

BOOK REVIEWS

Free Trade Today

Jagdish Bhagwati

Princeton and Oxford: Princeton University Press, 2002, 128 pp.

None of the usual jokes about economists apply to Jagdish Bhagwati. The Columbia University professor is as personable, charming, and provocative in print as he is in person, and all those attributes shine through in his new book, *Free Trade Today*.

Bhagwati's latest book is based on three lectures he delivered recently at the Stockholm School of Economics. That is the same venue where he gave another series of lectures on trade in the late 1980s that became the book *Protectionism*, a minor classic in the bibliography of free trade. This new book, Bhagwati tells us in the preface, is "a sequel to *Protectionism*, an equally short, accessible, wide-ranging work that brings the case for free trade to the skeptics and the critics today."

In the first section of the book, Bhagwati explains why free trade is still the first best policy despite two centuries of theoretical challenges. Economists have known since the 1840s that a nation can improve its welfare, in theory at least, by deviating from free trade. If a nation has enough weight in international markets, it can (in theory) force down global prices with a tariff, extracting more producer and revenue gain from the rest of the world than it gives up in lost efficiency or consumer welfare. Or it can (again, in theory) nurture "infant industries" behind a tariff wall to reap greater productivity gains later. In more recent years, we discovered "strategic trade policy," the idea that a country could (once again, in theory) benefit by protecting a strategic industry that could then bring home monopoly profits in the global marketplace.

Most of the justifications for deviating from free trade fit under the banner of "market failure." Free trade would be fine in an ideal world of perfectly competitive markets, the theorists concede, but we all know that markets are hardly ever perfect, and thus free trade is hardly ever the best policy. Bhagwati spends most of this short but pithy book demonstrating that even in this messy, imperfect world, free trade remains, almost always and everywhere, the best policy.

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Despite the frequent shouts of “Market Failure!” in our theater of public policy, Bhagwati makes a persuasive case that trade protection is almost never the right fire hose to reach for. First, market failure may be less of a problem than we think. He credits Chicago School economists for employing the tools of econometrics to measure how markets actually work, demonstrating that markets usually act “as if” competitive even if they do not fit the textbook description.

Second, even where domestic market failure exists, trade protection is not the right remedy. That is always true in purely domestic markets, where remedies should be aimed directly at fixing the distortion, through taxes, subsidies, or some other direct intervention, not through the indirect channel of trade protection.

Third, even if distortions exist in the international market, where protectionism could in theory be the right policy response, deviating from free trade will likely cause more problems than it solves. Here Bhagwati raises the public choice phenomenon of government failure. Trade intervention may in theory be able to raise national welfare, but politicians are more inclined to listen to lobbyists seeking special favors than economists when crafting trade policy. Thus, intervention to correct market failure is likely to result in government failure that only makes matters worse. “In short,” Bhagwati concludes, “the invisible hand may be frail, but the visible hand is crippled.”

In his second lecture, Bhagwati subjects America’s obsession with “unfair trade” to a withering analysis. Calling it “the American Virus,” he argues that fair-trade thinking has “intruded heavily into the political space, aiding the cause of protectionism—since virtually any asymmetry with another country can be cited as tantamount to unfair trade.”

Fair traders see threats everywhere—in Japanese industrial policy, in low labor and environmental standards in poor countries, in relatively higher trade barriers abroad—all resulting in an “un-level playing field” that allegedly puts American producers at a disadvantage.

Against that mindset, Bhagwati defends the right and need of nations to pursue differing domestic policies. The proper mix of labor and environmental laws for the United States will not necessarily be the right mix for Mexico or other less developed countries. He finds no empirical evidence for a global “race to the bottom” in social standards. If anything, it is protectionism that hurts the environment. As evidence, he points to the overuse of pesticides in rich countries because of farm-import barriers (with Europe’s Common Agricultural Policy being Exhibit A).

Bhagwati warns against using trade sanctions to enforce U.S. standards on the rest of the world. Trade sanctions are poorly suited to achieving non-trade objectives. As a general rule, policymakers should wield as many policy instruments as there are policy objectives. But reaching for trade sanctions is like trying to kill two birds (free trade and social agendas) with the single stone of trade policy. A far more promising approach would be to pursue free trade through trade policy and social agendas through other instru-

ments, such as international agencies and treaties aimed more directly at environmental and other social problems.

