COVID-19 AND THE END OF LAISSEZ-FAIRE GLOBALIZATION

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EXECUTIVE SUMMARY

COVID-19 has exposed a critical flaw in the global trading system: a manufacturing base that has left the world vulnerable to shortages of life-saving supplies. Because of these shortages, countries have resorted to export bans to try to preserve as many domestic resources as possible for their own people. The trade community has responded by urging removal of these constraints, and recommending tariff cuts on critical medical equipment.

These actions fail to recognize the root cause of the problem: a lack of production capacity to make sufficient quantities of these goods. For many decades now, the United States and many other countries have relied almost exclusively on the private sector to make production and sourcing decisions. The private sector's goal has to been to reduce costs and maximize profits, including through mergers and offshoring. This approach has resulted in a net reduction of global capacity. It has also resulted in geographical concentration of production.

This model is essentially a modern take on the laissez-faire approach that New Deal policymakers rejected. Under laissez-faire rules, reflected in modern times in the neoliberal model, the role of government is to protect capital holders, not to intervene in markets. As a result, the government does not protect competition itself.

This approach has opened the door to anticompetitive behavior by governments. Recognizing that capital's orientation is to maximize profits, some governments engage in cost suppression strategies to create artificially low costs. These strategies include labor and environmental regulatory suppression, tax havens, currency manipulation, and anticompetitive subsidies.

The combination of anticompetitive behavior by governments, and profit-maximizing behavior by the private sector, is what leads both to a net global lack of supply of critical goods, as well as geographical concentration that increases the risks of severe supply chain disruption.

In this context, it becomes clear that tariffs and export restraints are not the root cause of the problem, nor the solution. Tariffs did not inhibit imports of life-saving equipment: there was a global lack of supply of such equipment. Export restraints are similarly a very unfortunate consequence of a global shortage, but not a cause.

The root cause is unfair competition. A global trading regime that tolerates anticompetitive behavior is at odds with the vision of the system's founders, themselves New Dealers. Contrary to popular belief, they did not simply advocate tariffs cuts as a path to peace and prosperity. Rather, as advocates of free enterprise, they valued competition itself and believed governments had a duty to protect it. They crafted global trading rules to protect against unfair competition in the form of labor exploitation, currency manipulation, and monopolistic and other restrictive business practices. These rules were reflected in the Havana Charter, signed by over 50 countries in 1948. However, the American business community rejected the Charter, and the U.S. Congress never approved it. As a result, the global trading system defaulted to a laissez-faire regime. The creation of the World Trade Organization did not restore the true vision of the founders.

Removing tariffs and export constraints are standard neoliberal solutions to every trade problem. However, they will do nothing to address the fundamental problem of anticompetitive inducements to consolidate and offshore production, which is the actual cause of supply chain vulnerabilities. Moreover, neither plurilateral agreements nor regional trade agreements – themselves products of neoliberal policies -- adequately take into account the sourcing incentives that drive production, and as such are not structured to resolve the fundamental problem.

If we really want to solve the problem of shortages of life-saving equipment, we must go back to the original vision of the system and rebuild the rules to promote fair competition. That will encourage sufficient global capacity, promote geographical diversification of supply — and better serve humanity.

INTRODUCTION

COVID-19 has exposed a critical flaw in the global trading system: a manufacturing base that has left the world vulnerable to shortages of life-saving supplies. Because of these shortages, countries have resorted to export bans to try to preserve as many domestic resources as possible for their own people.[1] The trade community has responded by urging removal of these constraints, and recommending tariff cuts on critical medical equipment.[2]

However, these recommendations fail to recognize the root cause of the problem: a lack of production capacity to make sufficient quantities of these goods. Removing tariffs and export bans does nothing to resolve the underlying shortage.

