THE PROBLEM OF THE LIBERAL ELITES PART 1

As I pointed out in this post, conservative elites have completely lost their minds. But liberal elites have problems as well. The problem is more complex with liberals, and it will take several posts of reasonable length to get into it. To make things concrete, I'm going to begin with the liberal approach to trade, which gives me an opportunity to tie together several ideas I've raised based on books I've discussed here and at Firedoglake:

1. Karl Polanyi's argument in *The Great Transformation* that societies can only handle a certain amount of change before they revolt and demand protection. Social changes will come, but the pace of change dictates how much misery will be inflicted on the losers.

2. The absence of a clear definition of market in standard economics.

3. The failure of economic theory to incorporate the impact of raw economic power, including fraud and corruption.

The text for this post is a 1993 article in Foreign Policy by Paul Krugman titled The Uncomfortable Truth about NAFTA: It's the Foreign Policy Stupid.

Krugman begins by insulting the anti-NAFTA people.

> It is as hopeless to try to argue with many of NAFTA's opponents as it would have been to try to convince William Jennings Bryan's followers that free silver was not the answer to farmers' problems.
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> Indeed, the parallel is quite close. The populism of the 1890s represented a desperate attempt to defend agricultural America against deep economic forces that were changing it into an industrial

> nation. The choice of a monetary standard had very little to do with the real problems of the farm sector; a burst of inflation might have given some highly indebted farmers a brief respite, but it would have done nothing to reverse or even materially slow the industrializing trend.

Well, as I remember my high school history and related reading, that’s just wrong. My sophomore history teacher, a woman whose name I sadly have forgotten, encouraged us to read the muckrakers, and I chose Frank Norris’ *The Octopus* and *The Pit*. They tell an entirely different story, one that revolves around fraudulent financial schemes of a railroad company and traders in the pits of the Chicago Mercantile Exchange. Things haven’t changed much.

Norris’ stories fit better with this analysis published by a site operated by the Economic History Association, *The Economics of American Farm Unrest, 1865-1900*, written by James I. Stewart of Reed College. He explains that farmers “perceived” that their political and economic status was deteriorating. According to Stewart, farmers had three main complaints: a) farm prices were falling, decreasing their incomes, which they thought was the result of overproduction; b) monopolistic railroads and grain elevators were gouging them; and c) financial conditions, including usury by lenders, an inadequate supply of money and deflation which forced them to repay loans with more expensive dollars. They were not able to get government help for these problems because the legislatures were dominated by financial interests including banks and railroads, the oligarchs and monopolists of the day.

Stewart says that these claims do not match the statistical testing done by economic historians. For what it’s worth, I think his explanations are weak, but I’m no expert, and perhaps those silly farmers didn’t understand their lived situation as clearly as economic historians reading aggregated data decades later. Perhaps, for example, there were no usurious loans in that mix that resulted in mortgage loans averaging 2-3% above the norm in New England. After reciting the contents of several studies, Stewart explains that the real issue facing farmers was a massive increase in uncertainty and risk. As he puts it, farmers might experience one or more of the problems he discusses, or they knew someone who was affected by them, and this increased their concerns.

> What were the sources of risk? First, agriculture had become more commercial after the Civil War (Mayhew, 1972). Formerly self-sufficient farmers were now dependent on creditors, merchants, and railroads for their livelihoods. These relationships created opportunities for economic gain but also obligations, hardships, and risks that many farmers did not welcome. Second, world grain markets were becoming ever more integrated, creating competition in markets abroad once dominated by U.S. producers and greater price uncertainty (North, 1974). Third, agriculture was now occurring in the semi-arid region of the United States. In Kansas, Nebraska, and the Dakotas, farmers encountered unfamiliar and adverse growing conditions. Recurring but unpredictable droughts caused economic hardship for many Plains farmers. Their plights were made worse because of the greater price elasticity (responsiveness) of world agricultural supply (North, 1974). Drought-stricken farmers with diminished harvests could no longer count on higher domestic prices for their crops.

Stewart uses the passive voice throughout this passage. But except for growing conditions each of the causes he lists is the direct result of the intentional act of specific human beings either in government or business. In particular, the section on railroads makes it clear that managers took every advantage of their monopoly status, as did the owners of grain silos. There is no doubt that the same is true of bankers and merchants in many places. The deepening involvement of the US in international grain dealings was another opportunity to hurt farmers. In bad years, some of the losses from low harvests were made up from higher prices, until the "integration" world markets. In combination, these efforts of government and business effectively dumped all the risk of bad harvests on tens of thousands of farmers, while increasing the profits of a few shippers, grain merchants and speculators.

In other words, the effect of the policies chosen by the rich and powerful was to make the lives of an important segment of the population worse. Or in Stewart's bloodless words:

> Uncertainty or risk can be thought of as an economic force that reduces welfare

In Krugman's world, the forces facing these farmers would have been unstoppable. In the real world, as Stewart reports, the farmers organized themselves and forced legislative changes at the State and Federal level that protected them and enabled them to stay in business, the socially important business of growing food for their fellow citizens. They were able to transform the conditions of the markets they faced, using the power of government. They were able to slow the pace of change to a level that didn't ruin their lives despite the best effort of the powerful. It's a neat demonstration of Polanyi's idea about people demanding protection from violent social change.

There were massive changes in the markets facing farmers as they moved from subsistence farming to commercial farming at the local and state and then federal levels, and then into the world market. There were changes in the markets from lenders, railroad companies and other vendors. There was constant change in the terms of the markets during this period, to the point that it would be unreasonable to compare the grain market in 1865 with the grain market in 1895. And Stewart says nothing about mechanization during that period. Economic historians treat the price of wheat as the outcome of market activity without apparently looking at the changes in the nature of the markets. But, as Stewart points out, the regulation of these markets changed steadily over this period, and the outcomes to farmers were improved by those changes.

Third, the central part of Stewart's story is international trade in grain. The impetus for that change came from the powerful and wealthy shipowners, railroads, merchants and grain speculators, and not from the farmers. The roles of the people who operate railroad and overseas shipping lines, the merchants who import and export grain, and the grain speculators in Chicago is not even touched by Stewart's account. He does not even discuss the fraud and corruption that dominated the lives of those farmers and all of society. He and other economists neatly hide the power structures that created the problems of farmers and the forces the farmers beat down to protect themselves.

That pattern is repeated over and over in the story of trade.

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