ECIPE | EUROPEAN CENTRE FOR INTERNATIONAL POLITICAL ECONOMY

POLICY BRIEF

No. 7/2020

Work for Others, not Yourself:

Globalization, Protectionism and Europe's Quest for Strategic Autonomy

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EXECUTIVE SUMMARY

Protectionism and mercantilism are yet again at the centre of global economic policy. "America First" is the guiding ethos in a good part of US international economic policy. Beijing is taking a larger stake in China's economy and hand out privileges to domestic firms. Europe is increasingly occupied by achieving "strategic autonomy" and to create European champions at the expense of competition. Old and disreputed economic doctrines are getting a new lease on life. Behind this new orientation in international economic policy stands the old idea that a strong economy is an economy not dependent on others.

Human prosperity – our story of rags to riches – tells a very different story. Prosperity is generated when people collaborate and improve our collective intelligence. Open economies are much better at creating wealth because they operate by the principle that people should work for others, not themselves. They specialize – and in the process, they get far more dependent on others. Dependency is a factor of success; economic sovereignty is a sure way of depriving people of opportunity and prosperity.

INTRODUCTION

Ninety years ago – on June 17th, 1930, to be precise – President Herbert Hoover signed a new act with the somewhat unwieldy title "to provide revenue, to regulate commerce with foreign countries, to encourage the industries of the United States, to protect American labor, and for other purposes". It was controversial and passed the Senate by a small margin – 44 senators voted in favour, 42 against. But even if the debate was adversarial, few realized the far-reaching consequences of this act. There and then, it was assumed by many that the act was necessary to support an economy on the brink to the Great Depression.

The previous autumn, Wall Street had crashed: in a month, the New York Stock Exchange had fallen by close to 50 percent and the savings of many households had been depleted. Banks started to crumble and some of them would go bankrupt in 1930 and 1931. Unemployment skyrocketed. The US like a good part of Europe was tied to a gold standard that now spurred deflation rather than price stability. Europe imported less from the US; Americans started to stockpile gold. The country, it was argued, needed a new policy that would reduce imports and improve the current account surplus.

The result was the act that president Hoover signed 90 years ago. Today it's known by a different name: "the Smoot-Hawley tariff act". It was the boundary between two worlds – or two different eras: the ambition after the First World War to rebuild the liberal economic order and the growing resignation before the Second World War to defend that order. Smoot-Hawley was the start of a wave of economic nationalism that flooded the Western world in the 1930s.

Now there is the suspicion that we are yet again on the threshold of widespread economic nationalism. The Covid-19 pandemic and its responses have had a huge impact on economic activity – leading world economies have been falling faster than during the Great Depression. Just like other periods of economic turmoil, the reaction by many political leaders have been to reduce free trade – in the first place to secure the supply of facemasks, PPE and ventilators. The expectation, however, is that we are only in the beginning of a new wave of protectionism: trade barriers will increase as more governments think they are a good way to protect jobs. Globalization, some say, is about to die.

The apocalyptic sentiment is understandable. "America First" seems to be guiding much of America's international economic policy. In Europe, Emmanuel Macron, Angela Merkel and European Commissioners talk about creating "strategic autonomy" for the economy and that the region's digital dependence should be countered by a policy for "technology sovereignty". Despite attempts to dress this up as something else, its essence is pretty clear: protectionism. Moreover, China has deepened its programme for indigenous innovation – sprinkling resources on Chinese firms at the same time as foreign firms are confronted with increasing market-access restrictions. For all the economic superpowers, the ambition seems to be to reduce the dependency on others.

Protectionism and mercantilism are typical symbols for the idea of the powerful economy – the belief that an economy is resilient and strong when states reduce or at least manage economic interactions with other countries. Many economists and observers have for long had the view that protectionism is something that happens at the border – something that is distant from the central zone of economic policy. Just like in the past, however, protectionism operates in a different way: it grows inside out. Protectionism is the consequence of a policy for markets and regulations at home – by extension the core ideas that define contemporary political thought. And these ideas harbor economic naivety: the belief that a country can grow richer and manage economic modernization if the state regulates the temperature of competition. They also include the opportunistic view that my country can protect itself against foreign competition without others countries retaliating in kind. At the core sits a delusion: I will become stronger if I make myself less dependent on others.

WORK FOR OTHERS – NOT YOURSELF

The world's journey from poverty to prosperity tells a different story: it was when we started to work for others rather than ourselves that we moved from poverty to prosperity. Obviously, this is the essence of economic specialization: I work with something that others have developed and that yet again others will improve. About a hundred thousands years ago, our specie start a development where we cooperated and competed for our survival. It was a cultural rather than economic progress, but the result was astonishing. For millions of years, the skeleton had developed faster than the technology that our accumulated cognitive ability had mustered. When humans started to cooperate, we improved radically.

