by the absence of "fast track" negotiating authority: It expired in June 1994 and was not renewed for the duration of the Clinton administration. Consequently, the United States only entered into compacts that required little change in existing US policies and practices. World Trade Organization (WTO) bargains were reached in two sectors, telecommunications (Petrazzini 1996, Hufbauer and Wada 1997) and financial services (Dobson and Jacquet 1998), but otherwise multilateral liberalization was stalled (Schott 1998b). The collapse of the WTO ministerial in Seattle in December 1999 confirmed both the overarching importance of US negotiating authority and the impasse among WTO members. The collapse also emboldened antiglobalization activists to demonize trade officials for killing turtles and forcing "Frankenstein" foods on unwitting consumers, among other offenses.

In the aftermath of Seattle, the WTO needed new direction, and the Institute offered an extensive blueprint for recasting the trade agenda to address the myriad challenges confronting the trading system in *The WTO after Seattle* (Schott 2000). The erstwhile "Seattle Round" evolved into the Doha Development Agenda, launched in November 2001 in the wake of the terrorist attacks two months earlier. But these talks too followed a familiar pattern: The 2003 ministerial in Cancún failed and negotiators consistently missed deadlines (Jeffrey J. Schott, "Unlocking the Benefits of World Trade," *The Economist*, US edition, November 1, 2003; Hufbauer and Schott 2006). During this period, FTAA and APEC talks also faltered (Schott 2001, Bergsten 2001), and US trade policy came to rely on a single rail, bilateral FTAs. These developments reflected our third megatheme, the splintering coalition for free trade.

Splintering Coalition: Trade Beware! When President Eisenhower wrested control of the Republican Party from Senator Taft and aligned the Republican Party with the trade philosophy of Franklin Roosevelt, he created a bipartisan coalition for freer trade that endured until the early 1990s. Destler (1986) documented these trends in his classic study, *American Trade Politics*, now in its fourth edition. The coalition eventually splintered both because organized labor pictured international commerce as an engine for destroying US jobs and suppressing blue-collar wages and because critics at both extremes of the political spectrum came to view trade agreements as feathering the nest of multinational corporations but not improving the lives of ordinary people. Consequently, Howard Rosen's (2002) analysis of nine major trade bills between 1974 and 2002 found a particularly sharp drop in the likelihood of "yes" votes among House Democrats—falling from a probability of 89 percent in the 1970s to only 52 percent in the 1990s (though 2002). Given this trend, it is not surprising that US trade promotion authority (TPA)—formerly known as "fast track"—initially cleared the House by one vote in 2002 (and finally passed with only a three-vote margin) and that Central American Free Trade Agreement–Dominican Republic (CAFTA-DR) passed the House by a bare two-vote margin in 2005.

The causes and consequences of the splintering coalition inspired numerous Institute studies over the past six years: Graham (2000) on the virtues and vices of multinational corporations, Scheve and Slaughter (2001) on the perceptions of American workers, Kletzer (2001) on worker adjustment, Baldwin (2003) on the role of US trade unions, and Elliott and Freeman (2003) on global labor standards. In addition, the fourth edition of Destler's classic study, *American Trade Politics* (2005), added new sections on these contentious topics.

Rampant Globalization

Global forces swept across all dimensions of the world economy between 1980 and 2005, as depicted in table 3.1. Initially, these forces were broadly welcomed, not repelled. But the fractious US debate over the ratification of the NAFTA—which put a spotlight on the challenges involved in economic integration with developing countries—shifted public opinion dramatically. Strident opponents of a trade pact with Mexico warned of a

Table 3.1 Economic globalization: Sharp acceleration since the mid-1980s

Indicator	Before	After
Ratio of growth in merchandise trade to growth in global GDP	1.2 (1974–84)	3.3 (1990–2004)
FDI stock as a percentage of global GDP	5.9 (1980–85)	13.8 (1990–2004)
Royalty and licensing fees paid to US companies from foreign sources	$7 billion (1985)	$53 billion (2004)
International telephone traffic minutes	38 billion (1990)	145 billion (2004)
Foreign exchange transactions (daily)	$60 billion (1983)	$1.9 trillion (2004)
Worldwide number of Internet users	26 million (1995)[a]	1 billion (2005)

FDI = foreign direct investment

a. The World Wide Web did not exist prior to 1991.

