The Future of Global Trade Policy

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The onward march of globalisation is among the greatest economic and political stories of our era. Behind globalisation lie both deliberate policies of liberalisation and the revolution in communications and information technology. The latter, in turn, has allowed the emergence of integrated systems of production and distribution, managed by a new breed of global companies. The most important economic and political consequence of contemporary globalisation has been the "great convergence" of average incomes between the high-income countries of today and the emerging countries. As Arvind Subramaniam and Martin Kessler note, in an important recent paper:

"Until the late 1990s, only about 30 per cent of the developing world (21 of 72 countries) was catching up with the economic frontier (the United States), and the rate of catch-up was about 1.5 per cent per capita per year. Since the late 1990s, nearly three-quarters of the developing world (75 of 1033 countries) started catching up, at an accelerated annual pace of about 3.3 per cent per capita. Although developing country growth slowed during the global financial crisis (2008-12), the rate of catch-up with advanced countries was not materially affected and remained close to 3 per cent."[2]

This, in brief, is a world transforming.

The deliberate opening of economies to trade within a rules-government global trading system, has been the bedrock upon which the globalised economy has been built. Rising globalisation is, therefore, the theme of the first section of this lecture. The second section will examine why liberal trade policies have proved so robust, despite high unemployment and rising inequality in crisis-afflicted high-income countries. The third section will consider the challenges coming from outside the trade policy regime. In the final section, I will look at the challenges from within the trade policy regime.

The Rise of Globalisation

In their important analysis of what has happened, Arvind Subramaniam and Martin Kessler of the Peterson Institute for International Economics, in Washington DC, note seven important features of contemporary trends in the world economy:

1. Hyperglobalisation: greatest openness to trade and investment in world economic history.

2. Dematerialisation of trade: rising importance of services.

3. Goods versus services: decline of barriers to trade in goods, but continued high barriers to trade in services.

4. Universalisation: widespread embrace of globalisation.

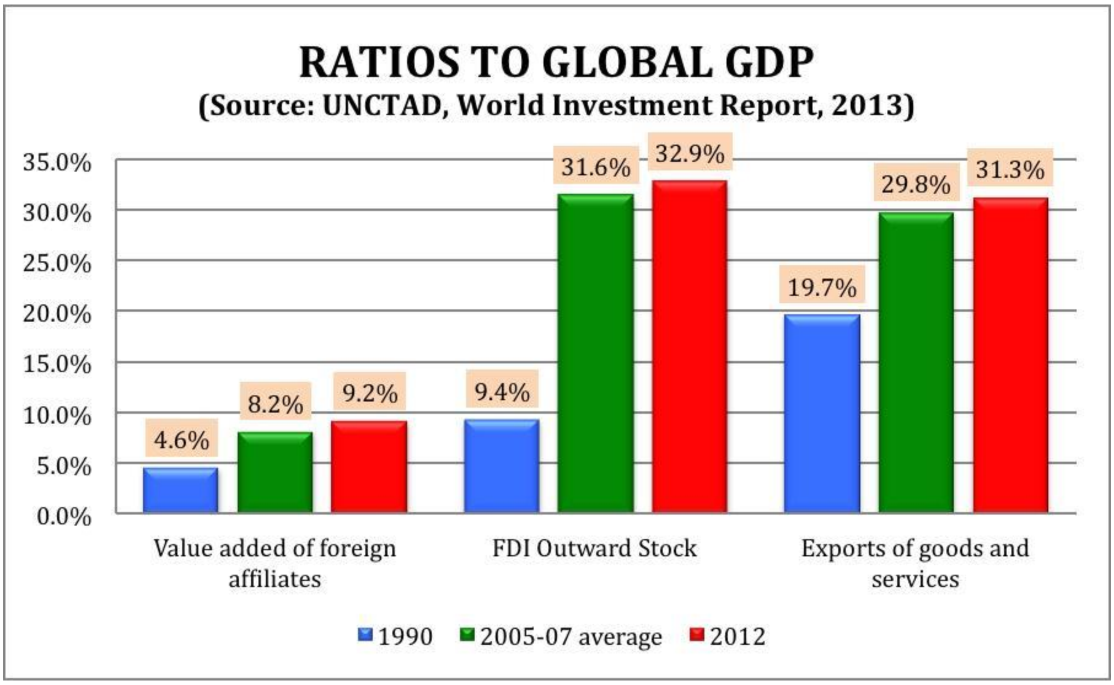
5. Two-way flows: similarity of North-to-South trade and investment flows

