

# Free Trade and the Polanyi Critique

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# Takeaways

- The Coase Theorem is a way to solve collective action problems in a way that avoids state intervention
- Free Trade is economic liberalism on a global scale
- The theory of comparative advantage supports the argument for free trade
  - Updated by Heckscher-Ohlin

# What is this person known for?



- (He looks a bit like his cat!)



# Beyond Ricardo's Comparative Advantage: more choice, fewer goods

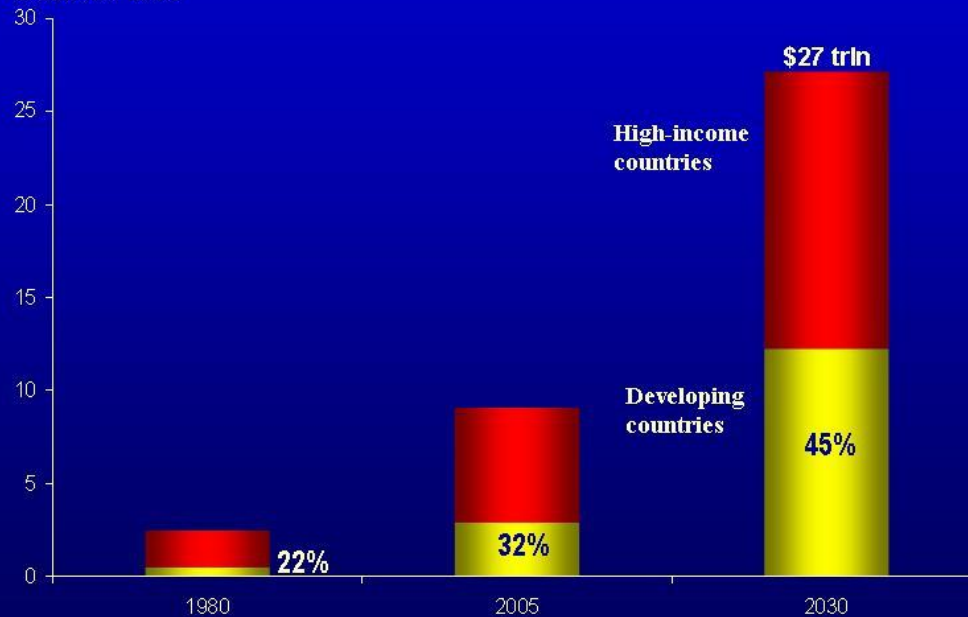
- Consumers want variety
- But tradeoffs between variety and cost of production—the lower the cost, the less variety
- Because of economies of scale
- Trade gives the consumer more variety but the world produces fewer varieties of each good
- Fundamental Fact of globalization
- There are 2 identical countries: They don't trade
- Country 1 produces A, B, C.
- Country 2 produces X, Y, Z
- = 6 varieties produced.
- Consumers only get three
- Then they trade....
- Production scales and concentrates –some brands knocked out : inefficiency!
- Now A, B, X, Y are produced and available in both countries
- Consumers get 4 choices.
- But only 4 varieties are produced.

# Free Trade leads to growth in Exports: Biggest growth in Developing countries

## Globalization increases developing countries share in world trade

Exports from developing and developed countries, 2005-2030

US\$2001 trln.



Source: World Bank simulations with Linkage model.

# Comparative Advantage is Dynamic



# Sum: Effects of Free Trade

- Efficiency → Growth → Good life for everyone
- Harmonious International Relations
- Role of the State: To let producers produce most efficiently—to separate politics and economics:
- the key actors for liberals are firms and consumers, not states.
- Commerce → Peace Why?
- Efficiency should be the basis of all political relations
- Does Free Trade make the state obsolete in international relations?

# Freedom as Purpose: Econ. Liberalism

Key Assumption is the rational self-interested individual who wants Freedom

*voluntary exchange. It's Human Nature!*

(no cooperation/collective action needed)

Price Mechanism (information about value+ lowers transaction costs)

Competition among producers

Innovation + specialization → division of labor

Comparative Advantage in exchange

Efficiency → Growth → Better life for all



# Criticizing assumptions

- Rationality does not always determine decisions
- Collective action is possible but even if the Coase theorem holds, state intervention is needed to enforce it.
- But not necessary for free trade
- New Critique: Polanyi
  - Markets aren't natural
  - They destroy community

# Polanyi attacks the causal chain of economic liberal thought

- Attacks core assumptions of economic liberalism: natural self interest and natural, self-regulating markets
- Argues that
  - Human behavior is motivated by social goals
    - greed and “rationality” are not “natural”
  - The market not “natural”
  - **His evidence is historical**

And because market behavior is  
Not “natural” it had to be imposed!



# Pre-Market Societies



- No Private Property
- No Money economy
- No “possessive Individualism
- No Markets

# Embeddedness of the Economy in Society



• Society

Economy

# Pre-market societies

## Society

- Mutual obligations
- Self-sufficiency
- Land is a gift from God
- Guilds
- Values: do what keeps the community  
Together, Justice

Economy  
• Minimal  
profits,  
competition