Rising Protectionist Threat Creates Risks for Texas

By Edward C. Skelton and Mike Nicholson

Expanding trade has brought jobs and business to Texas but has left the state particularly vulnerable to antitrade actions.

Nobel Prize-winning economist Paul Krugman once wrote: "If there were an Economists' Creed, it would surely contain the affirmations 'I understand the Principle of Comparative Advantage' and 'I advocate Free Trade.'"[1]

Economists endorse free trade because it creates healthier, more prosperous and more dynamic economies. Protectionism can sometimes provide fleeting benefits to specific domestic industries, but in the medium and long run it causes economic stagnation and inefficiency.

Unfortunately, political expedience often leads countries to ignore well-established wisdom and enact protectionist policies to preserve jobs during economic slowdowns. Even relatively minor flirtations with protectionism can snowball, leading to trade skirmishes and perhaps all-out trade wars and negative feedback cycles between recession and protectionism.

Today's financial turbulence has already brought restrictions on the flow of investment and capital.[2] Making matters worse, the surge in financial protectionism seems to be spreading to trade in goods and services. Yielding to protectionist pressures would increase prices and hurt industries that rely on foreign trade, worsening the recession in the short and medium run while hurting U.S. competitiveness in the long run.

Texas' long border with Mexico, busy ports and industrial mix—as well as passage of the North American Free Trade Agreement (NAFTA) in 1994—have fostered a sizable flow of goods and services to and from foreign countries. Expanding trade has brought jobs and business to Texas but has left the state particularly vulnerable to antitrade actions. Texas would suffer greatly if the U.S. and other countries implement protectionist measures.

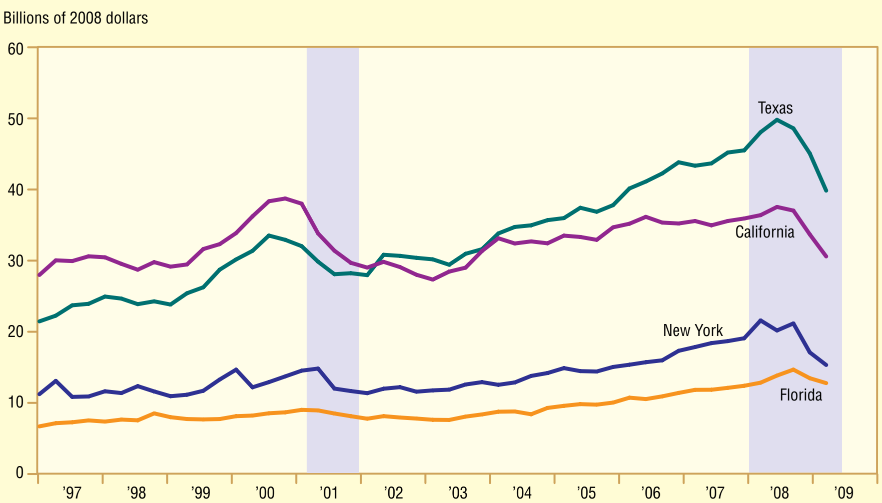
The Import of Exports

Texas benefits from trade. Data on the value of goods shipped overseas show that Texas has been the nation's largest exporting state since 2002, beating even such East and West Coast giants as California, New York and Florida (*Chart 1*).[3] Texas accounts for about 15 percent of all U.S. exports.[4]

In 2008, exports made up 16.8 percent of state output, ranking Texas third among states, behind only Louisiana and Washington. Looking at states similar in size, exports' share of state GDP was 7.6 percent in California, 7.3 percent in Florida and 6.7 percent in New York, placing the three in the bottom half of all states.

The Commerce Department's most recent data show that 6.7 percent of Texas' private-sector jobs were tied directly to goods exported in 2006, placing Texas 10th among states. Furthermore, the department reports that 22.9 percent of the state's manufacturing jobs were linked to exports. Chemicals, computers and electronics, machinery and petroleum-related products

Chart 1
Texas Leads All States in Exports



NOTE: Shaded areas represent U.S. recessions.
SOURCE: WISERTrade; seasonal and other adjustments by the Dallas Fed.

