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ECONOMIC NEWS UPDATE

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So it does indeed end with a whimper rather than a bang. Free trade, I mean. Thanks to a President too weak politically to withstand the protectionist surge of a Democratic congress, the era of ever-freer trade has come to an end. It expired quietly, with few mourners, and some of those who have done it in claiming that the corpse is alive and well.

Susan Schwab, US Trade Representative, found it politically necessary to claim that the deal cut by a weakened President Bush and a reluctant Treasury Secretary Hank Paulson with a triumphant US congress "shows the US is not turning protectionist". I doubt whether her more candid predecessor, Bob Zoellick, could have been persuaded to claim victory in the face of so significant a defeat.

The deal, still subject to congressional approval, is this. The Democrats will agree to approve two minor trade agreements, one with Peru and the other with Panama, in return for a Republican agreement to require its

trading partners to adopt a series of environmental and labor market "reforms". Those "reforms" include the recognition of the right of trade unions to organize workers, the outlawing of most child labor and of workplace discrimination, and a requirement to allow patent protections of pharmaceuticals to lapse overseas when they expire in the United States. We can sue our trading partners if they violate the agreement, and they can sue us. For example, if some country such as Panama decides that we are violating trade union rights here at home, they can bring suit to pressure congress to change the law.

Never mind that these provisions are an invitation to anti-trade forces in America to bring suit against countries deemed to be lax in enforcing these new standards. Or that the agreement opens the door to suits against our government. More important is what this deal tells about the shift in the balance of political forces that determine future trade policy.

Until now, the administration's supporters of free trade have been able to fight off Democrats' attempts to force these restrictions on America's trading partners. No longer. For two reasons.

First, there is Iraq, which has sharply reduced the President's ability to keep his congressional party in line. The Presidential coattails, once clung to by congressmen trying to ride Bush's popularity to victory, now are frayed beyond any ability to be useful to aspiring politicians. Indeed, the name of the game in Republican circles is to create as much distance as possible from the Oval Office.

Second, there is a shift in attitudes towards trade. Trade unions and Democratic politicians looking for a free-trade scapegoat are arguing that Wal-Mart prices, so attractive to consumers, come at the expense of exploited children in Asia and an underpaid workforce in America. Child laborers in Asia might be working themselves out of poverty, and Wal-Mart might be providing jobs for thousands unable to find work elsewhere, but that doesn't matter to critics of free trade and of the company.

In one sense, the free trade advocates in the administration have no one to blame but themselves. They have been unable to craft and to explain effective programs to transfer some of the gains of free trade to those who suffer from it -- displaced workers. Yes, there is a host of programs aimed at doing just that, but most workers can't cope with the bureaucratic shoals that must be navigated in order to be eligible for benefits. And yes, unemployment is virtually non-existent, but until very recently workers' wages have not kept pace with the growth of profits and executive compensation. That created

an opportunity for the administration's critics to claim that globalization and free trade raise corporate profits and executive compensation, while exposing ordinary workers to competition from dollar-a-day laborers in Asia and below the border.

Then there is China, increasing its wealth and, equally important, its political power on the back of an export boom sustained in part by an undervalued currency that gives it what even free traders concede is an unfair competitive advantage in world markets. And provides it with a huge and growing surplus in its trade with the US: \$63.3 billion in the first four months of this year, up 88% on the same period in 2006.

This week's semiannual Strategic Economic Dialogue between a US delegation headed by Hank Paulson and a Chinese delegation led by vice premier Wu Yi won't produce much progress on the currency question, or much reduce China's theft of intellectual property, which may stir congressional critics to consider legislation on those issues. With characteristic shrewdness, the Chinese took two steps to ease tensions in advance of the meeting. First, the People's Bank of China widened the range within which it would allow the renminbi to trade -- a meaningless gesture since the currency has never tested existing limits. To non-technicians: this move seems, but only seems, to allow the currency to appreciate.

Second, China announced that is placing \$3 billion of its huge currency reserves with Blackstone, the private equity group, thereby winning the favor of a group that is not only economically powerful in the United States, but politically very well connected,

especially with key senators who have been calling for trade sanctions against China.

So the state of play now is roughly as follows. After six months of tough negotiations, the administration agreed to accept Democratic restrictions in order to gain the prospect of approval of two minor trade agreements. Meanwhile, the more important agreement with Colombia has been put on hold until trade union leaders are satisfied by the Colombian president Alvaro Uribe that he will protect union leaders in that country, some of whom have been assassinated. This is a blow to the Bush administration, which had been counting on Uribe as an ally in its attempts to counter the influence of Venezuela's rabidly anti-American Hugo Chávez.

Also the very important agreement with South Korea has been sent back to the drawing board by a congress seeking more concessions from that country before it will consider repealing the 25% tariff we impose on SUVs manufactured in that country.

Two important questions remain. The first is whether the Bush administration can persuade important elements in the business community to support the deal, and whether Democratic leaders can overcome those of their colleagues who believe that the best trade deal is no trade deal. Neither is certain.

The second question is whether the deal is a template for others, a forerunner of an agreement in the Doha Round, and also presages congressional renewal of the President's fast track authority, which empowers him to put any trade agreement to congress for an up or down vote, no amendments allowed.

The deal-makers, most notably Schwab and Paulson on the Republican side, and Congressman Charlie Rangel, the suave chairman of the powerful House Ways and Means committee, for the Democrats, say it will. Trade union leaders disagree -- no trade deals so long as Bush is President, or better still, never. John Sweeney, president of the AFL-CIO, America's largest trade union confederation, has promised to oppose any trade agreement with South Korea or Colombia, as well as any extension of Bush's fast track authority. Unions may not have the clout they once did, but they still matter in close elections.

Pity, all of this, just when the falling dollar is boosting American exports, and a tit-for-tat trade war, closing markets to US goods, is the last thing a slowing American economy needs.



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