

# The Backlash Against Globalization

DEC Lecture

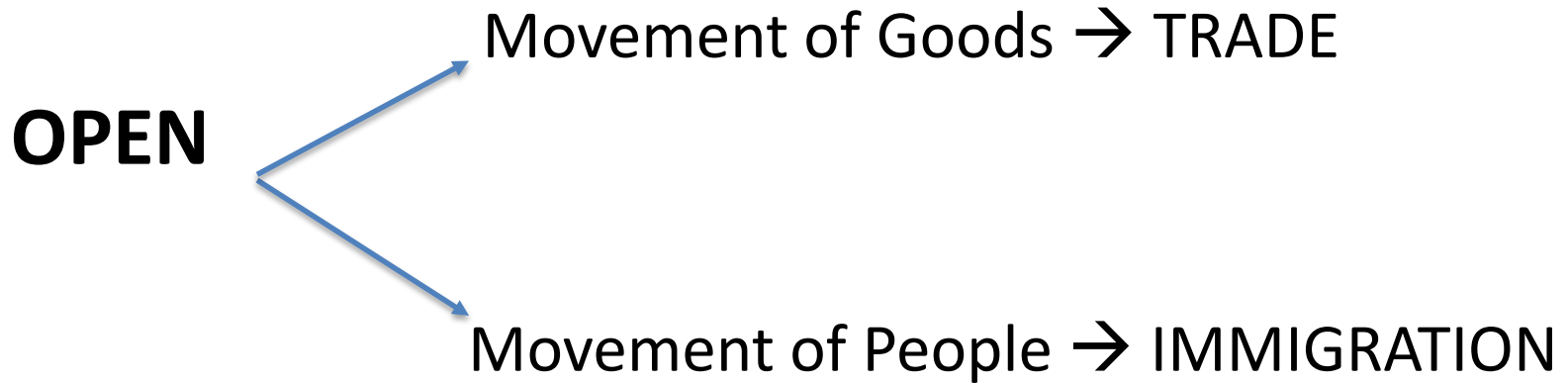
World Bank

March 13, 2018

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Yale University, NBER and BREAD

The 21<sup>st</sup> century political debate is not big versus small government, it's open versus closed.

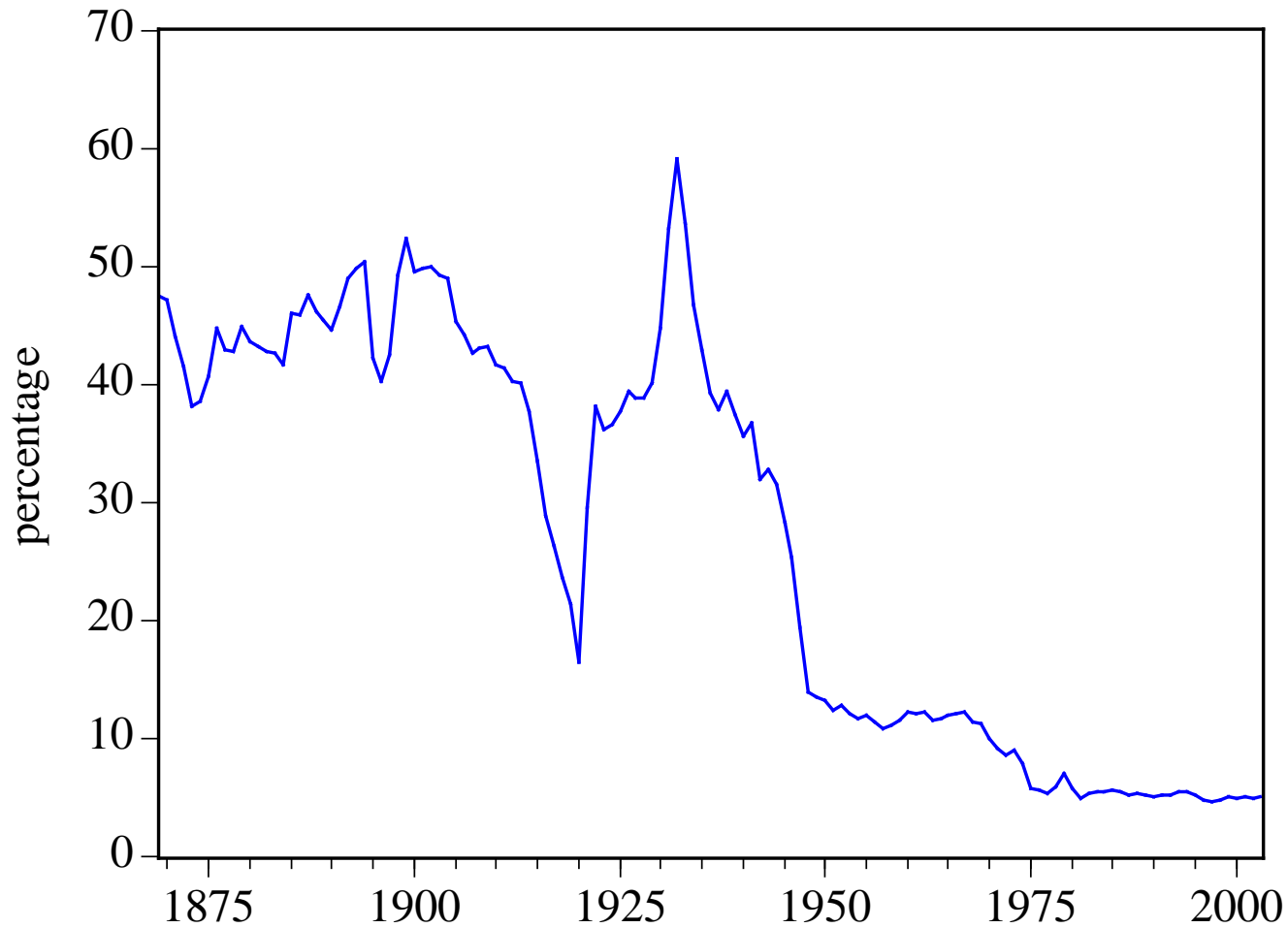


Source: David Brooks, New York Times, March 17, 2017: “Let Bannon be Bannon”

