Republican Commissioners' Views

The consequences of U.S. trade and current account deficits

Testimony before the Commission addressed three related, yet distinct, issues: (1) the consequences of "trade and globalization," (2) the consequences of trade deficits, and (3) the consequences of foreign trade barriers. As Chapter 2 notes, foreign trade barriers impose costs on the United States. We discuss ways to respond to foreign barriers in Chapter 6. This chapter addresses the consequences of trade and globalization and especially of trade and current account deficits.

The American economy is undergoing major changes that stem from a number of dramatic shifts, some, but not all, caused by the process of globalization. International trade is twice as important as it was twenty or thirty years ago. In addition, once-regulated industries are now substantially deregulated and more competitive, technology is changing rapidly in a host of fields, and evidence is mounting that investments in information technology are spurring improved productivity. These changes have contributed to the sustained growth of the U.S. economy and a high rate of return on investments that, ultimately, resulted in the trade deficits. There have also been costs associated with adjusting to these changes.

Declines in some industries and businesses and the rise of others is an inevitable part of a market-based economy. The economist Joseph Schumpeter wrote of the "creative destruction" inherent in capitalism. By this, he meant that some existing firms have to release resources to enable the entry of newer, more productive industries. The transformation of the United States from an agrarian to an industrial society and the movement of people from farms to cities and factories demonstrate the types of changes that have happened in the past. Today, that transformation continues, as services industries increase in importance and as the United States becomes an "information society."

Any change that transforms existing patterns of production and consumption, including "creative destruction," inherently entails some adjustments. If nothing else, people lose the stability of the status quo. The candlestick maker saw the value of his work and knowledge fall with the advent of the kerosene lamp. Today, a wide range of changes faces businesses and workers. Those changes affect jobs, communities, and industries. Further, there is concern that the costs of adjusting to these changes are not shared equitably.

The trade and current account deficits are principally the outcomes of our strong economic growth, and clearly America is better off with strong economic growth. Furthermore, as many

witnesses told the Commission, economies that are open to international trade generally have far better records of economic growth and better living standards than those that are less open. This observation is supported by reference to this nation's history: periods of open trade have tended to accompany rapid growth, while periods of trade restrictions have not.

Furthermore, Americans, as consumers, are better off having access to the wider range of goods and services produced internationally. In many cases, imports are less expensive than domestic products. In other cases, import competition has compelled U.S. industries to improve the quality of their products. And the variety of goods and services available to consumers would be smaller without international trade.

Numerous factors make the U.S. economy better able to adapt and adjust to the new developments inherent in today's globalized world economy than many other economies are. Most notably, U.S. financial markets provide a wide range of financing options to businesses, especially access to venture capital for start-ups. New and small businesses have been a vital source of innovation and employment growth in the United States. Some of today's largest U.S. companies, measured by stock market value, did not exist as recently as a decade ago. Also, U.S. businesses are often better able to adopt new technologies than are businesses in other countries, as Federal Reserve Chairman Alan Greenspan noted in a recent speech:

> *By law and by custom, American employers have faced many fewer impediments [than employers in Europe and Japan] in recent years to releasing employees. The difference is important in our new high-tech world because much, if not most, of the rate of return from the newer technologies results from cost reduction, which on a consolidated basis largely means the reduction of labor costs. Consequently, legal restraints on the ability of firms to readily implement such cost reductions lower the prospective rates of return on the newer technology and, thus, the incentives to apply them. As a result, even though those technologies are available to all, the intensity of their applications and the accompanying elevation in the growth of productivity are more clearly evident in the United States and other countries with fewer impediments to implementation.*[1]

Hence, the very factors that underlie the ability of U.S. industry quickly to take advantage of new alternatives that enhance their competitiveness add to the costs borne by workers. Changes in employment, wages, and the structure of the U.S. economy are the result of a range of causal factors including the trade deficit, increased levels of international trade, and increased use of technological innovations.

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[1] Alan Greenspan, "Global Economic Integration: Opportunities and Challenges," remarks delivered at the Federal Reserve Bank of Kansas City's symposium in Jackson Hole, Wyoming, August 25, 2000, p. 2. (Available at http://www.bog.frb.fed.us/BoardDocs/Speeches/2000/20000825.htm.)

