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## Do we need to re-think free trade?

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# The Current Column

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## Do we need to re-think free trade?

Bonn, 04.10.2016. German Vice Chancellor and Economy Minister Sigmar Gabriel recently declared the Transatlantic Trade and Investment Partnership (TTIP) a failure, and the Canadian Comprehensive Economic and Trade Agreement (CETA) is also facing strong opposition. Scepticism towards free trade agreements is at an all time high. And that is not all. The level of approval for free trade is falling generally, and globalisation critics are enjoying fresh momentum in large parts of the world, even among former champions of free trade, such as Germany. How do we explain these trends?

First: trade rules are advancing ever further into sensitive areas of national policy. The debate in Germany and the EU is primarily focused on the fact that more recent trade regulations often go far beyond the dismantling of tariffs, affecting issues such as consumer and environmental protection. For example, TTIP seeks to use regulatory cooperation to reconcile differences in standards between the US and the EU. If negotiators agree on the smallest common denominator, it is claimed that this will have a detrimental effect on those standards. Although leading policy-makers stress that European standards will not be lowered, there is tremendous concern within civil society. Consumer and environmental protection should be taken seriously in negotiations and not fall prey to economic interests. Instead, trade agreements should be used to reform general economic conditions for the global common good. At the same time, there is also room for discussion with regard to more traditional matters of trade policy, not least from the perspective of developing countries.

Second: the positive impact of free trade has failed to live up to several countries' expectations. Exports have long been seen as growth drivers. Increased fragmentation in production at global level provides proponents of market liberalisation with another cogent argument: in order to compete in global value chains, imported intermediate goods must also be available at low cost, which is a clear no to import duties and the protection of domestic industries. Global value chains do in fact offer major opportunities for developing countries especially. By using intermediate products from abroad, these nations can take on those parts of the production process that they are best equipped to manufacture or provide, without having to establish an entire industry themselves. Nonetheless, many developing countries are active primarily in low-wage segments,

for example, the sewing together of textiles. Critics stress that free trade keeps developing countries "trapped" in sectors that are in line with their current comparative advantage (e.g. the export of raw materials and simple assembly of imported intermediate goods), and that trade and investment agreements make it more difficult for them to upgrade to higher-quality goods and more complex production steps. Consequently, it is important to strike a balance between dismantling trade barriers and safeguarding a certain degree of political room for manoeuvre with regard to implementing national development strategies.

Third: not everyone has benefited from free trade. Free trade leads to changes in the economic structure of countries. If nations specialise according to their comparative advantage, growth will take place in sectors which make intensive use of the relatively favourable production factors. Conversely, this means jobs will be lost in areas where production steps can be carried out more cost effectively abroad, for example, iPhone assembly in China. In other words, there are both losers and winners when it comes to free trade. At the same time, the more efficient allocation of production ensures lower prices, which benefit all consumers. Nonetheless, recent research findings show that different consumption patterns have meant that poor sectors of the population have benefited less from free trade than wealthy ones. Prices of goods and services which are primarily consumed by wealthier sectors of the population have fallen more steeply than those of agricultural products, for instance, on which poorer population groups spend a greater proportion of their income. At an overall level, however, the welfare gain achieved by free trade would be large enough for the winners to balance out the losers and for everyone to potentially benefit in the end. Greater account should be taken of the different effects of free trade and appropriate policy measures discussed in future.

Free trade has been a key driver of economic development in recent decades. As such, we should not bury it in times of bleak global economic growth forecasts. But we do need a new kind of free trade which takes account of the criticism, some of which has been justified. To achieve this, international trade activities need to line up with the Sustainable Development Goals, economically, socially and environmentally. The G20 is a key actor when it comes to realising this objective.