

Economics of Free Trade – with a dash of Brexit

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1. Agenda

- The benefits of free trade
- Some arguments against
- What Brexit is about
- The impact to date
- Longer-term costs and benefits
- 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!



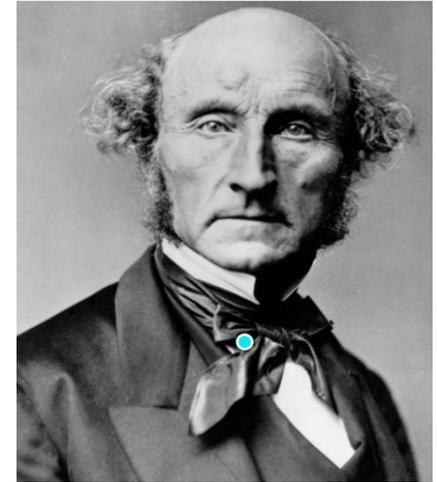
4. David Ricardo

- 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**



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. 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**.

9. Brexit: it's not just about the economics...

“I've never met anyone who's said...

I'd be in favour of Brexit if I thought the impact on GDP would be less than 2%, but I'll be in favour of Remain if I thought it was more than 5%

It's the issues of identity and culture and politics that are motivating people.”

Mervyn King, 2019
(Former Bank of England Governor)



10. 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



11. 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



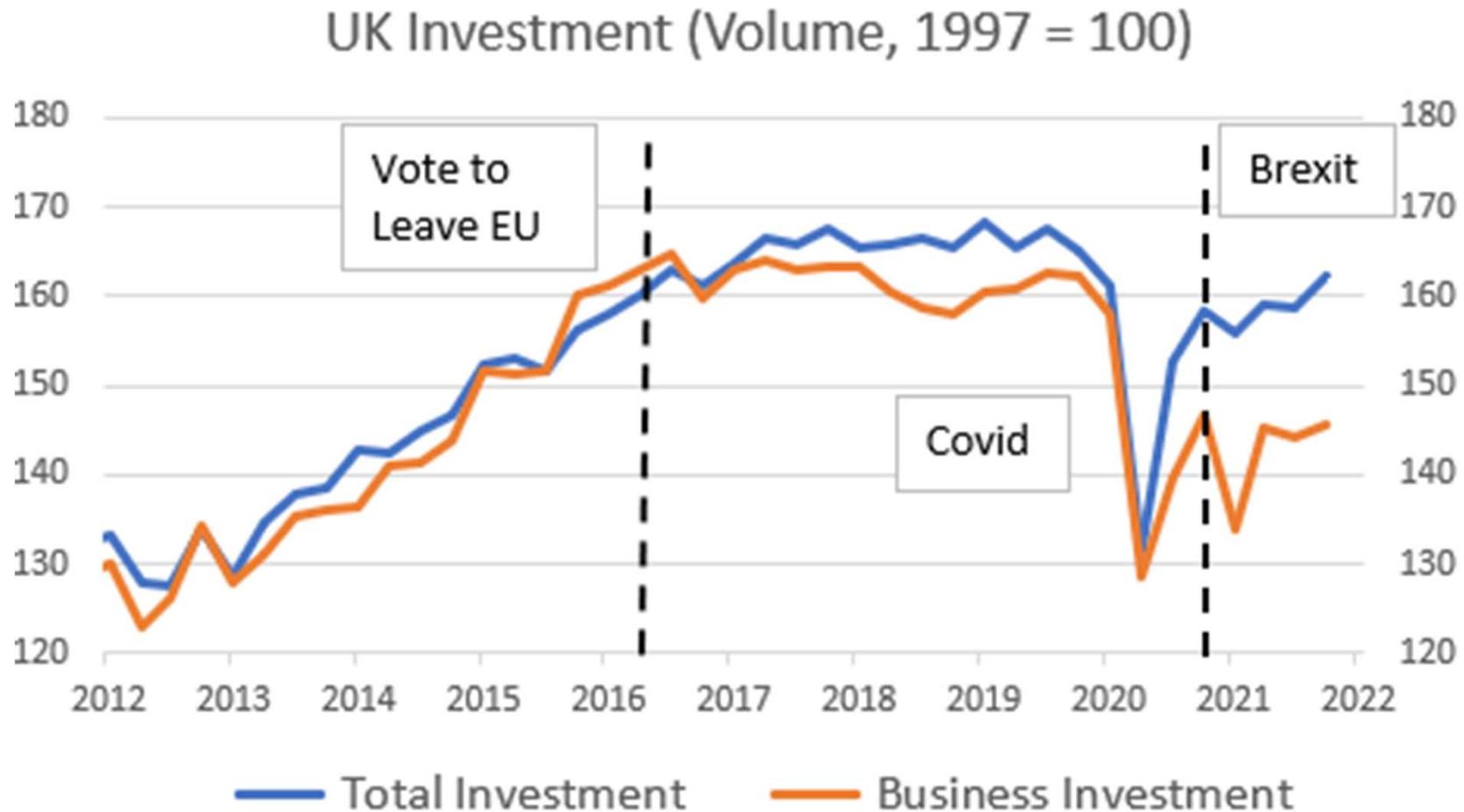
And we should add...

