

**US Trade Policy:
The Infatuation with FTAs**

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* This paper draws on remarks made at the American Economic Association meetings, January 1995, in Washington D.C., at a Panel Discussion on the Clinton administration's trade policy. I have retained much of the informal style of the discussion.

The US administration is poised to expand NAFTA to Chile and elsewhere. It also may be committed to turning APEC into a Free Trade Area (FTA). It seems therefore to have decided to persist in pushing ahead with these types of trading arrangements even though the multilateral WTO has been jumpstarted.

I believe that this policy of, indeed obsession with further expansion and creation of FTAs, instead of concentration now on multilateralism at the WTO, is a mistake. Let me explain why.

Orwellian Newspeak

At the outset, let me say that it is time that we realized that the phrase Free Trade Areas is Orwellian newspeak. It lulls us, indeed editorialists and columnists and politicians, into focusing only on the fact that trade barriers are lowered for members to the exclusion of the fact that, implicitly, the barriers are raised (relatively) for nonmembers. FTAs are therefore two-faced: they embody both free trade and protection. The reason is that they are inherently preferential and discriminatory. Perhaps, as economists interested in the quality of public policy discourse, we should take a pledge to rename the FTAs henceforth as PTAs (i.e. preferential trade areas) .

In that regard, let me say also that, during the lobbying campaign for NAFTA --- I should really call it NAPTA if I was to act on my suggestion above ---, an incompetently drafted statement of support for NAFTA made the rounds for our signatures. It was notable for its implied equation of the case

for the proposed FTA with the case for free trade, obfuscating the real issues¹. I was not asked to sign it and so the absence of my signature was not indicative of my views. [In fact, the media, in writing on NAFTA, occasionally described me as a notable signatory, assuming that I must have signed since I was a "free trader" or, as an irate administration economist of great distinction who was upset with my views and writings on Japan once denounced me, a "hyper-free trader".] I have little doubt that many economists signed the ill-tutored statement of support for NAFTA simply because, once the protectionist Ross Perot had staked out his opposition to NAFTA, there seemed to be only a binary choice much like the choice from two tasteless entrees in a restaurant: support protectionism or support NAFTA. Signing the imperfect statement in support of NAFTA must have seemed the lesser of two bad choices, quite obviously.

Now that Ross Perot is out of the way, NAFTA has passed, and the Clinton administration is embarked on extending NAFTA into new countries starting with Chile and is understood also to be desirous of turning APEC into

¹ The debasement of the economic discourse from the opposite viewpoint comes, on the other hand, from the occasional suggestion that, to join FTAs, countries need to satisfy prior conditions on macro-stability et.al. Thus, in a recent study, the wellknown economists Gary Hufbauer and Jeff Schott of the Institute of International Economics in Washington appear to list several criteria for countries to be invited to join NAFTA, assigning weighted grades for this purpose. This leaves me puzzled, if I have understood them correctly. Free Trade requires no such preconditions, so why should FTAs? If it is correct to impose such prior conditions for us to let them join us in freeing trade within an FTA, then we would have to revise all our textbooks and treatises on international economics which argue that, no matter what other countries' own policies, we will generally profit from freeing trade in a nondiscriminatory fashion. [The only difference would arise from the discriminatory nature of FTAs: we may be hurt by a trade-diverting FTA, in which case the FTA may be regarded as undesirable but the focus then is not on our potential FTA partner fulfilling prior preconditions but we ourselves doing so.] The Hufbauer-Schott type of thinking is thus not merely incorrect, insofar as (let me repeat) I understand it correctly. It could also be harmful if it spread from FTAs to thinking about Free Trade generally among policy circles.

an FTA, it is surely time to subject this pro-FTA policy to fierce scrutiny.² Such scrutiny, in my view, would expose this policy of the administration as a folly.³

For, in essence, the proliferation of such PTAs, where countries extend preferences in different trading arrangements, creates a “spaghetti bowl” phenomenon. Thus, the EU has different types of association agreements with countries outside of the core members; the US has hub-and-spoke arrangements with free trade with Israel which, in turn, is not a partner of NAFTA; Israel has arrangements with EU and US; Mexico is a member of NAFTA and of an aspiring APEC FTA; Mercosur is about to enter into negotiations for a preferential trading arrangement with the EU, and so on. As countries reach out for special deals, not just among developing countries (as they have done for decades) but with the major trading nations as well, the analogy with an orgy, with bodies intertwined and reaching out in different directions, may be more apt in the increasingly salacious Washington.

