Is Trump wrong on trade? A partial defense based on production and employment

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> "Free trade assumes that if you throw men out of work in one direction you re-employ them in another. As soon as that link is broken the whole of the free-trade argument breaks down" (J. M. Keynes, evidence to the Macmillan Committee on Finance and Industry, 1930).

Like Gresham's Law, "alternative facts" drive out facts.[1] If the economics profession had not decided long ago that the argument to be made here is wrong, we might not have President Trump.[2] We might not even have the deep cause of his success – the angry, indignant mood infecting swathes of western electorates.

Most of the 63 million Trump voters (47 percent of those who voted) express anger and indignation at elites who have been shredding the bargain on which complex democracies rest. They see those elites as taking a share of income and wealth beyond any plausible measure of social value, squeezing the last cent out of their workers or customers, and seeming to care little for the insecurities thrown up by technology and globalization. Of total employment growth in the US between 2005 and 2015, insecure employment in the categories of independent contractors, on-call workers and workers provided by contracting companies or temp agencies accounted for fully 94 percent.[3] Outsourcing of employment plays a big role in what David Weil describes as the "fissuring" of the workplace – depressing wages, magnifying income and wealth inequality, and generating a pervasive sense on the part of those at the wrong end of the fissuring that the world is cheating them, making them angry in return.[4] On top of this, many Trump voters are angry that the government is giving handouts to "shirkers", and sticking them with the tax bill.

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[1] Thanks to Adrian Wood for this sentence and a version of the next one.
[2] Trump also surfed on widespread perception that the political system is illegitimate. The latter perception is substantiated by surveys of thousands of election experts asked to assess the quality of hundreds of elections around the world, whose average put the US as 52nd among 153 countries on "electoral integrity", as reported by the Electoral Integrity Project. Reported in Eduardo Porter, 2017, "Dysfunction in U.S. democracy", *New York Times (International),* January 5. US voting turnout is one of the lowest in the developed world. In 2016 232 million citizens were legally entitled to vote; only 132 million did so (57%).
[3] Lawrence Katz and Alan Krueger, 2016, "The rise and nature of alternative work arrangements in the US, 1995-2015", March 29. By the end of 2015, workers in the authors 'alternative' employment constituted 16 percent of total workers.
[4] David Weil, 2014, *The Fissured Workplace: Why Work Became So Bad For So Many and What Can Be Done To Improve It*, Harvard University Press.

They now see themselves as, finally, members of a winning team ("we won, you lost, get used to it!"). They affirm their leader's strikes against pillars of the "establishment" order (including the media and even the judiciary), and they forgive the administration's lies, "alternative facts", authoritarianism, chauvinism, and billionaire composition at the top.[5]

But we should not understand Trump's victory as a *sui generis* case. It fits the larger pattern in the developed world whereby *financial crises* tend to empower the far-Right in their wake. A recent study by Michael Funke and colleagues examines political effects of financial crises in 20 developed countries over the past 140 years and 800 elections. They find:

1) government majorities shrink after a financial crisis, political polarization increases;
2) policy uncertainty increases;
3) voters tend to be drawn to the far-Right, which typically attributes blame to foreigners or minorities; on average, vote share of far-Right parties increases by 30% after financial crises; these effects are much stronger after financial crises than after 'normal' recessions or macroeconomic shocks that are not financial.[6]

The study suggests that the current wave of electoral support for "populist" leaders and parties in the US and much of Europe is a lagged response to the disruptions of 2008 and the drawn-out Great Recession. One might infer from it a bias for hope that the current far-Right wave will subside… if "normal" growth resumes and/or if governments undertake more pre- and re-distribution. The bias for hope is all the stronger when one remembers that Mr Trump attracted around three million votes less than Hillary Clinton; and that, so far, the far-Right forces in Europe have come close to governmental power only when allied with conventional Center-Right parties.

The elite response to President Trump is of course very different from the mass response. Philip Stephens of the *Financial Times* reports on foreign elite reaction: "A first take from friendly foreign ministries is that Mr Trump's economic nationalism threatens to fracture the open international trade system." This is the climactic sign of "a rogue American president" who "will prove a force for dangerous instability".[7]

Here, without getting into Trumpian specifics, I make a *partial* defense of President Trump's skepticism about the virtues of ever freer trade, ever more economic integration between countries.[8] My bottom line is that "the open international trade system" does need adjustment

[5] On the billionaire composition, *The Financial Times* reported ("Tillerson in line for $180m if confirmed", 5 January 2017, p.4) that Rex Tillerson, Donald Trump's secretary of state, will be given a payout worth about $180m to sever all financial ties to Exxon Mobil, because before his selection, the Exxon chairman and chief executive was in line to receive about 2 million shares in the oil group, worth about $182 m at today's prices. Mr Tillerson might consider himself hard done by compared to Stephen Schwarzman, the chief executive of Blackstone Group, the leveraged buyout firm, appointed by Mr Trump to be head of the president's business council. Schwarzman was paid $799 million in 2015. On lies and 'alternative facts', G. Grassegger and M. Krogerus, 2017, "The data that turned the world upside down", *Motherboard*, 28 January, at https://motherboard.vice.com/en_us/article/how-our-likes-helped-trump-win argue that they were not shoot-from-the-hip; they were carefully planned and micro-targeted on the basis of Big Data analysis of Facebook and other such data about individuals.
[6] M. Funke, M. Schularick, C. Trebesch, 2016, "Going to extremes: politics after financial crises, 1870-2014", *European Economic Review*, at http://www.sciencedirect.com/science/article/pii/S0014292116300587
[7] P. Stephens, 2017, "What the world hears from the White House", *Financial Times*, January 27, p.13.
[8] David Brooks of The New York Times warns that one should not take Trump's policy gestures seriously. "When Trump issues a statement, it may look superficially like a policy statement, but it's usually just a symbolic assault in some dominance-submission male rivalry game… His statements

to provide more "policy space" for national governments and regional blocs. "Cooperative internationalism" should be the goal, not the prevailing "integrative globalization" – which relies on multilateral institutions and American hegemony to glue the world together and prescribes that national governments should have no more influence over trade and other cross-border movements than US states or even EU states have over theirs. [9]

I. The elite globalization consensus

In this context globalization refers to the opening of domestic markets and the integration of global production via multinational corporations (MNCs). More broadly, it refers to movement in the world economy towards "one country", or "deep (not shallow) integration", where nation states have no more influence over flows of goods, services, capital, finance, ideas and people across borders than South Dakota or the other US states have across theirs. Ever since the 1980s leaders of western states – including shareholders and top executives of MNCs – have agreed that states, on their own and cooperating (in free trade agreements, and in inter-state organizations like the World Bank, IMF, World Trade Organization, European Union), should push for ever more globalization, more "market access" for their corporations, and less state "intervention" or "regulation" in markets.

Here is Martin Wolf of the *Financial Times*, one of the world's most influential economic commentators:

> "It cannot make sense to fragment the world economy more than it already is but *rather to make the world economy work as if it were the United States, or at least the European Union… The failure of our world is not that there is too much globalization, but that there is too little.* The potential for greater economic integration is barely tapped… Social democrats, classical liberals and democratic conservatives should unite to preserve and improve the liberal global economy against the enemies mustering both outside and inside the gates" (emphasis added).[10]

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should probably be treated less like policy declarations and more like Snapchat. They exist to win attention at the moment, but then they disappear… The crucial question of the Trump administration could be: Who will fill the void left by a leader who is all façade?" David Brooks, 2017. "The Snapchat presidency", *New York Times*, 4 January.