to South-North flows.

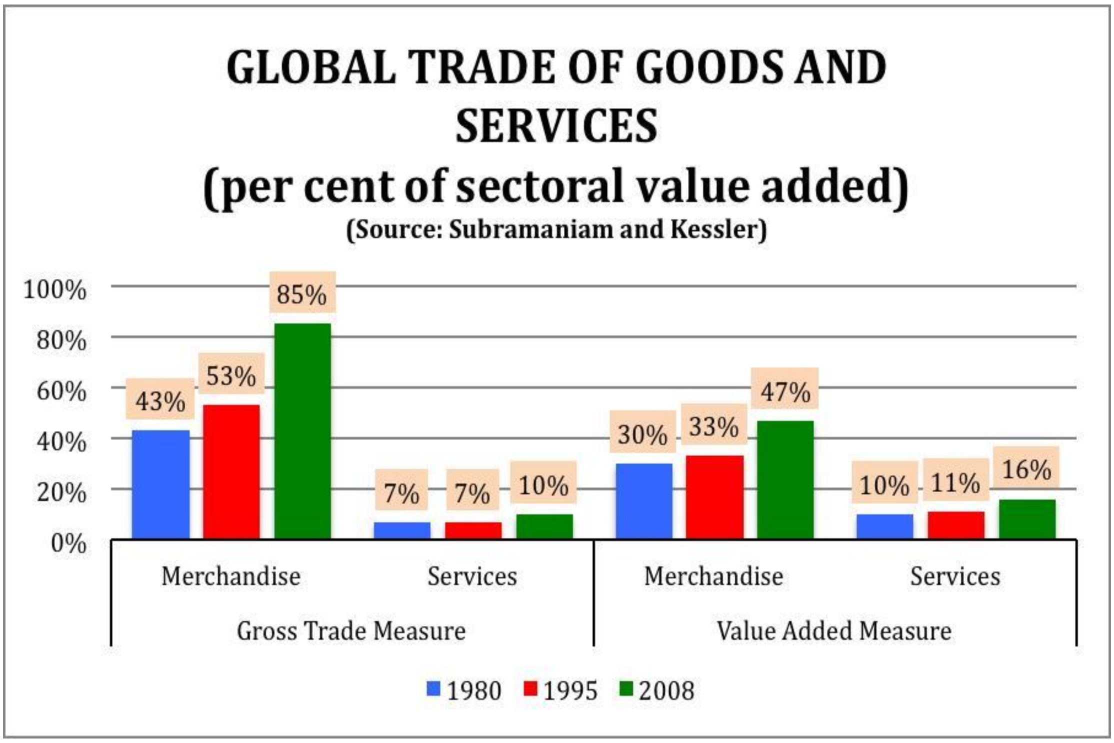
6. Mega-traders: rise of China.

7. Discrimination: proliferation of regional and preferential trade agreements and the current discussion of mega-regional ones.

First, hyperglobalisation is indeed the salient feature of our era. Between 1990 and 2005-07, the value added of foreign affiliates rose from 4.6 per cent to 8.2 per cent of global product, the stock of foreign direct investment jumped from 9.4 to 31.6 per cent of global product and exports of goods and services rose from 19.7 to 29.8 per cent of global product. Moreover, the crisis has not caused a fundamental break in the trends. Instead, we see modest further increases in openness: in 2012, value-added of foreign affiliates was 9.2 per cent, the stock of foreign direct investment was 32.9 per cent and exports of goods and services were 31.3 per cent of global product. (See chart.)