For many decades now, the United States and many other countries have relied almost exclusively on the private sector to make production and sourcing decisions. These policy choices reflect a renewal of the old laissez-faire model. The theory of laissez-faire emerged in the 18th century, in opposition to monarchical interference in the marketplace. Under this theory, markets work better when they are left alone, without government intervention. This model, which has persisted well past the demise of the age of monarchy, fails to account for the fact that what drives private sector production decisions – low costs and high returns to capital – does not necessarily serve the interests of the people more broadly. Moreover, in the quest to maximize profits, businesses are incentivized to limit competition, not foster it; reducing capacity is a basic justification for mergers.[3] To the extent that the needs of the people are at odds with interests of the private sector, this system serves the interests of the latter, not the former.

Therefore, as part of the New Deal, policymakers rejected this model and recognized that government intervention is necessary to protect markets – and people – from the natural excesses of capitalism. However, the growing popularity of neoliberalism[4] in the 1980s and 1990s revived the laissez-faire model and ushered in a new era of government deference to private sector decision-making. This ascension of corporate power resulted in renewed corporate concentration and the erosion of worker power. New trade rules aggravated this dynamic by liberalizing capital flows without providing guardrails against the risks of such liberalization. With these new trade rules in hand, the private sector was able to further maximize profits by not only frustrating domestic efforts to regulate, but also by exploiting lower labor and environmental regulations abroad – thereby putting further downward pressure on wages and environmental protections at home. This meant that supply chains ended up concentrated in those places where corporations could most maximize their profits. As we have seen, these concentrated supply chains weakened the ability of governments to respond to the pandemic.

However, a neoliberal model is not the only model upon which a global trading regime can be structured. Fortunately, the question of the appropriate model for such a regime is not new, and the founders of the multilateral trading system themselves identified solutions decades ago. Emerging from an era in which cartels engaged in economically and geopolitically damaging behavior, negotiators (including John Maynard Keynes) conceived of rules that would allow governments – and the global trading system itself – to protect competition. These rules would have disciplined unfair labor practices, monopolistic behavior, and currency manipulation.

The American business community rebelled against these proposed solutions, and they never entered into force. Nevertheless, they are as relevant today as they were after World War II.

I. WHY DO WE HAVE MANUFACTURING CAPACITY CONSTRAINTS?

Historically, we tend to think of supply shortages in terms of food. There may be droughts, or floods, that interfere with our ability to grow crops. We typically do not associate shortages with manufactured goods, because the supply is more within human control.

The shortages in medical equipment during the pandemic were man-made. We simply did not have enough capacity to meet demand. Many in the trade establishment treat the problem as though it is one of barriers to trade, and they therefore urge the removal of tariffs and export bans as if these measures will address the issue. However, removing tariffs and export bans does nothing to remedy the true problem: a global shortage of supply. It is because of this shortage, not tariffs, that prices for equipment are so high. Tariffs are almost meaningless in the face of the price hikes driven by short supply. Similarly, removing export bans does not increase the aggregate amount of supply: it simply means that the shortages move to different places. Therefore, if we want to address the real problem – the shortages themselves – we must move away from the reflexive instinct to invoke trade barriers as a scapegoat, which allows the neoliberal community to avoid the much more challenging problem of addressing systemic problems that led to shortages in the first place.

There are two aspects to the shortages, both of which must be addressed. The first is concentration of production in a few countries. When supply chains in those countries are disrupted, a shortage ensues everywhere else. Mask production, for example, is concentrated in China, and thus when COVID-19 disrupted Chinese production, the rest of the world was affected. This flaw is a manifestation of insufficient geographical redundancy.

The second and more deeply systemic issue is the insufficiency of capacity itself. This problem is more pronounced in production of higher-tech equipment, such as a ventilators, where ramping up capacity quickly can be more challenging.

This lack of capacity is based on an economic regime that prioritizes efficiency – that is, low cost – over resiliency. By definition, maximizing efficiency means having the capacity to produce in accordance with demand during normal circumstances. Yet additional capacity is precisely what the system needs during emergencies, which trigger surges in demand for particular products.