The Spaghetti Bowl: Problems with Preferential Trading Arrangements

Such spaghetti-bowl proliferation of preferential trading arrangements clutters up trade with discrimination depending on the “nationality” of a good., with inevitable costs that trade experts have long noted. In particular, consider the following points, some relevant only to Free Trade Areas, the others more general.

(i) Rules of origin, which are inherently arbitrary despite the Codifications we must live with, multiply under Free Trade Areas because

² The Economist, in a brilliant lead editorial in the end-of-the-year Double Issue, December 24th- January 6th, entitled “Battle Lines”, raised much the same issue, asking for an examination of the “increasing enthusiasm for regional, as opposed to global, agreements to liberalize trade” and avoiding “the mistake of unreservedly supporting everything Ross Perot attacks”. I congratulate this magazine which, along with The Financial Times, has played a distinguished and impressive role in raising the key analytical issues in regard to the world trading system in the last half a decade, while the US business magazines have done little except to play to nationalist and lobbying business viewpoints on issues such as NAFTA and Japan-bashing.

³ For a fuller analysis, see also my 1994 Wincott Lecture in London, to be published by the Institute of Economic Affairs and my Keynote Address in Tokyo in October 1994 at the Symposium organized by Nihon Keizai Shimbun and the Ministry of External Affairs in celebration of the 30th Anniversary of Japan’s accession to the OECD.

different members have different external tariffs, making the occupation of lobbyists (who seek to protect by fiddling with the adoption of these rules and then with the estimates that underlie the application of these rules, as in the recent Canadian Honda case) and of customs officers (who can make much money by assigning goods to different origins as suggested by those fetching gifts) immensely profitable at our expense.⁴

(ii) More generally, it is increasingly arbitrary and nonsensical to operate trade policy of all kinds on the assumption that you can identify which product is whose. When I was a student at Oxford in the 1950s, there used to be a Who's Whose, designed to list the bondings (or "steady relationships" in our slang) among the undergraduates. Needless to say, the sexual revolution and the rise of uninhibited promiscuity put an end to it. Similarly, with the phenomenal globalization of investment and production, a Who's Whose in defining trade policy is an increasing anomaly, tying up trade policy in knots and absurdities and facilitating protectionist capture.

Take some telling examples. We have tried assiduously to tell the Japanese that exports from their transplants in the US to Japan are not to be counted as US exports. On the other hand, when the Europeans tried to include the cars exported from these very transplants in their VER quotas on Japanese cars, Mrs. Carla Hills was up in arms! Again, just because imports from Japan are sought to be controlled, rather than imports from all sources without discrimination (as would be the case simply with a tariff or an auctioned VER), we have the EU getting into knots about whether Japanese transplants in UK are to be allowed freedom of access within the EU, and when would a car produced in Oxfordshire be British rather than Japanese.

Indeed, as the world economy increasingly muddies up the idealized picture of Japanese, American, British, Indian and Mexican goods that drives much of trade policy including particularly the pursuit of Free Trade Areas, the more we trade economists can see the wisdom of the great trade theorists of the past, Viner, Meade et.al., who were strongly wedded to

⁴ Anne Krueger and Kala Krishna have written extensively and illuminatingly on this problem; so has the distinguished lawyer-cum-trade-commentator, David Palmetier.

nondiscrimination and hence to MFN and multilateralism. As usual, a quote from Keynes, who had renounced his earlier skepticism of nondiscrimination during the British-American discussions of the design of the postwar Bretton Woods institutions, from his speech in the House of Lords in 1945, says it best:

“ [The proposed policies] aim, above all, at the restoration of multilateral trade... the bias of the policies before you is against bilateral barter and every kind of discriminatory practice. The separate blocs and all the friction and loss of friendship they must bring with them are expedients to which one may be driven in a hostile world where trade has ceased over wide areas to be cooperative and peaceful and where are forgotten the healthy rules of mutual advantage and of equal treatment. But it is surely crazy to prefer that .”⁵

(iii) Again, it is frequently claimed that trade creation will be the order of the day with FTAs and customs unions (CUs); hence we need not fear trade diversion. But, as I noted some years ago, when protection is administered (in the form of VERs, anti-dumping actions etc.), it is selective and variable. The endogeneity of such protection means that trade creation can turn into trade diversion. Thus, if the US crowds Mexico in an industry, potentially creating trade in the Vinerian sense, Mexico can, and probably will, start anti-dumping action against nonmember suppliers and seek to accommodate thus both its own and the US firms at the expense of nonmember suppliers, transmuting trade creation into trade diversion.

