JOINT ECONOMIC COMMITTEE

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INTERNATIONAL TRADE AND AMERICAN JOBS

The United States has seen excellent news on job creation in recent months. In the past two months, over 500,000 new jobs have been created. While the economy and labor markets continue to improve, many Americans are still worried about finding a job. Some observers believe that job growth has lagged because American jobs are being sent overseas, while others have suggested that Americans would benefit if companies were restricted from employing foreign workers abroad. There are also those who contend that American companies are jeopardizing U.S. economic health by doing business abroad. What is the real story about how trade impacts our economy and labor markets? Do open markets ultimately benefit the U.S. economy?

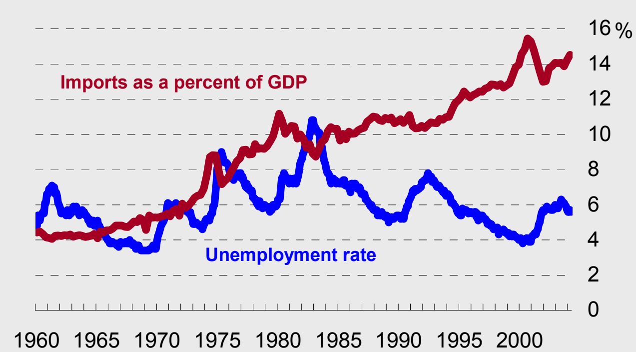
Highlights

- Over the past 20 years the unemployment rate has fallen significantly despite a steady increase in imports.
- Foreign companies employ thousands of U.S. workers in every state.
- While some U.S. companies hire foreign workers overseas, the United States still dominates the world in exporting services.
- U.S. multi-national corporations have consistently employed the vast majority of their employees within the U.S.

Free Trade and American Employment

A fundamental tenet of America's prosperity since World War II has been a willingness to support free trade and open markets. In turn, America has steadily lowered its own trade barriers in both Republican and Democratic administrations. The success of this policy is readily apparent: Figure 1 shows that over the past 20 years the unemployment rate has fallen significantly, even as imports have steadily increased. The economic reality is that America can create jobs even as it opens its markets to the world.

Trade Does Not Have a Negative Impact on Employment 1



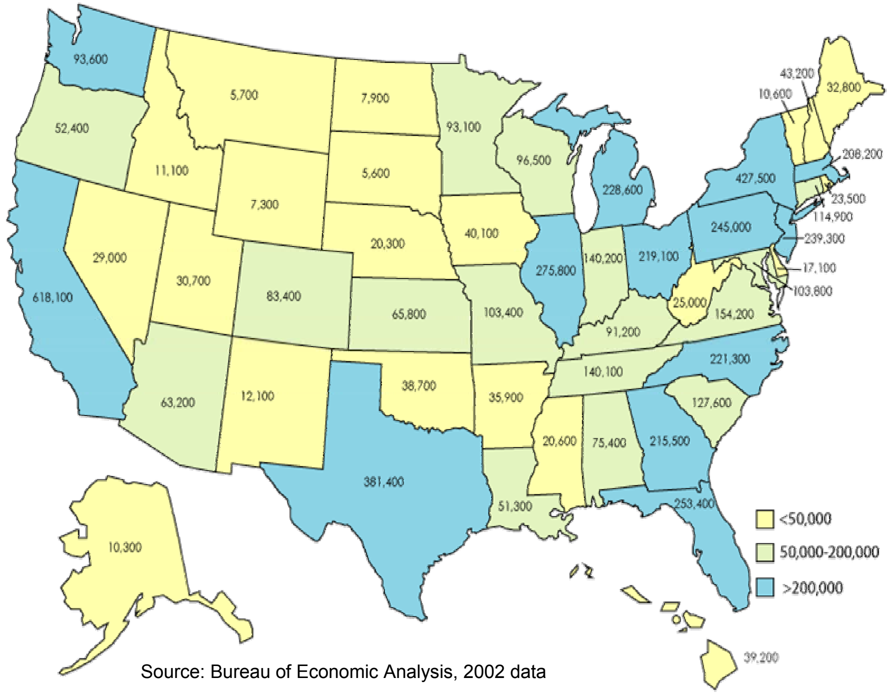
Source: Bureau of Economic Analysis; Bureau of Labor Statistics

In particular, the loss of jobs during the most recent recession and subsequent tepid job growth of 2001-2003 was driven by a slow-growing economy facing considerable uncertainty. For example, instability in the Middle East, the threat of terrorism, and high energy prices created an environment where firms were reluctant to add new employees. Now with a growing economy, firms are finding the need to expand payrolls to meet rising demand and, as a result, job growth in recent months has increased.

