Free Trade is Not Free:
Why Deglobalization is (Unfortunately) Here to Stay

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Abstract: A growing body of experts has identified the shift towards deglobalization as a major threat to both economic prosperity and the extensive international cooperation that has long characterized the "liberal world order." These experts contend that policy makers have failed to comprehend the extraordinary positive-sum nature of international trade. We call this narrative into question, and argue that free-trade advocates have frequently ignored the substantial transaction costs underpinning global commerce, especially those subsidized by the United States. We claim US policies supporting globalization after WWII were broadly consistent with the country's vital national security objectives until recently. Those broad objectives have shifted as a result of structural changes in geopolitical dynamics, technology, military costs, and the US's fiscal capacity. In sum, the costs of subsidizing global trade have been increasing, while the expected benefits of globalization have fallen. For these reasons, we argue deglobalization is here to stay.

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I. Introduction

Policy experts around the world have sounded the alarm. After an extended period of increased economic globalization, there are disturbing signs that progress on this front has not only stalled, but is now going in reverse. Global exports of goods and services, as a percentage of world GDP, peaked in 2008 and have fallen since then. Foreign direct investment shows a similar trend, reaching a high of 5.3 percent in 2007 and falling to 1.3 percent in 2020 (Rajan, 2023). Equally important, there is no longer a broad political consensus in favor of more open trade. After the failed Doha Round of world trade negotiations in 2014, there has been no concerted attempt to revitalize the push for trade liberalization. More ominously, the United States and China both seem determined to pull back from their earlier embrace of growing economic interdependence. And, the Covid pandemic revealed all too clearly the risks of distant and complex supply chains controlled by other, potentially hostile, nations.

In fact, observers are in broad agreement that the trend towards deglobalization will have profoundly negative consequences for the world economy. Over the past 75 years, increased global trade has been the pivotal factor in spreading prosperity and reducing poverty. In 1960, approximately 60 percent of the world lived in extreme poverty (defined as an individual daily income of less than 2.15 USD); by 2019, the percentage had fallen to just under nine percent (World Bank, 2022). Policies in support of trade liberalization transformed the theory of comparative advantage into a tangible reality for many nations. For those nations participating in the globalized economy, their wealth is therefore no longer determined solely by local access to natural resources, plentiful energy, arable land, and navigable waterways. In this global free-trade system, any country can, in principle, prosper by specializing in sectors in which they can compete internationally. The export revenues generated can then pay for imports the country cannot produce efficiently at home.

What, then, are the likely effects of deglobalization? The outlook looks grim. We can expect, most importantly, lower global economic growth. Less globalized trade will mean less competition, less innovation, and a drop in long-term trends in global output. For the wealthy

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nations of the world, slower growth is obviously undesirable, but it does not pose a fundamental threat to survival and human flourishing. GDP per capita for OECD Europe, for example, was approximately 44,000 USD in 2023 (IMF, 2023). The situation is starkly different in much of the world. Despite the impressive gains of the last 60 years, widespread poverty continues to plague the globe. According to the World Bank (2022), almost four billion people still live in countries with a GDP per capita of less than 7.00 USD per day. And these are likely to be the countries hardest hit by a reduction in globalized trade.

This disturbing scenario raises an obvious question: How are we to explain the widespread retreat from globalization? Why, in other words, do the world's policymakers seem willing to abandon such a highly effective method for spreading global prosperity? Policy experts have suggested two main lines of argument. Proponents of globalization argue, first, that many policymakers do not understand what is really at stake. They have failed, in other words, to comprehend the pivotal role of free trade in spreading prosperity and in fostering global peace and cooperation. The second line of argument is complementary to the first. The global surge in national populism has generated pressure on politicians to respond to the demands of disgruntled voters. The vote for Brexit and the election of Donald Trump are only the most well-known symptoms of this widespread backlash against mainstream political parties (Goodwin and Eatwell, 2018).

Both explanations lead to the same conclusion: policy makers are making an egregious error in their retreat from globalization (Posen, 2022; Prasad, 2023; Rajan, 2023; Subramanian and Freeman, 2020). Pointing to the widely acknowledged costs of protectionism, free-trade advocates argue that this policy shift is likely to seriously damage both global cooperation and prosperity. Deglobalization, they seem to argue, will generate only losers. And the poorest, most vulnerable nations of the world will be hit the hardest. To accept—or worse, embrace—deglobalization is thus the result of a deeply flawed analysis that must be corrected before it is too late.

Our main objective is to challenge this broad consensus on the underlying causes of deglobalization. We believe the pro-trade experts have underestimated the importance of shifting parameters underlying international trade, particularly in terms of transaction costs. They have

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subsequently made a logical error in attributing recent policy decisions rolling back globalism to ignorance or misguided national populism. Our argument proceeds by defining “globalization” and “deglobalization” in section II. We discuss what we view as the logical error concerning policymakers’ intentions that many pundits seem to make in section III, and we present our argument concerning transaction costs in section IV.

II. Empirical Developments in Deglobalization

“Globalization” typically refers to the substantial increase in world trade, especially from about 1970. International trade grew—in real terms—from 0.45 trillion dollars in the early 1960s to 3.4 trillion dollars by 1990, a factor of seven (Bernhofen et al., 2016: 36). Its path, measured as “trade as a share of total world GDP,” continued on a strong upward trajectory until roughly 2008-2009, years which correspond to the Global Financial Crisis. Figure 1 plots “trade as a share of GDP” for the entire world. “Trade” is defined as the addition of a country’s exports and imports (as a percentage of GDP), so the vertical dimension in the figure reflects the world average of each country’s $\frac{[\text{Exports}_i+\text{Imports}_i]}{\text{Country } i'\text{s GDP}}$. This ratio is also known as the “trade openness index.”

