

After NAFTA: Free Trade and Asia

By Franklin L. Lavin

The expansion in international trade over the past few decades has led to enormous benefits for both the United States and our trading partners. Our success with the North American Free Trade Agreement (NAFTA) and our ability to build on that success in 1993 through free trade agreements across the Pacific will provide an unparalleled opportunity to lock in that prosperity for the next generation. But before I dive directly into that thesis, let me back up a bit and explain how we have arrived at this present-auspicious position.

The last few years have witnessed the fading of the Cold War and the emergence of global economic issues as a primary dimension of U.S. foreign policy. As our nation tries to come to grips with the challenge of international financial and commercial issues, we might do well to recall some of the aspects of Cold War foreign policy management which contributed to our success during that "long twilight struggle."

The cornerstone of our security policy during the last five decades has been the concept of collective security—mutual defense treaties established with the other leading industrial democracies to protect the common safety. The North Atlantic Treaty Organization (NATO) and Australia-New Zealand-United States (ANZUS) Alliance stand out as two institutions which helped preserve the peace during those turbulent times.

Whereas our leadership in the 1940s grappled with the issue of security architecture, today we must grapple with the issue of economic architecture. The two paramount international economic institutions, the General Agreement on Tariffs and Trade (GATT) and the Group of Seven (G-7), which deal with trade matters and financial matters, respectively, have shown recently that they are both in need of being strengthened.

Generosity and Self-Interest. It is against this backdrop of a sea-change in foreign policy orientation and a boom in international economic activity that President Bush's "Agenda for American Renewal" speech must be seen. On September 10, in an address to the Economic Club of Detroit, President Bush said it was his goal to "develop a strategic network of free trade agreements with Latin America, with Poland, Hungary, and Czechoslovakia, and with countries across the Pacific." Margaret Thatcher commented on the President's speech some two weeks later, stating that the proposal constituted "a typical combination of American generosity and far-sighted understanding of its own self-interest."

Indeed, the U. S. experience with trade liberalization has always evoked these two concepts—generosity and self-interest—which one could say trade in general evokes. The U.S. has quite a bit of experience with trade liberalization, having set up free trade agreements (FTAs) with both Canada and Israel, and having established a preferential trading arrangement with the Caribbean nations through our Caribbean Basin Initiative.

Each of these openings in trade has led to increased exports from the United States, increased jobs in the U.S., and increased opportunity for U.S. consumers. And there is every reason to believe that our pending FTA with Mexico will result in similar economic benefits for both participating countries. As a follow-on to NAFTA, the President previously had proposed the idea of hemi-

Franklin L. Lavin is Deputy Assistant Secretary for East Asia and the Pacific at the U.S. Department of Commerce. The thoughts expressed in this lecture are not necessarily U.S. Government policy.

Mr. Lavin spoke at The Heritage Foundation on Tuesday, October 6, 1992.

ISSN 0272-1155. © 1992 by The Heritage Foundation.

spheric free trade, from the Yukon to Tierra del Fuego, through his Enterprise for the Americas Initiative (EAI). So the idea of expanding free trade across the Pacific is very much an evolutionary idea, building on previously adopted and proposed liberalizations.

Emphasizing GATT. The Detroit speech spells out a further refinement of this two-level process. On one level, we work through GATT to strengthen the multilateral system. On another level, we work toward the development of sub-groupings which allow us to proceed at a faster pace. Our move toward selective FTAs over the past decade notwithstanding, the United States consistently has taken a multilateral approach to liberalization. That is to say, the U.S. always emphasized the GATT as the appropriate vehicle for promoting world trade. GATT has been and continues to be the most useful vehicle, and we continue to believe that the Uruguay Round will yield benefits similar to the previous successful rounds. In addition, one could argue that the liberalizations taken to date were for specialized reasons: security concerns in the case of Israel and the Caribbean and border issues in the case of Canada and Mexico.

So historically we have attached a great deal of importance to the GATT process, but there are limits to using GATT as the sole vehicle for trade liberalization; perhaps this is somewhat akin to pursuing foreign policy only through international fora. GATT operates on the basis of consensus. Thus steps to which 105 GATT members must agree will necessarily be a long time in coming. The good news is that GATT encompasses some 90 percent of the merchandise trade which takes place in the world. The bad news is that because it is so broadly gauged, it sometimes moves very slowly.

If two or more countries have a desire to liberalize among themselves, shouldn't they be able to design a mechanism which would so provide? Why should countries which desire the benefits of increased trade have to proceed at a pace set by the least competitive or most protectionist member of the GATT?

