Too late to compensate free trade's losers

By Dani Rodrik
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It appears that a new consensus has taken hold these days among the world's business and policy elites about how to address the anti-globalization backlash that populists such as Donald Trump have so ably exploited. Gone are the confident assertions that globalization benefits everyone: we must, the elites now concede, accept that globalization produces both winners and losers. But the correct response is not to halt or reverse globalization; it is to ensure that the losers are compensated.

The new consensus is stated succinctly by Nouriel Roubini: the backlash against globalization "can be contained and managed through policies that compensate workers for its collateral damage and costs," he argues. "Only by enacting such policies will globalization's losers begin to think that they may eventually join the ranks of its winners."

This argument seems to make eminent sense, both economically and politically. Economists have long known that trade liberalization causes income redistribution and *absolute* losses for some groups, even as it enlarges a country's overall economic pie. Therefore, trade deals unambiguously enhance national wellbeing only to the extent that winners compensate losers. Compensation also ensures support for trade openness from broader constituencies and should be good politics.

Prior to the welfare state, the tension between openness and redistribution was resolved either by large-scale emigration of workers or by re-imposing trade protection, especially in agriculture. With the rise of the welfare state, the constraint became less binding, allowing for more trade liberalization. Today the advanced countries that are the most exposed to the international economy are also those where safety nets and social insurance programs – welfare states – are the most extensive. Research in Europe has shown that losers from globalization within countries tend to favor more active social programs and labor-market interventions.

If opposition to trade has not become politically salient in Europe today, it is partly because such social protections remain strong there, despite having weakened in recent years. It is not an exaggeration to say that the welfare state and the open economy have been flip sides of the same coin during much of the twentieth century.

Compared to most European countries, the United States was a latecomer to globalization. Until recently, its large domestic market and relative geographical insulation provided considerable protection from imports, especially from low-wage countries. It also traditionally had a weak welfare state.

When the US began opening itself up to imports from Mexico, China, and other developing countries in the 1980s, one might have expected it to go the European route. Instead, under the sway of Reaganite and market-fundamentalist ideas, the US went in an opposite direction. As Larry Mishel, president of the Economic Policy Institute, puts it, "ignoring the losers was deliberate." In 1981, the "trade adjustment assistance (TAA) program was one of the first things Reagan attacked, cutting its weekly compensation payments."

The damage continued under subsequent, Democratic administrations. In Mishel's words, "if free-traders had actually cared about the working class, they could have supported a full range of policies to support robust wage growth: full employment, collective bargaining, high labor standards, a robust minimum wage, and so on." And all of this could have been done "before administering 'shocks' by expanding trade with low-wage countries."

Could the US now reverse course, and follow the newly emergent conventional wisdom? Back in 2007, political scientist Ken Scheve and economist Matt Slaughter called for "a New Deal for globalization" in the US, one that would link "engagement with the world economy to a substantial redistribution of income." In the US, they argued, this would mean adopting a much more progressive federal tax system.

Slaughter had served in a Republican administration, under President George W. Bush. It is an indication of how polarized the US political climate has become that it is impossible to imagine similar proposals coming out of Republican circles these days. The effort by Trump and his Congressional allies to emasculate former President Barack Obama's signature health-insurance program reflected Republicans' commitment to scaling back, not expanding, social protections.

Today's consensus concerning the need to compensate globalization's losers presumes that the winners are motivated by enlightened self-interest – that they believe buy-in from the losers is essential to maintain economic openness. Trump's presidency has revealed an alternative perspective: globalization, at least as currently construed, tilts the balance of political power toward those with the skills and assets to benefit from openness, undermining whatever organized influence the losers might have had in the first place. Inchoate discontent about globalization, Trump has shown, can easily be channeled to serve an altogether different agenda, more in line with elites' interests.

The politics of compensation is always subject to a problem that economists call "time inconsistency." Before a new policy – say, a trade agreement – is adopted, beneficiaries have an incentive to promise compensation. Once the policy is in place, they have little interest in following through, either because reversal is costly all around or because the underlying balance of power shifts toward them.

The time for compensation has come and gone. Even if compensation was a viable approach two decades ago, it no longer serves as a practical response to globalization's adverse effects. To bring the losers along, we will need to consider changing the rules of globalization itself.

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