

BY GREG RUSHFORD

When George W. Bush first entered the White House, the United States had free trade agreements with just three countries: Canada, Mexico and Israel. But Bush trade officials let no grass grow under the West Wing, negotiating bilateral and regional FTAs with nearly a score of smaller trading partners.



First, they closed on deals that their counterparts in the Clinton administration had begun with Chile, Singapore and Jordan. Then they signed agreements with Australia, Morocco and Bahrain. That was only the beginning. The White House has since wrapped up negotiations for a free trade accord with six Central American countries and is negotiating others with three Andean nations, the five members of the Southern Africa Customs Union, not to mention Panama and Thailand. And it has its eye on (in no particular order) Egypt, Britain, Japan, Korea, Taiwan, Turkey and the Philippines. What's

more, there's serious talk of a mega-pact with 34 nations in the Western Hemisphere, to be called the Free Trade Area of the Americas. All told, we are talking about some 60 countries.

All this free trade is great economic news, right? Not quite.

For FTAs imply the existence of preferential trade privileges that exclude countries not privy to the deals. Unlike the World Trade Organization, where 147 countries pledge to treat every member identically, FTAs distort trade flows. And the consequences for American consumers are very real, affecting the cars they drive, the clothes they wear and even the country of origin of the tuna in supermarket cans. There are about 300 of these trade-distorting schemes in place around the world,

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TRENDS

creating a messy economic dish that Jagdish Bhagwati of Columbia University likens to a bowl of spaghetti.

Thus, without public notice, the United States is leading global trade policy in a radical new direction. For more than two centuries, Americans proudly claimed not to be the kind of people to use economic muscle to seek to gain leverage over other nations.

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Yet, whoever sits in the Oval Office for the next four years – a fact not known when this article went to press – is already committed to abandoning the high road on trade.

Bhagwati and his Columbia colleague Arvind Panagariya have warned that “we are witnessing possibly the biggest divide between economists and politicians in the postwar period.” They are calling for a moratorium on more FTAs until the ramifications have been considered. But don’t hold your breath.

WHY POLITICIANS LOVE FTAS

While economists tend to sneer at the very mention of preferential trade, politicians of both political parties love FTAs. And no wonder. These deals, negotiated between unequals, generally require foreigners to open

their markets to American exports, yet leave protection in place for “sensitive” domestic products.

In the United States-Australia FTA, for example, the Aussies agreed to open virtually all of their agriculture markets to American farm exports. But America’s cattle ranchers were pleased to learn that U.S. quotas on beef imports will be phased out over 18 years – as close to never as treaties go. For dairy products, the United States agreed to double its annual quota of about \$30 million, which sounds generous but represents just 0.17 percent of U.S. dairy production and only about 2 percent of imports. Meanwhile, the sugar lobby saw to it that the pact won’t allow one additional granule of alien sweetener to reach American shores.

The free trade road to Morocco also runs through the powerful U.S. farm lobby. The Moroccans were required to eliminate their export subsidies on tomatoes. But somehow, the subject of U.S. farm subsidies never came up. There are many, many, many more such examples, as each FTA contains perhaps 400 pages, with another 500 pages of annexes, exemptions, special carve-outs, different rules of origin and so forth. Indeed, for lobbyists these documents are hunting grounds almost as rich as the U.S. tax code.

For President Bush, FTAs also offer opportunities to reward friends and punish enemies. Prime Minister John Howard of Australia supported Bush in the war against Saddam Hussein. Helen Clark of New Zealand did not – and won’t be getting an FTA any time soon. Thus, the preferential trade approach offers a double whammy, both distorting efficient trade patterns and pitting friends against friends. “The decision by our major trading partner, Australia, to go it alone with the United States was not good news for New Zealand,” lamented Roger Kerr, the execu-



tive director of the New Zealand Business Roundtable.

FTAs can also conveniently mix national security policy with protectionism. Singapore, which unlike New Zealand offers safe haven for visiting U.S. warships, has been rewarded with special access to American markets. Again, New Zealand seems to be on the wrong end of a White House two-fer: American farmers and their allies on Capitol Hill have lined up in vigorous opposition to the idea of an FTA that would force American farmers to compete with unsubsidized farmers from Middle Earth. Make that a three-fer: American and Singaporean officials have made no secret of their hopes that the United States-Singapore FTA will divert some trade away from their strategic rival China.