Second, manufacturing and services have both become increasingly traded. None the less, the production of goods is still more open to trade than production of services. In the case of services, a huge divide in tradability has now opened up between services that can be turned into bits and so be transmitted costlessly across the globe and those that require face-to-face contact. Data on gross value of trade exaggerates its economic significance for goods, but underestimates its significance for services. This is because services are included within the gross exports of goods.



Third, a part of the reason for the lower degree of openness of services than of goods (particularly manufactures) is that barriers to trade are substantially higher in the former than the latter. This is partly because the liberalisation of services only began during the Uruguay Round. The conventional barriers to trade in goods are now very low, particularly in the high-income countries. This is much less true for services. Nevertheless, barriers to trade have been falling for both goods and services. Yet the economic opportunity afforded by liberalisation of trade in services is clearly greater than that afforded by liberalisation of trade in goods.

Fourth, the current era is one of universal globalisation. The average ratio of trade to GDP has risen from about 10 per cent in the mid-1950s to close to 25 per cent now. The latter is far higher than in 1913, when it was just below 15 per cent. Never before in the field of global commerce have so many countries been so open to trade in so many products and services.

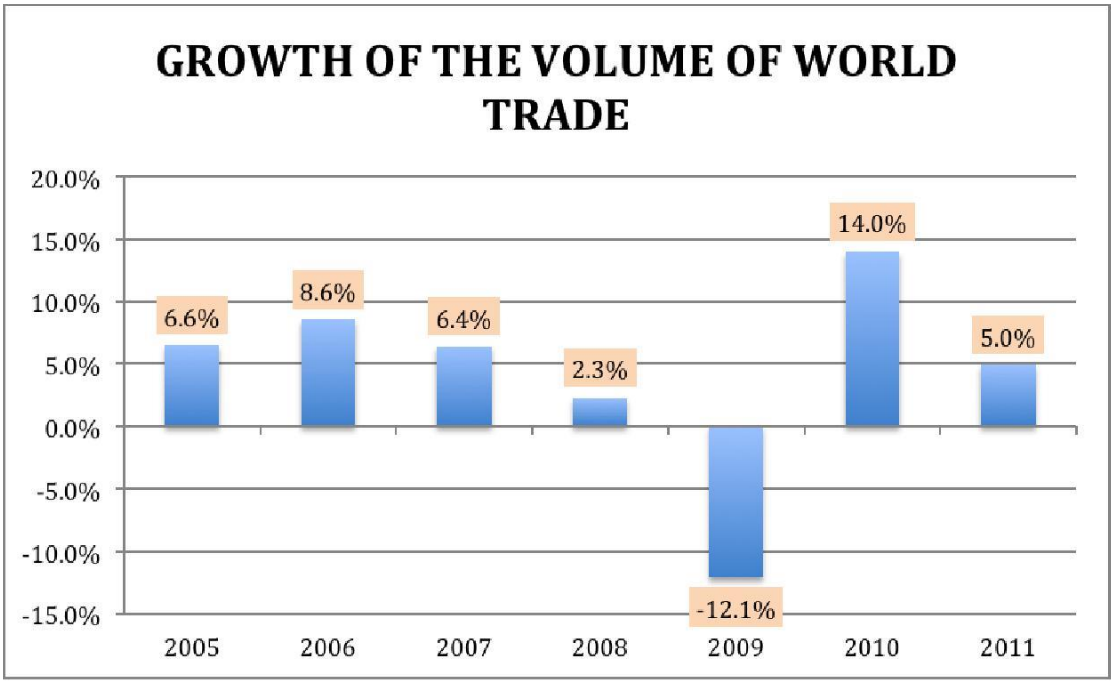
Fifth, trade and investment flows are becoming increasingly similar, in both directions. At first, this largely took the form of intra-industry trade among high-income countries. Then it increasingly took the form of two-way trade in parts and components within internationally integrated value chains, particularly between the high-income countries and Asian suppliers and among Asian suppliers. Finally, flows of FDI are also increasingly two-way, with substantial FDI by emerging countries in high-income ones.

