

WORLD TRADE AND THE AMERICAN ECONOMY

C. Fred Bergsten
Director, Peterson Institute for International Economics

A Presentation to the
World Trade Week Kickoff Breakfast
Los Angeles, California

May 3, 2010

I am delighted to help launch this 84th annual World Trade Week in Los Angeles, which is truly the “capital of the Pacific Rim” as last year’s keynote speaker suggested. I congratulate the ports of Los Angeles and Long Beach, the city of Los Angeles and the state of California for their leadership in promoting an active and constructive trade policy in the United States.

Trade and World Economic Growth

I am particularly pleased to be here today because the trade picture is so much brighter than when you met a year ago. At that time, both exports and imports were plummeting due to the global recession. US trade was dropping by annual rates of 25-30 percent and trade of some other major countries was falling even faster. World trade was falling even faster than in the early years of the Great Depression of the 1930s.

We should not have been surprised, however. Since the Second World War, trade has expanded by a multiple of world economic growth, rising about four times as fast in the fifty years prior to the recent turndown. It then dropped by a slightly higher ratio in late 2008 and early 2009. Fortunately, it is now recovering at least as rapidly. US trade has expanded by annual rates of over 20 percent since the recovery began in the third quarter of last year while GDP has been advancing

at a rate of 3-4 percent. Hence we can rest reasonably assured that trade growth is back on a robust track and resume thinking about how to foster it further.

Trade and the US Economy

That outcome is highly fortuitous because trade has become a huge contributor to the US economy, and looks like becoming even more critical in both the immediate and longer term future. Careful studies at our Peterson Institute for International Economics, employing three different methodologies, concluded that the US economy is about \$1 trillion per year richer -- about \$10,000 per household or almost 10 percent of our entire annual income at the time the studies were done a few years ago -- as a result of the trade expansion of the past half century¹. These gains derive from the availability of cheaper and more varied products via imports, higher productivity due to the pro-competitive impact of globalization and the higher wages that accrue to American workers from exporting more of the goods and services that they can produce most efficiently.

Increased trade, like any dynamic economic change, of course also generates adjustment costs, mainly in the form of temporary job dislocations and longer term reductions in earnings for some workers. We estimated these costs at about \$50 billion per year, a non-trivial sum. But this leaves the benefits from trade about twenty times greater, \$1 trillion compared with \$50 billion, affirming its very substantial net payoff to our economy.

President Obama has recently emphasized these gains from trade and called for a doubling of US exports over the next five years, with a goal of creating two million new jobs as a result. This

¹ Bradford, Scott C., Paul L.E. Grieco, and Gary Clyde Hufbauer. 2005. The Payoff to America from Global Integration. In *The United States and the World Economy: Foreign Economic Policy for the Next Decade*, ed. C. Fred Bergsten. Washington: Peterson Institute for International Economics.

would require annual export growth of about 15 percent but I believe we can and should do much better: we should aim to double the share of exports in the total US economy, from about 10 percent in 2009-2010 to 20 percent in 2020. The “bumper sticker version” of this proposal is “From 10 in 10 to 20 in 20.” Such a shift in the composition of US output is in fact necessary to implement the international “rebalancing” strategy agreed by the G-20 over the past year, under which the United States would no longer rely on debt-financed consumer demand to fuel our economy and the surplus countries (especially China, Japan and Germany) would no longer rely on ever-rising trade surpluses to fuel theirs.

Moreover, the United States must expand exports to achieve a constructive correction of the huge trade and current account deficits that we have run for most of the past three decades. These deficits already long ago converted us from being the world’s largest creditor country, which we were as late as 1980, to the world’s largest debtor country with a net foreign debt in excess of \$3 trillion today. Our external deficits have come down sharply over the past three years, largely due to the world recession, but are now rising again and could become far worse over the coming years and decades. A recent study at our Institute in fact shows that, if US budget deficits remain as large as now seem likely, our external deficits will rise toward unprecedented levels – by 2030, \$6 trillion and 15 percent of GDP, compared with the record to date of about \$700 billion and 6 percent of GDP in 2006, taking the net foreign debt to \$50 trillion and 150 percent of GDP.² This trajectory is so clearly unsustainable that the United States would inevitably be forced at some point, perhaps sooner rather than later, into a draconian adjustment (somewhat like Greece today) that could make the recent crisis look like a minor turndown. It would obviously be far better to improve our net

