

Trade, but Not so Free

di David Goodhart

A partial retreat from globalization will be a consequence of the coronavirus pandemic. A new approach to trade is required that combines a degree of openness with national control.

The coronavirus pandemic is a perfect metaphor for the perils of hyper-connection. But it merely draws attention to the already existing retreat from full-on free trade that has been gaining in support and legitimacy in recent years.

Democratic politics and national social contracts are asserting themselves against the laws of comparative advantage—which in any case turn out not to be quite as benign as many economics professors claim. This was brought home to me a few weeks ago, in the very early stages of the crisis, when I heard a very senior member of the British Conservative Party say that he was until recently an orthodox free trader/free marketeer but now regarded himself as an economic nationalist.

As Dani Rodrik, the Harvard international political economy professor and hyper-globalization critic, wrote recently in Project Syndicate: “Rather than putting the world on a significantly different trajectory, the crisis is likely to intensify and entrench already-existing trends... Hyper-globalization will remain on the defensive as nation-states reclaim policy space.”

World trade fell last year by 0.4 per cent. There has been no multilateral trade agreement since 1993. US President Donald Trump wants to bring back some of the US supply chain from China. And this is not a Trumpian eccentricity, most of the US political class is behind him here. It acknowledges that allowing China entry to the global market economy in the belief that it would transform politically (and become less mercantilist economically) is a gamble that failed. There has been technological decoupling too, the world will not end up on single global platforms.

Stock-Up and Re-Shore

Anxieties about climate change have moved up domestic and international agendas. This has created a bias towards localism, reduced travel, and a degree of self-sufficiency especially in food production, making life uncomfortable for unfettered free trade. China’s air quality has improved dramatically in the past few weeks as a result of measures to contain the coronavirus. And more generically Greta is asking whether you really need to eat strawberries in January?

The debate in much of the Western world is not so much about whether the crisis will hasten the partial retreat from liberal globalization that is already taken for granted, but rather what form the retreat will take in different places. Even such an advocate for liberal globalization as France’s President Emmanuel Macron, in a well-received speech to the French public on April 13, talked about “rebuilding France’s agricultural, industrial and technological independence” in the light of the various supply crises the country has experienced.

The response is likely to take two forms. First a focus on the lack of supply in critical areas during the crisis—medical supplies of various kinds (PPE clothing, virus testing materials, pharmaceuticals) and some food and energy essentials—which requires better stock-piling and some reserve capacity in just-in-time supply chains. Second, there is a more radical conversation taking place about strategic industries and re-shoring and the permanent renationalization of some supply chains, especially those dependent on a single country like China.

Diversifying Suppliers

The first is relatively uncontroversial and just a matter of good logistics. Almost all rich countries have been caught with a shortage of supplies of vital protective clothing and equipment for front-line staff. In many cases, they have turned to their manufacturers to adapt production lines. The same is true for some of the materials required for virus testing.

Many countries had acquired a sense of invulnerability over the recent globalizing decades and had lost the folk memory left by two world wars of the need to have security of supply. In the UK, the

No Deal Brexit preparations had exposed the British state's cavalier neglect of prudential housekeeping. Senior civil servants were warning the government that trading on WTO terms was expected to cause a shortage of NHS clinical supplies due to a customs check disruption of a minor administrative kind. This is something that should never have been allowed to happen in the first place, and the coronavirus crisis will presumably ensure that it never happens again.

Governments in the future may require companies to maintain slack in their supply chains and to diversify suppliers. Companies are likely to want to do these things anyway, but governments might choose to provide guidelines for companies as is the case in Switzerland. In the UK there have been longstanding concerns about the lack of oil and natural gas storage. These might also be extended to include vital rare earth minerals.

Limiting Dependence on Trade

The second set of ideas on strategic industries is more controversial and would require abandoning or adapting some of the state aid and anti-protectionism rules of the EU and even the WTO. Of course, nobody in the mainstream is arguing against maintaining high levels of international trade or in favor of radical self-sufficiency. (And some degree of self-sufficiency has always been permitted in farming and the defense sector.)

But when whole industries grind to a halt because of the lack of parts from China or Vietnam, and when many rich countries suddenly discover that they no longer have the capacity for mass vaccine manufacture, more profound questions about acceptable levels of protection for domestic supply in key sectors need to be asked.

In a country like the UK that might include questions about whether we need to maintain at least one volume steel producer? The UK imports a bit less than half its food—is that too much? Modern agriculture now depends on an array of chemicals and fertilizers—should Britain's last potash mine in North Yorkshire be supported by the Government? What about our dependence on Huawei post-coronavirus crisis?

