The Misleading Case for Unmanaged Global Free Trade

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To the delight of many commentators, bipartisan Congressional alliances seem poised to override objections from labor and environmental groups and grant the Obama administration "fast track authority" to complete the TransPacifc Partnership and the TransAtlantic Investment Partnership – the next steps on a steady march toward unfettered free-market globalization.

Advocates of these new international trade pacts are convinced that free market globalization is the way to accelerate economic growth and relieve poverty. This is a veritable article of faith, impervious to evidence that the world's economies have grown *more slowly* as free trade policies have spread – much more slowly than right after World War II. Looking at both statistical studies and the history of economic development, I conclude that the merits of free-market globalization are oversold.

What Really Worked Historically

New York Times columnist Thomas Friedman once challenged the critics of globalization to name "a single country that has flourished, or upgraded its living or worker standards, without free trade and integration." The accurate answer is that during the rise to economic prowess *every one* of today's developed countries relied heavily on government policies that managed and controlled its involvement in international commerce.

- The world's first industrial power, Great Britain, advocated free trade only *after* protectionist policies helped eighteenth-century industries become well established.
- During rapid development in the half century following the Civil War, the United States imposed tariffs on imports that averaged around 40 percent, a level higher than those imposed in virtually all of today's developing economies.
- During the second half of the twentieth century, both Germany and Japan relied on managed trade, not free trade, to propel their rapid economic growth.
- South Korea and Taiwan, two of East Asia's newly industrialized countries, made their way into the world economy with the aid of policies antithetical to free trade – including export subsidies, domestic-content requirements, import-export linkages, and restrictions of capital flows, including direct foreign investment.
- China is the most recent historical case to consider. Advocates of free market globalization argue that China has dramatically expanded its integration into the global economy as it also experienced a rapid rise in living standards. But even if China today is more open to international trade than in the past, it has relied on policies far from those promoted by advocates of "free trade." After three decades of global engagement the Chinese economy still does not have a convertible currency. It maintains state control of its banking system, regulates foreign ownership in equity markets, and uses state corporations to foster exports and investment abroad.

Contemporary Statistical Studies Fail to Make the Case

If history suggests the limits of pure free trade, what about recent statistical studies? According to those who define "free trade policy" as simply lowering tariffs and other barriers, such studies prove that this accelerates economic growth and reduces poverty. However, there are major problems in the way key studies move from evidence to policy prescription.

- One issue is nicely illustrated in influential work from World Bank economists David Dollar and Aart Kraay and in analyses from the global economic consulting firm A.T. Kearney. Both look only at levels of trade and assume that higher levels of trade imply the existence of "free trade" policies. The Kearney study, for example, finds a positive correlation between economic growth and the simple sum of a nation's exports and imports relative to the size of its economy. But this correlation does not tell us whether growth happens in conjunction with reductions in tariffs and other barriers or because of alternative efforts to actively manage trade. Equally flawed, the World Bank study uses decade -by-decade "*changes* in volume of trade as an imperfect proxy for *changes* in trade policy." This method also fails to get at the actual policy mechanisms at work in various nations. A better study by economists Francisco Rodriguez and Dani Rodrik found "little evidence that open trade policies – in the sense of lower tariff and non-tariff – are significantly associated with economic growth."

- Another key shortfall appears in studies that look at changes in policy without considering where policy ends up. The Kearny analysis, for instance, claims that rapid growth is associated with *changes* in countries' position on their index of globalization. But scholarly critiques of Dollar and Kraay have revealed that countries undertaking the sharpest recent cuts in tariffs still had higher average tariffs afterwards than most other countries. In other words, if a country has very high levels of tariffs and adjusts its tariffs downwards while still maintaining control over its trade, the effects may be positive for growth – but do not prove the efficacy of the sorts of extreme lowering of tariffs advocated by purists.

Moving to Smarter Trade Policies

Historical and contemporary evidence suggests policy conclusions almost exactly the opposite from those favored by believers in "free trade" as a panacea. Of course nations can benefit now – as they have in the past – from expanding international trade. The issue is not whether such trade can be beneficial, but how countries can best take advantage of upsides and avoid downsides such as job loss or downward pressure on wages. Progress does not lie in abandoning possibilities for managing domestic consequences by simply sweeping away all tariffs and regulations and privileging foreign investors. On the contrary, nations need carefully fashioned policies that take into account potential disruptions and make the most of complementarities. Free trade purism does not lead to *smart trade policies* that benefit everyone. A rush to unmanaged global trade might benefit the privileged, but it is not warranted by the facts – not if the goal is to help the majority of the world's people flourish economically.

Read more in Arthur MacEwan and John Miller, *Economic Collapse, Economic Change: Getting to the Roots of the Crisis* (Routledge, 2001).