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MASTERING THE WORLD ECONOMY

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

JANUARY 20 AND 22, 1987

(Part 2 of 4)

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MASTERING THE WORLD ECONOMY

TUESDAY, JANUARY 20, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The committee met, pursuant to recess, at 9:30 a.m., in Room SD-215, Dirksen Senate Office Building, the Honorable Lloyd Bentsen (chairman) presiding.

Present: Senators Bentsen, Matsunaga, Moynihan, Baucus, Bradley, Mitchell, Riegle, Rockefeller, Daschle, Packwood, Danforth, Chafee, Heinz, Wallop, Durenberger, and Armstrong.

[The Committee press release and the prepared written statements of Senators Bentson and Heinz follow:]

[Press Release No. H-1, Jan. 8, 1987]

FINANCE COMMITTEE CHAIRMAN BENTSEN ANNOUNCES EARLY TRADE HEARINGS

WASHINGTON, DC.—Senator Lloyd Bentsen, Chairman, announced Thursday the Senate Finance Committee will hold four days of trade hearings beginning Tuesday, January 13, 1987.

"Trade will be my top priority as Chairman and the first major item on the Committee's agenda this year," Bentsen said.

"These initial hearings are intended to develop a national consensus on the goals of American trade policy."

"We are facing an international economic situation that has changed permanently—what French Academician Albert Bressand called the 'world economy' and the United States, while no longer able to dictate economically to the rest of the world, is nevertheless the undisputed leader of the world trading system. We must, therefore, learn to master the new 'world economy'."

The hearings will be held on Tuesday, January 13, 1987, Thursday, January 15, 1987, Tuesday, January 20, 1987, and Thursday, January 22, 1987.

The hearings will begin each day at 9:30 a.m. in Room SD-215 of the Dirksen Senate Office Building.

The schedule of witnesses is as follows:

January 20, 1987—Mr. Lane Kirkland, President, AFL-CIO. Mr. Owen Bieber, President, International Union, UAW.

January 22, 1987—Mr. Alan Greenspan, Chairman and President, Townsend-Greenspan & Company, Inc. Mr. Robert Hormats, Vice President, Goldman-Sachs, Inc.

STATEMENT BY SENATOR LLOYD BENTSEN

The news has been filled in recent days with stories about the decline of the dollar. Yesterday, the dollar reached its lowest level against the yen since shortly after World War II.

There are some things to keep in mind amid all the activity related to this decline.

A lower valued dollar is good for our trade balance, so we should be bringing it down.

This should be done gradually and with caution, however. There's always the risk the value of the dollar could fall precipitously and that wouldn't be good for anyone. A lower valued dollar will help us sell our goods more easily in other countries but if it comes down too abruptly and results in recession for those countries then they still will not be able to purchase our goods.

We also need to be sure that the value of the dollar declines not only in relation to the yen and the mark but in relation to other currencies, as well. I have in mind especially the currencies of countries such as Taiwan and Korea.

Finally, we should keep in mind that currency exchange manipulation by itself won't resolve our trade problems. We must speak to other problems that make it difficult for us to compete in the world marketplace.

Reducing our trade deficit, for example, demands that we reduce our budget deficits.

It also demands that we put in place a coherent, consistent trade policy for this country. That's why we're continuing this series of hearings before the Finance Committee today.

We saw world trade expand during the 1970's and nations around the globe benefitted from it. But world trade has been flat throughout the 1980's, in the wake of an increase in world protectionism. We've seen country after country deny access to its markets for our goods and the goods of others.

If Europe and Japan would buy the manufactured goods of third world countries at the same per capita rate as the U.S. we would see world trade expand by $250 billion a year.

We want a trade policy that will serve America's national interests, expand world trade and make us more competitive. I believe we have a right to demand that nations exporting to America grant us equal access to their markets. We have a right to demand an end to unfair trade practices and dumping. We have a right to demand a rollback in barriers to trade all over the world.

The committee is pleased to have as its witnesses today, Mr. Lane Kirkland, President of the AFL-CIO and Mr. Owen Bieber, President of the United Auto Workers.

Statement of Senator John Heinz

This is the third in the Committee's series of hearings on trade policy. It is a particularly important one, because we will hear today from representatives of those most seriously affected by the changes taking place in the international economy—the workers.

Here in Washington, far away from any assembly lines, it is all to easy to get caught up in debates about exchange rates, the budget deficit, and questions of macroeconomic principle. We too quickly forget that there are real people behind those esoteric arguments—the workers who have made this country what it is.

They are entitled to decent jobs, decent meals, and good housing. Their children deserve an education. For thousands of workers, however, our trade policy has turned the American dream into a nightmare of lost jobs, lost opportunities and lost lives. To someone who had built his piece of the dream brick by brick on the assembly line, it is small comfort to tell him he can get a new job in the service sector. He knows better than we that one-third of those new jobs are part time and that all of them, on average, pay nearly 40 percent less than the industrial jobs that are being lost. He knows first hand that we are slipping backwards, not going forward.

Today's witnesses live with this tragedy every day, and I can think of few labor leaders better qualified to explain what is happening to American industry than Lane Kirkland, Lynn Williams and Owen Bieber. I hope the Committee—as well as representatives of the Administration who may be here—will pay close attention, because our witnesses will be talking about the real America—not the insulated cocoon inside the Beltway.

The CHAIRMAN. The committee will come to order.

These committee hearings are going to start on time. It is going to take a while for some of my colleagues to realize that, but they will adjust to it as we go along.

The news has been filled recently with talk about the drop in the value of the dollar. I think there are some things that we ought to keep in mind as we look at that kind of decline in the value of the dollar. In general, we had a bloated dollar, an overvalued dollar, that made us noncompetitive. To bring it down to reality is something we should strive for. But it ought to be done gradually and with caution.

There is always the risk that the dollar could fall precipitously and that wouldn't be good for anyone. But a lower valued dollar will help us sell our goods more easily in other countries if it doesn't come down too abruptly. And we don't obviously want it to result in a recession in those other countries.

We also though have to see that the dollar comes down in relation to its value, not just to the yen and to the mark but to the Taiwanese currency, to the South Korean currency, to others that are pegged to the dollar that actually have a stronger value and have not reflected it as yet. Those are the ones that are rushing in to fill the void as we see the difference develop between the yen and the dollar.

But reducing our trade deficit calls for many other things. It calls for getting down our budget deficit, and it calls for a coherent, coordinated trade policy. It calls for a trade policy where the President of the United States makes trade a number one priority, as it is for other nations around the world.

There was a time when we absolutely dominated world trade. That day is past. We have some tough competitors and we are going to have to deal with it that way. If we could get the rest of the nations, such as Germany and Japan, to buy manufactured products of third world countries on the same per capita basis as this nation does it would expand world trade by over $250 billion and the entire world would prosper by it.

We have with us today one of the not only national, but international, leaders working for labor across this world of ours, and trying to see what can be done to see that we raise the standard of living of all of our people. We have a lot of international conferences going on. We have a new round in trade negotiations. We have bilateral work that is taking place with Canada. What we are seeking here is advice, information as to how we can develop a positive, progressive trade policy that will improve the lot of all of our people.

We are delighted to have you here, Mr. Kirkland. And if you would proceed with your testimony, please.

STATEMENT OF LANE KIRKLAND, PRESIDENT, AFL-CIO, WASHINGTON, D.C., ACCOMPANIED BY BOB McGLOTTEN, DIRECTOR OF LEGISLATION, AFL-CIO, AND RUDY OSWALD, DIRECTOR OF RESEARCH, AFL-CIO

Mr. KIRKLAND. Thank you, Mr. Chairman. My name is Lane Kirkland. I am President of the AFL-CIO. With me is Bob McGlotten, and I will be joined shortly, I trust, by Rudy Oswald, our Director of Research. Bob McGlotten is our Director of Legislation, as you know.

Mr. Chairman and members of the committee, I appreciate this opportunity to discuss the views of the AFL-CIO on trade policy. I have submitted full testimony, but in the interest of time I will offer only a briefer statement.

We are particularly grateful for both the early scheduling of this hearing and your desire to move rapidly on the issue.

There is now general agreement that America's massive trade deficit presents a clear and present danger to the domestic economy. Those who have denied the existence of a problem or counseled patience to its victims have been at least somewhat chastened by the massive shift in U.S. trade patterns. The figures are stark. No sector of the economy is immune from the damage. But we agree the trade deficit is a problem. The question is what to do about it.

The deficit has not yielded to the prescriptions of the Administration or the predictions of economists. Recent experience tells us that worldwide economic expansion, falling dollar exchange rates, multilateral negotiations, or selected action against unfair trading practices by themselves have not and will not reduce the trade deficit, let alone offer relief to those afflicted by it.

The dollar has fallen for two years, but the trade deficit has shown no sign of abating. November saw a new all time record. The call for expansionary policies by our major trading partners, particularly Germany and Japan, is conceptually similar, but the facts do not support the assumption that they would satisfy any increase in their domestic demand with Amecican exports.

While the Administration's rhetoric on unfair trading practice has risen noticeably, and some unfair trade cases have been initiated, the number and selection of those cases leave something to be desired. Selling more insurance to Korea or tobacco to Japan will not erase our trade deficit.

We have yet to pry open the Brazilian computer market. While we applaud the effort to open the European agricultural market, we believe the manufacturing sector—our productive capacity and employment—is concentrated in being devastated, deserves equal treatment.

The final approach that has been tried and found wanting is the start of a new round of multilateral trade negotiations. We do not oppose negotiations, or, for that matter, any of the other steps already mentioned, in and of themselves. But even the most optimistic hopes for successful negotiations are years away. The damage is being wrought right now.

New agreements on services or investment will do little for the steel workers or farmers who have already lost their jobs or their land.

The issue at hand is the trade deficit. Any legislation to come from this committee will be a hollow shell if it lacks a strong deficit reduction provision. An effective provision would be one requiring any of our major trading partners who maintain excessive surpluses with us and who are found to engage in unfair trade practices must reduce those imbalances.

Without the prospect of some ultimate penalty, all of these other actions are doomed to failure.

We have been negotiating with Japan for years. Our exports to that market are not substantially higher than they were six years ago.

Germany, to date, has been unwilling to expand its economy or, for example, open its market to American telecommunication products.

Taiwan asserts it needs special privileges because it is a developing country.

Unless we take effective action, and soon, present trends in our domestic economy will accelerate. That should be a matter of deep concern to everyone. Domestic demand has been satisfied by imports financed by borrowing from abroad. America's trade deficit, coupled with these capital inflows, has recently bestowed another distinction on the United States. We have surpassed Brazil as the world's largest debtor nation.

From 1982 to 1985, we went from a $150 billion creditor to a $107 billion debtor. That trend continued in 1986, and projections of $800 billion in net debt by 1990 are common.

At that point, debt service of payments alone will consume one percent of real gross national product, requiring sharply reduced domestic spending, and with it a reduced standard of living.

The impact on employment has already been devastating. 1986 was one of only 10 post-World War II years with an unemployment rate above 7 percent. But six of those years were the years 1981 through 1986 when America's international trade position nose-dived.

High unemployment means lost tax revenues, increased transfer payments, and a deeper federal budget deficit. The government's previous response to these problems has been one of benign neglect. While America's most important trading partners are succeeding with traditional merchantilist policies, our trade policies or lack thereof tolerate far more employment instability than other industrialized countries.

Changes in trade law and policy are urgently needed to immediately begin the reduction of the U.S. trade deficit, and to provide predictable and timely relief to industries and workers injured by imports.

Within the international trading system it has long been agreed that certain practices, such as dumping and subsidies, convey unfair advantages, distort trade, and should be minimized or eliminated. But the list of unfair practices is concentrated on the capital or financial side of the production equation. Little, if any, attention is devoted to labor.

By what standard do we view abuses of finances more pernicious than abuses of the rights of people? By what logic do we sanction competitive advantages when they are gained by denying workers the right to organize and to bargain collectively, or by force to a compulsory labor, or by child labor, or by the refusal to observe even the most minimal health and safety standards?

Our living standard today is under siege from countries that gain competitive advantage from these reprehensible practices. American workers cannot and should not be asked to compete with foreign workers making a buck and a half a day.

Those who claim that American workers have prices themselves out of the world market are saying, in effect, that the American standard of living is too high. Their logic, that we will somehow get richer by getting poorer, escapes me. American workers are not too well paid and the American standard of living is not too high.

Foreign workers are too often too poorly paid and their standards of living are too low.

If developing economies are not to be dependent on production for export, they must develop domestic markets for their goods and services. That means expanding consumer purchasing power, and in other words, higher wages. One sure way to do that is by recognizing the legitimate rights of labor, and including violations of those rights in our laws governing unfair trading practices.

We can also expand consumer purchasing power in developing countries by addressing the continuing problem of their debts. The relationship between the growing indebtedness of developing countries and trade is clear. To maintain the semblance of solvency, these countries have been required to restrict imports and boost exports to earn foreign exchange to service their debt.

The burden of these policies falls disproportionately on the workers of both countries. In developing nations it means slow growth for even a shrinking domestic economy. In America, it means increased unemployment in the face of low wage competition.

For these reasons, we support proposals to insure that the burden is shared between capital and labor in a more equitable fashion, such as those advanced by Senator Bradley which envision a reduction in the principle owed as well as lower interest rates on the debt outstanding.

These are not simply economic issues. If developing countries are not forever to be ruled by and governed to enrich narrow, revolving elites, merchantile or military, they must encourage the growth of a working middle class and of stable democratic institutions; among them, free trade unions.

The task is not to reduce the quality of life in America to the lowest common denominator but to raise it and to raise the world to that higher level. Let us do that by exchanging our goods with other countries and not our standard of living. This is where Congress must exercise its responsibility.

The workers we represent hope that the One Hundredth Congress will send to the President a tough, effective trade bill that will help American workers and industry regain the production jobs and income lost in recent years, because merely tinkering with changes with trade law, no matter how much those changes may be needed, is not enough. We need more than a bill to change procedures. We need legislation that recognizes the magnitude of the problem and takes the steps needed to bring about a solution. Anything less is just smoke and mirrors.

I shall be happy to answer your questions.

The CHAIRMAN. Thank you very much, Mr. Kirkland.

With these economic summits going on, trade negotiations and that type of thing, and our deep concern about this trade deficit, the loss of manufacturing jobs in this country, how do you react to these kinds of approaches? Do you think we ought to accomplish the objective of retaining these jobs by starting a lot of 301 cases, retaliating against unfair trade practices? Should we protect every industry that is in trouble? What kind of an overall strategy do you think we ought to be working toward here?

Mr. KIRKLAND. Senator, I think it requires a combination of approaches. We feel very strongly that there needs to be a broad approach of the kind incorporated in the deficit reduction proposals that we have supported, the kind that are envisioned, for example, in the GATT-wide amendment to the bill in the House that was passed by the House last year, which would in effect put real targets and real teeth behind our efforts to open up the markets of other countries, and to discourage the merchantilistic practices and the unfair practices that have targeted and penetrated the American market as a consequence of trade strategems developed and pursued in a comprehensive way and a coordinated way by those countries.

In addition to that, I do believe that the role of the International Trade Commission should be strengthened, that its judgment should carry more weight, and that specific issues with specific areas of commerce ought to continue to be approached and approached more effectively by that means.

The CHAIRMAN. One of the things that concerns me very deeply is the problem of the person 30, 40, 50 years of age who spent his or her life developing a particular skill and then finding it no longer useful. We have had a great many programs in trying to resolve that problem: job relocation, skill training, that type of thing.

I note in the President's budget that he is proposing for fiscal year 1988 to replace a number of those existing job programs, such as Title 3 of the Job Training Partnership Act, trade adjustment assistance programs, with a new program to assist all dislocated workers.

I would like to have your comment on it, what you think we should be doing in that regard.

Mr. KIRKLAND. We, of course, welcome any added resources that are made available to deal with the problems of the unemployed, irrespective of the source of their, or the reason for their unemployment. And it would be certainly no intention of ours to suggest that that is not desirable. At the same time we do not believe that the trade adjustment assistance program, as originally envisaged, should be given the coup de grace in this manner. Rather, we think it should be funded and embraced and pursued up to the levels that were originally envisaged.

I recall very well the circumstances under which the trade adjustment assistance program was initially put forward. It was a part and parcel of trade liberalization legislation, and was put forward as the humane and appropriate way to deal with the victims of any shifts that might come about as a result of that initiative. That was the side of the bargain that was linked with the other side, the effort to further open doors to trade throughout the world, where one side was delivered and the other side was not when it became what was viewed as too much money, despite the fact that economists, editorialists, and others who dealt with this matter at that time always used to use the phrase, they would call for "generous trade adjustment assistance" as a way to respond and deal with the consequences of dislocation and disruption that might stem from shifts in the patterns of trade.

That promise has never been fulfilled. We believe that one objective of this committee should be to redeem that promise. I also believe that it is quite appropriate, a system of adjustment assistance, to relate it quite directly to the question of trade, and not merge and lose it in this broader approach.

Every citizen of this country bears the cost of social adjustment, social distress, economic distress, including that high and growing level of distress occasioned by this increasingly massive penetration and exploitation of the American market.

Every domestic manufacturer has to incorporate an element of those costs in his prices and in his competitive position.

It seems to me only just and proper and equitable that those who exploit the American market also be required to incorporate into their costs an element of the cost of the social and economic consequences of their access to our market.

So we would strongly favor a reinforced, an expanded program of trade adjustment assistance designed to deal with precisely the questions that you raised, and we consider it only just and logical that at least a major share of its cost should be borne by its authors, by the authors of this distress.

The CHAIRMAN. And I share that with you, Mr. Kirkland.

Members of the committee, under the early bird rule the arrivals were Bentsen, Moynihan, Rockefeller, Packwood, Riegle, Mitchell, Heinz, Armstrong, and Daschle. And we will observe the 5-minute rule. And now that I have said we will observe the early bird rule, I am going to violate it by calling on Senator Packwood, because the two of us are going to have to leave early to go over to the Rules Committee to see that we have enough money to operate on next year and this year, and to testify on that. And I am sure you are all supportive of it. And with that, I would like to turn to my colleague, Senator Packwood.

Senator PACKWOOD. Mr. Chairman, you are generous. And I hope we won't be gone very long at the Rules Committee and can get back.

Mr. Kirkland, is it your assumption that a high trade deficit ipso facto means high unemployment, and that if we had a low deficit there would be low unemployment.

Mr. KIRKLAND. Certainly that deficit is a major contributor to unemployment. I find it hard to read it any other way.

Senator PACKWOOD. The reason I asked is because a number of our trading partners that have surpluses at the moment have significantly higher unemployment than we do. I don't know if there is any correlation overseas, but it doesn't seem to have a worldwide correlation in terms of the surplus and the deficit.

Mr. KIRKLAND. I don't suggest, sir, that trade deficit is the only source of unemployment.

Senator PACKWOOD. But you think it is correlative. I mean if it goes down, unemployment will go down. Maybe not a lot, but they both go the same direction.

Mr. KIRKLAND. If it is accompanied by a proportioned increase in production.

Senator PACKWOOD. Yes. Fair enough.

Now on your worker bill of rights there is much of it I agree with. But I am curious about the wages, and whether you are saying that low wages, per se is an unfair practice or it violates a worker bill of rights?

Mr. KIRKLAND. No. In the bill of rights that we have, I don't think wages is incorporated in it. The approach relates to the enforcement in trade policy of measures that, by and large, most of these countries have subscribed to through their membership in the international labor organization, where they have committed themselves to complying with conventions governing, for example, the right to organize and bargain collectively, protection against child labor, very basic safety and health provisions.

This is not something that we are seeking to impose, or where we are proposing to export American standards. I would love to, but I fully understand the infeasibility of that.

We are simply saying that those internationally, generally accepted criteria that have been formulated internationally within the structure of the international labor organization, that, by and large, these countries have committed themselves by membership and by ratification of those conventions, are living up to them.

Senator PACKWOOD. There have been fewer people stronger than you, including the actions you took with the international labor organization a number of years ago, that have stood strongly and firmly for free association and worker rights. And, by and large, those are abused throughout the world. They are often in dictatorships, often in countries that are not dictatorships, that one way or another they seem to be able to abuse the right of free association. And I take my hat off to you a dozen times for what you have done, and stood for and have been willing to put the muscle of your organization behind it. But I thought these were some of the rights. Right of association, one; right to organize and bargain collectively, two; prohibition on forced labor, three; minimum age for employment of children, four. And then last is acceptable conditions of work with respect to wages, hours, safety and health. And that is a more amorphous one. I am not quite sure how to read that one.

Mr. KIRKLAND. Well, we would say certainly that they should be paid wages commensurate with their national circumstances. We have not undertaken to define to put into force and effect through trade legislation even the American minimum wage.

Senator PACKWOOD. So if a country is poor, we don't expect it to pay our wage level.

Mr. KIRKLAND. No.

Senator PACKWOOD. They just can't.

Mr. KIRKLAND. Well, we certainly expect them to respect the right of working people to organize and negotiate effectively their own wage levels.

Senator PACKWOOD. I want to ask you a specific on Hong Kong, and I brought it up before.

As I understand Hong Kong, the employees can bargain collectively. They have the basic rights that you are talking about. And Hong Kong has apparently not been guilty of any unfair trade practices. They have no barriers. We can sell anything we want there. Obviously, it is not a very big market; nobody sells a great deal there. But they are tremendous international competitors for us and tremendous competitors in this market.

Given those circumstances, should Hong Kong in any way be penalized or should there be any limitations put on what they send into this country? They don't seem to violate any of your tenets or any of GATT's tenets or anybody else's.

Mr. KIRKLAND. If they do not, then the answer to that is no. We put forward quite recently, in connection with the legislation governing the generalized system of preferences, a list of countries that we regarded as being in gross, gross violation of the provisions that are in the GSP relating to worker rights. And we did not seek in that first effort to get enforcement of that legislation to pick over every violation. We simply selected a group that we regarded as the 10 worst of those who benefit from the GSP and on the criteria that we have described.

We regret that the 10 were not taken off, as we recommended. However, the Administration did take off three, I believe, and placed one more under monitoring and with a prospect that it may be taken off.

So they at least acknowledged the feasibility and the workability of the approach.

Senator PACKWOOD. I agree with what you say. And some of those countries may have had a legitimate reason to be on that list 20 years ago, 25 years ago. These are not 97-pound weaklings now. They are tough international competitors. They can go head to head with us, or Japan, or Great Britain, or Germany. And there is no reason for most of them to be any longer on that list.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Packwood.

Senator Moynihan.

Senator MOYNIHAN. Mr. Chairman, might I just say first that I think Mr. Kirkland was being considered to us when you asked him about the trade adjustment assistance provisions that were enacted in the 1970s. He said they were part of a set of proposals to liberalize trade. And they were more than that, Mr. Chairman, as I know you would agree and Senator Packwood would too. They were part of an agreement that this committee made with the AFL-CIO. You came in here and said you would support the Tokyo Round, the last great trade negotiation, if the workers who lost their jobs as a consequence of changed trade patterns would receive trade adjustment assistance.

You kept your word. That most unlikely event took place, the Tokyo Round was consummated. And then we as a government broke our word, Mr. Chairman. It was not the choice of this committee, but it certainly was the event. And I think that is not to be forgotten. And it was a matter of delicacy for you not to remind us, but there are those of us who know we broke our word. We, the government, broke our word, which we gave you. And I think it is unfinished business for the Hundredth Congress.

I have two questions I would like to ask. We are very serious in this committee on this question of workers' rights. And we are aware that the AFL-CIO, going back a century has been concerned with maintaining international standards of competitiveness and that international trade not turn on the exploitation of workers. This is not something you thought up the last time you saw the trade deficit numbers. You have been at this since the 1880s. And Samuel Gompers, who founded the AFL-CIO, was the chairman of the commission which set up the international labor organization which the AFL-CIO has been faithful to through near 70 years now, and at times you had something to show for it.

With respect to the specifics of section 301, you would like to see it expanded with regard to Title 5 of the Trade Agreement Act of 1984.

What I think we would like to ask is, surely, there are more than 10 nations that would come under your judgment of not being in compliance with treaty obligations under international labor conventions. Could you talk about that a bit? And could we ask you if we could get a list of specifics? We had the 10, but they referred only to the preference system. Is that not the case?

Mr. KIRKLAND. That is right.

The ILO has a system unlike other international bodies, and it is one of the values of the ILO, a system for, well not exactly policing but at least oversight of compliance with the conventions that have been ratified, passed by the body and ratified by the various nations. It has a committee of experts made up of jurists and others from a variety of countries of all political complexions, which reviews compliance and receives complaints, and files a report periodically to the annual conference of the ILO, where it is received by a committee on application of standards.

Senator MOYNIHAN. So these are not just arbitrary judgments that somebody with an interest in the issue might make.

Mr. KIRKLAND. No.

Senator MOYNIHAN. These are well established procedures, and they are reviewed and they are multilateral.

Mr. KIRKLAND. They are reviewed in a thoroughly objective way, and rationally. There is a system of due process which affords every country the opportunity—sometimes, in our view, excessive opportunity and excessive delay—to come and show what steps have been taken to rectify their shortcomings. And that procedure has been in effect for a very long time, and it is a tripartite procedure, let me add.

Senator MOYNIHAN. Business is involved.

Mr. KIRKLAND. Business is involved, labor is involved and the government is involved in this entire process.

Senator MOYNIHAN. Can we ask then that—not that we wouldn't get it; we would like to get it from you—could you give us a list of the countries so designated at this point? I think we should put that into this. This involved treaty obligations, among other things, as well as the rights of American workers.

Mr. KIRKLAND. We can provide you with reports of the committee of experts and of the committee on the application of standards as far back as you care to go in the proceedings of the ILO.

Senator MOYNIHAN. Fine. Why not more than just the last one.

Mr. KIRKLAND. We, ourselves, I must point out, sir, feel that there is an excessive inclination toward timidity both in the selection of countries, and in the judgments, and in the mode of expression in those documents.

Senator MOYNIHAN. Well, we will welcome any recommendations that you want to add.

I have a specific question about something in your testimony. I don't think in the history of hearings on trade in the Committee on Finance that anyone has ever come before us to state the equivalent of your statement that, "In the 10-year period, 1977 to 1986, the hourly manufacturing wages in the United States have declined 9 percent."

Would you know of a 10-year period in which hourly wages of non-supervisory employees have declined that way in our history?

Mr. KIRKLAND. Perhaps during the depression, but I can't think of any others.

Senator MOYNIHAN. That would be a big bet because you go all the way from 1930 to 1940 with that data.

Mr. KIRKLAND. Yes.

Senator MOYNIHAN. I mean, the Depression might just be an example, but probably not because of the 1940 term.

But could I make the point that during this period, the median income of American families also declined? You might expect manufacturing wages to decline in a period of large import surpluses and trade deficits, but from 1970 to 1985, a 16-year period, there has been no increase in American family income. In fact, it peaked in 1973 and it has gone down since.

So the period of enormous trade deficits has also been the period of family budget deficits. We see ourselves with lower family income today than we have had since 1973. And again there cannot have been such a period before in history. Or do you think?

Mr. KIRKLAND. That has also been accompanied by a rather major increase in the number of multiple earners in the family.

Senator MOYNIHAN. That is exactly the case. Two-earner families are only just maintaining 1970 income levels in that duress.

My time is up, but can I make the point to Mr. Kirkland for his testimony, that you are right in your concerns, and we share them. There is an elemental thought. America has gone into the longest period of wage stagnation and income stagnation for families in its history. Not just the last recession. But in 18 years manufacturing wages have increased 18 cents. That means a man working his lifetime in a factory might see his hourly wage go up 50 cents. That is not the country we were raised in, even if we were raised in the Depression.

My time is up. Our next interlocutor is Senator Rockefeller, of West Virginia.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Kirkland, Senator Moynihan has made the point, as have you, that the basic wage of the American family has not increased. Now the argument often comes up in trade policy, and you have made it yourself, that we cannot reduce the American standard of living in order to compete. That is not an acceptable solution. If one looks at the Korean steelworker who makes $2.50 an hour and looks at our steelworker who makes maybe nine or 10 times more than that, one has a hard time squaring what is to be done.

Americans are buying more steel from overseas. We need restraints, voluntary or otherwise, to keep those imports down. One looks at negotiated wage settlements in this country, union and non-union. Wheeling-Pitt took a reduction. USX took a reduction. There is a substantial pattern either of reduction or of holding the line on wages which, if squared with inflation, equals a lower standard of living.

Now my question is: The reality of the world marketplace is that the newly industrialized countries—not to speak of heavily industrialized ones like Japan—are coming on very strongly. Japanese wage rates may be four or five times greater than in Korea, but there are a lot of other Koreas around.

We have to compete. We have to hold onto our market share. Someone has said that if we lowered every barrier and surrounded this country with nothing but closed doors, it might only take $25 billion off our trade deficit; that if we were able to penetrate more aggressively than we now do, through competitiveness, that that might only take another 15 or 20 billion dollars off our trade deficit because of lower global demand at present. Japan, and most everybody, is having trouble economically.

What is in your mind about the future of our standard of living? Are we going to face up to the longer term problem—that is, are we making ourselves more competitive? We suffer somewhat now, but in the longer term we will come out better. Or do we simply take lower wages, which may be happening, and suffer without that longer term hope?

Mr. KIRKLAND. Senator, I, of course, acknowledge the fact that in particular industries and enterprises that are under pressure, where our affiliates represent the workers, we have to, and have had to, increasingly in recent years make a very, very hard choice between the preservation of that place of employment and the maintenance—not to say improvement—of existing wage levels. And we have faced up to those realities, as we can demonstrate, and are, unfortunately and painfully demonstrating in many, many cases where the facts regarding the necessity for such concessions are credible.

And I suppose to the extent that we are helpful in maintaining a firm or an industry in business, and not letting it go under, that that holds with it and is based on the hope that we will get over this period of difficulty and resume the historical American march of progress toward improved standards that has been so deeply ingrained in our even founding principles of life, liberty and the pursuit of happiness.

I do not subscribe to the proposition that a stagnation or decline of the broad American standard of living is inevitable, unavoidable, and that perhaps we should trim and cut our classical aspirations, and accept the fact that we are going to move into approaching the status of another developing country, or third world country. I think it could happen in the face of inaction.

I think we must vigorously defend that standard, and we ought to do it not only simply because that is what we have always thought of as a basic element of the so-called American dream, but because if we go down, we are not going down alone. The entire world's economy will go down with us, and a spiral will take place that is hard to see the bottom of.

The circumstances that we face in times of our trade deficit are a consequence of the fact that we built largely on the basis of the American standard of living and the American historical goals the largest and strongest market in the history of the world. And that market is a target for the merchantilistic national policies of every other country with whom we compete.

And I meet frequently overseas and here with representatives of other countries, both my trade union colleagues and representatives of government and business, and have cautioned them against, or have tried to, against the proposition that their prosperity, their trade surpluses, can be built upon the exploitation of the American market; that if they rely so heavily on that market, access to that market, that they own economies depend upon it, and use it as a substitute for the expansion of their domestic market, and the provision of domestic needs, that when we go down they are going down with us. When that market collapses, their market collapses.

Senator MOYNIHAN. I think we will try to keep to our time schedule. We will go back to a second round.

Could I just interject on that point to say that recent reports in the press which can be disputed, I am sure Senator Rockefeller knows, say that average hourly earnings in Japan are $10.50 an hour and in the United States $9.50 an hour, although I don't think we have quite reached this point yet.

Senator Riegle, you are next, sir.

Senator RIEGLE. Thank you, Mr. Chairman.

Let me say to you, President Kirkland, and your associates that as one member of this committee, I appreciate very much the work and the accomplishments of the people that you present over the years, both in terms of building so much of the important gains in this country, and helping us to establish and have a strong middle class which has, in turn, made many of the things in our country possible, and in recent years, those of us from heavily industrialized areas, as we have watched what happened, as the trade invasion and other things have started to grind down, workers in those categories. The human consequence of that, I think, is something that is not well know.

We have lost literally millions of jobs of people, through hard work and by a high valued added output and production were able to have and earn their way into a middle class living standard. And then as those jobs have disappeared, those workers have been sliding backward into whatever jobs they could find. In many cases, we have got workers that have not been able to find any replacement work at all. Some of this is more regional than it might be in terms of a national situation. But I want to say that I appreciate very much all the work that has been done. I appreciate the struggle and the suffering that is going on at the present time in terms of what our workers who are caught in this situation are experiencing, and particularly their families. And in my mind that is one of the untold stories in this whole thing, the number of people at this minute who are out across this country with dismal prospects, and where children and maybe elderly parents as well that rely on their sons and daughters of working age to try to help them. There is a level of misery going on in that core element of our society that in years past has been one of the greatest strengths of this country, essentially the largest part of the core group of people that fought in the wars, that actually went and fought in the wars, who came back, and took these jobs and produced the kind of living standard that every single one of us are living off today.

And so I am deeply troubled about the fact that while we owe that group in our society I think a tremendous vote of thanks for what has been done, and I think a great commitment of effort to see to it that they can live as well as the rest of us now, we have an awful lot of people out there who today have been pushed out of their jobs, and are finding that it is almost impossible to be able to put their lives back together on any kind of a workable basis.

And I would like you just to take a minute, if you would. We have the auto workers coming after you and then the steel workers. But in terms of taking the broad cut of the workers who are under the umbrella of the AFL-CIO, those workers that have been hit head on and have lost their jobs, and have been forced out at all ages—some in their 30s, some 40, some in their 50s—tell us a little bit about the dimensions of that problem in human terms of what is going on out there, and in the size of that problem, and how we ought to think about that in terms of some national requirement here for us to change our policies in a way that can let those people come back in, and produce, and support themselves in a way that is not only important to them but is important to this country.

Mr. KIRKLAND. Well, Senator, I can't adequately describe the human effect on people of the loss of work. I think it ought to be something that everyone understands who identifies themselves, as most people do, in terms of their work, to lose that mooring, that source of self-respect, self-esteem, and the confidence that they can be adequate wives, husbands, fathers and mothers, and afford their children a decent chance in life.

Just to recite that I think is to suggest what its consequences are. And a visit to places like Lackawanna or some of those steel towns in New York and in some of those steel towns in Pennsylvania and other places where ways of life going back generations have been demolished, and communities blighted, would give a little picture of it. And talk to the people at food banks and union halls that have been turned into welfare offices, union halls that used to be places where the members gathered to pursue their common aspirations and could look forward with some confidence and be a part of that growth of that community. Now more and more places simply are welfare offices, places where people come to get bags of groceries or to explore what is available in terms of job training or placement assistance, that sort of thing, or welfare relief for their families. That is becoming increasingly common across the country. And I think the increasing attention paid to the issue is a reflection of the fact that it is no longer localized or regionalized, but it has become pervasive throughout the country as one source of occupations after another have been hit and demolished from the sun belt to the rust belt and from coast to coast.

No part of the country and no economic base is immune. That has been proven and demonstrated.

But it isn't just the workers, the guy who works by the hour and can be laid off by the hour. When they go down, you can see stark and graphic evidence that everything in the community goes with it, the butcher, the baker, the candlestick maker, the savings and loan officer, the real estate salesman, the insurance salesman, the teacher, the city officials that lose their tax base, everything.

So it isn't a situation where any element of our society can sit there and say, well, those bastards probably deserved it, and they are getting it, but I'm all right, Jack, because they are not going to be all right. It is going across the board.

Senator MOYNIHAN. Well thank you, Senator Riegle.

May I say to our friends opposite, we are just working on the early bird rule. And Senator Mitchell is next.

Senator MITCHELL. Thank you, Mr. Chairman.

Mr. Kirkland, in 1980, the United States had a trade deficit of just over $34 billion, and in 1986 it will be over $170 billion. To what do you attribute this enormous shift in our relative trading position? Have Americans, in your view, suddenly become less competitive? Has there been a significant increase in protectionist policy in other countries? What, in your view, are the causes of this enormous and significant shift?

Mr. KIRKLAND. I think there are a number of factors, Senator, and I don't know if I have the wit to grasp them all. I certainly believe that a major factor has been what I would call the systematic merchantilistic policies of other countries, policies that, in rhetoric, are defended under the guise of free trade but that are in fact the antithesis of it, but are rather policies and practices that Adam Smith inveighed against when he urged trade on the basis of comparative advantage. That is to say, merchantilism. I define "merchantilism" as a studied policy of a country to expand its exports and discourage imports. And if you look around the world you will find that that is the prevailing policy.

And when that happens, when all other trading countries are playing that game and put in place policies that are export-biased, the most open market is going to get the——

Senator MITCHELL. If I may interject to ask, it is directed merchantilism at the American market.

Mr. KIRKLAND. That is correct. And the most open and largest market is going to get the, suffer the consequences.

I don't think this has been adequately recognized. And, in fact, there are instruments, powerful instruments, in our society and in our economy that are pandering to other countries' merchantilism for their own purposes. And I would put in that category the banks that have these enormous loans outstanding and are interested in one thing, being able to carry them at full value on their books and getting them serviced, and who, directly through their consortia, their private consortia, through their instruments such as the International Monetary Fund, bring pressure to bear on other countries and other governments to place exports above all, and exports to the American market, so that they can pretend to service those debts and justify some continued roll-over of them, and so forth.

I think that is a major factor. That does not exhaust it.

Senator MITCHELL. Let me ask you one other question. What is the single most important step that we can take as a nation to correct this imbalance, in your judgment?

Mr. KIRKLAND. I think, sir, that is why I come back again to the element that I think is essential on a trade bill that is substantive and offers any real promise or hope in the near future, to approach a deficit reduction of the kind that we have described: that is to say, targets set for the systematic reduction of deficits applied to those countries who have surpluses with us that go beyond all reason, and who can be shown to be themselves applying these merchantilistic practices of discouraging various imports into their markets.

I think that is the substance without which, you may be able to produce a pretty good bun but there will not be any beef.

Senator MITCHELL. What is your response to those who criticize such a provision as protectionist and likely to increase protectionism around the world and therefore decrease trade?

Mr. KIRKLAND. I define "merchantilism" as the most common form of protectionism in the world today. And I think the application of measures of this kind are necessary to get delivery on some of the promises we always hear. And I hear them. I go to Japan and deal with my Japanese counterparts, just using Japan as a conspicuous example. And I suggest that a more balanced national economic policy would be in order; that they can't expect to live off of our market while it is shrinking; that they should provide for the construction of a more adequate domestic infrastructure, housing, all of the public services that are relatively deficient there, and take those steps necessary to build a larger domestic market, and instead of basing so much of their production on the prospect of export, focus it somewhat more on their domestic markets and afford other countries an opportunity to share in their increased domestic market.

And I think this would be a powerful tool toward getting a delivery on some of those promises that we continually get.

They hardly ever disagree with you. They agree and nothing happens.

I think rather than being protectionist, it is directed at practices that are protectionist, and I think would be the most powerful lever that we could bring into place to open up, to bring about a shift away from this idea that national prosperity in all of these other countries must be built on their exports. It would promote the notion that a more balanced approach is in order and is the only way to get a broad expansion of world trade, which we all want, rather than its diminution.

Senator MOYNIHAN. Thank you, Senator Mitchell. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you.

I have an opening statement I would like to have placed in the record at the appropriate place.

Senator MOYNIHAN. Without objection.

Senator HEINZ. Mr. Kirkland, we have been in a trade war for over a decade and we are only just now figuring out that we have been getting the hell beaten out of us. You have known that for a long time, and indeed many members of this committee have realized that. But that suggests to me that in addition to having lost up to now the battle on trade, there is another battle that we have been losing, and it has been one for public attention in coverage by the news media of this problem. It seems to me that the news media has great interest in reporting on every conceivable action that we take and labeling it as protectionist and a new reassertion of Smoot-Hawleyism. And for reasons beyond most of us they fail to take any interest, invest any effort in reporting the vast and growing array of protectionist practices of the merchantilist nations, such as Japan, Korea, and Taiwan.

So what do you attribute the lack of interest and, from my viewpoint, bias of the news media in this regard?

Mr. KIRKLAND. I hesitate to offer any very shrewd opinion on that. I think to some extent it is the product of conventional educations. The theory is always taught of comparative advantages, it is always taught in schools. And we grow up with textbooks expounding it under assumed conditions that once prevailed or were idealized in a different era, and we become the slaves of dogma. I refer you to Keyne's famous line about people of affairs who consider themselves immune from intellectual influences yet are often the slaves of little else. That mad men in power hearing voices in the air distill their frenzy from the scribblings of some long defunct economist.

I am sometimes led to think about another little line from a poem of Kipling called "Tomlinson." "The sins you do by two and two, we pay for one by one, and the God that you took from a printed book be with you," Tomlinson.

Senator HEINZ. Let me ask you this. This is the third day of hearings we have had. You are the first of the third set of witnesses. Everybody—Bob Strauss, Ed Pratt of Pfizer, John Young of Hewlett-Packard has decried the practices we were just talking about by Japan and others. There is, however, a wide divergence on what we ought to do about it.

One of the reasons there will be trade legislation is pure and simple that the Administration wants new round negotiating authority. Is it your view that they should simply not get any new round negotiating authority unless there is a means of dealing with the mercantilist nations or those who have managed, if you will, to pile up through unfair means a huge bilateral trade surplus?

Mr. KIRKLAND. Well, I certainly would keep that option available if it is useful in explaining the matter to the Administration. We have no objections to multilateral negotiations, per se. And we would be very interested in their contents. We are apprehensive that the contents of the round that this Administration is supporting do very little to address that real problem, but are designed to serve interests that really have no particular aim to advance American production and employment but rather addressing concerns of their own enterprises that can just as well be pursued overseas as here in many of these areas of services and so forth.

So I would have to see the contents of the undertaking ought to be the determining factor.

Senator HEINZ. Thank you.

My time has expired. If you might give some thought to what goals this committee might usefully include as conditions that must be met in any multilateral negotiations, we would, I am sure, welcome them. Thank you.

Mr. KIRKLAND. We made some representations in Punta del Este at the recent meeting which incorporate our views on that.

Senator MOYNIHAN. Mr. Armstrong, you are next.

If I could use just a moment for a statistical note. Earlier I was asked whether the decline in wages from 1977 to 1986, the 9 percent that Mr. Kirkland described, was without precedent, and he properly asked whether it is possibly the case that during the decade of the Depression, the 1930s, there was an equivalent decline. There was not, as we thought. There was that fill up at the end.

In fact, hourly wages from 1930 to 1939 went up about 13 percent.

The CHAIRMAN. I might review the order on the early bird arrivals again so each of you will know. It is Senator Armstrong, Daschle, Wallop, Danforth, Bradley, Baucus, Chafee, and Durenberger. Senator Armstrong.

Senator ARMSTRONG. Thank you, Mr. Chairman.

Did you get our budget approved over at Rules?

The CHAIRMAN. That is a tough crowd. [Laughter.]

Senator ARMSTRONG. Mr. Chairman, I am glad to join with other members of the committee in welcoming Mr. Kirkland who I have long admired all the more so after working with him on the Social Security Commission. And I especially, before coming to the subject of trade, Mr. Kirkland, I especially want to congratulate you and the AFL–CIO for your faithfulness even here this morning in raising the issue of oppressed workers overseas. That is not a very fashionable issue just now. And, in fact, most people are ignoring or turning their backs on the question of forced labor. And there are a handful of us at least who are very appreciative of your continuing efforts to give prominance to that concern.

Mr. KIRKLAND. Thank you.

Senator ARMSTRONG. Mr. Kirkland, did you by chance see the Washington Post editorial on trade yesterday?

Mr. KIRKLAND. Something about Washington Post editorials on trade caused my eyes to glaze over, sir. [Laughter.]

Senator ARMSTRONG. In fact, I was not going to ask if you understood it because I myself laid it aside in the hope that in due course staff could explain the exact meaning of it to me. But it does raise a point which has not been addressed by this hearing thus far, and about which I would seek your counsel.

The Post argues that the master key to the trade problem is really the budget deficit; that if the budget deficit comes down, our trade problem will correct itself. And that while there are other ways to solve the problem, in the opinion of the Post, if I understand their editorial correctly—and I think I got this much of the gist of it—that the other ways which are available either won't work or will produce seriously adversed side effects.

So they are saying if we are going to get the trade problem under control we have got to get the budget deficits under control. Do you share that point of view? Have you thought about it?

Mr. KIRKLAND. Not exactly, sir. I think probably one could elaborate through an arcane process—at least to me arcane—the manner in which budget deficits might theoretically produce trade deficits. But I observe that there are countries that seem to sustain rather large trade surpluses simultaneously with a rather large budget deficit.

And so the cause and effect is, to me, somewhat obscure. I think if given time and the aid of some of my heavy thinkers I could probably make a stronger case the other way around that large trade deficits contribute to and exacerbate budget deficits.

Senator ARMSTRONG. Another popular theory is that the value of the dollar is really the most serious cause of the trade deficit. Obviously, the dollar has plummeted. Do you share the believe that the value of the dollar determines our balance of trade? And if so, do you think it has come down far enough or that the dollar is now at about the right level? You want to see it go down some more. Or how do you feel about it?

Mr. KIRKLAND. My personal view of it sometimes depend on whether I am in Geneva at an ILO conference or here. If there is one thing that the decline in the dollar may have demonstrated to be false it is a notion that excessive wages are the problem. It also illustrates that hardened exponents of something called free trade are quite ready to be ultraprotectionists if they do it their way.

I find it hard to distinguish between protectionism sought by creating, let's say, barriers or raising costs by way of a tariff, and raising costs by way of devaluation. It seems to me economically the theoretical consequences are essentially the same.

Now in international terms they have cut our wages vis-a-vis the Japanese, I would say, by about 50 percent, and versus the Germans I would say substantially more. And that has occurred concurrently with the greatest increase in our trade deficit that we have ever endured.

So it has established the fact, let's say, that the Secretary of the Treasury and the economic brains of this Administration are rampant protectionists because their cure is a tariff called devaluation of the dollar, which is an act of governmental policy, not something that rained from the heaven. So if someone could explain the difference, I would be fascinated. I don't think you can.

Senator ARMSTRONG. I note that my time has expired, Mr. Chairman, but in due course I hope we can come back to this issue of the value of the dollar.

