Economic Policy Institute

# Adding insult to injury

## How bad policy decisions have amplified globalization's costs for American workers

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**What this report finds:** Globalization was always likely going to depress wage growth for the majority of American workers. But policy failures have significantly amplified these damaging effects, turning this from a manageable challenge into a deep economic wound for these workers—and into a political disaster for the country. These policy failures include:

- Failing to secure any reasonable compensation for those on the losing end of globalization
- Failing to address currency misalignments that have led to large trade deficits and hemorrhaging employment in manufacturing
- Passing trade agreements that have consistently aimed to undercut workers' economic leverage while carving out ample protections for corporate profits

The effects of globalization and our failed policy response to it are not just a problem for white manufacturing workers in the Rust Belt, but in fact affect the majority of workers and likely fall disproportionately on the wages of nonwhite workers.

**Why it matters:** Intentional policy decisions have amplified the costs of globalization to American workers on its losing end. Globalization has been used as a tool to shift economic leverage and power away from low and middle-wage workers, and this has contributed to the anemic wage growth for this group.

**What can be done about it:** To remedy the situation, the United States can:

- Use domestic policy to compensate (offset the losses to) negatively affected workers—but the first step is acknowledging the large scale of these losses.
- Stop pursuing new omnibus trade agreements that protect returns to capital while undercutting wages.
- Reorient international policy away from regressive trade agreements and toward measures that will benefit workers in the U.S. and in other countries—addressing currency misalignments; developing international policies to enable countries to tax capital income, including clamping down on abusive tax havens; instituting an international

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financial transactions tax; and harmonizing national policies aimed at combating global climate change.

# Executive summary

This paper provides the economic background necessary to forge a progressive response to the challenges posed by globalization. A progressive response should focus on the class-based distributional conflicts that are inherent not only in globalization writ large but also in the trade agreements and behavior of policymaking institutions that constitute the "rules of the game" governing it. A progressive response to globalization has the potential to boost living standards for low- and moderate-income Americans.

Conversely, responses to globalization and its rules based on a corporatist nationalism will be far less effective in boosting low- and moderate-wage workers' incomes. If globalization is viewed as a competition between nations, little in the way of help for low- and middle-wage workers will emerge. If instead globalization and the rules that govern it are correctly recognized as just another set of tools that have mobilized in recent decades in an intentional effort to shift bargaining power away from low- and middle-wage workers and toward corporate owners and managers, then a genuinely useful response might emerge.

Given the themes around trade policy that emerged over the course of the 2016 presidential campaign, one overarching point falling out of this underlying economics is worth mentioning upfront: the economic losses stemming from globalization and our regressively structured trade agreements are not a niche issue affecting only white working-class manufacturing workers in the upper Midwest. That group is only a tiny sliver of the overall losses. The losses are in fact much more widespread and actually fall disproportionately on communities of color. Choosing to worry about the impact of globalization and trade agreements on American workers is not prioritizing the concerns of white working-class workers in the upper Midwest; it is focusing on an issue of importance to all working-class workers.

## The pressure globalization has put on American workers' living standards has been significantly amplified by policy choices

Globalization of trade and capital flows was always likely going to be hard on tens of millions of American workers. Theory predicts and evidence validates that while growing trade (particularly but not exclusively) with poorer nations leads to overall national income gains, it also leads to so much upward redistribution of income that *most* workers are made worse off. The gross losses inflicted by globalization are not small, and they are widespread. One cannot measure the scale of losses by the number of jobs lost in manufacturing (though these are the most acute losses). Globalization has weighed down wage growth for tens of millions of American workers, if not a hundred million or more.

The damage wrought to many American workers by globalization has been amplified by the profound policy mistake of ignoring exchange rate misalignments. Policymakers have allowed the dollar to rise to levels that have hamstrung the competitiveness of U.S. exporters in global markets. The resulting (and entirely predictable) trade deficits have been a primary driver of job loss in manufacturing in recent decades, and these losses have amplified the regressive redistribution caused by trade.

Trade agreements in recent decades have also amplified the upward redistribution of income from globalization, through a number of channels. They have undercut American workers' bargaining power with employers and eroded protection for American workers' ownership claims on American institutional and organizational capital, but have increased protection for corporate managers and shareholders in a range of industries—particularly those that rely on enforcement of intellectual property claims (pharmaceuticals, software, and entertainment, particularly). In short, *they are not free trade agreements*; they are agreements that decide whose protection from economic competition will be eroded and whose protection will be enhanced.

The net effect of these agreements is that little to nothing has been done to help boost the volume of American exports—particularly in manufacturing. The failure of predictions that signing the agreements would reduce U.S. trade deficits has become conspicuous.

The decision to sign trade agreements that were the result of corporate capture of the treaty-crafting process and the decision to not protect U.S. manufacturing employment against misaligned exchange rates were visible and regressive insults to large swaths of workers already feeling the wage-suppression effects of globalization. These agreements and currency misalignments have made for poisonous politics in the effort to secure class-based solidarity in economic policy debates. Given the extraordinarily modest national economic gains that are estimated to result from these treaties, it seems hard to imagine that they were worth the political fallout.

## What can be done to redress the harm to workers?

A standard idea for responding to this problem of trade-induced redistribution—using nontrade policy tools to compensate those on the losing end of expanded trade—has never been tried on any serious scale. It should be. But this compensation is a much heavier lift than commonly thought, for two reasons: the net national gains from trade are much smaller than commonly advertised, while the gross losses to workers on the losing end are much larger.

The wage-suppressing effects of globalization for workers on the wrong end of it, amplified by trade agreements, has been significant, but do not explain anywhere near all of the upward redistribution in recent decades. Purely domestic policies *are* capable of fully compensating for the downward wage pressure of expanded globalization and even for the amplifying effects of trade agreements. For example, policy change that managed to restore collective bargaining rights to American workers would likely boost their economic leverage enough to fully offset the past drag of globalization.

