

Mr. Walters, do you have any additional comments you want to make to what Ambassador Fisher said or would you like to only take questions?

MR. WALTERS: No, Mr. Vice Chairman. Ambassador Fisher gave our agency's statement. Anything I would add would be redundant, but I would be happy to take questions.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much.

I want to invite my colleagues here to raise questions. Commissioner Krueger.

COMMISSIONER KRUEGER: Thank you.

I had a question for Mike Mussa. Thank you very much for coming. I enjoyed all of your testimony.

One of the things that we keep coming up against -- this is quite consistent with your testimony and really a follow-on -- is that the deficit by definition equals the gap between saving and investment, as Mr. Price and everybody has recognized.

On the other hand, we keep getting pleas for some action because there are some folks who think this deficit is too large. And you in your testimony said you thought it was unsustainable at the current level.

One of the pleas, of course, comes from protectionists. And so I'd like you to speculate for a moment, if you will. Suppose that, in fact, along about five years ago -- and I'm not picking five. It could be four. It could be six -- that there had been an anticipation of an increase in the current account deficit and there had, therefore, been, shall we say, a preemptive strike in the sense of a rising protection intended to set the increase in the current contest.

Would you care to speculate on what would have happened?

MR. MUSSA: It's clear in theory. If we raised import barriers to prohibitive levels and eliminated all trade, then we could make the trade deficit go away. So in that sense, it can work. And, indeed, when the Congress passed the Smoot-Hawley Tariff in 1930, there was a substantial effect in that direction.

So I think you could have some impact, but one needs to ask: What would be the other ancillary consequences for the U.S. and for the global economy? And they would not be good.

So I think that --

COMMISSIONER KRUEGER: What are those?

That's what I'm asking.

MR. MUSSA: I think that, first of all, as was emphasized by Ambassador Fisher, the American economy, consumers and businesses, benefit from buying imported goods that can be more cheaply and efficiently produced abroad than they can be at home.

And some of the efficiency of American business and the gain in productivity that we have enjoyed in this economy comes from the capacity of our businesses to access the cheapest and most efficient sources of materials and equipment. We begin to sacrifice that and make our businesses less competitive, not only at home but also abroad, as a consequence of making those costs substantially larger.

It's important to recognize when you look at U.S. trade that it is not primarily imports of consumer goods. We've got a big deficit in the imports of consumer goods, but most of our imports are, in fact, capital goods and industrial materials.

So if you're going to be raising trade barriers by substantial amounts with the intent of cutting the current account deficit through that mechanism, you're going to be raising business costs

and reducing efficiency gains as well. You're going to be damaging the interests of consumers. You're going to be injuring growth in the rest of the world.

And we saw in the emerging market crises of Asia and Russia and so forth, how it is that poor economic performance abroad feeds back negatively to affect performance in the United States.

And while I would not be among those who would take the position that the Smoot-Halley Tariff was a major cause of the Great Depression, I think there's little doubt that it was a contributing factor to the decline in output worldwide, not only from the U.S. action but also from the retaliatory actions that were taken elsewhere. So that is not the mechanism to be used to address the issue of the U.S. current account deficit.

Finally, I would say, as I emphasized in my statement, the growth that we have seen in the U.S. current account deficit in recent years has been, given what else was happening in the world economy, on balance a good thing for us and for the rest of the world.

That is not to say that it can continue to grow or, indeed, that it does not need to decline from

present levels. And we don't need to be concerned about how that is achieved.

But I think it is a mistake to look at what really is a very strong record of success, absolutely and even more so relatively, for the U.S. economy and a manifestation of that, which is the growth of the current account deficit and say, "Well, that's a bad thing." I think that's a misreading of what the situation has been.

VICE CHAIRMAN PAPADIMITRIOU: Thank you. Thank you all for your comments and for being with us.

You have discussed and others have this morning and on previous occasions the issue of the size of the deficit and the question as to its sustainability.

In listening to the testimony and thinking about it and being a businessman who is interested in where to invest in the world, it strikes me that the United States of America is the economy of enormous size with political stability, with economic stability, reasonable economic stability, and with security stability. It is an enormously attractive place to invest. It is a location on the face of the Earth, it

seems to me, that investors around the world almost can't ignore.

Now, that being the case, my question is this: Discuss what you think the issue of trade deficit sustainability is and the risks as to whether at some point it becomes less sustainable. You said there is some limit or suggested there is some limit. What happens then? Where do people go if they don't want to be here?

MR. MUSSA: Well, part of the problem I think has been that other areas of the world have not been particularly attractive places for investment in recent years.

