Policy Brief 211

1-1-2001

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Embargoed for release until
12:30 p.m. EST
January 22, 2001

Center for the Study of American Business

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January 2001

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DISPELLING THE MYTHS ABOUT THE GLOBAL ECONOMY

by Murray Weidenbaum

A Presentation to the
Economic Club of Detroit
Detroit, MI, January 22, 2001

Today I want to deal with a perplexing conundrum facing the United States: this is a time when the American business system is producing unparalleled levels of prosperity, yet private enterprise is under increasing attack. The critics are an unusual alliance of unions, environmentalists, and human rights groups and they are focusing on the overseas activities of business. In many circles, globalization has become a dirty word.

How can we respond in a constructive way? In my interaction with these interest groups, I find that very often their views arise from basic misunderstandings of the real world of competitive enterprise. I have identified ten myths about the global economy—dangerous myths—which need to be dispelled. Here they are:

1. Globalization costs jobs.
2. The United States is an island of free trade in a world of protectionism.
3. Americans are hurt by imports.
4. U.S. companies are running away, especially to low-cost areas overseas.
5. American companies doing business overseas take advantage of local people, especially in poor countries. They also pollute their environments.
6. The trade deficit is hurting our economy and we should eliminate it.
7. It's not fair to run such large trade deficits with China or Japan.
8. Sanctions work. So do export controls.
9. Trade agreements should be used to raise environmental and labor standards around the world.
10. America's manufacturing base is eroding in the face of unfair global competition.

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That's an impressive array of frequently heard charges and they are polluting our political environment. Worse yet, these widely held myths fly in the face of the facts. I'd like to take up each of them and knock them down.

1. *Globalization Costs Jobs*

This is a time when the American job miracle is the envy of the rest of the world, so it is hard to take that charge seriously. Yet some people do fall for it. The facts are clear: U.S. employment is at a record high and unemployment is at a 30 year low. Moreover, the United States created more than 20 million new jobs between 1993 and 2000, far more than Western Europe and Japan combined. Contrary to a widely held view, most of those new jobs pay well, often better than the average for existing jobs.

Of course, in the best of times, some people lose their jobs or their businesses fail, and that happens today. However, most researchers who have studied this question conclude that, in the typical case, technological progress—not international trade—is the main reason for making old jobs obsolete. Of course, at the same time far more new jobs are created to take their place.

2. *The United States Is an Island of Free Trade in a World of Protectionism*

Do other nations erect trade barriers? Of course they do—although the trend has been to cut back these obstacles to commerce. But our hands are not as clean as we like to think. There is no shortage of restrictions on importers trying to ship their products into this country. These exceptions to free trade come in all shapes, sizes, and varieties. They are imposed by federal, state, and local governments. U.S. import barriers include the following and more:

- Buy-American laws give preference in government procurement to domestic producers. Many states and localities show similar favoritism. Here in Michigan, preference is given to in-state printing firms;
- the Jones Act prohibits foreign ships from engaging in waterborne commerce between U.S. ports;
- many statutes limit the import of specific agricultural and manufactured products, ranging from sugar to pillowcases;
- we impose selective high tariffs on specific items, notably textiles; and
- many state and local regulatory barriers, such as building codes, are aimed at protecting domestic producers.

It's strange that consumer groups and consumer activists are mute on this subject. After all, it is the American consumer who has to pay higher prices as a result of all of this special interest legislation. But these barriers to trade ultimately are disappointing. Nations open to trade grow faster than those that are closed.

3. *Americans Are Hurt by Imports*

The myth that imports are bad will be quickly recognized by students of economics as the mercantilist approach discredited by Adam Smith over two centuries ago. The fact is that we benefit from imports in many ways. Consumers get access to a wider array of goods and services. Domestic companies obtain lower cost components and thus are more competitive. We get access to vital metals and minerals that are just not found in the United States. Also, imports prod our own producers to improve productivity and invest in developing new technology.

I'll present a painful example. By the way, I have never bought a foreign car. But we all know how the quality of our domestic autos has improved because of foreign competition. More recently, we had a striking example of the broader benefits of imports. In 1997-98, the expanded flow of lower-cost products from Asia kept inflation low here at a time when otherwise the Fed would have been raising interest rates to fight inflation. The result would have been a weaker economy. Moreover, in a full employment economy, imports enable the American people to enjoy a higher living standard than would be possible if sales were limited to domestic production.

