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WTO Report Card
America's Economic Stake in Open Trade

by Daniel T. Griswold

Executive Summary

Events in Seattle last November set the stage for a contentious debate in Congress this year about U.S. membership in the World Trade Organization. This study is the first in a series that will examine the costs and benefits of the WTO to the United States and to the rest of the world. By encouraging trade liberalization, the WTO promotes more vigorous global competition among producers, leading to lower consumer prices, rising worker productivity, and higher living standards.

The argument that trade liberalization through the WTO has made Americans poorer contradicts the most obvious facts about the U.S. economy in the year 2000. During the last five years, living standards have been rising for low- and high-income workers alike. More than 80 percent of the jobs created since 1993 are in occupations that pay above the median wage. Figures on the alleged decline of real wages are misleading because they overstate inflation and do not include the growth of nonwage benefits.

Despite warnings about "deindustrialization," manufacturing in America today is thriving. The resurgence of U.S. manufacturing comes against a backdrop of record imports. Since 1992, during a period in which the WTO and the North American Free Trade Agreement have both been in operation, the manufacturing output of the United States has risen by 42 percent.

America's open economy has not led to an outward flow of capital to low-wage countries. The outward flow of investment to Mexico and China remains relatively small. In fact, 80 percent of foreign direct investment by U.S. manufacturing firms in 1998 was in other high-wage countries.

America's trade deficit is the result, not of unfair trade barriers abroad, but of our continuing surplus of foreign investment. Trade liberalization through the WTO will not have a significant effect on the U.S. trade deficit in either direction.

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Introduction

Street protesters in Seattle during the World Trade Organization meeting last November delivered a long indictment against the organization and its guiding principle of trade liberalization. Union leaders, environmental activists, and protectionists such as Pat Buchanan charged that international agreements to expand trade have systematically undermined employment, wages, environmental standards, democracy, and national sovereignty. It seemed that whatever discontent anyone may have had with the state of the world today, trade was the culprit.

Meanwhile, defenders of trade liberalization were either silent, on the defensive, or overshadowed by the televised spectacle of chanting crowds, tear gas, and shattered store windows. Lost somewhere in the noise and the fog was the reality of what trade expansion and the WTO have accomplished for the United States and the global economy.

Events in Seattle set the stage for a contentious debate in Congress this year about U.S. membership in the WTO. Section 125 of the Uruguay Round Agreements Act, which Congress approved in December 1994, mandated a five-year review of the costs and benefits of U.S. membership in the WTO, with the required report to be delivered by the administration on March 1, 2000. Within 90 legislative days after receiving the report, any member of Congress can submit a resolution calling for U.S. withdrawal from the WTO. According to the law, the resolution must be discharged from committee after 45 days and submitted for a vote in the full House and Senate. Although such a resolution would need to clear the high hurdle of a certain presidential veto, the debate it stirs will focus attention once again on what free trade and the WTO mean for the United States.

One fact that friends and foes of trade can agree on is that America is becoming more open to the global economy. Since passage of the Reciprocal Trade Agreements Act in 1934 and the founding of the General Agreement on Tariffs and Trade in 1948, American tariff barriers have been on a downward trend, from an average of more than 40 percent in the 1930s to 2.8 percent today.[1] In addition to entering into multilateral trade commitments, the United States joined with Mexico and Canada in 1994 to form a free-trade area through the North American Free Trade Agreement. The result of those policy initiatives has been a steady expansion of America's integration into the global economy. The two-way flow of trade has now reached more than 25 percent of gross domestic product, a record high for this century and up sharply from the 1960s. The United States today is both the world's largest importer and its largest exporter.[2]

The WTO has also played an important role in facilitating trade liberalization in the rest of the world. Since the late 1940s, barriers against the free flow of goods and capital have been falling, with average global tariffs on manufactured goods down among industrialized countries from an average of more than 40 percent to under 4 percent today.[3] Meanwhile, developing countries have been unilaterally lowering their own barriers to trade and investment and now are 80 percent of the WTO's membership of 135. The result of that sea change in policy has been a geometric leap in global trade flows. The volume of world merchandise trade today is 16 times the volume in 1950, a rate of growth three times faster than the growth of global output.[4] The global flow of foreign direct investment (FDI) has more than quadrupled in the past decade, from $206 billion in 1990 to $827 billion in 1999.[5]

To the opponents of trade, of course, that is all bad news. They trace the beginning of America's alleged economic decline to the early 1970s, when the pace of our integration into the global economy quickened.[6] From their perspective, the creation of NAFTA and the WTO have only compounded our troubles. Their case against the WTO, free trade, and globalization rests largely on convincing us that we are worse off today than we would be if we had more vigorously resisted closer economic ties with the rest of the world.

This study is the first in a series that will examine the costs and benefits of the WTO to the United States and to the rest of the world. This opening study will focus on the impact of trade liberalization and WTO membership on the U.S. economy.[7]

The Link between Trade and Prosperity

To evaluate the economic impact of open trade and the WTO, we must begin with the fundamental question of why nations prosper. The answer, pared to its essentials, is this: A nation prospers economically to the degree that its people are productive. The more productive are its workers, the more prosperous is its economy. If productivity growth slows, so will the growth of GDP and living standards; if productivity growth accelerates, so too will the growth of GDP and living standards.

By definition, rising productivity means workers are producing more per hour of work. As productivity rises, more goods and services are available per worker to consume, invest, or trade for goods and services produced by workers in other nations. The competition among employers to hire workers ensures that real compensation per worker rises over time with output per worker. As a result, the rising productivity of a nation's workforce is matched by rising real compensation.

That basic assumption is confirmed by experience across nations and across time. The most advanced economies of the world—those of the United States, Canada, Japan, and Western Europe—are also the most productive. The poorest nations of the world are the least productive. In the United States, the slowdown in real wage growth after 1973 can be attributed directly to a slowdown in productivity growth. Consistent with that trend, the acceleration of real wage growth in the past four years can be attributed directly to an acceleration of productivity growth.

