Straight Talk on Trade

Ideas for a Sane World Economy

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CHAPTER 1

A Better Balance

The global trade regime has never been very popular in the United States. Neither the World Trade Organization (WTO) nor the multitudes of regional trade deals such as the North American Free Trade Agreement (NAFTA) and the Trans-Pacific Partnership (TPP) have had strong support among the general public. But opposition, while broad, tended to be diffuse.

This has enabled policy makers to conclude a succession of trade agreements since the end of World War II. The world's major economies were in a perpetual state of trade negotiations, signing two major global multilateral deals: the General Agreement on Tariffs and Trade (GATT) and the treaty establishing the World Trade Organization. In addition, more than five hundred bilateral and regional trade agreements were signed—the vast majority of them since the WTO replaced the GATT in 1995.

The difference today is that international trade has moved to the center of the political debate. During the most recent US election, presidential candidates Bernie Sanders and Donald Trump both made opposition to trade agreements a key plank of their campaigns. And, judging from the tone of the other candidates, standing up for

globalization amounted to electoral suicide in the political climate of the time. Trump's eventual win can be chalked up at least in part to his hard line on trade and his promise to renegotiate deals that he argued had benefited other nations at the expense of the United States.

Trump's and other populists' rhetoric on trade may be excessive, but few deny any longer that the underlying grievances are real. Globalization has not lifted all boats. Many working families have been devastated by the impact of low-cost imports from China, Mexico, and elsewhere.[1] And the big winners have been the financiers and skilled professionals who can take advantage of expanded markets. Although globalization has not been the sole, or even the most important, force driving inequality in the advanced economies, it has been a key contributor. Meanwhile, economists have struggled to find large gains from recent trade agreements for the economy as a whole.[2]

What gives trade particular political salience is that it often raises fairness concerns in ways that the other major contributor to inequality—technology—does not. When I lose my job because my competitor innovates and introduces a better product, I have little cause to complain. When he outcompetes me by outsourcing to firms abroad that do things that would be illegal here—for example, prevent their workers from organizing and bargaining collectively—I may have a legitimate gripe. It is not inequality per se that people tend to mind. What's problematic is *unfair* inequality, when we are forced to compete under different ground rules.[3]

During the 2016 US presidential campaign, Bernie Sanders forcefully advocated the renegotiation of trade agreements to reflect better the interests of working people. But such arguments immediately run up against the objection that any standstill or reversal on trade agreements would harm the world's poorest, by diminishing their prospect of escaping poverty through export-led growth. "If you're poor in

another country, this is the scariest thing Bernie Sanders has said," ran a headline in the popular and normally sober Vox.com news site.[4]

But trade rules that are more sensitive to social and equity concerns in the advanced countries are not inherently in conflict with economic growth in poor countries. Globalization's cheerleaders do considerable damage to their cause by framing the issue as a stark choice between existing trade arrangements and the persistence of global poverty. And progressives needlessly force themselves into an undesirable trade-off.

The standard narrative about how trade has benefited developing economies omits a crucial feature of their experience. Countries that managed to leverage globalization, such as China and Vietnam, employed a mixed strategy of export promotion and a variety of policies that violate current trade rules. Subsidies, domestic-content requirements, investment regulations, and, yes, often import barriers were critical to the creation of new, higher-value industries.[5] Countries that rely on free trade alone (Mexico comes immediately to mind) have languished.[6]

That is why trade agreements that tighten the rules, such as TPP would have done, are in fact mixed blessings for developing countries. China would not have been able to pursue its phenomenally successful industrialization strategy if the country had been constrained by WTO-type rules during the 1980s and 1990s. With the TPP, Vietnam would have had some assurance of continued access to the US market (existing barriers on the US side are already quite low), but in return would have had to submit to restrictions on subsidies, patent rules, and investment regulations.

And there is nothing in the historical record to suggest that poor countries require very low or zero barriers in the advanced economies in order to benefit greatly from globalization. In fact, the most phenomenal export-oriented growth experiences to date—Japan, South

Korea, Taiwan, and China—all occurred when import tariffs in the United States and Europe were at moderate levels, and higher than where they are today.

So, for progressives who worry both about inequality in the rich countries and poverty in the rest of the world, the good news is that it is indeed possible to advance on both fronts. But to do so, we must transform our approach to trade deals in some drastic ways.

The stakes are extremely high. Poorly managed globalization is having profound effects not only in the United States but also in the rest of the developed world—especially Europe—and the low-income and middle-income countries in which a majority of the world's workers live. Getting the balance between economic openness and policy space management right is of huge importance.

Europe on the Brink

The difficulties that deep economic integration raises for governance and democracy are nowhere in clearer sight than in Europe. Europe's single market and single currency represent a unique experiment in what I have called in my previous work "hyperglobalization."[7] This experiment has opened a chasm between extensive economic integration and limited political integration that is historically unparalleled for democracies.

Once the financial crisis struck and the fragility of the European experiment came into full view, the weaker economies with large external imbalances needed a quick way out. European institutions and the International Monetary Fund (IMF) had an answer: structural reform. Sure, austerity would hurt. But a hefty dose of structural reform—liberalization of labor, product, and service markets—would make the pain bearable and help get the patient back on his feet.

As I explain later in the book, this was a false hope from the very beginning.

It is undeniable that the euro crisis has done much damage to Europe's political democracies. Confidence in the European project has eroded, centrist political parties have weakened, and extremist parties, particularly of the far right, are the primary beneficiaries. Less appreciated, but at least as important, is the damage that the crisis has done to democracy's prospects outside the narrow circle of eurozone countries. The sad fact is that Europe is no longer the shining beacon of democracy it was for other countries. A community of nations that is unable to stop the unmistakable authoritarian slide in one of its members—Hungary—can hardly be expected to foster and cement democracy in countries on its periphery. We can readily see the consequences in a country like Turkey, where the loss of the "European anchor" has played a facilitating role in enabling Erdogan's repeated power plays, and less directly in the faltering of the Arab Spring.

The costs of misguided economic policies have been the most severe for Greece. Politics in Greece has exhibited all the symptoms of a country being strangled by the trilemma of deep integration. It is impossible to have hyperglobalization, democracy, and national sovereignty all at once; we can have at most two out of three.[8] Because Greece, along with others in the euro, did not want to give up any of these, it ended up enjoying the benefits of none. The country has bought time with a succession of new programs, but has yet to emerge out of the woods. It remains to be seen whether austerity and structural reforms will eventually return the country to economic health.

History suggests some grounds for skepticism. In a democracy, when the demands of financial markets and foreign creditors clash with those of domestic workers, pensioners, and the middle class, it is usually the locals who have the last say.

As if the economic ramifications of a full-blown eventual Greek default were not terrifying enough, the political consequences could be far worse. A chaotic eurozone breakup would cause irreparable damage to the European integration project, the central pillar of Europe's political stability since World War II. It would destabilize not only the highly indebted European periphery but also core countries like France and Germany, which have been the architects of that project.

The nightmare scenario would be a 1930s-style victory for political extremism. Fascism, Nazism, and communism were children of a backlash against globalization that had been building since the end of the nineteenth century, feeding on the anxieties of groups that felt disenfranchised and threatened by expanding market forces and cosmopolitan elites.

Free trade and the gold standard had required downplaying domestic priorities such as social reform, nation-building, and cultural reassertion. Economic crisis and the failure of international cooperation undermined not only globalization but also the elites that upheld the existing order. As my Harvard colleague Jeff Frieden has written, this paved the path for two distinct forms of extremism. Faced with the choice between equity and economic integration, communists chose radical social reform and economic self-sufficiency. Faced with the choice between national assertion and globalism, fascists, Nazis, and nationalists chose nation-building.[9]

Fortunately, fascism, communism, and other forms of dictatorships are passé today. But similar tensions between economic integration and local politics have long been simmering. Europe's single market has taken shape much faster than Europe's political community has; economic integration has leaped ahead of political integration.

The result is that mounting concerns about the erosion of economic security, social stability, and cultural identity could not be handled

through mainstream political channels. National political structures became too constrained to offer effective remedies, while European institutions still remain too weak to command allegiance.

It is the extreme right that has benefited most from the centrists' failure. In France, the National Front has been revitalized under Marine Le Pen and has turned into a major political force mounting a serious challenge for the presidency in 2017. In Germany, Denmark, Austria, Italy, Finland, and the Netherlands, right-wing populist parties have capitalized on the resentment around the euro to increase their vote shares and in some cases play kingmaker in their national political systems.

The backlash is not confined to eurozone members. In Scandinavia, the Sweden Democrats, a party with neo-Nazi roots, were running ahead of Social Democrats and had risen to the top of national polls in early 2017. And in Britain, of course, the antipathy toward Brussels and the yearning for national autonomy has resulted in Brexit, despite warnings of dire consequences from economists.

Political movements of the extreme right have traditionally fed on anti-immigration sentiment. But the Greek, Irish, Portuguese, and other bailouts, together with the euro's troubles, have given them fresh ammunition. Their euro skepticism certainly appears to be vindicated by events. When Marine Le Pen was asked if she would unilaterally withdraw from the euro, she replied confidently, "When I am president, in a few months' time, the eurozone probably won't exist."

As in the 1930s, the failure of international cooperation has compounded centrist politicians' inability to respond adequately to their domestic constituents' economic, social, and cultural demands. The European project and the eurozone have set the terms of debate to such an extent that, with the eurozone in tatters, these elites' legitimacy has received an even more serious blow.

Europe's centrist politicians have committed themselves to a strategy of "more Europe" that is too rapid to ease local anxieties, yet not rapid enough to create a real Europe-wide political community. They have stuck for far too long to an intermediate path that is unstable and beset by tensions. By holding on to a vision of Europe that has proven unviable, Europe's centrist elites have endangered the idea of a unified Europe itself.

The short-run and long-run remedies for the European crisis are not hard to discern in their broad outlines, and they are discussed below. Ultimately, Europe faces the same choice it always faced: it will either embark on political union or loosen the economic union. But the mismanagement of the crisis has made it very difficult to see how this eventual outcome can be produced amicably and with minimal economic and political damage to member countries.

Fads and Fashions in the Developing World

The last two decades have been good to developing countries. As the United States and Europe were reeling under financial crisis, austerity, and the populist backlash, developing economies led by China and India engineered historically unprecedented rates of economic growth and poverty alleviation. And for once, Latin America, Sub-Saharan Africa, and South Asia could join the party alongside East Asia. But even at the height of the emerging-markets hype, one could discern two dark clouds.

First, would today's crop of low-income economies be able to replicate the industrialization path that delivered rapid economic progress in Europe, America, and East Asia? And second, would they be able to develop the modern, liberal-democratic institutions that today's

advanced economies acquired in the previous century? I suggest that the answers to both of these questions may be negative.

On the political side, the concern is that building and sustaining liberal democratic regimes has very special pre-requisites. The crux of the difficulty is that the beneficiaries of liberal democracy, unlike in the case of electoral democracies or dictatorships, typically have neither numbers nor resources on their side. Perhaps we should not be surprised that even advanced countries are having difficulty these days living up to liberal democratic norms. The natural tendency for countries without long and deep liberal traditions is to slide into authoritarianism. This has negative consequences not just for political development but economic development as well.

