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Trade Policy and Election Promises: Does the Rhetoric Match the Facts?

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There are major differences among the presidential candidates on issues like tax levels, the role of government, Social Security, health care, and trade, and I would be happy to talk about any of them. I'm going to start, however, by talking about the candidates' views on trade. It's my main area of specialization in my current job. It also has the advantage of being what I was asked to talk about by the sponsors of this lecture.

I want to start with some ideas about how one should approach any of the policy pronouncements or campaign promises by presidential candidates. I would propose a four-step process:

First, ask yourself: Has the candidate stated a problem that is real? It is an interesting—some would say sad—feature of this wonderful society in which we live that those vying for political power may be tempted to exaggerate problems in order to justify the campaign promises or platforms on which they would like to be elected. We need to ask ourselves during election season if we agree that the situation being described by a candidate is real and if it's a problem. Is the description of it accurate and based on sound data?

Second, if the answer to those questions is yes, then has the candidate proposed a goal that is consistent with the problem? If job loss in certain communities in Ohio is the problem, is renegotiating NAFTA a reasonable and appropriate solution?

Third, is the proposed solution achievable? Is it something that can happen politically in the real world?

Talking Points

- To be informed voters, we have to try to read between the lines, be aware of nuance, judge emotional intensity, and look at the candidates' records. It's not easy, but absolutely necessary if our votes are to count in the way we want them to.
- We are all consumers, and the average benefit of our liberalized trade system for consumers has been estimated at up to $10,000 per year for a family of four. We get access to more goods and services, higher-quality goods and services, at lower prices as a result of trade.
- Trade benefits society as a whole. When our political candidates are saying something different, we need to listen carefully and cautiously. The changes they are promising could wind up costing us all dearly.

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Finally, and very importantly, will the proposed solution affect other areas as well, perhaps creating unintended negative consequences along with the promised benefit? This is always a significant problem in connection with economic issues. Our economy is a web of interconnections, and changes in one area often have effects in others. More broadly, government solutions generally imply tax increases or new regulations, both of which can sap the vitality from an economy.

Take an issue like climate change. We know we can reduce the emission of greenhouse gases by reducing the level of economic activity, and most of the proposals that have been suggested both domestically and internationally would have this effect, either through tax increases or cap and trade schemes. These increase the cost of energy and will reduce energy use, but they will also lower standards of living: We will have less income, less health care, more poverty, less scientific research and progress. Are we willing to accept these consequences?

"…Create More American Jobs"

What have the candidates actually said? Have they stated a problem that is real? Here's a quote from Senator Barack Obama's Web site: "Trade with foreign nations should strengthen the American economy and create more American jobs."[1]

I'm not sure I hear a problem, though the Senator seems to be implying that trade does not now strengthen the American economy. By all accounts, such an implication would be wrong.

The first half of the sentence is a statement of economic theory that has been demonstrated over and over throughout the world. Trade with foreign nations does in fact strengthen the American economy. We are not forced to trade. We do so because it makes us better off. If I as a consumer buy product X from country Y, it is because I am better off having made the purchase. If I as a producer sell product Y to country Z, it is because I am better off having done so. As long as these transactions are voluntary, it is a very safe assumption that they make each party better off and strengthen the economy.

The concept of comparative advantage tells us that if people or countries specialize in those areas of economic activity in which they are relatively more efficient and then trade their production with each other, the total amount of goods available will increase. So if you believe that a bigger economy—one with more goods available—is a stronger economy, trade is definitely a plus.

The second half of the sentence is more problematic. Senator Obama talks about creating more American jobs. Standard economic textbook examples of the benefits from trade—that is, the benefits of comparative advantage—assume fixed inputs of labor in both countries. In other words, they hold the number of jobs constant.

The benefit from trade is not that there are more jobs, but rather that labor is used more productively; i.e., that each worker, on average, produces more in an environment with specialization and trade than they would have before. Overall economic activity is more efficient, and production is higher, but there is no change in the number of jobs.

What, then, determines the number of jobs? Well, the size of the population for starters. And the amount of investment. Finally, the extent of freedom in the labor market—that is, how easy is it to hire and especially fire workers, and how strong are labor unions? A study in 2000 by Pietro Garibaldi and Paolo Mauro at the International Monetary Fund reports that there is less job creation where unions are powerful and that extensive employment protection by government and higher levels of taxation both appear to dampen job creation.[2]

Even if we agree that the overall number of jobs is not necessarily changed by trade, the composition of those jobs will definitely change. An individual may lose his or her current job as a result of trade and have to seek different employment.

