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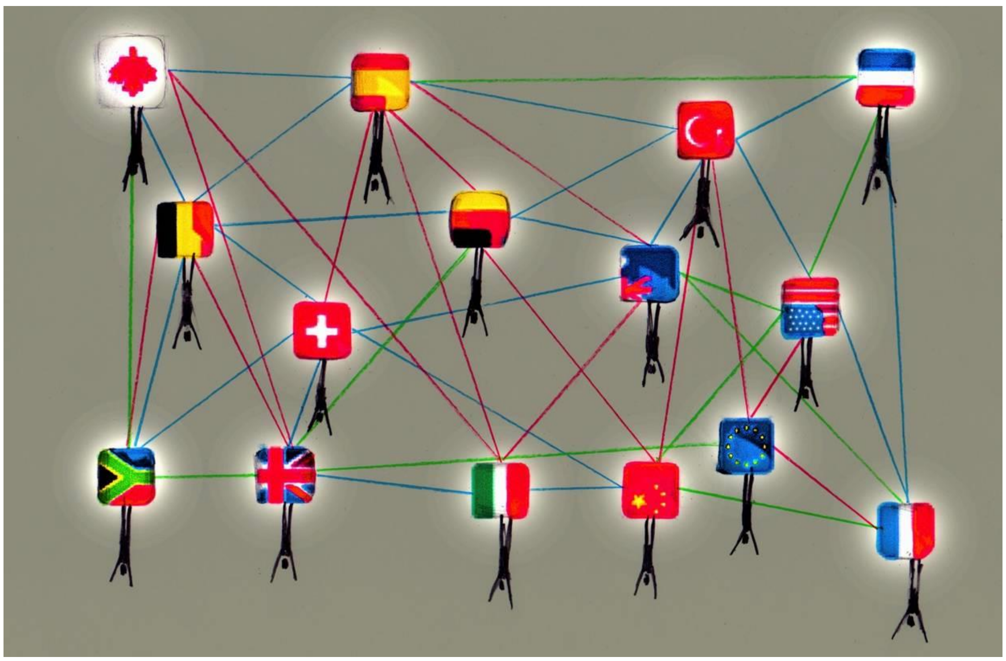
Understanding the Trump Trade Agenda

Returning to the 1950s is impossible. But currency Manipulation does hurt American workers.



If President-elect Trump is to establish a pro-growth trade policy, he must build upon America's postwar trade history. A lesson from that history is that if trade policy is to reinforce tax reform and regulatory relief in promoting economic growth, it must become more fair, not less free.

After World War II the consensus for free and open trade was strong. Scarred by the economic destruction wrought in the Great Depression by the 1930 Smoot-Hawley tariff and sobered by the challenges of rebuilding Europe and Japan and stopping the spread of communism, most Americans concluded that protectionism wasn't a viable national policy.

The U.S. had emerged from the war, to borrow FDR's phrase, as "the great arsenal of democracy." Its productive capacity was intact, and it was blessed with a modern capital base and a trained and highly motivated labor force. With much of the developed world in rubble, America was to enjoy a virtual monopoly in manufacturing for a quarter-century.

The 1950s and '60s are today viewed as the Golden Age of American manufacturing. In 1938 the United Kingdom exported more manufactured products than the U.S., while Germany, France, Italy and Japan combined exported more than twice as much as the U.S. But by 1953 U.S. manufacturing exports were nearly twice as large as the U.K.'s and a third more than those of Germany, France, Italy and Japan combined. In the 1950s real wages in manufacturing leapt 37%—22 times the growth rate of real manufacturing wages in the 1970s.

Incredibly, this anomalous period—the product of a global war that left Europe and Asia in ruins and 50 million people dead—has become the political benchmark for America's industrial performance. Its passing is now viewed as evidence that trade has hurt America.

