

Interview with Mireya Solís, Philip Knight Chair in Japan Studies and Senior Fellow of the Center for East Asia Policy Studies, the Brookings Institution

Free Trade Remains a Hope for Keeping the Global Economy on the Right Track

By Japan SPOTLIGHT

International trade and investment is a locomotive for maintaining global economic growth. How to consolidate trade and investment growth globally is a crucial issue given the need to reduce volatility in the world economy and turn it onto a stable and sustainable track. Dr. Mireya Solís is one of the leading experts on trade policy at the Brookings Institution, a think tank in the United States. *Japan SPOTLIGHT* had an occasion to interview her on her observations and views on what is happening in international trade and what can be done to establish a secure future for the coming generations.

Assessment of Recent Trade Policy Developments

JS: How do you assess the recent surge of protectionism?

Solís: Clearly we are not back to the 1930s, and have strong safeguards against a backlash because of the disciplines of the World Trade Organization. We are witnessing what experts refer to as creeping protectionism: the use of under-the-radar measures, such as anti-dumping and countervailing subsidies, that restrict trade. This has been the case since the global financial crisis, but if you look at the latest IMF reports on this, in the past three or four years there has been a resurgence. And this is very worrisome, because it comes at a moment when international trade does not look robust. It has experienced a major slowdown in the last few years, and there are many factors behind this. Clearly the weakness of global demand is part of it, but it is also that governments feel tempted to resort to these measures. So it is becoming a problem: trade has always been an engine for growth and development, and given the track record so far, and the possibility that things could get worse because of the rise of populist politics, this is obviously of great concern.

With respect to the rise of populism I think there are many different factors, but one that stands out is the rise of income inequality in the industrialized nations. In the US, we have had a period where the top income segments of the population have done well and have benefited from globalization, but people at the bottom do not feel that is the case. Now, trade is a very small factor behind increasing income



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inequality, and is not producing a mass of job losses of any kind; if there is one factor behind this change, it is technology. But in the debate in the US people often reach the conclusion that it has to be because of trade. And we have politicians that manipulate that sentiment to fuel those anxieties and say that turning towards protectionism will solve the problems, in some way turning the economy back to what it used to be. We know that is not possible, and would actually damage people dependent on export-oriented jobs, and damage consumers as well, since the economy has shifted so much structurally that those low-skill jobs would face a very uncertain future. Providing for the livelihood of these people would require a very different set of measures. But politically what resonates is the message that it is the fault of other countries not playing fairly, or that if we only protect our borders then we will be better

off. What makes this mix particularly potent is that combination of anti-immigration and anti-trade: it is really anti-immigration sentiment that generates most passion, but it also provides a common denominator in this sense that we need to board ourselves off, to not be an open country, and to fear diversity and plurality.

JS: Would the fear that foreign direct investment could lead to a hollowing-out of industry be a legitimate concern for advocates of protectionist policies?

Solís: This is a long-standing debate: the question of whether, if a company invests in another country, it means it has not invested at home and thus that the job creation and production activities went

overseas. But it depends on the kind of investment, the industry and so forth, and there is a very substantial amount of research that shows that frequently the companies that invest overseas are also creating jobs and investing at home. What they are usually doing in the case of industrialized countries is keeping the high-value-added end of the production process in industrialized countries, such as the research and development activities, and then they invest abroad and parcel out the other stages of production to reduce costs. And this allows them to keep up with international competition and to keep the jobs they provide in the industrialized world. I know in Japan there was a huge debate about hollowing-out after that major wave of investment in the 1980s, and we also had a debate like that here in the US because of NAFTA, but by and large I think all indications are that investment can be win-win for both home and host countries.

Trade Adjustment Assistance

JS: In light of emerging protectionist policies and anti-globalization sentiment, would you see trade adjustment assistance as a relevant policy?

Solís: I think the spirit of it is very relevant. What we have seen play out in this election season is the fact that we do not have the appropriate domestic measures to allow workers to cope with economic change. I have a book coming out early next year titled *Dilemmas of a Trading Nation*, and one of the issues it looks at is precisely the performance of the trade adjustment assistance program in the US. I think that we really should think about overhauling it. That does not mean I am advocating doing away with the system; on the contrary, I think the system has been ineffective, and we should think again about how to develop a safety net for American workers. There are many countries whose economies are heavily dependent on international trade; in Germany for example it accounts for 80% of GDP, but there this is not a jobs debate, because the country has a good set of labor adjustment policies that allow workers to deal with difficult conditions. We do not have that in this country.

As for how we should reform the system, first of all, it should not just be directed at workers who lose their jobs because of import competition. That is just a subset of workers, and again, most workers in the US that operate in the low-skill segment are losing their jobs due to the move towards labor-saving technology such as automation, artificial intelligence, 3D printing, you name it. And these people probably will react by scapegoating trade even though their jobs were lost because of more structural forces. We need to provide them with the resources to be able to adjust, and that should be a safety net for all displaced workers.