A Jobs-Creation Machine

In recent years, the U.S. economy has been a great jobs-creation machine. On average, the U.S. economy is creating about 150,000 additional jobs

1. Senator Barack Obama, Campaign Web site, "Economy," at *www.barackobama.com/issues/economy* (March 19, 2008).
2. Pietro Garibaldi and Paolo Mauro, "Job Creation: Why Some Countries Do Better," International Monetary Fund, *Economic Issues* No. 20, April 2000, p. 8.

each month. Now, that didn't happen last month. Non-farm employment reportedly declined by 63,000 people, so policymakers and economists are concerned.[3] But one month doesn't make a trend, and I would be very surprised if next month's figures don't show employment growth again.

Just looking at jobs lost or jobs gained doesn't tell the whole story. These figures are marginal changes in an overall flow of job destruction and job creation that is much larger. According to the chairman of the Federal Reserve, Ben Bernanke, on average, about 15 million jobs disappear each year in the U.S. economy.[4] They go away because people's consumption preferences change or because new products or new ways of production come into being. A very small percentage of jobs—2 percent according to Bernanke—goes away as the result of international trade.

The U.S. automotive industry proves a quick, useful case study. We've all heard stories of U.S. auto manufacturers in trouble. We can see the inroads foreign manufacturers have made in the industry every time we take a drive.

But a July 2007 report by the U.S. Bureau of Labor Statistics attributes automotive job loss in the Midwest not only to foreign competition, but also to domestic competition from states like Alabama, Kentucky, and Tennessee, as well as increased automation and productivity. Between 2000 and 2005, output per work hour in auto parts production increased by 28.6 percent.[5] Demand for foreign cars, originally created through imports, has led increasingly to U.S. production and new U.S. jobs. Members of the Association of International Automobile Manufacturers (AIAM)—which includes industry heavyweights Toyota, Honda, and Nissan—have invested more than $35.5 billion in 54 manufacturing and R&D centers in the U.S. since 1982.[6]

Fortunately for the economy as a whole, as 15 million jobs do go away each year, 17 million new jobs are being created. This constant creation and destruction of jobs is called churning. Actual levels of churning in the U.S. economy are even higher than those caused by job loss. According to Deputy Secretary of the Treasury Bob Kimmit, more than 55 million Americans left their jobs in 2005, while there were 57 million new hires.[7] This job churning is one of the most telling features of the highly flexible and ever evolving U.S. economy.

Costs and Benefits

The U.S. has higher rates of churning than most European countries. We also have higher levels of productivity growth, higher levels of GDP growth, and lower unemployment rates. Those are the benefits.

What are the costs? Well, each of those 15 million jobs that ceased to exist was being performed by a real live human being, and that human being and his or her family have undergone the stress of involuntary unemployment and a job change.

To be clear, in most of these cases, the people losing their jobs go on quickly to better, higher paying jobs than they held before. Again according to Bernanke, during the 1990s, average earnings in manufacturing industries that showed net declines in employment were $10.63 per hour. During the same period, wages in expanding service-providing industries were $11.26 per hour, or about 6 percent higher.[8]

3. U.S. Department of Labor, Bureau of Labor Statistics, *The Employment Situation: February 2008*, March 7, 2008, at *www.bls.gov/news.release/pdf/empsit.pdf* (March 19, 2008).
4. Governor Ben S. Bernanke, Remarks at Distinguished Speaker Series, Fuqua School of Business, Duke University, Durham, North Carolina, March 30, 2004, as published by the Federal Reserve Board at *www.federalreserve.gov/boarddocs/Speeches/2004/20040330/default.htm* (November 26, 2007).
5. Benjamin Collins, Thomas McDonald, and Jay A. Mousa, "The Rise and Decline of Auto Parts Manufacturing in the Midwest," *Monthly Labor Review*, October 2007, pp. 14–21 (March 19, 2008).
6. Association of International Automobile Manufacturers, "National Impact," 2007, at *www.aiam.org/public/aiam/impact/national_impact.aspx* (March 19, 2008).
7. Robert M. Kimmit, "Why Job Churn Is Good," *The Washington Post*, January 23, 2007.
8. Bernanke, Remarks at Distinguished Speaker Series.

There are cases, of course, where individuals who lose their jobs involuntarily don't find good-paying replacement jobs immediately. There are cases where a plant that is a major employer in a town may close, with harsh consequences for its employees, their families, and other businesses that served the community. The stories of these towns and the people that live in them are compelling.

In fact, one of the distorting features of our political dialogue is that these stories of individuals who suffer as a result of what Joseph Schumpeter called the "creative destruction" of capitalism are perfectly suited for television journalism. First of all, they are negative, and there is a strong bias in our media toward reporting negative rather than positive stories. I am not criticizing this. One of the main functions of our fourth estate is to observe and report things that need to be changed.

