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TESTIMONY BEFORE CONGRESS ON TRADE POLICY

Alan Greenspan,
Chairman, Federal Reserve Board;
testimony before the U.S. Senate Committee on Finance,
Washington, DC, April 4, 2001

I am pleased to be invited to discuss some of the important issues concerning international trade and the attendant implications for the U.S. economy and the world economy more generally. In doing so, I want to emphasize that I speak for myself and not necessarily for the Federal Reserve.

One of the most impressive and persistent trends of the last several decades is the expansion of international trade. Trade across national borders has increased far faster than world GDP. As a consequence, imports of goods and services as a percentage of gross domestic products worldwide, on average, have risen from approximately 12% forty years ago to 24% today.

To most economists, the evidence is impressively persuasive that the dramatic increase in world competition (a consequence of broadening trade flows) has fostered markedly higher standards of living for almost all countries that have participated in cross-border trade. I include most especially the United States.

Globalization as generally understood involves the increasing interaction of national economic systems. Of necessity, these systems are reasonably compatible and, in at least some important respects, market oriented. Certainly, market-directed capitalism has become the paradigm for most of the world, as central-planning regimes have fallen into disfavor since their undisputed failures around the world in the four decades following World War II.

Globalization, in turn, has been driven importantly by advances in technology. By lowering the costs of gathering information and conducting transactions, new technologies have reduced market frictions and provided significant impetus to the process of broadening world markets. Expanding markets, in turn, have both increased competition and rendered many forms of government intervention either ineffective or perverse.

The recognition of this prosperity-enhancing sea change in world markets and, in that context, of the counterproductive consequences of pervasive intervention has led many governments to reduce

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tariffs and trade barriers and, where necessary, to deregulate markets. These actions themselves have further promoted the very globalization that, interacting with advancing technology, spurred the deregulatory initiatives in the first place. The result of this process has been an advance and diffusion of technical change that has raised living standards in much of the world.

The international trading system that evolved has enhanced competition and nurtured what Joseph Schumpeter a number of decades ago called "creative destruction," the continuous scrapping of old technologies to make way for the new. Standards of living rise because the depreciation and other cash flows of industries employing older, increasingly obsolescent technologies are marshaled to finance the newly produced capital assets that almost always embody the cutting-edge technologies. This is the process by which wealth is created incremental step by incremental step. It presupposes a continuous churning of an economy in which the new displaces the old.

But there is also no doubt that this transition to the new high-tech economy, of which rising trade is a part, is proving difficult for a large segment of our work force that interfaces with our rapidly changing capital stock day by day. This is most evident in the rising fear of job skill obsolescence that has induced a marked increase in experienced workers going back to school (often community colleges) to upgrade their skills for a rapidly changing work environment.

While major advances in standards of living are evident among virtually all nations that have opened their borders to increased competition, the adjustment trauma resulting from technological advances as well as globalization has also distressed those who once thrived in industries that were once at the cutting edge of technology but that have become increasingly noncompetitive.

Economists will say that workers should move from the steel districts of western Pennsylvania to Silicon Valley or its equivalent. And eventually they, or more likely their children, will move. But the adjustment process is wrenching to an existing work force made redundant largely through no fault of their own. It may be argued that all workers should have the foresight to recognize long-term job opportunity shifts and move in advance of obsolescence. Such forecasting abilities are not in great abundance among workers. But neither are they evident among business managers or the economists who counsel them.

Yet the protectionist propensity to thwart the process of the competitive flow of capital, from failing technologies to the more productive, is unwise and surely self-defeating. History tells us that, not only is it unwise to try to hold back innovation, it is also not possible over the longer run. Generation after generation has experienced episodes in which those rendered technologically obsolescent endeavored to undermine progress, often appealing to the very real short-term costs of adjusting to a changing economic environment. In the end, these attacks did not prevail, and long-term advances in standards of living resumed.

Nonetheless, the campaign to expand free trade is never won. It is a continuing battle. Though tariffs in industrial countries have come down sharply over the past half-century, other barriers have become more prevalent. Administrative protection in the form of antidumping suits and countervailing duties is a case in point. These forms of protection have often been imposed under the label of promoting "fair trade," but oftentimes they are just simple guises for inhibiting competition. Typically, antidumping duties are levied when foreign average prices are below the average cost of production. But that also describes a practice that often emerges as a wholly appropriate response to a softening in demand. It is the rare case that prices fall below marginal cost, which would be a more relevant standard. In the view of many economists, antidumping initiatives should be reserved for those cases in which anticompetitive behavior is involved. Contrary to popular notions about antidumping suits, under U.S. law, it is not required to show evidence of predatory behavior, or of intention to monopolize, or of any other intentional efforts to drive competitors out of business.

