

# LABOR CENTER REPORTER

Number 165  
November 1985

## "THE U.S. TRADE CRISIS"

by Clair Brown

If current trends continue, the U.S. trade deficit will be between \$140 billion and \$150 billion annually for the rest of the decade. By 1990, the U.S. would owe foreigners about \$1 trillion. The interest payments alone on that foreign debt could be around \$100 billion annually. The trade deficit--caused by a highly over valued dollar--is crushing U.S. industry. Cheap foreign imports have already resulted in the loss of 1.8 million manufacturing jobs in the U.S. Since the underlying problem of the budget deficit cannot be resolved quickly, the government should undertake some short-term policies to counteract foreign trade's crippling blow to manufacturing and agriculture that otherwise might be economically viable.

This trade crisis is a direct result of President Reagan's 1981 tax cut coupled with his enormous military build up. Federal budget deficits grew from \$874 million in 1980 to \$185 billion in 1984 and are projected to be \$222 billion in 1985. Interest rates had to rise to attract enough money (including money from abroad) to service the national debt. Contrary to the view sometimes expressed, wage gains by U.S. workers are not the cause of the large trade deficit, since U.S. wages have declined relative to wages in other countries over the past four years.

High interest rates have made the U.S. dollar very attractive. Foreign investors convert their own currencies into dollars in order to buy high yielding bonds in the U.S. The resulting strong demand for the U.S. dollar has caused its value to rise 50% in value since 1981. Most economists think the U.S. dollar is now overvalued by 30-40%. The over-valuation of the dollar has made foreign-made goods cheap for U.S. consumers and U.S.-made goods expensive abroad. However, the deficit will be reduced only gradually, probably over a five year period, and the value of the dollar will respond slowly as interest rates fall. Another lag of 12-18 months exists between the drop in the value of the dollar and improvements in trade patterns.

**A Looming Recession**--Economists predict that without dramatic decreases in the federal budget deficit and the trade deficit, the U.S. economy will have another recession. A decline in output would decrease the demand for credit, and a decline in incomes would decrease the demand for foreign (as well as domestic) goods. Both of these outcomes would decrease our trade deficit, but a recession would also cause the loss of millions of jobs. In addition, a recession would do nothing to change the underlying structural problem of the federal budget deficit. And a recession might result in a further irreparable decline in the manufacturing base in the U.S.

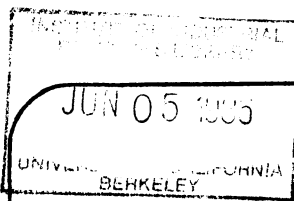
For these reasons, many economists and politicians are now arguing for some protectionist measures that would immediately reduce the trade deficit and would give us time to reduce the federal budget deficit and the value of the U.S. dollar. The economic arguments fall into groups--those that offset the structural problems caused by the overvalued dollar and those that offset the trade barriers imposed by other countries.

Professor Lestor Thurow, of MIT, argues that we must develop public policies for maintaining a balance between exports and imports since the over-valued dollar is causing an undesirable and unnecessary decline in manufacturing industry. Once distribution and marketing networks are lost, and customers have developed relationships with foreign suppliers, it is almost impossible to get back into business. Since the costs of getting back into business are even greater than the costs of going out of business, the short-run problem of an over-valued dollar can result in the long-run problem of an unwarranted decline in our industrial base and national output.

BERKELEY, CA 94720  
(415) 642-0323

CENTER FOR LABOR RESEARCH AND EDUCATION  
INSTITUTE OF INDUSTRIAL RELATIONS

UNIVERSITY OF CALIFORNIA, BERKELEY



Other economists argue that protectionist measures are appropriate in a world where the U.S. abides by free-trade principles and major competitors do not. Economists and politicians agree that the U.S. should threaten to close its own markets unless other nations open up their markets to U.S. goods. However, one study showed that trade barriers could account for at most 20% of the trade deficit. How well protectionist policies work depends primarily on how other countries respond--if they retaliate with further curbs on their own imports, the net gains to the U.S. are lower. A study by DRI concluded that a three-year tariff (declining from 20% to 7%) would cut both the federal budget deficit and the trade deficit by \$135 billion while increasing inflation only slightly. Another study at the University of Pennsylvania reached similar conclusions.

Another argument for protection of certain basic industries, such as shipping and steel, has been made on national security grounds. As Rudolf Oswald, chief economist of the AFL-CIO has said, "Clearly trade has always been restricted for national security reasons. And it would seem that national security would include certain industries that may be necessary for long-term stability of a country."

**Policies to Reduce the Trade Deficit--**Optimally, foreign countries would undertake policies that open their markets to U.S. goods and that increase their national output (and lower their unemployment) so that demand for U.S.-made goods to these countries would grow. In addition, the U.S. would lower its budget deficit by cutting military spending and/or raise taxes. However, these courses of action do not appear politically feasible any time soon. This means that other short-term policies to reduce the value of the dollar and to stem imports must be undertaken.

The recent five nation agreement to intervene in international currency markets to gently bring down the value of the dollar was a major step in the right direction. However, this intervention by itself is not sufficient to meet the short-term crisis. For this reason, broad support exists among Congressional Democrats for the Bentsen-Rostenkowski-Gephardt Bill that would impose a 25% customs surcharge on imports from any country whose exports to the U.S. exceeds its imports from the U.S. by 65%. A country would be exempt from the surcharge in any year in which it reduces its trade surplus by 10 percentage points. This measure would potentially affect our trade with Japan, South Korea, Taiwan, and Brazil.

The U.S. must be careful about the impact of any protectionist measures. Erecting trade barriers against developing countries can result in enormous hardships for those countries. Without access to rich U.S. markets, developing countries will have a difficult time raising the foreign exchange they need to buy industrial goods abroad. In addition, many South American countries must use the dollars received from their exports to the U.S. to repay their loans from U.S. banks. Closing our markets to them can force them to default on the loans.

Other hopeful measures are being implemented. The Administration will extend \$300 million as credit to industries that compete against foreign industries subsidized by their home governments. A new negotiating round of the General Agreement on Tariffs and Trade (GATT) is being convened. New regional and bilateral pacts are its goal. These approaches are more promising than the dozens of industry-specific proposals for quotas or tariffs that are now pending in Congress. The more broad-based approach will hopefully help reduce the trade barriers of other countries.

If not abated, the trade crisis will result in a long-term decline in our industrial base and a permanent loss in industrial jobs as a result of Reagan's large budget deficits. Economically, such destruction of our industry makes no sense and must be stopped. Since government fiscal policy is the cause of the problem, other government policies must now be used to offset the damage.

-- *Clair Brown*

This article does not necessarily represent the opinion of the Center for Labor Research and Education, the Institute of Industrial Relations, or the University of California. The author is solely responsible for its contents. Labor organizations and their press associates are encouraged to reproduce any LCR articles for further distribution.