

ECONOMIC NATIONALISM OR PROGRESSIVE GLOBALISATION? The choice for modern government

Alex Karalis Isaac

Criticism of globalisation – once confined to academia and the margins of politics – is becoming increasingly mainstream. Understanding the costs of globalisation, and reducing them, will be crucial to improving our standard of living over the next decade. However, the emergence of economic nationalism as a popular alternative to open markets works against such a future. Economic nationalism supposes that we can only prosper at the expense of others, and that we can exclude others from our markets while still enjoying access to theirs. Economic nationalism is becoming popular on both the left and the right, following its growth in Europe and the USA. Britain's next prime minister will be under pressure to depart from our traditional open stance towards global markets.

This would be an economic and social disaster. Liberals and progressives should be united in resisting 'protectionism-lite', a policy that creates poverty and international tension. But progressives must

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go further and ask how can we reduce the inequality and insecurity that has accompanied modern growth? This essay argues that those who benefit from globalisation need to contribute much more positively to the *life chances* of those who do not. If such social relations are to be expressed through government, politicians will have to undertake a significant and difficult re-evaluation of existing public institutions and spending priorities.

PREFACE

The challenges that will face our government over the next ten years will be quite different from those of the preceding decade. This essay is the first in a series that will be published by the Social Market Foundation over the next six months. They examine emerging issues for the next prime minister, and identify items of unfinished business for New Labour.

We will look at both economic and social policy issues. Britain has undoubtedly enjoyed a period of great economic tranquillity during the past fifteen years. In this time the traditional enemies of our prosperity appear, if not to have been slain, then at least to be in abeyance. Inflation, high levels of unemployment and industrial unrest have all been largely absent. It would be easy to assume that our political challenges now lie largely in the social sphere.

That would be a mistake. New economic difficulties now arise, particularly given changing power relationships between the developed West and the rising stars of the developing world: India and China. Chief among these is a bubbling ferment of economic nationalism. As Alex Isaac points out in this essay, this is 'protectionism-lite', in which the developed world tries to retain the full benefits of international trade while simultaneously excluding developing nations in the name of social protection.

The danger is that this kind of 'beggar thy neighbour' approach to world trade will end up by stultifying markets across the globe, causing considerable damage to international prosperity. The early signs are there in faltering world trade talks. This will hurt those Western countries that are largely responsible for the impasse. Perhaps more importantly, it will damage the developing world where some nations are currently enjoying industrial success through access to Western markets, and others desperately require fairer trade regimes for agricultural goods.

In the UK we are beginning to see calls from both the left and the right for a response in kind to the economic nationalism evident in the rest of Europe and the US. The cry is going up to resist foreign ownership of UK companies – not only from the unions but from parts of new Labour; and not only from the right's populist press, but also from UK industry leaders.

This illustrates precisely the dangerous nature of economic nationalism. These voices are responding to decisions taken in European capitals, and in Washington, and they demonstrate the tendency of nationalism to escalation. Fortunately, they are still in the minority in the UK.

So why has Britain not suffered the same calls for economic protectionism that have been growing in intensity elsewhere in the developed world? There are several factors that may help explain this. First, Britain has enjoyed a period of considerable prosperity over the last decade. Steady economic growth has tended to mask the negative impact that global trade movements have had on certain groups of workers and communities, as well as limiting negative impacts overall.

Second, Britain's economy underwent considerable restructuring during the '80s and early '90s, and as a result is less dependent on traditional manufacturing industries and agriculture than many of its European neighbours. There have been relatively few powerful voices arguing for protection of their own particular industries here, compared to other developed countries.

Third, Britain has always been a mercantile culture with national wealth built on often global movements of goods. In that sense, (although perhaps not in others) we have a history of openness and a tradition of accepting that the downsides of economic openness are outweighed by the benefits.

Finally, the UK underwent a relatively brutal public debate about the benefits of open markets during the 1980s – a debate that other countries are only now beginning to have.

But the government cannot assume that the argument for open markets has been won. There are a number of factors that might

cause a change of heart. An economic downturn or the return of significant unemployment; any examples of foreign investment pulling out in favour of their original home country or of UK-based companies being prevented from buying companies abroad: any of these might precipitate further calls for the barriers to go up.

Government will need to resist, whatever happens. As this essay makes clear, there is no future for the UK in protectionism. But there are things that government can do to maintain the UK consensus in favour of open markets.

Prudent economic management is obviously important. But if the UK population is to accept the argument that global markets are our best guarantor of overall prosperity, then government has to make clear that the *quid pro quo* will be assistance for those unfortunate few for whom open markets will mean the loss of their livelihood.

The Social Market Foundation will be undertaking research over the coming year examining what action government should take to assist those groups and individuals left behind by global movements of money and goods. We will look at regeneration policy, at household financial security, and at government responses to large-scale job losses.

Ann Rossiter
Director
Social Market Foundation

INTRODUCTION: PROTECTIONISM, GLOBALISATION AND ECONOMIC NATIONALISM

In most Western countries protectionism has been out of fashion since the end of World War Two, certainly in theory and often in practice. The last decade has been one of unprecedented economic openness. Globalisation has entered common parlance as a description of our economic circumstances. So why write a piece arguing against the threat of economic nationalism? Surely it's globalisation that is the problem?

