Recent Op-Eds on Trade and the Financial Crisis

1) "Check It: Union-loving free traders unite!" *The New Republic*, April 1, 2009.
2) "President Obama and Trade Policy," Keynote Luncheon Speech at World Affairs Council Summit, Washington DC, February 19, 2009
3) "Gordon Brown Should Keep Obama Honest on Free Trade," *Forbes.com,* March 4, 2009.
4) "That 'Buy American' Provision," *NYT.com Room for Debate Blog*, February 11, 2009
5) "Obama must fight the protectionist virus," *Financial Times*, February 5, 2009.
6) "Obama and trade: an alarm sounds," *Financial Times*, January 9, 2009.
7) "We need to guard against destructive creation" *Financial Times*, March 16, 2008.

THE NEW REPUBLIC

Check It

Union-loving free traders unite!

Jagdish Bhagwati, The New Republic Published: Wednesday, April 01, 2009

The proposed Employee Free Choice Act (EFCA), which passed the House on March 1, 2007, but was blocked by a Republican filibuster in the Senate, has now been reintroduced and still faces opponents in many quarters. Several economists and business groups deplore its promotion of a "card check" system, which would enable a simple majority of workers to sign up for a union and so avoid the subsequent holding of a secret-ballot election (under Section 2 of the act). These opponents deride the use of the phrase "free choice" in legislation that they see as denying it. And it is, indeed, hard to defend the denial of an automatic secret ballot.

But while these issues will doubtless be debated, and the actual legislation will go through the usual legislative mauling and modification, the current debate misses the essential reason why EFCA makes sense, a reason that has led a stout defender of free trade such as myself to endorse it. The proposal is an appropriate and free-trade-compatible approach to dealing with the overriding problem we face: the long-standing stagnation of workers' real wages.

There are two ways of understanding the stagnation of workers' wages in the United States. (This problem is distinct from the separate issues of "relative" inequality within the wage structure, which has reflected a high and rising "skill premium" for skilled workers; and the more drastic inequality between the incomes of the wealthy and everyone else.) One view, long embraced by the AFL-CIO and now imposed by them on the Democrats elected to the new Congress, is that the stagnation of our workers' wages is to be attributed to our trade with poor countries. In short, the idea is that trade with poor countries produces paupers in rich countries.

This fear of trade with poor countries is wrong in its premises. There is, currently, no compelling evidence that such trade is driving our real wages down. This is the conclusion reached by several empirical analysts, including Robert Feenstra, who heads the international trade program at the prestigious and nonideological National Bureau of Economic Research. If anything, my early work, developed further in my book *In Defense of Globalization*, as well as the recent findings of Harvard's Robert Lawrence, argues the opposite: The downward pressure on wages from other domestic factors such as acute and continuous technical change has been *moderated* by trade with the poor countries.

But the consequence of the AFL-CIO's mistaken fear is that the federation has pushed actively for the strategy of moderating competition from poor countries, specifically by insisting that their labor standards should be the same as ours. It's a strategy we economists call "export protectionism"-- reducing trade by asking the exporting countries to take actions that would restrain their exports. This strategy has worked politically with liberals in the United States because it enables the unions to present and press their demands, which in fact issue from self-interest, as being prompted by altruism and sympathy for foreign workers instead. But developing countries recognize this disguised protectionism; Brazil and India, both democracies with robust labor unions, have rejected the insertion of labor standards into trade treaties.

Whereas the AFL-CIO explanation of wage stagnation essentially *externalizes* the issue, scapegoating poorer countries as the cause of our problems, a rival explanation favored by the Service Employees International Union (SEIU)--which, led by Andy Stern, split from the AFL-CIO in 2005 and created a new labor coalition, taking 40 percent of the membership with it--has been to focus instead on a *domestic* institutional explanation for the stagnation. Some domestic factors putting a downward pressure on wages are obvious, like labor-saving technical changes apparent to the naked eye. Semi-skilled secretaries have been replaced by personal computers; assembly lines still exist, but the Charlie Chaplins have been replaced by skilled technicians working in a glass cage above, managing the mechanized assembly lines. But SEIU, like many labor economists, focuses on other institutional factors that have depressed wages. This camp points out that union membership in the United States has fallen, from 23.3 percent of the labor force in 1983 to 14.3 percent in 2003, and fallen by half in the private sector over a longer period, to as low as 9 percent; that these drops are largely attributable to the legislated obstacles to union organization; and, finally, that falling membership has put a lid on the ability to raise wages.

The ability to organize has been affected, for instance, by the Taft-Hartley legislation more than half a century ago, which has handicapped the ability to strike by making it easier to hire replacement workers and making it more difficult to stage sympathetic strikes. A union without effective ability to strike is a paper tiger. Legislative changes that would facilitate increased membership of the unions therefore have a claim on our attention.

There is much evidence that increased membership helps raise wages. True, much of the empirical work by Harvard's Richard Freeman and other labor economists shows that unions manage to reduce the ratio of top wages to the bottom wages. But there is some evidence that this is done not just by reducing the highest wages but also by increasing the lowest wages. Increased membership also increases the political clout of the unions and, in turn, leads to support for raising the minimum wage, which liberal labor economists are convinced helps the lowest wages overall (though this issue does remain a source of animated controversy among liberal and conservative labor economists).

What is indisputable, however, is that the AFL-CIO explanation of the problem of stagnant wages commands little scientific support, and its proposed solution leads to protectionism. By contrast, the rival explanation, led at the time of the split of the AFL-CIO membership by SEIU, has substantial scientific support and leads to domestic institutional reform, however imperfectly embodied in the Employee Free Choice Act, so recently and publicly supported by dozens of economists, including myself, in *The Washington Post*. The choice for President Obama, as he seeks to seize the Roosevelt moment, seems clear.

