

A Moderate Compromise: Economic Policy Choice in an Era of Globalization
(Excerpt) - by Steve Suranovic (Palgrave MacMillan, 2010)

Chapter 11 – A Policy Plan for the US

The key policy proposal in this study is unfettered free trade. But how is the world supposed to achieve that goal? Currently, movements towards trade liberalization, either through the implementation of free trade agreements or within the WTO, involve a process of reciprocity. Each country agrees to reduce some of its trade barriers, but only if the other country(ies) agrees to lower its barriers reciprocally. If other countries refuse to reduce barriers sufficiently, then progress towards liberalization is halted. Furthermore, if another country changes its policies and reneges on a previous promise, current trade agreements allow the other country to retaliate by removing some of its previous trade concessions.

Although this method of reciprocal trade concessions has had considerable success reducing barriers to trade over the past half century, recent trends suggest the process may be stuck. The failure to achieve even modest trade concessions under the Doha round of WTO talks and the difficulty in the US to approve negotiated free trade agreements are two bits of evidence that reciprocity may no longer work. At the same time the process prevents powerful players like the US and EU from unilaterally reducing barriers since to do so would give up possible bargaining chips for future negotiations. Finally, the economic crisis of 2008 has led to a modest increase in protectionism and to greater suspicions that free market philosophy is a failure. So can anything be done to stem the rising tide against free international markets?

Well one alternative, although admittedly a somewhat fanciful suggestion, is for the US to give up the strategy of reciprocity in trade negotiations and instead to

unilaterally accept and implement the principles of free markets over a designated adjustment period. But why should the US do this?

The US is the largest, most dominant and most dynamic economy in the world today. As such, it is best suited to withstand moderate strains and pressures that would arise in a truly competitive international environment. Because of its dynamism and innovative capacities, the US is also best suited to demonstrate how unleashing the full forces of a free market, reigning in the undue influence of corporations to restrict competition, and providing for an adequate generalized social safety net, can generate a renewed vitality and dynamism that other countries will wish to follow. In other words, the US can and should lead by example. Friedman (2002: p.73) suggested precisely the same approach more than fifty years ago when he wrote:

“Given that we should move to free trade, how should we do so? The method we have tried to adopt is reciprocal negotiation of tariff reductions with other countries. This seems to me the wrong procedure. In the first place, it ensures a slow pace. He moves fastest who moves alone. In the second place, it fosters an erroneous view of the basic problem. It makes it appear as if tariffs help the country imposing them, but hurt other countries, as if when we reduce a tariff we give up something good and should get something in return in the form of a reduction in the tariffs imposed by other countries. In truth, the situation is quite different. Our tariffs hurt us as well as other countries.”

A practical proposal could include the following elements:

- a. Start now with immediate free access for all goods and services for the least developed countries.
- b. Begin a transition to complete free trade with all countries within 5-10 years.

- c. Begin a transition to the complete elimination of all agricultural supports within 5-10 years.
- d. Dismantle trade remedy laws; or as a more modest first step, require that injury determinations incorporate consumer effects.
- e. Expand the allowances for legal immigration
 - i. Maintain strong restrictions for dangerous persons.
 - ii. Restrict access to social services for illegal immigrants.
- f. Transition to a generalized social safety net for all who suffer catastrophic losses regardless of the source of the distress.
- g. Strengthen private property protections and reduce government interventions .

The easiest change to make is the removal of all trade barriers with the least developed countries. The volume of trade with these countries is very small and the change would only affect a few agricultural, textile and apparel industries. Therefore adjustment costs would be minimal. Complete free trade with the rest of the world would require considerably greater adjustment, which is why it makes sense to spread the adjustment over 5 - 10 years. The same is true for the reductions in agricultural supports. Previous investments are likely to have been based on the presumption that trade barriers and agricultural supports would be maintained. Allowing a phase-in period would enable new investments to be redirected with regard to the new policy circumstances.

