

# THE PROBLEM OF LIBERAL ELITES PART 2 ON TRADE

Paul Krugman begins his 1993 defense of NAFTA by insulting its opponents gratuitously and wrongly. Then he offers the readers of Foreign Policy the defense of trade treaties they love.

The truth about NAFTA may be summarized in five propositions:

- NAFTA will have no effect on the number of jobs in the United States;
- NAFTA will not hurt and may help the environment;
- NAFTA will, however, produce only a small gain in overall U.S. real income;
- NAFTA will also probably lead to a slight fall in the real wages of unskilled U.S. workers;
- For the United States, NAFTA is essentially a foreign-policy rather than an economic issue.

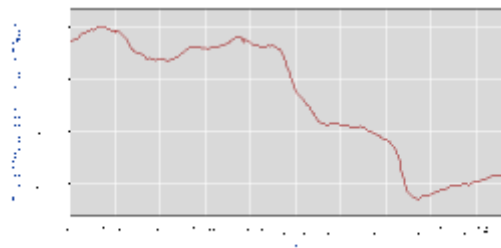
NAFTA won't affect the number of jobs, says Krugman, because the only important factor driving number of jobs is interest rates set by the Fed.

Moreover, it is a choice that responds to economic conditions; the decision to raise or lower interest rates represents a trade-off between the Fed's desire to raise employment (drive somewhere) and its fear of inflation (a speeding ticket). ...

Suppose that NAFTA really does lead to a rise in U.S. imports from Mexico, one that would, other things being the same, reduce U.S. employment by 500,000 over the next ten years. Will other things actually be the same? Of course not. The Fed, faced with the prospect of a weaker

economy, will set interest rates lower than it otherwise would have. Conversely, other things being equal, if NAFTA would add half a million jobs, interest rates would be higher. The Fed will, without doubt, miss the target-but it is as likely to overshoot as to undershoot, and over the course of a decade there is no reason to suppose that the average level of employment will be any different with NAFTA than without.

How did that work out? It seems to be true that the overall impact of NAFTA on employment was neutral, though not necessarily for the reason Krugman gave. See, for example this chart showing all manufacturing (definition) jobs for the period 1987 to the present, from the Bureau of Labor Statistics:



Formulating the issue in terms of total employment, by sector or otherwise, fails to answer any of the crucial questions. What was the effect of NAFTA on communities where the factories were closed? What kinds of jobs are the new ones? How do those jobs meet the needs of workers for income, financial security and job satisfaction? What happened in specific areas? Were the results the same for Los Angeles and for Celina, Tennessee? What happened to the losers? Who profited? Aggregate studies hide the real impact of trade treaties in exactly the way that they miss the point of the farmers' anger as I discussed in this post.

So, here's a story. My law partner was a Bankruptcy Trustee in Tennessee; he was assigned

to handle all the cases from the area around Cookeville, TN. In the mid to late 1990s, he was called to deal with an emergency bankruptcy of a cut and sew plant in his area. This is a company that has machines to cut fabric to a pattern and sewing machines; the workers cut the cloth and sew it into clothes. In this case, it was blue jeans. One Friday after work, trucks pulled up to the factory, loaded all the machines and office equipment and moved them to Mexico. They left behind several pallets of completed jeans, which needed to be secured and sold. The workers were not paid. The jeans were "hot goods", and became property of the US Department of Labor, which hired the Trustee to sell them and distribute the funds to the workers so they got partial payment. The secured creditors and general creditors got nothing. It was about that time my partner reported that one of his cases was a 35 year old guy with few teeth, which, his lawyer said privately, was the result of heavy meth use. That was only the first such case.

Perhaps Krugman would be surprised to learn that the Fed did not intervene to create new jobs in the Cookeville area. How exactly would that happen? Workers who lose their jobs burn up their savings or live off their friends and relations and churches, or on credit cards or the safety net until they get back on their feet. Many don't. Trade economists like Krugman don't count these and related losses when they run their computerized models. Most people don't care because they get cheaper jeans. All the discussion, all the studies of NAFTA, ignore these and many more localized effects.

Krugman admits that if the job losses were very large, his model might not work. Even if the impact of NAFTA on manufacturing jobs was small, that isn't so with China. Recent studies say that imports from China might have resulted in 2.4 million jobs lost between 1999 and 2011. Is that enough to upset Krugman's certainty? How many millions of jobs never happened here because US corporate executives exported US-made knowledge, US-generated capital, and frequently

entire US factories to other nations. Computer chips and other high-tech equipment weren't invented in Taiwan or China or Japan, but they got the advanced manufacturing jobs, not the citizens of the US whose hard work laid the groundwork for creating those valuable assets. Worse, the corporate executives arranged to duck US taxes on their profits. Their refusal to pay taxes leads to the further deterioration of conditions in the US.

Krugman knows this. His Nobel Prize was for his demonstration that "national location of specialized production is indeterminate; there will be specialization, but how it is distributed across countries cannot be determined ex ante", as a correspondent explained it to me in a private email. The policy of Asian nations is to grab those manufacturing operations by any means necessary. The US, dominated by single-minded free marketeers, doesn't have an industrial policy, or a safety net, for that matter. It relies on some magic and undefined "market" to fix everything.

Congress won't lift a finger to help the people of Cookeville. Liberal elites, like Krugman, tell us everything will work out fine. On average.

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