

The Importance of Trade to the New England Economy

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Bill Crozier has asked me to share my views on the importance of trade to the New England economy -- an importance that you and I both know cannot be overemphasized. However, I do not want to spend all my time recounting the benefits of trade to New England exporters and their employees. I'll start there, but you are aware of these facts and I will just be preaching to the already converted. Thus, I would like to spend some of my time with you reviewing why trade benefits the economy at large. To preview my main points, trade increases the efficiency with which each trading nation uses the resources available to it. And this increased efficiency improves each nation's standard of living. In addition, trade is linked to learning; it promotes technological progress and, thus, potential growth over the long run.

Unfortunately, current events indicate that a large part of the public believes that trade only benefits a few giant multinationals. Many individuals seem to forget the gains to consumers or to the economy as a whole. The resulting antipathy to trade

liberalization within parts of the general public diminishes the U.S. role in current trade initiatives, like the rapid development of a Latin American free trade area. Accordingly, I'll end by suggesting the need for a public education effort to remind citizens of the broad-based benefits of international trade.

Nowhere should the benefits of trade be more obvious than in New England. Here we sit on a pile of sea-scoured rock jutting out into the North Atlantic. We have no vast expanses of agricultural land, no iron or coal or oil. Basically, as Charles Francis Adams noted in the 1800s, New England's resources amount to "ice and rocks and men." While we have in the past exported rocks and ice, our most successful exports have always reflected the brain-power of our entrepreneurs and our skilled labor force.

Of course, many creative New England firms do export natural-resource-based products. You may, for instance, have noted the occasional news coverage of our exports of sea urchins and urchin roe to Japan; this holiday delicacy is out of season in

Japan's coastal waters in December but is particularly abundant off New England at that time. Similarly, one of Massport's chief exporters, in volume terms, is DeCoster Egg Farm of Turner, Maine, which ships over 10,000 metric tons of eggs a year, largely to the Far East. The secret of their success? Brown eggs. Since white represents death in parts of Asia, white eggs are not popular there. West Coast exporters tried dying their eggs in tea without success; they got found out.

Nevertheless, high-tech capital equipment and niche products that reflect our industrial history dominate our export base. Like the nation, New England's most valuable merchandise exports include industrial machinery, electronic equipment, transportation equipment, instruments and chemicals. However, within those categories, our export base differs considerably from the nation's, at least based on the detailed knowledge we have on trade with Canada, our largest trading partner. New England trade is three times more dependent on computer-related products than the nation (12 percent vs. 4 percent) and eight times more dependent

on integrated circuits (16 percent vs. 2 percent of total exports). For the nation, transportation exports mean autos, trucks and parts; in New England transportation exports mean aircraft and aircraft parts. In chemicals, organic products dominate at the national level, but in New England, pharmaceuticals loom most important. Again, reflecting our industrial heritage, textile exports continue to have above-average importance in New England but, not surprisingly, we export high-tech fabrics like Gortex, while clothing and synthetic fabrics top the list for the nation.

However, whether judging by trade with Canada or the world, New England has a favorable export mix when compared with the nation. We sell what the world wants, but we may not be selling it where it's wanted. If the growth in merchandising our exports by industry had matched the national pace to each foreign market, merchandise trade growth in New England would have been faster than the nation as a whole from 1987-1993. It wasn't. Why? Probably because New England is more dependent than the nation on merchandise trade with Western Europe and

Canada, and less dependent on trade with fast growing markets in Asia and Latin America. In 1993, emerging Asia and Latin America accounted for about 40 percent of U.S. exports, but for just 25 percent of exports from New England. As you know, Canada, the European Community, and Japan suffered more severe recessions than we did in the early 1990s, while most of the emerging markets continued to grow at quite healthy real rates.

Encouragingly, recent merchandise trade data from the Department of Commerce indicate that Massachusetts along with Maine, New Hampshire and Vermont outperformed the nation in exporting in 1995. As of last year, merchandise exports supported an estimated 403,000 jobs in New England, of which 219,000 were in Massachusetts. (That's about 7 percent of non-agricultural employment in both the region and the state.

Assuming that each \$1 billion in exports supports 17,000 jobs, last year's merchandise export growth accounted for about half of the regions's growth in nonagricultural jobs from 1994 to 1995.)

New England's improved export performance undoubtedly reflects strenuous public and private efforts to broaden the region's export horizons. During our periodic surveys of regional business conditions, many of our contacts have been reporting exciting gains in sales in Eastern Europe and China as well as other Asian and Latin American markets. In addition, of course, southern and western states may have been disadvantaged recently by their relatively great dependence on trade with Mexico and South America, given the drastic impact of the peso crisis on demand in these countries.

