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The Prospects for the World Trading System 2010: "Events, Dear Boy, Events"

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The Prospects for the World Trading System 2010: «Events, Dear Boy, Events»*

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This short paper reviews the factors likely to affect the openness of the world trading system during 2010. It is argued that the impact of announced official processes (such as the negotiations of the Doha Round, which is supposed to be completed in 2010, and the G-20 process) are likely to be far less important than a number of potentially disruptive, other developments, the magnitude of which cannot be known for sure at the beginning of the year even if their identity can. "Events" rather than "plans" will likely dominate in 2010. Given that each of these events could trigger restrictions on international commerce, it follows that some of the current optimism about "holding the line" against protectionism is misplaced.

Keywords: Protectionism, Trade policy, World trading system
JEL Codes: F10, F13

1 Introduction

The purpose of this paper is to identify the factors likely to have the greatest impact on the world trading system and on commercial policymaking during 2010. Having just experienced a year (2009) when trade-related outcomes differed markedly from those expected at its start, setting appropriate expectations for policymakers and anticipating possible threats to global commercial interdependence are essential if exports are to contribute the most to a broad-based economic recovery in 2010. In this paper it will be useful to distinguish between the likely impact of ongoing international processes relating to commercial policies, such as the Doha Round of multilateral trade negotiations, and events that may impinge upon national commercial policymaking but whose scale, likelihood, and impact are less well known. (The latter being the unanticipated "events" referred to in the subtitle of this paper.) Here it will be argued that the potential impact of the former is likely to be very limited, offering little prospects for creating new com-

* The reply of UK Prime Minister, Harold Macmillan, when asked by a journalist what factors tend to steer governments off course. Paper prepared for the Jeddah Economic Forum, February 2010.

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mercial opportunities. In contrast, the latter may prove decisive and are certainly worth economic policymakers undertaking some contingency planning in advance. Moreover, many of the less certain events are disruptive ones, that is, they are likely to induce governments to take measures that effectively restrict commerce. The remainder of this paper is organized as follows. So as to set the scene the principal commercial policy outcomes of 2009 are discussed in the next section. Then the likely impact in 2010 of known, ongoing international commercial policy initiatives is discussed. Section three of the paper also describes the potential consequences that three less certain contingencies could play in 2010 and the possible reaction to them by trade policymakers. The final section of the paper draws together the argument and includes some recommendations for economic policymakers as they prepare for 2010.

2 A brief review of commercial policy developments in 2009

The global economic downturn, which began with the disruption to financial markets in the third quarter of 2007, provided the principal backdrop for trade policy developments in 2009. The year began with fears that the extent of the associated collapse in global trade flows (see Figure 1), which during the early part of 2009 were on a par with experience in the early years of the Great Depression, would lead governments to engage in widespread beggar-thy-neighbor policies. Looking back it is difficult to understate the degree of pessimism held by trade policy analysts and policymakers during the first quarter of 2009. That protectionism on the scale of the 1930s did not ensue is quite remarkable and as the year wore on different explanations arose for this fortuitous outcome.

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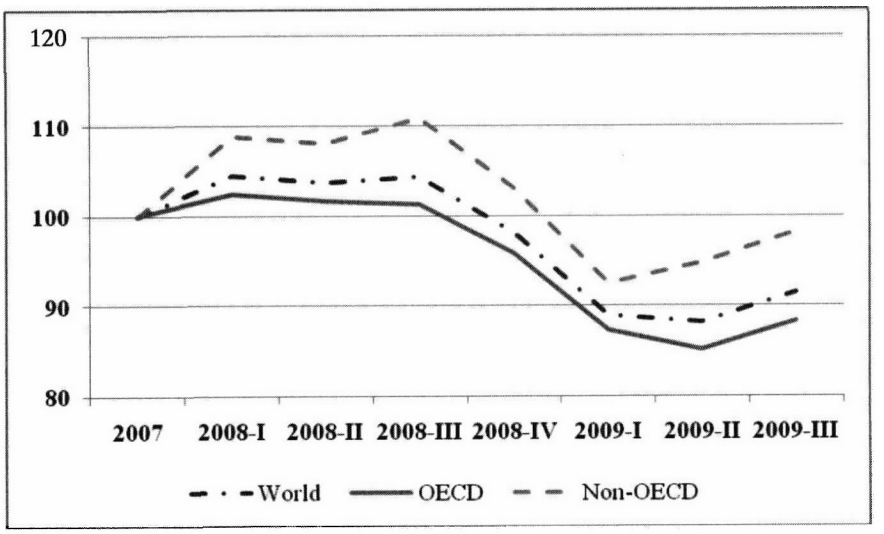
Figure 1: The collapse in international trade and subsequent turnaround



Source: OECD online database on monthly trade flows.