Furthermore, consistent with the principle of maximizing efficiency – particularly in the era of "short termism"[5] – businesses tend to operate on the model of "just in time" delivery and limit inventory.[6] As a result, both supply and supply chains are "too lean."[7] This approach prioritizes returns to capital over every other value. The overall construct views labor as a cost to be minimized, inventory as wasteful, and redundancy in the system as a problem to be eliminated through corporate consolidation. The strategy has resulted in increased executive compensation and returns to shareholders – while exacerbating inequality by reducing labor's share of GDP. It has also left people without access to basic goods during a global health crisis.

This economic regime did not emerge on its own. It is the result of a conscious political decisions; specifically, the decision to remove the state as much as possible from the market. According to this line of thinking, the role of the government is to provide "only the minimum conditions that are conducive to the exercise" of property rights.[8] Neoliberalism, the modern take on this approach, has prevailed over the past forty years, and it is globally widespread. As a result, governments all over the world defer to business to allocate resources. Businesses prioritize low costs and profits, while avoiding slack.

The trading system, embodied in the suite of trade agreements that have entered into force in the 1990s and thereafter, globalizes this approach because it, too, reflects neoliberal principles. The rules of the system are designed to compel governments to defer to businesses when it comes to trade and investment decisions. When those trade and investment decisions prioritize low costs and high profits above all else, then the global trading system also prioritizes low costs and high profits above all else.

This form of globalization is executed through the rules of the World Trade Organization (WTO). These rules, for example, impose disciplines on Member governments' ability to regulate food safety,[9] product safety,[10] and unfair trade.[11] The exception is the intellectual property rules, which compel governments to protect intellectual property[12] – yet, this is simply a further manifestation of the laissez-faire system's emphasis on property rights.

Capital benefits most from protections provided under a regime that requires governments to defer to capital above all else. By contrast, labor is not afforded any benefits under WTO rules. From a historical perspective, this omission is anomalous. Dating back to 1930, the United States has viewed suppression of labor rights as a matter of unfair competition,[13] inasmuch as labor is a factor of production. However, over the past several decades, labor rights have been framed as human rights instead of as a factor of production, thus marginalizing any argument that labor rules should be included in trade agreements. As a result, in 1996, the WTO itself repudiated the very idea of enforceable labor rights.[14]

Under this rubric, capital is free to move around the globe. Without standards on labor or the environment, capital can exploit differences in regimes, leading to what is commonly referred to as the "race to the bottom." Global competition for capital puts downward pressure on state regulations designed to protect society.

Moreover, as global trade rules emphasize the elimination of tariffs, capital can exploit differing labor and environmental rules with the assurance that goods produced in countries with lower levels of protection can be exported duty-free (or nearly duty-free) to jurisdictions with higher standards. Given the profit-maximizing priorities of multinational corporations, they are attracted to jurisdictions with particularly low costs. The reasons why the costs are low are not an important consideration.[15] Concentration of production in lowest-cost jurisdictions is a natural consequence of a laissez-faire economic system.

The founders of the multilateral trading system did not want a laissez-faire regime, however. They sought to establish a system based on free enterprise.[16]

In the modern era, there is little discussion of the difference between "laissez-faire" and "free enterprise." Indeed, laissez-faire capitalism and free enterprise have been "fused skillfully to such an extent that they are regarded as interchangeable."[17] An important distinction, though, is that laissez-faire focuses on an absence of government intervention, even to protect competition. Free enterprise, on the other hand, is focused on developing and maintaining a competitive marketplace and thus accepts government intervention as necessary where competition would otherwise be compromised.[18] Thus, laissez-faire is comfortable with unfair competition, be it through labor and environmental suppression, or industrial concentration, including monopolies.[19]

The founders of the multilateral trading system squarely rejected a laissez-faire model, along with the view that market participants make the best decisions. In the 1945 American proposal setting out a vision for the rules of trade, the government stated that

