PROFESSOR MORICI: Thank you. My remarks today are based on a study I did in 1997 for the Economic Strategy Institute and I brought along some copies to leave with your staff.

I would like to say I appreciate the opportunity to be here today.

Perhaps no economic question has been the subject of more myths and misunderstandings than the issue of the exploding trade deficit. Conventional wisdom holds that large trade deficits are a self-imposed affliction, either caused by inadequate savings or large government deficits. Moreover, since large trade deficits are a small portion of GDP, they are no cause for concern.

In the brief time that I have, I would like to leave the Committee with two ideas. First, external factors, including the policies of foreign governments, can and do affect the size of the trade deficit; and second, trade deficits are having significant adverse consequences for the U.S. economy.

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

However, when the combined federal and state government budget position fell from $195 billion deficit in 1992 to a $5 billion surplus in 1996, the current account deficit actually rose from $51 billion to $129 billion, because foreign governments stepped in and increased their purchases of U.S. securities from $43 billion to $133 billion. I would point out that these were not induced purchases in the sense that economists talk about induced changes in variables. Rather, these are autonomous shifts. They're policy decisions.

These purchases frustrated the exchange rate adjustments that should have accompanied the improvement in the U.S. fiscal situation, and these purchases kept the value of the dollar strong.

More recently, the collapse of statist industrial policies and the currency contagion in Asia had similar effects. They made U.S. imports artificially expensive and stifled demand for American exports such as aircraft and construction and engineering services. When measured in 1998 dollars, the U.S. trade deficit has averaged more than $100 billion a year since 1983 and this is having important negative consequences for U.S. incomes and growth.

Overall, U.S. export-and import-competing industries exhibit much higher labor productivity than other segments of the economy. For 1996, my estimates indicate that value added per employee is $96,000 in an export industry, $86,000 per year in an import-competing industry and $60,000 a year for the entire economy. By shifting labor from the more productive trade-competitive sectors of the economy, a $100 billion increase in the trade deficit reduces GDP by an estimated 0.6 percent.

Moreover, export-and import-competing industries include many of the most innovative and rapidly changing activities in our economy. Consequently, they invest more in R & D. Again, according to my study, these industries devote more than 5 percent of their value added to R & D, whereas the comparable figure for the entire private business sector is less than 2 percent.

These estimates indicate that the trade deficit reduced U.S. business-funded R & D by about 3 percent from 1983 to 1997. Production function studies for the U.S. economy indicate that such a decrease has lowered the rate of growth and potential GDP by about one half of a percentage point.

My bottom line is that many generalizations about the trade deficit don't hold up. We can impose large trade deficits on ourselves, and sometimes we have. However, large deficits can be imposed on us and exacerbated by the policies and events outside the United States, and they have.

Trade deficits are not benign. They have important effects on incomes in the present and in the future by altering the composition of what we make and by lowering investment in new products and innovation.

Thank you.

VICE CHAIRMAN PAPADIMITRIOU: Thank you very much.

Professor Shaikh.