The CHAIRMAN. Well I think it is a very important issue and needs to be further explored. And I think the comments have been helpful.

I would like to now recognize Senator Daschle.

Senator DASCHLE. Thank you, Mr. Chairman.

I have found this hearing to be extremely enlightening, and I want to commend you for your answers and for the quality of your testimony this morning, Mr. Kirkland, and likewise the AFL-CIO for incredible foresight they demonstrated many, many years ago when the issue of trade was not uppermost in the minds of most people in Congress. The genesis of much of our involvement today in the legislative process that has already begun comes from an early commitment and a clear appreciation of the perils that lie with regard to trade from the AFL-CIO.

On page 14 of your statement you speak with a great deal of concern about the word "competitiveness," and I was taken by that because John Young testified last week. And as he provided us a chart of all of the various factors for which we can deal with this measure, he cites human resource cost as a major disadvantage. And yet in his chart and in his testimony, he indicated that there is nothing for which he believes we need to do, need to address that issue; that that is an asset as much as it is, in the minds of some, a liability. But you speak with a great deal of force with regard to a synomymous quality of the word "competitiveness" was to reduce cost of labor.

To a skeptic on this committee or to someone who feels contrary, how do you argue that competitiveness is not detrimentally affected by the human resource cost? And how, as we measure our relative advantage in the future in trying to determine trade policy, do you think we ought to treat the issue of cost of labor?

Mr. KIRKLAND. Well only a fool would argue that labor costs are not a part of costs. They certainly are. But likewise, they have a dual function. They are also part of the market. And I don't think that you can expand trade by diminishing the market, by reducing people's capacity to function in the market.

And the American market particularly was built upon widespread purchasing power and a broad middle class and wage levels that open doors to entry into that middle class. And to attack that under the name of competitiveness by closing those doors of opportunity and shrinking that purchasing power seems clearly to me to be self-defeating.

There are other elements of it for productivity, I think, even though it is commonplace to note that the rate of increase in productivity in this country is lower than some of our major trading partners. The absolute productivity of the American workers is still the highest in the world. It is still the highest in the world. And the plight that we find ourselves in today I would argue with my last breath cannot be laid at the door of the American standard of living, nor should the solution be found in attacking the American standard of living which is essentially wage-based.

Besides, when you focus on the wages of the production worker, let's not forget that standards of human aspirations are set by others in our society. And I think that the disparity between the compensation levels of management in American industry far exceeds any disparity of compensation of hourly paid workers. And if we are going to change that relationship, let's start with the most privileged.

I would suggest then you explore perhaps legislation that ratchets down progressively American compensation standards, starting with the top, starting with those most privileged in our society who have enjoyed the fruits of a free society most fully. Start with American corporation executives, whose compensation is several multiples of earnings, let's say, of Japanese corporation executives. Let's then go, say, to the pay of anchormen and women on American television versus those on Japanese television; the wages and consulting and lecture fees of American economists compared to the economic staff of the University of Tokyo. Let's all do this together, starting with those who have been most privileged. And when you get that down, talk about the earnings of the guy who is struggling to raise a family on eight or nine bucks an hour. When you get there, let's talk.

Senator DASCHLE. You didn't mention members of the—— [Laughter.]

Mr. KIRKLAND. That was not inadvertent, sir. [Laughter.]

The CHAIRMAN. I don't think we will pursue that line of questioning. [Laughter.]

Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Kirkland, I have two areas that I would like to explore very briefly. The first is what contribution, what is the single greatest contribution that each of three sectors can make to solve this trade competitiveness problem? First is what is the single greatest contribution you think that management and business can make?

The next question I am going to ask you is what is the single greatest contribution organized labor can make here at home? And, third, the greatest single contribution that the U.S. government can make? First with business.

The CHAIRMAN. And we have a 5-minute limitation.

Senator BAUCUS. And I would appreciate it if you would just capsulize it.

Mr. KIRKLAND. Well, a lot of attention has been paid, under this broad rubric of education, to the need for restructuring the American educational system and improving it, all of which I am strong for and we have been for years. But I don't think it is a product of the lack of education of the working class. I think some of it can be laid at the door of the kind of education that management is getting. That is, the deficiencies in higher education, and business administration, and so forth.

I once heard someone, and I borrowed it, in fact, point out that one of the great advantages of Germany and Japan over us was that neither one of them had a Harvard Business School. [Laughter.]

But it seems to me that the emphasis in the management ranks has been the pursuit of wealth in those enterprises which lie across the stream of commerce and take a few billion out of it as it passes without producing anything. And I would like to see a little more focus on the glorification of those who are able to produce something a little better, and guide and manage its production, rather than those who concentrate so much and who enjoy such extraordinary rewards by dabbling in the purchase of companies, and loading them with debt, and the diminishing thereby of their capacity to compete.

Senator BAUCUS. I agree with that very much.

Now what about organized labor? What is the greatest single contribution organized labor can make here at home to help reduce the trade deficit?

Mr. KIRKLAND. By representing its members faithfully.

Senator BAUCUS. What does that mean?

Mr. KIRKLAND. That means negotiating for them with management in a realistic environment with a realistic attitude. And I think we pretty well demonstrated that over the years at often some pain to us through negotiations and I can cite examples at great length. You will hear from one of the authors of the Chrysler negotiations that was critical to the survival of that company, whereby, those members of that work force—the members of that union and the employees of that company—invested billions in the survival of that company.

Senator BAUCUS. What is the role——

Mr. KIRKLAND. And I think we have demonstrated that when the circumstances warranted, and when they are credible, that we will meet our responsibilities. Beyond that, I think we have been the only real force that concentrated a great deal of its energies and resources and efforts at trying to raise the standards and the rights of workers elsewhere.

Senator BAUCUS. What is the role of greater cooperation sharing between management and labor? A lot of commentators today think that management and labor relations in our country are too adversarial. They are too much in opposition to each other. One of the keys to increasing American competitiveness is for greater cooperation both in the good times and the bad times.

I wonder if you could comment on the propriety of that approach and perhaps give an example or two where that may have worked.

Mr. KIRKLAND. Well, I think there has been a great deal of superficial malarkey on that subject. The adversarial relationship that is so often cited in American labor management affairs simply does not imply ingrained hostility, class, or otherwise, which I think exists to a much lesser degree in this country than elsewhere.

It simply means that when you negotiate a contract you represent your side faithfully, and you don't purport to represent both sides. And that, to me, is the essence of our system of contract.

I once had a discussion with a group which included Mr. Morita, of Sony, and the representative of a French industry, and they were asked to try in a nut shell to define the differences between their societies and the American. Mr. Morita said, well, in simple terms, America is a society of contract and Japan is a society of status. The Frenchman said, America is a republican democracy. To understand France you have to realize that despite the form of it it is a monarchy. And I think there is a lot in both of those comments.

The adversarial process, as I define and understand it, which is simply that you faithfully represent your members because that is who you are engaged to represent. And the process of negotiating an agreement, a contract, where there are differences of interest does not negate the cooperation once that contract is reached. And in fact we favor cooperation. We would love to see more cooperation. We are ready to cooperate if we could get more of these hostile vindictive bastards in management to cooperate with us. [Laughter.]

If there is an impediment to cooperation, it is on the management side, not on the labor side.

The CHAIRMAN. Thank you very much, Mr. Kirkland. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Kirkland, I certainly couldn't agree with you more about the effect of the raiders on American business. I don't know why in the world we can't prevent the payment of green mail, which has left companies deeply in debt. Gillett, up my way, paid some $60 million in green mail to a raider and then ended up with a lot of problems as a result.

I think what you say about unfair trading practices is absolutely right. We should do more about changes in section 301 and we will be looking at that in this committee. Although the statistics show that out of a trade deficit of approximately $170 billion, unfair trading practices account for only $10 to 20 billion. I don't know whether that is accurate, but these figures are what the Commerce Department has told us.

One of the things that I think we ought to consider here is the subject of notice of plant closings, which are involved inevitably when we get into this intensified competition. Somebody is going to lose out in our country. Regretably, some aren't going to be able to compete.

Could you just briefly outline what your thoughts are on that, i.e. what kind of notice you would recommend? The statistics clearly show that if you get adequate notice, the susceptibility of the workers to a retraining program, and to adapt to it psychologically, and thus move on to other jobs is high; far better than if you just dropped the gate and then subsequently go around and try to do something about the retraining. Would you give me your thoughts on that, please?

Mr. KIRKLAND. Yes, sir.

We have advocated legislation to require a 90-day notice period before plant closure in order to afford not only the work force an ample opportunity to adjust, or to begin to adjust, but also the community, which also has a stake in the consequences of the departure of a major source of business, of employment, and of city revenue, all the other things that flow from an enterprise.

Senator CHAFEE. Well I think there is a lot of merit in that. I want to take a look at your legislation. I think it is important.

Let me ask you another question. And I don't think I asked you this before when you were here. I took a survey in my office in Washington here. We have 21 employees. I constantly lecture them about buying American. As a result of my effective lectures, 18 of them now drive foreign cars. [Laughter.]

And the nineteenth has sworn he will never buy an American one again. So then I carried the survey a step further. I said why? Is it price? The answer is no. They insist it is quality. Now many of them are women employees—and to them especially quality is important. They just don't want a breakdown on the road, and they don't want to spend time having repairs, even if it is a non-emergency type.

And as a result of this, obviously I came away depressed.

Senator HEINZ. Not as depressed as Owen Bieber is. [Laughter.]

Senator CHAFEE. Depressed both on my persuasive powers and depressed for American automobile manufacturers.

You have indicated here that management has got to shape up. And I think they do. What can we do to improve the quality of overall American productivity? I am not picking on the automobile people because this is just a survey I took. I didn't ask how many have foreign watches or whatever it might be.

What can we do? Is there anything specifically we can do in this committee, or is this just left to the free enterprise system and the competitive nature of the world to work out?

Mr. KIRKLAND. Well in terms of the automobile, I would defer to my colleague who could probably respond to that with more intimate knowledge than I.

I just remember a cartoon that appeared in the UAW journal some years back, in which an assembly line worker is talking to a person who is obviously representing someone in management, and he says that it is your design, your plant, your tools, your capital, your sales force, your profits, my fault.

And I think increasingly, with automation——

Senator CHAFEE. I am not directing this to the worker. I am directing it to overall, everybody, management——

Mr. KIRKLAND. The problem lies in probably design. But beyond that, I do think we went through a long period of time when we had a relative monopoly of the American market, when some of our manufacturers became convinced that they could make the American market want to buy what they wanted to make and sell, and they could do it with advertising, and with psychological appeals to emulation and other attributes of the human personality. That is the period when I think they liked to make gigantic television cabinets in which perhaps a modestly mediocre tube was put. But they sold the cabinet, nice Mediterranean style, knotty pine, or what have you. So they were selling air because it was to be made more cheaply and sold.

And then at that point I think some of our competitors, notably the Japanese, who I think above all are extraordinarily capable market analysists, came in and studied the market very carefully, and decided that there were certain gaps, and began producing for those gaps such as small, portable television sets, and, lo and behold, discovered that is what the people wanted after all.

In the case of automobiles, I don't know. I say this very hesitantly because Owen knows far more than I do about it. But we went through some shocks. There was a time when I think the market really did favor large automobiles that had relatively high gas consumption rates when we had the cheapest gas in the world. And it was customary to drive long distances on an elaborate highway system. And then came the oil shock. And I think that revolutionized the market and gave countries that had been producing smaller cars for different circumstances, different gas prices, and so forth, a major advantage that we have never been able to quite recover from. That is just my curbstone opinion.

Senator CHAFEE. Well I hope I can give you a more favorable report the next time we see you.

Thank you, Mr. Chairman.

Senator MATSUNAGA. Mr. Kirkland, I apologize for my being late and not being able to listen to your testimony. But I have been reading your testimony. I suppose, as in your case, with our job here, we are required to be in too many places all at the same time.

I think you make a highly agreeable statement when you say that unlike a few years ago there is now general agreement that America's massive trade deficit presents a clear and present danger to the domestic economy.

Assuming that to be true, and I agree that it is so, Ambassador Mansfield suggests that one of the problems causing that great trade deficit is that American industry has forgotten to appeal to the consumer. If American industry once more appealed to the consumer, Americans being great consumers would insist upon American goods, and foreigners as well would insist upon American goods. Of course, unfortunately, as you point out, our imports of manufactured goods have increased tremendously while our exports of manufactured goods have increased by only 2 percent during the present decade.

Now one of the complaints, the biggest complaint I hear from businessmen is that the cost of labor in the United States is much too high, which makes them unable to compete with foreign goods. What do you say to this?

Mr. KIRKLAND. Well I wouldn't trust management's judgment on that. I am sure they would like to get their labor for nothing, except their own labor, which they believe should be abundantly rewarded.

I do not think that you can establish a concurrence of the trends in our deficit with the relative dimensions of wage levels.

We ran a trade surplus at a time when American wage levels relatively, let's say to Japanese, were very high and likewise with other countries. We are running a disastrous trade deficit at a time when Japanese industrial wages on average are higher than American as a consequence of devaluation. And Germany has a very large trade surplus with us, with wages that are following devaluation against the mark, very much higher than American wages, and a system of social benefits and non-wage labor cost that far exceeds American, that make American social conditions that workers endure when they are laid off and so forth seem harsh and cruel by comparison.

And yet American multinational companies are willing to go to Japan and to Germany to produce for the American market, and work under systems of labor codes, and wage levels that they would not negotiate in the United States.

I think, sir, the answer is that the disparity that we suffer from, to some extent, is that capital is infinitely mobil and can jump barriers and locate behind walls and labor can not.

When you say American corporations, I don't know how many there are left any more. They are multinational corporations, and they are prefectly able to move around the world and take advantage, pursue the cheapest wage level that they can find. They may be Taiwan, or Singapore, or South Korea, or the Philippeans today and Brazil tomorrow, but there will always be someone cheaper, and they will regard the cheapest as the adequate wage level.

Senator MATSUNAGA. You suggested that corporate executives are over paid. Would you go to the extent of——

Mr. KIRKLAND. I have no problem with what they get paid. I think that is fine. I just think it would be very refreshing in view of what they make that they would stop pontificating about what others make.

Senator MATSUNAGA. You don't think they are over paid?

Mr. KIRKLAND. I don't know what "over paid" means.

Senator MATSUNAGA. No?

Mr. KIRKLAND. I never voted against a wage increase in my life. [Laughter.]

Particularly for you, sir. [Laughter.]

Senator MATSUNAGA. But you haven't had the opportunity to vote for pay raises for corporate executives, have you?

Mr. KIRKLAND. I don't mind people getting rich, sir. I would like to see them do something for their fellow man, for the country, in the process. I don't like to see them getting rich in the manner of the people that the Senator referred to who got richer by raiding a company and walking away with $50 million were overpaid.

Senator MATSUNAGA. Are you not concerned that corporate executives are being overpaid at the expense of the lower paid wage earner?

Mr. KIRKLAND. I don't quite follow you, sir. I don't say that. I say, as in the case of the green mail artist and the corporate raider, that is at the expense of people whom I represent, because the inevitable consequence of it is shut down plants and layoffs. And it is the worker that pays for that in the last analysis.

Senator MATSUNAGA. Well thank you very much, Mr. Kirkland. Although I do have other questions, and I am sure the panel would like to ask further questions, inasmuch as we have asked the next panel to be with us this morning, I thank you for your testimony. Perhaps we might be able to ask questions in writing to which you might respond in writing for the record.

Mr. KIRKLAND. I would be very happy to, sir.

Senator MATSUNAGA. Thank you very much.

Mr. KIRKLAND. Thank you.

[The prepared statement of Lane Kirkland follows:]

87-03

**TESTIMONY OF LANE KIRKLAND, PRESIDENT
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS
BEFORE THE SENATE FINANCE COMMITTEE
ON THE GOALS OF U.S. TRADE POLICY**

January 20, 1987

Mr. Chairman, members of the Committee, I appreciate this opportunity to discuss with you the views of the AFL-CIO on the trade crisis confronting the United States. You are to be commended for both the early scheduling of this hearing and your determination to move rapidly. The AFL-CIO believes the bill passed by the House in the 99th Congress made significant progress in addressing this vital national issue. The workers we represent are confident that the 100th Congress will complete that process and send to the President a tough, effective trade bill that will help American workers and industry regain the production, jobs and income lost over the last number of years.

The concern of those members is very basic and very dire. For the first time in our history, we have a generation of Americans who cannot reasonably expect to do as well as their parents did. The middle class is shrinking. Scores of domestic industries and millions of American workers have been left defenseless against an onslaught of imports spurred by foreign government practices and the vagaries of U.S. macro-economic policy. The absence of a strong and predictable U.S. trade policy has contributed significantly to their fate.

Legislation will be a hollow shell if it does not have a strong deficit-reduction provision. Such a provision requires any major trading partners who maintain excessive surpluses with us and are found to engage in unfair trade practices to reduce those imbalances. We have been negotiating with Japan, for example, for ten years, and during that time, the Japanese trade surplus with us grew substantially and goods made in the United States still have little access to Japanese markets.

Changes in trade law and policy to provide timely and predictable relief to workers and industries injured by imports are also long overdue. America's unfair trade laws must be strengthened to address new discriminatory commercial practices. The denial of worker rights by our trading partners can no longer be ignored. The international debt crisis must be addressed, insuring the banks accept their proper share of the burden. Legislation is also needed to deal with the problems of specific industries devastated by trade. While these and other measures are required to build the foundation of an effective policy in the upcoming years, it is essential that Congress take steps to begin the immediate reduction of America's trade deficit.

Worldwide economic expansion, falling dollar exchange rates or successful negotiations are by themselves unlikely to achieve reduction of America's trade deficit. The dollar has fallen for two years, negotiations don't deal with the real problems in manufacturing, and even if worldwide economic expansion took place, it doesn't follow that other nations would import more U.S. goods.

Impact of Deficits

Unlike a few years ago, there is now general agreement that America's massive trade deficit presents a clear and present danger to the domestic economy. Those who in the past denied the very existence of a problem, or counseled patience to the victims of trade, have been largely silenced by the enormity of the shift in U.S. trade patterns. The figures are stark.

U.S. trade deficits the last few years have been the largest ever recorded by any country and in 1986 will exceed $170 billion. This is more than four times higher than the 1980 level. For manufactured goods alone, America has gone from a surplus of $17 billion in 1980 to a deficit that will reach $148 billion in 1986.

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That record $170 billion deficit was reached between 1980 and 1986 because imports into the United States increased 52 percent while, incredibly, U.S. exports dropped by 2 percent.

No sector of the economy is untouched. Mines are closing, manufacturing communities are devastated and escalating numbers of farm families have been driven off their land.

While purchases of civilian goods have increased some 25 percent over the last six years, more than half of that increased demand has been satisfied by imports financed by borrowing from abroad. America's trade deficit, coupled with these capital inflows, has recently bestowed another distinction on the United States -- that of the world's largest debtor nation. From its position as the world's biggest creditor -- almost $150 billion in 1982, a sum that took almost 70 years to accumulate -- the United States in three short years passed Brazil to become the world's biggest debtor, owing some $107 billion at the end of 1985. U.S. debt continued to grow rapidly in 1986, and projections of $800 billion in net debt by 1990 are common. At that time, debt service payments alone will cost one percent of real the Gross National Product thereby requiring sharply reduced domestic spending and with it reductions in our standard of living.

Further, most economists project an exceedingly sluggish GNP growth rate of only 2.9 percent in 1987 for the U.S. economy. Central to these modest predictions is an improving U.S. trade balance. Yet, even the most optimistic analysis predicts, in this present policy climate, $150 billion deficits this year and $100 billion-plus deficits for the foreseeable future.

This economic future becomes even bleaker when considered in the context of the damage already done to the U.S. economy, in large part by trade, over the last six years.

The impact on employment has been devastating. Despite a modest drop in the unemployment rate for December, 7.9 million people continue to be officially out of work, with another 6.5 million either too discouraged to seek work or working part-time involuntarily. The year 1986 was only one of ten post-World War II years with an unemployment rate above 7 percent, yet six of those years were the years 1981 through 1986 when America's international trade position nosedived.

While total employment has grown in the last six years, that growth has taken place solely in the service sector. Employment in manufacturing has actually declined by some two million jobs. Further, the rate of employment growth in the last six years is 29 percent below average growth rates of the 1970s.

The jobs lost to trade are acknowledged. Last year, the Department of Commerce estimated that in 1984 alone 1.8 million jobs were displaced by trade. Updating that analysis for 1985 and 1986, the domestic economy suffered employment losses in those years due to trade of 2.2 and 2.5 million, respectively. Manufacturing was hardest hit.

In a study on displaced workers released in October, the Bureau of Labor Statistics reported that between 1981 and 1986, 13.1 million lost their jobs due to plant closure, slack work or layoffs -- years when our trade deficit was growing dramatically. More than five million of these displaced workers had been at their jobs for at least three years. Of these, the survey found that 18 percent remained unemployed and an additional 15 percent had left the workforce entirely. For those fortunate enough to find other jobs, 10 percent were working part-time, and of those securing full-time work, 40 percent were forced to accept lower pay.

Under that impact, average weekly earnings for U.S. non-supervisory production employees have declined about 9 percent from 1977 to 1986, in constant dollars. The reduction of employment in manufacturing and the growth of jobs in services contributed to this decline in pay. Average weekly earnings for manufacturing workers reached $395 in 1986. Workers averaged $176 in retail trade and $265 in the service industry, two sectors where the employment growth has been largest. In all, 60 percent of the new jobs created since 1979 paid less than $7,000 a year.

Family share of national income has also undergone a dramatic shift. For the period 1980 to 1985, the top 20 percent increased its share of national income to 43.5 percent, the highest concentration in the history of the series which began in 1947. By contrast, the bottom 20 percent of families received only 4.6 percent, the smallest share since 1954.

Loss of income and recessionary levels of unemployment also contribute significantly to the federal budget deficit. A Congressional Budget Office report stated last year that a one percent reduction in the unemployment rate would bring in $37 billion more in tax revenue and require $7 billion less in transfer payments like unemployment compensation, food stamps and welfare.

The government's response to these problems has been one of benign neglect. While America's most important trading partners are succeeding with traditional mercantilist policies, U.S. trade policies -- or lack thereof -- tolerate far more employment instability than other industrialized countries.

U.S. Trade Representative Clayton Yeutter echoed this view in a Forbes Magazine article some time ago by stating: "No other country in the world would have left its markets as open as the U.S., and clearly this has been of enormous benefit to the rest of the world. And by the way," Yeutter added, "we get very little credit for this. You don't hear the Europeans or the Asians or the Third World saying what a marvelous job we've done keeping our markets open during a difficult period. You just hear them clamoring for more access."

Further, little more concern is shown for workers once they are displaced by trade. The Administration has drastically reduced the funds available for supporting, training and upgrading skills for trade-displaced workers and continues to favor the elimination of the trade adjustment assistance program. Even the Administration's recent budget proposals, trumpeted as a belated recognition that additional adjustment efforts are needed, signal the end of trade adjustment assistance under the guise of program consolidation.

Nevertheless, many in the Administration now recognize that the U.S. trade deficit has reached crisis proportions. For example, Deputy U.S. Trade Representative Alan Woods recently stated in a Journal of Commerce article, "The world cannot get comfortable with a U.S. trading deficit of between $150 and $170 billion. The system will just crack. It's not in anyone's interest that that happen."

Insufficient Responses

The question now is what to do about it. Over the last few years, the Administration has relied essentially on the depreciation of the dollar, the need for our major trading partners to pursue expansionary policies, a rhetorically tougher approach to foreign trade practices, and a new round of multilateral trade negotiations.

The steep rise in the value of the dollar from 1980 to February 1985 contributed to America's trade problem, but the impact has been overstated. During that five-year period, U.S. bilateral trade deficits grew substantially with countries like Taiwan and South Korea who essentially tie their currencies to the United States. The U.S. bilateral trade deficit with Japan skyrocketed even though the dollar had appreciated only marginally against the yen. Now that the dollar has fallen against the yen, there is similarly little assurance that this alone will reduce the U.S. trade deficit. Japanese companies have responded by cutting their profit margins so they can maintain their share of the U.S. market. Insofar as U.S. exports to Japan are concerned, an official of Japan's Ministry of Trade and Industry, noting that primary products make up almost 70 percent of Japan's imports, was quoted saying "nobody would want to eat more even if imported agricultural products become cheaper."

Overall, the dollar has been in decline for almost two years, and the trade deficit has shown no sign of abating. In fact, the November deficit of $19.3 billion set an all-time record. While the dollar has dropped almost 40 percent against the yen and the mark, when it is measured against the currencies of the 25 countries from which we import the most merchandise, it has declined less than 10 percent. A recent Wall Street Journal headline sums it up best: "Dollar's Decline Fails to Narrow Trade Gap as 1985 Pact Intended."

The call for expansionary policies by our major trading partners, particularly Germany and Japan, is conceptually a similar approach. The problem with this proposal is that it assumes any increase in demand would be satisfied by U.S. exports, an assumption that is not supported by recent evidence. Between 1980 and 1985, real U.S. GNP increased by some 12 percent, with real imports increasing 45 percent. During this same time period, the Japanese economy grew 21 percent, but imports increased only 9 percent. Germany's economy grew 6 percent, and imports grew just 10 percent.

Both Germany and Japan maintain a huge worldwide trade surplus, $29 billion and $77 billion, respectively, and therefore have the capacity to substantially increase imports from the United States. Simple economic expansion, however, in the absence of other policy changes, will not necessarily bring this about. Their policies concerning imports must change as well. This should be a goal of any U.S. trade bill.

On the question of tougher Executive Branch action against harmful foreign trade practices, the Administration's rhetoric has risen noticeably in the last year or so. A number of long-standing complaints raised by domestic industry have apparently been settled. The Administration has even initiated some unfair trade cases itself in an effort to prove that the United States was serious. The number and selection, however, leave something to be desired. For example, selling more insurance to Korea will not solve our trade problems, and the actual results of Japan's agreement on tobacco or pushing Brazil to open its markets for computers and related equipment have not yet been realized. Today, there is a major dispute with the European Community over agricultural trade. We applaud the effort to open the European agricultural market. But doesn't the manufacturing sector, where our productive capacity and employment is being devastated, deserve equal treatment?

A few weeks ago, in another manifestation of this "new" get tough approach, the Administration announced the reduction of trade preferences for several countries, covering about $3 billion of goods. At the same time, however, they were increasing the preferences on other goods amounting to $2 billion. One of the products granted open-ended duty-free treatment was telephone equipment from Singapore. In the summer of 1985, AT&T announced that it was moving telephone production from its plant in Shreveport to Singapore, eliminating more than 1,000 jobs. How can we solve our trade problem when government policy aids and abets the export of American jobs?

Even though inadequate, these actions only came about when the Administration has been under intense pressure from Congress. Only Congressional action can insure that the United States vigorously pursues unfair trade practices. Our problems demand more than symbolic actions.

The final piece of the Administration's policy has been the initiation of a new round of trade negotiations. The AFL-CIO does not oppose trade negotiations in and of themselves. Negotiations in the past however have not provided the relief that is essential to the survival of trade-impacted industries and their workers in the United States.

Even if wildly successful, agreements are years away. The damage is being done right now. Negotiations will not create or implement an effective national trade policy or reduce America's huge trade deficits. We are principally concerned that negotiations are considered by the Administration as a pallid substitute for urgently needed action to remedy the injury to domestic industry and workers caused by America's massive trade imbalance. This concern is heightened by the Administration's antagonism to virtually all trade reform legislation considered by the Senate and its vehement opposition to the

House-passed Trade and International Economic Policy Reform Act of 1986. The AFL-CIO believes that that bill would have provided some immediate relief from the nation's trade problem and would have gone a long way to forming the foundation of an effective national policy for years to come.

The AFL-CIO is also concerned about the overwhelming priority given by the Administration to negotiations on services and investment in the new round. The principal trade problem facing the United States is undeniably the massive shift that has occurred in trade in the manufacturing sector and the resultant loss of employment. Emphasis on "liberalizing" trade in services and investment flows will have little impact on this central issue and may in fact accelerate the deterioration of the domestic manufacturing sector if essential U.S. protections in the goods area are sacrificed as the price for reductions in barriers to services and investment. Further, what may appear to some as "barriers" to service trade or international investment are in fact proper and even essential social and economic policies in both the United States and foreign economies. Banking and insurance regulations, protections of personal privacy, immigration rules and restrictions, and standards for lawyers, doctors and accountants are but a few examples.

While the unrestricted flows of services and investment may be important to certain corporate interests, this does not make it significant for the economy as a whole. Since to a large degree services must be produced where they are consumed, any U.S. employment gains from increases in service trade would be marginal at best. The growth of service sector employment domestically has been in areas unrelated to international trade. Similarly, negotiations aimed at easing restrictions on internation investment will do little to promote domestic economic growth and employment.

The AFL-CIO is also concerned over the possibility of reduction in U.S. tariff rates. We are adamantly opposed to any tariff cutting for import-sensitive products. A range of industries have already been seriously harmed by imports, and reductions in tariffs would only aggravate their difficulties.

Finally, agreements reached to launch the new round that ostensibly require a standstill and rollback in so-called trade restrictive measures are central to labor's concerns. The United States must not relinquish its right to take needed actions at the national level to defend domestic industry.

Needed Responses

Macro-economic measures, trade policy symbolism or multilateral trade negotiations will not by themselves provide the solution to America's trade crisis. Changes in trade law and policy are urgently needed. The AFL-CIO strongly supported many of the changes contained in the House trade bill passed last year. That bill was an attempt to deal with an exceedingly complicated problem in a comprehensive fashion. The AFL-CIO continues to believe that legislation must include provisions to reduce excessive surpluses with the United States from countries that maintain unreasonable trading practices. In addition, effective worker rights provisions; trade law reform that provides more effective injury relief and protection from unfair trade practices; measures to deal with the less-developed country debt crisis; and industry-specific remedies are needed.

<u>Deficit Reduction</u>

Any trade bill that hopes to begin addressing America's trade crisis must contain measures to reduce this country's trade deficit. The House bill contained such a provision. It would have provided badly needed impetus to countries that maintained excessive trade surpluses as well as unfair and discriminatory trade practices with the United States to begin immediately to reduce those surpluses in an orderly fashion. Both tests were necessary for any government action.

I want to commend the Chairman for his foresight in identifying this area as a vital component of needed trade legislation in the summer of 1985. The House bill passed in the Spring of 1986 made a number of modifications to the original proposal that significantly increased the discretion of the President in a variety of ways. We agreed to these changes very reluctantly, but continued to support the legislation as contained in the House bill because the basic thrust was good. It still is.

Though responsibly addressing the problem of both unfair trade practices and excessive surpluses, problems on which there are general agreement, the provision garnered considerable criticism from many quarters, the Administration in particular, as being protectionist and a latter-day version of Smoot-Hawley. It is neither, and is the only reasonable and effective method of insuring that the trading system will survive.

The Administration itself acknowledges that Japan, Germany, and Taiwan need to drastically increase their purchase of American products and reduce their trade surpluses. Negotiations to this end are going on continually. Yet it is clear that negotiations, without the prospect of some ultimate penalty are doomed to failure. We have been negotiating with Japan for years and U.S. exports to that market are not substantially higher than they were six years ago. Germany to date has been unwilling to expand its economy or, for example, open its market to American telecommunication products. Taiwan asserts it needs special privileges because it's a developing country.

But this approach gets labelled "protectionist." When news of the November trade deficit broke, the Washington Post story carried a headline that said it would "feed protectionist sentiment." The sentiment's not the problem. The trade deficit is.

Worker Rights

Section 301 should be amended to define as an unreasonable act, policy or practice the failure on the part of a country to take steps to adopt internationally recognized worker rights, as contained in Title V of the Trade Agreements Act of 1984. Failure to take such steps would result in the denial of most-favored-nation treatment as long as that country remained out of compliance. The AFL-CIO strongly believes that competitive advantage in trade should not be derived from the denial of the right to freedom of association, the refusal to insure a safe work environment, the exploitation of child labor or other such reprehensible practices.

Injury Relief

The "escape clause" (Section 201 of the Trade Act of 1974) was designed to provide a safety valve for those industries threatened with or experiencing serious injury from imports. Of the some 60 cases filed since this provision became part of law, only 13 have resulted in any relief. Even in these cases, the relief has rarely been enough to allow the injured industry to fully recover from the import assault. To improve the functioning of this provision, the standard used by the International Trade Commission (ITC) in finding injury should be changed to the GATT standard under which imports must be a cause (rather than a substantial cause) of serious injury or threat thereof. If the ITC finds injury, trade adjustment assistance should be automatically provided. We believe that while the U.S. Trade Representative (USTR) should have the discretion to modify the ITC recommendation, including the authority to negotiate Orderly Marketing Agreements, the USTR must be required to take some action to provide relief which fully redresses the injury.

Further, petitioners should have the option of requesting the establishment of an industry advisory group made up of representatives from business, labor and government to develop a plan to improve an industry's competitiveness. While the ITC should be required to take into account a group's plan in making its recommendation, the absence of a group or plan should not prejudice the ITC's decision.

Unfair Trade Practices

Section 301 provides the President with broad authority to take action against foreign countries whose practices burden, restrict or discriminate against U.S. commerce. ~~While~~ in recent months the Administration has initiated some actions against countries with unreasonable and unjustifiable practices, the United States must go beyond symbolic actions and vigorously pursue foreign practices that are harmful to U.S. domestic interests.

Among many needed changes, we strongly support provisions that would require action in response to foreign industrial targeting that causes or threaten to cause material injury. We must not allow domestic industry to fall victim to the coordinated and predatory practices of other countries.

In addition, the countervailing duty and the anti-dumping statute must be strengthened, and problems concerning intellectual property, national security, and trade with non-market economies must be addressed.

Less-Developed Country Debt Crisis

As part of any comprehensive solution to America's trade problem, steps to address the continuing problem of less-developed country debt are needed. The relationship between the growing indebtedness of the poorer countries and trade is clear. To maintain the semblance of solvency, these countries have been required to restrict imports and boost exports in order to earn foreign exchange to service their debt. The burden of these policies has disproportionately fallen on the workers of both countries. It is essential that measures be adopted to insure that this burden is shared in a more equitable fashion. The AFL-CIO supports proposals that would reduce the principal owed as well as mandate reductions in interest rates.

Industry-Specific Measures

Beyond the general reform and reorientation of U.S. trade law, measures designed to solve the problems of specific industries, such as textile and apparel, shoes, telecommunications, maritime transport, steel and printing, continue to be needed.

We stand ready to discuss these with you, as we have in the past, at any time.

Mr. Chairman, too often, workers are asked to bear all the burden of trade injury, and in the months ahead that demand may come to this committee in the guise of "competitiveness." Some will use that word to camouflage a desire for the United States to compete around the world on the basis of wages alone. Obviously, we will oppose that with all the blood that's in us. This new focus on competitiveness is regrettable if it ignores many of the qualitative aspects of economic life that have become important, if not central, to the functioning of our society. National decisions concerning clean air and water, hazardous substances, child labor, hours of work, the right to bargain collectively -- the list can go on and on -- can correctly be viewed as reducing our international competitiveness. Yet, few would suggest turning the clock back to a time of 10-year old workers, or unbreathable air. The real question before the nation isn't simply competition, but competition on what basis.

Here at home, business leaders have sought worker cooperation -- and by and large, they've gotten it, through a wide variety of creative agreements. In aerospace, in telecommunications, in transportation, the examples are legion.

But that cooperation was extended to only one type of employer -- the one the workers believe. To the extent the sacrifice and adjustment is shared and the venture is believable, workers will ratify new agreements. For the nation as a whole, then, it is reasonable to predict that creative agreements can be found to enhance competitiveness provided the government first proves its credibility with the action workers seek on foreign trade.

This is where Congress must exercise its responsibility to defend the national interest. Although sorely needed, tinkering with changes in trade law is not enough. The country needs more than a process bill. It needs legislation that recognizes the magnitude of our problem and implements recognizable steps to bring about that problem's solution. Anything less is just smoke and mirrors.

Attachments

Fact Sheet on Trade

U.S. Balance of Trade

In 1986, the U.S. trade deficit reached $174 billion, four times the level experienced in 1980. During this period, exports declined 2 percent with imports increasing 52 percent. The major component of this deterioration was manufacturing trade where the U.S. moved from a surplus of $17 billion in 1980 to a deficit of $113 billion this past year.

U.S. BALANCE OF TRADE
(Billions of Dollars)

	Merchandise* Trade Balance	Manufactured Goods Trade Balance	Balance on Current Account**
1980	- 36	17	2
1981	- 40	10	6
1982	- 43	- 7	- 9
1983	- 69	- 35	- 47
1984	- 123	- 83	- 107
1985	- 148	- 107	- 118
*** 1986	- 173	- 148	- 140

BILATERAL U.S. MERCHANDISE TRADE BALANCE
(Billions of Dollars)

	1980	1981	1982	1983	1984	1985	1986***
Japan	- 12	- 18	- 19	- 22	- 37	- 50	- 58
Canada	- 7	- 7	- 13	- 14	- 21	- 22	- 24
Germany	- 1	- 2	- 3	- 4	- 9	- 12	- 16
Taiwan	- 3	- 4	- 5	- 7	- 11	- 13	- 15
Mexico	+ 3	+ 4	- 4	- 8	- 6	- 6	- 5
Republic of Korea	---	---	---	- 2	- 4	- 5	- 8
Italy	+ 1	---	- 1	- 2	- 4	- 6	- 6

* Includes all trade in goods (agriculture, minerals, manufacturing products)

** Includes merchandise trade, services trade, investment income, unilateral transfers, military transfers

*** Projected

January 1987

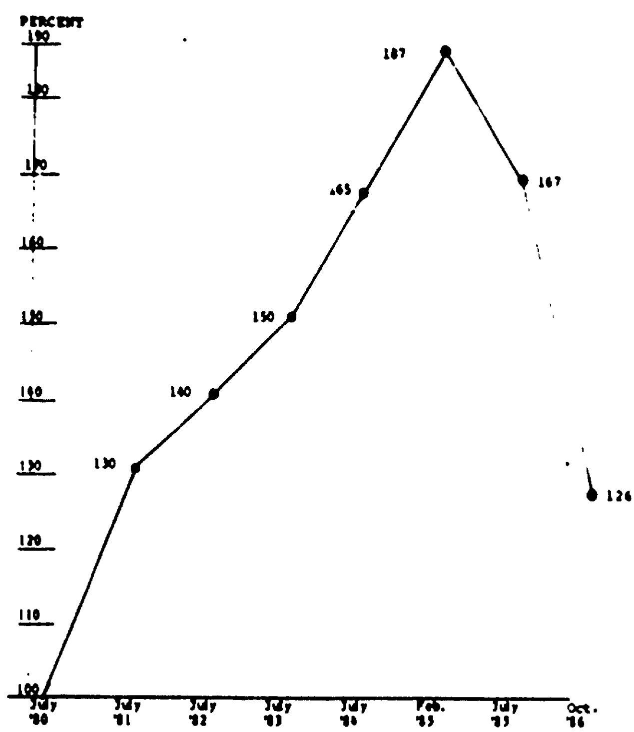
MONTHLY EXCHANGE RATES — October 1986
(Currency Units per U.S. Dollar)

	Oct. 1986	Feb. 1985	July 1980 *	% Chg Since Feb. 1985	% Chg Since July 1980
German Mark	2.01	3.30	1.75	- 39	+ 15
Canadian Dollar	1.39	1.35	1.15	+ 3	+ 21
Japanese Yen	156	261	221	- 40	- 29
Italian Lire	1,388	2,041	832	- 32	+ 67
Taiwanese Dollar	36.65	39.23	---	- 7	---
Korean Won	879	839	607	+ 5	+ 45

* Date of the lowest weighted-average exchange value of the dollar since exchange rates were allowed to float

In October 1986, the U.S. dollar on the Federal Reserve Index remained 26 percent higher against the currencies of our major trading partners than in July 1980. This is a drop of 32 percent from the peak reached in February 1985. It should be noted that the dollar has continued to rise against the Canadian dollar and the Korean Won, and has changed only marginally against the Taiwanese dollar.

Change in Value of the U.S. Dollar — July 1980* to October 1986
Trade Weighted-Average of Major Trading Partners - Federal Reserve Board



Senator MATSUNAGA. Our next panel of witnesses consists of Mr. Owen Bieber, president of the International Union, UAW, Detroit, Michigan; Mr. Lynn Williams, president, United Steelworkers of America, from Pittsburgh, Pennsylvania.

Mr. Bieber, we would be happy to hear from you.

STATEMENT OF OWEN BIEBER, PRESIDENT, INTERNATIONAL UNION, UAW, DETROIT, MI

Mr. BIEBER. Thank you, Mr. Chairman.

My name is Owen Bieber, president of United Automobile Agricultural Workers of America.

Mr. Chairman, I have a prepared statement that I would like to have filed in the record.

Senator MATSUNAGA. Without objection, it will be included in its entirety in the record.

Mr. BIEBER. Mr. Dick Warden, our Legislative Director, is with me here seated to the right.

I want to thank you and the committee for giving me the opportunity to come here this morning to testify. I want to say to all of you that we look forward to working with you and other Senators toward our shared goal of a U.S. trade policy that strengthens our economy and promotes the interest of America's working people.

There is no more compelling evidence of the need for a new trade policy than the incredible trade deficit our nation continues to accumulate. For 1986, the deficit almost certainly exceeded $170 billion. The impact on millions of workers, their families and communities, has been devastating. The toll of manufacturing industries with a deficit of more than $150 billion for 1986 has been especially high.

Try to imagine any other country in the world allowing this tremendous imbalance to occur. It is difficult because no other country would let it happen.

At the first sign of a significant persistent trade deficit, other countries mobilize their trade policy apparatus and develop strategies for restoring trade balance. Yet, in the U.S., when the UAW, the AFL-CIO, steelworkers and other unions, and representatives of a large number of industries spoke of the need to reassess our trade policy and focus attention on the growing trade deficit, we were attacked by the administration. We and our allies were branded with the title that is used to label anyone who questions the continued wisdom of a passive, unresponsive trade policy as "protectionists."

The world economy has significantly and permanently changed since the time when that term had any relevance to the reality of international trade. It has changed in ways that have made our current trade policy extremely dangerous to present and future economic well-being of our country and its people.

Evidence is mounting that the dividends of the misguided trade policy of this Administration include the increase in poverty, decline in family incomes, increased income inequality and the rapid erosion of the nation's industrial base.

The present trade policy is a failure and it must be revised now. The first priority of a realistic trade policy must certainly be a reduction in the U.S. trade deficit. The health of our important manufacturing industry is being undermined, and workers are being pushed out of good paying jobs into lower paid jobs, or worst yet, unemployment.

The U.S. must take the initiative to reduce its deficit and at the same time reduce the large worldwide surplus of Japan, West Germany, and others.

A proposal along these lines was included in the trade bill passed by the House last year. With a trade deficit even higher for 1986, the need for action is even more urgent.

Trade policy must go beyond the critical need to remedy the trade deficit and address the trade problems of individual industries. The domestic auto industry, for instance, is facing a sharp increase in imports from a variety of countries. Many of these vehicles are being imported by General Motors, by Ford and Chrysler. They are increasingly replacing U.S. production of small cars with what we call "captive" imports.

In addition, the vehicles assembled in the U.S. by Japanese companies contain imported engines, imported transmissions and many other parts not domestically produced parts.

The big three are also increasing their imports of parts, raising the value of imports still higher.

This combination of factors push the import share of domestic car sales over 28 percent for the first time ever in 1986, and the trade deficit for the auto industry over $50 billion. And these figures are certain to grow in the next few years, putting half a million auto workers' jobs at risk. Yet the administration has taken no position on the appropriate level of exports of Japanese cars to this country.

This blind indifference to the fate of crucial domestic industry must end. Despite a lot of Administration talk about opening up export markets, U.S. exports have stagnated since 1980. In real terms, they have fallen.

In dealing with the debt crisis in Latin America, the Administration chose to protect the interest of American banks at the expense of exporters. To generate funds for paying back foreign loans, the debtor countries were forced by world lending institutions with U.S. government support to severely restrict imports. And as the major trading partner of these countries, the U.S. has been hurt most by the cutbacks.

Again, the Administration's trade policy was passive when it should have been active in defending the interests of exporters.

Inasmuch as this Administration claims to be concerned about foreign unfair trade practices, it has opposed treating the denial of basic labor rights abroad as an unfair practice.

The current policy of ignoring the repressive labor conditions embodied in U.S. imports from countries with dictatorial governments is an affront to American workers and all fair minded people.

Mr. Chairman, the role of the trade policy in determining the future of the American economy is critical. Our trade policy should be, of course, for strengthening U.S. industries, improving living standards, increasing employment, and supporting equitable economic growth.

To succeed, the Administration must recognize the world as it is. Government intervention in the economy is the norm today, and the structure of industries with international markets is extremely complex.

To defend the interest of this country our trade policy must be flexible but tough. It must distinguish between the interest of multinational companies and the U.S. interest. It must look at long term as well as short term results. If we bring about these changes in trade policy, we will have taken a giant step toward assuring a stronger, more prosperous America for our children.

Thank you, Mr. Chairman. And when the time comes I would be pleased to try to answer any questions you or the other members of the committee may have.

Senator MATSUNAGA. Thank you very much. We shall now hear from Mr. Williams.

[The prepared written statement of Mr. Bieber follows:]

STATEMENT OF
OWEN BIEBER, PRESIDENT
INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE AND AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW)
before the
COMMITTEE ON FINANCE
UNITED STATES SENATE
on the subject of

TRADE POLICY

January 20, 1987

Mr. Chairman, my name is Owen Bieber. I am president of the United Automobile, Aerospace and Agricultural Implement Workers of America (UAW). We commend you for holding hearings on U.S. trade policy so early in this session of Congress, and I am pleased to have the opportunity to participate. The UAW believes that changes in trade policy are needed if we are to reduce the U.S. trade deficit and assure that international trade contributes to our objective of a diversified, full employment economy that produces an equitable distribution of income and expanding opportunities for workers. We are a long way from that goal today and every day of delay takes us even farther from it. That is why we consider this hearing so important and hope the Committee moves swiftly toward developing legislation to deal effectively with the problem.