² Cline, William R. 2009. Long-Term Fiscal Imbalances, US External Liabilities and Future Living Standards. In *The Long-Term International Economic Position of the United States*, ed. C. Fred Bergsten. Washington: Peterson Institute for International Economics.

export (and thus current account) position by expanding exports themselves rather than by shrinking imports through slowing our economic growth or imposing new border barriers.

Expanding US Trade

The operational policy question is how to obtain the needed increase in US trade, with a particular focus on exports but also expanding imports (which as noted clearly help the economy as well). There are three important parts of any effective strategy to do so.

The most important centers on the exchange rate of the dollar. Every 1 percent overvaluation of the dollar, relative to the underlying competitive position of the United States, chokes off \$20-25 billion of annual exports (and thus 100-150,000 high-paying jobs during a period of high unemployment like we are experiencing now). Our latest calculations at the Institute, updated to take account of the most recent changes in currency markets, suggest that the dollar is now overvalued by about 10 percent even after the orderly decline of about 25 percent that has taken place since 2002.³ This reduces exports by \$200-250 billion and displaces 1-1.5 million American workers. Elimination of this currency overvaluation, which would come without any budget cost, would be by far the most cost-effective strategy to increase US employment and would arguably have greater impact than the heralded fiscal stimulus legislation of 2009 (with its budgetary price tag of around \$800 billion).

The dollar has again become slightly overvalued against the euro, and the currencies of several other industrialized countries, but the great bulk of the remaining overvaluation is vis-à-vis

³ Cline, William R., and John Williamson. January 2010. *Notes on Equilibrium Exchange Rates: January 2010*. Policy Brief 10-2. Washington: Peterson Institute for International Economics.

the Chinese renminbi and several other Asian currencies that mirror it very closely. China causes much of the problem itself by its deliberate policy of aggressive intervention in the foreign exchange markets, buying about \$1 billion daily to keep its currency far weaker than underlying fundamental and market forces would suggest. Our studies show that this “China bloc” is undervalued by about 25 percent on average against the world as a whole, and by about 40 percent against the dollar, and that correction of this misalignment alone would strengthen the US trade balance by \$100-150 billion annually and support five hundred thousand to one million American jobs.⁴

A second measure to strengthen US sales abroad is liberalization of our export controls that are allegedly maintained to protect US national security. Our comprehensive study of the topic almost two decades ago showed that the United States was cutting off \$25-50 billion of foreign sales itself, often without much security benefit because the controlled products were readily available elsewhere around the world. We are now preparing a new analysis that looks like concluding that today’s numbers are at least as large. The Administration has conducted an extensive review of the issue, and Secretary of Defense Robert Gates has recently characterized the present system as a “decades-old, bureaucratically labyrinthine system (that) does not serve our 21st-century security needs or our economic interests,” but to date they have proposed only modest reforms to streamline the licensing of strategically sensitive products and technologies and more far-reaching changes are clearly needed.

Trade Agreements and the US Economy

⁴ Goldstein, Morris, and Nicholas R. Lardy. July 2009. *The Future of China’s Exchange Rate Policy*. Policy Analyses in International Economics 87. Washington: Peterson Institute for International Economics and Goldstein, Morris, and Nicholas R. Lardy. April 2008. *Debating China’s Exchange Rate Policy*. Washington: Peterson Institute for International Economics.

The third major instrument to expand US trade, including exports, is trade agreements. Our studies of the past suggest that about one quarter of the huge trade gains to the United States over the last half century, as reported above, have derived from these policy steps; the other three quarters resulted from GDP growth and technological advances in transportation and communications. Moreover, we believe that most of the benefits over the last decade or two came from trade negotiations and that considerable further benefit, approximating \$500 billion or another 5 percent of GDP, could be obtained by eliminating the remaining national barriers to trade (including our own).