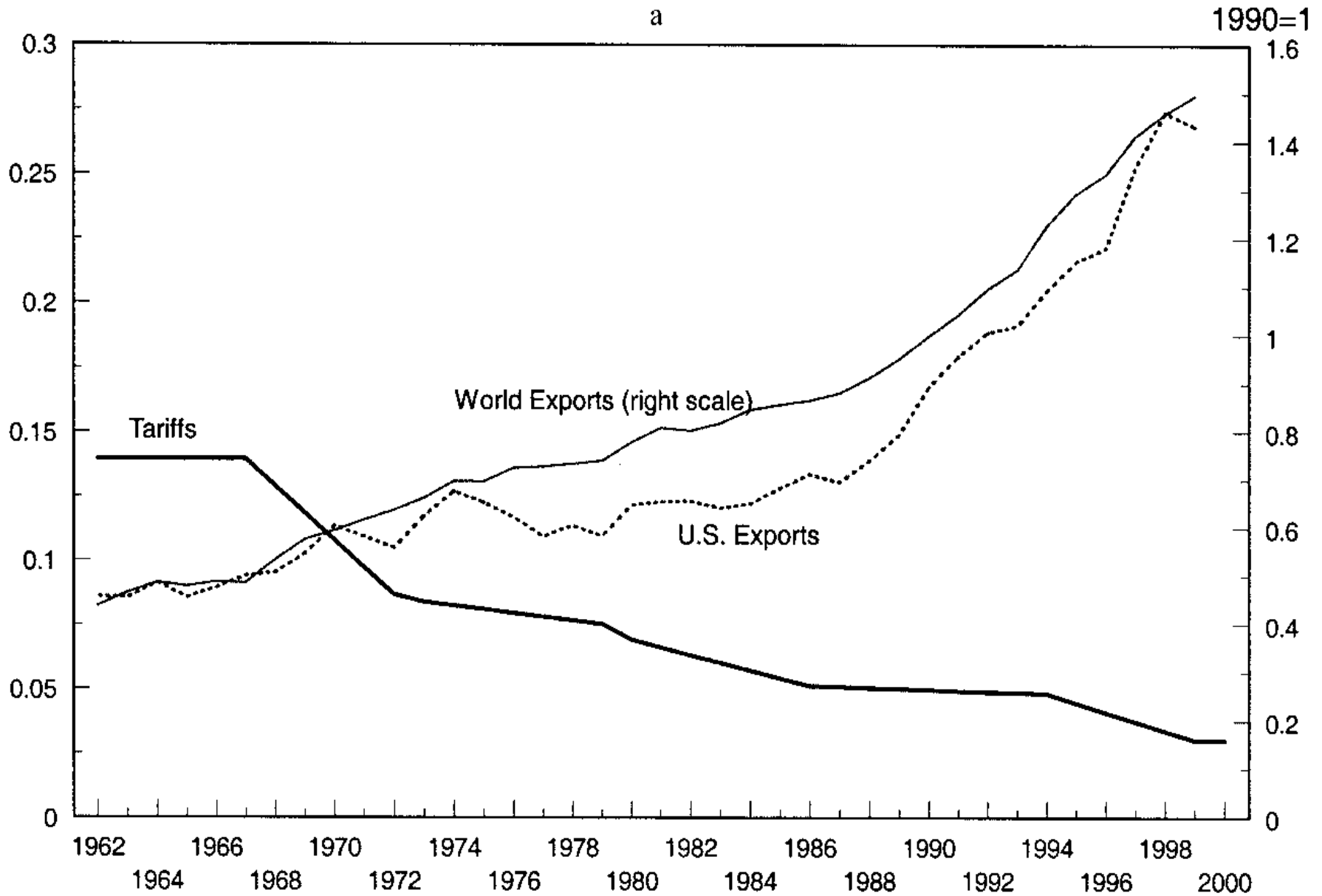
# The Age of Globalization

- Measureable Trade Barriers (i.e., tariffs) at an all-time low
- Trade Volumes have exploded post-World War II
- Many developing countries now integrated in world markets (China, India, South-East Asia, Latin America)

