

## A progressive trade policy

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### Introduction

Donald Trump's trade wars have forced many of us to re-examine what we hope to see in trade policy. At least in rhetoric, he has made the trade deficit front and center on his trade agenda. Many of us have argued that the trade deficit has been a major factor in the loss of relatively high-paying manufacturing jobs. For this reason, there are some grounds for being sympathetic to Trump's approach. However, in other areas, like his promotion of intellectual property rights and his demands on rules for the digital economy, he is diametrically opposed to progressive goals in trade policy.

This essay examines these issues in some detail. It makes three main points:

- 1) The benefits from reducing the trade deficit, while still substantial, are not nearly as large as the damage caused by running large deficits in prior decades.
- 2) There is no reason that progressives should want stronger protections for intellectual property in trade deals. It is not "our" property at stake, but rather the property of large US corporations. We should be thinking about class, not country.
- 3) Rules on a digital economy need serious attention. We all have come to recognize the risks that social media outlets like Facebook and Twitter can present to democratic debate. Countries should not be deprived of the means to protect themselves from false stories being spread over these networks.

While Trump's trade agenda is not one that most progressives will choose to embrace, he has helped to open up the debate on these issues and increase the likelihood that trade may be set on a more progressive path than the one followed over the last four decades.

### Does the trade deficit matter?

Many economists argue that the trade deficit should not concern us, that it is simply the result of the national savings and national investment balance. This is overly simplistic as a macroeconomic point and it ignores the compositional effect of a trade deficit.

As a macroeconomic point, the argument about national savings and investment balances is almost painfully silly. There is a national income accounting identity whereby the trade deficit (or more correctly, the current account deficit) must be equal to the gap between national savings and national investment. However, this identity says nothing about the direction of causation.

If we believe that the economy is always at or near full employment, then the savings/investment balance is fixed and trying to reduce the trade deficit in one area simply leads to an increase through another channel. For example, a tariff in this story would simply

lead to a rise in the value of the dollar, with the increase in the trade deficit from a higher valued dollar offsetting any reduction in the trade deficit from the tariff. The result is that the tariff simply ends up distorting trade, but does not affect the overall balance.

This story does not follow at all if we acknowledge that the economy is often far from full employment. In that case, a reduction in the trade deficit can increase output and employment, by creating more demand in the economy. With higher levels of output and employment, we will have more of both private savings (profits and savings from wage income) and public sector savings due to higher tax revenue. This means that the gap between domestic investment and domestic savings will be reduced by a rise in savings as a result of the lower trade deficit. The national income accounting balance still holds, but the trade deficit is now lower.

This is all basic logic that is taught in introductory economics classes, but we often see public debates that ignore it. The point is fundamental to any discussion of the trade deficit. As long as we do not think the economy is near full employment, the trade deficit can be affected by policy, apart from directly changing the domestic savings/investment balance.

Historically, the trade deficit has posed a problem not only because it was a drain on demand, but also because it affected the composition of employment. Since the overwhelming majority of trade is in manufactured goods, a larger trade deficit meant a loss of jobs in manufacturing. Manufacturing had historically been a source of relatively high-paying jobs for workers without college degrees. The loss of these jobs, therefore, reduced employment options for this large category of the workforce (still more than 60 percent of the workforce) and therefore put downward pressure on the wages of non-college educated workers more generally.<sup>1</sup>

This trade deficit induced loss of manufacturing jobs had a huge impact on the labor market in the last decade.<sup>2</sup> After remaining roughly constant for three decades, manufacturing employment fell by more than 3.4 million from 2000 to 2007 (20 percent of total employment), before the Great Recession pushed employment even lower. This job loss was associated with an expansion of the trade deficit from 1.5 percent of GDP in 1996 to a peak of just under 6.0 percent of GDP in 2005 and 2006. While the strong economic growth of the late 1990s was sufficient to offset the rise of the trade deficit at the end of the decade, once the recession hit in 2001, and growth slowed in subsequent years, manufacturing employment plummeted.

