AIMS Commentary

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# International trade and the US presidential elections:
## Why international trade is good for rustbelt states too

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Barack Obama and Hilary Rodham Clinton made a bit of a fetish of foreigner bashing in the lead-up to the Texas and Ohio primaries, and especially in the Buckeye state. Pennsylvania, with some significant rustbelt problems of its own and a looming primary, was next on the anti-trade rhetoric hit list. And recently Obama got into trouble with this remark, which suggested among other things that anti-trade sentiment is really just a sublimation of other, less politically palatable feelings:

> *[I]t's not surprising then they get bitter, they cling to guns or religion or antipathy to people who aren't like them or anti-immigrant sentiment or anti-trade sentiment as a way to explain their frustrations.*

It is interesting that on trade Obama and Clinton were largely silent in Texas. Why might that be? Because Texas, one of the largest states in the union has been a huge beneficiary of open trade with Mexico. Anti-NAFTA rhetoric was noticeably absent in the Lone Star state. Surely, though, the two Democratic candidates (John McCain is a vociferous free trader) can't be saying one thing to Texans and another to Ohioans? They wouldn't!

OK, they would. But let's talk about Ohio for a moment. NAFTA is a hot topic right now because the manufacturing sector in the US is under pressure and trade unions in that country have consistently painted NAFTA as the culprit in manufacturing job losses. In neighbouring Michigan, the (Canadian-born) governor has been busy pointing out that last year for the first time more automobiles were built in Ontario than Michigan. Ergo, the manufacturing sector's job losses are Canada's fault. But does that follow?

Even the Economic Policy Institute, close to the trade unions, thinks it doesn't. They at least are silent about Canada's role in the alleged role of NAFTA in undermining manufacturing jobs in Cleveland and Cincinnati and Youngstown. In their *Economic Snapshot* of February 27th, they say,

> *Overall, including both vehicles and parts, the U.S. trade deficit with Mexico has ballooned from $2 billion in 1993 to nearly $31 billion in 2007. Nationwide, the auto trade deficit with Mexico has cost us 363,000 jobs. That is why Ohio voters want the next president to rewrite NAFTA, and that is why Senators Obama and Clinton are so critical of the trade deal as it approaches its 15th anniversary.*

So it is all Mexico's fault.

Ummmm…not really. As Fareed Zakariah noted in *Newsweek* a few weeks ago,

> *NAFTA has been pivotal in transforming Mexico into a stable democracy with a growing economy. And, in Lawrence Summers's words, "[it] didn't cost the United States a penny. It contributed to the strength of our economy because of more exports and because imports helped to reduce inflation." Trade between the NAFTA countries has boomed since 1993, growing by about $700 billion. There are no serious economists or experts who believe that low wages in Mexico or China or India is the fundamental reason that American factories close down. And labor and environmental standards would do very little to change the reality of huge wage differentials between poor and rich countries' workers.*

And the very same Economic Policy Institute that is holding Mexico responsible for the ills of manufacturers in Ohio a few days earlier was reporting this:

> *1) The U.S. Department of Commerce reported yesterday that the goods and services trade deficit fell to $711.6 billion or 5.1% of GDP in 2007, a decline of $46.9 billion since 2006. The trade deficit dropped by an unexpectedly large $4.4 billion in December due to a sharp drop in imports of autos and vehicle parts and consumer goods….*
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> *2) The deficit fell to $711.6 billion, or 5.1% of GDP in 2007, a sharp drop of 0.6 percentage points over the deficit in 2006. The improvement in the deficit was explained, in part, by continued rapid growth of U.S. exports, which increased a record $176.1 billion (12.2%) in 2007, as shown in the Figure A. A slowdown in import growth to 5.9% ($129.2 billion) also played a key role. The slowdown in import growth in 2007 reflects softening in consumer spending in the overall economy. Both the import slowdown and export growth were probably driven in part by the depreciation of the dollar in recent years.*
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> *3) The U.S. trade deficit with China rose $23.7 billion (or 10.2%) to $256.3 billion, offsetting improvements in the trade deficit with other countries such as Canada, Germany, the U.K. and other EU countries, Taiwan, Brazil, and Chile.*

What conclusions can we draw from the juxtaposition of these three extracts?

