DISCUSSION PAPER

A Winning Trade Policy for the United States

Edward Alden
Robert E. Litan

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Introduction

The once-bipartisan consensus favoring agreements that reduce barriers to trade and investment has broken down, largely because of a decades-long failure of policy to facilitate the adjustment of those U.S. workers who have fared poorly in a more competitive global economy and to better tackle trading practices by some nations that have harmed some U.S. workers and firms. The United States needs to tackle these unfair practices while helping Americans who lose their jobs—whether due to trade competition, automation, or changing consumer preferences—to find other opportunities. But pulling out of existing trade agreements or slapping across-the-board tariffs on imports—as some are now advocating—would not address these more fundamental challenges. Protectionism is a backward-looking strategy that will only drive companies and investment away from the United States and encourage other countries to retaliate in kind. Raising trade barriers will hurt Americans as consumers and harm workers in firms that benefit from trade and are among the most innovative and successful in the United States. Protectionism will erode the United States’ edge as the world’s most innovative economy and will not help workers displaced by technological change and shifting consumer preferences.

The United States needs trade and economic policies that are forward looking, that help competitive industries, firms, and workers by creating new opportunities in fast-growing foreign markets. It needs more prompt and effective enforcement of trade laws to stop some foreign competitors from stealing technology, subsidizing their industries, or deliberately suppressing currency values to gain an unfair advantage in global markets. Most overdue are new, comprehensive, and universal policies that equip workers with the education and skills they need throughout their working lives, and not just in their high school and college years, to secure rising incomes and greater opportunities for themselves and their children. Such a forward-looking agenda would prepare workers and citizens for the future and help rebuild confidence that U.S. trade policies will benefit more Americans and help to cushion the transition for those who are harmed.
A Fractured Consensus

Domestic consensus about the benefits of trade, which has guided U.S. policy since the end of World War II, has broken down. In the 2016 presidential campaign, neither major party candidate favors expanding the established network of U.S.-led trade agreements along the current model. Donald Trump, the Republican candidate, has even threatened to pull out of existing trade agreements and to impose some new tariffs on imports. Although opinion polls show that Americans, on balance, believe that open trade has brought more benefits than costs to the United States, a majority also believes that trade has cost jobs and held wages down (see figure 1). The decline in support for trade has been especially pronounced among Republican voters (see figure 2).

Figure 1. Americans Split on Involvement in Global Economy


Figure 2. Republicans and Democrats Diverge on Whether Free Trade Agreements Are Good for the United States

The weak public support for trade could have serious consequences for the United States and for the world. Trade rules put in place over the last half century have strengthened U.S. alliances and prevented a retreat to beggar-thy-neighbor protectionism, even during the deep recession that followed the 2008 financial crisis. Trade and foreign investment have helped many poor countries become wealthier; the past two decades have seen more people climb out of poverty globally than during any other such period in history. Trade has brought economic benefits to all Americans, including through lower-cost and higher-quality consumer goods, and has especially benefited poor and middle-class Americans who spend more of their incomes on traded goods, such as food and clothing, that have fallen in price as trade agreements have opened up the U.S. market to imports (see figure 3). Trade agreements have also opened up new markets overseas for U.S. companies, which remain the most innovative and dynamic in the world, creating higher-paying export jobs.

Figure 3. Gains from Trade Across Income Groups


However, growing trade competition has also been costly for some Americans—indeed, costlier than most economists previously understood. During the 2000s, the surge in imports from China following its admission to the World Trade Organization (WTO) was partly responsible for a large loss of manufacturing jobs in the United States. One widely cited estimate suggests that roughly one and a half to two million of the more than five million jobs lost that decade were directly due to import competition. Although that number is quite small for an economy with nearly 145 million jobs, many of those who lost these jobs did not find new ones at comparable wages, and many others who could not find jobs at all ended up on social assistance. There are also ripple effects in the communities where these well-paying jobs are lost; when a factory shuts down or moves, residents have less income to spend in restaurants, grocery, hardware and other stores, causing more shutdowns and more jobs losses. These effects have been especially concentrated in regions of the country dependent on manufacturing. More broadly, while trade has brought big income gains to many workers in the developing world and to the highly educated in advanced countries, it has done little for the incomes of the middle classes in developed countries in Europe and in the United States—those in roughly the eightieth to
ninetieth percentile on global income distribution (see figure 4). The failure of policymakers to appreciate the costs of trade and to help workers develop new skills to prosper in the face of rising competition helps explain the weakened consensus over the benefits of trade.

