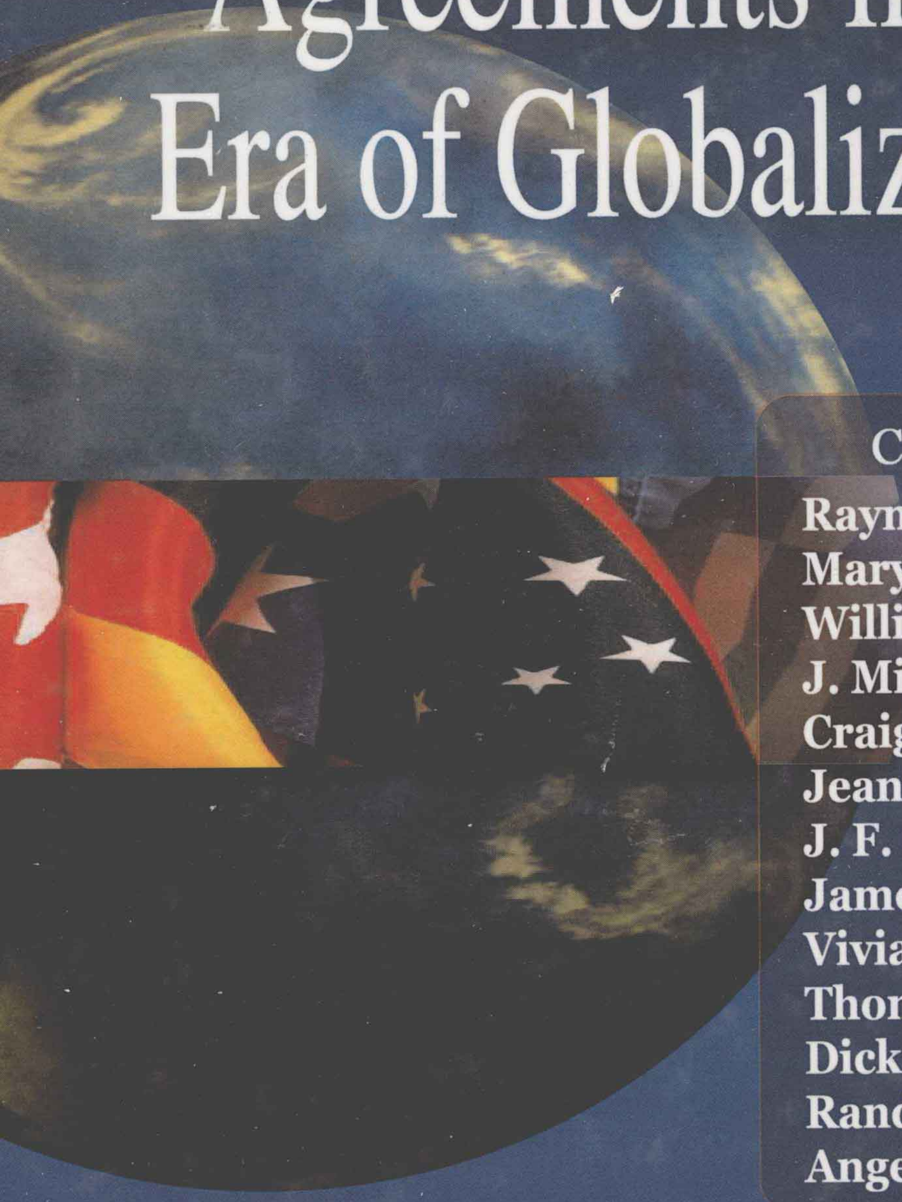
Trade Policies and Agreements in the Era of Globalization



Contributors

Raymond J. Ahearn
Mary Jane Bolle
William H. Cooper
J. Michael Donnelly
Craig K. Elwell
Jeanne J. Grimmett
J. F. Hornbeck
James K. Jackson
Vivian C. Jones
Thomas Lum
Dick K. Nanto
Randy Schnepf
Angeles Villarreal

Paul B. Lucus
Editor

NOVA

TRADE POLICIES AND AGREEMENTS IN THE ERA OF GLOBALIZATION

PAUL B. LUCUS
EDITOR

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Web Site: http://www.novapublishers.com

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PREFACE

Trade policies and agreements are a powerful weapon in the Era of Globalization. Most countries' strategy is to pursue muliple market-opening initiatives on a global, regional and bilateral basis, establishing models of success that can be used throughout all negotiations. This book presents some trade policies and agreements of the United States.