But even though progressive domestic policy could hold American workers harmless in the face of globalization, there is no virtue to preserving the trade policy status quo. Recent trade agreements have not led to faster growth, and, despite occasional genuine, good-faith efforts to write “better” agreements, the process of writing and enforcing these agreements is completely captured by corporate interests. There is no winning the game of trying to write a worker-friendly omnibus trade agreement, so a new game needs to be played.

Trade policy going forward should abandon the pursuit of ever more omnibus trade agreements and should instead focus on just three things: enforcing aspects of existing agreements and trade law when this will benefit American workers; reducing specific, identifiable trade costs when they are imposing large, regressive costs on Americans; and preserving open access to the U.S. market for poorer countries.

It is clearly true that a number of key economic challenges are best met at the international level and that a retreat to isolationism will not further progressive goals. Examples include international coordination to tax capital and close tax havens; the institution of a global financial transactions tax that could provide funding for pressing social needs; harmonizing climate change policy across countries to ensure that emissions are not just chased out of one country and into another; and ensuring that beggar-thy-neighbor currency misalignments are addressed in a fair and transparent way.

# The economics of globalization

In this paper we define *globalization* as the growing share of trade and capital flows scaled against national income. For the purposes of assessing the effects of globalization on American workers, it really does not matter what underlies the trend of globalization—whether it has been driven by policy reductions in barriers to these flows, or whether it has been driven by the decisions of American trading partners to enter the world trading system. Either one of these scenarios has the same effect on American outcomes.[1]

## Trade-induced losses affect a majority—not a minority—of American workers

The challenge of globalization for American workers is often painted as a problem of industrial workers losing their jobs to imports. Because manufacturing employment is now a small share of overall employment, these trade-induced losses are often described as “small and concentrated.” If it were true that globalization’s losses were concentrated on and borne by only a small group of workers, the politics would not be so challenging for progressives—small groups are easy to compensate. But this assessment of the situation is wrong—growing trade (particularly with poorer nations) actually inflicts losses on the *majority* of the American workforce.

This is not some heterodox stance. The most conventional textbook economics actually argues for surprisingly radical conclusions regarding the effects of globalization in the U.S. economy. When people say that economics teaches that expanded trade is a "win-win" proposition, this means only that trade is "win-win" for total national income in each partner country.[2] But textbook economics does *not* predict that expanded trade will be a win-win for all groups within those countries.

To see the logic of why this is so, take the case of China and the U.S. Reducing barriers to trade allows each country to specialize in what they do relatively more efficiently.[3] But this specialization means that domestic resources need to be reshuffled between sectors domestically. Because China is likely to specialize more in labor-intensive production while the United States is likely to specialize more in production that uses capital, skills, and credentials ("capital" henceforth) more intensively, this reshuffling will, in the end, reduce demand for labor and boost demand for capital in the United States. Because it can be shown that the sum of capital's gains exceeds labor's losses, globalization remains "win-win" at the country level. *Within* the U.S., however, there is nothing "win-win" about it; labor loses not just in *relative* terms, but can suffer *absolute* income losses as well.[4]

Importantly, these losses are not the damage stemming from the adjustment cost of manufacturing workers' temporary unemployment spell as they move between sectors after being displaced by imports. This temporary adjustment cost is not even factored into the considerations above (in the real world, they should be). Rather, the big damage is the *permanent* wage loss resulting from America's new pattern of specialization that requires less labor and more capital. Further, this wage loss is not just suffered by workers in tradeable goods sectors who are displaced by imports; it's suffered by *all* workers who resemble these workers in terms of credentials and labor market characteristics. A simple way to say this is that while landscapers may not be displaced by imports, their wages suffer from having to compete with apparel (and auto, and steel) workers who have been displaced by imports.

## There is widespread agreement that domestically driven compensation policies could undo this damage—so why haven't such policies been implemented?

We could in theory solve this problem through domestic compensation—using nontrade policy tools to progressively redistribute income even as expanded trade regressively redistributes it. But we have not. One reason why we have not is that there has not been any real agreement on the size of the group losing from expanded trade or the economic heft of their losses. Instead, there has been a concerted effort to define the group as "small and concentrated" and to pretend that policies often advertised as "compensation" for trade deals (Trade Adjustment Assistance [TAA], for example) are all that's needed. But even at its peak, TAA was too small—by orders of magnitude—to fully compensate for trade's gross losses.[5]

A relatively wonky point is that because the *net* national gains stemming from expanded trade are the outcome of much larger *gross* winnings and losses, the political economy of securing compensation is difficult. Basically, one would have to deny the winning group about 80 percent of their expected benefits from trade to mitigate the damages to the losing group.[6] And some of the mechanisms needed to effect a transfer this large (e.g., tax and transfer policies) are (at least in textbook analysis) potentially as distortionary to markets as trade barriers. In short, the "liberalize and then compensate" philosophy is nice in theory, and would be a clear improvement over the status quo for most American workers, but it has very little obvious economic advantage for domestic workers over a baseline of enhanced protectionism.[7]

Finally, given the intense focus on the plight of manufacturing workers in the 2016 presidential campaign, it is worth stressing one more time how widespread the losses from globalization really are—they are absolutely *not* confined to manufacturing. Listening to analysis of the presidential election, one would think that concerns about globalization and trade agreements are relevant only to white workers in a small handful of Rust Belt states. This is wrong. The wage-suppressing effects of globalization hit *all* workers without college degrees, across the country. Workers of all races and ethnicities are affected, and communities of color are disproportionately harmed. The harm of globalization is absolutely not a niche issue affecting only white working-class workers in the upper Midwest.

## Globalization can also drag on workers' bargaining power

The textbook analysis of the effects of trade on wage suppression discussed earlier assume that these effects run through trade flows that shift the relative demand for different types of labor. But trade's effects on wages could run through other channels as well. After all, in the real world, wages are not set in perfectly competitive labor markets solely through shifts in demand and supply curves. Rather, the relative bargaining power of employers and employees matters greatly for wage-setting, and the threat effects of growing globalization surely hamstring this bargaining power for many American workers. In previous eras, the only fallback position for employers in the face of a breakdown in wage bargaining was to stop production. Now employers have the option of setting up production facilities abroad. This improved fallback position boosts employers' bargaining power vis-à-vis their American employees, and this can lead to substantial downward pressure on wages.