The second thing we have not done in this country is to provide substantial skill acquisition opportunities. Trade adjustment assistance has not achieved that: the track record shows some workers gaining exemption from the requirement to receive training, and therefore they are receiving the added benefits but not the skills, and that did not equip them with the tools they needed to then find a new job. Another

element of some importance is wage insurance, a reaction to the fact that many people, on finding a new job, find it at a much lower salary, and therefore they do not take the job and stay unemployed. Wage insurance is a temporary subsidy so that they can find a job, do not suffer a major erosion in their earning power, and then either progress in that job or find a better opportunity.

And another issue is something that has really changed in the past few years: that we used to think of the US as a country of great flexibility in its labor market responses, and of great geographical mobility. We have found that people are not geographically mobile as they were in the past, and there is not enough relocation assistance in the existing trade adjustment assistance program. So we need to find ways to enable people to re-invent themselves, relocate, re-train; that is the kind of program we do not have and urgently need to complement our international openness.

Effective Presentation of Free Trade Merits

JS: How might we better explain the merits of free trade to those who are losing out from it?

Solís: We need to provide a means of adjustment and transitioning. But we also need to drive home the point that a lot of the changes these people are experiencing are to do with more fundamental forces; even without trade liberalization many of those people are in sectors that are facing structural decline, as is the case with some segments of Japanese agriculture and for low-skilled manufacturing jobs in the US. Identifying what is driving the change is very important, so that people understand that even if they forgo trade and all of the gains from it, they will not be going back to the golden old days because their economies have kept moving. We do need to embrace this change because it makes economies wealthier. And of course we need to address the pains of the losers, and adjustment assistance should be provided, but we should not lose track of the fact that we should also have genuine liberalization and modernization, and that it is important not to block the gains that come from these changes. And in drafting that adjustment policy, again, it should be about enabling the transition, giving those people a new future. It should not be about



Photo: The Asahi Shimbun

TPP meeting during the APEC Summit in Lima, Peru on Nov. 19, 2016

trying to block economic change by other means, because at the end of the day that change will continue to happen, because it is driven by structural change in the economy, but also because we will all be worse off if we try to use other means to block liberalization.

JS: How do you see the role of think tanks like the Brookings Institution in studying and making the case for free trade?

Solís: There has been a concerted effort by many think tanks, and a wealth of research, to disseminate objective information about the merits of trade agreements. The problem is that we now appear to be at a time where people are doubting the experts. It is really troublesome. We can provide all these analyses, these studies are out there, but as I wrote in a recent policy brief on trade and the US election, the traditional argument in favor of trade agreements does not resonate today. It does not resonate because we are living in a period of increasing income inequality, and because people are still reeling from the hardship of the global financial recession. We are on a recovery path, but the memories of the millions of job losses are still with us. Add to that the experience of the US in trade with China, which has received tremendous attention in this country, with many people saying it was such an unfair competition and we lost so many manufacturing jobs to China.

So the notion that trade has been a losing proposition for the US has gained traction. But while we have to highlight that gains far surpass losses, we also have to engage those fears head-on, not dismiss them with the notion that we are all better off at the end of the day. We have to set those people at ease and address each one of their concerns. So for example, on the China trade shock, the debate also has to factor in the gains for the US from exports to China, the gains to consumers, and that though we lost jobs in manufacturing, imports from China actually helped job creation in non-manufacturing sectors. That message does not carry through.

Another message we need to address is that for a long time, the message was that in the long run the economy comes back to equilibrium and therefore we should not think about jobs as a main consequence or focal point when discussing trade. But though that is what economists think, it is not what the public thinks: in the mind of the US public, there is no other issue more important than jobs. So what I did in this policy brief is say, let us have this debate on trade focused on jobs, because that is what people want to talk about. Let us make the case as to why trade creates more jobs than it destroys; why trade creates better jobs; why we have real issues unrelated to trade that are preventing people from accessing existing jobs – it is really quite remarkable that as of today, there are about 5 million jobs in the US that are going unfilled even though the openings are there. That has to do with the skill gap and market rigidities. So people are complaining about losing jobs to China when in fact we have jobs that are out of reach for people that would like to have them. That is the kind of research that we need to be in sync with the issues that are of true concern to the public, and I think that requires a re-tuning of our

case for trade.

JS: Do you think the argument that FTAs serve not only economic interests but also political interests would be a convincing argument in their favor?

Solís: I think it has resonance with people and resonance in Congress. It is important that these trade agreements should first and foremost be judged by their economic outcomes, and that there is a very strong case to be made just on that dimension. But it is also important to realize that these trade agreements have become part of American foreign policy and do have real political considerations. I do not think it wise to portray this as a message of a new advance, that if we do not do it then China will take over. But perceptions matter, and if we are seen as functionally unable to get this agreement through domestically, that has to hurt our international standing. That I think is the cost we will pay.

