

Trade, Inequality & the Election

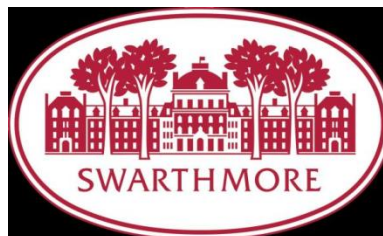
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Clair Wilcox Lecture

Swarthmore College, October 24, 2016



Who was Clair Wilcox?



- Taught at Swarthmore from 1927 to 1968.
- In 1930, gave President Hoover a petition urging veto of the Smoot-Hawley tariff, signed by 1,028 U.S. economists.
- Led the effort after WWII to establish the International Trade Organization.
 - General Agreement on Tariffs & Trade (GATT) signed in 1947;
 - Havana Charter in 1948 to establish the ITO.
- But ITO ratification was blocked by Senate isolationists.
 - Much as other noble US-led agreements have died in the Senate
 - League of Nations (1919).
 - SALT II (1979)
 - Law of the Sea (1982)
 - Kyoto Protocol on Climate Change (1997).
 - The GATT served in place of the ITO, until the WTO in 1994.

Overview on Trade & Inequality

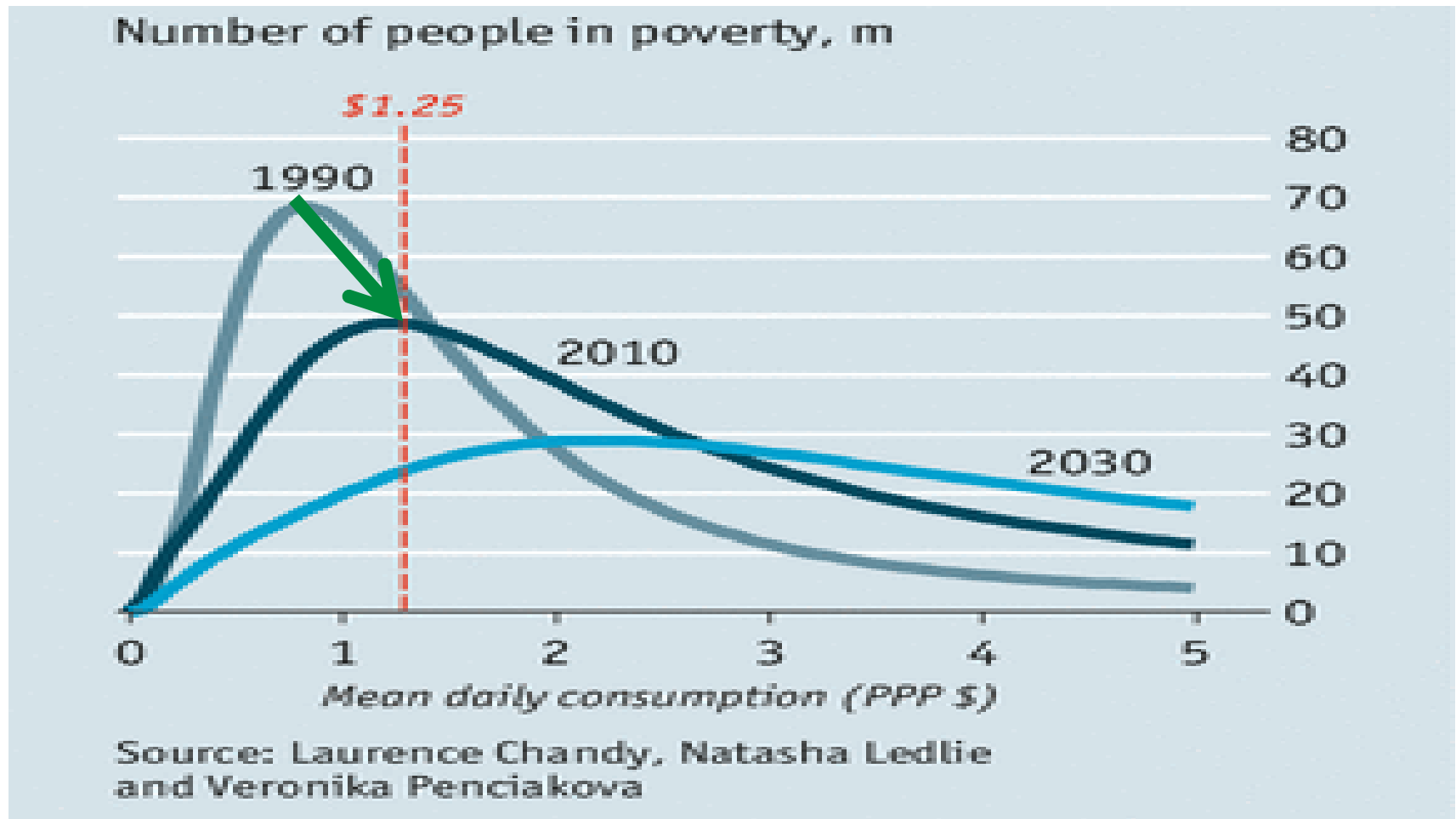
- Trade is good for economic growth, as measured by GDP.
- The doubts concern trade's effects on *other* things we care about in addition to income. Particularly inequality.
- The connection between trade and inequality has received intense interest in this strange presidential election year.
 - Why did Trump's success catch elites so much by surprise?
 - The story: “we hadn't adequately realized how deep was the hardship and anger of those left behind by globalization...”
 - Trade has led to inequality, and inequality has led to Trump. “
 - Analogous stories in Europe.
- I will talk
 - about trade,
 - then about inequality & its causes;
 - then a bit about the election.

Trade & GDP

- Widely agreed: trade is good *for economic growth*.
- In theory:
classical comparative advantage (Ricardo)
and modern theories of trade based on
imperfect competition (Krugman)
& endogenous productivity (Melitz).
- Empirically: many econometric studies.
 - E.g., one estimate: every .01 increase in a country's trade/GDP ratio raises income 3 ½ % (over next 20 years).
- Most Americans seem to agree:
 - Polls show surprisingly high support for trade.
- What about effects of trade on *other* objectives? Inequality? ->



We must note trade has helped *global* income distribution.



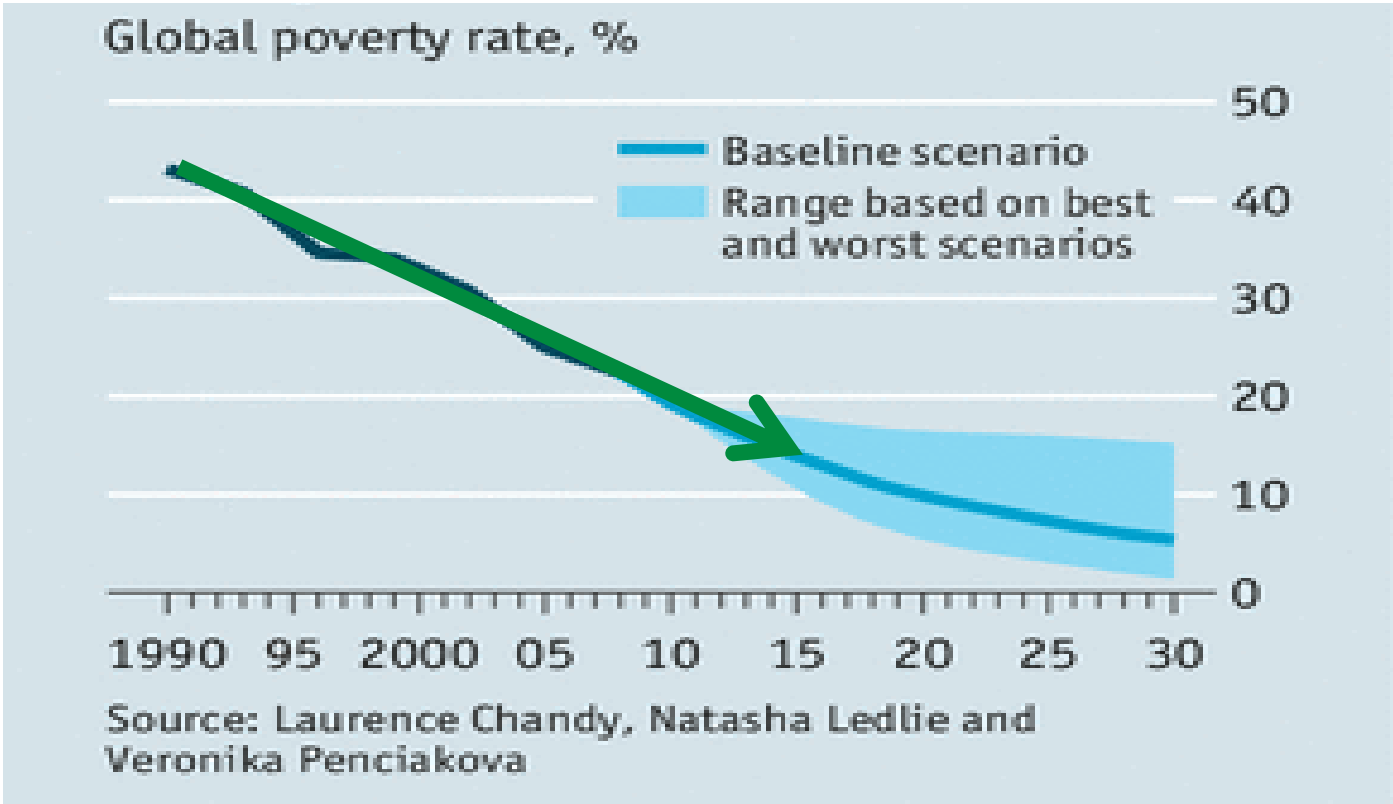
The Economist, June 2013, The world has an astonishing chance to take a billion people out of extreme poverty by 2030

[//www.economist.com/news/briefing/21578643-world-has-astonishing-chance-take-billion-people-out-extreme-poverty-2030-not](http://www.economist.com/news/briefing/21578643-world-has-astonishing-chance-take-billion-people-out-extreme-poverty-2030-not)

Global poverty has been cut more than 1/2 in the last 25 years

In 1990, **43%** of the population of developing countries lived in extreme poverty (then defined as \$1 a day) = **1.9 billion people**.