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CLOSE WINDOW

President Obama and Trade Policy

Keynote Luncheon Speech

at

The World Affairs Councils Summit Meeting, Washington DC,

February 19, 2009

By

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Vice President Biden recently said of the infamous Buy America provision in the Stimulus Bill, that:

> **"I don't view that as some of the *pure free traders* view it, as a harbinger of protectionism."**

I enjoy the Vice President's characteristic playfulness with words: he was not <u>buying</u> into the criticism of <u>Buy America</u>. In fact, when I last testified before him on the Senate Foreign Relations Committee on Sovereign Wealth Funds, I found him very engaging. After the testimony, I went up to him and, on seeing Senator Obama's chair vacant, I fell to talking about him. I argued that the attacks on him for his Pastor's inflammatory sermons were misplaced: no intelligent person that I knew kept awake during sermons! But, Obama had spent nearly a decade interacting with the splendid economists at the pro-trade, pro-markets Chicago Business School. Now, <u>that</u> was important: for, the company you keep is more important than the company that keeps you. Senator Biden's eyes twinkled with mischief as he responded: well, we had better make sure then that he <u>is</u> a liberal!

In fact, the Vice-President's defense of Buy America was quite uncharacteristic of him, as was his condemnation of "pure" free traders. Since I have no intention of rejecting the epithet "pure" and becoming instead a diluted, even

adulterated free trader, let me say why Buy America does constitute dangerous protectionism, and then proceed to put it into the context of the many points at which President Obama faces threats to the outward orientation in trade, multinational investment and international migration that has brought so much prosperity worldwide.

Indeed, the stakes are so high already, and increasingly so, that the time has now come for President Obama, whose rhetorical powers are so remarkable that he would have held his own in the British Parliament in the 18^{th} century when it had the great orators Edmund Burke, William Pitt the Younger and Charles Fox, to give yet another of his famous speeches like the one on race: this time on the virtues of free trade and indeed openness and the perils of protectionism and indeed of mutually harmful xenophobia in our and others' policymaking.

Let me start with trade, then go to foreign investment, and then to immigration, touching only on the principal danger points that should prompt and inform such a Presidential speech.

I: TRADE

1. <u>Buy America</u>

The Buy America provision, inconsistent as it was with our WTO obligations in the original House and Senate versions and has now been qualified by a new clause which requires that its application must be consistent with the international obligations assumed by the US as under the WTO, has been defended in indefensible ways. Three must be cited and rejected.

(i) Paul Krugman, has recently argued that increased US spending, as required today, would leak into demand for foreign goods, raising its cost to the US in shape of increased debt. So, there is a case for using protection to keep its impact on the US itself: the Buy America provision would then prompt others to imitate us and they would spend more and use protection to keep <u>their</u> increased spending to themselves. The result: more spending stimulus worldwide, and admittedly more such protection. But then the cost of protection is small in any event, especially compared to the benefits of increased spending.

Unfortunately, the Krugman argument must be rejected because its premises are implausible and violate what we already observe. There is plenty of evidence that others will retaliate, and that too not in a fine-tuned fashion. As the post-Smoot-Hawley experience showed us, trade wars are fought, not by the gentlemanly rules of English cricket, but by the no-holds-barred rules of American free style wrestling. The cost of protection, which even at the best of times is now estimated by the best economists on the subject (such as Robert Feenstra who leads the NBER Program on International Economics, and Paul Romer whose work on growth is most highly regarded) as on the high side, is likely to be even higher if we foolishly lead ourselves into such trade wars.

(i) The spokesmen for AFL-CIO also claim that the EU denies us access to their Government Procurement in several sectors, so we are entitled to retaliate and suspend their access to our Procurement. But this misunderstands the nature of the 1995 GPA at the WTO. The signatories to it (40 nations in all) have listed their sectoral and other exclusions and inclusions; and these do not match, of course, because the overall balance of "concessions" when the Uruguay Round was concluded and WTO was launched extended across many sectors such as manufactures and rules such as anti-dumping. We cannot unilaterally suspend the obligations we undertook

under GPA as part of that overall balance. If we were to do that, it would be no better than Libya or the first George W. Bush administration unilaterally violating treaty obligations, and that too by President Obama who has promised that we will return to the rule of law and to working with other nations rather than wielding a machete over their heads and aiming an AK47 at their hearts to get our way!

(ii) Does the qualifier inserted now at Obama's insistence in the Conference version which will now be law, that we will practice Buy America in a WTO-consistent way, protect us from the prospect of a trade war? Not likely. There are two problems.

First, this would mean that we would now begin to exclude China, India, Brazil and other non-signatories to GPA --- the developing countries were <u>not</u> expected to sign the GPA, one may recall --- and the result could be that they, in turn, could retaliate against our exports in several WTO-consistent ways: e.g. through raising lower applied tariffs towards the higher bound tariffs, and by switching purchases of nuclear plants from GE to France, and of aircraft from Boeing to Airbus. So, we would have a WTO-consistent trade war breaking out. President Obama has listened to critics, such as myself in a January op.ed. in <u>The Financial Times</u>, and insisted

on WTO-consistency; but now he needs to step up to the plate and denounce clearly the raising of trade barriers and discriminatory policies even when they are technically WTO-consistent.

Second, as anyone who knows trade litigation knows well, inserting a qualifier on WTO-consistency while leaving in the Buy America provisions means that any well-heeled lobby can persuade the relevant agencies, and co-opt obliging Congressmen to get for itself a Buy America exclusion of even signatories to the GPA by simply claiming that the exclusion was WTO-consistent, and then expect to get away with it unless the matter is brought by the adversely affected signatories before the WTO Dispute Settlement Mechanism. [Essentially, this is what happened with the Safeguards action against foreign steel soon after President George W. Bush took office in his first term. The administration claimed that its action was WTO-consistent, when many argued it was not, and then it was declared to be so at the WTO.

Besides, whether or not they take us to the Dispute Settlement procedures at the WTO, these excluded signatories will surely undertake their retaliation. It seems more sensible therefore to have eliminated the Buy America provision altogether, as Senator McCain properly suggested.