Chapter 1 - The 110th Congress has a full legislative and oversight agenda on international trade. The agenda may include considering legislation to implement a number of free trade agreements, possible renewal of trade promotion authority (TPA), as well as oversight of U.S. trade relations with China. This report provides information and context for many of these topics. It is intended to be read primarily by Members and staff who may be new to trade issues.

This report is divided into four sections in a question-and-answer format: trade concepts, U.S. trade performance, formulation of U.S. trade policy, and trade and investment issues. Additional suggested readings are provided in an appendix.

The first section, on trade concepts, deals with why countries trade, the consequences of trade expansion, and the relationship between globalization and trade. Key questions address the benefits of specialization in production and trade, efforts by governments to influence a country's comparative advantage, how trade expansion can be costly and disruptive to workers in particular industries and skill categories, and some unique characteristics of trade between developed countries.

The second section, on trade performance, focuses on the U.S. trade deficit and its impact on industries. Several questions address the causes of trade deficits, the role of foreign trade barriers, and how the trade deficit can be reduced. In terms of business impacts, the questions focus on which U.S. industries appear to be the most and least competitive, and on the relative size of the manufacturing sector.

The third section deals with the roles played by the Executive Branch, Congress, the private sector, and the Judiciary in the formulation of U.S. trade policy. Information on how trade policy functions are organized in Congress and the Executive Branch, as well as the respective roles of individual Members and the President, is provided. The formal and informal roles of the private sector and the involvement of the Judiciary are also covered.

The fourth section, on U.S. trade and investment policy, asks questions related to trade negotiations and agreements and to imports, exports, and investments. The justification, types, and consequences of trade liberalization agreements, along with the role of the World Trade Organization, are treated in this section. The costs and benefits of imports, exports, and investments are also discussed, including how the government deals with disruption and injury to workers and companies caused by imports and its efforts to both restrict and promote exports. The motivations and consequences of foreign direct investment flows are also discussed.

Chapter 2 - As imports from the People's Republic of China (PRC) have surged in recent years, posing a threat to some U.S. industries and manufacturing employment, Congress has begun to focus on not only access to the Chinese market and intellectual property rights (IPO) protection, but also the mounting U.S. trade deficit with China as well as allegations that China is selling its products on the international market at below cost (dumping), engaging in "currency manipulation," and exploiting its workers for economic gain. Members of the 109th Congress introduced several bills that would impose trade sanctions on China for intervening in the currency market or for engaging in other acts of unfair trade, while the Bush Administration has imposed anti-dumping duties and safeguards against some PRC products and pressured China to further revalue its currency and remove non-tariff trade barriers.

China runs a trade surplus with the world's three major economic centers — the United States, the European Union, and Japan. Since 2000, the United States has incurred its largest bilateral trade deficit with China ($201 billion in 2005, a 25% rise over 2004). In 2003, China replaced Mexico as the second largest source of imports for the United States. China's share of U.S. imports was 14.6% in 2005, although this proportion still falls short of Japan's 18% of the early 1990s. The United States is China's largest overseas market and second largest source of foreign direct investment on a cumulative basis. U.S. exports to China have been growing rapidly as well, although from a low base. In 2004, China replaced Germany and the United Kingdom to become the fourth largest market for U.S. goods and remains the fastest growing major U.S. export market. China is purchasing heavily from its Asian trading partners — particularly precision machinery, electronic components, and raw materials for manufacturing. China is running trade deficits with Taiwan and South Korea and has become a major buyer of goods from Japan and Southeast Asia.

In the past decade, the most dramatic increases in U.S. imports from China have been not in labor-intensive sectors but in some advanced technology sectors, such as office and data processing machines, telecommunications and sound equipment, and electrical machinery and appliances. China's exports to the United States are taking market share from other Pacific Rim countries, particularly the East Asian newly industrialized countries (NICS), which have moved most of their low-end production facilities to China.

This article provides a quantitative framework for policy considerations dealing with U.S. trade with China. It provides basic data and analysis of China's international trade with the United States and other countries. Since Chinese data differ considerably from those of its trading partners (because of how entrepot trade through Hong Kong is counted), data from both PRC sources and those of its trading partners are presented. Charts showing import trends by sector for the United States highlight China's growing market shares in many industries and also show import shares for Japan, Canada, Mexico, the European Union, and the Association for Southeast Asian Nations (ASEAN).

U.S. trade with the People's Republic of China (PRC) has raised several policy concerns. The trade is highly unbalanced in China's favor with a U.S. deficit of $201 billion in 2005. Year-to-date (January-October 2006), the U.S. deficit reached $190 billion. Many associate this deficit with the concomitant loss of American jobs in industries competing with rapidly rising imports from China. Some policymakers as well as leaders of industry and labor blame

China for unfair trade practices, including deliberately undervaluing its currency, which they claim create an uneven playing field for U.S. companies when competing against imports from the PRC. U.S.-China trade issues are often driven by larger policy objectives. U.S. trade with China is but one aspect of the overall U.S. policy of engagement with the PRC, a policy that serves broader U.S. interests. Trade also underpins Beijing's development strategy and contributes to domestic support for the PRC government.

