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**National Economic Education Delegation**

**Trade and Labor Narrative**

Date: 10/1/18

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Slides:

1. Opening slide
2. Alternative Opening Slide

<brief summary and opening>

1. DO NOT DEELETE: National Economic Education Delegation
   1. Brief discussion of what NEED is and NEED does
      1. 243 delegates, one in each state
      2. 37 honorary board – 2 Nobel prize winners, 4 former chairs of council, and a former Chair of the Federal Reserve
   2. Use our judgement for what should be said
2. Who we are?
   1. 44 honorary board – 3 Nobel prize winners, 6 former chairs of council, and 2 former Chairs of the Federal Reserve.
   2. 364 delegates, one in each state.
   3. 42 Global Partners
3. Where are we?
4. DO NOT DEELETE: Credits and Disclaimer
5. International Trade Policy
6. Trade is Good! Globalization and Economic Growth are Closely and Positively Related
7. **Trade Contributes to Growth**

There are also other benefits from trade. Here are four important examples.

First, trade can reallocate resources from low productivity to high productivity firms (see Melitz, 2003). When trade generates better foreign market access or more foreign competition in the domestic market, high productivity firms will grow but low productivity firms will shrink. This reallocation of resources makes both countries more productive.

Second, trade can increase the variety of goods available to consumers. For this and the subsequent results, see Krugman (1979). For example, even though the US and Japan both make cars, they make different varieties of cars. This increases consumer well-being assuming that consumers value having more varieties to choose from.

Third, exposure to foreign competition reduces the price setting power of domestic firms when there’s not much competition in the domestic market. The resulting lower prices benefit consumers.

Fourth, for some industries, production costs can fall quite a lot as the industry produces more output. Economists call this phenomenon “economies of scale”. For industries with economies of scale, countries can save a lot of resources by specializing in different industries. This both lowers prices and increases the productive capacity of the economy.

1. **Why is the Public Turning Against Trade?**

If trade has all of these great attributes, why, exactly is it that so many people are upset about international trade?

Fundamentally, this has to do with the way that the benefits of trade are distributed and the way that the costs of trade are distributed.

With regard to the benefits, they get widely distributed and are not always notices. Much the same happens with the introduction of a new technology. An individual consumer might save $50/year, which is great, but doesn’t make a big impact, while the overall economy, some 300 million consumers might save $15 billion collectively. This $15 billion is a big deal to the economy, but is hard to highlight.

The costs of trade, however, tend to be highly concentrated and are, perhaps overly, visible. I say overly, because a lot of the job loss attributed to trade may be due to other factors. More on this in a minute.

1. **The Basic Issue: Inverted V of Jobs in Manufacturing**

<click through to get a graph with the trend lines in it – the first one (buried behind the 2nd one) does not have trend lines in it>

I mentioned earlier that some job losses are inappropriately attributed to international trade. For the United States, the trend in manufacturing employment has been for recent dramatic declines. In the post-WWII era, manufacturing employment first increased significantly and then, after peaking in 1979, began to fall, quite dramatically after 2000.

1. **International Trade is Surely a Contributor**

This decline is often attributed to trade, largely because international trade, both imports and exports, grew dramatically during this period. That growth truly began in earnest in 1970, well before manufacturing employment peaked, but close enough, apparently for popular wisdom to grab ahold of the relationship.

It's also a little tempting to attribute the resurgence of manufacturing employment in the wake of the great recession to declining trade flows. This graph suggests declining trade flows, but it is scaled by GDP. Trade is not declining, so much as it is rising much more slowly than is the overall economy.

1. **But There is No V in the Fraction of Jobs in Manufacturing**

For several reasons, this relationship is more spurious than it is causal. In particular, the share of manufacturing employment of all employment in the U.S. economy has been falling throughout this entire period. It had a heyday during WWII, but that’s only because of the plethora of tanks, jeeps, ships, and airplanes that were being produced.

Once manufacturing employment returned to its usual level in the economy, it started a reasonably steady decline as a share of overall employment in the United States.

If trade were truly the cause, it seem likely that it would have affected the trend in the share of employment in manufacturing in the United States. But it has not.

1. **And Manufacturing Output Keeps on Growing**

It is also the case that during this period of declining manufacturing employment, output in the manufacturing sector continued to increase. Granted, its composition was highly likely to have been impacted by trends in trade – imports displacing previously domestically produced goods, in the ways that we have discussed – but the level is not likely to have been impacted in the way that we have observed.

However, unless production is systematically being pushed towards industries that simply use less labor to produce output – which it surely was – the attribution of all of this job loss to trade is inappropriate. Some of it surely is a result of trade, but productivity differences between import competing sectors and exporting sectors are unlikely to be large enough to explain all of the decline.