As is always the case, measuring bargaining power at all, let alone its ebb and fall, is difficult, so the precise empirical impact of this channel of globalization's wage-suppressing effects is hard to gauge. But there is growing evidence that these effects could be significant. Bertrand (2004), for example, shows that import competition tears down the protection that incumbent workers' wages have traditionally enjoyed against rising unemployment. Senses (2007) finds that offshoring is associated with greater elasticity of labor demand—implying that wage gains will cut more sharply into employment gains. Bivens (2006) finds evidence that industry-level rent-sharing is eroded by growing import shares. Jayadev (2007) finds capital account openness associated with a shift from labor to capital income shares across countries, and attributes this finding to the bargaining channel. Anderson, Tang, and Wood (2006) construct a model of globalization eroding American workers' privileged access to institutional and human capital and lowering wages through this channel. They find empirically that greater ease of movement of high-credential, high-skill managers leads to wage declines for American labor, supporting the predictions of their model.

Recognizing the bargaining power channel of globalization's impact on wages also highlights why a class-based progressive response to trade is more likely to help low- and middle-wage workers than an approach based on corporatist nationalism. A class-based approach to economic policymaking in general should specifically target measures to boost workers' bargaining power, both in the design of trade policy and through nontrade policies that can be used to compensate workers for the bargaining power erosion induced by globalization and trade policy. A corporatist approach instead just aims to keep *foreign* pressure from damaging U.S. workers (for example, the Trump threat/payoff approach to keeping the Carrier plant in the U.S., as noted by Bivens [2016]) but is fine with American corporate owners and managers pressuring the pay and jobs of American workers. Evidence of this last point includes the Trump administration nomination of Andrew Puzder for labor secretary, given that Puzder favors a suite of policy changes that would predictably damage the economic leverage and bargaining power of American workers relative to their American employers (McNicholas 2017).

## New, growing evidence means nobody can claim they don't know about trade's wage impacts

This clear prediction that growing trade will boost inequality and place downward pressure on the wages of most American workers is bolstered by real-world evidence. In earlier rounds of the "trade and wages" debate, Feenstra and Hanson (1999) find that up to 40 percent of the rise in the college premium can be explained by growing trade flows. Bivens (2013) also finds that the implied wage effects of trade expanded rapidly after 1995, as trade with lower-wage nations (particularly Mexico and China) picked up significantly. Bivens (2013) also finds that, by 2013, trade flows with low-wage nations were likely reducing wages for workers without a four-year college degree by roughly 5.6 percent. For a non-college-degreed worker making the median hourly wage and working full time, full year, this translates into just under $2,000 annually.

This estimate is quite close to what Autor, Dorn, and Hanson (2013) have found in a series of now-famous papers measuring the impact of growing trade with China. The Autor, Dorn, and Hanson (2013) results are that each $1,000 in imports per worker reduces American wages by roughly 0.7 percent. Given that Chinese imports in 2016 stand at roughly $4,000 per worker, this translates into a 2.8 percent wage reduction. And the Autor, Dorn, and Hanson (2013) results indicate that the impact on American wages of a given volume of imports from other low-wage countries is no different from the impact of Chinese imports. Imports from all low-wage countries in 2016 stand at roughly $8,000 per worker, implying a wage reduction of roughly 5.6 percent, or about $2,000 annually, for a full-time worker earning the median wage.[8]

## The wage damage caused by trade is not 'concentrated'

Again and again, the damage done by expanded trade to American workers is described by economic writers as being "concentrated"; the typical worker hurt by trade is assumed to be a manufacturing worker who has lost her job to import competition. While trade-displaced workers clearly face the largest individual losses among those suffering harm, in the aggregate the costs of these job losses are dwarfed by the wider effects of downward pressure on wages. Globalization does not just hurt manufacturing workers; it also actively weighs down the wages of workers in nontradeable sectors.

Often, the Autor, Dorn, and Hanson (2013) results are invoked to justify the claim that this damage is "concentrated." They do not. Autor, Dorn, and Hanson (2013) show that their measure of trade exposure—imports per worker—varies by roughly a factor of four between the 90th and 10th percentile of geographic locations in their data (from the years 2000 to 2007).[9] As noted above, the Autor, Dorn, and Hanson (2013) results indicate that workers in the area with the median level of trade exposure have suffered wage declines of roughly 5.6 percent, or $2,000 in annual earnings, due to the level of Chinese imports. Because the 90th percentile geographic areas—those areas that have greater trade exposure than 90 percent of all geographic areas—have double the trade exposure as the median area, this implies a $4,000 wage reduction in those areas. But even the 10th percentile geographic areas—those areas that have less trade exposure than 90 percent of all geographic areas—have fully half the trade exposure of the median area, and this implies a $1,000 wage reduction even in these low-trade areas.[10] To the extent that these are nontrivial differences between areas with greater and lesser trade exposure, one might call trade's wage costs "concentrated." But the fact that even in the least-exposed areas the typical worker likely sees wage declines of $1,000 per year stemming from trade argues strongly that these wage costs are in fact quite widespread.

Autor, Dorn, and Hanson (2013) interpret their results as showing that labor market "adjustment" to trade shocks is slow. That is a more-than-reasonable interpretation for some of the *employment* effects by geographic area, as mainstream economic theory argues that flexible labor markets tend to absorb all willing workers unless some labor market friction keeps this from happening. But a key part of employment generation in the face of a negative relative demand shock is that wages must *decline* to support employment growth, so the downward wage pressure found by Autor, Dorn, and Hanson (2013) could (indeed likely *would*) just get worse as labor markets fully "adjust."

## The wage damage caused by expanded trade is not ameliorated by lower prices

Often, proponents of expanding trade argue that its benefits are progressive because it lowers the prices of goods that are disproportionately consumed by low- and moderate-income households.[11] This, however, looks at only one narrow facet of trade's impact: lower prices for consumers stemming from cheap imports. But these lower prices for consumers *are* the gross benefits of expanded trade, so of course focusing solely on them would show trade helps everybody. One also has to examine the other effects of trade—those that impose gross costs as well.