Table 1
Tracking Texas' Leading Exports in 2008

Industry	Value (billions of 2008 dollars)	Share of Texas exports (percent)
Chemicals	38.2	19.9
Computers and electronics	35.4	18.5
Machinery	27.1	14.1
Petroleum and coal products	25.2	13.1
Transportation equipment	16.8	8.8
Primary metals	6.7	3.5
Electrical equipment, appliances	6.5	3.4
Agriculture	6.4	3.3
Fabricated metal products	6.0	3.1
Food	4.4	2.3

SOURCE: WISERTrade; seasonal and other adjustments by the Dallas Fed.

ranked as the top exporting industries in 2008 (*Table 1*).

Europe and Asia are growing markets for Texas exports, but the state's ties to Latin America run particularly deep. In 2008, the region provided a market for 46 percent of Texas' exports, representing 7.7 percent of the state's GDP. In contrast, U.S. exports to Latin America made up only 2 percent of GDP.

The growth of Texas' exports to Latin America has been aided by market-opening pacts such as NAFTA. About 70 percent of Texas' Latin America-bound exports go to Mexico. However, the state has diversified its trade in recent years. Exports to Brazil, Chile, Peru and Venezuela have all more than doubled in real terms since 2004, while sales to Mexico have declined.[5]

Research shows that free-trade agreements have boosted Texas' exports, GDP and employment. A Dallas Fed study found that NAFTA had a robust effect on Texas exports to Mexico, accounting for roughly a quarter of Texas' 111 percent increase in goods shipped to Mexico between 1993 and 2000.[6]

The study also found that NAFTA fostered statistically significant export gains to Mexico across a number of Texas' largest export sectors, including petroleum and coal products at 69 percent and electronic equipment at 49 percent.

A similar St. Louis Fed study used state-level data from 1988 to 1997 to show that NAFTA increased Texas' real exports to Mexico by an annual rate of 14 percent.[7] The study found that NAFTA also had a statistically significant, positive impact on Texas' exports to the rest of Latin America.

Other free trade agreements are also fueling Texas' Latin American exports. Texas A&M researchers found that the agricultural provisions of the Central America Free Trade Agreement–Dominican Republic resulted in $184.7 million of added business activity and 2,415 additional jobs for Texas.[8] Texas' exports to Chile have increased by 133 percent since the implementation of the U.S.–Chile Free Trade Agreement in 2004.

On net, the data suggest Texas' economy benefited from freer trade with Latin America. Even so, liberalization isn't without its downside.

All else being equal, both economic theory and empirical evidence suggest Texas workers in import-sensitive industries may lose jobs or experience wage cuts as a result of greater foreign competition. Workers displaced by trade face significant transition costs as they develop the job skills demanded by firms in other industries. During difficult economic times, these costs may rise, increasing the cries to protect unskilled domestic workers.

Protectionist Rumblings

Despite the theoretical and empirical arguments in its favor, trade liberalization has been facing headwinds.

U.S. Trade Promotion Authority for approving trade agreements, also known as fast-track negotiating authority, was allowed to expire in 2007. Under fast track, Congress was barred from amending or filibustering trade agreements, making negotiations easier. Since then, Congress has exhibited a greater skepticism toward trade by failing to ratify free trade agreements with South Korea, Colombia and Panama.

After years of stop-and-go talks, World Trade Organization negotiations broke down again in July 2008. These talks, formally known as the Doha Development Round, are aimed at lowering trade barriers and increasing global trade. Negotiations aren't expected to resume until later in 2009.

Protectionism often exacerbates economic downturns. Recognizing the danger in the current recession, the G-20 leaders signed a pledge in November 2008 to avoid protectionist measures. However, at least 17 of the countries reneged. Worldwide, 47 trade-restricting measures have been imple-

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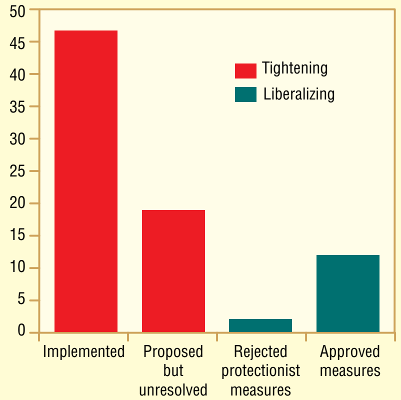
Chart 2

Protectionism on the Rise in G-20 Countries

(Trade policies proposed, October 2008 to February 2009)



NOTE: Excludes antidumping cases.

SOURCE: World Bank.

Any significant trade restrictions imposed on imports from the U.S. could hurt Texas' exports. When faced with increased trade barriers, firms often cut workers, hours and wages or even move operations overseas.

mented between October 2008 and February 2009 (*Chart 2*).

