

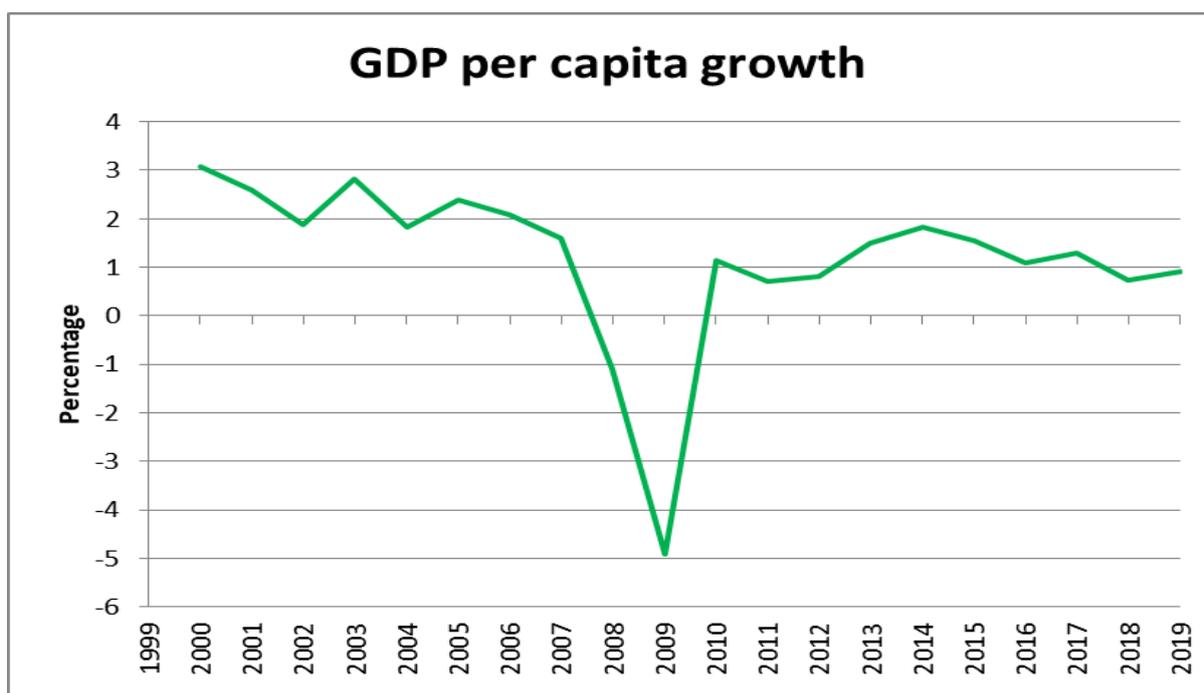
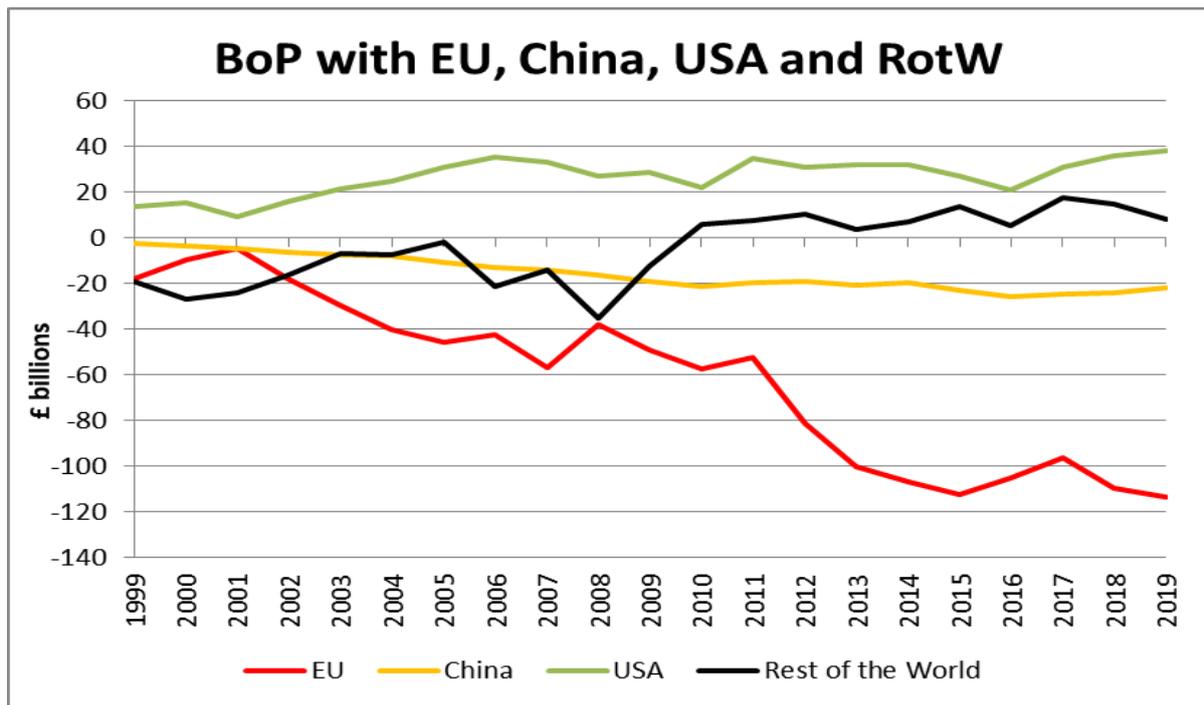
Policy Discussion Paper No.1

