Free Trade Doesn't Work

What Should Replace it And Why

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U.S. BUSINESS & INDUSTRY COUNCIL
Washington, D.C.
2009

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The Bad Arguments for Free Trade

Before we delve into the defective economics of free trade, we must clear a considerable mass of accumulated intellectual debris out of the way first. The issue is bound up in the public mind with a lot of extraneous questions, and we must disentangle it from these if we are ever to think straight about it.

For a start, we are *not* debating whether cosmopolitanism is a good thing. In many ways it is, but it is a cultural question that has little to do with the actual hard economics of international trade. Neither are we debating the choice between, in the words of *New York Times* columnist Thomas Friedman, "the Lexus and the olive tree,"[44] that is between the efficient but soulless rationalism of the global marketplace and the rooted particularism of nations and communities. The economics *itself* of free trade is legitimately controversial, so there is no justification for bracketing it as a settled question and turning to imponderables such as the relative value of prosperity vs. heritage.

We are also not debating the desirability of globalization as such (an historical process) or globalism (the ideology that favors that process).[45] Free trade, though it has ramifications that affect almost everything, is,

strictly speaking, a purely economic question, and globalization involves a lot more than economics. It includes cultural exchanges, population movements, global governance, the global environment, and many other things. So one can certainly oppose free trade and support globalization with respect to its noneconomic aspects, or vice-versa.

Even a certain amount of *economic* globalization is perfectly compatible with ending free trade. If every nation on earth had a 10 percent tariff, this would, by definition, be the end of free trade, but the world would probably still be globalizing economically—albeit in a slower and more controlled fashion than today. It has been estimated that the spread of air freight had the same effect as a tariff cut from 32 to 9 percent in the U.S. from 1950 to 1998. But no ideological energy is expended on the problem of air freight pricing.[46]

ECONOMIC GLOBALIZATION IS A CHOICE

Economic globalization is often debated as something that is either "good" or "bad" and will either "succeed" or "fail." But framing the alternatives as binary is far too crude, and tends to force uncritical approval on both counts. It encourages the assumption that we "must" make economic globalization succeed—and as a unitary package, with no choice about its different aspects being possible. The better questions to ask are how far will it go, what shape will it take, and what measures (if any) should we take to influence either?

If economic globalization is a good thing, then it should be able to survive our getting a choice about how far it is allowed to go. Attempts to foreclose that choice betray a distinct nervousness about what people might choose on the part of those who would foreordain the outcome—usually in favor of a radically *laissez faire* result. The tragedy of free trade is that it gives up some of the best tools humanity has to shape what *kind* of economic globalization it gets: tariffs and nontariff trade barriers. At the end of the day, there simply are not that many levers over the world economy that are both feasible to pull and have a large impact. If we rule out some of the best, we haven't got many left.

The fundamental message of this book is that nations, including the U.S., should seek *strategic, not unconditional*, integration with the rest of

the world economy.[47] Economic openness, like most things in life, is valuable up to a point—but not beyond it. Fairly open trade, most of the time, is justified. Absolutely free trade, 100 percent of the time, is an extremist position and is not. (The difference between the two is rational protectionism.) Valid economics simply doesn't support the extravagant notion that, in the words of techno-utopian *Wired* magazine:

> Open, good. Closed, bad. Tattoo it on your forehead. Apply it to technology standards, to business strategies, to philosophies of life. It's the winning concept for individuals, for nations, for the global community in the years ahead.[48]

Nations need instead a well-chosen *balance* between openness and closure towards the larger world economy.

One giveaway sign that *laissez faire* in foreign trade (which is what free trade is) is wrong is that *laissez faire* hasn't been taken seriously in America's domestic economy for well over 100 years—since before the era of Teddy Roosevelt's trustbusters around the turn of the 20th century. Despite perennial posturing to the contrary by free-market ideologues, we have, in fact, found reasonable levels of regulation in most parts of our economy to be best: neither outright state control nor absolute economic freedom. It is no accident that regulating international trade was well within the intention of the Founding Fathers: Article I, Section 8 of the Constitution *explicitly* authorizes Congress "to regulate Commerce with foreign nations."