This report presents data and analysis of China's trade that shed light on various policy issues, provides an overview of recent U.S. legislative initiatives, and examines the goals and constraints of U.S. trade policy toward the PRC. Some of the specific questions addressed are how the U.S. trade balance with China compares with those of the European Union and Japan, whether imports from China are merely replacing imports from other Pacific Rim nations, and how imports from China by industry compare with imports from other countries.

Chapter 3 - The United States is negotiating an unprecedented number of trade agreements. These agreements range from bilateral trade agreements with countries that account for meager shares of U.S. trade to multilateral negotiations that could affect large numbers of U.S. workers and businesses. During this process, Congress likely will be presented with an array of data estimating the impact of trade agreements on the economy, or on a particular segment of the economy.

An important policy tool that can assist Congress in assessing the value and the impact of trade agreements is represented by sophisticated models of the economy that are capable of simulating changes in economic conditions. These models are particularly helpful in estimating the effects of trade liberalization in such sectors as agriculture and manufacturing where the barriers to trade are identifiable and subject to some quantifiable estimation. Barriers to trade in services, however, are proving to be more difficult to identify and, therefore, to quantify in an economic model. In addition, the models are highly sensitive to the assumptions that are used to establish the parameters of the model and they are hampered by a serious lack of comprehensive data in the services sector. Nevertheless, the models do provide insight into the magnitude of the economic effects that may occur across economic sectors as a result of trade liberalization. These insights are especially helpful in identifying sectors expected to experience the greatest adjustment costs and, therefore, where opposition to trade agreements is likely to occur.

This report examines the major features of economic models being used to estimate the effects of trade agreements. It assesses the strengths and weaknesses of the models as an aid in helping Congress evaluate the economic impact of trade agreements on the U.S. economy. In addition, this report identifies and assesses some of the assumptions used in the economic models and how these assumptions affect the data generated by the models. Finally, this report evaluates the implications for Congress of various options it may consider as it assesses trade agreements.

Chapter 4 - For over 40 years, the United States has relied on unilateral trade preferences to promote export-led development in poor countries. Congressionally authorized trade preferences give market access to selected developing country goods, duty-free or at tariffs below normal rates, without requiring reciprocal trade concessions. The Caribbean Basin has benefitted from multiple preferential trade arrangements, the best known being those linked to the Caribbean Basin Initiative (CBI) begun in the mid-1980s. Since then, the growing number of reciprocal U.S. free trade agreements (FTAs) in the region have effectively replaced preferential trade arrangements, signaling a shift in U.S. trade policy and raising questions with respect to the future of those mostly smaller countries still relying on trade preferences. This report discusses the evolution of U.S. trade policy toward the Caribbean, focusing on the implications of moving from unilateral tariff preferences to reciprocal FTAs.

The U.S. Congress has approved multiple trade preference programs over the past three decades (production sharing, GSP, CBERA, CBI II, CBTPA, and HOPE Act of 2006). Each one amended trade rules and tariff preferences in ways designed to increase imports from CBI countries. Trade grew and many of the goals for development were supported. Evaluations of the benefits, however, suggested that they may not have been as robust as originally expected. Benefits tended to be concentrated in a few countries and products, often skirting industries with the greatest potential to stimulate exports. Also, the benefits of preferences are being eroded by multilateral trade liberalization and recently implemented FTAs.

A number of issues and circumstances are converging during the 110th Congress that will be a challenge for U.S. trade policy in the Caribbean region. Among these circumstances are the expiring trade preference programs, their limited use by remaining eligible countries, and the reluctance of these countries to make the transition to an FTA with the United States without some guarantee of a "development component" to the agreement. These concerns persist, despite the promise of permanent market access and increased investment that an FTA holds out. The Caribbean countries, long accustomed to dependent economic relationships, appear content to take a cautious and leisurely path toward any new arrangement with the United States.

For U.S. trade policy, which is still committed to achieving regional integration, these circumstances present a special challenge. Broader integration may be difficult to reconcile with the needs of very small developing countries, which are highly vulnerable to the vicissitudes of global economic trends and may require new and creative solutions, particularly if U.S. policy is still driven by the historical focus on development and regional security issues in addition to trade liberalization. In the context of continuing with trade preferences in similar or altered form, or opting for an FTA, the solution is not immediately obvious.

