DONALD A. MANZULLO, ILLINOIS
CHAIRMAN

CAROLYN McCARTHY, NEW YORK
RANKING MINORITY MEMBER

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Congress of the United States
House of Representatives
106th Congress
Committee on Small Business
Subcommittee on Tax, Finance, and Exports
B-363 Rayburn House Office Building
Washington, DC 20515-6320

March 14, 2000

The Honorable Murray Weidenbaum
Chairman
U.S. Trade Deficit Review Commission
Hall of the States, Suite 706
444 North Capitol Street, NW
Washington, DC 20001

Dear Mr. Weidenbaum:

I want to thank you for your kind letter of January 14, 2000 inviting me to appear before the U.S. Trade Deficit Review Commission on February 24, 2000 for a morning panel session with Members of Congress.

Unfortunately, the House of Representatives was not in session during that week of the President's Day district work period. I was back in Illinois attending numerous local functions and meeting with constituents.

I would have been honored to personally appear before the Commission to give my point of view about seriousness of the trade deficit and possible solutions to the problem. But because of this scheduling conflict, I was not able to attend. The purpose of this letter is to request that my written remarks be incorporated into the hearing record and taken into consideration as you develop your set of recommendations. If you have any questions about my testimony, please call me or my aide on the Subcommittee, Phil Eskeland, at (202) 226-2630.

Again, thank you for your invitation, and I wish you every success. Best wishes.

Sincerely yours,

Donald A. Manzullo
Chairman

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REMARKS OF THE HONORABLE DONALD A. MANZULLO BEFORE THE TRADE DEFICIT REVIEW COMMISSION

February 24, 2000

Mr. Chairman, I commend you for holding this hearing today and listening to the various points of view of elected Members of Congress. I represent a district that runs along the northern border of Illinois with Wisconsin, which includes (going west to east) Jo Daviess, Stephenson, Winnebago, Boone, McHenry, and the eastern two-thirds of Ogle County. I believe that the 16th District is a microcosm of the United States.

Starting at the Mississippi River, Jo Daviess and Stephenson Counties are predommately rural and are heavily dependent on agriculture, primarily in corn, soybeans, hay and dairy. Towards the center of the 16th District lies Winnebago County, which surrounds Rockford, the district's largest city and second largest city in the state. Rockford alone has over 950 factories, with 850 of them employing 100 or fewer people. Rockford is the largest producer of fasteners in the world and is considered the world's tool and die capital, as well.

Going further east towards Lake Michigan and the Chicago metropolitan area, the 16th District is also home to the two fastest growing counties in Illinois -- McHenry (fastest) and Boone (second fastest). Many people live here and commute to jobs either in downtown Chicago or in one of the closer Chicago suburbs. These counties deal with numerous problems associated with growth pangs of suburbia.

What is not well-known is the reliance of the 16th District on international trade for its economic health and well-being. While there are no precise export statistics for the entire 16th District, the metropolitan merchandise export total for Rockford gives us a clue as to this dependence. Rockford experienced an increase in exports from $521.6 million in 1993 to $926.5 million in 1998, which represents a 77.6 percent increase. This is over a 15 percent increase per year, which vastly outpaced national growth. The countries which experienced the greatest export growth rate for Rockford over the past five years were mostly developing and emerging economies – India (858.6 percent), Poland (578.9 percent), Argentina (475.4 percent), Mexico (294.7 percent), and China (282.8 percent).

What is fascinating about these export statistics is that they come from a city of about 150,000 people. Thus, Rockford is probably one of the most trade dependent cites, per capita, in the United States, at $6.2 million in exports per person. What happens in the trade arena is of great concern to me and the people I am proud to represent.

Earlier this month, the Commerce Department revealed the largest U.S. trade deficit figure ever, reaching $27 1.3 billion, a 65 percent increase over last year. The purpose of this hearing is to, first, to determine if the trade deficit matters and, second, what steps can be taken to reverse this trend.

With increasing trade, it is difficult to nationalize particular goods. One estimate reveals that nearly 40 percent of all American imports are simply intra-company transactions by American multinational corporations.[1] The Census Bureau also believes that as much as 10 percent of our nation's exports go unreported because of outdated collection methods.[2] Thus, the U.S. trade deficit may be less than where we think it is now.

