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Trade Primer: Qs and As on Trade Concepts, Performance, and Policy

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Congressional Research Service

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Abstract
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This report is divided into four sections in a question-and-answer format: trade concepts; U.S. trade performance; formulation of U.S. trade policy; and trade and investment issues. Additional suggested readings are provided in an appendix.

Keywords
trade, legislation, Congress, globalization, investment, trade agreements

Comments

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Trade Primer: Qs and As on Trade Concepts, Performance, and Policy

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Summary

The 112th Congress has a full legislative and oversight agenda on international trade. The agenda so far has included approval of legislation to implement free trade agreements with Colombia, Panama, and South Korea, and may take up enhanced enforcement of U.S. trade agreements, as well as Russia's accession to the World Trade Organization (WTO) and Permanent Normal Trade Relations (PNTR) status, oversight of the World Trade Organization's Doha Round, and trade relations with China. This report provides information and context for many of these topics. It is intended to assist members and staff who may be new to trade issues.

This report is divided into four sections in a question-and-answer format: trade concepts; U.S. trade performance; formulation of U.S. trade policy; and trade and investment issues. Additional suggested readings are provided in an appendix.

The first section, "Trade Concepts," deals with why countries trade, the consequences of trade expansion, and the relationship between globalization and trade. Key questions address the benefits of specialization in production and trade, efforts by governments to influence a country's comparative advantage, how trade expansion can be costly and disruptive to workers in particular industries and skill categories, and some unique characteristics of trade between developed countries.

The second section, "U.S. Trade Performance," focuses on the U.S. trade deficit and its impact on industries. Several questions address the causes of trade deficits, the role of foreign trade barriers, and how the trade deficit can be reduced. In terms of business impacts, the questions focus on which U.S. industries appear to be the most and least competitive, and on the relative size of the manufacturing sector.

The third section, "Formulation of U.S. Trade Policy," deals with the roles played by the executive branch, Congress, the private sector, and the judiciary in the formulation of U.S. trade policy. Information on how trade policy functions are organized in Congress and the executive branch, as well as the respective roles of individual members and the President, is provided. The formal and informal roles of the private sector and the involvement of the judiciary are also covered.

The fourth section, "U.S. Trade and Investment Policy Issues," asks questions related to trade negotiations and agreements and to imports, exports, and investments. The justification, types, and consequences of trade liberalization agreements, along with the role of the World Trade Organization, are treated in this section. The costs and benefits of imports, exports, and investments are also discussed, including how the government deals with disruption and injury to workers and companies caused by imports and its efforts to both restrict and promote exports. The motivations and consequences of foreign direct investment flows are also discussed.

Contents

Figures

Tables

Contacts

Trade Concepts[1]

Trade Expansion and Globalization

1. Why do countries trade?

Economic theory indicates that trade occurs because it is *mutually enriching*. It has a positive economic effect like that caused by technological change, whereby economic efficiency is increased, allowing greater output from the same amount of scarce productive resources. By allowing each participant to specialize in producing what it is relatively more efficient at and trading for what it is relatively less efficient at, trade can increase economic well-being above what would be possible without trade. There is a broad consensus among economists that trade expansion has a favorable effect on overall economic well-being, but the gains will not necessarily be distributed equitably. Although most economists hold that the benefits to the overall economy exceed the costs incurred by workers who lose their jobs to increased trade, others argue that the benefits are often overestimated and the costs are often underestimated.

2. What is comparative advantage?

The idea of comparative advantage was developed by David Ricardo early in the 19th century and its insight remains relevant today. Ricardo argued that specialization and trade are mutually beneficial even if a country finds it is more efficient at producing everything than its trading partners. If one country produces a given good at a lower resource cost than another country, it has an *absolute advantage* in its production. (The other country has an *absolute disadvantage* in its production.) If all productive resources were highly mobile between countries, absolute advantage would be the criterion governing what a country produces and the pattern of any trade between countries. But Ricardo demonstrated that because resources, particularly labor and the skills and knowledge it embodies, are highly immobile, a comparison of a good's absolute cost of production in each country is not relevant for determining whether specialization and trade should occur. Rather, the critical comparison within each country is the *opportunity cost* of producing any good—*how much output of good **Y** must be forgone to produce one more unit of good **X***. If the opportunity costs of producing **X** and **Y** are different in each economy, then each country has a *comparative advantage* in the production of one of the goods. In this circumstance, Ricardo predicts that each country can realize gains from trade by specializing in producing what it does relatively well and in which it has a comparative advantage and trading for what it does relatively less well and in which it has a comparative disadvantage.

3. What determines comparative advantage?

Most often, differences in comparative advantage between countries occur because of differences in the relative abundance of the factors of production: land, labor, physical capital (plant and equipment), human capital (skills and knowledge including entrepreneurial talent), and technology. Standard economic theory predicts that comparative advantage will be in activities that make *intensive* use of the country's relatively abundant factor(s) of production. For example, the United States has a relative abundance of high-skilled labor and a relative scarcity of low-

[1] This section was prepared by Craig K. Elwell, Specialist in Macroeconomics, Government and Finance Division, CRS.

skilled labor. Therefore, the United States' comparative advantage will be in goods produced using high-skilled labor intensively such as aircraft and comparative disadvantage will be in goods produced using low-skilled labor intensively such as apparel. In addition to differences in factor endowments, differences in productive technology among countries create differences in relative efficiency and may be a basis for comparative advantage. Nevertheless, some high skilled services jobs, such as computer programming and graphic design, can today be easily done in a country such as India because of the revolution in telecommunications.

4. Can governments shape or distort comparative advantage?

Government actions to influence comparative advantage can be grouped in two broad categories: policies that *indirectly* nurture comparative advantage, most often by compensating for some form of market failure, but not targeted at any specific industry or activity; and policies that aim to *directly* create and nurture comparative advantage in particular industries. Indirect influence on comparative advantage can emanate from government policies that eliminate corruption, enforce property rights, remove unnecessary impediments to market transactions, assure macroeconomic stability, build transport and communication infrastructure, support mass education, and assist technological advance. Policies that try to exert a direct influence on comparative advantage may include infant industry policies, industrial policies, or strategic trade policies. They all have the essential goal of identifying and nurturing particular industries that are thought to have extraordinary economic potential. In this view, realizing that potential requires initial government support, including protection from foreign competition. The efficacy of direct government efforts to shape comparative advantage is likely to vary significantly according to stages of economic development. China and India, for example, have used industrial policies to restructure their economies and enable them better to take advantage of world markets.

5. What is the *terms of trade*?

A nation's *terms of trade*—the ratio of an index of export prices to an index of import prices—is a measure of the export cost of acquiring desired imports. Increases and decreases in its terms of trade indicate whether a nation's *gains from trade* are rising or falling. A sustained improvement in the terms of trade expands what a nation's income will buy on the world market and can make a significant contribution to the long-term growth of economic welfare. Similarly, a falling terms of trade raises the export cost of acquiring imports, which reduces real income and the domestic living standard. Although trade is considered a process of mutual benefit, each trading partner's *share* of those benefits can change over time, and movement of the terms of trade is an indicator of that changing share.

6. What are the costs of trade expansion?

Like technological change and other market forces, international trade creates wealth by inducing a reallocation of the economy's scarce resources (capital and labor) into relatively more efficient exporting industries that have a comparative advantage and away from less efficient activities that have a comparative disadvantage. This reallocation of economic resources is often characterized as a process of "creative destruction," generating a net economic gain to the overall economy, but also being disruptive and costly to workers in adversely affected industries that compete with imports. Many of these displaced workers bear significant adjustment costs and many may find work only at a lower wage. Although economic analysis almost always indicates that the economy-wide gains from trade exceed the costs, the perennially tough policy issue is how or whether to secure those gains for the wider community while dealing equitably with those who are hurt by the process. Economists generally argue that facilitating the adjustment and compensating for the losses of those harmed by market forces, including trade, is economically less costly than policies to protect workers and industries from the negative impacts of trade. While it is debatable how well existing worker assistance policies have worked, funding is also a long-standing issue. The Peterson Institute for International Economics, for example, estimates the lifetime costs of worker displacement to be roughly $50 billion year, but calculates that the United States spends about $2 billion per year to address the costs connected to displacement.

7. Does trade destroy jobs?

Trade creates and destroys jobs in the economy just as other market forces do. Economy-wide, trade creates jobs in industries that have a growing comparative advantage and destroys jobs in industries that have a growing comparative disadvantage. In the process, the economy's composition of employment changes, but there may not be a *net* loss of jobs due to trade. Consider that over the course of the economic expansion, from 1992 to 2000, U.S. imports increased nearly 240%, but total employment grew by 22 million jobs and the unemployment rate fell from 7.5% to 4.0% (the lowest unemployment rate in more than 30 years.).

