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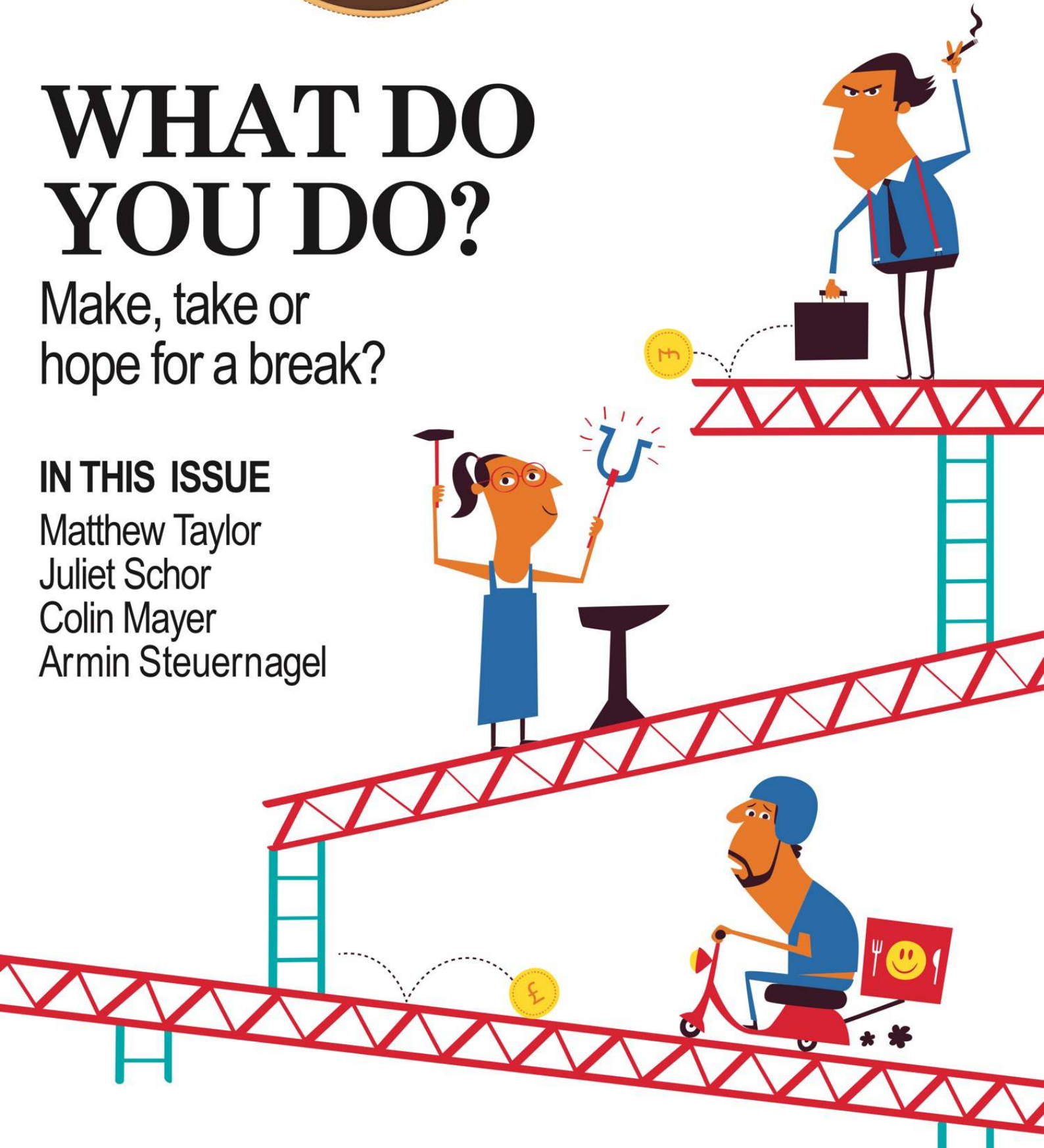
fresh thinking in economics

WHAT DO YOU DO?

Make, take or hope for a break?

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Lost and unfounded

The global trading system is broken says **Dr Joe Zammit-Lucia**. It is, he says, a politically, socially and economically unsustainable system designed for the 20th century and based on theories from the 19th with little relevance today. He suggests a way forward.