Well, yes and no. The popular political understanding of globalisation has certainly shifted. Most of today's leaders recognise that globalisation is not costless. This is a good thing, but it leaves politicians with a choice – either to try and ensure people have access to the education, infrastructure and support that makes them competitive and reasonably secure in a global economy, or to reject globalisation and seek isolationist forms of social protection instead.

Economic nationalism is such an isolationist response. Economic nationalism is about preventing trade and preventing the movement of capital.¹ It is about protecting select groups regardless of the wider cost – be they incumbent directors in fear of a takeover (more common), or workers in fear of their jobs (less common). Economic nationalism is protectionism-lite; the ad-hoc closure of markets here and there, without any acknowledgement that this is a challenge

¹ As international goods and capital markets exert more influence over people's lives than international migration (despite its political sensitivity) this paper is limited to those markets.

to wider political or economic processes of cooperation. Economic nationalism nevertheless leads to the adverse spiral of tit-for-tat denial that characterises protectionism and reduces opportunity for all.

The pressure to take nationalist action is growing. Ben Bernanke used an early speech as the Chairman of the Federal Reserve in 2006 to warn against the dangers of protectionism; this would have been unlikely even five years ago.² The IMF and the OECD quote possible increased protection among the risks to their (generally positive) forecasts for the global economy.³ The Doha round of negotiation at the World Trade Organisation stalled as the major groupings allowed their narrow self-interests to derail a universally beneficial solution. European leaders have taken to blocking deals between companies from member states of the EU. The new US congress is expected to be, at best, sceptical about trade.

To understand economic nationalism we must understand protectionism. Is this resurgence of protectionist activity and rhetoric going to sweep the world? How should the UK respond to it? Do we join and encourage the revival of economic nationalism or should we stand against it? Are there any credible alternative actions

² B Bernanke, *Global Economic Integration – What's new and what's not?* (Federal Reserve: <http://www.federalreserve.gov/boarddocs/speeches/2006/20060825/default.htm>, August 2006).

³ IMF, *World Economic Outlook September 2006. Financial systems and economic cycles* (Washington: IMF, <http://www.imf.org/Pubs/>

[FT/weo/2006/02/index.htm](http://www.ft.com/ftweo/2006/02/index.htm), 2006) pp. xiii-74; OECD, Editorial, 'Smooth Rebalancing' (in *OECD Economic Outlook No. 80 November 2006 Preliminary Edition*; Paris: OECD, <http://www.oecd.org/dataoecd/1/29/20332758.pdf>, 2006).

to protection that socially responsible governments could take?

In this paper I argue that open global markets are a good thing (I use globalisation in this paper to mean open global markets) and that Britain must stand up for them. But openness imposes high costs on some individuals, despite all that person's efforts and talent. Globalisation is not perfect, it is not even always attractive, but it is always more attractive than protectionist alternatives. American economist Richard Freeman has joked that the only thing economics can tell us is that communism is a bad idea; the argument against protectionism is almost as strong (the Soviet Union was the most protected nation ever).⁴

For 50 years Western economic policy has been, on balance, a force for multilateralism and reciprocity, although more 50 years ago than recently, and more between Western nations than the world as a whole. It is crucial that economic policy is again such a force, only more so than ever. The cooperation required to deal with global challenges from climate change to terrorism will be impossible if we cannot cooperate at a basic economic level.

These chapters start from the view that the market is a necessary but not a sufficient condition for prosperity and social justice. I accept Hobson's assertion that 'the market is a social institution'⁵ and suggest that the obligations of participants in the market-place extend beyond adherence to property rights and must include some effort to

⁴ He was only half joking. 'Labour market flexibility: lessons for the UK, the USA and the EU' (lecture at The Work Foundation, 13 December 2006).

⁵ M Freedman, *J A Hobson: A reader* (London: Unwin Hyman, 1988).

ensure the *chance* of success is fairly distributed and that the costs of openness are not borne solely by a few while the benefits accrue to many. If we fail to honour these obligations, trade and technical change may conspire to turn people away from a market they no longer see as a good gamble, and then economic nationalism will become a truly dangerous ideology.

THE RECENT HISTORY OF ECONOMIC NATIONALISM AND PROTECTION

We can identify four strands to recent trends in protectionism:

- resistance to foreign ownership
- resistance to foreign goods
- unwillingness to allow currencies to adjust to export strength
- the hiatus in world trade talks.

The first is by far the most common, the last by far the most worrying. All four demonstrate a growing disquiet with globalisation. This has long been evident in parts of the right and parts of the left, but is becoming more mainstream. Incumbent politicians now sense that blocking foreign economic activity can be both popular and politically acceptable. This is quite a recent development and explains the unease of Bernanke, the OECD and others.

