

January 31, 2008

## Economists Rethink Free Trade

**It's no wholesale repudiation, to be sure, but something momentous is happening as doubts begin to creep in**

by Jane Sasseen

Many ordinary Americans have long been suspicious of free trade, seeing it as a destroyer of good-paying jobs. American economists, though, have told a different story. For them, free trade has been the great unmitigated good, the force that drives a country to shed unproductive industries, focus on what it does best, and create new, higher-skilled jobs that offer better pay than those that are lost. This support of free trade by the academic Establishment is a big reason why Presidents, be they Democrat or Republican, have for years pursued a free-trade agenda. The experts they consult have always told them that free trade was the best route to ever higher living standards.

But something momentous is happening inside the church of free trade: Doubts are creeping in. We're not talking wholesale, dramatic repudiation of the theory. Economists are, however, noting that their ideas can't explain the disturbing stagnation in income that much of the middle class is experiencing. They also fear a protectionist backlash unless more is done to help those who are losing out. "Previously, you just had extremists making extravagant claims against trade," says Gary C. Hufbauer, a senior fellow at the Peterson Institute for International Economics. "Now there are broader questions being raised that would not have been asked 10 or 15 years ago."

So the next President may be consulting on trade with experts who feel a lot less confident of the old certainties than they did just a few years ago. From Alan S. Blinder, a former vice-chairman of the Federal Reserve and member of the Council of Economic Advisers in the Clinton Administration, to Dartmouth's Matthew J. Slaughter, an international economist who served on President George W. Bush's CEA, many in the profession are reevaluating the impact of globalization. They have studied the growth of low-wage work abroad and seen how high-speed telecommunications make it possible to handle more jobs offshore. Now they fear these factors are more menacing than they first thought.

## GAINS ONLY FOR A TINY SLICE

No one is suggesting that trade is bad for the U.S. overall. According to estimates by the Peterson Institute and others, trade and investment liberalization over the past decades have added \$500 billion to \$1 trillion to annual income in the U.S.

Yet concern is rising that the gains from free trade may increasingly be going to a small group at the top. For the vast majority of Americans, Dartmouth's Slaughter points out, income growth has all but disappeared in recent years. And it's not just the low-skilled who are getting slammed. Inflation-adjusted earnings have fallen in every educational category other than the 4% who hold doctorates or professional degrees. Such numbers, Slaughter argues, suggest the share of Americans who aren't included in the gains from trade may be very big.

"[That's] a very important change from earlier generations, and it should give pause to people who say they know what's going on," he says.

Blinder warns the pain may just be starting. He estimates that eventually up to 40 million service jobs in the U.S. could face competition from workers in India and other low-wage nations. That's more than a quarter of the 140 million employed in the U.S. today. Many of the newly vulnerable will be in skilled fields, such as accounting or research—jobs U.S. companies will be able to move offshore in ever greater numbers. "It will be a messy process of adjustment, with a lot of victims along the way," Blinder says.

The rumble of academic debate is already having an effect on the Presidential campaign. In an interview with the *Financial Times* late last year, Hillary Clinton agreed with economist Paul A. Samuelson's argument that traditional notions of comparative advantage may no longer apply. "The question of whether spreading globalization and information technology are strengthening or hollowing out our middle class may be the most paramount economic issue of our time," her chief economic adviser, Gene Sperling, recently wrote. Barack Obama's adviser, the University of Chicago's Austan D. Goolsbee, is not convinced free trade is the culprit behind the squeeze on incomes. But he believes many U.S. workers aren't sharing in the gains from open markets and fears a political blowback unless something is done.

## **A CALL TO ACTION**

What to do? Blinder argues for a big expansion of unemployment insurance and a major overhaul of the poorly performing Trade Adjustment Assistance program (TAA), which retrains manufacturing workers whose jobs disappeared. More vocational training and wage insurance, which would partially reimburse displaced workers who take new jobs at lower pay, also figure in his proposals. Both Clinton and Obama—and even Republican Senator John McCain—have similar ideas.

That's not enough, says Slaughter. He sees a need for some form of income redistribution to spread the gains from free trade to more workers. In a controversial article Slaughter co-wrote last summer for Foreign Affairs, he proposed "A New Deal for Globalization" in which payroll taxes for all workers earning below the national median income level would be eliminated. Slaughter has talked with campaign advisers in both parties. So far, he has no takers. But it's one more sign of how far the trade debate has moved.