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A progressive case for free trade, immigration, and global capital
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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast Dollar & Sense. Today my guest is Kimberly Clausing, an economics professor at Reed College. We're going to talk about her recent book, "Open: The Progressive Case for Free Trade, Immigration, and Global Capital." So, welcome to the show, Kimberly.

CLAUSING: Thank you so much for having me. It's a real pleasure to be here.

DOLLAR: I'm very excited about this topic, particularly looking forward to hearing about the progressive case for capital flows. But let's start with the kind of deeper foundation here. There's a lot of disappointment with globalization, particularly in the United States and some other advanced economies. How do you see the track record of globalization over the last 20 or 30 years?

CLAUSING: Yes, that's an excellent question. And I'll mostly take that question with respect to the United States, but I just want to say up front that it's also important to remember all the other countries of the world. I think the track record, particularly in the non-high-income countries, is much more unabashedly positive than it would be even in the high-income countries. But let's take the United States.
I view the track record of globalization over the past three decades as similar to the track record of capitalism itself in the sense that it comes with a lot of positives, it's probably better than the other alternative, but it also creates constant disruption. That disruption is important for many people and important to address. One question we might ask ourselves usefully when we think about this disruption is how big is it? How large are the consequences? Would we be better off with less globalization? And in general, what I've concluded from looking at the data and thinking about the experience is that even though the disruption is definitely there, we are better off not stopping or reversing globalization as a response.

Let me just briefly talk about why the discontent. If you look at the experience of U.S. workers over the past generation, you'll see that wage growth has been disappointing relative to prior generations–sometimes even very flat. You'll also see a dramatic increase in income inequality, regardless of which data you look at. It's undeniably dramatic. So, we could say, well, those two trends are extremely troubling, which they are. And therefore, we need to sort of reverse everything that might have contributed to those trends. But I would point out that there are lots of factors that contribute to those trends beyond globalization. Technological change is one that leaps to mind. That's extremely important. But I would also note that market power is a really significant issue in the U.S. economy today. We've seen a big increase in the market power of companies and capital relative to labor. And we've seen policies that have really turbocharged in many cases some of these effects.

When you look at different countries, they've all experienced increasing technological change and increasing trade, but they've handled the policy response to that differently and they've seen different outcomes on the ground. So, what I basically argue in this book is that the best policy response to all this disruption is to really go head-on and address the policies that workers would most benefit from. How can we best make sure gains in economic growth help workers? Usually that's through things like the tax system. It's not through stopping globalization in its tracks which, I think, can actually backfire and harm the very workers it purports to help. We can talk about that in detail as we go forward, I'm sure.

DOLLAR: I see a kind of theme in your book being that openness is basically good for the country, but we need complementary policies to really make sure that workers and citizens benefit from that. So let's take each of the major flows in turn and talk about both the case for openness but also some of the complementary policies that would make it better. Let's start with trade; we are the trade podcast and I think that's the most important flow.

CLAUSING: Let's first talk about the positives, and then the negatives, and then what to do about the negatives. So, on the positive side, it's undoubtedly true that trade has made our life as consumers much, much better than it would be without trade. And the growth in trade has made our life as consumers much, much better. Now, consumers don't tend to align to push their interests in political forums, so you don't necessarily see the major benefits to consumers well represented in the political process, but there are very serious upsides there.

Trade has also helped our export industries. So if we think about tech or pharma or Boeing in Seattle or the movie industry in Los Angeles, all of these are export industries that have more opportunities because they're able to trade. Trade has also helped many industries that we might not think of as export industries but nonetheless import a lot in addition to being quite active. So we might think construction and real estate, you know, they rely in part on imported steel and imported other products that might make them more productive. So those are also positives.

A final set of positives that I think is sometimes underappreciated by economists, but is quite important, is that trade tends to bring countries closer together and give them mutually recognized gains that they're reluctant to part with over small conflicts. So, if you look at the history of trade agreements and the history of countries trying to promote trade, it's often been an attempt to also make the countries get along better. The European Union is an excellent example. They used to fight quite often over there in Europe. At the end of World War II, there was sort of a deliberate recognition that that wasn't the best way to proceed, and so there was a eventually a launch of both the free trade agreements that began with coal and steel but then expanded to become the full-fledged European Union with all of its different provisions.

I think that was one illustration of ways in which countries can sometimes deliberately seek out sort of mutual economic exchange in a way to make these global problems like war easier to address. But we could also think about global problems like public health, like climate change. When countries are engaged in mutually beneficial exchange it's easier for them to work together in these other areas. Whereas if you're threatening your trading partners with trade wars and bullying them as the United States has tried that experiment recently, it's a lot harder to bring people to the table when you're interested in solving a bigger global problem. So I also view trade is an important part of international relations.

