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# U.S. Trade Concepts, Performance, and Policy: Frequently Asked Questions

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# U.S. Trade Concepts, Performance, and Policy: Frequently Asked Questions

## Abstract

[Excerpt] Congress plays a major role in U.S. trade policy through its legislative and oversight authority. There are a number of major trade issues that are currently the focus of Congress. For example, bills were introduced in the 113th Congress to reauthorize Trade Promotion Authority (TPA), the U.S. Generalized System of Preferences (GSP), and the U.S. Export-Import Bank, and legislative action on these issues could be forthcoming in the 114th Congress. Additionally, Congress has been involved with proposed free trade agreements (FTAs), including the Trans-Pacific Partnership (TPP) involving the United States and 11 other countries and the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union (EU). Also of interest to Congress are current plurilateral negotiations for a Trade in Services Agreement (TISA) and a new multilateral Information Technology (ITA) agreement in the World Trade Organization (WTO). Trade and investment policies of major U.S. trading partners (such as China), especially when they are deemed harmful to U.S. economic interests, are also of continued concern to Congress. Recent improved U.S. relations with Cuba have resulted in the introduction of several bills to boost bilateral commercial ties. The costs and benefits of trade to the U.S. economy, firms, workers, and constituents, and the future direction of U.S. trade policy, are the subject of ongoing debates in Congress.

This report provides information and context for these and many other trade topics. It is intended to assist Members and staff who may be new to trade issues. The 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, United States, Congress, policy, performance

## Comments

### Suggested Citation

Morrison, W. M., Bolle, M. J., Elwell, C. K., Jackson, J. K., Jones, V. C., & Villareal, M. A.. (2014). *U.S. trade concepts, performance, and policy: Frequently asked questions*. Washington, DC: Congressional Research Service.

A previous version of this report can be found here: [http://digitalcommons.ilr.cornell.edu/key\\_workplace/1333/](http://digitalcommons.ilr.cornell.edu/key_workplace/1333/)

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# **U.S. Trade Concepts, Performance, and Policy: Frequently Asked Questions**

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January 30, 2015

**Congressional Research Service**

7-5700

[www.crs.gov](http://www.crs.gov)

RL33944

## Summary

Congress plays a major role in U.S. trade policy through its legislative and oversight authority. There are a number of major trade issues that are currently the focus of Congress. For example, bills were introduced in the 113<sup>th</sup> Congress to reauthorize Trade Promotion Authority (TPA), the U.S. Generalized System of Preferences (GSP), and the U.S. Export-Import Bank, and legislative action on these issues could be forthcoming in the 114<sup>th</sup> Congress. Additionally, Congress has been involved with proposed free trade agreements (FTAs), including the Trans-Pacific Partnership (TPP) involving the United States and 11 other countries and the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union (EU). Also of interest to Congress are current plurilateral negotiations for a Trade in Services Agreement (TISA) and a new multilateral Information Technology (ITA) agreement in the World Trade Organization (WTO). Trade and investment policies of major U.S. trading partners (such as China), especially when they are deemed harmful to U.S. economic interests, are also of continued concern to Congress. Recent improved U.S. relations with Cuba have resulted in the introduction of several bills to boost bilateral commercial ties. The costs and benefits of trade to the U.S. economy, firms, workers, and constituents, and the future direction of U.S. trade policy, are the subject of ongoing debates in Congress.

This report provides information and context for these and many other trade topics. It is intended to assist Members and staff who may be new to trade issues. The 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 some industries, and some unique characteristics of trade between developed countries.

The second section, “U.S. Trade Performance,” lists data on U.S. trade flows and focuses on the U.S. trade deficit, including its implications for the U.S. economy. Questions address the causes of trade deficits, the role of foreign trade barriers, and how the trade deficit might be reduced.

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 roles of the private sector and the judiciary are also discussed.

The fourth section, “U.S. Trade and Investment Policy Issues,” lists 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 WTO, 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.

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# Trade Concepts<sup>1</sup>

## The Basics of Trade

### 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 (according to economic theory) can increase economic well-being above what would be possible without trade. The benefit of trade is attached to the product received (the import), not in the product given (the export). Hence, countries export in order to pay for imports.<sup>2</sup> 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.

Some goods that are imported into the United States, such as oil and bananas, cannot be produced economically in sufficient quantities to satisfy domestic demand. Many other products (including intermediate goods) and services are imported because they can be produced less expensively or more efficiently by firms in other countries. Many imports into the United States contain U.S.-made components (such as semiconductors inside a computer) or U.S.-grown raw materials (such as cotton used to make t-shirts). Consumers can benefit through access to a wider variety of goods at lower costs. This raises consumer welfare (i.e., consumers have more money to spend on other goods and services) and helps control the rate of U.S. inflation. 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.

### 2. What is comparative advantage?

The idea of comparative advantage was developed by David Ricardo early in the 19<sup>th</sup> century and its insight remains relevant today. Ricardo argued that specialization and trade are mutually beneficial even if a country finds that 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

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<sup>1</sup> This section was prepared by Craig K. Elwell, Specialist in Macroeconomics, Government and Finance Division, CRS.

<sup>2</sup> Although exports support jobs and economic activity, the end purpose of exporting is to obtain imports of goods and services and hence boost consumer welfare.

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-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 domestic market transactions, liberalize trade and foreign investment barriers, 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 policies to promote and protect certain industries (such as through subsidies or trade protection) that are thought to have significant economic potential. In this view, realizing that potential requires initial government support to help a country obtain its economic targets.<sup>3</sup> Some economists contend that direct government policies may often distort a country's trade and investment flows, reduce economic efficiency, undermine more economically competitive industries that do not receive government help, and diminish potential economic growth.

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<sup>3</sup> This is based on the belief that only the government can marshal the large level of financial resources needed to promote the development of targeted industries and that once a certain level of development is obtained, the government role in the economy can be reduced and the role of the private markets will expand.

## 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 its economic welfare. When that occurs, a nation's economy as a whole is often said to have become more globally competitive.<sup>4</sup> 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.

## Trade and Jobs

### 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 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 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. A 2008 study by the Peterson Institute for International Economics, for example, estimated the lifetime costs of worker displacement that were triggered by expanded trade in 2003 to be as high as \$54 billion, but calculated that the United States spent less than \$2 billion that year to address the costs for workers connected to that displacement.<sup>5</sup>

### 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 rapid economic expansion that occurred from 1992 to 2000, U.S. imports increased nearly 240%, but total employment grew by 22 million jobs and the

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<sup>4</sup> It is important to note that economic competition does not occur between nations, but rather, between the industries of those nations.

<sup>5</sup> Peterson Institute for International Economics, *Answering the Critics: Summary*, by Gary C. Hufbauer, January 2008, available at <http://www.iie.com/publications/papers/print.cfm?ResearchId=948&doc=pub>.

unemployment rate fell from 7.5% to 4.0% (the lowest unemployment rate in more than 30 years). From 2001 to 2007 (before the global financial crisis), U.S. employment grew by 7.1 million jobs, the unemployment rate dropped from 4.7% to 4.6%, while U.S. imports over the period increased by 70.8%. From 2007 to 2010, the U.S. unemployment rate rose to 9.6%, employment fell by 7 million, but U.S. imports declined by 2.0%. 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.<sup>6</sup> The near-term cost can be an exacerbation of weakness in the economy as foreign governments may retaliate with their own protective measures, causing a decline in exports. In the long run, trade protection may tend to reallocate employment from unprotected domestic industries toward protected domestic industries, but 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.<sup>7</sup> Therefore, it is reasonable to expect that, other factors constant, a large increase in imports, particularly from economies with vast supplies of low-skilled labor (such as China), could negatively affect the wages of low-skilled U.S. workers in import-sensitive industries. U.S. low-skilled workers have increasingly faced competitive from lower-cost producers, largely in developing countries. In many instances, economic globalization (discussed below) has led U.S. multinational firms to source a significant share of their labor-intensive production to lower-wage countries, which, to some extent, has put downward pressure on the wages of U.S. workers in some import-sensitive industries. On the other hand, U.S. workers in export-oriented industries on average are estimated to earn more than workers in non-exporting industries.<sup>8</sup> Overall, the evidence on whether or not trade has contributed to growing income inequality in the United States is mixed and inconclusive.<sup>9</sup> This is due in part because a number of other factors, such as advancing technology (where the jobs that are generated may

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<sup>6</sup> For example, protectionist measures placed on foreign steel imports (such as quotas and higher tariffs) might provide short-term relief for steel firms and workers. However, such policies could boost overall prices for steel, which would drive up cost for steel-users (such as auto producers) and subsequently reduce production levels and employment in those industries. In addition, costs for consumers would rise, reducing their demand for goods and services.