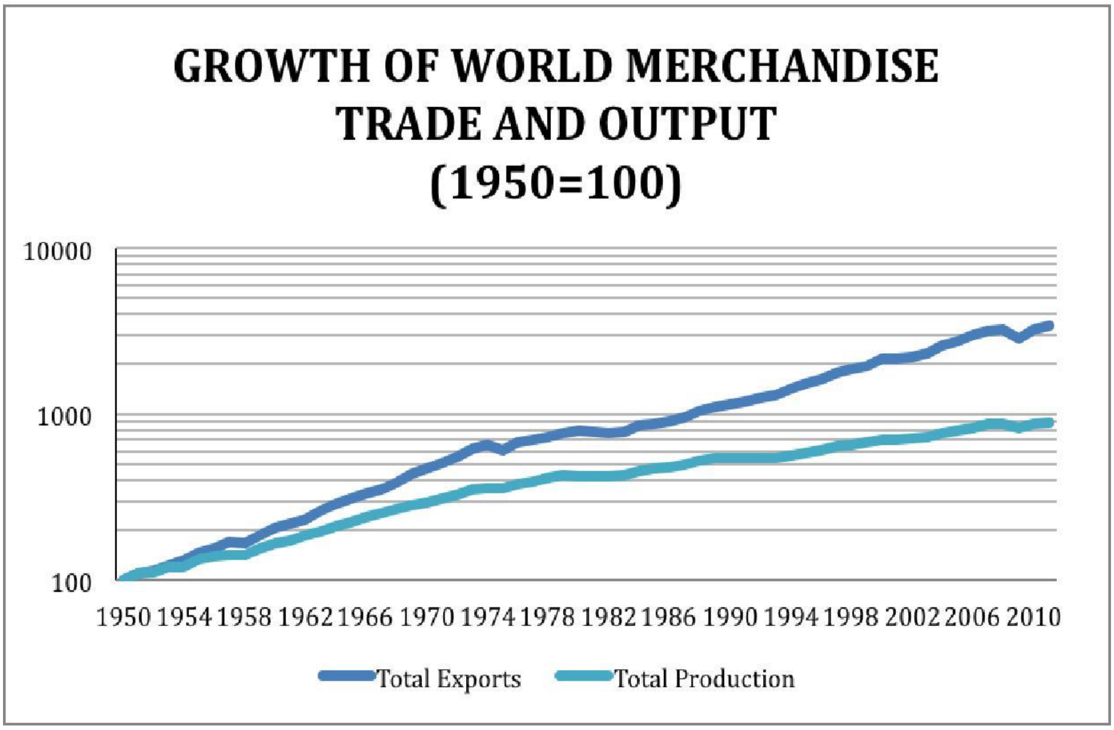
Sixth, the world is seeing in China the emergence of a new core country in world trade. China’s role is exceptional, because it is far more open to trade than other large economies and is also potentially much the biggest economy in the world. It seems quite likely that China will be much the biggest trader by the 2030s.

Finally, preferential trade has become increasingly important. Today, about half of the exports of the top 30 exporters go to preferential trading partners, but preferences still only cover about 17 per cent of world trade. Between 1990 and 2001 the number of Preferential Trade Agreements (PTAs) increased from 70 to 300. Finally, in the mid-1990s, about 75 per cent of preferential trade arrangements were regional; by 2003, this had dropped to about 50 per cent. All members of the World Trade Organisation, except Mongolia, have concluded at least one PTA. Some have concluded more than 20. Particularly important is the fact that, over the last 10 years nearly 40 agreements have included provisions on "WTO-plus" issues, such as competition policy, intellectual property rights, investment and capital mobility. [3]

Globalisation during the Crisis

Protectionism is the dog that has barely barked. Yes, it has proved impossible to complete the Doha round of multilateral trade negotiations, but this is not really because of the financial crisis. There have also been some protectionist actions. That is hardly surprising. But it is remarkable that the open trading system has survived not only the biggest recession since the 1930s, but a far longer period of rising inequality and worsening labour market prospects for a large proportion of the citizens of the high-income countries. Indeed, trade made a remarkable recovery after its collapse in 2009.





