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Interview with Ambassador Carla Hills
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USAPC: You co-chaired the Council on Foreign Relations' China Task Force, which issued a report on April 10 entitled, *U.S.-China Relations: An Affirmative Agenda, A Responsible Course*. Among other points, the report maintains that trade barriers are not a significant cause of the U.S.-China trade deficit. Please elaborate.

Hills: The Task Force reviewed a great deal of economic data and concluded that the U.S.-China trade deficit primarily reflects a broad macroeconomic imbalance between the two countries rather than unfair trade practices by China. Actually, China is one of the most open of the developing countries.

The bilateral deficit results largely from the fact that China consumes so little and saves so much. China's consumption rate is about 38 percent, which is extraordinarily low for a major economy. By comparison consumption in the United States is about 70 percent of GDP. In India it is over 60 percent. China's savings rate nudges 50 percent—quite high for a developing country. By comparison, the U.S. savings rate is in the negative range.

The Task Force believes the U.S. government could encourage China to stimulate domestic consumption and reduce political tension here by, for example, permitting the valuation of its currency to respond to market forces. We found that China was unlikely to permit its currency to appreciate in response to market forces if other East Asian governments, such as Japan and South Korea, did not do so as well. Thus, the Task Force concluded that a broader discussion regarding currency policy would be helpful.

Also, the Task Force concluded that increased Chinese government expenditures on health care, pensions, welfare, and education would help to stimulate domestic consumption and reduce savings, as would financial reforms aimed at opening the mortgage market, providing car loans, and creating other forms of consumer finance, like credit cards.

The Chinese people save so much because they are worried about their futures. Their government spends very little on social welfare programs—less than four percent of GDP. And for some time, China has had a one-child policy. Consequently, most Chinese cannot look to their children to support them in their old age—and they are aging very rapidly. So they feel they must save for their health, their pensions, and the education of their children.

USAPC: How about on the U.S. side of the relationship? Did the Task Force recommend actions the United States should take to help correct the misalignment?

Hills: Yes. The Task Force emphasized that, first, the United States should increase domestic savings by trimming the federal deficit and cutting back on "pork-barrel" spending. Second, we should strive to improve our competitiveness in the global economy by educating the U.S. population to be as efficient and skilled as possible. And third, the U.S. should continue to pursue market-opening trade negotiations so there are more markets for U.S. exports.

Getting the bilateral economic relationship in order will require *both* countries to undertake reforms. The trade imbalance is not primarily a result of China's trade barriers.

USAPC: That point is a very hard sell on Capitol Hill these days. Many lawmakers regard China's trade barriers as *the* problem.

Hills: Yes, there are some trade barriers, the principal one being China's failure to adequately protect intellectual property. The Task Force was quite harsh in its evaluation of China's efforts to enforce the protection of intellectual property rights (IPR).We argued that China's poor enforcement record and nominal penalties for IPR infringement reflect a lack of political will as much as they reflect a lack of capacity.

The Task Force urged the U.S. government to develop a system based on one already used by the U.S. Chamber of Commerce, which rates how well provincial governments enforce IPR. The system would help guide U.S. companies toward provinces that do a better job of protecting intellectual property. But it is important to bear in mind that even if China dramatically improved enforcement of IPR rules, that, in and of itself would not rectify the trade imbalance.

USAPC: With respect to IPR, the U.S. Trade Representative (USTR) announced April 9 that it had filed cases against China in the World Trade Organization (WTO) over (1) deficiencies in China's legal regime for protecting and enforcing copyrights and trademarks on a wide range of products and (2) China's barriers to trade in books, music, and films.

Some Members of Congress argued that USTR should have been more aggressive and taken China to the WTO much sooner. Do you agree?

Hills: No. I think USTR has done quite well. I applaud the bringing of IPR cases against China. It is much better to bring a case to the WTO where there is a violation than it is to haggle bilaterally. The WTO provides a system for resolving disputes. And if the complainant is correct, it is likely to prevail. The process eliminates a lot of potential hostility.