Also, such stories have the power to touch us emotionally. Again, I am not criticizing this. I'm glad we have the ability to be moved by the misfortune of others. I would not want to live in a world characterized by callousness.

But the story of the individual losing her job is, for the vast majority of such people, only half of the story. The other half is what happens next, and for most people what happens next is a new job with better working conditions and higher pay. Not for everyone, but for most.

So the story of job loss is only half of the story of capitalism's creative destruction of jobs and an even smaller part of the story of trade. The positive side of this process rarely shows up on the nightly news. We need our national leadership, including the candidates for President, to remind us of the whole story.

"Fair Trade"

Senator Obama's Web site includes a section entitled "Fight for Fair Trade." His basic policy prescription seems to be to pressure other governments to open their markets more to American goods. The pressure would come presumably in the form of threats to restrict access to the U.S. market for goods from other countries.

There are a lot of calls for "fair trade" these days, and it would be worthwhile to think about what this concept might entail. Does it mean exports and imports are balanced and that there is no trade deficit? We would be a much poorer economy in that case, with fewer and more expensive goods available for purchase and fewer financial resources coming into the U.S. to promote the investment that helps our economy and our incomes grow.

Does fair trade mean that we would insist that our tariff rates equal those of the foreign country with which we wish to trade? A tariff is just a tax, and we would in effect be letting other countries set our domestic tax rates for us.

Does fair trade mean that we should insist that other countries adopt labor and environmental standards equal to our own? This is an economic issue couched in moral tones, and it does have profound moral consequences. For me, the moral question is: Do we have the right to impose our standards on others? If we make another country artificially increase the cost of labor in industries producing tradable goods above its real wage rates, employment will go down in those industries and in the foreign country overall. The unemployed will suffer as a result. Poverty will increase. That's not a moral result by my calculus.

Should we make foreigners increase the level of environmental protection in their countries? Environmental protection is a good like any other. It has a price. A rich country will be able to afford more of it than a poor country. It may be better for the people of a poor country to opt for less environmental protection and more growth now in order to meet the immediate needs of their people and reduce poverty. Such a strategy may also be better for the environment in the long run because, as the society becomes richer, it will be able to afford better environmental protection than it can at present.

Philosophers and ethicists devote lifetimes to the study of societal equity and fairness. From my perspective, an agreement between two parties that is entirely voluntary and from which both parties benefit, even if the benefits are not equal, should enjoy a strong presumption of fairness. Win/win solutions are not as common as we would like in this world, and an economic arrangement that consistently delivers them, such as free trade, is a rare and precious thing. The alternatives—managed ism—will not deliver the same levels of benefits to all parties.

Government intervention is, by its very nature, coercive rather than voluntary. When government intervenes, it is to make someone do something they otherwise would not do. A tariff makes consumers pay more for a product than they otherwise would. A quota makes them buy more from a domestic producer even though they would have benefited from using a foreign manufacturer.

When we say trade protection, we are not talking about protecting consumers. We are talking about imposing costs on consumers—American consumers—to protect the status quo of current manufacturers and manufacturing practices. We are protecting our businessmen or farmers or labor unions from foreign competition, but it is the American consumer that is paying the cost.

At its most basic level, trade protectionism is nothing more than a transfer of income from consumers in America to selected producers in America. If that's something you want to do, you can vote accordingly. For me, fair trade is trade that is free of government interference.

NAFTA

Much to my surprise, the North American Free Trade Agreement (NAFTA) has become a prominent trade-related issue in this campaign. Senator Obama wants to renegotiate NAFTA "so that it works for American workers."

I had thought the issue of NAFTA was long settled. Its effects have been extensively studied in both the Clinton and Bush Administrations. Recently, the Office of the U.S. Trade Representative has looked at the U.S. economy during NAFTA and compared key indicators with the similar period before NAFTA. Here are some comparisons of the first 13 years of NAFTA with the 13 years before.[9]

- During NAFTA, U.S. employment went up from 112.2 million jobs to 137.2 million jobs, an increase of 25 million jobs. We haven't really heard Ross Perot's giant sucking sound.
- The average unemployment rate during NAFTA has been 5.1 percent, compared to 7.1 percent during the 13 years before its passage.
- Manufacturing output rose 63 percent between 1993 and 2006, compared to 37 percent between 1980 and 1993.
- Real compensation of manufacturing workers rose 1.6 percent annually during NAFTA as compared to 0.9 percent annually in the prior period.
- Investment rose 107 percent, compared to 45 percent in the comparable prior period.