<sup>7</sup> In 2010, for example, the percent of the U.S. population that had completed some form of tertiary education (e.g., college) was 26.8% compared to 2.7% of the Chinese population. See Barro-Lee Educational Attainment Dataset, at <http://www.barrolee.com>.

<sup>8</sup> See the Brookings Institution, *Export Nation: How U.S. Metros Lead National Export Growth and Boost Competitiveness*, by Emilia Istrate, Jonathan Rothwell, and Bruce Katz, July 2010, available at <http://www.brookings.edu/research/reports/2010/07/26-exports-istrate-rothwell-katz>.

<sup>9</sup> For a survey on the economic literature on this issue, see the World Bank and the International Labor Organization, *Making Globalization Socially Sustainable*, September 2011, pp. 232-259; and the OECD, *Divided We Stand: Why Inequality Keeps Rising*, Organization for Economic Cooperation and Development, 2011, pp. 21-45. The OECD study concluded that “neither rising trade integration nor financial openness had a significant impact on either wage inequality or employment trends within the OECD countries.”

require more advanced skills and higher education than was required in the past), may have had a significantly larger impact on relative wages than foreign trade. For this reason, many economists contend that most effective way to boost U.S. wages and reduce the level of wage inequality is to enhance U.S. education and skill levels to better enable workers respond more effectively to the rapidly changing nature of the global economy as well as technological advancements.<sup>10</sup>

## Economic Globalization

### 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 use of *economies of scale*. Economies of scale exist when a production process is more efficient (i.e., has lower unit costs) 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. What is economic globalization?

Globalization has come to represent many things. In general, economic globalization refers specifically to the increasing integration of national economies into a worldwide trading system. Economic 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, global trade has consistently grown faster than world production. For example, from 1980 to 2013, global exports of goods and services grew at an average annual rate of 5.6% compared to average annual global GDP growth of about 3.4%.<sup>11</sup> In addition, global exports as a percent of world GDP over this period rose from 20.9% to 31.3%. These data indicate that trade has been a driving force in the global economy.

Global integration in the United States (discussed in more detail in the next section) has advanced quickly, with imports of goods and services as a share of GDP rising from 4.3% in 1950 to about 16.5% in 2013.<sup>12</sup> More recent but far more dramatic has been the growth of international trade in assets. From 1990 to 2007 (before the 2008 global financial crisis hit), gross capital flows to and from the United States leaped by 1,495% as compared to a 248% advance of U.S. trade in goods and services. The rising economic integration of the world economy has been facilitated by two

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<sup>10</sup> A study by the Organization for Economic Cooperation and Development (OECD) estimated that a person with a tertiary education can expect to earn over 79% more than a person with only an upper secondary education. A person who has failed to obtain an upper secondary education in the United States can expect to earn only 64% of a high school graduate's earnings. See OECD Economic Indicators, Education at a Glance 2011, Country Note—United States, September 13, 2011, p.3, available at <http://www.oecd.org/unitedstates/48685294.pdf>.

<sup>11</sup> See International Monetary Fund, *World Economic Outlook Database*, April 2014.

<sup>12</sup> Council of Economic Advisers, Economic Report of the President and the Economist Intelligence Unit.

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

### **11. What are global supply chains and how do they relate to economic 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. To illustrate, the WTO estimates that in 2011, intermediate manufactured products accounted for 55% of global non-fuel trade,<sup>13</sup> and that on average about 26% of the value of national exports in 2008 included foreign content in the form of imported inputs used to produce these exports.<sup>14</sup> 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. The expansion of global supply chains (in both value terms and as a percent of total global trade) has been facilitated lower trade barriers and 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 firms to coordinate geographically fragmented production with relative ease. (The effect of globalization on U.S. trade flows are discussed in the section on U.S. trade performance.)

Global supply chains present both challenges and opportunities for U.S. small- and medium-sized enterprises (SMEs). On the one hand, SMEs face increased foreign competition because of globalization. At the same time, SMEs have gained business opportunities by the increase in outsourcing by U.S. and foreign MNCs. According to one study, U.S. SMEs accounted for 28% of U.S. direct exports in 2007. However, this figure rises to 41% when the value of U.S. SME sales to large U.S. exporting firms is included.<sup>15</sup>

### **12. How does globalization affect job security?**

A greater degree of international economic integration and specialization can add to disruptive forces in the marketplace, including concerns that over time high-wage and high-skilled U.S. service sector jobs may now be vulnerable to “outsourcing” (i.e., shifting business functions from the United States to countries with lower labor costs). Although globalization is unlikely to have a negative effect on overall U.S. employment rate or the average U.S. worker wage, greater volatility of U.S. worker incomes and employment in some sectors is a possible effect. For example, some U.S. MNCs have focused on performing high-end activities associated with innovating products such as research and development (R&D), while outsourcing component production and final product assembly to numerous overseas suppliers. Such activities may reduce the number of U.S. manufacturing jobs in some industries, but boost the number of service-related jobs in other industries. Some contend that globalization has increased volatility in employment and earnings for many U.S. workers and argue that trade adjustment assistance

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<sup>13</sup> The value of global exports of non-fuel intermediate goods was over \$7.7 trillion.

<sup>14</sup> WTO, *International Trade Statistics*, 2013, p.5.

<sup>15</sup> OECD, WTO, and World Bank, *Global Value Chains, Challenges, Opportunities, and Implications for Policy*, July 18, 2014, p. 22.

programs should be expanded to assist individuals negatively impacted by imports in order to help them more rapidly obtain employment in other sectors. Others contend that the real challenge for the United States is to implement policies that promote a highly educated and skilled work force and boost domestic innovation in order to ensure that the globalization process produces net benefits for the U.S. economy.

## U.S. Trade Performance<sup>16</sup>

### The U.S. Role in the World Economy

#### 13. Which are the largest global trading economies?

The largest trading economies for total trade in goods and services in 2013 were the United States, China, Germany, Japan, and France. China was the largest exporter of goods and services, while the United States was the largest importer (see **Table 1**). In terms of the largest merchandise trading economies in 2013, the top five were China, the United States, Germany, Japan, and the Netherlands. The United States was the largest merchandise importer and the second-largest merchandise exporter.<sup>17</sup> While the United States is a major global trader, the size of that trade relative to the size of the U.S. economy is much smaller than that of other major trading economies. U.S. exports and imports of goods and services as a percent of GDP in 2013 were 30.0%. This compares with 35.3% for Japan, 47.4% for China, 58.1% for France, and 85.5% for Germany.<sup>18</sup>

The U.S. share of global merchandise exports has changed significantly over the past five decades or so, due largely to the rapid increase of global trade, especially among developing countries.<sup>19</sup> The U.S. share of global merchandise exports over this period was as follows: 15.1% in 1960, 13.6% in 1970, 11.1% in 1980, 11.3% in 1990, 12.1% in 2000, 8.4% in 2010, and 8.4% in 2013.<sup>20</sup>

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<sup>16</sup> This section was updated by Wayne M. Morrison, Specialist in Asian Trade and Finance, Foreign Affairs, Defense, and Trade Division.

<sup>17</sup> If the 28 countries of the EU were treated as a single trading bloc, it would be the largest global trading economy for total trade in goods and services (including the biggest exporter and importer). In terms of merchandise trade, the EU would be the largest trading economy, trade, largest exporter, and second-largest importer (after the United States).

<sup>18</sup> The Economist Intelligence Unit database.

<sup>19</sup> The decline in the U.S. share of global merchandise exports may also be a reflection of the growing importance of U.S. exports of services relative to U.S. merchandise exports. For example in 1980, services accounted for 17.6% of U.S. global exports of goods and services, while in 2013 this figure was 30.2% (Source: Bureau of Economic Analysis).

<sup>20</sup> Historical data on global trade in services are limited.