Isolation Hurts Everyone

Foreign Companies Create Significant Employment in Every State 2

Number of employees



Source: Bureau of Economic Analysis, 2002 data

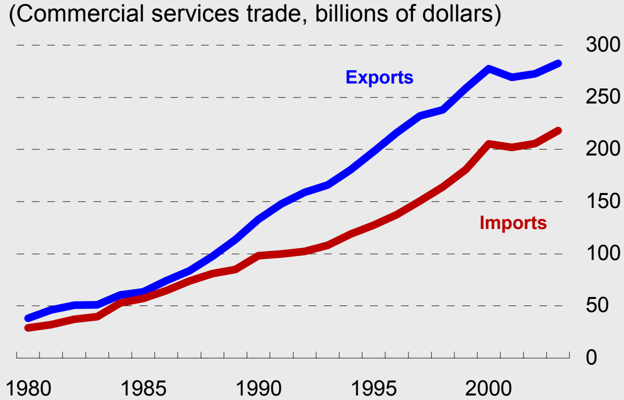
Economists are nearly unanimous in the deleterious effects of economic isolationism. Restricting trade in goods and services has *never* been effective in creating jobs in either the short or long run. The United States has gained much from its openness to trade over the years. For example, Figure 2 shows the number of American workers employed by foreign-owned companies in every state. Foreign firms have invested heavily in the U.S. and created significant numbers of jobs across the country. This is in large part because of America's flexible labor market, skilled workforce, and access to other markets. Economic isolationism runs the risk of jeopardizing these jobs and any future ones that will come to America's shores. By restricting trade in services and telling businesses where they can and cannot employ their people, an American job may be saved in one area, only to lose others in its stead.

America Competes Internationally

The United States economy today is overwhelmingly a service economy, an economy that relies less on the bricks and mortar of factories and more on our intellectual capital and highly educated workforce. America's economy has not always been structured this way. In the early 1900s, the bulk of America's economy was in agriculture, with 60% of gross domestic product (GDP) coming from the farm and only 22% engaged in services. The war years marked a major shift in the composition of the economy, as 28.5% of the workforce in 1947 was drawn into manufacturing and agriculture declined to 8.3%. But as America became the engine of global progress during the Cold War and beyond, our workforce shifted yet again and by 2002, approximately 80% of the economy was engaged in service industries (such as information technology, healthcare, software publishing, legal, and financial services) and a mere 1.2% was involved in agriculture.

The U.S. has a Trade Surplus in Services 3

(Commercial services trade, billions of dollars)



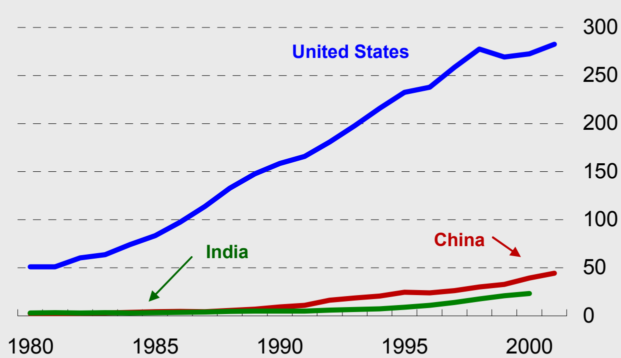
Source: World Trade Organization

Today, U.S. firms have a competitive edge in services and have excelled in selling these services internationally. While the increasing globalization of the past 20 years has seen some U.S. firms import services from firms abroad, Figure 3 shows that the United States has an impressive trade surplus in services. To put it simply, other countries are buying far more software, consulting, and other services from the

United States than the United States is buying from the rest of the world. Furthermore, Figure 4 shows that the gap between the service exports of American businesses and those of India and China (often thought to be our rivals for services) are immense, with the U.S. exporting nearly $300 billion worth of services in 2002 versus a *combined* total for India and China of $62 billion. These figures refute the claim that America's competitiveness is threatened by increased openness to foreign competition. The U.S. has steadily remained a net exporter of services because of its open business climate and skilled workers. Any attempt to decrease the flexibility of businesses to buy and sell services could potentially hinder U.S. activities in the area of greatest strength. Such action will inevitably cost Americans jobs and harm our competitiveness.