The globalization pattern is clearly evident in the “world” data series in Figure 1. Trade “openness” increased from 25 percent in 1970 to 61 percent in 2008. The rise in global supply chains meant that increasing numbers of countries could benefit from comparative advantages and specialization: many countries, not least among them China, substantially increased their per capita incomes and many others enjoyed considerably lower-cost consumer products as a result of this increased trade. This scenario largely describes the “win-win” description of foreign trade described by its proponents.

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Figure 1: Trade Openness Index: World Trade/World GDP, 1970 to 2021

Source: OurWorldInData.org from World Bank and OECD data.

Scholarly attention has focused on two broad causes for increased trade: changes in technology, and changes in trade policy. In simple terms, technological advancements in transportation and communication manifest as reductions in transportation costs. For example, the adoption and growth of shipping containerization, the beginning of which Bernhofen et al. place at 1966, is often cited as a principal cause (2016: 36). Improved data collection, analysis, and transmission helped launch the revolution in improved logistical control. We return to a critically overlooked aspect of transaction costs in section IV.

The second broad category responsible for the increase in world trade, liberalized trade policies around the world, are manifested in the proliferation of specific trade agreements, such as the World Trade Organization (WTO) in 1995 (Hanson, 2024: 164). These policies provided a framework for negotiating international trade relations, and eventually provided the "rules of the game," which nations were meant to follow in this grand international exchange of goods and services. It has been argued this framework encouraged cooperation in trade negotiations among nations (Anderson, 2016; Goldstein et al., 2007).

However, the momentum of world trade began to decelerate after the 2008-09 financial crisis. The crisis triggered a global economic downturn, which led to a contraction in demand and trade volumes. As credit conditions tightened, consumer spending plummeted; meanwhile increasing risk aversion reduced investment, and businesses scaled back their production and

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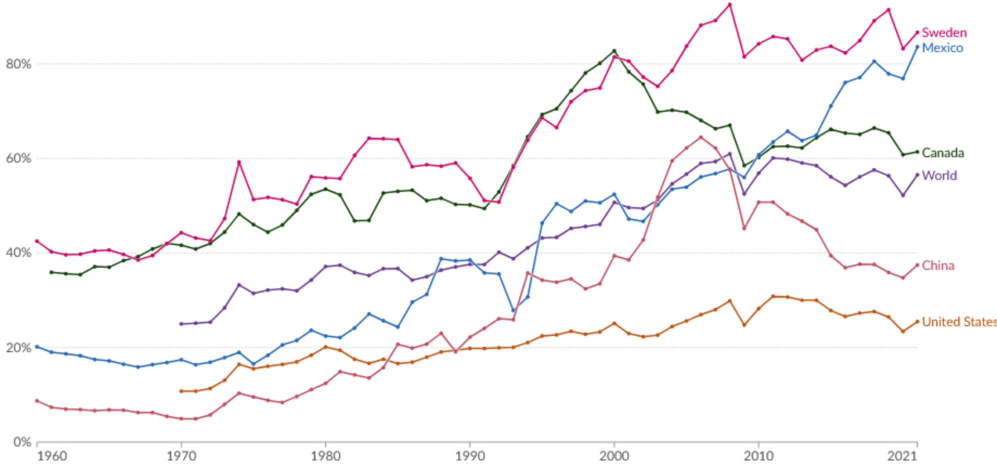
supply chain activities. The crisis also prompted some countries to adopt protectionist measures to shield domestic industries. Following the initial shock of the financial crisis, the volume of world trade nearly regained its pre-crisis level in 2011. However, while the global economy gradually recovered, the rate of trade growth remained subdued relative to the pre-crisis period: the peak in trade-openness therefore remains stalled in 2008.

The term "deglobalization" is largely used in reference to this slowing growth in world trade. While the reduction in absolute levels of trade openness is not large (61 percent in 2008 versus 56.5 percent in 2021), it is clear that something substantial has happened to the *momentum* in greater trade openness since 2008. Figure 2, which plots several countries' openness indices, also shows a shift in specific countries after about 2008. While the United States' openness has remained relatively steady in the low- to mid-20 percent range, several countries' indices, such as China's and Canada's, have fallen precipitously. An exception to this trend is, of course, Mexico, which has experienced increased trade, particularly with the rest of North America. We turn to the pundits' evaluation of that change, as well as ours, in the next section.

Figure 2: Trade Openness Index: World Trade/World GDP, 1970 to 2021 (world and various countries)



Source: OurWorldInData.org from World Bank and OECD data.

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III. The Experts' (Flawed) Analysis of Globalization/Deglobalization

Our argument concerning the flawed analysis of globalization/deglobalization begins by carefully separating three distinct claims that are often collapsed into one. Claim 1 is a straightforward empirical claim: globalization is the most effective way to maximize global economic output. An ancillary point, which is commonly included, implies that globalization is a universal win-win—or "everyone wins"—phenomenon. Deglobalization, in contrast, implies "everyone loses." We are in general agreement with the expert consensus on the first part of Claim 1: free trade is the most effective way to promote growth, reduce poverty, and broadly improve standards of living. We also accept the converse of this claim: a retreat from globalization will lead to negative economic, social, and likely political consequences. The frequently-implied claim that "everybody wins" is, however, problematic, a point we return to below.

Claim 2 is a normative, rather than an empirical, claim. At its core, many pro-trade experts seem to imply that because globalization is an effective means to maximize global welfare, policymakers *ought* to universally embrace policies that promote globalization. We will declare ourselves agnostic on this particular moral-philosophic claim, as our principal concern here is not with what policymakers *ought* to do, in some idealized sense.

