Feeling the Bern of Free Trade: Why does free-trade encounter political resistance?

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With the next U.S. Presidential Election just around the corner, Conor O'Malley very relevantly begins his paper by noting the unusual congruence in the perspectives on free trade of political nemeses Donald Trump and Bernie Sanders. Both men share an aversion to free trade, and what is more interesting is that this perspective is becoming increasingly less radical in the world of politics, despite the fact that economists virtually unanimously agree that free trade is, on balance, beneficial for an economy. O'Malley seeks to understand the divergence between academic consensus and political reality on the issue of free trade. It is acknowledged that there are two natural policy options which are used to respond to the losses associated with free trade: redistribution of the gains of free trade, or protectionism. O'Malley demonstrates that much of the anti-trade sentiment in modern political discourse can be attributed to a demand for protectionist policy amongst the disgruntled "losers" of globalization. Unless the "losers" of free trade are adequately compensated via redistributive mechanisms, he argues, anti-trade sentiment and protectionist policies will continue to thrive.

I. Introduction

Senator Bernie Sanders, one of the most prominent contenders for the Democratic Presidential nomination, has little in common with the President he is trying to replace, Donald Trump. And yet, on the topic of international trade, these two political opposites find a rare issue of policy congruence. Sanders, a self-avowed democratic socialist, has spent his decades-long political career positioning himself firmly as a trade sceptic, opposing the North American Free Trade Agreement (NAFTA), the Trans-Pacific Partnership (TPP), and the Trans-Atlantic Trade and Investment Partnership (TTIP) (Hufbauer & Jung, 2019). As a candidate, Trump was an equally voracious critic of trade, slamming NAFTA as “the worst trade deal, possibly ever”, and railing against countries “cheating” in the arena of international trade. Within days of his inauguration, Trump pulled the U.S. out of the TPP. Since then, the President has imposed tariffs on steel and aluminum, and Section 301 tariffs on Chinese goods, thus provoking a trade war between the world’s largest two economies (ibid.). Intriguingly, the President and Sanders’ convergence on anti-trade policies bears a sharp contrast to the economic academic community. Across generations and ideological spectrums, economists are in near unanimous agreement that free trade is broadly beneficial, spurring economic growth, lowering prices and offering consumers increased variety in goods (Mankiw, 2015). Why then, does free trade encounter so much political resistance?

This essay is motivated by the desire to understand what accounts for the divergence between academic consensus and political reality regarding the trade skepticism that has loomed large in contemporary political discourse. This essay contends that the failure to smooth the unevenly distributed gains from trade and remunerate those disaffected from trade weakens belief that economic integration brings widespread benefits (Kletzer, 2004). In making this case, this paper first offers a theoretical trade framework, derived from the Heckscher-Ohlin trade model. The model demonstrates that while trade leads to national gains, those gains are unequally distributed across economic actors. Governments then, ought to intervene and ensure that those losers from trade are adequately compensated. After outlining the scope of these policies, we argue that in practice such responses have been insufficient to nullify the economic anxiety caused by job loss. This inadequacy has been exacerbated by the shift away from the post-war "embedded liberalism" doctrine towards a neoliberal economic system, characterised by "rolling back the frontiers of the state" and reducing government welfare expenditure (Ruggie, 1995). As such, Kletzer's (2004) observation that "presumptions of an ability to compensate have only weakly translated into a record of compensation policies and programs" rings true. The penultimate section of this essay documents empirical evidence supporting the idea that exposure to trade in import-competing regions is causally linked to the demand for anti-free trade sentiment across Europe and America, a sentiment right-leaning parties have adapted to supply.

II. Theoretical Foundations of International Trade

At its simplest, economists argue that opening up to free trade expands an economy's consumption possibilities, relaxing constraints imposed in autarky. This section adopts a Heckscher-Ohlin (henceforth HO) model to illustrate national gains from trade. The justification for choosing the HO model is two-fold. First, the model emphasises a delineation between 'skilled' and 'unskilled labour', offering a more accurate reflection on contemporary levels of sectoral mobility than the frictionless labour specified in the specific-factors model. Relatedly, evaluating trade via the HO model follows the approaches of the extant literature (Mayda and Rodrik, 2001; O'Rourke and Sinnott, 2001; Wood, 1995) in determining attitudes to trade.

