# Why Trade Deficits Are Important

## A HOLE IN THE U.S. TRADE ZONE

by U.S. Representative Peter DeFazio

### Introduction

World trade has changed dramatically in the past decade, yet many pundits persist in portraying the debate over trade policy as a struggle between "protectionists" and "free traders." The complex new rules of NAFTA and the WTO have swept aside many of the barriers considered traditionally protectionist (mainly tariffs) and in their place substituted a host of new rules and secretive trade-dispute resolution processes, which hardly constitute free trade in the classic sense. The new trade rules have already had a dramatic impact on U.S. industry, workers, wage levels, farmers, and the environment—and much of it has been negative.

### Trade Deficits

If I told you the Oregon Ducks scored 21 points in last Saturday's football game, you would not have all of the information you would need to know who won the game—you would also need to know the other team's score.

Yet, proponents of our current trade policy argue that U.S. exports have increased. While true, that is only half the information: imports have accelerated at an even greater rate. The result is a skyrocketing U.S. trade deficit.

This trade deficit—currently a record $435 billion—is one of the most dangerous and overlooked results of recent U.S. trade policies.

One of the largest deficits in the history of the world, the U.S. trade deficit is an unprecedented 4.5 percent of the GDP (a higher percentage than the deficits of Indonesia and South Korea just prior to their economic implosions in 1997). To cope with this deficit, our country must bring in $2 billion more than it spends every working day. We simply cannot sustain this cost.

New free-trade agreements have been proposed as the key to future U.S. economic growth, but if those agreements mirror the current ones, they will further hurt economic growth. C. Fred Bergsten of the relatively conservative Institute for International Economics recently testified before Congress that the trade deficit is a drag on economic growth. He stated, "Export output falls and domestic demand that could be met by domestic output is instead satisfied by higher imports. U.S. output and employment suffer as a result and must be of concern."

Record trade deficits also mean that the US is increasingly, and dangerously, reliant on foreign capital. Today, foreigners hold 40 percent of U.S. Treasury debt, 24 percent of U.S. corporate bonds, and 13 percent of U.S. equities. In a dramatic understatement, Federal Reserve Chairman Alan Greenspan told Congress earlier this year, "there are ever increasing claims on the American economy by foreign investors and that can't go on indefinitely without some difficulty."

Foreign investors might look at the large US trade deficit and recent corporate scandals, change their minds about the attractiveness of the U.S. investment environment, and plunge the U.S. into an economic crisis. Argentina and Brazil have already been victims of fickle international capital market.

### Job Loss

As with the one-sided presentation of export data, free-trade proponents point to the jobs created by increased exports to justify their policies. Again, they ignore the other side: jobs displaced by increased imports.

The U.S. trade imbalance has eliminated millions of jobs at home and contributed to stagnant wages for those who remain employed. Using the same models that trade proponents use to estimate jobs created by exports, the Economic Policy Institute has estimated that the U.S. lost 3 million jobs from 1994 to 2000 because of increased imports and the rising trade deficit. Oregon alone lost more than

**Record trade deficits also mean that the U.S. is increasingly and dangerously reliant on foreign capital.**

41,000 jobs (See www.tradewatch.org for company-by-company layoffs in Oregon attributable to NAFTA). Today's U.S. wages—adjusted for inflation—are the same as those of the 1970s.

U.S. trade policies and deficits also contribute to the shift from high-paying manufacturing jobs to service-sector jobs. From the beginning of 1997 through the first quarter of 2002, U.S. manufacturing output rose only 12 percent, while imports soared 45 percent.

### Agriculture

It's not just industrial workers who have lost because of U.S. trade policies. Farmers and rural communities have been devastated. NAFTA and other trade agreements were a beacon of hope for America's farmers; government agencies and private researchers projected steady growth in exports throughout the 1990s.

These forecasts were backwards. U.S. farm exports dropped 22 percent between 1996 and 2000, while farm imports rose nearly 10 percent.

The U.S. balance of trade in farm products has fallen 57 percent since 1996, prices for major commodities have fallen nearly 50 percent, 72,000 family farms disappeared in the mid-to-late 1990s, and U.S. farm income is expected to decline nine percent in the coming year.

The Oregonian, highlighting the plight of farmers, detailed unfair trade practices of Chilean fruit growers that are causing Oregon farmers to go bankrupt (12/23/02, 4/28/02). The San Francisco Chronicle detailed the losses to fishermen because of salmon dumped onto the U.S. market by Chile (4/1/02).

The story is the same for other commodities and trading partners. Oregon wheat farmers asked me to support preferential trading status for China because of supposed market opportunities. However, China has a massive surplus of most agriculture commodities, including wheat, and thus no need to buy from U.S. farmers. After Congress approved Most Favored Nation trading status for China, and the first U.S. wheat shipment was accepted in China, wheat shipments ground to a halt. Shipments from Oregon wheat growers sat and rotted in Chinese ports. At the same time, Oregon lumber mills have been undercut by subsidized lumber from Canada. *(See Tom Potiowsky's article—ed)*

### Labor and the Environment

U.S. trade policies also have contributed to the degradation of labor rights and environmental protection both at home and around the world.