Turning to the negative side, which is also important, if you look at the disruption that a lot of American workers have faced over the last generation, particularly in geographically intense regions—you know there are parts of the United States that have experienced more disruption than others. You could look at a map, for instance, of places that have seen more job loss since 2000 and you'd see that they're pretty geographically concentrated. In some instances that job loss and that economic harm is quite concentrated in a way that correlates with extra import competition from developing countries. One example is this China shock literature, which has shown that some regions of the country that were more exposed to Chinese imports ended up experiencing disproportionate job loss. So I think that kind of disruption needs to be taken quite seriously.

When we think about the disruption with respect to Chinese imports in those geographically intense areas of the country, we need to remember that there's also a lot of other sources of disruption that affect workers all the time. Right? So, in addition to technological change, the capitalist economy itself generates a lot of disruption. If you look at the typical quarter in the U.S. economy, you'll see six million jobs are lost and that's a lot of job loss. But luckily in a typical quarter–not lately because of the coronavirus, but prior to that–in a typical quarter we also create about six million jobs. So if you think of that combination, there's just a lot of job churn. It's true that, you know, competition from China by some measures looks like it cost about two million jobs over a period of a decade or so. But every quarter we're generating a disruption, too. So I think if we just sort of try to make a trade agreement or a country the bully and story of economic disruption, we're sort of putting too much on the shoulders of that one agreement or that one country.

Now, how do we help those workers? I think there's a lot of really productive ways that we can go straight to their needs. So one example would be having government programs that provide wage insurance such that if a worker loses a job in a manufacturing industry, say, and has to take a lower paid service job, which can sometimes happen, that for a period of time the government helps make up the difference in their wage loss. And we have a tiny program that's linked to trade there, but I actually think it could be dealing from trade productively and sort of help workers who late in their careers might be losing jobs or facing disruption.

I think the earned income tax credit is actually an incredibly powerful tool. It's much broader than that. It basically helps every low wage worker by giving them a negative tax rate if their wages are low enough. The earned income tax credit is far more generous if you have children then if you don't, but it would be a stroke of a pen to make that equally generous for workers without children. It would be expensive, right? But there are other places where we can get revenue that I'm sure we'll talk about later today.

So those are just two examples of ways to help workers. I also think we need to focus on the balance of power between labor and corporations which we've seen really distorted lately by the fact that companies are having more and more market power whereas unions are diminishing, particularly unions in the private sector, and that's where they're really needed to counter that market power. And then a final policy that I think would be very helpful in addressing these worker needs is to focus much more on the fundamentals of the U.S. economy. It sounds boring, but part of how the U.S. economy got to be so successful over time was in focusing on the education of workers, focusing on infrastructure, and focusing on strong public institutions. We've let all three of those really crumble in recent decades, and I think we could afford to invest a lot more in those types of public investments that would really help the entire middle class prosper more.

DOLLAR: Thanks. I really appreciate those insights. I think it's easy to blame China or blame foreign trade on a pretty serious set of problems we have in the United States. But that analysis is shallow, and we're going to be disappointed if our solution to the kind of problems we're facing is just to

cut off trade with China. That is definitely not going to bring back good jobs or deal with the uncertainty, et cetera. So, that's great.
It seems to me the hardest of these flows to defend is capital flows. As I see it, they have a pretty bad name these days. The direct investment side is associated with outsourcing, taking our jobs away. And then the portfolio flows are often characterized as hot money. Not such a problem for the United States, but I've worked on a lot of different developing countries. The hot money flowing in and flowing out can have exchange rate effects and asset price effects. So, let's break this into two parts. So, what's the case for capital flows, free movement of capital, and then we can talk about some of the policy changes that might make the results better.

CLAUSING: Yes, so that's a huge question and we could probably have a podcast just on that if we wanted. But let me just hit the highlights here. So, I'll remind you first that the perspective of that book was very much a perspective from the United States. So I'm going to try to focus most on that in my response to your question, but I do think capital flows pose very different risks for poorer countries or emerging economies than they do for the United States. So, I'll touch on those just a little bit at the end, but I do think that distinction is an important one to make.

So one place to begin with the United States is to recognize that the United States is a net importer of capital. We, every year, borrow from foreign countries to a large magnitude–often in excess of three percent of GDP, sometimes up to five or six percent of GDP. And so that's capital that's flowing into the United States from abroad. When you worry about capital flows, you often hear stories about offshoring and those types of effects. And those are important, too, but one thing to remember is that there's a lot of inward bound foreign direct investment and a lot of inward bound foreign portfolio investment. And in fact, if you look at the some of that, there's more coming in than is going out.