The growth challenge compounds the democracy challenge. One of the most important economic phenomena of our time is a process I have called "premature deindustrialization."[10] Partly because of automation in manufacturing and partly because of globalization, low-income countries are running out of industrialization opportunities much sooner than their earlier counterparts in East Asia did. This would not be a tragedy if manufacturing was not traditionally a powerful growth engine, for reasons I discuss below.

With hindsight, it has become clear that there was in fact no coherent growth story for most emerging markets. Unlike China, Vietnam, South Korea, Taiwan, and a few other manufacturing miracles, the recent crop of growth champions did not build many modern, export-oriented industries. Scratch the surface, and you find high growth rates driven not by productive transformation but by domestic demand, in turn fueled by temporary commodity booms and unsustainable levels of public or, more often, private borrowing. Yes, there are plenty of world-class firms in emerging markets, and the expansion

of the middle class is unmistakable. But only a tiny share of these economies' labor is employed in productive enterprises, while informal, unproductive firms absorb the rest.

Is liberal democracy doomed in developing economies, or might it be saved by giving it different forms than it took in today's advanced economies? What kind of growth models are available to developing countries if industrialization has run out of steam? What are the implications of premature deindustrialization for labor markets and social inclusion? To overcome these novel future challenges, developing countries will need fresh, creative strategies that deploy the combined energies of both the private and public sectors.

No Time for Trade Fundamentalism

"One of the crucial challenges" of our era "is to maintain an open and expanding international trade system." Unfortunately, "the liberal principles" of the world trade system "are under increasing attack." "Protectionism has become increasingly prevalent." "There is great danger that the system will break down . . . or that it will collapse in a grim replay of the 1930s."

You would be excused for thinking that these lines are culled from one of the recent outpourings of concern in the business and financial media about the current backlash against globalization. In fact, they were written thirty-six years ago, in 1981.[11]

The problem then was stagflation in the advanced countries. And it was Japan, rather than China, that was the trade bogeyman, stalking—and taking over—global markets. The United States and Europe had responded by erecting trade barriers and imposing "voluntary export restrictions" on Japanese cars and steel. Talk about the creeping "new protectionism" was rife.

What took place subsequently would belie such pessimism about the trade regime. Instead of heading south, global trade exploded in the 1990s and 2000s, driven by the creation of the World Trade Organization, the proliferation of bilateral and regional trade and investment agreements, and the rise of China. A new age of globalization—in fact something more like hyperglobalization—was launched.

In hindsight, the "new protectionism" of the 1980s was not a radical break with the past. It was more a case of regime maintenance than regime disruption, as the political scientist John Ruggie has written. The import "safeguards" and "voluntary" export restrictions (VERs) of the time were ad hoc, but they were necessary responses to the distributional and adjustment challenges posed by the emergence of new trade relationships.[12]

The economists and trade specialists who cried wolf at the time were wrong. Had governments listened to their advice and not responded to their constituents, they would have possibly made things worse. What looked to contemporaries like damaging protectionism was in fact a way of letting off steam to prevent an excessive buildup of political pressure.

Are observers being similarly alarmist about today's globalization backlash? The International Monetary Fund, among others, has recently warned that slow growth and populism might lead to an outbreak of protectionism. "It is vitally important to defend the prospects for increasing trade integration," according to the IMF's chief economist, Maurice Obstfeld.[13]

So far, however, there are few signs that governments are moving decidedly away from an open economy. President Trump may yet cause trade havoc, but his bark has proved worse than his bite. The website globaltradealert.org maintains a database of protectionist measures and is a frequent source for claims of creeping protectionism. Click on its

interactive map of protectionist measures, and you will see an explosion of fireworks—red circles all over the globe. It looks alarming until you click on liberalizing measures and discover a comparable number of green circles.

The difference this time is that populist political forces seem much more powerful and closer to winning elections—partly a response to the advanced stage of globalization achieved since the 1980s. Not so long ago, it would have been unimaginable to contemplate a British exit from the European Union, or a Republican president in the United States promising to renege on trade agreements, build a wall against Mexican immigrants, and punish companies that move offshore. The nation-state seems intent on reasserting itself.

But the lesson from the 1980s is that some reversal from hyperglobalization need not be a bad thing, as long as it serves to maintain a reasonably open world economy. In particular, we need to place the requirements of liberal democracy ahead of those of international trade and investment. Such a rebalancing would leave plenty of room for an open global economy; in fact, it would enable and sustain it.

What makes a populist like Donald Trump dangerous is not his specific proposals on trade. It is the nativist, illiberal platform on which he seems intent to govern. And it is as well the reality that his economic policies don't add up to a coherent vision of how the United States and an open world economy can prosper side by side.

The critical challenge facing mainstream political parties in the advanced economies today is to devise such a vision, along with a narrative that steals the populists' thunder. These center-right and center-left parties should not be asked to save hyperglobalization at all costs. Trade advocates should be understanding if they adopt unorthodox policies to buy political support.

We should look instead at whether their policies are driven by a desire for equity and social inclusion or by nativist and racist impulses, whether they want to enhance or weaken the rule of law and democratic deliberation, and whether they are trying to save the open world economy—albeit with different ground rules—rather than undermine it.

The populist revolts of 2016 will almost certainly put an end to the last few decades' hectic deal making in trade. Though developing countries may pursue smaller trade agreements, the two major regional deals on the table, the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership, were as good as dead immediately after the election of Donald Trump as US president.

We should not mourn their passing. We should instead have an honest, principled discussion on putting globalization and development on a new footing, cognizant of our new political and technological realities and placing the requirements of liberal democracy front and center.

Getting the Balance Right

The problem with hyperglobalization is not just that it is an unachievable pipe dream susceptible to backlash—after all, the nation-state remains the only game in town when it comes to providing the regulatory and legitimizing arrangements on which markets rely. The deeper objection is that our elites' and technocrats' obsession with hyperglobalization makes it more difficult to achieve legitimate economic and social objectives at home—economic prosperity, financial stability, and social inclusion.

The questions of our day are: How much globalization should we seek in trade and finance? Is there still a case for nation-states in an age where the transportation and communications revolutions have

apparently spelled the death of geographic distance? How much sovereignty do states need to cede to international institutions? What do trade agreements really do, and how can we improve them? When does globalization undermine democracy? What do we owe, as citizens and states, to others across the border? How do we best carry out those responsibilities?

All of these questions require that we restore a sane, sensible balance between national and global governance. We need a pluralist world economy where nation-states retain sufficient autonomy to fashion their own social contracts and develop their own economic strategies. I will argue that the conventional picture of the world economy as a "global commons"—one in which we would be driven to economic ruin unless we all cooperate—is highly misleading. If our economic policies fail, they do so largely for domestic rather than international reasons. The best way in which nations can serve the global good in the economic sphere is by putting their own economic houses in order.

Global governance does remain crucial in those areas such as climate change where the provision of global public goods is essential. And global rules sometimes can help improve domestic economic policy, by enhancing democratic deliberation and decision-making. But, I will argue, democracy-enhancing global agreements would look very different than the globalization-enhancing deals that have marked our age.

We begin with an entity at the very core of our political and economic existence, but which has for decades been under attack: the nation-state.

CHAPTER 2

How Nations Work

In October 2016, British Prime Minister Theresa May shocked many when she disparaged the idea of global citizenship. "If you believe you're a citizen of the world," she said, "you're a citizen of nowhere."

Her statement was met with derision and alarm in the financial media and among liberal commentators. "The most useful form of citizenship these days," one analyst lectured her, "is one dedicated not only to the wellbeing of a Berkshire parish, say, but to the planet." *The Economist* called it an "illiberal" turn. A scholar accused her of repudiating Enlightenment values and warned of "echoes of 1933" in her speech.[1]

I know what a "global citizen" looks like: I make a perfect specimen myself. I grew up in one country, live in another, and carry the passports of both. I write on global economics, and my work takes me to far-flung places. I spend more time traveling in other countries than I do within either country that claims me as a citizen. Most of my close colleagues at work are similarly foreign-born. I devour international news, while my local paper remains unopened most weeks. In sports, I have no clue how my home teams are doing, but I am a devoted fan of a football team on the other side of the Atlantic.

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And yet May's statement strikes a chord. It contains an essential truth, the disregard of which says much about how we—the world's financial, political, and technocratic elite—distanced ourselves from our compatriots and lost their trust.

Economists and mainstream politicians tend to view the backlash as a regrettable setback, fueled by populist and nativist politicians who managed to capitalize on the grievances of those who feel they have been left behind and deserted by the globalist elites. Nevertheless, today globalism is in retreat and the nation-state has shown that it is very much alive.

For years, an intellectual consensus on the declining relevance of the nation-state reigned supreme. All the craze was about global governance—the international rules and institutions needed to underpin the apparently irreversible tide of economic globalization and the rise of cosmopolitan sensibilities.

Global governance became the mantra of our era's elite. The surge in cross-border flows of goods, services, capital, and information produced by technological innovation and market liberalization has made the world's countries too interconnected, their argument went, for any country to be able to solve its economic problems on its own. We need global rules, global agreements, and global institutions. This claim is still so widely accepted today that challenging it may seem like arguing that the sun revolves around Earth.

To understand how we got to this point, let's take a close look at the intellectual case against the nation-state and the arguments in favor of globalism in governance.

The Nation-State Under Fire

The nation-state is roundly viewed as an archaic construct that is at odds with twenty-first-century realities. The assault on the nation-state

transcends traditional political divisions and is one of the few things that unite economic liberals and socialists. "How may the economic unity of Europe be guaranteed, while preserving complete freedom of cultural development to the peoples living there?" asked Leon Trotsky back in 1934. The answer was to get rid of the nation-state: "The solution to this question can be reached . . . by completely liberating productive forces from the fetters imposed upon them by the national state."[2] Trotsky's answer sounds surprisingly modern in light of the eurozone's current travails. It is one to which most neoclassical economists would subscribe.

Many moral philosophers today join liberal economists in treating national borders as irrelevant, if not descriptively then certainly prescriptively. Here is Peter Singer:

> If the group to which we must justify ourselves is the tribe, or the nation, then our morality is likely to be tribal, or nationalistic. If, however, the revolution in communications has created a global audience, then we might need to justify our behavior to the whole world. This change creates the material basis for a new ethic that will serve the interests of all those who live on this planet in a way that, despite much rhetoric, no previous ethic has done.[3]

And Amartya Sen:

> There is something of a tyranny of ideas in seeing the political divisions of states (primarily, national states) as being, in some way, fundamental, and in seeing them not only as practical constraints to be addressed, but as divisions of basic significance in ethics and political philosophy.[4]

Sen and Singer think of national borders as a hindrance—a practical obstacle that can and should be overcome as the world becomes more interconnected through commerce and advances in communications.