Under the WTO dispute settlement rules, the parties to a dispute are required to consult for 60 days, which USTR and its Chinese counterpart did. Unfortunately, they did not resolve the dispute through consultation. USTR therefore was correct to file the suits when it did.

USAPC: Concerning another important Asian economic relationship, on April 1 the United States and South Korea concluded a groundbreaking free trade agreement (FTA). Leading members of the U.S. business community applauded the accord, but key American lawmakers strongly opposed certain provisions. Some observers worry that Congress may not approve the agreement.

What effect would Congress' failure to approve the U.S.-Korea FTA have on American economic leadership in Asia?

Hills: First let me say that I am very much in favor of the U.S.-Korea Free Trade Agreement. It is a good agreement that will make 95 percent of bilateral trade in consumer and industrial products duty free within three years. Most of the remaining tariffs will be abolished within 10 years.

It also tackles sensitive sectors that Korea has protected for many years, like agriculture. More than $1 billion worth of U.S. agricultural exports to South Korea will become duty-free immediately, with most of the remaining tariffs and quotas phased out over the first 10 years of

the FTA. We also will realize improved IPR protection and expanded opportunities for U.S. service industries, including telecommunications and e-commerce.

In short, the U.S.-Korea FTA has few exemptions—unlike those that have been negotiated by other WTO members. It is one of the few efforts worthy of the name "free trade agreement." And it goes much further than the most fervent optimist's aspiration for the current WTO round of multilateral trade negotiations.

As a result, bilateral trade will expand and stimulate economic growth with little diversion. That experience should help persuade Koreans, who have taken a highly defensive position against agricultural liberalization in the WTO talks, of the benefits of even broader liberalization.

The U.S.-Korea FTA also stands as a model for how other nations could open their markets to goods, services, procurement, and protected IPR just as the North American Free Trade Agreement (NAFTA) did when the so-called Uruguay Round of multilateral trade negotiations faltered in 1992. The NAFTA not only stimulated economic growth throughout North America, it also (1) encouraged the nations of the Asia Pacific to agree to gradually open their economies, (2) persuaded the 34 democratically elected leaders of the Western Hemisphere to negotiate a FTA for the hemisphere, and (3) breathed new life into the then-stalled global trade talks.

Politically, the U.S.-Korea FTA is equally important. Congress complains that the Asian nations have meetings that exclude the United States. An agreement with a major Asian nation like South Korea effectively throws a rope across the Pacific.

I remember when ex-Prime Minister of Malaysia Mahathir bin Mohamad said he wanted to draw a line down the Pacific and create an Asian economic caucus. Then Secretary of State James Baker said he did not want such a "line" because the United States has major interests in East Asia.

We cannot stop the Asian nations from talking to each other. We certainly talk to our friends in the Western Hemisphere. But I do think that if the Asian nations form an economic bloc or caucus that includes the ASEAN nations plus China, Japan, South Korea and possibly India, Australia, and New Zealand, the United States definitely will want to participate in that group.

One way for the United States to gain access to an emerging regional economic arrangement is to conclude a FTA with one or more of the major Asian economies. I think the U.S.-Korea FTA is a particularly good way to start.

USAPC: As we speak, the outlook for the WTO round of multilateral trade negotiations remains uncertain owing, in part, to strong domestic opposition in South Korea and many WTO member countries to liberalizing agricultural trade. Do you think we have gone as far as we can *politically* in liberalizing the global trading system?

Hills: No, I do not. But we must make a greater effort to explain to the public why open markets and economic interdependence benefit all countries.

Certainly, industrialized countries have enjoyed enormous benefits from globalization. According to studies by the Peterson Institute for International Economics, since World War II the U.S. economy has gained an additional $1 trillion per year as a result of globalization. That, in turn, has made every American household roughly $9,000 per year richer.

Developing countries that have opened their markets also have gained. They have grown five times faster than those that have kept their markets closed. This is apparent if you compare China and India. In the 1980s, China began opening its markets. In the subsequent 20-odd years, it has enjoyed 10 percent annual growth, attracted a tremendous inflow of foreign investment, and raised 400 million people out of poverty.

