Free Trade Reimagined

ROBERTO MANGABEIRA UNGER

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The World Division of Labor and the Method of Economics

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Contents

This book stands on its own as an argument about the international division of labor and the method of economics. The reader should nevertheless know that the argument forms part of a larger intellectual program. The program rebels against the tendencies now prevailing in the social sciences and humanities. It seeks alternatives to the arrangements and the assumptions of contemporary societies. It tries to give new meaning to the revolutionary ideas of human liberation and empowerment that, for the last few centuries, have aroused the whole world. It turns thought against fate.

False Necessity (Verso, 2001), *Social Theory: Its Situation and Its Task* (Verso, 2004), and *Plasticity into Power* (Verso, 2004) carry this program forward as a social theory. *What Should Legal Analysis Become?* (Verso, 1996) advances it in the discipline that, together with political economy, provides the most promising tools with which to reimagine the organization of social life. *Democracy Realized*: *The Progressive Alternative* (Verso, 1998) and *What Should the Left Propose*? (Verso, 2005) develop it as an institutional proposal. *Passion* (Free Press, 1984) and *The Self Awakened: Pragmatism Unbound* (Harvard University Press, 2007) deepen and generalize it as a philosophical conception.*

*For further texts from this intellectual program, see www.robertounger.net.

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Themes and Scope of this Book

The idea of free trade combines theoretical interest with practical significance. It takes us into the heart of economic theory and into the midst of contemporary debates about the world economy. It has become much more than a slogan to conjure with; it has turned into a promise or a menace, a nearly self-evident truth or a source of bafflement, the pride of the hardest of the hard social sciences and the bugbear of those who resist its conclusions.

If countries specialize in what they produce, the whole world can reap the benefits. It is a simple message of enormous power, promising both greater riches and more freedom.

As a subject of theoretical concern, free trade leads into the inner sanctum of economic theorizing. Belief in the gains to be secured through free trade, on the basis of established or constructed comparative advantage, has long been recognized as one of the most counterintuitive and characteristic of the notions of economics. It is a conception embodying the most pervasive theme in economic analysis: the idea of exchange, for reciprocal benefit, among specialized producers in a division of labor and of the market as a form of cooperation among strangers who are neither friends nor enemies and who need only the cold calculus of interest to establish a common practical bond. The deepest source of the appeal of free trade arises from the conviction that it is not a device but rather, as Alfred Marshall claimed, "the absence of any device."

As an issue of practical significance, free trade stands in the middle of contemporary debates about globalization: the emergent world trading system is as much the centerpiece of the present regime of globalization as the doctrine of free trade is the simplest and sharpest expression of economic analysis put to practical use. If we can change what free trade means and how it is organized, we can do the same, more generally, to globalization. And if we can have globalization on our terms, rather than on those of the supposedly irresistible forces that its contemporary form is claimed to represent, all bets are off: we are freer than we suppose to rethink and to reconstruct.

The doctrine of free trade, as it has been understood, is fundamentally defective. Its flaws cannot be remedied by a series of localized qualifications of analysis and policy. The alternative is not to embrace a theory justifying protectionism but rather to reject and to revise the terms on which the debate between free trade and protectionism has long taken place. Such a revision has implications for the method of economics.

The point of largest theoretical significance to emerge from my argument is that a system of free trade will be the more advantageous to those who engage in it (whether or not they are sovereign countries) if it allows them the greatest possible experimental freedom to change their practices and institutions of production. This freedom of revision, however, may conflict with what free trade has traditionally been understood to be and to require.

The point of greatest practical relevance, intimately related to that theoretical conception, is that it makes no sense to organize the world trading system around the goal of maximizing free trade, in the sense in which we are used to defining free trade. A single-minded insistence on the maximization of free trade gives too little weight to an imperative that turns out to be of vital, indeed of increasing significance: the need of every country, richer or poorer, to avoid lasting confinement to a particular place in the international division of labor and to the styles of production, the strategies of development, and the sets of institutions that may exert this confining influence.