(ii) <u>Bail-Outs</u>

Bail-outs, since they embody actual (as against implicit) subsidies, are regulated by the 1995 Subsidies and Countervailing Mechanism (SCM). Any sectoral subsidies under the SCM agreement are considered to be "actionable" (with only two subsidies, given for local content or for exports, declared illegal). There is little doubt therefore that an auto bail-out, which is limited to one sector, would be actionable under the SCM agreement; and when confined only to Detroit and not extended to the foreign transplants, the bail-out raises further red flags.

In fact, as Mr. Sarkozy plans to help Peugeot and other French car firms through similar bail-outs, the Obama and Sarkozy administrations need to sit down and see whether they can instead confine their assistance to the car industry to either restructuring under Chapter 11 style bankruptcy procedures, which is allowable as long as explicit subsidies are not included within the bankruptcy-defined restructuring --- in any event, with there being no SCM agreement on airline services yet, many airlines in the US have resorted to Chapter 11 and have survived whereas one, the Continental, has resorted to Chapter 11 twice and is known as the Chapter 22 airline--- , or to

possibly WTO-consistent non-discriminatory consumer subsidy schemes which subsidize car purchases regardless of who has produced the cars.

All this holds, of course, regardless of the economic wisdom of granting sectoral support to one industry when several are in recession: an issue on which there is much division in the country.

(iii) Labour and Environmental Standards

The preoccupation with Labour and (domestic) Environmental Pollution standards in trade treaties and institutions is a form of "export protectionism", prompted largely by the unions' fear that trade with the poor countries is driving down our workers' wages. If you believe that, and you do not wish to be recognized as a protectionist worrying about import competition, what is better than getting your competitors to raise their cost of production closer to your levels by getting them to accept your own standards?
In short, turn Tom Friedman on his head: make the world flat when it is not. Level the playing field. Call it "fair trade". Pretend you are doing it for their workers, not yours, that you are really being altruistic, and that your own self-interest is not the driving force for these demands.

Obama has bought into this because the Democratic Party has bought into it, and the Party has bought into it because the labour unions have bought the Democratic Party off on this at the elections. It is not surprising that the big, democratic countries like Brazil and India see through this self-serving nonsense; and when Howard Dean raised this demand at Davos this year, he was deservedly chewed out by Minister Emorim of Brazil (who serves under President Lula, who is ironically the world's most distinguished labour union leader and stoutly opposes the US attempts at introducing trade-unrelated demands into trade treaties and institutions).

The sad part of the story is that there is no compelling evidence that trade with the poor countries is a significant factor in the workers' predicament, and plenty of argumentation and evidence on the other side. So, not merely is the Democrats' position on this issue protectionist in the sense of export protectionism; it is also based on faulty empirical analysis. The sooner President Obama abandons this sanctimonious approach to the issue, which does him no credit, the better.

Instead he needs to use his intellectual ability and his political skills to steer the Democrats away from this <u>external</u> scapegoating of the issue of worker's wages and resulting

obsession with labour and domestic environmental standards in trade treaties and institutions, to focusing instead on domestic institutional measures to expand union membership, and other related measures, to address the problem.

II: FOREIGN INVESTMENT

Three popular measures on foreign investment need to be distinguished, of which one is not protectionist.

1. **Eliminate Incentive to Go Out**

Presidential candidate Obama did claim during the campaign that he would remove any bias in US tax law that encouraged US firms to produce abroad rather than at home. This is surely alright because no economist would be in favour of discriminatory taxation which distorts the choice of investment location.

2. **Create incentive to invest at Home rather than Abroad:**

For that very reason, one should not discriminate in favour of location of firms at home rather than abroad. That would be a distortion also. Unfortunately, excoriation of US firms that invested abroad, especially when they closed down a plant in Nantucket and opened up one instead in Nairobi, was what Senator John Kerry did during his Presidential campaign, calling such firms Benedict Arnolds. No, Benedict

Arnold was not an obscure English poet, a cousin of Matthew Arnold. He happens to be America's most notorious traitor!

3. **Firms should Come Home:**

Predictably, President Sarkozy has taken this folly to its outer limits by asking that French firms producing abroad should return to France. Referring to the Peugeot-Citroen assembly plant near Prague, he suggested that it be relocated in France: "We want to stop companies shifting production abroad [the Kerry objective] and, if possible, return it." He added: "If you build a Renault plant in India to sell Renaults to Indians, that's justified, but if you build a factory…in the Czech Republic to sell cars to France, that's not justified." Astonishingly, President Sarkozy is among the leading economic reformers in France today!

III: HIRING AND FIRING OF FOREIGN WORKERS

The hostility to openness and non-discrimination against alien goods and outward multinational investments extends also to foreign workers. Many would want to hire them last and to fire them first.

Thus, even Senator Grassley, an eminently reasonable Republican Senator from Iowa, authored an amendment

which was accepted in the Senate stimulus bill that would require that any company that received TARP funds and applied for workers under the H-1B process for getting temporary skilled foreign workers must comply with rules under which they would have to certify that were actively recruiting American workers and that they were not replacing laid off American workers with foreign workers. "Our common-sense amendment simply ensures that recipients of American taxpayer money makes American workers their first priority as they look to hire new employees."

Unfortunately, this attitude is spreading to other countries afflicted by the current crisis as well. Thus, there were wildcat strikes in January of this year in Great Britain over the use of foreign workers, prompting a forthright condemnation by Prime Minister Gordon Brown. The Prime Minister said, unequivocally, on BBC television: "That's not the right thing to do. It is not defensible." But the pressures are there, with Derek Simpson, the joint chief of the biggest British trade union, Unite, responding: "Whether you call it indefensible or not, a lot of people find it understandable in the circumstances."

As for illegal immigrants, there have been attempts in the Congress to slip into the stimulus package a ban on any illegal

worker finding employment within the stimulus-financed outlays, this to be ensured through reliance on an inadequate and error-infested employee-verification system called E-Verify.

Besides, there is some evidence that raids and deportations of illegal workers have increased sharply last year, to reduce the domestic stock of illegal immigrants even as the economic crisis has prompted some voluntary returns. Also, pressures are manifest for increased enforcement at the border with Mexico, to reduce new inflows of illegal immigrants. Both these measures would reduce the numbers of immigrants looking for jobs, increasing the probability of native Americans finding employment. The "nativist" elements in the populations therefore have a greater salience in the politics of immigration, thanks to the crisis.