The U.S. included a Buy American provision in the recently enacted stimulus package, contradicting the G-20 commitment not to implement new protectionist measures.[9] Although it passed in a watered-down version stipulating that trade agreements trump the Buy American requirement, this provision provoked a great deal of international outrage.

The Buy American brouhaha turned out to be more symbolism than substance. A more significant trade skirmish broke out between Mexico and the U.S. in March 2009, touched off by a provision in the 2009 U.S. federal budget. The U.S. closed its southern border to Mexican long-haul trucks by ending a 2007 pilot program that allowed a limited number of Mexican carriers into the U.S. and U.S. carriers into Mexico.

The U.S. action appears to go against NAFTA. Under the pact, all Mexican carriers were authorized to deliver cargo to border states starting in 1995 and anywhere in the U.S. starting in 2000. In 1995, however, the opening to Mexican trucks was delayed, ostensibly due to safety concerns.[10]

The argument that Mexican trucks don't adhere to U.S. safety standards appears groundless. According to U.S. Department of Transportation data on random safety inspections, U.S. carriers had a noncompliance rate of 21.7 percent, compared with 20.7 percent for all Mexican carriers and 7.3 percent for the carriers in the pilot program.

Immediately following the truck ban, Mexico passed retaliatory tariffs of 10 to 45 percent on 89 U.S. products, whose cross-borders sales are worth $2.4 billion a year. The tariffs targeted states represented by U.S. lawmakers who supported the truck ban while sparing imports whose restriction would create hardships for the poorest Mexican households. To put additional pressure on the U.S., Mexican trucking companies have filed a suit accusing the U.S of violating NAFTA.

Leaders elsewhere in Latin America are feeling pressure to shield their economies as trade drops, employment falls and populism gains traction. For example, Ecuador has sharply increased overall tariffs on more than 600 items, and Argentina has imposed new restrictions on many imports.

Trade Vulnerabilities

Latin America looms large for the three industries that generate more than half of Texas' exports. In 2008, 43 percent of computers and electronic exports, 38 percent of chemical exports and 31 percent of machinery exports were bound for Texas' top 10 Latin American trading partners.[11] The new trade restrictions in Ecuador and Argentina target the machinery industry.

Historically, the food and apparel sectors have been hotbeds of protectionist sentiment. Approximately 57 percent of Texas' apparel exports and 55 percent of its food exports are bound for the state's top Latin American trade partners. Argentina and Ecuador have placed restrictions on apparel, while food figures prominently in Mexico's new package of tariffs.

Any significant trade restrictions imposed on imports from the U.S. could hurt Texas' exports. When faced with increased trade barriers, firms often cut workers, hours and wages or even move operations overseas.

We don't know how many jobs will be lost due to any particular protectionist measure. However, employment data do give us some idea of how many jobs might be at risk. The three largest exporting sectors ranked by dollar value employed 3.2 percent of the state's private sector workforce as of December 2008 and composed 6.7 percent of its GDP in 2007, the last year for which data are available. The food and apparel sectors account for 1 percent of Texas' GDP and a little less than 1 percent of the state's employment.

All told, widespread protectionism threatens workers and could be expensive

Table 2

Some Latin American Countries Depend Heavily on Exports

Country	Exports to the U.S. (percent of GDP)
Mexico	**18.2**
Ecuador	16.5
Venezuela	15.0
Costa Rica	**12.8**
El Salvador	**9.5**
Guatemala	**7.8**
Colombia	5.2
Chile	**4.6**
Peru	**4.4**
Brazil	1.8
Argentina	1.7

NOTE: Bold indicates countries with free trade agreements with the U.S.

SOURCE: International Monetary Fund.

to the state in terms of forgone business activity. The toll would rise if a cycle of protectionist retaliation spreads the ill effects of trade barriers to other Texas industries.[12]

Latin American countries also have a lot to lose from protectionism. Their economies rely heavily on exports, primarily goods and raw materials bound for the U.S.

In 2008, exports across its northern border made up 18 percent of GDP in Mexico, Texas' biggest trade partner.[13] Exports are an important share of GDP for other top Texas trading partners, notably Venezuela, Colombia and Chile (*Table 2*).

