Andrei Potlogea

Better for All

Trade Liberalisation: The Economics

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Preface

Trade and the rules which govern its flow, have moved centre-stage globally with protectionism enjoying a potent appeal from the US to the EU. Here in Britain it is also in the spotlight, though for different reasons – the UK is preparing for trade after Brexit. Nonetheless the questions for policy are similar to those which took place at another dramatic time for politics and the economy, over repealing the early 19th century corn laws protecting the price of home grown corn through a sliding scale of tariffs on imported grain. Should the aim be free trade with ever greater trade liberalisation? Or should domestic producers today be protected by taxing imports (or imposing other barriers)? How should policy decide between different groups, as happened in the 19th century parliament?

The answers, even from economies with the same general outlook such as the US and the UK, tend to differ. Many people believe that freer trade can undermine home industry and that job losses are inevitable as cheaper imports displace home grown products. Others fear that the quality of imports or their likelihood to be safe, may not be as high as that of goods produced at home, or that some producer economies are not (but should be) following the rules and legal framework on product standards under law. For some, there are ethical concerns that a liberal global trade regime promotes the interests of large companies and multinationals at the expense of small home-grown challengers and undermines the diversity necessary for competitive functioning markets.

It is not only in developed economies such as US or France that such doubts exist or that trade policy matters at election time. Though the questions now developed in extensive academic literature may seem more complex than two centuries ago, at heart they are about the relative benefits and disadvantages of free (or liberalized) trade regimes, the perceived losses and gains of different trade policies for different groups, the impact on industries and jobs and the implications for the legal framework and regulation governing imports or domestic goods for export. They also raise questions about how best to respond to or exploit the consequences of liberalisation and how to deploy the economic tools which for government are a way of life – regulation, tax and public spending.

In this study, Dr Andrei Potlogea, an academic economist who specialises in international trade and economic geography weighs the economic debate, one in which economists like politicians, are divided about the merits of trade liberalisation. He explains how much of the concern is ill founded, and that the message from the labour market and on the supply, as well as demand, side of the economy is an upbeat one. There are good grounds for optimism about free trade and trade liberalisation. It brings significant gains for both emerging and developed economies. The effects on jobs and particular industries are offset by sectoral changes, with new industries and businesses springing up to develop expertise in specialized areas, with higher productivity and job creation. Consumers are in general better off, benefitting in a number of ways, not least from greater competition. Although the author agrees that there are some problems, these concern mainly the winning of the battle of ideas. He urges governments and protagonists to lead the debate on freer trade and proposes how to do this. For, as he reminds his readers, we do not live only in an economy, but in a political economy.

Sheila Lawlor
Director
Politeia, July 2018

I
Trade Liberalisation
The Political and Economic Debate

Since the 2016 US presidential elections, when Donald Trump was elected on a platform which seemed both explicitly protectionist and pitched against trade imports, there have been ample signs of similar shifts in public opinion elsewhere, including in Europe. Thus, the TTIP negotiations prompted extensive public opposition and even protests in a number of European countries; the ratification of CETA was slowed down and almost scuppered by a combination of intense public and political opposition; while in the UK the government's initial reticence in protecting the local steel industry triggered a significant public outcry.

Such recent hardening of public attitudes to trade liberalisation has been accompanied by a significant shift in the balance of opinion among academic economists, who have traditionally been supportive of free trade. Starting with the early years of the last decade, a number of studies have uncovered a series of substantial economic costs associated with trade liberalisation. Some of the most influential among these have focussed on the impact of increasing exposure to import competition from developing countries, particularly China, on economic outcomes in developed nations.

The findings of this strand of research make for a bleak reading for proponents of trade liberalisation: increased exposure to import competition was associated with increased unemployment, reduced and increasingly variable earnings, an accelerated pace of factory closures and increased reliance on welfare transfers. Moreover, the negative effects of import competition were not restricted to the directly affected domestic producers, but extended to businesses both upstream and downstream of those producers, as well as to non-tradable activities. Even more worryingly, the negative effects of trade liberalisation were found to be both geographically concentrated within countries and also concentrated among a narrow set of particularly vulnerable occupations and demographics.

The negative economic impact of import competition was found to have knock on effects in the social realm: the communities most exposed to foreign competition display significant drops in marriage and fertility rates, worse health outcomes, higher mortality rates, increases in the number of children born out of wedlock or to teens, increased crime rates and lower quality of local public services.

The change in the tone of the academic debate surrounding free trade has been stark, with support for trade liberalisation increasingly lukewarm. This is perhaps unsurprising if one considers the optimistic and arguably complacent views traditionally held by economists on the issue of international trade. Classical theories of trade emphasized that trade is a win-win for all countries that participate. Freer trade, the argument went, improves consumer welfare by lowering prices and increasing the variety of available goods, while at the same time raising the productivity of economies by helping reallocate resources to the most productive sectors and firms.

Economists had long acknowledged that the benefits of trade are likely to be unevenly distributed across different segments of the population, and that the destruction and expansion of industries that accompanies trade bears its own risks and costs. Until recently, however, the economic consensus was that these transition costs were likely to be small, and the gains were large enough to compensate for the losses that some do suffer. That consensus has now evaporated in light of recent research findings.

It is not only among politicians and economists that there has been a marked scepticism. Amongst voters and the wider public too, support for free trade in particular and for free markets in general has been gradually eroded. A 2015 YouGov analysis found that a plurality of the French – 35 per cent (though it should be mentioned that scepticism about trade has a long history in France) thought that free trade was bad for business in their country (while only 31 per cent thought it was good) - while 31 per cent thought trade had a negative impact on jobs (while only 29 per cent thought trade had a positive impact on employment). Even in export powerhouse Germany, only a narrow plurality of respondents (30 per cent to 27 per cent) thought that free trade was good for business, while on the topic of jobs Germans who thought that trade had a negative effect on employment outnumbered those who thought that the opposite was true (29 per cent considered trade to have a negative impact on employment while only 22 per cent considered trade beneficial for jobs).

Moreover, scepticism about international trade is now also widely shared by Americans, traditionally perceived as one of the nations most supportive of free trade. Research by the Pew Research Center revealed that in 2015, 34 per cent of Americans thought that free trade agreements slow down economic growth (as opposed to 31 per cent who believed that they accelerated growth), 46 per cent believed that they reduced wages (as opposed to 11 per cent who believed they make wages higher) while 46 per cent believed they lead to job losses (compared to 17 per cent who believed free trade agreements helped create jobs).

Worse, the pace of this widespread decline in public support for a liberal trading environment appears to have accelerated during the fallout from the Great Recession. Faced with squeezed living standards and the perceived unfairness of the distribution of the costs of the financial crisis, voters in several rich countries have asked their elected representatives to erect trade barriers to protect them from international competition. Moreover, politicians themselves have contributed to the shift in public mood against free trade. Traditionally protectionist voices were joined by other, more opportunistic ones, in blaming foreign competition for a wide range of adverse economic outcomes, many of which were, in fact, the result of domestic policy failures.