Meanwhile, economists deride the nation-state because it is the source of the transaction costs that block fuller global economic integration. This is so not just because governments impose import tariffs, capital controls, visas, and other restrictions at their borders, impeding the global circulation of goods, money, and people. More fundamentally, it is because the multiplicity of sovereigns creates jurisdictional discontinuities and associated transaction costs. Differences in currencies, legal regimes, and regulatory practices are today the chief obstacles to a unified global economy. As overt trade barriers have come down, the relative importance of such transaction costs has grown. Import tariffs now constitute a tiny fraction of total trade costs. James Anderson and Eric van Wincoop estimated these costs to be a whopping 170 percent (in ad valorem terms) for advanced countries, an order of magnitude higher than import tariffs themselves.[5]

To an economist, this amount is equivalent to leaving $100 bills on the sidewalk. Remove the jurisdictional discontinuities, the argument goes, and the world economy would reap large gains from trade, similar to the multilateral tariff liberalization experienced over the postwar period. So, the global trade agenda has increasingly focused on efforts to harmonize regulatory regimes—everything from sanitary and phytosanitary standards to financial regulations. That is also why European nations felt it was important to move to a single currency to make their dream of a common market a reality. Economic integration requires repressing nation-states' ability to issue their own money, set different regulations, and impose different legal standards.

The Continued Vitality of the Nation-State

The death of the nation-state has long been predicted. "The critical issue for every student of world order is the fate of the nation-state,"

wrote political scientist Stanley Hoffman in 1966.[6] *Sovereignty at Bay* was the title of Raymond Vernon's 1971 classic.[7] Both scholars would ultimately pour cold water on the passing of the nation-state, but their tone reflects a strong current of prevailing opinion. Whether it was the European Union (on which Hoffman focused) or the multinational enterprise (Vernon's topic), the nation-state has been widely perceived as being overwhelmed by developments larger than it.

Yet the nation-state refuses to wither away. It has proved remarkably resilient and remains the main determinant of the global distribution of income, the primary locus of market-supporting institutions, and the chief repository of personal attachments and affiliations. Consider a few facts.

To test my students' intuition about the determinants of global inequality, I ask them on the first day of class whether they would rather be rich in a poor country or poor in a rich country. I tell them to consider only their own consumption level and to think of rich and poor as referring to the top and bottom 5 percent of a country's income distribution. A rich country, in turn, is one in the top 5 percent of the intercountry distribution of per-capita incomes, while a poor country is one in the bottom. Armed with this background, typically a majority of the students respond that they would rather be rich in a poor country.

They are in fact massively wrong. Defined the way I just did, the poor in a rich country are almost five times richer than the rich in a poor country.[8] The optical illusion that leads the students astray is that the superrich with the BMWs and gated mansions they have seen in poor countries are a miniscule proportion of the population—significantly fewer than the top 5 percent on which I asked them to focus. By the time we consider the average of the top ventile as a whole, we have taken a huge leap down the income scale.

The students have just discovered a telling feature of the world economy: our economic fortunes are determined primarily by where (which country) we are born and only secondarily by our location on the income-distribution scale. Or to put it in more technical but also more accurate terms, most global inequality is accounted for by inequality across rather than within nations.[9] So much for globalization having revoked the relevance of national borders.

Second, consider the role of national identity. One may imagine that attachments to the nation-state have worn thin between the push of transnational affinities, on the one hand, and the pull of local connections, on the other hand. But this does not seem to be the case. National identity remains alive and well, even in some surprising corners of the world. And this was true even before the global financial crisis and the populist backlash that has unfolded since.

To observe the continued vitality of national identification, let us turn to the World Values Survey, which covers more than eighty thousand individuals in fifty-seven countries (http://www.worldvaluessurvey.org/). The respondents to the survey were asked a range of questions about the strength of their local, national, and global attachments. I measured the strength of national attachments by computing the percentages of respondents who "agreed" or "strongly agreed" with the statement "I see myself as a citizen of [country, nation]." I measured the strength of global attachments, in turn, by the percentages of respondents who "agreed" or "strongly agreed" with the statement "I see myself as a world citizen." In each case, I subtracted these percentages from analogous percentages for "I see myself as a member of my local community" to provide for some kind of normalization. In other words, I measured national and global attachments relative to local attachments. I rely on the 2004–2008 round of the survey since it was carried out before the financial crises in Europe and the United States

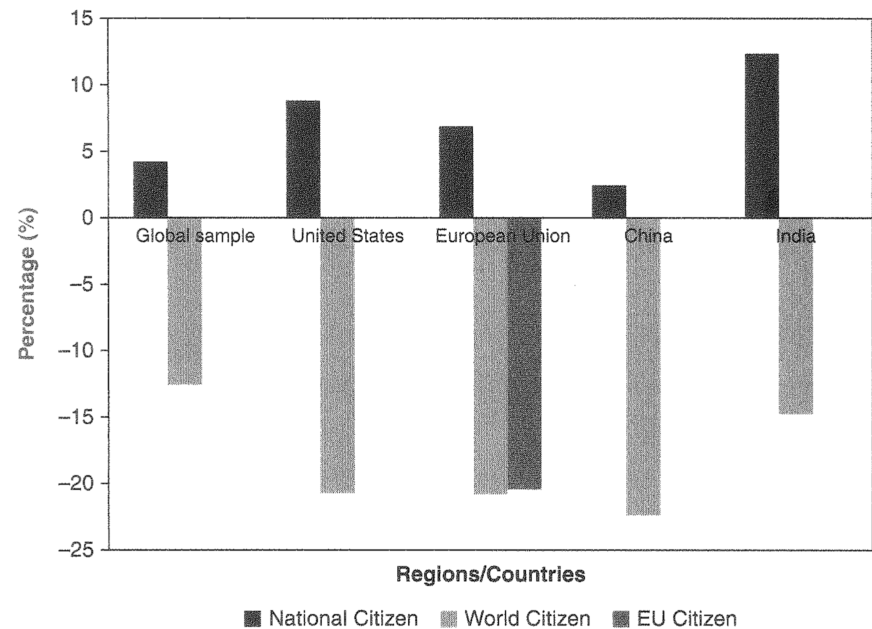

FIGURE 2.1 National, global, and EU citizenship (relative to attachment to local community). Percentages of respondents who "agree" or "strongly agree" with the statements "I see myself as a citizen of [country, nation]" and "I see myself as a world citizen," subtracted from analogous percentages for "I see myself as a member of my local community."
Source: D. Rodrik, "Who Needs the Nation State?" *Economic Geography*, 89(1), January 2013: 1–19.

and isolates the results from the confounding effects of the economic downturn.

Figure 2.1 shows the results for the entire global sample, as well as for the United States, the European Union, China, and India individually. What stands out is not so much that national identity is vastly stronger than identity as a "global citizen"—that much was predictable. The surprising finding is how it apparently exerts a stronger pull than

membership in the local community, as can be observed in the positive percentages for normalized national identity. This tendency is true across the board and the strongest in the United States and India, two vast countries where we may have expected local attachments to be, if anything, stronger than attachment to the nation-state.

I find it also striking that European citizens feel so little attachment to the European Union. In fact, as Figure 2.1 shows, the idea of citizenship in the European Union seems as remote to Europeans as that of global citizenship, despite long decades of European integration and institution building.

It is not a surprise to find that global attachments have worn even thinner since 2008. Measures of world citizenship have gone down significantly in some of the European countries especially: from –18 percent to –29 percent in Germany and –12 percent to –22 percent in Spain. (These are comparisons between the 2010–2014 and 2004–2008 waves.)

One may object that such surveys obfuscate differences among subgroups within the general population. We would expect mainly the young, the skilled, and the well-educated to have been unhinged from their national mooring and to have become global in their outlook and attachments. As Figure 2.2 indicates, there are indeed differences among these groups that go in the predicted direction. But they are not as large as one may have thought and do not change the overall picture. Even among the young (less than twenty-five years old), those with a university education and professionals, national identity trumps local and—even more massively—global attachments.

Finally, any remaining doubts about the continued relevance of the nation-state must have been dispelled by the experience in the aftermath of the global financial crisis of 2008. It was domestic policy makers who had to step in to prevent an economic meltdown: it was

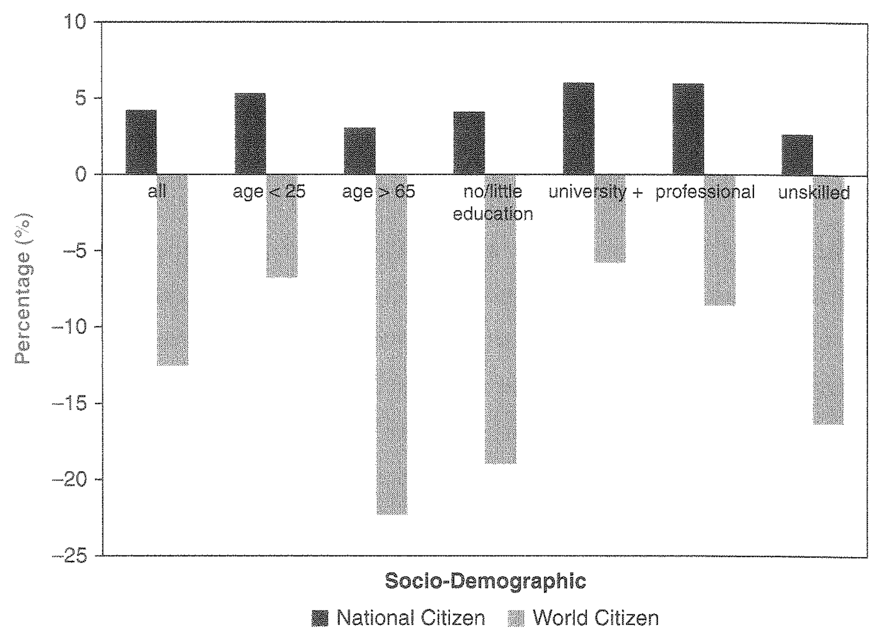

FIGURE 2.2 Effect of socio-demographics. Percentages of respondents who "agree" or "strongly agree" with the statements "I see myself as a citizen of [country, nation]" and "I see myself as a world citizen," subtracted from analogous percentages for "I see myself as a member of my local community."
Source: D. Rodrik, "Who Needs the Nation State?" *Economic Geography*, 89(1), January 2013: 1–19.

national governments that bailed out banks, pumped liquidity, provided a fiscal stimulus, and wrote unemployment checks. As Bank of England chairman Mervyn King once memorably put it, banks are global in life and national in death.

The International Monetary Fund and the newly upgraded Group of 20 were merely talking shops. In the eurozone, it was decisions taken in national capitals from Berlin to Athens that determined how the crisis would play out, not actions in Brussels (or Strasbourg). And

it was national governments that ultimately took the blame for everything that went wrong—or the credit for the little that went right.

A Normative Case for the Nation-State

Historically, the nation-state has been closely associated with economic, social, and political progress. It curbed internecine violence, expanded networks of solidarity beyond local communities, spurred mass markets and industrialization, enabled the mobilization of human and financial resources, and fostered the spread of representative political institutions.[10] Civil wars and economic decline are the usual fate of today's "failed states." For residents of stable and prosperous countries, it is easy to overlook the role that the construction of the nation-state played in overcoming such challenges. The nation-state's fall from intellectual grace is in part a consequence of its achievements.

