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## IS THE WORLD RETREATING FROM GLOBALISATION?

James W Dean and Vivek Dehejia

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## Is the World Retreating from Globalisation?

### Abstract

The past two centuries have witnessed growth in international trade along with a spread of liberal ideas and democracy across countries. This paper provides a brief history of the rise of Anglo-American liberal values and globalisation that coincided with the rise of Great Britain and then the United States as successive global hegemon. The paper suggests that elite support for and embrace of globalisation – including dimensions such as free movement of people, ideas, and technology – brought many benefits. However it has also resulted in populist resentment against falling wages, stagnating middle class incomes, and immigration in western liberal democracies. This phenomenon can help explain the support for and victory of new US President Donald Trump, whose policy proposals in the campaign targeted illegal immigration and trade agreements such as the North American Free Trade Agreement (NAFTA). The paper discusses the likely cost and benefits of Trump’s unfolding policy agenda. It also examines Trump’s fiscal and monetary policies, highlighting similarities between Trump and former US President Ronald Reagan. The paper concludes on the optimistic note that a pragmatic Trump’s focus on infrastructure spending may provide a boost to growth and job creation.

## Is the World Retreating from Globalisation?

### (1)

Our twin theses are these: First, over the past two centuries, most of the world's people have gained more freedom to choose what they buy and sell, and from whom they buy and sell it. This includes their own labour. Second, most of the planet's people have gained more freedom to choose their own governments.

Of course, there are dramatic geographic exceptions to these economic and political gains. And, over the past two hundred years, these gains have come sporadically rather than continuously; in other words, they have come in severe fits and starts.

In the jargon of economics: over the past two centuries, people have gained access to free(r) trade, both nationally and internationally. In the language of politics, people have gained the freedom to decide who governs them. In short, the world has gradually globalised, and it has gradually become more democratic.

But the rub is that even as economic intercourse has become more globalised, governments have not. In both democracies and dictatorships, voters continue to choose national governments rather than international or supra-national governments. Trade has become international, but government has remained national, little different from when the Westphalian nation-state was conceived centuries ago.

Globalisation has always threatened localism. Localism is, in effect, the antithesis of globalisation. And democracy – meaning rule by the people – tends to vote for local interests, or at most national interests. So we should not be surprised that localism – or at least nationalism – seems to be breaking out all over the planet.

We should also not be surprised that populism – which means, in its best sense, serving ordinary people rather than elites – is also breaking out all over the planet. Populism may arise within democracies such as the United States or Europe, within states that purport to be democratic but in practice suppress opposition, such as Russia and much of Eurasia, or in out-and-out one-party states like China.

Here we offer a “potted” history of the ups and downs of globalisation over the past century or two. We will then suggest why globalisation is presently threatened by nationalist and populist forces in many important parts of the world. Our thoughts today have in some ways been presciently prefigured by our

previous work on the topic — in particular, a lecture on the “paradoxes and puzzles of globalisation” that one of us (Dean) presented as a Festschrift lecture back in 2006.<sup>1</sup>

## (2)

If by globalisation we mean international trade in products and international flows of money, it reached a peak in the early 20<sup>th</sup> century, just before the First World War. For example, grain was traded daily between the world’s major producers, which were the US, Canada, Argentina and Ukraine. Argentina was richer than all of them except the US. Because communication by telegraph was well established, bids and offers for grain were sent and received almost instantaneously, and prices were thereby established on the Chicago Mercantile Exchange. Traders telegraphed buy and sell orders and a “spot” price was established, and so was a “future” price. So it is wrong to think that “derivatives” are something new. The Chicago futures price for commodities like grain all over the world was already active in the 1890s.

For most of the 19<sup>th</sup> century Britain was the most affluent country in the world, until in 1900 the US surpassed Britain in per capita income. Britain’s prosperity was the result of its leading role in the industrial revolution, but its prosperity was underpinned by a world order based on international trade and domination of sea routes by the British navy. The international trade was not necessarily free — anyone who knows the history of Britain’s colonization of India knows that — but it did underpin Britain’s prosperity, and to the extent it was free it benefited its trading partners too.