In the end, economic progress clearly rests on competition. It would be a great tragedy were we to stop the wheels of progress because of an incapacity to assist the victims of progress.

Our efforts should be directed at job skills enhancement and retraining (a process in which the private market is already engaged) and, if necessary, selected income maintenance programs for those over a certain age, where retraining is problematic. Thwarting competition, by placing barriers to imports, will prevent markets in the U. S. and other nations from deploying capital to their most productive uses, that is, the most cost-effective production of those goods and services most highly valued by consumers.

Protectionism will also slow the inevitable transition of the work force to more productive endeavors. To be sure, an added few years may enable some workers to reach retirement with dignity, but it will also keep frozen in place younger workers whose opportunities to secure jobs with better long-run prospects diminish with time.

I regret that trade policy has been inextricably linked with job creation. We often try to promote free trade on the mistaken ground, in my judgment, that it will create jobs. The reason should be that it enhances standards of living through the effects of competition on productivity. It is difficult to find credible evidence that trade has affected the level of total employment in this country over the long run. Indeed, in recent months we have experienced the widest trade deficit in history with unemployment still close to record lows.

Certainly, the distribution of jobs by industry is influenced by international trade, but it is also affected by domestic trade. The relative balance of supply and demand in a competitive market economy determines the mix of employment. When exports fall or imports rise, domestic demand and relative prices have invariably adjusted in the long run to leave total employment generally unaffected.

I also regret that, despite the remarkable success over a near half-century of the General Agreement on Trade and Tariffs, and its successor, the World Trade Organization, in reducing trade barriers, our trade laws and negotiating practices are essentially adversarial. They presume that a trade concession extracted from us by our trading partners is to their advantage at our expense and must be countered. Few economists see the world that way; trade is not a zero sum game.

If trade barriers are lowered by both parties, each clearly benefits. In almost every credible scenario, if one lowers barriers and the other does not, the country that lowered barriers unilaterally would still be better off having done so. Raising barriers to achieve protectionist equality with reluctant trading partners would be neither to our benefit nor to theirs. The best of all possible worlds for competition is for both parties to lower trade barriers. The worst is for both to keep them up. For these reasons, we should welcome the opportunity to contribute to the effort of working toward further trade liberalization. If we freeze competitive progress in place, we will almost certainly slow economic growth overall and impart substantial harm to those workers who would otherwise seek more-effective longer-term job opportunities. Protecting markets from new technologies has never succeeded. Adjustments to newer technologies have been delayed, but only at significant cost. Moreover, even should our trading partners not retaliate in the face of increased U.S. trade barriers, an unlikely event, we would do ourselves great harm by lessening the vigor of competitiveness in the U.S. The U.S. has been in the forefront of the postwar opening up of international markets, much to our and the rest of the world's benefit. It would be a great tragedy were that process stopped or reversed.

The arguments against the global trading system that emerged first in Seattle and then spread over the past year and a half arguably touched a chord in many people partly, in the judgment of many analysts, by raising the fear that they would lose local political control of their destinies. Clearly, the risk is that support for restrictions on trade is not dead, only quiescent.

Those who protest against "globalization" appear too often to be self-designated representatives of developing country interests. For all the reasons that I have cited earlier, these protests, however well intentioned, are wrong-headed. In particular, it is essential to note that probably the best single action that the industrial countries could actually take to alleviate the terrible problem of poverty in many developing countries would be to open, unilaterally, markets to imports from these countries. Such countries need more globalization, not less.

In many important respects, the past half-century has represented an uneven struggle to repair the close linkages among national economies that existed before the First World War. The hostilities bred of war, the substantial disruptions to established trading patterns associated with that conflict, and the subsequent poor economic performance over the next few decades engendered the erection of trade barriers around the world that have taken even longer to dismantle. To repeat that error would increase poverty among a significant segment of the world's population.

The U.S. has been a world leader in terms of free trade and open markets for capital as well as goods and services. We have benefited enormously from the resulting international competition: We have a wide range of goods and services available for consumption; our industries produce and employ cutting-edge technologies; and the opportunities created by these technologies have attracted capital inflows from abroad. These capital inflows have reduced the costs of building our country's capital stock and added to the productivity of our workers. Most economists would argue that we must reaffirm the U.S. leadership role in the area of international trade policy in order to improve standards of living in the U.S. and among all of our trading partners.

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