The gremlins of free trade

By Michael Stumo and Brian O'Shaughnessy
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THE ECONOMIC foundation of the United States is being eroded by a $2 billion per day trade deficit. We simply buy more than we sell. America was the world's biggest creditor, but is now the world's biggest debtor. Decent jobs are disappearing, and not being replaced.

The "free trader" versus "protectionist" debate is simplistic and misleading. International trade is good and a natural progression of commerce. But no household, company or country can sustain buying more than it sells for long, without consequences.

The problem is primarily caused by governments. The "comparative advantage" assertions from out-of-date economic theorists are irrelevant.

America has lost 3 million manufacturing jobs since 2000. Because we export far less than we import, new trade-related jobs have been insufficient in quantity and quality.

The losses extend beyond manufacturing to agriculture and the service industries. Alan Blinder, former Federal Reserve vice chairman, told the Wall Street Journal that "40 million American jobs [are] at risk of being shipped out of the country in the next decade or two."

Companies like Revere Copper Products are fighting this problem. We were founded in 1801 by Paul Revere and believe we are the oldest manufacturing company in the United States. Our modern copper rolling mill produces copper and brass sheet, strip, and coil. Since 2000, about 30 percent of the manufacturing facilities that were customers of Revere's mill have shut down or moved offshore.

America, long known as the breadbasket of the world, became a net importer of food products in 2005. American farmers have become more productive, innovative, and efficient than elsewhere. But food imports now exceed food exports.

Two problems created by governments are major causes.

The first is currency rate manipulation in Asia. Let's say the production cost of a brass doorknob in China is 100 yuan. The exchange rate for converting yuan to dollars is controlled by the government of China at eight yuan to the dollar, so the production cost in this example is $12.50. But if the exchange rate floated free, it would be five yuan per dollar, and the Chinese production cost would rise to $20.

US companies and farmers can compete when the currency rate floats free, but not when it is rigged.

The second core problem is hidden foreign tariffs called value-added taxes, or VATs. Most US import tariffs have dropped tremendously in the last 40 years, but virtually all our trading partners have replaced their tariffs with VATs, reflecting taxes they place on their own goods, on our exports to them.

A VAT tax system taxes goods - including imports - as value is added. When the World Trade Organization was established, VAT tariffs were exempted to placate France, which lowered its tariffs but raised its VAT tariffs on imports.

Today, more than 140 of our trading partners have implemented VAT systems. The average is 18 percent. The United States is the only major trading nation without a VAT, and cannot legally impose its income tax on imported goods. The playing field is not level. The overall trade impact is astounding.

For example, when the United States ships a $20,000 car to Germany, a 19 percent VAT is imposed at the border, or about $3,800. The delivered price rises to $23,800. The effect is the same as a tariff, which is why we call these VAT tariffs.

The House of Representatives just approved the Peru Free Trade Agreement. Peru has a 19 percent VAT. The United States will drop its already low tariffs further, and Peru will drop tariffs on a slower schedule. But Peru will always be able to impose a 19 percent VAT on US goods that it imports.

We do not complain of companies building plants offshore or importing foreign products if the playing field is level. But much offshoring and outsourcing is driven by the advantage of having a plant on the opposite side of these government-created barriers and then exporting the products to the United States. This is neither free trade nor Adam Smith's comparative advantage.

Congress can correct the currency manipulation problem easily by prescribing countervailing or antidumping duties to merely neutralize but not punish the practice.

Bills are pending in Congress that include sensible and effective remedies that are legal under the WTO and deserving of support from the Massachusetts delegation. If the WTO fails to support eliminating currency manipulation, then stepping outside the WTO may be a rational consideration.

Correcting the VAT tariff problem is more difficult. Because the VAT tariffs are legal under the WTO, America cannot neutralize them without risking trade sanctions. America should consider lowering taxes on jobs, replacing them with a US version of a VAT.

Approving new trade agreements makes little sense without correcting the currency manipulation and VAT problems. Our forefathers handed us a good country. We should not squander it.

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