Protecting Exports

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When the invitation to speak at this meeting arrived, I jumped at the opportunity to accept. I am a great believer in federalism in general. Moreover, among major national policy institutions, the Federal Reserve is probably better designed to keep in close touch with the states than any other federal institution. The Fed has regional roots serving a national purpose.

I'll not talk about monetary policy today but instead about an issue of great concern to me—the exports side of international trade. U.S. policy toward exports is primarily a matter of export promotion through financing arrangements—such as the Export-Import Bank, support for trade fairs and negotiations of various sorts. We need a broader view of exports, which is why I have chosen my title "Protecting Exports." In particular, we need a deeper understanding of the critical importance of foreign economic growth for U.S. exports and of the relationship between U.S. imports and U.S. exports.

Before proceeding, I want to emphasize that the views I express here are mine and do not necessarily reflect official positions of the Federal Reserve System. I thank my colleagues at the Federal Reserve Bank of St. Louis for their comments, particularly Cletus C. Coughlin, vice president and deputy director of Research, who provided special assistance. However, I retain full responsibility for errors.

SOME EXPORT FACTS

International trade is playing an increasing role in the U.S. economy. Since 1970, exports as a share of gross domestic product (GDP) have about doubled, from a bit less than 6 percent to 11 percent in 2006. These exports consist of both goods, such as industrial equipment and consumer goods, and services, such as insurance and financial services. For 2006, exports of goods were 70 percent of total exports and exports of services were 30 percent. This split has held relatively constant since the late 1980s.

Underlying the increase in U.S. trading activity is the behavior of numerous firms.[1] I should stress that the discussion that follows deals only with trade in goods. The number of firms involved in international trade in goods is increasing rapidly, and they are shipping more products to more foreign destinations than in the past. Exporting firms experienced relatively rapid employment growth and were a major force in U.S. job creation. These firms exhibit a number of characteristics, such as relatively higher productivity and larger size, which likely contribute

[1] See Bernard, Jensen, and Schott (2005) and Bernard, Jensen, Redding, and Schott (forthcoming). For reasons of data availability, I am restricting some of my statements to the SGA states and, thus, do not include Puerto Rico and the U.S. Virgin Islands even though their governors are members of the Southern Governors' Association. Nonetheless, I am confident that my general comments apply to all members of the Southern Governors' Association. Also, the export data I will be using, which are the best available, allocate exports to states based on the state from which goods began their journey to the port or some other point of exit from the United States. The transportation origin of exports is not necessarily identical to the location where the goods were produced. Thus, despite the inclination to think that exports from a specific state were produced in that state, that is not necessarily the case. Certain goods produced in one state may be counted as exports from some other state.

to their export success. Moreover, exporters tend to be more innovative and pay higher wages than their domestic counterparts.

Data on international trade and trade-related employment for the 16 member states of the Southern Governors' Association indicate that there are many linkages between exporting firms and other firms. Firms throughout the South are increasingly involved in international trade, and, during recent years, exports from the South have increased more rapidly than from the United States as a whole. In price-adjusted terms, exports from the member states as a share of gross state product increased from 5.8 percent in 1990 to 10.7 percent in 2006, an increase of 4.9 percentage points. Meanwhile, U.S. exports as a share of GDP increased from 7.8 percent to 11.4 percent, an increase of 3.6 percentage points. This growth in exports has been very beneficial to states throughout the South.

In 2006, export shipments of merchandise from the member states totaled $385.6 billion, an increase of 54.8 percent over its 2002 value. In 2006, these exports were shipped throughout the world. Not surprisingly, the two largest markets are Mexico ($73 billion) and Canada ($62 billion). In addition to the sizes of these markets, proximity as well as the relatively free trade environment stemming from the North American Free Trade Agreement contributed to the large export shares of these markets. Other top export markets are China, Germany, Japan, and the United Kingdom.

As you well know, exports provide numerous employment opportunities. Even if we restrict our focus to jobs associated with exports from the manufacturing sector, it is easy to see the importance of exports. Using data for 2003, the most recent available, estimates by the International Trade Administration indicate that slightly more than 1.7 million jobs in Southern states were related to exports.[2]

Of these 1.7 million jobs, 739,000 were directly in manufacturing and 983,000 were in firms serving manufacturing firms, which suggests the importance of linkages across various types of firms. While a number of small and medium-sized enterprises are exporters, numerous small and medium-sized enterprises also provide goods and services to exporters, many of whom are multinational corporations. These linkages can create business opportunities and enhance the productivity of small and medium-sized enterprises.

GROWTH MARKETS ABROAD

As foreign economies grow, the purchasing power of their residents increases. To tap into rising purchasing power abroad, U.S. firms must provide goods and services desired by these potential consumers. A sensible export strategy is to focus attention on foreign countries that are growing the most rapidly.