Regardless, some free trade economists are beginning to worry about the large size of the trade deficit. Fred Bergsten of the Institute for International Economics said last year that the large trade deficit "is the single biggest threat to the continued performance of the U.S. economy" because "we know that at some point the dollar will fall considerably," which could trigger a sell-off in stocks and bonds.[3] Chairman Alan Greenspan of the Federal Reserve also said last year that "(t)here is a limit to how long and how far (trade) deficits can be sustained...(O)ur growing international imbalances are apt to create significant problems for our economy."[4]

Fortunately, our economy keeps growing at a rapid pace. In 1987, when the trade deficit reached over three percent of Gross Domestic Product (GDP), the stock market crashed. Currently, the trade deficit is 2.9 percent of GDP. There is thought that we must find ways to lower the trade deficit before it is too late.

I agree with most economists that the large movements in the trade deficit are controlled by macro-economic market forces beyond the day-to-day control of the U.S. government. Sharp fluctuations in foreign currencies, increases in oil prices, economic collapses in key export markets contribute more than any other factor to a high trade deficit. In addition, peaks and valleys in the U.S. trade deficit have usually tracked with the overall strength of the U.S.

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[1] Laura D'Andrea Tyson, "Trade Deficits Won't Ruin Us," New York Times, November 24, 1997, p. A29

[2] "Understatement of Export Merchandise Trade Data," prepared by the Foreign Trade Division of the U.S. Bureau of the Census, January, 1997; and "Trade Gap May Not Be As Wide As You Think," Journal of Commerce, December 5, 1996 p. 1A

[3] "Trade Deficit Hit Record in February," Washington Post, April 21, 1999 p. El

[4] Remarks by Chairman Alan Greenspan at the 35th Annual Conference on Bank Structure and Competition of the Federal Reserve Bank of Chicago, Chicago, Illinois, May 6. 1999

economy. During good times, the trade deficit is high because of a seemingly insatiable demand by U.S. consumers for imports. During recessions, the trade deficit drops because of decreased U.S. consumer demand.

In addition, it is important to remember that imports are not always "bad." Many U.S. manufacturers import components that are used in final assembly for sale both in the U.S. and abroad. For example, IMTA of Rockford, which employs 26 people, imports basic machinery from Italy and customizes it according to the wishes of the U.S. buyer. IMTA sold a product to Ford Automotive Company for its crankshaft production plant in Michigan. Because this machine lowered the production hours for making crankshafts from 96 to 22 hours, Ford shelved its plans to move crankshaft production from Michigan to Mexico. Who was better for this import? I would argue it was the workers at the Ford plant in Michigan. But macro trade statistics miss these real-life stories.

Regardless, even though the U.S. exported at record levels last year, reaching $958.5 billion, there is still more that we can do. Hopefully, these efforts can chip away at the record-high trade deficit. Let me quickly discuss what we should ***not*** do.

First, I urge you to reject protectionist emotional impulses to restrict or impede legitimate imports. Imports play a valuable role in keeping inflation in check and provide competition to spur American companies to further innovate. However, if imports violate our trade laws, such as products made with prison labor, then I agree that we should use whatever legal mechanisms are already in place to stop those practices.

Second, I would argue against government manipulation of the value of the U.S. dollar. Too many U.S. producers rely on imported components: therefore, any devaluation would be reflected in a higher final price charged not just to customers abroad but to Americans here at home. Also, it could set off a series of competitive devaluations among other countries, which would offset any temporary gain we may have initially achieved.

Let me now focus on an area that hopefully everyone – protectionists and free traders – can agree we *should do:* maximize every export opportunity, within the boundaries of national security.

An overlooked issue in the trade deficit debate is the role that small business exporters play in our economy. According to the Commerce Department, between 1987 and 1997, the number of small business[5] exporters tripled, going from 65.900 to 202,185. Small businesses now account for 3 1 percent of total merchandise export sales spread throughout every industrial classification. But what is more surprising is that the fastest growth among small business

[5] Small businesses are defined by the Small Business Administration (SBA) by size (number of employees) and value (annual sales) depending upon the specific Standard Industrial Code (SIC). But no business, regardless of industry, can employ more than 500 and still be considered a "small business." Thus, for this purpose, a small business is defined as a firm employing 500 people or less

exporters has been with companies employing fewer than 20 employees. These very small businesses represented 65 percent of all exporting companies in 1997.

Despite these encouraging statistics, there is still more work that needs to be done. Even though the number of small business exporters tripled, they form less than one percent of all small businesses in the United States.[6] Even among these cutting-edge firms, nearly two-thirds of small business exporters sold to just one foreign market in 1997. In fact, 76 percent of small business exporters sold less than $250,000 worth of goods abroad. In other words, these are "casual" exporters.