If the immediate topic of this book is the contest over free trade and over the form of an open international economy, its ultimate subjects are the world division of labor and the method of economics. We cannot escape the confines of the traditional debate about free trade and protection and do justice to the possibilities of globalization without changing some of our most fundamental assumptions about market economies and the division of labor. That the future of economic growth lies with permanent innovation rather than with the coercive extraction of a social surplus, that freedom experimentally to combine people, ideas, and things must therefore be liberated from all unnecessary institutional restraints and dogmas, that the best market economy is the one that gives the greatest opportunity to the most people in the most ways, that a free economic system must be based on free labor, and that the capacity to use governmental power for the purpose of broadening opportunity can be exercised to advantage only insofar as the state ceases to be in the pocket of privileged and moneyed interests—all these are platitudes of contemporary discourse, embraced with the greatest enthusiasm by those who collaborate with the dictatorship of no alternatives under which the world is now bent.

The words of this litany, however, belong in the mouths of revolutionaries. To think these words through is to revise our ideas concerning what is most important about market economies and the division of labor in the workplace, the national economy, or the whole world. To make these words real is to rebel against the institutions in which market economies and the division of labor remain embodied.

It is an intellectual task for which the present methods of economics are inadequate. It would be tempting to adopt a strategy of caution, insisting that economics, purged of abusive applications and restored to analytic purity, provides help, and imposes no obstacles, to such a campaign. In this book I reject that claim: its modesty does not make up for its falsehood. The practice of economic analysis inaugurated in the late nineteenth century by Walras, Jevons, and Menger, which came to be labeled “marginalism” and which guided the mainstream of subsequent economic theory and culminated in the theory of general equilibirum, is not only insufficient to the execution of the task. It is also, in certain decisive respects, incompatible with it.

If economics continues to swing between purity of analysis, retreating from all controversial explanatory and prescriptive ideas, and abuse of application, unjustifiably equating abstract conceptions like the idea of a market economy with particular contingent sets of economic arrangements, it will not open the way. It will stand in the way. There are many past and present varieties of economic analysis, from the old institutional economics to the new behavioral economics, that suggest different methods and directions. However, they have not developed—and maybe they cannot develop—into ways of dealing with the problems that are central to the argument of this book. Their characteristic inability to imagine the possible forms of economic life cramps their insight into its actual forms.* For these reasons, the attempt here to revise the terms of the traditional controversy about free trade and protection and to reconsider the nature and prospects of the world division of labor leads as well into an argument about the method of economics.

Chapter One explains why there is intellectual as well as practical trouble with the doctrine of free trade. It begins by enumerating a series of puzzles about the nature and benefits of free trade that the development of economic ideas has deepened rather than solved. It goes on to discuss the failure of history to confirm doctrine: never has a practical program enjoyed so much prestige with so little justification in historical experience. It ends by discussing

*The "new institutional economics" of the late twentieth century, unlike the German institutional economics or the American institutional economics of the late nineteenth and early twentieth centuries, is not an example of such an arrested departure from the mainstream of thinking. Wedded to ideas of institutional convergence and functionalist determinism, it explains the institutional framework of economic activity, including the institutions of the existing market economies, in a way that makes these arrangements seem the natural or necessary setting of the advanced economies. As a result, it squanders the intellectual opportunity presented by the study of institutions and comes to represent an anti-institutional economics. There are few more striking instances of the right-wing Hegelianism—the real is rational—that pervades the social sciences today.

why a doctrine with feet of clay has been able to cut so imposing a figure in the debates of the modern world.

Chapter Two addresses the intellectual core of the argument for trade: the doctrine of comparative advantage. This doctrine turns out to be incomplete in a series of connected ways. To interpret correctly what it says, we have to combine it with much that it fails to say. The meaning of the part that we have, however, depends on the missing part. Criticism of the theory of comparative advantage leads directly into criticism of the dominant style of economic analysis; latter-day statements of that theory are among the most characteristic expressions of this style.

Chapter Three responds to the incompleteness of the doctrine of comparative advantage. It does so by presenting ideas—about international trade and, more generally, about the market economy and the division of labor—that can do justice to the puzzles and the facts explored in the first two chapters. In particular, these ideas provide building blocks for an approach to free trade. We cannot develop a better approach to free trade—one capable of transcending the conventional terms of the debate between free traders and protectionists—without questioning and revising the premises on which the traditional doctrine relied.