By 2010 it was down to 21% = 1.2 billion.



Inequality & anti-globalization.

Elections are domestic, of course.

Typical explanation for the surprise Trump nomination:

Globalization

⇒ US inequality.

⇒ Anger from those left behind

⇒ who then support radical changes.

“We should have seen it coming, but were out of touch.”

To summarize my take:

- Inequality has unquestionably risen, esp. in US.
- Trade & immigration probably play roles,
 - along with a long list of other factors.
- I don't see the inequality issue logically leading to Trump.
- There *are* some clear answers to the question: How can we address the wellbeing of workers who have been left behind?

Needless to say, trade creates both winners & losers.

- So does *every* change.
 - E.g., putting up tariffs would create both winners and losers.
- If we economists require Pareto superiority before recommending one policy over another, then we can never make any recommendations: someone always loses.
- Economists *can* make win-win policy recommendations if we express the distributional consideration in terms of a desired measure of overall inequality.
 - We can approve a policy that, while raising total income, also reduces the Gini coefficient,
 - lowers the poverty rate,
 - or raises median income.

Does trade worsen inequality?

- The Second Welfare Theorem of Economics suggests free trade increases the size of the pie by enough that the winners could compensate the losers, so that everyone comes out ahead, in theory.
- But, we need to consider, first:
are the losers from trade concentrated in the lower segments of the income distribution?
- A simple encapsulation includes three effects --
 - (+) Consumption: the opportunity to import at lower prices and with greater variety works to raise real income for all. My guess is that this helps lower-income families.
 - (-) Imports tend to hurt those in import-competing sectors.
 - (+) Those losses are offset by the gains for exporting sectors.
 - Export jobs pay an estimate 18% more.

What does trade theory say about income distribution?

- Ironically, the trade theory that dominated academic research during the 1950s-70s was Heckscher-Ohlin-Samuelson,
- which gives solidly respectable grounds for fearing trade would hurt American workers even in absolute terms.
- It divides the population into “Unskilled” workers vs. others (owners of capital or land, or skilled workers)
 - The Stolper-Samuelson theorem specifically predicts that workers in a capital-abundant country will lose from trade (wages fall), even though total real national income goes up.
- The H-O-S theory never did fit the facts very well empirically,
- and does not include the advances in trade theory since 1980.
- Still...

What about NAFTA? Didn't it devastate workers?

- No.
- Listening to claims that NAFTA hurt American workers, one would never guess that the half-decade after it went into effect
 - featured the most job creation in the last 40 years.
- In 1996-2000 GDP growth averaged 4.3%,
 - productivity growth = 2.5%
- Unemployment < 4% by end-2000.
- It's the one period since the 1970s when
 - lower-income workers shared fully in the gains:
 - real compensation/hour rose 2.2%,
 - median family income rose strongly:
 - from \$26,401 in 1993 to \$35,166 in 2000 [in real \$2002],
 - and the poverty rate declined steadily
 - from 33.1% in 1993 to 22.5% in 2000.
- Needless to say, lots of factors underlay those achievements.



Recent research on job loss in import-competing sectors

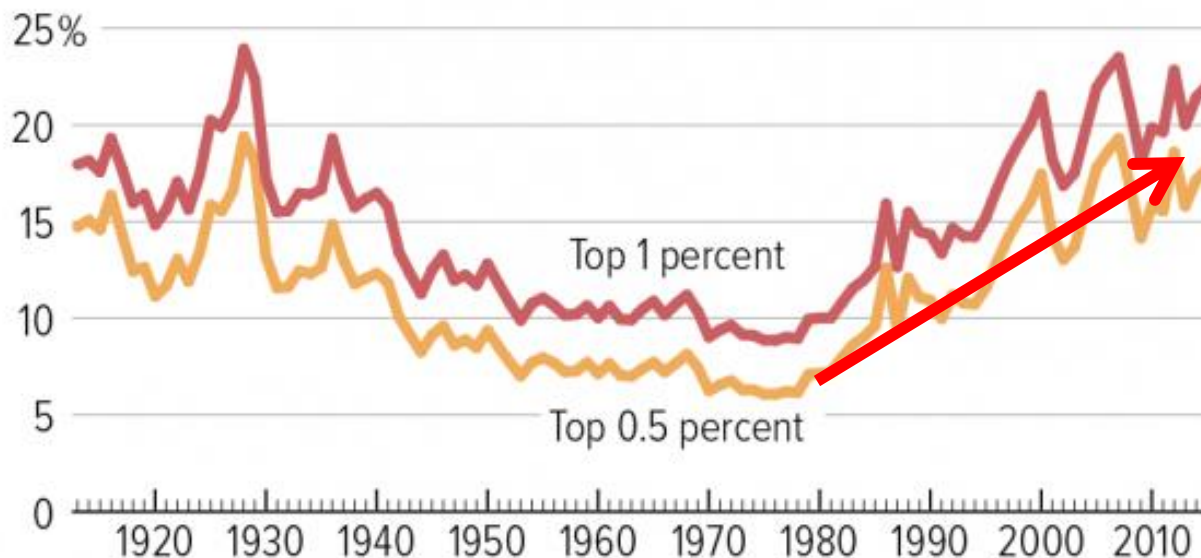
- David Autor, David Dorn & Gordon Hanson (2013, 2016) have found evidence that
 - a sizeable portion of lost US manufacturing jobs can indeed be associated with imports,
 - especially from China.
 - Employment & income in areas hit by such job losses can stay depressed for a much longer time than some had imagined.



The share of US income going to the top has indeed risen since 1980, and is now back to the 1920s.

Income Concentration at the Top Has Risen Sharply Since the 1970s

Share of total before-tax income flowing to the highest income households (including capital gains), 1913-2015



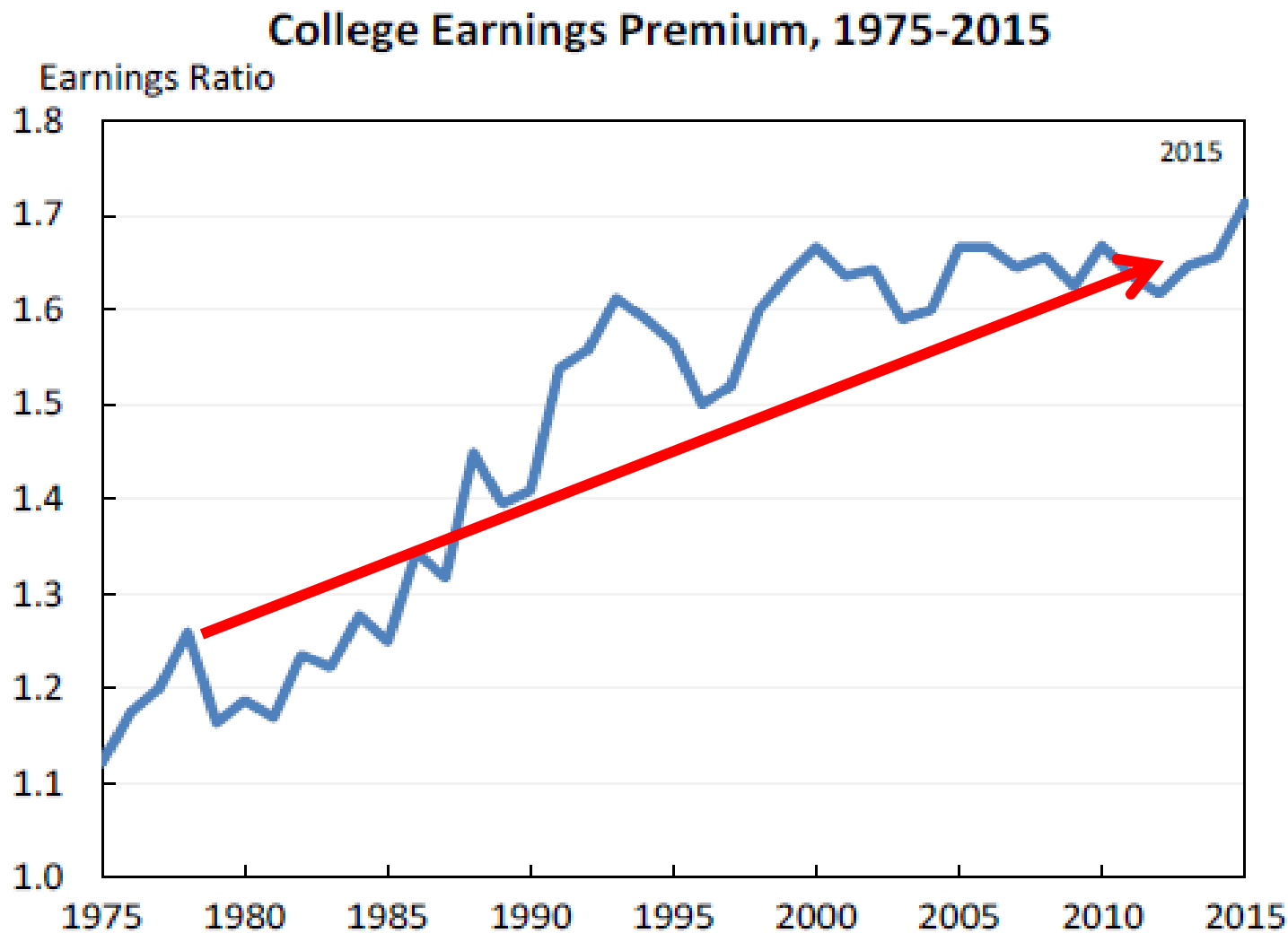
Source: Emmanuel Saez, based on IRS data