The U.S. Leads in the Export of Services 4

(Commercial services exports, billions of dollars)



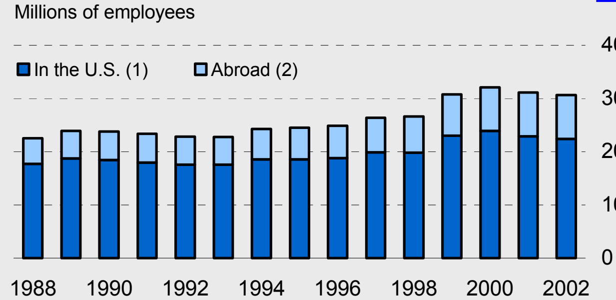
Source: World Trade Organization

Exporting Companies Create Jobs at Home

What impact do U.S. multi-national companies have on American employment? These businesses have been criticized for sending jobs abroad, and are accused of weakening the American economy. However, most companies conduct business abroad to retain the ability to compete in foreign markets and sell more U.S. goods and services, thus expanding business overall. Figure 5 shows that the ratio of American-based to foreign-based jobs has remained fairly steady over the past 15 years, meaning that as overall jobs have increased, there is more employment in the United States in addition to more employment abroad. Figure 5 also shows that the vast majority of jobs for U.S. multi-nationals, in both manufacturing and services, are based here in America. As jobs are added at U.S. companies abroad, the number of staff needed to support those jobs tends to increase, as companies must take on more home-based positions as well. A 1996 Coopers and Lybrand "Trendsetter" study confirmed this, noting that companies that planned to expand abroad grew at a "composite rate of 31.2%, while those with no plans to do business abroad expected a 24.9% growth rate."[1] The bottom line is that there are more jobs for everyone.

Multinational Firms Employ More Workers in the U.S. 5

Millions of employees



(1) Employees of U.S. parents (an American firm that owns 10% or more of a foreign business)
(2) Employment by majority-owned foreign affiliates of U.S. companies (a foreign firm that is at least 50 percent-owned by a U.S. firm).
Source: Bureau of Economic Analysis

The Benefits of the Dynamic Economy

Scottish economist and philosopher Adam Smith pointed out in 1776 that the benefits of trade, whether in goods or services, are spread throughout an entire society as goods and services become cheaper and workers specialize. Indeed, a recent study noted that over the period 1950-1998, countries that opened to trade saw their GDP grow an average of 1.5% *more* each year compared to before they liberalized.[2] Attempting to boost job growth by restricting foreign trade is a short-run panacea at best that inevitably unravels, harming

[1] Quoted in Drew Desilver, "High-tech Fields Lead Export Ranks: Industrial Sector Still Leads, but Exporting Mix Shifts Sharply," *Minneapolis-St. Paul Business Journal*, Mar. 31, 1997
[2] Wacziarg, Romain and Karen Horn Welch, "Trade Liberalization and Growth: New Evidence," National Bureau of Economic Research Working Paper No. 10152, December 2003.

our competitiveness, standard of living, and job growth.

The move toward free trade is not painless, however, and there are necessarily some job losses that occur as an economy reorients itself to a more efficient way of operating. For example, consider the telegraph worker. With the invention of the telephone, a new technological marvel soon swept the economy and revolutionized business and communications. Americans were better off, but the person at the telegraph office faced the elimination of not only their job but their entire industry.

While outlawing the use of phones might have preserved telegraph jobs, it would have prevented great economic progress and technological advances. Moreover, it would not have been a good use of society's resources to protect that one job, as research has often shown that the cost of saving jobs in a specific industry is often much greater than the benefits reaped from their protection. To illustrate this point, a recent study from the Federal Reserve Bank of Dallas estimated that across 20 of the most protected industries in the United States it costs consumers an average of $231,289 to save *one* job annually, ranging from $132,870 per job saved in the costume jewelry business to a whopping $1,376,435 for each of the 216 jobs saved in the benzenoid chemical industry.[3]

Conclusions

The strength of the U.S. economy lies in its ability to reinvent itself over time. The U.S. economy has gone from an agricultural economy to an industrial economy and is now the pre-eminent service economy in the Information Age. Recognizing that the benefits of innovation may still involve adjustment for a smaller segment of society, history shows that the best path toward creating jobs lies in improving the business climate and the skills of workers. Governments do not create jobs so much as they create the environment necessary for firms and entrepreneurs to create jobs.

Retreating into economic isolationism is not the way to create this environment. America has led a steady march towards free trade over the past 40 years, and our unemployment rate has moved independent of our openness to trade. Indeed, foreign investment has created new jobs in every state, and creating unnecessary barriers for firms attempting to expand their business does little to help American workers in the long run. American firms are also benefiting from the global marketplace, dominating the services market and remaining a net supplier of services to the world by a large margin. To sustain this demand for U.S. services, companies must hire staff at home to support overseas operations, meaning more good-paying jobs for Americans. Any movement to close off our borders to services trade will thus ultimately reduce employment, raise prices, and harm the competitiveness of American businesses.

[3] The Fruits of Free Trade: Annual Report 2002, Federal Reserve Bank of Dallas (Dallas, TX: 2002).