India has been much slower in opening its markets. As a result, it has attracted on average only about $7-8 billion worth of inward investment per year over the past decade, whereas China has attracted nearly $65 billion during the same period. That is quite a contrast. It shows how opening markets benefits rich and poor countries alike.

USAPC: The United States and Brazil, which founded the so-called G-20 developing country coalition in the WTO,[1] recently agreed to cooperate in bringing the WTO Round to a successful conclusion. Do you think that Brazil ultimately can persuade India and other Asian members of the G-20 to support ambitious agricultural reforms that would eliminate impediments to free trade?

Hills: I am a big believer that Brazil could make quite a difference in helping to bring the WTO Round to a successful conclusion through its leadership in the G-20. It has not yet done so. I find this curious because in the past Brazil has been an aggressive member of the Cairns Group, which has historically sought to open agricultural markets.[2]

The G-20 provides Brazil a good platform on which to talk to India about liberalizing agricultural trade. It could use this platform to talk to China and Russia as well. We must persuade developing countries about the benefits of liberalization, particularly in agriculture.

Today, tariffs on agricultural goods are five times higher than tariffs on industrial products. A multilateral agreement dealing with agricultural barriers will maximize poverty alleviation for it will require commitments from all nations. Developing countries as a group have higher tariffs than industrial countries and trade disproportionately with other developing countries. A WTO agreement will best integrate poorer nations into the global trading system by maximizing opportunity for their people and stimulating their economic growth.

USAPC: Do you think it would be appropriate for American companies to launch campaigns aimed at educating the man-on-the-street about the benefits of trade and globalization?

Hills: Quite clearly, if American companies want to keep international markets open, they must play a bigger role in educating the American public about the benefits of trade. I often tell audiences of corporate executives that they must educate their employees, whether they have

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[1] In 2003, Brazil led the creation of the G-20 in response to an agreement between the United States and the European Union on text aimed at liberalizing agricultural trade. Brazil and its developing country allies evidently were concerned that the U.S.-EU language would end up marginalizing their interests in the WTO Round. Brazil therefore formed the G-20 to enable the WTO's developing country members to bargain more effectively with Washington and Brussels in the agricultural trade talks that are part of the current WTO Round.

[2] The Cairns Group is comprised of 18 agricultural exporting countries from Latin America, Africa and the Asia-Pacific region. The Group is made up of both developed and developing countries and has been an active force in agricultural trade reform for 20 years. Cairns Group members include Argentina, Australia, Bolivia, Brazil, Canada, Chile, Colombia, Costa Rica, Guatemala, Indonesia, Malaysia, New Zealand, Pakistan, Paraguay, Philippines, South Africa, Thailand and Uruguay.

five or 50,000 on their payroll. They should do everything they can to educate their employee populations.

Corporate management must explain to employees how trade benefits the company, what percentage of company revenues comes from the company's international activity, what percentage of employees' paychecks can be attributed to trade, and why, therefore, the company needs open markets.

Employees should be informed that companies with international connections pay higher wages, offer more expansive benefits, and provide greater security than businesses that are focused only on the domestic economy. In short, U.S. workers should understand fully why it is in their interest to support open trade.

Also, the average American is not likely to know about—but likely would oppose—the inequities created by certain U.S. trading practices. These practices have the effect of robbing developing countries of a chance to participate in the global marketplace.

For example, our subsidies to producers of cotton crops are higher than the cash value of that crop. The subsidies serve to rob the poor sub-Saharan African nations of potential export opportunities, even though they are more competitive in cotton production.

Similarly, Americans should know that we do a great disservice to global stability by our restrictions on the import of sugar. The U.S. system of quotas greatly limits sugar imports, thereby enabling inefficient American producers to block export opportunities of poor countries that produce this commodity far more competitively. Not only do these quotas hurt nations that produce sugar—and in some cases drive these producers to grow illegal crops—but they also hurt the average American who must pay more for sugar.