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Why has inequality risen in the US?

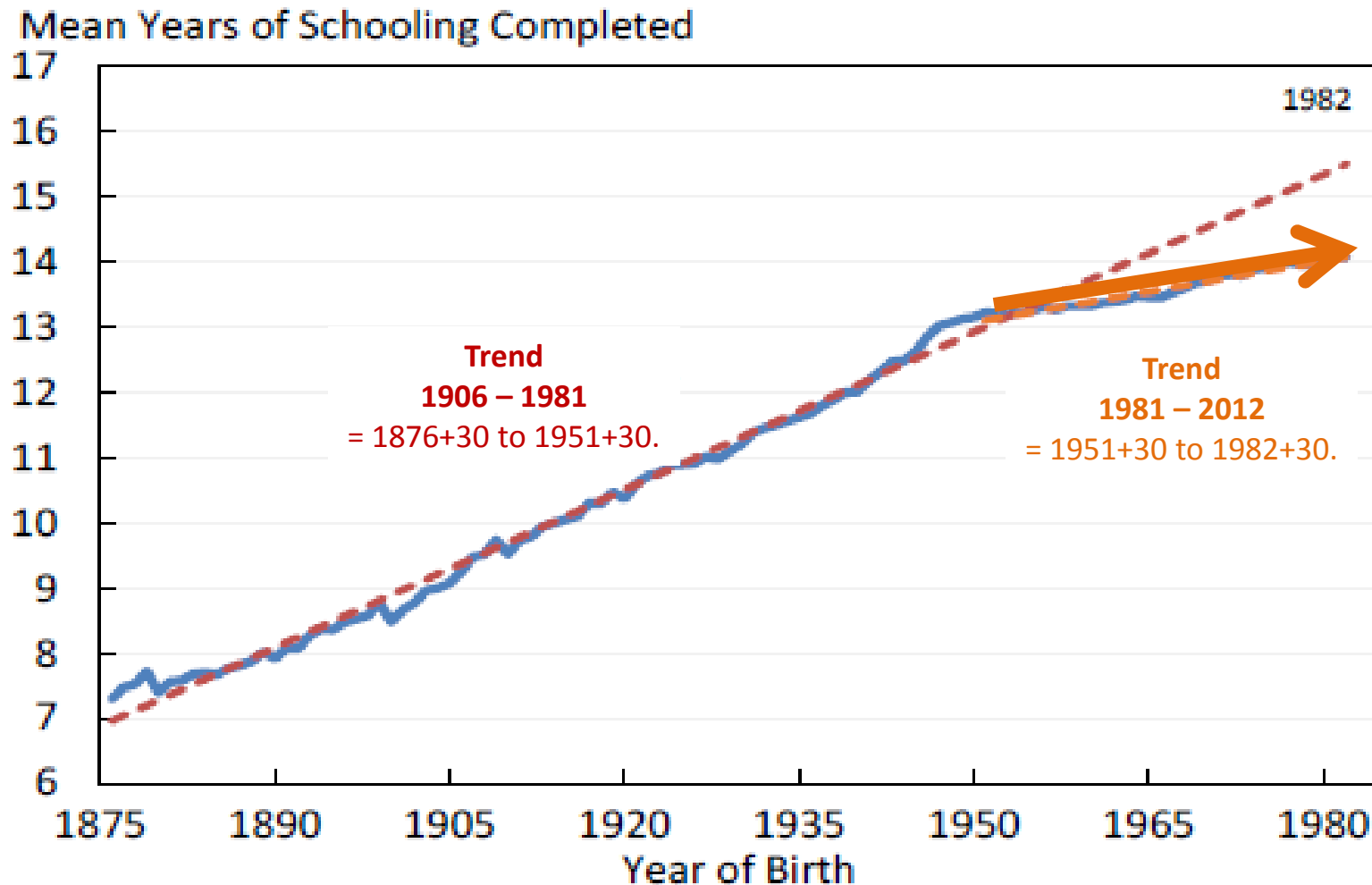
1. Trade probably does play a role, alongside other factors:
2. technological change raising demand for skilled workers,
3. outpacing education that raises the supply;
4. “winner-take-all” labor markets,
5. “assortative mating,”
6. reduced corporate competition & higher rents,
7. excessive executive compensation;
8. and Piketty’s wealth accumulation.

2. Widening gap between “skilled” & “unskilled” workers, defined by college graduation.



3. Trend in years of education slowed during 1981-2012.

Mean Years of Schooling at Age 30, U.S. Native-Born, by Year of Birth, 1876-1982



4. “Winner take all” labor markets



Taylor Swift earned \$170 million last year, making her the world’s highest paid celebrity (according to *Forbes*).

5. “Assortative mating”

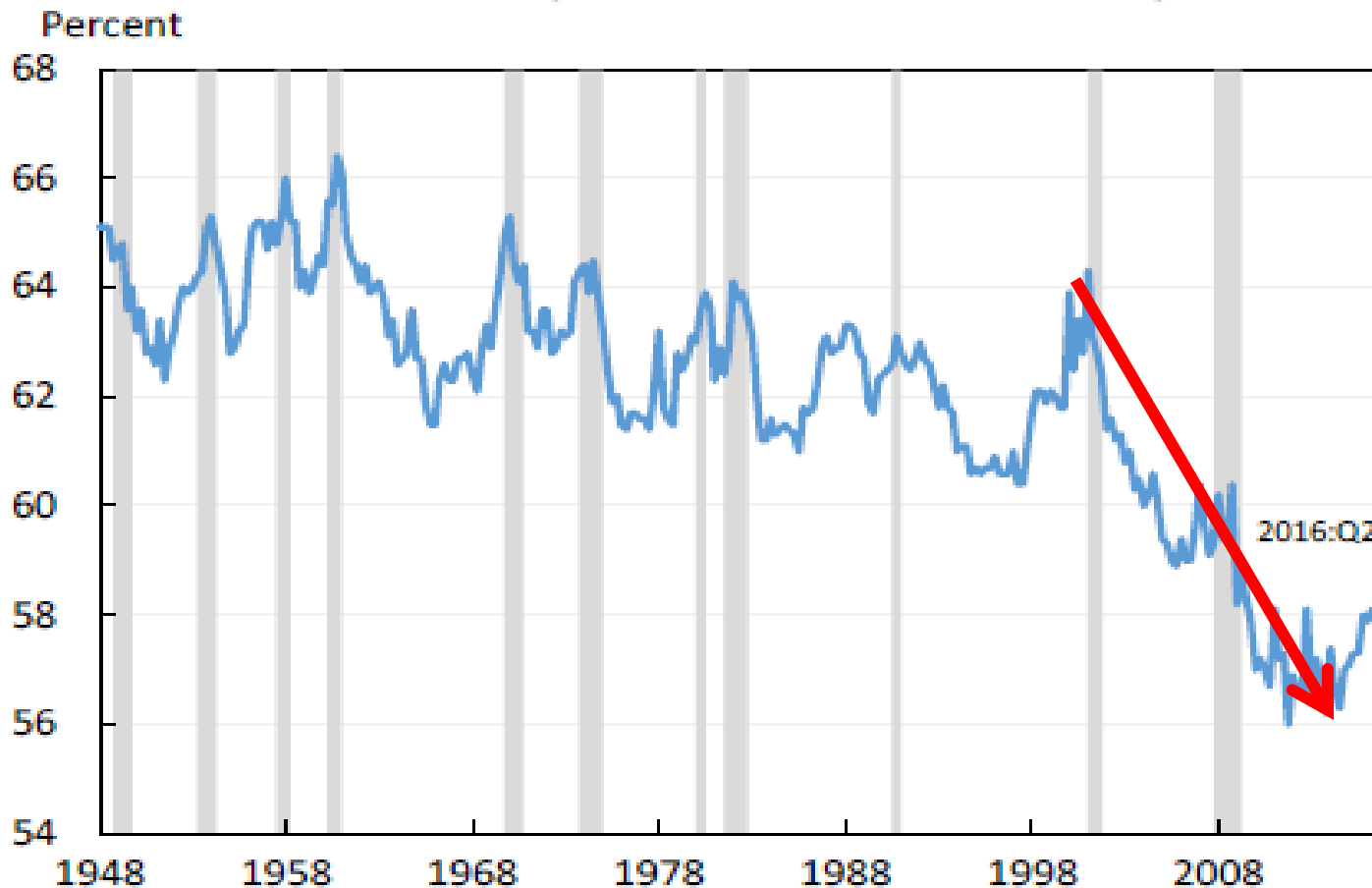
Crudely put: highly educated
& highly paid male professionals
used to marry their secretaries,