At my suggestion a few years ago when I was Economic Policy Adviser to the Director General of the GATT and we were planning an Annual Report on Regionalism, Brian Hindley of LSE and Patrick Messerlin of Paris investigated this possibility empirically to see if the well-documented anti-dumping actions (especially against Japan and the Far East) of the EC could be so interpreted as responses to the internal “trade-creating” competitive pressures rather than to exogenous intensification of competition from

⁵ Quoted (p.64) in The World Trading System at Risk, Princeton University Press: Princeton, 1991, based on the Harry Johnson Lecture that I delivered in July 1990. Italics have been inserted.

abroad. Their verdict was: yes, there is evidence in some cases that this had happened.⁶

The NAFTA's economist supporters, many untutored in any of these nuances because few had any professional competence in the complexities of trade analysis and realities, simply missed this important issue, focusing at best only on the observed trade barriers. When you combine this observation with the fact that our negotiators helped to weaken the improvement in discipline on anti-dumping at the Uruguay Round, as I observed above, the folly of our trade policy becomes obvious. Indeed, if you want to go down the PTA route, and to minimize the possibility of trade diversion, be sure that there is far more (not less) discipline on administered protection than we currently have!⁷

(iv) In regard to trade diversion, furthermore, Arvind Panagariya of the University of Maryland, a distinguished trade theorist and policy analyst, has raised the question: would not Mexico, and potential future developing countries of South America seeking to join NAFTA, themselves suffer from harmful trade diversion from joining NAFTA? Arguing that the US and Canada are largely open, and comparing with the alternative of nondiscriminatory trade liberalization, Panagariya has argued that trade diversion is indeed what Mexico et.al. face, with the US and Canada gaining from the preferential trade liberalization of Mexico et.al. and the latter losing

⁶ The Hindley-Messerlin paper has now appeared in a volume edited by Kym Anderson and Richard Blackhurst for the GATT and published by Harvester Wheatsheaf (UK), 1994.

⁷ Of course, trade diversion itself may be the principal driving force behind the choice of FTAs rather than nondiscriminatory trade liberalization as far as business lobbying is concerned. This "incentive" or "political economy" aspect of FTAs versus FT has been raised by me in "Regionalism versus Multilateralism: An Overview", published in 1994 in the World Bank volume on the subject, edited by Panagariya and de Melo. It was also the subject of an Economics Focus column in 1993 in The Economist. That business lobbies, interested in exports, may prefer to go for preferential trade barrier reductions in their favour rather than investing efforts in opening markets for their rivals as well is what I have long been stressing, noting the differential lobbying in favour of NAFTA as against the Uruguay Round and the GATT. This idea has been analytically pursued in recent theoretical papers by my Columbia University student Pravin Krishna and by Arvind Panagariya and Ronald Findlay, the latter forthcoming in Gene Grossman and Robert Feenstra (ed.), The Political Economy of Trade Reform, Essays in Honor of Bhagwati, MIT Press: Cambridge, Mass., 1995.

from it.⁸

One may well object: why should Mexico et.al. then want to join NAFTA? If the question is raised because it is inconceivable that the governments of these countries would not be rational in their policy choices, then that assumption itself must be clearly rejected. For one thing, as we know well from aid experience and literature, one can seek something which sounds good but actually does harm. Besides, the objectives of the leaders may be diversified. Thus, for instance, they may expect to gain political kudos by going along with NAFTA because, by granting preferential access to the US exporting interests, and through the implied underlining of Mexico's special relationship to the US, they may gain the support of the US in reaching out for prizes in a variety of unrelated political arenas. Thus, for example, in the absence of NAFTA and the willingness of President Salinas to put almost everything on the line for its passage, can one seriously imagine that the US would have gotten Mexico into the OECD⁹ or backed President Salinas for the important job of the Director General of the WTO¹⁰ ?

