Trade in the balance

Globalisation can make everyone better off. That does not mean it will

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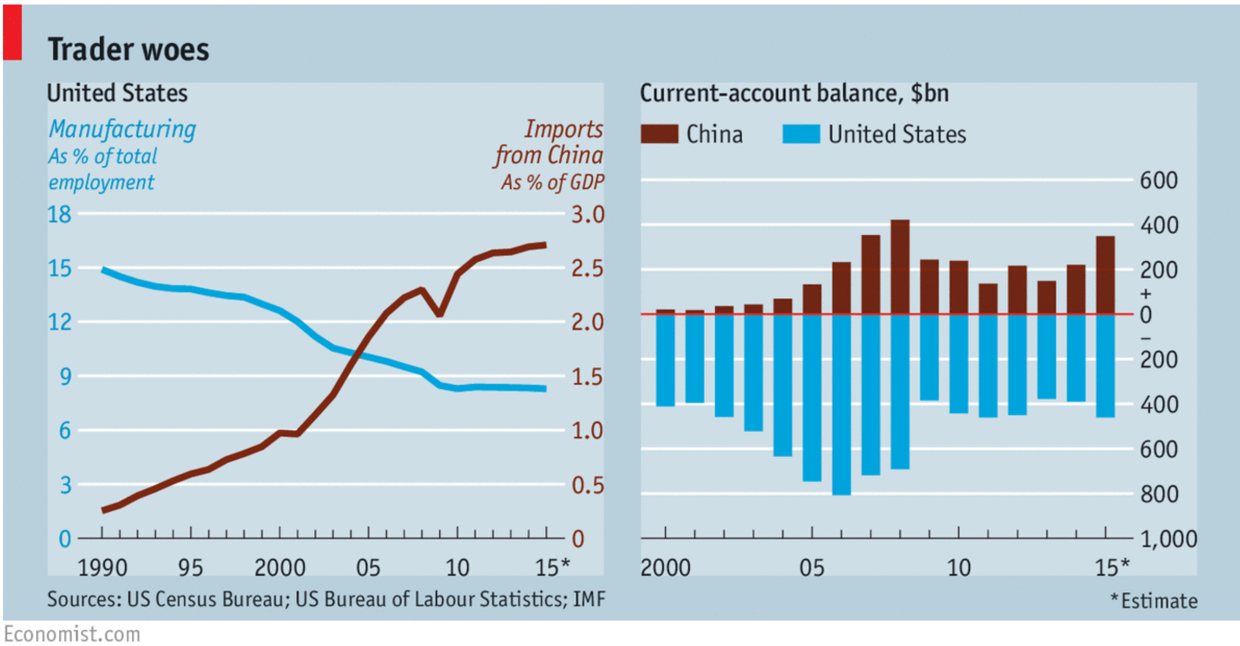

THE past two decades have left working-class voters in many countries leery of globalisation. Donald Trump, the billionaire television star who promises to slap a 45% tariff on Chinese goods if elected president of America, has partly based his candidacy on this angst. Economists tend to scoff at such brash protectionism; they argue, rightly, that trade does far more good than harm. Yet new research reveals that for many, the short-term costs and benefits are more finely balanced than textbooks assume.

David Autor of MIT, David Dorn of the University of Zurich and Gordon Hanson of the University of California, San Diego, provide convincing evidence that workers in the rich world suffered much more from the rise of China than economists thought was possible. In their most recent paper*, published in January, they write that sudden exposure to foreign competition can depress wages and employment for at least a decade.

Trade is beneficial in all sorts of ways. It provides consumers with goods they could not otherwise enjoy: without it only Scots would sip lovely Islay single malts. It boosts variety: Americans can shop for Volvos and Subarus in addition to Fords. Yet its biggest boon, economists since Adam Smith have argued, is that it makes countries richer. Trade creates larger markets, which allows for greater specialisation, lower costs and higher incomes.

Economists have long accepted that this overall boost to prosperity might not be evenly spread. A paper published by Wolfgang Stolper and Paul Samuelson in 1941 pointed out that trade between an economy in which labour was relatively scarce (like America) and one in which labour was relatively abundant (like China) could cause wages to fall in the place that was short of workers. Yet many were sceptical that such losses would crop up much in practice. Workers in industries affected by trade, they assumed, would find new jobs in other fields.

For a long time, they appeared to be right. In the decades following the second world war, rich countries mostly traded with each other, and workers prospered. Even after emerging economies began playing a larger role in global trade, in the 1980s, most research concluded that trade's effects on workers were benign. But China's subsequent incorporation into the global economy was of a different magnitude. From 1991 to 2013 its share of global exports of manufactured goods rocketed from 2.3% to 18.8%. For some categories of goods in America, Chinese import penetration—the share of domestic consumption met through Chinese imports—was near total.

The gain to China from this opening up has been enormous. Average real income rose from 4% of the American level in 1990 to 25% today. Hundreds of millions of Chinese have moved out of poverty thanks to trade. A recent NBER working paper suggests Americans will benefit too: over the long run trade with China is projected to raise American incomes. In parts of the economy less susceptible to competition from cheap Chinese imports, the authors argue, firms profit from a larger global market and reduced supply costs, and should also gain—eventually—from the reallocation of labour away from shrinking manufacturing to more productive industries.

But those benefits are only visible after decades. In the short run, the same study found, America's gains from trade with China are minuscule. The heavy costs to those dependent on industries exposed to Chinese imports offset most of the benefits to consumers and to firms in less vulnerable industries. Economists' assumption that workers would easily adjust to the upheaval of trade seems to have been misplaced. Manufacturing activity tends to be geographically concentrated. So the disruption caused by Chinese imports was similarly concentrated, in hubs such as America's Midwest. The competitive blow to manufacturers rippled through regional economies, write Messrs Autor, Dorn and Hanson, battering suppliers and local service industries. Such places lacked growing industries to absorb displaced workers, and the unemployed proved reluctant (or unable) to move to more prosperous regions. Labour-market adjustment to Chinese trade was thus slower and less complete than expected.

As a result, the authors found in a 2013 paper, competition from Chinese imports explains 44% of the decline in employment in manufacturing in America between 1990 and 2007. For any given industry, an increase in Chinese imports of $1,000 per worker per year led to a total reduction in annual income of about $500 per worker in the places where that industry was concentrated. The offsetting rise in government benefits was only $58 per worker. In a paper from 2014, co-written with Daron Acemoglu and Brendan Price, of MIT, and focusing on America's "employment sag" in the 2000s, the authors calculate that Chinese import competition reduced employment across the American economy as a whole by 2.4m jobs relative to the level it otherwise would have enjoyed.

The costs of Chinese trade seem to have been exacerbated by China's large current-account surpluses: China's imports from other countries did not grow by nearly as much as its exports to other countries. China's trade with America was especially unbalanced. Between 1992 and

2008, trade with China accounted for 20-40% of America's massive current-account deficit; China imported many fewer goods from America than vice versa.

Sub-Pareto

Trade generates enormous global gains in welfare. Generous trade-adjustment assistance, job retraining and other public spending that helps to build political support for trade are therefore sound investments. To make any of these policies work, however, economists and politicians must stop thinking of them as political goodies designed to buy off interest groups opposed to trade. They are essential to fulfilling trade's promise to make everyone better off.

Sources:

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