Chapter 5 - Trade promotion authority (TPA), formerly known as "fast-track" authority, is scheduled to expire July 1, 2007. With it will expire the authority: (a) that Congress grants the President to enter into certain trade agreements, and (b) for Congress to consider the agreements' implementing legislation under expedited procedures. Currently, the Administration is negotiating a number of trade agreements that may not be completed before the current TPA is set to expire. If these activities are to continue, TPA/fast-track renewal may be a central issue in the 110th Congress. Within the debate, a major issue is expected to be whether to include as a principal negotiating objective in trade agreements, "enforceable core labor standards."

Two TPA/fast-track authorities have incorporated labor provisions. The first, the *Omnibus Trade and Competitiveness Act of 1988* (OTCA), which expired in 1994, included the broad, general objective: "to promote worker rights." The *North American Free Trade Agreement*, with its labor side agreement, was negotiated under OTCA. The second and current TPA/fast-track authority with labor provisions, the *Trade Act of 2002,* includes protections for labor, modified by protections for country governments, businesses and investors. Seven free trade agreements (FTAs) — with Chile, Singapore, Australia, Morocco, Bahrain, Oman, and the Dominican Republic and Central America — were negotiated under this authority. All have only one enforceable labor requirement: that each country not fail to enforce its own labor laws in a manner affecting trade between the parties. (In contrast to this, the U.S.-Jordan FTA, negotiated in 2000 and approved in 2001 without TPA/fast track authority, includes enforceable labor provisions.)

Major options for labor provisions in renewed TPA focus on whether principal negotiating objectives should include "enforceable core labor standards." Supporters argue that including these could help: (1) slow the offshoring of certain U.S. jobs; (2) protect foreign workers against exploitative corporate behavior; (3) support the ability of workers to share in the gains from international trade; and (4) fend off an international "race to the bottom" based on labor costs. Opponents argue that: (1) core labor standards should be promoted by the International Labor Organization, not by trade agreements; (2) as countries develop, they adopt higher labor standards on their own; (3) stronger worker protections could discourage international investment; and (4) labor standards are disguised protectionism. History shows that with or without FTAs, trade will likely continue to grow.

This report examines issues relating to TPA/fast-track labor provisions in the larger context of global labor issues. It: (1) identifies the players and their positions; (2) tracks the enforceable labor provisions in TPA/fast-track laws and the FTAs negotiated under them; (3) presents some legislative options for new TPA/fast-track labor provisions; and (4) sets out arguments for and against enforceable core labor standards. Finally, it looks at possible outcomes and implications of the various legislative options

Chapter 6 - Mercosur is the Common Market of the South established by Brazil, Argentina, Uruguay, and Paraguay in 1991 to improve political and economic cooperation in the region following a lengthy period of military rule and mutual distrust. On July 2, 2006, Venezuela acceded to the pact as its first new full member, making Mercosur the undisputed economic counterweight to U.S. trade policy in the region, but raising questions about how it may shift regional political and trade dynamics. Collectively, the Mercosur countries have a diversified trade relationship with the world. The United States is the largest trade partner, the European Union (EU) a close second, with each claiming about 25% of total Mercosur trade. By contrast, the four Mercosur countries together account for only 2% of total U.S. trade. Including U.S. imports of Venezuelan oil, the "Mercosur 5" constitute 3.5% of total U.S. trade.

The Mercosur pact calls for an incremental path to a common market, but after 15 years only a limited customs union has been achieved. From the outset, Mercosur struggled to reconcile a basic inconsistency in its goals for partial economic union: how to achieve trade integration, while also ensuring that the benefits would be balanced among members and that each country would retain some control over its trade, production, and consumption structure. This delicate balance faced serious structural and policy asymmetries that became clear when Brazil and Argentina experienced financial crises and deep recessions. These economic setbacks disrupted trade flows among members, causing friction, the adoption of new bilateral safeguards, and a retreat from the commitment to deeper integration.

For now, Mercosur has turned to expanding rather than deepening the agreement. Many South American countries have been added as "associate members" and Mercosur has reached out for other South-South arrangements in Africa and Asia. These are limited agreements and unlikely paths to continental economic integration. Internal conflicts have highlighted Mercosur's institutional weaknesses and slowed the integration process. Uruguay has diversified its trade more toward the United States, and is showing signs of reconsidering the benefits of an "exclusive" Mercosur trade arrangement. Venezuela's accession to the pact adds a decidedly anti-American factor and may complicate both Mercosur's internal balance and regional trade relationships.

