Supporting Question 2

Featured Sources	**Source A:** Jeff Madrick, editorial opposing free trade, "Our Misplaced Trust in Free Trade," *New York Times,* October 3, 2014

Trade is one of the few areas on which mainstream economists firmly agree: More is better. But as the Obama administration pursues two huge new trade deals — one with countries in the Asia-Pacific region, the other with the European Union — Americans are skeptical. Only 17 percent believe that more trade leads to higher wages, according to a Pew Research Center survey released last month. Just 20 percent think trade creates jobs; 50 percent say it destroys them.

The skeptics are on to something. Free trade creates winners and losers — and American workers have been among the losers. Free trade has been a major (but not the only) factor behind the erosion in wages and job security among American workers. It has created tremendous prosperity — but mostly for those at the top.

Little wonder, then, that Americans, in another Pew survey, last winter, ranked protecting jobs as the second-most-important goal for foreign policy, barely below protecting us from terrorism.

Many economists dismiss these attitudes as the griping of people on the losing end of globalization, but they would do better to look inward, at the flaws in their models and theories. Since the 1970s, economic orthodoxy has argued for low tariffs, free capital flows, elimination of industrial subsidies, deregulation of labor markets, balanced budgets and low inflation. This philosophy — later known as the Washington Consensus — was the basis of advice the International Monetary Fund and the World Bank gave to developing countries in return for financial help.

The irony is that during the Industrial Revolution, today's rich countries — Britain, France and the United States — pursued the very opposite policies: high tariffs, government investment in industry, financial regulations and fixed values for currencies. Trade expanded, and capital flowed anyway.

World War II changed everything. Tariffs were seen as having exacerbated the Depression, and inadequate globalization as one cause of the two world wars. So, through the late 1970s, the United States and Europe cut tariffs, though currencies were fixed and capital was still highly controlled. Astonishing American prosperity in the three decades after 1945 led economists to overestimate the impact of free trade. In reality, high growth in those years resulted from many factors: pent-up demand from the war; the Marshall Plan; Cold War military spending; investments in universities, highways and scientific research; and falling oil prices.

Starting in the 1970s, however, under the influence of free-market enthusiasts like Milton Friedman, economists urged further removal of barriers to trade and capital flows, hoping to turn the world into one highly efficient market, unobstructed by government.

The results were often disastrous. The lowering of protective tariffs did not lead to rapid growth in Latin America, which stagnated in the 1980s.

Mr. Friedman's acolytes also urged the reduction or elimination of capital controls — starting in the 1970s in the United States, and in the 1980s in Europe — along with lower tariffs. This, too, was ruinous. An exodus of short-term investments contributed to financial crises in East Asia, Russia, Argentina and Turkey in the mid-1990s, and to the collapse of the Long-Term Capital Management hedge fund in 1998 (a prelude to the 2008 crisis).

Though these mistakes were recognized, the World Trade Organization continued to push one-size-fits-all rules, premised more on ideology than experience, that hurt developing countries.

In 1995, it demanded that members substantially reduce subsidies for export industries. Imagine what would have happened if South Korea, Japan and Taiwan had had to follow this guidance; they became economic powerhouses in the 1960s and 1970s by nurturing their export sectors. (To join the W.T.O., in 2001, China was forced to slash industrial subsidies, but it resorted to currency manipulation to boost its export sector.)

Also that year, the W.T.O. adopted a rule obliging members to abide by rich nations' patent laws. (Never mind that Americans stole technologies from Europe throughout the 1800s.) These laws typically enabled investors in rich countries to reap substantial rewards, while poor nations like India were forced to pay the same price for patented drugs as the rich West, because they were not allowed to make generic substitutes.

But the consensus was flawed. Even free-trade advocates now admit that American wages have been reduced as a result of outsourcing, the erosion of manufacturing and an ever-increasing reliance on imports. Middle-income countries, meanwhile, have been blocked from adopting policies that might make them world-class competitors. Nations that have ignored the nostrums of the Washington Consensus — China, India and Brazil — have grown rapidly and raised their standards of living. Improvements in poverty and inequality occurred in Latin America only in the 2000s, after the I.M.F. and the World Bank reduced their grip on those nations.

Expanding global markets is a worthy goal, but history offers lessons that can lead to more constructive trade, capital and currency policies.

The first is that gradual reform is more effective than a sudden turn to free markets, deregulation and privatization. Shock therapy in Russia was a failure, and nations from Argentina to Thailand paid a dear price for liberalizing capital markets too quickly. The historical models of sustained growth are clear: gradual development of core industries; economic diversification; improvements in literacy and education, especially for women; slow, deliberate opening of capital markets; and the protection of labor from abusive pay and working conditions.

A second lesson is that nations should be left space for experimentation. Some spend too much on social programs, others too little; some need transportation infrastructure, others improved banking; some require literacy programs, others advanced education; some need to subsidize emerging industries, others to privatize bloated state industries; some need worker protections like unemployment insurance, others need labor mobility. Most have too few regulations to protect the environment, finance and consumers.

A third lesson is that models of growth that depend indefinitely on exports are not sustainable. The large imbalances in trade between China and the United States distort economies. The same is true of Germany's huge trade surpluses, which are based on a fixed euro and restrained domestic wages.

Finally — and this is especially true for rich nations — every free-trade agreement should come with a plan to strengthen the social safety net, through job training, help for displaced workers, and longer-term and higher unemployment benefits. Free-trade deals must also be accompanied by policies to stimulate growth through infrastructure investments, subsidies for clean energy and, perhaps, other industries, as well as loans to small businesses, and even wage subsidies.

