The Heritage Lectures

504

The Key to U.S. Economic Growth And Leadership

By Representative Jim Kolbe

The Heritage Foundation

The Heritage Foundation was established in 1973 as a non-partisan, tax-exempt policy research institute dedicated to the principles of free competitive enterprise, limited government, individual liberty, and a strong national defense. The Foundation's research and study programs are designed to make the voices of responsible conservatism heard in Washington, D.C., throughout the United States, and in the capitals of the world.

Heritage publishes its research in a variety of formats for the benefit of policy makers; the communications media; the academic, business, and financial communities; and the public at large. Over the past five years alone The Heritage Foundation has published some 1,500 books, monographs, and studies, ranging in size from the 927-page government blueprint, *Mandate for Leadership III: Policy Strategies for the 1990s,* to the more frequent "Critical Issues" monographs and the topical "Backgrounders," "Issue Bulletins," and "Talking Points" papers. Heritage's other regular publications include the *Business/Education Insider,* and *Policy Review,* a quarterly journal of analysis and opinion.

In addition to the printed word, Heritage regularly brings together national and international opinion leaders and policy makers to discuss issues and ideas in a continuing series of seminars, lectures, debates, briefings, and conferences.

Heritage is classified as a Section 501(c)(3) organization under the Internal Revenue Code of 1954, and is recognized as a publicly supported organization described in Section 509(a)(1) and 170(b)(1)(A)(vi) of the Code. Individuals, corporations, companies, associations, and foundations are eligible to support the work of The Heritage Foundation through tax-deductible gifts.

The Heritage Foundation
214 Massachusetts Avenue, N.E.
Washington, D.C. 20002-4999
U.S.A.
202/546-4400

The Key to U.S. Economic Growth and Leadership: Congressional Approval of the Uruguay Round

By Representative Jim Kolbe

Yesterday, the House of Representatives passed a procedural motion and agreed to consider GATT Uruguay Round implementing legislation after the November elections. The final vote, which will be one of the most important votes we will cast in the 103rd Congress, will be on November 29. If it were not for the efforts of one member of the Senate, Congress would have considered legislation implementing the Uruguay Round before the congressional elections. I would not be exaggerating to describe the outcome of that vote as the most critical economic issue we face today and a key determinant of future U.S. trade policy.

The Uruguay Round represents the largest, most comprehensive trade agreement in history. It will reduce tariffs globally by one-third. Even more important, it will for the first time eliminate many non-tariff barriers to world trade in goods and services. Altogether, the agreement will mean a wider selection of lower-priced goods, expanded job opportunities, and an increase in the standard of living for citizens of all participating nations. It follows that such economic progress will inevitably contribute to world stability and reduced political tensions.

Before I discuss the specific benefits of implementing the Uruguay Round and the motivations and importance behind the multilateral trading system, I want to talk about the ways in which the world economy has changed in recent decades and how vital a free trade policy is for the United States.

There can be no doubt that the U.S. and the world are entering a new epoch for the international trading system. Since the idea of a new mega-round of trade negotiations was first proposed in 1982 and with its launching in 1986 in Punta del Este, Uruguay, world trade and investment flows have grown so much we can scarcely grasp their implication. At the same time, the U.S economy is emerging from a fundamental restructuring, one that leaves it poised to reap new benefits from international trade.

The dilemma of this new environment is that U.S. trade policy finds itself behind the eight ball. Our policies are inadequate for an economy that must meet the challenges of global economic integration and capitalize on economic opportunities. Indeed, our trade policy appears to be on the verge of gridlock over issues having little or nothing to do with international trade. At the same time, there is an increasing need for U.S. trade policy to be sharply focused and intelligent because of the threat that rapidly moving economic events in the global economy could pass us by.

A New Era in the International Trading System

Deepening global economic integration, the spread of free market philosophies, and the rapid economic expansion of developing countries have led to new patterns of international trade and investment. First, the composition of international trade has changed from its emphasis on manufacturing goods produced in a single country. Second, geographic patterns of trade and

---

Congressman Kolbe, a Republican, represents the 5th District of Arizona in the U.S. House of Representatives.

He spoke at a meeting of The Heritage Foundation's Trade Policy Working Group on October 6, 1994.

ISSN 0272-1155

investment are shifting with the rise of developing countries in Latin America and East Asia as well as countries of the former Soviet Union, Eastern Europe, and China.

The era when national firms specialized in particular products and traded across national boundaries is gone. It is being replaced by globalization of production and investment. That is, the horizontal form of trade is being supplanted by a new form where firms undertake different phases of production in different countries and combine them into a final product for domestic consumption or further international sale.