But has the nation-state, as a territorially confined political entity, truly become a hindrance to the achievement of desirable economic and social outcomes in view of the globalization revolution? Or does the nation-state remain indispensable to the achievement of those goals? In other words, is it possible to construct a more principled defense of the nation-state, one that goes beyond stating that it exists and that it has not withered away?

Let me begin by clarifying my terminology. The nation-state evokes connotations of nationalism. The emphasis in my discussion will be not on the "nation" or "nationalism" part but on the "state" part. In particular, I am interested in the state as a spatially demarcated jurisdictional entity. From this perspective, I view the nation as a consequence of a state, rather than the other way around. As Abbé Sieyès, one of the theorists of the French revolution, put it: "What is a nation? A body of associates

living under one common law and represented by the same legislature."[11] I am not concerned with debates over what a nation is, whether each nation should have its own state, or how many states there ought to be.

Instead, I want to develop a substantive argument for why robust nation-states are actually beneficial, especially to the world economy. I want to show that the multiplicity of nation-states adds rather than subtracts value. My starting point is that markets require rules and that global markets would require global rules. A truly borderless global economy, one in which economic activity is fully unmoored from its national base, would necessitate transnational rule-making institutions that match the global scale and scope of markets. But this would not be desirable, even if it were feasible. Market-supporting rules are nonunique. Experimentation and competition among diverse institutional arrangements therefore remain desirable. Moreover, communities differ in their needs and preferences regarding institutional forms. And history and geography continue to limit the convergence in these needs and preferences.

So, I accept that nation-states are a source of disintegration for the global economy. My claim is that an attempt to transcend them would be counterproductive. It would get us neither a healthier world economy nor better rules.

My argument can be presented as a counterpoint to the typical globalist narrative, depicted graphically in the top half of Figure 2.3. In this narrative, economic globalization, spurred by the revolutions in transportation and communication technologies, breaks down the social and cultural barriers among people in different parts of the world and fosters a global community. It, in turn, enables the construction of a global *political* community—global governance—that underpins and further reinforces economic integration.

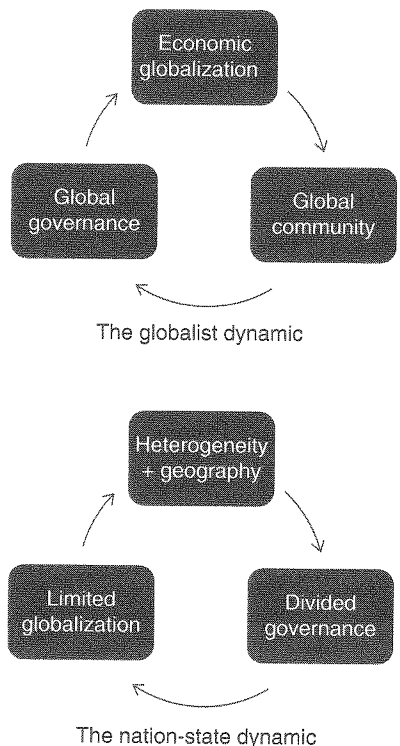

FIGURE 2.3 Alternative reinforcing dynamics
Source: D. Rodrik, "Who Needs the Nation State?" *Economic Geography*, 89(1), January 2013: 1–19.

My alternative narrative (shown at the bottom of Figure 2.3) emphasizes a different dynamic, one that sustains a world that is politically divided and economically less than fully globalized. In this dynamic, preference heterogeneity and institutional nonuniqueness, along with geography, create a need for institutional diversity. Institutional diversity blocks full economic globalization. Incomplete economic integration, in turn, reinforces heterogeneity and the role of distance. When the forces of this second dynamic are sufficiently strong, as I will

argue they are, operating by the rules of the first can get us only into trouble.

The Futile Pursuit of Hyperglobalization

Markets depend on nonmarket institutions because they are not self-creating, self-regulating, self-stabilizing, or self-legitimating. Anything that goes beyond a simple exchange among neighbors requires investments in transportation, communications, and logistics; enforcement of contracts, provision of information, and prevention of cheating; a stable and reliable medium of exchange; arrangements to bring distributional outcomes into conformity with social norms; and so on. Well-functioning, sustainable markets are backed by a wide range of institutions that provide the critical functions of regulation, redistribution, monetary and fiscal stability, and conflict management.

These institutional functions have so far been provided largely by the nation-state. Throughout the postwar period, this not only did not impede the development of global markets but it facilitated it in many ways. The guiding philosophy behind the Bretton Woods regime, which governed the world economy until the 1970s, was that nations—not only the advanced nations but also the newly independent ones—needed the policy space within which they could manage their economies and protect their social contracts. Capital controls, restricting the free flow of finance between countries, were viewed as an inherent element of the global financial system. Trade liberalization remained limited to manufactured goods and to industrialized nations; when imports of textiles and clothing from low-cost countries threatened domestic social bargains by causing job losses in affected industries and regions, these, too, were carved out as special regimes.

Yet trade and investment flows grew by leaps and bounds, in no small part because the Bretton Woods recipe made for healthy domestic policy environments. In fact, economic globalization relied critically on the rules maintained by the major trading and financial centers. As John Agnew has emphasized, national monetary systems, central banks, and financial regulatory practices were the cornerstones of financial globalization.[12] In trade, it was more the domestic political bargains than GATT rules that sustained the openness that came to prevail.

The nation-state was the enabler of globalization, but also the ultimate obstacle to its deepening. Combining globalization with healthy domestic polities relied on managing this tension well. Veer too much in the direction of globalization, as in the 1920s, and we would erode the institutions' underpinning markets. Veer too much in the direction of the state, as in the 1930s, and we would forfeit the benefits of international commerce.

From the 1980s on, the ideological balance took a decisive shift in favor of markets and against governments. The result internationally was an all-out push for what I have called "hyperglobalization"[13]—the attempt to eliminate all transaction costs that hinder trade and capital flows. The World Trade Organization was the crowning achievement of this effort in the trade arena. Trade rules were now extended to services, agriculture, subsidies, intellectual property rights, sanitary and phytosanitary standards, and other types of what were previously considered to be domestic policies. In finance, freedom of capital mobility became the norm, rather than the exception, with regulators focusing on the global harmonization of financial regulations and standards. A majority of European Union members went the furthest by first reducing exchange-rate movements among themselves and ultimately adopting a single currency.

The upshot was that domestic governance mechanisms were weakened while their global counterparts remain incomplete. The flaws of the new approach became evident soon enough. One type of failure

arose from pushing rule making onto supranational domains too far beyond the reach of political debate and control. This failure was exhibited in persistent complaints about the democratic deficit, lack of legitimacy, and loss of voice and accountability. These complaints became permanent fixtures attached to the World Trade Organization and Brussels institutions.

Where rule making remained domestic, another type of failure arose. Growing volumes of trade with countries at different levels of development and with highly dissimilar institutional arrangements exacerbated inequality and economic insecurity at home. What was even more destructive, the absence of institutions at the global level that have tamed domestic finance (a lender of last resort, deposit insurance, bankruptcy laws, and fiscal stabilizers) rendered global finance a source of instability and periodic crises of massive proportions. Domestic policies alone were inadequate to address the problems that extreme economic and financial openness created.

Suitably enough, the countries that did the best in the new regime were those that did not let their enthusiasm for free trade and free flows of capital get the better of them. China, which engineered history's most impressive poverty reduction and growth outcomes, was, of course, a major beneficiary of others' economic openness. But for its part, it followed a highly cautious strategy that combined extensive industrial policies with selective, delayed import liberalization and capital controls. Effectively, China played the globalization game by Bretton Woods rules rather than by hyperglobalization rules.

Is Global Governance Feasible or Desirable?

By now it is widely understood that globalization's ills derive from the imbalance between the global nature of markets and the domestic

nature of the rules that govern them. As a matter of logic, the imbalance can be corrected in only one of two ways: expand governance beyond the nation-state or restrict the reach of markets. In polite company, only the first option receives much attention.

Global governance means different things to different people. For policy officialdom, it refers to new intergovernmental forums, such as the Group of 20 and the Financial Stability Forum. For some analysts, it means the emergence of transnational networks of regulators setting common rules from sanitary to capital adequacy standards.[14] For other analysts, it is "private governance" regimes, such as fair trade and corporate social responsibility.[15] Yet others imagine the development of accountable global administrative processes that depend "on local debate, is informed by global comparisons, and works in a space of public reasons."[16] For many activists, it signifies greater power for international nongovernmental organizations.

It remains without saying that such emergent forms of global governance remain weak. But the real question is whether they can develop and become strong enough to sustain hyperglobalization and spur the emergence of truly global identities. I do not believe they can. I develop my argument in four steps: (1) market-supporting institutions are not unique, (2) communities differ in their needs and preferences regarding institutional forms, (3) geographic distance limits the convergence in those needs and preferences, and (4) experimentation and competition among diverse institutional forms is desirable.

Market-supporting Institutions Are Not Unique

It is relatively straightforward to specify the *functions* that market-supporting institutions serve, as I did previously. They create, regulate, stabilize, and legitimate markets. But specifying the *form* that institutions

should take is another matter altogether. There is no reason to believe that these functions can be provided only in specific ways or to think that there is only a limited range of plausible variation. In other words, institutional function does not map uniquely into form.

All advanced societies are some variant of a market economy with dominantly private ownership. But the United States, Japan, and the European nations have evolved historically under institutional setups that differ significantly. These differences are revealed in divergent practices in labor markets, corporate governance, social welfare systems, and approaches to regulation. That these nations have managed to generate comparable amounts of wealth under different rules is an important reminder that there is not a single blueprint for economic success. Yes, markets, incentives, property rights, stability, and predictability are important. But they do not require cookie-cutter solutions.

Economic performance fluctuates, even among advanced countries, so institutional fads are common. In recent decades, European social democracy, Japanese-style industrial policy, the US model of corporate governance and finance, and Chinese state capitalism have periodically come into fashion, only to recede from attention once their stars faded. Despite efforts by international organizations, such as the World Bank and the Organisation for Economic Co-operation and Development (OECD), to develop "best practices," institutional emulation rarely succeeds.

One reason is that elements of the institutional landscape tend to have a complementary relationship to each other, dooming partial reform to failure. For example, in the absence of labor market training programs and adequate safety nets, deregulating labor markets by making it easier for firms to fire their workers can easily backfire. Without a tradition of strong stakeholders that restrain risk taking, allowing financial firms to self-regulate can be a disaster. In their well-known

book *Varieties of Capitalism*, Peter Hall and David Soskice identified two distinct institutional clusters among advanced industrial economies, which they called "liberal market economies" and "coordinated market economies."[17] We can certainly identify additional models as well if we turn to Asia.

The more fundamental point has to do with the inherent malleability of institutional designs. As Roberto Unger has emphasized, there is no reason to think that the range of institutional divergence we observe in the world today exhausts all feasible variation.[18] Desired institutional functions—aligning private incentives with social optimality, establishing macrostability, achieving social justice—can be generated in innumerable ways, limited only by our imagination. The idea that there is a best-practice set of institutions is an illusion.