> "No government is ready to embrace "free trade" in any absolute sense . . . . Trade may also be restricted by business interests in order to obtain the unfair advantage of monopoly . . . . [F]irms have banded together to restrain competition . . . . These practices destroy fair competition and fair trade, damage new businesses and small businesses, and levy an unjust toll upon consumers. Upon occasion, they may be even more destructive of world trade than are restrictions imposed by governments.[20] "

Far from being a laissez-faire manifesto, it is a warning against the excesses of unfettered capital. John Maynard Keynes, who had in 1926 written a treatise entitled "The End of Laissez Faire," hailed the American proposal as "the blue prints for long term commercial . . . policy" and "the first elaborate and comprehensive attempt to combine the advantages of freedom of commerce with safeguards against the disastrous consequences of a laissez-faire system."[21]

This shared trans-Atlantic priority of protecting competition is reflected in the suite of rules the post-war architects designed to accompany the tariff cuts executed through the General Agreement on Tariffs and Trade (GATT), the 1947 predecessor to the World Trade Organization. These rules were embodied in the Havana Charter, and included the following enforceable disciplines: (1) labor practices;[22] (2) anticompetitive behavior, be it by governments or the private sector;[23] and (3) currency manipulation.[24] American business interests lobbied against the Charter, and it never entered into force.[25]

II. LAISSEZ-FAIRE GLOBALIZATION IN ACTION

Examining the state of medical equipment supplies illustrates the downsides of a global laissez-faire system. The supply constraints experienced during COVID are driven by the overall incentive to maximize "efficiency" and returns to capital.

A. MASKS

According to the Peterson Institute for International Economics, "the world is very reliant on China" for imports of personal protective equipment (PPE).[26] The Washington Post indicates that about half of the world's production of masks occurs in the People's Republic of China (PRC).[27] Masks, therefore, represent a circumstance in which production of an essential good is geographically concentrated, and particularly in the PRC.

In 2001, the PRC joined the World Trade Organization, and since then has become the World's Factory Floor. However, this development did not necessarily occur because of comparative advantage (i.e., because the PRC is a naturally competitive place to manufacture goods). The PRC, as a state capitalist economy with an authoritarian political structure, was able to take advantage of flaws in the global neoliberal system to attract capital, and therefore production, to its shores.

As discussed above, WTO rules impose disciplines on governments, but they do not establish floors for labor and environmental standards. For that reason, capital can use the regime to exploit lower labor and environmental regulation in foreign jurisdictions to maximize profits. Because the WTO focuses on liberalizing capital flows – rather than establishing rules to create conditions of competition – the PRC, in joining the WTO, did not sign up to rules that would require it to abide by any such minimum standards. In addition, the WTO does not provide a coherent set of rules to address cheating through currency manipulation.[28] Finally, the WTO lacks competition provisions. While the WTO has disciplines on the use of subsidies, they do not exist within the broader context of fair competition and are only actionable in specific circumstances. The ability of Members to countervail such subsidies has been rendered more difficult by Appellate Body rulings that muddy the analysis,[29] leaving WTO Members uncertain about whether their efforts to address injurious subsidies will survive WTO review.

Capital is free to go – indeed, incentivized to go – where production is cheapest. The PRC government put itself in a position of being the cheapest location, in part through a combination of labor rights suppression,[30] low environmental standards,[31] currency manipulation,[32] and massive subsidies across a range of sectors.[33] In this way, the rules of globalization have facilitated geographic supply chain concentration.

The United States used to have ample production of N-95 masks. However, according to the current owner of production facilities in Texas, the producer was acquired by another company (and another company after that), which idled production. According to The Washington Post, "{i}n less than a decade, almost 90 percent of all U.S. mask production had moved out of the country, according to government reports at the time."[34] Thus, a domestic failure to prioritize competition and reject corporate concentration ended up facilitating global concentration of production – in the PRC.

B. VENTILATORS

The available trade data do not indicate that ventilator production is concentrated in the PRC, as masks and other PPE are. Nevertheless, ventilators have been in short supply, globally.