GATT is valuable as a mechanism for moving the world trading community toward liberalization. But if we view it as the only mechanism for liberalization, we miss opportunities. Hence the Agenda for American Renewal calls for the successful completion of the current round, but it also states we will take trade liberalization where we can find it. We will move as rapidly as we can.

With NAFTA negotiated and awaiting ratification, our attention will turn first to liberalization in this hemisphere. Given the strong consensus for free trade which is developing across Latin America as well as the number of FTAs which already exist in the region, this process should take about two years to move to resolution. Mexico, for example, has already established FTAs with the Central American countries and Chile. The Southern Cone countries of Argentina, Brazil, Paraguay, and Uruguay have already established their own FTA, known by its Spanish abbreviation MERCOSUR. We should make 1993 the year in which the question of how to expand free trade into the Pacific changes from an idea in a speech to a practical question for leadership on both sides of the Pacific. Indeed, President Bush has stated that he intends to seek formal negotiating authority for these new FTAs in the first half of 1993.

Free Trade with the Pacific

If the issue facing the United States next year is how to expand free trade across the Pacific, I have a few unofficial thoughts to offer. The United States should pursue this goal as it has with the EAI in Latin America: Establish a set of independent free trade criteria and offer to begin discussions with any country that meets those criteria. If a country is committed to open markets for goods and services, if a country is committed to removing barriers to investment, if a country is committed to safeguarding intellectual property, then we can begin discussions. Which countries would be most likely to embrace these criteria? Looking solely at the commercial dimension, several economies come to mind. In the first tier of potential trading partners, one should put Australia,

Hong Kong, New Zealand, Singapore, and Taiwan. All of these economies have relatively open trading systems, are relatively affluent, and have highly internationalized markets.

Of these five, only New Zealand and Taiwan publicly have called for free trade agreements with the United States. Of course, the President's proposal is not even one month old. In addition, we should recognize that there are political considerations that potentially complicate decision-making. For example, Australia's leadership appears to have come out against an FTA at present. New Zealand relations are complicated by the ship visits issue. Hong Kong trade relations could be complicated by its eventual reversion to PRC rule. And trade relations with Taiwan are complicated by our lack of formal political ties.

The United States should also keep in mind the importance of three economic organizations in Asia: APEC, the CER, and AFTA. APEC, Asia Pacific Economic Cooperation, is a fifteen-member organization which has done a lot of work on the technical issues of trade such as customs standardization. The CER, or Closer Economic Relationship, is the Australia-New Zealand free trade agreement. AFTA is the ASEAN Free Trade Area, which begins to take effect next year among the six members of the Association of Southeast Asian Nations. These local economic groupings are welcome developments as they start the participating nations on the course of liberalization. Neither CER nor AFTA is a trade bloc, any more than NAFTA is, as they do not erect a common external tariff.

Counter-Arguments

Although the idea of U.S.-Pacific free trade has not been the subject of discussion for a great amount of time, it might be worthwhile to note the concerns which have been cited in opposition to the idea. To date, I have noted three kinds of concerns: those dealing with GATT, those dealing with cultural issues, and those dealing with trade diversion.

The GATT issues themselves are twofold. We sometimes hear objections to bilateral liberalizations because they are supposedly a diversion from GATT. A recent issue of *Asiaweek* stated in an editorial, "Every hour of effort poured down the APEC drain is effort lost to GATT." This ignores the fact that bilateral FTAs involve a separate set of issues discrete from those at the GATT. Additionally, most observers would take issue with the premise that the current round has suffered from an insufficient effort by the trade experts. The consensus of most observers is that the failure to move ahead with the round to date is because of political differences. If wrapping up the Uruguay Round was simply a matter of man-hours, I would be the first to endorse the idea that we temporarily suspend every trade negotiation we have going on around the world, fly everyone to Geneva, and finish the round.

Another GATT concern is that bilateral liberalization in itself undercuts GATT by establishing an alternative mechanism to liberalization. On the other hand, if a broad free trade area can be established, a smaller model could be held out as an example to propel GATT to freer trade. As a regional free trade arrangement moves ahead, it will put the onus on the recalcitrant members of the GATT to resolve their problems.

The second concern, U.S. political or cultural dominance, is one we have heard before. As you might imagine, we heard these complaints from certain quarters when we worked on both the Canadian and the Mexican free trade agreements. From my work in Asia, I have not seen much that would give credence to those complaints. Although Americans are keenly interested in marketing their products, there does not seem to be much interest in doing anything in Asia except leaving as soon as the sale is made. Nonetheless, we need to be sensitive to the cultures of the region, although we cannot let these cultural sensitivities serve as barriers for trade.