Sources: Preeg (2003); UNCTAD *World Investment Report 2005*; Bank for International Settlements (2005), www.bis.org; Internet World Stats, Usage and Population Statistics, www.internetworldstats.com; International Telecommunication Union, www.itu.int.

"sucking sound" of jobs and investment seeking low wages and a pollution haven. By the time China joined the WTO at the end of 2001, amid slowing growth worldwide, the critics of trade and globalization were firmly joined at the hip.

While commercial negotiations focused on merchandise trade through the late 1980s, the General Agreement on Trade in Services (GATS) became a centerpiece of the Uruguay Round. Meanwhile, awareness grew among trade policy officials that service and merchandise trade flows are both closely linked to foreign direct investment (FDI). In fact, "Mode 2" of the GATS dealt explicitly with market access via foreign commercial presence, while other WTO agreements addressed the connection between FDI and merchandise trade. Throughout the 1990s, international finance exploded and electronic commerce blossomed.

Along with Hollywood, 24-hour news, and migration, these trends became the economic face of globalization—an uplifting and inevitable force to Thomas Friedman and a nationalist rallying cry to Lou Dobbs. If the Institute had been launched in 2001 rather than 1981, it might have been named the Institute for Global Economics.[3] Yet, while "global" was not in the name, it was very much in the substance of the Institute's work.

3. In fact, in the early 1990s, former Korean Finance Minister and Institute Visiting Fellow Il SaKong gave this name to his own institute in Seoul, patterned after the Institute.

The Costs of Protection

In the 1980s, most journalists who wrote about trade were oblivious to the fact that barriers take money from domestic consumers. They penned wrenching accounts of farm and factory workers who lost their jobs to cheap imports, but the fourth estate had a hard time putting poetry to higher prices at the checkout counter. To provide a better balance, the Institute launched its "Cost of Protection" series, starting with *Trade Protection in the United States* (Hufbauer, Berliner, and Elliott 1986) and later updated and extended in separate monographs to Japan, Korea, China, and the European Union. The headline number, consistent across all studies, was the staggering cost per job saved in protected industries—figures upwards of $100,000 per job per year characterized the United States and Europe. Almost as noteworthy was the finding that protected firms, not workers, garner the lion's share of benefits. Indeed, Cline (1990, 251) calculated that US protection of textiles and clothing imposed a heavy burden on low-income US families, reducing the income of the poorest 20 percent of US households by almost 4 percent. These facts undergird the economic case for trade adjustment rather than trade protection to answer the disruption caused by globalization.

The cost-per-job-saved calculations have been most effectively used by a handful of firms that, in particular episodes, mounted coalitions against protection. Early examples were documented by Destler, Odell, and Elliott (1987), along with internal crosscurrents that hobble associations such as the Business Roundtable. More recently, distributors of luxury autos (such as Lexus cars), industrial users of steel (such as Caterpillar), and some clothing chains (such as Gap) have effectively reversed or limited the extent of ad hoc quotas. But on the whole, antiprotection coalitions are a story of the dog that didn't bark: Major sugar consumers (such as Coca-Cola), major clothing distributors (such as Wal-Mart), and major home builders (such as Toll Brothers) have not successfully or even conspicuously reversed high barriers that raised the prices of their wares.[4]

Benefits of Foreign Investment

In the late 1960s and early 1970s, fierce debate waged in the US Congress over "runaway plants" erected by multinational corporations. However, after the Burke-Hartke bill died in the House Ways and Means Committee in 1973, the issue was crowded off the US agenda by the first oil shock

4. Toll Brothers and other home builders paid the penalty of antidumping and countervailing duties on softwood lumber imports from Canada for more than 25 years, until a ceasefire was negotiated in 2006. These duties amounted to hundreds of millions of US dollars annually.

and rising inflation. For most of the 1960s and 1970s, the greatest criticism of multinational corporations emanated from developing countries, generally with a Marxist flavor. This was soon to change, as the forces of globalization turned the United States into the largest host country for FDI in the 1980s. Arguments were voiced in this country that foreign multinationals would depress American wages, skimp on research, and on the whole act as poor corporate citizens. Graham and Krugman (1989) turned such arguments on their head in *Foreign Direct Investment in the United States*, a book that saw its third edition in 1995.

