Globalisation can benefit everyone and make the UK profitable again

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VIEWPOINT

SIMON DAWSON/BLOOMBERG

The result of the UK EU referendum and the election of Donald Trump in the United States – let alone the rising backlash all over Europe – point to the fact that a huge section of the population feels bitterly discontented with the way they have been treated in recent years. This is hardly surprising. Average wages in the US are barely higher than they were in the 1970s. And a recent report from the Trades Union Congress showed that median wages in the UK dropped post the 2008 crash by as much as they did for those still with a job in Greece – by about 10pc.

Wages, adjusted for inflation, for more than half the UK population are still well below what they were in 2007. Much the same is true across most of Europe.

Nor is it difficult to see why this has happened. Globalisation has been hugely beneficial for those at the top of the income brackets in the West. But it's been lousy for everyone else. The crucial point is that it didn't have to be this way. It was bad policy decisions by western leaders which allowed this situation to be created. Why has trade liberalisation been so good for millions of people in developing countries and for the elite in the West but so bad for the middle and working class? There is a straightforward explanation. It is all to do with competitiveness.

When the post-war Keynesian consensus broke up in the 1970s, the irresponsible financial boom that followed generated serious inflation. The reaction in the West was to switch, almost overnight, to monetarist remedies to contain price increases. Interest rates were increased to staggeringly high levels – 15pc in the UK and 20pc in the US. The result was a huge increase in the exchange rate for western countries just as China was rejoining the trading world and devaluing the yuan by some 70pc during the 1980s.

The result was an amazing mismatch in the costs of producing nearly all manufactured goods. It became far cheaper to produce almost anything in the East, causing the deindustrialisation which occurred everywhere in the West. The UK then made a bad situation worse by liberalising capital flow and the capacity of foreign interests to buy up UK assets in the 1990s, the result being that the pound soared again, especially during the early 2000s. In 1970 nearly two thirds of UK GDP came from manufacturing. By 1990 this ratio was down to 20pc and now it is barely 10pc.

Does this matter? Yes – for three crucial reasons. The first is that productivity increases are much easier to secure in manufacturing than they are in services, so the smaller the proportion of GDP that comes from manufacturing the more slowly the economy is likely to grow.

The second is that most of what we sell abroad is still goods rather than services and we simply do not produce enough goods every year to pay for our imports. The result is a massive trade deficit, with our balance of payments running at about £100m in the red every year. To fill this gap, we either have to sell more UK assets or borrow money with a gross rate of return of about 5pc – every year we have a £100bn deficit our current account goes another £5bn in the red.

But most crucially of all, the effect of deindustrialisation has been to deprive huge swathes of the population of the high-quality, high-earning, blue-collar jobs which manufacturing is so much better at providing than services. In 1978, 6.6 million people worked in manufacturing in the UK. Now it is 2.6 million – only 8pc of the labour force but producing 10pc of GDP, showing how much higher output per hour is in this sector.

And where did all these jobs go? To China and elsewhere in the Far East. This is why there was such huge benefit to people living along the Pacific Rim from globalisation and why those living in the West who were not among the metropolitan elite did so badly out of it.

What can we do? We have to get at least a reasonable amount of the manufacturing – and the good jobs and prosperity that go with it – back. But how? We have to get the costs of making and selling things in the UK down to a sufficiently competitive level. And to do this we have to unwind the disastrous exchange rate policies which we have pursued for the past 40 years. We have to make it as economical to produce goods here – or at least a fairly high proportion of them – as it is to get them made on the other side of the world.

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How low would the exchange rate have to be to make this happen? It would have to be low enough to make the medium- and low-tech manufacturing we have lost profitable again and it is not that difficult to calculate what level that would be. Against the US dollar, it is between \$1.00 and \$1.10 – not so very far away from \$1.24 – but a lot less than the \$1.45 it was before the EU referendum. Could we get the exchange rate down to where it needs to be and hold it there? Yes, if the government was determined to see this happening. The crucial question is whether this would improve matters.

The key argument against bringing the pound down to make the economy more competitive is that this would not work. British goods and services, it is alleged, are just not price sensitive enough for devaluation to bring back manufacturing industry. Unfortunately, at £1.00 = \$1.45, this was largely true. Most services have never been very price sensitive on foreign markets and all that is left of UK manufacturing – mostly high-tech industries such as arms, vehicles, aerospace and pharmaceuticals – are hard to attack by low-cost competitors. But at \$1.00 or even \$1.10, the situation would be transformed.

Here's why. What really counts on price sensitivity for manufacturers is not selling more or less of what is already on the market. It is about decisions as to where manufacturing is located. At \$1.45, nearly all tradable medium- and low-cost manufacturing is unviable. At \$1.10 or a bit lower, it would become profitable again to locate in the UK. This is why price sensitivity would kick in with a vengeance and we would be able to reindustrialise.

If we want globalisation to benefit nearly everyone and not just a lucky minority, getting the exchange rate down to where manufacturing generally is viable is the only way of doing it which will really work.

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