The desperate need for a new trade policy is captured in a single indicator — the massive U.S. trade deficit. From $36 billion in 1980, the deficit has grown each year, until it now appears to have exceeded $170 billion for 1986. This ballooning figure is responsible for the loss of millions of jobs, especially in manufacturing industries where a 1980 trade surplus has fallen to a deficit of more than $140 billion. In automotive products, the 1986 deficit will far exceed $50 billion compared with an $11 billion deficit in 1980. The deterioration in the trade balance characterizes nearly all sectors of the U.S. economy, including agriculture and high technology industries. Millions of unemployed and underemployed Americans and thousands of depressed communities can explain their plight by pointing to the employment cutbacks and plant closings resulting from trade problems.

In nearly every industry, U.S. exports have stagnated, while imports have skyrocketed. Once strong U.S. exporting industries have seen their share of world markets decline, just as domestic industries have lost market share to the growth of imports.

The fact that Administration officials responsible for trade policy could allow this incredible trade deficit to accumulate is the most powerful argument favoring the need for a new U.S. trade policy. The UAW, along with other worker representatives and a variety of business interests, described the danger posed by our passive trade policy years ago, yet we were ignored by Administration officials.

Mr. Chairman, there are those who attribute the deterioration in U.S. trade performance to macroeconomic policy, exchange rates, and the insufficient international orientation of U.S. businesses. These and others point to the trade deficit as a sign of a lack of "competitiveness" in the world market. These explanations all have one thing in common — they minimize the role of U.S. trade policy in creating the severe problems of the economy and they demand no fundamental changes in the way the U.S. government interacts with foreign governments to regulate international trade.

In our view, all these explanations of the nation's international trade problem ignore the basic responsibility of those in the Administration in charge of trade policy — to assure that international trade helps achieve our national objectives for full employment and income growth. If macroeconomic policy is inconsistent with this objective, there should be a voice in the Administration making this case; if exchange rates are causing distress for U.S. producers, the cries of those adversely affected should be heard by the Administration; if opportunities for exports are visible, the government should facilitate taking advantage of them. Yet, even in these areas where the trade policy apparatus of the Administration could have acted, it failed to do so.

Where action has been taken, as with exchange rates, it has come only reluctantly because of intense public pressure and Congressional initiative.

The claim that U.S. businesses are not interested in foreign markets is especially irritating to those of us who have watched in anguish as American companies close domestic operations and move abroad. While many companies have joined this parade overseas only in the last few years of intensified international competition, the internationalization of production by U.S. firms has been going on for decades. These overseas operations have not only replaced U.S. exports, but they have in many cases replaced production for the domestic market with imports. Commerce Department data for 1982 shows that U.S. multinational corporations accounted for 46 percent of all U.S. imports and that, of that portion, one third was shipped from their own foreign affiliates. The foreign involvement of American firms is extensive. It has been used to build the profitability of individual firms, regardless of the consequences for American workers and communities.

In the auto industry, imports of assembled vehicles and parts by the domestic producers have grown dramatically in recent years and current plans call for continued increases. Cars imported by the U.S. based auto producers for sale under their own nameplates were only 6 percent of total car imports in 1984, but are expected to reach 20 percent in 1988. This will mean an increase in these "captive" imports from under 150,000 to more than 750,000 in only four years. They will be entering the U.S. from Mexico, South Korea, Taiwan, West Germany, Japan and Australia. The impact on American employment and production will be severe, especially in the small car segment, where most of these imports are concentrated. A similar process has begun in mid-sized and heavy duty trucks, as domestic producers bring in trucks from Brazil and Japan to sell as their own.

Mr. Chairman, I would like briefly to discuss another current explanation of the serious trade problems of American industries — that they lack international "competitiveness". On the one hand, the large trade deficit makes it painfully obvious that U.S. producers are having difficulty competing in international trade. On the other hand, simply saying this does not shed any light on <u>why</u> these difficulties exist. The number of specific proposals of those addressing this issue is extremely long, ranging from increased funding for foreign language study to changes in U.S. anti-trust and tax laws to changes in industrial relations and worker compensation. Many of these proposals have been poorly thought out, or are intended to achieve an objective that has nothing to do with "competitiveness". We believe many of the proposed changes in industrial relations fit into this category. Our support for additional investment by U.S. industry in this country and for additional funds for education are longstanding and pre-date the present initiatives. We will continue to support public policies and industrial policies that help our members achieve their individual potential while strengthening our economy, but these policies alone will not eliminate our problems in international trade.

While economic policies certainly have an impact on trade flows, the trade policy carried out by the Administration is the true indicator of how that Administration sees the relationship of international trade to the rest of the economy and the role of the U.S. in the world economy. Historically, the open U.S. market has been used to encourage economic development in politically friendly countries and to assure American firms that moved overseas of a market for their products. When the U.S. was far and away the world's strongest economy, the impact of the open market on domestic employment and production was small and demand for U.S. exports was strong. The Reagan Administration has ignored the changing world-wide situation, and has carried on as those before it — its trade policy is to keep the U.S. market as open as possible while seeking to open markets in other countries to a similar degree.

In today's world economy, however, the presumption that an open U.S. market has no important adverse impact on the domestic economy is both shortsighted and dangerous. The number of countries interested in, and capable of, exporting to the U.S. has increased dramatically, including developing as well as developed nations. Advanced technology and capital are exported daily around the globe to take advantage of low wage rates, tariff or non-tariff trade barriers, tax abatements, investment incentives and other government policies to attract foreign investment. In addition, industries abroad have been given government assistance in a wide variety of ways to stimulate growth in capacity much greater than domestic demand. The large and open U.S. market has been a consistent magnet for the production of these industries, including steel, autos, textiles and apparel, electronics and, most recently, semiconductors, personal computers, telecommunications equipment, petrochemicals and more.

These factors have contributed to the increase of U.S. imports from $253 billion in 1980 to $362 billion in 1985 and approximately $385 billion in 1986. Even with this incredible increase in imports, the Administration insists that there is no need to take action to defend the jobs of the millions of American workers displaced.

Because of its commitment to a wide open U.S. market, Mr. Chairman, the Administration has responded to the political demands for action on the trade deficit by focusing on expanding U.S. exports. This has taken the form of negotiations over a limited number of narrowly defined unfair practices that restrict U.S. exports and initiation of a new round of multilateral trade talks aimed at reducing barriers to expanded trade. The reason so many domestic interests concerned about trade have focused on eliminating unfair trade practices abroad is because the Administration has made it clear that that is one type of problem it may pursue. Despite the attention given to export promotion by the Administration, U.S. exports in 1986 will probably be lower than in 1980 in current dollars. Taking inflation into account, exports have declined substantially. In fact, government policies abroad limit markets for U.S. exports in many ways. The chances of substantially reducing U.S. trade deficits by a large and rapid expansion of exports are extremely slim.

The Administration has placed most of its trade effort on getting a new round of multilateral trade negotiations (MTN) underway and making certain that trade in services and investment issues, now uncovered by international rules, were included. The reasoning is that the U.S. has an advantage in service industries and could greatly expand such exports if barriers abroad were eliminated. Looking at the trade statistics for services reveals several important points: 1) services trade is made up of travel and transportation, proprietary rights (fees, royalties, profits on foreign operations) and business services — only this last item is the focus of Administration interest; 2) the U.S. surplus in business services was $3.6 billion in 1985, with exports of $7.6 billion — this hardly makes a dent in the $150 billion 1985 merchandise deficit; and, 3) business service imports are growing nearly as rapidly as exports — there is no reason to believe the U.S. surplus will grow substantially even with new trade rules. Unfortunately, the prospect for overall U.S. gains in the new MTN round are no better than in the services sector alone.

How, then, should we judge the trade policy of this Administration? There are some basic criteria we propose using: Has the policy improved employment levels and living standards? Has it enhanced the prospects for equitable economic growth? We believe that the Administration's commitment to concepts of the past, its laissez faire response to the problems of U.S. industries, and its ineffective efforts to convince foreign governments to allow open access to their markets, have contributed to a serious deterioration in U.S. economic capacity and potential, to an increase in poverty and a decline in family incomes, to higher unemployment than is warranted and to increased income inequality. A number of recent studies have shown that the proportion of middle-income families has declined and lower-income families increased, that many manufacturing industries have been badly weakened by import competition, lost exports and the serious problems of their domestic customers (farmers, oil producers, other manufacturers).

This is a failed trade policy, Mr. Chairman, and we need a new one if the future is to improve for workers, their families and their communities. And we can achieve this brighter future for Americans in a way that recognizes the legitimate aspirations of workers in poor and less developed nations: we can share growth, rather than pit one nation against another.

The first result of a realistic appraisal of American interests in the world economy would be a strong effort to reduce the worldwide U.S. trade deficit and the large worldwide surpluses of other nations. The current imbalance is widely acknowledged to be unsustainable and harmful to stable economic growth, yet the U.S. deficit continued to grow throughout 1986. Since the U.S. deficit is only the counterpart of the large worldwide surpluses run by Japan, West Germany, Taiwan and other nations, the solution is to reduce the imbalances in tandem. The fact that nearly all other countries of the world keep a tight rein on their merchandise and current account trade balances means that the passive policy of the Administration toward imports has concentrated the worldwide deficit (and the economic dislocation resulting from it) in the U.S., allowing movement toward greater international balance through U.S. action.

A proposal along these lines was included in the trade bill that passed the House in May, 1986. The Amendment sponsored by Congressman Gephardt would have forced nations with excessive surpluses with the U.S. to gradually reduce them. Since it ties this requirement to the unfair treatment of U.S. exports, the provision has the additional feature of improving the trade imbalance by encouraging the surplus nations to expand their purchases of U.S. exports, thereby increasing world trade.

We have described to this committee in the past the pain inflicted on workers in manufacturing industries by the worsening of the U.S. trade deficit. The sharp increase of the deficit in 1986, despite significant appreciation in the value of the currencies of some of the countries with large surpluses against the dollar, has only added to the number of victims and worsened their prospects for reemployment.

The rising indebtedness of the U.S. to foreigners adds further immediacy to the need for bringing the trade deficit down. The U.S. has surpassed Mexico and Brazil to become the world's largest debtor, creating obligations to make payments abroad for years to come. These payments are lost to the U.S. economy — they cannot be used to fund investment or consumption. The living standard of Americans will be lower as a result. Even when the annual trade deficit starts to decline, our foreign debt will continue to grow. Rapid action is needed to mitigate the problem.

The longer the U.S. trade deficit remains at the unprecedented levels it has reached in recent years, the more wrenching will be the process of restoring balance. The ability of U.S. producers to respond to opportunities for growth becomes further compromised by the continuation of shrunken markets and financial constraints. In our judgment, Mr. Chairman, action must be taken in 1987, and we look forward to working with your Committee to make certain that it happens.

Dealing with the immediate problem of the trade imbalance is only the first step in developing a U.S. trade policy that defends the interests of American workers. We also need new policies to respond successfully to the problems facing individual industries hurt by imports and those suffering from lost export markets. U.S. trade policy must, in both cases, attempt to strengthen domestic production, stimulate necessary investment and increase the stability of employment for workers in the industry.

The auto industry makes a good case study of how our trade policy toward industries injured by imports must be changed. In this case, as in most in which action is taken, the Administration was concerned only with heading off Congressional action to defend the industry from a sharp increase in the share of the domestic market supplied by imports. The Voluntary Restraint Agreement (VRA) negotiated with Japan in 1981 was an insufficient policy response in several respects: its initial three year duration was too short to permit an adequate reaction by domestic manufacturers to the increase in demand for small cars; the limit of a number of vehicles rather than a share of the market allowed imports from Japan to take a larger market share during the severe recession than was anticipated; Japan's exports of auto parts and trucks were not restrained, allowing the total automotive industry trade problem to grow, and; no specific commitments to U.S. investment and production were obtained from domestic producers in return for the restraints.

Because of these deficiencies in the VRA, the UAW sought legislation to achieve the objectives for U.S. trade policy noted above; the domestic auto content legislation would have done this. Its passage in the House in 1982 and 1983 was not, however, matched in the Senate.

When the three year term of the VRA expired, the Administration chose to negotiate only a one year extension. Following this, the Administration announced that the industry, as of early 1985, was on its own. But, by then, there was a new factor at work in the U.S. auto industry. One objective of the restraints, to convince a range of Japanese auto producers to build cars in the U.S., was at least partially achieved. However, the domestic industry is now facing another import crisis because of the failure of the Administration's auto trade policy to take into account the reality of the world auto market and the difference between the interests of the domestic industry (workers, parts producers, etc.) and the multinational U.S.-based firms that are its most important producers.

The world auto market outside the U.S. is characterized by government imposed domestic content requirements, local production requirements and import restrictions (high tariffs, informal restraint agreements with exporters, strict import quotas, etc.) By setting a relatively short period of restraint on imports into the U.S., the Administration was telling the U.S.-based companies that the U.S. would once again be the only open auto market and that it would be a target for the excess capacity of existing auto producing nations and the new capacity of countries aspiring to become auto exporters (South Korea, Taiwan, Mexico, Brazil, Yugoslavia, Malaysia, Australia).

This signal was not lost on the Big 3. They proceeded to use the absence of constraints on their actions, which they had insisted upon when the VRA was negotiated, to make arrangements to increase their own imports ("captives") of small cars and to expand their imports of parts, including engines and transmissions. The companies correctly anticipated an extremely competitive U.S. market in the post-restraint period, and they focused their domestic investment on their more profitable vehicles, thus ceding the expanding market for small cars to importers (including themselves). Because the companies could raise their own profits by selling imported rather than domestically produced small cars and by cutting costs through the use of imported parts and components, the companies have protected themselves from the inadequate trade policy of the Administration.

While the Big 3 have been protecting themselves by becoming importers, Japanese auto makers have built U.S. plants, or have plans to do so, for the same reason — to protect their U.S. sales and profits. The UAW welcomes these investments and the jobs for American workers they produce, Mr. Chairman. But we are disappointed at the low level of U.S. content in the vehicles assembled here. Unless the domestic content of these vehicles (transplants) increases, the higher level of U.S. production by Japanese auto companies will worsen the U.S. trade deficit with Japan and reduce employment in the domestic parts industry. Our own analysis shows that the total U.S. employment generated by a transplant facility is only one-fourth that produced by a traditional domestic plant, in which the vehicles include about 90 percent domestic content. We are anxious to see transplant production contribute to an improvement in our bilateral trade balance and to more employment opportunities for U.S. workers.

Taken together, the current trends in the auto industry will produce an import share of 35 percent and an additional share of nearly 15 percent for low U.S. content transplants as soon as 1988. This would leave a market share of only about 50 percent for fully domestic cars which, themselves, will contain a higher value of imported parts than they do now. The figures just released for 1986 sales show that we are well on our way to this result. Imports in 1986 accounted for sales of 3.2 million cars, for a market share of 28.3 percent, up from 25.7 percent in 1985.

The effects of these developments will be a serious erosion of employment in the U.S. industry. There are about half a million jobs in this industry at stake, nearly a third of current industry employment, as a result of the trade policy pursued by the Administration. This would produce untold hardship for the workers and communities affected, and reduce the size of an important, high technology domestic industry.

There is still time to prevent the unnecessary loss of these good paying jobs and the high value-added production the auto industry is responsible for, but there is not very much time. A reversal in U.S. trade policy is required. The Administration should negotiate restrictions on vehicle imports sufficient to defend the production and employment levels of the domestic industry. It must also assure that further investment in U.S. production, by domestic and foreign companies alike, takes place. Commitments by domestic producers to make those investments, though, must be an integral part of the restraints. A high level of imports would remain, but a competitive, strong domestic industry would also be maintained, providing needed jobs for American workers and keeping the industrial base of the nation sound.

This type of analysis of world market conditions and of the interests of U.S. firms should be conducted for all domestic industries facing serious import competition. The interests of American workers and the domestic economy must be assessed <u>before</u> imports or U.S. company outsourcing or foreign investment weakens domestic production beyond the point of recovery. Many essential U.S. industries (machine tools, semi-conductors) are perilously close to that point and a new trade policy is needed to preserve them.

U.S. export industries are in similar need of a trade policy that defends U.S. production and employment. The variety of barriers imposed by foreign governments against our exports has been catalogued by the Office of the U.S. Trade Representative for a second year and the list is extremely long. The vast majority of these barriers have been in place for years, yet they have been ignored by this Administration and previous Administrations.

Instead of actively pursuing the removal of tariff and non-tariff barriers to U.S. exports, Mr. Chairman, U.S. trade policy has, among other things, pursued investment treaties with our trading partners to make it easier for U.S. companies to invest abroad rather than to sell abroad. This approach may allow companies to benefit from supplying foreign markets, but it hurts American workers and domestic production capabilities in two ways: first, it replaces exports with foreign production, both in the country where the investment is located and in other markets formerly served by U.S. exports now supplied by the new plant; and, second, it creates new capacity for the company that is often shipped back to this country, replacing the domestic operation's sales to the domestic market. This is not a policy that promotes U.S. exports.

The Administration has begun to use the unfair trade practice statute of U.S. trade law to let other countries know what it considers unacceptable behavior in international trade. Unfortunately, the first set of self-initiated cases has covered problems that are not likely to set precedents to open up large numbers of U.S. job opportunities. Cases should be chosen for their domestic impact, not their public relations value.

There is one area of unfair trade practices, in which the Administration has opposed taking action, that should be used to set a precedent in defining unacceptable trading practices — the denial of internationally recognized worker rights. The American sense of fair play is violated when products made under repressive labor conditions are exported to this country and displace our workers. There are many countries around the world that have built an advantage in international trade by preventing workers from exercising the right to organize and bargain with employers, by failing to adopt minimum standards for conditions of work, or by allowing forced or child labor. The U.S. should officially repudiate any trading advantage obtained in this way and retaliate against the exports of such countries. Without a change in the current U.S. indifference toward the plight of workers abroad, trade policy will continue to be viewed with distrust by our members and all American workers. A provision, sponsored by Congressman Pease, to make denial of internationally-recognized worker rights an unfair trade practice was included in the trade bill approved by the House last year.

The Administration's treatment of industries that file petitions for relief from imports must also change. Under current law, an unnecessarily tough standard of injury due to imports must be met before an industry even receives consideration for trade relief. If a petition passes that hurdle, the President may refuse to impose quotas or higher tariffs to defend the U.S. industry. In the recent past, findings of injury to the copper and shoe industries were ignored by the President, and no action was taken to defend their declining U.S. production.

Mr. Chairman, we strongly believe that domestic industries deserve support from the government when imports cause serious damage. An industry that is found to be injured by imports should be assured of some relief through government action. The discretion allowed the President in current law has resulted in many industries that have lost jobs and output because of imports receiving <u>no</u> assistance from the U.S. government. The law also sets a standard of injury higher than that included in international agreements. The number of industries that even qualify for relief is minimized by this standard.

The purpose of trade policy in the area of domestic industry relief from imports should be to facilitate a strengthening of the industry in the context of the U.S. economy and the world marketplace. Present policy is to let struggling industries fend for themselves and assist only the small number that meet the stringent conditions of U.S. law or are able to generate enough political pressure to force the Administration to act. Companies left on their own have often made choices that undermine the U.S. industry, by moving plants abroad, purchasing imports to meet domestic demand, or giving up and going out of business, leaving the market even more open to imports. The Administration must take a more active role in shaping the economic future of America if we are to maintain our industrial strength.

Another Administration trade policy that has a double negative effect on U.S. production is its failure to take a firm position on the debt crisis facing a number of developing countries, especially in Latin America. This region has traditionally been a strong market for U.S. exports. The way the debt crisis in Latin American countries has been managed by the International Monetary Fund (IMF) and World Bank in conjunction with international banks — with official U.S. government support — has forced the countries to run large trade surpluses to generate the money to pay back the banks. To accomplish this, Latin American debtors have slashed their imports and stimulated exports. The U.S. is the primary trading partner of these nations, and our exports have been hard-hit by the cutback in Latin American imports; our industries have faced serious import competition because of the increase in their exports. American workers in agricultural and construction machinery, aerospace and machine tools have lost export jobs, and auto parts workers have lost jobs due to the increase in U.S. imports.

There is no U.S. trade policy that addresses the problem of Latin American debt, despite the fact that the program the Administration is pursuing amounts to protectionism for the bankers, assuring that they are paid in full, while hundreds of thousands of American workers lose their jobs because of the trade impact. This is a serious failing in current trade policy. A new trade policy should demand a fair distribution of the impact of the debt crisis that requires the banks to share in the burden. The Administration should, in general, be sensitive to the trade impact of any developments in world financial markets. Our trade policy should be flexible enough to defend the interests of U.S. producers as international financial conditions rapidly change.

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The UAW strongly believes that the purpose of trade policy is to set the standards for our international trade in such a way that trade benefits the U.S. economy and U.S. workers. Trade policy should not be an absolute statement of how the world ought to behave to achieve a textbook vision of "free trade" or "maximum efficiency". It should acknowledge the way governments and businesses in the world we live in behave and, understanding that, attempt to achieve the best results for Americans given that reality. Adopting this approach would, in itself be a remarkable achievement in changing U.S. trade policy.

Mr. Chairman, I have only touched on a few of the important trade policy issues facing our nation. The importance of redirecting this policy as quickly as possible toward defending U.S. employment, production and income must not be ignored. The health of our industrial economy and our standard of living depend on it. Significant changes in our domestic trade laws will be needed to realize this change and we look forward to working with your Committee to provide our ideas on that legislation.

Thank you, Mr. Chairman. I appreciate the opportunity to have shared the views of the UAW with you.

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STATEMENT OF LYNN R. WILLIAMS, PRESIDENT, UNITED STEELWORKERS OF AMERICA, PITTSBURGH, PA

Mr. WILLIAMS. Thank you, Mr. Chairman, for the opportunity to make a presentation to the committee this morning. Jack Sheehan, the director of our legislative efforts here in Washington, is here with me.

The 100th Congress has certainly demonstrated that national elections can have an impact upon national policies, or at least in prioritizing the issues upon which there should be a national response.

The Senate Finance Committee has already embarked on a search for a common ground to change our national trade policy. On the House side, H.R. 4800, "Comprehensive Trade Policy Reform Act of 1986," which passed the House by an overwhelming vote, has been reintroduced as H.R. 3 by the House leadership. All this has happened in an unprecedented fashion; namely, before the President's State of the Union message has been delivered.

I would like to think that such action portends not only the aggressiveness of the new Congress but is indicative of the gravity of the trade situation.

Last year, our union was an ardent supporter of H.R. 4800, and we again extend our support to that legislative approach because we are convinced that drastic remedial action is needed to correct the trade deficit of over $170 billion.

Today, the United Steelworkers of America testifies before you on broad trade issues, but we hope that we can return to respond to particular trade measures which your committee, it is anticipated, will shortly devise.

I would use my brief comments this morning to highlight a few points. I know that you realize that the USWA represents workers in an industry which has witnessed a devastating surge of steel imports, which contributed with failed economic policies to bring this industry from a peak production level in 1974 of 109.4 million tons of finished steel to approximately 71.5 million tons in 1986, and depleted the workforce from a level of 418,000 production workers to the current level of 172,000. Something is wrong. When the injury was sector specific, then perhaps the affliction could have been ignored. But now the malaise has affected all the trading components of the American economy. Mr. Chairman, misery doesn't need company, but company certainly commands attention.

First as to a consensus as to the problem. There is definitely a consensus that we are confronted with a trade crisis, the dimensions of which cannot be handled without direct intervention of the federal government.

Since 1981, our trade deficit has increased by some $130 billion. Even the Reagan Commerce Department, in its recent report, Performance in 1985 and Outlook, comments: "Current trade imbalances are not sustainable indefinitely and changes must ultimately occur, whether facilitated by coordinated trading partner actions or forced by other factors." We believe these "other factors" are legislative measures.

The political response from the Administration was that the international trade market was adjusting and that changes in the inflated dollar relevant to other currencies would bring about a balance.

The Administration insisted that the trade imbalances were not due to trade policies but to other causes. Up to now, it has resisted any change in trade policy, criticizing instead those who sought relief as being protectionists.

As late as October 1986, the abovementioned Department of Commerce report declared: "The fundamental cause of the widening U.S. trade deficit has been divergent macroeconomic policies and performance in the U.S. vis a vis its trading partners."

The problem was with other countries and American industry, not the Administration's trade policy. Steelworkers have watched imports rise from 15 percent of consumption in 1980 to almost 31 percent in January of 1985, around which time the ad hoc corrective action of the Voluntary Restraining Agreement was applied.

My point, Mr. Chairman, is that the trade deterioration has gone far enough. Market forces alone will not correct it. Congressional action is required.

Moreover, we are no longer engaged in international trade through a variety of national domestic markets. Commentators are constantly referring to the global market.

According to Peter Drucker in a Spring 1986 Foreign Affairs article: "These changes are permanent rather than cycle. We may never understand what caused them. The causes of economic changes are rarely simple. It may be a long time before economic theorists accept that there have been fundamental changes . . . Above all they will surely be most reluctant to accept that it is the world economy in control, rather than the macroeconomics of the nation-state on which most economic theory still exclusively focuses."

If that is the reality of today's trading environment, then we must revamp our trade laws and policies to reflect this new environment.

Consensus as to action. Our union would indicate that H.R. 3 represents a level of relief which could turn around the deterioration. We cannot simply declare that the problem is primarily one of decreased or suppressed U.S. export opportunities. I wish to emphasize this point because there is considerable public impression among those who are attentive to the crisis that the U.S. trade problem exists mainly in the inaccessibility of foreign markets to U.S. goods. Unfair trade practices which bar U.S. exports are viewed as a principal target.

While I do not denigrate the need to induce greater exports, the current trade imbalance and its impact upon American workers will not be addressed unless unfair trade practices in this market are corrected.

Despite the drop in the value of the dollar, U.S. exports continued to decrease in 1985 and slighly increased in 1986. Furthermore, the enormity of U.S. imports as compared to U.S. exports indicates that there must be a substantial reversal of the import flows.

According to the Commerce Department, "In 1985, U.S. goods imports, including oil, were almost 70 percent greater than U.S. goods exports. But even more significant, imports of manufactures—the goods produced by factories—were some $269 billion, almost 66 percent greater than U.S. manufactures exports."

Instead of focusing on the accelerated rate of manufactures imports (72 percent greater in 1985 than 1981), attention by the Administration was directed to lengthy export-oriented bilateral negotiations with Japan regarding specific commodities, the so-called MOSS talks. While results are yet to be measured, the expectations of U.S. export success pale when confronted with the magnitude of Japanese imports.

Frankly, Mr. Chairman, we have spoken out vigorously about the deindustrialization of America. The manufacturing sector has seen severe drop in employment. There is a little growth in jobs. Actually, we in the labor movement have been trying to devise plant shutdown legislation and displaced worker programs because we were unable to alert the general public to the seriousness of the problem.

Now, the realization of the problem is being acknowledged, especially the impact of trade. We must insist upon a very strong adherence to fair trade practices both in the forthcoming legislation and the new GATT Round. It is not enough to concentrate only on the export potential of the high tech industries and the service industries. We must confront the demise of our own domestic market for our manufacturing industries.

Reciprocity arrangement, while beneficial for export-oriented businesses, will not rearrange the trade deficit.

Again, the Department of Commerce report states: "There are, in fact, no other potential sources of improvement large enough to significantly offset the effects of continuing large manufacturing deficits . . . to achieve improved current account balances, U.S. manufacturers trade deficits must narrow sharply."

Our trade law must be able to respond to all forms of unfair trade practices and presidential discretion to withhold action should be restricted.

It is important that we acknowledge that the suppression of internationally recognized labor rights, while it involves human rights, creates an unfair economic advantage in world markets. Such suppression should be declared an unfair trade practice. Insistence upon compliance with fair trade practices cannot be considered as being an expression of protectionism.

Foreign competition, which is induced through subsidy and dumping practices, cannot be handled through normal marketplace principles. Simple reduction in prices cannot work in the long term. Yet, that is what industrial facilities and their workers are being asked to do.

Wage reductions do not result in competitive advantage but do cause a lowering of our standard of living. In steel, we have cut wages and have reduced capacity, but the threat of unfair trade remains without a strong trade policy.

Trade imbalance. We are, of course, concerned about the adverse impact that these enormous deficits are having in our own market. For steel, in addition to direct steel imports, approximately 7 million more tons enter the American market as indirect steel imports. Recovery in the manufacturing sector remains low. However, there is another dimension to the problem.

Deficits of these magnitudes cannot be sustained without having a devastating impact on the whole trading system. Some of our trading partners have become over extended and dependent upon our market for their manufacturing exports that sizeable changes can cause real problems.

The trade imbalance in the American market is not just an American problem. Nevertheless, if the adjustment process is to be less chaotic, then action must be undertaken now to reduce the deficits.

Again, Mr. Chairman, we do believe that legislative remedy is needed to prod the process.

Restructuring. A final point which I would like to make relates to the fact that our major industries are undergoing structural changes. For us in the labor movement, that unfortunately means loss of jobs. However, we do realize that unless the competitiveness of the global market is to be addressed, more American jobs and more American productive capacity will be eliminated.

Trade policy can make that process more disruptive or it can facilitate the restructuring.

In Europe, we have noticed that there has been a moderation of steel imports under the Davignon Steel Crisis plan so that a steel revitalization program can be pursued.

Our union recognizes that trade relief during a restructuring period should be conditioned upon the implementation of certain commitments by the industry, both management and labor. In fact, we have urged that there should be a coordination of various measures so that a more vitalized industry could emerge. Thus, for instance, we have strongly supported the current *quid pro quo* that accompanies the steel VRAs; namely, that the steel industry commit its resources to a modernization of its facilities. However, we would recommend that financial and governmental adjustment measures could accompany the period of trade restraint.

Our arrangement in steel is a very *ad hoc* approach. We would urge that Section 201 be revised so that restructuring industries might be able to obtain "escape clause" relief based upon a finding that inability to implement a restructuring or global competitive plan (developed on a tripartite basis) due to import penetration constitutes an injury. Enforcement of the trade restraint would be conditioned upon implementation of the plan.

Of utmost importance to any restructuring program is the necessity to establish a worker and community adjustment assistance program. Unfortunately, the Trade Adjustment Assistance program has been too eagerly criticized rather than improved. However, the scope of the problems confronting our workers and the rapidity of the structural changes being anticipated because of the emergence of the global market, we must couple our trade policies with an effective adjustment program.

I know that you already are aware that the so-called "exit costs", namely, certain contractual social adjustment programs for workers at idle facilities, like early pension and health care plans, are precipitating reorganization bankruptcies so that companies can shed their total pension liabilities. There are aspects of an adjustment or restructuring mandate which need to be reviewed. Otherwise, the bankruptcy route causes everyone to lose.

The USWA has, therefore, urged that a managed trade policy should be developed so that the readjustment process could proceed in an orderly manner.

We have recently concluded our collective bargaining sessions with the major steel companies. It was not a pleasant experience, but the union and the industry did try to adjust to the realities confronting the industry.

Wage adjustments were arranged so that the industry could have a lower employment cost obligation. Because these sacrifices have been made, it is our anticipation that the managed and reasonable trade market will allow the industry to recover its competitive capability. Extension of the VRA is an essential ingredient of that approach.

Additionally, Third World countries must recognize that export-led growth strategies are no longer viable. The trade market in certain products is overwhelmed with excess capacity. A managed trade policy would allow the necessary internal adjustment to occur so that such countries could develop their own domestic markets to absorb their productive capacity.

Mr. Chairman, we need a revision of our trade laws, but, most importantly, we need a new direction in our trade policy. Hopefully, the Congress can chart that course with cooperation from the Administration.

Thank you. And I would be pleased to answer any questions along with my colleague, Mr. Sheehan.

[The prepared written statement of Mr. Williams follows:]

STATEMENT

of

LYNN R. WILLIAMS
President

UNITED STEELWORKERS OF AMERICA

before the

SENATE FINANCE COMMITTEE

Trade Legislation

Washington, D.C.
January 20, 1987

The 100th Congress has certainly demonstrated that national elections can have an impact upon national policies--or at least in prioritizing the issues upon which there should be a national response. You, Mr. Chairman, have already embarked the Senate Finance Committee on a search for a common ground to change our national trade policy. On the House side, H.R. 4800, "Comprehensive Trade Policy Reform Act of 1986," which passed the House by an overwhelming vote has been reintroduced as H.R. 3 by the House leadership. All this has happened in an unprecedented fashion; namely, before the President's State of the Union message has been delivered. I would like to think that such action portends not only the aggressiveness of the new Congress but is indicative of the gravity of the trade situation. Last year, our Union was an ardent supporter of H.R. 4800, and we again extend our support to that legislative approach because we are convinced that drastic remedial action is needed to correct the trade deficit of over $170-billion.

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1. Consensus as to Problem

There is definitely a consensus that we are confronted with a trade crisis, the dimensions of which cannot be handled without direct intervention of the federal government. Since 1981, our trade deficit has increased by some $130-billion. Even the Reagan Commerce Department, in its recent report, *Performance in 1985 and Outlook*, comments: "Current trade imbalances are not sustainable indefinitely and changes must ultimately occur, whether facilitated by coordinated trading partner actions or forced by other factors." We believe those "other factors" are legislative measures.

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> "These changes are permanent rather than cycle. We may never understand what caused them--the causes of economic changes are rarely simple. It may be a long time before economic theorists accept that there have been fundamental changes. . . Above all they will surely be most reluctant to accept that it is the world economy in control, rather than the macroeconomics of the nation-state on which most economic theory still exclusively focuses."

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2. _Consensus as to Action_

Our Union would indicate that H.R. 3 represents a level of relief which could turn around the deterioration. We cannot simply declare that the problem is primarily one of decreased or suppressed U. S. export opportunities. I wish to emphasize this point because there is considerable public impression among those who are attentive to the crisis that the U.S. trade problem exists mainly in the inaccessibility of foreign markets to U. S. goods. Unfair trade practices which bar U.S. exports are viewed as a principal target. While I do not denigrate the need to induce greater exports, the current trade imbalance and its impact upon American workers will not be addressed unless unfair trade practices in this market are corrected. Despite the drop in the value of the dollar, U.S. exports continued to decrease in 1985 and slightly increased in 1986. Furthermore, the enormity of U. S. imports as compared to U.S. exports indicates that there must be a substantial reversal of the import flows. According to the Commerce Department:

> "In 1985 U.S. goods imports--including oil--were almost 70 percent greater than U. S. goods exports. But even more significant, imports of manufactures--the goods produced by factories--were some $269 billion, almost 66 percent greater than U.S. manufactures exports."

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Reciprocity arrangements, while beneficial for export-oriented businesses, will not rearrange the trade deficit. Again, the DOC report states:

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Foreign competition, which is induced through subsidy and dumping practices, cannot be handled through normal marketplace principles. Simple reduction in prices can't work in the long term. Yet that is what industrial facilities and their workers are being asked to do. <u>Wage reductions do not result in competitive advantage but do cause a lowering of our standard of living</u>. In steel, we have cut wages and have reduced capacity, but the threat of unfair trade remains without a strong trade policy.

3. <u>Trade Imbalance</u>

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4. Restructuring

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Our Union recognizes that trade relief during a restructuring period should be conditioned upon the implementation of certain commitments by the industry--both the management and labor. In fact, we have urged that there should be a coordination of various measures so that a more vitalized industry could emerge. Thus, for instance, we have strongly supported the current quid pro quo that accompanies the steel VRA's; namely, that the steel industry commit its resources to a modernization of its facilities. However, we would recommend that financial and governmental adjustment measures could accompany the period of trade restraint.

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Of utmost importance to any restructuring program is the necessity to establish a worker and community adjustment assistance program. Unfortunately, the Trade Adj tment Assistance program has been too eagerly criticized rather than improved. However, the scope of the problems confronting our workers and the rapidity of the structural changes being anticipated because of the emergence of the global market, we must couple our trade policies with an effective adjustment program. I know that you are already aware that the so-called "exit costs"; namely, certain contractual social adjustment programs for workers at idle facilities, like early pension and health care plans are precipitating reorganization bankrupticies so that companies can shed their total pension liabilities. There are aspects of an adjustment or restructuring mandate which need to be reviewed. Otherwise, the bankruptcy route causes everyone to lose.

The USWA has, therefore, urged that a managed trade policy should be developed so that the readjustment process could proceed in an orderly manner. We have recently concluded our collective bargaining sessions with the major steel companies. It was not a pleasant experience, but the union and the industry did try to adjust to the realities confronting the industry. Wage adjustments were arranged so that the industry could have a lower employment cost obligation. Because these sacrifices have been made, it is our anticipation that the managed and reasonable trade market will allow the industry to recover its competitive capability. Extension of the VRA is an essential ingredient of that approach. Additionally, Third World Countries must recognize that export-led growth strategies are no longer viable. The trade market in certain products is overwhelmed with excess capacity. A managed trade policy would allow the necessary internal adjustment to occur so that such countries could develop their own domestic markets to absorb their productive capacity.

Mr. Chairman, we need a revision of our trade laws, but most importantly, we need a new direction in our trade policy. Hopefully, the Congress can chart that course with cooperation from the Administration.

Senator MATSUNAGA. Thank you, Mr. Williams.
Going according to the early bird list, Mr. Rockefeller.
Senator ROCKEFELLER. Thank you, Mr. Chairman.
Mr. Williams, with respect to steel, you indicate that adjustments have been made on both sides and that there could be the possibility of a stronger future. Now there is a lot that seems to argue against that. Unfortunately, those of us who come from areas that produce steel see a soft worldwide demand and the way that some other countries—newly industrialized countries—are exporting to us apart from the voluntary restraint agreements.
My question is: The Carter Administration set up a task force that looked at what could be done about the steel industry in a broad sense. There was some feeling that although there were generous breaks given, some of the hard decisions which you referred to such as forcing management to invest in modernization to make the industry more competitive, simply were not followed up. In fact, some would say that was the weakness of the task force. It did not demand enough from management.
Now there is a new task force. In looking back over the past six years or so, what do you think could have been done by government, by management, and by labor that could have put steel in a stronger position?
Mr. WILLIAMS. Well I think, first of all, it would have greatly enhanced our opportunities to cope with all of these difficulties had we been able to maintain the tripartite approach to which you refer at the end of the Carter Administration.
We worked hard to persuade the Reagan Administration to continue with such an approach. They ultimately established the Steel Advisory Committee. Again, it was remarkable the extent to which the three parties involved, despite the deep, I suppose one could say, idealogical gaffs, were able to arrive at practical consensus about things which might be done. That committee disappeared then into history, and now we have the task force which, of course, is not a tripartite arrangement.
I think had we had throughout this 6-year period a continuing coordinated effort among industry, labor and the government to assess, to analyze, to address the problems, to attempt to put policy approaches in place, and to implement such policy approaches, I believe we would have been able to make a significant difference in things which had happened over this period.
Undoubtedly dealing with the trade crisis is, however, at the heart of the issue. And we never were able to deal with it vigorously enough. We had the trigger price mechanism which did some things, failed in other areas. We then pursued vigorously the idea both through legislation, through the Fair Trade in Steel Act, and also through a Section 201 petition, Bethlehem Steel and ourselves, pursued the idea of global quotas. We didn't succeed in that. The response to that from the Administration was the voluntary restraint agreement program. Its weaknesses are apparent. It has never been able to achieve its objectives. In fact, the last monthly figures we have in November show import penetration soaring again to something like in excess of 28 percent of our market. It doesn't succeed because it is not global because it does not deal with the entire problem. It deals with some piece of it.

I would quickly add that if we did not have the voluntary restraint agreement program I am sure things would be infinitely worse if one could imagine that. Our estimates are that instead of import penetration, annually in 1986 it works out currently at about 23 percent of the market. Instead of that kind of penetration, we would be sitting here discussing 35 or 40 percent penetration.

I don't know how to find words enough. It has been devastating. I guess that would have been total, total, total devastation or something of that kind of the steel industry.

So the major failure has certainly been in the area of dealing with the trade crisis which has escalated throughout the period. But I think had we had a more planned approach dealing with the investment needs, dealing with the modernization needs, dealing with the connection between those things and trade policy, we would certainly find ourselves in better shape as we enter into 1987 than we currently are.

Senator ROCKEFELLER. But you would strongly feel that any trade legislation ought to include a requirement that in order to receive continued protection, the industry must make the investment. In other words, it would be the opposite of what U.S. Steel—now U.S.X.—did, in making its commitment in areas other than steel. Is that not a fair tradeoff to request?

Mr. WILLIAMS. Our position has been in support of modernization throughout. We did not support the presentation of the Fair Trade in Steel Act until it included a modernization provision. And we have in our settlement the other day with U.S.X., why we have addressed this problem at the collective bargaining table, and a part of that settlement is a legally binding commitment from U.S.X. that they will put a caster in LeMon Valley; that they will modernize other facilities in LeMon Valley, in the Pittsburgh area; that they will continue with the modernization of their facility in Fairfield, in Birmingham, in Alabama; and that they will maintain production in some other facilities.

So we have attempted, which is not a very appropriate mechanism for attempting to deal with such problems. We have attempted even to use the collective bargaining process as a means to get at the needs to modernize the steel industry.

But I don't think we should go too far down that path. I mean, we should do all we can there. But we could have a very modernized industry, and without addressing the trade question still be in enormous difficulty. There is simply no way we see that there can be fair competition between the steel industry and the United States, however modern, paying anything approaching decent wages, and providing a decent standard of living in the United States, however defined, that can compete fairly with an equally modern industry in places like South Korea with labor costs of two or three dollars an hour.

We simply, as a nation, must face that circumstance, and must work our way through a resolution of that issue. To simply go by the textbook definition of "free trade" and permit goods from such facilities and such countries to flood into America is simply to destroy our industrial base and we see that happening day after day.

Senator ROCKEFELLER. Mr. Williams——

Senator MATSUNAGA. The time of the gentleman has expired.

Senator ROCKEFELLER. I'm sorry.

Senator MATSUNAGA. Senator Riegle.

Senator RIEGLE. Thank you.

Let me start out addressing you, president Bieber. Certainly we have worked together over a long period of years on problems facing the auto industry and, very particularly, auto workers. And while this trade invasion is still out of control, and with imported cars being the largest single item in the trade deficit in terms of the volume of the deficit, there is some good news. And the good news is is that we have managed to raise productivity in the auto industry on the average of 6 percent a year over each of the last six years. That is twice the rate of improvement for manufacturing overall, and it certainly is in line with the long history of the United Auto Workers in terms of being prepared to take those steps that are necessary to increase productivity. So we are seeing those kind of productivity gains. It doesn't necessarily answer all the questions raised by Senator Chafee about how our products—the end product, the cars we producc—are being viewed. But I think in that area also we are making some major progress.

We have got some distance to go. I would like to ask you what your assessment is at the moment of the volume of foreign cars still coming into the United States. Now Korea has become sort of a new Japan in the sense that they have the hottest selling, if you will, new foreign import in this market, but we have got cars coming in from Communist countries now, Yugoslavia and others, into this market.

And I am wondering, as you assess the current level of volume of foreign cars coming in here, and the overall rate of that penetration, how serious is it at the level it is today? How do you see the trend lines, and what light can you throw on the point if these percentages continue to rise, that we are likely to see the structure of the domestic auto industry damaged in new ways that we have not yet seen?

Mr. BIEBER. Well let me answer your question this way, Senator. First of all, 1986 has been herald as a record sales year in our country. We sold a lot of automobiles. But I would like everyone to recognize that under those conditions domestic units are down 400,000 in 1986.

Ford Motor Company, who has been hailed as making a lot of money in 1986—indeed they have—lost seventh-tenths of 1 percent of their market share from 1985. General Motors is down 1.6 percent.

Now lets look at the other side of that. Imports in 1986 took 28 percent of the market. That is up from 25.3 percent I think in 1985. All the projections that we have before us I think clearly show that unless something is done, we are going to see that market share, that import market share rise in 1987 to about 32 percent of the share of the market. You can see it projecting upwards.

We have at the present time in this country a 2 million unit idle capacity. That, Senator, will be theoretically reduced by the announcement of General Motors to close 11 plants. Three of those plants are in your home city. And Michigan hit very hard. The rest of them Ohio and across the country.

If we project what is happening to us, and that is assuming that the voluntary restraints that are now in place continue, if you take a look at what is happening as a result of the so-called transplants—these are primarily at the moment Japanese plants, but, of course, the Koreans are coming—we will very shortly have in this country the capacity of 4 million excess units. And that simply means if that happens, we are going to put 15 additional assembly plants at risk in this country. I will put it a little bit more bluntly. You will close another 15 assembly plants.

Senator RIEGLE. How many people would that likely involve, just in rough numbers? How many more people would be laid off as a result?

Mr. BIEBER. Well if you took 15 plants, assembly plants alone, and took an average of the most modern and intermediate, you would be talking, if you are talking 2-shift plants, you are talking 6,000 people per plant.

Let me also point out that when you hear the announcement of General Motors closing 11 plants and that affecting 29,000 people, you have to take into consideration the ripple effect. And the ripple effect is going to mean something in excess of 50,000 people, 50,000 people.

Senator RIEGLE. Who will lose their jobs.

Mr. BIEBER. That's right. All of those people are not, of course, within General Motors. They are in supporting industry: the steel industry, textiles, electronics, you name it.

Senator RIEGLE. My time is up.

Senator MATSUNAGA. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman.

I would like to ask both of you to respond to a question I asked earlier, and that is, to what do you attribute the enormous shift in the relative trading position of the United States in just the past six years from a position of a very modest trade deficit to now one that exceeds $170 billion? What in your mind are the principal factors? Have other countries enacted protectionist measures? Have American workers become suddenly less competitive? Are there other factors? I would ask each of you to address that briefly, please.

Mr. BIEBER. Well if I may start this out and turn it over to my colleague. First of all, I think Senator Riegle's opening statement relative to increased productivity in the auto industry speaks for itself. We have had phenominal growth.

