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Straight Talk on Trade: Ideas for a Sane World Economy

by **Dani Rodrik**

Princeton University Press, 2018.

Let us assume, for the moment, that the reader did not know who is the author of the book that is about to be reviewed and is asked whether its author is an economist or not. “Definitely not!” would be a very likely answer, as there are some quite good reasons for such a response. There are virtually no traces of economic methodology in the book: for example, there is no sentence that starts with “I assume”. The word “trade-off” - a trademark of economics - does not appear in the book, as it appears that there is no opportunity cost of any action or any policy that is recommended. From a methodological point of view, the book looks like a sociological treatise *à la* Streeck (Wolfgang Streeck 2016) on the world around the author. Furthermore, the author treats economists as a “they” and with some moral contempt, spelled not only at the beginning of the book, pointing out that “... reluctance to be honest about trade has cost economists their credibility with the public” (p. xi). So “they” are not honest and “their” credibility is undermined. Even more assuring that the author is not an economist is the treatment of economists as homogenous group, without any disagreement on any issue. With economists obsessed with exploring heterogeneity and its origins, such an approach should be unacceptable to them. The reader realises that the approach to the issues considered in this book is not well balanced as, for example, “market failures” are frequently mentioned in the book, but never “government failures”. This is not expected from the balanced approach of economists, so balanced that it produced a cry for “a single-handed economist”. Finally, the reader learns that economists sided “with globalization’s cheerleaders”, whoever these cheerleaders may be, instead of sticking “closer to their discipline’s teaching” (p. ix), as if the discipline’s teaching is predominantly against free trade and globalisation. Surely, this cannot be an economist’s writing.

Wrong, it is. The author is Dani Rodrik - an economist. Not just an ordinary academic economist, but the Ford Foundation Professor of International Political Economy at Harvard’s John F. Kennedy School of Government. No doubt a prolific author, with fresh thinking and thought-provoking contributions such as, for example, his recent book on economics and economists (Dani Rodrik 2015a). An economist who is the party breaker of economics conventional wisdom parties and whose motto seems to be “against the mainstream”, but still an economist and a very good one.

How to explain the paradox that an economist refers to economists as “they”? Perhaps, a thorough review of the book might provide some clues.

Since the book is a collection slightly edited op-eds, previously published as syndicated columns for *Project Syndicate*, it does not have a well-defined structure, so it is difficult to refer to its organisation. Taking into account the heterogeneity of the contributions within the twelve chapters of the book, their titles can be misleading. Nonetheless, three main sections of the book can be distinguished, though with a huge amount of good will on the part of the reader. The first and the biggest one is about globalisation, or rather “hyperglobalisation”, to use Rodrik’s own terminology. The second one is about (those) economists and the author’s notion of “ideas”. The third section is about the things that should or should not be done - about the way forward.

“The globalisation went too far!” - well, nothing new from Rodrik, as it was discussed in one of his previous books (Rodrik 2011), but it is interesting to analyse the reasons behind such a conclusion. The following insight is typical: “There is nothing in the historical record to suggest that poor countries require very low or zero barriers in the advanced economies to benefit greatly from globalization. In fact, the most phenomenal export-oriented growth experience to date - Japan, South Korea, ... - all occurred when import tariffs in the United States and Europe were at moderate levels, and higher than where they are today” (pp. 3-4).

Hence, everything is about stylised facts, labelled by the author as historical records. There is no need for any theoretical consideration, no need for an analytical model, no need for establishing and testing causality, for an explanation of the paradoxical “historical record”, let alone a counterfactual analysis of what could have happened to the export-based economic growth of those counties had the import tariffs been lower. The stylised facts approach to the analysis of globalisation and the conclusion whether it went too far or not is hardly methodology acceptable. Nonetheless, let’s stay within the framework of stylised facts to comprehend Rodrik’s arguments supporting the insight that globalisation went too far.

