STATEMENT OF

THE HONORABLE CARLA A. HILLS
Chair and CEO of Hills & Company, International Consultants
U.S. Trade Representative 1989-1993

BEFORE THE
UNITED STATES SENATE
COMMITTEE ON FINANCE

CONCERNING
"The Future of U.S. Trade Policy"

Tuesday, July 29, 2008

Mr. Chairman and Members of the Committee, thank you for inviting me to share with you my perspective on our nation's future trade policy, which I believe has the capacity to advance in a very major way America's economic, security, and strategic interests.

U.S. Policy of Opening Global Markets Has Greatly Enhanced Our Nation's Economic Growth

For more than 60 years, under both Democratic and Republican administrations, the United States has led the world in opening global markets. The results to date have been spectacular. World trade has exploded and standards of living have soared at home and abroad.

Economist Dr. Gary Hufbauer in a comprehensive study published in 2005 by the Institute for International Economics, now the Peterson Institute for International Economics, calculated that the opening of markets since World War II has increased our nation's GDP by roughly $1 trillion per year, thus raising the average American household yearly income by $9,500.

Trade and investment with partners in every region of the world have contributed to this very positive result. For example Canada and Mexico, our partners in the North American Free Trade Agreement, account for 25 percent of the gain; 15 members of the Europe Union for about 31 percent; Japan and China for about 8 percent each.

Global Markets have Cushioned U.S. Current Economic Downturn

Absent the boost that our economy currently receives from our international commercial activity, our nation would be in recession. As economist Dr. C. Fred Bergsten, Director of the Peterson Institute of International Economics, wrote in an Op Ed published in the *Financial Times* on June 30, 2008:

> "Over the past two quarters, the United States has recorded positive growth at an annual rate of 0.8 percent. . . Its 'net exports of goods and services,' the gross domestic product equivalent of the current account balance, have strengthened at an annual rate of almost 1 percent of GDP during that period. Hence the totality of recent U.S. expansion has been provided by the strengthening of the trade balance. Domestic demand has been falling, but the United States has been saved from recession by the rest of the world."

Further Opening of Global Markets Would Contribute Significant Additional Growth to the U.S. Economy

It is overwhelmingly in our nation's interest to continue to implement policies that will further open global markets. Dr. Hufbauer calculates that the additional opening of world markets to trade and investment would increase U.S. wealth by an additional $500 billion per year, making the average American household richer by an additional $4,500 per year. It is hard to think of another policy decision that could have such a positive impact on U.S. economic well-being.

Past U.S. Trade Policy of Opening Global Markets Has Helped to Reduce Global Poverty

It is not only the U.S. economy that has gained from the opening of markets; developing countries have benefited as well. On average, poor countries that have opened their markets to trade and investment have grown more than three times faster than those that kept their markets closed. Studies by the World Bank show that globalization has raised some 375 million people out of extreme poverty over the past two decades.

Further Opening of Global Markets Would Further Reduce Global Poverty and Enhance Economic Opportunity for All Nations, Including Our Own

U.S. leadership in achieving a broad agreement in the Doha Round of Multilateral Trade Talks would further reduce global poverty and build markets for tomorrow. As the early rounds of trade talks stimulated growth by rebuilding the economies of nations devastated by World War II, an agreement in the Doha Round that reduced trade barriers limiting developing nations' commercial opportunities would strengthen those economies and enlarge market opportunities for all nations, including our own.

Today nearly three billion people, almost half the world's population, live below the international poverty line of $2 per day. According to studies by economist Dr. William Cline at the Center for Global Development removing global trade barriers would yield $200 billion in long term economic benefits for poor countries and lift 500 million people out of poverty. About half of the benefit would come from opening markets for agricultural products.

Currently, agriculture tariffs are five times higher than tariffs on industrialized goods. That disproportionately harms the economies of poorer countries that typically have large rural populations. Making matters worse, tariffs are much higher on goods like textiles, apparel, heavy glass, and footwear that are primarily produced by poor countries, in effect placing a discriminatory tax on the products they trade. Last year, for example, Bangladesh paid the United States $120 million more in tariffs on its $3 billion of exports to us than France paid on its $37 billion in exports to us---that works out to be a 15 percent tax on Bangladesh's goods and less than one percent on France's.