However, the good news only goes so far. During 2009 plenty of evidence was collected that demonstrated that many governments resorted to discrimination against foreign commercial interests (see the reports of the *Global Trade Alert* and associated presentations)[1]. Recently, EVENETT (2010) summarized the main findings on protectionism in 2009 as follows:

- As measured by the percentage of tariff lines (products) affected every major trading jurisdiction, except Canada and Brazil, has resorted to above trend levels of protectionism.[2]
- Compared to the 1930s, when across the board tariff increases were used extensively, a different mix of protectionism was employed in 2009. Bailouts and subsidies – the overwhelming majority of which benefited

1 The last report of the Global Trade Alert was published on 14 December 2009, see EVENETT (2009a). The next report will be published to coincide with the Jeddah Economic Forum and will be available at that forum. All of the reports on such discrimination can be found on the following website, www.globaltradealert.org. The "statistics" and "advanced search" pages of that website makes it very easy for a government to ascertain which foreign state measures are likely to have affected its commercial interests.

2 Of the available estimates of "trend" or "normal" levels of protectionism, Professor Patrick Messerlin is the most conservative. MESSERLIN (2009) argues that typically four percent of product lines are affected by raising trade barriers in a given year. According to the Global Trade Alert database, all the major trading nations in the world (except Canada and Brazil) have breeched this four percent threshold since the first G20 meeting was held in Washington DC in November 2008. To see the evidence graphically see the third slide of EVENETT (2010).

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the manufacturing sector, not the banks and the financial sector – were by far the most prevalent form of discrimination.

- Other than the financial sector, the sectoral beneficiaries of protectionism do not appear to have changed much from before the global economic downturn.[3]
- Once reporting lags are taken into account, it is doubtful that the quarterly rate of protectionism imposed has slowed down.

These summary statistics do mask considerable cross-country and regional variation. In some regions, the Gulf and Africa in particular, a number of liberalizing measures have been taken by governments, especially with respect to foreign direct investment. The "contest for FDI" and associated jobs continues and this should be reflected in any balanced assessment of contemporary commercial policymaking. Overall, then, perhaps it is best to characterize the protectionism seen during this crisis as above-trend yet well below 1930s levels. No doubt these two features have colored how some have interpreted the 2009 record: optimists point to the latter and give credit to existing trade institutions, etc; pessimists emphasize the former and are concerned with how quickly, and in some cases whether, recent discrimination will be reversed. As the summary above suggests, both viewpoints can point to some support in the data. Better though to present all the dimensions of recent protectionism than to selectively choose elements from the factual record. The question immediately arises as to why a 1930s outcome did not occur in 2009? As the answer to this question has relevance for 2010 as well it is worth spending a few lines on it here. Unlike their predecessors in the 1930s, exchange rate policy constraints imposed by the Gold Standard and a fiscal policy orthodoxy that emphasized balanced budgets did not limit policymakers room for maneuver in 2009. Many governments relaxed substantially monetary policy and undertook fiscal stimulus packages in late 2008 and 2009 thereby counteracting falling aggregate investment and consumption demand. On this view, effective demand management limited domestic corporate pressure for protection from foreign competition (EICHENGREEN and IRWIN, 2009).

Others have argued that the spread of international supply chains has created an influential corporate constituency opposed to raising tariffs on all but final goods (and on top of this, in some jurisdictions retailers have been forceful advocates for low tariffs on final goods.) Another argument worth bearing in mind is that the freezing up of financial markets during the ear-