Later in his speech, Federal Reserve Chairman Greenspan commented that

> *…those of us who support continued endeavors to extend market-driven globalization need to understand and, if possible, address the concerns that give rise to the desire to roll back globalization.*[2]

The challenge to policymakers is finding a way to reduce these costs while maintaining the benefits that we have gained from trade and globalization.

What are the benefits of trade?

There are many reasons why nations trade. A nation cannot produce all the products that it needs or desires unless it is willing to do so very inefficiently and to incur extremely high costs in terms of a lowered standard of living. Economists have long noted that differences among nations in the relative cost of producing different products provide the basis for gains from trade. A nation may be able to produce many different products, but it is not efficient for it to try to produce everything. Trade provides the opportunity to take advantage of lower relative costs in other nations.[3] Further, traded goods and services will vary in cost, quality, and other ways, and consumers benefit by having the opportunity to decide what best suits their needs and desires. In testifying before the Commission, Patricia Davis, Director of the Washington [State] Council on International Trade and President of the Seattle Port Commission, explained:

> *Whether we shop at Nordstrom, Target, Toys R Us, the Bon Marche, or Costco, we will see an amazing selection of goods and prices. The people who benefit most critically are families at the lower end of the wage scale who have school-age children, and those elderly who must live frugally. It is a cruel deception that an open system of free trade is not good for working people. An import tariff is a tax. It is imposed on those least able to pay.*[4]

Another benefit from trade is that international competition forces producers in a nation to face the "best in the world." This competition encourages product improvements and limits the producers' ability to increase prices. Consumers benefit from the product improvements and lower prices induced by international trade.

Businesses and the workers that they employ also benefit from international trade. Businesses have access to lower-cost and/or higher-quality inputs that lower the cost and improve the competitiveness of U.S. products. Access to larger markets brings opportunities for greater profits, more jobs, and higher wages. For example, companies selling overseas may be able to realize increased economies of scale. That is, unit costs of production will fall as total output increases to supply foreign markets. Workers may also benefit. A recent report by the U.S. Trade Representative noted that jobs supported by American exports increased by 1.4 million between 1994 and 1998, with jobs supported by goods exports paying average wages about 13 to 16

[2] Ibid., p. 4.
[3] The key point here is that nations differ in lower relative costs, where the costs of producing any given item are based on the value of opportunities to produce something else.
[4] Hearing of the U.S. Trade Deficit Review Commission, Seattle, Washington, November 16, 1999.

percent above the U.S. national average. Finally, both businesses and their workers benefit when U.S. producers sell around the globe, because they are less vulnerable to a downturn in the home market.

Overseas markets are crucial to some industries. For example, about a third of U.S. crop production is sold abroad. Similarly, the U.S. aerospace industry, the largest U.S. net exporter, exports 42 percent of its total output. The commercial part of the industry is even more export oriented, selling nearly 75 percent of its output overseas. The Aerospace Industries Association estimates that roughly 340,000 workers in the industry depend on foreign sales, out of total industry employment of 800,000.

Imported goods can also enhance the competitiveness of U.S. products. American businesses need access to the lowest-cost intermediate goods or components to be competitive with foreign producers. In some cases, U.S. businesses also need access to the most advanced foreign technologies to remain competitive.

Finally, as witnesses in the Commission hearings repeatedly testified, a strong body of economic research has concluded that nations that are open to trade will, on average, grow faster than those that are closed. Jeffrey Sachs and Andrew Warner demonstrated this in a recent study.[5] They found that economic growth in developed nations open to trade averaged 2.25 percent between 1970 and 1990, while closed, developed nations averaged less than 1 percent.

Nobel Laureate Professor Milton Friedman also succinctly made this point when he observed:

> *Free trade in goods, services, and capital is by far the most effective way to expedite a worldwide transformation that promises a major improvement in human well-being around the world.* [6]

In her testimony before the Commission, Laura D'Andrea Tyson, dean of the Haas School of Business at the University of California, Berkeley, and former chair of the President's Council of Economic Advisers, summed up the benefits of international trade:

> *U.S. trade policy is based on the view that trade liberalization is good for America and good for its trading partners. With freer trade, consumers enjoy lower prices, higher quality, and greater selection…. Producers can sell to larger markets and enjoy higher profits, allowing them to maintain higher levels of production and employment…. Freer trade also increases competitive pressure on companies, which in turn encourages them to innovate and enhance their productivity… Trade liberalization is particularly important to the U.S. economy because foreign tariffs remain substantially higher in the rest of the world than they are at home and because 80 percent of the world's consumption and 96 percent of the world's population lie outside U.S. borders.*[7]

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[5] Jeffrey Sachs and Andrew Warner, "Economic Reform and the Process of Global Integration," Brookings Papers on Economic Activity 95:1 (Washington, DC: The Brookings Institution, 1995)
[6] Hearing of the U.S. Trade Deficit Review Commission, Palo Alto, California, November 15, 1999.
[7] Ibid.

