

Trump's tariffs and the truth about 'free' trade

China's determination to become the world's factory has left the West paying the price in lost jobs and mounting debts

by Juliet Samuel, The Times, Thursday 6th February 2025

There was, apparently, nothing that Mexico or Canada could do. The tariffs were coming. Asked whether America's neighbours could make any concessions to avert the 25% tax on their exports to the United States, Donald Trump replied: "No, nothing. Not right now. No."

I suppose, in a way, that was accurate because a whole lot of nothing is what they offered him, all things considered. There was talk of troop movements to their borders, the appointment of a "fentanyl tsar" to stop drug smuggling, a bit of spending – a few face-saving measures, mostly overlapping with activity that was already under way. Yet Trump pulled back and gave them a month's reprieve.

This isn't over. In fact, it is just beginning. Nor will this end with Trump. His actions may look like the aggressive outbursts of a deranged old man but it would be more accurate to describe them as the tremors of an earthquake, coming thanks to an unbearable build-up of imbalances in the global economy.

The imbalance has its roots in China's decision to follow Japan and South Korea in becoming the world's factory. Because of China's size, the effect of its industrial policies has been devastating to any country that failed to respond in kind, hijacking the entire system hitherto known as "free trade". The result is that the share of American (and British) GDP generated by manufacturing has been cratering for decades.

The usual story we're told about all of this is that when others waste gazillions in subsidies to become the world's leading maker of gizmos, it's their problem: one day they'll run out of money and it'll all come crashing down. But it's happy days for us, because we get flooded by cheap, state-of-the-art gizmos and everyone feels richer with one of those in their pocket. As for all those poor sods in the Rust Belt who used to make gizmos and now take opioids to pass the time, well, too bad for them, but that's progress. (Those subsidies, by the way, should not only be counted in cash grants but in anything that artificially lowers production costs, like suppressing wages, poor labour and environmental standards, depreciating currencies and so on.)

So we post-industrial countries have remained determinedly sanguine about what we persist in calling free trade even as the effect has expanded, first into modern kit of all sorts, such as phones and computers, then into stuff we have never even made at scale, like car batteries and fourth-generation nuclear reactors.

But what if this story is completely wrong? What if it misses out something big? As economists such as Michael Pettis argue, it misses out the true cost of letting domestic industries go to the wall. This cost takes various forms. The most obvious are unemployment and lost skills in former industrial areas. But because leaving people on the scrapheap is politically unpalatable, governments in the US and Europe have tended to spend and encourage spending to compensate: that is, we've created jobs in the state sector, handed out ever more benefits and kept interest rates low so everyone can keep borrowing. This has just about kept demand and activity ticking along, though at great cost in productivity and mounting debts.

As we are just discovering, there are other costs to losing your industrial base. It turns out that not having trusted suppliers of things like ammunition, nuclear power, electronics and rare metals is a bit of a problem. For the hegemonic superpower that is the US it may be an existential problem; even for smaller countries like the UK it's rather suboptimal. Tooling back up, or having your allies tool back up

so you can buy this stuff from a friendly country, is vastly expensive and difficult. In short, subsidies don't ultimately impose their primary cost on the governments handing them out if they can simply dump all their excess production on global markets. This is not true free trade and we should not feel queasy about rejecting it.

What is to be done? Trump's reaction is to start marauding around the world randomly slapping tariffs on countries like parking tickets. This is not the answer. A tariffs-based response that has any hope of turning the tide would have to involve a coalition of similarly affected countries all agreeing to impose high tariffs on China and other economies that heavily subsidise industry, such as Germany.

This is a ferociously difficult geopolitical problem. How could such a system single out Germany, sitting in the middle of a Europe-wide customs union? And is it really advisable, from a security point of view, to lump in South Korea and Japan with China?

Still, it's worth pursuing, to see if it can be made to work.

Alternatively, large blocs like Europe and the US could enter a subsidy arms race with China, which they have been tentatively moving towards. The risk, according to Pettis, is that you end up with massive global overproduction and under-consumption, leading to a collapse in demand that will generate a 1930s-style depression, only with subsidies instead of tariffs as the trigger.

Pettis puts forward another alternative: capital controls. Instead of tackling the problem by keeping out China's exports, tackle it by keeping out the huge glut of savings its mercantilism generates. If China and other unfairly run export economies cannot stick their extra savings in American (or British) companies, government bonds or property, they will be forced to invest them productively elsewhere – or, better yet, spend a bit more domestically on social welfare, environmental clean-up and higher wages. Their households could start buying a bit more and there would be more viable markets for our innovative companies to supply.

If it is to deal with imbalances across the world, however, such a system would need to be cleverer than the old gold standard that collapsed in 1971. It wouldn't fix currencies or penalise investment between countries that run reasonable trade policies. But it would aim to deal with imbalances and shield the free-market economies from the effects of rapacious mercantilists.

Such ideas are limited, so far, to the world of think tanks and academia. They will certainly find no favour with Wall Street or the City. But if and when the Trump tariff whirligig fails to save what's left of America's factories, don't be surprised if the policies on the table become even more radical. True free trade would be a wonderful thing. What we have now doesn't come close.