I think because their economic performance has been below what they are capable of achieving in the medium and longer term, the U.S. economy relative to the other industrial countries has performed particularly well in this decade.

Japan has been pretty much in persistent stagnation. Europe has grown really quite slowly. And the U.S. has been an attractive country in which to invest, notwithstanding the fact, as was mentioned earlier, that our domestic savings have been low but

our national savings rate is actually up from what it was in the 1980s.

Our investment rate relative to our GDP, our investment share, is up even more. So that means to finance the level of investment, which has been an important factor driving productivity growth in this economy, we have been importing foreign savings. They have been available to us, in part, because the investment climate elsewhere in the world economy has not been that attractive.

We at the International Monetary Fund believe that that situation is shifting. Growth in Europe does seem to be picking up. The emerging market countries are recovering. We think that the capital available to the United States will not be on such easy terms going forward, as it has been in the past.

Now, I continue to think that the United States will be an attractive place for positive net foreign investment. I can see one or two percent of GDP sustained for a very considerable period of time.

It would mean that our net debtor position as a country would probably then stabilize, not where it is now in the range of 15 percent of GDP but on the order of 25 or 30 percent of GDP. I would not be

alarmed by that, nor do I think foreign investors would be alarmed by it given the facts you pointed to: our stable economy, our stable political system, and so forth.

If we were going to have a sustained capital inflow of 4 percent of GDP, then we would be talking about net debtor position for the U.S. stabilizing in the range of 60 or 70 percent of GDP given the rates of return that foreigners typically earn on their U.S. investments. That seems a little large to be reasonable and sustainable.

So I would be thinking of a current account deficit that might persist for a very considerable period of time but a magnitude that is half or a little less than half of what we are expecting to see in the year 2000.

So it's not moving suddenly to a situation of balance but moving back to a deficit that is more of a sustainable size consistent with the capital inflows net that I think we should continue to expect are likely to come to the U.S. for some time.

VICE CHAIRMAN PAPADIMITRIOU: Commissioner Angell?

COMMISSIONER ANGELL: I would like to also follow up in regard to the question of what is unsustainable. What was surprising to me was that on Page 3 of your written statement, you put unsustainable together in the same sentence with the falling exchange value of the dollar.

Now, as I understand it, the United States has a saving shortfall, partly due to the huge rate of return on real capital goods. What I don't understand is: How in the world can you have a capital inflow of three percent or four percent of GDP while the exchange value of the dollar is falling?

I would think those would be, those two together would be, a disaster. I would think Mr. Greenspan would have a lot of work to do.

MR. MUSSA: Well, I think, as Mr. Price suggested, all of these things are linked, but what I envision in my written statement is that, looking over the next couple of years, -- I don't want to try and put a precise timing on it. We would be seeing a lower dollar and a smaller net capital inflow into the United States and a smaller current account deficit.

COMMISSIONER ANGELL: But you have incorrectly been expecting this for some time; correct?

MR. MUSSA: I recall when I was forecasting the U.S. economy in December of 1982. I said, "The dollar is too strong. It will need to come down."

I said in December of 1983, "The dollar is too strong and will need to come down."

I said finally in December of '84, not being discouraged by having been wrong two years in succession, "The dollar is too strong. It needs to come down." And the market got it right.

I think we are in a situation where the strong dollar is an essential component of the situation that produces a current account deficit for the United States of four percent of GDP. A deficit that we have been able to finance in a circumstance where capital flows have been attracted to the United States and to some extent repelled from other regions because investment opportunities have not been quite so attractive there.

I think that is, as was true in the early and mid-1980s, not a situation that can be sustained at that level a great deal longer.

MR. PRICE: It is true that, just as we have had a current account deficit, we have had a capital inflow during all this period. The dollar has

gone up some periods. The dollar has gone down other periods. We have had a capital inflow except for one quarter of the Persian Gulf War.

COMMISSIONER ANGELL: But if the dollar is on an upward trend, as it has been the last few years, that would seem to indicate that the trade deficit is not only sustainable, but it would seem to indicate that the appetite to move savings flow from abroad to the United States actually exceeds our trade deficit position.

MR. PRICE: It's been more flat for a year. Some currencies have gone up. Some currencies have gone down relative to the U.S. It's been more flat in the last year than it was for the --

COMMISSIONER ANGELL: Well, it hasn't been flat against the yen and the euro lately, has it?

MR. PRICE: It depends on what your endpoints are for the yen. It has gone down relative to the yen.

COMMISSIONER ANGELL: Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Commissioner Wessel?

COMMISSIONER WESSEL: Thank you.

