Ambassador Susan C. Schwab,
United States Trade Representative.

THE INTERNATIONAL ECONOMY

THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
888 16th Street, N.W., Suite 740
Washington, D.C. 20006
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com

Schwab on Trade

In an exclusive interview, America's chief trade negotiator assesses the world.

TIE: **Let's begin with the "big kahuna" of trade issues: farm support systems. It looks as if the United States and European Union could find some common ground, but that would require changes in agricultural subsidies. President Bush seems paralyzed, so Congress has been acting independently on agriculture issues. Can this Administration have any influence at this point? How will the upcoming U.S. presidential election affect the picture?**

Schwab: The United States does a farm bill every five years, and we've made clear to our trade partners that the 2007 farm bill is not our Doha Round offer. The Administration has taken a very firm position in favor of more reform in our farm programs, and Agriculture Secretary Mike Johanns obviously has had the lead on the farm bill. We would like to see our program moved, in the long term, more in the direction of what we call "green box" in World Trade Organization parlance. "Green box" programs are less trade-distorting, with less direct impact on price and quantity.

If and when there is a Doha Round agreement, the cuts and disciplines imposed on trade-distorting agricultural subsidies would then be overlaid on the farm bill. That is one of the reasons trade promotion authority is so necessary—we would be implementing the Doha Round agreement by changing domestic and international laws to phase ourselves into compliance.

The U.S. agriculture community understands this and we've been working very closely with them. Their objectives in this negotiation are pretty straightforward. They have indicated they are prepared to accept cuts in

---

Twenty years ago in the first issue of TIE, *Ambassador Schwab, then legislative director for Senator John Danforth (R-MO), published an article, "The Last U.S. Trade Bill," which discussed the "Omnibus Trade and Competitiveness Act of 1988," the bill that set the stage for NAFTA and GATT talks and dictated the terms of their approval by Congress.*

trade-distorting domestic support. The United States put a big proposal on the table in October of 2005 including 60 percent cuts in what we call "amber box" programs, meaning programs that are the most trade-distorting. That proposal was put forward under the expectation that the United States would take these actions in the context of a broader Doha Round agreement that opened new markets.

Now, the focus of the Doha Round is supposed to be economic development. The first and foremost action that will generate economic development and alleviate poverty both in developing and developed countries is opening markets enough to create new trade flows. A number of World Bank studies show that the single biggest impact on economic growth a trade agreement can have is in the area of reduction or elimination of trade barriers to agriculture. Market access has the biggest impact by far. Secondarily, the elimination or reduction of subsidies has a big impact.

So from the farm community's perspective, they are willing to give up a guaranteed check in the mail in exchange for potential new export sales. In terms of Doha negotiations, our allowable ceiling for aggregate trade-distorting domestic support is $48 billion. The offer we put on the table in 2005 was to drop that to $22.5 billion. In the last ten years we've spent anywhere from $11 billion up to $28 billion, and because of the nature of these programs, in some years the $22.5 billion ceiling will be a real cut. Plus, we have signaled we're prepared to do significantly more than that, but not unilaterally and only in the context of an ambitious and balanced package including manufacturing and services.

What makes the Doha Round much more interesting and challenging is that after so many rounds, all the easy stuff is done so only the hard stuff is left.

TIE: **Where do the Europeans stand on trade negotiations?**

Schwab: Agricultural trade negotiations have three pillars: market opening, export subsidies and agriculture, and domestic subsidies. In December 2005 in Hong Kong, there was an agreement to eliminate agricultural export subsidies by 2013. The United States was willing to do it by 2010, but the European Union wanted to put it off. Ultimately we reached an agreement to do it in 2013. The way the Doha Round negotiation works though is as a "single undertaking," meaning nothing is done until everything is done. So the agricultural export subsidy portion of the deal is agreed upon, but set aside for now. The European Union has an allowable ceiling for trade-distorting domestic support that is four times as great as ours and an actual use of trade-distorting subsidies three times as great as ours. They have signaled their willingness in the context of these negotiations to move closer to a two-to-one ratio. The real sticking point for the European Union, though, is market access, because they have a relatively closed market. Our average agricultural tariff is 12 percent, theirs is closer to 23 or 24 percent. For comparison, the global average agricultural tariff is 62 percent, and India's average is 114 percent.