Organizations such as the International Labor Organization have the expertise to address specific international social problems that is utterly lacking in the World Trade Organization. To the charge that the ILO lacks the “teeth” needed to enforce its findings, Bhagwati replies: “I would argue that God gave us not just teeth but also a tongue; and a good tongue-lashing, based on evaluations that are credible, impartial, and unbiased, can push a country into better policies through shame, guilt, and the activities of NGOs that act on such findings.”

After rebutting the latest objections to free trade, Bhagwati in his final lecture examines alternative ways to achieve it. Here he praises unilateral and multilateral liberalization, while condemning “aggressive unilateralism” and regional and bilateral agreements.

Good unilateralism is when a country lowers its own trade barriers for its own economic benefit, regardless of what other countries do. This form of “going alone” cuts through the nonsense of insisting that other countries lower their barriers first before we allow ourselves to reap the benefits of more competitive markets. It may also encourage other nations to liberalize, either in immediate response or later after they witness the benefits of open markets. Bhagwati notes the long list of countries, from China and India to Australia and New Zealand, that have liberalized unilaterally in the last two decades. “In short, we need to remember that if we refuse to reduce our trade barriers just because others do not reduce theirs, we lose from our trading partners’ barriers and then lose again from our own,” Bhagwati writes. In contrast, bad unilateralism is when a country like the United States uses its weight in the global economy to bully other nations into liberalizing their own markets through threats of trade retaliation.

Multilateral trade negotiations through the WTO are consistent with good unilateralism. They reinforce the benefits of import liberalization at home by opening up markets abroad, thus multiplying the economic gains and bringing domestic exporters into the free-trade coalition. But Bhagwati draws a sharp distinction between nondiscriminatory multilateral agreements and what he calls “preferential trade agreements.” PTAs (such as the North American Free Trade Agreement, Mercosur, the European Union, or the proposed Free Trade Area of the Americas) reduce barriers between members but otherwise discriminate against exporters from nonmembers.

Bhagwati heaps nothing but scorn on such arrangements. PTAs can “divert” trade away from more efficient producers outside the agreement, costing members more in lost tariff revenue than they gain from lower prices. They can also create a confusing “spaghetti bowl” of overlapping agreements that undermine the principle of nondiscriminatory trade. The worry about trade diversion, Bhagwati writes, “pales in comparison with the damage that PTAs now impose on the world trading

system, overwhelming multilateralism and its central tenet of nondiscrimination.”

The wisdom of regional and bilateral agreements is one of the few subjects that can sharply divide free-trade economists, and here, I believe, the great free-trade economist doth protest too much. PTAs are not optimal, but they are not the scourge on global free trade that Bhagwati makes them out to be. Evidence of trade diversion is small, and the benefits from major PTAs such as the European Union and NAFTA are palpably large. Regional and bilateral trade agreements provide a kind of safety valve in case the multilateral track becomes blocked, as seemed all too likely during the tortuous Uruguay Round and after the 1999 WTO ministerial in Seattle. As long as external tariffs are kept from rising, most PTAs seem to be incremental steps toward freer trade, not away from it.

But on the fundamental question of whether free trade is good policy, Bhagwati could not be on more solid ground. His sophisticated, far-ranging, and practical defense of free trade places the doctrine on a more solid footing than ever. When we consider that government officials often lack sufficient information or pure motives, free trade becomes the first, best policy—even if a higher state of domestic welfare could be reached in theory if just the “right” policies were implemented. Two centuries after Adam Smith, free trade remains a broad, secure, and accessible ledge high up the mountainside of good government policy. Jagdish Bhagwati wisely warns us in *Free Trade Today* that those final icy feet to the summit are not worth the risk.

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Free Market Environmentalism

Terry L. Anderson and Donald R. Leal
New York: Palgrave, 2001, revised ed., 241 pp.

In the first edition of *Free Market Environmentalism*, Terry Anderson and Donald Leal of the Political Economy Research Center sketched an environmental vision that eschewed government mandates in favor of markets, and replaced regulatory prohibitions with property rights. At the time, 1991, this was radical stuff. Ostensibly conservative policymakers had controlled federal environmental agencies for over a decade with little to show for it. Though the authors were reluctant to admit it, free market environmentalism (FME) was still a fringe idea. Environmentalists remained wedded to the use of government, and the federal government in particular, to achieve environmental goals. Some economists and policymakers used the language of economics in discussing environmental problems, or professed fealty to “market incentives,” but few were prepared to unleash unfettered markets on the ecology. Genuine free market environmentalism—that is, the use of market institutions, particularly property rights, voluntary exchange, and common law liability