TRADE

International trade policy that works for U.S. workers

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Overview

International trade comes with many benefits for Americans. It lowers the cost and increases the variety of our consumer purchases. It benefits workers who make exports, as well as those who rely on imports as key inputs in their work. It helps fuel innovation, competition, and economic growth. And it helps strengthen international partnerships that are crucial for addressing global policy problems.

Yet trade also poses risks. Because the United States is a country with large amounts of capital and a highly educated workforce, we tend to specialize in products that use those key resources intensively. That's why we export complex products such as software, airplanes, and Hollywood movies. Yet we import products that reduce demand for our less-educated labor because countries with lower wages are able to make labor-intensive products more competitively.

As a consequence, international trade has harmed many U.S. workers by lowering demand for their labor. Studies find that increased imports, particularly those from China during the early 2000s, displaced more than 1 million U.S. workers.[1] There is no evidence that particular trade agreements, such as the North American Free Trade Agreement, or NAFTA, created anywhere near so much displacement, yet many U.S. workers are also skeptical of trade agreements, which they associate with poor labor market outcomes in the U.S. economy over prior decades.[2]

Indeed, since 1980, the U.S. economy has delivered a poor performance for U.S. workers. While Gross Domestic Product growth has been strong, median household incomes have been relatively stagnant. Income growth in the bottom parts of the income distribution has fallen short of expectations just as income growth at the top has soared.[3] Yet, as disappointing as these outcomes are, the evidence indicates that factors beyond trade are driving most of these outcomes.[4] Such factors include dramatic technological changes, the increased market power of companies, and important tax and regulatory policy changes.

This essay first examines why blaming our trading partners and our trade agreements for disappointing labor outcomes carries two essential risks—it harms the very workers we are trying to help, as our recent experience with trade wars shows, and it distracts us from far more effective solutions to workers' woes. I then discuss effective solutions that should be at the heart of U.S. international trade policy, among them expanding the Earned Income Tax Credit, implementing wage insurance, and strengthening and modernizing corporate taxation, alongside recommendations for improvements in international trade agreements. International trade works best when it works for everyone, and policymakers have the tools at their disposal to make that happen.

Key Takeaways

THE EVIDENCE

- International trade lowers the cost and increases the variety of U.S. consumer purchases, benefits U.S. workers who make exports and those who rely on imports as key inputs, and helps fuel innovation, competition, and economic growth.

- International trade poses risks to less-educated workers since imports reduce demand for their labor, yet other factors, including enormous technological changes, the increased market power of companies, and important economic policy changes, also play key roles in the slow wage growth of many U.S. workers.

THE SOLUTIONS

- To help U.S. workers, expand the Earned Income Tax Credit, implement broader wage insurance programs, combat global tax avoidance, and craft improved trade agreements to better balance social goals.

What not to do: Regressive responses to trade challenges

Unfortunately, U.S. international trade policy has taken a serious turn for the worse over the past 3 years. Aiming to correct perceived injustices in past trade agreements, the Trump administration has engaged in a series of costly and ineffective trade conflicts, levying unusually high tariffs, and issuing frequent disruptive threats.

U.S. workers have borne the cost of these trade wars in three important ways. First, it is important to remember that tariffs are a tax, and, beyond that, they are a regressive consumption tax.[5] Low- and middle-income families spend a higher share of their income on tariffs than do the rich, both because they consume all or most of their income (and tariffs don't burden savings) and because they typically consume a higher share of the taxed import goods. Indeed, concerns over economic inequality were a key reason why reformers advocated for creating an income tax in the early 20th century, since tariffs fell too heavily on the poor.[6] Early evidence indicates that the new Trump tariffs have already cost U.S. households hundreds of dollars each year.[7]

