# Prospects for Future Inter-Regional Trade Cooperation

**by**
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## Foreign Trade Put to the Test: Latin America, the United States and the European Union as Important Economic Partners

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My thanks to the Konrad Adenauer Foundation for the opportunities to visit this lovely city and to present my views on the Prospects for Future Inter-Regional Trade Cooperation.

Our shared objective, I suggest, should be to focus on the conditions that would promote increased inter-regional trade. That may or may not involve an increase in inter-regional trade cooperation, a process that implies bargaining between the governments that are party to different regional trade agreements. Moreover, as I will develop, regional trade agreements are among the conditions that most restrict inter-regional trade.

International trade, by its nature, involves a voluntary agreement between buyers and sellers located in different countries. Many of the activities of governments, however, other than their fundamental role of enforcing property rights and contracts, distort or restrict international trade. The governmental activities that most distort or restrict international trade, I suggest, are the following:

1. national subsidies on the output or exports of goods and services,
2. national restrictions on the import of goods and services, and
3. bilateral or regional preferential trade agreements.

The U.S. Government, of course, is not uniquely guilty of these activities, but I will focus primarily on the effects of U.S. policies on inter-regional trade for two reasons: The U.S. Government is the biggest player in the game, and I understand U.S. policies better than those of any other government. I will leave you to draw the lessons from my remarks as they bear on the policies of other governments.

1. The production or marketing of many U.S. exports is subsidized by the Department of Agriculture, financed by the Export-Import Bank, insured by the Overseas Private Investment Corporation, or the beneficiary of a tax preference as a foreign sales corporation — with no obvious third-party benefits that would justify these subsidies. These subsidies are not trivial. Subsidies of agricultural production are now about $20 billion a year, and Congress has just approved a new $110 million program to market the exports of these products. The Export Import Bank was established 70 years ago to finance exports to the Soviet Union, has now become Boing's bank, and should have been retired some years ago. As a consequence, foreign producers of many products have to compete not only with American producers but with the U.S. Government, hardly a fair game, and we should not expect many governments to open their markets to subsidized U.S. products. In some cases, this has led other governments to retaliate by raising their tariffs on U.S. products that are not subsidized; the tax preference for foreign sales corporations, for example, now reduces U.S. tax revenue by about $5 billion a year and has recently provoked the European Union to levy a 5% tariff on hundreds of unsubsidized U.S. products because Congress has not yet eliminated this tax preference. The primary effect of most of these subsidies has been to distort the composition and destination of U.S. exports.

2. The most egregious U.S. restraint on imports, of course, is our very tight quota on sugar, a quota that primarily benefits a handful of Florida cane growers. As a consequence, the U.S. domestic wholesale price of sugar is over twice the world price, protecting the wholly artificial market for high-fructose corn syrup, and recently causing a number of U.S. candy makers to relocate to Canada and Mexico. Our highest tariff, the 25% rate on light trucks, has a smaller impact, only because the major Japanese manufacturers already produce these trucks in the United States; the major effect of this tariff is to protect both the U.S. and major Japanese manufacturers of light trucks from competition from the smaller Asian producers. But how can we expect to convince other countries to open their markets if the U.S. market is closed to the products for which they have a comparative advantage?

3. And third, the U.S. Trade Representative is now engaged in a mindless proliferation of bilateral trade agreements, most recently with Morocco. These agreements would almost surely reduce inter-regional trade by creating preferences for trade between the nations in the agreement relative to that with nations in other regions. Jacob Viner spelled out the distortions caused by bilateral trade agreements over 50 years ago, but this lesson has apparently not yet understood by many officials around the world; such agreements risk substituting the most efficient producer in the region for the most efficient producer in the world, reducing the allocative benefits of international trade. A regional trade agreement concerns trade within the region at the expense of reducing trade among regions.

In that respect, what about NAFTA? I continue to support NAFTA, primarily because it included the first and third largest trade partners of the United States from the beginning. For that reason, the trade creation effects of NAFTA have been substantially larger than the trade diversion effects. But that cannot be said for most or all of the other nations with which the U.S. has made or is considering bilateral trade agreements.

Another problem with bilateral trade agreements with the U.S.: They open a huge market in the United States in exchange for opening a much smaller market in the other nation. This gives the U.S. Trade Representative a huge bargaining power on other terms of the agreement; for this reason, Prof. Jagdish Bhagwati, probably the world's leading trade economist, has called the U.S. Government "a selfish hegemon" for the proliferation of bilateral trade agreements. I recognize that there may be some political benefits of bilateral trade agreements; that, presumably is why bilateral agreements were negotiated with Jordan and Morocco, nations with which the U.S. has very little trade.

What about a Free Trade Area of the Americas (FTAA), a U.S. political goal since the first Bush administration? My own view is that the FTAA is a fantasy of those who have not thought carefully about its effects. Most U.S. traded other than with Canada and Mexico, is oriented on an east-west basis with other industrial nations; although my wife and I favor the fines wines from Chile, the U.S. has very little trade with western hemisphere nations south of Mexico, other than in products like oil and cocaine that would not be affected by FTAA. The western hemisphere, briefly, is not a natural trade area. The creation of FTAA would artificially orient trade into three large regional agreements: the European Union, FTAA, and an Asian trade area rather than by the more complex patterns of free trade, reducing the trade among these regions. For the moment, I am pleased that the political complexity of negotiating a FTAA indefinitely delays the implementation of this bad idea.

For the U.S. Government, I suggest, the primary trade policy objectives should be (1) to put the U.S. house in order so that we could lead by example rather than by intimidation, and (2) to think very carefully about what it will take to rescue the Doha Round of multilateral trade negotiations. The first steps toward putting the U.S. house in order, I suggest, are unilateral decisions to eliminate those trade restrictions that were imposed during the Bush administration, eliminate the tax preference for foreign sales corporations, and eliminate the 25% tariff on light trucks. We need to stop describing tariff reductions as "concessions" rather than benefits in their own right. These measures would demonstrate the value of unilateral reductions of trade barriers even if they do not lead to a reciprocal response by other governments. The most important step toward reviving the Doha Round, I suggest, is for the United States, the European Union, and Japan to make a joint prior commitment to a phased reduction of agricultural subsidies and trade restrictions that would be implemented on completion of the Doha Round negotiations; there is no prospect of another round of multilateral trade negotiations unless the major industrial nations are prepared to reduce their agricultural subsidies and import restrictions. Reduce the scope of Doha Round: the WTO is becoming overloaded with issues that may best be addressed in other forms: for example drugs, investments, intellectual property, human rights, democracy, labour and environment etc. One benefit of multilateral negotiations is that the bargaining power of the U.S. government to impose side conditions unrelated to trade is substantially reduced.

In summary, a multilateral reduction of import restrictions would be the most effective way to increase inter-regional trade but is the most difficult to negotiate. Short of that, the U.S. Government should focus on unilateral reductions of U.S. trade barriers rather than a continued mindless proliferation of bilateral trade agreements and a continued misguided commitment to the fantasy of a Free Trade Area of the Americas.