Free Trade : The Next 50 Years

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Introduction

Two centuries ago the *Anti-Corn Law League* was the first single-issue pressure group to use modern public relations techniques to promote its message. It is fair to say that the movement for free trade founded by Richard Cobden is the political ancestor of the NGOs and campaigning movements of today. Last year was the bicentenary of Richard Cobden's birth, yet the issues that motivated him then - peace, freedom and free trade - are still live political issues today.

The scourge of protectionism is again on the rise, vested interests still seek import tariffs at the expense of the greater good. Cobden successfully campaigned in parliament and across the nation for the repeal of the Corn Laws. During the first half of the nineteenth century Tory landowners sort to encourage exports and limit imports in the belief that, by this effective subsidy, they could protect Britain and themselves from competition, whatever the cost to the poor. In the latter half of the twentieth century the European Union's Common Agricultural Policy imposed tariff burdens on Europeans whilst excluding cheaper imports from the developing world. Once again it is vested interests, in particular subsidy harvesting agri-businesses, which calls upon a new generation to campaign to defeat protectionism.

It seems more than ironic that in the twenty-first century it is those who believe themselves to be allies of the poor who advocate import tariffs in the developing world. The taxes they advocate will not only act as barriers to trade between the developing and the advanced world, they will harm the interests of those they seek to help and will act as barriers to South-South trade. Most African trade is regional not global, so who will gain from hindering such trade?

The anti-free trade, anti-globalisation movement has growing influence in church circles, yet free traders in the words of Cobden *"advocate nothing but what is agreeable to the highest behests of Christianity - to buy in the cheapest market, and sell in the dearest."* That poor families benefit the most from the lower prices that freer trade brings is axiomatic, but to deny farmers in the developing world higher export prices seems obscene. It is

time to shift the debate beyond economics into the moral dimension. Is it morally justifiable to make it unlawful for man to trade with his neighbours in the global village and to dictate who can trade with who?

Dr Razeen Sally, the author of this pamphlet, which is taken from his essay in *Towards a Liberal Utopia*, looks to the future of free trade in the context of the political, economic and intellectual times we find ourselves. He maps the geo-political realities of the high and low politics of trade. He advocates re-coupling the advocacy of free trade and free markets with limited government and *laissez faire* economics. Free trade is a part of the holistic imperative that political adherents of the modern *Third Way* school of mercantilism avoid facing up to with their "mixed-systems thinking".

Free Trade: The Next 50 Years realistically outlines the risks and opportunities for the champions of free trade who strive for international peace and prosperity.

Finally, we are grateful to John Blundell and the Institute of Economic Affairs for not only permission to republish this essay, but for 50 years of good ideas.

Paul Staines

Founder,
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London, 2005

> It tells them of freedom, and how freedom was won, and what freedom has done for them, and it points the way to other paths of freedom which yet lie open before them.
>
> John Bright (on the repeal of the Corn Laws)

> To expect, indeed, that the freedom of trade should ever be entirely restored ... is as absurd as to expect that an Oceana or Utopia should ever be established ... Not only the prejudices of the publick, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it.
>
> Adam Smith, Wealth of Nations

In the last half-century, expanding international trade and capital flows have progressively reintegrated the world economy in ever more complex ways. But protectionism lurks everywhere, always assuming new and potent forms. In the spirit of John Bright, one can fight for the freedom of trade in the next half century; but, echoing Adam Smith, it would be utopian to expect outright victory. Protectionism will still be around in 2055, and the battle will continue to rage.

My task is to take stock of free trade today, in theory and in practice, and then to look ahead. What are the emerging facts on the ground in terms of global political and economic trends? And what of the case for free trade in the next 50 years?

Taking stock: the case for free trade, past and present

Meta-economic arguments for free trade date back at least two millennia. An intellectual tradition from early Christian thought to Richard Cobden, Woodrow Wilson and Cordell Hull holds that open and flourishing international commerce brings about better understanding between peoples and buttresses peaceful, ever closer international relations.

The *economic* case for free trade emerged one and a half millennia later. Adam Smith's genius was to draw on pre-existing traditions of moral philosophy and economics to lay out a system of interrelating economic phenomena animated by laissez-faire, or what he called 'natural liberty'. This he extended to international trade.

Smith's system has been refined down the past two centuries. An international division of labour according to comparative advantage allocates resources more efficiently, resulting in the greater wealth of nations. It integrates hitherto separated national economies into a worldwide co-operative system that caters for reciprocal wants. There are all-round material gains, for rich and poor countries alike.