At the moment, the most promising US trade negotiation is the TransPacific Partnership (TPP) to which President Obama committed the United States last November. This effort to forge closer economic ties with a range of countries around the Pacific Rim is the Administration's only positive trade policy action to date. It was undertaken for two reasons: to counter the movement of major Asian economies to forge new trade compacts with each, and with the European Union, that will discriminate significantly against US exports; and to prevent the creation of an Asian bloc that would inevitably be dominated by China with major foreign policy and national security as well as economic implications for the United States. Only seven smaller countries other than the United States (Australia, Brunei, Chile, New Zealand, Peru, Singapore and Vietnam) are now engaged in the TPP but it could soon come to include at least Canada, Japan, Korea, Malaysia and Mexico and thus represent one of the largest trade groupings in the world.

The TPP is viewed by the Obama Administration and other participating countries as an important stepping stone toward eventual creation of a Free Trade Area of the Asia Pacific, as proposed by President Bush in 2006, that would cover the 21 member economies of the Asia-

Pacific Economic Cooperation (APEC) forum. President Obama will host the annual APEC summit in his home town of Honolulu in late 2011 and I believe the United States should aim to reach at least initial agreement on the TransPacific Partnership by then. The result would be a substantial opening of markets for the United States in some of the largest and most dynamic economies in the world.

Even more immediately, the Administration and Congress could take advantage of some very low-hanging fruit: the free trade agreements (FTAs) with Colombia, Korea and Panama that were negotiated by the Bush Administration. One recent study concluded that failure to ratify these pacts could cost the United States as many as 300,000 jobs annually as the putative partner countries proceed to implement FTAs with other major countries in Asia and Europe, and with Canada. US credibility in the TPP negotiations would of course be greatly enhanced by Congressional approval of these agreements, especially with Korea in light of its central role in the Asian dimension of the global trade mosaic.

The Administration could also advance US trade expansion goals by making a serious push for enhancement of, and thus domestic political support for, the Doha Round of multilateral negotiations in the World Trade Organization. The deal that is currently “on the table,” more than eight years after the Round was launched, remains far too small to generate much interest in the United States or elsewhere.⁵ But new US initiatives, especially on agriculture, could galvanize a series of offers from other countries in areas of considerable benefit to the United States, including

⁵ Gary Clyde Hufbauer, Jeffrey J. Schott, Matthew Adler, Claire Brunel, and Woan Foong Wong. Forthcoming. *Figuring Out the Doha Round*. Policy Analyses in International Economics 91. Washington, DC: Peterson Institute for International Economics.

services (where we have substantial comparative advantage and a sizable surplus) and in several manufacturing sectors.

The absence of major progress on all these trade policy issues, only partially rectified by the launch of the TPP, has a far broader and more worrisome implication for US trade. We know from history that an absence of liberalization initiatives produces a vacuum for trade policy into which protectionist forces can much more readily succeed. Such pressures are now all too apparent, most notably in Congressional efforts to attach Buy American provisions to a wide range of economic legislation (after doing so to the initial fiscal stimulus bill in early 2009). A failure to resume active market-opening efforts could produce backsliding that would be poisonous for world trade, the American economy and those of you here in Los Angeles that are so devoted to expanding international commerce.

Conclusion

Hence we face a very active trade agenda in 2010 and beyond:

- Restoring equilibrium in the exchange rate of the dollar to eliminate the competitive disadvantage that the United States suffers from its current overvaluation, especially through substantial currency action by China;
- Undertaking meaningful steps to expand US exports, in addition to the modest initiatives announced to date, so that they can realize their potential for creating good US jobs and reducing our global imbalances; and

- Restarting the momentum of liberalization by bringing the outstanding free trade agreements to the Congress, revitalizing the Doha Round and especially negotiating a successful Trans-Pacific Partnership with a meaningful group of Pacific Rim countries over the next eighteen months.

I know that you in Los Angeles will be in the forefront of these efforts and I encourage you to promote their realization as vigorously as possible. The United States must proceed ambitiously in these directions or we will be left behind as the world proceeds on trade without us. It has been a great pleasure to share these thoughts with you today and I look forward to working with you on them in the months and years ahead.