Trade Promotion Authority and
Institutions for Growth in the Global Economy

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Good morning, and thank you for the opportunity to join you today. Let me begin with a few “big picture” remarks and review the state of the world economy. However, I do so only as an introduction to a larger purpose – to advantage of this distinguished audience and dig a bit into the foundations of successful world economic growth.

Growth in the Global Economy

As we all know, the National Bureau of Economic Research recently made the official declaration that the United States is in recession. Although the NBER pointed to the events of September 11 as a key contributing factor, it dated the cyclical peak in March of 2001.
This is not news. Prior September 11, growth rates were much below their potential levels, and were recognized as unacceptably low. Accordingly, monetary and fiscal policy had moved decisively to reverse recessionary pressures. The Federal Reserve cut the target federal funds rate by 300 basis points from the beginning of the year through September 11, and $35 billion was returned to taxpayers during the third quarter as a downpayment on a large permanent tax cut. Since September 11, the Federal Reserve, the Administration and Congress have undertaken numerous efforts to provide insurance against the economic consequences of the attacks. This work is far from complete, but it is not the focus of my remarks today.

Outside the United States there is the need for resumption of economic growth in Japan and accelerated growth in Europe. During the first half of 2001, GDP declined in Japan. While the overall rate of growth in Europe remains positive, it has decelerated and Germany has experienced negative growth. Moreover, European Commission surveys of the outlook for new manufacturing orders and consumer confidence indicate recent deeper declines. From a direct U.S. perspective, more rapid growth in the major economies will raise our growth prospects as well. More broadly, it will enhance the likelihood of stability and progress in the rest of the world, such as developing Asia and Latin America. In the absence of resumption of global growth, trends in output and asset prices may force painful adjustments in these economies, as we are witnessing in Argentina.

While it is important to have a cyclical recovery, it is even more essential to raise the long-run rates of economic growth. By the OECD's account, European output growth was 2.1 percent in the first quarter – near its potential level of 2.4 percent. Merely engineering a return to this rate of growth – growth slowed to 0.4 percent in the third quarter – leaves much to be desired. Similarly, Japan cannot look to counter-cyclical macroeconomic policies alone as a savior. Monetary easing has enabled Japanese banks to obscure non-performing loan problems through continued lending to essentially insolvent firms. Funding these "zombie" firms is an inefficient allocation of resources that prevents any increase in output or activity. On the fiscal side, old-style public works construction spending impacts the same firms, limiting its impact.

Thus the inescapable conclusion is that deep, structural adjustments need to be undertaken in both regions. There is a caveat: The term “structural reform” is popular, partly because it has an elastic meaning that allows one to obscure specific policy actions. It would be a mistake, however, to apply a one-size-fits-all definition. The comparison between Europe and Japan is illuminating in this respect. In Europe, commentators from both the OECD and the European Central Bank have noted the lack of acceleration in productivity growth comparable to that witnessed in the United States. Rigidities in labor and product markets, sometimes exacerbated by regulatory impediments, are often cited as culprits. In Japan, removing the obstacles to reallocating labor and capital to activities with higher returns remains the central task. This task is inextricably linked to the banking and corporate system, which in the immediate post-war period served Japan well, but in the past decade, has hindered the adjustment process. Poorly performing business activities have survived on lifelines provided by banks; in the short term, this tendency dampened the downturn, but over the longer term, the resources devoted to sustaining such enterprises have been drained away from the more dynamic and profitable sectors of the economy.

It is important to remember that economic relations are not a race, despite the tendency by many to “compare” this number and that number. Economic interactions often take on a “win-win” form. Enhanced productivity growth in Europe and Japan is of interest to the United States because it will increase the range and diversity of goods that U. S. consumers and firms can purchase at the lowest prices. This process will serve to enhance our productivity. Moreover, as foreign incomes rise, demand for U. S. goods will also rise. This is a virtuous cycle that we should encourage.

Growth, of course, is not an end in itself. Economic growth raises standards of living – "consumption" in the language of economists. It also provides resources that may be devoted to a variety of non-market activities. Growth can fund environmental protection, charitable organizations, and a wide variety of non-market goods that are of interest to developed and developing economies alike.

Behind any successful growth episode lies improvements in productivity. Productivity growth in the United States accelerated during the second half of the 1990s relative to growth during the previous two decades. Economists generally believe that much of the higher rate of productivity growth is permanent. Information technology investment is likely to remain strong in the long run (once we get beyond the current weakness). Another source of gain is better ways of doing business (what economists call "total factor productivity"). Only a fraction of possible improvements have been made, so that productivity can continue to grow in this way.