This is not to say that differences in institutional arrangements do not have real consequences. Institutional malleability does not mean that institutions always perform adequately: there are plenty of societies whose institutions patently fail to provide for adequate incentives for production, investment, and innovation, not to mention social justice. But even among relatively successful societies, different institutional configurations often have varying implications for distinct groups. Compared to coordinated market economies, liberal market economies, for example, present better opportunities for the most creative and successful members of society, but also tend to produce greater inequality and economic insecurity for their working classes. Richard Freeman has shown that more highly regulated labor market environments produce less dispersion in earnings but not necessarily higher rates of unemployment.[19]

There is an interesting analogy here to the second fundamental theorem of welfare economics. The theorem states that any Pareto-efficient equilibrium can be obtained as the outcome of a competitive

equilibrium with an appropriate distribution of endowments. Institutional arrangements are, in effect, the rules that determine the allocation of rights to a society's resources; they shape the distribution of endowments in the broadest term. Each Pareto-efficient outcome can be sustained by a different set of rules. And conversely, each set of rules has the potential to generate a different Pareto-efficient outcome. (I say potential because "bad" rules will clearly result in Pareto-inferior outcomes.)

It is not clear how we can choose ex ante among Pareto-efficient equilibria. It is precisely this indeterminacy that makes the choice among alternative institutions a difficult one, best left to political communities themselves.

Heterogeneity and Diversity

Immanuel Kant wrote that religion and language divide people and prevent a universal monarchy.[20] But there are many other things that divide us. As I discussed in the previous section, institutional arrangements have distinct implications for the distribution of well-being and many other features of economic, social, and political life. We do not agree on how to trade equality against opportunity, economic security against innovation, stability against dynamism, economic outcomes against social and cultural values, and many other consequences of institutional choice. Differences in preferences are ultimately the chief argument against institutional harmonization globally.

Consider how financial markets should be regulated. There are many choices to be made. Should commercial banking be separated from investment banking? Should there be a limit on the size of banks? Should there be deposit insurance, and, if so, what should it cover? Should banks be allowed to trade on their own account? How much

information should they reveal about their trades? Should executives' compensation be set by directors, with no regulatory controls? What should the capital and liquidity requirements be? Should all derivative contracts be traded on exchanges? What should be the role of credit-rating agencies? And so on.

A central trade-off here is between financial innovation and financial stability. A light approach to regulation will maximize the scope for financial innovation (the development of new financial products), but at the cost of increasing the likelihood of financial crises and crashes. Strong regulation will reduce the incidence and costs of crises, but potentially at the cost of raising the cost of finance and excluding many from its benefits. There is no single ideal point along this trade-off. Requiring that communities whose preferences over the innovation-stability continuum vary all settle on the same solution may have the virtue that it reduces transaction costs in finance. But it would come at the cost of imposing arrangements that are out of sync with local preferences. This is the conundrum that financial regulation faces at the moment, with banks pushing for common global rules and domestic legislatures and policy makers resisting.

Here is another example from food regulation. In a controversial 1998 case, the World Trade Organization sided with the United States in ruling that the European Union's ban on beef reared on certain growth hormones violated the Agreement on Sanitary and Phytosanitary Standards (SPS). It is interesting that the ban did not discriminate against imports and applied to imported and domestic beef alike. There did not seem to be a protectionist motive behind the ban, which had been pushed by consumer lobbies in Europe that were alarmed by the potential health threats. Nonetheless, the World Trade Organization judged that the ban violated the requirement in the SPS agreement that policies be based on "scientific evidence." (In a similar case in 2006,

the World Trade Organization also ruled against the European Union's restrictions on genetically modified food and seeds [GMOs], finding fault once again with the adequacy of the European Union's scientific risk assessment.)

There is indeed scant evidence to date that growth hormones pose any health threats. The European Union argued that it had applied a broader principle not explicitly covered by the World Trade Organization, the "precautionary principle," which permits greater caution in the presence of scientific uncertainty. The precautionary principle reverses the burden of proof. Instead of asking, "Is there reasonable evidence that growth hormones, or GMOs, have adverse effects?" it requires policy makers to ask, "Are we reasonably sure that they do *not*?" In many unsettled areas of scientific knowledge, the answer to both questions can be no. Whether the precautionary principle makes sense depends both on the degree of risk aversion and on the extent to which potential adverse effects are large and irreversible.

As the European Commission argued (unsuccessfully), regulatory decisions here cannot be made purely on the basis of science. Politics, which aggregates a society's risk preferences, must play the determining role. It is reasonable to expect that the outcome will vary across societies. Some (like the United States) may go for low prices; others (like the European Union) will go for greater safety.

The suitability of institutional arrangements also depends on levels of development and historical trajectory. Alexander Gerschenkron famously argued that lagging countries would need institutions—such as large banks and state-directed investments—that differed from those present in the original industrializers.[21] To a large extent, his arguments have been validated. But even among rapidly growing developing nations, there is considerable institutional variation. What works in one place rarely does in another.

Consider how some of the most successful developing nations joined the world economy. South Korea and Taiwan relied heavily on export subsidies to push their firms outward during the 1960s and 1970s and liberalized their import regime only gradually. China established special economic zones in which export-oriented firms were allowed to operate under different rules than those applied to state enterprises and to others focused on the internal market. Chile, by contrast, followed the textbook model and sharply reduced import barriers to force domestic firms to compete with foreign firms directly in the home market. The Chilean strategy would have been a disaster if applied in China, because it would have led to millions of job losses in state enterprises and incalculable social consequences. And the Chinese model would not have worked as well in Chile, a small nation that is not an obvious destination for multinational enterprises.

Alberto Alesina and Enrico Spolaore have explored how heterogeneity in preferences interacts with the benefits of scale to determine endogenously the number and size of nations. In their basic model, individuals differ in their preferences over the type of public goods—or, in my terms, the specific institutional arrangements—provided by the state.[22] The larger the population over which the public good is provided, the lower the unit cost of provision. On the other hand, the larger the population, the greater the number of people who find their preferences ill served by the specific public good that is provided. Smaller countries are better able to respond to their citizens' needs. The optimum number of jurisdictions, or nation-states, trades off the scale benefits of size against the heterogeneity costs of the provision of public good.

The important analytical insight of the Alesina-Spolaore model is that it makes little sense to optimize along the market-size dimension (and eliminate jurisdictional discontinuities) when there is heterogeneity in

preferences along the institutional dimension. The framework does not tell us whether we have too many nations at present or too few. But it does suggest that a divided world polity is the price we pay for institutional arrangements that are, in principle at least, better tailored to local preferences and needs.

Distance Lives: The Limits to Convergence

We need to consider an important caveat to the discussion on heterogeneity—namely, the *endogenous* nature of many of the differences that set communities apart. That culture, religion, and language are in part a side product of nation-states is an old theme that runs through the long trail of the literature on nationalism. From Ernest Renan down, theorists of nationalism have stressed that cultural differences are not innate and can be shaped by state policies. Education, in particular, is a chief vehicle through which national identity is molded. Ethnicity has a certain degree of exogeneity, but its salience in defining identity is also a function of the strength of the nation-state. A resident of Turkey who defines himself as Muslim is potentially a member of a global community, whereas a "Turk" owes primary loyalty to the Turkish state.

Much the same can be said about other characteristics along which communities differ. If poor countries have distinctive institutional needs arising from their low levels of income, we may perhaps expect these distinctions to disappear as income levels convergence. If societies have different preferences over risk, stability, equity, and so on, we may similarly expect these differences to narrow as a result of greater communication and economic exchange across jurisdictional boundaries. Today's differences may exaggerate tomorrow's differences. In a world where people are freed from their local moorings, they are also freed

from their local idiosyncrasies and biases. Individual heterogeneity may continue to exist, but it need not be correlated across geographic space.

There is some truth to these arguments, but they are also counter-weighed by a considerable body of evidence that suggests that geographic distance continues to produce significant localization effects despite the evident decline in transportation and communication costs and other man-made barriers. One of the most striking studies in this vein was by Anne-Celia Disdier and Keith Head, which looked at the effect of distance on international trade over the span of history.[23] It is a stylized fact of the empirical trade literature that the volume of bilateral trade declines with the geographic distance between trade partners. The typical distance elasticity is around –1.0, meaning that trade falls by 10 percent for every 10 percent increase in distance. This is a fairly large effect. Presumably, what lies behind it is not just transportation and communication costs but the lack of familiarity and cultural differences. (Linguistic differences are often controlled for separately.)

Disdier and Head undertook a meta-analysis, collecting 1,467 distance effects from 103 papers covering trade flows at different points in time, and stumbled on a surprising result: distance matters more now than it did in the late nineteenth century. The distance effect seems to have increased from the 1960s, remaining persistently high since then (see Figure 2.4). If anything, globalization seems to have raised the penalty that geographic distance imposes on economic exchange. This apparent paradox was also confirmed by Matias Berthelon and Caroline Freund, who found an increase in the (absolute value) of the distance elasticity from –1.7 to –1.9 between 1985 and 1989 and between 2001 and 2005 using a consistent trade data set. Berthelon and Freund showed that the result was not due to a compositional switch from low- to high-elasticity goods but to "a significant and increasing impact of distance on trade in almost 40 percent of industries."[24]

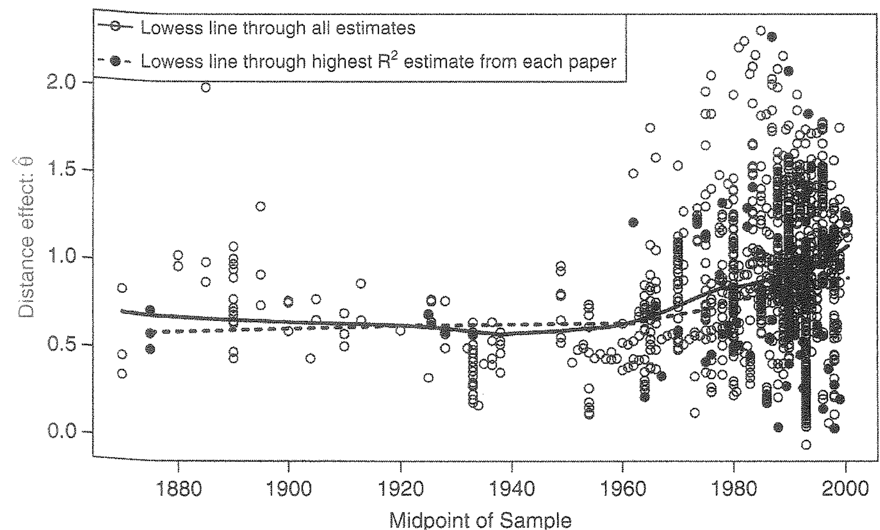

FIGURE 2.4 Estimated distance effect ($\hat{\theta}$) over time
Source: Disdier, A.-C., and Head, K. 2008. "The Puzzling Persistence of the Distance Effect on Bilateral Trade," *The Review of Economics and Statistics* 90(1): 37–48. With permission from MIT Press Journals.