Rules under NAFTA and the WTO prohibit discriminating against a product based on how it is made. In other words, a shoe is a shoe whether it is made by unionized labor in the U.S. or abused labor in China. Lumber from trees harvested sustainably is considered identical to lumber produced from unsustainable forest practices or subsidized production.

Proponents of free trade claim that

<u>A Response to Peter Defazio:</u>

### Why Exports and Imports are Not the Issue

In his discussion, Representative DeFazio makes several good points. He is entirely correct that as trade becomes freer some American workers have seen their wages fall and their jobs eliminated. He also levies valid criticisms against the political process that has led to tariff reductions. Unfortunately, Representative DeFazio also makes two common oversights in his analysis.

Two results from free trade are so pervasive that most economists take them as fact. The first is that movement towards free trade creates winners and losers. Representative DeFazio focuses on this fact. As falling tariffs lead to increased trade, there is a greater demand for workers in exporting industries and less demand for employees in import-competing industries. In the U.S., the former group tends to be well-paid, highly educated workers while the latter group consists of relatively unskilled and low wage workers. As a result, with free trade the rich get richer while the poor get poorer. There is, however, a second fact that can counter this. There is an undeniable positive link between average incomes and free trade. Those regions with the highest trade growth also enjoy the highest income growth while those with low trade growth experience stagnant income growth. How can this positive effect on income be reconciled with the losses that some experience? It is because the winners win more than what the losers lose. Increased international trade improves efficiency by allowing countries and firms to use their resources in the most productive fashion. Because this increases the total amount of money to go around, free trade can be used as a part of a plan for improving the lot of all workers. To complete the plan, it is necessary to take some of the gains from the winners and use them to compensate the losers through worker relocation efforts, training subsidies, welfare, and the like. Representative DeFazio ignores this second fact of international trade and condemns free trade outright. However, his problem does not lie with trade itself, but with the distributional effects that it causes.

This can be seen through DeFazio's suggested reforms. These recommendations fall into two broad categories. First, he calls for greater transparency and intra-government balance in policy formation. Second, he asks for greater recognition of environmental, labor, and industrial fairness issues. However, none of these have anything to do with the level of trade but instead relate to how governments deal with the effects from a given amount of trade. This means that DeFazio's problems with free trade are not actually problems with trade but with how our government responds to its effects. As such, attacking trade deprives us of a powerful tool for improving the lives of all workers.

DeFazio's second misstep is that he asserts that exports are goodwhile imports are bad. While this attitude is common, it makes little sense because one simply cannot exist without the other. The entire rea

*Continued on next page.*

incorporating labor rights and environmental standards is an inappropriate mixture of economic and social issues.

Representative Sander Levin, a key Democratic supporter of previous trade agreements, put it best when he said that labor and environmental issues "are fundamentally economic issues that are directly relevant to the structure of international competition. In the domestic context, we don't hesitate to say that right to work laws or emission standards, to pick two examples, are issues that affect economic competition. …accordingly, it is illogical and inconsistent to suggest these issues are irrelevant with respect to international commerce and competition."

Opponents of the Kyoto global-warming agreement are opposed to it not because it's a social agreement, but because of its potential economic impact.

## Sovereignty

Finally, as if destroying American jobs, rural communities, and the environment weren't enough, U.S. trade policies assault the sovereignty of U.S. citizens.

NAFTA's Chapter 11 allows, for the first time, a private company to sue a foreign government when a government takes an action that is "tantamount to expropriation." Unfortunately, the definition of this phrase is extraordinarily broad. If federal, state, or local officials pass a law or write a regulation that a company believes limits their ability to make a profit, that company can sue to overturn the law or regulation or get monetary compensation for lost profits.

This provision grants foreign investors in the U.S. greater rights than domestic companies. A string of Chapter 11 cases have been filed against Canada, Mexico, and the United States. (See Brent Foster's article and the sidebar by William Leiss and Stephen Hill—ed) In Loewen v. U.S., a Canadian company is arguing essentially that the U.S. tort system is illegal. A Canadian steel company has sued to eliminate "Buy American" laws for highway-construction projects in the United States.

These lawsuits are debated in secret tribunals that issue binding decisions without regard to consumer health and safety or the environment. No third parties can file briefs. Even states can't defend themselves. The Bush administration has total discretion over how or whether to defend state or local laws. (See sidebar "Negotiators and Arbitrators: Who is Chapter 11?")

Businesses use Chapter 11 protection as a first option to influence the sovereign lawmaking and regulatory processes of countries, rather than a last resort for egregious conduct by governments. If a country wants to keep a law that was ruled illegal by a tribunal, it has to pay for that right. In the end, either taxpayers pay millions to compensate corporations for our sovereign right to protect public health and safety or U.S. laws are repealed or gutted, as in the recent Commerce Department decision to relax dolphin-safe tuna-labeling rules.