An important issue for future productivity growth is the response of the U.S. to the need for enhanced security. Cost-effective responses are an important aspect of the adaptation to the new security environment. As an example, consider the need for increased security of economic activity, both physical security and the security of transactions – backup computer systems and the like. To the extent that our economic response results in duplicative security efforts by multiple parties, or excessive mandate of security policies, we will wastefully siphon funds that could be devoted to productivity enhancements and other investments into this effort.

The historical lesson is that private markets are resilient, efficient, and flexible in meeting new challenges. We should seek as our objective new standards for the security of the economy, but should be wary of dictating *how* to achieve our objectives. One of the success stories of the past thirty years has been the productivity benefits of deregulation. We should be wary of losing these benefits via excessive new regulation.

Institutions for Long-Term Economic Growth

We are all well aware that productivity growth does not arrive from the heavens. New technologies, process innovations, and other aspects of private-sector productivity gains are the result of investment, effort, testing, and implementation. Put differently, the important economic *outcome* – productivity growth – hinges on the structure of economic *incentives*. It is now understood that the effective use of economic incentives hinges upon the institutions in which they are embedded. It is from this perspective that I would like to review the benefits of an open world trading system, and the particular importance of Trade Promotion Authority.

World Trading System

One of the President's priorities is the U.S.-led effort for more open global trade. The large contribution of reduced trade barriers to growth in our standard of living has long been recognized. In 2000, the United States exported $1.1 trillion in goods and services – or 11 percent of gross domestic product (GDP).

Trade between nations is simply the international extension of the division of labor – a two-way street in which the United States exports its specialties (such as aircraft, industrial machinery, and agricultural commodities) in exchange for products produced efficiently abroad (such as coffee, crude oil, automobiles, and shoes). Trade raises the productivity of Americans, and productivity is the ultimate determinant of our standard of living.

The United States has the opportunity to reap significant gains from the future trade agreements. A recent study finds that a new World Trade Organization (WTO) round that lowers barriers to services and reduces tariffs by one-third on agricultural and industrial products would yield gains in the United States of about $177 billion.

This gain would be roughly equivalent to a $2,500 permanent increase in the annual income of the average family of four. An agreement on the Free Trade Area for the Americas that removes bilateral tariffs would increase GDP by about $53 billion, or about an $800 permanent increase in the annual income of a family of four.

These are important benefits for the average American household. Trade is sometimes portrayed as a threat to lower-income individuals. This is not the case. To take one example, in 1997 there was roughly $18 billion in tariffs, with nearly one-half on clothes and textiles. Who pays those tariffs? In an $11 trillion dollar economy, this might not seem like an important question – after all, $9 billion in clothing tariffs is a trivial fraction of overall consumption spending. The reality is that – measured as a fraction of their income – tariffs paid by the lowest -income quintile were roughly three times that of the highest-income quintile.

This is an example of the benefits of trade. Trade itself – not just either exports or imports in isolation – is the key. Opening foreign markets allows U.S. producers to maintain the 12 million jobs supported by exports. Under NAFTA, for example, Mexico eliminated its tariffs on light trucks and will eliminate tariffs on medium and heavy trucks and buses in 2003. U.S. exports of motor vehicles rose from $975 million in the five years preceding NAFTA to $6.6 billion in the five years after NAFTA.

Similarly, America's farmers rely on export sales. Exports of agricultural products amounted to $53 billion in 2000, with roughly 25 percent of gross farm income derived from foreign consumers.

Trade helps our domestic productivity. Expanding global trade allows the most efficient producers to grow because selling goods in the competitive international marketplace demands higher productivity. In fact, exporting plants have four to 18 percent higher productivity non-exporting plants.

As I noted earlier, imports and tariff reductions provide lower prices for American consumers. Imports provide other benefits as well. In particular imports provide inputs necessary for domestic production, including machinery, equipment, instruments, parts, and various other components to production that constitute 29 percent of imports. These imports – some of which are varieties not available at home – enable our industries to compete more effectively. Imports also provide competitive stimulus to improve domestic productivity growth.

Furthermore, many domestically produced goods are shipped abroad for further processing or assembly and then returned to the United States. In 1998, for example, the U.S. imported $27 billion of "production sharing" goods from Mexico, and these goods may be re-imported duty free. Nearly 60 percent of the value of these imports derives from U.S.-made components – roughly 15 percent of all U.S. imports from Mexico.

A the most striking feature of the current debate is that knowledge about the gains from trade is not new. The United States has benefited tremendously from trade agreements passed under TPA-like arrangements between the legislative and executive branches.

