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Trade Wars

What's Inside

The Fight Over the Global Economy's Future

A globalized economy was supposed to bring people together—or so went the dominant strain of thinking in the foreign policy world for most of the last few decades. In a few short years, the near consensus has collapsed. Gone are the prophecies of ever-accelerating integration and the paeans to trade and investment promoting prosperity and comity for all. Now, the discussion centers on just how much the world's two largest economies should "decouple," on pandemic-addled governments taking control of supply chains and vaccine doses, and on techno-democracies vying with techno-authoritarians to shape the digital commons. Far from tempering geopolitical competition, trade has offered another means of waging it.

Yet might today's pessimism miss as much as the Pollyannaish visions of the recent past did? Tracing patterns over two centuries, Harold James foresees a new wave of globalization, not in spite of today's fragmentation and discord but because of it: in a crisis, leaders tend to respond at first with nationalist posturing, only to accept before long that recovery demands more cooperation and connection, not less.

Gordon Hanson—building on his influential research documenting the magnitude of the so-called China shock to the U.S. economy—highlights the broken promises and acute harms of past trade agreements. Even a "worker-centric" policy, as the Biden administration has promised, will not be enough to get trade on a better track. A bolder approach is needed.

Adam Posen contends that blaming trade and openness for the United States' ills gets the problem exactly wrong: the culprit is a two-decade retreat from international economic engagement, which has increased inequality and hindered growth. Audrye Wong offers a similarly damning assessment of China's "economic statecraft," including headline-grabbing efforts such as the Belt and Road Initiative, which backfire as often as they succeed.

Finally, Matthew Slaughter and David McCormick observe that even as overall trade has plateaued, *flows of data* across borders have grown exponentially—yet spurred little in the way of international action to manage the momentous economic, political, and security implications. The United States, they argue, must take the lead in crafting new rules for a world in which data is power.

These diagnoses differ, and the prescriptions point in varying directions. But a common thread runs through them all, highlighting what old assumptions got wrong: ultimately, not immutable economic forces but policy choices— foolish or wise, myopic or farsighted—will determine where we go from here.

—Daniel Kurtz-Phelan, Editor

The Price of Nostalgia

America's Self-Defeating Economic Retreat

By Adam S. Posen

Anew consensus has emerged in American politics: that the United States has recklessly pursued international economic openness at the expense of workers and the result has been economic inequality, social pain, and political strife. Both Democrats and Republicans are now advocating "a trade policy for the middle class." In practice, this seems to mean tariffs and "Buy American" programs aimed at saving jobs from unfair foreign competition.

Any presidency that cares about the survival of American democracy, let alone social justice, must assess its economic policies in terms of overcoming populism. The protectionist instinct rests on a syllogism: the populist anger that elected President Donald Trump was largely the product of economic displacement, economic displacement is largely the product of a laissez-faire approach to global competition, and therefore the best way to capture the support of populist voters is to firmly stand up against unfettered global competition. This syllogism is embraced by many Democrats, who are determined to recapture an industrial working-class base, and many Republicans, who use it as evidence that the government has sold out American workers in the heartland. For politicians of any

stripe, playing to districts where deindustrialization has taken place seems to offer a sure path to election.

Every step of this syllogism, however, is wrong. Populist anger is the result not of economic anxiety but of perceived declines in relative status. The U.S. government has not been pursuing openness and integration over the last two decades. To the contrary, it has increasingly insulated the economy from foreign competition, while the rest of the world has continued to open up and integrate. Protecting manufacturing jobs benefits only a small percentage of the workforce, while imposing substantial costs on the rest. Nor will there be any political payoff from trying to do so: after all, even as the United States has stepped back from global commerce, anger and extremism have mounted.

In reality, the path to justice and political stability is also the path to prosperity. What the U.S. economy needs now is greater exposure to pressure from abroad, not protectionist barriers or attempts to rescue specific industries in specific places. Instead of demonizing the changes brought about by international competition, the U.S. government needs to enact domestic policies that credibly enable workers to believe in a future that is not tied to their local employment prospects. The safety net should be broader and apply to people regardless of whether they have a job and no matter where they live. Internationally, Washington should enter into agreements that increase competition in the United States and raise taxation, labor, and environmental standards. It is the self-deluding withdrawal from the international economy over the last 20 years that has failed American workers, not globalization itself.

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The trends tell a clear story about the United States over the past two decades: even as trade barriers have accumulated and immigration has more than halved, inequality and nativism have risen. Washington has given the angry, mostly white and male swing voters much of what they wanted on the international front, and they are still angry. Meanwhile, the lot of the United States' lower-wage service workers—predominantly female and disproportionately nonwhite—has worsened.

