What would post-autistic trade policy be?

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The theoretical case for free trade continues to crumble under the assault of New Trade Theory. But what actual policies does this imply? Unfortunately, this is unclear, as New Trade Theory is a mess. Once one leaves the autistic fantasy world of free trade's *laissez-faire* economics, one also leaves behind its tidy-but-false policy implications. Post-autistic trade economics must reconcile itself to inelegant theory – and almost certainly to catch-as-can policymaking closely dependent upon the economic experiences of the particular nation in question.

Because New Trade Theory implies that optimal trade solutions vary from nation to nation, and depend upon empirical facts that change over time, there is no universal solution to derive. We can only familiarise ourselves with the fundamental *logic* of the solutions New Trade Theory implies.

Let us take the United States as the test case, because it is the US retreat from free trade, given its size and command position in the world economy, that will probably bring about the global end of free trade. Not only is American support of the World Trade Organization the driving force for the expansion of free trade as a legal construct, but America's willingness and ability to sustain huge trade deficits is the anchor of the present global trading system. Furthermore, the US economy is most familiar to readers around the world, and it is a broad-based, not a niche, economy, and thus raises the key economic issues that concern us here.

National self-interest is assumed below to be the objective of trade policy. While this is dogmatic from an ideological point-of-view, it makes the policy logic tractable, and is a fairly reasonable assumption (although not the only possible one) about how the political systems of the US and its trading partners would behave.

The first big question of the post-free trade environment is the choice between uniform and strategic protectionism. Uniform protectionism means a policy that does not vary, like the same tariff on all imported goods. Strategic protectionism means a policy that varies according to the product, the country of origin, or some other variable. Obviously, tariffs aren't the only alternative to free trade; there also exist quotas, national content requirements, offset requirements, and a host of other policies. But we shall look at tariffs below simply because they are the simplest to analyse, and thus a good place to begin.

The key advantage of uniform protectionism is that it doesn't require knowledge, presently under-developed outside the sophisticated neo-mercantilist states of East Asia, of how to implement strategic protectionism correctly[1]. For example, a strategic tariff that varied by industry would be vulnerable to lobbyist manipulation, or to mistaken technocratic decision-making by the tariff-setting agency. And right now, it would be impossible to give a straight answer about exactly what a strategic tariff would involve. How could any elected official, subject

[1] See Fingleton, Eamonn. *Blindside*. New York. Houghton Mifflin Co, 1995.

to the usual pressures of an electoral democracy, vote for such a policy when he could not be told what it would do to the industries in his district?

Unfortunately, choosing a flat tariff means foregoing the economic gains a strategic tariff could have produced. Furthermore, without understanding strategic protectionism, uniform protectionism will be a 'black box' policy, and the electorate won't understand how or why it works. This will lead to misunderstandings about its costs and benefits, producing unnecessary political conflicts and bad policy decisions on domestic economic issues affected by it. More crudely, the problem with uniform protectionism is that even the most autarkist economist will admit that a tariff on bananas is not in the national interest.

A nation will be richer, by definition, if its economy concentrates on the production of high-value goods, which implies its optimal tariff policy is one that pushes its economy in this direction. But this means pushing it *away* from the production of low-value goods like bananas, which it should aim to import instead. But, at least to a first approximation, uniform protectionism protects, and thus promotes, domestic production of low and high value goods equally. This means it would give an advanced economy like the US more low-value industry, and less high-value, than successful strategic protectionism.

In essence, a flat tariff would force Americans (or the consumers of any other advanced industrial nation) to buy expensive domestically-produced goods that they could have sourced more cheaply abroad without economic harm. The jobs 'lost' to imports would be low-paying ones in low-grade industries that the nation had deliberately chosen to abandon in favor of more lucrative ones. Now a strategic tariff is designed to avoid this problem. If implemented correctly, it will produce significantly better results, as it will help the national economy systematically 'cream off' the most lucrative industries in the global economy.

The catch? It is very tricky to get right, and very costly to get wrong.

For a start, what is a high-value industry? Merely expensive products do not automatically make an industry high-value: Pakistan produces expensive Oriental rugs, but by means of huge amounts of low-paid labor, so this is not an industry a high-income nation should covet. But even having a higher tariff on industries with high productivity per man-hour, the fundamental basis of sustainable high wages, won't suffice. If Singapore has locked up the computer disk drive industry with a huge amount of sunk capital and accumulated know-how, then the cost of clawing one's way into this industry against an entrenched competitor may be more than it is worth. Particularly since out-competing the established Singaporean industry may mean driving down the price of the product on the world market to the point where it is no longer such a lucrative industry after all.