In times of economic hardship, when unemployment is high, governments will sometimes try to stimulate some domestic industries by protecting them from foreign competition. However, such measures are unlikely to increase total employment and could be costly. The near-term cost can be an exacerbation of weakness in the economy as foreign governments retaliate with their own protective measures, causing a decline in exports. In the long run, such attempts will tend to reallocate employment from unprotected domestic industries toward protected domestic industries, not increase total employment. More than just a transfer of well-being between sectors occurs, however, as there will be a permanent cost to the whole economy arising from the less efficient allocation of these resources.

8. Does trade reduce the wages of U.S. workers?

International trade can have strong effects, good and bad, on the wages of American workers. Concurrent with the large expansion of trade over the past 25 years, real wages (i.e., inflation adjusted wages) of American workers grew more slowly than in the earlier post-war period, and inequality of wages between the skilled and less skilled worker rose sharply. Trade based on comparative advantage tends to increase the return to the abundant factors of production—capital and high-skilled workers in the United States—and decrease the return to the less-abundant factor—low-skilled labor in the United States.[2] Therefore, it is reasonable to expect that, other factors constant, a large increase in trade, particularly increased trade with economies with vast supplies of low-skilled labor, could harm the wages of low-skilled U.S. workers. However, other economic factors such as technological change and the shifting structure of production among emerging economies may have mitigated the potential adverse effect of trade on wages. While there may be no strong evidence that expanding trade has depressed the *average* wages of U.S. workers, some evidence suggests that increased trade may have caused 10% to 20% of the increase in wage inequality.[3] Many observers believe the larger share of increased inequality of

[2] Only 10% of the U.S. labor force has less than a secondary level of education as compared to over 60% below this level in China's labor force. See U.S. Department of Labor, Bureau of Labor Statistics, *Current Population Survey,* 2006 and Barro, Robert and Jong-Wha Lee, "International Data on Educational Attainment," *NBER Working Papers 7911,* September 2000.

[3] For a survey of this evidence see Douglas Irwin, *Free Trade Under Fire*, Princeton University Press, 2002, pp. 90-97.

U.S. wages was likely caused by advancing technology's tendency to pull up the wages of high-skilled workers and increased immigration's tendency to push down the wages of low-skilled workers.

9. What is intra-industry trade?

A sizable portion of world trade sees countries exporting and importing to each other goods from the same industry. This phenomenon is called *intra-industry trade.* This type of trade is particularly characteristic of the large flows of products between advanced economies, which have very similar resource endowments. This suggests that there is another basis for trade than comparative advantage behind intra-industry trade: the exploitation of *economies of scale.* Economies of scale exist when a production process is more efficient (i.e., has lower unit cost) the larger the scale at which it takes place. This scale economy becomes a basis for trade because while the United States and Germany, for example, could be equally proficient at producing any of a wide array of goods such as automobiles and pharmaceuticals that consumers want, neither has the productive capacity to produce the full range of goods at the optimal scale. Therefore, a pattern of specialization tends to occur with countries producing and trading some sub-set of these goods at the optimal scale.

10. Why is intra-industry trade important?

A significant attribute of intra-industry trade is that it tends not to generate the strong effects on the distribution of income that can occur with trade based on comparative advantage. This attribute may explain why the large trade expansion that took place in the 1950-1980 period was less politically contentious than has been true for trade expansion since 1980. The earlier period was dominated by rising trade between advanced economies with similar endowments of productive resources and similar levels of technology. Therefore, trade at that time was largely an expansion of intra-industry trade that had no relatively abundant factor of production to exploit. As a consequence, it had little adverse effect on the return to the factors of production, including the wages of U.S. workers. In contrast, a much larger portion of the trade expansion since 1980 has been with less-developed economies with their relative abundance of low-skilled and priced labor—a likely source of downward pressure on wages in the developed economies.

11. What is globalization?

Globalization has come to represent many things, but economic globalization refers specifically to the increasing integration of national economies into a worldwide trading system. Globalization involves trade in goods and services, and trade in assets (i.e., currency, stocks, bonds, and real property), as well as the transfer of technology, and the international flows (migration) of labor. Since 1950, world trade in merchandise has consistently grown faster than world production. More recently, from 1990 to 2005 world trade in merchandise grew at about 6.0% per year as compared to about 2.0% for world output.[4] As a result, world exports as a percent of world GDP rose from about 12% to about 32%. In the United States global integration has advanced quickly, with imports as a share of GDP rising from about 10% in the 1950s to about 17% today. More recent but far more dramatic has been the growth of international trade in assets. In the 1990s gross capital flows leaped by 300% as compared to a 63% advance of trade in goods. The rising economic integration of the world economy has been facilitated by two types of

[4] See International Monetary Fund, *World Economic Outlook,* June 2006.

events: the myriad of technical advances in transport and communication that have reduced the natural barriers of time and space that separate national economies; and national and multinational policy actions that have steadily lowered various man-made barriers (i.e., tariffs, quotas, subsidies, and capital controls) to international exchange.

12. What is the global supply chain and how does it relate to globalization?

A supply chain is the interrelated organizations, resources, and processes that create and deliver a product to the final consumer. A global supply chain organized mostly by multinational corporations (MNCs) means that products that were once produced in one country may now be produced by assembling components fabricated in several countries. This supply chain has meant that as much as 30% of the recent growth of world trade has been through trade in intermediate products. Not only does such geographically fragmented production raise the level of trade associated with a particular final product, it also tends to raise the level of trade with both developing countries and developed countries. This growth of the global supply chain has been facilitated by technological advances that have increased the speed and lowered the cost of international transport and, perhaps most importantly, accelerated the international flow of information that allows MNCs to coordinate geographically fragmented production with relative ease. In addition, government action has achieved a substantial reduction of various man-made trade barriers and promoted movement toward a market based economy.

13. How does globalization affect job security?

A greater degree of international economic integration can add to disruptive forces in the marketplace, including concerns that an estimated 30 to 40 million high-wage and high-skilled U.S. service sector jobs may now be vulnerable to "outsourcing" over time. Although this increased integration is unlikely to have a negative effect on overall employment rate or the average worker wage, greater volatility of worker incomes and employment is a possible effect. While the precise causes remain unclear, some evidence for the United States indicates a steady rise in wage and employment volatility since the 1980s.[5] In response to this rise, some argue that because increased volatility raises the economic risk attached to employment and earnings, the "social safety net" that protects workers from periodic market disruptions should be expanded commensurately.

U.S. Trade Performance[6]

U.S. Trade Deficit

14. What is meant by the trade deficit?

The U.S. trade deficit is the difference between the value of U.S. exports and U.S. imports. The deficit on trade in goods (merchandise) of $738.3 billion in 2011 is what the media generally calls the trade deficit. The United States, however, usually runs a surplus in trade in services with the

[5] See Dani Roderik, *Has Globalization Gone Too Far?* Institute for International Economics, 1997.

[6] This section was updated by J. F. Hornbeck, Specialist in International Trade and Finance, Foreign Affairs. Defense, and Trade Division.

world. By adding net exports of services to the calculation, the trade deficit on goods and services was $560.0 billion in 2011. Adding in net transfers of investment income and remittances by individuals to foreign countries gives the broader measure of the trade deficit that is called the current account. Because of the size of outgoing remittances, the current account deficit is often larger than the deficit on goods and services, but not so in 2011. The current account deficit was $473.4 billion.

15. Why are different numbers reported for the trade deficit?

The data on imports and exports are reported in two ways that give similar but different numbers. When goods or services pass through U.S. borders, the Customs Service compiles the figures from shipping manifests and other documents and reports them to the U.S. Census Bureau. The Bureau then produces data on imports and exports and calculates the trade deficit on a Census basis. The detail in these data allows the import and export flows to be broken out into trade by countries, sectors, and major ports. The Census data are then adjusted to a balance-of-payments basis by accounting for military sales, adding private gift parcels, including foreign official gold sales from U.S. private dealers, and making other refinements. The following table shows U.S. trade data on both a Census and balance-of-payments basis.

Table 1. U.S. Exports, Imports, and Merchandise Trade Balances 2002-2011

(billions of U.S. dollars)

	Census Basis			Balance-of-payments Basis		
Year	**Exports**	**Imports**	**Balance**	**Exports**	**Imports**	**Balance**
2002	693.1	1,161.4	-468.3	697.4	1,171.9	-474.5
2003	724.8	1,257.1	-532.3	729.8	1,270.2	-540.4
2004	814.9	1,469.7	-654.8	822.0	1,485.5	-663.5
2005	901.1	1,673.5	-772.4	911.7	1,692.4	-780.7
2006	1,026.0	1,853.9	-827.9	1,039.4	1,875.1	-835.7
2007	1,148.2	1,957.0	-808.8	1,164.0	1,982.8	-818.8
2008	1,287.4	2,103.6	-816.2	1,307.5	2,137.6	-830.1
2009	1,056.0	1,559.6	-503.6	1,069.5	1,575.4	-505.9
2010	1,278.3	1,913.2	-634.9	1,288.7	1,934.6	-645.9
2011	1,480.7	2.207.4	-726.7	1,497.4	2,235.7	-738.3

Source: U.S. Department of Commerce, Bureau of Economic Analysis, U.S. International Transactions Accounts Data.