(v) Perhaps the most frequently-repeated "non-economic" argument on behalf of Mexico et.al. joining a preferential trade arrangement such as the NAFTA has been that it helps to "lock in the reforms", giving them credibility. But if this means locking in trade liberalization, I have argued that

⁸ Panagariya actually makes a persuasive case that Mexico et.al. are most likely to suffer a welfare loss even if the comparison is with the initial situation rather than with unilateral trade liberalization by them. In the latter case, the loss by Mexico et.al. is certain, of course, since US and Canada are assumed to be open in all situations being compared. Cf. Panagariya, "The Free Trade Area of the Americas: Good for Latin America?", University of Maryland, mimeo., 1994.

⁹ One may wittily remark that Mexico's undistinguished, low growth rate (by the standards of most developing countries) during the 1980s qualifies it as an OECD country ! Seriously, however, it is wellknown that Mexico got in because the US wanted this badly: as one of the highest officials of the OECD told me in private conversation, "Secretary Lloyd Bentsen [a major supporter of NAFTA] was very keen on it".

¹⁰ Remember that Mexico got into the GATT only in 1985, nor is it exceptional among the leading developing countries in terms of income level, sustained and high growth rates, effective assault on poverty, level of industrialization, degree of scientific achievement, and other indices that normally command one's attention. None of this, of course, is to detract from the significant accomplishments of the young Mexican leaders and technocrats, including Finance Minister Pedro Aspe, Trade Minister Jaime Serra and others in the splendid Salinas team, in moving Mexico through difficult political and economic reforms.

acceptance of GATT bindings can equally lock in the liberalization. Besides, it is as difficult for a small power like Mexico to get out of GATT obligations as it is to leave NAFTA once you are in.

As regards NAFTA giving credibility to Mexico's reforms, the recent crisis in Mexico lays that claim to rest just about as well as could be done. Real credibility in your reforms can come only from the credibility of your economic policies, not from an external pact like NAFTA, just as the announced commitment to a fixed exchange rate carries no credibility if the underlying macroeconomic policies are not themselves credible: it is the latter that give credibility to the announced fixed exchange rate, not the other way around! Thus, it is obvious that NAFTA has done little or nothing to establish the credibility of Mexico's reforms at home or abroad; claims that it would and did were simply so much hype that, repeated long enough by NAFTA proponents, came to be accepted as incontrovertible truth by many.

The Problem with Present US Policy: The WTO-plus Folly

In light of this analysis, I must confess that I find the approach taken by the Clinton administration, albeit with Republican support, in support of the pursuit of FTAs alongside the WTO to be mistaken despite its excellent intentions.

The approach seems to be, as reflected in the writings of the Treasury Undersecretary Larry Summers (one of our brightest economists and quite properly a star in the Clinton administration) and in the 1994 Report of the Council of Economic Advisers, that all forms of trade liberalization are good since they move us in the direction of free trade: unilateralism, bilateralism, plurilateralism, regionalism, multilateralism, indeed all "isms", take you to liberalization:¹¹

"economists should maintain a strong, but rebuttable, presumption in favor of all lateral reductions in trade barriers, whether they be multi, uni, bi, tri, plurilateral."

¹¹ Cf. Larry Summers, "Regionalism and the World Trading System", in Policy Implications of Trade and Currency Zones, Federal Reserve Bank of Kansas, 1991.

My gut reaction is to wonder what Larry Summers would say if, on hearing that he wanted our spending to be cut, I went upto him and said: cut anything you want, wherever you wish, it does not matter what, as it all leads to reduced spending; or, on hearing that he wanted revenues to be raised, I advised him, a wonderful public finance specialist of the neoclassical variety, to raise any and every tax in any way that he could since all taxes raised revenue. I am sure that he would get rid of me from the Department of Treasury at the earliest.