So is the answer, perhaps, to chase some industry that is *not* already locked up by a dominant producer? Unfortunately, that does not guarantee results, either. The US could have declared a tariff on supersonic passenger planes in 1965, to help Boeing, not the Anglo-French consortium that built the Concorde, win dominance in this then-promising industry. In an alternate universe, this might have been a great move, and 200,000 high-paying jobs might now be in Seattle and Long Beach, not Toulouse and Filton, because of it. But the industry turned out to be a dud.

Free traders' *laissez-faire* warnings against letting government pick winners are invalid if elevated to a universal dogma. But they are absolutely correct that one needs convincing reasons *why* government knows better than the free market, when one proposes to intervene with protectionism in an industry. The market isn't always right, but one cannot outsmart it without knowing something it does not know, or applying some analysis it does not apply.

What analysis would do this? Such an analysis would require a valid theory concerning which industries to protect, how much, when, and how. At present, we have only glimmers of this Theory of the Optimum Tariff. We have some good critiques of free trade, an understanding of how some fragments of the alternative might work, but there is no great protectionist synthesis. Logically, that synthesis would have to begin with the various refutations, within accepted mathematical economics, of free trade. That New Trade Theory already does. Then, it would deduce what the refuting theories imply would constitute effective protectionist policies.

New Trade Theory makes basically two lines of attack on free trade. The first pokes holes in the theoretical core of the free-trade position: the venerable Theory of Comparative Advantage. The second argues that even *if* the Theory of Comparative Advantage is true, free trade can *still* be sub-optimal. Let us look at the latter arguments first, simply because they're easier to understand.

The most obvious argument is simply income distribution. Even if free trade does maximise economic output, it can still cause an increase in income inequality that outweighs this for most earners. It could expand output by 3%, but this could consist of a 4% drop in the output received by the bottom 90% of the population, plus a 20% increase in that received by the top 10%.[2] Let us assume that we, as a political value-judgment, care about the *distribution* of goods; free trade theory only cares about maximising output. So it is technically true, but mismatched to our social objectives.

The policy implication of this argument? Restrict those aspects of foreign trade that increase income inequality. This question is complex, but it is clear that trade *must* increase income inequality, other things being equal, insofar as it forces low earners into competition with cheap foreign labor *more* than it does high earners. This would happen, for example, if it were easier to import goods whose production requires low-skill labor, like cheap manufactured goods and call-center services, than goods requiring high-skill labor, like accounting, legal services, business management, and surgery.

It follows that, hypothetically, one could blunt the increase in income inequality by making low earners less exposed to competition from foreign labor. Logically, one would do this by restricting imports of goods produced with low-skilled labor. This is not absolutely impossible, but it would be cumbersome to implement, and would tend to bias the economy in question towards the production of low-skilled goods. Unfortunately, this is actually the *last* thing we want, as these will, by definition, tend to be low-paid. When free traders charge protectionists with 'preserving today's jobs at the expense of tomorrow's,' this is usually what they are talking about. They are wrong, if their argument is elevated to an absolute, but right, as a caution.

[2] The numbers work if you remember that initial income distribution is not equal.

The essential problem is that the value of protecting low-end jobs entirely depends on whether the workers in question would otherwise hold better or worse ones. Saving rust-belt assembly line jobs at General Motors is good, if the alternative is working at Wal-Mart for half the pay. But it is bad, if it means locking up the nation's finite human and financial capital in aging factories when they could have been invested in new industries that pay better. New Trade theory recognises this fact, but disavows the possibility of an easy formula to discriminate the two cases, particularly *ex ante*, which is of course when policy must be made.

The next major argument against free trade, associated with Ian Fletcher[3], is that differences between nations in their preference for short vs. long-term consumption can make free trade, when running a trade deficit, merely the most efficient way to splurge on short-term consumption and long-term bankruptcy. If free trade is just a way for chronic deficit nations like the US and UK to eat more apples today, with the nations they run trade deficits with ending up owning the orchards tomorrow, they could be better off, paradoxically, with a policy *less* efficient than free trade. Efficient self destruction is not a good thing! And the analysis reveals they don't even have to be *outright* decadent, just *more* decadent than their trading partners, for free trade to gradually bleed them of their wealth.

Although it is open to any number of solutions, the interesting thing about this argument it is that it reminds one that it is possible to attack the problem of trade not head-on, but by way of trade's necessary counterpart: the payments a nation's residents give to foreigners in exchange for the imports. When a nation engages in deficit trade, it must, unless it is trading with Father Christmas, *always* be paying for its imports either by assuming debt to foreigners, or by selling off existing assets to them. Therefore, limitations on the ability of its citizens to assume foreign debt, or sell assets to foreigners, would combat its trade deficit. Any international system that regulated capital flows, as Bretton Woods did, could hypothetically opt to do this.