FREE TRADE IS NOT INEVITABLE

It is often said (or tacitly assumed) that in today's world, free trade is somehow inevitable. But if so, why do its supporters bother arguing for it? The inevitability of free trade certainly does not follow from the apparent inevitability of some form of capitalism, given the long history of protectionist capitalist economies. (The U.S. itself used to be one, as we will see in Chapter 6.)

Modern history has simply not been a one-way escalator to ever-increasing global economic interconnectedness. Instead, this interconnectedness has ebbed and flowed upon larger political currents. It was pushed up

by colonialism, but pushed down when former colonies, like the U.S. and India, adopted protectionist policies of their own after independence. It was pushed down by fascism on the Right and socialism on the Left. But it was pushed up by the Cold War. Prior to the 1970s, the peak of world trade as a percentage of economic output was in 1914—a peak to which it did not return for two generations.[49]

This flux is not an idle curiosity of unrepeatable history: anyone who assumes world trade can only go up in the long run should consider what Peak Oil or tightening environmental constraints may do to transport costs. Neither has increased trade always correlated with increased prosperity and its decline with the reverse: the world economy was less globalized in 1960 than in 1910, but more prosperous.[50]

Modern technology does not mandate free trade, either. While technology indeed favors the expansion of trade, by reducing shipping and transaction costs, it does not mandate that this trade be *free*, rather than subject to tariffs. Indeed, if technology erodes natural trade barriers like distance, and trade barriers are sometimes beneficial (as we will see below), then modern technology can, paradoxically, *increase* the justification for tariffs.

All inevitability arguments are moral evasions, anyhow, because offloading responsibility to the free market ignores the fact that we *choose* whether, and how much, to regulate markets. This is probably what the great protectionist President Teddy Roosevelt was driving at when he wrote that "pernicious indulgence in the doctrine of free trade seems inevitably to produce fatty degeneration of the moral fiber."[51]

THE NATION-STATE IS NOT IRRELEVANT

It is sometimes suggested that free trade is a moot question because globalization has made the nation-state "irrelevant." As Doug Oliver of the Cessna aircraft company recently said, in response to complaints about his company outsourcing its entry-level Skycatcher plane to a firm that supplies China's air force:

> Nothing is American any more. Nothing is German any more. Nothing is Japanese any more. Harley-Davidson sources parts from all around the world. Let's face it, we're in a global economy.[52]

This is all technically true (with respect to the sourcing of parts at least), but misses the point. Even if the internationality of modern supply chains means that America's trade balance adds up at the component rather than finished product level, we still run a deficit or a surplus. And even if who builds which finished products isn't the key to prosperity anymore, who builds which components increasingly is.

In any case, the nation-state is a long way from being economically irrelevant. Most fundamentally, it remains relevant *to people* because most people still live in the nation where they were born, which means that their economic fortunes depend upon wage and consumption levels within that one society.

Capital is a similar story. Even in the early 21st century, it hasn't been globalized nearly as much as often imagined. And it also cares very much about where it lives, frequently for many of the same reasons people do. (Few people wish to live *or* invest in Rwanda; many people wish to live *and* invest in California.) For a start, because 70 percent of America's capital is human capital,[53] a lot of capital behaves exactly as people do, simply because it *is* people. Another 12 percent is estimated to be social capital, the value of institutions and knowledge not assignable to individuals.[54]

So although *liquid financial capital* can indeed flash around the world in the blink of an electronic eye, this is only a fraction (under 10 percent) of any developed nation's capital stock. Even most nonhuman capital resides in things like real estate, infrastructure, physical plant, and types of financial capital that don't flow overseas—or don't flow very much. (Economists call this "don't flow very much" phenomenon "home bias," and it is well documented.)[55] As a result, the output produced by all this capital is still largely tied to particular nations. So although, for reasons we will examine in detail later, capital mobility certainly causes big problems of its own, it is nowhere *near* big enough literally to abolish the nation-state as an economic unit.

Will it do so one day? Even this is unlikely. Even where famously dematerializing and globalizing assets, like fiber optic telecom lines, are added—assets that supposedly make physical location irrelevant—they are still largely being added where existing agglomerations of capital are. For example, although fiber optic backbones have gone into places like Bangalore, India, which were not global economic centers a generation ago, big increments of capacity have also gone into places like Manhat-

tan, Tokyo, Silicon Valley, and Hong Kong, which were already important.[56] As a result, existing geographic agglomerations of capital are largely self-rein-forcing and here to stay, even if new ones come into being in unexpected places. And these agglomerations have national shape because of past history. Legacy effects can be extremely durable.[57] Previous technological revolutions, like the worldwide spread of railroads, were at least as big as current innovations like the Internet, and they didn't abolish the nation-state.