Second, both export workers and workers in industries reliant on imports as part of their production process are harmed by the disruption of global supply chains and export opportunities. Many countries facing new U.S. tariffs have retaliated, risking the livelihoods of workers, from soybean farmers to whiskey distillers. Disruptions to international supply chains have harmed U.S. auto production, negatively impacting auto industry employment.[8] And the chaos of constant tariff threats has introduced uncertainty and disruption into business planning, hampering investment while also weakening U.S. alliances and our ability to work with other countries in solving global problems.[9]

Third, and perhaps most importantly, all of the sound and fury surrounding these trade conflicts has distracted voters and policymakers from far more direct and productive ways to help workers. In fact, instead of using tax policy to make workers more secure, the recent tax legislation, known as the Tax Cuts and Jobs Act (passed in late 2017), increased worker insecurity. While those at the top received large tax cuts, most workers received only tiny tax cuts that disappear over time, leaving only greater government debt and the promise of higher taxes or spending cuts down the road.[10]

Moreover, the Tax Cuts and Jobs Act weakened health insurance markets by removing the mandate to purchase health insurance. This directly results in higher health insurance premiums in the health insurance market. Indeed, premium increases are likely to dwarf tax cuts for most families.[11]

What does a progressive response to trade look like? It supports labor.

There are far better ways to modernize economic policy to suit our global economy. The key is to ensure that all of the forces that buffet the U.S. economy (whether trade, technological change, or others) ultimately result in benefits for all U.S. workers.

How do we do that? Federal tax policy is our most effective tool. By taking more in tax payments from those who have "won" due to trade, technological change, and other market changes, and giving more in tax rebates to those who have "lost," we can make sure that gains in GDP translate into gains for typical workers. This can be done while also funding the important fiscal priorities of the federal government.

Elsewhere, I have elaborated on the outlines of such substantial tax reform.[12] Here, I will focus on two essential tools that go directly to worker problems: the Earned Income Tax Credit and wage insurance. The EITC rewards work and increases standards of living by generating negative tax rates for those with low incomes. Presently, this credit is far more generous for a parent with children than for a childless worker. At low incomes, the Earned Income Tax Credit turns every $10 of wages into $14 for a parent with two children; credits can top $5,800 for such families. But credits for childless workers are paltry, peaking at about $530. (In both cases, credits are phased out at higher incomes.)

Since linking the Earned Income Tax Credit to children adds complexity and compliance issues, one ideal reform would be to make the EITC more generous for all workers while simultaneously expanding refundable child tax credits.[13] It is important to make such credits refundable since many workers with lower incomes do not end up owing federal income tax, although they all pay payroll taxes and many also pay substantial state and local taxes.

Wage insurance is a second important way to help workers. Wage insurance targets those who have lost higher-paying jobs, helping workers cope with the painful nature of economic transitions. Wage insurance currently exists on a very small scale for some older trade-displaced workers, but it can be expanded to reach workers regardless of their age or the source of job loss.

With wage insurance, the government would make up 50 percent of the difference between the wage received at the old job and the new, lower-paying job. So, if a worker earning $50,000 lost her job and had to instead take a job (or multiple jobs) that paid $30,000, then the government would make up half of the difference. Of course, benefits could be capped and time-limited, and some employment experience would be required in order to qualify. Yet wage insurance would make economic disruption easier to bear. Wage insurance also provides more income to communities that are hit by geographically concentrated disruption due to trade, technological change, domestic competition, or other factors.

Both programs support work and, because they are linked to work, they have a far lower cost than universal support programs, allowing greater generosity. These two policies focus on the key economic problem at hand: It's not that the U.S. economy doesn't provide plentiful job opportunities, it's that existing jobs are too often poorly compensated. If recessions, disability, or child-rearing prevent employment, then those challenges can be handled through programs that target those populations directly.

What does a progressive response to trade look like? It modernizes taxation.

In order to finance wage insurance, an expanded Earned Income Tax Credit, and the many important fiscal priorities of the federal government, we need an efficient, fair, and administrable tax system. Unfortunately, the international mobility of capital creates a conflict between the globalization of economic activity and the revenue needs of the government. It is therefore paramount that we modernize the tax system to ensure that it is suited to a global economy.