In our interconnected economy, the fact is that the jobs "lost" from imports are quickly replaced by jobs elsewhere in the economy—either in export industries or in companies selling domestically. The facts are fascinating: the sharp run-up in U.S. imports in recent years paralleled the rapid growth in total U.S. employment. Both trends, of course, reflected the underlying health of our business economy.

The special importance of imports was recently highlighted by the director of the Washington State Council on International Trade: "The people who benefit most critically are families at the lower end of the wage scale who have school-age children and those elderly who must live frugally." She goes on to conclude: "It is a cruel deception that an open system of free trade is not good for working people."

4. *U.S. Companies Are Running Away, Especially to Low Cost Areas Overseas*

Right off the bat, the critics have the direction wrong. The flow of money to buy and operate factories and other businesses is overwhelmingly into the United States. We haven't had a net outflow of investment since the 1960s. That's the flip side of our trade deficit. Financing large trade deficits means that far more investment capital comes into this country than is leaving.

But let us examine the overseas investments by American companies. The largest proportion goes not to poor countries, but to the most developed nations, those with high labor costs and also high environmental standards. The primary motive is to gain access to markets. That's not too surprising when we consider that the people in the most industrially advanced nations are the best customers for sophisticated American products. By the way, only one-third of the exports by the foreign branches of U.S. companies goes to the United States. About 70 percent goes to other markets, primarily to the industrialized nations.

Turning to American investments in Mexico, China, and other developing countries, the result often is to enhance U.S. domestic competitiveness and job opportunities. This is so because many of these overseas factories provide low-cost components and material to U.S.-based producers who are thus able to improve their international competitiveness.

In some cases, notably the pharmaceutical industry, the overseas investments are made in countries with more enlightened regulatory regimes, such as the Netherlands. "More enlightened" is not a euphemism for lower standards. The Dutch maintain a strong but more modern regulatory system than we do.

5. *American Companies Doing Business Overseas Take Advantage of Local People and Pollute Their Environments*

There are always exceptions. But by and large, American-owned and managed factories in foreign countries are top-of-the-line—in terms of both better working conditions and higher environmental standards than locally-owned firms. This is why so many developing countries compete enthusiastically for the overseas location of U.S. business activities—and why so many local workers seek jobs at the American factories. After all, American companies manufacturing overseas frequently follow the same high operating standards that they do here at home.

I serve on a panel of Americans who investigate the conditions in some factories in China. I wish the critics could see for themselves the differences between the factories that produce for an American company under its worldwide standards and those that are not subject to our truly enlightened sense of social responsibility.

I'll give you a very personal example of the second category of facilities. While making an inspection tour, I tore my pants on an unguarded piece of equipment in one of those poorly-lit factories. An inch closer and that protruding part would have dug into my thigh. I also had to leave the factory floor every hour or so to breathe some fresh air. When I said that, in contrast, the American-owned factories were top-of-the-line, that wasn't poetry.

Yes, foreign investment is essential to the economic development of poor countries. By definition, they lack the capability to finance growth. The critics do those poor countries no favor when they try to discourage American firms from investing there. The critics forget that, during much of the nineteenth century, European investors financed many of our canals, railroads, steel mills, and other essentials for becoming an industrialized nation. It is sad to think where the United States would be today if Europe in the nineteenth century had had an array of powerful interest groups that were so suspicious of economic progress.

6. *The Trade Deficit Is Hurting Our Economy and We Should Eliminate It*

Yes, the U.S. trade deficit is at a record high. But it is part of a "virtuous circle" in our economy. The trade deficit mainly reflects the widespread prosperity in the United States, which is substantially greater than in most of the countries we trade with. After all, a strong economy such as ours—operating so close to full employment and full capacity—depends on a substantial amount of imports to satisfy our demands for goods and services. Our exports are lower primarily because the demand for imports by other nations is much weaker.