Nations become more productive through the division of labor, technological progress, investment in physical and human capital, and the reduction of inefficiencies:

- *Division of Labor.* As workers specialize, they become more skilled and productive at their particular tasks than they would be if they were required to perform a number of unrelated tasks. Companies also maximize their productivity by specializing in particular market niches or exploiting specialized "core competencies." As Adam Smith observed, nations are more productive when their people concentrate their efforts on what they do best and trade their excess production for goods and services produced in other countries.
- *Technological Progress.* New technology creates better products and methods of production. It allows us to produce more with a given amount of inputs, or to produce entirely new products that make our lives better. Computer and telecommunications technology has made possible such innovations as "just-in-time" delivery, computer-aided design, and Internet banking.
- *Physical Capital.* A larger stock of plant and equipment per worker raises productivity. Machines, and the technology they embody, allow workers to produce more per hour of work. In this way, investment in new plant and equipment not only returns profits to the investors but also raises the real compensation of the workers employed.
- *Human Capital.* As workers become more skilled and educated, they can use more sophisticated machinery and design new products and equipment that lead, in turn, to more productivity gains. One of the main reasons why Americans are so much more productive than workers in other countries is the high level of skills and education they possess.
- *Efficiency Gains.* Productivity can also be enhanced by the reduction of pure waste. Firms exposed to healthy price

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competition have a powerful incentive to control costs and eliminate waste in the production process. Such gains in efficiency result in lower prices for consumers and higher productivity for workers.

Open markets lead to higher productivity by encouraging most if not all of those positive forces in the economy. Trade promotes efficiency, the spread of new ideas and technology, the more efficient allocation of capital, and a greater international division of labor.

Trade allows Americans to increase their overall productivity by shifting capital and resources to sectors of the economy where we are more productive relative to other industries. By specializing in what we do best—for example, growing wheat, designing computer chips, and building aircraft—we can trade our surplus production for the goods and services that people in other nations are best at producing. The result of international specialization is that countries that trade enjoy higher productivity and higher living standards than they would if they did not trade.

Along with specialization, trade brings the dynamic blessing of competition. Competition spurs innovation, controls costs, and keeps downward pressure on prices. For consumers, enhanced competition means lower prices, better quality, and wider variety, raising the real value of their wages. For example, the quotas and tariffs the U.S. government maintains against imported textiles and clothing impose an estimated net cost on the U.S. economy of $10.4 billion a year.[8] The burden of this protectionism falls disproportionately on lower-income families, who spend a higher proportion of their incomes on essentials such as food and clothing. Fortunately, those quotas are scheduled to be phased out by 2005 under a WTO agreement.

The WTO has worked to open markets for U.S. exporters and to keep them open.

For domestic producers, trade allows access to lower-cost inputs and more sophisticated machinery. For example, the U.S. textile industry—even as it stifles foreign competition for its customers—has raised its productivity by importing state-of-the-art capital equipment from overseas suppliers. One reason U.S. computer makers are so competitive on world markets is that they can import a range of intermediate inputs, such as disk drives, monitors, semiconductors, and motherboards, from suppliers in Asia.

For exporters, trade expands markets abroad, making possible larger production runs and cost savings through economies of scale. Two sectors with the most to gain from liberalization are agriculture and services. In 1998 American farmers exported $54 billion in products, accounting for about a quarter of their cash receipts, despite relatively high trade barriers against farm imports worldwide. U.S. service providers accounted for 29 percent of total U.S. exports in 1998, up from 17 percent in 1950, again despite relatively high trade barriers.[9] WTO negotiations in agriculture and services set to begin this year are aimed at reducing the persistently high barriers to U.S. exports in those sectors.

The WTO has worked to open markets for U.S. exporters and to keep them open. During the financial turmoil abroad in 1997 and 1998, WTO commitments helped discourage countries in distress from reverting to protectionism under domestic political pressure. This helped to avoid a destructive cycle of trade retaliation such as the one that plagued the global economy in the 1930s. In addition, the United States has been the most frequent user of the WTO's dispute settlement mechanism, prevailing in 23 of 25 cases it has brought against other members. These cases have prompted the removal of discriminatory barriers against U.S. agricultural, services, and manufacturing exports. Also, if China is allowed into the WTO, its potentially huge market will be much more open to U.S. exporters. And since 1997 WTO members have negotiated three sectoral agreements that lower barriers to U.S. exports of information technology, financial services, and basic telecommunications services.

An open economy also provides additional capital from abroad, lowering domestic interest rates, expanding the nation's stock of capital, and raising the productivity of American workers. Japanese investment in U.S. auto plants, for example, has raised the productivity of American autoworkers by providing new plants and equipment and introducing new production techniques. An open economy has allowed

American investors, including workers vested in pensions, individual retirement accounts, and 401(k) retirement plans, to earn higher returns abroad and to spread, and thus reduce, the risk in their portfolios.

All these advantages of openness predicted by economic theory have been realized in the countries that practice open trade. The world's most prosperous countries are those that are relatively open to trade with other nations, while the poorest nations are those that remain relatively closed. If the protectionists were right, just the opposite would be true. In fact, according to a study by the Organization for Economic Cooperation and Development, nations relatively open to trade grow about twice as fast as those that are relatively closed—for all the sound economic reasons listed above.[10]

When the WTO agreements from the Uruguay Round of trade talks are fully implemented in 2005, their potential benefit could be an increase to global income of between $171 billion and $214 billion annually. The gains for the United States alone could amount to from $27 billion to $37 billion a year (in 1992 dollars)[11]—an impressive return compared to the $19 million Congress appropriates annually for our membership in the WTO.[12]

By encouraging trade liberalization, the WTO helps to raise living standards in the United States and the rest of the world. It encourages more vigorous global competition among producers, leading to lower consumer prices, rising worker productivity, and higher living standards.