After that, Graham and his colleagues tilted at FDI windmills at five-year intervals. Graham (2000) severely criticized antiglobalization activists for derailing the Multilateral Agreement on Investment. Graham and Marchick (2006) examined the national security threat of inward FDI in the wake of the US rejection of China National Offshore Oil Corporation's bid for Unocal and the Dubai Ports World bid for Peninsular and Oriental Steam Navigation Company's terminal leases. Meanwhile, Moran, Graham, and Blomström (2005) edited a comprehensive volume bringing together fresh work on the linkages between FDI and development.

Payoff from Globalization

These days, the old argument that protection takes money from Peter to pay Paul, with waste along the way, no longer enlists much support for globalization. Taxing Peter to pay Paul is an old game in Washington and every other capital city. The case for globalization must therefore be stated in positive terms to gain policy traction. In stating the positive case, the Institute has made four noteworthy contributions.

Jeffrey Frankel's (1997) pioneering study of regional trade agreements revived the gravity model as a working tool of trade analysis. While Frankel's analysis, based on data from the 1980s and earlier, estimated weak coefficients for the trade augmentation effect of FTAs, subsequent work by Rose (2004) and DeRosa and Gilbert (2005) arrived at much larger and more robust coefficients. Trade liberalization apparently sparks two-way commerce to a far greater extent than standard elasticity coefficients might suggest.

Drawing on econometric estimates of the relation between trade intensity and GDP growth, Cline (2004) estimated that total free trade, practiced by developed and developing countries alike, could lift an astonishing 500 million people out of poverty by 2015. If trade ministers revive and conclude a robust Doha Development Round, they could do far more for the world's poor than bilateral aid and multilateral development bank programs combined. Using a different methodology, Bradford and Lawrence (2004) calculated that integration of the markets for goods alone among just eight advanced countries (Australia, Canada, Germany, Italy, Japan, Netherlands, United Kingdom, and the United States) would raise the GDP of all Organization for Economic Cooperation and Development (OECD) nations by $450 billion annually (1997 dollars), with a spillover to developing countries of another $100 billion.

Bradford, Grieco, and Hufbauer (2005) assembled a range of methodologies, including the approaches just mentioned, to calculate US gains from more intense trade with the rest of the world—an important dimension, though not the only dimension, of globalization. Greater trade intensity since the Second World War—merchandise imports plus exports rose from 9 percent of US GDP in 1950 to 24 percent in 2003—reflects the combined forces of dramatic policy liberalization and rapidly falling transportation and communication costs. The centered calculation of resulting US GDP gains, drawing on five different methodologies, is about $1 trillion annually, about $10,000 per household each year. Future US gains, if the United States and the rest of the world complete the march to zero tariffs and quotas (not counting any future fall in transportation or communication costs), could be another $500 billion annually, about $5,000 per household.

Globalization Balance Sheet

As mentioned, in 1998 the Institute launched the multiyear, multiproduct GBS project under the direction of J. David Richardson. To date, the project has authored or inspired some 13 books and numerous articles by resident and nonresident fellows, and Richardson himself is working on a capstone volume, *Global Forces, American Faces*, which integrates the studies into current research along the same lines. Here is a sampler of headlines from the GBS project:

- American manufacturing plants that export continuously grow 0.5 to 1.5 percent faster per year than otherwise comparable plants that are locally focused. Globally engaged American firms in general, including services firms, grow up to 2 percent faster per year and enjoy 1 to 2 percent higher annual survival rates than otherwise comparable local firms.
- In American manufacturing as a whole, worker wages are about 10 percent higher at plants that export. Moreover, wages average up to 7 percent higher at plants with an equity stake from a foreign multinational corporation (MNC) and up to 15 percent higher at plants owned by an American MNC, compared with worker wages at comparable manufacturing plants that are not globally engaged.
- American workers at plants linked to either foreign or US-owned MNCs maintained these higher wages *even though* their MNC employers "offshored" 1.5 to 2 times as many intermediate input pur-

chases as comparable non-MNC plants.[5] More precisely, MNC plants imported—i.e., outsourced from offshore sources—11 to 16 percent of their supplies and components, whereas comparable non-MNC plants imported only 6 to 8 percent.