The 19<sup>th</sup> century “small – l” liberal world order crashed in 1914 with the onset of the First World War. After the war ended in 1918, the world devolved into nationalism, populism, and frozen international flows of goods and money, and then, from 1939 to 1945, was engulfed in another World War that was truly global in the sense that it extended well beyond Europe into Japan’s sphere of influence over swathes of Asia. The volume of international trade as a percentage of world

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<sup>1</sup> See James W Dean, “Paradoxes and Puzzles in our Globalized World”, Carleton Economics Papers, 2006, number 7, available here: <http://carleton.ca/economics/wp-content/uploads/cep06-07.pdf> . See also James W Dean and Vivek H Dehejia, “Optimal Globalization and National Welfare”, Carleton Economics Papers, 2004, number 17, available here: <http://carleton.ca/economics/wp-content/uploads/cep04-17.pdf> . Finally, see James Dean and Vivek Dehejia, “By ignoring free trade’s excesses, we lost those on the margins”, Globe and Mail, August 27, 2016, available here: <http://www.theglobeandmail.com/report-on-business/rob-commentary/by-ignoring-free-trades-excesses-we-lost-those-on-the-margins/article31582106/> .

income did not return to its pre-World War 1 levels until well after World War Two ended in 1945, roughly 1960-65.

### (3)

So where are we now? Since 1945, we have once again enjoyed a liberal world order – both “small l” (free trade) and “big L” (the welfare state) – this time underpinned by American prosperity and nuclear-backed air power rather than British prosperity and sea power. The United States was one of two superpowers until 1990, when the Soviet Union abruptly imploded after the prophetic fall of the Berlin Wall in 1989.

Scholars like Francis Fukuyama pronounced that 1990 witnessed the “end of history”, by which he meant that from then on we would all be “reading from the same page”: no more conflicts over ideology. Henceforth, we were all small l liberals who believed in free international trade in both goods and money, and in free elections<sup>2</sup>: in short, globalisation and democracy.

Anglo-American liberal values had won the war. And all of this was underpinned by American overwhelming military superiority – America was now hegemonic, the world’s only superpower, or, indeed, a “hyperpower”. And we had entered an era that some described as “hyperglobalisation”.

The Achilles heel was that there was no agreement about how far globalisation should go. Nor was there agreement about how far government should go – in other words, whether we wanted a big L liberal, Scandinavian world of high taxes and social welfare or a small l libertarian world of minimal government doing little except to protect borders, property rights, and the rule of law. These issues were considered secondary to the fact that we all believed in the limitless virtues of free trade and free and freely contested elections – and all the attached apparatus of democracy such as free speech and a free press. The formerly Communist world, notably Russia, agreed to this too. China was well on its way to embracing free trade, although not free elections.

America’s new hegemony was at its peak in September 2001, when Islamic extremists flew two airplanes into the Twin Trade Towers in New York, killing over three thousand people. And it was America’s extreme over-reaction – in particular, the misguided and mismanaged invasion of Iraq in early 2003 – that

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<sup>2</sup> See Francis Fukuyama, *The End of History and the Last Man*, Free Press, 1992.

began the unraveling of American hegemony, the results of which we are witnessing right now.

The election of Donald Trump is a direct result of that loss of respect for the United States in the world. It may – or may not – lead to an unraveling of the liberal world order that we have enjoyed, off and on, since the *Pax Britannica* period that began with the defeat of Napoleon in 1815 and which was then supplanted by *Pax Americana* a century and a half later.

#### (4)

What is happening to the liberal world order? Its two core components are globalisation and democracy, and both are currently under attack.

Globalisation embraces not only free movement of goods, services, and money, but also ideas, technology, and, theoretically, people. The populist revivals we are experiencing in the United States, Great Britain and continental Europe in large part protests against all these dimensions of globalisation.

In the United States, these populist protests are often against cheap imports from China that are blamed by Trump and his supporters for the “rust belt” – the dying pre-Silicon Valley old-technology towns like Buffalo, Cleveland, Detroit and Pittsburg that produced steel and automobiles, and that provided good secure jobs for high school graduates, and that made America’s middle class richer and richer until the mid 1970s, after which “blue collar” wages stopped increasing and income disparities began to widen.

The populist protests against cheap imports persist despite the fact that most of the widening income gap between the top ten percent and everyone else is *not* fundamentally due to cheap imports from China but due to the fact that China and now other countries like Vietnam and Bangladesh can produce everything from cars to clothing much more cheaply than can the first world, simply because unskilled labour is so much cheaper.

Moreover, the populist resentment against falling working class wages and stagnating middle class incomes is now increasingly focused not on cheap imports of goods and services, but on immigration, especially in Britain and Western Europe. To put this in perspective, immigration has long been blamed for falling wages in the US even more than in Europe, but a large body of academic research over the past two decades has shown that instead of immigration, or international trade, it is new versus old technology –

information technology (IT) versus steel and automobiles – that is to blame for stagnating wages.