The work of Eli Heckscher and Bertil Ohlin culminated in the HO theorem: "countries export goods that use intensively the factor of production with which they are relatively endowed, and import goods that use intensively factors that are relatively scarce at home" (quoted in Jones, 1956). Assume a standard 2x2x2 model. "Country A" is relatively well-endowed with skilled labour, giving it a comparative advantage in the production of machinery, a skill intensive good. Consequently, Country A is skilled-labour abundant and will export machinery. "Country B" is abundant in unskilled labour and has a comparative advantage in the production of textiles. These differences in endowments create potential to trade through encouraging specialisation in their comparative advantage. Each nation will export the good with which they have a lower opportunity cost of production, and import goods that they are less efficient in.

HO theory goes beyond merely predicting patterns of trade and has something to say about the distributional implications of trade, positing that the relationship between trade and wages is linked solely through changes in factor prices. As such, trade benefits individuals who are employed in the abundant, export-oriented sector and hurts those employed in the scarce sector, a proposition known as the Stolper-Samuelson Theorem (1941). For instance, let some free-trade arrangement between the two countries be proposed. Country A will export and produce more skilled-labour intensive products and the demand for skilled-labour goods will increase. The country will import more unskilled labour intensive goods, exposing domestic unskilled workers to more efficient import-competition. Their inability to compete with cheaper competition leads to a reduction in demand for unskilled workers, and a fall in the unskilled wage. As this process continues, unskilled workers face the prospect of job loss and unemployment, as their industry downsizes, offshores, or closes down. Wage inequality in Country A will widen, with wages of skilled labourers rising and wages of unskilled workers falling.

Heckscher and Ohlin's framework is theoretically compelling, but to what extent can their work guide our subsequent analysis? Assuming that agents are rational, support for trade is modelled as the change in utility from an initial "before free-trade" state to a "free-trade" state. It is hypothesized that unskilled workers in Country A will seek to oppose free trade, for fear of losing their job from the more efficient import-competing firms of Country B. And indeed, across a broad period of time, factor proportions prove a useful heuristic for evaluating trade receptiveness. Mayda and Rodrik (2001) exploit a cross-country dataset to find that "pro-trade preferences are significantly and robustly correlated with an individual's level of human capital in the manner predicted by the factor endowments model". Writing at a similar time, O'Rourke and Sinnott (2001) find cross-national evidence that "preferences are entirely consistent with [the] theory". Higher skilled workers are "more predisposed toward free trade than the low skilled" and that this "interaction effect is amplified in richer countries". Balistreri (1976) extends the model to include a range of foods and factors and tests the predicted outcomes of the model against the opinions of Canadians across various occupations. They conclude the model's predictions "seem to contribute significantly to an agent's opinion". Whilst each of these papers caveat that agents' overall preferences are contingent on more than distributional consequences of trade, ranging from "social status, relative incomes, values" (Mayda and Rodrik, 2001), there is sufficient empirical literature to suggest that the predictions of the HO and the Stolper-Samuelson Theorems hold. In skilled abundant countries then, unskilled workers are predicted to be disaffected by trade liberalization and are relatively more likely to oppose free trade than skilled workers.

III. Policy responses: their prospects and their inadequacies

The above confluence of theory and supporting empirical evidence is a necessary but not sufficient explanation of opposition to free trade. Economists have argued that the dislocation of labour that arises from trade can be offset through government intervention, whereby trade "winners" transfer some of their gains to "losers". If sufficient interventions could be provided, the initial losers of trade could share in the gains from trade. The spectrum of such policy options is most succinctly articulated by Rodrik (1997; 1998), who contends that policymakers can choose from three policy recommendations; take no action, take measures to compensate the losers of trade, or adopt a more protectionist trade policy. Assuming that politicians are office-seeking, we rule out policy option one on the grounds that a laissez-faire approach would be politically unpalatable, as it would cement the losses from trade. Confining the policy choice to the latter two options mirrors the contemporary political landscape.