The question is why the open trading system has proved so much more robust than in the 1930s and so what that tells us about its likely future. We can identify five mutually supportive explanations:

1. Institutions: role of the WTO.

2. Interests: role of multinational companies.

3. Ideas: triumph of the ideology of market openness.

4. Welfare: role of social safety nets.

5. Divergence: success of emerging countries.

First, the commitment to liberal trade is now entrenched in global institutions whose commitments have become a component of domestic law. This is not only true of the WTO. It is also true of regional agreements. The WTO, in addition, has a dispute resolution system that countries do not wish to violate openly, since they do not know when (or if) they themselves will need to take resort to the system. No such institutionalised system existed in the 1930s. Trade policy was, instead, a creature of domestic politics.

Second, global capitalism has largely replaced national capitalism. This is particularly true in manufacturing. Thus, instead of shared interests between companies and their employees, those interests are now split. Similarly, the interest of owners of capital is increasingly in the returns available from an internationally open capital market rather than from profits on domestic activities. Capital has become increasingly cosmopolitan. It is not an accident that agriculture remains highly protected. This is the one goods-producing sector not dominated by multinational enterprises, but rather by small national ones. Meanwhile, organised labour and the working class have experienced devastating collapses in their significance, as the economy has gone back to the future: to something that looks increasingly 19th century in character.

Third, 1989 has trumped 2008. The collapse of the Soviet empire demolished the credibility of alternatives to the market economy. This has remained true, so far, despite the anti-globalisation movement of the late 1990s and early 2000s and even the financial crisis itself. Indeed, it is quite remarkable how well the commitment to the market has survived the devastating collapse of the core of the market economy – the financial system. Whether this will continue to be the case is, inevitably, an open question.

Fourth, albeit battered, state-funded social safety nets exist in all the high-income countries and provide a degree of support unthinkable in the 1930s. It is probably also important that the old are a relatively large proportion of the population: the old barely rely on employment and large depend on state benefits, instead.

Finally, the high-income countries have not wished to abandon a system of open markets that they themselves created. Meanwhile, emerging countries have prospered since 2009 and, for this reason, see no reason to abandon the openness that has brought remarkable rewards for so many of them.

