POLICY BRIEFS SERIES

Why the Trans-Pacific Partnership and Immigration Are Needed for the Middle Class

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HARVARD Kennedy School
ASH CENTER
for Democratic Governance and Innovation

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About the Author

David Dapice is leading expert on the economic development of Southeast Asia and has worked extensively in Indonesia, Thailand, Cambodia, Myanmar, and Vietnam. He was principal advisor to the Indonesian Ministry of Finance when this country enjoyed its period of rapid growth. He is Professor Emeritus of Economics at Tufts University, where served as Chair of the Economics Department. He has taken leave at the World Bank (as a Brookings Policy Fellow in 1976–77), the Rockefeller Foundation (1980–81), and the Harvard Institute for International Development (1990–91). He has studied the Vietnamese economy since the late 1980s, with a particular emphasis on macroeconomic issues, public investment policy, and regional development. Dapice's expertise on matters of economic policy is regularly sought by the Vietnamese government. He is authored or co-authored a number of policy studies including Choosing Success: The Lessons of East and Southeast Asia and Vietnam's Future.

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Background

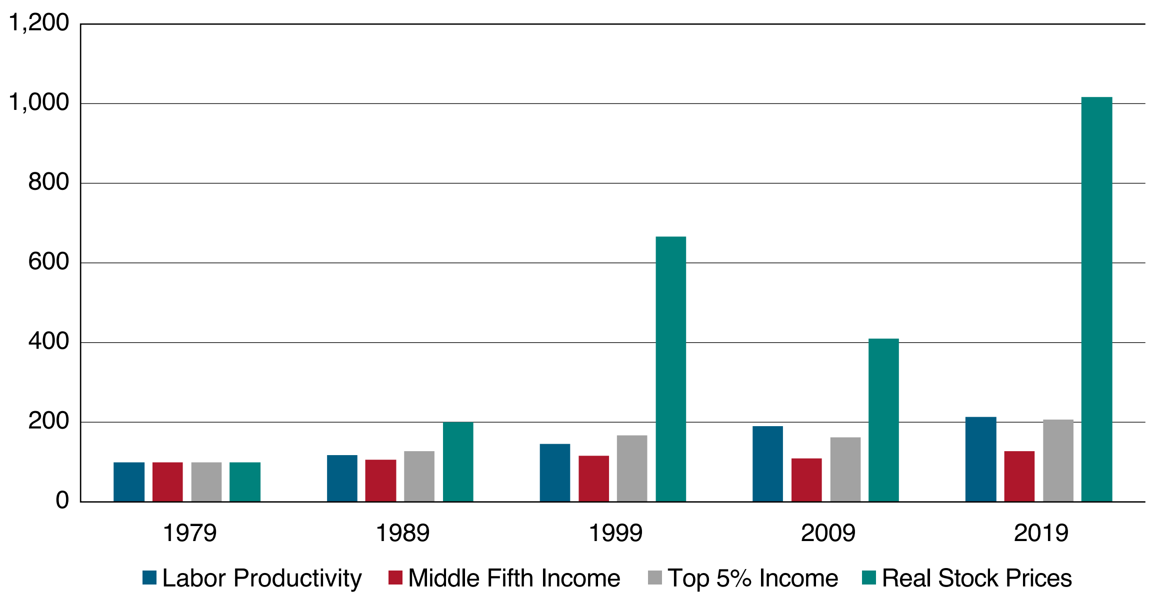
The US population aged 20–65, according to US Census projections, will grow by 355,000 a year this decade, and of that number, only 225,000 new entrants a year will likely be working and increasing the labor force. Yet, even after prepandemic employment is reached later this year or early in 2022, labor demand will continue to grow by millions of jobs far more than will be supplied by new entrants. There will, of course, be solutions. There will be more automation. The US could allow more migration, especially for those with skills that are needed. An easy solution would be to allow more labor-intensive goods, such as garments or assembled electronics, to be imported. If labor force participation rises to where it was in December 2019 when labor markets were very tight, about three million more workers will join the labor force. If these adjustments are not enough, there will be shortages and inflation, forcing the Federal Reserve to raise interest rates and perhaps cause a recession. Such a recession hurts middle- and working-class families. Avoiding a labor shortage is a priority.