The acid test is that our trade deficit quickly declines in the years when our economy slows down and that deficit rises again when the economy perks up. Serious studies show that, if the United States had deliberately tried to curb the trade deficit in the 1990s, the result would have been a weak economy with high inflation and fewer jobs. The trade deficit is a byproduct of economic performance. It should not become a goal of economic policy.

There is a constructive way of reducing the trade deficit. To most economists, the persistence of our trade imbalance (and especially of the related and more comprehensive current account deficit) is due to the fact that we do not generate enough domestic saving to finance domestic investment. The gap between such saving and investment is equal to the current account deficit.

Nobel laureate Milton Friedman summed up this point very clearly: "The remarkable performance of the United States economy in the past few years would have been impossible without the inflow of foreign capital, which is a mirror image of large balance of payments deficits."

The positive solution is clear: increase the amount that Americans save. Easier said than done, of course. The shift from budget deficits (dissaving) to budget surpluses (government saving) helps. A further shift to a tax system that does not hit saving as hard as ours does would also help. The United States taxes saving more heavily than any other advanced industrialized nation. Replacing the income tax with a consumption tax, even a progressive one, would surely be in order—but that deserves to be the subject of another talk.

7. *It's Not Fair to Run Such Large Trade Deficits With China or Japan*

Putting the scary rhetoric aside, there really is no good reason for any two countries to have balanced trade between them. We don't have to search for sinister causes for our trade deficits with China or Japan. Bilateral trade imbalances exist for many benign reasons, such as differences in per capita incomes and in the relative size of the two economies. One of the best kept secrets of international trade is that the average Japanese buys more U.S. goods than the average American buys Japanese goods. Yes, Japan's per capita imports from the United States are larger than our per capita imports from Japan ($539 versus $432 in 1996). We have a large trade deficit with them because we have more "capita" (population).

8. *Sanctions Work, So Do Export Controls*

It is ironic that so many people who worry about the trade deficit simultaneously support sanctions and export controls. There is practically no evidence that unilateral sanctions are effective in getting other nations to change their policies or actions. Those restrictions on trade do, however, have an impact: they backfire. U.S. business, labor, and agriculture are harmed. We lose an overseas market for what is merely a symbolic gesture. Sanctions often are evaded. Shipping goods through third countries can disguise the ultimate recipient in the nation on which the sanctions are imposed. On balance, these sanctions reduced American exports in 1995 by an estimated $15-20 billion.

As for export controls, where American producers do not have a monopoly on a particular technology—which is frequent—producers in other nations can deliver the same technology or product without the handicap imposed on U.S. companies. A recent report at the Center for the Study of American Business showed that many business executives believe that sanctions and export controls are major obstacles to the expansion of U.S. foreign trade.

9. *Trade Agreements Should Be Used to Raise Environmental and Labor Standards Around the World*

At first blush, this sounds like such a nice and high-minded way of doing good. But, as a practical matter, it is counterproductive to try to impose such costly social regulations on developing countries as a requirement for doing business with them. The acid test is that most developing nations oppose these trade restrictions. They see them for what they really are—a disguised form of protectionism designed to keep their relatively low-priced goods out of the markets of the more advanced, developed nations. All that feeds the developing nations' sense of cynicism toward us.

In the case of labor standards, there is an existing organization, the International Labor Organization, which has been set up to deal specifically with these matters. Of all the international organizations, the ILO is unique in having equal representation from business, labor, and government. The United States and most other nations are members. The ILO is where issues of labor standards should be handled. To be taken more seriously, the United States should support the ILO more vigorously than it has.

As for environmental matters, we saw at the unsuccessful meetings on climate change at the Hague late last year how difficult it is to get broad international agreement on environmental issues even in sympathetic meetings of an international environmental agency. To attempt to tie such controversial environmental matters to trade agreements arouses my suspicions about the intent of the sponsors. It is hard to avoid jumping to the conclusion that the basic motivation is to prevent progress on the trade front.

I still recall the signs carried by one of the protesters in Seattle, "Food is for people, not for export." Frankly, it's hard to deal with such an irrational position. After all, if the United States did not export a major part of its abundant farm output, millions of people overseas would be starving or malnourished. Also, thousands of our farmers would go broke.

