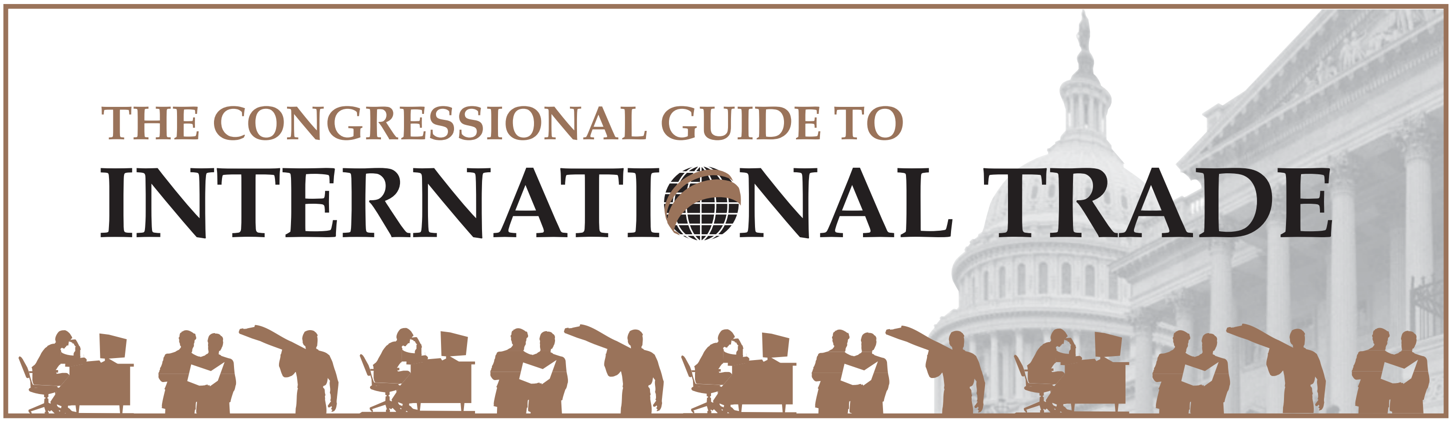
THE CONGRESSIONAL GUIDE TO INTERNATIONAL TRADE



The *Real* Impact of International Trade

In challenging economic times, the impact of international trade on jobs is often a source of fear and frustration. Some Americans now believe that we cannot compete in an increasingly competitive global economy. But when our focus shifts from short-term economic dislocations to our long-term outlook, it becomes clear that the United States is ready for the challenges ahead.

The American workforce is the most productive and flexible in the world. Our economy is resilient, innovative and able to produce huge numbers of jobs — 60 million from 1970 through 2000. And, according to the Bureau of Labor Statistics, the American economy will produce another 22 million net jobs by 2010.

Presented in a question and answer format, *The Congressional Guide to International Trade* connects the dots, cuts through volumes of misinformation and provides an understanding of the impact trade has on workers, companies and communities in the United States and abroad.

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Washington, D.C.

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The 21st century economy is global and fast paced. Increased international commerce has created and continues to support millions of high-quality American jobs and has helped raise our standard of living. And with 95.5 percent of the world's consumers living outside our borders, trade presents a tremendous growth potential for our economy. To succeed well into the 21st century and improve U.S. long-term economic growth, our companies and workers need greater access to global markets.

The alternative to expanding opportunities and access to global markets is a futile attempt to forestall change. Anti-trade organizations claim that isolating ourselves by erecting barriers will preserve the status quo, but this is a false hope. They have forgotten the disastrous lessons of the past, like the protectionist 1930 Smoot-Hawley Act that sparked a trade war and helped lead to a severe global depression.

As one becomes familiar with the real impact trade and globalization have on American workers, companies and communities, it becomes evident that trade is clearly in our best interests. To remain competitive, it is essential for America to invest in the people and industries of the future. We must welcome and even initiate change. As this document details in clear and concise language, international trade is not part of the problem... it is part of a brighter future.

Sincerely,

David Dreier
Member of Congress

Sincerely,

Cal Dooley
Member of Congress

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A Message from the Author

Job creation is beginning to rebound. Last October, non-farm payroll employment rose by 126,000, hopefully marking the end of the so-called "jobless" recovery. However, manufacturing jobs continued to fall, from a high of 21 million in 1979 to 14.5 million in October 2003. Many blame the 24-year-long trend on international trade, especially rising imports and recent job losses from worldwide sourcing. But careful analysis reveals that imports and global sourcing are not the cause of the decline in the manufacturing sector. Contrary to popular opinion, they actually provide many benefits to American companies, workers and consumers.

Manufacturing production in the United States has rapidly increased — not decreased — over the past 50 years, according to the Federal Reserve. New technologies and innovation have tremendously accelerated productivity growth enabling U.S. manufacturers to produce more goods with fewer workers. This has resulted in greater efficiency, increased wages and a higher standard of living, as well as freed up capital to be invested in new industries. Furthermore, while imports and worldwide sourcing have been rising, the U.S. economy has produced huge numbers of jobs — 60 million from 1970 through 2000. And the Department of Labor projects a net increase of 22.2 million more this decade.

How have imports and global sourcing helped America? Through the availability of lower-cost imported components and materials, U.S. manufacturers are able to become more competitive, and in turn sell more goods worldwide. Imports also benefit American consumers by providing greater choices and lower prices. This creates competition, forcing domestic producers to enhance value. And since imports help the American family stretch the dollar, more disposable income is available for education, health care and other goods and services — all activities that create jobs.

Like imports, worldwide sourcing also generates a number of advantages. For decades, U.S. manufacturers have sourced goods in countries like Canada, Mexico and, more recently, China. This has allowed U.S. firms to complement their strengths with those of their global partners. The result: the production of more globally attractive products. But that's not all. According to the International Trade Commission, the ability of U.S. and foreign companies to share in the production process has generated new jobs in the U.S. and helped retain jobs that otherwise would have been lost due to intense foreign competition.

During the past few years, some service jobs have begun to be located in India and other countries with well-educated, English-speaking labor pools. This has received much negative attention since some of the activities include knowledge-intensive functions such as software design. The data, however, indicates little downside. According to the McKinsey Global Institute, two-thirds of the economic benefits derived from purchasing services from India flow back to the U.S. Thus, firms engaged in worldwide sourcing generate higher profits, have more capital to invest in R&D, become more globally competitive and are better positioned to expand sales throughout the world. In the long run, new jobs are created — though not of the heavy manufacturing variety.

Fear of a "giant sucking sound" in this sector is unfounded since the vast majority of services cannot be purchased abroad. In fact, the U.S. service sector is predicted to greatly expand — accounting for approximately 20 million of the 22.2 million new jobs this decade, according to the Department of Labor. How well will these jobs pay? The U.S. service industry has become very sophisticated and globally competitive. In turn, average hourly earnings for production workers in the service sector have already caught up to those in manufacturing, as you will read in the following pages.