Now it turns out that that flow of inward capital is exactly equal and offsetting our trade deficit. And one myth that I tried to set aside in that book is that the trade deficit is telling us something about competitiveness or about the fairness of our trade agreements, because it's really not. What the trade deficit is telling you is that the country is borrowing on net from abroad and that borrowing is basically, you know, the IOUs that come from that trade deficit. So all the countries in the world that borrow run net trade deficits and all the countries in the world that net lend run trade surpluses.

So the question is, is that good for the United States? And the counterfactual really matters here. So if we assume that we're continuing to run big budget deficits, that we have savers that aren't that interested in saving a lot compared to our counterparts in Germany or China, and you imagine life without those capital inflows, without borrowing from abroad, then that would imply that interest rates would be higher and we'd have less investment. There'd be less economic growth, and we'd actually be kind of poorer as a result of cutting ourselves off from this source of international capital.

From the United States perspective, I think this borrowing has on net been beneficial. That doesn't mean we shouldn't address the root sources of the borrowing, but it's not about blaming foreigners. It's about sort of saying, okay, if we don't want to borrow so much let's consider running a balanced budget. Or, if we don't want to borrow so much, maybe Americans need to save more relative to all of their consumption. Those would be the things that would stop the foreign borrowing—not beating up on trading partners. And we've run that experiment the last few years. We've beaten up on trading partners, we've started trade wars, and we haven't seen an accompanying improvement in the trade deficit. That's because it's not a result of those factors; it's a result of all this borrowing. So that's, I think, a really important feature to remember when you're thinking about the United States–that close link between the borrowing and the trade deficit. That's what I'm trying to get across in the book.

Now, if we're thinking about international capital and its effects on poorer countries, I think it's important to distinguish types of international capital. So if I were an emerging economy, I would be much more interested in attracting foreign direct investment than foreign portfolio investment because foreign direct investment, where a company comes and sets up shop or merges with one of your local companies to do something in your economy, that tends to be a much more stable source of capital. It brings a lot of advantages including foreign technology and expertise into your economy–particularly in the non-extractive sectors. Extractive sectors come with their own challenges. Foreign portfolio capital can be a nice source of capital too, but it often is subject to rapid reversals that can cause big macroeconomic stability problems. And so, I think emerging economies might be a little less welcoming of that type or at least think about some of the institutional and macroeconomic factors that would reduce the ability of that type of capital to be disruptive. So I think the issues from emerging economy perspectives are somewhat different.

DOLLAR: If we come back to the United States, without being an expert, my casual impression is that our tax code still favors our companies investing overseas. The tax reform a few years ago was supposed to address this–perhaps it did partially. But I guess more generally, what would you do with the corporate tax code? In terms of the complementary policies to go with capital flows, I think taxation is really critical, and I know you're an expert in this area. So what would you do with the corporate tax including issues of outsourcing?

CLAUSING This is a really important area and one that I've spent decades of my life thinking about. I think the U.S. tax system both before and after this recent 2017 Tax Act – the Tax Cuts and Jobs Act as it was colloquially called – both before and after that legislation it's quite clear that the U.S. tax code encourages offshore earnings much more than domestic earnings. So, prior to that tax act, you could sort of accumulate income offshore in a tax haven jurisdiction, for instance, paying a very low tax rate and never have to pay tax at home unless you repatriated the income. That provided this huge incentive to book income offshore. After the tax legislation, we actually have a sort of direct exemption of foreign income from taxation in the United States for the first 10 percent return on assets. And after that, it's taxed at half the rate, roughly, that we apply to domestic income. So in both cases, there's a clear tilt of the playing field towards foreign income and away from domestic income.

This is one area where I think it would be quite helpful to have both better U.S. laws that reduce the tilt of that playing field. You could do this even unilaterally with a stronger minimum tax. There's a weak minimum tax in this recent legislation, but you could easily make it stronger. But I also think it's an area that's really ripe for better international cooperation. And we've seen some efforts through the OECD and the G20 to address this with this base erosion and profit shifting project that they have. The United States has been a somewhat reluctant and at times even hostile participant of that process. But I think, hopefully, some future administration not too long from now would be more welcoming to the idea of cooperation in this area, because I think even a little bit of international cooperation can go a long way to sort of reversing this race to the bottom.