The US has indicated it wishes to compete with China. Doing so effectively would require a broad approach, not simply military alliances. In particular, China has already formed a large trade bloc in Asia, and the obvious alternative—the Trans-Pacific Partnership (TPP)—was negotiated by the US but was never even put up for approval. It was opposed by Hillary Clinton during her campaign and was attacked and dropped entirely by President Trump, who disliked multilateral agreements that tied the hands of the US. Organized labor and many left-of-center politicians, such as Senator Bernie Sanders and representatives in the House, are also very skeptical of such agreements. The Biden administration seems to have little stomach to push for it, considering opposition within the Democratic Party and antagonism from the Republicans on many of his proposals. With so few friends and no obvious popular support, it would appear that any attempt to compete with China will fail even before a strategy is drawn up due to domestic politics. Given all this, it is worth asking: is the TPP actually bad for labor and the middle class?

Uneven Distribution of Gains

The basic problem with the US middle class (Graph 1) is that its real income has grown slowly and irregularly and much less than labor productivity, while stock prices exploded in real terms and incomes of the top income groups kept up with productivity growth. Between 1979 and 2019, labor productivity more than doubled as did the top 5% incomes. According to the US Census, the average real income of the bottom fifth grew 16% over 40 years; the middle fifth grew by only 27%, and the top 5% by 108% in the 40-year period. **Real stock prices of the S&P stock average grew ten times**. Since about 90% of stocks are owned by the top tenth of households, income and wealth distribution became more concentrated. Combined with sluggish real wage growth, this created a backlash against trade.

Graph 1: Index Numbers of Labor Productivity, Real Middle Fifth Income, Real Top 5% Income, and Real Stock Prices



Notes: Data points are for 1979, 1989, 1999, 2009, and 2019. Data are from "Economic Report of the President 2021" and census data for mean real incomes of middle fifth and top 5% (https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-households.html). Index of real values are constructed so that 1979 = 100. The S&P composite index of stock prices is used and adjusted by Table B-39, "Price Indices for Personal Consumption Expenditures," to get real values.

The Role of Manufacturing

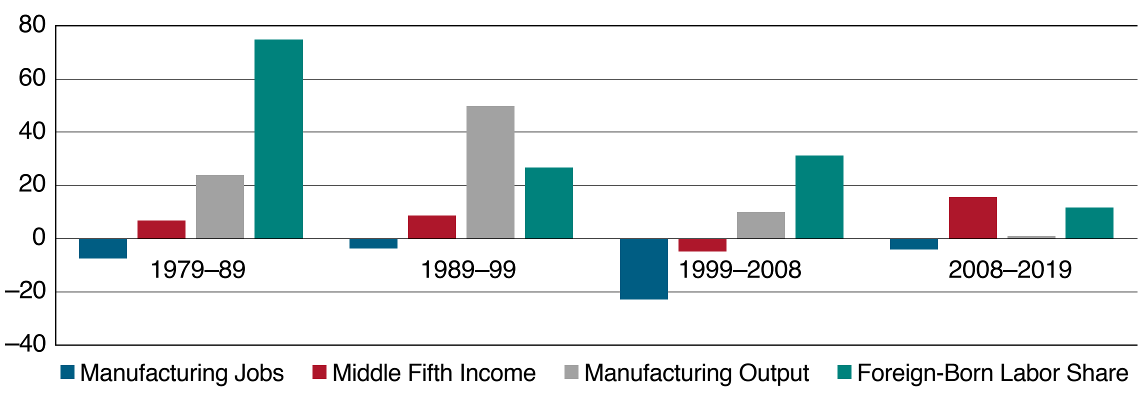
Manufacturing jobs, but not output, have been in a long-term decline since 1979 when there were nearly 20 million manufacturing workers. There were 12.8 million manufacturing jobs in December 2019 before the pandemic, yet the index of real manufacturing output more than doubled in that period.