Over time, humanity has improved the culture of cognitive cooperation and, as a consequence, our collective intelligence has become so much bigger. If Anne, Brigitte, and Christina have one ideas each, they have either all just one idea each – or three ideas together. It is when ideas meet each other – or to quote Matt Ridley in *The Rational Optimist:* "when ideas have sex" – that economic progress happen. In that way, the economic evolution follows the biological evolution.

Obviously, this is a simple and stylized version of how prosperity is generated and what makes an economy strong. But it is usually the simple economic insights that is the most difficult to accept. Ever since the birth of the modern economy, most of the big controversies in economic policy have stayed remarkably unchanged. Yes, many and restrictive regulations protecting business and labour from economic modernization will lead to less innovation – possibly stagnation. Over-active governments intervening in the economy will make business more occupied by currying the favour of bureaucrats than winning the sympathy of consumers. An economy highly dependent on one sector – like in many petrostates – will be a very fragile economy. And yes, economic nationalism and autarky mean that you should do everything on your own.

The principle of working for others – not yourself – challenges a central economic occupation: that the real choice for many economic policymakers is if they should promote a strong economy – or a prosperous one. Economist Jacob Viner famously described this choice as one between "power" and "plenty". State governance and orders before the World Wars tended to promote power over plenty. The evolution of the liberal economy changed that paradigm: power became an obstacle to prosperity. According to the International Monetary Fund, the five most prosperous countries in the world – measured as Gross Domestic Product per capita – are Luxembourg, Switzerland, Macau, Norway and Iceland. They all have in common that they are small economies that are dependent on others: they are not powerful. If the same list is extended to the 20 richest economies in the world, there are only two that can claim the status of being big economies – the United States and Germany. All the others are small economies that practice the principle of working for others.

Working for yourself, and not for others, was the guiding idea for Reed Smoot and Willis Hawley. Their protectionism wasn't a reaction to the Wall Street crash and the Great Depression. They had put forward their protectionist bill – raising tariffs by 20 percent – already in 1928 during a strong economic boom. The bill wasn't that much about the economy: it was rather a strategy for the Republican Party to win a larger part of the farm vote in the 1928 election. But Smoot and Hawley envisioned that the US would become less dependent on food imported from Canada and that federal income would grow when foreign goods were exposed to tariffs. Importantly, they argued that the future of the American economy would now be in their own hands: the country would yet again become strong.

However, it was clear already from the start that the tariffs would result in negative economic consequences. The US had a trade surplus with the rest of the world and farmers were more dependent on exports than many other sectors. A petition by 1,028 economists soberly concluded that import restrictions often become export restrictions: "countries cannot permanently buy from us unless they are permitted to sell to us". They were proven right.

Canada was badly affected by the tariff hikes and retaliated: many American goods got more expensive in the Canadian market because of higher tariffs. But Canada also responded with a new policy for preferential trade relations, especially with the United Kingdom. British goods in Canada suddenly got a lot more cheaper than American goods. Other countries adopted similar measures. As a consequence, the US lost both exports and export market shares: the US share of global exports fell from 15.6 percent in 1929 to 12.4 percent in 1932.

Isn't there a parallel today? Trump's trade war with China has hardly had the desired result: America's bilateral and global trade shares have declined – quite the opposite to Trump's attitude that "trade wars are easy to win". Between 2017 and 2019, US exports of goods to China fell by 18 percent at the same time as China's exports to the US declined by 11 percent. Moreover, total US trade was also affected – even if the damage was smaller. The US trade deficit increased and after ten years with a stable global trade share, the US share of global exports have fallen after 2017.

ECONOMIC AUTONOMY AND SOVEREIGNTY IN EUROPE

It's easy to take a pop at Trump's trade policy: after all, it's so counter-productive that many US protectionists are distancing themselves from it. The truth is, however, that Trump is far from alone in his belief in economic nationalism: European policy for international exchange is also getting more closed and the idea of the powerful economy is rapidly reproducing itself on the continent. In Europe, that delusion also has a longer history. For several hundred years, leaders in East and West, North and South, have practiced mercantilism. Big European firms are far more state-oriented than big business in the US – not least because public institutions are big owners in European multinationals. The French state is the biggest shareholder in Renault. Twenty percent of the votes in Volkswagen is controlled by the Niedersachsen state government. ST-Microelectronics, Europe's biggest semiconductor chip maker, is co-run by the Italian Treasury and Bpifrance, a French institution for public ownership. In utilities' sectors – like telecom and energy – states remain dominate owners.

Moreover, Europe has for long been occupied by the access to strategic resources. The German marriage between iron and rye – two central resources during the industrial revolution – was the foundation of Bismarck's protectionist tariff reform in 1879. Europe's first steps toward cooperation after the Second World War started with coal and steel, and later nuclear energy was added. Collaboration in matters of strategic resources wouldn't just assist the control of arms production and reduce the risk of war. Supra-national orders for some resources would also limit how far countries could go to cut the access for other countries to strategic resources and thereby deprive them of economic opportunities.