Indeed, research in the mid 1990s by one of us (Dehejia) and the economist Jagdish Bhagwati helped to establish the academic consensus that technology, not trade or immigration, is the real culprit in explaining wage stagnation and rising income inequality in the United States.<sup>3</sup> That consensus has come under attack in recent years, with some widely publicized research suggesting that international trade, in particular China's rise as a global trading power, might be a bigger culprit than we had thought.<sup>4</sup> It remains for scholars to sift this new research, but the jury still is out on those who claim that some of us unfairly gave trade a free pass in the wages and inequality debates of the 1990s.

## (5)

And now, enter Trump. Trump's populist appeal is primarily to working class white men who have been left behind by the shift from old to new technology in our new economy that is driven by IT and high finance. His policy proposals start with dramatic promises to stop illegal immigration (such as building a wall across the border with Mexico), block cheap Chinese imports (a 45% tariff against Chinese goods?), tear up trade agreements like the North American Free Trade Agreement (NAFTA) – which covers more trade with Canada than with the Mexico – and also block the passage of other trade agreements such as the “mega-regional” Trans-Pacific Partnership (TPP).

At the time of writing (late January 2017), Trump has begun to act on some of these promises, in particular the “wall” against Mexican illegal immigration, curbing immigration from Muslim countries, and formally withdrawing the United States from TPP, revealing that these were not just merely campaign pledges intended to be honoured in only the breach.

On the simple grounds that so much American trade is with its northern and southern neighbours, with which it has intricate economic and other sorts of

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<sup>3</sup> See Jagdish Bhagwati and Vivek Dehejia, “Freer Trade and Wages of the Unskilled: Is Marx Striking Again?”, in J. Bhagwati and M. Koster, editors, *Trade and Wages: Levelling Wages Down?*, AEI Press, 1994. A working paper version of the chapter appeared as Columbia University Department of Economics Discussion Paper No. 672, 1993, and is available here: [http://www.columbia.edu/cu/libraries/inside/working/Econ/ldpd\\_econ\\_9394\\_672.pdf](http://www.columbia.edu/cu/libraries/inside/working/Econ/ldpd_econ_9394_672.pdf).

<sup>4</sup> See, for instance, David H Autor, David Dorn, and Gordon H Hanson, “The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade”, NBER Working Paper No. 21906, January 2016, available here: <http://nber.org/papers/w21906>.

relationships, tearing up NAFTA would almost surely be lose-lose for the United States as well as for Canada and Mexico. By contrast, renegotiating NAFTA could, in theory, improve the impact of these agreements on the middle class if the United States extracts further concessions from Canada and Mexico. However, while the distribution of gains might be improved in favour of America, the total quantum of gain is unlikely to increase, and may even decrease, if any renegotiation, in effect, rolls back the trade liberalization component at the core of NAFTA.

TPP is a trickier proposition. By nature, it was intended not principally as a trade agreement but an agreement intended to foster “deep” integration across a wide range of “beyond the border” issues, including contentious ones such as intellectual property protection (IPP). There is little enthusiasm for TPP from genuine advocates for freer international trade which falls under the rules-based, multilateral World Trade Organization (WTO), one of the lynchpins of the postwar liberal global order.<sup>5</sup> Indeed, TPP represents the sort of over-reach into “hyper-globalisation” – on terms intended to benefit, principally, American corporate interests which lobbied heavily for it – that we do not need. Thus its demise is not one that we will mourn, and here, ironically, Trump is on the side of genuine free traders, albeit perhaps for the wrong reasons.

By contrast, a 45 percent tariff against Chinese or any other country’s imports is almost certainly lose-lose.

Immigration restrictions, in turn, are much harder to evaluate for several reasons: because gains, if any, may be intergenerational, because very large volumes of migration in a short span of time can test infrastructure, and because the “terror threat” from poorly vetted immigrants is very hard to predict. At its economic core, the issue is whether immigrants contribute more to the host country’s gross domestic product (GDP) than they take in terms of social welfare, broadly defined.

In sum, whether Trump’s policies on trade and immigration end up being as bad as the fear mongers have suggested will depend on which Trump prevails: the unabashed populist, some might say demagogue, who revels in the support of his white blue collar base, or the pragmatic dealmaker and seasoned businessman.

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<sup>5</sup> For further elaboration of this argument, see, for instance, Vivek Dehejia, “Trade and national interest”, *Mint*, October 12, 2015, available here: <http://www.livemint.com/Opinion/X6oSIbbiPwD0euvpno9HMO/Trade-and-national-interest.html> .

The fearful scenario is that Trump will play to his base, whether he quite believes the economics of tearing up trade deals and slashing immigration or not.