It appears Mercosur has opted for political cohesion over deeper economic integration. Mercosur, especially with Venezuela, will likely continue to resist movement toward a Free Trade Area of the Americas (FTAA), with Brazil in particular viewing the World Trade Organization (WTO) as the preferred alternative for achieving its trade policy goals. Given this impasse, it seems that the United States and Mercosur may continue to expand their influence through smaller trade agreements, presenting the possibility of two very different overlapping trading systems emerging in the Western Hemisphere centered around the U.S. and Brazilian economies. Few, if any, view this as an economically and administratively optimal alternative, presenting a formidable challenge to the future direction of U.S. trade policy in Latin America.

On March 26, 1991, Brazil, Argentina, Uruguay, and Paraguay signed the Treaty of Asunción, establishing the Common Market of the South (Mercado Común del Sur — Mercosur) with the intention of strengthening sub-regional economic and political cooperation. Since then, Mercosur has struggled to achieve deep economic integration, but has made strides toward political cohesion and emerged as an influential voice in regional trade negotiations. In particular, Mercosur has advocated its own expansion as an alternative to completing the proposed Free Trade Area of the Americas (FTAA).[1] On July 2, 2006, Venezuela acceded to the pact as its first new full member, making Mercosur the undisputed economic counterweight to U.S. trade policy in the region, and perhaps diminishing further expectations for a hemispheric-wide trade agreement. In December 2006, Bolivia also requested to become a full member. This report examines the evolution of Mercosur's policy decisions and performance as important elements for understanding the challenges to U.S. trade policy in Latin America.

Chapter 7 - On January 8, 2007, Canada initiated a World Trade Organization (WTO) dispute settlement case (DS357) against certain aspects of U.S. commodity programs in general, and the U.S. corn program in particular, by requesting consultations with the United States under the auspices of the WTO dispute settlement process. Canada's WTO case represents the present manifestation of long-simmering concerns that previously surfaced in 2005 in the form of an anti-dumping (AD) and countervailing (CV) duty case brought by Canadian corn producers who sought legal action for alleged unfair subsidization and dumping of U.S. corn in Canadian markets. Canada's International Trade Tribunal (CITT) ultimately ruled in favor of the United States on the 2005 AD/CV duty case. However, Canadian corn producers continued to press their concerns with the Canadian government about perceived unfair subsidization of U.S. corn. This pressure, and other supporting factors, likely contributed to the Canadian government's decision to request WTO consultations with the United States, thereby setting in motion the WTO dispute settlement process with its explicit rules and timetables for resolving a trade dispute.

In making its charges, Canada clearly seeks to build on Brazil's successful challenge of various provisions of the U.S. cotton program (WTO dispute settlement case DS267). Canada raises three explicit charges against U.S. farm programs. First, Canada contends that U.S. corn subsidies have caused serious prejudice to Canadian corn producers in the form of market price suppression in Canadian corn markets during the 1996 to 2006 period. Second, Canada argues that the U.S. export credit guarantee program operates as a WTO-illegal export subsidy. Third, Canada claims that U.S. fixed direct payments are not green-box compliant and should therefore be included with U.S. amber box payments, in which case the United States would be in violation of its $19.1 billion amber box spending limit for 1999, 2000, 2001, 2004, and 2005.

Since Canada's initial request for WTO consultations, several other WTO members — including Argentina, Australia, Brazil, the European Communities (EC), Guatemala, Nicaragua, Thailand, and Uruguay — have requested to join the consultations as interested third parties.

If successfully litigated, this case could affect all U.S. agricultural policy since the charges against the U.S. export credit guarantee and direct payment programs extend beyond corn to all major program crops. Should any eventual changes in U.S. farm policy be needed to comply with a WTO ruling in Canada's favor, such changes would likely involve action by Congress to produce new legislation. Congress will be revisiting U.S. farm legislation this year and could potentially address some of the issues raised by Canada's WTO challenge. U.S. Secretary of Agriculture, Mike Johanns, who has been advocating that a new Farm Act should be designed to make U.S. farm policy be "beyond challenge," has recently proposed changes to U.S. commodity programs that, if accepted in a new Farm Act, potentially could alleviate many of Canada's concerns while minimizing the likelihood of future WTO challenges.

Chapter 8 - This report is a brief overview of key issues addressed in CRS Report RL33864, *Trade Promotion Authority (TPA) Renewal: Core Labor Standards Issues*. Trade promotion authority (TPA), formerly known as "fast-track" authority, is scheduled to expire July 1, 2007. With it will expire the President's authority to negotiate trade agreements that Congress will then consider without amendment and with limited debate. For the 110th Congress, a likely issue in this debate is whether to include *enforceable core labor standards* as a principal negotiating objective in trade agreements. Accordingly, this report (1) identifies key labor provisions in the current TPA law and how they have translated into free trade agreements negotiated under it; (2) presents some legislative options, and summarizes arguments for and against listing enforceable core labor standards as a principal negotiating objective; and (3) looks at possible outcomes and implications of the legislative options.