Nevertheless, some policymakers advocate resorting to protectionism to prop up failing manufacturing industries. This would result in fewer, not more jobs. Federal Reserve Chairman Alan Greenspan recently stated that creeping protectionism must be thwarted and reversed. Shutting out imports and punishing companies that invest in overseas

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facilities will not stop the decline of jobs in the manufacturing industry. In fact, we would not want to reverse the long-term trend of rising productivity that parallels the path taken by the U.S. agricultural industry. In 1940, 9.5 million U.S. workers were employed on farms. By 2002, this dropped to less than 3.3 million. Yet, U.S. agricultural output can now feed the world. America did not "lose" 6.2 million farm jobs: they shifted to emerging industries. As a result, we became more efficient and prosperous.

The American workforce is the most productive and flexible in the world. As new knowledge industries and job opportunities emerge, it is important to give our workers the tools they need to succeed well into the future. Policies that support training and education, not protectionism, will help prepare our workers for the challenges ahead.

To help you understand the *real* impact international trade has on America, its companies and workers, we bring you *The Congressional Guide to International Trade.* We hope you find our guide valuable and welcome your comments.

Sincerely,

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In America today, trade and prosperity are a package deal. The more we prosper, the more we trade, and the more we trade, the more we prosper. By seeking to curb imports of manufactured goods or to derail market-opening trade agreements, opponents of trade will only undermine the ability of the U.S. economy to expand output and create well-paying jobs.

For American workers, trade is not about more jobs or fewer jobs, but about better jobs. Trade with the rest of the world raises real wages, brings in new investment and creates new opportunities for the kind of work Americans do best. 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. Along with specialization, trade brings the dynamic blessing of competition. Competition spurs innovation, controls costs and keeps downward pressure on prices. For consumers, this enhanced competition means lower prices, better quality and wider variety, raising the real value of their wages.

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. And one reason U.S. computer makers are so competitive in 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, allowing larger production runs and cost savings through economies of scale.

These truths about trade and the U.S. economy are clearly and concisely explained in *The Congressional Guide to International Trade.*

Sincerely,

Daniel T. Griswold

Daniel T. Griswold

Associate Director, Center for Trade Policy Studies
Cato Institute

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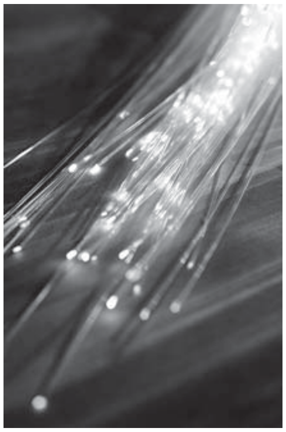


Q: How important is international trade to the U.S. economy?

A: International trade enables producers of goods and services to move beyond the U.S. market of 281 million people and sell to the world market of 6.2 billion. This is very good news, since exports support more than 12 million higher-paying U.S. jobs, strengthen companies and farms, and improve our tax base, while sending export revenue to local communities through restaurants, retail stores, etc.

In 1950, trade accounted for less than 5.5 percent of U.S. economic growth. Today, it has become an integral part of everyday life, accounting for more than 23 percent of economic growth in 2002 (25 percent in 2000). In fact, one in three acres of U.S. agricultural production is now exported.

Q: Do exporting companies perform better than non-exporting companies?

A: Yes.

According to Howard Lewis III and J. David Richardson's report *Why Global Commitment Really Matters!,* companies that export grow faster and fail less often than companies that don't. And their workers and communities are better off. According to this report, published in October 2001 by the Institute for International Economics, a Washington, D.C., think tank, U.S. exporting firms experience 2 to 4 percentage points faster annual growth in employment than their non-exporting counterparts.

But there's more to the story. Exporting firms also offer better opportunities for advancement, expand their annual total sales about 0.6 to 1.3 percent faster, and are nearly 8.5 percent less likely to go out of business. These gains are not dependent on any specific time period or export volume. Furthermore, sales abroad spread risk should the domestic market enter a period of slow growth or recession.

Q: Are workers in trade-related jobs paid less than the average wage?

A: No, quite the opposite.

According to *Why Global Commitment Really Matters!,* workers employed in exporting firms have better-paying jobs. For example, blue-collar worker earnings in exporting firms are 13 percent higher than those in non-exporting plants. Wages are 23 percent higher when comparing large plants, and 9 percent higher when comparing small plants. White-collar employees also earn more — 18 percent more than their non-exporting counterparts. Furthermore, the benefits for all workers at exporting plants are 37 percent higher, and include improved medical insurance and paid leave.

Why Exports Matter: More!, a previous report by J. David Richardson and Karin Rindal published by the Institute for International Economics and The Manufacturers Institute, states that less skilled workers also earn more at exporting plants.

Q: How do U.S. companies that receive foreign direct investment compare with firms that don't?

A: Recipients of foreign direct investment perform better.

According to Lewis and Richardson's report, U.S. plants that are recipients of foreign direct investment employ workers with 19 percent higher productivity, provide them with more machinery and equipment, and use more cutting-edge technology than their counterparts that are not globally engaged. Also noteworthy, these benefits accrue at plants with an equity stake as low as 10 percent and as high as 100 percent. Overall, the report says blue- and white-collar jobs at these plants pay 7 and 2.5 percent more, respectively, when comparing plant size, industry and location.

Q: How do U.S. companies that invest abroad compare with firms that don't?

A: They perform better.

Lewis and Richardson's data show that U.S. companies that have investments abroad use more advanced manufacturing technology than U.S. non-multinationals, or U.S. firms without investments abroad. And this has led to greater labor productivity. In fact, worker productivity is 11 percent higher in large U.S. multinationals and 33 percent higher in small ones as compared to their U.S. counterparts not invested abroad.

