SENATOR SARLANES: Well, Chairman Weidenbaum and Vice Chairman Papadimitriou and distinguished members of the Commission, I'm pleased to have had this opportunity to appear before you today to discuss the work of the Trade Review Commission. I very much appreciate the opportunity of having worked with Senator Byrd and Senator Dorgan on, I think, this very important issue.

Mr. Chairman, I submitted a full statement. And I'll abridge it as I move through here for the sake of time. I'd just simply ask that the full statement be included in the record.

CHAIRMAN WEIDENBAUM: And we will consider your full statement carefully.

SENATOR SARLANES: Thank you very much.
Over this past week, Chairman Greenspan testifying before the Congress noted that the strong American economy was, quote, "engendering a set of imbalances that unless contained threatened our continuing prosperity," end of quote.

The first imbalance that he noted in his testimony was -- and I quote him again -- "Growing net imports in a widening current account deficit that require ever-larger portfolio and direct foreign investments in the United States, an outcome that cannot continue without limit."

Now, Treasury Secretary Summers made a point in a speech he gave in mid-January. At that time, he stated, "It is obviously important for our own economy and for the global economy as a whole that the United States move, over time, to a more balanced external situation because a more balanced expansion is likely to be a more durable one."

He was, in a sense, echoing a comment by former Treasury Secretary Rubin about a year ago, shortly before a meeting of the G-7 countries, when Bob Rubin said, and I quote him, "The international system cannot sustain indefinitely the large trade imbalances created by the disparities in growth and openness
between the U.S. and its major trading partners," end of quote.

Now, just last Friday, the Commerce Department reported that in 1999, the United States recorded a deficit of $271 billion for goods and services, the highest annual deficit on record. This was a 60 percent increase from $164 billion in 1998. The deficit in 1999 for goods alone, merchandise trade deficit, was $347 billion, the highest on record. And our bilateral trade deficits with Japan, China, Mexico, Western Europe, and Canada also grew to their highest level ever in 1999.

Now, it was concern over the trade deficit at that time, not at this astronomical figure that I just recounted, and its consequences for the U.S. economy that led Senators Byrd, Dorgan, and myself to introduce legislation in the last Congress to establish the Trade Deficit Review Commission.

We thought there was a need for an independent bipartisan Commission made up of distinguished individuals of varied backgrounds and interests to study, as the statute provides, the nature, causes, and consequences of the United States merchandise trade and current account deficits.
It was our view that the causes and consequences of the trade deficit and the large external debt that the United States has accumulated as a result were poorly understood. To a certain extent, it seemed to us there was a reluctance even to discuss the trade deficit and the problems it might pose with the U.S. economy. As a result, the issue was often ignored. Some even denied that it was an issue.

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

It is our hope that the work of this Commission will be a starting point for that informed public discussion. The legislative mandate provided the Commission is broad and comprehensive. In light of this legislated mandate, there are four particular issues that I'd like to address in my appearance here before the Commission today.
Let me just say I find it absolutely incredible that we have simply ignored this trade deficit question thus far and its potential impacts on our economy. And I think one of the driving forces in our minds in establishing this Commission was that it presented an opportunity to bring a focus on this issue and to say it really does matter. This is something we have to look at, something about which we have to be concerned, and something to which we have to formulate some responses.

The first issue is the U.S. as a debtor nation. In fact, the legislation amongst the issues to be addressed says, "Any consequences for the United States economy of the current status of the United States as a debtor nation."

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

I had the privilege of working on the staff of the Council of Economic Advisers when Walter Heller was the Chairman under President Kennedy. I hasten to add I was a younger man at that point and was Heller's
administrative assistant. I don't want to bring down the quality of the economic staff of the Council of Economic Advisers by getting included within that group. So I was there doing primarily administrative work for the Chairman.

The economic report of the President in 1962, the first one produced with Heller as Chairman, laid out basic balance in international payments as one of the principal goals of economic policy.

The report presented the rationale for the policy, and I quote, "The balance of payments objective for the United States is to attain at high employment levels a balanced position in its basic international accounts during the next few years. The objective of a balanced basic position does not mean the balance must be maintained continuously. In some years, a surplus in international payments will be appropriate; in other years, a deficit."

And he went on to note that the improvement in our balance of payments was more than a U.S. problem since deficits are matched by corresponding surpluses elsewhere. So both surplus and deficit countries bear a joint responsibility.
The report also made this point, "For many years, the United States had little reason to be concerned whether all of these payments were covered by corresponding receipts from abroad."

Foreign demands for U.S. goods and services were large. The dollar was and still is the ticket of entry to the world's largest and most diversified market.