Figure 4. Global Absolute Gains in Income, 1998–2008

![Graph showing global income distribution](image)


While the effects of global trade on the U.S. economy are significant, trade is far from the most important factor shaping the working lives of Americans. Many Americans and their communities are struggling to keep afloat in a constantly changing economy. Much of this turmoil has little to do with trade or trade agreements: in a period of rapid technological changes and shifting consumer preferences, innovations are eliminating entire work categories and creating new ones. Computers have already replaced millions of jobs in factories and administrative offices, and more change is coming fast. American factories are increasingly staffed by robots rather than humans, and self-driving vehicles will eventually replace truck and taxi drivers (even Uber drivers). Global competition, facilitated by trade-liberalizing agreements, accelerates these competitive pressures. And many parts of the United States are struggling to adjust.

For the most successful firms and individuals, trade opens bigger markets and new opportunities. Other U.S. companies and their employees will face losses to more efficient overseas competitors. This is how trade works: economies will specialize in goods and services in which they have comparative advantages. The United States, for example, is a world leader in aerospace, pharmaceuticals, semiconductors, financial services, and entertainment, but has seen declines in textiles and apparel, furniture-making, consumer electronics, and other sectors. Even fair trade competition—conducted on the basis of rules agreed upon by the trading countries directly or under regional or global trade agreements—will produce some real dislocation. This is partly because of jobs lost directly to imports but mostly because companies continue to invest in technology and shrink their workforce to keep pace with new competition. For example, overall manufacturing output in the United States today is the highest it has ever been, but the number of workers in manufacturing has fallen by a third since the early 1990s as more tasks become automated (see figure 5).
When competition is distorted by foreign government subsidies and other interventions, however, the damages can be more widespread. The current debates over currency manipulation, for example, reflect legitimate concerns that some foreign governments have too often intervened in ways to give their industries artificial advantages in export competition. China, for example, heavily subsidizes a wide array of industries—including steel, aluminum, auto parts, and glass and solar panels—and often uses discriminatory government regulations to give its companies a leg up in other sectors (see figure 6). The result has too often been overproduction and falling prices that harm otherwise competitive companies in other countries, including the United States.

A winning trade policy for the United States should have three components. First, the United States needs to get far more serious about trade enforcement. Americans can accept that some jobs will be lost and some will be gained from a fair global competition, but they cannot and should not accept it when foreign governments are intervening heavily to tilt the competition in their favor. Until the U.S. government does more to persuade Americans that the competition is a fair one, it will be difficult to restore public confidence in trade. Second, the United States needs a comprehensive strategy to help many more of those who lose their jobs—whether to trade or technology or to changing consumer preferences—to find new ones at comparable wages. A serious, long overdue effort to finally cushion the losers from trade will allow the United States to pursue trade policies that can create more winners. Third, it should continue to lead in negotiations that open up new market opportunities for the most competitive U.S. sectors. The biggest gains in jobs and incomes for more Americans will come not from preserving older industries but from developing and leading in new ones.
Moving Backward Is Not the Answer

U.S. trade policies over the past half century have been neither the spectacular success nor the abject failure that proponents and critics like to claim. Trade agreements—whether through the WTO or through bilateral and regional trade arrangements—have lowered import barriers such as tariffs and quotas and have provided the framework for the growth of global trade under generally agreed-upon rules, including mechanisms for peaceful resolution of commercial disputes. These rules encouraged the historic growth of trade as a portion of total world output in the post–World War II era, growth that has recently halted and even shown signs of reversal (see figure 7). One reason for this change is that the agreements reached so far have fallen short in deterring mercantilist policies that some countries still follow: a combination of subsidies, currency manipulation, regulatory barriers, and other forms of subtle protectionism to promote exports and discourage imports.

Figure 7. World Merchandise Trade as Percentage of GDP

![Figure 7. World Merchandise Trade as Percentage of GDP](image)


The answer to inadequate trade rules, however, is not to resort to protectionism. The United States and other countries unsuccessfully tried that approach during the Great Depression; it would be even more damaging today. In no small part due to U.S. leadership on trade, companies have developed global supply chains that allow them to maximize efficiency across the production process. For example, Boeing, which is the largest U.S. exporter and provides tens of thousands of well-paid production jobs, relies on imported components from dozens of countries, and makes 70 percent of its commercial sales outside the United States. Boeing’s Dreamliner 787, in particular, includes wings made in Japan and Korea, engines made in the United Kingdom, landing gears and brakes from France, and lavatories made in Japan (see figure 8). If the costs of those components rise because of new import tariffs, Boeing would either be induced to move final production abroad or watch its market share fall to competitors like Airbus. One consequence would be fewer jobs for American workers at Boeing,
fewer jobs at the company’s U.S.-based suppliers, and fewer support and service workers whose jobs exist because Boeing is assembling aircrafts in the United States. What is true for Boeing is also true for many other U.S. manufacturers that rely on parts or components sourced from abroad.