3 For more evidence see AGGARWAL and EVENETT (2009).

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lier stages of the global economic downturn meant that firms needed cash – or working capital – to pay for supplies, wages, and *other immediate* outlays, rather than customers. By switching expenditures protectionism *eventually* delivers more customers to import-competing firms. Instead, governments reacted by supplying precisely what firms found so scarce and so badly needed, namely, cash. The liquidity support regimes may well have staved off a lot of pressure for other, less effective forms of state intervention, such as protectionism (EVENETT 2009b). In short, 2009 did not see the widespread resort to protectionism on the scale of the 1930s because governments felt they had more effective tools to address pressing first order macroeconomic and corporate needs.[4] The key question for 2010 is whether the fiscal and monetary policy tools deployed so extensively in 2009 will be available to the same extent and, if not, what other policy options are likely to be used. There is much talk – indeed self-congratulation – in official circles as to the role that international initiatives and accords have played in restraining protectionism during this global economic downturn. Particular prominence is given to the G20 declarations as they relate to commercial policy. As I have argued elsewhere, it is not at all clear that the participants shared the same understanding of these declarations (EVENETT 2009c). For example, by the time of the September 2009 Pittsburgh summit, G20 leaders committed themselves to the vague phrase "fighting protectionism." Worse, the Pittsburgh summit declaration contained far less specificity than the London G20 summit declaration five months earlier, which could be interpreted as a weakening of resolve. Nor is it clear, short of legislative and constitutional changes, that the heads of governments who made these G20 pledges have control over all of the state agencies whose actions can (intentionally or otherwise) discriminate against foreign commercial interests. For example, in many jurisdictions investigations of so-called unfair trade matters are undertaken by independent agencies that follow established legal rules and practice. In short, there is a serious question as to whether the G20 pledges eschewing protectionism *could have ever worked,* given that so much commercially-relevant state intervention these days has been delegated to independent regulators that are supposed to keep an arms-length relationship to central government. When it comes to the WTO, some have tried to argue that the multilateral trade accords have "held the line" against protectionism. Those who make these claims rarely specify with any precision the counterfactual; that is, what they think would have happened during 2009 in the absence of multilateral trade accords. A 1930s outcome?

4 The fact that very short term financial support has been complemented by medium term subsidy regimes rather than direct trade restricting measures suggests that something about the calculus underlying policy choices in 2009 differed from the 1930s.

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Surely not with respect to tariffs. Many are surprised to learn that the gap between maximum allowed tariffs and the applied tariffs is so large that over 100 WTO members could implement immediately the full Smoot-Hawley tariff increase without breaking their multilateral obligations (EVENETT 2009b). Put another way, for many WTO members their current tariff bindings would not prevent the implementation of the very tariff increase that is said to have triggered the 1930s era of protectionism! Something else was discouraging governments from raising tariffs – or made raising tariffs unnecessary.

More detailed examination of other binding trade accords and their weaknesses casts doubt on the self-congratulatory tone taken by some (see EVENETT 2009b for details.[5]) Only in time will we learn just how many governments' internal deliberations on major forms of economic intervention were decisively restrained by the recognition and acceptance of obligations arising from binding trade accords.[6] As suggested earlier, I prefer an alternative interpretation of recent events: the experience of 2009 suggests that in most leading economies the availability of effective policy instruments that did not involve discrimination against foreign commercial interests enabled many governments to reconcile two genuinely-held objectives during the darkest days of the crisis: to restore health to their national economies and companies while not fundamentally disengaging from the global economy. Of course, the G20's deliberations were not the only major international commercial initiative that gained attention during 2009. Attempts were made to advance negotiations in the Doha Round but these quickly ran into long-standing constraints. What can be said, however, is that by 2009 these constraints are far more transparent than in the past – and this will be just as important for 2010 as it was for 2009. For example, the deadlock over agriculture persists despite a new U.S. administration and an Indian parliamentary election, laying bear the interest groups in both countries that really shape those countries' respective negotiating positions.

More fundamentally, most parties have demonstrated their reluctance to undertake politically painful agricultural and other reforms in the context of a multilateral trade accord. Consolidation of prior reforms is deemed acceptable to some, but real cuts in existing programs are off the negotiating

5 Comments on the impact of binding rules on government procurement and subsidies are made in this paper.

6 Proponents of the view that binding trade accords really did restrain protectionism in 2009 would enhance their case considerably by identifying and publicizing significant cases where appeals to binding trade obligations materially affected government decisions. Indeed, should a body of such evidence emerge and survive scrutiny it would certainly affect my view on the record for 2009.