This paper suggests is that the tone of the debate on trade liberalisation has become too strongly sceptical about its merits. In order to rebalance the discussion four main arguments in support of free trade will be considered: (1) Recent findings do not undermine the fact that there are substantial aggregate gains for both developed and developing countries from maintaining a liberal trading regime and continuing trade liberalisation; (2) These gains are likely to be particularly significant for developing nations, making trade liberalisation a key tool for poverty alleviation; (3) Some of the short and medium run costs associated with trade liberalisation might be overstated, wrongly attributed to trade liberalisation or may have been incurred anyway due to other factors such as technical progress; and finally (4) Many of the short to medium run costs of trade have either been amplified by deficient domestic policies or could be partially mitigated via improved policy interventions.

After considering the benefits of free trade, the paper will consider how best trade liberalisation can be advanced so the prospective gains are realised. It suggests that supporters of freer trade should focus on identifying the least costly (i.e. the least distortionary) way to maintain and advance public consent for trade liberalisation. This is because we inhabit not an economy, but a political economy, and as a result the pursuit of trade liberalisation in democracies relies crucially on continued public support. This point is very often lost on analysts focussed on narrow economic considerations or highlighting the aggregate gains from trade.

The paper further suggests that free trade protagonists could modify their position and message on a number of counts in order to win greater levels of public support for trade liberalisation. First, they should embrace gradualism. As adjustment costs to the impact of trade liberalisation have been shown to be significant, allowing for a phased implementation of trade liberalisation measures is likely to reduce disruption and allow those negatively affected more time to adapt. In turn, this is likely to reduce their opposition to liberalisation.

Second, supporters of trade liberalisation should endorse activist domestic policies aimed at mitigating the short run distributional and adjustment costs of liberalisation. These may include policies aimed at promoting the mobility of workers across sectors, such as job re-training programs, or policies aimed at promoting geographical mobility. Third, greater attention should be paid to public concerns regarding the unequal distribution of the gains from trade. Proponents of freer trade should therefore consider supporting [at least] limited transfer programs that ensure a more equitable distribution of these gains.

Last but not least, supporters of trade liberalisation need to improve their communication strategy with the wider public. In particular, two shifts in communication approach are likely to be particularly consequential for improving the quality of the public debate around trade. The first is to more energetically challenge and disprove the myths and misunderstandings surrounding the politically contentious issue of trade deficits. The second is to show greater willingness to discuss honestly and openly the trade-offs between national sovereignty and (deep) trade integration involved in negotiating modern trade agreements. This latter course of action may or may not enhance public support for trade liberalisation, but would probably guard against some of the wild swings in support for free trade observed recently.

In the chapters which follow, chapter II describes the benefits of trade liberalisation for developed economies; chapter III focuses on the gains from trade liberalisation for developing countries; chapter IV discusses political economy considerations and tackles the issue of how to secure public consent for continued trade liberalisation. Chapter V concludes by outlining an approach to trade liberalisation in a post-Brexit world.

II
The Gains from Trade Liberalisation
Developed Economies

In the last few decades, developed economies have often played the role of defenders and promoters of trade liberalisation. This section argues that, in spite of new difficulties generated by the changing nature of trade and the increasing competitiveness of developing nations, rich nations should maintain their commitment to free trade and continued trade liberalisation. The logic of the argument is straightforward: the (net) gains from trade predicated by classical trade theory have not been disproved by recent research, are still significant and worth pursuing.

The Tangible Benefits of Trade Liberalisation

Much of the recent scepticism about the merits of trade liberalisation can be attributed to new evidence documenting the negative fallout from increased import competition. It is important to note, however, that while many of these studies do an excellent job at identifying the losers from foreign competition and quantifying their losses, they often only look at one side of the ledger. Once one takes a broader view, the picture surrounding trade liberalisation improves considerably.

Let us begin our discussion with the supply side of the economy. Here, the weight of the evidence indicates that the benefits of trade in terms of increased (domestic) economic efficiency, promised by classical theories, have indeed materialized during past liberalisation episodes. An instructive example is provided by the analysing the much politicized topic of Chinese imports in the US. While it is indeed true that increased import competition from China was associated with job losses and increased risk of closure among US manufacturing plants, Magyari (2017) points out that shifting attention to US manufacturing *firms* reveals a much more encouraging picture.[1]

She finds that firms more exposed to Chinese import competition actually expanded their manufacturing employment as they reorganized towards sectors less exposed to Chinese competition and benefitted from lower costs of production due to the availability of cheaper intermediate inputs.[2] Moreover, these firms expanded employment by hiring both more production workers, to whom they paid higher

[1] It is perhaps easiest to think of a manufacturing firm as a collection of manufacturing plants.
[2] In other words, although Chinese imports may have reduced employment within some establishments/ plants, these losses were more than offset by gains in employment within the same firms.

salaries, and more workers engaged in complementary service activities (such as R&D, design, engineering and headquarter services). The evidence is thus broadly consistent with firms successfully responding to increased import competition by reorganizing, improving efficiency and creating higher quality jobs.

Another interesting piece of evidence supporting the productivity benefits of trade liberalisation, this time from Europe, comes from a study by Nicholas Bloom, Mirko Draca and John Van Reenen. Analysing European firms following the removal of product specific quotas with the occasion of China's accession to the WTO, they find that increased Chinese competition led to both technology upgrading within firms and to the reallocation of employment towards more technologically advanced firms. The combined impact of these within and between firm effects is to cause technological upgrading in those industries most affected by Chinese imports. Moreover, these effects are large, and can account for about 12 per cent of European technology upgrading between the years 2000 and 2007.

The benefits of trade liberalisation to developed country consumers are if anything even easier to account for than the supply side benefits discussed above. Classical theories of international trade promise benefits to consumers in terms of lower prices and greater choice. Encouragingly, the empirical evidence largely backs up these predictions. For instance, Bai and Stumpner (2017) analyse detailed US barcode level price data and find that product categories facing higher import penetration from China experienced slower price inflation. The effect is found to be driven by both changes in the prices of existing goods and the entry of new goods.

Furthermore, recent research by Fajgelbaum and Khandelwal indicates that the gains from trade liberalisation, both in developed and developing countries, accrue disproportionately to lower income consumers. This is largely because poorer households spend a higher fraction of their budgets on tradable goods, whose prices are typically reduced by trade liberalisation. Trade liberalisation benefits are likely to be even higher among the lower income consumers of rich nations, as it provides them with easier access to the cheaper varieties of consumer goods typically produced in developing nations.

Given the discussion above, it should come as no surprise that most studies that estimate the aggregate effects of trade liberalisations find significant gains. This result prevails even in studies that do their best to incorporate frictions and adjustment costs to trade liberalisation[3], and when only considering the 'static' or short-run effects of liberalisation. Thus, the seminal study of Eaton and Kortum (2002) estimates welfare gains of moving from autarky to free trade to range between 0.2 and 10.3 percent for 19 OECD countries; Caliendo, Dvorkin and Parro (2017) use a model embedding mobility frictions and adjustments costs find that the US actually experienced an aggregate welfare gain (albeit a relatively modest one) from the notorious 'China shock'; while Hsieh and Ossa (2011) find that recent productivity growth in China provided welfare benefits for the rest of the world via trade channels.