Chapter 9 - U.S. merchandise trade is trade in goods only, not services. In 2006, U.S. exports, imports, and trade deficit reached their highest historical values: U.S. exports were $1.0 trillion, a 14.5% increase; U.S. imports were $1.9 trillion, a 10.9% increase; and the U.S. merchandise trade balance reached -$818 billion, a 6.6% increase.

Merchandise trade statistics are used to measure trade in commodities and with partner countries and groups. Latest official annual trade statistics of the U.S. Department of Commerce, used in this report, show that U.S. exports remain strong and growing and that U.S. imports remain even stronger, resulting in the largest annual merchandise trade deficit in U.S. history.

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Chapter 1

TRADE PRIMER: QS AND AS ON TRADE CONCEPTS, PERFORMANCE, AND POLICY*

Raymond J. Ahearn, Mary Jane Bolle, William H. Cooper, J. F. Hornbeck, James K. Jackson, Vivian C. Jones, Dick K. Nanto, Angeles Villarreal, Craig K. Elwell and Jeanne J. Grimmett

ABSTRACT

The 110th Congress has a full legislative and oversight agenda on international trade. The agenda may include considering legislation to implement a number of free trade agreements, possible renewal of trade promotion authority (TPA), as well as oversight of U.S. trade relations with China. This report provides information and context for many of these topics. It is intended to be read primarily by Members and staff who may be new to trade issues.

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The third section deals with the roles played by the Executive Branch, Congress, the private sector, and the Judiciary in the formulation of U.S. trade policy. Information on

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* Excerpted from CRS Report L33944, dated March 27, 2007.

how trade policy functions are organized in Congress and the Executive Branch, as well as the respective roles of individual Members and the President, is provided. The formal and informal roles of the private sector and the involvement of the Judiciary are also covered.

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TRADE CONCEPTS[1]

Trade Expansion and Globalization

1. Why Do Countries Trade?

Economic theory indicates that trade occurs because it is *mutually enriching.* It has a positive economic effect like that caused by technological change, whereby economic efficiency is increased, allowing greater output from the same amount of scarce productive resources. By allowing each participant to specialize in producing what it is more efficient at and trading for what it is less efficient at, trade can increase economic well-being above what would be possible without trade. There is a broad consensus among economists that trade expansion has a favorable effect on overall economic well-being, but the gains will not necessarily be distributed equitably. Moreover, although most economists hold that the benefits to the overall economy exceed the costs incurred by workers who lose their jobs, some economists argue that the benefits are often overestimated and the costs are often underestimated.

2. What Is Comparative Advantage?

The idea of comparative advantage was developed by David Ricardo early in the 19th century and its insight remains relevant today. Ricardo argued that specialization and trade are mutually beneficial even if a country finds it is more efficient at producing everything than its trading partners. If one country produces a given good at a lower resource cost than another country, it has an *absolute advantage* in its production. (The other country, of course, has an *absolute disadvantage* in its production.) If all productive resources were highly mobile between countries, absolute advantage would be the criterion governing what a country produces and the pattern of any trade between countries. But Ricardo demonstrated that because resources, particularly labor and the skills and knowledge it embodies, are highly immobile, a comparison of a good's absolute cost of production in each country is not relevant for determining whether specialization and trade should occur. Rather, the critical comparison within each country is the *opportunity cost* of producing any good — *how much output of good Y must be forgone to produce one more unit of good X.* If the opportunity costs of producing

X and Y are different in each economy, then each country has a *comparative advantage* in the production of one of the goods. In this circumstance, Ricardo predicts that each country can realize gains from trade by specializing in producing what it does relatively well and in which it has a comparative advantage and trading for what it does relatively less well and in which it has a comparative disadvantage.

3. What Determines Comparative Advantage?

Most often, differences in comparative advantage between countries occur because of differences in the relative abundance of the factors of production: land, labor, physical capital (plant and equipment), human capital (skills and knowledge including entrepreneurial talent), and technology. Standard economic theory predicts that comparative advantage will be in activities that make *intensive* use of the country's relatively abundant factor(s) of production. For example, the United States has a relative abundance of high-skilled labor and a relative scarcity of low-skilled labor. Therefore, the United States' comparative advantage will be in goods produced using high-skilled labor intensively such as aircraft and comparative disadvantage will be in goods produced using low-skilled labor intensively such as apparel. In addition to differences in factor endowments, differences in productive technology among countries create differences in relative efficiency and may be a basis for comparative advantage. Nevertheless, some high skilled services jobs, such as computer programming and graphic design, can today be easily done in a country such as India because of the revolution in telecommunications.