16. What are the causes of the record trade deficits?

The fundamental cause of the U.S. trade deficit is excess spending by U.S. consumers, business, and government. In essence, Americans consume more than they produce. This allows other countries to sell more to the United States than they buy from the United States. Economists characterize this as a lack of domestic savings by Americans caused, for example, when households buy on credit, businesses invest with borrowed funds, and the government runs budget deficits. As long as foreigners (both governments and private entities) are willing to loan the United States the funds to finance the lack of savings in the U.S. economy, the trade deficit can continue. The United States, however, accumulates more and more debt.

17. What role do foreign trade barriers play in causing trade deficits?

Trade barriers tend to affect bilateral trade in specific products and with particular countries, but they do not necessarily affect the size of the overall U.S. trade deficit. For example, trade with Burma or North Korea is non-existent or small because of U.S.-imposed export barriers. Foreign countries also impose barriers to imports and limit foreign access to their markets by a variety of measures. Some barriers are overt, such as high tariffs or import quotas. Others are less visible, such as income tax audits by tax authorities of persons buying foreign automobiles or controls over foreign exchange that prevent citizens of other countries wishing to purchase imports from obtaining the foreign currency necessary. If, for example, a government requires exporters to sell their dollars to the government at a fixed exchange rate, and that government invests the dollars in U.S. securities rather than allowing businesses and consumers to use the dollars to buy American exports, then this combination of government intervention in currency markets plus exchange controls can increase the size of the U.S. trade deficit.

Foreign trade barriers also can affect the profitability of U.S. exporters and thereby influence the size of the overall U.S. trade deficit. If U.S. exporters are able to sell more to a country that has lowered its trade barriers, the exporting companies can increase their profits, hire more American workers, and possibly increase the overall U.S. saving rate. This can occur only if the economy is operating at less than full employment (unemployment rates exceeding 4% or so).

18. How does the trade deficit affect the exchange value of the dollar?

Without sufficient inflows of capital, a trade deficit causes other parts of the economy to adjust, particularly the country's exchange rate—for the United States, this is the value of the dollar relative to that of the Chinese renminbi, Japanese yen, Canadian dollar, British pound, or European euro. The way the adjustment mechanism works is that the excess of U.S. imports causes a surplus of U.S. dollars to flow abroad. If these dollars are then converted to other national currencies, their excess supply tends to lower the price of the dollar relative to other currencies (exchange rate), and the value of the dollar depreciates. This causes imports to be more expensive for American consumers and U.S. exports to be cheaper for foreign buyers. This process gradually causes U.S. imports to decrease and exports to increase and for the trade deficit to diminish.

The dollar, however, may not be exchanged for foreign currencies because it holds a special status in global financial markets and because the U.S. economy is viewed both as a safe haven for storing wealth and as an attractive destination for investments. In some countries, the dollar is used as a medium of exchange, and in most countries it is used as a reserve currency by central banks. Foreign governments can intervene to keep the value of their currency from appreciating relative to the dollar by buying excess dollars and sending them back to the United States by buying Treasury securities or other U.S. assets. This is what China has been doing, and Japan also intervened in currency markets in September 2010 (for the first time since the spring of 2004) to keep the value of the yen from rising too high. Private Japanese investors also had been causing the same result by investing their savings overseas where interest rates have been higher. Until 2008 when the global financial crisis erupted, investors were engaged in "carry trade" transactions through which they borrowed funds in Japan and bought securities in higher-interest rate countries abroad.[7] The surplus of dollars, therefore, may not cause the dollar to depreciate or the trade deficit to decrease.

19. How is the trade deficit financed?

The U.S. trade deficit is financed by borrowing from abroad. This takes the form of net financial inflows into the United States. In 2011 U.S. net financial inflows amounted to $396.4 billion. Foreigners acquired $783.7 billion in assets in the United States (excluding financial derivatives), while Americans acquired $387.3 billion in assets abroad. Within these totals foreigners purchased an additional $141.8 billion in Treasury securities but sold $76.3 billion in other government securities. They also decreased their deposits at U.S. banks by $221.2 billion and sold $55 billion in U.S. currency. Foreigners also invested $228 billion in their companies located in the United States.

20. Is the trade deficit a problem for the U.S. economy?

Most view the U.S. trade deficit as a dual problem for the economy. In the long term, it generates debt that must be repaid by future generations. Meanwhile, the current generation must pay interest on that debt. Whether the current borrowing to finance imports is worthwhile for Americans depends on whether those funds are used for investment that raises future standards of living or whether they are used for current consumption. If American consumers, business, and government are borrowing to finance new technology, equipment, or other productivity enhancing products, the deficit can pay off in the long term. If the borrowing is to finance consumer purchases of clothes, household electronics, or luxury items, it pushes the repayment of funds for current consumption on to future generations without investments to raise their ability to finance those repayments.

In the short term, the trade deficit could lead to a large and sudden fall in the value of the dollar and financial turmoil both in the United States and abroad. Before the 2008-2009 global financial crisis, the U.S. current account deficit exceeded 6% of GDP and was placing downward pressure on the dollar. Since 2008, the U.S. current account deficit has declined in real terms because of the economic downturn and stood at approximately 3% of GDP in 2011. Foreign investors continue to look to the United States as a safe haven for their money. As a result, the U.S. Treasury has had no problem selling securities to fund the U.S. budget deficit. Eventually, however, if foreign investors stop offsetting the trade deficit by buying dollar-denominated assets, U.S. interest rates would have to rise to attract more foreign funds into U.S. investments. Rising interest rates could cause havoc in financial markets and also may raise inflationary pressures. Global financial markets are now so closely intertwined that turmoil in one market can quickly spread to other markets in the world.

21. How long can the United States keep running trade deficits?

U.S. deficits in trade can continue for as long as foreign investors are willing to buy and hold U.S. assets, particularly government securities and other financial assets.[8] Their willingness depends

[7] See Nakamae, Tadashi. Weak Yen Conundrum. *The International Economy*, Winter 2007, pp. 42-45.

[8] See Mann, Catherine L. *Is the U.S. Trade Deficit Sustainable?* Washington, Institute for International Economics, 1999. 224 p. See also: CRS Report RL33274, *Financing the U.S. Trade Deficit*, by James K. Jackson. CRS Report RL31032, *The U.S. Trade Deficit: Causes, Consequences, and Policy Options*, by Craig K. Elwell.

on a complicated array of factors including the perception of the United States as a safe haven for capital, relative rates of return on investments, interest rates on U.S. financial assets, actions by foreign central banks, and the savings and investment decisions of businesses, governments, and households. The policy levers that influence these factors that affect the trade deficit are held by the Federal Reserve (interest rates) as well as both Congress and the Administration (government budget deficits and trade policy), and their counterpart institutions abroad.

22. How can the trade deficit be reduced?

In reducing the U.S. trade deficit, the policy tool kit includes direct measures (trade policy) that are aimed at imports, exports, and the exchange rate, and indirect measures (monetary and fiscal policies) aimed at U.S. interest rates, saving rates, budget deficits, and capital flows. Monetary and fiscal policy, however, usually address conditions in the U.S. macroeconomy and generally consider the trade deficit only as a secondary target. It is ironic that the most effective method of reducing the trade deficit is through monetary and fiscal policy, yet monetary and fiscal policy is rarely determined by the trade deficit.

23. What is the role for trade policy in reducing the trade deficit?

Trade policy consists of the strategies, goals, and initiatives by governments to change the laws, regulations, and agreements that provide the framework for international trade and to take action to remedy distortions in the movement of goods, services, and capital flows across national borders. U.S. trade policy operates along four paths: (1) opening markets abroad for U.S. exporters; (2) protecting U.S. industries from imports that are unfairly traded (sold at prices lower than those in the exporting country) or from import surges that cause, or threaten to cause, serious injury; (3) promoting exports; and (4) trying to ensure that exchange rates are not manipulated by other nations to gain competitive advantage or to hinder the process by which trade is brought into balance.

Currently, U.S. trade policy to open markets abroad is conducted at three levels: through bilateral negotiations and trade/investment agreements, through establishing free trade agreements, and through multilateral negotiations under the WTO. Trade policy plays a proactive role in leveling the playing ground for U.S. business, a remedial role in correcting distortions in trade caused by foreign government intervention, and a reactive role in addressing specific problems raised by U.S. businesses. The specifics of U.S. trade policy are discussed in the section on "U.S. Trade and Investment Policy Issues" below.

