

# Democratic Commissioners' Views

## Trade policies to reduce U.S. trade deficits and ensure that globalization helps everyone

### A. Introduction

The globalization process has engulfed the WTO and its sister multilateral institutions, the International Monetary Fund (IMF) and the World Bank, in a series of fundamental assaults and controversies. Proposals for a new round of trade negotiations were stopped in Seattle in late 1999 by three groups: the developing countries, which are increasingly dissatisfied with the system; major developed countries and a block of developing countries that refused to compromise on including issues such as intellectual property rights, agriculture, and subsidies for the round; and finally, forty thousand to fifty thousand protesters, who succeeded in making human rights, labor rights, and environmental concerns a part of the public consciousness of why there is opposition to the WTO. Since Seattle, large protests from a wide variety of labor, environmental, farm, and religious and other citizen's groups occurred on a broader scale, protesting the activities and policies of the International Monetary Fund and the World Bank.

### Sources of the crisis of globalization

Our mandate directs us to examine the causes and consequences of the trade deficits. We will restrict our policy proposals to areas directly related to trade and trade deficits, because both have similar effects on workers and communities. However, we would be remiss if we did not place these issues in their larger global context. The Asia financial crisis in 1997 and 1998, and the subsequent crises in Russia, Brazil, and other countries in Latin America have resulted in falling incomes in these regions. Consequently, imports from the United States have fallen. A rush of capital flows from the crisis areas into the United States drove up the value of the U.S. dollar, caused foreign goods to be less expensive in the United States, and fueled the subsequent recovery of many of these regions, which rapidly increased their exports to the United States. The campaigns and protests against globalization have simultaneously challenged both the WTO and the international financial institutions.

Our report identifies clear, measurable economic problems caused by globalization that have helped fuel the protests against trade deficits and the WTO (see Chapter 3). We have provided extensive documentation on the number of job opportunities that were lost because of growing trade deficits and the rapid growth of income inequality in both developed and developing countries that is directly linked to globalization. In addition, the wages of all production workers in the

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United States (not just those in industries that compete on global markets) have been reduced by at least 4 to 8 percentage points simply because of trade-related factors in the last few decades. In addition, the gap between the incomes of the top 10 percent and the rest of the U.S. workforce has also grown significantly in this period. A significant share of this inequality is due to trade, which has been confirmed by dozens of independent studies. These are actual, measurable problems that must be honestly confronted at the same time that the benefits of expanded trade are acknowledged, thereby improving the public's understanding of the benefits of trade.<sup>1</sup> While reasonable people can disagree about the magnitudes of these problems, it is no longer possible or credible to deny their existence.

*Differences between the Democratic Commissioners' views and those of the Republican commissioners.* The two groups have fundamental differences of approach that simply could not be fully resolved. Nonetheless, we were able to reach agreement on several specific issues that are outlined below. Unfortunately, these common measures will not alone be sufficient to reduce America's trade deficit and the problems globalization causes. Thus, we outline a number of additional policies that could not only reduce the costs and increase the distribution of benefits from globalization but also would reduce the trade deficit.

Our analysis of the problems related to globalization and growing trade deficits – and the policy responses they demand – is based on the factual record this Commission established. We were not able to prepare a full cost-benefit analysis of the effects of trade. However, we do conclude that the trade deficit, and the risk that it could lead to a financial crisis and a major recession, is a significant enough threat to the U.S. economy that can no longer be ignored. We also found that trade has worsened the distribution of income and the wage levels of a substantial share of all U.S. workers.

We have identified a number of trade policies that can help reduce the U.S. trade deficit and also improve the overall impacts of globalization on the economy. They can also improve the benefits of trade and their distribution and reduce globalization's cost. In this way, the pressure from many sectors of society to slow down or stop globalization would be reduced. Most sectors, including businesses, communities, and most workers, will benefit if there is a reduction in the risks and costs of the trade deficit and if the net benefits of trade are improved and distributed more equitably. We conclude that the objections of many groups to globalization are based on their personal experiences over the past two or three decades as well as their values and view of the problems we face. This chapter presents policy proposals that address their concerns.

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<sup>1</sup> For example, the other Commissioners make the following claim in Chapter 6: "The benefits of trade are so substantial to our nation's prosperity that it is important for government, business, and academic leaders to explain more clearly that economic integration is still the best means we have to raise standards of living and increase global stability." Republican Commissioners Viewpoints, Chapter 6, p. 1.

## B. Causes of the trade deficit and the high costs of globalization

We identified a number of long- and short-term causes of the trade deficit in Chapter 2, all of which must be addressed through new types of trade and domestic policies. We outlined seven long-term problems. They are the following:

The U.S.' unequal relationships with major trading partners and the world as a whole. This is reflected in a persistent difference between the elasticity of U.S. import demand as incomes rise in the United States and the elasticity for U.S. exports as incomes rise in foreign countries. Without taking other actions, the U.S. trade balance cannot improve unless the value of the U.S. dollar steadily depreciates (which would also cause a reduction in U.S. national income).

Persistent differences in market structure and openness in a number of specific areas lie behind the differences in income elasticities. Examples include steel dumping and the sale of auto parts in Japan, which is effectively barred by the private actions and interconnected relationships in various keiretsu groups. Other examples include persistent, systematic, nontariff trade barriers in countries such as China and Japan.

Multinationals not only control a large share of world trade, but also a large share of that trade takes place within the firm itself and with its foreign subsidiaries and partners. Exports of parts and components associated with such trade have been described as "tourist exports," because they frequently reenter the United States as assembled products. Such exports do not stimulate new employment but instead reduce it as a growing number of assembly plants move offshore. Firms such as GE are consciously promoting and demanding foreign outsourcing both within the firm and with prime suppliers, exacerbating this problem.<sup>2</sup> In addition, these firms have made inadequate efforts to develop the domestic production base. Multinationals from the United States, more than those from most other parts of the world, have become detached from the state. Many of these firms are now stateless entities, almost a law unto themselves. Companies such as General Electric are seeking to actively reduce their connections to the United States, the country where most of the strategic technologies were developed, often with government resources.

Loss of competitiveness by many U.S. manufacturing firms, which is driven by two separate forces: at the top, U.S. producers are being squeezed by foreign producers in European nations and other wealthy countries that have now achieved higher levels of overall productivity (output per worker nationwide) and productivity growth rates; at the bottom, U.S. firms and workers are being squeezed by low-wage developing countries that fail to enforce their own domestic labor and environmental standards in order to repress worker rights and pro-

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<sup>2</sup> Richard Merli, "GE 'encourages' suppliers to move overseas – or else," *O'Dwyer Report* (August 2000). See also, Aaron Bernstein, "Welch's March to the South as GE pressures suppliers to shift to Mexico, unions dig in," *Business Week* (December 6, 1999), p. 74. Bernstein notes that "several of GE's business units – including aircraft engines, power systems, and industrial systems – have been prodding suppliers to move to low-cost Mexico, where the industrial giant already employs 30,000 people. GE even puts on 'supplier migration' conferences to help them make the leap."

duction worker wages, and to lower environmental control costs for producers. Also, many developing countries do not recognize prevailing international standards. In a few cases, currency manipulation by developed and developing countries has been used to develop structural trade surpluses with the United States and the rest of the world. This has been done in violation of WTO rules.

Low levels of savings in the United States have reduced the supply of capital for domestic investment and encouraged borrowing and foreign direct investment from abroad. Some economists blame this factor for most of or the entire trade deficit. However, we believe that it is only one of many factors that have contributed to the trade deficit. Nevertheless, as we show below, there are win-win policies that can increase savings and encourage employment growth.

Over time, the cumulative costs of financing America's debt will substantially add to the overall U.S. current account deficit. As foreign debt continues to pile up over the next few years, we will reach a point where the current account deficit will grow rapidly. As is shown in Chapter 4, this will happen as the costs of servicing the debt grow, even if the U.S. balance on goods and services trade stabilizes.

The U.S. trade deficit has also been exacerbated by a number of short-term problems. They include the following:

Recent increases in oil prices, as a result of the Organization of Petroleum Exporting Countries' (OPEC) decision to tighten its production quotas during a surge in demand. These increases explain about half of the increase in the U.S. trade deficit in 2000. While Federal Reserve Board Chairman Alan Greenspan and others have recently predicted that oil prices will come down in the near future, this episode highlights the need for a more effective policy in the United States (and other countries).

The U.S. dollar has appreciated sharply since 1995 for at least two reasons: increased growth rates in the United States relative to the rest of the world, especially since 1997; and, the financial crises that have swept many parts of Asia, Latin America, and Russia the last three years, which have resulted in huge inflows of private capital in search of higher returns and a safe haven. Appreciation of the U.S. dollar has increased the U.S. trade deficit in the past few years.

The reduction in economic growth rates in the rest of the world has also reduced demand for U.S. exports. Meantime, surging growth rates in the United States, especially the past year, have pulled in vast quantities of imports.

Finally, the U.S.' trade and current account deficits, and its rapidly accumulating stock of net foreign debt (all growing as a share of GDP), threaten domestic and international economic prosperity. This risk is already increasing the general public's anxiety. Furthermore, it is partially responsible for the decline of all major U.S. stock indices this year. If it occurs, a financial crisis is likely to result in a "hard landing" for the domestic economy, a recession, or worse. Moreover, a sharp decline in U.S. demand would quickly be transmitted to other countries worldwide that depend on exports to the United States. Thus, growing U.S. trade and financial deficits are a threat to the overall health of the United States as well as to the global economy. The United States must develop contingency plans and authorize new policy tools that could be used quickly in order to minimize the damage to itself and other countries.