In some periods, the surplus of receipts was so large that the United States took actions to moderate its effects, both at home and abroad. In other words, we sought to moderate our surpluses when we deemed them to be too large as a contribution to the workings of the international economy.

Beginning in the 1970s but particularly in the past two decades, the U.S. has moved away from that position. The United States has run a merchandise trade deficit every year but 3 since 1970, for 30 years.

The U.S. merchandise trade deficit has exceeded $100 billion every year but 2 since 1984. We have run a deficit in trade in goods and services every year since 1982, and we have run a current account deficit every year since 1982.
According to the Congressional Research Service, as a result of the accumulation of current account deficits, the U.S. moved from being a creditor nation to being a debtor nation in 1987. The U.S. debtor position went from $34 billion in 1987 to $200 billion in 1989, $352 billion in 1994, $767 billion in 1996, $1.2 trillion in 1997, and $1.5 trillion in 1998. We first went into debtor status in '87 at $34 billion. We're now at $1.5 trillion debtor status.

A result of this growing foreign debt is that the balance of interest dividends and profits earned and paid on foreign investments in the United States compared with U.S. investments abroad has turned negative.

Throughout most of the post-World War II period, U.S. investors earned considerably more on their investments abroad than foreign investors earned in the United States, reached a high of $33 billion in 1981. In 1997, this dropped to a negative balance of just over $5 billion, fell further to $22 billion in 1998.

We're the world's largest debtor nation. The servicing of this debt has now increased the U.S. deficit on current account. Previously, at least we
were getting an offset. Now it compounds it. It adds to it.

This current account deficit and net inflows of capital are projected to continue at about $230 billion per year from 1999 to the year 2002. This implies an increase in the foreign indebtedness of the United States of about a trillion dollars every four to five years.

By the year 2002, we could be in debt to the rest of the world by more than $2.4 trillion. And foreign debt as a percent of gross domestic product could rise from over 15 percent in 1998 to about 25 percent in 2002.

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

Now, whether we can sustain this depends on whether foreigners are willing to increase their
investments in U.S. assets enough to offset the rising deficit on current account.

In a sense, we have put our economic fortunes in the hands of foreign investors. I think this is clearly not a desirable position for the United States to find itself in. And I think we should have the explicit economic goal of reducing this economic vulnerability.

I regard this as a tremendous overhang over the U.S. economy. I think we have ignored it. It has built up at a very rapid rate. It is now at exceedingly high levels, at such high levels that the servicing of this debt is adding to the annual deficit each year. In other words, we have crossed that line.

The second issue is the persistent and substantial bilateral trade deficits. The legislation charged the Commission to examine the extent to which there is a reciprocal market access substantially equivalent to that afforded by the United States in each country with which the U.S. has persistent and substantial bilateral trade deficit, the extent to which those deficits have become structural.

Now, most of the discussion of the trade deficit recently is centered around the macroeconomic
influences on our balance of trade, the relative growth rates of the U.S. and its major trading partners, exchange rates, investment flows.

I'm obviously not going to embark here on an extended discussion of the relationship between savings and investment other than to underscore the point a number of witnesses who have testified before the Commission have made in explaining the distinction between an accounting identity and causality.

An identity does not show the direction of causality. Do levels of savings affect trade or do levels of trade affect savings? Actually I go around quoting Lester Thurow on this issue from time to time.

The macroeconomic forces I mentioned have no doubt played a role in the deterioration of the U.S. balance of trade and payments in recent years. And obviously you'll need to address that in your report. But we ought not to lose sight of the fact that our bilateral trade relationship, especially with Japan and China and, to a certain extent, with other countries and Asia, has been characterized by deficits that seem immune to the economic cycle.

Now I'm going to skip over this paragraph about the trade with the European Union, where we have
moved in and out of surplus and deficit, which to some extent correlates and parallels these macroeconomic factors, these economic cycle factors that I talked about.

So I think it's fair to say that our trade balance with the EU has generally shifted, as one would expect, with the economic cycle. That is not true of Japan and China.

In 1983, the United States had a bilateral trade deficit with Japan of just under $20 billion. It grew to $46 and a half billion in 1985, $56.7 billion in 1987. Since then it has not fallen below $41 billion. It has fluctuated. It has risen steadily in recent years.

Last week the Commerce Department reported a record bilateral U.S. trade deficit with Japan of $74 billion. That's a record last year. And the overall record has been a large bilateral trade deficit that in significant measure seems immune from the economic cycle.

The experience with China has been even more one-sided. In 1983, the United States had a bilateral trade deficit with China of $72 million, million, not billion, million. It fell to a deficit of
$9 million in 1985. And since then it has increased every year without exception from $1.6 billion in '86, $10.4 billion in 1990, $56.8 billion in 1998.