While this loss of manufacturing jobs was devastating to large sections of the industrial Midwest, it is not likely reversible. The relatively high-paying and union jobs that were lost are likely to be replaced by lower paying non-union jobs insofar as they come back as the trade deficit is reduced. We can see this through a variety of measures.

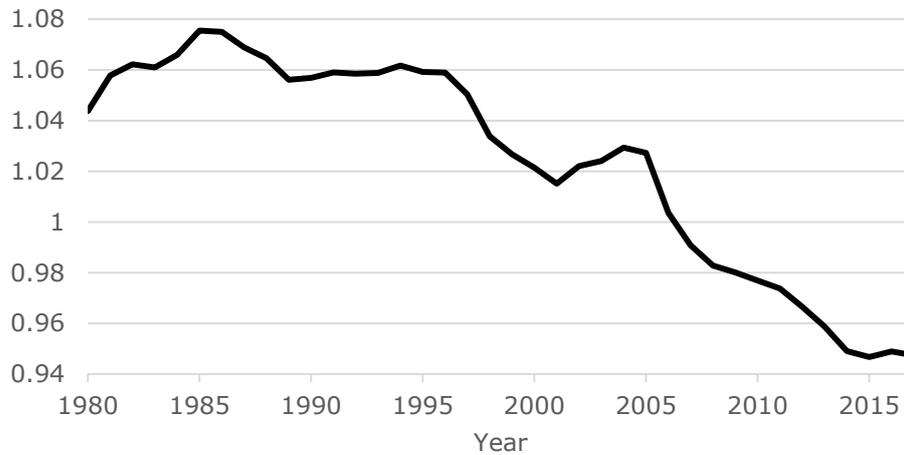
First, a simple comparison of the ratio of hourly wages for production and non-supervisory workers in manufacturing to the wages of private sector workers as a whole shows a persistent decline since 1996, as shown in Figure 1.

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<sup>1</sup> Bivens (2013) and Krugman (2008).

<sup>2</sup> Autor et al (2016).

**Figure 1** Ratio of average hourly earnings for workers in manufacturing to average hourly earnings in private sector overall, 1980–2017

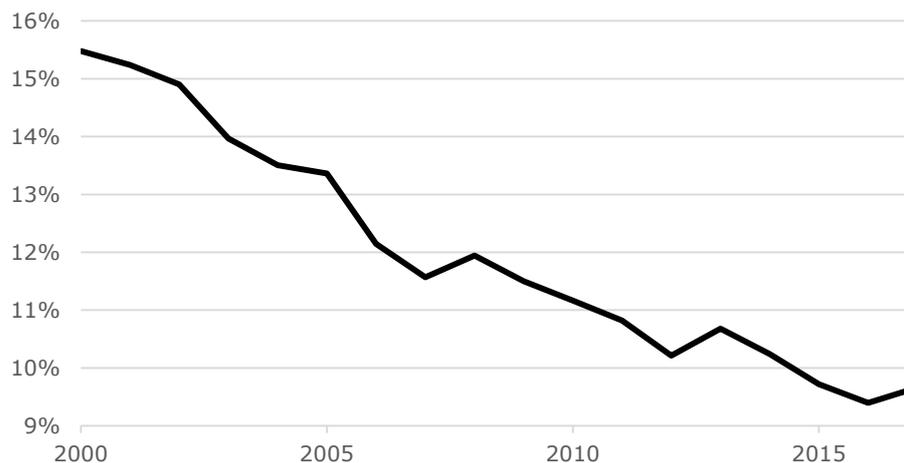


Source and notes: Bureau of Labor Statistics (2018b).

The ratio of hourly wages was 1.059 in 1996. It fell below 1.0 in 1997 and by 2017 it was down to 0.947. While manufacturing jobs more typically offer health care insurance and other benefits, meaning that the ratio of compensation rates would be somewhat higher, there is little doubt that the advantage for non-college educated workers from working in manufacturing has declined substantially over the last two decades.<sup>3</sup>

The decline in the premium for manufacturing employment also coincides with a decline in the unionization rate in the sector. This is shown for the years 2000 to 2017 in Figure 2.