- In American service firms, wages are 6 percent higher in tradable (export- and import-oriented) subsectors than in comparable sectors that are locally insulated. Premiums in high-technology services are even larger: American wages are 15 percent higher in high-tech tradable professional and business service firms than wages for otherwise comparable workers.
- In sum, globally valued and high-technology occupational skills create additive worker benefits. Workers' investment in the skills required to find employment in high-technology, tradable occupations pays premiums *above and beyond* garden-variety investments in education and experience.
- But globalization creates losers as well as winners (Kletzer 2004). In 2000–2001, a recession period, workers in broad import-sensitive sectors (roughly 30 percent of manufacturing jobs) experienced dislocation rates that were more than double those facing other manufacturing workers (6.1 percent compared with 2.8 percent). American workers in tradable services likewise faced dislocation rates that were twice as high as workers in nontradable services (10.6 percent versus 5.4 percent).
- In their new jobs, workers dislocated from import-sensitive manufacturing sectors in 2000–2001 suffered mean losses in earnings that were twice as high compared with the late 1990s. Almost one-third of recently dislocated workers suffered earnings losses above 25 percent.
- The American backlash to globalization is widespread, not just the vocal objection of a small fringe (Scheve and Slaughter 2001). Many Americans oppose further immigration, trade integration, and liberalization of investment barriers. The backlash grew in the 1980s and 1990s in close correlation with the flattening out of labor market prospects for American workers with median skills. Scheve and Slaughter estimate that every extra year's education in their cross section of voters makes an American 5 to 6 percent less likely to support higher import barriers and 2 to 3 percent less likely to oppose immigration. Americans recognize the benefits from globalization, but give much

5. Offshore outsourcing is the substitution of imported inputs for inputs formerly produced by a firm's own workers. This is part of the general trend toward outsourcing, which substitutes inputs from arm's-length suppliers for inputs formerly produced internally by a vertically integrated firm.

more weight to the perceived cost of volatile jobs and sluggish wage growth.

- In brief, the patterns revealed by the GBS project suggest an expanding array of *both* benefits and burdens from America's global trends, but also an expanding *scope* for both benefits and burdens across the American workforce and American firms.

- While the political split between proglobalization and antiglobalization sentiment is roughly 50-50 in the United States, the economic balance between national gains and dislocation losses is hugely lopsided. Estimates by Bradford, Grieco, and Hufbauer (2005) indicate that annual US gains from globalization since the Second World War are about $1 trillion, whereas annual dislocation losses are around $50 billion—a ratio of 20 to 1.

Multilateral Trade Negotiations

Until the failed GATT ministerial of November 1982, postwar US trade policy had focused exclusively on multilateral trade negotiations in the GATT. The rejection by other countries of US initiatives to prepare for a new round of GATT talks—due to both protectionist concerns and the lack of readiness to add trade in services to the negotiating agenda—led then US Trade Representative Bill Brock to pursue bilateral free trade agreements (FTAs) with Israel and Canada. These talks were regarded as complements to, not substitutes for, the GATT process; US officials maintained their efforts to launch what became the Uruguay Round in 1986. Over the two decades since, the United States has followed a multitrack trade strategy—involving a mix of bilateral, regional, and multilateral negotiations—to address the unfinished and new international trade agenda and to propel economic growth. Institute studies have tracked these efforts and sometimes presaged new initiatives. In particular, Institute authors have undertaken

- strategic planning for multilateral trade negotiations (MTNs), starting with a blueprint for the prospective Uruguay Round (Hufbauer and Schott 1985) and then for the first trading round in the WTO (Schott 1996, 1998b, 2000).

- assessment of MTN results, starting with Hufbauer and Erb (1984) on subsidies in the Tokyo Round, then Schott's 1994 *Uruguay Round: An Assessment*, and Dobson and Jacquet (1998) on financial services. More recently, in Bergsten (2005) and Hufbauer and Schott (2006), the Institute has contributed journal articles and policy briefs on progress and problems in the Doha Round.

- analysis of traditional sectors resistant to reform in the postwar era, notably studies on agriculture by Hathaway (1987) and Elliott (2006) and on textiles and clothing by Cline (1990, rev. ed.).
- analysis of "new" issues on the GATT/WTO agenda, including Graham and Richardson (1997) on competition policy, Graham and Krugman (1989) and Graham (2000) on investment, Maskus (2000) on intellectual property rights, Esty (1994) on *Greening the GATT* (1994), and Elliott and Freeman (2003) on labor standards.