One of the dangers of capital mobility that we didn't get to in the last question is that because capital is mobile and labor is not, you're going to end up with governments being really tempted to lighten the tax burden on capital and shift the tax burden onto labor. Well, because of all this economic inequality and disruption that we've seen, this is kind of the opposite of what you want the tax system to be doing right now. Capital is done really well, labor is facing a much more stagnant wage situation, so you'd really like the tax system to be working in the opposite direction to tax the winners from globalization and to help the losers. Right? But we've actually seen policy going the opposite direction in part because of international competition.

But this is not inevitable. I actually think there's really easy things countries can do – even unilaterally, but best with a little bit of cooperation – that would sort of counter this dynamic and actually encourage other countries to raise their tax rates. For instance, even if the U.S. just put in a tougher minimum tax then our trading partners would have the choice of either collecting that revenue themselves by raising that tax rate or letting the U.S. collect the revenue. It kind of changes the dynamic towards a race to the top instead of a race to the bottom, but it does require a little bit of political will.

One thing I can imagine that would be really useful to do in the years ahead would be to pursue kind of a modern version of some of these big trade agreements. So if you imagine sort of reinvigorating the Transatlantic Trade and Investment Partnership around goals like tax competition and climate change, but also keeping the trade part, giving market access to the two economies – the EU and the U.S. – to each other's markets. Maybe focus less on the corporate interests around intellectual property and investor state dispute settlement and all that and more around worker and citizen interests in areas like climate change and tax competition. Right? So you'd provide the free trade outcome, but you'd also be saying, okay, well, we should price carbon, and we should have a border adjustment for that, and we're going to tackle tax competition at the same time. And that kind of agreement could really make globalization work for citizens. Not just for the companies, not just for the winners, but for the economy as a whole, because it would kind of pair together these important collective action problems and help governments make progress on all of them together. So I think that could be a great start to a better outcome.

It need not be just to the benefit of the rich countries that I imagine partaking in this. If we do a better job taxing capital or a better job controlling climate change, that's going to really help the emerging economies of the world, too, because it's going to easier for them to collect their own corporate taxes if they don't have to worry about it all ending up in Bermuda or Switzerland. And it's going to be easier for them to have water on their fields and all the other nice things that come from controlling climate change if the EU and the U.S. are taking it seriously. So that might be one way to start on some of these goals.

DOLLAR: We'll come back a little bit more on potential trade agreements at the end. But first, I do want to cover immigration. I think immigration is a key source of dynamism and growth for the U.S. I'm genuinely curious whether you favor high-end immigration vs. low-skilled immigration or skill-neutral immigration policy? So, what's the case for immigration, and how would you change our policy?

CLAUSING: Yeah, I think the case for immigration is so overwhelmingly positive. This was one of the great things about writing that book, because I was had a hunch that immigration was great and then I really dug into the research and it was even better than I thought it was. If you look at the research, it's just such a clear win for the United States. It helps our innovation–and there's tons of evidence on that. It helps job creation because immigrants are much more entrepreneurial, and they found more businesses and they hire people. It provides our labor force with all sorts of skills that were lacking both at the high end and the low end. We see at the high end you've got a lot of scientists and engineers who are immigrants, but you also see immigrants filling really important roles on things like elder care and those kinds of areas that we may have a shortage of domestic workers for. And it also helps with the sort of demographic issues that we face with the budget deficit and with our aging population to have a robust labor supply. Recent generations of immigrants are more likely to have higher fertility rates, too, so they help that demographic burden question. So I think it's just an incredible boon for the U.S. economy.

If I were so lucky as to have a role in shaping U.S. immigration policy would look like, I would suggest more immigrants of every type. But let me be a little more specific here. I think one area where we could stand to move in the exact opposite direction of recent Trump administration actions would be to be far more welcoming to international students. They're really a great boon to higher education which is one of our best industries here in the United States. They provide capital service exports while they're here as students. And many of them want to stay in the United States and work and be productive entrepreneurs and scientists and engineers and all these great jobs here. I would suggest something like an automatic green card program for graduates of accredited U.S. universities because I think that would be a great way to expand high skilled immigration.

But I also think that the very foundations of this country, and here I'm going to move to a somewhat more moral argument, are really about being welcoming to all. Right? To refugees as well as scientists. And I think we could stand to be a lot more welcoming to the refugees of the world and to people who may have had a hard life in their home countries and are looking for a new start in the United States. Of course, we have to have some limits on that, but I think we can afford to easily let in more of those types of immigrants, too. And these folks often go on to be very productive Americans with a fierce sense of loyalty and love for this country. And I would love to see us sort of get behind the ethos of the Statue of Liberty and the poem at its base and less about erecting walls and separating children. Those types of policies are really a moral stain on the country as well as economically wrongheaded.