While employment in manufacturing broadly fell from 1979 onwards, the 1989–1999 period had the smallest contraction of only 3.9% compared to a 21% contraction in 1999–2008, *before* the global financial crisis was fully felt. In general, as Graph 2 shows, there is a very erratic association between changes in the changes of real incomes in households in the middle fifth and employment or output in manufacturing. Do changes in manufacturing output drive middle-class income? One finds income growth strong when manufacturing output growth is strong as in the 1990s, but middle-class incomes also grew after the global financial crisis when manufacturing growth was near zero from 2008–2019. With manufacturing now providing less than 10% of all jobs, it is not surprising if the 2021 US economy relies more on service and construction jobs for middle-class incomes than on manufacturing.

The worst period for manufacturing jobs and middle-class income was 1999–2008. That period also showed a marked slowdown in manufacturing output, even before the 2009 plunge in real GDP and jobs. Yet the *worst* period for manufacturing output growth was 2008–2019—exactly when the US combined an expansionary fiscal policy (which tends to strengthen the dollar and promote imports) with tariffs. Middle-class income did grow well in this period. By 2019, the middle fifth of households enjoyed real income 10% higher than the 1999 level, though labor productivity in manufacturing jumped 50% in the same period and more than 46% for the entire nonfarm sector. The growth in the share of foreign-born labor in the work force similarly has a low correlation with changes in real incomes. For example, the percentage change in foreign-born labor was similar in the 1990s and the 1999–2008 period when incomes first grew and then declined. Middle-class incomes grew from 1979–1989 when migration was very high, and incomes grew more when migration was low. Since migration can both complement and compete with native workers, it is not surprising that the patterns are erratic.

It does not take much thought to explain why incomes of the middle fifth did well in the decades ending in 1999 and 2019 when unemployment was very low or did poorly in 2009 in the midst of a severe recession. In the 1990s, there was a secular boom caused by the end of the Cold War and the rise of the internet. In the later part of the last decade (2010–2019), there was fiscal expansion and easy money. Notably, there was not a boom in business investment or construction in the past few years, even leaving out the pandemic. The 2017 tax cut focused on corporations, and the wealthy had very limited real impact on new investments—many remarked on the rise of stock buybacks, mergers, and executive compensation. Yet the willingness to forego austerity after 2016 allowed labor markets to tighten, and this helped lower- and middle-income groups to benefit—though the policies on immigration may also have had an influence.

Graph 2: Percentage Changes in Manufacturing Jobs, Output, Middle Fifth Real Incomes, and Foreign-Born Labor



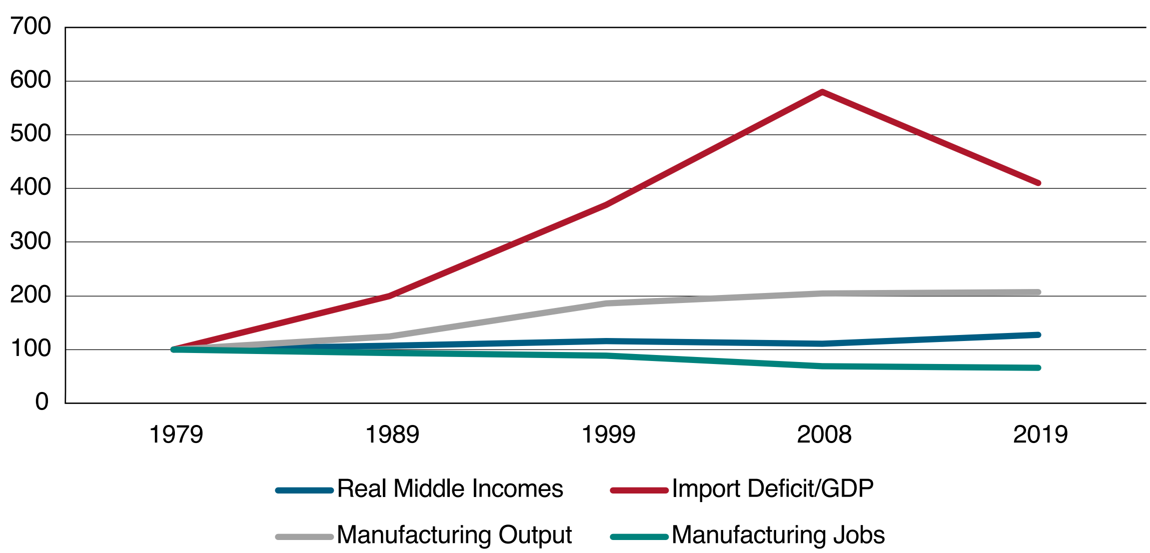
Notes: Real average incomes of the middle fifth of households are from the US Census. Other data are from "Economic Report of the President 2021" and from earlier volumes for historical data. Data on foreign-born share of labor force are found in https://www.census.gov/content/dam/Census/library/working-papers/2018/demo/2018-paa-poster-fb-labor-force.pdf and https://www.conference-board.org/pdf_free/workingpapers/E-0036-08-WP.pdf.

