

President Obama and Trade Policy

Keynote Luncheon Speech

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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 buying into the criticism of Buy America. 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, that 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 is 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 18th 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. Buy America

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 their 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 not 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 The Financial Times, 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) Bail-Outs

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 external 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.