[9] Disclosure: I have a dog in this fight. I worked in the Trade Policy Division of the World Bank in the late 1980s. In the evenings and at weekends I worked on finishing my book, *Governing the Market*, Princeton University Press, 1990, 2004 – a project entirely separate from the Bank. But given my broad knowledge of East Asia the division asked me to write a substantial paper about how East Asian countries had gone about promoting exports. I agreed, but added that I would also have to discuss how they had gone about substituting imports, because export promotion and import substitution were like the two wings of the same bird. Emphatic no, was the response; import substitution could only be mentioned in negatives. Shortly after, I left the Bank for the more honest climate of the US Congress' Office of Technology Assessment. See Wade, 2009, "Reflections: Robert Wade, interviewed by Alex Izurieta", *Development and Change*, v.40, n.6, November, p.1153-1190. See also Wade, 1993, "Managing trade: Taiwan and South Kora as challenges to economics and political science", *Comparative Politics*, 25, 2, January, p.147-168, which gives a more extended economic and political analysis of the trade regime of Taiwan and South Korea than in *Governing the Market*. Also, Wade, 2014, "Current thinking about global trade policy", *Economic and Political Weekly,* XLIX, 6, February 8, p.18-21, gives an account of current thinking about global trade policy (especially in the context of the Sustainable Development Goals), by way of showing how most of UNCTAD (but not the division which produces the *Trade and Development Report*) has been captured by those who give top priority to "trade facilitation", code for almost free trade.

[10] M. Wolf, 2004, *Why Globalization Works*, Yale University Press, p.4.

Here is Renarto Ruggiero, former head of the WTO:

> "trade integration is not just a recipe for growth but *also security and peace*, as history has shown" (emphasis added).

Here is the WTO saying on its website: global integration under WTO and predecessor GATT supervision

> "has been *one of the greatest contributors to economic growth and the relief of poverty in mankind's history"* (emphasis added).

Here is the World Bank summarizing others' research findings, with which it agrees:

> "*openness to international trade*, *based on largely neutral incentives, was the critical factor in East Asia's rapid growth"* (emphasis added).[11]

The World Bank's Structural Adjustment Loans over the 1980s carried more trade liberalization conditions than those in any other policy domain. The Bank treated trade liberalization as the queen of policies, not just one among many, saying that free trade policy will limit the amount of damage from other government interventions in the market.[12]

The *Financial Times* peppers its editorials about trade protection with negatives like "mercantilist" and "populist", and stresses that any one country benefits from adopting free trade policy even if others do not – because protection amounts to throwing rocks in your own harbor. Apparently the collective interest of any country and of the world at large always favors free trade, because free trade maximizes the size of the pie. Only self-seeking "vested interests" want protection in order to get more of the pie for themselves, at inevitable cost to society.

A big business voice comes from Percy Barnevik, when CEO of the Swedish-Swiss multinational Asea Brown Boveri (ABB):

> "I would define globalization as the freedom of my group to invest where and as long as it wishes, to produce what it wishes, by buying and selling wherever it wishes… while putting up with as little labor laws and social convention constraints as possible." [13]

Finally, Bernard Arnault, in 2000, CEO of French luxury group LVMH and 10th richest person on Earth:

> "Businesses, especially international ones, have ever greater resources, and in Europe they have acquired the ability to compete with states… Politicians' real impact on the economic life of a country is more and more limited. Fortunately."[14]

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[11] World Bank, 1993, *The East Asian Miracle: Economic Growth and Public Policy,* p. 292.
[12] World Bank, 1989, "Strengthening trade policy reform", Washington DC, November 13.
[13] Quoted in J. Gelinas, 2003, *Juggernaut Politics: Understanding Predatory Capitalism,* Zed Books, p. 21
[14] B. Arnault, quoted in Serge Halimi, 2013, "Tyranny of the one per cent", *Le Monde Diplomatique (English),* May 1.

These statements illustrate the tendency for globalization champions to attribute “all good things” to trade and investment integration, including (1) global poverty reduction on an unprecedented scale, (2) East Asia’s remarkable economic rise, and (3) global peace and security.

Though they assert causality, the statements are not intended to pass a test of evidence. Their job is to affirm identity: that the speaker or organization is a member of the global elite team which wants capital, goods and services to be able to move freely worldwide between locations and sectors, as the defining feature of desirable globalization, assuming that what is good for the team is good for humanity and the biosphere.

Implicitly or explicitly the claims downplay the value of “policy space” and the value of the solidarity obligations embedded in the idea of “nation”, ignoring the employment point made by Keynes in the epigraph. The claims should be understood in the light of Daniel Kahneman’s observation, “Declarations of high confidence mainly tell you that an individual has constructed a coherent story in his mind, not necessarily that the story is true”.

II. Comparative advantage and free trade as the crown jewel of the neoclassical paradigm

Globalization champions draw comfort from neoclassical economic theory, which purports to give a rigorous and “general interest” justification for the policy of free trade in goods and services.[15]

The argument today rests on basically the same theory of comparative advantage as David Ricardo proposed in 1817 – a theory which was static, timeless, abstract, elegant, and which today broadly retains those characteristics (with some theoretical qualifications to do with “increasing returns”, which are treated as unimportant for practical policy in the real world). In the following two centuries the theory acquired the status of jewel in the crown of the increasingly dominant neoclassical paradigm.

As Paul Krugman quipped,

> “If there were an Economist’s Creed, it would surely contain the affirmations, ‘I understand the Principle of Comparative Advantage’ and ‘I advocate Free Trade.’”[16]

Gregory Mankiw, author of the most widely used textbook in economics, declared,

> “Although economists often disagree on questions of policy, they are united in their support of free trade. Moreover, the central argument for free trade has not changed much in the past two centuries… [E]conomists’ opposition to trade restrictions is still based largely on the principle of comparative advantage.”[17]

[15] Ha-Joon Chang and Ilene Grabel give a measured account of the mainstream theory, its strengths and weaknesses, in *Reclaiming Development: An Alternative Economic Policy Manual,* 2014, Zed Books, London.
[16] Paul Krugman, 1987, “Is free trade passé?”, *J. Economic Perspectives* 1 (2) Fall, p. 131.
[17] N. Gregory Mankiw, 2008, *Principles of Economics,* 5th ed., Mason: Thompson, p. 57

Jagdish Bhagwati, celebrated trade economist at Columbia University, put the point more colorfully:

> "Only Neanderthals among the economists now militate against free trade: unfortunately, they will never lack an audience but fortunately, they have little effect presently".[18]

Finally, Douglas Irwin, historian of economic ideas:

> "…one should recognize that free trade commands respect among economists largely because of its continuing theoretical attractiveness" (rooted in the theory of comparative advantage).[19]

Surveys of economists' opinions confirm that there is nothing that economists, especially American economists, agree about more than the virtues of free or almost free trade. For example, a survey of nearly 1,000 economists in five industrialized countries asked them to "generally agree", "agree with provisos", or "generally disagree" with 27 propositions. "Tariffs and import controls lower economic welfare" was the one that elicited most agreement. Seventy nine percent of the American economists and 57 percent of the whole sample said, "generally agree".[20]

III. The argument for free trade policy

The argument boils down to three propositions supporting the conclusion that the institution of free trade is 'right' for each country and the world.