I think very bluntly, Senator, the problem is simply that over the last six years we have had what I term a very passive trade policy. A thumbnail description of that is, we have done really nothing. We have let everybody come in who chooses to come in, take whatever piece of our market that they choose to take. We have done a lot of talking about opening their markets in return, but the record speaks for itself. It has not resulted in that kind of a situation.

At the same time I would point out to you that in the case of automobiles, if you look around the world, everyone else has taken measures to protect that auto industry because they realize the importance of that viable auto industry to their well-being, to the well-being of their economy. And you can go across the entire world, and I know somebody will say, well, for instance, West Germany doesn't really have that kind of a set quota. Well, just look at the record. They do have. They rely upon the Commonwealth countries. If you look at from Mexico, to Italy, to France, to the U.K., where it is granted, there isn't a set figure, but look at the figures. Every time the penetration of that market in the U.K. exceeds 11, 12 percent, somehow miraculously the ships veer off from the U.K. shores and they come to America, because they are told if you don't do something about keeping it within that limit, we are going to enact some tough legislation.

So, Senator, my answer to your question is simply because we have had a passive trade policy, and we haven't stepped up to the responsibility of protecting the future of America and the future living standards of America.

So while I get very perturbed about other countries coming in and unloading on us, I must say we need to look in the mirror. And it is our responsibility, all of us, to see to it that we take action that will, in fact, guarantee a decent future for America. And there is a whole lot more we can get into, and that is the whole idea of basic industry that has left our shores, and not only our ability as that industry flees to provide a decent living standard, but we better take a look at being able to provide the safety of this country because I am alarmed at that.

You know, when you don't produce engines, and transmissions in America, then you don't train technicians to build those transmissions and engines either.

Senator MITCHELL. Mr. Williams.

Mr. WILLIAMS. I concur, obviously, and agree very much with the way Owen has described the circumstance. I suppose the way I would put it is to say the same thing somewhat differently is that it seems to me that what has happened is that faced with economic development generally, and then the energy crisis, that both the developing countries and the developed countries, to a greater or lesser extent, adopted what I would describe as the Japanese model, and what Mr. Kirkland described earlier today as the merchantilist model of dealing with their economic problems. A model based on developing export specialties of one kind or another focused at the American market, the largest available market in the world, combined with some mix of restrictive policies in terms of entry into their own market, either tariff barriers or quota barriers or non-tariff barriers or some mix of policy.

I think that became seen as the way in which other countries in the world could deal with their problems. I think it was encouraged, for example, by the International Monetary Fund. When any country got in trouble, the IMF would arrive with a package of assistance. Inevitably that package of assistance involved saying to the country—Brazil is a good example—that you must focus your policy on exports. You must develop a steel industry and ship steel to the United States, for example, and you must restrain import flows one way or another in order to get your own circumstance in balance. Many other elements in that.

Our financial community had a stake in those kind of developments because they had bad loans out there that they made on the basis—they have never been willing to make any loans to me, let me tell you, over the years—and they needed some houses to make sure those loans were protected. So they would go along with such policies. And this combination, I think, has been focused on the American market as the market that is going to save the world. And steel and Europe, for example, Owen talks about automobiles. The European community has restricted steel imports of about 10 percent, a little less than 10 percent of their market over all of these years, and yet has raised the flag of protectionism in retaliation on all the rest of it any time we have approached or discussed their actions and their actions in relation to our market.

We, as Owen said, simply failed to respond to that situation. Or our response has been in preaching to the rest of the world. Let's go do it the other way, fellows. Let's all practice free trade according to the American model. The rest of the world will politely say sure, let's meet, let's talk, let's agree, and we will do this, we will do that. But nothing ever happens. And meanwhile, the crisis becomes greater and greater. We need effective active trade response to the reality with which virtually the rest of the world is approaching our market.

I don't think I am paranoid on that subject. I think if you look at any developed country, almost without exception, and any developing country, you will see elements of that approach to the current situation. We simply need to respond realistically to that.

We are not for a minute preaching that the world should quit dealing with each other. We are not for a minute talking about Smoot-Hawley and building a wall around America pretending that the rest of the world isn't out there. But we say we need a trade policy that recognizes that reality, and manage these trade flows in a way in which American workers and American industry and the American society has an opportunity to grow and to prosper along with the rest of the world. That is really as critical to their interest as it is to ours. And however much they may object to actions we take, if we don't protect the standard of living in America and don't protect the market in America and don't retain our ability to produce things and to develop the talents that are necessary for production in America, why the rest of the world will go down with us.

Senator MATSUNAGA. Mr. Heinz.

Senator HEINZ. Mr. Chairman, thank you.

I suspect that Owen Bieber and Lynn Williams know this, but at the conclusion of World War 11 the United States accounted for 25 percent of the free world's gross product. Today we account for just a little over 20 percent of the free world's gross product. And yet today we accept a disproportionate share of everybody else's exports. Forty percent of all of Korea's exports; 40 percent of Japan's; 50 percent of Taiwan; 80 percent of Canada; 58 percent of the LDCs.

We have been the engine of growth for the free world ever since World War II. And you could say that it made a lot of sense back in the 40s and 50s for us to do that. But now some of the countries that I mentioned have higher standards of living than we do.

My question to Lynn Williams deals with the steel industry and the variety of proposals that the committee has been looking at—and I think they are all good proposals. And in both Owen Bieber's testimony and yours, Lynn, you mention the need to take a tougher line on unfair trade practices, to extend the steel VRA, to improve worker and community adjustment, to restructure Section 201. I have a question for you later about that if there is time.

But the steel industry right now is facing a continuing and maybe even deepening crisis. With the restructuring of LTV because of bankruptcy industry analysts estimate that the company will be able to reduce the price of its steel $80.00 a ton now that the company has shifted roughly $2 billion on to the PBGC and lots of other liabilities to suppliers and workers. That suggests to me that other steel companies, unless we do something about it, will be forced to follow the LTV example if they are to survive.

Now speaking for myself and I think a good many others, the prospect of a further wave of bankruptcies, layoffs, plant closings, dumping of liabilities on either the government or small suppliers who can ill afford it is to be avoided by almost whatever it takes. And my question is, is there enough in this legislation that is going to help us avoid that or do we have to look elsewhere?

Mr. WILLIAMS. There is not nearly enough in this legislation to deal with the crisis in the steel industry specifically. The way we put that group of concerns, that group of emergency concerns to the President's task force was to suggest to them that it would make a great deal more sense for the Administration and the government generally to get out ahead of this problem rather than to stand back and let the problem continue to develop.

Somebody is going to have to pay for it in the end anyway. And the government, the people of America, if there is to be a steel industry in America, are going to have to ultimately deal with that crisis if the scenario unfolds as you have described it. And we think rather than pay the money at the back end, as you will after the crisis develops, and then try desperately to deal with the PBGC concerns and desperately to deal with the worker adjustment concerns, and deal with the devastated communities, and find welfare resources to look after the people whose lives will be destroyed, and all the rest of it, it would make a great deal more sense to get out ahead of it. In our view, the way to get out ahead of it is, first of all, to do something steel specific about these exist costs, about these PBGC concerns and all the rest of these pension costs, to find a way to deal with that in terms of the steel industry alone, and separate it out from the rest of it rather than distort the entire PBGC process, if you will, because of the devastation that is going on in the steel industry.

Senator HEINZ. Let me——

Mr. WILLIAMS. I'm sorry.

Senator HEINZ. No. I didn't mean to—I am just worried about this yellow light, and I just need to get a follow up in.

Mr. WILLIAMS. All right.

Senator HEINZ. There is no telling when the next train is going to leave the legislative station. I said earlier when Lane Kirkland was here the Administration needs the multilateral negotiating authority that will be a part of the trade bill. There is no guarantee that they will need steel restructuring legislation, per se. Maybe they will, maybe they won't.

My question is whether you think the restructuring legislation—and I use the term as a kind of a catch all for what we have been discussing—should be a part of this trade legislation which we hope to report in a month or two?

Mr. WILLIAMS. If that provides a mechanism for something to be done quickly, Senator, I would be enthusiastic about it. I think it is a crisis that demands attention. And you are the experts in terms of the legislative process, not me. So if there is a way that that can be dealt with more quickly, that is the most urgent need facing everyone involved in the steel industry, workers, and corporations and the like.

Senator HEINZ. Thank you. My time has expired.

Senator MATSUNAGA. Senator Danforth.

Senator DANFORTH. Gentlemen, I apologize to everyone for not being here the whole morning, but the Commerce Committee is holding hearings on the question of competitiveness, and just try to cover two committees holding hearings on basically the same problem is a challenge.

Let me just put one fundamental question to you. I would like your advice as to what course we should try to follow in Congress. It seems to me we have two basic choices. Either we can take the position that basically the U.S. can compete; that we can compete in international markets; that we want to compete in international markets; we want to trade. We can take the position that if the value of the dollar continues to be relatively low, that if we toughen our stance against unfair practices, that if our people are well trained, that if we have tax policy which encourages competitiveness, we can compete. Now that notion that we can compete if we really want to is I think covered by the word "competitiveness" which is the great buzz word now. That is one approach.

The other approach is to say that competitiveness really isn't what we want to do. That is really not the goal we want to pursue. We don't really believe that America can compete, and we think that we should adopt policies which basically are aimed at protecting our markets.

Now if we go the former route, you know, you might have a hundred different ideas of what to do about increasing competitiveness, and some of them might be acceptable to the Administration, some might not be. But at least we would be in the legislative process and going somewhere. There would be at least some possibility of working out legislation that would, in fact, be competitiveness legislation on which the Administration might be able to reach some compromises and accommodations and which would actually lead to legislation that would be in the statute book.

If, on the other hand, Congress is to adopt the second strategy that competition is something we don't think we can do very well under any set of circumstances, and therefore we want to go the protection route, I think that it is certain that any legislation that we would pass would be basically a campaign document. In other words, it would set up a debate in the 1988 Presidential campaign, but it wouldn't lead to real legislation in the meantime.

And my question to you two is, which of the two courses do you think that we should pursue?

Mr. BIEBER. Senator, if I may respond, first of all. Let me say that I, too, read the papers and I hear all of the use of the buzz word "competitiveness." Let me first of all say to you again, and I have said this many times before. I have said it to this committee before. I am not one who wants to shy away from competitiveness, but I think we have to be careful how we define that, and we have to recognize that we cannot solve our entire problem simply by using the fancy word, "competitiveness." Let me give you a couple of examples.

We have used the figures here already of increased productivity that we have witnessed in the auto industry, but certainly I don't think any one of us wants to be put in a position where we say the only way that we can compete, and if I can use as an example is to meet, for instance, the wage level of South Korea. Let me point out that we are asked to compete against them with the intrusion of that corner in the market. And I might point out it took the biggest share of our market in a single year of any entity. And you have only seen the entity from Hyundai. You are now going to see it very shortly from Daywoo, 50 percent owned by General Motors, importing a car for General Motors, a plant in Korea which has the latest technology in it. We don't have anything here in our General Motors plants that they don't have. The difference is that because the workers' rights there are trampled upon, the average wage in that auto plant is $1.54 an hour. If you look at the assembler, it is $1.94 an hour.

Now, Senator, we can't compete just straight out on that. On the other hand, I take no back seat for the advances that we have made in our industry in competitiveness and we continue to do that.

I don't think it is a question of one or the other. I think we need to look at both. But I think it is absolutely essential that when you look at a trade policy now, two very important things, deficit reduction, and I think you also have to look very seriously at trade deficit reduction.

Senator DANFORTH. Trade deficit reduction or budget deficit reduction.

Mr. BIEBER. Trade deficit reduction and workers' rights.

Senator DANFORTH. Thank you. Mr. Williams?

Mr. WILLIAMS. I share the view, Senator, with great respect, that I think you pose the alternatives too starkly or they suggest too simple a solution, that we can go one path or the other. I don't think the real world really works that way. I think, particularly today, that the real world requires us to go the one way in some areas and the other way in other areas.

If you will, to adopt something like the pragmatic policy that other countries around the world have adopted that are causing us this kind of difficulty. There certainly are areas where we can be competitive. There are areas in which we have been out in the leading edge of competition and have seen others then come and destroy our lead.

There are some areas in which in current circumstances it is almost impossible to imagine our being able to maintain a level of competitiveness, and yet in areas in which are vitally important to the maintenance of a modern industrial economy and the development of a better future.

What we desperately need, Senator Heinz made reference to the post-World War II situation, where we had a very imaginative national policy in the United States supported with an international policy, with support in other countries, that dealt most effectively with the circumstances at that time, and created prosperity in the United States and provided prosperity in other countries in the world as well.

What we desperately need is to find some leadership and some statement with the kind of imagination to put together a plan, a trade policy, an international policy, if you will, which can provide the same kind of opportunity at the end of this century and on into the next. All of the growth in economies around the world, all of the development that is going on, should be the means for prosperity, both for them and for us. And what seems to me has happened, we have got ourselves trapped in a policy in which all the negatives come to the floor, and all the destructive elements come to the floor, and all of the impossibilities of competition in dealing with these matters come to the floor, and we are somehow losing track of the positive side of that.

We need a judicious mix of policy which looks after and maintains the basic strengths of the American economy and the American standard of living, and in coordination with others, provides the basis for which to move forward across the world.

So it isn't just dealing with protecting some industries and advancing others. It is a matter of putting that together in an appropriate mix of policies.

Senator DANFORTH. My time is up. I would just say I certainly don't think the game is being played well or the game is being played fairly today. But I do think that we have to face up to the question of whether we want to play it. And I don't think that that basic issue can be finessed. I really think that the fundamental question before us or the country is whether we truly want to compete in international markets. Either we do or we don't. For most of our history, we didn't. For most of our history as a country, we didn't try to, we didn't have to, we didn't want to. International competition has been—international trade has been a recent phenomenom for the United States. And maybe we want to go back to our historical origins. I don't recommend that, but I think that maybe that fundamental question is one that should be asked before we start embarking on the direction of pursuing what we call competitiveness.

Senator MATSUNAGA. Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Gentlemen, I would like to follow up somewhat on the line that Senator Danforth just pursued, and to some degree, Senator Mitchell earlier.

I frankly think that there is no choice in the question posed by Senator Danforth. We have to compete in international trade. The figure I hear is 75 percent of the goods and services we produce in America is involved in international competition. The fact is we have to compete.

The real question is, it seems to me, in what way?

Senator Mitchell posed a question about, and to some degree, so did Senator Danforth, that is, to what degree are the problems we have due to unfair foreign trade practices. That means we have got to get tougher and knock down those foreign trade practices. On the other hand, to what degree is our problem due to failure of America to take care of its problem on its own? Just out and out hustle.

The question I have for each of you is, to the best you can quantify the degree to which our trade deficit is due to unfair foreign trade practices. I will include failure of countries to respect worker rights, for the sake of this discussion, as an unfair foreign trade practice. On the other hand, to what degree is our trade deficit attributable to our failure to pay attention to foreign markets, to try to sell overseas, to try to design products that the Japanese and other people may want to purchase, to the failure to pay attention to quality, failure to pay attention to all the things that have to be done just to hustle harder, and better and smarter in order to sell a product?

So the question is, I would like you to quantify the best you can—I know it is difficult—but is one-half the problem due to foreign unfair trade practices? Is three-quarters of the problem due to unfair foreign trade practices? Or what portion, to the best of your ability, is our trade deficit due to unfair foreign trade practices?

And I say that in part because—I asked the question in part because, as we all know, it is easy for human nature to criticize the other guy. It is his fault. It is very easy for us not to look at ourselves and ask ourselves to what degree are we a part of the problem? To what degree can we contribute to the solution? So I am curious in your sense of honesty now because we haven't got a lot of time here because we have got this big trade deficit facing us. So honestly to what degree do you think the problem is attributable to our failure to get out there, and hustle, and compete, and pay attention to quality, and education, and research and development, all the things we have to do? On the other hand, to what degree because those done by other countries are just unfair.

Mr. BIEBER. Well, Senator, if I might, I don't know what percentage to pick out of the air.

Senator BAUCUS. Just a rough guess.

Mr. BIEBER. Well I don't want to do it that way. Let me just answer your question, I hope, that the answer will give you a little bit of insight and you can pick your own percentage.

First of all, I again say that the auto industry has been very competitive. I mean it has continued to increase its competitiveness by the increase in productivity that we have been able to bring out of the auto industry.

On the question of quality, you know, if you go back to 1980 and before that, I think we produced a lousy car. And why did we produce it? Because the emphasis was not necessarily of quality. If the person didn't have the car that they ordered on the first day the new model was, they didn't ask you about quality, they just wanted to know why they didn't have that car. So that the whole design, the method in which we build the car has been tremendously changed. And I think today we have a high quality American car. Does that say it can't be better? No. Obviously it can be and it should be.

We have a situation where the competence and the intrusion in our market, we have a voluntary restraint agreement which is still in place at 2.3, arguing to hopefully get that continued. I say it ought to be reduced. In the meantime, we have had the so-called transplants that have come to our country bringing huge amounts of preassembled work in which puts greater pressure on our market.

Look at the area of competitiveness. The problem that we are put up against is not just to sit down. And believe me, my union has done that. We have more joint programs going today than any time in our history. There is very few of our locations where we do not have them. We have situations where the worker sit down and reduce the price of a product that comes off the board from $70.00 to 10 or 12 dollars, and in response to that we don't get the investment from our own domestic company here, or the multinational company, I should say, here, but which now taken overseas to a low wage country, and with that goes all of the development, all of the R&D that we have put in, to reducing the cost on that product.

So we are in a catch 22 in this whole argument of competitiveness. We sat down, we worked out ways to be competitive, and the next day you get up and the competition that you are now competing against is an arm of that same multinational company located somewhere now, Malasia, Korea, Vienna, Austria, and it's now our new competition that we just built. And it is very, very hard to compete under those types of conditions. I don't know what all we have to do.

I know one thing. We cannot continue the route that we have been on unless we want to destroy, literally destroy the American way of life. That is what we are doing.

Senator BAUCUS. Mr. Williams.

Mr. WILLIAMS. Well I wouldn't know how to quantify the part of the problem that's due to one ferry import. It is clearly a major part of the circumstance. And the new change in the new kind of economy we face is a big part of it too.

Let me simply say that we produce steel in America with fewer manhours per ton than anybody else in the world. And by that basic test of how competitive workers in the steel industry in the United States out there in the factory floor are, they now lead the world. They lead the world despite the fact that the percentage of continuous casting isn't as high here, although we are catching up rapidly with everybody else in the world. But despite what technological deficiencies there may be, as compared to the Japanese or the Europeans, we are in fact the most productive. We have the most productive workers in the world right now. So that, alone, clearly isn't the answer because finding ourselves in that circumstance hasn't solved the problem. And that surely goes to the question of unfair trading practices and all the rest of it.

The reality of the world economy, of course, which Owen has described in specific terms in the auto industry, is another reality that needs to be faced. All of the classical economic theories about free trade were developed in terms of nation-states competing with other nation-states. We now live in a world where capital is totally mobile, goes anywhere else where it chooses to go in the world; where management is totally mobile, can apply its management skills anywhere in the world; where technology is totally international. And the corporations can take their management, and take their technology and take their capital and apply it anywhere in the world that they choose to. The only immobile aspects are people and communities, human beings and their skills, the nation-state itself, if you will, and the challenges, how does the nation stay? How does America preserve what's good in this society, in this new world, which is a world of unfair trading practices, which is a world of targeted merchantilist policies by other nations, but is also a world of multinational corporations and international financial institutions who sit in New York. They don't plan about the future of the United States. They don't plan about the future for working people in communities in America. They plan the world.

And I don't envy you your responsibilities, but you all need to find a way to deal with that reality too if you truly wish to solve this problem, truly wish to serve the needs of the people of America and their future.

Senator BAUCUS. I might suggest that we have to find a solution to that problem.

Mr. WILLIAMS. We are working very hard at it, sir.

Senator BAUCUS. Thank you very much.

Senator MATSUNAGA. Mr. Bieber, Mr. Williams, I think you have expressed a concern here about the auto industry, and the steel industry just as we were concerned about our pineapple industry just about a decade and a half ago. When unionism became well established, the pineapple industry decided to go abroad, and, in some instances, lock, stock and barrel. They took the old canning factory over to where they could find labor at 60 cents an hour instead of the $5.00 an hour that we paid in Hawaii. And we find that American industry is putting American workers out of jobs by going overseas.

I recall a time when representatives of the industry, came before a congressional committee hearing which was held in Hawaii—they were complaining about an industry having difficulty, due to, too much foreign competition. I asked them whether we should raise the tariff on canned pineapples which we import from foreign countries. Their reaction was "oh, no, no, no, you can't do that." "Why not?" I asked. They respond that without their branch canneries in foreign countries they can't continue the pineapple industry here in Hawaii. This was an industry that at one time supplied the whole world with pineapples while today 50 percent is imported from foreign countries.

What do you suggest we do legislatively? That is, shall we impose tariffs? Well that might invite retaliation. Should we impose higher taxes on American corporations going abroad? We are searching for an answer; we see the problem.

With regard to the auto industry let me relate this experience of mine to you.

As a United States Senator, I wouldn't have foreign cars in the family. By carrying an insurance policy, upon graduation from college, I would present each of my five children with a brand new car; but it had to be an American car. But, boy, the problems they have had with those cars. The Vega, you know, was a lemon. And the Phoenix too was a lemon. And even the Chevy Celebrity was a lemon. All the cars that my kids bought were lemons. I don't know if somebody was unhappy with the U.S. Senate or what.

So I finally decided that maybe I should switch to what Iaccoca was boasting about so much, the Chrysler.

So I went to a Chrysler dealer, and the sales manager heard that I was a Senator. So he came and showed me around, and then he said to me, Senator, if I were you I would buy that model there. And I asked "why?" He replied, "Because that has a Mitsubishi motor. It won't give you any trouble." [Laughter.]

Here I was out to buy an American product, and here is a salesman, the managing salesman, trying to sell me a Japanese product.

Mr. BIEBER. Well you touched upon one of my pet subjects. If I might, Senator—you throw too many things out here and I won't be able to answer them—let me just say, first of all, the whole question of quality, you know, breakdowns do happen in the best of families I guess you can say. I just remember within the last couple of days the announcement of the Audi recall. So that is a good indication that it is not always limited to American cars.

And you pick out another one of my pet peeves, and that is the Vega. You have to understand, Senator, that General Motors didn't want to build a Vega. We practically had to beat them over the head to convince them that they had to build a small car.

I remember Walter Reuther's statements for years and years ago and statement after statement urging the American automobile industry to build a small car. They didn't want to build it because the profit margin was very, very small on it. And, frankly, that is part of our problem now because of the multinational companies that they are, they don't really want to build a small car now in America. They want to cease all of that.

First of all, they said to me, well let the Japanese have that. And I said, well if you give that to the Japanese—you know, I think they are pretty intelligent—I think they are going to come at the higher level of car. You know what I was told? Well that's a ways down the road, maybe 15 years.

One of the problems with our industry, short-term vision instead of long-term vision as well. They don't want to build that car now. They bring it in.

One of the problems that is going to hit us even more is now we are getting the plant set up, joint venture set up with General Motors, and Suzuki and Canada. It's going to produce a couple of hundred thousand cars. At best, they will sell less than 30,000 in Canada, and we will have that intrusion here.

Now, Senator, you are absolutely right. Some of those cars that were built were lemons. I want you to take this into consideration.

The worker on that line has to build that car according to how he is told to build it. Today, thank God, we have educated companies to involve workers, as they did in Japan, and continue to do in Japan. But we are getting more involvement here.

We also have to have a properly engineered car. Thank God, the car is better engineered today.

Now last but not least is that dealer. I have great trouble with the dual dealerships because those dealers have a great deal to do with repeated sales. And obviously I can understand when you take that car to that dealer, first of all, I can understand when the dealer moves you to the foreign car. We had a lot of those cats in Detroit doing that. You know why? Because at that point they were getting $1,200 to $1,500 over and above the sticker price. So the good old American way, they steered you to that foreign car so they made the extra bucks.

The other problem is that when the two cars come in—and that is where again the American companies ought to really step on those dealers—the Japanese dealership has to service that car. He is told he has to service it. You give the number one service or you are not going to be around.

The American way with the domestic car is again the first once or twice the dealer is very apt to run it through the front door and out the back door if you don't watch him. Now there will be one quick stop, and that is to make out the report under the warranty so they get paid for it. But you go back once or twice or three times. Now that's not all dealers. That is some of them.

Senator, you understand I also sit on another committee in which I represent the workers, but it's not a union meeting. It is a board of directors meeting. And I voiced the same thing there, and that includes one of those companies that you just talked about.

Senator MATSUNAGA. Mr. Williams——

Mr. WILLIAMS. I would just add that I think a piece of solving the overall problem is to deal with the question of the multinationals and and international finance community, and find ways in which they are encouraged, indeed required to exercise more responsibility in terms of America and the future of America and their base in America, and not be quite so concerned and so quick to go everywhere else in the world and deal with every other problem first.

Senator MATSUNAGA. Well business is guided, number one, by profit. Business is for profit. What I want to know, and I am sure my colleagues would like to know, is what can the Congress do legislatively to correct the situation which we recognize? And that is the problem.

Mr. BIEBER. Yes, it is, Senator.

Going back to the trade issue, that is precisely why my union was very supportive of H.R. 4800, now H.R. 3, that has been reintroduced because while we talked about steel and auto here, certainly the farmers have the same problem. You pointed out the problem that the pineapple industry in Hawaii has. And I think, Senator, while there is no easy answer to it, I felt that certainly the trade deficit reduction piece of that bill made sense, because it is not saying to our trading partners, we don't want to trade with you; you can't trade with us. But it is saying to them there has to be some semblance of fairness.

We are not saying, you know, you have to stop sending this, or you have to stop sending that. But there has to be a way. Either you have to open up your doors to take our products, vice versa, or if you don't, then you do have to limit what comes into this market.

We cannot just sit idly by and see this market destroyed. It is the only lucrative market left in the world. And what bothers me and what is beyond my comprehension, quite frankly, is how the multinational companies and others, including those who export, whether it be Japan or Germany or Korea, those who export, if we keep on reducing our jobs here, reducing the industrial base of this country, eliminating the good paying jobs which generate the customers for that market, then I don't think we have to be geniuses to know it is only a short period of time before we destroy that market.

And the point that I think we have to work hard in getting across to our trading partners, they are helping to destroy that market as well. And the bottom line is it isn't going to. It just isn't going to be to anyone's advantage.

I think we have to accept the fact that the multinational companies have always and will continue unless something is done to stop it look at the bottom line. And I have always said they have no flag other than the flag which may have a dollar bill painted on it. They understand that bottom line.

But I think it behooves all of us, and I think Senator Baucus said before, not just you but all of us, to really take on this issue now, and to recognize that the time is late, and we can't just leave it drift.

I would say to the democratic members of this panel, I worked hard to get you seated in that position. I have said a lot of things in the last six years. I said them here this morning, about the failure——

Senator DANFORTH. You could also say it about the republican members you worked hard to get us unseated. [Laughter.]

Mr. BIEBER. Well I think that follows, Senator. That is the result.

My point is that, you know, I don't think the Administration has stepped up the responsibility. I urge all of you, but I say to the democrats on this committee, that the people of the country I think was looking very pointedly at these problems in 1986, and they will be looking at them in 1988 as well.

And Senator Danforth has a selfish stake in that because it just dawned on me that he is up for reelection in 1988 as well.

Senator MATSUNAGA. I am going to rise above politics as chairman and say let's keep politics out of this. [Laughter.]

I am sure members have other questions, but we have kept you overtime already. We have our respective caucuses to attend. So I thank you, Mr. Bieber and Mr. Williams, Mr. Sheehan, Mr. Warden. And the committee stands in recess subject to the call of the Chair.

[Whereupon, at 12:45 p.m., the hearing was recessed.]

MASTERING THE WORLD ECONOMY

THURSDAY, JANUARY 22, 1987

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The Committee met, pursuant to notice, at 9:37 a.m. in Room SD 215, Dirksen Senate Office Building, the Honorable Llyod Bentsen (chairman) presiding.

Present: Senators Bentsen, Baucus, Boren, Bradley, Daschle, Packwood, Danforth, Chafee, Heinz, Wallop, Durenberger, and Armstrong.

[The prepared statements of Senators Bentsen and Heinz follow:]

STATEMENT OF SENATOR BENTSEN

It is my hope that Congress this year will pass trade legislation that will make it easier for America and countries around the globe to export their goods. And I hope the President will sign this legislation.

The Finance Committee is engaged in a search for ways to spur exports of our product. We are not interested in searching for ways to export blame for our trade problems.

Clearly, a lot of the blame lies right here in Washington and we must recognize that.

In fact, when you take into account this capitals' inattention to trade for years and years and years, *all* the blame for this country's trade problems comes right here to roost.

In addition to continued inaction on trade, this government's failure to reduce our huge budget deficits exacerbates the situation.

We saw a report from the bipartisan Congressional Budget Office this week, in fact, that the President's budget falls more than $30 billion short of meeting the Gramm-Rudman target for fiscal 1988.

And I doubt that Congress will do much better in meeting the target during its deliberations this year.

So it is correct that we need look no farther than Washington—with an especially piercing stare at the huge federal budget deficits—when seeking the causes of our trade deficits.

But it would be a mistake to make the claim, as some have, that the budget deficits are the sole cause of our trade situation; to argue that the only effective way to reduce our trade deficit is to reduce our budget deficit.

Actually, to some extent our trade deficit adds to our budget deficit instead of the other way around. Economic growth in this country fell far below the 4% plus rate that was expected last year and the consensus among economists is that the trade deficit was to blame. Increased growth, or course, would have shrunk the budget deficit.

The U.S. budget deficit last year equalled just over 22% of federal spending. The Japanese budget deficit, by comparison, equalled just over 20% of federal spending in that country and since Japan has the world's largest trade surplus it is clear that budget deficits are not the sole cause of our competitiveness problems.

Italy's budget deficit last year equalled 27% of total federal spending and Italy reduced her trade defict by 80% during the year, while ours was reaching new record heights.

Our budget deficits aren't the sole cause of the problem, though they are a significant part of it.

We don't want to become involved in a chicken or egg argument here. Which came first, the trade deficit or the budget deficit? Which should we address first? We must be working on both.

STATEMENT OF SENATOR JOHN HEINZ

Mr. Chairman, today's hearing is the fourth in this series providing an overview of trade policy and the need for trade legislation. Today's witnesses are economists. While I have high regard for today's witnesses as individuals, I cannot resist pointing out that their profession has distinguished itself over the last few years by adding much more heat than light to the trade debate.

It is tempting at this point to stack the record with old columns and news stories from 1985 containing the many predictions of economists about the imminent decline of the trade deficit and the macroeconomic causes of it. Events since then have demonstrated that most of those predictions—and the analysis on which they were based—were wrong. Indeed, what these hearings are bringing out is the fact that the real world is far more complicated than even the most sophisticated econometric models, and that there are, therefore, no simple solutions to our trade problems.

To cite one current example, economic theory suggests that when a nation's currency appreciates, as the yen has been doing, its export prices will go up in compensation. What we have discovered in the real world, however, is that to the Japanese maintaining market share is more important than maintaining profit levels. In some sectors, like steel, prices have actually dropped while the yen was going up, as the Japanese are determined to hang on to their share of our market at any cost. In policy terms this means we cannot expect the fall of the dollar to have the predicted effect, and we cannot count on it to solve all our trade problems for us.

Thus we learn by experience as well as by textbook. Fortunately, today's witnesses have an ample supply of both sources of knowledge, and I trust they will draw from both in their remarks to the Committee.

The CHAIRMAN. The committee will come to order.

It is my hope that this year we are going to pass trade legislation through this committee and through the Senate that is going to increase the export of goods around the world. I hope that the President will sign that piece of legislation.

We are looking for ways to spur exports. We are not interested in trying to blame the rest of the world for some of our own problems. Clearly, a lot of the blame rests right here in Washington, and the budget deficit is a good part of it.

We are looking at a deficit in the budget from the President that falls about $30 billion short of the Gramm-Rudman target, according to the Congressional Budget Office. In all candor, I doubt that the Congress will do much better when we finally get through with the budget that we present.

But I think it would be a mistake to claim, as I have heard some claim, that the budget deficit is the sole cause of our trade situation, and that the only effective way to reduce that trade deficit is by reducing the budget. There is no question but that the budget deficit is a contributing factor. But actually, to some extent, our trade deficit adds to our budget deficit, in addition to the other way around.

Economic growth in this country fell below the four percent that was expected last year, and the consensus among many economists is that the trade deficit contributed to the slow growth. Increased growth, of course, would have shrunk the budget deficit.

Let me give you some numbers, because there have been some questions as to how the U.S. budget deficit compares to that of other countries.

The U.S. budget deficit last year equalled just over 22 percent of federal spending. The Japanese budget deficit, by comparison, equalled just over 20 percent of federal spending in that country. Since Japan has the world's largest trade surplus, it is clear that the budget deficit is not the sole cause of our competitiveness problem.

Italy's budget deficit last year equalled 27 percent of total federal spending, and Italy reduced its trade deficit by 80 percent during the year, while ours was reaching new record heights.

So our budget deficits aren't the sole cause of the problem, although they certainly are a significant part of it.

We are very pleased this morning to have some distinguished economists who are prepared to testify before us. We will hear from them as a panel, and will follow the early-bird rule on questioning by Senators, with a limitation of five minutes.

We have Dr. Alan Greenspan, who is the Chairman and President of Townsend-Greenspan and Company; we have Mr. Robert Hormats, who is the Vice President of Goldman, Sachs; and we have Professor Dornbusch of the Department of Economics, Massachusetts Institute of Technology.

Before they proceed, I would like to ask the ranking Minority member if he has some comments.

Senator PACKWOOD. No comments, Mr. Chairman.

The CHAIRMAN. Dr. Greenspan, will you proceed?

STATEMENT OF ALAN GREENSPAN, CHAIRMAN AND PRESIDENT, TOWNSEND-GREENSPAN AND CO., INC., NEW YORK, NY

Dr. GREENSPAN. Thank you very much, Mr. Chairman. It is a privilege to be here addressing such a crucial issue which confronts not only this nation but the world as a whole.

I will excerpt from my prepared testimony, but I request that my full statement be appended to the record.

This historic advance of the dollar in foreign exchange markets between 1980 and early 1985 left in its wake unprecedented American trade and current account deficits. These, in turn, now have resulted in an extraordinarily large and still growing stock of U.S. dollar-denominated assets distributed among international currency portfolios.

The trade deficit and dollar surplus have made credible concerns about the possibility, if not yet the probability, of a freely falling dollar exchange rate, higher inflation and interest rates in the United States, slower real world trade growth, or some combination thereof.

We are becoming a country where economic conditions are increasingly dependent on external forces, and economic policies increasingly limited by events abroad.

Today, our more than $40 billion current annual account deficit means that gross claims against the United States are expanding at a rate of nearly $200 billion a year. More importantly, perhaps, Euro currency claims denominated in dollars also continue to grow.

Total world-wide cross border bank claims currently amount to about $2.5 trillion, more than two-thirds of which are denominated in dollars.

The accumulation of American debt by Japanese, European, and other surplus countries has now reached a point of near saturation. Bob Hormats and I, I might add, disagree somewhat on this particular issue; but I think it is crucial to the extraordinary outlook which we are confronting, and I hope that he and I will try to resolve where our differences lie.

Foreigners are attempting to diversify out of the dollar, if for no other reason than the dollar share is perceived of as excessive. Although the outstanding stock of dollar-denominated debt does not change thereby, these desires to diversify keep downward pressure on the dollar exchange rate.

The dollars forced on markets by our 1985 and 1986 current account deficits could have been absorbed without a fall in the exchange rate, had the Federal Reserve allowed interest rates on dollar-denominated securities to rise relative to the yields of comparable securities in yen, deutsche mark, and other key currencies. But with a very sluggish American economy, the Federal Reserve resisted the expansion of dollar-denominated interest rate premiums throughout 1985 and most of 1986. This forced a necessary reversal of the dollar's unprecedented climb. Since the adjustment fell wholly on the exchange rate, the dollar's value dropped sharply from its peak in early 1985.

The failure of our trade deficit to respond rapidly to the weakness of the dollar was largely owing to the willingness of Japanese and European shippers to absorb exchange rate changes into shrinking profit margins, rather than forgo their market shares in the United States.

Profit margins on imported goods have fallen from apparently post-World War II record levels in early 1985 to levels that are now close to the bottom of the historic range. This absorption phase has apparently ceased, however. Since the late spring of 1986, weakness in the dollar's exchange rate has been rapidly translated into higher U.S. import prices on nonoil goods. American real exports are just now beginning to expand, almost two years after the exchange rate peaked, and the deceleration of imports is still sporadic. While we obviously will not know for another month or more, it appears that the sharp deterioration of the reported November trade deficit was an aberration that will soon reverse.

The American trade deficit and world-wide dollar surplus represent a major international disequilibrium that will be difficult to resolve. There are not very many policy options that can be used to squarely confront the problem, and even fewer that do not carry undesirable side effects.

Significant progress in reducing the U.S. budget deficit, a crucially important domestic policy goal in its own right, does not automatically imply a significant reduction in the trade deficit, but at least it should move us in that direction. In this regard, Mr. Chairman, I am in agreement with you on exactly what you have said.

A really credible deficit reduction should bring down inflation expectations and long-term interest rates substantially. This presumably would lead to accelerated domestic capital investment, possibly enough to replace much of the foregone U.S. real federal spending with U.S. private investment expenditures, leaving our external deficit substantially intact.

However, lower inflation rates implies a continuing reduction in U.S. unit costs of production that does reach to the root of the problem, and would encourage U.S. exports, discourage U.S. imports, and assist in bringing about a gradual reduction in the trade deficit.

The ideal solution, in my judgment, would be a continued gradual reduction in the exchange rate of the dollar. I must say I emphasize "gradual." A smooth depreciation would mean an only modest increase in import prices and inflationary pressures. This would gain time for shrinking unit costs to improve the competitiveness of American production.

Cost reductions remain the only credible alternative to further dollar depreciation as a mechanism to close our trade deficit. A sharp reduction in American unit costs of production would increase both our export and import competitive edge, at existing exchange rates. There are already signs of improved industrial productivity as a consequence of very large cost reductions in import-sensitive industries during recent years. The improvement to date may not be enough, however, and more time is required.

I might say, parenthetically, that the data on American productivity that are released with respect to the industrial area are probably going to be revised upward, because I think our industrial production index, which is the basis of that measure, is probably not yet picking up what is clearly a remarkable reduction in costs that American industry has managed to put into place in the last two years.

Unfortunately, the ability of central banks to smooth out exchange rate fluctuations against the dollar is severely limited by an extraordinarily large overhang of cross border claims denominated in dollars. Central banks simply cannot absorb a significant fraction of these claims, while simultaneously avoiding destablizing inflationary repercussions in their domestic financial markets. They do have the capability of smoothing the dollar's downward adjustment by periodic interest rate increases, and reversals. Properly calibrated, such a policy can be tactically effective.

It is important to recognize that protectionist actions, either through quotas or increased tariffs, create the same internal inflationary pressures in the United States as does the weakness in the dollar. Protectionism does not permanently protect American jobs. Rather, it slows the needed transfer of resources and employment opportunities from one segment of the economy to another.

Too often, protectionism has created an illusory sense of job security among employees in so-called protected industries. Steel industry employment has dropped from approximately 500,000 as recently as five years ago to a current level of half that, and steel is arguably one of our most protected industries.

It is hard to imagine an unprotected industry making adjustments much more rapidly than that.

It is appropriate for trade legislation to focus on the adjustment process internally, however, and seek to ease the training and transition problems of moving resources from one segment of the economy to the other.

The trade deficit will eventually decline and probably disappear. If foreigners refuse to finance our current account deficit, that deficit must necessarily return to zero. However, the process can be implemented in a variety of ways, not all of which are equally attractive.

If higher inflation and higher interest rates are economically unpalatable, and protectionism ultimately self-defeating, buying time for cost reduction to take hold is appropriate.

The improvements now in place are unlikely to be enough, however, and time is at a premium. Hence, it appears increasingly likely that the major part of trade deficit reduction will be imposed by market inflation and interest rates.

As we move into the 1990's, the closing of the trade deficit will be a major force affecting the United States. We will find increasingly that ownership of American assets by Japanese, Europeans, and even Koreans, will create the types of frictions that the spread of American investments abroad engendered in Canada and Europe following World War II. The recent loosening of America's grip on the world economic agenda, which was taken for granted for the better part of this century, however, is reversible. But it will require budget deficit reductions to improve America's cost structure, deft orchestrating of the seemingly inevitable reduction of the dollar's exchange value, and an eschewing of protectionist legislation.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Dr. Greenspan. I particularly appreciate your staying within the time limitations.

I would say to the other witnesses, as I look at the length of some of your testimony, we will take your testimony in its entirety for the record. But I would appreciate if you would limit your remarks to 10 minutes, because a number of my colleagues have already told me how they are looking forward to asking you questions.

[The written prepared statement of Dr. Greenspan follows:]

Excerpts from the Testimony of Alan Greenspan Before The Committee on Finance United States Senate

January 22, 1987

The historic advance of the dollar in foreign exchange markets between 1980 and early 1985 left in its wake unprecedented American trade and current account deficits. These, in turn, now have resulted in an extraordinarily large and still growing stock of U.S. dollar-denominated assets distributed among international currency portfolios. The trade deficit and dollar surplus have made credible concerns about the possibility, if not yet the probability, of a freely falling dollar exchange rate, higher inflation in the United States, slower real world trade growth, or some combination thereof.

The process by which the U.S. trade deficit will be closed and the dollar stabilized exemplifies a growing "internationalization" of America. The United States is becoming a country where economic conditions are increasingly dependent on external forces, and economic policies increasingly limited by events abroad. The policy options available to confront these problems are few, and some are likely to produce unwanted side effects. In any event, the adjustment process is going to be difficult and sometimes discouraging over the years immediately ahead.

The Dollar Exchange Rate and Dollar Claims

As the U.S. dollar rose sharply on foreign exchange markets during the first half of the 1980's, the proportion of U.S. domestic demand supplied by foreign producers rose dramatically. The corresponding reduction of U.S. exports and an even greater expansion of U.S. imports not only erased America's 1980-81 current account surplus, but also reversed what was then a strong U.S. net creditor position against the rest of the world. Today, our more than $140 billion current account deficit means that America is issuing new net debt each year greater than the currently outstanding total stock of Brazilian or Mexican debt. Moreover, since U.S. residents currently are expanding claims against foreigners at about a $50 billion annual rate, gross claims against the U.S. are expanding at a rate of nearly $200 billion per year. Euro currency claims denominated in dollars also continue to grow.

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Total world-wide cross border bank claims currently amount to about $2.5 trillion, more than two-thirds of which are denominated in dollars. No other currency is a significant factor. Despite Japan's dramatic rise as an international financial power, for example, international claims denominated in yen remain a small fraction of those denominated in dollars. However, the accumulation of American debt by Japanese, European and other surplus countries has now reached a point of near saturation. Foreigners are attempting to diversify out of the dollar, if for no other reason than the dollar's share is perceived as excessive. Although the outstanding stock of dollar-denominated debt does not change thereby, these desires to diversify keep downward pressure on the dollar exchange rate.

The dollars forced on markets by our 1985 and 1986 current account deficits could have been absorbed, without a fall in the dollar's exchange rate, had the Federal Reserve allowed interest rates on dollar-denominated securities to rise relative to the yields of comparable securities denominated in yen, deutsche mark and other key currencies. But with a very sluggish American economy, the Federal Reserve resisted the expansion of dollar-denominated interest rate premiums throughout 1985 and most of 1986. This forced a necessary reversal of the dollar's unprecedented climb. Since the adjustment fell wholly on the exchange rate, the (trade-weighted) dollar's value (measured against America's ten major industrial trading partners) dropped by almost 40% from its peak in February 1985.

While it is certainly true, as many have pointed out, that the overall decline is significantly less if we include in the exchange rate average the currencies of the Pacific rim countries and other developing countries whose currencies have not gained appreciably against the U.S. dollar, this may not be the relevant consideration. Changes in the dollar exchange rate influence real economic expansion via dollar-denominated foreign prices: import prices, which affect the competitiveness of U.S. producers at home, and foreign domestic prices that, affect the competitiveness of American exporters abroad. Prices of goods imported into the United States, excluding oil, appear to be more credibly determined by the unit production costs in major industrial countries and by the operating profit margins of our suppliers in these countries. Although the evidence here is not yet conclusive, what is clear is that the failure of U.S. import prices to increase late in 1985 and early in 1986 was due to foreign currency price reductions in major industrialized countries, not because of the predominance of imports from countries with currencies pegged to the U.S. dollar.

Thus, the failure of our trade deficit to respond rapidly to the weakness of the dollar was largely owing to the willingness of Japanese and European shippers to absorb exchange rate changes into shrinking profit margins, rather than foregoing their market shares in the United States. Profit margins on imported goods have fallen from apparently post-World War II record levels in early 1985 to levels that now are close to the bottom of the historic range. This absorption phase has apparently ceased, however. Beginning in the late spring of 1986, weakness in the dollar's exchange rate has been rapidly translated into higher U.S. import prices on nonoil goods. American real exports are just now beginning to expand, almost two years after the exchange rate peaked, and the deceleration of imports is still sporadic. While we obviously will not know for another month or more, it appears that the sharp deterioration of the reported November trade deficit was an aberration that will reverse soon.

Limited Policy Options

The American trade deficit and world-wide dollar surplus represent a major world-wide disequilibrium that will be difficult to resolve. There are not very many policy options that can be used to squarely confront the problem, and even fewer that do not carry undesirable side effects.

For example, downward pressure on U.S. money market rates apparently ended in the fall of 1986. This was followed by an expansion of interest rate yield spreads in favor of the dollar, especially against the yen, since Japanese rates also fell then. Wider yield spreads temporarily stabilized the dollar exchange rate against the yen in particular. By raising interest rates on dollar securities, we support the exchange rate and may hold imported inflation at bay. Higher interest rates also should reduce the trade deficit indirectly, by suppressing America's economic growth and hence its appetite for imports. However, it is difficult to imagine interest rates in the United States rising sufficiently to choke off more than a small proportion of our imports. In addition, the noncompetitive relationship between prices of domestically produced goods and imported goods remains unaltered.