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The United States should <u>have a constructive international economic policy, rather than a defensive one that blames global forces</u> for its ills. Such a policy would start with the recognition that the United States has not been subjected to reckless economic opening by Washington elites and that the rest of the world is continuing to further integrate without it. Globalization goes on no matter what, and trade in particular is more resilient to U.S. withdrawal than many would like to believe. Where there are real comparative advantages in production, yielding large cost or quality differentials, purchasers will find a way to get the goods and services they want. No single economy's tariff regime can ever control a significant part of world trade, even when leveraging a large internal market; the rest of the world is always larger, and the opportunities missed are always found by someone else. As technology makes international commerce ever more transparent and efficient, the U.S. economy's unilateral efforts to defensively withdraw from it will become only more futile.

<u>Instead, the United States should actively seek to encourage the type of change in its own economy</u> that it once sought to make other countries undertake through trade deals.

Washington should agree to international standards defined by limited but strong and well-enforced rules, ones that focus on observable behaviors of companies and governments, not on numerical targets or institutional aspirations. Four areas of potential international agreement are particularly ripe for the United States to pursue.

The first is international corporate taxation. Corporations often evade taxes by shifting their profits to low-tax jurisdictions, a practice that erodes government capacity and the political legitimacy of market economies. *The digital economy* has made these distortions even greater, although large technology companies are far from the only firms to exploit the loopholes. On this front, progress may be imminent. Members of the Organization for Economic Cooperation and Development are currently in negotiations on ways to combat corporate tax evasion, and some European governments have threatened to levy taxes on digital goods and services produced by Big Tech. Collective international action should give the United States an opportunity not only to raise its tax policies up to the standards of other advanced economies but also to prevent its own companies from evading taxes.

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Finally, U.S. officials should practice what I have called "*principled plurilateralism*." In this strategy, groups of countries come together to strike agreements on high standards for international commerce, with membership in the groups determined solely by compliance with those standards. American politicians are unlikely to advocate that the United States join trade deals in the near future, but there is something the country can do in the meantime: encourage such an approach by major democratic allies, such as Australia, Canada, Japan, Singapore, and the United Kingdom. Even progress undertaken without

U.S. membership benefits the United States by making more visible its own deficiencies and pressuring it to up its own game.

GOODBYE TO ALL THAT

The United States needs to embrace economic change rather than nostalgia. Telling voters that the "good jobs" of manufacturing are the key to restoring their prosperity and that the country must be protected from global competition is not only misleading; it is also destructive. That path will cost jobs overall, further entrench the bias against lower-wage service workers, and do little to lure voters away from right-wing populism. You cannot buy off nativists and populists by reinforcing their nostalgic sense of status. Similarly, even well-meaning efforts to repair rural and exurban communities by tying people to their local jobs will in fact make them more vulnerable economically, which in turn will fan the flames of reactionary politics.

Can Trade Work for Workers?

The Right Way to Redress Harms and Redistribute Gains

By Gordon H. Hanson

Unsurprisingly, Americans have complicated views on trade. Although a majority of voters see free trade as a good thing, barely one-third believe that it creates jobs or lowers prices. In response, political elites and elected officials across the ideological spectrum have scrambled to distance themselves from free-trade policies and from the major pacts of the past. For its part, the Biden administration has made a noble-sounding but vague pledge to pursue a "worker-centric" trade policy. The specifics are still unclear, but such an approach will likely include more aggressive so-called Buy American provisions, which

require government agencies to give preference to U.S. products when making purchases; increased pressure on trading partners to respect workers' collective-bargaining rights; and a hawkish relationship with China. Despite the rhetoric, these proposals put the administration well within the bounds of existing U.S. trade policy—tweaking margins here and there.

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THE CHINA SHOCK

Part of what made the surge in Chinese exports so painful for American workers was that many of them lived and worked in industry towns. When manufacturing jobs in those towns disappeared in response to rising import competition, it wasn't just factory workers who suffered: everyone else did, too. Consider Martinsville, a small town in southern Virginia that is part of a manufacturing belt that stretches through North Carolina and into northern Georgia, Alabama, and Mississippi. In 1990, 41 percent of the working-age population in the three counties surrounding Martinsville worked in manufacturing, with half of those workers employed by just two industries: furniture and knitted outerwear. This made Martinsville what economists call an "industry cluster," a place that enjoys a productivity boost from workers and firms specializing in a narrow set of industries operating in close proximity to one another.

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China's rise, although disruptive for many workers, has nevertheless benefited the U.S. economy. The expansion of global value chains, which meant that different stages of manufacturing could happen in different places, allowed U.S.-based multinationals, such as

Apple and Qualcomm, to fully commercialize their intellectual property. The patents and product designs for the iPhone, for instance, were developed in California, at Apple's Cupertino headquarters—but they became valuable only because the Chinese manufacturing giant Foxconn could assemble huge numbers of handsets in Shenzhen. These innovations are economically valuable for U.S. workers and shareholders, as well as the millions of people lifted out of poverty in China. American consumers benefit from China's rise, too, through lower prices on the goods they purchase.