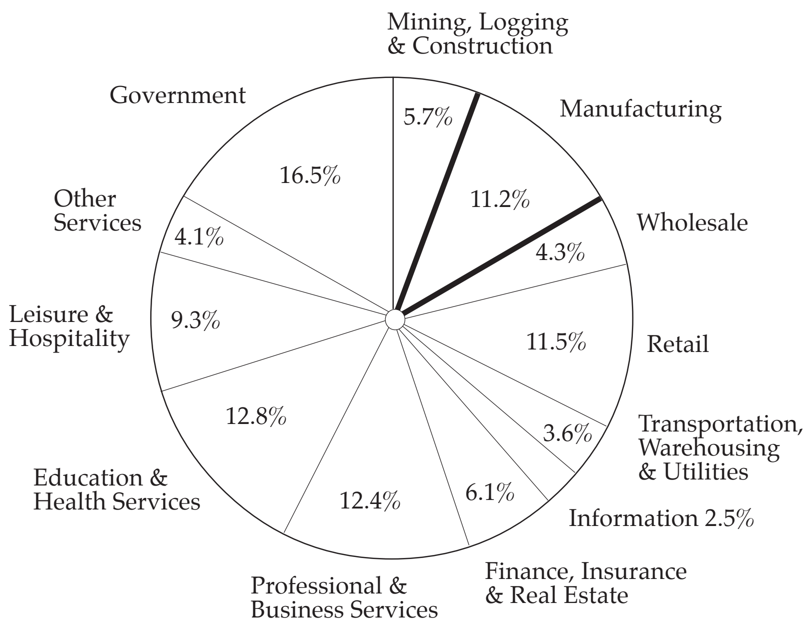
In addition, average annual earnings of employees at large U.S. multinationals are 18 percent higher than at their U.S. non-multinational counterparts; at small multinationals this number increases to 25 percent. Even though analysis indicates difficulty in separating out white-collar job gains at American-owned multinationals, blue-collar job gains are significant.

Q: Do imports put U.S. jobs at risk?

A: International trade does sometimes cause employment to increase in one sector and decrease in another. But so do many other factors. Exaggerated fears of massive job losses due to imports are misplaced. Contrary to some claims, only a very small percentage of American jobs are ever put at risk from imports.

U.S. Non-Farm Workforce by Percentage

October 2003



According to the Bureau of Labor Services, in October 2003 the goods-producing workforce (manufacturing, 11.2 percent; mining, logging and construction, 5.7 percent) accounted for approximately 17 percent of non-agricultural employment; service-providing workers accounted for the remaining 83 percent. The workers not in the manufacturing sector are in industries that by their nature do not produce tradable goods or services, or where imports account for a very small to nonexistent share of domestic supply, according to Daniel Griswold, associate director of the Cato Institute's Center for Trade Policy Studies. And in the manufacturing sector, only a small number of workers are in industries considered import-sensitive, which is defined as having an import penetration of at least 30 percent. How is this determined?

Of more than 450 separate four-digit Standard Industrial Classification (SIC) manufacturing sectors, only 66 were identified by Griswold as being import-sensitive. Employment in these 66 categories represented 12 percent of manufacturing workers in 1994 or less than 2 percent of total non-farm workers — a surprisingly small figure.

In 2002, agricultural workers numbered 3.3 million and represented approximately 2.4 percent of total U.S. employment, as reported by the U.S. Department of Labor. According to Griswold, some agricultural sectors (such as dairy products, sugar and peanuts) are more vulnerable than others (the larger export-oriented sectors such as wheat, corn and soybeans). "Even in farm sectors most vulnerable to import competition," said Griswold, "the potential job losses are minuscule in relation to the overall U.S. labor force."

Q: What is the impact of imports on consumers?

A: Contrary to some claims, imports are good for the economy and consumers. Imports offer American consumers greater choices, a wider range of quality and access to lower-cost goods and services. They create competition, forcing domestic producers to improve value by increasing quality and/or by reducing costs. And since imports allow the American family to purchase more goods for less money — stretching the dollar — more disposable income is available for education, health care, home mortgages, vacations, etc. Imports also help keep inflation down, which is one of the most important factors in raising our standard of living.

"Three out of four families living below the poverty line in America today own a washing machine and at least one car," observe John Micklethwait and Adrian Wooldridge, authors of *A Future Perfect*. "Ninety-seven percent own a television; three out of four have a VCR. Thanks to all that terrible competition, many gadgets are much more affordable, particularly in terms of the number of work hours needed to acquire them."

Q: Do imports hurt U.S. manufacturers?

A: Not really.

Imports not only afford American families a higher standard of living — a primary economic goal — but through the availability of lower-cost imported inputs, such as components and materials, U.S. producers are more competitive, which results in enormous benefits.

In 2001, half the $1.14 trillion in goods Americans imported were capital goods ($298 billion) and industrial supplies and materials ($274 billion). As stated by Griswold: "Such imports as petroleum, raw materials, steel and semiconductors are used directly by American producers to lower the cost of their final products. The lower costs in turn lead to increased sales at home and abroad and, in many cases, higher employment within the industry."

According to the World Trade Organization (WTO), "Imports expand the range of final products and services that are made by domestic producers by increasing the range of technologies they can use. When mobile telephone equipment became available, services sprang up even in the countries that did not make the equipment. Additionally, because imports offer unique capabilities at attractive prices, they are proven to enhance worker productivity. And higher productivity leads to a host of benefits."

Q: Why are manufacturing jobs declining?

A: The number of U.S. manufacturing jobs declined from a high of 21 million in 1979 to 14.5 million in October 2003. During this period, the percentage of manufacturing jobs relative to total U.S. employment fell from 21 percent to 11 percent. The primary reason: a combination of technology and high productivity.

Productivity gains generated by new technologies in manufacturing have consistently outpaced productivity gains in other sectors of the economy. As a result, new technologies and processes have permitted manufacturing firms to produce ever-increasing output with fewer workers.

According to Federal Reserve Governor Ben Bernanke, "In real terms, manufacturing production in the United States has risen rapidly over the last fifty years. . . . If manufacturing output has not declined, then what explains the sharp reductions in U.S. manufacturing employment that have occurred not only in the past few years but over preceding decades as well? The answer is a stellar record of productivity growth. Over the years, new technologies, processes and products have permitted manufacturing firms to produce ever-increasing output with ever fewer workers. The long-run trend in manufacturing is similar to what occurred earlier in agriculture: At one time a majority of the U.S. population lived on farms; but agricultural productivity has improved so much that although farm workers only represent 2.5 percent of the workforce, they are able both to feed the nation and export substantial quantities of food as well."

Bernanke also notes, "Strong productivity growth provides major benefits to the U.S. economy in the long term, including higher real incomes and more efficient and competitive industries."

Q: Does protectionism effectively save jobs in failing industries over the long term?

A: No, it does not.

Scholars and leaders of industry alike agree that even if a greater level of protectionism were implemented, low-technology jobs would still be replaced by technology or shifted to lower-wage locations over time. Robert Reich, former U.S. Secretary of Labor, stated that "Even if millions of workers in developing nations were not eager to do these [low-technology] jobs at a fraction of the wages of U.S. workers, such jobs would still be vanishing. Domestic competition would drive companies to cut costs by installing robots, computer integrated manufacturing systems or other means of replacing the work of unskilled Americans with machinery that can be programmed to do much the same thing."

There are many examples of technology raising worker productivity and business efficiency, where output increased or remained the same while utilizing fewer but higher paid workers. According to *Trade, Jobs and Manufacturing,* a 1999 Cato study by Daniel Griswold, "In the last two decades, tens of thousands of telephone operators and bank tellers have been displaced from their jobs, not by imports, but by computerized switching and automated teller machines."

