Compete, Don't Retreat

Promoting Opportunity and Growth through Open & Fair Trade

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Executive Summary

Anti-trade rhetoric, once largely limited to populist policymakers and street protestors, has become a fixture in the political debate on both sides. Republicans and Democrats alike, spurred by surveys indicating that a majority of Americans are opposed to free trade agreements, are increasingly using isolationist language when it comes to discussions about globalization. They recognize that many middle-class Americans blame globalization in general and free trade in particular for the tremendous anxiety they feel about their economic security. That is because although the benefits are enormous, free trade has its costs – most visibly, disruption to domestic companies that compete against low-cost imports and a subsequent loss of jobs in many cases.

However, retreating from free trade agreements, though politically popular, is a short-sighted position that will ultimately damage economic opportunity for our country at a time when we need to compete aggressively to maintain our dominant position in the global economy. Free trade is an element of expanding economic growth and opportunity, since it broadens new markets for American products and services, lowers the cost of consumer goods for families, attracts foreign investment in the United States, and helps poor countries get on the path to economic development.

To rebuild support for free trade, we need a new compact on globalization that pushes for opening new markets, ensures that our trading partners meet their commitments, and addresses head-on the dislocations created by free trade by ensuring that America's workers have a safety net, as well as the best skills and education in the world. By reshaping the debate in this way, leaders in Washington can have the best of both worlds – politically viable policies that help individuals and firms navigate the potential challenges of free trade while fully reaping its benefits for the economy. Hope Street Group urges the following approaches to build support for free trade:

- ***Recommendation #1: Go global.*** The focus of trade policy should be on global agreements, as these would encompass a bigger volume of trade, would avoid potential distortions created by a plethora of smaller deals, and potentially would create tradeoffs that could ultimately result in lower tariffs. Regional and bilateral trade agreements should be seen only as a second-best backstop, where progress on global liberalization is impossible. "Fast track" authority, which presents trade deals to Congress for an up-or-down vote, is critical to enable executive branch officials to negotiate effectively in multilateral forums.

- ***Recommendation #2: Enhance support to American workers affected by trade and economic disruptions.*** Making health insurance and pensions portable from job to job would increase efficiency and decrease the risk associated with labor market changes. Existing programs to help workers find new employment and relocate should be improved and fully funded.

- ***Recommendation #3: Invest in the American workforce and workplace.*** Supporting workforce development and mid-career retraining programs would help older workers transition to new careers. Reforming the current system of corporate welfare would level the corporate playing field and lower the cost of government, helping U.S. firms remain internationally competitive.

Policy Discussion

Recommendation #1: Go global.

Hope Street Group suggests that Congress and the President seek to implement a comprehensive and coherent strategy to pursue broad free trade agreements. Such a strategy would include:

- ***Renewal of Fast Track Authority.*** Congress should indefinitely extend the President's fast track authority to free the officeholder to pursue broad trade agreements. Doing so would not give the President a "blank check" – Congress still would have an opportunity to vote up or down on individual agreements.

- ***Focus on comprehensive global agreements.*** The first priority for trade policy should be global agreements through organizations such as the World Trade Organization (WTO). As these agreements are reached, all efforts should be made to consolidate smaller agreements (regional or bi-lateral) into the wider framework. This maximizes economic benefits and minimizes distortions from different trade regimes.[1]

- ***Bi-lateral and regional agreements as a last resort.*** Only if agreements are unreachable through global regimes should the president pursue regional, sub-regional or bi-lateral agreements (in that order). While such regional agreements may be helpful, a piecemeal approach increases compliance costs and creates regulatory distortions, limiting the economic benefits for the U.S. and other countries.

  One area in which the U.S. could jump-start effective bi-lateral/regional agreements that could lead to fruitful global regimes is intellectual property (IP) protection. Since the U.S. is far less dependent on agriculture for its economic growth than most developing nations, Hope Street Group believes that should the Doha round of trade discussions (which have been stymied because of the concerns of developing countries over agricultural issues) resume, the potential for a trade-off would exist between developing country demands for freer agricultural trade and U.S. insistence on IP protection. Agriculture currently represents only 0.7% of U.S. GDP, in comparison to 27% of the GDP of developing nations, though this industry is a heavyweight in terms of domestic lobbying power. To overcome resistance from the domestic agricultural industry and break the logjam, U.S. firms in the technology, media, and healthcare industries have to become convinced that significant benefits – in the form of better IP protection abroad – merit their involvement in pushing for a deal more aggressively; moreover, the U.S. government needs to call for, and successfully push through, policies that value IP protection abroad over other American commercial interests that are less valuable to the economy.