**Table 1. Largest Global Trading Economies Based on Total Trade in Goods and Services (G&S) : 2013**

(in billions of U.S. dollars)

	Total Trade in G&S	Exports of G&S	Imports of G&S	Total Trade as a % of GDP
United States	5,033	2,262	2,770	30.0%
China	4,483	2,356	2,127	47.4%
Germany	3,194	1,707	1,487	85.5%
Japan	1,729	794	934	35.3%
France	1,633	795	838	58.1%

**Source:** Economist Intelligence Unit.

Various organizations have developed indexes to assess the “openness” or “competitiveness” of the U.S. economy relative to other global economies. For example, the Heritage Foundation publishes an “Index of Economic Freedom.”<sup>21</sup> Its 2014 report ranked the United States as the 12<sup>th</sup> “freest” economy out of 186 economies (Hong Kong, Singapore, Australia, Switzerland, and New Zealand ranked as the top 5).<sup>22</sup> Similarly, the World Economic Forum (WEF) produces an annual “Global Competitiveness Index.”<sup>23</sup> The WEF’s 2014-2015 report ranked the United States third (up from fifth from the 2013-2014 report) after Switzerland and Singapore.<sup>24</sup>

## The U.S. Trade Deficit

### 14. What is meant by the trade deficit?

A trade deficit occurs when a country’s imports are greater than its exports. There are various measurements of the U.S. trade deficit. In general, most media reports on the U.S. trade deficit refer to the balance of U.S. trade in goods (merchandise). In 2013, the U.S. merchandise trade deficit was \$688 billion, down from a peak of \$816 billion in 2006. However, a large and growing level of U.S. trade is in services, where the United States usually runs large annual surpluses. In 2013, that surplus was \$225 billion.<sup>25</sup> By adding net exports of services to the calculation, the U.S. trade deficit on goods and services was \$476 billion in 2013. Further adding in net transfer payments (such as investment income and dividends) and net transfer payments (such as foreign aid) gives the broadest measure of a nation’s trade balance—the current account balance. In 2013, the United States recorded a \$400 billion current account deficit, down from its historic peak of \$807 billion in 2006 (see **Table 2**). The decline in the U.S. trade deficit was largely caused by two

<sup>21</sup> The index is based on assessments of the rule of law, limited government, regulatory efficiency, and open markets.

<sup>22</sup> The Heritage Foundation, *2014 Index of Economic Freedom*, available at <http://www.heritage.org/index>.

<sup>23</sup> The WEF defines competitiveness as “the set of institutions, policies and factors that determine the level of productivity of a country.” Its global competitive index scores are calculated by analyzing country-level data covering 12 categories, including institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.

<sup>24</sup> World Economic Forum, *Global Competitiveness Report 2014-2015*, available at <http://www.weforum.org/issues/global-competitiveness>.

<sup>25</sup> U.S. exports and imports of services in 2013 were \$687 billion and \$426 billion, respectively.

major factors: the global economic crisis (which, for example, significantly reduced U.S. demand for imports) and a decline in U.S. oil imports.

**Table 2. U.S. Merchandise Trade and Current Account Trade: 2004-2013**

(in billions of U.S. dollars)

Year	Census Basis			Current Account Basis			
	Exports	Imports	Merchandise Balance	Imports of G&S	Exports of G&S	Net Transfers and Net Income	Current Account Balance
2004	814.9	1,469.7	-654.8	1,161.5	1,771.4	-23.9	-633.8
2005	901.1	1,673.5	-772.4	1,286.0	2,000.3	-31.2	-745.4
2006	1,026.0	1,853.9	-827.9	1,457.6	2,219.4	-45.0	-806.7
2007	1,148.2	1,957.0	-808.8	1,653.5	2,358.9	-13.3	-718.6
2008	1,287.4	2,103.6	-816.2	1,841.6	2,550.3	22.1	-686.6
2009	1,056.0	1,559.6	-503.6	1,583.1	1,966.8	3.0	-380.8
2010	1,278.5	1,913.9	-635.4	1,853.6	2,348.3	50.7	-443.9
2011	1,482.5	2,208.0	-725.4	2,127.0	2,675.6	89.3	-459.3
2012	1,545.7	2,276.3	-730.6	2,216.5	2,754.1	76.9	-460.7
2013	1,579.6	2,268.3	-688.7	2,280.2	2,756.6	76.1	-400.3

**Source:** U.S. Department of Commerce, Bureau of the Census and the U.S. Bureau of Economic Analysis.

**Note:** Data may not add up due to rounding.

## 15. Why does the United States run a trade deficit?

The most significant cause of the U.S. trade deficit is the low rate of U.S. domestic savings relative to its investment needs. In order to make up for that shortfall, Americans must borrow from abroad from countries (such as China) with excess savings.<sup>26</sup> Such borrowing enables Americans to enjoy a higher rate of economic growth than would be obtained if the United States had to rely solely on domestic savings.<sup>27</sup> This in turn boosts U.S. consumption and the demand for imports, producing a trade deficit.<sup>28</sup> The U.S. trade deficit is an indicator that Americans consume more than they produce. 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 (such as by buying U.S. Treasury securities), the trade deficit can continue. The United States, however,

<sup>26</sup> This occurs, for example, when households buy on credit, businesses invest with borrowed funds, and the federal government runs budget deficits.

<sup>27</sup> U.S. gross national savings as a percent of GDP is among the lowest of any major global economy. If the United States could only draw from domestic savings to fund domestic investment demand, real interest rates (and the costs of borrowing) would likely increase significantly, which could negatively affect U.S. economic growth in the short run.

<sup>28</sup> There are a number of other factors that also can affect the size of the U.S. trade deficit in the short run. For example, falling oil prices can reduce the cost of oil imports and thus reduce the value of total U.S. imports. Differences in economic growth between countries can affect trade balances as well. For example, more rapid economic growth in the United States relative to its major trading partners could cause U.S. imports to rise faster than its exports, thus increasing the size of the U.S. trade deficit.

accumulates more debt.<sup>29</sup> As of March 2014, the U.S. public debt was \$17.6 trillion, up from \$7.1 trillion in March 2004.<sup>30</sup>

## **16. How significant is the size of the U.S. trade deficit and how does it compare with other major economies?**

Economists often look at the size of the U.S. trade deficit relative to the size of the U.S. economy (gross domestic product, or GDP). This measurement is particularly useful in examining trends over time or comparing U.S. data with those of other countries. As can be seen in **Figure 1**, the U.S. balance on the current account relative to GDP deteriorated sharply from 1991 to 2006; it reached a record high 5.8% of GDP in 2006. Since that time, the U.S. current deficit as a percent of GDP has generally declined, due in large part to the effects of the global economic slowdown that began around 2008.

**Table 3** lists current account balances as a percent of GDP for the top 10 largest global economies in 2013 (based on GDP on a purchasing power parity basis), along with data on the ratio of domestic savings to total investment for each country.<sup>31</sup> The countries with the largest current account surpluses as a percent of GDP included Germany (7.3%), China (1.9%), and Russia (1.6%). The largest economies with the biggest current account deficits as a percent of GDP included the United Kingdom (4.5%), Brazil (2.6%) and the United States (2.4%).

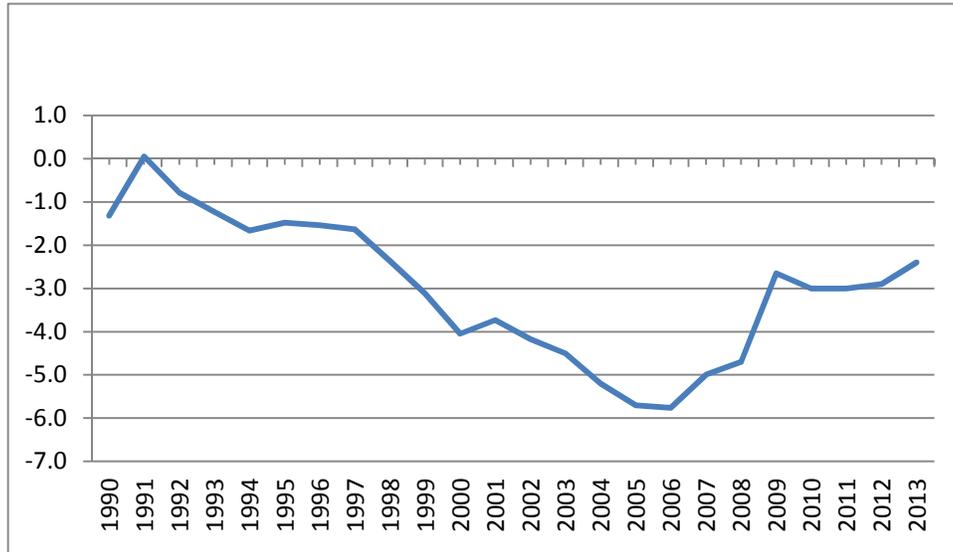
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<sup>29</sup> If for some reason foreign investors lost faith in the U.S. economy, they might stop investing in the United States and/or sell their holdings of U.S. assets. The United States would have to rely more on domestic savings, which could cause U.S. interest rates to rise and lower U.S. GDP growth.

<sup>30</sup> As of March 2014, foreigners held 33.7% of the total public U.S. debt and 57.8% of the amount of the U.S. public debt that is privately held.