U.S. export growth to a country and the growth of that foreign country are closely related. When we examine export growth from 2002-2006 and the top 50 U.S. export destinations in 2006, we find a high correlation (0.63 for the United States as a whole and 0.51 for Southern States) between export growth and income growth abroad. Southern states' exports to China and India grew rapidly between 2002 and 2006, by a factor of nearly three to both China and India.

Numerous examples can be provided of how growth abroad is providing opportunities for firms based in the South. Consider an example from Arkansas. A Springdale, Arkansas, company, JV Manufacturing, is providing technology for hydraulic compactors that smash refuse before it is taken to a landfill.[3] Currently, these compactors are being used in Huaibei, China. Plans are in the works to export the technology to other regions of China. This example involving growth and trash suggests a plethora of other opportunities. Undoubtedly, given China's environmental problems, U.S. firms with environmentally friendly

[2] See www.ita.doc.gov/td/industry/OTEA/jobs/Reports/2003/jobs_by_percentciv_totals.html.

[3] See Morasch (2006).

technology, as well as firms involved in clean-up operations, should prosper.

The consequences of economic growth are being felt by PowerCurbers Inc., a manufacturer of equipment used in making concrete curbs and paving.[4] This firm, based in Salisbury, North Carolina, is experiencing large increases in demand, especially from buyers in China, India and Vietnam. Investment in the infrastructure needed for transportation services is a critical factor for economic growth.

Economic growth in conjunction with a free-trade agreement has provided a number of export opportunities for Southern firms in Chile. For example, Wikoff Color Corporation, located in Fort Mill, South Carolina, recently signed a contract in Chile to provide inks and coatings used in the production of scratch-off lottery tickets and prepaid phone cards.[5] Meanwhile, Impex, located in Paducah, Kentucky, has experienced large increases in conveyor systems used in mining in Chile.[6]

Another consequence of economic growth is increased demand for food products. Increases in income from low levels invariably lead to increased demand for animal protein. Chicken, pork and beef are all exported from Arkansas to China.[7] Tyson Foods exported the majority of frozen chicken cuts, which is the leading food export from Arkansas to China. We could multiply these examples many times over.

What these examples illustrate is that economic growth provides export opportunities and that these export opportunities come in numerous areas. The key role that income growth plays in international trade also suggests that, from a national perspective, exports and imports are linked. One linkage is as follows: Foreign income growth affects U.S. exports, which help to determine U.S. income and, therefore, imports. Consequently, changes that affect exports will affect imports and vice versa. Thus, actions that limit U.S. imports will also tend to reduce U.S. exports because they depress income growth abroad. Few people seem to understand that raising import barriers will tend to reduce export opportunities. Countries with high trade barriers and relatively low levels of imports will also have relatively low levels of exports.

TRADE WAR DANGERS

Let's look more closely at the finding that exporting firms have relatively higher productivity than non-exporting firms do. Research suggests the conclusion that higher productivity is a requirement for, rather than a consequence of, engaging in international trade. A possible reason for the requirement of high productivity is that the high entry costs of becoming an exporter can only be borne profitably by the most efficient firms.

Interestingly, research has shown that after firms enter export markets they do experience faster growth of employment and output than non-exporters do. Reduced barriers will induce more firms to export. Increased exports in turn would generate an increased demand for labor and, therefore, higher wages. Low-productivity non-exporting firms would be forced to exit the industry and both capital and labor would be reallocated from the less productive non-export firms to the more productive exporting firms, increasing average productivity and average wages.

The productivity facts relating to exporting firms suggest an important role for trade liberalization in improving the aggregate productivity of the economy. Productivity gains stemming from trade liberalization allow for increases in output and income. Recent research indicates

4 See Tannenbaum (2006).

5 See www.buyusa.gov/southcarolina/wikoffcolor.html.

6 See Tompkins (2005).

7 See Smith (2007).

that the payoff to the United States of liberalization of trade and international investment has been quite large.[8] Based on several different statistical approaches, the estimated payoff ranged from 7.3 percent to 13.2 percent of U.S. GDP in 2003. Using 2006 dollars, these estimates suggest a higher per capita income in the United States ranging from $3,000 to $5,434. These are not small effects.

The preceding reasoning, supported by empirical estimates, implies that negotiations that reduce trade barriers can be very beneficial.[9] Conversely, legislation that imposes trade barriers will likely be harmful. To my disappointment, as I survey the current state of trade negotiations and numerous legislative proposals, I am troubled that the direction of trade policy in the immediate future may not be the right one. Let me give you a few of the many reasons that create my concern.

First, fast-track negotiating authority expired on June 30. This authority allows the president to negotiate trade agreements that Congress can either accept or reject, but cannot amend or filibuster. The lack of fast-track authority matters because trading partners are extremely reluctant to negotiate with the United States when experience indicates, unfortunately, that agreements may be substantially altered during the legislative process.