**Figure 2** Unionization rate in manufacturing, 2000–2017



Source and notes: Bureau of Labor Statistics (2018b).

<sup>3</sup> An analysis that controls for gender, age, and education found that the premium for manufacturing employment for non-college educated workers fell from 13.1 in the 1980s to 7.8 percent in the period from 2010 to 2016 (see Mishel, 2018.) It is worth noting that the latter figure is an average for the seven-year period. Given the drop in the wage ratio throughout this period, the premium was almost certainly lower at the endpoint in 2016 than the average. It has likely continued to fall in the last two years.

In 2000, the unionization rate in manufacturing was 15.5 percent, two percentage points above the economy-wide average of 13.5 percent. By 2010, when manufacturing employment had bottomed out, the unionization rate had fallen to 11.2 percent. While there has been a modest increase in manufacturing employment since then, the number of union members in the sector has continued to fall. As a result, the unionization rate in manufacturing was down to 9.7 percent in 2017. This is actually below the economy-wide average of 10.7 percent, although still somewhat above the private sector average of 6.5 percent.

The implication of this pattern of wages and unionization rates is that we are unlikely to see a substantial growth in the number of relatively high-paying manufacturing jobs, even if we have a large reduction in the trade deficit. The jobs that would be created in manufacturing would likely be lower-paying on average than current jobs in manufacturing, and they would be less likely to be unionized.

For this reason, the compositional effect of a reduction in the trade deficit is not likely to provide a benefit to the labor market that is anywhere near as large as the harm caused by the rise in the trade deficit. Nonetheless, the benefit for less educated workers would not be altogether trivial.

If we envision that a successful policy on the trade deficit could reduce it by two percentage points of GDP, this would correspond to an increase in manufacturing output of 20 percent. If we assume that manufacturing employment rises proportionately, it would mean an increase in manufacturing employment of 2.6 million workers. In a workforce with almost 160 million workers, the addition of 2.6 million jobs offering somewhat higher pay than alternatives to non-college educated workers will not hugely change the position of these workers, but the effect will not be altogether trivial.

It is important to note that the wage benefit from increased manufacturing employment will be primarily for men. Employment in the sector continues to be overwhelmingly male, with women holding just 28.2 percent of the jobs in the sector, compared to 49.7 percent in the economy overall.<sup>4</sup>

The bottom line is that there would still be beneficial wage effects from compositional shift resulting from a lower trade deficit, but these are considerably smaller than they would have been in prior decades. The loss of millions of good-paying jobs, and the damage done to the communities that depended on them, is irreversible.

The other side of the trade deficit is the effect on overall demand. As noted earlier, this story remains poorly understood. A large trade deficit is a drain on aggregate demand, just as weak investment or weak consumption is a drain on aggregate demand.

For many decades, most economists denied that a sustained shortfall in demand could be a serious problem. While all but the most dogmatic real business cycle proponents acknowledged that the economy could face shortfalls of demand in a recession, the prevailing view was that these shortfalls would be relatively brief and could be readily offset by the Fed's monetary policy.

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<sup>4</sup> This only counts direct employment by the industry. The gender composition may be somewhat different for the 11.3 percent of manufacturing jobs that are filled through employment agencies. See Dey et al. (2017) and Bureau of Labor Statistics (2018a).