but now are more likely
to marry highly educated & (relatively) highly paid women;
and the couple passes the advantages on to their children.

6. The share of US national income going to labor has declined since 2000 in part due to increased market power of firms, says Furman.

Labor Share of Income, Nonfarm Business Sector, 1948-2016

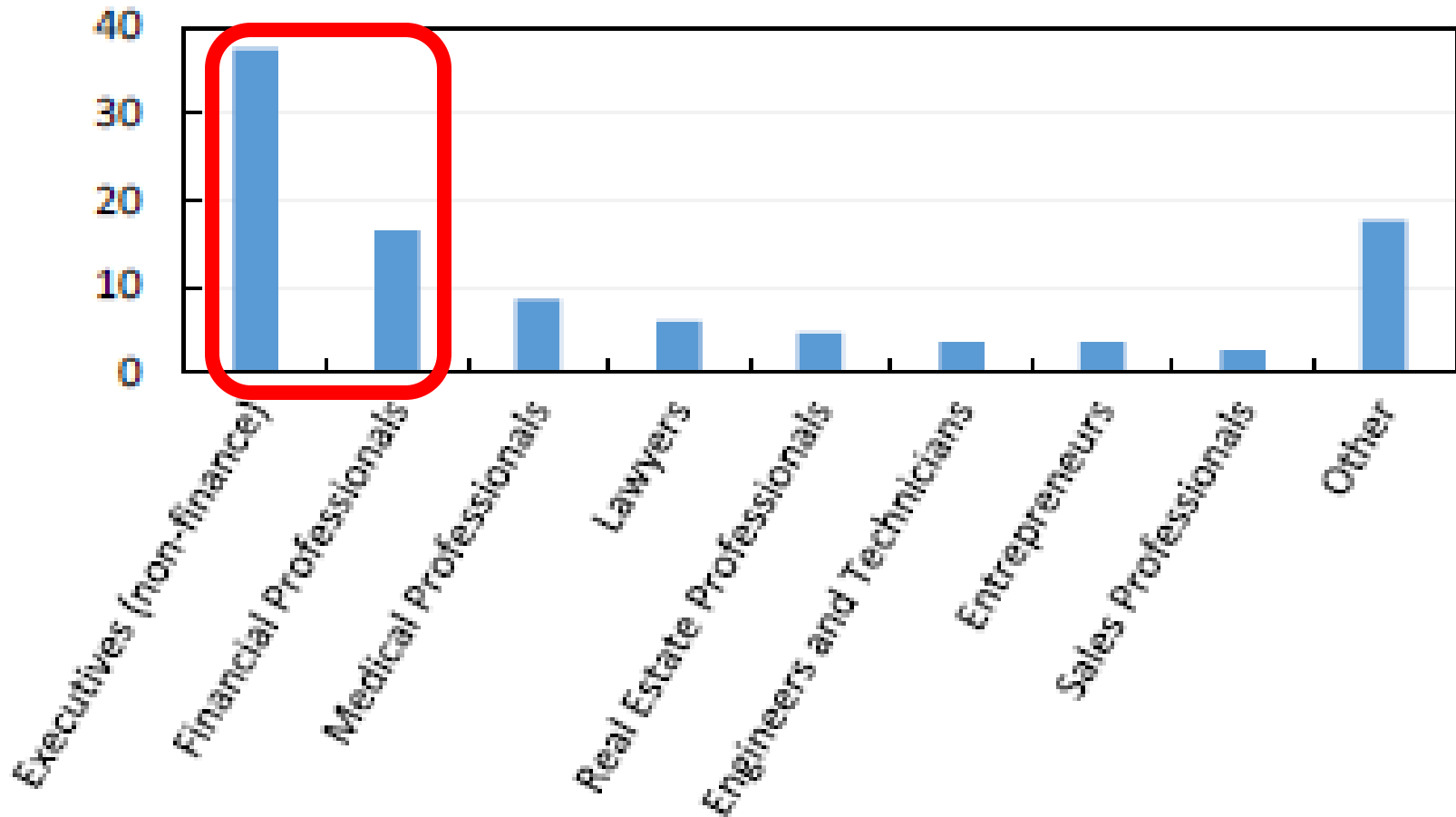


7. Excessive compensation?

Many top-1%-ers are executives and/or in finance.

Composition of Top 1 Percent Income Share by Primary Occupation

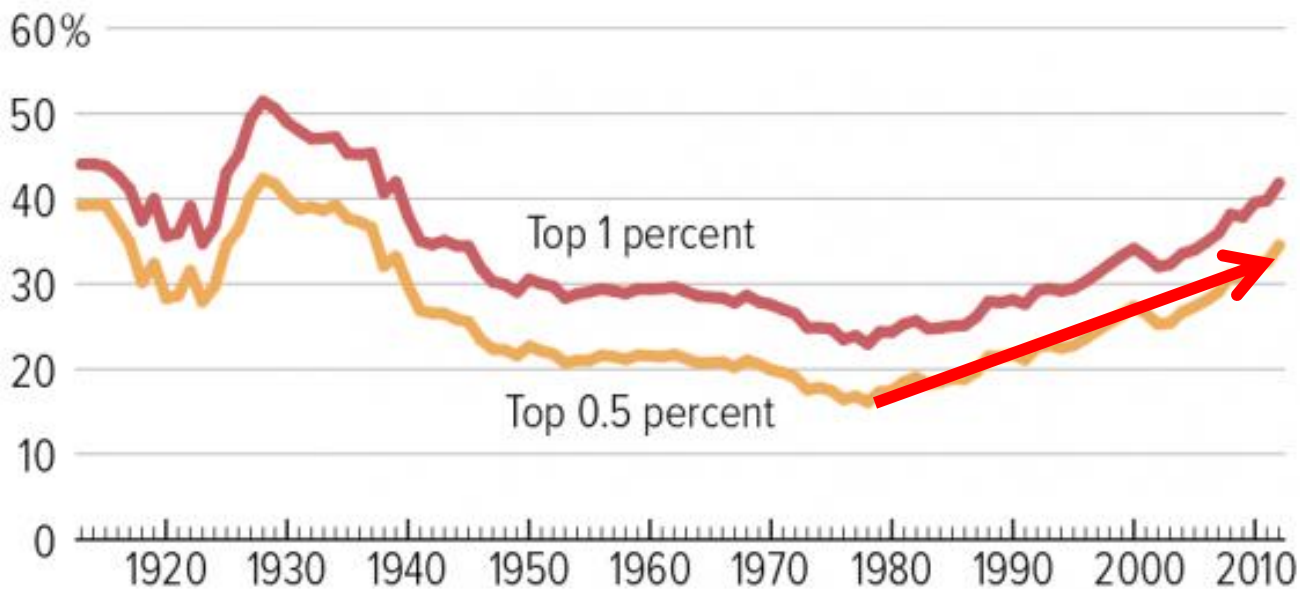
Percentage of Top 1 Percent Income Share



