Washington Center *for* Equitable Growth

Evidence for a stronger economy

When "Globalization" is Public Enemy Number One

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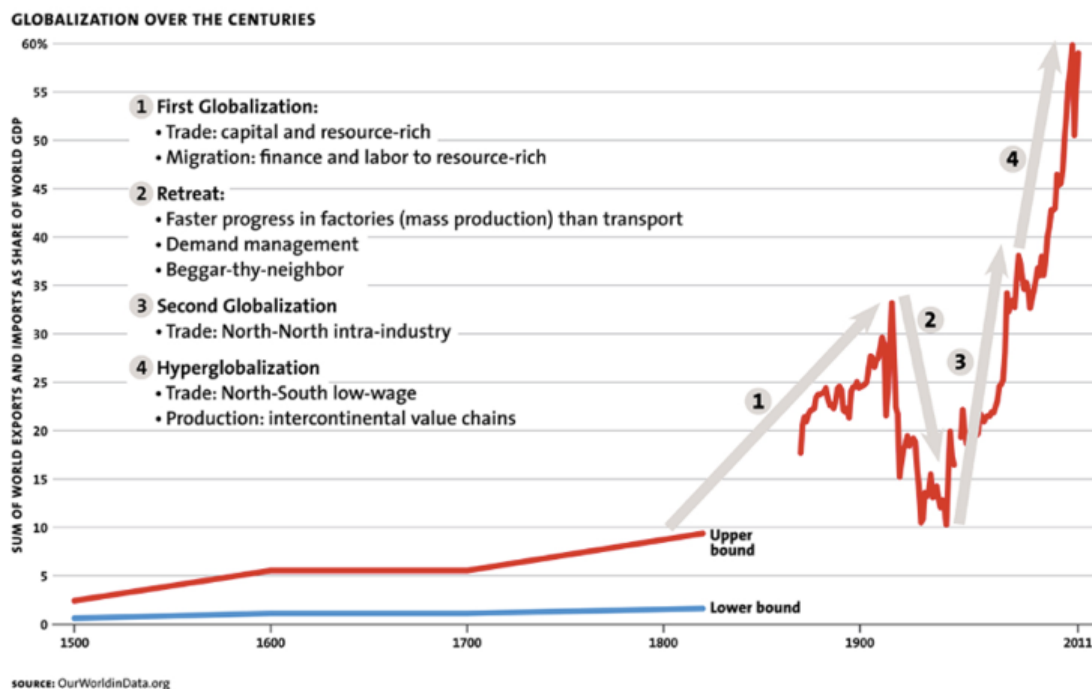


***Milken Institute Review**: WHEN GLOBALIZATION IS PUBLIC ENEMY NUMBER ONE: The first 30 years after World War II saw the recovery and

reintegration of the world economy (the “Thirty Glorious Years,” in the words of French economist Jean Fourastié). Yet after a troubled decade — one in which oil shocks, inflation, near-depression and asset bubbles temporarily left us demoralized — the subsequent 23 years (1984-2007) of perky growth and stable prices were even more impressive as far as the growth of the world’s median income were concerned.

This period, dubbed the “Great Moderation,” was by most economists’ reckoning largely the consequence of the process of knitting the world together. The mechanism (and impact) was largely economic. But the consequences of globalization were also felt in cultural and political terms, accelerating the tides of change that have roughly tripled global output and lifted more than a billion people from poverty since 1990.

So why is globalization now widely viewed as the tool of the sorcerer’s apprentice? I am somewhat flummoxed by the fact that a process playing such an important role in giving the world the best two-thirds of a century ever has fallen out of favor. But I believe that most of the answer can be laid out in three steps:

> The past 40 years have not been bad years, but they have been disappointing ones for the working and middle classes of what we now call the “Global North” (northwestern Europe, America north of the Rio Grande and Japan).
> There is a *prima facie* not implausible argument linking those disappointing outcomes for blue-collar workers to ongoing globalization.
> * In any complicated policy debate that becomes politicized, the side that blames foreigners has a very powerful edge. Politicians have a strong incentive to pin it on people other than themselves or those who voted for them. The media, including the more fact-based media, tend to let elected officials set the agenda.