Trade, Jobs, and Wages

> The United States is swapping good manufacturing jobs for lower paying service jobs. . . . The result: the living standards of working men and women are declining, and America is becoming a nation of hamburger flippers.
>
> —Ross Perot,
> *Save Your Job, Save Our Country*, 1993

> The U.S. workers' real median wage still remains more than 4% lower than in 1973.
>
> —Lori Wallach and Michelle Sforza,
> *Whose Trade Organization?* 1999

One of the oldest charges against free trade is that it destroys jobs. The charge contains a grain of truth. Like technology, expanding the freedom of Americans to trade can accelerate the shift of employment from one industry to another. While trade is responsible for destroying some jobs, it also creates new jobs. The result is not more or fewer jobs in the U.S. economy but a better mix of jobs.

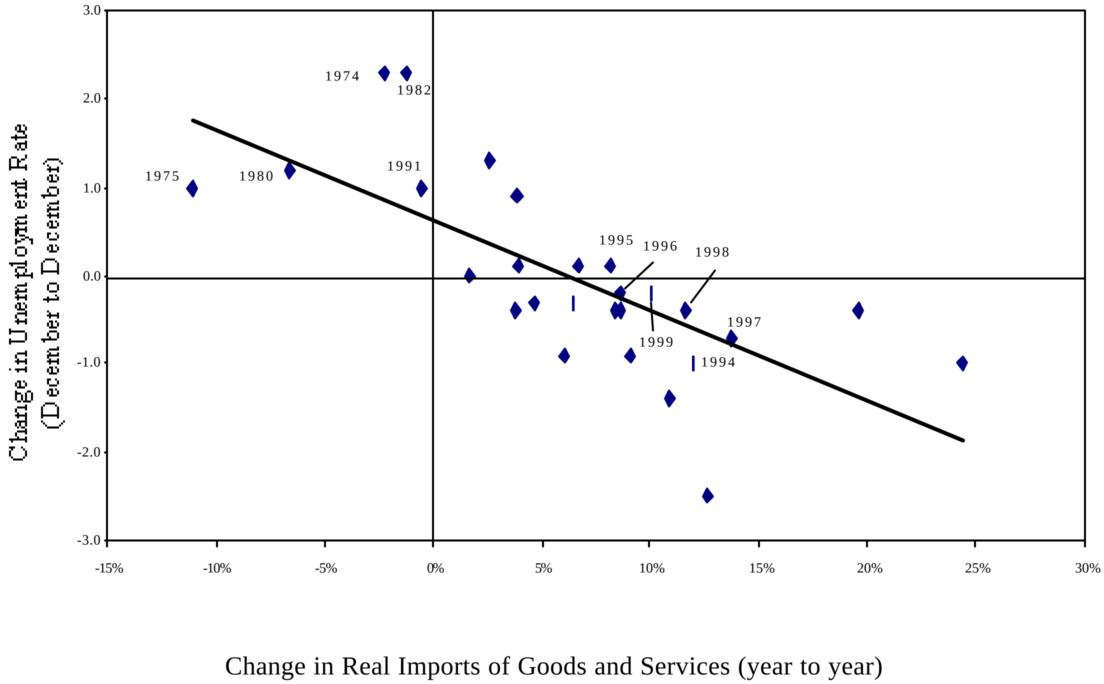
The notion that expanded international trade causes general unemployment in an economy is obviously false. In the past decade, as U.S. trade barriers have fallen and two-way trade has expanded, total civilian employment in the United States surged by 16 million, from 117 million jobs in 1989 to 133 million in 1999.[13] That explosion of job creation helped to push the unemployment rate down to just above 4 percent by the end of 1999, the lowest level in 30 years.[14]

Critics of trade mistakenly assume that imports raise the unemployment rate by displacing Americans who would otherwise make the same products domestically. In reality, import growth and the unemployment rate are negatively correlated. The more we import, the more jobs there are for Americans; or, to phrase it more precisely, the more Americans who hold jobs, the more we can afford to import.

Since 1973 the unemployment rate has tended to fall more rapidly in years with strong import growth and to rise in years when import growth was weak or negative (Figure 1). In fact, every percentage point increase in the rate of import growth during that period is associated with a 0.1 point drop in the unemployment rate. A 15 percent increase in real imports will typically be associated with a 0.9 point drop in the unemployment rate during the year (December to December), while a smaller 10 percent increase in real imports is associated with a 0.4 point drop in unemployment. A 5 percent fall in real imports is typically matched by a 1.1 point increase in unemployment.

The world's most prosperous countries are those that are relatively open to trade with other nations, while the poorest nations are those that remain relatively closed.

Figure 1
Imports and Unemployment, 1974–99



Sources: Monthly unemployment rates are from the Bureau of Labor Statistics, http://146.142.24/cgi-bin/survey most. Annual real imports are from Department of Commerce, *Survey of Current Business* 79, no.12 (December 1999): 135. 1999 imports are from the *Economic Report of the President 2000,* p. 333.

The connection between the unemployment rate and imports offers no comfort to protectionists who promise to drive down the unemployment rate by restricting imports. Since 1973 there has not been a single year in which falling imports have been associated with a falling unemployment rate. The empty lower-left quadrant in Figure 1 shows the hollowness of the protectionists' argument. The debate over trade should not be about the number of jobs in our economy; it should be about the kind and quality of jobs.[15]

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The Real Story of Real Wages

Even though trade does not reduce the total number of jobs in our economy, what about the quality of the jobs and the wage gap between high- and low-skilled workers? Critics of trade expansion contend that we are trading away good-paying jobs in manufacturing for lower-paying jobs in the service sector. As evidence, they point to widely quoted figures that are purported to show that the average real wage in the United States has fallen since 1973, and that trade with low-wage countries is primarily to blame.