In any case, a one-time increase in yield spreads produces only temporary relief. The accumulation of claims against the United States, implicit in an unending string of payment deficits, eventually would flood the rest of the world with unwanted claims on the United States. We must assume foreign investors would become decreasingly willing to absorb these claims. Indeed, the continued desire of Japanese and other investors to shed excess dollar obligations and other dollar-denominated securities now has produced further dollar depreciation, even with higher yield spreads favoring the dollar.

If the dollar should fall very rapidly, the current account deficit also would improve more rapidly, channeling fewer excess dollars into world financial markets. However, low import operating profit margins almost immediately would translate any further dollar depreciation into higher dollar prices for imports. Such increases would continue until foreign produced goods clearly were noncompetitive with U.S. domestically produced merchandise. But this also would leave us with a disturbingly high rate of overall inflation, coupled with higher interest rates, that could throw the United States back into the inflationary imbalances of the 1970's.

It is important to recognize that protectionist actions, either through quotas or increased tariffs, create the same internal inflationary pressures in the United States as does the weakness in the dollar. Protectionism does not permanently protect American jobs. Rather, it slows the needed transfer of resources and employment opportunities from one segment of the economy to another. Too often, protectionism has created a illusory sense of job security among employees in so-called protected industries. Steel industry employment has dropped from approximately 500 thousand as recently as 1981 to a current level of 200 thousand, and steel is arguably one of our most protected industries. It is hard to imagine an unprotected industry making adjustments much more rapidly than that.

It is appropriate for trade legislation to focus on the adjustment process internally, however, and seek to ease the training and transition problems of moving resources from one segment of the economy to the other. Still, we have the capacity to make the adjustment process considerably worse, not only for ourselves but for our trading partners as well, by instituting protectionist measures.

It should also be noted that significant progress in reducing the U.S. budget deficit, a crucially important domestic policy goal in its own right, does not automatically imply a significant reduction in the trade deficit, but should move us in that direction. If a markedly lower budget deficit were accompanied by much slower economic growth (or even recession) and renewed price disinflation in the United States, then our trade deficit indeed would retreat quickly. On the other hand, and more likely, a really credible deficit reduction also should bring down inflation expectations and long-term interest rates substantially. This presumably would lead to accelerated domestic capital investment, possibly enough to replace much of the foregone U.S. real federal spending with U.S. private investment expenditures. Our external deficit need not automatically move down with the budget deficit, with lower inflation expectations presumably supporting continued foreign acquisition of dollar claims. However, lower inflation expectations today presumably are based on lower actual inflation rates over a fairly long time horizon. This implies a continuing reduction in U.S. unit costs of production that does reach to the root of the problem, and would encourage U.S. exports, discourage U.S. imports, and assist in bringing about a gradual reduction in the trade deficit.

The ideal solution, which I fear we have few policy tools to encourage, would be a continued gradual reduction in the exchange rate of the dollar. A smooth depreciation would mean an only modest increase in import prices and inflationary pressures.

This would gain time for shrinking unit costs to improve the competitiveness of American production. Cost reductions remain the only credible alternative to further dollar depreciation as a mechanism to close our trade deficit. A sharp reduction in American unit costs of production would increase both our export and import competitive edge, at existing exchange rates. There are already signs of improved industrial productivity as a consequence of very large cost reductions in import sensitive industries during recent years. The improvement, to date, may not be enough, however, and more time is required.

Unfortunately, the ability of central banks to smooth out exchange rate fluctuations against the dollar is severely limited by an extraordinarily large overhang of cross border claims denominated in dollars. Central banks simply cannot absorb a significant fraction of these claims, while simultaneously avoiding destabilizing inflationary repercussions in domestic financial markets. They do have the capability of smoothing the dollar's downward adjustment by periodic interest rate increases, and reversals. Properly calibrated, such a policy can be tactically effective.

A Difficult Adjustment

No matter how America confronts its growing trade problem and the difficulties of its resolution, what must be kept in mind is that the adjustment process is going to be difficult and sometimes discouraging in the years immediately ahead.

There appears to be no immediate evidence that our trade or current account deficit will shrink very rapidly, even if exports are robust and imports sluggish in 1987 and beyond. With U.S. exports to the world little more than half the level of foreign exports to America, it will take extraordinary U.S. export growth to make much of a dent in the overall deficit. This means that the substantial adjustment must come on the import side, and it will not be easy to dislodge America's newly found fondness for foreign consumer and industrial goods. Moreover, the current account deficit is increasingly swollen by one payment we have to continue, namely interest charges on this accumulated debt.

Nevertheless, the trade deficit eventually will decline and probably disappear. If foreigners refuse to finance our current account deficit, that deficit must necessarily return to zero. However, the process can be implemented in a variety of ways, not all of which are equally attractive. If higher inflation and higher interest rates are economically unpalatable and protectionism ultimately self-defeating, buying time for cost reduction to take hold is appropriate. The improvements now in place are unlikely to be enough, however, and time is at a premium. Hence, it appears increasingly likely that trade deficit reduction will be imposed by market driven inflation and interest rates.

The trade deficit reduction process also is likely to be deflected temporarily by an emerging financial innovation. Yields on dollar-denominated securities are increasing, relative to those on securities denominated in yen or deutsche mark. If spreads expand further, increasing numbers of corporate borrowers will conclude that the spreads imply too much future dollar deterioration and, as a consequence, will begin to borrow at lower deutsche mark or yen rates. Interest rate spreads tend to reflect the market's average expectation of future currency changes, of course, but the larger the spread, presumably the larger the fraction of the market that takes a contrary view.

As a consequence, we are likely to see a notable increase in American issues of securities denominated in yen, deutsche mark, Swiss francs, and probably even the ECU, effectively lowering the quantity of U.S. dollars being added to international portfolio accounts. The inclination to diversify out of the dollar will be temporarily lessened thereby, and the effect on both dollar interest rates and exchange rates will be softened. This means only that the deficit reduction process will take longer and that the aggregate claims against U.S. residents will be increased, since only a lower dollar exchange rate and/or lower American unit production costs eventually can restore balance to our international accounts.

Internationalization of the American Economy

Unless current trends are unexpectedly derailed, the 1990's will witness far less American dominance of the world economy than at any time in the last half century. The United States is becoming a country where economic conditions are increasingly dependent on external forces and economic policies increasingly limited by events abroad.

With an annual current account deficit of $140 billion, more than 3% of our consumption of goods and services is being financed by foreign savings. That appears quite unlikely to persist much beyond the early 1990's as foreigners become increasingly disinclined to finance our trade deficits. In one way or the other, we will lose a full year's normal GNP growth over the next decade, as American consumption sheds its dependence on foreign savings and adjusts to American produced incomes.

On top of this, there will be an inevitable drain on U.S. resources resulting from a rebound in real oil prices, although the impact should not be as pronounced as in the early 1970's. Since oil consumption was much higher, the then quadrupling of petroleum prices effectively transferred a clearly measurable fraction of our GNP to OPEC and world oil producers. The smaller 1990's impact also will be significant, however, if only because it will occur in the same time-frame as our current account deficit is being eliminated.

As we move into the 1990's, both the closing of the trade deficit and the rise in oil prices will be major forces affecting the United States. Both will be initiated largely by forces external to the United States. For the first time in this century America will be "internationalized." We will find increasingly that ownership of American assets by Japanese, Europeans, and even Koreans, will create the types of frictions that the spread of American investment abroad engendered in Canada and Europe following World War II. The recent loosening of America's grip on the world economic agenda, (which we had taken for granted for the better part of this century,) is reversible. But it will require budget deficit reductions to improve America's cost structure, deft orchestrating of the seemingly inevitable reduction of the dollar's exchange value, and eschewing of protectionist legislation.

STATEMENT OF ROBERT D. HORMATS, VICE PRESIDENT, GOLDMAN, SACHS & CO.

Dr. HORMATS. Thank you very much, Mr. Chairman. I appreciate the opportunity to visit again with this committee.

I commend you and the members of the committee for holding these hearings so early in this One Hundredth Congress. By doing so you are highlighting the nature and severity of the trade problem; and, you are beginning what I believe to be an urgent national necessity, which is to have a national debate on trade, which we haven't had for years, leading to a consensus on trade policy. That I is particularly important, because divisions within this government make it difficult for us to come up with clear directions for our policy internally; and, our credibility with other countries is much greater if we have a common sense of purpose within this country. That can be based on this debate and the trade legislation which emerges therefrom.

A few basic points, Mr. Chairman.

One, the magnitude of the problem. Fifteen years ago, I can recall as a young staff member on the NSC that we had a $4 billion trade deficit, the first for the United States since World War II. The panic over that caused the President of the United States, President Nixon, to impose a 10 percent surcharge on imports and terminate convertibility of the dollar into gold. At the end of last year, we were averaging a roughly $4 billion trade deficit every week. Things have changed rather dramatically over the years!

The danger in this large trade deficit and our large current account deficit is that unless they begin to decline soon, we are going to, by the end of this decade, face an external debt of over $700 billion, intense demands for trade restrictions, and pressures to pull back troops in Europe. A whole range of things follow from the United States becoming a large debtor country.

The trouble is that, like 1971, too much of the discussion has been focused on assigning blame, and too little on addressing the fundamental reasons for this imbalance. And I think that is one important virtue of the hearings this committee is holding.

The central question today is not whether the U.S. trade deficit will be reduced. The trade deficit will be reduced, because it is both economically and politically unsustainable. The central question is whether it will be reduced in an orderly way, by a combination of currency changes, higher demand abroad and lower budget deficits at home, or in a disorderly way, in an environment of volatile currencies, protectionism, and lower growth.

But there are longer term questions as well: How does this country position itself for the future? How do we structure our economy to compete more effectively in the world? How do we use the coming multilateral trade negotiations, which are likely to be the last in this century, to build a more open economy? And how do the major economies avoid currency and trade imbalances in the future?

At stake in this debate is not just this nation's trade balance for 1987, but the position of the United States in the world economy for years to come, growth in the United States and most other countries, and the cohesion of alliances vital to our security.

Bearing this in mind, it is important to recognize that it took several years for the U.S. to get into its present trade difficulties, and it will take time for us to get out. Attempts at trade restrictive or short-term solutions will unquestionably lead to frustration and could seriously harm prospects for attaining long-term U.S. goals.

Let me just briefly, Mr. Chairman, describe some of the reasons why the trade deficit, despite the decline of the dollar, is as high as it is:

First, the dollar was too strong for too long, causing U.S. companies to lose market share abroad and locate more production abroad, while other companies and other nations were able to gain a strong market foothold here;

Although the dollar has fallen, it has not fallen against a number of major currencies; moreover, the price adjustments as a result of the dollar's decline have begun to take place, but relatively slowly—that is to say, the effect of a change in the exchange rate, insofar as it actually affects trade flows, is that prices of imported goods in the United States have to rise, and prices of American goods in foreign markets have to stay stable while the price of domestic goods in those markets goes up. Those changes are occurring, particularly on the export side; but we haven't seen much in the way of results. I believe we will early next year see some of these results begin to manifest themselves.

Third is a problem Secretary Baker has talked about a great deal, which is growth in other countries. It has been relatively slow.

We also have the problem of continued excess of U.S. private and government borrowing over U.S. domestic savings. This involves a massive inflow of capital from abroad, which permits us to maintain levels of consumption and investment higher than would be the case than if we relied on our own savings.

We also have a point which Senator Bradley has been mentioning, quite correctly: the debt problem in Latin America has been a major constraint on American exports to that area; it also induces them artificially to try to boost exports to the United States, while most other countries of the world are not really taking their share of Latin exports.

Foreign trade barriers are major problems. They are not so much an immediate cause of our difficulties, in the aggregate, but they certainly affect major sectors of our economy, therefore dealing with those must be a priority.

And last is disappointing American productivity.

In my written testimony I have described some of these in greater detail. I will skip most of that, except to make a couple of points which might be useful to bear in mind as we proceed.

One, the first set of statistics I put down shows just how much the debt of key U.S. sectors has climbed in recent years. From 1980 through 1985, debt of American households increased from 51 percent of GNP to 59 percent of GNP. Business debt rose from 50 percent of GNP to 58 percent of GNP. Federal debt rose from 26 percent of GNP to 39 percent of GNP, by far the biggest of those increases. That has been one important reason for the drawing of foreign capital into this country, and it certainly had a major effect on exchange markets.

The lead point about the current account deficits and where they are leading? I have mentioned the size of the debt we are likely to have by 1990. One number I think illustrates the point: By 1990, if the debt goes up the way I anticipate it will, this country will be spending roughly one percent of our GNP simply to pay interest abroad on the U.S. debt. It also means that our capital market is heavily dependent on imports of capital from abroad.

In 1985, for example, fully 44 percent of net new Treasury financing in long-term bonds was purchased by Japanese institutions. And that is a substantial amount of money, indicating how much we rely on foreign capital markets for funding of the U.S. Government and the private sector.

I also would simply mention the report of the President's Commission on Industrial Competitiveness, that growth in U.S. productivity in the past has been relatively low compared to other countries. This committee knows full well the basic reasons for this. I have elaborated on some of them in my testimony, and perhaps we can deal with some of those in the discussions.

I would simply say that an attitudinal change that is important here, too. And that is: The United States is today a debtor country which behaves as if it were a creditor. We haven't really caught up with the fact that we need to export.

Just a few examples that I have picked at random:

In the last 20 years, administrations of both parties have imposed economic sanctions which hurt American companies, without accomplishing intended foreign policy goals—soybeans, grain, oil equipment have all suffered. Other items have been targets of this folly as well. Permanent damage was done to ourselves.

Second, the Defense Department still has trouble in recognizing that the United States is not the only source of much of the grey area equipment it wants Americans to stop selling abroad.

For a time, I think there was not really an understanding, in part of the Administration at least, that the overvalued dollar presented difficulties to the United States.

It is also the case, as I mentioned earlier, that we have not had a national consensus on trade policy which we can project internationally. The absence of this consensus has caused a great problem for our negotiators. People don't take us seriously if different people are saying different things from different vantage points.

We also, have been "sitting on our rights" in the GATT, without being aggressive enough in dealing with some of the problems we have. We can't expect a level playing field, a totally level playing field, but we can try to get rid of the moats and the fortifications on the playing field so that it is a little more level than it is today.

There is also a problem among the industrialized countries. Western governments have not yet fully digested the magnitude of recent changes in the world economy, changes that necessitate a better harmonization of underlying policies, and significant efforts to avoid currency distortions. With so much money sloshing around the world, it is simply impossible to have stable currency markets if countries' performance and policies are radically different.

Second, Japan and Europe have been slow to recognize that the days when they could argue that their trade barriers should be tolerated by the world because they were small countries and their actions would not really hurt the international economic system, while the U.S., because of its size and its impact on the international trading system, was urged to practice a special form of discipline, are long since over. These countries need to play a greater role in sharing the responsibilities that the United States has exercised for a number of years.

Let me just mention—and I will talk about it a little bit later, because I am sure questions will arise—the specific problem I touched on earlier of the major decline in American exports as a result of a weakness in Latin American economies and the debt constraints on financing. That is not a foreign exchange problem; it is simply a debt-related problem, and it is very serious.

Let me now just briefly touch on the future and what we need to do to address these problems, because, Mr. Chairman, you made the point that it is not simply one issue, the deficit, it is a whole range of issues.

One, the price of imported goods in this country are going to have to rise more in order to reduce the differential that was built up during the period of 1980 to 1985, to help American goods regain their competitiveness with imports.

Second, American products are going to have to become more competitive in foreign markets.

Also, domestic demand in other countries is simply going to have to grow more strongly than in the past, because exchange rates is only one part of the equation; growth rates are another.

Foreign assistance is another point that I would mention briefly here, and that is: The United States, after World War II, provided a great deal of assistance to help improve growth and equilibrium in the world economy. Today, the major capital exporters have an opportunity to provide some assistance to the countries of Latin America, which would do two things: help them stabilize their economies, and enable them to buy more goods from this country, which would improve the overall imbalance.

Then, there is the question of the budget deficit lagging productivity, and a number of other items that I touch on in my written testimony.

Let me conclude on the question of U.S. trade policy, this is going to be a central issue for this committee over the next several months.

The trade bill, as I mentioned, can be a leadership vehicle. It can have two basic functions: one, be a vehicle for forging a national consensus on trade policy; second, demonstrate to America's trading partners a new-found unity of purpose between the Executive Branch and the Congress.

Without going into specific detail, there are a few things that might be worth your considering from a strategic point of view:

Trade negotiations, no matter how successful, will not in themselves dramatically reduce the U.S. trade deficit. U.S. negotiators should not be expected to obtain concessions significantly greater than those they are empowered to give.

Second, the goal of achieving substantially equivalent sectoral opportunities is desirable in principle, but there must be room for flexibility to make tradeoffs among sectors if those tradeoffs produce a net economic benefit to the United States.

Third, a distinction should be made between tightening up procedures regarding the use of Section 301 and changing U.S. laws with respect to dumping and countervailing duties in ways that are inconsistent with the GATT. If we do so, that change may be used as a pretext by those who simply want to slow down the negotiations.

Fourth, it will be important to reinvigorate our commitment to U.S.—Canadian negotiations. And this is the point that you, Mr. Chairman, have made repeatedly. Not only can those provide new trade opportunities and remove distortions on cross-border trade but they also serve notice on other countries that the U.S. is seriously interested in expanding trade and that unreasonable obstacles to multilateral progress will channel U.S. energies toward areas in which bilateral progress can be made.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Professor Dornbusch?

[The prepared written statement of Dr. Hormats follows:]

TESTIMONY OF ROBERT D. HORMATS
VICE PRESIDENT, GOLDMAN, SACHS & CO.
BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE
JANUARY 22, 1987

Mr. Chairman:

I am grateful for the opportunity to testify at this initial series of hearings on U.S. trade. By seeking the views of individuals who see this issue from different perspectives and holding these hearings early in the 100th Congress, this Committee is highlighting the severity of the US trade problem and the necessity of dealing with it on the basis of a national consensus -- one aimed at ensuring that solutions to it promote domestic prosperity and America's broad international interests.

Fifteen years ago a $4 billion US trade deficit -- the first for the US after World War II -- caused President Nixon to impose a 10% import surcharge and terminate convertibility of the dollar into gold. Toward the end of last year, the US recorded a nearly $4 billion trade deficit in an average week. Even allowing for inflation, that is an astonishing increase.

A very junior staff member of the National Security Council staff in 1971, I still recall the shock in Congress and the Executive Branch at the deterioration in the US trade position that had led to this first post-war trade deficit as well as the quickness with which so many blamed this problem on the rest of the world. Equally striking was the tendency of other nations to place the blame almost entirely on the US and their reluctance to see the weakened US trade position as an international problem requiring a multilateral solution.

The present US trade deficit is far more dangerous than in 1971. And, we now also have an enormous current account deficit. Unless these begin to decline soon, the US will face an external debt of over $700 by 1990, intense demands for new trade restrictions, and Congressional pressures for troop cuts abroad. Like 1971, however, too much discussion has been focussed on assigning blame and too little on addressing the fundamental reasons for this imbalance.

The central question today is not whether the US trade deficit will be reduced. It will be -- because it is both economically and politically unsustainable! The central question is whether it will be reduced in an orderly way -- by a combination of currency changes, higher domestic demand abroad, and lower budget deficits at home -- or in a disorderly way, in an environment of volatile currencies, protectionism, and lower growth.

But there are longer term questions as well: How does this country position itself for future? How do we structure our own economy to compete more effectively in the world? How do we use the coming multilateral trade negotiations -- probably the last in this century -- to build a more open international economy? And how do the major economies avoid currency and trade imbalances in the future?

At stake in the current trade debate is not just this nation's trade balance in 1987 but the position of the US in the world economy for years to come, growth in the US and most other nations, and the cohesion of alliances vital to US security. Bearing this in mind, we must recognize that it took several years for the US to get into its present trade difficulties and it will take time to get out. Attempts at trade restrictive, short-term solutions will lead to frustration and could seriously harm prospects for attaining longer term US goals.

RECENT DISAPPOINTMENTS

When the dollar began its fall toward the end of 1985, there were high hopes that the US trade deficit would soon decline. Instead, the deficit has risen. The dollar's fall has failed so far to reduce our trade deficit for several reasons:

-- the dollar was too strong for too long, causing US companies to lose foreign market share and locate more production abroad while companies in other nations were able to gain a strong market foothold in the US;

-- although the dollar has fallen, that decline has not extended to currencies of some important US trading partners; moreover the price of imports from even those countries against whose currencies the dollar has fallen has risen quite slowly and the foreign currency price of US exports in such countries has fallen only recently. This has retarded the expected decline in US orders for foreign-made goods and the pick up in foreign orders for US goods;

-- sluggish growth in major industrialized countries has limited their imports of American goods; many of these countries find it hard to break the pattern of reliance on exports for a significant portion of their economic growth;

-- the continued excess of US private and government borrowing over US domestic savings requires a massive inflow of capital from abroad; that permits consumption and investment spending in the US at levels that draw in more imports than would take place absent a large savings-investment gap.

-- poor economic performance and severe debt constraints on growth in Latin America and other Third World countries together slow their demand for imports and induce them to artificially boost exports; the major trade impact falls on the US.

-- foreign trade barriers continue to harm sectors of the American economy. But, although their removal should be a major US priority, they are not the major reason for the enormous magnitude of the trade imbalance the US now faces, and simply eliminating them without a proper alignment of currencies, higher growth abroad, and a reduction in our domestic imbalances will do little for our overall trade position.

-- disappointing American productivity is troublesome because it means that some sectors of the US economy are not in a strong position to take advantage of the dollar's decline or lower trade barriers abroad.

A DISCUSSION OF THESE PROBLEMS

Before turning to policy recommendations, I will briefly examine some of the underlying causes of these problems.

First, what portion of this country's trade imbalance is home made?

Second, to what extent have the policies of this country's industrialized country partners and problems of cooperation among the major democracies contributed to US trade difficulties?

Third, what part has high Third World debt played in the deterioration of the US trade position?

DOMESTIC POLICY ISSUES

At the heart of America's trade problem is the failure of this nation to maintain a balance between its financing demands and its level of savings. The difference is met by imports of capital that lead to a higher level of imports than would occur if this country saved enough to meet its borrowing needs (or alternatively, cut its borrowing to more closely match its savings rate). In short this country is living beyond its means -- importing enormous amounts of capital from abroad and the goods that this capital finances.

Three sets of figures illustrate the point.

The first set shows just how much the debt of key US sectors has climbed in recent years. From 1980 through 1985 debt of households increased from 51% of GNP to 59% of GNP; business debt rose from 50% of GNP to 58% of GNP; and federal debt shot up from 26% of GNP to 39% of GNP -- nearly two times the increase of the other two.

The second set illustrates how this increase was associated with a large gap between savings and investment. During the period from 1961-1970 US personal savings averaged 4.7 percent of GNP while corporate savings averaged 3.3% of GNP. Combining the two, the US realized an average net private savings rate of 8% of GNP. The Federal deficit then averaged about .5% of GNP. Thus, total net savings averaged about 7.5% of GNP. Net domestic investment was usually about 7% of GNP. So the US could export capital amounting to about .5% of GNP, That, in effect, helped other countries to buy US goods and services -- so we had a small current account surplus during that period.

By 1985 annual personal saving had slipped to 3.3% of GNP, and corporate savings to 3.2%, for a net private savings rate of 6.5%. But the federal deficit had grown to roughly 5% of GNP. Even including state and local government surpluses (totaling 1.4% of GNP) that adds up to a total net savings level for the US of 3% of GNP. As net private domestic investment added up to 5.7% of GNP, the US had to borrow over 2.7% of GNP from the rest of the world. That borrowing -- causing the value of the dollar and US imports to surge -- was the mirror image of our current account deficit in 1985 of $117 billion.

The last set of figures compares US savings/investment/current account performance with other countries. From 1971 through 1979 US gross domestic investment was nearly 17% of GNP while gross domestic savings averaged 16%; in 1985 gross domestic investment was the same 17 % of GNP while gross domestic savings (private savings minus the government deficit i.e. government "dissaving") had fallen to roughly 14%. That gap, as noted, was associated with the rise in the dollar and in the US trade and current account deficits. In contrast, Japan and Germany throughout this period recorded gross savings levels well above gross domestic investment (which in part can be accounted for by relatively slow growth in those nations) -- leading to substantial amounts of savings available for them to export. That excess was borrowed by large capital importers such as the US -- helping it to finance its rising levels of imports.

A significant portion of the inflows of foreign capital that occurred after 1982 did so because US banks slowed lending to developing countries and increased it at home while continuing to attract funds from abroad (thus increasing their net inflows from abroad). And some funds came to the US to take advantage of investment opportunities in the private sector. Some of these flows occurred because tight money policy in the face of expansive fiscal policy raised interest rates to attractive levels.

A 1986 Commerce Department report underscores the link between the federal deficit and trade: "The critical element in producing these imbalances was the uninterrupted expansion of the federal budget deficit from about $60 billion in 1980 to over $200 billion in 1985. Absent the very large government deficits, private saving probably would have been more than adequate to meet US investment needs, the dollar exchange rate would probably have been lower, and the net foreign capital inflows and the accompanying very large current account and trade deficits probably would not have occurred."

My intention here is not to burden the Committee with statistics, but to underscore the point that this country will confront continuing imbalances so long as it suffers from a large domestic savings-investment imbalance.

Moreover, the recent string of large current account deficits has caused the US to build up a net foreign debt which by 1990 will require this country to spend roughly 1% of our GNP just to pay interest abroad and over time could make investors less willing to hold dollar securities. Increasingly the level of investment, consumption and interest rates in the US has come to depend on foreign capital. In 1985, for example, fully 44% of net new Treasury financing in long-term bonds was purchased by Japanese institutions. There is a serious financial risk in this enormous US appetite for capital. Should new capital flows to the US abate, American interest rates would rise and domestic growth would slow as the government and private sector would have less money to finance their borrowing needs. And, the need for foreign capital complicates the job of the Fed because a pullback by foreign investors in dollar securities that triggers a sharp drop in the dollar might suggest the need for an increase in US interest rates while the weakness of the US economy would argue strongly against that course. The Fed would be in a difficult position.

I do not subscribe to the notion that it is inevitable that foreigners will at some point dump dollars so quickly and in such large amounts that the currency will collapse. Indeed Europe and Japan still have only about 5%-10% of their financial assets in US dollar assets -- hardly a figure which would cause them to feel that their portfolios were saturated with dollars. But they could, from time to time, refrain from buying dollar securities if they anticipate a continued fall in the dollar or a rise in US inflation; in so doing they would hasten the dollar's decline, push up the price of imported and ultimately domestic goods, and drive up interest rates in the US. A similar sharp weakening of currencies, dramatic reduction in domestic economic activity and surge in inflation, it may be recalled, happened to Britain in 1976 and in most of Latin America in the early 1980s. We cannot assume that because the US is big and has a strong economy -- or that because our debt is in our own currency rather than someone elses -- we are completely immune from these potential adversities.

A second troublesome aspect of the US domestic situation is highlighted in the Report of the President's Commission on Industrial Competitiveness -- the growth of US productivity has been low compared to that of other major countries. This is highly disturbing but not surprising when one considers the subpar US performance in three critical factors that determine productivity: our educational system by most tests is not performing as well as those of Japan, West Germany, or other countries of Europe; civilian research and development expenditures are lagging behind those of our major trading partners; and, low savings and high government demands on those savings that are available mean that the cost of capital in this country tends to be higher today than abroad. To be sure these negatives have in part been offset by growing emphasis on research by the US private sector, links between corporations and universities to pioneer new technologies, welcome progress in deregulating key sectors of the economy and greater latitude by the Justice Department in allowing mergers and acquisitions. But without getting the fundamentals right on education, savings, and research and development spending the US will compete in the race for the future with one foot stuck in the starting gate.

There is also the question of a sustained national commitment to exports. Old attitudes die hard. American industry has increasingly come to recognize that its survival depends on meeting international competition. This has been recognized only slowly in some cases because of the habit of relying heavily on the large American domestic market -- but most US companies today have active strategies for meeting foreign competition by improving the efficiency of production in the US, locating new plants abroad, or developing cross border research, production and distribution alliances.

The real lag here is in the US government. In the last twenty years administrations of both parties have imposed economic sanctions which hurt American companies without accomplishing the intended foreign policy goals. Exports of soybeans, grain, oil equipment and other items have been the targets of this folly. Permanent damage was done to American exporters. The Defense Department still has trouble in recognizing that the US is not the only source of much of the "grey area" equipment it wants Americans to stop selling abroad. And it hurts US high companies by excessive restrictions on their sales of technology even to Western nations. Moreover, it was only in the fall of 1985 -- thanks to Secretary Baker -- that the administration recognized how harmful the strong dollar was to US companies and did something about it. Even now the Export Import Bank has to battle for funds.

We have also failed to develop a national consensus on trade policy that we can project internationally. The President has paid insufficient attention to the subject and failed to push US positions with foreign leaders. Intense differences have been allowed to fester unresolved in the administration. The White House and the Congress have not communicated well on this subject thereby causing other nations to question whether US negotiators have sufficient political backing. Leaders of American business and labor have for several years felt that their trade interests have not been put forward forcefully enough in international forums. Many feel we have been "sitting on our rights" in the GATT while others have been actively their trade interests forcefully in bilateral talks using political leverage.

PROBLEMS AMONG THE INDUSTRIALIZED DEMOCRACIES

Although much of the US trade problem is rooted in imbalances and inadequacies of this nation's own domestic performance and policy, a part must surely be attributable to economic problems in our major Western trading partners and failures in economic cooperation among the industrialized democracies.

Western governments have not yet fully digested the magnitude of recent changes in the world economy -- changes that necessitate a better harmonization of underlying policies and significant efforts to avoid currency distortions. Billions of dollars, yen and deutschemarks are exchanged daily on world currency markets; the greater the divergence among national economic policies and performance, the greater the chances of currency volatility and misalignments. That in turn can lead to major and prolonged trade imbalances of the type we are now experiencing.

As national capital markets have become closely integrated, economic sovereignty has been sharply diminished. Yet governments have not devised ways to exercise shared sovereignty. Their policies, as today, frequently work at cross purposes. Attempts to achieve policy compatibility -- such as the coordinated effort to realign currencies decided on at the Plaza Hotel in September. 1985 or the parallel lowering of interest rates early in 1986 -- are usually made after periods of currency instability or sizeable trade imbalances when leaders have little choice. Governments have appeared content to try to deal with such problems after the fact; they have had trouble in summoning the foresight or the will to avoid them.

Second, shifts in global economic strength have not been matched by changes in attitude or habits. The US is a debtor country that still behaves as if it were a creditor; and Japan and Germany are creditor countries that cannot break habits developed when they were debtors.

Popular opinion in the US has not yet come to grips with the notion that we cannot continue indefinitely as large external borrowers. Moreover, it is hard to lecture other nations -- particularly West Germany and Japan -- on economic policy as long as this country cannot come to grips with its domestic deficit.

Japan and much of Europe have been slow to recognize that the days when they could argue that their trade barriers should be tolerated by the world because they were small countries and their actions could not really hurt the international economic system -- while the US, because of its size and impact on the international trading system was urged to practice a special form of discipline -- are long since over. But popular opinion in these nations has not yet come to terms with the notion that the long term interest of their societies will be served by their assuming a greater portion of the global economic management role that the US took on after World War II.

Third, the industrialized democracies have tended to use annual Economic Summits and similar gatherings to press one another for short-term policy improvements -- i.e. for "fine tuning" -- rather than to achieve a meeting of minds on consistent medium-term growth and balance of payments strategies. To have done so might have enabled leaders to chart steady and internationally compatible courses at home. Sharp differences in national savings and government borrowing, conflicting monetary policies, and other divergencies will breed currency and trade problems.

Forth, these governments have allowed the GATT to fall into disrepair. A series of bilateral arrangements to restrict trade, widening subsidies, and growing disregard for the rules has condemned the world to an escalating series of trade problems. One of the most egregious distortions has occurred in agriculture. Taxpayers in the US, Europe and Japan pay billions for agricultural subsidies and consumers -- through propped up prices -- pay billions more. But only a portion of these funds gets to farmers. A recent study by the Department of Primary Industry in Australia points out that in Japan consumers and taxpayers lose $2.50 for every dollar transferred to producers; the figures for the European Community and the US are $1.50 and $1.38 respectively. It notes also that the Common Agricultural Policy "has probably been responsible for a loss of employment of around one million jobs in the non-agricultural sector of the EC." Yet despite such waste there is still no agreement on how to reduce trade and domestic distortions.

There are various other areas in which similar -- albeit it less costly -- distortions exist. Many, however, are more difficult to quantify in traditional trade terms. Barriers to advanced US technology, to transmission of data, and to foreign operations of banks and insurance companies all pose problems for US companies. Violations of copyright, patent and trade mark laws deprive US corporations of the fruits of their research and investment. And subsidies imbedded in economies cause competitive problems for American companies which must compete with them.

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RELATIONSHIP BETWEEN LDC DEBT AND TRADE

While much of the focus of the trade discussion has been on trade imbalances with Japan, Europe and Canada, little attention has been devoted to the connection between Third World debt and the US trade deficit. In 1981, the US had a trade deficit with all developing nations of $33 billion; in 1985 it was roughly $51 billion. With Latin America the US had a trade surplus in 1981 of one billion dollars; in 1985 the US had a trade deficit of $18 billion. Although that figure represents only about 15% of the US trade deficit, it is nonetheless part of the problem. It is a particularly important problem for those areas of the US South East and South West that have traditionally relied on sales to Latin America.

There is a fundamental dilemma in US debt policy as it relates to trade. The advice we give to third world nations is that they should devalue their currencies, tighten up on domestic demand, improve the efficiency of domestic industries to boost their competitiveness, and thus earn more foreign exchange with which to service and repay their debt. Yet it is precisely the growing exports of Third World products -- particularly labor-intensive products -- that troubles American workers and companies that must compete. A second element of the problem is that although US banks hold only about one third of the Latin American debt -- with the banks of Europe and Japan holding the rest -- the lion's share of the increase in the exports of Latin America (which are necessary to service that debt) go to the US.

It is true, as Senator Bradley has frequently stated, that higher growth in Latin America and a reduction in debt-related constraints on imports, would be of considerable benefit to the US. It will be some time before US exports to that continent reach their 1981 level of $42 billion -- a figure supported at the time by what proved to be excessive borrowing. But there is room for some increase above the 1985 levels of $31 billion. How this should be done without weakening the US banking system and its willingness to provide new funds to the indebted countries presents one of the important policy issues this country has not yet resolved.

And that leads to an even more troublesome dilemma. There are two major international imbalances that must be resolved simultaneously -- the US trade deficit and the Third World debt.If the US trade deficit is narrowed as the result of a decline in US growth rather than an increase in growth in other major industrialized countries that would lead to a deterioration in the Latin American debt situation. And if the US is consistently called upon to absorb the bulk of the increase in exports of the high debt countries as well as the more active competitors of East Asia that will simply add to a trade imbalance which is bound to generate an adverse reaction here, to the detriment of the high debt and other countries.

THE FUTURE

Reducing the US trade deficit will depend primarily on two factors:

-- the increase in prices of imported goods in this country along with a decline in prices of American goods abroad translated in foreign countries -- followed by a shift in the pattern of new orders resulting these price changes. Although such shifts have occurred slowly, they are underway. The most promising prospect is for a growth in US exports because that is where most price adjustment has occurred. This export improvement should be realized not only with our major industrialized partners but also with smaller countries where the lower dollar should give US exporters a boost. On the basis of price shifts that have already taken place, the US trade deficit is likely to decline by $25 to $30 billion in 1987 -- still leaving a sizeable trade deficit. But the longer this price and order shift takes to occur in amounts sufficient to make a real difference on trade, the sharper the future decline in the dollar is likely to be;

-- higher growth in domestic demand abroad relative to that in the US. From 1981 through 1985 exports accounted for nearly half of West German growth and over one quarter of Japanese growth while a third of US domestic demand has been satisfied by imports. Increases in domestic demand in our major trading partners -- not only in these countries but also in others with low inflation rates and high unemployment -- coupled with the currency and price changes described above would significantly reduce the US trade imbalance. (But we must recognize that there are genuine differences of opinion over precisely how to boost growth in these countries and scepticism abroad about the benefits of "quick fix" stimulus.) If stronger domestic demand abroad do not occur, the burden of trade adjustment will be placed even more heavily on exchange rate changes.

But there are other steps that could help. Although foreign assistance has rarely been thought of as a device for promoting trade adjustment, it has an important role to play. After World War II US financial assistance to Europe and developing countries helped to reduce world financial imbalances. Today the large capital exporting countries -- such as Japan, West Germany, the Netherlands, and Taiwan -- could utilize their export credit agencies to give their financial institutions guarantees and other incentives to provide untied, low interest loans to high debt countries pursuing sound domestic policies. That would enable the high debt countries increase growth and to loosen somewhat the debt constraints on their imports. The US would benefit from the resulting expansion of export opportunities in this hemisphere; and pressures on Europe and Japan for a "quick fix" stimulus would be reduced. Such financial support should not be seen as a way of taking high debt countries off the hook in their efforts to improve their domestic policies and performance but as an added inducement to put their economic houses in better order.

Let me now turn to domestic policy measures to improve our competitive position.

First, we must reduce the size of our domestic savings-investemnt gap. In the next few years that reduction can only come from reducing the financing required by the federal government. If the federal deficit can be cut in half by 1990 there should be room to finance a reasonable level of private investment and the remaining budget deficit to a substantial degree from our domestic savings, thereby substantially reducing our call on foreign capital with the trade and external implications attendant thereon.

Second, we must improve lagging productivity. There have been many suggestions for new types of industrial policy to address this problem. But here I find myself in the Vince Lombardi school of economics: let's concentrate on the fundamentals. Education, research and development and capital availability.

In 1958, in response to Sputnik, Congress passed the National Defense Education Act. That was instrumental in this country's surpassing the Soviets in space technology and other areas of technology for that matter. Imports are the Sputnik of the 1980s. Today we need a new act -- a National Productivity Education Act -- to emphasise the training of scientists and engineers; in addition it must substantially enhance programs for mid-career training and retraining to keep pace with rapid shifts in technology and jobs. Education today is a national security issue just as surely as weapons programs; parsimony on America's education budget is the greatest of threats to our continuation as a great military and economic power.

Congress will also need to revisit the issue of whether the US government is doing enough to support research and development. I must confess to a sense of uncertainty as to the net affect of last year's tax bill on the pace of US research. It will be important to monitor developments in this area in order to determine whether new tax inducements are needed.

Capital availability will largely be a function of the amount of public savings claimed by the federal government. To the extent that the deficit is reduced, more funds will available for the private sector; but the tax and regulatory climate will also be important in order to ensure that the terms on which capital is available are competitive with conditions in other nations.

This brings me finally to the question of US trade policy. This Committee has an extraordinary opportunity to take the leadership role on the trade issue by shaping a trade bill which addresses key American priorities. A trade bill is a leadership vehicle. It can have two basic functions:

-- It can be the vehicle for forging a national concensus on trade policy. We need a national debate over trade policy leading to agreement on our basic goals. At present trade policy is carried out ad hoc with little agreement -- even within the executive branch -- on our overall objectives for improving access to other markets and modernizing the trading system, what our highest priorities are, or what we must give in order to achieve our goals. A bipartisan consensus -- shaped by an extensive dialogue with the private sector -- could give our trade policy consistency and direction.

-- It can demonstrate to America's trading partners a new found unity of purpose between the executive branch and the Congress. That should strengthen the hand of our trade negotiators. And it should reduce concerns abroad -- often used as a pretext by those not eager to negotiate with the US -- that US negotiators do not speak for the Congress and that as a consequence Congress might refuse to implement the results of the negotiations.

Without elaborating now on specific details of a trade bill, it would be useful to consider few strategic points when shaping it:

-- trade negotiations, no matter how successful, will not in themselves dramatically reduce the US trade deficit; and US negotiators should not be expected to obtain concessions significantly greater than those they are empowered to give;

-- the goal of achieving substantially equivalent sectoral opportunities is desirable in principle but there must be room for flexibility to make tradeoffs among sectors with a net economic benefit to this country. While strict reciprocity is unlikely to be possible -- and confining the executive to that type of negotiating straight jacket would be undesirable -- the concept of greater equivalence of opportunity is a sound one. We may not be able to obtain a completely level playing field, but we should insist on removal of the moats and fortifications;

-- a distinction should be made between tightening up procedures regarding the use of Section 301 and changing US laws with respect to dumping and countervailing duties in ways that are inconsistent with the GATT; on the eve of negotiations to improve the multilateral trading system -- the last opportunity we will have to do so in this century -- if the US were to unilaterally seek to reinterpret existing rules it would raise doubts abroad as to this country's willingness to play by any new rules that were negotiated and could be used as a pretext to stall negotiations.

-- it will be important to reinvigorate our commitment to US-Canadian trade negotiations. Not only can these provide new trade opportunities and remove distortions in cross border trade and investment; they also serve notice on other countries that the US is seriously interested in expanding trade and that unreasonable obstacles to multilateral progress will channel US energies toward areas in which bilateral progress can be made;

-- some accommodation between industrialized and developing nations must come out of trade negotiations; the developing nations of

East Asia are among the world's fastest growing markets and most active competitors. Failure to agree on an appropriate balance of benifits and responsibilities with them would condemn the trading system to frequent disputes and disruptions

-- the emphasis of our efforts should be on the expansion of exports rather than limiting imports; a more active application of pressures to open foreign markets should be recognized by the executive branch and America's trading partners as the necessary counterpart to averting pressures here for new import restrictions.

Mr. Chairman, exchange rate and trade issues are placing growing stress on the international economy and on this nation. This is a time for leadership. This country faces serious challenges in the period ahead. It can face these successfully if it recognizes the new era in which we live -- one in which we must compete more actively, conduct our domestic economic policies more wisely, and insist on an international economic system which affords this country the expanding opportunities that others expect of us.

STATEMENT OF RUDIGER DORNBUSCH, DEPARTMENT OF ECONOMICS, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MA

Mr. DORNBUSCH. Thank you, Mr. Chairman.

I welcome the opportunity to express to this committee my views on U.S. policy priorities in the years to come. I would like in particular to talk about trade LDC-debt relationships that in the past haven't received all the attention that they deserve.

I see the big issues for the world economy in the coming 10 years, first, to be the solution of the U.S. trade deficit; second, and related, the U.S. budget deficit; third, how to cope with the debt overhang of less-developed countries, and fourth, how to solve the problems posed by the catching up in productivity and cost performance of less-developed countries with the industrialized countries.

The policy setting for these adjustments is complicated by the fact that our trading partners, even today, are reluctant to pursue sensible policies, perhaps in part because they see our own lack of sense.

I would like first to review how the debt problem looks at this stage. In 1982 all of Latin America went into moratoria when no new money was available to pay the interest payments that had habitually been borrowed and suddenly could not be gotten anymore from the banks.

Credit rationing occurred. The international system stepped in with adjustment programs and financing programs, which were expected, in a very short time, to remove the debt problem from the front page by adjustment in debtor countries. Since much of the problem was the result of mismanagement in debtor countries, setting things straight was believed to solve the problems.

Nineteen eighty-two was a deep recession year, very high interest rates; hence, it was believed that the world economy the ordinary course of recovery and consolidation would make a major contribution to solving the debt problems.

The world economy has not, in fact, helped. Interest rates have come down some, but not much in real terms. Commodity prices in fact have been falling since 1982, aggravating the debt problems, and growth in industrialized countries, except in the United States, has been very poor.

But even though the world economy did not make a major contribution to solving the debt problems, the debt problem looks, by and large, solved, when we look at the fact that debtor countries are paying most of their interest.

Until 1985, increasingly, those countries have managed to produce trade surpluses with which to earn these dollars to pay interest on their commercial debts. In that sense, it was a success.

But if you ask how that success was achieved, there is a very simple number to bear in mind in that, in America, investment as a fraction of GNP has fallen by merely six percentage points. That is exactly the improvement in their noninterest-rate surpluses; that means, interest is being paid by not investing.

Of course, that is not a sustainable policy, certainly not in countries where the growth rate of the labor force is four percent. If for five years there is no investment in those terms, that is extraordinary. If the outlook is, as it is now, that that should be continuing, then there is a real serious economic and political problem on the horizon.

The second side of the debt problem is our commercial banks, who own a third of the problem debt in the world. And these debts are concentrated, of course, in the major money center banks; very little in small commercial banks.

Over the last four years—over the last five years—commercial banks have built up their capital. The large exposure has been reduced to levels where limited debt reduction by repudiation of relief would now not be a problem for the banking system.

The remaining problem, then, in the debt situation is that less-developed countries, and particularly in Latin America, have suffered enormous reductions in their per capita incomes, that they have very precarious macroeconomic situations because all of a sudden their budgets were visited with an extra six percent of GNP external debt service and, like us, they really don't know how to pay for it. Unlike us, they can't print dollars to pay for it. Hence, the extraordinary recessions, the extraordinary inflations, and the extraordinary attempts to become more competitive, have more exports, less imports, in order to service the debt.

That is not the normal course of the debt problem. In the 1930's, all of Latin America simply defaulted on their debt and immediately started growing, and outperformed the industrialized countries. Today, the opposite is true, by and large, because of the way the debt problem is being handled by the multilateral institutions and the industrialized countries, which is to extract at maximum speed interest payments and to exert significant political pressure.

I see as one of our major problems an easing of the debt collection process, bearing in mind that at present a large part of the interest is being paid by our manufacturing industries.

The second problem I would like to draw attention to is the link of trade and debt as we look at it from the U.S. economy. If we look at trade with Latin America, we have had a swing in our bilateral trade balance since 1980 of $10 billion, and that is a very, very small number. But if we look at trade with developing countries and focus on manufacturing, which is the area of biggest policy concern in the U.S., the swing is $45 billion. That is an extraordinary number, because that is way upward of seven percent of our manufacturing output. And I think it is that size of swing that explains why manufacturing is waking up to the fact that rapid debt collection is really at their expense and not in the nation's uniform interest.