These are the short-term (or static) gains from trade. That is but the necessary preface to capital accumulation, economies of scale and other long-run (or dynamic) gains, such as the transfer of technology and skills, and the competitive spur that comes from exposure to world-class standards of practice. This feeds into productivity gains, increases in real incomes and economic growth. Indeed, it was the dynamic gains from trade which Smith and his contemporary David Hume emphasised. They strongly linked free trade (broadly defined to include cross-border flows of capital and people) to domestic institutions and growth, all on the canvas of the long-run progress of commercial society.

Adam Smith fortified his presumption in favour of free trade with an explicit political argument. Protectionism is driven by 'the clamorous importunity of partial interests' who capture government and prevent it from having 'an extensive view of the general good'. Free trade, in contrast, tilts the balance away from rent-seeking producer interests and towards the mass of consumers. It is part of a wider constitutional package to keep government limited, transparent and clean, enabling it to concentrate better on the public good.

As important to Smith and Hume was the moral case for free trade, centred on individual freedom. Individual choice is the engine of free trade, and of progressive commercial society more generally. It sparks what Hume called a 'spirit of industry'; it results in much better life chances, not just for the select few but for individuals in the broad mass of society who are able to lead more varied and interesting lives.

To sum up: free trade is of course associated with standard economic efficiency arguments. But the classical liberal case for free trade is more rounded, taking in the moral imperative of individual freedom and

linking it to prosperity. Finally, free trade contributes to, though it does not guarantee, peaceful international relations. Freedom, prosperity, security: this trinity lies at the heart of the case for free trade.

Taking stock: free trade in practice

The historical record shows that countries that are more open to the world economy grow faster than those that remain closed. Post-1945, the gradual liberalisation of trade and capital flows in the OECD spurred western European reconstruction, recovery and catch-up growth. The outward orientation of Japan and other East Asian countries played an important role in their catch-up growth. The massive liberalisation of foreign trade and inward investment in China, in tandem with internal liberalisation, has contributed to spectacular and sustained growth since the 1980s.

Developing and transitional countries with progressively more liberal trade policies have growing ratios of trade and inward investment to national income, with rising shares of manufactures in total exports, and with sustained increases in real incomes per head. These are mostly middle-income countries bunched in East Asia, Latin America and Eastern Europe, but now include low-income but fast-growing China and India. The bad news is that this leaves about 2 billion people in 75-plus countries with stagnating or declining aggregate growth. These are low-income and least-developed countries that have liberalised less, though they suffer too from other intractable problems such as poor climate and geography, rampant disease, civil war and chronically corrupt, predatory governments.

External liberalisation, it must be emphasised, is not a panacea. Questions as to how it is sequenced with other economic and political reforms, and whether it should proceed fast or slowly, will find different answers in different countries at different times. Furthermore, trade liberalisation on its own may not deliver much. But in interaction with improvements in domestic institutions there are abundant, long-term gains from trade liberalisation. External opening creates the spontaneous stimulus for institutional upgrading to better exploit trade and investment opportunities, for example, through better currency and banking practices, and the development of ports and inland communications. Reciprocally, better

enforcement of property rights and contracts, cleaner, more efficient public administration, and more investment in infrastructure maximise the gains for importers, exporters and domestic and foreign investors. Openness, therefore, is a handmaiden of growth, not a quick fix.

What of the international political and policy framework to support a freer trading system? Right through the nineteenth century to 1914, national governance, in the context of a decentralised system of nation-states, coexisted with increasing international economic integration (what we now call globalisation). Has the globalisation-and-governance equation changed that much a hundred years on? Arguably it has not. It is national governments, not international organisations, multinational enterprises or NGOs, which fulfil the core functions of law and public policy. Not least, it is they who decide whether trade policies are more or less liberal.

This is not to deny the importance of international cooperation where national-level action is insufficient. Unfortunately, the record of most post-war international economic institutions has been one of ad hoc bureaucratic intervention in markets, often exacerbating misguided government intervention at home. The 'aid business' is a case in point. The General Agreement on Tariffs and Trade (GATT) was a notable exception: its non-discriminatory rules and reciprocal negotiations furthered the liberalisation of trade from the late 1940s onwards.

Looking ahead: world political-economic trends

What makes the crucial difference to globalisation today, and probably for the next half-century, is the dramatic opening of, first, China and then India. They are the world's second- and fourth-largest economies respectively (at purchasing power parity), and account for 40 per cent of humanity. With still-low levels of per capita income, they have the potential for stellar catch-up growth rates for decades ahead. Their integration into the world economy, still in its early stages, promises to be more momentous than that of Japan and the East Asian tigers, and perhaps on a par with the rise of the USA as a global economic power in the late nineteenth century.

