Testimony of the Honorable Grant D. Aldonas
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Trade and Globalization

Introduction

Chairman Rangel, Mr. McCrery, and Members of the Committee, welcome the opportunity to be with you and want to thank you for holding this hearing on trade and globalization as part of the Committee's series on economic conditions in the United States. By way of introduction, I am currently the William M. Scholl Chair at the Center for Strategic and International Studies. I previously served as the Under Secretary of Commerce for International Trade from 2001-2005.

In my view, these hearings are long overdue. We are in an era of rapid and unprecedented economic change – change that has no rival even in the industrial revolution, the previous era of globalization at the end of the 19th Century, the Great Depression, or the extraordinary economic growth of post-World War II America. Given that fact, it is worth remembering that the changes wrought by those earlier eras rewrote the basic social contract in America and elsewhere in the world.

A similar process is under way today. Like all eras of change, many of the forces at work can be profoundly beneficial. At the same time, change brings inevitable hardships, particularly for those in our society who are least able to adapt to the changes they face.

I am a firm believer in free markets. Not only because they are economically efficient, but because they are inextricably bound up with and reinforce the exercise of the broader political freedoms that represent the genius of our democracy and our society. The habits of freedom are not, in fact, neatly divisible between political and economic spheres. Much of the legacy of our own history, including both its best and worst, underscores the point that individuals without their economic freedom lack the wherewithal to exercise their political rights.

That said, I am also a firm believer in democracy and in the values that underpin our great nation. In the midst of the Civil War, President Lincoln pointed out a simple fact – we will either succeed together or fail together. For we are one country, economically and politically. The glue that holds us together is our shared commitment to freedom and equality. It is the vision of America as an equal opportunity society that holds us together and draws so many, including my father, from other countries to our shores.

So, while I am a believer in the benefits of globalization, I also think it is critical that we examine the effects of globalization, not just in terms of economic efficiency, but also in terms of our ability to deliver on the promise of an equal opportunity society. And, we should measure our own actions in response to the economic challenges we face on that same basis.

That is why it is critical for Congress – and particularly the House of Representatives, which is as close to the voice of the American people as any institution in our government – to play the role that the our Founding Fathers and the Constitution set out for it. Your job is to serve as the mediator between the aspirations of all your constituents and the reality of the economic challenges we face. Your responsibility is to make choices that serve the best interests of all Americans, not just a select few, whether those select few are corporate presidents or union members.

What that means in more practical terms is that we need to have an honest debate about the terms of our engagement in the global economy. It is too easy to label advocates of free trade as uncaring and to easy to label those who express concerns about international trade as protectionists or isolationists. What's missing is what I hope your hearings will provide – a thoughtful appraisal of where we stand in the global economy and what it will take to ensure that all Americans have the tools to succeed in the global economy going forward.

Now, having said that, let me lay my cards on the table in terms of what I see both as to where we stand in the global economy and what it will take to ensure that all Americans have the opportunity to succeed. Free markets and the liberalization of trade serve the interests of the poorest in our society precisely because free markets represent the greatest leveling force we know. The reason our antitrust policy disfavors monopoly and limitations on competition is because limits on competition serve the interests of entrenched power and perpetuate privilege. Contrary to what many of globalization's critics say, the same holds true of our trade policy.

That does not mean that government does not have a role and that only the market is relevant to achieving our economic and social goals. Government has a critical role to play in putting the tools of the global economy in the hands of every willing worker in the U.S. economy and in helping every American adapt to the economic changes we will inevitably face in the coming years.

The reasons why that is the case and the economic policies we ought to adopt to ensure that the benefits of globalization reach every American make up the remainder of my testimony. I want to start by defining what drives globalization and then discuss what tools we have, including but not limited to trade policy, to shape the terms of our engagement in the global economy in ways that will allows us to deliver on the promise of equal opportunity.

What Globalization Is and Is Not

It is important to be clear about what globalization is and what it is not in order to think clearly about how we shape the terms of our engagement in the global economy. In my view, there is no more important topic for the Committee to consider as part of its work because it is the forces driving globalization – rather than globalization itself – will shape our economic future and that of the younger Americans who follow us.