I. To properly evaluate Summers' "WTO-plus" position and the corresponding U.S. policy today, however, let me begin first by saying that, despite the problems concerning PTAs that I noted, I would consider the embrace of PTAs tolerable under two different circumstances¹² :

*When a group of countries wants to develop a Common Market : in this case, not just trade but also investment and migration barriers are eventually eliminated just as in a federal state and the full economic and political advantages of such integration follow; and

* When it is not possible to move to fully multilateral free trade for all through multilateral trade negotiations (MTN), at the GATT or now the WTO, so that the only feasible way to continue reducing trade barriers is to go down the route of preferential free trade areas, seeking to spread them among as many willing nations as you can find, in the hope that this route will eventually procure worldwide free trade.¹³

The former argument underlay the European initiative for the Common Market. The latter argument provided the original motivation for the United States, a keen opponent of PTAs and an avid supporter of multilateralism throughout the postwar period, to shift course and to embrace PTAs by initiating the Canada-US Free Trade Agreement (CUFTA) in 1983. The failure to secure agreement from Europe and the developing countries to start a new Round of MTN at the GATT Ministerial in November 1982 led

¹² The rest of my analysis below draws extensively on the penultimate section of my Wincott Lecture, op.cit. .

¹³ I analyze below the empirical relevance today, and the merits generally, of this argument and reject it as good policy.

Ambassador Brock to this approach.; and the intention then was certainly to use a hopefully ever-expanding set of FTAs, with the US acting as both catalyst and nucleus, to achieve the worldwide free trade that could not be reached through MTN at the GATT any more.

With Secretary James Baker, this open-ended approach, where the US-centered FTAs would be open to any nation anywhere --- they were informally discussed with Egypt and ASEAN nations at the time ---, became captured by the proponents of "regionalism" who linked it instead, and constrained it, to the Americas, as part of President Bush's initiative for the Americas. Thus grew the fears at the time that the world was dividing into three blocs: the EU, the Americas, and possibly a Japan-centered Asian bloc.

In the event, the US expanded CUFTA to NAFTA, and is now poised to go down the FTA route more energetically, promising to take Chile and then other South American nations on board. While the idea of regionalism is not dead, the Washington policymakers, in response to criticisms including mine¹⁴, have occasionally expressed the view that the earlier open-ended nonregional FTAs approach will be adopted instead. Thus, President Bush, in a major speech in Detroit at the end of the Presidential campaign, promised that he would extend NAFTA to Eastern European nations and to the Far East. And recently, the Clinton administration has tentatively suggested, according to media reports, the possibility of extending NAFTA to South Korea and Singapore.

But I must ask, in light of the many crippling defects of FTAs which I noted earlier: is this infatuation with FTAs¹⁵, including the pressure which was reportedly being exerted by the United States to move APEC in the

¹⁴ Cf. Jagdish Bhagwati, "President Clinton's Trading Choices: Beyond NAFTA What?", *Foreign Policy*, Summer 1993. I advocated there the position taken above that the best course was to return now to multilateralism and to give up on further FTAs. But that, if FTAs were to be pursued, then nonregional FTAs were better than regional ones because, among other reasons, the regional approach would be more likely to promote fragmentation of the world economy into preferential blocs.

¹⁵ It is sometimes argued that the United States is mainly responding to the desire of the South American countries themselves for an FTA of the Americas. This is misleading. There is no doubt today about the desire of the administration to proceed with such an agenda, and the catalytic effect that its desires are having currently in advancing that agenda.

direction of an FTA, desirable when the multilateral trading system has already been jumpstarted with the ratification of the Uruguay Round by the major trading nations and the birth of the WTO? Would it not be wiser for the world's only remaining superpower, and currently also its most robust economy, to take again the leadership role on multilateral free trade and to focus on converting NAFTA into a Common Market instead of seeking to extend it to more members and, given the inherently-preferential nature of FTAs, spreading what can be properly considered to be a stain on the now-realistic vision of a nondiscriminatory world trading system? This in fact would seem the sensible policy, with the second of the two arguments cited earlier in support of FTAs then seen as lacking in force today.

II. However, the US position today is clearly that, even if the WTO is working, trade liberalization via the FTAs and WTO should be pursued together because either (1) we can have a "WTO-plus" approach since all types of liberalization are additive and separable or, more optimistically, (2) there is even a benign relationship between the two, so that FTAs serve to prompt multilateral trade liberalization. I believe that neither position is plausible.