Of the two policies, economists overwhelmingly support redistributive mechanisms, arguing that such mechanisms spread the national welfare gains from trade, irrespective of regions or sectors. The origins of such welfare state policies can be traced to the "embedded liberalism" of the post-war era when "societies embraced international liberalization" but "its effects were cushioned by the newly acquired domestic economic and social policy roles of government" (Ruggie, 1995). The catalyst for their implementation was a desire to avoid the beggar-thy-neighbour policies and political extremism of the inter-war years, which brought disastrous economic and political ramifications. Rodrik (1997) documents a profound shift in government expenditure as a percentage of GDP accompanying the move towards free trade, doubling from 21% before the Second World War to 47% in the years after. Importantly, Rodrik (1997) notes that the "increase in social spending and income transfers drove the expansion of government" spending, indicative of the "New Deal" or "Welfare State" policies of the U.S and Great Britain respectively. More specifically, the HO framework would suggest compensatory mechanisms ought to counter the relative immobility of labour. Through up-skilling programs which enhance factor mobility, unskilled labour could more effectively transition into expanding, highly skilled industries (Feenstra & Lewis, 1994). From a theoretical perspective, compensatory mechanisms represent the best prospect of balancing efficiency and equality considerations surrounding trade. Why then have these policies wilted in popularity over the last three decades, and why have voters gravitated to protectionism?

Firstly, striking the balance of appropriate compensation without distorting the benefits of trade and globalisation more broadly has proven a challenge. For instance, Dixit and Norman (1986) propose the implementation of commodity taxes to compensate the losers of trade, but the premise that this can be done without eliminating the gains from trade has been severely contested. Rodrik (1997) argues that "the increasing mobility of capital has rendered an important segment of the tax base footloose", whilst Brecher and Chourhri (1994) argue a commodity tax large enough to compensate losers may eradicate all gains from trade. Free-flowing capital constrains the ability of national governments to raise revenue to pay for insurance, as any effort to increase taxation may induce capital flight. As such, revenue generating interventions may have an unintended dampening effect, limiting the ability to provide expensive welfare programmes. Coupled with this has been what Rodrik (1998) described as an attack on the welfare state. Upon assuming office in 1981, Reagan cut the weekly compensation associated with Trade Adjustment Assistance (TAA) by 20%, a program which provides re-employment services and compensatory benefits to American workers who lost jobs due to increased import competition (Mishel, 2016). For her part, Thatcher talked about "rolling back the frontiers of the state" and that "public expenditure is at the heart of Britain's present economic difficulties" (quoted in Dean, 2013).

Existing safety nets have always had "a number of holes" but the fiscally conservative policies that have defined much of the last three decades have undoubtedly aggravated workers' anxiety about the prospect of losing their jobs (Kletzer, 2004). Insufficient funding and ineffective utilisation of resources have resulted in an inability for compensatory mechanisms to mitigate the distributional consequences of liberalisation and have led, as HO theory would predict, to widening levels of inequality between unskilled and skilled workers.

The inability of compensatory mechanisms to assuage worker's fears regarding the associated costs with job displacement is a reality best articulated by Kletzer and Litan (2001) and Kletzer (2004). Unemployment insurance is time-limited and generally inadequate, continuing to replace a little less than 50% of the average worker's previous salary. They also face the stress of foregoing expensive items like health insurance. Kletzer (2004) also finds evidence that though import-competing displaced workers are only slightly less likely to be re-employed, they suffer considerable average earning losses, estimated to be about 13% less than their previous mean. Less formally educated workers experience the greatest difficulty maintaining earnings. Kletzer and Litan (2001) provide two solutions. The first is health care subsidies to ensure those unemployed can keep their existing coverage. The second is a form of wage insurance. Crucially, workers would receive a percentage of their lost wages only upon re-employment. These policies marry the need to cushion the losses following displacement with conditionality of the wage insurance to incentivise displaced individuals to accept a new job quickly and to reintegrate into the labour force. As of 2020, neither of these policies have been pursued to any extent by either Democratic or Republican leadership.