Bilateral and Regional Trade Negotiations

Throughout the GATT/WTO era, the United States has given priority to Geneva negotiations. At the same time, however, FTAs have been pursued with increasing vigor, particularly in periods when Geneva talks have drifted, to maintain momentum for trade liberalization, to forge alliances in favor of new liberalization both bilaterally and multilaterally, and to catalyze other major trading nations to work more diligently in the GATT/WTO. The United States has concluded bilateral FTAs with a variety of its trading partners and launched complementary regional initiatives in the Western Hemisphere, Southeast Asia, and the Middle East North Africa region. Apart from NAFTA, however, US trade negotiations with its main trading partners—the European Union, China, and Japan—have been conducted primarily through multilateral channels.

Institute work has focused on the United States, given the influence of US initiatives on the multilateral trading system and the fact that Europe already had its network of preferential trading arrangements. Institute conference volumes documented the evolution of US policy, first in the late 1980s when the collapse of the "mid-term review" of the Uruguay Round (1988) sparked interest in an FTA between the United States and Canada. *Free Trade Areas and US Trade Policy,* edited by Schott (1989), examined the objectives and prospects for bilateral US pacts with countries in Latin America and East Asia.

Institute studies have assessed both the role of FTAs in US trade policy and the benefits and costs of pursuing specific accords. In some cases, Institute analyses provided a blueprint for prospective negotiations; in others, Institute findings were cited in subsequent ratification debates in the partner countries. Because Institute studies exposed either potential problems that would have to be addressed or warts and blemishes in the negotiated outcomes, they provided an objective antidote to the "pep rally" press releases of the partner governments. Indeed, in one instance, governments decided not to pursue FTA talks after reading the detailed Institute assessment of the negotiating requirements (Hufbauer and Baldwin 2006). In another, Taiwan rejected the bottom line Institute conclusion not to proceed with a bilateral FTA and has continued to push, so far unsuccessfully, for a FTA with the United States (Lardy and Rosen 2004). Since the initial FTA with Israel in 1985, the United States has actively engaged in bilateral negotiations with countries across the globe. Current and prospective US FTA partners number around 30 and account for almost 44 percent of total US trade and more than half of US merchandise exports (see table 3.2).[6] Institute studies have examined both the broad policy implications of regional and bilateral agreements and the application of an FTA policy to prospective US partners (Schott 1989 and 2004).

Because of its path-breaking role in linking two developed and one developing country in a comprehensive FTA and its impact on subsequent US trade pacts, Institute studies have focused special attention on NAFTA (Hufbauer and Schott 1992, 1993, 2005). Our initial studies examined the issues and problems in pursuing deeper North American economic integration and then assessed the negotiated outcome. More recently, in Hufbauer and Schott (2005), we assessed the decadal experience of NAFTA and examined the key challenges to North American economic integration that still confront the three trading partners.

NAFTA set the precedent for a series of initiatives that followed in Latin America and East Asia, as US trading partners queued up for NAFTA-like negotiations. The Institute's NAFTA trilogy established a baseline for analyzing new ventures with other countries. Institute studies have assessed the costs and benefits of entering FTA negotiations with individual countries, starting with Korea (Choi and Schott 2001) and followed by Taiwan, Egypt, Switzerland, Pakistan, Colombia, and Indonesia. An overall study of a US–Middle East FTA will soon be published. In addition, Bergsten has written numerous articles on prospects for a US-Japan accord and a monograph on a prospective free trade deal with New Zealand.

Has all this activity undercut US support for ongoing WTO negotiations? The experience to date argues that it has not—though the answer with regard to the Doha Round is not completely written. Bilateral and regional talks have often advanced during lulls or breakdowns in multilateral negotiations. For example, the NAFTA talks were launched at a time when US-European differences on agriculture had put the Uruguay Round in a deep freeze; then in late 1993, APEC initiatives helped propel the final compromises needed to conclude the round. The FTAA negotiations began in the 1990s as the WTO struggled in its first years to develop consensus for new efforts to advance multilateral trade liberalization.