The Role of Imports

The decade after 1999 was extremely negative for workers—they lost real income, even if the 2009 plunge is removed. Manufacturing output growth, even to 2008, was only 10% over 1999, and manufacturing jobs took a huge hit. Graph 3 below shows these changes with the goods *deficit* in the balance of trade relative to GDP. All values are expressed as index numbers with 1979 = 100.

Graph 3 shows negative income growth for the middle fifth of households in the 1999–2008 period. The best decades for income growth were the 1990s and the period after the global financial crisis. Yet the 1990s had rapid growth in import deficits relative to GDP (nearly doubling) and fast industrial output growth, while the last decade had import deficits (to GDP) ending close to 1999 (after peaking in 2008) and close to zero industrial growth. It is not at all clear if import growth is determining or reflecting incomes or manufacturing growth. It depends on if import growth is mainly due to demand, as in the 1990s, or due to a supply shift—possibly connected to currency manipulation or other subsidies—as might be true in the decade or so after 2000. What is clear is that the mixture of tariffs and loose fiscal policy after 2017 did not bring back manufacturing jobs or output growth, at least relative to 2008. It is fair to argue that the manufacturing losses after 2000 and before 2009 were connected to the very rapid growth in imports. But it is not evident that tariffs helped claw back that ground. Even the gains in middle incomes from 1999 to 2019 amounted to only 10% in two decades. That is very slow compared to the 46% gain in nonfarm productivity.

Graph 3: Index Numbers of Real Income for Middle Fifth of Households, Goods Deficit to GDP, and Manufacturing Growth and Jobs (1979 = 100)



It is here that the critics of the TPP—which *do not* include the World Bank, US International Trade Commission, or the Peterson Institute of Economics as well as independent academics who specialize in trade—go wrong. The US already has low trade barriers. Other nations have higher ones. Bringing down trade barriers makes less difference to US import demand but helps US exports. US export jobs tend to be better paid. In addition, for many goods, tariffs only increase costs rather than redirect production to the US. The share of imports in GDP was the same in 2016 and 2019, even after the imposition of many significant tariffs. This is *not* an argument that GDP grows from TPP, though it likely would. It is an argument that the middle class would benefit from other countries opening up. What the TPP would do is make it less likely that illegal subsidies would tilt the table against US workers or have other trade barriers preventing them from selling into growing markets that others have negotiated access to.

The only hope for an effective competition with China is for enough politicians in the center to agree to look at the facts, not the mythology surrounding TPP. The US can and should help those who have been left behind—mostly from technology changes but also from trade. Running the economy "hot" and investing in training and infrastructure would help. An immigration policy that lets in the skilled people needed but does not put too much pressure on less skilled native workers also has a role, though humanitarian priorities should also weigh in the balance.

A policy package will help the middle class. It is already being put in place, but what is not yet in place is an understanding that those policies can be combined with trade deals that also help the middle class. Nor have the dots been fully connected that refusal to act on such deals means we are ceding influence in Asia to China. We should not be investing in aircraft carriers if we cannot invest in ourselves and our trading partners—and we will not do the latter sufficiently without a trade deal.