(1) The Summers "WTO-plus" position, with trade liberalization under FTAs and WTO as separable and additive is as persuasive and sensible as the "marriage-plus" proposition was shown to be in the film An Indecent Proposal by Robert Redford and Demi Moore. It is hard to imagine that the pursuit of trade liberalization via NAFTA and APEC is simply additive to its pursuit at the WTO: one surely affects the other.

(2) The real question is whether the pursuit of FTAs will have a benign or a malign effect on the WTO-centered process of trade liberalization. In fact, it is now customary to assert, in defense of pursuing FTAs despite the preferential nature of FTAs and the success of the WTO, that there is a benign, symbiotic relationship between FTAs and the multilateral system, and that the former is a faster process and, in turn, speeds up the process of dismantling trade barriers and making progress generally at the WTO. Pursuing my "marriage-plus" analogy, I might say that this is like the

optimistic prescription for “open marriage”: adultery is seen as improving marriage. Superficially, this scenario sounds plausible. But, on closer examination, it can be seen to be an untenable view.

In particular, consider the popular argument that FTAs, at least where led by the United States, will be of the “open regionalism” variety so that, with steadily increasing members, we will arrive at full multilateralism. As Rudiger Dornbusch put it today, “you get two members and the third will want to be in”, and then the fourth and, to draw on Agatha Christie, “then there will be all” in the FTA, arriving effectively at worldwide free trade just as we multilateralists want. By contrast, and by implication, the WTO cannot lead to effective and speedy liberalization on its own: it is too unwieldy.

But this contention is naive for several reasons. Take the question of speed. FTAs are at least as hard to negotiate as multilateral trade treaties like the Uruguay Round. After a decade, there are three countries in NAFTA; by contrast, the Uruguay Round took over seven years to negotiate, with over 115 nations and negotiations over a large range of old and new issues.

To argue that NAFTA expedited or smoothed the way for the conclusion of the Round would be equally silly, though it is often done. Thus, President Clinton’s success with NAFTA is supposed to have helped him with his passage of the Round through the Congress. True, President Clinton found his free-trade voice on NAFTA; but why should we assume that he would not have found it on the Round if it was the only game in town?

Also, remember the immense political divisions (far greater than over the Uruguay Round) that arose over NAFTA. The proximity of Mexico, and the fear that trade would only intensify the adverse effect that the much-noticed and feared Mexican illegal immigration was exerting on real wages of the unskilled in the United States, wound up making the freeing of trade

with the poor countries a fiercely controversial issue.¹⁶ It is hard to imagine that, with so many issues and so many countries involved in the Round and hence diffusion of focus instead of the exclusive focus on one particular country feared by the unions and the workers as a palpable threat to their living standards, the politics would have been as difficult on the Round by itself. The baggage of the NAFTA fight was thus hurtful (in giving remarkable political salience to an issue that was almost created in the NAFTA crucible) to the cause of multilateral free trade extended to developing countries generally, and hence to the passage of the Uruguay Round and to the future functioning of the WTO (where issues such as the Social Clause have also therefore gained more credibility), not helpful. NAFTA's passage also was subject to Mexico's acceptance of the Supplemental Agreements on environmental and labour standards. But, as I and others have often argued elsewhere, this is exactly the wrong way to go: why should such agreements be a precondition for freer trade? These demands could have been successfully resisted, as they are so far, at the GATT, whereas Salinas caved in simply because this was a superpower bargaining in a one-on-one format with a vastly inferior power. In turn, this has strengthened the environmental and labour lobbies into arguing that because NAFTA did it, so must the WTO, and the Clinton administration has not been able to stand up to these demands. In short, the NAFTA has made the WTO's business more complex, not less.

In fact, I have argued that these and other lobbies cannot have escaped the conclusion that the smart way to go is through US-centered

¹⁶ Free trade and free immigration are indirect and direct ways, respectively, in which a poor country with abundant unskilled labour could reduce the real wages of our unskilled labour. This has long been understood, both in the theoretical literature on trade and on immigration, and was also implicit in the great debate in Britain prior to the enactment of the 1905 national legislation restricting immigration: at the time, free traders were also free immigrationists and free immigration was often called "free trade in paupers". For a detailed analysis and documentation of these questions, see my "Free Traders and Free Immigration: Friends or Strangers?", Russell Sage Foundation, New York, 1991. It was thus perfectly plausible to me that, during the NAFTA debate when the administration and Salinas kept talking about how NAFTA would reduce illegal immigration, the response of many was contemptuously dismissive: according to them, we needed to stop NAFTA and to stop illegal immigration directly by closing the border more effectively.