I would also note that our problems with developing countries will become increasingly tough. They have learned to implement our superior technology, with our capital equipment, but they do it at wage rates that are a very, very small fraction of ours, but productivity levels that aren't very different. If our wage and manufacturing is $13, and theirs is $2, and they work a bit harder and a bit better, then we do have a problem. Our trade with Korea is an example of this.

The third problem I would like to draw attention to is the performance in other industrialized countries and how it affects our trade situation.

Over the last five years, our growth, cumulatively, has been 20 percent; other industrialized countries, excepting the U.S., have grown at 10 percent. That 10-percent differential is reflected in a much higher level of imports here, and a much lower level of exports. They haven't grown as much, because the rest of the world did not grow as rapidly as we did.

That problem is not going to be solved by the convergence of growth rate that now is to be seen, with everybody expecting two and a half percent. In order to redress the effect of the cumulative growth differential, they would have to grow, for a while, more rapidly than we do, or else we have to become more competitive.

That takes me to the policy recommendations that I see.

The first is an urgent attention to a different handling of the debt problem. The fashionable solutions are a debt equity swap and a reversal of capital flight; neither of them is a serious way of coping with the problem.

The next one on the Christmas shopping list is a facility where the Japanese put in $60 billion to bail out our commercial banks. I also think that is not very serious.

And that leaves us with two solutions: One is to do nothing, which is the recommended solution by commercial banks, pending the arrival of the taxpayer; and the other is to go in the direction of saying, "First, the U.S. Administration should stop actively collecting LDC debts," that is the policy position that has been advocated by Milton Friedman and other conservative economists.

The CHAIRMAN. I didn't understand that; would you repeat that?

Mr. DORNBUSCH. Yes. That the U.S. Administration should stop actively collecting debts. And I will emphasize that in a moment.

That policy position has been advocated by conservative economists, who say the only reason debts are being collected in full rather than with a reasonable write-down is because foreign policy pressure is being applied to virtually every LDC to come to a solution with a creditor involving full payment at rates of interest in excess of commercial rates. So, an easing is the minimum, and institutionally that is easy through the IMF.

But I think we must look further ahead and say, "If per capita incomes in many debtor countries have fallen 25 percent, perhaps we are creating for us a foreign policy problem of an order of magnitude that is worth looking at twice," and that means we should ask: Isn't it in our interest to have targeted, selective, limited, reasonable—all the adjectives—debt relief on our policy agenda? And I certainly favor the spirit of the Bradley Plan in that direction.

I think there are two important other policy directions to move in. I believe trade policy is not the priority, since all that will come out of it is primarily to stop foreigners selling here. Our priority must be to bring the dollar significantly lower in world currency markets so that our wages, in terms of foreign currency, are somewhat more competitive--I think 30 percent is a good number. And secondly, to seek much lower world interest rates, because the high level of interest rates in conjunction with the slowing down of growth as we correct our budget deficit would mean increasing financial fragility in the U.S., in developing countries worldwide.

Thank you.

[The written prepared statement of Professor Dornbusch follows:]

DEVELOPING COUNTRY DEBT AND U.S. TRADE PROBLEMS[1]

Rudiger Dornbusch
Massachusetts Institute of Technology

The world economy of the next ten years will be dominated by the resolution of four problems: the U.S. trade deficit, the budget deficit, the LDC debt overhang and the extraordinary gains in manufacturing export performance of developing countries. For the United States the news is uniformly bad: our standard of living, which has gotten out of line with fundamentals, will decline. The policy challenge is to keep that decline to a minimum and bring it about as soon and as smoothly as possible.

Our standard of living has gotten out of line with fundamentals as a result of several factors: unsustainably low taxation, overvaluation of our currency, sharp cuts in investment and large trade surplusses forced on debtor countries by our debt strategy, the catching-up of developing countries in their ability to produce our goods at a significant cost advantage, and an external environment of sluggish growth in demand and continued high real interest rates.

. External competitiveness has recovered insufficiently from the overvaluation of 1980-85 to assure continued high employment and a closing of the trade gap.

. The budget deficit is not disappearing. Forecasts of a $100 billion deficit by 1990 are based on implausibly optimistic assumptions on sustained growth and declining interest rates.

. Bank claims on LDCs are deteriorating as it becomes apparent that our policy of rapid debt collection translates into recession and inflation abroad and increased trade deficits here.

. Cost competitiveness, superior quality and better marketing by Japan, and a host of developing countries leads to increasing import penetration in the U.S. and loss of external markets. Any offsetting export growth from new products or technology is altogether missing.

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[1]Testimony before the Senate Finance Committee, January 22, 1987.

. Growth in spending in other industrial countries has persistently lagged behind that in the U.S. so that the rest of the world has taken a free ride on our spending spree. Real interest rates continue to be exceptionally high as a result of our failure to secure policy coordination. These high real interest rates trasnslate into budget deficits and thus feed back as a burden on investment and growth of the world economy.

The inevitable adjustment is a cut in our standard of living. In fact, what the U.S. requires at this stage is a traditional IMF program. Policy makers, of course, shy away from adjustment when there is no outright crisis. But the postponing of adjustment only increases the severity of the correction in taxes and real wages that must ultimately be made. The reasons are quite obvious: delaying budget cuts means more borrowing. The increasing debt accumulates at high real interest rates thus raising future deficits and hence the required increase in future taxes.

Delaying the adjustment of our trade problems means an increasing loss of productive capacity and jobs at home and an increasing external debt. The later the adjustment, the larger the real wage cut to generate the earnings to service the accumulated external debt. Delaying our adjustment further also means that an extra large cut in real wages will be necessary in the future to bring back all those firms who are now closing down or are shifting operations abroad. Early and sizeable adjustment of the dollar, over and above what has already occurred, will help keep to a minimum rhe risk of a really massive crisis down the road. Delay carries an extra burden in that it creates of financial fragility.

The best policy is to secure at the earliest possible time a major reduction of the dollar in world currency markets, perhaps as much as 30 percent, and to adopt a credible path of budget correction by increased taxation of consumers. At the same time it is essential that tax benefits for investment be restored and the cost of capital to investing firms be lowered.

3

In a longterm perspective education standards must be raised in the U.S. and the business community must relearn to focus on fundamentals (production and selling) rather than on finance.

The extent of adjustment is very much dependent on the policy performance abroad. If we can secure lower world real interest rates and increased spending abroad our trade and fiscal problems will be lessened and so will be the need for extra taxes and real wage cuts. But in judging our likely success in the next few years pessimism is warranted because of the lack of understanding and leadership that has characterized the administration's economic policy over the past few years. The lack of sense is apparent in our fiscal policies and in the management of LDC debts. The U.S. (excepting the Federal Reserve) today is seen by our partners abroad more nearly like a drunk elephant rather than a leader with a clear sense of direction.

Against this policy background I will comment in more detail on the developing country debt problem and our trade problems with developing countries.

1. THE LDC DEBT PROBLEM

The debt experience of the 1920s and 1930s was one of pervasive default. By comparison, today's debt service performance remains surprisingly on track. A great historical experiment is now underway in which involuntary debt service is being extracted at high costs to the debtors and to the trading interests of the creditor countries. The essential instruments are two: a return of government involvement in private debt collection that had gone out of fashion after 19th century gunboat diplomacy, and the IMF as the administrator of adjustment programs and debt collection.

But even with this help debt collection is becoming precarious. The sharp decline in growth and investment in debtor countries is becoming increasingly unacceptable. This is reinforced by the poor prospects of a return to voluntary lending and the absence of any kind of debt relief except when countries stage a confrontation as Peru and Mexico have done. The Baker plan turned out to be primarily a cover for commercial banks to reduce their share in debt rescheduling, leaving the bag to multilateral agencies with no net benefit to the debtors. Major debtor countries, including Argentina, Brazil and the Philippines, now see the Mexico deal of sharply reduced spreads, significant mediumterm finance and contingencies as a model in the shortterm. In the longterm they expect a more generous kind of relief.

LDC debts can be kept in the present manner going if enough rescue ingenuity and pressure is applied. But the costs of avoiding a solution are mounting for the debtor countries, the creditors' trade and employment, and the creditors' foreign policy interests. The debt problem in its trade implications is certainly one element in the growing U.S. protectionist sentiment. This is now more widely recognized and hence a broader debate on realistic options is emerging.

We start with some factual background regarding two issues: First, the extent of LDC adjustment and the shift in financing of imbalances Second, the exposure of commercial banks and the quality of debts.

LDC Adjustment and Financing: In the aftermath of the debt problem lending by the private sector became involuntary, as did debt service by the debtor countries. The debtor countries produced sharp reductions in their current account imbalances, more than making up for the increased interest burden.

Table 1 shows the shifts in the current account and in financing for Latin America. While commercial banks in 1981 lent to Latin America at the rate of $54 billion, by 1985 they were actually reducing their exposure.

Table 1 Latin America: Current Account Imbalances and Financing (Billion U.S. $)

	Current Account	Borrowing	
		Official Creditors*	Private Creditors
1981	43.3	6.5	54.1
1982	42.0	14.6	28.8
1983	11.4	17.7	2.0
1984	4.9	10.7	7.0
1985	5.9	5.1	-0.6

*including reserve-related liabilities.
Source: IMF

The striking fact in these numbers is the large adjustment in the debtors' current account and the disappearance of private market financing. The adjustment America has been achieved largely at the expense of investment. This point is apparent by looking at Table 2 which shows the ratio of gross investment to GDP and the non-interest surplus, likewise measured as a fraction of GDP.

Table 2 Latin America: Investment and the External Noninterest Surplus (Percent of GDP)

	1977-82	1983-85	Change
Gross Investment	24.3	18.5	-5.8
Noninterest External Surplus	-0.6	4.7	5.3

Source: IMF

The shift in gross investment is approximately of the same size and in the opposite direction as that in investment: Latin America is accomplishing the improvement in debt service by cutting down on investment. There are several channels through which the current process of debt collection makes this almost inevitable. Perhaps the most significant is the fact that involuntary debt service forces on the government budget stringency that is most easily met by postponing or simply giving up investment. This effect is quite apparent in any of the debtor countries where public sector investment has declined dramatically. For example in Mexico public sector investment has declined by 5 percent of GDP.

The fact that investment is sacrificed rather than consumption is entirely appropriate when disturbances are shortlived. But a serious issue of misallocation arises when, as is the case now, the postponement lasts several years and is expected to continue. Growth of the labor force is not matched by expanding job opportunities and, as a result emphasis is on further wage cutting rather than on a recovery of the standard of living.

Bank Exposure and the Quality of Debts: Table 3 shows the claims by U.S. banks on the non-oil LDCs, both in dollar terms and as a fraction of capital. The table makes a distinction between various groups of banks to highlight the concentration of exposure in the large banks.

Table 3 U.S. Bank Claims on Problem Debtors

	All U.S. Banks	9 Major	15 Major	All Other
	(Billion $)			
Latin America	$80.4	$60.5	$16.0	$15.2
Other Debtors	$12.6	$8.8	$1.9	$1.2
	(Percent of Capital)			
Latin America	78.9%	148.6%	80.0%	36.9%
Other Debtors	12.3%	21.7%	9.5%	2.9%

Source: Federal Reserve

Attention focusses on the exposure measures since these highlight the vulnerability of banks to possible defaults. We show separately the data for exposure to Latin America which is of particular interest because Latin debt accounts for the major part of debts and, for cultural reasons, is judged the most vulnerable.

Exposure has declined significantly since 1982. In part this is cosmetic, in part it reflects a strategy of raising bank capital (including notes) and a sharp curtailment in "new money" commitments. Part of the increase in capital takes the form of equity commitment notes rather than actual equity. Raising capital via these notes reflects the double advantage of favorable tax treatment and a potentially more favorable timing of actual equity issue. It leaves open the question of where the financial effects of an actual call on the commitment would fall. It is clear that there is a sharp difference in exposure between the large money market banks on one side and all the other banks. A complete Latin write-off of debts would wipe out the large banks but would keep the smaller ones intact. This is one of the senses in which LDC debts are a "Big Bank" problem.

Quality of Debts: One measure of the quality of these bank loans is provided by the discount at which they trade in the second hand market. There is now a well-functioning market in which banks can sell or swap loans in their portfolio. Business is done between banks but also with corporations and even private investors. Table 4 shows the discounts for problem debtors.

Table 4 Some Problem Debtors

Country	Debt per Capita ($)	Interest/ GDP Ratio	Cumulative per Capita GDP (%) 1981-85	Debt to US banks (Bill.$)	Loan Price[a] (Cents/$)
Argentina	1662	7.9	-18.7	8.4	66.0
Bolivia	622	10.0	-22.4	0.1	7.5
Brazil	791	5.8	-1.6	22.2	75.5
Chile	1740	12.9	-8.6	6.5	68.0
Colombia	395	3.3	-0.2	2.2	86.5
Mexico	1261	6.3	-4.3	24.2	56.5
Peru	680	10.8	-14.8	1.5	19.0
Philippines	456	6.2	-15.0	5.1	73.5
Venezuela	2000	8.1	-21.6	9.7	74.5

[a] Average price in cents per dollar debt in the secondary market.
Source: World Bank, IMF and Dealer Information

The evidence is, of course, quite striking. Discounts of 30 or 40 percent suggest that the market must assign a very significant probability to partial or complete default. These valuations might be affected by the fact that the market continues to be quite narrow, without a massive spreading of the risks to widows, orphans and insurance companies that might ordinarily be expected to hold some share of these claims. But even with allowance for the narrowness of the market the discounts are very large. It must certainly be clear that these deep discounts suggest that an imminent return to voluntary lending is quite implausible. The economic and political difficulties associated with the adjustment, and the excessive indebtedness in some instances such as Chile, are the main reason.

2. SOLUTIONS TO THE DEBT PROBLEM ?

The debtor countries problem today is to gain debt relief so as to free resources for investment. External resources are required to support the governments' growth policies without risking financial instability. Tax reform and improved tax enforcement are certainly the overriding instrument. Improved efficiency in the public sector is important, but without external resources for growth, mediumterm adjustment will not get a chance to start.

We now briefly review the main directions of solution that have been suggested.

A Better World Macroeconomic Environment: In 1982 the prospects of strong growth in the industrialized countries, lower interest rates, a weaker dollar and stronger real commodity prices were the central scenario which encouraged the "muddling through process". This scenario gave confidence that by the end of the decade debt-export ratios would decline significantly. Some of these developments have, in fact occurred, and for some countries they have even be reinforced by an unexpectedly large decline in oil prices. But the expected benefits in terms of enhanced creditworthiness are not there, or at least not pervasively so. It is true that Korea is certainly at present not a problem debtor, but Brazil clearly is and so are many other countries.

Looking ahead to the next few years, what macroeconomic developments can be expected and how will they affect the debt situation? The central development for the world economy is US budget balancing. There are basically three scenarios. In one case rapid budget cutting is accommodated by monetary expansion in the U.S. and in the rest of the world. In this setting interest rates decline sharply, growth is sustained and the main exchange rates between industrial countries remain unaltered. This is a highly favorable scenario for LDCs in that the shift toward much lower interest rates implicitly transfers to them resources in amounts far in excess of what taxpayers in any country are willing to do.

The second scenario envisages the same budget cutting, perhaps more spread out in time, but without monetary accommodation. In that case interest rates decline somewhat but there will be a world recession. Most debtors would not benefit, or at least very little, since the lower interest rartes are offset by slack in their export markets.

A third scenario envisages a hard landing: budget cutting and a flight from the dollar that forces the Federal Reserve to raise interest rates to stem the inflationary impact of depreciation. Such a development would certainly bring about systemwide illiquidity and likely default.

The world macroeconomy does hold out some promise. A Gramm-Rudman-Hollings, soon and with worldwide monetary accommodation, would make a major advance toward solving the debt problem. But for the time being there is not much of a sign of either the budget cutting or of the monetary accommodation.

Debt-Equity Swaps: The debt problem has two aspects. The first is that debtors cannot service their debts as contracted. Moreover, the interest they pay comes largely at the expense of much needed investment in their economies. Thus debtors have a resource and investment shortage. On the lenders side small banks are tired of the acrobatics involved in debt collection. They want to avoid yet another round of rescheduling. But there is no money in the debtor countries to pay them off, nor can the large banks do so, given their already extravagant exposure. These twin problems strain the skills of regulators, accountants and policy makers world-wide.

Creditors' attention is therefore shifting to new ways of liquidating debts without taking outright and massive losses on the entire portfolio. But if banks are to get out, who will get in? Debt-equiity have swaps emerged as an attractive part of a solution to the debt problem. Their apparent merit is to solve several problems at once: They allow banks to sell off loans without a massive decline in loan prices, debtors can reduce their external debt and at the same time pull in foreign investment.

The basic difficulty is that debt-equity swaps amount to a budget subsidy by debtor countries that will let banks get out and foreign investors get in. But when the Central Bank pays off its external debt in home currency this will be inflationary. The inflationary impact is offset by domestic debt is issue to maintain the money stock unchanged. Hence, when everything is done, the government has a reduced external debt, but a matching increase in domestic debt. The country owns less of its capital stock since the foreign investor will have bought some and in return has redeemed some of its external debt.

In the budget there will now be reduced interest payments on external debt offset by increased domestic debt service. There is a net reduction in interest if the debtor country can appropriate most of the discount at which the external debt is traded and if the domestic interest rates (in dollars) is not too high relative to the cost of servicing the external debt. The net result is likely to be an increase in debt service because real interest rates in debtor countries are exceptionally high.

On the balance of payments side reduced interest payments are matched, at least potentially, by increased remittances of dividends or profits of the new foreign owners of the national capital stock. In fact, the country becomes less liquid since it is much easier to control the service of bank debt than the remittances of multinationals. The massive outflow of remittances from Brazil in 1986 makes this point.

Debt-equity swaps are primarily a balance sheet operation, selling good assets (why else would foreigners buy them?) for bad assets (why else would creditor banks sell them at a discount?). They do finance investment, but this occurs at the budget cost of a subsidy and applies to investment that would have taken place anyway. Balance sheet trick are not a substitute for gaining extra real resources for investment. Improved government budgets in the debtor countries, increased efficiency in their public sector and net resource transfers from abroad are the only way for investment and growth to return. Bankers and bad debts, with their lien on debtor countries' finance ministers, remain the major obstacle.

Of course, debtor countries should open all doors to foreign direct investment. But there is no justification for subsidizing direct foreign investment. Debt-equity swaps agreed between private firms and their commercial bank creditors (without government intervention or subsidies) are entirely appropriate. Likewise there cannot be any objection to direct foreign investment. On the contrary, there should have been more of it in the past, and the more there is in the future the better. The objections raised here concern exclusively the use of an already strained budget to grease the wheels.

Reversal of Capital Flight: The wishful thinking turns to the $100 billion or more of Latin assets that have fled from financial instability and taxation to the industrial countries, especially the U.S. Reversing these capital flights, primarily in the case of Mexico or Argentina, would make it almost possible to pay off the external debt. The reason is that much of the debt was incurred in the first place to finance the exodus of private capital.

The idea that private capital could be the main solution or at least an important one is naive. There is little historical precedent for a major reflow and when it does happen, it is the last wagon of the train. Einaudi once observed that savers "have the memory of an elephant, the heart of a lamb, and the legs of a hare". Capital will wait until the problems have been solved; it won't be part of the solution and even less as a bridge head.

It is often argued that if only countries adopted policies conducive to guaranteeing savers stable positive real rates of interest the capital flight problem would not be an issue. But that argument is not very operational in three respects. First, in the context of adjustment programs it is unavoidable to devalue. Compensating savers for the loss they would have avoided by holding dollar assets would place a fantastic burden on the budget which in turn would breed financial instability. Second, practicing high, positive real interest rates poses a serious risk to public finance. The public debt which carries these high real rates snowballs, and that in turn is a source of instability. Third, it is a bad habit to raise the return on paper assets above the prospective return on real capital. That is terrible supply side economics which ultimately erodes the tax base, and deteriorates the financial system by souring loans.

It is also worth recognizing that the capital flight problem is to a large extent of our own doing. The Administration in an effort to fund our own deficits at low cost has promoted international tax fraud on an unprecedented scale. The only purpose one can imagine for the elimination of the withholding tax on nonresident asset holdings in the U.S. is to make it possible for foreigners to use the U.S. financial system as a tax haven. To compete with the tax-free U.S. return anyone investing in Mexico (and actually paying taxes there) would need a yield differential, not counting depreciation and other risk, of quite a few extra percentage points.

There is much talk about the problems of banks putting in new money only to see it spent by debtors like Mexico on capital flight. Of an extra dollar of new money conceded by creditors 70 cents are said to leave in extra capital flight. The fact is that our banks are the chief vehicles for and beneficiaries of the capital flight. The treatment of capital flight by the banking community, with these issues in mind, is not only outright cynical but also shortsighted. This system enhances the political explosiveness of the debt crises by placing on workers in the LDCs an even more serious adjustment burden.

The Facility: A number of proposals recognize that old debts oversized mortgages on the debtor countries which impede the free and voluntary flow of new funds. The vehicle to bring in new capital is a facility that buys up LDC debts from banks and makes available for debtors reductions in debt service costs.[2] The international fund with scope for risk diversification and credit standing provides important opportunities for passing on benefits to the debtors without destructive effects on the solvency of banks or the asset position of their stock holders.

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[2]The most recent proposals are in an editorial by David Obey and Paul Sarbanes in the New York Times, Nov. 9,1986 and the suggestion for a Japan Fund made in various speeches by Jim Robinson of American Express.

The details of such facility schemes vary. Invariably they are administered by the World Bank. On the basis of a capital subscription to be made by an as yet undesignated donor (typically Japan) and leveraged by borrowing in the world capital market, the facility would take over from banks LDC debts, or buy these in the second-hand market. The benefit of the reduced cost of capital, and of the facility's purchases at discounts of debts from banks would be passed on to debtors in the form of more favorable interest rates or debt reduction.

The conception of the facility draws attention to an important practical problem in credit markets. The higher the interest rate charged on credit, the less likely that it can and will be paid. Hence a policy of risk premia is exactly that, it makes loans risky. Thus the facility would avoid this problem by charging a common interest rate, but it would reward countries for performance by a policy of writing-down debt outstanding.

Such a facility introduces a new party into debt negotiations. Concerned with the solvency and productivity of the facility the management would potentially take positions in rescheduling agreements to assure that the value of the assets it carries is not impaired by extortionary settlements or unreasonable adjustment programs. One might imagine, in a particular situation, that the facility makes available a longterm reconstruction loan to a particular country and in exchange secures from the banks extraordinary reductions in spreads or maturities. Of course, to perform this function agressively the manager requires stature and independence, beyond the immediate reach of the U.S. Treasury.

The main question about the facility, the issue of the donor aside, is who should be the beneficiaries. The facility must, ultimately, involve tax payers money although this may occur in a highly remote, off-budget and leveraged fashion. The use of tax payer's money makes it reasonable to ask whether the facility should benefit starving African debtors, middle-income Latin America or winners such as Korea. Assigning the use of the fund primarily to Latin America, rather than to Africa whose debt is mainly to governments and international organizations, might suggest that the facility has overtones of a bank bail-out.

Debt Relief: Debtor countries have failed to form an effective cartel that could impose debt relief in the form of a write-down, sharply reduced interest rates, generous grace periods and consolidation of debt into perpetuities. On the contrary, debtor coutries have competed with each other and, as a result, have wound up with poor terms and a short leash.

There were only two attempts so far to turn debt service into a major political issue. One is the case of Peru, the other is the Mexican move of this spring. In each case the extreme domestic costs of debt service and the destructive effects on investment, inflation and growth potential led the governments to try and limit the damage. It is hard to believe that Peru got very far. But it is certain that Mexico initiated an important change in policies and procedures. The Mexican success suggests that with enough determination debtors can in fact secure reduced spreads, contingency funds and even an underwriting of growth.

At the same time the debt problem is starting to become a U.S. political issue. This is the case in part for reasons of foreign policy. But another important motivation is that the poor U.S. trade performance is seen as a reflection of debtor countries' need to earn foreign exchange for debt service.

The Bradley plan recognizes the trade-debt link and emphasizes the need to create a vehicle for trade-debt discussions. Focussing explicitly on the link between debtor country trade concessions and targeted, limited debt relief this approach makes debt consciously a political issue. Besides facilitating the regulatory system to make it easier to effect write-downs the proposal also calls for reduced interest payments, extra money and debt write-downs.

Of the several negative responses to the Bradley plan, none is particularly persuasive. The least compelling involves moral hazard. It is argued that any and all kind of debt relief deteriorates or even destroys the beneficiaries ultimate chances of renewed access to the international capital market. Countries who accept debt relief, it is said, will be tainted. Only those who service humbly will see the day of voluntary lending. Historical precedent for all of Latin America would suggest the opposite.

There are two further aspects to the debt relief discussion worth drawing out. It is rightly pointed out that Latin America's debt reflects to a large extent mismanagement and capital flight. Granting debt relief to Latin debtors, and not for countries where management was more careful, therefore would seem to reward poor policy performance and thus invites repetition. But here the moral hazard argument can also be made in two other directions. First, not giving debt relief means that the governments of creditor countries enforce bad loans. They thus encourage poor lending policies on the part of commercial banks who expect to be able to rely on governments to collect for them even the poorest sovereign loans. The major weakness of the moral hazard argument in cases such as Mexico and Argentina results from the fact of capital flight: those who today service the debt are primarily workers whose real wages are cut. Those who engaged in capital flight are rewarded by capital gains and thus turn out to be net beneficiaries of the debt crisis. The moral hazard argument thus can easily be turned around to support the case for debt relief.

In the end the obstacle to organized debt relief comes from the fact that tax payers are unwilling to underwrite debtor country growth and politicians are unwilling to confront the banks, even if the case is compelling. Political solutions to the debt problem are therefore likely to lie in the neighborhood of what Mexico secured and, unfortunately, far away from more ambitious plans. With very limited relief the debt problem will remain an overwhelming burden on the growth prospects of debtor countries.

3. TRADE AND DEBT

There is considerable difficulty in allocating the deterioration of the U.S. external balance between competing causes: the overly strong dollar, the rapid domestic growth relative to that abroad, the budget deficit, the turn forced on debtors' trade balances by the need to service external debts and the increased competitiveness of developing countries. All these factors combined add to our $150 billion trade problem.

Trade with Latin America is typically highlighted because of the shartp reduction in import spending in that region. In the period 1980-1986 our trade balance with Latin America shifted by about $10 billion and now is in deficit. Not all of this can be attributed to the debt crisis since our loss in competitiveness must certainly account for some part of these data. It is also true that trade figures of the early 1980s are inflated by Latin America's overvaluation and spending spree. But even so it is quite apparent that there was a major shift in the bilateral balance amounting to $10-12 billion.

The bilateral trade balance, even attributing all of this to the debt crisis, does not seem to represent much damage. After all, this is less than a quarter of 1 percent of GNP! Of course, this does not exhaust the damage and GNP is not the proper scale variable. Other damage to U.S. trade and investment interests occur via the depression of demand and profitability in the debtor countries. U.S. multinationals who produce for the home market in those countries have sharply reduced sales and profits. Similarly there are losses in US exports of nonfinancial services to debtors. There are no ready estimates of these losses.

<u>LDC Trade</u>: But the Latin American numbers are misleading in three respects. First, they include the effect of sharply depressed commodity prices as a reduction in our imports and hence a reduction in the swing of the trade balance. Second, these numbers do not include all debtor countries. Finally, the data do not reflect the special developments in manufactures which are, at least in party, the result of the debt crisis. Table 5 corrects for these problems and shows U.S. imports from and exports to all developing countries (including OPEC). The table also reports separately the developments in manufactures trade which deserve special attention.

Table 5 U.S. Trade With Developing Countries
(Billion $)

	All Goods			Manufactures		
	Imports	Exports	Balance	Imports	Exports	Balance
1980	122.6	79.6	-43.0	29.5	55.6	26.1
1981	121.3	87.4	-33.9	35.1	61.5	26.4
1982	103.7	80.7	-23.0	37.0	55.5	18.5
1983	107.4	71	-54.7	45.9	45.7	-0.2
1984	125.9	72.7	-53.2	61.8	47.5	-14.3
1985	122.2	69.7	-52.5	65.5	46.0	-19.5

Source: Gatt

Table 5 highlights the extraordinary deterioration in our manufactures trade with developing countries. The swing since 1980 is more than $40 billion. From a surplus of $26 billion the bilateral balance in manufactures has shifted to a $20 billion deficit. That amounts to 1 percent of GNP or nearly 6 percent of value added in manufacturing. The extraordinary size of this shift explains why the manufacturing industry points to the debt crisis as an important part of their difficulties.

Of course, not all of the swing in manufactures trade is the result of the debt crisis. Exports from Hong Kong, Taiwan, Singapore and even Korea are largely unrelated to the debt crisis. But the table does suggest that, for whatever reason, our manufacturing problems are not exclusively due to the dollar or to Japan. In fact, developing countries will become an increasing problem for our manufacturing sector. This is simply a result of their catching at extraordinarily rapid rates with our technology. They have come into a position of producing most of the goods that we produce today and they can do so at significantly lower cost. Inertia makes the erosion of our manufacturing sector gradual, but that the erosion is taking place is beyond question.

Table 6 shows that the inroads by developing countries in the U.S. market, in manufacturing especially, parallel now that of Japan. Moreover, the import competition is not limited to textiles. In the 1973-85 period developing countries rivalled Japan in their increase in market share for engineering products. Much more of that lies ahead in the next ten years.

Table 6 Share of Japan and Developing Countries in U.S. Imports

	Japan		Developing Countries	
	1973	1985	1973	1985
All Imports	14.7	20.2	29.9	34.0
Manufactures	22.0	27.9	17.4	26.0
Textiles & Clothing	14.5	6.0	56.0	68.2
Engineering Products	36.9	37.9	10.1	18.1
Household Appliances	52.7	59.6	23.7	30.9

Source: Gatt

Developed Countries: Our trade with industrial countries has suffered through two channels. The first is the rapid growth in demand in the U.S. compared to the rest of the world. In the period 1983-1986 U.S. demand grew at the rate of by 20.3 percent while demand in other industrial countries grew by only 10.5 percent. The discrepancy meant that our imports grew much more rapidly than our exports. The impact of this cumulative growth differential on our trade balance will not be reversed by the convergence of growth that is now predicted. Our import level, as a result of the past differential, will be permanently higher than our export level unless there is a period during which the other industrial countries grow faster than the U.S. There is no prediction that this will happen. That means a larger adjustment must come from the exchange rate and competitiveness.

The real depreciation that has taken place since early 1985 brings competitiveness (relative to industrial countries) back to the level of 1980.

That is not a sufficient adjustment for a number of reasons. First, as already noted, the cumulative growth differential calls for an extra depreciation. Second, the persistent overvaluation has led firms to close here and reopen abroad, thus permanently harming the trade balance. Third, our deteriorating trade performance relative to LDCs needs an offsetting improvement in our trade with developed countries. The sharp increasse in import penetration shown in Table 7 gives an indication of the magnitude of adjusdtment that is required.

Table 7 Import Penetration
(Percent of Domestic Demand)

	Capital Goods	Consumer Goods
1980	14.6	6.9
1982	19.7	7.7
1985	29.2	10.8

For all these reasons, and as a forward looking incentive to it is essential that the dollar be reduced in world currency markets by a very significant amount, say 30 percent. The resulting gain in competitivenes relative to Europe and Japan, and to a lesser extent relative to LDCs, provides the necessary incentive to reverse trade flows and restore production and investment in the U.S.

The attempt to single out individual LDCs and lean on them to appreciate is a poor substitute for a much wider and pervasive gain in competitiveness that we need.

4. INTEREST RATES

Over the next few years the U.S. needs to correct the budget deficit while at the same time restoring investment incentives for firms. The only plausible channel (barring defense cuts and cuts in entitlement programs) is to implement a broad based tax such as a value added tax.

The budget correction, once it takes place, will reduce aggregate demand and thus risk putting the economy in recession. To maintain full resource utilization the trade balance should, at that time, be improving strongly. Moreover, interest rates should come down to reinforce demand. On the trade side there are significant lags in the response of trade flows to the exchange rate. To have a smooth adjustment it is therefore of great importance that exchange rate adjustments should lead the budget cutting which has almost immediate effects on demand. This reinforces the argument for a further, immediate depreciation.

Lower interest rates are required in the world economy because the current level of real rates is very high by historical standards. This is brought out in Table 8.

Table 8 U.S. Real Interest Rates[a]

Period	Real Rate	Period	Real Rate
1926-80	-0.1	1970-80	-1.1
1950-80	-0.1	1980-85	3.5
1960-70	1.3	1985-86	3.7

[a]T-Bill rate adjusted for the realized rate of CPI inflation.

Lower real interest rates are not only desirable as a stimulus to demand, once budget cutting gets underway. They are also essential for financial stability. There are obvious benefits for debtor countries, agriculture and on overindebted firms. But there is also an important budgetary effect. Lower interest rates reduce interest payments in the budget. In Europe and in Japan that provides room for fiscal expansion to raise their growth rates. Here it reduces the size of required tax increases.

The importance of interest rate cuts for a smooth macroeconomic future is on a par with the need for a lower dollar.Tax increases may take time, but there is no reason to wait with depreciation and interest rate cutting. A determined policy of lowering the dollar will force on our overly reluctant trading partners a choice between matching our cuts in rates or losing export jobs. No doubt they will strike a balance. Of course, there is a risk of inflation. But wage settlements continue to be so moderate that the large benefits from these policies compare favorably to the costs of possibly some extra inflation.

Failure to pursue budget, interest and exchange rate adjustment will drive the U.S. increasingly in a direction where we share all the ills that have been plaguing Great Britain over the past twenty years or more.

The CHAIRMAN. Professor, you stepped right into the middle of the controversy, didn't you? Those are some interesting proposals, and we will get back to them. They are of great interest to me, as one who was born and reared on the Mexican border and sees a country strapped in debt that can't buy our products anymore.

Dr. Greenspan, you made an interesting comment—well, throughout the testimony, but in particular at the end of the testimony when you were talking about the increase in foreign investment in this country, and what it means for the future, down the road. You just touched on it.

I was in Houston, flew down the day before yesterday. I landed and got off the plane in my home town. There was an enormous delegation waiting there, and I looked toward them with great anticipation, until I realized that they were not interested in me at all. There was a gentleman from Asia that they were welcoming, in hopes he would put a new plant in Houston.

They rode off in their limousine, with their chase cars and all, and I couldn't help but understand the concern in trying to bring in new industry to the country. I look at governors who go to Europe and Asia and encourage those kinds of investments in our country, with great tax concessions, fiancing, all types of things in the way of enticements.

And I understand the advantages of that, and I understand the internationalizing that is taking place here in our economy. But we must have some problems resulting from that investment in the future, I suppose.

Would you expand on that a bit?

Dr. GREENSPAN. I think, Mr. Chairman, that what we are looking at is a fundamental change in America's position in the world. We have gotten adjusted to the fact that we are importing and we are running a trade deficit. I don't think we have yet fully understood the implications of a very long string of current account deficits and the accumulations of claims net against the United States of the order of magnitude that Bob Hormats was talking about in his testimony,

It is not just paper. A substantial and increasing proportion of those claims against the United States will be in direct investment, and indeed they are inevitable if we are to finance these trade deficits.

And as you point out, they obviously are positive in many respects, because, in a sense, they do create jobs, they do create industry, they do create incomes for American workers. But I think we also must understand that it also has an extraordinary effect upon the American psyche, because we are going to find that, while we used to be I would say, rather un-understanding of our Canadian friends abroad when they used to argue that we had too much investment there, I think we are going to start to exhibit those same concerns ourselves. There is a sense in which, while America will continue by far as the major producer of world goods, the ownership of that structure will change. It can't change by a great deal, because the numbers we are talking about, while they seem very large in dollar terms, are still a relatively small fraction of the aggregate net equity of the American system.

The CHAIRMAN. But other than psychological, what other problems do you foresee?

Dr. GREENSPAN. The basic problems are that you begin to have a group of foreign investors who will, of necessity, begin—as they should—to get involved in the American political process. Because, to the extent that there is an interfacing of government policies, regulations, with business, we are going to begin to see that an increasing part of that will be against the Japanese, against the Europeans, and the like.

The CHAIRMAN. Dr. Greenspan, those nations are very much involved in the political process of this country right now. Almost every major lobbyist in this town has some foreign client. They respond quickly, and we hear.

Now, because of my time limitation, I would like to ask one question of Mr. Hormats.

Mr. Hormats, you made a comment that I would like you to amplify on a bit. Why should we have a trade bill?

Mr. HORMATS. I think there are two basic reasons.

One: Since the end of the Tokyo Round, which was six or seven years ago, we really have not addressed the trade problem as a nation. There are various factions who have perfectly legitimate interests in particular aspects of trade, either limiting trade or pushing access to foreign markets, we really haven't pulled together our national priorities for the last seven years.

A lot of people want a lot of things out of these negotiations. How do we address these? What are our priorities? What do we really want, and what are we willing to give in order to get it?

That is point one, and without that we will not really have enough cohesiveness to present a concrete negotiating position to the other countries.

The second is, unless there is a trade bill the Executive Branch will not be a credible negotiator with other countries. And this is something which I have tried to explain to my friends in the Executive Branch for a number of years.

I have been through this before. There is a basic feeling abroad that unless there is legislation which demonstrates congressional support for the trade positions that American negotiators are advocating, other countries are going to question whether the United States negotiators can deliver, whether they can get the implementing legislation.

Senator PACKWOOD. Do you mean a trade bill, or just an extension of the fast-track authority?

Mr. HORMATS. Pardon me?

Senator PACKWOOD. Do you mean a whole trade bill? Or just the extension of the fast-track authority?

Mr. HORMATS. Both. At this point, both, because now the debate is such that we need a trade bill to just figure out what we really want to get out of this negotiation.

And the second thing is that, not only will other nations doubt our credibility without the trade bill, but without it we will not have one sense of common purpose. The fact that you can get the Executive Branch and the Congress behind one piece of legislation, I think, gives us a lot of latitude, a lot of leverage vis-a-vis other countries; whereas, if they don't have it, if there is not a single piece, they will try to pit one part of the government off against another and play all the angles they can. A consensus is important at home, and it gives us a lot more power abroad.

The CHAIRMAN. I see my time has expired. Let me read off the list of arrivals and the order of questioning: Senator Heinz, Senator Danforth, Senator Rockefeller, Senator Packwood, Senator Durenberger, Senator Wallop, Baucus, Chafee, Bradley, Riegle, Daschle, and Boren. And the five-minute limitation will apply.

Let me also state that there has been an incredible interest by the members of this committee in these hearings. We have 20 members of this committee, and with all the competition of the other hearings taking place, and we have them taking place right now, and some members have been coming and going—we have averaged between 18 and 19 of the members here during these hearings. That is extraordinary for any committee in the Senate, with the competition for the time of the members. And I am most appreciative of that kind of attendance.

Senator Packwood?

Senator PACKWOOD. Mr. Dornbusch, right at the end of the testimony on page 22 and 23, almost as a throwaway, although I don't think you mean it as that, you say, "Over the next few years the U.S. needs to correct the budget deficit while at the same time restoring investment incentives for firms. The only plausible channel, barring defense cuts and cuts in entitlement programs, is to implement a broad based tax such as a value added tax."

Are you talking about that as an additional tax to reduce the deficit? Or are you talking about it as a substitute for some of the taxes on income or capital we now have?

Mr. DORNBUSCH. I certainly think of it as an additional tax, to reduce the deficit and to help finance the restoration of the investment tax credit. I do not believe that any of the talk about deficit reduction under way in fact is in any sense concrete. On the current path, with normal macroeconomic development, the deficit would be $200 billion in 1990.

Senator PACKWOOD. Now, do you care if it is a value added tax, or do you simply want it to be a tax on consumption in some form or another?

Mr. DORNBUSCH. In some form or another. Yes, indeed.

Senator PACKWOOD. How about an electronic funds transfer tax?

Mr. DORNBUSCH. That is not "in one form or another." I want it very broadly-based. The value added is easy conceptually, but there are a number of different ones that may be as convenient. It should be nondistorting and very broad based, with enough revenue to put us safely within sight of budget balance.

Senator PACKWOOD. Let me ask you a question about the electronic funds transfer. It is not broadly based, but it is about a $220 trillion base. It's a whale of a base.

Mr. DORNBUSCH. But I think the incidence of that is not directly and exclusively consumption.

Senator PACKWOOD. Correct.

Mr. DORNBUSCH. And in that sense it could well be very distortionary.

Senator PACKWOOD. Mr. Hormats, let me ask you about it.

Mr. DORNBUSCH. It would be a subsidy to Brinks.

Senator PACKWOOD. It would be what?

Mr. DORNBUSCH. A subsidy to Brinks trucks. [Laughter.]

Senator PACKWOOD. Well, interesting. Until the first one is robbed, and $8 or $9 million in cash disappears because somebody was trying to avoid an .00001 transaction tax, my hunch is they would go back to the tax. [Laughter.]

Mr. DORNBUSCH. I think multiply it by a billion.

Senator PACKWOOD. Let me ask you, Mr. Hormats, about sectoral bargaining and reciprocity. You are not wild about getting into an eye-for-an-eye on this bargaining: if they won't let us sell cars, we won't let them sell cars.

Mr. HORMATS. There is an important issue here, and that is, I would like to see, if I had my druthers, I would like to see reciprocity of the type that you have indicated, which is not so much an eye-for-an-eye but a general type of reciprocity—more openness in sectors abroad in which we are open. That type of reciprocity, without trying to be an accountant on it.

Senator PACKWOOD. You mean sort of like the bill that we passed last year out of this committee—as I recall, pretty close to unanimously—pointed at Japan and telecommunications?

Mr. HORMATS. I am not an expert in that field, but the principle I gather was to get greater openness in that market, and therefore it seems to me that is the principle that is important—not, I wouldn't say, strict reciprocity, but the basic concept.

The problem is this, that there are times when you can't get it, simply because there are differences in the way economies work. There are certain things where we can't give foreign reciprocity, because the Federal Government can't speak for the states on banking and insurance and such things. So, reciprocity is something that might put us in a straightjacket, too, so we ought to be careful about that.

Senator PACKWOOD. Well, there are times that you probably are going to want it. With the Japanese, as far as reciprocity on cars, they say, "Fine." But we sell 20,000 cars a year there in an open market, and they sell five million here on an open market.

Mr. HORMATS. Yes. My concern here is, let's not get into too much of a negotiating straightjacket on the point.

The second consideration is that there will be times when we can get a tradeoff among sectors, where we will say they want something that opens one of our sectors more, and we say we want something in another sector that is important from a national interest point of view. So, I think it is not a good negotiating factor. A, it won't work, and B, it puts us in a straightjacket, and C, we may not want it because it may constrain our negotiators.

Senator PACKWOOD. Well, I use the term very directly. If you mean it as a tradeoff, "You let us into telecommunications, and we'll let you into candy," I don't regard that as sectoral trading; that's just general horse trading, an attempt to lower barriers generally.

Mr. HORMATS. But that is what tends to happen in these negotiations.

Senator PACKWOOD. But that is probably what should tend to happen.

Mr. HORMATS. Yes, that's right, exactly. And that is why, if there is too narrow a constraint on one-for-one, tit-for-tat negotiations, in each sector you can't get that horse trading, which is where the national interest will be served in the long run.

Senator PACKWOOD. What do we do to get Japan, Korea, Taiwan, and the others to pick up their share of Third World trade?

Mr. HORMATS. You have put your finger on a big problem. The big increase in Third World imports, manufactured imports, over the last five years has come into the American market. And there is a problem here—sort of a disparity. We have a third of the Third World debt; Japanese and European banks collectively have two-thirds. Yet, the bulk of the manufactured exports that the Latin Americans sell in order to get the money to service that debt comes to the American market.

What is needed on their part is a combination of market openness, and financial aid. We have a close trading pattern with Latin America, and they sell us most of their goods. But it does strike me that either these capable exporting countries should take a larger share of the manufactured exports of Latin America, or, if for some structural reason they can't do that, then they should provide through their export-import banks and other vehicles untied, relatively soft loans to reduce the debt constraint on those countries. It is not doing something for us; it is part of the global balancing that we need.

The CHAIRMAN. Senator Durenberger?

Senator DURENBERGER. Thank you, Mr. Chairman.

Mr. Hormats, I want to come back to that, because I think it is a very good point.

But first, for those who have been here before, I have made the observation that this side of the table looks just like it did eight years ago. That concerns me, because most of this side of the table is up for reelection in 1988; none of us may be here.

The CHAIRMAN. Starting with the middle.

Senator DURENBERGER. Starting in the middle. [Laughter.]

Somehow, I missed that.

But I have a theory of the politics of 1978, which is that I have a hard time finding any policies or principles to run on. This is very heady stuff, you know, a nation's value system and some of the principles that ought to guide it. I have this horrible feeling that elections have been and may be for one more time based on how people feel about things in general in this country. And I have a feeling that the next election is probably going to be decided in the heartland of this country. It's not going to be decided on the East or West Coasts, because that's where the benefit, in large part, of this import boom is taking place and all of the electronic funds transfers are taking place.

So, I want to ask you a question that relates to particularly Latin American debt, as that debt relates to the heartland of this country. Two of the three of you have spoken strongly to it, and I agree with your theory.

The pressure on Latin American debtors to export in order to earn hard currency has forced, in combination with boycotts and so forth, has forced an incredible expansion of agricultural exports out of Latin America. My question is: Have you given some thought to and can you tell us how you would relate the Latin American debt problem to the problem the farmers face in this country in competing for international markets? And to what extent do you think the Latin American debt is contributing to the glut in the international marketplace? And if you think we ought to make that some priority involving this problem, why do you think we ought to?

Mr. DORNBUSCH. I believe in agriculture the problems are not primarily the Latin debt but the extraordinarily high growth rates worldwide in agricultural productivity. They have been implemented to a good extent in Latin America, reinforced by exchange rate changes to make those countries even more competitive. But I think, even without the Latin debt crisis, we would have the agricultural problem.