Similar attitudes can be found today – especially in France and Germany. Both governments have just launched Gaia-X – an attempt to create a European cloud that can compete with Amazon, Google and Microsoft. Both countries want to use state subsidies to produce batteries for cars and aero-planes – and make the continent less dependent on foreign battery producers. The have pushed through a new EU policy for "Important Projects of Common European Interests" – and that policy includes less strict rules on state aid. The French Commissioner, Thierry Breton, argues that "globalization has gone too far" and launched in the beginning of the year a proposal for a new industrial policy with the ambition "to make the most of localization as an opportunity to bring more manufacturing back to the EU in some sectors".

Angel Merkel seems to share Breton's ambition. In April, Merkel and Macron made the case for economic sovereignty in Europe – which is a coded way of saying that we should work more for ourselves and less for others. The French Economy Minister, Bruno Le Maire, hounds Renault and Peugeot for having production in other EU countries like Slovenia. No, France hasn't lost its appetite for impossible technology projects: the government is now intent on creating a digital platform for tourists that should compete with Airbnb and booking.com.

That last example is telling. European dependence on digital platforms with an American birth certificate has become a grievance: the EU has an ax to grind. The dependency is often described in the language that Senator Smoot and Representative Hawley used to describe imports from Canada of wheat, potato and dairy: a threat to domestic sovereignty. A platform like booking.com is seen as a threat – not as an opportunity for hotels and guests to find each other. The European auto industry is said to be threatened by Google and other platforms that can poach value added and margins for the car makers. According to some European politicians, when we use the services of Amazon Web Services we deprive Europe of the chance to collect data in European clouds. It's not a matter of competitiveness – at least not competitiveness alone – that AWS, Microsoft and other foreign suppliers could offer services that are better and safer than the services offered by many European cloud services. Now it's also a global race for accumulating data. The guiding economic thought is that big isn't just beautiful – but also strong.

BIG IS BEAUTIFUL

Europe is naïve, argued the French and German governments last year in a petition for a new industrial policy. The EU doesn't allow big firms to merge in the ambition of creating "European champions" – industrial giants that are dominating their sectors. As a result, European multinationals remain small pygmies in a global market where industrial colossi from American and Asia increasingly set the tone. Europeans, therefore, are robbed of an opportunity to work with scale advantages and cannot invest as much as foreign rivals in research and development. When technocrats in Brussels side with consumers and block industrial mergers that would lead to oligopoly, let alone monopoly, they are putting a straightjacket on European competitiveness – *or so we are told.*

The Franco-German initiative came hard on the heels of the Commission blocking a train merger between Alstom and Siemens. Margaret Vestager, the Danish Competition Commissioner, knew what she did: this merger would result in a near-monopoly like market for the merged firms in almost ten European countries. Train operators were dissatisfied with the merger. Authorities and federal entities that procure rolling stock and signaling systems also protested as they feared costs would shoot up as a consequence of the merger. National competition authorities in several European countries were in opposition too. Despite the resistance to a merger that obviously would lead to bad results for consumers and competition, the French and German governments made a new call for "European champions".

The idea that size is key to competitiveness has a long history. It got a boost after the Second World War when the business sector got infused by organizational ideas from the military – ideas that promoted large units, linear management strategy, and bureaucracy. The model for the business sector was not the innovator or the entrepreneur but *"The Organization Man"* and *"The Man in the Gray Flannel Suit",* to quote Sloan Wilson's classic book about bored people in bureaucratic organizations. IBM and its philosophy of "corporate socialism" was seen as the corporate ideal – at least until the company's crisis in the 1980s. Size was the key to success.

There is something unfashionable in Europe's quest for "champions". Many companies fail rather than succeeds after big mergers. Big firms are slow and seldom lead in innovation and product development – and around Asia, where big conglomerates dominate the business sector, many are envious of Germany's *Mittelstand,* the ecology of agile mid-sized industrial firms that for long has been a pride of the country. Technological change and digital modernization mean that success is often defined by innovative entrepreneurship and organizations with a culture of experimentation – a culture that allows failure. Our current economic transformation gives an advantage to business models where firms use the services, technology and intellectual property of others – not where they build in-house capacity for themselves.

"WHEN IDEAS HAVE SEX"

A strong economy is an open economy where human capital and organizations get dependent on others. This economic culture is now challenged by a state-oriented economic doctrine. We are yet again at a Smoot-Hawley-moment in our economic history: protectionism and mercantilism are growing – and with them the myth that economic strength comes from encouraging exports and depressing imports. Industrial policy becomes more important than competition. The business sector gets trained in asking governments for favours rather than putting innovative products on the market. The state gets stronger – but not the economy.

This experiment will end in tears – just like past efforts to make governments the ringmaster of the economy. Sustained prosperity happens when individuals are allowed to cooperate freely – within and across borders. That's when healthy economic behavior is premiered. That's when new ideas are born.