SCUSA 60 THEME:
"MEASURING PROGRESS AND DEFINING NEW CHALLENGES"

## GLOBAL ECONOMIC AND TRADE ISSUES

*Economic freedom is a moral imperative. The liberties to create and build, or to buy, sell, and own property is fundamental to human nature and foundational to a free society. Economic freedom also reinforces political freedom. It creates diversified centers of power and authority that limit the reach of government. It expands the free flow of ideas; with increased trade and foreign investment comes exposure to new ways of thinking and living which give citizens more control over their own lives.*

*2006 National Security Strategy*

SCUSA at 60 occurs not only during a crucial election year when there exist many calls for change to the future path of America, but also in the midst of the most serious financial crisis of this generation which poses a threat to capitalism as we currently know it. A new administration gives America an opportunity to measure its past progress, define new challenges, and identify goals to overcome these challenges. Initial questions that may come to mind include: how does the United States balance the increasing trend towards globalization with the potential negative effects it may have on some domestic industries? What threats to national security are real as certain jobs move outside our borders? How does the increasing income inequality—both domestically and abroad—affect the national security of the United States? Will the global financial crisis lead to a global regulatory system? What threat to international competition would such a system impose? How does the financial crisis slow down the global move to free trade?

Among the traditional election topics being debated is the issue of free trade around the world. Both candidates agree that globalization—the integration of national economies into the international economy through trade, foreign direct investment, capital flows, migration, and the spread of technology—will benefit not only the United States but also those nations who engage in free trade. The great majority of, if not all, economists agree that free trade is an important step towards improving the world's overall standard of living. In the nineteenth century, David Ricardo's economic theory of comparative advantage suggested that free trade leads to a more efficient allocation of resources, with those countries participating in the free trade benefitting.

As a result of this notion that free trade benefits all those who engage in it, the past decade has witnessed the emergence of regional trade agreements and proposals and regional blocks such as the EU, NAFTA, CAFTA, ASEAN, FTAA, and G-20. These agreements have been pushing countries toward greater levels of economic integration, which should be leading countries to a higher standard of living and reducing the level of poverty around the world. Have we been experiencing true higher standards of living? Or, have we been experiencing an increasing disparity between the rich and the poor? Some economists, such as Paul Krugman—winner of this year's Nobel Prize in Economics "for his analysis of trade patterns and location of economic activity"--estimate that globalization has had measurable effects on the rising inequality in the United States. Others, such as Lawrence Katz and Robert Lawrence argue that trade has only accounted for 5-15% of the domestic income inequality and that rich countries no longer have significant numbers of low-skilled workers that could be affected by competition from poor countries.

Regardless of the true causes of the income inequality, there is consensus that such inequality exists. Therefore, we must consider what effects the income inequality will have on future policy. For example,

for all the benefits that trade theory provides, countervailing forces opposed to free trade are on the rise. In the midst of slower economic growth, there are increasing calls for domestic protection of jobs. In the context of the war on terrorism, there are greater restrictions on international migration and private capital flows. Increasingly, security considerations influence nearly every domestic and global policy decision, and therefore have significant economic impacts.

With the financial crisis spreading around the globe, countries are reevaluating their financial structure and the implications it has on their national security. The current crisis has led many countries —most notably European—to call for tougher oversight of the international financial markets. An international super-regulator would restrict capital flows between countries, which would slow the movement towards free trade. It is common during times of crisis and widespread panic for countries to lean more toward a protectionist stance, but from an economic perspective such stances lead to policies that ultimately slow economic growth and introduce inefficiencies into markets. The United States has occupied the top position in the global financial order, but the time has come where a great majority of the world is questioning whether the U.S. should maintain its top financial ranking.

As the United States seeks to assess the goals and consequences of American action at home and abroad, how can it promote its own agenda without appearing to strong arm other nations? Ending protection for declining industries would free up resources for growth sectors and should improve relations with developing countries. Policies that end domestic protection for some industries, however, will be unpopular at home and cheered abroad. How does a new administration balance such controversial policies? Ending subsidies to sectors in which we are highly efficient, such as agriculture, may also improve U.S. policy credibility and raise the incentives for developing countries to undertake needed market reforms. Yet, some Americans are still suspicious of free trade and are unwilling to allow certain jobs to leave the United States—often citing security issues as reasons to maintain production of some goods and services domestically despite economic evidence to the contrary. For example, one of the arguments cited in opposition to allowing Mexican truckers into the US market despite being required by NAFTA was national security. Is this a legitimate concern or does the elimination of protections and subsidies actually help to further U.S. interests? If the U.S. is truly at the top of the financial order, does it have a responsibility to lead the world out of the crisis? If so, resorting to protectionist ideas could be counterproductive and potentially cause slower growth, or even economic decline. On the other hand, moving the country away from protectionist ideas at this time is a difficult political tightrope to walk.