Merchandise trade is therefore increasingly dominated by multi-national firms who conduct a robust trade in parts, components, and semi-finished goods among affiliates and joint ventures. The dynamics behind this transformation of the global marketplace vary by industry and by country. This vertical international trade is ushering in an era where countries specialize in different phases of production without necessarily being the consumer of the finished product.

Another increasingly important component of international commerce—though still under-counted in trade statistics—is that of services. This sector includes such things as travel and transportation, advertising, accounting, consulting, telecommunications, architecture, construction and engineering, finance, insurance, and education. And since 1981, world trade in services has grown more than 100 percent.

A third point about the composition of trade is that an acceleration of foreign direct investment (FDI) flows in the world over the last decade will likely intensify trends toward component manufacturing and trade in services. Average annual worldwide FDI growth rates equaled roughly 34 percent from 1985 to 1990—a rate of growth far in excess of trade growth rates and world GDP growth rates in the same period.

The second trend I spoke of was the shifting geographic pattern of trade. It is hard not to be astonished by the explosive economic growth of East Asia and Latin America. These regions have lifted their economic performance with deep market reform, privatization of state-owned enterprises, and the promotion of entrepreneurship. The results speak for themselves.

For example, East Asia's share of global commerce grew from 7.5 percent of the world total in 1980 to nearly 14 percent by 1991. Trade among East Asian countries also exploded in recent years. While still a major market for East Asian goods, the U.S. has declined in relative importance as intra-regional trade has grown. In 1986, 30 percent of the region's exports were destined for the United States; by 1991, that percentage had fallen to 21 percent.

In contrast to a decade earlier, Latin America today has a bright future. Real growth has returned and it is strong. Inflation has been reduced by two thirds—much more in some countries. Dollar reserves have doubled.

Latin American intra-regional trade is booming much the same as that of East Asia. Latin exports to other destinations in the region increased 90 percent in real terms between 1985 to 1992. It is worth noting that intra-regional trade growth has been greatest in countries with sub-regional or bilateral trade arrangements. As might be expected, the relative importance of the U.S. market to Latin America exports has slightly declined given the growth rate of both global and intra-regional trade. This trend is likely to continue.

The Rapid Evolution of the U.S. Economy

Widely perceived but not as well understood is our own economic transformation. Revolutions in communications, information processing, and automated production have radically altered the way we provide goods and services in our economy. So too has it changed our understanding and the prism through which we view the domestic and international marketplace.

Over the last decade, U.S. companies—notably those in manufacturing—have made sweeping changes to reduce labor costs, increase productivity, and improve product quality. While partially encouraged by international pressures, this change was and continues to be largely induced by internal economic factors. Companies have combined technology with a better-trained, slimmed-down workforce to improve the bottom line and maintain their competitive position. The result has been declining manufacturing employment even as manufacturing as a percentage of gross domestic product has remained constant. Conversely, we increasingly rely on the services sector for high-wage, high-skilled job creation. This trend is likely to continue for several years.

Another development affecting our economy is the rising importance of foreign direct investment. The close relationship between FDI and U.S. exports is reflected in the increasing proportion of foreign trade that takes place *within* U.S. and other multinational corporations. A recent study showed that 55 percent of U.S. exports consisted of intra-firm trade. Of this total, 32 percent was U.S. exports by American multinationals to foreign affiliates, and 23 percent was exports by foreign firms operating in the U.S. to parent companies or other affiliates.

That in a nutshell is the challenge to U.S. domestic and international economic policy: how to stimulate high-wage, high-skilled job opportunities in the service sector while maintaining a healthy environment for our competitive manufacturing industries even as employment declines further in those industries.

Part of the answer lies in developing a coherent, focused U.S. trade policy, reflecting the new realities of the global economy and trading system. Increased trade is imperative if we are to raise the U.S. standard of living and the create high-wage jobs. Once our economy was self contained. Now it is increasingly more reliant on the world economy as a source of economic growth and rising national income.

For instance, in contrast to our trade deficit in merchandise goods, the U.S. service sector has been generating sizeable trade surpluses. Between 1986 and 1992, U.S. exports of services more than doubled to $179 billion, until it now equals 41 percent of the value of U.S. merchandise exports in 1992. The U.S. surplus in services trade in 1992 was $56 billion, offsetting nearly three-fifths of our merchandise trade deficit of $96 billion. Trade in services clearly can be a major job creator in the U.S. economy if properly emphasized and nurtured.