4. Can Governments Shape or Distort Comparative Advantage?

Government actions to influence comparative advantage can be grouped in two broad categories: policies that *indirectly* nurture comparative advantage, most often by compensating for some form of market failure, but not targeted at any specific industry or activity; and policies that aim to *directly* create and nurture comparative advantage in particular industries. Indirect influence on comparative advantage can emanate from government policies that eliminate corruption, enforce property rights, remove unnecessary impediments to market transactions, assure macroeconomic stability, build transport and communication infrastructure, support mass education, and assist technological advance. Policies that try to exert a direct influence on comparative advantage may include infant industry policies, industrial policies, or strategic trade policies. They all have the essential goal of identifying and nurturing particular industries that are thought to have extra-ordinary economic potential. In this view, realizing that potential requires initial government support, including protection from foreign competition. The efficacy of direct government efforts to shape comparative advantage is likely to vary significantly according to stages of economic development. China and India, for example, have used industrial policies to restructure their economies and enable them better to take advantage of world markets.

5. What Is the Terms of Trade?

A nation's *terms of trade* — the ratio of an index of export prices to an index of import prices — is a measure of the export cost of acquiring desired imports. Increases and decreases in its terms of trade indicate whether a nation's *gains from trade* are rising or falling. A sustained improvement in the terms of trade expands what our income will buy on the world market and can make a significant contribution to the long-term growth of economic welfare.

Similarly, a falling terms of trade raises the export cost of acquiring imports, which reduces real income and the domestic living standard. Although trade is considered a process of mutual benefit, each trading partner's *share* of those benefits can change over time, and movement of the terms of trade is an indicator of that changing share.

6. What Are the Costs of Trade Expansion?

Like technological change and other market forces, international trade creates wealth by inducing a reallocation of the economy's scarce resources (capital and labor) into relatively more efficient exporting industries that have a comparative advantage and away from less efficient activities that have a comparative disadvantage. This reallocation of economic resources is often characterized as a process of "creative destruction," generating a net economic gain to the overall economy, but also being disruptive and costly to workers in adversely affected industries that compete with imports. Many of these displaced workers bear significant adjustment costs and many may find work only at a lower wage. Although economic analysis almost always indicates that the economy-wide gains from trade exceed the costs, the perennially tough policy issue is how or whether to secure those gains for the wider community while dealing equitably with those who are hurt by the process. Economists generally argue that facilitating the adjustment and compensating for the losses of those harmed by market forces, including trade, is economically less costly than policies to protect workers and industries from the negative impacts of trade. While it is debatable how well existing worker assistance policies have worked, funding is also a longstanding issue. The Peterson Institute for International Economics, for example, estimates the lifetime costs of worker displacement to be roughly \$50 billion year, but calculates that the United States spends about \$2 billion per year to address the costs connected to displacement.

7. Does Trade Destroy Jobs?

Trade creates and destroys jobs in the economy just as other market forces do. Economy-wide, trade creates jobs in industries that have a growing comparative advantage and destroys jobs in industries that have a growing comparative disadvantage. In the process, the economy's composition of employment changes, but there may not be a *net* loss of jobs due to trade. Consider that over the course of the last economic expansion, from 1992 to 2000, U.S. imports increased nearly 240%, but total employment grew by 22 million jobs and the unemployment rate fell from 7.5% to 4.0% (the lowest unemployment rate in more than 30 years.).

8. Does Trade Reduce the Wages of U.S. Workers?

International trade can have strong effects, good and bad, on the wages of American workers. Concurrent with the large expansion of trade over the past 25 years, real wages (i.e., inflation adjusted wages) of American workers grew more slowly than in the earlier post-war period, and inequality of wages between the skilled and less skilled worker rose sharply. Trade based on comparative advantage tends to increase the return to the abundant factors of production — capital and high-skilled workers in the United States — and decrease the return to the less-abundant factor — low-skilled labor in the United States.[2] Therefore, it is reasonable to expect that, other factors constant, the large increase in trade over this period, particularly increased trade with economies with vast supplies of low-skilled labor, could harm the wages of low-skilled U.S. workers. However, other economic factors such as technological change and the shifting structure of production among emerging economies may have mitigated the potential adverse effect of trade on wages. While there may be no strong evidence that expanding trade has depressed the *average* wages of U.S. workers, some evidence suggests that increased trade may have caused 10% to 20% of the increase in wage inequality.[3] Many observers believe the larger share of increased inequality of U.S. wages was likely caused by advancing technology's tendency to pull up the wages of high-skilled workers and increased immigration's tendency to push down the wages of low-skilled workers.

