Searching for Common Ground and Areas of Basic Agreement

In its deliberations, the Commission to Review the Trade Deficit encountered a great variety of public policy issues, many of long-standing concern. We succeeded in reaching agreement in a significant number of instances, but we were unable to do so in many others.

This statement attempts to develop some common ground while candidly describing the different approaches that Commissioners developed on the remaining issues. Where those disagreements are important, we undersigned Commissioners provide our own viewpoint.

All Commissioners share common principles and believe that these should form the foundation for a trade policy that deserves widespread support and could serve as a basis for American leadership. These common principles include

- enhancing the standard of living, both in the United States and the rest of the world; and
- recognizing that our economic interests as well as our moral values must govern our policies and actions.

Some context is helpful in applying these principles. The United States has the most active, varied, and influential private sector or civil society in the world. Business, labor, environment, human rights, ethnic, and religious groups compete vigorously for the attention of policymakers in an effort to move their issues to the top of the national policy agenda. The views of concerned citizens are a fundamental part of our democratic process, and these views influence both the content and implementation of our nation's policies. However, not all issues have equal importance in advancing our national interests. Even those that rank high often cannot all be pressed effectively at the same time. Ultimately, it is the responsibility of the President working with his (or her) administration and the Congress to develop a sound, multidimensional trade policy that strikes a proper balance among our many concerns and is comprehensible, not only to other nations but to our own citizens.

The basic objective of U.S. trade policy is not a technical matter. It is to raise the standard of living of the American people. At the same time, the American democracy is founded on a range of values and principles, including the advancement of freedom and democracy, the promotion of widespread prosperity, respect for human rights, the maintenance of labor rights, the protection of the environment, and the upholding of our national security. At times, efforts to promote these values and principles may be in conflict with each other and with trade policy. In seeking to implement trade policy, the institutions of government must strive to set priorities and reconcile differences. The differing views among the Commissioners as contained in this report should not detract from the underlying consensus in support of these fundamental American values.

The large and growing U.S. trade deficit brings to the fore a host of important and related issues. Indeed, the legislative charter establishing the Commission makes that clear. These related issues include

- the effects of imports on American workers, consumers, businesses, and communities;
- problems encountered by and the markets available to American exporters;
- the fears and opportunities generated by globalization;
- the ability to sustain large and growing trade deficits in the future; and
- the support for dealing with trade problems without resorting to protectionist measures.

In this interconnected and fast-changing world, some public concerns about the economy and foreign trade are not directly tied to the trade deficit. Reducing the deficit would not effectively deal with such challenges as

- how to create an economy that generates a large number of good jobs;
- how to get people who lose jobs back into well-paid, productive work;
- how to reduce trade barriers and unfair practices facing American companies; and
- how to get Americans to better understand and respond to issues that arise from an increasingly global economy.

The task that faced this Commission was how to deal simultaneously with the statistical and technical issues of the excess of imports over exports and the substantive questions that Americans raise as they face an increasingly interconnected, fast-changing world economy.

During each minute of 1999, over $1.8 million worth of goods and services were exported by American businesses, while over $2.3 million worth of goods and services were imported. Those traded goods and services are integral parts of our economy—for example, exports of wheat, airplanes, and professional services, and imports of oil, clothing, and consumer electronics. Many imports are essential inputs to American businesses and enable them to compete in export markets and to sell to American consumers at lower prices and higher quality than would otherwise be possible.

International trade is more important to our economy today than at any time in the past. By dollar value and volume, the United States is the world's largest trading nation. We are the world's largest importer, exporter, foreign investor, and host to foreign investment. Yet, as a nation, we hold conflicting views on international trade. Many Americans are ambivalent about "globalization," and some are outright hostile. The growth in international commerce is one of the most visible and controversial elements of globalization. Trade agreements are no longer an esoteric subject occupying the interest of technical experts—they are debated loudly on Capitol Hill and around the country.