8. Supporting Piketty: The share of wealth at the top has also been rising.

Wealth Concentration Has Been Rising Toward Early 20th Century Levels

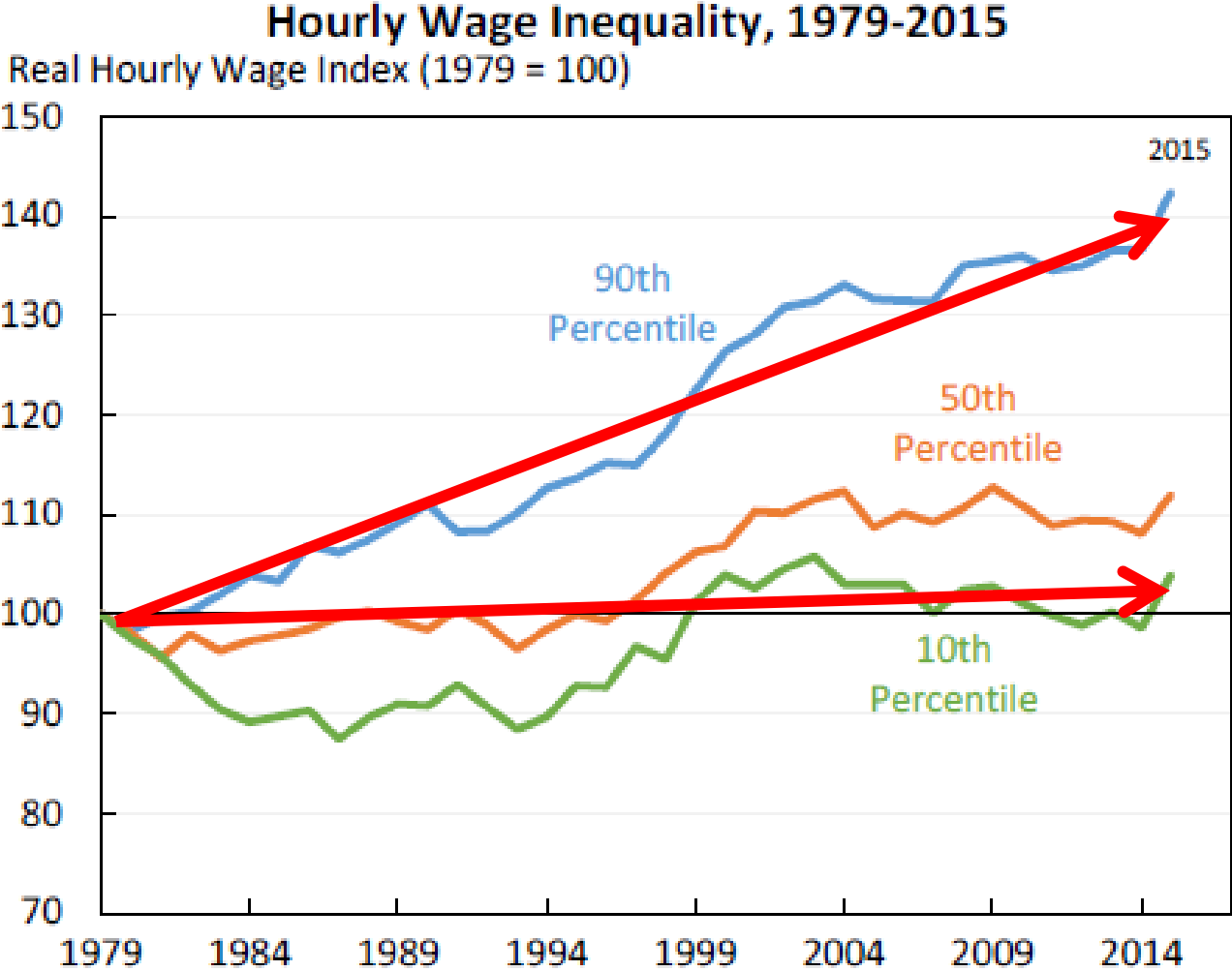
Share of total wealth held by the wealthiest families, 1913-2012



Source: Saez and Zucman, May 2016

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On the other hand, the big increase in inequality has been *within* labor (and within capital).



What weights should we place on each of these 8 factors in explaining increased inequality?

- I don't know.
- Probably all or most of them merit some weight:
- Trade, technology, education, winner-take-all, assortative mating, rents, executive compensation, or Piketty's wealth accumulation.
- Surely one must diagnose the cause before deciding on the corresponding remedy?
- No, I don't think one has to.

The Second Fundamental Welfare Theorem.

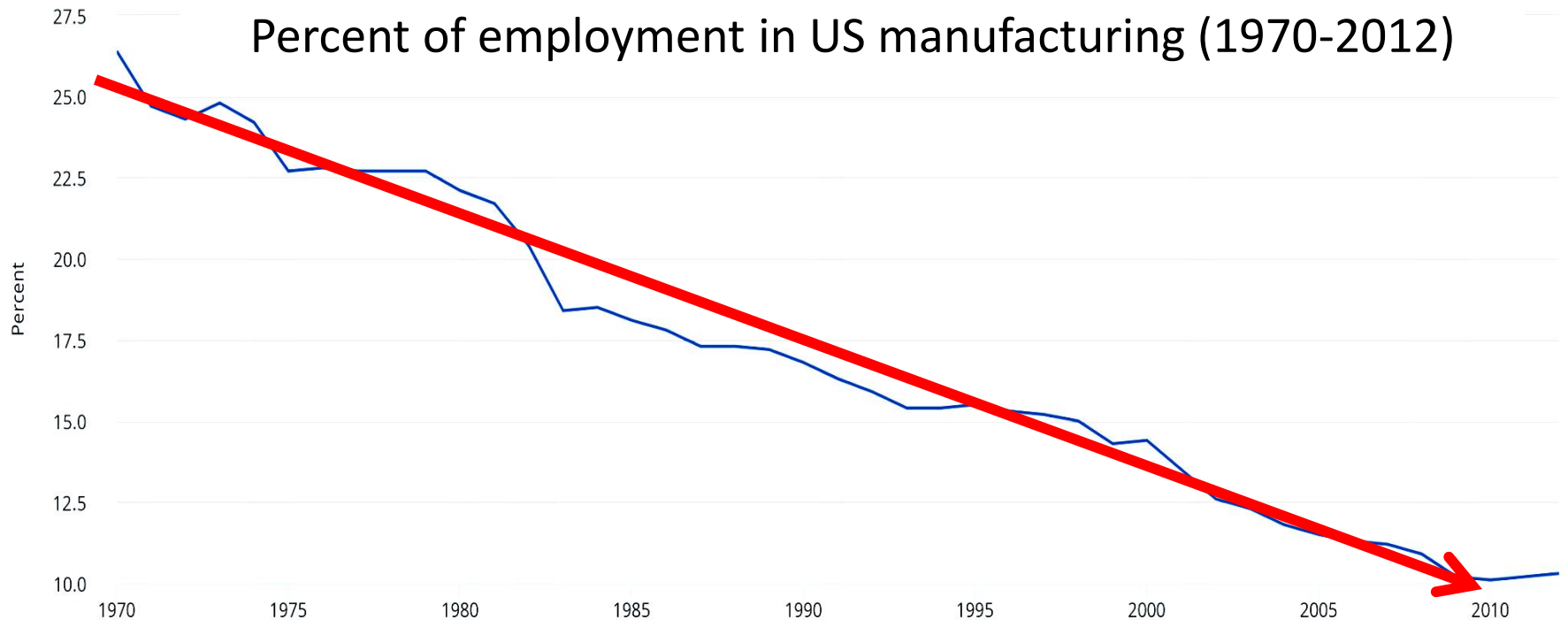
- When individuals are free to engage in trade, the size of the economic pie increases enough that the winners could in theory compensate the losers,
 - in which case everyone would be better off.
- Skeptics of globalization may understand this theorem and yet, reasonably, point out that the compensation in practice tends to remain hypothetical.
- They suggest that we should take the political failure to compensate losers as given, and so try to roll back globalization.
 - But an alternative would be the reverse strategy: take *globalization* as given and instead work on trying to help those left behind.
 - This is the sensible strategy.
 - Why?

For one thing, it would be difficult to reverse globalization even if we wanted to.

- Even leaving aside the negative effects of trade wars on economic growth,
 - and the geopolitical damage,
- nothing a president does would be likely to bring trade back down to the levels of 60 years ago,
- and still less likely to bring the number of manufacturing jobs back up anywhere near the levels of 60 years ago.

We are not going back to 1950,
when manufacturing jobs were 32% of the national total
vs. down to 10% by 2010

-- any more than we are going back to 1790
when farmers were 90% of national employment, vs. 2% today.



Some of those lost jobs were in autos & steel,

- where those northern workers who lacked a college education but were lucky enough to get a job in those two industries could earn a high income.
- Since 1960, the number of jobs in sectors like steel fell by ½;
 - while the number of jobs in health care increased 6-fold.
- International trade was one factor that helped put an end to those high-paying jobs (along with productivity growth and relocation from the north to the south)
 - while improving the reliability, fuel efficiency and affordability of cars for all of us
 - not just importing autos,
 - but also making US autos competitive again.
- Regardless, it is hard to see how we could go back.

The most effective policies to help those left behind (“to compensate the losers”):

- The program to help specifically those losing their jobs due to trade is Trade Adjustment Assistance (which the Democrats try to expand).
 - But why help only the small number of workers who have identifiably lost their jobs due to trade agreements?
 - **Wouldn't it be better to help those who have been left behind regardless if the cause is trade, technology, or something else?**
 - and to do it in ways that still reward work.