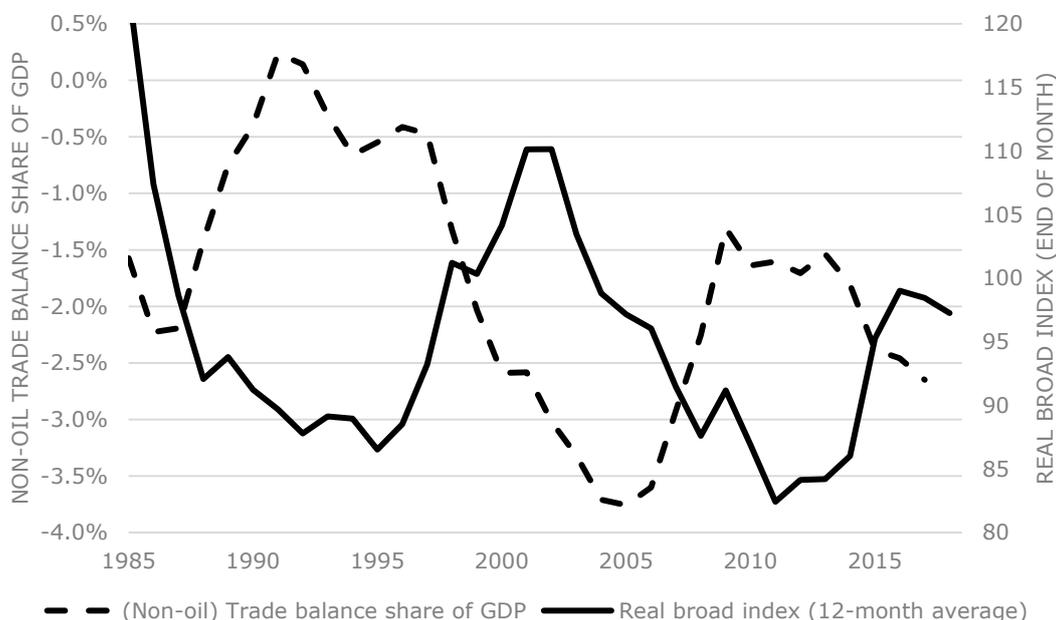
Since the Great Recession, the idea that “secular stagnation” a sustained shortfall in demand, could be a serious problem has been accepted by much of the mainstream of the profession. Nonetheless, the source of this shortfall is almost always seen as being in the weakness of consumption or investment demand, almost never in the trade deficit.

However, regardless of the preferences of economists, an increase in the trade deficit of two percentage points of GDP has the same impact on aggregate demand as a fall in consumption or investment of two percentage points of GDP. If we are concerned about the macroeconomic effects of the latter, then we must also be concerned about the macroeconomic effects of a large rise in the trade deficit.

While is true that a shortfall in demand from any source can be offset by increased government spending, there remain serious political concerns about running excessive budget deficits. In a context where the size of the budget deficit is limited for political reasons, we have to look to lower trade deficits as a potential route for sustaining levels of demand that are consistent with full employment. There is no magic to balanced trade, but a lower trade deficit will mean more demand in the economy. For this reason, we should be looking to policies that reduce the size of the trade deficit.

The simplest policy for reducing the trade deficit is reducing the value of the dollar. There is a strong relationship between the value of the dollar against other currencies and the non-oil trade deficit, as shown in Figure 3.

**Figure 3** Non-oil trade balance as share of GDP vs. real value of the US dollar, 1985–2018



Source: Bureau of Economic Analysis and Federal Reserve Board.

The trade deficit had been relatively small through the early and mid-1990s. It exploded in the late 1990s in response to the run-up in the dollar following the East Asian financial crisis. As a result of that crisis (or more accurately, the bailout from the crisis) developing countries, adopted a policy of deliberately keeping down the value of their currency in order to run large

trade surpluses. While China was the most important actor, other developing countries also bought up massive amounts of reserves in order to keep down the value of their currencies against the dollar.

It is worth mentioning that the trade surpluses of developing countries were not necessary to support their growth. The major success stories in the developing world actually grew more rapidly in the early and mid-1990s when they were running trade deficits than in the last two decades. The idea that rich countries, and the US in particular, had to run trade deficits to allow the poor in the developing world to escape poverty contradicts both standard trade theory (poor countries are supposed to import capital) and actual history.

Reducing the value of the dollar is really just the standard story of how persistent trade deficits are supposed to be corrected in a system of floating exchange rates. In fact, the dollar would certainly have fallen in value relative to the currencies of our trading partners in the last decade if they had not bought up massive amounts of currency to be held as foreign reserves.

Incredibly, in national politics facts have been turned on their head. Somehow it is now a “protectionist” position to want a market-determined exchange rate, while those claiming to be “free traders” are fine with a dollar that has been deliberately pushed up by the actions of foreign central banks.

