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The "Balancing Trade Act of 2007"

Abstract

This paper will put forth a description of the "Balancing Trade Act of 2007", (known herein as the "Trade Act"), and the rhetoric of the Sponsor of this bill will be examined and analyzed.

I. Description of the Trade Act

On January 4, 2007, Representative Marcy Kaptur (D, Ohio) introduced the Trade Act.[2][3] The Trade Act was then referred to the House Subcommittee on Trade on January 18, 2007.[4] It appears that no further action has been taken on the Trade Act since January 18.[5] In simple terms, this Act would require the President to take some sort of action to eliminate or reduce the U.S. trade deficit with any country which amasses a trade surplus with the U.S. of at least $10 billion in three consecutive years and then report to Congress on his efforts.

This Act would place two requirements on the President of the United States. First, this Act would require the President to "take the necessary steps to create a trading

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[2] H.R. 169 "Balancing Trade Act of 2007", 110th Congress (1st Session), introduced January 4, 2007. Accessible at http://thomas.loc.gov/cgi-bin/query/D?c110:1:./temp/~c110TbnKEF::
[3] There were 11 co-sponsors: Representatives Roscoe Bartlett (R, MD), Howard Coble (R, NC), Steve Cohen (D, TN), Jerry Costello (D, IL), Peter DeFazio (D, OR), Chaka Fattah (D, PA), Bart Gordon (D, TN), Walter Jones (R, NC), Dale Kildee (D, MI), Dennis Kucinich (D, OH), and Charles Norwood (R, GA).
[4] Library of Congress information on H.R. 169, accessible at http://thomas.loc.gov/cgi-bin/bdquery/z?d110:HR00169:@@@P
[5] Id.

relationship with the country that would eliminate or substantially reduce that trade deficit, by entering into an agreement with that country or otherwise," if "in 3 consecutive calendar years the United States has a trade deficit with another country of $10,000,000,000 or more."[6] The Trade Act does not clearly address the scope of the agreement or action, or what the subjects addressed in the agreement or action should be. Second, this Act would impose reporting requirements on the President.[7] The Act does not mandate tariffs, quotas, voluntary export restrictions, or any other trade restriction, but leaves the nature of the action to be taken at the President's discretion. The President would be required to submit a report (within three months after enactment of the Trade Act) describing "the likely reasons for the trade deficits with each country" and "the steps the President intends to take."[8] The President would also be required to submit an annual report to Congress describing "actions taken to carry out" the Trade Act's requirements.[9]

II. Congressional Rhetoric and economic analysis

In her remarks after proposing the Trade Act, Representative Marcy Kaptur (D, Ohio) asserted that the large U.S. trade deficit with China has numerous negative effects on the U.S. economy. She stated that if the U.S. trade deficit with China had been "corrected" that the U.S. would be "stronger today."[10] She blamed the U.S. trade deficit with China for the "kind of annual budget deficits that we're having."[11] Representative Kaptur assured the Congress that a reduction in the U.S. trade deficit with China would, "restore our economic independence, competitiveness and begin creating jobs across our

[6] Balancing Trade Act of 2007 at §2(a).
[7] Id. at §2(c).
[8] Id. at §2(c)(1)(A) and §2(c)(1)(B).
[9] Id. at §2(c)(2)
[10] Representative Marcy Kaptur, "Congressional Record: July 12, 2007 (House)" at H7764-H7765. Accessible at http://frwebgate3.access.gpo.gov/cgi-bin/waisgate.cgi?WAISdocID=18098521545+11+0+0&WAISaction=retrieve
[11] Id.

country again."[12] She noted that, "[f]ree trade can be productive and it can be profitable, but only if it is free trade among free people."[13] Representative Kaptur made no assertions as to which kind of trade restriction (tariff, export subsidy, voluntary export restriction, etc.) would be superior.

a. The United States would not necessarily be stronger today if the trade deficit with China had been reduced in prior years.

