Trade barriers will not stop China's rise

By Adair Turner
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If, back in the 1980s and 1990s, the US government, rather than arguing for Chinese economic opening, had prohibited any US company from investing there, China's rise would have been significantly delayed, though not permanently prevented. Because that did not happen, China's rise is now self-sustaining.

There are widespread worries that US President Donald Trump's protectionism will erode the long-term benefits of global trade. There are also hopes, mostly among Trump's supporters – including many US companies – that tough policies can prevent China from becoming America's technological equal. But worries about the long-term impact of reduced global trade may be exaggerated, and the hope of keeping China down has no chance of being fulfilled.

Trade occurs for three reasons. For starters, countries have different inherent resources: some have oil, others copper; some grow bananas, others wheat. If that trade were stopped, global prosperity would suffer. But trade in commodities and agricultural goods actually counts for a minor share of total trade, and will undoubtedly continue to do so.

Trade also reflects differences in labor costs. Low-cost countries produce labor-intensive manufactured goods, using machinery imported from high-labor-cost countries. As economists such as MIT's David Autor have shown the impact of this in developed countries can be both bad for some workers and good for company profits. But it can be extremely good for any developing country that fosters a fruitful balance of inward investment and local entrepreneurship and uses the proceeds of export-led growth to invest in infrastructure and skills. China's dramatic economic success would have been impossible without trade initially driven by labor-cost differences.

In the future, however, this type of trade will probably become less important. With wages in China now rising rapidly, its labor-cost advantage is fast diminishing. And while many people assume that manufacturing will then move to other low-wage countries – say, in Africa – much of it may return to advanced economies, though to highly automated factories that create very few jobs.

Finally, specialization and economies of scale in manufacturing, research and development, and brands generate trade between equally rich countries. European luxury cars are exported to the US, Harley Davidsons are imported into Europe, and multiple highly specialized items of capital equipment are traded in both directions.

Once these trade connections are in place, any sudden change in tariffs will be severely disruptive. So Trump's policies undoubtedly pose a major short-term threat to global growth. But in the long term, trade between continents of roughly equal income *per capita* is less crucial to prosperity than often assumed.

The key issue is how large an economic area is needed to foster economies of scale and complex integrated supply chains while still maintaining intense competition among multiple firms. If a country like Ireland, with a population of five million, tried to be self-sufficient in all goods, its income would be a fraction of today's level. Even if much larger Britain, France, or Germany attempted autarky, the hit to productivity and living standards would be very large.

But China's continental economy of 1.4 billion people could achieve almost all possible economies of scale while still maintaining

intense internal competition; in principle, India could, too. The United States, with 300-plus million people, would suffer only slightly if it exported and imported little beyond its borders, and the same is true for the European Union's single market of 520 million.

Beyond some point, the potential benefits of wider trade between equally rich countries inevitably decline. If there was less trade among the continental-scale economies of China, the US, and Europe in 2050 than there is today, the direct impact on living standards would be small.

What would be lost without global trade – and even more so without investment flows – would be the transfer of knowledge, technology, and best practices. China's economic takeoff began with labor-cost arbitrage, but has been sustained by massive knowledge transfer. And while a small element of that transfer reflected industrial espionage, the vast majority was automatic, legal, and inevitable.

Chinese workers and managers employed by Western companies learned new techniques. Suppliers had to meet high standards, and local entrepreneurs could then draw on quality supply chains to compete. Joint ventures inevitably led to knowledge transfer to local partners, and Western companies willingly entered them to gain access to China's huge internal market.

The US is now worried about China's rising technological prowess. Businesses regret the loss of economic rents that arise from superior technology and intellectual property; and national security hawks worry about the potential geopolitical consequences of America's eroding technological edge. Tariffs on Chinese goods are in part a response to such concerns, and limits on Chinese acquisitions of American high-tech companies address this perceived threat directly.

But it is simply too late. If, back in the 1980s and 1990s, the US government, rather than arguing for Chinese economic opening, had prohibited any US company from investing there, China's rise would have been significantly delayed, though not permanently prevented.

Because that did not happen, China's rise is now self-sustaining. A huge and increasingly affluent domestic market will make exports less vital to growth. Rapidly rising wages are creating strong incentives for best-practice application of robotics, and China's companies are becoming cutting-edge innovators in artificial intelligence, electric vehicles, and renewable energy. And President Xi Jinping's "Made in China 2025" program will help foster a shift to high-value manufacturing supported by Chinese domestic R&D. Even if the US now slammed the trade and investment doors shut, it would make little difference to China's rising economic and political power.

That is not true of poorer developing economies, such as India and all of Africa, which hope to emulate China's rapid rise. These economies already face the threat that automation will foreclose job creation in export-oriented factories. The most important priority amid today's Trump-induced turmoil is to ensure that such challenges are not exacerbated by harmful restrictions on trade.

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