Large, persistent trade deficits[1] have become part of the U.S. economic landscape. However, there is no common understanding of their nature, causes, and consequences for our nation. The record-setting and growing trade deficits over most of the last two decades have added to concerns over the growing internationalization of modern economies.

In our strongly held view, trade deficits are a part of the recent "virtuous circle" of the U.S. economy, contributing to low interest rates (with the net inflow of funds from foreign investors increasing the overall supply of investment funds) and to low inflation (with imported products meeting domestic demand for goods and services that exceeds domestic production). The huge trade deficits have helped to make possible a period of high employment and rapid economic growth. By enabling U.S. investment to exceed U.S. saving and U.S. consumption to exceed U.S. production, trade deficits have contributed to higher American living standards.

Others see trade deficits as a measure of the problems that international trade causes our society, particularly the jobs and business lost to import competition. Most egregiously in this view, persistent trade deficits between the United States and several other nations represent the impact of unfair foreign trade barriers. U.S. businesses are seen as unable to sell their products in those nations because of their restrictions on U.S. imports while, at the same time, businesses from those nations have easy access to our markets. But, the positive feedback effects of some of our imports on jobs in U.S. export industries should not be forgotten. The competitiveness of U.S. producers is enhanced by their ability to source globally the lowest cost and highest quality parts and components.

As in many other areas of public policy, neither approach may be totally right or totally wrong. Congress created the U.S. Trade Deficit Review Commission in 1999 to assess the nature, causes, and consequences of the U.S. trade and current account deficits. The questions posed in the Commission's mandate, as well as testimony at Commission hearings, made clear that the issues surrounding the trade deficit were inseparable from the broader concerns surrounding the impacts of international trade and globalization.

The nature of the trade and current account deficits

The U.S. trade and current account deficits are large and rose rapidly in the late 1990s. The current account deficit for 1999 was $331 billion, and projections envision a deficit in 2000 of over $450 billion. Figure 1 shows an overall pattern of deficits since the mid-1980s, although balance was almost achieved in the early 1990s. The close relationship between the trade and current account deficits is clearly visible. Those deficits are especially pronounced with some nations, including Japan, China, Mexico, and Canada.

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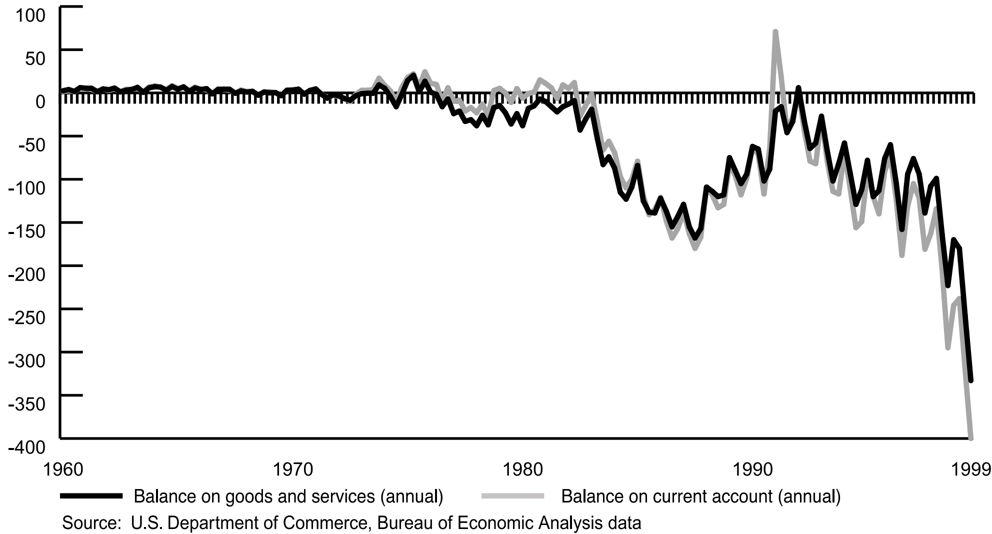
[1] Most popular discussions focus on the trade balances, which measure the difference between imports and exports of goods (merchandise) and services. Many professional analyses use a more comprehensive measure, the current account balances, which also include flows of interest and profits, and unilateral transfers (gifts). As a practical matter, often the two measures are used interchangeably.