Our fundamental objection is neither to Claim 1 nor Claim 2, *per se*. We believe mainstream proponents of globalization engage routinely in an analytical sleight of hand that combines (empirical) Claim 1 and (normative) Claim 2 to generate a third (empirical) claim regarding the *motivation* for both pro- and anti- globalization policies: it is this motivational claim that seems to form the basis for their views that current policy, which is moving away from globalization, is flawed. At the core of Claim 3 is the (often implied) stance that—in the past—national policymakers actually were specifically promoting pro-globalization in order to improve world living standards. From this perspective, *the retreat from globalization can only be understood as an irrational policy error* based on either (i) a failure to fully understand the arguments in Claim 1, or on (ii) political pressure from narrow-minded populists. We reject the empirical Claim 3, and argue such a view misdiagnoses the current policy environment.

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Our rejection of Claim 3 is based on "Hume's guillotine" (Hume, 1739)—conflating the "ought" with the "is"—which is often considered to be a subspecies of the naturalistic fallacy.[1] Economists should be intimately familiar with Hume's admonition in the guise of the "positive-normative" distinction. Positive (or "empirical") claims, we tell our introductory students, are synonymous with "facts:" these are, in other words, the *is*. In the case of positive *theory*, we attempt to explain the interaction of social phenomena by explaining the nature of "how *x* impacts (or causes) *y*," not "how we would like *x* to impact *y*." We have no intention of suggesting normative claims are improper or inadmissible, merely that we should not conflate—or worse, disguise—the normative with the positive.

Normative positions are often deeply embedded in—and confused with—positive analyses. A glaring example can be found in public finance theory that preceded the public choice movement. The earlier tradition of public finance routinely obscured the *ought* with the *is* by subtly shifting between the implication that government *ought* to correct market failures to assuming—and widely propagating—the notion that government actually *does* correct market failures (Buchanan, 1984). This intellectual slight-of-hand has generated untold confusion both within, and outside of, economics about the nature of state action. The entire public choice enterprise can well be understood as a methodological attempt to re-establish a clearer division between normative and positive models of the state.

Thus, simply identifying that policy *x* will cause outcome *y*, where *y* is deemed valuable, does not mean policymakers will actually pursue policy *x*, or that they even intended *y*, had they pursued *x*. This insight is related to the more familiar "unintended consequences" notion, or the idea that simply because *y* occurred hardly proves it was intended.[2] In fact, this line of reasoning is considerably more consistent with basic economic intuition—especially that of public choice—than one that assumes past policymakers were actively involved in maximizing some

[1] Hume's discussion of the matter is found in Book 3, Part 1, Section 1, or in the reference reprint [1896: 469]. The concept is referred to as a "guillotine" because it proposes to sever *descriptive* statements from *prescriptive* ones. Much of the remainder of our explanation on Hume's guillotine is taken from Jakee and Spong (2003: 82-83).
[2] In other words, Hume's problem of confusing the *ought* with the *is* has much in common with Adam Smith's (2007 [1776]) insight concerning "unintended consequences." For a recent treatment of Smith's emphasis on unintended consequences, see Infantino (2020). Such an intellectual overlap should not be altogether surprising, given the close relationship between Smith and Hume (see Rasmussen, 2017).

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benevolent global utilitarian social welfare function when they adopted increasingly liberal trade policies.

It appears to us that many globalization advocates have engaged in this logical error, just as scholars and policy analysts did prior to the public choice movement. In the case at hand, the pro-globalists have identified a "good"—an increase in global welfare—and assumed, or implied, that is what governments intended to pursue. To be more precise, these experts seem to imply that governments in the postwar era supported pro-trade policies *in order to* maximize something like a global utilitarian welfare function. And, the argument goes, the only reason we would now deviate from such a policy is a misunderstanding of these forces, or ill-advised populist pressure.

As noted, we fully endorse the claim that widening trade in the past likely *did* maximize such an imaginary function. The logical error is in assuming this was the actual motivation for pro-globalization policy. Our argument, which we will spell out in the next section, is that maximizing such a global utilitarian welfare function was decidedly *not* what past policymakers intended. Rather, the increase in trade was a *byproduct* of pursuing other—dare we say, less magnanimous—interests.

Put in this context, a number of issues arise in addition to the historical one that asks, "did policymakers *actually* engage in maximizing global utility during the period that globalism was on the rise?" While we return to the historical question in the next section, it is worth raising other logical problems with the "global utility max" claim. First, why would policymakers maximize something like a *global* utilitarian welfare function? Seventy years of public choice analysis would ask whether citizens would vote for such a policy, whether political leaders actually deliver such a policy, whether bureaucrats would comply with the wishes of elected leaders, and so on.[3]

Second, merely noting this is a utilitarian function raises a well-known problem with that particular ethical rule: *that there can be losers*, as well as winners, in such a "maximized" system. On this matter—and related to public choice concerns—we cannot assume that

[3] For those unfamiliar with public choice, or modern political economy, see Jakee (2022) for a brief introduction and history.

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policymakers would willingly trade away jobs in, say, Detroit factories for improved standards of living among the chronically poor in China. This is a very wide logical gulf to traverse, and it is far from clear that the historical record of actual policy objectives in the advanced democracies would support such a claim.

In sum, to point out that global GDP and living standards around the world have been increased by more liberal trade policies does not prove these welfare improvements were the actual goal of the policymakers. It is our contention that liberalization was largely a byproduct of another set of policies: thus, the massive increase in both trade and living standards was incidental to a different set of policymaking objectives. In the next section, we lay out our view of how the geopolitical landscape has changed, and particularly how underlying costs—and the United States' ability to finance them—has fundamentally changed.

