

Why Brown and Bush may pay the price for free trade crusade

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Gordon Brown and George W. Bush have one thing in common. No, not their brand of toothpaste, nor a fondness for jeans and casual jackets. Nor a willingness to see the Iraq war through to victory. Nor a belief that tax cuts can stimulate economic growth.

What they have in common is a belief that their nations and the world are served by the preservation of the free trading regime that has contributed so much to economic welfare in the post-World War Two period.

Both have a relaxed attitude towards the free movement of people, and are therefore reluctant to prevent immigrants from joining their nations' workforces. Both resist efforts to raise barriers to the free flow of goods into their countries, with an occasional politically necessitated lapse on Bush's part. And both favour the free flow of capital and welcome the investment of sovereign wealth funds in their nations' financial and other institutions.

The British Prime Minister and the American President might be the last two men standing in the fight against protectionism. Unless you count Tony Blair and John McCain, which you probably shouldn't, since Blair is otherwise engaged, and McCain has a long way to go before he sits in the Oval Office

where he can affect trade policy.

All three pillars of free trade – free movement of people, goods, and capital – are under assault, or soon will be. Start with people. In America, conservatives are outraged that the President (and McCain) won't build a fence to keep Mexicans out, and deport the 11, or 13, or 20 million illegally working at the country's most menial and back-breaking jobs. In Britain, Brown has been criticised for adopting a policy that has turned over hundreds of thousands of new jobs to Polish and other immigrants who prefer pay cheques to disability benefits.

Then there are imports of goods. Britain has forfeited control over its trade policy to the EU – creating the delicious irony of Peter Mandelson being in charge of a policy area that in an earlier day would have been controlled by his least-ardent fan, Gordon Brown. Mandelson now finds it necessary to accommodate French and Italian pressure to stem the flow of imports from China.

And in America, all of the Democrat candidates have responded to trade union pressure and unease among many voters about the "hollowing out" of American industry, by promising to take a dim view of new trade-opening agreements. Indeed, Hillary Clinton has even called for re-examination of the North Atlantic Free Trade Agreement (Nafta), a measure of which her husband, now clearly slated to be co-president in a Hillary Clinton administration, is inordinately proud.

Then there is capital. Brown says Britain welcomes foreign investment and is open for

business. Bush says he is glad to see America's money coming home and welcomes the investment of sovereign wealth funds in America's hard-pressed banks. So far, so good for the free traders. But neither man will be able to hold to that position for very long. The sovereign wealth funds are not like other investors. They are large pools of capital controlled by governments.

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Governments have political as well as economic objectives. Vladimir Putin aims to control the flow of natural gas into Western Europe, not just because he wants to maximise the profits from sale of Russia's natural resources. He also seeks political leverage: he can now threaten Western Europe with cold, dark nights if they prove too friendly to America, or too willing to provide Nato with adequate resources, or otherwise offend Russian sensibilities.

So, too, with the massive funds in the hands of Middle Eastern governments. Yes, their investment in Western banks, struggling to restore their balance

sheets to some semblance of health after writing off sub-prime and other bad loans, is a blessing for the banks. But there is going to be a sting in the tail. Consider Norway, hardly a country subject to the political pressures that exist in Russia, China, and the Middle East. It dumped Wal-Mart shares when the giant retailer fought to prevent the trade unions from getting a toehold in its stores. That was a political, not a purely economic, decision.

Or consider this: suppose Russia makes a bid for a major UK utility, such as Centrica, extending its control over energy supply. Or that the China Development Bank expands its \$3 billion, three per cent stake in Barclays Bank to, say 10 per cent, which would certainly give it a policy say in the bank's lending policies. Or that Middle Eastern sovereign wealth funds by their very presence as major owners of US and Western banks deter boards from funding entrepreneurs in Israel, or companies developing alternatives to oil-based fuels.

Already the International Monetary Fund is calling for more transparency – a long-held Brown goal – on the part of these funds. And regulators who rely on shareholders to discipline the executives of the companies they own are worried about two problems: either that the funds will be active investors and politicise investment, labour and environmental policies, or remain passive, in which case managements will be free to pursue their own interests rather than those of all shareholders.

Brown won't be able to rely on Adam Smith for intellectual

support of unrestricted free trade. His townsman, faced with Chinese currency manipulation and artificial barriers to imports imposed by Japan, would say "There may be good policy in retaliations" if they force changes in the policy of trading partners. "The recovery of a great foreign market will generally more than compensate the transitory inconvenience of paying dearer during a short time for such [imported] goods."

Nor can he any longer rely on a massive consensus by economists in favour of free trade. Under a headline, "Economists Rethink Free Trade," *Business Week*, a well-regarded magazine, notes: "Something momentous is happening inside the church of free trade: doubts are creeping in." Those doubts stem from the fact that the benefits of globalisation seem to be confined to upper-income groups.

Never mind that overall trade has enriched Britain, or that the perception that the middle- and lower-income groups have not benefited is much disputed. Economists of all political persuasions now feel comfortable advising politicians they serve that support for free trade might carry unpleasant consequences when the votes are counted.

Sir Humphrey famously terrified his minister by praising his policy proposals as "very brave". That might soon be true of the Prime Minister's attempts to reduce barriers to freer trade.

Simon Heffer's column will appear tomorrow