Figure 1

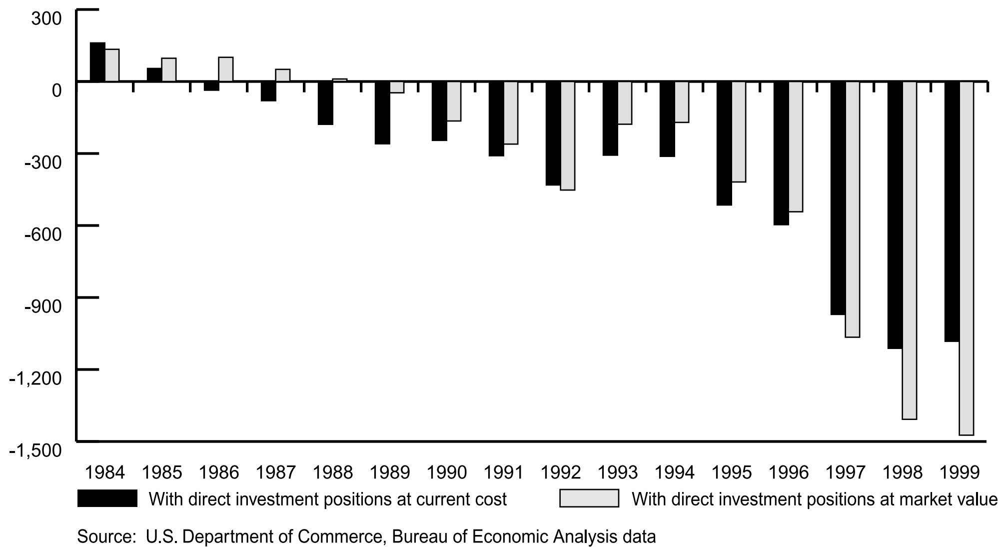
Trade and Current Account Deficits, 1960–99
(Dollars in billions)



Sustained trade and current account deficits and the associated capital inflows have moved the United States from being the world's largest "creditor" to the world's largest "debtor." The terms "creditor" and "debtor" are commonly used. What the data actually measure is something different and more technical—the "net international investment position" of the United States. This category includes both foreign purchases of U.S. stocks and bonds, as well as foreign investment in U.S. plant and equipment and foreign exchange reserves of foreign governments. (See figure 2.)

Figure 2

U.S. Net International Investment Position, 1984–99
(Dollars in billions)



Although foreign companies building factories in the United States and foreign investors buying shares of corporate stocks have different economic effects than foreign purchases of Treasury or corporate bonds, "borrowing" is commonly used as shorthand for both types of financial flows.

