# Commentary: Factors Driving Global Economic Integration

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This is a wide-ranging paper that gives us a very big picture of a very big subject—the factors driving global integration. The scope of Michael Mussa's paper is impressive, as it touches upon the international transfer of noodle technology, the development of port wine, and the origins of the sugar beet, while also bringing Thucydides, Napoleon, and Lincoln into the analysis. The latter reminded me of the apocryphal story in which Lincoln is reputed to have said: "I do not know much about the tariff, but I know this much. When we buy manufactured goods from abroad, we get the goods and the foreigner gets the money. When we buy the manufactured goods at home, we get the goods and we keep the money." (Taussig 1914, 1915). If Mike had served on a Council of Economic Advisers in the Lincoln administration, I am sure that—for all of his tact and restraint—he would not have failed to respond: "Mr. President, of all the words that you have spoken, only the first eight are correct: 'I do not know much about the tariff.'" He then would have proceeded to set him straight on the issue of trade policy.

Mike organizes his discussion of increasing economic integration around three primitives: tastes, technology, and policy. He will get no argument from me that all three have been contributing and interactive factors in the recent wave of globalization. In elaborating on this theme, however, Mike has touched upon so many topics that he has created a veritable feast for any discussant. I will try to restrain

myself from overindulging and elaborate on just three points, all of which have to do with trade integration rather than capital market integration, which is the subject of later discussion at this conference. My three points are: (i) that policy has played a distinctive and complementing force to technology in shaping U.S. trade flows in the 1990s, (ii) that public support for increased integration appears to depend partly upon whether technology or policy is the driving force behind that integration, and (iii) that the resistance to policy initiatives to spur further integration reflects, in part, the economic interests of a solid but perhaps shrinking fraction of the American public.

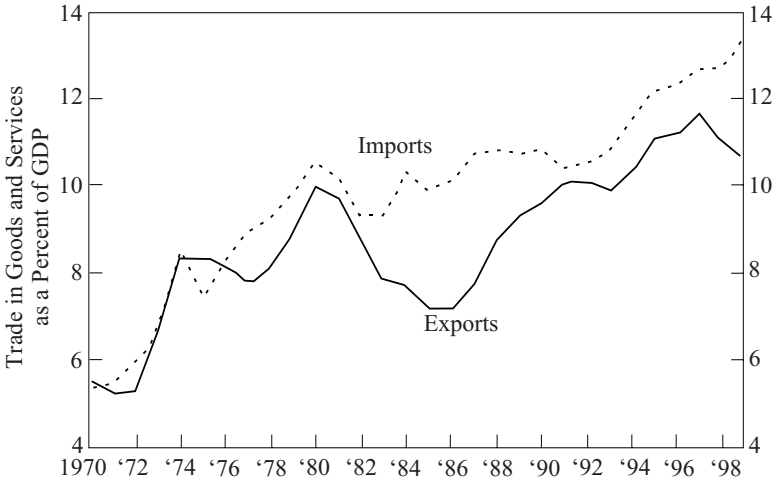
**U.S. trade flows in the 1990s**

My first point is that policy has been a distinctive and complementary force to technology in shaping U.S. trade flows in the 1990s. The standard way of illustrating the importance of international trade in an economy is to examine the ratio of trade to GDP.

Chart 1 presents the evolution of U.S. exports and imports of goods and services as a percent of GDP from 1970 to 1999. The rise in these ratios has not been linear over the past thirty years. Rather, there are two large, discrete jumps in the trade to GDP ratio, one in the early 1970s and another in the late 1970s, that coincide with big increases in world oil prices. The big increase in the U.S. import bill, as a result of this price increase, (recall that mineral fuels accounted for nearly 30 percent of U.S. imports by value in 1980) manifests itself in a rise of the import to GDP ratio. But those imports must be paid for with something, and the export ratio, therefore, rises as well—in both cases brought about by a depreciation in the value of the dollar.

