Making Global Markets Work for American Workers

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A subtle shift in emphasis in trade agreements…

- “Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods …”

GATT (1947)

- “Resolving to establish a comprehensive regional agreement that promotes economic integration to liberalise trade and investment, bring economic growth and social benefits, create new opportunities for workers and businesses, contribute to raising living standards, benefit consumers, reduce poverty and promote sustainable growth …”

TPP (2016)

Reflecting a broader transformation of globalization

- The “embedded liberalization” model (GATT/IMF)
  - world economy at the service of domestic economy
  - tackling restrictions at the border, limited scope, w/ compensation
  - export-oriented groups as counterweight to domestic protectionists
  - capital account management
  - policy space, autonomy for each national developmental model
- The hyper-globalization model (WTO, FTAs, financial globalization)
  - globalization as the end rather than the means
  - tackling behind-the-border “restrictions;” capital mobility, deep integration, (necessary) decline of compensation
  - international firms and banks as the new rule and agenda setters
  - approach predicated on ultimate convergence of economic models

While some countries continued to play by the earlier (BW) rules

<u>Hyper-globalist ideal</u>

- market economy, with exclusively private ownership
- no interference in international trade
- liberal investment regime
- IP protection
- free capital mobility
- free currency float

<u>Chinese reality</u>

- continued reliance on state direction and state-owned enterprises
- moderate trade barriers, export subsidies
- technology transfer and local content restrictions
- IP violations
- controlled capital account
- managed exchange rate

Successful globalizers' policies cannot be copied, but they carry an important lesson

Making globalization work requires a proactive domestic economic strategy (that goes beyond education and training)

- full-employment macro policies
- labor market institutions that address inequities in bargaining power
- employment-friendly technology policies (Acemoglu, Tyson)
- public-private collaboration aimed at getting firms to internalize "good jobs" externalities
  - aka "industrial policy"
  - Rodrik & Sabel, Building a Good Jobs Economy (2019)

Primacy of domestic agenda

- In two senses:
  - Positive: what happens at home has (and will have) much greater impact on workers than what happens in world markets
  - Normative: domestic priorities (of inclusive prosperity) takes precedence over international economic integration

- Q: How to ensure the latter, where labor is concerned?

Next…

- How is trade different from other (domestic) shocks?
- Why compensation falls short
- Implications
  - For trade agreements
  - For self-help (anti-social dumping)

What does economics say about trade and trade agreements?

- Comparative advantage and gains from trade
  - reducing barriers at the border generally enlarges overall economic pie
    - with some important caveats in the presence of market imperfections/failures
  - but not everyone wins
    - less-skilled workers and import-competing sectors lose out
    - Stolper-Samuelson theorem and generalizations
  - gains from trade and redistribution are two sides of the same coin
    - since gains from trade derive from productive reallocation of resources
- Diminishing gains from trade
  - as trade barriers get smaller, redistribution looms larger compared to the gains from trade
- New trade agendas entail ambiguous benefits and even sharper conflicts in terms of distribution and/or values
  - trade-off between gains from trade and gains from regulatory diversity (e.g., TRIPS, ISDS, subsidies, regulatory harmonization)

But is trade special?

- Other labor market shocks tend to quantitatively dominate
  - SBTC, automation, demand shifts, etc.
- And there may be little reason to treat/respond to labor market displacement due to trade differently from other sources of labor market churn
  - compensation should be independent of labor market shocks?

A thought experiment

Suppose we can engineer a social reordering that leaves Harry $5 richer and John $4 poorer. Should we do it?

The scenarios below describe different mechanisms that achieve those ends. Should they be blocked or allowed to run their course?

A. Harry works hard, saves and invests a lot, and comes up with new techniques and products, while John lags behind.
B. Harry finds a cheaper (or higher quality) supplier in Germany.
C. Harry outsources to a supplier in Bangladesh, which employs child workers in 12-hour a day shifts and under hazardous conditions.
D. Harry brings Bangladeshi workers to the U.S. under temporary contracts, and puts them to work under conditions that violate domestic labor, environmental, and safety laws.

Mechanisms matter to evaluations. People tend to respond differently to scenarios. For economists, B and C are alike; but then not clear why they reject D.