Moreover, it is important to note that the studies mentioned above are likely to underestimate severely the merits of trade liberalisation. This is because these studies ignore the longer run or 'dynamic' benefits that freer trade may provide. These include, among others: increased productivity due to greater competition and improved diffusion of ideas across countries; increases in complementary flows of Foreign Direct Investment (FDI) and specialist workers (e.g. foreign firms may invest in distribution or retail units in home country, or may integrate local factories in their global value chains); learning by exporting effects etc. Studies that aim, albeit imperfectly, to estimate the gains from trade inclusive of these additional effects typically find gains from trade that are at least double, and often more than triple those that emerge from short-run studies. For instance, the seminal study of Feyrer (2009) finds that for each 1 per cent increase in a country's trade, its GDP is increased by 0.5 per cent. Applied to the trade creating effects that have been estimated for major recent trade liberalisations (NAFTA, China's WTO accession), this estimates yield the conclusion that these agreements added significantly to the output of developed and developing nations alike.

Furthermore, the changing nature of modern international trade has served to augment the benefits of trade liberalisation while raising the cost of protectionism. Much of today's trade is trade in intermediates, with parts or components crossing borders numerous times before recognisable final products are finished. This process allows the operation of highly efficient regional and global value chains, where each task is performed in the location with the greatest comparative advantage in that particular activity.

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[3] Admittedly the ability of current (even state of the art) trade models to embed an extensive list of adjustment costs and consider the potentially complex distributional effects of trade liberalisation is still limited.

A prime example of this development is the rapid integration of European economies in the last three decades, as a consequence of both improved technologies and the reductions in (intra-European) trade frictions brought about by EU expansion. The result has been the creation of highly efficient European value chains, the so-called 'Factory Europe', in which the more sophisticated Western European economies specialized in the design and advanced engineering stages of production, leaving processing and assembly activities to take place in developing Eastern European economies. This specialization, coupled with the increasing returns to scale that could be exploited due to the larger European market substantially increased productivity, making Europe as a whole more competitive on global markets.[4]

In the context of the development and operation of the increasingly integrated regional and global value chains described above, the unilateral introduction by a jurisdiction of even relatively modest trade protections can substantially raise overall production costs and can lead to a country being excluded from global value chains, with significant losses in terms of productivity and welfare.[5]

Last but not least, let us consider the more indirect and harder to measure benefits that may accrue to developed countries from trade liberalisation, particularly when the removal of barriers involves developing nations. First among these, opening up rich country markets to developing nations aids economic development in the latter. While this may serve to relocate some sections of global value chains to poor nations (to the detriment of some rich country workers), it also serves to increase developing nations' demand for sophisticated goods and services typically produced in developed economies. Next, while negotiating trade agreements, developed countries may extract economic policy concessions in developing nations that benefit all parties: improved enforcement of property rights, governance reforms, protection of intellectual property rights[6] (which often benefits developed nation innovators), anti-corruption measures etc. Again, an example of this is provided by the process of EU enlargement, where the reforms undertaken by developing Eastern European nations as part of their accession

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[4] In fact the EU as a whole has recently been the biggest actor in world trade, being both the largest exporter and the largest importer of goods, and running a very substantial trade surplus.

[5] For instance, Gawande et al. (2015) conclude that the increasing fragmentation of production across global value chains may have prevented countries from raising trade barriers and inducing protectionist measures in the follow-up of the Global Crisis of 2008.

[6] In principle, offering access to rich country markets in exchange for intellectual property rights protection could enhance welfare for everyone, as ensuring that developing nations contribute to global innovation is in principle efficient. However, many commentators maintain that rich nations have often pushed the case of intellectual property protection too far, in an attempt to help their innovators extract excessive rents from developing nations.

process arguably played a substantial role in their subsequent growth and modernisation.

Furthermore, increased trade with developing nations can often substitute for poor-to-rich country immigration flows[7], and increased living standards in developing countries due to increased trade may reduce the incentives for migration. Given the political and social tensions emerging in many developed nations (including the US and many EU member states) around the issue of immigration, this can be seen as an additional benefit of trade liberalisation. Finally, promoting trade integration that aids poorer countries develop can help build international political goodwill. This is likely to become increasingly important in the future as the world grapples with complex global governance issues that require enhanced international cooperation.

Free Trade: A False Target?

The case in favour of freer trade for developed economies rests not only on the substantial benefits outlined in the previous section, but also on the fact that the costs of liberalisation are likely to be (1) overestimated, (2) mis-attributed to trade or (3) subject to mitigation by appropriate policy action. In this section I discuss the potential overestimation and mis-attribution of costs to trade liberalisation, leaving the discussion of policy to Chapter IV.

The large number of high quality studies that have documented significant adjustment and distributional costs associated with trade liberalisation means that these costs can no longer be ignored when discussing trade policy. However, it is important to note that there is still substantial uncertainty regarding the interpretation and magnitudes of these adverse effects found to be associated with freer trade.

From an interpretative standpoint, many of the studies that document negative effects of trade liberalisation are 'partial equilibrium' analyses, that focus on identifying the sectors most negatively affected by import competition and quantifying their losses. However, from a broader, 'general equilibrium' perspective, the findings of these studies are often difficult to interpret and indeed often misleadingly interpreted. In particular, it is important to note that many of the job displacements attributed to trade

[7] In principle, one can think of trade and immigration as alternative ways to ship labour internationally. Given that immigration entails additional costs and externalities, and has faced significant political opposition in developed nations, trade may in fact often be the 'cheaper' way to shift labour internationally.

by recent research may in fact represent job shifts, not job losses.[8] For instance, in recent research on the effects of NAFTA, Scott (2011) attributes a net loss of 400,000 US manufacturing jobs to increased trade with Mexico. However, he also finds that roughly 300,000 of the manufacturing jobs displaced by the pattern of growing trade with Mexico are not net reductions in total US jobs but rather shifts in net jobs from manufacturing to other sectors.

Substantial uncertainty also affects the magnitudes of the negative affects attributed to trade liberalisation by the recent literature. For instance, the seminal study of Autor et al. (2013) attributes the loss of about 1.5 million US manufacturing jobs (and 2 million total jobs) to increased competition from China in light of its WTO accession in 2001. In a recent comment however, Feenstra, Ma and Xu (2017) show that controlling for local housing conditions (a contemporaneous housing boom was affecting the localities less exposed to Chinese import competition) reduced the number of US job losses to less than half – 800,000. While it is not clear which of these two estimates can be considered more reliable, the large gap between them reveals the imprecision inherent in attempts to assess the impact of trade on employment.