<sup>31</sup> A ratio of over 100 indicates countries that save more than they need for domestic investment, which makes them a net global lender, and thus, such countries typically run current account surpluses. A ratio of below 100 indicates countries that do not save enough to meet their investment needs. Such countries are net borrowers and typically run current account deficits.

**Figure 1. U.S. Current Account Balance as a Percent of GDP: 1990-2013**  
(%)



Source: Economist Intelligence Unit and International Monetary Fund.

**Table 3. The Ratio of National Savings to Total Investment and Current Account Balances as a Percent of GDP for Major Economies in 2013**  
(%)

	Domestic Savings/Investment Ratio	Current Account Balance/GDP
Germany	135.8	7.3
China	125.0	1.9
Russia	107.2	1.6
Japan	103.3	0.7
France	94.0	-1.4
India	91.5	-2.1
Mexico	90.5	-1.8
United States	84.9	-2.4
Brazil	79.8	-3.6
United Kingdom	69.1	-4.5

Source: Economist Intelligence Unit.

Note: Countries are ranked according to the ratio of domestic savings to investment in 2013.

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

Some policy makers view the size of the U.S. trade deficit with certain countries (such as China, where the U.S. merchandise trade deficit totaled \$318 billion in 2013—by far the largest U.S. bilateral trade imbalance) as an indicator that the trade relationship is “unfair” and the result of distortive policies, such as subsidies, trade barriers, currency intervention, discriminatory regulations, investment restrictions, and failure to establish an effective mechanism for protecting

intellectual property rights (IPR)—to name a few. Such policies tend to affect bilateral trade in specific products and with particular countries and can negatively affect the profitability of U.S. exporters and overseas investors. To some extent, such policies may also affect bilateral trade balances, but do not necessarily affect the size of the overall (global) U.S. trade deficit, which, as noted earlier, is largely a reflection of the level of U.S. savings. If distortive measures were reduced in certain countries, U.S. exporters would sell more of their products to them. But if U.S. consumption/savings behavior did not change, an increase in U.S. exports would likely result in an increased demand for imports, and the overall U.S. trade deficit would likely remain relatively unchanged (all things being equal). Similarly, the reduction of distortive trade policies in one country might raise manufacturing costs to such an extent as to cause firms to move production to another country. As a result, U.S. imports from the first country would fall, while imports from the second country would rise. This would lower the U.S. trade deficit with the first country and increase it with the other, and the overall U.S. trade deficit would be relatively unchanged.

### **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 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, the dollar's 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 will gradually cause U.S. imports to decrease and exports to increase, thereby decreasing the trade deficit.

Foreign holders of U.S. dollars may not always exchange them for other currencies because the dollar 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 dollars and essentially sending them back to the United States through purchasing U.S. Treasury securities or other U.S. assets. China, for example, has been doing this since 1994, and, as a result, it has become the largest foreign holder of U.S. Treasury securities (at nearly \$1.3 trillion as of August 2014) and the largest holder of foreign exchange reserves (at \$4.0 trillion as of July 2014). Efforts by Japan in recent years to boost economic growth by expanding its money supply have led some critics to charge that such policies are largely aimed at depreciating the yen in order to boost Japanese exports.

Some analysts contend that several countries have intervened in currency markets to hold down the value of their currencies and that this has hampered, to some extent, the realignment of global trade balances, which in turn has negatively affected the U.S. economy. For example, a July 2012 study by the Peterson Institute for International Economics contends that "currency manipulation," based on "excessive" levels of foreign exchange reserves (FERs), is widespread, especially in developing and newly industrialized countries. The study identified 22 economies that "manipulate their currency" based on the size of their FERs as a percent of GDP and the cumulative increase in FERs as a percent of GDP in 2012, the most significant of which were China, Denmark, Hong Kong, South Korea, Malaysia, Singapore, Switzerland, and Taiwan. The Peterson Institute estimated that currency intervention by the 22 economies increased the U.S.

current account trade deficit by \$200 billion to \$500 billion and caused the loss of 1 million to 5 million U.S. jobs.<sup>32</sup>

### **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 (which is reflected in the U.S. current account data). In 2013, U.S. net financial inflows amounted to \$353 billion. Foreigners acquired \$906 billion in assets in the United States (excluding financial derivatives), while Americans acquired \$553 billion in assets abroad. Within these totals, foreigners purchased an additional \$141.8 billion in Treasury securities and \$44 billion in other government securities. Foreigners also invested \$193 billion in their companies located in the United States.<sup>33</sup>

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

Many economists 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 because such investments will boost the level of economic growth in the long run. 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, which implies that in the future consumption levels will have to fall in order to pay for the debt, which lower future economic growth. Some economists warn that, under certain circumstances, a continually rising U.S. trade deficit could spark a large and sudden fall in the value of the dollar and financial turmoil in both the United States and abroad.<sup>34</sup>

The U.S. current account deficit as a percent of GDP reached a peak of 5.8% in 2006 and has fallen significantly since, declining to 2.4% in 2013, although much of that decline was the result of the effects of the global economic slowdown.<sup>35</sup> Although the U.S. economy has not yet fully recovered to pre-crisis levels, 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 a crisis in financial markets and may also raise inflationary pressures. Since global financial markets are now so closely intertwined, turmoil in one market can quickly spread to other markets in the world.

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

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<sup>32</sup> Peterson Institute for International Economics, *Currency Manipulation, the US Economy, and the Global Economic Order*, by C. Fred Bergsten and Joseph E. Gagnon, December 2012.

<sup>33</sup> These data are reported by the U.S. Bureau of Economic Affairs, *U.S. International Transactions*.

<sup>34</sup> See for example, the Peterson Institute for International Economics, *The Dollar and the Deficits: How Washington Can Prevent the Next Crisis*, by C. Fred Bergsten, November 2009, available at <http://www.iie.com/publications/papers/paper.cfm?ResearchID=1312>.

<sup>35</sup> International Monetary Fund, *World Economic Outlook database*, October 2014.

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.<sup>36</sup> Their willingness depends 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 further 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 policies, however, usually address conditions in the U.S. macro-economy and generally consider the trade deficit only as a secondary target.

## **Understanding Data on U.S. Trade and the Economy**

### **23. How important is trade to the U.S. economy?**

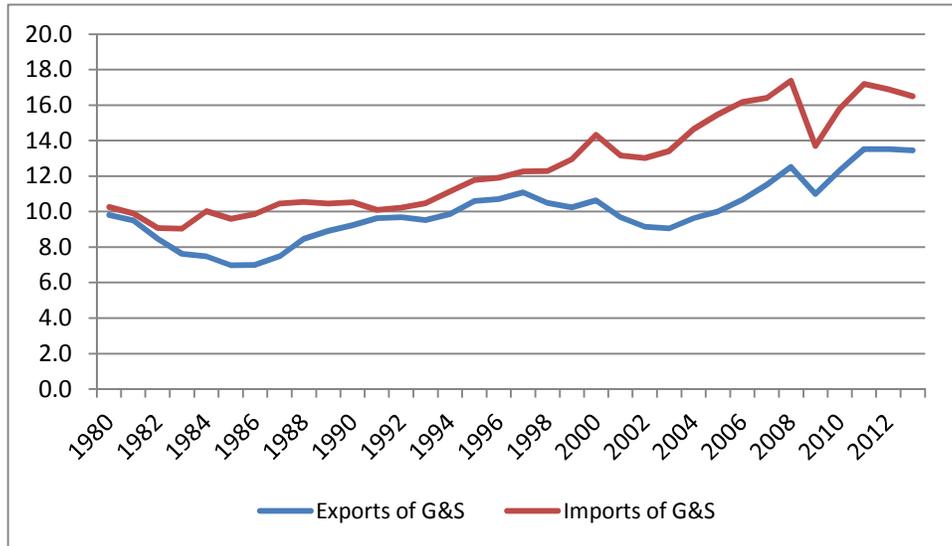
As indicated in **Figure 2**, the level of U.S. trade in goods in services relative to GDP has risen markedly over the past three decades. U.S. exports of goods and services as a percent of GDP rose from 9.8% in 1980 to 13.5% in 2013, while imports of goods and services increased from 10.3% to 16.5%. According to the U.S. Department of Commerce, in 2011, U.S. exports “supported” 9.7 million jobs in the United States, which was 27.6% higher than 1993 levels.<sup>37</sup>

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<sup>36</sup> 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.

<sup>37</sup> Commerce uses the term “supported” rather the term “created” because exports constitute one category of U.S. GDP, which can expand or contract like other sectors of the economy. Jobs are gained and lost in various sectors, even when the United States is at full employment. And when the U.S. economy is at less than full employment, the government can use fiscal and monetary policy to boost economic growth in order to boost employment. In any given year, a significant level of a company’s product could be exported. The aggregate demand coming from abroad helps support a certain level of employment at the company. In some years, foreign demand may contract, leading to a decline in exports. The company might respond by attempting to boost sales domestically. If that cannot be done, some workers may be laid off, and some of these would seek employment in other sectors of the economy.

