

# Global Economics and Free Trade

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# Trade Theory

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## The basic economics of international trade

- Trade theory focuses on the basis for international trade and the microeconomic implications of expanding markets and trade.
- Trade theory dates back to arguments in the early 19<sup>th</sup> century about the value and virtues of free trade.
- Then, as now, trade was seen by some as a powerful social good, and by others as a pernicious attack on the common man.
  - In today's vernacular one might say that there is a suspicion that free trade is good for the 1% but bad for the working person.
- In the United States, the authority to negotiate trade agreements was given to the president under the Trade Promotion Authority (TPA) passed in 1974.

# Trade theory is incredibly politically controversial!

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- To this very day, trade policies are politically controversial and are often the subject of polarized political debate.
- In 1992, H. Ross Perot launched an independent campaign for the Presidency and made the North American Free Trade Agreement (NAFTA) a major issue:
  - We have got to stop sending jobs overseas. It's pretty simple: If you're paying \$12, \$13, \$14 an hour for factory workers and you can move your factory South of the border, pay a dollar an hour for labor,...have no health care—that's the most expensive single element in making a car— have no environmental controls, no pollution controls and no retirement, and you don't care about anything but making money, there will be a **giant sucking sound going south**.
- Today the Trans Pacific Partnership (TPP), an Obama administration priority, divides Republicans and Democrats.
  - TPP Fast track authority and TPA renewal done in and signed on June 29, 2015
  - Opposed by Bernie Sanders, Elizabeth Warren, and many other Democrats.
  - Rand Paul opposed, but most Republicans supported.
  - [https://en.wikipedia.org/wiki/Trans-Pacific\\_Partnership](https://en.wikipedia.org/wiki/Trans-Pacific_Partnership)
  - Trade Negotiations Completed October 6, 2015
    - <http://www.nytimes.com/2015/10/06/business/trans-pacific-partnership-trade-deal-is-reached.html?smid=fb-nytimes&smtyp=cur>
  - The Republican nominee for President, Donald Trump, has broken with the party and is a vehement opponent of the TPP.
  - The Democratic nominee for President, Hillary Clinton, was once a supporter of that TPP, but the success of Bernie Sanders and Elizabeth Warren in opposing TPP, has changed her view to oppose it now.

# The Foundation of Global Economics and Trade Theory

- The economists Adam Smith and David Ricardo showed clearly that free trade was of benefit in most cases, but it has been an argument that has persisted to this day –is free trade good or bad, and for whom?
  - Not only Western culture faced this dilemma. In the early 15<sup>th</sup> century China was a mighty seafaring nation that sailed the coasts of India and Africa and perhaps much further. They were by far the mightiest sea faring and trading nation on earth. Their ships dwarfed Columbus' Nina, Pinta, and Santa Maria. By the mid 15<sup>th</sup> century a new leadership in China pulled back their fleets, burned their ships, charts, and records, and decreed that China had no need of anything from the world outside the middle kingdom.



# Mercantilism

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- Mercantilism was a theory, very prevalent in 16<sup>th</sup>-18<sup>th</sup> century Europe, that viewed state control of trade to be an arm of economic and geo-political power –to be used to give a nation a comparative advantage over competitors.
- It continues to influence governments today to varying extent.
  - <https://en.wikipedia.org/wiki/Mercantilism>
  - Wikipedia listed several actions taken by mercantilist governments:
    - forbidding colonies to trade with other nations
    - monopolizing markets with staple ports
    - banning the export of gold and silver, even for payments
    - forbidding trade to be carried in foreign ships
    - subsidies on exports
    - promoting manufacturing through research or direct subsidies
    - limiting wages
    - maximizing the use of domestic resources
    - restricting domestic consumption through non-tariff barriers to trade.
  - Many of these actions remain in use today.
- It is important to recognize that the mercantilist approach used state control of trade not only to strengthen the nation but to weaken their opponents.
- Adam Smith stated “that their interest lies in beggaring all their neighbours.”
  - Joan Robinson then used this phrase to describe nations’ actions during the great depression of the 30’s.

# The Theory of Absolute Advantage –Adam Smith

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- Adam Smith's 1776 publication: "*An Inquiry into the Nature and Causes of the Wealth of Nations*" critiqued mercantilist ideas, and argued that:
  - it was impossible for all nations to become rich simultaneously by following mercantilism because the export of import and instead stated that all nations would gain simultaneously if they practiced free trade and specialized in accordance with their absolute advantage.
  - the wealth of nations depends upon the goods and services available to their citizens, rather than their gold reserves.
- He refuted the zero sum game theory of trade then prevalent.
- **The Theory of Absolute Advantage:** Adam Smith's late 18<sup>th</sup> century concept that trade is a positive sum game. He used household behavior to explain his concepts:
  - "It is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy.
  - It makes no sense for a country to waste resources trying to produce goods that it could acquire cheaper elsewhere.
  - [https://en.wikipedia.org/wiki/Absolute\\_advantage](https://en.wikipedia.org/wiki/Absolute_advantage)