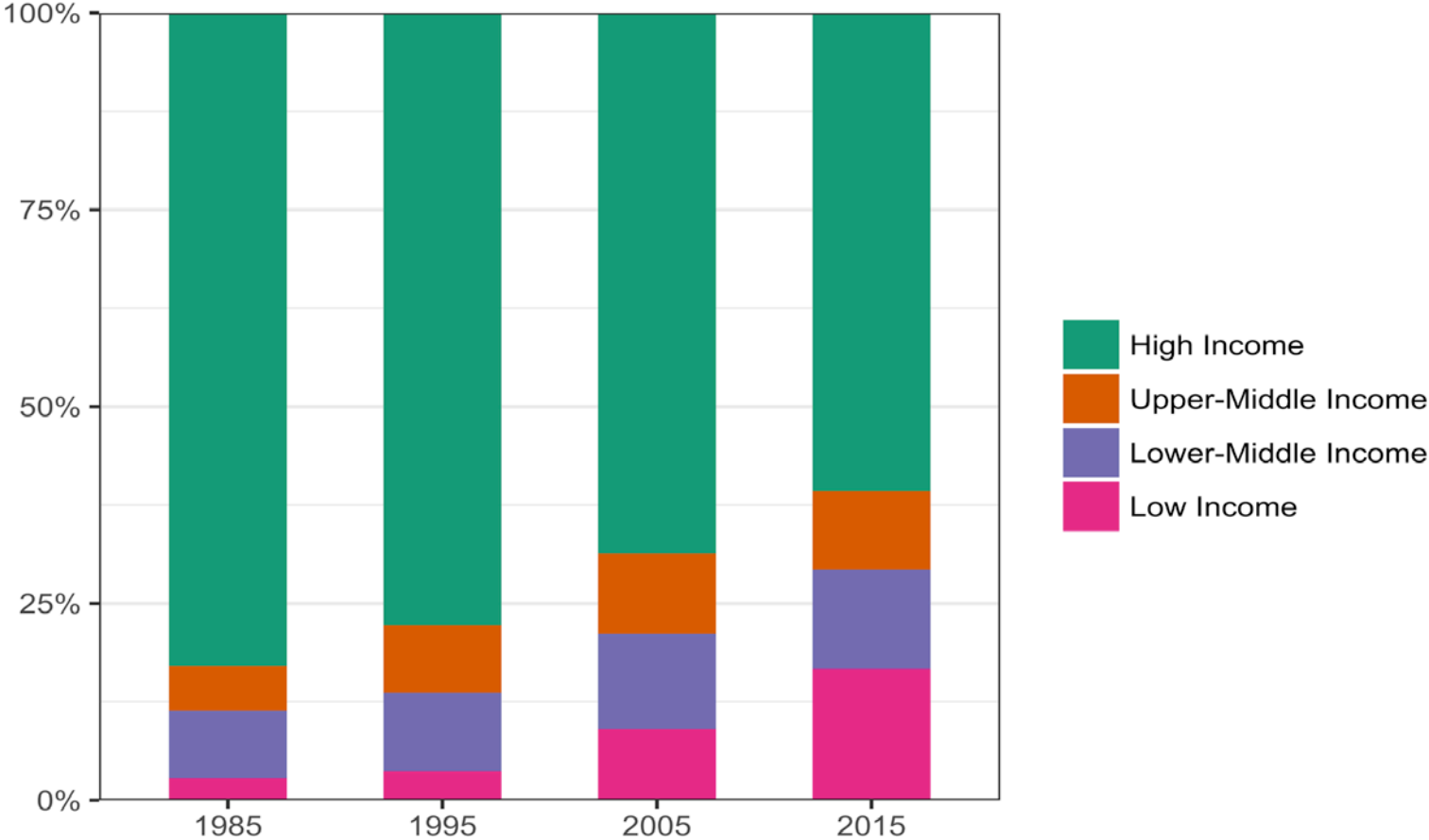
# Average U.S. Tariffs 1875-2002



# From Yi (JPE, 2003)



# Composition of World Exports by Income Group

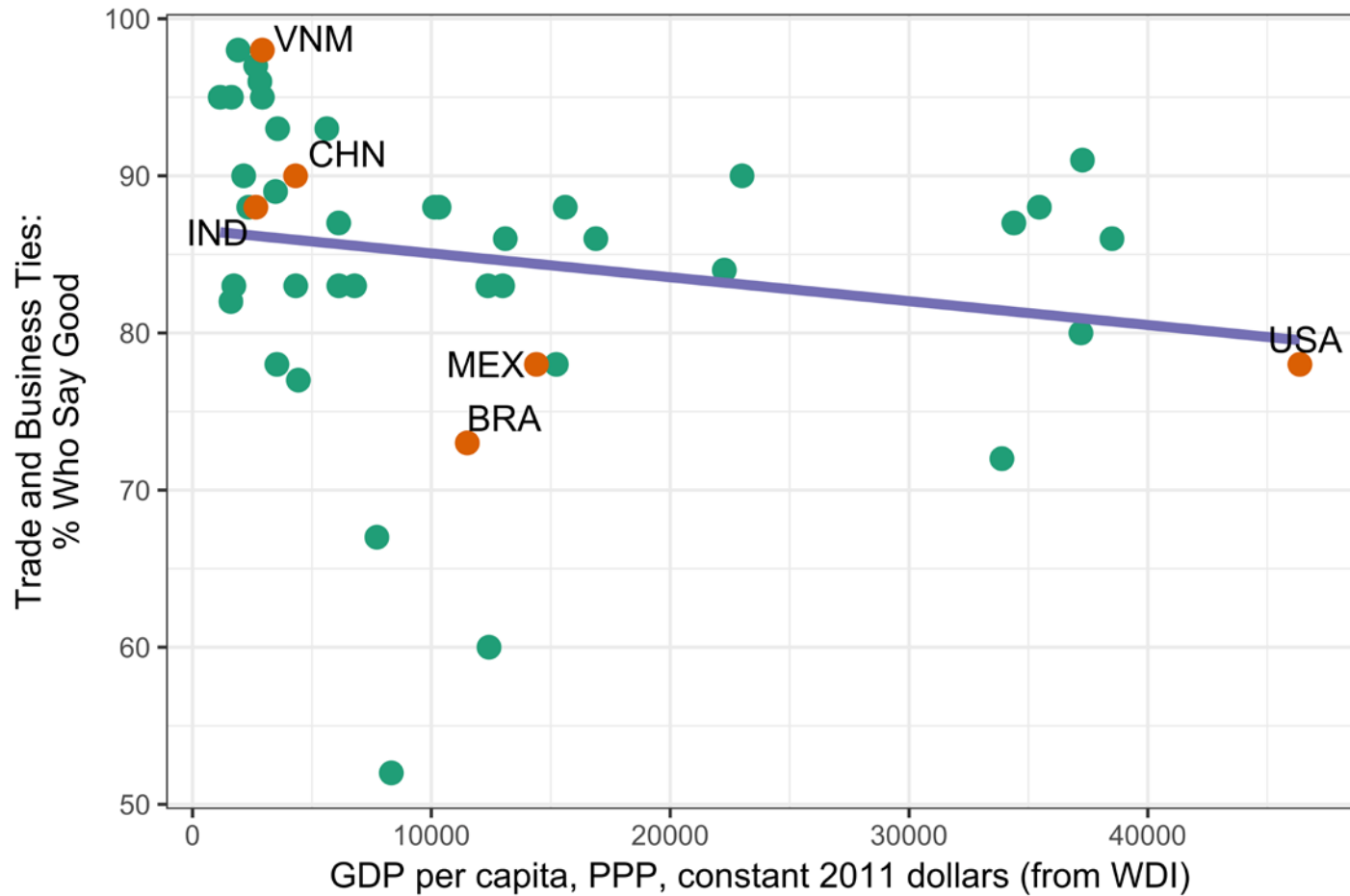


Source: WDI, Pavcnik (2017); a country's time-invariant income category based on 1987 WB income groups.

# The Backlash

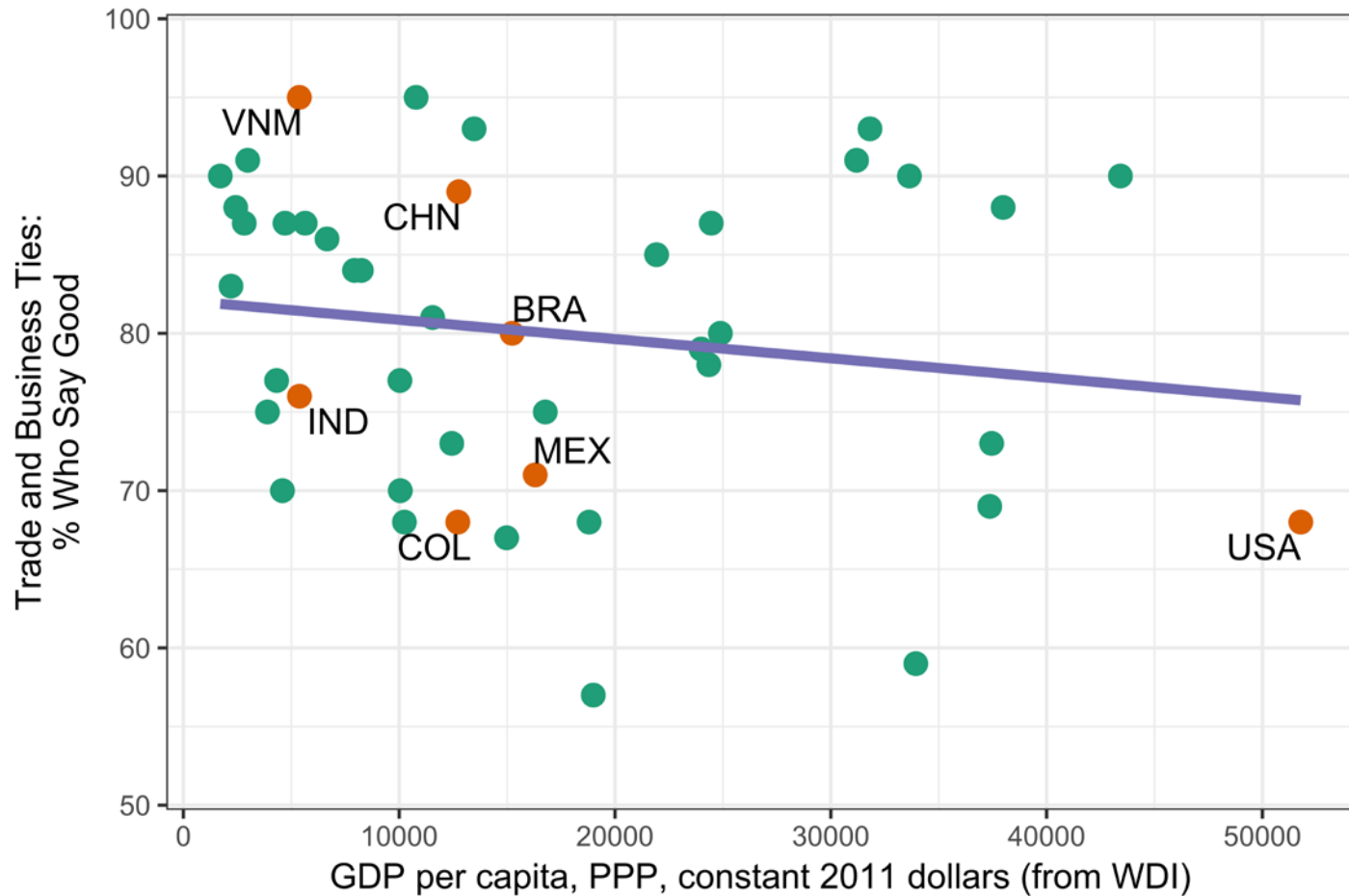
- Revolt of the public in many (developed) countries against free trade and immigration
- Disconnect between academic research and public debate
- Academia: Emphasis on aggregate gains from free trade
- Public Debate:
  - Disruptions (at the individual or regional level) caused by increasing globalization
  - Rising Inequality
  - Renewed Calls for Protectionism