Trade and the Economy

Introduction

The justification for Brexit often varies depending on whom you talk to. For many it is immigration or sovereignty, and for others fisheries or security, but for me a prime reason is to take back control of our economy and re-establish economic growth. There is no need to refer to dodgy forecasts to see this. All we need to do is look at cold, hard, historical fact.

Two graphs



These graphs, using figures downloaded from the ONS website, show the full extent of the disaster that has been our membership of the EU Single Market and Customs Union. Some of you may have seen my earlier Balance of Payments (BoP – or Current Account, the nation's profit and loss account, which is mainly but not exclusively trade) graph up to 2017 when it appeared that devaluation following the referendum was providing some relief. Now we can see that the underlying trend has returned. In fact the following points arise:

1. Our deficit with the EU at £113bn is now even greater than it was in 2015 (£112bn),
2. I have added China and the USA this time. Our deficit with China is modest by comparison and need not concern us too much (it has also reduced slightly since 2015), and our surplus with the USA has increased significantly from £21bn to £38bn,
3. Our surplus with the rest of the world is much the same but our total deficit is worse.
4. Growth in our average standard of living continues to decline.

How this affects the economy

An increasing trade deficit presents British business with a contracting market. As people buy more and more foreign stuff and less and less British stuff two things happen. First jobs are lost as business contracts, and second investment suffers as business will not invest into a contracting market. Growth is a function of investment, so the result is stagnating growth as the second graph shows.

Now you may say "but we have full employment". Yes we do, but that is only because government has used both fiscal and monetary policies to expand demand which then creates replacement jobs. The problem is that it also creates debt, so we now have record levels of National Debt from fiscal policies, which has just exceeded £2tn for the first time (it was less than £400bn in 2002 and set to be fully paid off within a few years) and also record levels of Personal Debt resulting from monetary policies. That is not a sustainable position, particularly as regards personal debt. Sooner or later that debt bubble will burst with devastating consequences. And the cost of the increased national debt will hit us hard when interest rates rise.

You may also ask why investment and growth have not recovered as these new jobs have been created. I can only guess but I suspect it is because they are mainly in personal services, and there is very little if any productivity gain in personal services.

Is Free Trade a Good Thing?

Almost all politicians and economists swear by free trade, and both Boris and Nigel advocate a free trade agreement with the EU and as many others as possible with the rest of the world. But they are not thinking it through.