Trade policy aims at reducing the U.S. trade deficit by increasing U.S. exports or decreasing U.S. imports. U.S. trade policy, however, operates under multiple constraints. Trade policy, for example, can affect specific trade flows, but the overall trade deficit tends to be determined by macroeconomic conditions (savings and investment flows). The U.S. government, moreover, faces legal obligations, political resistance, and other constraints on policy aimed at decreasing imports or increasing exports. Free market principles and U.S. law, for example, preclude the government from moving against big box retailers that sell low-cost imports from China. U.S. obligations under the World Trade Organization preclude arbitrary increases in import tariffs or large direct subsidies for U.S. exporters, and only under special circumstances, usually related to national security or severe offenses to international humanitarian values (e.g., genocide) does the United States block trade with a specific country (e.g., Cuba or Burma).

24. Who are the leading U.S. trade partners?

As shown in the following table, in 2011, Canada was America's largest merchandise trading partner, but China has passed Mexico (now third) to take second place in the ranking. Fourth was Japan, then Germany, and the United Kingdom.

Table 2. Top U.S. Trading Partners Ranked by Total Merchandise Trade in 2011

(millions of U.S. Dollars)

Rank	Country	Total trade	% Share	U.S. Exports	U.S. Imports	U.S. Balance
0	World	3,687,481	100.00	1,480,552	2,206,929	-726,377
1	Canada	597,275	16.2	280,764	316,511	-35,746
2	China	503,214	13.7	103,879	399,335	-295,457
3	Mexico	460,649	12.5	197,544	263,106	-465,562
4	Japan	194,980	5.3	66,168	128,811	-62,643
5	Germany	147,535	4.0	49,134	98,401	-49,266
6	United Kingdom	107,140	3.6	55,964	51,176	4,787
7	Korea South	100,141	2.7	43,505	56,636	-13,131
8	Brazil	74,315	2.0	42,943	31,372	11,572
9	France	67,828	1.8	27,844	39,983	-12,139
10	Taiwan	67,226	1.8	25,898	41,328	-15,429
11	Netherlands	66,298	1.8	42,827	23,471	19,356
12	Saudi Arabia	61,296	1.7	13,820	47,476	-33,657
13	India	57,795	1.6	21,628	36,167	-14,540
14	Venezuela	55,604	1.5	12,351	43,253	-30,903
15	Singapore	50,504	1.4	31,393	19,111	12,282
16	Italy	49,960	1.4	15,991	33,968	-17,977
17	Switzerland	48,867	1.3	24,453	24,414	39
18	Belgium	47,307	1.3	29,877	17,430	12,477
19	Ireland	46,828	1.3	7,608	39,220	-31,613
20	Russia	42,858	1.2	8,285	34,573	-26,287
21	Hong Kong	40,810	1.1	36,513	4,298	32,215
22	Malaysia	39,990	1.1	14,218	25,772	-11,554
23	Nigeria	38,553	1.1	4,815	33,738	-28,923
24	Australia	37,756	1.0	27,516	10,240	17,276
25	Colombia	37,431	1.0	14,315	23,116	-8,801

Source: Data from U.S. Department of Commerce, as reported by Global Trade Atlas.

Note: Total trade = imports + exports.

25. Which industries appear to be the most competitive as measured by the size of their trade surpluses? Which are the least competitive as measured by their trade deficits?

The international competitive advantage of specific industries can be measured in a number of ways—one of which is their trade balances. Other measures include profitability, value added, productivity, employment, and technological change. **Table 3** shows the balance of trade for U.S. industries (as defined by 2-digit Harmonized System tariff classifications). By this measure, the industries with the largest surpluses, in 2011, include aircraft and spacecraft, cereals, other grains and seeds, plastics, miscellaneous chemicals, meat, animal feed, cotton/yarn/fabric, optics, and medical instruments. These U.S. industries can be considered the most competitive in international trade. The table also shows those industrial sectors with the largest deficits in trade. These include mineral fuel and oil, electrical machinery, motor vehicles, machinery, apparel, furniture, toys, and organic chemicals.

Despite the large trade deficit by the mineral fuel and oil sector, the major oil companies remain quite competitive. They are multinational firms who, themselves, do much of the importing of crude oil for their refineries often from their own sources of oil. The deficit in trade in electrical machinery, moreover, may reflect more the global supply chain of multinational producers who may be located in the United States and have competitive products but manufacture their machinery abroad.

Table 3. U.S. Industries with the Largest Trade Surpluses and Deficits in 2011

(million U.S. Dollars)

	Largest Trade Surpluses		Largest Trade Deficits	
Rank	**Description**	**Surplus**	**Description**	**Deficit**
1	Aircraft, Spacecraft	66,001	Mineral Fuels	-325,971
2	Cereals	26,131	Electrical Machinery	-119,681
3	Plastics	19,201	Motor Vehicles	-82,676
4	Misc Grain, Seed, Fruit	19,126	Nuclear Reactors, Boilers	-81,971
5	Misc. Chemicals	13,076	Apparel, Clothing Knitted	-39,499
6	Optics, Medical Instruments	12,985	Apparel, Clothing not knitted	-34,810
7	Meat	10,230	Furniture, Bedding, Lamps, etc.	-30,249
8	Cotton, yarns, fabrics	9,849	Pharmaceuticals	-26,850
9	Animal feed, Food Waste	6,548	Footwear	-21,365
10	Woodpulp, Etc.	6,084	Toys, Games, Sport Equip.	-20,579
11	Tanning, Dye, Paint, Putty	5,330	Special Imports	-14,043
12	Pearls, Precious Stones, Coins	4,361	Iron & Steel articles	-13,669
13	Soap, Wax, etc	3,848	Rubber Goods	-13,146
14	Ores, Slag, Ash	3,719	Organic Chemicals	-10,369
15	Hides, Skins, Leather	2,707	Beverages, Spirits	-10,047
16	Misc. Edible Preparations	2,594	Textile Art/Sets	-9,982
17	Dairy Produce, Honey	2,150	Leather Goods	-9,791

	Largest Trade Surpluses		Largest Trade Deficits	
Rank	Description	Surplus	Description	Deficit
18	Edible Fruit, Nuts, Citrus	2,033	Coffee, Tea, Mate & Spices	-7,889
19	Books, Newspaper; Manuscript	1,564	Fish, Crustaceans	-7,634
20	Railway/Tramway Stock	1,376	Misc. Base Metals	-4,612
21	Ships, Boats	1,040	Special Classification	-3,910
22	Arms, Ammunition	1,196	Clocks and Watches	-3,702
23	Photographic/Cinematography	950	Ceramic Products	-3,373
24	Manmade fibers, yarns	795	Wood and Wood Articles	-3,333
25	Paper/Paperboard	780	Edible vegetables, roots, tubers	-3,306

Source: CRS. Underlying data from U.S. Department of Commerce. Data are on a Census Basis by 2-digit Harmonized System codes.

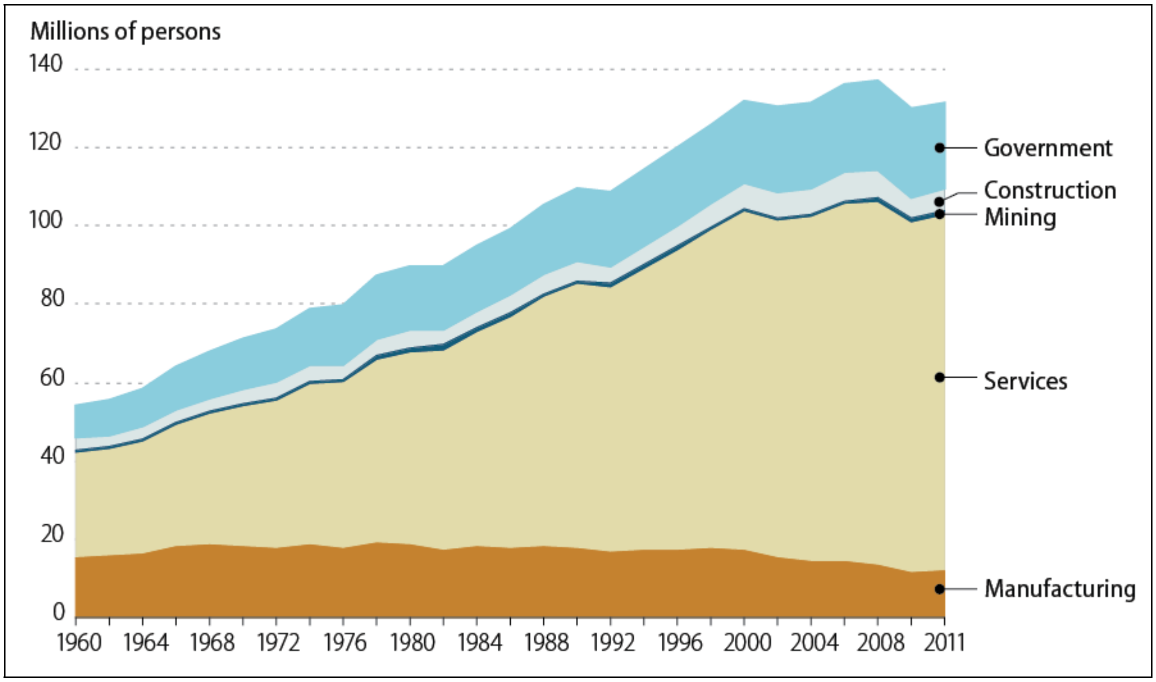
26. Is the U.S. manufacturing sector shrinking?