Leaving this puzzle aside for the moment, let us turn to an altogether different type of evidence. [25] In the mid-1990s a new housing development in one of the suburbs of Toronto engaged in an interesting experiment. The houses were built from the ground up with the latest broadband telecommunications infrastructure and came with a host of new Internet technologies. Residents of Netville (a pseudonym) had access to high-speed Internet, a videophone, an online jukebox, online health services, discussion forums, and a suite of entertainment and educational applications. These new technologies made the town an ideal setting for nurturing global citizens. The people of Netville were freed from the tyranny of distance. They could communicate with anyone in the world as easily as they could with a neighbor, forge their own global links, and join virtual communities in cyberspace. One

might expect they would begin to define their identities and interests increasingly in global, rather than in local, terms.

What actually transpired was quite different. Glitches experienced by the telecom provider left some homes without a link to the broadband network. This situation allowed researchers to compare wired and nonwired households and reach some conclusions about the consequences of being wired. Far from letting local links erode, wired people actually strengthened their existing local social ties. Compared to nonwired residents, they recognized more of their neighbors, talked to them more often, visited them more frequently, and made many more local phone calls. They were more likely to organize local events and mobilize the community around common problems. They used their computer network to facilitate a range of social activities, from organizing barbecues to helping local children with their homework. Netville exhibited, as one resident put it, "a closeness that you don't see in many communities." What was supposed to have unleashed global engagement and networks had instead strengthened local social ties.

There are plenty of other examples that belie the death of distance. One study identified strong "gravity" effects on the Internet: "Americans are more likely to visit websites from nearby countries, even controlling for language, income, immigrant stock, etc."[26] For digital products related to music, games, and pornography, a 10 percent increase in physical distance reduces the probability that an American will visit the website by 33 percent—a distance elasticity even higher (in absolute value) than for trade in goods.

Despite the evident reduction in transportation and communication costs, the production location of globally traded products is often determined by regional agglomeration effects. When the *New York Times* recently examined why Apple's iPhone is manufactured in China, rather than in the United States, the answer turned out to have

little to do with comparative advantage. China had already developed a massive network of suppliers, engineers, and dedicated workers in a complex known informally as Foxconn City that provided Apple with benefits that the United States could not match.[27]

More broadly, incomes and productivity do not always exhibit a tendency to converge as markets for goods, capital, and technology become more integrated. The world economy's first era of globalization produced a large divergence in incomes between the industrializing countries at the center and lagging regions in the periphery that specialized in primary commodities. Similarly, economic convergence has been the exception rather than the rule in the postwar period. Economic development depends perhaps more than ever on what happens at home. If the world economy exerts a homogenizing influence, it is at best a partial one, competing with many other influences that go the other way.

Relationships based on proximity are one such offsetting influence. Many, if not most, exchanges are based on relationships, rather than textbook-style anonymous markets. Geographic distance protects relationships. As Ed Leamer put it, "geography, whether physical or cultural or informational, limits competition since it creates cost-advantaged relationships between sellers and buyers who are located 'close' to one another."[28] But relationships also create a role for geography. Once relationship-specific investments are made, geography becomes more important. The iPhone could have been produced anywhere, but once relationships with local suppliers were established, there are lock-in effects that make it difficult for Apple to move anywhere else.

Technological progress has an ambiguous effect on the importance of relationships. On the one hand, the decline in transportation and communication costs reduces the protective effect of distance in market relationships. It may facilitate the creation of long-distance relationships

that cross national boundaries. On the other hand, the increase in complexity and product differentiation, along with the shift from Fordist mass production to new, distributed modes of learning, increases the relative importance of spatially circumscribed relationships. The new economy runs on tacit knowledge, trust, and cooperation—which still depend on personal contact. As Kevin Morgan put it, spatial reach does not equal "social depth."[29]

Hence, market segmentation is a natural feature of economic life, even in the absence of jurisdictional discontinuities. Neither economic convergence nor preference homogenization is the inevitable consequence of globalization.

Experimentation and Competition

Finally, since there is no fixed, ideal shape for institutions and diversity is the rule rather than exception, a divided global polity presents an additional advantage. It enables experimentation, competition among institutional forms, and learning from others. To be sure, trial and error can be costly when it comes to society's rules. Still, institutional diversity among nations is as close as we can expect to a laboratory in real life. Josiah Ober has discussed how competition among Greek city-states during 800–300 BCE fostered institutional innovation in areas of citizenship, law, and democracy, sustaining the relative prosperity of ancient Greece.[30]

There can be nasty sides to institutional competition. One of them is the nineteenth-century idea of a Darwinian competition among states, whereby wars are the struggle through which we get progress and self-realization of humanity.[31] The equally silly, if less bloody, modern counterpart of this idea is the notion of economic competition among nations, whereby global commerce is seen as a zero-sum game. Both

ideas are based on the belief that the point of competition is to lead us to the one perfect model. But competition works in diverse ways. In economic models of "monopolistic competition," producers compete not just on price but on variety—by differentiating their products from others'.[32] Similarly, national jurisdictions can compete by offering institutional "services" that are differentiated along the dimensions I discussed earlier.

One persistent worry is that institutional competition sets off a race to the bottom. To attract mobile resources—capital, multinational enterprises, and skilled professionals—jurisdictions may lower their standards and relax their regulations in a futile dynamic to outdo other jurisdictions. Once again, this argument overlooks the multidimensional nature of institutional arrangements. Tougher regulations or standards are presumably put in place to achieve certain objectives: they offer compensating benefits elsewhere. We may all wish to be free to drive at any speed we want, but few of us would move to a country with no speed limit at all where, as a result, deadly traffic accidents would be much more common. Similarly, higher labor standards may lead to happier and more productive workers; tougher financial regulation to greater financial stability; and higher taxes to better public services, such as schools, infrastructure, parks, and other amenities. Institutional competition can foster a race to the top.

The only area in which some kind of race to the bottom has been documented is corporate taxation. Tax competition has played an important role in the remarkable reduction in corporate taxes around the world since the early 1980s. In a study on OECD countries, researchers found that when other countries reduce their average statutory corporate tax rate by 1 percentage point, the home country follows by reducing its tax rate by 0.7 percentage points.[33] The study indicated that international tax competition takes place only among

countries that have removed their capital controls. When such controls are in place, capital and profits cannot move as easily across national borders and there is no downward pressure on capital taxes. So, the removal of capital controls appears to be a factor in driving the reduction in corporate tax rates.

On the other hand, there is scant evidence of similar races to the bottom in labor and environmental standards or in financial regulation. The geographically confined nature of the services (or public goods) offered by national jurisdictions often presents a natural restraint on the drive toward the bottom. If you want to partake of those services, you need to be in that jurisdiction. But corporate tax competition is also a reminder that the costs and benefits need not always neatly cancel each other. Although it is not a perfect substitute for local sourcing, international trade does allow a company to serve a high-tax market from a low-tax jurisdiction. The problem becomes particularly acute when the arrangement in question has a "solidarity" motive and is explicitly redistributive (as in many tax examples). In such cases, it becomes desirable to prevent "regulatory arbitrage" even if it means tightening controls at the border.

What Do Global Citizens Do?

Let's circle back to Teresa May's comments at the beginning of this chapter. What does it even mean to be a "global citizen"? The Oxford English Dictionary defines "citizen" as "a legally recognized subject or national of a state or commonwealth." Hence, citizenship presumes an established polity—"a state or commonwealth"—of which one is a member. Countries have such polities; the world does not.

Proponents of global citizenship quickly concede that they do not have a literal meaning in mind. They are thinking figuratively.

Technological revolutions in communications and economic globalization have brought citizens of different countries together, they argue. The world has shrunk, and we must act bearing the global implications in mind. And besides, we all carry multiple, overlapping identities. Global citizenship does not—and need not—crowd out parochial or national responsibilities.

All well and good. But what do global citizens really do?

Real citizenship entails interacting and deliberating with other citizens in a shared political community. It means holding decision makers to account and participating in politics to shape the policy outcomes. In the process, my ideas about desirable ends and means are confronted with and tested against those of my fellow citizens.

Global citizens do not have similar rights or responsibilities. No one is accountable to them, and there is no one to whom they must justify themselves. At best, they form communities with like-minded individuals from other countries. Their counterparts are not citizens everywhere but self-designated "global citizens" in other countries.

Of course, global citizens have access to their *domestic* political systems to push their ideas through. But political representatives are elected to advance the interests of the people who put them in office. National governments are meant to look out for national interests, and rightly so. This does not exclude the possibility that constituents might act with enlightened self-interest, by taking into account the consequences of domestic action for others.

But what happens when the welfare of local residents comes into conflict with the well-being of foreigners—as it often does?[34] Isn't disregard of their compatriots in such situations precisely what gives so-called cosmopolitan elites their bad name?

Global citizens worry that the interests of the global commons may be harmed when each government pursues its own narrow interest.

This is certainly a concern with issues that truly concern the global commons, such as climate change or pandemics. But in most economic areas—taxes, trade policy, financial stability, fiscal and monetary management—what makes sense from a global perspective also makes sense from a domestic perspective. Economics teaches that countries should maintain open economic borders, sound prudential regulation, and full-employment policies, not because these are good for other countries but because they serve to enlarge the domestic economic pie.

Of course, policy failures—for example, protectionism—do occur in all of these areas. But these reflect poor domestic governance, not a lack of cosmopolitanism. They result either from policy elites' inability to convince domestic constituencies of the benefits of the alternative, or from their unwillingness to make adjustments to ensure that everyone does indeed benefit.

Hiding behind cosmopolitanism in such instances—when pushing for trade agreements, for example—is a poor substitute for winning policy battles on their merits. And it devalues the currency of cosmopolitanism when we truly need it, as we do in the fight against global warming.

Few have expounded on the tension between our various identities—local, national, global—as insightfully as the philosopher Kwame Anthony Appiah. In this age of "planetary challenges and interconnection between countries," he wrote in response to May's statement, "the need has never been greater for a sense of a shared human fate."[35] It is hard to disagree.

Yet cosmopolitans often come across like the character from Fyodor Dostoyevsky's *The Brothers Karamazov* who discovers that the more he loves humanity in general, the less he loves people in particular. Global citizens should be wary that their lofty goals do not turn into an excuse for shirking their duties toward their compatriots.

We have to live in the world we have, with all its political divisions, and not the world we wish we had. The best way to serve global interests is to live up to our responsibilities within the political institutions that matter: those that exist, within national borders.

Who Needs the Nation-State?

The design of institutions is shaped by a fundamental trade-off. On the one hand, relationships and preference heterogeneity push governance down. On the other hand, the scale and scope of the benefits of market integration push governance up. A corner solution is rarely optimal. An intermediate outcome, a world divided into diverse polities, is the best that we can do.

Our failure to internalize the lessons of this simple point leads us to pursue dead ends. We push markets beyond what their governance can support. We set global rules that defy the underlying diversity in needs and preferences. We downgrade the nation-state without compensating improvements in governance elsewhere. The failure lies at the heart of globalization's unaddressed ills as well as the decline in our democracies' health.

Who needs the nation-state? We all do.