The key is to encourage more small businesses to enter the trade arena and then to prod "casual" small business exporters into becoming more active. If we were able to move in this direction, it could boost our exports by several billion dollars. With the growth of the Internet economy, I am optimistic that we can move in this direction. However, we need to insure that our U.S. Export Assistance Centers (USEACs) are ready to meet this challenge so they can help increase exports from the small business community. In addition, we should strive to make sure that services received over the Internet are not subject to trade barriers in any form, including customs duties.

We also need to bring some common-sense reform to our unilateral economic sanctions process. The Institute for International Economics (IEE) concluded that sanctions prevented between $15 and $19 billion in U.S. exports in 1995. At the time, the U.S. had sanctions on 26 countries. Since then, some sanctions have been lifted or modified; but other new ones have been imposed. The IIE also concluded that most of these sanctions have not accomplished their foreign policy goal except to transfer work from one American factory or farm to a foreign competitor.

Let me give you an example from back home in Illinois. In 1996, the Export-Import Bank of the United States (Ex-Im) declined to support U.S. exporters who had willing buyers in China for construction equipment and hydroelectric power generators for the Three Gorges Dam project because of vague environmental concerns. The Clinton Administration wanted to send a signal that it did not approve of the project. Many people decry the rapidly growing trade deficit with China. Yet, the Clinton Administration bypassed $1 billion -- yes, that is $1 billion -- in export opportunities to this large public works project in China.

ROTEC Industries, of Elmhurst, hoped to supply $130 million worth of concrete placing equipment to China Because of Ex-Im's decision, they were only able to sell $3 1 million of their product, $13 milllon of which had to be subcontracted to South Korea. In addition, prior to Ex-Im's negative decision, ROTEC was the only manufacturer of this specialized equipment. Because of Ex-Im's inaction, a Japanese-French consortium copied ROTEC's concepts on paper and is now a new, vigorous competitor worldwide. ROTEC depends heavily on trade for its success, exporting up to 90 percent of its production. Not only did Ex-Im's decision lose $112

[6] There were more than 23.2 million small businesses that filed tax returns in 1996, according to The State of Small Business: Report of the President, 1997

million in immediate export sales for ROTEC but it also jeopardized their long-term viability by creating another foreign competitor.

Another major Illinois exporter, Caterpillar, expected to export $200 million worth of construction equipment to the Three Gorges Dam. These sales never materialized because of Ex-Im's negative decision. There are more than 12 major suppliers to Caterpillar located in the 16th District of Illinois. Several of these suppliers are suffering because of the decrease in demand for agriculture, construction, and mining equipment including Rockford Powertrain and Ingersoll Milling and Machine. A $200 million order to China certainly could have helped these suppliers weather the current economic difficulties.

In August, 1997, China awarded $740 million in contracts for 14 hydroelectric power generating units. None of these units will be made in America. All will be made either in Canada or in Europe. However, two companies with a U.S. presence will manufacture this equipment abroad -- General Electric in Canada and Voith Hydro in Germany. Ex-Im's equivalents in Canada (Export Development Corporation or EDC) and Germany (Hermes) had no problem helping their exporters win these huge overseas sales opportunities. Compounding the direct loss to U.S. workers at GE and Voith is that in order to comply with local content requirements of EDC and Hermes, these companies will buy parts and services from suppliers in Canada and Germany, respectively. Thus, several northern Illinois businesses, which supply these larger companies in the U.S., undoubtedly lost some sales opportunities because of this sanction -- and they probably do not even know it.

The irony is that the Three Gorges Dam construction is proceeding according to schedule. China found other foreign companies to supply their needs. The only practical result from this sanction was to transfer work from ROTEC, Rockford Powertrain, Ingersoll, and others to their foreign competitors.

There are more examples, particularly with the recent imposition of the sanctions on India and Pakistan that cost one company in the 1 6th District millions of dollars of machine tool exports. Thus, the cost estimate of sanctions on the U.S. economy by IIE may even be a conservative estimate.

Related to sanctions in the need for genuine export control reform. Few people know that the U.S. government places more restrictions than any other government in the world on its exporters to sell legitimate commercial products to customers around the world. Estimates on the economic impact of export controls on the U.S. economy range from $10 to $60 billion.' For encryption alone, which uses codes to protect electronic data, the economic impact of severely limiting its export ranges from $35 to $96 billion.'