Forbes.com

Contributors

Gordon Brown Should Keep Obama Honest On Free Trade

Jagdish Bhagwati 03.04.09, 9:32 AM ET

Prime Minister Gordon Brown addresses the U.S. Congress Wednesday. He will doubtless touch, as distinguished commentators like Martin Wolf have recommended, on the urgency of fixing the financial (Wall Street) and the interactive macroeconomic (Main Street) crisis.

But, frankly, every layman and economist, from Joe Blow to Joe the Plumber to Joe the Nobel laureate--no parallel to the Three Stooges should be read into this remark--has delivered himself on what needs to be done, with President Obama properly expressing his frustration at all the nit-picking that is creating an atmosphere of chaos and distrust, one that cannot be good for getting things moving quickly again.

Rather, the prime minister needs to address the Congress on where it is notoriously out of step with what is needed today to kill the cobra of anti-openness and near-xenophobia that is threatening us from several directions--and where Obama's track record to date leaves something to be desired. The prime minister, and his foreign secretary, David Miliband, famously warned both Obama and Hillary Clinton during the primaries to cool the rhetoric against trade. Now is the time to ask the president to raise the rhetoric *on behalf of* trade and, indeed, openness generally.

Obama faces protectionist pressures on trade, of course. Some are pointedly from the labor lobbies who have led the president to use his first meetings with President Felipe Calderón of Mexico and Prime Minister Stephen Harper of Canada to urge on them tougher labor standards, a protectionist demand that arises from unjustified fear of external competition and the consequent desire to raise the foreigners' cost of production.

Other pressures have come in the Buy America provisions in the stimulus package bill where there is now, thanks to the president having listened to some of us, the requirement that World Trade Organization consistency be observed, leaving nonetheless a wide-open loophole for protectionism that can, and will, break out in ways which the president has not faced up to. Yet other pressures come from the lobbies that have pushed for a WTO-inconsistent bailout to Detroit: Sectoral subsidies are clearly actionable under the Subsidies and Countervailing Measures agreement of 1995 at the WTO.

Indeed, Obama faces anti-openness pressures at several other levels too. There are demands that multinational investment be taxed or intimidated into remaining at home rather than going abroad (though, so far, the extreme, Sarkozy-style urging of French firms abroad to return to France has not disgraced the American scene); and in demands that foreign workers and immigrants be fired first and hired last, especially if the stimulus package expenditures are involved.

Through all this, the "no-drama" Obama has kept a low profile. Unlike the world's leaders at the last G-20 meeting, he has not turned his rhetoric loose against protectionism. Yet we face today a dangerous virus that requires a passionate response. Given the constraints he faces from the labor unions (who have been the main supporters of Buy America provisions), and the Democrats in Congress who owe their elections to support from the unions (and have supported the Buy America provisions, in turn), he requires all the international urging and shaming to push him into doing what the hour needs.

Indeed, Brown needs to take a bold, comprehensive overview of the many points at which we confront the real danger that will unravel the open economy in trade, multinational investments and immigration, thus undermining the unprecedented prosperity--and with it the significant reduction in world poverty--that openness has brought in the postwar period.

If he does it with the eloquence and clarity that he increasingly displays, this will be the Gordon Brown moment. It may well induce the president to seize his own moment, in a reciprocal gesture to his host, when he comes to the April meeting of the G-20 in London.

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The New York Times
ROOM FOR DEBATE
A Running Commentary on the News

FEBRUARY 11, 2009, 3:18 PM

That 'Buy American' Provision

By THE EDITORS

(Photo: Maurizio Gambarini/European Pressphoto Agency)

"Buy American" is a familiar cry in Washington, even though the vast majority of American economists and policy makers oppose anything that hints at protectionism. President Obama has said that "we can't send a protectionist message," and the Senate softened a buy-American provision in the stimulus bill it passed by stipulating that any government procurement policies comply with World Trade Organization rules. But business interests argued that the language favoring American producers should have been removed altogether.

Why is the buy-American idea objectionable, or, alternatively, under what circumstances should it be promoted?

***Robert E. Scott** is the senior international economist at the Economic Policy Institute.*

The buy-American rule in the stimulus bill is smart policy that won't run afoul of any of our trade treaties.

When the government buys steel for a bridge, for example, it has several objectives. Minimizing costs is one, but when the economy is in recession, there is added incentive to stimulate domestic employment. And when steel is purchased from a domestic producer the workers' wages generate further spending, which supports yet more jobs in the domestic economy.

When domestic industries have been injured by unfair trade practices, protecting them is good policy.

Although the United States and 38 other countries have signed World Trade Organization procurement codes prohibiting restrictions on government purchases between member countries, the act does not violate these commitments. Indeed, the House version of the act implicitly exempts these countries from the buy-American clause, and the Senate version does so explicitly.

Some of the loudest protests about buy-American provisions have come from self-interested American companies like Caterpillar and General Electric that manufacture overseas. Foreign ministers from China and Russia, which haven't signed the procurement codes, have also complained, but these countries simply want something for nothing. Giving them access to stimulus spending will dilute the impact of the recovery bill and eliminate all incentives for them to sign the codes.

When domestic industries have been injured by unfair trade practices, protecting them is good policy. For example, China spent more than $15 billion on energy subsidies for its steel industry in 2007 alone. These subsidies were illegal under World Trade Organization rules, and the United States has an obligation to protect domestic steel producers in such cases.

A Retaliatory Spiral

***Jagdish Bhagwati**, a professor of economics and law at Columbia and a senior fellow at the Council on Foreign Relations, is the author, most recently, of "Termites in the Trading System."*

Despite protectionism rearing its ugly head from time to time during the campaign, Barack Obama has been mostly silent on trade issues. This was a disappointment for many of us who are supporters of free trade. We were reassured when he finally argued — and the Senate agreed — that the buy-America provisions in the stimulus package bill must be consistent with World Trade Organization rules. But more needs to be said, and done.

