The Heritage Foundation

ISSUE BRIEF

No. 4376 | APRIL 09, 2015

What Big Labor Gets Wrong on Trade

Ryan Olson

Congressional debate over trade promotion authority and the ongoing negotiation of the Trans-Pacific Partnership has raised the profile of trade policy in recent weeks. In their zeal to block action, some critics of free trade have been encouraging common misperceptions with arguments that are patently false and ignore some of the most basic accepted principles of economic theory.

Within the economics profession, there is virtually no debate about the benefits of free trade. Specialization and trade are the basic building blocks of modern economies. Extending those principles over the widest possible geographic area is a key to widespread prosperity. Falling trade barriers and free trade agreements (FTAs) have improved economic and social conditions globally.

Regrettably, rather than embracing the historic opportunities for growth through globalization of international trade and investment, U.S. labor unions have hunkered down in a defensive posture to thwart change and preserve existing manufacturing structures at whatever the cost. Unsurprisingly, recent claims by the AFL-CIO and other advocates of protectionism have been more forceful and more inaccurate than ever.

On March 18 at the Peterson Institute for International Economics, AFL-CIO President Richard Trumka laid out labor's opposition to FTAs, weighing in on the debate about the future of U.S. trade policy.[1] The misconceptions below are drawn from his presentation.

Correcting the Misconceptions

Recently, U.S. labor groups have highlighted in public speeches a few common misconceptions about free trade and its effects on the U.S. economy and the global economy.

Misconception #1: Trade policy is not working as indicated by current account deficits, net international debt position, rising inequality, and labor and wage data.

Reality: Wages have steadily risen since 1960. Current account deficits and the net international debt position are poor indicators of the effectiveness of U.S. trade policy.

The U.S. has an open economy and freely imports and exports goods, services, and capital. As a result, any trade deficits are offset by investment flows into the U.S. economy in the form of either direct equity investment or other financial holdings. A so-called negative trade or current account balance means not only that large amounts of goods and services are flowing into the U.S. economy, but also that foreigners are investing massively in U.S. companies and financial products—a positive indication of the health of the U.S. economy.

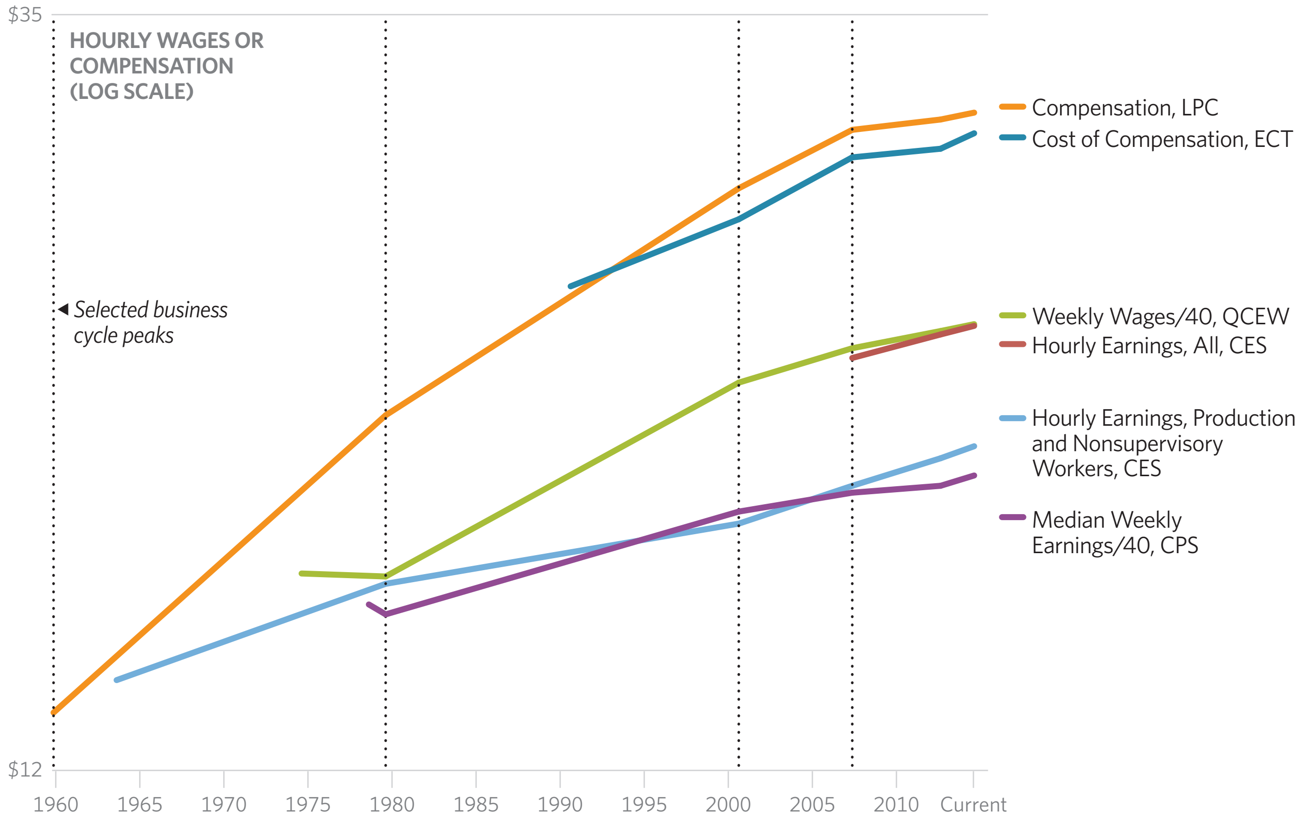
The historical record shows clearly that trade deficits are a sign of good times for the U.S. economy. Indeed, the U.S. experienced the largest expansions of the trade deficit in recent years during periods of significant growth in the 1990s and between 2002 and 2006. Conversely, the trade deficit *shrank* as the economy slowed during the "Great Recession."

