

Protectionist Fallacies*

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Common Fallacies

There are many fallacies that are shared by the Democrats and the Republicans, and repeated endlessly by even leading journalists in the United States (Journalism schools in the US, it seems, teach you how to write but not what to write: their ignorance of the economics of what they write about is generally abysmal. By contrast, the English economic journalists such as Martin Wolf of Financial Times and Clive Crook formerly Dy Editor of The Economist, and top German journalists in Die Welt and Die Zeit, for example, are superbly trained, not just in their craft but also in the discipline of Economics)

1. Trade Openness harms the overall Economy.

Much evidence opposes this proposition. E.g. postwar experience with progressive trade liberalization coincided with increasing prosperity, interrupted only by periods reflecting macroeconomic difficulties resulting from phenomena such as the success of OPEC and consequent jump in oil prices and the subsequent Volker-induced deflation in the world economy.

The main liberalization occurred in the developed countries, under many Rounds of MTN (multilateral trade negotiations) under GATT auspices, with the developing countries exempted from trade liberalization at the GATT under Part IV provisions for Special & Differential Treatment but enjoying improved MFN access to developed country markets that were being opened up . So they profited from liberalization by the developed countries, in any event.

Over the postwar period, however, there was also extensive unilateral trade liberalization, even in the developing countries, which reflected the general spread of the idea that protection was harmful.

2. Trade Openness with Poor Countries produces Poor in the Rich Countries:

This belief has led unions to endorse trade openness between like-wage countries (e.g. CUFTA between US and Canada) but to oppose it between high-wage and low-wage countries (e.g. extension of CUFTA to include Mexico in NAFTA). But this is a fallacy.

To see this, remember that we have two alternative narratives here: one anti-trade and the other pro-trade. The latter is more plausible. The anti-trade narrative assumes that cheaper labour-intensive goods from the poor countries will harm labour in the labour-intensive industries (this is what economists call the Stolper-Samuelson effect). But most of the labour-intensive industries in the rich countries have died out in various ways. And the remaining workers, as indeed workers in all sectors, do gain as consumers from buy cheaper imported consumer goods (the Walmart effect). Similarly, with labour-saving technologies putting pressure on wages, cheap labour-intensive imports cushion, not accentuate, the impact of such technical change on workers' real wages (as extensively argued by Bhagwati and others in many writings). So, the correct narrative is a pro-trade one for workers' real wages, not an anti-trade one.

None of this is, of course, is to deny the need for effective worker retraining programs to help displaced workers regain productive employment, or for broader social safety nets in society.