  In addition to rallying domestic support to push for better IP protection abroad, the United States should also engage currently-offending countries to help address this problem; without their support, unilateral action – or even action by way of a multilateral institution – will be significantly less effective. As a means of engaging these nations, the United States should emphasize that tightening IP protections will serve that country's own interests by encouraging inflows of foreign investment.[2]

Recommendation #2: Enhance support to American workers affected by trade and economic disruptions.

In order to help workers and their families mitigate the risks of capitalism's "creative destruction," our nation's economic safety net needs to be modernized and strengthened. A more modern safety net should be freed from the confines of bureaucratic programs, under the control of workers, and should equip workers with the tools to effectively manage their particular circumstances. These programs should be characterized by flexibility, portability, well-managed risk, clear and usable information, and simplicity. Properly revitalized, our nation's safety net would not simply be a more generous unemployment assistance program, but would dramatically empower workers in the following ways:

- ***Increase portability of health insurance and pensions.*** One of the risks associated with foreign trade is that economic disruptions can threaten jobs. Job loss can put pressure on almost every aspect of financial and physical well-being, including lowered income, a reduction in personal assets, and consequences for retirement income as well, given an employer-based pension plan. Further, job loss can often result in a loss of health care or a transition to temporary and expensive health care under COBRA.

Better policy could alleviate these problems. Savings and health care programs should be made fully portable, enabling workers to bring their coverage and assets with them to new jobs with new firms, thus maximizing worker mobility and flexibility.[3] Rules governing tax-friendly investment programs (such as 401(k)s and IRAs) should be simplified so that there is one set of rules for all workers, rather than the confusing range of plans that exist today. Finally, firms offering investment plans should be encouraged to move to an "opt-out" framework, where workers are automatically enrolled in a basic plan with a modest contribution unless they select an alternative. Research has shown that such an approach results in substantially higher participation levels.

- ***Aid workers in identifying the most promising job and relocation opportunities.*** For workers who desire or are forced to find new employment, the most accessible opportunities are those that are in the same industry, the same physical location, and involve similar day-to-day responsibilities – in other words, a similar job that is nearby. In cases where an industry is undergoing structural decline, such jobs are unlikely to be available. Support programs should aim to identify jobs that could be done by an unemployed person with the smallest geographic move and least amount of retraining.

  How do laid-off workers get information about job opportunities? The issue today is not so much the availability of information, since detailed statistics and projections for employment by occupation are kept by the Department of Labor and thousands of job advertisements are available in newspapers and online. However, it is the organization of this information that is at the heart of the problem. Efforts by the Department of Labor to provide a set of centralized "One-Stop" centers – both physical locations and on-line – where laid-off workers can find resources and apply for benefits are sensible, but could improve through better execution.

  The key is to facilitate the development of tools that help workers "map" the spectrum of jobs that are available. This could be done physically, by using geo-mapping tools to locate jobs in a searcher's industry. It could also be done conceptually, by prioritizing job opportunities based on the degree of linkage to a worker's existing skill set and responsibilities. By logging data on worker transitions, the system would become dramatically more effective over time in identifying transitions with the highest success rate and exposing linkages between different jobs types and industries that might not be obvious from a simple categorization of skill sets. Information of this kind might be available on some private job websites but would be more valuable in the public domain.

- ***Cushion the blow to wages.*** Frequently, workers forced to transition into a new industry are not able to fully apply their previous skills, which may have been specific to their old job. As a result, they may suffer temporary or permanent wage losses. To ease the transition and encourage workers to take a new job, the government should offer Targeted Wage Subsidies (TWS) to the new employer on a short-term basis. The financial support provided by TWS cushions the initial cost of employee development and training, with the intention of increasing the employee's marketability, so that the employer would be less likely to lay-off the employee once the subsidy terminates. An evaluation of the program has shown that the subsidy is most effective when the intervention is connected to other support skills training (i.e. job readiness, soft skills training).