President Bush was miffed in 2003 when Egypt declined to support the U.S. challenge to the Europeans in the WTO on genetically modified food. Since then, talk of an Egyptian FTA has ebbed, allowing the more compli-

ant Bahrain to move to the front of the line. And after Chile respectfully declined to kiss his ring, the president conspicuously delayed signing the United States-Chile FTA. Bush relented only after pressure from American businesses, which were upset that the delay was costing them money, even as it made America look petty.

But don't blame just the Republicans. Democrats, including John Kerry, are also in the business of pressuring foreigners to bend a knee to Uncle Sam's domestic pressure groups. Kerry has said, for example, that if he becomes president, he would veto the Central American Free Trade Agreement – called by its acronym, *Cafta* – as currently written. Kerry is pandering to protectionists in U.S. labor unions, who have vowed to kill *Cafta* unless the Central Americans agree to structure their domestic labor laws to conform to the demands of the AFL-CIO. And these union guys are not easy to please: they opposed the Australian FTA, nominally on



the grounds that Australia couldn't be trusted not to employ child labor.

The U.S. trade representative, Robert Zoellick, doesn't apologize for using the levers of trade to drive national security priorities. But he does offer a higher-minded rationale for U.S. policy, which he has dubbed "competitive liberalization." Zoellick argues that FTAs can be used to convince other members of the WTO that America is prepared to walk away from the WTO's ongoing Doha Round of trade liberalizing negotiations unless recal-

citant countries stop stalling.

Zoellick – who is widely credited for his leadership in pressing the WTO's Doha talks – has a point. "FTAs provide institutional competition to keep multilateral talks on track," noted Daniel Griswold, a trade analyst with the libertarian Cato Institute. "If other members of the World Trade Organization become intransigent, the United States must have the option of pursuing agreements with a 'coalition of the willing' in pursuit of trade liberalization."



And he is not alone among free traders. John Jackson, a law professor at Georgetown University and an authority on WTO issues, also favors FTAs. But Jackson's endorsement is qualified: "There is a risk that FTAs will become trade-diverting," he concedes, "particularly in the rules-of-origin area."

IT'S THE RULES, STUPID

It doesn't take much digging to see how FTAs divert trade flows. Just ask Brenda Jacobs, a lawyer who represents clothing importers.

The FTA with Israel specifies that where the apparel is cut determines where the garment is made, she notes, while Jordan's FTA has a rule that says where the clothing is assembled determines the origin. "And then, with Nafta" – the North American Free Trade Agreement between the United States, Canada and Mexico – "the yarn and fabric must be produced within the three countries," Jacobs added.

The so-called "Nafta yarn-forward" rule of origin is aimed to please the U.S. textile lobby, which wanted to ensure that clothes sewn in Mexico for export north would be made from fabric woven in the United States. The U.S.-Singapore FTA has a similar rule. But since Singapore doesn't weave its own fabric and it makes no commercial sense to ship it all the way from America, the FTA has a complex formula for tariff preferences for clothing made in Singapore from fabric that might come from third countries.

The United States has yet more rules for clothing exporters from Africa and the Caribbean. And for the businesses involved, it all gets very complicated. "Any reasonable businessman has to weigh the costs and risks of compliance with these preference programs, against the costs of simply ignoring the duty-free preferences and just paying full duty," Jacobs noted. "Sometimes it happens that the cost of paying full duty is less than the risks involved in ensuring compliance with the FTAs."

POLITICALLY CORRECT CARS AND TRUCKS

The rules of origin for cars and trucks are every bit as political as those for clothing. Under Nafta, 62.5 percent of the content has to come from within North America. If a car has the required 62.5 percent Nafta content, it can enter the United States from Mexico or Canada duty-free, and thus avoid the 2.5

TRENDS

percent tariff on imported cars. The idea was pushed by Detroit, which aimed at driving up the costs of imports from Japan. A 2.5 percent tax on imported cars may not seem prohibitive. But as anyone who has ever haggled over the price of a car can attest, every extra dollar added to the sticker could be the deal killer.

There are also paperwork burdens associated with figuring out where the various components that go into automobiles come from. In the United States-Canada FTA in force since 1989, a shock-absorber assembly put together in Canada from partly Canadian and partly Japanese parts was considered Canadian. But in 1993, when the FTA was blended into Nafta, the rule changed.