The difficulty here is that there exist perfectly legitimate reasons for individuals and corporations to assume foreign debt and sell assets to foreigners. And it is only changes in the nation's *net* debt and asset position that matter, so any given transaction means nothing. Furthermore, because foreign debt, and foreign equity in a nation's assets, are sources of capital for its economy, limiting them would tend to raise the price of capital, i.e. interest rates. So this policy would only be viable if combined with a rise in its savings rate, so that domestic capital could make up the shortfall.

The remaining arguments about post-autistic trade policy concern the theoretical heart of the free-trade case: the venerable Theory of Comparative Advantage.

The most profound such attack is that of Ralph Gomory and William Baumol[4]. They observe that the Theory of Comparative Advantage conceals hidden assumptions. For a start, it presumes that the free international market will automatically shunt every nation into producing that which it is best at, by the same invisible hand that operates in the domestic economy. But real-world industrial history reveals that which nation captures which industry is often quite arbitrary, a matter of 'who got there first' and other historical accidents. There is no *natural*

[3] Ian Fletcher, "A Neoclassical Hole in Neoclassical Free Trade", *post-autistic economics review*, issue no. 26, 2 August 2004, article 5, http://www.paecon.net/PAEReview/issue26/Fletcher26.htm

[4] See Gomory, Ralph & Baumol, William. *Global Trade and Conflicting National Interests*. MIT Press, 2001.

reason why Switzerland should long have dominated the watch industry, or Taiwan dominate the laptop industry today. In the language of technological history, these outcomes are path-dependent.

This insight is a part of the burgeoning economics of 'multiple equilibria:' the free market sometimes gives no *one* right answer, only answers that are 'locally' optimal, i.e. better than similar alternatives. They are not necessarily 'globally' optimal, i.e. better than any feasible alternative[5]. But if this is true, then the equilibrium the market settles on is not necessarily more efficient than others it might have settled on, and there is no absolute necessity to defer to it.

Of course, this doesn't mean that any outcome policy-makers might wish to impose is an equilibrium, even a local one, or can be produced by the fiat of policy. Neither does it mean that getting from one quasi-arbitrary equilibrium, to a better one, is easy. It just means that the free market won't necessarily deal a nation the best hand it could possibly have obtained, as classic Ricardian trade theory claims it will do.

Autistic economists hate multiple equilibria, but they are hard to explain away. What they imply, is that in the world economy, some industries are 'retainable:' once established, they are to meaningful extent sheltered from the full blast of competition, and can rack up exceptional profits – and pay exceptional wages – as a result.

The most familiar case of this concerns so-called 'infant industries.' But it is not a matter of infant industries only, or only of newly-industrializing nations, as the continuous technological evolution of the world economy means that parts of many industries are always 'infant.' The global economy has a continuously-evolving cutting edge, in which retainable industries are being won, and free trade is not necessarily the way for a nation to win them.

Thus there can be[6] a conflict between a nation's most efficient choice in the short run – stick to what it produces best, as revealed by the international free market – and the possibility that sacrificing a bit of short-term efficiency could help it win more lucrative industries in the long run. The Theory of Comparative Advantage is intrinsically short-termist, because it only analyses how a nation may best exploit the comparative advantage it has *today*, and says nothing about how a nation can shift its comparative advantage, over time, up the rungs of the global economy. But it is this upwards evolution – and avoiding its downward converse – that ultimately matters more to a nation's standard of living than whether it squeezes every last drop out of the comparative advantage it has today.

The catch, of course, is that there is no easy formula for winning at this game. Japan protected its car industry and developed a world-beater. Brazil protected its computer industry, and got stuck with expensive and mediocre domestic computers.

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[5] Do not confuse the use of the terms 'local' and 'global' here with their geographic sense. Their use here concerns mathematics, and has only an indirect connection to globalism or the global economy.

[6] Though there may not be; this is the maddening thing about New Trade Theory: it depends upon circumstances. New Trade Theory's mathematics will accommodate any set of genuine empirical facts, rather than telling hard data it can't possibly exist, as classic free trade theory tends to do. The price one pays for this is a lack of one-size-fits-all prescriptions for what nations should do.

One indication that Gomory and Baumol's critique is really onto something is that their theory predicts the world economy will exhibit intense rivalry between nations, as they jockey for industrial advantage, not the celestial harmony free trade theory predicts, in which only foolish nations, which don't understand the Theory of Comparative Advantage, waste their time rebelling against the natural order. Their theory is thus the perfect theoretical underpinning for a counter-hegemonic critique that recognises the dishonesty of the dominant economic powers of the day preaching the 'naturalness' of this order to everyone else, but is realistic about the failure of the old-fashioned socialist economics that is usually offered as the alternative.