**Figure 2. U.S. Exports and Imports of Goods and Services as a Percent of GDP: 1980-2013 (%)**



**Source:** Economist Intelligence Unit, based on data by the U.S. Bureau of Economic Analysis.

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

As shown in **Table 4**, in 2013, Canada was America’s largest merchandise trading partner, followed by China, Mexico, and Japan. China was the largest source of U.S. imports, followed by Canada, Mexico, and Japan. Canada was the largest destination of U.S. exports, followed by Mexico, China, and Japan.

**Table 4. Top U.S. Trading Partners Ranked by Total Merchandise Trade, 2013**  
(in billions of U.S. dollars)

Rank	Country	Total trade	U.S. Exports	U.S. Imports	U.S. Balance
	World	3,848	1,580	2,268	-689
1	Canada	634	301	332	-31
2	China	562	122	440	-319
3	Mexico	507	226	281	-54
4	Japan	204	65	139	-73
5	Germany	162	47	114	-67
6	South Korea	104	42	62	-21
7	United Kingdom	100	47	53	-5
8	France	77	32	46	-14
9	Brazil	72	44	28	16
10	Saudi Arabia	71	19	52	-33

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

**Note:** Totals may not add up due to rounding.

## 25. How does economic globalization “complicate” interpretation of U.S. trade data?

Trade is becoming increasingly complex. In the past, companies tended to source most or all of their production in one country, using inputs that were largely made domestically. Today, MNCs produce worldwide, often using inputs that are sourced from the United States and worldwide. China is a good example of this phenomenon. Since initiating free market reforms in 1979 and opening up its economy to global trade and investment, China has emerged as a major center for global supply chains. Because of China’s large pool of low-cost labor, many export-oriented multinational corporations have moved production from other countries (primarily in Asia) to China. In many cases, products that are “made in China” are actually products that are “assembled in China,” using imported inputs (such as components) that are designed and produced globally. The value added that occurs in China is often quite small relative to the total value of the finished product when it is imported into the United States and elsewhere, and a significant level of the profits from the sale of the product are estimated to accrue to the multinational company that owns the brand.<sup>38</sup>

The rapidly changing nature of global supply chains has made it increasingly difficult to understand and interpret the implications of trade data for the U.S. economy. To illustrate, when the United States imports such products as iPhones and iPads, it attributes the full value of those imports as occurring in China, even though the value added that occurred there is quite small. Apple Inc., (the U.S. firm that developed these products) is the largest beneficiary in terms of the profits generated by the sale of its products, and most of its product design, software development, product management, marketing, and other high-wage functions and employment occur in the United States.<sup>39</sup> In other words, U.S. trade data may show where products are being imported from, but they often fail to reflect who ultimately benefits from that trade. In many instances, U.S. imports from China are really imports from many countries. Yet, the full value of the final imported product is attributed to China, which results in what one might consider to be an inflated trade deficit figure. A joint study by the Organization for Economic Cooperation and Development (OECD) and the WTO estimated that the U.S trade deficit with China would be reduced by 25% in 2009 if bilateral trade flows were measured according to the value-added that occurred in each country before it was exported.<sup>40</sup> Additionally, one study estimated that 24.7% of U.S. imports from Canada, and 39.8% of U.S. final merchandise imports from Mexico, consist of value added from the United States.<sup>41</sup>

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<sup>38</sup> Chinese authorities report that nearly half of China’s exports and imports are conducted by foreign-invested firms there.

<sup>39</sup> Apple products, such as iPhones and iPads are developed in the United States, but are assembled in China using imported components. One study estimates that the wages paid to Chinese assembly workers accounted for 1.8% of the value of an iPhone and 2.0% of the value of an iPad in 2010. Apple’s success is largely the result of its ability to innovate, not manufacture. See *Capturing Value in Global Networks: Apple’s iPad and iPhone*, by Kenneth L. Kraemer, Greg Linden, and Jason Dedrick, July 2011, available at [http://pcic.merage.uci.edu/papers/2011/Value\\_iPad\\_iPhone.pdf](http://pcic.merage.uci.edu/papers/2011/Value_iPad_iPhone.pdf).

<sup>40</sup> *OECD/WTO Trade in value-Added (TIVA) Database: China*, at <http://www.oecd.org/sti/ind/TiVA%20China.pdf>.

<sup>41</sup> NBER Working Paper, *Give Credit Where Credit is Due: Tracing Value Added in Global Production Chains*, September 2010, p.32.

## U.S. Manufacturing

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

Media reports of factory closings and worker layoffs, and the plethora of labels indicating that merchandise was made in China, Mexico, or any of a number of foreign countries, often reinforce the perception that the U.S. manufacturing sector is shrinking. Two ways of examining this issue are to look at U.S. manufacturing output and manufacturing employment. Such data paint a mixed picture. To illustrate:

- From 1987 to 2013, the value of real output by U.S. manufacturing increased by 61.5%.<sup>42</sup>
- From 1980 to 2011, the value-added of U.S. manufacturing as a percent of GDP fell from 20.0% to 11.5%, services grew from 56.0% to 68.5% of GDP.
- From 1987 to 2013, U.S. manufacturing became more efficient as labor productivity (measured by output per hour) increased by 128.7%.
- U.S. employment in manufacturing peaked at 19.4 million in 1979, but fell to 12.0 million by 2013,<sup>43</sup> while jobs in private services during this time increased from 48.9 million to 95.8 million. In addition, U.S. employment in manufacturing as a percent of total non-agricultural employment fell from 21.6% in 1979 to 8.9% in 2013, while the level for private services grew from 54.3% to 70.0%.

These data indicate that, while U.S. manufacturing output has increased, its importance relative to the economy has declined. U.S. employment in manufacturing has declined in both the number of workers and as a percent of non-agricultural employment. The decline in U.S. manufacturing employment was likely partly caused by the increase in labor productivity (such as the introduction of new technologies) as fewer workers are now needed for a given level of production than were needed in the past. In addition, the jobs in the service sector increased sharply, both in numbers and as a percent of non-agricultural employment. As noted earlier, globalization may have impacted the U.S. manufacturing in some industries. Apple Inc. designs its products in the United States, but outsources most of its production to firms in China. Apple's main source of its profits stems from its ability to innovate new products, not from their production. In addition, many U.S. manufacturing firms use imported inputs (such as parts) from low-wage countries in their production to lower costs. Also, from a statistical standpoint, some of the "decline" in manufacturing may have resulted from reclassification of jobs in U.S. employment data, that is, jobs that used be classified under manufacturing are now classified under services. Manufacturing remains an important component of the U.S. economy. U.S. manufacturers are estimated to perform 70% of all private-sector R&D and account for 60% of U.S. exports.<sup>44</sup> According to the United Nations, in 2012, the United States ranked second after China in terms of gross value added of manufacturing (i.e., the actual value of manufacturing that

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<sup>42</sup> Real output peaked in 2007, fell sharply in 2008 and 2009, and rose each year from 2010 to 2013.

<sup>43</sup> Manufacturing employment fell to a low of 11.5 million in 2010.

<sup>44</sup> *Advanced Manufacturing National Program Office* at <http://www.manufacturing.gov/welcome.html>.

occurred in the country, excluding inputs and raw materials used in production is subtracted). The value for manufacturing in China was \$2.6 trillion versus \$2.0 trillion for the United States.<sup>45</sup>

## **Formulation of U.S. Trade Policy**

### **Role of Congress**

#### **27. 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, such as through the enactment of tariff schedules and trade remedy laws, and the approval and implementation of reciprocal trade agreements.

#### **28. 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 primary responsibility for trade matters. Each committee has a subcommittee dedicated exclusively to trade issues. Other committees may have a role should trade agreements, policies, and other trade issues include matters under their jurisdiction.

#### **29. In 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 provide advice on trade negotiations with the executive branch; and conducts oversight hearings on trade programs and agreements to assess their conformity to U.S. law and congressional intent.

#### **30. 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.

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<sup>45</sup> United Nations, *UNdata*.

### **31. 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 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 that the trade implementing bill will receive expedited and unamended consideration. The most recent TPA expired in 2007 and as of this writing has not been renewed by Congress.

## **Role of the Executive Branch**

### **32. Who is in charge of U.S. trade policy?**

The President directs overall trade policy in the executive branch and performs specific trade functions granted to him by statute. The chief 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 U.S. trade policy, as well as negotiating trade agreements and enforcing U.S. trade laws (see 19 U.S.C. 2171).

