

**STATEMENT BY SENATOR PAUL S. SARBANES
BEFORE THE TRADE DEFICIT REVIEW COMMISSION
February 24, 2000**

Chairman Weidenbaum, Vice Chairman Papadimitriou, distinguished members of the Commission, I am pleased to have the opportunity to appear before you today to discuss the work of the Trade Deficit Review Commission.

Earlier this month the United States achieved the longest economic expansion in its history at 107 months of continuous growth. The U.S. economy has attained high levels of growth with the lowest unemployment and the lowest inflation in thirty years. The expansion has gone on long enough so that its benefits have begun to be felt by even the hardest to employ workers in our economy.

At the moment, the outlook for the continuation of the economic expansion is good. As Federal Reserve Board Chairman Alan Greenspan noted in testimony to Congress last week, "There is little evidence that the American economy, which grew at more than 4 percent in 1999 and surged forward at an even faster pace in the second half of last year, is slowing appreciably. At the same time, inflation has remained largely contained."

In his testimony, Chairman Greenspan also noted that the strong American economy was "engendering a set of imbalances that, unless contained, threaten our continuing prosperity." The first imbalance that he noted in his testimony was "growing net imports and a widening current account deficit" that "require ever larger portfolio and direct foreign investments in the United States, an outcome that cannot continue without limit."

Treasury Secretary Lawrence Summers made a similar point in a speech he gave on January 14. At that time he stated, "It is obviously important, for our own economy and for the global economy as a whole that the United States move over time to a more balanced external situation because a more balanced expansion is likely to be a more durable one." In making this point, Secretary Summers echoed a comment former Treasury Secretary Robert Rubin made just one year ago shortly before a meeting of the G-7 countries: "The international system cannot sustain indefinitely the large trade imbalances created by the disparities in growth and openness between the U.S. and its major trading partners."

Just last Friday the Commerce Department reported that in 1999 the United States recorded a deficit of \$271.3 billion for goods and services, the highest annual deficit on record. This represented a 60% increase from \$164.3 billion in 1998. The deficit in 1999 for goods alone was \$347.1 billion, also the highest on record. U.S. bilateral trade deficits with Japan, China, Mexico, Western Europe, and Canada also grew to their highest level ever in 1999.

It was concern over the trade deficit and its consequences for the United States economy that led Senator Byrd, Senator Dorgan, and myself to introduce legislation in the last Congress to establish the Trade Deficit Review Commission. We felt there was a need for an independent, bipartisan commission made up of distinguished individuals of varied backgrounds and interests to study, as the statute provides, "the nature, causes, and consequences of the United States merchandise trade and current account deficits."

It was our view that the causes and consequences of the trade deficit, and the large external debt that the United States had accumulated as a result, were poorly understood. To a certain extent, it seemed to us there was a reluctance even to discuss the trade deficit and the problems it might pose for the United States economy. As a result, the issue was often ignored. Some even denied that it was an issue.

In my view, the continued growth in our trade deficit and accumulation of external debt is an issue we ignore at our own peril. There is a need for an informed public discussion about the causes and consequences of the U.S. trade deficit, and consideration of actions that could be taken to minimize the risks it poses to continued U.S. economic growth.

It is our hope that the work of this Commission will be a starting point for that informed public discussion. The legislative mandate provided the Commission is broad and comprehensive. In reviewing the legislative mandate, there are four particular issues that I would briefly like to bring to the Commission's attention.

U.S. As A Debtor Nation

The legislation includes an extensive list of "Issues to be addressed" by the Commission. Among them is, and I quote, "Any consequences for the United States economy of the current status of the United States as a debtor nation."

Prior to 1970, the United States had a trading relationship with the rest of the world that was generally in balance or in slight surplus. In fact, the U.S. made a balance or surplus in our payments with the rest of the world an explicit goal of national policy.

I had the privilege of working on the staff of the Council of Economic Advisers when Walter Heller was the Chairman under President Kennedy. The Economic Report of the President in 1962, the first one produced with Heller as Chairman, laid out “basic balance in international payments” as one of the principal goals of economic policy.