First, having the buy-America provisions stay in, even with the W.T.O.-consistency qualifier, is much less satisfactory than what Senator John McCain suggested, which was to take them out altogether. The truth is that lobbyists can spend vast amounts of money challenging the qualifier, leaving protectionism alive and well.

The buy-American provisions unravel previous trade agreements unilaterally and in violation to the concessions we made.

Second, the notion that even an effective W.T.O.-consistency qualifier in our procurements will soothe other nations and prevent trade retaliations and trade wars is naïve. Contrary to what others believe, countries like Brazil, China and India, which have not signed the W.T.O.'s 1995 agreement on governmental procurement and, therefore, do not enjoy those rights to our procurement purchases, will retaliate. They can raise many current tariffs also in a "W.T.O.-consistent" way. (Remember that China and India have large public sectors.) They can easily shift their purchases of aircraft, nuclear reactors and other high-value goods from us to Europe and Japan. We would then retaliate, prompting retaliations by the others: all in a W.T.O.-consistent fashion. Indeed, President Obama would find himself in a W.T.O.-consistent trade war.

The A.F.L.-C.I.O. argues that the Europeans, for their part, protect certain domestic sectors in their government procurement decisions, so it is O.K. for us to close their access to our procurement via buy-American provisions. But this is a mistaken argument.

The W.T.O.'s agreement on government procurement allows signatories to choose the sectors to which they will apply it. So, we have chosen our sectors where the others can bid for our contracts just as the European Union has chosen their sectors where we can bid. These choices, and therefore exclusions of other sectors, are part of the overall balance of concessions that were reached in several areas like agriculture, services and manufactures. To argue that we are now free to terminate access to our procurement in areas we previously agreed to open to bids from the Europeans is to unravel that bargain unilaterally and in violation to the concessions we made.

With the bailout to Detroit straining the 1995 W.T.O. agreement on subsidy and countervailing measures and inviting a spread of mutually harmful subsidies worldwide, and with the demands for "fair trade" also being assiduously pressed on him by the unions lobbies wrongly fearful of external competition, President Obama faces several protectionist challenges. It is time now for him to make one of his resounding speeches, this time on the virtues of free trade and the perils of protectionism.

Buy American, While We Can

***Roger Simmermaker**, an electronics technician for a large defense contractor and the vice president of his local machinists union, is the author of "How Americans Can Buy American."*

It's simply not necessary to buy the steel, iron and other manufactured materials we need to build and repair our roads and bridges from other countries when we can supply it ourselves.

The buy-American provision in the economic stimulus bill isn't as much about a return to protectionism as it is about a return to the American virtues and values — self-sufficiency, self-reliance and independence — that this country was founded on.

There's nothing wrong with achieving a balance of trade if we have to restrict imports to do it.

Workers in foreign countries don't pay taxes to America. Only American workers pay taxes to America. We need to employ American steelworkers, ironworkers and autoworkers so we need to not only keep and create American jobs, but we also need to keep our huge and growing national debt from getting hopelessly out of control.

When we borrow money from China to pay for the stimulus bill, we'll be borrowing — and paying interest on — money that used to be ours before we sent it there in the belief that free trade and cheap foreign imports were the answers to a prosperous economy.

At best, the buy-American provision of the stimulus bill will help balance world trade. As Americans, we seek balance in virtually every aspect of our lives. We strive to balance our work life and our family life. We strive to balance our commitments to our communities and our commitments at home. There's nothing wrong with achieving a balance of trade if we have to restrict imports to do it.

The answer to America's economic problems is right in our own backyard: buy American while there is still American left to buy.

Disaster Lesson From the 1930s

***Burton Folsom Jr.**, a professor of history and management at Hillsdale College and a senior historian at the Foundation for Economic Education, is the author of the "Myth of the Robber Barons" and "New Deal or Raw Deal?"*

"Slap a tariff on China and save American jobs," the protectionists say.

The collapsing export market after 1930 helped to set off a decline in American industry.

This tempting line of reasoning is flawed for two reasons. First, if Americans pay more for, say, American-made shoes or shirts, then they have less to spend for other things they might need — they are simply subsidizing inefficient local producers. And those American manufacturers, who are protected from foreign competitors, have little incentive to innovate and cut prices.

Second, if we refuse to buy China's imports, China will refuse to buy our exports, including our first-rate computers and iPods. Our export market collapses. We saw this happen during the Great Depression when Congress passed, and President Herbert

Hoover signed, the Smoot-Hawley Tariff in 1930. That tariff, the highest in United States history, foisted high import duties on more than 3,000 foreign items. The Europeans immediately retaliated, and this deepened the Depression throughout the world. When we refused to buy Swiss watches, for example, the Swiss refused to buy American wheat and Chevrolets.

The collapsing export market after 1930 helped to set off a decline in American industry. United States automakers sold more than five million cars and trucks in 1929, but only about 1.8 million in 1933. Other causes (including tax increases under both Hoover and Franklin D. Roosevelt) also made the Great Depression worse, but the Smoot-Hawley Tariff was a significant reason the Depression was as severe as it was — 25 percent unemployment at its worst.

Free trade benefits buyers and sellers. Tariffs benefit certain sellers at the expense of all buyers.

Necessary Breathing Space

***Ha-Joon Chang**, an economist at the University of Cambridge, is the author of "Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism."*

Is protectionism good or bad? The short answer is that it depends.

There are two kinds of protectionism. One is the protectionism that developing countries need to protect and nurture new producers. It is known as infant-industry protection and is based on the same reasoning that people use when they send their children to school, rather than making them child laborers. It can fail but it was successfully used by virtually all of today's rich countries when they were developing countries themselves — starting from 18th century Britain, through 19th century United States and Sweden, to 20th century Japan and Korea.

We need a new international trade agreement that allows for transparent, forward-looking and time-bound protectionism.

The other is a kind of protectionism that all countries, both mature and developing, sometimes need when they must make sudden large adjustments. Unlike finance, where things can be rearranged quickly, the real economy takes time to adjust. Therefore, when you have a big shock like today's economic crisis, it makes sense to create the breathing space for the producers to restructure. This is why, even as they are repeating their commitments to free trade, the rich countries are providing their industries a huge amount of direct and indirect protection.