6. These data do not include countries or regions participating in the FTAA talks but not in separate free trade talks with the United States (the main exclusions are Mercosur, Venezuela, and Caricom).

Table 3.2 Bilateral FTA partners of the United States as of June 2006
(billions of dollars)

		US merchandise trade, 2005				
Country/region	2005 GDP	US exports to[a]	US imports from[b]	Trade balance	Total trade	FTA status[c]
Canada	1,130.2	183.2	287.5	–104.3	470.8	A
Mexico	768.4	101.7	169.2	–67.5	270.9	A
Korea	793.1	26.2	43.2	–16.9	69.4	C
Malaysia	130.8	9.5	33.7	–24.2	43.2	C
Singapore	117.9	18.7	15.1	3.6	33.8	A
Thailand	168.8	6.6	19.8	–13.2	26.4	C
CAFTA-5	77.3	11.5	13.4	–1.9	24.9	A/B
Israel	123.5	6.5	16.9	–10.4	23.4	A
Australia	708.0	14.6	7.4	7.3	22.0	A
Indonesia	276.0	3.0	11.9	–8.9	14.9	D
Colombia	122.3	5.0	8.8	–3.8	13.7	C
Chile	114.0	4.7	6.7	–2.1	11.4	A
SACU-5[d]	258.3	3.8	6.8	–2.9	10.6	C
United Arab Emirates	133.8	7.9	1.4	6.5	9.3	C
Dominican Republic	29.2	4.4	4.6	–0.3	9.0	B
Ecuador	33.1	1.7	5.9	–4.1	7.6	C
Peru	78.6	2.0	5.1	–3.1	7.2	B
Egypt	93.0	3.1	2.1	1.1	5.2	D
Panama	15.2	2.0	0.3	1.7	2.3	C
Jordan	12.9	0.6	1.3	–0.7	1.9	A
Oman	30.3	0.6	0.5	0.1	1.0	B
Morocco	52.0	0.5	0.5	0.0	1.0	A
Bahrain	12.9	0.3	0.4	–0.1	0.7	B
Subtotal (FTA partners)	5,279.5	418.1	662.3	–244.2	1,080.4	
United States (world trade totals)	12,485.7	804.0	1,662.4	–858.4	2,466.4	

CAFTA-5 = Central American Free Trade Agreement (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua)
SACU-5 = Southern African Customs Union (Botswana, Lesotho, Namibia, South Africa, and Swaziland)

a. US domestic exports.
b. US imports for consumption.
c. A = in effect; B = signed; C = under negotiation; D = under consideration
d. Suspended in April 2006.

Sources: GDP: IMF's *World Economic Outlook* database, September 2005; trade data: USITC Dataweb.

Importantly, however, the FTAA talks did not distract US officials from taking the lead in launching the Doha Round in November 2001.

The US Free Trade Coalition Splinters

When I. M. Destler authored the first edition of *American Trade Politics* in 1986, a bipartisan coalition for free trade dominated the US Congress. To be sure, during the Reagan era, autos, steel, and a few other industries grumbled loudly, as they were buffeted by international competition and a strong dollar. But after the Plaza Accord, congressional dissent was limited to jawboning with foreign governments, using the malleable "crowbar" of Super 301 to launch unfair trade complaints, and invoking minor provisions of the Omnibus Trade Act of 1988 such as advance notification prior to a plant shut down.

In the 1990s, with globalization rampant, US trade policy became a salient feature of the domestic economy and thus more contentious. The fractious congressional debate over NAFTA stoked partisan fires. As the trade agenda broadened to cover a large array of domestic subsidy and regulatory policies and as trade pacts were used to pursue foreign policy as well as economic objectives, more members took a keen interest. Maintaining a protrade coalition became increasingly complex. Fast-track authority lapsed, and Congress rebuffed attempts to renew the authority in 1994, 1997, and 1998. As noted in the Institute volume *Restarting Fast Track* (Schott 1998a), some Democratic members held fast track hostage in retaliation for Republican opposition to their favored domestic programs.