The 1993 Uruguay Round of the GATT, upon full implementation, has been estimated to imply a per-year income gain of between $600 and $800 for the average household of four. The cuts in tariffs contained in this agreement mean that U.S. consumers can purchase goods more cheaply; the tariff cuts under the Uruguay Round were similar to a $310 tax cut for an average household of four.

The benefits of free trade are substantial and investments in the institutions that support a global trading system are valuable. Indeed, an institutional commitment is a good way to overcome instances of short-sightedness. In developing countries, the advantages of international trade produce income for not only commercial consumption, but also access to better food, better health care, better education, and technologies that will help improve the environment. In a developed country, stiff import barriers on labor-intensive goods from developing countries such as clothing, leather, or agriculture not only harms consumers but reduces the income of people in developing countries as well.

A recent World Bank study identified developing countries as "globalizing" on the basis of the growth in trade related to GDP and their reduction in average tariff note. It found that, in the 1990s, the income per person in globalizing developing countries grew more than three-and-a-half times faster than it did in non-globalizing developing countries. In the six years following completion of the Uruguay Round, exports from developing nations grew by nearly $1 trillion, to a level of $2.4 trillion last year. The United States in particular has been an engine of export growth for developing nations. There has been an 82 percent increase in U.S. imports from developing countries (87 percent increase in chemical products and 72 percent increase in textiles) between 1994 and 2000.

Building on this success is important. New global trade negotiations would generate approximately \$36.4 billion-\$172 billion a year in higher incomes for developing nations, according to one study. Another study shows that potential income gains for developing countries from a multilateral round are greater than recent flows of official assistance and roughly comparable to total inflows of foreign direct investment. An IMF/World Bank study notes that eliminating all barriers to merchandise trade would yield static welfare gains of between \$80 and \$180 billion to developing countries. These numbers are well in excess of annual aid flows to these countries.

Gains to the United States from trade would be enhanced by the granting to the President of Trade Promotion Authority (TPA). The case for TPA rests on three legs. First, as I just discussed there is an important role of an open world trading system plays a significant role in aiding productivity and standards of living. Second, formal trade agreements contribute to the architecture of our trading system.

Since World War II, a bipartisan consensus in the United States has supported the idea that multilateral trade negotiations should establish rules for world trade and should free that trade from artificial barriers imposed by governments. The freeing of world trade would not just benefit the U.S. economy, but would also strengthen the world economy, thereby serving the nation's foreign policy interests.

For this reason, the United States has been a member of GATT since its inception in 1947. The United States is also a member of the World Trade Organization (WTO), the international trade body that was created by the resulting agreement. The WTO is an international institution in which the United States negotiates agreements to reduce barriers to trade with 144 other members. The WTO is also a forum for countries to enforce trade agreements and continue negotiations toward expanding world trade opportunities.

At the most recent WTO meeting in Doha, Qatar, the member countries agreed to launch another series of negotiations on trade liberalization. Negotiations will commence in a number of areas, including agriculture, services, industrial market access, a limited set of environmental issues, antidumping and subsidies, and WTO dispute settlement rules.

Some of the issues slated for discussion have proven particularly difficult to deal with in the past, suggesting that gains from such a round could be large. For example, many countries maintain high barriers on agricultural products; a new trade round will attempt to address both impediments to trade in agricultural products and government subsidies in this sector.

At the same time, the United States is currently involved in efforts to liberalize trade with a larger number of our hemispheric neighbors. Discussions for the Free Trade Area for the Americas (FTAA) began at the Summit of the Americas, which was held in December 1994 in Miami. Thirty-four countries agreed to construct a free trade area in which barriers to trade and investment will be progressively eliminated, and to complete negotiations for the agreement by 2005. The FTAA covers market access, agriculture, services, investment, intellectual property, competition policy, and dispute settlement.

In short, I think it is quite clear that there is tremendous value to multilateral agreements that institutionalize a commitment to free trade among countries.

The final step, of course, is to make clear the link between Trade Promotion Authority and the quality of trade agreements. Trade Promotion Authority would allows the President to submit a negotiated trade agreement to Congress for a simple up or down vote, without amendment and modification.

Obviously, Congress still has its final, rightful say on whether or not the United States signs any trade agreement. TPA, though, provides the President with maximum flexibility and gives the United States additional credibility in the international community. It enhances our bargaining power in these negotiations. It also ensures that trade agreements will maintain a focus on trade, as intended by the negotiating parties. TPA sends a signal to other countries that U.S. is united in active engagement in trade negotiations that will benefit all participating countries.

What evidence is there to support TPA? First, this type of authority has a long history. Starting with the 1934 Reciprocal Trade Agreements Act (RTAA), Congress agreed to give its prior approval to any trade agreement reached by the Executive, although it did require that the negotiating authority be renewed every three years. In the Trade Act of 1974 required that Congress approve trade agreements after their negotiation, Congress agreed to a "fast track" procedure in which Congress would vote in a timely fashion and without amending the agreement.