Institutions are slow to change. And those who benefit most from any system will keep on defending it. Meaningful change only comes in times of crisis. So it may take a credible, Trump-induced, US threat to bring the global trading edifice down to stimulate reform of, what is, a system that is no longer fit for purpose.

This is not the narrative that one usually hears about our globalised system. Defenders of globalisation claim that it brings prosperity to all and that Trump's threat of trade wars with China and others are irresponsible and will bring widespread economic damage.

But there may be some justification for a narrative that questions the global way.



Unsound foundations

The free trade edifice is built on David Ricardo's theory of comparative advantage developed in 1817. Yes, you read correctly, 1817. It holds that a country has comparative advantage in the production of any particular good of equivalent quality when its marginal cost of production is lower than that of other countries.

"Welfare" is maximised when countries focus their production in areas where they had comparative advantage and traded with others who had a different comparative advantage.

The theory was very powerful – in the early nineteenth century. And it underpins everything to do with the global structure of free trade and its economic justification.

The world has changed beyond all recognition, yet the theory of comparative advantage still reigns.

"Comparative advantage today arises merely from some countries' willingness to employ slave labour and inflict widespread environmental damage."

In Ricardo's time, comparative advantage between nations changed only very slowly. The nature of the production of wine and cloth did not change dramatically in a few short years. The transfer of technology and know-how did not happen in months. There were not as many multiple definitions of quality as there are today.

There were none of the highly-sophisticated marketing machines of today's corporations that could magic up new definitions of quality and desirability from essentially similar goods. And it was a world that traded largely in goods not services. So Ricardo's underlying constraint of goods of equivalent quality therefore largely held true in the nineteenth century.

Given that today's world would be unrecognisable for Ricardo, it is time for a serious debate about the degree to which his theory, and therefore the whole economic basis of international trade, remains applicable. There is a perspective that says that much comparative advantage today arises merely from some countries' willingness to employ slave labour and inflict widespread environmental damage whereas others are not. Is that the basis on which we want to base the global order?

What has changed?

The pace and nature of change is set only to accelerate. And much of that change is rendering our previous conception of globalisation obsolete.

"World trade produces net benefits for all" was the 20th century mantra. Now it is clear that those benefits are very unevenly distributed with consequent economic, social and political implications. The free movement of global capital was seen as a vital fuel for growth and development. Now it is seen as a mechanism for financial destabilisation, a system for hiding large amounts of illicit money, and a facilitator of tax arbitrage.

Low labour costs were seen as the competitive advantage of developing countries. Now they are seen as the basis of unfair competition. Persistent unidirectional trade imbalances were dismissed. Now we understand their corrosive effects on deficit countries.

In an information-driven world, privacy and national security issues affect trade – from the manufacturing of routers, to the security of data platforms, to building self-driving cars. For instance, Qi Lu of the Chinese tech company, Baidu, explains: “The days of building a vehicle in one place and it runs everywhere are over. Because a vehicle that can move by itself by definition it is a weapon.”

“In an information-driven world, privacy and national security issues affect trade.”

For decades, if not centuries, economists have written about externalities – the social, economic and, more recently recognised, environmental costs imposed on others. But we have, by and large, done very little about them. Now our societies are growing less tolerant of such costs – and the social and environmental costs of a globalised economy are huge.

The 20th century culture defined human beings as “consumers”. We were all simply agents that drove growth through ever-greater consumption. Economically and socially, consumption became defined as our reason for existence. Now many of us see ourselves as being more than consumers. And we have started to question how, in a finite planet, we can persist in equating economic success with ever more consumption and ever more growth.

Globalisation has driven, and been driven by, the rise of the multinational corporation. Economically, this was seen as a model of economic efficiency. Now many see the multinational model as potentially corrosive. A characteristically damaging

behaviour of the multinational corporation is in creating social upheaval as they move from one country to the next in search of the lowest costs. Typically they move on taking their jobs with them while leaving governments to clear up the resulting mess through the welfare system.

They put pressure on elected governments by playing them off against each other in investment, employment, taxation and lowering of regulatory standards. And they grow to dominate markets through monopoly or oligopoly while competition authorities choose impotence over action in the vain hope that they are creating “national champions”.