Sensible policies to help those left behind include:

- Wage insurance (as proposed by Obama in SoTU);
- More progressive income tax system (central to HRC's plan)
 - including an expanded Earned Income Tax Credit,
 - and more progressive payroll tax rates too;
- and universal health insurance (e.g., Obamacare & beyond).
- Universal pre-school ed. (again, favored by Obama & HRC);
- infrastructure investment spending;
- Financial regulation, such as Dodd-Frank and beyond (e.g., Hillary Clinton's proposal to impose a risk fee on large financial institutions).

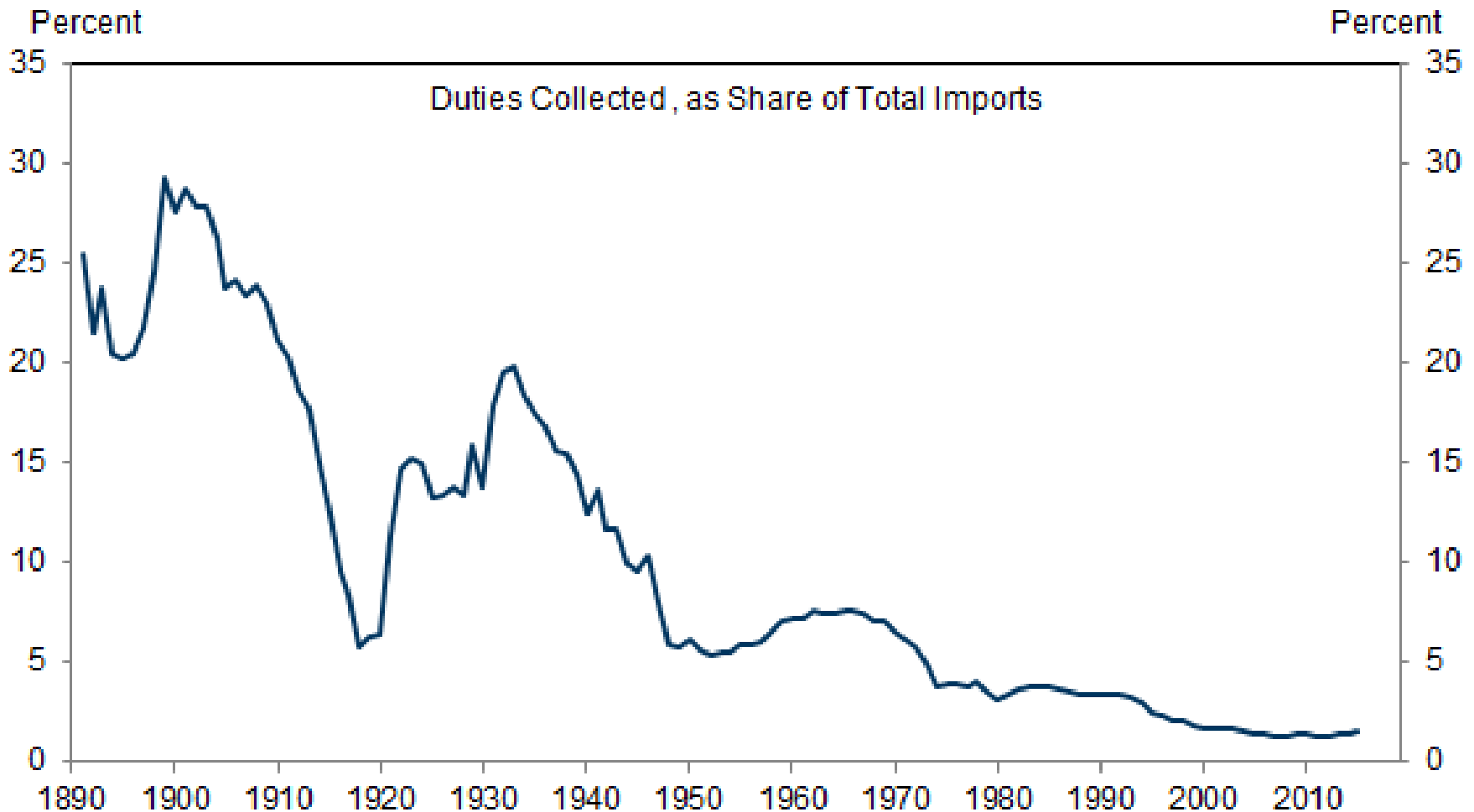
The other party tries to block these measures,

- arguing that government overreach impedes growth.
- In that respect, the choice in this election is the same as usual.

Appendices

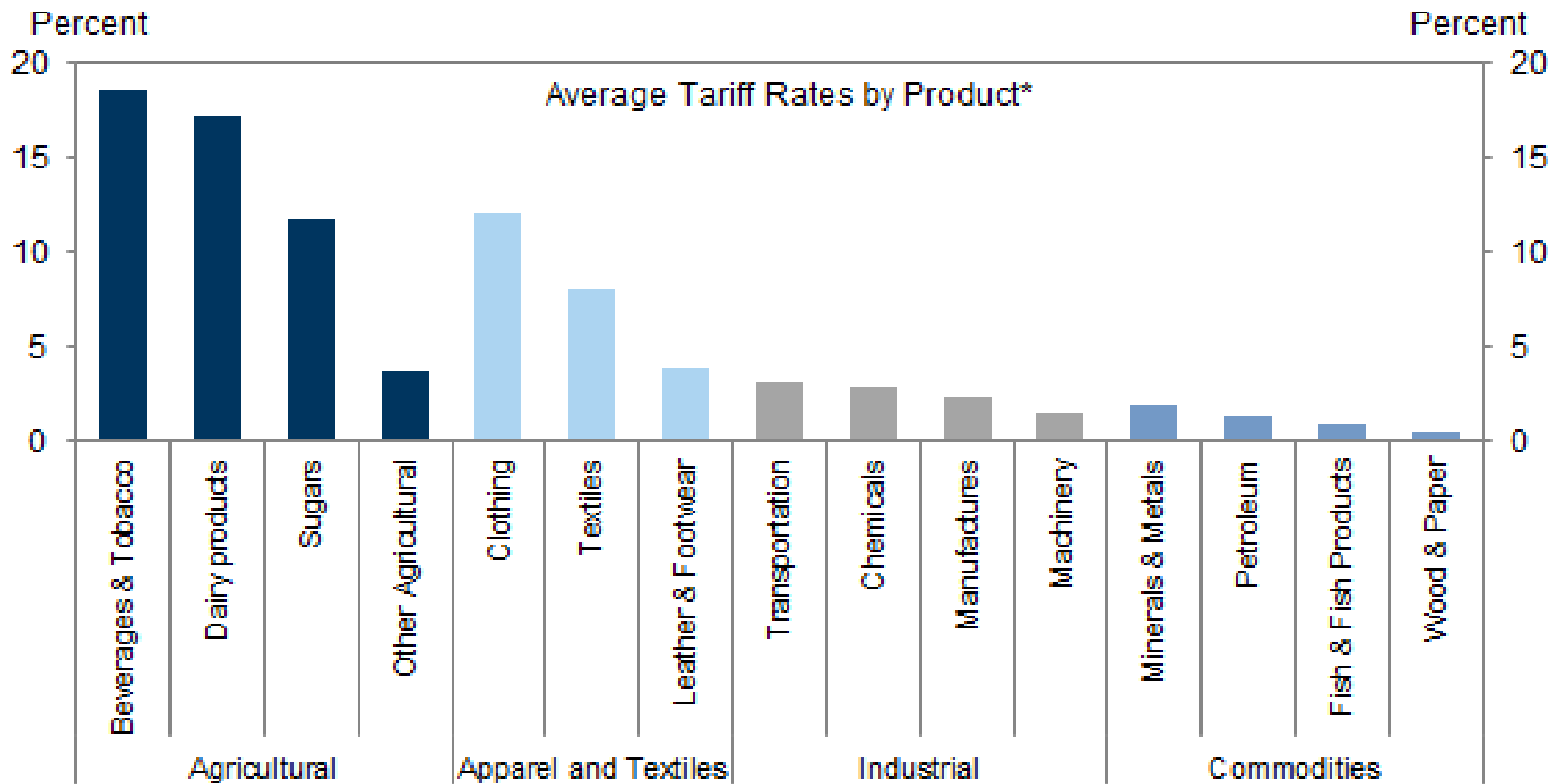
- Appendix 1: A century of US trade liberalization
 - Job losses in manufacturing
- Appendix 2: Opinion polls on trade
- Appendix 3: Trade and the environment
- Appendix 4: Improved global income distribution.
- Appendix 5: For each of 8 inequality diagnoses, one might think of a targeted policy response.