# Attitudes towards Free Trade - 2002

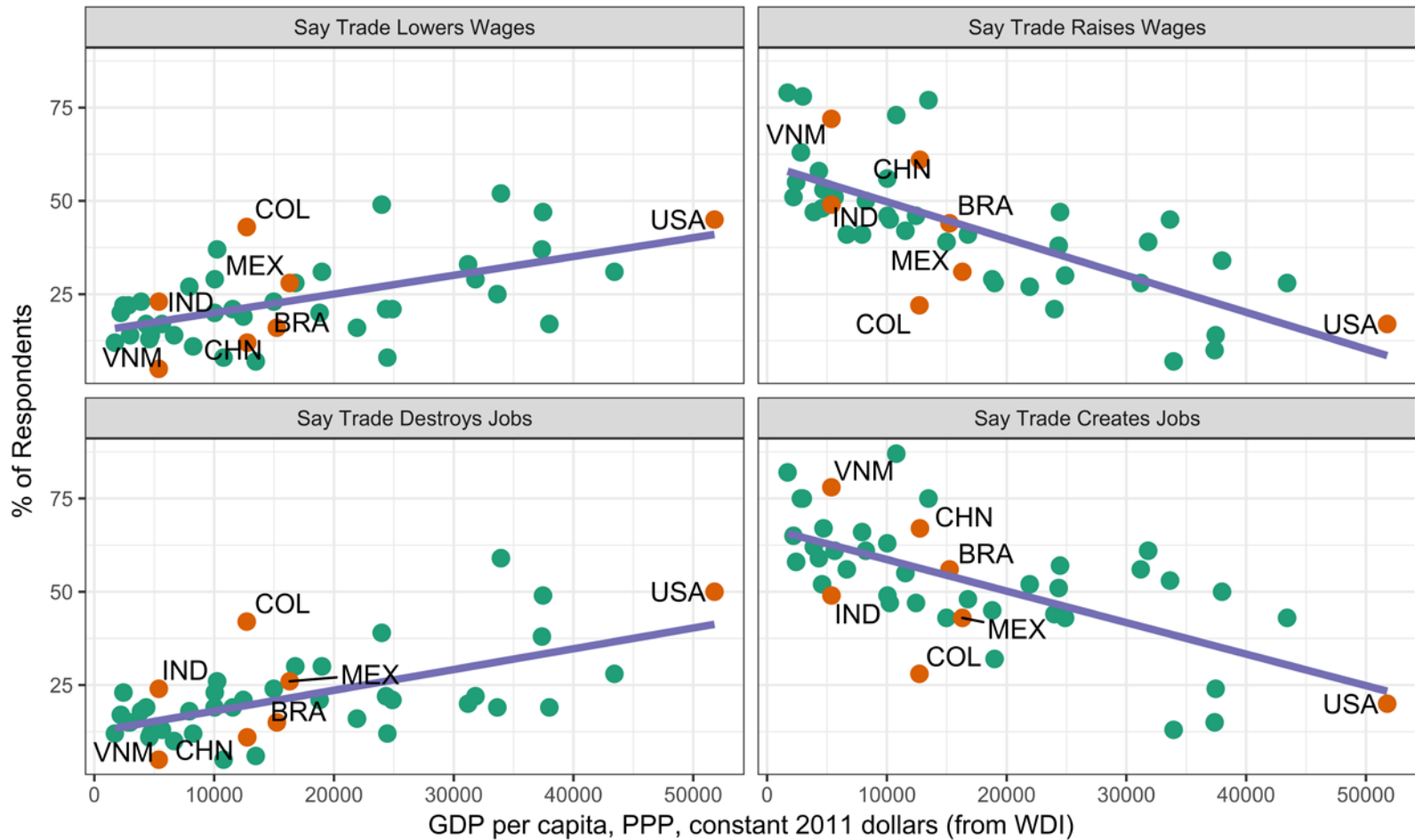




# Attitudes towards Free Trade - 2014



# Views on Trade and Labor Market Outcomes



# Questions for Economists

- What is the role of academic research?
- Why engage with protectionists:
  - Distributional concerns merit our attention
  - Understanding the roots of the backlash = prerequisite for addressing it
  - Rising protectionism threatens the gains from globalization

# Academics' Responsibility

Recent academic research is characterized by two important trends:

- Focus on *Aggregate Gains from Trade*
  - Until very recently, little interest in distributional effects of trade or transition costs.
- Strong Belief in *Irrelevance of Trade Policy*
  - Trade is close to free these days, and trade policy has become irrelevant.

# Aggregate Gains vs. Distributional Impacts

- One of the main insights of trade theory is  
**TRADE IS NOT A ZERO-SUM GAME**
- All countries potentially benefit
- In “old” theory gains realized by exploiting comparative advantage. Result: Increased production efficiency and lower prices for consumers.
- In “newer” theories, additional channels for gains from trade: additional variety, increased quality, economies of scale, reallocation of economic activity towards more efficient firms.

# Aggregate Gains vs. Distributional Impacts (contd.)

- BUT: Equally important insight of trade theory:  
→ **TRADE GENERATES DISTRIBUTIONAL CONFLICTS  
WITHIN A COUNTRY**
- Nature of conflict depends on time horizon and factor mobility
- “New” trade theories generate additional channels for conflict: firm market power; consumer vs. firm interests; small vs. large firms, etc...

# Aggregate Gains vs. Distributional Impacts: The Role of Research

- Aggregate gains from trade well understood by now
- Solid understanding of sources of gains from trade
- But quantitative effects? Less agreement
- Welfare calculations based on static models usually imply SMALL gains from trade

## Research on Aggregate vs. Distributional Effects (contd.)

- ACR (Arkolakis, Costinot and Rodriguez-Clare) sufficient statistic for aggregate gains from trade:
  - Aggregate gains depend only on **share of domestic expenditure and trade elasticity** in a large class of models.
- But implication of ACR: Gains from trade small!



## Research on Aggregate vs. Distributional Effects (contd.)

- BUT: What about dynamic gains? Multiple sectors?
- Are results credible? Or artifact of specific assumptions?
- But why is this question interesting? Are we questioning the gains from specialization?
- We've known this since Adam Smith!

## Research on Aggregate vs. Distributional Effects (contd.)

- Contrast to “Distributional Effects”. Relatively little work.
- Questions regarding distribution equally important and first-order for public perception of trade.
- General lesson from existing work: effects dependent on setting and particular policies implemented. Example: Latin America

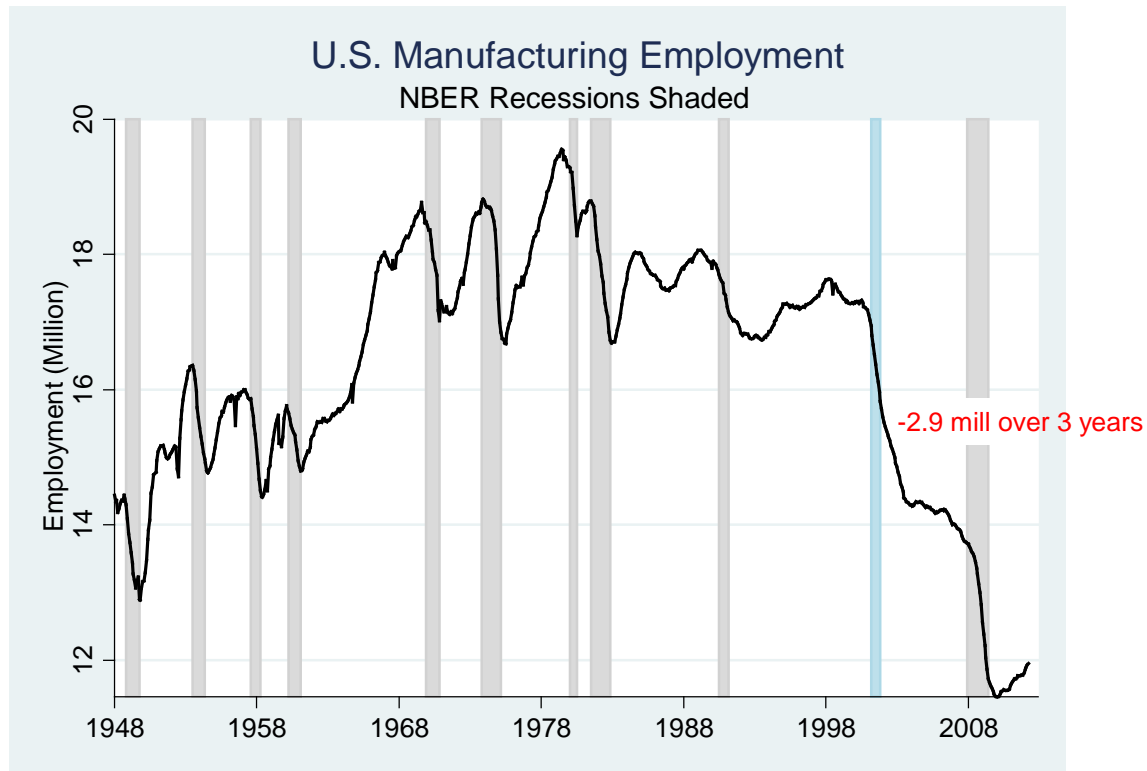
# Distributional Effects

- At the individual (worker or household) level:
  - Increase in Skill Premium
  - Job Loss
  - Move to informal sector
- At the regional level:
  - Areas (within a country) exposed to more liberalization fare worse
- Producers vs. Consumers:
  - Do Consumers benefit from efficiency gains in the form of lower prices?

