

The GLOBAL ECONOMY: Contemporary Debates

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PART

II

The Economic Impact of International Trade

TRADE AND JOBS IN THE UNITED STATES

The United States has run persistent trade and current account deficits since the early 1970s. Each year, residents of the United States import more goods and services from residents of other countries than they sell to residents of foreign countries. The U.S. trade deficit averaged \$94 billion per year between 1980 and 1999. In 2002, it rose to its highest level ever, peaking at \$435 billion, about four percent of U.S. gross domestic product. Most of this deficit arises in the U.S. trade account, which measures imports and exports of goods. In 2002, the U.S. trade account registered a deficit of \$484.4 billion. The United States ran a \$49.1 billion surplus in internationally traded services, producing an overall current account deficit of \$435.2 billion. And while the slower economic growth that has characterized the early part of this decade should reduce the trade deficit, figures from the first half of 2003 suggest that the deficit continues to widen. Persistent current account deficits have translated into growing foreign indebtedness as the United States borrows from the rest of the world to pay for its imports in excess of its exports. Indeed, in 1980 the United States was the world's largest creditor nation; the United States had more financial claims on the rest of the world than the world had on the United States. By the end of the 1980s, the United States had become the world's largest debtor nation.

Such deficits raise a number of issues that have been at the center of policy debate during the last 20 years. What causes the United States to run such persistent trade deficits? What impact does the trade deficit have on job creation and destruction in the American economy? Are such large deficits sustainable, or must the United States change its policies in order to reduce, if not fully eliminate them? If the United States must adjust, what policies are most likely to work, and what consequences will such adjustment have on the American economy? While all of these issues have received considerable attention in the policymaking arena, discussion has thus far failed to produce a consensus view that the deficit is an urgent problem that needs attention.

The two readings presented in this chapter examine two issues generated by the current account deficit: its causes and its impact on employment. Robert E. Scott, an economist based at the Washington DC think tank The Economic Policy Institute, argues that the trade deficit eliminates American jobs. He estimates that between 1994 and 2000 as many as three million jobs, most in well-paying

manufacturing industries, were lost as a direct consequence of American trade deficits. According to Scott, the trade deficit, and thus the large number of lost jobs, are caused by American trade policy. In particular, he argues that the terms under which the United States has participated in the North American Free Trade Agreement and the World Trade Organization are the chief cause of the imbalance in America's trade account. Without quite saying so, he asks the reader to conclude that additional trade liberalization will further worsen the deficit and therefore eliminate additional jobs.

Douglas A. Irwin, an economist who teaches at Dartmouth College, challenges the logic of Scott's analysis, as well as Scott's conclusions. Irwin argues that the trade deficit has no net effect on the number of jobs available in the United States. In his view, one can't focus solely on the trade deficit. One must also look at how the United States pays for these trade deficits. Once you do, you begin to notice that although some jobs are no doubt lost as a consequence of trade deficits, others are created by the capital inflows that the United States attracts to finance the deficit. Irwin also argues that American trade policy is not the underlying cause of the current account deficit. The deficit, he argues, is caused by an imbalance between domestic savings and domestic investment, and has nothing whatsoever to do with how open the United States is to international trade. Thus, raising tariffs or adopting other protectionist barriers will do little to eliminate the deficit, and engaging in additional trade liberalization will not increase the deficit. The implication of Irwin's analysis, therefore, is that the United States can engage in additional trade liberalization without concern that such policies will reduce the number of jobs available to American workers.

Fast Track to Lost Jobs: Trade Deficits and Manufacturing Decline are the Legacies of NAFTA and the WTO

ROBERT E. SCOTT

The U.S. has experienced steadily growing trade deficits for nearly three decades, and these deficits have accelerated rapidly since the North American Free Trade Agreement took effect in 1994 and the World Trade Organization was created in 1995. The toll on U.S. employment has been heavy: from 1994 to 2000, growing trade deficits eliminated a net total of 3.0 million actual and potential jobs from the U.S. economy.¹

Yet despite substantial evidence that current trade policies have resulted in massive trade deficits and job losses, the Bush Administration is pressing Congress for “fast track” trade negotiating authority, by which the President could submit trade agreements to Congress for a yes or no vote without amendment.² Fast-track promoters want this authority to make it easier to extend NAFTA throughout the hemisphere in a proposed Free Trade Area of the Americas (FTAA) agreement and to expand the WTO in a new round of multilateral negotiations. Promotion of fast track has even made its way into the post-September 11 debate over an economic stimulus. House Appropriations Committee Chairman Bill Thomas has repeatedly urged that Congress include fast track authority in any economic stimulus plan.

The dismal U.S. track record in negotiating trade agreements since the mid-1990s, as indicated by the nation’s growing trade deficit and the attendant economic problems, suggests that a fast track is exactly what the nation does not need:

- While gross U.S. exports rose 61.5% between 1994 and 2000, imports rose much more, by 80.5%.
- Job losses associated with the trade deficit increased six times more rapidly between 1994 and 2000 than they did between 1989 and 1994.
- Every state and the District of Columbia suffered significant job losses due to growing trade deficits between 1994 and 2000. Ten states, led by California, lost over 100,000 net jobs.
- The manufacturing sector, where the trade deficit rose 158.5% between 1994 and 2000, shouldered 65% of the surge in job losses during that period.

From Economic Policy Institute Briefing Paper, Washington, DC: The Economic Policy Institute, 2001.

- U.S. trade deficits with NAFTA partners Canada and Mexico increased nearly four-fold between 1993 and 2000, driven primarily by direct U.S. investment in Mexican and Canadian factories that export to the United States. The sustained appreciation of the U.S. dollar also encouraged investors around the world to build new and expanded production capacity at home to export more goods to the U.S. As a result, U.S. markets have been flooded with imports from Asia, Europe, Central and South America, and Africa since 1994.