Not only does this sharp tariff differential constitute a gross inequity in our global trading system, but by limiting the commercial opportunities for poorer countries, it contributes to their continuing poverty. Dr. Cline calculates that on average when a developing country increases its ratio of trade to total output by one percent, it achieves a one percent reduction in its level of poverty. Integrating poorer nations into the global trading system is a proven way to reduce their poverty.

<u>Reducing World Poverty by Further Opening Global Markets Would Strengthen Our Nation's Security</u>

Reducing global poverty by enlarging economic opportunity for poorer states is not simply a humanitarian measure; it directly contributes to our nation's security. It is instructive to note that three large developing countries participating in the Doha Round---Bangladesh, Indonesia, and Pakistan---each of which have substantial Muslim populations and are challenged by domestic instability, together account for 300 million people living below the international poverty line. Similarly six African nations---the Democratic Republic of the Congo, Kenya, Mozambique, Nigeria, Tanzania, and Uganda together account for another 200 million people living below the poverty line.

Failure to enlarge the economic opportunities for these nations by further integrating them into the global trading system will condemn large numbers of their people to poverty making them more susceptible to recruitment by those who would do us harm.

The challenges presented by poverty are dire throughout the entire Greater Middle East. As pointed out by the Progressive Policy Institute:

> “[T]his region---30 majority Muslim countries stretching from Morocco through the Middle East to Pakistan, Afghanistan, and Central Asia---saw its share of trade and investment plummet by 75 percent between 1980 and 2000, as its population grew by a quarter billion. The region now has the world’s highest unemployment with figures of 25 percent or more common among young people. This prolonged economic contraction is precisely the phenomenon that helped produce the fascist and communist movements of 20th century Europe and East Asia.” [1]

In addition, we know that impoverished states lack the ability to enforce their laws and secure their borders making it much more difficult for our government to deal effectively with serious transnational problems---like terrorism, organized crime, narcotics trafficking, money laundering, illegal arms sales, disease pandemics and environmental degradation.

<u>The Benefits of Multilateral and Bilateral Trade Agreements</u>

Our nation can achieve substantial economic, humanitarian, and security benefits from both multilateral and bilateral trade agreements. The liberalization that can be secured in a multilateral agreement like a successful Doha Round agreement results in enlarging commercial opportunities with 153 nations. The bilateral agreements that are negotiated by our government achieve far greater market liberalization but with a single trading partner.

The Korean Free Trade Agreement, for example, will eliminate tariffs on 94 percent of trade in industrial products within three years of enactment, and 60 percent of U.S agriculture exports to Korea will become duty free immediately. Also, the agreement will remove a range of non-tariff barriers and provide protections for U.S. investors. In addition the agreement will energize an alliance in a key region of the world.

Similarly in the Free Trade Agreement negotiated with Colombia, eighty percent of all tariffs on U.S. exports of industrial and consumer products and over half of the tariffs on all of our agriculture exports will be eliminated once the legislation approving agreement is signed---including the removal

---

[1] See Winning in the World Economy II, a publication of the DLC Global Economy Project, July 2008, page 10

of tariffs of 80 percent on beef, 35 percent on cars, and 20 percent on furniture, and much, much more. Over time, all Colombian tariffs are eliminated, creating substantial new economic opportunity for our exporters. Equally important, this agreement will significantly advance our security interests in a region beset with instability and anti-Americanism.

Looking at the 14 regional and bilateral free trade agreements that the United States has negotiated over the years, with the exception of our agreements with Canada and Australia, in every instance before negotiations commenced, all of the nations involved had substantially duty-free access to our market through our various General System of Preference programs, the Caribbean Basin Initiative, the Andean Trade Preference Act, and the African Growth and Opportunity Act. Illustrative are two of the bilateral agreements currently awaiting Congressional approval: Today Colombia has 90 percent free access to our market, and Panama has 95 percent, whereas our producers of goods and services face very significant trade restrictions in both countries. Approval of these agreements will give them substantial new export opportunity.

