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Trade and the American Economy: Why Trade Promotion Authority Matters

President's Council of Economic Advisers

This Special Report, prepared for the ACCF, draws on a paper released by the Council of Economic Advisers in February, 2002, entitled "Trade and the American Economy: The Case for Trade Promotion Authority." The ACCF offers this Special Report in an effort to promote discussion on the impact of trade promotion authority on U.S. economic growth and living standards.

Background

The strength and well-being of the American economy is tied to that of the global economy. For the United States to advance its long-standing interest in an open world trading system, it must provide the leadership necessary to reduce trade barriers around the world. But for the past seven years, the executive branch has lacked Trade Promotion Authority, leading the process of opening trading markets to stall. The costs of inaction are mounting: significant trade barriers hampering U.S. exports remain, the commercial disadvantage of the United States is growing as countries around the world conclude trade agreements without us, and the most powerful force for economic development in poorer nations remains underutilized.

Trade Is Good for the American Economy

Over the last few decades, international trade has become an integral part of the U.S. economy. International trade brings enormous benefits to the United States and to the rest of the world. Trade between countries is mutually beneficial in the same way that a voluntary transaction between individuals makes both parties better off. Most of us do not produce for ourselves even a fraction of the goods we consume; instead, we "export" the goods and services that we produce with our own labor and "import" the goods and services that we wish to consume. This division of labor enables us to enjoy a higher standard of living than would be possible if we tried to produce everything for ourselves.

Trade between nations is the international extension of this division of labor. Trade is a two-way street. The United States exports some of the goods and services it produces in exchange for imports of the goods and services produced by other countries. The United States, for example, specializes in the production of aircraft, industrial machinery, and agricultural commodities (particularly corn, soybeans, and wheat). In exchange for exports of these products, the United States purchases, among other things, coffee, crude oil, automobiles, and shoes.[1] Both exports and imports are beneficial and help make the United States a richer and more efficient economy.

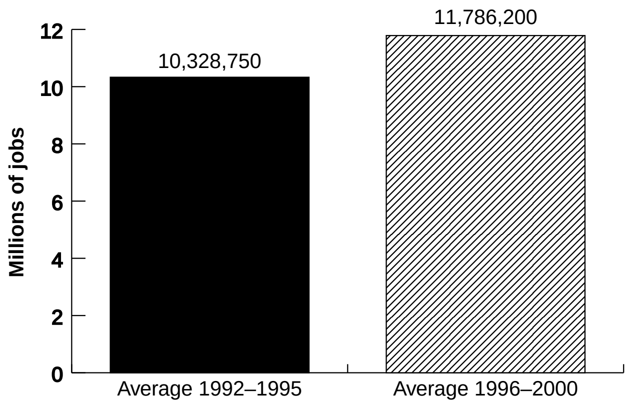
The Benefit of Exports

When foreign markets are open to the United States, American workers have another market in which they can sell the goods and services that they produce. The United States exported over $1 trillion in goods and services in 2001—10 percent of our gross domestic product (GDP).[2] Over 12 million American jobs are supported by exports[3] (see Figure 1). Opening foreign markets for U.S. producers allows them to expand their output and hire more American workers.

The health of many sectors of the American economy depends upon trade. America's farmers, for example, rely on sales to foreign markets. Key manufacturing industries also depend upon foreign markets. The aerospace industry exports over 40 percent of its output, while the chemical industry exports nearly 20 percent.[4] Even the service sector increasingly looks to foreign markets for its expansion. Service exports, which include sales of insurance, financial, educational, and telecommunications services, are among the most rapidly increasing part of U.S. trade, reaching nearly $314 billion in 2001.[5]

The opportunity to sell goods in the competitive international marketplace provides incentives and rewards for domestic firms that raise their productivity. Studies have

Figure 1 U.S. Jobs Supported by Goods and Services Exports



Source: Calculations by the Office of the U.S. Trade Representative.

shown that exporting plants have 4–18 percent higher total factor productivity than comparable non-exporting plants.[6] Expanding trade provides greater markets for the most efficient producers, thereby helping to improve domestic productivity performance and raise living standards.