Getting a lower-valued dollar should not be a herculean task in trade negotiations. There is a precedent for a negotiated reduction in the value of the dollar, the Plaza Accord that was negotiated in 1985 under President Reagan. This led to a sharp reduction in the value of the dollar over the next three years against the currencies of our major trading partners at the time. This had the desired effect on the trade deficit. It had been rising sharply and had crossed 3.0 percent of GDP by 1985. The reduction in the value of the dollar led to a reversal, with the trade deficit falling to roughly 1.0 percent of GDP at the start of 1990, before the impact of the recession.

While other countries, most importantly China, would likely demand some quid pro quo in exchange for agreeing to raise the value of their currency, it is difficult to imagine that they would altogether refuse to bargain on this issue. The real value of the yuan has already risen substantially against the dollar over the last fifteen years. A further rise would not derail China's economy.<sup>5</sup>

It is likely that the United States could have persuaded China and other countries to raise the value of their currency in the last decade before trade destroyed so many good-paying manufacturing jobs. However, this was not a priority for the Bush administration, nor for leading Democrats who touted the virtues of a high dollar.

US trade negotiators were more concerned about issues like market access for our financial industry, or the patents and copyrights of the pharmaceutical industry, the software industry, and the entertainment industry. It is also important to remember that political powerful companies like Walmart benefited from having access to low-cost imports. They were not

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<sup>5</sup> China has managed to deal effectively with a sharp reduction in its trade surplus in the past. It went from having a surplus of 9.1 percent of GDP in 2008 to 1.8 percent of GDP in 2011. Through this period, it managed to sustain a near double-digit growth rate.

anxious to have the price of imports increase. For these reasons, adjusting currency values has not been a priority for US trade negotiators in recent years.

### **Intellectual property: it isn't ours**

Much reporting on trade negotiations emphasize the importance of protecting "our" intellectual property from China and other countries who they claim do not sufficiently protect it. The argument, especially with respect to China, is not only do they not provide sufficient protections to the patents and copyrights of US corporations, but they require technology transfers as a matter of policy.

Specifically, a company like Boeing or GE will be required to have Chinese partners as a condition of setting up operations in China. The Chinese partner then gains access to the company's technology, which it then masters and becomes a competitor in future years.

The politicians and the media assert that the country as a whole has an interest in stopping this practice. We don't.

At the most basic level, why should we be upset that new companies are coming to the forefront in world markets and are able to deliver goods and services at lower prices than existing companies? This is what capitalism is supposed to be all about. Furthermore, if the deals requiring technology transfers were bad business for our companies, why do they do it? Boeing, GE, and the rest must have concluded that the benefits of doing business in China were so great that even if they had to transfer technology to a potential competitor they still end up better off than if they simply refused to set up operations there. There is no obvious reason that the US government should take this paternalistic position that it has to protect our largest corporations from their own short-sighted behavior.

This is very much a class story. If the United States can force China to accept terms that are better for our companies than the ones that they could negotiate individually, then they will end up with higher revenues and profits than would otherwise be the case. This is good for stockholders in these companies, but it means that everyone else will be paying higher prices and/or getting inferior products because our actions stunted the growth of an otherwise successful Chinese competitor.

There is an argument that these companies will hire more US workers as a result of a strong US position on technology transfer. This is possible, but the gains here are likely to be small. First of all, the reason they are going to China, to begin with, is that they are looking to get lower cost labor than is available in the United States. If the threat of technology transfer discourages companies from relocating operations to China in the first place, that means more jobs for US workers, not less.

Second, the location of the home country does not necessarily determine where the jobs will be. Millions of US workers are now working for foreign multinationals like Volkswagen, Toyota, Foxconn, and others. There is no reason to believe that, on net, we get more good-paying jobs in the United States if Boeing can locate in China without worrying about technology transfers than in a world where a Chinese competitor wins market share from Boeing and becomes a major supplier of planes in the United States and world market.

In the latter case, our planes are cheaper and/or better, which presumably means lower cost air travel. This both directly raises real wages and frees up more money to spend on other items. This is the classic argument for free trade. Why would “free traders” be opposed to it? The issue here is about protecting the profits of Boeing and other large companies; it is not about US jobs or fairness in trade deals.