Such assumptions concern some of the most fundamental ideas in economics: the nature of a market economy and of the alternative institutional forms it can take; the reasons why some of the central problems of an economy must be solved outside the economy, in politics, and why the organization of politics is therefore decisive for the character of economic life; the features of a division of labor—in the workplace, in a country, or in the whole world—that are most important to innovation and growth; and the way we should think about the division of labor once we rid ourselves of the tyranny of the ideas for which Adam Smith's pin factory and Henry Ford's assembly line have been made to stand. Rethinking free trade turns out to depend on much more than ideas about commerce.

These views form the backdrop to the development and defense of three theses about free trade advanced in Chapter Four: first, about the economic circumstances in which free trade is likely to be most beneficial or most dangerous; second, about the political circumstances in which restraints on trade are likely to serve broader or narrower interests; and third, about the paradoxical and misunderstood relation among the different ways in which free trade—or, more generally, a free economy—can be free. Taken together, these theses form the elements of a way of thinking about free trade. They also provide the rudiments of an approach to the building of an open world economy. It is a way of thinking that neither reaffirms nor repudiates the traditional commitment to free trade as an indispensable part of the road to global progress. What it has to say cannot be adequately captured within the terms of the familiar disputes between free traders and protectionists.

Chapter Five explores the programmatic implications of the analysis, its consequences for the reformation of the world trading system as well as for the redirection of national development strategies. Free trade forms the kernel of the theory and practice of globalization. We have become accustomed to the idea that all we can do with globalization is to have either more or less of it, or to have it either more slowly or more quickly. The argument of this book leads to the conclusion that we can and should have free trade and globalization on terms different from those in which we now encounter them. We need not merely dose them or pace them; we can rethink and remake them. Ideas alone are powerless to produce such a reorientation. However, we cannot bring it about without ideas.

Chapter 1

Troubles: The Enigmas of Free Trade

Familiar Problems, Disturbing Solutions

I begin by enumerating some familiar problems in the doctrine of free trade conducted on the basis of specialized lines of production within an international division of labor, particularly when such national specializations are motivated by comparative advantage.* These problems—and the solutions that have been proposed for

*A country is said to enjoy an absolute advantage over another country in the production of a good if it can produce the good more efficiently, that is, at lower cost, than the other country. It is said to enjoy a comparative advantage over another country in the production of a good if it can produce that good at lower opportunity cost than the other country, that is, with relatively less opportunity to commit the resources it devotes to the production of that good to a more efficient use. A country that fails to have an absolute advantage in the production of a good may nevertheless possess a comparative advantage in it. Comparative advantage vastly expands the basis for international specialization of production. For this reason, and because it is both counterintuitive in its claims and far-reaching in its implications, it has been, ever since its formulation by David Ricardo almost two hundred years ago, the cornerstone of thinking about international trade. The next chapter deals at length with the doctrine of comparative advantage. The distinction between absolute and comparative advantage is largely irrelevant to the puzzles listed immediately below, although comparative rather than absolute advantage would ordinarily be regarded as the main field for their application. Thus, I use in the following list the simple term "advantage."

them—have not been thought to discredit either the central insight of the doctrine or its programmatic consequence, the beneficence of free trade. Indeed, they do not. They nevertheless pose a challenge that contemporary thinking about trade and free trade has yet adequately to meet. How, why, and with what result the force of this challenge has continued to be evaded is a matter requiring further reflection. Consider a brief, nonexhaustive list of these long-recognized objections and complications.

1. The assumption of a uniquely efficient assignment of productive specializations among countries in an international division of labor: who is to produce what. Even if we assume that comparative advantage is a given rather than a construction (see the next proposition on this list), it is more realistic to suppose that there are alternative sets of efficient assignments of advantage among economies, just as there are multiple ways any economy can be in equilibrium, each with different consequences for national welfare and growth. The less that advantage is determined by nature, the greater is likely to be the significance of the problem of multiple efficient solutions to the allocation of specialized national roles in world trade. Each such allocation will have distinct results for both welfare and growth.

2. The assumption that advantage is given rather than made. This assumption becomes less tenable as we move away from natural advantage. The most tangible example of made advantage is the development of economies of scale and scope, as well as of concentrations of skill, in a line of business in which a country may have had no natural advantage. However, once the principle is admitted that advantage can be deliberately created by governmental initiative and collective action, it applies to every reason for a country's practical success or failure, including its institutions and practices, social and political as well as economic. Trade theory has had difficulty coming to terms with how the construction of advantage occurs, for the same reason that economics in general has had trouble dealing with how the institutional and psychological assumptions of maximizing behavior in a market economy are established and modified.