Hence it doesn’t take much of a crystal ball to foresee a few decades of backlash to globalization in our future. More of what is made will probably be consumed at home rather than linked into global supply chains. Businesses, ideas and people seeking to cross borders will face more daunting barriers.

Some of the consequences are predictable. The losses to income created by

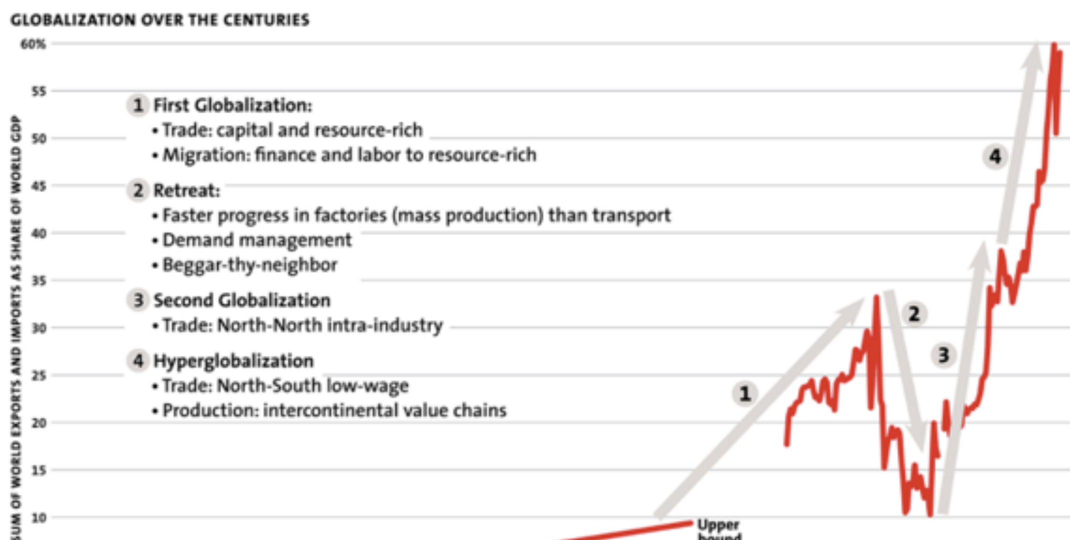
cross-border barriers to competition will grow. And more of the focus of economic policy will be on the division of the proverbial pie rather than how to make it larger. Small groups of well-organized winners will take income away from diffuse and unorganized groups of losers.

Measured in absolute numbers, an awful lot of wealth will be lost. But those losses won't approach, say, the scale of the output foregone in the Great Recession. Figure on a 3 percent reduction in income, equivalent to the loss of two years' worth of growth in the advanced industrialized economies.

Most well-educated Americans, I suspect, will either be net beneficiaries of the reshuffling of income or won't lose enough to notice. Disruption often redounds to the benefit of the sophisticated who can see it coming in time to get out of the way or turn it to their own advantage. But that's a minority of the population, even in rich countries. Real fear about where next week's mac and cheese is going to come from applies for a tenth, while fear about survival through the hard times is still a thing for a quarter of humanity.

Why do I believe all this? Bear with me, for my explanation demands an excursion down the long and winding road of centuries of globalization.

Globalization in Historical Perspective: On the brilliant date-visualization website, Our World in Data, Oxford researcher Esteban Ortiz-Ospina, along with site founder Max Roser, has plotted best estimates of the relative international "trade intensity" of the world economy — the sum of exports and imports divided by total output over a very long time. In my reproduction I have divided the years since 1800 into four periods and drawn beginning- to end-of-period arrows for each.