In the early 19th century, the English Luddites attempted to destroy textile machines because they replaced weavers. Modern-day "Luddites" want to do essentially the same thing — but they have mistakenly attacked trade instead of technology.

Q: What are the real costs of protectionism?

A: Although in some instances protectionism may help fledgling industries for limited periods of time, current and decades-old studies indicate that protectionism actually has severe negative consequences. Reducing the number of imports through the use of trade barriers only raises the costs of goods and services to consumers and results in net job losses.

According to the 2002 U.S. International Trade Commission report, *The Economic Effects of Significant U.S. Import Restraints*, if all U.S. trade barriers had been simultaneously eliminated in 1999, 175,000 full-time workers would have been displaced, with the textile and apparel sector incurring nearly 90 percent of that loss. This would have represented only one one-hundreth of 1 percent of the 1999 labor force of 122.1 million. However, the report indicates, 192,400 full-time jobs would have been created, resulting in a net gain of nearly 17,400 jobs. In addition, total output would have increased by $58.8 billion.

The WTO determined in 1988 that $3 billion was added annually to grocery bills of U.S. consumers to support sugar import restrictions. In the late 1980s, U.S. trade barriers on textile and clothing imports raised the cost of these goods to consumers by 58 percent. And when the U.S. limited Japanese car imports in the early 1980s, car prices rose by 41 percent between 1981 and 1984. The objective was to save American jobs. However, in the end, it cost more jobs due to a reduction in the sale of U.S.-made automobiles, according to the WTO.

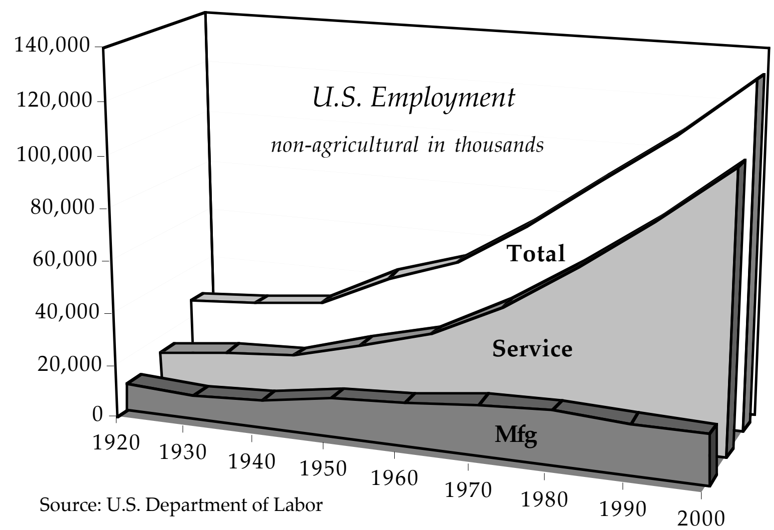
Additionally, the report *Trade, Jobs and Manufacturing* contends that if import barriers on sugar products were eliminated, imports would surge by almost 50 percent and domestic production would fall by 7.2 percent. The resulting job losses in sugar-related industries would total 2,290 out of 16,400 full-time industry jobs — a small number compared to an average of 235,000 net new jobs the U.S. economy created each month leading up to 1999, the year the report was released.

Commenting on the costs of protectionism to consumers, Peter Sutherland, former Director General of General Agreement on Tariffs and Trade (now the World Trade Organization), said, "It is high time that governments made clear to consumers just how much they pay — in the shops and as taxpayers — for decisions to protect domestic industries from import competition. Virtually all protection means higher prices. And someone has to pay; either the consumer or, in the case of intermediate goods, another producer. The result is a drop in real income and an inability to buy other products and services."

Mr. Sutherland continued, "Maybe consumers would feel better about paying higher prices if they could be assured it was an effective way of maintaining employment. Unfortunately, the reality is that the cost of saving a job, in terms of higher prices and taxes, is frequently far higher than the wage paid to the workers concerned. In the end, in any case, the job often disappears as the protected companies either introduce new labor-saving technology or become less competitive. A far better approach would be to use the money to pay adjustment costs, like retraining programs and the provision of infrastructure."

Q: Is the U.S. economy able to produce new jobs to compensate for those lost in manufacturing?

A: Yes.



The U.S. economy generated 60 million net new jobs from 1970-2000, and is predicted to create 22.2 million more jobs by 2010, according to the U.S. Department of Labor, Bureau of Labor Statistics. Daniel Hecker, an economist in the Office of Occupational Statistics and Employment Projections, Bureau of Labor Statistics, says, "The economy will continue generating jobs for workers at all levels of education and training, although growth rates are projected to be faster, on average, for occupations generally requiring a postsecondary award (a vocational certificate or other award or an associate or higher degree) than for occupations requiring less education or training. Most new jobs, however, will arise in occupations that require only work-related training (on-the-job training or work experience in a related occupation), even though these occupations are projected to grow more slowly, on average."

According to the Bureau of Labor Statistics' *Occupational Outlook Handbook 2002-2003*, service-producing industries are expected to account for approximately 20 million of the 22.2 million new wage and salary jobs generated over the 2000-2010 period.

Q: What impact does trade have on wages and income inequality?

A: According to the International Monetary Fund, "Nearly all research finds only a modest effect of international trade on wages and income inequality."

Note: Since the late 1970s, the wages of less-skilled American workers have decreased relative to those of more-skilled workers. Similar patterns are occurring in the United Kingdom. In contrast, countries with relatively rigid wages, such as France, Germany and Italy, have experienced higher unemployment rates.

Q: What is globalization?

A: Globalization, also known as internationalization, is a dynamic process that involves the integration of national markets through international trade (exports and imports), foreign direct investment (ownership and control of a company located in a foreign country) and portfolio investment (ownership of stocks, bonds or other financial instruments). Based on free-market capitalism and powered by advances in telecommunications (microchips, satellites, fiber optics and the internet), transportation and finance, globalization enables companies and individuals to establish relationships anywhere in the world. In addition, it provides billions of people worldwide the means to obtain a higher standard of living.

In their book *A Future Perfect*, John Micklethwait and Adrian Wooldridge argue that globalization increases people's freedom to shape their identities and sharpen their talents. It allows consumers to buy the best the world has to offer, while giving producers the tools to find buyers and partners worldwide. As a result, companies and individuals are empowered to generate new wealth in ways undreamed of just a few years ago.

But the impact of globalization goes far beyond the balance sheet. It is transforming our culture and political relationships, and in the process, impacting virtually every aspect of our lives. These changes are forcing difficult challenges for some — and no doubt creating much controversy.

Q: How is globalization impacting U.S. manufacturing?