The argument that trade liberalization through the GATT/WTO has made Americans poorer contradicts the most obvious facts about the U.S. economy in the year 2000. Americans today are much better off than they were in the early 1970s by virtually every economic measure available. Americans are living longer, enjoying better health, and consuming more goods and services per capita than ever before.

The claim of declining real wages is misleading for two reasons: it overstates inflation, and it does not acknowledge the growth of nonwage benefits. In the past few years economists have reached a consensus that the official consumer price index systematically overstates inflation; the 1996 Boskin Commission estimated the overstatement to be about 1.1 percentage points a year.[16] Compounded over 25 years, an annual 1 percentage point overstatement of inflation would cause a 26 percentage point understatement of the growth in real wages—which would turn the alleged 4 percent drop in real wages into a 22 percent gain in purchasing power.[17]

The commonly cited real wage numbers also fail to include such nonwage benefits as health insurance premiums, retirement account payments, eye and dental care, stock options, and paid maternity leave. Nonmonetary benefits as a share of wages have risen by one-third since 1973: from 32.7 percent in 1973 to 42 percent in 1995.[18] Failure to account for nonwage benefits makes the real wage numbers grossly misleading.

Even those flawed numbers indicate that the angst over real wages is misplaced. In the past three years real wages have begun to rise strongly again in step with rising productivity. According to the Bureau of Labor Statistics, real wages rose by an annual average of 2 percent in 1997, 1998, and 1999, during a period in which imports and foreign investment in the United States were rising to record levels.[19] Real per capita disposable income is up 17 percent in the past decade.[20]

This rising tide of real compensation has lifted all boats, including those of less-skilled workers, as the expanding U.S. economy has raised demand for all types of labor. According to the Council of Economic Advisers: "Between 1993 and 1998, real average household incomes have grown between 9.9 and 11.7 percent for every quintile of the income distribution, and the median African American household has seen a 15 percent increase in real income. Between 1993 and 1998, family incomes in the lowest quintile rose at a 2.7 percent annual rate, slightly faster than the 2.4 percent rate recorded by the top quintile."[21]

If the critics of trade were right—that more open trade drives down real wages, especially for low-skilled workers—then none of those developments should be happening.

Who's Flipping Hamburgers?

Predictions that trade would turn us into a nation of hamburger flippers have proven to be ludicrous. That myth is built on the misconception that service jobs are somehow inherently inferior to those in manufacturing, which gives rise to the erroneous assumption that the ongoing growth of the service sector has caused a decline in real living standards.

Since the passage of NAFTA and the Uruguay Round Agreement, the service sector in the United States has expanded so much that, today, service-producing industries account for more than 80 percent of all jobs in the United States. It is true that a significant number of service jobs are relatively low paying, in particular those in the retail trade, but the fastest-growing sectors of service employment are on the high end. According to a study by the U.S. Department of Labor, 81 percent of the new jobs created since 1993 have been in industry/occupation categories paying above-median wages, and 65 percent are in the highest-paying third of categories.[22]

Those new jobs are in communications, computer programming, finance, teaching, management, and other white-collar professions. Overall, the typical manufacturing job pays only about 1 percent more than the typical service job, and that gap is about to vanish. For nonretail service jobs, the average pay is now about 5 percent higher than for manufacturing jobs.[23]

It would be wrong to describe the lower-paying service jobs as dead-end work. Many workers prefer those kinds of jobs for the flexible hours and work experience they offer. The fast-food industry, to cite the most obvious example, has become a virtual training program for the American workforce, with millions of workers gaining their first on-the-job experience in the industry. Today nearly 70 percent of workers flipping burgers and performing other tasks in the fast-food industry are under the

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age of 20.[24] For most of those workers, low-end service jobs are a valuable but temporary step on the ladder to greater economic success.

Critics of trade tend to romanticize the appeal of manufacturing jobs. This sector of the economy also has its share of low-end jobs that pay below-average wages, in particular in the textile and apparel sectors. Working conditions can also be less pleasant, safe, and secure than in the large majority of service jobs. The shift from manufacturing to service jobs partly explains the dramatic decline in the death rate from on-the-job accidents in recent decades.

It is simply a myth that an economy cannot prosper if the share of jobs in manufacturing is falling. The current U.S. economy is proof.

The Gap between Rich and Poor

Another charge against open trade is that it has widened the gap between rich and poor in America. The claim rests on the theory that trade with low-wage countries has driven down the wages of low-skilled domestic labor. According to the theory, competition with poor countries causes U.S. industries to shift production away from labor-intensive goods, thus reducing the demand in this country for low-skilled workers. The result is what economists call "factor price equalization"—U.S. wages for low-skilled labor are dragged down toward the level in less-developed countries.

The theory sounds plausible on its face, but it fails to explain what has actually been occurring in the U.S. economy. It is true that, until the mid-1990s, the wage gap had been growing between workers with a college degree and those with only a high school education. But the evidence points to technological change, not international trade, as the primary reason for the widening gap between wages of skilled and unskilled workers.

If trade were the dominant factor, then most industries should be increasing their percentage of low-skilled workers to take advantage of lower wages. But, in fact, U.S. industries across the board have been shifting their workforces toward higher-skilled positions. This demonstrates that the rising wage premium for college degrees has been due, not to external competitive pressures, but to broader internal changes in the American economy. Specifically, a more information-based, technologically driven economy needs relatively more brains and less brawn than did the more manufacturing-based economy of the past.