In the years from 1800 to 1914, which I call the First Globalization, world trade intensity tripled, driven mostly by exchange between capital-rich, labor-intensive and resource-rich regions. Countries with both sorts of endowments benefit by specializing production in their areas of comparative advantage. Meanwhile, huge migrations of (primarily) people and (secondarily) financial capital to resource-rich regions established a truly integrated global economy for the first time in history.

The period from 1914 to 1945 saw a dramatic retreat, with the relative intensity of international trade slipping back to little more than its level in 1800. There are multiple, complementary explanations for this setback. Faster progress in mass production than in long-distance transport made it efficient to bring production back home to where the demand was. The Great Depression created a path of least political resistance in which governments sought to save jobs at home at the expense of trading partners. And wars both blocked trade and made governments leery of an economic structure in which they had to rely on others.

This retrenchment, however, was reversed after World War II. The years 1945 to 1985 saw the Second Globalization, which carried trade intensity well above its previous high tide in the years before World War I. But this time, the bulk of trade growth was not among resource-rich, capital-rich and labor-intensive economies exchanging the goods that were their comparative advantage in production. It largely took place within the rich Global North, as industrialized countries developed communities of engineering expertise that gave them powerful comparative advantages in relatively narrow slices of manufacturing production in everything from machine tools (Germany) to consumer electronics (Japan) to commercial aircraft (the United States).

After 1985, however, there was a marked shift to what Ortiz-Ospina calls "hyperglobalization." Multinational corporations began building their international value chains across crazy quilts of countries. The Global South's low wages gave it an opportunity to bid for the business of running the assembly lines for products designed and engineered in the Global North. Complementing this value-chain-fueled boost to world trade came

the other aspects of hyperglobalization: a global market in entertainment that created the beginnings of a shared popular culture; a wave of mass international migration and the extension of northern financial markets to the Global South, cutting the cost of capital and increasing its volatility even as it facilitated portfolio diversification across continents.

Hyperglobalization, Up Close and Personal: Of these value-chain-fueled boosts to international trade, perhaps the first example was the U.S.-Mexico division of labor in the automobile industry enabled by the North American Free Trade Agreement of the early 1990s. The benefits were joined to the more standard comparative-advantage-based benefits of reduced trade barriers. At the 2017 Milken Institute Global Conference, Alejandro Ramírez Magaña, the founder of Cinépolis, the giant Mexican theater group that is investing heavily in the United States, summed up the views of nearly all the economists and business analysts in attendance:

> Between the U.S. and Mexico, trade has grown by more than six-fold since 1994 … 6 million U.S. jobs depend on trade with Mexico. Of course, Mexico has also enormously benefited from trade with the U.S.… We are actually exporting very intelligently according to the relative comparative advantage of each country. Nafta has allowed us to strengthen the supply chains of North America, and strengthened the competitiveness of the region…

Focus on the reference to “supply chains”. Back in 1992, my friends on both the political right and left feared—really feared—that Nafta would kill the U.S. auto industry. Assembly-line labor in Hermosillo, Mexico had such an enormous cost advantage over assembly-line labor in Detroit or even Nashville that the bulk of automobile manufacturing labor and value added was, they claimed, destined to move to Mexico. There would be, in the words of 1992 presidential candidate Ross Perot, “a giant sucking sound,” as factories, jobs and prosperity decamped for Mexico.

But that did not happen. Only the most labor-intensive portions of automobile assembly moved to Mexico. And by moving those segments, GM, Ford and Chrysler found themselves in much more competitive positions vis-a-vis Toyota, Honda, Volkswagen and the other global giants.