The recent history of protectionism is a litany of lost opportunities, and shows some potential to escalate very expensively. If the *impasse* in trade talks under the Doha development round really does signal the end of multilateralism, the global costs will be large – for stability, prosperity, environmental cooperation, and most especially for developing nations.

While this is typical of protectionism over the past century, modern

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economic nationalism has, so far, demonstrated something slightly new: a belief it is possible to cherry-pick the best bits of globalisation, to keep all the benefits one's own nation enjoys while excluding any costs. This is not a sustainable position because excluding domestic costs means denying someone else opportunity and encouraging tit-for-tat retaliation.

Low-level protectionism can continue and even grow without destroying the global economy; it is possible to protect a few (farmers, for example) at limited cost to others. But this is particularly unjust – some groups are exposed to the rigours of competition and others sheltered, depending on who has the stronger lobby. The more protection becomes acceptable the more obvious this is, and the greater the pressure for yet more protection. Eventually increasing protection provokes a response from trading partners. The choice between nationalism and globalisation may not be binary, but nationalism quickly tends to develop into a spiral of tit-for-tat retaliation in which the huge benefits of globalisation disappear and the costs of isolation emerge.

The examples below show that unease about economic nationalism is well founded.

Foreign ownership: strategic yoghurt and credit-non-mobilier

Resistance to foreign ownership has become particularly evident in Europe, where economic nationalism, and its coiffured offshoot economic patriotism, are sometimes considered new political movements. Typically, they are employed to protect incumbent board members from takeovers, particularly if shareholders approve these advances.

This is an incoherent approach to capital markets, in which the general presumption of openness is not challenged but from time to time

particular deals are thwarted. The risks and costs of cross-border business are increased for the sake of benefiting a very few people. Nationhood is not a good criterion for evaluating the potential success of a merger, takeover or investment. We currently lack such criteria and our ignorance is costly, but if we are to persist with open capital markets in the meantime we must resist the substitution of national ego for effective regulations or business culture. For economic nationalists, defeating foreign ownership is the first step to defeating foreign imports, and it makes this more politically achievable. Regardless of the shortcomings of mergers and acquisitions, a wave of capital market protectionism will be a bad thing for the global economy.⁶ Several recent examples show this:

- Italian bank Antonveneto collaborated, with scandalous results, with the Bank of Italy to block a takeover by Dutch ABN Amro.
- Italian power company Enel was blocked out of a potential takeover of Franco-Belgian utility Suez, by merging Suez with state-owned Gaz de France.
- Danone managed to scare off potential interest from PepsiCo, and has assumed legendary status as a protected strategic industry despite the fact it is not, and no French government ever actually claimed otherwise. But it did not need to; President Chirac's 'personal vow to "resist the attack"⁷ was sufficient to create the legend. Nationalist rhetoric remains virile despite the evidence against its consequences.

The EU was founded on the recognition that prosperity is mutual and that reducing barriers to cooperation is good for everyone. Economic

⁶ For example E Black, T Carnes, T Janik *The Long-term Success of Cross Border Mergers and Acquisitions* (SSRN: <http://ssrn.com/abstract=270288>, May 2001, or DOI: 10.2139/ssrn.270288). The authors find negative abnormal returns, but so do many who study internal mergers and acquisition activity, e.g. A Agrawal, J Jaffe, G N Mandelker, 'The post

merger performance of acquiring firms' (*The Journal of Finance* 47:4, 1992).

⁷ Quoted in A de Jasay, *Hostile to Whom* (Library of Economics and Liberty, <http://www.econlib.org/library/Columns/y2006/Jasayhostile.html>, 2006).

nationalism is entirely contrary to this, suggesting that we can only prosper by denying others opportunity. Economic integration has driven the cultural and political success of the union; deciding to undo this process is arguably a bigger threat to the union's future than the failure of any political treaty could ever be.

Not to be outdone, the US has been involved in some spectacular and shortsighted blockages of its own:

- CNOOC, a Chinese oil company, tried to buy US firm Unocal with a very high priced offer. Political pressure from Congress and the papers scared the Chinese off, and either saved the Chinese a lot of money or handed Chevron a deal, when it subsequently bought Unocal at much lower price.
- Dubai Ports World was blocked from a legitimate takeover of P&O by Congress, under the false protestation of national security. From electioneering and scaremongering to murky relationships with Middle Eastern competitors, the politics of this nationalism demonstrated just what a haven for insider dealing and prejudice protectionism it is.

Foreign goods: bra wars and steel barons

After the disaster of disintegration between the two world wars, the global economy was rebuilt through trade: trade in goods is unequivocally associated with growth, on which employment relies.⁸ Any tendency to reverse the trend of the last 50 years and pursue isolation in goods markets is very disturbing. It costs business and consumers in the West and it costs vulnerable workers in the East

⁸ Industrialisation aside; but even here partial openness, e.g. to capital goods, is preferable to complete import substitution, which makes exports uncompetitive and industrial policy prone to corruption.

dearly when demand for their goods is unpredictably curtailed. There are two key recent examples, one European and one American.