We tend to speak of globalization as if it were a force in and of itself. It is not. Globalization is a noun, not a verb. It is a consequence, not an all powerful economic tide that is sweeping over us.

The reason it is important to say that is because how we define globalization will tend to shape our view of the options we have for defining our economic future. Viewing globalization as a single, monolithic external force almost necessarily implies the need to protect ourselves from it by isolating ourselves from the world economy. Viewing globalization purely as a function of trade policy or trade agreements will inevitably lead us to think that retooling our trade policy might be sufficient to shape our response to the global economy.

I understand why that is an attractive thought. Trade policy has become a flashpoint in American politics precisely because it represents the interface between our economy and those of our neighbors and trading partners. It lends itself to the easy answer about how to address our ills. Because trade policy deals with the intersection between our economy and the global economy, both sides of the debate tend to invest trade policy with a power that it does not have.

If, however, there are forces at work in the process of globalization other than trade and trade policy, I think we would all agree that a focus on trade policy alone would not be adequate to the task of shaping our response. We would be wise, under those circumstances, to look beyond the tools of trade policy for the answers to the challenges we face. And, that is where much of the truth about responding to globalization lies.

There are three broad trends that have driven the current integration of world markets. The first is technology, which has sharply reduced the cost of communication and transportation that previously divided markets even where there were no other barriers to trade.

Plainly, trade policy tools – whether in the form of tariffs or antidumping duties on imports – will not help us in the face of technological change. In fact, quite the opposite, isolating the United States and U.S. producers from international competition will only mean that we would fall behind in terms of technology, which ultimately contributes to our productivity and our ability to compete.

In the world of trade policy, imports get a bad rap. We tend to think of exports as good and imports as bad. In fact, imports and the competition and the spur to technological innovation they provide are critical to our ability to remain in the game globally. When he was Chairman of the Senate Finance Committee, my former boss, Senator Bill Roth, used to say – frequently, and to all that would listen – that “there was no protection in protectionism.” The reason he said that was that he understood that it was competition that kept us sharp and continually innovating.

It may seem ironic or counterintuitive, but limiting imports as a means of grappling with the changes that new technologies have wrought is the surest way to be washed away by the competition those changes generate.

The second force that has driven the accelerating integration of global markets is not often discussed as an economic phenomenon. That is the end of the Cold War. What the end of the Cold War represented in economic terms was the elimination of barriers that had divided the world into warring camps for the better part of the 20th Century. Like any markets that are divided for artificial reasons, both markets – the west and the east – maintained production capacity in excess of what would be needed in a single integrated world market.

With the fall of the Berlin Wall and the acceleration of China's movement toward a market economy, the barriers that had sustained that excess capacity fell. With the collapse of economic activity in the former Soviet Union, the installed industrial capacity sought new markets through exports and gained market share by cutting prices. The effect on pricing and competition in the markets for a broad range of industrial products reacted predictably. The price effect ensured that we would face the burden of adjustment along with the former Soviet states.

Developments in the steel industry provide an example of the fallout from that process. Exports of steel from the former Soviet Union have disrupted markets for over a decade largely because the remaining capacity found no market in the former Soviet states and was priced to sell on world markets. That caused a significant drop in both world and U.S. prices, putting significant pressure on our steel producers to adjust to new levels of competition.

We are, in fact, still in the midst of absorbing the overcapacity that flourished in those times. And, the adjustment process has been delayed by continuing distortions in various markets. Again, steel offers an example. The lack of significant capital market disciplines in China has kept an enormous amount of old steel capacity on stream even as China has added new capacity. Fortunately, China's growth has absorbed much of the excess, but only a slight downturn in China's growth could drive steel prices down again, forcing another round of adjustment.

Both instances offer some insight into how and when trade tools might be useful, but underscore the basic point that the larger forces driving globalization require economic policy responses that reach beyond trade policy. There is little that either tariffs or other border measures could have done to offset the effects of adjustment unleashed by the end of the Cold War.

Certainly, the steel industry used antidumping actions and lobbied heavily for relief under section 201 of the Trade Act of 1974. Based on my own direct experience in those episodes as Under Secretary of Commerce for International Trade, however, the real clue to the steel industry's current success flows from higher demand among developing countries like China and India meeting their infrastructure needs (i.e., offsetting the decline in demand in the former Soviet states) and the adjustments that the industry has made to lower their productions costs, rather than trade restraints.