# On Distributional Impacts: Labor Markets

- Increase in Skill Premium in the 70s, 80s and 90s (trade, technology, or both?)
- Polarization starting in the late 90s (trade, technology, or both?)
- Decline in US Manufacturing Employment in the last 15 years (technology or China shock?)
  - > In pictures:

# Post-War U.S. Manufacturing Employment



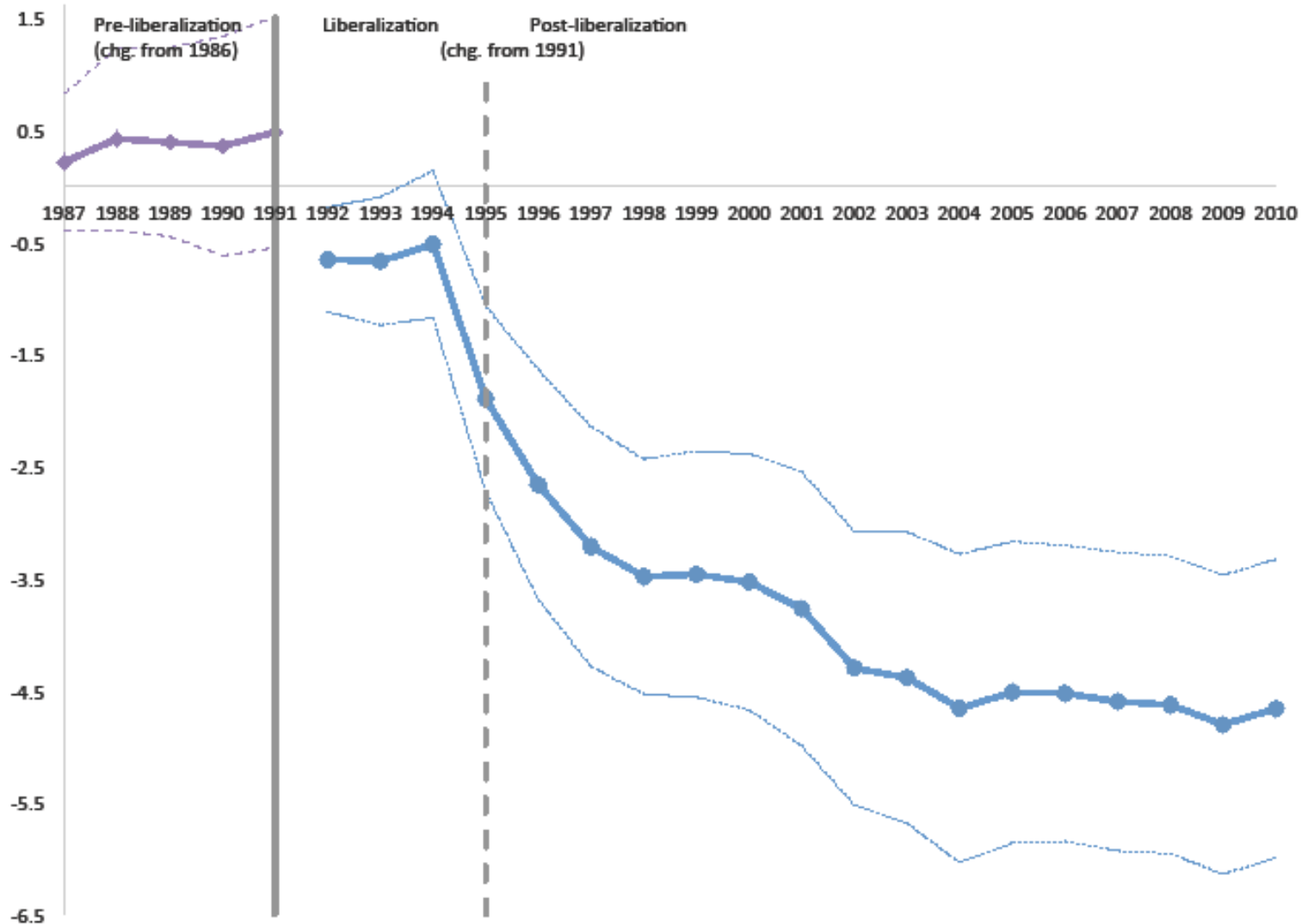
## Distributional Effects (continued)

- A positive trend: many recent papers focus on distributional effects of trade.
- For identification of winners and losers, time frame of analysis is important.
- But how long is the “long run”? How much mobility is there? How large are mobility and general adjustment costs?

## Distributional Effects (continued)

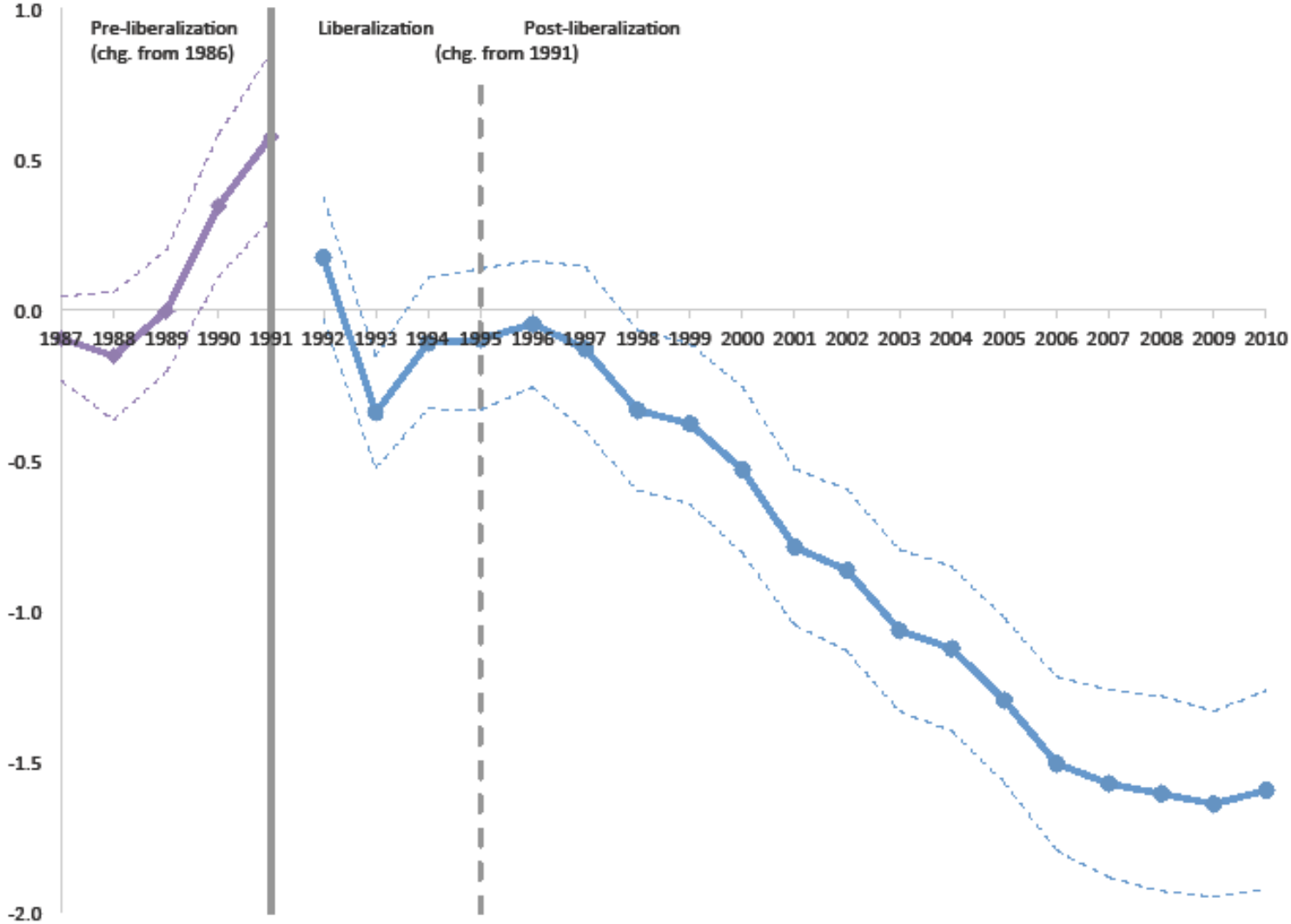
- Two observations here:
  - Autor et al: Large effects after nearly a decade of adjustment (2001-2010)
  - Dix Carneiro and Kovak (Brazilian Trade Liberalization in early 1990s): striking, counter-intuitive results: adverse effects get magnified over time, and long-run distributional impact larger than short-run impact.

