How a Stable Trading System Benefits Nations Small and Large

by
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1 Introduction

Three decades ago anti-globalisation protests erupted around the world. Most visible among these were the protests at IMF, World Bank, and WTO meetings—sharply-focused demonstrations in Dubai and Singapore; violent protests on the streets of Washington DC, Madrid, and Seattle—but dissatisfaction appeared in varied forms elsewhere as well. Protestors charged world trade and the international economic system with exploiting those already ill-treated in the world: Income inequality rising and poorer nations falling further behind; workers facing depressed wages and unemployment while capital raced nimbly around the world to reap high returns; shipping volumes growing manifold, as were carbon emissions, deforestation, and pollution, all worsening the global climate crisis.

Then defenders of the international economic system responded with the logic of comparative advantage and free exchange. If nations traded voluntarily, they had to see benefit from the exchange. The theory of comparative advantage said, moreover, that the win-win outcome was no delusion. Trade is fair; all parties gain.

Today the global trading system is again under attack, but this time by a different set of actors. The Trump administration, most significantly, asserts the international trading system has failed America. The charge is that trade-surplus countries run lopsided industrial policies to raise their manufacturing exports and thereby accumulate wealth and geopolitical power. In this reasoning these policies privilege national manufacturing and exports while taking resources away from their own consumers. At the same time they inflict loss on the American worker and raise inequality in US society. Going beyond this, legal erudition in the USTR office and elsewhere draw on language that suggests trade imbalances are about more than just national consumption and investment choices, on the one hand, and market-distorting industrial policies, on the other. Instead, trade imbalances represent resurgent ideological Cold War divides ("democracies should come together against China and its export-promotion policies") as

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well as threats to America's national security (the fentanyl epidemic in the US; China's emerging technological superiority and its accumulation of US financial assets).

International trade is blamed for deindustrialization, worsening economic security, harming the environment, increasing inequality and unemployment, and raising national vulnerability and strategic interdependence. Economic security is taken as legitimate justification for all manner of trade disruption. Tariffs in the US have regained a resonance not seen since the times of Alexander Hamilton, Abraham Lincoln, and the Republican Party platform of 1890. Industrial policy is openly practised everywhere, across both advanced and developing economies. Trade has transmogrified into contestation over chokepoints and balance of payments, rather than competition over productivity. Over 70% of world trade might follow still WTO multilateral rules, but since 2019 disruptions to trade imposed by individual nations have risen more than three-fold (Georgieva, 2023). Given the convergence of both establishment and protestor voices, might there be substantive content in how international trade has fallen from its previous position as posterchild of the success of rules-based multilateralism and pathway to peace and prosperity?

This essay argues that in this assessment a critical confusion has crept into our thinking. Scholars and policymakers have come to identify international trade with outcomes that it neither guarantees nor seeks to produce. The instrument has been conflated with the objective: International trade is not a goal. It is a tool.

As any instrument, trade can be deployed well or poorly. It can help promote efficiency, resilience, growth, innovation, security, or inclusiveness. But it can also degrade them. Whether trade is beneficial depends not on trade itself but the goals it is asked to serve and the other policies that accompany it. Moreover, if the instrument and objective of trade need to be separated, so too should observers and policymakers stop thinking of trade imbalances as sufficient statistic.

This essay makes three points. First, trade has fallen into disrepute in part because both its critics and defenders have confused the instrument with the objective. Trade should not be thought of as an end in itself, but instead needs to be considered against a clear statement of goals. Second, it is a false binary to set globalisation on one end and economic isolationism on the other. By separating the instrument from the objective, policymakers can use trade in combination with other policy tools. Third, a stable trading system can continue to provide substantial benefits for countries both large and small. Provided that trade is used optimally as instrument, those benefits go beyond the traditional ones of comparative advantage and market scale, and encompass, for each participating nation, improved resilience, innovation, security, and productivity. At the systemic level, trade, again when deployed well, can establish norms and standards, and thus provide a global public good, and can serve as conduit for knowledge dissemination, learning, and capability-building.

The policy challenge, therefore, is not whether to abandon trade. It is how to do trade better.

2 Trade has fallen into disrepute

The economics discipline provides two distinct arguments for free trade. First, traditional theories of comparative advantage say that when two nations are different—however their productivities might differ, or however they might be differently endowed in capital and labour—trade benefits both: the outcome is win-win at the level of the nation. Second, even if the two nations are identical, provided that increasing returns to scale operate, trade again benefits both.

But beyond this, policy positions on trade grew associated with broader ideological perspectives. Advocates came to look at laissez-faire free trade as having intrinsic virtue in terms of, among other things, political freedom. Critics, on the other hand, increasingly treated it as intrinsically harmful.