Another issue to consider when assessing the costs of trade liberalisation is that some adverse economic outcomes may have been mistakenly attributed to freer trade. In particular, disentangling the role of trade from that of automation in driving the sharp decline in manufacturing employment experienced by many developed economies in recent decades has proved difficult. Aside from the integration of several large developing economies into the world trading system, the last few decades have seen the sustained advance of labour saving technologies in most manufacturing sectors. This raises the possibility that some of the job losses attributed to trade might have in fact been caused by enhanced automation. Indeed, according to a recent study by the Center for Business and Economic Research at Ball State University, 85 per cent of the 5.6 million manufacturing job losses experienced by the US during the interval 2000 to 2010 are attributable to technological change — largely automation — rather than international trade. By contrast, Autor et al. (2015) find that import competition from China has a greater role than technological change in driving employment losses at the level of US local labour markets.

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[8] It is important to note that ‘job shifts’ induced by trade are not costless. Research indicates that workers who are displaced by import competition and find work in other sectors tend to experience substantial wage losses. However, it is still true that ‘job shifts’ are substantially less costly than ‘job losses’ (which are associated with long term unemployment). Thus interpreting ‘job shifts’ as ‘job losses’ still leads to an overestimation of the costs of trade liberalisation.

Furthermore, even in cases in which particular job losses can credibly be linked to import competition, it is difficult to assess the (marginal) effect of trade liberalisation on the employment of import competing sectors. This is because many of the jobs that are displaced by trade would have otherwise been eliminated by automation had trade not 'got to them first'. The activities eliminated by import competition in rich countries tend to be labour intensive, which makes them uncompetitive given the high wages prevalent in these locations. However, had trade integration not occurred, these same activities would have also presented the strongest incentives for automation, as the scope for cost reductions involving the replacement of workers with machines would have been greatest. In this context, it makes sense to consider the (marginal) effect of trade liberalisation to be only the bringing forward of the date when some jobs and activities were eliminated from developed economies. Thinking of the effects of trade liberalisation in this way makes it almost impossible to estimate the costs of freer trade in terms of lost employment. However, as the analysis above illustrates, there are theoretical reasons to believe that the (marginal) contribution of trade to job losses may be modest.

Trade Liberalisation – The Costs and Their Mitigation

The discussion above notwithstanding, it is indeed the case that trade liberalisation can still bring about some adverse economic effects, particularly in the short run. This is primarily because trade liberalisation suffers from a lead-lag problem: the costs of freer trade, while often relatively small, tend to be incurred quite rapidly, while the benefits, while substantial, tend to accrue over a longer period of time. In this context, policy can (and should) play a role in reducing the costs and augmenting the benefits of trade liberalisation for developed countries. However, in recent times, faulty economic policy in many rich countries has often achieved the exact opposite. For example, the 'strong dollar' policy that has often been popular with US authorities in the last few decades has rendered many US based activities uncompetitive on international markets, arguably leading to an overshoot of 'offshoring' to low wage countries. In other words, instead of cushioning the short-run impact of import competition, US monetary policy has often served to deepen the extent of manufacturing job losses, thus raising the perceived costs of freer trade.

Moreover, many of the short run costs associated with trade liberalisation can be attributed to the existence of barriers to the reallocation of workers across sectors and locations. Workers displaced by trade often experience unemployment spells and earnings losses because finding alternative employment often requires a change in occupation or moving to a different location. In turn, these adjustments carry significant monetary and non-monetary costs. It is important to note, however, that a significant portion of the barriers affecting worker reallocation is in fact policy induced. For instance, in the United States between the 1950s and 2008 the share of employment covered by occupational regulation rose from roughly 5 per cent to nearly a third. Thus, workers displaced by import competition (or any other economic shock) today find almost a third of the labour market inaccessible to them due to these regulatory protections. Similarly, workers looking to relocate in search of work to successful cities and regions often find these locations unaffordable. This is because onerous planning regulations reduce the supply of housing in these prosperous locations and thus artificially raises its cost. An additional problem, particularly severe in parts Europe is the portability of various social benefits, such as housing benefits or social housing provision, that also artificially increase the frictions to spatial mobility.

Reversing these and other policies would go a long way towards reducing the adjustments costs associated with trade liberalisation and raising public support for freer trade. But arguably policymakers should be more ambitious than to merely set out to ensure that policy does not aggravate some of the adverse effects of foreign competition. Indeed activist policies can complement trade liberalisation by further enhancing its benefits while cushioning its medium run costs. Such activist policies, including job training programs, relocation subsidies and targeted welfare support will be discussed in greater detail in Chapter IV.

III
Emerging Economies and Trade Liberalisation

Developing countries have traditionally been sceptical of the benefits of trade liberalisation. Until the early 1990s, the dominant school of thought concerning the optimal trade policy of developing countries maintained that in order to grow their economies, these emerging markets needed to protect their ‘infant industries’ from international competition. These types of ‘import substituting industrialization’ policies were widely applied, and even registered some success in a limited number of cases.[9]

However, starting from the early 1990s, the changing nature of international trade, which shifted towards more intense trade in intermediates and the development of global value chains, brought about a significant change in the trade policies of many developing nations. Rather than attempting to develop entire vertically integrated sectors behind prohibitive trade barriers, these countries found that it was often easier to make progress by opening up to trade and allowing the sections of global value chains in which they had a comparative advantage locate in their jurisdictions. As a result, most developing economies embarked on a process of rapid trade liberalisation starting from the early 1990s. In this section I argue that this development should be celebrated and further encouraged, as developing countries have even more to gain from further trade liberalisation than rich nations.[10]

China: a Testament to Trade Liberalisation?

Perhaps the most natural place to start a discussion highlighting the benefits of trade liberalisation for developing countries is to invoke the case of China. Its rapid integration into the world economy in the last few decades brought about one of the most remarkable economic transformations in history. As it opened up to foreign goods, capital and technology, and secured improved market access to major trading partners, China rapidly joined global value chains triggering one of the most rapid and most prolonged episodes of export-led economic growth. As a result, the face of the country has been comprehensively transformed: a formerly agricultural nation is now widely considered ‘the workshop of the world’; millions have been drawn from villages into China’s bustling cities, particularly on its coasts, and most importantly, hundreds of millions of its citizens were lifted out of poverty.

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[9] Most notably the case of South Korea.

[10] This background discussion on the evolution of the trade policy of developing nations draws on material from Richard Baldwin’s recent book, *The Great Convergence* (Harvard, 2016).

The role of the relatively liberal global trading regime of the last few decades in fostering China's recent economic success is arguably insufficiently understood and appreciated. Indeed, the willingness of major developed economies such as the US to grant improved market access to Chinese exporters was highly consequential in driving Chinese growth, and potentially of equal import to the liberalising measures undertaken by China itself. This can perhaps most easily be seen by noting the significant improvements in the trading and overall economic performance of China around the time of its accession to the WTO in 2001.