TIE: **How are the negotiations going? In a recent speech, you mentioned Brazil, India, and several other nations are now blocking a final deal.**

Schwab: You already referred to agriculture as the "big kahuna." It's the big kahuna in terms of the politics of these negotiations. It is not necessarily the big kahuna in terms of growth in global trade flows. The other areas of the negotiations, industrial goods—Non-Agricultural Market Access or NAMA in WTO parlance—and services are also incredibly important. The future is services trade flows, followed by manufacturing trade flows, which both far exceed agricultural trade flows.

But back to the development objective, new trade flows in agriculture really contribute most of the welfare gain. What makes the Doha Round much more interesting and challenging is that after so many rounds, all the easy stuff is done so only the hard stuff is left. The real question is, what are the advanced developing countries prepared to do? It turns out that 70 percent of tariffs paid by developing countries are paid to other developing countries. Our average industrial tariff is 4 percent. If the goal is generating economic growth, part of what you really need to generate is south-south trade. It may not be politically correct for somebody from a developed country to be saying this, but this stratum of developing countries needs to be opening its markets more to each other.

***TIE:* Do they all consider themselves as competing for the U.S. market?**

Schwab: Well, there are several concerns, including a latent nervousness on the industrial side of developing economies in particular that if they open their markets, the Chinese will come and wipe them out. The other is that developing countries are not used to having to contribute. All of us welcome the developing and particularly the advanced developing countries being fully represented in these negotiations. This is no longer a multilateral trade negotiation where the United States and European Union go off in a corner, cut a deal, and then expect everybody else to go along. Brazil, India, and China are at the table.

What that requires, however, is going beyond north-south rhetoric and recognizing that the world today is much more complicated. It is in their own interest for this stratum of advanced developing countries to participate more fully, not just in making decisions but also in making commitments. Yes, the developed countries have to do the most, but one has this sense that some of the advanced developing countries are hiding behind the lesser-developed countries as a way of avoiding having to make a contribution. That isn't leadership. I value the relationships that we have with countries such as India, Brazil, South Africa, and others that are expressing reservations. Their leaders—President Lula and Prime Minister Singh and President Mbeke—are global leaders. The question is whether their countries are prepared to step up and show leadership by example, not just leadership in rhetoric.

***TIE:* There's a lot of buzz that we may be seeing the end of the big trade agreement. What do you think? And why hasn't corporate America stood up for Doha as much as they have stood up for trade in the past?**

Schwab: I sincerely hope this is not the end of a multilateral trade negotiating era. That would be a real setback in terms of global economic growth. In order to generate the maximum economic benefits

The single biggest impact on economic growth a trade agreement can have is in the area of reduction or elimination of trade barriers to agriculture.

Why Agriculture?

So why do we focus so much on agriculture relative to other parts of our economy? Agriculture's share of GDP and employment is less than those of manufacturing and services. Yet agriculture as a constituency has paid a lot more attention to trade negotiations than have either the manufacturing or the services sectors. Why aren't our elected representatives hearing more from, say, the financial services sector about the Doha Round? The answer is that for someone focused on profit and loss on a daily basis, a multilateral trade negotiation that has gone on for six years is bound be boring. Part of the problem is that trade negotiation has so much jargon: Swiss coefficients, for example, and amber boxes and green boxes. No business person makes decisions on the basis of Swiss coefficients, right? So until this negotiation gets far enough along to offer potentially tangible results for a business person, it's not surprising business people don't pay a whole lot of attention.

—S. Schwab

from trade agreements, they need to be multilateral. And I say this as one who is very actively engaged in bilateral and regional negotiations. Those tend to be much deeper, more comprehensive, and more innovative deals than are possible in a multilateral context. But nothing takes the place of a really solid multilateral agreement. If we didn't have the WTO at this point, we'd have to invent it. The Doha Round will ultimately reach a conclusion, maybe this year or two or three years from now. And of course you've got criticism of the bilateral and regional deals and whether the whole "spaghetti bowl" approach promotes or detracts from global trade liberalization. I think ultimately bilateral and regional deals can contribute to the multilateral process.