What's more, even in those instances, trade restraints came at a significant cost. While the section 201 relief may have helped the U.S. steel industry adjust, it also raised the costs of small manufacturers in the U.S. auto parts industry that already faced incredible pressure from U.S. car manufacturers to reduce the prices of their finished products. In other words, the smaller downstream manufacturers could not pass on the increase in prices resulting from higher steel costs, despite the fact that they too faced intense international competition. In other words, many of our traditional trade tools have become a double-edged sword in the global economy, creating winners and losers in their own right.

No one I know would like to return to the Cold War, even if it looks considerably more stable than the international environment we find ourselves in now. But, equally important, there is nothing that our trade policy tools can do to reverse that trend. They are of some limited use in addressing the trade-distorting aspects of it, but ultimately we have to find a way to adjust to that competition until markets find a new equilibrium between productive capacity in certain industries and demand, much as has happened in the case of steel.

The last significant driver of globalization does directly involve trade policy – that driver is the success achieved in lowering the barriers to trade through successive rounds of multilateral trade negotiations under the auspices of the General Agreement on Tariffs and Trade ("GATT") and various regional and bilateral agreements, such as the European Union and the North American Free Trade Agreement ("NAFTA"). The reductions in trade barriers coincided with periods of significant long-term economic growth in the United States and other economies that opened themselves up to the global economy. Indeed, all of the economic evidence suggests that economies that were more open to trade have fared better economically than those that have remained closed.

In one sense, that should not come as a surprise. The whole purpose of engaging in trade is to allow us to specialize in what we can do best. Because we are more efficient at those activities, we are more productive and that gain in productivity translates into a higher standard of living. Economies like the United States that are more open to trade have also maintained relatively higher standards of living.

Along those same lines, it is worth underscoring the fact that, even as we are discussing the impact of trade and globalization on our economy and whether it produces winners and losers, the economy continues to grow steadily. Unemployment currently sits well below the 6 percent figure that the Clinton Administration identified as full employment and well below the trend line of the last 30 years.

What that reflects is an economy that is extraordinarily flexible and capable of adaptation. It is that flexibility and adaptability that is the hallmark of success in the global economy and holds the clue to the economic policies we should pursue in order to succeed in a global age.

But, for now, it is worth asking what we would do with traditional tools of trade policy to reverse the progressive lowering of tariffs that have resulted from our network of trade agreements? The answer is, of course, we should do better at opening markets and eliminating trade-distorting practices. The argument most often heard is that we have been out-negotiated and ended up signing inequitable deals that forced us to open our economy faster than our trading partners opened theirs.

The point, however, is that even those arguments against the recent history of our trade agreements do not counsel a pause in negotiations. What the criticisms necessarily imply is the need for further negotiations to address the inadequacies of the past arrangements, rather than rolling back the disciplines that already exist or otherwise violating our international obligations in an effort to redress what is perceived as an imbalance between our duties and our rights under those accords.

In short, trade policy alone is neither the author of the economic challenges we face as a country nor the answer to those challenges. We do, in fact, need an adjustment policy worthy of its name. In my view, we ought to think of every tool of economic policy, including trade negotiations, as fair game in an effort to improve the ability of our citizens to adapt and succeed in a global economic environment. But, that, of course, means looking at a variety of other instruments of economic policy that extend well beyond the purview of trade, even though many of them reside in the Committee's jurisdiction.

The Economic Challenge Facing America

If you asked me to define the critical economic challenge confronting America, globalization would not top the list. The greatest challenge we face is demographic. We have a rapidly aging workforce, which means many more retirees and fewer productive workers. With fewer workers, we will need to raise our productivity significantly simply to maintain our existing standard of living, much less raise it. In my view, we should bend every tool in our economic policy arsenal – whether in tax policy, trade policy, transportation policy, or education – toward lifting our productivity.

That is not as simple as it sounds since professional economists do not always agree on what economic policy inputs succeed in raising our productivity and our economic growth. Doing it in the face of the continuing competitive pressure generated by globalization makes it seem doubly difficult.