3. Trade Openness adversely affects Income Distribution by leading to concentration of gains in top 1%

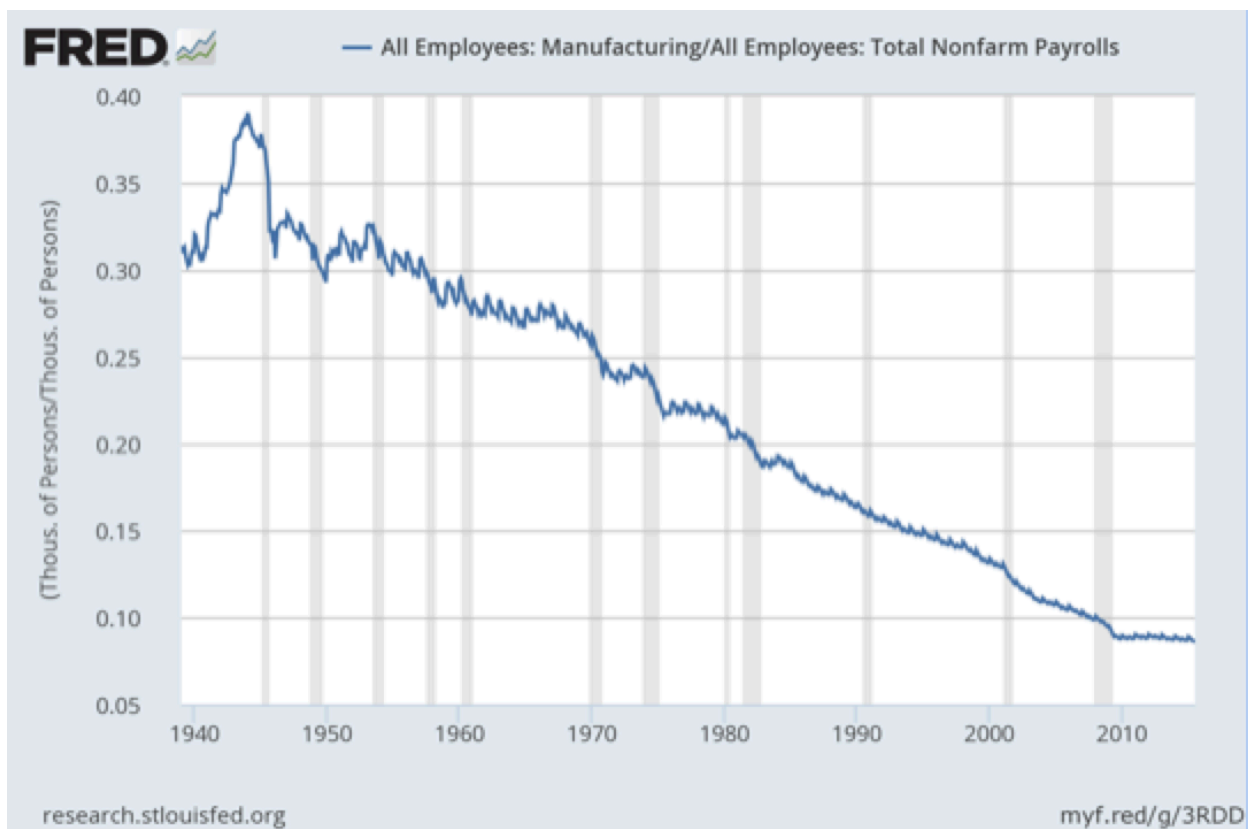
This argument ignores the fact that there is little evidence that trade is the cause of such wealth and income concentration. For instance, in a detailed study of poverty levels in Indian states using household surveys, Devashish Mitra has found that trade was not associated with poverty rates; indeed poverty rates have dropped rather dramatically in the Indian economy during the period in which it has become more globalized. Equally, Pravin Krishna and Guru Sethupathy found no association between trade and income inequality in India. That, in a number of countries, openness has led to improved income distribution has been argued recently also by the World Bank.

Separately, Piketty, who has documented the apparent increase in concentration of wealth over recent decades, ignores the fact that the top 1% is not made up of a static group; People move in and out of the group (i.e., there is inequality but also mobility). It is interesting that Piketty, who writes knowingly about English and French literature does not mention Thomas Mann who got the Nobel Prize for *Buddenbrooks* where the third generation's fortunes decline. When we mentioned this omission to a French economist, he said amusingly that the French do not consider German literature to be literature!