If you examine the U.S. tariff schedule, you will see that tariffs are extremely regressive. They are much higher on ordinary goods than on luxury items. Tariffs on heavy glass are much higher than tariffs on Tiffany crystal. Tariffs on shoes are much higher than tariffs on leather luxury goods. The United States should be a leader in correcting these inequities.

USAPC: So the average American often must pay more at the check-out counter because of protective trade practices. But some Americans are paying an even steeper price in that they are losing their jobs because of trade. You have said that we must find a way to use the money we have earned from trade expansion to rectify problems caused by trade-related job dislocation. Please elaborate.

Hills: Yes, there are some people who are displaced by reason of trade. However, there are many more people who are displaced by reason of technology. I would target assistance at both groups because it is impossible for those affected to distinguish the cause of the displacement, and they are a politically vocal group.

If business and political leaders want to keep markets open, we must deal with those who are adversely affected as a result of trade-related displacement. The U.S. government should provide more and better training to those who are displaced. Our current assistance and training programs are inadequate.

For example, the Trade Adjustment Assistance (TAA) program does not cover services workers. This group constitutes 80 percent of the U.S. workforce. In addition, TAA only applies to people 50 years of age or older, so it does not help younger, displaced workers. And it has a $10,000 limit. So if you are a laid-off steelworker earning $80,000 a year and you immediately find a new, entry-level job in the computer industry for $45,000, you suffer quite a shortfall.

As I mentioned earlier, studies by the Peterson Institute for International Economics (IIE) calculate that (1) the United States is richer by $1 trillion per year as a result of the opening of global markets over the past half century and (2) we could add another half trillion dollars per year to our economy by further removing trade barriers.

Our nation currently spends about $2 billion annually to address directly the costs connected to displacement. IIE calculates that expanding TAA to cover displaced workers would cost between $3 billion to $12 billion per year depending on the breadth of coverage and the amount of benefits. This is far less than the $1 trillion yearly we currently derive from open markets.

I am persuaded that we need a government program that pays part of the loss a worker may incur in having to change industries to secure employment, particularly if the job is in a new sector that is more promising. Perhaps the government would provide 90 percent of the pay differential the first year, 80 percent the second year and so forth until the worker gets his or her bearings and no longer is at the entry-level salary. That money will upgrade our workforce by providing the very best training a worker can get, which is training on a real job.

I also favor programs encouraging business to do more to train workers. For years, we have provided tax incentives to business to upgrade capital equipment. But the United States is not as active in heavy industry as in earlier years. The knowledge sector is where we are growing. I would like to see the U.S. government provide tax incentives to encourage business to develop our human capital.

USAPC: The President's authority to negotiate trade agreements expires on June 30. Congress must renew this authority. House Democrats, in particular, appear unlikely to approve renewal of Trade Promotion Authority (TPA) unless the Bush Administration agrees to include labor and environmental standards in all trade agreements. Is this a reasonable demand? Will it make U.S. trade policy more ethical, as some Democrats maintain?

Hills: We have to be careful about what we insist other countries do. I have heard loose talk in Congress about including provisions in trade agreements that would require the trading partner to enact laws that enforce the International Labor Organization (ILO) standards.

The problem with that requirement is that the United States does not enforce every ILO standard. We do not permit agricultural workers to organize, for example. I do not know how the United States can insist that other countries adhere to a code that we have not fully adopted.

I believe in labor standards in the sense that we certainly want countries to upgrade their laws where they are deficient. But if we examine a trading partner's labor laws and they appear to be reasonable, what then becomes important to us is that the nation enforces those laws. USTR used this approach in FTAs it negotiated with the Andean nations, Colombia, Peru, and Panama.

It would be a mistake, in my view, to ask these Latin American nations to open up the FTAs for the purpose of adding labor and environmental provisions. If there are specific labor provisions that Congress would like included, perhaps this could be done via side letters.

U.S. lawmakers should be very careful of what they demand, lest the same be asked of our nation. If Congress insists on compliance with ILO standards, it then should be prepared to change U.S. labor laws, some of which involve state laws. But Congress always has harbored quite a lot of resentment toward countries that ask the United States to change its domestic laws.