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## How China Helps America's Poor

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### **The University of Chicago's Christian Broda says U.S. trade with China has reduced prices and mitigated inequality.**

In an election year, there's never a shortage of economic bogeymen. With the 2008 campaign in full swing—and with the U.S. economy reeling from sky-high oil prices, the housing crisis, and the credit crunch—politicians are busy railing against a number of convenient villains, including China, Wal-Mart, and “globalization.” Meanwhile, candidates of all stripes profess concern over rising income inequality.

Christian Broda believes that much of this rhetoric is deeply misguided. “I’m an empirical guy,” says the 32-year-old economist. In his latest paper, co-authored with his University of Chicago colleague John Romalis, Broda argues that the effects of globalization have been misunderstood—and that rising inequality has been overstated.

“The U.S. presidential campaign has sometimes sounded like a contest to prove who despises trade the most,” Broda wrote recently in the *Financial Times*. “Media reports of job losses to China and the destructive effect of Wal-Mart on local businesses are ubiquitous. . . . This public debate has taken for granted that inequality. . . has risen as a result of globalization.”

Not so, Broda argues. When it comes to statistics on poverty, trade, inflation, and inequality, “interpretations of data, even official ones, can be really messed up once you look at the underlying structure of things,” he says. “Most of the time, our conventional wisdom is based on data that require some structure—and many times, the assumptions and interpretations made about that structure are completely off.”

In their newest study, Broda and Romalis contend that inequality has actually grown very little over the last decade. According to their research, the perceived rise in inequality—accepted as gospel by many economists and political figures—comes down to a simple measurement error, namely, focusing only on income, rather than on the prices of goods that particular groups consume.

“We are underestimating the gains from trade,” Broda says. “The current statistical interpretation ignores the fact that a poor household today can access goods that, in the 1960s, they could not—microwaves, DVDs—and, more importantly, that the prices of the staples that lower-income households consume have also gone down dramatically.”

Indeed, he claims that lower-income Americans, who tend to spend more on certain goods, have made impressive strides over the past decade, thanks largely to U.S. trade with China.

The Broda-Romalis paper, “Inequality and Prices: Does China Benefit the Poor in America?,” shows that from 1994 to 2005, much of the increase in U.S. income inequality was actually offset by a decline in the price index of the goods that poorer households consume. Inflation for the richest 10 percent of U.S. households, which tend to spend more on services, was 6 percent *higher* than inflation for the poorest 10 percent, which tend to spend more on nondurable goods, the type of goods often imported from China and sold at Wal-Mart.

Broda and Romalis found that in the sectors where Chinese imports have increased the most (especially nondurable goods such as canned food and clothing), prices have fallen dramatically. They estimate that about one-third of the price decline for the poor is directly associated with rising imports from China. “In the sectors where there is no Chinese presence,” Broda says, “inflation has been more than 20 percent.”

“In the '60s, all the talk was about trying to win the war against poverty,” he adds. “The bottom line with our study is that we may have won the war against poverty without even noticing it. Here we have Congress debating why the poor in America haven't been able to grasp the great economic growth we've seen in the last 30 years. ‘It's been only concentrated in the top 1 percent,’ they say. And, absolutely, that segment has grown a lot. But that doesn't mean that the poor haven't been able to access part of that progress.”

Broda's argument on inequality goes against the grain, and as such, it's gaining attention. “As improbable as it may seem,” their University of Chicago colleague (and *Freakonomics* author) Steven Levitt wrote recently in *The New York Times*, “I believe them.”

Born in Argentina, Broda came to the United States in 1998 to get his master's degree at the Massachusetts Institute of Technology. He stayed at MIT to receive his doctorate.

“In Argentina, everybody's an economist,” he says. “Grocers, taxi drivers, everybody. The reason is that, if you don't know economics, you are essentially at the risk of losing all of your money. Argentina, you know, has a history of very volatile economic situations. You think about any extreme example of economic phenomena—inflation, default, volatility—and Argentina is up there as an example.”

Witnessing a series of hapless economic policies in his home country led Broda to consider economics as a career. So did horse racing. “I've been going to horse races since I can remember—since I was five, six years old. Horse racing really got me thinking about numbers, because horse racing has so much to do with statistics, the odds. Of course, I think the really enticing part of horse racing, when I was really small, had to do with the horses themselves. As I grew up, though, I became more boring, and focused more on the numbers,” says Broda, who is married and has two toddlers.

At MIT, Broda worked with Rudi Dornbusch, a professor who was highly influential in the field of international economics. Dornbusch was also known for his ability to explain complicated problems simply.

“He guided me to thinking that there was a role for an empirical guy within this profession to look at even the simple things, but much more carefully than before,” Broda says. Since then, Broda has focused on using micro data to explain “big picture” macro questions—everything from the Japanese retirement system to why strawberries are now available in cooler climates during winter.

“I don’t do complicated things,” he says. “I prefer simple. Many systematic biases are extremely simple. When you think about it, there are a lot of simple things out there that are not understood, so why get complicated?”

Simple shifts in analysis, he notes, can make a huge difference when it comes to your view of the world. “Let’s face it: it’s hard for people that have a job, a life, and are specializing in a particular industry to go through and analyze the data. I teach MBA students, and most of them come with the conventional wisdom very engrained in their mind. This is often a structure put into place by a very clean, knowledgeable reading of the press, by the way. These are very smart people, but some of these things we talk about—trade, globalization, China—they are not perfectly intuitive.” He laughs. “They’re intuitive, of course, after somebody tells you. Before, it’s not obvious. A lot of things in statistics are like that.”

So are many aspects of politics. And while much of Broda’s work is inherently political, he tries to avoid being partisan. “I hope I didn’t convey any political stance,” he says, leaning forward, “because this is not about that. It’s about making the right assumptions and using common sense. It’s about finding the right answer.”

Though he argues that economic analysis can “make the debate more mature,” Broda doesn’t expect much statistical soul-searching in an election year. “I’d be surprised if many politicians take a step back and talk about these issues in anything but the conventional way. A few of the issues I discuss, as you know, are not terribly popular. But that’s what’s good about my role in academia, in a way—I don’t care whether they are popular or not.”

Academia’s role in the United States also fascinates Broda. “Professors, academics are very engaged, for instance, in the press, and that’s not the role that academia plays in other countries. Academia is much more isolated there. Here, I am challenged and pushed to make what I’m doing useful.”

He pauses. “And here, of course, I come back to the beginning. It’s the testing that’s enticing to me. I don’t think that academia always has to be useful. There are people who have to be thinking about the clouds, because eventually, something might come out of that that may reshape conventional wisdom. But that’s not what motivates me.”

Addressing big-picture questions with smaller data, however, does. One project underway is an analysis of the impact of the 2008 federal tax rebate checks. Broda acknowledges that “these are certainly tough times” for the global economy, but he remains upbeat about the future.

“I am by all means an optimist,” he says. “There may be some ups and downs, but we are living in a world of prosperity. The last 20 years have been amazing in terms of the way we’ve changed our well-being.”

He gestures out the window at the Chicago cityscape. “Okay, we’re not seeing flying cars. But I can talk to my family in Argentina, seeing each other through the phone—and it’s free.”

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Photograph by Stephen Hill.