# Effects of Brazilian Trade Liberalization on Employment (Dix-Carneiro and Kovak, 2015)





# Effects of Brazilian Trade Liberalization on Earnings (Dix-Carneiro and Kovak, 2015)



## **Note: Developed vs. Developing Countries**

- Argument: Distributional concerns more pronounced in developed countries. In developing countries, growth and development are the first-order questions.
- True. But protectionist calls in the US threaten imports from low wage developing countries
- And several papers have identified distributional effects in developing countries. Losers can potentially block further liberalization

# The Role of the Informal Sector

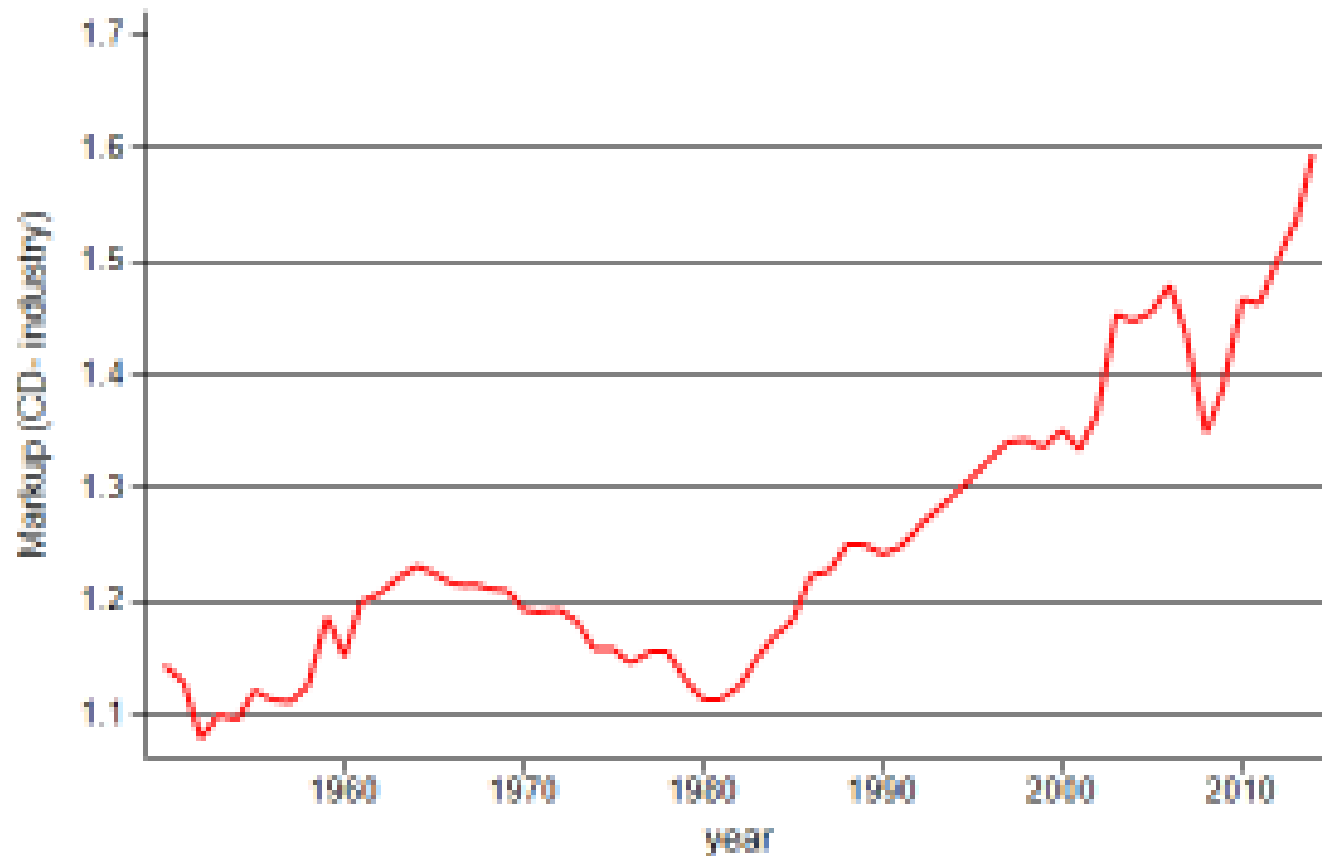
- In Dix-Carneiro and Kovak, labor market eventually recovers because of expansion of **informal sector**
- How general is this result?
- Role of Labor market frictions?
- Welfare and policy implications?
- Thought-provoking

# First Handbook of International Trade Krueger (1984)

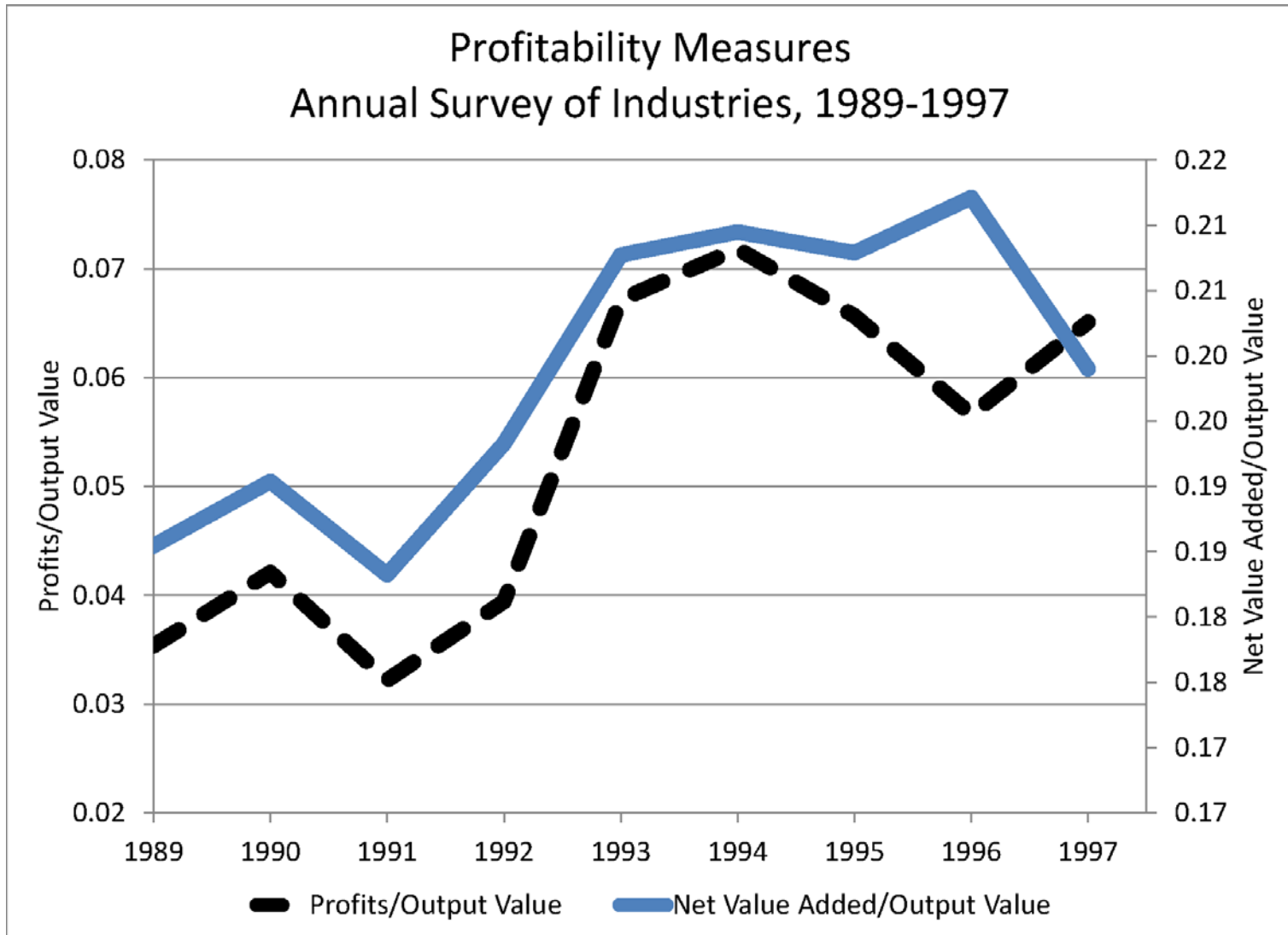
“A survey of the trade and development literature ten years hence will surely focus more on the properties of transition paths [i.e., how to move away from severe domestic and trade distortions], and less on considering the welfare implications of protection, than is currently possible”