Through the 1980s, however, the trade ratios are relatively flat: Imports as a share of GDP were roughly the same in 1993 as they had been in 1980, and exports were recovering from the hit taken by the strong dollar in the mid-1980s. Only after 1993 is there a continuous upward trend in the ratio of imports to GDP and (until recently) the ratio of exports to GDP. Much of this increase in the trade ratio can be attributed to increased integration in North America, fueled first by the U.S.-Canada Free Trade Agreement in 1989 and then the North

**Chart 1**
**U.S. Exports and Imports of Goods and Services as a Percent of GDP, 1970-1999**




Source: International Trade Administration, U.S. Department of Commerce, http://www.ita.doc.gov/td/industry/otea/usfth/aggregate/H99t05.txt.

American Free Trade Agreement (NAFTA) in 1994. In fact, the steady rise in the U.S. import share since the early 1990s is largely due to trade between the United States and its NAFTA partners. Comparing 1993 (the year before NAFTA took effect) to 1999, the share of U.S. merchandise exports destined to NAFTA countries rose from 30.5 percent to 36.4 percent of total exports, while imports from NAFTA countries rose from 26.0 percent to 30.1 percent of total imports (www.ita.doc.gov).

Much of this increase in recorded trade is intermediate goods at various stages of production passing back and forth across the U.S.-Canada and U.S.-Mexico borders, getting recorded by customs officials at ever higher values due to the incremental processing that takes place in each location. Indeed, the most pronounced shift in the composition of U.S. trade in recent decades is the rise of trade in cap-

ital goods components. In 1980, 13 percent of U.S. merchandise imports consisted of capital goods; in 1999, over 30 percent of U.S. merchandise imports consisted of capital goods. (Capital goods are defined as machinery, equipment, parts, components, and accessories, excluding automobile parts, which have also loomed large since the U.S.-Canada Auto Agreement in 1965.)

Thus, the big rise in the U.S. import share in the 1990s may be a bit of a statistical illusion. More recorded trade does not necessarily mean more economic activity, just that the activity is being split up and is now crossing national borders. This is what has been variously called "outsourcing," "vertical disintegration," "vertical specialization," "slicing up the value chain," etc. (Hummels, Rapoport, and Yi 1998). The auto industry provides a leading example of this "vertical specialization"—near complete vertical integration has given way to substantial trade in components that criss cross borders within the greater NAFTA area and get counted by customs officials each time they pass by.

NAFTA almost certainly accelerated this process, and it is, therefore, likely that technology and policy have played complementary roles in increasing North American integration. Of course, we do not know the counterfactual: Perhaps the maquiladora trade with Mexico would have boomed even in the absence of NAFTA. Yet we know from empirical gravity equation models that preferential trade agreements such as NAFTA usually have a major impact in shaping bilateral trade flows.

**Technology or policy?**

My second point is that public support for increased integration appears to depend partly upon whether technology or policy is the driving force behind that integration. The issue of whether increased integration has been driven more by one factor than the other may at first seem purely academic. As long as both are pushing in the same direction of greater trade flows, what difference does it make?

Economists do not know the precise degree to which recent trade

integration has been policy-driven or technology-driven, but it appears that the public views the difference as important. A study of American public opinion polls regarding trade finds an interesting dichotomy. There is strong public support for international trade when it is described broadly and without reference to trade policy. According to one fairly representative poll taken in 1996, nearly 70 percent of Americans believe that trade is good for the U.S. economy.

However, when the public is asked about specific trade policy initiatives, whether it is NAFTA, the WTO, PNTR for China, or Fast Track, the degree of support is substantially less (Slaughter and Schieve 2001). The implication is that the American public appears to be willing to accept increasing trade in the abstract, driven by the anonymous force of technology but much less willing to support integration driven by trade policy initiatives. This is consistent with the finding that the public appears to care strongly about jobs destroyed because of imports but not particularly care about jobs destroyed due to the invisible hand of technological change.