Free trade agreements have had a positive effect on some Latin American economies. Mexico's exports have grown substantially since NAFTA's implementation in 1994 (*Chart 3A*). Despite the country's attempts to diversify its exports, nearly three-quarters of overseas sales still went to the U.S. in 2008. Chile depends less on the U.S. market; even so, its exports surged following implementation of the Chile–U.S. free trade agreement in 2004 (*Chart 3B*). Free trade agreements with Central America and Peru are still too new to gauge their effects.

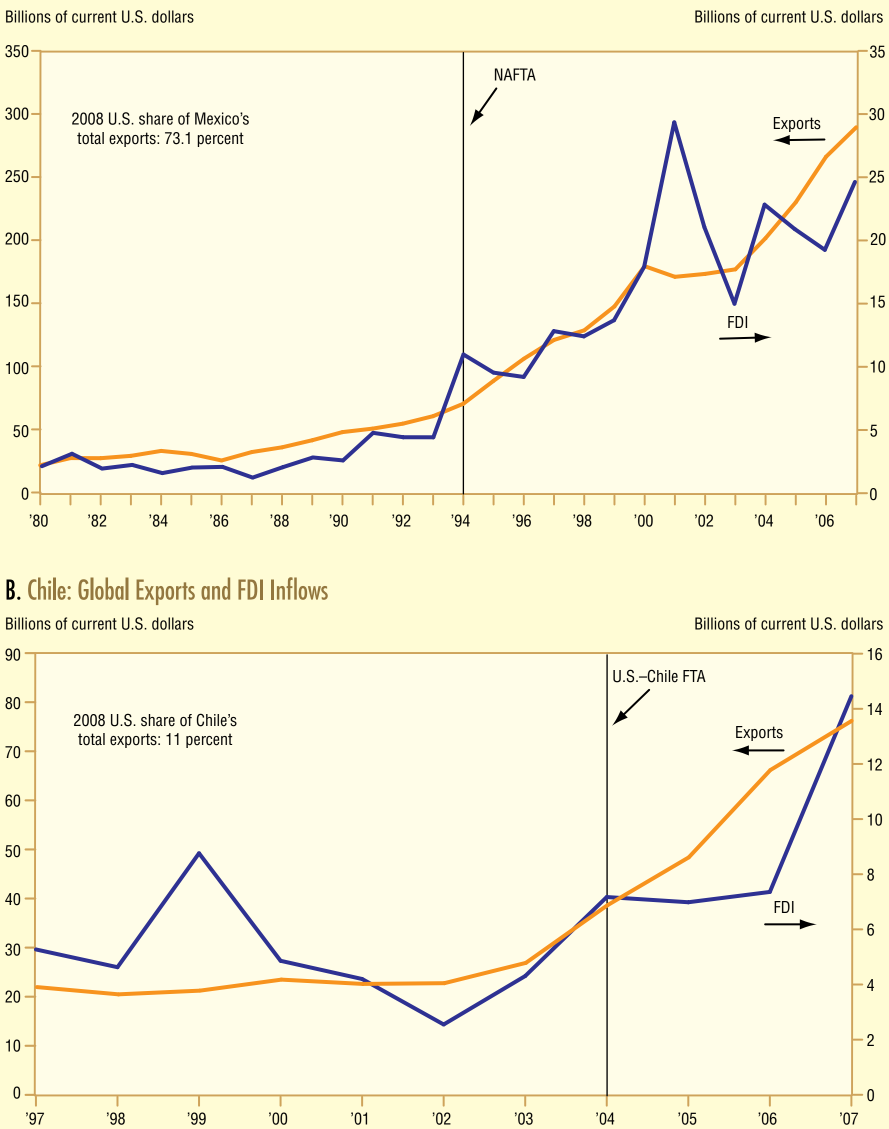
For most countries, increasing overseas sales go hand-in-hand with rising foreign direct investment (FDI), particularly in exporting sectors. FDI is important because it encourages economic development and accelerates the transfer of technology to developing countries, making their economies more competitive.

For many Latin American countries, exports to the U.S. constitute a substantial proportion of their overall GDP, and the detrimental effects of protectionism could be significant. If declining exports make countries less competitive, this could trigger decreases in FDI in the longer run. This might also damage an important source of financial stability in a time when international financial turbulence has taken a significant toll on regional economies.

Chart 3
Exports Increase After Free Trade Agreements

A. Mexico: Global Exports and FDI Inflows

B. Chile: Global Exports and FDI Inflows



NOTE: Exports calculated on a balance-of-payments basis.
SOURCE: World Bank Development Indicators.