So, in short, I would like more of every type. There has to be some limits because otherwise we'd end up kind of with infrastructure problems as too many people would come at once, but I think there's a really strong economic case for more high-skilled immigrants. And there's even a strong economic case for more refugees, too, although that does create some concerns in the really short run about state and local budget stress and the like. So you'd want to manage that flow carefully, but we can certainly afford to let in more and we should.

DOLLAR: I totally agree with you about both ends of that – handing out green cards to college and graduate school graduates, but also being more generous and welcoming to refugees. So last question, Kim. You mentioned a potential U.S.-Europe trade agreement. I think we're pretty far away from that. But do you see in any of these trade agreements we've actually been signing–the enhanced NAFTA, the so-called USMCA, the phase one trade deal with China–are these things moving us in the right direction? Potential rejoining of TPP may also be a little bit of a stretch, but I think that's more believable than moving ahead quickly with a European agreement. So how do you see these different trade agreements fitting with your agenda?

CLAUSING: Yeah. So, I know that some of that may seem a little lofty earlier, but we should also remember that the political momentum can change quickly, and we may be on the verge of such a moment pretty soon. One thing I would note with all of these agreements like NAFTA and the USMCA and the TPP, is they're often villainized by both the far left and the far right vastly out of proportion to any possible effect that they could have.

Even if we imagined the perfect NAFTA that was like the dream of the labor groups, for instance, and just had every provision just right and all the enforcement that we wanted, and we contrasted that with the NAFTA that we actually experience, I suspect that the true labor market effects of those two different agreements would be really very similar. Mexico isn't that big of a country. It's not really the dominant force in what's happened to workers over the last 40 years. And those that would say otherwise I don't think have taken a good look at the actual data. So I think some of these trade agreements are made out to be bad guys despite the fact that they really have pretty minor effects compared to other things. Even the places where we see trade being really disruptive, like in the Chinese case, we didn't have a trade agreement with China. They joined the WTO. It's true, I suppose, we could have tried harder to stop that, but it's weird to sort of say to a country of over one billion people, like, we're going to try to inhibit you from joining this international rules-based organization. So I think that we'd be better off focusing on direct ways to help our workers than trying to stymie other countries from participating in the world trading system.

In terms of the particulars, the USMCA I don't think is all that different from NAFTA. There are a couple tweaks that really involve adopting parts of TPP and adding it to NAFTA. There are a couple areas where they are a little more sensitive to goals of labor communities and the like. So you could argue that it's kind of like NAFTA 2.0. It's not really a new thing; It's just a slight tweak. I don't view it in a particularly negative light. I think it's way better than just ending an agreement that we've had since 1994 abruptly, which I think would be quite disruptive to the U.S. economy as well as to those in Canada and Mexico. I view USMCA is as a much better alternative than just throwing away NAFTA.

TPP, I would like to see the U.S. rejoin the CPTPP, and in that sort of rejoining process I think we might usefully rethink some of the ways in which that agreement might have overly emphasized the interests of, say, intellectual property and investors and focus more on some of these other things. I actually think there would be room to tackle tax and climate as two add-ons to that in a new administration. I can't see any of this happening under the Trump administration, but I'm optimistic that we could have a reset in some of these areas.

When we do have conflicts with countries, I think it's important to have trading partners and friends. So, for instance, if we look at the effectiveness of the U.S. in shaping Chinese policy on issues like the Uighur population or Hong Kong or the South China Sea, I would argue that in all of those cases we've been less effective with this approach that we've tried lately of bullying and putting on tariffs and restricting the opportunities for trade than we would have been if we had proceeded with the TPP and applied a different type of softer pressure with those other countries of the world. I think we'd likely be more effective with that type of pressure than with shooting ourselves in the foot with these trade wars. So, I'd like to see these agreements be modernized, but I don't think we should make them out to be the real source of workers' troubles because I don't think that's the case.

DOLLAR: I'm David Dollar and I've been talking to Kimberly Clausing who makes a really compelling progressive case for free trade. If you want to hear more about that, you're going to have to read her book, "Open: The Progressive Case for Free Trade, Immigration and Global Capital." So thank you very much, Kim.

CLAUSING: Thank you so much for having me. It's been a pleasure.

DOLLAR: Thank you. And thank you all for listening. We'll be releasing new episodes of Dollar & Sense every other week, so if you haven't already, make sure to subscribe on Apple Podcasts or wherever else you get your podcasts and stay tuned.

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