A: The integration of traditional manufacturing, new technologies, national markets and improved supply chain management — all spawned by globalization — is transforming American manufacturing. In the process, resources have shifted to sectors with competitive advantages. As a result, productivity has climbed to new highs and, due to the American ability to change and improve, innovation is flourishing. For instance, the use of muscle on the factory floor is a thing of the past. Today, self-directed workers operate in teams and apply more sophisticated skills to create and run new processes.

Thomas Friedman writes in *The Lexus and the Olive Tree* that "The relative decline of the United States in the 1980s was part of America's preparing itself for and adjusting to the new globalization system." This process will continue to affect manufacturing in the United States and abroad.

Q: How must companies adapt to the new global environment?

A: With the fast-paced changes brought on by the dynamic global economy, tremendous pressure is put on companies to adapt. Lester Thurow, author and MIT professor, states that "businesses must be willing to destroy the old while it is still successful if they wish to build the new that will become successful." He points out that four of the five makers of vacuum tubes never successfully made transistors after transistors replaced vacuum tubes, and even the fifth is not a player today.

Of the 500 companies that originally comprised the S&P 500 in 1957, few currently remain on the list. Why? According to Arie de Geus, author of *The Living Company,* "The average life expectancy of a multinational corporation — Fortune 500 or its equivalent — is between 40 and 50 years." Long-lived companies, he contends, are sensitive to their environment, cohesive with a strong sense of identity, tolerant and conservative in their financing.

Q: What change does globalization create in the workforce?

A: Globalization is forcing ongoing changes similar to those introduced by the industrial revolution. Shifting from an agrarian society to an industrial economy compelled workers to leave farms in search of factory jobs. Industrialization created anxiety and fear, and demanded that workers learn new skills. With the advent of globalization, the U.S. is increasingly specializing in more complex, value-added goods and services. Consequently, new skills again are demanded.

Gradually, globalization has created, transformed and streamlined jobs in the United States. This has forced workers to continually improve their job skills and add greater value. Now, after years of dynamic change, these improvements are bearing fruit for the vast majority of Americans.

Q: How can workers adapt to new global economic realities?

A: Adapting to change is never easy. To help workers adjust to the changing working environment, on August 6, 2002, Congress reauthorized the Trade Adjustment Assistance (TAA) program through fiscal year 2007 and added provisions. Overall, the TAA goal is designed to help trade-affected workers return to suitable employment as quickly as possible.

Today, the ability to seize the best job opportunities is often dependent on the level of education one has obtained. It is no surprise that unemployment is higher among those with lower levels of education and skill. For example, in October 2003, the U.S. unemployment rate for workers age 25 years and older without a high school diploma was 8.3 percent. It declined to 4.9 percent for high school graduates, was 4.5 percent for those with some college education, and was 3 percent for college graduates.

The occupational groups projected to decline or be among the slowest growing are more likely to be dominated by workers who do not obtain education beyond high school. Conversely, occupations with the highest rates of growth are more likely to employ workers with higher educational attainment.

According to the U.S. Department of Labor's report *Futurework*, "We are living in a new economy — powered by technology, fueled by information, and driven by opportunity on our side." By 2050, the report indicates, the U.S. population is expected to increase by 50 percent. As the knowledge economy emerges, it is essential that our young people develop the skills needed for tomorrow.

It is very clear: as globalization creates opportunity, it generates more opportunities for those workers who are better educated. Because the uneducated could be left behind, lifelong learning policies are essential in today's economy and even more so in tomorrow's economy. It is also important for companies to nurture proactive global corporate cultures to support this goal.

Q: Why have trade and globalization been labeled as destructive by so many?

A: Job losses, often erroneously assumed to be the result of international trade and globalization, are frequently reported in the media. Unfortunately, jobs gains are rarely covered in newspapers or on television. As a result, the bad news often overwhelms the good. This has had the cumulative effect of negatively impacting public opinion on trade and globalization.

As the internet, satellites and fiber optics eliminate the impact of distance on economic activities, we are reliving what railroads and electricity brought to an earlier age. Because change is occurring so quickly, our level of anxiety and fear is heightened. Just as Marxism was a response to the Industrial Revolution, anti-globalization can be seen as a reaction to rapid change in the modern world.

Unfortunately, a tremendous volume of misinformation about trade and globalization is being disseminated to Members of Congress and others throughout the United States and worldwide. This pattern needs to change.

Q: Do U.S. manufacturers who establish facilities abroad typically seek cheap labor, provide poor working conditions and welcome lax environmental laws?

A: No, they do not.

Although exceptions exist, many anti-trade organizations promulgate the notion that, as a whole, U.S. manufacturers investing abroad seek low-cost facilities in order to cut labor and environmental costs, and provide sweatshop-like working conditions. Although the intentions of these organizations are good, their logic is flawed.

Their argument is based on the notion that weak environmental and worker standards give producers in poor countries a significant cost advantage. They also theorize that this puts pressure on other countries to lower their standards in order to compete, prompting a "race to the bottom." If this were correct, investment would be flowing to underdeveloped countries with the poorest labor and environmental records. In reality, the opposite is true.

Developing countries or countries with low-cost labor tend to attract only a small portion of America's foreign direct investment. For example, in 2001, 94 percent of U.S. manufacturing investment abroad was directed to high-wage countries, according to Deloitte Research. The most important determinants of capital flows are political stability, education and productivity levels, communications and transportation infrastructure, the rule of law, proximity to market and the ability to repatriate profits. This is why developed countries, which pay the highest wages and have the strongest environmental laws, are the destinations for the vast majority of foreign direct investment.

American manufacturers who do invest in developing countries typically offer higher wages and better working conditions than local employers. This makes jobs at U.S. facilities highly prized and, over time, leads to improved environmental and worker protection at all levels.

In fact, U.S. companies operating abroad act as agents for change. Through their operating standards, business practices, values and principles, U.S. companies often serve as role models, charting a path for other foreign and domestic companies to follow. This strategy, which is good for business, results in greater employee loyalty, less absenteeism, higher morale and increased productivity.

In reality, little incentive exists to establish facilities in countries with weak standards. Research indicates that countries with weak standards do not have a better global export performance than countries with higher standards. Studies also show that after a country's per capita income reaches about $5,000, environmental improvement becomes a higher national priority. This is a result of a better educated and more politically aware population that grows more sophisticated as a country's living standards rise. In turn, these people put greater pressure on government to establish and enforce stricter environmental regulations and allocate more resources to environmental quality.

As incomes rise, educational levels also rise sharply. Families can send their children to school rather than to work. Research indicates that child labor declines sharply as the level of economic development increases.

Q: Do U.S. production sharing operations abroad destroy U.S. jobs?