1) Free trade leads to production specialization in activities in which the economy holds a "comparative or relative advantage" (not "absolute advantage");
2) This pattern of production specialization yields maximum efficiency of resource allocation among the trading partners, and therefore maximum "welfare" for these trading countries;
3) Economists should recommend policy measures which will result in maximum efficiency (including free trade) and leave it to political choice as to how to distribute the resulting maximum income or consumption.

The basic idea is simple. People want to consume a wider mix than can be produced at home more cheaply than could be imported. Therefore, driven by relative costs, countries tend to export goods whose production makes intensive use of resources or factors (including land, labour, skilled labour, capital) which are abundant nationally, and import goods whose production requires resources scarce nationally. A country with trade barriers blocks this efficiency-enhancing mechanism and imposes higher costs of its consumption mix on its population ("puts rocks in its own harbor"). A country which lowers its trade barriers tends to raise its specialization of production, exports and employment in the resource abundant

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[18] Jagdish Bhagwati, 1998, "Free trade: what now?", Keynote address at University of St Gallen, May 25, https://academiccommons.columbia.edu/catalog/ac:123560, p. 8

[19] Douglas Irwin, 1996, *Against the Tide: An Intellectual History of Free Trade,* Princeton University Press, p. 224

[20] B. Frey, W. Pommerehne, F. Schneider, G. Gilbert, 1984, "Consensus and dissensus among economists: an empirical enquiry", *American Economic Review*, 74, 5, pp. 986-94.

products, so the returns to the abundant resources tend to rise relative to the returns to the scarcer resources. Ergo, free trade is best for each country and the world, enabling maximum consumption from a given stock of resources.

The argument has more recently been fortified by the fall in “coordination costs” and “information costs” thanks to ICTs (information and communication technologies), as well as production changes that facilitate the unbundling of production into discrete tasks to be done in scattered locations.[21] These developments enable a country to get better access to production, marketing and managerial knowledge than before, and so able to stretch its comparative advantage into the export of products previously out of reach.

In the event that imports of a set of products drive a country’s producers out of those products, this is all to the good, because the imports reveal that the products in which the country holds a comparative advantage have changed. Over time in any one economy, as wages and other costs rise, the economy should lose production and jobs in its relatively less productive industries to lower cost economies and gain them in its relatively more productive industries.

It is scarcely an exaggeration to say that *comparative-advantage-driven free trade is the core mechanism by which modern mainstream economics explains the great question, how market capitalism generates human welfare.* Beneficial global integration – moving towards “one economic country” – is the overarching narrative of the past several decades. See the earlier quotes from Ruggerio, Wolf, and the others, and the results of the survey of economists’ opinions.

So both specialists and public discourse writ large are confident that, first, the theory of comparative advantage is compelling as an *explanation* of production specialization and trade patterns; second, it is also compelling as the theoretical *justification* for the policy of free trade; and third, the empirical evidence is strong that trade liberalization raises growth rates, and that countries with freer trade have better economic performance than countries with less free trade.

On these grounds believers dismiss those who advocate some degree of trade management with the charge that they are willing to sacrifice the “general interest” (implicitly defined in terms of larger consumption, regardless of employment) in order to protect the interests of narrow interest groups (such as trade unions, or inefficient small and medium enterprises, which typically provide much employment).

IV. Free trade in question: the theory is not robust

At a high level of aggregation the theory of comparative advantage “works”, in the sense that global trade patterns are broadly in line with its predictions. Countries with abundant land and scarce skilled labor (Africa) tend to produce and export land-intensive products and import manufactured products, and countries with scarce land and abundant labour (East Asia) tend

[21] Adrian Wood, 2017, “Variations in structural change around the world, 1985-2015: patterns, causes, and implications”, WIDER Working Paper 2017/34, United Nations University World Institute for Development Economics Research.

to produce and export labour-intensive manufactured products and import land-intensive and skill-intensive products.[22]

But this is not the end of the story. The theory's broad consistency with trade patterns does not translate straightforwardly into the policy conclusion that free trade is best for each country and the world. The theory rests on a raft of assumptions so limiting of its domain of applicability as to make one wonder how it could have survived for so long as the crown jewel of economic theory. Here are some of them.[23]

No externalities

The theory assumes no externalities; in other words, assumes that prices reflect true economic value – including the economic cost of environmental damage and the economic gains of one company's innovation for other companies. The theory is driven only by what is included in prices. A country with lax environmental standards will produce and export too much of some goods, because prices do not include environmental damage (deaths from ambient air pollution, for example); and countries with higher environmental standards will import too much relative to prices which do incorporate environmental damage. Less than free trade could benefit both sides. Similarly, free trade can lead to companies producing positive spillovers for other companies being wiped out by foreign competition, because their prices do not reflect their hidden value to others in the same country. Assuming no externalities of course limits all free market theory, not just comparative advantage theory.

Full employment is sustained

The theory assumes full employment throughout, ignoring "transitional costs" of increased exposure to trade. By assuming full employment, it avoids facing a trade-off between the welfare gains from trade and the welfare losses from unemployment or precariate employment. See Keynes' epigraph. Implicitly, the theory sides with consumers, not with those whose income from labor (rather than capital) might be threatened by unrestrained imports. It is as though the "Walmart effect" of cheap imported consumer goods completely eclipses the employment losses associated with rising imports of manufactures (now amplified by post-2008 fiscal austerity).

The slowness of labour market "adjustment" to trade shocks – and recessions – than assumed in the globalization consensus has been measured by David Autor, David Dorn and Gordon Hanson. They study the effects of "the China shock" that began in the early 1990s in the form of a surge of manufactured exports to the US. They find that,

> "Alongside the heralded consumer benefits of expanded trade are substantial adjustment costs and distribution consequences… *Adjustment in local labor markets is remarkably slow, with wages and labor-force participation rates remaining depressed and unemployment rates remaining elevated for at least a full decade after the China shock commences… At the national level,*

[22] Adrian Wood, 2017, "Variations in structural change around the world, 1985-2015: patterns, causes, and implications".
[23] This section draws on Ian Fletcher, 2010, *Free Trade Doesn't Work: What Should Replace It and Why*, U.S. Business and Industry Council, Washington DC; and Vishaal Kishore, 2014, *Ricardo's Gauntlet: Economic Fiction and the Flawed Case for Free Trade*, Anthem Press. Thanks to Adrian Wood for comments.

> *employment has fallen in U.S. industries more exposed to import competition, as expected, but offsetting employment gains in other industries have yet to materialize*."[24]

They calculate that about 55 percent of job losses in US manufacturing between 2000 and 2007 was caused by "rising exposure to Chinese import competition", and 33 percent in the earlier period, 1990–2000.[25]

More evidence on the slowness of labour market adjustment comes from OECD figures on unemployment. As of 2015, eight years after the onset of the global financial crisis in 2007-08, some 44 million people were unemployed and wanting work in the OECD, 37 percent higher than the rate before 2007. The mainstream response prescribes fiscal austerity and job retraining. This is like saying – when 100 dogs are ushered into a room where 95 bones have been hidden and five emerge without a bone – "the five dogs have insufficient bone-finding skills and need more training", rather than the Keynesian response, "there are insufficient bones for the number of dogs".