Mike does not think that conditions are ripe for a return to isolationism, and I would agree. Although increased integration harms the economic interests of certain groups, it also creates countervailing groups that have a stake in sustaining open markets. Direct investments and international diversification by domestic producers in such sectors as automobiles and semiconductors have also muted pressures for protection against foreign competition. And despite public skepticism about NAFTA and other trade agreements, protectionism today is a difficult political sell. In 1895, Theodore Roosevelt wrote to Henry Cabot Lodge, "Thank God I am not a free-trader. In this country pernicious indulgence in the doctrine of free trade seems inevitably to produce fatty degeneration of the moral fiber." Such talk today does not inspire much support. It is too easily countered by comments such as that made by Senator John McCain at the Republican convention that "building walls is for cowards."

**Resistance to integration**

But while protectionism may be a hard sell, further trade liberal-

ization is also a hard sell—as I am sure Mike Moore will tell us at lunch. This brings me to my third and final point: that economic interests, and not simply misunderstandings, account for much of the deep-seated resistance among some to further policy-driven integration. Some of this opposition comes from the eclectic group of noisy protesters who recently visited Seattle and Washington. But the more quiet, and in my view much stronger, opposition to trade liberalization comes from the economic interests of unskilled workers, which has manifest itself in a reluctance by Congress to press forward with new trade initiatives. Overcoming resistance to freer trade does not simply mean correcting the misperceptions of some of the more vocal protesters. The issue is not simply one of getting the right message out and selling the public on the value of the multilateral trading system. Rather, some strong underlying economic interests are at work.

Research by my colleague Matthew Slaughter has shown that individuals who are less skilled are significantly more likely to oppose freer trade than their more skilled counterparts (Slaughter and Schieve 2000). This has been confirmed in public opinion surveys. A study by the University of Maryland's Program on International Policy Attitudes (2000, p. 61) concluded that "In most cases, there were minimal variations between different demographic groups in their attitudes toward issues related to globalization. With a few rare exceptions, the majority positions in all demographic groups were the same . . . The demographic group that showed the strongest variation was education, with those at higher educational levels having more positive attitudes toward globalization and trade."

Educational attainment, therefore, appears to be the source of a major division over trade policy. It should come as no surprise that skilled workers in high technology industries have a stake in further opening world markets, while unskilled workers in textiles and apparel have sought to restrict trade. Those who lack substantial investments in human capital are precisely the individuals whose real wages have been hammered in recent decades. Even if trade is thought to account for a small part of the rise of the skill premium in the wage structure, hostility to trade agreements may be consistent with the underlying economic interests of unskilled workers. This is

simply an apparent example of the Stolper-Samuelson theorem, in which increased trade may have contributed to a decline in the relative price of unskilled labor-intensive goods and, therefore, in the factor reward to unskilled labor.

The skill and education level of the median voter is not particularly high. More than half of the American adult population has achieved no more than a high school education (Statistical Abstract of the United States 1999, p. 170). If it is in their economic interest to oppose trade-expanding agreements, then simply telling them about virtues of free trade will not diminish their opposition. It is futile to tell them that they should support freer trade when it is not in their interests to support it. Whether we like it or not, their interests have and will continue to filter through to the Congress.

The key, of course, is to have a highly skilled, well-trained, and educated workforce that will be in a better position to cope with the stresses of the global economy. Demographics are working in favor of the population attaining, on average, a higher level of education. The cohort who is age 25 to 34 years has a much higher rate of educational attainment than the older cohort who is aged 65 to 74 years — two thirds of whom achieved no more than a high school education (Statistical Abstract of the United States 1999, p. 170). Over time, this demographic shift could translate into greater political support for open trade policies. But if that happens, it will be a slow process.

In conclusion, Michael Mussa is absolutely correct that both technology and policy have been driving factors behind world economic integration. My cautionary note to policymakers is that the public views integration through technology as being quite different from integration through policy. If technological shifts are bringing about the increased integration anyway, then, in the future, policy may play a supporting rather than a leading role should the risk of a backlash become too great. If policymakers insist upon new initiatives aimed at deepening integration, those initiatives must be carefully designed and motivated if they are to have a hope of reaching fruition.

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