### **33. 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.

### **34. How are trade decisions made?**

The USTR has primary responsibility for trade negotiation and trade policy decisions within the executive branch. However, such decisions often involve areas of responsibility that fall under other Cabinet-level departments, at times requiring a multi-department interagency 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.

### **35. 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.

### **36. 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**

### **37. 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 Congress has provided in Section 135 of the Trade Act of 1974, as amended. Currently there are 28 committees (with about 700 citizen advisors), which are administered by the USTR's Office of Intergovernmental Affairs & Engagement (IAPE) in cooperation with a number of other federal agencies.<sup>46</sup> The three-tier system consists of (1) the President's Advisory Committee for Trade Policy and Negotiations (ACTPN); (2) five general policy advisory committees dealing with environment, labor, agriculture, Africa, and intergovernmental issues; and (3) 22 technical advisory committees in the areas of industry and agriculture.<sup>47</sup> These committees have been set up in order to ensure that private sector views are known and considered in the formulation and implementation of U.S. trade policies and programs.

### **38. 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 before congressional committees on trade matters. Private sector representatives are also invited or requested 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 order, on their industries and sectors. Private sector organizations also lobby Congress and the executive branch to promote their interests in U.S. trade policy actions and agreements.

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<sup>46</sup> For additional information, see *Statement of Lisa Garcia, Assistant U.S. Trade Representative for Intergovernmental Affairs & Public Engagement, Before the House Ways and Means Committee, Hearing on Trade Advisory Committee System, July 21, 2009*, available at <http://waysandmeans.house.gov/media/pdf/111/garcia.pdf>.

<sup>47</sup> The main advisory committees include: the ACTPN; the Agricultural Policy Advisory Committee (APAC); the Agricultural Technical Advisory Committee for Trade (ATAC); the Industry Trade Advisory Committees (ITAC); the Intergovernmental Policy Advisory Committee (IGPAC); the Labor Advisory Committee (LAC); the Trade Advisory Committee on Africa (TACA); and the Trade and Environment Policy Advisory Committee (TEPAC).

### **39. Why do groups attempt to lobby on trade decisions?**

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 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. Such groups are also concerned with obtaining greater market access in various countries. Consequently, groups representing businesses, farmers, workers, consumers, and other segments of the economy strive to make sure that their views on trade policy decisions are represented.

## **Role of the Judiciary**

### **40. How do federal courts get involved in trade?**

Legal challenges may be brought in federal court by importers, exporters, domestic manufacturers, 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 antidumping and CVD proceedings and governmental actions involving the implementation of WTO and free trade agreements may not be challenged in federal court.<sup>48</sup> 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.

### **41. 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

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<sup>48</sup> For further information, see CRS Report RS22154, *World Trade Organization (WTO) Decisions and Their Effect in U.S. Law*, by Jane M. Smith, Brandon J. Murrill, and Daniel T. Shedd.

Federal Circuit and to the U.S. Supreme Court. Statutory provisions related to the USCIT may be found at 28 U.S.C. Sections 251-258 (establishment) and 28 U.S.C. Sections 1581-1585 (jurisdiction).

## U.S. Trade and Investment Policy Issues

### Trade Negotiations and Agreements

#### 42. 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;
- gain an advantage for U.S. exporters over foreign competitors in a third-country market;
- increase access to lower cost imports that help to control inflation and offer domestic and industrial consumers a wider choice of products; and
- encourage trading partners, especially developing countries, to rationalize their trade regimes, and thereby improve the efficiency of their economies.

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

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

#### 43. 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) and the proposed Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (T-TIP), involve three or more countries in a geographic region; **plurilateral agreements** involve a number of countries (not always from the same region) that often negotiate to liberalize trade in a specific sector, such as the proposed Trade in Services Agreement (TISA); and **multilateral agreements**, such as those negotiated in the World Trade Organization (WTO), cover a significant share of global trade.

#### 44. 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 favor or promote their interests.

#### **45. What is the World Trade Organization (WTO)?**

The WTO is a 160-member body that establishes through negotiations and implements the multilateral system of rules on trade in goods, services, agriculture, IPR, trade remedies, and on other trade-related matters and adjudicates disputes under the rules. Fundamental principles of the WTO include non-discrimination and national treatment 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).<sup>49</sup> The WTO administers 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). It also oversees multilateral and plurilateral negotiations among its members.

#### **46. 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. From January 1995 to June 2014, 482 dispute settlement complaints have been filed in the WTO, with the majority of disputes resolved through consultations and negotiations rather than through a ruling by a WTO dispute settlement panel (or the WTO’s Appellate Body). WTO members have an obligation to comply with WTO dispute resolution rulings, and if such compliance is not forthcoming, the WTO member that filed the complaint can request authorization to impose trade sanctions against, or seek compensation from, the defending WTO member.<sup>50</sup>

WTO decisions do not have direct effect in U.S. law. Thus, in the event a U.S. statute is found to be inconsistent with U.S. obligations in the WTO, the dispute findings may not be implemented except through U.S. legislative action. Where an administrative action is successfully challenged, the 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,

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<sup>49</sup> The GATT was first established in 1947, and up until 1994, it administered global trade rules. During the Uruguay Round Agreements, the WTO was established as the successor to the GATT, starting in 1995.

<sup>50</sup> See CRS Report RS20088, *Dispute Settlement in the World Trade Organization (WTO): An Overview*, by Daniel T. Shedd, Brandon J. Murrill, and Jane M. Smith.

provided that certain statutory procedures for such actions are followed.<sup>51</sup> As a matter of policy, the United States generally seeks to comply with WTO dispute settlement rulings that go against it, as doing so helps ensure that other WTO members comply with rulings that have gone against them, including those brought by the United States.

#### **47. 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 include issues of importance to developing countries. The negotiations have primarily focused on three areas—agriculture, non-agricultural goods,<sup>52</sup> 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. In December 2013, WTO members reached consensus on a Trade Facilitation Agreement (TFA) to remove customs obstacles at the border. However, beginning in July 2014, implementation of the agreement has been held up by India because of its concerns over food security issues.<sup>53</sup> On November 13, 2014, the USTR announced that the United States and India had resolved their differences.<sup>54</sup>

#### **48. 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, IPR, government procurement, worker rights, and environmental protection.

#### **49. How do FTAs that the United States negotiates generally differ from those negotiated among other countries?**

The United States currently has 14 FTAs in force that include 20 countries.<sup>55</sup> The FTAs that the United States negotiates are often more comprehensive and high standard 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 IPR protection, government procurement, and provisions on labor and environment, and several other issues. The United States is currently negotiating a number of FTAs, including the TPP, involving

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<sup>51</sup> Uruguay Round Agreements Act, P.L. 103-465, §§123(g), 129, 19 U.S.C. §§3535(g), 3538.

<sup>52</sup> This is referred to as the non-agricultural market access negotiations (NAMA), which includes manufacturing products, fuels and mining products, fish and fish products, and forestry products.

<sup>53</sup> See, CRS Report R43592, *Agriculture in the WTO Bali Ministerial Agreement*, by Randy Schnepf.

<sup>54</sup> USTR, *Press Release*, November 13, 2014, at <http://www.ustr.gov/about-us/press-office/press-releases/2014/November/Statement-by-Ambassador-Froman-on-US-India-WTO-Trade-Facilitation-Agreement>.

<sup>55</sup> These include Australia, Bahrain, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Korea, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, and Singapore. See USTR, *Free Trade Agreements*, at <http://www.ustr.gov/trade-agreements/free-trade-agreements>.

the United States and 11 other countries in the Asia-Pacific region; and the Transatlantic Trade and Investment Partnership (TTIP) between the United States and the European Union. The United States has sought to make the TPP a comprehensive high standard free trade agreement that can serve as template for future FTA negotiations, especially through addressing issues that have not traditionally been address in other trade agreements, such as the development of new rules on state-owned enterprises (SOEs) and digital trade.<sup>56</sup>

#### **50. 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.<sup>57</sup>

### **Import Issues<sup>58</sup>**

As noted earlier, countries export in order to obtain imports, which benefit various parts of the economy. Lower-priced imports generally benefit the U.S. economy as a whole. However, in some instances, imports may harm certain import-sensitive U.S. firms, in particular when foreign firms or governments seek to employ trade-distorting measures. The federal government seeks to use a number of trade tools to combat unfair foreign trade policies and assist those injured by foreign trade. In some cases, such policies are intended to help create a “level playing field” for U.S. producers and workers, induce foreign countries to eliminate trade-distortive policies, or to help import-sensitive firms adjust to the changing nature of global competitive through the use of Trade Adjustment Assistance (TAA).

