Globalization and Its Discontents

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We increasingly hear, especially from politicians on the US right, that globalization is a problem. It hurts our workers and makes us more dependent on producers in other countries and their governments.

But is globalization a problem? In answering the question, we need to look not only at the costs of globalization but also at the benefits. To leave out the benefits is to engage in "single-entry bookkeeping." And the benefits are many—from cheaper goods and services to diversification of supply chains to a more peaceful world.

The Main Costs of Globalization

First, though, we need to consider a major cost of globalization: the loss of jobs for people who are used to working in a particular industry and lose their jobs because of competition from imports. One of the biggest shocks that imports caused to domestic jobs is labeled the "China shock." When China was granted most-favored-nation status in 2000, US consumers took advantage by buying hundreds of billions of Chinese imports annually. In 2016, a National Bureau of Economic Research study by MIT economist David Autor and his co-authors David Dorn of the University of Zurich and Gordon H. Hanson of the University of California, San Diego, made a big splash with its estimate of as many as 2.4 million jobs lost in US industries that competed with Chinese goods. According to these three authors, adjustment of these displaced workers to other industries was slow and a large percentage never regained the real income from working that they had had before the "China shock."

The estimate of job loss by Autor et al. is at the high end. A later study, published in 2018 by Lorenzo Caliendo, Maximiliano A. Dvorkin, and Fernando Parro of the St. Louis Federal Reserve Bank, concluded that "the China trade shock resulted in a reduction of about 0.55 million US manufacturing jobs, about 16 percent of the observed decline in manufacturing employment from 2000 to 2007." There's a big difference between 2.4 million and 550,000 jobs. Caliendo also found that the job loss was approximately offset by increases in jobs in services, construction, and wholesale and retail trade.

The other main cost of globalization is dependence on producers in other countries. What could happen, for example, if Taiwan, which produces a huge percent of the semiconductors that Americans buy, were to be invaded by the Chinese government? There's a good chance that semiconductor production would be hobbled, especially if China's government took over production and we got the glories of socialism.

Consumer Benefits from Globalization

One should never do a cost/benefit analysis without considering benefits. Let's do so.

Globalization is, essentially, free trade. Economists from Adam Smith on have been well aware of the benefits of free trade. Free trade gives people an incentive to specialize in producing the goods and services in which they have a cost advantage, which economists often call a comparative advantage. Each of us has an advantage in very few things. For me, it is writing and speaking about economics. For a teacher, it's teaching. For an auto mechanic, it's fixing cars. And even within those areas, people specialize. My advantage in economics is in laying out ideas clearly with words; even though I was a math major as an undergrad, those math skills have withered. A teacher may be very good at English and very bad at math. An auto mechanic may specialize in Mercedeses but not know much about Fords.

The ability to trade with others is what allows people to specialize. And the gains from trade are often huge. I can't fix a car but I can make money to hire someone to fix my car. I can't trim branches off a tall tree in my back yard, but recently I hired someone for $4,800 to do so. That seemed like a lot of money to me. But compared to climbing thirty feet or more up the tree and cutting the branches myself, an activity that could have easily left me crippled for life or cost me my life, $4,800 was a bargain.

There's nothing special about free trade across international borders. The principles are the same whether I in Pacific Grove am trading with someone in neighboring Monterey or someone in Mexico, Myanmar, or Morocco. Free trade both within a country and across international borders is what has led to our huge standard of living. If that doesn't seem obvious, think about how you would live if you could never trade. You could never buy wood, food, clothing, pharmaceuticals, or computers and, moreover, could never buy the inputs that are used in making those things. In such a situation, many of us would starve.

We in the United States are lucky. Before the European Union was formed, we were the largest free trade zone in the world. With over 330 million people with a huge array of skills, with a lot of capital equipment, and with fairly decent mineral resources, we need to engage in less international trade than people in other countries. So if we couldn't trade across borders, we would be worse off but not nearly as badly off as, say, Canadians if they couldn't trade.

Still, international trade makes us substantially better off. We can get coffee from Colombia instead of buying the limited supplies that Hawaii has to offer and building expensive hothouses in the lower forty-eight. We can get bananas from Central America rather than building hothouses to grow them domestically. And how would we get rubber for our tires?

Moreover, the gains to consumers from trade with China are massive. The above-mentioned Caliendo study found that consumers benefited in two ways: lower prices on Chinese goods and lower prices on US goods produced in part with intermediate inputs from China. In an interview, the above-mentioned Dvorkin stated, "US consumers gained an average of $260 of extra spending per year for the rest of their lives, we estimated, all stemming from the increased imports from China." In an August 2019 study for the Centre for Economic Performance at the London School of Economics, economists Xavier Jaravel and Erick Sager wrote that the gains to American consumers were about $400,000 per job lost from trade with China. Moreover, they found, in categories of products that catered to low-income consumers, price declines were larger than the overall price declines due to increased trade with China.

What About that Ohio Worker?

You might be thinking at this point that all these gains to consumers are small comfort to the worker in, say, Ohio, who lost his job because of imports from China. He may well be worse off because the lower prices of goods from China don't make up for the 15 or 25 percent wage cut he took to get another job. But that doesn't mean he doesn't benefit from free international trade. Relatively free international trade existed in the United States long before China got its deal in 2000. So the gains from trade overall may well make up for that large wage cut.