The shortage has proven particularly frustrating because nearly a decade ago, the U.S. government actually anticipated it and set out to foster development and production of inexpensive ventilators. The government contracted with a company in California to do just that. However, the company was bought out by a rival, who succeeded in terminating the government contract.[35] That rival, originally an American company,[36] eventually became an Irish company – and produces ventilators there, which are exported back to the United States. Many IP-dependent companies engage in this strategy because of Ireland's low tax rate[37] – the tax version[38] of the labor and environmental arbitrage that the neoliberal system incentivizes. As with masks, we see the pattern of domestic consolidation and offshoring driving shortages of medical equipment. Concentration eliminates net capacity, and offshoring – in this case, due to Ireland's tax regime – leaves particular regions, such as the United States, in short supply. American automobile workers suddenly had to become ventilator producers to make up the difference.

As a result, rather than having a diversity of companies producing a diversity of ventilators in diverse places at diverse price points, the incentives built into the system promoted industry concentration and the offshoring of production to tax havens.

Moreover, while the PRC is not currently a source of concentrated production for more advanced medical equipment, this could change and thus aggravate the problem of geographical concentration. In 2015, the PRC issued an industrial policy called Made in China 2025. This policy targets 10 sectors, including medical equipment.[39] The PRC's goal is to move toward self-sufficiency and dominance in these sectors.[40] This is a decidedly non-laissez-faire approach to trade – and one that a laissez-faire global trading system is not equipped to address.

The Made in China 2025 policy is alarming to businesses outside of the PRC precisely because of the fundamentally anticompetitive orientation of the PRC's approach to sectors of interest. Although the PRC at one point went through a period of market-oriented reforms, it eventually reverted to promoting consolidation of companies, and that policy has persisted.[41] The strategy is designed to achieve economies of scale and to foster national champions to increase size and market share in foreign markets,[42] but beyond that, government support "enables . . . [state-owned enterprises] (SOEs) to acquire foreign businesses and offer products far below market prices, shutting out foreign firms . . . . Chinese SOEs are also protected from competition by market barriers for foreign firms, as well as substantial subsidies and preferential loans . . . ."[43]

This is the strategy underpinning the PRC's approach to steel, aluminum, solar, and glass. Ironically, these strategies can lead to excess capacity when the state either overshoots the target, or simply refuses to take capacity offline. The excess capacity is itself anticompetitive because it drives prices so low that market-oriented firms cannot compete. This is why the founders of the global trading system emphasized the importance of free enterprise – not laissez-faire, and not state trading.

The focus with the PRC tends to be on state-owned companies,[44] but it should be noted that not all dominant PRC companies have been, or are, state-owned.[45] There is no reason to limit the analysis to SOEs.

III. TRADITIONAL FIXES WILL NOT SOLVE THE PROBLEM

At present, many of the responses to the shortages exposed by COVID-19 are grounded in the very neoliberal thinking that contributed to the shortages in the first place. There are calls for elimination of duties on medical equipment. There are also proposals to expand regional trading blocs that are meant to mitigate the consequences of state capitalism. However, these approaches do not address the root cause of the problem: global and domestic economic rules that prioritize cheap production and high returns to capital – even when these priorities have a negative effect on competition and production.

A. REMOVING DUTIES

The instinct to remove duties on medical equipment is understandable, particularly from a humanitarian perspective. However, as explained above, duty-free treatment for medical equipment aggravates the incentives to source in locations that suppress costs, because those goods can then be exported to other jurisdictions duty-free.

Indeed, if a subset of WTO members chooses to remove duties, it could compound the problem. Under WTO "most-favored nation" rules, if a few WTO members negotiate zero tariffs on a sectoral basis, those members must then extend the zero tariffs to goods of all WTO members – even WTO members that have themselves not committed to eliminate duties.