#### **51. Why do countries import goods and services from other countries?**

Some goods that are imported into the United States, such as oil and bananas, cannot be produced economically in sufficient quantities to satisfy domestic demand. Many other products (including intermediate goods) and services are imported because they can be produced less expensively or more efficiently by firms in other countries. Many imports into the United States contain U.S.-made components (such as semiconductors inside a computer) or U.S.-grown raw materials (such as cotton used to make t-shirts).

#### **52. What are other benefits of imports?**

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<sup>56</sup> For additional information on this issue, see CRS Report R42694, *The Trans-Pacific Partnership (TPP) Negotiations and Issues for Congress*, coordinated by Ian F. Fergusson.

<sup>57</sup> A listing of TIFAs can be found on the USTR’s website at <http://www.ustr.gov/trade-agreements/trade-investment-framework-agreements>.

<sup>58</sup> This section was prepared by Vivian C. Jones, M. Angeles Villarreal, and Mary Jane Bolle, Specialists in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Consumers can benefit through access to a wider variety of goods at lower costs. This raises consumer welfare (which means consumers have more money to spend on other goods and services) and helps control the rate of U.S. inflation. 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.

### **53. What are the costs of imports?**

By affording increased competition to U.S. companies producing similar products, imports can contribute to U.S. job losses and business failures. In some cases, import competition can cause job losses and company failures that are concentrated in a region or sector, which can cause considerable economic distress in a community. The use of unfair trade policies (such as export subsidies) to boost sales in the United States can result in trade tensions.

### **54. What are the main U.S. 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 unjustifiable and restrict U.S. commerce), and Section 337 (focuses on unfair practices in import trade such as patent and copyright infringement).

### **55. What is the purpose of the countervailing duty law?**

The purpose of the CVD law is to offset any unfair and injurious competitive advantage that foreign manufacturers or exporters might enjoy over U.S. producers as a result of receiving a government 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 specific benefit to 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.

### **56. 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 cause or threaten to cause material injury to a U.S. industry.

### **57. 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 temporary 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. Safeguard measures are permitted under WTO rules.

### **58. What is the Trade Adjustment Assistance (TAA) Program?**

Congress passed the first trade adjustment assistance program as part of the Trade Expansion Act of 1962 (P.L. 87-794) and it has extended and changed the TAA provisions over time. TAA was developed to provide certain types of temporary assistance to workers, firms, farmers, and communities that may be negatively impacted by foreign trade. Funding for TAA was \$797 million in FY2013, down from \$1.8 billion in FY2010.

### **59. 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 the losers of free trade while spreading the cost of freer trade to society as a whole, and (3) as a way to defuse domestic opposition to trade liberalizing agreements and measures. TAA skeptics argue that such assistance is costly and economically inefficient, reduces worker and firm incentives to relocate and adjust, and may not be equitable given that many economic groups hurt by changing economic circumstances caused by factors 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.

## **Federal Export Issues<sup>59</sup>**

The federal government maintains a number of programs and policies to promote certain U.S. exports. Some programs provide direct assistance to U.S. exporters, such as financing or trade counselling. Other U.S. policies attempt to promote exports by negotiating trade liberalization measures, such as through FTAs, or agreements to enhance trade rules and disciplines. In some instances, the federal government seeks to restrict certain exports.

### **60. 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 and access to growing markets overseas. 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.

### **61. 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

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<sup>59</sup> This section was prepared by M. Angeles Villarreal, Shayerah Ilias Akhtar, and Wayne M. Morrison, Specialists in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

which they can buy imports. Exports, according to this view, are foregone production that could have been consumed domestically (and instead are used to acquire and consume imports).

## **62. 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.

## **63. 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 (mostly) floating exchange rates, a large export surge will cause foreigners to buy more dollars to pay for those exports.<sup>60</sup> This raises the demand for dollars and increases its price relative to other currencies. Since the United States does not intervene in currency markets to fix its exchange rate, the higher value of the dollar makes U.S. exports more expensive and may reduce their sales.

## **64. How does the U.S. government promote exports?**

There are at least 20 federal agencies involved in promoting U.S. exports and supporting U.S. investment. For example, the Export-Import Bank (Eximbank), the Department of Agriculture, and the Overseas Private Investment Corporation (OPIC) administer various finance programs aimed at helping U.S. firms invest in certain developing countries (largely in order to advance certain U.S. foreign policy goals, which in turn may boost U.S. exports). In some cases, U.S. trade financing is provided to help U.S. firms obtain a “level playing field” against certain foreign firms that may be receiving subsidized financing from their respective governments. In addition, the Department of Commerce, through the International Trade Administration (ITA), acts to promote U.S. exports of goods and services (particularly by small and medium-sized companies) by providing a number of support services, such as export counselling.<sup>61</sup> Boosting U.S. exports was elevated as a priority issue with the Obama Administration’s introduction of the National

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<sup>60</sup> A number of countries, including China, do not have a floating currency. Such countries often seek to control or limit currency changes through government intervention—a policy some critics describe as “currency manipulation.” See CRS Report R43242, *Current Debates over Exchange Rates: Overview and Issues for Congress*, by Rebecca M. Nelson.

<sup>61</sup> These services are largely handled by ITA’s U.S. and Foreign Commercial Service (USFCS) Global Markets division. Other ITA sections, including the Enforcement and Compliance and Industry and Analysis divisions, are also involved in promoting U.S. exports.

Export Initiative (NEI) in the 2010 State of the Union Address.<sup>62</sup> The NEI set a strategy to double U.S. exports by 2015 in an effort to boost the economy and generate employment growth.<sup>63</sup>

### **65. Are U.S. export promotion programs beneficial to the U.S. economy?**

This is a hotly debated question. A number of economic justifications have been given for supporting or opposing government export promotion programs and policies. Economic theory generally holds that free markets should determine the most efficient allocation of scarce resources, based on supply and demand factors. However, market failures may prevent the market from operating at its "optimal" or most efficient level, causing the market to either over-allocate or under-allocate resources to various economic activities and leading to economic waste. Thus, in order to remove such market failures and promote economic efficiency, some form of government intervention may be warranted. The existence of imperfect information in the market, spillovers, and imperfect competition are examples of market failures that often are cited as justifying government export promotion programs, the presumption being that either the composition or level of U.S. exports is below that which would maximize U.S. living standards. From an economic perspective, much of the debate over export promotion involves whether some market failure actually has occurred, and whether government intervention can produce net benefits for the economy as a whole.

Supporters of export promotion programs assume that market failures have occurred and have led to significant misallocation of resources in the economy. Some view export promotion as a corrective tool to ensure that resources are directed to their most efficient use. Proponents argue that these policies can boost exports substantially, improve national living standards, and (during periods of less than full employment) increase output and employment. An additional justification used involves instances when U.S. firms find themselves unable to compete in certain overseas markets because their foreign competitors have received significant levels of government support, including subsidized export financing.<sup>64</sup> U.S. policies to counter or offset such subsidies, it is argued, will create a level playing field for U.S. firms and possibly induce other countries to discontinue providing export subsidies.

Opponents of export promotion programs dispute that significant market failures have occurred, and warn that government intervention may interfere with the efficient operation of the market. Such critics argue that export promotion policies are little more than distortive subsidies that favor some firms over others, reduce efficiency within the economy, result in terms-of-trade losses, and diminish national living standards. In addition, while critics concede that trade promotion programs may help boost employment and production during periods of less than full employment, they question why exporting firms should be favored for assistance over other U.S. firms. Some argue that broad monetary and fiscal policies aimed at stimulating domestic demand may provide a more effective means of boosting the economy.

Many economists would argue that addressing market failures could boost U.S. economic efficiency. However, various factors, such as global macroeconomic policies and the economic

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<sup>62</sup> See NEI website at <http://trade.gov/nei>.

<sup>63</sup> The government also seeks to promote exports indirectly, such as by negotiating with other countries to remove trade and investment barriers, improve transparency of trade laws and regulations, improving IPR protection, and urging countries to implement policies to promote economic growth (which would boost their demand for imports).

<sup>64</sup> It is argued that losses to U.S. firms could be significant when such activities determine which firms are able to obtain purchase agreements involving large infrastructure projects.

growth rates of the United States and its major U.S. trading partners, trends in global trade policies (such as expansion of trade liberalization policies or, conversely, increased trade protectionism), and international exchange rates will likely be among the most significant forces determining the level and composition of U.S. exports in the long run.

#### **66. What does the U.S. government do to restrict exports and why?**

Congress has authorized the President to control the export of various items for national security, foreign policy, and economic reasons.<sup>65</sup> 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 U.S. Departments of Commerce, State, Energy, and the Treasury administer these programs.

