

## Paul Krugman on Foreign Trade in the US Economy

### TROUBLE WITH TRADE

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Published: December 28, 2007 (New York Times)

While the United States has long imported oil and other raw materials from the third world, we used to import manufactured goods mainly from other rich countries like Canada, European nations and Japan.

But recently we crossed an important watershed: we now import more manufactured goods from the third world than from other advanced economies. That is, a majority of our industrial trade is now with countries that are much poorer than we are and that pay their workers much lower wages.

For the world economy as a whole — and especially for poorer nations — growing trade between high-wage and low-wage countries is a very good thing. Above all, it offers backward economies their best hope of moving up the income ladder.

But for American workers the story is much less positive. In fact, it's hard to avoid the conclusion that growing U.S. trade with third world countries reduces the real wages of many and perhaps most workers in this country. And that reality makes the politics of trade very difficult.

Let's talk for a moment about the economics.

Trade between high-wage countries tends to be a modest win for all, or almost all, concerned. When a free-trade pact made it possible to integrate the U.S. and Canadian auto industries in the 1960s, each country's industry concentrated on producing a narrower range of products at larger scale. The result was an all-round, broadly shared rise in productivity and wages.

By contrast, trade between countries at very different levels of economic development tends to create large classes of losers as well as winners.

Although the outsourcing of some high-tech jobs to India has made headlines, on balance, highly educated workers in the United States benefit from higher wages and expanded job opportunities because of trade. For example, ThinkPad notebook computers are now made by a Chinese company, Lenovo, but a lot of Lenovo's research and development is conducted in North Carolina.

But workers with less formal education either see their jobs shipped overseas or find their wages driven down by the ripple effect as other workers with similar qualifications crowd into their industries and look for employment to replace the jobs they lost to foreign competition. And lower prices at Wal-Mart aren't sufficient compensation.

All this is textbook international economics: contrary to what people sometimes assert, economic

theory says that free trade normally makes a country richer, but it doesn't say that it's normally good for everyone. Still, when the effects of third-world exports on U.S. wages first became an issue in the 1990s, a number of economists — myself included — looked at the data and concluded that any negative effects on U.S. wages were modest.

The trouble now is that these effects may no longer be as modest as they were, because imports of manufactured goods from the third world have grown dramatically — from just 2.5 percent of G.D.P. in 1990 to 6 percent in 2006.

And the biggest growth in imports has come from countries with very low wages. The original “newly industrializing economies” exporting manufactured goods — South Korea, Taiwan, Hong Kong and Singapore — paid wages that were about 25 percent of U.S. levels in 1990. Since then, however, the sources of our imports have shifted to Mexico, where wages are only 11 percent of the U.S. level, and China, where they're only about 3 percent or 4 percent.

There are some qualifying aspects to this story. For example, many of those made-in-China goods contain components made in Japan and other high-wage economies. Still, there's little doubt that the pressure of globalization on American wages has increased.

So am I arguing for protectionism? No. Those who think that globalization is always and everywhere a bad thing are wrong. On the contrary, keeping world markets relatively open is crucial to the hopes of billions of people.

But I am arguing for an end to the finger-wagging, the accusation either of not understanding economics or of kowtowing to special interests that tends to be the editorial response to politicians who express skepticism about the benefits of free-trade agreements.

It's often claimed that limits on trade benefit only a small number of Americans, while hurting the vast majority. That's still true of things like the import quota on sugar. But when it comes to manufactured goods, it's at least arguable that the reverse is true. The highly educated workers who clearly benefit from growing trade with third-world economies are a minority, greatly outnumbered by those who probably lose.

As I said, I'm not a protectionist. For the sake of the world as a whole, I hope that we respond to the trouble with trade not by shutting trade down, but by doing things like strengthening the social safety net. But those who are worried about trade have a point, and deserve some respect.