It is possible that Representative Kaptur's claim is referring to military, political, or economic strength. Many supporters of trade protectionism claim that some industries are "vital to a country's security because its product or the skills it develops are invaluable to the country during wartime or periods of national emergency."[14] However, the items that the U.S. imports from China do not seem to be products which meet this test. Using 2005 data, we see that the "Top Twenty U.S. Imports from China" include office machines, telecom equipment, apparel, electrical machinery, furniture, footware, manufactured metals, industrial machinery, fabrics, travel goods, road vehicles, and building fixtures, among others.[15] In an emergency most of these products could easily be produced in the U.S., or imported from other countries (such as Canada or Mexico). But, if some of these industries are essential to national security, the U.S. should stockpile completed production or set up public-private research and development firms to preserve endangered skills, before interfering with free trade.[16]

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[12] Id.
[13] Id.
[14] Dennis Appleyard, Alfred Field, and Steven Cobb, International Economics, McGraw-Hill Irwin (2006) (5th ed.) at 308.
[15] Thomas Lum and Dick Nanto, "CRS Report for Congress: China's Trade with the United States and the World" (2007) at 20 (Table 3). Accessible at http://www.fas.org/sgp/crs/row/RL31403.pdf
[16] Appleyard, Field, and Cobb at 310.

Many also fear that China may "use its $1.33 trillion . . . of foreign reserves as a political weapon."[17] However, it seems unlikely that China would carry through on a threat to liquidate its dollar reserves in a manner which would cause a precipitous decline in the dollar-yuan exchange rate. The Chinese government would see the value of their dollar reserves plummet. It is unlikely that the Chinese political objective would be worth the loss of a large percentage of the purchasing power of their massive dollar reserves.

The economic power of the U.S. is not adversely effected by the U.S. trade deficit with China. The economic power of a country could be determined by its production (GDP) or its welfare (Absorption).

$$Y = C + I + G + NX$$

$$A = C + I + G = Y - NX$$ [18]

It is clear that U.S. trade with China is only one small piece of GDP. The U.S. trade deficit with China does not impact production or welfare negatively because "[w]e can always raise C, I or G to compensate."[19] Since we can raise C, I, or G to compensate, the U.S. economy can operate at its maximum, non-inflationary, long-run rate no matter the size of the U.S. trade deficit with China.

Actions taken to reduce the U.S. trade deficit with China would make the U.S. less efficient. If the U.S. is currently producing at its production possibility frontier, then, all else equal, any imposed change in the mix of goods and services produced will cause

[17] Ambrose Evans-Pritchard, "China threatens 'nuclear option' of dollar sales", Telegraph (UK), Oct 8, 2007. Accessible at http://www.telegraph.co.uk/money/main.jhtml?xml=/money/2007/08/07/bcnchina107a.xml
[18] Class notes from Econ 265.
[19] Ed Tower, "What everyone should know about international trade", Prepared lecture notes for Econ 265 at 1.

the U.S. to produce inside of its production possibility frontier and therefore produce more inefficiently. The U.S. can maximize its GDP and welfare by producing at the production possibility frontier and then trading to consume the mix of goods and services that maximize welfare. We should expect that the U.S. will have trade deficits with some countries and surpluses with others, and that the U.S. will have trade deficits in some categories of goods and services and surpluses in others.

b. <u>The trade deficit with China is not a cause of federal budget deficits.</u>

Representative Kaptur's claim that the trade deficit with China causes federal budget deficits is based a National Income identity discussed in introductory economics classes.

$$S = I + NX$$

National savings (public and private) are equal to investment plus net exports. Representative Kaptur's argument assumes that the negative NX value resulting from trade with China causes S to drop (increased budget deficits).

Intuitively, it appears more likely that budget deficits cause trade deficits and not the other way around. It seems likely that Congress and the White House set expenditure levels and tax rates based on political and policy concerns that are independent from the levels of anticipated imports and exports for that year. Budget deficits decrease savings and require an offsetting decrease in investment or net exports. It is almost certain that the decreases in savings caused by budget deficits have had a negative impact on the trade balance because it is unlikely that investment declines by the full amount of the decrease in savings. It is much more reasonable to think of U.S. budget deficits as a cause and not a result of the U.S. trade deficits with China (and in the aggregate).

c. An elimination of the United States' trade deficit with China would not increase competitiveness nor trigger job creation.