As Paul Krugman, a trade economist at the Massachusetts Institute of Technology, explains:

> The evidence suggests that factor price equalization was not the driving force behind the growing wage gap. The rise in demand for skilled workers was overwhelmingly caused by changes in demand within each industrial sector, not by a shift of the U.S. industrial mix in response to trade. No one can say with certainty what has reduced the relative demand for less-skilled workers throughout the economy. Technological change, especially the increased use of computers, is a likely candidate; in any case, globalization cannot have played the dominant role.[25]

Empirical evidence confirms that trade was not a major factor in the widening wage gap. William Cline, in a study on the impact of trade on wages, found that international trade and immigration "are unlikely to have been the dominant forces in rising wage inequality." [26] After surveying the literature and employing his own Trade and Income Distribution Equilibrium model, Cline concluded that skills-based technological change was by far the largest identifiable contributor to the growth in income inequality. He concluded that international trade and immigration together explained only about 10 percent of the growing gap between wages for low- and high-skilled workers.[27]

It is true that, although technology has provided the much bigger shove, technology and trade have been pushing in the same direction—toward greater reliance on high-skilled workers. Anti-trade critics try to twist this into a black mark for globalization, but would they really prefer the opposite? Would anybody really want to see an American economy that relied increasingly on low-skilled workers? The increasing premium on education, skills, and training is surely good news for America's future. If some Americans lack the skills to take full advantage of the promise of that future, the proper response is to improve our public policies on education and training—not to dumb down the American economy by blocking technological progress or erecting trade barriers.

America's Thriving Manufacturing Base

> If we keep shifting our manufacturing jobs across the border [to Mexico] and around the world and deindustrializing our country, we will not be able to defend this great country and that is a risk we will never take.
>
> — Ross Perot, *Larry King Live,* November 9, 1993

> [NAFTA] will destroy the sugar-beet industry. It will destroy the flat glass industry. And of course it will destroy the auto industry.
>
> —Rep. David Bonior (D-Mich.), Congressional briefing, March 25, 1993

Despite predictions of its imminent doom, manufacturing in America today is thriving. American factories are producing more goods than ever before. Healthy gains in efficiency have kept American manufacturers competitive in international markets, maintaining America's position as the world's no. 1 exporter of manufactured goods. The resurgence of U.S. manufacturing comes against a backdrop of record imports.

Far from deindustrializing, America in the past decade has experienced a robust expansion of industrial output. Since 1992, during a period in which the WTO and NAFTA have both been in operation, industrial production—which includes the output of U.S. mines, utilities, and factories—has increased 37 percent. Manufacturing output by itself has risen even faster, by 42 percent (Table 1).

Table 1
America's Industrial Expansion, 1992–99

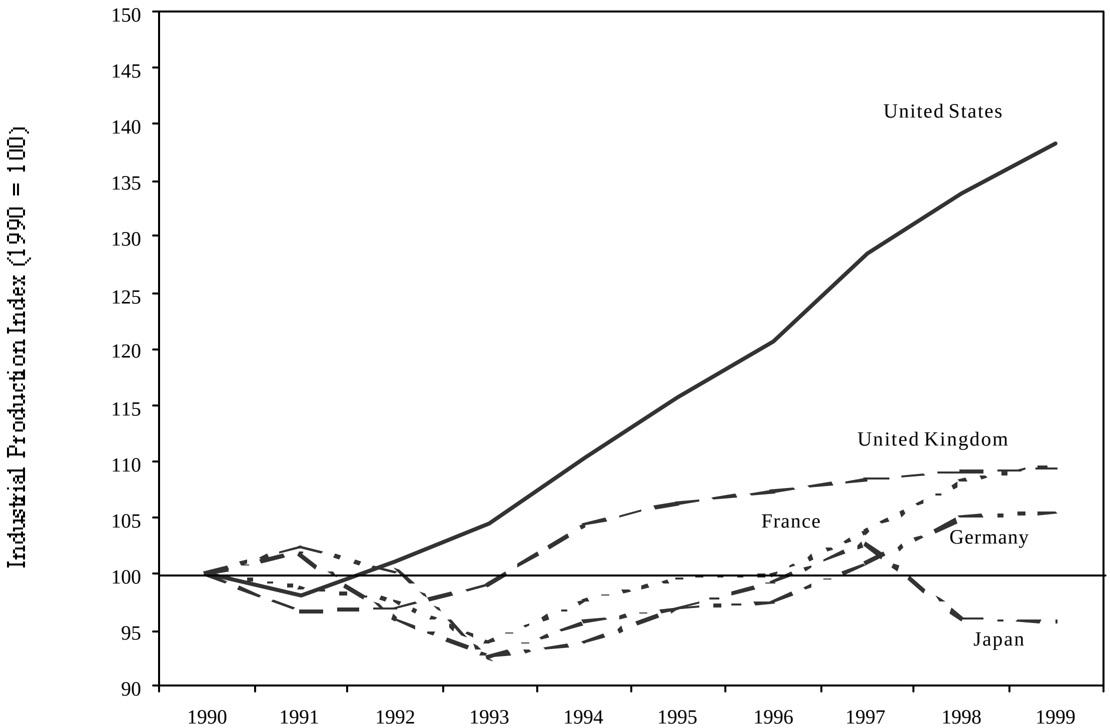
	1992	1999	Change (%)
Industrial production index	100	137.2	37.2
Manufacturing	100	142.3	42.3
Iron and steel	100	122.9	22.9
Fabricated metal products	100	128.8	28.8
Industrial machinery and equipment	100	230.5	130.5
Electrical machinery	100	389.6	289.6
Motor vehicles and parts	100	151.0	51.0
Apparel products	100	90.8	-9.2
Cars and light trucks produced	9,491,395	12,592,967	32.7
U.S. motor vehicle industry, employment	812,500	989,800	21.8

Sources: Joint Economic Committee, *Economic Indicators,* January 2000, pp. 17–18; and *Ward's Automotive Yearbook 1999* and *Ward's 1999 Motor Vehicle Facts and Figures Book* (Southfield, Mich.: Ward's Communications).

Consider the example of the U.S. auto industry. Domestic output of motor vehicles and parts has shot up 51 percent since 1992. Total domestic output of cars and light trucks reached 12.6 million in 1999, a record high and up more than 3 million since 1992. Strong domestic demand for new cars, light trucks, and sport utility vehicles has helped to boost profits and employment in the industry. In 1998 domestic automobile employment approached 1 million, an increase of 177,000 since 1992. Industry profits were healthy in 1999. Those are not the signs of an industry that has been destroyed.