For example, while expanded trade lowers prices for imports, it also raises domestic prices for exported items.[12] At the national level, because imports are more likely than exports to be consumption goods, this does mean that trade's net effect is to lower prices faced by consumers. But it is possible that exported items are also disproportionately consumed by low- and moderate-income households. Take an obvious example: the U.S. exports a lot of food products (grain, beef, etc.). If it did not export a lot of these food products, their prices would be cheaper in the United States. Given that lower-income households likely spend a higher share of their income on food than higher-income households, expanded trade of food exports could well have regressive effects.

Further (and much more importantly), looking only at *prices* misses the effect that growing trade has on *wages*. The same fall in import prices that benefits consumers also leads to lower wages for most workers. Essentially, as growing imports lower prices of import-competing goods produced in the United States, domestic production of these import-competing goods becomes less profitable, and so this production shrinks. As this domestic production shrinks, resources displaced from this sector have to try to find employment in more capital-intensive sectors. This leads to a reduction in demand for labor (as well as bidding up the price of capital), and this in turn triggers adverse wage effects. The more imports drive down domestic prices for domestic goods, the worse the wage effect is. This wage effect, again, harms most workers, not just those located in particularly trade-exposed regions.

It is clear that the decline in wages stemming from this process will be larger than the decline in prices.[13] This means that falling import prices are not a net benefit from trade for the majority of American workers on the wrong end of globalization's distributional conflict.

Finally, the estimates of wage declines caused by growing trade in this paper are real, inflation-adjusted wage changes—that is, they fully price in the effect of price declines driven by trade (or by anything else). So it is absolutely clear that these workers are losing, regardless of price declines.

## Unaddressed currency misalignments have amplified globalization's challenges

The theoretical case for expanded trade pulling down wages for most American workers generally assumes this wage drag would occur even in the presence of balanced trade. But the United States has run persistent trade deficits, particularly from the late 1990s onward. These deficits, and the sharp job loss they have caused in manufacturing, have amplified the regressive effects of growing globalization.

These deficits have been driven largely by exchange rate misalignments—the result of policy choices that have kept the value of the U.S. dollar too high to be consistent with balanced trade. A strong dollar makes U.S. exports expensive and U.S. imports cheap, and this results in trade deficits. It also means that the United States absorbs more imports than it would otherwise, pushing workers out of import-competing sectors into nontradeable sectors and leading to a reduction in relative labor demand, thus amplifying the wage-depressing effects of trade flows. For this and other reasons, failure to keep the value of the dollar close to its trade-balancing level has been a key policy mistake in recent decades.

### Manufacturing job loss is not inevitable

Occasionally it is claimed that manufacturing job loss is inevitable and has more to do with fast productivity growth—the ability to produce more goods with fewer workers, thanks to technology/automation—than with trade deficits.[14] This is clearly wrong. From 1965 to 2000, employment in manufacturing hovered between 17 and 19.5 million, depending on the phase of the business cycle. After 2000, it began falling, reaching its trough of under 11.5 million in 2010, and it hovers below 12.5 million today (EPI 2016). Yet the pace of productivity growth from 1965 to 2000 was notably more rapid than the pace has been since 2000.[15] In short, it is not the pace of technological change that coincided with the decline in manufacturing employment; it is instead the emergence of large trade deficits sandwiched between two steep recessions.

The fact that manufacturing employment was steady for 35 years in the face of rapid productivity growth often gets muddled when people focus on manufacturing's *share* of overall employment. Here it is true that faster productivity growth in manufacturing has clearly contributed to net employment growth occurring in other sectors. But manufacturing's share of total employment has fallen post-2000 much faster than it would have absent the rise of large trade deficits. In the end, a falling manufacturing *share* of employment over time is indeed to be expected, but the absolute hemorrhaging of employment levels in manufacturing we have seen over the past 16 years is not. This relatively recent manufacturing employment implosion is much more attributable to rising trade deficits than to productivity growth.

### Trade deficits are—by definition—caused by currency misalignments

Trade deficits are, by definition, evidence of a currency that is too strong to balance trade flows. Further, they can only be reduced with a currency depreciation.[16] Sometimes people point to other issues in trade policy and claim that these can drive trade deficits: subsidies for exports, for example, or labor rights violations that keep wages artificially low, and argue that these, not currency values, are the source of trade deficits. But as concerning as these other policies may be for other reasons (and the violations of labor rights are deeply concerning), the effect they have on the trade deficit can be entirely neutralized by an exchange rate that is free to adjust to a level that balances trade. But the U.S. exchange rate has not balanced this trade in recent decades, and the result is large trade deficits that have strangled any recovery in manufacturing employment after the 2001 recession and have even placed a drag on recovery from the Great Recession.

Sometimes the too-strong American dollar over the past two decades was the result of private capital flows, and sometimes it was the result of intentional mercantilist currency management on the part of American trade partners. In the end, though, the *source* of this currency misalignment is irrelevant; the macroeconomy does not respond to *why* the dollar is strong, only to the fact that it is. In recent years, the debate over exchange rates has focused too strongly on the issue of currency management (or "manipulation"). This in turn has led to it being framed as an issue of a virtuous United States being victimized by predatory trading partners. This moralizing is irrelevant and misleading. A strong dollar vis-à-vis the Chinese yuan, for example, creates both winners and losers within the United States and within China. And while official currency management by China has largely relented in recent years, this does not mean, contra many supposed experts, that the U.S.–China exchange rate is no longer an economic problem. It just means it is a problem now exacerbated by private capital flows rather than official ones. But again, the macroeconomy does not care *who* is inflating the value of the dollar, only that it is inflated.

## The economics of trade agreements

As noted in the previous section, the integration of the U.S. with the poorer global economy was always likely going to put some drag on wage growth for most American workers. But the regressive consequences of this within the United States have been amplified by the structure of specific trade agreements we have signed in recent decades.