Fear of Globalization: Barry Eichengreen, my colleague in the economics department at Berkeley, wrote that there is unlikely to be a second retreat from globalization:

> U.S. business is deeply invested in globalization and would push back hard against anything the Trump administration did that seriously jeopardized Nafta or globalization more broadly. And other parts of the world remain committed to openness, even if they are concerned about managing openness in a way that benefits everyone and limits stability risks that openness creates…

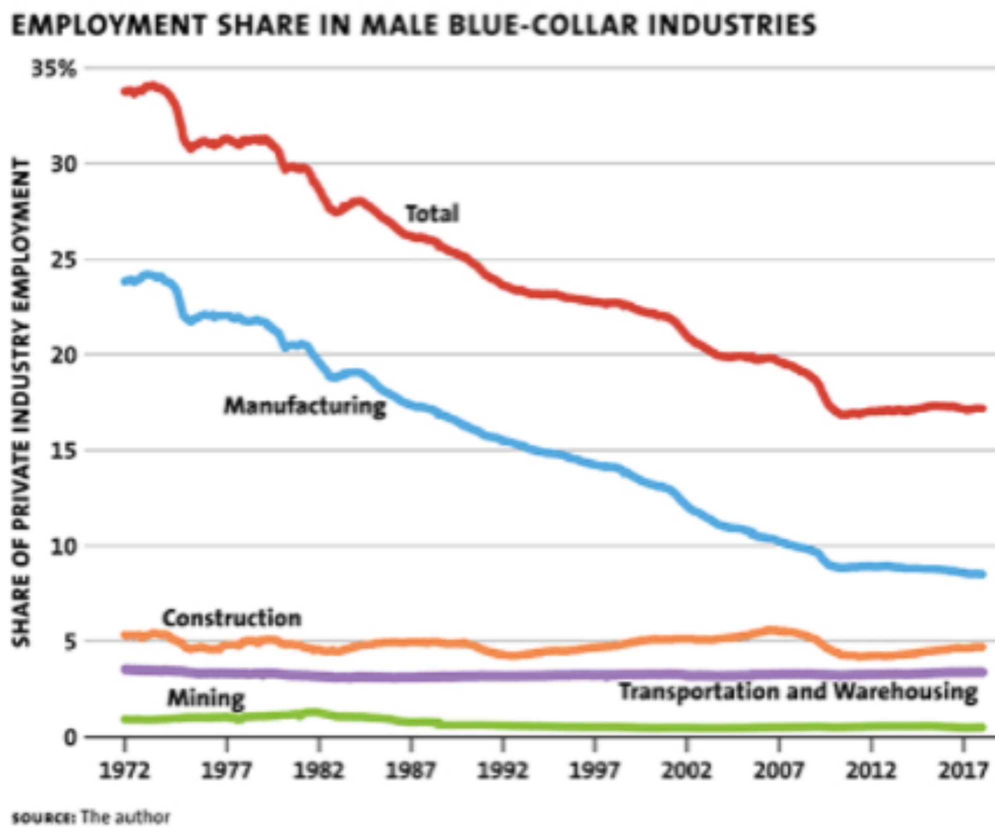
But I see another retreat as more likely than not. For one thing, anti-globalization forces have expanded to include the populist right as well as the more familiar populist left. It was no surprise when primary contender Bernie Sanders struck a chord by condemning Nafta and the opening of mass trade with China as "the death blow for American manufacturing." But it was quite another matter when the leading Republican candidate (and now president) claimed that globalization would leave "millions of our workers with nothing but poverty and heartache" and that Nafta was "the worst deal ever" for the United States.

The line of argument is clear enough. Globalization, at least in its current form, has greatly expanded trade. This has decimated good (high-paying) jobs for blue-collar workers, which has led to a socioeconomic crisis for America's lower-middle class. U.S. Trade Representative Robert Lighthizer buys this:

> Nafta has fundamentally failed many, many Americans. … [Trump] is not interested in a mere tweaking of a few provisions and a couple of updated chapters. … We need to ensure that the huge [bilateral trade] deficits do not continue, and we have balance and reciprocity…

It's conceivable that the Trump administration will yet pay homage to the post-World War II Republican Party's devotion to open trade. But it seems unlikely in light of the resonance protectionism has had with Trump supporters. And if the Trump administration proves not to be a bellwether

on globalization, it is surely a weathervane.