Fast track by itself, a procedural rule designed to facilitate passage of new trade agreements, will have no effect of any kind on the economy. It is unlikely that the U.S. can negotiate and submit for approval any new agreements for at least three years, and it will take even longer for these agreements to affect the economy. Moreover, if past trade deals are any indication, fast track and new trade deals are likely to curtail growth, not increase it.

Between August 1998 and September 2001 the U.S. manufacturing sector had already lost 1.4 million jobs (BLS 2001c). In the wake of the attacks of September 11, unemployment is likely to grow. As a result, the underlying employment problems related to trade, especially in the manufacturing sector, will be much costlier and more visible over the next few years than they were in the 1990s, when the U.S. economy was generating two to three million jobs per year.

If the U.S. had achieved balanced trade in this period, as was predicted by the advocates of NAFTA and the WTO, U.S. manufacturing would be much stronger today and in a much better position to weather the downturn that is now under way. But the fact that 25 steel-producing companies, now including Bethlehem Steel, have declared bankruptcy reveals that rapidly growing trade deficits had corrosive effects on the U.S. industrial base (Nag and Goldfarb 2001). Rather than putting new trade deals on a fast track, policy makers should step back for a strategic pause, during which they can review the structure, enforcement, and effectiveness of U.S. trade policies.³

GROWING TRADE DEFICITS AND JOB LOSSES

Supporters of NAFTA and the WTO frequently tout the benefits of exports while remaining silent on the impact of rapid import growth (Zoellick 2001). But any evaluation of the impact of trade on the domestic economy must look at both imports and exports. When the United States exports 1,000 cars to Germany or Mexico, plants in this country employ U.S. workers in their production. If, however, the U.S. imports 1,000 cars from Germany or Mexico rather than building them domestically, then a similar number of U.S. workers who would have otherwise been employed in the auto industry will have to find other work. Ignoring imports and counting only exports is like balancing a checkbook by counting only deposits but not withdrawals.

U.S. trade deficits and job losses increased much more rapidly between 1994 and 2000 than they did between 1989 and 1994, as illustrated in Figure A. Indeed,

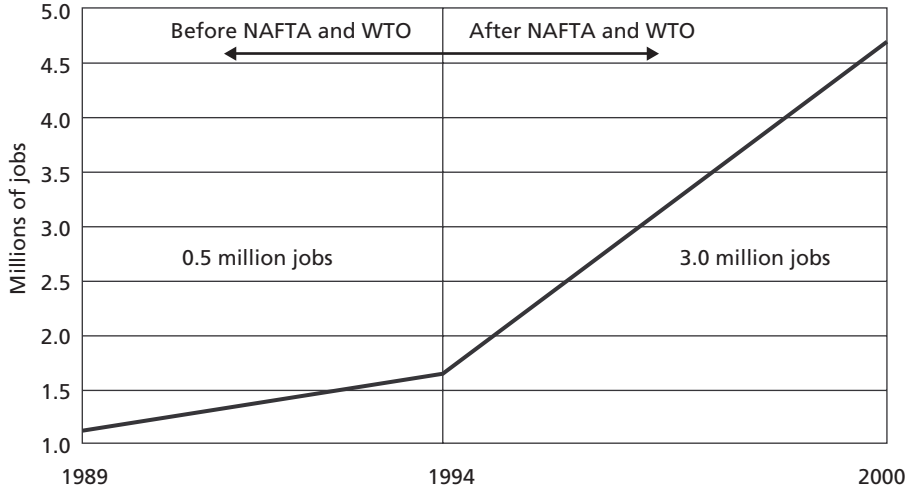


FIGURE A ■ NET U.S. JOB LOSSES DUE TO TRADE DEFICITS, 1989–2000

Sources: U.S. Census Bureau; Bureau of Labor Statistics; Bureau of Economic Analysis.

persistent barriers to U.S. exports (as well as overvaluation of the U.S. dollar) have contributed to these growing deficits, but NAFTA and the WTO were supposed to overcome those barriers. These agreements, and globalization more generally, have also contributed to rising income inequality, depressed real wages for production workers, and increased numbers of companies using threats to move plants to China, Mexico, and other countries to reduce wages, eliminate benefits and work rules, and thwart union organizing campaigns (Scott 2001).

The impact of trade on employment is one of the most widely used measures of the costs and benefits of trade policies, but also one of the least understood. The top half of Table 1 reports the amounts of, and changes in, goods trade (not including services), measured in constant 2000 dollars.⁴ The bottom half of Table 1 estimates the employment impact of trade. These estimates utilize a detailed, 192-sector model that is prepared annually by the U.S. Bureau of Labor Statistics (see the methodology section for more details).

The net employment impact of trade is determined by the relationships between imports, exports, and the domestic labor requirements for each type of good. An increase in exports creates demands for U.S. workers to produce those goods, while an increase in imports reduces demand for U.S. workers, either because imports displace comparable U.S. products or because new demand is satisfied with foreign rather than domestic products.

Although gross U.S. exports increased 61.5% between 1994 and 2000, those increases were overshadowed by the growth in imports, which rose 80.5%, as shown in top half of Table 1. As a result, the 1994 U.S. trade deficit of \$182 billion increased 141.6% to \$439 billion by 2000 (all figures in inflation-adjusted 2000 dollars).