The causes of the trade and current account deficits

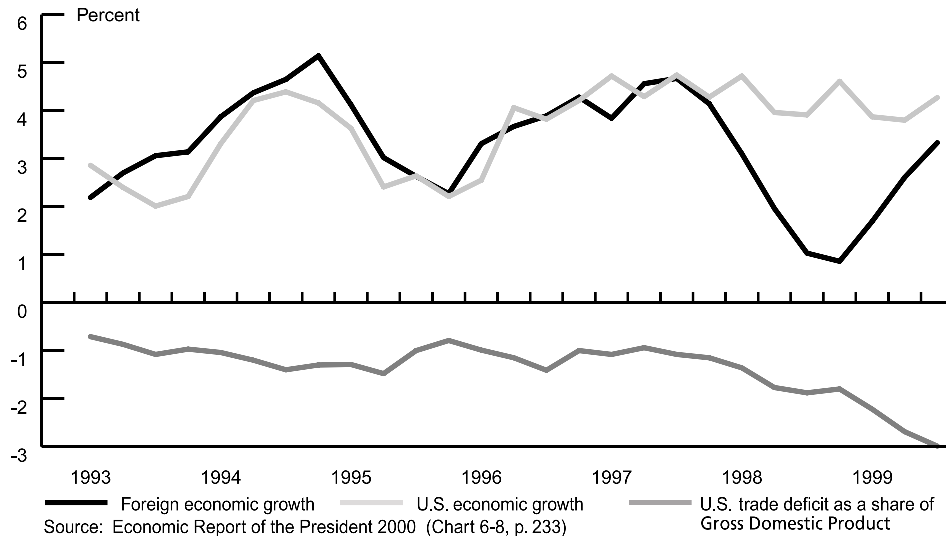
Many reasons have been advanced to explain the causes of our large and growing trade and current account deficits, but not all of these are generally accepted. The first and most widely held reason is that the more rapid expansion of the U.S. economy compared to the economies of our trading partners clearly contributes to the deficits. A rapidly growing domestic economy generates strong demand for imports, while less rapidly growing foreign economies generate weaker demand for our exports. A second reason is that the American economy's strength has encouraged foreigners to invest in and lend to Americans and that has led to a real appreciation of the U.S. dollar, which has lowered import prices and raised prices abroad of our exports. A third reason advanced by some is the belief that foreign trade barriers that hinder U.S. exports can contribute to trade deficits (specialists in international economics tend to discount this last point).

Yet another way of explaining these deficits is the macroeconomic approach that most economists use to analyze these matters. They focus on the huge imbalance between domestic saving and domestic investment as the fundamental cause of the major inflows of foreign funds that, as they are respent, are the basic source of the excess of imports over exports.

Some facts and relationships are clear. When our economy grows relatively more rapidly, we import much more; conversely, when foreign economies grow relatively more slowly, they import less from us. (See figure 3.) In fact, econometric studies have found a consistent pattern that U.S. imports increase at an even faster rate than our incomes—as much as twice as fast. While the United States has enjoyed strong economic growth (4.3 percent in 1999), the economies of our trading partners have not risen as rapidly (the rest of the world grew only at about 2 percent). The economy of Japan, the world's second largest economy was stagnant throughout the 1990s. The United States was the only strong major market during most of that period.

Figure 3

U.S. and Foreign Economic Growth and U.S. Trade Deficit, 1993–September 1999
(Quarterly Data Expressed at an Annual Rate)



The strength of the dollar during the 1990s also contributed to the persistent trade and current account deficits. Continuing large trade deficits would be expected to lead to a declining value of the dollar—were it not for the high productivity of capital relative to our saving rate that generates such a large capital inflow, which bids up the value of the dollar. The rising stream of foreign capital moving into the United States could be slowed down by a rise in our national saving rate. But, at present, a strong dollar makes our imports less expensive. However, it lowers the growth rate of our exports by making them more expensive to foreign customers.

Foreign trade barriers that limit U.S. exports can adversely affect our industries and their employment. Over time, these barriers and our own export impediments can reduce investment in specific domestic industries, lessening competitiveness in those industries. However, U.S. import barriers are not altogether benign, imposing burdens on both foreign and domestic businesses.

The consequences of the trade and current account deficits

The trade and current account deficits have coincided with fundamental changes in the U.S. economy. Deregulation, globalization, and rapid technological innovation have altered the structure of the economy. Globalization—the process of increasing the integration of many national markets for goods, services, and information into a global market—is a reality that will not go away. The changes are sweeping, with varied implications across the nation. Our producers and consumers gain when they can purchase goods and services at lower prices and in greater variety than would otherwise prevail. Increased openness to trade and ideas contributes to higher

levels of economic growth, a key element in raising the standard of living. Moreover, foreign competition spurs U.S. companies to enhance their competitiveness by lowering costs and improving productivity.

At the same time, these changes also have created costs and increased uncertainty. Change is an inevitable part of a market-based economy. Economist Joseph Schumpeter wrote of the "creative destruction" inherent in capitalism. The earlier transformation of the United States from an agrarian to an industrial society and the movement of people from farms to cities and factories were disruptive to many, but the overall result was positive. Today, that transformation continues into an "information society."