The good news is that the competition that globalization brings is absolutely essential to drive the gains in productivity that contribute most to improving our efficiency and raising our standard of living. What's more, by lowering the cost of putting the tools of the global economy in the hands of American workers, trade liberalization and globalization can contribute to their ability to compete.

Now, workers also need the training necessary not only to do their current jobs, but to adjust to changes in the market for their services. They would also benefit from an environment that facilitated their ability to move from job to job and industry to industry without losing their health insurance and retirement benefits.

Businesses need roughly the same things. They need economic policies that encourage their ability to retool just the way workers need the training to adjust to changes in the market. Businesses also need policies that reinforce their ability to reap efficiencies from the shop floor as well as the step change in technology that flows from their spending on research and development.

What you can see immediately is that government has a critical role to play in setting the right environment for both workers and businesses in a way that maximizes their ability to prepare for and shape their own economic future. Indeed, that should be the focus of our economic policy response to globalization.

Economic Policy in a Global Age

Given the analysis set out above, what should the committee explore in terms of changes in U.S. economic policy? Let me offer just a few examples that might point the way toward a more coherent response to globalization and offer our firms and workers the opportunity to succeed in a global economy.

By all means, the Congress should assert its traditional oversight responsibilities with respect to the negotiation of trade agreements and the conduct of trade policy. Congress should also focus intently on developments in the dispute settlement processes under the World Trade Organization and our bilateral agreements to ensure that we are using those tools aggressively in our exporters' interest. Congress should also reexamine our unfair trade laws to ensure that they serve their purpose, which should be to deter unfair trade practices, rather than become a vehicle for ongoing protection, often at the expense of other American manufacturers.

That said, more of the Committee's focus and the Congress' focus should bear in on creating the economic environment that encourages adaptability and adjustment. The Committee should, for instance, reexamine the basis for the research and development tax credit which helps start ups but does nothing significant for our manufacturing base despite the billions of dollars they invest in research and development in order to maintain their competitiveness in the global economy. Similarly, if the Committee wants to encourage equity investment and entrepreneurialism, as well as close the trade deficit, it should eliminate the preference for debt under the tax code that has given us a highly leveraged economy and eliminate the double taxation of a worker's income that a tax on interest and dividends implies.

From the perspective of workers, the Committee should reexamine our adjustment assistance programs. First and foremost, the Committee should question why, if the most valuable training takes place on the job, we have a program that obliges workers to get out of the job market for an extended time in order to qualify for benefits, all the while their skills are eroding.

Second, the Committee should examine whether the adjustment assistance we offer should be linked to trade, which simply creates the need to define a layoff as trade-related in order to qualify, rather than acknowledging that the adjustment workers face is now a permanent feature of the American economy and that workers would be better served by a program that was designed with that in mind, rather than a now largely artificial link to an increase in imports.

Third, the Committee should look closely at enhancing the portability of health insurance and retirement benefits in ways that reach beyond the current commitments to portability.

Finally, the Committee should examine alternatives, such as picking up the cost of moving expenses in lieu of training, when a worker can find employment elsewhere and is prepared to move.

My own instinct is that both the business community and labor leaders would be willing to work with the Committee in developing an agenda along those lines because it has one important virtue – it would actually come to grips with what both businesses and workers actually face in terms of competing in a global economy.

Trade Policy's Role

Our trade policy should dovetail with that more comprehensive strategy to come to grips with what globalization really demands of both U.S. businesses and workers. In that context, the Committee has an opportunity to shape the future goals of our trade policy as it prepares to consider renewal of the President's Trade Promotion Authority ("TPA").

Indeed, the negotiating objectives set out in TPA should serve as Congress' voice on trade policy. It should reflect the Committee's aspirations for our trade policy, as well as providing our negotiators with their instructions. In that regard, I do think we should renew our focus on eliminating trade-distorting subsidies and other policies and practices designed to shift investment and employment artificially from one country to another.

I know that much of the focus of organized labor has been on negotiating objectives that would require increased labor protections and stronger enforcement of those rules under the domestic law of our trading partners. Having worked on that issues both on the Hill and in the Administration and having been a part of negotiations on the topic, I have to say that I am honestly skeptical that the approach will achieve labor's aims.