Social contracts and globalization

- What kind of market transactions should we condone as a society (and which should we block)?
- In domestic setting, the answers we give to this question are codified in our laws and regulations (but evolve)
  - minimum wage laws and labor standards
  - financial regulations
  - health, safety, environmental regulations
  - taxes and other redistributive arrangements
- Different nations, different rules
  - arising from preferences, circumstances, or experimentation
- By joining markets together, globalization creates arbitrage opportunities among these different rules
- Leading to
  - a gap between de jure and de facto rules
  - dissonance between implicit social contracts and prevailing (de facto) practices

Why compensation does not work in trade

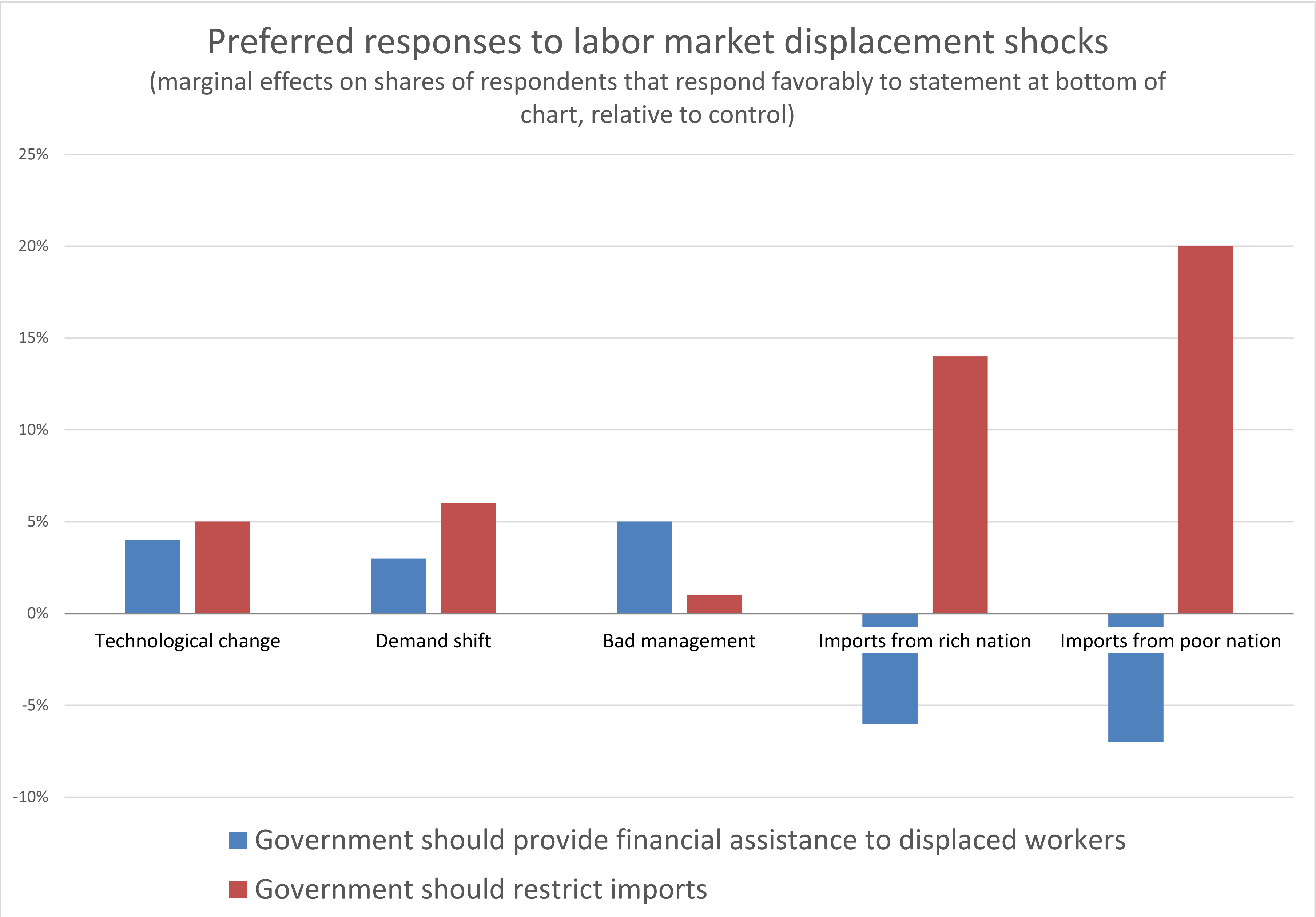
- Feasibility: the distribution-to-net-gains ratio (economics)
- Credibility: ex-post compensation inherently subject to time inconsistency (politics)
- Rules: political conflict today increasingly about the behind-the-border encroachments of new-style trade agreements (norms of fairness, institutional arrangements)