It is also interesting to note that the nations with whom we have a free trade agreement account for almost half of our exports and about one-third of our imports, while in excess of 80 percent of our trade deficit is with nations with whom we do not have a free trade agreement.

And we should not forget that trade agreements, multilateral and bilateral, encourage rule of law, respect for property, and transparency. In the world at large there is a strong correlation between more open economies and the growth of a middle class that inevitably clamors for clean air, clean water, safe streets and a more accountable government…interests that we seek to encourage around the world.

In short both multilateral and bilateral trade agreements can deliver very substantial benefits in addition to broadening economic opportunities for our workers, farmers and businesses.

<u>Erosion of the Bipartisan Consensus Supporting Open Trade</u>

Notwithstanding the proven benefits that our trade agreements deliver, in recent years we have seen a sharp reversal of the bipartisan consensus favoring the free flow of goods, services, capital, and ideas that has guided our nation for the past 60 years, and the election debates have polarized the trade debate even more.

It is hard to believe that just over a decade ago the United States, led by a Democratic administration, was celebrating the passage of the North American Free Trade Agreement, pledging with 33 other democratically elected leaders of the Western Hemisphere to negotiate a Free Trade Area of the Americas, and endorsing an agreement reached among the 21 economies of the Asia Pacific region to liberalize trade throughout that region.

Since then we have been drifting toward what Robert Samuelson calls "a new mercantilism" which he defines as "policy intended to advance [one country's] own economic and political interest at other countries expense." Mercantilism is in stark contrast to David Ricardo's theory of comparative advantage that argues that all countries benefit if global markets are kept open and each country sells what it produces best. That theory has successfully guided our bipartisan trade policy for more than six decades.

Yet the polls of today reflect that a majority of Americans of both political parties are skeptical about the value of trade agreements.

In order to maintain an open trade policy that is proven to advance very significant national interests, we need to understand and respond to what is causing the disconnect between its documented benefits and the declining support it receives from the American public. I believe there are two basic causes. One is lack of information, and the other is economic anxiety.

Making the Case for Trade

One factor contributing to the decline in public support for trade is that Americans are uninformed about the economic, humanitarian, and security benefits that our nation derives from our agreements that open foreign markets to trade and investment. Most Americans have not thought about what would happen to our economy if we did not have access to global markets. With less than five percent of the world's population, our nation produces roughly 20 percent of the world's output, we need customers beyond our borders to buy our computers, machine tools, aircraft, soybeans, construction equipment, flat glass, and so much more.

Few know that international trade has made the average American household richer by $9,500 per year or that an agreement in the Doha Round that reduced trade barriers by just one-third would increase the average American's annual income by $2,000. They are unaware that the Bureau of Labor Statistics has documented that trade has helped Americans of modest means lower their costs for what they must spend for the necessities of food and clothes from 27 cents of every dollar in 1973 to less than 17 cents today.

They hear repeatedly that the North American Free Trade Agreement (NAFTA) has cost our nation "millions of jobs." They do not know that studies by the nonpartisan Congressional Research Service document that NAFTA has resulted in "little or no impact" on aggregate employment in the United States; instead according to careful economic analysis by Dr. Hufbauer at the Peterson Institute for International Economics the payoff to the average American household from the NAFTA is roughly $600.

Most Americans are unaware that jobs connected to international activity earn on average 13 to 18 percent more than jobs in the overall economy. They hear that imports costs jobs, when in fact studies show that there is a high correlation between an increase in imports and job creation.[2] They do not know that 97 percent of our exporters are small and medium size businesses that account for one third of our sales abroad and need foreign markets to prosper so that they can continue to be the backbone of job creation in this country.

They are unaware that the bulk of the foreign investment by U.S. multinationals is to secure market access not to secure lower wages. A full 80 percent of the overseas production by our manufacturing affiliates occurs in high-wage countries. Nor do they know that investments by foreign companies in the United States create over 5 million high paying jobs.