These trends show that the classical argument for free trade is as relevant as ever. Trade and related economic

reforms enable China and India to better exploit their comparative advantages in a more specialised international division of labour. Market-based reforms also provide the stimulus for inward investment, the transfer of technology and skills, and a more competitive, entrepreneurial business environment. These replenishing gains boost growth, which in turn leads to poverty reduction. China's breathtaking reforms have already delivered massive gains.

India lags behind, but with glimpses of take-off on the back of accelerating reforms. The rest of the world gains too. Consumers elsewhere can buy cheaper and more varied products. Developed-country firms cater to expanding Chinese and Indian demand for capital- and skill-intensive goods and services. By 'offshoring' manufacturing jobs to China and services jobs to India in low-value activities, they can scale up, improve productivity, and generate better-skilled, higher-paying jobs at home. Exporters in other developing countries also discover large new markets for oil and other commodities (witness China's voracious appetite for such imports).

Two other emerging global economic trends will likely move centre stage in years and decades to come: 1) the cross-border movement of labour; 2) South–South trade.

First, the freedom of people to move hither and yon in search of work was part of nineteenth-century free trade in practice. This was reversed in the twentieth century. Now, the relaxation of pervasive restrictions on cross-border labour movement promises huge gains for developing and developed countries. Opening borders to people can only be achieved gradually and piecemeal. It demands political patience and resourcefulness. Nevertheless, it should be at the heart of a twenty-first-century free trade agenda.

Second, inter-developing country trade – already 40 per cent of their overall trade – is throttled by the high barriers developing countries erect against each other. Significant developing-country liberalisation would not only improve their own productivity; it would also allow low-income and least-developed countries to better exploit their comparative advantages by exporting to the fast-growing markets of middle-income countries.

These trends, if not discouraged, will increase the wealth of nations. They will widen the horizons of individual

freedom, especially for hundreds of millions in the developing world who have been cruelly deprived of it. Not least, commercial bonds across the North–South divide will make international relations more stable and secure. But none of this is pre-programmed – as we know from the eternal lesson of summer 1914. It depends crucially on the right political decisions, nationally and internationally.

Behind every free trade opportunity lurks protectionist danger. Four long-term threats come to mind.

First, organised interests benefiting from protectionism will continue to lobby against liberalisation, in both developed and developing countries. Second, the ideological opposition to free trade has changed form. It now unites anti-globalisation NGOs with more mainstream critics of globalisation who call for 'global governance' to redress global inequities. Concerted global action to provide aid, enforce 'corporate social responsibility' and harmonise labour, environmental and other standards seems to have a higher priority than market-based reforms in the developing world.

It is the alliance, witting or unwitting, between old-style rent-seeking interests and new-style ideological forces which will present a formidable political threat to free trade in decades to come.

Third, most developing countries are mired in wretched poverty, disease, crime and murderous internal strife. States are failing miserably or have collapsed. The old solutions of aid and policy driven by international organisations have not worked. But these countries are still ruled by venal and thuggish elites, and lack the history and institutions to sustain market-based reforms 'from below'. The dilemma is real; problems are likely to get worse; and they will spill over to luckier parts of the world in the form of refugees, illegal migrants and terrorism.

Fourth, the 'low politics' of trade and related economic policies cannot be divorced from the 'high politics' of international security (or the lack of it). There are new global security flashpoints post-cold war and post-11 September, chiefly Islamic fundamentalism and the international terror networks fanning out from the oil-rich Middle East. This poses an ever greater threat to the free

movement of people, goods and services across land, sea and sky.

Looking ahead: making the case for free trade in the next 50 years

The core political and economic case for free trade, in the service of freedom, prosperity and security, will have equal force 50 years hence.

The point is to update it to keep up with ever changing realities. How must it adapt?

First, the post-1945 case for free trade has become too narrow and mechanical. Free trade should burst these chains and return to its classical liberal foundations in Smith and Hume.

The Bretton Woods and GATT settlements combined a partial restoration of nineteenth-century free trade with expanding government intervention at home. Post-war trade theory reflected such 'mixed-systems thinking' by decoupling free trade from laissez-faire. In addition, 'liberalism from above' has prevailed: trade liberalisation has relied on international organisations and inter-governmental negotiations. Both 'mixed-systems thinking' and 'liberalism from above' were politically expedient after World War II; but, over time, they have entrenched misguided conventional wisdoms. The first is that big-government infringements of private property rights at home will not flood across borders and overly damage international commerce. The second is that international institutions deliver trade liberalisation 'from outside', and only through 'concessions' to foreigners in a game of haggling.