Elimination of the trade remedy laws is an important step in demonstrating a commitment to free trade. However, because these laws are so firmly entrenched in US

law and because they are sanctioned for all WTO members, it would be difficult to eliminate them entirely. As a compromise, one simple adjustment would be to require that injury determinations take into account the impact on consumers as well as producers. In this way, domestic consumers will be less likely to be shortchanged because of the involuntary transfers to import-competing businesses.¹

Expansion of legal immigration would also solidify a US commitment to free market principles. In a dynamic economy, new workers are like injections of oxygenated blood. Not only do the majority of immigrants have the motivation to succeed but also by coming into a competitive system they are able to be absorbed in ways that will stimulate additional production. It is immaterial whether high or low skilled workers are allowed to enter. At all levels they will enable new production at lower prices for more consumers. Although immigration will take some jobs away from Americans in the transition, they will also act to promote greater expansion of the size of the overall economy.

Of course, whether due to increased competition from the removal of trade barriers, or the increased immigration, the additional competition will inspire a faster churning process in the labor and capital markets and more people will be temporarily injured in the adjustment process. For some, hard times will be persistent in which case a compassionate society can and should provide assistance. Thus, improving the generalized safety net is an important component of this policy strategy. The key feature though should be to avoid policies like trade adjustment assistance, which help workers who are hurt because of only one type of competitive circumstance. Instead, assistance should go to any worker that suffers much greater than usual harm caused by competition

in general. Thus, a worker who loses out due to local competition should have equal claim to services, as one who loses out due to import competition or because of expanded immigration. Of course the benefits should not be too generous and should only go to citizens who are suffering the most. If the safety net is too generous, the incentive to adjust quickly to the new market circumstances will be reduced.

It is certainly true that unilateral free trade and agricultural support reductions will give an advantage to some foreign firms over domestic firms. It would be easy, as is always done, to claim the advantage is unfair and to insist that protections be maintained. Indeed this is the standard operating procedure and the reason why it is unlikely that such a policy change could be implemented. Political pressures would prevent it from happening. Nonetheless this proposal suggests a completely new mindset.

The US can compete regardless of what unfair practices others may follow. It is important to realize that for all the competitive advantages a country like China or Vietnam or others enjoys in some industries, they also endure countless disadvantages as well. Among these are immature legal systems, lack of contract enforcement, considerable governmental red tape, poor security, poor corporate governance practices, and weak financial systems. When one country has advantages in some sectors, either natural or government induced, other countries will have advantages somewhere else. That is the principle of comparative advantage. Thus, if the US dismantled its system of protection unilaterally, despite competitive gains by foreign countries in some sectors, the US would realize gains in new sectors. The trick is to discover what those new sectors will be. This is something governments cannot do effectively; neither can academic

researchers, think tanks or any other group of smart people. Only through the private competitive discovery process will we learn where the newly viable sectors will be.

To accept and promote competition requires business owners and workers to be ready and willing to adjust to changing circumstances. Removing trade barriers and agricultural supports will change the costs of doing business in some industries and force them to adjust to the new conditions. Allowing greater immigration will do the same. If they can't adjust appropriately, it is true that they will fail. Those that do fail will release their capital and workers to be reallocated to other sectors where they can be relatively productive once again. However, these business failures do not represent a failure of the system. Instead they are the strength of the system. It is through the continual business creation and destruction process that workers and companies learn resiliency, learn to be quick and nimble, and learn how to provide most effectively for the wants and needs of the people of the country and the world. It is through this process that businesses discover the most efficient means to satisfy consumer demands. It is also the way for the US to show leadership and economic strength and to contend with the ever-growing pressures of competition from China, India and other expanding economies abroad. Friedman (2002, p73-74) emphasized how free trade raises a nation's economic power when he noted that,

“I believe that it would be far better for us to move to free trade unilaterally, as Britain did in the nineteenth century when it repealed the corn laws. We, as they did, would experience an enormous accession of political and economic power. Let us live up to our destiny and set the pace, not be reluctant followers. ... We could say to the rest of the world: We believe in freedom and we intend to practice it. No one can force you to be free. That is your business. But we can offer you full cooperation on equal terms to all. Our market is open to you. Sell here what you can and wish to. Use the proceeds to buy what you wish. In this way cooperation among individuals can be world wide yet free.”