Very few Americans know that opening of global markets and expanding trade opportunities help to alleviate the poverty that puts weak states at risk. They are unaware that wealthy governments, including our own, pay their farmers huge subsidies that force more efficient farmers in poor countries out of the market or that 80 percent of the subsidies we pay go to large agribusinesses not to small family farmers. They would be surprised to learn that the United States, Europe, and Japan spend over $7 billion each year to subsidize their less competitive sugar farmers, which is a sum greater than

[2] See for example Karmin, Doug, *The Facts on Trade Deficits and Jobs,* Progressive Policy Institute, Policy Report.

the total exports of more efficient sugar producers in very poor countries in Africa.

Political leaders should make it a priority to educate Americans about such facts so that our citizens understand why open trade and investment are among the most effective tools our government has to generate economic growth, alleviate poverty, and encourage global stability. They could encourage universities, think tanks, business, and the media to better inform Americans about what they gain from opening world markets. All these groups could do more. Universities could offer more classes on international economics and trade, and think tanks could publish more articles on those subjects.

And businesses could do more. It would make a huge difference if the CEO of every U.S. business with any international activity would tell his/her employees, whether they number five or 5,000, the percentage of revenues the company derives from its foreign trade and investment and the percentage of the employee's paycheck that can be traced to the company's international activities. Depending on their size, companies could inform their employees about how foreign trade and investment boost America's prosperity, alleviate grinding global poverty, and strengthen our nation's security in a variety of ways---from posting relevant facts on wall posters, blackboards, closed circuit TVs, websites, and company newsletters, to enclosing information with the W-2 forms and in pay envelops.

Reducing Job Anxiety

While educating Americans about the benefits of open trade is necessary, it will not be sufficient to turn the political tide. Making the case that the opening of markets expands choice, lowers costs, and creates opportunity will not persuade the textile worker in South Carolina who has lost his job and blames Chinese imports or the telephone operator in Ohio who learns that her job has been shipped to a call center in India.

And we will not win support for trade from a laid-off manufacturing worker by pointing out that the United States is still the world's largest producer of manufacturing goods and that technology, not trade, has transformed the manufacturing sector over the past decade enabling us to produce 30 percent more goods with 20 percent fewer workers. To be credible we must admit that the gains from trade do not make every citizen a winner.

To preserve the benefits we gain from open global markets, we need to do a better job of helping those who are displaced by the rapid changes driven by technology and globalization. We can do this---**<u>not by closing down trade</u>**---but rather by allocating some of the very substantial yearly gains we derive from trade to fund programs to help those who are adversely affected get back on their feet. Polls show that workers' anxiety is substantially reduced when they are told that free trade is accompanied by programs that help displaced workers.

Increasingly policy analysts are looking at wage insurance, a program that supplements the income of a displaced worker who takes an entry level job in a new sector at lower pay. Reducing the income-gap encourages the worker to stay in the workforce, and importantly secures for that worker the most effective training there is, which is training connected to an actual job.

The Alternative Trade Adjustment Act (ATAA) adopted by Congress in 2002 was a step in the right direction, but it is quite limited: it applies only to manufacturing workers who are 50 years of age or older earning less than $50,000, and covers only half the pay gap between the old and new job, in an amount not to exceed $10,000 over a two year period.. These limits on age, earnings, and insurance coverage coupled with the exclusion of service workers who currently constitute eight out of ten of those in our workforce, make the program inadequate. There are a number of thoughtful studies suggesting constructive changes in the program.[3]

Polls also show that making health care benefits portable and providing a tax credit to help fund health premiums during the period of unemployment help to reduce worker anxiety. Although the Health Coverage Tax Credit included in the Trade Act of 2002 was another step in the right direction, the Government Accountability Office recently found that the tax credit at its current 65 percent level is insufficient to offset the high cost of maintaining health insurance during unemployment. As a result, usage has been extremely low.