To see how these alternative approaches conflate instrument and goal, consider when a country chooses to source a critical import from a single supplier. When that supplier offers the best combination of price and quality, this minimises cost and maximises productivity. In the historical reality, for many manufactured goods over the past two decades, single-sourcing such imports from China achieved optimal domestic production.

But that same country can instead choose to diversify purchases across multiple suppliers. Such diversification—perhaps across Vietnam, Mexico, Indonesia in addition to China—will almost surely sacrifice efficiency. But at the same time, under practically any reasonable assumption on the probability distribution of risks, such an alternative import strategy increases resilience, reduces dependency, evades a possible bottleneck, and avoids a single point of failure.

Which is the right strategy?

The answer depends not on trade itself but on the objectives that the country seeks to achieve. If **cost-minimisation** is the objective, trade should be concentrated on China. If **resilience and security** are the objectives, trade should be diversified across a number of nations. The point is, both strategies involve trade.

Trade only provides the instrument. It does not determine choice or outcome. Or if it does, it is because an implicit assumption has been made about goals to achieve.

2.1 Traditional identification

Historically, economists and policymakers assumed the objective to be economic efficiency. Free exchange shifted resources to their highest-value use. Competition disciplined producers. Consumers gained access to lowest-cost goods. Economic theory guided this thinking whether via differences in technology or factor endowment, or because of increasing returns. If economic efficiency is the goal, free trade is the instrument and achieves win-win outcomes for all.

But that, however, is not the entire argument. M. Friedman (1962) and M. Friedman and R. Friedman (1980) added further an equivalence between free trade and political and human freedoms. In this view—aligned but different—the ability to undertake free trade is what keeps the US-centric liberal international order true to its ideals: ensuring free and open trade is, in effect, the same as guaranteeing political freedoms.

Closely related to this political view is the idea that if a nation intervenes in the workings of its domestic markets, that tilts the playing field, is unfair, and is undertaken with a view to disadvantaging the nations with whom it trades. So any such state intervention must be condemned.

Certainly some interventions are zero-sum in nature. But not all of them are. If a government subsidises research on curing cancer, a resulting scientific breakthrough will improve the well-being of all humanity. That nation's market intervention, all else equal, actually provides a global public good.

2.2 Criticisms

Set against these different identifications, however, are criticisms.

A leading objection is inequality. What is called the China Shock—the hypothesis that imports from China have eliminated jobs, hollowed out industries, and disenfranchised entire communities—-is, in essence, a proposition regarding trade and inequality: however trade affects aggregate well-being, gains and losses are not evenly distributed. Some communities suffered severe employment losses and income declines even as consumers elsewhere benefited from lower prices.

A second objection concerns development hysteresis. When comparative advantage encouraged production resources to shift, unless appropriate policies are adopted, the ensuing specialisation locked developing countries into low-value manufacturing. Industrial upgrading would require upfront fixed costs that could not be justified so long as short-run returns from low value-added activity remained attractive.

A third objection was that short-run efficiency on cost reduction failed to provide long-term resilience. Instead, it generated fragilities. The reasoning is that when comparative advantage leads to a single nation so specialised that no others can match its cost reductions and speed of re-engineering, then, no matter its efficiency benefits, such a global supply chain carries a strategic chokepoint. The entire system becomes less resilient to shocks, whether natural events like tsunamis and earthquakes, or disruptions of geopolitical intentionality.

While these objections are valid they don't overturn the case for trade.

The difficulty in the discussion often is that critics and supporters have in mind different features of trade. One side points to distributional effects, developmental concerns, and strategic vulnerabilities; the other to efficiency gains from specialisation and exchange. All these can simultaneously be valid. But simply announcing or measuring one effect without comparing its magnitude and permanence to the others does not advance the discussion.

When a defender of trade responds to concerns about the China Shock, say, by presenting yet more evidence that trade increases total GDP or raises employment in other industries, that does not answer the criticism. Those concerned about the China Shock were never disputing aggregate gains. Their concern was distributional. Similarly, evidence that trade raises efficiency does not by itself address concerns on strategic interdependence. Efficiency and security are different objectives, even as trade remains the same instrument.

Conflation between instrument and objective means the debate on trade is unnecessarily polarized.

3 Policy choices

On the other hand, recognising the distinction between instrument and objective opens up new policy possibilities. Having additional degrees of freedom in setting appropriate goals means that policymakers need not choose between just complete openness and total isolationism. Instead, they can address the more useful and relevant question: How should trade be deployed to advance society's broader goals.