The point is we have **had** 'free' trade within the EU Single Market and Customs Union for the past 28 years, and as the graph shows it has been an absolute unmitigated disaster. Whereas our 'unfree' trade with the rest of the world has been moderately successful. The point is that free trade will only create economic growth if it presents business with an expanding market to invest into, whereas this record has had precisely the opposite effect. Free trade may help where trade is already in balance, but it will only magnify a deficit if

that is where you start, as we do. It works by increasing the volume of trade in each direction so that businesses on each side can invest into an expanding market. But if both imports and exports increase by roughly the same percentage on top of a deficit then the deficit will as well. That is just simple mathematics! Whilst you may see some investment opportunities on the export side you will see greater losses on the import side.

Even less sophisticated populist politicians will advocate free trade because they make imports cheaper, and will quote the Repeal of the Corn Laws in the 1840s. At least two points must be made here:

1. Import tariffs are a tax, a component of government revenues. Other things being equal if you reduce one tax you will just have to replace it with another. There are no free lunches! As taxes go they have the benefit of stimulating the economy through import substitution, whereas all other taxes undermine it, so it makes sense to have import tariffs in the mix.
2. The repeal of the corn laws was not a free trade deal with any other country. It was a unilateral decision to cash in part of our trade surplus from manufactures for the benefit of the poor. Today we do not have any such surplus to cash in.

Look at it another way. For the past hundred years or so Britain has run a trade deficit on current account funded from inward foreign investment on capital account. You can't print foreign currency unfortunately! Even leaving aside the question of whether it matters if foreigners own our economy, history shows that all the most successful and high growth economies have done it the other way round. They have used trade surpluses on current account to fund outward investment on capital account, and almost all have used mercantilist policies (using trade tariffs) to do so. It is expanding export as well as domestic markets that have stimulated investment and growth. The emergence of the British economy and Empire in the 17th to 19th centuries was based on mercantilism, as was the French under Jean-Baptiste Colbert, Louis XIV's finance minister, as was the later emergence of the German economy under the mercantilist policies of Frederick the Great of Prussia, and since the second world war the Japanese and Chinese economies. **IF WE WANT TO MAKE BRITAIN GREAT AGAIN THEN WE MUST USE THE POLICIES WHICH MADE US GREAT IN THE FIRST PLACE.**

So how do we dig ourselves out of this hole?

Well first we must scrap the interim tariffs Parliament put in place in March 2019 in the event of a No Deal Brexit, which may well now occur. These were tantamount to unilateral free trade for imports but not for exports – completely arse-about-face! The EU **must** under WTO rules charge the same tariffs on imports from us as they (and we) currently do on imports from anywhere else (where they do not have agreements to the contrary). Which means we must charge them tariffs as well if imports are not to go through the roof at the expense of British jobs.

I am a gradualist when it comes to economic policy as the economy seldom responds well to sudden change. So I would put in place exactly the same tariffs as the EU, but in the first instance limited to 5%. That would result in a reduction in tariffs on imports from the rest of the world where they are higher and produce on balance an inflation-free transition.

Thereafter I would increase the tariffs at a rate of 1% pa until our current account moves into surplus. That is the point where it may become advantageous to do trade deals, but not before.

As regards our exports - a matter which has caused great and understandable concern to our exporters facing for example EU tariffs of 10% on cars and fruit and veg or 40% on Welsh lambs – how can we protect them? Simple. We just use the new import tariff revenues to fund directly the foreign tariffs on our exports so our export customers don't have to pay them. So long as we have a deficit that will give the Treasury a cash flow surplus sufficient to fund these payments.

Now some of you may say, as have a few lawyers I have asked, that that is illegal because it is subsidising our exports. However I refer them to Article 2 of the WTO's Agreement on Subsidies and Countervailing Measures which is where a '*prohibited subsidy*' is defined as a "*payment to a specific entity within the jurisdiction of the granting authority*". These would be payments to foreign entities, such as foreign importers or even directly foreign customs agencies, which clearly lie outside our own jurisdiction. Such payments would therefore be entirely legal. We can therefore not only protect our exports into the EU from tariffs but also reduce the effect of tariffs on our exports elsewhere where currently we face them, including all those countries with which the EU has trade agreements, which means we don't have to bother replacing them. So not only will our economy get a huge boost from import substitution, which it would do anyway, but also one from increased exports.

So what's not to like?