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The U.S. Midterm Elections and Globalization

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Control of both houses by the Democratic Party when the new U.S. Congress convenes early next year will almost certainly make U.S. trade policy more protectionist than it has been under Republican domination. The Democrats on the whole are less amenable than Republicans to open trade, and many of the Democrats who were elected to Congress expressed this sentiment. It is now unclear whether pending free-trade agreements, such as those with Peru and Colombia, will be approved by Congress, or whether the Doha Round of the World Trade Organization or the Free Trade Area of the Americas will move forward during the next two years.

Republicans, on the other hand, seem to be unconcerned about growing U.S. trade and current account deficits—the current account deficit was $791 billion last year and will be higher this year. Indeed, the main argument of conservative economists is that the deficit in the balance of payments is a sign of U.S. strength in pulling in foreign investment.[1] Regardless of whether the current or capital account is dominant—my view is that the two work in tandem—the current account deficit is financed either by foreign investment or an increase in U.S. foreign debt. Since George W. Bush assumed power in 2000, U.S. foreign debt has almost doubled.

The term globalization is usually meant to include increases in trade, augmented investment flows, improved communications, and a greater ability to move goods, services, and capital efficiently. Under globalization, much trade takes place in intermediate goods, and this involves coproduction of goods in separate countries. This, in turn, requires lower trade barriers to minimize the expense of moving goods and services across national borders. The formation of the European Union, the North American Free Trade Agreement, and free-trade arrangements in Asia and Latin America and between countries in different regions are part and parcel of globalization in that they are designed to permit much intra-industry trade—for example, producing engines in one country and other components in another and doing the final assembly of cars and trucks in either. Increases in trade and investment in a globalized world are larger than increases in gross domestic product. Globalization also encompasses outsourcing parts of total operations to locations such as call centers, producing parts for computers, and even reading X-rays, when this can be done more cheaply.

If one is the CEO of a large corporation with global reach and with affiliates or subsidiaries in many parts of the world, globalization becomes a way to make one's company products or services more competitive. That was the basis for setting up call centers in Jamaica, adding labor value to partially finished goods in Mexico in the *maquiladora* or in other assembly centers in Central America, or taking advantage of the skill of Indians in computer programming.

There are losers in this process, such as the workers who are dismissed from their jobs in the United States, and there are winners, such as those who get good-paying jobs in export industries. The workers in countries who get the jobs also benefit. Creating winners and losers from economic change is nothing new; technology changes create winners and losers, and the "progress" inherent in this comes from creating more winners than losers and generating higher productivity-permitting wage increases for the winners. This was true when the cotton harvester replaced manual harvesting, when automobiles took over from horse-and-buggy transportation, and when personal computers became ubiquitous.

The main shortcoming of this process is that many countries, including the United States, do little to compensate the losers. Low-wage and low-skilled workers in the United States were the first to suffer from the combination of job loss and little to no compensation. Consequently, U.S. labor unions became protectionist. Political leaders in towns and cities that lost jobs to foreign locations and did not develop other activities to create jobs attacked open markets—or, put differently, they attacked globalization.

Many of the Democrats who won in the midterm elections took this position—that U.S. free-trade agreements were job killers. These positions of labor unions and politicians in affected locations instigated long-standing import restrictions in the apparel and steel industries in the United States. Sugar growers have long obtained protection in the U.S. market. Industrial leaders who could not meet the foreign competition and were unable to set up cheaper production facilities abroad sought

[1] The balance of payments has three main accounts: the current account; the capital account; and the change in reserves to end up with a balance. Omitting the change in reserves, when there is a financial outflow on the current account, mostly from trade, this implies a financial inflow on the capital account.

protection for their operations. U.S. industries such as construction and agriculture that are unable to produce in other countries seek to reduce costs by hiring undocumented immigrants or lobbying for guest-worker programs. The complaints against outsourcing involved skilled workers who were adept at playing the political system, and consequently, the arguments against outsourcing are often quite sophisticated.