In 1970, the value of trade—both goods and services combined—equaled 14 percent of our GDP. By 1993, the value had doubled. A conservative estimate according to the United States Trade Representative's office puts that number at 36 percent in 2010. That means that more than a third of our wealth will depend entirely on doing business with other nations. Public policy makers and the American public must recognize this increasing importance of trade to our economic future.

The Importance of a Multilateral Trading System to the U.S.

More than fifty years ago, shortly before the outbreak of World War II, Secretary of State Cordell Hull said this about the importance of having a global environment fostering free trade:

> A thriving international commerce, well adjusted to the resources and talents of each country, brings benefit to all. It keeps men employed, active, and usefully supplying the wants of others. It leads each country to look upon others as helpful counterparts to itself rather than as antagonists.

The significance of that idea cannot be overstated, especially in the post-Cold War period. Not only are more countries graduating to developed status under GATT, but new nations are emerging from the economic lethargy of Soviet domination. These emerging capitalist economies must be integrated into a free multilateral trading system that promotes cooperation among its members. China—already the third largest economy in the world—is seeking to redefine its GATT membership, which lapsed in the 1950s. These nations are at an impressionable stage; the world community cannot ignore this unique opportunity to reduce economic and political tensions among countries with such diverse and often competing interests.

Although not a perfect system, the merits of the multilateral trading system are indisputable. The steady increase in the number of countries that have joined GATT is a testimony to its growing role in expanding trade. Twenty-three countries participated in the Geneva meeting that approved the GATT charter in 1947. Over 100 signed the Uruguay Round agreement in April.

Exporting nearly $475 billion of goods each year makes us the largest exporter in the world. Total trade today comprises more than 15 percent of gross domestic product. Moreover, workers in export-oriented industries earn 22 percent more on average than do workers in non-export oriented industries.

Alan Greenspan, Chairman of the Federal Reserve, continues to give a cautious but favorable assessment of the American economy and its outlook. He points to our moderate unemployment and increased levels of business investment and productivity—economic measures that demonstrate the strength of the American economy. Without a strong multilateral trading system, American economic strength would be poised to capture the economic benefits, but would be unable to reach its potential. In international trade, there are only two ways to go—forward or backward. One cannot stand still in this arena.

That being true, our workers, employers, and consumers need a trading system with strong rules based on free trade, wide coverage, and effective dispute settlement. Strengthening the GATT system is imperative to our economic future—particularly after a dozen tough years of economic restructuring, defense downsizing, and continued federal efforts at deficit reduction.

A strong multilateral trading system not only produces economic benefits, but also very clearly improves U.S. national security. Reducing trade barriers and strengthening the economic relationships among developed and developing nations creates a strong trading system that contributes to world stability and raises the living standards of all nations. That can only increase the likelihood of peaceful cooperation among major world powers.

U.S. National Economic Interests and the Reagan Initiative

It is widely acknowledged that the international trading system has been severely strained for the last fifteen years, that is, since the conclusion of the last major round of world trade negotiations. The international trading environment of 1994 is different than that which existed when GATT was founded in 1948. Not only has the composition of trade flows changed, but they have become a more important component of nearly every country's economic activity. The result has been a curious dichotomy—an increasing interdependence of national economies coupled with increasing conflict among trading nations over how the system should work.

Frustrated by GATT's declining effectiveness and driven by our own latent protectionist tendencies, the U.S. has followed a trading policy the last two decades whose sole unifying feature seems to be increasing unilateralism and regionalism.

To avoid a breakdown in the trading system, the U.S. and other world leaders recognized that the rules governing international trade needed to be modified. The system had to reflect the world's new competitive realities and resist further pressures to pursue protectionist policies. Three significant problems confronted the world trading system at the time we launched the Uruguay Round.

First, with the substantial rise in GATT membership, negotiation and implementation of GATT agreements which all countries would subscribe to became increasingly more difficult and time-consuming. Over the years, subgroups of nations within GATT have undertaken their own supplemental agreements—often known as codes—leaving out other GATT member countries as non-signers. As a result, some GATT members were bound in ways that others were not —creating a free-rider problem. Furthermore, supplemental agreements had different mechanisms for dispute settlement—adding confusion to an already weak, time-consuming system of resolving conflicts.