I wonder whether it would make more sense as a pro-labor, pro-worker agenda to focus intently on those distortions in other countries' trade policies and practices that artificially encourage a shift in investment and employment to their markets, rather than where the market would otherwise dictate. Ultimately, the fight is not about labor standards, as worthy a goal as that is. It is a fight over jobs – whether the jobs will be here in the United States or whether they will shift in response to trade and investment-distorting practices of our trading partners.

Let me suggest an example that illuminates not just what I think a truly pro-employment trade policy would look like, but also underscores why we need to engage more broadly on the negotiating front, rather that walk away from the negotiating table at this stage, which the failure to renew TPA would imply. The example involves China.

China's currency peg has received an enormous amount of attention in the past couple of years. Most objective analysts agree that the renminbi is undervalued. But, what is not clear to me is that the currency peg is the most significant trade and investment distortion extant in the Chinese system.

The argument generally runs that we should compel China to revalue its currency upward or demand that it float. What most fail to consider is that a revaluation is likely to work only under certain circumscribe conditions, most importantly conditions under which China maintains its currency controls at the same time. It is worth thinking through the logic of a position that would fully eliminate all barriers to the free float of China's currency, including the elimination of the currency controls.

Currently, China's pool of savings is larger than its economy. Those savings are currently invested in an effort to prop up its currency. That means China buys our Treasury bonds as a way of sopping up the dollars in its economy and the excess liquidity they represent. What that means both from an individual saver's perspective in China and from the perspective of the Chinese economy as a whole, that they are making a poor investment – one that generates a significantly below market rate of return.

What would happen to those savings if the average Chinese saver was able to invest freely anywhere in the world, which is what a complete liberalization of the Chinese currency regime would actually imply? Those savings would seek a higher rate of return; one that would not necessarily flow from further investment in China's overheated property markets or another steel mill. To the extent those savings flowed abroad in search of a higher rate of return, it would put downward pressure on the renminbi, not encourage its appreciation. The net result would be a fall against the dollar (or at least a limit on the renminbi's upward rise).

In short, we should be careful what we wish for on the currency front. But, the more serious problem, in my view, is that the focus on currency diverts our attention from a far more injurious set of economic policies and practices. Currently, Chinese state-owned banks account for much of the finance that drives investment in manufacturing capacity in China, particularly in basic manufacturing like steel. Those state-owned banks continue to lend for political reasons in many instances and their exorbitant non-performing loan rates translate into a zero cost of capital for their borrowers. Imagine what that does to distort investment in manufacturing world wide.

The answer to that problem, moreover, lies squarely within the ambit of our trade policy. It involves opening the Chinese market to U.S. and other financial institutions that would enforce stronger capital market discipline on lending throughout the Chinese market. Such discipline would eliminate the distortions that the current Chinese practices create, which translates into jobs. It also identifies a target for which our traditional trade policy tools would be extraordinarily useful.

In other words, negotiating an agreement that opened the Chinese market further to U.S. banks and financial firms would not only increase our services exports and help redress the bilateral trade balance with China, it would also offer the possibility of doing more about the underlying complaint of U.S. workers, which relates to employment opportunities more than labor conditions in China.

In fact, even if the goal was to address China's labor practices directly, I wonder whether we would not be better off addressing them in pure trade terms. To the extent that the Chinese houkou system, which ties labor to specific enterprises, limits their ability to seek employment elsewhere, it is, in economic terms, a significant subsidy to any Chinese firm that benefits from the undervalued labor. That is not to dismiss the serious and legitimate human rights questions that attend the houkou system, but we may find that we have a better case by presenting the problem in traditional trade terms that we would if we make the case purely in terms of labor rights.

In short, there are many things that trade policy can do to help create an environment in which the playing field is level and, frankly, I think it is ultimately consistent with the notion of free trade to ask for the elimination of those sorts of trade-distorting practices mentioned above. But, the point should be to use trade policy where it is best calculated to achieve our aims, rather than in those instances in which other economic policy tools would be better equipped to help American firms and workers succeed in the global economy.

Thank you.