“The United States created a list of major auto parts and the content of those parts had to be traced,” explained Washington trade lawyer Lewis Leibowitz. “If the parts were assembled in Canada, when you traced the source of the components you couldn’t count the Japanese value.” Today, there are people in all the auto companies who spend their days figuring out how to compile the tracing lists. “It’s a very burdensome, expensive procedure that drives costs up,” Leibowitz notes.

In the United States-Australia FTA the rules changed again, this time requiring “only” a 50 percent local content for cars. But the most interesting part of the United States-Aussie trade bilateral is its provision that allows the nice folks from Down Under to ship light trucks to the United States duty-free – thus avoiding the hefty 25 percent U.S. tariff on foreign trucks.

This truck tax has an interesting history that illustrates how politics trumps economics. It was first imposed in 1963 by President Johnson, who was angered that Europeans were not buying American chickens. The idea was to punish Germany’s popular Volkswa-

gen Microbus (a precursor to the minivan), which is why the tax quickly became known as the chicken tariff. There was never any pretense of an economic justification for taxing foreign trucks at 10 times the rate of cars.

In the late 1980s and early 1990s, Detroit (then at war with Japan and its rising minivan exports) fought vigorously to keep the chicken tariff on the books. But over the years, the Big Three’s protectionist passions began to wane. Chrysler is now owned by Germans, as is a large chunk of Mitsubishi. Meanwhile, Toyota and Honda don’t care much about the chicken tariff, as they make trucks in the United States.

Thanks to the Australia FTA, some sporty Aussie light trucks called “Utes” (Aussie for utility vehicles) may well start appearing in U.S. showrooms. Utes are made by General Motors’ Holden subsidiary, so GM now likes the idea of allowing Australia to sell light trucks to America. Meanwhile, Ford now wants to export light trucks to the United States from Thailand, which helps explain why that country is in negotiations to become a member of the U.S. economic coalition of the willing.

SWIMMING WITH THE FISHES

For perhaps the best example of how preferential trade deals divert global trade flows while causing turbulence in political waters, consider Charlie the Tuna.

The United States still maintains tariffs on canned tuna that range from 12.5 percent (packed in water) to 35 percent (packed in oil), even though America’s tuna canneries moved offshore long ago. America’s remaining tuna work force consists of perhaps 600 people in Bumble Bee Seafoods operations in Southern California and Puerto Rico.

When Nafta was ratified in 1993, the United States granted Mexico duty-free treatment



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for canned tuna, beginning in 2008. But that left Caribbean tuna countries, including Trinidad and Tobago, in a sulk. So in the Caribbean Basin preference deal, those countries received what Mexico had gotten. Bumble Bee didn't mind, as it was happy to export its canned tuna to the United States from its operations in – you guessed it – Trinidad and Tobago.

But then Ecuador, a major tuna country, asked why the U.S. Congress would put its tuna workers at a competitive disadvantage. That's when StarKist's Charlie the Tuna, Bumble Bee's archrival, got hooked by politics.

In 2002, the House Ways and Means Committee voted to grant Ecuador immediate duty-free access for its processed tuna in the Andean Trade Preference Expansion Act. StarKist, which operates in Ecuador, was delighted.

Bumble Bee wasn't. It turned out that Bumble Bee had found a way to work around the U.S. tariffs in its own operations in Ecuador by turning the fish into filets after gutting, cleaning and cooking them. The filets are exported to Bumble Bee facilities in the United States, where they are put into cans by machines. But in its operations in Ecuador,

TRENDS

StarKist had been packing its tuna in pouches (the hot new look for tuna in American supermarkets) – and paying the high U.S. tariffs.

Bumble Bee liked the idea that rival StarKist was taxed heavily, and sparked a major lobbying battle when it persuaded Senator John Breaux, Democrat of Louisiana, to offer an amendment to the Andean trade legislation aimed at keeping canned tuna tariffs on Ecuador as high as possible.

The issue was ultimately settled by a compromise that allowed StarKist to export its tuna in pouches duty-free, while leaving the existing tariffs on tuna that is canned in Ecuadorian-owned tuna factories. The Ecuadorians seem to be used to being treated in such discriminatory ways by Yankees, and didn't protest much. But that wasn't the end of the story.