One key challenge is addressing the profit shifting of multinational companies. Estimates indicate that the U.S. government was losing more than $100 billion a year due to the profit shifting of multinational corporations before the Tax Cuts and Jobs Act.[14] And while that law took some steps to reduce profit shifting, it took other steps that made profit shifting worse by offering U.S. companies a territorial tax system that exempts much of their foreign income from U.S. taxation and by taxing other foreign income at a reduced rate.[15]

The new tax law also directly encourages the offshoring of U.S. physical assets by U.S. multinational companies because foreign income in low-taxed countries is more lightly taxed when companies have more assets offshore. Early evidence shows that U.S. multinational companies receiving large tax breaks under the law have responded to such incentives by increasing foreign investment.[16]

Improving the collection of the corporate tax is an important step toward a better tax system. The corporate tax is an essential part of taxing capital since the vast majority of U.S. equity income goes untaxed at an individual level by the U.S. government, as it is held in tax-exempt accounts or by individuals or institutions that are exempt from U.S. tax.[17] Capital is becoming a larger share of national income, and taxing capital is an integral part of a fair tax system. This is because capital income is more concentrated than labor income, and capital income is often the result of "rents" that stem from market power or from reaping the gains of global markets and technological change.

Fortunately, there are simple ways to modernize the U.S. corporate tax. One step that could be taken nearly immediately is to strengthen the minimum taxes that are part of the Tax Cuts and Jobs Act, while also raising the corporate tax rate.[18] In the medium run, it would be useful to rethink our entire system of international taxation in a way that makes it less vulnerable to profit shifting. A system of formulary apportionment is promising in this regard, and it is already being considered by other countries and as a model for digital taxation.[19]

The latter proposal works best within a context of international cooperation. Modernizing international trade agreements could provide an excellent forum for such coordination.

What does a progressive response to trade look like? Better trade agreements.

Our multilateral trading system was built over the seven decades since World War II, and it serves an essential function—implementing the rules of the world trading system. The United States should restore our commitment to the World Trade Organization, continuing multilateral efforts to foster the free flow of trade, while at the same time reforming domestic policies to ensure that the resulting prosperity is widely shared.

Preferential trade agreements such as the North American Free Trade Agreement have often been vilified for prioritizing corporate interests over those of workers.[20] While there is little evidence that such agreements have harmed workers, there is still substantial room to improve U.S. trade agreements by better balancing corporate and social interests. So-called investor state dispute settlement provisions and intellectual property provisions should either be eliminated or substantially rethought because they unnecessarily prioritize corporate interests over larger social aims.[21]

In fact, trade agreements can be a useful tool for governments to constrain corporate power. By combining trade liberalization with joint agreements on issues such as tax and regulatory competition, agreements can help counter the negative consequences of capital mobility. When companies threaten to relocate based on tax or regulatory considerations, governments often choose lower tax rates and looser regulations than would otherwise be socially desirable.

Modern trade agreements can pair the "carrot" of open market access with other socially desirable aims, such as combatting corporate tax avoidance or tackling climate change. International trade agreements, for example, could explicitly allow border adjustments to counter inadequate climate policies among trading partners. Global externalities such as climate change require global cooperation. International trade agreements provide a useful forum to build trust and cooperation. In contrast, as we've seen lately, trade wars breed distrust, making cooperation less attainable.

Conclusion

Even ideal international trade agreements will not address the increased economic inequality and wage stagnation of the previous decades since trade agreements had very little to do with these trends. Responding by ramping up trade conflicts and erecting trade barriers only adds insult to injury, harming U.S. workers instead of helping them.

To best help workers, we need to focus on policies that target their needs most directly. An expanded Earned Income Tax Credit can put more of the gains from trade (and other economic forces) in workers' pockets, and wage insurance can ease the pain of those who have lost jobs due to economic disruption.