President George W. Bush at the UN General Assembly in September 2005 said, "…the United States is ready to eliminate all tariffs, subsidies and other barriers to the free flow of goods and services as other nations do the same."[1] However, numerous countries throughout the world consistently question U.S. motives in the Bretton Woods institutions and the global economic system in general. The collapsing Doha Round talks illustrate the many difficulties and challenges facing global trade, especially since President Bush's fast track powers were not renewed. Are these institutions impartial, or are they merely puppets of powerful economic actors or politically aligned voting blocs? Are the existing institutions such as the World Trade Organization (WTO), International Monetary Fund (IMF), and the World Bank still the best means to promote American interests? Could regional and bilateral trade agreements meet the country's economic goals more efficiently? If so, can the United States afford to distance itself from these multilateral forums at a time when the United States already faces criticism for its bilateral approach to foreign policy?

Despite the fact that trade and jobs dominate the national political dialogue, *weekly* turnover in the world's foreign exchange markets exceeds that of the *annual* global trade in goods and services. The

[1] George W. Bush, cited by U.S. Trade Representative Susan C. Schwab, during remarks at WTO Headquarters, 24 July 2006.

current global financial crisis threatens the economic well-being of developing and developed countries, with tangible consequences for the United States. How can the U.S. lead the world out of crisis? Should the U.S. lead the way? What is the role of the world's multilateral institutions in managing these risks in the system? For example, many nations feel that the IMF's preconditions of specific institutional and policy reforms prior to lending funds are overly restrictive and are entirely political in nature. Heavily managed exchange rates, such as the fixed exchange rate of the Chinese yuan, are often considered "unfair" because managed exchange rates cannot be considered the market equilibrium rate. Should the new U.S. administration increase pressure on such countries to allow their currencies to freely float and settle at market equilibria? What are the costs to the United States of not responding to the risks of global imbalances created by the informal Bretton Woods II regime?

Several other challenges are cited by the 2006 *National Security Strategy* include overcoming protectionist impulses of countries that put at risk the benefits of open markets; integrating nations that lack the rule of law and frustrate the economic aspirations of their people by failing to encourage entrepreneurship; reducing countries' dependencies on foreign oil; and reducing restrictions on the free flow of capital which deny investments, economic opportunity, and new jobs to those who need them most. Failing to overcome such challenges could present risks to U.S. national security. Say, for instance, that the global income inequality between rich and poor countries continues to grow, then it could be argued that poor countries would resort to allowing terrorist organizations to operate within their borders in exchange for some economic prosperity. Such actions would pose potential direct and indirect threats to U.S. interests around the world.

While poverty may not cause terrorism, many argue that poverty demoralizes ambition, stifles aspiration, and creates a breeding ground for anti-western sentiment. Does the free movement of goods and capital actually improve economic welfare as economists argue or is it an impoverishing force around the globe? Why does the distribution of the gains from trade become central to the political economy of trade and development? Will globalization lead to economic interdependence and democratization? How should the United States and other wealthy countries treat the losers of globalization, whether they are entire countries or socio-economic groups within countries? We have heard both campaigns advocate the strengthening of U.S. social safety nets and job transition training—particularly through programs like Trade Adjustment Assistance (TAA), which was established in 1962 and expanded in 1993 and 2002. What type of governmental assistance can be applied to cushion the negative economic impact of the liberalization of trade? Are other measures different than TAA necessary to weaken the political backlash in the U.S. against globalization? How can the U.S. overcome the protectionist impulses of other countries as the world endures the worst global financial crisis of this generation?

There are numerous other challenges that the new administration of the United States will face in its first term. How can the administration employ economic policies to maintain U.S. hegemony in the world, or does the administration take an approach accepting of the decline of the unipolar international system, and seek ways to improve global well-being at the expense of some domestic industries? Has the economic liberalization of the former Soviet Union and Latin America countries resulted in growth and positive political reforms that enhance the security of the United States? Or are these countries showing signs of regressing back into more centrally planned economies? Have market reforms swelled the ranks of the middle class and strengthened its role as the bearer of liberal democratic values? What lessons have been learned from the pace of reforms? What role should the US take in dealing with the challenge of Hugo Chavez-like leaders who have rolled back market reforms in the developing world?

Finally, what goals must be set in order to continue to open markets and integrate developing countries into the interdependent economic landscape? How does the new administration diversify energy markets to ensure energy independence? How should the U.S. seek to help reform the

international financial system to ensure stability and promote growth worldwide while minimizing negative impacts at home?

These are the types of economic challenges, concerns, and opportunities that delegates to SCUSA 60 will address on the Global Economics and Trade roundtable.

## RECOMMENDED READINGS


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WTO Website. "What is the WTO? Basics," http://www.wto.org/english/thewto_e/whatis_e/tif_e/tif_e.htm (sections under "Basics," from "What is the World Trade Organization?" to "The Uruguay Round".)

**Doha Round and Regional Trade Agreements**

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**International Capital Flows**

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