IV. The Shifting Calculus of Costs and Benefits in a Globalized Economy

As noted throughout this chapter, the overall results of increased globalization have been nothing short of astounding. We have witnessed an unprecedented period of global peace, widespread economic growth, and a dramatic reduction in extreme poverty over the last 70 years. And while these developments have benefitted hundreds of millions of people around the world, the United States has managed to maintain its global dominance as "the liberal hegemon." From this vantage point, the United States' (former) embrace of globalization appears as the ultimate win-win: not only did the United States remain in a position of world dominance, but countries around the world raised their standards of living. Why, then, are we today witnessing signs the United States is no longer fully committed to this proven framework for global peace and prosperity?

We would argue there is an unacknowledged paradox at the heart of the globalized economy. The wide range of policies that make globalization possible are, in fact, the result of decisions made by sovereign countries in the pursuit of their own national interest. One need not endorse every aspect of the "realist paradigm" in international relations to acknowledge that all nations, regardless of regime type, show a marked tendency to favor the interests of their own citizens over the interests of others (Mearsheimer, 2018). While moral philosophers can make compelling arguments for why we *should* value all human life equally, both the historical record

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and casual observation clearly show that national interests remain a powerful force around the world. It is not that human beings do not care about the welfare of others; it is simply that we tend to care more about "our own people first" (Haidt, 2012).[4]

We begin by making three, arguably uncontroversial, assumptions concerning national interests in a globalized world. First, as noted, we assume all countries promote international policies that primarily serve their own national interest. If the pursuit of the national interest inadvertently contributes to the global utility function, that is a beneficial byproduct; it is not the motivation for the policy itself. The second point, which is often obscured by the positive-sum nature of global trade, is to recognize that different nations have distinctive, and sometimes conflicting, interests. Finally, nations differ dramatically in the amount of power they wield in shaping global outcomes.

The acknowledgement of national interests does not imply, of course, that distinctive national interests must lead to international conflict. In fact, much of the appeal of globalization lies in its potential capacity to transform conflict between nations into mutually beneficial exchange based on specialization and trade. But the reality of shared benefits through trade must not be conflated with the disappearance of distinctive national interests. Many advocates of globalization appear to make this error. The implicit assumption is that because a globalized economy benefits "everyone," all countries have a rational interest in embracing policies that promote globalization.

We argue a country's policy stance on globalization will always be conditional: it is based on a national assessment not only of the benefits—but also the costs—of policies required to promote and maintain globalization. A cost-benefit analysis of this magnitude can, of course, only be based on rough estimates of the short- and long-term consequences of a global trade regime. But our underlying claim does not require great precision in this regard. What matters for our analysis is only that countries have distinctive interests, and they exercise agency in favoring national interests over those of the so-called global community.

[4] Tullock (1981), incidentally, has an insightful view on such grand, international, redistributions, which starts with the assumption that people are considerably more concerned with the welfare of their fellow citizens than they are with those in distant nations, however impoverished.

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By our account, then, a crucial explanation for the *policy* retreat from globalization—in the case of the United States, in particular—is due to a change in the long-term national calculus regarding the overall costs and benefits of maintaining the globalized economy *from a US policy point of view*. While the pundits are surely correct in viewing the United States as a major beneficiary of a globalized economy, they fail to appreciate the enormous *transaction costs* inherent in maintaining a globalized economy. And, an important set of those costs have been borne overwhelmingly by the United States since WWII. We broadly review the historical role played by the United States in globalization, next.

Some historical context

The origins of the "liberal world order," and the remarkable expansion of global trade, can be traced to the end of WWII. Thanks largely to the alliance between the United States and Soviet Union, the war ended in the total defeat of Germany and Japan. But that alliance of convenience broke down very quickly. Stalin's Red Army, which bore the brunt of the fighting against Hitler's forces, was able to establish the "facts on the ground" in all the countries that had the misfortune of lying east of the Iron Curtain. As Stalin established communist puppet regimes throughout Eastern and Central Europe, the United States found itself in dire need of reliable allies who could balance the daunting power of the Soviet Union.

Faced with the complex challenges of the Cold War, the United States developed an innovative four-pronged strategy that proved remarkably successful (Ikenberry, 2011; Kagan, 2012). The United States chose to promote both the political transformation, and the economic recovery, of both Germany and Japan. Second, it sponsored the Marshall Plan in a bid to speed the recovery of war-torn Europe.[5] Third, it created a security umbrella for its European allies with the establishment of NATO. Finally, and arguably most importantly, the United States promoted international trade by maintaining global peace and by subsidizing the costs of maritime transport.

Only the United States—with its unrivalled economic and military power—has had *both the objective as well as the capacity* to take on the essential role of the global police. *The*

[5] However, see Cowen (1985) for a persuasive account of why the Marshall Plan was largely insignificant in real economics terms.

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motivation for bearing these costs was not an altruistic concern for the wellbeing of Europe or the global community. This American strategy was, in other words, decidedly not designed to maximize some global utilitarian social welfare function, but was predicated on rebuilding Europe and Japan, and cultivating enduring partnerships with former enemies and traditional allies. The fact that this policy also promoted a surge in global prosperity was therefore an unintended, and a fortuitously benign, byproduct of US national strategy.

The incidental promotion of global trade did have the effect of transforming geopolitical rivals into trusted economic partners. And, by coordinating its NATO partners, the United States hoped to deter the Soviet Union militarily while preventing the dangerous re-emergence of geopolitical rivalry among its allies. As such, we argue that US support—and direct subsidization—for globalization in the postwar period, and the hyper-globalization of the last 25 years, was the result of a unique geopolitical period in which the national benefits for the United States exceeded the costs of subsidizing that trade.