The report presented the rationale for the policy, and I quote: “The balance of payments objective for the United States is to attain, at high employment levels, a balanced position in its basic international accounts during the next few years.. .The objective of a balanced basic position does not mean that balance must be maintained continuously. In some years, a surplus in international payments will be appropriate, in other years, a deficit. But the average position over a period of years must be strong enough to maintain confidence in the parity of the dollar.”

The Report also stated: “Improvement in the U.S. balance of payments is more than a U.S. problem. Our deficit is matched by corresponding surpluses elsewhere.. .Surplus and deficit countries bear joint responsibility for rectifying payments imbalances and for maintaining the stability of the international monetary system during the period of adjustment.”

The Report also made the following point: “For many years, the United States had little reason to be concerned whether all these payments were covered by corresponding receipts **from** abroad. Foreign demands for U.S. goods and services were large; the dollar was, and still is, a ticket of entry to the world’s largest and most diversified market. *In some periods, the surplus of receipts was so large that the United States took actions to moderate its effects both at home and abroad.*”

The U.S. recognized that a balance in the international payments position of the major countries was in the interest of the United States and in the interest of the world economy. This view was so strongly held, that the U.S. sought to moderate its own surpluses when they were deemed to be too large.

Beginning in the 1970s, but particularly in the past two decades, the United States has moved away from that position. The United States has run a merchandise trade deficit every year but three since 1970. The U.S. merchandise trade deficit has exceeded \$100 billion every year but two since 1984. The U.S. has run a deficit in trade in goods and services every year since 1982; it exceeded \$100 billion in every year but three. The U.S. has run a current account deficit every year since 1982. The current account deficit exceeded \$100 billion in eleven of those years, including the past six.

According to the Congressional Research Service, as a result of the accumulation of current account deficits, the United States moved from being a creditor nation to being a debtor nation in 1987. The U.S. debtor position went from \$34 billion in 1987 to \$200 billion in 1989, \$352 billion in 1994, \$767 billion in 1996, \$1.2 trillion in 1997, and \$1.5 trillion in 1998.

A result of this growing foreign debt is that the balance of interest earned and paid on foreign investments in the United States also has turned negative. Through most of the post-World War II era, U.S. investors earned considerably more on their investments abroad than did foreign investors in the United States (a high of \$33 billion in 1981). In 1997, however, this balance dropped to a negative \$5.3 billion and fell further to \$22.5 billion in 1998. The United States has become the world's largest debtor nation, and the servicing of that debt has increased the U.S. deficit on current account.

The U.S. current account deficit and net inflows of capital are projected to continue at about \$230 billion per year from 1999 to the year 2002. This implies an increase in the foreign indebtedness of the United States of about a trillion dollars every four or five years. By the year 2002, the U.S. could be in debt to the rest of the world by more than \$2.4 trillion and foreign debt as a percent of gross domestic product could rise from over 15% in 1998 to about 25% in 2002.

Several witnesses who have testified before the Commission, including Wynne Godley of the Levy Institute, warned that if the balance of trade does not improve, there is a danger that over a period of time the United States will find itself in a “debt trap,” with an accelerating deterioration both in its net foreign asset position and in its overall current balance of payments.

Whether the U.S. can sustain its current account deficit over the foreseeable future depends on whether foreigners are willing to increase their investments in U.S. assets enough to offset the rising deficit on current account plus the net outflows of interest income on foreign investments. In this sense, the current account deficit puts the economic fortunes of the United States partially in the hands of foreign investors.

This is clearly not a desirable position for the United States to find itself. In my view, the U.S. should have an explicit goal of reducing this economic vulnerability.

Persistent and Substantial Bilateral Trade Deficits

The legislation which established the Commission also directs it to examine and report on “the extent to which there is reciprocal market access substantially equivalent to that afforded by the United States in each country with which the United States has a

persistent and substantial bilateral trade deficit, and the extent to which such deficits have become structural.”

The recent discussion about the trade deficit has generally centered around the macroeconomic influences on our balance of trade - relative growth rates of the United States and its major trading partners, exchange rates, and investment flows. I do not want to engage in an extended discussion here over the relationship between savings and investment other than to make the point that a number of witnesses who have testified before the Commission have explained the distinction between an accounting identity and causality. An identity does not show the direction of causality. Do levels of savings affect trade, or do levels of trade affect savings? I have actually quoted Professor Thurow on this point on a number of occasions.