Those countries, in fact have a debt crisis, because their primary commodity prices, too, have collapsed.

Mr. HORMATS. That is right. There has been a big structural change in trade. For instance, the big importers of the Seventies—China and India—are now virtually self-sufficient. Then you have the European Community subsidies, which are quite substantial.

It is true that Mexico used to be a very big market for American grain, and that has been reduced somewhat, and it is also true that Argentina has to export more because of the inducement of the debt problem. But I think the magnitudes there are not as large as some of the other changes.

Let me cite one point. It is something I had in my testimony, but you reminded me of it on this agricultural issue: It is a recent study that I think this committee might be quite interested in. It is done by the Department of Primary Industry in Australia. Let me give you two interesting facts that I think are useful in arguing for some improvement in global trade imbalances in agriculture.

This recent study points out that in Japan consumers and taxpayers lose $2.50 for every dollar transferred to producers. The figure for the European Community is $1.50.

Senator CHAFEE. Could you go slower?

Mr. HORMATS. Yes. For every dollar that gets to a farmer in Japan, the consumers and the taxpayers of Japan, pay $2.50. For every dollar that gets to a European Community farmer, the European taxpayer and consumer, together, pay $1.50. In other words, a third of it is waste.

For the United States, for every dollar a farmer gets, the American taxpayer and consumer together pay $1.38.

Now, I haven't looked into the methodology on the study, but it is quite a good study. I think USTR has copies of it. It illustrates the point of the enormous waste that is involved in agricultural programs and how distortive they are of trade and of taxpayers' money and of resource flows.

The second point it makes is that the common agricultural policy "has probably been responsible for a loss of employment of around one million jobs in the nonagricultural sector of the European Community."

I would just add one third point, and that is that France now is a net payor into the common agricultural policy; whereas, it used to be a recipient.

What it adds up to, I think, is that if we can't make progress on this area, where the waste is so egregious, then it is hard to imagine us doing it in other areas, because this cries out for some multilateral solution.

Dr. GREENSPAN. Let me just add to what has been said.

The problem is going to continue to worsen, and the reason it is going to continue to worsen is that, if you track the productivity trends across the world, what you are beginning to see is not so much an issue of great new agricultural technology insights, but you are moving the best agricultural practices around the world; so you are bringing the average yields on crops up towards the higher range of technical capability. And we've got a long way to go on this issue.

So if you look at the arithmetic of what is happening on this issue, you begin to see that the aggregate markets in various different agricultural products are gradually going down, and America's share is going down as well of that declining structure. And I suspect that when we look at the dramatic declines in real estate values in, say, Iowa, when an acre that went for $3000 now goes for well under $1000, that is a reflection of the fact of this extraordinary change in agronomy which is not about to reverse.

I would suspect that what we are going to see in the United States is a very great difficulty in resurfacing as a major agricultural exporter in the world, because I think the world is changing in a way which is adverse to our interests in this respect.

The CHAIRMAN. Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

Dr. Greenspan, what level should the U.S. dollar fall to, compared to the yen and the mark, to achieve equilibrium?

Dr. GREENSPAN. Well, I think that is a wonderful question, to which I wish I knew the answer. I would like to address it in two ways: First, the value of the yen has got to be, significantly stronger relative to the dollar than it is now, as indeed the whole structure of all currencies are.

But it is important to also ask the question, "Over what timeframe?" Because it makes a fundamental difference as to how quickly those adjustments occur.

Senator BAUCUS. How quickly should they occur?

Dr. GREENSPAN. I would say four or five years. And the reason I say that is, if you get an adjustment, as an example, of 150 to 155 in the yen, to say 130 or 120, or whatever is required to bring equilibrium, in a relatively short period of time, say a year, you will create a very significant rise in import prices in the United States which will spill over into the domestic price structure and engender a degree of inflation which I would say should be unacceptable to us.

Senator BAUCUS. What do we do about the Taiwanese, Korean, I guess Brazil—other currencies that seemingly are pegged to the dollar?

Dr. GREENSPAN. I think there is no question. If you look at Taiwan's accumulation of reserve balances, it is fairly obvious that their currency has got to strengthen. It is not only the United States which is having a problem here, but it is clear that the Japanese are as well.

I would say, at the moment, that you cannot account for that stability in their exchange rates without very evident policy actions on their government's part. And I would suspect that part of the whole structure of international bargaining is going to have to be to get them to adjust their rates upward and more in line with the yen that currently exists.

Senator BAUCUS. On that point, it seems to me that with increased international competition at least in America, economic policy more and more is going to drive foreign policy. It just seems to be an inevitable trend, as I see it.

And that gets a bit to the question that Senator Packwood raised—namely, about Second World swaps and bargainings and so forth—in his discussion with Mr. Hormats.

I would like to ask all of you about the advisability of escalating economic policy relative to political dealings, as far as other countries concerned.

Some of the leverage we have, say with Japan, trying to get Japan to absorb more of the Third World exports, has been closing our markets to Japan. But of course, that hurts American consumers. It hurts a lot of Americans in many ways. Don't we have some other political leverage we can use? The most extreme case is withdrawing some strategic national security protection from Japan, for example. That may hurt us, too, but at least a little less directly. It hurts Japan more than it hurts us, in the short term.

I am just curious as to what kinds of leverage, in addition to denying market access to the U.S., do we have, in your judgment, to try to encourage Japan to do what we know it should do.

Sure, there are problems we should take care of at home, too; I am not dismissing the items we have to take—that is, reduce our budget deficit. But I am focusing more on what other leverage we have.

Mr. HORMATS. It is an interesting problem. There is a bit of history here, and that is that American Presidents traditionally have devoted very little of their time their energy or their prestige to pressing American trade interests. Many of them find trade a little too complicated, and because the national security element of their discussion with foreign heads of state tends to be a relatively dominant item on their agendas, also, as leader of the NATO Alliance, American Presidents basically have been reluctant to push trade issues to the brink, to the extent that they——

Senator BAUCUS. That is the history.

Mr. HORMATS. That is the history, and as a result, other countries don't really think that trade is important to the United States. A trade bill would help there.

Second, how do you change that? I guess that is the basic point.

Senator BAUCUS. Should it be changed?

Mr. HORMATS. Well, it is a very careful balancing act for an American President; he doesn't want to do anything that disrupts alliances; on the other hand, if he is not seen as more serious about trade, other countries don't take us very seriously in this area.

Part of the problem is attitudinal. Once the United States is very clear about what it want's to get, it is more likely to have other countries take it seriously.

It is very difficult to use security-related leverage, because, to the extent you convince the Russians, for instance, that our troops in Europe or our troops in Asia are going to be determined by trade balances, the credibility of our strategic deterrent begins to erode a little bit.

Senator BAUCUS. Except for our allies, though.

Mr. HORMATS. It might do that, but I think you wouldn't want to send these signals. It is a tough balance, and I think it is a question of emphasis—how much emphasis the President is going to put on it.

We find, in the Section 301 cases that we have gotten some results—not as much as many people might like, but little by little we are getting access to foreign markets as a result of 301. If people are convinced that the Secretary of State and the Secretary of the Treasury and the President are behind it, we will get more leverage. The problem is, we haven't tried it. If you get a consensus that we want to go after four or five major things, major in other countries, and get the Executive Branch behind it, I think you will see more in the way of results without having to use security-related leverage.

Senator BAUCUS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Chafee?

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Hormats, I would like to get from you on the record as strong a statement as you can give me on the effect of the failure to pass the fast-track extension. What would that mean?

Mr. HORMATS. It would basically undermine the credibility of our negotiators, because I think it would be another indication that they were not going to be able to deliver the legislature on the things they had negotiated. That, basically, is what would happen.

Let me go back. The origin of all of this is the American selling price for chemicals several years ago. That bit of history is useful to recount again.

U.S. ngotiators negotiated a very complicated deal with getting rid of the American selling price, and the Congress didn't enact it. And that meant that when we went back for the next round of trade negotiations, they said to us, "We are not going to negotiate with you, because we don't believe you can get the Congress to support what you have negotiated." So, it seems to me that that type of legislation is very important.

What is even more important is the consensus behind it—one that it reflects a commitment of both the Executive and the Legislature to successful negotiations, and to implement their results, without their being held up indefinitely.

Senator CHAFEE. Do you think we ought to proceed with that extension this year?

Mr. HORMATS. Yes, I think so.

Senator CHAFEE. Another question: Economists that come before us always talk about the difference between the U.S. savings and the Japanese and other nations' savings. Are they really comparable?

I am asking this from the statisticians' point of view. Is insurance included? Investments in insurance? Equity in one's home? Is that a "saving," and does that count? Or do we just look at savings deposits in banks?

Dr. GREENSPAN. No, Senator, we look at precisely what you listed, and more.

There are difficulties in trying to get the Japanese statistics to look like ours and try to match them up and see exactly where the differences are. After all of the statistical adjustments and all of the statistical errors, you can't get away from the central conclusion that Japanese save more than we do.

We only know a few of the reasons. We do know that the tendency to have significant bonuses as part of the average paycheck during the year creates some higher savings rates, as indeed it does in the United States. We have the same experience. When we pay large bonuses, a significant part of it is saved. We also know that their attitude towards debt is different, and a variety of other technical differences.

But when you get down to it, and you have looked at all of the individual issues, it is a cultural question, fundamentally; they tend to be far more prudent than we in that respect. And as a consequence, everyone who has looked at these data always tends to come away with the fact that it is a structural and fundamental difference between our two cultures.

Senator CHAFEE. Now, we have had testimony from Mr. Strauss here, who listed reducing the federal deficit as by far the most important thing we could do to reduce trade deficit. Mr. Hormats has echoed that. And you, Mr. Greenspan, have said the same, although you say it is a tremendous help but not the cure-all.

Yet, at the same time, we had some labor leaders in here the other day who almost dismissed that, saying, "Look at Japan; look at Canada." Now, what is our answer? The Puritan Ethic says we shouldn't have the federal deficits. But how does Canada get away with it? How do the Japanese get away with it?

Dr. GREENSPAN. Well, they do different things. It doesn't follow that, if it is not appropriate for them, it is not appropriate for us. There are innumerable ways in which the federal deficits, central government deficits, affect trade.

Irrespective of what is involved in other countries, what is true here is that, to the extent that we bring the deficit down, it will in part help our trade balance.

I might add that it is a very complex question, because I can make the case, and indeed in my formal remarks I do, that you can get a very significant reduction in the budget deficit and, as a consequence of that, get a very small effect on the trade deficit. It is not a simple issue, even though when one looks at the national accounts you can very clearly see in the United States that we have had a very significant rise in our budget deficit and, concurrently, a very significant rise in our trade deficit, and they look as though they are linked. They are linked only very marginally.

Senator CHAFEE. Well, my time is up. I would like another round when we get to it. Thank you.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Thank you very much, Mr. Chairman.

Professor Dornbusch, in a few sentences could you describe the connection between over-zealous debt collection and the trade deficit between the United States and the country in which there is over-zealous debt collection?

Mr. DORNBUSCH. In 1982, the typical debtor country was borrowing from commercial banks all the interest payments that they owed and, in addition, some to have a good time. In 1980-82 they had huge budget deficits, exactly like the U.S. now. Every debtor country was like the U.S., even today—overvalued currencies, huge budget deficits, borrowing in the world capital markets to finance what everybody enjoyed.

Suddenly, they couldn't borrow any more, because commercial banks, who were the main lenders, found there might be a problem. And from one day to the next, what previously they had borrowed, they had to earn. They had to pay interest in dollars; they had to earn dollars.

The only way known to earn dollars is to export more and import less. So those countries did two things: One, they immediately cut budgets, raised the interest rates sharply, and as a result there was a recession, seen in my paper. The large decline in per capita—that is, the shift to austerity—happened within six months rather than over years.

The second part: In the face of that large recession, in order to restore employment, they had a very significant depreciation of their currency relative to everybody. The average real depreciation in Latin America was of the order of 40 percent.

So, Latin America became highly competitive, and that means their exports suddenly were competitive in our markets, whether it was shoes or Brazilian airplanes or Brazilian car engines, or Mexican, or Korean for that purpose—Korea was in exactly the same position. And at the same time, a sharp reduction in imports.

The import reduction was accentuated by the fact that public-sector investment was completely cut out in the course of IMF programs. So were our machines.

Senator BRADLEY. So, essentially you are saying that the connection resulted in a dramatic increase in Latin American exports into the United States because of the currency imbalance, and it led to a significant dropoff in U.S. exports to Latin America because of the debt-induced recession. Is that correct? Is that maybe one of the reasons why wheat exports to Mexico dropped 98 percent in three out of four years?

Mr. DORNBUSCH. Certainly it is a good part of the decline in wheat exports. The world price decline is somewhat wheat. It is not, though, that the Mexicans eat half the wheat; they only eat 30 percent less. But that, of course, is export reduction.

Senator BRADLEY. You made a couple of comments about the manufacturing trade. I thought your point there was that in the manufacturing trade the deficit with developing countries is even greater than the overall deficit. What were those numbers? And how is that related to the debt?

Mr. DORNBUSCH. I was impressed with the small numbers that one comes up with when one looks at Latin America's total bilateral trade balance sheet. And those numbers, of course, are mentioned by anyone who says that in trade they have nothing to do with each other.

But of course, it has to, because every manufacturer has horror stories about what happened to them with Latin America.

So, I did look at the manufacturing numbers, and there in fact is a $45 billion shift, whereas with total trade it is much less. It is much less for total trade, because all commodity prices fell, and therefore our imports fell.

Senator BRADLEY. Do you mean a $45 billion shift since about 1982?

Mr. DORNBUSCH. Since 1980–81.

Senator BRADLEY. So the difference between our manufacturing exports, and their increase in manufacturing exports to the United States, is now $45 billion?

Mr. DORNBUSCH. Indeed.

Senator BRADLEY. Do you have any sense about how many jobs that means?

Mr. DORNBUSCH. It is seven percent of manufacturing production. I won't translate it into jobs, but it is a huge amount.

Senator BRADLEY. That have been lost because of the debt question?

Mr. DORNBUSCH. Because of the debt and the gain in competitiveness in developing countries.

Senator BRADLEY. Now, if I could follow up with one last question, as I see the light: In terms of alternatives with respect to the debt issue, how do you judge the various alternatives to debt relief?

Mr. DORNBUSCH. I think certainly nobody would want to do in the bank; so, one has on one side to keep bank debts intact to the maximum possible. But I think it is also unreaslistic to believe that every debtor country will ultimately pay off fully their debt with full accumulated interest.

So, the current strategy of complete, instant enforcement, quarter by quarter, so the balance sheet doesn't go bad, is totally unreasonable. It is only warranted if one in fact believes that the U.S. taxpayer in the end is going to pick up the balance. If that statement is correct, and I think it is correct, then one wants to be much easier.

In the Philippines today, one wants to say we have a huge foreign policy interest that that country is not going further to Communism because we are standing there and saying, "Debt payment first; economics afterwards." We would say, "Well, why not a good three-year program, where some of the interest is lent, and where the interest payable isn't going to be libor plus one and a half, but at a concessionary rate that makes it possible for the government to put a minimum growth program back. Income per capita in that country is down 15 percent. That makes it very, very easy for Communists to agitate.

I think that kind of situation warrants a selective, limited, targeted, reasonable debt relief policy.

Senator BAUCUS. Senator Daschle?

Senator DASCHLE. Thank you, Mr. Chairman.

I would like to follow up on Senator Packwood's most interesting dialogue with our witnesses this morning with regard to reciprocity.

You understandably decried protectionism. Mr. Hormats in particular caught my attention when he said that we must deal with foreign trade impediments; make that a priority.

My confusion with regard to the problems of protectionism and your call for prioritization of a program for reciprocity leads me to ask both you and Dr. Greenspan to define what you mean by "reciprocity" and "protectionism." Where does one leave off and the other enter in?

Mr. HORMATS. Well, one can look at this from a number of perspectives. Basically what you are trying to do, and where we should be placing our emphasis, is on getting greater access to foreign markets. That should be the basis of what we are doing in our bilateral discussions and the basis of what we are doing in the next round of multilateral trade negotiations which is coming up.

Now, the inevitable question is, what leverage do you use? Do you say to the other side with whom you are negotiating, "If you don't open up, we are going to close our sector and give you exactly the same type of access that you give us"? It seems to me, for a variety of reasons that is a tempting way of approaching these negotiations. In the final analysis, I think it is very difficult for us to do that; basically, because (a) there are a lot of people in the United States who would argue quite convincingly that that means a big increase in domestic prices; there are others who would say it reduces competitiveness; and there are others who would say it is not a particularly useful negotiating tactic, for two reasons: one is that if you use it others are going to say, "We will do the same to you." And there are areas in which we have restrictions on particular sectors which are greater than other countries have. If we get into that type of game, we might win some, we might lose some.

So, it is not a particularly convincing type of negotiating technique.

Second, and the point I was trying to make, there are times when what you want in return for giving up a little bit more in sector-A is not improvement in access to sector-A you want improvement and access in sector-B. So, if you get into a strict sort of negotiating straightjacket, the negotiators may have much less latitude for making tradeoffs among particular sectors. And that becomes a problem.

Let's suppose—let me give you an example. On the services sector, let's suppose you wanted reciprocity in services, States have a good deal of control over who can establish banks in their jurisdiction. And you may well find that a government says, "We are not going to give your banks access to our market, unless you give us the same access," which means, "You have to guarantee that our banks are going to be able to establish themselves in Montana, in California, and New York." Our States may refuse. If we start getting into that, it seems to me, we run into a lot of things that we don't anticipate. It is too narrow a negotiating framework for us to find comfortable from our own domestic point of view, and I don't think it would succeed. Much as in concept it sounds great, I don't think it would succeed in practice.

Senator DASCHLE. Dr. Greenspan, I am still yearning for a succinct definition of the difference between reciprocity and protectionism. Will you enlighten me in a more succinct way?

Dr. GREENSPAN. I will try, Senator.

Senator DASCHLE. Let me just get one more question in, and maybe you can address it in the limited time I have left in part of your response.

We have an example right now: The Administration has decided to impose duties on certain products from the EEC in response to their imposition of barriers with regard to $400 million of agricultural products there.

Is that, in your opinion, as you answer my first question, reciprocity or protectionism?

Dr. GREENSPAN. Well, let me first see if I can give you a definition. You are raising an interesting question, but the issue is really quite fuzzy.

It basically gets to the question of whether or not you are trying to prevent imports or create exports. And in part it is essentially motivational, as distinct from tactical; because, if in fact a particular policy, say initiated by the American Government, is really for the purpose of blocking foreign shipments to the United States, and reciprocity is employed as a process to do that, then it is truly protectionism.

If in fact there is a strong interest to expand American exports, and that in a sense the gun that is effectively pointed in a reciprocity duel really has no bullets in it and really could never be fired, then you are dealing with true reciprocity. It is a very tough thing to call, because what you are in effect ultimately down to is an issue of a threat of doing something to yourself which you don't want to do.

I am not sure, however, that I can apply precisely how one would answer the specific issue with respect to the EEC. As best I can judge, that it is true reciprocity and not protectionism, but it could eventually turn out to be the reverse, because there is no clear-cut way of making that determination.

Senator BAUCUS. Senator Packwood?

Senator PACKWOOD. Thank you, Mr. Chairman.

Alan, I would define it this way: There is about one-third of this Congress that is protectionist, and maybe one-third of this country in good times, let alone bad times—"We don't want to sell any computers, and we are not going to buy any Toyotas. Put up the barriers. The only thing we will ever buy overseas are raw materials in short supply." That is protectionism.

I don't use reprocity so much as "retaliation," where we will say on occasion to a country, "If you will not let us sell rice in Japan, and beef, and tobacco, we are not going to let your cars in." And, on occasion, you have got to prove you are not bluffing on that. If you never pull the trigger, it doesn't mean anything.

But I have a feeling that our market is so big that, if we were to say to Japan, "If you won't let us sell rice and beef and tobacco and lumber, we won't let your cars in," and we say to Korea, "If you won't let us sell insurance, we won't let your cars in," Korea might think, "Damn. If they keep the Japanese out, and we can move into the market with our Hyundais, where we are competing with the Japanese, we'll let them sell insurance in this country and see if we can't get a month up or a year up on the Japanese."

Our market is big enough that I think we can use that threat. That is what I mean by "retaliation."

I want to ask Mr. Hormats a couple of questions.

You said a trade bill ought to be something more than just the extension of fast-track authority.

One, should a trade bill have some kind of time limits on executive action under 201 or 301?

Mr. HORMATS. Yes I think so.

Senator PACKWOOD. Okay. Two, under 301, where we have found an unfair trade practice, should a trade bill compel retaliation?

Mr. HORMATS. On 301?

Senator PACKWOOD. Yes.

Mr. HORMATS. I think it should compel an action of some sort, a positive action but not necessarily a retaliatory action. There should be a greater presumption for retaliation, but it shouldn't compel it, because there are going to be times when the President, for reasons that have to do with his broader——

Senator PACKWOOD. How do you draw that in a statute?

Mr. HORMATS. There are various ways of doing it. One, you can take a good more of the authority, of the initiating authority, and the procedural authority, and put it in the Office of the U.S. Trade Representative, which the Business Roundtable, as I understand it, has supported. I think that proposal is a good one.

It doesn't mandate that in every circumstance there should be retaliation, but——

Senator PACKWOOD. Well, that is the part I want to get to. I understanding moving the authority. But if you don't compel retaliation, how are you going to make sure you get it from time to time when we think you should get it?

I am not suggesting we ought to have compulsory retaliation, but I'll be darned if I know how you draw that line.

Mr. HORMATS. I don't either, and that is one of the great difficulties of trade policy. You want to create a greater sense of probability of firm action, but you also want to leave the President, who given his broader authorities may on occasion decide that it is not appropriate in a given case a measure of flexibility. And there is no foolproof way of doing it. I think the best way is to give USTR more authority, but not mandatory authority.

Senator PACKWOOD. A third question on 201 and the textile and shoe cases we had, especially the shoe case. Many people are saying, "Here, the shoe people followed the law to the letter: they went before the ITC, they got the finding, and then they found out the law didn't work." Well, the law allowed the President to have discretion. I think the issue is not that the law didn't work, but the law said the President doesn't have to follow the ITC's recommendations.

Mr. HORMATS. On 201.

Senator PACKWOOD. On 201.

Should the President be compelled to follow the ITC's recommendations?

Mr. HORMATS. This is an interesting issue. I think, on 201, there is a problem if you go to the ITC, you find out that there is injury, and then either you get import relief or you get nothing.

I think that on 201's we ought to have a broader range of relief alternatives that the ITC can recommend.

Senator PACKWOOD. I don't mind that, but I want to know if the President should have to pick one.

Mr. HORMATS. Yes.

Senator PACKWOOD. Okay.

Mr. HORMATS. Not necessarily import relief. There are other alternatives.

Senator PACKWOOD. Yes, I understand that.

Mr. HORMATS. One could be relief from certain regulatory restraints.

Senator PACKWOOD. But he should not be able to just say nothing.

Mr. HORMATS. He should have to come up with some type of alternative. It may not be import restrictions; it may be regulatory relief, it may be support for new R&D programs. But if industry is injured to the degree that it gets through the ITC process, there should be some type of government relief.

Senator PACKWOOD. Professor, let me ask you a question, back on this electronic funds transaction tax again.

It is tremendously broad-based, no question about that, and a very small percentage raises a lot of money. I really don't think people are going to try to move to cash transactions to avoid a relatively miniscule tax.

So I take it your objection to it may be that you don't really think it is a consumption tax but basically a business tax that will not be passed along.

Mr. DORNBUSCH. Well, it will have to come along in the form of higher prices for firms who are intensive in cash transfers; so, in the end, it comes out of the consumer's pocketbook.

Senator PACKWOOD. So, in the end it is a consumption tax.

Mr. DORNBUSCH. Well, it may also make our exports less competitive, because they are produced by businesses, and they are, for example, capital goods.

I can see a lot of ways in which it goes in the wrong places. That is why I think a broad-based close to consumption tax is much preferable to something that you know will be paid but you aren't sure by whom.

Senator PACKWOOD. Okay. And on the VAT, you are assuming that it will be rebated at export?

Mr. DORNBUSCH. If we start that, that might be complicated, because you would have to do it from the imports up to the final product. So, there are easier ways.

I wonder whether I might say a word about trade policy.

I believe that unless we set the dollar straight we will have many, many more hearings where we try to find gimmicks to stop imports and to stop them faster and better.

Our major problem is that our wage is $13. Next in line, Japan, is $10, and then LDC is $2 and less. No amount of calling it "unfair trade practices" or "dumping," whatever, will stop that trade in the end; because, if we stop them from subsidizing exports, like we did in Korea, then they will depreciate the currency, and imports come through another door.

In the end, all the trade will wind up here unless the dollar is reasonably priced, and it is not now.

Second, we should correct that very, very rapidly, because if we wait four or five years and do it gradually over that period, as Mr. Greenspan suggested, there is going to be a lot of disinvestment happening in the meantime here. A lot of firms will go abroad, close down, and won't start up.

While there is definitely an inflation cost to doing it fast, like tomorrow morning, I think it is good policy of reindustrialization of America.

The last word: Someone said, "What can we do in our economic foreign policy discussions?" The best weapon we have is to take the dollar down, and then we can say, "You guys have a problem." And it works.

Yesterday there was a visitor from Japan already to ask what they possibly could do for us. I think we could have a lot more visits like that, rather than being seen as dumping trade restrictions selectively at the rest of the world.

Thank you.

Senator BAUCUS. How quickly should we bring the dollar down, then? You think very quickly, and Dr. Greenspan thinks gradually, four to five years.

Dr. Greenspan, what is your rejoinder, or your rebuttal?

Dr. GREENSPAN. Well, I think you have to examine the consequences of what happens when the exchange rate of such a crucial a currency as the dollar is dropped very dramatically.

The first thing that is going to happen, obviously, is that short-term interest rates are going to go up under very significant pressure for U.S. dollar denominated securities. The spread that exists now between dollar securities and, say, those securities that are denominated in the yen and the deutsche mark, which is now a reasonably good spread, will increase.

You also risk some fairly significant ruptures in the international financial system because of the incredible complexity of transfers that are going on, and very rapid changes in currencies increases the risk that some obscure insurance company in Monaco, for example, that none of us have ever heard of, will end up with $5 billion in defaults landing on our shores with very major potential dangers to our whole system.

There are very large international financial risks as well as interest rate risks and domestic economic policy problems in the United States from a very rapid adjustment. We are way out of adjustment; we have a long way to go; but I think that the costs, that is the risks involved in adjusting very rapidly, are greater than the costs, which do exist, in allowing the adjustment to occur much more slowly, that is, of course, if you can possibly do it.

Senator BAUCUS. Mr. Hormats?

Mr. HORMATS. I just have a couple of thoughts on that.

Senator BAUCUS. What end do you have? Four or five years, or quickly?

Mr. HORMATS. I am in the middle. [Laughter.]

There are two points I would make. One is that the government really is not in charge of what the exchange rate is, as we have seen.

Senator BAUCUS. I'm sorry, what was that again?

Mr. HORMATS. The government cannot determine what the exchange rate is. So, the notion that we should get it down tomorrow, even if someone in Washington said that was a great idea, the exchange markets and their millions of transactions that go on every day essentially set the currency rate of the moment.

Senator BAUCUS. Do you mean if Voelker and Baker both said it should go down further, it wouldn't go down further?

Mr. HORMATS. If Voelker said the exchange rate should go down by, say, 10 percent, it would probably move in that direction. But basically, people would look at relative asset values, and then it would come back to some differentiation between asset values in this country and asset values abroad.

There is a certain degree to which people in authority can talk the dollar in certain directions; but, essentially, financial decisions are going to become a more significant factor after a period of time.

But the second point is this: Even if one concludes the dollar should go down more sharply, the other side of that is that you want other countries to create a higher level of domestic demand. Because if the dollar simply goes down without those countries doing something to offset the reduction in profits and in exports that come about as a result of the change in the dollar, then we get the exchange rate benefit but part of that is offset by slower foreign growth.

So, as the dollar goes down, you want other countries to juice up their economies more and get a higher rate of domestic growth.

The other point I would make is this: The real question as to whether the dollar has gone down enough relates to what it means to relative prices. That is to say, does the price of foreign goods in the United States go up so that we make back some of the competitiveness we lost in the domestic market over the last several years? And do American goods in foreign markets regain their competitiveness vis-a-vis the prices of foreign made products in those markets?

The adjustment there has been very slow, and that is one of the factors creating pressures on currency markets. We have not seen the price adjustments that we would hope to see, in part because importers selling goods in the United States have squeezed down their profits to retain market share.

This is beginning to change. I would say, on the import side, we have regained about 40 to 45 percent of the competitiveness lost in the 1980–85 period. On the export side we have gained a lot more of the competitiveness we have lost. So, we will probably see, in 1987, an improvement on the export side which exceeds the improvement we will see on the import side.

Senator BAUCUS. Well, in addition to that, isn't there a question of quality? It seems to me one reason our trade deficit hasn't come down as quickly as many thought it would a few months ago is because Americans are willing to pay for perceived quality.

Mr. HORMATS. Yes.

Senator BAUCUS. That is, they think that Japanese cars are good cars, and they will pay, perhaps a premium based on that perception. It just seems to me, for that reason it is not only the exchange rates, not only the value of the dollar, but it is also a big burden on the backs of American business to pay attention to quality of American products, so that Americans start buying American and foreigners start buying American.

You know, the Japanese think automatically that any American product is superior in quality—it is just an automatic assumption. And in some cases it might be valid.

But I agree with you in your analysis about exchange rates and so forth, but it seems to me that another big part of the problem here is that the United States has to pay more attention to quality.

Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Mr. Hormats, you are a veteran negotiator, and you have dealt with the Japanese over the years. Our trade deficit—well, 40 percent of it is with Japan, or something in that neighborhood.

Yet, it seems to me we send delegations over to Japan, and Senators over there and their representatives come over here, and we tell them, "Shape up" and "let our products in, or we are going to retaliate in some virulent form" They say, "Yes, yes," and nothing happens. We have all had wonderful visits with Ambassador Mansfield, and he leads us in, and we meet the Japanese and nothing has changed as far as I can see. Well, maybe we are selling some more cigarettes in Japan.

I know that you are not for sectoral-specific negotiations, but why can't we say to the Japanese, "Look, you come in and bid on equipment for AT&T, and unless you let us into the market to bid on your national telecommunications setup, we are just not going to let you sell any telecommunications equipment in this country. Now, that's it." What would happen?

Mr. HORMATS. There are times when we have tried an approach that is not too different from that. One, I have to tell you they wouldn't believe it, because when negotiators have made that point, or something along those lines, they have quickly found that there are plenty of people on the other side of the issue who say, "That is not on," who will prevent that sort of ultimate recourse, ultimate retaliation, from taking place—there are people within the Executive Branch and people outside of the Executive Branch. So, if we were to take that position, they probably wouldn't believe it.

Second, with Japan, as I see, we have made some progress, and they have over a period of time reduced barriers in specific sectors.

The problem, though, goes to a general, in a way cultural, attitudinal difference. There are a lot of traditional buyer-seller relationship in Japan; this is a very significant part of the way they do business and the way they live. It is a very internalized economy.

There is an enormous gap between what they consume and invest, and what they save. And that difference in effect pushes out a lot of capital which causes a big current account surplus for them. This is not going to be taken care of by any specific types of trade measures, even if we were to pursue some of these things more actively.

Senator CHAFEE. I am not saying that we should seek an even trade balance with Japan, but just in certain areas. Again, this gets not to protectionism but what you might call reciprocity, or market access. I am not saying that we have got to have market access to all of the agricultural sector. Just take this one area of telecommunications.

As I understand it, our equipment is superior or certainly equal in this particular area.

Mr. HORMATS. You can tick them off. They are the traditional lists that this committee knows well. Telecommunications equipment is certainly one. Oranges, meat, leather products, a whole range of things, going from the very traditional to the very modern.

Basically, even when the barriers have been reduced, as in some cases they have, there is still just an attitude of concentrating on domestic purchases.

Senator CHAFEE. Well, the reason I chose telecommunications is because you are dealing with governmental agencies rather than private firms which have their own intricate traditional/cultural purchasing roots.

But the reason I asked the question, because it follows somewhat along the lines of a question by Senator Packwood, is that we are trying to write a trade bill. A trade bill won't encompass reducing the national deficit; a trade bill has got to say: Do A, B, C, or D; give more power to the STR, and so forth.

One of the items we might include or could well include, based on the reaction of the witnesses, is this sectoral reciprocity. Now, should we have it? Should we put it in?

Mr. HORMATS. If you were to say, if we don't get what we want in specific areas, should we respond by raising barriers in that same sector? I would have a lot of doubts about that, because sometimes we won't want to respond in that specific sector. If you were to say, if we don't get something in Sector-A and we take it to the GATT and we find we haven't gotten what we want, then some type of reaction is probably desirable. I don't know what it would be, and I wouldn't want to compel the Executive Branch to undertake a specific type of reaction; but it seems to me that there are going to be cases where we will find that the foreign barriers are so enormous and so unsupportable by the other country that we want to take some type of compensatory or retaliatory action.

And I would strengthen section 301 to create a great presumption that we would take action against what we call "unfair trade barriers." I wouldn't make it mandatory, but I think if you could do anything in this negotiation to strengthen the credibility of our desire to get more access to foreign markets, using 301, then I certainly would do it.

Senator CHAFEE. May I ask one more question? My time is up.

The CHAIRMAN. Go right ahead.

Senator CHAFEE. I have always supported all measures for free trade and voted against protectionism, but our people at home, rightfully it seems to me, say, "Something is insane." Korea can flood our country with every form of product made, and we can't get in there to sell ours. And if we do, we have to go into some sort of joint venture that they impose on us. We have this tremendous market, which is so important to them, you would think we could use it in some more effective way to obtain access than we do. What should we do to get that access? Again, use section 301 and the procedure you talked about?

Mr. HORMATS. I would think the 301 is the most convenient vehicle we have in the current trade law for doing that, and it has the advantage of being oriented toward getting greater access to foreign markets and therefore puts the emphasis where we want to put it.

Your question is one that has been something that has troubled me, too. As a negotiator, I found there were many times when the other side was doing something that was so unreasonable that it was indefensible. And, I would go there, and I would try to get the restriction changed but I didn't have the authority to take action against the country if they didn't do what was asked of them.

What you don't want to do, I think, is create something that the President has to take action whenever the United States determines something is unfair, but we need a greater probability that we will act.

I don't think I can define it any more specifically than that, because each case is different; but I do think that we have not been as assertive of our export interests as we should be, and I do think that a greater degree of credibility behind procedures like 301 would give us an advantage.

It is not perfect; it doesn't give us a totally convincing retaliatory response; but then, again, there are problems with doing that as well. I can't answer the question any more specifically.

Senator CHAFEE. Well, the mood of this committee, at least as I feel it, is to levy a mandatory requirement that the President cannot escape from. I think there are dangers in that. There should be a loophole.

But, if the STR wants to do something, did you find in your experience that you had to check with the President? Or could you move ahead? Well, of course, you didn't have that much power.

Mr. HORMATS. The STR?

Senator CHAFEE. Yes.

Mr. HORMATS. It's true. Either you checked with the President or you checked with someone who had more power than USTR—the Secretary of the Treasury in some cases. But I can tell you that a lot of times the USTR wanted to do something, and I believe if we had had the support of senior people in the Executive Branch we could have gotten a lot more progress on negotiations than we did, even without having to pull the trigger.

Senator CHAFEE. But how about having it the other way? If you have these strong powers, and you were prepared to exercise them, do you think the President would step in and restrain the STR very often?

Mr. HORMATS. That is the record. The President has restrained the STR on many occasions—and I am not second-guessing the President, because the President has to run an alliance and has a lot of other things. But there have been many occasions where we have been too restrained—I am sure Bill Brock when he comes up, or Clayton Yeutter or Bob Strauss, could tell you of several negotiations where the USTR wanted to take a tougher position and, for a broader range of reasons that had less to do with trade than with other types of American interests, there was a restraint placed on the USTR by the President.

So really, it is not a question of just legislation. And that is why I get to the question of consensus, because I think it all boils down to that.

If you have a much greater American priority placed on trade, then the negotiator has a much stronger hand, and there is a feeling on the part of the person with whom he is negotiating that, the Americans are going to be firm on this, because there is a consensus between the Executive and the Legislature that exports and market access are important to the United States.

More importantly, unless these other countries do open up more, that is going to make it more difficult for this President and the next President to hold the line and keep this market open.

In the final analysis, you are right: keeping the American market open is what these countries want and need. And at some point, whether there is reciprocity or not, if there is a record built up of inadequate American access to key foreign sectors, whether the President wants it or not there has got to be a lot more restriction in this market. Other countries have not yet awakened to that reality.

That, in a way, is our strongest negotiating chip, the fact that the initiative will be taken out of the hands of the Executive Branch, with whom these countries negotiate, and there will be tough action taken, which these countries won't want. And unless they wake up to that fact, that type of thing is going to happen.

Senator CHAFEE. Dr. Greenspan, do you agree that we ought to leave the President a loophole there under 301?

Dr. GREENSPAN. Senator, having been on the other side of this as Bob Hormats has, the President has a national security foreign policy agenda which often is very significantly in contradiction to the specific requests and requirements of USTR.

There are undoubtedly innumerable occasions when the STR has been overridden without very much thought and, probably in the full context of the President's responsibilities, I would say incorrectly. But I think it is very important to recognize that, no matter how important trade issues are, and they are indeed very important, the President's responsibilities in the national security area and the diplomatic area must take precedence, as I see it, on this issue.

Senator CHAFEE. Dr. Dornbusch, do you agree?

Mr. DORNBUSCH. I believe that the focus on the small changes in the negotiations and sanctions really will not meet the big problem that the U.S. will face.

Europe, in industry, is building up to become like Japan: essentially inward-looking, never buying abroad. Latin America has started free trade between Brazil and Argentina. Mexico is trying to adhere. If that happens, there will be a common market, and we will be out. Much the same will happen in the Far East.

So our problem is much larger than to get faster into Korea. I think what the U.S. at this time should try a free trade area with countries like Mexico, Korea, and Brazil, to get in there, because they are already in here. And that way we would open markets to us in a major way. In the piecemeal way that we pursue it now, with arm-breaking, in the end we get nothing for.

Senator CHAFEE. Well, that is a rather dramatic proposal, to get into a free trade—do you mean such as we are negotiating with Canada now?

Mr. DORNBUSCH. If you will go to Korea, and you will talk to the people who talked to the U.S. Senators, they say, "We have a very long list of things we will do for them if they ask for it." And if you add it up, it really is not very much. But it will take three years, until they have given slowly everything away. In the meantime, U.S. industry isn't doing very well.

Senator Baucus talked about quality of foreign goods. We have another five years to get accustomed to those, until the dollar is down enough, and then we'll say, "Well, they are really better."

I think our problems are much, much larger than we believe. The realignment of the dollar will be resisted, foreign markets will stay closed—maybe we will get an extra five percent, but that is little—and in the meantime the rest of the world is catching up so fast with U.S. industry that there really is no plausible reason to buy anything here, because it is both cheaper and better abroad.

An enormous inertia keeps us alive, but the tendency for erosion is very strong. So we have to look a bit further and say, "Where are we going to make a living? There are all these closed markets." But what is the incentive for those markets to open up? They will, if we break their arm; but as slowly as possible, because they have only so many arms. That is why we have to look a bit further ahead and say, "Isn't the intelligent solution, since they are already here, to talk free trade and get the hold before Japan will do a thing like that?"

Senator CHAFEE. Thank you, Mr. Chairman.

The CHAIRMAN. Let me say that there is no question in my mind but that we must have the power to retaliate. We just must have that.

One of the problems we run into is what you are talking about, Dr. Greenspan. You've got a pecking order. The Treasury and the State Department and the Defense Department sit above the salt. Each of them has his own responsibility, whether it is State or Treasury or the Defense Department, and they give that a priority, with great influence on the President.

The day when trade was way down the list of priorities, that day is past. We can't afford that anymore. Trade has to be a top priority for our country. It shouldn't be beneath the dignity of a President to call the chief executive of another country and tell him, "We really are interested in selling this product." I don't think that is crass; I think that is what we have to do. We have to sell.

They talk about retaliation, saying, "Well, all we get is an escalation of retaliatory actions in this kind of a trade law." Well, you have to retaliate very selectively. You have that outrageous example that you were talking about, and then you have to come in and really make them understand it.

I am not all that concerned about retaliation escalating to any degree if you pick your targets. From the time I spent in business, I soon learned that you don't run off your number-one customer. You make some kind of adjustment, make some kind of a compromise so he can still make enough income to pay his bills. And that is the kind of problem we are facing.

I think we have had some extraordinary testimony, and it has been very helpful. I have talked to a number of the members, and you gentlemen have certainly contributed to it.

Yes?

Senator CHAFEE. If you are through, could I ask one more question?

The CHAIRMAN. I'm not through, but I'm winding things up and will get back to you, Senator Chafee.

I want to serve the interests of Senator Bradley, who had to leave for another committee. He has a question concerning the cost to banks, and, Professor Dornbusch, if you will reply for the record on that one in writing, I would appreciate it. His question is: Banks claim that debt relief would cut into their profits; yet, the only alternative plan is new money paid by banks to debtors so debtors can turn around and pay interest to banks. Isn't it true that the profits banks earn on troubled LDC loans are an accounting fiction, since they depend on emergency loans by the very same banks? And don't the discounts troubled LDC loans touch on the market raise even more questions about the LDC debt profits that banks want to continue to claim on their books?

If you would, give me that for the record in writing, please, because I want to express another frustration for just a moment here, Senator Chafee.

When I look at some of the large banks in this country, and I see this taking place, and this fiction of earnings in many instances where the bank loans the money to that debtor nation to pay the interest, to keep the earnings of that bank up, then I don't see the charge-offs taking place on bad loans.

Some of these loans to these countries will never be paid and that's the reality. I don't think we can legislate across the board and say we charge off 20 percent or 10 percent or five percent; that doesn't make sense. But I do think the regulatory authorities ought to quit turning their backs on it, and they ought to selectively look at those loans, and they ought to push those banks to start charging off bad loans when they are convinced they are bad loans. They ought to put the same kinds of pressures on those banks they put on some of the smaller banks when they are talking about bad domestic loans.

I have watched them turn their backs on those kinds of problems because they don't know what to do about it. They don't turn their backs on bad domestic loans out in Iowa and Nebraska. They say, "The cash flow isn't there, and you are going to charge it off." And they've got the banks so scared they won't even make new loans in some of those areas.

I watched the problem in the Southwest, in Oklahoma and Texas and Louisiana, and they sure make them charge off their loans, and they sure make the profits, and the book value of those banks go down.

I would rather have a mortgage on an empty building in Houston than a piece of a loan to some of those countries that we see carried, because ultimately that building is going to be worth whatever the mortgage was—ultimately. I am not sure the same thing is the case with some of these loans to some of these countries. But once again, that is for the regulatory authorities to decide, and they ought to be pushed in that regard. I don't think they are discharging that responsibility.

Insofar as 301 cases are concerned, it is a tough problem. As you say, Mr. Hormats, time and time again Presidents have not exercised their authority, chosen not to use it, when many of us think, from an economic standpoint for our country, it was well overdue.

Drafting this legislation is going to be a difficult one for us, to narrow down that discretion to some degree, and yet build some parameters where we think we could put some safeguards in. It is not easy.

That is why I am glad to be here at the moment with Senator Chafee. Through this day we have had almost every member of this committee here at one time or another. That is the way it has been through these hearings. Consensus is not going to be easy for this committee.

I think the contribution that you folks have made has been very helpful to us in better understanding what we have to strive for.

Now I will say to my friend, go ahead.

Senator CHAFEE. Thank you, Mr. Chairman.

What I am thinking about in this question is, we are going to pass a trade bill in this committee, and the House is going to pass a trade bill, and we will go into conference.

The House is quite likely to have in theirs a provision that I am confident we will not have. They will have the so-called Gephart Amendment which sets numerical targets for countries such as Japan, Taiwan, and West Germany, to lower their trade surpluses with the United States. And I believe they have to lower them by 10 percent a year for the next three years, or face restrictions on their imports.

Now, I am dead set against that, but just for the record I would like to hear what you gentlemen have to say on a provision like that.

Dr. Greenspan?

Dr. GREENSPAN. I think it would be a terrible mistake, and I trust that in conference, should that be there, the Senate would hold firm, assuming that that piece of legislation does not enter the Senate's bill.

Senator CHAFEE. Well, I cannot imagine it being in the Senate's bill, but let us make the assumption that it is not in the Senate's bill and it is in conference because of the House.

Dr. GREENSPAN. Yes. I can think of a lot of things that can be done on trade legislation; but few would cause as much havoc—which would be unfortunate not only for the United States but I believe for the rest of our trading partners as well—to have that particular notion in a trade bill.

Senator CHAFEE. Mr. Hormats? You can refer to it as "The Gephardt Amendment," because somebody will be quoting you when we get into conference. So, go to it.

Mr. HORMATS. I don't differ from Alan at all on this.

Let me just add one other point, though, just to confirm the argument: There have been times when the United States has had a big trade deficit with one country and a big surplus with another, a big bilateral surplus with another. Suppose that other country had said to us, "You have too big a surplus with us; we are going to cut back our imports with you," while we still have, of course, that deficit with that other country.

The world works in sort of multilateral ways, and anytime you get legislation with these types of provisions in them, it seems to me, as Alan said, it is just counterproductive. And it could be used against us in the final analysis.

If the exchange rate goes down as much as Rudy wants, we will be having trade surpluses at some point. And suppose someone hauls this thing out of their pocket at the next round and says, "All right, fellows, you passed this; now we are going to use it on you." It is a world where nothing stays still, and we could find ourselves, if we improve our productivity and reduce our deficit and get our dollar down, competing with certain countries; we will have big trade surpluses with some of them—we hope.