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

12. The costs of Brexit uncertainty

- Even before Brexit itself, the 2016 vote to leave the EU had some significant impacts on the UK economy:
 1. The value of the **pound** fell, making imports more expensive and leading to an increase in inflation (only partly offset by a boost to exports)
 2. Business **investment** stalled
 3. Some business was lost from the **City**
 4. Net **migration** from the EU slowed (only partly offset by an increase from the rest of the world)

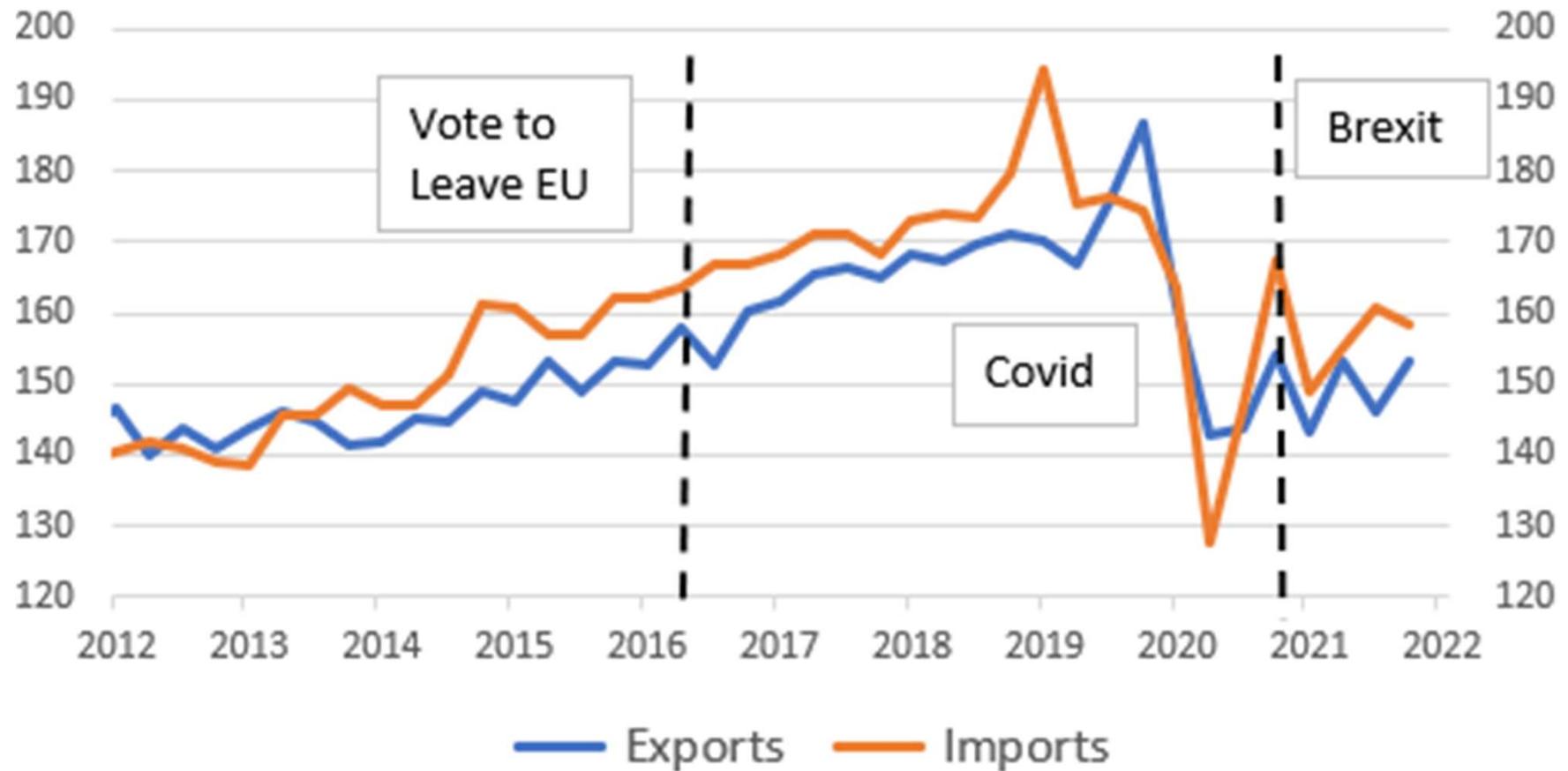
13. Brexit and business investment



Source: Office for National Statistics

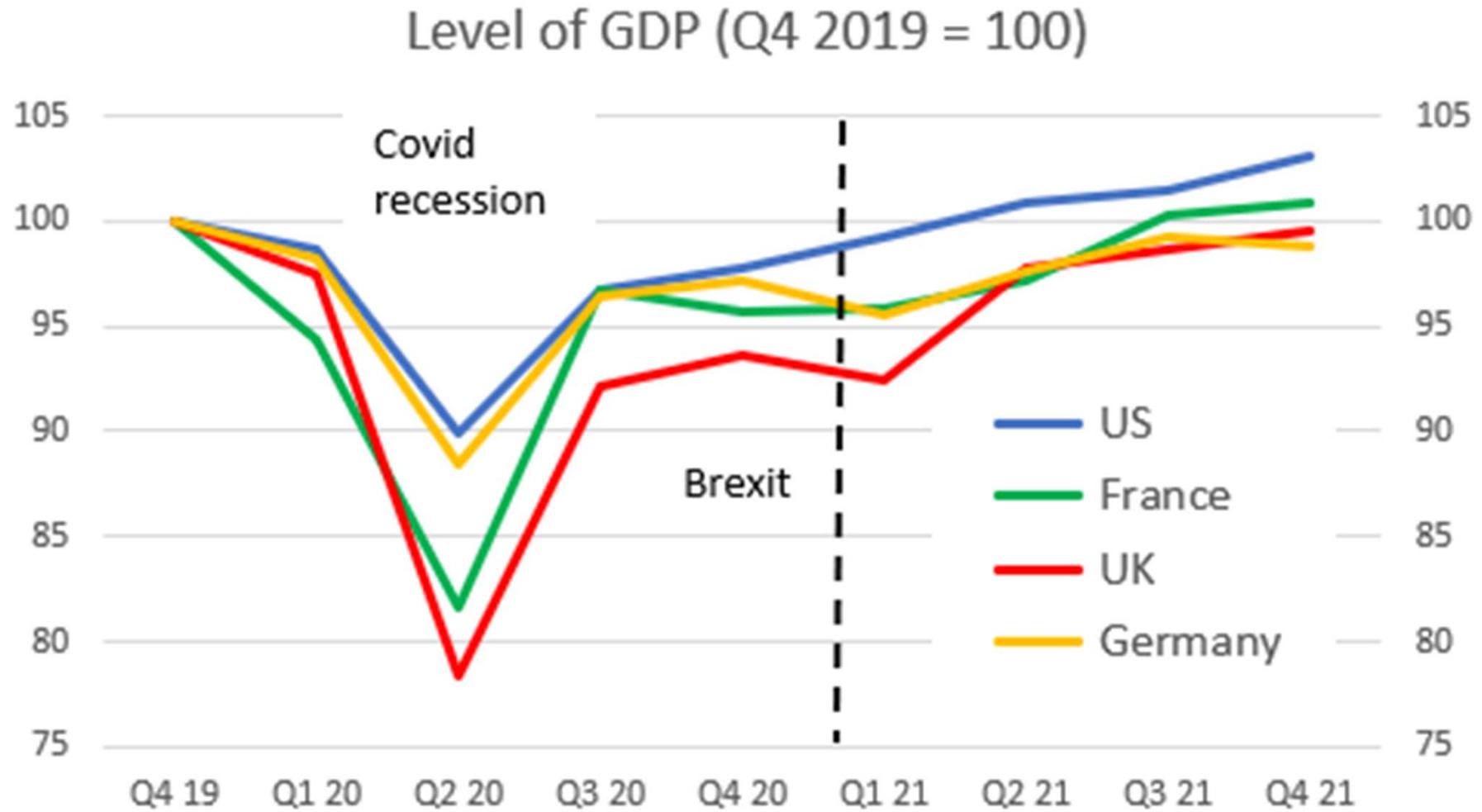
14. Brexit and trade

UK Trade (Volume, Goods and Services, £bn)



Source: Office for National Statistics

15. Brexit and GDP



16. Brexit long-term economic costs and benefits

- Potential costs
 - new tariffs and non-tariff barriers for **trade** with EU
 - knock-on effects on investment and **productivity**
- 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**
 - Impact on **real wages**

17. Conclusions

- Costs of Brexit always likely to be more visible and immediate, benefits more broadly spread and will take longer. But uncertainty at least is now clearing.
- In the long run, the economics could go either way: will the gains from independent policies on global trade, tax 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
- Brexit not yet 'done' either

Any questions?

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