As shown in Table 1, total U.S. exports rose from \$583 billion to \$942 billion between 1994 and 2000. This net increase of \$359 billion created 2.8 million jobs

TABLE 1 ■ U.S. TRADE AND TRADE-RELATED JOB CREATION, 1989–2000

Changes in U.S. Trade, 1989–2000 (billions of constant 2000 dollars)

	1989	1994	2000	Changes since 1994	
				Dollars	%Change
U.S. exports	422	583	942	359	61.5%
U.S. imports	560	765	1381	616	80.5
U.S. trade balance	–138	–182	–439	–257	141.6

U.S. trade-related job creation, 1989–2000

	1989	1994	2000	Changes since 1994	
				No. of jobs	%Change
U.S. exports	4,131	5,723	8,494	2,771	48.4%
U.S. imports	–5,244	–7,371	–13,186	–5,815	78.9%
U.S. trade balance	–1,113	–1,648	–4,692	–3,044	184.8%

Sources: U.S. Census Bureau; Bureau of Labor Statistics; Bureau of Economic Analysis

or job opportunities. On the other hand, the \$616 billion rise in imports eliminated 5.8 million jobs. Thus, the \$257 billion increase in the trade deficit eliminated a net of 3.0 million jobs or job opportunities in this period. By contrast, between 1989 and 1994 growing trade deficits eliminated approximately 500,000 jobs. Thus, the number of jobs lost since 1994, after implementation of NAFTA and then the WTO, was six times larger than in the previous period.

JOB LOSSES ACROSS THE UNITED STATES

In all 50 states and the District of Columbia, imports more than offset exports between 1994 and 2000, with associated job losses. Net job loss figures range from a low of 6,838 in North Dakota to a high of 364,197 in California. Other hard-hit states include Texas, New York, Pennsylvania, Michigan, North Carolina, Illinois, Ohio, Tennessee, Florida, Indiana, Georgia, and New Jersey, each with more than 100,000 net jobs lost.

While job losses in most states are modest relative to the size of the economy, the promise of new jobs was the principal justification for NAFTA and the WTO. According to the agreements' promoters, the predicted new jobs would compensate for the increased environmental degradation, economic instability, and public health dangers that the agreements would bring (Lee 1995, 10–11). If NAFTA and the WTO have not delivered net new jobs, they cannot provide enough benefits to offset the costs imposed on the American public.

Table 2B, which presents job losses as a share of the total labor force in each state, identifies several smaller states that have been hard hit by trade-related

TABLE 2A ■ TRADE-RELATED JOB LOSSES BY STATE, 1994–2000

State	Jobs	State	Jobs lost
Alabama	63,239	Montana	7,521
Alaska	6,972	Nebraska	15,312
Arizona	32,461	Nevada	16,493
Arkansas	37,469	New Hampshire	12,936
California	309,762	New Jersey	84,749
Colorado	34,982	New Mexico	16,733
Connecticut	31,431	New York	179,288
Delaware	6,467	North Carolina	133,219
District of Columbia	6,558	North Dakota	5,788
Florida	100,047	Ohio	135,139
Georgia	89,736	Oklahoma	42,266
Hawaii	7,116	Oregon	41,124
Idaho	11,021	Pennsylvania	142,221
Illinois	139,537	Rhode Island	19,164
Indiana	102,873	South Carolina	54,233
Iowa	31,770	South Dakota	8,458
Kansas	23,248	Tennessee	96,355
Kentucky	50,948	Texas	227,559
Louisiana	44,940	Utah	22,523
Maine	22,357	Vermont	6,283
Maryland	31,057	Virginia	66,083
Massachusetts	64,434	Washington	45,739
Michigan	152,061	West Virginia	14,458
Minnesota	49,925	Wisconsin	73,476
Mississippi	41,338	Wyoming	6,977
Missouri	68,392	Total	3,044,241

Source: U.S. Census Bureau; U.S. Bureau of Labor Statistics

TABLE 2B ■ JOBS LOST AS PERCENT OF STATE LABOR FORCE

State	Jobs lost	Percent of labor force
Rhode Island	19,164	5.8
North Carolina	133,219	3.7
Maine	22,357	3.6
Tennessee	96,355	3.6
Indiana	102,873	3.4
Mississippi	41,338	3.3
Michigan	152,061	3.2
Alabama	63,239	3.1
Arkansas	37,469	3.1

(continued)

TABLE 2B ■ CONTINUED

State	Jobs lost	Percent of labor force
South Carolina	54,233	3
Kentucky	50,948	2.8
Wyoming	6,977	2.8
Oklahoma	42,266	2.7
Wisconsin	73,476	2.6
Georgia	89,736	2.5
Missouri	68,392	2.5
Oregon	41,124	2.5
Ohio	135,139	2.4
Pennsylvania	142,221	2.4
Texas	227,559	2.4
Alaska	6,972	2.3
Illinois	139,537	2.3
Louisiana	44,940	2.3
Utah	22,523	2.3
District of Columbia	6,558	2.2
New Mexico	16,733	2.2
South Dakota	8,458	2.2
Nevada	16,493	2.1
New Hampshire	12,936	2.1
New Jersey	84,749	2.1
New York	179,288	2.1
California	309,762	2
Iowa	31,770	2
Massachusetts	64,434	2
Vermont	6,283	2
Idaho	11,021	1.9
Minnesota	49,925	1.9
Virginia	66,083	1.9
Connecticut	31,431	1.8
West Virginia	14,458	1.8
Colorado	34,982	1.7
Delaware	6,467	1.7
Kansas	23,248	1.7
Montana	7,521	1.7
Nebraska	15,312	1.7
North Dakota	5,788	1.7
Washington	45,739	1.7
Arizona	32,461	1.6
Florida	100,047	1.5
Hawaii	7,116	1.2
Maryland	31,057	1.2
Total	3,044,241	2.3

Sources: U.S. Census Bureau; U.S. Bureau of Labor Statistics

job losses in the late 1990s, including Rhode Island (job losses equivalent to 5.8% of the workforce), Maine (3.6%), Mississippi (3.3%), Alabama (3.1%), and Arkansas (3.1%).