The first one is rising inequality. As Rodrik pointed out: “Growing volumes of trade with countries at different levels of development and with highly dissimilar institutional arrangements exacerbated inequality and economic insecurity at home” (p. 29). Though the causality is missing, at least in this book, though the author specifies in the book that the main source of growing inequality is technological change, the crucial question is: what is so bad about rising inequality? Joseph E. Stiglitz (2012) and Thomas Piketty (2014) failed to provide a convincing answer, but for Rodrik the crucial consequence is the rise of populism, both left and right one, in developed countries - a rebellion against the elite by the losers in globalisation. The problem is, however, that losers occur in any change in society, with any turning of the tables of fortune, not only in globalisation. As Barry Eichengreen (2018) vividly demonstrated in his compact history of populist temptation, losers are only a necessary condition for populism to emerge, but not the sufficient one. Eichengreen (2018) also demonstrated that there have been a variety of public policies that have prevented the emerging of populism, i.e. that undermine the incentives for losers to subscribe to populist ideas. After all, the causality from globalisation to the rise of populism in the developed world is not so straightforward.

Two more notes regarding globalisation-enhanced inequality and the losers of trade liberalisation. First, it is hardly convincing to accuse economists of neglecting the losers of trade liberalisation and subsequent specialisation along the lines of comparative advantage. This is precisely what the Stolper-Samuelson theorem is about, being a standard issue covered by mainstream international economics textbooks. Not only does the theorem predicts winners and losers of foreign trade, it also provides grounds for political economy considerations, who and with what level of zeal will be for and who will be against foreign trade liberalisation. Second, do the distributional consequences of trade liberalisation mean that it should be avoided even if it increases social welfare, consider as a sum of individual utilities? Oh yes, it is about individual utilities, measured by consumer surplus, a measure that increases with the decrease of consumer prices due to foreign trade liberalisation, i.e. globalisation - something that is never mentioned in the book. Back to the point: in other words, should all Kaldor-Hicks improvements be rejected and only Pareto improvements accepted? Very few improvements are of that type and with that policy making criterion the world would be much less developed than it is now. Well, this is the ultimate consequence of this line of reasoning by the author, and it should be spelled out.

The other reason why globalisation has gone too far, according to Rodrik, is the inherent contradiction between globalisation, global governance and democracy. Globalisation, according to the author, needs global governance and that violates democracy which is not global, but rather an inherently nation-state phenomenon. From another viewpoint, sticking to democracy undermines global governance and, consequently, globalisation. Not only is this trilemma static and rigid, as pointed out by Douglas Nelson (2018), but it is not based in reality, especially the relations between globalisation and global governance. According to Rodrik, global governance is a necessary condition for globalisation, but in many cases this relation does not hold. For example, there is no need for international competition law in order to uphold global trade and relations between firms, undertaking in competition law parlance, and customers in the global market. Although there are academics who subscribe to this idea (David J. Gerber 2010), their arguments are not convincing and, more importantly, such governance does not exist - national competition laws differ significantly among themselves and all of them are enforced by national, in some cases also regional competition authorities (e.g. the European single market and the European Commission as a competition authority). And this very institutional arrangement, hardly global governance, enabled the globalisation that, according to Rodrik, has gone too far. If the proof of the pudding is in the eating, then global governance is not a necessary condition for globalisation, at least not in the rigid way suggested by Rodrik. The other problem with this trilemma is that global governance does not necessarily contradict democracy. International agreements, the legal ground for global governance, are ratified by the national parliaments of the nation states, in a democratic procedure, if democracy exists at the nation-state level. If it does not exist, it is hardly globalisation or global governance that is at fault.

Rodrik's perception of democracy is a bit specific. "In a democracy, when the demands of financial markets and foreign creditors clash with those of domestic

workers, pensioners, and the middle class, it is usually the locals who have the last say” (p. 5). About what? About the amount of deficit funded by borrowing? About the terms of the borrowing? About the level of their wages that are paid out of borrowed money? About not paying back the borrowed principle? Democracy is a procedure in which political decisions are made and by which government is made accountable to the electorate - it is not about operational decisions that are made by the government. Even in the case of direct democracy, such as Swiss referendums vividly demonstrate, the issues are the institutional reforms, whatever is on the agenda, not the operational decisions of the Ministry of Finance or the Central Bank. Furthermore, Rodrik’s point has a strong flavour of populism - it is the people, not the elite, who “have the last say”, who are making decisions about their own entitlements irrespectively of liabilities.