By the time Destler authored the fourth edition of *American Trade Politics* in 2005, the bipartisan free trade coalition had almost totally fractured. Major trade legislation could be passed only with the overwhelming support of House Republicans because House Democrats were almost unified in opposition. Five years after fast track failed to pass congressional muster, the rebranded TPA passed by a 3-vote margin (25 Democrats and 190 Republicans) in the Trade Act of 2002, while CAFTA-DR passed by only two votes in 2005 (15 Democrats and 202 Republicans). Protrade Democrats such as Calvin Dooley (D-CA) became a vanishing breed. The free trade coalition fractured for multiple reasons, but the underlying forces were information technology and global competition. As information technology diffused through the economy, it not only boosted average productivity growth (from a meager 1.5 percent between 1973 and 1995 to 3 percent between 1996 and 2005) but also sharply raised the salaries of the highest quintile of the workforce (1.6 percent annually in real terms between 1990 and 2004) while the lowest quintile experienced stagnant wages (0.2 percent annually). Armed with IT, each skilled American could do the work of several unskilled Americans at higher wages per employee but lower costs per unit of output.

At the same time, global competition put enormous pressure on blue-collar factory workers and white-collar office workers alike. In the ensuing drama of wage dispersion and job disruption, the global economy made a more obvious and politically attractive target than information technology. Highly polarized politics, clashing congressional personalities, bitter disagreement about social safety nets, and genuine concerns about the impact of market forces on labor and environmental conditions abroad added to the underlying forces that fractured the free trade coalition. Being both analytical and constructive, the Institute's fellows, starting with Destler, not only diagnosed the break but also offered solutions.

Labor Practices at Home and Abroad

The "pauper labor argument" is a durable myth that originated with 19th century trade between England and India and today contends that trade between the United States and China will inevitably drag US wages down to the Chinese level. The myth has a surface similarity to the famed Stolper-Samuelson factor price equalization theorem, but the theorem depends on highly restrictive assumptions that are seldom fulfilled: the same technological menu available to rich and poor countries alike, the massive exchange of labor-intensive goods for capital-intensive goods, and fixed stocks of capital.

In fact, research finds little connection between widening income disparities in the United States and the growth of merchandise trade. Trade flows are highly concentrated in manufactured goods; manufacturing technology differs vastly between the United States and developing countries; on balance, the capital intensity of imports is about the same as exports; stocks of manufacturing capital are highly elastic to the real rate of return; and in any event, the lowest-paid workers in American society are concentrated in nontraded services such as gardening, home care, restaurants, public transportation, and janitorial services.

Like other economists, Institute authors have tried to drive a stake in the pauper labor argument, but contemporary political debates suggest that the challenge remains. Indeed, the offshore outsourcing controversy, discussed in a moment, can be viewed as a modern version of the pauper labor argument.

The second strand of the labor debate concerns the danger of exploitation abroad, particularly in developing countries, whatever the impact might be on wages in the United States or the European Union. Social champions argue that US commercial policies should aim for grander goals than income gains accruing to American workers and firms. Elliott and Freeman (2003) developed this theme, illustrated by approaches such as labeling, ISO 15000 standards, and voluntary codes that might become a central component of US trade policy under a Democratic president.

Offshore Outsourcing

Through articles, press, and TV, Catherine Mann (2003, 2005) fast became an acknowledged expert on "offshore outsourcing"—the delivery of services through electronic means from workers abroad to large US firms, such as Dell, Microsoft, JPMorgan, and American Airlines. As offshore outsourcing became an antiglobalization rallying cry, Mann highlighted several inconvenient facts. Estimates of US jobs actually displaced are small (under 0.5 million relative to a US workforce of 140 million) and projections are highly speculative. Most of the impact is on lower-skilled service work, exemplified by call centers. The US workforce benefits from a large amount of "onshore insourcing" as skilled lawyers, doctors, accountants, and investment bankers provide services to foreign clients. Finally, and perhaps most significantly, Mann contends that outsourcing certain IT functions boosts the productivity of US firms, in much the same channels as the diffusion of IT over the past two decades. Her broad conclusion is that the United States gains more than it loses from outsourcing and that one answer to competitive pressure is a tax credit for corporate training programs that upgrade the skills of American workers.

Trade Adjustment

Struck by the huge costs of retaining jobs in declining industries through trade protection—upwards of $70,000 per job per year in the 1980s—Hufbauer and Rosen (1986) proposed that quantitative restrictions be converted to degressive ad valorem tariffs. They proposed that the revenue thereby raised be devoted to generous worker adjustment measures. The idea of recapturing quota rents from producers and distributors, here and abroad, was further developed in *Auction Quotas and United States Trade Policy* by Bergsten et al. (1987). Whatever its economic merits, the idea was anathema to those enriched and never gained political traction in the United States (though it was adopted to unravel protection in Australia and New Zealand and other countries).