- In 2005 the EU provoked domestic and international conflict by suspending the status of Chinese-produced clothes and textiles already in European warehouses and in transit on ships. Threatening jobs in retail, the move was as unpopular with some governments as it was welcomed by others.
- In 2001, George Bush introduced a steel tariff that contravened World Trade Organisation obligations. This unprecedented protectionism quickly backfired, raising the price of steel on which much other manufacturing depends and threatening to provoke a reaction from trading partners that would cost jobs across America. Rarely have the limits of protectionism been so eloquently demonstrated.

Currencies: pegged to the wire

Despite disparities of wealth and the liquidity of modern capital markets, nations cannot forever consume more than they produce, or sell goods abroad without buying at home. Currency adjustments help to bring surplus and deficit countries towards balance.

If big nations peg their exchange rates to drive export growth ahead of trend, they will ultimately alienate, if not impoverish, overseas markets, as well as deny their own people material return for their effort. Such activities create serious global imbalances and provide major ammunition for foreign protectionists. They represent a failure to adjust to newfound wealth and influence. They are an important example of modern protectionism or economic nationalism, one developing nations are particularly guilty of.

- China is most often mentioned in this respect, particularly by the USA. The two nations have the largest bilateral trade deficit the world has known; appreciation of the Chinese currency would greatly aid a smooth rebalancing and reduce the risk of US protectionism. Unfortunately, China's reliance on export driven growth makes this as difficult as it is necessary.⁹

World trade: gimme, gimme, gimme

Less reported than blocked deals and stranded underwear, but ultimately much more threatening, is the breakdown of world trade talks. I have included this under the rubric of economic nationalism because the same narrow, shortsighted definition of self-interest that inspires the favourable treatment of national champions inspires trade negotiators to ask for everything and offer nothing.

This approach is not very constructive, but if trade negotiators are returning to governments suspicious of the prosperity of their neighbours, they do not have much choice. The breakdown of multilateralism will cost the developing nations most; it is a major threat to the development goals politicians are keen to promote. While richer nations can afford a less effective trading system, there is no reason why they should want to. Interestingly, emerging nations have been as guilty as established nations of demanding concessions without offering to reduce their own destructive behaviour.

- Brazil, South Africa and other major developing nations want access to Western agricultural markets, and have much to lose from Western protectionism. But most of these countries also refused to

⁹ This difficulty is discussed in W Hutton, *The Writing on the Wall* (London: Little Brown, 2007).

consider changes to protection in non-competitive parts of their own economies.

- India has much to gain from more liberal trade in services, but is unlikely to generate much faith among its trading partners while her own tariff system looks back to more insular periods in her economic history.
- By far the greatest responsibility lies with the EU and the US. Access to their agricultural markets (and labour markets) are negotiation priorities for developing nations; without a first move from the major economic powers negotiations are unlikely to start again.¹⁰

The major political challenges of the next decades – climate change and international security – will require serious cooperation and a recognition that nations cannot act solely in their own interest. The retreat of economic multilateralism is, therefore, particularly worrying. While economic integration can drive political cooperation, conversely political cooperation becomes difficult if countries are competing to isolate themselves and protect their share of world wealth, instead of cooperating to increase it.

Challenging climate change will require international cooperation – technological development, technology transfer and carbon trading on a global scale will be necessary to reach the emissions reductions science requires. Nations with close economic relations have a much better chance of achieving this than nations that are drifting apart.

¹⁰ J J Schott, *Completing the Doha Round* (Washington: Institute for International Economics, <http://www.iie.com/publications/pb/pb06-7.pdf>, October 2006).

POLITICAL CHALLENGES FOR A NEW PRIME MINISTER

The British government is under increasing pressure to step back from globalisation and seek isolationist responses to domestic welfare problems or corporate difficulties. These protestations are still quite isolated, more knee-jerk reactions to specific incidents than coherent platforms. However, it is crucial that government resists the temptation to make headlines by accepting strident but ill-thought-out demands. Below I discuss some examples of such political pressure and their shortcomings.

Protectionism on the left

In general, the trade union movement does not oppose open international markets but promotes efforts to help people become more competitive and succeed in them. The TUC's support of regional development agencies is a good example.¹¹

Sometimes, though, a specific closure leads some union leaders to call for the suspension of the market and the return of large-scale government industrial policy. The (former) TGWU's Tony Woodley provided an example in *The Guardian* on the closure of Peugeot's plant in Coventry.¹² He calls for:

- temporary subsidy to struggling industry
- government to take a stake in struggling factories
- an end to unpatriotic off-shoring
- the adoption of more French-style labour law

¹¹ <http://www.tuc.org.uk/economy/tuc-12641-f0.cfm>

¹² T Woodley, 'A market driven massacre' (*The Guardian*, April 2006).

- public spending that prioritises manufacturing
- rewards for good investors and punishments for bad.

The anger is understandable but the solution – one we tried extensively in the 1970s and which led to an electorate prepared to back a decade of Thatcherism – is not acceptable for modern progressive government.