A: Several anti-trade groups feel U.S. production sharing is totally unnecessary and should be eliminated. What they don't understand is that production sharing actually saves more jobs here at home than would be lost due to protectionist efforts to place an outsourcing straight jacket on business.

Production sharing, the allocation of different stages of the manufacturing process to different countries, has many benefits. For one, it can result in lower manufacturing costs while increasing a company's level of global competitiveness. This process not only helps retain jobs that otherwise would be lost due to competition, it also grows jobs in capital-intensive manufacturing, product development, design and marketing-related activities here in the U.S.

Also known as co-production or cross-border manufacturing, production sharing allows firms anywhere in the world to complement their respective strengths by providing access to unique technology, raw materials, specialized intermediate inputs or labor skills in a way that creates greater product value.

Production sharing is sometimes the only viable strategy available to companies to make products more competitive here and abroad. Under the U.S. production-sharing Harmonized Tariff Schedule provision 9802, U.S. materials that are assembled, processed or improved abroad can be shipped back to the U.S., incurring duty only on the foreign labor and non-U.S.-made materials. As such, these imports — which often contain substantial U.S. content — are more price competitive than other imports with no U.S. content, and are subject to lower Customs duties.

Q: What would happen if production sharing were discontinued?

A: In the late 1980s, the U.S. International Trade Commission conducted a survey of 900 U.S. firms engaged in production sharing. When asked what they would do if the production-sharing provision were eliminated, respondents indicated they would increase reliance on foreign-made parts or suffer a loss of U.S. market share to foreign competitors not using U.S.-made components. Their responses, ranked according to frequency, were:

- Turn to foreign suppliers of components,
- Discontinue producing labor-intensive products and import them from East Asia,
- Move all manufacturing to Asia,
- Cut back U.S. production and target a market niche not threatened by imports, or
- Go out of business.

These options are poor alternatives to production sharing, especially since the strategy is responsible for generating new jobs and retaining those that would be lost due to intense foreign competition, according to the U.S. International Trade Commission.

Q: Do other countries engage in production sharing?

A: Yes, they do.

The number of firms around the world engaging in cross-border manufacturing is on the rise. In fact, it involves more than $800 billion or at least 30 percent of total manufacturing trade annually, according to the World Bank report *Just How Big Is Global Production Sharing?* And the growing interdependence of countries utilizing this strategy also is evident, since trade in components and parts has been growing considerably faster than trade in finished products.

Companies in Japan, Korea and Taiwan co-produce in China, Indonesia, Malaysia, Thailand and the Philippines primarily to reduce their labor costs. In the European Union (EU), most co-production involves apparel, auto parts and electronic products, and it occurs mainly in Poland, the Czech Republic, Hungary and Slovenia — countries with inexpensive but well-educated labor forces. A growing share of EU co-production is taking place in Northern Africa.

As a result of its growing use, production sharing for many companies has become a necessary strategy used simply to keep up as opposed to achieving a competitive advantage. But while co-production has allowed many producers to cut costs, improve technology and increase their level of competitiveness, not all have benefited. Some companies have invested in foreign-based production sharing facilities only to find unexpectedly low levels of productivity, excessively high turnover, poor infrastructure and a corrupt legal system. Consequently, many of these firms have abandoned their efforts.

Q: How has worldwide sourcing changed?

A: In the past, global sourcing typically involved the purchase of foreign goods. In recent years, however, worldwide sourcing has expanded to include services. (Note: Unlike production sharing, which utilizes U.S. components and materials in the final product, products purchased overseas may or may not include U.S. components and materials.)

Labor-intensive services have begun to be sourced in India, the Philippines, Malaysia and other countries with large, well-educated, English-speaking labor pools. This has been made possible by new technologies that allow for the transfer of huge amounts of information around the world at minimal costs — coupled with the ability to digitize and computerize many services.

Since global sourcing is structurally simpler in the service sector than in the manufacturing sector in terms of resources, space and equipment requirements, worldwide sourcing of services is expected to grow. The McKinsey Global Institute report says that fear of massive job losses is unfounded, since the vast majority of services cannot be purchased abroad and will remain in the U.S.

But the report goes much further. It estimates that two-thirds of the economic benefits from sourcing services in India flow back to the U.S. In turn, U.S. companies that outsource generate greater profits, become more globally competitive, and are better positioned to sell more goods and services worldwide. As indicated above, the Bureau of Labor Statistics predicts that service-producing jobs will increase by 20 million from 2000 to 2010. This figure accommodates service-producing jobs lost due to global sourcing and a variety of other reasons.

Q: What impact do service exports have on the economy and jobs?

A: For the last 32 years, the U.S. service sector has generated a trade surplus that has consistently reduced the trade deficit.

For example, in 2002, U.S. exports of services decreased the trade deficit by more than $65 billion, and even more so in previous years when the global economy was growing at a faster rate. Since 1980, U.S. service exports have grown more than 150 percent faster than exports of goods. But more importantly, tremendous benefits are currently derived from — and huge potential is offered by — the service sector in terms of economic growth, personal income, employment and exports. This fact is not widely acknowledged. It is becoming increasingly likely that the telecommunications/digital infrastructure that is making the global sourcing of services possible today is the same infrastructure that will significantly support an even greater boost in service exports.

Q: Do service jobs pay poorly?

A: No.

When some people envision the service sector, they think of employees flipping hamburgers. In reality, the U.S. service sector has become extremely advanced and internationally competitive. In turn, the sector's wages have risen considerably. For example, in December 2002, January 2003 and February 2003, average hourly earnings for service production workers reached $15.49, $15.51 and $15.65, respectively, according to the Bureau of Labor Statistics. During these months, average hourly earnings for U.S. manufacturing production workers were $15.48, $15.53 and $15.56. This indicates that hourly wages in the service sector have finally caught up to the manufacturing sector.

With the recent introduction and availability of new and inexpensive technology — led by telecommunications, computers and the internet — millions of people and companies worldwide now have the ability to purchase more services from the United States. As a result, the U.S. service sector will continue to grow. Note: The number of workers employed in U.S. service producing industries has steadily climbed. In October 2003, it reached 108 million or 83 percent total employment.

Q: Have trade and globalization harmed developing countries or the poor?

A: Since globalization emerged in the 1970s, world infant mortality rates have fallen by almost half, adult literacy has increased more than a third, primary school enrollment has risen and the average life span has shot up 11 years. In the short span of 1990 through 1998, the number of people living in extreme poverty in East Asia and the Pacific decreased 41 percent — one of the largest and most rapid reductions in history.

Today, 24 developing countries representing about 3 billion people, including China, India and Mexico, have adopted policies enabling their citizens to take advantage of globalization. The result: their economies are catching up with rich ones. The incomes of the least globalized countries, including Iran, Pakistan and North Korea, have dropped or remained static. What distinguishes the fastest growing developing countries from the slowest growing developing countries is clear: their openness to trade.