The third complaint is an economic one: the standard economic textbook argument of trade diversion. In other words, if Country A and Country B liberalize their mutual trade, Country C could be worse off if it had traditionally been an exporter to either A or B, and were subsequently displaced. In certain rare cases, this trade diversion (so-called because with liberalization, trade is diverted from the most efficient exporter to one who enjoys a preferential trading arrangement) could be so great as to exceed the benefits of increased trade between A and B. Country A might be better off. Country B might be better off. But the degree to which country C is worse off could conceivably even offset the improvements of both A and B.

There is a policy response and an economic response to this argument. The policy response to this complaint is simple: liberalization should be offered to A, B, and C. If any country fears being displaced by other countries' liberalizations, it need only liberalize itself. The economic response is that the prospect of increased trade in the case of NAFTA, for example, vastly outweighs the minor cases which might exist. Economist Lawrence Krause states that the greatest threat to economic expansion in Asia in 1993 is the possibility that NAFTA would not be ratified.

Principles for 1993

Let me sum up by offering four principles we should keep in mind as this issue moves forward next year:

- 1. We need to find the right way to turn the President's vision into a workable proposal.** President Bush has stated he will seek congressional authority for negotiating these follow-on trade agreements. As GATT and NAFTA are on their way to being resolved, say in March 1993, the United States government should formally put forward a framework of criteria which would allow us to begin discussions. These discussions could be bilateral initiatives or multilateral arrangements as was first proposed by then-Undersecretary of State Robert Zoellick as "After-NAFTA links." We also need to explore how APEC can contribute to greater trade liberalization, as was most recently suggested by Australian Prime Minister Paul Keating.
- 2. The free trade proposal must be all-encompassing and GATT-consistent.** All countries have sectors of their economies which are less competitive and therefore would experience the greatest dislocation should that country move toward free trade. Countries frequently seek to exempt those sectors from free trade agreements. The proposal a country offers, rather than being genuine free trade, becomes free trade in all sectors except those in which other countries compete well against them. Hardly an inviting proposal. We need to seek free trade agreements for all goods and services. We need to eliminate barriers to investment, and we need solid protection for intellectual property rights. Like NAFTA, these new FTAs need to be built around reductions in trade barriers, not common external tariffs.
- 3. We need to recognize that most barriers to trade are non-tariff barriers (NTBs).** It will do us no good to simply negotiate tariff reductions leaving NTBs intact. Regulations currently in place prohibit or mitigate against U.S. television commercials in various Asian countries, for example. Similarly, some countries prohibit U.S. banks from having branches or even off-site ATM machines. All of these NTBs will have to be resolved for the agreements to be genuine FTAs.
- 4. We need to recognize the difference between a "hub and spoke" system and a plurilateral system.** The "hub and spoke" model of FTAs envisions a series of bilateral FTAs in which the United States might sign an agreement with Country A and another one with Country B and would thereby enjoy free trade privileges with both A

and B, but Countries A and B would not enjoy free trade privileges with each other. A plurilateral model envisions a system in which participating countries would automatically enjoy free trading privileges with all other members.

It's easy to see the advantages of the latter system, particularly as free trade expands. One could hardly be thought of as generous or far-sighted if, for example, one were to require a mid-sized country such as Thailand, which might be the 28th country to sign an FTA with the United States, to go ahead and negotiate 27 other FTAs around the world.

Conclusion

NAFTA represents about 30 percent of world GNP. Every country in the Western Hemisphere except for three has expressed a desire to participate in the EAI, which should lead to free trade across North and South America. If we think it is reasonable that free trade will be expanded across the Pacific over the next few years, over 40 percent of the world's economic activity could take place through a U.S.-led free trade area.

Seeking greater free trade with our Asian partners will not be easy. Every country will react differently to this proposal; some with enthusiasm, many with noncommittal but positive words, some with disdain. In the United States we will also face criticism from people who would rather protect 19th century business practices than build them into 21st century businesses. This should neither trouble nor surprise us. We seek nothing but the right to buy and sell our goods and services as a free people. If some countries are prepared to move with us on equal terms in the spirit of friendship, we welcome them and we are flexible enough to take advantage of an opportunity. If other countries feel they need to wait, we are patient enough to understand.

President Bush elaborated on some of the themes of his Detroit speech, saying, "During the Cold War, we built a global security structure to contain and counter the Soviet Union and communist aggression. We forged military alliances across the Atlantic and Pacific that underpinned that structure. In the post-Cold War era, we need a strategic global economic and trade policy that will ensure our position as an economic and export superpower as well." U.S. leadership secured world peace through the post-war era. U.S. leadership can secure world economic prosperity for generations to come.