With these advantages in mind, Biden should *reengage with U.S. trading partners and make it a priority to rejoin the Trans-Pacific Partnership*—a wide-reaching trade agreement among a dozen countries. Doing so would deepen the economic relationship between the United States and the countries that will produce parts, components, and goods for the next generation of U.S. technology. It would also strengthen U.S. ties with countries that would like to see Beijing live up to its commitments as a member of the World Trade Organization, providing Biden with allies he will need if he wants China to improve its behavior.

***Despite the downsides, globalization has undoubtedly helped the U.S. economy*.**

More broadly, the Biden administration should focus on the consequences of job losses rather than their causes. The China trade shock hurt many U.S. workers and their communities. But so, too, have automation, the Great Recession, and the COVID-19 pandemic. And because the scarring effects of job losses are the same whether imports,

robots, or a virus is responsible, responses to the damage should not depend on the identity of the culprit. On its own, making U.S. policies on trade more worker-centric won't do the trick. All economic policy needs to be more worker-centric, in terms of being attuned to the destructive effects of concentrated layoffs and plant closures.

The administration should assume that in response to a large and localized employment decline, few workers without college degrees are likely to relocate—especially older ones who were born in the United States. It is a mistake to believe that because of the dynamism of the U.S. labor market, localized spikes in joblessness will sort themselves out; they don't, and they require immediate remedies. In its current form, however, the U.S. unemployment insurance program usually extends benefits only when the national economy is in a severe recession. Such an approach did little to help communities such as Martinsville weather greater foreign competition. A better system would consider the severity of regional shocks when setting the duration and generosity of benefits.

Abundant evidence suggests that such help reduces the fallout from sudden job losses without creating disincentives for displaced workers to find new jobs. But policymakers do need to be mindful of that risk if they expand similar programs. Doing so would be a matter of providing workers with assistance and incentives to return to work quickly. Also problematic is the way that TAA encourages people to stay out of the labor force to receive approved forms of job training. And such training may not even be the best prescription for many workers, who might be better off receiving money to help pay off bills or to

finance a move to a place with better employment prospects. The legislation that created TAA makes such aid possible, but it is rarely offered in practice. An improved system would give workers more flexibility in how they could use extra unemployment insurance.

For some, paying for retraining or occupational licensing may be the right choice. For others, covering moving costs or investing in a new business might be the better investment. Congress should give workers freedom of choice, rather than saddling them with the burden of a one-size-fits-all program.

Finally, when considering how to promote job creation in distressed regions, it is important to acknowledge that most of the U.S. jobs that were lost to import competition (or to automation) are not coming back. The China trade shock ended almost a decade ago. Today, China's economy is slowing, its comparative advantage in labor-intensive products is slipping, and its government is directing resources away from the private sector and toward state-owned and state-approved enterprises whose record of productivity growth is unimpressive. As China tries to pivot into high-tech sectors such as robotics and artificial intelligence, Bangladesh, Vietnam, and other countries in South and Southeast Asia are positioning themselves to capture market share in the sectors in which China used to dominate. For that reason, it would be a mistake to try to foster a manufacturing renaissance in places such as Martinsville; furniture and apparel companies may no longer find cheaper labor in China, but they will find it elsewhere. Encouraging optimism about the reshoring of jobs would only lead to more disappointment, and might further fuel the backlash against free trade and globalization.

Helping left-behind regions should be a core goal of Biden's administration.

The Biden administration should instead try to help communities such as Martinsville thrive. Doing so will require ingenuity and experimentation. Federal officials should give their local and state counterparts wide latitude to pursue policies that are right for the places they serve. Conventional approaches won't necessarily be the most effective. Take *tax incentives*, for example, which officials often use to entice businesses to move to their states or municipalities. The economist Timothy Bartik has found that although such measures expand output in targeted industries, they appear to do little to raise local living standards. And for each job they create, such incentives impose costs that are nearly ten times as high as those of some other options for creating employment, such as redeveloping defunct industrial sites known as brownfields.

So what actually works? Evidence shows that *active labor-market programs*, designed to help young and disadvantaged workers succeed in the labor market, are a good bet. Successful approaches provide people with assistance in their job searches, help the young build the soft skills required to find and hold a job, and deliver technical training tailored to promising local industries, such as health care or information technology. Other alternatives to tax incentives include attracting college-educated workers to distressed communities through student-debt forgiveness or the promise of an immigration visa, providing services to help local firms expand into new markets, and improving access to

capital for small and medium-size businesses—many of which are owned by members of minority groups and are poorly connected to existing sources of finance.

***Helping left-behind regions should be a core goal of Biden's administration*. But trying to undo three decades of structural change in the global economy isn't the right way to get there.**

Biden and his team need to be clear-eyed about what trade policy can and cannot do to help workers hurt by globalization. The damage has been done, and free trade isn't going anywhere. Protectionist measures and narrow attempts to placate labor unions will do little to help workers who are already hurting or to help others avoid a similar fate. Better to help the unemployed get back on their feet with generous and direct assistance and to create a far stronger safety net to protect future generations of American workers