For many of the world's poorest countries, the primary problem is their inability to participate in the globalization process. Contrary to anti-globalist doctrine, globalization benefits poor nations and the less privileged, as well as wealthy nations and the affluent. According to the 2000 WTO report *Trade, Income Disparity and Poverty,* "Trade liberalization (the removal of trade barriers) helps poor countries catch up with rich ones ... this faster economic growth helps to alleviate poverty." In fact, the report concludes, trade "is essential if poor people are to have any hope of a brighter future."

The WTO study concurs with the 2000 World Bank report *Growth Is Good for the Poor.* Studying data from 80 countries over four decades, *Growth Is Good for the Poor* confirms that "Openness to foreign trade benefits the poor to the same extent that it benefits the whole economy."

Globalization, Poverty and Inequality, published in 2000 by the Progressive Policy Institute, a Washington, D.C., think tank, contends that "less globalization is generally associated with less development." Similar to other studies, *Globalization, Poverty and Inequality* concludes that anti-globalists are wrong.

According to this report, "No country has managed to lift itself out of poverty without integrating into the global economy." And who would know this better than former Mexican president Ernesto Zedillo, who said: "In every case where a poor nation has significantly overcome its poverty, this has been achieved while engaging in production for export markets and opening itself to the influx of foreign goods, investment and technology — that is, by participating in globalization."

This same conclusion has been reached by Jeffrey Sachs and Andrew Warner of Harvard University. They contend in their report *Economic Convergence and Economic Policies,* published by the National Bureau of Economic Research, that developing countries with open economies grew by 4.5 percent a year in the 1970s and 1980s, while those with closed economies grew by 0.7 percent a year. At this rate, open economies double in size every 16 years, while closed economies double every 100 years.

If remaining world merchandise trade barriers are eliminated, potential gains are estimated at $250 - $650 billion annually, according to the IMF and World Bank. About one-third to one-half of these gains would accrue to developing countries. Removal of agricultural supports would raise global economic welfare by an additional $128 billion annually, with some $30 billion going to developing countries.

Globalization may not be a panacea for all economic ills, but it certainly helps alleviate them. However, it has had negative consequences on some developing countries that lack sound legal or financial systems. As a result, anti-globalists with good intentions but bad policy recommendations often make globalization the scapegoat for many of the world's ills.

In the end, the facts don't lie. According to authors John Micklethwait and Adrian Wooldridge, "In 1960, the average wage in developing countries was just 10 percent of the average manufacturing wage in the United States; in 1992, despite all that terrible globalization, it had risen to 30 percent ... globalization helps the whole pie get bigger." In fact, there are numerous examples of this principle. As stated by Micklethwait and Wooldridge, "Deng Xiaoping's decision to open China's economy in 1978 helped some 800 million peasants more than double their real incomes in just six years, arguably the single greatest leap out of acute poverty of all time."

Q: How important is "good" government?

A: Globalization has put a premium on good government and increased the costs of poor government. Consequently, governments must redefine their role in light of heightened competition among countries and companies. This is forcing governments to adopt policies that support international trade, privatization, economic stability, deregulation of capital markets, investment attraction and a fair and enforceable legal system. And since economic activity is now mobile, governments must provide the technological infrastructure that supports a cluster of related industries.

Q: How has the value of the dollar fluctuated since the 1970s?

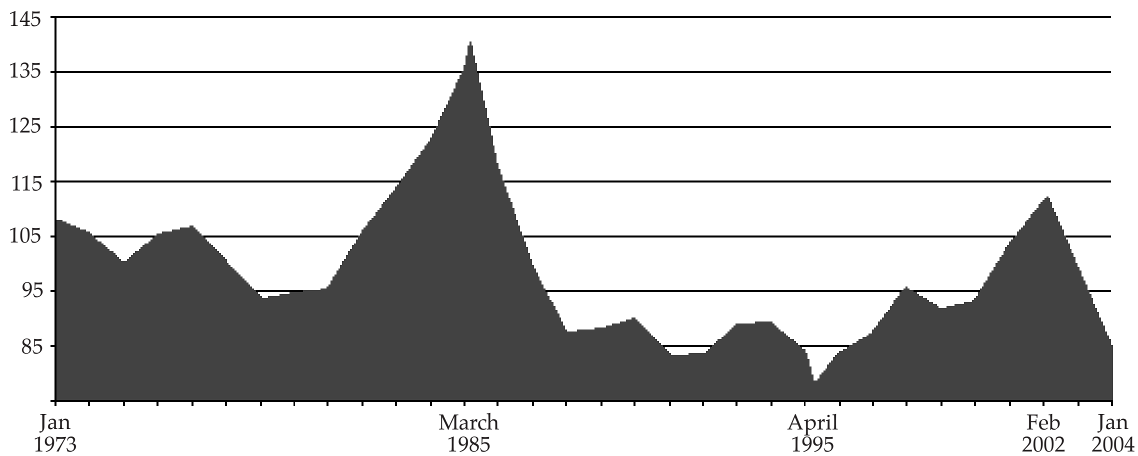
A: In March 1973, the Federal Reserve's Nominal Major Currencies Dollar Index was set at 100. In March 1985, the U.S. dollar reached its highest level at 140.35, while its lowest point came about 10 years later, in April 1995, when it fell to 77.68. In February 2002, the index climbed to 111.97, as compared to major currencies.

Why did the dollar rise through February 2002? During the 1990s, foreign investment flowed into the United States at an unprecedented pace. The longest U.S. peacetime expansion on record, strong productivity gains and a stock market with exceptional returns attracted capital from all corners of the globe. Additionally, after the Asian crisis and uncertainty over the value of the euro, investment looking for a safe haven poured into the U.S.

Why has the dollar lost value since February 2002? By early 2002, the U.S. current account deficit, the budget deficit, less foreign investment in the U.S., a volatile American stock market and a decline in U.S. consumer confidence contributed to the dollar's subsequent decline. Although the dollar's value has decreased to 84.71 in January 2004, it's still above its mid-1990s level.

Value of the U.S. Dollar

Federal Reserve's Nominal Major Currencies Dollar Index



Q: How does the value of the dollar impact the U.S. economy?

A: The effects of a rising or declining dollar are complex and not always well understood.

When the dollar decreases in value, U.S. exports become more attractive abroad. In turn, companies selling more goods and services often hire more workers. But a decreasing dollar has other consequences. For example, U.S. manufacturers who rely on imported components and materials will find it more costly to produce their goods. In turn, these manufacturers may absorb this added cost, which will reduce corporate profits and possibly impact hiring, or they may pass this increase on to consumers, which could lead to inflation. Additionally, a dollar that is weakening or declining in value for lengthy periods of time or at a rapid pace can dampen investor confidence and result in less U.S. inbound investment. In turn, this can make it difficult to finance the budget deficit and may lead to higher interest rates. Thus, business expansion becomes more costly and compromises the ability of companies to hire new employees.