The Benefit of Imports

One benefit of imports is that they give businesses and consumers access to types of goods that may not be produced in the United States, as well as inputs that are necessary for domestic production. Imports of specialized equipment help American businesses acquire world-class technologies, enabling them to compete on an equal footing with foreign competitors who already have access to those technologies. Over 25 percent of U.S. imports are non-automotive capital goods: machinery, equipment, instruments, parts, and various other components.[7] And daily staples of American households, such as coffee, tea, and certain tropical fruits, are imported because the United States does not produce many of the world's available varieties. Imports bring about lower prices for consumers on a number of everyday goods, such as food and clothing. These lower prices increase the purchasing power of every consumer dollar spent, again raising living standards.

Trade Promotes Good Jobs

The expansion of trade raises the average income of the American worker. This is because wages in import-competing industries are well below average, whereas wages in exporting industries are well above average. The United States tends to export more skill-intensive manufactured products, such as aircraft, construction machinery, engines and turbines, and industrial chemicals.[8] Average hourly earnings in the aircraft industry were 56 percent above the average in manufacturing, for example, and were 21 percent higher in the pharmaceutical industry.[9] In addition, one study found that in 1992, blue-collar workers in the average exporting plant earned 13 percent higher wages than those in the average non-exporting plant (see Figure 2). For white-collar workers, the premium was 18 percent (see Figure 3).[10]

Exports and imports generate major benefits for the economy, but imports often raise concerns about worker displacement. Yet the decisions of U.S. producers to switch to imported supplies are responsible only for a fraction of job displacements in any given year—1.9 percent of the non-seasonal layoffs in the United States in the third quarter of 2001.[11]

The flip side of workers who may be displaced due to increased imports is the expansion of workers who owe their jobs to exports. Indeed, trade should be viewed as a mechanism that shifts jobs, displacing import-competing positions but often increasing opportunities in export-competing sectors.[12] Trade will not only be likely to secure the 12 million jobs already linked to exports,[13] but could also enhance the employment opportunities of others.

Workers who are displaced from their jobs due to imports are given special financial assistance by the federal government to smooth their transition to new jobs. These programs help ease the effects of economic change to workers by providing additional financial assistance to them as well as worker retraining opportunities.

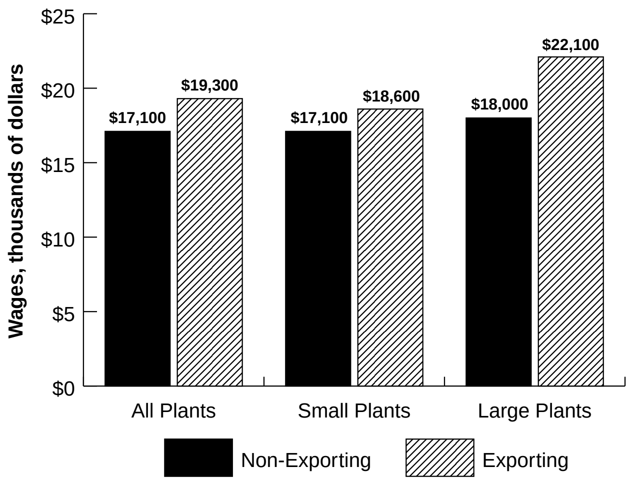
Imposing trade restrictions in an effort to save the jobs of workers displaced by imports will only destroy jobs in other sectors of the economy. If government trade barriers hinder access to imported capital goods, then domestic firms purchasing those inputs will be forced to operate with higher costs of production. This adversely affects their competitive position vis-a-vis foreign rivals who have free access to such capital goods. Domestic producers may lose sales, forcing them to downsize their workforce or even to shift production abroad where the inputs are freely available.

Trade Agreements Are Good for the American Economy

As the world's largest exporter and one of the most open countries in the world, the United States stands to gain from removing barriers to trade in goods and services. The United States has indeed benefited tremendously from recent trade agreements. For example, the 1993 Uruguay Round of the General Agreement on Tariffs and Trade (GATT), upon full implementation, has been estimated to imply a per-year income gain of between \$600–\$800 for the average household of four.[14]

Unfortunately, the process of dismantling trade barriers and updating trade rules had, until recently, stalled. Nearly a decade has passed since the Uruguay Round, the most