The first four points come broadly under economic nationalism, using the power of the state against the international market. Subsidy and public ownership has been extensively tried and failed. The attack on off-shoring is poorly based in fact – off-shoring is a fraction of internal job loss, accounting for only 9% of European job losses in the fourth quarter of 2006, a figure ‘in line with data from previous quarters’.¹³ This is not a definitive figure but it reminds us that globalisation is part of the general process of capitalism, of market-driven growth, it is not a radical new departure that destroys any hope of security. We accept market-driven growth because the alternatives have failed spectacularly; those job losses that are created by globalisation need to be understood in this context.

Further, world demand is crucial for our employment level (over 70% of our manufactures are exported; provoking protectionism would be disastrous for the sector) and global production adds hugely to our standard of living. To suggest that ordinary British people do not benefit from globalisation is to be more shortsighted than the worst junk bond dealer. In his article, which calls for more social cohesion and better employment, Woodley’s admiration of France is misplaced.

¹³ *European Restructuring Monitor Quarterly* 4 (Brussels: European Foundation for the Improvement of Living and Working Conditions, 2007) pp 5-6.

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Its unemployment rate is twice the UK's and its employment rate is ten percentage points lower.¹⁴ Whole communities are permanently excluded from the labour market, the lack of social cohesion leads to serious riots, and many work on exploitative temporary contracts – the inevitable counterparts to the expensive, inflexible privileges some on the left admire.

The last two points are interesting: we do need to know why open capital markets do not encourage growth as strongly as open goods markets.¹⁵ Government could be much more intelligent in its procurement of manufactures (which is massive); more predictable demand could sustain competitive UK industries at world price, but this is currently lacking.

To summarise: the left's call for economic nationalism is leading down a well-worn road that brings poverty, injustice, stagnation and vicious reaction. But different solutions to the inequalities and injustices of modern growth are very possible, and provide clear and plausible alternatives. The government is right to resist shortsighted solutions to the need to compete internationally. In the last section we discuss more sustainable alternatives.

Protectionism on the right

There is significant tension between support for international capitalism and the isolationist nationalism that every so often afflicts right-wing views of migration. The Conservative election campaign of 2005 was a good example.¹⁶ But this probably reflects cultural rather than economic protectionism (which is outside the remit of this essay).

14 *Boosting Jobs and Incomes – policy lessons from re-assessing the OECD jobs strategy* (Paris: OECD, 2006) pp 6-7.

15 See J E Stiglitz, *Capital Market Liberalisation, Growth and Instability* for an approachable argument, and details of peer-reviewed evidence (<http://www2.gsb.columbia.edu/>

[ipd/sept/CML_JES_Instability.pdf](http://www2.gsb.columbia.edu/ipd/sept/CML_JES_Instability.pdf)).

16 Critically considered in J Berrow, *Incoming Assets: Why the Tories should rethink their immigration policy* (London: SMF, 2005).

Internationally there are always examples of business leaders who will try to use protectionism to feather their own beds at the expense of others. The American steel tariff discussed above is a good example. Britain has been relatively free of such outright favouritism for many years. There is a creeping resistance to foreign ownership though, which is inconsistent with a belief in markets.

Alex Brummer in the *Daily Mail* provided an excellent example.¹⁷ Unlike Tony Woodley he had only one policy recommendation – Ferrovial must not be allowed to buy BAA. This is typical of pick-and-choose economic nationalism. The language is instructive – Brummer mentions problems with debt and monopoly but references to ‘fall[ing] into foreign hands’, ‘repel[ling] the invaders’, ‘overseas predators’ and ‘Sir Francis Drake’ suggest his interest is not so much in the role of leveraged buyout in infrastructure development, but in narrow nationalism. The government is right to resist Brummer’s criticism, as nationalism leads only to further sclerosis in the markets we rely on for our prosperity.

Economic nationalism is featherbedding for the fortunate few and it is the leading edge of more general protectionism. For all the difficulties with individual deals, we know that trade and prosperity are closely linked, so we must resist nationalism as a criterion for judging deals.

Resisting calls for protectionism from the right may be an odd position for a progressive British government to find itself in, but it is definitely the right one.

¹⁷ A Brummer, ‘Deal that must not get off the ground’ (*Daily Mail*, 7 June 2006).

A more common problem with right-wing attitudes to globalisation is the failure to acknowledge that markets may not be perfect; that there may be a need for strong and positive social relations and even government to help people acquire skills, adjust to change and live through periods of unemployment. This is currently an attitude the right in the UK is moving away from, which is particularly welcome.

In the final section of this paper I set out some basic features of a progressive government's response to globalisation, which future SMF papers will consider in more detail. Next, we consider why the UK will be better off maintaining its open stance, despite the growing pressures described above.

REASONS TO STAND AGAINST PROTECTIONISM

Supporting free trade can seem like a big mistake when confronted by the costs open markets impose on some people. It feels like 'whole communities' can decline now in a few years, such is the pace of change and the intensity of competition in the modern economy.

William Keegan at *The Guardian* tells the following cautionary tale to all would-be evangelists for the global economy:

[A trade negotiator I met at Davos] had met an old friend whose previously successful US furniture business had collapsed in the face of the kind of international competition that he (the former official) had been busily promoting.