Conclusions

The best 20-year period for American workers was from 1979–1999, with strong gains in the 1990s coming after an average decade. The 1999–2019 period included the decade after the global financial crisis, where the middle-income gains were big but from a depressed base. The two decades after 1999 resulted in zero real income growth for the bottom fifth and only 10% growth for the middle fifth. Even the top fifth of households had income growth less than half as fast from 1999–2019 as the previous 20-year period. During the 1990s, imports grew quickly and manufacturing jobs slowed their decline, while industrial output growth was rapid. There was no "giant sucking sound" of factory jobs to Mexico, as Ross Perot had predicted after NAFTA—manufacturing jobs grew after NAFTA into 2000. Attempts to use tariffs to gain jobs and accelerate output growth have not been notably successful, with industrial production only 1% higher in 2019 than 2008; manufacturing jobs fell 7% from 2008 to 2019.

ASEAN is a large and fast-growing market. China, Japan, South Korea, and the EU have negotiated favorable trading access to these markets while the US is largely excluded.

The US labor force will grow slowly in the 2020 decade, and current and future federal spending will create excess demand for labor. While a small part of this likely labor shortfall can come from increased worker participation rates, it is likely that many lower-productivity tasks will either require importing labor, automation, or increased trade. The alternative is inflation, higher interest rates, and a likely recession. For both domestic workers and foreign policy, it makes no sense to refuse to join the TPP. What is needed is a bipartisan centrist group to make this argument to both "American Firsters" and labor unions and the left wing of the Democrat Party that it is fully in US interests, including those of working people. There is scant hope of persuading ex-President Trump, but perhaps others can look at the facts and change their positions. Without engaging in Asian trade fully, there is no hope of competing with China successfully and US inflation will be more of a problem.

Appendix

Table 1: Census: Mean Income in 2019 $ for Selected Quintiles (In Thousand $)

	Bottom	Middle	Top
1979	13.2	54.1	142.5
1989	14.0	57.7	170.7
1999	15.3	62.7	208.2
2009	13.8	59.2	204.1
2019	15.3	68.9	254.4
% Change:			
1979–1999	15.9%	15.9%	46.1%
1999–2019	0%	9.9%	22.2%

Source: https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-households.html

Table 2: Index of Industrial Output, Manufacturing Employment, and Imports/GDP

	1979	1989	1999	(2008)	2009	2019
Imports/GDP	9.6%	10.5%	13%	(17.4%)	13.7%	14.6%
Index of Manufacturing Workers	100	93	89	(69)	61	66
Index of Industrial Production*	100	124	186	(205)	177	207

*Indices set so that 1979 = 100; data from tables in "Economic Report of the President 2021"

Notes: Real manufacturing production had doubled from 1979 to January 2008 before the global financial crisis, and in 2008 imports to GDP were 17.4%, an all-time high. Incomes were similar in 2008 and 2009. After nearly doubling while imports grew to 2008, industrial production rose only 1% from 2008 to 2019 as imports/GDP fell. Taking "peak-to-peak" measures are a better way of measuring changes than measuring from a depressed level.

Notes

1. CNN quotes Moody's Analytics projecting 19 million new jobs this decade in total (see https://www.cnn.com/2021/04/05/politics/fact-check-biden-infrastructure-jobs-19-million-buttigieg-deese/index.html). The proposed infrastructure program would create 2.7 million jobs out of the 19 million total.
2. A tight labor market can allow workers to raise wages. An overheated market leads to a wage-price spiral.
3. Senator McConnell, the majority leader, would not bring the TPP to a vote.
4. The only widely discussed academic study of the TPP that was critical was by two Tufts University researchers. They were generally criticized by academics for using an inappropriate model and getting highly suspect results.
5. Table B-34 from the "Economic Report of the President 2021" has data on manufacturing output. FRED (Federal Reserve Economic Data) has manufacturing jobs; see https://fred.stlouisfed.org/series/MANEMP.
6. Both the level of imports to GDP for goods and the net deficit of goods to GDP may be important, but the goods deficit is used here because exports of goods creates jobs and offsets the impact of imports.

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