Imports are often blamed for what is perceived as the shrinking of the U.S. manufacturing sector. Media reports of factories being closed, workers laid off, and the plethora of labels on merchandise that indicate the product was made in China, Mexico, or any of a number of foreign countries reinforce that perception. Employment in U.S. manufacturing has declined moderately over the past half century (See **Figure 1**). In 1960, 15.4 million persons were employed in manufacturing. That number peaked at 19.4 million in 1979 and has declined to 11.8 million in 2011.[9] Some of this decline, however, has resulted from the "fracturing" of the production process in discrete steps that can either be done in-house or outsourced. Much service work, such as accounting, cleaning, maintenance, shipping, and security, that previously may have been done in house (and, therefore, counted as manufacturing) is now being done by contract service firms and counted as services employment. Since total U.S. employment has risen, manufacturing's share of total nonfarm employment has dropped from 29% in 1960 to 9.0 % 2011.

Most of the new jobs are being created by the service sector. In 1960, 35.1 million persons worked in service-producing industries (including government). By 2011, employment in services (including government) had more than tripled to 113.4 million persons.

[9] These data are based on reports from employing establishments and do not include proprietors, self-employed persons, unpaid family workers, private household workers, and those employed in agriculture.

Figure 1. Employees on Nonagricultural Payrolls by Major Industry
(1960-2011)



Source: Bureau of Labor Statistics, U.S. Department of Labor.

Even with reduced employment, production by the manufacturing sector as a whole continues to rise, although production in some sectors has been stagnant or declining. What appears to be happening depends on the industry, but studies of de-industrialization generally conclude that it is being caused primarily by developments internal to the economy and not by trade. These include technological change, the shift in consumer demand from manufactured products toward services as incomes rise, and the declining relative price of manufactured items. Import competition has played a role in certain industries. One study concludes that import competition has contributed less than one-fifth to the relative decline of manufacturing in the advanced economies and has had little effect on the overall volume of manufacturing output in those countries.[10]

27. Which industries are losing the most jobs?

The industries that are incurring large deficits in their balance of trade are under heavy competition from imports and have been reducing employment. **Table 4** shows certain of those industries with the recent peaks in their employment and their employment in 2011. The peak dates range from 1991 to 2008, while the declines since then range from -83.2% for the apparel industry and -75.1% for textile mills to -9.3 for machinery.

[10] Brady, David and Ryan Denniston, "Economic Globalization, Industrialization and Deindustrialization in Affluent Democracies," *Social Forces,* 85 no. 1 (Sep 2006): pp. 297-310, 312, 315-316, 318, 320-327.

Table 4. Recent Peaks and Current Employment for Industries With Heavy Import Competition

(thousand Persons)

Industry	Recent Peak	Peak Employment	December 2011 Employment	Change
Motor Vehicles and Parts	Feb. 2000	1,330.3	736.6	-44.6
Electrical Equipment and Appliances	Jul. 2006	436.1	369.1	-15.3
Computer and Electronic Products	Aug. 2004	1,327.4	1,107.4	-16.6
Machinery	Mar. 2008	1,193.8	1,082.0	-9.3
Textile Mills	Feb. 1995	480.9	119.6	-75.1
Textile Product Mills	Jan. 1995	248.3	114.3	-54.0
Apparel	Dec. 1991	891.1	150.1	-83.2
Furniture and Related Products	Apr. 2004	578.1	348.6	-40.0
Plastics and Rubber Products	Feb. 2000	959.9	639.5	-33.4

Source: U.S. Bureau of Labor Statistics.

Formulation of U.S. Trade Policy

Role of Congress[11]

28. What role does Congress play in the making of trade policy?

The role of Congress in formulating international economic policy and regulating international trade is based on express powers set out in Article 1, Section 8, of the U.S. Constitution, "To lay and collect Taxes, Duties, Imposts and Excises" and "To regulate Commerce with foreign Nations, and among the several States," as well as the general provision to "make all Laws which shall be necessary and proper" to carry out these specific authorities. Congress exercises this power in many ways, among the most important being the enactment of tariff schedules and trade remedy laws, and the approval and implementation of reciprocal trade agreements.

29. What committees take the lead in exercising congressional authority over trade?

Because of the revenue implications inherent in most trade agreements and policy changes, the House Ways and Means Committee and Senate Finance Committee have responsibility for trade matters. Each committee has a subcommittee dedicated exclusively to trade issues. Other

[11] Prepared by J. F. Hornbeck, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division; and Jeanne J. Grimmett, Legislative Attorney, American Law Division.

committees may have a role should trade agreements, policies, and other trade issues include matters under their jurisdiction.

30. What explicit ways does Congress make trade policy?

U.S. trade policy is founded on statutory authorities, as passed by Congress. These include laws authorizing trade programs and governing trade policy generally in areas such as tariffs, non-tariff barriers, trade remedies, import and export policies, political and economic security, and trade policy functions of the federal government. Congress also sets trade negotiating objectives in law, requires formal consultation from and opportunity to advise on trade negotiations with the executive branch (in part through the Congressional Oversight Committee—COG), and conducts oversight hearings on trade programs and agreements to assess their conformity to U.S. law and congressional intent.

31. How can individual members affect trade policy decisions?

Individual members affect trade policy first as voting representatives who determine collectively the statutes governing trade matters. They may also exercise influence as sitting members on relevant committees, in testimony before those committees, whether as a member of it or not, and in exercising informal influence over other members through the exercise of the political authority and power invested in them by the electorate.

32. What is meant by fast track or Trade Promotion Authority (TPA)?

TPA (formerly fast track) refers to a statutory mechanism under which Congress defines trade negotiating objectives, authorizes the President to enter into reciprocal trade agreements governing tariff and non-tariff barriers, and allows their implementing bills to be considered under expedited legislative procedures, provided the President observes certain statutory obligations in negotiating trade agreements, including notifying and consulting Congress. The purpose of TPA is to preserve the constitutional role of Congress with respect to consideration of implementing legislation for trade agreements that require changes in domestic law, while also bolstering the negotiating credibility of the executive branch by assuring the trade implementing bill will receive expedited and unamended consideration. TPA expired in 2007 and as of this writing has not been renewed by Congress.

Role of the Executive Branch[12]

33. Who is in charge?

The President directs overall trade policy in the executive branch and performs specific trade functions granted to him in statute. The principal adviser to the President on trade matters is the United States Trade Representative (USTR), a cabinet-level appointment that has primary responsibility for developing, coordinating, and implementing of U.S. trade policy (19 U.S. C. 2171).

[12] Prepared by J. F. Hornbeck, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division, and Jeanne J. Grimmett, Legislative Attorney, American Law Division.

34. Why was the USTR created?

Congress created the USTR in 1962 (originally as the Office of the Special Representative for Trade Negotiations) to heighten the profile of trade and provide better balance between competing domestic and international interests in the formulation and implementation of U.S. trade policy and negotiations, which were previously managed by the U.S. Department of State.

35. How are trade decisions made?

The USTR has primary responsibility for trade policy decisions within the executive branch; often, however, they involve areas of responsibility that fall under other cabinet-level departments, at times requiring a multi-department process. To implement this process, Congress established the Trade Policy Committee, chaired by the USTR and consisting of the Secretaries of the Treasury, Commerce, State, Agriculture, Labor, and other department heads as the USTR deems appropriate. The USTR subsequently established two sub-cabinet groups—the Trade Policy Review Group (TPRG) and the Trade Policy Staff Committee (TPSC). The executive branch also solicits advice from a three-tiered congressionally established trade advisory committee system that consists of private sector and non-federal government representatives.

36. What are the functions of the executive branch in U.S. trade?

The executive branch executes trade policy in a variety of ways. It negotiates, implements, and monitors trade agreements, and has responsibility for customs enforcement, collection of duties, implementation of trading remedy laws, budget proposals for trade programs and agencies, export and import policies, and agricultural trade, among others.

37. When does the President get involved in trade decisions?

The President is responsible for influencing the direction of trade legislation, signing trade legislation into law, and making other specific decisions on U.S. trade policies and programs where he deems the national interest or political environment requires his direct participation. This can take place in many areas of trade policy, such as requesting TPA/fast track authority, initiating critical trade remedy cases, meeting or communicating with foreign heads of state or government, and other areas subject to or requiring high political visibility.