Challenges from outside the Trading System

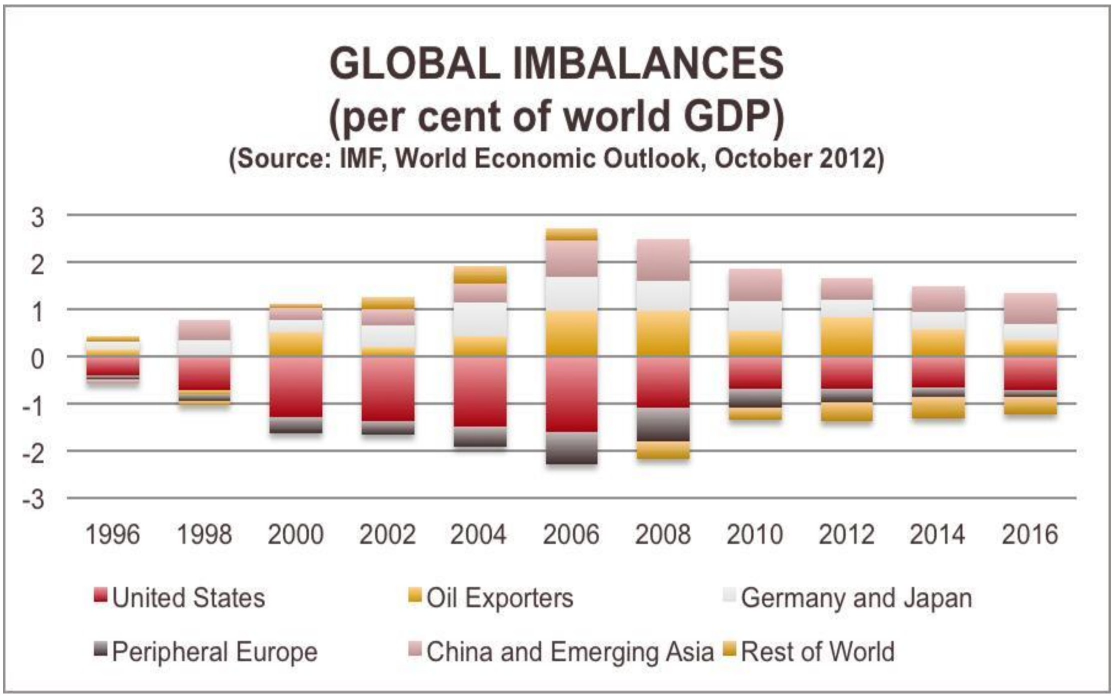
In all, then, the story is one of astonishing success. It has proved possible to achieve and then sustain an unprecedented degree of openness to trade (and, more recently, direct investment), across the globe, despite the recent challenges of a huge financial crisis and subsequent global recession. So what are the challenges ahead? I suggest the following:

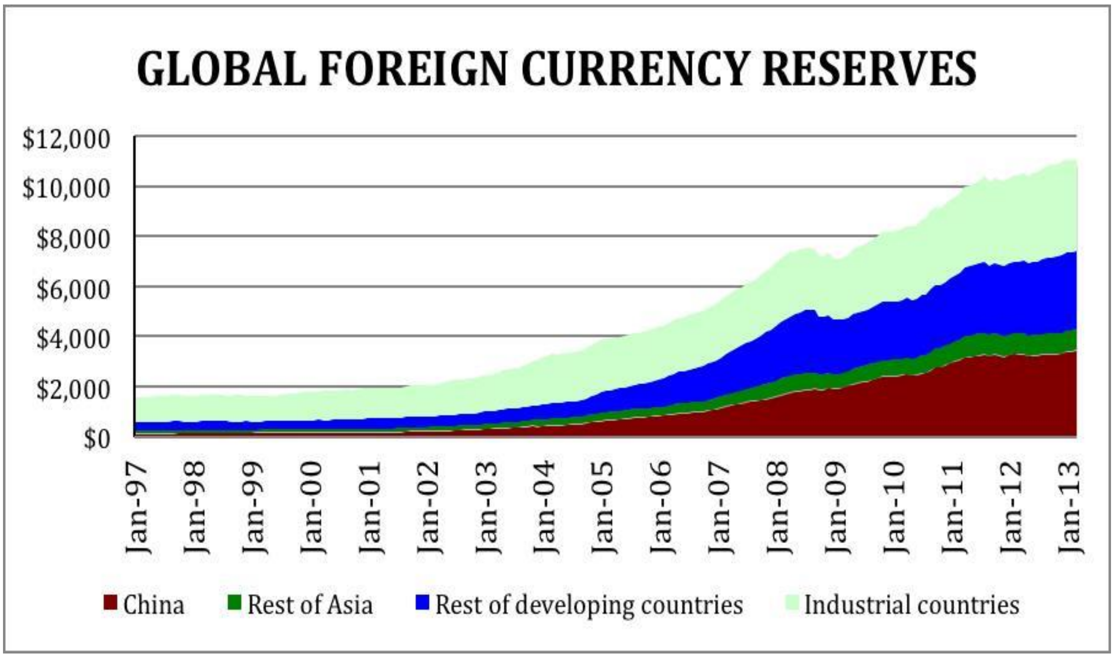
1. Imbalances: the link between trade and exchange rates.