In line with his previous contributions (Rodrik 2011), the author uses the term hyperglobalisation. But the problem is that the term is not clearly specified. The reader cannot grasp the standard by which hyperglobalisation is distinguished from globalisation. The author specifies hyperglobalisation as “the attempt to eliminate all transaction costs that hinder trade and capital flow” (p. 28). It is now clear that it is a normative concept and that it does not exist in reality, since it is “the attempt”, but the problem is that the world with no transaction costs, i.e. with transaction costs “eliminated”, exists only in economic textbooks, and in reality it is ruled out, even in the local markets. Not only does hyperglobalisation not exist, according to Rodrik’s own definition, but it is a goal too distant to be achieved. So much for the usefulness of the concept.

It seems that it is even more important that Rodrik misses the point by asking the wrong question, a normative instead of a positive one. Instead of asking whether globalisation has gone too far, the author should ask questions about the content of contemporary globalisation. Hence, he missed the most important point, that contemporary globalisation is based on the unbundling of production process and competition between segments of the value chains, rather than competition between final products. The unbundling takes place within the framework of multinational corporations, which dislocate (by offshoring) segments of their value chains across the globe, bringing capital, technology, information (know-how), and virtually unconstrained demand of the global (components) market to developing countries. This is the basic insight of a very well-researched book on contemporary globalisation (Richard Baldwin 2016). Hence, the question is not how far globalisation went, but in what way it advanced - completely different from the one Rodrik has in mind.

That is why his notion of premature industrialisation (Rodrik 2015b) is obsolete; not in the sense that the share of employment and added value of manufacturing drops in most developing countries, but in his normative analysis of the impact of that development on the economic growth and development of poor nations. The author provides a number of reasons why industrialisation is good for development, not only economic, as he believes that it is good for the development of liberal democracy. Nonetheless, his analysis is based on several assumptions. Investments are based on domestic savings and are made by domestic entrepreneurs. These investments are focused on the production facilities for final goods both for the domestic and interna-

tional markets. Due to the lower (predominantly labour) costs, these products are competitive in the global market. This is *grosso modo* what happened in Japan, South Korea *et al.* Rodrik is completely right that such industrialisation cannot happen again, and that this is no longer an option for poor countries, but he is not right that such a development leaves them with mainly non-tradable services as the engine of growth. Inclusion of those countries and their labour in the unbundled value chains, along the lines described by Baldwin (2016), provides quite a new opportunity for the development of poor countries. Technological progress has not stopped; it is reasonable to expect that it will accelerate in the future, so it can be assumed that unbundling will continue, taking into account that many activities within manufacturing sector are actually (pre-production, post-production and post-sale) services, but this time tradable services, not the ones that Rodrik refers to. It seems that Rodrik's pessimism regarding premature deindustrialisation is - a bit premature.

Unbundling his own impossibility triangle (globalisation - global governance - democracy), Rodrik stands in defence of the nation state. Rightly emphasising that global democracy is a contradiction in terms, the author leaves democracy aside and focuses on the nation state, emphasising the concept of sovereignty, along the lines of the Peace of Westphalia. The first question is against whom nation state should be defended. The surprising answer is: against neoclassical economists, as Rodrik conjecture is that "most neoclassical economists would subscribe" to Leon Trotsky vision of "completely liberating productive forces from the fetters imposed upon them by the national state" (p. 17). Well, an amusing new insight is that neoclassical economists are not concerned with basic the assumption of their analysis, their common methodology or other trivial issues of economics, but that they are Trotskyist, subscribing to his visions. Permanent neoclassical revolution!