The case that the US trade agenda is protectionist is even clearer with patent and copyright protections. These government-granted monopolies are equivalent to tariffs of many thousands of percent.

The impact is clearest and most pernicious in the case of prescription drugs. Patent-protected drugs often sell at prices that are several hundred times greater than their free market price.<sup>6</sup> In addition to the enormous economic distortions created by market barriers of this magnitude, this is also a question of peoples’ lives and health. In nearly all cases drugs are cheap to manufacture, which means that they would be readily affordable for all but the very poor, if they were sold as generics at their free market price. Government-granted patent monopolies make these drugs incredibly expensive, which means that people without large amounts of money or insurance cannot afford them.

When the US government requires our trading partners to have stronger and longer patents and related protections for drugs, it is working to increase the profits of Pfizer and other pharmaceutical companies. It is not defending the interest of US workers. The same applies to efforts to strengthen copyright protections for Microsoft or Disney. This is good news for major shareholders in these companies, not for the rest of us.

In fact, we should see the licensing fees and royalties that these companies collect from our trading partners as being in direct competition with other exports. The basic logic is that if China has to pay more money to Pfizer and Disney in licensing fees and royalties, this will lead to a higher valued dollar, other things equal. (The need for dollars to pay these fees increases the demand for dollars in world currency markets.) With a higher valued dollar, other US goods and services are less competitive. In effect, a larger trade surplus on intellectual property means a larger trade deficit on everything else. For this reason, most of us have no interest in forcing other countries to pay our companies more for their intellectual property claims.

There is another concern that is often raised that if China and other countries can freely use all the research that US companies performed, then we will effectively have been made suckers by paying for their research. This sort of complaint ignores the realities of the world economy. China’s economy is already more than 25 percent larger than the US economy.<sup>7</sup> It is on a path to be twice as large as the US economy in a decade. It also spends a considerably larger share of its GDP on research and development than the United States. This means that if there are no well-established rules on sharing the cost of research, China stands to lose much more than the United States. They will have much more technology to “steal” than we will.

For this reason, it is in China’s interest to develop international mechanisms for sharing of research costs. Hopefully, it will promote a more efficient model than the system of patent and

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<sup>6</sup> Collins (2016).

<sup>7</sup> International Monetary Fund (2018).

copyright monopolies. Science and technology will advance more quickly if research findings are openly shared and widely available. In this world, the costs for developing drugs, medical equipment, software, and other items would be paid up front, then all these items could be sold in a free market with no restrictions.<sup>8</sup>

Moving beyond intellectual property, progressives should look to subject the most highly paid professionals, specifically doctors and dentists, to international competition. Doctors in the United States earn more than \$250,000 a year on average, roughly twice as much as their counterparts in other wealthy countries. There is a similar story with dentists. If the barriers that protect these professionals were removed and their pay fell to the average for the wealthy countries, the savings would be on the order of \$100 billion a year or \$700 per family. This would also put downward pressure on the pay of the top end of the workforce more generally, the big winners in the economy over the last four decades.

For some reason, progressives never seem interested in using the market against the rich. This attitude is bizarre. The right is constantly developing new ways in which it can structure the market to put downward pressure on the wages and living standards of those at the middle and bottom in order to give more to the top. Progressives could and should respond by developing alternative ways to structure the market to reverse this upward distribution. Increased trade in highly paid professional services offers a great opportunity for reversing a big chunk of the income distributed upward. We should challenge the “free traders” to support the removal of the trade barriers that allow very high income for their friends and relatives.

### **Trade and the internet**

An important aspect of the latest set of trade deals, such as the Trans-Pacific Partnership and the United States, Mexico, and Canada Agreement (USMCA), is the rules being put in place for the Internet and e-commerce. These rules are largely being designed to further the dominance of US giants like Google, Facebook, and Amazon. They limit the ability of countries to regulate these giants and the Internet more generally. While the issues involved with the good regulation are complex and require way more technical knowledge than I possess, there are two types of problems that should concern progressives.

