

The economics of free trade (with a dash of Brexit)

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1. Agenda

- Why free trade is a 'good thing'
- Some arguments against free trade
- Four case studies:
 1. tariffs on agricultural imports
 2. state aid for steel and cars
 3. lessons from the pandemic
 4. impact of Brexit on UK-EU trade
- Q&A

2. What is 'free trade'?

- 'Free trade' happens when people can buy goods and services from whomever and wherever they like, including from abroad, without obstruction from governments.
- In practice, trade barriers are common, including **tariffs** (taxes on imports) and **non-tariff barriers** (such as red tape, quotas, and outright bans)
- 'Unilateral free trade' is when one government lowers its own trade barriers without waiting for others to reciprocate

3. Adam Smith on free trade

- Adam Smith (1776) emphasised the benefits of **specialisation**: trade improves welfare by allowing people to concentrate on whatever they do best.
- Even if it were possible for every person to grow all their own food, make their own clothes, and meet all their needs for shelter, healthcare and entertainment, the results would clearly be less than ideal.



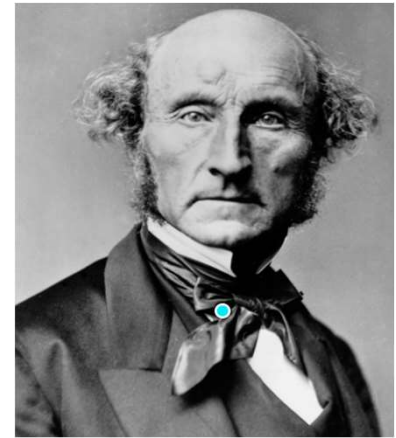
4. David Ricardo

- David Ricardo (1817) took Smith's ideas further by showing that it is not even necessary for one country to have an *absolute advantage* in order for there to be gains from trade.
- Instead, each party simply needs to focus on what they do best compared to the alternatives available to them.
- This is the concept of **comparative advantage** (which almost everybody struggles to understand!)



5. John Stuart Mill

- JS Mill (1848) developed the point that increased openness to trade makes countries more efficient in *whatever* it is that they do.
- In other words, free trade boosts **productivity**.
- Examples include the ability to import better machinery and equipment, the sharing of knowledge, and the additional competitive pressure on domestic producers.



6. Why is free trade still controversial?

- Despite this, many still argue that we need to be saved from 'cheap foreign imports'.
- In part this is because trade barriers typically provide a large benefit to a small number of people who find it easier to form lobby groups and attract public sympathy.
- It is difficult for politicians to resist calls that 'something must be done' to protect small farmers, or steelworkers.

7. “Free trade destroys jobs”

- Free trade is likely to ‘destroy’ some **jobs** in some sectors. But it creates *more* jobs in those sectors where countries do have a genuine advantage.
- Jobs in these sectors are likely to be **higher paid** and **more secure**.
- Since free trade improves overall welfare, it should be possible to help those who might lose out to adjust, and still leave society as a whole better off.

8. “Free trade isn’t fair”

- What does this actually mean?
- Lower **quality**? This is an issue for product labelling and marketing, not state intervention.
- Lower **standards**, e.g. animal welfare? Again, can be left to consumer choice
- Dangerous? Correct policy response is then an outright ban, not attempting to price goods out of the market with tariffs
- ‘**Dumping**’? If foreign governments want to subsidise UK consumers, why not let them...

9. “Free trade is bad for the environment”

- Importing foods and other goods from countries that can produce them more efficiently can actually be better for the planet than ‘**buying local**’, even if transport costs are higher.
- In any case, tariffs are a blunt tool to deal with environmental **externalities**.
- These should be tackled instead by specific taxes directly linked to the harm involved (such as carbon taxes), or by targeted subsidies where (for example) farming provides some wider public benefit.

10. Tariffs on agricultural imports

- The National Farmers Union argues that removing tariffs would make it 'all but impossible' for British family farms 'to compete with vast volumes of imports from the southern hemisphere produced in a very different manner'.
- But what does this mean?
- The hard reality may simply be that agriculture in Australia and New Zealand is more efficient, thanks to factors such as more favourable weather or **economies of scale**.

11. State aid for steel and cars

- The UK is no longer a major steel producer, but so what? We can import steel from Germany, France, Italy... (not just China)
- Cheaper imported steel is good for the rest of UK manufacturing
- Trump's steel tariffs are estimated to have cost \$900,000 a year for every job 'saved'
- Why are we subsidising Nissan to make cars or electric batteries here – rather than just importing them?

12. Lessons from the pandemic

- International trade allows countries to spread risks by accessing a wider range of suppliers, making them more resilient to shocks.
- The pandemic has illustrated the benefits of globalisation: imagine if every country had tried to develop and produce its own vaccines.
- It is far more efficient, and safer, to be able to source essentials like PPE from a variety of competing suppliers worldwide, rather than tie up resources in domestic capacity that will rarely be needed.

13. The EU's two main economic pillars

- Single Market
 - four freedoms of movement (goods, services, capital, people)
 - regulations that apply to whole economy
- Customs Union
 - no internal 'tariffs' (taxes on imports)
 - common external tariffs
 - little scope for independent trade policy



14. Brexit means 'taking back control' of...

1. 'Borders': end free movement of people from the EU
2. 'Laws': leave the EU's Single Market and end jurisdiction of European courts
3. 'Money': stop paying into the EU budget



And we should probably add...

4. 'Trade policy': leave the EU's Customs Union
5. 'Fish'

15. The costs of Brexit uncertainty

- Even before Brexit, the vote to leave the EU had some significant impacts on the UK economy.
- The **pound** fell, making imports more expensive and leading to an increase in inflation, partly offset by a boost to exports.
- Business **investment** stalled.
- Some business was lost from the **City**.
- Net **migration** from the EU slowed, partly offset by an increase from the rest of the world.

16. Brexit long-term costs and benefits

- Potential costs
 - new tariffs and non-tariff barriers for **trade** with EU
 - knock-on effects on investment and **productivity**
 - exclusion from EU projects
- Potential benefits
 - lower barriers to trade with **rest of world**
 - freedom to determine own **regulations** and **taxes**
 - savings on contributions to EU budget
- Could go either way
 - greater control of **immigration**

17. Three good sources for Brexit analysis

UK IN A
CHANGING
EUROPE

www.ukandeu.ac.uk

INSTITUTE
FOR
GOVERNMENT

www.instituteforgovernment.org.uk

BRIEFINGS FOR
BRITAIN

www.briefingsforbritain.co.uk

www.julianhjessop.com

18. Impact of Brexit on UK-EU trade

- The new barriers to trade with the EU have hit **imports** more than **exports**. This is a 'bad thing'.
- Some disagree. The UK's large deficit in trade in goods with the EU is still seen by many as a 'cost' of EU membership. Correspondingly, any reduction in this deficit is seen as a 'benefit' of Brexit.
- But forcing consumers and businesses that were happy to trade with the EU before Brexit to switch to trading with the rest of the world, or 'Buy British', does not make them any better off.

19. Conclusions on Brexit (my personal views)

- Brexit is about a lot more than just UK-EU trade (where the impact will almost inevitably be negative)
- Uncertainty has been bad for the economy, but is now clearing
- In the long run, the economics could go either way: will the gains from independent policies on global trade and regulations be enough to offset increased frictions in trade with the EU?
- Jury still out on how committed this government is to free trade and open markets (e.g. state-aid rules)

Any questions?

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