Changes that bring destruction of old patterns of economic activity, even "creative destruction," can entail costs as well as benefits. Manufacturing, particularly, has been affected during most of the post-World War II period. Although overall manufacturing production increased more than fourfold between 1945 and 1999, manufacturing's share of total national output fell from 27 percent to 13 percent during that same period (its share of employment fell even more sharply due to substantial increases in productivity).

Some industries have seen dramatic reductions in sales and employment during the past half century. Domestic production of many labor-intensive consumer items has declined sharply and, in some cases, has been abandoned. Other industries have grown rapidly during the same period, including many new firms associated with information technology. But no industry, be it high tech or low tech, is immune from the changes that have occurred. When we focus on a more recent period, we find that, on balance, the trend has been quite positive. About 18 million new jobs were created between 1991 and 1999, and the unemployment rate declined to a long-term low.

Many observers, however, have noted the seeming paradox of high levels of worker insecurity at this time of high employment. Numerous reasons have been advanced to explain this paradox, and they are of varying validity. They include the development and adoption of new technology, increases in international trade, higher skill requirements for workers, declines in the extent of unionization, decreases in the real minimum wage, increases in immigration, and the recent tendency of business restructurings to result in layoffs during "good times" as well as during business downturns. However, the relative importance of these possible causes is uncertain, in part because of the complex ways in which they interact.

In the view of several witnesses at the Commission’s hearings, wages and profits in the U.S. economy diverged over the 1990s, as multinational corporations relocated production to foreign nations with lower wage levels, maintaining or boosting their profits while putting pressure on U.S. workers to accept lower wages in order to keep their jobs. Further, they see moves to these foreign locations as enabling the corporations to operate under other nations’ environmental laws, some of which are less stringent or more laxly enforced than here.

We do not accept the validity of these criticisms. The bulk of overseas investment by U.S. firms has been in developed nations with comparable or higher labor costs and labor and environmental standards. Moreover, studies by the World Bank report that differences in environmental costs are not a significant factor in the relocation of business. The primary motive of American investment, in high-cost areas of Western Europe, for example, has been to be close to foreign markets and to surmount trade barriers.

Members of the Commission hold different views on the importance of trade in the changes occurring in the U.S. economy. In the view of some Commissioners, imported goods—particularly from nations that shield their domestic industries while they "target" U.S. industry in a predatory manner—are responsible for the declining importance of manufacturing in the U.S. economy and growing disparities in incomes. In our view, however, changes in technology, particularly as they lead to increased productivity and the development of new industries, are the main reason for manufacturing's reduced share of total economic activity and especially of employment. We note that manufacturing output in the United States continues to reach record highs.

Will trade deficits persist—and will they endanger the U.S. economy?

Large and growing trade and current account deficits may pose risks to the U.S. economy, at least in the long term. Financing a $450-billion annual trade deficit means that the United States has to attract an equally large amount of new foreign capital, net of new U.S. overseas investment. The attractiveness of the United States as a destination for foreign funds has enabled us to acquire the needed capital easily. However, the likelihood that large trade deficits will endure for some time into the future means that the United States will continue to draw heavily on overseas investors. To the extent that national saving increases, however, less foreign capital will be needed.

We do not see a significant danger that the foreign capital needed to finance the trade and current account deficits will be unavailable in the foreseeable future. Even if other economies grow rapidly and become more attractive places for investment than they are today, international capital markets will likely continue to be able to meet U.S. financing demands. Nevertheless, no one can offer certainty in these matters. Expert opinions differ substantially about how long current conditions can last and under what circumstances the deficits will decline. Witnesses at the Commission's hearings offered a wide range of views.

Some witnesses believe that the most likely scenario is that reasonable adjustments in the exchange value of the dollar, together with economic recovery abroad, will produce a "soft landing." In this case, the trade deficit comes down substantially in a normal adjustment process that would not generate significant adverse effects on the United States. Both American and foreign

investors thus benefit. Indeed, this has been our experience in recent decades. This is a view that we share.

