

MR. KNETTER: Thank you. Like Alan, I will assume that the Commission has had a chance to at least get a copy of my written testimony. I will not attempt to cover all the ground that's covered in the written testimony in my oral remarks. The written testimony is summarized by I think seven or eight bullet points that you can skim over if you'd like. I would be happy to talk about any of the information in that testimony in the question and answer period.

I would like to thank the Commission for inviting me to come and testify before you. I think this is a very important issue. As Chairman Becker alluded to, in Hanover, New Hampshire, we have had a little excitement in the last week. We have had two town meetings, featuring a number of the leading contenders for the nomination in the two major parties. I guess I was struck by the fact that over the two days of questioning that I got to witness, no one raised a question about the trade deficit. I am not sure really what to take from that. No one raised a question about the manufacturing base. It could be that people in New England don't really think about those issues as much because we aren't necessarily a hotbed of manufacturing in the same way the industrial heartland is here.

But I actually conclude from that something a little bit different. I actually think we're dealing

more with a semantic issue. I think people are concerned about what's going on out there in the economy and what's happening to people's job stability and compensation. There was some general concern expressed about how it is globalization might be affecting the American worker. I think that's really the broader question that is implicit in the Commission's mandate.

I think focusing narrowly on the ramifications of the trade deficit would really be a mistake for the Commission. I think it is very important that you all adopt a view on how big the trade deficit can be before some alarm bells ought to start going off in our heads that this is really getting to an unsustainable point. I personally don't think we are at that point yet, but I don't think the Commission should limit itself to coming to a view on that issue alone.

I think the broader question is, what is international trade doing to the American economy and the American workforce. That is a harder question to answer.

It is unmistakable that in the last two or three decades, we have seen a coincident rise in international trade and in trade deficits and income inequality, however you would like to measure it. I

don't think anyone would dispute those facts. Alan and I might disagree over whether we should look at wages or compensation when we decide whether the typical worker is doing better or worse in real terms. But I don't want to get into those details.

I think there is no question that inequality has risen, however you want to measure it, by family, by worker, sorting on different worker types within industries, across industries. That has become an issue for a lot of Americans that we need to think about. The question is, what has international trade had to do with that? How does that work?

I don't think the trade deficit tells us the answer to that question. I think if we managed to get to a point where we had a zero trade deficit, as we nearly did in the early 1990s, we would still be experiencing large impacts on our economy from international trade. So I think keeping our focus on the trade deficit could make this whole mission a bit too narrow.

There has been a good deal of research activity in the economics profession that's tried to identify what the underlying causes of this rise in income inequality are. I would say there are four leading candidates that people offer up when they think about this question.

The first one is technology change. Everyone is aware there has been a dramatic change in information technology and its application within not only manufacturing industries, but service industries.

A second factor people point to very quickly, is globalization, increased economic interaction with the rest of the world.

A third thing that is often mentioned is de-unionization.

COMMISSIONER LEWIS: What was number three?

MR. KNETTER: De-unionization. So declining rates of unionization.

Then a fourth that I have seen considered in a number of studies is the declining real minimum wage.

At present, I would say if you took a poll of economists who have done a lot of serious work on this issue, and I mean spinning out the current population survey tapes and looking at the data for millions of households every year since 1967 and trying to make sense of the trends in the data, you would find them reaching the conclusion that technology change has been more important in explaining the rise in income inequality. Globalization would probably rank second in that poll.

However, I would say there is a lot of uncertainty. I don't think anyone has written a definitive paper that convinces me it's technology and not international trade. I happen to think international trade is a little bit more important than probably the typical member of my profession.

But there is no denying that all these factors are inter-related. Without increased international competition, I am not sure we would see the same rate of adaptation of information technology in the effort to improve productivity, which in turn has effects on workers, especially non-college educated workers.

What are the implications of this quest for a culprit for economic policy? That is an even bigger question. Suppose we were able to identify that in fact international trade was causing some rise in income inequality in the United States. It's not obvious what we ought to do about that. We could run down a list of options and ask ourselves how they might work. One thing we might consider is stopping imports or restricting imports in some way so that there was less impact of international competition on our labor market.

I don't know how we are going to decide which industries are allowed to protect themselves from

imports and which aren't. I am not sure which government Commission is going to be able to make an impartial judgment about that.

We could think about opening foreign markets, but I would caution that probably the benefits of increased exports are going to accrue more to workers in the high technology sector than in the traditional manufacturing sector. So I'm not sure that would help income inequality.

We could try to subsidize a manufacturing base, but once again, I'm not sure where we draw the line at which industries are critical and which ones aren't. I am not sure that within government, we could come up with a mechanism that would consistently do this on the basis of some objective criteria as opposed to political pressure.

I think the fundamental question is are we in this to help industries or are we in this to help people? I personally think that helping people is an easier sell. I think the reason no one asked a question about the trade deficit or the manufacturing base at the town meetings this week is because people don't have an attachment to a number like the trade deficit. They don't all have an attachment to a particular industry, but they understand what real

human suffering is. They have an understanding of why we would want to help people who are in need.

I think we need to sort of proceed through this kind of line of questions, asking ourselves what would we do if we knew it was globalization that was increasing inequality. I think the way we need to approach it constructively is to say how can we help people who are damaged by industry transitions.

I think we can do that by helping them acquire skills, helping them identify good job opportunities, and helping them relocate if they need to, to take advantage of those. Thank you very much.