The impacts of NAFTA and the WTO on the U.S. job market were obscured by the boom-and-bust cycle that has driven domestic consumption, investment, and speculation in the mid- and late 1990s. Although there was net job loss in the international sector of the economy between 1994 and 2000, total employment rose rapidly in the U.S., causing overall unemployment to fall to record low levels. However, with the bursting of the stock market bubble, unemployment has risen from 3.9% in October 2000 to 4.9% in September 2001 (BLS 2001c).

Table 3 summarizes the direct and indirect effects of trade on employment in all U.S. industries, including primary commodities and services that provide inputs for traded goods. Changes in the numbers of jobs lost (shown in the last two columns) illustrate several key effects of trade policies on the U.S. The U.S. deficit in manufacturing trade increased 158.5% between 1994 and 2000, and the manufacturing sector was responsible for the vast majority of all job losses: 1.9 million jobs lost in manufacturing compared with 3.0 million overall jobs lost between 1994 and 2000, or 65% of all losses. Agriculture, forestry, and fisheries lost nearly 116,700 jobs.

TABLE 3 ■ U.S. TRADE-RELATED JOB LOSSES BY SECTOR, 1989–2000 (THOUSANDS OF JOBS)

Industry	1989	1994	2000	Number of jobs	% Change
Agriculture, forestry, fisheries	91.2	150.0	33.4	-116.7	-77.8%
Mining	-84.2	-98.7	-255.8	-157.1	159.1
Manufacturing	-874.0	-1,243.8	-3,214.9	-1,971.1	158.5
SPECIFIC MANUFACTURING INDUSTRIES					
Food and Kindred Products	-0.4	22.4	-6.5	-28.9	n.a.
Tobacco	5.8	8.7	5.7	-3.0	-34.1
Textile mill products	-104.2	-135.8	-239.9	-104.2	76.7
Apparel and related products	-247.1	341.8	611.1	-269.3	78.8
Lumber and wood products, except furniture	-17.9	-62.9	-181.2	-118.3	188.2
Furniture and fixtures	-55.2	-59.6	-144.0	-84.0	141.7
Paper and allied products	-17.5	-9.2	-42.5	-33.3	363.8
Printing, publishing, and allied products	46.9	40.3	1.1	-39.2	-97.2
Chemicals and allied products	23.4	25.3	-62.2	-87.5	n.a.
Petroleum refining and related products	-5.2	-3.9	-16.0	-12.1	308.7
Rubber and miscellaneous plastics products	-66.6	-73.6	-105.3	-31.7	43.0
Leather and leather products	-104.4	-141.7	-232.9	-91.2	64.3
Stone, clay, glass, and concrete products	-35.2	-37.1	-80.8	-43.6	117.5
Primary metal products	-76.5	-76.8	-160.8	-84.0	109.4

(continued)

TABLE 3 ■ CONTINUED

Industry	1989	1994	2000	Number of jobs	% Change
<i>Blast furnace and basic steel products</i>	-40.2	-52.8	-77.1	-24.3	45.9
Fabricated metl prod exc mach & transp equipment	-59.8	51.6	-158.8	-107.1	207.5
Machinery, except electrical	-21.4	16.8	-27.6	-44.4	n.a.
<i>Computer and office equipment</i>	0.5	-10.8	-15.4	-4.6	43.0
Electrical & electronic mach, equip, & supplies	-123.1	-140.8	-377.2	-236.2	168.0
<i>Household audio and video equipment</i>	-47.3	-51.0	-107.5	-56.5	110.7
<i>Communications equipment</i>	-13.6	-7.1	-38.8	-31.7	448.6
Transportation equipment	-69.4	-43.8	-261.9	-218.0	497.2
<i>Motor vehicles and equipment</i>	-197.6	-202.8	-404.6	-201.8	99.5
<i>Aerospace</i>	127.5	152.0	163.6	11.6	7.7
Scientific & prof instr; photograph & opt gds, etc.	19.7	26.8	49.5	22.7	84.7
Miscellaneous manufactured commodities	34.0	-205.6	-562.8	-357.2	173.8
Transportation	-54.5	-66.4	-186.4	-120.1	180.9
Communications	-7.6	-11.0	-32.5	-21.5	195.6
Utilities	-14.9	-16.6	-43.9	-27.3	164.1
Trade	-26.1	-33.8	-91.1	-57.3	169.9
Financial insurance and real estate	-24.5	-34.6	-104.4	-69.8	201.6
Services	-198.7	-266.6	-724.8	-458.2	171.9
Government	-13.0	-17.4	-46.2	-28.7	164.8
Special industries	0.0	0.0	0.0	0.0	n.a.
Total	-1,113.2	-1,647.6	-4,691.8	-3,044.2	184.8

Sources: U.S. Census Bureau; U.S. Bureau of Labor Statistics

On a per capita basis, workers in these primary product sectors were about twice as likely to suffer a job loss as someone employed elsewhere in the economy.

Within manufacturing, almost every industry experienced a net loss of jobs since 1994, the only two exceptions being aerospace products and scientific and professional goods and instruments. Motor vehicles (201,800 jobs lost), electrical equipment and machines (236,400), and textiles and apparel (a combined 373,500 lost jobs) were the hardest-hit industries. Every other sector, even such notable surplus sectors as printing and tobacco products, suffered significant losses between 1994 and 2000 (though they still registered surpluses in 2000). Most of the hard-hit states listed above have high concentrations of the particular industries listed here.

In all, 17 of the 20 manufacturing industries experienced net job losses in 2000. This pattern is the end result of the \$439 billion U.S. trade deficit in 2000. Before riding a fast track to further agreements, it seems sensible to pause and ask

why NAFTA and the WTO were powerless to stem these losses, or whether they perhaps played a role.