In contrast, however, other witnesses expressed concern that the United States could suffer a "hard landing." In this view, an event such as a sharp and persistent decline in the stock market could make the United States less attractive as a destination for foreign capital. Such a change could engender large increases in interest rates in order to attract the necessary funds to finance the trade deficit. The holders of this viewpoint believe that the result of these events could be a recession, possibly severe. In a recession, the value of the dollar could fall as the U.S. economy loses favor with foreign investors. A sharp drop in the dollar's value could raise the cost of imported goods substantially and increase inflationary pressures.

No one knows the likelihood of this downside risk of the continuing deficits. As Federal Reserve Chairman Alan Greenspan has commented:

> *…[W]e do not know how long net imports and U.S. external debt can rise before foreign investors become reluctant to continue to add to their portfolios of claims against the United States. At that point, the safety valve of net imports could narrow or close.*[2]

No amount of analysis can accurately determine whether any of these scenarios—or perhaps a different one—will occur. Members of the Commission agree, however, that it would not be prudent to dismiss totally the possibility of a "hard landing" and the danger that the consequences could be severe if it were to occur. This underscores the desirability (1) in the short run, to develop monetary and fiscal policies that recognize such a possibility, even if remote; and (2) in the longer run, to develop policies that will enhance the competitiveness of American business and labor. We emphasize the point that considering this possibility does not mean that the United States should refocus basic economic policy to bring the trade or current accounts into balance. In fact, had this been an economic policy goal during the 1990s, econometric analyses indicate that the result would have been disastrous for the United States.

Recommendations to address trade and current account deficits

Trade and current account deficits highlight two crucial and interrelated facts: (1) the United States is a key part of the global economy, and (2) international trade and capital movements are an important segment of our economy. The United States has benefited greatly as trade and capital flows have enhanced our standard of living and promoted economic resilience. But not all individuals and communities have benefited as a consequence of the increased links to the rest of the world. Addressing the negative consequences is essential to developing and maintaining a national consensus that focuses on opening markets rather than on imposing trade restrictions.

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[2] Speech to the White House Conference on the New Economy (Washington, DC, April 5, 2000).

Efforts to stop globalization would be counterproductive. The challenge for government, businesses, and workers is to take advantage of the opportunities created by globalization, minimizing disruption as appropriate, and assisting those bearing the costs of adjusting to the changes it brings.

For government, this means that we must recognize that persistent trade and current account deficits and the more than $2-trillion negative net international investment position—our "foreign debt"—limit economic policy in important regards. For example, the combination of low household saving, the large trade deficits, and our substantial foreign debt argues in favor of a fiscal policy that encourages national saving.

In developing future policy, we must remember that the United States possesses considerable strengths. The large "foreign debt" has to be seen in the context of the substantially larger value of assets that Americans hold, as well as the size of the U.S. economy. Investment in the United States has been more attractive than investment in other nations, influencing both U.S. and foreign investors to increase their investments here. Events that would rapidly change those perceptions are unlikely, even if they cannot be completely ruled out.

Foreign trade barriers and predatory trade practices offend the sense of fairness of Americans who see the greater openness of our economy. All of the Commissioners agree that a vigorous trade policy to break down trade barriers is essential.

- We call for a new round of multilateral trade negotiations. We do not believe that these negotiations should be contingent on including labor, environment, and human rights issues, including enforcement of each nation’s current laws, in the agenda for these negotiations. Such restrictions are widely viewed, especially in the developing world, as a disguised form of protection and could prevent multilateral trade negotiations from getting under way.
- We all support efforts to make the World Trade Organization (WTO) processes, including the dispute settlement process, more open and transparent, either through ongoing negotiations at the WTO in Geneva or in a new round of multilateral negotiations. Furthermore, developing public support for a new round will be strengthened by greater compliance with existing agreements as well as reforming the WTO.
- The United States should strengthen its efforts to monitor and enforce trade agreements by elevating responsibility for enforcement within the current trade policy agencies and by assigning sufficient numbers of qualified staff for this task.