## **C. Policy proposals**

### **Goals and structure**

*General goals.* The packages of proposals outlined here are designed to achieve three goals. These goals, and the policies that are needed to achieve them, are designed to address both the broad negative consequences of globalization and the specific need to reduce the trade deficit. A clear majority of Commissioners represented in both reports believe that globalization is changing the U.S. economy in ways that, at a minimum, must be addressed through greatly expanded programs of wage insurance, health care, and adjustment for all Americans who are displaced for any reason from a job (see joint Chapter 5).

We recommend a much larger program of specific actions that will simultaneously reduce the costs of globalization and the trade deficit. The policies proposed by the other Commissioners will have little impact on the trade deficit or on trade outcomes.

*Ensuring a high and rising standard of living for all Americans.* There has been too much concentration of the gains from trade in the top 10 percent and 20 percent of families in the income distribution. The wages of a much larger number of production workers have actually declined in real terms during the past two and a half decades. The real incomes of the bottom 80 percent of families were largely stagnant until the late 1990s.

*Create new rules for the global economy that improve global labor and environmental standards, and their enforcement.* Business and government policies in many developing countries have repressed labor, depressed wage growth, and sacrificed safety and environmental conditions. The International Monetary Fund (IMF) and the World Bank, under the guise of promoting deregulation and labor market "flexibility," have also actively supported these policies. The results have included job loss and downward pressure on wages in the United States and other developed countries. There has also been a race to the bottom in wages, working conditions,

and environmental quality in the poorest developing countries, together with sharp increases in the share of national income that is comprised of corporate profits and wages for elite workers. As a result, the gap between the haves and the have-nots has widened enormously, worldwide.

*Promote new approaches to trade deficit reduction.* Policies designed to achieve the first two goals can help reduce the trade deficit. However, many years will be needed for these changes to take effect and alter actual trade flows and conditions. Yet, the trade deficit is a potential threat to the economy. In addition, many of the policies that are needed to reduce the trade deficit (such as enhanced enforcement of trade agreements and stronger bilateral policy efforts that are designed to reduce structural trade barriers) will also help achieve higher standards of living and new rules for the global economy. Each of these goals is mutually reinforcing.

## **Policy baskets**

We have organized our policy proposals into six broad baskets. They illustrate themes that are designed to correct the short-term and long-term structural causes of the trade deficit and to reform the global trading system in order to reduce the costs of globalization and increase its benefits. As shown below, many of the specific policy proposals also serve more than one purpose.

The list of specific proposals that are discussed in the next section is not meant to be exhaustive. Rather, we wish to illustrate the kinds of initiatives that are needed to make substantial progress in each of the six following areas:

- Measures to increase manufacturing competitiveness
- Macroeconomic and monetary policy initiatives
- Enhanced trade enforcement
- New rules for the global trading system
- Improved oversight, monitoring, compliance, and enforcement of our trading rights and agreements, wage insurance, training, and adjustment assistance

## **Specific policy proposals**

Policy proposals that serve more than one purpose are cross-referenced below, using the initials or short titles of each policy group.

### **Measures to increase manufacturing competitiveness**

The U.S. manufacturing sector is being squeezed from the top because our productivity growth rates lag behind those of other countries, especially Japan and European nations, and from the bottom because of low wages and the lax regulatory environment in the poorest developing countries. Despite the recent growth of services trade, the vast bulk (80 percent) of world trade is in manufactured goods and other commodities.<sup>3</sup> Therefore, in order to close the trade gap,

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<sup>3</sup> World Trade Organization, 1999 and Trade Deficit Review Commission staff, personal communication.

U.S. manufacturing must expand capacity by about 30 percent in order to provide enough exports and import-competing goods. Substantial investments are also needed to increase research and development and to upgrade the skills of American workers.

## **1. Invest in manufacturing research and development and create incentives to expand domestic manufacturing capacity**

During the past forty years, federal support of all types of research and development (military and nonmilitary combined) as a share of GDP peaked in 1964, when it reached 2.1 percent of GDP. Total research and development has steadily declined since the 1960s. It reached a record low of 0.8 percent of GDP in 1998.<sup>4</sup> As noted in Chapter 3, federal spending for manufacturing research and development in particular has declined sharply since the 1980s. Historically, defense research and development has consumed the majority of all federal research dollars. Since the mid-1960s, when it peaked at 1.0 percent of GDP, federally funded, nondefense research and development has also declined sharply as a share of GDP. In 1998, nondefense research and development reached a historic low of 0.38 percent of U.S. GDP. Recent increases in productivity and output growth, often attributed to the so-called "New Economy," are largely based on the widespread application of technologies that were developed ten to thirty years ago (e.g., transistors, microprocessors and personal computers and the Internet). Public investments in basic and applied research provided the basic technologies that were used to develop these products. They also developed prototypes and financed early production runs of products such as computers and microprocessors. Increased public funding for nondefense research and development is critically needed to finance the technologies that will provide the foundation for the growth in the American economy for the next forty to fifty years.

There is set of issues that needs to be addressed before the United States can expand publicly funded research and development and expect to earn an acceptable rate of return on these investments. Much of the increase in federal research and development funding will take place under grants to or contracts with private companies. Because of the tremendous growth in foreign outsourcing and FDI, and of stateless multinationals, steps must be taken to ensure that this research benefits the nation and not just the companies involved. The basic notion that should be explored is the need to create reciprocal obligations. Conditions should be attached to publicly supported research and development to ensure that it is used primarily to increase production and employment in the United States and that firms do not sell or export publicly supported technologies to other countries.<sup>5</sup>

The United States also needs to substantially expand manufacturing capacity. This would enable us to reduce the trade deficit without increasing inflationary pressures and the Federal Reserve's temptation to raise interest rates--a decision that could lead to increased unemployment. Every U.S. recession in the last two decades was caused or exacerbated by monetary tightening in response to actual or anticipated inflation increases. Since the last major period of

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<sup>4</sup> National Science Foundation, National Science Foundation/Division of Science Resources Studies, Federal Funds Survey, Detailed Historical Tables, Fiscal Years 1951-98 Table B-11, p. 107, and Bureau of Economic Analysis, National Income and Products Account, web page: <http://www.bea.doc.gov/bea/dn1.htm>.

<sup>5</sup> Such restrictions could be WTO legal if the programs are offered with the same restrictions to both domestic and foreign-owned companies, thus making the conditions consistent with WTO standards of national treatment.

currency appreciation, U.S. industry has lost capacity, distribution, and marketing channels at home and abroad. This lost capacity has not been rebuilt. For these reasons, we recommend the following:

- Federal research and development spending should immediately be increased by at least \$13 billion over the next three years.<sup>6</sup> New measures are also needed to go along with these resources to ensure that the funds are used to expand production and employment. Funding for private projects must come with a contractual set of reciprocal obligations on the part of private firms to employ any technologies developed with such funds in ways that benefit the national interest.
- For the long term, plans should be developed and implemented to increase total federal spending on nondefense research and development to at least 1 percent of GDP, especially for manufacturing. The Council of Economic Advisers and the National Economic Council, in consultation with the National Science Foundation and the National Research Council, should develop a jointly sponsored industry government program for achieving these levels of spending and for increasing research and development in the private sector in similar proportions.
- The Council of Economic Advisers and the National Economic Council should also work with industry to develop public policies that, together with the other policies described below, will provide resources and incentives for firms to expand and upgrade manufacturing capacity in the United States.

## **2. Education, training and apprenticeship programs (also part of incomes policies)**

We endorse the joint proposals in Chapter 5 of this report for adjustment assistance, benefit support, and wage insurance. However, those proposals are not sufficient to meet the national need for skilled workers. Additional programs and public and private investments in education, training, and skills development are also needed. Chapter 5 endorses the use of tax credits to encourage firms to invest in training, but we think these programs, while important, will not provide enough trained workers to meet the needs of a growing manufacturing sector, particularly as the baby boom generation begins to retire in the next few years.

Therefore, we propose the following:

- The U.S. Departments of Labor and Commerce should work with industry, labor, academia and Congress to develop new policies and programs that are designed to increase privately funded and operated training programs. For example, several authors have proposed that the United States adopt new laws that would require all private firms in the United States to contribute 1 percent to 2 percent of their total gross receipts in a "use-it or lose-it" training fund. Such programs are already being used in Europe (e.g., France) to support skills development. Firms would be free to use these funds

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<sup>6</sup> The National Coalition for Advanced Manufacturing has supported similar proposals. See "Smart Prosperity: An Agenda for Enhancing Productivity Growth" (Washington D.C.: NACFAM, October 2000).

to train their own workers. They would also be free to pool their resources into regional or national skills development programs to increase local supplies of different kinds of skilled workers (e.g., computer programmers or machine tool operators). Such joint programs might be more appropriate for small- and medium-sized industries. Funds not used during any given year should be allocated by the Department of Labor to new regional and national training programs.

### **3. Capital formation for small and medium-sized enterprises**

Another barrier to the recovery of the U.S. manufacturing sector is the difficulty small- and medium-sized firms in the United States have in raising capital for new investments. A fundamental reorganization of the U.S. financial system has taken place over the past two decades. Before banking deregulation, small- and medium-sized firms relied on local and regional banks as sources of loans to finance business operations (e.g., inventories) and long-term capital investments. Few of these firms have ever had access to the national capital markets--they are simply too small to justify the costs of a national equity offering.