CAUSES OF RISING TRADE DEFICITS

U.S. trade deficits with its NAFTA partners, Canada and Mexico, expanded from \$16.6 billion in 1993 to \$62.8 billion in 2000 (Scott 2001). Almost all of this growth occurred after 1994, when NAFTA was implemented. The primary mechanism driving this growth has been the movement of foreign direct investment (FDI) by the U.S., in the form of factories and even complete supply networks in some cases, to Mexico and Canada.⁵ Between 1993 and 1999 U.S. FDI in Mexico increased by 169%; in Canada it more than quadrupled. Counting all sources, Canada and Mexico have absorbed more than \$151 billion in FDI since 1993. These inflows of FDI, along with bank loans and other types of foreign financing, have funded the construction of thousands of Mexican and Canadian factories that produce goods for export to the United States. One result is that the U.S. absorbed an astounding 82% of Mexico's total exports in 2000.⁶ The growth of foreign production capacity has played a major role in the rapid growth of exports to the U.S., growth in the U.S. trade deficit, and growth in trade-related job losses.

The sustained and substantial appreciation of the U.S. dollar—more than 31% since the second quarter of 1995, using the Federal Reserve's broad index of its real (inflation-adjusted) value⁷—greatly stimulated FDI around the world, especially in Mexico, China, and other developing countries. This substantial increase in the real value of the U.S. dollar makes other countries' exports to the United States cheaper for U.S. buyers while making imports from the United States more expensive in foreign markets. This devaluation of foreign currencies relative to the dollar also encourages investors around the world to build new and expanded production capacity at home to export even more goods to the U.S. Hence, U.S. markets have been flooded with imports from Asia, Europe, Central and South America, and Africa since 1994.

The creation of the WTO has hurt U.S. workers and industries in many ways. One of the principle differences between the WTO and the GATT—the General Agreement on Tariffs and Trade that governed world trade from the end of World War II until December 31, 1994—is that the WTO agreement created a new institution (the WTO) with the power to interpret and enforce the agreement's rules.⁸ For example, the WTO has found on several occasions that U.S. laws providing tax exemptions for certain "foreign sales corporations" (FSCs) are illegal. As a result, the European Union recently sought and received authorization from the WTO (a decision that is under appeal) to impose \$4 billion in sanctions on U.S. goods because the U.S. failed to change these laws (EU 2001; Alden 2001). Many U.S. firms, especially makers of aircraft and other high-value industrial machinery and equipment, maintain that these laws are essential to counteract the EU's WTO-sanctioned rebates of value-added taxes on their own exports. It is hard to explain to an ordinary citizen or company why the EU rebates are allowable under the WTO's "free trade" rules while the U.S. system for subsidizing exports is not. From the

point of view of U.S. firms and workers, this case does not rise to the standards that would be required by a fair trading system. Many of the jobs of 800,000 U.S. workers and thousands of U.S. companies involved in aerospace will be jeopardized if the U.S. is forced to scrap FSCs.

There are a number of other ways in which the WTO and NAFTA have hurt U.S. economic interests. These include the “investment” chapters in NAFTA that have been used to overturn national laws in areas ranging from land use to environmental and safety standards (Wallach 2000). Before negotiations have even begun in a new trade round, policy makers are battling over whether U.S. agricultural subsidies conflict with present and potential future WTO trade rules on agriculture, and whether those payments must be cut in the near future (Scott and Hersh 2001; Congress Daily 2001).

The real costs of NAFTA and the WTO for workers, communities, and businesses were greatly underestimated in the debates over these agreements, and the promised benefits have failed to materialize. But the conclusion to be drawn is not that further trade liberalization should be stopped. There is no doubt that, in the long run, a system of both freer trade and fair trade which ensures that all participants play by a well-defined set of humane, market-based rules can maximize incomes for most, if not all, countries around the world. NAFTA and the WTO have failed to achieve these desirable outcomes because they were fatally flawed. Existing trade agreements should be repaired and rebuilt before moving ahead with another round of broad, new trade deals.

METHODOLOGY USED FOR JOB LOSS ESTIMATES

This study uses the model developed in Rothstein and Scott (1997a, 1997b) to analyze the impact of trade on employment. This approach solves several problems that are prevalent in previous research on the employment impacts of trade; these problems include looking only at the effects of exports and ignoring imports; failing to adjust trade data for inflation; and applying a single employment multiplier to all industries, despite differences in labor productivity and utilization.

The model used here is based on the Bureau of Labor Statistics’ 192-sector domestic employment requirements table, which was derived from the 1992 U.S. input-output table and adjusted to 1998 price and productivity levels (BLS 2001a). This model enables an estimate of the direct and indirect effects of changes in goods trade flows in each of these 192 industries. This study updates the 1987 input employment requirements table used in earlier reports in this series (Rothstein and Scott 1997a, 1997b; Scott 1996).

We use three-digit, SIC-based industry trade data (Bureau of the Census 1994 and 2001), deflated with industry-specific, chain-weighted price indices (Bureau of Labor Statistics 2001b). We concord these data from HS to SIC (1987) classifications using tables provided with the Census trade data. We then concord the SIC data into the BLS sectors using sector-plans from the BLS (BLS 2001a). We calculate state-level employment effects by allocating imports and exports to the states on the basis of their share of three-digit, industry-level employment (BLS 1997).⁹