It is precisely the episode of China's accession into the WTO that has been the focus of much of my own recent research. Alongside my co-author Wenya Cheng[11], we study how this significant trade liberalisation affected local economies and local labour markets in China. This analysis begins by arguing that China's entry into the WTO significantly improved China's access to major foreign markets, particularly the US. This improvement in Chinese market access to the US resulted primarily from China being switched to a more favourable trading regime by US authorities as a consequence of being a WTO member. In turn this significant improvement in market access affected different locations (defined as cities) within China differently. This was because some sectors experienced more significant improvements in foreign market access than others, and because local economies varied markedly in terms of their sectoral specialisation.

We proceed to relate the extent to which each major urban area in China was exposed to foreign market access improvements as a result of WTO accession with their subsequent economic performance after 2001 (the accession year). We find that cities that were subject to larger improvements in their international trading environment experienced much faster growth in population, employment and output following China's WTO accession. This growth seems to have been partially driven by a surge in investment, which flowed, both from domestic and overseas investors, preponderantly towards the areas with the most improved trading conditions. Moreover, the effect of trade liberalisation does not seem to be limited only to the directly affected sectors (i.e. the sectors experiencing substantial improvements in foreign market access following China's WTO accession) but spill over to other tradable and nontrable activities. Among tradable sectors, spillovers operate primarily via labour and input-output channels, whereas demand channels mediate the spillovers from tradable to nontradable activities. Indeed, these indirect effects of trade liberalisation transmitted

[11] Wenya Cheng is a Lecturer in Applied Economics at the University of Glasgow.

via spillovers are often of a larger magnitude than the direct effects on the most exposed sectors.

There are perhaps two key lessons that emerge from our research. First, the gains from trade liberalisation for developing countries can be very large. This is because the direct benefits of liberalisation are amplified by complementary inflows of FDI, intersectoral links within the tradable sector as well as spillovers from the tradable sector to the nontradable sector. Second, the adjustment costs to trade liberalisation may often be lower in developing nations, which can explain the greater support for freer trade in these countries relative to the developed world. Developing countries tend to have a comparative advantage in labour intensive sectors which often means that trade liberalisation has strong job-creation effects. Moreover, at least in the case of China, worker reallocation across sectors and locations in the aftermath of trade liberalisation seems to have been rapid and caused little disruption. This may be because the lower skilled jobs that are prevalent in China are less differentiated, making re-training and adjustment easier.

It is important to note that our findings are still likely to understate the benefits to China of the trade reforms associated with its WTO accession. To begin with, we mostly focus only on the benefits created by one specific change in US trade policy, and largely ignore the consequences of China's own liberalisation measures. These are likely to have brought substantial additional benefits, with a recent study by Amiti et al. (2017) suggesting that the improved availability of cheaper intermediate inputs (due to the reduction of Chinese import tariffs) may have been even more consequential than the US trade liberalisation we study in driving China's recent impressive economic performance.

Moreover, our research focuses on the production side of the economy and ignores the benefits of freer trade on the consumer side. As with their rich nation counterparts, Chinese consumers benefitted from lower prices and improved consumer choice as a result of trade liberalisation (in particular due to the reduction of Chinese import barriers as part of the WTO accession negotiations), and also stood to benefit indirectly from China's integration into global supply chains, which raised the productivity of Chinese firms and the quality of their products. Finally, our research also omits the more indirect social and political benefits brought about by freer trade. For instance, the advance of urbanization partially caused by trade liberalisation is likely to have brought about additional benefits associated with city living: increased productivity (due to agglomeration), human capital accumulation, social modernisation etc. Moreover, the integration of China in the world economy gave its trading partners a stake in its development and gave it a stake in the existing economic and institutional order. This should in principle facilitate cooperation on a broad range of issues related to global governance.

Global Manufacturing Supply Chains and the 'Commodity Super-Cycle'

Focussing our discussion of the gains from trade for developing countries on China, arguably the most salient story of export led economic success, may lead the reader to suspect that the example was cherry-picked to produce the most positive assessment of the benefits of trade liberalisation. While it is indeed the case that China has been particularly adept at leveraging the opportunities provided by freer trade in the last few decades, the bulk of the evidence indicates that most developing nations have benefitted from the trend towards trade liberalisation that started in the early 1990s.

In fact, developing nations can be broadly classified in two groups according to the way in which freer trade has benefitted them. A first set of countries has broadly followed the path of China and integrated into global manufacturing supply chains by securing improved access to foreign markets and lowering their own barriers to trade. [12] The most notable examples in this group of countries include (aside from China) Korea, India, Indonesia and Thailand. Also in this group we could include Eastern European countries that have secured EU membership in the last decade and have subsequently integrated in Europe-wide value chains (perhaps the most notable success story among this set of countries is Poland, which has achieved a high level of integration with the highly sophisticated German economy). A second group of countries benefitted more indirectly from the 'commodity super-cycle' by the rapid industrialisation of the first group. The most notable members of this group include Brazil, Nigeria, Mexico and Venezuela.[13]

All in all, while the gains from trade liberalisation have arguably been very uneven across developing countries (with the benefits for the second group arguably more precarious and short lived), the overall picture of the effects of the recent trend towards freer trade on developing economies is a compellingly positive one. This is perhaps most easily illustrated by the fact that this period of global trade liberalisation has

[12] Richard Baldwin argues compellingly in his recent book, *The Great Convergence*, that improving communication technologies also played an important role in integrating developing countries in global supply chains, and thus in accounting for the convergence in economic performance between rich and poor countries observed recently.

[13] Australia is also an important member of this group of countries to benefit from the 'commodity supercycle', but is not a developing country.

coincided with a ‘Great Convergence’ in living standards between large sections of the developing world and industrialised countries.

Trade Realism: Short-Term Losses, Overestimated Benefits

The encouraging picture of the effects of trade liberalisation for developing nations depicted in the previous section should not detract from the fact that freer trade is also likely to generate losers in these countries, at least in the short run. The adjustments costs to opening up to foreign competition may be lower than in rich countries, but they are likely to remain significant. In this context, as for developed countries, the role of complementary policy interventions that serve to cushion the short run costs and amplify the longer run benefits of trade liberalisation is crucial. Some of these policies will be discussed in greater detail in the next chapter.

Another frequent pitfall in discussions surrounding trade liberalisation in developing countries is the tendency in some quarters to overemphasize its benefits, particularly in the short to medium run. In turn, when these benefits are slow to materialise or smaller in magnitude than promised, the credibility of pro-trade voices is called into question. While freer trade and the integration into global value chains can produce substantial benefits for developing nations, they do not represent a silver bullet. If unaccompanied by additional (and complementary) pro-development policies such as encouraging the acquisition of skills and the adoption of new technologies, providing secure property rights, reducing burdensome regulation or corruption, the effects of freer trade alone on the economic performance of these countries is likely to be modest.

IV
Free Trade: Winning Public Support

Our discussion so far has revealed that while trade liberalisation has the potential to bring about substantial economic benefits to developed and developing nations alike, it often carries short run costs that make it unpopular with electorates, particularly in rich countries. In this context, an important question for supporters of freer trade to answer is how to secure the consent of sceptical electorates for continued trade liberalisation such that the potential gains from trade are realized.