Rising trade does not drive rising income inequality

The theory of comparative advantage accounts for aggregate (consumption) gains from trade and neglects the distributional consequences. To see the significance of this neglect, take an example from Ian Fletcher.[26] A country lowers trade barriers, then imports more clothes and exports more aircraft, in line with its comparative advantage. Its GDP goes up. For each million dollars of production, clothing requires one white collar worker and nine blue collar workers, aircraft require three white collar workers and seven blue collar workers. So demand for white collar workers goes up, demand for blue collar workers goes down; and their wages move in the same direction. But most workers are blue collar. So most workers face a fall in their employment conditions, even as GDP goes up, thanks to free trade moving the economy closer into line with its comparative advantage. Dani Rodrik calculates that freeing up trade in the US shuffles five dollars to different groups for every one dollar of gain in GDP.[27]

Trade remains balanced

The theory assumes that trade remains balanced between the trade partners.[28] The exchange rate is assumed to adjust so that relative cost differentials (due to differences between countries in their relative factor endowments) are translated into relative price differentials across borders, which lead profit-seeking producers to specialize in line with comparative advantage. If one country's absolutely advantaged goods (think China) start to flood the markets of others (think Brazil), exchange rates will adjust sufficiently to ensure that before long comparative advantage dominates absolute advantage, and trade returns to

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[24] David Autor, David Dorn and Gordon Hanson, 2016, "The China shock: learning from labor market adjustment to large changes in trade", NBER WP 21906, January, www.nber.org/papers/w21906, emphasis added.
[25] David Autor, David Dorn and Gordon Hanson, 2013, "The China syndrome: local labor market effects of import competition in the United States", American Economic Review, 103 (6): 2121-68, at 2139.
[26] Ian Fletcher, 2017, *Free Trade Doesn't Work*, p. 109
[27] Dani Rodrik, 1997, *Has Globalization Gone Too Far?,* Washington: Institute for International Economics, p. 30.
[28] "In trade theory, it is standard to assume that trade is balanced". David Autor, David Dorn and Gordon Hanson, 2016, "The China shock: learning from labor market adjustment to large changes in trade", NBER WP 21906, January, www.nber.org/papers/w21906, p. 12.

balance. (Analytically, the adjustment could also occur through wage and price changes. But these are even more implausible in the modern world than exchange rate changes.)

Underlying the invocation of the balancing exchange rate is an assumption that *international trade is basically barter* – producers barter goods among themselves. *Money is simply a neutral medium of exchange, to lower transactions costs*. The assumption rationalizes the discipline separation between “international trade”, with its specialists, and “international finance”, with its specialists (in exchange rates, payments systems and capital markets), with little communication between the two.

The assumption that international trade is basically barter – and is balanced -- removes a fundamental dynamic of foreign exchange markets, a dynamic which explains why *(1) a trade deficit need not produce an exchange rate devaluation, and (2) the exchange rate change need not restore balanced trade* (no payments surpluses or deficits).

Exchange rates are determined not only by relative flows of goods and services, but also by, often speculative, capital flows unrelated to the financing of trade. Capital flows can and do drive exchange rates far from levels at which trade would balance. They are driven by herd behavior based on “guesses” about how certain “news” will affect the behavior of financial market participants and thereby the direction of asset price movements, on which the speculation builds.[29]

So countries with high inflation, high interest rates, and large current account *deficits* can experience currency *appreciation* rather than depreciation (needed to reduce current account deficits), as they become targets for carry trade “investors” (speculators) buying the domestic currency with money borrowed elsewhere at low interest rates.[30]

The *Trade and Development Report 2009*, from the United Nations Conference on Trade and Development (UNCTAD), sums up:

> “The most important lesson of the recent [2008] financial crisis is that financial markets do not ‘get the prices right’; they systematically overshoot or undershoot due to centralized information handling, which is quite different from the information collection of normal goods markets. In financial markets, nearly all participants react in a more or less uniform manner to the same set of ‘information’ or ‘news’, so that they wind or unwind their exposure to risk almost in unison. *The currency market, in particular, causes results quite different from those envisaged by theory, such as an appreciation of the nominal exchange rate in countries that have high inflation rates over considerable periods of time*.”[31]

[29] For overview analyses of the global financial system and efforts to “reform” it, see R. H. Wade, 2007, “A new financial architecture?”, *New Left Review*, 46, July-August, pp. 113-129; 2008, “Financial regime change?”, *New Left Review*, 53, September-October, p.5- 22; Jakob Vestergaard, 2009, *Discipline in the World Economy: International Finance and the End of Liberalism*, Routledge.

[30] See UNCTAD, *passim, Trade and Development Report* . On Iceland as a case in point, see R. H. Wade and S. Sigurgeirsdottir, 2012, “Iceland’s rise, fall, stabilization and beyond”, *Cambridge J. Economics*, vol. 36, no. 1, January, 127-144; and R. H. Wade, 2009, “Iceland as Icarus”, *Challenge*, 52, 3, May-June, pp. 5-33.

[31] UNCTAD, 2009, *Trade and Development Report 2009*, p. 116, 127, references omitted.

Empirically, we know that, since the global liberalization of capital flows in the late 1970s, trade imbalances have persisted for long periods, together with high exchange rate volatility – which can have the effect of jerking economies, and people, around like yo-yos. Yet the theory of comparative advantage assumes that exchange rate adjustment will occur by enough to keep trade balanced.

Short-term efficiency gains cause higher long-run growth

The theory of comparative advantage tells how countries can reap efficiency gains by reallocating their *existing* resources by moving to freer trade. It is silent on the effects of the reallocation on long-run growth. If the reallocation results in the country moving out of activities rich in increasing returns to scale, or in technological linkages upstream and downstream, or in productivity gains due to physical proximity (an "industrial ecosystem"), it can harm growth.

Take Ricardo's famous example, showing that both England and Portugal gain by moving towards free trade, resulting in England specializing in textiles and Portugal in wine, consumption of both being higher in both countries than in the absence of trade. That is the end of the comparative advantage story. But of course, now England has the textile industry, with its spillover links to the industry for steam engines and machine tools, which provides England with a platform to enter many other state-of-the-art sectors (stretching its comparative advantage). Portugal has wine, whose technology has not changed for hundreds of years and whose linkages to other sectors are thin. Good for England, bad for Portugal. And in fact, decades before Ricardo wrote, England and Portugal had switched to largely free trade in these products. Portugal's promising textile industry was wiped out, and English (very mobile) capital, including Ricardo's family's, took control of Portugal's vineyards as their owners went into debt with London banks.[32] Portugal fell rapidly into the ranks of Europe's poorest countries. Ricardo knew all this very well. He was an English gentleman, financier and Member of Parliament, and his theory of comparative advantage was a mask for advancing the emerging hegemon's national interest against others'.[33]

V. Globalization in question: the economic evidence is ambiguous

Now to focus more directly on empirical evidence. As noted, during the past several decades globalization – including freer trade and capital mobility – has led to production specialization broadly in line with the theory of comparative advantage. Adrian Wood explains with reference to 1985-2015,

> "In skill-abundant developed countries, manufacturing became more skill-intensive. In land-scarce developing East Asia, labour-intensive manufacturing expanded, especially in China. In land-abundant developing regions, however, manufacturing stagnated or declined, while in land-scarce

[32] Ian Fletcher, 2017, *Free Trade Doesn't Work*, p. 114.