Figure 8. Fragmentation of Production: The Boeing 787 Dreamliner

Protectionist responses would force U.S. companies that are now successful exporters to maintain less efficient, less productive facilities in more countries. General Electric (GE), one of the world’s leading manufacturers of heavy equipment and capital goods, has already indicated that it is moving to “localize” production worldwide to insulate the company from the possibility of higher trade barriers that would make it more expensive to ship its products across national borders. Although technologies such as 3D printing have made localization an increasingly attractive business proposition, if companies are forced into such decisions because of government actions, the result will be a reduction in wealth for the world, and for the United States and its citizens.

In short, a backward-looking policy of trade protection would not deliver the benefits its advocates claim and would further erode public confidence in U.S. economic policy. Today’s angry public would be even angrier in the future.
A Forward-Looking Trade and Skills Policy

A forward-looking trade and skills policy would address the two main sources of opposition to more open trade and trade agreements: it would discourage the unfair trade practices of some countries and would facilitate the adjustment of workers in import-competing industries to help them move to new jobs at the same wage levels or, over time, potentially higher wages. Furthermore, such a policy would also bolster the competitive advantages of the broad sectors of the U.S. economy—such as high technology, aerospace, higher education, pharmaceuticals, financial services, entertainment, and tourism—that are already winning in the global economy. This would generate new jobs that pay higher wages to more Americans.

ADDRESSING UNFAIR TRADE PRACTICES

One potent source of concern about trade is the perceived or actual unfairness of other countries’ trade practices and policies. Although trade agreements have strived to create a system of enforceable trade rules, some countries continue to skirt those rules, and enforcement is both spotty and time-consuming. A public that is highly distrustful of government in general and of trade in particular needs assurances that the next administration (and future administrations) will be tough in enforcing already negotiated trade rules, before even considering whether to negotiate new rules.

The U.S. government needs to use all available laws and international agreements—as well as develop new tools—to discourage trade distortions. These include not just the regular use of the WTO dispute settlement system but also the proactive use of U.S. trade laws to shield U.S. companies and their employees from the disadvantages of unfair trade practices. The government needs to be willing to self-initiate these investigations so that actions can be taken in a more timely fashion. State and local governments, which often find themselves competing with foreign governments over job-creating investments and export opportunities, should be given a greater voice in setting trade policy and enforcement priorities.

The challenge with trade enforcement is not just for the government to act proactively and forcefully but to be seen by the public as doing so. High-profile actions are sometimes needed. The best modern example was the administration of President Ronald Reagan. Reagan launched two of the most consequential trade liberalizing negotiations in history: the Uruguay Round of global trade talks that led to the creation of the WTO and the U.S.-Canada Free Trade Agreement, which was later expanded into the North American Free Trade Agreement (NAFTA) with Mexico. But Reagan also pursued some of the toughest trade enforcement actions in U.S. history, including slapping $300 million in import duties on Japanese semiconductors in an effort to force Japan’s market open to imports of U.S.-made semiconductors. The George W. Bush administration similarly imposed high tariffs on steel imports in 2001 even as it was asking Congress for authority to pursue future trade agreements. In the modern history of U.S. trade policy, public and congressional support for trade liberalization have always been contingent on the perception that administrations were prepared to act aggressively and visibly against violations of trade rules.
Another big reason for concern over trade is the disruption it causes to the lives of workers in import-competing firms and industries. These consequences should not be dismissed merely because economic studies have consistently shown that other factors—notably productivity-enhancing improvements in technology and shifts in consumer demand—have been more important causes of disruption. Because trade policies are so visible and because they are changed by the government, they attract outsized attention in the public debate. As U.S. Trade Representative Michael Froman has put it:

The fact is you don’t get a vote on automation, on whether there’s going to be a new generation of computers or robots that might replace your job. You don’t really get to vote on globalization. It’s a factor of the containerization of shipping, the spread of broadband, the integration of economies like China and Eastern Europe that used to be closed and are now part of the global economy. You do get a vote on trade agreements. So trade agreements become the vessel into which people pour their very legitimate concerns about job security, wage stagnation and income inequality.4

U.S. policy has further reinforced these public perceptions of trade as the primary culprit in job disruption. The most generous government program to help dislocated workers, known as Trade Adjustment Assistance (TAA), is only available to workers who can demonstrate that their jobs were lost due to import competition, and the criteria for qualifying have long been rigid. As a result, in 2015, the program covered only fifty thousand unemployed Americans.5 To better address the dislocations caused not just by trade but also by other disruptive factors, a new approach—which might be called livelihood insurance—should be taken to help people retrain for new jobs and careers in their communities or elsewhere in the country.