9. What Is Intra-Industry Trade?

A sizable portion of world trade sees countries exporting and importing to each other goods from the same industry. This phenomenon is called *intra-industry trade.* This type of trade is particularly characteristic of the large flows of products between advanced economies, which have very similar resource endowments. This suggests that there is another basis for trade than comparative advantage behind intra-industry trade: the exploitation of *economies of scale.* Economies of scale exist when a production process is more efficient (i.e. has lower unit cost) the larger the scale at which it takes place. This scale economy becomes a basis for trade because while the United States and Germany, for example, could be equally proficient at producing any of a wide array of goods such as automobiles and pharmaceuticals that consumers want, neither has the productive capacity to produce the full range of goods at the optimal scale. Therefore, a pattern of specialization tends to occur with countries producing and trading some sub-set of these goods at the optimal scale.

10. Why Is Intra-Industry Trade Important?

A significant attribute of intra-industry trade is that it tends not to generate the strong effects on the distribution of income that can occur with trade based on comparative advantage. This attribute may explain why the large trade expansion that took place in the 1950-1980 period was less politically contentious than has been true for trade expansion since 1980. The earlier period was dominated by rising trade between advanced economies with similar endowments of productive resources and similar levels of technology. Therefore, trade at that time was largely an expansion of intra-industry trade that had no relatively abundant factor of production to exploit. As a consequence, it had little adverse affect on the return to the factors of production, including the wages of U.S. workers. In contrast, a much larger portion of the trade expansion since 1980 has been with less-developed economies with their relative abundance of low-skilled and priced labor — a likely source of downward pressure on wages in the developed economies.

11. What Is Globalization?

Globalization has come to represent many things, but economic globalization refers specifically to the increasing integration of national economies into a world wide trading system. Globalization involves trade in goods and services, and trade in assets (i.e. currency, stocks, bonds, and real property), as well as the transfer of technology, and the international flows (migration) of labor. Since 1950, world trade in merchandise has consistently grown faster then world production. In the recent period of 1990-2005 world trade in merchandise grew at about 6.0% per year as compared to about 2.0% for world output.[4] As a result, world exports as a percent of world GDP rose from about 12% to about 32%. In the United

States global integration has advanced quickly, with imports as a share of GDP rising from about 10% in the 1950s to about 17% today. More recent but far more dramatic has been the growth of international trade in assets. In the 1990s gross capital flows leaped by 300% as compared to a 63% advance of trade in goods. The rising economic integration of the world economy has been facilitated by two types of events: the myriad of technical advances in transport and communication that have reduced the natural barriers of time and space that separate national economies; and national and multi-national policy actions that have steadily lowered various man-made barriers (i.e. tariffs, quotas, subsidies, and capital controls) to international exchange.

12. What Is the Global Supply Chain and How Does It Relate to Globalization?

A supply chain is the interrelated organizations, resources, and processes that create and deliver a product to the final consumer. A global supply chain organized mostly by multinational corporations (MNCs) means that products that were once produced in one country may now be produced by assembling components fabricated in several countries. This supply chain has meant that as much as 30% of the recent growth of world trade has been through trade in intermediate products. Not only does such geographically fragmented production raise the level of trade associated with a particular final product, it also tends to raise the level of trade with both developing countries and developed countries. This growth of the global supply chain has been facilitated by technological advances that have increased the speed and lowered the cost of international transport and, perhaps most importantly, accelerated the international flow of information that allows MNCs to coordinate geographically fragmented production with relative ease. In addition, government action has achieved a substantial reduction of various man-made trade barriers and promoted movement toward a market based economy.

13. How Does Globalization Affect Job Security?

A greater degree of international economic integration can add to disruptive forces in the marketplace, including concerns that an estimated 30 to 40 million high-wage and high-skilled U.S. service sector jobs may now be vulnerable to "outsourcing" over time. Although this increased integration is unlikely to have a negative effect on overall employment rate or the average worker wage, greater volatility of worker incomes and employment is a possible effect. While the precise causes remain unclear, some evidence for the United States indicates a steady rise in wage and employment volatility since the 1980s.[5] In response to this rise, some argue that because increased volatility raises the economic risk attached to employment and earnings, the "social safety net" that protects workers from periodic market disruptions should be expanded commensurately.

U.S. TRADE PERFORMANCE[6]

U.S. Trade Deficit

14. What Is Meant by the Trade Deficit?

The U.S. trade deficit is the difference between the value of U.S. exports and U.S. imports. The deficit on trade in goods (merchandise) that reached a record $836 billion in