Recent decades' trade treaties have gone far beyond simple tariff-cutting (which would have by itself put some drag on wages, through the mechanisms described above). Many of the non-tariff-related innovations in trade agreements began enhancing protections for corporate interests while undercutting workers' wages. For example, trade agreements in the 1990s began including investor-state dispute settlement (ISDS) provisions. These ISDS provisions made it much safer and more profitable for international corporations to invest in export facilities abroad by providing enhanced legal protection for corporate assets abroad.

This investment abroad lowers costs in trading partners' export industries and leads to cheaper imports coming into the United States, which pressures American wages through standard Stolper-Samuelson channels. The ISDS provisions can also hamstring American workers' bargaining power. One way to view these provisions from the American perspective is that they purposefully eroded American workers' implicit monopoly on the legal and institutional capital that made employers confident about investing in the United States.[17] In a sense, business environments in other nations that were either more worker-friendly or capitalist-risky helped boost American wages. Trade agreements have tried to level this previous advantage, thereby undercutting American wages.

From our trading partners' perspective, these ISDS provisions have often been used aggressively by American companies to not just enforce uncontroversial property rights claims, but to attack any policy change—including prudential regulatory changes—that threaten profits. These provisions are the starkest example of how class-based approaches can highlight areas where workers here and abroad have common interests. American workers have an interest in keeping ISDS provisions from making it easier to send production overseas and erode their stake in institutional capital that keeps their wages up. But foreign workers have an interest in keeping ISDS provisions from allowing their governments to undertake corporate-friendly restructuring of their economies—which might not be politically popular—in the name of adhering to trade agreements while claiming that these agreements will provide benefits through access to the U.S. market.

Despite the fact that trade agreements erode protections for U.S. workers' wages, it would clearly be wrong to label recent trade pacts as "free trade" agreements, as these ISDS provisions provide increased protections for investors. Further, many specific provisions of recent decades' trade agreements have clearly increased protections for specific corporate interests. For example, these agreements universally force other countries to meet much higher levels of protection for intellectual property claims of American companies than they had to meet formerly. Essentially, poorer countries are forced by these treaties into spending resources to act as domestic bill collectors for companies like Pfizer, Microsoft, and Universal. Given that the beneficiaries of enforcement of these amped-up intellectual property claims are shareholders and corporate managers of these companies, it is obvious that these provisions just magnify the regressive consequences of trade flows.

Often debates over trade agreements get muddied by proponents' insistence that the damage done by *trade* to the majority of American workers is somehow unrelated to the *trade agreements* we have signed in recent decades. It is certainly possible that we would have seen a sharp increase in international trade and capital flows even in the absence of trade agreements over the past 20 years. But a range of new research indicates that these agreements themselves boost trade significantly more than was previously thought.[18]

More importantly, this "hate the trade, love the trade agreements" argument is largely a dodge. The entire point of these agreements has been to increase trade and capital flows. If you think these flows put pressure on American wages and yet you work to maximize these flows by passing trade agreements (that contain no measure of compensation), you cannot claim to be innocent of doing anything bad to American workers.

# How should a progressive policy respond to all of this?

From the perspective of the majority of American workers, expanded trade—amplified by trade agreements—has the primary effect of dragging on American wage growth. And wage growth for the typical American worker has lagged far behind overall productivity growth in recent decades. This growing wedge between productivity and pay is the root cause of the rise in income inequality over this time.[19] It is important to note that globalization does not explain all, or even most, of this growing wedge between productivity and pay. But it does play some role.

As a society we could have decided that the best response to the regressive redistribution of income caused by globalization was to use other policy tools to reverse this effect. So, for example, we could have responded to the trade-induced wage losses by improving labor standards or using taxes and transfers to hold workers' take-home pay constant. And it is clear that any comprehensive policy aimed at boosting American wage and income growth should indeed do most of these things.

In short, we *could* have given American workers a relatively prosperous life with growing opportunities even as we signed regressive trade agreements. But why should we even bother with the "regressive trade agreements" part of this equation?

Some would object to the idea that trade agreements must, by definition, be regressive. They would argue that the next trade agreement could be better for American workers if we just tweaked the rules to get them right. But by now it is clear that the entire process of pursuing large, omnibus trade agreements has been captured by corporate interests. This capture has happened with every agreement since the North American Free Trade Agreement (NAFTA). Each new agreement has text that has been tweaked for better (U.S.–Jordan) or worse (the Central American Free Trade Agreement [CAFTA]). But the constant is that the highest priorities of the corporate sector (ISDS and intellectual property protection) are given the most attention while efforts to use trade agreements to serve progressive goals largely fail.

Others would argue that the benefits to overall national income from trade agreements are so large as to justify undertaking the agreements. But these benefits are generally far oversold. Take, for one example, widely cited estimates from the Peterson Institute for International Economics on the potential growth payoff for the United States from the Trans-Pacific Partnership negotiated by the Obama administration. Their most aggressive growth forecast was that the TPP would provide a *one-time level shift* in U.S. gross domestic product of 0.4 percent after 10 years.[20] Essentially, the U.S. economy *with* TPP was forecast to reach an income level by September 2016 that it would have reached in December 2016 without TPP, and then to grow at the same pace afterward. Importantly, these estimates only examined the provisions of TPP that *liberalized* trade; they made no attempt to quantify the growth drag resulting from the increase in protectionism included in some portions of the treaty.

## The US should stop pursuing new trade agreements

Given the regressive insult that recent decades' trade agreements have layered on top of the regressive injury caused by globalization *writ large*, our perpetual pursuit of ever more trade agreements should be stopped, once and for all. One institutional change that a president could make to halt the perpetual pursuit of these agreements is to announce that under the current administration, the office of the United States Trade Representative (USTR) would no longer be in the business of negotiating treaties. Instead, it would simply focus on enforcing provisions of existing trade law that benefit American households.