A changing economy and the consequences of international trade

Substantial changes underway in the U.S. economy have resulted in an increased level of competition. When combined with global overcapacity in some key industrial sectors including commodities, automobiles, and steel, increasing levels of international trade have reduced the ability of businesses to set prices. Further, economic regulation has been reduced, increasing the importance of market competition in the U.S. economy. A final change is the increasingly effective use of information technology in the U.S. economy, with a resulting improvement in manufacturing productivity and more efficient business processes generally.

These changes are unsettling for many. Increased competition brings benefits to consumers; it does so by challenging businesses, their owners, managers, and employees and by forcing changes that entail some costs. One result, as Chapter 1 notes, is that some public opinion surveys have found high worker anxiety, despite low unemployment.

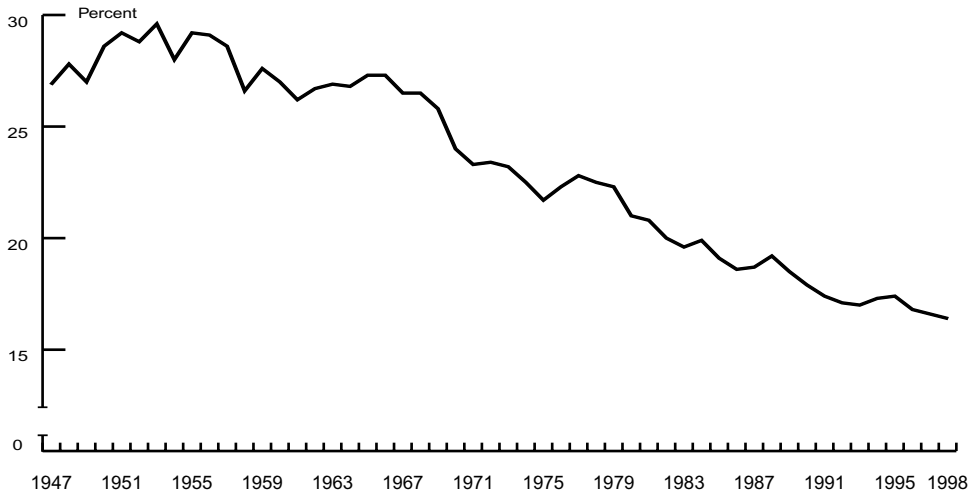
Trade and changes in industrial structure[8]

Manufacturing is changing, as it has for most of the post-World War II period. Manufacturing's share of U.S. output has fallen from 27 percent in the 1950s to 16 percent recently (see Figure 3.1). Some industries have seen dramatic decreases in employment, production, and capacity during this period. Production of labor-intensive consumer goods, such as footwear, toys and sporting goods, and clothing and apparel have been cut back sharply or are even in the process of disappearing from the United States. Other industries, such as many related to information technology, have been created or grew substantially during the same period. Manufacturing also has been changed by the growth of intrafirm international trade.

[8] A detailed analysis of the decomposition of U.S. and international trade data and trends is found in "The US Current Account: A Sectoral Assessment of Performance and Prospects" by Allen Lenz that was prepared for the U.S. Trade Deficit Review Commission. It can be found on the Commission's web site, http://www.ustdrc.gov, and on the CD-ROM included with the printed copies of this report.

Figure 3.1

Manufacturing's Share of U.S. GDP, 1947–98



Source: Bureau of Economic Analysis

Ever more businesses are outsourcing some or all of their production and support operations. They are focusing on what they do best and outsourcing the rest. The retained functions include design and marketing of the products, with manufacturing increasingly outsourced to "contract manufacturers" – companies that specialize in manufacturing to the design and specifications of other firms. The combination of modern, low-cost digital communications, falling transportation costs, and reductions in barriers to trade and investment has altered the options available for deciding where the outsourced work will be performed. All these changes have made it possible to move various steps in the production process to locations that provide the most efficient, lowest-cost source of supply. Consequently, many labor-intensive production processes are moved to countries with low labor costs. A business may design a product and produce some parts and components in the United States, export them for final assembly in Mexico or Asia, and then reimport the final product for sale in the United States.