By the mid-1970s, Europe and Japan had been rebuilt and Korea and Taiwan had become industrialized. A system of wealth creation based on trade and market-driven economies was beginning to crush the Soviet Union, transform China, win the Cold War and bring economic opportunity and greater prosperity to billions. By 1976 American manufacturing as a percentage of global exports had fallen back to its prewar levels.

Just as the postwar period ended, another transformation was afoot. In 1978 China came into the world market, followed by India, Brazil, Turkey and, after the collapse of the Soviet Union, Russia and Eastern Europe. The supply of labor available for the production of global exports spiraled upward between 1978 and 2000. The world's capital-labor ratio fell, increasing the relative returns to scarce capital while lowering the relative returns to abundant labor.

Once again, Americans were the greatest beneficiaries of these changes. The U.S. had accumulated approximately one-third of the world's physical capital and roughly the same share of the world's human capital—based on the level of postsecondary education. But it supplied only 4% of the world's labor. Some Americans lost, however, especially unskilled workers.

Even as U.S. production of manufactured goods continued to rise at an increasing rate, the demand for relatively unskilled labor was further depressed by computer-based automation. According to a study last year by Ball State University, between 1990 and 2000 automation had an effect on manufacturing jobs that was 6.6 times bigger than the effect of imports. Living standards in America have continued to rise—faster when U.S. economic policy fostered growth and slower when it didn't—but unskilled workers have fallen further behind.

<u>Postwar trade agreements have actually improved America's competitive position</u>, as U.S. trading partners have generally lowered tariffs more than we have. After China joined the World Trade Organization, Beijing cut the average tax it imposed on foreign-produced goods from 14.6% in 2000 to 3.2% in 2014. But the U.S. didn't change its taxes on Chinese goods. After the U.S. entered the North American Free Trade Agreement, Mexican taxes on U.S. imports fell from roughly 12.5% to zero and Canadian taxes on U.S. goods dropped

from roughly 4.2% to zero. In return, U.S. taxes on Mexican and Canadian imports fell from 2.7% to zero.

The largest source of unfairness in world trade today is currency manipulation, which distorts exchange rates and trade patterns, cheating consumers and producers. As President-elect Trump has repeatedly pointed out, by intervening in their currency markets, nations have been able to make the prices of their exports cheaper and the prices of imported goods more expensive.

Further, in virtually every trade agreement America has ever entered into, unfair trade provisions resulted from a series of special-interest deals—sugar being the most famous. Today, according to our analysis of Agriculture Department data, for every producer benefiting from the U.S. sugar tariff, 70,983 American consumers are cheated by sugar prices 50% higher than world prices.

If Mr. Trump convinced the WTO to ban nations from intervening in their currency markets except in emergency conditions, and if he renegotiated trade agreements to remove special interest deals, he would help American workers and raise world living standards as well.

While the real wages of unskilled workers have stagnated over the past 30 years, the premium earned by Americans with a four-year college degree has more than tripled, according to a recent study by the University of Chicago's Kevin Murphy and Robert Topel. As the return on human capital continues to rise, more effective policies are needed to help workers acquire skills. Mr. Trump's proposal to unleash the talent of students now trapped in failing public schools by empowering their parents with greater school choice will have a positive, significant and lasting effect on wages—bigger than any change in trade policy can bring.

Above all, pro-growth policies are critical, especially tax reform that encourages investment and regulatory relief that liberates productivity advances. From 1900 to 2000 employment in agriculture declined from 41% of the workforce to 1.9%, but because America employed pro-growth policies—except during the Great Depression—the number of jobs in the country rose almost fivefold and the average real income rose eightfold.

Eliminating currency manipulation and special-interest provisions in existing trade agreements will benefit American workers, raise world living standards and reinforce the impact of Mr. Trump's recovery program. Industrial policies that seek to reward or punish businesses based on where they invest will impede the recovery or doom it, as will protectionist policies that restrict trade. Wages are stagnant in America today not because we have too few taxes and restrictions on international trade, but because we have too many taxes and restrictions on domestic trade here at home.

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