So by all these indicators, we have been better off during NAFTA than we were before its passage.

Do They Mean What They Say?

Now, you may think I have been picking on Senator Obama. I have used his statements because his positions on trade tend to be at one end of the spectrum. Senator Clinton's rhetoric on trade is similar in many respects to Senator Obama's but tends to be more nuanced. If you wanted to be ungenerous, you could even say she leaves herself a little bit of wiggle room. Most notably, she has called for a trade "timeout,"[10] which could mean changing a lot of things or changing nothing. We don't really know.

Senator McCain supports existing and proposed trade agreements and wants to further lower barriers to trade.[11] His campaign would seem to promise a continuation of the Bill Clinton/George Bush policies on trade liberalization.

Interestingly, all three candidates talk about pressuring other countries to lower their barriers, getting better enforcement of agreements, leveling the global playing field, and helping workers who lose their jobs.

9. Office of the U.S. Trade Representative, "NAFTA Facts," *NAFTA Policy Brief*, October 2007, at *www.ustr.gov/assets/Trade_Agreements/Regional/NAFTA/Fact_Sheets/asset_upload_file366_13495.pdf* (November 26, 2007).
10. Hillary Rodham Clinton, "Clinton's Statement on the Trade Agenda," February 19, 2008, at *www.cfr.org/publication/15611/clintons_statement_on_the_trade_agenda.html*.
11. Senator John McCain, Campaign Web site, "On the Issues: McCain Tax Cut Plan," at *www.johnmccain.com/Informing/Issues/0B8E4DB8-5B0C-459F-97EA-D7B542A78235.htm* (March 19, 2008).

Even though there is a range of views, the candidates often use similar rhetoric. It can be difficult to parse the differences. We also face a real dilemma in knowing whether the candidates really mean what they say. Witness the recent spectacle of an Obama adviser reportedly telling the Canadian government that his candidate didn't really mean what he was saying against NAFTA.[12]

To be informed voters, we have to try to read between the lines, be aware of nuance, judge emotional intensity, and look at the candidates' records. It's not easy, but absolutely necessary if our votes are to count in the way we want them to.

The big mistake that all the candidates make in trade discussions is in limiting the talk only to jobs. Remember that, according to Fed Chairman Bernanke, only 2 percent of jobs lost in the U.S. are lost because of trade. The other 98 percent are lost because of other factors, mainly changes in taste or increases in productivity. And more jobs are created than are lost. Nobody wants to criticize changes in taste or increases in productivity, so trade seems to become the target of opportunity when trying to address economic insecurity or job loss.

Let's go back to the beginning when I asked whether the problem the candidates are talking about is a real problem. There is no question that some people lose their jobs in ways that cause problems for them and that some very small percentage of those lost jobs is the result of trade. But more people are gaining more jobs and more prosperity as a result of the exact same processes. Given the large benefits for society as a whole, versus the small costs, we would be hard-pressed to change the system in a way that improved overall well-being for society as a whole. Renegotiating NAFTA or turning back globalization would really be a case of throwing the baby out with the bathwater.

Can we help those few who do have problems as a result of the system adjust and get their lives going again? Absolutely, and we already have programs designed to do just that. These programs, which include things like trade adjustment assistance and unemployment assistance, may help people in need at critical moments in their lives. The problem is ensuring that they provide help without reducing the incentive to work. We need to evaluate them by the same criteria for effectiveness and efficiency that we use, or should use, for any government program: Does it work? Is it cost-effective?

Conclusion

In closing, let me just express the wish that candidates would talk less about jobs and more about the benefits of trade for consumers. We are all consumers, and the average benefit of our liberalized trade system for consumers has been estimated at up to $10,000 per year for a family of four.[13] We get access to more goods and services, higher-quality goods and services, at lower prices as a result of trade. It doesn't make the news, but the benefit is real.

I don't know of a single economist—not one—who doesn't agree that trade benefits society as a whole. When our political candidates are saying something different, we need to listen carefully and cautiously. The changes they are promising could wind up costing us all dearly.

—Ambassador Terry Miller is Director of the Center for International Trade and Economics at The Heritage Foundation. He delivered these remarks at the Catholic University of America in Washington, D.C.

12. Michael Luo, "Memo Gives Canada's Account of Obama Campaign's Meeting on Nafta," *The New York Times*, March 4, 2008, at *www.nytimes.com/2008/03/04/us/politics/04nafta.html?ref=worldbusiness* (March 19, 2008).
13. Executive Office of the President, *2007 Economic Report of the President*, October 4, 2007, at *www.gpoaccess.gov/eop/index.html* (November 26, 2007).