# Comparative Advantage -David Ricardo

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- Another British economist who followed Smith in the early 19<sup>th</sup> century, David Ricardo, took Smith's theory one step further.
- Ricardo demonstrated that nations could gain from specialization even if they lacked an absolute advantage.
- A country's gains would come from specializing in those activities, which, at world prices, that country is relatively better at, even though it may not have an absolute advantage in them.
- **Comparative advantage** is considered the key theoretical underpinning of trade theory.
- Example from Wikipedia ([https://en.wikipedia.org/wiki/David\\_Ricardo](https://en.wikipedia.org/wiki/David_Ricardo)):
  - With "**comparative advantage**" Ricardo argued in favor of industry specialization and [free trade](#). He attempted to prove, using simple mathematics, that industry specialization combined with free international trade always produces positive results. This theory expanded on the concept of [absolute advantage](#).
  - Ricardo argued that there is mutual national benefit from trade even if one country is more competitive in every area than its trading counterpart and that a nation should concentrate resources only on industries where it had a comparative advantage,<sup>[13]</sup> that is in those industries in which it has the greatest competitive edge. Ricardo suggested that national industries which were, in fact, profitable and internationally competitive should be jettisoned in favor of the most competitive industries. Ricardo's theory of [comparative advantage](#) assumes the existence of an industry and trade policy at a national level. It does not presume that business decisions are or should be made independently by entrepreneurs on the basis of viability or profit.
  - Ricardo attempted to prove, using a simple numerical example, that international trade is always beneficial.<sup>[14]</sup> [Paul Samuelson](#) called the numbers used in Ricardo's numerical example dealing with trade between England and Portugal the "four magic numbers".<sup>[15]</sup> "In spite of the fact that the Portuguese could produce both cloth and wine with less amount of labor, Ricardo suggested that theoretically both countries benefit from trade with each other."
  - I.e. Although Portugal could also produce cloth at a lower cost than England, it should still focus on Wine and import cloth since it had a larger comparative advantage in wine.

## Later economists took issue with both Adam Smith and David Ricardo

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- [Joan Robinson](#), in the 1930s, pointed out the reality following an opening of free trade with England: Portugal endured centuries of economic underdevelopment:
  - "the imposition of free trade on Portugal killed off a promising textile industry and left her with a slow-growing export market for wine, while for England, exports of cotton cloth led to accumulation, mechanization and the whole spiraling growth of the industrial revolution".
  - Robinson argued that Ricardo's example required that economies were in static equilibrium positions with full employment and that there could not be a trade deficit or a trade surplus. These conditions, she wrote, were not relevant to the real world. She also argued that Ricardo's theory did not take into account that some countries may be at different levels of development and that this raised the prospect of 'unequal exchange' which might hamper a country's development, as we saw in the case of Portugal.
  - She used the Adam Smith phrase of "*beggar thy neighbors*" to describe national actions during the great depression of the 30's.
  - She became a fan and apologist of Mao Tse-Tung later in life. This hampered acceptance of her theories by many.
  - [https://en.wikipedia.org/wiki/Joan\\_Robinson](https://en.wikipedia.org/wiki/Joan_Robinson)



# Factor Endowment Model

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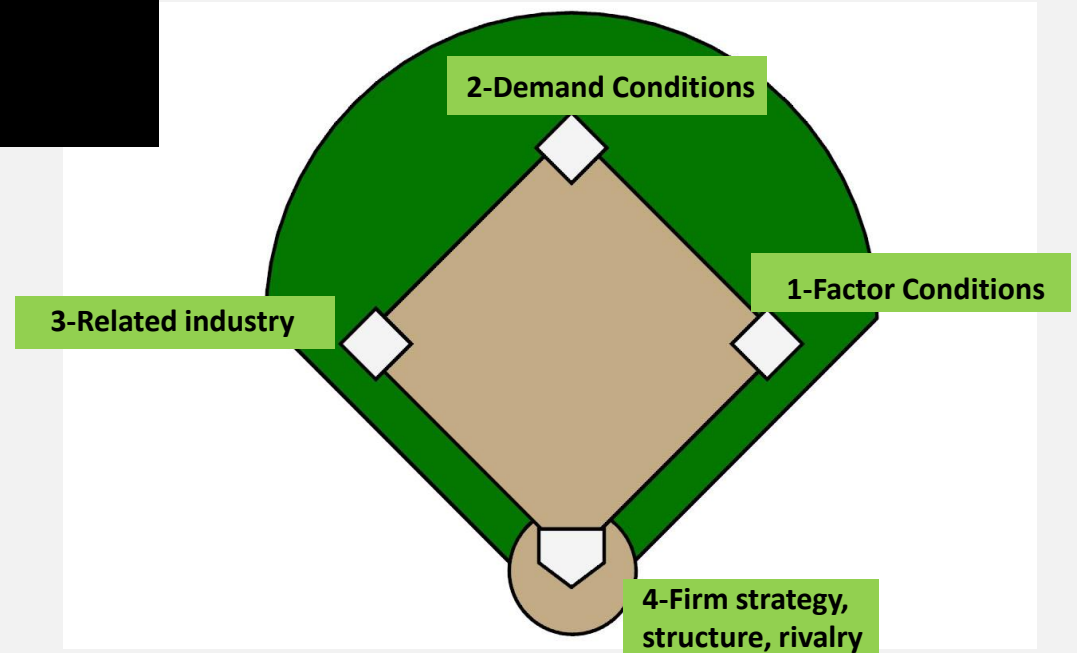
- The Factor Endowment model was developed by Eli Heckscher (1919) and Bertil Ohlin(1933) and later refined by MIT's Paul Samuelson (1949).
- This theory hypothesizes that countries export the products that use their abundant factors intensively, and import the products using their scarce factors intensively.
  - Ex. A nation with large oil reserves will have a comparative advantage in oil production over another with fertile soil, which will have a comparative advantage in agricultural production.
- While this has some obvious truth and sounded very good, it did not fit well with empirical research later done by Leontief.
- **The Leontief Paradox:**  
the counter-intuitive conclusion that the US, the most capital abundant country in the world, exported labor-intensive commodities and imported capital-intensive commodities.
  - This paradox drove much research over the following years to try to understand why that was.