The Real Impact of Globalization: Portions of the case against globalization have some traction. It is, indeed, the case that the share of employment in the sectors we think of as typically male and typically blue-collar has been on a long downward trend. Manufacturing, construction, mining, transportation and warehousing constituted nearly one-half of nonfarm employment way back in 1947. By 1972, the fraction had slipped to one-third, and it is just one-sixth today.

But consider what the graph does not show: the decline (from about 45 percent to 30 percent) in the share of these jobs from 1947 to 1980 was proceeding at a good clip before U.S. manufacturing faced any threat from foreigners. And the subsequent fall to about 23 percent by the mid-1990s took place without any “bad trade deals” in the picture. The narrative that blames declining blue-collar job opportunities on globalization does not fit the timing of what looks like a steady process over nearly three-quarters of the last century.

Wait, there’s a second disconnect. Look at the way the declines in output

divide among the sub-sectors (see page 29). Manufacturing was about 15 percent of nonfarm production in the mid-1990s and was still about 14 percent at the end of 2000, even as trade with Mexico and China accelerated into hyperdrive. Indeed, the bulk of the fall in "men's work" has been in construction, which represented 7 percent of private industry production in 1997 and represents just 4 percent today. Warehousing and transportation have also taken a big hit in terms of proportion.

The biggest factors on the real production side over the past 20 years have not been the out-migration of manufacturing, but the depression of 2007-10 and the dysfunction of the construction finance market that continues to this day.

The China Shock: The case that the workings of globalization have had a major destructive effect on the employment opportunities of blue-collar men over the past two decades received a major intellectual boost from the research of David Autor, David Dorn and Gordon Hanson on the impact of the "China shock."

One of their bottom lines is that the loss of some 2.4 million American manufacturing jobs "would have been averted without further increases in Chinese import competition after 1999." Moreover, the effects on workers and their communities were dislocating in a way in which manufacturing job loss generated by incremental improvements in productivity not associated with factory closings was not.

The China shock was very real and very large: its significance shouldn't be discounted, especially in the context of a close presidential election whose outcome may have a large, enduring impact on the United States — and, for that matter, the world. But some perspective is needed if one is to allow the tale of the China shock to influence thinking about globalization.

Start with the fact that, in most ways, this is a familiar story in the American economy that long preceded the rise of China. Dislocation associated with the relocation of production facilities is more damaging to people and places than incremental changes in production processes, whether the movement is across state lines or across continents.

When my grandfather and his brothers closed down the Lord Bros. Tannery in Brockton, Massachusetts to reopen in lower-wage South Paris, Maine, the

move was a disaster for the workers and the community of Brockton — and a major boost for South Paris. When, a decade and a half later, my grandfather found he could not make a go of it in South Paris and started a new business in Lakeland, Florida, it was the workers and the community of South Paris who suffered.

The fact that, in the case of globalization-driven dislocation, the jobs cross international borders adds some wrinkles, but not all of them are obvious. As demand shifts, jobs vanish for some in some locations and open for others in other locations. Dollars that in the past were spent purchasing manufactures from Wisconsin and Illinois and are now spent purchasing manufactured imports from China do not vanish from the circular flow of economic activity. The dollars received by the Chinese still exist and have value to their owners only when they are used to buy American-made goods and services.

Demand shifts, yes — but the dollars paid to Chinese manufacturing companies eventually reappear as financing for, say, new apartment buildings in California or to pay for a visit to a dude ranch in Montana or even to buy an American business that otherwise might close. GE, which had been openly seeking a way to offload its household appliance division for many years, sold the business to the Chinese firm Haier, the largest maker of appliances in the world. How different might the world have been for the employees of White-Westinghouse who were making appliances if a Chinese firm had been trolling the waters for an acquisition before the brand disappeared for good in 2006?