Role of the Private Sector[13]

38. What is the formal role of the private sector?

The formal role of the private sector in the formulation of U.S. trade policy is embodied in a three-tiered committee system that the Congress has provided in Section 135 of the Trade Act of 1974, as amended. These committees advise the President on negotiations, agreements and other matters of trade policy. At the top of the system is the 30-member Advisory Committee for Trade Policy and Negotiations (ACTPN) consisting of presidentially appointed representatives from local and state governments and representatives from the broad range of U.S. industries and labor.

[13] Prepared by William H. Cooper, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

The USTR administers the ACTPN in cooperation with the Departments of Agriculture, Commerce, Labor, and other relevant departments. At the second tier are five policy advisory committees—Trade and Environment Policy, Intergovernmental Policy; Labor Policy; Agriculture Policy, and Africa. The third tier consists of 17 sector-specific committees—one on agriculture and 16 on industry—who provide technical advice. The USTR and the relevant department Secretary appoint members of the sector-specific committees in the latter two tiers.

39. What is the informal role that the private sector plays in the formulation of U.S. trade policy?

The private sector helps shape U.S. trade policy in a number of informal ways. For example, representatives from industry and non-government organizations may be invited to testify or ask to testify before congressional committees on trade matters. Private sector representatives are also invited or request to testify before the United States International Trade Commission (USITC), the U.S. Department of Commerce, or other government bodies to provide assessments of the potential impact of pending trade actions, such as an antidumping or countervailing duty orders, on their industries and sectors. Private sector organizations also lobby Congress and the executive branch to forward their interests in U.S. trade policy actions and agreements.

40. Why are trade decisions so heavily lobbied?

Trade is becoming a larger and increasingly integral part of the U.S. economy. Virtually all kinds of agricultural and manufactured goods are tradeable—they can be exported and imported. In addition, a growing number of services—once considered non-tradeable because of their intangibility—can be bought and sold across borders because of technology advancements, such as the Internet. As a result, how U.S. trade policy is shaped and implemented can affect a broad spectrum of people in the United States. For some industries, firms, and workers, congressional decisions to support a particular free trade agreement or Department of Commerce rulings on antidumping cases, subsidies, and other cases could affect both employment and growth. Those decisions could also influence product choices of U.S. consumers. Consequently, groups representing the multinational national corporations, small businesses, farmers, workers, consumers, and other segments of the economy strive to make sure that their clients' views on trade policy decisions are represented.

Role of the Judiciary[14]

41. How do federal courts get involved in trade?

Legal challenges may be brought in federal court by importers, exporters, domestic manufacturers and producers, and other parties affected by governmental actions and decisions concerning trade. Cases may involve, for example, customs classification decisions, agency determinations in antidumping and countervailing duty (CVD) proceedings, presidential decisions to (or not to) restrict imports under trade remedy statutes, or the constitutionality of state economic sanctions. The federal government may also initiate legal proceedings against individuals and firms to enforce customs laws or statutory restrictions on particular imports and exports. Some trade statutes may preclude judicial review. For example, most preliminary determinations in

[14] Prepared by Jeanne J. Grimmett, Legislative Attorney, American Law Division.

antidumping and CVD proceedings and governmental actions involving the implementation of WTO and free trade area agreements may not be challenged in federal court.[15] While most federal cases involving trade laws are heard in the U.S. Court of International Trade (see below), cases may also be filed in other federal courts depending on the cause of action or proceeding involved. Court decisions may significantly affect U.S. trade policy when they examine whether an agency has properly interpreted its statutory mandate, determine whether an agency has acted outside the scope of its statutory authority, decide how much deference should be granted the executive branch under a particular statute, or rule on whether a trade statute violates the U.S. Constitution.

42. What is the U.S. Court of International Trade?

The U.S. Court of International Trade (USCIT) is an Article III federal court located in New York City with exclusive jurisdiction over a number of trade-related matters, including customs decisions, antidumping and countervailing duty determinations, import embargoes imposed for reasons other than health and safety, and the recovery of customs duties and penalties. Formerly known as the Customs Court, the USCIT was renamed in the Customs Court Act of 1980, which also significantly enlarged its jurisdiction. The court consists of nine judges, no more than five of whom may be from the same political party. Judges are appointed by the President with the consent of the Senate. USCIT decisions are appealable to the U.S. Court of Appeals for the Federal Circuit and to the U.S. Supreme Court. Statutory provisions related to the USCIT may be found at 28 U.S.C. §§ 251-258 (establishment) and 28 U.S.C. §§ 1581-1585 (jurisdiction).

U.S. Trade and Investment Policy Issues

Trade Negotiations and Agreements[16]

43. Why does the United States negotiate trade liberalizing agreements?

The United States negotiates trade liberalizing agreements for economic and commercial reasons, including:

- to encourage foreign trade partners to reduce or eliminate tariffs and non-tariff barriers and, in so doing, increase market access for U.S. exporters;
- to gain an advantage for U.S. exporters over foreign competitors in a third-country market;
- to increase access to lower cost imports that help to control inflation and offer domestic and industrial consumers a wider choice of products; and
- to encourage trading partners, especially developing countries, to rationalize their trade regimes, and thereby improve the efficiency of their economies.

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[15] For further information, see CRS Report RS22154, *World Trade Organization (WTO) Decisions and Their Effect in U.S. Law*, by Jeanne J. Grimmett.

[16] This section was prepared by William H. Cooper, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

The United States also negotiates trade liberalizing agreements for foreign policy/national security reasons, including:

- to strengthen established alliances;
- to forge new strategic relationships; and
- to establish a presence in a geographic region.

44. What are the various types of trade liberalizing agreements?

In general, reciprocal trade agreements can be categorized by the number of countries involved: **bilateral agreements**, such as free trade agreements (FTAs), are between two countries; **regional agreements**, such as, the North American Free Trade Agreement (NAFTA), involve three or more countries in a geographic region; and **multilateral agreements**, such as those negotiated in the World Trade Organization (WTO), involve many countries from virtually all regions.

45. Who benefits from trade liberalizing agreements? Who loses?

Economic theory suggests and empirical studies have generally concluded that economies as a whole benefit when trade barriers are removed because economic resources (land, labor, and capital) are employed more efficiently. However, economic theory and studies also point out that the benefits of trade liberalization are not distributed evenly within an economy and not even among economies. Some industries, firms, and workers "lose" if they cannot adjust to the increased foreign competition resulting from the trade agreement or if particular provisions of the trade agreement disadvantage their interests. Other industries, firms, and workers "win" if they can take advantage of new market opening opportunities presented by the trade agreement or if particular provisions of the trade agreement favors or promotes their interests.

46. What is the WTO?

The World Trade Organization (WTO) is a 153-member body that establishes through negotiations and implements the multilateral system of rules on trade in goods and services and on other trade-related matters and adjudicates disputes under the rules. A fundamental principle of the WTO is non-discrimination in trade among the members. The WTO was established in January 1995 as a part of the agreements reached by the signatories to the General Agreement on Tariffs and Trade (GATT) at the end of the Uruguay Round negotiations. The WTO's primary purpose is to administer the roughly 60 agreements and separate commitments made by its members as part of the GATT (for trade in goods), the General Agreement on Trade in Services (GATS—for trade in services), and the agreement on trade-related aspects of intellectual property rights (TRIPS).

47. How are disputes resolved under WTO agreements?

If a WTO Member believes that another Member has adopted a law, regulation, or practice that violates a WTO agreement, the Member may initiate dispute settlement proceedings under the WTO Dispute Settlement Understanding. The process begins with consultations and, if these fail to resolve the dispute, the Member may request that the WTO establish a dispute panel. A panel report may be appealed to the WTO Appellate Body by either disputing party. If the defending Member is found to have violated a WTO obligation, the Member will be expected to remove the challenged measure. If this is not done by the end of the established compliance period, the prevailing Member may request authorization from the WTO to take temporary retaliatory action.

In most cases, retaliation consists of tariff increases on selected products from the defending Member. To date, over 420 complaints have been filed since the WTO agreements entered into force, with the majority of disputes resolved through consultations and negotiations rather than the panel process.

WTO decisions do not have direct effect in U.S. law. Thus, in the event a U.S. statute is found to violate a WTO obligation, the dispute findings may not be implemented except through legislative action. Where an administrative action is successfully challenged, the United States Trade Representative (USTR) decides what, if any, compliance action will be taken. If sufficient statutory authority exists to amend or modify a regulation or practice or to issue a new determination in a challenged administrative proceeding, the USTR may direct the agency involved to make the change, provided that certain statutory procedures for such actions are followed.[17]

48. What is the Doha Round?

Since the GATT was signed in 1947, its signatories (member countries) have revised and expanded the trade rules in various rounds of negotiations to liberalize global trade. The Doha Development Agenda (DDA) is the ninth round and the first under the WTO. It is named after the city where it was launched in November 2001—Doha, Qatar. The WTO members included "development" in the title to reflect their intention to emphasize issues of importance to developing countries. The negotiations have primarily focused on three areas—agriculture, non-agricultural goods, and services, although members have conducted negotiations in other areas as well, such as rules. As of this writing, negotiators have not been able to reach agreement and conclude the round.