[33] For an account of how western states today manage to maintain their dominant position in international economic organizations and steer these organizations to champion the great globalization consensus, see R. H. Wade, 2013, "The art of power maintenance: how western states keep the lead in global organizations", *Challenge*, 56, 1, January-February, pp. 5-39.

> South Asia manufacturing was held back by low literacy and weak infrastructure."[34]

However, this is a very broad empirical pattern of the factor-intensity of production and exports. The champions of free trade and more globalization make much grander and more normative claims about benefits far exceeding costs. They are inclined to overstate the benefits of free trade and globalization and underestimate the costs (even when confined to material benefits and costs, as in GDP, and especially when extended to employment).

We saw earlier how globalization champions – such as the WTO and the World Bank – tend to attribute "all good things" to rising levels of economic globalization. Recall the World Bank saying, "openness to international trade, based on largely neutral incentives, was the critical factor in East Asia's rapid growth". No ambiguity: "[L]argely neutral incentives… was *the* critical factor" (emphasis added). Nothing in the World Bank study comes close to validating this claim. Also, recall the WTO saying that "global integration… has been one of the greatest contributors to economic growth and the relief of poverty in mankind's history". Not to forget Renarto Ruggiero, former head of the WTO, declaring, "trade integration is not just a recipe for growth but also security and peace, as history has shown."

Globalization champions tend to assume that – while globalization certainly brings aggregate benefits larger than costs – sectional interests adversely affected by international competition can successfully lobby the (often predatory) state for less globalization and more protection, at cost to the more diffuse (therefore less organizable) "general or societal interest". So globalization champions dismiss critics as not understanding the theory or as speaking for vested interests.[35]

By way of critique, we can start with Paul Krugman's point: "The first thing you need to know is that almost everyone exaggerates the importance of trade policy."[36] This is a surprise coming from an economist who won the so-called Nobel Prize in Economics[37] for his work on trade theory.

Dani Rodrik affirms that,

> "Countries that have done well in the post-war period are those that have been able to formulate a domestic investment strategy to kick-start growth and those that have had the appropriate institutions to handle external shocks, not those that have relied on reduced barriers to trade and capital flows".[38]

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[34] Adrian Wood, 2017, "Variation in structural change around the world, 1985–2015", abstract.
[35] This section draws on Graham Dunkley, 2016, *One World Mania: A Critical Guide to Free Trade, Financialization and Global Integration,* Zed Books.
[36] Paul Krugman, 2015, "TPP at the NABE", *New York Times*, 11 March.
[37] Why "so-called"? See Philip Mirowski, "The neoliberal ersatz Nobel Prize", paper for presentation to conference on The Road from Mont Pelerin II, December 2015. Krugman was honored for showing how the well-known real-world phenomenon of increasing returns could be incorporated into formal trade models, which previously had been driven only by comparative advantage. Remarkable is that this incorporation happened so recently, given that since the early 20th century business leaders competed by building companies big enough to drive down costs through economies of scale and speed sufficiently to establish monopoly positions.
[38] Dani Rodrik, 1999, *The New Global Economy and Developing Countries: Making Openness Work*, Overseas Development Council, Policy Paper 24, Washington DC, , p. 93.

Francisco Rodriguez summarizes literature on the link between openness and growth, and finds that six major measures of openness are only weakly if at all correlated with growth (and the causality could go both ways). Also, most growth accelerations are not correlated with trade openings.[39]

Global growth has *fallen* steadily every decade since the 1960s – from over five percent in the 1960s to under three percent over the 2000s. Yet measures of economic integration between national economies show a fairly steady *increase* during these decades.

Many developing countries had their fastest post-World War II growth during their period of "import substitution" with managed trade – which the reigning elite consensus treats as always harmful to the national interest and the global interest. The consensus ignores the mechanism of managed trade in East Asia: the combination of strong encouragement to export certain products and strong encouragement to replace imports in certain other products, complemented by strong encouragement to invest and re-invest within the national territory. The result was that highly managed trade and capital flows (until the 1990s) helped to generate unusually fast and sustained growth, which sucked in rising volumes of imports in the less-protected sectors. The incentive regime restrained imports of (especially luxury) consumer goods while facilitating imports of advanced capital goods. *Closely managed trade went with fast growth of trade*.[40]

Whatever one concludes from these trends, it cannot be that trade liberalization tends to generate faster growth. At most, a step up in trade liberalization could be expected to produce a small, one-off increase in GDP, but there is no evidence that it reliably generates faster growth.

In short, ample evidence is at hand with which to challenge the great globalization consensus. Together with the critique of comparative advantage theory, the evidence suggests we should consider an alternative line of argument to the mainstream's core proposition: namely, the aggregate costs of the present level of trade and capital integration outweigh benefits; but sectional interests – especially MNCs and elites vested to international capital – press states for always more openness against the "general interest" (defined not just in terms of consumption but also employment). See the Barnevik and Arnault quotes above. "Free trade agreements" like the North America Free Trade Agreement (NAFTA), and bilateral investment treaties (BITs), are a case in point.

Indeed, a defining moment in the death of "the nation" as an economic and social protection entity in the US came in 1992 with the signing of NAFTA, by which the US, Canada and Mexico took a giant step towards a single economic unit (from "shallow" to "deep integration"). US workers undertook mass protests against it, accurately forecasting large-scale job losses at home, to no avail. Barak Obama, before being elected US president in 2008, declared,

[39] F. Rodriquez, 2007, "Openness and growth: what have we learned?", DESA Working Paper 51, UN, August.

[40] Robert H. Wade, 1990 (2004), *Governing the Market*; Wade, 1993, "Managing trade: Taiwan and South Kora as challenges to economics and political science", *Comparative Politics*, 25, 2, January, pp.147-168; Wade, 1991, "How to protect exports from protection: Taiwan's duty drawback scheme," *The World Economy*, 14(3): 299-309.

> "… entire cities have been devastated by trade pacts. I don't think NAFTA has been good for America, and I never have."[41]

NAFTA has brought large material gains to shareholders and top executives of US and Canadian MNCs and to their dependent Mexican counterparts. It has also stimulated FDI into Mexico, and manufactured exports from Mexico. But Mexico's growth has been sluggish since the 1990s, behind most other countries in Latin America. Average real wages have fallen to the point where the average real wage in Mexico City is below Shanghai. In a recent poll in Mexico, only 20% of respondents believed that NAFTA had been good for Mexican consumers and businesses. A Mexican economist noted,

> "as a development strategy, it should have led to higher sustained growth, generated well-paid salaries and reduced the gap between Mexico and the United States. It has remained well below what was hoped for."