Contrary to what the critics of trade predicted, American industry has not been losing ground, either in absolute terms or relative to the rest of the world. America remains the world's top exporter of manufactured goods, with exports in 1998 worth $528 billion.[28] America's share of global manufacturing exports held steady in the 1990s at about 13 percent.[29] Among America's leading exports in 1998 were aircraft, computer equipment, telecommunications equipment, valves and transistors, passenger cars, and motor vehicle parts. Compared with the other major industrial powers, including the once feared Japanese juggernaut, the United States has

Figure 2
Industrial Production, 1990–99



Source: Joint Economic Committee, *Economic Indicators*, January 2000, p. 35.

The shift to service-sector jobs is a natural consequence of a more advanced and prosperous economy.

been widening its lead in industrial output in the past decade (Figure 2).

Open U.S. markets have been essential to the competitive strength of America's most dynamic high-tech manufacturing industries. For example, U.S. personal computer manufacturers are among our leading exporters. But open up one of those PCs and you'll find a microcosm of the global economy: operating system and microprocessor from the United States, memory chips from Japan and Korea, a disk drive made by a U.S. company in Singapore, a motherboard and peripherals from Taiwan. Any attempt to close off the American economy with tariff walls would be a disaster for the U.S. computer industry.

Free trade has been a tonic for American industry. International competition has spurred innovation, efficiency, and customer satisfaction. The biggest winners have been American families, who benefit from the lower prices, greater variety, and higher quality of products that international competition makes available. Not all industries benefit from open competition, of course. Output and employment in the domestic apparel sector continue to fall as production shifts to lower-cost producers abroad. But, for the health and vitality of the American manufacturing sector as a whole, not to mention the overall economy, international trade has been a blessing.[30]

Warnings about deindustrialization tend to focus, not on output, but on jobs. But even here, the worries are based on an irrelevant half-truth: manufacturing employment has not been growing. The number of Americans employed in manufacturing at the end of 1999 was about 18.4 million, up slightly from 1992 but down from the all-time peak of 21 million in 1979. Before the downturn in exports hit in 1998, in the wake of the East Asian economic crunch, the number of manufacturing jobs in the United States had actually increased by 700,000 from the first quarter of 1993 through the fourth quarter of 1997.

In the end, the debate over jobs is irrelevant because the real measure of a nation's industrial might is not the number of people employed in this or that sector but the value of what they produce. The fact that American manufacturers can produce 42 percent more than they could in 1992 with about the same number of workers is a testament to rising efficiency—"competitiveness," if you will—not industrial decline.

The shift to service-sector jobs is a natural consequence of a more advanced and prosperous economy. As incomes rise, families tend to spend a smaller share of their income on goods and a correspondingly larger share on services. We spend relatively more than we used to on such services as travel, eating out, recreation, lawn care, entertainment, and financial advice. It only makes sense that, as our relative consumption of manufactured goods falls, so too will our relative production—even as our absolute production continues to climb. Virtually all the other advanced economies in the world have undergone the same transition. The relative decline of manufacturing is a sign not of national decline but of a nation reaching a higher stage of economic development.

Table 2
U.S. Foreign Direct Investment Flows, Manufacturing, 1994–98 (net flows, millions of $)

	1994	1995	1996	1997	1998	1994–98 Average
Mexico	(1,707)	(1,910)	(1,626)	(2,745)	(399)	(1,677)
China	(454)	(341)	(520)	(949)	(1,039)	(661)
EU, Japan, Canada, total	(872)	(3,428)	23,681	16,901	64,268	20,110
European Union	(109)	(965)	13,382	12,113	59,008	16,686
Japan	1,728	779	8,504	2,678	2,413	3,220
Canada	(2,491)	(3,242)	1,795	2,110	2,847	204
World, total	(4,316)	(15,733)	13,213	7,989	60,774	12,385

Source: U.S. Department of Commerce, Bureau of Economic Analysis, "International Accounts Data," http://www.bea.doc.gov/bea/dil.htm.
Note: Figures in parentheses are net FDI outflows.

No Giant Sucking Sound

> Now when you've got a 7-to-1 wage differential between the United States and Mexico, you will hear the giant sucking sound.
>
> — Ross Perot, *CBS Evening News,* November 10, 1993

> With Clinton's GATT treaty in 1994, the final scaffolding of the Global Economy was in place. The United States had assured its own Fortune 500 companies that if they shut their plants in Seattle or Salt Lake and opened in Singapore or Shanghai, they could export back to America, free of charge. We gave our greatest companies the most powerful incentives to pack up and leave; and they responded accordingly.
>
> —Patrick J. Buchanan, *The Great Betrayal,* 1998

More than half a decade after congressional approval of NAFTA and the WTO, domestic investment in the United States is booming. The same open economy that has benefited American consumers and workers has created a profitable climate for new business investment. As a result, more than a trillion dollars was spent in the United States last year on fixed nonresidential private investment.

The record expansion now heading into its 10th year has been marked by a healthy growth in investment. Since 1992 real nonresidential private investment in the United States has almost doubled, from $630 billion to more than $1.2 trillion (in 1996 dollars). Real investment in information-processing equipment and software has more than tripled.[31] The surge in investment and new technology has led directly to the rise in worker productivity that in turn has fueled economic expansion and rising living standards.

The predicted flight of capital to countries with lower costs and standards never materialized. In fact, during the past decade the United States has been the world's largest recipient of foreign investment. Year after year the United States has run a net surplus in its capital account, with

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foreign savers investing more in the United States than American savers sent abroad. This inflow of foreign capital has kept interest rates down, built new factories, and brought new technology and production methods to our economy. If there has been any giant sucking sound since 1993, it has been the rush of global capital to the safe and profitable haven of the United States.

