Calming Workers' Fears About Trade

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Workers in developing countries, such as this one in Nicaragua, need not only a basic social safety net but also an education system that trains them for rapid change.

Even though the global economy has been expanding, workers and the governments that represent them show increased anxiety about trade. Most changes in the workplace leading to job displacement can be attributed to advances in technology, but it is increasing imports that attract more blame. Protectionism is the wrong response. Better solutions have been proposed for governments to address workers' anxiety.

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Pascal Lamy, director-general of the World Trade Organization, has called on the international community to reinvigorate the moribund Doha Round of negotiations because he fears that failure could put at risk the rules-based multilateral trade regime. The real difficulty goes beyond the specific negotiating issues at Doha. In developed and developing countries alike, the idea that global economic integration brings social benefit is increasingly controversial. As a result, many countries show a growing appetite for using discriminatory and trade-distorting practices as discretionary policy tools.

Anti-dumping actions, temporary tariffs or quotas in response to import surges, production subsidies, and trade-distorting regulations are easy to understand when economic growth is stagnant. Unless a growing economy can create easy opportunities for other industries to absorb labor quickly, then trade concessions and economic shocks, or both, can create clear losses in import-competing industries, especially for workers whose skills and experience are tied to their existing employment. Such policies can be used to preserve the status quo.

Rapid contraction within any sizable sector of the economy exacts a political toll. But the erosion of faith in open global markets and multilateral rules seems surprising in an era of robust overall economic growth. The answer to the conundrum lies in the quickened pace of technological change.

Technological Change and Job Anxiety

We have witnessed significant labor-saving technological change in manufacturing over the past 60 years. In most developed economies, productivity growth in manufacturing has averaged 3 to 5 percent per year since 1950. At the same time, manufacturing employment has grown little or has actually declined. This has reduced the share of employment in manufacturing and has led to a corresponding rise in the share allocated to services.

At the same time, falling global transport costs have contributed to a rising share of manufactured output that is traded internationally. More recently, service-sector outsourcing has led companies in many countries to restructure the way they do business.

Structural change is equally rapid in many developing countries as cities expand and traditional agriculture and small-scale cottage industries give way to greater specialization for the global market.

All of these shocks mean that more sectors of the economy feel threatened by actual or potential international competition, and this view is common in countries at different levels of economic development.

A second and related issue is the fear that growing trade between more-developed and less-developed regions of the world is the main cause of increased income inequality in the United States and high unemployment in Europe. Yet as Princeton University economics professor Paul Krugman and others have argued, the probable cause is falling internal demand for unskilled labor, which is likely generated by technological change that is biased toward highly skilled workers. International economic integration may have had some small influence on the timing of these labor market changes, but they would have occurred in any case.

Nonetheless, public anxiety about job insecurity focuses on trade liberalization in part because job displacement is often quite costly in industries that face strong competition from imports. Yet governments should not respond to this sense of insecurity by abandoning a principled commitment to open engagement with the world market or by relying more heavily on administrative protection and other policies that favor particular domestic companies or sectors of the economy.

The Problems With a Protectionist Remedy

The most important competition that takes place within any country is not between domestic companies and foreign rivals, but among domestic companies for scarce labor and capital at home. Trade barriers and domestic subsidies may raise output, employment, and profit in certain domestic industries, but they do this by disadvantaging other domestic companies not favored by subsidies or protection. And if the source of profit in favored industries is higher domestic prices instead of higher productivity, then that profit represents lost income to someone else in that country. It is not a gain in national income.

These policies pit domestic consumers as well as companies that use imported intermediate inputs against often politically well-connected producers of import-competing products. Because the protective policies often are opaque and the process that leads to them hidden from view, they expand the scope for special-interest lobbying. This socially unproductive excessive profit seeking often redistributes income away from society's most needy citizens and diverts scarce resources away from sectors likely to produce high levels of economic growth.

One advantage of trade openness is that world prices usually provide better information about scarcity than prices distorted by interest group pressure. World prices provide better incentives to domestic consumers and companies to use resources in a way that maximizes the value of national income. Companies and consumers in more open economies often have a wider choice of higher-quality goods, and these economies may experience a faster rate of technological diffusion if technology is embodied in imported inputs or foreign investment.

Yet another advantage of trade openness is that it diminishes the market power that highly concentrated domestic industries have within their home country. Openness is a very effective competition policy. This is especially true for smaller developing economies in which many domestic industries have only one or two major companies.

How Best to Respond?

In nations with a well-developed public sector, job insecurity among workers can be addressed using a number of targeted programs. Older tools such as expanded trade adjustment assistance (TAA), which is money spent on retraining workers laid off as a result of trade, can help make trade agreements more palatable to skeptical legislatures. Unfortunately, TAA systems are administratively complex, and they do not always reach the workers who most need the assistance or who are most adversely affected by trade. Programs that are more likely to restore vitality to trade liberalization are ones that directly address the causes of worker anxiety and that reach more people.

In a policy paper for the Peterson Institute for International Economics, Peterson senior fellow Lori Kletzer and Brookings Institution senior fellow Robert Litan advocate a new safety net for all displaced workers. The two pillars of the proposal are wage insurance and subsidies for health insurance for qualifying workers upon reemployment. Though their argument is directed at the U.S. experience, the idea of providing social insurance against the things people fear most about job loss has great appeal. Existing unemployment insurance does nothing to allay the fear of wage loss upon reemployment, and paying the benefit only upon reemployment would tend to shorten unemployment duration and hasten the development of new skills on the job.

Another approach involves expanded use of tax advantages for retraining. Companies could spread the costs over years for qualifying forms of worker training, and individuals could receive tax deductions or credits for individual educational expenses in qualifying programs.

In many developing economies, the public sector's effective reach is much shorter, and there are clear government priorities that should rank much higher than industrial policy or managing trade. One such priority should be to build a sound fiscal architecture of clear tax codes enforced by independent and impartial judiciaries so that revenue can be collected efficiently and fairly. In addition, broadening the tax base would permit governments to collect more revenue while reducing high tax rates—including high taxes on imports and income—that breed tax evasion and public corruption.

A sound revenue base would permit governments in developing economies to perform many tasks that only they can do. Young people need a basic framework for educational advancement, especially at the primary and secondary levels. Comparative advantage is a moving target, and, given the rapidity of change in the recent past, workers will need transferable skills that will permit them to work in many industries over their working lives. Basic health care needs to be extended to more people so that productive lives are not compromised by easily prevented chronic illness. And lastly, every citizen should be able to rely on a basic social safety net so that anxiety about employment does not translate into a phobia about the changes the world market is bringing.

Pascal Lamy may be right. There is some risk that a failed Doha negotiation could trigger a round of inward-looking policies or even "beggar-thy-neighbor" tactics such as competitive currency devaluations and increased protective barriers. On the other hand, the real future of global economic integration may be decided less at the global negotiating table and more by how countries respond to domestic job anxiety. ■

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