Some people worry that this will lead to a 1930s-style all-out trade war. But in the short run, there is actually no danger of that. Now we have the World Trade Organization, the European Union and many other regional trade agreements that limit protectionism. Of course, in the longer run, if veiled protectionism continues, we run the risk of making a mockery of these agreements and destroying the global trading system.

However, the solution to this problem should not be an adherence to the principle of free trade, which is not workable in practice anyway, but instead to establish a new international agreement that allows a transparent, forward-looking and time-bound protectionism as well as more infant-industry protection for developing countries. In other words, by allowing more protectionism now in a controlled way, we will be able to preserve the international trading system better in the longer run.

Trade Wars Kill Jobs

***Gary Clyde Hufbauer**, a senior fellow at the Peterson Institute for International Economics, is the co-author of a recent policy brief on the buy-American proposal.*

The buy-American proposal in the stimulus package makes no sense — not for United States employment, and certainly not for spurring recovery from the world's worst downturn since the Great Depression.

The positive impact of the provision would be trivial: fewer than 9,000 American jobs and only a few billion dollars of American imports.

The positive impact of the provision drafted in the Senate bill in terms of jobs and trade would be trivial: fewer than 9,000 American jobs and only a few billion dollars of American imports. But the negative impact — coming as it does from the United States — would be a disaster. Essentially this measure says to the world: "Go ahead and put on new protection, just so long as you obey the letter of your commitments in the World Trade Organization."

Other countries have plenty of room, within their legal commitments, to raise tariffs on imports from the United States or in less visible ways to punish leading American exporters, like FedEx, Microsoft, TimeWarner, United Technologies, Boeing, Caterpillar and General Electric. Indeed, in a tit-for-tat trade war, the United States could easily lose far more than 9,000 American jobs. The fact that France is asking its auto firms to cut down production in the Czech Republic, or that British banks are pulling money out of South America does not mean the United States should follow them down the protectionist path. It's not our habit to imitate the worst behavior of Europe or anyplace else.

Supporters of the buy-American provision correctly state that other countries already impose higher barriers on their industrial imports than the United States does — that's certainly true for Argentina, Brazil, China, India, Indonesia and South Africa. But world recovery will be long delayed if countries decide that "leveling up" to the highest barriers is the right way to go.

Help U.S. Manufacturing

***Sherrod Brown** is a Democratic senator from Ohio.*

As Congress debated the economy recovery package, it became clear that the American people have been willing to reach deep into their pockets and spend tens of billions of dollars to build roads, repair bridges and construct water and sewer systems. And all that they want is that the work be done by Americans and that the materials they use are made in America.

Who could be against that? Well, some Ivy League economists don't like it — something about Smoot-Hawley and the Great Depression. And newspaper publishers pontificate about free trade theory, as they see their advertisers flee and their papers shrink. And the corporate executives of some of America's largest corporations tell us it will cause a trade war, as they collect million-dollar bonuses while laying off American workers and outsourcing jobs to China and India.

These are not people who are about to lose their jobs to bad trade policy. Other than this small, shall we say elite group, you could search far and wide and find almost no one who thinks "Made in America" is a bad idea.

Yet when some of us in the Senate proposed strengthening the buy-America laws, and enforcing the buy-America rules, that have been around for decades, some economists, newspaper publishers and business executives accused us of being — gasp — protectionists.

An $800 billion trade deficit and they accuse the United States of protectionism? Two-billion-dollars-a-day net outflow of trade dollars and they claim we are closing our borders? In Ohio, people would say that accusations like that don't pass the straight face test.

The purpose of buy-America laws is to promote United States manufacturing and encourage new industry — both of which come in handy when a country is trying to put its economy on the right track, maintain global economic leadership and create jobs for the millions of American standing in unemployment lines.

Let's be clear. Buy America does not mandate the purchase of United States goods. Buy America allows waivers in cases where American-made products necessary for a project are not readily available. Waivers are also allowed where total project cost is 25 percent more expensive than it would be if imports were used. The buy-America provision in the economic recovery package maintains this flexibility.

It does not violate World Trade Organization agreements or any international trade laws. It encourages the use of taxpayer dollars to invest in American companies and create jobs. Buy America is a choice. Do we want to use billions in tax dollars to create jobs in Ohio or in China?

While our European and Asian competition too often subsidizes their industries, protects their businesses and fights for their workers, our manufacturers continue to decline. And our government gives companies tax breaks when they outsource jobs. Countries around the world practice trade according to their national interest. Perhaps the United States should do the same.

Damages Outweigh Gains

Anne Krueger*, a former first deputy managing director at the International Monetary Fund, is a professor of international economics at the School of Advanced International Studies at Johns Hopkins University.*

The damage to employment would surely outweigh any gains. This is even more true now than it was in earlier years as industries throughout the world have sought supplies of their parts and components from the cheapest source.

Once protectionist measures are adopted, they are difficult to remove.

The buy-American measure in the stimulus package would do little, in part because few imports are used in construction projects. But the signal that it would send to other countries would invite protective measures to the detriment of American exports and employment.

Once protectionist measures are adopted, they are difficult to remove. In the long run, choking off through protection the integration of the world economy reduces productivity and prospects for future growth of all economies. It does not make any sense to sacrifice longer term growth prospects for measures that, even in the short run, offer very little prospect except for the very few at the cost of many others.

Comment

Obama must fight the protectionist virus

Jagdish Bhagwati

President Barack Obama faces protectionist pressures. These are not just from the labour lobbies that have led Joe Biden, US vice-president, to chide "pure free traders" and to ask for "fair trade"; and which, astonishingly, have also led the US president to use his first meeting with President Felipe Calderón of Mexico – overwhelmed by the brutal fight against drug cartels caused by the US failure to legalise drugs – to urge on him tougher labour standards, a protectionist demand that is clearly aimed at raising Mexican costs of production. The pressures come also from the lobbies pushing for a Detroit bail-out that is inconsistent with the World Trade Organisation.