The paucity of natural experiments in international economics presents difficulties in capturing the impact of trade on employment. For instance, it may be that workers who apply for re-training programs are more hardworking or enthusiastic than those that do not. One notable case that allows us to draw tentative conclusions about the effectiveness of such policies is Hyman's (2018) study of the TAA Program. In establishing the causal benefits of exposure to re-training, Hyman exploits quasi-random variation in assignment of TAA applicants to investigators. The author finds that "TAA-approved workers have ~$50,000 greater cumulative earnings, driven by both higher incomes and greater labor force participation". There are, however, significant caveats to this paper. First, these gains erode such that annual incomes among TAA and non-TAA workers fully converge after ten years. Secondly, the authors agree with Jacobson (1998) who states that "workers acquire substantially more human capital enhancing knowledge on the job than in the classroom". For Kletzer (2004), upskilling through on-the-job training is preferable to that of the TAA, which has no effect on formal education and focuses on short run demanded skills which have often become obsolete (Hyman, 2018). We can tentatively conclude that existing schemes have limited abilities to adequately compensate those disaffected, though it must be stressed that the limited available research hamstrings our ability to firmly cite the effectiveness of such up-skilling as mitigating the harms of trade.

Thus far, this essay has argued that trade creates losers, and when these losers are inadequately compensated they less likely to support free-trade policies. How then, does this opposition to free-trade manifest with regards to political resistance? As previously stated, identifying causality and causal mechanisms is complicated given endogeneity concerns in the form of omitted variable bias or reverse causality. For instance, trade may have played a role in the electoral success of Trump, but so too did cultural issues and the unpopularity of Hillary Clinton (Norris & Inglehart, 2019). However, a recent series of papers by David Autor, David Dorn, and Gordon Hanson (2013; 2016) have begun to quantify the role of trade in fuelling the demand for anti-trade sentiment.

Autor, Dorn, and Hanson (2016) note that the radical transformation of the Chinese economy in the latter two decades of the 20th century "provides a rare opportunity to study the impact of a large trade shock on labour markets in developed countries". This "China Shock" allows the authors to bypass issues of endogeneity by "instrument[ing] for the growth in U.S imports from China using Chinese import growth in other high-income markets" (Autor et al., 2013). Of particular relevance are their findings which consolidate the contention that trade has led to displacement, the victims of which have been inadequately compensated. Working with Daron Acemoglu, the authors find that net trade related displacement as a result of this "China shock" ranges from 2 to 2.4 million jobs over the period 1999 to 2011 (Acemoglu et al., 2016). The political ramifications of this dislocation are found to be non-trivial and has created significant demand for a change in policy. Autor et al. (2016) find that from 2004 to 2016, more exposed regions became more likely to adopt right-wing perspectives on economic and cultural issues. Adverse economic shocks induce shifts favouring Republican legislators and Republican Presidential candidates. These pieces providing empirical support for the conventional wisdom that Trump's victory was catalysed by a more trade-sceptic electorate, with workers left behind enthusiastic to embrace protectionist policies in lieu of free-trade.

Colantone and Stanig (2018) extend this discussion by offering a supply side account of the rise of anti-trade sentiment. In particular, they note that across 15 Western European nations nationalist and radical right parties have adopted a policy agenda of "economic nationalism". National and radical right parties have had stunning electoral success offering a nostalgia that taps into the zeitgeist of those who globalisation has left behind. These parties combine domestic free-market policies with strong protectionist stances. Crucially, they articulate messages which resonate with those exposed to import-competition, appealing to communities that risk losing "national or regional identity from global economic competition" (Colantine & Stanig, 2018). Combined with this reaffirmation of nationalist confidence is a belief that protectionist tools like tariffs and quotas can both blunt globalisation whilst ensuring the continuation of expected welfare gains. Whilst empirically contentious, ignoring the basic premise of comparative advantage, such a narrative is compelling. Irrespective of its veracity, this supply side account crucially illustrates the Republican advantage from the "China Shock". Trump and the Tea Party movement changed the contours of the Republican Party, framing trade agreements as "compromising American sovereignty", and advancing a more unabashed economic nationalist agenda (Autor et al., 2016), policies undoubtedly popular with the disgruntled workers of the Mid-Western states.

IV. Conclusion

Trade theory may make sense amongst academics, but the political reality of trade policy has been a far-cry from the supposed rising tide that lifts all boats. As long as policymakers fail to compensate the losers of globalisation, populist politicians and inward-looking agendas show no sign of abating.

V. References

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