# Porter's Diamond

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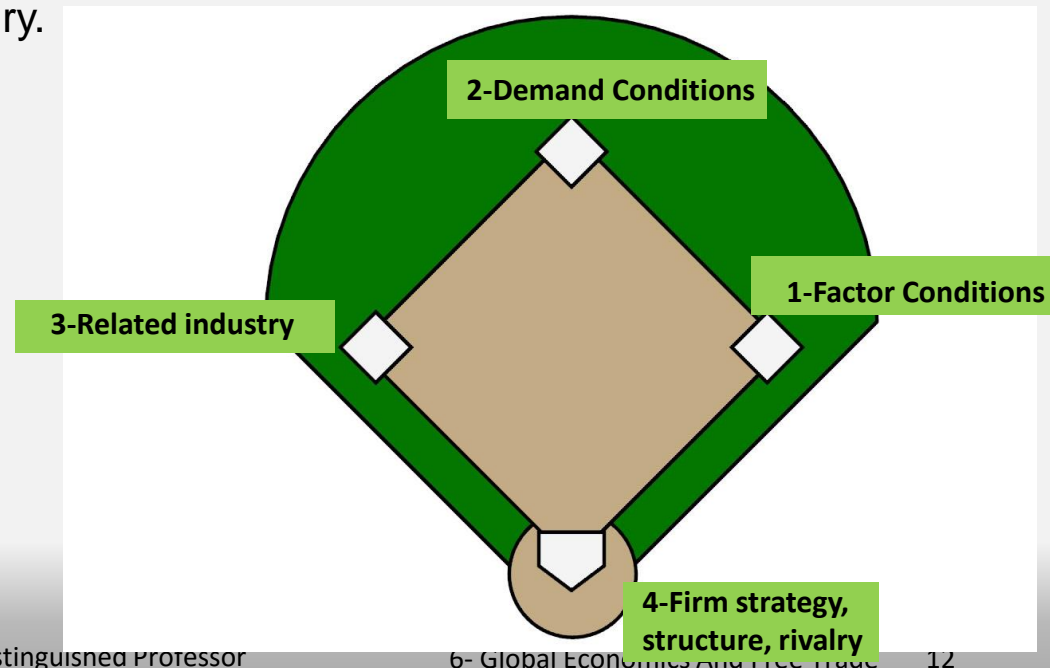
- Michael Porter, a Harvard University economist developed a more advanced analysis in 1990 of a theory of national competitive advantage.
- Porter contends that a nation can create new advanced factor endowments such as
  - skilled labor,
  - a strong technological and knowledge base,
  - government support, and
  - culture.
- A **nation** gains a competitive advantage if its **firms** are competitive.
  - Firms become competitive through innovation
- Porter contends that national wealth is not set by factor endowments, but created by strategic choices.
  - National prosperity is not inherited, it is created by choices.

# Porter's Diamond



## Porter's Diamond Contd.

- 4 attributes comprise the basis for a country's diamond of national competitive advantage.
  - Factor conditions – the nation's position in terms of factors of production, such as skilled labor and infrastructure.
  - Demand conditions – includes the degree of sophistication of consumers in the domestic market.
  - Related and supporting industries- includes suppliers and complimentary industries.
  - Firm Strategy, structure, and rivalry – conditions for organization of companies, and the nature of domestic rivalry.



## Expanding Markets and Economic Efficiency

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- International trade and globalization are not only the results of increasing economic efficiency, they are causative forces as well.
  - Competition drives efficiency.
- There is no assurance that expanding markets, increasing competition and a greater productive efficiency will lead to a more equitable distribution of wealth.
- Therefore carefully crafted government policies are necessary to correct some of the injurious effects of the impersonal marketplace.
- This describes much of the evolution of capitalism from the unfettered capitalism of more than a hundred years ago to the regulated social capitalism that most developed countries now espouse.

## Unfettered capitalism –an anecdote

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- In the mid 1980's I was working with the Soviet Academy of Sciences and delivering computer equipment to their scientists –who were allies in Gorbachev's efforts at perestroika.
  - Marxism and communism were being replaced by capitalism.
- One evening I grabbed a cab to a distant club for a social evening.
- To my surprise, the same cab was waiting when I left the club late that night. The reason quickly become clear: he asked me for one hundred dollars to take me back to the hotel, and he was the only cab around. "But you only charged me \$4 to bring me here!" I complained. "Yes, it is capitalism" he replied proudly.
- To him, new to capitalism, it meant the unfettered capitalism of the 19<sup>th</sup> century and not the regulated capitalism of the 20<sup>th</sup>.
- We argued vigorously, and I angrily set out on foot. He followed slowly while letting me see how difficult my journey would be and also making better and better offers. Eventually he brought the price down to a level I would pay to avoid the danger of a late night stroll in Moscow.
  - Aside: That is why the regulated cabbies today resent the ability of Uber to charge varying rates on the same routes.

# Criticism of Free Trade

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- During the 90's and first decade of this millennium, there has been strong bi-partisan support for free trade agreements.
- That support has evaporated in recent years as grass roots communities saw their industries closing and moving to sites outside the united states.
- By 2016, this anger boiled over into the election. On the left Bernie Sanders excoriated free trade much as Joan Robinson had done earlier. On the right, Donald Trump made cracking down on trade with Mexico and Asia into a major campaign issue.
- The mainstream candidates in both parties were caught a bit unawares by the intensity of the uprising. Republicans had generally supported past free trade agreements, but so had the Democrats. Hillary Clinton rapidly backed away from her previous strong support for the Trans Pacific Partnership.
- A decade that had begun with strong bi-partisan support for free trade evolved into strong bi-partisan anger at free trade agreements.
- A Boston Globe article did a good job of chronicling the fall of free trade support.
  - <https://www.bostonglobe.com/ideas/2016/03/15/fair-hits-free-trade/yDOWlfMvtvRTB3nyMlmjtO/story.html>
  - Jonathan Schlefer, senior researcher in the Business, Government, and International Economy unit at Harvard Business School.