Ironically, the enduring relevance of the national economy is clearest in some of the "poster child" countries of globalization, such as Japan, Taiwan, South Korea, Singapore, and Ireland. In each of these nations, economic success was the product of policies enacted by governments that were in some sense *nationalist*. Japan industrialized after the Meiji Restoration of 1868 to avoid being colonized by some Western power. Taiwan did it out of fear of mainland China. South Korea did it out of fear of North Korea. Ireland did it to escape economic domination by England. In each case, the driving force was not simply desire for profit. This exists in every society (including resource-rich basket cases like Nigeria, where it merely produces gangsterism), but does not reliably crystallize into the policies needed for economic growth. The driving force was a national *political* need which found a solution in economic development.

There is no getting around politics. Politics is still mostly practiced at the national level, and practiced *with sovereignty* only at that level. And the reality for almost all people and corporations is that national policies still matter. It matters whether one has good physical infrastructure and basic security. It matters whether one must constantly pay bribes to get things done. It matters whether one gets cut out of the best opportunities in favor of political cronies. It matters whether the local education system produces quality employees. It matters whether one has a sound currency to work with. It matters whether the local population reveres things like science, efficiency, and entrepreneurship. And it matters, finally, whether the politicians in charge of all these things are wise enough to keep them that way, and whether the voters (if the country is a democracy) are wise enough to elect the right politicians.

Globalization doesn't make the above things less important—let alone "irrelevant." They are arguably even *more* important in a more globalized world because the rewards for getting them right and the punishments for getting them wrong are larger. Without globalization, mediocre industries

can just sputter along for decades. But with globalization, these industries can get wiped out. But they can also conquer the world if they're *not* mediocre. So national policies are arguably more important than ever.

There is an important related factor: as Michael Porter of Harvard Business School has observed:

> Competitive advantage is created and sustained through a highly localized process. Differences in national economic structures, values, cultures, institutions, and histories contribute profoundly to competitive success. The role of the home nation seems to be as strong as or stronger than ever. While globalization of competition might appear to make the nation less important, instead it seems to make it more so.[58]

So what we can call *economic national character* matters. One sign of this is that even multinational companies are almost always strongly tied to particular nations. Despite the myth of the stateless corporation, only a few dozen firms worldwide maintain over half their production facilities abroad.[59] According to one study, multinational companies "typically have about two-thirds of their assets in their home region/country, and sell about the same proportion in their home region/country."[60] Another meticulous 2008 study bluntly concluded that:

> Globalization as popularly understood does not exist. For example, there is no evidence that U.S. firms operate globally. Instead, they both produce and sell on a home region basis, as do MNEs [multinational enterprises] from Europe and Asia.[61]

So whatever else multinational corporations may be guilty of, vanishing into denationalized thin air isn't it.

Economic nationalism is usually held up by free traders as a dumb and reactionary force. Sometimes, of course, it is. Boneheaded economic nationalism belongs in the junkyard of history with all the other ideologies rusting there. But economic nationalism can also be a smart, technocratic, forward-looking force—indeed one of the key things that makes globalization *work*—when implemented correctly. Nations with weak or fragmented national cohesion, such as Nigeria, Afghanistan, or Iraq, haven't exactly seized the opportunities of the global economy lately.

THE MYTH OF THE BORDERLESS ECONOMY

The cliché that we live in a borderless global economy does not survive serious examination.

Because the U.S. is roughly 25 percent of the world economy, a truly borderless world would imply that imports and exports would each make up 75 percent of our economy.[62] This would create a total trade level (imports plus exports) of 150 percent of GDP. Instead, our total trade level is 29 percent: imports are 17 percent and exports 12 percent.[63] So our economy is nowhere near borderless. And as our trade is almost certainly destined to be balanced by import contraction, rather than an export boom, in the next few years, our trade level is almost certainly poised to go *down*, not up.