In this section I argue that the key to alleviating public concerns about the effects of trade liberalisation is to promote policies that mitigate the short run distributional and adjustment costs entailed by freer trade. Moreover, I suggest that depending on the particular sectors and circumstances involved, a combination of the following three policy 'instruments' should be used to put forward liberalisation programmes that are palatable to the public: (1) gradualism – trade liberalisation programmes should be implemented gradually to allow sufficient time for the reallocation of resources (particularly workers) in the economy to occur, with minimum disruption; (2) complementary macroeconomic and microeconomic policies that reduce the barriers to intersectoral and geographic mobility should be implemented, and any policies that raise artificially such barriers should be eliminated; (3) public employment, risk sharing and welfare policies should be implemented to ensure a wider distribution of the gains from trade across broad segments of society. Given that all these policies also carry costs, the objective of the policy mix should be to secure public consent for continued trade liberalisation while minimizing policy induced distortions to individuals' decision to work, save and invest.

To these policy recommendations I also add two suggestions regarding the approach proponents of freer trade may want to take when communicating about liberalisation with the wider public. The first is to prioritise educating the public about the often misunderstood and over-politicised issue of trade deficits. The second and perhaps more important one is to show greater willingness to discuss openly and honestly the sacrifices in terms of policy and regulatory discretion (and arguably sovereignty) that are required to pursue the 'deep' trade liberalisations of the future. This may or may not secure greater support for freer trade, but should prevent the wild swings in public support for trade liberalisation observed in recent years.

In what follows I develop the logic behind the policy proposals mentioned above, and where appropriate I illustrate their applicability with the example of the recent controversy in the UK surrounding the protection of the domestic steel industry (and in particular the iconic plant at Port Talbot) in the face of intense Chinese competition. I focus the example on the UK as this country is likely to soon engage in a significant reconfiguration of its international trade arrangements. However, the main lessons and policy recommendations outlined here applicable more widely, including in Europe and the US.

A Gradualist Approach?

Given that much of the short run costs of trade liberalisation are due to the sluggishness with which workers reallocate across sectors, one straightforward policy response would be to seek trade agreements in which liberalisation measures are phased in slowly (over say a period of 5 years or more). Alternatively, effective protection can be maintained via targeted subsidies. These measures could in principle allow workers in uncompetitive sectors more time to re-train and seek alternative employment, thus cushioning any short-run adverse effects and lowering political opposition to freer trade. For instance, in the case of UK steel, Britain could sign trade agreements in which import tariffs for steel are gradually reduced from a relatively high rate over a period of time.

Gradualism is of course not costless, as it entails foregoing some of the gains from trade for a period of time. Its desirability therefore depends on a number of factors: the position of the protected sector in input-output relationships, its geographic location(s) and whether the conditions making the sector uncompetitive are likely to be temporary or permanent. Thus, holding other things equal, protection is more costly for sectors that provide inputs for many other activities in the economy (as it raises the cost of these activities), more beneficial when applied to sectors that are concentrated in less developed areas with little alternative employment (adjustment costs are likely to be high in this case), and easier to justify in situations in which the sectors are uncompetitive due to temporary circumstances.

Applying this type of analysis to the case of the UK steel sector reveals the complications involved in devising trade policies that preserve most of the gains from trade while limiting short-run disruption. On the one hand, protecting steel from foreign competition is likely to prove costly as it is an input in the production of many other products. On the other hand, the steel sector is concentrated in relatively poor parts of the UK where alternative employment is limited, while some of the conditions making the sector uncompetitive, such as competition from heavily subsidised Chinese steel are likely to be temporary. In this context, a short period of tariff protection followed by a period of state support via subsidies may be warranted. Crucially, the period of tariff protection needs to be kept short to ensure the competitiveness of downstream sectors, which are more important to the UK economy in terms of both employment and value added.

The analysis above, and the issue of gradualism in general, are of course highly controversial. Many economic analysts point out that the foregone gains from the slow and gradual implementation of desirable economic policies (such as trade liberalisation) can be substantial. For instance, in the case of fiscal consolidation, Shuknecht and Tanzi (2005) find that countries that engaged in rapid and ambitious reductions of public spending in the last two decades of the twentieth century experienced notably superior economic performance. Faced with this type of evidence, many commentators argue that desirable policy reforms should be implemented swiftly and any short-run losers should be compensated via complementary policies (such as transfers or subsidies, which I also discuss below). However, it is important to note that these alternative policies also carry costs and often also have long implementation lags. For instance, subsidies need to be financed via distortionary taxation, while the implementation of job training programs that help those hurt in the short run by trade liberalisation (or other beneficial policies) can be slow and costly. Thus, on the balance of risks and given the importance of securing public support for trade liberalisation in today’s polarised political environment, the arguments supporting a gradual approach to trade liberalisation remain robust.

A second critique raised by analysts that are sceptical of gradualism invokes political economy considerations. Gradualism, it is argued, may undermine the credibility of policy as it allows opponents of reform the time to organize and lobby for policy changes to be watered down or reversed. However, while these considerations cannot be discounted, they are likely to be less severe in the case of trade liberalisation. This is because trade policy, unlike purely domestic policy domains, involves agreements with other sovereign governments, which make policy reversals costly and risky. In this context, the optimal approach to trade liberalisation is therefore likely to involve the (relatively) swift negotiation and ratification of trade agreements that include gradual implementation clauses. This approach should, under most circumstances, deliver policy that is both credible (due to the high cost and risk of policy reversals that affect the interests of another sovereign government) and carries lower short run adjustments costs (thus maximizing public support). However, it is important to note that the constraining effects of trade agreements that make gradualism less costly than in other contexts also have other, arguably less benign, political economy implications. These are discussed in greater detail in the next chapter.

Minimising the Short Term Costs: The Role of Policy

Aside from allowing enough time for the necessary adjustments to take place, the policy mix accompanying trade liberalisation needs to take active steps to lower the cost (and increase the speed) of these adjustments. Policymakers have two broad classes of instruments at their disposal to achieve this goal: macroeconomic tools and microeconomic interventions.

Focussing on macroeconomic policy first, it is advisable that the completion of major trade agreements is accompanied by a period of expansionary fiscal and monetary policies. These policies should aim to keep labour markets strong and unemployment low, such that the workers displaced by trade liberalisation have the best possible prospects to find alternative employment.

Targeted microeconomic interventions are also likely to be an important part of the optimal policy mix. Such interventions should promote the reallocation of workers most likely to be negatively affected by freer trade and should include re-training programs and re-location support. For instance, in the case of the UK steel industry, to complement the measures discussed in the previous section, the government should consider running large retraining programs in the regions most affected by the decline of the steel sector, as well as offer subsidies to encourage workers to re-locate to more prosperous parts of the country. Needless to say, any policies that artificially raise the costs of necessary adjustments, such as onerous occupational licensing rules or restrictive planning policies in prosperous regions should be revised or eliminated.