Because tariffs are a cost, eliminating those tariffs reduces cost. That reinforces the kind of cost advantage that, as we have seen, allows market manipulators to attract investment. For example, suppose the U.S. tariffs on ventilators were 10%. If a producer wanted to offshore production to a country where the costs were only 9% lower than costs in the United States, that producer would not be able to increase profits by exporting the ventilators back to the United States. On the other hand, if the tariffs on ventilators were zero – as they are in the United States but not necessarily in other countries – the producer would be incentivized to offshore production anywhere with marginally lower costs, and export those ventilators back to the United States, duty-free.

Moreover, any country that wanted to incentivize domestic production of medical equipment could choose not to sign on to such an agreement, maintain its own tariffs, and lure production to its shores with the security of being able to export those products back, duty-free, to any countries that eliminated tariffs. As a result, the zero-tariff countries would themselves be less cost competitive as a result of tariff elimination. Therefore, this approach would likely reinforce the very geographic concentration problem that COVID-19 has exposed.

B. REGIONAL TRADE AGREEMENTS

Another strategy to address concentration is relying on trade deals outside of the WTO. Japan is hoping to use the Trans-Pacific Partnership (TPP) to diversify medical equipment supply chains, and in particular to reduce dependence on the PRC.[46]

In principle, this approach could work – if the rules in fact promoted diversification, which they currently do not. Regional agreements such as TPP move supply chains away from the global default if the benefit of producing in the trade agreement region outweighs the benefit of producing outside the region.

However, the incentives to shift production to the region depend very much on what the tariffs are as applied to non-TPP parties. The U.S. tariff on masks is 7%. Assume the U.S. is a party to TPP, and under TPP, the tariff on masks made in the TPP region would be zero. If the costs in a non-TPP party are 8% lower (for whatever reason – arbitrage, subsidies, currency manipulation, or true efficiency) then, a producer will still find it more profitable to produce these masks in the non-TPP party and then export them to the United States. The company is saving 8% on costs, and only paying 7% on tariffs. Under that scenario, TPP does not actually incentivize a shift in production to the TPP region.

The problem is that most countries' tariffs are so low that the active cost suppression strategy by another country can easily overcome the tariffs. Even the 7% tariff on masks did not stop production from being offshored to the PRC.

The tariffs on industrial equipment tend to be even lower than those on apparel (masks are considered apparel). The United States, for example, has eliminated – on a global basis – tariffs on most non-textile medical equipment.[47] This makes regional agreements even more challenging as a tool for diversification. Let's assume the United States is a TPP party. Why would a producer currently manufacturing in the PRC be incentivized to produce in the TPP region if it can export to the United States duty-free from the PRC?

Moreover, goods do not have to be entirely manufactured in the TPP region in order to benefit from a TPP duty preference. The rules of origin in the agreement establish on a product-by-product basis how much of a finished good must be made in the TPP region in order to qualify for the duty preference. For medical equipment, the rules in TPP require 30% of the goods to be made in the TPP region.[48] Therefore, 70% of the inputs can be made in the PRC. That will not lead to meaningful diversification away from the PRC, which is Japan's stated goal. The supply chain concentration issue is not only a matter of concentration of production of the finished good: it is also a matter of the parts. As long as there is a concentration of parts supplies, supply chain concentration – and vulnerability – will remain an issue.

Further, although the TPP rules establish core standards for labor and the environment to mitigate the race to the bottom, these rules are only applicable to the parties themselves – not to third-parties, such as the PRC. As a result, while Japan and other TPP members must comply with labor and environmental standards, the countries supplying the other 70% of the ventilators do not. In that way, these agreements do not fully address the underlying labor and environmental arbitrage concerns.

Finally, the TPP rules do not address concentration. As we have seen, the source of the shortages is a combination of both offshoring and concentration. Although TPP has a competition chapter, the competition chapter includes no substantive rules to mitigate concentration itself. Instead, many of the rules are designed to provide due process for those accused of breaching domestic competition law.[49] While due process is important, it is striking just how much of the text is devoted to due process for those accused of behaving in an anticompetitive manner, while so little is devoted to defining – or addressing – anticompetitive behavior itself.