Yes, even the most hard-bitten theoretician or practitioner can be moved by the kind of evidence he or she normally dismisses as anecdotal – until they witness it first hand.

At the end of this piece Keegan tells us he is both 'a free trader and a protectionist.'¹⁸ But why support free trade at all, given the kind of experiences described above? Why doesn't Keegan abandon open markets completely?¹⁹

Quite simply, the vast majority of theory predicts, and evidence demonstrates, that open trade between nations employs more people, more of the time, at a higher standard of living, than closed economies are capable of doing.

Even if other nations continue to promote nationalism, Britain has little to gain and much to lose from such a path.

Trade, the standard of living and inflation

For this essay I assume an improving standard of living requires, at least, high employment and real wage growth for the vast majority of the population, the vast majority of the time. This is something our choices about trade and protection can have a very large influence over.

Further, we can say that this wage growth must be non-inflationary. The 1970s and 1980s were a very expensive lesson in how badly our economies deal with inflation. Inflation targeting is a strong candidate for one of the economic policies most responsible for our recent stable growth. Non-inflationary wage growth can only come from improved productivity, both globally and at home.²⁰ Sustainable increases in living standards depend on maximising our potential productivity growth.

Theory and evidence show that both employment and productivity

¹⁸ W Keegan, 'The Limits of Free Trade' (*The Guardian*, 14 November 2006).

¹⁹ His actual solution – that we don't need to push for *more* openness in Western goods markets, but should hold on to current (high) levels of openness – suggests he is ultimately more of a free trader than a protectionist.

Where I would argue the West does need to make progress is in opening access to its agricultural markets (see above).
²⁰ Hence the Treasury's increasingly prominent focus on productivity.

depend strongly on trade. When campaigners for economic nationalism point to jobs lost through outsourcing or industrial migration, they are pointing to a very incomplete picture. In Britain, particularly, the recent period of intense globalisation has brought higher employment and growth than we traditionally enjoy. The case against economic nationalism is a strong one, and it is crucial we restate it in the current political climate.

Eight reasons to resist economic nationalism

1. Fundamental processes of wealth creation rely on trade

An increasing degree of specialisation has been one of the driving forces of increasing prosperity since Adam Smith's time at least. We rarely comment on such fundamentals and most policy decisions do not affect them. But protectionism is different; protectionism limits and can even reverse this most basic process of wealth creation. If we don't need growth, we have nothing to fear from protectionism. The problem is that employment requires growth.

2. Gains from trade

Protectionism leaves goods unmade and services unemployed across the global economy. But it does not necessarily reduce the rate at which we consume our natural resources, nor does it leave us with money to save, quite the reverse: *protectionism is about paying more to get less*. Less consumption, less employment, less carbon reducing innovation.

3. Efficiency

Preventing trade increases the cost of production. Rising prices reduce demand and the poorest people's demand falls first and furthest. Falling demand reduces the opportunity to make and sell other goods

and services. The prices of intermediate goods rise, reducing output across the economy. A vicious cycle of contraction and unemployment sets in.

4. Incentives

The more certain a government bailout, the less likely is any management or workforce to invest in reducing costs, increasing output or adopting new technology. The more protected an industry, the more resources it will soak up and the less it will produce. Protectionism increases costs within a given technology – increasing the rate at which it becomes an unsustainable policy.

5. Escalation

We cannot make decisions about economic nationalism in isolation; we either encourage our partners' destructive tendencies, or demonstrate more sustainable solutions to domestic and international challenges.

6. Falling prices

Falling prices make a wage go further and help keep inflation under control; this is good for growth and our quality of life. Spending less on basic goods produced abroad increases demand for high quality goods and services produced domestically. Trade changes national economies; it does destroy industries, but it also creates new ones. It is a fallacy to argue that trade replaces jobs with cheap goods; it increases both employment and consumption.

7. Productivity

Innovation provides new jobs and higher wages. Openness encourages the exchange and development of new ideas and it increases competition, which is the major incentive for adopting these new techniques. Only countries with open product markets have been able to remain relatively on top of technological developments. Allocating

resources more efficiently is another source of productivity growth. The more we allow prices to allocate resources, the more this happens. Again this relies on trade.

8. Employment

Trade lowers prices and increases future incomes. This can sustain rising demand, enabling high levels of employment even with high levels of competition and innovation.

CONCLUSION: PROGRESSIVE RESPONSES TO GLOBALISATION

Globalisation is a necessary condition for our prosperity but it is not sufficient. Armed with this knowledge, how can government act? It must adapt to provide a set of social institutions that deliver growth and high employment, together with equality of opportunity and broad-based gains in living standards.

Necessity of a social market

The most basic response to globalisation, the Thatcherite response – epitomised in Tebbit's 'on yer bike' call – will likely become politically untenable as fear of insecurity spreads to new and influential groups in society. Such fear need not be closely correlated with reality to be politically influential.²¹ We know that a retreat from trade would be hugely costly to the UK and the world economy. This creates a basic efficiency argument for effective 'social market' government. Government should recognise we need markets, but also that people

²¹ B Maddox, 'Why the first election loser is free trade' (*The Times*, 7 November 2006).

have to want to come to the market-place and follow its rules. This requires both a certain security and a reasonable expectation of success, or people will refuse the gamble and seriously undermine the global economic system.