# Distributional Impacts Contd.: Product Markets

- Increase in US Firm Profits (i.e. Markups)
- Role of Globalization?



# Evolution of Markups in India



# Effect of Indian Trade Liberalization on Markups

- Liberalization of input tariffs reduced costs of producers
- Cost reductions were not passed through completely to consumers in form of lower prices
- So profits increase
- In the short run, producers benefit more than consumers
- But firms with highest markup increases have the most new product introductions
- Potentially substantial dynamic gains through product innovation and higher product quality

# **On the perceived irrelevance of trade POLICY:**

A few examples:



# “Why the TPP Matters”

[NYT 2015.4.4](#)

“[One myth undermining support for the TPP] is that recent trade agreements have hurt jobs.... This argument fails to differentiate between the impacts of increased global trade and those of trade agreements.

[It] is globalization, technology and flawed educational and tax systems that are driving this trend, not trade pacts.”

# A Role for Trade Policy?

“Most journalistic discussion of the growth of world trade seems to view growing integration as driven by a technological imperative – to believe that improvements in transportation and communication technology constitute an irresistible force dissolving national boundaries.”

Krugman (1995)

# A Role for Trade Policy?

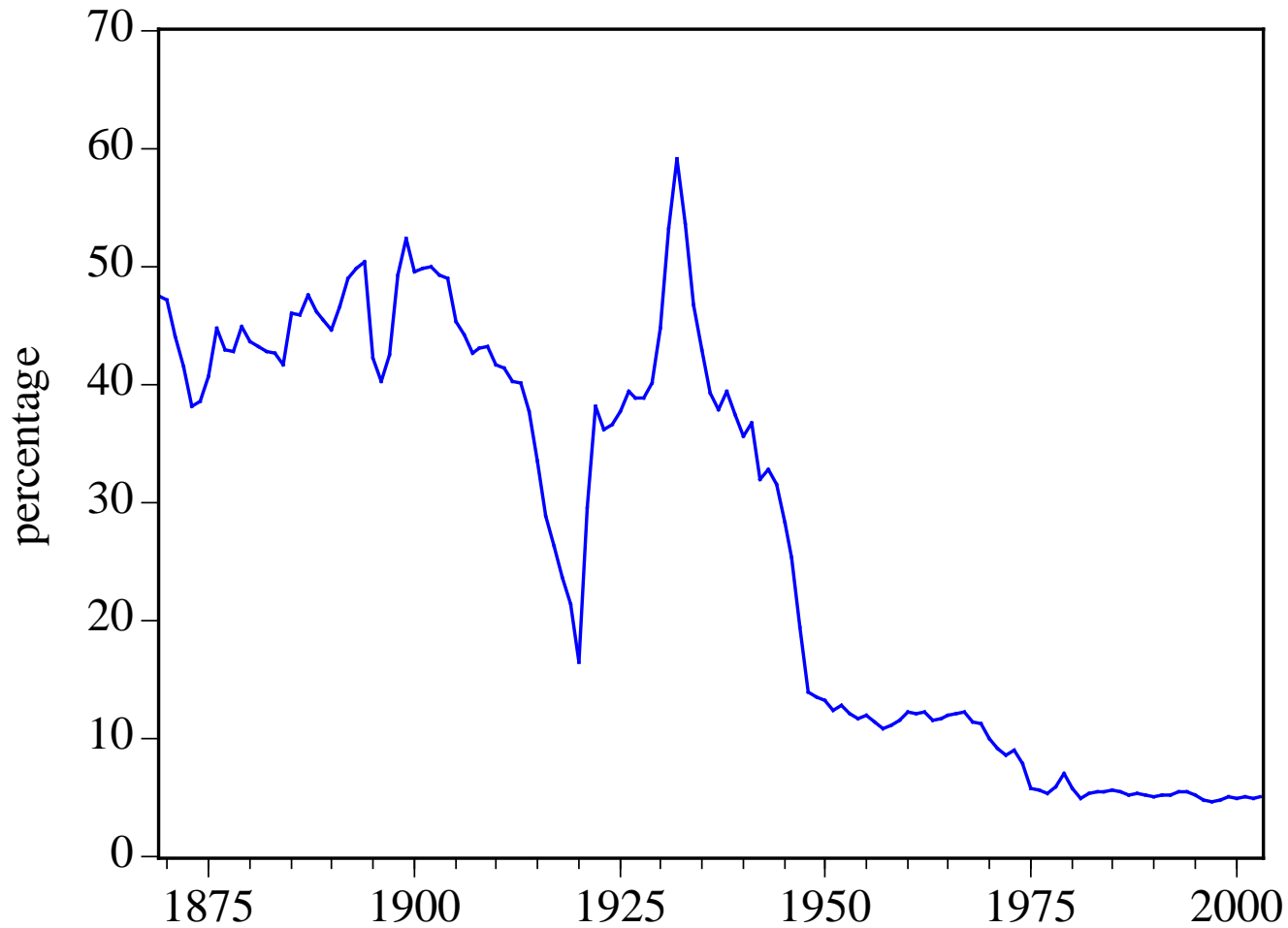
“Relative to when I started working as a trade economist in the early 1980s, **the world is completely liberalized**. So the incremental gains from anything that could happen as a result of WTO negotiations are just infinitesimal”.

Lant Pritchett (2008)

## Against this background:

- What was there left to do? Free trade advocates seemed to have won the battle.
- Attitude reflected not only in quotes above, but also in academic research
- Shift of focus towards “economic geography” and spatial allocation of economic activity indicative of lost interest in INTERNATIONAL Trade.