This does not mean that there is no possible scope for (genuine) trade liberalization to be used as a tool to help American households. But this liberalization should be targeted in areas and sectors where it would relieve *genuine* economic challenges. For example, a clearly pressing problem for most American households is the high cost of health care. Health care costs in recent decades have been driven in part by the rising cost of pharmaceuticals. Given that drugs cost much less in many other countries than they do in the United States, genuine trade liberalization could provide some relief to American households by allowing drug reimportation. But the larger point is that efforts to liberalize trade should be driven by the desire to solve actual problems facing American households; it should not be driven by an assumption that the pursuit of ever-more trade deals is good in and of itself.

## How should the US renegotiate existing trade agreements if the opportunity arises?

Abandoning the perpetual pursuit of omnibus trade agreements will stop additional harm, but it won't undo harm that's already been done. The Trump administration seems to be proposing to undo or renegotiate past trade agreements, starting with NAFTA. In looking at NAFTA, the first thing to note is that the U.S. and Mexican manufacturing sectors have become tightly integrated in recent decades. One need not like the new equilibrium to which this integration has led our economies to recognize that ripping this integration apart could well impose new costs on American workers. Undoing a treaty like NAFTA, even if done intelligently with a progressive focus, would be challenging. Undoing it rashly, with a simple-minded aim of declaring American victory over Mexico, will most certainly provide no help to American workers.

All of this said, removing the ISDS provisions and putting enforceable labor and environmental standards in the body of the treaty (such standards are currently in toothless side agreements) would be welcome changes to NAFTA.[21] Further, provisions harmonizing intellectual property protection and financial regulation could be scrapped as well, with little downside. It seems hard to imagine why Mexico and Canada would object to this latter change, especially if the U.S. agreed to allow changes those countries wanted (perhaps some enhanced agricultural protection in Mexico).

In essence, the goal in any reform of NAFTA, and in all trade talks going forward, should be to make access to the U.S. contingent on basic respect for the labor and environmental standards rather than contingent upon the adoption of a range of corporate-friendly domestic policy preferences. How closely the Trump administration's priorities overlap with this goal will be a key tell as to how much help their trade policy reorientation will actually give American workers.

## But aren't trade agreements good for American exporters?

Proponents of trade agreements frequently stress the potential benefits to American exporters. This export focus is a bit odd, given that the textbook argument for the benefits of trade is that it will increase imports. In this argument, exports are the cost of expanded trade—what we need to produce and send to foreign consumers in order to purchase imports.

It is true in theory that trade agreements could be good for U.S. exporters if they were to reduce foreign barriers to American goods. But in reality, the structure of trade agreements keeps this benefit from appearing for the vast majority of American exporters, particularly in manufacturing. For one thing, the intellectual property protections in trade agreements force foreign consumers to pay more for American software, pharmaceuticals, and entertainment. This displaces foreign consumption of other American exports, such as manufactured goods. And the extra money that foreign consumers must pay for these intellectual property claims are emphatically *not* the result of liberalized trade, but are the result of increased protectionism.

Further, because no trade agreement has ever addressed the problem of exchange rate misalignments in any enforceable way, too often large exchange rate swings have followed the enactment of trade agreements, resulting in a huge increase in American trade deficits, not an export boom.

## Won't the abandonment of trade agreements hurt workers in poorer countries?

The most compelling concern raised in debates about America's policy stance toward globalization is that putting a halt to signing more trade agreements could reduce benefits that accrue to the poor nations of the world from access to the U.S. market for their exports. The goal of maximizing the benefits of U.S. market access for developing countries is a meaningful goal with real ethical implications. Yet it is far from clear that this goal is well-served at all by today's globalization status quo, or that a progressive rethinking of this status quo would necessarily increase the cost of these countries' access to the U.S. market.

We should begin this discussion by noting that the benefits of access to the U.S. market accruing to developing countries are often wildly inflated, and are often confused with benefits these countries have attained by liberalizing *their own economies*. It is true that rapid development in emerging economies has pulled billions out of poverty in recent decades. This is obviously a good thing. But too many (Beauchamp [2016], for example) have made implicit claims that this development and poverty reduction crucially hinged on improved access to U.S. markets. Yet the evidence they marshall does not support this claim.

For example, Beauchamp highlights a figure from Wacziarg and Welch (2008) showing that growth rates jump following an episode of liberalization. The size of the causal effect of trade liberalization on economic growth is a hugely contested issue in empirical economics, but we will take this study as given for now. The important thing to note about it, however, is that its results only measure the growth effect of *unilateral*, *domestic* liberalization. That is, they measure when (say) China decides to reduce *its own tariffs*, not when the tariffs of its trading partners are reduced. So the growth acceleration documented in this data is driven entirely by countries' own decisions and not by market access granted by trading partners.[22]

How can we be sure that recent decades' trade agreements have *not* been crucial in spurring the growth improvement in much of the developed world during this time? Because we know that the trade liberalization undertaken since the early 1980s (well before NAFTA) is utterly marginal compared to what came before. This is not a contested point. Take the Bradford, Grieco, and Hufbauer (2005) results frequently cited in policy debates. They claim to find enormous benefits from trade liberalization over the past 60 years. As Bivens (2007) notes, the magnitude of these claimed benefits is frankly implausible. But even Bradford, Grieco, and Hufbauer (2005) show that the post-1982 period of trade liberalization constitutes just *0.1 percent of the total benefits*. So, even according to this extremely pro-liberalization study, one could erase decades of trade agreements (the period that saw the creation of the WTO, NAFTA, CAFTA, the Korea-U.S. free trade agreement, PNTR with China and China's entry into the WTO, and many others) and yet leave *99.9 percent* of the increase in U.S. market access granted to other countries' exports since World War II untouched. It is hard to see this as cataclysmic for the (worthy) cause of maximizing this access.

Further, for the general cause of maximizing U.S. market access for poorer countries, it is likely that the post-1982 period is even worse than this study indicates. The key here is recognizing that "trade liberalization" and "access to the U.S. market" are not the same thing. Would "rolling back trade agreements" automatically *reduce* access to the U.S. market for poorer countries? Not necessarily.