As the U.S. banking system has been reorganized, there has also been a major shift in the structure of national financial markets. Large corporations rely to an increasing degree on bonds and other large, debt-financing instruments. The market for these instruments has grown enormously during financial market reform. Likewise, local banks are rapidly being acquired by regional banks, which are, in turn, becoming national-scale institutions and acquired by the largest national banks.

As financial markets have reformed themselves under deregulation, small- and medium-sized enterprises (SMEs) have been left behind, without sources of debt or equity capital. As a result, many of them are being starved for capital and failing to grow as rapidly as they might otherwise. Also, they are not making the investments they need to modernize their existing facilities or for new plants.

Countries such as Germany and Italy use local and regional development funds to provide SMEs with subsidized financing. While there may be little interest in creating such publicly funded institutions in the United States, there are public/private-financing alternatives.

One of the most attractive options is to develop a government-backed security-pooling program. It could be called a "Fannie Mae [Federal National Mortgage Association] for SMEs." It would have several advantages over the current structure of U.S. debt and equity markets. These funds would have at least two advantages for SMEs and for financial markets. First, by pooling loans (or stock) into bond (or equity) packages, these funds could eliminate the scale problem that most small firms face when trying to raise capital on the open market. Secondly, by pooling

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debt or equity in such packages, the risk-return ratios would be greatly improved. The risk of failure in any one firm could be spread over all participants. This would dramatically lower the cost of debt financing for small firms.

Equity financing could be even more valuable. Though the risk of failure may be small, this would be more than offset by the possibility that some firms would do very well, perhaps going public on their own. Plus, the overall rate of return to the entire group would increase significantly as the capital shortage was eliminated by the pooled fund. The Small Business Administration (SBA) is one agency that has the skills needed to initiate such a program. The program could also be tied into the SBA's program of subsidized small-business loans. This new, government-sponsored enterprise should make loans as well as buy loans from other originators (banks, insurance companies, finance companies). It could also buy stock in the companies and then pool its stocks to reissue to large institutional investors.

There is a clear precedent for government purchases of private stocks in the Reconstruction Finance Company (RFC), which operated from 1932 to 1957. It was inaugurated by President Herbert Hoover to buy stock in banks and recapitalize banking system during the Depression. The RFC went on to become a major lender, making loans to small business, creating Fannie Mae, and financing the war.<sup>7</sup>

The SME program should also establish reciprocal obligations to ensure that the funds provided are used to create jobs and production capacity in the United States, and that these resources are not moved offshore during the life of the loan or security issue. These firms are increasingly being pulled to Mexico and other low-wage location by the multinationals that are often their most important customers.

Therefore, we recommend the following:

- The U.S. Department of the Treasury and the Federal Reserve Board of Governors should request legislation from Congress that would create a government-sponsored enterprise that would create pooled financing mechanisms for SMEs. The authorizing legislation should also establish reciprocal obligations between the firms receiving assistance and the U.S. government, which require that the resources will be used to create jobs and production capacity in the United States.

It is also important to note that Fannie Mae and its sister institutions have been highly profitable and have raised extensive funds on debt and equity markets. These institutions are also sources of revenue for the government, and they do not rely on public subsidies.

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<sup>7</sup> Personal communication e-mail, dated October 31, 2000 from Jane D'Arista of the Financial Markets Center, Richmond, Virginia.

## 4. Trade corps

In addition to aggressively monitoring the enforcement of and compliance with existing trade agreements, it is vital that our nation make every effort to capitalize on activities that open markets. Too often, we have found that market access agreements fail to lead to the expected improvements in our nation's trade posture. Clearly, there are a number of reasons for this. Sometimes, there is simply a failure to comply. Many times, we find that new trade barriers replace dismantled barriers. While many of our nation's largest companies have the resources to support their overseas activities, many small- and medium-sized businesses need additional support to facilitate their efforts.

- We recommend that the resources of the United States and the Department of Commerce's U.S. and Foreign Commercial Service (USFCS) be significantly expanded to increase the number of commercial officers who can assist U.S. business in capitalizing on market-opening initiatives. In allocating resources, the USFCS should place priority on those countries with the greatest market opportunities and where recent market access agreements have been reached. Expansion of this program will help stimulate exports.

## 5. Labor sponsored investment funds

Pension funds that are managed by unions and other employee organizations control a growing share of privately controlled financial assets in the United States. In some countries, worker organizations have created special funds that accept retirement investments from employees and invest those assets in projects that are designed to save and create jobs, to support community development, and to demonstrate support for workers who have become unemployed.

Canada has adopted tax regulations that support the creation of such funds by allowing individual investments to be sheltered in a Registered Retirement Savings Account (similar to an Investment Retirement Account in the United States). Some provinces also offer a tax credit to workers who invest in such funds. In Quebec, investors in the Solidarity Fund, the first fund of this type to be established, receive a 20 percent tax credit on their investments on top of the tax sheltering of the investment. These are substantial savings incentives.

The Solidarity Fund has invested in hundreds of firms and enterprises since its inception and has provided investors with an average annual rate of return of 6.75 percent, on top of the social benefits provided by these local investments. These investments have been used to

- rescue local firms in financial distress;
- provide investment capital for projects in outlying regions where capital was scarce; and
- enhance labor/management cooperation by educating workers about the finances of their own enterprises, in which they may become part owners.<sup>8</sup>

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<sup>8</sup> Pierre LaLiberte, "The economic impact of labour-sponsored venture capital corporations: A case study from Quebec," *International Labour Review*, Vol. 137, No. 1 (1998), pp. 47-59.

In South Africa, where labor unions control more than 40 percent of all pension funds in the nation, labor is developing strategies for investing a substantial share of these assets in community development and job creation projects. In a country where unemployment has averaged 40 percent in recent years, such projects can play a major role in stimulating the national economy.

We recommend that

- the administration should request new legislation to authorize the creation of worker-sponsored investment funds. This legislation should also allow and encourage states to offer tax credits or other financial incentives to encourage workers to invest in such funds.

## **Macroeconomic and monetary policy initiatives**

### **1. Contingency planning**

As Chapter 4 shows, as the trade deficit increases, there is a growing risk that the United States will be hit by a financial crisis if foreign investors become concerned about the ability of the United States to finance its trade deficits by borrowing from abroad, or, if the U.S. stock market drops suddenly, there could be a race for the exits as investors rush to sell dollars and move their investments abroad. That would result in a sudden fall in the dollar and possibly an increase in U.S. interest rates.

No one can predict whether or when the crash will come or precisely how markets will react. However, since the risk of a crisis is growing, it is completely irresponsible for the United States to fail to prepare emergency contingency plans and options for government responses. Thus, we recommend the following:

- The U.S. Department of the Treasury and the Federal Reserve Board should establish a planning group that will develop contingency and advance plans for crisis responses. This group needs to determine whether and how our laws provide authority to handle any crises. If our laws are inadequate, the administration should request new legislation quickly that would provide the authority as well as the resources that could be needed. Thus, we need to establish a consensus between Congress, the administration, and the Federal Reserve on appropriate responses to potential crises. We recommend the following:
  - The Federal Reserve must not raise interest rates in a currency crisis. If a crisis occurs, reserves must be poured into the banking system immediately, regardless of inflation and unemployment levels. Previous currency crises in Denmark, Sweden, and the United Kingdom (U.K.) (see Chapter 2) demonstrate that raising short-term interest rates cannot prevent currency depreciation in the long run. However, higher rates are guaranteed to reduce the growth of the economy and increase unemployment.
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- The U.S. Department of the Treasury and the Federal Reserve must determine whether additional "circuit breakers" are needed in the event of significant collapses in asset or currency markets. Will existing limits on the movement of stock prices be sufficient to contain an enduring crisis? Should the Fed consider more direct interventions, on a temporary basis, as a last resort? Should it make such interventions to thwart speculative attacks on the dollar?
- The planning group must consider that Americans may be the first to run for the exits in the event of a financial crisis. Usually, insiders are the first to know when troubles begin with asset sales or corporate earnings. What should be done about transfers by U.S. citizens? Should short-term limits on capital outflows be established? China and India were the only major developing countries in South and Southeast Asia to be unaffected by the 1997-98 currency crisis, and both countries retain severe restrictions on capital inflows and outflows. Again, new legislation would be required to give Treasury emergency authority to impose such controls.
- It may also be necessary to establish short-run controls on capital inflows in order to limit the use of hedge funds and other sophisticated financial instruments that could be used to speculate against the dollar. Such speculation can become a self-fulfilling prophecy, as was the case when private investors forced the U.K. out of the European Exchange Rate Mechanism in 1992.