American manufacturers continue to be net investors in Mexico and China, but the relative magnitude of the investments remains small. From 1994 through 1998 the annual net outflow of FDI in manufacturing to Mexico averaged $1.7 billion; the net annual outflow of manufacturing investment to China has been even smaller, averaging $661 million (Table 2). Those sums are inconsequential in a U.S. economy that averaged almost $8 trillion in annual GDP during the same period. In contrast to the relative trickle of outward investment to Mexico and China, domestic investment in U.S. manufacturing in 1997 totaled $192.3 billion.[32] In fact, from 1994 to 1998, the United States received an average annual net inflow of manufacturing FDI of $12 billion.[33]

While anti-trade polemicists focus all their attention on jobs shipped overseas, they ignore the jobs shipped here. Today some 12.3 percent, or almost one in eight, of manufacturing workers in America are employed by a U.S. affiliate of a foreign-owned company.[34] Honda, Toyota, DaimlerChrysler AG, BMW, Fuji, and other foreign-owned companies have become major employers in the United States.

As is the case with trade, most of America's foreign investment dealings are with other advanced economies. According to a study by the Deloitte & Touche consulting firm, 80 percent of FDI by U.S. manufacturing firms in 1998 was in other high-wage countries.[35] The top five destinations for U.S. manufacturing FDI in 1998 were the United Kingdom, Canada, the Netherlands, Germany, and Singapore—all high-wage economies with labor, health, and environmental regulations comparable to or more restrictive than those of the United States.[36]

Outward U.S. foreign investment is not drawn primarily by low wages and lax regulations in poor countries. "Contrary to common belief, cheap labor does not drive U.S. manufacturing FDI," the Deloitte & Touche study concluded. "Indeed, global expansion strategies are driven in large part by relative economic stability, well-developed infrastructures, lucrative market potential, and talented and skilled workers. Access to lower cost labor and raw materials are important, but not the primary driver."[37]

By focusing on low wages in less-developed countries, the opponents of openness miss the crucial fact that workers in poor countries are much less productive than workers in the United States. Their wages are lower, not because they are inherently lazy or incapable, but because they lack the human and physical capital and the pro-market institutions that foster higher productivity. Their countries have historically followed unsound economic policies: punishing tax rates, heavy market regulation, neglect of education, traditional hostility to foreign investment, high import barriers, and inflationary monetary policy. The policy mistakes that have kept wages low in poor countries also discourage foreign investment.

The United States has nothing to fear from openness to trade and investment with less-developed countries. Global trade liberalization encouraged by the WTO promotes investment, growth, and development in the United States as well as our trading partners.

America's Benign Trade Deficit

With the U.S. economy performing so well during a period of record trade expansion, complaining about the trade deficit has become the last refuge of the enemies of openness, who routinely point to the record deficit as prima facie evidence that global trade is undermining the U.S. economy. They argue that future trade agreements threaten to "worsen" the deficit and therefore should be opposed.

America's trade deficit is not the result of unfair trade barriers abroad; it is the result of our continuing surplus of foreign investment. The net inflow of capital allows Americans to import goods and services in excess of what we export—hence the trade deficit. As long as our level of domestic investment exceeds our level of domestic savings, the United States will be a net recipient of foreign capital and will run a trade deficit. In contrast, nations such as Japan will routinely run trade surpluses because their level of domestic savings exceeds domestic investment.

Unless a policy addresses the balance of savings and investment, it will have no ultimate effect on the trade deficit. Protectionism aimed at reducing the trade deficit would only deprive foreign producers of the dollars they would otherwise earn by exporting to the United States. The resulting reduction of dollars in the international currency markets would then drive up the dollar's value, making U.S. exports less attractive abroad and imports more attractive at home—offsetting the effects on the U.S. trade deficit of a protectionist tariff.

Under current conditions, the U.S. trade deficit is actually a sign of America's relative economic health compared with that of our major trading partners. The deficit reflects the attractiveness of U.S. investments and the spending power of U.S. consumers, whose rising employment and real wages have spurred demand for imports. This is why, as a general rule, the U.S. trade deficit grows during periods of economic expansion and shrinks during periods of sluggish growth or recession.[38]

Trade liberalization through the WTO will not have a significant effect on the U.S. trade deficit in either direction. It will make the countries that participate in the liberalization more prosperous by allowing their citizens to reap the productivity gains from the spread of technology, more efficient production, and a more economical division of labor.

Conclusion

America's membership in the WTO has been a double blessing for the United States. The liberalization of markets abroad has created export opportunities for U.S. companies, raising profits, employment, and wages in industries that serve expanding global markets. Meanwhile, WTO membership exerts pressure on the U.S. government to keep our own market open to the global economy, which gives American families access to a wider range of affordable goods and services, thus raising the real value of our paychecks. The competition from abroad spurs domestic producers to keep prices down, develop new and better products, and adopt more efficient production methods. The ability to import raw materials, capital equipment, and intermediate inputs, such as competitively priced steel and semiconductors, lowers the cost of production for U.S. producers and keeps them competitive in global markets.

All the economic arguments against the WTO agenda of trade expansion have proven to be hollow in practice as well as in theory. The U.S. economy is thriving at a time of record trade and international investment. America's unprecedented integration into the global economy has been accompanied by record low unemployment, booming investment and industrial production, and rising real wages up and down the income scale.