49. What are free trade agreements (FTAs)?

At a minimum, FTAs are agreements between/among two or more countries under which they agree to eliminate tariffs and non-tariff barriers on trade in goods and services among them, but each country maintains its own trade policies and regulations, including tariffs, on trade outside the FTA. FTA partner countries may also agree to reduce barriers or otherwise establish rules of behavior in other economic activities—investment, intellectual property rights (IPR), government procurement, worker rights, and environmental protection.

50. How do FTAs that the United States has negotiated generally differ from those negotiated among other countries?

The FTAs that the United States negotiates are often more comprehensive than those that are negotiated among other countries, particularly developing countries. The standard U.S. FTA model includes not only the elimination of tariffs on trade in goods among the FTA partners, but also reduction of barriers on trade in services, rules on foreign investment, requirements for intellectual property rights protection, government procurement, and provisions on labor and environment. These rules may not necessarily guarantee "free trade," but may condition or influence the terms of competition in specific markets.

[17] Uruguay Round Agreements Act, P.L. 103-465, §§ 123(g), 129, 19 U.S.C. §§ 3535(g), 3538.

51. What are Trade and Investment Framework Agreements (TIFAs)?

A TIFA is an agreement between the United States and another country (for example Egypt) or group of countries (for example, ASEAN) to consult on issues of mutual interest in order to promote trade and investment among the participants. Most U.S. TIFAs are with developing countries. The United States and its TIFA partner(s) agree to establish a joint ministerial-level council as the overall mechanism for consultation with the possibility of establishing issue-oriented working groups. A TIFA is a non-binding agreement and does not involve changes in U.S. law; therefore, TIFAs do not require congressional approval. In some cases, TIFAs have led to FTA negotiations.

Import Issues[18]

52. Why do countries import goods and services from other countries?

Some goods that are imported into the United States, such as bananas or crude oil, cannot be produced at home or produced in sufficient quantities to satisfy domestic demand. Many other goods and services are imported because they can be produced less expensively or more efficiently by other countries.

53. What are other benefits of imports?

Consumers can benefit through access to a wider variety of goods at lower costs. Producers can benefit through access to lower priced components or inputs that can be utilized in the production process. Longer term, import competition can also pressure companies to reduce costs through innovation, research, and development, leading to growth in economic output and productivity.

54. What are the costs of imports?

By providing increased competition to companies producing similar products, imports can contribute to job losses and business failures. If these job losses and company failures are concentrated in a region or sector, imports can also be a cause of considerable economic distress in a community.

55. How does the government deal with disruption and injury to producers and workers?

The government tries to help producers and workers who are adversely affected by trade through application of various trade remedy laws. These laws include responses to unfair trade practices and to increased levels of injurious imports, as well as the Trade Adjustment Assistance program.

56. What are the main trade remedy laws?

Two primary trade remedy laws aimed at unfair trade practices are the antidumping (AD) and countervailing duty (CVD) statutes. Other trade remedy laws include Section 201 (see below), Section 301 (focuses on violations of trade agreements or other foreign practices that are

[18] This section was prepared by Vivian C. Jones, Mary Jane Bolle, and J. F. Hornbeck, Specialists in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

unjustifiable and restrict U.S. commerce), and Section 337 (focuses on unfair practices in import trade such as patent and copyright infringement).

57. What is the purpose of the countervailing duty law?

The purpose of the CVD law is to offset any unfair competitive advantage that foreign manufacturers or exporters might enjoy over U.S. producers as a result of receiving a subsidy. As defined by the WTO, a subsidy is a financial contribution, such as a loan, grant, or tax credit, provided by a government or other public entity that confers a benefit on manufacturers or exporters of a product. Countervailing duties, if imposed, are designed to equal the net amount of the foreign subsidy and are levied upon importation of the subsidized goods into the United States.

58. What is the purpose of the antidumping law?

Dumping generally refers to an unfair trade practice in which an exporter sells goods in one export market at lower prices than comparable goods sold in the home market or in other export markets. Companies may dump products to gain market share or deter competition. U.S. law provides for the assessment and collection of antidumping duties when an administrative determination is made that foreign goods are being dumped or sold at less than fair value in the United States, and that such imports are materially injuring a U.S. industry.

59. What is the import relief (safeguards) law?

Chapters 1 and 2 of the Trade Act of 1974, as amended, provide the President with the authority to apply safeguard measures temporarily (increased tariffs or quotas) to restrict imports if they threaten or cause serious injury to a domestic industry. Safeguard measures apply to products that are not necessarily traded unfairly. This provision recognizes that liberalization of trade barriers can change competitive conditions and that in certain cases domestic industries should be provided a period of relief to allow time for adjustment. The U.S. International Trade Commission investigates and recommends on import relief cases, and the President takes final action.

60. What is the Trade Adjustment Assistance Program?

Congress passed the first trade adjustment assistance program as part of the Trade Expansion Act of 1962 (P.L. 87-794). Although Congress has changed the TAA provisions over time, currently TAA is offered in three separate programs. The first, and by far the largest, program provides eligible certified workers with education, wage reimbursement, job search and relocation allowances, and tax credits for health insurance. A second program covers certified eligible firms by arranging for technical assistance for adjustment to increased competition. A third program applies to farmers and provides technical assistance and financial grants to help them become more competitive. Congress has authorized a fourth program for communities, but the program is currently expired, except for the Trade Adjustment Assistance Community College and Career Training program.

61. What is the Rationale for TAA?

In proposing the program, supporters in Congress argued that those injured by increased trade competition as a result of public policy should not be required to bear the full cost of the impact. Justification rested on arguments for (1) economic efficiency, by speeding the adjustment process and returning idle resources to work more quickly, (2) equity, by compensating for lost income while spreading the cost of freer trade to society as a whole, and (3) political pragmatism, by defusing opposition to trade liberalizing legislation. TAA skeptics argue that such assistance is costly, economically inefficient, reducing worker and firm incentives to relocate and adjust, and may not be equitable given many economic groups hurt by changing economic circumstances caused by other than trade policies are not afforded special economic assistance. Despite disagreement, Congress has consistently found compromise positions to maintain the program over the past five decades.

Export Issues[19]

62. What are the benefits of exports?

From the perspective of individual companies, export markets provide opportunities to expand production and increase efficiency by taking advantage of economies of scale. Companies may also be able to sell goods and services at higher prices than they can obtain at home. From the perspective of individual workers, jobs in export-oriented industries often provide higher than average wages.

63. What are some costs of exporting?

From an economic perspective that views higher levels of consumption as being the goal of economic activity, countries export goods and services in order to earn the foreign currency with which they can buy imports. Exports, according to this view, are foregone production that could have been consumed domestically.

64. What factors most determine U.S. export levels?

Economists maintain that the overall level of U.S. exports is determined primarily by the same macroeconomic conditions that generate the U.S. trade deficit. These include the level of savings and investment, the foreign exchange rate, and willingness of foreigners to invest in U.S. assets. U.S. exports also depend on economic growth rates in major markets. The higher the rate of economic growth in Asia (particularly Japan and China), Europe (particularly Germany, the UK, and France), Canada, and Latin America, the more people in those markets are likely to buy U.S. exports, other things being equal.

65. What factors determine the exporting success of specific sectors?

The level of American exports in specific sectors depends both on the overall level of exports and on an interplay of factors such as the relative competitiveness of the American industry, trade barriers abroad, and sometimes the degree of U.S. export promotion. The higher the overall level of exports, the more individual sectors are likely to sell abroad, but given the impact of macroeconomic factors, export surges by a particular sector often are offset by a decline in exports by other sectors. In a world of floating exchange rates, a large export surge will cause foreigners to buy more dollars to pay for those exports. This raises the demand for dollars and increases its price relative to other currencies. Since the United States does not intervene in

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[19] Prepared by Angeles Villarreal, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

currency markets to fix its exchange rate, the higher value of the dollar makes U.S. exports more expensive and may reduce their sales.

66. How does the U.S. government promote exports?

For many years, the U.S. government has promoted exports by providing credit, finance, and insurance programs that are administered by the Export-Import Bank, the Department of Agriculture, and the Overseas Private Investment Corporation. In addition, the Department of Commerce through the Foreign Commercial Service in the International Trade Administration of the Department of Commerce acts to promote U.S. exports of goods and services, particularly by small and medium-sized companies. This issue has been elevated with the Obama Administration's introduction of the National Export Initiative (NEI) in the 2010 State of the Union Address. The NEI is a strategy for doubling U.S. exports by 2015 in an effort to generate two million new jobs.