## Boston Globe: Fair Hits on Free Trade

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– <https://www.bostonglobe.com/ideas/2016/03/15/fair-hits-free-trade/yDOWlfMvtvRTB3nyMlmitO/story.html>

- The article chronicles the rise and fall of free trade theory from Ricardo, through Robinson, to the present day. It shows how Britain used protectionist techniques to grow its economy, much as Japan, China, and Korea have done in more recent times.
- “US Treasury Secretary Alexander Hamilton, seeing what Britain had done, urged the use of protection and subsidy in his “Report on Manufactures” in 1791. At first, little came of it. However, tariffs raised to pay for the War of 1812 proved salutary for industry, so Congress raised them again, to around 35 percent. The protectionist Abraham Lincoln raised them yet again. From the Civil War to World War II, they ranged from about 40 to 50 percent, and the US economy grew faster than any other. “
- But that bubble burst with the passage of the infamous “Smoot-Hawley Tariff in 1930 which most economists see as deepening, if not creating, the great depression.



# The Smoot-Hawley Tariff

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- From the Globe article cited:
- *“The United States’ infamous Smoot-Hawley tariff of 1930 was just a bump up to the high end of the historical range. Yet for the most advanced economy to impose it, it had perilous effects, triggering a cascade of protectionism elsewhere, successively shutting off demand, and deepening the Depression. Joan Robinson of Cambridge University, who insisted growth depends on sustaining demand, dubbed Smoot-Hawley a “**beggar-thy-neighbor**” policy. Mainstream economists borrowed her phrase but never accepted her logic. “*
- The experience of the Smoot-Hawley Tariff meant that most mainstream economists and politicians oppose (or even fear) protectionist policies.
- Like most ideas, the pendulum swings toward both extremes from time to time and it is very hard to maintain a balanced middle course.

## The Economist - “Trade, at what price?”

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“America’s economy benefits hugely from trade. But its costs have been amplified by policy failures”

- The Economist; Apr 2, 2016
- <http://www.economist.com/news/united-states/21695855-americas-economy-benefits-hugely-trade-its-costs-have-been-amplified-policy>
- This article in the economist does a very good job of illustrating both the benefits and the challenges of free trade.
- It highlights the fact that different people and different places experience the benefits and the harm that can come from free trade.
  - While many consumers, urban areas, agricultural producers, and corporate headquarters areas benefited, America’s rust belt manufacturing areas were devastated.
- The article traces the path of the US economy as it began to open up to inexpensive imports in the 1980’s.
- When President Clinton signed the North American Free Trade Agreement in 1993, the trend began to accelerate.

## The Economist- “Trade at What Price?”

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- NAFTA created a common, almost tariff free, trade zone among the US, Canada, and Mexico.
- Canada had an economic structure similar to the United States and trade had moved smoothly between the countries for years. US automakers, for example, manufactured on both sides of the US-Canadian border near Detroit and could move goods back and forth with little restriction.
- Mexico was much different. Wage rates were far lower and trade was much less across the border. NAFTA changed all of that.
  - The situation was further exacerbated by a severe devaluation of the peso. This effectively lowered wage rates, measured in American dollars, in Mexico and made imports much less expensive.
  - The fact that the US economy was over ten times larger than that of Mexico kept it from being much worse.
- In 2013, ten years later, the volume of imports from Mexico had grown five times while exports to Mexico grew about 3.5 times.
- The result was a yawning \$23 billion trade deficit.
  - While that is less than 1% (0.2%) of US GDP, it was significant.

## However, the effects of NAFTA were dwarfed by China

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- In 2001, China joined the World Trade Organization.
- Although that did not directly change tariffs, it signaled China's intention to become a major world exporter, a signal that only confirmed what had been apparent for years before.
- The accession to the WTO may not have changed trade tariffs, but it gave investors more confidence that the US would not easily impose tariffs on goods they were manufacturing in China for import to the US. It also gave confidence to those who were investing in China that their investments would not be blocked, nationalized or otherwise interfered with,
  - Many also feel that China has kept the value of its currency, the Yuan, at an artificially low level –making imports even less expensive than they would otherwise be.
- From 2001 until 2015, US imports from China grew from 1% of GDP to 2.7%.