Only with the coming of the Great Recession do we see not blue-collar job churn but net blue-collar job loss in America. And that was due to the government's failure to properly regulate finance to head off the housing meltdown, the subsequent failure to properly intervene in financial markets to prevent depression, and the still later failure to pursue policies to rapidly repair the damage.

All that said, the connection between the China shock in the 2000s and increasing blue-collar distress in the 2000s on its face lends some plausibility to the idea that globalization bears responsibility for most of their distress, and needs to be stopped.

The Globalization Balance Sheet: Last winter, in a piece for http://vox.com,

I made my own rough assessment of the factors responsible for the 28 percentage point decline in the share of sectors primarily employing blue-collar men since 1947. I attributed just 0.1 percentage points to our "trade deals," 0.3 points to changing patterns of trade in recent years (primarily the rise of China), 2 percentage points to the impact of dysfunctional fiscal and monetary policies on trade, and 4.5 percent to the recovery of the North Atlantic and Japanese economies from the devastation of World War II. I attributed the remaining 21 percentage points to labor-saving technological change.

This 21 percentage points has very little to do with globalization. Yes, with low barriers to trade, technology allows foreign exporters to make better stuff at lower cost. But American producers have the parallel option to sell them better stuff for less. And thanks to technology, consumers on both sides get more good stuff cheap. Economists slaving away in musty offices can invent scenarios in which technological change favors foreign producers over their American counterparts and thereby directly costs blue-collar jobs. But the assumptions needed to get that result are highly unrealistic.

To repeat, because it bears repeating: globalization in general and the rise of the Chinese export economy have cost some blue-collar jobs for Americans. But globalization has had only a minor impact on the long decline in the portion of the economy that makes use of high-paying blue-collar labor traditionally associated with men.

Why is this View so Hard to Sell?: Pascal Lamy, the former head of the World Trade Organization, likes to quote China's sixth Buddhist patriarch: "When the wise man points at the moon, the fool looks at the finger." Market capitalism, he says, is the moon. Globalization is the finger.

In a market economy, the only rights universally assured by law are property rights, and your property rights are only worth something if they give you control of resources (capital, land, etc.) — and not just any resources, but scarce resources that others are willing to pay for. Yet most people living in market economies believe their rights extend far beyond their property rights.

The way mid-20th century sociologist Karl Polanyi put it, people believe that they have rights to land whether they own the land or not — that the

preservation and stability of their community is their right. People believe that they have rights to the fruits of labor — that if they work hard and play by the rules they should be able to reach the standard of living they expected. People believe that they have rights to a stable financial order — that their employers and jobs should not suddenly disappear because financial flows have been withdrawn at the behest of the sinister gnomes of Zurich or some other tribe of rootless cosmopolites.

Dealing with these hard to define, sometimes conflicting claims to rights beyond property is one of the major political-rhetorical-economic challenges of every society that is not stagnant. And blaming globalization for the unfulfilled claims of this group or that is a very handy way to pass the buck.

The good news is that, whatever the merits of the grievances of those who see themselves as losers in a globalizing economy, sensible public policy could go a long way to making them whole. Three keys would open the lock:

- The failure of regional markets to sustain good jobs could be managed by much more aggressive social-insurance — unemployment, moving allowances, retraining and the like — along with the redistribution of government resources to create jobs where they have been lost.
- More aggressive fiscal measures to keep job markets tight.
- Karl Polanyi's key remains at hand, too. While many Americans claim to worship at the altar of free markets, they still believe that they have all kinds of extra socioeconomic rights — to healthy communities, to stable occupations, to appropriate and rising incomes — that are not backed up by property rights. Governments could intervene on their behalf.

That way lies tyranny, we've been told, but also very high-functioning social democracies like Sweden, Germany and the Netherlands.

The bad news, of course, is that the public policies needed to soothe the grievances blamed on globalization seem further out of reach today than they were decades ago. Probably the best one can hope for is that the fever subsides sufficiently to allow for a realistic debate over who owes what to whom.

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