We also need to recognize that the global economy generates new policy challenges. Tax rules need to be modernized to combat international tax avoidance, and trade agreements also need to be modernized, both to put workers at the center of the conversation and to better address global policy challenges such as tax competition and climate change.

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Endnotes

1 David Autor, David Dorn, and Gordon Hanson are frequent co-authors on these studies. For a list of their related papers, see "Papers," available at http://chinashock.info/papers/ (last accessed September 2, 2019).

2 For more regarding the research on NAFTA, see J. Bradford DeLong, "NAFTA and other trade deals have not gutted American manufacturing — period," Vox.com, January 24, 2017, available at https://www.vox.com/the-big-idea/2017/1/24/14363148/trade-deals-nafta-wto-china-job-loss-trump; M. Angeles Villarreal and Ian F. Fergusson, "The North American Free Trade Agreement (NAFTA)" (Washington: Congressional Research Service, 2015); Gary Clyde Hufbauer, Cathleen Cimino, and Tyler Moran, "NAFTA at 20: Misleading Charges and Positive Achievements" (Washington: Peterson Institute for International Economics, 2014).

3 For an overview of these trends, as well as the causal factors behind them, see Kimberly A. Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital* (Cambridge, MA: Harvard University Press, 2019), Chapter 2.

4 Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital*, Chapter 4.

5 See Jason Furman, Katheryn Russ, and Jay Shambaugh, "US tariffs are an arbitrary and regressive tax," VoxEU.org blog, January 12, 2017, available at https://voxeu.org/article/us-tariffs-are-arbitrary-and-regressive-tax. While some argue that tariffs will be borne in part by foreigners, the evidence indicates that consumers bear most of the burden. For recent examples, see Mary Amiti, Stephen J. Redding, and David E. Weinstein, "The Impact of the 2018 Trade War on U.S. Prices and Welfare." Discussion Paper No. 13564 (The Center for Economic and Policy Research, 2019); Pablo D. Fajgelbaum and others, "The Return to Protectionism." Working Paper No. 25638 (National Bureau of Economic Research, 2019).

6 For additional historical background, see Steven Weisman, *The Great Tax Wars* (New York: Simon and Schuster, 2002).

7 See Mary Amiti, Stephen J. Redding, and David E. Weinstein, "New China Tariffs Increase Costs to U.S. Households," Liberty Street Economics, May 23, 2019, available at https://libertystreeteconomics.newyorkfed.org/2019/05/new-china-tariffs-increase-costs-to-us-households.html.

8 There have been numerous news stories on these examples. For a soybean example, see National Public Radio, "Soybean Farmer Loses From Retaliatory Tariffs With No Bailout Funds In Sight," All Things Considered, May 11, 2019, available at https://www.npr.org/2019/05/11/722476220/soybean-farmer-loses-from-retaliatory-tariffs-with-no-bailout-funds-in-sight. For autos, see Jamie L. LaReau, "GM would be hit hardest if Trump imposes tariffs on Mexico," *Detroit Free Press*, May 31, 2019, available at https://www.freep.com/story/money/cars/general-motors/2019/05/31/trump-tariff-mexico-gm-immigrants/1299393001/.

9 There are many related news stories. See Ana Swanson, "U.S. Insists on Limiting Foreign Metals, Angering Allies," *The New York Times*, March 26, 2019, available at https://www.nytimes.com/2019/03/26/us/politics/us-mexico-canada-metal-quotas.html; Greg Ip, "Trump's Trade Levers Test Long-Term U.S. Alliances," *The Wall Street Journal*, June 2, 2019, available at https://www.wsj.com/articles/trumps-trade-levers-test-long-term-u-s-alliances-11559495186.

10 For a nonpartisan distributional analysis of the legislation, see Tax Policy Center, "Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act" (2017).