So why do we focus so much on agriculture relative to other parts of our economy? Agriculture's share of GDP and employment is less than the shares of manufacturing and services. Yet agriculture as a constituency has paid a lot more attention to trade negotiations than have either the manufacturing or the services sectors. Why aren't our elected representatives hearing more from, say, the financial services sector about the Doha Round? The answer is that for someone focused on profit and loss on a daily basis, a multilateral trade negotiation that has gone on for six years is bound be boring. Part of the problem is that trade negotiation has so much jargon: Swiss coefficients, for example, and amber boxes and green boxes. No business person makes decisions on the basis of Swiss coefficients, right? So until this negotiation gets far enough along to offer potentially tangible results for a business person, it's not surprising business people don't pay a whole lot of attention.

This is no longer a multilateral trade negotiation where the United States and European Union go off in a corner, cut a deal, and then expect everybody else to go along.

I wish the business sectors of our trading partners would pay more attention because I wish they were pushing their negotiators. In the United States we have statutory private sector advisory systems, so even if the private sector *per se* is not paying attention, we are still meeting with a thousand advisors who offer advice and sharpen our focus. And we're constantly going up to Capitol Hill and getting input. In many other countries, negotiators either fly blind or only hear from those industries or businesses that feel threatened. Then the negotiators come to the table so focused on their defensive interests that they ignore their offensive interests. That's one of the biggest problems we've had with the Doha Round.

TIE: **There's a theory that China, India, and others are quickly heading toward excess capacity in manufacturing, and just to survive will jump into services—the mainstay of the U.S. economy. Do you see a tidal wave of political reaction coming to competition in services?**

Schwab: The debate on the future of services trade could in fact be very interesting. One of my favorite examples of how convoluted all this can be is call centers. In the big debate over outsourcing call centers to India, I always ask how many call center jobs were lost to outsourcing relative to the number of call center jobs lost to the do-not-call list. My guess is that significantly more jobs were lost to the advent of the do-not-call list than anything that could be accounted for by outsourcing. The flip side—and the biggest challenge for anyone trying to make a pro-trade argument—is the notion that trade and trade agreements represent a positive-sum game. Some activists would have you believe it's a zero-sum game and everybody loses.

U.S. Treasury Secretary Hank Paulson has been leading the Strategic Economic Dialogue with the Chinese and one of the issues we've tried to address is what happens if you let markets work relative to overregulation. Look at businesses such as express package delivery, or EBay, or Starbucks—industries that simply did not exist or would not have developed in the face of over-regulation. UPS tells us for every forty new packages being shipped overseas, they add a job in the United States—a Teamsters job, I might add. The challenge here is staying

The biggest challenge for anyone trying to make a pro-trade argument is the notion that trade and trade agreements represent a positive-sum game. Some activists would have you believe it's a zero-sum game and everybody loses.

focused on moving up the food chain. That requires education, access to capital, the free flows of ideas, and the capacity of entrepreneurs to succeed. It's a hard concept to translate overseas, let alone at home.

TIE: **To what extent do currency relationships and current account imbalances make your job difficult or impossible?**

Schwab: This is a question where I am always pleased to defer to Secretary Paulson and the Treasury Department. Suffice it to say we are, on a daily basis, faced with the fact that the trade representative's office has no control whatsoever over a lot of macroeconomic factors that influence our work—exchange rates, relative growth rates, savings and investment—a whole panoply of issues. We tend to focus primarily on those issues that directly affect trade, such as government intervention in the form of subsidies, or trade barriers, or increasingly the absence of protection of intellectual property rights.