Structural Reform to Promote Trade Liberalization

JS: How do you think negotiations on FTAs could be restarted or encouraged? Might it be helpful to promote discussion of structural reform simultaneously with trade liberalization?

Solís: I think so, because that is in many ways the intent of the liberalization effort. It is about enhancing the productivity of an economy, making it more competitive, and these trade agreements not only provide the incentive of giving expanded market access abroad, but are also about addressing domestic weaknesses. There is a long-standing issue in trade liberalization, that many countries use free trade agreements to advance their own domestic reforms. For example, the case of Mexico in NAFTA: one of the clearest cases of a country that saw that its own economic model had reached its limit, that it needed to shift gears fundamentally, and that trade liberalization was going to be an essential component of this. I also think that the current policy of Abenomics in Japan shares this program of economic revitalization. And one of the most powerful things that these agreements provide is credibility, reassuring us that each government is truly serious and committed to delivering on its reforms. This helps a great deal by giving assurances to the market and other players that this is about transforming the domestic economy as well.

Sectoral Liberalization Efforts Rather Than FTA

JS: With delays to FTA negotiations like the TTP or TTIP, might it be effective to promote sectoral agreements such as on IT, e-commerce or the environment?

Solís: Well I think it is all hands on deck, if you will, and we should have a multi-track policy to pursue liberalization through different vehicles. So if these sectoral agreements can move forward, that is good news, especially if the trade agreements are significantly delayed. Some of these sectoral agreements are also facing difficulties to be quite frank. I am thinking of TiSA, the international services agreement: some groups that have been very vocal and significantly delayed the TTIP, especially in Europe, are very much now setting their eyes on TiSA. And some of the things they dislike about the behind-the-border agenda are concerns that are also going to be pressing in those negotiations. So I would not assume that sectoral agreements are necessarily going to be easier. I think we have now a significant anti-globalization backlash that is going to manifest itself on different fronts. We should continue to pursue these agreements, as they stand to provide significant benefits, but we also need to keep focused on overcoming the anti-globalization backlash, because that is going to be the common denominator affecting the fate of every other initiative we pursue that involves behind-the-border issues.

JS: What do you think about the current status of the WTO? Could it be coming back to play a key role in trade liberalization again?

Solís: I certainly hope we could revive the WTO. I think a more robust multilateral trading regime is essential. But I am not sure yet that we have come up with a solution to the problems of the WTO that have produced so much negotiation deadlock. I think it is inescapable to reach the conclusion that the Doha Round is de facto dead, which means it is the first time that we have failed to substantially wrap up a multilateral round of negotiations that were in play for so many years. Its progress in trade facilitation is very important, but in many ways that is a low-hanging fruit. The question is, can the WTO generate membership-wide trade agreements that deal with rules not just on facilitation but on all those issues that are covered in the mega-regionals, such as intellectual property, state-owned enterprises, the digital economy and so on, while adhering to its multilateral ideal?

I think that is extremely difficult because the WTO is a very large organization with 164 members, which operates on the rule of consensus, has adopted the principle of the single undertaking, and has a very well-functioning enforcement mechanism that means countries are going to be very careful about what commitments they undertake, because they are going to be enforced. So I just do not see how to untangle the negotiation knot at the WTO. What we are really seeing in its place is the spread of what we call variable geometry arrangements: plurilateral agreements when a group of countries decide they want to pursue an agenda or issue further.

But can the WTO go back to actually providing across-the-board liberalization commitments? That is an open question, and for a multilateral regime it is a fundamental one.

Photo: The Asahi Shimbun



The closing ceremony of the WTO's 10th Ministerial Conference in Nairobi, Kenya on Dec. 19, 2015

Assessment of Future Trade Liberalization

JS: Finally, how do you assess the future of trade liberalization overall?

Solís: Unfortunately I am pessimistic. I think we are at one of the most difficult junctures we have faced. The election of Donald Trump as president of the US suggests there will be major changes in US trade policy in the next few years. He has announced he will send a letter of intention to withdraw from the TPP on Day 1 of his administration, and we will be watching to see if he delivers on his other promises to renegotiate trade agreements or impose punitive tariffs. Coming out of the election, it is very worrisome to have a country like the US have the kind of debate it has had on trade; I think what you hear reflected in that debate does not capture where the American public by and large is. Opinion polls show that the vast majority of Americans have a positive view of trade, but it is also true that a very vocal segment of the American population feels the economic rules are unbalanced and that they are not benefiting, and that is what we need to address if we want to recreate a domestic consensus. So trade liberalization has advanced to a level where it has become indispensable to cultivate the politics of openness at home, because the line between what is international and domestic is blurring. But we have low growth, and are still recovering from the global financial crisis; people have been hurt by these economic tribulations and they are defensive. These mega-regional trade agreements have been a sort of great experiment, a test of whether we have the instruments to move forward or not. Without their success, the domestic incentives or the political leadership, the future becomes very clouded, and I do hope we can shift course. A lot of it requires action on the domestic economic and social policy front.

JS

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