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table. Moreover, few appear willing to pay for reforms in trading partners that have already been implemented and from which they already benefit. Under these circumstances the very logic of reciprocal trade negotiations breaks down as there is no apparent basis for a deal, resulting in this case in the recitation of negotiating offers with low ambition.[7] In the meantime, grand statements to complete the Doha Round by artificially specified deadlines (a practice the G20 leaders have succumbed to, like their G7 predecessors) are reiterated, the effect of which is to erode the credibility of those foolish enough to utter these remarks.

Even worse, the never-ending Doha Round has called into question whether governments[8] are willing to undertake meaningful cooperation on commercial policies in the WTO, representing another death knell for multilateralism.[9] In addition to its compromised negotiating function, WTO members routinely circumvent their reporting obligations and are reluctant to support intensive monitoring initiatives. The very weakness of Dispute Settlement, the so-called jewel in the WTO crown, derives from its greatest strength, namely, the binding nature of its findings. The binding nature ultimately attracts cases that are more and more sensitive to the interests of the larger WTO members, increasing the risk that at some point a sovereign party will simply not accept the "legally binding" outcome. The difficulties in concluding the Boeing and Airbus subsidy disputes demonstrate the outer limits of the effectiveness of the WTO's Dispute Settlement Understanding. All in all, 2009 was not a kind year to the multilateral approach to solving commercial policy problems.

Even though the prospects for the Doha Round are bleak, no WTO member has officially abandoned the negotiations. No government would wish to take the wrath for doing so, especially when an attractive alternative – which I have coined "informal abandonment" – can be coupled with a strategy of signing regional trade agreements. The apparent chase for additional

7 There is, of course, the argument that a multilateral accord could usefully lock-in prior trade reforms. While I have a lot of sympathy with this argument, what is more important is that certain commercial groups (in particular U.S. manufacturers and exporters) appear to attach a very low probability to the reversal of reforms in many emerging markets, see little value then in binding in current applied tariffs, and ultimately are not prepared to "pay" in negotiating concessions for the access to emerging markets that they currently enjoy. Attitudes towards the value of binding may well change. Indeed, if the global economic crisis induced a number of large emerging markets to raise their tariffs again then it would be difficult to argue that bindings have no value. Perversely, then, such a bout of protectionism in emerging markets may actually help to make the case for completing the Doha Round.

8 Readers should note that in this paragraph the blame is put squarely on the WTO members/governments and not on the WTO officials that do so much to service the multilateral trading system.

9 The abject failure of the Copenhagen climate change conference in December 2009 is another reminder of the limits of multilateralism as a vehicle for advancing international collective action.

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slices of market access and the contest for foreign direct investment, with the multiple opportunities for advancement and promotion that regional trade accords bring, remain an irresistible mix for many trade officials and ministers. While some research has cast doubt on just how much reform actually takes place in the context of regional trade agreements (especially when compared to unilateral trade reform), there was one regional trade agreement of systemic significance concluded in 2009. That agreement involved the Republic of Korea and the members of the European Union. Coming after the failure to ratify the U.S.-Korea free trade agreement, and bearing in mind the high degree of commercial rivalry between Japanese and Korean firms, some have argued that the implementation of the Korea-EU deal will induce commercial lobbies in the US and in Japan to encourage their governments to seek better market access in the other large trading economies. To date those economies' governments have refrained from signing regional trade agreements with one another, preferring to deal with one another through the WTO. While there are no illusions that negotiations between the larger industrialized markets (US, Japan, and EU) would be straightforward, the day when such negotiations are launched may have come a lot closer. From a systemic perspective, optimists argue that such developments will bring forward a major WTO negotiation that will "multilateralize" the benefits granted in any regional trade agreements between the major players. Doubters rightfully ask why the big players would be willing to share the benefits of their regional trade agreements with smaller players – and whether there is a large enough payoff to the big players in going through the pain of reopening finely-balanced accords between themselves. Moreover, there are some important subjects – such as agricultural subsidies – that are unlikely to be constrained by regional trade agreements, so rule making in the latter will not be a substitute for multilateral accords in every area of government policymaking. Taken together these considerations highlight the stress and partial fragmentation that the world trading system experienced in 2009. Now I turn to the prospects for 2010.

