Confessions of a Neoliberal

"Should We Still Support Untrammeled International Capital Mobility? Or Are Capital Controls Less Evil than We Once Believed?" by J. Bradford DeLong, in *The Economists' Voice* (Issue 1, 2004), www.bepress.com/ev.

As a dewy-eyed neoliberal economist in the early 1990s, DeLong was an enthusiastic proponent of encouraging governments in the developing world to lift controls that prevented capital from flowing to and from their countries. The logic seemed impeccable: Foreign investment had helped the United States and other "developing" countries in earlier times, and now it would help today's developing countries.

"Working at the U.S. Treasury [as deputy assistant secretary] in 1993, I naively projected that after NAFTA, there would be a net capital flow of some $10 to $20 billion a year to Mexico for decades to come." New capital did indeed go to Mexico, as did new export industries and other benefits, but more capital left the country than entered it—a pattern that has been repeated in many other developing countries. Ironically, the United States is by far the biggest magnet for this money, much of it from investors seeking safety. Overall, the developing world is sending some $90 billion annually to the United States.

At the same time, the predicted increase in investment by the world's richer countries never fully materialized, thanks in part to the hair-raising financial crises in Mexico (1995), East Asia (1997), and Russia (1998). As those crises illustrate, greater international capital mobility has left poorer nations more vulnerable to the sudden and devastating withdrawal of capital when sentiment shifts. And it has increased international economic inequality.

For all his regrets, DeLong, who now teaches at the University of California, Berkeley, still favors only "the most minor of controls to curb the most speculative of capital flows." Under the old system, governments in the developing world controlled investment in their countries. Not only did they do a bad job, but the opportunity to manipulate the rules inevitably led to political corruption. That seems decisive to DeLong: "In the end, we may have to tolerate the equality-lessening reverse flow of capital, in order to promote the equality-increasing and wealth-increasing diminution of corruption in less developed countries."

Distance Isn't Dead

"Trade Costs" by James E. Anderson and Eric van Wincoop, in *Journal of Economic Literature* (Sept. 2004), 2014 Broadway, Ste. 305, Nashville, Tenn. 37203.

It's easy to assume, in our age of instant communication, that goods travel around the world with nearly the speed and ease of e-mails. But they don't. They need to be shipped, jump trade barriers, cross borders, and be distributed in a recipient country. According to Anderson and van Wincoop, economists at Boston College and the University of Virginia, respectively, the picture that emerges from recent research points to surprisingly high costs for international trade. In the industrialized countries, these costs amount to roughly the equivalent of a 170 percent tax. In developing countries, the costs may be more than twice that.

Imagine a doll that costs $1 to manufacture. The authors calculate that it costs an additional 21 percent to transport it to a customer country. That makes $1.21. Then tack onto that 44 percent for "border-related trade barriers"—partly tariffs, but mostly language, security, and currency exchange costs. That boosts the cost to $1.74. Finally, add 55 percent more for the wholesale and retail distribution costs involved in getting the doll into the hands of a child. That brings the final cost (excluding profits and nontrade costs, such as merchandising) to $2.70.

Anderson and van Wincoop are mostly concerned with the surprisingly difficult mea-