The macroeconomic forces that I mentioned have no doubt played a major role particularly in the deterioration in the U.S. balance of trade and payments in recent years, and should figure prominently in the Commission’s report. Nevertheless, we should not lose sight of the fact that our bilateral trade relationship, especially with Japan and China, and to a certain extent with other countries in Asia, have been characterized by deficits that seem immune to the economic cycle.

It is instructive, for example, to compare our bilateral trade relationship since 1983 with the European Union with our relationship with Japan and China. According to data from the Commerce Department compiled by the Congressional Research Service, the United States had a bilateral trade deficit with the EU in 1983, a recession year, of \$2.3 billion. As the U.S. economy recovered from the recession, our bilateral deficit with the EU expanded by 1986 to \$27.2 billion.

The U.S. trade balance with the EU actually went into surplus in 1990, 1991, and 1992 as the U.S. economy slowed. In 1991, the U.S. had a bilateral trade surplus of \$14.2 billion with the EU. By 1993, as the U.S. economy began to grow and growth in the EU started to slow, the U.S. again had a trade deficit with the EU of \$4.9 billion. That deficit has expanded steadily since as U.S. growth has exceeded growth in the EU. In 1999, the U.S. had a bilateral trade deficit with the EU of \$43.7 billion.

Although the U.S. has certainly had trade disputes with the EU over the years, it is fair to say that our trade balance with the EU has generally shifted as one would expect with the economic cycle.

That is not true of Japan and China. In 1983 the U.S. had a bilateral trade deficit with Japan of \$19.6 billion. It grew to \$46.5 billion in 1985 and \$56.7 billion in 1987, and has not fallen below \$41 billion since. There has been some fluctuation from a low of \$41.8 billion 1990 to \$65.6 billion in 1994 to \$47.6 billion in 1996. It has risen again steadily since 1996 and last week the Commerce Department reported a record bilateral U.S. trade deficit with Japan of \$73.9 billion. But the overall record has been a large, bilateral trade deficit that in significant measure seems immune from the economic cycle.

The experience with China has been even more one-sided. In 1983, the US had a bilateral trade deficit with China of \$72 **million**. It fell to a deficit of \$9 million in 1985. Since then it has increased every year without exception from \$1.6 billion in 1986 to \$10.4 billion in 1990 to \$29.4 billion in 1994 to \$56.8 billion in 1998. Last week the Commerce Department reported that the US bilateral trade deficit with China reached a record \$68.7 billion. This is nothing new because the U.S. trade deficit with China has set a new record every year since 1986.

In 1999, U.S. trade deficits with Japan and China accounted for over 40 percent of the total U.S. deficit. Given the chronic nature of those deficits, it seems clear that trade barriers, currency policy, and perhaps other non-market factors are influencing our trading relationships. A significant portion of our trade deficit problem is thus not a function of relative growth rates but of formal and informal trade barriers, a fact which the Commission will have to confront directly in its report.

Exchange Rate Manipulation

The legislation also directs the Commission to examine and report on “The impact that currency exchange rate fluctuation and any manipulation of exchange rates may have on United States merchandise trade and current account deficits.”

The Omnibus Trade and Competitiveness Act of 1988 requires the Treasury to submit an annual report to Congress, with an update after six months, on international economic and exchange rate policy. It also requires the Treasury Secretary to analyze annually the exchange rate policies of foreign countries, and to consider whether countries manipulate the rate of exchange between their currency and the dollar for purposes of preventing effective balance of payments adjustments or gaining unfair competitive advantage in international trade. The Secretary of the Treasury is required to undertake negotiations with those manipulating countries that have material global current account surpluses and significant bilateral trade surpluses with the United States.

Since the enactment of the statute, the Secretary of the Treasury has found at different times that Taiwan, South Korea, and China have engaged in currency manipulation, although no country is currently subject to such a determination.

I bring this provision to the attention of the Commission because it goes directly to one of the mandates of the Commission to study. I also mention it because several of the distinguished witnesses that have appeared before the Commission, including Professor Peter Morici of the University of Maryland, Professor Robert **Blecker** of American University, and Ernest Preeg of the Hudson Institute have pointed to currency manipulation as one of the causes of our trade deficit.