3. The assumption that it is tenable to foreclose the two previous sets of concerns by saying that either advantage, when not given by nature, will be generated by market activity itself or that it will be produced by governmental intervention, with all its attendant risks (playing favorites, riding hobbyhorses). In fact, advantage has always been shaped by a combination of private enterprise and public action. As soon as we acknowledge this fact, however, we realize that there is no closed set of possible institutional forms of such a combination. Indeed, there is no single and uncontroversial institutional achievement of worldwide free trade.

The concept of a market economy is institutionally indeterminate. That is to say, it is capable of being realized in different legal and institutional directions, each with dramatic consequences for every aspect of social life, including the class structure of society and the distribution of wealth and power. The idea of a universal regime of free trade is institutionally indeterminate in the same sense and for the same reasons. Which of its institutional realizations prevails has immense importance for the future of humanity. These debates cannot be captured within the categories of long-standing controversies about free trade and protection.

4. The assumption that so long as we correct market imperfections (according to the formula of first, fix them; if not, compensate for them by a domestic initiative; only as a final resort, impose a restraint on trade), we can move from the static efficiency of free trade to its intertemporal efficiency and from its intertemporal efficiency to its beneficial effect on economic growth. In fact, the first link holds only if intertemporal efficiency is defined so narrowly as to deprive it of theoretical or practical interest, and the second link (as the later observations about historical experience confirm) is nonexistent.

Moreover, the language of market imperfections, as applied to the “infant industry” and “monopoly power in trade” arguments for protection, trivializes the central point: not how to reestablish the market or what to do when the market fails, but what kind of market—on the basis of what institutions and practices—to establish in the first place. We cannot reach this point by focusing solely on advantage, whether given or made; on the contrary, the analysis of advantage presupposes that we have already disposed of this issue to our satisfaction. We have not.

5. The assumption that a country's trade policy should not be influenced by the willingness of its trading partners to abolish or to diminish restraints on trade. The traditional view (against which strategic trade theory staged a limited revolt) has been that although real-world departures from this assumption may justify circumstantial resort to reciprocity and retaliation, they do not compromise the case for a trade regime that is as universal and as free as possible.

6. If, however, the whole system of world trade and all the institutions and practices by which it is realized in any given historical circumstance are both particular and contingent, if they are incapable of being inferred by pure analysis from the idea of free trade, if they are the products of shifting conflicts of interest and vision on the world stage, if they therefore deeply bear the imprint of everyone's strategies, and if the strategies of a few preponderant economic powers are likely to be decisive in determining their content, then the assumption that a country's trade policy should be independent of the trade concessions it wins from the countries with which it trades makes little sense. Strategic trade theory failed to go far enough in resisting it.

A puzzle will occur to any reader of this book who has studied the history of debates about free trade and protection. Everything in this short list of ambiguities and flaws in the traditional doctrine of free trade based on comparative or absolute advantage is well known. The interest of the list lies in combining the ideas that constitute the list, in deepening and generalizing them, and in grasping their unrecognized implications. The student of the controversy about free trade, however, will object that the history of this debate has been largely preoccupied with beliefs of an entirely different order. To these beliefs the propositions in the short list bear no self-evident relation.

Traditional objections to free trade can be broadly placed into two categories. In one category are the arguments concerning the special instances in which restraints on trade may be justified because of the failure to solve what today we would describe as a collective-action problem in the development of a regime of universal free trade. If markets are not universally open, it may not, under certain conditions, be in the interest of every trading party to act as if they were; that is, it may not be in its interest to offer its trading partners a unilateral and unreciprocated abolition of restraints on trade. This claim was the nub of Robert Torrens's "terms of trade" argument.

It is an argument that has always invited a twofold response from the defenders of free trade as it is conventionally understood. One response emphasizes how special are the conditions under which restraint may be more advantageous than unreciprocated protection. The other response insists that the actual practice of protection is likely to squander its theoretical benefits by lending itself to the service of powerful interests and fashionable dogmas.