The most effective way to help developing countries improve their working conditions and environmental protection is to trade with and invest in them. As for the charge that companies invest in poor, developing nations in order to minimize their environmental costs, studies of the issue show that environmental factors are not important influences in business location decisions. As I pointed out earlier, most U.S. overseas direct investment goes to developed nations with high labor costs and also high environmental standards.

10. *America's Manufacturing Base Is Eroding in the Face of Unfair Global Competition*

Unfortunately, some of our fellow citizens seem to feel that the only fair form of foreign competition is the kind that does not succeed in landing any of their goods on our shores. But to get to the heart of the issue, there is no factual basis for the charge that our manufacturing base is eroding—or even stagnant. The official statistics are reporting record highs in output year after year. Total industrial production in the United States today is 45 percent higher than in 1992—that's not in dollars, but in terms of real output.

Of course, not all industries or companies go up—or down—in unison. Some specific industries, especially low-tech, have had to cut back. But, simultaneously, other industries, mainly high-tech, have been expanding rapidly. Such changes are natural and to be expected in an open, dynamic economy. By the way, the United States regularly runs a trade surplus in high-tech products.

It's important to understand the process at work here. Technological progress generates improved industrial productivity. In the United States, that means to some degree fewer blue-collar jobs and more white-collar jobs. That is hardly a recent development. The shift from physical labor to knowledge workers has been the trend since the beginning of the 20th century. On balance, as I noted earlier, total U.S. employment is at an all-time high.

If you have any doubt about the importance of rising productivity to our society, just consider where we would be if over the past century agriculture had not enjoyed rising productivity (that is, more output per worker/hour). Most of us would still be farmers.

Conclusion

It is vital that we correct the erroneous views of the anti-globalists. Contrary to their claims, our open economy has raised living standards and helped to contain inflation. International commerce is more important to our economy today than at any time in the past. By dollar value and volume, the United States is the world's largest trading nation. We are the largest importer, exporter, foreign investor, and host to foreign investment. Trying to stop the global economy is futile and contrary to America's self-interest.

Nevertheless, we must recognize that globalization, like any other major change, generates costs as well as benefits. It is essential to address these consequences. Otherwise, we will not be able to maintain a national consensus that responds to the challenges of the world marketplace by focusing on opening markets instead of closing them. The challenge to all of us is to urge courses of action that help those who are hurt without doing far more harm to the much larger number who benefit from the international marketplace.

We need to focus more attention on those who don't share the benefits of the rapid pace of economic change. Both private and public efforts should be increased to provide more effective adjustment assistance to those who lose their jobs. The focus of adjustment policy should not be on providing relief from economic change, but on positive approaches that help more of our people participate in economic prosperity.

As you may know, I recently chaired a bipartisan commission established by Congress to deal with the trade deficit. Our commission included leaders of business and labor, former senior government officials, and academics. We could not agree on all the issues that we dealt with. But we were unanimous in concluding that the most fundamental part of an effective long-run trade adjustment policy is to do a much better job of educating and training. More Americans should be given the opportunity to become productive and high-wage members of the nation's workforce. No, I'm not building up to a plea to donate to the college of your choice, although that's a pretty good idea.

Even though I teach at major research universities—and strongly believe in their vital mission—let me make a plea for greater attention to our junior colleges. They are an overlooked part of the educational system. Junior colleges have a key role to play. Many of these communityoriented institutions of learning are now organized to specially meet the needs of displaced workers, including those who need to brush up on their basic language and math skills. In some cases, these community colleges help people launch new businesses, especially in areas where traditional manufacturing is declining. A better trained and more productive work force is the key to our long-term international competitiveness. That is the most effective way of resisting the calls for economic isolationism.

Let me leave you with a final thought. The most powerful benefit of the global economy is not economic at all, even though it involves important economic and business activities. By enabling more people to use modern technology to communicate across traditional national boundaries, the international marketplace makes possible more than an accelerated flow of data. The worldwide marketplace encourages a far greater exchange of the most powerful of all factors of production—new ideas. That process enriches and empowers the individual in ways never before possible.

As an educator, I take this as a challenge to educate the anti-globalists to the great harm that would result from a turn to economic isolationism. For the twenty-first century, the global flow of information is the endless frontier.