U.S. foreign policy measures, particularly export controls and export sanctions, adversely affect the mix of goods and services that we produce, import, and export.

- The United States should review and revise current export control policies for civilian technologies with both military and commercial uses. The purpose of such a review should be to relax those policies whenever appropriate in light of current national security and economic considerations.
- In the future the United States should limit unilateral imposition of export sanctions to those cases in which a high-level national interest is clearly at stake and where the likely effectiveness of such measures is high.

Over the past two decades, the number of available jobs in the United States grew substantially. For much of this period, however, workers did not see compensation (wages and fringe benefits) growing to match increased productivity. Further, workers today have far greater need for marketable skills than in the past. They change jobs more frequently, and the wage differential between the most- and least-educated members of the workforce continues to grow. We must enhance the ability of American workers to adjust more rapidly to the inevitable changes they will face. A majority of the undersigned members recommends the following specific actions:

- Increasing private and public efforts to provide more effective worker adjustment assistance, with such efforts extending to all workers bearing the costs of adjustment to economic change irrespective of why they have lost their jobs or whether they are eligible for specific trade adjustment aid.
- Expanding the educational and training opportunities available to all Americans, because a more productive workforce is the key to our long-term international competitiveness.
- Promoting labor mobility by removing barriers to retraining and to taking new jobs. Serious consideration should be given to providing wage insurance to temporarily fill some of the gap between a displaced worker's old wage and a lower wage in a new job. Depending on the adequacy of funding, the program might also include providing for health insurance coverage during periods of sustained unemployment.

Finally, all Commission members urge improving the process of gathering and disseminating the basic data on international trade. More detailed and more up-to-date information is essential to an informed citizenry and to achieve more enlightened decision-making. A reasonable increase in the current depressed funding level is surely justified.

Conclusions

Maintaining large and growing trade deficits is neither desirable nor likely to be sustainable for the extended future. These deficits reflect fundamental imbalances in the American economy: As a nation we consume more than we produce, and we invest more than we save. A substantial slowdown in the rate of U.S. economic growth would reduce the magnitude of those problems but not eliminate them.

New economic policies that reduce those fundamental imbalances would help to curb the trade deficit in a constructive and sustainable manner. In that spirit, the following five principles are offered to help guide U.S. policymakers as they consider and enact the policies required to position the American economy for fruitful participation in the growing international economy of which we are a major and constituent part.

The following principles represent our attempt to identify some common ground to deal with the problems and opportunities generated by the increasing participation in the dynamic global marketplace on the part of American workers, businesses, investors, and consumers:

- Develop trade policies that promote a strong and growing U.S. economy by avoiding restrictions on trade, emphasizing opening markets and eliminating trade barriers and predatory trade practices. Even the United States, as the most open large economy in the world, still maintains an array of restrictions on imports and on exports.
- Fully enforce U.S. international trade laws and the international agreements that we have entered into, while trying to ensure that the nations we trade with fully enforce the international agreements they have entered into.
- Reduce U.S. dependence on foreign funds by enhancing our competitiveness in the global marketplace and increasing the extent to which domestic saving is adequate to finance domestic investment.
- Even though international commerce on balance substantially benefits the American people, a sense of fairness requires us to recommend paying more attention to those who are hurt by international trade and U.S. participation in the global economy. The challenge is to develop courses of action to minimize the harm and help those who are hurt without doing far more harm to those who benefit from international commerce.
- The focus of U.S. policy to adjust to the consequences of trade and the trade deficit should be on positive approaches that help more of our people participate in economic prosperity, rather than providing relief from or attempting to halt economic change. The most fundamental aspect of an effective, long-run adjustment policy is to do a much better job of educating and training Americans to become more productive and higher wage members of the nation's workforce.

Respectfully submitted,

Murray Weidenbaum, Chairman
Wayne Angell, Member
Carla Hills, Member
Anne Krueger, Member
Don Rumsfeld, Member
Robert Zoellick, Member