It is hard to sort out how much of U.S. international trade such business patterns represent. The U.S. government does not collect trade data that enable an estimate of how much trade is outsourced. However, it is possible to determine that intrafirm trade represents a significant share of U.S. exports and imports and has grown modestly since 1982 (the first year data are available). In 1997, 24 percent ($224 billion) of U.S. exports and 15 percent ($157 billion) of U.S. imports were a result of intrafirm trade between U.S. parents and affiliates. The total volume of U.S. intrafirm trade in 1997 ($381 billion) represented 19 percent of U.S. trade. The intrafirm share of imports has increased marginally, from 14 percent to 15 percent, since 1982. The intrafirm share of exports has increased more, from 20 percent in 1982 to 24 percent in 1997.

There are no signs that these changes have run their course. As noted in Chapter 2, the features of the current economic expansion have been increased investment, particularly in information technologies, and a substantial increase in productivity. Increasingly effective use of information technology in the U.S. economy has led to improvement in manufacturing productivity and more efficient business processes generally. Nonfarm business productivity rose 3 percent in 1998 and 1999, and subsequent data point to even larger increases in 2000.

Does manufacturing still matter?

Despite these changes in the makeup of the U.S. economy, manufacturing continues to be important to the U.S. economy and will continue to be so. Manufacturing is also important from a trade perspective. It will, however, face intense competition.

Trade in manufactured goods dominates both U.S. and world commerce, including the trade flows among developed countries and between developed and developing nations. It has been the dominant component in the U.S. trade and current account balances. In 1999, the deficit in manufactures trade was $271 billion. This deficit, plus the $65 billion deficit in oil, was roughly equal to the U.S. current account deficit of $340 billion.

Trade in manufactured goods is also the predominant way in which countries compete in international markets. The globalization of the value chain and the role of export-led growth in many developing countries mean that a major focus of economic competition is the attraction of manufacturing capacity and its success in export markets.

Globalization and the continued dispersion of the location of manufactured goods production is encouraged by a variety of factors: lower tariffs and other trade barriers, low-cost transportation, rapid communication, the increased ability for speedier transfer of technology, the "commoditization" of manufacturing enhanced by the growing use of contract manufacturers, and the export-led growth strategies of developing countries.

When the U.S. current account deficit decreases (for whatever reason), not all manufacturing industries will experience major declines on the inflow side. The demand for a large portion of U.S. imports is relatively price inelastic (an increase in the price of the product will lead to a smaller percentage decrease in demand than the percentage increase in the price). This inelasticity is due in part to the exhaustion of or decline in natural resources or to the noncompetitiveness or, in some cases, the nonexistence of domestic production. U.S. oil production is sufficient to supply less than half of U.S. consumption. The United States has also become highly dependent on imports of basic industrial materials, such as nonmetallic minerals (with a 1999 deficit of $13 billion) and nonferrous metals (with a 1999 deficit of $10 billion).

Loss of price competitiveness has even affected some high-technology goods, with resulting large deficits in those industries as well. Examples include office equipment and automatic data processing equipment (a 1999 deficit of $36 billion) and telecommunications equipment (a 1999 deficit of $23 billion).

One final product category that deserves mention is motor vehicles. The 1999 deficit in motor vehicle trade was $90 billion. On a unit basis, imports in 1999 accounted for over one-fourth of U.S. motor vehicle sales. However, nearly two-fifths (or $34 billion) resulted from the location of production by traditional U.S. brands (General Motors, Ford, and Chrysler) in Mexico and Canada. This trade would be little affected by foreign economic growth rates or by changes in the exchange rate of the dollar.

The manufacturing product groups in which the United States has positive balances are limited. They include chemicals (1999 trade surplus of $8 billion); transportation equipment, principally aircraft (with a 1999 trade surplus of $35 billion); professional and scientific equipment ($9 billion); and specialized industrial machinery ($4 billion).