## 2. Exchange Rate Policies

The United States must confront two important problems with the current exchange rate market and control system. First, as explained in Chapter 2 (causes of the trade deficit), we believe that several countries have used "beggar-thy-neighbor" currency management to artificially depreciate their currencies and create and expand global current account surpluses. Second, the dollar has also become significantly overvalued. Since 1995, it has appreciated by 23 percent. This has made imports cheaper and U.S. exports more expensive, thus increasing the U.S. current account deficit. The general appreciation of the dollar should be a topic of higher visibility and concern to the next administration. We propose several specific policies to correct these distortions and problems:

*Rejuvenate use of treasury foreign exchange reports.* In Chapter 2, we reported on the 1988-92 successes of the Treasury Foreign Exchange Reports and negotiations. The U.S. Treasury Department found sufficient evidence that showed that three countries (Korea, Taiwan, China) were manipulating their exchange rates. Subsequently, the Treasury entered into negotiations with Korea and Taiwan that eventually reduced or eliminated their actions. However, these reports have been less actively used since that early period. Statutory language in the 1988

Trade Act (see Chapter 2) requires that the Treasury publish Foreign Exchange Reports twice annually. However, no reports were published in 1998. Only one report was published annually in 1995, 1996, and 1997.<sup>9</sup> Since 1994, the Treasury Department has not found a single country guilty of "manipulating its exchange rate."

- This Commission believes that it is essential for the Treasury to rejuvenate the use of its biannual reports to Congress on international economic and exchange rate policies. It should also actively identify and initiate negotiations with countries that engage in currency manipulation.

*Risk that China will devalue once it enters the WTO.* Recent news reports suggest that China is actively making plans to "widen the trading bans" and steadily liberalize currency trading, but only after China enters the WTO.<sup>10</sup> This sets the stage for a repeat of a pattern that the United States has seen before. Ever since Canada entered a free trade agreement with the United States in 1989, its dollar steadily depreciated by a total of about 30 percent against the U.S. dollar (1989-- Fall 2000). The process was more abrupt and extreme in Mexico, where the peso crashed and lost more than 40 percent of its value in 1994-95, about one year after it entered the North American Free Trade Agreement. In these cases, devaluation led to deep recessions, surging exports to the United States, and a growing U.S. trade deficit.

If China decides to devalue its currency in order to increase its exports to the United States and thereby further increase its surplus with the United States, we should be prepared to respond directly. Any devaluation should be construed as a signal of nonacceptance of the broad rules of the WTO and the current playing field that reflects America's free trade philosophy. The Chinese government must understand that such behavior is anathema to the spirit of WTO accession and to its permanent normal trade relations status and that swift action by the United States will follow and frustrate any Chinese desire to further stimulate unfair exports to the United States. For this strategy to be effective, we recommend that

- the United States consult with the world's leading trading nations to expand the consultation process. The process would determine whether a devaluation by any of the world's leading trading countries was intended to take advantage of its trading partners in order to build up large, sustained global current account surpluses, or whether the devaluation is likely to destabilize the financial system. This group should also jointly determine the actions that should be taken when currency crises and manipulations occur.

The need for fundamental changes in macroeconomic policies requires, in turn, that the United States make a much stronger effort to coordinate its macroeconomic policies with those of Japan and Europe. Such coordination must encourage those countries to reflate and stimulate their economies, thus building demand for our exports while reducing capital inflows into the United States.

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<sup>9</sup> The Commission staff was unable to locate the reports indicated on the Treasury's web page or in the Senate Library. The Treasury confirmed that the missing reports were not issued, personal communication, phone conversation with Mark Cutler, Treasury Undersecretary for International Affairs (November 27, 2000).

<sup>10</sup> Alan Yonan Jr., "FX Asia: China May Tinker With Exchange System After WTO," *Wall Street Journal* Newswire (October 25, 2000).

### **3. Tax policy**

There are certain provisions in the U.S. tax code that stimulate the movement of productive capacity overseas. For example, the deferral of foreign source income provides an incentive for U.S. multinational corporations to invest their profits outside our borders in productive capacity to avoid paying U.S. taxes.

- Congress and the administration should create a joint study group to examine provisions of the Internal Revenue Code to determine which provisions stimulate the movement of productive capacity outside the United States. Transfer pricing statutes and regulations should be reviewed to determine what impact they have on tax receipts and trade flows. We should also examine other provisions (for example, the research and development tax credit) to determine their impact on our international trade flows and the decision-making of U.S. multinational corporations.

### **Enhanced trade enforcement**

#### **1. Auction quotas**

In certain circumstances, a trade remedy authorized under U.S. law is the use of quotas to limit imports to the United States. Quotas may be imposed to respond to an injurious surge in imports or unfair and predatory trade practices. Quotas may also be imposed through a voluntary restraint agreement, as was the case during the 1980s when there was a dramatic surge in car imports from Japan.

When quotas are first imposed, demand may not drop in relation to the price increases. As a result, the foreign exporter may benefit from "quota rents." For example, in the case of the U.S. voluntary restraint agreement with Japan on auto exports to the United States, Japan's auto manufacturers benefited for a time from higher profits, as domestic consumption in the United States did not decline immediately in response to Japanese price increases. Although production patterns and pricing arrangements did change ultimately in response to quotas, Japanese auto companies gained significant quota rents.

One response to this problem is the potential for quotas to be auctioned to exporters. Thus, any quota rents that arise would flow to the United States. Practiced by certain other countries, quota auctioning is an effective way to ensure that the benefits of trade remedies are appropriately delivered. Implementation of a quota auctioning system could be done easily. The right to export products to the United States could be auctioned off to bidders in certain quantities. Thus, an entity that wants to export a product covered by a quota would have to pay for the right to export. The market would determine the value of the export rights. With some products, a certain volume of exports could be allocated based upon historical sourcing patterns in order to

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prevent a disproportionate impact on exports from lesser developed countries or disadvantaged producers. Quota auctions should be considered for implementation when quotas are determined to be the proper remedy in certain trade actions.

## **2. Explicit and hidden policies that adversely discriminate against U.S. firms, especially in Asia**

Testimony and evidence presented to this Commission have made clear that Japan and China have both failed to provide reciprocal access to their markets in exchange for more liberal rules of access to the U.S. market. The result: highly unbalanced trade and massive bilateral trade deficits between the United States and both countries. In 1999, the deficit with Japan was \$73 billion; the deficit with China stood at \$69 billion. In 1999, Chinese exports to the United States were six times the volume of U.S. exports to that country. We will provide suggestions for addressing the structural causes of these imbalances with new policies and enforcement procedures--measures that should be adopted by the U.S. government.

The United States should take the following steps to address its unbalanced trade relationships with Japan and China:

- Attack barriers to U.S. exports through bilateral trade negotiations and by making credible threats to impose significant sanctions where reciprocity clearly does not exist.

*China.* It is important to note that about half of the U.S. trade deficit today is with two countries: Japan and China. The United States needs to focus its policy initiative on its huge bilateral deficits with those countries, taking into account their structural roots and causes. Japan and China are notorious for their overt and covert trade barriers. They have also practiced extensive currency discrimination for many years (see exchange rate proposals, p.190). For many years, such trade barriers have resisted efforts to enforce trade agreements to increase market access for U.S. goods. Unlike U.S. trade patterns with the rest of the world, U.S. trade with Japan and China has not reflected changes in economic growth rates and other macroeconomic factors. China also maintains high tariff barriers. Meanwhile, both countries have created an extensive network of public and private nontariff barriers to U.S. goods that have contributed substantially to the large, bilateral U.S. trade deficit with each country.

U.S. companies have also experienced huge losses of revenues because of China's refusal to enforce intellectual property rights, which are also the subject of numerous, unenforced trade agreements between the two countries. However, the entire structure of intellectual property rights has become a major obstacle in WTO trade negotiations. The developing countries agreed to accept and enforce developed country proposals for intellectual property rights standards. This has resulted in billions of dollars of payments from poor developing countries to

firms in the United States and the European Union. Developing countries also insisted that changes to intellectual property rights standards must be included in the next round of WTO negotiations. This was a major reason for the failure of the Seattle round.

- China has maintained both high tariffs on U.S. goods and high levels of regulatory obstacles to block the access of U.S. goods to the Chinese market. In addition, the Chinese government's severe restriction of workers' rights to organize has kept wages low and produced artificially low prices for Chinese goods. Although China has agreed to reduce or eliminate many tariffs on manufactured goods and commodities, it has recently begun to backslide on its WTO commitments. The United States and the WTO should not allow China to avoid promises it made in return for its accession to the WTO. Furthermore, China should not be allowed to erect further nontariff barriers to replace and enhance the tariffs that are being eliminated.
  - The use of government subsidies is another significant form of nontrade barrier that U.S. producers face in both Japan and China. For example, the high level of government ownership in Chinese industries has often involved channeling subsidies to firms to artificially depress the prices of Chinese export goods. Either state and local ownership of firms should be quickly phased out, or new mechanisms should be put in place to offset the resulting distortions to the market (see proposal for the Japanese auto parts sector below).
  - The U.S. Department of Commerce and a new Congressional Trade Office (see below) should carefully track Chinese compliance with the specific terms of the accession agreement if China enters the WTO, as well as other agreements that the United States has signed with them. In addition, more specific tracking mechanisms need to be put into place with our other major trading partners, particularly Japan, Mexico, and Canada, as well as some countries in the European Union that have significant unfair trade practices.
  - Specifically, the United States should identify country-by-country priorities and timetables to remove specific trade barriers and anticompetitive practices.
  - The United States should also establish broad goals for stabilizing and then reducing the deficit for the countries listed above, and we should implement policies needed to achieve these goals.
  - The administration should identify the specific economic and noneconomic leverage (i.e., the full range of our sovereign tools) that should be used in bilateral relations and/or multilateral forums to influence countries to abandon market entry barriers, and trade and investment policies and practices that also limit U.S. exports.
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*Japan.* Although tariffs facing U.S. exports in Japan are relatively low, the actual level of protection that blocks access to the Japanese market is substantial. This is because of nontariff barriers such as regulatory obstacles and discriminatory treatment of U.S. goods. For example, in 1995, the Institute for International Economics published a study that calculated the implied margin of protection that keeps imports out of Japan. They estimated that Japan's invisible protection for machinery imports was the equivalent to an average tariff of 140 percent. With this amount of invisible protection in place, it is clear that U.S. industrial producers have great difficulty exporting their products to Japan. Regulatory trade barriers have allowed the Japanese government to target and substantially block imports of U.S. telecommunications, automobiles, and auto parts. In addition, highly subsidized agricultural production in Japan has blocked U.S. agricultural exporters whose goods would otherwise be highly competitive in the Japanese market. The United States has entered into dozens of trade agreements with Japan, most designed to open the Japanese market to U.S. exports and FDI. Meanwhile, the Japanese market remains closed to most U.S. goods and investors. Only 53 percent of those trade agreements have been implemented successfully.<sup>11</sup> The United States should target Japan for a special set of treaty monitoring and enforcement actions. In particular, it should

