Economic Policy Institute

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September 26, 2001

The Honorable J. Dennis Hastert
Speaker, United States House of Representatives
232 U.S. Capitol Building
Washington, DC 20515

The Honorable Richard Gephardt
Democratic Leader
United States House of Representatives
204 U.S. Capitol Building
Washington DC 20515

The Honorable Thomas A. Daschle
Majority Leader
United States Senate
221 U.S. Capitol Building
Washington, DC 20510

The Honorable Trent Lott
Republican Leader
United States Senate
230 U.S. Capitol Building
Washington, DC 20510

Dear Sirs:

As you know, the nonprofit Economic Policy Institute has long been involved in research and policy analysis on the issues of trade and globalization – including providing testimony and advice when solicited by members of Congress. I am taking the unusual step of writing this letter out of concern that the current crisis is being used as an excuse to pressure Congress to give the president the authority to put international trade and investment agreements on a Congressional "fast track."

Such an effort to promote a controversial and politically divisive agenda is clearly inappropriate at a time when national unity is essential.

This effort is also inappropriate on economic policy grounds. Rather than agreeing to a fast track, the Congress should put trade policy on hold while it examines the impact of previous agreements in light of the growing threat posed by the trade deficit to our nation's economic stability, and the failure of our current international economic strategies to produce promised improvements in the lives of the world's poor.

The United States has entered into several hundred trade agreements over the past two decades. The U.S. Trade Representative tells us that two of them, NAFTA and the Uruguay Round, have created a benefit of $1,300 to $2,000 for the average American family. But a look at the source of such numbers shows that they do not represent the actual experience of these treaties but rather estimates based on forecasting models of what the effects might be. As a soon-to-be-released EPI study of these models shows, they are abstract exercises based on unrealistic assumptions (the absence of unemployment, for example). Indeed, these were the same models that predicted that NAFTA would bring about a U.S. trade surplus with Mexico. Seven years later, we are running a trade deficit of some $35 billion, which translates into a loss of about 367,000 jobs on our side of the border.

Certainly, before Congress gives away its responsibility to amend such agreements, it should make a thorough analysis of how past agreements meet the claims that were made for them.

Virtually all of these agreements were promoted as a way to reduce the U.S. trade deficit. Instead, the gap between imports and exports has expanded. Driven by that widening gap, the U.S. international balance of payments deficit last year reached $450 billion, roughly 4.5 percent of our gross domestic product (GDP). In order to finance these annual deficits, Americans have had to borrow from abroad. Last year the U.S. foreign debt – the difference between foreign claims on U.S. assets and American claims on foreign assets – reached 20 percent of our GDP. On its current trajectory, U.S. foreign debt will double to 40 percent in five years. To put this in perspective, debt is 50 percent of the GDP of Argentina's imploding economy.

Because the U.S. dollar is so widely accepted around the world, pundits have dismissed the danger of a crisis of confidence. Certainly the United States is not Argentina. But common sense tells us that we cannot forever borrow and sell our assets in order to buy from the rest of the world more than we sell. At some point the interest burden will become too high, and foreign investors will be unwilling or unable to keep financing our rising debt, causing the dollar to plummet and interest rates to rise sharply. The United States will then be forced into a trade surplus as incomes fall far enough to reduce imports and wages fall far enough to make U.S. goods competitive. Economist Wynne Godley of the Levy Institute estimates that bringing the trade deficit into balance by 2006 would require doubling the U.S. unemployment rate to about 9 percent.

So far, we have avoided such a crisis, largely because the red-hot economy of the 1990s induced foreign investors to buy our overpriced securities. In a sense, the U.S. economy has been like a corporation whose booming domestic division has obscured the losses from the firm's foreign operations. From 1992 to 2000, 23 million jobs were created in the U.S. domestic sector, while 4 million were lost in international trade. It is clear that the

domestic boom – powered in the last half of the 1990s by a speculative stock market bubble – was unsustainable, and will no longer justify official disregard of our foreign financial imbalances.