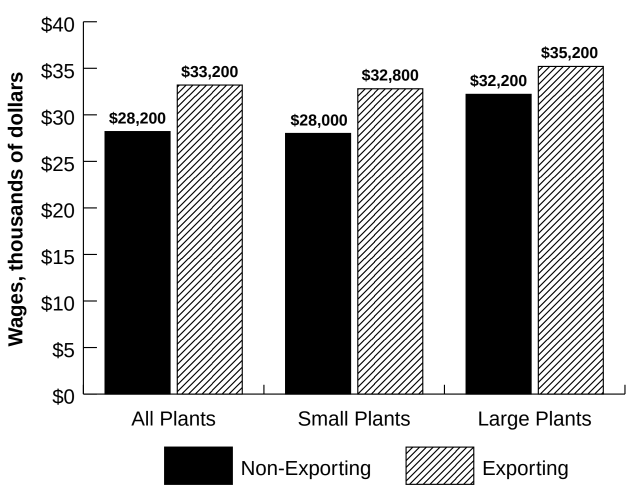
Figure 2 Wages of Blue-Collar Workers in Average Exporting and Non-Exporting Plants in 1992



Note: All Plants represents average of all sizes, locations and industries of plants; Small Plants represents average of locations and industries of plants with fewer than 250 workers; Large Plants represents average of locations and industries of plants with greater than 250 workers.

Source: J. David Richardson and Karin Rindal, *Why Exports Matter: More!* (Washington, D.C.: Institute for International Economics and the Manufacturing Institute, 1996).

Figure 3 Wages of White-Collar Workers in Average Exporting and Non-Exporting Plants in 1992



Note: All Plants represents average of all sizes, locations and industries of plants; Small Plants represents average of locations and industries of plants with fewer than 250 workers; Large Plants represents average of locations and industries of plants with greater than 250 workers.

Source: J. David Richardson and Karin Rindal, *Why Exports Matter: More!* (Washington, D.C.: Institute for International Economics and the Manufacturing Institute, 1996).

recent set of trade negotiations to be completed. There are many reasons why the pace of trade liberalization has slowed in the United States; one is that trade negotiations have been made more difficult because our trading partners recognize that approval of trade agreements may involve renegotiating terms with the U.S. Congress.

This is one reason why Trade Promotion Authority is an urgent priority. Trade Promotion Authority involves the promise by the Congress that it will give thorough, yet expedited, consideration to any trade agreement reached by the U.S. president, and that it will not amend any agreement submitted by the president. Note that the Congress must give its consent to any agreement reached by the executive branch before it is implemented, and retains the option to reject an agreement it finds unacceptable. Trade Promotion Authority, however, is essential to convince our trade partners that the United States is serious about the negotiations and that U.S. negotiators have the support of the Congress.

Trade Promotion Authority will facilitate upcoming negotiations that promise to benefit the United States significantly. For example, the United States helped to launch a new multilateral trade negotiating work program at the World Trade Organization ministerial meeting in November, 2001. Because the multilateral negotiations promise to reduce barriers to U.S. trade around the entire world, the potential gains from a new trade round are sizeable. *One study finds that if a new trade round reduces world barriers on agricultural and industrial products and on trade in services by one-third, the gains to the United States could amount to $177 billion annually, or about $2,500 for the average American family of four.*[15] While there are many factors related to the successful completion of the work program, the prospects would improve with a clear signal from the Congress that it supports Trade Promotion Authority.

A lack of leadership in promoting free trade around the world carries a high price for the United States.

■ **First, many foreign barriers to U.S. exports remain in place.** These barriers deny us access to foreign markets. U.S. producers face extremely high tariffs in many developing countries. Many of our trading partners, including the European Union (EU) and Japan, maintain high barriers on agricultural goods. The United States also faces discriminatory regulations in many countries. These obstacles must be tackled in future trade negotiations.

■ **Second, while the United States is deciding whether to pursue further trade agreements, other countries have moved ahead with their own.** The EU has proceeded with bilateral and regional negotiations that reduce tariffs on their products but not on those produced in the United States.[16] Since 1990, the EU has reached trade agreements with 20 countries, including Mexico, South Africa, and Morocco.[17] The EU is actively involved in other negotiations that, if concluded, would give EU producers preferential access to those foreign markets. This access could undercut U.S. exports to those markets. The damage to American interests from exclusion from foreign trade agreements is not just confined to discriminatory tariff treatment in these areas. Most trade agreements include provisions dealing with trade in services, product standards, regulatory treatment, and investment provisions. Trade agreements that do not include the United States can result in discriminatory regulations and unfavorable standards for American business and workers.