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[7] Richardson, J. David, Sizing Up U.S. Export Disincentives, 1995, Institute for International Economics, Washington, DC, p. 127-131 and Emerging Security Needs and U S. Competitiveness: Impact of Export Controls on Cryptographic Technology, Computer Systems Policy Project, 1995.
[8] Cliff Jemigan, Beyond High Tech Survival, Olive Hill Lane Press. 1998, p. 50

Again, some of these estimates are dated because the Clinton Administration has acted to remove some of the more egregious export control barriers, particularly on computer hardware exports. In addition, the Clinton Administration has just recently rewrote the regulationsdealing with encryption to the general satisfaction of the software industry. Hopefully, the export market potential as estimated by some will come to pass.

However, there have been some retreats on export control reform primarily in two areas. First, any proposed computer export control reform must wait six months for Congressional review before becoming effective. This policy does not make sense for technologies like computers that have a three month innovation cycle. Some U.S. computer companies have threatened to move production abroad unless this review policy is shortened to a maximum of 30 days. Other U.S. companies are concerned about foreign competition, who make similar equipment, that are not encumbered by these unique U.S. export control rules.

There is nothing unique or special about high-end U.S. computers, "Supercomputers" are nothing more than regular computers performing the same functions at a faster rate. It is also important to remember that yesterday's "supercomputer" is today's laptop.

I remember when I first entered Congress in 1993 and some thought the world was going to end when the Clinton Administration first proposed changing the definition of a "supercomputer" from 195 Million of Theoretical per Second (MTOPS) to 2,000 MTOPS. That sounds like a very large and scary number, particularly in the "wrong" hands. Yet, most Personal Computers (PCs) now sold in the United States have a semiconductor chip in them that performs above the 2,000 MTOPS level. If that change did not take place in 1993, we may have not seen the revolution in technology that is taking place throughout the Information Technology (IT) industry. It could have stifled our recent economic growth, with no benefit towards our national security because our foreign competitors would have easily made those sales.

In 1998, the Department of Commerce estimated that U.S. computer companies' worldwide sales totaled over $230 billion. As the author of legislation in the 103rd Congress to lift all export controls on computer exports, except to embargoed or terrorist countries, it's time to revisit this issue. Current shackles on high-end computer exports hampers the long-term viability of the IT industry that is so critical to our economic and national security.

Another area where U.S. export control policy contributes to a higher trade deficit is in the area of commercial satellite exports. Last week, *Newsweek*[9] printed a story of the loss of market share in this highly competitive field to foreigners because of our export control policy. U.S. commercial satellite sales abroad fell 40 ***percent*** last year. American global market share dropped from 72 percent in 1998 to 65 percent in 1999. While everyone recognizes we should be very careful in monitoring commercial satellite sales to China and Russia, this cautious attitude has spread to every satellite export, even to close allies.

[9] "Left on the Launch Pad," Newsweek, February 28.2000. p 45

Like high-power computers, commercial satellites are sophisticated but not unique. France, Germany, and Japan, among other nations, manufacture similar equipment. When the U.S. loses one sale, it translates into an immediate major increase in the trade deficit. Last year, Orbital Sciences of Dulles, Virginia lost an $80 million contract to build part of a radar satellite for Canada because the State Department did not approve their export license request in time. This is one reason why our trade deficit with Canada ballooned from $16.7 billion in 1998 to $32.1 billion in 1999. It's time speed up the commercial satellite export licensing process for our friends and allies and also place reasonable but firm time lines on the approval process for satellite exports to China and the former republics of the Soviet Union.

Fifth, we need more market-opening initiative like the U.S.-China World Trade Organization (WTO) accession agreement The next big trade issue for this year will be the battle over whether or not we will let China implement the most sweeping free market changes they have ever agreed to. The actual vote will be about granting Permanent Normal Trade Relations or PNTR to China. But we must put this vote in real-world context. China will enter into the WTO regardless of what we do in Congress. The only question is whether or not our American exporters will be able to take advantage of the market-opening initiatives contained in the U.S.-China WTO Accession agreement.

