

Potential threats to global trade

There is a strong correlation between the growth of the world economy and the expansion of global trade. While it is a two-way relationship, the causality is primarily from trade growth to income growth rather than the other way around.

The world would have been poorer had there been no international exchange of goods and services. Trade has allowed countries to specialise and enjoy economies of scale and scope. Efficiency gains resulting from such international specialisation and exchange have led to higher incomes and better living standards everywhere.

The rapid growth of the world economy in the recent past is due in no small measure to international efforts to bring down tariff and non-tariff barriers through multilateral trade negotiations. It is fairly obvious that trade restrictions could only have negative impacts on the global economy.

An important lesson from the Great Depression of the 1930s was that protectionism is too dangerous: it is what made the Great Depression painful, pervasive and persistent. There are frightening prospects that countries caught in the current global recession might succumb to domestic protectionist pressures and turn the current slump into a Great Recession.

There are fears that the United States will turn up the heat on its trading partners, now that the Democrats, known for their tough stance on trade matters, control both the White House and Congress.

President Obama, who criticised Free Trade Agreements (FTAs) during his election campaign (for the wrong reasons), may have mellowed since but there are limits to how much he can do to free up trade, given the domestic social and economic agendas.

The current crisis threatens to unleash protectionist forces in many countries, ostensibly to minimise job losses at home. It is argued that reduced imports will translate into increased demand for domestic goods and services, and hence more jobs for local workers. Such inward-looking beggar-thy-neighbour policies would only lead to diminished trade flows.

The much anticipated anti-recessionary measure in the form of coordinated fiscal stimulus packages in all major crisis-hit economies has turned out to be a non-starter: countries have opted for the unilateral rather than the multilateral approaches, and tied their spending to domestically produced goods and services, not imports.

Nationalistic slogans such as “Buy American” in the US, “Buy China” in China, “Buy Indonesian” in Indonesia, and “Buy Malaysian” in Malaysia show that the lessons of the Great Depression have been forgotten.

The G20 agenda of warding off such protectionist threats to global trade provides some hope, but a disconnect exists between what the G20 says and does. At last

November's meeting in Washington, a decision was taken to not raise tariffs, only to be recanted by 17 member countries within months.

The London meeting of the G20 in March renewed its pledge to keep protectionism at bay, which was reassuring, but walking the talk is not going to be like a walk in the park for the G20.

The greatest threat to global trade will be from the upcoming exercise to "rebalance" the global economy, along with the East Asian economies' search for "new" growth models. The current global malaise is viewed as a consequence of serious imbalances in the world economy: the US saves too little and spends too much while East Asia spends too little and saves too much, and this has led to lopsided trade flows, with US deficits being financed by East Asian savings.

This has not been sustainable. Realising how vulnerable their economies are to slumping external demand, many East Asian countries are looking at new growth strategies that would lessen their dependence on exports.

It has dawned on these economies that the post-crisis US economy is unlikely to return to the old equilibrium where growth was driven by excessive consumption, which means that export-led East Asian economies cannot return to their pre-crisis growth trajectory.

There is a real danger of these countries re-orientating their economies away from the export market toward domestic alternatives, especially where the domestic sector is sizeable.

Such a re-orientation might rekindle protectionist forces at home and weaken the constituency for freer trade in the region. One way to minimise this risk is to stay open, with greater emphasis on intra-regional demand rather than domestic demand. However, care must be taken to avoid bias against extra-regional trade.

This is not to suggest there is an imminent threat to global trade arising from all this. Nor is there any sign of a major shift towards protectionism, but one can notice a gradual retreat. A sure way to stomp any backslide would be to breathe new life into the stalled Doha Round of multilateral trade negotiations under the auspices of the World Trade Organisation.

The lack of progress in the Doha Round seems to have spawned many bilateral FTAs. While FTAs may be welcomed as "second-best" in the absence of "first-best" multilateral agreements, there is nothing much to cheer about.

The rules of origin in the FTAs vary not only from one agreement to another but also from product to product. These rules, which relate to the minimum domestic content needed for goods to qualify, are complex, now dubbed "the noodle bowl" syndrome. They make life extremely difficult for not only manufacturers but also Customs officials who have to verify compliance. Increased paperwork has raised transactions cost for traders.

FTAs have inadvertently become a barrier to trade. Their recent proliferation, without discipline on the rules of origin, has made trade transactions unwieldy. This underscores the need to put the Doha Round back on track, as multilateral agreements are based on the principles of non-reciprocity, non-discrimination and most-favoured-nation treatment.

If the G20 is serious about exorcising the spectre of protectionism, it should jump-start the stalled Doha Round. The sooner the better.

Adapted from “Openness only way to crawl out of the great slump”, The New Straits Times, 22 July 2009