■ **Third, new areas of commerce are emerging in which the United States has a productive advantage, including trade in services, telecommunications, e-commerce, etc.** Unless global rules are written ensuring that foreign markets remain open, the United States will find that other countries could restrict access through special taxes and arbitrary and discriminatory regulations. The United States must begin to negotiate now to prevent the use of taxes and regulations that harm our commercial interests.

■ **Fourth, the costs of not participating in ongoing world trade negotiations means that U.S. exports will face increasing discrimination in foreign markets.** When U.S. firms labor under disadvantageous tax treatment in foreign markets, it translates into lost sales for American firms. This clearly harms America's commercial interests.

Conclusion

Active promotion of trade by the United States serves our commercial, foreign policy, and security interests. Expanding trade helps the American economy become more productive and competitive and grow more rapidly. Expanding trade generates economic opportunities in other countries, creating a climate for economic and political freedom.

Other countries will continue to actively promote their commercial interests, even if the United States remains on the sidelines. If we remain a spectator, the United States will begin to lose its influence in the world and its influence over future rules governing world trade. Not only will formidable barriers to U.S. exports remain in place, but the United States will face an international economic environment that increasingly discriminates against it. It is time to give trade negotiations a better chance for success by enacting Trade Promotion Authority. ❖

Notes:

1. U.S. Department of Commerce, Bureau of the Census, "U.S. International Trade in Goods and Services" (monthly release).

2. U.S. Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts* (updated quarterly).

3. Based on calculations by the Office of the U.S. Trade Representative.

4. U.S. Department of Commerce, Bureau of the Census, *Annual Survey of Manufacturers*.

5. U.S. Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts* (updated quarterly).

6. Andrew B. Bernard and J. Bradford Jensen, "Exceptional Exporter Performance: Cause, Effect, or Both?" NBER Working Paper 6272 (Cambridge, Mass.: National Bureau of Economic Research, 1997).

7. U.S. Department of Commerce, Bureau of Economic Analysis, *National Income and Product Accounts* (updated quarterly).

8. U.S. Department of Commerce, Bureau of the Census, "U.S. International Trade in Goods and Services" (monthly release).

9. U.S. Department of Labor, Bureau of Labor Statistics, data from the National Compensation Survey.

10. J. David Richardson and Karin Rindal, *Why Exports Matter: More!* (Washington, D.C.: Institute for International Economics and The Manufacturing Institute, 1996).

11. Note that, in America's dynamic labor market, most layoffs are due to seasonal work, contract completion, or internal company restructuring due to domestic factors. See U.S. Department of Labor, Bureau of Labor Statistics, "Extended Mass Layoffs" (quarterly release). Note that reasons for layoffs are reported by employers, who may not attribute layoffs to import competition, even though that is the cause.

12. Note that trade does not affect overall employment; fiscal and monetary policies do.

13. Calculations by the Office of the U.S. Trade Representative.

14. Council of Economic Advisers, "America's Interest in the World Trade Organization: An Economic Assessment," November 1999, and calculations by the Office of the U.S. Trade Representative.

15. D. Brown, A. Deardorff, and R. Stern, "Impacts on NAFTA Members of Multilateral and Regional Trading Arrangements and Initiatives and Harmonization of NAFTA's External Tariffs" (University of Michigan, Research Seminar in International Economics Discussion Paper 471, June 2001). Population data from the U.S. Department of Commerce, Bureau of the Census, and family gains calculations by the Council of Economic Advisers. For more estimates of the gains from a new trade round, see the following studies: J. Francois, *The Next WTO Round: North-South Stakes in New Market Access Negotiations* (Adelaide, Australia: Centre for International Economic Studies, University of Adelaide, 2001); and T. Hertel, "Potential Gains from Reducing Barriers in Manufacturing, Services and Agriculture," *Review,* Federal Reserve Bank of St. Louis, July-August 2000.

16. Some economists criticize these types of bilateral and regional agreements, suggesting that they conflict with multilateralism. (See *The Economics of Preferential Trade Agreements*, eds. J. Bhagwati and A. Panagariya [Washington, D.C.: AEI Press, 1996].) Others disagree. (See C. Freund, "Spaghetti regionalism," Board of Governors of the Federal Reserve System, International Finance Discussion Paper 680, September 2000.)

17. World Trade Organization, "Mapping of Regional Trade Agreements," note by the Secretariat, October 2000.