CHAPTER 10

New Rules for the Global Economy

Suppose that the world's leading policy makers were to meet again at the Mount Washington Hotel in Bretton Woods, New Hampshire, to design a new global economic order. What are some of the guiding principles of global economic governance on which they might agree? Here are seven commonsense principles I first proposed in 2011, which I think are more relevant than ever.[1]

1. Markets must be deeply embedded in systems of governance. The idea that markets are self-regulating received a mortal blow in the global financial crisis and should be buried once and for all. Markets require other social institutions to support them. They rely on courts, legal frameworks, and regulators. They depend on the stabilizing functions that lenders-of-last-resort and countercyclical fiscal policy provide. They need the political buy-in that redistributive taxation, safety nets, and social insurance programs help generate. They need public investment in infrastructure and R&D to innovate. What is true of domestic markets is true also of global ones.

2. Democratic governance and political communities are organized largely within nation-states, and are likely to remain so for the foreseeable future. The nation-state lives, and even if not entirely well, remains essentially the only game in town. The quest for extensive global governance is a fool's errand, both because national governments are unlikely to cede significant control to transnational institutions and because harmonizing rules would not benefit societies with diverse needs and preferences. The European Union is possibly the sole exception to this truism, but Brexit, the rise of populist parties, and the reassertion of national autonomy show the limits of the political dimensions of the European project.

Too often we waste international cooperation on overly ambitious goals, ultimately producing weak results that go little beyond the lowest common denominator among major states. When international cooperation does "succeed," it typically codifies the preferences of the more powerful states or, even more frequently, of international corporations and banks in those states. The Basle rules on capital requirements; the WTO's rules on subsidies, intellectual property, and investment measures; and investor-state dispute settlement (ISDS) arrangements typify this kind of overreaching. We can enhance both the efficiency and the legitimacy of globalization if we empower rather than cripple democratic procedures at home.

3. There is no "one way" to prosperity. Once we acknowledge that the core institutional infrastructure of the global economy must be built at the national level, it frees up countries to develop the institutions that suit them best. The United States, Europe, and Japan are all successful societies; they have each produced comparable amounts of wealth over the long term. Yet the regulations that cover their labor markets, corporate governance, antitrust, social protection, and even banking and finance have differed considerably. These differences enable journalists

and pundits to anoint a succession of these "models"—a different one each decade—as the great success for all to emulate. Such fads should not blind us to the reality that none of these models can be deemed a clear winner in the contest of "capitalisms." The most successful societies of the future will leave room for experimentation and allow for further evolution of institutions over time. A global economy that recognizes the need for and value of institutional diversity would foster rather than stifle such experimentation and evolution.

4. Countries have the right to protect their own regulations and institutions. The previous principles may have appeared uncontroversial and innocuous. Yet they have powerful implications that clash with the received wisdom among boosters of globalization. One such implication is that we need to accept the right of individual countries to safeguard their domestic institutional choices. The recognition of institutional diversity would be meaningless if nations were unable to "protect" domestic institutions—if they did not have the instruments available to shape and maintain their own institutions.

We should therefore accept that countries can uphold national rules—tax policies, financial regulation, labor standards, or consumer health and safety—and can do so by raising barriers at the border if necessary, *when trade demonstrably threatens domestic practices enjoying broad popular support.* If globalization's advocates are right, then the clamor for protection will fail for lack of evidence or support. If they are wrong, there will be a safety valve in place to ensure that these contending values—the benefits of open economies and the gains from upholding domestic regulations—both receive a proper hearing in the domestic political debate.

5. Countries do not have the right to impose their institutions on others. Using restrictions on cross-border trade or finance to uphold values and

regulations at home must be sharply distinguished from using them to impose these values and regulations on other countries. Globalization's rules should not force Americans or Europeans to consume goods that are produced in ways that most citizens in those countries find unacceptable. But they also should not allow the United States or the European Union to use trade sanctions or other kinds of pressure to alter the way that foreign nations go about their business in labor markets, environmental policies, or finance. Nations have a right to difference, not to impose convergence.

6. The purpose of international economic arrangements must be to lay down the traffic rules for managing the interface among national institutions. Relying on nation-states to provide the essential governance functions of the world economy does not mean we should abandon international rules. The Bretton Woods regime, after all, did have clear rules, even though these were limited in scope and depth. A completely decentralized free-for-all would not benefit anyone; one nation's decisions can affect the well-being of others. What we need are traffic rules that help vehicles of different size and shape and traveling at varying speeds navigate around each other, rather than impose an identical car or a uniform speed limit on all. We should strive to attain the maximum globalization that is consistent with maintaining space for diversity in national institutional arrangements.

7. Nondemocratic countries cannot count on the same rights and privileges in the international economic order as democracies. What gives the previous principles their appeal and legitimacy is that they highlight democratic deliberation—where it really occurs, within nation-states. When nation-states are not democratic, this scaffolding collapses. We can no longer presume a country's institutional arrangements reflect the

preferences of its citizenry. So, nondemocracies need to play by different, less permissive rules.

These principles support a different model of global governance, one that would be democracy enhancing rather than globalization enhancing. They would open up space for democracies to improve their functioning at home, without prejudging what the policy outputs ought to be or whether the result is greater economic integration. Global governance could then usefully contribute to democracy, through global norms and procedural requirements designed to enhance the quality of domestic policy making—instead of rules aimed at increasing global trade and investment.

Specific examples of such requirements are global disciplines pertaining to transparency, broad representation, accountability, and use of scientific/economic evidence in domestic proceedings. Disciplines of this type are already in use in global institutions to some extent. For example, the World Trade Organization's Agreement on Application of Sanitary and Phytosanitary Measures (the SPS Agreement) explicitly requires the use of scientific evidence when health concerns are at issue for imported goods. Procedural rules of this kind can be used much more extensively and to greater effect to improve domestic decision-making. Antidumping rules can be improved by requiring that consumer and producer interests that would be adversely affected by the imposition of import duties take part in domestic proceedings. Subsidy rules can be improved by requiring economic cost-benefit analyses that incorporate potential consequences of industrial policies for both static and dynamic efficiency.

The key point is this: problems rooted in failures of domestic deliberation—those produced by beggar-thyself policies—can be solved only through improved democratic decision-making. Global governance can make a very limited contribution here, and only if it focuses

on enhancing domestic decision-making rather than constraining it. Otherwise, global governance becomes a yearning for technocratic solutions that override and undercut public deliberation. That, in turn, is a recipe for democratic malfunction and populist reactions.

Fair Trade and Free Trade

Many of the problems of the world economy are exemplified by the tensions between China and the Western economies, countries with very different social systems and approaches to economic management.

When China negotiated to join the World Trade Organization, there was a critical question: Is China a market economy, as the United States and the EU understood the term? As typically happens when diplomats face a thorny question, the decision was postponed. China's WTO accession agreement signed in December 2001 permitted the country's trade partners to deal with China as a "nonmarket economy" for a period of up to fifteen years. NME status in turn meant that it was a lot easier for importing countries to impose special tariffs on Chinese exports, in the form of antidumping duties. In particular, they could use production costs in more expensive countries as a proxy for true Chinese costs, increasing both the likelihood of a dumping finding and the estimated margin of dumping. Many countries, such as Argentina, Brazil, Chile, and South Korea, have already rewarded China with market-economy status—but not the United States and the European Union.[2]

The delay has simply postponed the escalation of the trade conflict between these giant economies. Unfortunately, the terms of this battle have ensured nothing was done to address the deeper flaw of the world trade regime. Regardless of whether China is given market economy status, prevailing antidumping measures are ill-suited to the task of addressing concerns over unfair trade. This is not because such

concerns are ungrounded but because they go well beyond dumping. Antidumping facilitates protectionism of the worst kind, while doing nothing for countries that need legitimate policy space.

Economists have never been fond of the WTO's antidumping rules. From a strictly economic standpoint, pricing below costs is not a problem for the importing economy as long as the firms that engage in the strategy have little prospect of monopolizing the market. That is why domestic competition policies typically require evidence on anticompetitive practices or likelihood of successful predation. Under WTO rules, however, pricing below costs on the part of exporters is sufficient for imposing import duties, even when it is standard competitive practice—such as during economic downturns.

This and other procedural elements make antidumping the preferred route for firms to obtain protection from their foreign rivals when times are tough. The WTO does have a specific "safeguard" mechanism that enables countries to raise import tariffs temporarily when imports cause "serious injury" to domestic firms. But the procedural hurdles are higher for safeguards, and countries that use them must compensate exporters who are adversely affected.

The numbers speak for themselves. Since the WTO was established in 1995, in excess of three thousand antidumping duties have been put in place (with India, the United States, and the EU being the heaviest users). The corresponding number for safeguard measures is a mere 155 (with developing countries being the heaviest users). Clearly, antidumping is the trade remedy of choice.

But beyond the economics, the global trade regime must address issues of fairness in addition to economic efficiency. When domestic firms have to compete with, say, Chinese firms that are financially supported by a government with deep pockets, the playing field becomes tilted in ways that most people would consider unacceptable.[3] Certain

types of competitive advantage undermine the legitimacy of international trade, even when (as with this example) they may confer aggregate economic benefits to the importing country. So, the antidumping regime is not without its political logic.

Trade policy makers are deeply familiar with this logic, which is why the antidumping regime exists in the form that it does, enabling relatively easy protection. What they have never taken on board is that the fairness argument extends beyond the dumping arena. If it is unfair for domestic firms to compete with foreign entities that are subsidized or propped up by their governments, is it not similarly unfair for domestic workers to compete with foreign workers who lack fundamental workers' rights such as collective bargaining or protections against abuse in the workplace? What about firms that despoil the environment, employ child workers, or provide hazardous employment conditions—are they not a source of unfair competition?

Such concerns about unfair trade lie at the heart of the antiglobalization backlash. Yet trade remedy laws allow little room for them beyond the narrow commercial realm of pricing below cost. Labor unions, human rights NGOs, consumer groups, or environmental groups do not have direct access to protection in the way that firms do.

Trade experts have long been wary of opening up the WTO regime to questions about labor and environmental standards or human rights, fearing the slippery slope of protectionism. But it is becoming increasingly clear that failure to take these issues on board does greater damage. Refusal to acknowledge that trade with countries with very different economic, social, and political models raises genuine legitimacy concerns undermines not only those trade relationships but the entirety of the trade regime.

We must distinguish between two different versions of an argument as to why trade may be problematic from a social or political

perspective. Some suggest trade is problematic because it redistributes income. The basis for that claim is true, but trivial. Pretty much everything else that happens in a market economy redistributes income somehow. Technology and market competition are the source of endless churn in an economy. Moreover, plenty of other things, including skill-biased innovation and minimum wage laws, have vastly greater effects on income distribution than trade per se.

So it makes very little sense to set international trade apart and decouple it from other domains or approaches for dealing with inequality in labor markets at large (progressive tax systems, active labor market policies, employment-friendly macro policies, etc.). Imports from, say, France may adversely affect domestic firms that are displaced, but there's no reason to treat the people who lose out any differently than workers who are adversely affected by, say, technological innovation. There is a coherent justification for compensating the losers of free trade for reasons of solidarity and equity—but the justification would apply in the case of innovation too. Consequently, the preferred remedies should be the same as well.