Through all this, the "no-drama" Mr Obama has kept a low, indeed invisible, profile. With his innate ability to moderate highs and lows, he has been America's first "lithium president". Fortunately, on Tuesday he stepped up to the plate on the Buy American provisions in the stimulus package, leaving little doubt as to where his sentiments, and his policy preferences, lie.

Yet, protectionism is a dangerous virus that requires a passionate response. Indeed, Mr Obama faces his two most serious protectionist challenges from the Buy American provisions that have infiltrated his stimulus package and from the China-bashing on "currency manipulation" that surfaced in the confirmation hearings of Tim Geithner, Treasury secretary .

The Buy American provisions, which would require that companies use US steel and manufacturing products in projects funded by the bill, seem reasonable. If the US has a stimulus package, why should the benefit of it extend to other countries? An influential columnist has suggested this is not what we economists call "beggar my neighbour" policy: the US is not diverting a given amount of aggregate world demand to itself at other countries' expense. Rather, it is a case of not rewarding your neighbours when you stimulate spending and are adding to world demand: neighbours should reflate their own economies. Such protectionism by the US will therefore stimulate other nations into creating their own stimulus packages.

This is a naive argument, because other nations will not see the US action in this light. Instead, they will respond in kind, as they did after we enacted the Smoot-Hawley tariff in 1930 and as many are already threatening to do. So, if the Buy American legislation does get enacted, count on trade wars breaking out, so that Americans learn history, which they do not study enough at school, by seeing it repeated in their own lifetime.

A passionate response is required to the Buy American provisions and to the China-bashing on 'currency manipulation'

Yet some do worry about thus undermining the WTO, which has inherited from the General Agreement on Tariffs and Trade the many roadblocks to re-enacting that history of mutually harmful outbreaks of trade barriers. They have argued, therefore, that the US can enact WTO-consistent procurement rules by excluding from US procurement China and India, among other developing countries, which have not signed the optional procurement code. But remember that these nations can also retaliate in WTO-consistent ways. They often have "bound tariffs" – ceilings, which are significantly above the "applied", that is, actual, tariffs; and it is possible to raise the applied tariffs towards the bound levels without any restraint at all.

Nothing would prevent India and China from choosing to raise tariffs thus on items of export interest to the US. Besides, they could shift their own purchases of aircraft away from Boeing to Airbus, and of nuclear reactors from American to French companies. The response would, of course, be for the enraged US congressmen to start enacting their own retaliation. The game would become lively.

The accusation that China "manipulates" its exchange rate, which also promotes protectionism towards it, is another important cause for worry. Most senators are convinced the issue is clear-cut. It is not. The Washington magazine, The International Economy, once asked more than 60 economists: at what level should the Chinese currency be set? The answers, including those from some of our deepest thinkers on exchange rates, were revealing. Some wanted a float. Ron Mckinnon and Richard Cooper wanted to keep the currency at existing levels. And those who wanted revaluation fell into 11 groups ranging from 5 per cent revaluation to 40 per cent and above.

President Bill Clinton marred the first year of his presidency by indulging the Japan-bashers whom he had cultivated in his campaign. President George W. Bush succumbed also to steel protectionism in his first year. They had time to change, however. But Mr Obama, in the midst of a historic economic crisis, can ill afford to repeat this pattern: he has to fight protectionism right away or live to see the virus spread beyond control.

The writer is university professor, economics and law, at Columbia University and senior fellow at the Council on Foreign Relations, New York. His latest book is Termites in the Trading System: How Preferential Agreements Undermine Free Trade (Oxford, 2008)

Comment

Obama and trade: an alarm sounds

Jagdish Bhagwati

In the Financial Times, I argued that, unlike with Hillary Clinton, there were several reasons why one could be optimistic that Barack Obama would follow a pro-trade policy despite "prudential" protectionist talk on the primaries circuit ("Obama's free-trade credentials top Clinton's", March 3 2008). But the US president-elect's eloquent silence on trade issues – and his failure to balance his protectionist appointments with powerful trade proponents – require that we abandon these illusions and sound an alarm.

Consider Mr Obama's support for the multilateral trading system. It must be admitted that the Doha round is on hold and Mr Obama could not move it forward even if he so desired. A principal problem is that its completion turns critically on the US making further reductions in its distorting agricultural subsidies. But the issue has become even more difficult with the collapse of commodity prices and hence increases in support payments. Besides, history shows that the freeing of trade is nearly impossible to achieve in times of macroeconomic crisis.

But Mr Obama (unlike Gordon Brown) missed the opportunity, provided by the Group of 20's affirmation of trade's importance, to affirm that he attaches the highest priority to closing the Doha round and will work on this urgent task throughout his first year.

More important, Mr Obama has missed the bus on preventing a slide back into protectionism. His pronouncements on the car bail-out disregard the lessons of the early 1930s when the Smoot-Hawley tariff was signed into law and a competitive raising of tariff barriers ensued. We learnt then that tariffs and trade restrictions could indeed increase our national income by diverting a given amount of insufficient world demand to our markets. But then others could do the same to divert our demand to their goods, so that the result was reduced trade and deepened depression. Far better to keep markets open and increase aggregate world demand. So, the architects of the General Agreement on Tariffs and Trade (merged in 1995 into the World Trade Organisation) built into it institutionalised obstacles to an outbreak of mutually harmful trade policies.

But what trade barriers did after 1930 can be done also by subsidies. So we now have strict rules on subsidies as well. Under a 1995 WTO agreement, export subsidies and "local content" requirements are prohibited as directly damaging to trade and all other subsidies that are specific to companies or industries are open to complaint; and this applies even when they are claimed to be environmentally friendly.

There is no doubt that a bail-out just of cars, and within that specifically of Detroit, would qualify for countervailing action and dispute settlement challenges. It is important therefore that Mr Obama declare unambiguously that any bail-out will be WTO-consistent, because every other country will otherwise be emboldened to follow suit. Mr Obama, who has properly denounced unilateralism, should also not be the president who undermines respect for the rule of law that the WTO embodies at the multilateral level.