A truly unified world economy would also mean that rates of interest and profit would have to be equal everywhere, or the differences would be arbitraged away by the financial markets. But this is nowhere near being the case. Even between adjacent and similar nations like the U.S. and Canada, national borders still count: Canadian economist John McCallum has documented that trade between Canadian provinces is on average *20* times as large as the corresponding trade between Canadian provinces and American states.[64] It has been estimated that the average cost of international trade (ignoring tariffs) is the equivalent of a 170 percent tariff, of which 55 percent is local distribution costs and 74 percent is international trade costs.[65] Much of international trade is interregional anyway, not global, being centered on European, North American, and East Asian blocs; this is true for just under 50 percent of both agriculture and manufactured goods.[66]

In reality, the world economy remains what it has been for a very long time: a thin crust of genuinely *global* economy (more visible than its true size due to its concentration in media, finance, technology, and luxury goods) over a network of regionally-linked national economies, over vast sectors of every economy that are not internationally traded at all (70 percent of the U.S. economy, for example).[67] On present trends, it will remain roughly this way for the rest of our lives.[68] The world economy in the early 21st century is not even remotely borderless.

FREE TRADE AS FOREIGN POLICY

Free traders since 19th-century liberals like the English Richard Cobden and the French Frederic Bastiat have promised that free trade would bring world peace. Even the World Trade Organization (WTO) has been known to make this claim,[69] which does not survive historical scrutiny. Britain, the most freely trading major nation of the 19th century, fought more wars than any other power, sometimes openly with the aim of imposing free trade on reluctant nations. (That's how Hong Kong became British.) Post-WWII Japan has been blatantly protectionist, but has had a more peaceful foreign policy than free-trading America. In reality, free trade sometimes dampens international conflict and sometimes exacerbates it. It enriches belligerent autocrats and helps them dodge democratic reforms. Today, it strengthens the Chinese military by building up China's economy and expanding its access to military technology through both trade and through purchases of American technology companies with the money earned thereby.

Attempts to link free trade to counterterrorism don't stand up, either.[70] The U.S. is the world's leading free trader, but somehow the world's biggest terrorist target anyway. Free trade's widespread global unpopularity combines with the perception that America is behind it to antagonize peoples and governments around the world as often as it rallies them to our side. Occasionally, free trade may bribe foreign governments to cooperate with the United States, but it also enriches nations, such as Saudi Arabia and Venezuela, whose elites are knee-deep in funding terrorism and other international mischief. Hard coding free trade as a legal obligation, as the WTO does, frustrates our ability to use trade concessions as leverage to win foreign cooperation against the bad guys.[71]

Ironically, the CIA seems to grasp many of these problems better than the supposedly economics-oriented agencies of the U.S. government. In its *Global Trends 2015* report, the agency warns that:

> The process of globalization...will be rocky, marked by chronic financial volatility and a widening economic divide...Regions, countries, and groups feeling left behind will face deepening economic stagnation, political instability, and cultural alienation. They will foster political, ethnic, ideological, and religious extremism, along with the violence that often accompanies it...Within countries, the gap in the standard of living also will increase...Increased trade

> links and the integration of global financial markets will quickly transmit turmoil in one economy regionally and internationally.[72]

Neither does free trade spread human rights. If China had to rely upon domestic demand to drive its economy, locking up its population as factory slaves would not be such a viable strategy. The same goes in other nations, and free trade agreements then frustrate attempts to impose sanctions on human rights violators. The sanctions imposed on South Africa in 1986, for example, would be illegal today under World Trade Organization rules.[73]

FLASHY, EMPTY ARGUMENTS

Some arguments for free trade are sheer intellectual fluff—such as the idea that we should engage in it because it embodies the spirit of the age, the tide of history, or some other contemporary repackaging of these dated ideas.[74] Magazines like the libertarian *Reason*, the techno-utopian *Wired*, and the entrepreneurship-oriented *Fast Company* reveled in such themes all through the dot-com boom years of the late 1990s.[75] The hallmark here is loose, breathless prose whose actual analytical content dissolves among the vague terms and hyperbolic assertions. (Cf. the quote on page 21.) The aim, above all, is to make free trade *hip*: the wave of the future. But free trade's hard economics is just 19th-century *laissez faire*, the economics of the iron law of wages.[76] Its intellectual kernel is David Ricardo's 1817 theory of comparative advantage.[77] New trade theory, on the other hand, is a genuinely modern—indeed 21st century—school of thought. Free trade is far too old to be parading itself as the latest thing.