Major tuna processors in Asia, notably in Thailand and the Philippines, asked why their tuna workers were getting the short end. Philippine officials pointed out that some 17,000 tuna workers in southern Mindanao were mostly Muslims who were on the front lines of the battle against one of Al-Qaeda's Asian franchises. "It is unjust, unreasonable and counterproductive" for Congress to legislate a competitive disadvantage for Philippine tuna workers, declared Albert del Rosario, Manila's ambassador in Washington, "The thing that I find unreasonable about this is that the Philippines is in partnership with the United States in the war against terrorism."

That was in 2002. Officials from Thailand echoed the sentiment; neither country, however, has found anyone in the U.S. government prepared for a knockdown with Congress to give the two countries a break on tuna tariffs. But in the United States-Australia FTA, the United States did agree to exempt

that country from tariffs on canned tuna.

Why? Because if there's one thing lobbyists know how to do, it's count. Australia has only one tuna cannery, Port Lincoln Tuna Processors. The Aussies hope that their tuna factory will export roughly \$15 million in canned tuna in 2005, and perhaps add 70 new jobs. Meanwhile, Thailand, the world's largest canned tuna exporter, had 19 tuna canneries at last enumeration – and remains the object of American tariff discrimination.

At least the Thais are negotiating an FTA with the United States, where they can grovel for a preference for their tuna industry. This, of course, could wipe out Philippine tuna exports. But Washington won't negotiate an FTA for the Philippines.

Not surprisingly, Philippine officials have been fuming. When talking to U.S. officials, Filipinos tend to bring up the subject of tuna at every available opportunity. "I did not know that someday I would be dealing with tuna," Secretary of State Colin Powell quipped in Manila in August 2002 after being upbraided by an exasperated Philippine President Gloria Arroyo. "We should have served you a tuna sandwich," instead of ham, Arroyo – herself a U.S.-educated economist – shot back.

HISTORY FORGOTTEN

When American officials express indifference to complaints from foreigners who are hurt by discriminatory U.S. trade policies, they might reflect upon America's own history – and upon how the current enthusiasm for negotiating preferential trade runs against centuries of deep-rooted American aversion to trade-distorting schemes.

"The American revolution was fought in part over the British insistence that the colonies trade with Britain and not with France," noted the Washington trade lawyer David Palmeter. "The Declaration of Independence

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condemns King George III 'for cutting off our trade with all parts of the world.'"

In 1778, Benjamin Franklin negotiated an alliance with France that helped the colonies win their independence from England. As Walter Isaacson observes in *Benjamin Franklin: An American Life*, "the commercial rights that the Americans granted were mutual, nonexclusive and permitted a system of open and free trade with other nations." In a letter to Congress, Franklin made it clear that "no monopoly of our trade" had been granted. "None are given to France but what we are at liberty to grant to any other nation."

In 1794, President George Washington dispatched Chief Justice John Jay to London to negotiate what became the most controversial preferential deal in American history. When it was presented to the American public the next year, Jay's Treaty immediately became the cause of widespread resentment, and for good reason.

"It recognized England's right to retain tariffs on American exports while granting English imports most-favored status in the United States," explained Joseph J. Ellis in *Founding Brothers*, his analysis of America's revolutionary generation.

America's economic appeasement was aimed at trying to buy off a powerful foreign power – and like most appeasement, it didn't work in the long run. Jay's Treaty contributed to the tensions that erupted in the War of 1812.

There's a lot more to this history. At the turn of the 20th century, while Europeans

carved out trading enclaves in China, John Hay advocated an open door for trade with China. After World War I, the third of Woodrow Wilson's Fourteen Points was "the removal, so far as possible, of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the peace and associating themselves for its maintenance."

When the General Agreement on Tariffs and Trade was established after World II, the first and foremost principles were enshrined in GATT Articles I and III. Article I required all signatories to grant all of their trading partners most-favored-nation tariff treatment. Article III requires signatories not to discriminate in favor of some trading partners over others, the so-called "national treatment" principle.

However, Article 24 of the WTO grants member countries an exemption to strike special bilateral and regional customs unions and special trade arrangements. "This was supposed to be a very limited exemption, but in practice you can drive a truck through it," David Palmeter explained.

Like it or not, the world economic system is increasingly distorted by a plethora of FTAs – a trend driven by the world's only superpower. The next occupant of the White House might want to reconsider the wisdom of using America's leverage to negotiate one-sided economic treaties that will inevitably breed further resentment in a world that is increasingly inclined to distrust United States motives about everything. **M**