This paper, in its entirety, can be found at
http://report.heritage.org/ib4376

The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

CHART 1

Wage Growth Since 1960



Source: Salim Furth, "Stagnant Wages: Fact or Fiction?" Heritage Foundation *Issue Brief* No. 2993, March 11, 2015, http://www.heritage.org/research/reports/2015/03/stagnant-wages-fact-or-fiction.

IB 4376 heritage.org

Inconveniently for critics, the U.S. has an overall trade surplus with its FTA partners and bilateral trade surpluses in 11 of its 14 FTAs.[2] However, the trade balance with a particular country or group of countries is not important. Rather, the free flow of goods and services is important because it increases efficiency, aids investment and job growth, and keeps prices low.

Contrary to labor unions' claims, wage and labor data do not indicate that U.S. trade policies are failing U.S. workers. Following the Uruguay Round of trade negotiations and North American Free Trade Agreement (NAFTA), the U.S. labor market experienced a period of sustained improvement. Between 1992 and 2000, the U.S. unemployment rate dropped consistently, settling at a low of 3.9 percent in 2000. Furthermore, while some claim that U.S. wages have fallen in recent decades, the data indicate the opposite. Based on multiple measures of compensation, wages have steadily risen since 1960. In particular, the wages of nonsupervisory workers—a measure that particularly captures low-skill workers, who are the most vulnerable—have risen faster than the wages of all workers since 2006.[3]

1. Richard L. Trumka, "U.S. Trade Policy and American Workers: Finding the Elusive Win-Win Solution," speech at the Peterson Institute for International Economics, Washington, DC, March 18, 2015, http://www.iie.com/publications/papers/trumka20150318.pdf (accessed April 2, 2015).
2. U.S. Census Bureau, "U.S. Trade in Goods by Country," http://www.census.gov/foreign-trade/balance/ (accessed April 2, 2015).
3. Salim Furth, "Stagnant Wages: Fact or Fiction?" Heritage Foundation *Backgrounder* No. 2993, March 11, 2015, http://www.heritage.org/research/reports/2015/03/stagnant-wages-fact-or-fiction.

TABLE 1

Most Partners in U.S. Free Trade Agreements See Wages Improve

PERCENTAGE CHANGE OF MEAN REAL MONTHLY EARNINGS

Country	Before U.S. Free Trade Agreement	After U.S. Free Trade Agreement
Dominican Republic	n/a	+1.0%
Costa Rica	n/a	+2.5%
Nicaragua	n/a	-1.9%
Korea	+1.4%	+2.5%
Chile	n/a	+2.3%
Colombia	+1.5%	+2.6%

Source: International Labor Organization, ILOSTAT Database, http://www.ilo.org/ilostat (accessed April 2, 2015).

IB 4376 heritage.org

Misconception #2: Trade deals are actually investment deals, which allow companies to move capital offshore and ship goods back to the U.S.

Reality: Trade deals are both investment and trade deals.

The most recent trade deals—including deals with Panama, Korea, and Colombia—have included provisions to lower tariff and non-tariff barriers and to protect investors' rights. Yet trade deals certainly are not deals meant specifically to allow companies to move capital offshore and ship goods back to the United States. They increase everyone's freedom to buy, sell, and invest on the global marketplace.