Trade and jobs

With the strong economic growth of the 1990s and the emergence of new industries, the U.S. economy has created millions of new jobs. The President's Council of Economic Advisers and the U.S. Department of Labor estimated that twenty million new jobs were created between 1993 and 1999; the study also estimated that 81 percent of the new jobs were in occupations that pay above-median wages. Other industrial nations have not had similar success.

This job creation has occurred as substantial changes were taking take place in the American workforce. Manufacturing's share of total employment has declined steadily over the post-World War II period, while services' share of total employment has grown.[9] Because of rapid productivity growth, the drop in the manufacturing share of employment was substantially greater than the decline in manufacturing's share of GDP over the same period (see Figure 3.1).

However, despite the rapid creation of new jobs, there is great concern in the labor force over the changes underway. Federal Reserve Board Chairman Alan Greenspan has commented that

> *[T]he rapidity of change in our capital assets, the infrastructure with which all workers must interface day-by-day, has clearly raised the level of anxiety and insecurity in the workforce. As recently as 1981, in the depths of a recession, International Survey Research found twelve percent of workers fearful of losing their jobs. In today's tightest labor market in two generations, the same organization has recently found 37 percent concerned about job loss.*[10]

[9] The number of manufacturing jobs rose very little over that period, from 16 million to 19 million, while the total number of jobs more than tripled, growing from 40 million to 129 million.
[10] Alan Greenspan "The Interaction of Education and Economic Change," remarks to the American Council on Education (Washington, DC: February 16, 1999).

At first blush, worker insecurity at a time of historically high employment and job creation is a paradox. However, recognizing that the process of job creation and destruction means that workers will frequently change jobs explains the paradox. In the past, business has responded to economic downturns with temporary layoffs as a way to cut production to meet diminished demand. Today, however, the competitive forces that have helped induce greater productivity in the economy have also led to permanent layoffs and plant closings as companies seek to improve their competitive position and their profitability during "good economic times." For example, since 1990 there have been five layoffs involving fifty thousand workers or more. Another twenty companies have had reductions of nine thousand or more.[11] (Chapter 5 examines the data on layoffs and job turnover in detail.)

What is the relationship between trade, wages, and the distribution of income?

There is an ongoing debate over the impact of trade on wages and the distribution of income. The benefits of trade have clearly contributed to an improved standard of living for Americans as both consumers and workers. Nevertheless, there are some who take the position that trade has adversely affected the wages of American workers and made the distribution of income in the Untied States more unequal.

There are two key weaknesses in the analysis that purports to demonstrate that trade has adversely affected wages and the distribution of income. The first weakness is the result of measurement errors in the data. The second weakness is that, irrespective of how it is measured, the research of the economics profession does not support the conclusion that trade was a significant cause of any adverse changes in the distribution of income.

Problems with the data on changes in real wages and the distribution of income

By some measures, income inequality grew in the 1980s and early 1990s, with the relative differences between the highest- and lowest-income households increasing. Irrespective of the positions taken in the debate over what took place during that period, everyone agrees that the trend has reversed since 1995. Furthermore, real wages (i.e., wages adjusted for inflation) are claimed to demonstrate a stagnation in wages for much of the working population for the 1980s and though the mid-1990s. Again, everyone agrees that here has been an improvement in real wages since the mid-1990s.

The data used to support the claim that there had been stagnation in real wages and an adverse shift in the distribution of income are subject to significant weaknesses:

[11] Jerry Jasinowski, "Improving the Condition of the American Worker," Central New York Business Journal, (10 June 1996).

- First, changes in real wages are estimated by taking data on actual pay changes and then adjusting them downward for increases in prices, as measured by the rate of inflation. However, there are serious problems with the current estimates of inflation. A number of respected studies have concluded that current measures of inflation significantly overstate the true increase in the prices. Consequently, changes in the real income of all workers are underestimated to the extent that inflation is overstated. In fact, using the reasonable estimates of the impact of the erroneously large measures of inflation yields a sustained period of rising real wages rather than the purported stagnation in real wages.

- Second, the focus on wages ignores the fact that in recent decades wages have become a declining portion of worker compensation. A rising share of the compensation dollar has been devoted to health insurance, retirement benefits, and other nonwage components of the compensation package.