A much weaker economic strategy is the path the US is on now. Continual complaints about the unfair trade practices abroad and persistent demands for protections are not indicators of economic strength and global leadership. If the largest most successful economy in the world can't compete with the competitive pressures from China or India, then who can?

Implementation of unilateral free trade also achieves one other important effect; it would redirect currently unproductive resources towards more productive activities. Considerable resources are currently used discussing and arguing about future trade policy changes with other countries. In addition, corporations and business groups maintain large legal and lobbying staffs in Washington DC to both monitor and influence international policy decisions. Once unilateral free trade is implemented, the motivation behind many of these efforts will cease. Perhaps most importantly, a commitment to promote competition and free trade, would enable businesses to redirect their attention to making a better product for their customers rather than protecting and promoting their individual competitiveness by lobbying Washington. The savings to business, consumers and taxpayers could be considerable.

Obstacles along the Way

Those interests vested in the way the system currently operates have enormous influence over proposed changes. Chances are very good that sound proposals to change the way we conduct trade policy would be viewed as a radical departure from standard practices and would have little chance of making it through the legislative process. The

agents who stand to lose from a change in the system are precisely the ones who can most influence the outcomes produced by the system.

In addition, policymakers won't easily give up policy levers they can use to please the voting public and procure votes in the next election. Lawyers and lobbyists won't easily give up their influence in the political process and the salaries that come with it. Workers won't easily be convinced that competition with foreign businesses and foreign workers and the adjustment it requires will make the economy stronger. Finally the agricultural industry will not be easily convinced that they should give up their subsidies. Thus, despite plenty of calls for change by American politicians, it seems unlikely that the political process, as it is currently configured, can produce very much change.

Arguments against this proposal and in favor of the status quo requires its supporters to accept an important assumption that this book has argued is simply not true. For example, supporters of interventionist trade policies would have to argue that their policies will be an improvement for the country overall; and act as if their sophisticated analysis provides a clear conclusion about the national welfare effects of their proposed policies. However, as we've argued in Chapters 2 and 3, there is no way for anyone to know with confidence whether policy interventions will be good or bad in some overall sense. The same is true for the suggestion that the US pursue free trade. There is no way to know whether free trade will be an improvement in some overall sense. Nonetheless free trade is suggested here, not based on a presumption of superior knowledge, but rather because it is consistent with the moderate principles of justice and the larger understanding that every policy choice has uncertain impacts.

Of course there is an intellectually honest way to argue in support of an interventionist trade policy or the status quo. That approach would accept the ambiguity of the national welfare effects of policies and argue that it is appropriate to give special favor to politically influential groups. Special interests could argue that protection in the form of antidumping duties or safeguard actions should be given to import competing industries because these industries have more effectively influenced politicians to implement competition-reducing policies that work in their favor and against the interests of other citizens. Since the losing groups (for example consumers) were clearly not influential enough to prevent the legislation enabling these trade policies, their losses are less consequential than the benefits accruing to the winning groups. Such an honest assessment of why to implement trade interventions is unlikely to be as convincing however, and so it remains likely that special interests will be relegated to argue on the basis that they have superior knowledge of the effects.

Conclusion

Nevertheless all hope need not be lost. In order to achieve a new result, an important first step is to clearly define the goals and provide the justification for achieving them. This book has taken that step. In this case, the goal is not really an outcome as much as a process; the competitive process of free and voluntary exchanges and the freedom for private businesses to make their own decisions in their own interests and the interests of their customers. What outcome that process produces is completely unknowable because it will be the result of numerous independent microeconomic decisions resulting in numerous successes and failures. It will be an experimental process in which businesses are continually investigating what best serves consumer demand in

the current moment, while recognizing that what is best in future moments may be completely different, thereby requiring ongoing discovery.