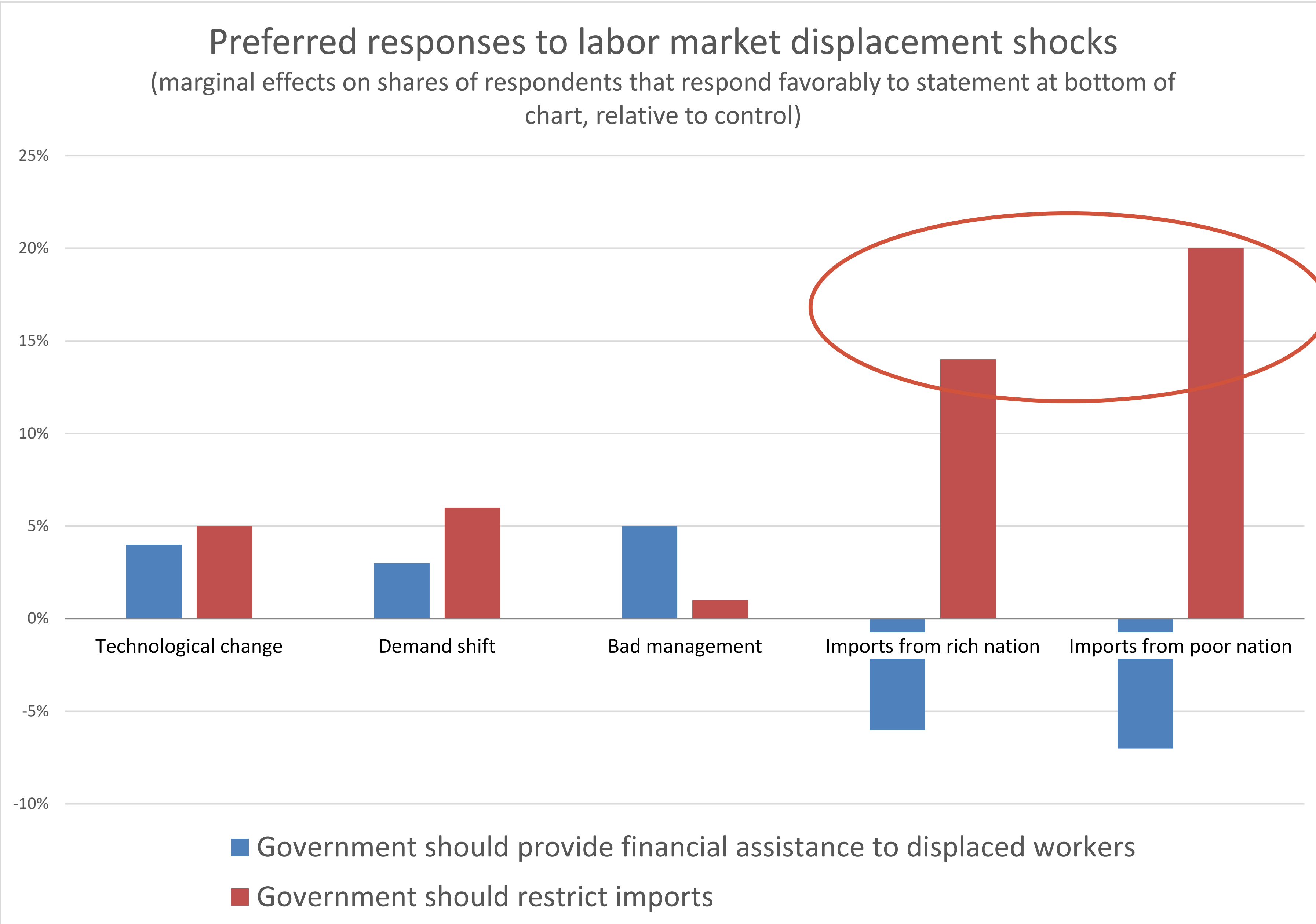
The economic limits of compensation

- Lump sum transfers typically not possible
- In practice compensation involves economic distortions at several margins (taxes, transfers to recipients)
- Antras et al. (2017):
  - "trade-induced increases in inequality of disposable income erode about 20% of the gains from trade, while the gains from trade would be about 15% larger if redistribution was carried out via non-distortionary means."
  - Note that in Antras et al. trade costs are iceberg costs, not tariffs (or QRs). The latter have revenue implications, and imply greater redistribution.
- In advanced stages of globalization, economic costs of compensation would eat up bulk (if not all) of the gains from trade
  - Even with an excess burden of taxation as low as $0.10 per dollar, the gains from trade are more than exhausted with the kinds of redistributions yielded by simulations above
- Moreover, as capital become more mobile internationally, burden of taxation shifts to labor, defeating the purpose

The political limits of compensation

- Credibility: promises to redistribute ex-post are time-inconsistent when a trade deal undermines power of veto players
  - TAA has typically been underfunded and ineffective (GAO 2012)
- Fairness and distributive justice: when trade entails regulatory arbitrage, compensation misses the target
  - survey evidence from a randomized experiment (Di Tella and Rodrik 2019)