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ENDNOTES

1. The total number of jobs and job opportunities is a measure of what employment in trade-related industries would have been if the U.S. trade balance had remained constant (and holding everything else in the economy constant) between 1994 and 2000. Maintaining a constant trade balance while growing rapidly, as the U.S. did between 1994 and 2000, would have required that imports grow more slowly than they did and/or that exports grow faster. If the U.S. economy had grown at exactly the same rate under this condition as it did between 1994 and 2000, then more jobs would have been created in import-competing and exporting industries.
2. For example, U.S. Trade Representative Robert Zoellick recently stated, "Congress needs to enact U.S. trade promotion authority so America can negotiate agreements that advance the causes of openness, development, and growth" (Zoellick 2001).
3. For further discussion of the need for a strategic pause, see Faux (2001).
4. Goods trade is examined here for several reasons. First, many of the components counted as services in GDP, such as profits and interest on foreign deposits, do not directly affect employment. Second, many of the financial and business services that are now exported simply support factories that have moved abroad. While such exports may support some jobs in the U.S., in many cases these businesses are providing services to factories that would otherwise be located in the U.S. Finally, the Census Bureau does not provide detailed data on trade in services.
5. Bronfenbrenner (2001) has developed a database that tracks plant closures in the U.S. and links them to the opening of new facilities owned or controlled by the same company in other countries. Preliminary results suggest that these data closely match trends in U.S. trade flows.
6. INEGI (2001), Bureau of the Census (2001), and EPI calculations.
7. The dollar reached a low point of 82.6 on the Federal Reserve's index in the second quarter of 1995 (quarterly average of monthly data), and recently stood at 108.7 in the third quarter of 2001 (Federal Reserve, Federal Reserve Statistical Release, H1.0 Foreign Exchange Rates, <http://www.federalreserve.gov/releases/H10/Summary/>).
8. Disputes at the WTO can be settled between the parties or decided by dispute resolution panels, which have the authority to issue findings of WTO law. Parties that have been injured in such cases are entitled to impose sanctions that are sufficient to restrict imports from the offending country by an amount equal to the trade losses suffered by the "injured" party (Wallach 2000). While the findings of WTO panels are not legally

binding on any country, the resulting penalties are often large enough to force countries to change their laws to conform to the WTO's demands. The U.S. has lost a larger number of the cases brought against it at the WTO (Public Citizen 2001).

9. Other studies—see California State World Trade Commission (1996), which finds 47,600 jobs created in California from increased trade with Canada alone—have allocated all employment effects to the state of the exporting company. This is problematic, because the production—along with any attendant job effects—need not have taken place in the exporter's state. If a California dealer buys cars from Chrysler and sells them to Mexico, these studies will find job creation in California. However, the cars are not made in California; the employment effects should instead be attributed to Michigan and other states with high levels of auto production. Likewise, if the same firm buys auto parts from Mexico, the loss of employment will occur in auto industry states, not California.

The Employment Rationale for Trade Protection

DOUGLAS A. IRWIN

Economic analysis has long established free trade as a desirable economic policy. This conclusion has been reinforced by mounting empirical evidence on the benefits of free trade, and yet protectionism is far from vanquished in the policy arena. Of course, this is nothing new: as Adam Smith observed more than two hundred years ago, “not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose” free trade (Smith 1976, 471). Industries that compete against imports will always actively promote their own interests by seeking trade restrictions. But, as Smith acknowledges, the general public also has concerns about foreign competition. The argument that resonates most strongly with the public and with politicians is that imports destroy jobs. Is this an accurate view of trade as a whole? And if so, are import restrictions the remedy? . . .

DOES FREE TRADE AFFECT EMPLOYMENT?

The claim that trade should be limited because imports destroy jobs has been trotted out since the sixteenth century (see e.g., Viner 1937, 51–52; Irwin 1996, 36ff). And imports do indeed destroy jobs in certain industries: for example, employment in the Maine shoe industry and in the South Carolina apparel industry is lower to the extent that both industries face competition from imports. So, we can understand why the plant owners and workers and the politicians who represent them prefer to avoid this foreign competition.

But just because imports destroy some jobs does not mean that trade reduces overall employment or harms the economy. After all, imports are not free: in order to acquire them a country must sell something in return. Imports are usually paid for in one of two ways: the sale of goods and services or the sale of assets to foreign countries. In other words, all of the dollars that U.S. consumers hand over to other countries in purchasing imports do not accumulate there, but eventually return to purchase either U.S. goods (exports) or U.S. financial assets (foreign investment). Both exports and foreign investment create new jobs: employment in export-oriented sectors such as farming and aircraft production is higher because of those foreign sales, and foreign investment either contributes directly to the national

From *Free Trade Under Fire*. Princeton: Princeton University Press, 2002, p. 70–90

capital stock with new plants and equipment or facilitates domestic capital accumulation by reducing the cost of capital.

Thus, the claim that imports destroy jobs is misleading because it ignores the creation of jobs elsewhere in the economy as a result of trade. Similarly, while trade proponents like to note that exports create jobs, which is true, they generally fail to note that this comes at the expense of employment elsewhere. Export industries will certainly employ more workers because of the foreign demand for their products, but exports are used to purchase the very imports that diminish employment in other domestic industries.

Since trade both creates and destroys jobs, the pertinent question is whether trade has a *net* effect on employment. The public debate over NAFTA consisted largely of claims and counterclaims about whether it would add or subtract from total employment. NAFTA opponents claimed that free trade with Mexico would destroy jobs: the Economic Policy Institute put the number at 480,000. NAFTA proponents countered with the claim that it would create jobs: the Institute for International Economics suggested that 170,000 jobs would be created (Orme 1996, 107).

In fact, the overall impact of trade on the number of jobs in an economy is best approximated as zero. Total employment is not a function of international trade, but the number of people in the labor force. . . . Employment in the United States since 1950 has closely tracked the number of people in the labor force. And while there is always some unemployment, . . . this is determined by the business cycle, demographics, and labor market policies rather than changes in trade flows or trade policy. For example, unemployment rose in the early 1980s and the early 1990s because the economy fell into recession, not because of the behavior of imports.