# Qui Bono?

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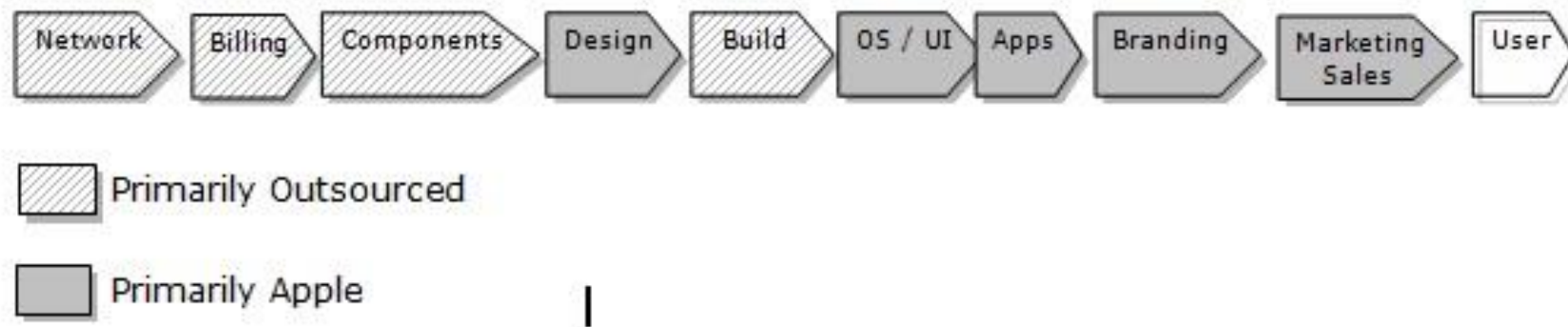
- Who benefited from these dramatic changes?
- US consumers were the big beneficiaries.
  - Clothing and furniture is the same price today that it was 30-35 years ago!
  - High powered electronics were brought into the reach of even the less economically advantaged in the US.
  - Robert Lawrence and Lawrence Edward estimate that China trade benefited the average US consumer by \$250 by 2008.
  - Paradoxically, the biggest benefit went to the poorer consumers since the wealthier consumers spend a smaller proportion of their income on such goods.
- Some US Firms were huge beneficiaries
  - Sale of autos and auto parts to Mexico went from \$10 billion to \$70 billion.
  - Exports to China tripled between 2005 and 2014.
  - Workers in these firms benefited since exporting firms tend to have higher average pay than others.
    - Estimated wage premium is 18%
  - By placing low skill/high labor tasks overseas and high skill jobs in the US, many firms have increased both productivity and profits.

## Example: Apple iPhone Value Chain

- Apple took a look at their entire value chain and decided which of these to do themselves and which they would contract to others.
  - *Simon Reading, Bernt Wahl, Hannes Hesse, Chris Volz, Johnson Nguyen*
    - [people.ischool.berkeley.edu/~hal/Courses/.../Tech/.../H-iphone.doc](http://people.ischool.berkeley.edu/~hal/Courses/.../Tech/.../H-iphone.doc)

### C. Value Chain

The value chain below illustrates the context in which Apple delivers value to the customer with the iPhone:

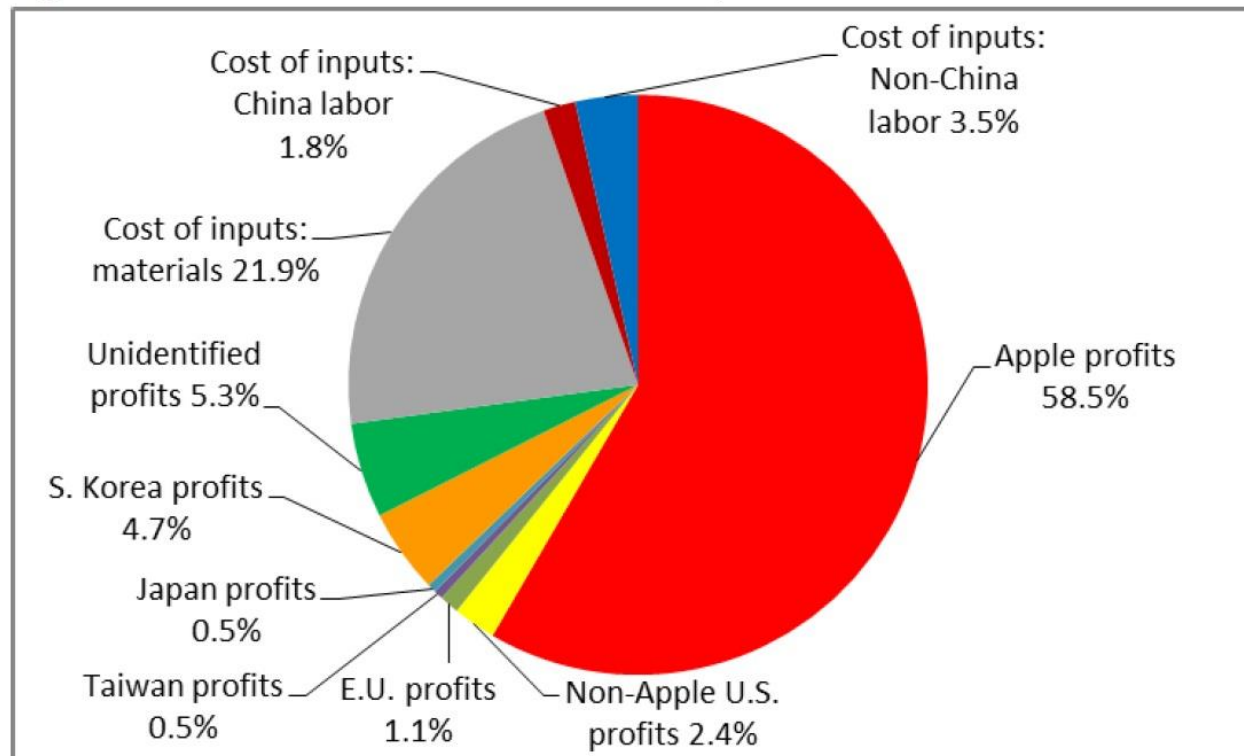


# Capturing Value in Global Networks: Apple's iPad and iPhone

How does that value chain translate into the share of the value?