I appreciate all of you being here today. I would like to ask a question of the integration, mainly Mr. Walters and Mr. Price, the integration of what you do with our negotiators.

During the NAFTA negotiations, the Mexicans engaged in 99 separate sector surveys to determine what their negotiating priorities should be. In terms of dealing with our own negotiators, we found out that no analysis had been done. It was basically one or two meetings with the industry, and then hit or miss as to what we should be achieving.

Has that changed with the accession agreement with China? And what do you think you might be able to do to assist our negotiators in developing priorities for where we should be looking in the future?

MR. PRICE: I'm going to have to defer to David because I have not been involved in it.

MR. WALTERS: You probably know we do normally seek advice of the International Trade Commission. The International Trade Commission in a lot of ways, although it is an independent agency, staffs the Administration for the provision of sound and objective economic analysis. They provide highly

detailed advice, sector by sector, sometimes at a very detailed level.

With the NAFTA, of course, as the endpoint was known, zero tariffs on everything, the purpose of that analysis was to identify sectors which were more import-sensitive. It's a general objective of trade agreements that areas where the sensitivities are greatest have the longest phase-in of trade obligations.

The longest phase-in was for corn in Mexico that product being extremely sensitive in Mexico, which is still to a substantial extent an agrarian society.

So we do get formal analytical advice from the ITC. We try to assess potential agreements internally. We assess them through an interagency process. We have a whole full range of advice from private sector advisers, some of whom bring formal analysis as the basis for advice, others less formal analysis, more descriptive type material.

I certainly wouldn't say that we enter into negotiations blind. We do analysis with the resources we have. We also regularly canvas the private sector as to what's going on in the academic realm to see how

it can be enlightening in terms of guiding the trade negotiations.

COMMISSIONER WESSEL: What weight based on what you have just said should we give to the ITC report on the accession agreement, which indicates the trade deficit will go up? And our charge is to look at the trade deficit and its long-term implications.

MR. WALTERS: Well, two things. First of all, on the narrow point of the trade deficit, the ITC analysis showed the trade deficit going up with China but down with the world. So the effect of China's accession was a greater reduction in the deficit with all countries other than China, and the increase of China.

This was a general equilibrium model with all countries reflected. In a multilateral trade and payment system, you get effects throughout the system from the bilateral agreement.

I would say also with respect to the study on China's accession, and in general work in this area, the modeling environment is becoming in a lot of ways less and less comprehensive of the type of things that we negotiate in trade agreements.

Typically, and the ITC study is no exception to this, what the formal models can take into account are tariff changes and a very, very few non-tariff changes in the goods sector, such as a change in quantitative restriction.

They cannot deal with anything in services. They cannot deal with any rules changes. Increasingly, this is what trade agreements are about, changes in rules, codes of behavior, and increasingly the services side.

Another shortcoming, of course, is most of these studies are static. So what the ITC did was look at 1998 as it was, in fact, and then run a formal experiment where the accession package was put in place in 1998 and gave us an answer which was based on how 1998 would have been different had accession been in place.

China's accession to the WTO in the package that we negotiated with them is not an investment in 1998 in a policy sense. It's an investment in 2010 and 2020, when China, which is growing very rapidly, will be a much bigger economy. This is just another way in which the type of analysis that ITC used, which is state of the art, it's not a criticism of the

Commission staff, does not fully capture the effect of the agreement.

The third thing I would mention is -- and this is more technical than even the rest -- these models are all very, very highly aggregated by product sector. There were 25, 30, 35 sectors in the ITC study. The way these models work is to measure the benefit from specialization in production, allowed by the reduction of barriers between sectors, but it captures nothing within sectors.

So if you have a single sector that has 30 percent of U.S. trade with China in it and there are significant benefits to be derived from increasing trade among those products within the sector, it totally escapes the ability of those models to measure.

All of this is a long way of saying that we use, the Commission uses, the tools, the best tools, that are available. We seek the best advice that is available. But one must interpret the results of these tools relative to their merits and shortcomings.

Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Commissioner Zoellick?

COMMISSIONER ZOELLICK: I want to thank the panel again for your testimony and then taking the time to be with us.

I think my question is principally for Dr. Price, but others may be able to comment on it. It relates to the part of your written testimony that refers to the statistics on which we and others are basing our judgments.

I was struck by your statement that the understatement of U.S. exports could be as great as ten percent and a comment that I didn't find in your written statement but I thought was in your oral presentation, where you referred to a possible gap of about \$100 billion due to statistical discrepancies. Those are significant numbers, even given the context with which we're dealing.