Back to more serious considerations, Rodrik's main argument for the desirability of nation states and their sovereignty is that: "Market-supporting rules are non-unique. Experimentation and competition among diverse institutional arrangements therefore remain desirable" (p. 25). The author goes a step further with a (rather inappropriate) modification of the second fundamental theorem of welfare economics: "Each Pareto-efficient outcome can be sustained by a different set of rules" (p. 33). In other words, the insights of institutional economics are irrelevant, there is no universal finding about which institutions are good and which are not, and all we can and should do is trial and error, i.e. unbridled experimentation, like voodoo doctors or shamans, with *ex post* results proving that some solution was or was not good in a specific situation. A bit strange, because it was exactly institutional competition, something the author is in favour of, comparing it to the "monopolistic competition" (p. 43), that has already provided economists some results, and they already know which institutional solutions are in principal good or bad, at least which should be avoided altogether. Hence, there is no need to start from scratch every time and it is not exactly that every set of rules can produce a Pareto efficient outcome.

The author favours economic institutions diversity, and that is his main argument in favour of the nation state. Accordingly, his position is that no economic institutions should be imposed on developing countries by the US and other Western countries, e.g. institutions for the protection of private intellectual property rights, as

that is one of the demands in the negotiation of free trade agreements. Nonetheless, he demonstrates no understanding for diversity of political institutions. He believes that countries with specific institutional features, one regarding the control of environmental pollution and the other regarding “social dumping”, i.e. low social protection of employees, should be punished by importing countries in terms of the barriers to trade. Hence, there are some specific institutions that should be imposed and others that should not. The case for nation state, along the lines of its sovereignty, is not effectively defended with the arbitrary selection of which rules should be imposed on the countries and which should not. It seems that Rodrik is in favour of political globalisation (no need for experimentation in that field, consistent with the “end of history” concept), but against the economic one.

It is also important to distinguish between globalisation and nation building. The European Union, as the result, and European integration, as the process, are not the case of globalisation, so it should not be used as the showcase for globalisation failures - something the author regularly does. As demonstrated by Bojan Kovačević (2017), European integration is, from the very beginning, a process of (multi)nation building, and a united Europe goal is nothing but the federal state of Europe. Every aspect of nation building, including the creation of the citizens of Europe, i.e. constituency, has been included in this endeavour. Hence its failure is not the failure of globalisation but is another “failed” state. Rodrik clearly has the European Union in mind when claiming that: “Economic integration requires repressing nation-states’ ability to issue their own money, set different regulations, and impose different legal standards” (p. 18). This is not true even for the European Union, let alone global economic integration. Though, irrespective of this confusion, the author rightly points out that: “Europe faces the same choice it always faced: it will either embark on political union or loosen the economic union” (p. 8).

The analysis of the Eurozone development, the Greek financial crises, the French economic problems, and other European economic setbacks demonstrates Rodrik’s commitment to Keynesian medicine - all the problems are on the demand side, and increasing aggregate demand will be sufficient to sort out the Greek recession, and the French economic problems will go away through “fiscal flexibility” (perhaps a political correct term for fiscal deficit) irrespective of the structural and institutional issues, for example rigidity of the French labour market, so well analysed by Jean Tirole (2017), followed by detailed and consistent recommendations for its institutional reform. Generally, the author downplays the relevance of structural reforms for European economies, especially when considering the German position and recommendation for the Eurozone, specifying that “austerity policies are short-sighted even from the perspective of Germany’s own economic interest” (p. 62). Hence, it is a bit surprising that only a few lines later the reader comes across the following sentence: “The German argument for structural reform does make a lot more sense for the longer run, for political as well as economic reasons” (p. 63). Which Rodrik should the reader believe?