It is important to consider the costs of such programs. Significantly, the same studies that calculate the U.S. economic gain from foreign trade to be $1 trillion per year, calculate that the annual costs of funding wage insurance

---

[3] See for example Howard F. Rosen, *Strengthening Trade Assistance*, Policy Brief 08-2, Peterson Institute for International Economics (2008)

and transitional health care assistance for all dislocated workers, regardless of whether trade is the cause of the job loss, to be about $12 to $15 billion annually. Our government currently spends less than $3 billion on programs to help displaced workers adjust. To rebuild public confidence in open markets, we need to do more.[4]

Growing income inequality is another factor contributing to Americans' anxiety. They are worried that the shift in earnings away from unskilled workers in favor of higher skilled workers will enable countries with large pools of unskilled workers to destroy the American dream. It is true that the pay gap is widening between those who are educated and those who are not. As Nobel Prize winning economist Dr. Gary Becker has pointed out the earnings differential of those with a college degree over those with a high school diploma has jumped from 30 percent in 1980 to 70 percent today, while the premium over that for graduate degrees is up from 50 percent to well over 100 percent.

If the United States is to remain super-competitive in the 21st century, we will need a workforce that is the best trained and most productive in the world. That will require us to improve education at the K through 12 levels. It is unacceptable that today more than one-third of our high school students fail to graduate. Funding is not the problem. According to a 2005 OECD study, the United States is tied for first place with Switzerland in annual spending per student in public schools. Rather than continuing to debate whether the teachers' unions or the officials in the public school system are to blame for blocking needed reforms, Congress could create a bi-partisan commission involving union leaders and some of our nation's recognized education reformers to develop a plan to improve our primary and secondary school systems.

We will also have to attend to deficits in our college education if our nation is to maintain its leadership position in today's technologically driven world. We need to encourage more of our young people to become better educated in the hard sciences. In a recent Op-Ed recently published in *Globalist,* Dr. Jacob Kirkegaard, a scholar at the Peterson Institute for International

[4] See e.g., Kletzer and Rosen *Easing the Adjustment Burden on U.S. Workers* The United States and the World Economy, Institute for International Economics (2005)

Economics, points out that Americans no longer lead the world as holders of college degrees:[5]

> "American baby boomers aged 55-64 led the global economy in tertiary education when they entered the workforce in the 1970s. Today's American workforce entrants aged 25-34 barely make the global top ten. . . .At least ten percentage points more of young workforce entrants in Russia, Canada, Japan, and Korea today have a tertiary degree than does the present share of youngsters in America. That indicates that present and future generations of Americans may not possess the same relative skill advantages to thrive in the global economy as did Americans aged 55 and older."

Dr. Kirkegaard explains:

> "Measured as a share of the total number of bachelor's, master's, and doctoral degrees granted by U.S. universities, science and engineering (S&E) degrees have held largely steady at least since the mid 1970s. Shortages of new S&E graduates are thus related more to the general educational stagnation in the United States than to any relative decline in popularity of these fields."

Some have called for incentives for college students to study math and science. Others believe that we should finance college education in exchange for public service. For years we have given tax incentives to encourage businesses to invest in capital equipment to enhance our nation's productivity. Now we need to focus on how to create effective incentives to enhance our human capital.

Private Sector Involvement

Just as the private sector can help make the case for trade, so too can it help in creating and supporting programs that help cushion the costs of displacement and build the skills needed to adjust to today's fast changing world. A new Administration and leaders in Congress should enlist its help. Business leaders have a genuine interest in figuring out ways to reduce economic anxiety here at home for they cannot afford to have global opportunities shrink. And policy analysts at think tanks and universities can

[5] Dr. Kirkegaard draws from his book The Accelerating Decline in America's High Skilled Workforce, (2007).

assist in thinking through policy recommendations that will most effectively deal with the issues that are contributing to the anxiety that is growing among Americans.

Some companies have already launched effective educational programs for their employees. For example, I know of one company that pays the tuition costs and gives up to three weeks per year of paid time off for its employees to take classes at accredited colleges and universities. It also grants $10,000 in stock to those employees who obtain a degree.

When, for reasons of efficiency, it must relocate an employee's job domestically or overseas it extends its educational offer to four years. Since the program began in 1996, 20,000 of its employees have earned degrees. The company figures the program costs it about $60 million per year. With revenues of $48 billion, it believes this investment that enhances the skills and creates a bond with its workers is well worth the cost. Smaller companies could create programs to upgrade their employees' education that are suitable to their revenue streams. An all-out effort is needed.