The United States’ efforts to help its workers adjust to economic changes driven by technology and global competition have long been inadequate. The United States spends a fraction of what most European countries do on retraining and placement of unemployed workers (see figure 9). It needs a more ambitious approach, one that reaches far beyond trade-induced displacement and enables workers to upgrade their skills throughout their lifetimes so they can adapt to changing work opportunities.
There exists a successful model for what is called here livelihood insurance. American farmers, who have seen their work opportunities diminish over the years as farming has become far more capital-intensive and productive, have long enjoyed government support through various forms of insurance. One form is education, which prepares children of farmers and those in related agricultural occupations for other careers if they so choose. For those who remain in agriculture, crop insurance historically has paid farmers when harvests are low due to bad weather or other natural causes or when commodity prices fall sharply in years of bountiful harvests.\(^6\)

American workers in other sectors should have a similar form of insurance that offers some protection against job and income loss not just from trade competition but also from technology and changing consumer demands. Such livelihood insurance would have three central components. The first is expansion of the earned income tax credit for low-income workers, a program that has already been shown to reduce poverty significantly among families in the intended income group. The second is wage insurance that tops up salaries for workers who lose positions they have held for three years or more and are reemployed at lower pay. Existing programs, such as that offered to trade-displaced workers under TAA, cover too few workers; the program should be expanded, as the Barack Obama administration has proposed, to cover at least half of the lost wages for a period of two years, which encourages recipients to look for higher-paying work. And there is a case for wage insurance lasting for the rest of their working lives for some older workers, too many of whom are now leaving the labor force and collecting Social Security disability payments.\(^7\) Third, there should be income-contingent, repayable loans (up to a limit) for workers who want to retrain for new careers and upgrade their employment skills. Finally, like the TAA program, there should be subsidies to help workers to move to where the jobs are; U.S. geographic mobility has been falling in recent years, leaving employers in some parts of the country looking for new workers even as workers cannot find new jobs in their old communities.
All three components of this insurance would require that individuals either be employed or be actively seeking to prepare themselves for new jobs. In this respect, livelihood insurance only helps those who want to help themselves and thus reinforces America’s ethic and commitment to personal responsibility.

The proposed program could be financed from general revenues or as part of any comprehensive tax reform. It could be paid for through the existing worker insurance program, which is the payroll tax deduction used to pay for Medicare and Social Security. Lifting the income cap on that tax (currently about $120,000 annually) would raise more than $100 billion annually in revenues, more than enough to pay for the proposed program.

Federal, state, and local governments should also make a new push to reemploy some displaced workers who may not desire or benefit from universal lifetime education by increasing funding for building and refurbishing America’s aging infrastructure (see figure 10). This is especially important for middle-aged and older individuals in manual occupations who face the biggest hurdles in retraining successfully for other occupations. Public works projects can help to fill the gap by providing good employment opportunities for those who would not otherwise benefit from the livelihood insurance scheme. The need to develop infrastructure is enormous. The American Society of Civil Engineers has estimated that the United States needs to increase infrastructure spending by at least $1.5 trillion over the next decade just to keep up with repairs and that infrastructure deficiencies are already weakening the economy. Just as important, infrastructure investment is critical to help the United States compete more successfully in the global economy and to gain more from its trading relationships. These investments should focus on infrastructure that will improve the efficiency and competitiveness of the U.S. economy—including expanded and upgraded seaports and airports, smart power grids, improved cybersecurity, and renewable energy. Various financing options are possible, including public-private partnerships and both state- and national-level infrastructure banks. An infrastructure spending program also should be supplemented by regulatory reform that speeds up approvals for projects that currently take far too long to receive government approval.
Such measures should also be supported by a variety of state and local economic development initiatives. Some U.S. cities have made this adjustment by capitalizing on their comparative advantages in particular technologies, or through efforts led by local entrepreneurs in both the private and public sectors. Like individual workers in the new economy who should not rely on one employer or even one career throughout their lifetimes, cities should not be complacent that their industry structures today will forever remain that way. A strong commitment to quality education, geared to the changing needs of employers, is also paramount.