Therefore, regional trade agreements can in theory facilitate supply chain diversification. However, they must be reformed in key areas in order to do so.

C. WTO REFORMS

The WTO recognizes that subsidies to domestic industries can be harmful to trading partners. Subsidies are not generally prohibited under WTO rules, but one WTO Member can sue another if the latter is providing subsidies that are harming trade.

Many WTO Members agree that these subsidy rules require reform. The United States, the European Union, and Japan have issued a statement outlining the nature of the reforms. They include various measures to address subsidies that keep chronically unprofitable companies alive ("zombie" companies); "excessively large" subsidies; subsidies leading to or maintaining excess capacity; and rectifying the Appellate Body's interpretation of when subsidies are, or are not, provided by a government entity.[50] These changes are designed to address the harmful aspects of state capitalist subsidies that are not captured by current rules.

In principle, these reforms would tackle one aspect of the way the system has been exploited to engage in anticompetitive trade practices. For example, zombie companies are not competitive, and in a market-based system would go through orderly bankruptcy proceedings.[51] Instead, when these companies are kept alive, they are competing not on the basis of market principles, but on the basis of government support. Other companies trying to compete on the basis of market principles find themselves up against companies that are simply not accountable to a bottom line. The zombie companies stay alive while the market-based companies are forced under, or seek comparable subsidies from home governments.

However, as with TPP, these rules do not address the underlying problem of concentration. Disciplining subsidies in this way, without broader reforms, reflects a continuation of the neoliberal approach of limiting government involvement and failing to appreciate the ways in which private sector incentives contribute to market failures. As the United States experiences a renewed interest in strategic industrial policy, it is important to recognize that subsidies can be a legitimate tool for addressing supply chain flaws.

The WTO reform proposals are inadequate. They do not tackle other anticompetitive incentives, such as attracting investment through various forms of arbitrage. Notwithstanding the labor abuses that lead to fatal factory collapses,[52] as well as the increasing use of forced labor,[53] labor rules are not on the table. Similarly, notwithstanding widespread concern over global warming and the contribution of global industrial activity to global warming, environmental rules are not part of the reform efforts either. The Organization for Economic Cooperation and Development is attempting to deal with the tax arbitrage problem, but the United States has recently withdrawn from the discussions.

Finally, the current WTO reform agenda fails to address currency manipulation. Although there is a debate about whether currency manipulation is an issue today, there is little doubt that it has been used in the past to create an unfair advantage by a range of countries – and little doubt that it will remain a temptation in the future, including in response to the economic consequences of COVID-19.

Therefore, the WTO reform efforts seek to address only one aspect of the much broader competition problem besetting the global economy.

D. RESHORING WITHOUT GLOBAL REFORM

COVID-19 has highlighted the consequences of decades of blithe offshoring of manufacturing — and manufacturing jobs. There is a new awareness that the United States needs an industrial base. The Defense Production Act went from an obscure Korean-war era statute to a credible vehicle for making equipment in short supply. There is a proposal for a National Investment Authority, a vehicle for "coordinating and mobilizing the nation's financial, physical, technological, and human capital, to ensure the structural health and resilience of the U.S. economy — both in crisis times and beyond."[54] Other countries are likewise assessing their own industrial base and their ability to serve their populations. Japan, for example, is spending up to $2 billion to onshore production of critical equipment.[55]

However, unless we reform the global trading rules, reshoring supply chains will either be temporary, or require significant, ongoing subsidization. If the rules remain unchanged, then any onshored facilities will be susceptible to offshoring just as they were before. The lure of producing in artificially low-cost, high-return locations will remain. If countries continue massive subsidy programs for the purpose of dominating certain sectors, then the United States and others seeking to compete in those areas may find themselves compelled to engage in massive subsidies themselves in order to keep onshored production viable. As noted above, subsidies can be a valid tool for industrial policy. But a subsidy race is a waste of resources – and one that democracies are at risk of losing when the other party is an authoritarian state-capitalist regime with a seemingly limitless capacity for spending. Therefore, if the incentives remain the same – offshoring to locations that suppress costs and otherwise engage in anticompetitive behavior – then the results will be the same. As such, while many countries are considering ways to onshore production, those countries that want to be able to retain that production will also benefit from considering meaningful changes to the rules of globalization.