We Must Learn from History

As Norman Cousins once said: "History is a vast early warning system."

There are some eerie similarities between circumstances that prevailed last century and those that currently exist. Remember that from 1860 to 1914 we enjoyed a remarkable period of global growth that was cut off by World War I. This earlier period was characterized by relatively open trade, limited capital regulation, tremendous technological innovation with the introduction of the radio, telephone, and internal combustion engine, and a robust global economy where America was the largest contributor.

After World War I, we failed to muster the political will to reopen the global economy. The decade that followed the end of hostilities saw tensions grow among the great powers, an unstable alliance system, and the spreading influence of the Bolsheviks who were hostile to capitalism and dedicated to using violence to change the world in accordance with their ideology.

In the face of a slowing economy, candidate Herbert Hoover pledged in the 1928 Presidential campaign to help American farmers by raising tariffs on agricultural goods. Domestic anxieties soared with the 1929 banking crisis, and on June 17, 1930 Congress sent to the President the Smoot Hawley Act raising tariffs to record highs on over 20,000 imported goods.

President Hoover said that he disapproved of the Act, but signed it notwithstanding a petition sent him by 1008 economist urging him to veto. Before the ink dried on his signature, our trading partners began the retaliation that helped to bring the global economy and our own to a standstill contributing to the frictions that once again brought the world to war.

Today, by comparison, after six decades of stunning growth and truly extraordinary technological achievement, tensions are increasing as the world seeks to adjust to the rise of China and India. Alliances at the Security Council and NATO have weakened. Al Qaeda and other *Jihadist* groups hostile to Western values seek through violence to change the world according to their ideology, our financial institutions are again under stress, and high energy costs and the credit squeeze have slowed our economy causing steady lay-offs.

Against this backdrop, elected representatives are claiming that open trade is costing our nation millions of jobs and are pledging to vote against trade agreements already negotiated and to pull out of others. Restrictive legislation has been introduced in the 110th Congress ranging from penalizing outsourcing to curtailing Chinese imports, and members have passed a farm bill that has increased subsidies in the face of record commodity prices.

Efforts to limit trade as well as inward and outward investment because of a fear of foreign competition risk repeating the policy mistakes that have cost us so dearly in the past. And failure to integrate developing nations into the global trading system will not only limit our own future economic opportunities, but risks alienating large numbers of the excluded populations encouraging them to side with those who would do us harm.

Looking forward, our great country must marshal the political will to lead the world in lowering global trade barriers to create new economic opportunity for all nations including our own. That will require our public and private sectors to work hard to rebuild a domestic constituency that understands what is at stake and to take the steps necessary to ensure that our nation can and will compete vigorously and effectively in the 21st century.

Recommendations

1. Encourage the current and the successor Administrations to complete the Doha Development Round to secure for our nation the very substantial economic, humanitarian, and security benefits it could deliver.
2. Enact the Free Trade Agreements with Colombia, Panama, and South Korea that are pending before Congress to secure for our nation the substantial economic gains and strategic benefits that each will bring.
3. Enact Trade Promotion Authority so that our trading partners will be willing to negotiate with our government about opening sectors that present them with tough political challenges. Because our Constitution vests Congress with authority over trade and the Executive branch with authority to negotiate with foreign governments, a compact between our two branches of government is required if we are to secure for our nation the greatest economic, security, and strategic benefits possible from opening foreign markets.
4. Inform Americans about the very substantial economic, humanitarian, strategic and security benefits that can be obtained from our nation's trade agreements that open global markets and encourage businesses, universities, think-tanks, and the media to do so as well.
5. Reform and broaden the Alternative Trade Adjustment Assistance Act by covering service workers, expanding the wage insurance program, and increasing the Health Coverage Tax Credit.
6. Create a bi-partisan commission to study effective ways to improve American's human capital, focusing on actions that will improve students' performance at our primary, secondary, and tertiary schools, as well as results from post-diploma training programs.