- Third, there has been a significant decline in the relative cost of a large number of consumer products that a short time ago were considered luxury goods. The near universal availability of a range of products, including household appliances (such as refrigerators and washing machines), consumer electronics (such as color televisions and VCRs), and automobiles has led to a significant rise in the real quality of life of the entire population. The recent rapid decline in the cost of personal computers and rise in the number of households owning them is the most recent example of this phenomenon. The increase in the overall quality of life that results from improved access to such products is not measured well by the data on prices and the distribution of income.

- Fourth, because the data on income distribution represent a static look at the relative incomes of different strata of the population, they give a misleading picture of what is actually happening to real people. For example, a student in 1980, working part-time while in school, would appear in the data as a low-income worker. In the 1990 data that same (former) student might be working fulltime, making a good salary, and would appear in a higher earning strata of the income distribution. This worker is clearly significantly better off in 1990 than in 1980. However, there is nothing in the data used to assess what is happening to the income distribution that sheds light on the extent to which people move between different income strata or how the income of real people has actually changed.

Hence, the debate over the relationship between the distribution of income and trade is flawed by the inaccurate measures of what has happened to real income in the United States.

Economic research on the impact of trade on the distribution of income

Research by the economics profession has found that trade is not a significant cause of changes in the distribution of income. That research points to other factors, most significantly the introduction of new technology, as the primary cause of the reported changes in relative income. Other causes identified by the research include declines in the extent of unionization, decreases in the real minimum wage, the growth of services employment, and the existence of greater immigration.

The substantial body of quantitative economic research concludes that factors other than international trade account for almost all of the reported adverse change in real wages and the income distribution[12] up to the mid-1990s. In particular, these studies have found that increased business use of technology leads to greater wage gains by skilled workers and leaves low-skilled workers relatively worse off–even if their jobs remain. As noted in Chapter 2, increased investment in information technology has contributed to economic growth. However, this situation has also increased the skill requirements for workers and, in some cases, led to the elimination of some jobs. Estimates of what share of the increased inequality of incomes can be attributed to technology vary, but generally the estimates find that about one-half of reported increased wage inequality is attributable to the greater use of technology. For example, the 2000 edition of the Occupational Outlook Handbook presented this outlook for metalworking machine operators:

> *One of the most important factors influencing employment change in this occupation is the implementation of labor-saving machinery. In order to remain competitive by improving quality and lowering production costs, many firms are adopting new technologies, such as computer-controlled machine tools and robots. Computer-controlled equipment allows operators to simultaneously tend a greater number of machines and often makes setup easier, thereby reducing the amount of time set-up workers spend on each machine. Robots are being used to load and unload parts from machines. For these reasons, the lower-skilled positions of manual machine tool operators and tenders are more likely to be eliminated by these new technologies because the functions they perform are more easily automated. The spread of new automation will lead to rising employment, however, for NC [numerically controlled] machine tool operators.* [13]

The elimination of low-skilled jobs, which has taken place in many occupations, may also be seen in the changes in the increased differential between the wages of more- versus less-educated workers. The differential between college and high school graduates, according to several studies, has grown. For example, in The State of Working America 2000-01, Lawrence Mishel, Jared Bernstein, and John Schmitt estimated that this "college premium" grew for both men and women between 1973 and 1999 (see Table 3.1).

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[12] The analytical literature on these issues is summarized in two papers prepared for the Commission: David Blanchflower, "Globalization and the Labor Market" (Hanover, NH: Dartmouth College, Sept. 2000); and Edward Wolff, "Trade and Inequality: A Review of the Literature" (New York: New York University, June 2000). These papers are available on the Commission's Internet site, http://www.ustdrc.gov, and on the CD-ROM included with the printed copies of this report.

[13] "Metalworking and Plastics-working Machine Operators," in the U.S. Bureau of Labor Statistics 2000-01 Occupational Outlook Handbook at http://stats.bls.gov/oco/ocos224.htm.

Table 3.1:
Estimates of the "college premium": Differences between college and high-school educated workers, 1973-99

(percentages)

	Men	Women
1973	25.3	37.7
1979	20.1	26.5
1989	33.9	41.0
1995	37.1	46.7
1999	42.4	48.3

Source: The State of Working America 2000-01, p. 145

A pattern of greater rewards for education can also be seen in the changes in real hourly wages for workers with different levels of education. In The State of Working America 2000-01, the authors report that workers with college or advanced degrees saw wage growth over the past three decades, while those with high school or less saw slower growth (and, for many years, declining wages). Table 3.2 illustrates the changes in workers' hourly wages, 1979-99, with workers grouped by their education.