More recently, however, our analysis suggests the national interests of the United States are no longer tightly aligned with the interests of the global community. From an American calculus, the costs of subsidizing global trade are no longer greater than its own benefits from that trade. For the remainder of this section, we articulate our position concerning the costs and benefits of trade *from a national policy point of view*. This argument relies heavily on the role transaction costs play.

Transaction costs defined

While the so-called free-trade regime has made it possible for nations to utilize their comparative advantage, the concept of "free trade" is a misnomer. A large body of economic scholarship—from Coase (1960) to Williamson (1975) and North (1990)—has revealed the decisive impact of "transaction costs" in determining the viability of even the simplest economic exchange. And, global trade is anything but simple. The complex exchanges that take place over vast distances generate different types of transaction costs, including, but not limited to: search and information costs, negotiating costs, contracting costs, monitoring and enforcement costs, transportation and logistics costs, and transaction risk due to product defects, delivery delays, and currency fluctuations.

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Even a moment's reflection reveals the myriad ways that trade between nations—which must encompass vast geographical distance and highly divergent cultural norms and legal systems—adds an order of magnitude to the underlying challenge of the most "basic" transaction costs of exchange. We acknowledge that many of the costs in international trade are borne by the firms that participate in the global economy. What is often overlooked, however, is the unique role played by the United States in subsidizing a liberal world order that has not only maintained global peace but has also ensured safe transport on the world's waterways.

Consider, for example, that an important factor in stimulating global trade has been the sharp drop in the cost of maritime transport. Today, about 80 percent of global trade by volume is transported via sea routes (UNCTAD, 2017), and a recent World Bank report estimated that the cost of international maritime shipping has declined by approximately 40 percent since 1990 (Dappe et al., 2017). This reduction is normally attributed to technological advancements, increased vessel sizes, and improvements in port efficiency.

We have no reason to question the role of improved shipping technology and better port infrastructure in stimulating globalization through the reduction of maritime transport costs. This view, however, neglects one of the very foundations of an expanding global economy: that the huge volume of global trade we have come to take for granted has arisen precisely because of the order and stability associated with the United States' world dominance. Transaction costs, then, will be part of the calculus of not only firms but nations that are contemplating their involvement in world trade. We argue the costs and benefits to the United States—*from a policy perspective*—have fundamentally changed and we turn to those changes next.

Transaction costs of maintaining global order are increasing

We now discuss a short list of costs and benefits that have fundamentally changed the policy calculus for the United States, highlighting three areas: increasing military expenditures, increasing fiscal constraints *within* the United States, and increasing military expenditures by major rivals and changes in technology that have made military operations more costly.

Safe transport for commerce is a basic prerequisite for a globalized economy, and it is the growing cost of maintaining safe transport where we begin our discussion. Prior to the

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establishment of the liberal world order, a handful of “great powers” maintained navies in order to protect their own commercial fleets and, perhaps, to obstruct (or destroy) the commerce of their rivals. For many decades now, the United States has chosen instead to police the world’s waterways on behalf of all nations engaged in global trade. It should be noted, moreover, that the global benefits of this policing role are clearly a textbook definition of a “public good.” While it might be worthwhile to consider the inherent problem of the “rest of world” free riding on US efforts in this context, our sole aim here is to point out that the United States—and its taxpayers—have indeed shouldered this burden since the end of WWII.

In fact, building and maintaining a blue water navy that spans the globe is exorbitantly expensive. The cost of this subsidy for maritime transport is therefore substantial. In addition to the costs of ships and personnel, a global naval presence also requires an extensive range of ports and military facilities around the world. At the peak of WWII, control of the world’s oceans could be ensured by the US Navy, thanks to its 367 destroyers and 376 frigates (US Navy, 2017). Due in part to a long-term strategic shift to large carrier groups, today’s navy has a total of only 67 destroyers on active duty. Despite annual defense spending of 877 billion USD in 2023 (or approximately 3.5 percent of GDP), American naval resources are already stretched very thin (Peterson Foundation, 2023; Brands, 2024).

Relatedly, it is a well-known fact that the United States spends more than any other country on national defense, which at first glance, might seem self-evident: given its large population and its great wealth, the US is unrivalled in its capacity to finance military expenditures. But the scale of US military expenditures completely dwarfs spending in all other countries, including Russia and China. In fact, US spending is greater than the total spending of the next nine countries combined. This point is clearly illustrated in Figure 3.