  Early efforts in this regard have shown some success in Canada, both in helping individual families and lowering the cost to the government relative to unemployment insurance benefits.[4] In order for TWS to be effective, they must be designed so that employers do not choose employees simply because they are subsidized – but because there is a real match between the two parties' supply and demand. In that respect, it becomes necessary to promote a multifaceted approach that combines training with links to employers, job search assurance, and life skills. Given the highly targeted nature of this program, it should be used mainly to hire for discrete projects rather than to alleviate the pressures of high unemployment regions.

Such a program could be administered through the current unemployment insurance system. However, the policy should be managed carefully to ensure that it would stay focused on the targeted population, would lower overall government outlays, and would avoid large-scale labor market distortions.

Recommendation #3: Invest in the American workforce and workplace.

One of our primary solutions – both long and short-term – to the problems of worker transition could be addressed through education. Better education and training could reduce the negative effects of job losses due to trade and prepare workers for future economic disruptions. America's economic prosperity hinges on preparing our current workforce to be flexible and adaptable, capable of moving quickly to other jobs and industries.[5] These policies should be geared toward steering workers away from "routine" jobs, which are easily automated or outsourced, and towards jobs that require high levels of creativity.

- ***Invest in the workforce.*** Support for early and mid-career re-training should be better coordinated and funded in order to help workers transition from a shrinking industry to a growing one, In many cases, older workers facing dislocation simply take early retirement. While younger workers, who have a competitive advantage because they have invested less in outmoded skills and have more time to invest in acquiring new skills, benefit from re-training. However, middle-aged workers face special difficulties, as the years of training and experience they have accumulated may not be relevant in a new industry, but they may not have accrued nearly enough assets for retirement. Therefore, effective programs should focus on transitional assistance by helping managers and experienced line-workers retool for jobs in new industries. Such programs would be a win-win proposition for both workers and the government, since they could reduce the costs of social insurance as a higher proportion of workers becomes re-employed.

- ***Invest in the workplace.*** Innovation and competitiveness are essential for American businesses to compete in the new global economy. Too often, the trade dilemma is presented as an "either-or" scenario – either America can keep jobs by keeping wages to a minimum and shedding costly employer-based health care and retirement plans, or it can shift its jobs abroad to reduce the cost of doing business. However, Hope Street Group believes a competitive America is defined by its ability to create jobs that pay high wages and support a rising standard of living with policies that reinforce innovation and growth.

Economic Discussion

Decades of research have shown that free trade results in significant aggregate benefits, including higher productivity, lower prices, and higher standards of living. It is predicted that steps toward global free trade and investment in both products and services could translate into more than $500 billion more in annual income for the U.S.[6] In short, free trade is in the economic interest of the United States for at least three reasons:

1. ***Free trade is a catalyst for economic growth in the United States.*** Lower trade barriers (such as tariffs and taxes) would reduce the cost of importing goods and services. This, in turn, would help lower prices along the supply and production chains, which would reduce the cost of goods and services for consumers. Lower price pressures tend to result in lower interest rates, which could boost investment in housing, industrial capacity, and productivity-enhancing

technology.

2. ***Free trade promotes improved productivity by U.S. firms***. Open markets, by definition, allow lower cost producers to participate in setting prices. As a result, Chinese manufacturing firms, paying an hourly wage of $0.40 per hour, would compete directly with U.S. firms paying $10 per hour. This dynamic would force the higher cost producer to innovate to improve quality or lower costs, both of which would be advantageous to consumers. Huge benefits have accrued to U.S. firms as international competition spurred investments in technology and processes, which led to dramatic gains in productivity and efficiency. While some of these gains would come at a cost to individuals, firms, and occasionally entire industries, strategies to address these costs have been outlined in this paper.

3. ***Opening U.S. markets helps poor countries get on a path toward economic development.*** The path for many developing countries to become economically developed nations begins with agriculture. Improving agricultural efficiency increases migration into towns and cities, where the development of a manufacturing and services sector can occur more readily. However, if global agricultural markets are flooded with subsidized crops, or U.S. markets are closed off to developing countries' manufacturing exports, this development path is shut off.