- Kenneth L. Kraemer, Greg Linden, and Jason Dedrick<sup>1</sup>
- University of California, Irvine, University of California, Berkeley and Syracuse University
- » [http://pcic.merage.uci.edu/papers/2011/Value\\_iPad\\_iPhone.pdf](http://pcic.merage.uci.edu/papers/2011/Value_iPad_iPhone.pdf)

**Figure 1. Distribution of value for iPhone, 2010**



## Who gets hurt?

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- As we have seen in the work of economists from Joan Robinson up to Paul Krugman today, some people get hurt.
- The pain caused by globalization is acute and felt in very targeted places. When a factory closes in a city and moves to another country, the workers find themselves with no jobs and few options.
- The benefits, as we have seen are diffuse and felt more broadly, but also are harder for the average worker to see and feel. For those left behind when a factory closes, it is nearly impossible to perceive benefits.
- These job losses have been compounded by increases in productivity that mean that fewer workers can produce the same amount of product –EVEN IF THE MANUFACTURING REMAINS IN THE US.
  - Robert Lawrence estimated that the average annual losses in manufacturing jobs came to 484,000 per year in the mid 2000's, but that only 188,000 of those losses were because of Chinese imports.



Technology changes at the same time as free trade made things complicated.

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- At the same time that trade was opening up with Mexico, China, and other countries, technology was rapidly changing the nature of work in the United States.
- *“Economic theory predicts that trade, though often good for average incomes, will squeeze the pay of those workers whose skills are relatively abundant overseas. A sharp rise in the college premium—the additional wages earned by skilled workers—from around 30% in 1979 to almost 50% by 2000 seemed to corroborate that theory, as it coincided with the first wave of cheap imports.”*
- *“Paul Krugman, a trade economist, estimated that trade with poor countries explained only a tenth of the growth in the skilled-worker premium in the 1980s. Mr. Krugman and others found that technological change was more to blame. That would explain why the return to education increased even in poor countries, which trade theory did not predict.”*
  - <http://www.economist.com/news/united-states/21695855-americas-economy-benefits-hugely-trade-its-costs-have-been-amplified-policy>

But, the Impact of Free Trade has been important.

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- Daron Acemoglu, David Autor and others chalks up about 1m of 5.5m manufacturing jobs lost between 1999 and 2011 to Chinese competition (with similar-sized job losses in other industries).
- “David Autor of MIT, David Dorn of the University of Zurich and Gordon Hanson of the University of California, San Diego, provide convincing evidence that workers in the rich world suffered much more from the rise of China than economists thought was possible. In their most recent paper\*, published in January, they write that sudden exposure to foreign competition can depress wages and employment for at least a decade.”
  - <http://www.economist.com/news/finance-and-economics/21690073-globalisation-can-make-everyone-better-does-not-mean-it-will-trade>
  - \*“The China shock: Learning from labour market adjustment to large changes in trade”, David Autor, David Dorn and Gordon Hanson, NBER Working Paper 21906, 2016. <http://www.ddorn.net/papers/Autor-Dorn-Hanson-ChinaShock.pdf>

## Economists continue to see Free Trade as Positive but...

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- “*International Economics: Theory and Policy*,” Paul Krugman and Maurice Obstfeld note that,
  - “*Owners of a country's abundant factors gain from trade, but owners of a country's scarce factors lose... compared with the rest of the world the United States is abundantly endowed with highly skilled labor and (...) low-skilled labor is correspondingly scarce. This means that international trade tends to make low-skilled workers in the United States worse off -not just temporarily, but on a sustained basis.*”

## A reprise of H. Ross Perot.

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- H Ross Perot's quote, for which he had been pilloried, turned out to be fairly accurate; *"We have got to stop sending jobs overseas. It's pretty simple: If you're paying \$12, \$13, \$14 an hour for factory workers and you can move your factory south of the border, pay a dollar an hour for labor,...have no health care—that's the most expensive single element in making a car— have no environmental controls, no pollution controls and no retirement, and you don't care about anything but making money, there will be a giant sucking sound going south."*
- To be more accurate, he could have said "to Mexico, China, other emerging markets, and automation.
- But any way you analyze it, it has caused huge pain in US employment and that pain is particularly concentrated in the Midwestern rust belt and the south.

# Policies to ameliorate the pain of free trade -TAA

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- Because the negative impacts of free trade are concentrated and the positive impacts are widespread, it is generally recognized that new developments in free trade need to be accompanied by social policies that help the negatively impacted industries and workers adapt to the changed environment.
- In 1962 Congress passed a “**trade-adjustment assistance**” (TAA) program. It was further expanded after the signing of NAFTA.
  - Workers can get an extension (six months during the 2000s) to their unemployment-insurance payments.
  - Displaced workers can enroll in training programs and get paid.
  - Over age 50 workers get up to \$12,000 over two years to partially replace pay lost when taking a lower paid job.
- Until 2009, TAA was limited to those displaced by trade agreements like NAFTA, but did not cover the China challenge.
- While it covered factories closing because of competition, it did not cover the rest of the supply chain. Most infuriatingly, it did not cover those whose employers moved jobs to China
- Autor and his colleagues found that in areas affected by trade with China, new spending on disability benefits was more than double new spending on unemployment insurance and TAA because these were more lucrative than TAA.
- Only about a third of those eligible entered a training program,
  - Less than \$2000 was not much of an incentive.
- The wage-insurance scheme did not replace all of the lost earnings.
- The youngest workers, who were losing the most in lifetime earnings were not eligible.
- TAA was improved after the recent (2008-2009) recession, but many will never make up what they lost
  
- To conclude: The assistance was **not enough** to make up for the negative impacts of the trade.
- This is a failure of policy and NOT due to lack of resources.