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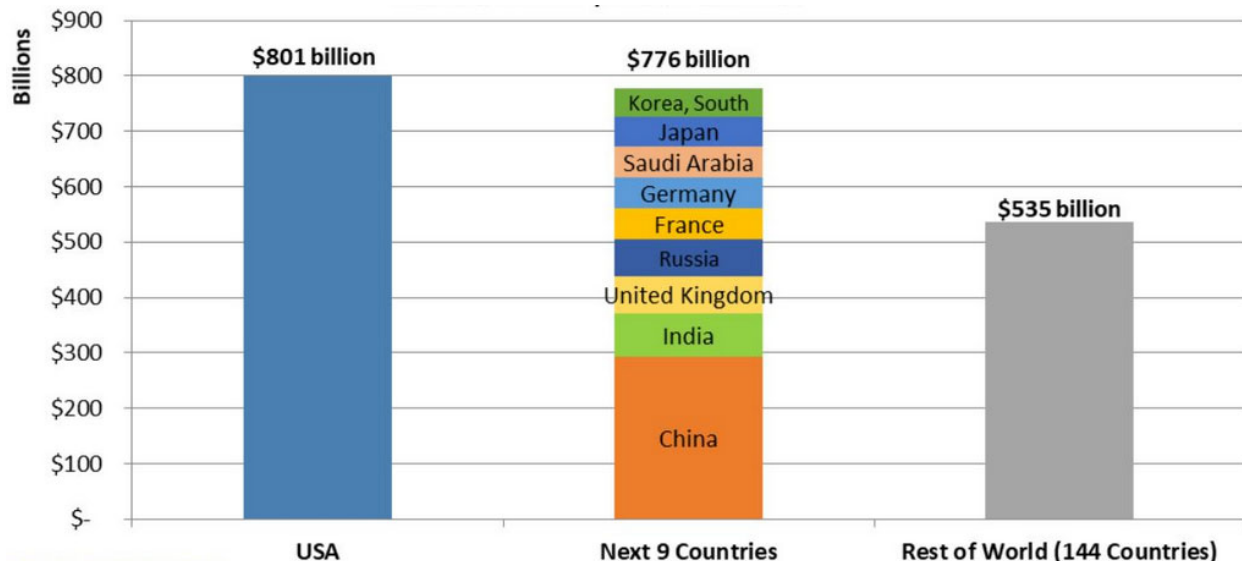
Figure 3: US vs. World Military Spending (2021)



Source: Institute for Policy Studies (2022), based on data from SIPRI Military Expenditures (2022).

Ironically, from a geopolitical perspective, the United States is blessed with a greater degree of "natural security" than probably any nation in history, owing largely to geography. The NAFTA nations of Canada and Mexico are not only tightly interlinked with the US economy and allied with US interests. Equally important, both nations are extremely weak in military capacity and do not pose a threat to US security. The Atlantic and Pacific Oceans, which form the eastern and western borders, provide an even greater degree of protection. While it is true the United States cannot be fully sheltered from acts of terrorism or long-range air strikes, there is no possibility whatsoever that a hostile nation could invade the homeland with ground forces (Stratfor, 2016).

Due to its extraordinarily favorable geopolitical environment, one might assume the United States could radically reduce defense expenditures with little risk to its national security. And yet the US continues to vastly outspend even major powers, such as China and Russia. This tension between massive expenditures and what would seem to be the country's most obvious "defensive" requirements should be striking. This spending paradox is even more puzzling when we consider our next class of "costs" confronting the United States in its maintenance of global order.

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Our second set of costs, *the internal cost of financing government activities*, has changed substantially in recent decades. Despite its enormous wealth, the United States has developed a chronic dependence on deficit spending to finance government expenditures (Jakee and Turner, 2023).[6] This applies not least to military spending; annual borrowing routinely exceeds total defense costs. Since 1932, the federal government has only run surpluses in 11 years. The largest deficits (as a percentage of GDP) since WWII, were incurred during the great recession of 2008-2009, peaking at over nine percent of GDP, and then during the Covid crisis, when the deficit soared to over 14 percent of GDP. What is arguably even more alarming is the *post*-Covid situation. Despite the end of the pandemic and a robust economic recovery, the deficit still exceeded six percent of GDP in 2023. There is, moreover, no reason to believe a balanced budget will be achieved at any time in the foreseeable future.

Chronic reliance on budget deficits has led, in turn, to a dramatic increase in the national debt. The Congressional Budget Office predicts an unprecedented surge in debt over the next 30 years, rising from 100 percent to 166 percent of GDP, and this figure only counts debt that is "publicly held" (CBO, 2024). As the national debt mounts, rising annual interest costs will themselves become a significant factor in aggravating the underlying deficit. In fact, 2024 marks a major watershed in US public finance: from that point on, *interest payments* on the national debt will exceed total military expenditure, which has traditionally been the third largest category of federal spending after Social Security and health care. The fact that Social Security and Medicare costs will rise even more dramatically offers little consolation (Wallerstein, 2024). The dire CBO projections can be readily seen in Figure 4.

[6] This recent work (2023) builds on Buchanan and Wagner (1977) and on earlier work by the present authors (Jakee and Turner, 2002). Jakee and Turner (2002) extend Elinor Ostrom's insights (i.e., Ostrom, 1998) and model complex government fiscal processes as a "fiscal commons." Analogous to the subset of common pool resources that Ostrom identifies as overexploited, we argue the fiscal commons are overexploited because of poor comprehension of the pools themselves, and weak control over access.