For example, they point out that during the 1990s, Japan, China, and other governments dramatically increased their purchases of U.S. government securities, propping up the value of the dollar against other currencies. This helped to sustain both their trade surpluses and U.S. trade deficits, even as the United States eliminated its budget deficit. Mr. Preeg states that foreign governments increased official dollar holdings from \$432 billion in 1989 to over \$947 billion in 1999.

I urge the Commission to examine this issue as it prepares its final report, and to emphasize the importance of Treasury compliance with the reporting requirements of the 1988 Omnibus Trade Act.

Trade Promotion

The legislation which established the Commission also requires it to examine and report on “The extent to which the coordination, allocation, and accountability of trade responsibilities among Federal agencies may contribute to the trade and current account deficits.”

The Export Enhancement Act of 1992 established in law the Trade Promotion Coordinating Committee - TPCC - which is made up of all the agencies of the Federal government involved in trade promotion.

The TPCC is chaired by the Secretary of Commerce. The statute requires the TPCC to coordinate the development of the trade promotion policies and programs of the United States government, and develop a government wide strategic plan for carrying out Federal export promotion and export financing programs. The TPCC is required to submit an annual report to Congress on the development and implementation of its strategic plan, which has come to be known as the National Export Strategy. The next report is due at the end of March.

Under the leadership of former Commerce Secretary Ron Brown and the present Secretary of Commerce, William Daley, the TPCC has enjoyed some success in bringing greater coordination and focus to the large number of export promotion programs of the Federal government. The TPCC has also developed an annual unified federal trade promotion budget that attempts to put into perspective the resources the Federal government invests in export promotion.

I urge the Commission to review the work of the TPCC in fulfilling the mandate of the legislation. It is well known that many foreign governments invest significantly more in export promotion and export finance programs than does the United States. Without a doubt this puts U.S. exporters at a competitive disadvantage with companies from those countries. At a minimum, the U.S. should make the best use of the resources in puts into this area, and in my view the TPCC is an important mechanism for achieving that goal.

Trade Statistics

Finally, the legislative mandate for the Commission also requires it to review “the adequacy and accuracy of the current collection and reporting of import and export data.”

We cannot expect to make good policy concerning the trade deficit and foreign indebtedness without thorough and detailed statistics. I hope the Commission takes seriously its charge to make proposals to improve our statistics on international trade and investment. The Census Bureau itself has concluded that it has a substantial undercount of our imports and exports. Our trade statistics are all based on the documents filed by importers and exporters and they are not always filed or filed completely. There are also apparently gaps and data collection problems in the services trade and investment flows measured by the Bureau of Economic Analysis. This is a challenging and fast-changing area and the statistical agencies have been under tight budgets. I hope that you can come to some constructive recommendations in this area..

Conclusion

There are of course other important issues that the legislation directs the Commission to examine. One of particular importance to me is the “impact of the merchandise trade and current account deficits on the domestic economy, industrial base, manufacturing capacity, technology, number and quality of jobs, productivity, wages and the U.S. standard of living.” Another is the “impact that labor, environmental, or health and safety standards may have on comparative and competitive trade advantages.” These are central issues to which I am sure the Commission will give great attention.

It seems to me that there is a consensus now developing that trade deficits do matter. The accumulation of substantial trade and current account deficits over a period of two decades has undeniable consequences of the U.S. economy. Aggressive efforts to reduce foreign trade barriers, end currency manipulation, promote U.S. exports, and encourage more rapid growth by our major trading partners are clearly called for. More complex is the appropriate response at the macroeconomic level. It seems to me an important task for the Commission is to develop options for reducing the risk of a sharp economic adjustment that our escalating trade and current account imbalances could cause.

At a minimum, however, we should do no harm. In the context of our current high growth, high employment economy, a large across the board tax cut that would add further fiscal stimulus would be extraordinarily unwise and counterproductive. Among other consequences, it would deepen the deterioration of our trade and current account balances and increase the risk of a severe economic downturn.

Let me conclude by thanking the Commission for the opportunity to share these thoughts with you. I believe the work you are doing has great importance for the country. I wish you luck in carrying out your challenging task.