

OP-EDS

The Payoff from Globalization

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The battle over the Central American Free Trade Agreement (CAFTA) recalls some familiar themes. The "modern" debate over trade barriers can be traced to the 19th century. Then as now, the debate has been dominated by special interests (land barons vs. merchants in the 19th century; the AFL-CIO vs. the Chamber of Commerce today). There is no question that trade liberalization creates winners and losers. Affected citizens and companies have every right to plead their case.

But Congress should consider how freer trade affects the nation as a whole. Since World War II the United States has led the international quest to liberalize world trade and investment. With leadership from the White House, Congress has slashed the simple average tariff rate from 40 percent in 1946 to 4 percent today, and other industrial nations have done much the same. After a half-century of steady liberalization it is fair to ask, what do Americans have to show?

As it turns out, quite a lot. Using four different methods, we estimate that the combination of shrinking distances-thanks to container ships, telecommunications and other new technologies-and lower political barriers to international trade and investment have generated an increase in US income of roughly \$1 trillion a year (measured in 2003 dollars), or about 10 percent of gross domestic product. This translates to a gain in annual income of about \$10,000 per household.

Unfortunately for the cause of continued liberalization, Americans do not receive this money as a check marked "payoff from globalization." Instead, the payoff is hidden within familiar channels: fatter paychecks, lower prices and better product

choices (compare the telephones available now with the standard black model of 1980).

Nevertheless, each of our four methods uncovers a large payoff. First, we parse international data that correlate the expansion of international trade with economic growth. This shows that the increase in US income sparked by more intense trade equates to 13.2 percent of GDP. In the second method, we calculate how lower tariffs stimulate US productivity through competitive forces and bring greater product choices to US producers and consumers. The estimate for these benefits comes to 8.6 percent of GDP. Third, we draw on a computable general equilibrium model to suggest how today's economy would react to the restrictive Smoot-Hawley trading environment of the 1930s. That exercise indicates an estimate of 7.3 percent more in GDP from liberal trade. Finally, we calculate the productivity benefits arising from use of imported components and find a benefit of 9.6 percent of GDP. While none of the four estimates is perfect, the broad result is clear: The benefits of trade and investment liberalization are positive and large.

Given the large gains from past liberalization, and today's low tariffs and modest investment barriers, skeptical commentators might say, "Been there, done that." But our estimates of future policy liberalization alone (excluding likely benefits from better communications and transportation) indicate that a move from today's commercial environment to global free trade and investment could produce an additional \$500 billion in US income annually, or roughly \$5,000 per household each year. Much of the benefit would come from sectors of the economy that were effectively ignored during earlier rounds of liberalization: services, agriculture, transportation and trade with developing countries. No single trade or investment agreement can confer the entire range of benefits on Americans; instead, the prize requires steady liberalization-through agreements such as CAFTA and the World Trade Organization's Doha round, each providing a steppingstone toward the eventual goal.

Despite the huge payoff to the United States, maintaining political support for trade liberalization has never been easy. Poli Sci 101 gives the explanation: Large gains are widely dispersed, and much smaller private losses are highly concentrated. Surveying several estimates, we arrive at a middle-of-the-road figure of roughly 225,000 trade-related job losses per year. Most dislocated workers find new jobs in six months, many far sooner; but some are unemployed for an extended period. Even workers who are re-employed may face significant pay cuts. Taking these features into account, we estimate that the lifetime costs of a year's worth of trade-related job losses is roughly \$54 billion, about \$240,000 per affected worker. This is a huge loss on a personal level, but only about 5 percent of the annual national gains from liberalization. Moreover, a rough estimate of the adjustment costs to agricultural landowners suggests that the progressive removal of trade barriers and farm subsidies over a decade could lower agricultural land values by \$27 billion a year. The strident opposition to CAFTA from sugar barons such as the Fanjul family confirms that this is a sensitive matter. Yet again, lower property values are a one-time private loss and a fraction of national gains.

America's national interest will best be served by staying the course of free trade and investment. At the same time, it is morally imperative to address private losses incurred by dislocated workers; as well, it may be politically necessary to cushion the blow to agricultural land values. The federal government spends less than \$2 billion per year helping trade-dislocated workers. Over the past decade, the Organization of Economic Cooperation and Development estimates that US government policy has boosted domestic farm incomes by an average \$40 billion per year through direct subsidies (\$23 billion) and trade barriers (\$17 billion). Given the enormous dividends from international trade, more should be done for workers forced to bear the burden of economic adjustment. Meanwhile, US farm subsidies should be spent in ways that help farm owners adjust, rather than encouraging them to fight liberalization with all their political energy.