- set explicit, measurable goals and targets for increases in U.S. exports, FDI, and market access in Japan. Performance-based trade policies are the only types that have ever had a significant impact on U.S. market access and exports to Japan.<sup>12</sup>

### **3. Continued and enhanced enforcement of antidumping and subsidy laws**

We unanimously reject the other Commissioners' proposal to eliminate U.S. antidumping and countervailing duties laws. We believe this view fails to acknowledge the crucial roles played by (1) other countries' protected home markets; (2) noncompetitive market and institutional structures in place in many countries worldwide; and (3) the damage that is being done to a wide range of capital-intensive industries in the United States – once capacity is lost, it is seldom, if ever, replaced (a process that economists refer to as “hysteresis”). We offer two specific proposals that illustrate the kind of legal reforms that are needed. However, much more will remain to be done, especially to correct procedures that adjudicate dumping cases in the United States.

*Improved dumping and subsidy offsets.* In the past, under law, when the United States imposed antidumping or countervailing duties, any amounts collected are paid into general revenue. U.S. law should be changed to allow for duties to be paid to the petitioners for appropriate expenditures, if dumping or countervailable subsidies continue after there is an order that imposes duties. If our competitors continue their unfair practices, those who are being injured should be able to receive relief. This can be done without altering current dumping and subsidy injury determinations or methodology.

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<sup>11</sup> Source: U.S. Chamber of Commerce of Japan.

<sup>12</sup> See Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High-Technology Industries* (Washington, D.C.: Institute for International Economics, December 1992). See especially Chapters 3 and 4, pp. 53-154, particularly the case studies of the MOSS talks in technology-intensive products, Cray and the supercomputer market, and the U.S. Japan semi-conductor agreement.

For two reasons, this approach should help ensure that these unfair practices do not occur in the first place: our competitors will know that their activities will not undermine the long-term strength of our industry, and they will not be rewarded for their dumping or subsidies with increased prices and profits from the U.S. market.

Today, competitors can prey on U.S. industry with the knowledge that any damage they inflict could seriously undermine its competitiveness. Under this approach, injured domestic producers would be compensated if dumping or subsidies are continued. Continuing unfair imports will result in penalties that are paid to the injured parties and enable them to retool, reinvest, and stay in business. Furthermore, it will help ensure that the employees do not pay the price with diminished wages or the loss of jobs and that unfair competitors do not profit from their unfair practices. Therefore, we recommend that

- U.S. law be changed to allow for assessed antidumping and countervailing duties to be paid to the petitioners for appropriate expenditures. Under the proposal, collected antidumping and countervailing duties could be used to reimburse domestic producers for investments in the following categories: (1) plant, (2) equipment, (3) research and development, (4) personnel training, (5) acquisition of technology, (6) pension benefits, (7) health care benefits, (8) acquisition of raw materials and other inputs, (9) borrowed working capital needed to maintain production, and (10) environmental equipment or technology.

## **New agency to self-initiate unfair trade cases**

Antidumping and countervailing duties (subsidy offset) laws provide effective protection for domestic producers where foreign producers charge less for products sold in the United States than in their home or other third-party markets, or where governments subsidize capital, research, or production costs. These policies are particularly important for preventing the abuse of competitive producers in high fixed-cost, capital-intensive industries.

Many countries restrict access to their home markets in such industries through formal and informal trade barriers. In addition, there are also very credible allegations that there are world cartels in a number of basic commodities (for example, steel and aluminum) that further reduce competitive pressures for cartel members. In the case of steel, the United States is the only major producer that has not agreed to participate in these cartels.

Such restrictions allowed producers in the recent Japanese antidumping case (for hot-rolled steel) to charge prices in their home market that were about 35 percent below those in the United States (net of tariff and transportation costs).<sup>13</sup> The steel industry has filed many antidumping and countervailing duties cases since 1998, when the financial crises in Asia and other regions caused exports to the United States to surge and import prices to drop sharply.

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<sup>13</sup> U.S. International Trade Commission, Investigation Nos. 701-TA-384 and 731-TA-806-808 (Final) "Certain Hot-Rolled Steel Products From Brazil, Japan, And Russia," Final decision reached in June 1999.

Despite the filing of numerous fair trade cases, total employment in blast furnaces (SIC [Standardized Industrial Classification] 331) fell by more than eight thousand workers, or 2.8 percent through August of 1998.<sup>14</sup>

Imports in other industries have also surged since 1998, and observers have suggested that their products are also being dumped in the U.S. market. However, for several reasons, many of these industries have not filed antidumping complaints. Consider the machine tool industry, which has also been hit by a surge of cheap imports. This industry is highly fragmented, at home as well as abroad. Antidumping cases are very expensive to file and litigate. Few machine tool producers can afford to pay for them. Furthermore, there is a growing presence of foreign-owned machine tool manufacturers and distributors in the United States. Thus, the structure of the industry prevents them from using fair-trade laws when they may be entitled to protection from unfairly traded imports. Therefore,

- we recommend that Congress and the administration establish an independent agency that would be charged with self-initiating and litigating antidumping and other types of unfair trade cases when there is a clear national interest in defending industries that are unable to protect their own interests.<sup>15</sup> This agency should use its authority to safeguard the competitiveness of U.S. manufacturers when they are confronted with unfair competition from imports.

This new agency would greatly increase the number of government-initiated trade cases.

#### **4. Executive branch trade reorganization**

We believe that the government needs enhanced capabilities for monitoring industrial performance, trade, and investment, and their implications for working people, national income, and the balance of payments.

In order to strengthen the monitoring of and compliance by our trading partners, we must improve the process and elevate its profile and the resources allocated to this task. A strengthened system would include process changes, resource reallocation, and organizational changes at the Department of Commerce, the Office of the U.S. Trade Representative, and the interagency trade policy process. The Office of the U.S. Trade Representative is charged with leadership in trade policy; that leadership should include promoting enhanced monitoring and enforcement. Currently, an interagency Trade Policy Review Group coordinates trade policy formulation. However, there is no interagency group that is charged with monitoring compliance with trade agreements. Thus, there is a potential for enforcement efforts to be poorly coordinated and to suffer from ineffective oversight by senior, policy-making officials.

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<sup>14</sup> Employment measured on an annual average basis, using data that are not seasonally adjusted. Source: Bureau of Labor Statistics, National Employment, Hours and Earnings homepage: <http://stats.bls.gov/sahome.html>

<sup>15</sup> This office could not be located in the offices of the U.S. Trade Representative (USTR), Department of Commerce, or the USITC. The USTR is responsible for negotiating new trade agreements that could change U.S. trade laws, and Commerce and the USITC are both responsible for adjudicating unfair trade cases.

- We recommend that the President elevate the status of monitoring and compliance with in the Office of the U.S. Trade Representative by upgrading the present position of the Assistant U.S. Trade Representative for Enforcement and Monitoring to deputy status, and providing a commensurate increase in resources need to greatly expand enforcement activities. This deputy USTR should be responsible for preparing cases for WTO dispute settlement.
- We recommend the formation of an interagency Trade Monitoring and Compliance Group, chaired by the Undersecretary of Commerce for Monitoring and Compliance. Group members would have an agency composition similar to the Trade Policy Review Group.<sup>16</sup>
- The Department of Commerce should raise the profile of industrial monitoring and development. Commerce should establish separate offices (none exist today) for all of the major industrial groups such as primary metals and transportation equipment and also major subgroups such as blast furnaces, basic steel products, motor vehicles, and aircraft and aircraft parts. These offices should also have the authority to prepare with labor and industrial representatives sector-specific plans for raising industrial output, employment, and productivity growth.

## **5. The U.S. response to specific attacks by foreign governments on U.S. sectors or industries**

The United States should take unilateral action to specifically respond to a focused, direct attack by a foreign government on an American industry or sector. In this section, we examine two sectors, film production (government subsidies), and auto parts (nontariff trade barriers) to highlight some of the different kinds of attacks that are made on U.S. industries.