So my question is: How do we fix this? And as a follow-up, to make it a little easier, if you have some specific suggestions for the Commission that might go into greater detail that are not appropriate to discuss at length here, I think I and many others would be interested in seeing them because when we see these numbers and one can have differences to that degree, I think that could be significant.

MR. PRICE: I am not sure whether it was '97 or '98, but we had for that year, I think it was '97. We showed a capital inflow that was \$100 billion different from our current account balance. Over the last four years, we have had gross domestic income grow almost \$200 billion more than our measure of gross domestic product.

If you try to do the computations, if you try to make the world mesh together, it's hard enough when you've got a big player like the U.S. not having its own numbers fit together, how do you make the world numbers add up?

There are three pages in my written testimony of some ideas of what we can do to improve our international statistics. The world is changing very rapidly. And the way businesses relate to each other is changing rapidly.

We still are sending out surveys on paper, trying to collect data for things that are like the way the world had been organized. And it's much more the international transactions that are not fitting the mold for which our statistical arrangements were put together. And you'll find some of the flavor of that here.

We had one very minor budget item that I think is potentially important. Our exports, as you mentioned, initially have been estimated a minimum of three, probably six or seven, maybe as much as ten percent understated. If it's seven percent, we're talking about \$70 billion missing in the way we're counting.

Very few of the statistics we put together are done the way we do the trade statistics. Except for trade and this morning's unemployment claims, which are based on administrative data, almost all of the statistics we put together are based on samples.

For the trade data, we process millions of documents for imports and exports. We go through a keying-in process to come up with what happens in exports and imports.

Not everybody files. Not everybody files accurately. Particularly when we have, you know people are not expected to file under \$2,500 in exports. And as we have raised the threshold, from 2,000, say, to \$2,500 for what you are required to file an export for, they just say: Well, what was the recent shipments of the 2,000-2,500 category? And let's just assume it's

the same ratio over time. There's one percent. We add one percent of what we now measure above 2,500.

With NAFTA, with the lowering of airfreight, with the Internet, we have reason to believe that there is a lot bigger portion of our exports that is going in under the \$2,500 category than our formula does.

There's the under-count. In Laredo, we did an education campaign. When it's over 2,500, you're supposed to file. And we got at least a 50 percent increase in the amount of filing. We're never going to get a complete count in this, but in the same way that we have an under-count in the way we count the nation's population, you can debate about whether the fine detail is accurate. But nationally you have a sizeable under-count of the population.

We have an under-count of our exports and our imports. And we need to find a way to statistically correct for that and not rely exclusively on the totals we come out of from the administrative data.

COMMISSIONER ZOELLICK: If I could just have the indulgence of a brief follow-up on this? I really think this may be worth the time of you and your

colleagues given the interest that we saw this morning among some of the members of Congress because if I were going to offer a forecast, I think the world is going to move more in the direction that you're outlining.

And certainly all the businesses with which I am associated do everything electrically now in terms of their information base. And I am, frankly, concerned that our government is about one generation behind but, yet, policymakers are making decisions and assumptions and newspapers are out there making reports based on old systems. And the information may be all false or at least to significant degrees.

I think it is incumbent on a government to come forward with some specific ideas about how to fix that. And if we can possibly give some added momentum and attention to those situations, I think it would be worthwhile.

MR. PRICE: We would welcome that. And I have talked to Steve Landefeld, the Director of the BEA, and to Fred Knickerbocker, the head of the Economics Directorate at the Census Bureau, who produced all of these numbers under them. They're here to work with you to see what can be done.

COMMISSIONER ZOELLICK: And there may be multiple methods.

MR. PRICE: Well, I just want to caution that it -- I don't want to say that we're doing everything on the forefront at all places, but one of our problems is also a lot of businesses themselves, including those who are exporters.

People came to us for early release of steel trade data. We agreed we had reliable data we could put out early on steel import statistics. I wanted to put out the export statistics at the same time. We couldn't do that. We had 98 percent of our imports are filed electronically and only two-thirds of our exports are filed electronically.

We can't key in all those millions of documents until six weeks later. That's why the trade statistics come out so late. We just released them last Friday for the month of December.

We've got to move electronically. But that third of export documents are still not being filed electronically. We've been encouraging for five years for businesses to do it. They've not wanted to do it.

So we can do a better job, but we also need to encourage the private sector to be more helpful in

getting these data in. And the good part is I think as the cost of information goes down, the ease and comfort of people using these networks work together, then in the next few years, maybe we can get better compliance.

COMMISSIONER ZOELLICK: Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Commissioner Thurow?

