



Is There Any Future for Trade Liberalization Agreements?

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World – USA = ?

- Any return of US to trade liberalization forums must wait at least four years; perhaps eight or even more.
- In the meantime, what can the rest of the world do? What should it learn from the recent US and European elections?
- What to do when (if!) US returns?



Revolt of the “left behind”

- “This election ... is about the decades-long slide into economic oblivion experienced by many Americans, which undermines your arguments on the benefits of globalisation and free trade.”
 - reader’s letter in *The Economist*, October 22, 2016
- Other issues (esp. Race) were important, but focus here on trade aspects.



Anger, bitterness of voters focuses on trade issues

- Trump's support across US states correlates with job loss, wage stagnation
- Brexit vote motivated by anti-trade as well as anti-immigration sentiments
- Rise of nationalist parties in France, Germany, Netherlands, Scandinavia, ...
- TPP, TTIP, CETA ... blamed in media, political debates



Economic theory

- Trade brings aggregate gains for each country, but losers/winners within each
- Winners can compensate losers and ensure Pareto improvement using:
 - Person-specific lump-sum transfers (Samuelson, Grandmont-McFadden)
 - Commodity taxes/subsidies (Dixit-Norman), easier b/c depend only on population statistical (not individual) information, so less or non-manipulable



Empirical findings

- Traditional belief: technology has been the main cause of job and wage losses in rich countries; effect of trade competition small by comparison
- Recent research (Autor-Dorn-Hanson etc): trade with China had significant effect on job & wage losses in the US



Policy (in)action

- Aggregate economic benefit usually offered as sufficient reason to justify trade liberalization
- GATT-WTO process explicitly excludes most domestic policies (ban subsidies)
- No explicit compensation of losers
- Adjustment assistance, retraining etc patchy and ineffective



Understandable opposition

- Implied message to losers for 40+ years: “You are not going to be compensated for your losses, but be happy with the thought that you could have been!”
- Will resulting anger, frustration, bitterness stop or reverse trade liberalization, or is there a better way forward?



Necessary (NOT sufficient) conditions for progress

- Each country's citizens need assurance that they won't be kept worse off
- Each country must assure others that it will abide by its commitments
- Both are problematic unless domestic redistribution and adjustment policies form an integral part of trade deals



Trade agreements should include domestic promises

- So *expand* the scope of trade treaties: include domestic compensation and adjustment policies explicitly
- Ratification will simultaneously define each government's commitment to its own citizens, and assure other countries that internal politics will not lead it to violate external commitment



Relation to ideas of Rodrik and Schelling

- Rodrik trilemma: can have at most two out of democracy, economic integration, and national sovereignty
- Schelling: giving up freedom of choice can be good strategy, allowing credible commitment
- Question: How to find good commitment strategies



Optimum sovereignty

- Every stage of governance involves *some* loss of sovereignty; key is to choose *over what*
- Should optimize this considering costs and benefits: the latter includes value of ability to make credible commitment
- Generalization of the concept of “fiscal federalism”



Limits to compensation

- Compensating everyone for all losses will create moral hazard: people can take arbitrary risks without fear of loss
- Financial crisis good example
- So public compensation should cover losses created by some policy shifts, not other uncertainties or personal actions
- Boundary hard to maintain in practice



Compensation for losers from all policy shifts?

- Not for routine countercyclical changes in monetary, tax & expenditure policies
- Gov'ts should clarify which policies are transitory, and which semi-permanent on which investors etc. can rely
- But compensation for losses caused by trade policy changes has become politically essential, so include in treaties



References

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