3 Factors likely to shape the world trading system in 2010

Here it will be useful to differentiate between factors that are already built into the timetables of commercial diplomacy and international organizations in 2010 and those events that are less certain to happen but whose consequences could be such that policymakers ought to undertake some contingency planning. With respect to the former two meetings of the G-20 leaders are scheduled, one in Canada in June and in Korea in November.

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Indications from Seoul suggest[10] that, after ritual statements about the importance of an open world economy, trade policy and associated matters are not expected to receive substantial billing during the Korean chairmanship. Indeed, it has been suggested that any trade policy matters be dealt with at the Canadian summit, leaving the Korean summit open to ruminate the longer-term sources of economic growth.

As far as I can glean, the Korean plans in 2010 for trade policy in the G-20 process are unambitious and, therefore, represent a missed opportunity. Senior officials from G-20 nations claim to have done important work deliberating on the merits and timing of exit strategies for crisis-related fiscal and monetary stimuli. Such work might be usefully complemented by a similar, informal process among trade officials that identified principles for unwinding or replacing the discriminatory state measures undertaken during the global economic downturn. A starting point for this work on exit strategies for discriminatory measures would be to accept the principle that such measures taken during the crisis are temporary and will ultimately be eliminated, or replaced by non-discriminatory alternatives.[11] Given the G-20's palpable lack of interest in binding approaches to international policy coordination, any work on exit strategies for discriminatory measures would have to emphasize consensus building, monitoring and information sharing, and the sequential unwinding of implicated measures.

There is, of course, a link between the G-20 Leaders summits and WTO deliberations in so far as the former's declarations have urged that the Doha Round be completed in 2010. Here, again there are reasons for expecting very little to be accomplished. In terms of the domestic political constraints that have prevented a deal being done in the past, these will if anything tighten during 2010, not least as the Americans approach their mid-term elections in November. It is difficult to see a politically savvy White House wanting to go into an election where any recently made commitments to reduce the magnitude of potential agricultural subsidies, for example, will almost certainly be characterized by opponents as real cuts in payments.[12] Nor are Indian concerns about rural livelihoods or others concerns about

10 Namely in the speeches of Dr. Il Sakong, the lead Korean official on the G-20 process in 2010, many of which are found on the internet. The author listened to a lengthy speech by Dr. Sakong in Seoul in November 2009 at a conference organized by the Korea International Economic Policy institute and the CEPR.

11 To the extent that some discrimination against foreign commercial interests is absolutely necessary to attain some legitimate crisis-era goal then the principle ought to be that only those measures no more discriminatory than necessary to meet a given objective should be retained.

12 Similar considerations applied in the last midterm elections under the Bush Administration. Competition for seats in the US House and Senate from agricultural states remains keen.

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Chinese manufacturing competitiveness likely to change, especially as in some product markets Chinese exports have gained market share during the global economic downturn. Unless circumstances relax these domestic political constraints, they will continue to be projected to the multilateral level, and stalemate will endure. Indeed, identifying these circumstances ought to be a pre-requisite before optimism about the completion of the Doha Round in 2010 is merited. Beyond the scheduled trade policy agenda, three other factors may well shape commercial policymaking in 2010. Although in what follows each is discussed in turn, nothing should be inferred about their importance from the sequence in which they are presented.

The first potentially disruptive "event" is the speed and extent of national economic recoveries in 2010. Currently available data shows considerable diversity in the pace of economic recovery, with Asia and much of the developing world enjoying robust economic expansions whereas certain industrialized economies (such as Germany) still experience anemic growth. The latter economies are likely to face more corporate bankruptcies and growing unemployment levels in 2010, putting greater pressure on governments to intervene to "save jobs", "protect the national competitive base" etc. Furthermore, this year central bankers have indicated their wish to start withdrawing their liquidity support to banks, much of which it transpired was used to buy government debt and so fund fiscal stimuli. Moreover, repricing in the bond market is putting pressure on governments to cut fiscal deficits.[13] Taken together, pressures for fiscal and monetary policy retrenchment in 2010 are likely to be significant, reducing the tools available to governments to support national firms without overtly discriminating against foreign commercial interests. Put another way: the Eichengreen-Irwin argument that accounted for the limited resort to protectionism in 2009 may apply in reverse in 2010. On this logic the nations most likely to trigger this dynamic are those with feeble economic recoveries, facing bond market pressure, and zealous central bankers determined to withdraw support from the banking systems, perhaps exacerbated by elections and political opportunism.