2. Climate change: trade and the global environment.

3. Inequality: trade and wages.

First, as John Maynard Keynes argued, liberal trade becomes problematic if exchange-rate intervention is used as a successful alternative to protection. This is what the Australian economist, Max Corden, called “exchange rate protectionism”. Normally, that has been a small problem: either the intervention or the macroeconomic impact has been small. But between the Asian crisis of 1997-98 and today, both assumptions have proved to be false: the imbalances became huge; the intervention in foreign currency markets was also enormous; and the ability of countries to offset the impact of the intervention through monetary and fiscal policy proved quite limited, once interest rates hit the zero bound. It is possible – even likely – that, once the high-income countries, particularly the US, recover, these imbalances will rise rapidly, once again. If so, this might strengthen arguments for countervailing action.





Second, a big challenge arises over global environmental externalities. A basic assumption of the trade policy regime is that subsidies are distorting. But what happens if a group of countries agree to impose a tax on emissions of carbon dioxide or a subsidy for low-emission technologies. The argument, in both cases, is that this is internalises a global externality. If so, such a policy does not represent a distortion, but rather the removal of one – a failure to deal with a global distortion. Now, go further. Assume that, as a result of a tax, production shifts from the country imposing it to a country that does not impose it. Aggregate emissions will not fall. They may even rise. The country imposing the tax can argue that it has a right to prevent the shift in production, since this concerns a global rather than a local externality. This then creates a case for a countervailing duty on imports of products that are produced in emissions-intensive ways. Indeed, one can argue that this is the best way of producing a global regime of carbon pricing.

Third, there is the question of the link between trade and rising inequality, particularly in high-income countries. There is much debate over how strong this link actually is. A plausible answer is that it has been a part of the explanation, particularly for the decline in well-paying job opportunities in the middle of the wage distribution, as employment in manufacturing collapses, but other factors were also at work, including changes in technology and corporate governance, developments in social mores and the rise of winner-takes-all markets.

The best mechanism for dealing with the distorting impact of currency intervention would be a global agreement within the International Monetary Fund. Similarly, the best mechanism for dealing with the challenge of the global environment would be an effective treaty. Finally, the best way to deal with the rise of inequality would be taxation of the winners. But all these are problematic: progress is unlikely to be made within the IMF on contentious exchange rate issues; the ability to reach a binding and effective treaty on climate change is constrained by disagreement over the urgency of the task, by the number of parties that would have to agree and the distributional issues - intergenerational, interpersonal and international - that would have to be resolved. Finally, the rising mobility of capital, both corporate and personal, and the growing political power of its owners has made it far more difficult to raise taxes.

These challenges may either not be resolved, making the outcome of liberal trade far less beneficial than it could be, or they will be resolved in a malign way, via rising disintegration of the liberal global economy, as is already happening, to some degree, in finance.

Challenges from within the Trading System

In addition to the challenges from outside the trading system, there are also three challenges from within it. These are:

1. Doha round: Failure to complete and consequent loss of legitimacy.
2. Mega-regional negotiations: the plan to launch the Trans-Pacific and the Trans-Atlantic Partnerships, with the US as the hub.

3. China: the need to bring a new hegemonic trade power fully into the system.

The three challenges are self-evidently connected.

One of the reasons for pursuing the mega-regionals is that the Doha round is seen to have failed, largely because the most recalcitrant members of the WTO hold it hostage. Again, a reason for launching the mega-regional negotiations is that it allows like-minded countries to pursue discriminatory liberalisation, at the expense of China. Yet it is also quite clear that these strategies are dangerous. There is a risk that the result will be to split the trading system, as competition emerges between a rising China and a declining west, both trying to impose their own views of how the system should work on their trading partners.