Preferred responses to labor market displacement shocks
(marginal effects on shares of respondents that respond favorably to statement at bottom of chart, relative to control)
25%
20%
15%
10%
5%
0%
-5%
-10%
Technological change
Demand shift
Bad management
Imports from rich nation
Imports from poor nation
Government should provide financial assistance to displaced workers
Government should restrict imports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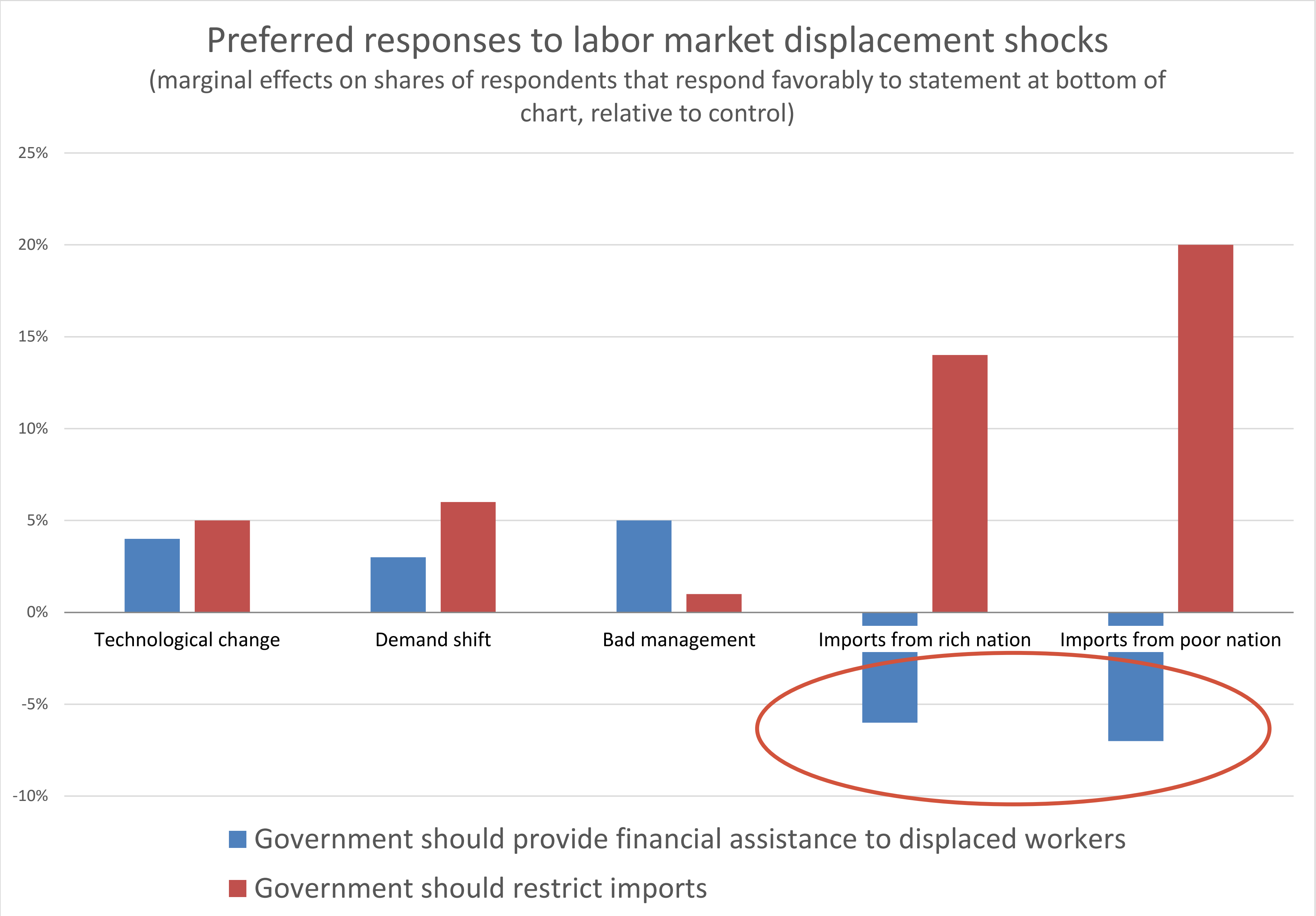

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Implications for trade policy

- Labor clauses in “deep integration” trade agreements
  - record to date very poor
- Self-help: dealing with “social dumping”
  - an anti social dumping proposal (Rodrik 2019)
  - to uphold principle that countries have the right to “protect” national (labor) standards when trade undermines domestic institutional arrangements, by withholding market access if necessary
  - through domestic deliberative process open to all stakeholders
- But “protection” works only if there is something worth protecting
  - hence return to (primacy of) domestic agenda