Table 3.2:
Changes in real hourly wages for all workers by education, 1979–99
(annual percentage change)

	Less than High School	High School	Some College	College	Advanced Degree
1973-79	-0.1	-0.4	-0.6	-1.1	-0.9
1979-89	-1.7	-0.9	-0.4	0.3	0.8
1989-99	-1.0	0.0	0.0	1.0	0.9
• 1989-95	-2.1	-0.8	-0.8	0.1	0.5
• 1995-99	0.8	1.1	1.1	2.3	1.6
1979-99	-1.1	-0.5	-0.3	0.2	0.5

Source: The State of Working America 2000-01, p. 153

Technological innovations and educational differences, however, do not provide a complete explanation of wage dispersion. Other, but less significant, reasons that labor economists cite for the reported decline in real wages for less-skilled workers and the increase in wage inequality include the growth in the share of the workforce employed in services industries, declines in unionization, and declines in the real minimum wage.

Increased services employment may contribute to income inequality for several reasons. First, services encompass an extremely wide array of skill levels, from highly skilled professional and managerial jobs to lower-skilled clerical and manual work—thus, there is a greater opportunity for dispersion of incomes. Second, unionization has traditionally been lower in services than in manufacturing and extractive industries, and unionization has generally tended to reduce wage and income inequality.

For a variety of reasons, the share of workers in the U.S. economy who are members of unions has declined. The decline of the unionized share of the workforce has been dramatic in the 1980s and 1990s. In 1954, for example, 25 percent of workers were members of unions. In 1979, this number had fallen slightly to 24 percent; but in 1999, only 14 percent of workers were union members. Some studies suggest that some share of reported increased inequality can be attributable to this decline in unionization since unionization tends to lessen wage dispersion. Other research points to a link between international trade and globalization and the decline in unionization.

In sum, the research of the economists that we reviewed concludes that increases in international trade have been at most a minor contributor to the reported adverse changes in wage and earnings inequality. However, as discussed, trade has played an important role in reducing inflation and enhancing opportunities for better jobs. Hence, it is our view that the supposed role of international trade in the rising inequality in U.S. wages is illusory.

Conclusions

International trade has brought and continues to bring considerable benefits to the United States and its citizens, including access to a wider array of products and services and opportunities for high-wage jobs. The pressure of international competition has spurred domestic companies to improve their efficiency and productivity (including a higher quality of output) in order to improve their competitiveness. The competitiveness of U.S. industry has also benefited from access to lower-cost and/or higher-quality inputs. International trade has enhanced our standard of living. Any policy response to trade and current account deficits should not undermine those benefits, just as it must also recognize that these deficits are largely the outcomes of our strong economic growth (as Chapter 2 explains).

Nevertheless, international trade and other aspects of "globalization" bring change to the U.S. economy, to businesses, and to workers. While the dynamic nature of the U.S. economy and our ability to both create and eliminate jobs have each helped to generate our current prosperity, these factors have led to adjustment costs and also contributed to increased worker insecurity. Technological innovation, trade, and other factors have led to the decline of some firms and industries and the growth of others. In this process, some workers and communities have enjoyed substantial gains, while others have not. The great bulk of empirical research shows

that the contribution of trade to adverse movements in the wages of lower-skilled workers and the distribution of income is far smaller than widely thought. Trade gets blamed for far more than its limited effect on wages and income distribution.

The challenge to policymakers is to develop courses of action that help those who are hurt without doing far more harm to the much larger number who benefit from the international marketplace. Part of that challenge is developing more effective adjustment assistance, especially education and retraining, enhancing the availability of health insurance during extended periods of unemployment, and improving the flexibility of the U.S. labor market. (Chapter 5 addresses these issues.)

Looking to the long term, providing broad-based, high-quality education for the U.S. labor force is of paramount importance. One clear observation stands out from the studies we have reviewed. Over the past twenty years, the real wages of U.S. workers with advanced education have steadily risen, while real wages of workers with a high school education or less have not. For the American workforce to be able to achieve a higher standard of living, this country needs much more ongoing and successful high-quality education for the segment of the population whose education now stops with high school, or earlier.