Consider inequality. Critics point to how trade reduces the cost of living for affluent consumers. But if trade can lower costs of living for one group, then it can do so for another. If trade is capable of generating targeted distributional effects, policymakers can put in place complementary measures that direct those benefits towards lower-income households and vulnerable communities. Trade is certainly distributional. But whether the distributional consequences are progressive or regressive depends on institutions and policies in place.

The same logic applies to developmental lock-in. The logic of comparative advantage by itself can certainly make, in comparison, overly costly the opening of new industrial sectors. The logic says that industrial policy—state interventions that seek to transform the industrial composition of economic activity—can re-orient the dynamic arc of development.

China's economic rise illustrates this. However one might assess the broader aspects of China's economic model, participation in global trade has not locked that economy into low-value activities. In China's case trade provided opportunities. Domestic policies shaped how those opportunities were used.

The lesson here is not on the success or failure of industrial policy in isolation. Instead, it is that industrial policy provided, in China's development, a necessary corrective against the developmental lock-in of comparative advantage in trade.

Finally, consider economic security and import dependence. Relying overly on a single source opens a vulnerability to disruption. This can be due to shocks from natural events or from a competitor bearing intentionality. However, the appropriate response is not to abandon trade or to close oneself in isolation. Instead, it is to diversify to multiple trading partners, building inventory contingencies, fostering alternative suppliers, and strengthening domestic capabilities in related sectors.

The objective is to raise resilience through increased use of the instrument of trade, not to argue that trade degrades resilience. A world with multiple trading relationships presents alternatives. A world without trade presents none.

4 A stable trading system benefits countries small and large

There is a core set of ideas on trade that should be held inviolate. These share features with the core of multilateralism: that there should be a level playing field; that peaceful dispute resolution should be the norm; and that nations should cooperate when faced with common challenges.

Subject to such a core, viewing trade as an instrument—in tandem with other policy tools—unlocks its value to achieve different national objectives.

No handbook of policymaking suggests that a single instrument should pursue every objective. Instead, conventional economic policy routinely involves multiple instruments and multiple targets. Monetary policy, fiscal policy, industrial policy, competition policy, and education policy all interact. So too should trade policy.

Trade by itself is an instrument that cannot be used to achieve multiple objectives. For addressing simultaneously different goals, trade needs to be used in tandem with other instruments.

But if trade as an instrument is not to be associated with only an objective of economic efficiency, trade by itself has yet other systemic positive impact on world order. That is, beyond the usual economic identification of comparative advantage, economies of scale, product differentiation, and learning by doing effects, trade can provide further strengths to the international system as a whole, not just benefits to individual nations.

A stable trading system lowers uncertainty, enabling investment, innovation, and longer-term planning.

Trade weakens the domestic market power of incumbents in favour of nimble, agile innovation. It influences standards and norms towards those that best deliver well-being. Trade is a concrete conduit by which the rules-based multilateral order operates, and so is an example for yet other ways in which the world can work together. Trade agreements, dispute settlement procedures, common standards that work, and predictable relationships help transform nations away from power-based engagement towards rules-based structured interaction. Trade is a commitment device for good governance, rule of law, and transparency. Trade thus provides a highly-visible setting within which states can be seen to pursue self interest without resorting to power-derived coercion. This safeguards the system against **Epic Fail** outcomes (Armstrong and Quah, 2026), worse than zero=sum situations where nations undertake actions that result in losses for everyone.

A stable trading system benefits all countries, small and large. Among the most important ways it does this have almost nothing to do with the logic of economic exchange. Put simply, trade is an institutional foundation for inadvertent international cooperation.

5 Conclusion

Trade has fallen into controversy and disrepute for different reasons. But many disagreements surrounding it have become intractable because trade as an instrument has become increasingly conflated with trade as an objective.

This essay has argued that trade is intrinsically neither virtuous nor harmful. It is an instrument. Whether it advances efficiency, resilience, development, inclusiveness, or security depends on the objectives society assign to it. But that choice needs to be made explicit.

Recognising this helps clarify many contemporary debates. Many critical observations about trade are accurate: it can increase inequality, worsen strategic vulnerability, and lock in long-term disadvantageous development trajectories. When trade the instrument is paired with the objective of short-term efficiency, it would be surprising if it also at the same time achieved all the other different objectives society ought to have.

Trade policy should not be viewed in laissez-faire isolation apart from all other policies.

Trade policy can be made more effective by drawing on these three principles: (1) trade is only an instrument and not an end; (2) societies are free to specify what goals they seek to achieve, with economic efficiency just one among others; and (3) the options that trade makes available should be used in tandem with other policy instruments to achieve society's goals. Used intelligently, a stable trading system will indeed benefit all countries small and large.

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