FTAs rather than through the WTO, since you can first get Mexico to buckle under to these demands, then tell Chile and others: this is how NAFTA is, so you must accept these “nontrade” terms and conditions if you wish to come on board. Of course, this strategy works so much better than trying to impose these extraneous, indeed harmful, conditions through multilateral trade negotiations where all these countries are together and have more bargaining power. So much then for the idea of “open regionalism” or Ambassador Brock’s idea of rapidly expanding open-ended FTAs. Yes, if you agree to several extraneous, essentially trade-unrelated “side payments” (to use the terminology of John Whalley in his work on CUFTA) or “conditions” which have nothing to do with trade liberalization, you can qualify to join, not otherwise! It is like saying: my bridge club is open to everyone provided they wear mustaches, smoke pipes, wear ties and shine their shoes. This is openness indeed!

In fact, then, FTAs have become a process by which a hegemonic power seeks to (and often manages to) satisfy its multiple nontrade demands on other, weaker trading nations better than through multilateralism; the persistence of FTAs despite the success of the WTO must be traced at least partly to an awareness of this reality.¹⁷ And, if this analysis has an element of truth to it, then FTAs seriously damage the multilateral trade liberalization process by facilitating the capture of it by extraneous demands that aim, not to reduce trade barriers, but to increase them (as when market access is sought to be denied on grounds such as “eco dumping” and “social dumping”).

To sum up, my view therefore is that the FTAs, aside from being preferential trading arrangements with the economic drawbacks I outlined earlier, are a particularly damaging institutional arrangement to legitimate in the world trading system. The time has surely come for international economists to cut through the Orwellian newspeak, and the sloppy argumentation, of Free Trade Areas and begin to think the unthinkable: should FTAs really continue to qualify under Article XXIV or should it be

¹⁷ See the discussion in my “Threats to the World Trading System: Income Distribution and the Selfish Hegemon”, Journal of International Affairs, 1994.

revised to apply only to groups of countries aiming to create a Common Market ?¹⁸

APEC: The Challenge before Its Asian Members

I am afraid that the Clinton administration is unlikely to even raise these questions. It is currently wedded to the wrongheaded FTA approach as the President shuttles from one regional summit to another, blissfully unaware of these issues and applauded by a media that cannot rise above the glitter of the staged regional summits.

Meanwhile, a battle could be joined between the US (and its Latin American allies) and the Asian nations at the next APEC meeting in Osaka, Japan, over the issue of whether APEC should also become an FTA as the US reportedly seems to favour. I believe that Japan and the Far Eastern superperformers could use this opportunity to play a leadership role in halting the US slide towards obsessive FTA-mindedness and restoring a principal focus on multilateralism at the WTO. Let me explain why and how.

Japan and the Far Eastern superperformers, known often as the new Japans, have produced supreme examples for the rest of the world by transforming their nations into world class economies in just one generation of phenomenal growth. Many talk in economics of the "Japanese miracle": I sometimes wonder if ours is after all not truly a "dismal science" if, every time an economy does strikingly well, we call it a miracle!

True, many seek in this outstanding success the validity of their own pet policy prescriptions. And, indeed, few things can be explained in terms of a single cause. But, even though my own pet theory is that outward-orientation produces major dividends for a country, I think there is broad agreement that Japan and the new Japans have done tremendously well by going for world markets.¹⁹

¹⁸ As far as I know, the archival research has not been done to tell us why both FTAs and CUs were included in Article XXIV. I speculate on the original rationale of Article XXIV in The World Trading System at Risk, op.cit.

¹⁹ In regard to imports, there has certainly been "controlled openness" in Japan; and the role of protection in her development, as of the other Far Eastern nations, is more complex than made out by ideologues on the side of either free trade or protection.