Protectionism has profound dangers. A country that seeks to minimize foreign competition in low-wage industries is apt to become a low-wage country itself. If antipathy to globalization reduces the competitiveness of U.S. manufacturing and service activities, the benefits would go to a minority of the population at the expense of the majority. This has long been the rationale for assistance to those who lose jobs because of international trade (i.e., don't practice protectionism, but compensate the losers instead). The shortcoming of this position in the United States has been the inadequacy of this assistance. The United States could not long remain an economic powerhouse and a high-wage country by masking its inefficiencies through protectionism rather than exploiting its strengths in activities requiring cutting-edge technologies and a well-educated population. To borrow from Tom Friedman, the world is flat only for those people able to take advantage of globalization because of their education and the agglomeration of competitive activities in their home countries—as is now taking place in China and India, but not in Africa.

I wish to add to the customary definition of globalization. One aspect now getting the attention it deserves is what happens to global commons—global warming, depleting the oceans of fish, excessive withdrawal of water from transborder aquifers, and so on. The recent plea by Nicholas Stern of the United Kingdom to take action now, when the costs would not be prohibitive, to stabilize greenhouse gas operations is a vivid example of the need for global action. This action will not take place unless the political climate changes in the United States; and it is unlikely this will happen soon.

A second aspect to which I wish to call attention is the need for amplification in the trade foundation of globalization. The United States has accepted the role of debtor to the world—as the ultimate destination of goods and services that has led to the large U.S. deficits on the current account. Many countries, predominantly in Asia, seek to have trade surpluses by keeping their exchange rates undervalued, certainly with respect to the U.S. dollar. The United States has bilateral trade deficits with many countries, but the two largest deficits in 2005 were with China ($201 billion) and Japan ($82 billion).

A trading system under which different countries play by different rules on such a crucial issue as exchange-rate practices does not merit the word "system." There must be a limit to how much longer the United States can maintain such high trade and current account deficits and how much more foreign debt the United States can tolerate. There could be a soft landing, under which gradual realignment of exchange rates could lead to a large reduction of the U.S. balance-of-payments deficit, but there is no evidence that this is happening. It is unlikely that any one country, China for example, will allow a major appreciation of its exchange rate as long as other countries with perennially undervalued rates do not act simultaneously. What is needed, in my view, is a collective negotiation on exchange rates. Failing this, the United States may suffer a hard landing and this would affect welfare throughout the world. In this sense, there is globalization—economic disaster in the United States would be contagious.

I will summarize my thoughts with three points:

1. The pressure on China to move more rapidly to allow its exchange rate to appreciate is likely to increase dramatically. My sense is that China expects this, based on its recent announcement that it will invest more of its foreign reserves in nondollar currencies. The most important U.S. supporters of China's economic policies have been large corporations producing and buying from there, and these corporate leaders are apt to be Republicans. Labor unions, by contrast, would like to dampen imports from China and are likely to support more vigorous U.S. pressure on China's exchange rate. Senator Charles Schumer (D-N.Y.) has been a leader in proposing a high tariff on imports from China if there is no movement on the exchange rate, and the constraints against doing this have now diminished with Democratic control of the Senate.

2. Support for globalization comes from the desire of the leaders of large industrial and service industries to enhance their companies' competitiveness in world trade. No single company or any one country, no matter how important, could halt the march of globalization. Many political leaders in the United States would like to reduce the salience of globalization and may even try to accomplish this, but are not likely to succeed to any great extent. However, if there is a common effort to make the trading structure more of a single system under which important trading countries play by the same rules, especially with respect to exchange rates, this could succeed; and, if it did, it would make globalization an even more formidable force in the world economy.

3. Globalization should be redefined, or amplified, to take into account issues on which collective action is needed, such as taking steps to reduce the danger of global warming and working jointly to correct the payments imbalance that makes the United States vulnerable to a crash landing that would also damage the rest of the world.