These benefits would more than offset the costs associated with firms and workers that could potentially be displaced by trade. There is no question that the labor market is in constant flux. Existing firms are continually trying to make their operations more efficient to reduce costs and increase profits; job losses may be the result of these efforts. At the same time, jobs are constantly being created as other businesses expand or new businesses are created by entrepreneurs. Data from the U.S. Department of Labor shows that in any given quarter, there is a net gain of roughly 300,000-500,000 jobs. However, this gain encompasses enormous churn – more than 7 million jobs are created and lost over the same time period.[7]

Since layoffs tend to be more concentrated than the benefits of market expansions, a vocal minority will resist free trade unless it can be convinced that it will be adequately prepared and compensated for downturns. Unfortunately, this has not been the case thus far. Rather than pursuing protectionist policies – which will inevitably cause more harm in the long run – Hope Street Group believes that policy should focus on investments in workforce development and dramatically upgrading the support system for workers in industries most vulnerable to foreign competition.

Political Discussion

The past year has been witness to great political pressure toward more protectionist U.S. trade policies. In fact, the 109th Congress alone introduced 27 pieces of anti-China trade legislation, while the 110th Congress introduced more than a dozen of these bills in just its first three months.[8] This trend reflects the fact that although its benefits are enormous, free trade has its costs. New technologies often enhance efficiency and productivity, but that efficiency means some firms can operate successfully with fewer employees. Merger and acquisition activity may enhance competitiveness, but frequently this process includes painful layoffs and facility closures. Entire industries can be pressured by competition with inexpensive foreign goods, such as the textile industry in the southeastern United States.

As a result, trade policy has increasingly become a lightning rod for controversy. In many respects, the move toward a more open trade policy in the 1990s, with major agreements such as the North American Free Trade Agreement (NAFTA), looks to be foundering: World Trade Organization (WTO) talks on a new round of tariff reductions have stalled, many newly elected members of Congress champion protectionist policies, and the huge U.S. trade deficit – especially with respect to China – continues to attract criticism. Support for free trade policy has ebbed considerably.

A recent survey by the Pew Research Center shows that almost half of Americans (48%) believe free trade agreements cause job losses in the U.S., while just 12% say that trade agreements have created jobs. In addition, 44% say that free trade has lowered wages for American workers. The visible downsides of free trade – disruptions to domestic companies that compete against low-cost imports and subsequent job losses in many cases – have led many workers and elected officials to question whether the benefits of free trade are worth the costs.

These trends in public opinion have great potential to influence the economic policy debate well beyond the 2008 presidential elections. Bipartisan cooperation to ensure open trade with worker protection is possible, as revealed by discussions between the Bush Administration and Congressional Democrats that would add labor and environmental conditions to trade bills in exchange for Democratic support. Therefore, it is more important than ever to elucidate the costs and benefits of international trade in a way that addresses the real economic challenges at hand. Otherwise, the U.S. risks implementing policies that may isolate it from the world markets, leading to a reduction in U.S. global competitiveness.

Rebuttals

"Tariffs are necessary to protect U.S. jobs."

Response: Job creation is the best jobs program. Trade does create job losses in some sectors, but overall the benefits outweigh the losses. Throughout the 1990s, the U.S. became significantly more open to trade and real household incomes grew on average by at least 10% for every quintile of the income distribution.[9] Tariffs affect jobs in manufacturing sectors because they raise the price of raw materials. Even as jobs are being lost, many others are being created — otherwise, the U.S. unemployment rate would be much higher than the 4.7% it is today.[10]

Tariffs may delay, but do not prevent, the loss of jobs in sunset industries. Such protectionist strategies only prolong the inevitable at a great cost to U.S. consumers. One such example is the 2002 tariff on imported steel. Steel prices began to plunge in 1998 and 31 steel mills had filed for bankruptcy before the tariffs. After the tariffs were instituted, several more mills filed for bankruptcy. Only a rebound in global steel prices – a rebound that had its roots in strong growth in developing countries facilitated by the expansion of free trade – helped to ameliorate conditions in this sector.

Jobs in inefficient industries are already going overseas, tariffs or no tariffs. We need to focus on helping people, not saving obsolete jobs.

"We need agricultural subsidies to protect the family farmer."