The first is a development issue. The US companies have clearly taken the lead in establishing a worldwide Internet presence. Developing countries should have the opportunity for fostering their own competitors. It will obviously be very difficult for start-up in Brazil or Mexico to compete with a giant like Google or Facebook. Trade deals should not preclude the option for these countries to provide assistance to start-ups in these areas with the hope they could be viable competitors at least in their home country.

The other issue is that we now know that these companies engage in a wide range of dubious practices, such as sharing personal information without permission and spreading false news stories with the intention of promoting ethnic hatreds or influencing elections. A provision of these trade deals prevents countries from requiring Internet companies from maintaining a physical presence. If an Internet-based company like Facebook has no physical presence in a country, then it is difficult to see through what mechanisms it could stop or penalize such harmful practices.

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<sup>8</sup> I discuss mechanisms for this sort of funding in Baker (2016).

Countries do have a right to prevent personal information on their citizens from being shared against their will and from having false news stories widely circulated among their population. If trade deals block countries from being able to protect themselves from the bad practices of the Internet giants, this is a very serious problem.

This means, at the least, that the Internet provisions should be subject to a full debate before any trade deal can be finalized. That is a strong argument for more openness in the drafting of trade deals. Furthermore, since no one has seemed to work out a good regulatory system for the Internet at this point, it might be best just to exclude rules on the Internet from trade deals for now, rather than risk locking ourselves and other countries into provisions that will prevent effective regulation.

### **The job-saving provisions in the new NAFTA**

The USMCA contains a number of provisions that are ostensibly designed to save jobs in the United States, primarily in the auto sector. Specifically, the deal raises the domestic content requirement in the auto industry to 75 percent from 62.5 percent. It also requires that at least 40 percent of the value-added in a car come from workers earning at least \$16 an hour.

These provisions are likely to have a very limited impact on employment in the auto industry in the United States. As far as the domestic content rules, many cars would already qualify under the 75 percent rules. Some are close to this cutoff, which may then encourage them to use a bit more parts and labor from the three parties to the agreement. With other cars, which are further from the 75 percent cutoff, companies will likely just choose to pay the 2.5 percent tariff to which they would be subjected as a non-complying vehicle. The net impact on employment in the US industry is likely to be small.

The \$16 cutoff is basically a limit on the Mexican labor content. This cutoff is so far above Mexican pay rates that it cannot be seen as an effort to boost pay in Mexico. (A \$10 or even \$12 cutoff may have had this effect.) Here too, the net effect on employment in the US industry is likely to be limited, but it is effectively restricting the extent to which Mexico can rely on increased employment in the auto sector as a path for growth. In this respect, it is a very cynical ploy towards a country that has not particularly benefitted from NAFTA in the first place. (The gap between the per capita income in the United States and Mexico has actually grown larger in the quarter century that NAFTA has been in effect.)

These sort of industry-specific deals are likely to prove hard to enforce and primarily result in large opportunities for gaming. They are not the way that we should be looking to go in future trade deals.

### **Conclusion: trade can be progressive**

Trade has been quite deliberately structured in the last four decades to redistribute income upward. While US policy has been promoted under the banner of “free trade” this is 180 degrees at odds with the reality. While US manufacturing workers were quite deliberately placed in direct competition with low-paid workers in the developing workers, the barriers that protected doctors and dentists and other highly paid professionals were left in place or even strengthened. At the same time, we put in place longer and stronger patent and copyright

protections to shift more income to drug companies and the entertainment and software industries.

There is no plausible story for reversing the opening to trade in manufactured goods over the last four decades, although we can and should look to have more balanced trade overall. The heart of a progressive trade policy rests on reversing the protections for highly paid professionals and also for patent and copyrights monopolies.

There is considerable validity to the argument for the benefits of free trade and it applies very much to these areas. Furthermore, the benefits from getting away from patent and copyright protections will be broadly shared. These monopolies are not protecting “our” intellectual property, but rather the property of the major corporations in these sectors.

In designing policy, we have to remember that the issue is class, not country. This makes it possible to design trade policy in which the vast majority of people in the countries affected will be winners.

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