This is because agreements like NAFTA are not just exercises in providing costless access to U.S. markets. For example, as we noted before, recent trade agreements have universally required that U.S. trading partners adopt intellectual property standards that benefit U.S. pharmaceutical, software, and entertainment companies. These provisions impose real costs on foreign (often poor) consumers by raising the prices they pay for drugs, computers, and entertainment. They also, by definition, constitute a heavy price for the greater access to the U.S. market obtained in these trade agreements. One could easily imagine a world where this market access was granted at a lower price than is provided today. For example, making more liberal U.S. market access contingent on meeting minimal labor and environmental standards—instead of being contingent on these poorer countries spending scarce domestic resources becoming bill collectors for drug, software, and movie companies—would be a huge win for poorer countries' ability to export to the United States.

## The US should pursue international cooperation on economic policy to solve these problems

Are calls to abandon the modern process of pursuing omnibus trade agreements tantamount to isolationism? Not at all. There are numerous challenges facing the United States and other countries that can only be solved through international cooperation. We should reorient our international economic policymaking to focus on these challenges, not on the problems allegedly addressed by current trade agreements. Below are a few ways the international community can work together to forge solutions with widespread benefits.

**Coordinate globally to enable countries to tax capital income and to clamp down on abusive tax havens.** Capital is mobile internationally, and capital incomes are extremely concentrated at the top of the income scale (in all countries). If progressive taxation is seen as a desirable policy, then countries must be able to tax capital without it simply fleeing (either for real or on paper) to low tax rate havens. Zucman (2015) has documented how enormous the problem of untaxed capital is.

**Institute a global financial transactions tax (FTT).** A particularly good way to tax capital is through FTTs. But FTTs would be far more effective—both in curbing speculative excess in finance and as revenue generators—if they were instituted internationally, rather than in any one specific country.

**Harmonize national policies aimed at combating global climate change.** At the moment, some of the benefits of any single country undertaking policies to increase the cost of carbon emissions are lost when carbon-intensive production migrates to countries without a climate policy. This carbon “leakage” makes the policy less effective and implicitly penalizes workers in tradeable goods sectors that live in countries with aggressive climate change policies. This is a terrible dynamic with serious international economic policy implications.

**Coordinate internationally to address exchange rate misalignment.** Perhaps most relevant to debates over trade, international coordination on exchange rate misalignment would be of huge help to workers around the world. For most of the past 20 years, the value of the U.S. dollar has been too high to balance trade. In some periods, this misalignment was driven by private capital flows (for example, a large appreciation versus the Euro during the U.S. stock market bubble in the late 1990s, as foreign investors reached for dollars to invest in American companies). In other periods, this misalignment was driven by intentional policy decisions of trading partners (for example, the very large accumulation of official currency reserves by the Chinese government from the late 1990s to roughly 2012). Whatever the source of exchange misalignments, they are damaging. In the United States in the 2000s, these misalignments sapped aggregate demand through net export channels, while the capital inflows associated with them kept long-term interest rates low, propping up demand through home-building. This constellation of demand was eventually unsustainable and contributed to the Great Recession. Conversely, China throughout the 2000s was not demand-constrained, so benefits from net exports were minimal and could have been achieved with other instruments besides managing the value of its currency. Using international coordination to keep misaligned exchange rates from causing damage around the world should be a much higher priority than pushing more business-as-usual trade agreements.

# Conclusion

Finally, it is worth noting how odd it is that recent decades’ trade agreements have so often been championed by Democratic presidential administrations. Again, the textbook understanding of trade liberalization is that it will boost national income overall while redistributing enough income regressively to leave most workers worse off. In this sense, it is quite similar to the textbook effects of cutting top marginal tax rates and financing these cuts with across-the-board cuts to government transfer payments like Social Security or Medicare.[23] Yet almost no Democratic president would champion such a tax-cut-cum-transfer-cut strategy. So why would a Democratic president champion trade liberalization without compensation that leads to the same outcome? Most Democratic members of Congress seem to understand the regressive effects of trade liberalization. While the major trade agreements of recent decades have tended to be supported by Democratic presidents and a majority of Republican lawmakers, most Democrats in Congress have opposed these agreements.

Of course this does not mean that Democrats must never support a decent trade agreement (should one be found); instead it means that their role in this debate should be to insist upon good agreements and compensation sufficient to restore the wage growth prospects of the huge number of workers that will be harmed. This compensation should come in the form of broad-based, large domestic interventions that restore bargaining power or boost incomes for low- and moderate-wage working people and their families. A full menu of policies to do this can be found in Mishel and Eisenbrey (2015).

Relying only on domestic compensation to deal with the effects of trade on American workers, however, assumes that the trade agreements we have signed in the past 20-odd years have been exercises in good-faith liberalization of trade that have greatly expanded access of the world's poor to U.S. markets. But, in fact, they have not been. They have instead been the result of corporate capture that has engaged in selective and regressive protectionism while restricting the policy space of our trading partners. This is not how we should be engaging in the world, and it is not retreating into isolationism to recognize this. We can do better by both America's workers and the workers of our trading partners.

# About the author

**Josh Bivens** joined the Economic Policy Institute in 2002 and is currently the director of research. His primary areas of research include macroeconomics, social insurance, and globalization. He has authored or co-authored three books (including *The State of Working America, 12th Edition*) while working at EPI, edited another, and has written numerous research papers, including for academic journals. He often appears in media outlets to offer economic commentary and has testified several times before the U.S. Congress. He earned his Ph.D. from The New School for Social Research.

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# Endnotes

1. As long as the increase in trade flows is exogenous, it is straightforward to map out its effects on American wages. In theory, trade flows could have increased because American wages were changing, but very few professional participants in the trade and wages debate consider this possibility a serious hurdle to assessing trade's impact on wages.

2. Of course, even this claim that expanded trade is "win-win" between countries is subject to all sorts of caveats. The most important one is that it assumes full employment in both countries. Samuelson (2004) identifies other important caveats as well.