Skepticism about free trade is often stigmatized with *ad hominem* attacks. These mostly come down to variations on the following:

> *"Protectionists are dummies, losers, incompetents, hippies, rednecks, dinosaurs, closet socialists, or crypto-fascists."*[78]

Here's free trader Barack Obama's version, delivered to an audience of campaign donors in the exclusive Pacific Heights neighborhood of San Francisco while seeking the Democratic nomination in April 2008:

> You go into these small towns in Pennsylvania and, like a lot of small towns in the Midwest, the jobs have been gone now for 25 years and nothing's replaced them. And it's not surprising, then, they get bitter, they cling to guns or religion or antipathy to people who aren't like them or anti-immigrant sentiment *or anti-trade sentiment* as a way to explain their frustrations.[79] (emphasis added)

God forbid the unemployed of an old-line industrial state should think *trade* has anything to do with their problems! But economic logic isn't even really the issue here, because these arguments are aimed at people who don't even *try* to understand economics, but do care immensely about their social status.[80] The media are saturated with this attitude. Thus magazine articles on trade problems focus on the unemployed, implying that only life's losers oppose free trade (and that their unemployment is probably their own fault, anyway). The careers of people whose jobs are being lost to offshoring? Mere "drudgery." Their lives are obviously nothing worth worrying about. *They're not like us here in Pacific Heights.*

This is largely just a chic veil thrown over class bias. Despite the documented center-left preferences of most journalists on social and cultural issues, on economic issues, including trade, they lean right.[81] A late-1990s survey by the watchdog group Fairness and Accuracy in Reporting found, for example, that only on environment-related economic is-sues were they to the left of the public. But on trade, they were well to the right. For example, 71 percent of editors and reporters supported Fast Track negotiating authority for the North American Free Trade Agreement, while 56 percent of the public opposed it.[82] As 95 percent of these editors and reporters had incomes over $50,000, and more than half over $100,000, this comes as no surprise.[83]

ARROGANCE AND INCOHERENCE

The media sometimes tell us that America's labor force is so much more skilled than other nations that free trade will cause us to cream off the best jobs in the global economy. The next minute, they tell us that our poor math skills and work ethic are the root of our economic problems and that we should only blame ourselves. These obviously can't *both* be true.

Sometimes, we are told to stop being arrogant and face up to the fact that the world isn't our oyster anymore and that Americans aren't entitled to be richer than foreigners. Fair enough: we're not *entitled* to any particular economic outcome. But we certainly are entitled to a government that seeks to defend our prosperity, if that's what we elected it to do.

Signs that America's trade policies are dangerously wrong are often reinterpreted as evidence that our economy is so strong that it can survive even *this* problem. For example, because we have survived a record trade deficit, which would have produced a currency collapse in any other nation, trade deficits must not matter. But that is like saying that because the strong constitution of a patient has enabled her to survive cancer, cancer isn't a disease. If free trade *is* a cancer slowly eating at our economy, we need to know *now*—especially if it is a problem whose solutions have long lead times, as many solutions do.[84]

Our present complacent attitude is the same one taken by past economic powers, such as the British, Spanish, Ottoman, and Chinese Empires, which postponed economic reform until it was too late. Consider the following piece of triumphalist free-trade rhetoric:

> Our capital far exceeds that which they can command. In ingenuity, in skill, in energy, we are inferior to none. Our national character, the free institutions under which we live, the liberty of thought and action, an unshackled press spreading the knowledge of every discovery and of every advance in science, combine with our natural and physical advantages to place us at the head of those nations which profit by the free interchange of their products. Is this the country to shrink from competition? Is this the country which can only flourish in the sickly atmosphere of prohibition? Is this the country to stand shivering on the brink of exposure to the healthful breezes of competition?[85]

Those words could have been spoken by an American politician yesterday, on either side of the aisle. In fact, they are from a speech by British Prime Minister Sir Robert Peel—in 1846! His soaring confidence turned out to be misplaced, and Britain's economic decline began shortly thereafter.

