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Trading Exaggerations

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As the Bush Administration and Congress gird for battle this fall over four newly signed free trade agreements, one could be forgiven for thinking that these FTAs must be economically momentous to merit the looming conflict. But one would be wrong. While the global political stakes are huge, the domestic economic stakes are penny ante.

The agreements with Panama, Peru, and especially Colombia and South Korea are immensely important for U.S. foreign policy. They can also play an important role in spurring economic development in these U.S. allies. But the debate in the United States has largely focused on how the U.S. economy and U.S. workers will fare. By that measure, these agreements are trivial.

How can it be that FTAs' impact is so badly misconstrued? There are multiple layers of confusion. To begin with, there is a general tendency to see trade as affecting workers more than research really supports. Technological change and domestic competition have both had a large impact on workers in recent decades, but they are much harder to protest than trade agreements.

One might ask why we should bother with such agreements, if we can barely discern their effects on the U.S. economy. The answer is that FTAs can have an enormous political and economic impact on our trading partners.

Whatever one thinks about trade's effects on workers in general, there are two reasons to think that the impact of the FTAs under discussion would be much more muted. First, these FTA partners are small relative to the size of the United States. South Korea is the most significant of the bunch, with an economy just under 10 percent the size of the United States, but it's a developed economy with an average income of roughly \$25,000 per year. Colombia's economy is less than 3 percent of the size of the U.S. economy. Peru and Panama are smaller still.

The second key point is that the United States is already open to trade with these countries. Colombia, for example, already gets special access to the U.S. market through existing preference programs. In 2006, 92 percent of U.S. imports from Colombia entered duty-free - that's before any agreement is adopted! The new liberalization that occurs

under such agreements is thus lopsided in favor of U.S. exporters. Given the countries' small size, though, even these benefits are small.

One needn't be steeped in the mysteries of international economics to discern all this. Congress requires that before the Administration submits an FTA, it must first get an assessment of the agreement from the independent non-partisan U.S. International Trade Commission (USITC). Those publicly-available reports make for rather repetitive reading. The USITC found that the Peru agreement might increase U.S. output by more than \$2.1 billion. If that sounds impressive, remember that U.S. annual output exceeds \$13 trillion. So we're talking about an increase of less than 0.02 percent. The positive effects of the Colombia FTA were estimated to be a bit larger, but still less than 0.03 percent. In the case of Panama, the USITC found that "U.S. imports would not likely grow significantly since most Panamanian products already have duty-free access to the U.S. market as a result of trade liberalization under the TPA because most Panamanian products already enter the U.S. market duty free."

In other words, the likely economic effects of these agreements are positive, but so small that they would be wiped out as rounding errors in ordinary newspaper reports on U.S. economic progress.

One might ask why we should bother with such agreements, if we can barely discern their effects on the U.S. economy. The answer is that FTAs can have an enormous political and economic impact on our trading partners. In the case of Peru, for example, President Alan García barely beat a staunch opponent of the United States in the last election. He did so promising economic reform and trade. An FTA between the United States and Peru would cement those reforms in place and reward Peru's allegiance.

Colombia is even more significant politically. As Hugo Chavez in neighboring Venezuela has attempted to rally Latin America against the United States, Colombia has remained steadfast in its support. To repay them with the public repudiation of a negotiated FTA would leave the United States' reputation in the region in tatters.

As bad as this would be, at least the United States' commitment to the Western Hemisphere is clear. If the United States were to forsake South Korea, that would likely be read as the U.S. abandonment of Asia. China has already been maneuvering to arrange regional Asian groupings that exclude the United States. To spurn the Koreans would almost certainly further U.S. exclusion in the region.

True enough, these are political arguments for economic agreements. But if the economic effects of the FTAs in the United States are negligible, why not focus on the political impact? If these agreements have enormous foreign policy benefits coupled with very small economic benefits (not costs!) it is hard to fathom how anyone looking out for the United States' best interests could oppose them.

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