A rising dollar, which often leads to increased foreign investment in the United States, makes U.S. exports of goods and services more expensive abroad and can result in lost export deals. Additionally, according to Fred Bergsten of the Institute for International Economics, every 1 percent rise in the U.S. dollar's trade-weighted value boosts the U.S. current account deficit by at least $10 billion. If perceived as unsustainable, a rising current account deficit can negatively affect confidence in the U.S. economy and, in turn, accelerate downward pressure on the dollar.

Overall, a rising or declining dollar has a number of positive and negative consequences. But one thing is certain: A stable and predictable dollar is extremely important to the well being of the United States.

Q: How does currency instability in developing countries affect U.S. exporters and our economy's ability to create jobs?

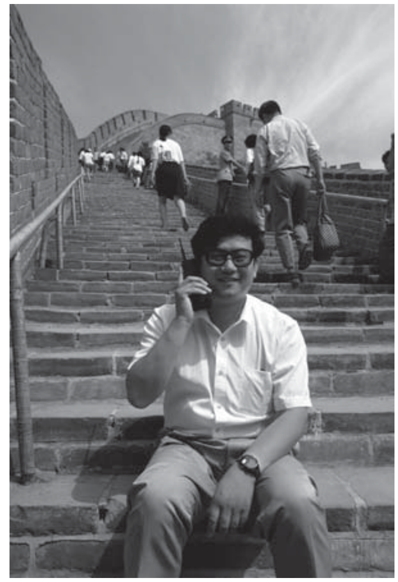
A: Currency instability in developing countries negatively impacts U.S. exporters and harms our economy's ability to create jobs.

For example, on December 20, 1994, an attempted currency adjustment by the Mexican government accelerated out of control. Within two days pressures mounted; currency reserves used to prop up the peso quickly dwindled. As a result, the peso was allowed to float freely. Shortly thereafter, it nose-dived. Like falling dominoes, what began as a short-term liquidity crisis turned into a full panic. Fallout quickly spread to Brazil and Argentina whose economies dipped along with those in other developing countries worldwide. As a result, U.S. exports to Mexico and other affected developing countries slowed. With fewer sales abroad, job growth ceased at many U.S. companies dependent on these markets.

In the 1990s, Southeast Asian countries increasingly pegged their currencies to the U.S. dollar. After mid-1995, the U.S. dollar began to appreciate. As this occurred, Southeast Asian exports became more expensive while pressure mounted on their exchange rates. In late 1996, foreign investors questioned Thailand's ability to repay its loans and began to move their money out of the country. Fearing a loss in the Thai baht's value, foreign investors and Thai companies began in February 1997 to convert the currency into U.S. dollars — accelerating a devaluation. With diminished reserves, the Thai central bank was forced to let the baht float downward. Fearing neighboring countries shared many of the same weaknesses as Thailand, confidence in Malaysia, Indonesia and South Korea plummeted, resulting in a regional financial crisis. Consequently, economic growth in emerging Asian countries, excluding China, dropped precipitously.

Regions of the U.S. that were more dependent on exports to East Asia were affected to a greater extent than regions that were less dependent. Western states, such as Washington, Oregon, Arizona, California and Alaska, were more affected due to their higher concentration of exports to East Asia which included aircraft, semiconductors, electrical equipment and processed foods. Parts of the farm belt, the industrial Midwest and southern states were affected to a lesser degree. The Northeast, including New York, New Jersey, Pennsylvania and Connecticut, probably were impacted the least since a smaller percentage of their exports targeted the affected region.

Q: How has China's accession to the WTO affected U.S.-China trade?



A: On December 11, 2001, after 15 years of negotiations, China officially became the 143rd member of the WTO. As part of its accession agreement, China pledged to undergo massive reform that would include significantly reducing its trade barriers. The effect of China's tariff reductions are already evident.

From 2001 to 2002, Chinese world imports rose by 21 percent to reach $295 billion, according to the WTO (in contrast, U.S. world imports rose by 2 percent). As a result, China moved up two spots to become the United States' seventh largest export destination, buying $22 billion in U.S. goods. If Hong Kong were added, China would move into fourth place. Importantly, in 2002 China ranked as the United States' fastest-growing export market.

In 2002, China become the United States' third largest supplier, selling $125 billion in goods to the U.S. This represented 38 percent of Chinese world exports and created a U.S.-China trade deficit of $103 billion. Why is this happening? Much of the U.S. deficit with China is due to China's growing competitiveness in many of the same industries as other Asian countries. This has made China an increasing threat in the region, especially in textile and electrical appliance sectors. The U.S. trade deficit with China reflects a shift of U.S. labor-intensive imports away from other Asian countries to China. As a result, low-tech products the U.S. previously imported from other Asian countries are now being imported from mainland China. Consequently, as U.S. imports from China have increased, U.S. imports from the rest of Asia have decreased.

Q: How has China's currency valuation impacted U.S.-China trade?

A: China is believed to be manipulating its currency and not allowing it to adjust to market forces for the purpose of achieving a competitive advantage. As a result, some analysts believe the renminbi, also known as the yuan, is undervalued by as much as 30 percent as compared to the U.S. dollar. In turn, this artificially lowers the Chinese cost to manufacture goods and makes Chinese exports more attractive.

In response, some politicians have suggested that China should allow its currency to immediately float, assuming it would rise to a higher level. However, many economists believe that if China were to immediately float the yuan, the currency would become volatile due to China's weak financial sector, instability associated with the country's transition to a market economy and difficult economic adjustments associated with WTO-mandated reforms. In turn, a widely fluctuating yuan could have a destabilizing effect and fall well below current levels, leading to another Asian financial crisis.

As China continues to implement reforms, movement toward full currency convertibility is expected. As evidenced by the Mexican and Asian currency crises, it is necessary for China to develop the necessary infrastructure to support a stable yuan. Thus, a sound Chinese currency supported by strong economic fundamentals will result in greater Chinese demand for U.S. goods and services. A destabilized China could have disastrous consequences for the United States and the world.

Job creation is beginning to rebound. However, manufacturing jobs continue to fall, from a high of 21 million in 1979 to 14.5 million in October 2003. Many blame the 24-year-long trend on international trade, especially rising imports and recent job losses from worldwide sourcing.

But careful analysis reveals that imports and global sourcing are not the cause of the decline in the manufacturing sector. Contrary to popular opinion, they actually provide many benefits to American companies, workers and consumers.

Presented in a question and answer format, *The Congressional Guide to International Trade* connects the dots, cuts through volumes of misinformation and provides an understanding of the impact trade has on workers, companies and communities in the United States and abroad.

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