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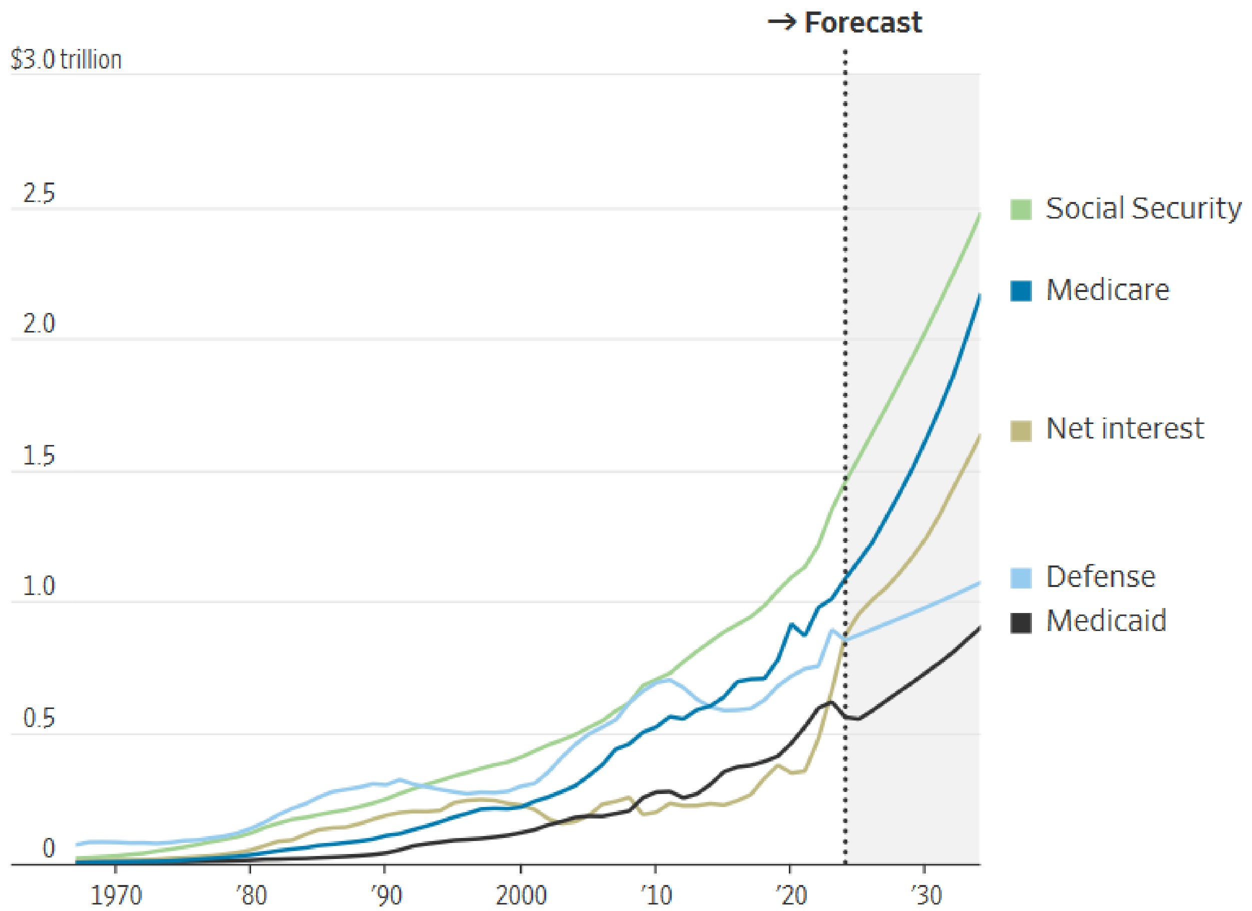
Figure 4: US Federal Government Outlays by Major Category



Source: Wallerstein (2024) based on CBO (2024) data.

It is impossible to predict how US policymakers will respond to the unavoidable fiscal crunch that lies ahead, however, the prospects for substantial cutbacks in the large entitlement programs appear limited. It is even more difficult to imagine taxes can be raised enough to begin to compensate for the exploding costs of these massive social programs and increasing debt-service costs. If major entitlements cannot be cut substantially—and taxes cannot be raised significantly—something else has will have to give. And that something, we argue, is likely to be military expenditures. This is not to suggest that the United States will be dethroned from its position as a dominant military power. Our claim is far more limited. Due to growing fiscal constraints, the United States will likely be forced to reduce the military spending that has subsidized both global security and safe maritime transport.

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The third aspect of the increase in transaction costs of maintaining global order *involves escalating military expenditures by major rivals, and changes in technology*. There are, in other words, significant shifts in both military technology and in efforts to control the world's waterways. This shift can be seen in the dramatic expansion of China's navy and Russia's ambition to control the resource-rich Arctic. We suspect the United States will be increasingly hard-pressed to effectively match its major geopolitical rivals in their own "near abroad." To do so will necessarily further raise the costs of US military operations.

The role of technology in reducing the costs of inflicting global damage is evidenced in the shutdown of the vital Red Sea trade routes beginning in 2023. With the help of low-cost but high-precision missile technology, the Houthi rebels from Yemen have revealed a novel and surprisingly cheap challenge to freedom of navigation (Hookway, 2024). The presence of a major US carrier group facilitated devastating bombardments of Houthi positions. However, even the United States' massive advantage in military firepower has proven incapable, at least so far (in early 2024), of reopening the sea lanes.

Benefits of US subsidization of global trade are likely falling

While we have focused largely on the increasing transaction costs of subsidizing the global order that underpin international trade, we would argue the benefits of trade have also changed. In broad terms, it is useful to think of the issues we discuss, next, as recent phenomena that raise the actual costs of trade—to the traders themselves—and hence *lower the net benefits of global trade from a policy perspective*. We distinguish between two categories of risk: random events and the increased risk of geopolitical conflict, or war.

We begin with the claim that "random events" have caused serious disruption to trade flows, and hence have directly raised the cost of trade. In 2021, for example, a large container ship ran aground in the Suez Canal. This single event, in a channel that accounts for almost 10 percent of global maritime traffic, blocked all transport in the region for six days (Cramer, 2022). To take another example, the shipping delays caused by drought in the Panama Canal in 2023 and 2024 are far more serious from a US perspective. Although the Panama Canal accounts for only five percent of global shipping, it accounts for almost 40 percent of US container traffic.

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Particularly alarming are the growing concerns that the transit delays here, which trigger higher shipping costs, are not an aberration but are likely to become the new normal (Dahl, 2024).