### **Investment Issues<sup>66</sup>**

#### **67. What are the main kinds of capital flows?**

Generally, the two main kinds of capital flows are foreign direct investment (FDI) and foreign portfolio investment. FDI involves 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.<sup>67</sup> Foreign portfolio investment involves the purchase of foreign equities or bonds, loans to foreign residents, or the opening of foreign bank accounts. FDI often involves a long-term commitment and can 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.

#### **68. Which is larger—trade or capital flows?**

It depends. Recent data indicate that from 1985 to 2012, global trade in goods and services, as measured by exports, tripled from \$6 trillion a year to \$19 trillion a year. During the same 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 \$7.0 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. 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

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<sup>65</sup> These include economic and trade sanctions that have been imposed against various countries and groups.

<sup>66</sup> Prepared by James K. Jackson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

<sup>67</sup> According to the BEA, direct investment implies that a person in one country has a lasting interest in, and a degree of influence over, the management of, a business enterprise in another country. As such, it defines FDI as ownership or control of 10% or more of an enterprise's voting securities, or the equivalent, is considered evidence of such a lasting interest or degree of influence over management.

and the cost of securities. A survey of the world's leading central banks indicated that the daily trading of foreign currencies totals was more than \$5.3 trillion in April 2013.<sup>68</sup>

### **69. 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 FDI 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. In addition, many firms often find it advantageous to operate close to their customers in foreign countries, where tastes and preferences may differ from those in the home market. Foreign markets may also enable multinational firms to access various resources, such as a well-educated work force, which might contribute to the firm's R&D activities. Some FDI activities involve mergers and acquisitions that may help a firm become more globally competitive.

### **70. Why has foreign investment increased so dramatically in recent decades?**

From 1990 to 2012, the stock, or the cumulative amount, of foreign direct investment in the world grew by more than tenfold from \$1.8 trillion to \$23 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 (FDI) 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.

### **71. What are the levels of U.S. FDI outflows and inflows?**

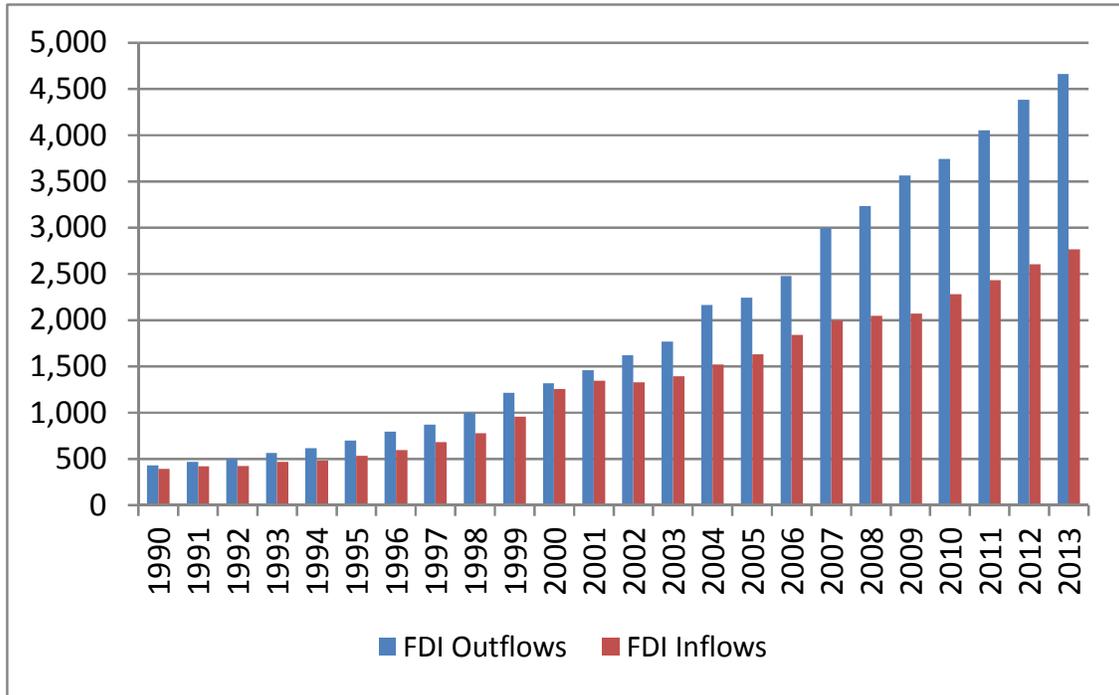
FDI flows to and from the United States have increased rapidly over the past few decades. From 1990 to 2013, the stock of U.S. FDI abroad rose from \$431 billion to nearly \$4.7 trillion, while the stock of FDI in the United States increased from \$395 billion to nearly \$2.8 trillion (see **Figure 3**). The largest destination for total (or the stock of) U.S. FDI outflows through 2013 included the United Kingdom, the Netherlands, Luxembourg, Canada, and Bermuda, while the largest sources of total FDI inflows included the United Kingdom, Japan, the Netherlands, Canada, and France.<sup>69</sup>

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<sup>68</sup> Bank of International Settlements, the Anatomy of the Global FX Market Through the Lens of the 2013 Triennial Survey, BIS Quarterly Review, December 2013, p. 27.

<sup>69</sup> Source: U.S. Bureau of Economic Analysis. Data are on a historical-cost basis.

**Figure 3. U.S. FDI Outflows and Inflows: 1990-2013**  
(in billions of U.S. dollars)



**Source:** Bureau of Economic Affairs.

**Note:** Data are on a historical-cost basis.

**72. What are some of the benefits of FDI?**

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 FDI 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. Are there costs associated with FDI?**

Concerned observers argue that U.S. FDI in production facilities 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 adversely affected 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 did the previous nationally based ownership.

#### **74. What are Bilateral Investment Treaties (BITs)?**

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 (or non-discriminatory) treatment (often referred to as most-favored-nation 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 the Committee on Foreign Investment in the United States (CFIUS) and what does it do?**

CFIUS is an interagency committee that serves the President in overseeing foreign investment transactions that could affect the national security of the country. CFIUS was established initially by an executive order of President Ford in 1975 with broad responsibilities and few powers. The authority to review foreign investments, known as the Exon-Florio provision, was formally established in 1988 with the passage of P.L. 100-418. In 2007, the Foreign Investment and National Security Act (P.L. 110-49) established CFIUS itself in statute and expanded the role of the committee in reviewing foreign investment transactions that could affect "homeland security" and "critical industries." Some foreign investors and foreign governments have objected to the expanded role of CFIUS as being counter to the long-standing U.S. position of an open investment climate. The authority granted to the President to block foreign investment transactions, however, has been invoked only twice since 1988, although in a few instances, issues and concerns raised by CFIUS have led foreign investors to cancel a planned purchase or to divest itself of the purchase if the deal had had already been completed.

## **Additional Readings**

### **CRS Reports**

CRS Report R43841, *International Trade and Finance: Key Policy Issues for the 114th Congress*, coordinated by Mary A. Irace and Brock R. Williams

CRS Report RL31032, *The U.S. Trade Deficit: Causes, Consequences, and Policy Options*, by Craig K. Elwell.

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CRS Report RL33274, *Financing the U.S. Trade Deficit*, by James K. Jackson.

CRS Report RL32964, *The United States as a Net Debtor Nation: Overview of the International Investment Position*, by James K. Jackson.

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CRS Report R43242, *Current Debates over Exchange Rates: Overview and Issues for Congress*, by Rebecca M. Nelson.

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CRS Report R43741, *India-U.S. Economic Relations: In Brief*, coordinated by Michael F. Martin

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CRS Report RS22154, *World Trade Organization (WTO) Decisions and Their Effect in U.S. Law*, by Jane M. Smith, Brandon J. Murrill, and Daniel T. Shedd.

CRS Report RS22823, *Overview of Labor Enforcement Issues in Free Trade Agreements*, by Mary Jane Bolle.

CRS Report RL32371, *Trade Remedies: A Primer*, by Vivian C. Jones.

CRS Report R41916, *The U.S. Export Control System and the President's Reform Initiative*, by Ian F. Fergusson and Paul K. Kerr.

CRS Report RL32461, *Outsourcing and Insourcing Jobs in the U.S. Economy: Evidence Based on Foreign Investment Data*, by James K. Jackson.

CRS Report RL33388, *The Committee on Foreign Investment in the United States (CFIUS)*, by James K. Jackson.

CRS Report RS21857, *Foreign Direct Investment in the United States: An Economic Analysis*, by James K. Jackson.

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