Of course, the fault is not all due to NAFTA. The government and the domestic private sector have failed to increase investment in R&D, regulations remain burdensome, and banks have lent less than their Latin American counterparts, leaving small and medium enterprises scrambling for credit.[42]

VI. Globalization in question: the political evidence is ambiguous

The discussion of NAFTA takes us to the political effects of trade liberalization and capital mobility. The core point is that as the dominant private economic agents detached from their domestic markets, shareholders and top executives of MNCs lost the idea of belonging to a nation, the idea of a basic solidarity with their people, including employees – because their sales and profits no longer depended mostly on the domestic market. As Robert Blecker says,

> "Although the US economy has been running large trade deficits that represent net losses of jobs in tradeables industries, US-based corporations have no such large deficits and have profited immensely from their foreign operations."[43]

Western states under strong influence from business lobbies have been unwilling to protect the public from goods and services produced in cheap labor countries; justifying their unwillingness by faith that globalization – specifically, free trade and investment – will benefit "all (hard working) families" in the longer run. [44]

A cartoon in the *New York Times* captures the point obliquely. A private jetplane lands at an airport, the red carpet is rolled out, down the gangplank walks the chief executive, who declares to his companion,

[41] Quoted in S. Thornton, 2008, "Trade pact smolders in fiery campaign", AFR, 31 March, www.afr.com.
[42] A. Ahmed and E. Malkin, 2017, "Mexico doesn't feel like winner in trade deal", *New York Times (International),* January 6, p. 1.
[43] R. Blecker, 2005, "International economics after Robinson", in B. Gibson (ed), *The Economics of Joan Robinson: A Centennial Celebration,* E. Elgar Publishing, p. 341.
[44] Luiz Carlos Bresser-Pereira, "The political crisis of globalization", http://www.bresserpereira.org.br/view.asp?cod=6723

> "Why should my taxes pay for roads and bridges?… When I don't really use them?"

The cartoon illustrates that the rich now have so much income and wealth relative to the rest of the population that they can effectively live in orbits quite separate from those of the large majority, free from the downsides of globalization, and shape public policy to their liking on issues where their preferences diverge from those of the median voter.[45]

Technology, particularly information and communication technology (ICT), probably accounts for a larger part of job losses in western manufacturing than imports from cheap labour sites.[46] But what matters for political effects is perception, and it is easier for those displaced from well-paying manufacturing jobs into low-wage service jobs or no jobs at all to blame foreigners and foreign countries for their hardship than to blame amorphous technology or inanimate robots.

Erosion of the idea of the nation as an economic solidarity entity (continuing since the 1980s) has gone with a second negative effect of globalization, namely, erosion of Center-left parties and movements all over the West. In the face of triumphant globalization ideology the Center-Left has long tried to compete with the Right by (a) adopting similar neoliberal economic policies of deregulation, liberalization, privatization, downplaying "the nation" an economic unit, unlike Trump, while (b) differentiating itself from the Right on "social" (or "moral") issues like abortion, gender equality, and gay rights. The strategy has had limited success, especially since the financial crisis of 2007-08. These "social" issues are not compelling for electoral majorities, whereas core issues of employment, income protection, and social protection, are compelling – yet the Center-Left hardly differs from the well-financed low-tax Right on this terrain.

A third political effect of globalization is that, finding little comfort from the Center-Left, those who feel disadvantaged, even humiliated, as they see all around the wealthy few making huge fortunes and living luxuriously, and as they see the state giving help to minorities and immigrants financed with their taxes, grasp at comfort from people and parties who do speak the language of "the nation", meaning "people like us", and who promise to "support the people, not the elites". Even when they see the billionaire leader appointing many billionaires to his cabinet. We noted earlier that this broad pattern is well-established in elections around the developed world in the wake of financial crises, not specific to the recent US election.

VII. Why have economists been so committed to free trade and globalization?

Why have the large majority of professional economists, especially in the academy and in western-dominated international organizations like the World Bank and IMF, been committed to free trade policy, downplaying theoretical and empirical weaknesses in order to remain so?

[45] Martin Gilens, 2014, *Affluence and Influence: Economic Inequality and Political Power in America*, Princeton University Press. And not to be missed, Keith Olbermann, https://m.youtube.com/watch?feature=youtu.be&v=gPayKb39Kao

[46] Separating out the causal weight of "globalization" and "technology" on employment, wages and working conditions is difficult because they are so interrelated. Offshoring of manufacturing raises the supply of people seeking employment in service sector jobs, and the spread of information technology makes it easier for companies to outsource many low-skill tasks – running the cafeteria, building maintenance, security, hotel reception – to low-wage subcontractors. See Eduardo Porter, 2017, "How domestic outsourcing hurts workers", *New York Times (International)*, 2 March, p. 10.

The teaching of economics in just about all universities of the western world, and in large parts of the developing world, socializes students into belief in the rightness of the "market" paradigm, and the more "rigorous" the training the more thoroughly socialized they become.[47] The paradigm focuses on price competitiveness – free labor markets, flexible prices, free international trade – as the key to national competitiveness. It treats the market system as "self-organizing", firms being essentially passive except for competing in price. It treats technology as external to production, as something which firms can buy on the market. It has no built-in process of innovation, no conception of an "industrial ecosystem" of firms competing and cooperating with each other.[48] With all these things stripped out, the culture of the profession elevates belief in comparative advantage and free trade as the litmus test of competence to be an economist, as the earlier quote from Krugman suggests.

The market paradigm fits the larger "conservative" worldview, which sees the market as 'natural' and the realm of 'freedom', the state as artificial and the realm of coercion (often predatory coercion). This worldview is not just cognitive ("how the world works"), but intensely normative ("how the world should work", "the right order of society").[49] In the market paradigm, the role of government is limited to "correcting market failures"; so state "interventions" in the market have to be carefully justified case by case. Many conservatives do accept the case for taxes to curb some "externalities", such as pollution taxes to discourage private agents from polluting the environment. Some would even favor a carbon-emissions tax, but not emission regulations (as in Obama's Clean Power Plan).[50]

In short, the consensus belief in free trade stems from the wider cognitive and normative belief – inculcated in economics education -- that the key to economic development lies in improving the scope of, and the institutions of, ex*change*. Government should strengthen property rights, foster the rule of law, and do what is necessary to align domestic prices with international prices (which means, free trade); and then, having put the right incentive structure in place, get out of the way, allowing the production structure to emerge as the result of profit-seeking investment decisions by private firms, domestic and foreign equally.

[47] As one example, G. Racko, et al., 2017, "Economics education and value change", *Academy of Management Learning and Education*, January.

[48] The Crash of 2008 and the ensuing Long Recession, and the experience of taking economics undergraduate courses which made no mention of these events, prompted three Manchester University students in 2011 to form the Post-Crash Economics Society to explore how to get a wider range of approaches into the curriculum. The movement has spread to 43 student campaigns in 15 countries. It is unified around the drive to shift economics from a public no-go area, occupied by a tiny minority of the population who speak the profession's language; and around the drive to introduce more critical thinking, more evaluation, into exams – which currently are comprised mostly of multiple-choice questions to be answered on the basis of rote learning repeated under invigilation. The original three students have written a book, reviewed by Aditya Chakrabortty, 2017, "The Econocracy review – how three students caused a global crisis in economics", *The Guardian*, 9 February, https://www.theguardian.com/books/2017/feb/09/the-econocracy-review-joe-earle-cahal-moran-zach-ward-perkins. See also A. Chakrabortty, 2013, "Mainstream economics is in denial: the world has changed", *Guardian*, 28 October, at: http://www.theguardian.com/commentisfree/2013/oct/28/mainstream-economics-denial-world-changed

[49] For a discipline so strongly normative, it is paradoxical that economics is an ethics-free zone, lacking relevant teaching, journals, newsletters, conferences or even professional codes (the latter until very recently, and then very partial ones). See G. DeMartino and D. McCloskey (eds.), 2016, *The Oxford Handbook of Professional Economic Ethics*, Oxford University Press; and E. Fullbrook, 2016, *Narrative Fixation in Economics*, World Economics Association Books.