Yet there remains deep-seated inclination to frame the trade policy debate in terms of its impact on employment. This has motivated many attempts, however futile, to quantify the overall employment effects of trade. Analysts at several Washington think tanks (both favorable and unfavorable to NAFTA) have settled upon the rule of thumb that every \$1 billion in exports generates or supports thirteen thousand jobs (implying conversely that every \$1 billion in imports eliminates thirteen thousand jobs) as a way of evaluating the employment effects of trade agreements. Some NAFTA proponents argued that, because Mexico was to eliminate relatively high tariffs against U.S. goods while U.S. tariffs against Mexican goods were already very low, the agreement would generate more exports to than imports from Mexico. Using the rule of thumb, it was therefore reasoned that NAFTA would result in net job creation. Anxious to sell NAFTA to a wary Congress, Mickey Kantor, the Clinton administration's trade representative, claimed that two hundred thousand jobs would be created by 1995 as a result of the agreement.¹

Such formulaic calculations were publicized to fight the dire forecasts that thousands of jobs would be lost as a result of NAFTA. But even if tariff reductions are asymmetric, exports may not grow more rapidly than imports. Trade agreements themselves have little effect on any bilateral trade balance or the overall trade balance, as we will see shortly. And it is a mistake to think that changes in the trade balance translate into predictable changes in employment; a booming economy with low unemployment may be accompanied by a growing trade deficit

because people have more money to spend on imports. Thus, any attempt to isolate the portion of the change in overall employment that is due to changes in trade is immediately suspect: it is bound to rest on implausible and arbitrary assumptions, and the predictions are ultimately unverifiable. In addition, stressing the positive employment effects of trade gives the false impression that achieving a higher level of employment is the principal motivation for pursuing more open trade policies. . . . The reason for pursuing more open trade policies is not to increase employment but to facilitate the more productive employment that comes with mutually beneficial exchanges that raise aggregate income.

* * *

EMPLOYMENT AND THE TRADE DEFICIT

Does the trade deficit injure domestic industries and have adverse effects on employment? In every year since 1976, the value of goods and services imported into the United States has exceeded the value of goods and services exported. Should the trade deficit be a matter of concern and reversing it an objective for trade policy?²

The connection between the trade deficit and employment is more complex than the simple view that jobs are lost because imports exceed exports. . . . The correlation between the merchandise trade deficit and the unemployment rate is actually negative: the trade deficit has risen during periods of falling unemployment and has fallen during periods of rising unemployment. As noted earlier, the business cycle may be driving this relationship: a booming economy in which many people are finding employment is also an economy that sucks in many imports, whereas a sluggish economy is one in which expenditures on imports slacken.

A deeper understanding of the trade deficit, however, requires some familiarity with balance of payments accounting. Balance of payments accounting may be a dry subject, but it helps lift the fog that surrounds the trade deficit. That accounting also suggests which remedies are likely to be effective in reducing the deficit, should that be considered desirable.

The balance of payments is simply an accounting of a country's international transactions. All sales of U.S. goods or assets to nonresidents constitute a receipt to the United States and are recorded in the balance of payments as a positive entry (credit); all purchases of foreign goods or assets by U.S. residents constitute a payment by the United States and are recorded as a negative entry (debit). The balance of payments is divided into two broad categories of transactions: the current account, which includes all trade in goods and services, plus a few smaller categories; and the capital account, which includes all trade in assets, mainly portfolio and direct investments.

The first accounting lesson is that the balance of payments always balances. By accounting identity, which is to say by definition, the balance of payments always sums to zero. This implies that

$$\text{Current account} + \text{capital account} = 0.$$

Because the overall balance of payments always balances, a country with a current account deficit must have an offsetting capital account surplus. In other words, if

a country is buying more goods and services from the rest of the world than it is selling, then the country must also be selling more assets to the rest of the world than it is purchasing.³

To make the link clearer, consider the case of an individual. Each of us as individuals export our labor services to others in the economy. For this work, we receive an income that can be used to import goods and services produced by others. If an individual's expenditures exactly match his or her income in a given year, that person has "balanced trade" with the rest of the economy: the value of exports (income) equals the value of imports (expenditures). Can individuals spend more in a given year than they earn in income, in other words, can a person import more than he or she exports? Of course, by one of two ways: either by receiving a loan (borrowing) or by selling existing financial assets to make up the difference. Either method generates a financial inflow—a capital account surplus—that can be used to finance the trade deficit while also reducing the individual's net assets. Can an individual spend less in a given year than that person earns in income? Of course, and that individual exports more than he or she imports, thereby running a trade surplus with the rest of the economy. The surplus earnings are saved, generating a financial outflow—a capital account deficit—due to the purchase of financial investments.

What does this mean in the context of the United States? In 2000, the United States had a merchandise trade deficit of about \$450 billion and a services trade surplus of \$80 billion. The balance on goods and services was therefore a net deficit of about \$370 billion, but owing to other factors (net income payments and net unilateral transfers) the current account deficit was nearly \$435 billion, or 4.4 percent of that year's GDP. This implies that there must have been a capital account surplus of roughly the same magnitude. Sure enough, in that year U.S. residents (corporations and households) increased their ownership of foreign assets by just over \$550 billion while foreigners increased their ownership of U.S. assets by over \$950 billion. Therefore, the capital account surplus was approximately \$400 billion. In other words, foreigners increased their ownership stake in U.S. assets more than U.S. residents increased their holdings of foreign assets, the mirror image of the current account deficit (Joint Economic Committee 2001, 36–37).

The balance of payments "balances" in the sense that every dollar we spend on imported goods must end up somewhere. Here's another way of thinking about it: in 2000, the United States imported almost \$1,440 billion in goods and services from the rest of the world, but the rest of the world only purchased \$1,070 billion of U.S. goods and services. What did the other countries do with the rest of our money? They invested it in the United States. In essence, for every dollar Americans handed over to foreigners in buying their goods (our imports), foreigners used seventy-five cents to purchase U.S. goods (our exports) and the remaining twenty-five cents to purchase U.S. assets. What assets are foreign residents purchasing? Some are short-term financial assets (such as stocks and bonds) for portfolio reasons; some are direct investments (such as mergers and acquisitions) to acquire ownership rights; and some are real assets (such as buildings and land) for the same reasons. . . .