The World Economic Forum describes competitiveness as "factors driving productivity and, thus, enabling sustained economic growth and long-term prosperity."[20] These factors are classified under 12 pillars.[21] These include institutions, infrastructure, macroeconomic stability, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market sophistication, technological readiness, market size, business sophistication, and innovation.[22]

Elimination of the U.S. trade deficit with China would not increase U.S. competitiveness. A reduction in trade with China would be more likely to reduce U.S. competitiveness. It would likely cause a reduction in goods market efficiency, technological readiness, and market size. It would also likely have a negative impact on innovation. The only possible pillar under which the U.S. trade deficit with China could hamper U.S. competitiveness would be macroeconomic stability. However, there is reason to believe that the historically large U.S. trade deficit is most likely not destabilizing.[23]

An elimination of the U.S. trade deficit with China would not trigger job creation. As noted in section II(a), the U.S. trade deficit with China does not impact production or

[20] World Economic Forum, "The Global Competitiveness Report 2007-2008". Accessible at http://www.gcr.weforum.org/

[21] Id.

[22] Id.

[23] See William Poole, "How Dangerous is the U.S. Current Account Deficit", Speech, November 9, 2005. Accessible at http://www.stlouisfed.org/news/speeches/2005/11_09_05.htm) (noting that the U.S. debt is denominated in dollars and that the U.S. net international investment position as a percentage of GDP is significantly less that that of other countries which did not face destabilizing corrections).

welfare negatively because “[w]e can always raise C, I or G to compensate.”[24] Since we can raise C, I, or G to compensate, the U.S. economy can operate at full employment no matter the size of the U.S. trade deficit with China. Therefore, if C, I, and G are raised to full employment levels, then the elimination of the U.S. trade deficit with China can not create additional jobs.

d. The benefits that a country gains from free trade are not dependent upon whether that country's trading partners are democracies or non-democracies.

Nations receive many benefits from participation in free trade with other nations. The U.S. gains from the ability to specialize in the production of goods and services in which it is most efficient (has a comparative advantage).[25] The U.S.'s increased output can then be traded in global markets, yielding increased welfare. Increased competition from trade results in fewer domestic monopolies and oligopolies and increased efficiency of domestic firms.[26] The U.S. also benefits from the increased quantities and varieties of goods and services from which consumers can choose.[27] The U.S. also benefits from a reduced probability of various forms of conflict with China. This is because increased interaction between those in the U.S. and China results in increased appreciation and understanding of cultures,[28] and because both the U.S. and China are subject to trade's

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[24] Ed Tower, “What everyone should know about international trade”, Prepared lecture notes for Econ 265 at 1.

[25] Douglas A. Irwin, Free Trade Under Fire . Princeton University Press (2005) (2nd Ed.) at 26.

[26] Id. at 38. See also id. at 42-43 (noting that free trade results in increased efficiency of domestic firms because they can access foreign technology and because of increased competition for customers).

[27] Id.

[28] Russell Roberts, The Choice: A Fable of Free Trade and Protectionism Pearson Prentice Hall (2007) (3rd Ed.) at 57 (noting the experiences that Ed's daughter had with international students); See Irwin at 49 (stating that trade “breaks down the narrow prejudices that come with insularity”).

correlation with non-authoritarian forms of government, a lesser likelihood of warfare, and lower levels of corruption.[29]

The benefits that the U.S. reaps from free trade with China are independent of China's form of government. The benefits from U.S. specialization, competition with foreign producers, and increased consumption opportunities do not depend on whether China's form of government is "free". The Chinese government has placed few barriers on cultural appreciation and understanding between U.S. and Chinese citizens. It appears that the nature of the Chinese government does not create a level of fear which impedes interaction between U.S. and Chinese citizens. This can be contrasted with Eastern Bloc states during the Cold War, whose citizens needed to be more cautious due to the high level of activity by the secret police and informants.

Representative Kaptur argued that if the U.S. trade deficit with China were eliminated, that the U.S. would be stronger, that the U.S. economy would be more competitive, and that jobs would be created. She also asserted that the U.S. trade deficit with China causes budget deficits and that the benefits of free trade can only be realized if trading partners are free. These arguments are not supported by economic theory or statistical evidence. If this bill were to be passed, the President may be compelled to take some sort of action to reduce the U.S. trade deficit with China. If the President and Congress imposed restrictions on U.S. – China trade, they would fail to achieve the goals articulated by Representative Kaptur, and would likely have an effect opposite to her intent, in some circumstances.

[29] See Irwin at 51-52.