This "fast track" procedure has been used to pass our most recent important trade agreements, including NAFTA and the Uruguay Round of the GATT, both in 1993. However, the commitment by Congress to fast track passage to execute trade agreements lapsed in 1994.

Another way to see the importance of TPA is to look at the between parliamentary and divided powers systems. In parliamentary systems, the trade minister is appointed by the party in power. This usually gives the minister a clear mandate, as well as a majority to approve the agreement. The process is more streamlined. Canada, the UK, and Australia all have parliamentary systems.

On the other hand, in systems such as the US, the negotiators are not necessarily from the same party as those who have the power to accept or reject it. In addition, without some sort of prior agreement such as trade promotion authority that binds the Congress to consider trade agreements under a closed rule, the Congress can make amendments. And there is no guarantee that once the agreement has been amended the other country will still accept it.

A particularly interesting hybrid is the European Union. The European Commission negotiates trade agreements on behalf of the EU, which must be approved by the European Council. However, as the Commission has the sole right of initiative, the Council cannot unilaterally adopt amendments to proposals from the Commission. This has helped speed the process of concluding free trade agreements (FTAs) with outside countries, as evidenced by the five that have come into effect since the beginning of 1998. The average time to conclude these FTAs was under 2 years.

The flip side to trade flows is international capital flows. So, before closing let me add a few thoughts on the architecture of the financing side of international economic relationships.

International Financial Institutions

Among the key institutions are international financial institutions like the International Monetary Fund and the World Bank. The international financial institutions (IFIs) must retain key roles in the international financial system in promoting macroeconomic stability and preventing financial crises, and in generating economic growth and alleviating poverty in the world's developing countries.

Toward these ends, the responsibilities of the IFIs should be clarified so that policies may be matched more closely to the underlying problem. The International Monetary Fund (IMF) should focus on promoting sound macroeconomic policies and monitoring economic conditions. In the context of the current global slowdown, it is possible that more countries will come under liquidity pressure. With this backdrop, it is useful to adhere to principles that distinguish between illiquidity and insolvency.

It is a useful function to have a facility for illiquid, but otherwise solvent nations. In the case of an insolvency problem, the focus should be to free the underlying real assets (capital and labor) of the country to be productive in the future and not be dragged down by the financial overhang. Debts may be restructured at a fraction of their value with past creditors, and the nation is allowed to move forward toward a path of greater productivity and growth.

Accordingly, it would be useful to focus future official interventions along the following lines. First, intervention should require evidence of either a systemic risk of contagion (or, if by a country or group of countries on particular security or geopolitical concerns.

Second, intervention should be oriented toward producing a sustainable economic situation. To do so, a credible and sustainable fiscal and monetary regime must exist and be accepted by the nation's political process, and the magnitude of the intervention must be sufficient to actually produce this new sustainable equilibrium.

Third, official financial assistance should attract, not substitute for, additional private sector involvement.

Finally, intervention should be liquidity oriented. Early warning of potential future insolvencies may be enhanced via initiatives that will help transparency and aid the private market in providing discipline. Two examples are Reports on Standards and Codes (ROSC) and Financial Sector Assessment Reports (FSAP). These provide valuable information to both the IFIs and the private sector on the overall status of financial performance in countries. Through this type of monitoring and dissemination of information, the IMF can facilitate action to avert crises before they fully emerge.

In contrast, the development banks should focus their resources first on countries that cannot access the international capital markets. This aid should focus on raising productivity and per capita incomes, emphasizing human capital, open trade, and private enterprise.

With regard to promoting reform, loans should be made available to governments that demonstrate their commitment to sound economic policies and management, the rule of law, enforceable contracts and a stable government process. Grants should be used to provide basic health and education services to the poorest and least creditworthy countries.

There has been some progress since the Meltzer Commission's thoughtful review of the IFIs' missions. The IMF has taken steps to rationalize its lending facilities, and promote the adoption of international best practices in such areas as bank supervision and securities market regulation. Both the IMF and the World Bank have extended relief to the heavily indebted poor countries. Transparency is increasing at both institutions. The IMF's approach with Argentina demonstrates a new commitment to distinguishing insolvency from a lack of liquidity as well as a realistic assessment of the effects of contagion.

Concluding Remarks

Long-term economic growth is the key to rising living standards in the United States and the global economy. Encouraging economic growth requires a stable and favorable fiscal and monetary policy to be sure, but fostering institutions to promote beneficial international trade and finance regimes is also an important task for public policy.