America succeeded under free trade (albeit at mounting cost) during the Cold War. But that was a world that was half communist or socialist, and many other nations, as in Latin America, practiced an inward-looking

economics that took them out of the game as serious competitors to us. So we didn't have to face true global free trade. Now we do. Like many ideals, free trade is more attractive when you don't really have to live by it.

NUMBERS THAT DON'T PAN OUT

Many popular arguments for free trade sound persuasive until real numbers intrude. For example:

> *"Free trade is good for America because it means a billion Chinese are now hungry consumers of American products."*

But America is running a huge trade *deficit*, not a surplus, with China. ($268 billion in 2008,[86] about 39 percent of our total).[87] China deliberately blocks imports, mainly with non-tariff barriers, in order to decrease consumption, increase savings, and boost investment. (Its high investment rate is the main reason its economy is growing so fast.) As a result, even the limited purchasing power China's mostly poor population does have rarely gets spent on American goods. The dream of selling to the Chinese functions primarily as bait to lure in American companies, which are forced by the government to hand over their key technological know-how as the price of entry.[88] They then build facilities which they discover they can only pay off by producing for export. The China market remains the mythical wonderland it has been since the 19th-century era of clipper ships and opium wars, when it was hyped just as aggressively as today.

A related myth is this:

> *"Other nations are rapidly catching up to American wage levels. India, for example, has a middle class of 250 million people."*

But middle class in India means the middle of India's class system, not ours: a family income about a tenth of what it would take here. India's per capita income is only about $1,000 a year; an Indian family with $2,500 a year can afford servants.[89] For $5,000 a year, American corporations offshoring work can hire fresh computer-science graduates.[90]

This myth is calculated to soothe American anxieties:

"Offshoring is a tiny phenomenon."

Offshoring, of course, is just trade in services. But it's just getting started and will be big soon enough, thanks to 15 percent per year compound growth.[91] Alan Blinder, former Vice-Chairman of the Federal Reserve and now a professor at Princeton, has estimated that it will ultimately affect up to 40 million American jobs.[92]

Here is a hopeful dream some people console themselves with:

"Cheap foreign labor is not a threat to American wages because increasing prosperity will drive up wages overseas."

While this *may* be true in the long run, at currently observed rates of income growth, it will take decades at best. And it may not happen at all, as the past experience of nations like Japan, which rose from poverty to wages similar to the U.S., may not be replicated. Sub-Saharan Africa has a lower per capita income today than 40 years ago[93] and worldwide, the UN reported in 2003 that 54 nations were poorer than they had been in 1990.[94]

This common claim has no real quantitative basis:

"Free trade brings us enormous benefits."

But one of the dirty little secrets of free trade is that the benefits of expanding it even further—as we are endlessly told we must do—are actually quite small, *even according to the calculations of free traders themselves.*[95]

This next claim appeals to the American sense of superiority:

"We can sustain our huge trade deficit indefinitely because foreigners are so eager to invest in our wonderful business climate."

Unfortunately for this idea, most foreign investment in the U.S. goes for existing assets. For example, of the $276.9 billion invested in 2007, $255 billion (92 percent) went to buying up existing companies.[96] Even worse, much foreign investment goes into mere government debt—which gets converted, by way of deficit spending, into consumption, not investment.

Here is a sophisticated-sounding analysis that seems to take the drawbacks of free trade seriously:

> *"Free trade costs America low-quality jobs, but brings high-quality jobs in their place."*

That would obviously be a kind of free trade we could live with. But the hard data actually show America losing both kinds of jobs. For example, according to the Bureau of Labor Statistics, the U.S. lost over 54,000 engineer and architect jobs between 2000 and 2008.[97]

This myth is particularly slippery:

> *"Savings to consumers from buying cheaper imports outweigh the wages lost by not producing these goods domestically."*

But there is no data that actually proves this, particularly since the crucial data concerns the long term, which we have not yet had the opportunity to observe. And there is no principle of economics that guarantees that this will be true, even in theory.[98] But we do know that during George W. Bush's term in office, America lost over three million manufacturing jobs.[99]

Here is a seductive and, frankly, rather dangerous idea:

> *"America is still the world's richest country, and we're free traders, so free trade must be right."*

But any case for free trade that turns on the present general prosperity of the United States ignores the fact that short-term prosperity is a *lagging* indicator of the fundamental soundness of a nation's economy. Immediate prosperity largely consists in the enjoyment of wealth, such as housing stock, produced in years past, so a nation that has been rich for a long time has considerable momentum to ride on. Declining industries may even reap record profits during the years in which they liquidate their competitive positions by outsourcing production, cutting investment, and milking accumulated brand equity.