In a second category are the arguments dealing with the perverse distributive effects of free trade in a particular situation, including both distribution among sectors of the economy and distribution among classes of society. In this second category fall Frank Graham's "increasing returns argument" (according to which if manufacturing is subject to increasing returns to scale and agriculture to decreasing returns to scale, a country importing manufactured goods and specializing in agriculture may have reason to impose a tariff on manufactures in order to encourage a shift to the higher-productivity sector, with its increasing returns to scale), Mihail Manoïlescu's related "wage differential argument" (according to which developing countries might be justified in imposing restraints on trade to encourage the movement of labor from low-wage, low-productivity agriculture to high-wage, high-productivity industry), James Bristock Bridgen's so-called Australian argument (according to which restraints on trade might be justified for countries whose factor endowments were such that, although facing diminishing returns in agriculture, they continued to specialize in the world economy as agricultural exporters), and the Stolper-Samuelson theorem (according to which an import tariff may raise the real income of labor and reduce the real income of capital when the import-substituting sector produces a labor-intensive good).

The common element in these arguments of the second category is the claim that, under the special conditions each of them stipulates, free trade may produce a redistribution of gains among sectors of production or among classes of society that is economically inconvenient as well as socially undesirable because it inhibits a national economy from climbing the ladder of productivity more quickly.

Both sets of arguments address circumstances in which, for particular reasons, the case for free trade may fail to persuade. They provide no basis for resisting trade beyond those circumstances or for revising our view of its benefits. They thus reinforce John Stuart Mill's contention that "the protectionist doctrine finds support in some particular cases"—and only in such cases.

The result is to provoke from the defenders of the doctrine of free trade a response that has succeeded in robbing these objections from the competitive assumptions or the distributive effects of freer trade of much of their theoretical and practical force. The response comes in two parts. The first part is to interpret each of the arguments as the description of a low-productivity trap. The way out of the trap, the votaries of free trade say, is not to restrict openness in the global market; it is to radicalize openness—competition, flexibility, and capability through education, training, and benchmarking—in the domestic market. The second part is to suggest that so long as market failure persists, the short-term antidote to its perverse distributive consequences should be a corrective or compensatory transfer of resources. Restraint on trade should be a last resort; it is likely to be the most costly solution, and its costs are likely to be magnified by the foothold it provides for the ravages of favoritism and dogmatism.

So it is that the two familiar sets of objections to the doctrine of free trade conducted on the basis of comparative advantage can be quickly and effectively circumscribed. The doctrine is general; the objections are particular. Because they are particular, they invite particular responses that leave the essentials of the doctrine untouched.

Now return to the earlier summary list of analytical conundrums. They are not particular; they are general. They reveal difficulties or ambiguities in the conception itself, not just in its application to specific circumstances. They suggest that free trade—the international division of labor, the global trading regime—might have different meanings and be organized in different ways, with different consequences. They imply that instead of choosing more or less free trade, we might think of free trade in a different manner and organize it accordingly.

The problems on the short list therefore enjoy a conceptual priority to the two families of practical arguments—about collective action and about distribution—that have occupied so much of the historical controversy about free trade and protection. Until we have solved these problems, we cannot know with assurance what to make of those well-known arguments. Is there a way of conceiving, developing, and organizing an open world economy that prevents countries from falling into low-productivity traps like those described by Graham, Manoïlescu, and Bridgen? Can the problem of collective action in the construction of such an open world economy be solved in a way that enables countries to diverge, even increasingly, in their forms of economic organization as well as in their lines of business?

A central theme runs through the preceding discussion of the conundrums latent in the conception of free trade and of the matters left unresolved by the historical debates about protectionism. The theme is the need for a contest among ways of imagining and of organizing worldwide free trade. The significance of the conundrums is to suggest that there is room to rethink international free trade and therefore also room to reorganize it. The meaning of the history of the debates is that until we determine what our intellectual and practical alternatives are in that larger struggle, we cannot bring those debates to a close, or even assign them a definitive meaning.

There is no single uncontroversial realization of the idea of a universal regime of free trade. To take a simple example, will it be free trade of goods with mobility of labor or free trade of goods without mobility of labor? So long as there are different possible futures, including different possible futures of free trade itself, there will be different strategies among its participants, committed by reason of interest and vision to one such future against others. Strategizing is not what takes place when free trade ends. A regime of free trade is not a perpetual-motion machine that, once established, absolves us of further institutional choices and strategic conflicts.