Appendix 1: US Import Tariff Rates have Declined to Historical Lows



Data Source: US International Trade Commission

US Tariffs are Low Except On Agriculture & Apparel

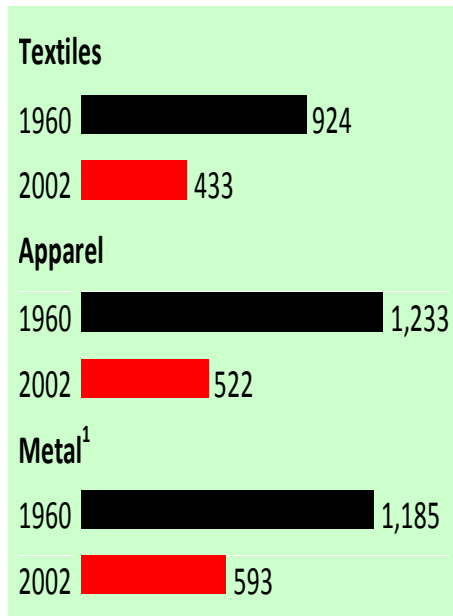


*Average most-favored-nations tariff rates data as of 2014

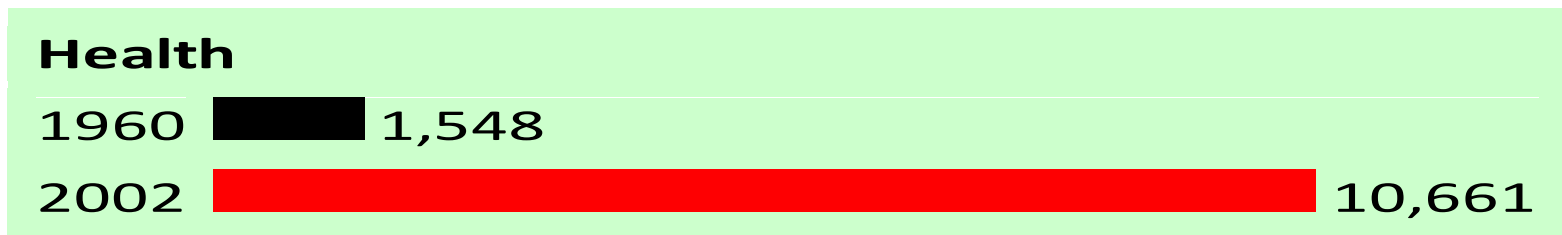
Source: World Trade Organization

The evolving employment mix

Jobs in clothing and steel fell by half



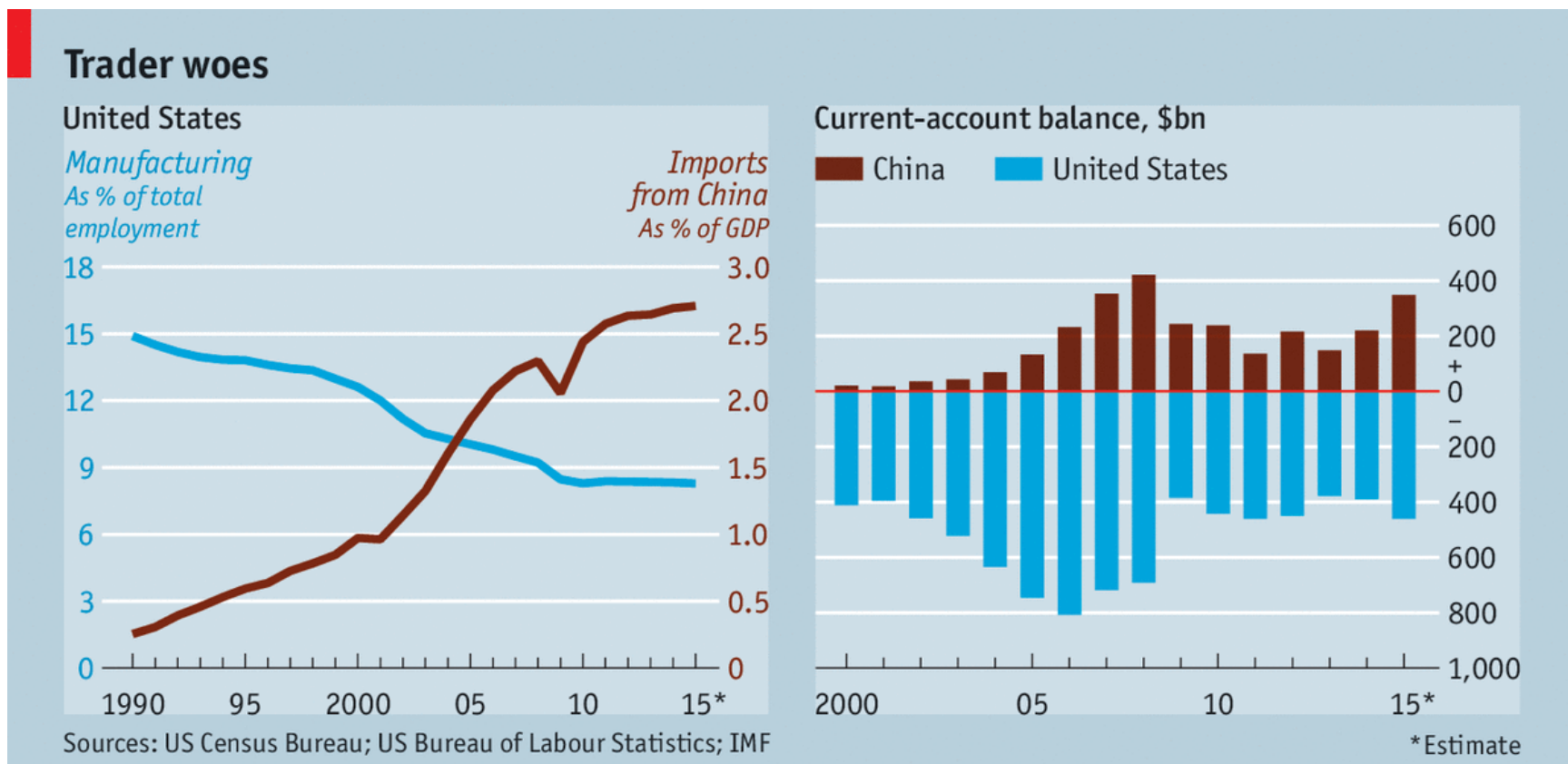
while the number of jobs in health care increased six-fold:



Some of the decline in US manufacturing jobs can indeed be associated with imports, especially from China.

according to David Autor, David Dorn and Gordon Hanson,

[The China shock: Learning from labour market adjustment to large changes in trade](#)", NBER WP 21906, 2016. And "[The China syndrome: Local labour market effects of import competition in the United States](#)", *American Economic Review*, 2013.



Economist.com

Economist, Feb 6th 2016,

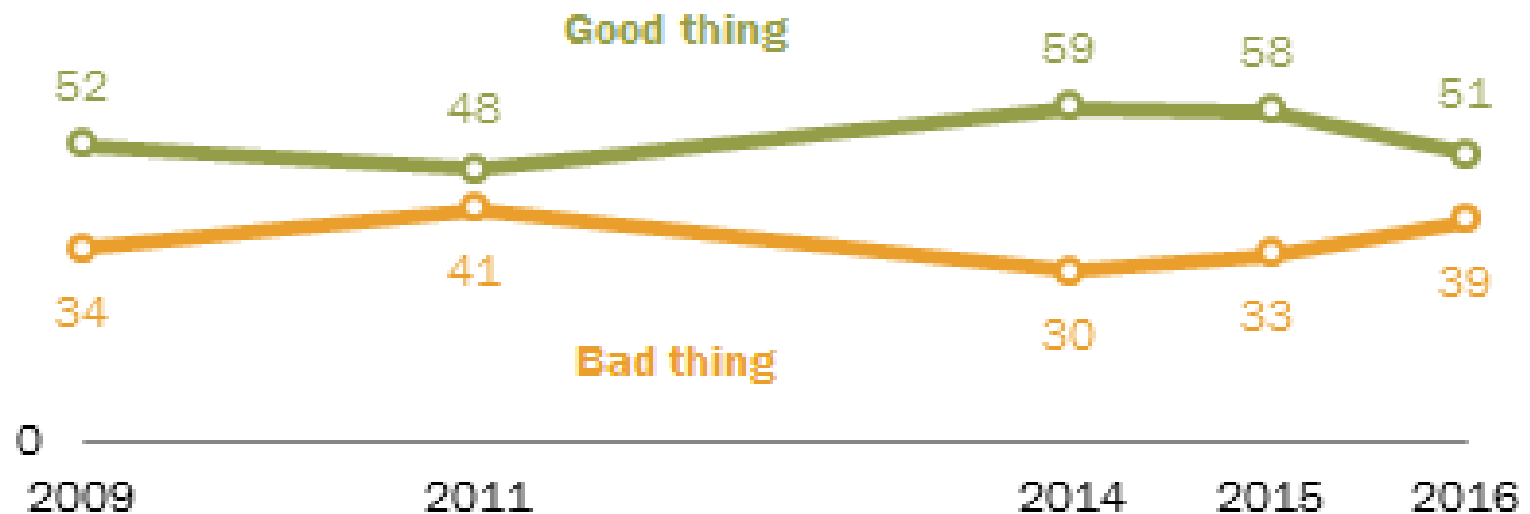
“Trade in the balance: Globalisation can make everyone better off. That does not mean it will”

Appendix 2: Polls tend to show Americans support trade

Americans continue to favor free trade agreements

Free trade agreements between the U.S. and other countries have been a ___ for the United States

100 %

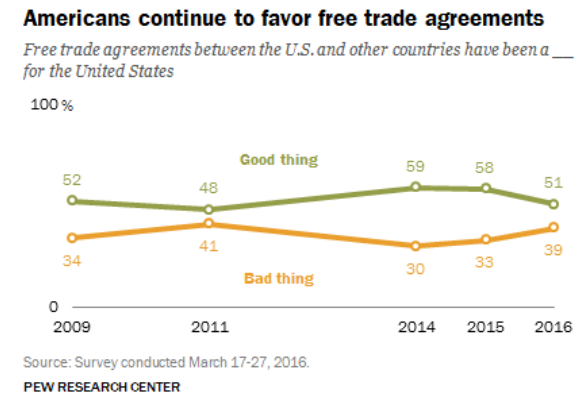


Source: Survey conducted March 17-27, 2016.