But perhaps the most significant disruption is the major geopolitical shift we have seen over the past couple of decades. The post-war world order was characterised by Western dominance and overseen by the steady hand of US hegemonic power. Now we have three trading blocs – the US, China and its sphere of influence, and the European Union. Economists have known since the 1980s that, in such a structure, competition between blocs becomes much more likely than co-operation.

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Given the real and putative challenges that the current globalisation model brings, can anyone seriously argue that our global trading system must be preserved as is?

What do we do about it?

While it is the case that globalisation, as currently conceived, is increasingly subject to challenge, a U-turn to strive for isolated self-sufficiency is not the way to cooperative stewardship of the world's resources and opportunities. There are six areas that will need to be prioritised if we are to preserve a peaceful international trading system:

- stronger competition policy;
- management of trade imbalances;
- harmonised regulation;
- support for small businesses;
- regulated flow of capital;
- more local focus; and
- greater cultural and educational exchange.

Competition policy

Competition policy needs to be more muscular. Globalisation has been allowed to place too much power in the hands of oligopolistic corporations at the expense of SMEs and consumers. Competition authorities have largely been asleep at the wheel – or in thrall to powerful commercial interests.

Trade imbalance

We need to accept that persistent unidirectional trade imbalances are unsustainable. How to correct them will be a challenge (previous attempts at managed trade have not been particularly successful). But we must abandon the fiction that such asymmetries don't matter or that they are simply due to 'macroeconomic factors' and therefore beyond the reach of trade policy.

Regulation

Today's trade barriers are no longer mainly about tariffs. They reflect regulatory differences between trading blocs. Since regulatory structures reflect local values, they cannot be smoothed away in all-encompassing Free Trade Agreements. Going forward we need to focus on creating framework agreements that work towards mutual regulatory recognition over time.

Small businesses

Governments need to invest in growing their SME base and helping such companies access international markets should they wish to. They also need to avoid setting the rules of trade in such a way that they benefit larger companies preferentially

Flows of capital

We need to distinguish between trade and international flows of capital. The latter have reached a stage where they often become destabilising. Is it time to re-visit the limits for the free flow of capital?

“The 20th century culture defined human beings as “consumers”.

Local focus

All governments should encourage more localism. Not as a protectionist measure but as a way of growing their own skills' base and reducing the environmental cost of dispersed supply chains.

Culture and education

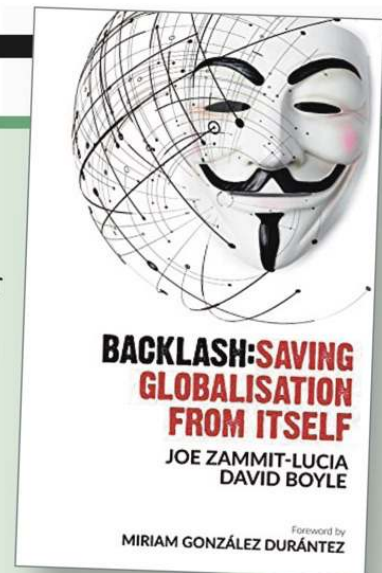
We need to place more emphasis on cultural and educational exchange. This is

BACKLASH: SAVING GLOBALISATION FROM ITSELF

“This is a book for this perilous moment; whether facing up to Brexit, populism or protectionism. Politicians, who have too often taken the inevitability of globalisation, and with it the benefits of free trade, for granted, need now to read this and think fresh thoughts, radical thoughts, about how to make trade again serve the public and our democracies, not overbear them.”

The Rt Hon the Lord Lansley

UK Co-chairman, UK-Japan 21st Century Group



a more effective route towards fostering mutual understanding among peoples than trade.

Meanwhile the real enemies of globalisation are those who maintain that there is nothing to fix. Perpetuating an indefensible *status quo* will eventually cause globalisation to eat itself. Those who doggedly stick to the *status quo* because, for the moment, it happens to suit their interests will, in time, find that it no longer suits those interests.

Stability can only come from embracing change and adapting to the times. And by forever rejecting the words that should never again pass any policy-maker's lips: “There is no alternative.”

■ Dr Zammit-Lucia is an entrepreneur and commentator on business and political issues. He is co-founder and Trustee of the think tank for the radical centre, Radix, (www.radix.org.uk). He is the co-author with writer, localist and Radix director, David Boyle of *The Death of Liberal Democracy?* in 2016 and, in May this year, *Backlash: Saving globalisation from itself* – both published by Radix.