Many of the indicators used to show America economically outperforming the rest of the world are questionable, anyway. Our low unemployment rate looks less impressive once prison inmates and other forms of

nonemployment are factored in.[100] Our high per capita income is largely a result of Americans working longer hours than in other developed nations and of our having a higher percentage of our population in the workforce. As a result, our output per man-hour of work is much less impressive,[101] even less so if one assumes that our currency is unsustainably inflated (as it probably is). And due to American income inequality being the highest in the developed world, less of our GDP reaches the bottom 90% of our population than in any other developed country.[102]

THE FREE TRADE SQUEEZE

The economic forces that cause free trade to squeeze the wages of ordinary Americans today are relentless. As Paul Krugman puts it:

> It's hard to avoid the conclusion that growing U.S. trade with Third-World countries reduces the real wages of many and perhaps most workers in this country. And that reality makes the politics of trade very difficult.[103]

Free trade squeezes ordinary Americans largely because it expands the world's supply of labor, which can move from rice paddy to factory overnight, faster than its supply of capital, which takes decades to accumulate at prevailing savings rates. As a result, free trade strengthens the bargaining position of capital relative to labor. This is especially true when combined with growing global capital mobility and the entry into capitalism of large formerly socialist nations such as India and China. As a result, people who draw most of their income from returns on capital (the rich) gain, while people who get most of their income from labor (the rest of us) lose.

This analysis is not some cranky Marxist canard: its underlying mechanism has long been a part of mainstream economics in the form of the so-called Stolper-Samuelson theorem.[104] This theorem says that freer trade raises returns to the abundant input to production (in America, capital) and lowers returns to the scarce one (in America, labor). So because America has more capital per person, and fewer workers per dollar of capital, than the rest of the world, the equilibrating process generated by free trade tends to hurt American workers.

Free trade also affects different kinds of labor income differently. The impact of free trade on a worker in the U.S. is basically a function of how easy it is to substitute a cheaper foreign worker by importing the product the American produces.[105] For some extremely skilled jobs, like investment banking, it may be easy to substitute a foreigner, but foreign labor (some yuppie in London) is just as expensive as American labor, so there is no impact on American wages. For jobs that cannot be performed remotely, such as waiting tables, it is *impossible* to substitute a foreign worker, so again there is no direct impact. (We will look at indirect impacts later.) The occupations that suffer most are those whose product is easily tradable *and* can be produced by cheap labor abroad. This is why unskilled manufacturing jobs were the first to get hurt in the US: there is a huge pool of labor abroad capable of doing this work, and manufactured goods can be readily packed up and shipped around the globe. Because low-paid workers are concentrated in these occupations, free trade hurts them more.[106]

It follows from the above that free trade, *even if* it performs as free traders say in other respects, could still leave most Americans with lower incomes. And even if it expands our economy overall, it could still increase poverty. In a word: *Brazil*, where an advanced First World economy exists side-by-side with Third World squalor and the rich live behind barbed wire. Latin America generally is not an encouraging precedent with respect to free trade: in the words of former World Bank chief economist Joseph Stiglitz, "In Latin America, from 1981 to 1993, while GDP went up by 25 percent, the portion of the population living on under $2.15 a day increased from 26.9 percent to 29.5 percent."[107] Growth happened, but much of the population got nothing out of it. Another cautionary tale from the region is Argentina, whose per capita income was 77 percent of America's in 1910, but which underwent economic decline and is now only 31 percent of ours.[108]

In recent decades, trade-induced wage decay has been relentless at the bottom half of America's economic ladder (and is now starting to spread upwards). According to one summary of the data:

> For full-time U.S. workers, between 1979 and 1995 the real wages of those with 12 years of education fell by 13.4 percent and the real wages of those with less than 12 years of education fell by 20.2 percent. During the same period, the real wages of workers with 16 or more years of education rose by 3.4 percent, so that the wage gap between less-skilled and more-skilled workers increased dramatically.[109]