[50] M. Feldstein, T. Halstead, N.G. Mankiw, 2017, "A conservative case for climate action", *New York Times (International)*, February 10.

The dominance of the market paradigm has hardly been challenged by the new phase of capitalism associated with the hyper-growth of the financial sector and turbo-charged by ICTs. Money funds and shareholders are pressing companies to give priority to success targets such as profits, dividends, and share prices; and to shift production to cheaper sites offshore, using investable funds at home to buy back shares (to boost share prices), as distinct from invest in R&D and training. Stock markets now tend to reward dividends and share buy-backs, not investment.[51,52]

We see the impacts of the market paradigm in the fracturing of the European Union and Eurozone, gripped by the German and other northwest European countries' conviction that their own economic success is due to their devotion to the market paradigm – flexible costs and prices, small budget deficits, low inflation, and private utilities. They urge the peripheral countries to follow in their footsteps, with fiscal austerity, labour market deregulation, and privatization. They miss the point that their own economic success comes from a very different production and employment system than exists in most of the periphery (Greece, Portugal and southern Italy, for example).[53]

Both the contrast in economic performance within the European Union, and my critique of the globalization agenda, can be understood in terms of the much less favored 'production' paradigm. As Ricardo is the source of the market paradigm, Charles Babbage is the source of the production paradigm, in the form of his 1832 book, *On the Economy of Machinery and Manufacturers.*[54] His successors included Alfred Marshall, Allyn Young, Edith Penrose and George Richardson. It is a fair bet that most economics PhD students in Anglo universities have never heard of these people, let alone read them.[55]

The production paradigm says that the core mechanism of how economies transform (or not) lies in the combination of production capabilities, business organization, and economic governance; or what Michael Best calls the "capability triad".[56] Economies with high capability pivot on a sufficient density of "entrepreneurial" firms which pull basic and applied R&D or production and marketing ideas from MNCs with branches in the economy in question, into innovation in products, processes, organizations, and marketing. These entrepreneurial firms do not emerge by themselves as a natural result of a well-working market. Their own internal capacity development requires a larger ecosystem of finance, skills and S&T partnerships; which depends on trust in social interactions, and therefore physical and/or cultural proximity. The government (national or regional) is the organizer, the steward of the infrastructure

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[51] William Lazonick, 2014, "Profits without prosperity", *Harvard Business Review,* September; OECD, 2015, *Business and Financial Outlook*, Paris.
[52] For a discussion of how mainstream economists' deep normative commitment to the market paradigm blinded them to the build-up of the causes of the Crash of 2008 and subsequent Great Recession, see R. H. Wade, 2016, "Economists' ethics in the build-up to the Great Recession", chapter 15 in G. DeMartino and D. McCloskey (eds.), *The Oxford Handbook of Professional Economic Ethics*, p.268-292
[53] R. H. Wade, 1982, "Regional policy in a severe international environment: Politics and markets in South Italy," *Pacific Viewpoint*, 23(2), October: 99-126; Wade, 2012, "Greece, breaking the doom loop", *Le Monde Diplomatique* (English), blog, 6 July.
[54] Babbage is credited with inventing the mechanical calculator and pushing for the high precision engineering necessary to build such machines, and being one of the first to infer general principles of effective production from close observation, which Ricardo-inspired economists did not do.
[55] On the World Bank's full-on embrace of the market paradigm starting in the 1980s, and move away from helping to boost borrowing countries' production capabilities, including material infrastructure, see R. H. Wade, 2015, "Agenda change in western development organizations: from hard production to soft, timeless, placeless policy", *Lahore J. of Economics*, 20: SE, September, pp. 1-12.
[56] This section draws on Michael Best, forthcoming (2017), *How Growth Happens: The Economics You Were Never Taught*, Princeton University Press.

needed to support this ecosystem. "Macro stabilization" has a supporting, not driving role. Well-known examples are Boston's Route 128, Silicon Valley, the Third Italy, and Germany's *mittelstand* and similarly organized small and medium enterprises (less than 500 employees) in Austria, Denmark, Finland, Netherlands, Switzerland.[57] The most spectacular transformation of all is Singapore, which, like Ireland and Malaysia, aggressively invited in MNCs and also, unlike those cases, carefully developed national capacity to pull more complex production and technology from corporate headquarters to local operating divisions in Singapore and from there to national firms.

From this point of view, the standard argument that: "it is OK, in terms of the national interest, for firms to offshore their 'scale-up' production provided 'start-ups' with their knowledge stay at home" is mistaken, because (a) innovation depends on building on experience of production, "learning while doing", and (b) scale-ups are where the jobs are, not the start-ups.[58]

Germany's economic performance, and in particular its large trade surpluses, comes out of the production system codified in the production paradigm – combined with the longstanding agreement between government, business and labor to hold down wages and domestic demand.

Britain, on the other hand, is a sad case of the costs of following the market paradigm. British manufacturing (with exceptions) was slow (compared to northwest Europe) to introduce interchangeable parts, a culture of "continuous improvement", profit-sharing reward incentives, team-based multi-skilled work organization, minimal separation between managers and workers, and heavy investment in vocational education. Britain remained stuck with piece-rate incentive systems, elaborate job classifications, sharp hierarchical separation between managers and workers, even as its manufacturing firms lost more and more market share.[59] By way of compensation, the government undertook ad hoc industrial policy with subsidies, tax concessions and material infrastructure driven not by a national or regional strategy but by electoral calculation and intense lobbying in the shadows.

British-owned road car manufacturers were wiped out by foreign firms assembling in Britain – which imported two thirds of their parts and components in place of domestic production. The British government did little to encourage them to deepen their production in Britain, saying, in

[57] For the role of US government agencies in forming innovation-focused networks of competing and cooperating firms, see R.H. Wade, forthcoming (2017), "The American paradox: ideology of free markets and practice of directional thrust", *Cambridge J. Economics.*

[58] See Andrew Grove, 2010, "Andy Grove: how American can create jobs", BloombergBusinessweek, July 1. https://www.bloomberg.com/news/articles/2010-07-01/andy-grove-how-america-can-create-jobs. Grove was co-founder and CEO of Intel. He says, "As happened with batteries, abandoning today's 'commodity' manufacturing can lock you out of tomorrow's emerging industry… Our fundamental economic belief, which we have elevated from a conviction based on observation to an unquestioned truism, is that the free market is the best of all economic systems – the freer the better… [Evidence that this is not true] stares at us from the performance of several Asian countries in the past few decades. These countries seem to understand that job creation must be the No. 1 objective of state economic policy. The government plays a strategic role in setting the priorities and arraying the forces and organization necessary to achieve this goal. In a thorough study of the industrial development of East Asia, Robert Wade of the London School of Economics found that these economies turned in precedent-shattering economic performance over the '70s and '80s in large part because of the effective involvement of the government in targeting growth of manufacturing industries."