TIE: **Your office did a lot of work on the recent series of free trade agreements. On Capitol Hill you have in Ways and Means Chairman Charlie Rangel (D-NY) and Senate Finance Chairman Max Baucus (D-MT) two statesmen who want to rise above partisanship and pass these agreements, but they're being stymied by the leadership. Is that your sense? Do the free trade agreements have any chance of going through?**

Schwab: Since this Administration came into office, we have built a strong portfolio of free trade agreements. There are four very strong agreements awaiting Congressional passage: Peru, Columbia, Panama, and South Korea. South Korea obviously is the biggest deal. It represents the largest economy in the world negotiating with the tenth-largest economy in the world, our seventh-largest trading partner. The agreement would rival the original U.S.-Canada agreement in terms of size and scope of economies. But even the three Latin free trade agreements cover about 79 million people. If 95 percent of the world's population is outside our borders and we want to expand our markets, what better place to go than our own neighborhood? For many years Peru, Columbia, and Panama have had essentially one-way free trade access to this market. They are prepared to reciprocate in exchange for a permanent agreement, locking it in so they can generate the kind of investment that they want to see in their own economies. Many Republicans and Democrats on the Hill understand this, and understand not just the economic importance of these free trade agreements but the geopolitical importance. That includes Finance Committee Chairman Baucus and Ways and Means Committee Chairman Rangel.

One has the sense that there is a fight within the Democratic caucus over what is the right thing to do, generally and politically. In May we reached what we consider to be a historic agreement with the House and Senate leadership and the minority leadership on the addition of enforceable labor and environmental standards. Many Democrats for the past fifteen years have been saying that but for the absence of labor and environmental standards in our trade agreements, they could have voted yes. All four of our trading partners agreed to reopen these free trade agreements and add these new provisions. Now we're waiting to see how that plays out starting with Peru. The thought that the Democratic Party could explain not taking action on or voting down three free trade agreements that take one-way trade situations and turn them into two-way reciprocal free trade agreements is sort of mind-boggling.

In addition, these countries are extremely important allies for us in Latin America. We want Peruvian and Columbian farmers to produce things other than coca, and this offers an incentive. In the case of South Korea, you are talking about a $78 billion two-way trade relationship in goods and services. The Korean economy is somewhat smaller than ours but it's still quite huge—approaching $1 trillion a year—and far more closed than our market is. The Koreans have relatively unfettered access to this market for their products and services. What the agreement does is level the playing field. There are compelling economic, commercial, and geopolitical reasons for all four of these free trade agreements and we're going to see in the next fifteen to eighteen months how the leadership in the Congress responds. Is this the party of Franklin Roosevelt and John Kennedy, who were major figures in U.S. trade policy and trade history, or not?

***TIE:* How much time do you spend selling the concept of free trade within the United States as opposed to actually sitting down negotiating trade deals?**

Schwab: Of my time and the time of my senior team over my tenure, probably 55–45 or 50–50 percent of our time was spent negotiating deals versus selling the concept of free trade. The last two years of intensive Doha negotiations have not necessarily been representative.

***TIE:* What changes have you seen?**

Schwab: I worked on Capitol Hill in the 1980s when the currency was way out of whack, leading to the Plaza Accord. There was a lot of unhappiness in the trade community then. It's interesting, if you look at the fundamental statistics now, a large trade deficit notwithstanding, unemployment is almost as low as it has ever been. The United States is a massive net creator of jobs. Economic output is up. Manufacturing output is up. All these different indicators do not reflect what one would presume would be associated with a trade deficit. Everyone likes demagoguing NAFTA, but comparing the ten years prior to NAFTA and the Uruguay Round with the ten years following, the unemployment situation has improved, manufacturing output has risen, and the economic growth rate is up.

***TIE:* So why is trade such a hot political issue?**

Schwab: Because it is so easy to demagogue. The President has spoken very forcefully and very eloquently about the risks of protectionism, isolationism, and nativism. We as a nation need to always be on guard against turning inward or blaming others. What has been the basis of our successes in this world? It is immigration. We are a nation of immigrants. It is free and fair trade. But as you know, the benefits of trade are so diffuse while the negative impacts of trade—and there is directly measurable negative impact—tend to be very narrow and affect a very vocal constituency.

***TIE:* The Peterson Institute for International Economics did a study that found the payoff per household from trade was about $9,000 per year.**

Schwab: That's right. And if we were to eliminate all barriers going forward it would add perhaps $4,500 per household. The impact of NAFTA and the Uruguay Round on household income is an extra $1,300–$1,800. And here's another great statistic: Jobs related to exports pay 15–18 percent more. The data is compelling, and yet it is systematically ignored by the demagogues.