Risk Sharing, Public Employment and Welfare Transfers

Sometimes ensuring the gradual implementation of trade liberalisation and taking policy action to assist the required adjustments will not be sufficient to gain wide-spread public support for freer trade. In these situations additional measures may be required to reassure the public that the gains from trade will be widely shared.

Perhaps the first among these is ensuring adequate risk sharing among local communities within each country. It is crucial that (central) governments do not allow the quality of public services (in particular education and healthcare) in areas most adversely affected by foreign competition to deteriorate. This is a particularly important point to keep in mind given the recent drive towards greater decentralisation in many countries. While decentralisation does indeed bring many benefits, if vital public services are funded solely from local revenue with little risk sharing across communities, this can lead funding gaps and inadequate provision in areas experiencing adverse impacts from trade liberalisation.

Moreover, unlike the effects of import competition which are likely to be short-lived, substandard schooling for instance can have long run detrimental effects. The best way to guard against these effects (and the opposition to trade they are likely to trigger), is for central governments to provide funding top-ups to local authorities particularly adversely affected by foreign competition.[14]

A second set of additional measures to cushion the short run costs of trade liberalisation involve the expansion of public employment or other forms of public procurement. While this of course raises the risk of wasteful projects, given the inadequate provision of infrastructure, education, health and social care in many developed countries, there should be enough scope for an expansion of public services that adds real value to citizens. Such an expansion in public services would serve to absorb some of the workers displaced by import competition and other adverse economic shocks.

Lastly, governments should also consider a limited expansion of social insurance and welfare transfer programmes. While these programmes are likely to be the costliest and provide the smallest benefits[15] among the ones discussed in this section, it is nevertheless the case that they can play a role in mitigating the effects trade induced job displacement for those least able to adjust to the new economic conditions. Moreover, at least anecdotal evidence indicates that opposition to freer trade is strongest in the countries with the most limited welfare transfer programmes, which would seem to indicate that these programmes can play an important role in securing public consent for freer trade. It is important thus to note that these type of welfare programme expansions are likely to be more appropriate in countries where welfare support is modest (such as the US) and less likely to be useful in locations where welfare provision may already be excessive or mis-targeted (arguably the case in a number of European countries, including the UK). In these latter cases, the scope for policy improvement is given more by the recalibration of welfare systems and the reconsideration of policy priorities rather than the further beefing up of often already substantial welfare machinery.

[14] Note that the same logic applies to other economic shocks, such as technological displacement.

[15] The benefits are likely to be limited even for recipients, as the welfare effects of social transfers are likely to be smaller than those of employment.

Trade Deficits and Sovereignty: Educating the Public

Aside from shifting some of their policy positions to reflect recent research and placate some of the concerns of the general public, proponents of freer trade also need to improve their communication strategies. In particular, two changes in communication approach could prove particularly useful in improving the quality of debate around trade liberalisation: a strong focus of proponents of freer trade to dispelling some of the myths surrounding the notion of trade deficits; and an increased availability on their part to talk openly and honestly about the costs in terms of sovereignty of modern, 'deep' trade agreements.

Trade deficits are undoubtedly one of the most misunderstood concepts in international economics. Many people (including the incumbent US president) see the trade balance as a way of 'keeping score' regarding a country's international trade activities, and trade deficits as an indication that the country is 'losing', or being taken advantage of by its trading partners. However, this logic is misguided. Trade deficits are merely the counterpart of borrowing from abroad, and tend to emerge in countries characterised by low domestic saving rates. It is not at all clear, however, that the ability to borrow resources from other countries with excess savings is detrimental to a nation's welfare. Admittedly, and all else equal, larger trade deficits may be associated with larger short run adjustment costs to trade liberalisation. But the solution to this problem (and to lowering trade deficits should this be considered desirable) is not to impede trade but to enact macroeconomic policies that encourage domestic savings and reduce reliance on borrowing from abroad. Clarifying these points should remove an important source of public scepticism to trade liberalisation.

Another misunderstanding that proponents of freer trade need to fight against concerns the nature of remaining trade costs and the nature of modern trade agreements. We now live in a world in which remaining tariffs and quotas are no longer the worst barriers to international trade. Instead, non-tariff barriers are currently the biggest impediment to international trade, and any meaningful future trade liberalisation will have to find ways to significantly lower them. The difficulty, however, is that many of these barriers emerge from differences in rules and regulations across jurisdictions, such that goods need to be subjected to costly inspections to assess their suitability to be sold in each particular market. As a result, lowering these non-tariff barriers involves seeking greater homogeneity in rules and regulations across countries, which in turn implies lowering the policymaking discretion of each jurisdiction. This gives rise to an important trade-off between national sovereignty and further trade liberalisation (or market integration), which should be recognised fully by the proponents of freer trade.[16]

Often, the supporters of trade liberalisation have sought to downplay this issue by pointing out that the negotiation and ratification of trade deals is typically the preserve of democratically accountable governments who represent the interests of their constituents. However, this argument is in most circumstances insufficient. The crucial point of contention here concerns the ability of current governments to constrain the policy space of future governments. Unlike domestic policies that can be modified in a relatively straightforward manner when the preferences of the public change, trade policy arrangements tend to be more inflexible. This is because the policy space is often constrained by obligations entered into (often by past governments) via trade agreements with other sovereign governments. In turn, these constraints on trade policy are difficult to remove, as they typically involve costly renegotiations with other governments (which may see their interests harmed) or running the risk of a degradation in relationships with international partners.

It is important to note at this juncture that the difficulties posed by this trade-off between domestic policy discretion and trade integration do not uniformly apply in all cases, and can vary wildly depending on context and the participants involved in negotiation. Where economies have equivalent legal and regulatory frameworks including for consumer protection, this problem is less pronounced, even if significant difficulties can still emerge e.g. over states' desire to protect favoured industries. The problem is more difficult to resolve when the regulatory frameworks including for consumer protection are not equivalent or insufficiently robust.

The complexities of navigating the trade-offs between trade integration and national sovereignty have already been evident in a series of recent set-backs affecting trade blocks and trade liberalisation efforts. These issues have particularly come to the fore in the EU, where the very deep integration of the economies of member states, alongside a rapid pace of regulatory harmonisation and an expanding role for EU institutions, has led to disquiet in some quarters about loss of national sovereignty. Similar issues have also emerged during the process of negotiating so called deep trade agreements, such as TTIP, TPP or CETA.

[16] Perhaps the most compelling characterisation of the trade-off between sovereignty and deep trade integration is offered by Dani Rodrik, in his description of the 'Political Trilemma of the Global Economy'.