**Film production.** A specific case in point was examined in the Commission's New York City hearing on the state of the American film production industry. Witnesses made a convincing case that the federal and provincial governments of Canada are providing substantial tax subsidies to induce American film production companies to relocate to Canada. The extent of the subsidy is so large that the lost production that has been documented amounts to (a) billions of dollars annually and is growing, and (b) has resulted in the creation of a vast infrastructure of film production in Canada that has almost entirely been created by American companies induced to go to Canada. Thousands of actors and support personnel directly employed by the industry have lost their jobs because of these government subsidies, and the indirect impact on businesses and industries that have supported the industry amounts to additional hundreds of millions of dollars. For 1998, the estimated impact was \$2.8 billion, a figure that directly adds to the bilateral trade deficit between the United States and Canada (for 1999, it amounts to over 5 percent of our merchandise deficit with Canada).

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<sup>16</sup> Members should be from the Undersecretary/Deputy Trade Representative level from the following agencies for whom relevant issues are being discussed. For example, the following departments and agencies could be represented: Commerce, Agriculture, State, Treasury, Labor, Justice, Defense, Interior, Transportation, Energy, Health and Human Services, Environmental Protection Agency, Office of Management and Budget, Council of Economic Advisors, International Development Cooperation Agency, and the National Security Council.

- These tax subsidies are a classic example of an unfair trade practice. The United States should take appropriate bilateral action to nullify the artificial government inducement. The Commission recommends that
  - The State Department provide a démarche to the government of Canada demanding the elimination of the subsidies.
  - If Canada fails to dismantle its policies, legislation should be enacted that would provide subsidies to the American film production industry that are at least equivalent to those provided by Canada. Commission testimony indicated that American film producers do not desire to relocate to Canada, but the economic differential between costs in the United States and in Canada were so large, investors and financial planners insisted on the relocation.

Such behavior will only be curtailed when foreign governments begin to believe that the United States is willing to take strong action to curtail attacks or predatory practices toward American industries

**Auto parts.** The United States has been negotiating market-opening agreements in this sector with Japan since the late 1970s. The Carter administration negotiated the first such agreement in 1980. Yet, the United States had an auto parts trade deficit of \$9.7 billion with Japan in 1998. In testimony before the Commission, Ronald Cutler, chairman of the U.S. Auto Parts Advisory Committee, explained the causes for this deficit, despite two decades of trade negotiations and market access agreements with Japan:

*Japan's economy is entangled in web-over-web of regulatory controls; nontransparent administrative guidance procedures; bank loan failures; exclusionary keiretsu relationships and other market access barriers. ... In particular, the exclusionary practices of Japanese-keiretsu groups linking vehicle parts and vehicle manufacturers in Japan and the U.S. continue to tilt the field and make it very difficult for U.S. suppliers to expand business with Japanese auto makers in all major world markets, despite U.S. industry competitiveness and continued leadership in the newest high-technology areas.*<sup>17</sup>

As noted in the earlier recommendations, quantitative targets and restrictions are particularly well suited to Japan's tight institutional structure. For these reasons, we recommend the following policies for managing auto parts trade with Japan.<sup>18</sup>

- Establish and monitor progress toward specific, deficit reduction goals with Japan on a sector-by-sector basis until Japanese global and bilateral surpluses with the United States and the world are substantially reduced or eliminated.

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<sup>17</sup> Testimony of Ronald Cutler, before a hearing of the Commission held on November 16, 1999, in Seattle, WA, "US-Asia Trade and Market Access," prepared statement, p. 2.

<sup>18</sup> These are based on two of the recommendations made by Ronald Cutler and the Auto Parts Advisory Committee, *ibid.*, p. 6.

- Identify additional leverage that can be employed in bilateral and/or multilateral negotiations to convince Japan either to reduce its market access barriers in auto parts and other key sectors or take action to offset the impact of those barriers. Japan must either modify the institutional structures of its economy or set up mechanisms to offset the harm they cause other industries worldwide.

## **New rules for the global trading system**

### **1. Including labor and environmental standards in bilateral and regional trade agreements**

The Democratic Commissioners place great importance on the role of human factors in assessing the causes and consequences of the trade deficit and the necessary policy responses. This is exemplified in the Democratic Commissioners' emphasis on labor rights, human rights, and environmental concerns and the growing inequality of income in the United States. The Democratic Commissioners believe that we need to establish new rules for the global economy that promote and protect the human values that Americans support.

We believe that the next administration and the U.S. Trade Representative should make the inclusion of enforceable worker rights and environmental standards in the core provisions of trade agreements its top priority in future trade negotiations. Also, the United States should seek to renegotiate all significant signed trade agreements (those that apply to more than \$100 million in trade annually) to include labor standards. In addition, the process through which those agreements are negotiated must be improved by including more complete and public assessments of their likely impact and consulting much more extensively with Congress and key interest groups throughout society.

The recently completed U.S.-Jordan Free Trade Agreement is a good example of how this kind of process can produce much better agreements for all parts of society. It includes path-breaker language on labor rights. The key labor rights clause (Article 6) states:

*The Parties reaffirm their obligations as members of the International Labor Organization ("ILO") and the commitments under the ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up. The Parties shall strive to ensure that such labor principles and the internationally recognized labor rights set forth in paragraph 6 are recognized and protected by domestic law.<sup>19</sup>*

Article 6 lists five of the most important core labor standards: "The right of association; the right to organize and bargain collectively; a prohibition on any form of forced or compulsory labor; a minimum age for the employment of children; and acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety." Ironically, this standard may impose

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<sup>19</sup> Agreement Between the United States of America and the Hashemite Kingdom of Jordan on the Establishment of a Free Trade Area, U.S. Trade Representative's home page: <http://www.ustr.gov/regions/eu-med/US-JordanFTA.shtml>.

more of a burden on the United States than it does on Jordan; the United States has only formally endorsed two of the standards, while Jordan has endorsed them all. The key clause on the environment (Article 5) requires that

*[T]he Parties recognize that it is inappropriate to encourage trade by relaxing domestic environmental laws. Accordingly, each Party shall strive to ensure that it does not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such laws as an encouragement for trade with the other party.*

The process for negotiating this agreement was also path breaking. Extensive consultations occurred with representatives of many nongovernmental organizations, including U.S. labor unions as well as the USTR's permanent sectoral business advisory groups. In addition, unlike in some previous U.S. trade agreements, a "Draft Environmental Review" of the proposed agreement was prepared as part of the negotiations rather than after the agreement was completed.

Given the difficulties in achieving progress in the WTO on labor and environmental rights, we believe that it may be easier for the United States to make progress on these issues in bilateral and regional trade negotiations (such as the proposed Free Trade Agreement of the Americas). For these reasons, we recommend that

- the U.S. government make the inclusions of labor and environmental standards that are enforceable through trade sanctions a top priority in all future U.S. trade agreements. In addition, the USTR should attempt to revise previous significant trade agreements to include enforceable labor and environmental standards.

A commitment to making labor rights and environmental standards the top U.S. trade negotiating priority can help level the playing field for workers in the United States and worldwide vis-à-vis the U.S. multinationals that are taking advantage of unfair wages and working conditions in the poorest developing countries.

## **2. Blue and green 301**

Section 301 of U.S. trade law is one of the main provisions that are used to address foreign unfair trade practices. Through the 1980s and early 1990s, it was one of the principal tools for prying open foreign markets. Section 301 is viewed by many as one of the levers that forced our trading partners to the negotiating table for sessions that led ultimately to the completion of the Uruguay Round of multilateral trade negotiations. Our trading partners understood that the United States would not allow its right to export goods to their markets under the General Agreement on Tariffs and Trade to be violated and would use unilateral actions to address the most egregious market barriers. Therefore, they chose to negotiate multilateral rules. In exchange for eliminating the use of unilateral penalties in 301 cases by the United States, they agreed to be bound by the WTO's dispute resolution procedures or face potential U.S. action.

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A similar approach should be taken with regard to labor and environmental standards. Clearly, the labor and environmental standards and the enforcement activities of other nations have an impact on trade flows and the advantages each party receives. Countries that fail to enforce their own laws may reduce market opportunities for U.S. products through diminished living standards in their countries, attract investments through lax environmental regulatory enforcement, and put downward pressure on U.S. wages (as Bronfenbrenner's research for the Commission so clearly shows) and environmental standards. Thus, it should be emphasized that section 301 of our trade law should be used to fight these actions.

- The administration should require the Department of Labor to compile an annual report – similar to the annual human rights report issued by the State Department – on nations' compliance with their own laws and internationally recognized workers' rights. They should also examine practices that may diminish our trading rights and recommend action by the USTR. The Environmental Protection Agency should do the same with respect to environmental issues.

### **3. Expand ILO review activities**

For several reasons, we disagree with the other Commissioners' analysis of the ILO and its desired role in the world trading system. First, the other Commissioners argue that the WTO lacks the competence and experience to deal with labor issues. There is nothing to prevent the WTO from becoming involved and gaining the requisite experience.

Secondly, because the ILO is a tripartite organization, as explained in the Republican Commissioners' viewpoints, it is fundamentally weaker than the WTO, which is a multinational agency, with the full regulatory powers that status implies. Decisions made in the ILO often represent the lowest common denominator among available policy options, because of the need to find consensus among the three partners: business, government, and labor. This helps explain why organized labor has filed so few cases at the organization in the last ten years, as noted by the other Commissioners.

A much better proposal would be to use the ILO to determine whether core labor standards had been violated by any company or country, and then pass responsibility for enforcement to the WTO. This is analogous to the procedures used in antidumping cases in the United States, where the U.S. International Trade Commission determines whether injury has occurred, and the Commerce Department determines the appropriate remedy. In this case, the evaluation of whether a labor standard has been violated will be determined by the excellent technical staff of the ILO, which is not subject to the limits imposed on policy-making by the ILO's tripartite structure.