Response: Domestic agricultural subsidies are enjoyed primarily by agribusiness, not the small family farmer. The 2004 U.S. farm bill provided $182 billion in subsidies to farmers over ten years — money coming directly out of taxpayer dollars. However, most of this money is not helping small family farms; 70% of farm subsidies go to just 10% of recipients, with low-income farms getting less than 1% of direct payments. For the bottom 80% of farmers, the average annual subsidy payment was just under $1,300. For agribusinesses, the sums were much larger: in 2002, Riceland Foods received over $110 million and Producers Rice Mill received nearly $84 million. In most instances, subsidy money does not reach the farmers themselves but instead goes to landowners, allowing companies like Chevron to collect over $250,000 in farm subsidies.[11] John Hancock Insurance collected over $2 million in peanut subsidies from 1995-2005, while the poorest 50% of peanut farmers shared 2% of all direct subsidy payments.[12] The U.S. sugar subsidy is perhaps the most concentrated of all: a single Florida family received almost half the benefits from the sugar support program in 2004.[13]

However, prices for agricultural goods have risen dramatically over the past year, and this has translated into a huge windfall for farmers across the board.

"Free trade only benefits the rich."

Response: Nothing could be further from the truth. Most tariffs are regressive taxes – effective rates actually rise as income falls. For example, the bottom quintile of income earners spends a higher proportion of its income on apparel than any other segment of the population, so they are likely to be hurt disproportionately by anything that pushes up apparel prices.[14] In general, tariffs increase costs in the overall economy and are an inefficient way to redistribute purchasing power. By increasing the cost of imported goods (raw materials, as well as finished products), tariffs put upward pressure on prices. Consequently, lowering tariffs would effectively give a broad tax cut across all socio-economic groups.

"Protectionism keeps American industries strong by preventing unfair competition from countries with weak environmental and labor safeguards."

Response: Protectionism is an expensive and ineffective mechanism for shielding companies from competition. It alleviates pressures on a company or industry to become more efficient, keeping costs high and therefore reducing the purchasing power of Americans' income. In the short term, companies and workers in a protected industry do benefit but at the cost of higher prices for everyone else in the economy. Studies by economists across the political spectrum have shown that tariffs and other trade barriers are a net cost to the economy as a whole.

"American workers already get plenty of assistance through programs like Trade Adjustment Assistance."

Response: Current trade adjustment assistance schemes are inadequate. There are tax-based schemes that offer assistance to displaced workers, but these generally remain inadequate on levels of both program design and efficacy to address the challenges posed by global trade. Currently, assistance comes in the form of limited education grants, certain tax deductions associated with educational expenses, the deductibility of interest on student loans, education tax credits, and subsidized student loans. However, these programs are broad policies with low applicability to the issues facing trade-affected workers:

- These assistance schemes do not allow deductibility for any program that directly qualifies or prepares someone for a new career. For those employees who might otherwise receive education from their employers, the incentives are misaligned as employers are uncertain to capture any benefits from workers they train.

- The education deductions are not useful for those most at risk – those who are unlikely to have the basic skill set or financial resources to pay for training in the first place. Indeed, most of these programs are focused on students going to 4-year colleges and not those needing skills training during a mid-career transition. Programs that do exist, such as the HOPE grants or the Lifetime Learning Credits, tend to be difficult to claim or understand for many low and middle-income earners. According to the GAO, in 2002 only 27% of eligible people took advantage of these programs.[15]

- Job training is under-resourced in the U.S., as the government spends less than almost any of its peer developed nations on job training and job search assistance.[16]

"Losing manufacturing jobs that provide middle-class wages and benefits to gain low-paying service jobs doesn't make sense."

Response: America has been losing low-skilled manufacturing jobs for two decades. Yet a careful accounting of these losses shows that most have disappeared not because of free trade, but because of improved productivity – fewer people doing the same or more work with the help of better equipment and more efficient organization. Turning back this change is tantamount to stopping economic growth in its tracks; recall that two centuries ago much of the U.S. workforce was involved in food production. The U.S. manufacturing sector is making a shift toward high-tech and high-skilled jobs, and the services sector is adding employment in areas from banking to tourism. Though these jobs may require computer and technical skills, many are open to factory workers willing to be retrained. Rather than futilely attempting to stop a changing economy, we are better off re-training those in shrinking industries to move into faster growing fields.