What Price for Home-Grown?

These are all legitimate questions and they feed into a wider skepticism about free trade that has been growing in strength in recent years. The critics argue that for all of the benefits of international trade, the neat theories of free trade and comparative advantage have been oversold. And they have a point. Free trade, as the economist John Maynard Keynes pointed out, only works if the people displaced from good jobs by imports get equally good jobs elsewhere in the economy. The election of Donald Trump is one kind of proof that this has not been happening.

Hold on, say the free traders. Of course there will be downward pressure on wages and job losses in the short run, but in the long run, the additional purchasing power we acquire from cheaper imports means we can buy other goods and services that will create equally good jobs elsewhere in the economy. Moreover, they say, when given the choice between protecting the Mid-West manufacturing plant and enjoying good quality, cheaper stuff in Walmart, people have voted with their wallets for the cheaper stuff.

But they have not been given a proper choice. Of course, people will always prefer cheaper goods but not at any price. If the choice was between slightly more expensive goods and services and the preservation, or more gradual decline, of a certain agricultural or industrial way of life they might well support such a deal. Indeed, they do so in the EU through the Common Agricultural Policy.

Economics' Blind Spot

People are well aware that they are both producers and consumers. The end of production is not just consumption, as Adam Smith asserted, it is also about what sort of life you might have as a producer. This is one of those places where economics reveals its blind spot for culture and human beings in the round.

Research also suggests that much trade doesn't follow any discernible pattern of comparative advantage. The UK economist Graham Gudgin has shown that for countries in North America and Western Europe, joining free trade agreements has caused slower, not faster growth in recent

decades. Unlike comparative advantage in natural resources, which is better described as absolute advantage, comparative advantage in manufacturing systems is usually quite marginal.

Much of the comparative advantage of recent decades has been simply taking advantage of lower labor costs in poorer countries. Apple makes iPhones in China which does benefit US consumers and to some extent Chinese workers, but the main beneficiaries are probably Apple executives and shareholders. Bringing some of that production back to the US, even at the cost of slightly higher prices, would not, I suspect, be unpopular.

More National Resilience

In the 19th century, Britain did completely embrace free trade. As the workshop of the world, it was enormously to the country's advantage to do so, and the British imported most of their food by the end of the 19th century. The result was that they nearly starved in two world wars.

To repeat, nobody sensible is arguing for self-sufficiency or anything like it, but almost everyone is now talking about more national resilience in supply chains and less dependence on China, particularly in technology. And isn't the logic of comparative advantage to produce specialist monocultures in a world that values diversity in all things?

Most of the economics profession is very uncomfortable with this drift in the argument, but there are some economists and political economists like Dani Rodrik, Ha-Joon Chang, Barry Eichengreen and Robert Skidelsky who have long argued for more democratic caveats to free trade. Rodrik argues that where there is a national consensus about preserving some aspect of an economy or culture, for example French restrictions on Hollywood film imports, these should be allowed and not attract sanctions from international trade regulators.

And a new UK government that is serious about regional and industrial policy, and about shifting more high value economic activity northwards, is implicitly protectionist. It is not going to promote high-tech export industries in Hartlepool and then allow them to be wiped out by imports. It will either protect with subsidies or tariffs. Free trade theory does allow some such protection under the title infant industry protection, which is far preferable to senile industry protection, but EU state aid policy is not friendly to either.

The unlikely bedfellows of populism, environmentalism and technology are all pointing in the same direction—reshoring of some forms of production, a bit more self-sufficiency, more teleconferencing with people in other countries rather than immigration, all in all a retreat from the hyper-globalization of recent decades.

Mitigating the Costs of Free Trade

Free traders will not unreasonably point to some costs. It could mean a bit less growth. Global supply chains are a force for peace, and breaking them up could bring back inflationary pressures. It could also mean that the dramatic fall in poverty in poorer countries will slow or stop. Why not just try to mitigate the costs of free trade better? Subsidize the losers more intelligently? Or, the free trade skeptic might reply, why not prevent there being so many losers in the first place?

As Barry Eichengreen says, the problem with the global economy is not a lack of openness but a sense that “the nation state has fundamentally lost control of its destiny, surrendering to anonymous global forces.” And as Hans Kundnani put it in a recent issue of The Observer newspaper, it is time the UK government adjusted its rhetoric and stopped its paeans of praise to free trade. Part of the point of Brexit is to put politics before economics, democratic legitimacy before economic growth. Of course, we still want lots of trade and sustainable growth but at less cost to other things that people hold dear. A new rhetoric is needed that combines an appropriate level of openness with a sense of national control. An economic nationalism that liberals can feel comfortable with.