#### 4. Beware “modernizing 201”

The Republican Commissioners put forth a group of proposals to improve laws that protect industries from import surges. In substance, these are rather mild-sounding proposals that would improve the process of filing and settling section 201 (import surge) trade cases; they are also intended to encourage U.S. industries to use surge protection in cases where dumping has taken place. This is proven by their final proposal, which suggests that the United States indicate its "willingness" to "eliminat[e] ... antidumping laws." In other words, the United States would offer up U.S. antidumping laws as a concession that could be used in trade negotiations. We have already indicated above the reasons for our opposition to this particular proposal.

While import surge laws can be useful in some circumstances, they have several drawbacks relative to other fair trade measures. First, despite the fact that section 201 and WTO surge provisions technically allow for up to eight years of import relief, the maximum is usually three years, four in a few special cases. This is because the United States and other countries are required to offer compensation (usually some kind of improved import access to another U.S. market) if the relief extends beyond three or four years.

Secondly, section 201 relief (quotas or tariffs) must be rapidly phased out during the relief period. Thus, the relief is usually effective for only a year or two. However, antidumping relief is provided for a full five-year period and may be extended (at no cost to the United States) after a review, if there is sufficient evidence that dumping and injury would recur.

Finally, in practice, the President almost always exercises his authority to review and negotiate actual surge policies after the USITC has completed a case and proposed a remedy. Usually, the President reduces the amount of relief that is to be awarded. Hence, the benefits of surge relief are much less than those offered by other fair trade remedies. In addition, presidential review may and has exceeded the time allowed and therefore may cause additional delay. Indeed, it is because of the delays inherent in the existing trade laws that expanded authority to use injunctions for violations of our trade laws has support from some Commissioners. Although we endorsed above the use of auction quotas (where appropriate) and do not have significant reservations about the Republican Commissioners' other proposals to "expedite" and improve the 201 processes, we think that the benefits of these changes will be quite limited. We think that it is much more important to preserve and enhance the enforcement of U.S. antidumping and antisubsidy rights.

## **5. Review of WTO dispute resolution decisions involving interests of the United States as a party**

An American review body should be created, by legislation, to review WTO panel decisions on cases involving U.S. interests or where the United States is a party, comprised of trade experts from academia, former trade officials and trade practitioners, labor groups, and industry, and to report its findings regularly to the oversight bodies of Congress and to the President.

- A U.S. advisory council should be established to review WTO dispute settlement panel decisions involving the United States as a party. The panel should be composed of U.S. trade law practitioners, academic international trade specialists, former trade officials, labor groups, and industry.

The advisory council should review each WTO dispute settlement to which the United States is a party. It should offer an assessment (which may contain minority views) on the effect of such decision on the short- and long-term economic health of the United States and on particular industries. It should monitor and report on the level of compliance by other parties in cases where the United States is the winner and the other party is required to take action or pay compensation to the United States. The council may take into account the history of previous and related WTO dispute settlements and may attempt to predict the overall trend of WTO dispute settlements affecting the United States. After each settlement review, council assessments should be offered to the congressional leadership in both houses and to the President.

## **6. Severance taxes for runaway production**

It is clear that a more aggressive program for worker training and adjustment assistance (including firm and community adjustment assistance) needs to be implemented to address the dislocations in the U.S. economy. As Chapter 5 indicates, the United States should implement a "triggerless" adjustment program and overall policy that assists those who lose their jobs – whether from trade, technological change, or any of a number of other causes. Those who find themselves in need of adjustment assistance should not be forced to follow a labyrinthine path to determine their eligibility. Rather, a program should be developed that provides immediate assistance in order to restore family income as soon as possible.

Over time, such an adjustment program could entail significant costs. As part of the effort to defray them, Congress and the administration should analyze the need and appropriateness of imposing severance taxes on business entities that relocate their facilities outside of the United States. Adopting severance taxes could help to fund a program to assist the dislocated. It could also potentially act as a "speed bump" in terms of businesses seeking to relocate their operations. As companies do a cost-benefit analysis of whether they should move their opera-

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tions, it may be appropriate to require them to factor in a portion of the costs of assisting the adversely affected. As part of this analysis, one should examine whether state or federal inducements or subsidies have been offered to maintain or attract business development. One should also look at whether recouping part or all of those inducements might be appropriate to help defray the cost of adjustment assistance.

## **Improved oversight, monitoring, compliance, and enforcement of our trading rights and agreements**

### **1. Congressional trade office**

We also endorse the proposal to establish a Congressional Trade Office

"Congress shall have the power (...) to regulate commerce with foreign nations."<sup>20</sup>

The framers of the U.S. Constitution placed sole authority for the development of trade policy and the regulation of foreign and interstate commerce in the hands of Congress. Congressional efforts to carry out this mandate are hampered by a splintered framework for handling trade issues and limited resources to do so. Committees with primary jurisdiction for trade issues cannot address the increasingly broad array of issues that are now inherent in U.S. trade policy. Consequently, trade bills can be referred to several committees in both houses of Congress.

But there is nothing that ensures that every committee has adequate information or analytical resources to assess the bills. Section 332 of the Tariff Act of 1930 allows the Senate Committee on Finance and the House of Representatives' Committee on Ways and Means to request that the International Trade Commission conduct an investigation. Other committees do not have the same direct access to the ITC, which has the largest staff with trade expertise among the agencies that are charged with congressional support.

- We strongly recommend the creation of a nonpartisan Congressional Trade Office modeled after the Congressional Budget Office. Its purpose would be to provide Congress with trade data and analysis, activity that would support Congress in fulfilling its constitutional responsibility to regulate foreign commerce and oversee the conduct of trade policy. Like the Congressional Budget Office's, the reports of this new office should not recommend specific actions, but they should provide reliable and authoritative analysis of alternative policies.

In addition, we also believe that the Congressional Trade Office needs a slightly broader mandate. Representatives from the Congressional Trade Office should also participate in all future U.S. trade negotiations. They should also act as a liaison between U.S. trade negotiators and Congress.

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<sup>20</sup> U.S. Constitution: Article I, Section 8.

## 2. Annual report from Commerce

Monthly, quarterly, and annually, the U.S. government publishes tens of thousands of statistics that detail and summarize the U.S. goods and services trade, the current account, financial and direct investment flows, and other trade-related information. Yet, learning about and assessing the nation's trade performance from these disparate statistics is a formidable task that deters all but professionals and the most determined individuals.

Thus, there is a need for an information source that pulls together relevant data from the various government agencies and summarizes, interprets, and explains it in nontechnical language. Such a report would not only be useful to the public but also to Congress and state governments.

- We recommend that the Commerce Department's International Trade Administration annually publish a report that provides a comprehensive analysis of the prior year's external transactions. The report should establish a U.S. performance base and examine trends and changes in merchandise trade, business services trade, and other components of the current account and relate that performance to global trade and investment flows. The report should provide reasonable detail about the product and the geographic composition of both the goods and services trade. For example, performance and trends in auto, aircraft, computer, steel, telecommunications equipment, and other major goods product groups should be described and assessed. A similar decomposition of the services trade and role and the performance of its major components should also be provided.<sup>21</sup>
- The report should also provide separate analyses or chapters about the impact of trade on the distribution of income and wages, labor rights, and communities. It should estimate by income group the costs and benefits of trade to the United States and to its workers.

## 3. WTO--new round?

Even before the Uruguay Round of multilateral trade negotiations was completed (which formed the foundation for the World Trade Organization), member countries were discussing which issues would be handled in a new round. During the Uruguay Round, several were either not addressed at all or were incompletely addressed. Accordingly, there has been increasing pressure to address these issues – and new ones – in multilateral negotiations.

In Seattle in 1999, ministers and heads of state that represented WTO members met to try to develop an agenda for a new round and to begin the long, arduous process of reaching a new multilateral agreement. For various reasons – including enormous public pressure; lack of a

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<sup>21</sup> The publication series "United States Trade: Performance In [year] and Outlook," published annually by the International Trade Administration, U.S. Department of Commerce, for the years 1983 through 1988, provides a useful model of the kinds of information that would be of value.

consensus on an agenda; the intransigence of the European Community, Japan, and other countries on issues related to agriculture and other areas – the Seattle meeting ended in failure.

The Commission as a whole was split on whether or not to call for a new round. Half of the Commission believed that it was important to begin negotiations for a new round of multilateral trade talks as soon as possible. We believe that it would be unwise to rush ahead. We think it is important first to assess whether previous commitments reached in the Uruguay Round and through prior agreements are being implemented, and what steps, if any, should be taken to ensure compliance with them.

Additionally, we believe it is important to expand the agenda for negotiations to ensure that worker rights and environmental issues are appropriately addressed. Indeed, Congress, as part of the implementing legislation for the Uruguay Round, called on the administration to push at the WTO for the formation of a working party on worker rights that would lay the groundwork for addressing these important issues. There will not be public support for moving forward until the broad range of U.S. interests are put on the negotiating agenda.