COMMISSIONER THUROW: If you want to move on, my question is not so vital that it has to be asked.

VICE CHAIRMAN PAPADIMITRIOU: That's okay. Ask your question.

COMMISSIONER THUROW: We have been talking about sustainability. And, of course, that's one issue. But let's just assume for the moment it isn't sustainable. Then the question is: Do you get a soft landing or a hard landing?

Of course, the soft landing, as you indicated, as the rest of the world grows faster, Americans save a little more, consume a little bit less, and the dollar falls a little bit. The balance of trade gets better. And the loss in consumption is made up by the smaller deficit and the balance of trade.

The question is: Is it possible to have a quick run on the dollar? And I remind you of the Summer of 1992, we tend to forget that. Where in very short order, there were runs on the Italian lira, the British pound, and the French franc and the French in the summer of '92 were probably the best performing economy in the industrial world. They certainly were the best performing economy in Europe at that time on essentially every measure, inflation, growth, et cetera.

Across all three on the panel, is it possible to have a run on the dollar?

MR. MUSSA: The experience of the last quarter century of floating suggests that you do get large sudden changes in major currency exchange rates, and one should not rule out that possibility.

However, we had an enormous downward correction of the dollar in the mid-1980s. And there were many fears expressed about the dire consequences of the hard landing, and they didn't seem to materialize.

Now, we're a little less well positioned in the sense we've got less spare capacity in the U.S. economy. So maybe the inflationary consequences would

occur more rapidly. On the other hand, I think the overvaluation of the dollar is occurring much less now than it was in early 1985.

So I wouldn't worry excessively that if we got 15 or 20 percent downward correction of the dollar that would be a key policy problem. I would worry much more if we got a sharp downward correction in the equity market.

MR. PRICE: The Treasury Department is the part of the Administration that talks about future movements of the dollar and policy toward the dollar, but I would like to talk about, if I could, just the run toward the dollar that we have seen the last couple of years and give something of an answer to the question Dr. Krueger asked about what if we had -- let's just take the counter-factual.

What if we had decided four years ago we were going to keep imports from rising so that we wouldn't let the current account get above two percent, one and a half percent, wherever it was, four years ago? I think it's unambiguous that today we would have had much lower GDP, much less real growth, higher inflation, less investment.

If we had kept out that two percent of GDP that now reflects our larger current account deficit, that would have been \$180 billion of imports to keep out as that has wedged up the last several years. We would have had a less healthy economy today than we do now.

MR. WALTERS: I don't mean any disrespect, Professor Thurow, but coming from a microeconomic agency, rather than macro, we just don't deal with things that would allow me to say anything reasonable on that question.

COMMISSIONER THUROW: Okay.

VICE CHAIRMAN PAPADIMITRIOU: Chairman Weidenbaum?

CHAIRMAN WEIDENBAUM: I have a quick question for Dr. Mussa. So much of the discussions we have had here in all of these sessions have been in terms of the current account deficit being the pacing element and the inflow of foreign capital being the accommodating element.

To what extent does the degree of causation go the other way?

MR. MUSSA: I think there is a degree of causation. I think Mr. Lee spoke to this issue in his

prepared testimony. There are a number of things that all add up to the current account. And, in principle, each one of them is potentially an active, rather than a passive player.

I think the main driving force has been the strength of the U.S. economy, the rapid rise of productivity, and confidence in business investment in the United States that has driven up demand in the United States and also made this an attractive place for foreigners to want to place their investment.

Those things have both together pushed up the dollar. And the attractiveness of foreigners investing in the United States I think has been an active force in these developments, not an entirely passive one.

VICE CHAIRMAN PAPADIMITRIOU: Thank you.

Commissioner D'Amato?

COMMISSIONER D'AMATO: Yes. I just have a quick information question for Mr. Walters. We had this negotiation and agreement with the Chinese, which everybody is talking about. We're going to be voting here, but no one has seen the agreement. When are we going to see the agreement?

MR. WALTERS: Can I get back to you on that?

(Laughter.)

COMMISSIONER D'AMATO: That probably would be a good idea. Before the vote I would think we would do that.

MR. WALTERS: Yes.

VICE CHAIRMAN PAPADIMITRIOU: Thank you all very much. We appreciate your coming here. Thanks.

I would like to invite the members of the next panel to come forward. Let me, from the outset, thank the members of the panel for agreeing to provide their wisdom to this Commission in its deliberations with this important task to review the trade deficit, an important aspect of our economy.

Since we're running out of time, I want to sort of go right into the commentaries. And, therefore, I want to ask Dr. Gong to begin first.