The second less-than-certain factor relates to the carbon-related border tax adjustments. Certain European leaders, most notably the President of France, appear determined to introduce such schemes nationally or EU-

13 In the past week the *Financial Times* has reported that it is now more expensive to insure a standard portfolio of European government debt than a comparable portfolio of debt from leading European corporations. Such prices overturn the long-standing presumption that sovereign debt is risk-free and less likely to default than corporate debt.

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wide during 2010. The significance of this is not just that determining the international burden-sharing scheme to mitigate climate change is contentious (as the Copenhagen conference in December 2009 laid bare), there are real fears on the part of some that the implementation of any border tax adjustments will ultimately discriminate against foreign commercial interests.[14] If the previous year has demonstrated anything, it is that India and China will take aggressive retaliatory steps to defend their commercial interests. A hastily introduced border tax adjustment, implemented without consultations with leading trading partners and in a manner that does not build their confidence, risks provoking a substantial backlash, some of which will undoubtedly involve cross-border discrimination.

The third contingent factor relates to the bilateral exchange rate between China and the United States. Critics of China's decision to stop the slow appreciation of this exchange rate appear to be growing in number on both sides of the Atlantic.[15] Some governments in the Eurozone are particularly concerned because the appreciation of the euro against the dollar implies an appreciation vis-à-vis the yuan/renminbi. The temporary across-the-board ten percent (duty) import surcharge implemented by the United States on 15 August 1971 has been mentioned several times as a possible precedent for redressing perceived contemporary misalignments.[16] While the imposition of such a surcharge will undoubtedly harm the implementing jurisdiction, it would do substantial damage to international supply chains that tap into the Chinese labor market, with adverse knock-on effects for Chinese living standards. The reaction to any such import surcharge is unlikely to be limited to Beijing, however, as other countries may fear that Chinese exports previously destined for the U.S. market are to be diverted to other jurisdictions. Consequent concerns about import surges arising from this export diversion may well induce other jurisdictions to raise import duties against Chinese products. A further concern is that this is an

14 Notice the concern here is about *de facto* discrimination that arises with implementation. These concerns may be in addition to any about any de jure discrimination built into a national or regional border tax adjustment regime.

15 The change in the views of what might be termed "respectable opinion" in the leading Western newspapers and journals over the past few months has been remarkable. One can now find credentialed analysts – who profess to support free trade – willing to argue in favor of levying an import surcharge on Chinese imports if China does not allow the yuan/renminbi to appreciate. See, for example, Martin Wolf "Grim Truths Obama should have told Hu," *Financial Times,* 17 November 2009.

16 For an analysis of the legality of this surcharge under US law (rather than WTO law) see "Yoshida International, Inc. v. United States: Was the 1971 Import Surcharge Legally Imposed?" *Michigan Law Review,* Vol. 73, No. 5 (Apr., 1975), pp. 952–969. It should be added that the U.S. precedent is not the only example of an across-the-board import surcharge being imposed. Denmark and the United Kingdom have imposed such surcharges in the past in relation to their currency policies, although it has been contested just how similar the motivation and circumstances surrounding these surcharges were.

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election year in the U.S. and it may be tempting for some American politicians to make Chinese products the scapegoats for any domestic economic underperformance. Monitoring developments on Capitol Hill and in Washington DC more generally will be essential.

The purpose of this section has been to argue that three contingencies could significantly disrupt the world trading system in 2010. None of these events need spiral out of control but there are no assurances that they won't. The tests facing trade policymakers this year are not the same as those in 2009; it would be wrong to assume that just because widespread protectionism was averted in 2009, history must repeat itself in 2010. Given the potential protagonists are all leading trading nations, surely it is prudent to encourage dialogue, transparency, and other confidence building measures bilaterally and in regional and international fora.

4 Concluding remarks

The fate of the world trading system in 2010 is likely to rest on how policymakers react to the "events" thrown up in the next twelve months, rather than outcomes of established official processes, such as the G-20 and at the WTO. It would be wrong for trade ministers and their officials to overlook these potential events in their planning. Moreover, the realization that these contingencies exist should serve as a reminder that the world trading system as not yet restored its pre-crisis calm. Ultimately, the proponents of an open world economy must continue to make their case, monitor the activities of governments, and encourage accommodation in the resolution of international commercial disputes.

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