# The effect of the rise in protectionism on multinational companies

- An interview with the CEO of General Electric (GE), Jeff Immelt, illustrates the challenges that the rise of protectionism will present to global multi-nationals.
  - **“Jeff Immelt says the relationship between business and government is absolutely busted. And no one has a fix;” LinkedIn; Daniel Roth, July 28, 2016.**
    - [https://www.linkedin.com/pulse/jeff-immelt-says-relationship-between-business-government-daniel-roth?trk=e-ml-b2\\_content\\_ecosystem\\_digest-hero-14-null&midToken=AQH2fnFZ2zihcw&fromEmail=fromEmail&ut=2ogbOCTWwRODk1](https://www.linkedin.com/pulse/jeff-immelt-says-relationship-between-business-government-daniel-roth?trk=e-ml-b2_content_ecosystem_digest-hero-14-null&midToken=AQH2fnFZ2zihcw&fromEmail=fromEmail&ut=2ogbOCTWwRODk1)
  - *“Technology, productivity and globalization have been the driving forces during my business career. In business, if you don’t lead these changes, you get fired; in politics, if you don’t fight them, you can’t get elected... In the U.S., we want exports but seem to hate trade and exporters.”*
  - *“I graduated from high school in the '70s. We were No. 1 in education, we were No. 1 in infrastructure in the 1970s. Today, we’re not in the top 15 in math and science, our infrastructure’s not in the top 20. We have other things to fix as a country other than just trade. When you’re driving home tonight say, “I believe in exports. That’s why we don’t have an EXIM bank,” right? Just say it three times to yourself and you burst into laughter. So all the things we say we’re for as a country, we don’t really act on it. But as a company, we can navigate with or without it. We’re going to do what we have to do.”*
  - *“It’s too complicated to explain in the environment we have today. I try to go to D.C. and talk to people about export banks. Here’s what China does, here’s what Germany does, here’s what Canada does. And on the other side, there’s no listening. It’s dogma and philosophy and things like that.”*

*“We’re in 185 countries; we can’t wait for that. So we’re not in a mode today where real communication can take place.”*

*“I don’t think business should give up, but I would say that every executive who’s maybe watching this: You’re on your own, brother. You better go chart your own path because if you’re waiting for TPP, if you’re waiting for the Republicans to get why the Export-Import Bank’s important, you’re going to be waiting a long time. So chart the path on your own.”*

## Protectionism resurges around the world

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- Issues relating to free trade have created a surge in populist sentiments around the world –just as they have in the US.
- Two major issues appear to be driving this populism –protectionism and immigration. While the link between immigration, free trade, and entrepreneurship may not be obvious, we have seen that the free movement of both goods and people seem to be linked with successful global entrepreneurship.
- When the United Kingdom (UK) voted to leave the European Union (known now as the Brexit) on June 23, 2016. these two issues were front and center.
  - [https://en.wikipedia.org/wiki/United\\_Kingdom\\_European\\_Union\\_membership\\_referendum,\\_2016](https://en.wikipedia.org/wiki/United_Kingdom_European_Union_membership_referendum,_2016)
- Now many European business leaders fear that the Brexit will lead to increased protectionism and increased restrictions on employment across borders. They are sophisticated enough to know that this bodes ill for the economies in the region.
  - <http://www.economist.com/news/business/21701659-firms-fret-eu-without-britain-will-be-protectionist-and-over-regulating-german-business>

# How will Brexit affect the economy and entrepreneurship

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- Many experts are predicting dire economic consequences from Brexit. This opinion piece in the New York Times gives the general consensus that Brexit will lead to economic disaster for the UK and to significant challenges to the EU while also having a negative impact on the world economy.
  - <http://www.nytimes.com/2016/06/27/opinion/this-is-just-the-start-of-the-brexit-economic-disaster.html>
  - *“Faced with such uncertainty, businesses are likely to continue to put investments on hold. Consumers may pull back, too. The resulting downturn will cause the government’s budget deficit, already large, to swell. The pound’s depreciation, which might have been expected to boost exports, is unlikely to do much to cushion the blow. Its huge decline in 2008 failed to boost exports and Brexit will dent them.”*
- We have seen that Global Entrepreneurship is heavily impacted by uncertain policies and unreliable political structures. This is certain to be the case with Brexit.
- However, one must also note that entrepreneurs can often be very clever in finding ways to profit from even the worst economic disasters. It will not be easy. It may not be pretty, but it probably can happen.



## The US Business Press Opines:

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- Brexit's Real Impact Would Be Gradual and Global
  - Wall Street Journal; Jun 22, 2016
    - <http://www.wsj.com/articles/brexits-real-impact-would-be-gradual-and-global-1466616893>
  - “The United Kingdom's exit from the European Union would mark a **reversal in the global trend** toward greater economic integration. WSJ's chief economics columnist Greg Ip explains that the major impact may be slowed global growth over the long term.”
  - “Brexit would be the starkest repudiation yet of the postwar consensus favoring ever-deeper global integration. That consensus is already fraying in the face of growing **protectionism** and **anti-immigrant** sentiment world-wide. A further unraveling would undermine global growth prospects already clouded by aging populations and miserable productivity.”

# What might the Global Impact Be?

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- “The Potential Impacts Of Brexit On The Global Economy”
  - Forbes; June 29, 2016
  - <http://www.forbes.com/sites/baininsights/2016/06/29/the-potential-impacts-of-brexit-on-the-global-economy/#1bacaab20e00>
- Some Potential and possibly likely impacts:
  - *“The flight to safety away from the epicenter of this British-EU divorce will push capital away from the region and toward key safe-haven markets including the U.S.—especially Treasuries—and to Japan. This will further lower market interest rates and raise relative currency values.”*
  - *“A higher U.S. dollar and Japanese yen are negative to both economies’ export sectors. In the case of Japan, this is particularly unhelpful to its efforts to reinflate and reinvigorate the economy after decades of deflation.”*
  - *“The higher U.S. dollar also triggers additional pressure on China to float the yuan lower, as it is caught in the divergence between its two largest export markets—the EU and the U.S.”*
  - *“For the U.S., the negative impact on exports is relatively small compared with trends in domestic demand, but the deflationary pressure on tradable goods will widen the divergence between reasonably strong inflation in the services sector vs. reasonably strong deflation in the goods sector.”*
  - *“The European Central Bank will be compelled to raise its level of intervention yet again, as risk premiums across the region rise. Among the larger Eurozone members, Italy is in a particularly vulnerable position—now made more vulnerable. Each blow to members of the Eurozone periphery also further make Germany’s outperformance in the Eurozone even more unsustainable.”*