Is there a way of avoiding or at least mitigating this danger? Yes, is the answer. As I have argued on previous occasions it would be possible to negotiate a single advanced preferential trading arrangement, to embrace both the TPP and the TAP, with the simple proviso that any country, not least China, would be able to join, provided it accepted the disciplines embodied in this agreement, though undeveloped countries should be accorded the benefits unilaterally and freely. The advantages of this approach are that it would encourage further liberalisation among a widening coalition of the willing. At the limit, the new arrangement could become an agreement within the WTO.

This proposal might work better than that of a “China round” proposed as an alternative to the Doha round by Mr Subramaniam and Mr Kessler. But it is necessary to retain scepticism on both alternatives. As the World Bank’s Bernard Hoekman notes:

“It is not at all obvious that killing off the Doha Round and launching a new “China Round” will make a difference in this dynamic. A number of the policies for which the European Union and the United States would like to negotiate disciplines are going to be difficult to agree on (for example, the role of state ownership of companies, industrial policies, and government procurement). The fundamental constraint that is precluding the Doha Round from being concluded—namely that the United States and the European Union have little to offer—continues to apply. The same reasoning suggests that the extent to which the "mega-regionals" will put "pressure" on Brazil, China, and India to come to the negotiating table may be limited. Much will depend on the extent to which incentives result in economically meaningful outcomes and the degree to which these outcomes imply discrimination against products coming from non-parties."[4]

While such open preferentialism could, in theory, reconcile plurilateralism with multilateralism and preferences with non-discrimination, this does not mean that the new approach would actually work, in practice. The obstacles to reaching a successful agreement on these mega-regional deals are large, as Mr Hoekman notes. While the gains from further liberalisation of services and from some combination of mutual recognition and harmonisation of regulatory standards could be substantial, these are profoundly contentious issues, as the European Union has discovered. Agricultural issues – including over genetically modified organisms – would also remain difficult. There is a very good chance therefore that the new plurilateralism would fail, further undermining the credibility of liberalisation.

Conclusion

The global trade regime is a troubled triumph. The onward march of globalisation demonstrates that it is indeed a triumph. The difficulties it now faces show that it is a troubled one. It is troubled partly because of its very success: the easy part has been done; and it has also become increasingly intrusive. At bottom, the challenge is that of making global governance work in an era of "hyperglobalisation", the "great convergence", global environmental challenges, financial crises and rising inequality in high-income countries. The trading system has to respond to that challenge. But it cannot deal with it successfully on its own. The era when trade could be successfully separated from other policy concerns is now over, largely because the world economy has become so open and so integrated. A hyperglobalised world will need a greater degree of global governance. The challenge is huge. But it is also inescapable.

[1] Chief Economics Commentator, *Financial Times*, London. This lecture was delivered on 15th July 2013, in honour of the thirtieth anniversary of CUTS (the Consumer Union and Trust Society) of India.

[2] Arvind Subramaniam and Martin Kessler, "The Hyperglobalization of Trade and its Future", 2013, http://www.gcf.ch/wp-content/uploads/2013/06/GCF_Subramanian-working-paper-3_-6.17.13.pdf. See also

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Bernard Hoekman, "Comment on 'The Hyperglobalization of Trade and its Future' by Arvind Subramaniam and Martin Kessler, http://www.gcf.ch/wp-content/uploads/2013/06/GCF_Subramanian_-Comments-by-Hoekman_6.17.13.pdf.

[3] Richard Baldwin, "21st Century Regionalism: Filling the Gap between 21st Century Trade and 20the Century Trade Rules", Policy Insight No. 56, Centre for Economic Policy Research, Washington D.C., http://www.cepr.org/pubs/policyinsights/PolicyInsight56.pdf.

[4] Bernard Hoekman, “Comments on “The Hyperglobalization of Trade and Its Future,” by Arvind Subramanian and Martin Kessler”, http://www.gcf.ch/wp-content/uploads/2013/06/GCF_Subramanian_-Comments-by-Hoekman_6.17.13.pdf