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The Cost of Doing Business With China

My print column this week examines the effect on U.S. jobs of the trade deficit with China. Does the massive imbalance between imports and exports cost the U.S. millions of jobs?

A frequently cited report says it has. Dozens of members of Congress signed a letter last month citing the report from the Economic Policy Institute, a Washington-based think tank, that found trade with China has cost the U.S. 2.4 million jobs.

However, some economists and China analysts point out several potential problems with the estimate, including that several countries have run up trade deficits during boom times as they invested in growth — including the U.S., where there has been essentially no correlation between unemployment and trade deficits, overall and with China. The numbers move seemingly in random ways compared to each other.

“By the logic of their argument, any country that runs a trade deficit should experience perpetual loss of jobs and wages, and any country that runs a surplus should experience perpetual gains in jobs and wages,” Arthur Kroeber, head of China research for the economic-research company GaveKal Dragonomics, wrote in an email. “Yet many developing countries run consistent current account deficits (for example South Korea during much of the 1970s and ’80s) and still experience high job and wage growth, while other countries run persistent surpluses yet have stagnant employment and wage growth (e.g. Germany and Japan).”

“Vigorous job creation and larger trade deficits are both hallmarks of strong economic growth,” said John Murphy, vice president of international affairs at the U.S. Chamber of Commerce, who has written critically about the EPI report. Scott Kennedy, a political scientist at Indiana University, said of the claims about China costing U.S. jobs, “China is just a scapegoat.”

Robert Scott, the senior international economist at EPI who produced the numbers, defends the study, pointing out that many factors contribute to economic growth rates, and it is possible for the same factor to drive down both the trade deficit and employment — such as the recession that ended last year in the U.S. That doesn’t mean that a trade deficit causes higher employment. Scott also notes that other studies, like his, have assumed that every dollar of a trade deficit displaces domestic production.

Scott Paul, executive director of the Alliance for American Manufacturing, which has posted Scott’s findings in an interactive map, said the assumption about displacement of domestic manufacturing is sensible. “There is an extraordinary amount of competition between U.S. production and Chinese production,” Paul said. “A lot of people like to assume that China is making things we don’t make here. That may be true in some areas, but it is not in others.”

Susan Houseman, a senior economist at the W.E. Upjohn Institute for Employment Research in Kalamazoo, Mich., said that Scott’s calculations make more sense than the claim occasionally made in U.S. economic circles — and, recently, by the White House — that increased productivity has backfired on U.S. manufacturing workers. Houseman has found that much of the supposed productivity gain can be chalked up to offshoring of some processes, meaning it was an artificial gain: If production is divided by U.S. workers, but others do some of the producing, U.S. workers would seem to be gaining productivity they really aren’t.

Houseman sees indirect signs that trade deficits may be driving down employment: “Job losses in manufacturing are

almost perfectly correlated with growth in import penetration," Houseman said. "It's really very striking."

Ray Fair, an economist at Yale University, prefers using his multicountry econometric model to estimate the potential effect of China's allowing its currency to appreciate — which, he found earlier this year, would be negligible in terms of U.S. employment. "This is a complicated question, where one needs a complete multicountry model to analyze," Fair said. He added, of his model, "It's been extensively tested." Of his finding, Fair added, "The trade deficit is 'affected by many things, and it is not sensible to relate, say, the U.S. deficit with China to U.S. employment,' Fair said.

Paul Krugman, an economist at Princeton University and columnist for the New York Times, wrote on his Times blog last year that his back-of-the-envelope calculation concludes China's "artificial" trade surplus is costing 1.4 million jobs in the U.S. "If China were to end or reduce that artificial trade surplus, the extra demand would find its way to the advanced countries through a variety of channels, most of them not captured by the Fair model," Krugman wrote in a statement provided by a New York Times spokeswoman.

Scott and Krugman criticize the assumptions Fair fed into his model. "In my view, there is no evidence that the effects of renminbi revaluation on prices, wealth, real wages or interest rates [in the U.S.] will be significant," Scott said.

Krugman added, "When I looked at Ray Fair's estimates, my conclusion was that he was running an exercise that didn't at all correspond to the current situation." For instance, Krugman points out that the Fed is running up against the so-called zero lower bound that may keep it from raising interest rates in response to a Chinese currency revaluation.

One thing all three of these methods have in common is that they all seek to describe the relationship between trade and jobs rigorously, with some kind of model or formula. This improves on other efforts that are based on extrapolating from individual cases of companies closing factories and moving their operations offshore, said Catherine L. Mann, an economist at Brandeis University's business school. She credited the EPI estimate for its "transparent methodology," but she said it is "one where the underpinning assumptions are not valid."

EPI's Scott "made a heroic effort given the enormous data holes" in U.S. statistics about trade, such as which industries imports are being used in, and the price of imports per unit, said Michael Mandel, a senior fellow at the Progressive Policy Institute, a moderate Democratic think tank. "I can't criticize him for the effort he made. He's answering questions people want to answer."

Alan Tonelson, a research fellow at the U.S. Business and Industry Council, an advocacy group for small businesses, said more government-collected data would help shed light on trade's impact on jobs. "I'd like every multinational company to report, what do they export, what do they import — and what do they source in the U.S., what do they source overseas," said Tonelson, who wrote about the trade deficit in a New York Times op-ed last month.

Further reading: The conservative Cato Institute and American Enterprise Institute also have criticized the EPI report. The Congressional Research Service analyzed the economic impact of China's currency intervention in a report earlier this month.

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