The current indifference toward the rising trade deficit seems inexplicable, particularly considering the bipartisan panic a few years ago when the fiscal deficit of the federal government reached the same share of GDP. Similarly, we have engendered a national debate over projections that the Social Security Trust Fund might have to start borrowing money in 2038. Yet, on our current path, the trade deficit will touch off a serious economic crisis long before the Social Security Trust Fund needs a modest tax increase to cover its obligations.

The root cause of the problem is not that we trade with other countries. Fast-track supporters are correct that freer trade can bring benefits in the form of cheaper goods. But those benefits can only be sustained when trade remains in rough balance. Rather, the root cause is our economy's extraordinarily high propensity to import. As the report of the U.S. Trade Deficit Review Commission noted last year, "For an equal increase in national income in the United States and foreign countries, the United States increases its purchase of imports proportionally more than foreigners increase their exports." With the trade gap structured to grow faster than our income, it is no surprise that trade agreements have had the perverse effect of widening the trade deficit and thus increasing the debt.

We cannot escape the accumulated consequences of having consumed more than we've produced. But we can stop making it worse. Moreover, given that there is some evidence that the terrorist network has the sophistication to coordinate stock market speculation with large-scale violence against financial targets, the last thing we need is for U.S. currency to become weaker and subject to market attacks.

A "strategic pause" in our relentless pursuit of trade expansion would give us time to develop policies to make the structure of the U.S. economy consistent with freer and more open trade.

We also need a pause to reexamine the global economy in which trade policy is enacted. The Uruguay Round and the North American Free Trade Agreement were not just about lowering barriers to trade. In each case, the U.S. conditioned access to the U.S. market for poor countries on their agreeing to restructure their economic policies along radical laissez-faire lines. Reinforced by State Department and USAID policies, as well as pressure from the IMF and the World Bank, countries have been privatizing government, deregulating agriculture, and opening up vulnerable Third World economies to volatile capital flows.

The economic result of these policies is disappointing. Although there have been exceptions, comparing the last 20 years under globalization with the previous 20, world growth has slowed, poverty has risen, and inequality has grown. Despite efforts by supporters of unregulated trade to paint a rosy picture, the facts are stark. As another forthcoming EPI report will show, poverty remains widespread and is growing in Eastern Europe, Central Asia, sub-Saharan Africa, and Latin America. In 1980, 400 million people – the poorest 10 percent of the world – lived on an average of 72 cents a day or less; the same number had

only 79 cents a day or less to live on in 1990, and just 78 cents a day or less in 1999. And those numbers are even bleaker when inflation is factored in.

The gap between rich and poor has grown dramatically, which is troubling news not only from a humanitarian viewpoint but also because of its potential for global destabilization. In 1980 median income in the richest 10 percent of countries was 77 times greater than in the poorest 10 percent; by 1999 that income gap had grown to 122 times. The evidence is clear that liberalized trade and capital flows have led to more, not less, poverty and inequality in many parts of the world.

Promoters of a forced march to free markets dismiss these trends as “transition” problems. In the long run, they say, everyone will ultimately benefit. Perhaps. But even in advanced countries the capitalist process of “creative destruction” generates insecurity and pain. In Third World countries it rips up communities, families and implicit social contracts that in many cases have been in force for a thousand years. And it creates a swamp of hopelessness that breeds the bin Ladens of the world.

Iran is a case in point. The militant Islamic regime was a reaction to the Western values of the U.S.-backed Shah, a model economic reformer. His attempt to impose an American-style agribusiness displaced masses of small farmers and their families who turned to the ayatollahs – not because of some theological conversion, but because they had been set adrift in an open, deregulated economy in which they could not compete.

This is not an argument for protection or isolation. But the world has changed, perhaps forever. It is now generally acknowledged that we need to rethink our national security policies, our budget priorities, our judicial processes and our foreign policy. Similarly, before rushing through an agenda that was problematic even before September 11, we need a thorough review of the way in which our policies may be contributing to the dangerous destabilization of Third World societies, and the future destabilization of the United States.

I might suggest that you consider that the Joint Economic Committee undertake this responsibility.

As in the past, our institute will be happy to assist the Congress in deliberating these issues.

Sincerely,

Jeff Faux
President