The happier scenario is that the pragmatic Trump will prevail, and realize that a re-writing of NAFTA, even a cosmetic one, will be far better than tearing it up. The pragmatist Trump will also realize that an immigration policy which focuses on curbing illegal immigration and perhaps reducing refugee flows from failing states in the Middle East and elsewhere, while allowing well regulated legal immigration of skilled workers to continue at more or less present levels, will ultimately serve his own political constituency best of all. But it is, as yet, too early to tell which Trump will show up.

Interestingly, in what may turn out to be prescient remarks, the former Prime Minister of Canada, Stephen Harper, suggested recently that we are likely to get Trump the pragmatist rather than Trump the (self-)destructive populist. In an address at a major foreign policy conference in New Delhi in January 2017, Harper argued that a pragmatic Trump — one who takes a transactional, hard-nosed approach to American foreign policy, focused on securing the American national interest — might, in the long run, be better for America’s global partners than an ideologically driven policy which lurches from the over-reaching assertiveness of President George W. Bush and his “neo-conservative” advisers, to the self-criticism and inward turn of the Liberal President Barack Obama.<sup>6</sup> If this logic applies to domestic economic policy, too, the outcome may be more benign than many expect. It is too early to say anything definitive.

So is there anything unambiguously promising about Trump’s economic program, one that is both populist and pragmatic and a win-win for America and the world? Yes there is — at the time of writing, the United States Senate was about to begin debating a very large infrastructure program. This stems from a proposal at the top of the agenda in Trump’s acceptance speech after winning the general election in November 2016.

Infrastructure — ranging from highways to bridges to airports to affordable higher education — would be a much-needed investment in tomorrow’s America. That’s from the supply side. On the demand side, many worry that the spending necessary to sustain growth may be subject to “secular stagnation”, a term coined by Harvard economist Alvin Hansen during the Great Depression and more

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<sup>6</sup> See “Keynote Address of Stephen Harper”, Raisina Dialogues 2017, available here [video]: <https://www.youtube.com/watch?v=QHUnhTXA2CE>.

recently revived by another Harvard economist and former Secretary of the Treasury, Lawrence Summers.

Thus, Trump, like Reagan, may end up being a “closet Keynesian”, even though the avowed rationale for Trump’s economics, as for Reagan’s, derives from the “supply side economics” of Nobel economist Robert Mundell and his former student Arthur Laffer.<sup>7</sup> This might happen if the demand side kick of the combination of increased spending and tax cuts ends up dominating the long run productivity gains coming from the supply side, as many Keynesians believe was the case with Reagan’s economic policies.

Another sense in which Trump’s economics may mirror that of Reagan’s is in the push for sound monetary policy — in Trump’s case, to normalize monetary policy by winding down “unconventional monetary policies” (UMPs) and begin returning interest rates to more normal levels and away from the zero lower bound above which they have hovered since the Great Financial Crisis of 2008, much as Reagan gave then Federal Reserve chair Paul Volcker the green light to raise interest rates and slay the dragon of inflation. Trump flagged this priority as early as the second presidential debate with Democratic candidate Hillary Clinton in the fall of 2016, in which he was critical of the asset price bubbles and other distortions that the Fed’s low interest rate policies were causing, in his view.

Indeed, if Trump’s fiscal policy proposals significantly increase inflationary expectations, which seems to be in the offing, there will be a natural impetus to raise the policy interest rate even within the context of an orthodox inflation targeting monetary policy framework. In fact higher inflation expectations should in and of themselves push nominal interest rates higher.

Thus, the advent of Trump may provide the much needed exit from UMPs that eluded last Fed chair Ben Bernanke and has thus far eluded the current chair, Janet Yellen. The magnitude of what needs to be done should not be underestimated: in the aftermath of the Great Financial Crisis, the balance sheet of the Fed mushroomed from about \$800 billion at the outset to about \$4.5 trillion now. There is a lot of unwinding that remains to be done, and it remains to be seen whether it will be done under the watch of Yellen or her successor, whom President Trump will appoint in 2018.

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<sup>7</sup> See James W Dean, “The Trump plan that dare not speak its name”, Mint, December 1, 2016, available here: <http://www.livemint.com/Opinion/wTNHgsN3cUZml7SwUU2nFK/The-Trump-plan-that-dare-not-speak-its-name.html> . See also Vivek Dehejia, “A return to Reaganomics?”, Mint, November 15, 2016, available here: <http://www.livemint.com/Opinion/LY0HLSBI149I9utUZjMg6J/A-return-to-Reaganomics.html> .

As for Trump's ambitious spending plans, if he can get them through a potentially recalcitrant Congress, they may indeed provide a stimulus to growth in the short run as well as a boost to productivity in the long run. And, apart from providing a much needed kick-start to anaemic global growth, this economic boost may create jobs for many of those white working class men who voted him in to office in the first place.