***TIE:* It seems we've had an experiment with globalization over the last quarter-century that has resulted in enormous wealth creation and poverty reduction. People now take the prosperity for granted. It's been like nothing in recorded history. But do you sense things starting to go backwards? Is there a retrenchment beginning?**

Schwab: Two things set the current era apart. One is the tremendous growth and opening up economically of China, and the corresponding implications for policy and politics for a lot of countries, not just the United States. The second is the fact that we have seen so much prosperity and economic growth that in many ways we're victims of our own success. Most barriers to trade and capital flows have disappeared, and we have seen the benefits. There is complacency associated with this growth—leaders in countries growing at double-digit rates ask, "Why do I need a trade agreement? Why do I need to make tough choices and jeopardize my political standing with my agriculture community or my manufacturing community?" I'm not talking about the United States, but about India, Brazil, Argentina, and South Africa.

If we were to move into an era of more stagnant growth, would that make politicians think more about

UPS tells us for every forty new packages being shipped overseas, they add a job in the United States—a Teamsters job, I might add.

The thought that the Democratic Party could explain not taking action on or voting down three free trade agreements that take one-way trade situations and turn them into two-way reciprocal free trade agreements is sort of mind-boggling.

how to jumpstart growth and thus become more enthusiastic about trade agreements? The solution to sustaining these growth rates is to try to open markets.

TIE: **Some say the situation in China is beginning to look like a classic bubble. The Chinese have been stockpiling commodities and building manufacturing capacity, not necessarily driven by a market assessment of demand. One inevitability of life is that bubbles burst. Could a post-bubble China become a huge global disinflationary force?**

Schwab: There is a real risk of Chinese progress in moving from a controlled economy to a market economy stalling or going backwards. You see that in certain decisions being made about protecting and nurturing national champions, about restrictions on foreign direct investment.

TIE: **It was reported recently that the Bank of China alone holds nearly $10 billion in U.S. subprime mortgages. Around the time of this announcement, the Shanghai market jumped 20 percent, while the rest of the global market was melting down. What's wrong with this picture?**

Schwab: We talk in the Strategic Economic Dialogue about issues of transparency, disclosure, and access to information. The downside of controlling information is you can have tremendous skewing of markets.

TIE: **Countries such as China, India, and the oil producing economies—in most cases not democracies or certainly not free economies—have accumulated trade surpluses and huge currency reserves. In the 1970s, we recycled petro dollars by selling the Middle East weapons. In the 1980s through the beginning of this decade, we sold the booming Asian economies Treasury bonds. Lately, we're seeing quasi-governmental or official government investment vehicles using surplus dollars to try to buy hard assets. Have surpluses built to the point where the savings-surplus governments really have to diversify in their investments? Will Americans allow a KGB-run government in Russia or the Chinese government to buy 10 percent of Microsoft or 10 percent of Boeing, earning board seats at those companies? Of course U.S. businesses invest heavily in Chinese firms, but our investors aren't government entities. Aren't we looking at some tough political and strategic decisions to be made that call for some preemptive thinking on national treatment of industries?**

Schwab: That question would take much longer to answer than I have time for today. Part of the intent with the new CFIUS (Committee on Foreign Investment in the United States) legislation is to be more transparent and to have a more straightforward process so as not to be sending signals that somehow we're against foreign direct investment. I can't believe we were all upset because the Japanese were buying Rockefeller Center and the Sears Tower. We need to decide what is really of concern from a national security perspective.

TIE: **Do you think concerns about carbon emissions could be a major trade obstacle coming down the pike?**

Schwab: It depends on how the issue is handled. We're beginning to peer at the nexus between traditional trade and traditional environmental concerns. In Doha, there are a couple of examples of trying to eliminate trade barriers on environmental goods and services, such as scrubbers. It seems to me that there are healthy ways that the two sets of issues can come together and there are unhealthy ways, both in terms of the environment and in terms of the trading system and global economic growth.

TIE: **Thank you very much.** ◆