

PETER MORICI

Peter Morici is a Professor of International Business at the University of Maryland and a Senior Fellow at the Economic Strategy Institute in Washington, DC. Prior to joining the University and ESI, he served as Director of Economics at the U.S. International Trade Commission. He directed the agency's professional economists working on ITC investigations and providing trade policy advice to the House Ways and Means and Senate Finance Committees, U.S. Trade Representative, Council of Economic Advisors, and other executive agencies.

Dr. Morici received his Ph.D. in Economics from the State University of New York at Albany in 1974. From 1974 to 1976, he taught at Augsburg College in Minneapolis. In 1976, he joined the Federal Energy Administration, and in 1978, moved to the National Planning Association in Washington. At NPA, Dr. Morici served in positions of increasing research and managerial responsibility and was elected a Vice President in 1983. Dr. Morici joined the University of Maine as a Professor of Economics in 1988 and was Director of its Canadian-American Center from 1990 to 1993. In addition, he served as an adjunct Senior Fellow at the Iacocca Institute from 1988 to 1992 and at the National Planning Association since 1988. From 1988 to 1990, he directed the Council on Foreign Relations study of the future of the Canada-U.S. Free Trade Agreement, and in 1992, he served on the Office of Technology Assessment Panel for the study of the North American Free Trade Agreement. In 1998 and 1999, he directed a Ford Foundation funded study on the Future of U.S. Trade Policy at ESI. Currently, he is directing two studies at ESI: Antitrust in the WTO, funded by a grant from the U.S.-Japan Friendship Commission; and Collective Bargaining Rights and Labor Standards in the World Trading System, funded by a grant from the Ford Foundation.

An acknowledged expert on international business, international trade and investment agreements, industrial policy and economic integration, he is the author of 15 books and monographs. Among these are: Setting U.S. Goals for WTO Negotiations (Washington: The Economic Strategy Institute, 1999); The Trade Deficit: Where Does It Come from and What Does It Do (Washington: The Economic Strategy Institute, 1997); Free Trade in the Americas (New York: The Twentieth Century Fund, 1994); Trade Talks with Mexico: A Time for Realism (Washington: National Planning Association, 1991); Making Free Trade Work: The Canada-U.S. Agreement (New York: Council on Foreign Relations Press, 1990); Making America Competitive (Bethlehem, PA: The Iacocca Institute, 1990); and Reassessing American Competitiveness (Washington: National Planning Association, 1988). He has published widely in leading public policy and business journals such as Foreign Policy, International Economy, Regulation, Barron's, and the Harvard Business Review. He has offered public lectures and taught at conferences and institutes at over 100 institutions including the Columbia School of Journalism, Harvard Business School, Georgetown University Law School and School of Foreign Service, University of Western Ontario, University of Toronto, Universidad Tecnologica de Mexico, and CIEMEX/WEFA. He views have been featured on CNN, Reuters Financial Network, CBS News, and national broadcast networks in Mexico, Chile, Canada, Australia, New Zealand and Japan.

REMARKS BEFORE THE
U.S. TRADE DEFICIT REVIEW COMMISSION
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Good afternoon Mr. Chairman and members of the Commission. My name is Peter Morici and I appreciate this opportunity to appear before you today. I am a Professor of International Business at the University of Maryland in College Park and a Senior Fellow at the Economic Strategy Institute in Washington, DC. My remarks are based on a 1997 study that I undertook for the Economic Strategy Institute on the causes and consequences of large trade deficits.

Perhaps no economic question has been the subject of more myths and misunderstandings than the issue of the exploding U.S. trade deficit.

Conventional wisdom holds that large trade deficits are a self-imposed affliction, either caused by inadequate savings or large government deficits. Moreover, since trade deficits are a small portion of GDP, they are no cause for concern.

In the brief time that I have, I would like to leave the Committee with two ideas. First, external factors--including the policies of foreign governments--can and have affected the size of U.S. trade deficits. Second, trade deficits are having significant adverse consequences on the U.S. economy.

In the early 1980s, large federal budget deficits did drive up domestic interest rates, and in turn, attracted private foreign investors. These investors needed to convert their marks, yen and other currencies to dollars to purchase U.S. securities. This drove up the value of the dollar and caused the current account to swing from a surplus of \$5 billion in 1981 to deficits averaging \$135 billion from 1985 to 1989.

However, when the combined federal and state government budget position improved fell from a \$195 billion deficit in 1992 to \$5 billion surplus in 1996, the current account deficit actually rose from \$51 to \$129 billion, because foreign governments increased their purchases of U.S. securities from \$43 billion to \$133 billion. These purchases frustrated the exchange rate adjustments that should have accompanied the improvement in the U.S. fiscal situation, and these purchases kept

the value of the dollar strong.

More recently, the collapse of statist industrial policies and the currency contagion in Asia had similar effects. They made U.S. imports artificially inexpensive and stifled demand for American exports such as aircraft and construction and engineering services.

When measured in 1998 dollars, the United States trade deficit has averaged much more than \$100 billion a year. This is having important negative consequences for U.S. incomes and growth.

Overall, U.S. export and import-competing industries exhibit much higher labor productivity than other segments of the economy. For 1996, my estimates indicate that value added per employee was \$96 thousand in export industries, \$86 thousand in import-competing industries, and \$60 thousand for the entire economy. By shifting labor from the more-productive, trade-competitive sectors of the economy, a \$100 billion increase in the trade deficit reduces GDP by an estimated 0.6 percent.

Moreover, export and import-competing industries include many of the most innovative and rapidly changing activities in our economy. Consequently, they invest more in R&D. Again, according to the ESI study, export and import-competing industries devoted more than 5 percent of their value added to R&D, whereas the comparable figure for the entire private business sector is less than 2 percent. These estimates indicate that trade deficits reduced U.S. business funded R&D by about 3 percent from 1983 to 1997.

Production function studies for the U.S. economy indicate that such a decrease has lowered the rate of growth in potential GDP by about 0.5 or 0.6 percentage points a year.

My bottom line is that many generalizations about the trade deficit do not hold up. We can impose large deficits on ourselves--and sometimes we have. However, large deficits can be imposed on us and exacerbated by policies and events outside the United States too--and they have. Trade deficits are not benign. They importantly affect incomes in the present and in the future by altering the composition of what we make and lowering investment in new products and innovation.

Thank you.