The decisive wake-up call regarding globalization risk was triggered by the mother of all random events: the Covid Pandemic that started in late 2019. Even four years later, it is difficult to grasp the extent to which this novel virus overturned the orthodoxy concerning the wisdom of complex global supply chains and extensive economic interdependence. In calculating the transaction costs of global trade, virtually no one anticipated the possibility that, across the world, factories could be closed, transportation networks could be shut down, and national borders could be sealed off. One of the most striking results of the crisis was the resurgence in policies that prioritized one's own nation over others. All countries, including close allies, adopted policies designed to protect the welfare of their own citizens, with little regard for the so-called "global community." Suddenly the quest for optimal efficiency through extensive specialization and global trade was called into question as the *actual* costs of engaging far-flung international trade increased. National policymakers, not least in the United States, started to look for ways to reduce dependency on foreign suppliers of vital goods.

A second category of risk, the increased possibility of geopolitical conflict, has generated even greater alarm regarding economic interdependence with potentially hostile nations (Copeland, 2022). The Russian invasion of Ukraine signaled the brutal "return of history" to the European continent. The war has had a devastating effect on the Ukrainian economy, with GNP falling by an estimated 30 percent in 2022. But the economic impact extends far beyond Ukraine. Prior to the invasion, Russia and Ukraine ranked among the world's top agricultural exporters. The war, including the blockade of Ukrainian exports in the Black Sea, has led to a sharp drop in exports and, in turn, to significant price increases and food shortages in global markets (Kilfoyle, 2023).

The impact on energy prices has been even greater. Over the last two decades, Germany and many other European nations became highly dependent on cheap energy from Russia. At the start of the war, Russia provided more than half of Germany's natural gas, a third of its oil, and almost half of its coal imports. The loss of cheap Russian energy has hit the German economy very hard. According to a recent report, the energy shock has caused the largest postwar decline

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in living standards and the most severe economic downturn since the 2008 financial crisis (Wintour, 2024). As Germany has long served as the locomotive for the broader European economy, a long-term decline in German economic strength would have severe repercussions for the entire EU.

One of the main attractions of globalization was the hope that extensive economic interdependence would eliminate the risk of large-scale warfare. The Russian invasion of Ukraine shattered that illusion. Policymakers are now forced to confront a question that was, until very recently, simply not on the agenda: what are the risks in remaining dependent on both Taiwan and China for a vast range of products, ranging from vital minerals to advanced semiconductors? Starting with President Trump and escalating with President Biden, US economic policy is increasingly focused on reducing dependence on both Taiwan and China (Agrawal, 2023).

In concluding our discussion of the changing benefits of world trade, we assume policymakers attempt to assess the likely economic consequences of reducing foreign trade and economic interdependence. The result will vary dramatically from one country to another. While globalization generates economic prosperity by utilizing comparative advantage, specialization, and trade, the contribution of global trade to a given country's prosperity is highly variable. Sweden's prosperity, for example, is inextricably linked to its ability to participate in global markets, which can be seen in Sweden's "trade openness" in Figure 2, above (greater than 80 percent of GDP). In the absence of global trade, Swedish standards of living would likely suffer heavily. The picture could hardly be more different for the United States, which is nowhere near as dependent on international trade (barely 20 percent of GDP), especially beyond its very close neighbors. The United States is therefore unlikely to experience anything like the fall in living standards that many other countries will as it pulls back from more global trade.

V. Conclusion

Our basic argument, to state it simply, is that mainstream analysis of global economics has been ignoring the considerable transaction costs that must be paid to maintain global peace and ensure safe passage over the world's waterways. It for this reason we argue that "free trade is not free." These costs have been borne overwhelmingly by the Unites States, the only nation that has had

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both the motivation and capacity to maintain a global navy and other military assets. These vast assets have effectively subsidized global "order."

We further argue policy makers are motivated primarily by the desire to serve national, not global, interests. Until fairly recently, the national interests of the United States were broadly consistent with the expansion and maintenance of global economic order, since, during the Cold War, the primary motivation was to incentivize allies to counter the threat of the Soviet Union. Thus, the increase in global trade and the prosperity that it engendered were byproducts of this more pressing national interest.

This peculiar alignment of national interests and globally-beneficial policies is now waning. We contend the cost-benefit calculus, from a US policy perspective, has been fundamentally altered due to two broad factors. First, *transaction costs* associated with protecting international waterways and serving as the world's police—including, importantly, the growing fiscal constraints of the federal government—have increased substantially from their Cold War levels. Second, the *benefits* of participating in global trade for the United States have likely fallen as random events and the disruptions caused by recent geopolitical conflicts have increased. As a result of these changing factors, the United States is unlikely to continue its extensive support for globalization. Greater economic integration among the complementary economies of NAFTA nations means the United States will be less dependent on the rest of the world than it was in the past.

More recent policies support our position that the US pullback from globalization is likely a long-term one. Since at least the start of the Trump administration, the United States has shifted from strong commitment to "the Washington consensus" to an "American first" style of industrial policy. Many observers initially viewed Trump's policy shifts, especially towards China, as a bizarre aberration that would be quickly corrected when more steady hands regained power. These observers were wrong. The Biden administration has actually doubled down on this policy shift, not least by offering huge subsides for both American and foreign companies to relocate their production facilities to the United States (Muro, 2023).

This policy retreat, in the case of the United States, is therefore not caused by flawed analysis or misguided populist pressures. The United States will largely abandon the "grand"

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vision of globalization because it no longer has the motivation—or the capacity—to pay the transaction costs that have subsidized global trade for so long.

We should, in conclusion, be clear that we are in no way endorsing this new American industrial policy, which is increasingly oriented toward subsidizing domestic industries. These policies come with their own array of problems, largely documented in the trade literature over many decades. We merely want to point out that the underlying rationale for this major policy adjustment is not simply a misunderstanding of the benefits of trade or misfit populists. Furthermore, any moves to counter the deglobalization trend must presumably start with the correct diagnosis of the underlying problem. We hope we have aided with that diagnosis.

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