Also encouraging is the outlook for growth in our traditional trading partners in 1996. Although France and Germany have been going through a rough patch and probably experienced negative growth in the last two quarters, European GDP growth is generally expected to accelerate in the second half of the year. Incoming data -- housing starts, auto sales, and the like -- indicate a rebound in Canada as well. In Japan the worst recession of the post-war period finally seems to be over, as private investment

and industrial production are picking up steam. Even in Mexico, fourth quarter GDP fell considerably less than expected from year-ago levels. Their contraction seems to be over, and some analysts expect that Mexican output will have recovered its pre-crisis levels by the middle of next year.

Nevertheless, it remains essential that New Englanders continue their efforts to expand their export markets. Over the long run, annual growth in the mature industrial countries is likely to stay in the 2 to 2.5 percent range. All of these countries face pressures to reduce government budget deficits. In Europe the need to meet Maastricht fiscal standards looms large, and in Japan the budgetary impact of a rapidly aging population is a constant concern. Moreover, in all of these countries, firms continue to feel burdened by excess labor. Like fiscal stringency, industrial restructuring is likely to restrain growth in the mature economies for the foreseeable future. By contrast, the emerging markets are expected to continue growing at relatively rapid rates.

I hope you've noticed that so far, I have been discussing only

merchandise exports. Unfortunately, we have no data on state exports of services like tourism, transportation, and business and professional services, which now total for the nation as a whole close to 40 percent of merchandise exports. From national data we know that service exports have been growing quite a bit faster than exports of goods -- an 85 percent increase for private service exports between 1988 and 1994, for instance, versus a 60 percent increase for goods. We also know that services, including finance, insurance and real estate, account for a larger share of employment in New England (39 percent) than in the nation (34 percent). Thus, we are probably safe in assuming that New England accounts for a disproportionately large share of the nation's rapidly growing service exports.

National data indicate that travel and transportation exports bulk largest in service exports, and any walk through Copley or Harvard Square clearly suggests that Boston has been successful in attracting a growing number of foreign tourists who, reportedly, spend more per person in local stores and restaurants than U.S.

travelers. It is worth noting, moreover, that tourism is one service export that employs relatively large numbers of less skilled workers. License and royalty receipts account for another major share of service exports. A significant part of our biotech and software companies' foreign earnings falls in this category. And foreign earnings often equal 30 to 50 percent of these companies' total revenues. Other major service exports include education, financial services, telecommunications, data processing and data base management services, and construction, engineering and architectural services -- all major industries in New England.

During a recent conference on the contribution of service exports to the Massachusetts economy, a conference sponsored by The Alliance for the Commonwealth and the Boston Fed, we heard a series of fascinating case histories from successful service exporters. Helpful as these case studies are, we really need more complete information if the New England states and region are to take full advantage of expanding foreign markets for our services. The Alliance is starting a much needed effort to improve our

knowledge of Massachusetts service exports. A national initiative to provide comparable, consistent data on service exports by state would also be extremely useful. But in this era of federal downsizing, we may have to be patient.

Now I would like to broaden the perspective from exporting and discuss the benefits of trade for the economy as a whole. As I mentioned at the outset, international trade increases the efficiency with which regions and nations use the resources available to them. By so doing, trade raises these nations' standard of living above levels achievable in the absence of trade. As David Ricardo pointed out to his fellow Britons during the Industrial Revolution, nations gain by producing and exporting the products which require the resources that each possesses in comparative abundance. Even if an industrialized nation is absolutely more efficient at producing all goods, it will still gain from using its resources to produce goods at which it is relatively more efficient while importing goods made in countries that are relatively efficient at other products.

In Ricardo's classic example, thus, it was better for England, with its relatively abundant capital and skilled labor, to concentrate on making cloth to trade for wine from Spain, rather than to pull labor and capital away from textiles in a struggle to make domestic wine. By concentrating on what each country was equipped to do best and trading, both countries could consume more wine and cloth in total than they could in the absence of trade.

In this classic example of the gains from trade based on the uneven distribution of resources and comparative advantage, each country's exporters clearly gain from having access to larger markets, while firms making import-competing goods lose out, as they and their workers are quick to tell their elected officials. Consumers in both countries gain by having access to cheaper and more varied goods. The gains to exporters and consumers together should more than offset the losses suffered by import-competing firms in both countries; though, again the perceptions of this may vary by who is telling the story.