67. What does the U.S. government do to restrict exports?

Congress has authorized the President to control the export of various items for national security, foreign policy, and economic reasons. Separate programs and statutes for controlling different types of exports exist for nuclear materials and technology, defense articles and services, and dual-use goods and technology. Under each program, licenses of various types are required before an export can be undertaken. The Departments of Commerce, State, and Defense administer these programs.

Investment Issues[20]

68. What are the main kinds of capital flows?

Generally, the two main kinds of capital flows are foreign direct investments and foreign portfolio investments. Foreign direct investments involve the acquisition of real assets such as real estate, a manufacturing plant, or controlling interest in an ongoing enterprise by a person or entity from another country. Foreign portfolio investments involve purchase of foreign equities or bonds, loans to foreign residents, or the opening of foreign bank accounts. Direct investments involve a long-term commitment and usually have direct employment stimulation advantages for the host country while portfolio investments are extremely liquid and can be withdrawn often times at the click of a computer mouse. In addition, there are official capital flows generated by governments for various purposes such as humanitarian assistance and other foreign aid.

69. Which is larger—trade or capital flows?

It depends. Recent data indicate that from 1985 to 2009, global trade in goods and services, as measured by exports, tripled from $6 trillion a year to $19 trillion a year. During the same twenty four-year period, capital flows, as measured in the balance of payments accounts (direct, portfolio, and other official investments), more than quadrupled from $1.1 trillion a year to $5.2 trillion a year. But during this time period, there also has been an explosion in growth in other types of capital flows, known as foreign exchange and over-the-counter derivatives markets.

[20] Prepared by James K. Jackson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

These markets facilitate trade in foreign exchange and other types of assets. While the capital flows associated with these markets do not directly relate to transactions in the balance of payments, they do affect the international exchange value of the dollar, which in turn affects the prices of goods and services and the cost of securities. A survey in 2010 by the world's leading central banks indicated that the daily trading of foreign currencies totals more than $4.1 trillion.

70. Why do companies invest abroad?

For the most part, firms invest abroad to increase their profits. Economists and other experts generally conclude, however, that a broad range of factors influence a firm's decision to invest abroad. The major determinants of foreign direct investment are the presence of ownership-specific competitive advantages in a transnational corporation, the presence of locational advantages such as resource endowments or low-cost labor in a host country, and the presence of superior commercial benefits in an intra-firm relationship as opposed to an arm's-length relationship between investor and host country. Multinational firms apparently are motivated by more than a single factor, and likely invest abroad not only to gain access to a low-cost resource but to improve their efficiency or to improve their market share.

71. Why has foreign investment increased so dramatically in recent decades?

From 1990 to 2010, the stock, or the cumulative amount, of foreign direct investment in the world grew by more than ten fold from $1.8 trillion to $19 trillion. This rapid growth arises from a number of factors. One of the most important factors has been a change in public policies toward foreign direct investment among most countries. Foreign direct investment has come to be viewed favorably not only by the economically advanced countries, but also by developing economies, which now often compete to bring in much-needed capital, technology, and technical expertise. Currently, about three-fourths of all direct investment is placed among the highly developed economies where consumer tastes and workers wages are comparable.

72. What are some of the benefits of direct foreign investment?

Generally, economists argue in favor of unimpeded international flows of capital, such as direct investment, because they estimate that such flows positively affect both the domestic (home) and foreign (host) economies. For the home country, direct investment benefits the individual firms that invest abroad, because they are better able to exploit their existing competitive advantages and to acquire additional skills and advantages. Direct investment also seems to be associated with a strengthened competitive position, a higher level of skills of the employees, and higher incomes of firms that invest abroad. Host countries benefit from inward direct investment because the investment adds permanently to the capital stock and often to the skill set of the nation. Direct investment also brings technological advances, since firms that invest abroad generally possess advanced technology, processes, and other advantages. Such investment also boosts capital formation and contributes to a growth in a competitive business environment and productivity. In addition, direct investment contributes to international trade and integration into the global trading community, since most firms that invest abroad are established multinational firms.

73. What are some of the costs of direct foreign investment?

Concerned observers argue that U.S. direct investment abroad supplants U.S. exports, thereby reducing employment and wages in the U.S. economy. While it appears unlikely that the overall U.S. employment level is affected by direct investment flows, jobs in particular companies and sectors can be eliminated when a company decides to produce similar products abroad. For example, if a U.S. auto company closed an assembly line in the United States and opened one in Mexico assembling the same product line, U.S. auto assembly jobs are lost. Similarly, while inward flows of foreign direct investment tend to create new jobs, there sometimes is concern that the new foreign owners may not serve as stable and dependable community partners as the previous nationally based ownership.

74. What are BITs?

Bilateral investment treaties (BITs) are agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories. Most treaties contain basic provisions that cover the following areas: scope and definition of investment, admission and establishment, national treatment, most-favored-nation treatment, fair and equitable treatment, compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds, and dispute settlement mechanisms, both state-state and investor-state. U.S. BITs have to be ratified by the Senate.

75. What is CFIUS?

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that serves the President in overseeing the national security implications of foreign investment in the economy. CFIUS was established by an Executive Order of President Ford in 1975 with broad responsibilities and few specific powers.

Additional Readings

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List of Questions

Trade Concepts

1. Why do countries trade?

2. What is comparative advantage?

3. What determines comparative advantage?

4. Can governments shape or distort comparative advantage?

5. What is the terms of trade?

6. What are the costs of trade expansion?

7. Does trade destroy jobs?

8. Does trade reduce the wages of U.S. workers?

9. What is intra-industry trade?

10. Why is intra-industry trade important?

11. What is globalization?

12. What is the global supply chain and how does it relate to globalization?

13. How does globalization affect job security?

U.S. Trade Performance

14. What is meant by the trade deficit?

15. Why are different numbers reported for the trade deficit?

16. What are the causes of the record trade deficits?

17. What role do foreign trade barriers play in causing trade deficits?

18. How does the trade deficit affect the exchange value of the dollar?

19. How is the trade deficit financed?

20. Is the trade deficit a problem for the U.S. economy?

21. How long can the United States keep running trade deficits?

22. How can the trade deficit be reduced?

23. What is the role for trade policy in reducing the trade deficit?

24. Who are the leading U.S. trade partners?

25. Which industries appear to be the most competitive as measured by the size of their trade surpluses? Which are the least competitive as measured by their trade deficits?

26. Is the U.S. manufacturing sector shrinking?

27. Which industries are losing the most jobs?

Formulation of U.S. Trade Policy

28. What role does Congress play in the making of trade policy?

29. What committees take the lead in exercising congressional authority over trade?

30. What explicit ways does Congress make trade policy?

31. How can individual members affect trade policy decisions?

32. What is meant by fast track or Trade Promotion Authority (TPA)?

33. Who is in charge?

34. Why was the USTR created?

35. How are trade decisions made?

36. What are the functions of the executive branch in U.S. trade?

37. When does the President get involved in trade decisions?

38. What is the formal role of the private sector?

39. What is the informal role that the private sector plays in the formulation of U.S. trade policy?

40. Why are trade decisions so heavily lobbied?

41. How do federal courts get involved in trade?

42. What is the U.S. Court of International Trade?

U.S. Trade and Investment Policy Issues

43. Why does the United States negotiate trade liberalizing agreements?

44. What are the various types of trade liberalizing agreements?

45. Who benefits from trade liberalizing agreements? Who loses?

46. What is the WTO?

47. How are disputes resolved under WTO agreements?

48. What is the Doha Round?

49. What are free trade agreements (FTAs)?

50. How do FTAs that the United States has negotiated generally differ from those negotiated among other countries?

51. What are Trade and Investment Framework Agreements (TIFAs)?

52. Why do countries import goods and services from other countries?

53. What are other benefits of imports?
54. What are the costs of imports?
55. How does the government deal with disruption and injury to producers and workers?
56. What are the main trade remedy laws?
57. What is the purpose of the countervailing duty law?
58. What is the purpose of the antidumping law?
59. What is the import relief (safeguards) law?
60. What is the Trade Adjustment Assistance (TAA) Program?
61. What is the rationale for TAA?
62. What are the benefits of exports?
63. What are some costs of exporting?
64. What factors most determine U.S. export levels?
65. What factors determine the exporting success of specific sectors?
66. How does the U.S. government promote exports?
67. What does the U.S. government do to restrict exports?
68. What are the main kinds of capital flows?
69. Which is larger—trade or capital flows?
70. Why do companies invest abroad?
71. Why has foreign investment increased so dramatically in recent decades?
72. What are some of the benefits of direct foreign investment?
73. What are some of the costs of direct foreign investment?
74. What are BITs?
75. What is CFIUS?

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