In testimony before the Senate in February, Federal Reserve Board chairman Alan Greenspan reminded senators that America's openness to imports and immigration has fueled the U.S. economy, prolonging our record expansion. "As we are creating an ever more complex, sophisticated, accelerating economy, the necessity to have the ability to bring in resources and people from abroad to keep it functioning in the most effective manner increasingly strikes me as relevant," he testified. The Fed chairman then went on to warn that, unless fears about trade and openness are addressed, "I do think the forces against globalization can significantly undercut this remarkable surge in prosperity that we are observing."[39]

By encouraging governments around the world to liberalize trade, the WTO enhances the individual freedom as well as the material well-being of Americans. Through a rules-based approach to trade policy, the WTO

"I do think the forces against globalization can significantly undercut this remarkable surge in prosperity that we are observing."
—Alan Greenspan

discourages governments from exercising self-defeating power over the economic lives of citizens. Because of the WTO, Americans are not only better off materially; they are also a bit freer from the power of government to decide what they produce and consume.

Notes

1. Council of Economic Advisers, "America's Interest in the World Trade Organization: An Economic Assessment," November 16, 1999, http://www.whitehouse.gov/WH/EOP/CEA/html/wto/, p. 1.

2. Ibid.

3. Organization for Economic Cooperation and Development, *Open Markets Matter: The Benefits of Trade and Investment Liberalization* (Paris: OECD, 1998), p. 31.

4. Ibid., p. 25.

5. United Nations Conference on Trade and Development, "World FDI Grows 25 Percent in 1999, Surpassing U.S.$800 Billion," Press release, February 8, 2000, http://www.unctad.org/en/press/pr_2837.en. htm.

6. Pat Buchanan, in his anti-trade manifesto, *The Great Betrayal* (New York: Little, Brown, 1998), p. 53, marks the beginning of the "free-trade era" as the conclusion of the Kennedy Round of GATT negotiations in 1967. His allies on the left, Lori Wallach and Michelle Sforza, *Whose Trade Organization?* (Washington: Public Citizen, 1999), p. 156, date "the onset of globalization in its current form" to 1973.

7. Subsequent studies will examine the impact of the WTO on U.S. law and national sovereignty and on labor and environmental standards in advanced and less-developed countries.

8. U.S. International Trade Commission, *The Economic Effects of Significant U.S. Import Restraints: Second Update 1999*, USITC investigation no. 332-325, publication 3201, May 1999, p. 36.

9. Council of Economic Advisers, "America's Interest in the World Trade Organization," p. 9. The leading U.S. service exports are travel and transportation services; royalties and licensing agreements; business, professional, and technical services; and financial services.

10. Organization for Economic Cooperation and Development, p. 10.

11. Council of Economic Advisers, "America's Interest in the World Trade Organization," p. 2.

12. U.S. Trade Representative, "1999 Annual Report of the President of the United States on the Trade Agreements Program," March 2000, Annex II, p. 10.

13. Council of Economic Advisers, *Economic Report of the President 2000* (Washington: Government Printing Office, 2000), p. 348.

14. Ibid., p. 354.

15. Total employment in an economy is determined by labor market flexibility and by broader, macroeconomic factors such as monetary policy. This means, of course, that proponents of trade expansion who argue that it will "create jobs" are propagating the same fallacy as opponents who argue that it will "destroy jobs."

16. The main reason why the CPI systematically overstates inflation is that it fails to capture the beneficial impact of new products on the purchasing power of our paychecks. Americans today can buy a minivan full of products—such as personal computers, VCRs, microwave ovens, cellular telephones, and digital cameras—that simply were not for sale in 1970, at least not at a price any of us could afford. And when those new products are finally added to the CPI shopping basket, the most dramatic price reductions have already been realized.

17. Author's calculation, based on an average annual CPI increase of 5.4 percent from 1973 to 1998.

18. W. Michael Cox and Richard Alm, *Myths of Rich and Poor: Why We're Better Off Than We Think* (New York: Basic Books, 1999), p. 18.

19. Council of Economic Advisers, *Economic Report of the President 2000,* p. 360.

20. Ibid., p. 341.

21. Ibid., p. 27.

22. Council of Economic Advisers and U.S. Department of Labor, Office of the Chief Economist, "20 Million Jobs: January 1993–November 1999," December 3, 1999, p. 5.

23. Cox and Alm, p. 146.

24. Ibid., p. 147.

25. Paul Krugman, *Pop Internationalism* (Cambridge, Mass.: MIT Press, 1997), pp. 46–47.

26. William R. Cline, "Trade and Income

Distribution: The Debate and New Evidence," Institute for International Economics, Washington, International Economic Policy Brief no. 99-7, September 1999, p. 3.

27. Ibid., p. 5.

28. United Nations, *Monthly Statistical Bulletin*, March 2000, p. 275.

29. U.S. Bureau of the Census, *Statistical Abstract of the United States: 1999* (Washington: Government Printing Office, 1999), Table 1243, p. 755.

30. For a more detailed analysis of the impact of international trade on domestic manufacturing and employment, see Daniel T. Griswold, "Trade, Jobs, and Manufacturing: Why (Almost All) U.S. Workers Should Welcome Imports," Cato Institute Trade Briefing Paper no. 6, September 30, 1999.

31. Council of Economic Advisers, *Economic Report of the President 2000*, Table B-17, p. 327.

32. Joint Economic Committee of Congress, p. 10.

33. U.S. Department of Commerce.

34. William J. Zeile, "Foreign Direct Investment in the United States: Preliminary Results from the 1997 Benchmark Survey," *Survey of Current Business* 79, no. 8 (August 1999): 32.

35. Deloitte Consulting, "Foreign Direct Investment Trends of U.S. Manufacturers: 1999 Annual Report," Deloitte & Touche, New York, 2000, p. 1.

36. Ibid., p. 12.

37. Ibid., p. 1.

38. For a more detailed discussion of the causes and consequences of the U.S. trade deficit, see Daniel T. Griswold, "America's Maligned and Misunderstood Trade Deficit," Cato Institute Trade Policy Analysis no. 2, April 24, 1998.

39. Alan Greenspan, "The Federal Reserve's First Monetary Policy Report to Congress for 2000," Testimony before the Senate Banking Committee, February 23, 2000. The quote was in response to questions from Sen. Robert Bennett (R-Utah).

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