In running a current account deficit, the United States is selling assets to the rest of the world. These foreign purchases of domestic assets allow the United

States to finance more investment than it could through domestic savings alone. In essence, the United States is supplementing its domestic savings with foreign investment and thus is able to undertake more investment than if it had relied solely on domestic savings. The equation that expresses this relationship is

$$\text{Current account} = \text{savings} - \text{investment.}$$

Once again, this equation is an identity, meaning that it holds by definition. A current account deficit (the capital account surplus) implies that domestic investment exceeds domestic savings. Conversely, countries with current account surpluses have domestic savings in excess of domestic investment, the excess being used to purchase foreign assets via foreign investments (capital account deficit).

Because the United States is a net recipient of foreign investment, it is difficult to say much about the impact of the trade deficit on the number of jobs in the economy. The Economic Policy Institute, a Washington think tank aligned with organized labor, regularly issues reports stating that the trade deficit has destroyed American jobs. So why has the unemployment rate fallen during periods of large trade deficits? In recent years, they have argued that job losses due to trade have been more than offset by job creation due to consumer spending and business investment (e.g. Scott and Rothstein 1998). And yet that higher business investment is made possible precisely because of foreign capital inflows, the flip side of the current account deficit. If the United States took action to reduce the trade deficit (supposedly reducing the number of jobs lost to trade), those capital inflows would necessarily fall. Then domestic investment would have to be financed by domestic savings, implying higher interest rates, which would reduce the number of jobs created by business investment. In the end, a lower trade deficit's positive impact on employment would be offset by the negative impact of lower domestic investment and higher interest rates.

So what are the implications for trade policy? The current account is fundamentally determined by international capital mobility and the gap between domestic savings and investment. The main determinants of savings and investment are macroeconomic in nature. Current account imbalances have nothing to do with whether a country is open or closed to foreign goods, engages in unfair trade practices or not, or is more "competitive" than other countries. If net capital flows are zero, the current account will be balanced. Japan's \$11 billion current account deficit grew to a \$87 billion current account surplus in 1987 not because it closed its market, or because the United States opened its market, or because Japanese manufacturers suddenly became more competitive in international markets. The surplus emerged because of financial and macroeconomic reasons in Japan and the United States.⁴

Trade policy cannot directly affect the current account deficit because trade policy has little influence on the underlying determinants of domestic savings and investment, the ultimate sources of the current account. If a country wishes to reduce its trade deficit, then it must undertake macroeconomic measures to reduce the gap between domestic savings and investment. . . .

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ENDNOTES

1. Hufbauer and Schott (1993, 14), for example, conclude that NAFTA and Mexican economic reforms "will create about 170,000 net new U.S. jobs in the foreseeable future. . . . Our job projections reflect a judgment that, with NAFTA, U.S. exports to Mexico will continue to outstrip Mexican imports to the United States."
2. To investigate the causes and consequences of the trade deficit, Congress set up the Trade Deficit Review Commission, which issued its report in November 2000. Unfortunately, the commission split along partisan lines. Democrats viewed the deficit as malign (a serious threat to employment in trade-affected industries), while Republicans viewed the deficit as benign (as reflecting the good state of the economy). The commission's report is available at <http://www.ustrdc.gov>.
3. A country therefore cannot experience a "balance of payments deficit" unless one is using the old nomenclature that considers official reserve transactions (an important component of the balance of payments under fixed-exchange-rate regimes) as a separate part of the international accounts.
4. Japanese exporters became more price competitive in the U.S. market due to the appreciation of the dollar in the early to mid-1980s, but this appreciation was driven by capital flows into the United States. While trade policy cannot directly affect the current account deficit, the deficit does affect trade policy. A large trade deficit puts a competitive squeeze on both exporting and import-competing industries resulting mainly from the exchange rate appreciation that usually accompanies the rising deficit. This pressure fuels protectionist sentiment, as seen by the experience of the early and mid-1980s.

REVIEW AND DISCUSSION QUESTIONS

1. While Scott and Irwin disagree about much, the two also agree on some issues. Identify those parts of the analyses where the two authors do agree.

2. What does Scott neglect in his analysis that Irwin argues is necessary in order to gain a full accounting of the impact that trade and trade deficits have on jobs in the United States? Do you agree with Irwin that these other things must be taken into account? Why or why not?
3. Irwin argues that the trade deficit has no net effect on the *number* of jobs available to workers in the American economy. Does this mean that trade deficits have no impact on American jobs and American workers? Why or why not?
4. In 2003, President George W. Bush signed legislation implementing a large tax cut. Drawing on the logic of Irwin's analysis, what impact might we expect this tax cut to have on the U.S. current account balance?
5. Suppose the U.S. government decided to enact policies to bring the current account into balance. Relying on Scott's analysis, what specific policies would you propose to bring about this adjustment? What policies would you propose if you relied instead on Irwin's analysis? Which approach do you think would be most likely to succeed?

SUGGESTIONS FOR FURTHER READING

In 1999, Congress created the U.S. Trade Deficit Review Commission “to study the nature, causes, and consequences of the United States merchandise trade and current account deficits.” The Commission's Report, published in 2000 and available at the link below, reflects the two perspectives presented here and puts a partisan stamp on them. <http://www.ustrdc.gov>

If you are interested in the sustainability of the current account deficit, see: Catherine L. Mann. *Is the U.S. Trade Deficit Sustainable?* Washington, DC: The Institute for International Economics, 1999.