If Congress rejects PNTR for China, the agreement will be shelved. Other market-opening agreements that China negotiated with our foreign competitors will become operational. American exporters will then have one hand tied behind their back as they try to compete with foreign companies who are able to sell in China with lower tariff duties and regulatory barriers. What is the practical real-life impact of the U.S.-China WTO accession agreement? The highly-respected think-tank, the Institute for International Economics (IIE), estimated that this agreement will immediately increase U.S. exports to China by approximately $3.1 billion. Over the long-term, the IIE believes U.S. exports to China could grow by $21.3 billion. The non-partisan Congressional Research Service has a more conservative estimate of nearly $14 billion. The U.S. Department of Agriculture (USDA) estimates that U.S. agriculture exports to China will increase by $2 billion under this agreement.

Regardless, all these studies conclude that U.S. exports will increase to China with this agreement. Why? Generally, for manufactured goods, the average Chinese tariff rate will drop from 24.6 percent to 9.4 percent by 2005. Chinese tariffs on U.S. agricultural products will decrease from an overall average of 3 1.5 percent to 14.5 percent by 2004. The agreement will also prevent offsets and technology transfers as a condition of a sale. It also phases out various "local content" requirements, This will allow U.S. exporters to continue and perhaps increase sales to U.S. multinational companies that have a presence in China. The agreement also will allow you to sell directly to customers in China, without having to go through middlemen, usually government-owned Import-Export companies. In other words, you will have unrestricted distribution and trading rights within China.

The agreement also reinforces existing U.S. law to ensure against Chinese import surges and unscrupulous Chinese trade practices. It continues to allow China to be considered as a non-market economy for the purposes of our anti-dumping and countervailing duty laws. In other words, the agreement protects against unfair pricing schemes, where a foreign producer charges much less for a product in the United States than what they sell the identical product in their home country or even below the cost of production. It protects against Chinese government subsidies of exports and import surges that threatens the very existence of an entire U.S. industry.

Let me give you an example from back home about the importance of these laws as it applies to China. A few years ago, I assisted a company in McHenry, Illinois – Brake Parts – to combat unfair trading practices of certain Chinese manufacturers of rotors and brake drums. We were able to win a judgment against Chinese rotor makers before the International Trade Commission (ITC). This verdict imposed a retroactive higher import duty on Chinese rotors. We sent China a message that they should compete on a level-playing field against American manufacturers of similar product. This decision enabled Brake Parts in 1998 to announce an expansion that created 150 to 200 new jobs in McHenry. The U.S.-China WTO Accession Agreement will still allow companies like Brake Parts to pursue their legal options to combat any unscrupulous Chinese trade practices that may emerge over the coming years, even with passage of PNTR.

Finally, we need to become engaged in a comprehensive trade negotiating round. It's difficult to quantify how that will directly impact U.S. exports because we have not even set the parameters of the topics of discussion. Obviously, an agreement that focuses just on agriculture or services will have less of an impact than an agreement that touches all the areas of international trade.

But let me give you two concrete examples of what the delay in these trade talks means for the people I represent back home. In 1997, corn growers lost to Argentina an opportunity to sell 78 million bushels to four Latin American countries. Argentina negotiated a free trade agreement with these countries and does not have any tariff or import duty assigned to their farm products. U.S. farmers face an average 11 percent extra tariff duty or tax on their products entering Chile and other Latin American countries. Workers at the Chrysler Neon plan in Belvidere did not build an additional 4,000 cars to sell to Chile. Instead, the work was redirected to Chrysler's Neon plant in Mexico because Mexico has a free trade agreement with Chile.

There are countless other examples like these all across the United States where American workers could make product or offer services for export but cannot because foreign governments impose a variety of obvious and sometimes creative barriers to imports. While some argue that even if all trade barriers were eliminated, it would only make a "dent" in the trade deficit, every little bit helps. Our trade negotiators should expend every effort to make sure that market conditions-are the only considerations in international transactions. We should not have companies make economic decisions based on how they can either avoid or take advantage of certain aspects of a government's trade policy.

When looking at the trade deficit, it seems insurmountable. If you look at each issue area separately, it will not "solve" the trade deficit by itself. Trade promotion alone will not make much of a contribution to U.S. exports. **Knocking down** foreign trade barriers alone will not give us a trade surplus. Export control or **sanctions reform** will not turn around the trade deficit picture. But all together, they can contribute to a significant boost in U.S. exports, which will help offset some of the effects of the trade deficit.

Will this be enough to overcome the rate of growth of U.S. imports? That is difficult to say. I do not want to restrict America's choices. Imports usually drop during an economic downturn, which nobody wishes to see. But we cannot do much to boost U.S. exports if we continue the status quo on our current trade policies. In short, we need a comprehensive approach to international markets that focus both on trade policy and promotion to maximize U.S. exports.