In addition to these one-time gains based on comparative advantage, trade also allows dynamic gains based on economies of scale and specialization or increased competition. Among industrial countries, for example, trade liberalization generally leads to increased two-way trade in closely related products like different grades of paper, newsprint versus fine stationery, say, or different types of integrated circuits, as producers on both sides of a disappearing border seek economies of scale or specialization. Again, consumers get a more varied menu and better prices than they would in the absence of trade. But in this case, many import-competing firms also thrive by finding a niche from which they can serve the domestic market or can even begin exporting themselves. Thus, gains from trade based on economies of scale can over time benefit almost everyone. And the prevalence of two-way trade has helped smooth adjustments to recent trade liberalizations.

It is true, however, that in the short run increased trade can leave certain industries worse off. Indeed, it seems quite obvious

that increased competition from low-paid labor in developing countries is one -- but only one -- of the explanations for the increased wage inequality now causing distress in this country. (As you may know, between 1969 and 1993, real earnings for men in the bottom earnings quintile fell more than 10 percent while real earnings for males in the top quintile rose over 15 percent.) However, most analysts that have looked at this subject concluded that technological change is the key contributor to the increase in wage inequality seen in the 1980s, with international trade a lesser factor.

To the extent that trade is perceived as to blame for increased wage inequality, however, we get calls for increased protectionism. But, in my view, the more effective response to this problem is a focus on improving worker skills and labor mobility. Indeed, protectionist tariffs on imports, particularly consumer goods and capital equipment, would lower most workers' real wages and make our manufacturers less competitive on world markets. Thus, tariffs would be a very expensive way of

helping individuals hurt by imports, and would do nothing to equip them to find more productive jobs.

To end with one final benefit for the entire economy, international trade promotes technological progress. Marco Polo's trips and the voyages of the 15th and 16th century explorer-traders leap to mind, but the close links between trade and technology diffusion are remarkably durable. The recent discovery of the five-thousand-year-old Iceman with his copper-bladed ax high in the Swiss-Italian Alps dramatized how travelers carried new technologies throughout Copper Age Europe. Here in North America, knives made from an unusual flint show that the Red Paint People were trading all along the coast from northern Labrador to New Jersey at least four thousand years ago.

Jumping back to the present, economists seeking to explain emerging Asia's remarkable growth rates generally point to these nations' readiness to embrace trade liberalization. In these countries, imports allowed and import competition promoted the adoption of increasingly advanced production methods, while

exporting permitted firms to make increasingly sophisticated products on a scale they could not achieve within the domestic market.

The links between trade and technology remain important for a high-tech region like New England. Since New Englanders surely hope to retain their current comparative advantage in knowledge-intensive goods and services, it is essential that the region's firms and workers be exposed to technical breakthroughs and have a chance to work with the most advanced equipment and components, which increasingly originate overseas. Indeed, data on foreign holders of U.S. patents, and on license and royalty payments to foreigners confirm that the flow of technology is no longer entirely one way. Moreover, just as exporting allows developing countries to exploit economies of scale unavailable at home, so too New England firms developing cutting-edge products benefit from large external markets that permit them to move faster along successive learning curves.

Unfortunately, as the widespread suspicion of NAFTA and

the World Trade Organization make clear, sizable segments of the U.S. public do not fully appreciate the essential importance of international trade for the U.S. economy. This lack of understanding matters, because it hinders the United States in taking a leadership role in current trade negotiations. For example, since the expansion of NAFTA appears to be on hold, the Latin American countries are charging ahead to create a Latin American free trade area with Brazil as the major market. The United States also needs to be able to provide leadership in ongoing negotiations concerning service exports and intellectual property rights. These issues are, of course, of particular interest here in New England.

For this reason, I will end by suggesting the need for a public education effort to promote a better understanding of the benefits of trade for the nation and the region. While programs to encourage exporting are clearly worthwhile, a wider appreciation of the benefits of trade for today's consumers and tomorrow's technological progress is also essential and deserves support. Moreover, whether technological progress or trade liberalization is

the primary cause of increased earnings inequality, worker retraining is clearly a more effective response than blaming foreign competition. Indeed, admitting the existence of transition costs for low-skilled individuals and asking the majority who benefit from trade to share these costs by financing improved retraining programs could be the most effective way of moderating protectionist sentiment. Otherwise, lack of political support for trade liberalization may undermine the U.S. position in ongoing trade negotiations and endanger the fragile trading system laboriously constructed over the last fifty years that has served over the long run to benefit us all.