Trade agreements: Only half the story

No trade accord, no matter how liberal, will be able to achieve its goals if the business environment—social as well as economic—is not a healthy one.

These are not happy times for free traders. The Doha Round of the WTO as well as the FTAA is limping along, and the future of CAFTA hangs in the balance, as well. One major public opinion poll recently revealed that only 32 percent of the American public supports CAFTA, with the majority of respondents believing that potential job losses and economic damage to the U.S. would result if the agreement were passed and implemented. Despite irrefutable evidence that free trade agreements produce far more winners than losers—in the case of CAFTA U.S. economic welfare gains could approach $248 million and boost U.S. exports to the world by $1.9 billion—the American public remains hostile to many of the very free market principles that made their own country a beacon of prosperity.

While trade liberalization agreements are an indispensable vehicle of economic growth and prosperity for rich nations as well as poor ones—Jagdish Bhagwati's In Defense of Globalization and Martin Wolf’s Why Globalization Works make this argument quite convincingly—their very proponents often over-hype the importance of these accords, attributing to them some magic bullet quality. As a consequence, many of the supporters of free trade become excessively disheartened when liberalizing accords hit a political roadblock.

As any international business executive will attest, regional economic integration schemes, whether NAFTA, Mercosur, Andean Community, or Caricom, are far less important than unilateral policies and actions that boost the attractiveness for trade, finance, and investment not just for foreign firms but for local companies, as well. Regional schemes do set collective, stable rules of the game for all; make the playing field more transparent; send the right signal to the private sector it’s safe to go into the water; and in some cases—automotive with Mercosur, manufactured goods in the Andean Community, services in Caricom, and capital goods in NAFTA—these agreements can have a direct impact on cross-border trade and growth. However, for the most part the benefits are indirect. Stated in practical terms: tariff reductions from 14 percent to 3 percent will not influence the investment decision of a Canadian company in Mexico if high labor costs, poor transport infrastructure, periodic theft of cargo, and burdensome regulations continue to characterize the business environment for that firm.

For U.S. companies, regional economic integration provides an added benefit but not a substitute for the macroeconomic, regulatory, and market factors that determine trade, finance, and investment decisions anywhere in the world. Business conditions and long-term potential are the sine qua non of corporate decision-making. In one of the first studies of NAFTA impacts on U.S. firms, Stephen Blank of Pace University and I examined 72 multinational subsidiaries in Mexico and Canada, in addition to U.S. corporate headquarters. We found NAFTA to be but the trilateral recognition of a decade old process of forming a new North American economic architecture of corporate integration, including intra-firm rationalization of production and distribution. For example, a company would conduct its R&D in Montreal, manufacturing in Austin, and assembly in Guadalajara. Campbell Soup, to cite but one firm, consolidated Mexican, Canadian, and U.S. operations in 1991—nearly four years before NAFTA. As the CEO said at the time: We intend to market locally, manufacture regionally, source globally—with common technology, knowledge, and supplies.

Hopefully, the WTO, FTAA, and CAFTA will see the light of day in 2005 or 2006. In the meantime, the most important, most immediate, and most beneficial measures for facilitating market liberalization and spurring global commerce are those that focus on business environment. An important 2001 World Bank research study on the regulation of business entry found the worst obstacles for new business creation were: corruption, inadequate infrastructure, crime, access to credit, high taxes, and oppressive regulations. The removal of these roadblocks, as well as implementation of a second generation of reforms including those dealing with issues of education, health care, and housing, are essential for firm attraction, retention and expansion—

Unfortunately, consumer credit in Brazil is virtually nonexistent. Given weak bankruptcy laws, bank lending is nil.

local and foreign.

No trade accord, no matter how liberal, will be able to achieve its goals if the business environment—social as well as economic—is not a healthy one. As both Chile and Trinidad and Tobago convincingly illustrate, unilateral actions to open markets, deregulate the economy, improve infrastructure and education, and address social needs are the surest paths to achieving the benefits of economic liberalization even before the bonus of free trade agreements are signed.

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