The shift from Thatcherism is clear in UK politics, with three terms of Labour government and the new Conservative leadership keen to ditch the utterly individualist associations the party has long worn. This is encouraging. Unfortunately there is no clear model of a social market economy or politics, and there is no obvious or certain set of responses to the domestic challenges of globalisation. If we first look at how our domestic settlement is failing people in the UK, we can then suggest some plausible policy responses that any government taking a progressive response to globalisation should take alongside a commitment to economic openness.

Three problems

The regional problem

The regional problem has been with us since the interwar years when the 'depressed areas' became official parlance for the North. Manchester is now growing faster than London, but a look at relative employment performance in the North East and the Midlands shows just how bad this problem can still be.²²

The poverty problem

Even in successful regions, social mobility is falling, wage mobility is declining, wage growth is often uncertain, and inequality is rising.²³

²² North East unemployment rate 6.9%, West Midlands 6.1%, national average 5.6%; July-September 2006. ONS, *Labour Market Statistics, November 2006* (London: ONS, <http://www.statistics.gov.uk/pdffdir/imsuk1106.pdf>, 2006).

²³ See, for example, the rise in the Gini coefficient (a measure of the expected proportional income gap between randomly selected individuals) since 1979. M Brewer, A Goodman, J Shaw, L Sibieta, *Poverty and Inequality in Britain 2006* (London: IFS, 2006) Figure 2.10, p. 24.

Technology and trade are, *ceteris paribus*, polarising our labour market and our society; advantage is increasingly handed from one generation to the next. *Ceteris paribus* is therefore not acceptable. The institutions and economic policies that have evolved to deal with earlier periods of globalisation must be reviewed and adapted in the light of the sustained inequality that has accompanied our recent prosperity.

The insecurity problem

Although employment and unemployment performance for the past decade have been encouraging for most of the OECD, people do not feel secure. This is a problem that any politics of social globalisation must try to overcome. A domestic politics that can sustain the prosperity that follows from open markets will have to pay detailed attention to the politics, the policy and also the social relations of unemployment, poverty and security.

Progressive responses

What is government's role in an effective social market economy? An effective social market economy is one of opportunity, where growth does not come at the price of ever greater polarisation. If this sounds hopelessly left wing, consider the following (from Alan Greenspan): 'An increased concentration of income... is not the type of thing which a democratic society, a capitalist democratic society can really accept without addressing.'²⁴

We are a long way from addressing this challenge and it is clear government must provide key basic investments, with large positive externalities, where the market does not.

²⁴ Joint Economic Committee, *The Economic Outlook 2005* (quoted in Brookings Institution, The Hamilton Project, Washington: The Brookings Institution, 2006).

- In a knowledge economy the essential investment is in education and training – providing the basic skills that, with suitable employment opportunity, provide the foundation for a world-class workforce.
- Effective transport is essential to effective markets. Britain's transport infrastructure is not famously attractive; changing this must be a priority for governments.
- Innovation is notoriously difficult to provoke but Western governments must increasingly look to do so – innovation is likely to be a key source of 'sticky jobs'.²⁵ Sticky – high value-added, non-migrating – jobs can bring Western workers prosperously through the period of global adjustment as Asian wages catch up with the West's. Investment in science and basic research is not a luxury but an economic and social necessity. More knowledge about how to translate this into actual business development is also a priority, especially for the UK.
- The safety net approach to welfare fails millions – people are more likely to die on incapacity benefit than to find a job.²⁶ What is the role of active employment policy and could a genuine insurance scheme allow government spending to find more constructive destinations than providing low quality 'retirement' for displaced workers?

Meeting the challenge of globalisation, therefore, requires prioritising new areas of government spending. The Treasury has set out an intention to do this, and the Leitch, Eddington and Barker reviews cover some of the key early research that must inform policy on skills, transport and productivity.²⁷ The Conservatives are reviewing all areas of social policy. This is extremely positive.

²⁵ Phrase suggested by R Freeman, *Labour Market Flexibility*, at The Work Foundation, 13 December 2006.

²⁶ M Haddad, ed., *The Incapacity Trap: Report of the SMF commission on incapacity benefit reform* (London: SMF, 2005).