1. **And Manufacturing Productivity is on the Rise**

<Note: it wouldn’t be unreasonable to drop the previous slide and make the points above and below using just this slide – there’s a little redundancy here>

Given that manufacturing productivity, or output per worker in the sector has increased significantly since 1980, it seems quite likely that technological change has played a significant role in causing employment losses in manufacturing. In particular, in the steel industry, technological change has been significant – see, mini-mills.

That employment in manufacturing has declined so consistently since the late 1940s is more likely attributable to labor saving technological change than to trade. Trade not doubt plays a role, but the main point here is that a lot of the job losses in manufacturing are possibly being blamed on trade when they should be blamed on technological change instead.

In no way is trade to be let off the hook, but it is not likely the major influence that conventional wisdom seems to think that it is.

1. Not That Trade Has Been Absolved of All Ills
2. **Costs of Trade**

***Earnings:***

Clearly, there are important distributional effects of international trade in goods and services. We, as a profession, have known for 80 years that there is a tension between trading more and the well-being of low-skill/low-wage workers in the United States.

There are relatively few low-skilled workers in the United States when compared to many of our trading partners. They are certainly a lower proportion of the labor force than they are in China. Accordingly, in the absence of trade, their wages will be higher in the U.S. than in China. Opening up trade exposes these workers to competition from low-skilled workers abroad, which lowers their earnings.

The exact opposite effect happens for more highly skilled workers. Trade will primarily serve to increase their earnings.

***Adjustment Costs:***

In addition to the effects on wages, there are adjustment costs. There is no question that growing trade will reduce employment in some industries (import-competing) and increase employment in other industries (exporting). There is thus a necessary transition from one industry to another for many workers. The costs of these transitions can be enormous and are generally greater for low-wage workers than for high-wage workers. People do not like to move and there is trauma in losing your job.

1. **Understanding Adjustment Costs**

There are costs borne by both firms and workers associated with these adjustments. For firms, they need to search for new workers, train new workers, adjust to new employees, and absorb the costs of releasing workers that are no longer needed.

For workers, the costs are perhaps more significant. There are certainly emotional, or psychic costs associated with job loss and moving. Friends, and familiarity of your surroundings are all surrendered. Very often workers will have skills that were useful only to the firm that they were hired at or in the industry in which they were working. These skills, if the worker is employed in an import competing industry, may well just have lost all of their value.

There is also the cost of a job search. Again, this is generally easier for high wage workers as their job markets are more likely to be nationwide, making information about available jobs relatively easy to come by. Harder for workers with lower skills. It is also very expensive to move across geographies. These costs again are more easily borne by high wage workers than low wage.

There are therefore great inequities associated with the transition. It is harder generally for lower skilled and lower wage workers than those with more labor market skills.

1. **Estimates of Adjustment Costs**

Estimates of the costs suggest that they are much higher in developed countries than in developing countries for firms. They also suggest that layoffs are more likely to happen all at once, with groups of workers being laid off rather than gradually.

For workers, there have been new estimate in the last 10 years. Let’s have a look.

1. **Estimated Costs to Workers of Changing Jobs**

In the U.S., it is estimated that worker adjustment costs are about 6 times annual earnings. This is a staggeringly large cost! It is also much less than is estimated for most of the developed world, or developing countries.

1. **Characteristics of Adjustment Costs**

Additional issues associated with trade adjustment include the fact that many industries are geographically concentrated. This means that not only will these regions be hit relatively hard from trade adjustment, but that there may not be good alternative employment in the region. Workers will have to leave and the local economy may well be unable to recover.

It is also true that not all workers displaced by trade fully “adjust”. It is sometimes true that the effect might be permanent: wages may never recover and the emotional toll can last for a very long time and have a permanent influence on the family.

These adjustment costs can be large and can significantly reduce the gains from trade. Estimates suggest that it is still very well worth opening borders and continuing to engage in trade, but the gains may not be as large as expected when these costs are included in the calculation.

1. **Why Adjustment Costs Matter**

Adjustment costs matter for a variety of reasons. In particular, they serve to erode the popular support for trade. As they are so visible, they can have a tendency to overwhelm the benefits of trade to the public.

It is also true that these adjustment costs suggest that there is a lot of policy work to be done to make labor markets more efficient. This would help not only to address the adjustment costs associated with trade, but also of job loss more generally.

1. **Common Myths About Trade**
2. **Myth 1: Trade Causes Unemployment**

It is an intuitive notion that import competition contributes to job loss and therefore to unemployment. Recent studies have validated this view. There is often a significant lag between displacement due to trade and finding a new job. However, the magnitude of this effect relative to other things driving unemployment is very small. Business cycles are much more likely to contribute and to drive long term trends in unemployment than is trade.

The trend in this graph is toward declining unemployment rates over time. Throughout the duration of this graph trade was rising, suggesting its small role in determining aggregate unemployment in the economy.