Diversifying supply chains does not necessarily mean that every country will seek to be self-sufficient. There are benefits to trade. However, countries will rightly want to have an industrial base that is sufficiently robust to then be scaled up to meet demand during emergencies.

The value of such core capacity is illustrated by the vital role the automotive industry played in producing ventilators,[56] necessitated by the consolidation and offshoring of American ventilator production. Autos represents a sector that has managed to retain at least part of the kind of broader industrial ecosystem that facilitates onshoring, including a trained workforce and research and development.[57] Nevertheless, pressure to continue to facilitate the offshoring of the automotive supply chain was significant during debates over both the Trans-Pacific Partnership[58] and the new NAFTA.[59] The very effort to secure North

American production through stronger regional sourcing rules was deemed “protectionist,”[60] and the evaluation of the benefits of retaining production in North America is typically characterized exclusively in terms of cost.[61] The embedded assumption in those arguments was that the United States could continue to enjoy a comparative advantage in design and engineering, without actually producing the goods; however, that assumption ignores the degree to which engagement across design, engineering, and production divisions drives innovation – and thus long-term competitiveness.

However, as Harvard Business School Professors Gary Pisano and Willy Shih have explained, geographical proximity of research, design, and production for some industries creates a “virtuous cycle” that promotes innovation.[62] Thus, mass offshoring “has seriously eroded the domestic capabilities needed to turn inventions into high-quality, cost-competitive products, damaging America’s ability to retain a lead in many sectors.”[63] Moreover, offshoring has cascading effects throughout the supply chain, with “lasting damage . . . not only on a firm’s own capabilities but also on those of other companies that serve its industry, including suppliers of advanced materials, tools, production equipment, and components.”[64]

Therefore, reshoring is one aspect of the solution. But in order for reshoring to be more than a fleeting fad, we must accept that a fixation on corporate profits is at odds with the goal of developing – and sustaining – a resilient industrial base. Moreover, without changes to global trading rules or a commitment to comprehensive and long-term subsidization, supply constraints will remain an endemic threat.

A global pandemic and medical supplies have been used to illustrate the point, but we do not know what will trigger the next shortage – nor what the next shortage will be.

IV. TRUE REFORM: TOWARD GLOBALIZATION BASED ON FREE ENTERPRISE

A prevailing assumption for decades has been that laissez-faire globalization is the only model upon which "free trade" can occur, and that any government effort to regulate competition constitutes protectionism. This assessment, however, is false. Laissez-faire globalization protects capital – not competition. For that reason, the founders of the multilateral trading system crafted a suite of rules that prioritized fair competition, and considered such rules an essential component of creating a free enterprise system.[65]

These rules remain relevant today. If we are looking to move away from a system that prioritizes low costs and high returns above all else, and toward a system in which supply chains are diversified across regions and companies, then different rules are required. To foster fair competition globally, we can begin by revisiting the rules crafted in 1948:

- **Enforceable labor standards;**
- **Rules to address anticompetitive behavior, whether by governments or private enterprise; and**
- **Prohibitions on currency manipulation, with an express fact-finding role for the International Monetary Fund.**

These rules must be modernized to include:

- **Enforceable environmental standards; and**
- **Provisions to address tax arbitrage.**

COVID-19 has reminded governments that their role is more than just facilitating the priorities of private sector behemoths. When the government fails to protect competition itself, fatal results follow: core capacity is offshored based on exploitation of people, the environment, and the tax base; countries are left with hollowed-out industrial platforms that are challenged to surge production of critical goods as needed; and trading partners turn to export bans to preserve scarce goods for their own people, at the expense of others.

This Darwinian outcome is not the only choice. We can prioritize fair competition instead.

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