The goal is also a set of government policies that will inhibit involuntary transfers. This means laws protecting the security of individuals, in their persons, their homes and businesses. It means maintaining a judicial system to enforce contracts and render judgments about appropriate punishments for violations of laws. However it also means dismantling the current government policies that have enabled influential groups in the past to use the government regulatory system as a means to transfer money and resources from others involuntarily. This doesn't mean dismantling all government, only that part of government that clearly violates the proscriptions against involuntary transfers.

Lastly, the goal is also a set of government policies that will encourage and promote voluntary transfers. Voluntarily doing good things for others less fortunate is the least contentious way to promote a compassionate response for those who would otherwise suffer in a competitive system. In many societies today that may involve a democratic choice to use government to provide an acceptable social safety net.

The moderate compromise is a new way of thinking about how to choose policies. It's much like looking at the world with a new set of glasses. The old glasses revealed a different view of the world depending on who wore them. Some saw free trade and free markets as good for everyone. They analyzed the costs and benefits of alternative policies and argued that policies be chosen to maximize net benefits. Others saw a world dominated by profit-grabbing multinational corporations who exploited workers and threatened the natural environment. They longed for a world in which social justice

prevailed, but saw little evidence of it in the real world. Everyone was convinced that the view through their set of glasses was the true and accurate view of the world; no one ever doubted what they saw.

The new glasses correct the distortions that were seen and propagated under the old view. They provide a comprehensive perspective on the world by allowing one to see how economic, political and social considerations all interact and affect each other. At the same time though, the new glasses don't allow one to predict the future, or project future outcomes. Instead they more clearly show why attempts at prediction of social and economic outcomes are hopeless. This is why the compromise principles, the moderate solution, seeks to establish a simple, straightforward set of rules to guide behavior rather than attempting to achieve particular final outcomes.

Perhaps most importantly though, these new glasses are not rose-colored. They don't offer a vision of a utopian economy. They shouldn't convince the wearer that, with the right set of policies, all good will come to all people. Instead the glasses reveal the, sometimes harsh, reality of the competitive economic system. Competition provides a means for all people to achieve the very best outcome for themselves, but there are no guarantees for anyone. Because abilities, effort and luck will naturally vary across people, different people will not achieve the same level of success. Indeed, if the moderate compromise works as intended, some people will most certainly fail within the system. Despite these misfortunes though, the glasses also reveal the ways in which society can be compassionate towards its weaker and less fortunate members. There is no reason why the harshness of competition cannot be tempered with compassion, as long as compassion does not come at the expense of competition itself.

Finally, although these new glasses offer a whole new perspective on the policies and behaviors of people and countries in a globalizing world, the clarity is not absolute. Using these glasses most effectively will take some practice. Some of the issues are so complex that the new perspective from the glasses alone may not be enough to solve the problem. Therefore, much more work remains to be done. Although the heuristic mechanism provides a simple guide to policy, as was shown in Chapter 10, there are both easy cases and hard cases. Choosing appropriate policies in the more difficult cases may require much more thoughtful research. The design of this research would be somewhat different than is typical in the economics literature though. Rather than attempting to predict the welfare effects of policies, or identifying potential winners and losers, research would focus instead on furthering awareness of the market mechanism, or ascertaining policy consistency with the basic principles. Research also needs to be directed towards implementation; namely, how does one progress to a moderate compromise solution within a representative democratic system? Unless we can overcome the political obstacles, these policy proposals will remain very difficult to implement. In the meantime, my hope is that these new glasses offer a glimpse of what a moderate compromise global policy plan with people working together towards a common goal could look like, and why that plan promotes economic well being and justice for people around the world.

ⁱ Rodrik (1997; p. 83) suggests replacing the serious injury test with the following: “... demonstrate broad domestic support, *among all concerned parties*, for the proposed safeguard measure.”