PEW RESEARCH CENTER

Polls tend to show Americans support trade

- A [survey last month](#) by the nonpartisan Pew Research Center found
 - Americans by 50 to 42 % said trade agreements had been “a good thing” for the US.
- July [Washington Post-ABC News poll](#). Asked if they wanted the next president to support trade agreements or oppose them,
 - 75 % of respondents said they wanted a supporter
 - Vs. 17 percent favored an opponent.
- A [Gallup poll](#) early this year found that
 - 58 percent of Americans viewed trade as an economic opportunity,
 - 34 percent as a threat.
- Similarly, in [a July poll for NBC News](#),
 - 55 % of registered voters agreed with a statement that trade was good “because it opens up new markets and we cannot avoid the fact that it is a global economy,”
 - while 38 % agreed trade was bad “because it has hurt manufacturing and other key industries.”





Appendix 3: Trade can have either positive or negative effects on the environment.

- Example of negative effects:
 - “Race to the bottom” in environmental regulation among national governments pursuing of cost-competitiveness.
- Example of positive effects:
 - Trade in environmental goods & services.
 - US ended 1980s tariffs & quotas on fuel-efficient Japanese autos, benefiting both consumer pocketbooks & air quality.
 - Almost $\frac{3}{4}$ of EU trade-remedy barriers currently target imports of products used for renewable energy! (Kasteng, 2013; Wu, 2014)
 - AD remedies currently block trade in solar power inputs:
 - US has AD tariffs on imports of Chinese solar panels (2012, 2014, 2015).
 - China has them against imports of polysilicon from US & EU (2012 & 2016);
 - EU has penalties on imports of Chinese solar glass & panels (2013, 2015).
 - They should be dropped, either by negotiation or unilaterally.



Which tend to dominate in practice,
positive or negative effects of trade on the environment?

Econometric estimates depend on environmental criterion.

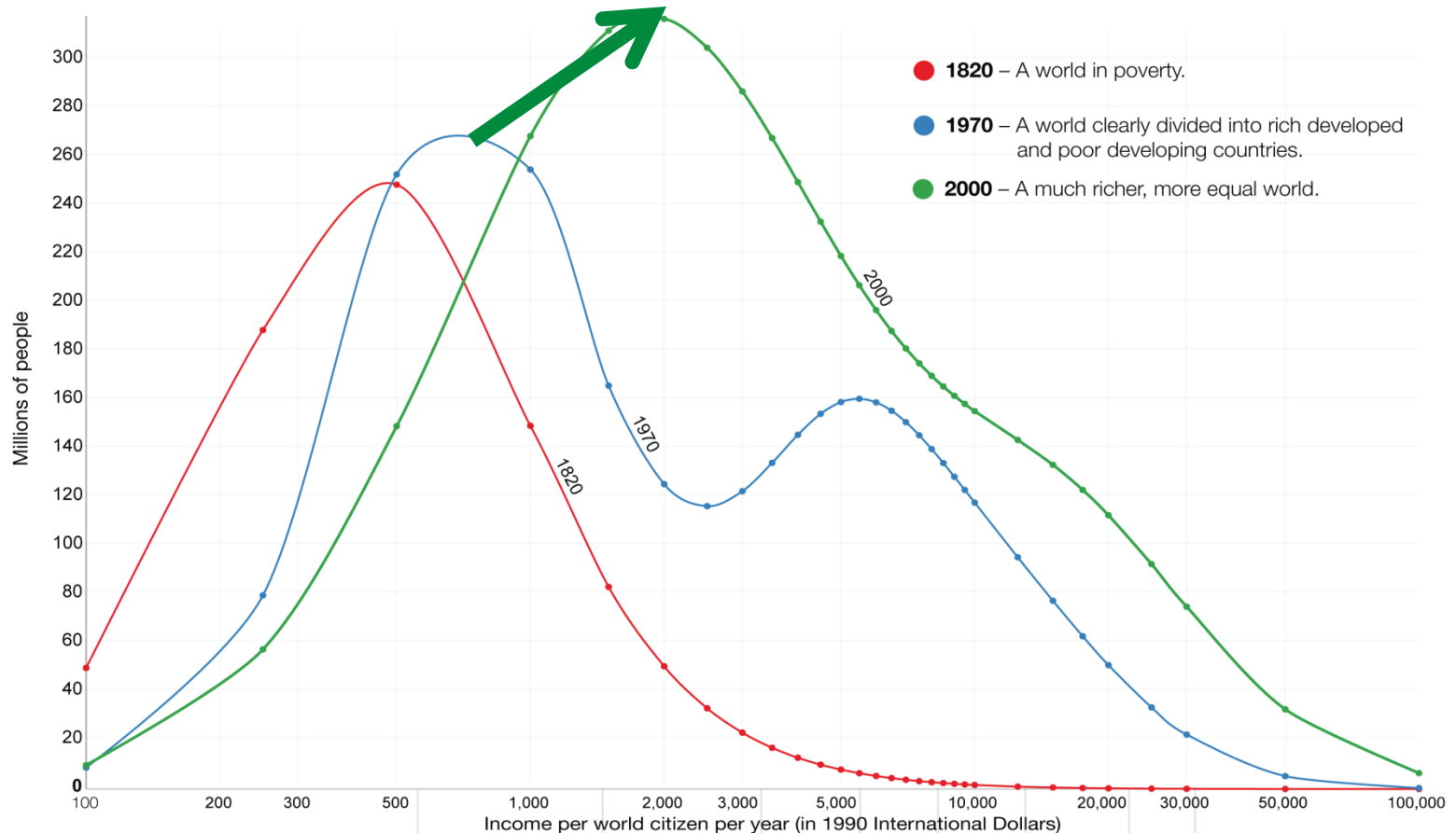
- For SO_2
 - Trade seems to be beneficial
 - “Environmental Kuznets Curve” =>
at higher incomes, people want to clean the environment.
- For CO_2
 - Even at high levels of income, trade continues to hurt.
 - The “freerider” problem => popular desire for environmental quality cannot be enacted at the national level, absent an effective multilateral treaty à la Paris Agreement.

Appendix 4: *Global* inequality fell sharply 1970-2000.



The World Income Distribution in 1820, 1970 and 2000 – by Max Roser

The yearly income of all world citizens is measured in International Dollars. This is a currency that would buy a comparable amount of goods and services a U.S. dollar would buy in the United States in 1990. Therefore incomes are comparable across countries and across time.



Average income in 2010 – same currency measure and same data source – for comparison: Madagascar (675 \$), Iraq (1610 \$), India (3370 \$), Peru (5770 \$), China (8030 \$), Chile (13,880 \$), Japan (22,000 \$), USA (30490 \$)

Data source: www.Clio-Infra.eu via van Zanden et al. (2014) – *How Was Life?*, OECD.

The interactive data visualisation is available at OurWorldinData.org. There you find the raw data and more visualisations on this topic.

<https://ourworldindata.org/global-economic-inequality>

Licensed under [CC-BY-SA](https://creativecommons.org/licenses/by-sa/4.0/) by the author Max Roser.

Over the last 25 years, poverty has fallen especially rapidly in such countries as China, Indonesia & India

For each of the 8 inequality diagnoses, one might think of a targeted policy response:

1. Trade

- Trade Adjustment Assistance or, better yet, wage insurance.

2. Technology and 3. education

- Make college more accessible to lower-income students.

4. “Winner-take-all” labor markets.

- An rise in income taxes & payroll taxes for the upper 0.1%.

5. “Assortative mating”

- Education again, especially universal pre-school.

...

For each of the 8 inequality diagnoses, a targeted policy response continued:

...

6. Reduced corporate competition and increased monopoly rents

- More aggressive anti-trust action.

7. Executive compensation, especially in finance

- Reforms such as “say on pay,” separating the function of CEO & Chairman of the Board, “claw-back provisions,” and so on;
- Continued financial reform, begun under Dodd-Frank
 - e.g., Hillary’s risk-tax on large financial institutions.
- Higher tax rates on the upper 0.1% and, very specifically, eliminating the carried-interest deduction.

8. Piketty’s wealth accumulation:

- Inheritance tax, at least on estates above \$5 million.