Continuing with his second thoughts about the results of structural reforms, Rodrik points out the results of a meta-study of the impact of these reforms. “The modal estimate of the impact (of structural reforms on growth) was statistically in-

significant, meaning that it was impossible to conclude with any confidence whether the effects were positive or negative” (p. 53). The reader could compare this quote with what was really printed in the article Rodrik refers to (Jan Babecky and Nauro F. Campos 2011): “The positive effects of structural reforms on growth materialize with some time lag. We present evidence that the average magnitude of the long-run reform effect on growth is substantially larger than that of the average short-term effect... The use of lagged reform measures shows that reforms have negative contemporaneous (short-run) effects which are offset by positive effects in subsequent periods (long-term)” (p. 152). Bad news for Rodrik, not only on the effects of structural reforms.

The author distorts the finding of economic theory. It is simply not true that, as he points out: “the proposition that rent controls reduce the supply of housing is violated under conditions of imperfect competition” (p. 141). It is violated only in the case of monopoly - rather rare, if not a unique situation in the housing market. However, not all, very far from that, imperfect competition conditions are monopolies. Furthermore, even in the case of a monopoly it is violated only in the short-run. In the long-run, with decisions to entry or exit the industry, capital will move to some other industry. Those who are interested in a reality check - historical facts as Rodrik would put it - should consider the case of the UK.

Rodrik’s issues with economic theory continue as he analyses rents that are created in the market. “International rules on patents and copyright reflect the ability of pharmaceutical companies and Hollywood - to take just two examples - to get their way” (p. 129). Consequently, according to Rodrik, it is not always a choice between good and bad policies. “Often, the choice is between yielding to domestic rent-seekers or to foreign ones. In the former case, at least the rents stay at home!” (p. 130). Well, the first question an economist would ask is about the origin of the rent. Is it the consequence of R&D, producing some new medicine, in case of pharmaceutical company, which increases consumer welfare, or not? Because if it is, then that rent is the key incentive for technological progress and endogenous economic growth (Philippe Aghion and Peter Howitt 1992), therefore increasing consumer welfare. If it is not, if its origin is the creation of barriers of entry or trade, e.g. custom tariffs, without any technological change, without any innovation, it only reduces consumer welfare and creates allocative inefficiency; not even all consumer welfare is transferred to the rent, part of it is wasted. Daren Acemoglu and James A. Robinson (2012) built their case on inclusive institutions precisely on the difference between rents appropriated by Bill Gates, an innovator, and Carlos Slim, a tycoon whose empire is protected by government-built barrier to entry - a typical domestic rent seeker. Instead of asking those questions, Rodrik claims straightforward that it is better that rents stay at home, likely with domestic tycoons, oligarchs, crooks *et al.*, whose only innovation was perhaps in the area of bribing domestic politicians for protection, since protection is for sale, as demonstrated by Gene M. Grossman and Elhanan Helpmann (1994). To use Acemoglu and Robinson terminology, rents staying home, with domestic rent-seekers, is the reason why nations fail. And Rodrik has just penned a recipe for that failure.

Rodrik is definitely not happy with the “rational-choice political economy”, actually public choice theory, as he is convinced that vested interest cannot be the

explanation of various political disasters. He suggests the alternative - ideas. "Interests are not fixed or predetermined. They are themselves shaped by ideas - beliefs about who we are, what we are trying to achieve, and how the world works... In truth we don't have 'interests'. We have *ideas* about what our interests are" (p. 163). So, the reader would infer, a politician does not have an interest in being re-elected (in democracy) or just staying in office (in autocracy) he/she has an idea that his/her interest is to remain in office. Well, that does not seem like a great analytical distinction, though Rodrik points out that the interests of political actors are socially constructed, "rather than determined by well-defined material facts... Interests, in fact, are 'one form of idea'" (p. 168). Even if it is true, and that cannot be tested, it still does not seem like a great analytical distinction. Rodrik ends the discussion with the observation that "the possible application of this approach to political phenomena has not yet received much attention" (p. 169). The reader is left wondering why, as the author does not provide an explanation.