# What does the economic future look like after Brexit?

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- A survey of UK Business owners in early July 2016 revealed that pessimism had jumped from 25% before Brexit to 50% after.
  - <https://www.yahoo.com/news/pessimism-among-uk-businesses-almost-doubles-eu-vote-231250775--business.html?ref=gs>
  - The survey was conducted by YouGov (<https://today.yougov.com/>) and the UK Centre for Economics and Business Research (CEBR) (<http://www.cebr.com/>)
- The overwhelming consensus of economic experts is that there will be significant negative consequences for the UK and the EU and somewhat less significant consequences for the rest of the globe.
- However, this kind of event is so unprecedented that all predictions must be viewed with some skepticism. The only certain prediction is that Brexit has introduced uncertainty into the world's economy and uncertainty is generally bad for business and entrepreneurship.
- Brexit, and other political events have also revealed a populist appetite for more protectionist policies. Much of the economic progress that we have seen in the last 50 years has been due to the elimination of protectionism and the move toward more democratic governments and freedom of individual movement.
- Entrepreneurship is certain to be more challenging in the next decade, but (as I already noted) the uncertainty also creates opportunity for those who see it and are willing to take the risk.
  - One caveat added here is that some of the risks may be legal and/or moral risks.

## In Conclusion

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- We have traced the history and controversy around trade theory since Adam Smith wrote *Wealth of Nations* in 1776 and introduced the theory of absolute advantage.
- David Ricardo then introduced the theory of comparative advantage in 1817.
- During the great depression of the 1930's, Joan Robinson developed scathing critiques of both approaches.
- Later economists have developed more refined approaches, but there remains controversy over the benefits of free trade.
- Most see that free trade is an overall positive experience for a nation and the globe, but it is also apparent that some segments of society benefit more than others and some segments feel more of the negative effects.
  - The consensus is that free trade needs to be accompanied by policies that share with the disadvantaged segments some of the benefits reaped by the advantaged segments.
- Free trade has been a huge benefit for global entrepreneurship.
- The rise of worldwide populist sentiments against free trade and liberal immigration policies will be a equally large challenge for global entrepreneurship, but will also present some opportunities for those alert to solutions and willing to assume the risk.

# Reading links in order of appearance

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- [https://en.wikipedia.org/wiki/Trans-Pacific\\_Partnership](https://en.wikipedia.org/wiki/Trans-Pacific_Partnership)
- <http://www.nytimes.com/2015/10/06/business/trans-pacific-partnership-trade-deal-is-reached.html?smid=fb-nytimes&smtyp=cur>
- [https://en.wikipedia.org/wiki/Absolute\\_advantage](https://en.wikipedia.org/wiki/Absolute_advantage)
- [https://en.wikipedia.org/wiki/David\\_Ricardo](https://en.wikipedia.org/wiki/David_Ricardo)
- [https://en.wikipedia.org/wiki/Joan\\_Robinson](https://en.wikipedia.org/wiki/Joan_Robinson)
- <https://en.wikipedia.org/wiki/Mercantilism>
- <https://www.bostonglobe.com/ideas/2016/03/15/fair-hits-free-trade/yDOWlfMvtvRTB3nyMlmtO/story.html>
- <http://www.economist.com/news/united-states/21695855-americas-economy-benefits-hugely-trade-its-costs-have-been-amplified-policy>
- <http://www.economist.com/news/finance-and-economics/21690073-globalisation-can-make-everyone-better-does-not-mean-it-will-trade>
- <http://www.ddorn.net/papers/Autor-Dorn-Hanson-ChinaShock.pdf>
- [https://www.linkedin.com/pulse/jeff-immelt-says-relationship-between-business-government-daniel-roth?trk=eml-b2\\_content\\_ecosystem\\_digest-hero-14-null&midToken=AQHfzfnFZ2zihcw&fromEmail=fromEmail&ut=2ogbOCTWwRODk1](https://www.linkedin.com/pulse/jeff-immelt-says-relationship-between-business-government-daniel-roth?trk=eml-b2_content_ecosystem_digest-hero-14-null&midToken=AQHfzfnFZ2zihcw&fromEmail=fromEmail&ut=2ogbOCTWwRODk1)
- [https://en.wikipedia.org/wiki/United\\_Kingdom\\_European\\_Union\\_membership\\_referendum,\\_2016](https://en.wikipedia.org/wiki/United_Kingdom_European_Union_membership_referendum,_2016)
- <http://www.economist.com/news/business/21701659-firms-fret-eu-without-britain-will-be-protectionist-and-over-regulating-german-business>
- <http://www.nytimes.com/2016/06/27/opinion/this-is-just-the-start-of-the-brexit-economic-disaster.html>
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- <http://www.forbes.com/sites/baininsights/2016/06/29/the-potential-impacts-of-brexit-on-the-global-economy/#1bacaab20e00>
- <http://www.economist.com/news/finance-and-economics/21701501-economists-who-foresaw-backlash-against-globalisation-consensus?fsrc=scn%2Ffb%2Fte%2Fpe%2Fed%2Ftheconsensuscrumbles>