## Necessary Reforms

Our current trade policies allow multinational corporations to receive the lion's share of the benefits of expanded trade without extending benefits to workers, communities, public health, or the environment. There is a better way.

First, Congress should maintain its constitutional authority to "regulate commerce with foreign nations" (Article I, Section 8). Fast-track trade negotiating authority—which allows the President to negotiate trade agreements with virtually no input from Congress and forces Congress to vote yes or no without the opportunity for amendments—destroys the checks and balances articulated in our Constitution. This inappropriate delegation of authority is particularly problematic since today's agreements deal with more than setting tariffs. They have broad impacts on the environment, consumer and worker safety, and a vast array of domestic regulatory standards.

Second, trade agreements must include, in the main text, recognition of the five core labor standards: freedom to associate, the right to organize and bargain collectively, ban on child labor, ban on forced labor, and ban on discrimination in employment. These standards should be enforced through the same mechanisms that enforce the commercial provisions in the agreement. Similarly, trade agreements must include environmental protection measures, enforceable with the same dispute resolution procedures and penalties as commercial provisions. For example, trade agreements could allow barriers against agricultural products grown with toxic chemicals or fish harvested in an unsustainable manner. At a minimum, trade agreements should not trump multilateral environmental agreements.

Third, investor-protection provisions must be narrowed significantly. The language "tantamount to expropriation" [mlg6]should be removed. Companies should receive compensation only if physical assets, such as a factory, are seized.

Fourth, Congress should create a Congressional Trade Office, modeled on the Congressional Budget Office, to provide expert, non-partisan analysis on trade issues. Congress currently relies too much on the Executive Branch for trade analysis.

These steps would go a long way toward creating a mutually beneficial trade policy that benefits workers, consumers, and the environment while protecting our sovereignty.

Congressman Peter DeFazio was first elected to the U.S. Congress in 1986. He is a member of the House Select Committee on Homeland Security, with jurisdiction over the newly created Department of Homeland Security. DeFazio is also a member of the Transportation and Infrastructure Committee, and serves as ranking member of the Aviation Subcommittee, where he is a vocal advocate for consumers and aviation security. He also serves as a member of the Coast Guard and Maritime Transportation Subcommittee and the Railroad Subcommittee

DeFazio and his wife, Myrnie Daut, live in Springfield, OR. He has logged over two million miles traveling between Oregon and Washington, DC about three times each month to serve the people of Oregon's Fourth Congressional District in the United States Congress. http://www.house.gov/defazio/

*Continued from previous page.*

son we export is so that we can import in return. To say that only exports are good is like saying that saving is good while withdrawing is bad. However, the entire reason we save is to withdraw or borrow down the line. Just as we expect individuals to cycle through periods of saving and borrowing, we should expect countries to cycle through periods of trade surpluses and deficits. If we continually export more than we import, then we will never enjoy the full benefits of our hard work. Exports are not good and imports are not bad, instead they are both necessary parts of a single process that allows us to benefit from trade.

Despite these oversights, DeFazio's analysis reminds us of the need to respond to the negative consequences of free trade. This is especially important since these losses often fall on poorer Oregonians. However, instead of abandoning free trade as DeFazio suggests, I counter that it is better to recognize free trade as a double-edged sword that must be wielded carefully if we are to reap its large benefits in a fair manner.

*Dr. Ronald B. Davies*

Ronald Davies is a professor at the University of Oregon. His research focuses on international trade and foreign direct investment. He is also a faculty advisor for Alpha Phi Omega, a national co-ed service fraternity.

## On The Web

*Oregon's Future* Online Edition

www.oregonsfuture.org

### The Environmental Benefits of Globalization

**John Charles**, Director Environmental Policy Program of the Cascade Policy Institute Environmental activists who criticize free trade often make two arguments. First, they criticize the American lifestyle as environmentally "unsustainable" and fear that adoption of similar values by other cultures through globalization would result in catastrophic shortages of finite natural resources. As summarized by environmental writer **Alan Thein Durning**, "If people in 3rd World countries lived the same lifestyle as the average American, we'd need seven more earths to provide all the natural resources."

The second argument is that international trade encourages multi-national corporations to shop for the locations offering the weakest environmental protections, fostering a "race to the bottom" that puts profits ahead of all other values. While these are legitimate concerns, there is little evidence to support either argument.

*...continued on web*

### Taking Advantage of the Trade Opportunity

**Wayne Lei, Ph.D**, Director of Environmental Affairs, PGE and **Bill Blosser**, Board Member, International Sustainable Development Foundation

Oregon is uniquely positioned to be an international gateway for trade in goods, services and technologies that advance sustainable development…helping to globally stop the environmental destruction of past practices, improving efficiencies and designing things more intelligently for the future. Leveraging the best of what large and small companies have to offer, Oregon can use its natural assets and learned capabilities to take advantage of this growing global marketplace. Taking advantage means we need to actively support our existing companies, build on their strengths and more effectively market the Oregon brand in the U.S. and internationally—if we don't, others will.

*...continued on web*

Additional forum articles available on our website **www.oregonsfuture.org**