# Average U.S. Tariffs 1875-2002



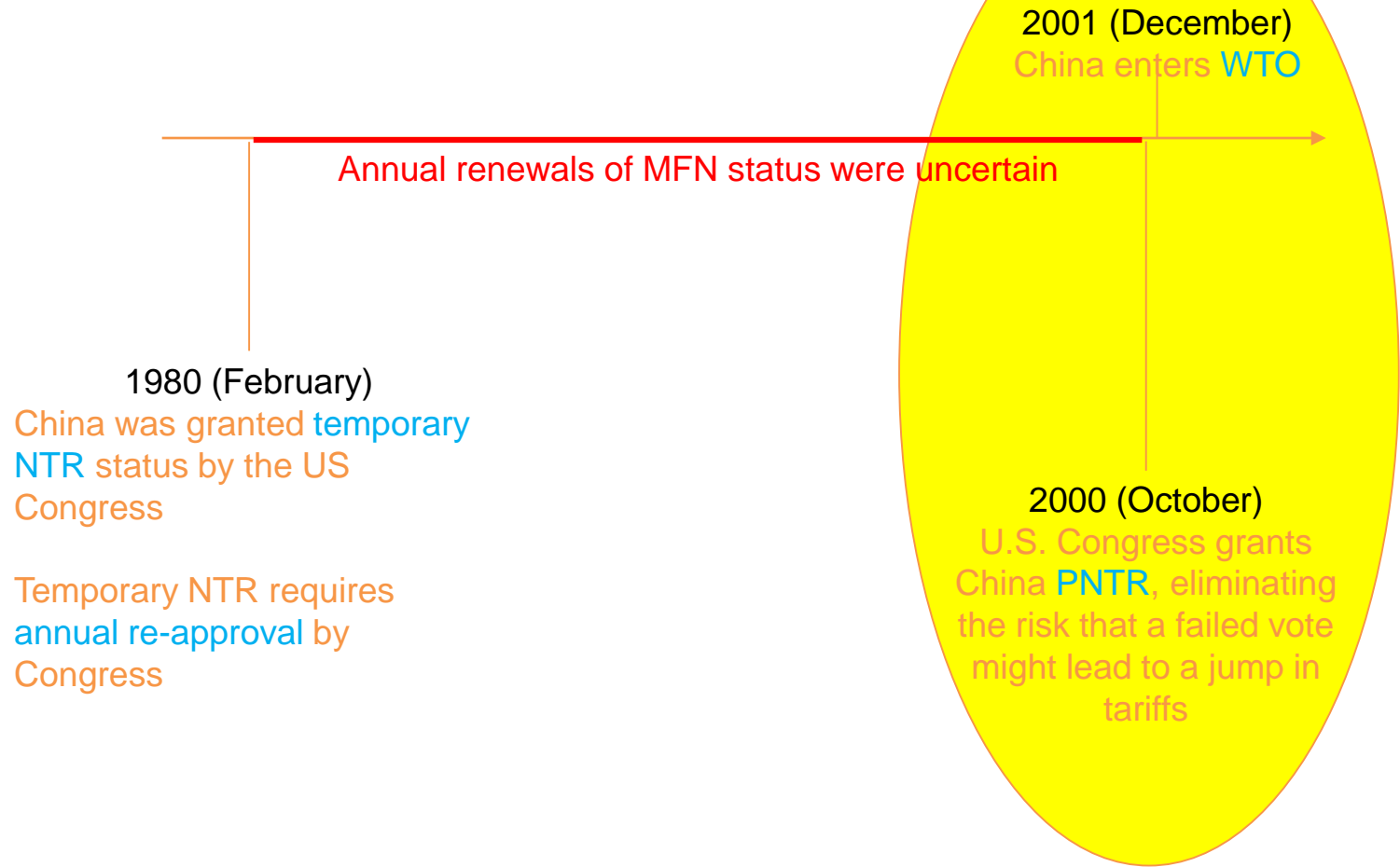
# Goldberg and Pavcnik (2016)

- “Is it indeed the case that trade policy has become irrelevant, or is the shift of academic research away from trade policy simply the result of the difficulties and complexities associated with its measurement?”
- Investigation of changes in trade policy matters!
- Example: Pierce and Schott (AER, 2013)

# US NTR and Non-NTR Tariffs

- **NTR** = Normal Trade Relations
  - Synonym for Most Favored Nation (MFN)
- The US has two basic tariff schedules
  - **NTR tariffs** : for WTO members; generally low
  - **Non-NTR tariffs** : for non-market economies; generally high; set by Smoot-Hawley (1930)
- How does China fit into these categories?

# US-China Trade Policy, 1980-2001





# Pierce and Schott (AER, 2013)

- POLICY: China's receipt of Permanent Normal Trade Relations (PNTR)
- Link decline in US manufacturing employment post-2001 to PNTR
- PNTR did not change actual tariff rates
  - Chinese imports were eligible for low NTR rates starting in 1980
  - But access to these rates required annual renewal by Congress
  - Without renewal, tariffs would rise to higher, Smoot-Hawley levels
- With PNTR, the possibility of tariff hikes was eliminated
- Pre-PNTR uncertainty over possible tariff hikes likely discouraged
  - US firms from investing in trade relationships with Chinese firms
  - US firms from opening plants in China
  - U.S. firms from investing in labor-saving technologies
  - Chinese firms from making investments to export to US

# Pierce and Schott: Conclusions

- Strong link between US manufacturing job loss and PNTR
  - Not evident in EU which did not undergo similar policy change
- Potential mechanisms include
  - Greater incentives for U.S. firms to import inputs and final goods
  - Greater incentives for Chinese firms to scale up exports
  - Greater incentives for U.S. firms to introduce labor-saving technologies

# Back to the NYT article: “Why the TPP Matters”

[NYT 2015.4.4](#)

“Three myths are undermine support for the TPP in the US.”

“The first is that recent trade agreements have hurt jobs and wages and widened income inequality. This argument fails to differentiate between the impacts of increased global trade and those of trade agreements. The M.I.T. economist David H. Autor and colleagues concluded that from 1990 to 2007, Chinese imports accounted for 21 percent of the decline in American manufacturing employment.”

“But the United States does not have a bilateral trade deal with China. **These jobs were lost to expanding trade — not to a trade agreement.**”

“Yes, income inequality has widened to economically and socially harmful levels. But it is globalization, technology and flawed educational and tax systems that are driving this trend, **not trade pacts.**”

# Measurement Challenges

- More and better data than ever before
- BUT: Despite more and better data, still key economic entities hard if not impossible to measure (NTBs, “behind the border” restrictions, regulatory restrictions)
- Are we really in an ‘Era of Free Trade’?

## Measurement Challenges (continued)

- Research consistently finds “trade costs” (backed out based on models) to be substantially higher than trade policy barriers
- But “iceberg trade costs” hard to link to policy
- Much more research needed on proper measurement of cross-border restrictions.  
Case studies potentially very useful

# Two Examples

- a) **Miravete et al (2015):** “Innovation, Emissions Policy, and Competitive Advantage in the Diffusion of European Diesel Automobiles”, CEPR Wo. Paper
- Greenhouse emissions policy enacted by European regulators gave a competitive advantage to European auto makers over foreign imports by enabling the adoption of diesel cars, and that this non-tariff policy was equivalent to a 20% import tariff, effectively cutting imports in half.
- b) **Conconi et al (2016):** “From Final Goods to Inputs: the Protectionist Effect of Rules of Origin,” Wo. Paper
- NAFTA RoO on final goods led to a significant reduction in Mexican imports of intermediate goods from non-NAFTA countries. On average, RoO decreased imports of intermediaries by around 30 percentage points

# Measurement Challenges (continued)

To conclude:

- Academic research needs to be more receptive to such studies
- Need to open up the black box of “trade costs”
- Are markets really open? Do exporters have market access in foreign destinations?

# **Additional Challenge: Global Production Sharing**

- Goods now cross borders multiple times
- Implication → Magnification effect of trade barriers and trade liberalization
- First-order question for research: How should we measure trade flows now?
- Measures based on value-added do justice to the sequential and fragmented nature of the production process.
- Active (though esoteric) area of research!



# **TO CONCLUDE: Implications for Research**

- There is a big gap between the conclusions of academic research and the current backlash against free trade
- How do we made research more relevant to the concerns of the public? What issues should research focus on in the future?

# Three Main Agendas

1. Shift focus from aggregate gains of trade to distributional effects of trade. Moreover, focus on transitional adjustment dynamics.
2. Bring back focus on POLICY
  - Better measurement of trade barriers
  - More case studies?
3. Better understanding of implications of global production sharing

# Final Remarks

- Protectionism is not the solution
- BUT: In order to solve a problem, you first need to acknowledge that you have one.
- Making academic research, especially in International Trade, POLICY-relevant again, is an important step!

**THANK YOU!**