We Must Talk About Trade

Vicky Pryce

There is no doubt that we are entering a phase of retrenchment from globalisation after a few decades during which greater volumes of cross-border transactions supported the world economy, integrated large parts of the world, not only China, and also in the process moved hundreds of millions out of absolute poverty. Growth in the couple of decades before the financial crisis was happening without too much inflation requiring any serious corrective action. The European Single Market expanded a domestic market for each member country to 450m people across easily accessed borders. Monetary policymakers in the developed world kept interest rates relatively low and basked in the glory of having ‘sorted macro’.

And yet the good inflationary environment had very little to do with domestic monetary policies and instead much to do with an enhanced global trade environment and considerable offshoring of production from high-income countries to lower-wage emerging nations. That also happened of course within the EU as more low-cost countries entered the regional economic arrangement after the collapse of the Soviet Union.

At the same time the opening of markets encouraged greater competition and also allowed countries and regions to specialise in areas where they had a comparative advantage, often in relation to skills and technology. As capital controls were progressively relaxed, funds flew across borders taking advantage of new opportunities. Considerable investment in new production processes allowed improvements in efficiency and productivity. The expansion of the world middle class also meant that economies of scale could be more easily achieved.

Yes there were frictions. Unfair trade practices and undercutting and competitive devaluations and state aid all needed to be policed by competition authorities and also the WTO- see for example Airbus (European) vs Boeing (US) -and many more. In order also to prevent tax competition amongst countries the OECD has had to broker agreement among its member states for a minimum global corporation tax rate for multinational firms.

It is also true that as many new countries like China entered the new global trade scene, the WTO authority diminished somewhat with a gradual move away from multilateral rules to more bilateral trade agreements. These, by their nature, tend to be suboptimal. Nevertheless that period still saw tariffs generally lowered and the benefits of just-in-time production and diversified and effective supply chains passed through to consumers in the form of low prices and wider choice.

And then came the financial crisis and the ensuing credit crunch and austerity that followed, and a decade later Covid, the war in Ukraine and the energy shock. It now looks like a permanent break has been put in the pace of global integration. The UK of course went through its own exit from the EU single market and customs union through Brexit. But the supply chain disruptions, huge production displacements, increased transport costs and a dash for food and energy security have all brought the previous model into question. Onshoring – or “re-shoring”, is now the name of the game. State aid and the pursuit of regional, national or domestic champions, once frowned upon, is now again considered to be a rational economic policy given the changed economic environment - even if more costly.

It was of course all already unwinding before the latest series of crises. The IMF has tracked trends in trade in goods, services and investments and in a January 23 blog[i] highlighted the slowdown in the process of global integration over the last decade and the sharp increase in the number of new trade restrictions that were imposed. The Trump era contributed of course, not only with tariffs and non-tariff restrictions against China but also with Europe and Latin America- and even briefly with Canada.

But now the cold trade war is intensifying. This is not only vis a vis Russia where sanctions and export restrictions as well as price caps have been in operation for some time and now extending to a wider set of Russian products and potentially affecting many countries and companies involved in trading with Russia, directly or indirectly. US and other countries' have also been imposing increasing restrictions on tech goods exports to, and imports from, China as well limits on Chinese tech firms involvement in critical sectors in the West. The issues are ostensibly concerns over potential industrial espionage and worries about Intellectual property and national security.

This culminated in the G7 communique after their meeting in Hiroshima last weekend referring to the intentions to 'de-risk' trade with China which they also accuse of using trade as a form of 'economic coercion '[ii]. Though stressing that this doesn't mean 'decoupling' from China, the implication is still of more restrictions ahead rather than opening up. The Chinese have already reacted this week by banning US firm Micron's memory chips used in critical infrastructure areas of their economy on security grounds[iii].

The tit-for-tat could well escalate. And it will be hard to see how one can really envisage a return to what may now be seen, despite its imperfection, a 'golden age' of globalisation that, for a while at least, served the world well.

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[i] Confronting Fragmentation Where It Matters Most: Trade, Debt, and Climate Action (imf.org)

[ii] https://www.politico.eu/article/g7-vs-china-us-europe-unite-tough-message-summit-statement/

[iii] https://edition.cnn.com/2023/05/22/tech/china-ban-us-micron-chips-intl-hnk/index.html