The core idea of trade adjustment assistance had its own difficulties. It ran into the principled opposition of Secretary George Shultz, who objected to special benefits for workers dislocated by imports. It ran into entrenched Republican opposition to *any* enlargement of the social safety net. Retrospective evaluation of trade adjustment assistance (TAA) programs showed little positive effect in shifting dislocated workers to new careers. Finally, organized labor derided TAA as burial insurance. By the time NAFTA was debated, in 1993, TAA was only marginally effective in garnering political support for trade pacts.

Against this background, Kletzer and Litan (2001) came up with a novel approach: assistance for dislocated workers contingent on getting a new job, not staying unemployed. "Wage insurance" was to compensate in part for the difference between a dislocated worker's wage in the old job and the new job. This idea was embraced as a pilot program along with a tripling of overall appropriations for TAA programs (as a quid pro quo for Democratic support for TPA) in the Trade Act of 2002.

Environmental Awareness

Starting with NAFTA, then the "greenest trade agreement ever," environmental issues began to make an appearance in trade policy. They grew from concerns about a form of "social dumping"—the fear that environmentally destructive firms would take advantage of weak standards and lax enforcement in developing countries and move production abroad. The connection with trade policy thus had a much more mercantile flavor than the "big picture" environmental issues—global warming, ozone holes, and endangered species. Although the Montreal Protocol and the Convention on International Trade in Endangered Species (CITES) both invoked trade measures, and although commercial instruments were an intended part of the Kyoto Protocol, these international accords were not first and foremost about trade policy. Much more in focus were practices that might cut the costs of affected industries and spur their relocation. Against this background, Daniel Esty (1994) authored a call for a Global Environmental Organization (GEO) as a sister institution to the GATT.

The Next 25 Years

What do the next 25 years hold for trade policy? Since our crystal ball is not particularly clear, we write this final section more to throw out provocative questions than to provide speculative answers. Our successors at the Institute's 50th anniversary party can decide whether we asked the right questions and enjoy a good laugh over our predictions.

- In our view, the biggest question is whether the march toward more intense international integration—trade, investment, even migration—will grind to a halt. Will global powers attempt to "corner" energy supplies? Will episodes of terrorism and disease drive up the security tax on trade in goods and services? Will insistent nationalism interrupt the expansion of global MNCs? Will a resurgence of populism, fueled by the seemingly skewed distribution of global growth, stop the show? Our guess is that the advance of communications and transportation technology, coupled with the gains reaped as billions of newcomers enter the market economy, will prove more powerful than the forces of isolation. Nations will deal with the unequal distribution of wealth and income by national measures, not by closing their borders. The march will go on.

- A follow-up question: What will be the contribution of policy-driven liberalization by comparison with privately driven globalization? Private markets, working within static rules and barriers, have greatly increased economic activity across borders—not only "good commerce" but also, alas, "bad commerce," exemplified by drug trafficking, money laundering, and illegal migration (Naím 2005). Private markets will continue to drive international activity in the future, owing to the rise of e-commerce, the integration of capital markets, and the fall of transportation and communication costs. Our guess is that, even if the Doha Round, the FTAA, and APEC all flop, merchandise trade will still expand at 2 to 4 percent per year faster than world GDP, and that e-commerce, direct investment, and financial capital will grow at a much faster clip. That said, it would certainly help if public policy provided a tailwind, not a headwind, for the integration of world markets.
- Finally, will the WTO sputter as an engine of liberalization and take a long slumber, reminiscent of the ILO between 1930 and 1990? Admittedly, our view is heavily influenced by the difficulty in bringing the Doha Development Round to a robust conclusion. We foresee that the mantle of leadership in the globalization agenda will increasingly be borne by bilateral and regional agreements. But we do not foresee exclusive economic blocs centered on China, the European Union, and the United States. Rather, we predict a crisscross network of agreements. Messy, to be sure, but sufficiently flexible that clever firms will circumvent discriminatory barriers by locating the right slices of their global operations in just the right places.

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