HELPING THE MOST COMPETITIVE SECTORS

The public is rightly concerned about the costs of trade and global economic competition, but the United States has more to gain than any other country from continued trade opening and better enforcement of trade rules. U.S. tariffs and other barriers to trade are among the lowest in the world; new agreements such as the Trans-Pacific Partnership (TPP) would require other countries to do far more to lower their trade restrictions. And such agreements can significantly benefit America’s most dynamic sectors. The TPP, for example, includes breakthrough rules on digital trade that will help companies—such as Facebook, eBay, Google, IBM, and GE—that employ hundreds of thousands of Americans at high wages. The United States also remains the most innovative economy in the world, and rules that protect intellectual property will help it maintain that lead. Some of the biggest trade barriers remain in so-called service sectors—such as telecommunications, engineering design, architecture, and financial services—where U.S. exports are growing most strongly and the United States runs a large trade surplus.
If the United States does not make ongoing efforts to lower such barriers, it will tie the hands of the most competitive sectors of its economy. With tariffs already low in most countries, the largest remaining trade barriers are mostly regulatory and ownership restrictions that disproportionately affect these service sectors. These “business service” sectors already employ about 25 percent of U.S. workers—compared to less than 9 percent in manufacturing—in jobs that pay about 20 percent more than the average manufacturing job. Expanding markets abroad for these industries is the best way to create more winners from trade. The United States should continue to move forward on trade negotiations that will lift foreign barriers to trade and investment that hurt industries and firms in those sectors in which it is leading or will lead the rest of the world, including technology, services, and high-value manufacturing.
Conclusion

If America is to win the twenty-first century, it should pursue policies that increase the gains from trade, discourage unfair trade practices, and spread the benefits broadly to more Americans, both by doing more to help those who are harmed by the rapid pace of economic change and by supporting growth in competitive sectors that employ Americans at higher wage jobs. Discredited policies like broad trade protection are not the answer. The United States needs to move forward with better enforcement of trade rules, livelihood insurance that helps Americans move into the new jobs created in the twenty-first century, and new agreements that increase the demand for cutting-edge products and services in which it is a leader.

Americans have reasons to be skeptical about whether such measures can be implemented given the deep partisan divisions in Congress. For too long Congress has been at a standoff between Republicans who mostly favor trade agreements but resist redistributive programs that would help the losers from trade and Democrats who favor redistribution but mostly see trade agreements as harmful. The 2016 election could result in a still deeper standoff—including a refusal by Congress to pass the TPP or to move forward with other trade agreements. But it could also realign Republicans to respond to their voters by becoming more sympathetic to the plight of those harmed by trade and other causes of economic dislocation and Democrats to similarly align with their voters, some 60 percent of whom believe that trade and trade agreements are good for the United States.

The U.S. business community in particular, especially firms that benefit from open trade—as buyers of imported inputs and exporters of intermediate or finished goods and services—should champion these changes. U.S. companies have benefited greatly from trade opening led by the U.S. government and would be harmed if elected leaders turned their backs on global trade. While many American companies now see themselves as global companies, their ability to succeed on a global scale depends heavily on the willingness and ability of the U.S. government to champion new trade rules and to stand behind U.S. companies when they are harmed by unfair foreign trading practices. Without a new trade enforcement and skills agenda, the progress made for these firms and their workers and for consumers through open trade and investment since the end of World War II could be reversed.

This is a perilous time for U.S. trade policy. The old approaches to trade no longer enjoy broad popular support, and many voices are arguing for a retreat from the global economy that would leave Americans poorer and the United States’ ability to shape trade rules diminished. Instead, the country’s political leaders need to come together on a forward-looking agenda—one that rebuilds public confidence that U.S. trade policies will boost the wealth of more Americans and helps to better prepare its citizens for the economic changes to come.
About the Authors


**Robert E. Litan** is an adjunct senior fellow at the Council on Foreign Relations. He is an economist and attorney with nearly four decades of experience in law, economic research, and policy, and as an executive in the private, public, and government sectors. Through his extensive publications and many speeches and testimony, Litan has become a widely recognized national expert in regulation, antitrust, entrepreneurship, innovation and finance, and international trade, among other policy subjects. He is currently a partner with Korein Tillery, a law firm based in St. Louis and Chicago specializing in large case antitrust litigation, and a senior consultant to Economists, Inc.


3. This toughened rule enforcement strategy is discussed in more detail in the second monograph of this series.


6. Crop insurance should be distinguished from tariffs that continuously protect some crops from foreign competition or subsidies of some agricultural products that continuously and artificially support their production. Both distort trade and should be included as part of any future trade negotiations designed to reduce distortions of agricultural markets.
