

Trade creates losers. Here's how to help them

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AS EARLY as 1941, Paul Samuelson, a Nobel prize-winning trade economist, argued that globalisation causes economic hardship for some. He continued to write that the losers from globalisation need to be compensated by the gainers to address the drastic increase in inequality we have seen in the past few decades. Yet this compensation has never really happened.

America is a striking example of this. Recent research estimates that Chinese import competition caused 20% of the losses in manufacturing jobs in America. These displaced workers barely got 10% of their fall in wages as compensation from public support systems. Many have ended up suffering permanent income losses, and the regions where these losses are concentrated have gone into rapid economic decline.

This is not just an American story. Low-skilled workers across the developed world are in a trap of stagnating, even falling, real wages. Adjustment policies to give them temporary relief or re-training during difficult transitions exist in many countries, but they are notoriously inadequate. For example, the European Globalisation Adjustment Fund doesn't provide for any temporary relief; it just funds retraining programmes. These retraining funds have stringent eligibility criteria, so that the programme is heavily under-used.

Moreover, retraining programmes have low success rates, and America's Department of Labour estimates that retrained workers have a one-in-three chance of not finding a new job. Workers therefore remain exposed to hardship from changes in their economic environment, and losers from the past few decades have never really seen any of the prosperity that globalisation brought to many global firms and their workers.

Many have argued that these disparities have polarised people and contributed to the current rise in nationalist politics. The common solution suggested by some politicians is that putting up protectionist barriers will undo the economic damage suffered by those who lost out earlier. This is not what is happening. Protectionism is not undoing the losses; it is de-skilling workers even more.

Take Brexit, which involves Britain breaking from its largest trading partner, the European Union. The depreciation of sterling which followed the Brexit referendum is already hurting British workers. Forthcoming research from the Centre for Economic Performance at LSE finds that British firms have cut back on training programmes for their workers, in anticipation of reduced trade ties with

the EU. Employers provide a large share of skills training, so the Brexit-induced reductions will have a long-term negative impact on human capital and worker earnings—quite the opposite of what the protectionist policy is intended to achieve.

Looking to the future, if private investments in human capital fall, public investments would need to step up even more to ensure workers don't suffer permanent job losses. Public policy has been complacent about setting up well-functioning compensation and reemployment assistance for those who suffer from the churn of economic conditions. For example, the average American worker got back less than 1% of the earnings lost to Chinese import competition as unemployment benefits and "trade-adjustment assistance". Many workers had to resort to disability payments for temporary relief.

Redistributing the gains through taxes, and public transfers to a comprehensive adjustment programme, would redress the disparities caused by such changes. High-productivity, low-inequality economies like Denmark and Sweden commit about 1% of GDP to retraining and upskilling workers, while countries with greater inequality such as America and Britain spend substantially less than that. Silicon Valley and the City of London can surely give up some of their massive gains to ensure Detroit and Hull do not fall even further behind.

Many economic changes, though, require more than just national redistribution, if the losers are concentrated on one side of the border. Samuelson warned more than a decade ago about the decline of manufacturing in the West. He wrote that in an integrated world, economic changes that dampen the comparative advantage of a country also create permanent income losses in that country. Public policy therefore needs to figure out what to do with those 80% of workers who lost their jobs for reasons other than just import competition from developing countries.

Addressing the hardship increasingly faced by these workers requires a combination of redistribution and regulation. Adjustment-assistance programmes need to be generously funded and to cover economic changes that go beyond globalisation. Production and capital are much more internationally mobile now, so there is a greater chance of firms shopping around for lower wages, lower taxes and lax regulation. Raising the resources to fund programmes for temporary relief and retraining of workers will therefore require policies that can reallocate resources from the worldwide gainers towards the potential losers.

Worldwide redistribution systems don't exist. Even simple international policies, like plugging tax-haven loopholes, have seen little or no progress. Domestic policy therefore has to fill the gap in international policy. And it can do this. First, by generating resources from different international jurisdictions. Second, by enforcing compliance with worker protections. And third, by channelling resources from the gainers towards policies that offset the deskilling of workers who are likely to fall behind.

It is a form of compensation to those who are harmed by globalisation that Paul Samuelson, who passed away in 2009 at the age of 94, might have endorsed.

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