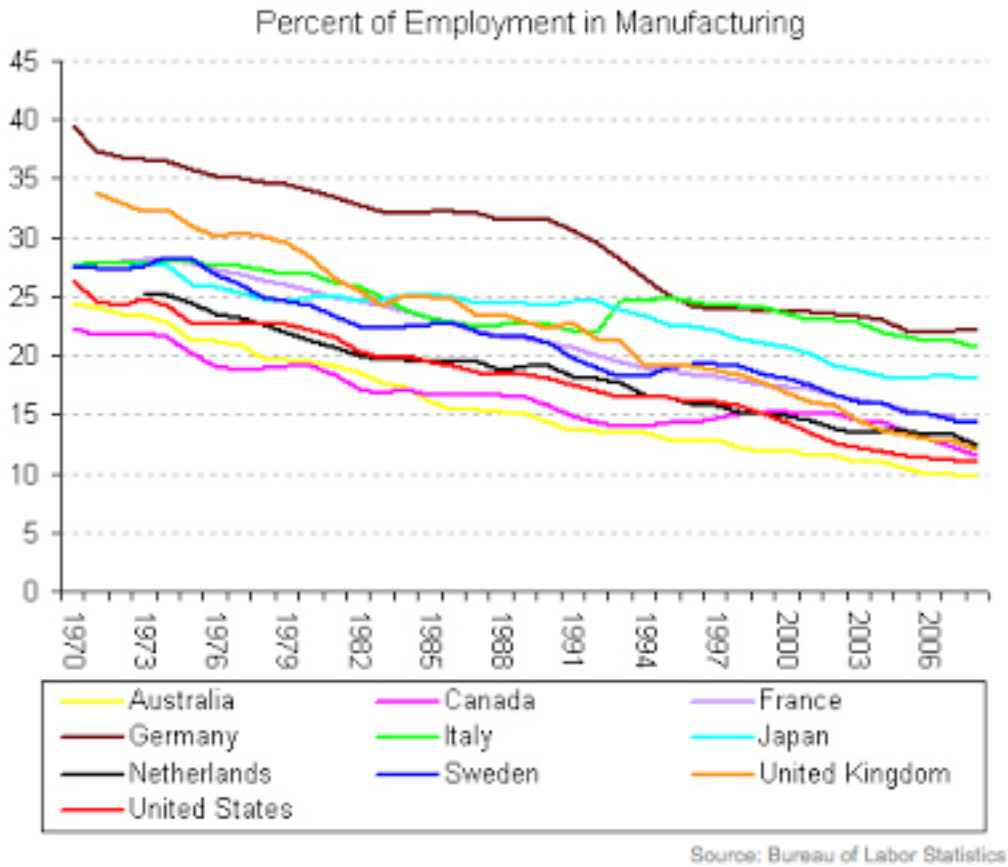
4. Openness to Trade has led to Shrinking of Manufactures

The notion that trade openness has led to a decline of manufacturing, by having US manufacturing shift to foreign countries with cheap labor or other natural and government-created artificial advantages in recent years, has also fed a near-frenzy of protectionism.

But this belief is in error. Thus, the decline in manufacturing employment has been ongoing for over a half century (as evidenced by the steady –nearly linear -- decline in the share of manufacturing workers in overall non-farm employment in the US since the 1950s).



Indeed such a decline is almost universal among the countries in the west (see chart below) .
Thus, it is quite similar to agriculture declining relative to manufactures in earlier times.



5. Trade with China has hurt our Economy

A study by Autor, Dorn and Hanson of how Chinese imports correlate with adverse impact on manufactures in different parts of the US has been widely cited by journalists and by economists worried about competition with China, to the point of being described by some excitable

economist columnists as the most important study in recent times. But their conclusion against China appears questionable.

As Phil Levy of the Chicago Council of World Affairs has pointed out, if safeguard actions had been invoked against China ---- when China entered the WTO, added safeguards against China had been provided for ---, the effect would most surely have been to "shunt" exports from China on to other exporters. Of course, then the argument against competition with Chinese exports shifts to competition against total imports from China together with imports from these other suppliers, so import competition, as against competition only with Chinese exports, must be reckoned with. The exclusive focus on China as the villain in the analysis is then misplaced.

Besides, when one looks at the total amount of wages lost due to decline of employment in the Autor-Dorn-Hanson study, it is a miniscule amount: the average worker in their study is estimated to have lost less than 10 dollars a week in nominal income. This is such a small amount that it is very likely to have been outweighed by the lower cost of imported goods from China. While the need for a social safety net is clear, the alarm raised by unsuspecting journalists about the findings of the Autor-Dorn-Hanson study has clearly done much harm by helping to shaping the protectionist zeitgeist.

6. Nothing more is to be gained from Further Liberalization

This fallacy, advanced by Dani Rodrik in writings including in the FT and by others, has been rebutted by many trade economists: there is still much scope for liberalization in agriculture and services; besides, even in manufactures there are many peaks which need to be ironed out.

7. Trade leading to Growth is wrong; the causation is the other way around

Panagariya has shown in a well-known article in The World Economy, using data for several countries in the postwar period, that countries that have registered high growth rates of exports have also grown more rapidly. Rodrik argues that this does not indicate causality; and that higher growth may well be the cause of the higher export growth. Of course, this is possible; and indeed countries that grow faster may well be able to liberalize more and hence may have higher growth of exports.