'Mixed-systems thinking' forgets that free trade is part and parcel of free markets; it is but an element of a constitutional whole that includes limited government and laissez-faire at home. Of course, there can be no complete return to a mid-Victorian British social contract, especially in conditions of modern democratic politics. But free trade should be recoupled to (qualified, not unbounded) laissez-faire. It stands in contradiction to what Michael Oakeshott calls an 'enterprise association' in which government is an interfering 'estate manager', catering to a superabundance of rent-seeking interests. Rather it must fold back into a

'civic association' in which smallish (but not minimalist) government provides essential public goods.

Furthermore, twenty-first-century free trade should rely less on twentieth-century 'liberalism from above' and more on nineteenth-century 'liberalism from below'. With the latter method, the liberalisation impulse comes from national governments acting unilaterally (or autonomously), and spreads internationally by example (or competitive emulation). Unilateral free trade makes economic sense, since welfare gains come quicker from unconditional home import liberalisation than they do from protracted international negotiations. It makes political sense too. Governments have the fl exibility to initiate policies and emulate better practice abroad in experimental, trial-and-error fashion, tailored to specific local conditions. The World Trade Organization (WTO) and bilateral/regional trade agreements can be helpful auxiliaries in advancing a liberalisation agenda, but they are poor substitutes for what David Landes calls 'initiation from below and diffusion by example'. Their importance should not be exaggerated.

Second, Western governments and intellectuals, on the right and the left, seem to prioritise democratisation in the Third World, partly in the belief that it will promote economic reforms. The evidence is mixed at best. In China and several other East Asian countries, market-based reforms, including trade and investment liberalisation, have occurred under authoritarian governments. In much of the rest of the developing world, illiberal democratisation has reinforced cartel-promoting and protectionist economic policies, and it has stunted the build-up of market-supporting institutions. Economic and related institutional reforms (such as internal and external liberalisation, and the enforcement of private property rights and contracts) should have top priority in China, Russia, Iraq, Afghanistan and elsewhere. This is what the West – particularly the USA – should be encouraging. Political democracy should be allowed to emerge gradually and organically in the wake of economic growth and institutional development, as it has done in South Korea and Taiwan.

Third, free trade must work with the grain of wider geo-political realities. There have been marked shifts in international politics since the end of the cold war, and more recently after 11 September. No serious challenge exists to US leadership abroad; Europe and Japan are

internally sclerotic and externally pusillanimous; other powers are on the rise, notably China, India and Brazil; the transatlantic alliance is no longer the fulcrum of international relations; and politics and economics are moving inexorably in an Asia-Pacific direction, from the Indian Ocean to Tierra del Fuego.

The one constant in this shifting political template is US leadership. For the foreseeable future, the USA will remain the indispensable anchor for global security, prosperity and freedom – far more important than any international organisation or international treaty. It is vital that it leads from the front: in securing the global pax against systemic security threats; in helping to rescue and reconstruct failed states; in maintaining open and stable international financial markets; and, not least, in breaking down barriers to trade, investment and the movement of workers across the world. Above all, the USA must lead by example, setting the standard for liberal economic policies worldwide by what it does at home. This includes untying existing knots of domestic protectionism.

There will be times when the USA will have to resort to unilateral 'liberal imperialism' when international institutions dither and fail. Otherwise 'liberal internationalism' – the multilateral cooperation envisaged by Woodrow Wilson and Cordell Hull – should prevail. The GATT/WTO has been its foremost and most successful expression on the economic front. Robust US leadership is sine qua non to the future relevance and workability of a presently crippled WTO. The USA will need like-minded coalitions inside the WTO and outside it, however. In the future they will be found less across the Atlantic and more in Asia-Pacific, especially China. Not only must the USA lead by example at home: it must also display the enlightened sensibility to construct and maintain genuinely two-way 'coalitions of the willing' abroad. Free trade's future depends on it.

Conclusion

The power of ideas should not be underestimated. John Stuart Mill did say that 'a good cause seldom triumphs unless someone's interest is bound up with it'; but he also remarked that it is 'the word in season, which, at a critical moment, does much to decide the result'. It falls to free trade's friends to spread their word in season with global

political currents, anti-protectionist interests (such as exporters, downstream users of imported inputs, multinational firms with global production networks) and (often unanticipated) events.

Historically, free trade has needed its commanding public champions. Cobden, Bright and Gladstone filled that role in Victorian Britain, as did Cordell Hull and Ludwig Erhard in the last century. There are precious few around today.

FREE TRADE: THE NEXT 50 YEARS
Razeen Sally

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In *Free Trade : The Next 50 Years* Dr Razeen Sally takes stock of the past and present. He examines free trade in practice and in the context of global political and economic trends as well as mapping the geo-political realities of high and low politics. *Free Trade: The Next 50 Years* realistically outlines the risks and opportunities for champions of free trade. He makes the case for a free trade future with some suggestions for the contemporary campaigning heirs to Cobden and Bright as they strive for international peace and prosperity.