About Hope Street Group Discussion Papers

Hope Street Group is a new generation of leaders dedicated to building an Opportunity Economy. We build diverse coalitions from our network of business, civil society and political leaders to drive innovative policies that make social and economic mobility possible for all Americans. Hope Street Group Discuss Papers are written by volunteers supported by Hope Street Group staff. Papers typically synthesize positions from think tanks of the left and right, and are intended to be user-friendly tools for busy decision-makers to more easily promote opportunity and prosperity. To learn more, visit www.hopestreetgroup.org.

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1 For example, the United States has imposed a tariff on imported ethanol from Brazil even though it is much more energy and cost efficient to produce ethanol from sugar cane (as is done in Brazil) than from corn (as is done in the U.S.). However, under the Central America Free Trade Agreement (CAFTA), a "carve-out" of the 1984 Caribbean Basin Initiative (CBI), up to 7% of the previous year's U.S. ethanol output is allowed to be imported duty free to the U.S. As a result, some Central American countries are exempt from U.S. ethanol tariffs, which is leading ethanol to be shipped indirectly from Brazil to the U.S. via selected CAFTA countries where it is reprocessed. This process is highly inefficient, but is still more efficient than producing ethanol with corn. Even though the most efficient step would be to import ethanol directly from Brazil, the U.S. is domestically expanding corn ethanol production and supporting it by imposing tariffs in addition to importing ethanol from Brazil through Central America. Furthermore, if this regime should ever change, those Central American countries that channeled ethanol between Brazil and the U.S. will find themselves with useless ethanol facilities that existed only because of a trade-related distortion.

2 For a more detailed analysis of the role of IP protection in trade, please refer to HSG's policy briefing on intellectual property, *Intellectual Property Enforcement and Trade: Rallying Domestic Support for IP Protection Abroad* (forthcoming).

3 For Hope Street Group's recommendation on pension and retirement reform, see *Expanding Retirement Security for all Americans.* Online. Available: http://hopestreetgroup.org/expanding_retirement_security. Accessed: December 19, 2007.

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6 Grant Aldonas, et. al. "Succeeding in the Global Economy: A New Policy Agenda for the American Worker," *The Financial Services Forum Policy Research*, (June 2007). Online. Available: http://www.financialservicesforum.org/site/c.mtJ2J7MKIsE/b.2871097/k.6C47/Succeeding_in_the_Global_Economy_A_New_Policy_Agenda_for_the_American_Worker.htm. Accessed: December 7, 2007.

7 U.S. Department of Labor, *Business Employment Dynamics Summary*, (Washington, D.C., November 16, 2007). Online. Available: http://www.bls.gov/news.release/cewbd.nr0.htm. Accessed: December 7, 2007.

8 Grant Aldonas et. al.

9 U.S. Bureau of the Census, *Current Population Survey: Historical Income Tables*. Online. Available: http://www.census.gov/hhes/www/income/income.html. Accessed: December 7, 2007.

10 U.S. Bureau of Labor Statistics, *Employment Situation Summary*. Online. Available: http://www.bls.gov/news.release/empsit.nr0.htm. Accessed: December 17, 2007.

11 For as full accounting of farm and business subsidies, see Environment Working Group, *Farm Subsidy Database*, Online. Available: www.ewg.org/farm. Accessed: December 18, 2007.

12 Environmental Working Group,: http://farm.ewg.org/farm/top_recips.php?fips=00000&progcode=peanuts

13 Norbert, Michel, "Nothing Sweet About Sugar Subsidies," *Heritage Foundation*, (March 27, 2004). Online. Available: http://www.heritage.org/Press/Commentary/ed031204a.cfm. Accessed: December 7, 2007..

14 See for example the Survey of Consumer Expenditures: http://www.bls.gov/cex/

15 General Accountability Office, *Student Aid and Postsecondary Tax Preferences,* GAO Report #GAO-05-684 (July 2005). Online. Available: www.gao.gov/new.items/d05684.pdf. Accessed: December 7, 2007.

16 Lori Kletzer and William Koch, "International Experience with Job Training: Lessons for the U.S.," (paper prepared for a conference on "Job Training and Labor Exchange in the U.S." sponsored by the W.E. Upjohn Institute and the U.S. Department of Labor, Augusta, Michigan, September 19-21, 2002).