A few years ago, I gave a talk to about thirty congressional aides in which I made that point. Another speaker summarized my point by saying I was claiming that "Walmart [which gets a huge percent of its goods from China] makes up for the loss in wages and jobs for workers whose firms are put out of business by Chinese competition." I responded that I wasn't saying that at all. Rather, I was saying that free trade overall, not just with China but also with every other country whose producers we trade with, more than makes up for those workers' losses from the new Chinese competition.

At an event I spoke at about fifteen years ago, during the "China shock," another speaker, financial adviser Ron Muhlenkamp, told an interesting story. He had spoken to an audience of steelworkers in Pennsylvania whose median age, he estimated, was about fifty-five. They, to a man, all wanted to hold off on steel imports until they retired in about five or so years. Then he asked, "Who here wants your son to work in the steel industry?" Not a hand went up. They realized that they had tough jobs and wanted protection of the industry only until they retired. But they wanted their adult children to get cleaner, safer jobs. They didn't get their way totally; some of their jobs disappeared, but at least their adult children would get nicer jobs, even if the jobs paid somewhat less.

Dependence on Foreign Suppliers

What about dependence on foreign suppliers? Isn't that a downside of foreign trade? Yes, but it's offset by less dependence on domestic suppliers.

Consider baby formula. We have had a baby formula crisis in the United States for about a year. One reason is the US government's tariffs. According to the Congressional Research Service, the most-favored-nation tariff for baby formula is between 14.9 percent and 17.5 percent. Moreover, the Food and Drug Administration has other restrictions on imports. Here's what US Customs and Border Protection says on its website about the FDA restrictions:

> *"Infant or baby formula may be imported to the United States without prior sanction by the Food and Drug Administration (FDA), as long as the facilities that produce, store, or otherwise handle the products are registered with FDA, and prior notice of incoming shipments are [sic] provided to FDA. Prior notice is not required for infant or baby formula for an individual's personal use (e.g., for consumption by the individual, family, or friends, and not for sale or other distribution) that is carried by or otherwise accompanies the individual when arriving in the United States. Imported infant or baby formula products are subject to FDA inspection when offered for import at the US ports of entry."*

Presumably FDA regulators believe that baby formula from other countries, including high-income countries whose residents care about safety about as much as we do, is too dangerous unless the FDA blesses it.

What about the Pentagon's dependence on foreign suppliers, particularly those in Taiwan, for semiconductors? That is a problem. Here's what defense economist Ben Zycher says about the general problem of DoD reliance on imports:

> *"Suppose that some defense good is purchased from foreign suppliers and that this arrangement is subject to easy but unpredictable cutoffs. Suppose, also, that such interruptions are easy to insure against, with stockpiles, alternative suppliers in other parts of the world, or excess production capacity in the United States. If so, foreign dependence does not yield vulnerability. The central question, therefore, is not the source of the defense goods but the ease with which interruptions in supply—whether foreign or domestic—can be insured against or hedged. If domestic dependence is more difficult to insure against than foreign dependence, then, ironically, domestic dependence may yield greater vulnerability.*
>
> *What could make insurance more difficult for domestic purchases than for foreign ones? One possibility is the expectation of price controls during future conflicts. Producers of defense-related*

goods know that the prices of such goods can rise dramatically when a government at war or preparing for war increases its purchases of those goods. These price increases serve an important function: they reward domestic producers for stockpiling goods in advance, for maintaining excess production capacity, and for increasing production quickly. But domestic producers also know that governments attempting to constrain budget increases and reacting to political pressures on "war profiteering" and the like often impose explicit or implicit price controls on just such goods. The imposition of price controls on petroleum products during some past wars is but one example. Taking anticipated price controls into account, domestic producers would not invest as much in stockpiles or excess production capacity as is optimal for society. Nor are they likely to increase production as much when price controls are imposed. But governments for the most part cannot impose price controls on foreign producers. On net, therefore, foreign producers actually may have stronger incentives to stockpile and to maintain excess production capacity. The "vulnerability" issue is thus far more complex than the common foreign/domestic dependence view suggests."

Heavy reliance on Taiwan is a problem, but it doesn't follow that the US government should subsidize domestic production, as it does with the CHIPS Act. It might be better for the Pentagon to diversify, buying semiconductors from countries other than Taiwan.

A More Peaceful World

Let's not forget another benefit of globalization: it creates peace. Baron de Montesquieu, whom the founding fathers drew on in drafting the US Constitution, said it best: "Peace is the natural effect of trade." The more that countries trade with each other, the less likely they are to go to war because they come to depend on each other. It's not a sure thing. Trade between Britain and France on the one hand, and Germany on the other, was very high just before World War I. But what we can say is that more trade between two countries reduces the odds that those countries will be at war. In a 2006 study, Solomon W. Polachek, an economist at SUNY Binghamton, and Carlos Seiglie, an economist at Rutgers, reported that a doubling of trade between two countries leads to a 20 percent decline in belligerence.

Many people today are questioning the value of globalization. But they do so only by looking at the costs of globalization, and occasionally exaggerating those costs, and leaving out the many benefits of globalization. Globalization makes us more prosperous, less dependent on domestic suppliers, and more peaceful.