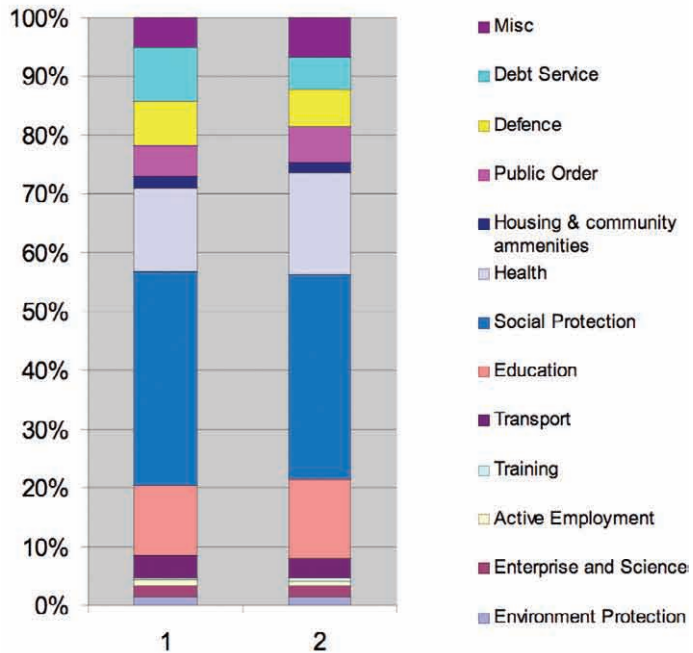
²⁷ http://www.hm-treasury.gov.uk/Independent_Reviews/independent_reviews_index.cfm; see also HM Treasury *Budget 2006*, chapter 6, *Delivering high quality public services* (London: Her Majesty's Treasury, 2006).

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But the challenge is a massive one. New Labour has had considerable success in overturning the Thatcherite consensus about the *size* of government. Redefining the *shape* of government will be a far harder challenge. Supporting innovation, training, education and infrastructure development is key to meeting the challenges of globalisation, but it is not what government traditionally does. Starting to do it is a worthy goal for politicians searching for renewal.

The scale of the challenge is clear from a comparison of government spending before and under New Labour.

Figure 1. Share of expenditure on services in 1995(1) and 2004(2)



As we see, the two are very similar, and the greatest change has been in health care, an electorally popular slice of spending. The spending covering the above priorities is a small fraction of government activity – about 20%. Although redirecting any spending growth to new priorities could go some way to making government activity reflect government priorities, it is clear that significant reform of existing institutions will also be necessary.

Remodelling welfare payments so that they are less of a pension for displaced workers and more of a source of opportunity will be crucial to this, as the OECD's recent review of its jobs strategy suggested.²⁸ Building on recent successes in labour market policy, and overcoming its failures, is the subject of the recent SMF essay by Stephen Evans.²⁹

Social relations

People's experience of wellbeing, opportunity and marginalisation is not solely, probably not primarily, a function of government activity. How people relate to each other is crucial to how we experience our lives.

There is not much ideology left in politics, but if governments are to build institutions that support broad-based growth, politicians need to think about what sort of society they want to represent.

Openness is akin to a public good; everyone is subjected to the same level of openness and it enhances opportunity overall. However, the costs of providing this openness, particularly unemployment, fall far more unevenly than those of providing most public goods. If such

²⁸ OECD, *Boosting Jobs and Incomes – Policy lessons from re-assessing the OECD jobs strategy* (Paris: OECD, 2006) p. 18, Figure 5.

²⁹ S Evans, *Delivering Full Employment: From the New Deal to personal employment accounts* (London: SMF, 2007).

a reciprocal, interdependent understanding of unemployment and prosperity can form the foundations of a post-Thatcherite concept of society, then sustained enthusiasm for open markets may become far more certain than is currently the case.

Such a recognition would mean new social attitudes to unemployment and poverty. Attitudes based not on discrimination and marginalisation, but on the recognition that accepting the risks of open markets enhances prosperity for all. Such social relations would demand effort from those who benefit from openness to improve the life *chances* of those who do not. A meaningful, modern interpretation of social responsibility must surely include a consideration of these relationships.

Regardless of the particular pattern of spending or the method of delivery, any social market government must strive to build an understanding of society that is based on reciprocity and responsibility. Responsibility to understand that growth can be costly, and that the market alone is not currently living up to its potential for a significant section of the population.

An agenda for new governments

Modern prosperity has come at a price: higher inequality and falling social mobility. This has led many to question globalisation, the major source of that prosperity. Other people question globalisation now that the benefits are starting to be felt outside the West, and Indians or Brazilians, as well as Americans, can invest in and own European firms. Criticism from both the left and the right leaves government with a choice – to reject globalisation or to reform in progressive response to it.

To reject globalisation would be an expensive error for developed countries, as we discovered between the wars. Internationally, the costs would be even higher – destroying opportunity for billions in developing nations and undermining global political cooperation.

There is a clear agenda for modern socially minded government – to stand up for global markets but to reform the institutions that have traditionally accompanied openness.

This requires a vision of prosperity through reciprocity to inform the foreign and domestic policies of future governments. As we have seen, this is absent from much of the current discourse about prosperity and its consequences, which concentrates instead on how people can hold on to what they have, to the exclusion of others.

Such a vision could provide a foundation for the institutional evaluation and reform that must accompany a commitment to open markets.

We can further say that this reform should emphasise social interactions and government investments that increase opportunity. Though common rhetoric, the pattern of government activity suggests that achieving such a goal will actually be a formidable task. However, there is some hope that our future leaders will compete to achieve it.

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