If Mr Obama's silences on multilateral trade are disturbing, should we be pleased by his strictures against bilateral free-trade agreements? On closer examination, though, this is not a vote for multilateralism but just the opposite. To understand this paradox, consider that labour union lobbies and their political friends have decided that the ideal defence against competition from the poor countries is to raise their cost of production by forcing their

He needs a stellar crew that will dispel the unions' baseless fear that trade with poor countries harms US workers' wages

standards up, claiming that competition with countries with lower standards is "unfair". "Free but fair trade" becomes an exercise in insidious protectionism that few recognise as such.

This cynical tactic can work only when the US is engaged in negotiating FTAs, typically with weak countries. It does not work for the multilateral system where powerful, democratic countries such as India and Brazil reject such trade-unrelated demands. So, the "fair trade" lobbies, which Mr Obama continues to embrace, gravitate towards FTAs rather than the WTO. The Democrats' opposition to occasional FTAs – including the latest one with Colombia – reflects, then, a recurring attempt at imposing yet more draconian demands on small countries rather than a preference for the multilateral trading system. If he is to embrace multilateralism and free trade forcefully, Mr Obama needs a stellar crew that will understand the protectionist nature of "fair trade" demands and dispel the unions' baseless fear that trade with poor countries harms American workers' wages.

Alas, his cabinet appointments include Mrs Clinton, whose trade scepticism is badly muddled at best, as secretary of state, and Hilda Solis, who reflects the anti-trade sentiments of the union federation, AFL-CIO, as labour secretary. His advisers include Robert Rubin, whose credibility on policy issues is undermined by Citigroup's receipt of large bail-out funds, and Larry Summers, the brilliant former Treasury secretary whose recent FT columns on trade and wages suggest prudence in the current political environment. The US trade representative position was offered to Congressman Xavier Becerra, a trade sceptic at best, and has now gone to Mayor Ron Kirk with credentials only as a supporter of the North American Free Trade Agreement, hardly suggesting a forceful presence in support of the open, multilateral trading regime.

The writer is a university professor, economics and law, at Columbia and senior fellow in international economics at the Council on Foreign Relations. His latest book is Termites in the Trading System: How Preferential Agreements Undermine Free Trade (Oxford, 2008)

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We need to guard against destructive creation

Print

By Jagdish Bhagwati
Published: October 16 2008 19:13 | Last updated: October 16 2008 19:13

It seems clear that the**current financial crisis**, terrifying though it is in its dimensions, will not be allowed to turn into the Great Crash of 2008. However, the larger lessons of the crisis, and its commonalities with previous calamities, must still be learnt if a new financial architecture is to be designed that can reduce the prospect of something similar happening again.

We can be optimistic about the effective handling of this crisis based on several factors. The Great Crash of 1929 has taught everyone lessons in what to do and, more importantly, in what *not* to do. Monetary policy is being loosened, not tightened: we can thank Milton Friedman's influential analyses for that. Fiscal policy will be expansionary, not deflationary: we all live in the age of John Maynard Keynes, whose fiscal prescriptions were unavailable in 1929 and grew out of the mistaken doctrines and policies of that time. The Smoot-Hawley tariff of 1930, which led to "competitive" increases in protectionism by all, accentuated the Crash. No one is willing to repeat that error.

Neither Ben Bernanke, the Federal Reserve chairman, nor Hank Paulson, the Treasury secretary – nor for that matter, President George W. Bush, who must take ultimate responsibility – wants to go down in history as another President Herbert Hoover, who presided over the Great Crash.

Besides, the ideology of the US is a lack of ideology. Where Nicolas Sarkozy, the French president, could not resist being photographed reading Marx's *Das Kapital* and announcing the death of "capitalism", the Americans settled down to fix the problem. They will do everything required to stem the crisis: for evidence of this, witness the **shift** of the $700bn (€515bn, £401bn) bail-out fund from buying toxic assets to recapitalising banks.

When the dust has settled, we must ask the question: why did this crisis occur? There are specifics that are not applicable everywhere. The crisis was, for example, kicked off by highly leveraged lending for uncreditworthy mortgages by the quasi-governmental**Freddie Mac** and **Fannie Mae**. But the problems became huge because "policy innovations" had been racing ahead of comprehension. The securitisation of mortgages was an innovation that led unwittingly to what Wall Street calls "betting the company". Credit-default swaps allowed**AIG** to bring in huge returns but at high risk if things went wrong, which they did.

The Long Term Capital Management crisis had a similar problem. At its heart were derivatives that no one quite understood. The Asian financial crisis was a result of a different innovation: the spread of capital account convertibility to economies that had registered miraculous growth for three decades, based on trade, but which were felled by their shift to financial convertibility. The downside had not been anticipated.

In each case, the assumption was that financial innovation was like non-financial innovation. When the personal computer was invented, the economy profited without upheaval. The typewriter became obsolete – an example of what Joseph Schumpeter famously called "creative destruction". But with financial innovation, the downside can be lethal – it is "destructive creation". We have to work hard at defining the downside scenarios.

The failure to think about the downside results from what I call the "Wall Street-Treasury Complex". Robert Rubin went from Goldman Sachs to the Treasury and back to Citigroup. Hank Paulson went from Goldman Sachs to the Treasury and will doubtless return also to Wall Street. This network shares the optimistic scenarios that Wall Street spins. Mr Rubin was in charge of the Treasury during the Asian financial crisis, whereas Mr Paulson was among the five major investment banking chief executives who persuaded the Securities and Exchange Commission not to extend prudential reserve requirements to their companies.

We therefore need a truly independent commission of experts to look closely at each financial innovation and work out its potential downside. Keynes once wrote that the inevitable never happens, it is always the unexpected. This commission would be charged with trying to narrow the range of the unexpected. We do not have to be blindsided by downsides just because we lazily surrender to the euphoria of the Complex.

The writer, a university professor at Columbia University and senior fellow at the Council on Foreign Relations, is the author of In Defense of Globalization (Oxford), reissued in 2007 with an afterword