[59] See the dramatic contrasts between organization in a British-owned factory in Britain and a Japanese-owned one making similar products, in Ronald Dore, 1973, *British Factory-Japanese Factory: The Origins of National Diversity in Industrial Relations,* George Allen & Unwin, London.

the spirit of the market paradigm, “If they can get cheaper parts elsewhere, then they should do it”. The Japanese, Korean and Taiwanese governments would have had a more developmental mindset.

Britain’s low level of output per hour productivity relative to its peers (a bit over three quarters of the US, German and French levels, about the same as Italy, and stagnant since 2007) has been the subject of much research and anguished commentary. The conclusions typically point to: (1) poor infrastructure (rated by the OECD as second worst in the G7); (2) low investment in R&D (at 1.7 percent of GDP in private and public R&D, well below the OECD average, let alone the leaders on over 3 percent of GDP); and (3) a relatively unskilled population, which cannot drive productivity forward.[60]

Strangely overlooked as causes of Britain’s low productivity are: (4) British companies have for two centuries invested relatively heavily overseas compared to at home (the opposite in Germany, Japan, South Korea). (5) The economy has become dominated by finance, with its demands that British companies give priority to success targets such as profits, dividends, and share prices; and use investable funds at home to buy back shares so as to boost share prices. Finance has also had a backwash effect on the “real” economy, attracting highly skilled people to work in finance by offering remuneration many times that available elsewhere. (6) Britain’s captains of industry and its financial magnates are zealous champions of the market paradigm. So they rubbished the government’s green paper on industrial strategy published in early 2017, saying that the solution to lagging productivity is not “industrial strategy” but cuts in regulations – even though OECD measures show that Britain’s labor and product market regulation is low and about the same as in the US.[61]

Emphasising the costs of the last three points would challenge the core of the market paradigm in a way that emphasizing the first three does not. Meanwhile, all the attention is on the costs of Brexit, which will be small compared to the loss from low productivity.

VIII. Conclusion

It may be that,

> “President Trump, animated by private motives as yet undisclosed, wants to bring about a Russian-American axis that would enfeeble Nato, destroy the European Union and dominate a continent reduced to politically dysfunctional national fragments… Operating under the ‘America First’ rubric, Donald Trump has instantly turned the US into a rogue state. Internationally agreed rules on trade, territories, refugees, climate and disarmament are, it seems, to be treated as no longer binding on America.”[62]

The problem is that branding Trump “populist” goes with knee-jerk condemnation of everything he favors. Here is Philip Stephens of the *Financial Times*: “No one should pretend, though, that the populists have the answers. Protectionism impoverishes everyone.”[63] As in

[60] Martin Wolf, 2017, “The productivity challenge to the British economy”, *Financial Times*, January 27.
[61] Nicholas Oulton, 2017, “Productivity puzzle meets delusions of adequacy”, letter, *Financial Times*, February 8.
[62] Joseph O’Neill, 2017, “The case for putting Brexit on hold”, *Guardian*, February 10, p. 29.
[63] Philip Stephens, 2017, “Why the liberal order is worth saving”, *Financial Times*, 10 February, p. 11.

all the *Financial Times'* commentary, he leaves "protectionism" completely unbounded, his blanket condemnation inviting the reader to suppose it means something close to autarky – an obviously stupid trade regime.

I have used Trump's skepticism about free trade as an excuse for questioning the crown jewel status of the theory of comparative advantage and the said-to-be-rigorously derived-and-empirically-well-supported policy of free trade as best for each country and for the world. The reigning belief that all countries should practice free or almost free trade, and that the purpose of "free trade agreements" and international organizations like the WTO is to move public policy towards freer trade – and deeper economic integration more generally – can be challenged on several grounds set out in sections IV–VI, not repeated here.

The standard response to these challenges is:

> "Policy must target the problems directly, and not use protection. The trade-off between free trade and employment must be handled by more social protection and more skill training, while keeping (or moving to) free trade and deep integration. This is best for all."

But what if these policy responses are barely forthcoming? Moneyed politics works strongly against them, as we see in the US's threadbare social protection system.

The British government gives another example. Soon after Theresa May became the Prime Minister of the Conservative government in mid 2016 she declared to the Conservative Party conference,

> "Our economy should work for everyone, but if your pay has stagnated for several years in a row and fixed items of spending keep going up, it doesn't feel like it's working for you."

She was right. But her government inherited – and crucially, maintained – tax and benefit plans which have the opposite effect; which give substantial tax cuts to the relatively well-off, and give substantial benefits cuts to those of working age. As Martin Wolf says,

> "The government has decided to give greater priority to… the better off than to the relatively worse off."[64]

In short, making a level playing field does not ensure that the players turn up to play. Creating effective institutions of exchange in conditions of free trade does not tilt the production-business organization-economic governance capability triad towards innovation and expansion of higher value-added activities. The government can play a crucial role in securing the latter, including by managing trade as part of a larger investment strategy. But first we have to dispense with the saturated scorn with which managed trade is dismissed as "protectionism".

All inter-state agreements imply some sacrifice of national autonomy. Agreements on health, environment, human rights, refugees, development, tax evasion, minimum top marginal tax

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[64] Martin Wolf, 2017, "May's policies make a mockery of her rhetoric", *Financial Times*, February 10, p. 11.

thresholds and the like, have a high potential for mutual gains between the signatory states; they should be encouraged in the spirit of "cooperative internationalism". Liberalization agreements on trade, investment, capital mobility and other domains of economics and finance typically have far-reaching, more ambivalent effects on the structures of production, employment and income distribution in which national populations live. They express the spirit of "integrative globalization", which encourages governments to improve the conditions for markets in their country, remove limits on cross-border economic flows, and let the production and employment structures develop as they will on the basis of private profit-seeking competition between domestic and foreign firms equally.[65]

Free trade is the sensible rule of thumb most of the time in most sectors. It is sensible because the efficiency gains are often real, even if the theory of comparative advantage over-generalizes them; and it is a simpler rule for any state and for inter-state agreements than rules for managed trade. But the argument made here about production and employment, in the context of economic growth rather than static resource efficiency, suggests that inter-state agreements, including the rules of the WTO, should be revised to permit more government "leadership" and "followership" of the market – sometimes by leading the production structure into activities the private sector would not undertake on its own, sometimes by making bets on initiatives already underway in the private sector to assist those initiatives to scale up.[66] This contrasts with the current situation, in which the WTO restricts the use of instruments relevant to developing countries' efforts to upgrade the national production structure – including tariffs, non-tariff barriers, and direct industry subsidies – while allowing instruments relevant to advanced countries' efforts to grow new activities on the world frontier, such as R&D subsidies. The WTO is, put crudely, an industrial upgrading device for advanced countries, an industrial downgrading device for developing countries.[67] President Trump surely does not intend his skepticism of free trade to benefit developing countries, but it gives the potential for others to modify international rules towards more "policy space".

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[65] I take "cooperative internationalism" and "integrative globalization" from Dunkley, 2016, *One World Mania.*
[66] R.H. Wade, 1990, "Industrial policy in East Asia: does it lead or follow the market?", chapter 9 in G. Gereffi and D. Wyman (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, Princeton University Press.
[67] R.H. Wade, 2003, "What development strategies are viable for developing countries? The World Trade Organization and the shrinking of 'development space'", *Review of International Political Economy*, 10(4), November, 621-44.