A related insight is that productivity growth in the trading partners of an advanced economy like the US does not necessarily benefit that economy. Paul Samuelson recently published a paper demonstrating this mathematically[7]. Once again: the Theory of Comparative Advantage only tells a nation what its best move is under *present* conditions; it says nothing about whether free trade may help the rest of the world economy evolve against its interests over time. The disturbing thing about this critique is that it appears to imply that, under some circumstances, advanced nations have a real interest in 'holding others back', something that has been suspected by Marxist critics for a long time[8].

The classic Theory of Comparative Advantage also suffers, like much of autistic economics, from the problem of externalities. The key issue here is the poorly understood economic ecology of supporting-industry networks, which can collapse as described here:

> 'At aircraft maker Boeing Co, for example, "the more Boeing outsourced, the quicker the machine-tool companies that supplied it went bust, providing opportunities for Chinese competitors to buy the technology they needed, better to supply companies like Boeing."'[9]

The policy implication here is unclear, beyond a strong suggestion that the evolutionary economics of industrial ecology may have a larger role to play in future trade policy formation than is presently realised. The value of an industry network is greater than the sum of the value of the firms in it, and cannot be measured by conventional economic measures, which only take the aggregate of individual firm values into account.

Another critique of the Theory of Comparative Advantage is by Paul Craig Roberts.[10] He argues that it presupposes facts that were once at least mostly true, but no longer hold today. For one, that capital and technology are fixed, not mobile, between nations. In 1950, it would not have been feasible for General Motors to relocate its plants to India, because India in 1950 was a socialist country that wouldn't have wanted a capitalist behemoth like GM, and because the technology of 1950's auto production depended on a vast installed base of plants, human capital, and supporting infrastructure, which India didn't have and GM could not have built there at

[7] http://econ-www.mit.edu/faculty/download_rp.php?id=50

[8] Though of course, New Trade Theory does not license elevating this to a political dogma, as it reveals that under some circumstances, the dominant economic powers have much to gain, selfishly, by promoting growth in under-developed nations!

[9] Kynge, James. *China Shakes the World*. New York. Houghton Mifflin Co, 2006.

[10] Testimony before the U.S.-China Commission Hearing on China and the Future of Globalization. (http://www.uscc.gov/hearings/2005hearings/written_testimonies/05_05_19_20wrts/roberts_craig_wrts.htm)

feasible cost. But in 2006, companies face no such constraints, and relocating white-collar work to India, and blue-collar work to China, is easy. This critique would seem to imply that the advantageous policy for advanced nations is to resist the 'leakage' of their capital and technology to newly-industrialising ones. The nationalistic implications of this may be disturbing, but under some circumstances, they may be validly drawn.

Post-autistic trade policy is in its infancy. Given that global free trade is unlikely to outlive the looming collapse of the dollar[11], there is an urgent need to work out these principles. Otherwise, the end of free trade may simply produce a policy vacuum that will be filled by irrational nostrums derived from populist demagogy, special-interest corruption, and misunderstood history.

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contents page for issue 41

post-autistic economics review index

post-autistic econommics network home page

A Guide to What's Wrong with Economics

[11] These words were written in mid-December, 2006, at which point the dollar had already slid somewhat.

Post-trade processing occurs after a trade is complete; at this point, the buyer and the seller compare trade details, approve the transaction, change records of ownership, and arrange for the transfer of securities and cash.Â James Chen, CMT, is the former director of investing and trading content at Investopedia. He is an expert trader, investment adviser, and global market strategist. Learn about our editorial policies. James Chen. Reviewed by. Start studying Chapter 18 Post Quiz. Learn vocabulary, terms and more with flashcards, games and other study tools.Â 235. Which of the following about trade is true? a. Protectionism (i.e., policies that limit trade in certain goods) promotes both economic prosperity and greater employment. b. Countries that have a lot of resources, like the United States, are always hurt by trade. c. Specialization and trade leads to mutual gains for countries. d. Countries will have a higher standard of living when they produce as many goods as possible. 7. Posting links in other subs pointing to specific submissions or comments here is subject to a ban, depending on context. Mocking or ridiculing this sub or its users on other subs may result in a ban here. 8. Misleading, fabricated or sensationalist headlines are subject to removal. 9. Self posts that lack context or content may be removed. 10. Submission Statements are required for link and image posts. Link posts without a Statement will be removed after 20 minutes. A Submission Statement is a 2+ sentence comment in reply to your post, in your own words, that describes why the post is relevant to the sub. [Meta] Posts.Â the cia built anonymous and the resultin splinter factions and now the state as a free to use supercomputer made up of autistic savants. permalink. embed.