First, that the position of manufacturers in the US is strengthening, not weakening, and that it is strengthening *because of international trade opportunities and the weakening of the US dollar*. That weakening of the greenback is only starting to bite, which may explain why anti-NAFTA rhetoric is still attractive today in Ohio (but not Texas). But I would be willing to bet that when the election rolls around in six months or so, that a great many more Ohio factory workers will be acutely aware that it is chiefly exports that are sustaining their jobs in the face of a weak domestic economy. According to Dan Griswold of the Cato Institute,

> *Canada and Mexico are the top two markets for exports from Ohio, accounting for more than half of the state's exports in 2006. According to the Ohio Department of Development, 283,500 workers in the state earn their living in the export sector, with machinery, car parts, aircraft engines and*

> *optical/medical equipment among the leading exports.*

Second, even if you thought that "trade" was the cause of America's domestic economic weakness, it is by and large not the trading partners with whom America has trade agreements like NAFTA who are the "culprits". China, whose trade surplus with the US is growing apace, has no trade agreement to threaten to rip up. What it does have is an exchange rate kept artificially low by a sustained effort to keep their currency pegged to the US dollar. China and other East Asian currencies that have a similar currency management regime have seen the value of their currency rise only about 12.5% since 2002 and a mere 5.8% last year, whereas a broad cross-section of currencies, inflation adjusted and trade-weighted, has gained 28% against the dollar since 2002, and nearly 7% last year. The US trade balance has improved significantly with the latter group (including Canada), but continues to decline with the former.

There is a great irony here. As Juan Carlos Hidalgo of the Cato Institute points out in a February 18th piece in the *American Spectator,* countries that pursue artificially low exchange rates (he is concerned with Latin American countries like Argentina, Colombia, Peru, Bolivia, Costa Rica, Guatemala, etc., but the lesson is by and large the same), end up by importing inflation, losing monetary discipline and losing access to foreign imports and hence know-how. His counsel:

> *These governments should stop decreasing the foreign exchange value of their currencies and restore price stability by pursuing monetary stability. As local currencies appreciate, imports will increase the demand for dollars, putting downward pressure on foreign exchange rates. Governments can accelerate this process by unilaterally reducing their own trade barriers to foreign goods — a win-win scenario.*

Finally, much of Ohio's problems are self-inflicted. According to one recent survey of US states, Ohio is 47th out of 50 in economic competitiveness, whereas Texas is in the top ranks, attracting investment and high quality jobs while Ohio languishes. What this has to do with trade agreements is anybody's guess.

Finally, the candidates forget that trade is not the only thing affecting the number of jobs in the manufacturing sector in the US. It is surely correct that US companies that are still trying to survive in industries where America no longer has any comparative advantage are rapidly losing market share and the only way to survive is to shift production to countries that do enjoy such a comparative advantage. That is the source of much of the populist economic rhetoric of the Lou Dobbs of this world who claim that offshoring is unpatriotic. On the other hand, the $2-billion invested annually by US manufacturers in new plants in Mexico is, according to Griswold, *a tiny fraction of the $150 billion or more those same companies invest annually in domestic manufacturing capacity. American factories actually added a net half-million new manufacturing jobs in the five years after NAFTA.* And even for those displaced by offshoring, those workers in the US that were previously in low-value added manufacturing, can now shift to higher value added industries such as pharmaceuticals, chemicals and sophisticated machinery and equipment such as aircraft engines.

The other factor that the candidates never never mention is that productivity enhancing machinery and equipment and new technologies generally are probably a much bigger driver of employment declines in US manufacturing than jobs lost to cheap imports. I wonder how many votes they'd win if they said that there could be more jobs if only companies and their workers would give up computers, labour-saving robots and sophisticated telecommunications and so forth?

Watch for some great fireworks on just these themes between the last free-trader standing, John McCain, and whoever the Democrats nominate to contest the election in November.

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