A large open economy such as the United States simply cannot have both a trade deficit and a capital account deficit. By definition, the two must essentially balance. When the U.S. imports more goods than it exports (a trade deficit), the outward financial flows generated as payments for the excess imports return to the U.S. in the form of investments, either in U.S.-based companies or U.S. government debt. These financial flows are a positive thing for the U.S. economy, generating jobs or financing important government activities.

Misconception #3: U.S. trade policy suppresses wage growth in foreign countries.

Reality: While information remains sparse, data collected by the International Labor Organization (ILO) indicate that this is largely not true.

In all but one country with available data, real wages expanded after adoption of an FTA with the U.S. In Colombia, the FTA with the U.S. went into force in 2012, and real wages expanded by 2.6 percent between 2012 and 2013. This is faster than real wage growth before the FTA, which averaged 1.5 percent between 1996 and 2011. The story is similar in Korea. Wage growth before the Korea–U.S. (KORUS) FTA averaged 1.4 percent between 1996 and 2012. Between 2012 and 2013 real wages expanded by 2.5 percent annually. After agreements were signed with the U.S., real wages in the Dominican Republic, Costa Rica, and Chile grew at average rates of 1.0 percent, 2.5 percent, and 2.3 percent per year, respectively. Only in Nicaragua did wages decline.[4]

Misconception #4: Colombia's inequality, wages, and violence against trade unionists have worsened since the U.S.–Colombia Free Trade Agreement.

Reality: Real wages expanded by 2.6 percent between 2012 and 2013, while labor violence and inequality have been falling.

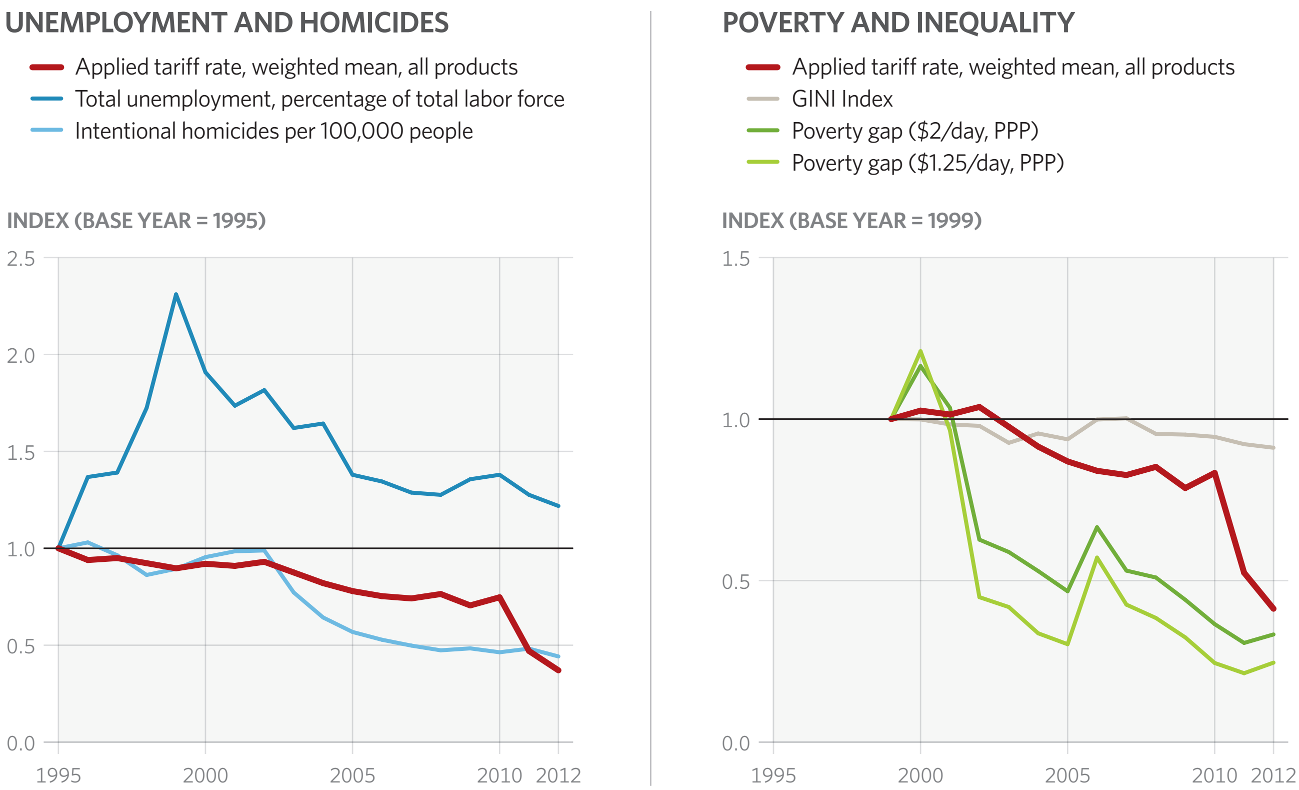
Since Colombia joined the World Trade Organization in 1995, weighted tariffs have fallen from 11.9 percent to 4.41 percent in 2012. Meanwhile, unemployment has fallen from a high of 20 percent in 1999 to 10.6 percent in 2012. Meanwhile since 1999, the percentage of people living at $1.25 and $2.00 per day has fallen by around 60 percent, while the economy has become more equal and gross domestic product per capita has risen by 39 percent.[5]