Last week the Commerce Department reported the bilateral trade deficit with China reached a record $68.7 billion. In fact, last year U.S. trade deficits with Japan and China accounted for over 40 percent of the total U.S. deficit.

Given the chronic nature of those deficits, it seems clear that trade barriers, currency policy, and perhaps other non-market factors are influencing our trading relationship. And I think the Commission will have to confront this problem very directly in its report.

The third issue I want to mention is exchange rate manipulation. The legislation charges the Commission to examine and report on the impact that the currency exchange rate fluctuations and any manipulation of exchange rates may have on U.S. merchandise, trade, and current account deficits.

Now, we passed in 1988 in the Trade and Competitiveness Act, a requirement for the Treasury to submit an annual report to Congress and then to update it every six months on international economic and
exchange rates to find countries that are manipulating the rate of exchange in order to gain a trade advantage.

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

I mention it not only because it's one of the charges to the Commission for its examination but because several distinguished witnesses that have appeared before the Commission, including Professor Peter Morici of Maryland, Robert Blecker of American University, and Ernest Preeg of the Hudson Institute, have pointed to currency manipulation as one of the causes of our trade deficit.

They point out that Japan and China have dramatically increased their purchase of U.S. government securities in the '90s, propping up the value of the dollar against other currencies, which helps to sustain their trade surpluses. Mr. Preeg states the foreign governments increased official
dollar holdings from $432 billion in 1989 to over $947 billion in 1999.

The fourth issue is the trade promotion. Again, there's a charge to the Commission to examine the coordination, allocation, accountability of trade responsibilities among federal agencies. We put into place in the Export Enhancement Act a Trade Promotion Coordinating Committee.

Under the leadership of former Commerce Secretary Ron Brown and now Secretary Daley, they have had some success in coordinating and focusing a large number of export promotion programs of the Federal Government. But we think they can do more.

We know that foreign governments invest significantly more in export promotion and export finance programs than the United States, thereby placing our exporters at a competitive disadvantage.

Finally and very briefly, Mr. Chairman, let me urge the Commission -- again, it's one of your legislative mandates -- to look at the adequacy and inaccuracy of the current collection and reporting of import and export data.

The Census Bureau itself has concluded that there's a substantial undercount. Our trade statistics
are all based on the documents filed by importers and exporters. They're not always filed or filed completely. There are gaps in our data collection, particularly in the services trade and investment flows.

These statistical agencies have been under a tight budget. And I very much hope you can come up with some constructive recommendations.

I asked Chairman Greenspan about this whole problem about accurate statistics. You know, we're not talking about a lot of additional money invested in the statistical agencies in order to give us these up-to-date figures -- on the basis of which we make very broad and sweeping policy decisions.

In conclusion, let me just note that there are other important issues the legislation directs the Commission to examine. One of particular importance to me is the impact of the merchandise trade, and current account deficits on the domestic economy, industrial base, manufacturing capacity, technology, number and quality of jobs, productivity, wages, and the U.S. standard of living. And another is the impact labor, environmental, or health and safety standards may have on comparative and competitive trade advantages. I
very much hope the Commission will give careful attention to both of these issues.

I think there is a developing consensus that trade deficits do matter, that they are a problem, that the accumulation of substantial trade and current account deficits over a period of two decades has undeniable consequences for the U.S. economy.

Aggressive efforts to reduce foreign trade barriers, end currency manipulation, promote U.S. exports, encourage more rapid growth by our major trading partners are clearly called for. More complex is the appropriate response at the macroeconomic level. And it seems to me that's one of the great challenges before the Commission.

Let me simply close, Mr. Chairman, by thanking you and your fellow Commissioners for the work you're doing. I think it has great importance for the country. And as I look at all of the economic statistics that we deal with now, this is the one that gives me the greatest cause for concern.

We now have the lowest unemployment, the lowest inflation in 30 years. We've brought the federal budget out of a deficit and into surplus. We're now, of course, arguing about what to do with
those surpluses. We don't actually have them. They are predicted surpluses, just to make that point.

But this trade deficit figure year after year, which has run up this huge debt figure, which we now have to service, I think has created an overhang on the economy that gives me great concern. I thank the Commission.

CHAIRMAN WEIDENBAUM: Thank you, Senator Sarbanes.

I didn't want to interrupt you while you were talking about your earlier service at the EA. As you know, I followed you on the staff of the EA by a few years, but I recall the fond memories that the more senior members of the EA had of your earlier service.

SENATOR SARBANES: Well, thank you very much, Mr. Chairman.

CHAIRMAN WEIDENBAUM: At this point I'd like to recognize the Junior Senator from North Dakota, Senator Dorgan.