There is a second, different social and political objection to trade—that trade violates norms embodied in our institutional arrangements. The suggestion here is that trade may undercut the social bargains struck within a nation and embedded in its laws and regulations. Think for example of workers that must compete with countries where bargaining rights are severely repressed by authoritarian governments. These workers are effectively told that they must either accept lowering their own standards of pay and bargaining or lose their jobs. In such cases compensating the losers would be beside the point, because what is at stake is the surreptitious modification of the rules of the game—the undermining of domestic social bargains through the back door. Trade is not merely a market relationship but an intervention into

domestic institutions and an instrument for reconfiguring them to the detriment of certain groups. Responding to such an injury by directly curtailing the trade flows that have the alleged effect would have a legitimate basis. After all, this is no different than keeping imports out that violate, say, domestic health and safety regulations, which most countries already do.

And this brings us back to fair trade. The notion of fair trade is much derided by economists who view it as a thinly disguised cover for self-interested protectionism. But it is already enshrined in trade laws (in the form of antidumping and safeguard remedies), although in a skewed, corporation-friendly way.

So rather than abandon the fair trade concept, we should broaden it, as it exists in trade law, to include *social* dumping. Just as countries can impose duties on goods that are sold below costs, they should be allowed to restrict imports that demonstrably threaten damage to domestic regulatory arrangements. I discuss what such a process may look like in my book *Globalization Paradox*. I would argue that this would not open the trade regime to more protectionist abuse than current antidumping practices already do!

The benefit of thinking about fair trade along these lines is that it allows the drawing of a clear line between trade flows that threaten legitimate domestic political arrangements and those that don't. For example, there is a clear distinction between situations where a trade partner's low wages are due to low productivity versus the abuse of worker rights (including, say, the absence of collective bargaining, or freedom of association.). Both may generate distributional implications at home—but there is a problem of unfair trade only in the second case.

Economists should be more willing to accept that trade may fail to pass the fairness or legitimacy test in certain circumstances. Paradoxically, this would strengthen their defense of international trade in the

bulk of cases where the test is easily passed. It would enable them to speak to popular concerns about fairness in trade without undermining the general case for trade.

Advocates of globalization lecture the rest of the world incessantly about how countries must change their policies and institutions to expand their international trade and to become more attractive to foreign investors. This way of thinking confuses means for ends. Globalization should be an instrument for achieving the goals that societies seek: prosperity, stability, freedom, and quality of life. Whether globalization sets off a race to the bottom or not, we can break the deadlock between the proponents and opponents of globalization by acknowledging a simple proposition: social dumping that undermines democratically legitimated domestic practices is not acceptable.

The principle rules out extremism on both sides. It prevents globalizers from gaining the upper hand in cases in which international trade and finance are a backdoor for eroding widely accepted standards at home. Similarly, it prevents protectionists from obtaining benefits at the expense of the rest of society when no significant public purpose is at stake. In less clear-cut cases, in which different values must be traded off against each other, the principle forces internal deliberation and debate—the best way to handle difficult political questions.

One can imagine the questions that a domestic political debate may raise. How much social or economic disruption does the trade in question threaten? How much domestic support is there for the practices, regulations, or standards at stake? Are the adverse effects felt by particularly disadvantaged members of society? How large are the compensating economic benefits, if any? Are there alternative ways of achieving the desired social and economic objectives without restricting international trade or finance? What does the relevant evidence—economic and scientific—say on all these questions?

If the policy process is transparent and inclusive, these kinds of questions will be generated naturally by the forces of competition among interest groups, both pro- and antitrade. To be sure, there are no fail-safe mechanisms for determining whether the rules in question enjoy "broad popular support" and are "demonstrably threatened" by trade. Democratic politics is messy and does not always get it "right." But when we have to trade off different values and interests, there is nothing else on which to rely.

Removing such questions from the province of democratic deliberation and passing them on to technocrats or international bodies is the worst solution. It ensures neither legitimacy nor economic benefits. International agreements *can* make an important contribution, but their role is to reinforce the integrity of the domestic democratic process rather than to replace it.

By refusing to acknowledge the possibility of social dumping—and failing to put in place remedies to it—the trade technocracy has instead opened the door to populists and demagogues on trade. It has allowed trade in general to come under attack instead of the specific problematic flows that probably constitute a very small share of overall imports. It is a clear instance of trade purists doing damage to their cause.

Some regional trade agreements do take social dumping concerns on board, but I think trying to "improve" other countries' labor, environmental, or social standards through trade agreements is generally ineffective—and also misguided to the extent that it puts commercial interests in the driver's seat of what is a deeper developmental problem. There is an important difference, often eluded in fair trade discussions, between using trade policy to prevent the undermining of domestic standards and the use of trade policy to export our standards to other countries. The first is legitimate; the second much less so.

Even if we care about human rights, labor standards, and environmental safeguards in other countries, we should pursue these goals in other international forums, dedicated specifically to these goals, and not through trade deals. If Vietnam has a labor problem, let us not delude ourselves that we can fix it through TPP. And if that problem threatens to undercut our own labor standards, let's deal with that as an instance of social dumping, through domestic trade remedies.

I recognize that such considerations leave me at odds with all the established strands of thinking on trade. Populists such as President Donald Trump have correctly identified the malaise with trade and have capitalized on it. But they greatly exaggerate the real-world significance of the "fairness" concern and seem determined to fix a surgical problem with a sledgehammer.

Meanwhile, economists rightly point out that trade is only weakly implicated in the major economic problems of the day—deindustrialization and income inequality. They are correct that the distributional consequences of trade are better addressed with safety net programs and nontrade remedies. But they have systematically downplayed these consequences—especially when the requisite compensatory programs have remained on paper. And they seem unable to grasp the valid core of the public concern on social dumping.

Finally, progressive voices and their allies affiliated with the labor movement in the United States have been keenly aware of the potential of social dumping. But they want to fight it with revamped global governance measures that are at best ineffective and, at worst, the cause of populist backlash in the countries subject to them.

Responding to the economic and political crisis of our day requires that we restore a healthy balance between an open global economy and the prerogatives of the nation-state. That in turn requires that we be

honest about trade's consequences, in particular the stresses it generates for our social compacts alongside the economic opportunities.

None of this implies, for example, that democracies should not trade with nondemocracies or countries with labor abuses. The point is that commercial logic is not the only factor that should govern their economic relationships. We cannot escape, and therefore must confront the dilemma that the gains from trade sometimes come at the expense of strains on domestic social arrangements. Public discussion and deliberation are the only way that democracies can sort out the contending values and trade-offs at stake. Trade disputes with China and other countries are an opportunity for airing—rather than repressing—these issues, and a step forward to ultimately democratizing the world's trade regime.

Conflict between North and South?

Fair trade of this sort isn't antitrade—quite the opposite. Globally, the principle of fairness should include leeway for poorer countries to grow their economies. That means not saddling them with the restrictive rules on intellectual property, industrial policies, capital-account regulations, and investor rights, as current regional trade agreements typically do. For progressives who worry both about inequality in the rich nations and poverty in the rest of the world, the good news is that it is indeed possible to advance on both fronts. But to do so, we must transform our approach to trade deals in some drastic ways.

The world's trade regime is currently driven by a peculiarly mercantilist logic: you lower your barriers in return for me lowering mine. This logic of "exchange of market access" has little economic justification, but has been remarkably successful in promoting trade expansion.

Now that the world economy is already very open, it has run its useful course and causes more problems than it solves.

The principles I laid out above would replace it with a different logic, that of "exchange of policy space." Poor and rich nations alike need to carve out greater space for pursuing their respective objectives: the former to restructure their economies and promote new industries and the latter to address domestic concerns over inequality and distributive justice. Progressives should not buy into a false and counterproductive narrative that sets the interests of the global poor against the interests of rich nations' lower and middle classes. With sufficient institutional imagination, the trade regime can be reformed to the benefit of both sides of the equation.

National Citizens, Global Consciousness

Recognizing the centrality of nation-states and the futility of global governance is compatible with reorienting national interests, over time, in a more global direction. Progress along such a path would require national citizens to recognize that their interests extend beyond their state's borders. National governments are accountable to their own citizens, at least in principle. So, the more global these citizens' sense of their interests becomes, the more globally responsible national policy will be.

This may seem like a pipedream, but something along these lines has already been happening for a while. The global campaign for debt relief for poor countries was led by nongovernmental organizations that successfully mobilized young people in rich countries to put pressure on their governments. Multinational companies are well aware of the effectiveness of such citizen campaigns, having been compelled to increase transparency and change their ways on labor practices around

the world. Some governments have gone after foreign political leaders who committed human-rights crimes, with considerable domestic popular support. Nancy Birdsall, the president of the Center for Global Development, cites the example of a Ghanaian citizen providing testimony to the US Congress in the hope of convincing American officials to pressure the World Bank to change its position on user fees in Africa.

The greatest potential upside to such bottom-up efforts to "globalize" national governments can be found in environmental policies, particularly those aimed at mitigating climate change—the most intractable global problem of all. Interestingly, some of the most important initiatives to stem greenhouse gases and promote green growth are the products of local political pressures. World Resources Institute president Andrew Steer notes that more than fifty developing countries are now implementing costly policies to reduce climate change. From the perspective of national interest, that makes no sense at all, given the global-commons nature of the problem.

Some of these policies are driven by the desire to attain a competitive advantage, as is the case with China's support for green industries. But when voters are globally aware and environmentally conscious, good climate policy can also be good politics.

Consider California, which in early 2012 launched a cap-and-trade system that aims to reduce carbon emissions to 1990 levels by the year 2020. While global action remained stalled on capping emissions, environmental groups and concerned citizens successfully pushed for the plan over the opposition of business groups, and the state's Republican governor at the time, Arnold Schwarzenegger, signed it into law in 2006. If it proves a success and remains popular, it could become a model for the entire country.

Global polls such as the World Values Survey indicate that there is still a lot of ground that needs to be covered: self-expressed global

citizenship tends to run 15–20 percentage points behind national citizenship. But the gap is smaller for young people, the better educated, and the professional classes. Those who consider themselves to be at the top of the class structure are significantly more globally minded than those who consider themselves to be from the lower classes.

As I have already noted, "global citizenship" will always remain a poor metaphor, because there will never be a world government administering a worldwide political community. But the more we each think of ourselves as globally minded and express our preferences as such to our governments, the less we will need to pursue the chimera of global governance.

CHAPTER 11

Growth Policies for the Future

Global arrangements that open up space for national policy autonomy must be complemented by domestic policies that put that space to good use. That means pursuing economic strategies that are at once productivity enhancing and socially inclusive. We face considerable uncertainty as to what will work in a global environment marked by significant economic and technological dualism, both within and among nations. But the good news is that there is no shortage of good ideas. I begin with the challenges facing developing nations, and then turn to the advanced economies.

Will Developing Nations Lead the World Economy?

The future of the global economy lies more and more in the hands of poor nations. The United States and Europe struggle on as wounded giants, the casualty of their financial excess and political paralysis. They seem condemned to years of low growth at best, widening inequality, and possible social strife.