Senator CHAFEE. All right.

Dr. Dornbusch?

Mr. DORNBUSCH. The further the dollar is misaligned, the more extravagant the non-market solutions to solve the problem. If the dollar was down significantly, they would have a problem; they would expand, and our trade would be more nearly balanced. I think the Gephardt Amendment is a terrible idea.

Senator CHAFEE. That is excellent; thank you very much.

(Laughter)

Dr. GREENSPAN. I must say for the record that Richard Gephardt is a very thoughtful man. Where this amendment came from is beyond me.

Senator CHAFEE. Why he would ever put his name on it is beyond me.

All right. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Gentlemen, thank you very much. It has been very helpful to us, and I appreciate your time.

[Whereupon, the hearing was concluded, at 11:48 a.m.]

[Professor Dornbusch's answers to Senator Bradley's questions follow:]

REPLY TO QUESTIONS POSED BY SENATOR BRADLEY

The questions can be usefully addressed in the context of calculations of the cost of the "Bradley Plan". It is worth noting at the outset that much of current bank lending, which serves to finance merely the paying of interest, amounts to a window-dressing operation. Banks lend to LDCs who return the funds as interest payments. Taking advantage, until last year, of high marginal tax rates, banks then set aside part of these accounting profits as loan loss reserves. At the end countries have higher debts and banks higher loan loss reserves. Dividends have been distributed and the taxpayer has already shared, but the debtor countries have had no benefit.

The effects of the Bradley plan on bank profitability and stability have been exaggerated in their respects. First, the plan would be applied selectively, not across the board to every problem debtor. Therefore one cannot simply take all problem debts as the basis for calculating debt relief. Second, the plan envisages quite explicitly regulatory and possibly tax relief that allows banks to spread the costs of the relief over a number of years. Since the banks' participation is largely voluntary—regulatory incentives aside—they would only participate if they thought it were to their benefit. It is a premise of the plan that the government cannot force the banks to give away concessions. It can only create a tax and regulatory environment in which banks chose to participate.

The third reason why the costs of the Bradley plan have been vastly overstated is much more subtle. Banks are now accruing profits which are basically paper profits: they lend to a debtor who uses the loan to pay interest. If one day the loan goes into default it will turn out, ex post, that dividends were distributed that would more wisely have been used as loan loss reserves. Outside commercial banks, throughout the financial system, there is a pervasive belief that ultimately the loans must be written down. The secondary market attests to the same fact. But on the books of commercial banks paper interest is recorded as hard profit. Writing down these paper profits merely recognizes a fact, it does not in any substantive way take money away from stock holders.[1]

The Federal Reserve has made calculations of the costs of the Bradley plan, taking into account the tax treatment of losses to banks. Table 8 shows the total costs to the 9 money center banks and the 15 other large banks of a program in which, for a three year period, interest rates are reduced by 3 percentage points and the principal is written down, each year, by 3 percent. The figures in the table represent maximum and minimum annual average losses expressed as a percentage of 1985 after-tax earnings. The table shows two cases: relief applied to 10 Latin American countries and to all 15 Baker plan countries. The package analyzed in the table amounts to a cumulative 10 percent debt relief plus a 3-year interest relief.

TABLE 1.—THE ACCOUNTING COST TO BANKS OF THE BRADLEY PLAN: 1987–89

[Annual average percent of 1985 after-tax earnings]

	10 Latin American countries	15 Baker plan countries
9 Money center banks	50–75	57–86
15 other major banks	21–32	24–37

Source: Federal Reserve.

The losses to banks in these calculations are not spread out for tax purposes over a long horizon but must be taken immediately. These factors of course sharply increase and overstate the costs compared to a more realistic scenario. But even with these overstatements the damage to bank profitability of as large and across-the-board plan as underlies the calculations is limited. The plan certainly does not mean the destruction of the banking system but rather a temporary reduction in net earnings Since reported earnings represent in fact to some extent only paper earnings the estimate of the true cost is even further reduced.

All things considered the Federal Reserve study would seem to document that one can seriously discuss debt relief without having to fear that it will destroy the banking system. In fact, unless the banks expect to profit they will not participate. But, of course, banks will be slow to accept because they sense the potential for a much bigger participation of the taxpayer. No doubt, it will take a major crisis—say Brazil 14 month in arrears—before banks will chose to cooperate.

[By direction of the chairman the following communication was made a part of the hearing record:]

[1] In another edition of the Bradley plan it would be helpful to add a Luthof option: should the debtor who negotiates relief experience a significant improvement in its external position it will share this with the creditors by servicing also some of the debt previously forgiven.

Statement of
Ford Motor Company
Senate Finance Committee Hearings on Trade
January 28, 1987

Ford Motor Company is extremely pleased that the Senate Finance Committee is moving so promptly to review the U.S. trade situation and work toward trade legislation.

From the viewpoint of an industry that was one of the first to experience the impacts of trade imbalances, it seems as though we have been talking about the trade issue or its close associates, industrial policy and industrial competitiveness, forever. And while we have been debating it in the U.S., our trading partners have capitalized on an overvalued U.S. dollar and an expanding U.S. economy to grab a major foothold in the U.S. market.

However, the sharply rising U.S. trade deficit finally seems to have succeeded in getting everyone to recognize that the U.S. has a major problem and to start seeking realistic solutions. That's welcome news.

Let's look first at the problem. By any measure, U.S. trade accounts have reached crisis proportions. The 1986 trade deficit is projected to reach nearly $175 billion. The current account is a broader trade competitiveness measure, including not only merchandise trade, but also trade in services and income from investments abroad. This account has been in the red since 1981 and will reach $140 billion in 1986 (Exhibit I).

Estimates of the impact of these deficits on U.S. jobs vary only in degree. A study by a Department of Commerce economist estimates that the trade-related job loss in the U.S. manufacturing sector was over 2.0 million; other estimates range as high as 3.0 million.

Since 1980, average U.S. GNP growth has run well below the estimated potential growth rate because of the drag of the U.S. trade deficit (Exhibit II).

The major impacts of worsening trade deficits have been felt in those industries that are particularly sensitive to foreign trade. But the impacts go well beyond the auto, steel, and other basic industries, which should have been regarded as a warning flag. The President's Commission on Industrial Competitiveness found that even in high-technology industries, the U.S. has lost world market share in 7 out of 10 sectors. Industries including computers, semiconductors, telecommunications, and analytic instruments are now suffering from the effects of massive trade imbalances.

Another impact of the rising trade and current account deficits is the build-up of net U.S. debt to foreigners. The rising U.S. trade and current account deficits and budget deficits have been financed by increasing U.S. foreign debt. By the end of 1986, the U.S. foreign indebtedness reached an estimated $250 billion.

The U.S. has attracted so much foreign capital to finance the trade deficit that it changed from a creditor to the world's largest debtor in just three years, after being a net international creditor since 1914. This inflow of foreign capital has allowed the U.S. to live beyond its means, but most experts believe continued rapidly increasing debt is unsustainable and could lead to a very difficult correction. Further, servicing the accumulation of international debt is costly and will depress future growth and affect the U.S. standard of living. The U.S. foreign debt has been estimated to increase to $500-$800 billion by 1990. This range implies a servicing cost of $40-60 billion annually (Exhibit III).

There has also been a fundamental erosion in U.S. manufacturing. The persistent rise in the value of the dollar between 1980 and 1985, coupled with the relative openness of the U.S. market led foreign firms to increase production for the American market. Imported good's share of the U.S. market increased by over ten percentage points to nearly one-third of all goods sold in the U.S. in 1986 (Exhibit IV).

Capitalizing on an expanding U.S. market and relatively higher U.S. producer costs due to the strong dollar, foreign producers from traditional trading partners captured increased market share and new competitors entered the market. This will have lasting competitive effects -- making it more difficult for U.S. producers to recover domestic market share even as the dollar becomes more competitive. Once again, this extends far beyond U.S. basic industries. The import share for computers rose from 7% in 1981 to 18% in 1985. According to data assembled by the National Association of Manufacturers, the trade account in high technology goods changed from a $26.6 billion surplus in 1981 to a deficit of $2 billion in 1986 -- and these inroads will not be readily abandoned by foreign producers.

Americans understand that there is a tradeoff between jobs and imports. In a recent Roper public opinion survey, 76% believe that jobs are more important than lower prices for American consumers (Exhibit V).

How did we reach this trade crisis? There are a number of factors worth mentioning. The U.S. federal budget deficit kept upward pressure on real interest rates and attracted capital from other countries. The result was a stronger dollar and more expensive U.S.-produced goods and services.

Declining U.S. competitiveness, due to relatively lower U.S. productivity growth, rising costs of production and shortfalls in product quality played a part, but not the large part that seems to have become fashionable to cite. As noted in Exhibit I, as recently as 1981, the U.S. had a current account surplus.

The short time it took for the U.S. to shift from surplus to deficit should call into question those who wish to blame management or U.S. workers for the trade problem. As Dr. Martin Feldstein, former Chairman of the President's Council of Economic Advisors and President of the National Bureau of Economic Research, wrote recently:

"...fundamental aspects of American industry cannot change in as short a time as the five years in which the United States has gone from trade surplus to trade deficit. For the same reason it is wrong to attribute the massive trade deficit to a fundamental deterioration of U.S. productivity, of American product quality, or of other basic aspects of potential competitiveness. The primary reason for our deteriorating trade imbalance was the 70% rise of the dollar that occurred between 1980 and the spring of 1985." (Exhibit VI)

Further, the issue of competitiveness is more properly one of the competitiveness of the U.S. as a production base, not of American companies in a worldwide context, including foreign subsidiaries. As Exhibit VII notes, U.S. multinational companies have managed to retain their share of world trade, despite the strong dollar. Profitable production can be maintained by production outside the U.S. What's at stake is U.S. jobs, the U.S. technological base, and U.S. industrial capacity.

Another factor is the $1 trillion debt of the less developed nations. To service their foreign debts, the developing countries have simultaneously boosted exports and cut back purchases of U.S. goods to minimize capital outflow.

Unfair trade practices by other countries -- barriers to U.S. goods and export incentives -- contributed to the trade deficit, although many of these were in place prior to 1980. Dr. Feldstein also cites the decline in real price of oil and relatively slow growth overseas as contributing causes, but states unequivocally that "none are as important quantitatively in raising the U.S. trade deficit as the sharp appreciation of the dollar."

No matter what order of causation one chooses, there seems to be increasing agreement that the present levels of current account deficit and foreign debt are unsustainable and could lead to a very difficult correction.

Economists believe -- and history suggests -- that the current account will eventually go back toward balance because the willingness of foreign investors to accumulate dollar assets is not unlimited. The U.S. trade deficits, therefore, cannot be financed by an ever increasing inflow of foreign capital. But without a sound and coordinated U.S. policy, there can be serious impacts on jobs and industries in the meantime as well as a possible hard landing for the dollar.

As MIT economist Lester Thurow notes:

> "Theoretically one should not worry about the demise of American companies and industries ... but reality is marked by very large transition costs and lots of irreversibilities. Given severance pay, early retirements and low prices for used machinery, the costs of going out of business can be enormous. Given the need to acquire and train a labor force and to develop distribution and marketing networks, the costs of getting back into business are even larger. Once a market position is lost and customers have developed relationships with foreign suppliers, it can be virtually impossible to get back into business. As a result, countries have to worry about the long-run industrial costs of intermediate-run overvaluation of their currency."

Given the very real jobs and dislocation impacts already felt by U.S. industry, U.S. policy should strive to accelerate the return to equilibrium in our trade and current accounts in order to arrest the negative impact on U.S. jobs, industrial capacity, and technology development that is occurring.

First and most important, the U.S. should set a goal and a timetable for restoring balance in the current account. As Exhibit VIII shows, a five-year timetable would bring the current account back into balance on approximately the same curve that it has deteriorated since 1981.

The major action necessary to achieve the goal of current account balance must be a continuation of actions to restore the dollar's competitiveness. The yen appreciation has not yet resulted in progress on reducing the $60 billion trade deficit with the U.S. Currency adjustments can be painful, as U.S. industry learned with the rapid escalation of the dollar in 1980-85, but the longer the imbalances, the greater the potential consequences for the U.S. and its trading partners alike.

More than half of total U.S. trade is accounted for by countries with currencies that have not appreciated against the U.S. dollar since January, 1985. This has given these countries -- particularly Korea, Taiwan, and Hong Kong -- an unwarranted cost advantage that has translated directly into an increase in imports from those countries. Imports from Taiwan, South Korea, and Hong Kong now account for 12.5% of total U.S. imports. The U.S. should continue its efforts to make the U.S. dollar competitive with the yen and European currencies, but should also step up negotiations with the Far East NIC countries toward prompt, substantial appreciation of these currencies (Exhibit IX).

Some have raised the question of whether balancing the U.S. current account could throw the U.S. into recession. That clearly needs not be the case. A weaker dollar will raise the cost of imported goods, however, it will also make U.S. goods and services more competitive, which will <u>stimulate</u> U.S. production. The net impact on GNP should be negligible -- certainly not enough to cause a recession.

Second, while we pursue the overall goal of restoring balance in our current account, we cannot ignore bilateral trade deficits that are large and chronic. After eight series of market-opening initiatives, the U.S.-Japan trade deficit continues to rise. It is clear that we need to send Japan a very strong signal that its trade surplus with the U.S. -- which reached nearly $60 billion last year -- is unacceptable and must be reduced.

Japan missed a major opportunity to take positive action to reduce the automotive trade deficit, which accounts for half of the total bilateral deficit, when it announced plans to keep shipping 2.3 million 100% made-in-Japan cars to the U.S. In addition to the cars shipped to the U.S., Japan is assembling more and more cars in the U.S., which contain mostly Japanese-made parts. Ford had recommended that Japan cut its car shipments to the U.S. to below 2.0 million units just to keep the automotive deficit where it is. The announcement signals a lack of intent on Japan's part to seriously address this imbalance.

Steel, semiconductors, machine tools and a host of other industries present similar sectoral challenges. And in other sectors, the problem is reciprocity -- easy access for foreign manufacturers to the U.S. market, but a web of obstacles for U.S. products in foreign markets. Market opening actions, export promotion and export financing programs should continue to be pursued zealously.

In bilateral negotiations, the U.S. goal should be a reduction in the trade accounts that are most out of balance and action on sectoral problems where there are likely to be severe losses in jobs and manufacturing capability before balance can be restored.

Third, the U.S. must take aggressive action to reduce the federal budget deficit and adopt policies to encourage savings and investment. A continued decline in government borrowing to offset the reduced capital inflow from abroad would help hold down interest rates and maintain investment activity. Good progress has been made in reducing budget deficits, but the Administration and the Congress must work together to avoid any backsliding during this critical period (Exhibit XI).

Fourth, U.S. policy must encourage U.S. firms to step up action to improve competitiveness and they must do so. Those industries and firms that survived the rapid rise in the dollar that led to increased import competition at home and abroad have made major strides in improving competitiveness.

At Ford, product quality has improved dramatically in recent years. Based on customer research, the quality of 1986 models is more than 50% better than that of 1980 models -- better than its domestic competition, exceeding some imports, and closing the gap rapidly. Investments for the aerodynamically-styled Ford Tempo, Thunderbird, Taurus, and Aerostar and Mercury Topaz, Cougar, and Sable -- which now have established Ford as a leader in the "look of the future" -- were committed in the years when things looked darkest.

Ford has reduced its operating costs by about $5 billion since 1979 and its breakeven point by over 30%. Salaried employment has been reduced by about 30% and plans are under way to trim an additional 20% or more in our automotive business during the next five years. Moreover, since 1980, Ford worldwide productivity measured on a vehicles per employee basis is up 45% and over the same time period, the number of labor hours per vehicle produced fell some 30%.

These are the kinds of actions that American industry must take to survive against foreign producers with dramatically lower costs -- and there is much more to be done.

Fifth, U.S. policy should provide a better "safety net" for workers who are displaced by a combination of import competition and the productivity and competitiveness actions that are required in response. We generally support the recommendations of the Secretary of Labor's Task Force on Economic Adjustment and Worker Dislocation, including proposed increases in funding for trade adjustment assistance and the Jobs Partnership Training Act.

Sixth, the U.S. also must examine all federal policies with a view toward industrial competitiveness. Laws and regulations that disadvantage U.S. producers should be revised and the economic impact of the tax reform bill should be carefully monitored to evaluate whether the economic stimulation we hope will occur compensates for the substantial increase in the tax burden of U.S. industry.

Seventh, U.S. policy should be to continue to encourage our trading partners to stimulate domestic economic growth. Dr. Feldstein notes that if all countries outside the U.S. were to increase real rates of economic growth from a projected average of three percent per year for the next two years to five percent, this by itself would only raise the demand for U.S. exports by about $15 billion -- less than one tenth of the total trade deficit. But domestic growth in trade surplus countries can serve to offset the pain of correcting their trade imbalances with the U.S.

Eighth, the U.S. should also develop a strategy for a successful resolution of LDC debt. LDC policy should focus not just on debt service, but the steps required to resume and maintain economic growth. It is also important to increase the role of capital surplus countries -- particularly Japan and Germany -- in solving the LDC debt problem.

Ninth, while the quantitative importance of unfair trade practice is not great, the U.S. needs to take stronger steps against unfair trade practices to relieve the impacts on businesses hardest hit by such practices. Therefore, we support changes to current U.S. trade law that would:

- Transfer authority to take action under Section 301 from the President to the U.S. Trade Representative and establish guidelines for implementation of final decisions in 301 cases in a timely manner;
- Make qualification for relief under Section 201 consistent with GATT article XIX as part of harmonizing world trade laws; and
- Enhance the protection of intellectual property.

Tenth, in the interest of promoting and fostering worldwide trade, Ford supports presidential authority to enter into multilateral trade negotiations, provided that the Administration establishes specific negotiating objectives that properly reflect the nation's trade interests and that there is regular consultation with Congress, business, labor and consumers throughout the negotiations.

There are many interrelated policy areas that must be addressed if we are to turn around the trade imbalances that have so affected U.S. industry and it will be difficult to devise trade legislation that is tough but fair.

Ford believes the fundamental goals of U.S. trade legislation should be:

- to set a goal of achieving current account balance. A five-year period would reasonably parallel the period of decline;
- to establish a currency regimen that will lead to a competitive dollar and achievement and maintenance of current account balance; and
- to facilitate the ability of our negotiators to redress trade imbalances on a multilateral, bilateral, and sectoral basis as required.

Thank you for the opportunity to express Ford's views on this issue of vital national importance. We hope that the committee can be instrumental in structuring legislation that will restore U.S. trade competitiveness.

Ford Motor Company

January 28, 1987

Exhibit I

The U.S. Trade Crisis

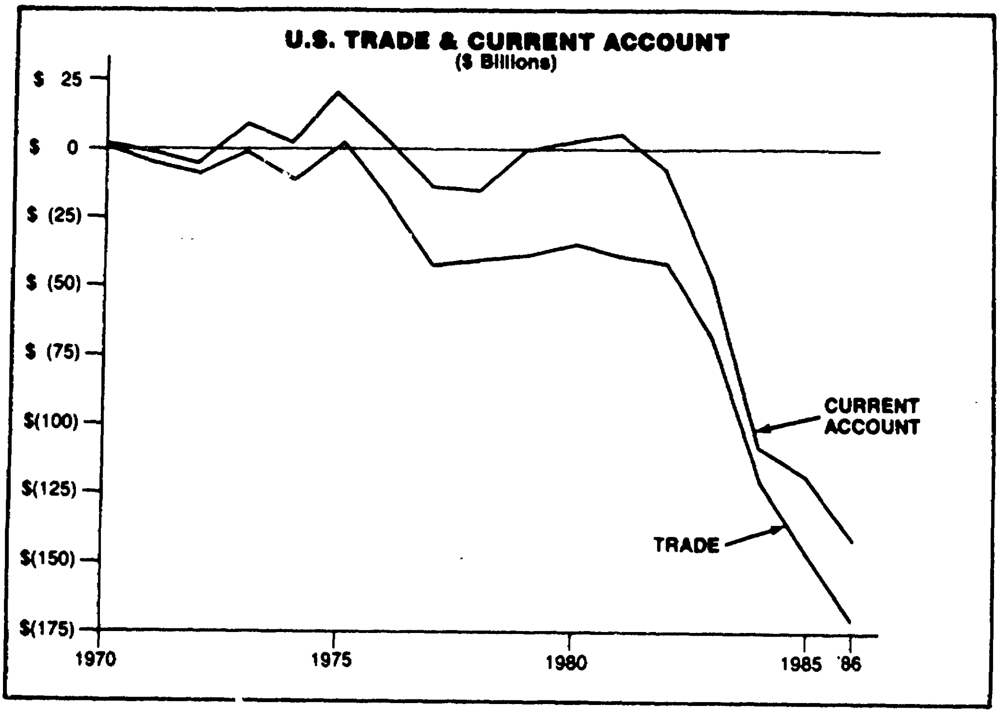

Exhibit II

The Trade Deficit Has Hurt Employment and Been a Drag on GNP

Experts disagree about the level, but most agree that there have been major employment impacts from the trade deficits:

Source	Estimated Manufacturing Job Losses
C. Fred Bergsten, Director, Institute for International Economics (Spring 1985)	3 million
David Lund, Dept. of Commerce (January 1986)	1.5 million loss to imports 1.1 million loss from few exports
Office of Business Analysis, Dept. of Commerce (January 1985)	2.3 million lost to net trade
U.S. Commissioner of Labor Statistics (June 1985)	2.0 million
Roger Brinner, Chief Economist, Data Resources, Inc. (1985)	just under 2 million

In addition to the loss in manufacturing jobs, the trade deficits have reduced total GNP for the last six years.

U.S. GNP Growth

	1980	1981	1982	1983	1984	1985	Est. 1986
. GNP Effect of Net Exports	1.6%	(0.3)%	(0.6)%	(1.5)%	(1.9)%	(0.7)%	(1.1)%
. Domestic GNP	(1.8)	2.2	(1.9)	5.1	8.3	3.4	3.8
Total GNP Real Growth	(0.2)%	1.9%	(2.5)%	3.6%	6.4%	2.7%	2.7%

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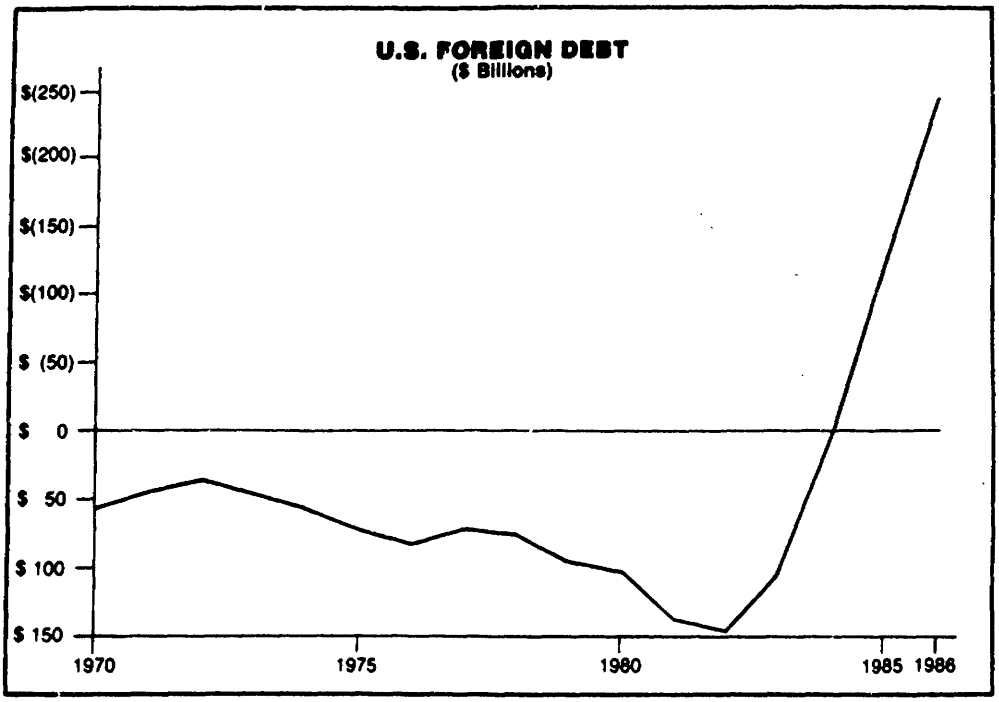
Exhibit III

Foreign Debt Has Also Reached Crisis Proportions



<u>Imports Have Sharply Increased Their Share of the U.S. Market</u> EXHIBIT 17

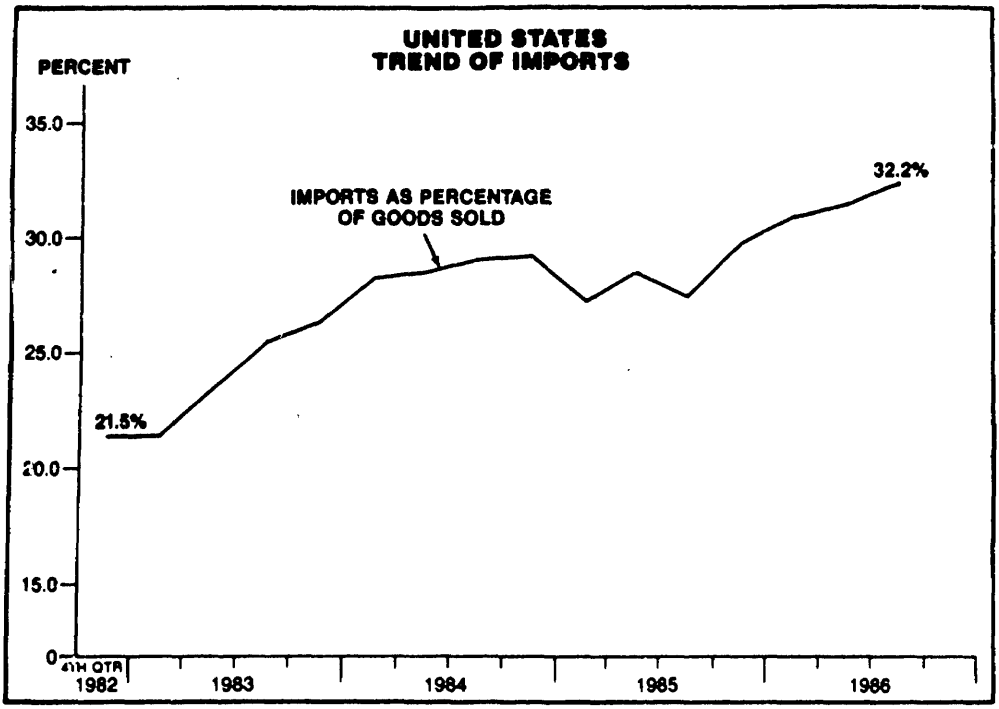


EXHIBIT [illegible]

The Deterioration in the Trade Accounts is Due Mostly to the Sharp Appreciation of the Dollar

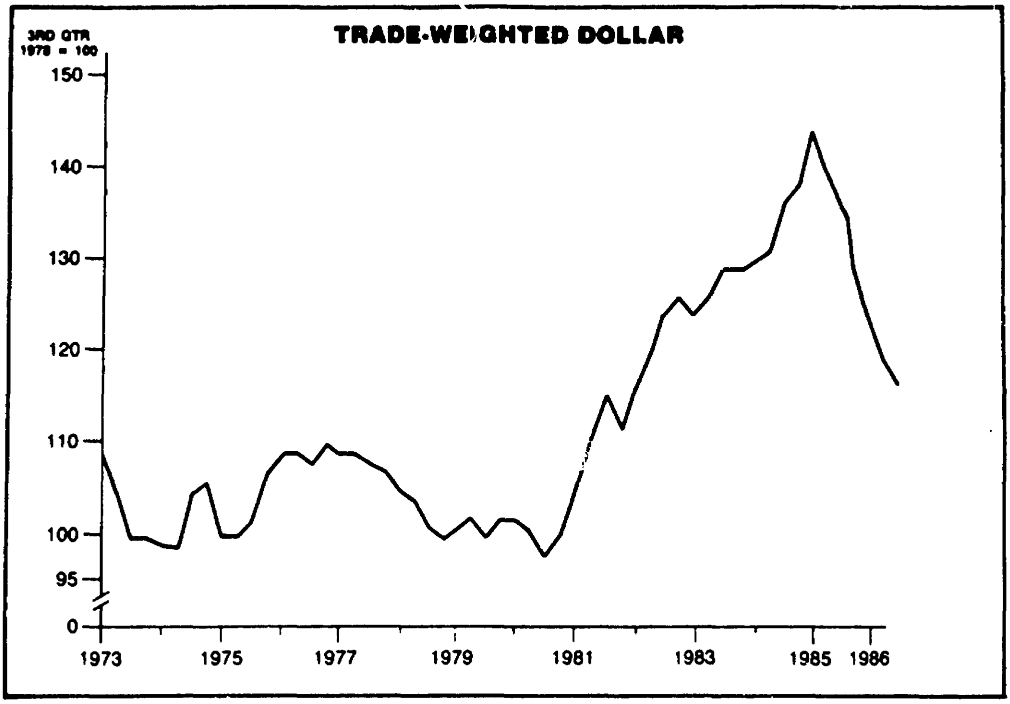


Exhibit VII

Multinational Companies Find Ways to
Remain Competitive Despite Currency Distortions

Year	Share of World Exports of Manufacturered Goods Held by: All U.S. Exporters		U.S. Multinational Corporations, in the U.S. and Overseas
1957	22.7%		n.a.
1966	17.5		17.7%
1977	13.3	down 39%	17.6
1982	14.3		17.7
1983	13.9		17.7

Source: National Bureau of Economic Research

Exhibit VIII

The U.S. Goal Should be to Restore Current Account Balance

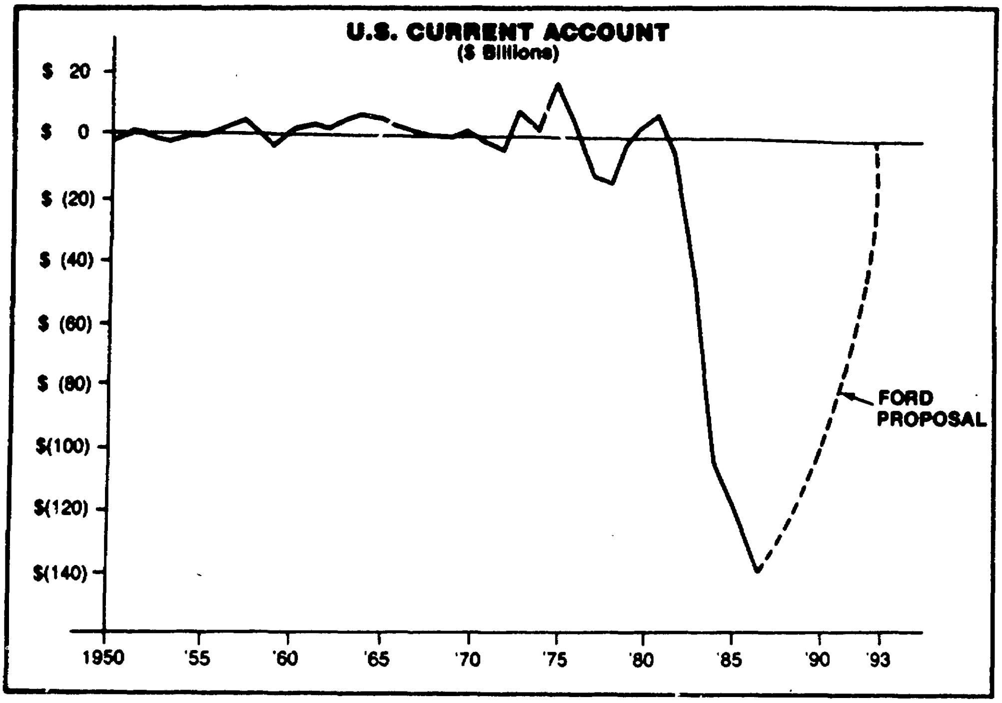
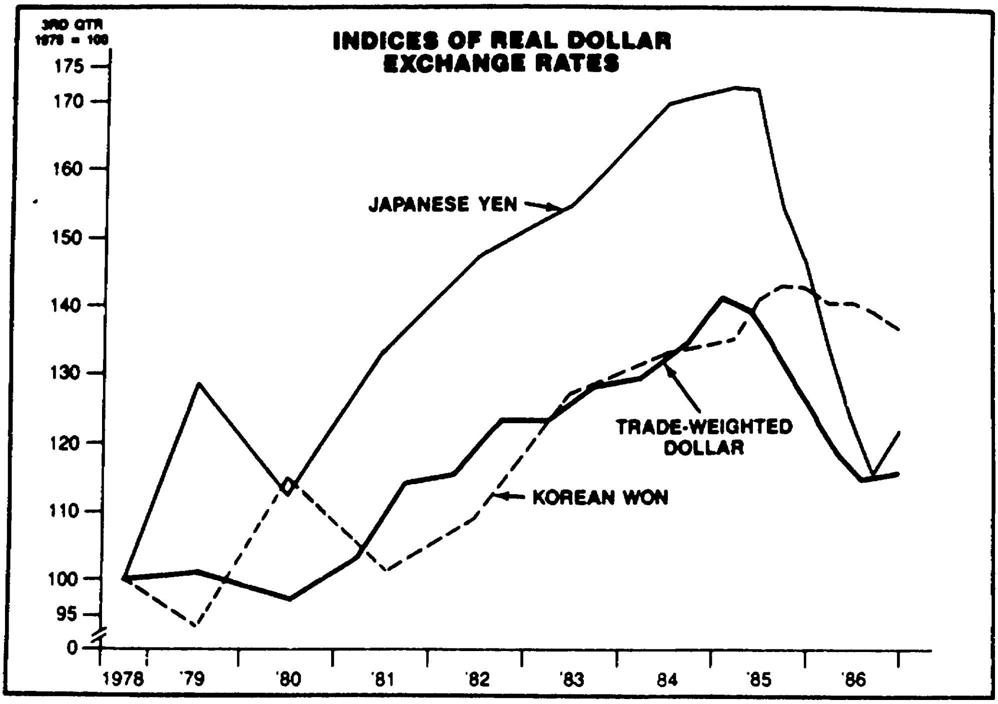


EXHIBIT A

Action on Currency is Key to the Trade Problem



Some Bilateral Trade Problems Demand Attention

Exhibit X

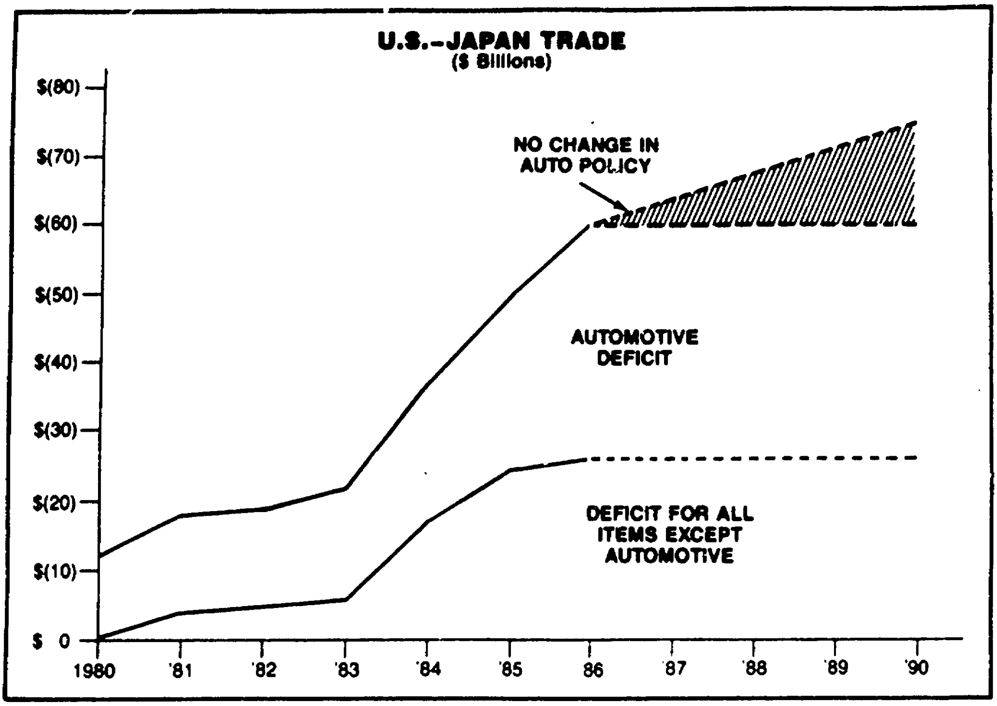


Exhibit A.

The U.S. Budget Deficit is an Integral Part of the Problem

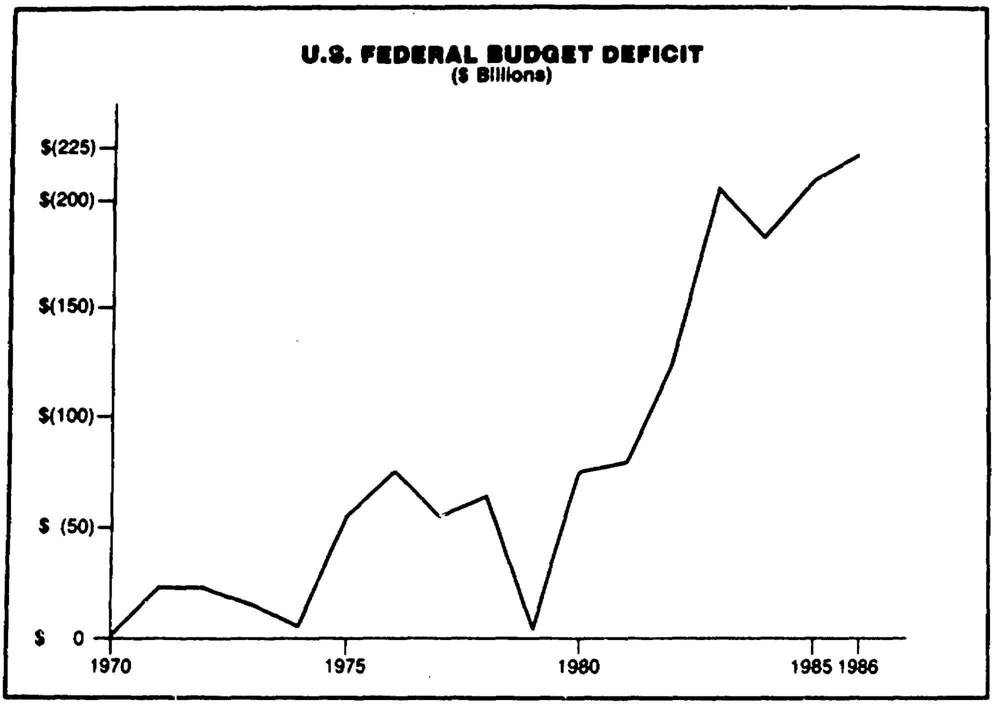


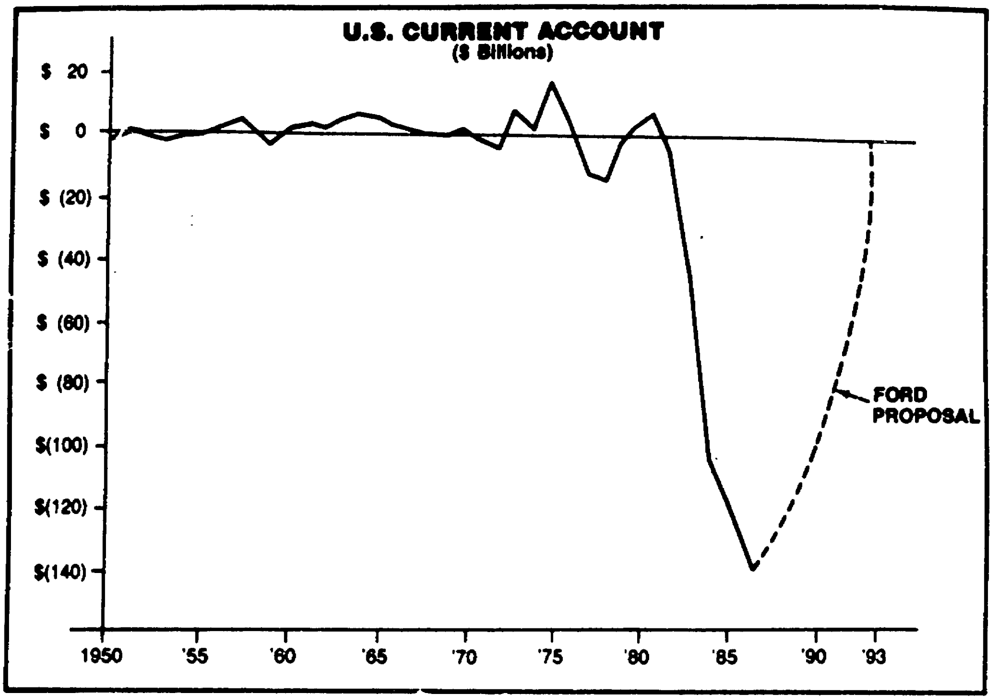
Exhibit XII

Goals for U.S. Trade Policy

- Set goal of achieving a balance in the current account in five years.
- Establish a currency regimen that will lead to a competitive dollar and achievement and maintenance of current account balance. Major action is needed on currencies, such as the Korean won and the Taiwanese dollar, which have not strengthened with the yen.
- Continue to press for reductions in bilateral trade accounts that are most out of balance and continue to attack sectoral problems where there are likely to be severe losses in jobs and manufacturing capability before balance can be restored.
- Take aggressive action to reduce the federal budget deficit.
- Encourage U.S. firms to step up actions to improve competitiveness.
- Provide a better "safety net" for displaced workers.
- Eliminate or modify laws and regulations that disadvantage U.S. producers.
- Continue to encourage our trading partners to stimulate domestic economic growth.
- Develop a strategy for a successful resolution of LDC debt.
- Take stronger steps against unfair trade practices to relieve the impacts on businesses hardest hit by such practices and to protect U.S. intellectual property.
- Enter into multilateral trade negotiations, but with negotiating objectives reflecting the nation's trade interests and regular consultation with Congress, business, labor and consumers.

Exhibit VIII

The U.S. Goal Should be to Restore Current Account Balance



Economists believe -- and history suggests -- that the current account will eventually go back toward balance because the willingness of foreign investors to accumulate dollar assets is not unlimited. The U.S. trade deficits, therefore, cannot be financed by an ever increasing inflow of foreign capital.

But without a sound and coordinated U.S. policy, there can be serious impacts on jobs and industries, as well as a possible hard landing for the dollar.

Given the very real jobs and dislocation impacts already felt by U.S. industry, U.S. policy should strive to accelerate the return to equilibrium in our trade and current accounts in order to arrest the negative impact on U.S. jobs, industrial capacity, and technology development that is occurring:

- The U.S. should set a goal to achieve a balance in the current account in five years.

- A five-year timetable would bring the current account back into balance on approximately the same curve that it has deteriorated since 1981.

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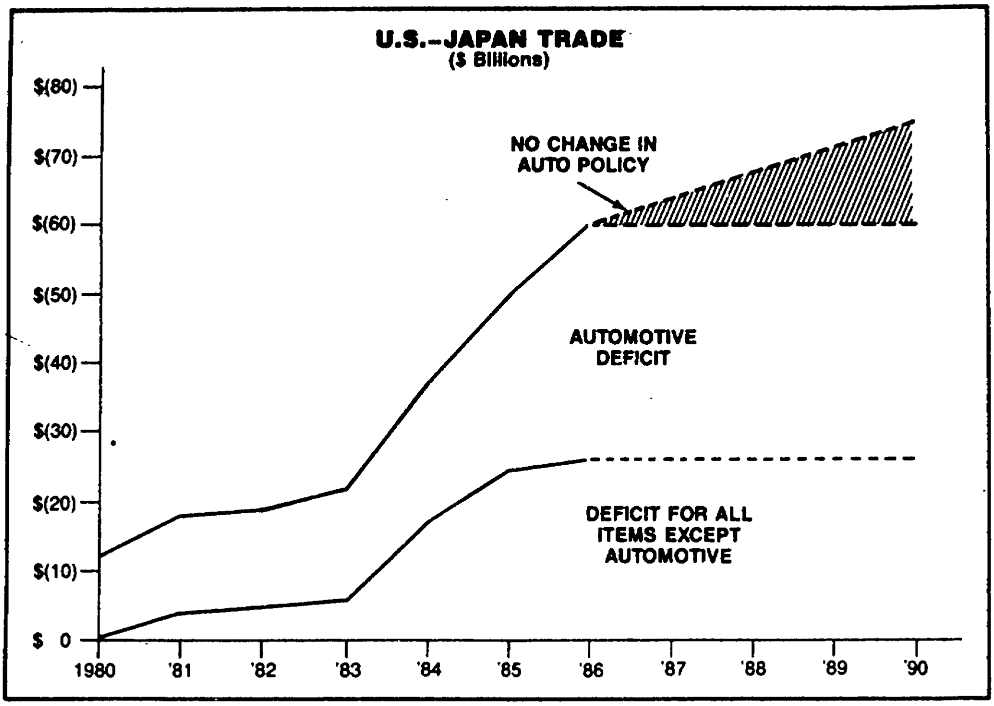
Exhibit X

Some Bilateral Trade Problems Demand Attention



We should strongly signal trading partners with excessive bilateral trade surpluses with the U.S. that these surpluses must be reduced.

Voluntary restraints and other orderly marketing agreement mechanisms remain valuable tools for preventing short-term dislocations.

Unfortunately, Japan just missed a major opportunity to take positive action to reduce the auto deficit, which accounts for half of the total bilateral deficit.

- On January 26, Japan announced that it plans to keep shipping 2.3 million cars to the U.S. That's in addition to a 56% increase in the number of cars assembled in the U.S. by Japanese producers -- which contain mostly Japanese-made parts.

- Ford had recommended that Japan cut its car shipments to the U.S. to below 2.0 million units. Given Japan's announcement, no progress on the U.S.-Japan deficit is likely.

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