3. "Relatively" is the crucial word here—even if production costs were lower in China for both clothing and aircraft (they are not—and U.S. productivity advantage in the latter dominates the wage costs), it would still make more sense for China to specialize in the former, as their cost advantage is naturally much greater in more labor-intensive industries. Think of a lawyer who types faster than her secretary—will she decide to cut back on the legal services she provides to do more typing? Of course not—she'll concentrate on the activity where her relative (not absolute)

advantage is greater.

4. Those familiar with trade theory will recognize this as a description of the Stolper-Samuelson theorem. This theorem says that expanded trade will see the return to a country's abundant factor of production increase, while the return to its scarce factor will decline. What's key in this description is that "abundant" and "scarce" are relative terms that compare the U.S. to the global economy. So, while workers without a four-year college degree constitute the majority of the U.S. workforce, they constitute the scarce factor of production for the U.S. because they represent a smaller fraction of the U.S. workforce than the global workforce. There is a longstanding debate in the international economics realm about whether this Stolper-Samuelson theorem is *precisely* correct. For a good sampling of this debate, see Davis and Mishra (2007) and Wood (2009). While the strict mapping of factor prices and product prices may well not hold in the real world, there is ample supporting empirical evidence that the bundle of imports and exports in the United States economy really does lead to excess supplies of labor and deficient supplies of capital relative to the nontraded economy. It is hard to see how this would not translate into lower returns for labor and higher returns to capital. As Wood (2009) argues, "narrow" versions of Stolper-Samuelson that work through textbook, perfectly competitive markets that allow precise mapping of product and factor prices will likely fail. But "broad" versions that simply say trade leads to lower demand for labor and higher demand for capital in the United States will almost surely hold. Finally, there is a temptation to say that because the first versions of Stolper-Samuelson predicted relative increases in the Global South, and this has not generally happened, that it cannot be relevant for the United States. This is far too facile an argument. For one, it could be that Stolper-Samuelson effects are indeed at work in the Global South, but are simply being swamped by other determinants of wage growth (growing productivity, the move from rural to urban labor markets, etc.). For another, since Feenstra and Hanson (1997), there has been a modified form of Stolper-Samuelson that argues for trade and offshoring in a continuum of goods (not just two) that pushes all countries' factor demand toward capital and away from labor, as globalization allows every country to "take a step up" the value chain.

5. For this comparison of globalization-induced redistribution and various policy initiatives, see Bivens (2008).

6. This is based on the rough rule of thumb that trade redistributes about five to six times more income than it creates.

7. Securing better market access for workers in developing countries is a persuasive reason why "liberalize and compensate" is a better overall strategy if one is also concerned (as one should be) with the welfare of workers outside of the United States.

8. See Bivens (2013) for how imports from low-wage countries are measured.

9. The specific geographic areas they examine are "commuting zones," or "CZs." In 2000, the Census Bureau identified 709 CZs across the United States.

10. This implicitly assumes that all other developing country imports have the same dispersion across geographic locations as imports from China.

11. An example of this is Matt Yglesias's recent claims on the *Vox* podcast regarding trade, wages, and prices: "[Trade protection] is not really a transfer from fancy coastal people who don't really spend that high a share of their income on import goods, but a transfer from residents of places like Eastern Kentucky and Mississippi to residents of not-rich but more-affluent areas like Wisconsin, Michigan, and Pennsylvania" (*Vox* 2016).

12. The intuition for this is relatively simple: as trade barriers fall or as incomes abroad rise, there is greater competition to buy the output of American producers. As exports rise, American consumers are in effect competing with foreign consumers for purchasing this output, hence prices rise.

13. The intuition is that the cost of producing something can be broken down into the constituent price of inputs. Since trade leads to prices for one of these inputs falling (labor) while the other input's price rises (capital), the percentage fall in labor's price (wages) must be greater than the percentage change in prices.

14. See Bivens (2015b).

15. See Scott (2015) for some evidence on productivity growth, trade deficits, and manufacturing employment.

16. This is true even if one believes that the root cause of trade deficits is deficient domestic savings, a commonly expressed view. Focusing on domestic decisions about how much to save is largely a distraction in debates over trade deficits. In recent years, trade deficits have surely affected the level of saving, as income and savings have been largely driven by the level of aggregate demand, which is affected by the trade balance. Further, even at full employment the savings decisions of American trading partners (the global savings glut, for example) can have very large impacts on trade deficits. But even if one believed that increasing domestic savings is the key to reducing trade deficits, this increased savings would only translate into a lower trade deficit through *an exchange rate change*. And if one believes that these necessary exchange rate changes are being blocked by policy action, then one can cut right to changing these exchange rates directly.

17. A formal description of how this monopoly is eroded and affects wages is provided by Anderson, Tang, and Wood (2006).

18. Two papers demonstrating that trade liberalization might have stronger effects on trade flows than conventional measures might indicate are Pierce and Schott (2016) and Ruhl (2008).

19. See Bivens and Mishel (2015) for an extensive discussion of this pay–productivity disconnect.

20. See Bivens (2007) and Bivens (2015a) on the overselling of estimated gains from specific trade liberalizations.

21. The labor standards would mandate that all signatories respect the labor standards that the International Labour Organization (ILO) has identified as fundamental rights for workers. Failure to recognize and enforce these standards could then constitute grounds for countervailing trade protection measures.

22. This is, by the way, entirely consistent with economic theory—in mainstream trade theory (see Krugman [1993]), the benefits of "free trade" are dominated by the benefits of importing cheaper goods, and the benefits of expanded exports are very minor. And the ability to import cheaper goods is entirely at the discretion of our trading partners and not contingent on any decisions we make about market access.

23. Furman (2016) makes an excellent point that the GDP gains stemming from cuts in tax rates predicted by textbook models actually boost welfare by a much smaller amount, as these gains mostly stem from either more work (which causes disutility) or more savings (which means consumption is deferred). This criticism does not apply to the income gains spurred by textbook trade liberalization. However, more importantly, the losses from a tax/transfer cut strategy and

from expanded trade are both welfare-damaging in comparable ways.

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