Free trade has been a priority for the Obama administration, but Congress, wisely, has not given it "fast track" authority, as it gave Presidents Bill Clinton and George W. Bush, to negotiate new trade deals without its approval.

Any trans-Pacific agreement, its terms still a secret, should be discussed in the open with ample protection of worker rights and healthy debate over regulatory changes requested by developing countries or big business. A

trade agreement with the European Union makes more sense, but the danger is that environmental, financial and product-safety regulations will be watered down to meet the demands of corporate interests.

Economists are correct that free trade need not be a zero-sum game. But the genuine gains in prosperity from free trade can be maximized, and broadly shared, only if the policy errors of the past 40 years are properly understood.

Jeff Medrick, "Our Misplaced Faith in Free Trade," *New York Times Sunday Review*, October 3, 2014. http://www.nytimes.com/2014/10/04/opinion/sunday/our-misplaced-faith-in-free-trade.html.

Supporting Question 2

Featured Source	**Source B:** Paul Krugman, editorial opposing free trade, “Is Free Trade Passé?” (excerpts), *Economics Perspectives*, Fall 1987

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." For one hundred seventy years, the appreciation that international trade benefits a country whether it is "fair" or not has been one of the touchstones of professionalism in economics. Comparative advantage is not just an idea both simple and profound; it is an idea that conflicts directly with both stubborn popular prejudices and powerful interests. This combination makes the defense of free trade as close to a sacred tenet as any idea in economics.

Yet the case for free trade is currently more in doubt than at any time since the 1817 publication of Ricardo's *Principles of Political Economy.* This is not because of the political pressures for protection, which have triumphed in the past without shaking the intellectual foundations of comparative advantage theory. Rather, it is because of the changes that have recently taken place in the theory of international trade itself. While new developments in international trade theory may not yet be familiar to the profession at large, they have been substantial and radical. In the last ten years the traditional constant returns, perfect competition models of international trade have been supplemented and to some extent supplanted by a new breed of models that emphasizes increasing returns and imperfect competition. These new models call into doubt the extent to which actual trade can be explained by comparative advantage; they also open the possibility that government intervention in trade via import restrictions, export subsidies, and so on may under some circumstances be in the national interest after all.

To preview this paper's conclusion: free trade is not passé, but it is an idea that has irretrievably lost its innocence. Its status has shifted from optimum to reasonable rule of thumb. There is still a case for free trade as a good policy, and as a useful target in the practical world of politics, but it can never again be asserted as the policy that economic theory tells us is always right....

However, showing that free trade is better than no trade is not the same thing as showing that free trade is better than sophisticated government intervention. The view that free trade is the best of all possible policies is part of the general case for laissez-faire in a market economy, and rests on the proposition that markets are efficient. If increasing returns and imperfect competition are necessary parts of the explanation of international trade, however, we are living in a second-best world where government intervention can in principle improve on market outcomes. Thus as soon as the respectability of non–comparative-advantage models in international trade was established, international trade theorists began to ask whether the new view of the *causes* of trade implied new views about appropriate trade *policy.* Does acknowledging economies of scale and imperfect competition create new arguments against free trade?

Paul Krugman, "Is Free Trade Passé?" *Journal of Economic Perspectives* 1, no. 2 (1987): 131–144. Copyright © 1987 American Economic Association. http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.1.2.131.

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Featured Source	**Source C:** Joseph Stiglitz, videotaped interview by Jere Van Dyk about barriers to free trade, *Free Trade?* (excerpt from transcript), April 3, 2006

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The Voice for Ethics in International Affairs
With
Joseph Stiglitz
Economist and Professor
Columbia University
April 3, 2006
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Joseph Stiglitz: Free Trade?
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JOSEPH STIGLITZ: We don't really have a free trade regime. Free trade would mean that you took away all barriers to trade, all impediments to a level playing field.

For instance, the United States and the European Union subsidize agriculture. That means that almost half of the income of produced in these countries comes from government subsidies; they don't just rely on the market. Free trade would be to rely on the market alone. Some might argue that they spend more money farming Washington than they do farming the land.

The problem is that developing countries, too poor to give subsidies, have to compete with this highly subsidized Western agriculture. So even if they were twice as efficient, they would have a hard time competing. But they have all kinds of other problems that would make it more difficult for them to take advantage of a free-trade regime, even if such existed. For example, you have to take your product to the port, put it on a ship to the United States where it can be sold. But if your roads don't exist, if your ports aren't very good, it's hard to export. Developing countries have a very weak infrastructure. So we say that they have internal barriers to trade as well as the artificial barriers to trade of tariffs and other artificial government-imposed trade impediments.

Trade negotiations lower the artificial barriers, but in the past they have done nothing about the internal barriers. Europe opened up its markets unilaterally to the least-developed countries about three or four years ago. They recognized that in the past, trade agreements had been totally unfair to developing countries and they said: "We care about those who are less fortunate than us. We give aid. Well, rather than just giving a handout, let's help them grow and let's open up our markets." So they took away their tariffs on most goods.

But very little trade resulted. Part of the problem was the technical provisions, but it also had to do with supply-side constraints—that they had neither the goods to produce, nor the infrastructure to deliver any goods to market. The result was very little increase in real trade.

The video of the entire interview can be found online at https://www.youtube.com/watch?v=4rgj9EG5PS8.

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