On a more positive note, however, the outcomes of some of these recent trade negotiations have also shown that these issues, while difficult, can often be overcome. In the case of CETA, for example, a combination of gradualism, in which particularly politically sensitive issues were parked, and sustained political commitment to liberalisation, which allowed many other difficult issues to be resolved, meant that the agreement was finally signed. Nevertheless, in the current political climate of most developed nations, openly discussing the costs of deep trade integration in terms of reduced national sovereignty is likely to prove increasingly crucial. Admittedly, these open discussions may or may not increase public support for freer trade. However, they should ensure that whatever support for trade liberalisation is ultimately won is on sounder footing, thus reducing the risks of costly reversals of trade liberalisation in the future.

V
Conclusion

This paper aims to re-balance the current academic and public debate about the impact of trade liberalisation. While recent research has conclusively shown that trade liberalisation can bring about adjustment and distributional costs in the short run, it remains the case that the longer run benefits of freer trade are substantial for developed and developing economies alike. There is, therefore, a strong case for the current (relatively) liberal international trade regime not only to continue, but to be extended and augmented by further liberalisation.

However, the findings of recent research which finds difficulties in the short-run adjustment to trade liberalisation should not simply be ignored, and proponents of freer trade need to adjust their policy positions if they want to see the significant potential gains of freer trade realised. In particular, I argue that they need to embrace gradualism and the activist use of complementary policies that can cushion the short run adverse effects of trade liberalisation for some groups. These policies are likely to not only enhance the overall gains from any trade liberalisation but also make liberalisation more likely by addressing some of the voting public's concerns about freer trade.

Supporters of freer trade should also change the way they communicate about trade liberalisation. I emphasize two shifts in communication strategy that are likely to be particularly beneficial for the quality of the public debate around the issue of trade: a focus on dispelling some of the most misleading myths about freer trade, particularly surrounding the issue of trade deficits; and a willingness to openly discuss and debate the trade-off between national sovereignty and trade integration that is likely to become more visible in the future, as countries begin to contemplate modern 'deep' trade agreements**.**

I would like to conclude this piece by drawing out some of the key lessons applicable to the United Kingdom as it prepares to leave the European Union. The UK looks set to embark on a very significant reconfiguration of its international trade arrangements over the next few years. In this context, the main objective of domestic policymakers should be to minimize disruption and any short-run costs associated with changing trade arrangements, as this will be crucial to securing continued public support for the type of liberal trading regime on which the country's future prosperity will depend.

The first lesson applicable to the UK concerns the role of gradualism in calibrating trade policy, which will be crucial if the aim of a smooth transition to new trading arrangements is to be achieved. This gradualism must in turn rest on three pillars. The first concerns Britain's new trade relationship with the EU. Here Britain should seek both to preserve as much as possible of the existing mutual market access by aiming to keep both tariff and non-tariff barriers low (e.g. via a customs union, a customs partnership or technological solutions), and to ensure that any increase in trade frictions that still takes place as a result of Brexit is phased in gradually during a transition period. This should be feasible to achieve as it also serves the interests of the EU to ensure minimal disruption and ample adjustment time for economic agents.

The second pillar of a successful gradual approach to reconfiguring Britain's trading arrangements concerns the more than 40 nations with which Britain enjoys preferential market access as a result of trade deals concluded by the EU. Here the main objective in the short to medium run must be the 'grandfathering' of these arrangements as part of bilateral trade deals with the UK. These deals can then be amended and improved at a later date to be better tailored to the needs of the UK and of the relevant trading partners. Finally, the third pillar of the policy of gradualism that I recommend concerns the rest of the world. Here the recommended policy is to aim to negotiate ambitious trade deals that contain gradual phase in clauses of at least the most disruptive liberalisation measures. This type of mix should ensure that significant gains from trade are realized at least in the medium run, while mitigating any short run disruptions that may erode public support for freer trade.

The second useful lesson for Britain's policymakers concerns the role of complementary policies that can reduce the short run costs of trade liberalisation. In the UK context, the most likely source of these costs relates to the country's widening regional disparities coupled with its high (and still increasing) barriers to the spatial reallocation of labour. In response to these challenges, policy should aim to improve economic opportunities in lagging cities and regions (say via location specific subsidies or by re-locating public sector workers and activities out of London) and reduce the barriers to moving to the nation's most successful cities by tackling the issue of housing affordability in these locations. This latter objective could be best achieved via a significant reduction of current planning restrictions, complemented where necessary by public housebuilding programmes.

The third lesson emphasizes the importance of diagnosing the shortcomings of current trade arrangements and seeking areas for improvement. In other words, British policymakers need to have a clear view of where the main opportunities presented by further trade liberalisation lie. In Britain's case two such opportunities come to mind: liberalizing trade in services and liberalizing trade in agricultural goods. As a nation with a strong comparative advantage in services (in particular financial and legal services), Britain is particularly negatively affected by the inadequate coverage of services in most existing trade agreements. Moreover, the costliness of the current arrangements in terms of missed opportunities are increasing over time, as services are growing rapidly as a share of the world economy. In this context, Britain should champion ambitious further liberalisation of trade in services and fully explore the opportunities provided on this issue by some of the modern trade agreements, such as the TPP, which have made some progress in covering services.

Agricultural products are another significant missed opportunity of the current trading arrangements. This is because they remain the only major category of goods that is still subject to significant tariffs, as many countries seek to protect their domestic farmers. These arrangements are again particularly problematic for the UK as it is a large net importer of agricultural goods. In this context, pursuing trade liberalisation in agriculture could provide both a welcome boost to UK consumers and provide Britain with useful leverage in trade negotiations as it seeks to expand market access in the sectors in which it has comparative advantage, such as services. Note however, that trade liberalisation in this area should also proceed gradually, to avoid undue disruption to the domestic farming sector.

Last but not least, this piece has emphasized the crucial rule of open public debate in configuring a politically sustainable (and hence stable) trade policy. This lesson applies perhaps most strongly to the UK's current circumstances, as it seeks to reconfigure its international trade arrangements and take policy decisions with implications for many years to come. Recent polls and elections seem to indicate that the British public retains a strong commitment to free trade but desires the UK to maintain policy discretion over a number of areas such as migration and natural resource management. Again, in the context of these policy preferences, perhaps the most promising area for British trade negotiators to explore is that of modern 'deep' trade agreements, such as the newly ratified TPP, which could provide an attractive compromise between attractive levels of access to foreign markets while maintain substantial levels of domestic policy discretion over key domains.

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Many people imagine that freer trade will undermine home industry. Job losses, they believe, inevitably follow as cheap imports swamp the market. Others fear imports from lax regimes endanger health and safety. For some, lighter regulation means the playing field is not level. Across the west, in developed economies, such as the US and the EU trading bloc, such concerns are now central to shaping trade policy and have put protectionism back on the map.

In *Better for All - Trade Liberalisation: The Economics*, Dr Andrei Potlogea, an economist from the University of Edinburgh, shows that many of these concerns are ill founded and labour market fears are unjustified. Free trade and trade liberalisation bring benefits to developed and emerging economies. New industries and businesses emerge, developing expertise in specialized areas. Higher productivity and job creation follow. There is an upward curve for business, the workforce and the economy. And, above all, consumers are better off.

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