But the whole story of ideas, not the interests of political agents, however convincing it may be, is just a prelude for the broadside about policies and those who made it. "...political agents design their own strategy space. The available instruments are up for grabs and limited only by their political imagination" (p. 180). So, this is the bottom line: everything is possible, no exogenous constraints whatsoever, especially not hard constraints; the only thing that counts is the good will of the ruler (the term from economic theory, benevolent dictator, would be politically incorrect), his/her imagination (according to the author, late Ethiopian Prime Minister Meles Zenawi was such a person; "I ... enjoyed these talks more than most meetings I have in Washington, DC, and other democratic capitals" p. 191) and, perhaps, a knowledgeable advisor. And all that, the reader would presume, under the slogan "maximum gain for minimum pain", which is the title of one of the book's sections. If the reader believes that...

Two recommendations for the future. The first one, related to the issue of free trade, starts from the scratch, as if nothing had happened in past several centuries. Perhaps the previous cynical comment on the permanent revolution in this review was not so inappropriate. "If the policy process is transparent and inclusive, these kinds of questions (about free trade) will be generated naturally by the forces of competition among groups, both pro- and antitrade" (p. 233). The only problem is that competition is distorted by the logic of collective action (Mancur Olson 1965). Antitrade interests are (individually) substantial and focused (domestic corporations) and, due to that constellation, it is relatively easy for that interest group to solve the free rider problem, the most important problem of collective action, including lobbying. Contrary to that, trade interests are not (individually) substantial, and they are very dispersed (e.g. consumers), hence the free rider problem cannot be solved as the costs of solving are prohibitively high. All that has been extensively explored by Grossman and Helpmann (2001). The vivid example of these discrepancies explains why the peanut quota protection exists in the US for domestic peanuts farmers, despite the substantial welfare losses that it produces (Randal R. Rucker and Walter N. Thurman 1991). In short, this is not a level playing field. One could even suggest that there is the role of economist to speak on behalf of those who cannot defend their

interests due to the substantial collective action problem. Hence, following this Rodrik's recommendation would probably lead to deep protectionism.

The other one is the product of "some creative thinking and institutional engineering (that can) save capitalism from itself - once again" (p. 261). The result is the recommendation that government sets up a number of "professionally managed public venture funds that would invest and take equity stakes in a large cross-section of new technologies" (p. 262). The idea is to raise the resources by issuing bonds in financial markets. Now the question is whether private venture funds exist and whether they fund technologically innovative start-ups. Yes, they exist, and, at least in the US, they operate rather well. So, what is the reason for government-owned venture funds? Since society, through the government as its agent, would end up as a co-owner of the new generation of technologies and machines, "the share of profits from the commercialization of new technologies would be returned to ordinary citizens in the form of a social innovation dividend. This income stream would supplement workers' earnings from the labor market" (p. 263). Hence, this is ultimately a redistribution mechanism. With the high volatility of returns from new technologies, after all they are new, i.e. not yet tested, not to mention the cash outflow for servicing the obligations towards the bond holders, this is hardly an efficient redistribution mechanism and it is hardly anything else. So much for creative thinking and the shift to the "innovation state".

This book is nothing but the recycling of previously published op-eds, and, as pointed out by Nelson (2018), op-eds are produced to make one point, simply and clearly, not to develop some idea at length and to provide comprehensive arguments in its favour. But this was known to the author well before he committed himself to this publishing endeavour. It seems that there was no clear idea was to be accomplished with this book.

Moreover, the book is not well-edited, so some insights are randomly repeated throughout the book, just as most things about the structure of this book are random. The list of institutions that the market requires appears several times on different pages and in different chapters. Also, the famous statement by Mervyn King that "banks are global in life and national in death" is recurring. The reader got it first time.

The motto of this book could be not only "against the mainstream", but "against the mainstream at any cost". That could explain why Rodrik's talk on trade and globalisation was anything but straight. The book he produced this time, contrary to some of his previous contributions, is not thought provoking. It is a sad lullaby with the regular Orwellian rhyme: two legs, i.e. mainstream, bad; four legs, i.e. anti-mainstream, good. Taking into account his reputation as a crisp mind, bright analyst, and his legacy as a thought-provoking author, the reader would expect his next book to be better. Much better!

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