'Crack Cocaine of Economics'

Economists overwhelmingly support trade liberalization because of its most powerful implication—that countries can capitalize on their comparative advantages, lowering consumer prices and boosting world GDP in the long run. Despite economists' blessing, freer trade nearly always faces political pressures favoring beggar-thy-neighbor policies intended to protect some domestic workers and businesses. The specter of protectionism tends to loom when economies falter and anxieties over jobs and incomes build.

In a C-SPAN interview in February 2009, Dallas Fed President Richard W. Fisher remarked, "Protectionism is the crack cocaine of economics. It may provide a high. It's addictive, and it leads to economic death."

Fisher's words carry a warning for Texas, a state that has enjoyed significant benefits from foreign trade. This very success leaves the state exposed to protectionist experimentation, particularly in the Americas. While attempts to curtail imports and lock out foreign companies damage the U.S. economy and harm U.S. consumers, the effects would be particularly detrimental to the Texas economy.

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Notes

[1] "Is Free Trade Passé?" by Paul R. Krugman, *Journal of Economic Perspectives*, vol. 1, no. 2, 1987, pp. 131–44.

[2] See "Global FDI Policy: Correcting a Protectionist Drift," by David M. Marchick and Matthew J. Slaughter, Council on

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Foreign Relations, Council Special Report no. 34, June 2008.

[3] Imports also make important contributions to the economy. At a minimum, bringing in foreign products lowers prices and increases consumers' choice. Unfortunately, data that apportion U.S. imports among the states don't exist, leaving the analysis of trade's impact on Texas to focus solely on exports.

[4] It is important to note that these data, which come from the World Institute for Strategic Economic Research (WISER), are measured on an origin of movement basis, reflecting the state from which merchandise begins its movement to the final point of export. WISER adjusts Census Bureau data compiled from Shipper's Export Declarations (SED). Consequently, the available data have limitations. For instance, the SED occasionally indicates the state of brokers, wholesalers or freight consolidators rather than producers of the good bound for export. This bias is more pronounced for agricultural shipments than for manufactured exports. The Census Bureau is currently working to address this inconsistency.

[5] Texas has also successfully diversified by increasing trade beyond Latin America. For instance, since 2004, real exports to the European Union have grown at a rate of 50 percent, and real exports to China have grown at a rate of 40 percent.

[6] "Did NAFTA Spur Texas Exports?" by Anil Kumar, Federal Reserve Bank of Dallas *Southwest Economy*, no. 2, 2006.

[7] "NAFTA and the Changing Pattern of State Exports," by Cletus C. Coughlin and Howard J. Wall, *Papers in Regional Science*, vol. 82, no. 4, 2003, pp. 427–50.

[8] "Economic Impacts of CAFTA–DR on Texas," by Parr Rosson and Flynn Adcock, Center for North American Studies, Issue Brief 2007-09, Texas A&M University, December 5, 2007.

[9] This Buy American provision is Section 1605 of the American Recovery and Reinvestment Act. It would have had little direct impact even in its original form. The additional U.S. steel production fostered by the provision would support roughly 1,000 jobs. See "Buy American: Bad for Jobs, Worse for Reputation," by Gary Clyde Hufbauer and Jeffrey J. Schott, Peterson Institute for International Economics, Policy Brief 09-2, February 2009.

[10] The prohibition on Mexican trucking in the U.S. is only applicable to new carriers attempting to transport goods from Mexico into the U.S. There are more than 800 Mexican carriers, all majority-owned by American firms that have trucking permits grandfathered from more than 20 years ago.

[11] The top 10 Latin American trading partners are Mexico, Brazil, Venezuela, Colombia, Chile, Peru, Argentina, Ecuador, Guatemala and Costa Rica.

[12] If no other country responds with trade barriers, it is true that unilateral protectionism can be beneficial in the short and medium run. However, research suggests that even unilaterally opening an economy to trade can be beneficial. See "Measuring the Benefits of Unilateral Trade Liberalization, Part I: Static Models" and "Measuring the Benefits of Unilateral Trade Liberalization Part 2: Dynamic Models," by Carlos Zarazaga, Federal Reserve Bank of Dallas *Economic and Financial Review*, Third Quarter 1999 and First Quarter 2000.

[13] Unlike with the other Latin American countries, much of Texas' exports to Mexico consist of intermediate goods. They're particularly important to Mexico's maquiladora industries, which process or assemble U.S. inputs for export back to the U.S.