The common and combined effect of these problems is to require the qualification and the expansion of traditional free trade doctrine. The movement to save the doctrine from the objections will not be persuasive and successful unless it goes in a particular direction. This direction emphasizes the multiplicity of possible successful assignments of productive specializations among countries. It also underlines the role of governments and firms in making new comparative advantage. Multiplicity rather than singularity of opportunity and response; advantage and capability as achieved rather than as given, as goals rather than as guides—these are the characteristic themes of plausible answers to those objections.

What emerges from such answers is a way of responding to the five problems I have just enumerated that disposes of them by doing just the opposite of what has been the main tendency of economic theorizing for the last hundred and twenty years. The response disposes of these problems only by undermining the idea of the market (in this case the world market realized through universal trade) as a perpetual-motion machine that can define its own presuppositions and pick out uniquely efficient solutions to the problems of resource allocation. It disposes of them only by weakening the contrast between the effort to find the most efficient (or even Pareto-improving, that is to say better for everyone) solution within the given framework and then by reinventing the framework. And it therefore disposes of them only by connecting economics and politics rather than by keeping them carefully and anxiously apart.

Consider, for example, the substitution of the idea of constructed comparative advantage for the idea of established comparative advantage. Once we acknowledge that comparative advantage can be, and always has been, shaped by governmental initiative and collective action as well as by private enterprise, we have to ask which features of a trading system may either encourage or inhibit such restless tilting of the scales. Once we combine the idea of constructed comparative advantage with the idea of multiple answers to the question of who may be the most efficient producer of what in the world economy, we begin to tear down the wall between the debate about how to understand and how to organize universal free trade and the struggle over the content of the development strategies different countries should embrace. And once we admit that the institutional indeterminacy of the market concept—our inability to infer a particular legal and institutional organization of the market from the abstract idea of a market—is aggravated by the institutional indeterminacy of the idea of global free trade—the possibility of interpreting the legal and institutional implications of this idea in sharply divergent ways—we begin to wonder what it is that we embrace when we commit to free trade.

So each of the well-known objections I have listed yields to answers that are almost as familiar. However, the cumulative effect of these answers is to make the theoretical meaning and the practical significance of the doctrine of free trade depend on ideas about much more. My argument expands into empirical and normative controversy rather than retreating from it. In this sense, it devalues the autonomy of economic analysis rather than enhance it. It goes in a direction opposite to the direction that economic theory has on the whole taken. It uses trouble to create, through more trouble, insight.

The History of Free Trade and Protection: Subversive Lessons

There has never been a more astonishing contrast between the intellectual prestige of a social or economic doctrine and the weakness of its vindication by historical experience than the influence enjoyed by the idea of the advantages of universal free trade, in the face of facts that seem to contradict this idea.

Any fair-minded reading of the historical record shows that there is no evidence for a consistent or general positive relation between free trade and economic growth. There is more than a little evidence for the supposition that they have often been negatively related. I do not take this evidence to justify a systematic bias toward trade protection; indeed, it is a central tenet of the argument of this essay that the terms of the traditional debate about free trade and protection are and continue to be ill-conceived. It is impossible to achieve intellectual clarity so long as we stubbornly rely on misreadings of the historical record. The facts at issue are not obscure; they do not depend on research into as yet unvisited archives or on convoluted interpretations of hermetic texts. They are as simple and straightforward as we can ever expect a set of complex historical events, over extended time, to be.

For much of the nineteenth and twentieth centuries—until the present episode of globalization began in earnest in the closing decades of the last century—the rich countries of the North Atlantic world were a stronghold of protectionism. The most notable exception was the pioneering industrial power, Great Britain. By contrast, free trade, based on established comparative advantage, prevailed, by a combination of political imposition and ideological submission, in much of the poorer rest of the world.

In continental Europe, a protectionist bias prevailed for most of the nineteenth century. It became strongest in the period from 1892 to 1914. This was the heyday of the previous episode of globalization—the one that came before the globalizing impulse of the late twentieth and the early twenty-first centuries. The most notable movement toward free trade took place in the years following the Anglo-French trade treaty of 1861. It is striking that this turn to free trade persisted during the period of the great European depression of the 1870s, an economic downturn in some respects more severe than the depression of the 1930s.

No Western country professed a more long-standing and radical devotion to protectionism than the one that was destined to become the leading economic power in the world, the United