Second, the Doha Development Agenda multilateral trade negotiations appear to be on the verge of collapse. A collapse of the Doha round would raise doubts about the future effectiveness of the World Trade Organization, which is the key international organization for negotiating, implementing and enforcing multilateral trade agreements.

Third, many in the United States seem to favor a more confrontational approach with the Chinese, despite the fact that China is a huge market with rapid growth in purchases of U.S. goods.[10] Frankly, I do not understand the strategy of attacking a very large, rapidly growing customer. China is an increasingly frequent target for anti-dumping actions. In international trade law, "dumping" is said to occur when a firm sells a product at a higher price in its home market than the price it charges when it exports the same product to another country. If U.S. manufacturers can establish that they are being harmed by dumping on this definition, then duties (i.e., import taxes) are imposed to counteract the extent of the dumping. The illogic of antidumping laws is clear: Would we prefer that U.S. consumers pay higher prices than charged abroad? Would U.S. consumers be harmed in the most extreme possible "dumping" scenario in which they received goods from abroad for free?

Currently, the Chinese share of anti-dumping actions is nearly double its share of U.S. imports. Moreover, in March 2007, the Commerce Department began applying anti-subsidy laws to China. This action reversed 23 years of policy and led to filings that China has illegally subsidized exports of tires, paper bags, steel pipes and steel nails. These legal actions are anti-consumer.

The U.S. is also pursuing complaints against China within the World Trade Organization. The U.S. trade representative has initiated four cases against China, which is more than against any other country at this time. The charges include illegally high Chinese tariffs on automobile parts imported from the United States. U.S. pressure to reduce barriers for U.S. exports should ideally encourage a more open world trading system; however, the prospects for successful negotiations dim when, simultaneously, the United States is imposing import barriers.

Some U.S. legislative proposals seem to be based on a presumption that trade retaliation is an effective strategy; however, economic history suggests otherwise. Rather than passive compli-

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[8] See Bradford, Grieco, and Hufbauer (2006).

[9] Bradford, Grieco, and Hufbauer (2006) conservatively estimate that global free trade would produce higher per capita income ranging from $1,540 to $2,069 using 2003 dollars or from $1,679 to $2,255 using 2006 dollars.

[10] See Weisman (2007).

ance with trade restrictions, the targeted country tends to retaliate. Successive rounds of retaliation can spiral into a trade war. Actually, the process should be called "an anti-trade war." Restriction of a country's exports forces it to reorient its economy toward alternative suppliers and markets. Such a reorientation is facilitated by the fact that a trade retaliation policy tends to expand the role of government in the targeted country. In the present case, U.S. interests are likely best served by an increasing role for individual consumers and firms in a more market-oriented Chinese economy.

A tragic episode from economic history provides additional reasons for my concerns about the future course of trade policy. The Great Depression was a global catastrophe. Most researchers agree that the Smoot-Hawley tariffs of 1930 precipitated retaliation and likely worsened the effects of the Great Depression by contributing to the collapse of trade throughout the world in the early 1930s. An all-out trade war seems unlikely today, but a series of smaller barriers inflicting economic costs on a trading partner has the possibility of inflicting harm far beyond the original target. I am very uncomfortable with the numerous actions and proposed legislation that not only are unlikely to affect the large U.S. trade deficit but also are increasing the chances of escalating trade frictions. Escalating trade frictions have the potential to hinder international trade and economic prosperity both here and abroad.

There is a role, of course, for protecting U.S. consumers from unsafe products, but this role should not depend on whether goods are produced in the United States or abroad. A key principle is that identical standards that address genuine safety issues be applied to a good regardless of where it is produced. One unfortunate possibility is that product safety issues become part of a trade war. For example, recently the United States suspended some Chinese seafood imports after finding traces of cancer-causing chemicals. Shortly thereafter, the Chinese suspended imports of chicken feet, pig ears and other animal products from seven U.S. companies.[11] The Chinese justification for their action was that the products contained bacteria as well as residues of drugs and pesticides. There is no reason why the two countries should not work cooperatively on a food inspection program to serve their common interests in high-quality food.

CONCLUDING COMMENTS

The U.S. economy is fully employed; the unemployment rate has been below 5 percent since December 2005, compared to an average rate of 6 percent over the past quarter century. Given that the United States does not have a high unemployment rate, we need to focus less on creating more jobs and more on creating better jobs. Better jobs require more productive workers and pay higher wages.

Growth in U.S. exports in coming years will play a critical role in creating better jobs. U.S. exporting firms on average enjoy higher productivity than those that sell only into the U.S. internal market. Because export opportunities are especially great to countries abroad that are growing rapidly, we need to encourage that growth, or at least not interfere with it. Imports into the United States from high-growth countries help to encourage growth abroad. We have a common interest with all the countries of the world in promoting trade liberalization. Increasing liberalization is central to creating better jobs around the world, including here at home. In our approaches to trade issues, we need to shift attention from protecting workers against imports to protecting exports. That will be the key to a more prosperous future.

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[11] See Irvin (2007).

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