11 For a direct comparison, see Chye-Ching Huang, "Fundamentally Flawed 2017 Tax Law Largely Leaves Low- and Moderate-Income Americans Behind" Testimony before the House Budget Committee, February 27, 2019, Appendix, available at https://www.cbpp.org/federal-tax/fundamentally-flawed-2017-tax-law-largely-leaves-low-and-moderate-income-americans#tableEmbed.

12 For a broad sketch of a comprehensive tax reform plan that would modernize our tax system for the challenges of today's economy, see Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital*, Chapter 10. For detailed suggestions on how to move forward after the Tax Cuts and Jobs Act, see Kimberly A. Clausing, "Fixing the Five Flaws of the Tax Cuts and Jobs Act." Working Paper (SSRN, 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3397387.

13 A long list of reforms to strengthen the administration of the Earned Income Tax Credit was recently suggested by the National Taxpayer Advocate in a special report to Congress. See National Taxpayer Advocate, "Earned Income Tax Credit: Making the EITC Work for Taxpayers and Government" (2019), Volume 3.

14 Kimberly A. Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act." Working Paper (SSRN, 2019), available at https://papers.

ssrn.com/sol3/papers.cfm?abstract_id=3274827; Kimberly A. Clausing, "The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond," *National Tax Journal* (2016)' Kimberly A. Clausing, "How Big is Profit Shifting," Working Paper (SSRN 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3503091. Estimates of a similar magnitude are found by the Organisation for Economic Co-operation and Development. See OECD, "BEPS Action 11: Improving the Analysis of BEPS" (2015); Gabriel Zucman, *The Hidden Wealth of Nations* (Chicago: University of Chicago Press, 2015); Fatih Guvenen and others, "Offshore Profit Shifting and Domestic Productivity Measurement." Working Paper No. 23324 (National Bureau of Economic Research, 2018); Joint Committee on Taxation, "Estimates of Federal Tax Expenditures for FY 2014–2018" (2014); Thomas Tørsløv, Ludvig Wier, and Gabriel Zucman, "The Missing Profits of Nations." Working Paper No. 24701 (National Bureau of Economic Research, 2018).

15 Clausing, "Profit Shifting Before and After the Tax Cuts and Jobs Act."

16 Brooke Beyer and others, "The Effect of the Tax Cuts and Jobs Act of 2017 on Multinational Firms' Capital Investment: Internal Capital Market Frictions and Tax Incentives." Working Paper (2019).

17 For a discussion of the rising share of capital in national income, see Clausing, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital*, Chapter 2. For a discussion of the low share of equity income that is taxed at the individual level, see Leonard E. Burman, Kimberly A. Clausing, and Lydia Austin, "Is U.S. Corporate Income Double-Taxed?" *National Tax Journal* 70 (3) (2017): 675–706.

18 For a discussion of these steps, see Clausing, "Fixing the Five Flaws of the Tax Cuts and Jobs Act."

19 Reuven S. Avi-Yonah, and Kimberly A. Clausing, "Reforming Corporate Taxation in a Global Economy: A Proposal To Adopt Formulary Apportionment." *In Path to Prosperity: Hamilton Project Ideas on Income Security, Education, and Taxes* (Washington: Brookings Institution Press, 2008) pp. 319–344; Reuven S. Avi-Yonah and Kimberly A. Clausing, "Towards a 21st Century International Tax Regime," *Tax Notes International* (2019).

20 The new NAFTA agreement (known as United States-Mexico-Canada Agreement) made modest improvements in some areas, by reducing the bite of some intellectual property provisions and emphasizing enforcement of labor laws. Still, despite much brinkmanship and uncertainty, the new agreement involved relatively minor changes, not all of which were improvements.

21 An excellent list of specific suggestions is discussed in Kimberly Ann Elliott, "Developing a More Inclusive US Trade Policy at Home and Abroad." Policy Paper 146 (Center for Global Development, 2019).