During this period of liberalizing trade, labor violence and violence in general have fallen. According to a 2012 report by Escuela Nacional Sindical, killings of trade unionists have declined from 186 in 2002 to 22 in 2012.[6] Since 1995, the homicide rate per 100,000 people has declined from 70 to 31, which

4. International Labor Organization, "Mean Real Monthly Earnings of Employees by Type of Scenario (Local Currency)," http://www.ilo.org/ilostat/faces/help_home/data_by_subject/subject-details?_adf.ctrl-state=vywk6ak5s_4&_afrLoop=370539820549206 (accessed April 2, 2015).
5. World Bank, World Development Indicators, http://data.worldbank.org/data-catalog/world-development-indicators (accessed April 2, 2015).
6. Andrew Willis, "Strikes Surge as Killings of Colombian Union Leaders Fall," Bloomberg Business, October 25, 2015, http://www.bloomberg.com/news/articles/2013-10-25/strikes-surge-as-killings-of-colombian-union-leaders-fall (accessed April 2, 2015).

CHART 2

How Colombia Has Benefited from Liberalized Trade



Note: Tariff rates for 1998 and 2003 have been interpolated.
Source: World Bank, World Development Indicators, http://data.worldbank.org/data-catalog/world-development-indicators (accessed April 2, 2015).

IB 4376 heritage.org

is still unacceptably high, but not a pending catastrophe compared with the past two decades.[7]

Misconception: NAFTA, permanent normal trade relations with China, and KORUS have helped companies to move their supply chains overseas to the disadvantage of Americans.

Reality: Overall, trade liberalization has been positive for American workers, and increased international trade supports import-specific jobs and allows manufacturers to import intermediate goods for processing.[8]

Dynamic supply chains are a sign of a healthy and responsive global economy reacting to consumer demand. Even imports of final goods support jobs. Research indicates that imports of Chinese apparel, toys, and sporting goods products support more than 550,000 jobs in the U.S. These jobs range from longshoremen and truck drivers to high-paying jobs, such as marketers, designers, and sales people.[9]

In addition, lowering barriers to entry into the U.S. has allowed U.S. consumers to access cheaper products.[10] The compounding effect of the lower cost

7. World Bank, World Development Indicators.

8. Bryan Riley and Terry Miller, "Congress Should Get Smart and Cut Tariffs to Boost Trade Freedom," Heritage Foundation *Special Report* No. 146, October 23, 2013, http://www.heritage.org/research/reports/2013/10/congress-should-get-smart-and-cut-tariffs-to-boost-trade-freedom.

9. Derek Scissors, Charlotte Espinoza, and Terry Miller, "Trade Freedom: How Imports Support U.S. Jobs," Heritage Foundation *Backgrounder* No. 2725, September 12, 2012, http://www.heritage.org/research/reports/2012/09/trade-freedom-how-imports-support-us-jobs.

10. Mark J. Perry, "Christmas Shopping: 1958 vs. 2012," American Enterprise Institute, December 19, 2012, http://www.aei.org/publication/christmas-shopping-1958-vs-2012/ (accessed April 2, 2015).

of products and rising wages means that Americans' standard of living has improved dramatically in recent years. These benefits accrue particularly to people at the lower end of the income distribution, allowing them to access products that would previously have been too expensive.

Labor Should Recognize the Benefits of Trade

With trade high on the Washington political agenda, misconceptions about free trade are rife. In particular, labor groups seem adamant in denying the clear benefits of trade to both U.S. and foreign workers. Instead of denying the benefits and trying to protect particular industries, groups of workers, and declining union dues and membership, U.S. labor unions should work to help their members adapt to the dynamic global economy.

Globalization has led to profound, positive changes in society and economies around the world. Adaptation, not obstruction, is the way to maximize benefits. It is time for big labor to go to work to help its members take advantage of the opportunities of a global economy and to stop working against what clearly benefits both Americans and foreigners.

*—**Ryan Olson** is a Research Associate in the Center for Trade and Economics, of the Institute for Economic Freedom and Opportunity, at The Heritage Foundation.*