The second major problem of GATT was the lack of effective dispute resolution. Too often, industries with legitimate grievances against foreign trade practices must wait years before cases are resolved—by which time individual companies may be out of business or individual workers out of work. In 1987, the U.S. Chamber surveyed U.S. trade complaints under section 301 procedures over a ten-year period. Section 301 is the provision that provides the domestic counterpart to GATT dispute settlement procedures and U.S. domestic authority to impose import restrictions as retaliatory action against unfair foreign trade practices. Congress first created this authority in the trade act of 1974 to enforce—if necessary—U.S. rights against unjustifiable, unreasonable, or discriminatory foreign trade practices which burden or restrict U.S. commerce. The survey looked at two groups of complaints: those settled using GATT procedures and another group where a resolution was negotiated independent of GATT with the offending foreign country. Their findings indicated that the average time to settle GATT cases was 4.6 years, while the average for non-GATT cases was 1.3 years.

The third problem with the current GATT system is the growing amount of trade excluded from GATT disciplines, and the lack of effective protection for intellectual property or investment. The world is dominated by increasingly service-oriented economies, and service is excluded from GATT coverage. Similarly, agricultural trade has been totally uncovered by GATT. With U.S. exports in services at $180 billion annually, and with 50 to 60 percent of our economy in the service sector, lack of GATT coverage for services, quite obviously, poses a huge problem for our companies and workers.

To respond to these challenges, President Ronald Reagan began his efforts for another round of world trade negotiations in 1982. The initial response among most developed and developing countries was disinterest. But, by 1986, after a second oil shock, sentiment had changed. So, in that year, at Punta del Este, Uruguay, GATT members took up the huge challenge by adding to the traditional trade agenda of tariffs, textiles and clothing, subsidies and safeguards, and antidumping the new subjects of agriculture, intellectual property protection, services, and investment. The addition of these new subjects was a recognition of the increasing size and importance of financial and service trade flows among countries. With the increasing membership and diversity of GATT, a re-examination of the institutional structure of GATT became an imperative if cooperation and cohesion among its large and diverse membership was not to be lost altogether.

Thus, strengthening the GATT institution itself and the mechanism for dispute resolution, eliminating the free rider problem, and expanding GATT's coverage to reflect economic realities were primary objectives for U.S. negotiations as nations gathered in Uruguay.

Results of the Uruguay Round

While the U.S. fell far short of achieving all its objectives, the Round must be considered a success when viewed from our narrow national interests. We did obtain a major reduction in tariff and non-tariff barriers and constructed a new set of trading rules better suited for the global economy facing us in the 21st century. Through the establishment of a new administrative institution, the World Trade Organization, the U.S. was able to strengthen the GATT institutional framework and eliminate the free rider problem.

The Uruguay Agreement is being treated by its signatories as a "single undertaking." In other words, participants agree to accept all the results, or none of them. Such acceptance is a condition for membership in the new World Trade Organization.

The dispute settlement procedures were strengthened considerably, meeting our objective of a clearer, stronger, and more timely process that could be applied to all parts of the agreement. This was a key objective of the American business community.

In the area of trade-related intellectual property protection, the agreement establishes improved standards for the protection of intellectual property rights. U.S. trading partners, especially developing countries, must significantly improve their local framework for protection of intellectual property. With it, we expect to see a reduction of piracy of such items as U.S. designs and chemical formulas.

Additionally, the Uruguay Round provides for greater access to foreign markets for U.S. exporters and investors, and reduces current tariffs across-the-board by one-third. Reduced tariffs means a net tax cut for U.S. consumers and a tax cut for the world that will grow to over $750 billion over the next decade. Resulting economic growth will translate into significant new employment opportunities and additional high-paying jobs associated with the increased production of goods for export to these now-open markets.

In conclusion, it will be a serious blow to U.S. national economic interests and freer trade if the 103rd Congress fails to implement the Uruguay Round this year. We simply cannot afford to postpone this net plus for the American economy. The new GATT is an agreement that plays to our strengths as the world's largest trading country, the biggest exporter, and the most productive economy. It opens foreign markets at precisely the moment when American businesses and workers have sharpened their competitive edge. It will create hundreds of thousands of additional high-wage jobs for U.S. workers in the coming decade and provide a better political environment for world stability. The President and Congress must not delay. We must not be faint-hearted. We must have the courage to move swiftly forward to implementation. American workers and consumers *need* the benefits of the Uruguay Round.

And while successful implementation of the Uruguay Round will represent a landmark achievement for strengthening the multilateral trading system and a significant step toward liberalizing trade, we must continue to move forward. The content of the Uruguay Round agreements are more a reflection of the trade agenda when the initiative was launched in 1986 than a reflection of today's trading reality.

Therefore, as we wait and work toward congressional approval of the Uruguay Round, we must recognize the economic challenges that lie ahead and begin formulating ideas for U.S. policies to meet them.

✧ ✧ ✧ ✧