Thus, preferential free trade areas where you set your sights low by thinking only of FTA-limited markets, instead of rooting for free trade where you are going for the world's markets, have not characterized this area. Even ASEAN, a grouping of political significance, had no economic dimension of substance for much of its life. Multilateralism came naturally with these attitudes. It may be argued that these attitudes were strengthened in turn with economic success whereas pro-FTA attitudes have often been associated with economic weakness: Imperial Preference went with Britain's fear of the newly-emerging competition from Germany and the United States, whereas the NAFTA debate betrayed a similar desire of many business groups and politicians to keep Mexico's markets for themselves instead of sharing them with Japan and the EU. This "Mexico-is-for-us" sentiment even found its way into some of President Clinton's speeches in favour of NAFTA, you will recall, playing equally to the Japan-bashing sentiment in Washington.²⁰

But, while we may debate the many reasons for these Asian nations' desire to go for the world's, rather than just regional and subregional, markets,

it surely provides Japan and the economically successful Far Eastern nations with a potential leadership role in world trade policy.

The post-Uruguay agenda at the WTO will inevitably involve our looking again at Article XXIV in a much more careful way than has been done to date. But more than that, the new Director-General of the WTO will have to provide leadership that seeks to shape the emerging picture of exploding

²⁰ It was noteworthy that President Zedillo, beleaguered by the peso crisis, also cited Mexico's "privileged access" to the US market as an argument for keeping confidence in Mexico's economic soundness. As I remarked, the name of the FTAs game is discrimination!

preferential trade groupings and to confront its impact on WTO-centered multilateralism, instead of simply accepting their emergence as a foregone political reality. In this task, the role of countries such as Japan, and the Asian nations, which have generally and indeed properly kept away from preferential trade arrangements like FTAs, in providing countervailing support to the WTO leadership will be essential.

In the meantime, Japan and indeed the other Asian members of APEC can play a useful role at APEC itself by opposing its being turned into yet another FTA. APEC can set an example by rejecting such a model and using the arrangement rather as a way of coordinating policies in the region on questions such as an Investment Code and, equally important, on the new issues before the WTO (such as Labour and Environmental Standards). My informed guess is that, on these new issues as well, Japan and the Asian nations have much to offer that is different from what the US seeks, and is wiser. APEC, since it straddles part of Asia and part of the Americas, may well be the place for these remarkable Asian nations to bring their friends across the common ocean to greater wisdom on these new issues and thus to assist the development of the WTO in more appropriate directions.

When APEC meets this year in Osaka, Japan in particular will have the opportunity to provide leadership on the future role of APEC and its relationship to the new WTO, helping to reshape and shift our trade policy on FTAs and multilateralism in the right direction. I suggest that it do so by:

- * seeking agreement among the Asian APEC members (including prospective new Asian members such as India) that APEC would not become a preferential FTA, while ensuring that the American members of the APEC

(led by the United States) are confronted clearly on the broader issue of the utmost importance, i.e. whether multilateral free trade, not a spaghetti bowl of preferential free trade areas, is to be the centerpiece of the newly emerging world trading system;

* at the same time, embracing an APEC agenda that includes coordination of policies and positions at the WTO on matters such as the wisdom of inclusion at all of labour standards and the optimal nature of the inclusion of environmental matters in the WTO; and

* transforming President Suharto's call for free trade in the APEC region by 2020 explicitly into a concerted effort to achieve this goal by a succession of, not APEC-alone liberalizations, but focused APEC initiatives, in conjunction with G-7 (whose non-European members are members of APEC), to launch multilateral trade negotiations to reduce trade barriers worldwide on a nondiscriminatory (MFN) basis.

This can be Asia's central contribution to the design of the new world trading system, in keeping with Asia's commitment in the postwar period to a nonregional, nonpreferential approach to world trade. Whether Japan and Asia can rise to the leadership role that is required now on these central questions of the design of the new world trading system, undertaking a proactive policy, or whether they will continue to play a reactive role that leaves leadership and hence the architecture of the new world trading system entirely to others, is a key issue now. If the architecture of the new world trading system is left entirely to the United States on its current course, and to the European Union which too has proliferated all kinds of preferential

arrangements with other countries not in the core of the Common Market, it is likely that the dilution of the multilateral trading regime by the spaghetti bowl of preferential trading arrangements will be our fate. That would be a tragedy.

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