#### **4. Assessment regarding implementation activities**

The USTR's office claims that almost three hundred trade agreements have been signed during the Clinton administration. These run the gamut from product-specific agreements with a single country to comprehensive, multilateral agreements such as the General Agreement on Tariffs and Trade's Uruguay Round, which covered a broad range of sectors for trade among more than one hundred countries. Yet, during this period, despite the benefits proclaimed at the signing of the agreements, the U.S. trade deficit has continued to rise. Many of the expected benefits have failed to materialize.

In 1997 and 1998, Congress rejected President Clinton's request for fast-track negotiating authority. It did this partly because many members of Congress were dissatisfied with the progress of trade agreements. Indeed, after editorializing about the importance of admitting China to the WTO in the summer of 2000, the Washington Post indicated just a few months later that it was concerned about China's potential failure to meet the terms and conditions of the accession agreement that the Chinese had been negotiating.

Monitoring and enforcement of current trade agreements is vital – not only to ensure that the agreement benefits are actually achieved but also to develop greater public support for the U.S. trade agenda.

- Before aggressively engaging in new trade negotiations, it is important that the United States– with oversight by Congress – review trade agreements that are currently in force and determine whether and how they have been implemented by U.S. trading
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partners. The Congressional Trade Office proposed above should prepare this report. It should include an inventory of implementation activities, and it should be compiled with input from the private sector, nongovernmental organizations and others. The report should be publicly released and subject to congressional hearings.

## 5. Market access initiatives

It is clear that market access impediments continue to plague our farmers, workers, and businesses. Each year, the USTR publishes the National Trade Estimates – essentially a catalog of the market barriers and unfair trade practices around the globe. The year 2000 report exceeded more than four hundred pages and described global barriers blocking U.S. products.

At the Commission's hearings, which were held around the United States, a number of business leaders, economists, labor officials, and other witnesses described how barriers affected their ability to export products. Clearly, if the American people are going to be asked to take the tough steps that are required daily to maintain and increase U.S. competitiveness, they need assurance that they will have a fair chance to export their products. Public support for further trade liberalization is dependent on increasing public confidence that trade is not just a one-way street where other nations enjoy virtually unfettered access to the U.S. market while they are able to protect their own markets from U.S. competition.

While the Department of Commerce and the USTR have expanded their trade compliance and monitoring efforts, much more needs to be done. Those efforts are directed at ensuring that prior trade agreements and commitments are evaluated. They also recommend further actions to address noncompliance. However, the administration must aggressively begin to reduce the backlog of trade complaints and existing market barriers that face U.S. products and services. Super 301, that section of the 1988 Omnibus Trade Act that sought to prioritize U.S. activities with regard to responding to unfair trade practices, is no longer in force. We recommend that

- Congress review Super 301 and reenact it with whatever changes are necessary to ensure that the administration pursues the most egregious market access impediments expeditiously.

As part of this effort, Congress should consider expanding the tools that are available to the administration so that they include reciprocal action to respond to foreign trade barriers. The President could have limited advance authority to respond to foreign trade barriers by implementing reciprocal practices here. Often, a trading partner will indicate that its practices are not meant to prefer domestic industry to foreign competitors.

- In instances such as these, the administration should have the flexibility to determine whether the foreign practices should be implemented here in the United States. It is
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unlikely that the target country would seek to bring an action at the WTO, as they would be calling into question their own practices and activities. Reciprocal action should only be evaluated as a tool to pressure other countries to change their practices and not to create an escalating trade confrontation.

Additionally, the administration should evaluate its budget to determine whether there are adequate resources to identify potential market access opportunities in foreign markets.

- The budget for the U.S. Foreign and Commercial Service should be increased to provide for additional personnel and resources in those countries that could provide the greatest opportunity for U.S. exports. Emphasis should be placed on advocacy services to assist U.S. businesses as well as on the identification of sales opportunities through government and private sector contacts. The U.S. Foreign and Commercial Service should give Congress additional recommendations for fulfilling its mission most effectively.

## **6. Performance-based trade**

As has been noted in several report sections, approximately three hundred separate trade agreements have been reached during the Clinton administration. Yet, our trade deficit continues to skyrocket. And the results of many of these trade agreements are difficult to discern.

Part of the problem can be attributed to U.S. trading partners' failure to comply with agreement terms. Part of this is attributable to the difficulty of tracking specific trade flows and actions that have followed upon the implementation of agreements. Part of the problem may be the structure and specific commitments that are contained in the trade agreements themselves. Performance-based trade initiatives may be appropriate to counter intractable market barriers and long-term problems.

Performance-based trade initiatives can take many forms. For example, in the semiconductor market access agreement reached between the United States and Japan, there were specific targets for determining minimum compliance levels with the intent of the agreement. The Japanese and the United States, in reviewing compliance efforts – and achievements – in implementing the commitments in the agreement, regularly reported foreign market share of U.S. semiconductor producers. Other performance-based trade initiatives with Japan have included similar approaches for identifying yardsticks that determine whether success was being achieved.

It is important to design these measures to ensure that they act as a minimum level of access, not as a ceiling on U.S. exports. While numerical or market share approaches may be appropriate in certain instances, other approaches that evaluate not only the amount of market access but also the quality of that access might also be advantageous to U.S. national interests. No

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one formulaic approach should be pursued. Rather, U.S. negotiators should seek to conclude agreements that will achieve real results.

## **Wage insurance, training and adjustment assistance**

Joint Chapter 5 calls for a more comprehensive approach to training and the adjustment assistance needs that result from economic dislocation. In the past, not only has there been a limited program design with respect to this issue, but also the funding needs of the programs have often not been met. We need to prepare for the changes that are constantly occurring in the U.S. economy in a way that builds public confidence so that people believe there will be a program to assist them they are adversely affected.

Too often, funding has been an impediment to assistance. For example, funding for Trade Adjustment Assistance has often been an afterthought to trade agreements. Though such funding has been viewed as a necessary cost of achieving congressional passage, the goal has been to fund the program at the lowest level necessary for support.

Other adjustment issues also have been raised in the past. For example, during the NAFTA deliberations, there was extensive discussion about the need to address environmental and other infrastructure needs along the border. Nonetheless, inadequate resources have been provided. As development along the border has increased, many problems have simply gotten worse. While we endorse the joint proposals of Chapter 5, we also support the following recommendation:

- Congress should examine the prospect of devoting tariff revenues associated with new trade agreements to a fund that would cover many adjustment costs. Since the cost of adjustment should be highest in the early years, the stream of revenue from tariffs – which will diminish over time as tariffs are reduced – should decline with the costs of adjustment assistance. However, this will not eliminate the need for other funding sources or budget allocations.

## **D. Summary and conclusions**

We identified three major goals for U.S. trade policy:

*Ensuring a high and rising standard of living for all Americans.* New trade policies are needed to close the gap between upper-income families and the bottom 80 percent of the labor force, who have been working harder for less for nearly three decades.

*New rules for the global economy that improve global labor and environmental standards, and their enforcement.* The time has come to develop a global new deal that will rein in the excess-

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es of multinational corporations, governments, and international institutions in promoting forms of globalization that turn a blind eye to inequality and injustice.

We propose a wide variety of new policies that can help reduce the trade deficit while reducing the threat of a significant economic downturn due to our increasingly unsustainable deficits.

Specific policy proposals include the following:

- *Measures to increase manufacturing competitiveness.* We propose to substantially increase federal research and development spending but suggest that future spending be tied to guarantees that the research will increase U.S. employment and output. We also recommend new programs to channel capital to small- and medium-sized enterprises, enhance trade promotion, and promote labor-sponsored investment funds.
  - *Macroeconomic and monetary policies.* Here we recognize that the United States is in critical need of crisis contingency plans and guidelines for monetary policy in the event a crisis should occur. Also included are policies to correct exchange rate manipulation and eliminate tax incentives that subsidize runaway shops.
  - *Enhanced trade enforcement.* These policies will attack hidden and nontariff barriers to U.S. exports in countries such as China and Japan, provide for enhanced enforcement of antidumping laws, including creation of a new agency to self-initiate fair trade complaints, and measures to reorganize government trade activities.
  - *New rules for the global trading system.* In this section, we begin by praising the administration for breaking new ground on labor and environmental standards in the U.S.-Jordan Free Trade Agreement and suggest that enforceable labor and environmental standards should be included in trade agreements. We are opposed to using import surge law (section 201) in place of antidumping proceedings. We also endorse recent proposals for a permanent committee to review WTO decisions involving the United States, and also severance taxes to limit runaway corporations.
  - *Improved oversight, monitoring, compliance, and enforcement of our trading rights and agreements.* We believe that it would be premature to launch a new WTO round until progress is achieved on the inclusion of labor rights and environmental standards in any new agreement and until outstanding issues at the WTO, such as agriculture and services, have been settled. We support proposals to create a Congressional Trade Office, similar to the CBO, that would provide objective analysis of trade issues and also serve as an adviser to Congress on trade negotiations. Several new reports are needed, including a regular trade assessment from Commerce and an analysis of progress on WTO implementation from the USTR's office. We also support proposals to
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stimulate export market access through a renewal of section 301, use of performance-based trade tools, and also auction quotas where appropriate.

- *Wage insurance, training, and adjustment assistance.* Last, but not least, we support a vastly expanded program of retraining and adjustment assistance, available to all displaced workers, and not just those directly injured by trade. Workers also need wage insurance and other social benefit guarantees, and we recommend that certain tariff revenues be used for these purposes as a first step in this direction. These measures will reduce the costs of trade for workers, but they will not eliminate the broader costs and risks associated with globalization and U.S. trade deficits.