But a number of in-depth studies of developing countries underline the robust nature of the exports-to-growth nexus, with trade liberalization leading to enhanced growth of income. For example, the Indian experience shows that, once India embarked in 1991 on reforms which included reducing trade barriers, the growth rate accelerated and this, in turn, finally reduced poverty, showing that growth was a "pull-up", not a "trickle-down" strategy. It was the change in policies introduced with economic reforms in 1991 onwards that improved trade performance and hence led to enhanced growth rate of GNP.

Other Fallacies: Chiefly on the Political Left

1. Fallacy 1: Misunderstanding Professor Samuelson as a Protectionist

When running behind Obama, and embracing protectionism, Hillary Clinton and her staff argued erroneously that Professor Samuelson had justified protection in his celebrated article in the Journal of Economic Perspectives. For someone who otherwise seems to be very smart, this was a real bummer. For, Professor Samuelson's argument was about how exogenous events such as a hurricane could hurt, say Miami, but to respond to this event by shutting off trade was only to compound the loss – as was clearly pointed out by nearly all the top trade economists of the day

2. Fallacy 2: "Pause" as Protectionism

Hillary Clinton also asked for a "pause" in signing new trade agreements, which is a way of sitting on the protectionist fence. By contrast, Obama simply asked for NAFTA to be reopened and renegotiated: it was clear that he thought this was a way of throwing a small bone at the protectionist Rottweilers which did not involve a meaningful surrender to them. This contrast between Hillary Clinton and Obama was commented upon by Bhagwati in the Financial Times where it led to his endorsing Obama instead of Hillary Clinton when all the smart money was on Hillary Clinton.

3. Fallacy 3: Surrender to Lobbies seeking to impose their Demands on Trade Agreements:

Most Democratic politicians today also seem to believe that trade treaties/agreements should include intrinsically "trade-unrelated" features such as labour standards, environmental standards, exaggerated IP provisions etc. This is also a folly.

Turning a trade treaty into a vehicle for pursuing these extraneous agendas, often imposed by US lobbies seeking their own advantage, makes no sense because, as many have argued (including Bhagwati in his Oxford book, *Termites in the Trading System: How Preferential Trade Agreements Undermine Free Trade*) these trade-unrelated agendas should be pursued, because of their complexity, in specialized agencies (e.g. ILO for labour standards) and through special negotiations (e.g. Kyoto, Copenhagen and Paris for environmental issues).

Another effect of PTAs like TPP (a "mega-regional") is that they then fragment trade. Thus, with India objecting to these US-lobbies-driven agendas on functional grounds and China on political grounds (e.g. it will not surrender its right to treat labour in non-humane ways) , TPP divides Asia into three blocs.

Bhagwati has therefore proposed that, to ensure open regionalism, TPP ought to be opened to new members such as India and China as long as they are willing to liberalize trade and you should not require them to accept all kinds of extraneous US-lobbies-determined demands. He uses the analogy: if you wish to join a golf club, you ought to be able to play golf; but you should

not be expected to join other members in singing madrigals on Sundays. Of course, the Democrats hide their self-serving demands behind the PR that these extraneous conditions are the features of a "modern" trade agreement! Or, as Hillary Clinton put it once, TPP with such extraneous features is the "gold standard", ironically unaware that no respectable economist today except for Robert Mundell is for the gold Standard!

4. The Buffett Fallacy (on Balance of Payments):

Warren Buffett (the Oracle of Omaha), is a much-advertised cheerleader for the Clintons. But Bhagwati was alerted by Professor Samuelson to his dangerous proposal many years ago in Fortune magazine to get rid of US balance of payments deficit by not permitting more imports than could be financed by US export earnings. This sounds like a great idea until you realize that this is exactly what countries like India were doing with their external accounts, leading ultimately to their trade levels sinking, albeit with "balanced trade". Proposals like Mr. Buffett's sound brilliant until you realize that so does the proposal to cure a beast of dysentery by plugging it up from behind: the dysentery is cured but the beast dies, Buffett knows better than almost anyone else how to make money; but if he has any actual influence on balance of payments policies, even God cannot help the United States.