1. **Myth 2: Trade Deficits are Driven by Trade Agreements and Tariffs Can “Fix” Them**

A trade deficit occurs when the value of imports is greater than the value of exports – it is important to note that it is value and not volume. The numbers of each good that is imported or exported is not directly relevant except when combined with price to establish value.

Why exactly this happens is because we also trade financial instruments and assets in addition to goods and services. It turns out that when you consider this trade as well, the U.S. does not run any sort of a deficit. The trade deficit only looks at goods and services. In fact, there will be a surplus in trade in assets that exactly offsets the deficit in goods and services.

The U.S. routinely runs a deficit in international trade and a surplus in investments. Here, you can see that they mirror each other.

The reason they have to balance out is because of the exchange rate. The more investments foreigners make in the United States, resulting in a surplus in investment flows, the more dollars they have to buy in order to buy the investments. This raises the demand for the dollar, which raises its value.

When the value of the dollar rises, the dollar price of imports falls, so we import more. At the same time, the foreign currency price of U.S. exports rises, so foreign consumers buy less.

1. **The Budget Deficit-Trade Balance Link**
2. **U.S. Savings and the Trade Deficit**

Here we see the inverse relationship between the savings rate in the United States – among private households – and the trade deficit. At times when the savings rate is high, before 1980, as the savings rate dropped, the trade deficit increased.

Raising savings rates and reducing government borrowing is the surest way to reduce the trade deficit.

1. **General Agreement Among Economists**

The Institute on Global Markets at the University of Chicago regularly surveys a group of prominent economists on policy issues or important economic issues. There is general agreement amount these economists, but not consensus, about whether or not reducing the fiscal deficit would shrink the trade deficit.

Of those who have some confidence in their answers, more than half agree with the statement.

Important to note is that very few, only one, indicated that they disagree with the statement.

1. Policy Solutions
2. **Tariffs**

Despite their popular appeal and current use, it is generally believed by economists that tariffs and other forms of border protection are a costly way of reducing trade costs.

Tariffs do reduce imports of particular goods. They do this by raising prices, which causes purchasers of those goods – consumers and producers, alike – to buy fewer imports. The rising prices tend to change or distort what people buy and what firms produce. This introduces sometimes significant inefficiencies into the economy.

It is also true that imposing imports will not be well received by our trading partners. As such, retaliation, or imports in foreign countries could well be placed on our exports. This would reduce exports in the same way that our tariffs would reduce imports.

In the long term, as we have discussed, the exchange rate would adjust so that the tariffs would, in fact, have no effect on the trade deficit.

Basically, imposing tariffs have exactly the opposite effect of opening borders to trade. Trade results in big welfare gains that are dispersed throughout the economy, but also significant costs to a small part of the economy.

Similarly, tariffs bring gains to a small part of the economy while imposing costs on everybody else.

There are generally considered to be a bad way to alleviate the costs of trade.

1. **General Consensus of Economists on Tariffs**

When surveyed, prominent economists all agree that tariffs are not a good way to try and stimulate employment in specific industries – generally STRONGLY agree.

1. **Directed Support: Adjustment Costs**

The most efficient way to offset the adjustment costs would be directed support to those who have lost a job and are struggling to find a new one.

There is an existing Trade Adjustment Assistance program that is supposed to do just this. However, it has traditionally been badly underfunded and not all displaced by trade qualify. Turns out to be very difficult to discern just who has been displaced by trade.

Better would be a program that provides benefits universally to those suffering adjustment costs.

1. **Balanced Budgets**

As discussed earlier, it is quite likely that the best way to reduce the trade deficit, using government policy, would be to reduce the budget deficit and debt. The deficit in 2018 was $778 billion and the debt currently stands at more than $21 trillion.

Reducing the debt would also have the attractive features of reducing the share of the government budget, currently 8% that goes toward paying the interest on the debt.

It would also reduce our foreign debt exposure. China currently holds more than $1 trillion in U.S. Treasuries. There are some who worry that China could start to unload these securities, causing interest on Treasuries to rise, doing damage to the U.S. economy. There is some, but very little evidence that China has started to pursue this path in retaliation for U.S. tariffs.

1. **Conclusions**

To summarize the conversation about international trade so far, I have discussed the fact that trade and growth are positively related. International trade, through a variety of channels, efficiency and competition, in particular, can lead to economic growth.

One of the primary benefits of international trade is lower prices. This is good for consumers and for firms that purchase imports or import competing products as inputs to production.

Unfortunately, the gains are widespread and not generally acknowledged by those who feel them, while the losses from trade can be highly concentrated. It is this concentration of losses that has helped to turn public opinion away from international trade and toward protectionism.

We have also discussed how tariffs and other means of reducing imports is not the most effective way of mitigating the harm caused by trade. As the benefits of trade are generally believed to outweigh the costs, there is likely a better way. In particular, we can address the problem of labor dislocation more generally, aiding workers displaced by international trade at the same time.

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